FARMERS SUPPORTING INDEPENDENT AGRICULTURE

Family Farms. Local Economy. Land Stewardship.

AT WHAT COST?

How University of Illinois Farm Management Policy Harms Illinois Farming and Rural Life

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Executive Summary

The University of Illinois farm management policy is harming farms and local communities, and the policy must be changed in order to start reversing the harm that is already being done. The University of Illinois has a proud land grant tradition, and over the course of many years, over 13,000 acres of farmland have been given to the University which are spread over 44 farms in 17 Central Illinois counties. Recently, the University changed its farm management policy. The new policy rents University farmland to farmers on a high cash rent basis. The high cash rent policy transfers $1.3 million annually from tenant farmers directly to the University, while also costing local communities $3.25 million in lost spending driven by local farmers. This income transfer adds 0.03% to the University's annual $3 billion budget, but imposes high costs on farms and rural communities. In addition, the University is held up as an example by other landowners, who in turn are also seeking maximum cash rents. This exacerbates the problem for farmers and communities, multiplying the costs to both many times over as more landowners seek high cash rent leases. These high cash rent practices threaten the long term sustainability of the land, which is the key natural resource in Central Illinois. Farmers Supporting Independent Agriculture calls on the University of Illinois to return to its proud agricultural heritage and reverse the harmful farm management policy that threatens family farms and rural communities throughout Central Illinois.

Farmers Supporting Independent Agriculture (FSIA) is a faith-based community organization that works to save family farms, preserve the local economy, and promote sound land stewardship in Central Illinois. FSIA is a member organization of the Central Illinois Organizing Project (CIOP).

CIOP is a faith-based community organization comprised of over 30 congregations, civil rights, and neighborhood organizations.

Individual Impact

Robert Klemm is a Central Illinois farmer who has farmed for decades in addition to running his own tax accountancy business. Like many Central Illinois farmers he rents much of the land that he farms, and among the land he farms is a portion of land owned by the University of Illinois. Because of his dual professional roles, he has particular insight into the financial pressures facing local farmers and rural communities. The recent University farm management policy change to high cash rent leases is having a negative impact on farms and communities throughout Central Illinois. "It is important to maintain family farms in Central Illinois, because they are a real benefit to local communities," said Robert Klemm, farmer and FSIA member. "High farmland cash rent prices accelerate the deterioration of our local rural communities, and it is important for the University of Illinois to change its policy and stop renting its farmland to the highest bidder. It is harming our communities."

Robert Klemm's concerns about the University's farm management policy change are similarly reflected by concerns raised by the Illinois Farm Bureau at the time of the policy change. Dennis Vercler, Illinois Farm Bureau Spokesperson, noted that the new farm management policy "sticks the tenant with the risks involved in farming".[1] Mr. Vercler also stated that the Illinois Farm Bureau is concerned that the University's decision will influence other institutions and landowners to adopt similar high cash rent policies. "The University is viewed as a leader in agriculture, and rightfully so," Vercler said. "But this process might invite other institutions to change to a farm lease and the cash rent levels they [the University] receive might be used as a benchmark to increase rates across the region." Marla Todd, Champaign County Farm Bureau Information Director, also noted concerns about the long-term effects the policy would have on the farmland. Dodd said, "The tenants who continuously farm the land in a crop share do not see it [their tenure on the land] as a one-shot wonder. There is a real commitment to the stewardship of the land." The policy change also has implications for the future relationship between Illinois farmers and the university. "The agricultural community helps protect and provide research funding for the University," Todd said. "It would not be a good idea to dampen the relationship."[2]

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[1] "University-Owned Land Under New Lease," *The Daily Illini* (Champaign), 4 February 2005.

[2] Ibid.

University Farm Management Policy

• The University of Illinois has been given 13,000 acres of farmland, comprising 44 farms scattered over 17 Central Illinois counties, over the course of many years by generous donors.

• The University was established as a land grant university and is one of the largest landowners in Illinois.

• The recent University policy change reverses decades of sound farmland management.

• **University policy contradicts the farm management recommendations of its own College of Agricultural, Consumer, and Environmental Sciences and University Extension experts.**

<u>Current University of Illinois Policy</u>

• University owned farmland is rented on a high cash rent basis, with an impending move to highest bidder cash rent leases.

• University owned farmland will be managed to maximize returns by employing market-based management practices.

• University owned farmland will be assessed annually and sold when possible.

<u>FSIA Recommended Policy</u>

• Stop highest bid cash leases for University owned farmland. These types of leases harm family farmers and communities.

• Follow management guidelines established by University scholars and extension experts. Stewardship and conservation are as important as annual productivity.

• Stop the unnecessary sell-off of University owned farmland.

Costly Community Impact

<u>Unintended Consequences</u> – The University's farm management policy is harming family farmers and rural communities in Central Illinois. The University's high cash rent policy is intended to increase University income, but the unintended consequence is that much harm is being done to farm families and local communities.

<u>Market-Setting Behavior</u> – The University of Illinois high cash rent policy is also helping set the farmland cash rent market in Central Illinois. The University farmland management policy is held up as an example by other landowners, who then seek high cash rent on their farmland. The influence and public image of the University is helping perpetuate the influx of high cash rent farmland in Central Illinois. This influence is effectively multiplying the cost imposed on rural communities by spreading the problem. According to recent findings, a high cash rent environment costs local counties at least $10 million annually in lost business.

<u>High Cost</u> –The University's farm management policy is transferring $1.3 million in annual income from farmers to the university every year. This adds a mere 0.03% to the University's $3 billion annual budget, but is extremely costly to farmers and rural communities. The high cash rent policy redirects income from farm families to the University. Farmers tend to spend in their local communities, so any reduction in net farm income results in lost economic activity for the community. A conservative estimate is that the rural communities of Central Illinois lose $3.25 million per year as a direct result of this policy. The University policy is giving local farmers a pay cut and driving money out of our rural communities.

<u>Short-Term Thinking</u> – The University policy maximizes farmland income on annual basis. This is a shortsighted approach for managing farmland. Instead, it is important for agricultural policy decisions to instead be based on a five to ten year horizon that allows for decisions that account for the long-term productivity and environmental sustainability of farmland.

<u>Poor Stewardship</u> – Farmland was given to the University to be cared for and to provide for the financial security of the University. The University of Illinois has a proud land grant tradition, and the current high cash rent policy is damaging this legacy by threatening the soundness of University owned farmland and sowing ill will among farmers and community members.

<u>Lost Productivity</u> – The long-term productivity of the farmland is at risk due to incentives that are created by the high cash rent policy. A high cash rent environment creates incentives for the farmer to cheat. High cash rent pushes the farmer to reduce the amount spent on fertilizer and other inputs that maintain and promote soil productivity over the long run.

<u>Declining Asset Value</u> – High cash rent environments lead to poor stewardship decisions that will directly impact the asset value of University farmland. Failure to maintain soil fertility and productivity will drive down the value of University owned farmland, which also harms local communities. Productive farmland is the key natural resource in Central Illinois, and any policy decisions that threaten the productivity of this resource jeopardize our local communities.

<u>Classroom Contradiction</u> – The University's farm management policy directly contradicts agricultural instruction at the University and the farm management recommendations of agricultural experts in the University Extension. The University is a crucial voice and example, and is one of the key agricultural research centers in the country. It is important for the University to live up to its own professed standards.

Research & University Extension Findings

Research by agricultural economists and agricultural extension staff throughout the region demonstrates the potentially costly impact of high cash rent leases on tenant farmers and on the lands that they farm. Many farmers in Central Illinois own only a portion of the land that they farm every year. The rest of the land that they farm must be rented from landowners, a growing proportion of whom are absentee landowners who live many miles away from the land that they own. Farmland leases tend to be either crop share leases or cash rent leases. In a crop share lease, the landowner and farmer share production costs, including seed, fertilizer, and other input costs. After harvest, the farmer and landowner split the crop in a ratio according to the rental agreement. In a cash rent lease, the farmer pays a fixed amount per acre to the landowner. The farmer is responsible for all production costs and owns the entire crop after harvest.

More landowners are choosing cash rent leases, which transfer risk to the farmer while also transferring income from the farmer to the landowner. Over time, more farmland is being cash rented and whenever a cash rent lease is negotiated the cash rent is generally increased.[3] The farmer assumes more risk in a cash rent lease because the farmer's income depends solely upon crop harvest while the landowner has already been paid. A poor harvest or plunging commodity prices can dearly cost the farmer, and this price risk is more costly for a farmer in a cash rent lease who has already paid the landowner months ago.

Cash rent leases create incentives that threaten long-term farmland productivity. A main reason for this is that the tendency exists for the landowner to maximize the cash rent price charged to the farmer and the farmer's incentive is to maximize annual

[3] Gary Schnitkey, "Farm Economics Facts & Opinions: Farmland Leasing Update," *Farm Business Management*, Department of Agricultural and Consumer Economics, College of Agriculture, Consumer and Environmental Sciences, University of Illinois (2002) : 2-4.

production in order to ensure a profit. Neither of these tendencies are in the long-run interest of farmland productivity and environmental stewardship. In economic terms, the farmer chooses the inputs in order to maximize expected profit. Because the farmer is operating on a lease basis and does not have indefinite tenure on the land, he does not face the full long-term cost of using the land's attributes [4] As a result, the farmer is much more likely to "overutilize" inputs provided by the landowner, namely land attributes like soil moisture and nutrients. A farmer can increase his wealth by overutilizing land attributes by not planting crops in a proper rotation, overusing chemicals and fertilizers that erode the soil, tilling in ways that increase crop output but reduce soil moisture, or foregoing the application of some chemicals and fertilizers to cut short-term costs.[5] In general, many practices that increase the next year's crop may come at the expense of later crops and the long-term viability of the land.[6]

The selection of a tenant farmer through a cash rent bidding process poses the greatest danger to long-run farmland productivity. Selecting tenant farmers through a cash rent bidding process is growing in popularity with landowners. It is generally expected that an auction process will realize the maximum possible cash rent, but the high bid cash rent increases the farmer's incentive to farm in an unsustainable manner in order to realize a profit. The highest bidding farmer very well may not follow production practices that promote long-run soil productivity, practices that are in the landowner's interest.[7] A crucial issue for farmers is deciding how much to bid to cash rent farmland. There are two reasons why this is such an important decision. The first is that rented acreage makes up a substantial portion of land that a farmer farms. Second, farm profit margins are very thin for most farmers. Paying too high a cash rent price will make the farmland unprofitable.[8] High bid cash rent leases reduce tenant farmer incentives to improve the productivity and value of a property by using improved farming practices. Tenants sometimes see such improvements bid away from them, so little incentive exists to engage in farming practices that fail to add to the current year's bottom line. Open bidding for farmland also results in local bidding

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[4] Douglas Allen and Dean Lueck, "Contract Choice in Modern Agriculture: Cash Rent versus Cropshare," *Journal of Law and Economics* 35, no. 2, (1992) : 404.

[5] Allen and Lueck, 401.

[6] Allen and Lueck, 409.

[7] Bruce B. Johnson, Roger A. Selley, H. Doug Jose, and John D. Cole, "Cash Leasing of Cropland in Nebraska Dialogue," in *NebGuide*, G1387, (Lincoln, Neb.: University of Nebraska-Lincoln, Institute of Agriculture and Natural Resources, 1999, revised 2000) , 4.

[8] Gregory Ibendahl and Ronald Fleming, "What Should Farmers Pay for Cash Rents," paper presented at the Southern Agricultural Economics Association Annual Meeting, Mobile, Ala., 1-5 February 2003, 1.

wars for cash leases which can lead to excessive rent payments.[9] In local markets, current cash rent rates are no guarantee that renting the land is profitable for the farmer. Local conditions, such as land location, may drive rental rates instead of just land productivity.[10]

In recent years cash rent levels show steady increase, but at the same time overall returns to the farmer have not increased. The trend of higher cash rents means that landowners are capturing more of the returns while farmers are earning less. Over the last ten years in Illinois, cash rent bids have sometimes exceeded what is a practical level for farmers who farm rented farmland. Cash rents beyond what is practical prevent farmers from making a profit from the land they rent.[11] To stay in operation in this type of environment, farmers must either reduce costs or farm more acres.[12] Production cost reduction jeopardizes proper soil care and long-term stewardship, and the push for more acreage drives local bidding wars increasing the odds of annual loss. The recent spike in commodity prices is being used as a rationale for substantial cash rent increases, but there are some calls for caution whether the higher commodity prices are sustainable.[13] Findings indicate that long-run increases in commodity prices do not necessarily translate into higher long-run farmer returns.[14] As the commodity price level rises, production input costs and cash rent prices will most likely increase in conjunction with the rise in commodity prices. These cost increases will absorb most gains in farmer income.[15] It appears that tenant farmers will remain caught in a high cash rent environment with corresponding production cost pressures that will exacerbate damage to the long-term productivity of farmland as sustainable farming practices become too costly to maintain.

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[9] Johnson, Selley, Jose, and Cole, 1.

[10] Ibendahl and Fleming, 2.

[11] Kevin Brooks, "Your Lease Arrangement: Should a Landowner Make the Switch to Cash Rent?" *Farm Business Management*, Department of Agricultural and Consumer Economics, College of Agriculture, Consumer and Environmental Sciences, University of Illinois (2002) : 2.

[12] Schnitkey, 4.

[13] Gary Schnitkey and Dale Lattz, "Farm Economics Facts & Opinions: Are Increasing Cash Rents Justified?" *Farm Business Management*, FEFO-06-21, Department of Agricultural and Consumer Economics, College of Agriculture, Consumer and Environmental Sciences, University of Illinois (2006) : 1.

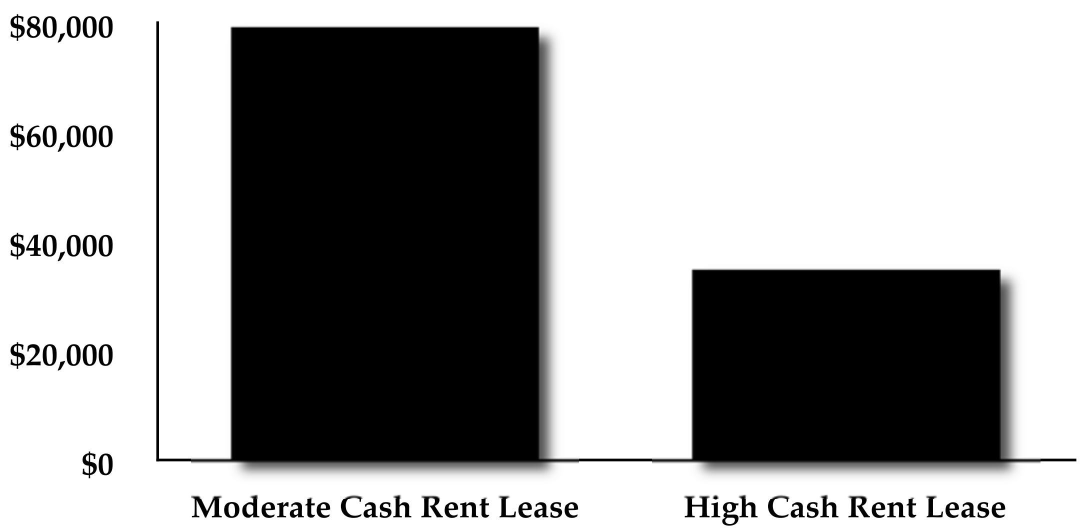
[14] Ibid.

[15] Ibid., 2.

Local Impact Case Study: Logan County

The University of Illinois farmland cash rent policy costs Central Illinois farms, farmers, and communities more than the policy gains the university. High cash rents directly transfer income from farmer to landowner, and the farmland rental environment in Logan County, Illinois serves as good case study of the impact of a high cash rent environment on farmers in Central Illinois. Logan County is an apt case study because of the unique arrangement of farm leases in the county. Due to an accident of history, about half of the county's farmland is owned by one family, and the farmland is rented on a high cash rent basis. The other half of the county's farmland is owned by a variety of landowners, and the rents for this farmland are generally moderate cash rents. According to a Logan County Farm Business Farm Management study of 2005 farm earnings, annual net farm income is cut by 55% for farmers in a high cash rent environment when compared to incomes for farmers in a moderate cash rent environment. In the 2005 study, 200 farms were surveyed with 100 high cash rent farms and 100 moderate cash rent farms. Soil quality and productivity levels were comparable between farms; the key difference was cash rent level. In the study, farmers of high cash rent farms had net farm incomes $40,000 less than farmers of moderate cash rent farms.

2005 Logan County Net Farm Income



In addition to the income impact on the farmer, there is also an income impact on rural communities. Farmers tend to spend in their local communities, so any reduction in net farm income results in lost economic activity in the community. Based only on the 200 farm sample, Logan County communities lost $4 million in income that was transferred directly from the farmer to the landowner. With approximately 600 total farms in Logan County, the total county economic impact is most likely in excess of $10 million. This is a significant loss for a county of 31,000 residents.

Agriculture is a key industry throughout Central Illinois, and the growth of high cash rent leases is common to every Central Illinois county. The economic impact in the other counties in Central Illinois is of similar magnitude to that experienced in Logan County. Farms owned by the University of Illinois are scattered throughout 17 counties of Central Illinois, and the high cash rent policy of the University farms is encouraging other farmland owners to seek high cash rent on their farms as well. It is no stretch to say that the current University of Illinois high cash rent policy is costing the counties of Central Illinois millions each year in income transferred directly from farmer to the university and also in lost business that farmers can no longer afford to conduct in local communities. The impact quickly spreads from farmer to the rest of the community and county.

Reclaiming a Proud Tradition: Necessary University Policy Changes

The University of Illinois adopted a harmful farm management policy that is costing farmers and communities millions of dollars annually. The University is a significant agricultural leader in Illinois and throughout the Midwest. The recent farm management policy change calls into question the University's agricultural leadership, and it is important for the University to reclaim and maintain this proud heritage. Farmers Supporting Independent Agriculture calls on the University to repair a broken policy in order to move toward a healthier economic and environmental future for Central Illinois farmers and communities.

FSIA Policy Recommendation:

- **Stop the high cash rent policy and the move to high bid cash rent leases, and return to a policy that reflects a desire to earn fair and consistent returns.**

- **Follow farm management guidelines which have already been crafted by University of Illinois researchers and publicized on the University's own Farmdoc website in order to change University policy to balance the need for short-term return with that of long-term fertility and sustainability.**

- **Stop the unnecessary sale of University owned farmland.**

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