

2015

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Recommended Citation

Edwards, William (2015) "Managing finances with high grain prices," *Ag Decision Maker Newsletter*: Vol. 11 : Iss. 7 , Article 3.

Available at: <http://lib.dr.iastate.edu/agdm/vol11/iss7/3>

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Managing finances with high grain prices

by William Edwards, extension economist, 515-294-6161, wedwards@jastate.edu

Columns about financial management on the farm usually appear when commodity prices are low, interest rates are high, or some other condition puts a squeeze on cash flow. Over the long run, however, how we manage when prices are high may have even more impact on the economic viability of the farm business. No one wants to miss the boat when prices are good, but sinking the ship is even worse.

Another Crisis?

Current grain prices are as attractive as we have seen for many years. And the best part is that they are caused by an increase in demand, not a short crop, as is often the case. If the world's appetite for energy remains at current levels, high prices may persist. On the other hand, there are always some "old-timers" around who remember the late 1970s when export expansion fueled an explosion in farm commodity prices, and the U.S. was poised to feed the world for many years to come. A combination of factors turned the boom into a bust, and financial stress permeated the farm sector during the 1980s.

Are current conditions similar to the 1970s? The strong increase in demand for grains and oilseeds is similar, though for different reasons. However, we have not had any short crops or grain embargoes, and the general inflation rate in the economy has remained low and steady. The average ratio of farm liabilities to assets for Iowa farms in 1970 was 21 percent. By 1985 it had risen to 34 percent. At the beginning of 2006, though, it was only 11 percent. Most Iowa farms have a substantial equity cushion.

Grain farms, at least, are certainly looking at improved cash flows and farm income for 2007, barring severe crop losses. How should a bumper crop of cash receipts be invested? Here are some possibilities.

Pay Off Debt

Although the average Iowa farm has a low debt-to-asset ratio, there are still many operations that have substantial liabilities from purchases of land, livestock, machinery or other fixed assets. Paying off debt ahead of schedule will reduce interest costs down the road, and provide a cushion when leaner years return. Compare

interest rates on all loans, and see which ones allow for early repayment without penalty. Remember that reducing debt carries a guaranteed rate of return equal to the interest rate on the borrowed funds.

Extra funds can be used to reduce operating lines, and create a larger credit reserve for emergencies. The "current ratio" is the value of current assets like cash, stored grain, market livestock and supplies, divided by debt payments and accounts payable that are due in the next 12 months. Most lenders like to see a current ratio of 2.0 or larger. The dollar difference between current assets and current liabilities is called "working capital," and should be equal to at least 25 to 35 percent of annual gross revenues for most farms.

Pay Cash

Many farming operations will look to replace depreciated assets such as machinery and equipment in the next few years. Instead of financing such purchases with credit, cash receipts may be sufficient to make the trade. Operators who have been leasing machinery may find this is a good time to switch to ownership and build up some equity in their equipment line. If cash is not sufficient to finance the entire purchase, a larger than usual down payment can make the debt easier to service in the future.

Land purchases look very tempting today, despite (or maybe because of) rapidly increasing land values. Increased revenue from high grain prices will eventually be bid into land prices and cash rents—it is happening already. Realistically, it doesn't take any new management skills to produce corn and soybeans for ethanol or biodiesel, but it does take access to land. Thus, a larger proportion of net farm income will accrue to land ownership and a lower proportion will accrue to labor and management.

Budget carefully when financing land purchases. Will it take a profit margin equal to 2006 or 2007 levels to meet future payments? Or can you make it cash flow under more typical economic conditions? Farm land mortgages represent a long-term commitment. Purchasing fewer acres with a higher down payment can lower financial risk.

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Stay Flexible

Rental rates have also been pushed up by bullish grain markets. Unlike land purchases, most leases obligate the operator for only one year or a few years. Given the uncertainty about where "fair" rental rates should be, many tenants and landowners have agreed on flexible cash rent agreements, with the final rent established according to actual prices and yields. The ISU Extension Ag Decision Maker website has more information on flexible leases (see Flexible Farm Lease Agreements, File C2-21, www.extension.iastate.edu/agdm/whole-farm/html/c2-21.html).

Spreading net worth over more crop acres can have the same "leverage" effect as borrowing more funds. The average net worth per crop acre for Iowa farmers is around \$1,000. Values substantially below this mean that small variations in the market will have a larger effect on the farm's equity.

Finally, it doesn't hurt to have a little fun when extra cash is available. Take that vacation you have always wanted, or remodel the kitchen. You have earned it!

New hybrid not approved in international markets, farmers must keep seeds separate

DES MOINES - Iowa Secretary of Agriculture Bill Northey today encouraged Iowa farmers planting corn from Syngenta with the new "AgriSure™ RW" trait, which is resistant to rootworm, to check into marketing restrictions they will face during harvest this fall.

Sure™." The safest option available to farmers is for them to feed it to their own livestock.

"AgriSure™ RW MIR 604" has been approved by the USDA's Animal and Plant Health Inspection Service for use in the United States, but the product has not yet been approved for use by a number of countries around the world.

A major market disruption would result if "AgriSure™ RW" is found in the export channels or by countries that have not yet approved of its use. Additionally, biotech missteps may lead to additional regulation as well as longer waiting periods in the future for international acceptance.

"New technology, like corn that is resistant to rootworm, has been a huge benefit to farmers and it is important that we continue pursue this technology in a responsible way if farmers are going to meet their mandate to feed and now fuel the world," Northey said. "But, it's critical that Iowa farmers understand the restrictions that they will face as they try to market 'AgriSure™ RW' this fall and the potential enormous negative effect on our export markets if it is not handled properly."

"Syngenta has assured me that they are confident that this event can be introduced without incident and it's important they are right," Northey said. "Many experts and industry leaders have expressed concerns that Syngenta has rushed this hybrid to market and I hope those concerns aren't proved to be justified."

Since "AgriSure™" is currently only approved for domestic use, farmers will be responsible for finding markets that only serve domestic users when marketing their crop this fall. This includes Dried Distillers Grains (DDGs) produced from "AgriSure™ RW" corn by ethanol plants.

The National Corn Growers Association has requested that Syngenta not release the trait this planting season based on the current lack of full Japanese approvals. Japan is the U.S. leading export market and accounts for nearly 5 percent of total U.S. production. According to USDA, approximately 20 percent of the corn crop in America is exported annually.

Currently, it is unknown how many feed mills, ethanol plants and elevators in Iowa are willing to take "Agri-

It is likely many international markets would be closed if "AgriSure™ RW" is found in shipments to Japan or other countries that have not yet approved of its use.

It's important that farmers pay close attention to the "communication and commitment" form they signed when purchasing the product and to double check

New hybrid not approved for international markets, farmers must keep seeds separate, continued from page 5

to see limitations placed on them by the agreement. Farmers may also want to mark the planting locations on their farm maps to track of the "AgriSure" plants at harvest.

The co-mingling of corn at elevators and the increasing amount of DDGs from ethanol plants that are being exported makes the separation of "AgriSure™" corn from varieties that have been approved for export very difficult.

The rapidly changing ethanol industry is causing companies that haven't exported corn or DDGs in the past to examine international markets as a possible new destination for these products. As a result, some elevators and ethanol plants that have not exported in the past may be looking to in the future.

"The best advice for farmers that have already pur-

chased or planted this hybrid is for them to contact their elevator or feed mill and to stay in touch with them regularly until they deliver this fall," said Northey. "It's vitally important for all farmers to understand the restrictions that they will face this fall and are preparing now to deal with them."

Farmers with questions or concerns can learn more on Syngenta's website at www.agrisuretraits.com or by calling a toll free line at 1-866-796-4368.

Farmers with questions or concerns can contact the Iowa Department of Agriculture and Land Stewardship at (515) 281-5321, the Iowa Corn Growers Association at (515) 225-9242 or the Iowa Attorney Generals Office at (515) 281-5351. The Iowa Corn Growers also have a "Know Before You Grow" website with more information on all biotech hybrids that can be found at www.iowacorn.org.

Updates, continued from page 1

Internet Updates

The following updates have been added to www.extension.iastate.edu/agdm.

Setting Your Price – C5-17

Commodities versus Differentiated Products – C5-203

Demand – C5-204

Decision Tools

The following decision tools have been added to www.extension.iastate.edu/agdm.

Cash Flow Budget - multiple crops and livestock – Use this Decision Tool to calculate a detailed cash-flow budget for your farm with multiple crops and livestock.

... and justice for all

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