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The Art of Leasing Negotiation in a Frenzied Environment

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Market Report	Yr Ago	4 Wks Ago	12/15/06
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	$94.19	$85.59	$84.94
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	135.82	112.34	114.77
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb	118.05	102.10	100.58
Choice Boxed Beef, 600-750 lb. Carcass	158.28	143.08	143.41
Western Corn Belt Base Hog Price Carcass, Negotiated	57.59	56.01	54.25
Feeder Pigs, National Direct 45 lbs, FOB	57.33	55.68	*
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	66.01	65.09	64.50
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest	84.00	*	*
National Carcass Lamb Cutout, FOB	243.70	253.61	251.70
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu	*	4.68	4.53
Corn, No. 2, Yellow Omaha, bu	1.86	3.29	3.33
Soybeans, No. 1, Yellow Omaha, bu	5.66	6.28	6.27
Grain Sorghum, No. 2, Yellow Columbus, cwt	2.48	5.32	5.59
Oats, No. 2, Heavy Minneapolis, MN , bu	2.18	2.70	2.79
Hay			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	120.00	135.00	135.00
Alfalfa, Large Rounds, Good Platte Valley, ton	65.00	87.50	87.50
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	52.50	82.50	82.50

* No market.

Let's face it. The farm economy across much of Nebraska has literally been turned upside down in the past few months by the "Ethanol Gold Rush." Demand for corn has shot corn prices upward beyond $3.00 per bushel, when only a year earlier the harvest prices hovered around $1.50. Many expect these new price levels to hold, at least for the 2007 crop season.

For crop-share leases, both landowner and tenant are going to be sharing in this likely economic windfall for 2007. Likewise, they will be sharing the risk factors associated with this bullish price situation. Although our research suggests that some of these crop-share arrangements are not very current in terms of relative tenant/landowner contributions, this type of lease may still provide the most appropriate economic allocation of the expected revenues for 2007.

For cropland cash leasing, however, today's economic environment poses a whole new perspective for 2007. To illustrate, assume an irrigated parcel that averages 200 bu/ac corn yields. At $3.25 a bushel next fall, the gross revenue is $650 an acre. This compares to $2.25 a bushel in recent years (even with some portion of the crop forward-contracted), which grossed $450 an acre. In other words, a revenue windfall approaching $200 an acre may be possible for 2007. However, lower yield expectations under more limited irrigation, a drop in commodity prices and different crop rotation schemes may diminish this revenue windfall. Nonetheless, there is certainly reason for both landowners and tenants to reassess their 2007 cash rent contracts.

Unfortunately, there are extreme examples of both (1) landowners demanding, and sometimes getting, exorbitant cash rent increases for 2007, and (2) tenants quickly trying to lock in last year's cash rents for 2007 with their naive and uninformed landowners. Neither extreme is in the best interest of all parties being served. Given the fact that both tenants and landlords need one another and can benefit from partnering over the long-run, a more rational negotiation of 2007 cropland rental rates is called for. Here are some pointers to keep in mind:

- Even if the 2007 rental rate was already determined in early fall, before the recent market shifts occurred, it may be wise for the parties to rethink the contract. In fact, a particularly noble action would be for the tenant to take the initiative to renegotiate the contract for a higher rental rate. While that may certainly mean foregoing some of the 2007 earnings for the tenant, it would do wonders to solidify the longer-term tenant-landowner relationship. In short, it is a *win-win* opportunity.

- It may be easy for landowners, when hearing of extreme cash rent increases, to demand similar increases of their own tenants. In essence, the idea may be to extract as much of the short-term economic windfall as possible. However, since the tenant's contribution to the lease may be as much or more than the landowner's, it would seem more reasonable to negotiate a fair share. Here, the landowner must be willing to recognize the value of long-term rental agreements that may be much more valuable than extracting as much of the anticipated one-year windfall as possible. Again, a more reasonable and fairer agreement is *win-win.*

- As to some specifics of the cash lease rate, both parties may need to agree on a reasonable expectation of 2007 gross revenues given expected commodity prices and expense adjustments, and then estimate the dollar increase in net returns that these would suggest. This dollar difference could then be split in a mutually-agreeable manner, with the landowner portion being the upward dollar adjustment in per-acre cash rents. Remember, this is assuming that last year's rental level was essentially current, so there is no lagging rent levels from previous years to make up.

- Since a cash-rent tenant is bearing essentially all of the risk (in contrast to crop-share leasing where both parties are sharing the risk burden), the expected dollar windfall to the tenant may be adjusted upward from that allocated to the landowner. But this adjustment could also be negotiated.

- Only time will tell whether or not this economic environment is viable long-term. Therefore, it is important for both parties to understand and agree that a negotiated upward adjustment in crop cash leases is for one year only. Until there is some degree of equilibrium returning to the economy, it should be understood that rents will be appropriately adjusted, either up or down, on a year-by-year basis to the mutual agreement of both parties.

To illustrate, we've built two scenarios using the Farm Lease Calculator, a spreadsheet used to evaluate, analyze and determine crop budgets and lease arrangements. This spreadsheet can be downloaded free from the UNL Ag Economics website (found at end of article). The two scenarios used will be of Eastern Nebraska pivot irrigated and dryland cropland with a corn-soybean crop rotation. Revenues and expenses are highlighted in Table 1 (on next page).

Under the average yields and commodity price levels we've used in these scenarios, the tenant has $213.06 per acre under the irrigated scenario and $119.58 per acre under a dryland scenario to apply to cash rent, given the data above, under a corn-soybean crop rotation. A sensitivity matrix of these two scenarios showing the revenues available to the tenant under various price and yield outcomes is shown in Tables 2 and 3 (on next page).

These numbers suggest that expected crop revenues for 2007 may well lead to higher cash rents. For example, if the 2006 irrigated cash rent was $150 per acre, the projected 2007 revenues suggest a windfall of $63.06 to the tenant ($213.06-$150) if no rent adjustment occurred for 2007. If that projected one-year windfall was shared in some fashion with the landowner, it would not be unreasonable to suggest the cash rent be raised to $175 to $180 per acre. Likewise, under dryland situations, with 2006 rents at $90 per acre, the shared windfall of about $30 would suggest similar percentage increases for 2007. In other words, even under rather conservative estimates, an increase of at least 15 to 20 percent over 2006 levels appears appropriate. To not do this is to deny some of these returns which rightfully belong to the landowner.

Obviously, each rental situation is unique and needs to be carefully negotiated to be mutually fair and agreeable. Given the environment, risk management is a key point of negotiating as well. A consideration is to make the added windfall amount due in the second payment of the cash rent. Additionally, a circuit breaker clause may be appropriate as well. While forward contracting alleviates much of this risk, should prices or even yields fall precariously, the clause may be fitting. These risk adjustments can be beneficial to both parties, and would be particularly applicable to dryland acres where there is added weather risk. Using the Farm Lease Calculator to assess each leased parcel may be helpful for both tenants and landowners to agree on a fair 2007 rent. There is certainly some economic gain to be expected in the near term for the corn-producing areas of the state. But only with the right attitude and careful consideration on the part of both parties will the cash rental market be able to adjust towards a *win-win* outcome. That is the *Art of Leasing Negotiation.*

Table 1. Cash Lease Budget Summary

Tenant Cash Lease Revenue:	Irr Corn	Irr Soybeans	Dry Corn	Dry Soybeans
Yield per Acre:	200	60	120	35
Price per Unit:	$2.80	$6.25	$2.80	$6.25
Crop Revenue	**$560.00**	**$375.00**	**$336.00**	**$218.75**
Net Gov't Payments:	$25.00	$25.00	$15.00	$15.00
Other Income per Acre	$0.00	$0.00	$0.00	$0.00
Total Revenue:	**$585.00**	**$400.00**	**$351.00**	**$233.75**

Tenant Cash Lease Expenses:	Irr Corn	Irr Soybeans	Dry Corn	Dry Soybeans
Seed:	$45.00	$28.00	$26.25	$19.20
Fertilizer:	$57.00	$9.58	$38.85	$0.00
Herbicide:	$31.96	$25.81	$31.96	$25.81
Insecticide & Fungicide:	$0.00	$6.62	$0.00	$6.62
Crop Insurance:	$12.00	$9.00	$8.00	$6.00
Crop Consulting:	$8.50	$8.00	$0.00	$0.00
Machinery/Field Operations:	$68.92	$61.18	$68.92	$61.18
Custom Operations:	$0.00	$0.00	$0.00	$0.00
Irrigation:	$48.00	$48.00	$0.00	$0.00
Labor/Management:	$17.50	$17.50	$10.00	$10.00
Drying, Storage, Transportation:	$32.00	$8.40	$19.20	$4.90
Interest on Cash Expenses:	$9.60	$6.32	$5.48	$3.23
Total Expenses:	**$330.48**	**$228.40**	**$208.66**	**$136.93**
Revenue Less Expenses:	**$254.52**	**$171.60**	**$142.34**	**$96.82**

Table 2. Irrigated Crop Revenue Less All Expenses Except Cash Rent Under Various Prices and Yields

		Yields	Below		Average	Above	
			25%	**10%**		**10%**	**25%**
		Irr Corn	**150**	**180**	**200**	**220**	**250**
Prices		**Irr Soybeans**	**45**	**54**	**60**	**66**	**75**
25% Below	**Irr Corn** **Irr Soybeans**	$2.10 $4.69	$13.75	$63.21	$96.18	$129.15	$178.61
10% Below	**Irr Corn** **Irr Soybeans**	$2.52 $5.63	$66.35	$126.32	$166.31	$206.29	$266.27
Average	**Irr Corn** **Irr Soybeans**	$2.80 $6.25	$101.41	$168.40	**$213.06**	$257.72	$324.71
10% Above	**Irr Corn** **Irr Soybeans**	$3.08 $6.88	$136.47	$210.47	$259.81	$309.14	$383.14
25% Above	**Irr Corn** **Irr Soybeans**	$3.50 $7.81	$189.07	$273.59	$329.93	$386.28	$470.80

Table 3. Dryland Crop Revenue Less All Expenses Except Cash Rent Under Various Prices and Yields

		Yields	Below 25%	Below 10%	Average	Above 10%	Above 25%
Prices		Dry Corn Dry Soybeans	90 26	108 32	120 35	132 39	150 44
25% Below	Dry Corn Dry Soybeans	$2.10 $4.69	$1.34	$30.68	$50.23	$69.79	$99.12
10% Below	Dry Corn Dry Soybeans	$2.52 $5.63	$32.55	$68.12	$91.84	$115.56	$151.13
Average	Dry Corn Dry Soybeans	$2.80 $6.25	$53.35	$93.09	**$119.58**	$146.07	$185.80
10% Above	Dry Corn Dry Soybeans	$3.08 $6.88	$74.15	$118.05	$147.31	$176.58	$220.47
25% Above	Dry Corn Dry Soybeans	$3.50 $7.81	$105.36	$155.50	$188.92	$222.34	$272.48

The complete Nebraska Farm Real Estate Survey can be found at: http://agecon.unl.edu/realestate/
The UNL Farm Lease Calculator can be found at: http://www.agecon.unl.edu/resource/farmcalc.html

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Last Issue of the Year

Have a Safe and Happy Holiday!!!