Farmland IN PERSPECTIVE

Winter 2009–10 Volume 30, No. 4

GOODWIN

Goodwin & Associates Real Estate, L.L.C.

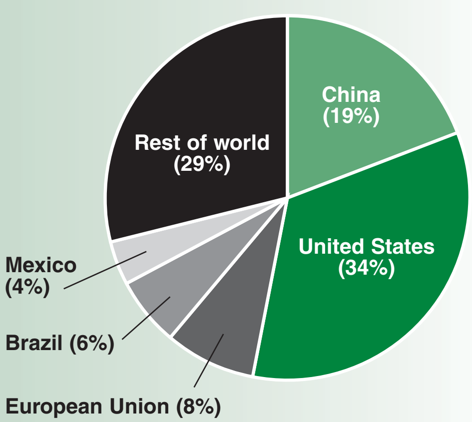
Mark Goodwin
Real Estate Broker

21036 S. States Lane
Shorewood, IL 60404
(815) 741-2226

China Shifts Corn Use to Industrial Products

Use of corn to make starch, sweeteners, ethyl alcohol, and other industrial products has accounted for most of the growth in China's corn use during the past decade. Despite this surge in industrial use, China still has a surplus of corn, according to the Economic Research Service of the U.S. Department of Agriculture.

China and the United States accounted for over half of world corn use in 2007/08



Note: 2007/08 market year (China: October–September; United States: September–August).

Source: USDA, Economic Research Service using USDA, Foreign Agricultural Service, Production, Supply, and Distribution estimates. Accessed in February 2009.

Continued on page 2

What should your cash rent be?

By Gary Schnitkey

Cash rents rise and fall with profit margins from crop farming. In recent years, determining fair cash rents has been challenging due to commodity price volatility, and these challenges are likely to continue. Yet, cash rents have been trending higher and will likely continue to do so. That said, flexibility in setting cash rents may be the best strategy for the best returns on farmland investments as returns for the 2009 crop remain uncertain due to dramatic fluctuations in commodity prices.

Historical perspective

The dramatic fluctuations began in 2006 when the increased use of corn for ethanol production prompted corn prices to increase dramatically. To maintain enough acres in soybean and wheat production to meet demand, their prices followed suit. The rising commodity prices brought record high agricultural returns for corn and alternative crops. The prices for other commodities, such as rice and cotton, however, remained relatively unaffected. In Corn Belt states such as Illinois, agricultural returns were more than three times average returns from 2000 through 2005.

The returns for 2007 and 2008 remained high, but in 2009 significantly higher input costs eroded profit even as commodity prices fell. In Illinois, for example, 2009 corn returns were projected to be 40% lower than record 2008 returns. Agricultural commodity prices fell in the fall of 2008 as the financial crisis and the U.S. recession decreased demand for agricultural products.

Production costs reached record highs in 2009 due to skyrocketing fuel and fertilizer prices. Nitrogen fertilizers are made from natural gas. Seed and pesticide prices also increased significantly.

In the fall of 2009, the corn and soybean crops contained abnormally high moisture levels. A wet spring coupled with a cool summer meant a late crop which grew more slowly than normal and may not have reached full maturity. High moisture levels, even in November and December, resulted in high drying costs. Drying costs were estimated to be at least $50 or more per acre in 2009 than in 2008 in many areas of the Corn Belt.

Continued on page 2

Cash Rent *cont. from page 1*

2010 Returns

As the 2009 crop came in, production costs for 2010 were being projected lower. Estimates put fertilizer at as much as $75 per acre less; soybeans, $35 per acre less; and wheat, $55 per acre less than the cost in 2009. Drying costs could be less too, if crop moisture levels are closer to normal in 2010.

In addition, commodity prices could rebound. Toward the end of the 2009 calendar year, 2010 production can be contracted at $4.00 per bushel of corn, $10.00 for soybeans and $5.00 for wheat. If commodity prices are stable and yields normal, 2010 cropland returns could be higher than 2009 returns and higher than the average returns in 2000 to 2005. They would not, however, reach the levels of 2007 and 2008. The 2010 cropland returns then could be good, but not great. Changes in prices, yields and costs, though, could also change this forecast.

Calculating Cash Rent

Record high cropland returns from corn and soybeans in 2005 through 2009 brought corresponding increases in cash rents. Average cash rents in Illinois, for example, increased 31% between 2005 and 2009. Reports from farm managers suggest that cash rents will remain stable in 2010.

Stable cash rents make sense, especially for farmland whose cash rent was not at the high end for 2009. Farmers who are paying average rents may have seen little profit in 2009. Profits may return in 2010 if yields are normal.

If rents were set aggressively high for 2009, some decline may be appropriate. Farmers paying high cash rents in 2009 may even incur losses for the year. Moreover, 2010 returns are not projected at 2007 and 2008 levels. If rents were to be set for the 2007–08 cropland return levels, they may not be sustainable into 2010 and beyond.

At the end of 2009, large uncertainties remained with the year's cropland returns. Commodity prices were changing dramatically within short time periods. Between September and December 2009, cash corn prices increased by more than $0.50 per bushel. Soybean prices increased by more than $1.00 per bushel between October and December. Similar moves, either up or down, are unlikely in future months, leaving large impacts on returns.

Given this uncertain environment, flexibility may be justified when setting cash rents. While cash rent levels may be higher than in 2000 through 2005, some farmers may be worried about possible losses due to quickly changing commodity prices and untimely marketing decisions. Cash rent arrangements that build in flexibility will benefit both landowners and farmers. The farmers can minimize losses in adverse price and yield environments. The landowners may obtain higher rents as farmers may be willing to set rents higher on average with the flexibility in the rental agreement.

Use of *Flexible* Cash Rent

Agricultural returns have been in a state of flux with considerable variations from one year to the next. This variability has led to difficulty in setting equitable rents for farmland and the increased use of flexible cash rent lease arrangements.

Rent types

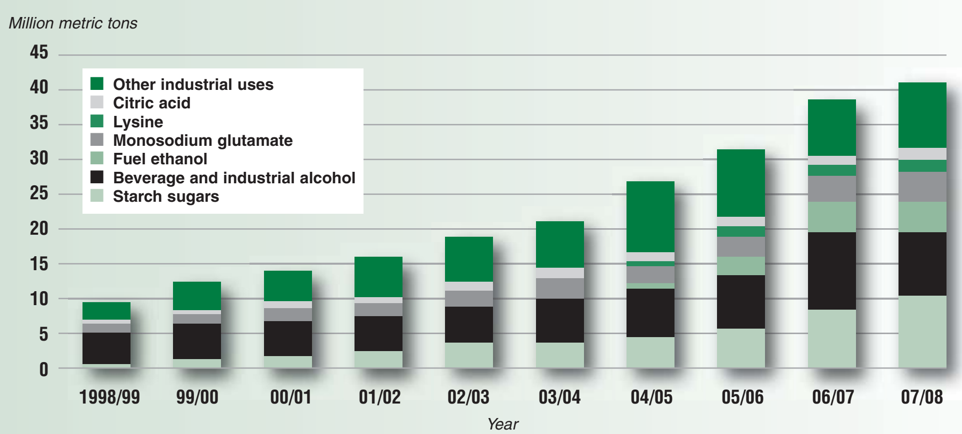
Historically, most rental arrangements between landlords and tenants have been share-rental arrangements. Under a share-rental arrangement, a landlord and tenant share in crop production, government payments and direct costs. Direct costs include fertilizer, seed, pesticides, drying, and storage. In productive areas of the Corn Belt, the share usually is 50-50, with the landlord receiving 50% of production and government payments and paying 50% of the crop costs. In lower productive areas and other regions of the United States, these percentages, as well as how specific production costs may be shared, can change.

Over time, use of share rent arrangements has decreased and cash rental arrangements have increased. Cash rental arrangements are fairly simple with the landlord receiving a fixed dollar payment for the use of their farmland, usually on a per-acre basis. This payment may be received in one installment prior to planting or in two installments: one in spring and one in the fall.

China Shifts Corn Use *cont. from page 1*

As the world's second-leading consumer and producer of corn, China accounted for 19% of world consumption in market year 2007/08. In past years, China was a leading exporter of corn, but its exports fell from a peak of 16 million metric tons (MMT) in calendar year 2003 to less than 1 MMT in 2008. To date, the country is not a significant corn importer, but many market analysts expect this may change as a result of China's rising consumption.

Growth in China's industrial use of corn encompassed a variety of products



Note: Chart shows estimated use of China's corn for industrial products. Market year is October–September.

Source: USDA, Economic Research Service using Yu. Zuojang. "Analysis on China's Corn Deep Processing Industry." International Corn Industry Conference, Dalian, China. September 2008.

ts Increases _ *by* Gary Schnitkey

For these fixed payment situations, the landlord pays the real estate taxes, and the tenant receives all revenue and pays all production costs.

The primary advantage of the cash rent lease arrangement is its simplicity. Landlords and tenants only have to agree on a rental rate, and there is no accounting for splits of yields and costs between landlord and tenants.

Handling variability

One of the major shortcomings of cash rents is their failure to adjust to changes in returns. In recent years, agricultural returns have increased. This increase has largely occurred because of the increased use of corn in ethanol production which began in 2006. As a result of this increase in use for ethanol, Corn Belt crop prices increased, leading to higher returns for these crops. Cotton and rice prices did not share in these increases.

Landlords with share rental arrangements would automatically participate in increases in return because they share in crop production. However, landlords with cash rent arrangements would not share in increased returns without adjusting their cash rental rates.

Adjusting cash rents from one year to the next presents problems because it is difficult to determine what crop prices and agricultural returns will be in the coming production year. Currently, commodity prices vary widely within short periods. In this environment, setting a "high" cash rent may result in the farmer experiencing losses. Setting a "low" cash rent may result in too low of a return for the landlord.

Flexible cash rents

To overcome this problem, the use of flexible cash rent has increased. Under a flexible cash rental lease arrangement, the total cash rent amount is not set, but it will vary with revenue. Many alternatives exist in flexible cash rent lease arrangements. Flexibility may be introduced through various factors such as general commodity price levels, area crop yields (within the framework of production costs) or a variation of each.

Under a typical flexible cash rent lease, a minimum cash rent usually is set. This can vary widely, depending on the county and state where the farm is located. If you are not familiar with cash rent levels for your area, you may be well advised to contact your local professional farm manager or county extension personnel for information or assistance.

All details should be spelled out in a written annual lease arrangement. Many farmers prefer a longer term agreement, but it is difficult with the variability of the input factors to project beyond a one-year term. If factors remain relatively constant, then it is very simple to re-write the lease for a subsequent year. Longer term leases can cause problems if factors such as commodity prices and expenses vary widely or if the owner's objectives change.

Cash rents

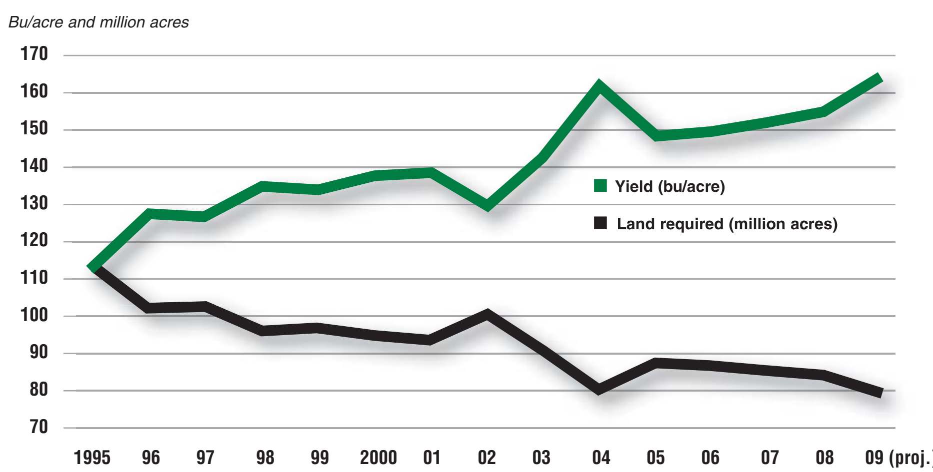
A flexible cash rent lease has advantages, but may not be for all landlords. Some landlords will prefer the known cash return associated with a cash rent lease arrangement. If this is the case, a couple points should be kept in mind. Lease lengths should be kept to one or two years. It is challenging to set a cash rent for more than a year because it is difficult to predict agricultural returns. Moreover, landlords still will need to be prepared to adjust cash rents as returns change.

Dr. Gary Schnitkey *serves as a professor and farm management specialist in the Department of Agricultural Economics, University of Illinois. His extension activities focus on risk management and farm income evaluation.*

Sustained growth in corn productivity

The 2009 corn crop may be the second largest on record for the United States. Prior to 2003, U.S. farmers produced only one corn crop that exceeded 10 billion bushels. Since then, U.S. farmers have produced two 10 billion bushel crops, two 12 billion bushel crops, and the 2009 crop will likely be their second 13 billion bushel crop. If so, it will have taken 31% less land to produce a 13 billion bushel crop in 2009 than it would have taken to grow the same-sized crop in 1995, according to the Renewable Fuels Association.

U.S. historical corn yield and equivalent land area required to produce 13 billion bu.



Source: Renewable Fuels Assn.

Farmland
IN PERSPECTIVE

Mark Goodwin & Associates Real Estate LLC
21036 S. States Ln.
Shorewood, IL 60404

ADDRESS SERVICE REQUESTED

Prsrt. Std.
U.S. Postage
PAID
Chicago, IL
Permit No. 1705

PRINTED WITH SOY INK