The Best Time to Buy or Lease Farmland

When is the best time for producers to buy farmland?

The two major things to consider are:

- the amount of profit more land will bring in, and
- the farming operation's cash flow.

If the additional mortgage payments strain or deplete your operating capital and the additional profits aren't more than enough to cover the costs, it may not be a good time to buy, no matter how reasonable the price is. You need to be able to maintain your payments and your cash flow.

Calculating the ratio between the proposed mortgage payment to the value of the fair market land rental can help you decide if buying a piece of land now is a good deal or too expensive. While profitable ratios can vary somewhat between farms, there are general rules to consider:

- A ratio of 2.0 or lower is usually a good deal.
- A ratio of 3.0 is usually the tipping point for most farms.
- A ratio higher than 3.0 is generally not a good deal.

The old adage that it takes three acres of paid-for land to pay for one additional acre is a good one to remember.

What is fair market land rental?

This is usually in the range of 18 per cent to 22 per cent of gross revenue (yield per acre times price per bushel). For example: A farm with an average wheat yield of 50 bushels and three-year average price of $7 would make the average gross revenue $350 per acre. Fair market land rental should be about $66 per acre (the range is usually about $63 to $77 per acre).

A land payment to rental ratio of 2.0 would equal a land payment of $132 per acre (based on a 25 year amortization at 6.125 per cent fixed rate) or a calculated land value of $1,668 per acre. A land payment to rental ratio of 3.0 would equal a land payment of $198 per acre or land value of $2,501 per acre. The relationship between the productive capacity of the land and its value can be estimated. This will help you decide if you should think about buying land now.

There are also several risks that need to be considered in this process. These include: lower commodity prices, rising interest rates, lower yields and how the buy will affect the key solvency ratios (debt to equity and debt to assets) and debt service margin (enough cash flow to comfortably make the payments).

Using the previous example, a 10 per cent drop in commodity prices will cut the potential land value by $250 per acre. A 10 per cent drop in yield will cut the potential land value by $250 per acre. A 2.5 per cent rise in interest rates will cut the potential land value by $496 per acre. This highlights the need for risk management planning and cost of production analysis.

Land value planning is an integral component in making financial decisions for your business. The Crop Land Rental Rate Calculator (see Resources section) enables farmers to estimate land rental values based on gross revenue, margin over operating costs, investment return of land value, and crop share arrangements.

Resources

- A Legal Guide to Plan Farmland Ownership (PDF) explains the factors you should consider when inheriting, buying, renting or leasing farmland.
- Crop Land Purchase Value Planner (Excel) enables farmers to estimate land values based on gross revenue and estimated land rental rates. Land value planning is an integral component in making financial decisions for your business.
- RentPlan Crop Land Rental Rate Calculator (Online, Excel or PDF) enables farmers to estimate land rental values based on gross revenue, margin over operating costs, investment return of land value, and crop share arrangements.

Contact us

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