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7-15-1993

# Land Rental Adjustment Considerations; Future Prospects for Livestock Producers

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### Recommended Citation

Pflueger, Burton and Murra, Gene, "Land Rental Adjustment Considerations; Future Prospects for Livestock Producers" (1993). *Economics Commentator*. Paper 292.

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SOUTH DAKOTA STATE UNIVERSITY  
No. 323 July 15, 1993



## LAND RENTAL ADJUSTMENT CONSIDERATIONS

by

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Wet conditions of many fields have prevented plantings, have been responsible for changes in cropping plans, and may reduce yields of some of those crops already planted. Additionally, landlords and tenants are concerned about their rental agreements and the dim outlook for tenants in making rental payments this year.

This article focuses on considerations for negotiating rent payments in a year when conditions are such that tenants may not be able to make normal rental payments. Methods of establishing flexible cash rental rates based on adjustments for both changed crop prices and crop yields are discussed. Share rental arrangements are not examined in this article as those arrangements inherently provide for risk sharing between the tenant and the landlord.

### Rent Adjustment Considerations

When a cash rental agreement has been established, and then it is discovered that the full rental payment cannot be made, landlords and tenants may want to consider negotiating new rental agreements. If the landlord and tenant already have a sound and satisfactory business relationship, the rent adjustment negotiations have a better chance of succeeding. If not, the landlord may choose to void the lease if the tenant does not pay the full rental rate--allowing the landlord to obtain a new tenant the following year.

However, the landlord must understand that if the tenant has less than full ability to make a payment in a disaster year, there may be many others who also would have limited ability to make the payment. The landlord may choose, although not required to do so, to share some of the risk of the failed crop year and determine an alternative rental rate  
(Continued on page 2)



## FUTURE PROSPECTS FOR LIVESTOCK PRODUCERS

by

Gene Murra  
Ext. Livestock Specialist

The past 12 months have been both exciting and unpredictable for the livestock sector. Many factors have combined to create the unexpected. A quick look at some of those factors, along with a discussion of what might happen in the next 12 months, is the subject of this newsletter.

### Cattle Industry

The big news in the cattle industry has been prices. Cash fed cattle prices went to a record \$87.50 this past Winter. Live cattle futures also were at record highs. Heavy snows which created terrible feeding conditions were a major contributor to pushing prices well beyond what anyone expected. Those same snows caused much higher feeding costs and created losses, not profits, even with the higher prices. Those high prices, along with low grain prices, helped move feeder cattle prices to higher-than-expected levels (but not to record levels).

In addition to the weather impact, demand for beef was strong, not only within the U.S. but also for exports, especially Japan. That demand, along with weather-reduced supplies, caused record high retail prices for beef.

The situation for next year is somewhat complicated. Recent Cattle on Feed reports support the contention that beef supplies in the coming year will be close to last year's levels. While the number of cattle on feed is above last year, recent placements of cattle on feed have been slightly below last year.

Demand for beef, while still strong, could face stronger challenges from both pork and poultry. While pork production is not expected to increase, large decreases are not expected. And, once  
(Continued on page 3)

(Land Rental ... continued from p.1)  
agreeable with the tenant. Some landlords may be willing to forego part or all of the rent payment if they are financially secure. Some may allow the tenant to make up a portion of the unpaid cash rent over a period of years in the future. Regardless of the consideration reached, both parties must be willing to negotiate in good faith.

Good faith negotiations require that everyone recognize that each party has their own cost- and income-needs to consider. Each party must be willing to share those figures with the other. It must be recognized that many land rental rates are set on what the local market can bear, rather than necessarily on what the landlord needs to cover his ownership costs or what the tenant can afford to pay based on expected production.

For renegotiation of rental rates to be successful, financial considerations will need to be shared. Tenants will need to recognize that landlords may be counting on the rental payment as a major or sole source of income and need to consider what impact the downward adjustment of rental rates would have on the ability of the landlord to meet his family living needs.

Help is available from both the Cooperative Extension Service and through the S. D. Department of Agriculture Mediation Program for tenants and landlords to work through the rental rate adjustment negotiations.

### Flexing Cash Rents

Flexible cash rental arrangements can offer advantages and disadvantages just as with other types of rental agreements. Most of the advantages and disadvantages relate to the risk and income sharing potential of the different flexing methods. Most flexible cash rent arrangements are concerned with 1) flexing for changes in price only, or 2) flexing for both changes in price and variations in yield. Flexing arrangements can be used to adjust rents higher or lower depending on conditions.

Flexing for Price can be accomplished in a variety of ways. The first would be to consider a base level of rent and then make an adjustment based on the ratio of the current year's price to the base price. This will require that the tenant and the

landlord agree to what the base rent and the base price will be. For example, they may agree that the base rent is \$53 per acre and the base price of corn is \$2.00 per bushel. Also the determination of the current year's price would be agreed on and may be the closing price at a local elevator during a specified time. If, continuing with the example, the current year's price was \$2.40, the rent adjustment would be  $\$53 \text{ (base rent)} \times [\$2.40 \text{ (current price)} / \$2.00 \text{ (base price)}] = \$63.60$ . In a disaster year, if sufficient acreage is affected, the supply of a commodity is reduced and the price moves higher.

Another method of flexing cash rental rates would be to set the rent equal to the value of a given quantity (i.e., bushels) of the crop to be produced. For example, the rent may be specified as the value of the 5,500 bushels of corn based on the average closing price at the local elevator. When using this method of flexing, the location and time period to be used for determining the rent should be agreed upon in advance and stated in the lease agreement.

One other method of flexing cash rental rates would be to adjust the rate only if the price received for the commodity is outside a specified range. For example, the agreement may state that the rent would be \$53 per acre if the current year's price is between \$1.90 and \$2.10--with the provision that for every 10 cent change in price above or below the stated range of prices, the rent would increase or decrease by a stated number of dollars such as \$3.00 per acre.

Flexing for Price and Yield requires that the tenant and landlord agree on a base rent tied to a base yield and a base price. These types of rental agreements should state specifically how the current year's price is to be determined. Also, the measurements for yield should be stated giving consideration to moisture, quality, and measurement determination such as total weight or test samples. To follow this method and continuing with the example used before, additionally assume that the base yield is 100 bushels per acre and the current year's yield is 80 bushels per acre. In this situation, the rent would then be  $\$53 \text{ (base rent)} \times [80 \text{ (current yield)} / 100 \text{ (base yield)}] \times [\$2.40 \text{ (current price)} / \$2.00 \text{ (base price)}]$  to equal a rent of \$50.88.

For a year when yields were extremely low, the rental adjustment could be illustrated as follows: \$53 (base rent) \* [10 (current yield) / 100 (base yield)] \* [\$2.40 (current price) / \$2.00 (base price)] to equal a rental rate of \$6.36. However, landlords would typically want a minimum rate below the base rent which would be paid regardless. The reason is sufficient money to pay property taxes and other direct expenses. Since many cash rental payments are paid twice per year (April and November) a flex method could legitimize a minimum April payment with no final payment made in the event of a serious crop shortfall.

Another method of adjusting rental rates would be to specify a percentage of the current crop value as the rental rate. For this method the same considerations would be required for determining current yield and price, but also the tenant and the landlord would need to agree on the percentage share of the crop used for calculating the actual rental value. The formula for this method would be: Current year's yield \* current year's price \* agreed percentage equals current year's rent. This is different from a share rental approach since both price and yield variations are considered and the tenant is required to make a cash payment to the landlord; the landlord does not market his share of the production as he would under a share rental agreement.

Should tenants and landlord want to use some type of flexible rental agreement the provisions, as in all lease agreements, should be specified in writing. Having a formal lease agreement can help clarify for both parties exactly what the provisions of the lease agreement are.

The crop year of 1993 will require that tenants, landlords, and lenders all work together to determine if rental rates need to be adjusted, and, if so, what the best method of adjustment will be. It is important to remember that the wet conditions affect a wide geographic area and that the impacts will be felt by the tenants, their landlords, their communities, and the state.

#### Reference

Fixed and Flexible Cash Rental Arrangements For Your Farm, North Central Regional Publication #75, undated.

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(Future Prospects ... Cont'd from p.1)  
again, poultry production likely will expand. Even the foreign market is subject to some changes. Economies of some of our major beef importers are not as strong as they could be and that could reduce their demand for our beef.

The feeder cattle market has held strong through the early Summer. However, much of what will happen there will depend upon fed cattle prices (now in the mid-\$70's and holding) and corn prices (up a lot in early July and subject to a weather market for another two or three months).

With all of the above uncertainty, only a fool would attempt to predict prices. Given that caveat, forecasts will be made. Fed cattle prices should hold above \$70 this Fall, with the mid-\$70's the most likely area for prices most of the time. Lowest prices should occur during the early Fall with slightly higher prices expected early in 1994. The record levels reached last year appear to be untouchable.

Feeder cattle prices should hold close to year ago levels. If grain prices move much higher, some lowering of feeder cattle prices is expected. Conversely, lower grain prices will help support feeder cattle prices. The \$100 area and above is not out of reach for 400-500 pound steer calves. If all conditions are favorable, prices much above \$100 could be seen, especially for lighter but high quality animals. The \$80's and even \$90's are possible for 600-700 pound steers. Again, much will depend upon grain and fed cattle prices.

#### Hog Industry

The big news in the hog industry is the temporary halt in expansion. The Hog and Pig report for June 1 was the first to show a decline in the breeding herd for many months. The 1 percent decline in the breeding inventory versus last year was deemed bullish enough by the trade to move prices \$4 or so higher on the futures board. That meant futures prices for Fall and Winter months close to \$45, not great but better than before the report!

Other factors noted in the pork industry this past year include continued structural changes, good demand, and prices above what many expected. The



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structural changes involve both larger scale production (sometimes through contracting) and vertical integration. While the industry has a long way to go to be like the poultry industry, major changes have occurred.

Demand for pork has been strong. The "other white meat" campaign in the U.S. and a strong export market both have helped. Also, producers and processors have made progress in providing a safe product in the form the consumer demands.

Prices in late 1992 and early 1993 were not high (no records were set as was the case for cattle), but they were above expectations. Fall 1992 prices stayed above \$40 when some forecasters expected prices in the mid-to-low \$30's.

As noted earlier, the last Hog and Pig report provided a great deal of optimism for this Fall and into early 1994. Even then, price forecasts would tend to be in the mid to maybe low \$40's for a good share of the next 6-9 months. Extremely high prices are not likely. The \$50 area seems to be out-of-reach for Fall 1993 and early 1994.

Also, it must be remembered that producers can change pork output very quickly. Just because farrowing expectations (note,

the word is expectations) are below year earlier levels, higher (or even steady) cash hog prices and lower (or continued low) grain prices could create an expansionary situation.

The structural changes noted earlier likely will continue at a slow, but steady pace.

In total, the next 12 months don't appear at this time to be either gloom and doom or highly promising. The need for good management will become more important, especially in the area of feed costs. Anyone who stands still will be losing ground.

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## ECONOMICS COMMENTATOR

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475 copies of this publication were produced at a cost of less than \$100.