

How Long Can I Afford to Lose Money on Rented Ground?



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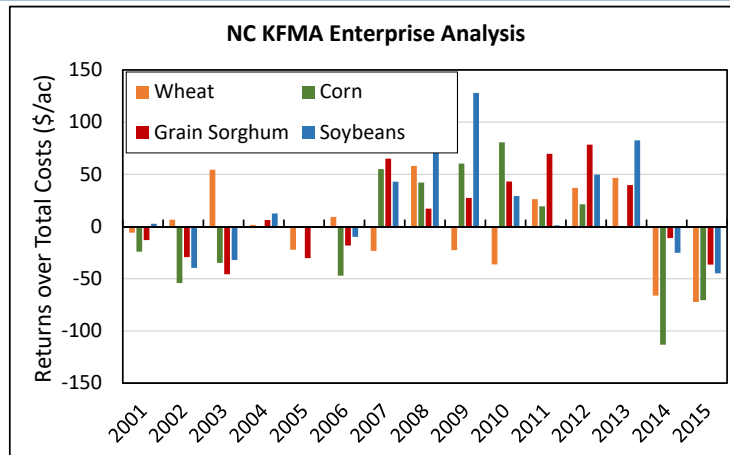


Land Values

- Affected by profitability in ag sector
- But land values do not adjust as quickly as profitability to changes in commodity prices
- Adjustment period due to
 - Long-run reason for buying and holding land
 - Expectations of buyers/sellers



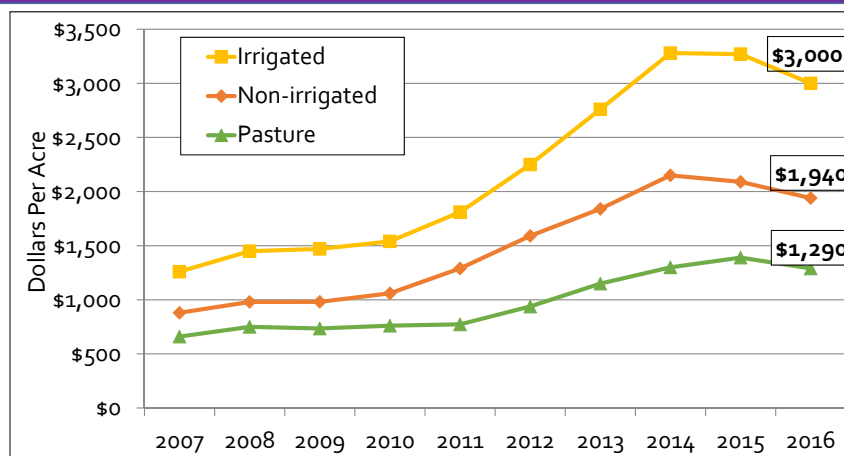
Returns to Farming



Source: KFMA Enterprise Reports (<http://www.agmanager.info/kfma>)



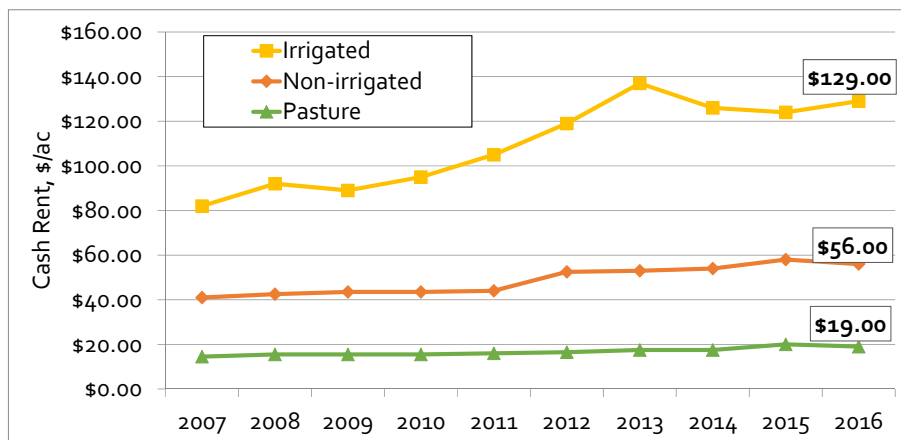
Kansas Land Values



Source: USDA-NASS



Rental Rates



Source: USDA-NASS



Rental Rates

- Do not change quickly. Why?
 - Multi-year leases (3-5 year average) with fixed cash rent
 - Negotiating a lower rent is difficult and some landowners dislike volatility in returns
 - Landowners may drop tenant rather than take a lower rate
- Adjustment in rents will get messy...



Bad Situation

- What if you find yourself in a situation where you are paying more for a leased parcel than you expect to profit from it?
- Decision to drop a parcel is multi-dimensional and varies by farm and parcel
- How do you approach this decision and what do you need to make the right one?



Decision Framework

- Time horizon for your decisions
- Short-run: cover your variable (cash) costs and you can keep going
 - Variable costs: fertilizer, chemicals, seed, fuel, labor
 - Fixed costs: depreciation on machinery, property taxes, utilities, management labor, owned land charge
- Long-run: cover all your costs (variable + fixed) to keep going
- We expect poor profitability for several more years
 - How long is the short-run for you?



What is needed to make decision?

- Data
 - Up-to-date and going back several years
 - Accrual-based balance sheet that is updated monthly
 - Have to know your fixed and variable costs
- Complete list of pros and cons specific to this parcel
 - Location of parcel relative to home operation
 - Non-pecuniary implications of keeping or losing parcel (family situation)



When to let it go...

- Negotiations haven't moved the needle on lowering rent
 - Switching to a flex lease, crop share
 - Switching to a single year rental rate rather than multi-year to allow for adjustment up as soon as profits improve
- You can't cover your variable costs of operating it
- Your lender says you have to



Decision comes down to comparing your options

Costs of you keep the parcel

- Loss of dollars from farming it
 - Covering cash costs
 - Not paying yourself, no return to owned machinery
 - Lower/no return to owned land
- Can you cut other costs to keep land base (family living expenses)
- Loss of dollars from subleasing it (might be able to lose less money)



Costs if you let it go

- Unlikely to get it back or find alternative parcel in the near future
- Own too much machinery relative to land base
 - Keep it idle if owned outright
 - Use for custom work if need to offset loan payment
 - Sell machinery: tax implications

Run the numbers...

- KFMA enterprise data from 2015
 - Corn, wheat, and soybeans at state level
 - Highest 1/3 in profitability
 - Corn: 475 acres
 - Wheat: 762 acres
 - Soybeans: 519 acres
- Decide whether to drop 300 acre parcel
 - Even crop mix (1/3)
 - Estimate that you are paying 75% more per acre than you can afford



Returns by Enterprise

Corn - 2015	\$/acre	Wheat - 2015	\$/acre	Soybeans - 2015	\$/acre
<u>Returns</u>		<u>Returns</u>		<u>Returns</u>	
Yield	124.00	Yield	44.00	Yield	45.00
Price	3.00	Price	3.75	Price	9.00
Total Returns	372.00	Total Returns	165.00	Total Returns	405.00
Total variable costs	256.09	Total variable costs	151.37	Total variable costs	183.27
Total Fixed Costs	117.82	Total Fixed Costs	78.37	Total Fixed Costs	110.51
Total Costs	373.91	Total Costs	229.74	Total Costs	293.78
Returns over TC	-1.91	Returns over TC	-64.74	Returns over TC	111.22



If you keep the land

- Look at the profitability across the entire farm
 - Using new crop bids for 2017 from Salina
- Currently losing money across entire farm:

Total Returns	512,625.00
Total Variable Costs	384,603.82
Total Fixed costs	173,037.13
Total Costs	557,640.95
Total Returns per Acre	291.93
Total Costs per Acre	317.56
Total Net Returns per Acre	-25.64



If you walk away...from unaffordable land

- Don't pay rent or other variable costs for those 300 acres
- But overhead is now spread over a smaller land base
- Result:

Total Returns	418,425.00
Total Variable Costs	273,030.82
Total Fixed costs	173,037.13
Total Costs	446,067.95
Total Returns per Acre	287.38
Total Costs per Acre	306.37
Total Net Returns per Acre	-18.99
Change in Net Returns/Acre	6.65

Walking away improves your financial situation by \$6.65/acre (long run)



If you walk away...from affordable land

- For land you are not overpaying on, profitability is reduced if you drop those leased acres

With land		Without land	
Total Returns per Acre	291.93	Total Returns per Acre	287.38
Total Costs per Acre	304.75	Total Costs per Acre	306.37
Total Net Returns per Acre	-12.82	Total Net Returns per Acre	-18.99
		Change in Net Returns/Acre	-6.16

Walking away from affordable land worsens your financial situation



What to do?

- Reduce costs using rationalization
 - Unpaid operator labor ~ “I don’t have to be paid to be here”
 - Land & interest charge ~ “The land is already paid for, so I don’t need a return”
- Reduce costs in other ways
 - Sell machinery, land
 - Reduce family living expenses
 - Intensify management decisions to lower cash costs of production

