

# Farmland pressure

BY CHRISTY COUCH LEE

**W**ITHOUT a doubt, the topic of cash rental rates is a hot one. With long-run prices forecast at \$4.60 for corn and \$10.60 for soybeans, making positive returns on some high cash rental rates could be tough. But giving up rented farmland almost guarantees an opportunity lost forever — even when the markets improve.

With profit margins tightening in 2016, will farmers push to drop cash rent prices? And will landowners let them? Or will producers take the chance and risk losses in the short term, banking on land rates and markets to improve in the long term?

Ultimately, it's not a simple situation. But farmers, farm managers, real estate professionals and lenders across the state seem to be in agreement: Land values are holding strong, and cash rental rates are largely an issue to be determined by each individual farmer and landowner.

Doug Hensley, president of Gorsuch-Hensley Real Estate and Auction, Canton, says he believes the pressure on land values is greater than it has been in years.

"In Illinois and across the Midwest, we are facing the first real negative pressure that we've had with land values in several years," he says.

"Land values are driven predominantly by a couple of things related to each other: crop production in any given year and the commodity prices associated with that production, and interest rates," Hensley adds. "We have seen a remarkable run-up in land values over the past 30 years, and it's become even more pronounced since the implementation of the Renewable Fuel Standard in 2005."

However, with commodity prices on the downward trend for the past 12 to 24 months, producers could see red ink on 2015 income statements and cash flows, as well as in the coming year, Hensley says.

"I don't think we've seen a lot of pull-

## Key Points

- Land value pressure is greater than in the past several years.
- Farmers have propped up local land markets with cash.
- Professionally managed farms may see lowered cash rents.

back in the land market yet — it's actually surprising how much the land market has sustained itself," he says. "That's due, in large part, to buyers in the past 12 months being mostly farmers, and quite simply, they've used significant amounts of cash from recent profits. As soon as they run through that cash and working capital, however, I expect we're going to see things tighten up a bit more."

Remember this, Hensley says: Real estate is a local market. "People always try to paint the land market with a broad brush," he says. "But from where you're sitting now, 15 miles in any direction is a different market. What holds true in one neighborhood may not be the case just a few miles down the road."

## Cash rental rates today

Randal Fransen, president of the Illinois Society of Professional Farm Managers and Rural Appraisers and farm manager at First National Bank of Dwight, agrees that land values are holding strong in the state.

"Surprisingly, my perception is that land values have held up quite well, despite a significant drop in the value of commodities during recent months," Fransen says. "Although land is not paying as well as it did during 2013 and 2014, it is still perceived to be a stable investment with long-term advantages over many other investments."

Bill Christ, a Country Financial agent and a 2015 Prairie Farmer Master Farmer from Metamora, says he's seen land values holding steady in his area, with farms in Marshall and Woodford counties recently selling for \$11,000 to \$12,700 per acre.

"I thought the land values had soft-

ened some," he says. "But farmers are still pretty well capitalized from the past five years, it seems. And if the opportunity is there to purchase adjoining farms, they will make the acquisition. Sometimes, you only have one chance in a lifetime that land will change hands."

Ryan Aupperle specializes in farm management, real estate and appraisal — primarily for absentee landowners — for his family's business, Heartland Ag Group, in Forsyth. In central Illinois, Aupperle says, land peaked in 2012 at about \$13,000 an acre and has now softened to an average of just under \$12,000.

"We see it on pretty solid footing, with several uncertainties on the horizon, including the biggest wild card of interest rates," he says.

Hensley says many expected land values to have decreased by this point. But interest rates were projected to have increased by this point, as well.

"That just hasn't happened," he says. "I believe that if we continue with lower commodity prices, and if we do eventually see higher interest rates like we expect, we'll see even more downward pressure on land values going into the fall of 2016."

## More negotiations on the horizon?

Fransen says farmers, in many cases, may try to push for lower cash rents in the year to come. However, there is no simple, all-inclusive solution.

"In the case of a professionally managed farm, it is likely that some downward cash rent negotiation may occur," he says. "It is typical that these properties make rent adjustments — both upward and downward — at a more rapid pace than nonprofessionally managed properties."

Hensley believes cash rent rates in 2016 will likely depend, in large part, on an individual's situation.

"Think of it this way: A lot of people have traveled 10 to 15 miles to rent a decent-sized farm," he says. "In many cases, people have paid a very competitive cash rent to have the right to operate that property. As people go into 2016, however, many will re-evaluate the situation. Is it worth driving that mileage and paying that rate for this farm?"

And despite what many would believe, Fransen says, rates could possibly increase in some areas.

"In the case where a farmer has enjoyed a lower rent level over many years in a more relaxed rental arrangement, it is quite possible that the rents may remain the same, or perhaps even increase slightly if yield levels were outstanding," he says. "Although yields were generally thought to be harmed by excessive water during 2015, some communities saw amazing yield levels on quality farmland. If rents have historically been low on this type of land, the rents may hold firm, or even increase somewhat for next season."

It is important for producers to evaluate the quality and convenience of rented farms, Hensley says, to determine if operating in a low or negative margin for a period of time is worth the eventual long-term returns.

"I believe some farmers will push back on rents," Hensley says. "Whether the landlord will negotiate? That's dependent on the landlord and his or her goals."

*Lee writes from Wellington.*

■ For more on how to think like a landowner, see Page 6.

# cooker

## Pushing pencils

**L**ANDOWNERS will likely see land values softening in the years to come. In return? Balance sheets, and more importantly, cash flow statements could suffer, particularly in the land value and equipment categories.

"Balance sheets are going to see pressure," says Doug Hensley, Gorsuch-Hensley Real Estate and Auction. "What really matters, though, are cash flow and income statements. Farmers have traditionally been asset-rich and cash-poor — and that will generally continue to be true. They're really going to have to watch their working capital and their underlying ability to pay their bills."

Randal Fransen, First National Bank of Dwight, says most farmers have prepared for the current situation, and hopefully in return, their financial statements will remain healthy.

"Obviously, significant value will be lost from balance sheets of those who hold most of their asset values in farmland properties," he says. "Right now, however, it would appear that land values are not dropping dramatically and rapidly, so most of the declines occurring in balance sheet values now appear to be something that most prudent farmland owners and their lenders might have anticipated. Like any other investment, farmland will certainly cycle through periods of value increase and value decrease. This is something to be expected from most any investment."

Hensley warns farm operators to be cautious as they deploy capital in 2016. "I would make sure I have some dry powder, so to speak, so I can make a move if I need to cover expenses," he says.



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## Inside Illinois Ag

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Prairie Farmer

# Think like a landowner

BY CHRISTY COUCH LEE

**C**ONVERSATIONS about cash rents between farmers and landowners in the coming year will be many, says Ryan Aupperle, Heartland Ag Group. One viable solution: variable-rate cash leases.

"Variable-rate cash rent allows for shared risk between farmers and landowners. Flex leases allow rates to move higher and lower, according to how the gross income is being carved up," he says.

It's important to remember the landowner's perspective in these markets, too, Aupperle says. "It's easy to say landowners need to back up rents," he says. "However, they had previously enjoyed returns of about 4% on land values. Recently, the returns have been as low as 2.5%. So we do feel like landowners have shouldered some of the burden, too."

Aupperle says he's fielded many calls from farm operators asking for advice on talking with their landowners. His greatest recommendation is to evaluate entire-farm costs before making the call.

"No one wants to take a loss, but if it's a small loss on one tract — versus a loss on the entire farm — and it can be absorbed into the cost of the operation, it could be worth it to absorb that loss and keep the landowner happy," he says.

Randal Fransen, First National Bank of Dwight, agrees. Sometimes, paying a higher-than-profitable cash rent rate for a specific tract of land can be justified for a short time. Other times, that's not the case.

"Perhaps a farmer has an opportunity to retain a highly productive tract of farmland at a rental level that seems to be quite high, given the recent drop in earning power, due to weaker commodity prices," Fransen says. "This farmer may retain this land at a rate that seems quite high, but he may also have other properties rented at rates far below what the market may allow. In this case, some farmer equity may be

'burned,' but not necessarily to the point where it will cause great harm to his or her operation. Yet others will, out of a sense of pride, attempt to maintain leases when rental values are clearly not justified. In these cases, a farmer may be hurt and a significant amount of equity may be burned."

Remembering the relationship aspect of farming is critical when approaching discussions between farmers and landowners, Aupperle says. "It's hard to say you're willing to take a loss. But ultimately, this is a relationship business over multiple years. If farmers can maintain that relationship by taking a loss for a year or two, it could lead to getting the phone call when a guy retires or looks to make a change. You have to be in the situation to take that opportunity when it presents itself."

Aupperle encourages farmers to work with landowners for solutions. "We're all in this together, and we're going to have to collectively get through this cycle," he says.

Lee writes from Wellington.

## THEY SAID IT

"Going forward, we are going to be right back to where we were 20 years ago, before the boom. One has to be prudent of every investment. It seems like in the past five to seven years, you could do anything and it would work out. That's not the case anymore."

**Bill Christ, Metamora farmer**

"Transparency is important in relations with landlords. My brother farms, and one of the things I believe he does well: He communicates effectively with his landlords. He's not necessarily trying to influence them, but rather he wants to provide information to them so that they can understand the situation with their farm. This is important all the time, but especially during times of tighter margins. You must communicate."

**Doug Hensley, Gorsuch-Hensley Real Estate and Auction**

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