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# Taking Losses on Cash Rent Farmland to Avoid Losing Farmland: A Risky Strategy

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Many farmers are very reluctant to give up rented farmland because of high cash rents. Doing so foregoes future returns it economic conditions improves, as farmers giving up farmland have almost no chance of renting that farmland in the future. As a result, some farmers will consider paying cash rents resulting in negative returns in the next year believing that returns will improve in the future. If this strategy is followed, realistic expectations of future returns should be used. Prices of $4.60 for corn and $10.60 for soybeans have been suggested as long-run prices. If farmer returns are negative or low at these long-turn prices, expectations of generating positive returns in the future do not seem prudent.

## Background

In a recent survey reported on AgWeb of *Pro Farmer* and *LandOwner* subscribers here, farmers were asked if they would be willing to walk away from farmland if the cash rent is not lowered in 2016. Results were:

- 12% indicated that they "absolutely will" walk away from farmland,
- 28% indicated that they "probably will",
- 50% indicated that they "probably will not",
- 10% indicated that they "absolutely will not".

Note two items about these results. The first is that 40% of the farmers – those in the "absolutely will" and "probably will" categories – are strongly considering walking away from high cash rent farmland. In my opinion, this is a high number relative to what those percentages would have been in recent years. This higher percent signal softness in the cash rental market.

Note, though, there are 60% of the farmers – those that are in the "probably will not" and "absolutely will not" categories – not considering walking away from farmland. In many cases, not walking away is because cash rents are at levels where profits can occur at current price expectations. In other cases, farmers may be looking for improving economic conditions.

## Operator and Land Returns and Long-Run Prices

For many farmers, current cash rents are above those that will generate returns at current price expectations. To illustrate, Table 1 shows estimated 2016 operator and land returns at different prices. Operator and land returns are split between the landowner and farmer. If operator and land return is $230 per acre, and the cash rent is $280 per acre, the farmer has a loss of $50 per acre.

**Table 1. 2016 Operator and Land Returns for Different Expected Prices by Four Illinois Regions.**

| Price: Corn | Price: Soybeans | | Illinois Region[1]: Central-High | North | Central-Low | South |
|---|---|---|---|---|---|---|
| | | | Expected Yield | | | |
| | | Corn | 201 | 196 | 186 | 164 |
| | | Soybeans | 58 | 60 | 53 | 48 |
| | | | $ per acre | | | |
| $3.60 | $8.10 | | 206 | 169 | 152 | 80 |
| $3.90 | $8.90 | | 229 | 192 | 171 | 94 |
| $4.20 | $9.75 | | 268 | 231 | 205 | 123 |
| $4.60 | $10.60 | | 319 | 282 | 252 | 162 |
| $4.80 | $11.40 | | 359 | 323 | 289 | 195 |
| Avg 2014 Cash Rent | | | 293 | 265 | 243 | 163 |

[1] Revenues, yields, and costs are adapted from 2015 Illinois Crop Budgets. Besides price, revenue from ARC-CO is varied over price scenarios.

Operator and land returns are given for four regions: Central Illinois with high-productivity farmland (Central-High), Northern Illinois (North), Central Illinois with low productivity farmland (Central-Low) and Southern (South) Illinois. In Table 1, regions are arrayed from the highest yielding region on the left (Central-High) to the lowest yielding region on the right (South). Operator and land returns decrease with lower yields. Even though these are Illinois specific regions, returns shown in Table 1 are generalizable to a wider geographical area.

Non-land costs used in calculating operator and land returns come from *2016 Illinois Crop Budgets* here. For the Central-High category, non-land costs for corn are estimated at $554 per acre in 2016. Non-land costs were $615 per acre in 2013, $588 in 2014, and an estimated $581 in 2015. Therefore, the $554 per acre estimated for 2016 represents a significant reduction from costs in recent years.

Prices used in 2016 budgets are $3.90 per bushel for corn and $8.90 per bushel for soybeans. At these prices, the operator and land return for Central-High for a 201 bushels per acre corn yield is $229 per acre (see Table 1). The average cash rent for Central-High was $293 per acre in 2014. Therefore, cash rents must decrease by $64 per acre from the 2014 level for the farmer to have zero farmer return. For a farmer to have a positive return, cash rents would have to decrease more.

In many situations, there may be a reluctance to reduce cash rents by this amount. The $3.90 corn price and $8.90 soybean price may be below long-run prices. There may be hope that prices increase in the next several years.

Previous analyses (February 27, 2013) suggest that $4.60 per bushel for corn and $10.60 for soybeans. Given that a farmer believes these long-run prices are accurate, current cash rents should provide positive returns at those prices.

At a $4.60 corn price and $10.60 soybean price, the operator and land return for Central-High is $319 per acre (see Table 1). Take $70 per acre as a reasonable level of farmer return. Then, cash rent would be $249 per acre ($319 operator and land return - $70 farmer return).

Note two things about the implied $249 cash rent:

1. The farmer has losses at 2016 expected prices. A $3.90 corn price and $8.90 soybean price generates a $229 operator and land return (see Table 1), $20 less than the $249 rent.

2. The $249 implied rent is below the average cash rent. Therefore, following the strategy of hoping for positive returns requires lowering rent if rents are near or above the average levels.

**Riskiness of this Strategy**

Given expected losses, basing rents on long-run prices is a risky strategy. While these long-run prices seem appropriate, there could be a relatively long period in which prices are below the long-run average. As an example, prices were below long-run averages in the late 1990s and early 2000s. Therefore, a farmer could take significant losses for years before a positive return again occurs. Moreover, the estimation of long-run prices is not exact. Long-run prices could be lower or higher. Lower long-run prices would cause setting cash rents based on those long-run prices to be an unprofitable venture.

On the other hand, lowering cash rents by these large amounts could also be a risky strategy for landowners. Lowering cash rents will reduce a landowner returns, and it is possible that revenues may be above current expectations.

These risks suggest using a variable cash leases such as a cash rent with bonus (September 9, 2015). Base levels in the $180 to $200 per acre range could be set for farmland with expected corn yields near 200 bushels per acre. Revenues then could be shared above a base level.

**Summary**

Some farmers may be considering taking loses in 2016 on cash rent farmland so as to not lose farmland. If this strategy is based on long-run prices, cash rents may still have to come down. There are obvious risks in taking losses currently with expectations of higher returns in the future.

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