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## Renegotiating Cash Rents Down for 2015

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Actual cropland returns in 2013 and projected returns in 2014 and 2015 are considerably below returns from 2010 through 2012. In many cases, projected 2015 returns will be lower than current cash rents, likely require renegotiating for lower cash rents. This article evaluates these situations by 1) identifying farms requiring adjustments in cash rents, 2) identifying how far cash rents must be lowered, and 3) providing comments for both land owners and farmers.

### Farms Requiring Adjustment Downward

Two factors will impact the need for adjusting rents downward. The first is the farm's cash rent relative to the average rent for farmland of similar productivity. There is a considerable range in cash rents for farmland of similar type. Some rents are \$100 per acre higher than the average, and some farms can be \$100 lower than the average. Those cash rents that are relatively lower will not require adjusting downwards. Downward adjustment in cash rents likely are needed for relatively high cash rents.

Sources for average cash rents are readily available. A map with average cash rents by Illinois County is available ([farmdoc daily, September 10, 2013](#)). This county data is from U.S. Department of Agriculture. Based on this data, average cash rents for different expected corn yields have been constructed:

140 bu expected corn yield has an average cash rent of \$151 per acre,  
160 bu expected corn yield has an average cash rent of \$205 per acre,  
180 bu expected corn yield has an average cash rent of \$259 per acre, and  
200 bu expected corn yield has an average cash rent of \$313 per acre.

The second factor is how fast cash rents on a farm have gone up in recent years. Between 2006 through 2013, average cash rents increased in Illinois by an average of 7.7% per year. This means that the average cash rent is 68% higher in 2013 as compared to 2006. If the cash rent on a farm has lagged these increases, there may be rational for keeping the cash rent high into 2015.

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As an example, take a farm that has a 200 bushel expected corn yield that had a cash rent of \$179 per acre from 2006 through 2012. The cash rent then increased to \$300 per acre in 2013. Keeping the \$300 cash rent in 2015 could be justified because the landowner did not get as much return in 2006 through 2012, even though the farmer likely will face a loss. (As an aside, allowing cash rents to lag agricultural returns is not a recommended practice.)

### Extent to which Rents need to be Adjust Downward

Cash rents need to be below operator and land returns for the farmer to have a positive return. The 2015 Illinois Crop Budgets (As of July 22, 2014, [farmdoc website](#)) can be used to estimate operator and land returns. Table 1 shows estimates for differing commodity prices.

**Table 1. Projected 2015 Operator and Land Returns for Regions of Illinois Given Differing Price Scenarios.<sup>1</sup>**

Region	Price				
	Corn	\$4.20	\$3.75	\$4.50	\$5.00
	Soybeans	\$10.50	\$10.00	\$11.00	\$12.00
		\$ per acre			
North (194 bu corn yield, 59 bu soybean yield)		226	167	269	347
Central-High (199 bu corn yield, 57 bu soybean yield)		259	200	304	381
Central-Low (184 bu corn yield, 52 bu soybean yield)		195	140	235	307
South (165 bu corn yield, 47 bu soybean yield)		87	83	91	150

<sup>1</sup> Yields and costs taken from 2015 Illinois Crop Budgets. A 50-50 corn-soybean rotation is used in northern and central Illinois. A 1/3-1/3-1/3 rotation of corn, soybeans, and wheat/double-crop soybeans is used in southern Illinois.

Based on current prices on futures markets, the 2015 Illinois Crop Budgets uses a \$4.20 per bushel corn price and a \$10.50 per bushel soybean price. At those prices, the projected operator and land return for northern Illinois farmland is \$226 per acre (see Table 1). The budgets use an expected corn yield of 194 bushel per acre, and the cash rent for land of this productivity is near \$290 per acre. If the cash rent is \$290 per acre, the cash rent would have to decrease by \$64 per acre to the projected \$226 per acre operator and land return for the farmer to have \$0 return. Cash rents would have to decrease more than \$64 for the farmer to have a positive projected return.

### Problems in Setting Cash Rents and Use of Variable Leases

Many cash rents are set in the fall prior to production. In the fall, it is difficult to determine accurate commodity prices to use in budgets. There are good reasons to believe that the long-run price for corn will average \$4.60 per bushel ([farmdoc daily, February 27, 2013](#)). There will be periods in which the corn price will be \$1.00 or more higher than this average, as happened in 2011 and 2012. And there will be periods in which corn price averages below \$4.00 per bushel. Currently, it appears that we are moving into a period of lower commodity prices, with futures prices suggesting prices below the \$4.60 long-run average.

Moreover, commodity prices and yields can vary from the fall estimates. Gross revenue from an acre will depend on supply and demand conditions. On the supply side, planting and yields around the world will impact actual prices. Of particular importance will be harvested acres and yields in South America during the winter and harvested acres and yields in North America in 2015. Predicting 2015 acreages and levels is not possible at this point.

Table 1 shows the impacts of different prices on operator and land returns. A \$3.75 corn and \$10.00 soybean price are at the low end of probable prices for 2015. At these prices, operator and land returns are projected at \$167 per acre, \$59 below the \$226 return at a \$4.20 corn price. A \$5.00 corn price and a \$12.00 soybean price is at the higher end. The operator and land return in a \$347 per acre return, \$121 per acre higher than the return at a \$4.20 corn price. For these prices, there is a \$180 range in operator and land returns ( $\$180 = \$347 - \$167$ )

There is a difficulty in setting a cash rent given this range of possible revenues. In hindsight, rents will be too high or too low relative to actual returns. One possibility for dealing with variable revenues and returns is to use rental arrangements that vary lease payments based on economic performance. Share rental arrangements which share revenues and direct costs between the land owner and farmer are one such alternative.

Another alternative is to use a variable cash lease. A variable cash lease has minimum cash rent that is paid by the farmer to the land owner. A "bonus" may be paid if gross revenue is higher than a trigger revenue. These agreements are more fully described here ([farmdoc daily, September 27, 2011](#)).

### **Suggestions for Land Owners**

Many land owners prefer the simplicity of cash rental arrangements, and desire that the cash rent not to vary much from one year to the next. The desire to have stable cash rents across years is not practical given variability of agricultural returns, unless a land owner is willing to accept a cash rent significantly below going market rates. These low cash rents are needed to provide a cushion to farmers given the wide swings in revenue from one year to the next.

If land owners desire higher average returns, they will need to bear some of the risk associated with agricultural returns, and vary cash rents from one year to the next. Variable cash leases and share rental arrangements are one mechanism for varying rents. If a fixed cash rent is used, the rental rate should be evaluated each year, and may need to be changed when return prospects have changed.

In renegotiating 2015 rents, land owners should be aware that economic conditions for farms have changed. Most farms had relatively high incomes in the years between 2006 and 2012, with particularly high returns from 2010 to 2012. Since the fall of 2013, commodity prices have decreased. So far in the summer of 2014 the prospects of large crops have put downward pressure on prices. Incomes in 2014 will be below those in 2010 through 2013. Prospects are for continued low returns going into 2015 ([farmdoc daily, July 8, 2014](#)).

### **Suggestions for Farmers**

Renegotiating cash rents down presents farmers with a delicate situation, with the potential to lose farmland as a result of the negotiations. For farmers with a high proportion of farmland cash rented at above average cash rent levels, the need to adjust cash rent will be evident, as continued renting farmland at those high cash rent levels will result in large projected income losses.

However, many farms do not have all of their farmland cash rented at high cash rent levels. Often, a small proportion of farmland is rented at high levels. Farmers in this situation can continue to rent the high-cash-rent farmland without jeopardizing the financial position of the farm. In essence, other lower cost farmland subsidizes farming the high cash rent farmland. Farmers in this situation should evaluate the impacts of losing the high cash rent farmland on their farms' income potential. If a cash rent cannot be negotiated lower, not farming high cash rent farmland may be a financially better alternative.

## Summary

Cropland returns are projected much lower in 2014 and 2015 than they were in 2010 through 2013. These lower returns will cause a need to adjust cash rents down on many farms. This will be a difficult process for both land owners and farmers. Use of variable cash leases or share rental arrangements could be an alternative to fixed cash rents, thereby allowing the rental payment to vary with return results on a farm. If a fixed cash rent arrangement continues to be used, lowering cash rents from previous years likely is required for farms with relatively high cash rents.

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