Trends in Nebraska Farm Real Estate and Flexible Lease Arrangements

Jim Jansen
Extension Economist
jjansen4@unl.edu
402-261-7572

U.S. Farmland Ownership, Tenure, and Transfer
United State Department of Agriculture
Economic Research Service

August 2016
https://www.ers.usda.gov/topics/farm-economy/land-use-land-value-tenure/

Percent of U.S. farmland rented by County
US Farmland, Ownership, and Tenure, USDA-ERS, Aug 2016

Percent of U.S. farmland rented by County
US Farmland, Ownership, and Tenure, USDA-ERS, Aug 2016
Selected Charts & Maps
United State Department of Agriculture
National Agricultural Statics Service

August 3, 2017
https://www.nass.usda.gov/Charts_and_Maps/Land_Values/
Ag Credit Survey & Ag Finance Databook
Kansas City Federal Reserve

Farm Economy Seeking Footing, Nov 9, 2017
https://www.kansascityfed.org/research/indicatorsdata/agcreditsurvey

Agricultural Lending Increases, As Do Interest Expenses for Farmers, Feb 2, 2018
Farm Lending Stabilizes, but Bank Liquidity Tightening, Oct 19, 2017
https://www.kansascityfed.org/research/indicatorsdata/agfinancedatabook
Interest Expenses on U.S. Farms
Agricultural Finance Databook, KC Fed, Feb 2, 2018

Bankers Comments from the Tenth District Agricultural Credit Survey, KC Fed, Aug 10, 2017

- We have been completing more FSA loans as well as secondary market conventional real estate loans for restructuring debt to enhance working capital and improve debt structure. Also, some borrowers have sold some assets to reduce debt servicing. – Western Nebraska
- We did more FSA guaranteed loans this year than we have in the past, but it was more proactive to make sure our producers are able to cash flow. – Central Nebraska
- Working capital is gone for most [producers]. We are now burning through core equity. We have the highest percentage of major workouts and restructures I have seen in my 25 years. – South-central Nebraska

KC FED – Tenth District Average Interest Rates, Third Quarter Agricultural Credit Survey, KC Fed, Nov 9, 2017

Bankers Comments from the Tenth District Agricultural Credit Survey, KC Fed, Nov 9, 2017

- With low commodity prices we expect most of our farm customers to lose money or at best breakeven. – Southcentral Nebraska
- We have seen consecutive "No-Sale" on land auctions. – Northeast Nebraska
- Through our area we expect some wonderful yields that will make up for some of the price drops, but it may not be enough for the highly leveraged borrower. – Southeast Nebraska
Nebraska Farm Real Estate Survey Preliminary Estimates 2018

- Preliminary estimates from the Nebraska Farm Real Estate Survey will be published on March 14, 2018
- Please visit agecon.unl.edu/realestate to register for the preliminary estimates online presentation session
- Session will cover changes in Nebraska land values and rental rates for the 2018 production year

Alternative and Flexible Farmland Leases
The Principles of Flex Leasing

A. Establish a “base rent”
B. Establish the ceiling and floor
C. Decide on how the rent will be adjusted
D. Set the payment dates
E. Get the lease in writing
F. Maintaining the lease

Principle: Establishing the Base Rental Rate

- Methods for estimating the base rental rate:
  - Adjusting survey data ~ UNL or NASS regional rates
  - Cash equivalent from crop share
  - Return on investment
- What I am willing and able to accept and tenant is willing and able to pay?
  - Tenant: What is the maximum I can pay?
  - Landlord: What is the minimum I am willing to accept?

How will the Lease be Adjusted?

- We will largely be comparing expected farm performance against actual performance
  - If performance is better than expected, more rent is paid
  - If performance is less than expected, less rent is paid

Principle: Limiting Your Risk

- Set upper and lower limits for your contract
- Do not expose yourself to unlimited upside and downside risk
- How do you do that?
Establishing the Ceiling and Floor

<table>
<thead>
<tr>
<th>Rent Range</th>
<th>Minimum Rent</th>
<th>Base Rent</th>
<th>Maximum Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>$140</td>
<td>$175</td>
<td>$175</td>
<td>$210</td>
</tr>
</tbody>
</table>

If Rent Falls Below $140, the Default Min Payment is Made
If Rent Rises Above $210, the Default Max Payment is Made

Principle: When is Payment Made?

- As the tenant and landowner, you need to decide on when payment is made
- You won’t know the final yield until after harvest
- Decide on a minimum due and when

- Spring – 1st installment
- Summer – 2nd installment
- Harvest – 3rd installment

Minimum Payment Due – one time or split it up over the season?

Principle: What is the Minimum Due?

- If we put into the contract a minimum due, we can make that due first

- “A minimum payment of $____ is due on March 1st with a final payment due on Jan. 1st of the following year”
- Or whatever you choose to do

ADJUSTING THE BASE RENT
The Per Unit of Production Method
Flex on Unit Change

- The easiest way to pay for rent is by the number of units produced
- Whether you realize it or not, some portion of every bushel of grain you produce goes to pay for cash rent
- What if you just paid rent for each bushel you grew...no more, no less

Understand Calculating Percentage Change

- Assume in March that the prices for soybeans was $9.50 per bushel, but rose to $12.00 per bushel after a November rally. What would be the percent change in price?

\[
\text{Percentage Change} = \left( \frac{\text{New Value} - \text{Old Value}}{\text{Old Value}} \right) \times 100
\]

\[
= \left( \frac{$12.00 - $9.50}{$9.50} \right) \times 100 = 26.3\%
\]

Variable Rent by Bushels

- For every change in number of bushels produced – measured as a percentage
  - If production is better than average:
    - Cash rent goes up
  - If production is less than average:
    - Cash rent goes down
Variable Rent by Yield Adjustment

<table>
<thead>
<tr>
<th>Rental Rate</th>
<th>$175/ ac.</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-yr Farm APH</td>
<td>150 bu.</td>
</tr>
<tr>
<td>% Change in Yield</td>
<td></td>
</tr>
<tr>
<td>Actual Production</td>
<td>160 bu.</td>
</tr>
<tr>
<td>Difference (160 bu. - 150 bu.)</td>
<td>10 bu.</td>
</tr>
<tr>
<td>Percent Change [(160 bu. - 150 bu.) / 150 bu.] x 100</td>
<td>6.7%</td>
</tr>
</tbody>
</table>

Rent $175/ac.
Percent Increase in Rent ($175 x 6.7%) $12/ac.
Final Rent $187/ac.

In this example a farmer produced 106.7% of the APH, meaning the landlord will receive 106.7% of the negotiated base rental rate.

Variable Rent by Price

- In this example the MPCI planting-time and harvesting-time price indexes will be used.
  - Beginning price is the February average of the December corn futures contract
  - Ending price is the October average of the December corn futures contract
  - These are easy to find; require the least effort to calculate
  - You may use whatever index you want

Variable Provision by Crop Price

<table>
<thead>
<tr>
<th>Rental Rate</th>
<th>$175/ac.</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-yr Farm APH</td>
<td>150 bu.</td>
</tr>
<tr>
<td>Planting Time Price Guarantee</td>
<td>$3.30/bu.</td>
</tr>
<tr>
<td>Actual Harvest Time Price Guarantee</td>
<td>$3.75/bu.</td>
</tr>
<tr>
<td>Difference ($3.75/bu. - $3.30/bu.)</td>
<td>$0.45/bu.</td>
</tr>
<tr>
<td>Percent Change [(3.75/bu. - 3.30/bu.) / $3.30/bu.] x 100</td>
<td>13.6%</td>
</tr>
</tbody>
</table>

Rent $175/ac.
Percent Increase in Rent ($175 x 13.6%) $24/ac.
Final Rent $199/ac.

<table>
<thead>
<tr>
<th>Rental Rate</th>
<th>$175/ac.</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-yr Farm APH</td>
<td>150 bu.</td>
</tr>
<tr>
<td>Planting Time Price Guarantee</td>
<td>$3.30/bu.</td>
</tr>
<tr>
<td>Actual Harvest Time Price Guarantee</td>
<td>$2.85/bu.</td>
</tr>
<tr>
<td>Difference ($2.85/bu. - $3.30/bu.)</td>
<td>-$0.45/bu.</td>
</tr>
<tr>
<td>Percent Change [(2.85/bu. - 3.30/bu.) / $3.30/bu.] x 100</td>
<td>-13.6%</td>
</tr>
</tbody>
</table>

Rent $175/ac.
Percent Decrease in Rent ($175 x -13.6%) -$24/ac.
Final Rent $151/ac.
The Change in Income Method: Merging Price and Yield Together

ADJUSTING THE BASE RENT

<table>
<thead>
<tr>
<th>Percent Change in Income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rental Rate</strong></td>
</tr>
<tr>
<td><strong>$175/ac.</strong></td>
</tr>
<tr>
<td><strong>Expected Yield</strong></td>
</tr>
<tr>
<td><strong>150 bu.</strong></td>
</tr>
<tr>
<td><strong>Expected Farm Price</strong></td>
</tr>
<tr>
<td><strong>$3.30/bu.</strong></td>
</tr>
<tr>
<td><strong>Expected Farm Income</strong></td>
</tr>
<tr>
<td><strong>$495/ac.</strong></td>
</tr>
<tr>
<td><strong>Actual Yield</strong></td>
</tr>
<tr>
<td><strong>140 bu.</strong></td>
</tr>
<tr>
<td><strong>Actual On-Farm Price</strong></td>
</tr>
<tr>
<td><strong>$3.86/bu.</strong></td>
</tr>
<tr>
<td><strong>Actual Farm Income</strong></td>
</tr>
<tr>
<td><strong>$540/ac.</strong></td>
</tr>
<tr>
<td><strong>Difference ($540/ac. - $495/ac.)</strong></td>
</tr>
<tr>
<td><strong>$45/ac.</strong></td>
</tr>
<tr>
<td><strong>Percent</strong></td>
</tr>
<tr>
<td><strong>(540/ac. - 495/ac.) x 100</strong></td>
</tr>
<tr>
<td><strong>9.0 %</strong></td>
</tr>
<tr>
<td><strong>Final Rent</strong></td>
</tr>
<tr>
<td><strong>$191/ac.</strong></td>
</tr>
</tbody>
</table>

- Expected and actual farm income do not include any safety net payments or crop insurance indemnity.

Maintaining the Contracts

- Written leases must have a termination date
- Use roll-over clauses to manage negotiations, but do not use them as a crutch
- When rolling, print a new lease with a new termination date
- Have the lease reviewed by a legal professional as needed
- Include those parties in negotiation that have an interest in the outcome
Final Comments

• There are an infinite number of ways to adjust a cash lease, these are only a few examples...
• Start simple and small and build from there
• Evaluate different options and methods in using alternative lease provisions
• Remember the goal of the provisions
  • Manage the risk of the unknown in production
  • Receive income in the form of risk investment

Practice Using The Various Methods

• A look at the website: https://fairrent.umn.edu/