FARM BUSINESS MANAGEMENT

Variable Cash Rent Leases

University of Illinois
Farm Business Management Resources

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Farmland Leasing in Illinois

According to the 2012 Census of Agriculture, of all the land in farms in Illinois, 40 percent is owned and 60 percent is leased. There are generally two kinds of leases in Illinois, crop share leases and cash rent leases. Both of these leases have variations from the 'traditional' lease agreements.

According to a 2015 survey of farm managers who are members of the Illinois Society of Farm Managers and Rural Appraisers, 42 percent of their leases are crop share leases, 51 percent are cash rent leases and 7 percent are using custom farming arrangements. A further breakdown of the crop share leases indicate that 25 percent of all leases are traditional crop share arrangements, 11 percent are crop share with supplement rents where the operator pays an additional per acre rent amount and 6 percent are crop share with other modifications, such as the operator paying all the chemical or seed expense. Of the 51 percent of cash rent arrangements, 31 percent of all leases are traditional fixed cash rent leases and 20 percent are variable cash rent leases.

Data from the Illinois Farm Business Association (FBFM) also gives some insight to farmland ownership and leases used in Illinois. Their data indicates that on a statewide basis, 23 percent of the land farmed is owner operated, 34 percent is crop shared and 43 percent is cash rented. Their data does not break down the different types of variations from the traditional crop share and cash rent leases.

Variable Cash Rent Leases

There are two types of cash rent leases. The most common is the fixed cash rent lease where the operator pays the landlord a fixed cash rent amount per acre. The other is a variable or flexible cash rent lease where the cash rent amount paid per acre is based on some measure of productivity of the farm, such as crop yields, grain prices or a combination of both. Variable cash rent leases are being used more due to the uncertainty and fluctuation from year to year in grain prices, yields and input costs.

There are advantages and disadvantages to landowners and operators with a variable cash rent lease compared to a fixed cash rent lease. Advantages include:

- Depending on the lease terms, a variable cash rent lease may reflect a more equitable rent level for the current economic conditions than a fixed rent.
- The landowner has the opportunity to share in additional revenue when incomes are higher than expected due to higher prices, yields, or both.
- Risk levels should be reduced for the operator. Many variable cash rent leases will have a base or minimum rent that will be lower than a fixed cash rent. This will result in a lower rent for the operator in times when incomes are down.
- Variable rent leases do not necessarily have to be renegotiated every year due to fluctuations in revenues. The variable rent terms should adjust for changing revenues. This does not mean that variable cash rent leases should not be reviewed from time to time as revenues and costs change.

Some of the disadvantages to a variable cash rent lease include:

- Variable rent leases shift more risk to the landowner than a fixed rent lease, a disadvantage to the landowner.
- Profits in high-income years will be shared between farmers and landowners thereby reducing farmer returns, a potential disadvantage to the farmer.
- More negotiation between the landowner and operator will be needed in writing the lease. For example, a base or minimum rent may need to be determined and the variable rent terms will need to be established. A maximum rent may also be negotiated.
- There may be less incentive for the operator to maximize yields and revenue as some of the additional revenue because of trying to maximize profit will be shared with the landowner.

There are many ways to structure a variable cash rent lease. Most variable cash rent leases include a minimum or base rent amount the landlord will receive and an additional or bonus payment will be made if certain yields and/or prices are achieved. The minimum or base rent serves a couple of purposes. First, it provides a minimum cash rent amount for the landlord no matter what the economic results are for the year. Second, it helps meet the definition of a cash lease for Farm Service Agency (FSA) purposes. This means that any government program payments tied to the farm will be paid to the operator and they do not have to be shared with the landowner. In many cases, landowners do not want to share in FSA payments to reduce the complications associated with interacting with FSA. According to the FSA Handbook regarding this issue, FSA states that: If a lease provides for a guaranteed amount and share of the crop or crop proceeds, such agreement will be considered a cash lease if the lease provides for both:

a) A guaranteed amount such as a fixed dollar amount or quantity; and
b) A share of the crop proceeds.

Variable Cash Rent Lease Examples

There can be numerous types of variable cash rent leases. Below are three examples for illustration purposes of how variable cash rent leases may work.

Example 1:
Cash rent equals 35% of gross crop returns with a minimum of $225 per acre. Gross crop returns equal actual yield times local cash price. The local cash price equals the average price calculated from the cash price at local Elevator A for the first trading day of the month for the months of March through November. Actual yield for corn is 220 bushels per acre with an average price of $3.25 per bushel. Actual yield for soybeans is 65 bushels per acre with an average price of $9.00 per bushel.

Rent for corn acres equals 220 bpa x $3.25 = $715 x 35% = **$250.25 per acre**.

Rent for soybean acres equals 65 bpa x $9.00 = $585 x 35% = $204.75. Rent equals minimum of **$225 per acre.**

Example 2:
Base rent of $225 per acre, with a base yield of 185 bushels per acre and base price of $3.50 per bushel for corn. For soybeans, the base yield is 58 bushels per acre with a base price of $9.25 per bushel. Minimum or guaranteed rent of $225 per acre. Base rent is adjusted up or down based on actual yields and the local cash price. The local cash price equals the average price calculated from the cash price at local Elevator A for the first trading day of the month for the months of March through November. For

corn, the actual yield is 220 bushels per acre with an average price of $3.25 per bushel. For soybeans, the actual yield is 65 bushels per acre with an average price of $9.00 per bushel.

Rent for corn acres equals $225 x 220 bushels per acre (bpa) / 185 bpa x $3.25 / $3.50 = **$248.46 per acre**.

Rent for soybean acres equals $225 x 65 bpa / 58 bpa x $9.00 / $9.25 = **$245.34 per acre**.

Example 3:
Base (minimum) rent of $200 per acre. Landowner receives bonus payment of 50% of gross revenues over base rent plus nonland costs. Nonland costs for corn are $525 per acre. Bonus trigger for corn is $725 per acre ($200 base rent plus $525 nonland costs). Nonland costs for soybeans are $325 per acre. Bonus trigger for soybeans is $525 per acre ($200 base rent plus $325 nonland costs). Gross revenues based on actual farm yield times local cash price. The local cash price equals the average price calculated from the cash price at local Elevator A for the first trading day of the month for the months of March through November. Actual yield for corn is 220 bushels per acre with an average price of $3.25 per bushel. Actual yield for soybeans is 65 bushels per acre with an average price of $9.00 per bushel.

Rent for corn acres equals 220 bpa x $3.25 = $715. Gross revenue is below $725 trigger so no bonus payment is due. Rent equals base rent of **$200 per acre**.

Rent for soybean acres equals 65 bpa x $9.00 = $585. Bonus payment equals $585 - $525 = $60 x 50% = $30 per acre. Total rent for soybeans = $200 + $30 = **$230 per acre**.

As illustrated by the examples above, different variable cash rent leases will result in different cash rents even under the same economic conditions. It is very important for both the landowner and operator to have a clear understanding of the range of potential rent levels given different yield and price scenarios. While variable cash rent leases might not be an acceptable lease alternative for all landowners or operators, in certain situations it may result in a more equitable solution for those landowners preferring a cash rent lease but willing to share some of the production and price risk with the operator.

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