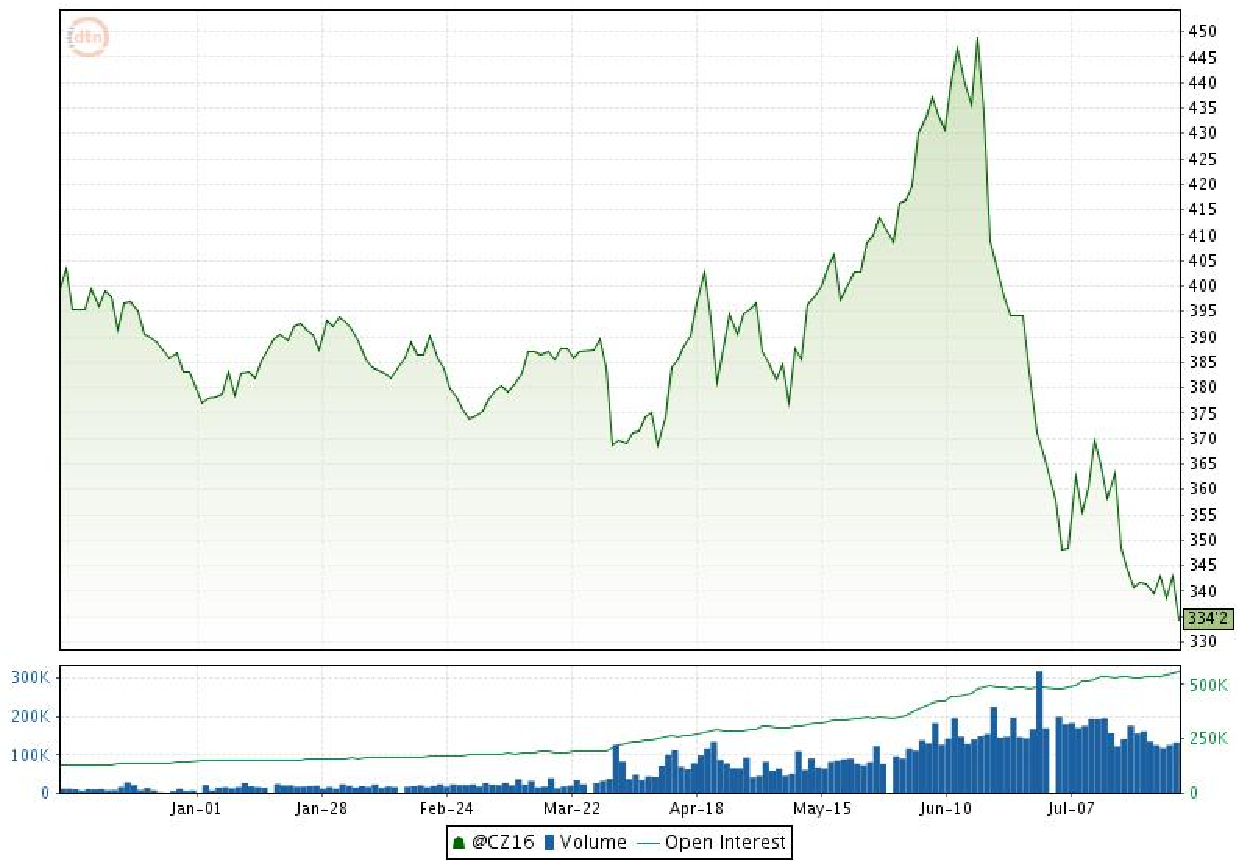
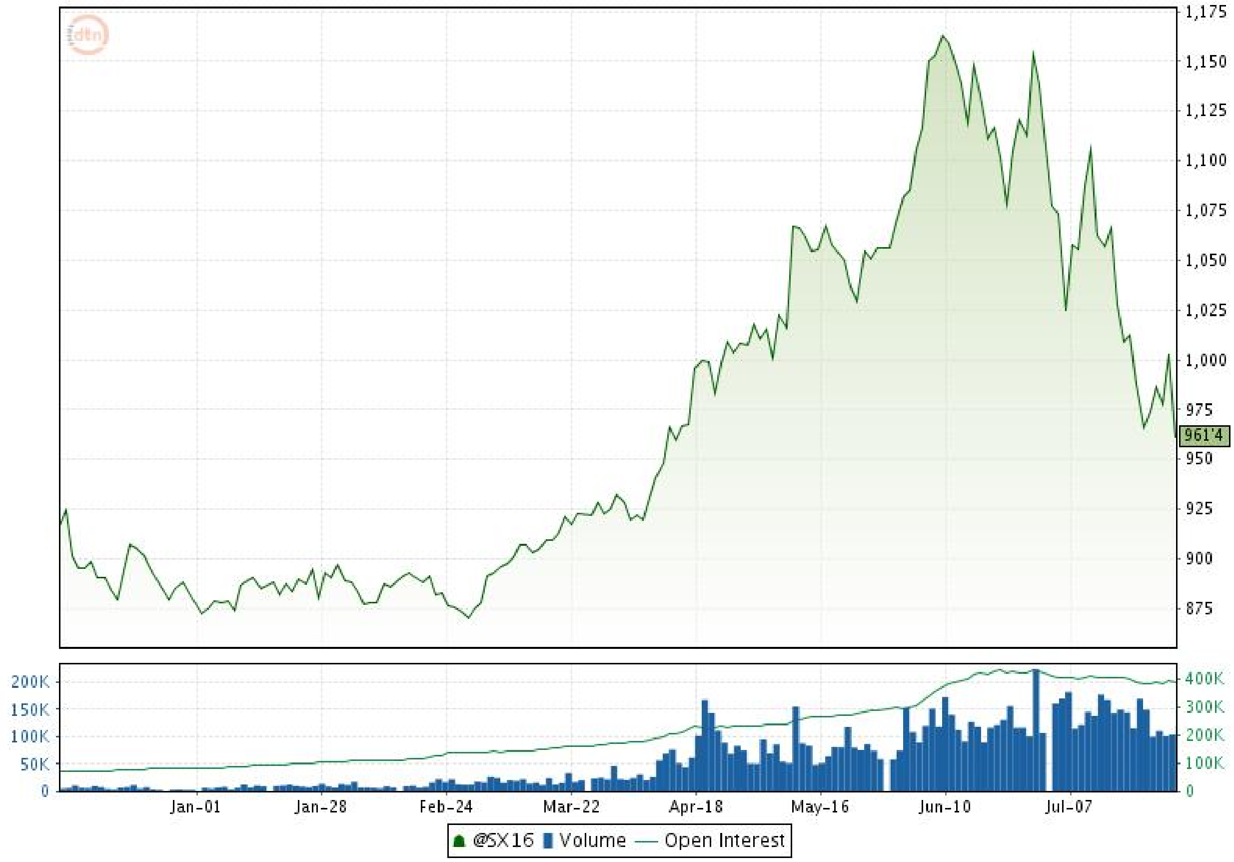
2016 Crop Outlook

The 2016 growing season has been nearly ideal for much of the Midwest. There have been areas of problems with excessive wetness in southwest Iowa, which delayed planting or required replanting. These problem areas were very few and not very widespread. Once planting was completed the growing season provided adequate rainfall for the developing corn and soybean crops. Other yield reducing factors, like diseases, insects, and damaging weather were very limited. Many farm tenants and farm operators have indicated these are the best looking crops they have seen in a long time. These conditions are great for producing crops, however anticipated large crop yields have been placing downward pressure on the commodities market. This downward pressure can be seen in the following chart for December 2016 futures price. The peak seen in the chart occurred in June. During this time fields were beginning to dry out and rain was needed across a large part of the Midwest. A very widespread rain occurred and the rally was over. The price on the right side of the chart is as of August 2, 2016.



A similar chart for soybeans is below. The soybean market has had a rally as well, but the decline has been less drastic than the corn market.



With the down trend in commodities producers are going to again be looking to reduce the cost of production for the 2017 growing season. Finding a balance between reducing inputs and reducing yields is a difficult task. Most produces have already made changes to herbicide and fertilizer programs to reduce costs. Altering fertilizer use further could reduce crop performance and reducing herbicide application could lead to the spread of herbicide resistant weeds. Both options could have negative impacts on the land. Farms that have a history of low fertility and weed control problems typically will not rent or sell for as much, as farms with good fertility and weed control. Other options for reducing production costs include seed cost, machinery cost, and land cost. With the consolidation in the seed market prices have remained high, but some price reductions are possible with companies looking to increase market share. Machinery costs can be reduced by selling equipment that does not get much use, or by using alternative farming practices, such as, switching from traditional tillage to a reduced tillage or no-till program. These farming practices vary from farm to farm and operator to operator, there is no one solution for all operators to reduce machinery costs. The other area to reduce cost is with the cost of land. With historically low interest rates refinancing farm real estate loans under new terms, has the ability to reduce land cost and free up capital for other uses. This cost saving tool only provides savings on land owned and not rented land. For many farm operators leased land is a large part of their operation. These operators will be asking the land owners for a reduction in the rental rate for 2017. It is my opinion that amount of reduction will be directly related to the quality of the property being rented. Farm properties with high yield potential will be reduced the least, but farms with lower yield potential will be larger reductions in rental rates.

In order to maintain rental rates and returns for landowners it may be a good opportunity to look at the type of lease being utilized on the property.

In recent history a traditional cash rent lease with the payment all due in the spring was the lease of choice for many landowners. This lease type may still be the best option depending on the goal and risk profile of the landowner. The advantages of this lease are knowing the exact amount of rent to be received and there is very little risk to the landowner, since there is no exposure to the commodity market or production risk. The disadvantage to this lease type is there is no upside to the rent if production or the markets increase.

There are several alternatives to the traditional cash rent lease. These include flex or variable cash rent leases, net share leases, crop share leases, or custom farming.

Flex or variable cash leases are becoming more popular in the market. These leases typically require a base or guaranteed rent due in the spring and a flex payment in the fall. The flex payment is not guaranteed but is calculated on a formula listed in the lease. The formula can include variable for commodity prices, crop production, or both. There are several methods to calculate the flex payment. The advantage of this lease type are knowing the guaranteed rent amount and having the possibility of increased rent if the market or production are good. The disadvantages to this lease is its more complicated than a traditional cash rent lease and more terms must be negotiated with the tenant. This is a good lease option if the land owner is optimistic the commodity will increase once the lease terms are negotiated.

Net share leases is like a cross between a cash rent lease and a crop share lease. A net share lease calls for the landowner to be paid based on a percentage of the gross proceeds of the crop produced on the property. Many of these leases call for 25 – 35% gross proceed from the property. Gross proceeds include crop sales, government program payments, and insurance payments. While this lease is dependent on the market and the production there is downside risk; since crop insurance proceeds are included in the calculation there is limited downside. The advantage of this lease is the upside potential, if production and commodity prices are good the rent increases also. The disadvantages to this lease type are, the rental rate is not fully known until harvest and requires extensive documentation and cooperation with the tenant.

Crop share leases were widely used in the past, but have been phased out by other leasing alternatives. Crop share leases typically called for the crop produced on the property to be split 50% to the land owner and 50% to the tenant. The crop expenses were also split, with the tenant providing the labor and machinery. Advantages to this lease type are the upside potential based on yields and commodity market. The disadvantages to this lease type are capital in required for crop inputs and returns are not realized until after harvest. There are also production and market risk associated with this lease.

Custom farming, while not a lease, is an option for some landowners. In a custom farming operation, the landowner provides all of the crop inputs, hires an operator to perform the farming tasks, and receives all of the crops produced on the property. With this type of operation, the landowner assumes all of the production risk and the commodity market risk. Crop insurance is available to reduce production and price risk, but it does not completely eliminate these risks. This type of operation is best suited for the landowner who is not opposed to risk and wants to maintain complete control of the property.

If you are interested in alternative leasing options, please contact us.

Farm real estate had seen high rates of appreciation. This appreciation has kept many potential buyers out of the market, since achieving the desired rates of return was difficult. With the recent correction in the commodity market land prices have begun to correct as well. With near record low interest rates and lower land values, there may be some opportunities to acquire additional farm real estate at discounted prices. Currently there are not many properties for sale, but we anticipate more properties to come onto the market this fall and winter.

If you are interested in acquiring additional farm real estate, please contact us to discuss your ownership goals.

Sincerely,

Adam Thien AFM