Establishing a rental rate and agreement that work

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For The News

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Part two of two

The 2012 crop season is now complete, and many farmers have taken advantage of the warm fall weather to do some fall tillage and planting of cover crops. If there were any corn fields left standing for the gun deer season, they have since been harvested and the deer have cleaned up what was missed in the fields.

Farmers are ready for the holidays and wondering what the new year will bring. If you own land or rent land, now is the time to review your farmland rental agreement and rates.

Last time we talked about fixed cash rent lease arrangements, which are the most common form of farmland leases. This lease is typically a fixed amount per acre and a simple lease arrangement established between owner and tenant. It provides low risk and return for the landowner, while offering high risk and return for the tenant. There are other approaches for determining cash rental rates as well.

Landowner's ownership cost

Under this approach the landowner calculates the cost of resource ownership. These costs might include:

Land: fair market value of land used for agricultural purposes

Interest on land: land value multiplied by opportunity interest rate to estimate annual land charge

Real estate taxes: actual taxes due annually

Land development: average dollars spent annually for improvements such as lime, conservation practices, tillage, etc.

Percent of land value

Land ownership may be viewed as just another type of asset in a portfolio of investment alternatives. Owners would likely be looking for a rate of return commensurate with other types of investments, adjusted for differences in risk. Comparable investments would include investments of a similar holding period.

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In recent years, land values have been increasing rent as a percent of value to decline. Wisconsin has seen cropland cash rents as a percent of land value decline from 3.7 percent in 2001 to 2.5 percent in 2010, per USDA National Agricultural Statistics Service. A partial explanation for this trend is a general decrease in interest rates and returns for alternative investments during the past decade.

Share of gross crop value

Cash rental rates tend to follow the gross revenue from the crops being produced. Gross crop revenue includes potential revenue from the sale of the crop and can also include USDA commodity payments and crop insurance indemnity payments.

Rents have generally averaged about 25 to 30 percent of gross crop revenue from corn and 35 to 45 percent of gross crop revenue from soybeans. The expected yield can be based on actual yields obtained form the farm in recent years.

Expected prices can be found by adjusting the relevant harvest time future prices for typical basis values, or checking to see what forward contract prices are being offered by rent is being determined. These percentages and estimated yields and prices for the coming year can be used to estimate a fair cash rental rate.

Average yields

A cash rental rate can be based on a farm's average actual yields (e.g. five-year or 10-year average). For example, assume the average rental rates are $0.53 per bushel for corn and $1.61 per bushel for soybeans, based on the latest survey information you have collected. If your farm has an average corn yield of 140 bushels per acre, this results in a rental rate of $74 ($0.53 x 140 bu. $74) per acre. An average soybean yield of 46 bushels per acre results in a rental rate of $74 ($1.61 x 46 bu. $74) per acre.

If this method used actual yields produced, it would become a variable rent from year to year. If the rent is based on a constant or expected yield, it is a fixed cash rent. This is a reasonable approach when selling prices are relatively stable over time. It is also useful for adjusting the rental rate for differences in productivity among farms.

Adapted from "Fixed and Flexible Cash Rental Arrangements for Your Farm," North Central Farm Management Extension Committee.

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