CASH RENT FOR CROPLAND

(Guaranteed Amount or Flexible Rent)

Many cash rent landlords did not share in high prices for grain in 1973 and 1974. However, cash rents in general went up considerably in 1974 due to pressures from landlords as a result of higher prices for grain and from tenants bidding up the rent where land was available.

HOW MUCH "RISK" DO YOU WANT TO ASSUME?

If the landlord wants a guaranteed amount of cash rent, then the tenant must realize he is assuming all of the risk from price fluctuation and yield variation. On the other hand, the landlord must generally be satisfied with a somewhat lower return than he would normally receive over time from a crop share lease. This occurs because it is customary in any business for the man who assumes the major risk to receive the windfall profits as well as to absorb the losses. The established cash rent then is determined before the crop season starts based on how knowledgeable the landlord and tenant are of the costs of their particular inputs to the agreement, the supply and demand of both land to rent and tenants in the area, the going market rate or customary rents in the area, the potential crop yields, and the estimated price of the commodity grown. The two big risk factors are in estimating the price of the grain and in yield projection.

As a result of the wide fluctuating prices in grain the last few years some landlords that have been cash renting may prefer a 50-50 crop share lease. Here both parties to the lease would share the price and production risks. This share rent route for the retired landlord may have social security implications by having his farm income cut his social security payments because he could be materially participating in management.

1/ Prepared by John E. Moore, Extension Economist, Farm Management, Ohio State University, March, 1975.

Other landlords, such as absentee owners or widows who lack business experience, may prefer the more certain income that comes from a definite amount of rent. Also the tenant with good financing and management ability may prefer to assume the major risk and continue to cash rent in the conventional way

FLEXIBLE OR SLIDING SCALE CASH RENT

Landlords values - the landlord's necessary net income flow to pay principle payments, interest, taxes and family living - varies widely. Deciding on the minimum rent acceptable can determine whether a sale of the farm and investing the proceeds in other alternatives is more realistic.

However many landlords might be content with less than a full return to capital (i.e., 6-8%) because land has been an appreciating asset and they feel it is a good hedge against inflation.

The flexible method may appeal to landlords and tenants who prefer to set up an agreement that could run for several years. The amount of rent paid could be automatically adjusted by (1) the price of the product where you have agreed on a definite amount of bushels of the grain as rent, (2) price of product and percent of yield and (3) price of product, yields, and input costs.

In the first case, the landlord takes his cash rent in kind, (so many bushels of corn, beans, etc. may be delivered to an elevator or priced at a certain time and place). What was the cash rent in previous years before prices started to fluctuate? Divide this rent by an average grain price at that time and this would be the number of bushels times today's price to equal the cash rent. Suppose this is 25 bushels of corn then if today's price of corn is $2.00 rent would be $50.00. If price is $1.50 rent would be $37.50 or if price is $2.50 rent would be $75.00 per acre. Corn and beans grown could be based on an established number of bushels of corn. With this method the landlord exposes himself only to the output price risk. The number of bushels of corn may be 20 or 30 bushels depending on your yield potential and supply and demand factors.

The second method involves both prices and yield risk factors depending on the two parties contributions to the enterprise.

TABLE I -- AN EXAMPLE

LANDLORD AND TENANT SHARE PRICE AND YIELD RISK ON AN ACRE BASIS

ITEM	VALUE PER UNIT	ANNUAL COST PER UNIT	LANDLORD COST	TENANT COST
Land	\$550 @ 8%	\$ 44	\$ 44	--
Taxes	8	8	8	--
Labor	4 (5 hrs.)	20	--	20
Management*	--	25	2.50	22.50
All other production costs		145		145
Total costs		242	54.50	187.50
Percent assumed by each party			22%	78%

* Assuming corn price @ \$2.50 yield @ 100 bu per acre and total management being 10% of gross income and tenant contributes 90% and L.L. 10% of the management.

Based on our example, the landlord would get 22% of the crop while the tenant would get 78% of the crop. In this situation, there may be some incentive for the tenant to reduce production inputs as he only receives 78% of the output, while supplying 100% of the productive inputs.

If corn was $2.00 per bushel times 22% of 100 bushels = $44 for cash rent. corn at $2.50 = $55 rent corn at $3 = $66. Or if yield is 120 bu. and corn price $2.50 and 22% to landlord the rent would equal 26.4 bu times $2.50 or $66 rent per acre. As you can see the assigned values to land and production costs can make a big difference; so both parties must be realistic. Land needs to be at agriculture value for example and the net value after taxes is what you would have to invest if you were comparing to non-farm investment alternatives. The rate of interest needs to be what you can get, not necessarily what you have to pay. Table I is only an example covering all costs. The tenant may have excess labor and machinery that would not be productively employed without the extra land. Your particular cost structure must be followed for budgeting your situation.

The third route involves looking at all costs for both parties much as you would for share rent. Each party determines the minimum amount of acceptable returns and the amount of rent desired to cover all costs and risk. Then the landlord would be guaranteed a minimum rent plus a graduated increase as returns exceeded the base used to determine the minimum rate. The tenant must be compensated for his risk if returns fall below the amount needed to guarantee the minimum to the landlord. Actually if you are going into detail as much as the third method you might as well share rent.

CONCLUSION

The flexible cash lease may appeal to landlords and tenants who prefer that a lease run for several years. The rent paid can be automatically adjusted by the price of grain and or yield levels.

Periodic updating through the use of production budgets would become necessary only as input costs and technology changes affect the income-expense relationship.

In applying this system to an individual farm situation, considerations must, of course, be given to: (1) customary rates paid in the community, (2) time and place market price would be established, (3) productivity of the land and whether or not it has an erratic production history, (4) the capability of the tenant to maximize profit in the production of the crop, and (5) bargaining position of both parties.

Flexible cash rents can be worked out for other crops and situations using the above approach. The above examples and relationships should not be used automatically! Relevant data from each specific farm situation should be used to arrive at an equitable solution to that particular farm's problem.