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Setting Up Flexible Lease Agreements

A growing number of farm operators and landlords are considering a flexible, cash-lease-rental agreement as an alternative to standard cash-rental rates.

A typical, flexible lease allows the final cash-rental rate to vary as crop prices and/or yields vary, or as gross revenue per acre exceeds established targets. The use of a flexible-cash-rental lease is potentially more equitable for both the landlord and farm operator, depending on the situation.

A true, flexible cash lease allows for the landlord to receive additional land rental payments above a base land-rental rate, if the actual crop yields and/or market prices, or the gross revenue per acre, exceeds established base figures. A true, flexible cash lease would also allow for the base rent to be adjusted downward, if actual crop yields and prices, or revenue per acre, fall below the established base figures.

Most flexible leases have been modified in recent years, and only flex upward with added rental payment to the landlords, if the base crop yield and/or prices, or revenue per acre, are exceeded. The modified base rent plus a bonus approach is acceptable if the base cash-rental rates are kept within a reasonable range. If the base rent is set too high (above breakeven levels), resulting in a loss, it is very difficult for the producer to recoup any of those losses with a flexible lease. There are many variations of flexible land-rental leases in existence, some that are very workable, and some that do not work as well. In most flex leases, one half of the base rent is paid prior to planting, and any bonus or additional rents are paid with the second half or final rental payment.

Flexible leases can work well for newer or younger farm operators that may not be able to afford the higher, cash-rental rates for farmland. Most ag lenders support the use of flexible leases as a way to reduce financial risk in a farming operation. A flexible lease makes it easier for producers to utilize risk management tools such as crop revenue insurance policies and forward-pricing of grain. A flexible lease, with a fair-base rental rate, allows landlords the security of a solid base-rental rate, while having the opportunity to

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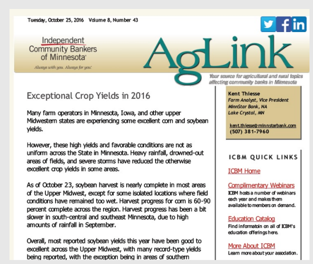

Tuesday, October 25, 2016 Volume 8, Number 43

Exceptional Crop Yields in 2016

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share added profits when crop prices and/or yields exceed expectations. Flexible leases are a nice alternative for landlords who want to continue to work with long-standing farm operators, without setting cash-rental rates too high in an effort to keep current tenants.

One of the biggest challenges with flexible cash-rental leases is determining the base rent per acre, which in most instances, is the minimum rental rate for the year on a land parcel. The base rate should be adjusted upward or downward annually, depending on changes in crop-price expectations, average crop yields, or the projected breakeven values for crop production in the coming year. The best way to establish the base-rental rate is to have a rental rate per acre that is agreeable to both the landlord and farm operator, with an established method of calculation. There are several different ways to approach the determination of a base-rental rate.

Many flexible cash leases require a base yield of some type. The easiest method to get a base yield is to use the crop insurance APH yield, which is updated annually. Another alternative to determine a base yield for a crop could be using the producer's annual production value on a farm, which is averaged over a period of years. Actual yield calculation on the farm for a given year can be determined by warehouse receipts, settlement sheets, scale tickets, bin measurements, yield monitors, or any other method that is acceptable to both the landlord and farm operator.

The base price for a crop could be the projected October harvest price at a local grain elevator or processing plant for that crop on a specified date prior to planting (ex.: March 1 or April 1 for corn and soybeans), and the final price, is the price for that crop at the same location on a specified date in the Fall (ex.: October 15). In some instances, a weekly or monthly average price at the local level from planting to harvest is used to determine the final price. Whatever method is used to determine both the base and final prices should be consistent, using the same grain elevator or processing plant as a source for the local grain price.

With the occurrence of much higher crop input costs in recent years, some flexible cash leases have been modified, and are now based on gross revenue triggers that exceed the cost of production, rather than on crop yield and price triggers. In this type of lease, the landlord only receives additional cash-rental payments beyond the base rent when the final gross revenue per acre (yield x price) exceeds the established cost of production for the year. Typically, the added flex-rent payment to the landlord would be a set percentage of the added gross revenue per acre above the established cost of production per acre, which is usually around 30-35 percent for corn, and about 35-40 percent for soybeans, with a maximum rental rate per acre.

Just as with crop yields and prices, determining the established cost of production for a crop for the year can be a challenge. Some

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possibilities would be to use cash-flow statements for the year, which are prepared by a farm management advisor, ag lender, or the producer. Many universities and farm management associations have average cost of production data available. There also probably needs to be allowances in a flexible lease to allow for added costs or expenses due to weather or emergencies.

There are many variations to setting up a flexible lease agreement between a landlord and farm operator, including using yield-only, price-only, or a base-crop revenue, compared to a harvest-crop revenue, with or without using cost of production, and many more. The big key, regardless of the flexible lease agreement, is that both the landlord and tenant fully understand the rental agreement and the calculations that are used to determine the final rental rate. It is also very important that flexible lease agreements, as well as all land rental contracts, be finalized with a written agreement. Successful, flexible-cash-lease agreements, just as any other long-term, cash-rental agreement, have always involved cooperation, trust, and good communication between the farm operator and the landlord.

Kent Thiesse, Farm Management Analyst, has prepared an updated information sheet titled: "Flexible Lease Agreements for 2017." To receive a free copy of this information sheet and other land rental information, contact Kent Thiesse at: kent.thiesse@minnstarbank.com.

Iowa State University has some very good resources on flexible cash leases and written, cash-rental-lease contracts, including sample cash rental contracts, which are available on their "Ag Decision Maker" website.

The University of Minnesota has a computer spreadsheet titled "Fair Rent," which is an excellent resource for determining equitable land rental rates and evaluating flexible lease examples, and is available on the following website: https://fairrent.umn.edu.

Rising Rural Property Taxes Highlights Annual Legislative Forum on Dec. 8

Residents and local elected officials are invited to attend the 34th-Annual Rural Legislative Forum on Thursday, December 8 at South Central College in North Mankato.

This year's theme is: "Rapidly Rising Property Taxes Challenging Rural Minnesota."

The legislative forum will provide an overview of the property tax system in Minnesota, including how property taxes are calculated and the use of property tax funds. Participants will also hear about the impact of school bond issues on agriculture property taxes.

Eric Willette, Property Tax Research Director for the Minnesota Department of Revenue, will be the keynote presenter for this thought-provoking forum, which will also touch on the ag property tax legislation that was passed during the 2016 state Legislative session, but was not enacted into law.

A complete schedule of the event is available here.

Registration and other information can be found here.

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