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Financial management with high prices

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2011 ACRE enrollment deadline nears, continued from page 2

Collecting a 2011 ACRE payment for soybeans is possible but not likely. The 2011 Iowa revenue guarantee increases to $479.50 per acre for beans using a 50.5 bushel per acre average for the 5-year Olympic average yield times a 2-year simple average cash price of $10.55 per bushel times 90 percent.

Soybean Example: Suppose in 2011, Iowa produces a final state soybean yield equal to the 5-year Olympic average state bean yield of 50.5 bushel per acre. The national average cash price for the 2011 marketing year would have to drop below $9.49 per bushel ($479.50/A divided by 50.5 bu/A). In February 2011 USDA forecast a national average cash price of $13 per bushel for the 2011-12 marketing year.

The potential for 2011 ACRE payments seems limited, especially in Iowa which leads the nation in both corn and soybean production. Should Iowa have a 2011 final state yield that is below the 5-year Olympic average yield, the likelihood is national prices would be higher. Thus, with tight U.S. ending stocks forecast for the 2011-12 crop marketing year, the probability of triggering 2011 ACRE payments seems quite low.

For ACRE analysis go to Iowa State University Extension's Ag Decision Maker site:
www.extension.iastate.edu/agdm/crops/html/a1-45.html
www.extension.iastate.edu/agdm/crops/html/a1-33.html

Financial management with high prices

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

Rarely do Midwest agricultural producers see above average prices for both grains and livestock at the same time. Even though prices of feed, seed and fertilizer are also at historical highs, many farm families will find themselves with more than the usual amount of cash left over in 2011.

Much has been written about financial management strategies when times are tough. In reality, the most important financial decisions are often made when times aren't so tough. As one ag lender said, "Most bad loans are made in good times." So how can farmers position themselves for the inevitable downturn?

Replace assets. Updating the machinery line and replacing equipment now will lower cash flow requirements in the future. It is possible to "live off depreciation" when margins get tighter. But don't invest in larger machinery unless you really need the extra capacity. And use equity dollars as much as possible.

Expand cautiously. Many farmers want to invest extra cash in land, but when everyone is looking to buy, prices rise rapidly. Buying land with 50 percent or more equity will help ensure that the payments will cash flow even under lower prices. The same holds true for livestock facilities. Highly leveraged expansion projects during high price periods often come on line just in time for lower selling prices. Borrowing to grow the business is acceptable, but keep the ratios in line.

Improve efficiency. Look for ways to invest in cost-saving technology. Innovations like automatic guidance systems and seed shut-offs save money in the long run. Improved feeding systems can cut waste and lower costs of gain.

Reduce debt. Look for the highest interest rate loans you have, and see if there is any penalty for prepaying principle. Reducing debt provides a guaranteed return on your investment, and leaves equity available for borrowing again in the future.

Fix interest rates. Current interest rates are low by historic standards. The small penalty charged for a fixed rate could look like a bargain in a few years.

Forward price production. Many grain producers who forward priced their products in 2010 felt cheated when prices soared at harvest time. But that was an exceptional year. Tight supplies could possibly lead to even higher prices, but you don't have to hit a home run if you get enough singles and doubles. Don't overlook opportunities to forward price livestock, too. Livestock Gross Margin and Livestock Revenue Pro-

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tection insurance are available for cattle, hogs, lambs and milk at a relative low cost through your crop insurance provider.

Negotiate a flexible lease. Incorporating both actual yields and prices into a formula used to set the cash rent each year will automatically reduce costs when revenues decline, while fixed cash rents may take several years to react. And the landowner can still benefit from higher returns. Avoid locking in high rents for multiple years unless you can price your product for the same period.

Diversify assets. You don't have to limit yourself to agriculture. There may be bargains available in non-farm real estate or retail ventures. Or mutual funds can return a steady income at a level of risk that you are comfortable with.

Consider ACRE (again). Enrollment in the ACRE program was light when it was introduced in 2009. But ACRE guarantees are based on a two-year moving average of the marketing year price. That two-year average price is projected to be $4.48 for corn and $10.55 for soybeans for 2011 crops. Both could be substantially higher for 2012, however. The cost for signing up is loss of 20 percent of your USDA direct payments through 2012. The enrollment deadline is June 1 this year.

Take a vacation. Long hours and hard work deserve a reward when the income is there.

The farm crisis of the 1980s was hard on all farmers, but those who put their financial houses in order during the years leading up to that period were able to weather the storm successfully.

Selling your crop insurance bushels

by Steven D. Johnson, farm and ag business management specialist, Iowa State University Extension, (515) 957-5790, sdjohns@iastate.edu

The March 15 deadline for making 2011 federal crop insurance decisions has passed. Farmers can still add coverage options such as hail or wind. With record new crop corn and soybean prices being offered this spring, consider combining your crop insurance coverage with a pre-harvest marketing strategy and the delivery of bushels.

Crop insurance as a risk management tool

Most farms utilize a crop insurance product that provides a revenue guarantee on a percentage of their actual production history (APH). The most common product used by Iowa farmers in 2011 will likely be Revenue Protection (RP). In speaking with many crop insurance agents, many farmers "bought up" coverage this year to the 80 percent or 85 percent levels.

The decision to increase the coverage level could have been in combination with the use of enterprise units to save on premium. There is a greater risk if you elect enterprise units, since you decrease your chances of collecting an indemnity. That's because you combine all your farms together by crop across the county for determining loss.

Using policies such as Revenue Protection (RP) or Revenue Protection with the Harvest Price Exclusion (RPE) guarantee both yield and price using farm level APHs. However, RPE does not offer a higher harvest guarantee should the harvest price (futures price average in October) be higher than the projected price (futures price average in February).

The Yield Protection (YP) is also a farm-level product, but does not trigger an indemnity unless a yield loss first occurs. The indemnity for both RPE and YP are limited to the projected price only.

Pre-harvest marketing strategies

The 2011 projected price is $6.01 per bushel for corn and $13.49 per bushel for soybeans, respectively. Use of RP or RPE guarantees the farm's APH times the level of coverage. These are often referred to as the guaranteed bushels or the farm's insurance bushels.

Let's use an example to understand how the Revenue Projection (RP) product works. Say your farm's average APH is 160 bu/A and you elect the 75 percent level of coverage; your guaranteed bushels are 120 bu/A. To calculate the revenue guarantee you simply multiply the guaranteed bushels (120 bu/A) times the projected price of $6.01/bu. to get $721/A.

Using RP in 2011 should provide a comfort level in selling bushels for delivery on a portion of your

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