FARM BUSINESS MANAGEMENT

University of Illinois
Farm Business Management Resources

Cash Rent Leases

Department of Agricultural and Consumer Economics • College of Agriculture, Consumer and Environmental Sciences
University of Illinois at Urbana-Champaign

Farmland Leasing in Illinois

According to the 2012 Census of Agriculture, of all the land in farms in Illinois, 40 percent is owned and 60 percent is leased. There are generally two kinds of leases in Illinois, crop share leases and cash rent leases. Both of these leases have variations from the 'traditional' lease agreements.

According to a survey of farm managers who are members of the Illinois Society of Farm Managers and Rural Appraisers, for 2015 42 percent of their leases were crop share leases, 51 percent were cash rent leases and 7 percent were using custom farming arrangements. A further breakdown of the crop share leases indicated that 25 percent of all leases were traditional crop share arrangements, 11 percent were crop share with supplement rents where the operator pays an additional per acre rent amount and 6 percent were crop share with other modifications, such as the operator paying all the chemical or seed expense. Of the 51 percent of cash rent arrangements, 31 percent of all leases were traditional fixed cash rent leases and 20 percent were variable cash rent leases.

Data from the Illinois Farm Business Association (FBFM) also gives some insight to farmland ownership and leases used in Illinois. Their data indicates that on a statewide basis, 23 percent of the land farmed is owner operated, 34 percent is crop shared and 43 percent is cash rented. Their data does not break down the different types of variations from the traditional crop share and cash rent leases.

Cash Rent Leases

Cash rent leases have become the most common lease type in Illinois surpassing crop share leases according to the sources listed above. Cash rent leases have been the more common lease type in northern Illinois for a long time but have become more popular in central and southern Illinois in recent years, although crop share leases are still the most common lease type in central Illinois according to the FBFM data.

Generally, there are two types of cash rent leases. The most common is the fixed cash rent lease where the operator pays the landlord a fixed cash rent amount per acre. The other type of cash rent lease is a variable cash rent lease where the cash rent amount per acre is based on some measure of productivity of the farm, such as crop yields, grain prices or a combination of both. There are a number of methods used in calculating a variable cash rent amount. Variable cash rent leases are discussed in a different leasing fact sheet.

As mentioned above, a fixed cash rent lease calls for a fixed cash payment, generally based on a per acre amount, from the operator to the landlord. The landowner pays the real estate taxes and might incur some insurance cost for liability coverage on the land. The landowner would still be responsible for capital improvements to the land such as tiling and conservation project improvements. The landowner could receive an extra cash payment for buildings such as a house or machine shed that the operator uses. The operator receives 100 percent of the crop and government payments and pays or provides 100 percent of the crop, machinery and labor inputs. The operator generally is responsible for making all the production and marketing decisions.

The timing of the cash rent payment can vary but a common arrangement has the operator paying a portion of the cash rent in the spring, say March 1, and the final portion of the rent being paid in the fall, say November 1. The percentage of the payment made in each installment is negotiable but a common arrangement is 50 percent paid in the spring and 50 percent paid in the fall. Again, the number of payments and the percentage paid with each payment is negotiable. There has been some shifting over time to 100 percent of the payment being made in the spring, especially on professional managed farms. This takes away the risk to the landowner of the operator not being able to make the second payment due to financial difficulties. If this is the case, some reduction in the rent amount can be justified due to the fact the landowner is receiving all the rent up front well before the crop is harvested and the operator has a chance to market grain to pay the rent. Many operators will need to borrow funds to pay rents due in the spring and summer and will incur an added interest expense on the borrowed funds.

Most cash rent lease terms call for a one-year lease but it is not uncommon to have a three, four or five-year lease term. The advantage of a one-year lease term is that the cash rent amount can be adjusted for the current economic conditions. The disadvantage to a one-year lease term is that the cash rent amount does have to negotiated every year.

One of the challenges with a fixed cash rent lease is determining an equitable or "fair" cash rent amount. Many times leases are negotiated and set in the fall or winter ahead of the year of the lease. At that time, yields are unknown and crop prices can change considerably from the time the lease is signed until when the crop is marketed.

Due to the timing of setting the cash rent lease levels mentioned above, past economic returns are often used in setting current rent levels. This then can cause a lag in adjustments in the rent level to current economic conditions. This may be acceptable in a long-term operator landowner relationship but can cause an inequitable return to the operator and landowner in a short term lease relationship.

Despite the challenge in determining the fixed cash rent level, there are advantages to the landowner with this type of lease. These include:

- The amount of income the landowner will receive and the timing of when they will be receiving the income is known.
- The landowner will most likely receive some if not all of their income earlier than if the land was rented under a crop share arrangement. However, there may situations for tax planning the landowner does not want part or all of the cash rent until the year after the lease year.
- Less management input and time is required from the landowner. The landowner is not burdened with marketing grain, paying their share of the crop inputs and making crop insurance and government program decisions. This may especially be beneficial for absentee landowners or those that have little direct agricultural production expertise.
- Generally, less contact is needed with the tenant and there is less of a chance for potential conflict with the operator given the fixed terms of the lease.
- Less risk is assumed by the landowner. Their returns are not subject to yield and price volatility.
- Income from these type of leases is not subject to social security taxes. That may be the same for crop share leases depending on the level of managerial involvement from the landowner.

Potential disadvantages to the landowner with a fixed cash rent lease agreement include:

- The challenge of determining a "fair" cash rent amount.
- The possibility that the cash rent amount may need to be negotiated from year-to-year given changing economic conditions.
- The landowner may receive less of a return in good economic times than with a crop share lease.

- The landowner is giving up some control of the land in that they will have limited input on production decisions such as crop rotations, fertility application rates, etc. There is always some concern that the operator might "mine" the land and not maintain fertility levels. This however can be monitored with soil testing the land at recommended frequencies.
- If the landowner is wanting to pay social security tax on the earnings from the farm to build up their social security base, income from a fixed cash rent lease will not contribute to this.
- A cash rent lease may limit the use of some estate planning tools (special use valuation of farmland and eligibility for paying estate tax over a 15-year time period) as compared to a crop share lease. This is probably not an important factor to most farmland owners but it would be prudent to discuss this with your tax accountant and/or attorney.

Some of the advantages and disadvantages for the landowner in a fixed cash rent arrangement may have the opposite effect to the operator. For example, all the production risk is shifted to the operator with this lease type. In lower revenue years, the tenant may be paying too much rent however higher revenue years may benefit the tenant. Also, in a time period of rising grain prices and incomes rents are probably below what they should be but in times of decreasing grain prices and incomes rents are probably too high.

Even though a landowner's return is less reliant on the performance of the operator with a fixed cash rent lease than a crop share lease, the selection of the operator is still very important. It is important to have an operator you can trust and will be good stewards of the land regardless of the lease type. Most landowners want to enter into a long term arrangement with their operator regardless of the lease type.

Issued by: Dale Lattz, Department of Agricultural and Consumer Economics