

# 5 Reasons for Modernizing the Farm Leasing Industry



*By Mike Downey, Land, Lease & Farm Succession Consultant*

It is estimated 70% of family farms will change hands over the next 15 years. Many of these will transition to a generation that didn't grow up on the farm or operate it themselves. This will place a greater emphasis on landlord-tenant relationships in the future, more-so than we've even seen in Agriculture. Here are our top 5 take-away's from the present-day farm leasing industry:

- 1. The most common method in establishing a cash rental rate is to charge a rate similar to what other people are charging in the area.** This comes verbatim from the 2019 Iowa State Extension Farmland Leasing Booklet, and we agree this has a huge influence on how farmland rental decisions are being made throughout the industry today.
- 2. The establishment of true market value is determining what**

**others are willing to pay. This is the public land auction approach to renting farms.** Let's establish fair market value based on what people are willing to bid in a competitive environment. We have seen an increase in such formats ranging from sealed bid, open bids, online only bids, and most recently internet companies offering bidding venues via social media.

3. **Most land rents are negotiated well ahead of when the crop is actually harvested.** This leads to a timing issue resulting in a lag in cash rental rates in relation to commodity prices and farm income. When cash rent lease arrangements first came online years ago, many rates were not finalized until after harvest when the outcome of the crops and prices were known. Now, leases are negotiated well ahead of when the crop is even planted. Most rental rates are fixed but prices and yields vary and may finish the growing season at much different levels than estimated at lease signing.
4. **The definition of "fair income" has changed as it relates to land ownership and farmland value trends.** Cash rental rates tend to follow land prices and the strong demand for farmland from non-farming groups has caused a disconnect to occur between farm profit margins and what people are willing to pay for ground. Crop share leases once dominated the leasing industry where income and expenses were simply split 50-50. Now, cash leases prevail but generally speaking, rental rates have not adjusted downward significantly compared to the respective drop in commodity prices and farm income over the last 5 years.
5. **Farmland leasing trends do not correlate well with an increased focus on Conservation.** Most in the industry recommend negotiating your rental rate every year to keep up with the volatility in market prices. This causes uncertainty in many landlord-tenant relationships in an

industry where many agricultural groups are promoting an increase in conservation and land stewardship practices. However, most conservation programs are longer term in nature, not year to year as most farm leases are handled today.

## **CONCLUSIONS**

All of these combined is promoting a trend of consolidation in production agriculture where the competitive advantage to bid on land lies with those that hold economies of scale and can afford subsidization. We have seen this consolidation affect our small towns and rural communities as operations grow larger and fewer in size. We also cannot discount the fact that both existing and young producers need to grow to remain competitive which further supports this trend. This trend will continue to threaten the integrity of what the family farm and production agriculture will look like in the future.

## **MODERNIZING THE FARM LEASING INDUSTRY**

The above land auction approach for renting farmland is touted by some as a necessary means to modernize an industry that lacks reliable and adequate information for landowners to base decisions. Is it rationale to base decisions from what our neighbors are supposedly willing to pay or what our neighbors are supposedly receiving for rent? Or, does this lead to information that may be inflated and skewed based on the influence of coffee shop talk and rumorville that some may actually interpret as reliable and accurate data?

All we know is if we continue to practice the same habits we will likely see the same results. Therefore, we wish to share with you another method for renting farmland which we believe to be a more feasible, practical, and long-term sustainable way in establishing strong landlord-tenant relationships as well

promoting consolidation in a responsibly way.

## **500 ACRE FAMILY FARM FOR RENT**

Imagine the opportunity to rent 500 prime acres where your opportunity is not how high you're willing to bid, but how well the strengths in your operation match up with the goals and objectives identified by the landowner for their farm?

We recently helped a retiring farm couple utilize this very approach. Yes, receiving a fair rental income was important to them for retirement. However, equally important were other factors such as finding a tenant that shared similar philosophies on stewardship and care of their land, timeliness, quality, good communication, as well as establishing a relationship with a family that would span to their next generation.

This retiring farmer, being a coffee drinker himself, also didn't want to create an unnecessary buzz through the countryside they have witnessed other bidding situations cause. Instead, we worked with them to establish upfront what they felt to be a fair price and terms for their farm and eliminated the bidding component from the process.

Ultimately, their fair price was 20% to 25% below the so-called "going rate" being paid by the neighbors, but in return, there would be a structure in place to allow the rental rate to be more flexible and move with the market. There would still be a base guaranteed level of income, however, their new tenant would also share with them a portion of their net returns in a profitable year. Since the lease structure is more flexible, it will allow the tenant to share a percentage of their profits in the year they are actually profitable, versus paying more rent a year later as is the case with most fixed cash leases.

The process was telling. Removing the price component from the bidding process also removed the only competitive advantage some farm operations hold in renting farmland. This also created a process more about the “why” versus a process only centered around “how much” which baffled some producers that had never seen this approach.

## **CONSIDER YOUR ROLE IN THE TRANSITION AHEAD**

This flexible lease structure is trending in the industry and now represents one-third of the leases in some regions of the Midwest. We believe it be the modern-day alternative to farm leasing with the advantages of a crop share and fixed cash lease all wrapped into one. Whether you are a soon to be retiring farmer turned landlord, the next generation to inherit farmland, or simply tired of the year to year rent negotiations please know there are other options available that may be more suitable for you and your farm over the long term.

As your family farm transitions, we hope you consider how your approach to renting farmland impacts the consolidation occurring in production agriculture and whether your lease arrangement truly incentivizes all the factors that are important to you and your farm.

If you are interested in a custom lease analysis for your farm, please feel free to email me at the contact information below.

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