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## Creating a Flexible Swine Building Rental Agreement

Tith volatile hog prices and the growing turnover of producers, there is renewed interest in leasing swine production facilities. However, both owners and renters are often unsure what is a fair rental rate for buildings. One method of renting swine facilities is to develop a flexible rent schedule. The advantage of this innovative rental arrangement is that the rental fee rises and falls with changes in the local monthly hog price. Allowing building rents to fluctuate with the price of hogs reduces risks for producers who need to keep their production costs low to remain competitive. Also, the flexible rent schedule provides an income for owners who still have value left in their facilities.

# **Developing an Agreement**Base Rental Rate

A base rent for the swine facilities can be established by using one of the methods outlined in *AgDM File C2-26*, <u>Computing a Livestock Building Cash</u> <u>Rental Rate</u>. As a general rule, the facilities cost is in the range of 8 to 12 percent of the cost of finishing swine, excluding the purchase cost of the feeder pig.

#### Rent Adjustment Factor

To compute a rent adjustment factor, establish a base market hog price. This can be a typical or long-term average hog price. You can use *AgDM File B2-10*, <u>Historic Hog and Lamb Prices</u> as a reference.

Next, estimate the actual market hog price for the lease period. You can use the quoted cash price from a local hog buying plant at the middle and end of each month, or monthly market prices collected by the National Ag Statistics Service at: <a href="www.nass.usda.gov">www.nass.usda.gov</a> (go to Quick Stats Lite). Note: if prices are quoted in \$ per hundredweight of carcass weight, they can be adjusted to a liveweight by multiplying by 0.76. Alternatively, both the base price and the actual price can be in \$ per carcass weight.

At the end of the lease period, compute the rental adjustment factor by dividing the actual market price by the base market price. The rental payment is then adjusted higher or lower, depending on the rent adjustment factor. For example, if the base market liveweight price is \$65 per cwt. and the actual live market average price is \$71.50, the rental adjustment factor is 1.10 (\$71.50 / \$65). If the base rent established above is \$30,000, the actual rental rate is \$33,000 (\$30,000 x 1.10).

A portion of the base rent (e.g. one-half) may be paid at the beginning of the rental period, with the remainder of the adjusted rent due at the end of the rental period.

#### Rental Window

In order to reduce extreme changes in rent due to large fluctuations in hog prices, a minimum and a maximum rental rate (rental window) may be used. For example, a rental window may allow the rental rate to be no more than 25 percent above or below the base rent. With a base rent of \$30,000, the rental rate could be no less than \$22,500 and no more than \$37,500.

#### **Executing the Agreement**

A legal written lease agreement needs to be formalized between the owner and renter. The base rent, the base market price, the lease period, the rental payment provisions, and the rental window need to be agreed upon by both parties. The agreement can provide an extended lease period with a yearly review of the lease. The lease should be very explicit about how the average payment period price will be determined and who will collect and establish the price.

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### Example

- 1. The lease period is from Jan. 1 to Dec. 31.
- 2. The base annual rental is \$30,000.
- 3. One-half of the base rental payment (\$15,000) is due on Jan. 1 and the remainder of the adjusted rent is due on Dec. 31.
- 4. The base market price is \$65 per cwt. (liveweight).
- 5. The cash market at a local hog buyer on the 15th and 30th of each month is used to derive the monthly market prices. Carcass weight prices are adjusted to liveweight.

#### Assume the average market price during the year is \$98.68 per cwt. (carcass).

- The first rent payment is \$15,000 (\$30,000 / 2 = \$15,000)
- The average liveweight price is \$75.00 (\$98.68 x 0.76 = \$75)
- The rent adjustment factor is 1.154 (\$75 / \$65 = 1.154)
- Total rent is \$34,620 (\$30,000 x 1.154 = \$34,620).
- The ending rent payment is \$19,620 (\$34,620 \$15,000 = \$19,620)
- The pigs marketed per year is 2,607 (2.8 turns x 950 head x .98 (2% death loss) = 2,607)
- The rent per pig marketed is \$13.28 (\$34,620 rent / 2,607 head = \$13.28)

#### Assume the actual average live market price is \$55.60 per cwt.

- The first rent payment is \$15,000 (\$30,000 / 2 = \$15,000)
- The rent adjustment factor is .855 (\$55.60 / \$65 = .855)
- Total rent is \$25,650 (\$30,000 x .855 = \$25,650)
- The ending rent payment is \$10,650 (\$25,650 \$15,000 = \$10,650)
- The pigs marketed per year is 2,607 (2.8 turns x 950 head x .98 (2% death loss) = 2,607)
- The rent per pig marketed is \$9.84 (\$25,650 rent / 2,607 head = \$9.84)

#### Summary

This method of renting swine facilities requires great attention to market prices as well as coordination and communication between the rental parties. But it offers a fair and equitable arrangement to both parties in times of highly volatile market hog prices.

Similar agreements can be negotiated for farrowing or swine nursery buildings.

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<sup>...</sup> and justice for all