Rental Rates & Rental Agreements

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Types of leases on crop land

- **Crop-share:** Landowner receives a share of annual revenues (grain sales and government payments) and shares certain production costs
  -- Yield risk, price risk, and input (e.g., fertilizer) price risk are shared

- **Net share:** Landowner receives a share of annual revenues (grain sales and government payments), but pays no production costs
  -- Yield risk and price risk are shared

- **Fixed cash rent:** Landowner receives a fixed annual cash payment (Landowner has no yield or price risk)
Types of leases on crop land

- **Combination share / cash rent:** Landowner receives a fixed annual cash payment but has upside potential through a share of the crop (may or may not share inputs)

- **Cash rent – flex on price:** Landowner receives cash payment that is based upon crop price (bushel rent)

- **Cash rent – flex on yield:** Landowner receives cash payment that is based upon crop yield

- **Cash rent – flex on revenue:** Landowner receives cash payment that is based upon crop revenue (i.e., yield x price)

- **Cash rent – w/bonus:** Landowner receives cash payment and ad hoc bonus at tenant discretion
Distribution of crop leases by type of lease...

Sources: IL – Schnitkey; IA – Duffy, et al.; KS – Schlegel and Tsoodle

- Corn Belt generally has a higher percentage of cash rent
- Trend is towards more cash rent most everywhere – why?
- The use of “non-traditional” leases is increasing (speed of adoption varies considerably regionally)
Length of cropland leases in years...

<table>
<thead>
<tr>
<th>State</th>
<th>Share</th>
<th>Cash</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iowa (2007)</td>
<td>18.1</td>
<td>9.5</td>
<td>11.4</td>
</tr>
<tr>
<td>Kansas (2010)</td>
<td>n/a</td>
<td>n/a</td>
<td>18.6</td>
</tr>
<tr>
<td>Oklahoma (2010-2011)</td>
<td>17.0</td>
<td>14.0</td>
<td>15.3</td>
</tr>
</tbody>
</table>

Sources: IA – Duffy, et al.; KS – Schlegel and Tsoodle; OK – Doye and Sahs

Producers tend to lease land from the same landowner for a relatively long time (cash rent tends to be for shorter length of time – why?).

Long-term relationships can be good or bad...
Determining the terms of a lease...

- How are cash lease rates or the terms of crop share leases established?
  - Short answer is “the market”
  - That is, the terms of a lease are determined by Producers (demand) negotiating with Landowners (supply)
Market established rates...

- Land Use Value Project of the KSU Ag Econ Dept annually conducts one of four surveys (irrigated, non-irrigated, pasture, input costs)
- Kansas Agricultural Statistics (KAS) annually surveys landowners and producers regarding land values and cash rents
- Local and regional surveys of leasing practices
- With surveys there is often a trade-off between statistical validity and level of aggregation
Examples of market established crop shares...

### Percent of Leases by Crop Share Percentage

<table>
<thead>
<tr>
<th>Landlord Share</th>
<th>NW-10</th>
<th>WC-20</th>
<th>SW-30</th>
<th>NC-40</th>
<th>C-50</th>
<th>SC-60</th>
<th>NE-70</th>
<th>EC-80</th>
<th>SE-90</th>
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<tr>
<td>20.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>1.4%</td>
<td>0.0%</td>
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<tr>
<td>25.0%</td>
<td>0.0%</td>
<td>3.5%</td>
<td>1.4%</td>
<td>0.0%</td>
<td>0.7%</td>
<td>0.0%</td>
<td>5.3%</td>
<td>1.0%</td>
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<tr>
<td>33.3%</td>
<td>96.2%</td>
<td>96.5%</td>
<td>94.5%</td>
<td>62.7%</td>
<td>83.4%</td>
<td>90.8%</td>
<td>22.3%</td>
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<td>40.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>1.4%</td>
<td>28.9%</td>
<td>13.1%</td>
<td>6.4%</td>
<td>27.7%</td>
<td>9.1%</td>
<td>0.0%</td>
</tr>
<tr>
<td>50.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>2.7%</td>
<td>6.3%</td>
<td>0.7%</td>
<td>2.1%</td>
<td>44.7%</td>
<td>17.2%</td>
<td>4.2%</td>
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<tr>
<td>66.7%</td>
<td>0.0%</td>
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<td>0.0%</td>
<td>0.0%</td>
<td>0.7%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>1.0%</td>
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<tr>
<td>75.0%</td>
<td>1.9%</td>
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<td>0.0%</td>
<td>0.0%</td>
<td>0.7%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Other</td>
<td>1.9%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.7%</td>
<td>0.7%</td>
<td>0.7%</td>
<td>0.0%</td>
<td>1.0%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Color coding scale**

- > 80%
- 50-80%
- 20-50%
- 5-20%
- < 5%

Source: Schlegel and Tsoodle -- 2010 KAS/KSU survey (available at www.agmanager.info)
Kansas Nonirrigated Cash Rents, 2011*

Averages can be misleading because...

1) Not all land is equal
2) Not all relationships are equal
3) We don’t know the terms of the lease (e.g., are bonuses included?)

* Cash rent values as reported by USDA NASS and Kansas Agricultural Statistics (KAS).

KAS did not report values for BR, DP, GT, KE, RA, TH and WY counties – values for these counties were filled in with multi-county averages.

State average = $44.00 compared to $43.50 in 2010 (+1.1%)
Wide variability in rents exists...

Figure 1. Distribution of Farm Cash Rents Minus County Average Cash Rents, 2010.

Source: FEFO 11-21, Schnitkey, Department of Agricultural and Consumer Economics, University of Illinois.
Large differences in observed/reported rents...

- Partly due to land quality differences
- Big portion due to relationships
- Landowners and tenants are generally aware of differences that exist and much of these differences are consistent with their desires

Implications...

- Average cash rents are not a good indication of what it takes to acquire land
- High cash rents we hear about are not an indicator of average rents

Source: FEFO 11-21, Schnitkey, Department of Agricultural and Consumer Economics, University of Illinois.
Determining the terms of a crop lease...

• How are cash lease rates or the terms of crop share leases established?
  – Short answer is “the market”

• When market reported rates are not sufficient to answer the question at hand, what do we do?

• While landowners and tenants (i.e., the market) ultimately determine terms of crop share and cash leases, we use the *equitable* concept to arrive at a starting point for negotiations – and to better understand the market.
Principles embodied in an equitable lease...

- Profit maximization (MR=MC)
- Economic profits (expected profit = 0*)
- Opportunity costs
- Risk across lease types
- Equal rates of return on annual investment (if economic profit = 0, then return on annual investment = 0)

* On average, in the long run
On average, we seldom cover total costs. Why?

Source: KFMA Enterprise Analysis Report
On *average*, we seldom cover total costs. Why?

**Average Management Margin for Corn and Soybeans in IL**

<table>
<thead>
<tr>
<th>Year</th>
<th>Corn Margin</th>
<th>Soybeans Margin</th>
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<tbody>
<tr>
<td>1991</td>
<td>-0.33</td>
<td>-0.96</td>
</tr>
<tr>
<td>1992</td>
<td></td>
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</tr>
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<td>2009</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Corn (1991-05 = -0.33; 2006-10 = 0.48)**
- **Soybeans (1991-05 = -0.96; 2006-10 = 0.69)**

**Source:** Illinois Farm Business Farm Management Association (2009 and 2010 are estimates)
What adjustment will occur and how fast will it happen?

### Central IL -- High Productivity, Corn and Soybean Returns

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>5-yr Avg</th>
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<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crop revenue²</td>
<td>$343</td>
<td>$457</td>
<td>$693</td>
<td>$668</td>
<td>$614</td>
<td>$793</td>
<td>$861</td>
<td>$726</td>
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<tr>
<td>DP and CC payments⁴</td>
<td>$45</td>
<td>$27</td>
<td>$25</td>
<td>$25</td>
<td>$28</td>
<td>$24</td>
<td>$24</td>
<td>$25</td>
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<tr>
<td>Crop insurance proceeds</td>
<td>$8</td>
<td>$2</td>
<td>$0</td>
<td>$24</td>
<td>$4</td>
<td>$19</td>
<td>$17</td>
<td>$13</td>
</tr>
<tr>
<td><strong>Gross revenue</strong></td>
<td>$431</td>
<td>$486</td>
<td>$718</td>
<td>$717</td>
<td>$646</td>
<td>$835</td>
<td>$902</td>
<td>$763</td>
</tr>
</tbody>
</table>

| **Costs**            |       |       |       |       |       |       |       |          |
| Total direct costs   | $144  | $147  | $162  | $216  | $306  | $232  | $268  | $237     |
| Total power costs    | $52   | $55   | $66   | $76   | $76   | $81   | $84   | $77      |
| Total overhead costs | $42   | $45   | $48   | $49   | $47   | $50   | $52   | $49      |
| Total non-land costs | $237  | $246  | $276  | $341  | $429  | $363  | $403  | $362     |

| **Operator and land return⁵** | $194 | $240 | $442 | $376 | $218 | $473 | $499 | $401 |
| **Land costs⁶**          | 147   | 150   | 166   | 197   | 209   | 215   | 248   | 207     |
| **Operator return⁷**     | $44   | $49   | $48   | $75   | $79   | $85   | $90   | $75     |
| **Net return⁸**          | $3    | $41   | $228  | $105  | -$71  | $173  | $161  | $119    |

2. Crop revenue equals yield per acre time price per bu.
4. Includes revenue from direct and counter-cyclical programs.
5. Represents a return to pay for land and provide the operator a return.
6. Land costs are represented by a cash rent.
7. Operator return provides the farmer a return for invested equity capital and labor.
8. Positive net return indicate economic profits while negative values indicate economic loses. In equilibrium profits are expected to average $0 over time.

**Source:** Historic Corn and Soybean Returns, IL Farm Business and Farm Management and University of Illinois

In equilibrium profits are expected to average $0 over time.
A good crop share lease should follow five basic principles...

1. Yield increasing inputs should be shared

2. Share arrangements should be re-evaluated as technology changes

3. Total returns divided in same proportion as resources contributed

4. Compensation for unused long-term investments at termination

5. Good landlord/tenant communications
Principle #3: Returns divided in same proportion as resources contributed.

This requires annual contributions of both parties to be identified (budgeting type approach).

Base input values on expectations consistent with the time-frame of the lease (if expectations end up being significantly off, be willing to make adjustments).
Principle #3: Returns divided in same proportion as resources contributed.

Annual contributions (i.e., costs) identified through budgets

- Tenant’s contributions ($$$)
- Landowner’s contributions ($$$)
- Shared contributions ($$$)

Determine relative contributions of non-shared costs (e.g., T = 63.5% and LO = 37.5%)

Equitably shared inputs are shared 63.5% / 37.5%

Total costs

Total non-shared costs
Methods of establishing cash rent values...

- Market going rate (if available)
- Crop share equivalent (adjusted for risk)
- Landowner’s cost
- Amount tenant can afford to pay

The last three require yield, price, and government payment projections (as well as cost information used for crop share).

I typically focus on these two.
Landowner/producer risk-return tradeoff

Return, $/ac

Risk, $/ac

Cash rent

Crop share

[Producer]

[Landowner]

Landowner/producer risk-return tradeoff
What folks told us about the risk premium...

How should cash rent for *non-irrigated* land compare with expected returns from equitable crop share...

![Bar chart showing responses to questions about cash rent for non-irrigated land.](chart.png)

- 6.9% said 5-10% higher
- 21.3% said roughly equal
- 32.2% said 5-10% less
- 28.2% said 10-15% less
- 9.4% said 15-25% less
- 2.0% said >25% less

81.7% said 0% to 15% less

(responses at 2010/11 Winter Lease Meetings in Kansas, n=202)
What folks told us about the risk premium...

How should cash rent for **non-irrigated** land compare with expected returns from equitable crop share...

![Bar chart showing percentages of responses.](responses at 2011/12 Winter Lease Meetings in Kansas, n=217)
Comparison of landowner income by lease type...

Landowner Income by Lease Type & Land Quality, 2009-10

Source: Schnitkey, G. University of Illinois
Why might producers pay a higher rent with a cash lease than crop share?

• Lower costs (easier to manage)
• Increased production flexibility
• Ability to manage risk with crop insurance
• Easier method of expansion
• Timing of when rates were negotiated
• Other???
Whose responsibility is it to see to it that a landowner’s cash rental rate is “fair and equitable” considering current conditions?

1. Landowner
2. Tenant

Who typically has better information?

(responses at 2011/12 Winter Lease Meetings in Kansas, n=163)*

* Participant breakdown: 41.5% tenants, 45.7% landowners, and 13.0% other
One solution -- cash rent auctions...

### Cash Rent Auctions in Iowa -- Feb 2-4, 2012

#### 2-Year lease (2012 and 2013) -- Money up front for 2012

<table>
<thead>
<tr>
<th>Ac-wtd avg</th>
<th>Total Lease</th>
<th>Min</th>
<th>Max</th>
<th>Corr with $/acre</th>
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<tbody>
<tr>
<td>$486</td>
<td>$3347.7</td>
<td>$325</td>
<td>$530</td>
<td>0.362</td>
</tr>
<tr>
<td>$476</td>
<td>$139.5</td>
<td>$325</td>
<td>$530</td>
<td>0.748</td>
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<tr>
<td>$530</td>
<td>$421.1</td>
<td>$325</td>
<td>$530</td>
<td>0.072</td>
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<table>
<thead>
<tr>
<th>Tract</th>
<th>County</th>
<th>$/acre</th>
<th>Acres</th>
<th>CSR</th>
<th>$/CSR</th>
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<tr>
<td>1</td>
<td>Cass</td>
<td>$475</td>
<td>132.6</td>
<td>79</td>
<td>$6.01</td>
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<tr>
<td>2</td>
<td>Guthrie</td>
<td>$525</td>
<td>153.4</td>
<td>81.5</td>
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<td>Guthrie</td>
<td>$525</td>
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<tr>
<td>4</td>
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<td>$520</td>
<td>78.1</td>
<td>77.9</td>
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<tr>
<td>5</td>
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<td>78.6</td>
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<td>$6.14</td>
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<td>$5.73</td>
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<td>$6.84</td>
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<tr>
<td>9</td>
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<td>$425</td>
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<td>67.8</td>
<td>$6.27</td>
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<td>10</td>
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<td>199.4</td>
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<td>11</td>
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<td>12</td>
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<tr>
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<td>$5.78</td>
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<td>18</td>
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<td>$435</td>
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<td>20</td>
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<td>$490</td>
<td>145.0</td>
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<td>22</td>
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<td>55.2</td>
<td>$8.15</td>
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<td>23</td>
<td>Mitchell</td>
<td>$530</td>
<td>221.0</td>
<td>86.1</td>
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<tr>
<td>24</td>
<td>Mitchell</td>
<td>$400</td>
<td>70.4</td>
<td>62</td>
<td>$6.45</td>
</tr>
</tbody>
</table>

**Source:** Edwards, Cash Rental Rates for Iowa, 2012 Survey
Cash rent auction in NW KS...

**Land Lease Auction**

2150 Acres +/-  
Located in Sheridan and Thomas County, Kansas

Saturday, January 15, 2011 • Time: 2:00 p.m.

Owner: Ward J. Munkres  
Sale Location: Shepherd's Staff building,  
225 Main St., Rexford, KS
**Cash rent auction in NW KS ...**

**Munkres cash rent auction, January 15, 2011**

<table>
<thead>
<tr>
<th>Tract</th>
<th>Cropland acres (FSA)</th>
<th>$/acre</th>
<th>Annual wheat dollars</th>
<th>Stubble a</th>
<th>Corn stalks a</th>
<th>Milo stalks a</th>
<th>Govt payments</th>
<th>Govt pymt per acre</th>
<th>Avg %</th>
<th>PPM</th>
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<tr>
<td>1</td>
<td>214.0</td>
<td>$110</td>
<td>$23,540</td>
<td>108.0</td>
<td>106.0</td>
<td>$3,255</td>
<td>$15.21</td>
<td>2.00</td>
<td>37.50</td>
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<tr>
<td>2</td>
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<td>$271,084</td>
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<td>683.1</td>
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**Overall per acre values**

- **$126.56**
- $12.13
- $1.75
- 21.80

**Correlation of cash rent with above columns**

- 0.51
- 0.14
- 0.04

Only marginal differences in farmability and land quality across tracts, except that tract 2 had several acres in a lagoon.

All land is non-irrigated, fairly flat, little erosion, and has good road and grain market access.

All land is open, i.e., no growing wheat.

Land leased for 5 years and tenant must ensure no loss of soil fertility during lease term, i.e., must reimburse

Land owner at end of lease for any reduced fertility (both N and P), as judged by before & after soil tests.

Land located near Rexford and Gem in both Thomas and Sheridan counties, Kansas.

Pre-auction expectations likely were centered around $80/acre.
Kansas county-level non-irrigated crop cash rents...

So, what is the market value?

TH
$38
($37.50 – 2011)

SD
$36
($37.50 – 2011)

* 2010 Cash rent values as reported by USDA NASS and Kansas Agricultural Statistics (KAS).
Whether you have participated in them or not, what is your opinion of cash rent auctions?

1. I love them
2. They are okay
3. I’m indifferent
4. Don’t care for them
5. I hate them

(responses at 2011/12 Winter Lease Meetings in Kansas, n=34)
NO SECRETS. Farmland tenants generally dislike public lease auctions for two reasons: 1) They remove the traditional, personal relationship bond between the owner/tenant and reduce it to a numbers game; and 2) It publicizes actual cash rents so all the landlords in the area can compare how their leases stack up.
Given within year variability, what price do you use in budgets?

Weekly Average CBT Corn Futures Prices

Cents per bushel

Dec, Jul
Given within year variability, what price do you use in budgets?
Given within year variability, what price do you use in budgets?
Flexible Cash Rents – WHY?

- Method of allowing rents to vary from year-to-year without having to renegotiate rents annually (avoid mental anguish associated with rental rate negotiation)

- Way of sharing/managing risks associated with volatile markets (without hassles of crop share lease)

- More transparent than ad hoc “bonuses”

- A good way (requirement?) of working with the “new breed” of landowners?

- Somewhat “force” a higher level of communication relative to fixed cash rent (poor/lack of communication is often an issue with problem lease arrangements)
Flexible Cash Rents – WHY NOT?

• Complex!

• Theory and intuition guide conceptual design, but little help with specific details

• May not be needed if cash rents are renegotiated frequently (every year?)

• Hard to think of everything, which means we might need to be “tweaking” arrangement regularly

• If designed wrong, might increase risk

• Appealing for certain situations, but not appropriate in all cases (depends on why you are considering cash rent)
The off-farm siblings have it all wrong, focusing on the prices received. This superficial analysis fails to examine the input costs and all the risk and volatility in today’s agriculture.

Many producers are commenting that margins are being squeezed and are even negative, given some input price scenarios. However, the off-farm siblings only see land values and cash rents increasing.

To all parents reading this article, be careful of the pressures being exerted by your children who are not involved in the farm. ... As a tip for those children on the farm, be ready to show how much high input costs and variation in prices have impacted farm and ranch economics in recent years.
Summary

• Trend away from crop share leases will likely continue – increases the importance of communication for tenants

• Likely will see an increased number of “hybrid” leases in the future (makes lease evaluation/comparisons more difficult)

• Average rents reported in surveys have limited value for setting rates of individual parcels for numerous reasons

• Use of cash rent auctions likely will increase as a means of “leveling the field” with respect to information (tenants are encouraged to be pro-active in sharing information)

• Lease-related problems that exist are often associated with non-business like behavior (family often the worst)
For more information and decision tools related to farm management, marketing, and risk management go to www.AgManager.info

If interested in receiving weekly AgManager.info Update or any of our other Ag Econ newsletters via email, please contact Kevin Dhuyvetter or Rich Llewelyn. (Kevin: kcd@ksu.edu -- 785-532-3527 or Rich: rvl@ksu.edu – 785.532.1504).