

Flexible Cash Farm Lease Considerations

The crop price volatility witnessed in recent years has made it difficult to forecast price and thus the use of fixed cash rent rates. The landowners that adapted flexible cash farm leases received a guaranteed base cash rent, in addition to a flex payment that was likely triggered by higher gross revenue (yields and/or price). With the decline of crop prices in the fall of 2008, the potential risk of setting high fixed cash rents for 2009 and beyond became a great concern for most tenants.

The use of a flexible cash farm lease will likely be fairer to both the landowner and tenant. However, coming up with a base rent, in addition to a maximum cash rent amount, plus a way to reflect a flex payment, is often challenging.

FSA Policy Change

Beginning in 2009, the Farm Service Agency (FSA) rules state:

For 2009 through 2012, a lease that provides for the greater of the guaranteed amount or share of the crop or crop proceeds shall be considered a cash lease if the lease provide for guaranteed amount and share of the crop.

With this change, the burden of many flex leases as crop share leases, and therefore requiring the government farm programs to be shared with the landowner, has been removed. The direct payments shared were typically a few dollars per acre, but the landowner had to sign-up for the annual Direct & Counter-Cyclical Program (DCP) as a result.

Expect with this change the use of flexible cash rents that guarantee a minimal base rent, or set bushels, to be more common. In addition, new flexible cash leases will likely use the actual farm yields to determine the rental rate, or help establish the gross revenue levels above which flexible rent payments are triggered.

For Central Iowa, most of the guaranteed base cash rents witnessed for 2009 were between \$200 and \$300 per acre. Such rents are typically on more productive land where high fixed cash rents have escalated. The

maximum rent tends to be about \$100 per acre above the pre-established base rent. Having a maximum rent is a good safeguard for the tenant in order for them to determine their potential cost of production, calculate breakeven prices, and implement pre-harvest marketing strategies for production on this farm.

Determining Yield and Prices

To establish the farm's actual yield (dry weight for corn adjusted to 15.5%) most lease arrangements will need to reflect grain bin measurements, scale tickets, settlement sheets, yield monitor data, grain cart scales, or other verifiable methods. The simplest price determination might be the FSA's Posted County Price (PCP) for October and November. With FSA shifting to a 30-day moving average of PCP in 2009, this will be easy to access from the FSA's web site. However, this amount could underestimate the potential value of the harvested crop since it uses only the fall pricing period. Extending the pricing period beyond November is not suggested, since the landlord should not benefit from the decision of the tenant to store or sell their crop. Price improvement post-harvest largely reflects basis and futures market carry, and the landowner does not typically pay storage or interest on the crop.

Averaging a series of harvest delivery bids at a local co-op or elevator is worth consideration for establishing the crop price on a flex lease. Such a price overcomes the potential low harvest price bias, and yet reflects the likely wider basis for a fall delivery period. This is a price that the tenant could receive should they decide to forward contract a portion of their crop on that farm. So the average price for a flex lease payment could be the cash price at a local elevator, perhaps four times during the year; mid-January, mid-April, mid-July or mid-October. Specific days of the month should be established. If you say the 15th of the month, note in the lease that if the 15th falls on a weekend, then the trading day closest to the 15th.

If a larger number of pricing periods is desired, choose one day of the month to collect the harvest delivery bids. You might want to have the local grain merchandiser simply print out this average price at the conclusion of harvest that reflects this monthly average from January

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to October to avoid having to record this price every month. Have them print out the numbers requested, and sign and date this information.

Gross Revenue Triggers

Determining the gross revenue triggers for both corn and soybean crops needs to be established. If crop production costs appear to be too high or too low annually, then changes could be made to: base rent, maximum rent, and the flexible cash lease triggers that more accurately reflect cost of production. For 2009, consider not triggering the flex payment until gross revenue exceeds the total cost of production, including the base cash rent. If a tenant knows their estimated cost of production for each crop, use this number. The ISU Extension publication FM-1712, *2009 Estimated Costs of Crop Production* could be another consideration. Those costs for conventional tillage, medium yield would be \$692 per acre for a Corn following Soybean rotation, and \$491 per acre for a Soybeans following Corn rotation.

New ACRE Program Considerations

Beginning in 2009, flexible cash lease agreements might request actual yield data as required by the FSA's new Average Crop Revenue Election (ACRE) program. The details of this program are yet to be finalized, but the forward thinking could help with enrolling this farm in this new program beginning in the spring. Since the program will require actual production in bushels for each FSA Farm number divided by the actual planted acres, consider adjusting the cash rent to reflect the actual certified planted acres on the farm reported by the tenant to FSA each summer. Thus, cash rent could adjust to actual planted acres that year (used by FSA to determine yield per planted acre), and also be recognized in the new ACRE program calculations in determining the farm's revenue guarantee.

The yield would then match up with the actual farm yields required by the ACRE program for each crop produced. Thus the lease could designate the landowner be provided a copy of the acreage certification (FSA form 578) by July 15th and the actual farm yields (likely a new FSA Form) by December 15th. In a flexible cash farm lease, the first half base rent could be collected prior to planting and the second half of the base rent, plus the potential flex payment could be calculated by December 15th and paid on or before December 20th each year. This type of arrangement could put a lot more

transparency into planted acres and actual farm yields and allow for this flexible cash lease to continue for all four years of the new farm program (2009, 2010, 2011 and 2012).

Multi-Year Considerations

The election decision for enrollment in the new ACRE program is irrevocable, which will require the landowner(s) signature(s) and that farm must remain in the ACRE program through 2012. Since the tenant is the only one deemed "at risk" on a cash rent farm, if an ACRE payment is made, it is payable to the tenant. Consider the use of flexible cash farm leases and enrollment in the ACRE program along with a multi-year cash lease arrangement.

Where good tenant and landowner relationships exist, the landowner feels good about the four year commitment to the ACRE program, and the tenant likely wants to better manage production risk on this farm. Thus once a multi-year agreement through 2012 is agreed upon, the tenant can take advantage of banking fertility on this farm, better match machinery/equipment, and benefit from pre-paid expenses. The December period for paying the second half cash rent plus flex payment likely matches the tenant's income tax strategies and keeps the landlord's income in one taxable year.

Web Sites with Flexible Cash Farm Lease Information

Consider the following web sites in assisting you to put together a Flexible Cash Farm Lease in 2009.

ISU Extension Flexible Farm Lease Arrangements publication and Decision Tool:

<http://www.extension.iastate.edu/agdm/wholefarm/html/c2-21.html>

ISU Extension 2009 Estimated Cost of Crop Production publication:

<http://www.extension.iastate.edu/agdm/crops/html/a1-20.html>

ISU Extension Evaluating Profitability of Crop Rotations Publication and Decision Tool:

<http://www.extension.iastate.edu/agdm/crops/html/a1-80.html>