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Selling your crop insurance bushels

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Financial management with high prices, continued from page 3

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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guaranteed bushels. Should a natural peril like drought, flood or hail occur; any shortfall in bushels below the 120 bu/A should trigger an indemnity payment calculated at the \$6.01/bu projected price.

Shortfall in harvest yield

Now the proverbial question: “What if I don’t raise those bushels that I’ve committed to delivery?” Use the example and understand that the harvest yield estimated was only 100 bu/A, but your guaranteed bushels were 120 bu/A. Your indemnity will simply reflect those missing 20 bu/A times \$6.01/bu or \$120.20/A. If you’d committed all 120 bu/A to delivery, you’ll still need to work with your grain merchandiser to “buy back” those extra bushels.

Many times there will simply be a charge of 10 to 20 cents per bushel since other merchandiser bushels can be substituted for your shortfall. Since you’ll be collecting an indemnity payment following harvest reflecting \$6.01/bu, the ability to “buy back” bushels is negated. Should the harvest price (futures price average in October) be less than the futures price that you contracted bushels for delivery, the “buy back” will be even less and reward your pre-harvest marketing strategy.

Note this indemnity reflects a futures price average, which is to your advantage. That’s because the futures prices in most Corn Belt locations tend to be higher than the cash price used for “buy back” bushels. This is especially true at harvest when the basis (cash minus futures) tends to be the widest.

Revenue guarantee vs. harvest guarantee

Where many farms struggle in utilizing crop revenue coverage and pre-harvest marketing of bushels for delivery is the ability to recalculate the revenue guarantee. The example includes two extreme harvest price estimates. The high harvest price is \$8/bu and generates an indemnity of \$160/A. The low harvest price is \$4/bu but creates a much larger Indemnity totaling \$321/A. That’s because in the example, the actual harvest yield is multiplied times the higher of the projected or harvest price to create the calculated revenue. To determine the indemnity, subtract the calculated revenue from the harvest guarantee.

Example: Revenue Protection (RP) Coverage Low Harvest Yield w/High vs. Low Harvest Prices

<u>Category</u>	<u>High Harvest Price</u>	<u>Low Harvest Price</u>
Farm’s APH	160 bu/A	160 bu/A
Level of Coverage	75%	75%
Guaranteed Bushels	120 bu/A	120 bu/A
2011 Projected Price	\$6.01/bu	\$6.01/bu
Revenue Guarantee	\$721/A	\$721/A
Harvest Yield (Estimated)	100 bu/A	100 bu/A
Harvest Price (Estimated)	\$8/bu (Dec. futures in Oct.)	\$4/bu (Dec. futures in Oct.)
Harvest Guarantee	\$960/A	No change: \$721/A
Calculated Revenue	\$800/A	\$400/A
Indemnity	\$160/A	\$321/A

The \$8/bu harvest price estimates allow for a new harvest guarantee to be calculated, since \$8/bu is higher than the \$6.01/bu projected price. Note this calculation is not available for the RPE product, since you have an exclusion on the harvest price.

Selling guaranteed bushels

The key is the indemnity for any shortfall in bushels uses the projected price and has a minimum of the \$6.01/bu. The advantage of the RP over RPE is that should the harvest price be greater than the projected price, a new harvest guarantee is calculated.

If you choose to pre-harvest sell bushels for delivery, consider timing those sales when December corn futures or November soybean futures are higher than the projected price. This way you’re guaranteed that if you come up short of bushels, you can collect a minimum of \$6.01 per bushel for corn or \$13.49 per bushel for soybeans, respectively.

Conclusion

The use of crop insurance revenue products such as Revenue Protection (RP) can easily be used in combination with a pre-harvest sales strategy that commits guaranteed insurance bushels to delivery.

Use of forward contracts and hedge-to-arrive contracts are common tools for selling these bushels. It’s still important to understand how to use a variety of marketing tools. For bushels that you prefer not to commit to delivery, consider protecting the futures price with tools such as futures hedges and/or buying put options.

Updates, continued from page 1

Internet Updates

The following updates have been updated on www.extension.iastate.edu/agdm.

Evaluating Farm Accounting Software -- C6-32 (2 pages)

Decision Tools and Current Profitability

The following tools have been added or updated on www.extension.iastate.edu/agdm.

Projected ACRE Payment Rates for Iowa Crops -- A1-33

Average Crop Revenue Election (ACRE) Payment Estimator -- A1-45

Delayed Planting and Replanting Evaluator -- A1-57

Season Average Price Calculator -- A2-15

Corn Profitability -- A1-85

Soybean Profitability -- A1-86

Ethanol Profitability -- D1-10

Biodiesel Profitability -- D1-15

Returns for Farrow-to-Finish -- B1-30

Returns for Weaned Pigs -- B1-33

Returns for Steer Calves -- B1-35

Returns for Yearling Steers -- B1-35

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