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Custom fit your farm lease

by William Edwards, extension economist, 515-294-6161, wedwards@iastate.edu

Iowa farms come in all sizes and shapes. Finding the right lease arrangement for each farm requires some careful thought. Fortunately Iowa land owners and operators have several common and some not so common types of leases to choose from.

Table 1 shows how the number of acres under each of the most common types of lease agreements has changed over the last few decades.

Table 1. Ownership and Leasing Agreements, percent of Iowa Farm Acres

	1982	1992	2002
Operated by owner	55	49	40
Cash rent lease	21	26	39
Crop share lease	21	22	18
Custom farmed, other	3	3	3

Source: Farmland Ownership and Tenure in Iowa, Iowa State University Extension PM 1983, 2004.

The number of acres under traditional crop share lease agreements has declined slightly since 1982, but the biggest shift has been from owner-operated acres to cash rented acres. It is likely that many of these acres are held by retired farmers or their heirs, who wish to retain ownership as an investment or for a steady source of income.

Cash Leases

Cash lease agreements are popular with land owners because they provide a fixed income, at least for the length of the contract, and require very little involvement in the management aspects of growing and marketing the crop. Many tenants prefer cash leases, as well. When a tenant is renting from multiple owners, cash rents reduce the amount of record keeping needed and let the tenant manage all the rented acres as a single unit. Grain can be commingled for purposes of storage and marketing. Some tenants feel that they can rent land based on average expected yields in the area, and if they are able to achieve superior yields they will retain all the additional income.

The primary disadvantage of a cash lease is the need to agree on a rental rate that accurately reflects the profit potential of the farm. Tenants and owners need to

re-evaluate the amount of rent periodically, sometimes annually. When yields and prices are relatively stable, setting the rent may be fairly easy. However, when conditions are more volatile it becomes more difficult to determine a mutually agreeable rent.

Crop Share Leases

Sharing of costs and production has been a traditional means of renting land in Iowa for over a century. Rental terms have changed very slowly, even when technology has changed the relative values of the contributions from the owner and the tenant. The most desirable feature of a crop share lease is that both parties automatically share in increases or decreases in profits, making yearly negotiations about rental terms unnecessary. Share leases also allow young operators to benefit from the expertise of experienced landowners, and decrease the amount of operating capital the tenant has to supply by over 50 percent. If a tenant is farming enough acres to reach the limitations on USDA commodity program payments, a share lease may prevent some payment dollars from being lost.

Whether land owners are willing to take on the added financial risk and management considerations of a crop share lease is a very individual question. Retired operators who still want to have active involvement are good candidates for share lease agreements. In other cases a professional farm manager may be hired to carry out the owner's management and marketing responsibilities.

Other Choices

Owners or managers who wish to assume all price and production risk and be very involved in management may choose to have their land custom farmed. Tenants who custom farm often find that adding some extra land with a guaranteed return allows them to fully utilize their machinery and labor with adding financial risk.

Tenants and owners who are willing to share risk but want the simplicity of a cash lease may prefer some type of flexible cash rent agreement. A future article will examine flexible leases in more detail.

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Comparing Returns

Figure 1 shows how the returns to a landowner under three different types of lease agreements would have varied since 1990. The crop share lease income is based on one-half of the revenue received from the state average yields and cash prices from each year, plus one-half of any USDA commodity payments and crop insurance indemnities paid each year. One-half of the estimated costs of seed, fertilizer, pesticides, crop insurance, drying and operating interest were deducted, but land ownership costs were not deducted. The land was assumed to be planted half to corn and half to soybeans.

The returns to a cash lease were the average cash rental rates for Iowa as estimated by the annual Iowa Farmland Cash Rental Rate Survey carried out by ISU Extension. Again, no land ownership costs were deducted. The return to a flexible cash lease assumed that the rental rate was equal to 35 percent of the gross value of the corn crop and 45 percent of the gross value of the soybean crop each year. These terms were chosen for purposes of illustration, but many other variations could be used.

Figure 2 shows the return to the tenant each year after subtracting estimated production costs and cash rent payments. The average returns from the three types of leases were nearly identical over the 17-year period, for both the owner and the tenant. However, the fixed cash lease put nearly all the income variability on the tenant's shoulders. The crop share lease and the flexible cash lease shared risk between the two parties, and provided very similar returns in most years.

Figure 1. Return to Owner for Corn-Soybean Rotation

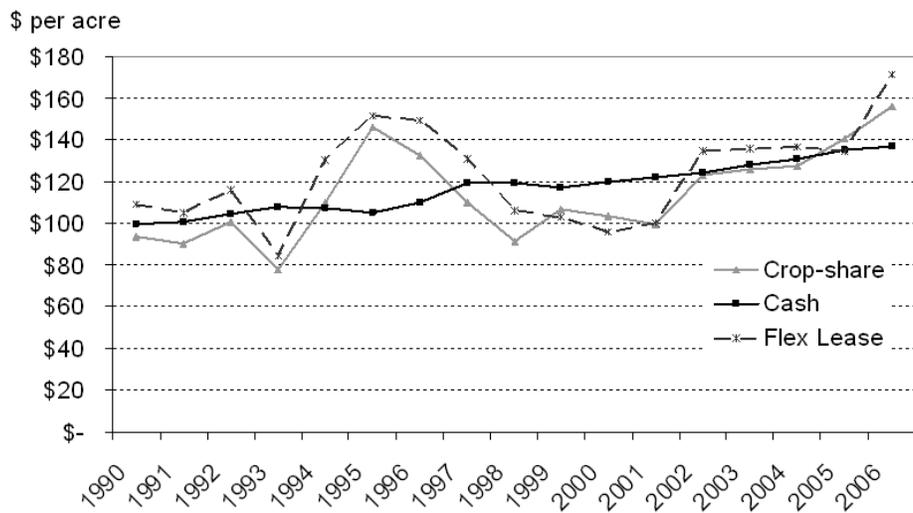


Figure 2. Return to Tenant for Corn-Soybean Rotation

