



# Ag Decision Maker

## A Business Newsletter for Agriculture

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### Flexible cash leases and crop insurance proceeds

by William Edwards, extension economist, 515-294-6161, wedwards@iastate.edu

Flexible cash leases have grown in popularity in Iowa. A 2007 survey showed that 12 percent of the state's cash rent agreements had provisions for adjusting the rental rate based on actual yields, prices and/or other factors. Recent volatility in corn and soybean prices has pushed that percentage even higher.

Most flexible leases start with some measure of gross crop revenue for calculating the actual rent each year. The rent may

be equal to some fixed percent of the gross revenue, or a rent bonus may be calculated based on a percent of the amount by which the gross revenue exceeds a base level of revenue. In either case, the gross revenue is the product of the farm level actual yield (or county yield) and some measure of actual market price.

#### Crop insurance indemnity payments

The widespread production losses due to hot, dry weather in 2012 have raised the question of whether crop insurance indemnity payments also should be included in the gross crop revenue used to determine the cash rent. Landowners who are part of a flexible lease contract cannot purchase crop insurance directly because they do not have an interest in the crop; that is, they never actually own any of the grain. However, they can indirectly "insure" their rental

payment by including indemnity payments received by the tenant in the gross revenue calculation.

The premiums paid by the tenant should be subtracted first, however. This is true even in years when no payments are received; that is, premiums should be subtracted from the gross revenue before the percentage is applied to calculate the rent or bonus. In this way, the landowner is indirectly paying for a share of the insurance coverage, which is supporting the gross revenue and rent each year.

*continued on page 2*

**Handbook updates**  
 For those of you subscribing to the handbook, the following new updates are included.

**Historic Cattle Prices – B2-12**  
 (5 pages)

**2011 Iowa Farm Costs and Returns – C1-10** (12 pages)

**Farmland Value Survey (Realtors Land Institute) – C2-75** (2 pages)

Please add these files to your handbook and remove the out-of-date material. *continued on page 6*

#### Inside . . .

Fairness in estate and business planning..... Page 2

Balance of crop rotations in 2013 ..... Page 4

"Insuring Iowa's Agriculture" workshop set for Nov. 5.. Page 5

Management tips for drought-stressed forages ..... Page 5

Flexible cash leases and crop insurance proceeds, continued from page 1

**Example**

For example, assume a farm planted to all corn has a flexible rent equal to 30 percent of the gross revenue each year. The tenant purchases a Revenue Protection policy with a 75 percent guarantee for a cost of \$20 per acre. The farm's APH (proven) yield is 160 bushels per acre, so the guarantee is for 120 bushels per acre. However, the actual yield turns out to be only 100 bushels per acre this year, 20 bushels per acre below the guarantee. If the indemnity price turns out to be \$7.50 per bushel (average of the December corn futures contract price during the month of October), then the indemnity payment will be 20 bushels x \$7.50, or \$150 per acre.

Subtracting the original premium of \$20 would leave a net insurance payment of \$130 per acre. Adding this to the gross revenue would increase the flexible rent by \$130 x 30 percent, or \$39 per acre, enough to offset the loss in "actual" revenue. If there had not been a crop loss, the gross revenue estimate would have been decreased by the value of the premium, \$20 per acre, and the rent would decrease by 30 percent, or \$6 per acre, as a result.

Some flexible lease contracts that call for a base rent plus a bonus set the base revenue value equal to the tenant's cost of production. If the crop insurance premiums are included in the cost of production value, then it would not be necessary to net them out of the gross revenue used to calculate the bonus—they have already been accounted for.

**Other considerations**

Indemnities and premiums for production insurance policies for hail, wind and fire losses can be handled in the same manner as multiple peril policies. If the acres included in the insurance unit include multiple rented or owned farms, it may be necessary to pro-rate the crop insurance proceeds among the farms, based on the size of the losses on each farm.

How to handle crop insurance premiums and payments should be discussed at the beginning of the lease period. If no consideration was given to including insurance indemnity payments in the 2012 lease, then the tenant would not be obligated to do so. However, some agreement should be reached about how to handle potential payments in the future.



**Fairness in estate and business planning\***

*by Neil E. Harl, Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University, Ames, Iowa. Member of the Iowa Bar, 515-294-6354, harl@iastate.edu*

**F**arm and ranch estate and business planning involves countless choices and numerous wrenching decisions but none that ranks with pursuing fairness between and among the heirs. In almost every situation where it is planned for the farm or ranch business to continue into the next generation, and it is contemplated that there will be both on-farm and off-farm heirs, the issue of fairness is paramount if one of the objectives of the parents is to assure harmony within the family after the deaths of the parents. The trend of family conflict has been clearly on the upward swing in such situations with all too many ending in bitterness if not in litigation. The observation

is heard, all too frequently, ". . . had our parents known just how much conflict within the family their decisions would generate, they would have handled it differently."

If anything, the recent increases in farm and ranchland values have stoked the disagreements and led to more serious (and more formal) challenges to the plans left behind by the parents.

**Relationship between the parents and the on-farm heir or heirs**

The issue of fairness nearly always begins with the understandings over the sharing of income

*continued on page 3*

*Fairness in estate and business planning, continued from page 2*

from the operation with the on-farm heirs. Often, there is deliberate undercompensation for some significant time period, perhaps until the deaths of the parents. Many parents have difficulty believing that their college-educated child merits a salary or other compensation of \$50,000 per year and that may be at the low-end of what the child may be giving up to return to the farm. Moreover, the parents, growing up and beginning farming in a different era, and often without a college degree, never dreamed of a salary at that level. Often, parents will cite how they got started “on a shoestring” and little more. They may not say so, but they often believe that the child joining the operation should come back at a modest wage and demonstrate his or her commitment to the farming operation. Besides, as they often point out, cash flow just does not permit payment of lofty salaries year in and year out.

So the first principle of fairness – never close a year with deliberate undercompensation of anyone.

After the deaths of the parents, pleas by the on-farm heir for the sharing to tilt slightly in favor of the on-farm sibling may fall on a deaf ear with the retort that there never was undercompensation of anyone. And, in some instances, that may be correct. In any event, it is often difficult to get the off-farm heirs to see the world of compensation as the on-farm heirs see it.

The parents, seeing that the sharing of income is below what it should be, may be inclined to be more generous with the off-farm heirs. That move is hardly lost on the off-farm heirs, who often do not find out about that until the parents are both out of the picture.

### **Craft a choice for the off-farm heirs**

At some point, and this is at the judgment of the parents, depending upon when they are ready to begin sharing ownership of the farming operation with the entire family, it is important to make it clear that the sharing will be carried out on a basis of fairness and each of the children (or grandchildren or both) will have choices on how

they will be able to participate in the farming operation.

- One type of arrangement may include an opportunity for the off-farm heirs to be or become happy, cheerful and contented investors. Experience has shown that such a strategy is more likely to succeed if the business plan at that point is a two-entity business plan –
  - 1) a production entity that includes only the parents and the on-farm heir or heirs and
  - 2) a land owning entity with participation in ownership open to all family members.Owners of the entities can be assured that if they wish to cash out of their family investment, an arrangement to do so has been built into the governing documents.
- The other type of arrangement, for those off-farm heirs who, for various reasons, would prefer not to be involved in the family operation, is to provide an “exit” strategy with a commitment to purchase the interests of the heirs who prefer not to become involved in landownership, to have their interest valued with payment to be made over a 15- to 20-year period with interest on a formula basis on the unpaid balance. Such an exit strategy should also be made available to the on-farm heirs. They should have the opportunity to make a midcareer shift if their interests and aspirations change, as well.

### **Level with the entire family**

The biggest single mistake parents make is to fail to share their thinking with the entire family, but particularly with the off-farm heirs. The refrain is often heard, “They never shared a thing with us kids.” Even before career choices are made or commitments made to those showing some interest in the farming operation, it is wise for the parents to begin to share their thinking, emphasizing that their core objective is to be fair to every member of the family. As time goes on, and career choices are made, the parents should continue to share their thinking, emphasizing at

*continued on page 4*

Fairness in estate and business planning, continued from page 3

every turn that their guiding objective is to be fair to the children, some of whom may have gone off to college and a career off the farm, others have gone off to college and returned to the farm and others have married and drifted off to the four corners of the world.

The reward for being transparent and completely open may be long in coming, but it will, in almost

every situation, be warmly regarded and favorably referred to after the parents have gone to assisted living or departed from this earth. It is perhaps the most enduring legacy the parents can leave behind.

*\*Reprinted with permission from the Sept. 21, 2012 issue of Agricultural Law Digest, Agricultural Law Press Publications, Kelso, Washington. Footnotes not included.*



### Balance of crop rotations in 2013

*by Steven D. Johnson, farm and ag business management specialist, Iowa State University Extension, (515) 957-5790, sdjohns@iastate.edu*

What can we expect in row crop acreage in 2013? With the early 2012 harvest, thoughts turn to planting intentions for next year.

Iowa and the Corn Belt will likely not plant as many acres of corn in 2013 as in 2012. Referring to what some call the drought hangover, drought gets in people's minds and lingers for years.

Many farmers want to get their crop rotations back in balance after planting more corn-on-corn in recent years.

With relatively tight U.S. marketing year ending stocks for both corn and soybeans by August 2013, any problems in global production, such as South America weather, could push farmers to plant one crop over another by spring.

Since 2008, the annual corn to soybean planted acreage percentage in Iowa tends to run between 56 percent to 59 percent, favoring corn, and is slightly less, 53 percent to 56 percent, for the nation. Expect these percentages to decrease in 2013 with the likelihood of more soybean acres being planted.

Observers suggest many factors may have contributed to the shift to more planted corn acres in the past, including improved corn genetics, disease/pest challenges in soybeans, new improved tillage equipment, and crop insurance considerations. Higher cash rent prices likely favor planting corn for the higher net revenue potential. South America weather concerns, followed by the U.S. drought, ran soybeans to record high prices by early September.

Farmers need to evaluate their own individual circumstances. That includes everything from land costs, crop rotation issues and price expectations. I think the lack of soil moisture and the drought experience will weigh heavily on farmers' minds in making 2013 planting decisions.

To help farmers evaluate profitability for their own operation, Iowa State developed a decision tool posted to the Ag Decision Maker website, [www.extension.iastate.edu/agdm](http://www.extension.iastate.edu/agdm). The online worksheet (A1-80) provides sample figures and protected formulas for producers to insert their own numbers and determine their own rotation comparisons.



## “Insuring Iowa’s Agriculture” workshop set for Nov. 5

by William Edwards, extension economist, 515-294-6161, wedwards@iastate.edu

Are you interested in the latest innovations in crop insurance? A one-day workshop for crop insurance providers and users will be held Nov. 5, 2012, at the Scheman Building on the Iowa State University campus in Ames. The leadoff topic is the APH trend adjustment, led by Dr. Gary Schnitkey, Department of Agricultural and Consumer Economics, University of Illinois. The premium rerating process will be discussed by Dr. Bruce Sherrick, Department of Agricultural and Consumer Economics, University of Illinois. That will be followed by production records and reviews, led by Michael Sieben, senior vice president, National Crop Insurance Services.

In the afternoon, Tim Davis, Product Standards and Administration Division, RMA, will cover the High Risk Alternative Coverage Endorsement (HR-ACE). Dr. Roger Elmore and Dr. Andy Lensen, extension crop production specialists with the

Department of Agronomy at Iowa State will discuss the recommended corn and soybean practices following a drought. They will be followed by Dr. Charles Hurburgh, ISU Extension grain quality specialist, discussing the grain quality considerations for 2012. To wrap up, Chad Hart, ISU Extension economist, will show the implications for crop insurance from the proposed 2012 Farm Bill.

The workshop has been approved for six hours of continuing education credit for crop insurance professionals. The registration fee is \$100 before Oct. 29 and \$110 after that date. Registration is from 8-9 a.m. with the conclusion of the sessions at 4 p.m. The workshop will also include lunch with one of the Cyclone coaches and displays from the major crop insurance companies in Iowa.

Register now at <http://www.uccs.iastate.edu/mnet/insuringiowasag/home.html>, or call 515-294-6222.

## Management tips for drought-stressed forages

By Stephen K. Barnhart, professor, Department of Agronomy, (515) 294-7835, sbarnhar@iastate.edu

The Midwest has seen some of the most extreme drought conditions of recent memory. Some rain has come recently for most of this area, but not enough for most of us to feel comfortable. Pastures may still be in poor condition. Many hayfields are showing enough recovery to maybe yield at least one more cutting. Regionally, hay supplies are tight and prices are high. Forage management considerations are many. Here are some things to think about as you prioritize your options.

### Hay and pastures

The goal is to help keep perennial forage plants ‘perennial.’ During the fall weeks, perennial forage legumes and grasses respond to shortening days and cooling average daily temperatures and progress through their gradual “cold hardening” process. The genetics of the variety and local

climatic conditions determine how cold tolerant the plant crown and taproot can be during the winter months. Most successfully winterhardened perennial forage legumes and grasses can withstand soil temperatures in the crown area to about 0-4°F without crown tissue damage. At lower soil and crown temperatures, varieties and individual plants will vary in the degree of cold damage they may experience.

To best acquire their potential for winter survival, these forage plants should get five to six weeks of uninterrupted growth to accumulate root carbohydrates and proteins before going dormant for the winter. A ‘killing freeze’ is about 23-24°F for several hours. Then, no more cutting or grazing until next season.

If you do decide to cut one more hay cutting or grazing, it is important to manage fall harvests

*continued on page 6*

Management tips for drought-stressed forages, continued from page 5

or grazings to give the plants the best chance for strong winter survival. It is best to wait until at or after the killing freeze (23-24°F) for the last hay cutting, then leave a 5- to 6-inch stubble. It is not recommended to take a late season harvest from a new (2012) seeding.

The same goes for late season growth management of pastures. Try to allow three to four weeks of fall recovery before a killing freeze, and then, if you are going to graze again, leave an average of 3 inches or so of lower stem bases on the grasses.

The practical problem with these management strategies is that it involves removing livestock from pasture. And no more hay harvest – in an already hay shortage season. I can't decide what is most important for you.

### Fertilization

Fall is a good time to soil test and fertilize both hay and pastures with needed potassium (K) and phosphorus (P). This will help drought-stressed forage stands to overwinter and improve regrowth and yields next spring. Applying 25 to 40 lbs of nitrogen to grass pastures during the last few

weeks of their fall growth will aid in stimulating more fall tillering (branching) and for more vigorous recovery in the spring.

Give recovering hay and pasture stands time to 'catch up' or regain more vigor next spring.

If fall recovery was not favorable, or you did cut or graze late in the season in 2012, the recovering forage plant may still be under some physiological stress. Hay and pasture plants will benefit from allowing a bit more recovery and growing time next spring before they are cut or grazed. For best 'recovery management,' delay the first cut of alfalfa stands until they reach early- to mid-bloom. For pastures, allow 3 to 4 inches of growth in the spring before livestock turnout.

### Repairing and reseeded

Consider 'interseeding' or 'frostseeding' drought-thinned pastures next late winter or early spring. Frostseeding is the broadcasting of legumes or additional grass seed in late winter when the last few weeks of night-freeze and daytime-thaw aids in seed coverage. Interseeding is using a drill to no-till legumes or forage grasses into an existing sod. Spring interseeding dates are mid-March through late-April.

Frostseeding works best with legumes on the thinnest, least competitive sod areas. Grasses are generally more effectively established with interseeding than with frostseeding. With both frostseeding and interseeding, having the existing pasture sod grazed closely (like many of our pastures following the summer drought stresses) reduces early season competition. Further competition for shade, sunlight and soil moisture can be reduced by timely and thoughtful rotational grazing for the first few months of new seedling establishment. For more details, see these ISU Extension and Outreach publications: Pm-856, Improving Pasture by Frost Seeding, and Pm-1097, Interseeding and No-till Pasture Renovation.

Updates, continued from page 1

#### Internet Updates

The following information files have been added or updated on [www.extension.iastate.edu/agdm](http://www.extension.iastate.edu/agdm).

**July Corn Basis** – A2-43 (12 pages)

**July Soybean Basis** – A2-44 (12 pages)

#### Current Profitability

The following tools have been updated on [www.extension.iastate.edu/agdm/info/outlook.html](http://www.extension.iastate.edu/agdm/info/outlook.html).

**Corn Profitability** – A1-85

**Soybean Profitability** – A1-86

**Iowa Cash Corn and Soybean Prices** – A2-11

**Season Average Price Calculator** – A2-15

**Ethanol Profitability** – D1-10

**Biodiesel Profitability** – D1-15

**Returns for Farrow-to-Finish** – B1-30

**Returns for Weaned Pigs** – B1-33

**Returns for Steer Calves** – B1-35

**Returns for Yearling Steers** – B1-35

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