Flex Leases: 101

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Leasing Arrangements

Leasing Arrangements

"Traditional"

- Crop share (share income and some expenses)
- Net share (share income but not expenses)
- Fixed cash rent

"Hybrid"

- Flex leases (flex on price, yield, or revenue)
- Fixed cash rent with bonus

Crop Share Leases

- Farmer and landowner share risk
  - Production risk: disease, drought, pests
  - Commodity prices
  - Input prices
- Management decisions
  - Made jointly or with a lot of communication
  - Technology adoption may change arrangement

Fixed Cash Leases

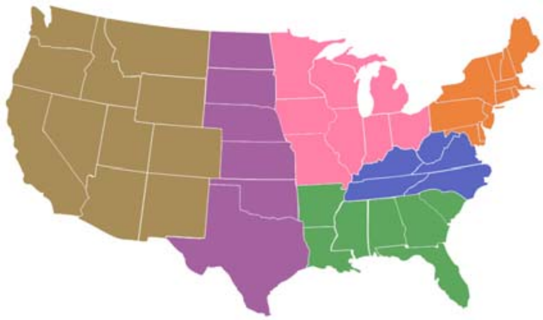
- Farmer takes on majority of risk
  - Payments are made regardless of production, prices, or costs
- Management decisions
  - Do not typically involve the landowner
  - Communication levels are often lower

Flex Leases

- Fixed cash component
  - Agreed to prior to production year
- Flexes on sources of risk
  - Production levels
  - Market prices
  - Revenue
- Combines good features of other types of leases

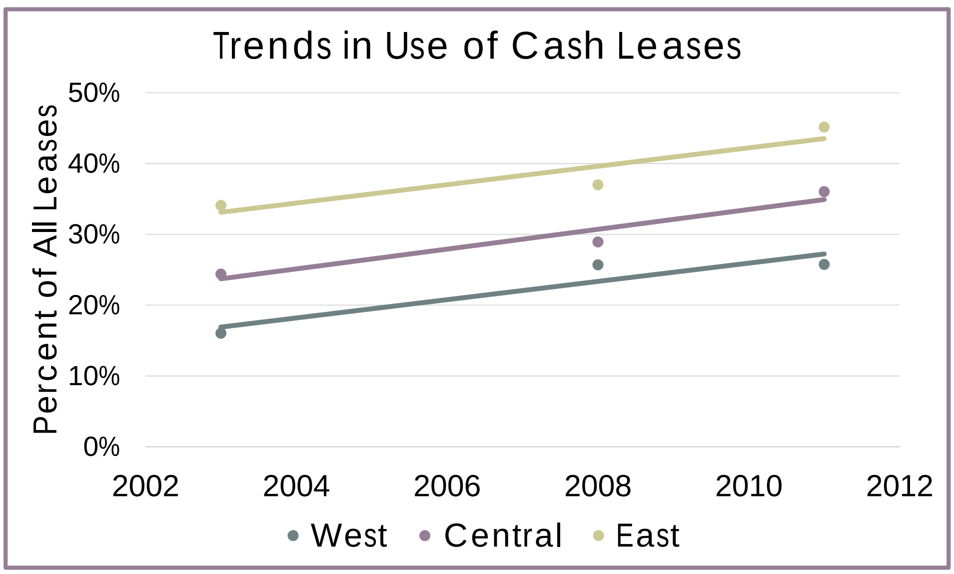
Types of Leases

Region	Cash	Share	Flex
Great Plains	64.9%	25.4%	5.9%
Midwest	74.0%	14.8%	6.6%



Source: USDA-NASS TOTAL Survey 2014

Trends in Leasing Arrangements



Source: Schlegel and Tsoodle – 2002, 2008, 2011 KAS/KSU surveys

Choice of Lease Arrangement

- Risk aversion by parties involved
  - Crop insurance reduces producer risk
  - Landowners want a guaranteed income
- Transaction costs
  - Landowners becoming generationally and geographically removed from farming
  - Producers management multiple leases/landowners

Terms of a Flex Lease

Why a Flex Lease?

- They are more complicated, so what makes it worth the effort?
  - Fluctuating markets and uncertain yields make it hard to arrive at a 'fair' rental rate
  - Payment is a function of outcomes, not prearranged values
  - Increases the amount of communication between tenant and landowner

Lease Terms

- The most common type of flexible lease is comprised of a base rent plus bonus
  - The base rent is an agreed upon value that creates a floor for the land payment
  - The bonus amount can be a function of gross revenue, prices, or yields
- Why are informal bonuses something to avoid?

Keys to a Good Flex Lease

- Transparency
  - It has to be easy to demonstrate to the landowner where the prices and/or yields come from that comprise the flex calculation
- Ease of calculation
  - Really complex calculations can be frustrating for the landowner and lead to misunderstandings

Example of a Flex Lease

Flex Example

- Base rent must be determined in advance of the season
  - Use of average USDA rental rates is common in the Corn Belt
  - Could also determine a formula based on historical gross revenues that is updated regularly

Flex Example

- Determining the base rate:
  - USDA rental rate by county
    - Released every two years, easy to update
  - Historical based on net share lease
    - Use historical APH yields from crop insurance
    - Use historical prices received by farmer
    - Agree to a net share amount (15-20% of historical gross revenue)

Flex Example

- Base rent in McPherson County
  - $60/acre (from USDA 2019 rental rates)
- Flex is a function of gross revenue in excess of total costs
  - Total costs (land cost + costs of production)
  - Assume a 35-40% flex percentage
  - If gross revenue (price * yield) exceeds totals costs, then landowner receives bonus

Flex Example – McPherson Co.

- Base amount: $60/acre
- Total costs: ($60 + $290) = $350/acre
- Gross revenue: ($3.35/bu * 129 bu/ac)= $432.15
- Flex amount: ($432.15 - $350) * 40% = $32.86
- Total payment to landowner: 60 + 32.86 = $92.86/ac

Data Sources

Determining Yield

- Make sure that you agree on the data source
  - Weight tickets (if all the crop is sold or put into commercial storage)
  - Combine yield monitors or weigh wagons
  - Storage bin capacity
  - County average yield estimated by USDA (not announced until March of following year)

Determining Price

- Should represent the potential income that could be received from selling the crop
- Typically use an average across marketing months

Determining Price – Corn Example

- Local elevator prices on:
  - April 1 (Oct. delivery) $3.27
  - June 1 (Oct. delivery) 3.85
  - October 1 (cash) 3.03
  - November 1 (cash) 3.04
  - December 1 (cash) 2.96
  - Average: **$3.23**

Other Issues

Other Considerations

- May want to have an advance payment
  - Have the base rent paid up front and the flex payment paid at harvest (or when data are collected)
- Rental rate range
  - May set a minimum and a maximum to avoid a very high or very low rent
  - Revisit the formula/base rent regularly to keep from getting out of reasonable range

Other Considerations

- Written lease is desirable
  - Outlines the specifics of the flex formula and the data sources
  - Keeps everyone in the know

Resources

Resources for Leases

- Example leases: Ag Lease 101
  - https://aglease101.org/
- Explanation of flex leases: ISU
  - https://www.extension.iastate.edu/agdm/wholefarm/html/c2-21.html
- Decision tool: KSU-Lease
  - http://www.agmanager.info/land-leasing/land-rental-rates/ksu-lease

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