

# Farm Lease Letter

---

Letter No. 4

CASH LEASE

July 2000

Cash leases have been popular in recent years. Many landlords have favored them because of their simplicity and the fact that the level of rent is known in advance. Many tenants also prefer the cash lease due to the planning freedom it allows.

Under a cash lease the risk of price and yield decline and of increased operating costs are fully borne by the tenant. Thus, it works best where crop production is fairly stable and yield or price risks are not great. Cash rent is usually not satisfactory for the tenant whose financial position is shaky.

Cash rents tend to reflect the previous year's price and yield situations and are likely to be too high in periods of low prices or low yields.

## ADVANTAGES OF CASH LEASES

### *From the landlord's standpoint*

- Landlord knows income for the year ahead and can plan accordingly (assuming the operator's financial position is sound).
- Requires less knowledge of farming by the landlord than share leases.
- Requires less capital from the landowner than crop or livestock share leases.

- The owner is relieved of making many operating decisions.
- Landlord doesn't have to decide whether to store or sell crops or when to sell.

### *From the tenant's standpoint*

- Tenant has more freedom for decision-making and increased responsibility than under a shared lease.
- The tenant gets all of the returns from superior management.

## DISADVANTAGES OF CASH LEASES

- Determining a fair rental rate in advance is often difficult.
- Maintaining the farm's productivity may sometimes be difficult due to the tenant's uncertainty about future tenure (fertility level, conservation practices, etc.)
- Input costs and cash flow requirements of the tenant are more than twice that of share leases.

---

...and justice for all

The Iowa Cooperative Extension Service's programs and policies are consistent with pertinent federal and state laws and regulations on nondiscrimination. Many materials can be made available in alternate formats for ADA clients.

- Interests of tenant and landlords may vary at many points. Owners look back at years when price and yield rewarded the extra risk taken by the operator and desire more rent. Changes in the Farm Program have removed the “safety net” for the tenant. Says one operator, “my crop-share landowner understands when prices and yields dip that it’s often beyond my control. The uninvolved owner will see a weed somewhere and be dissatisfied. My cropshare owner tends to balance cost of another herbicide application (as I do) against effect on potential “net”, says another operator.
- Partial or full rent prepayment if required by the landlord can create cash flow difficulties for a tenant.
- Higher risk for the tenant than share leasing.

### **CALCULATING CASH RENT**

At least four methods can be used to establish a fixed cash rent for a particular farm. Calculating rent by a combination of these methods will provide a range, which should be helpful in making the final decision.

### **LANDLORD’S COST APPROACH**

This method is based on the landlord’s ownership costs; the DIRT-5 Depreciation on wells, tile, fences, buildings, etc., (if part of the lease); and Insurance (property damage, liability); Repairs to improvements; property taxes; and interest (opportunity interest on the investment). Conservation compliance costs on highly erodible acres is another.

Careful judgment should be used in establishing the farm’s value and choosing an interest rate. A realistic value reflecting the price that would be paid for the farm at the present time if it were to be sold should be used. The rate of return on the value

should be similar to that which could be expected from other investments carrying similar risk and similar potential for appreciation and depreciation.

After completing the analysis, it is important to recognize that landlords seldom receive enough rent to cover total ownership costs of buildings and improvements. Thus, this method may result in an unrealistically high figure, especially if the farm is highly improved.

Rule-of-thumb: Cash rent often equals 4 to 5% of present fair market value after the cost of property taxes and upkeep.



**ADJUSTED NET SHARE RENT**

What might be an equivalent cash rent, without adjusting for price and yield risk, and interest on extra operating money required? It can be estimated as follows:

50-50 Crop Share Lease (Land Owner)		
	1999	2000 est.
100 acres corn x 135 Bu. yield x 1/2 share	6750 bu.	6750 bu.
Corn price or loan rate	\$ 2.00	\$ 2.00
Value of production	\$13,500	\$13,500
Transition Payment	<u>\$ 1,004</u>	<u>\$ 918</u>
	\$14,504	\$14,418
Storage: 3 mo. @ \$.10	(\$ 675)	(\$ 675)
Production cost @ \$53.50 x 100 ac.	(\$6,000)	(\$6,000)
Corn rental income	\$ 7,829	\$ 7,743
Per acre corn	\$ 78.29	\$ 77.43
100 acres soybeans, 45 bu. yield x 1/2	2250 bu.	2250 bu.
Cash price	\$ 5.25	\$ 5.25
Value of production	\$11,813	\$11,813
Transition payment	<u>\$ 1,004</u>	<u>\$ 918</u>
	\$12,817	\$12,731
Production costs	(\$4,500)	(\$4,500)
Storage 6 mo. @ \$.03 per mo.	<u>(405)</u>	<u>(405)</u>
Soybean rental income	\$ 7,912	\$ 7,826
Per acre	\$ 79.12	\$ 78.26
Combined rental income (200 acres)	\$15,741	\$15,569
Rental income per acre	\$ 78.71	\$ 77.85

\* The above example does not include any additional transitional payments received or to be received.

This approach relates cash rents to share rents. With this approach, an average net landlord's share over a period of years is used as a starting point for setting the cash rent. If past rents are unknown, an estimate can be made by multiplying the landlord's anticipated share of the crop by expected prices and subtracting expenses. In estimating the net rent, use yield, price and cost figures that can be realistically expected for the year ahead. Typical share arrangements for the community should also be used. Once the net share rent has been determined, the two parties must decide how much to adjust for

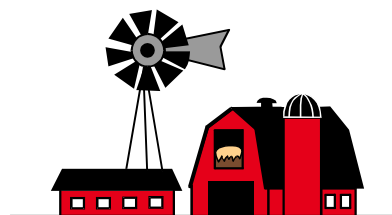
risk, which is being shifted from landlord to tenant by changing from a share to a cash lease. This is a matter of bargaining between the landlord and tenant. It may be approximated at the cost of interest and gross revenue insurance and put option on the rental share of the crop.

**TENANTS RETURN TO LAND APPROACH**

This method involves estimated income generating capacity for farmland and subtracting production costs to determine expected returns available to the land. Multiplying acres by estimated yields by estimated price for the crop production on the farm provides an estimate of gross income. Next, subtract seed, fertilizer, machine and power costs, crop insurance and labor costs from the gross income. Labor costs should include the value of the tenant's and his family's labor. The remainder must cover rent, risk, management and profit. Thus, this figure, discounted for the tenant's risk and management is the maximum the tenant could pay for rent.

What might be available for rent, risk, management and profit if everything goes as planned? The calculation process follows:

Tenant's Return to Land Approach		
	1999	2000
100 acres corn x 135 bu./ac.	\$27,000	\$27,000
100 acres soybeans x 45 bu./ac	\$23,625	\$23,625
Transition payment	<u>\$ 4,016</u>	<u>\$ 3,672</u>
Estimated gross income	\$54,641	\$54,297
Less:		
Seed, fertilizer, seed and power costs, and labor costs	\$35,362	\$35,914
Return to rent, risk, management and profit	\$19,299	\$18,383
Per acre (200)	\$ 96.40	\$ 91.92



If livestock production involving rented facilities is a part of the farming operation, the tenant may want to work through a similar procedure to determine how much rent he can afford to pay for the use of livestock facilities.

**CASH RENT MARKET APPROACH**

This method is based on rents being paid for similar farms in the area. Adjustments should be made for differences in the productivity of the farm and the improvement involved. This method should reflect the rental market for farmland in the area.

**FINAL RENT DETERMINATION**

A combination of the above approaches may be used to negotiate a final figure acceptable to both landlord and tenant. The landlord and tenant may wish to discuss figures each has put together independently to identify areas of agreement as well as difference. The bargaining process provides an opportunity for both parties to understand the other’s point of view. Intelligent bargaining requires that each party know what his and the other party’s contribution are worth and what local leasing arrangements usually provide.

**Iowa Farm Land Value and Rental Rates**

	<b>Rent per Acre</b>					<b>Ratio of Rent to Value</b>				
	1996	1997	1998	1999	2000	1996	1997	1998	1999	2000
Crop Land	1996	1997	1998	1999	2000	1996	1997	1998	1999	2000
Land Value	1,682	1,837	1,801	1,781	??	6.5	6.5	6.6	6.6	??
Rental Rate	110	119	119	117	120					

Source: Cash Rental Rates for Iowa, FM 1851, May 2000  
 1999 Land Value Survey, FM1825, January 2000

The results of a more detailed cash rent survey are available from your County Extension Office. Ask for “Cash Rental Rates for Iowa”