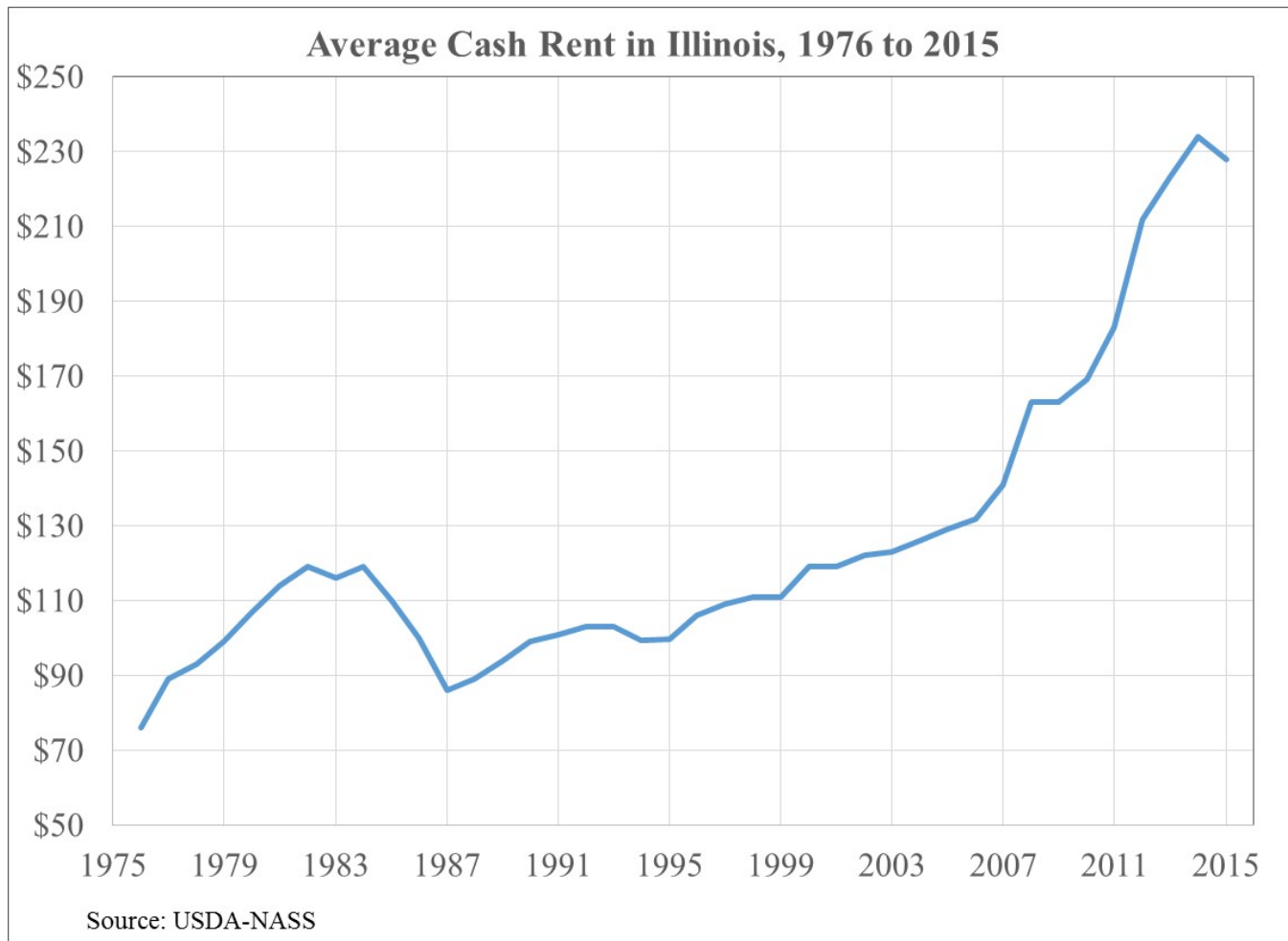


# Evaluating Rental Agreements and Land Values with Lower Prices

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Nick Paulson  
University of Illinois  
[npaulson@illinois.edu](mailto:npaulson@illinois.edu)

# Average Cash Rent in IL



[www.farmdocdaily.illinois.edu](http://www.farmdocdaily.illinois.edu)

# Professionally Managed Cash Rents in IL

**Table 1. Actual 2014 and 2015 Cash Rents and 2016 Rents on Professionally Managed Farmland in Illinois**

Land Productivity (Expected corn yield	2014 Average <sup>1</sup>	Professionally Managed Farmland <sup>2</sup>		
		2014 Rent	2015 Rent	2016 Expected
	\$/acre	\$/acre	\$/acre	\$/acre
Excellent (190 Plus bushels)	293	374	350	318
Good (170 - 190 bushels)	243	322	295	267
Average (150 -170 bushels)	159	285	250	219
Fair (Less than 150 bushels)		214	200	177

<sup>1</sup> Compiled from National Agricultural Statistical Service data.

<sup>2</sup> From surveys conducted by the Illinois Society of Professional Farm Managers and Rural Appraisers.

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# Why Cash Rents *Could (Should?)* Adjust

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1. Farm income will be down considerably in 2015, and 2016 likely will be a repeat of 2015 if significant cost cuts do not occur
2. Non-land costs plus cash rents exceed gross revenue, need to cut costs

# Controlling Land Costs

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- **Assess your financial situation**
  - Working capital, Current ratio
- **Information and communication**
  - Crop budgets
- **Alternative lease arrangements**
  - Hybrid or flex designs

# Hybrid or Flex Lease Designs

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- **Typical components**
  - Base rent level
  - Bonus tied to yields, prices, and/or revenues above a certain level
  - Reduces losses for farmer when returns are low, provides landlord with more rent when returns are higher
- **Becoming more popular, particularly on professionally managed farms**

# Hybrid or Flex Lease Designs

- Example from [September 9, 2015](#) daily post:
  - \$200 base rent
  - Bonus: 50% of revenue above total cost

Non-land costs: \$500/acre    Total cost: \$750/acre  
200 bu/acre yield

	Corn Price = \$3.50 Revenue = \$700	Corn Price = \$4.25 Revenue = \$850/acre
Rent	\$200/acre	$\$200 + 0.5 * \$100 = \$250/\text{acre}$

# Why Cash Rents *Might Not* Adjust (or why it won't feel like they are...)

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## 3. Many farmers are financially strong and could postpone cost cutting decisions...

- Rents are not renegotiated every year
- Build up of working capital, willingness and ability to accept negative returns to keep control of the land
- Actual rents vary from reported averages

## 4. Environment is different today...

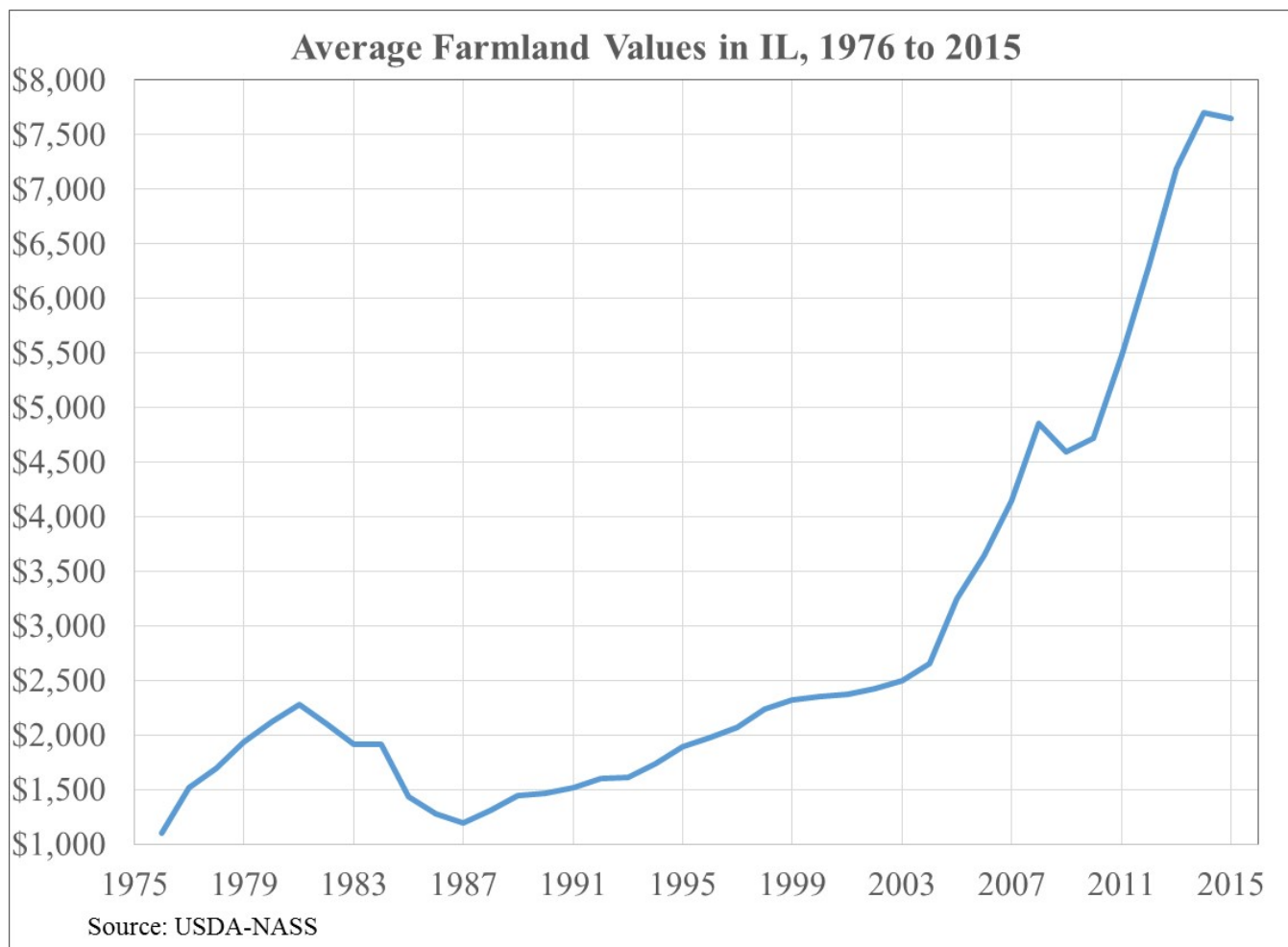


# Cash Rent Averages

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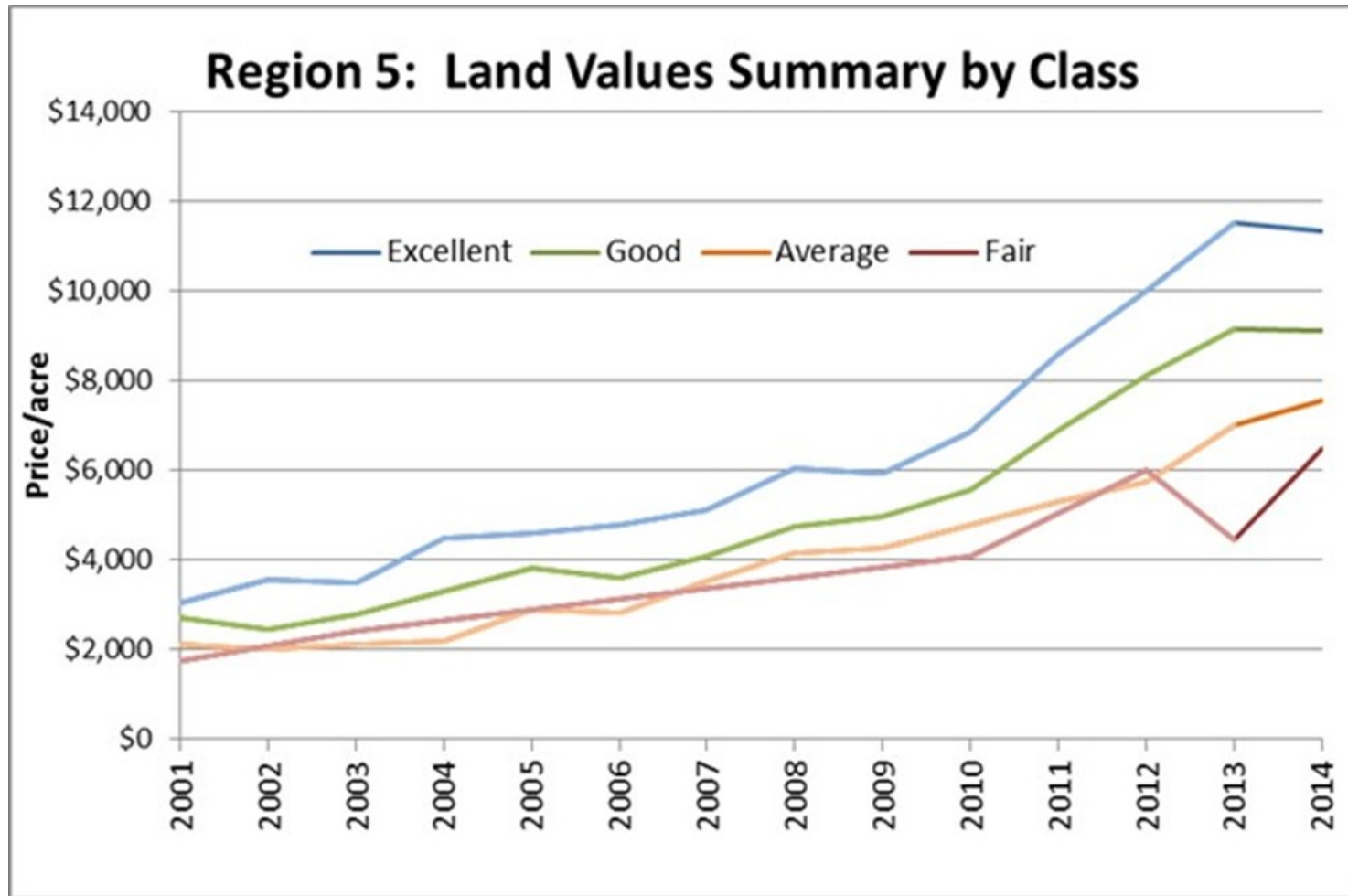
- **Distribution around average cash rents**
  - Average in IL was \$230 in 2014, \$228 in 2015
  - County averages range from \$308 to \$80
  - Averages paid on farm operations vary around county averages
  - Variation across parcels on the same farm operation
- High end rents will likely come down
- Low end rents may continue to rise
- Averages may not change

# Average Farmland Values in IL



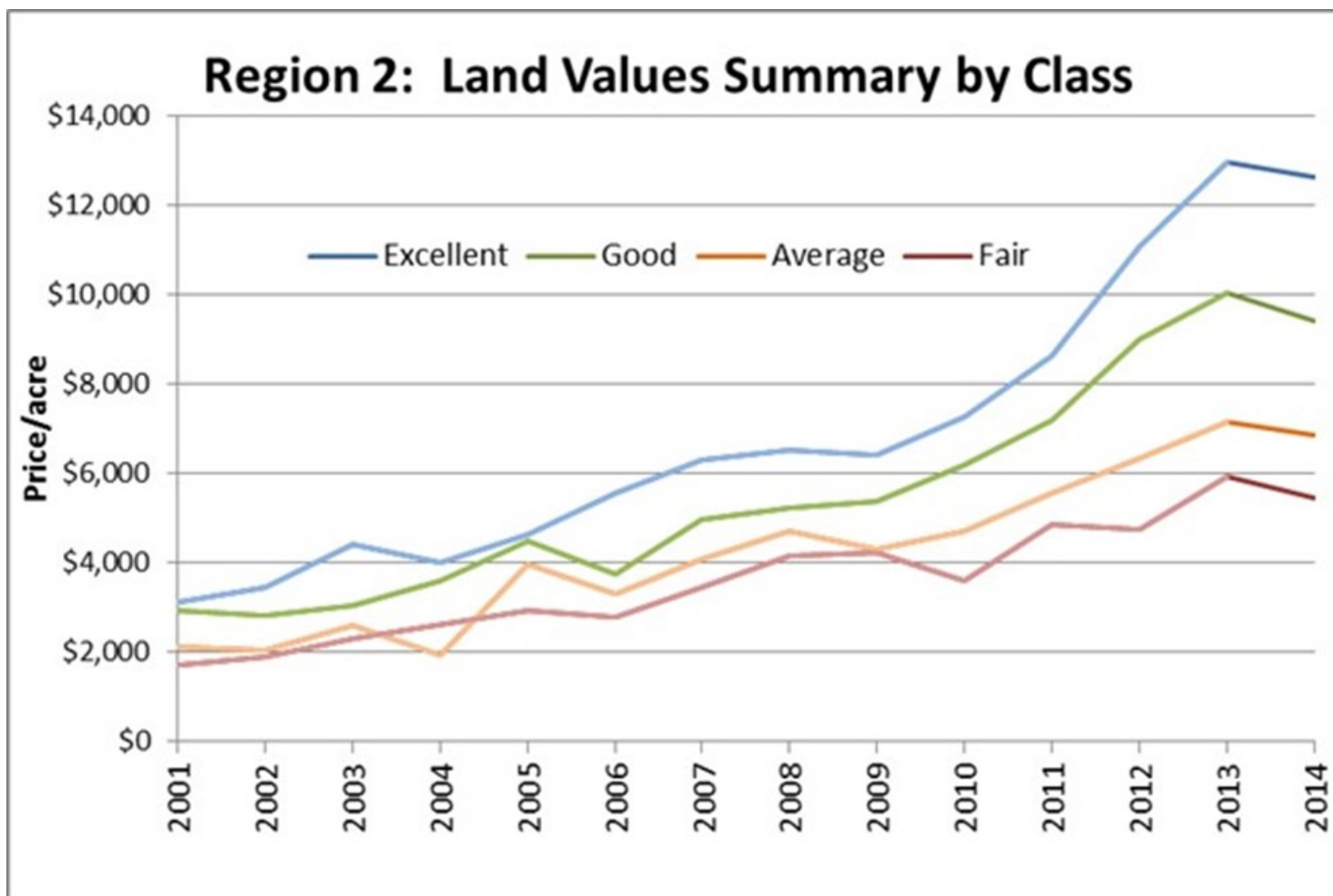
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# East-Central IL



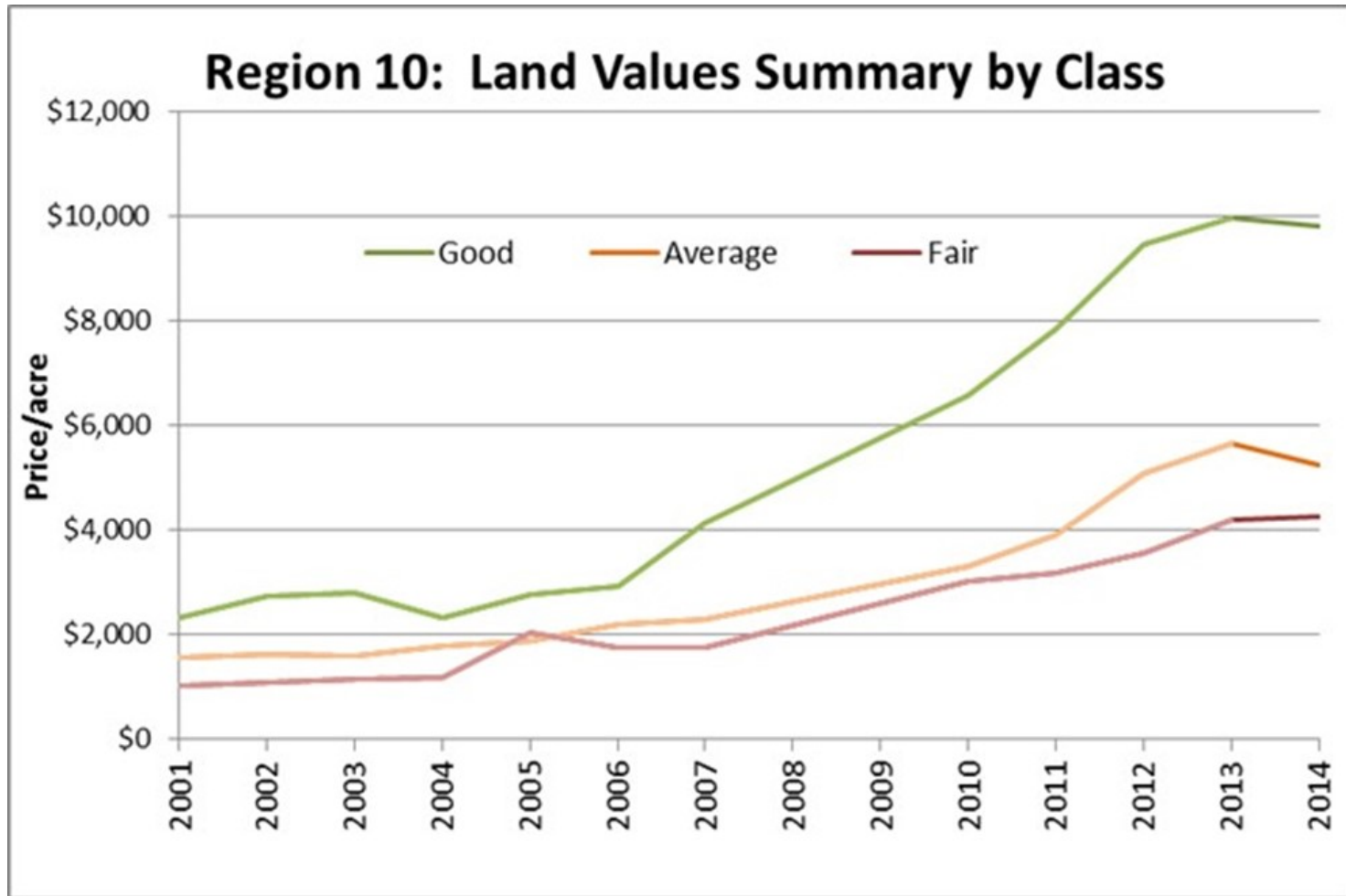
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# Northwestern IL



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# Southern IL



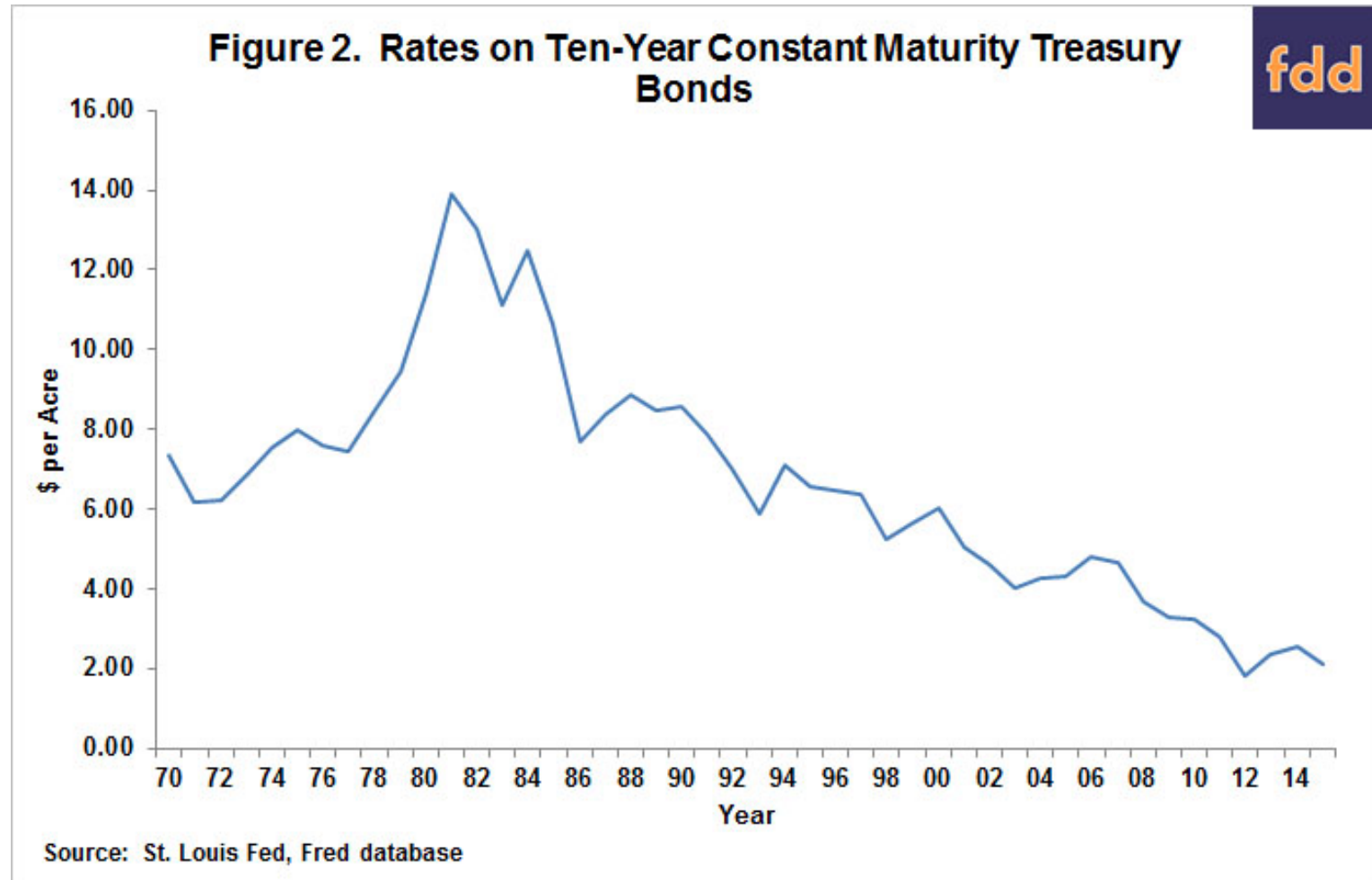
[www.farmdocdaily.illinois.edu](http://www.farmdocdaily.illinois.edu)

# Farmland Values

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- **Two main factors**
  - **Income stream associated with farmland**
    - Cash rent income
    - Adjustments for ownership costs
  - **Discount rates**
    - Interest rates
- **Long-term levels are what (should) matter**
  - Perceived permanence/appropriateness of current levels
- **Other factors**

# Interest Rates: 10-year CMT



# Capitalized Value of an Asset

- Discount rate,  $r$
- Annual income generated by asset,  $I$
- Capitalized Value or Price,  $P$

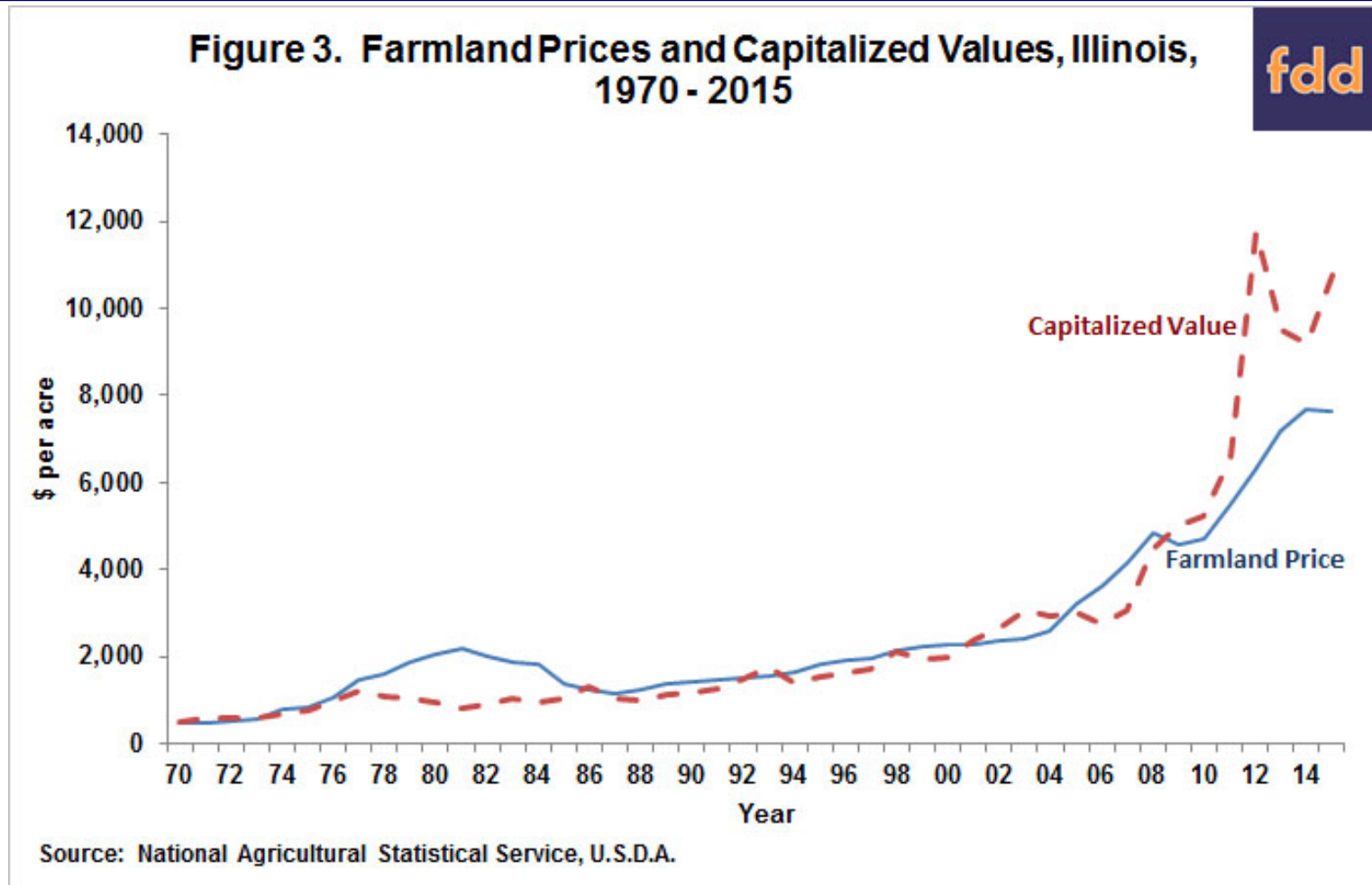
$$P = \frac{I}{r}$$

- Example: \$230 cash rent farm (avg in IL)

Discount rate ( $r$ )	2%	3%	4%	5%
Land Value	\$11,500	\$7,667	\$5,750	\$4,600



# Average Value vs. Implied Capitalized Value in IL



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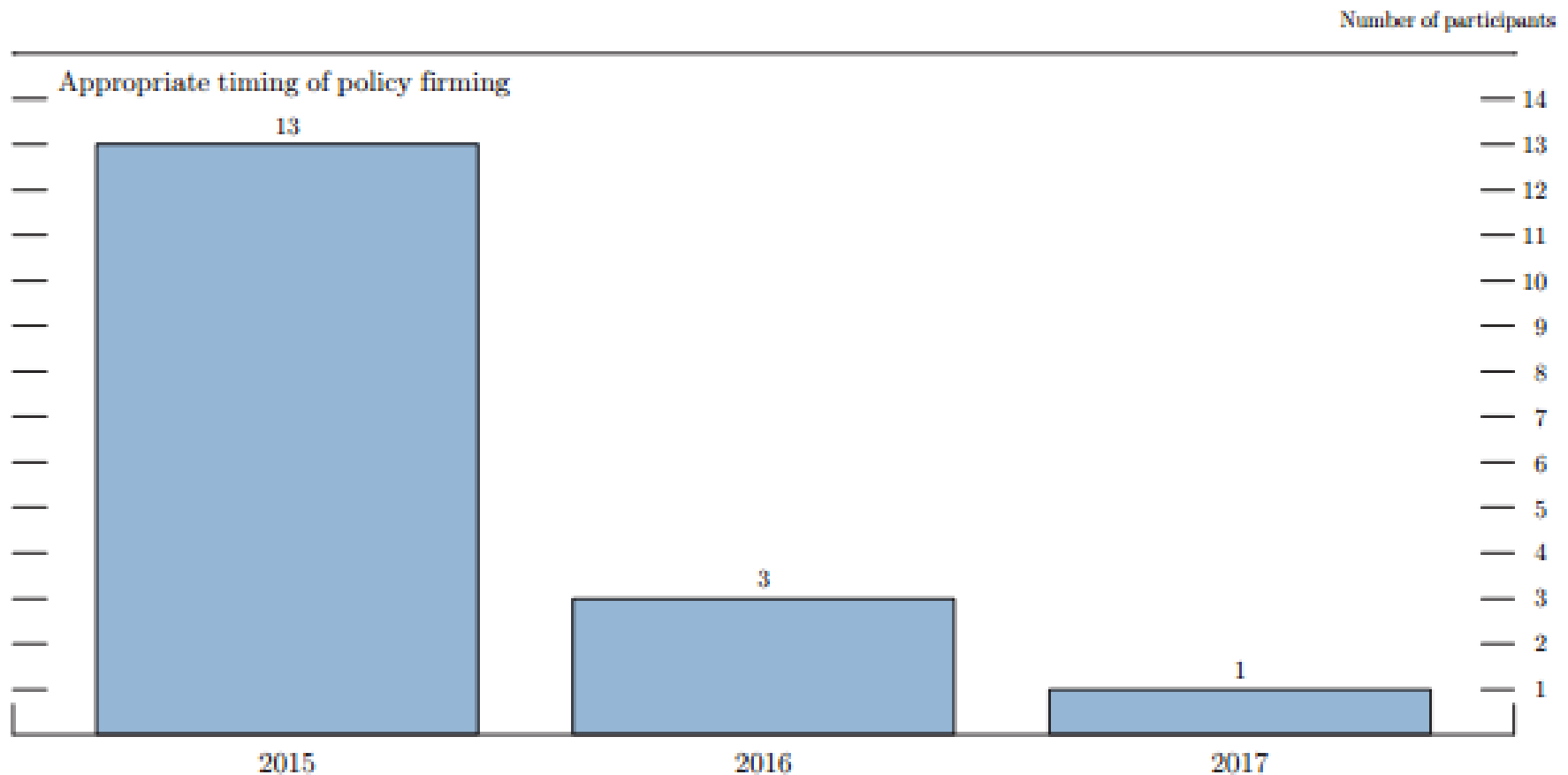
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# Why Land Values *May Not* Remain Stable

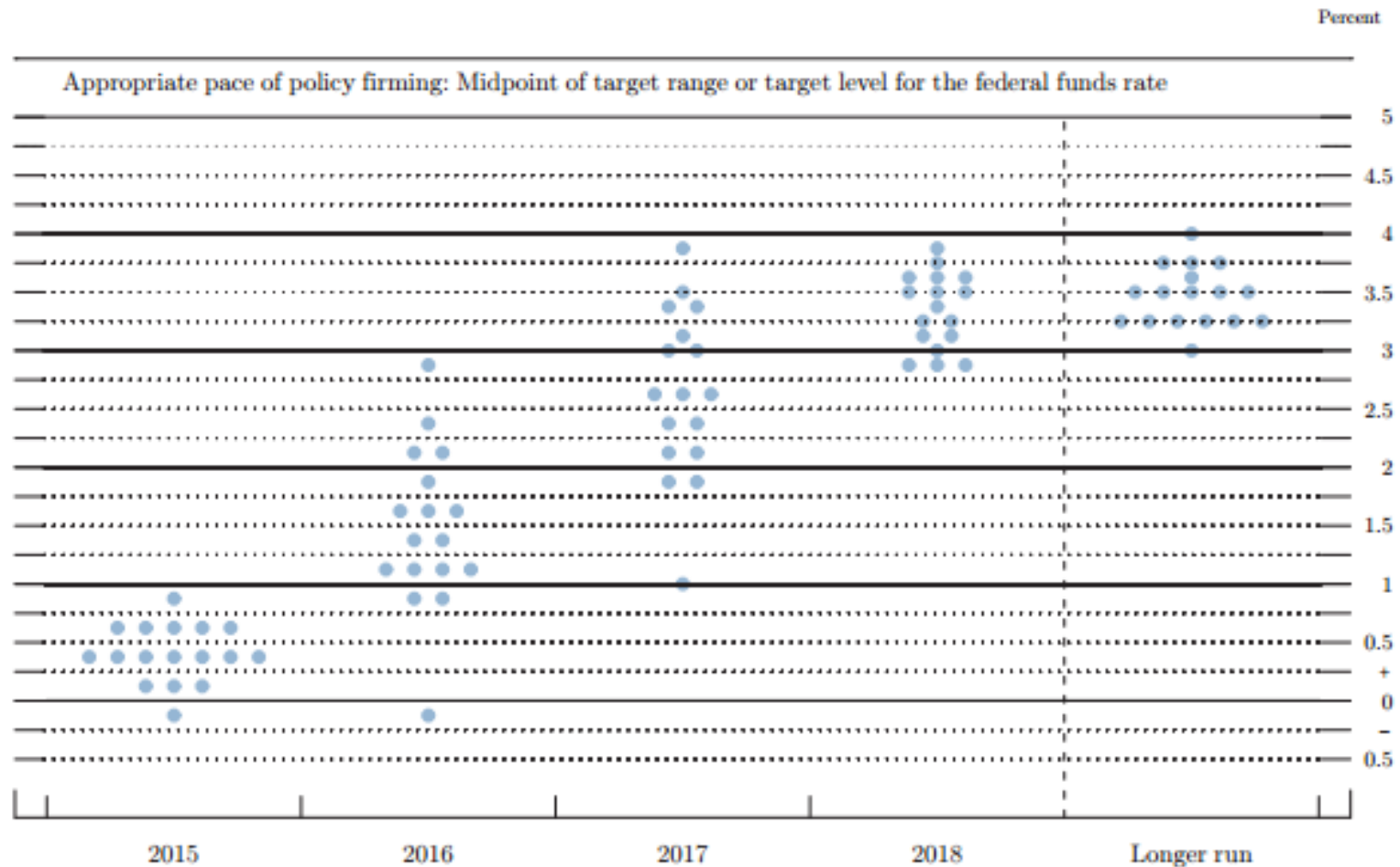
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- Lower returns, reduces income generating component of land values
- Increase in interest rates could increase discount rate component of land values
  - At low interest rates, farmland values can be very sensitive to changes

# Monetary Policy Expectations (from September 2015)



# Monetary Policy Expectations (from September 2015)



# Why Land Values *May* Remain Stable

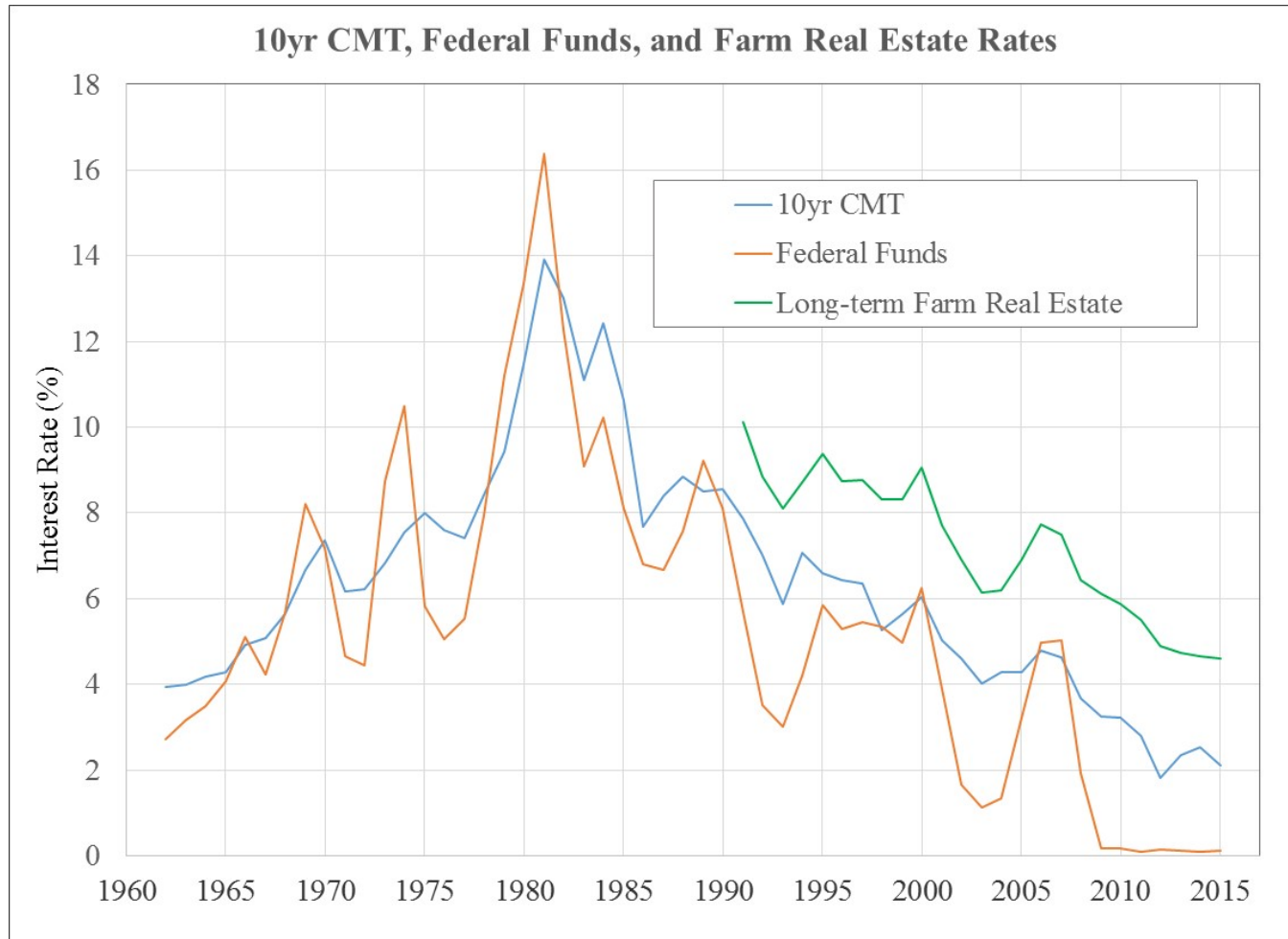
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- Capitalized value well above average market value of farmland
  - Farmland market has not viewed current income (rents) or interest rate levels as permanent

## 4. Environment is different today...

- Strong ag sector balance sheet
- Crop insurance, other support
- Interest rates

# Historical Interest Rates



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# Summary

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- **Cash Rents have been rising with other production costs**
  - Some rents may adjust in response to lower returns
  - Some rents may not adjust
- **Farmland Values have also risen**
  - Lower cash rents and higher interest rates may cause land values to decline
  - Land values may remain relatively stable
  - Depends on market's long-term views