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Caution Advised on High Land Rental Rates

Many crop producers in the Upper Midwest are coming off one of their best crop production years ever.

In addition, many farm operators in the same region who are enrolled in the Ag-Risk Coverage (ARC-CO) farm program option, recently received an ARC-CO payment on their 2015 corn crop. However, the payments were highly variable and some producers did not receive any ARC-CO payment for 2015. These two factors are causing farm operators to be overly optimistic about crop income expectations for 2017 and resulting in some landlords being unwilling to reduce high cash-rental rates for the 2017 crop year.

Many farm operators in several portions of Minnesota, Iowa, and South Dakota had 2016 corn and soybean yields that were 10-20 percent above their 10-year crop insurance actual production history (APH) yields. Using these high yield levels as a planning tool for 2017 is just as big of a mistake as using lower crop yields from a few years ago. It is best to use the updated, 10-year APH yields, or other verifiable, historical-yield data, to make yield projections.

It is also important to remember that the ARC-CO farm program payments that farm operators recently received were for yield losses and price reductions from the 2015 corn crop. The farm program payments in the current Farm Bill are not guaranteed yearly, as they were for nearly two decades prior to the current farm program. Based on the likelihood of higher-than-normal average corn and soybean yield levels in most counties in the Upper Midwest for 2016, along with lower benchmark corn and soybean prices for 2016, the likelihood of receiving significant ARC-CO payments for the 2016 crop year will be less, compared to the 2014 and 2015 crop years. Any 2016 ARC-CO payments will not be made until October 2017.

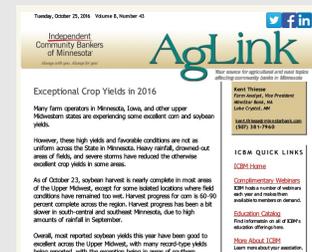
Cash-corn and soybean prices dropped in 2015 and have remained fairly low since that time, with some improvement in soybean prices occurring this year. The projected, forward prices for Fall 2017 are similar to current price levels and there is some concern that prices could drop even lower next year. Cash-corn prices in southern Minnesota are currently near \$3.00 per bushel and cash-

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soybean prices are near \$9.00 per bushel, with even lower prices in western Minnesota and the Dakotas. Comparable, new crop prices for Fall 2017 are similar to the current, cash-corn and soybean prices. Many of the current, cash-rental rates were established when projected corn prices prior to planting were above \$4.00 per bushel and soybean prices were above \$10.00 per bushel.

Average crop input expenses for corn and soybean production in southern Minnesota, excluding land costs, rose about 20-30 percent from 2011 to 2013. Fertilizer and fuel costs declined somewhat in the past couple of years, while most other input costs held steady from previous years. Some experts are projecting total cash expenses for corn production to decrease slightly for the 2017 crop year. However, production costs are highly variable from farm to farm, depending on fertility level, availability of livestock manure, and farm operator efficiency.

The tight cash flow margins in crop production for the 2017 crop year are causing some concern for farm operators, as they negotiate land rental rates for the next year. The very tight, or even negative profit margins for next year's crop, are also a concern for ag lenders, as they begin to refinance crop producers for the 2017 crop year. Some farm operators will need to do some serious evaluation before agreeing to pay very high land rental rates for 2017, which could potentially lead to some large financial losses for their farm operation.

Revenue protection (RP) crop insurance policies have been a very good risk management tool for crop producers on rental land in recent years. The RP policies protect against reduced crop revenues, due to a combination of lower-than-expected yields and dropping grain prices.

RP insurance policy guarantees are based on the Chicago Board of Trade (CBOT) futures prices for December corn and November soybeans in the month of February. Based on current CBOT price levels, the RP base price for the 2017 crop year for corn would be nearly the same as the 2016 base price of \$3.86 per bushel, and compares to: \$4.15 per bushel in 2015; \$4.62 per bushel in 2014; and \$5.65 per bushel in 2013. The current, base-price estimate for 2017 soybeans would be about \$9.85 per bushel, compared to: \$8.85 per bushel in 2016; \$9.73 per bushel in 2014; and \$11.36 per bushel in 2014.

A farm operator that usually carries an 80 percent RP crop insurance policy on corn, and has a 190 bushel-per-acre APH corn yield, would have had a revenue guarantee of \$858.80 per acre in 2013, \$702.24 in 2014, and \$630.80 in 2015, compared to an estimated guarantee of only about \$586.72 per acre for 2016 and 2017. If higher land rental rates for 2017 are still at 2013 and 2014 levels, a crop producer is incurring considerable more financial risk for 2017, compared to the risk levels of a few years ago.

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2017 may be to enter into a flexible, cash-rent agreement, which sets a reasonable base-rental rate that is based on average crop yields, typical production costs, and projected 2017 prices. A flexible lease would have provisions to increase the final, annual rental rate in the event of exceptional crop yields and/or higher-than-anticipated crop prices in 2017. These final cash-rent adjustments should be based on actual crop yields and/or crop market prices during the Fall of 2017, with any rental-rate adjustments occurring on the final land rental payment for the year. If the base-rental rate is set higher than realistic breakeven levels for the farm operator, the flexible lease will not be very effective to address the added financial risk.

For more information, contact Kent Thiesse, Farm Management Analyst and Vice President, MinnStar Bank, Lake Crystal at: 507-381-7960 or kent.thiesse@minnstarbank.com.

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