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2009 Rental Decisions Given Volatile Commodity Prices and Higher Input Costs

Gary Schnitkey and Dale Lattz
Department of Agricultural and Consumer Economics
University of Illinois

Turmoil within the financial sector has caused concerns about the performance of economies around the world. These concerns have lead to dramatic declines in commodity prices with current cash bids in the $3.50 per bushel range for corn and the $8.50 range for soybeans.

Moreover, there is a great deal of uncertainty concerning the level of prices in 2009. Will corn prices average in the $3 range, $4 range, or $5 range? Arguments can be made for a continuing softness of commodity prices or a return to prices near levels experienced in the summer of 2008. This uncertainty is much larger than in recent years and presents difficulties in determining expected returns available for splitting between landlords and tenants. This in turn leads to difficulties in setting appropriate cash rent levels. Given these difficulties, we suggest the following.

If at all possible, use variable cash rent or share rent arrangements. These arrangements vary returns to the operator and landlord based on yields, prices and input costs (share rent arrangement), thereby automatically adjusting rents and returns to changing economic conditions.

If a fixed cash rent arrangement must be used, delay setting the cash rent until March 2009. Currently, it is difficult to form reasonable expectations of corn and soybean prices for use in budgeting 2009 returns. As a result, it is difficult to agree on a cash rent level. By March some price uncertainty may have dissipated. Moreover, base prices used for revenue crop insurance policies will be set, providing farmers with opportunities to purchase revenue crop insurances. If the cash rent must be set now, realize that the fundamentals of prices and costs suggest lower cash rent bids then what would have been established just a few months ago and what would have been justified by 2007 and 2008 returns. In fact, cash rents based on current projected prices and costs will be below average rent levels in the 2004 through 2006 period.

Consider re-negotiating 2009 cash rent levels if rent levels have already been set at “high” levels. Cash rent bids based on corn above $5.00 per bushel and soybeans above $11 per bushel may no longer be appropriate. If prices remain low into December, it may be time to reduce “high” cash rents. Laying the groundwork for these renegotiations now seems prudent. This recommendation is particularly relevant for tracts whose cash rent levels were set commiserate with return levels in 2007 and 2008. If cash rent levels were low relative to returns in 2007 and 2008, 2009 may be viewed as a catch-up year and re-negotiation may not be needed in 2009.
Currently, there is a great deal of price uncertainty. This is causing difficulties in setting cash rents. We suggest using share rent or variable cash rent arrangements. More detail on variable cash rents is available from publications in the Management and law & Taxation sections of farmdoc (www.farmdoc.uiuc.edu). If a fixed cash rent arrangement must be used, we suggest waiting in setting the cash rent level. Cash rent agreements set at relatively high levels may need to be renegotiated.