

Flexible Farm Lease Agreements

Fluctuating markets and uncertain yields make it difficult to arrive at a fair cash rental rate in advance of each crop year. To address this problem, some owners and tenants use flexible lease agreements in which the rent is not determined until after the crop is harvested. The final rental rate is based on actual prices and/or yields attained each year. A recent survey showed that flexible leases accounted for nearly 12 percent of all cash leases in Iowa.

Flexible leases have the following advantages:

- The actual rent paid adjusts automatically as yields or prices fluctuate.
- Risks are shared between the owner and the tenant, as are profit opportunities.
- Owners are paid in cash – they do not have to be involved in decisions about crop inputs or grain marketing.

Option A: Share of Gross Revenue

The most common type of flexible lease calls for the owner to receive cash rent equal to a specified share of the gross revenue of the crop. The value of the crop is determined by multiplying the actual harvested yield by the market price available, usually at harvest time. Under this type of lease both price and yield risks are shared between

tenant and owner, in the same proportion as the gross revenue. In this respect, it is similar to a crop share lease.

Most of the flexible leases in Iowa specify that the rent will be equal to anywhere from 25 to 40 percent of the gross crop value or gross crop revenue. Table 1 below shows average cash rents in Iowa as a percent of the gross crop value and revenue for the past 10 years. Gross crop value is the state average yield times the state average price from October through December. Gross crop revenue includes gross crop value plus all USDA commodity program payments and crop insurance indemnity payments. In recent years these values have been nearly identical, because only direct payments of about \$20 to \$25 per acre have been received from the USDA, and crop insurance payments have been small.

Example 1 – Corn

- Cash rent will be equal to 25 percent of the gross crop revenue.
- The actual yield of corn is 150 bushels per acre, and the actual price is \$6 per bushel.
- USDA direct payment is equal to \$20 per acre.
- The gross income is equal to $(150 \times \$6) + \$20 = \$920$.
- The cash rent is equal to $(25\% \times \$920)$, or \$230 per acre.

Table 1. Average Iowa Cash Rent as a Percent of Gross Crop Value and Gross Crop Revenue (\$/acre)

Year	Average Cash Rent Paid ^{1/}		Average Gross Crop Value ^{2/}		Cash Rent as % of Gross Crop Value		Average Gross Crop Revenue ^{3/}		Cash Rent as % of Gross Crop Revenue	
	Iowa	Corn	Soybeans	Corn	Soybeans	Corn	Soybeans	Corn	Soybeans	
2001	\$ 122	\$278	\$198	44%	62%	\$ 367	\$ 266	33%	46%	
2002	\$ 124	\$368	\$269	34%	46%	\$ 401	\$ 280	31%	44%	
2003	\$ 128	\$382	\$262	33%	49%	\$ 429	\$ 300	30%	43%	
2004	\$ 131	\$360	\$286	36%	46%	\$ 433	\$ 307	30%	43%	
2005	\$ 135	\$337	\$294	40%	46%	\$ 484	\$ 305	28%	44%	
2006	\$ 137	\$499	\$318	27%	43%	\$ 570	\$ 331	24%	41%	
2007	\$ 148	\$595	\$495	25%	30%	\$ 627	\$ 503	24%	29%	
2008	\$ 176	\$734	\$455	24%	39%	\$ 776	\$ 482	23%	37%	
2009	\$ 183	\$672	\$488	27%	37%	\$ 708	\$ 502	26%	36%	
2010	\$ 184	\$800	\$554	23%	33%	\$ 850	\$ 569	22%	32%	
Average 01-05	\$ 128	\$345	\$262	38%	50%	\$ 423	\$ 292	30%	44%	
Average 06-10	\$ 166	\$660	\$462	25%	36%	\$ 706	\$ 478	24%	35%	

^{1/} Cash Rental Rates for Iowa, AgDM File C2-10

^{2/} Iowa average yield x Iowa average cash price in Oct.-Dec.

^{3/} Iowa average yield x Iowa average cash price in Oct.-Dec., plus USDA payments and crop insurance indemnity payments.

Option B. Base Rent plus Bonus

Another type of flexible lease formula specifies a base or minimum rent, plus the owner receives a share of the gross revenue in excess of a certain base value.

The **base rent** may be the amount that was being paid several years ago, before the recent increases in grain prices (see Table 1).

The **base value for gross revenue** can be the amount that would be received under typical yield and price conditions corresponding to the base rent (see Table 1). It can also be equal to the tenant's cost of production per acre, including the base rent. This, in essence, becomes a profit-sharing plan.

The bonus may vary from one-third to one-half of the amount over the base revenue. Both parties must agree on how to calculate gross revenue, and whether a gross revenue below the base level will cause the actual rent to be less than the base rent value. If the base rent is also specified as the minimum rent, it should probably be set lower than a typical fixed cash rent for the same land; otherwise, the landowner does not share in any of the downside risk.

Example 2 - Soybeans

- Base rent is \$150 per acre.
- Tenant's cost of production is \$260 per acre, excluding land.
- Base gross revenue is \$410 per acre ($\$150 + \260).
- Bonus is 35% of the gross revenue in excess of \$410 per acre.
- Actual yield is 52 bushels of soybeans per acre and actual price is \$13 per bushel.
- USDA direct payment is equal to \$20 per acre.
- Gross Revenue is equal to $(52 \text{ bu.} \times \$13) + \$20 = \$696$ per acre.
- Revenue in excess of the base = $\$696 - \$410 = \$286$
- Rent is equal to \$150 plus 35% of \$286, or $\$150 + \$100 = \$250$.
- However, if the market price of soybeans is only \$9 per bushel, the gross revenue would be only \$488, the bonus would be $(\$488 - \$410) \times 35\% = \$27$, and the rent would be \$177 per acre.

Sharing Risk

Owners and tenants should carefully consider the type and degree of risk they want to assume. Taking on risk means greater losses when prices or yields are low, but can result in larger profits in better years. Owners who wish to receive a fixed income from their farm investments

may have to accept a lower long-term rent than those who are willing to share risk. Tenants with substantial financial obligations should consider adopting other means of reducing risk, as well, such as purchasing crop revenue insurance.

Leases that base the rent on price only or yield only may actually increase the tenant's risk in some years. This is because prices may be high when yields are low, or prices may be low when yields are high. Thus, adjusting the rent based on only one factor does not always reflect the actual profits received in that year. Adjusting the rent for changes in both price and yield ensures that the actual rent will be closely tied to the tenant's income each year.

Determining Yield

It is important to agree ahead of time on the procedure for determining the factors that will be used to calculate the final rent. These factors should be based on information that is available to both parties. Actual yields can be determined by:

- weight tickets, if all the crop is sold or put into commercial storage
- combine yield monitors or weigh wagons
- storage bin capacity

When crops stored on the farm are ultimately sold, any variation from the estimated yield can be used to adjust the rent paid for that crop. Estimated yields should be corrected to a standard moisture level, for example, 15 percent moisture for corn.

Some flexible leases use the county average yield as estimated by USDA. This avoids the question of how to measure the actual production and removes the influence that above or below average management ability has on yields. However, county average yields are not generally announced until March each year.

Determining Price

The price used to calculate the final rent payment should represent the potential income that could be received from selling the crop. This can be the cash price at a local elevator or processor on a specified date, or an average of nearby prices on several dates. Prices on dates near or before the time the final rent is paid should be used even though the crop may actually be sold later. Only if the landowner is providing storage facilities should prices after harvest be used.

Forward contract prices available before harvest can be included, too. Many farm producers begin pricing their

crop in the spring or summer months. In that case, using the price offered for harvest delivery on one day per month from March through December, for example, may best reflect the overall value of the crop.

Another alternative to using a local price is to use a futures contract price minus a normal basis value for the location of the farm.

Other options include using the **posted county prices** calculated by FSA each day, or the monthly average cash prices reported by the National Agricultural Statistics Service (NASS) Iowa branch.

Example 3 - Determining Price

Local elevator prices on:		
April 1	(October delivery)	\$5.06
June 1	(October delivery)	4.72
October 1	(cash)	4.48
November 1	(cash)	4.62
December 1	(cash)	<u>4.87</u>
Average		\$4.75

Government Payments

The Farm Service Agency (FSA) no longer specifies that under a lease arrangement in which yield risk is shared between the tenant and the landowner, any USDA payments for which the farm may qualify must be shared in the same proportion as the risk. All payments are now paid to the tenant. In such cases, these payments can be included in the gross revenue estimates used to determine the amount of rent due. This includes direct payments, ACRE payments and SURE payments.

Crop Insurance Payments

Nearly 90 percent of Iowa's corn and soybean acres are insured with multiple peril crop insurance. In years of low production and/or low prices, insurance indemnity

payments can add significantly to a producer's revenue. Including crop insurance payments in the gross revenue used to calculate the flexible rent allows the landowner to share indirectly in the benefits of this risk management tool. Of course, the landowner should share the cost, as well, meaning that crop insurance premiums should be deducted from the gross revenue used to calculate the rent, even in years when no indemnity payments are received.

Other Issues

Some tenants and landlords may want to avoid the possibility of a very high or very low rent in a given year by setting a maximum and/or minimum rent. This keeps the actual rent paid each year within a desirable range.

Many leases ask for a portion of the rent to be paid in advance, possibly by March 1. Under a flexible lease, the advance payment may be for a fixed amount while the final payment depends on actual prices and yields.

The flexible lease formula to be followed should be tested by using several different price and yield possibilities so as to illustrate the range of potential cash rents. Regardless of what type of agreement is adopted, it should be described in writing (with an example) and made a part of the written lease contract. The following page can be used as a lease supplement to specify flexible lease terms.

Other Resources

ISU Extension publication *FM 1538/AgDM C2-12* contains a standard farm lease form. ISU Extension publication *FM 1801/AgDM C2-20* contains information on how to determine a fair cash rent.

An interactive spreadsheet to analyze flexible farm lease agreements is available on the Ag Decision Maker website at: www.extension.iastate.edu/agdm/wholefarm/xls/c2-21flexiblerentanalysis.xls.

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Flexible Cash Rent Agreement

The amount of cash rent to be paid by the operator to the owner for the portion of the real estate designated as cropland shall be determined as follows (fill in the blanks where needed):

	Corn	Soybeans	
Area of cropland	_____	_____	acres
<u>Option A.</u>			
Percent of gross revenue to share	_____ %	_____ %	
<u>Option B.</u>			
Base rent per acre (if applicable)	\$ _____	\$ _____	per acre
Base gross revenue (if applicable)	\$ _____	\$ _____	per acre
Percent of gross revenue to share in excess of base	_____ %	_____ %	
Minimum rent per acre (if applicable)	\$ _____	\$ _____	per acre
Maximum rent per acre (if applicable)	\$ _____	\$ _____	per acre

Yield: The actual yield use to calculate the rent shall be determined as follows: (check)

farm yield, determined by: yield monitor bin measurements delivery receipt other
 county average yield as reported by NASS
 other methods (describe): _____

Price: The actual price used to calculate the rent shall be determined as follows:

Source of price information to use _____
 Dates of prices to use _____

USDA Payments: The value of any payments received as the result of participation in programs of the United States Department of Agriculture for the crop year for which the variable cash rent applies shall be divided as follows:

- a) Direct Payments: Owner _____ % Tenant _____ %
- b) ACRE Payments: Owner _____ % Tenant _____ %
- c) SURE Payments: Owner _____ % Tenant _____ %

Payment Dates: The cash rent as determined by the above procedure shall be paid as follows:

<u>Date</u>	<u>Amount (fixed \$ amount or flexible rent as calculated)</u>
_____	_____
_____	_____
_____	_____

Examples or Actual Rent to Pay (fill in numbers to show how the rent will be calculated)

	<u>Option A. Percent of gross income</u>		<u>Option B. Base rent plus bonus</u>	
	Corn	Soybeans	Corn	Soybeans
	bu.	bu.	bu.	bu.
Yield				
x Price	\$ _____	\$ _____	\$ _____	\$ _____
= Gross crop value	\$ _____	\$ _____	\$ _____	\$ _____
+ Other payments (USDA, insurance)	\$ _____	\$ _____	\$ _____	\$ _____
= Gross revenue	\$ _____	\$ _____	\$ _____	\$ _____
x % shared	_____ %	_____ %	\$ _____	\$ _____
= Total rent per acre	\$ _____	\$ _____	\$ _____	\$ _____
			_____ %	_____ %
			\$ _____	\$ _____
			\$ _____	\$ _____
			\$ _____	\$ _____
			\$ _____	\$ _____
			\$ _____	\$ _____