Future deals could alter owner-tenant relationships

By **WILLIE VOGT**

IN coffee shops around the country, tongues are wagging about skyrocketing farmland values in the Midwest. Whether you're talking about 32% in Iowa or heading west to see 9% in California (for already high-priced, top-quality land), these are significant numbers. In addition, to tie up land, tenants are increasingly willing to pay what at one time would be considered exorbitant rents.

Key Points

- Rising land rates may change owner-tenant dealings.
- Flex leases can take many forms.
- There is a growing need for up-to-date field information.

In this series, we strive to look beyond the immediate news of the day to determine how current events may impact key issues in the future. With this hot Midwest farmland purchase market, are there expected outcomes to plan for in your farm business?

Looking at the 2011 land boom, the Federal Reserve Bank of Chicago pointed to a few facts in its report issued late last year. In that region — which includes Michigan, northern Illinois, northern Indiana, the southern two-thirds of Wisconsin and all of Iowa — year-over-year gains in land values topped 25%. While there was some evidence that bankers were requiring higher levels of collateral, the report also showed that repayment rates or farm loans rose in the third quarter, and loan renewals and extensions declined. In effect, farmers are paying for this land with cash, or in ways that don't impact debt.

Depending on the part of the country, there's a rising trend toward non-farm ownership of land. In the latest land survey for Iowa, for example, 22% of purchasers were non-farmers; in some parts of the state, however, non-farm buyers made up as much as 30% of sales.

Changing relationships

How could this hot market create other changes? As the land prices settle into new, higher "base" prices, buyers may need more information. "A [Corn Suitability Rating] of 80 or the FSA office yields don't mean anything," says Mark Gannon, US Farm Lease, an Ames, Iowa company piloting a new kind of leasing relationship between owner and tenant. "Buyers and tenants need more information about the true productive capacity of that ground."

And rents are definitely on the rise. "We've seen rental rates as high as $500 on our system, and we're working with landowners to go with flexible rents," Gannon says.

Rising crop-price volatility is increasing the risk for owner and tenant in the rental relationship. Iowa, which has a Sept. 1 deadline for closing owner-tenant deals, often forces annual renegotiations. Gannon explains that the hot land market changes that owner-tenant negotiation and has everyone on edge.

"There are all kinds of flex leases based on prices and yields," Gannon explains. "As owners and tenants moved away from the crop-share lease, they sought something simpler. Cash rent is simple. A flex lease can be complicated, but we have a simplified product that is palatable and fair to both parties."

US Farm Lease is piloting what it calls the Fair Lease, which requires the tenant to share information about yield and price, but aims to be simpler than some flex approaches.

The Fair Lease, which is a branded product, works to take out the "individual" nature of farm data to set the pricing, and work with known public figures. For example, county-average cash rent and input costs are based on Iowa State University figures. The price for grain received is based on public figures. "We based it on the price the operator can market the grain through the year for forward-contracting in the fall," Gannon explains.

Sharing information

US Farm Lease helps manage these owner-tenant relationships, working with owners and gathering pertinent information from tenants. "Owners want to go [the flex-lease] route, but they're reluctant because they think it can be complicated," Gannon says. "We work with the tenant and require specific records, including management information like fertilization records."

That fertility information is important. Gannon talks of major land sales that went through in the state without a good soil test or other information. "Most farmers feel they're better than the last guy who had the land, and they can overcome any of the land's deficiencies," Gannon notes. "But we've seen ground that was so depleted it took two to five years to return to optimum conditions."

About 57% of land in Iowa is rented, with similar levels across the Midwest. Rising rents may call for a rise in information-sharing between owner and tenant, regardless of lease type. "What is that land really worth?" Gannon asks. Auctions can raise the base price of land, but eventually savvy buyers are going to want more 60- to 70-year-old historical soil survey data, such as the Corn Suitability Ratings in Iowa, on a piece of ground before buying or renting. Many tracts have changed dramatically since those soil surveys were done, and using them exclusively will get you in trouble. US Farm Lease and others will eventually come up with ways to associate actual yield and cost information with a piece of property to determine true economic value.

You can learn more about the US Farm Lease approach by visiting *www.usfarmlease.com.*

New flex lease at work

WHEN looking at the US Farm Lease Fair Lease flex approach, there are a few things at work. First is the base rent for the owner. Then there's a flex — usually 10% to 33% the owner is entitled to if farm income hits a target. The lower the base, then the higher the flex payment, and vice versa.

For example, an acre of corn ground has a base rent of $350 per acre and a flex of 20% (of the net income for that acre after base rent is removed). For example, if corn is $5.38 and the yield is 180, gross income for that acre is $968.40. Subtract the base rent of $350 to get $618.40. From that you subtract variable input costs, based on Iowa State University figures, of $335.54, to get $282.86. The flex 20% of that net number is $56.57 to the owner. The tenant nets $226.29 per acre.

Since costs are based on Iowa State University standard figures in the agreement, a savvy farmer with solid buying skills can reduce total costs even further, but the flex is based on those standard costs. In essence, the tenant could make more than that $226 figure in this example. Good marketers can also beat the local forward-contract prices, and this is another advantage to the tenant.

US Farm Lease's role is to set up the lease and monitor it, including the recordkeeping and billing for the flex payment. Mark Gannon, US Farm Lease, adds that this system encourages long-term relationships and is friendly to all operators, big and small.

As for those "high rents," Gannon makes an observation: "Rents are running about a 4 to 5% return, just as they did when land costs were lower. So essentially it's the same percentage; the net cost is just higher."

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