

Farmland

IN PERSPECTIVE

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Why Written Leases?

Written leases have many benefits, especially when they:

- Define when and how the lease can be terminated.
- Can require more timely decisions regarding continuation/termination than an oral lease.
- Address landowner and tenant rights.
- Address special circumstances such as:
 - What happens if the landowner dies and the property is sold?
 - What recourse does a tenant have if they are growing a multi-year crop and the lease is terminated after one year?
 - How much control does a landowner have over chemical applications?
 - How will a tenant be compensated for multiple-year fertilizer applications?

Standardized leases are available from Cooperative Extension offices or the agricultural departments of state universities.

Leasing Trends: What is the Right Rent?

by Gerald A. Harrison

Farmland values are rising, with double-digit increases seen recently in many areas. As a result, many investors consider farmland a superior investment. Across the United States, values are increasing, with some Corn Belt sales, for instance, now at \$3,500 to \$4,500 per acre.

Rent values likewise are increasing. Farmers require a critical mass of farmland to meet their income goals. They gain it by ownership and cropland leases. Bids for farmland leases are driven by numerous forces, including competition among tenants, the excellent farm income in 2004, and overall income expectations for 2005 and beyond.

Cash rents published recently for University of Illinois farmland are more than \$200 per acre for prime cropland. While these rates are well above average rental rates for 2005, they reflect what tenants will offer in appropriate circumstances.

Cash Rent

Cash rent usage continues to increase. According to an Iowa survey, about 65 percent of land rented in 2002 was cash rented with most of the remainder in crop-share leases. In the past 20 years, the amount of land cash rented has increased nearly one percent per year, while land that is owner-operated has decreased 14-15 percent during the same period.

Landowners and tenants may prefer cash rent for several reasons, including ease in comparing bids, fixed income (avoiding risk) for landowners, minimizing record keeping for the farmer, and the lack of farming knowledge by the landowner.

Cash Rent Challenges

Cash rent, though, does have a downside for both landowners and tenants. Whether the landowner is "at risk" or not (in effect, a "producer") has significant implications for estates with a potential federal estate tax liability. Cash renting leaves the landowner "not at risk," and if the cash rent is to a "non-family member" the landowner's estate will be disqualified from the special-use valuation of farmland for federal estate tax purposes.

This year, for a landowner with more than a modest wealth in farm or ranch land, special-use valuation may allow heirs to remove as much as \$870,000 of land value from a deceased landowner's federal tax estate. This federal tax law is a major benefit for families with substantial holdings of farm or ranch land. Those who collect cash rent, though, may experience other negative income tax aspects.

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If a landowner does not materially participate, a landowner can share rent and not owe self-employment tax. Material participation is an active involvement in the farm operation.

The best leasing arrangement for you depends upon your own situation, knowledge and expertise.

Cash rent is riskier for the farm operator than a share lease and may have implications for government program payment limitations — an increasingly scrutinized area — for large scale farmers. If the farmer leased on shares, a part of the crop costs and output risk is shared with the landowner, and part of the government payments belong to the landowner. This allows the tenant to rent more land, and still remain in compliance with government program payment limitations.

If the crop share lease is structured properly, the long-term results for profits may be similar to cash rent. Custom farming can be profitable for the farmer and shifts virtually all the risk to the landowner.

Landowners, though, may need management help to oversee a share-lease or custom farming operation which would include crop marketing. Professional farm management services are available widely from individuals and companies.

A landowner may avoid the need to keep “up-to-date” on current farming practices by going to a cash-rent leasing arrangement, assuming all factors are bid into their cash rent—but it may be difficult to assess all factors when setting up a lease.

Covering Expenses

Budgets typically show that rent has to be below market rates for the average farmer to cover all costs, including machinery depreciation. Consider, for example, an Arkansas budget for center-pivot irrigation on loamy soil with 150 bushel corn per acre. The total costs (direct costs plus a machinery and equipment charge) are more than \$400 per acre. See www.agmanager.info.

Only if the yield is larger than the budget estimates and/or if the government program payments per acre are sizable for a given farm acreage

will dollars be available for land rent.

If cash rent is 70 cents a bushel (\$105 per acre), it is easy to see the stress on a tenant. With an average or below-average cost and yield, the farmer may not net the \$85 per acre budgeted for machinery overhead.

In a competitive rental market, the tenant must have the ability to cut costs or obtain superior yields or both. For example, an extra 40 bushels of corn per acre at a net price of \$2.50 per bushel (which includes the government price and income support) gives an extra \$100 for rent per acre.

Crop Insurance

Farmers know and landowners should be aware of the range of crop or income insurance options available to them to help remove crop-production risk. Crop insurance may facilitate taking advantage of pre-season pricing opportunities. In early 2004, it was possible to lock-in soybean prices well above \$8.00 per bushel. With crop insurance, producers could price a very high proportion of their expected production by taking advantage of the pre-season high prices, using the futures market, and by paying for crop insurance with government payments. This minimum risk strategy, along with very good yields in 2004, may be a major factor for the recent upward pressure on land values and crop rents for 2005.

Congress continues to approve “disaster payments” for crop producers with uninsured losses above 35% for most crops. However, those who are able to benefit from “disaster payments” must acquire crop insurance for their future production.

A major concern for 2005 is Asian Soybean Rust. Damage from this rust is covered by multiple-peril crop insurance. Producers, however, must support an insured claim with the timely identification of the rust and have applied recommended treatments. See www.farmdoc.uiuc.edu/cropins/ for information on crop insurance choices.

Land Rent Data

The 2004 third quarter issue of the *Purdue Agricultural Economics*

Report includes an annual survey of land values and cash rents for three classes of land in each of six areas of Indiana. See <http://www.agecon.purdue.edu/extension/pubs/paer/>. The survey for 2004 finds that cash rents range from 75 cents to \$1.02 per bushel of expected corn yield. This indicator is an average for a quality of soil in an area, but is a useful indicator if the yield potential is known for a specific parcel of land and the least-cost method of obtaining that yield is used.

In the Corn Belt, cash rents are four to six percent of land value. When land values rise rapidly, rents tend to lag behind at about four percent of land value as reflected in the Purdue Land Value and Cash Rent Surveys that have been conducted since the mid 1970s. See <http://www.agecon.purdue.edu/extension/pubs/paer/>.

Landowners who are not knowledgeable about their total farm situation may minimize the return to their land investment. An ill-informed landowner without management assistance may be wise to seek assistance or to advertise for rent bids. Evaluating farmers does take local knowledge and expertise.

The Right Arrangement

What is the right rental or lease arrangement for your land? Would you be better off not cash renting? Does it fit your individual situation better to share lease or even become “the producer” (the farmer) by custom hiring tillage, planting, cultivation and harvesting and, thus, owning the crop? The best leasing arrangement for you depends upon your own situation, knowledge and expertise.

Some farm operations do use custom services. How much farming activity is necessary for the best use of your land is an important question in arriving at the right rental arrangement. Reduced tillage, including no-till on various farms, may be appropriate and, in fact, required by government conservation plans for some farmland to be eligible for direct government payments.

Many factors can influence land rent: size of, shape of and access to fields; soil fertility and acidity; existing or available contracts for growing seed or specialty crops; availability of manure; and location with respect to markets and the direct USDA program payments (payments are deter-

mined by past program participation, crop acre base and assigned or elected yields under recent options).

A recent Kansas State University report says 25 to 30 percent of land value comes from the federal price and income support programs.

Generally, program support payments may be a similar portion of cash rent.

A landowner who does not have complete information may benefit from the assistance of a professional farm manager or consultant. Across the nation, the Cooperative Extension Service conducts educational seminars based on demands for various topics. Land grant universities provide education on farm management and marketing. University specialists publish information in print, online and in the farm press. Farm manage-

ment education may be appropriate for landowners who want to stay more actively involved for the benefit of their children and grandchildren.

Conclusion

Rent and lease arrangements vary widely due to the nature of land, competition among tenants, farm program payments, farm economy outlook and a landowner's knowledge of the situation. No substitute exists for knowledge about your land. Agricultural universities and professional farm managers provide a good source of information as well as decision-making aids for leasing decisions.

Landowners who cannot obtain or deal with the relevant information are well advised to seek professional

management assistance. By seeking management assistance, a landowner's heirs may benefit as the landowner maximizes the return to the family property.



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Insights on Lease Notices

Tenants and landowners should be careful about lease termination notices and whether a right to or requirement for a termination notice exists, according to Gerald Harrison, Purdue University Cooperative Extension Service Agricultural Law Specialist.

"Term leases" may not require a notice, whether the lease is oral or written. However, it is a good idea to give a notice, particularly from the management point of view. Producers, tenants and landowners need to know where they stand with their farm operations.

Many landowners may be unaware of a tenant's rights. "Disputes come up every year in Indiana — and I'm sure across the country — when new farmland owners think they bought a farm free of the lease, or the farm goes into an estate and maybe the heirs don't want the current tenant," he said.

"The fact of the matter is, a lease is good against a decedent's estate or a new owner, if indeed a tenant has a valid lease," Harrison says. "Many times, particularly in oral leases, a tenant has a right to a termination notice, and December or January of a current crop year is probably too late for a timely notice."

The final termination notification dates vary from state to state. Consult your local, professional farm manager consultant and a lawyer who specializes in agricultural law for specific dates in your area.

State	Traditional Verbal Lease Year*	Traditional Verbal Notification Date*
Arkansas	January 1 – December 31 <i>But may vary. Consult your farm manager.</i>	June 30
Florida	Not well defined. <i>Consult your farm manager.</i>	Not well defined. <i>Consult your farm manager.</i>
Illinois	March 1 – February 28	October 31
Indiana	March 1 – February 28	November 30
Iowa	March 1 – February 28	September 1
Minnesota	Not well defined. <i>Consult your farm manager.</i>	Not well defined. <i>Consult your farm manager.</i>
Missouri	March 1 – February 28 <i>(Sometimes Jan 1 – Dec 31)</i>	60 days prior to when the oral agreement was initially given.
Wisconsin	March 1 – February 28	December 1 <i>90 days advance notice is required to terminate a verbal lease.</i>

*Traditional lease year and notification date for verbal leases. In some states, the lease continues "as is" unless notified by a specified notification date. Lease years and notification dates may vary based on the terms of a written lease. Consult your farm manager or attorney for confirmation.

This information is intended for general education and should not be used as a substitute for an individual's or a business' need for legal and other informed counsel.

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LAND REALTOR® OF AMERICA

Winnie Stortzum, ALC, GRI, ARA, REALTOR® and appraiser at Boyd Real Estate, Inc. of Arcola was recently honored as the 2004 Land REALTOR® of America by the REALTORS® Land Institute (RLI). Stortzum was selected from a field of 1,500+ members of RLI – all farm and land brokers in the United States, Canada and Mexico.

Winnie Stortzum
ARA, ALC, GRI

This prestigious award recognizes dedicated service as a REALTOR® and land broker, participation in community activities and related business activities, and high ethical standards. RLI, an affiliate group of the National Association of REALTORS®, is a national organization of real estate professionals specializing in all aspects of land sales – farms and ranches, commercial properties, vacant and recreational acreage and investment properties.

Stortzum has been selling and appraising farmland at Boyd Real Estate, Inc. in central Illinois since 1981. She has previously been recognized as the 1994 Illinois Farm and Land Broker of the Year; the 1992 Associate-REALTOR® of the Year from 35,000+ members of the Illinois Association of REALTORS®; and the 1991 REALTOR® of the Year by the East Central Illinois Board of REALTORS®.

Stortzum has a B.S. in Education with Honors from Eastern Illinois University and a M.A. in Teaching from the University of Illinois. She holds an Accredited Land Consultant (ALC) designation with RLI; a Graduate, REALTOR® Institute (GRI) designation with the National Association of REALTORS®; and an Accredited Rural Appraiser (ARA) designation with the American Society of Farm Managers and Rural Appraisers. She is also an Illinois Certified General Appraiser.

With her specialization in farm real estate sales, rural appraisals, and consulting, Winnie Stortzum can be an invaluable resource for you. Please give her a call or return the postage-paid card for further information or help with any questions you may have. *Thank You!*



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