# Establishing a Rental Rate and Agreement That Works

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As the harvest is nearing completion, plans for next year are in the works. One of these planning tasks is rental agreements either looking for new contracts or determining what you should be renting your land fair.

"What is land renting for?" is one of the most common questions that comes through this office. With that being said, here is my advice on how I encourage producers and land owners to look at establishing a fair rental agreement. Both parties want an agreement but they generally start at different places. The lessor wants his obligations covered like property taxes and a return on investment. The lessee wants a rent that will provide him with a return on investment as compared to his risk and expenses. Since both parties have different needs it will take some time to negotiate an agreement. So here are some ways to start looking at what is a far price.

**The Base System**
This is a system where the actual value of the land determines the land rental rate. For this system you use the following formula:
***R= LV (RoI) + PT+ IC+ OC***
*R=rental rate LV=Land Value RoI= Return on Investment PT= Property Taxes per acre IC= cost of insurance per acre OC=Other misc. costs*

For example if land is worth $3000 per acre and a rate of return of 2% (general recommendation is 1-3%) is received. Property taxes are $15 per acre and $10 per acre with insurance and $5 for miscellaneous upkeep expenses per acre.
**R = $3000 (.02) +15 + 10 + 5** or a rental value of $90 per acre
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This base price looks attractive to some and not so attractive to others. With the way commodity prices have risen then fallen all within a matter of a couple months, the question remains what can the producer afford to pay? This can lead into a flexible leasing agreement. Flexible leasing agreements could be beneficial to both parties because there is higher payment for the land owner in good times and less payment for the producer in poor times. In technical terms, you are sharing in the risk potential.

**Flexible Leases**
The first type is a simple flex agreement. In this type of an agreement there is a base is established and the rental price is flexed utilizing gross income per are, per unit price, yield, or a combination. So the way this system works is establishing the baseline and multiplying by the difference ratio.

An example would be looking at a simple gross income flex agreement. From historical data, the average gross income for that crop is $250 per acre. The base rental price is $90 per acre. The actual gross income for the year was $230 per acre. To find the new rental price I use the following formula:

***R= BR*(AGI/BGI*)** **R = 90 (230/250)** or $82.80 per acre

R=Rental Rate BR= Base rental rate AGI= Actual Gross Income BGI= Baseline Gross income

The second type of flexible agreement is adjustments outside of a specified range. This can be done on either a gross income per acre, price per unit, or on a yield bases. The key to making this system work is to develop a fair range.

If our base price of $90 per acre and have a flex agreement dependant on the yield for corn and have an established range 125-175 bushel per acre. If yields are outside that range, then there would an adjustment to the base rental rate. For our example, for every 10 bushels outside that range a $10 adjustment would be made. If the yield was 187 then the new land rent would be $100 per acre and if the yield dropped to 108 bushel per acre the new land rent would be $80 per acre.

There are some key components to WRITING these types of agreements.

- Have a solid method to determine historical data that both parties can agree on
- When using a price or gross income method have a clear method of determining the current price. One way could be take the average price paid by the coop from September 15-October 15.
- Using a yield method, how will yield be calculated or determined.
- Consider putting floors and ceilings in the flex plan.

As with all types of leasing agreements, please take the time to sit down to find out what the needs and expectations of both parties are. The information provided here is a reference to start a conversation. When the terms are agreed upon, make sure that you write down the expected terms of the agreement including when payments are due, accurate descriptions of the land, length of the lease (include start dates and ending dates), and include all appropriate names and signatures.

Time spent across the table over good conversation will lead to building a rental agreement that works. Free lease forms can be found on line at www.mwps.org, click on free plans and materials.