

2011-2012

K-State Leasing & Excel Workshops

January 25, 2012

Northwest Kansas Educational Service Center
703 W. 2nd St.
Oakley, KS



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Leasing & Excel Workshop

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www.agmanager.info



What we're going to do today...

- Introduction to Rental Arrangements

- Types of leases
- Principles of leases
- Available information

Objective is to get us all on the same page with regard to terminology and information that is publicly available.

- Ethics of leasing

Discuss issues/factors that lead to potential problems with lease arrangements (seem to be more common in current environment).

- Working with *KSU-Lease.xls* (hands on)

Best way to learn is to actually get on the computer! Work with an example representative of the region, but learn how to tailor numbers to your situation.

Feel free to ask questions, disagree, and/or make comments at any time...

Introduction to Rental Arrangements



Over the years, the majority of land leasing questions we receive pertain to:

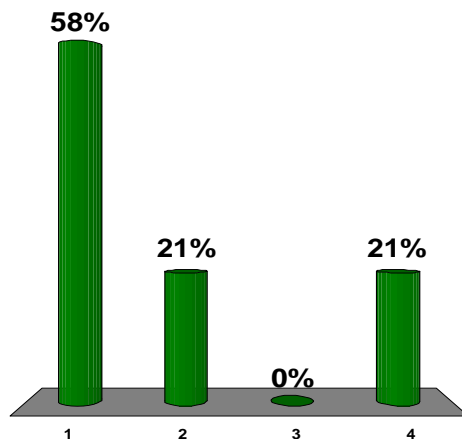
- Impact of adopting new technologies
- Cash renting (folks always want the "going rates")
- "Non-traditional" leases
 - Net share rent
 - Flexible cash rent
 - Bushel rent
 - Combination cash/cropshare
- Terminating leases

... regardless of the topic pertaining to lease terms, method of addressing questions does not change.

Test to make sure clickers are working ...

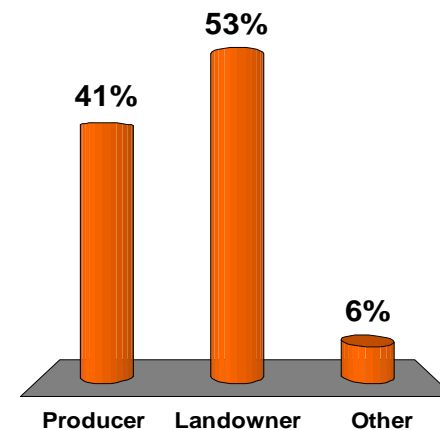
Which best describes your computer / internet access situation?

1. High speed internet
2. Dial up internet
3. Computer, but no internet
4. I have a calculator, does that count?



Which best describes you?

1. Producer
2. Landowner
3. Other



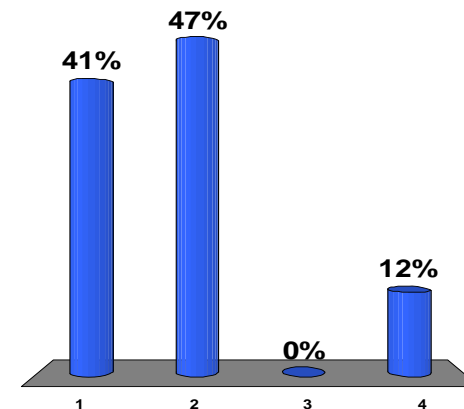
Types of leases on crop land

- **Crop-share**
 - Landowner receives a share of annual revenues (grain sales and government payments) and typically shares certain production costs
- **Cash rent**
 - Landowner receives a fixed annual cash payment in exchange for use of the land
- **Numerous variations around these two**

What type of leases do you use?

The lease arrangement for the majority of non-irrigated crop acres I rent or manage is...

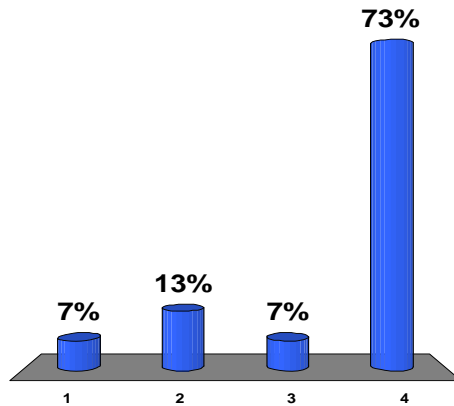
1. Crop share
2. Cash rent
3. Other
4. Does not apply



What type of leases do you use?

The lease arrangement for the majority of *irrigated* crop acres I rent or manage is...

1. Crop share
2. Cash rent
3. Other
4. Does not apply



Distribution of non-irrigated crop leases by type of lease...

Region	Cash	Share	Other
Northwest	35.2%	54.6%	10.2%
West Central	21.3	58.5	20.2
Southwest	20.8	76.1	3.1
North Central	41.3	54.8	3.9
Central	32.8	53.8	13.4
South Central	34.0	63.0	3.0
Northeast	48.7	42.4	8.9
East Central	50.9	39.6	9.5
Southeast	35.9	58.2	5.9
State	35.7	55.7	8.6

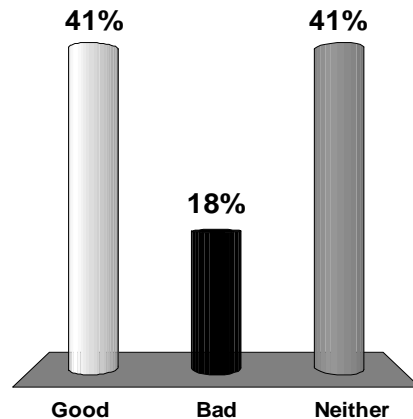
Source: Schlegel and Tsoodle -- 2010 KAS/KSU survey

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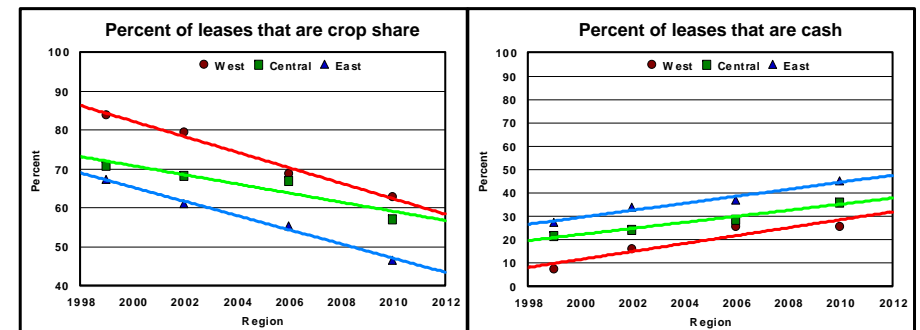
Crop share versus cash leases...

Relative to equitable crop share leases, fixed cash leases are...

1. A good thing
2. A bad thing
3. Neither (just different)



Trend towards more cash rent...



Source: KSU and KS Ag Stat - Non-Irrigated Farm Lease Arrangement Surveys

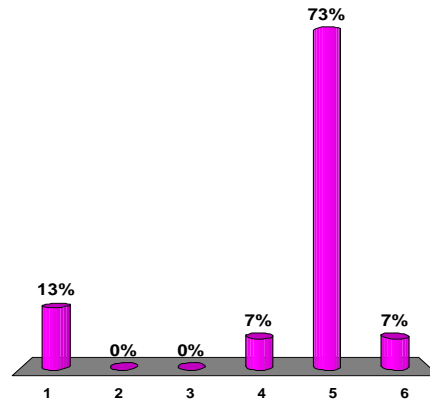
Crop share continues to be the most prevalent, but the trend has been a shift from crop share arrangements towards more cash rent leases.

- 1) What factors have been behind this trend?
- 2) Will this trend continue, stabilize, or reverse?

Timing of cash lease payments...

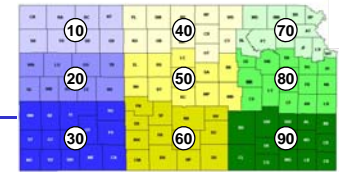
On cash leases, payments are due...

1. Jan 1 (approximately)
2. At planting
3. At harvest
4. Dec 31 (approximately)
5. Multiple times
6. Other



Length of cropland leases...

KAS Crop Reporting Districts



Region	Years rented
Northwest (10)	16.7
West Central (20)	17.6
Southwest (30)	21.0
North Central (40)	17.8
Central (50)	16.0
South Central (60)	18.1
Northeast (70)	21.9
East Central (80)	20.4
Southeast (90)	18.9
State	18.6

Producers tend to lease land from the same landowner for a long time.

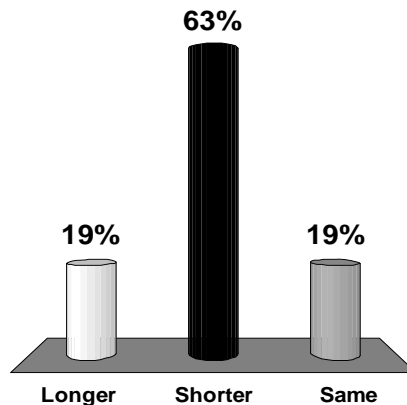
Long-term relationships can be good or bad...

Source: Schlegel and Tsoodle -- 2010 KAS/KSU survey

Crop share versus cash leases...

Relative to crop share leases, the length of leases (number of years) for fixed cash rent tend to be...

1. Longer
2. Shorter
3. Basically the same



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”
- 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.



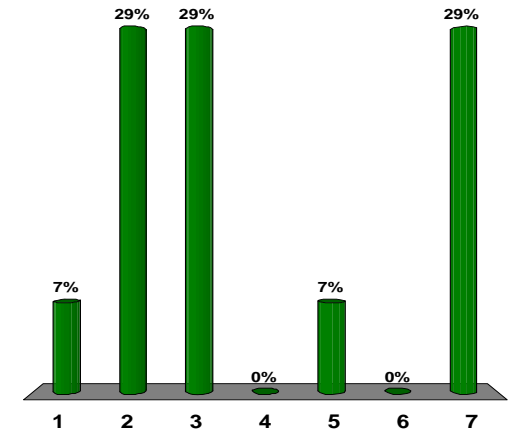
Identifying “the market” established rates through the use of surveys...

- Land Use Value Project of the K-State 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
- With surveys there is often a trade-off between statistical validity and level of aggregation

Sharing of expenses...

On non-irrigated crop share leases, we share the following:

1. Nothing
2. Fertilizer
3. Fert & chem
4. Fert & seed
5. Fert, chem & seed
6. Other
7. Does not apply



Example of market established crop shares...

Crop	Landlord's Percent of Crop Received (and of Costs Paid)*			
	33% Share	40% Share	50% Share	Other % Share
Wheat (21 Leases)	19			2
% of Total Leases in Lease Arrangement	90.5%	No Responses	No Responses	9.5%
% of Leases Sharing Fertilizer Costs	100.0%			0.0%
% of Leases Sharing Herbicide Costs	68.4%			0.0%
% of Leases Sharing Insecticide Costs	21.1%			0.0%
Corn (11 Leases)	11			
% of Total Leases in Lease Arrangement	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Fertilizer Costs	90.9%			
% of Leases Sharing Herbicide Costs	81.8%			
% of Leases Sharing Insecticide Costs	54.5%			
Sorghum (7 Leases)	7			
% of Total Leases in Lease Arrangement	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Fertilizer Costs	100.0%			
% of Leases Sharing Herbicide Costs	57.1%			
% of Leases Sharing Insecticide Costs	42.9%			

* The percentages calculated in this table represent the percent of landlords sharing the same percent of costs as they share of the crop. For example, 68.4% of landlords receiving 33% of the wheat crop paid 33% of herbicide expenses.

Source: Schlegel and Tsoodle -- 2011 KAS/KSU survey (available at www.agmanager.info)

Example of market established crop shares...

Crop	Landlord's Percent of Crop Received (or of Costs Paid)*			
	33% Share	40% Share	50% Share	Other % Share
Wheat (21 Leases)	21			
% of Total Leases in Lease Arrangement	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Fertilizer Costs	95.2%			
% of Leases Sharing Herbicide Costs	52.4%			
% of Leases Sharing Insecticide Costs	52.4%			
Corn (4 Leases)	4			
% of Total Leases in Lease Arrangement	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Fertilizer Costs	100.0%			
% of Leases Sharing Herbicide Costs	25.0%			
% of Leases Sharing Insecticide Costs	25.0%			
Sorghum (8 Leases)	8			
% of Total Leases in Lease Arrangement	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Fertilizer Costs	87.5%			
% of Leases Sharing Herbicide Costs	62.5%			
% of Leases Sharing Insecticide Costs	50.0%			

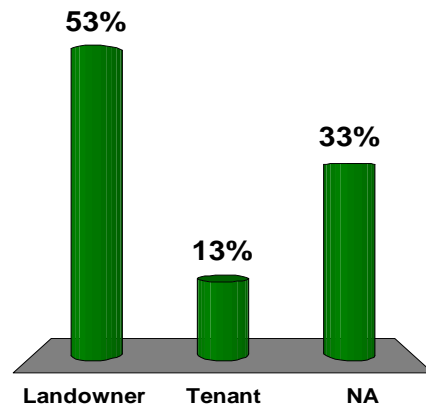
* The percentages calculated in this table represent the percent of landlords sharing the same percent of costs as they share of the crop. For example, 52.4% of landlords receiving 33% of the wheat crop paid 33% of herbicide expenses.

Source: Schlegel and Tsoodle -- 2011 KAS/KSU survey (available at www.agmanager.info)

Ownership of pivot...

On irrigated land the center pivot system is typically owned by the...

1. Landowner
2. Tenant
3. Does not apply



Example of market established irrigated crop shares...

Crop	Landlord's Percent of Crop Received (or of Costs Paid)*				
	25%	33%	40%	50%	Other
Wheat (4 Leases)	25.0%	75.0%			
% of Leases Sharing Fertilizer Costs	100.0%	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Herbicide Costs	100.0%	100.0%			
% of Leases Sharing Insecticide Costs	100.0%	100.0%			
% of Leases Sharing Energy Costs	No Response	No Response			
Corn (36 Leases)	16.7%	61.0%	5.6%	5.6%	11.1%
% of Leases Sharing Fertilizer Costs	100.0%	100.0%	100.0%	100.0%	100.0%
% of Leases Sharing Herbicide Costs	100.0%	100.0%	100.0%	100.0%	100.0%
% of Leases Sharing Insecticide Costs	100.0%	100.0%	100.0%	100.0%	100.0%
% of Leases Sharing Energy Costs	No Response	100.0%	100.0%	100.0%	No Response
Soybeans (8 Leases)	12.5%	75.0%		12.50%	
% of Leases Sharing Fertilizer Costs	100.0%	100.0%	No Responses	100.0%	No Responses
% of Leases Sharing Herbicide Costs	No Response	100.0%		100.0%	
% of Leases Sharing Insecticide Costs	No Response	100.0%		No Response	
% of Leases Sharing Energy Costs	100.0%	100.0%		100.0%	
Alfalfa (7 Leases)	28.6%	14.3%		57.10%	
% of Leases Sharing Fertilizer Costs	100.0%	100.0%	No Responses	100.0%	No Responses
% of Leases Sharing Herbicide Costs	No Response	100.0%		100.0%	
% of Leases Sharing Insecticide Costs	No Response	100.0%		100.0%	
% of Leases Sharing Energy Costs	No Response	100.0%		No Response	

*The percentages calculated in this table represent the percent of landlords sharing the same percent of costs as they share of the crop. For example, 100% of landlords receiving 33% of the wheat crop paid 33% of fertilizer expenses.

Source: Schlegel and Tsoodle -- 2008 KAS/KSU survey (available at www.agmanager.info)

Example of market established irrigated crop shares...

Crop	Landlord's Percent of Crop Received (or of Costs Paid)*				
	25%	33%	40%	50%	Other
Wheat (8 Leases)	12.5%	87.5%			
% of Leases Sharing Fertilizer Costs	100.0%	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Herbicide Costs	No Response	100.0%			
% of Leases Sharing Insecticide Costs	No Response	100.0%			
% of Leases Sharing Energy Costs	No Response	No Response			
Corn (31 Leases)	9.7%	87.1%		3.2%	
% of Leases Sharing Fertilizer Costs	100.0%	100.0%	No Responses	100.0%	No Responses
% of Leases Sharing Herbicide Costs	100.0%	100.0%		100.0%	
% of Leases Sharing Insecticide Costs	100.0%	100.0%		No Response	
% of Leases Sharing Energy Costs	100.0%	85.7%		100.0%	
Sorghum (3 Leases)		100.0%			
% of Leases Sharing Fertilizer Costs	No Responses	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Herbicide Costs		100.0%			
% of Leases Sharing Insecticide Costs		100.0%			
% of Leases Sharing Energy Costs		100.0%			
Soybeans (2 Leases)		100.0%			
% of Leases Sharing Fertilizer Costs	No Responses	100.0%	No Responses	No Responses	No Responses
% of Leases Sharing Herbicide Costs		100.0%			
% of Leases Sharing Insecticide Costs		100.0%			
% of Leases Sharing Energy Costs		100.0%			

*The percentages calculated in this table represent the percent of landlords sharing the same percent of costs as they share of the crop. For example, 100% of landlords receiving 33% of the wheat crop paid 33% of fertilizer expenses.

Source: Schlegel and Tsoodle -- 2008 KAS/KSU survey (available at www.agmanager.info)

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 rate of return = 0)

* On average, in the long run

A good crop share lease should follow five basic principles ...

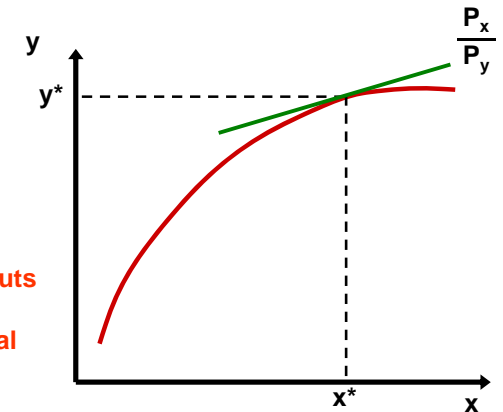
1. Yield increasing inputs should be shared
 2. Share arrangements should be re-evaluated as technology changes
 3. Total returns divided in same proportion as resources contributed
-
4. Compensation for unused long-term investments at termination
 5. Good landlord/tenant communications

Principle #1: Yield increasing inputs should be shared

Examples of yield increasing inputs

- Fertilizer
- Irrigation water
- Herbicides ???
- Seed ???

Sharing yield increasing inputs in the same % as income provides the economic signal to both parties to apply the optimal amount of the input.



Principle #2: Technology may affect share arrangements

Examples of technological change

- Reduced-/no-till
- New crops/rotations (e.g., double crop)
- Center pivot irrigation
- Hybrid seed
- Bio-technology
- Precision agriculture (GPS, autoswath)



Impact of new technologies ...

- Why do people adopt new technologies?
- What happens as “new” technologies become common practice?
- How does this impact relative contributions?

Adoption of new technologies ...

- ... tends to cause problems because traditional arrangements or rules-of-thumb are often not appropriate.
- ... should not be a problem if we follow basic principles of a good lease.
- ... if problems persist as to what is equitable, can lead to alternative leasing arrangements (e.g., cash lease).

Principle #3:
Returns divided in same proportion as resources contributed.

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

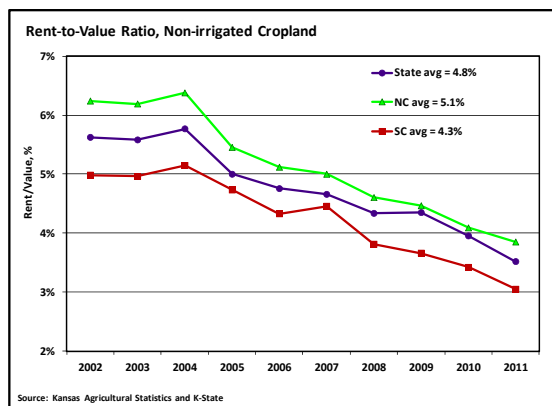


Base input values on expectations consistent with the time-frame of the lease (if expectations end up being significantly off, be willing to make adjustments).

Land contribution ...

The land contribution has typically been based on an “average market value” for the land along with an historical average return to land.

As cash leases become more common, the land contribution can be set equal to the cash rent. However we still often struggle with what the “right” number is.



Machinery contributions ...

Machinery contribution should be based on average costs. Two methods for estimating the machinery contribution:

1. Machinery investment approach - annual contribution is based on depreciation, interest, repairs, fuel and oil, and labor.
2. Custom rates approach - annual contribution is based on reported custom rates and the typical operations.

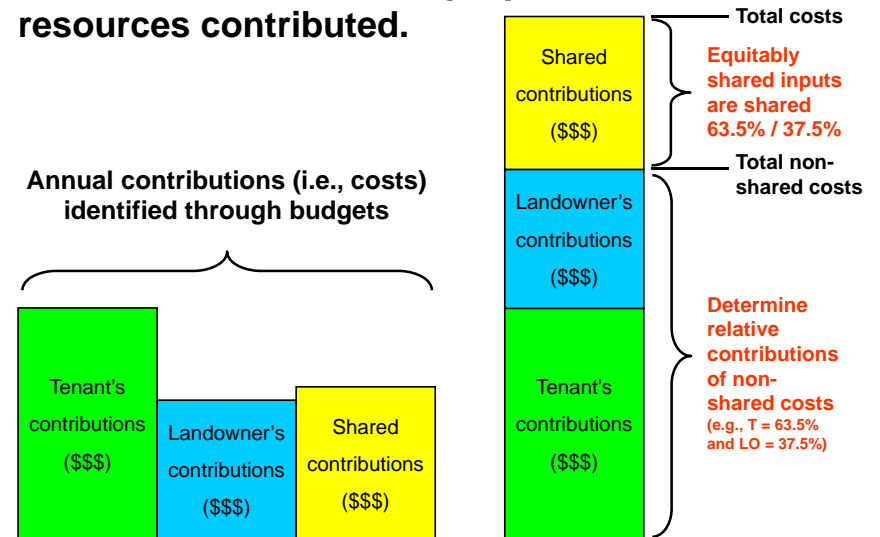


Crop production input contributions ...

The value of contributions for input expenses such as seed, herbicides, insecticides, fertilizer, etc. are generally valued at current market prices and represent “typical” production practices.

How do we deal with input prices if they deviate significantly from historical averages (e.g., fertilizer, fuel)?

Principle #3: Returns divided in same proportion as resources contributed.



Principle #4: Compensation for unused long-term investments at lease termination.

It is generally recommended that landowners make long-term investments such as terraces, irrigation well, lime, alfalfa seed, etc.

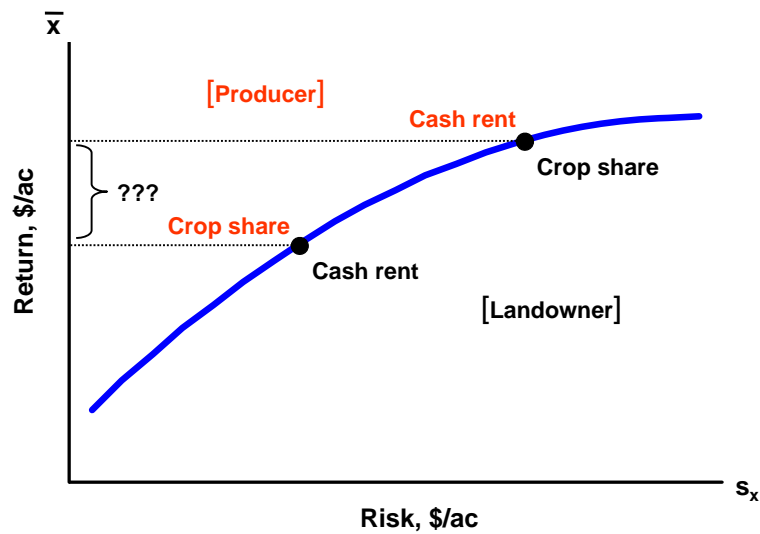
If the tenant pays for long-term investments, or shares their cost, he should be compensated for his share of any value that remains when the lease is terminated

Principle #5: Good communications between the landlord and the tenant.

Because so many of the terms of a lease are based on negotiation between the landowner and the tenant, good communications are critical.

A lease is a legal contract in Kansas, thus it is suggested that terms of the lease agreed upon by both parties be put in writing. This becomes more important as the complexity of leases increases – or as the volatility of crop and input prices increases.

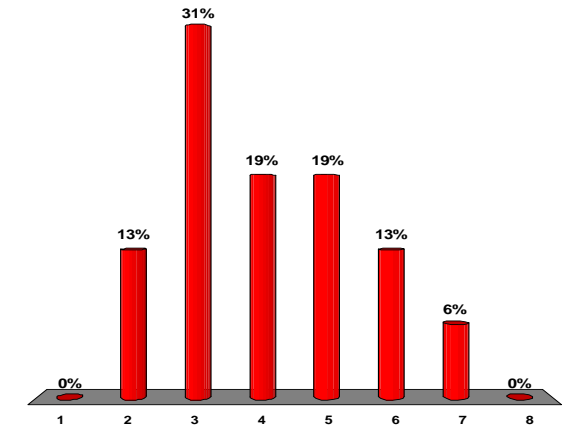
Landowner/producer risk-return tradeoff



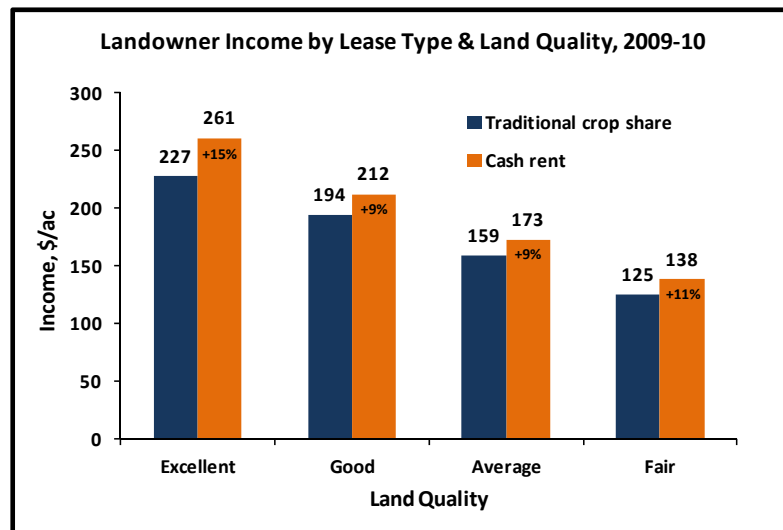
Risk premium...

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

1. 5-10% higher
2. Roughly equal
3. 5-10% less
4. 10-15% less
5. 15-20% less
6. 20-30% less
7. 30-40% less
8. >40% less



Comparison of landowner income by lease type...



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???

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

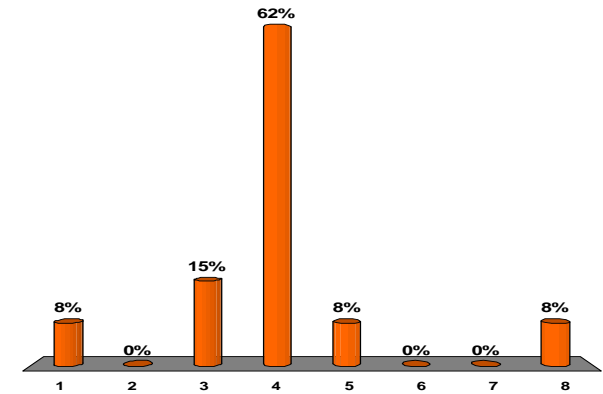


The last three require yield, price, and government payment projections (as well as cost information used for crop share).

Market rate for average cash rent...

Average cash rent per tillable acre for non-irrigated crop land in 2011 in my area was...

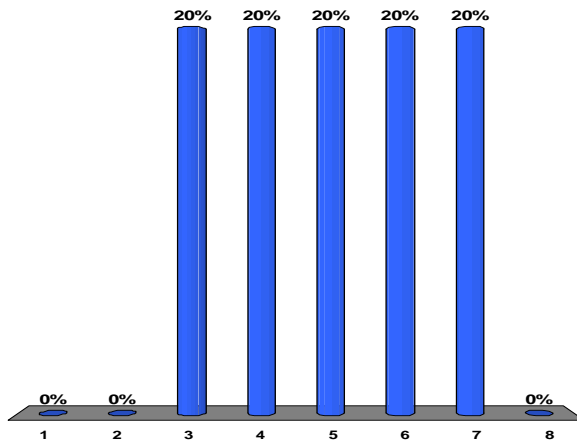
- < \$25
- \$25-\$30
- \$30-\$35
- \$35-\$40
- \$40-\$50
- \$50-\$60
- \$60-\$75
- > \$75



Market rate for average cash rent...

Average cash rent per wet acre for irrigated crop land in 2011 in my area was...

- < \$60
- \$60-\$75
- \$75-\$90
- \$90-\$110
- \$110-\$140
- \$140-\$170
- \$170-\$200
- > \$200



KAS surveyed market rates ...

USDA United States Department of Agriculture National Agricultural Statistics Service, Kansas Field Office

AGRICULTURAL LAND VALUES & CASH RENTS

Kansas Agricultural Statistics
Cooperating with the Kansas Department of Agriculture
Released: September 12, 2011

2011 Kansas Farmland Value Up 14 Percent
The average value of all farmland and buildings for 2011 in Kansas is estimated to be \$1,250 per acre. This compares with \$1,100 in 2010 and \$1,020 in 2009. Kansas' average value of all farmland and buildings increased 14 percent from 2010 to 2011. Irrigated cropland values rose 13 percent from 2010 while non-irrigated cropland increased 14 percent in value from last year. The value of Kansas pasture land increased 3 percent from 2010 to \$410 per acre.

2011 Cash Rents Up from Previous Year
The 2011 average cash rent farmers pay for non-irrigated cropland in Kansas was \$44 per acre, up from \$43.50 in 2010. The cash rental rates for non-irrigated cropland ranged from a low in the Southwest District of \$30.50 per acre to the high in the Northeast District of \$64.50 per acre. Following the Northeast District was the East Central with \$48.50, down \$1.50 from 2010, and the North Central with \$47.50 per acre.

The 2011 cash rental rate for irrigated cropland in Kansas averaged \$105 per acre, up from \$95 per acre in 2010. The Northeast District had the highest rent with \$120 per acre, followed by the North Central at \$122 and the Northeast at \$118 per acre. The Southwest District had the lowest irrigated rent with \$63 per acre, followed by the Central District with \$85.50 and East Central with \$84 per acre.

The pasture cash rent averaged \$18 per acre in 2011, up from \$15.50 in 2010. The rent for pasture in Kansas ranged from \$9.00 per acre in the Southwest District for a low to \$21.50 per acre in the Northeast District for the high. The Northeast District was followed by the East Central with \$21 and the North Central with \$19.50. Douglas County has the highest average cash rental rate in Kansas at \$33 per acre, up \$1 from last year.

Year	Irrigated Cropland		Non-Irrigated Cropland		Pasture and Rangeland		All Farmland and Buildings	
	Value	% Change	Value	% Change	Value	% Change	Value	% Change
2001	1,060	435	675	72.00	36.00	12.40	645	30,628
2002	1,280	640	879	79.00	36.00	4.00	825	31,485
2003	1,590	645	854	69.00	4.10	12.40	895	32,252
2004	1,980	690	888	72.00	37.00	4.20	1,120	32,760
2005	1,160	770	808	73.40	13.40	870	96,260	
2006	1,200	620	854	74.00	39.00	13.70	870	41,262
2007	1,260	980	914	82.00	41.00	860	14,500	45,374
2008	1,450	660	1,020	92.00	7.00	15.50	1,020	47,524
2009	1,500	1,000	1,050	89.00	43.00	7.00	1,530	47,586
2010	1,600	1,100	86.00	43.00	7.00	15.50	1,100	50,820
2011	1,900	1,250	1,300	105.00	44.00	8.10	1,400	1,700

¹ Rental rates are for land only. ² All farmland published in August 2012.

KAS report (switched to county-level in 2009 for rent, dropped CRD-level land values in 2011)

Farm Management Guide MF-1100

Kansas Land Prices and Cash Rental Rates

Department of Agricultural Economics - www.agriculture.ksu.edu
Kansas State University Agricultural Experiment Station and Cooperative Extension Service
Kurtis C. Broyer, Agricultural Economist, Terry L. Kansas, Professor Emeritus

The Farm Management Guide reports Kansas land prices and cash rents for 1995-2010. These data are useful to farm managers in determining cash rental rates, to landowners in calculating indices for making lease adjustments to land prices, and to landowners and investors who have expectations on historical price and rental levels for farmland. The average prices in this guide encompass parcels of land that vary widely in productivity. Thus, these data are more appropriate for analyzing trends than for establishing market value or rental rates for specific tracts of farmland.

Kansas Agricultural Statistics
For reporting purposes, Kansas Agricultural Statistics Service has divided the state into seven agricultural statistical districts. The districts are: Northeast (NE), West Central (WC), Southwest (SW), North Central (NC), East Central (EC), South Central (SC), and Southeast (SE). Since 1976, Kansas Agricultural Statistics has collected price information on three types of land: non-irrigated cropland, irrigated cropland, and pasture. This information is combined in two additional land groupings: all cropland and all land in farms. The all cropland land values represent an average-weighted average of irrigated and non-irrigated cropland. Although these two groupings do not represent a particular class of land (e.g., non-irrigated cropland), they provide a broader classification of interest.

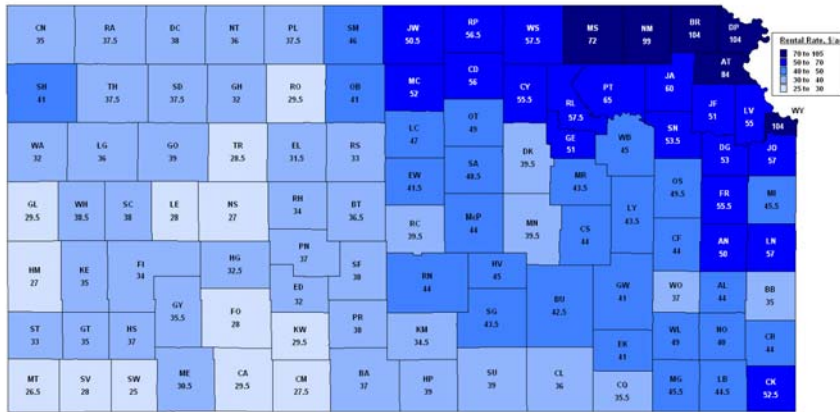
The land values for all land in farms reported also include the value of any buildings that may be on the land. The value of the buildings represents a small portion of the total value, on average, and thus this reporting method does not significantly affect the accuracy of land value reported.

Kansas Land Prices
Tables 1 through 5 show average prices of land and buildings. Table 1 is each district and an average for the state for the most recent 20 years reported. Data are shown for each of the five land groupings: all land in farms, all cropland, non-irrigated cropland, irrigated cropland, and pasture. The annual data are based on surveys conducted by Kansas Agricultural Statistics in June of each year using information on each farmer's land values and the percentage change in land values from the previous year as of June 1.

Year	SW	WC	SW	NC	EC	SC	SE	KS
1991	830	853	821	827	842	855	850	840
1992	878	866	818	862	862	890	874	862
1993	919	911	812	871	881	906	890	887
1994	957	956	812	921	898	942	928	907
1995	991	996	844	927	945	979	960	933
1996	1,019	1,019	869	956	974	1,014	911	948
1997	1,040	1,040	888	980	1,000	1,040	910	970
1998	1,060	1,060	907	1,000	1,020	1,060	930	990
1999	1,080	1,080	926	1,020	1,040	1,080	950	1,010
2000	1,100	1,100	945	1,040	1,060	1,100	970	1,030
2001	1,120	1,120	964	1,060	1,080	1,120	990	1,050
2002	1,140	1,140	983	1,080	1,100	1,140	1,010	1,070
2003	1,160	1,160	1,002	1,100	1,120	1,160	1,030	1,090
2004	1,180	1,180	1,021	1,120	1,140	1,180	1,050	1,110
2005	1,200	1,200	1,040	1,140	1,160	1,200	1,070	1,130
2006	1,220	1,220	1,059	1,160	1,180	1,220	1,090	1,150
2007	1,240	1,240	1,078	1,180	1,200	1,240	1,110	1,170
2008	1,260	1,260	1,097	1,200	1,220	1,260	1,130	1,190
2009	1,280	1,280	1,116	1,220	1,240	1,280	1,150	1,210
2010	1,300	1,300	1,135	1,240	1,260	1,300	1,170	1,230

KSU report - basically a repackaging of KAS data (show more history and estimate "missing values")

Kansas Nonirrigated Cash Rents, 2011*

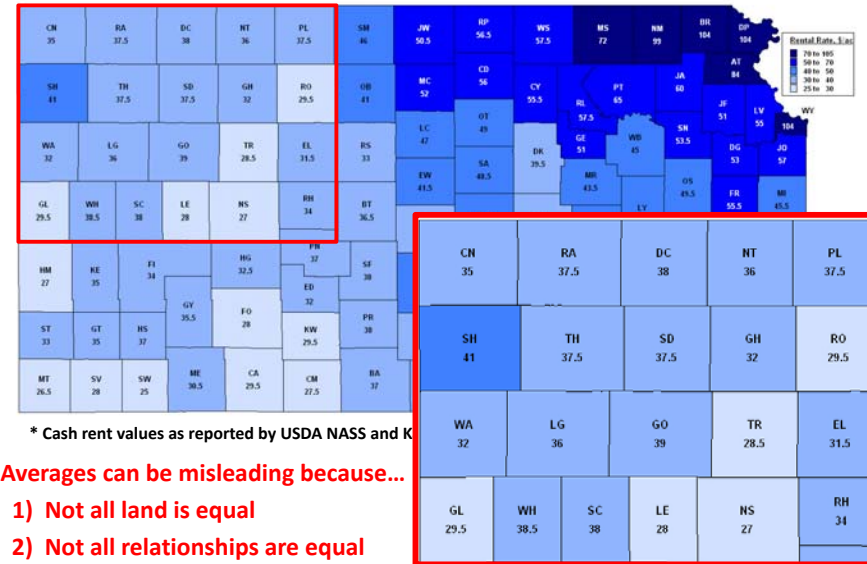


* Cash rent values as reported by USDA NASS and Kansas Agricultural Statistics (KAS).

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%)

Kansas Nonirrigated Cash Rents, 2011*

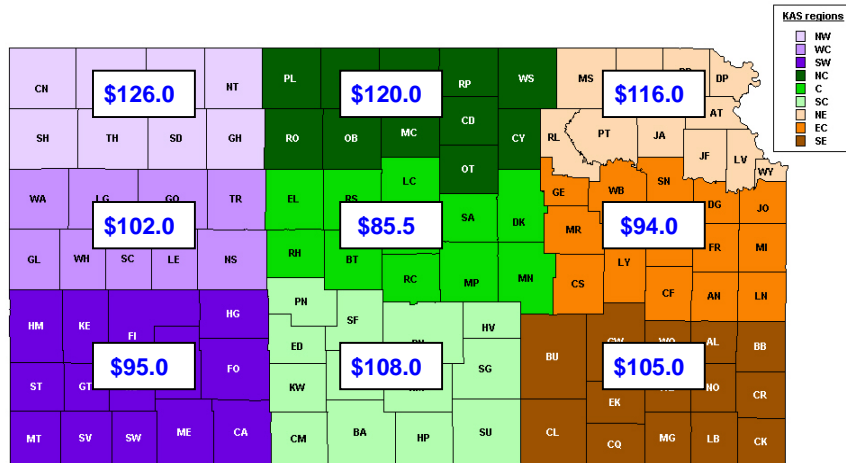


* Cash rent values as reported by USDA NASS and KAS.

Averages can be misleading because...

- 1) Not all land is equal
- 2) Not all relationships are equal

2011 average irrigated cash rent*



* 2011 Cash rent values as reported by USDA NASS and Kansas Agricultural Statistics (KAS). Values at the county level were only reported for 28 of 105 counties.

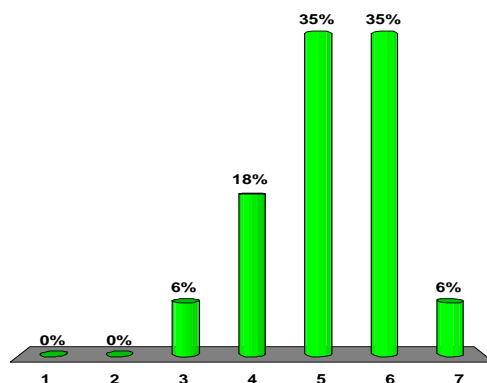
Methods of establishing cash rent values ...

- Crop share equivalent (adjusted for risk)
 - Converts equitable crop share rent to an expected dollar amount per acre
- Landowner's cost
 - Based on the premise of landowner's continuing to receive comparable returns to what has been received in the past
- Amount tenant can afford to pay
 - Residual approach – after tenant pays all expenses, whatever income is left represents cash rent

Crop land cash rents for 2012...

My estimate as to what cash rents for crop land in 2012 will be, relative to 2011, is...

1. Down > 10%
2. Down 5-10%
3. Down 2-5%
4. Steady
5. Up 2-5%
6. Up 5-10%
7. Up > 10%



Flexible Cash Rents



Flexible Cash Rents – WHAT?

- Flexible cash rents simply refer to land rental arrangements where the amount of cash rent paid (received) can vary based upon some pre-determined formula (i.e., formalizes bonus rents)
- Methods of “flexing” rental rates, i.e., formulas are based on:
 - Yield (actual for producer, county average, etc.)
 - Price (harvest, season average, actual)
 - Revenue (yield x price, crop insurance, residue)
 - Costs (e.g., fertilizer price)
 - Other...

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
- Not 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)

Ethics of Leasing

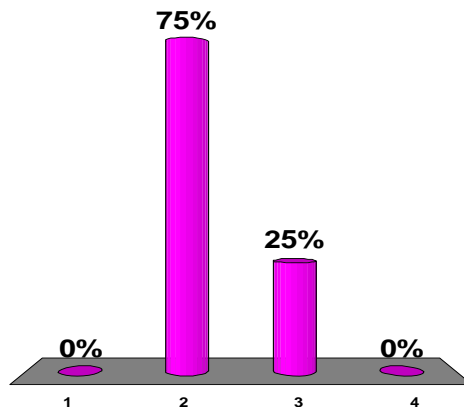
(thoughts from Kevin and Terry)



View of other party to the lease...

How do you view the other party in a lease?

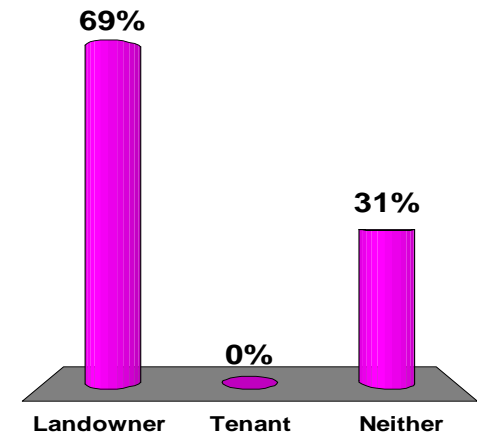
1. Competitor
2. Partner
3. Neither C nor P
4. Does not apply



View of other party to the lease...

Who has more “power” in negotiating the terms of a lease?

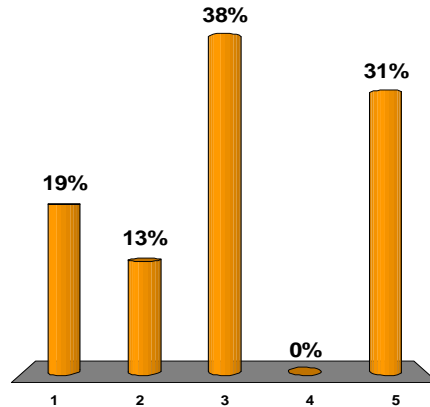
1. Landowner
2. Tenant
3. Neither (roughly equal)



Fixed cash leases...

Of land that I rent (manage) on a fixed cash rent, on average, the rental rate is renegotiated...

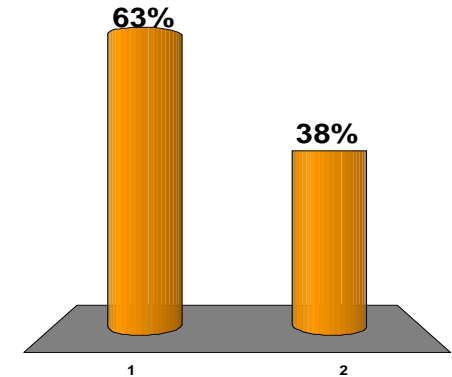
1. Every year
2. Every other year
3. Every 3-5 years
4. 6 years or more
5. Does not apply



Responsibility for rental rates...

Whose responsibility is it to see to it that a landowner's cash rental rate is equitable considering current conditions?

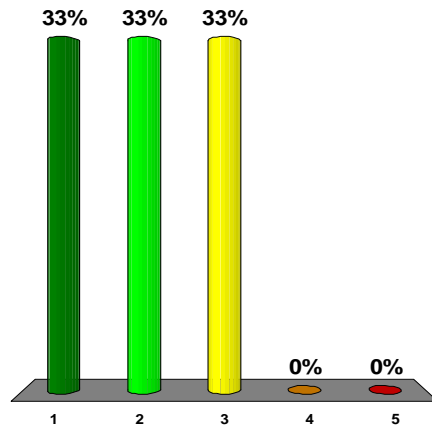
1. Landowner
2. Tenant



"Other" government program payments...

Producers should receive 100% of payments from programs such as CSP that are due to their management.

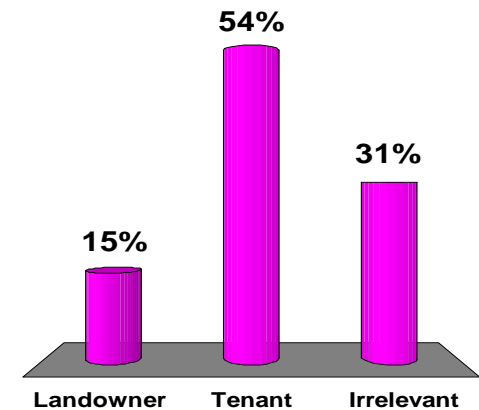
1. Strongly agree
2. Agree
3. Neutral
4. Disagree
5. Strongly disagree



View of other party to the lease...

When thinking about rental rates, who "typically" needs the income from the land the most?

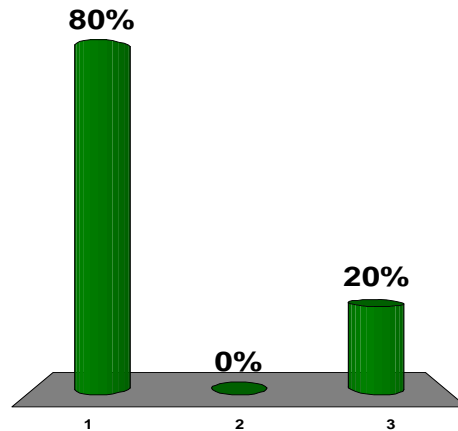
1. Landowner
2. Tenant
3. Does not matter



Mineral / wind rights leasing...

If land is leased for mineral/wind rights, who should receive the income?

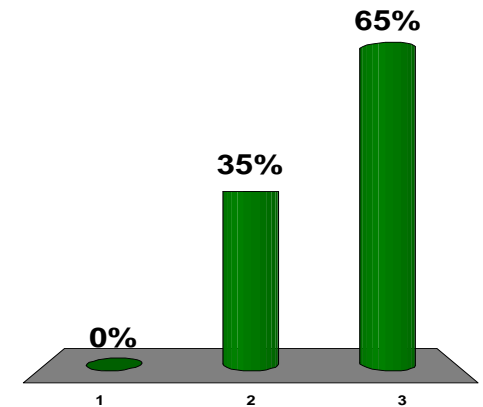
1. Landowner
2. Tenant
3. Shared



Mineral / wind rights leasing...

Who should receive income for compensation for damages associated with oil / gas exploration?

1. Landowner
2. Tenant
3. Shared



Rental Ethics . . . Our Perceptions

- Tenants have the information (power)
- Cash rents tend to rise over time
- Manna-from-heaven payments often should be shared
- Foot-in-door high rents often inappropriate
- Landowners need money just like tenants
- Landowners are sometimes unethical too
- Family situations often are the worst
- Ethical behavior more profitable in long run

Tenants have the power!

- Landowners often:
 - Are generations and geographically removed
 - Are unaware of current farming practices/technology
 - Are old and easily taken advantage of
 - View the arrangement with a tenant as a long-term commitment handed down from their parents
 - Think that farming is a low-income business and so want to “do their part” in aiding it
 - Believe there are few potential tenants and so are beholden to the existing tenant
- Tenants take advantage of the situation
 - Unintentionally (may be poor managers)
 - Intentionally (“she never asked me to raise rent”)
- Only occasionally do we see a landowner shafting a tenant

Tenants have the power!

- Landowners often:
 - Are generations and geographically removed
 - Are unaware of current farming practices/technology
 - Are often not actively involved in the business
 - View land as an investment
 - Think to “believe”
- Tenants often:
 - Unintentionally (“she never asked me to raise rent ”)
- Only occasionally do we see a landowner shafting a tenant

Many of these points are the result of the fact that a number of landowners are landowners “by inheritance” as opposed to investing in land intentionally. Thus, returns are often viewed as “money I never had before” as opposed to “what I expect from my investment.”

Cash rents rise over time

- Although cash rents do fall about 25-30% of the years, on average they rise 2-3% annually
 - Unusual to see a 3-year contract rate that shouldn't be higher than the previous contract
- Landowners & tenants who see stable crop-share terms for years think that translates to stable cash rent
 - We see cash rental rates that haven't changed for years and decades
 - Landowner: “We didn't know.”
 - Tenant: “She never asked for a higher rent.”

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Manna-from-heaven payments

- Unexpected payments, typically from the government, should be shared according to parties' costs
 - Examples: CRP, CSP, EQIP
- If tenant does nothing to earn payment it should go to the land, i.e., the landowner
- Such payments should be discussed between landowner & tenant (especially the relative associated costs)

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Foot-in-door high rental payments

- High rent payments on new contracts often are followed by stagnant rates for many years, which could be:
 - A) Tenant overbids to get land, then realizes he's not profitable so rationalizes stagnant rents
 - B) Tenant uses this as a strategy to acquire land and pay lower-than-market rents over time
 - This is the least ethical outcome of the two
- Some tenants who do this actually beg for lower rents in near future, realizing that landowners are reluctant to change tenants
 - This is really unethical!

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Landowners need money too

- Tenants often make the argument that “she doesn’t need the money”
 - This is completely irrelevant!
- Admittedly, landowners sometimes foster this perception
 - ... which tends to change when investment-minded heirs acquire land being rented

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Landowner ethics

- Landowners may use their land for non-ag purposes and yet expect the same rent
 - Utility poles, oil leases
 - Lease hunting
- Landowners think if they paid too much for land it should bring a higher rent
 - This is completely irrelevant!
- Landowners might demand certain farming practices yet expect market rent
 - e.g., no fertilizer; conventional tillage, no double cropping
- Landowners make demands on current tenants to “fix” problems of past tenants

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Family situations often are the worst

- “Sweat-equity” parent-child relationships lead to unrealistic expectations across generations
- Family members have trouble believing their own parents, children, or siblings would cheat them
 - Backlash then goes overboard
- Family members often are “always around” and so the pain always resurfaces
 - Hard to “forget and move on”

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Ethics is good long run economics

- Poor ethics results in high tenant turnover:
 - Increases cost of relationship establishment and monitoring
 - Reduces profit to the land (tenant makes short run decisions)
- Bad business leads to unethical behavior
 - Poor management causes “I deserve more”
 - Bad behavior is rationalized
- Good ethics should emerge because it is the “right thing to do,” not for the purpose of long-run profit-maximization

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Miscellaneous

- Landowners rarely will evict tenants!
 - Often will sell land rather than evict tenants
 - Will put up with atrocious behavior of tenants (especially relatives)
- We as educators / consultants have some blame
 - Promote perceptions of “poor returns to farming,” “sweat equity,” etc.
 - Believe, like many, that farming is “special”
- Educators / consultants should
 - Tell landowners it’s okay to evict tenants
 - Help clients understand that **FARMING IS A BUSINESS!**

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**Questions
Comments
Discussion**





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(Kevin: kcd@ksu.edu -- 785-532-3527 or Rich: rwl@ksu.edu – 785.532.1504).