When Grant Anderson makes the rounds to deliver final payments on what could be $400 rent checks this fall, he plans to add a word of caution to his landowners: Please, don’t get used to this. “This is top-dollar rent. A lot of guys will go broke if they promise to pay this kind of money every year, and the price of corn goes back to $2,” the Belgrade, Minn., producer says.

It was only a few years ago that rents half that level seemed like a stretch. But lease terms changed once commodity markets went wild and the competition for everything from corn to specialty crops like sugar beets and potatoes intensified. Growers like Anderson need five-year leases for rotations and to benefit from lime and proper fertilization. Such long-term commitments are challenging when it’s only money that counts and there’s a line of potential renters knocking on every landowner’s door.

To stay competitive in this environment, “we’ll need to share the good times with our landlords,” Anderson says. Frankly, when he signed 2011 leases 12 to 15 months ago, he had no idea how generous he was going to be. Most of his recent landowners are on a simple “flex”-rent formula that rewards them when commodity prices rise. It starts at a base rent of $150 an acre on irrigated land with 200-bushel corn potential, then increases $1 per acre for each 2-cent increase in corn based on the Farm Service Agency’s posted county average price. Anderson attached a summary of rents based on a range of prices plus a link to the USDA web site so landowners can see their status at any time (see table on page 28). In 2010, when cash corn prices averaged $3.54, rents ran about $200. If 2011 corn averages $7, rents will hit nearly $400. “There’s huge upside potential for landowners in this formula,” Anderson says, but he doesn’t regret sharing. “My dad always said a landowner should be entitled to a third of the corn crop, because that’s what their land contribution was worth. With $7 corn, $400 hardly seems like enough.”

MOOD SWINGS. While competition for rental land isn’t new, the stakes for cash renters like Anderson are.
Bipolar swings in commodity markets and weather have worsened since corn began its meteoric rise in 2006, which can make promising fixed cash rents 12 to 18 months in advance hazardous to your financial health.

Take the variables for 2011 crops. In July 2010, many farmers started to calculate what they could afford for 2011 cash rents. Cash corn was running under $4, and DTN’s imaginary 1,500-acre central Illinois farm, Longview Acres, was projecting a net loss of at least $30 per acre after paying a $220-per-acre rent. Fast-forward a year, and cash prices had soared to $7. The net profit potential on 175-bushel corn had ballooned to about $650 per acre—if the entire production was sold at market highs. In real life, the $680-per-acre range in profit potential shows the extreme uncertainty surrounding today’s markets, and grower returns will be all over the map. Volatility has fueled the shift to flexible cash rents that offer landowners significantly more upside potential than a standard lease, as long as they share some of farming’s revenue risks. In some cash rent battlegrounds of Illinois, 75% of all the new leases were flexible cash rents in 2010, according to surveys by the state’s farm managers and rural appraisers. Overall variable cash rent accounted for 28% of the state’s leases in 2010, up from practically zero five years ago.

Flex leases aren’t as popular in northwest Iowa, where yields are stable and ethanol plants and livestock operations keep demand humming. But Dennis Reyman, of Stalcup Ag Services, in Storm Lake, says some farm-management firms have encouraged the switch. “At least you are capturing some of the upside for landowners in a year like 2011,” he says. “Share rents or custom leases can do it, too, but this is a way to keep cash rent landowners in the game.”

In the counties surrounding Belleville, Ill., flexible cash-bonus clauses are common, and most of them triggered payments for landowners in 2010. Because of the area’s above-average yields last year, most landowners collected an extra $10 to $40 per acre on yield-only leases, the state’s farm managers report. Bonus clauses based on price and yield provided large dividends of $85 to $125 per acre in some cases, thanks to an unusual 2010 harvest price rally.

The drawback Reyman sees is that terms are open to imagination, and no two flex leases are identical. “One contract I’ve seen set a complicated 28-day period for pricing grain at local elevators, but the tenant objected because he felt he didn’t know where he stood,” Reyman says. “I used a four-day average, but a lot of tenants like to set rent, keep it simple and capture all of the upside if markets take off.”

NOT A FLEX FAN. Terry Jones, a farmer from Williamsburg, Iowa, negotiated most of his cash rents in July to get ahead financial forecasts can be hazardous to your health. Moody commodity markets meant Longview Acres, DTN’s imaginary 1,500-acre central Illinois corn and soybean farm, projected losses when rents were being negotiated in July and August 2010. A year later, profits soared to near $700 per acre. Such market volatility has increased interest in flexible cash rents.
Iowa farmer Terry Jones prefers to pay landowners a bonus rent rather than use a flex-rent agreement.

Flex rent has little appeal to Jones. He thinks growers need incentive to maximize yields with extra fertilizer applications or fungicide treatments, but would lose some of that incentive if landowners didn’t share some of the expense.

“Most of my elderly landowners prefer straight cash leases anyway, so they know what income they have to live on for the year,” he says. To keep landowners happy after a year of exceptional returns like 2011, however, he simply pays a bonus rent rather than a preset contractual figure.

Advocates say that as long as base rent is not set too high, flex terms offer an alternative to cash rents that have escalated beyond the average growers’ comfort zone. Top rents for Illinois trophy farms with corn-yield history above 180 bushels brought $357 per acre in 2011 and averaged $319 per acre, according to the Illinois Society of Professional Farm Managers and Rural Appraisers. That’s up from $183 in 2007, or a 74% jump in just four years. Even good-quality land averaged $271 per acre last year, a gain of almost $100 in the same time span.

Lender Input. But lenders may also have a say in encouraging a shift from cash to flex rents. Ross Anderson (no relation to Grant) is chief credit officer for AgriBank, the Farm Credit System’s district bank with lending institutions in 15 states. He thinks farmers who rent the bulk of their operations—maybe 80% or more—run the risk of mismatching high fixed costs with highly variable income, just like pork integrators did before pork prices collapsed in 2008.

Cash rents of $300 and up may be common as long as $5 or better corn exists, he argues, but it won’t take much change in commodity prices or normal yields to erase profit margins. In July, Ross Anderson asked credit officers in 15 Grain Belt states to consider how an abrupt drop in prices would affect the largest farms in their portfolios.

He believes many of the 5,000-acre to 15,000-acre farmers who set the pace at cash rent auctions actually pose more risk to themselves and lenders than smaller growers who have built equity by owning most of what they farm. Locking in fixed rates with multiyear leases only adds to their exposure. In the scenarios he’s run for AgriBank, Anderson thinks it’s reasonable to expect that someone who owns most of their land could have a $2-per-bushel cost advantage on 50-bushel soybeans compared to someone who rented the same ground for $215 per acre.

Bidding wars don’t hold much appeal to farm operators. “To get your foot in the door with new landlords, dollars are king,” Grant Anderson says. So far, his landowners have only experienced ever-increasing rents, but flex terms mean they will reset when commodity prices come back to earth. “What I’m striving for is a long-term relationship. Once I prove myself, I’m hoping dollars-per-acre aren’t so paramount.”

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NO TWO FLEX LEASES ALIKE

Some leases, like the one used by Minnesota’s Grant Anderson, flex simply on changes in price (see example below). Others adjust based on gross revenue using a formula of yields and prices. The most complex terms set a base rent but pay a bonus using a farm’s actual net profits.

To see sample flex-rent leases, go to the University of Missouri web site at www.extension.missouri.edu/publications/DisplayPub.aspx?P=g423.

To understand and calculate the variables in a flex lease, go to Iowa State University’s web site at www.extension.iastate.edu/agdm/wholefarm/html/c2-21.html.

Rent Rates
Amount and Payment of Rent

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$150 BASE RENT @$2.50 CORN, ADDITIONAL $1 PER ACRE FOR EACH 2 CENTS OVER $2.50 PCP AVERAGE PRICE NOV. 1, 2010--NOV. 1, 2011

FARM SERVICE AGENCY WEB SITE: https://arcticocean.sc.egov.usda.gov/acr