



IFES 2015: Evaluating Rental Agreements and Land Values with Lower Prices

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December 23, 2015

Recommended citation format: Paulson, N. "IFES 2015: Evaluating Rental Agreements and Land Values with Lower Prices." *farmdoc daily*, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, December 23, 2015.

Permalink:

<http://farmdocdaily.illinois.edu/2015/12/ifes-2015-evaluating-rental-agreements-land-values.html>

This is a presentation summary from the 2015 Illinois Farm Economics Summit (IFES) which occurred December 14-18, 2015. A complete collection of presentations including PowerPoint Slides (PPT) and printable summaries (PDF) are available [here](#).

It is well known that cash rental levels increased considerably throughout Illinois and the entire Corn Belt region from 2006 to 2014. In 2006, the average cropland cash rent in Illinois was \$132 per acre. By 2014, the average cash rent had risen to \$234 per acre, an increase of more than 77% over the 8-year period. This increase in cash rent levels is a direct result of higher commodity prices and the resulting increase in returns earned by crop producers over the same time period.

However, the 2014 crop year marked the beginning of a multi-year period of lower crop prices and returns. Average crop budgets for Illinois in 2014 and 2015 show negative returns for corn and soybean producers paying typical cash rent levels for their region. Current budget projections for 2016 suggest a third consecutive year of negative returns at average cash rent levels with corn prices below \$4.00 per bushel, and soybean prices below \$9.00 per bushel.

With the short-term outlook from the USDA suggesting that these lower prices levels will continue to persist, costs of production will need to be cut to achieve positive returns. Land costs, specifically cash rent levels, are one area where adjustments may need to be made. Since there is some evidence of this already taking place with average cash rent levels declining to \$228 per acre in Illinois for 2015. Data from the Illinois Society of Professional Farm Managers and Rural Appraisers (ISPFMRA) shows that average cash rent levels declined from 2014 to 2015, and are expected to decline again for 2016. The expectation is for rents to decline by 10% on higher quality farmland, and around 12% on average to fair farmland.

Cash rent negotiations can be difficult for both the tenant and the landowner. Open communication and the use of current and accurate information is key in coming to an agreement that will benefit both parties. Alternative lease arrangements, often referred to as hybrid or variable cash leases are becoming more and

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more common to address the uncertainties associated with crop production. These types of arrangements can provide downside risk protection to the tenant in the event of low prices or poor yields, while also increasing the rental payment to the landowner during periods of higher than expected crop revenues.

Future returns and discount or interest rates are typically thought of as the two biggest factors impacting farmland prices. Thus, the uncertainty surrounding crop returns and cash rent levels, as well as the future of interest rates, is also leading to concerns about farmland values. Expectations are for a tightening of monetary policy and an increase in interest rates over the next 3 years. However, the exact timing and magnitude of that increase is up for debate.

Using the average cash rental rate for farmland in IL, and the 10-year constant maturity US treasury rate as a discount rate proxy provides a capitalized farmland value which, historically, aligns closely with the average farmland value in IL from 1985 through 2010. Since 2010, the implied capitalized value of farmland has increased well above the actual average market value for IL farmland due to quickly rising cash rents and very low interest rates.

Thus, the short-term outlook for cash rent levels and interest rates suggests a potential decline in farmland prices. However, implied capitalized values do not suggest that farmland values are currently too high or in a bubble condition. This is in contrast to the early 1980s when actual farmland values exceeded capitalized values, or were in excess of their fundamental values. Still, some small to moderate downward pressure on land values has already been reported anecdotally in 2015. Additional adjustments will continue to depend on changes in rent levels and interest rates which will become more evident in the coming year.

Additional Resources

The slides for this presentation can be found at:

http://www.farmdoc.illinois.edu/presentations/IFES_2015

For current agricultural land rent and value information, see:

<http://www.farmdocdaily.illinois.edu/>

<http://farmland.illinois.edu/>