

## CASH RENT

HOW MUCH IN 1983?

## CROP SHARE RENT

IS OUR LEASE FAIR?

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## CASH RENT

The Market Approach: Cash rents paid in your area in 1982 can be obtained from figure 1. Average cash rents in 1983 will be down about 5 percent. For more specific information, check with neighbors and creditors.

The Desired Return Approach: Use Form A of Worksheet 1. We suggest using a real interest cost (interest rate - expected inflation rate) of 4 percent (.04) as an interest charge on current investment value. Adding other costs will bring the gross cash rent to about 5 percent of the market value of land. Good buildings can add 10 percent to their market value, but old buildings may add nothing.

A net return of only 3 to 4 percent has been acceptable to landowners since this about equals longer term real interest rates. Higher interest rates of recent years have been offset by increasing land values. During the 1970's, Minnesota farmland increased in price at an average rate of 17 percent per year, compared to a general inflation rate of 7 percent per year in consumer prices. Since land prices move with inflation rates, land is a "growth stock" as well as one giving annual dividends and, as such, it will continue to pay rather low cash dividends. Reduced inflation rates and lower farm incomes in the 1980's dropped land prices 10 to 25 percent versus the 5 percent drop in cash rents, thus increasing current returns from 3 percent to 4 percent.

Compared With Crop Share Lease: Use Form B1 of Worksheet 1 to compare costs of tenant or returns of landowner under a projected crop share lease with cash rent. Cash rents should be lower than crop share rents since (1) the landowner gets some of his money earlier, (2) the landowner does not have to tie up any money in crop production costs, (3) the landowner avoids production and price risks, and (4) he also has less management input. But, current cash rents may be higher than projected returns from an average crop share in many areas.

Maximum For Tenant: Use Form B2 of Worksheet 1 to make an estimate of the maximum cash rent that can be paid. To "keep" the land another year, the tenant may be willing to give up part of his normal machinery overhead and labor costs. However, he must budget some minimum return for his labor and equipment use. And, he should not sign a longer-term (3 or 5 year) lease that does not cover all machinery depreciation and allow for some return to labor and management. High cash rent bids have brought financial trouble to many operators—especially in high risk production areas.

Alternatives To The Cash Rent: Landowners and tenants may want to explore going to a crop share or a flexible cash lease. The most popular flexible lease seems to be one which allows for price adjustment only. With this arrangement, the following formula is typically used.

$$\text{Adjusted Rent} = \frac{\text{Base Cash Rent In Past}}{\text{Base Market Price For Crop (bu.)}} \times \frac{\text{Actual Market Price}}{\text{Per Bushel}}$$

When the lease is drafted, the landowner and tenant must agree on a per acre "base cash rent," a "base bushel price," and how the "actual market price" is to be decided: where and when. They can set limits on the degree of adjustment by agreeing on some minimum and maximum cash rent per acre.

A simple approach that can also adjust for yields (annually if desired) is a percent-of-crop arrangement. The percent that land contributes to total production costs varies from 20 percent on low value land in northeastern Minnesota to over 40 percent on the highest value land in south central Minnesota (see figure 2). Thus, the landowner might be paid the equivalent of, say, 30 percent of the yield of each of the major crops (actual or expected) times the average price received by Minnesota farmers (or some other reported price) for the past year. A portion of this can be paid in the spring.

FIGURE 1. 1982 CASH RENTALS FOR CROPLAND

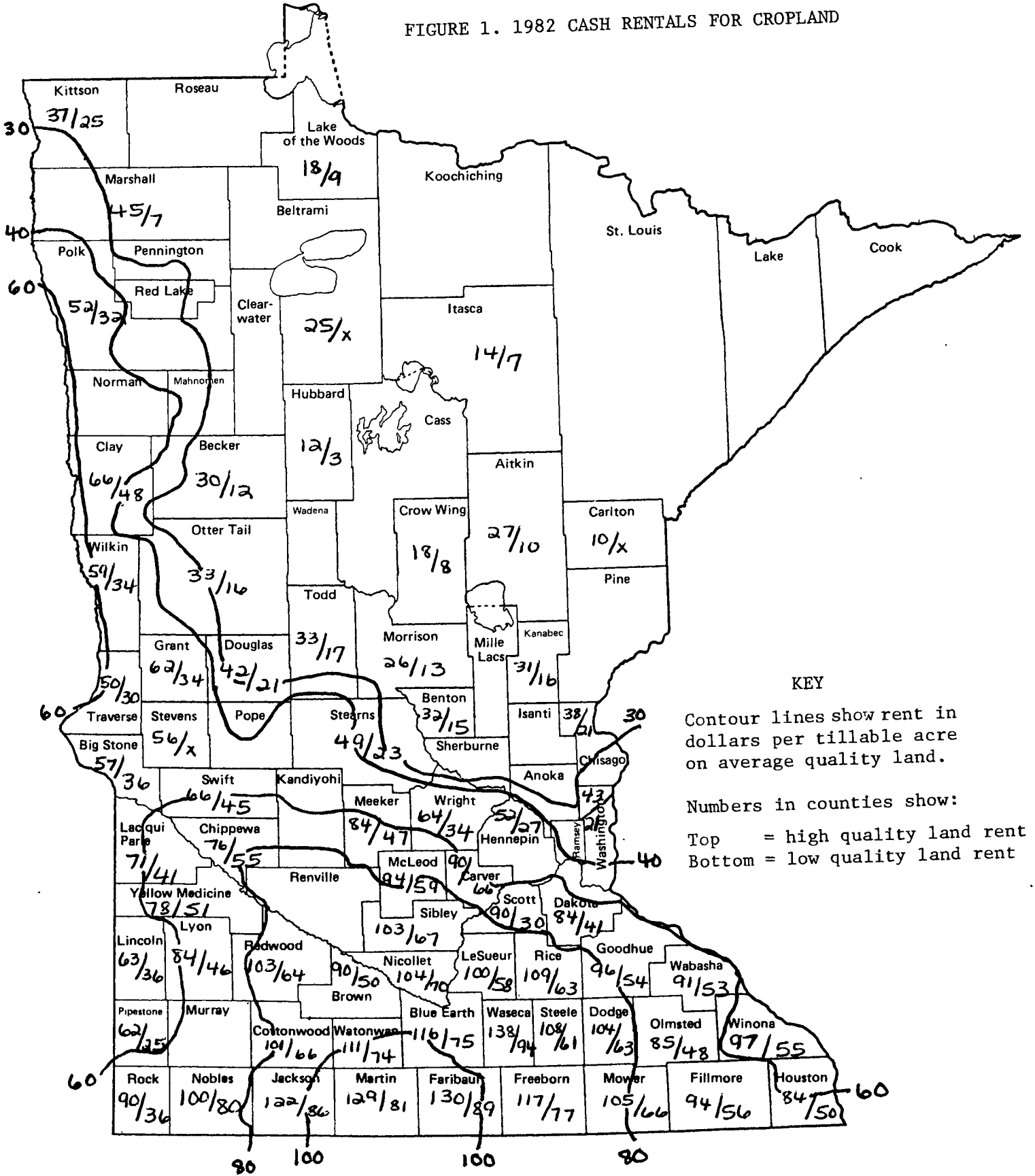
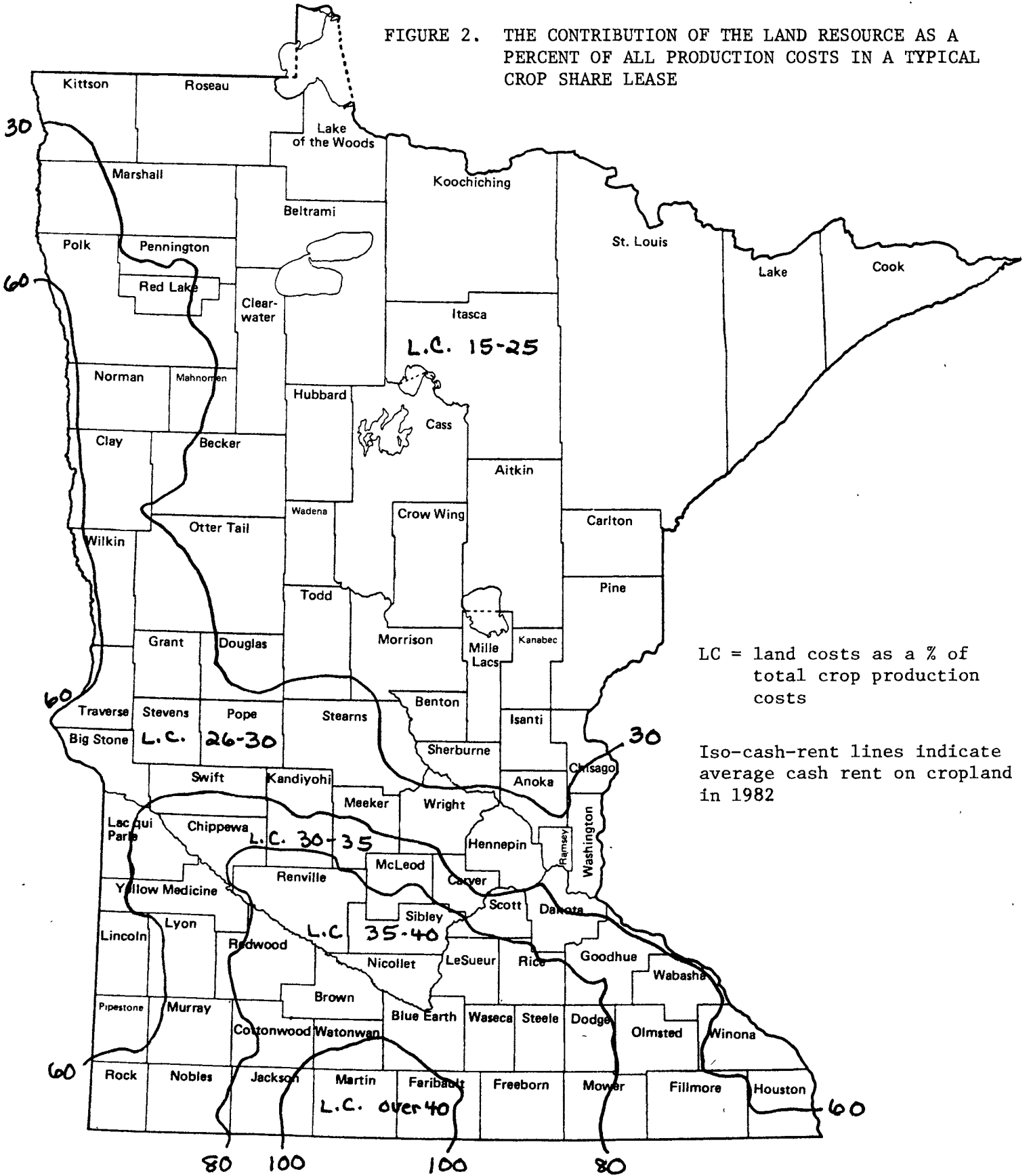


FIGURE 2. THE CONTRIBUTION OF THE LAND RESOURCE AS A PERCENT OF ALL PRODUCTION COSTS IN A TYPICAL CROP SHARE LEASE



LC = land costs as a % of total crop production costs

Iso-cash-rent lines indicate average cash rent on cropland in 1982

CROP SHARE ARRANGEMENTS

Like cash rental rates, the type of crop share arrangement typically found in an area is determined largely by the market value of land. For example, in areas where cash rents range from \$20 - \$50 per acre, the 1/3 - 2/3 predominates. The 40/60 share is most common in \$50 - \$75 cash rent land, while the 50/50 predominates in areas with rents above \$75 per acre. The 1/3 - 2/3 arrangement predominates in the northern part of the state, while the 50/50 prevails in south central and southeastern Minnesota (see figure 3).

A fair crop share arrangement is one in which the landowner and tenant share the resultant crop in the same percentage as they contribute inputs of land, labor, machinery, seed, fertilizer, etc. Table 1 indicates the typical sharing of operating costs in the major share rent areas of the state. However, since share arrangements should vary with the relative value of the land contribution (estimated by its cash rental value), landlords and tenants should use Worksheet 2 to calculate a fair arrangement based on major crops grown.

Note that the last line of this worksheet can be used to help set a price objective to use when developing a forward pricing strategy.

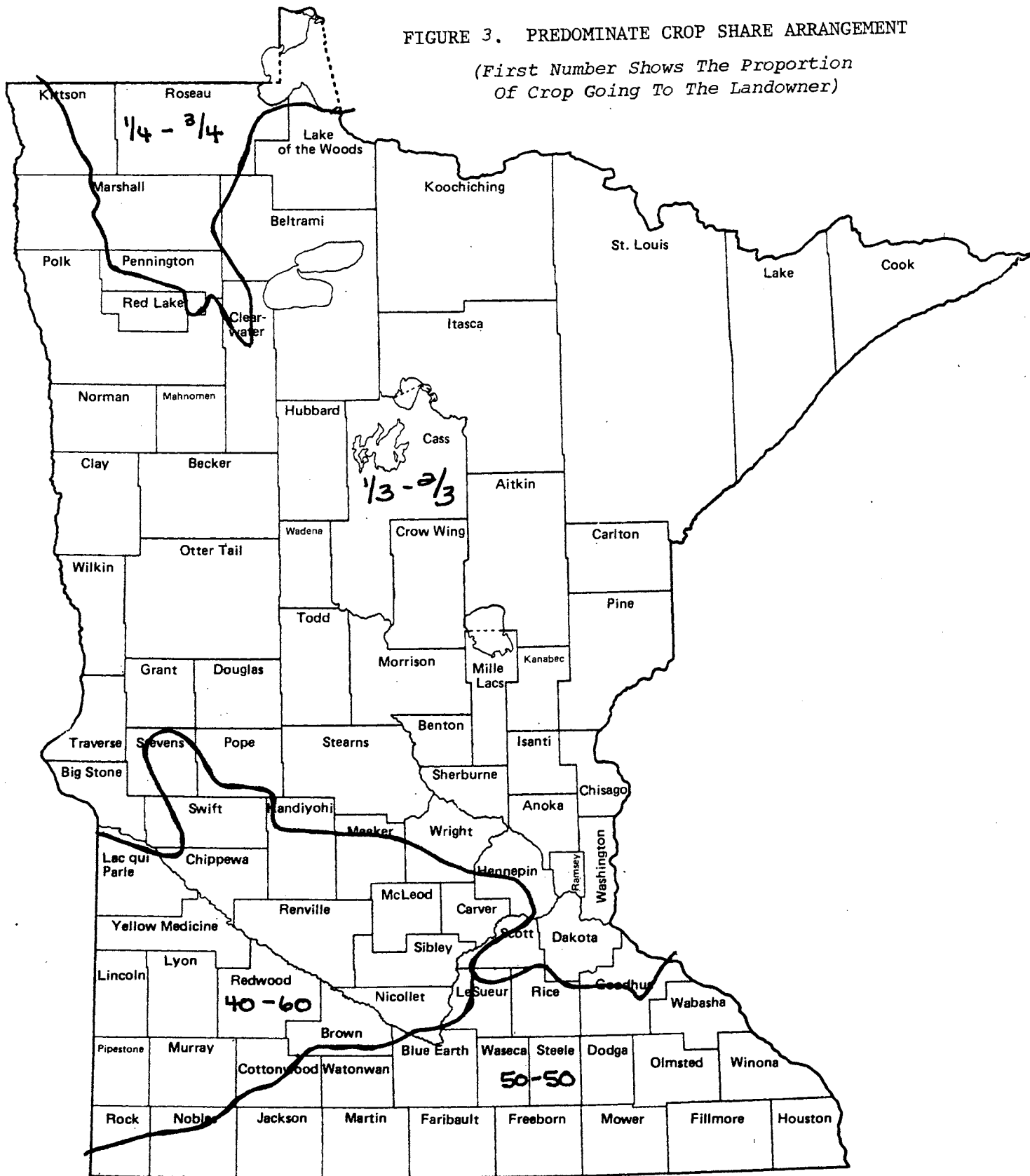
Table 1. Typical Sharing Of Costs - Landlord's Share\*

	Type Of Share Arrangement		
	<u>1/3-2/3</u>	<u>2/5-3/5</u>	<u>1/2-1/2</u>
	-----percent paid by landlord*-----		
Seed	0	0	50
Fertilizer	33	40	50
Chemicals	33	40	50
Harvest	0	0	variable
Drying - fuel & electricity	33	40	50
- overhead	0	0	0
- in town	33	40	50

\* The landlord shares shown are not necessarily equitable shares for any particular farm or area. For example, a 2/5 share arrangement may include sharing in seed costs in an area where there are many typical 1/3-2/3 share rents. Conversely, a 1/3 share arrangement may exclude some of the "typical" landlord items shown above in an area where 40-60 arrangements are common.

FIGURE 3. PREDOMINATE CROP SHARE ARRANGEMENT

(First Number Shows The Proportion Of Crop Going To The Landowner)



WORKSHEET 1. ALTERNATIVE PROCEDURES FOR CALCULATING CASH RENT

Form A - Cost Or Desired Return Approach

	<u>Your Farm</u>	
Interest: Land Value \$ ___ x ___ (real interest rate)	_____	
Real Estate Taxes . . . . .	_____	
Annual Insurance . . . . .	_____	
Annual Repairs and Improvements . . . . .	_____	
Annual Expected Decline In Building Values . . . . .	_____	<u>Per Acre</u>
Total Landowner "Costs" . . . . .	\$ _____	\$ _____

Form B1 - Breakeven Approach: Cash Versus Crop Share

<u>Gross Income</u>									
<u>Crop</u>	<u>Acres</u>		<u>Normal Yield</u>	=	<u>Total Production</u>	x	<u>Price/Unit</u>	=	<u>Total Farm</u>
		x		=		x	\$	=	\$
_____	_____	x	_____	=	_____	x	_____	=	_____
_____	_____	x	_____	=	_____	x	_____	=	_____
_____	_____	x	_____	=	_____	x	_____	=	_____
_____	_____	x	_____	=	_____	x	_____	=	_____
_____	_____	x	_____	=	_____	x	_____	=	_____
<b>Total</b>	_____		xxx		xxx		xxx	(A)	\$ _____

<u>Variable Expenses</u>									
<u>Crop</u>	<u>Seed</u>	<u>Fert &amp; Chem</u>	<u>Other</u>	<u>Total</u>		<u>Acres</u>		<u>Total Farm</u>	<u>Landowner's Share</u>
		(per acre)							
_____	\$ _____	\$ _____	\$ _____	\$ _____	x	_____	=	\$ _____	\$ _____
_____	_____	_____	_____	_____	x	_____	=	_____	_____
_____	_____	_____	_____	_____	x	_____	=	_____	_____
_____	_____	_____	_____	_____	x	_____	=	_____	_____
_____	_____	_____	_____	_____	x	_____	=	_____	_____
	xxx	xxx	xxx	xxx		_____	(B)	\$ _____	\$ _____

Return over variable expenses (A - B) . . . . .	(C)	\$ _____	\$ _____
Other rental income (hay, pasture, etc.) . . . . .	(D)	_____	\$ _____
Total farm rent (C + D) . . . . .	(E)	_____	\$ _____
Less risk adjustment: total farm rent \$ ___ x ___ % . . . . .	(F)	_____	\$ _____
Breakeven cash rent (E - F) . . . . .	(G)	_____	\$ _____
		Per Acre	\$ _____

Form B2 - Maximum Rent Approach - Tenant

A. Return over variable expenses - total farm (C above) . . .	\$ _____
B. Machinery and equipment costs . . .	\$ _____
C. Labor and management charge . . .	\$ _____
D. Total overhead costs (B + C) . . . . .	\$ _____
E. Maximum cash rent tenant can afford to pay (A - D) . . .	\$ _____
	Per Acre \$ _____



WORKSHEET 2. RENTAL ARRANGEMENT WORKSHEET

(use this worksheet to determine whether you have a fair share lease arrangement)

Crop: Corn	Yield = 120 bu.	Yield = _____ bu.
	<u>Typical Share</u>	<u>Your Situation</u>
	<u>Landlord</u> <u>Tenant</u>	<u>Landlord</u> <u>Tenant</u>
<u>Desired Crop Share Arrangement</u>	50%      50%	_____ %      _____ %
<u>Non-Shared Contribution</u>		
Land - Cash Rent Equivalent	\$100.00	\$ _____
Machinery (replacement & repair)	0	72.00
Gas, Oil & Grease	0	16.00
Labor & Management (plant & harvest)	4.00	13.00
	=====	=====
TOTAL NON-SHARED	\$104.00	\$ _____
Non-Shared Contribution Provided	50%      50%	_____ %      _____ %
<u>Shared Expenses - In The Desired Percentage Stated Above:</u>		
Seed	\$ 9.00	\$ _____
Fertilizer - Starter	6.85	6.85
Broadcast	8.25	8.25
Nitrogen	9.00	9.00
Herbicide	6.00	6.00
Hail Insurance	3.00	3.00
Insecticide	1.85	1.85
Interest, Op. Loan	3.35	3.35
Drying	15.00	15.00
Trucking <i>(Tenant hauls one time &amp; these costs are in fixed contribution)</i>		
Hired Labor <i>(Tenant provides all labor)</i>		
Storage <i>(Each party stores their own)</i>		
	=====	=====
TOTAL SHARED EXPENSES	\$ 62.30	\$ _____
TOTAL SHARED & NON-SHARED	\$166.30	\$ _____
Price Needed (pre-storage) cost ÷ yield	\$ 2.77	\$ _____

