Types of Farmland Leases and National Trends

Presented by...

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President and CEO
Tackling the Subject

- The evolution of the farm lease
- A review of common lease terms
- Who owns the land
- Who is buying and selling
  - How this affects rental arrangements
- A look ahead
The Evolution of Farm Leasing

- **My Dad . . .**
  - Started farming in 1937 on a share lease with horses
    - Share leases led the market into the 1980s

- **Today, cash rent is king for many farm operators**
  - Multiple landlords, complicated record keeping
  - Large machinery and large fields
    - Technology driven – GMOs – Herbicides – Less labor/acre
  - Easier to compete on cash rent
    - Share crop . . . Out farm the other guy!
    - Cash rent . . . A bigger pile of cash or a good banker!

- **Other operating alternatives give some options to younger farm operators and smaller farmers**
  - Hard to compete with more cash
Current Lease Types Utilized on 4,700 Managed Farms

Trend

44% Cash Rent

36% Crop Share

20% Blended and Custom

Based on a combination of the farm’s potential and owner’s goals

Source FNC
Today’s Operating Alternatives

• **Direct Operations**
  • Owner assumes all risk of both production and prices
  • Pays all input costs
  • Employs labor and owns equipment
  • May own livestock
  • Receives all crop and livestock revenue and government payments
  • May also do recreational leasing

*Profit varies by operation*
Best Returns . . .

• Custom Farming
  • Owner assumes all risk of both production and price
  • Landowner pays all input costs
  • Landowner hires all operations completed
  • Landowner receives all crop revenue and government payments
  • Popular with investors
Can Work Well for Young Operators

Blended Custom

Enhanced sharing of production and price risk

- Landowner pays all crop input costs and receives 80% to 90% of the crop
- Operator provides labor, machinery, fuel, and receives 10% to 20% of crop and government payment
- Operator is motivated to produce well
- Owner is rewarded for additional investment in crop inputs
Lost Favor in the 1980s

• Bushel Leases
  • Negotiated bushels per acre regardless of yield and price
  • Share risk and reward of price
    • Not eligible for government payments
  • Gaining popularity due to higher commodity prices
  • Attractive to some larger operators
Gaining in Popularity

- **Cash Rent**
  - Typically no risk in production or price
  - A fixed amount based on:
    - Your farm’s production potential
    - Price outlook for commodities
    - Government payments
    - Competition for land in your area
    - Any improvements
      - Houses, buildings, grain storage
      - Irrigation equipment
      - Tiling
    - We recommend payments in advance for the full amount.
New Trend…

Cash Rent-Plus

Base rent regardless of price or production

Plus...

Additional rent if prices rise or production is above average

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Example:

Base rent of $300 per acre (regardless of yield or price)

Plus

Additional rent of 33% of actual yield

X

Average of spring and fall crop insurance price

Less

Base Rent
An Example:

200 bushels per acre corn yield
x $6.50 per bushel
=$1,300
x 33%
= $429 per acre

$429 total rent
- $300 base rent
= $129 per acre extra rent
A Quick Look at Rents

- 2012 cash rents increased from 25% to 40% across our key crop growing territory.
- Most cash rent is paid up front on March 1.
- Many variable rate cash rents are now in use
  - Based on a percentage of the actual crop
  - Base cash rent near the market, up front
  - Average crop price determined by RP Insurance
- We expect cash rents to increase 5% to 10% for 2013
  - Revenue was protected with insurance in 2012
Participatory Leases

- Custom leases increasing in popularity
  - Higher returns than cash rents
- Predominate share lease is 50/50 in Iowa, Illinois, Indiana, and Ohio
  - Modified with less expenses to owner or a supplemental cash rent of $25 to $50 or more
- Some Bushel leases
  - Vary from 33% to 40% of average or estimated yield
Sample Farm Income Analysis

- 160 acres, 156 tillable
  - Cash rent - $350 per acre
  - Corn yield – 192 bushels per acre
  - Soybean yield – 60 bushels per acre
  - Average sales price per bushel
    - Corn $6       Soybeans $13
  - No seed costs to the owner on the crop share lease
  - Custom costs
    - Corn $85 per acre and soybeans $60 per acre
## Investment Analysis Summary

**FARM:** 160 acres x $8,500 per acre = **$1,360,000** Value of Farm

<table>
<thead>
<tr>
<th>INCOME</th>
<th>100% CUSTOM FARM OPERATION</th>
<th>80% BLENDED CUSTOM LEASE</th>
<th>50% CROP SHARE LEASE</th>
<th>35% NET SHARE LEASE</th>
<th>CASH RENT LEASE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Crop Sales</td>
<td>$151,710</td>
<td>$121,368</td>
<td>$75,855</td>
<td>$53,099</td>
<td></td>
</tr>
<tr>
<td>2. Government Payment</td>
<td>$1,808</td>
<td>$1,446</td>
<td>$904</td>
<td>$633</td>
<td></td>
</tr>
<tr>
<td>3. Supplemental/Bonus Cash Rent</td>
<td>NA</td>
<td>NA</td>
<td>$</td>
<td>NA</td>
<td>$</td>
</tr>
<tr>
<td>4. Cash Rent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$54,600</td>
</tr>
<tr>
<td>5. TOTAL CROP INCOME</td>
<td>$153,518</td>
<td>$122,814</td>
<td>$76,759</td>
<td>$53,731</td>
<td>$54,600</td>
</tr>
<tr>
<td>6. TOTAL CROP EXPENSES</td>
<td>$85,141</td>
<td>$63,553</td>
<td>$27,719</td>
<td>$9,459</td>
<td>$4,368</td>
</tr>
<tr>
<td>7. *Estimated RP Coverage at: 75%</td>
<td>$82,880</td>
<td>$66,304</td>
<td>$41,440</td>
<td>$29,008</td>
<td>NA</td>
</tr>
</tbody>
</table>

* The Revenue Protection guarantee is based on the ACTUAL PRODUCTION HISTORY

| 8. NET INCOME/TILLABLE AC       | $438                        | $380                      | $314                 | $284                | $322             |
| 9. Misc. Farm Income (Pasture, bldg., etc.) | 0                                          | 0                          | 0                    | 0                   | 0                |
| 10. Misc. Farm Expense (taxes, liab., etc.) | $4,680                                           | $4,680                    | $4,680               | $4,680              | $4,680           |
| 11. Total Management Fee        | $12,209                      | $10,988                   | $7,631               | $5,341              | $4,368           |
| 13. Return On Investment        | 4.7%                        | 4%                        | 3.3%                 | 3%                  | 3.4%             |
## Expense Analysis for Custom Farm Operation

<table>
<thead>
<tr>
<th>Item</th>
<th>Owner’s Share</th>
<th>Corn</th>
<th>Soybeans</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Crop Sales</td>
<td>100%</td>
<td>1,152.00</td>
<td>793.00</td>
</tr>
<tr>
<td>2. Seed</td>
<td>100%</td>
<td>85.00</td>
<td>40.00</td>
</tr>
<tr>
<td>3. Fertilizer &amp; Insecticide</td>
<td>100%</td>
<td>171.75</td>
<td>75.50</td>
</tr>
<tr>
<td>4. Herbicide</td>
<td>100%</td>
<td>37.00</td>
<td>37.00</td>
</tr>
<tr>
<td>5. Lime</td>
<td>100%</td>
<td>40.00</td>
<td>40.00</td>
</tr>
<tr>
<td>6. Irrigation</td>
<td>100%</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>7. Trucking</td>
<td>100%</td>
<td>28.80</td>
<td>9.15</td>
</tr>
<tr>
<td>8. Drying</td>
<td>100%</td>
<td>28.80</td>
<td>0.00</td>
</tr>
<tr>
<td>9. Storage</td>
<td>100%</td>
<td>14.40</td>
<td>7.63</td>
</tr>
<tr>
<td>10. Harvesting</td>
<td>100%</td>
<td>25.00</td>
<td>0.00</td>
</tr>
<tr>
<td>11. Custom tillage</td>
<td>100%</td>
<td>60.00</td>
<td>60.00</td>
</tr>
<tr>
<td>12. Crop Insurance</td>
<td>100%</td>
<td>50.00</td>
<td>50.00</td>
</tr>
<tr>
<td>13. Return to Management</td>
<td>100%</td>
<td>92.76</td>
<td>63.77</td>
</tr>
<tr>
<td>14. Other Expenses</td>
<td>100%</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>15. TOTAL CROP EXPENSES</td>
<td></td>
<td>633.51</td>
<td>383.04</td>
</tr>
<tr>
<td>16. Cost to produce 1 bu.</td>
<td></td>
<td>3.29</td>
<td>6.38</td>
</tr>
<tr>
<td>17. NET CROP INCOME</td>
<td></td>
<td>518.49</td>
<td>409.96</td>
</tr>
<tr>
<td>Per acres planted</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18. TOTAL GOVT PAYMENT</td>
<td>100%</td>
<td>1,166</td>
<td>641</td>
</tr>
<tr>
<td>19. NET INCOME/ENTERPRISE</td>
<td></td>
<td>$533.44</td>
<td>$418.18</td>
</tr>
</tbody>
</table>
## Cash Rent Ranges

<table>
<thead>
<tr>
<th>Area</th>
<th>Cash Rent Range (per acre)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois - Central and Northern</td>
<td>$250 to $550</td>
</tr>
<tr>
<td>Illinois – Southern</td>
<td>$125 to $300</td>
</tr>
<tr>
<td>Missouri – Eastern</td>
<td>$150 to $275</td>
</tr>
</tbody>
</table>

- Many cash rent leases switch to some form of flex/bonus payment.
- Biggest factors are variability in quality and how farm is exposed to the market.
## Cash Rent Ranges

<table>
<thead>
<tr>
<th>Area</th>
<th>Cash Rent Range (per acre)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indiana – west-central</td>
<td>$225 to $400</td>
<td>High demand for quality soil</td>
</tr>
<tr>
<td>Indiana – southern</td>
<td>$150 to $275</td>
<td>Soil drainage, water retention important variables</td>
</tr>
<tr>
<td>Indiana – northern</td>
<td>$175 to $300</td>
<td>Drainage is important in tighter soils</td>
</tr>
</tbody>
</table>
Today’s Farmer

- Two thirds of farmers classified residential
  - Average size – 160 acres
  - Account for only 6.5% of farm revenue
    - Three of four operations lose money
      - Average loss is $7,000 per year
  - Average off-farm earnings top $82,000

- Commercial farms account for 93.5% of farm revenue
  - Average 1,600 acres
  - 10% of commercial farms earn 80% of farm revenue
    - Total earning at $182,000
      - Nearly all of this income is from the farm

Source – 2008 USDA Census of Agriculture
Aging Landowners ...

- **Current farm operators**
  - Average age over 55
  - More “kids” are going home after college to farm (1970s?)
  - Most rent on retirement
    - Few sell the land
    - Land will go to non-farm kids who become non-operating landowners
      - Most will hold the land for a period of time
      - 3% to 5% sell (FNC)
The Silent Majority . . .

- **Non-operating landowners**
  - 75% over age 65 *(FNC survey)*
  - Pass land to heirs
    - Some will gift the land
    - Most cash rent
    - This is the group who sells
      - Own over 55+% of the land
      - 95% of our sales
The Land Market Today

- Land values drive rents . . .
  - High-quality farms and ranches still in high demand
    - Highest prices are at auction
      - Returns have dropped by 35% to 40%
        - Historically low cap rates from 3.25% to 4%
        - Affects yearly rents
  - More demand for lesser-quality land
    - Buyers are attracted to the better returns
    - Prices are starting to increase on the lower quality units
Who’s Selling?

- **Today’s land seller**
  - Non-operating landowners make up over 90% of the market
    - Individuals and families who have inherited the land
      - Most over the age of 65
    - Trusts and non-profits

Source FNC
Who’s Buying

- **Two types of investors in the market**
  - 1. Those who currently own land and like the asset
    - Add on acres, generally low leverage
    - Cash lease or custom
  - 2. New investors
    - Bullish on ag
    - Will leverage – 50%
    - Plan to hold for 10 years
    - Often little ag knowledge
    - Initially 5% - now 3.5% to 3.75% returns
      - Mostly cash lease their land

- 3. Farmers are spending profits and expanding
  - They are spending cash, but some are also leveraging land they already own
    - Estimate 30% – 40% of sales have leverage
  - The margins are getting thin
    - Very high operating costs
    - Little margin for error
    - Less operating debt
FNC sold 850 units, $640 million in 2012

- Active farmers dominate the buy side of the market taking 70% to 75% of the sales
  - They buy most of the auctioned properties
  - New high prices are generally set by farmers at an auction
  - A new phenomenon -- the 80+ year old cash buyer!
- Investors purchased between 25% and 30% of the properties
  - Highest east of the Mississippi and Mid South
  - Traditional investors buy approximately half
    - More likely to bid/buy at auction than non-traditional
  - Non-traditional new investors have been purchasing the other half
A Long - Term Play . . .

- Farmers
  - Own for a lifetime and beyond
  - Using a lot of cash
  - Average their cost over other land

- Investors are still basing purchases on return – 10-year window
  - Very focused on the return
  - Adjusted expectations downward to get something bought
  - Some price resistance
  - Some are using $4.50 corn to evaluate cap rates
New Money in the Market

- Fund buyers
  - Bank trust departments creating funds for client investment
  - Hedge funds adding to their holdings
  - Individuals creating funds
  - Individuals buying for the first time because they are bullish on ag
The chart compares the June 2011 and June 2012 prices for various states. The states mentioned are Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Texas, and Washington. The prices are as follows:

- Nebraska: $7,000 in June 2011, $10,000 in June 2012
- North Dakota: $6,000 in June 2011, $7,000 in June 2012
- Ohio: $6,500 in June 2011, $7,500 in June 2012
- Oklahoma: $2,500 in June 2011, $2,500 in June 2012
- South Dakota: $6,000 in June 2011, $7,000 in June 2012
- Tennessee: $3,000 in June 2011, $3,500 in June 2012
- Texas: $2,700 in June 2011, $3,500 in June 2012
- Washington: $7,000 in June 2011, $8,500 in June 2012

Source: Farmers National Company Agent Survey
Are We Focused on the Right Risks?
For the Near Term

- Good land values well into 2012
- Profit potential remains strong
- Strong demand for land to rent again in 2013
Thank You!