



## Conservation Discussions

By Bryon Kirwan, Central National Agriculture Economist

### ***Renting Buildings-How to Calculate Options***

You are looking for ways to make your operation more efficient and profitable. In your search for options, you come across a currently unused building (e.g. barn, machine shed, grain bin, etc.) that you would be interested in utilizing as a part of your operation. How do you approach the owner with an offer for rent? What may be a fair offer, and could there be more than one value? This discussion paper is an attempt to outline and frame a discussion for both landowners and producers. The information below can be used by both parties in a rental discussion.

#### **Building Costs**

In any structure, there are ownership/overhead costs associated with the building. They include depreciation, interest, repairs, taxes, and insurance. These can be referred to as the “DIRTI-5”. Let’s look at the “DIRTI-5” and what they represent.

**Depreciation**—the mechanism that accounts for the wear and age of a building. Depreciation is also a value used in tax calculations. Buildings that are fully depreciated may still be useful. Using straight line annual depreciation cost based upon an expected 25-year life of a building, 4% would be the calculated annual depreciation cost. Specialized livestock production buildings often have a shorter expected life, hence a higher annual percentage cost.

**Interest**—expressed as the interest on a loan, or as the opportunity cost if a building is fully paid for. A 5% figure is used here as an example. This value can and will change over time.

**Repairs**—expressed as the cost of upkeep (from normal wear and tear). A commonly used budgeting figure to represent repairs is 3% of the cost of a building. Specialized buildings may have a higher annual repair cost.

**Taxes**—represent the property taxes paid on the land and building. A common budgeting value to use is 1% of the cost of a building.

**Insurance**—if the actual insurance cost is not known, it can typically be approximated with the formula: *replacement cost* x 1% on the building in question (on depreciation-based policy).

These percentages in this example total 14%. For a building that had an original cost of \$100,000.; the estimated annual rent would be calculated as:  $\$100,000 \times 14\% = \$14,000$ .



This calculated value may be higher or lower than the situation would indicate for a given building. At a minimum, owners desired rental rates cover at least the variable cash costs to entice them to want to consider renting a building. Those costs include repairs, taxes, and insurance, or 5% based upon the above example; calculated as  $\$100,000 \times 5\% = \$5000$ .

### **Enhancing Returns**

From a renter's perspective, evaluation is typically framed on 'what can I afford to pay'? This value is based upon what the individual believes the addition of the facility will add to the production regimen; or based upon what savings may be achieved by having access to a building. These values can be calculated by looking at a partial budget analysis, revolving around the expected change in the operation. This same formula could be used for expanding production (such as adding livestock), or for avoiding expenses (such as keeping machinery under cover). This is the basis for partial budget analysis, where individuals look at "what changes" as part of an informed decision-making process.

A formula to calculate this change can be represented by:

$$(Current\ Return + Expected\ Gain - Rent) - (Current\ Return) = Net\ Change.$$

To be economically advantageous for someone to rent a building, they would want to be able to achieve a gain or efficiency, but not have to pay all the expected gain in the form of rent.

### **Market Rates**

In some locales, there may be established 'market values' for rent based upon a number of factors. These commonly include dollars per head per month, dollars per square foot, cents per bushel per month, or other agreed upon measures. These figures may be available from Extension offices, Farm Management Companies, rural appraisers, or local banks. Another measure may be provided by surveys in some states (such as the Iowa State Farm Custom Rate Survey).

These types of data sources typically have values already calculated and the owner and renter can simply look at the values expressed and determine if they are representative of the discussion they are having.

### **Summary**

These discussions do not reflect all the possible methods to determine building rent; but rather some of the more common methods. There is no end to the methods and variations two willing parties can incorporate to come to an agreement on a rental arrangement. At the end of the discussion, what is most important is that there is agreement between the parties as to the terms, (including ending, renewal, sale, and termination agreements) and the terms should be written down so there is no misunderstanding later.

References taken from Extension publications in: Ohio (<https://u.osu.edu/ohioagmanager/2014/10/29/what-is-a-fair-rental-price-for-farm-buildings/>), Iowa Ag Decision Maker (<https://www.extension.iastate.edu/agdm/wholefarm/html/c2-26.html>), and Missouri (<https://extension.missouri.edu/publications/g427>).