Ag News

Summer 2020 *from F&M Bank*

Message from Mike Holloway

Mike Holloway

Thank you for your patience and understanding during the COVID-19 crisis. F&M Bank has worked diligently to keep our customers and employees safe and secure. We are focused on providing you our excellent customer experience in a safe, sanitized, and comfortable environment.

Once again, there's been uncertainty in agriculture, this time due to the pandemic. Nevertheless, F&M remains committed to the agricultural industry. Farmers founded our communities with their dedicated work ethic and commitment to strong values. The bank has one of the largest ag lending portfolios in eastern Iowa and western Illinois and provides numerous agricultural loan programs. Also, F&M's ag banking team has a wealth of experience. We are here to help with advice, capital, and support for the needs of your operation.

Now more than ever, thank you for your loyalty and business!

Sincerely,

J. Michael Holloway
Senior Vice President and
Senior Loan Officer

What to Consider for a Farm Succession Plan

Many farm families dream of passing the farm on to future generations, but the reality is that relatively few farm businesses survive the generation of their founding. In a 2001 survey of farmers in twenty-six states, thirty-nine percent classified the farm as being in the family for three or more generations, while thirty-six percent classify the farm as first generation. The 2014 Iowa Farm and Rural Life Poll revealed that fewer than half of the farmers surveyed had identified successors for their farm operations. These numbers show that a goal to transition a family farm operation to future generations takes more than dreams – it requires concrete steps to build a succession plan.

A succession plan can provide helpful guidance as individuals move into and out of the farm operation in keeping with their life cycle. Critical issues in succession planning include:

1. Planning for shifts in management from one generation to the next.
2. Transitioning asset ownership from generation to generation.
3. Anticipating events that could disrupt management and ownership succession.

Seven major elements of a succession plan include the following.

1. Build the Farm Management Team

Multi-generational operations only survive if the individuals involved are successful in building an internal management team. This typically involves:

A. Stressing the idea of a team approach to making decisions rather than simply deferring to senior individuals.
B. Focusing on developing management skills in the incoming generations.
C. Emphasizing cross training to develop skills and experience at all levels.
D. Developing a functioning and effective system of routine communication.
E. Implementing routine, non-threatening evaluation of all team members so everyone comes to understand their strengths and weaknesses.

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2. Address the Power Issue

Succession planning involves the issue of who can control decision making. From a fundamental planning perspective, this requires the creation of an environment in which decision making power is secondary to the quality of decision-making input. A succession plan should contain a "power audit" to focus upon decision making under alternative scenarios.

Example: A farmer died unexpectedly at age 48, leaving a spouse (who received 48 percent of the stock in a family farm corporation) and four children (each of whom inherited 12 percent of the stock). The children have generally voted as a block since that time to pursue an aggressive expansion strategy with no dividends declared. Mother is extremely unhappy that her stock has produced no income in decades. She is confident that her late husband never once thought about who would have the whip hand of control.

3. Anticipate Disruptions

Related to the "power" issue, but involving a broader range of concerns, is the matter of anticipating disruptions in the gradual shift of ownership and control to future generations. It may be that everyone will die in an orderly manner, all marriages will remain intact, and no serious disputes will arise. But, a succession plan should focus on the "what if" possibilities. What if individuals die or retire prematurely or one or more marriages were to be dissolved with a possible division of farm ownership?

When serious and fundamental disagreements arise, how will these situations be mediated? Are risk management tools in place to cover major tort or other liabilities to the operation? These types of developments are difficult to plan for but failure to plan can produce wrenching consequences. A strong succession plan will consider these possible disruptions and provide for contingency plans.

4. Assure Fair Compensation

Especially for younger generation individuals who have little decision-making power, it is important to address the matter of compensation for labor and management contributions – what is sometimes referred to as "sweat equity." It is important to compensate each individual fairly each year. If cash compensation would strain the farm operation cash flow, part of the compensation could be paid in increased equity in the business.

5. Value Ownership Interests

Periodic valuation of ownership interests on a fair and equitable basis is a key part of protecting owners and heirs of the farm business. Valuation methods will vary, depending on the farm business structure – such as whether the farm is in a sole proprietorship or general partnership structure, or in a corporate or limited liability structure. The ownership interests of senior majority owners should be valued as well as the interests of minority owners. From year to year, methods for valuing the farm and ownership interests may include measuring total net worth of the operation and assigning interests to the owners. Another methodology could be looking at discounted earnings, by calculating the value of expected future earnings in current dollars. Periodic appraisals may be necessary – of land, buildings, implements, livestock, and other farm assets. The owners may agree upon a periodically re-negotiated fixed price based upon an inventory of all assets in the farm business. The services of financial, accounting, tax, and appraisal professionals will be necessary.

Jonathan D. Holthe
Senior Vice President & Senior Trust Officer

6. Protect Minority Owners

In addition to providing for a fair and equitable valuation of ownership interests, minority owners can be protected from the possible harshness of majority rule in other ways. Carefully drafted provisions for triggering first option and buy-sell agreements can be used to create a market for stock or other forms of ownership interests. Traditional decision-making rules can be modified in various ways to provide greater protection for the minority owners. Examples may include providing for a greater than majority vote (or perhaps a below-majority vote) for certain types of decision-making. Other key issues may be decided by agreement, such as contracts for employment for a specified number of years, which may include compensation agreements.

7. Encourage Phased Retirement

Another element of a succession plan focuses on encouraging senior individuals to retire. Components may include appropriate levels of retirement compensation. Planning for non-farm retirement income is vital – and must be encouraged throughout the working years. This includes making adequate payments into Social Security and other investment vehicles for the purposes of generating non-farm retirement income. Reduced-responsibility positions on the management team should be established for those approaching the retirement years so that incoming generations transition into decision-making activities.

In Conclusion

In the final analysis, a successful plan of succession in the farm business depends heavily on the personal chemistry of the individuals involved. However, a carefully considered and thought-out succession plan can be helpful in shaping expectations and in providing a framework for implementing the steps needed for an efficient and tranquil transition.

For questions regarding estate planning, please contact Jon Holthe (309) 343-0002, ext. 20605.

O'Rourke, Melissa. "Constructing a Farm Succession Plan: Elements to Consider." Accessed July 27, 2020. https://www.extension.iastate.edu/agdm/wholefarm/html/c4-17.html

MFP and CFAP Payments, Corn and Soybean Uses, and Future Farm Profitability

Federal aid in the form of Market Facilitation Program (MFP) and Coronavirus Food Assistance Program (CFAP) payments have increased returns and the financial stability of grain farms in 2018, 2019, and likely in 2020. However, corn and soybean returns have been low since 2013, when the growth of corn use in ethanol plateaued. Recent declines in soybean exports have worsened returns. The uses of corn and soybeans must grow in the future if corn and soybean returns are to reach higher levels. If uses do not increase, a combination of two items will need to occur: 1) financial aid and intervention from the Federal government will need to continue, or 2) farmers will need to make financial adjustments as well as lower cash rents. These factors are illustrated by evaluating time trends of corn and soybean returns and then associating return periods with corn and soybean use.

Without large changes in expected supply and demand conditions, additional Federal aid likely will be needed in 2020 and 2021 to avoid large losses for corn and soybean production. Whether this aid is forthcoming is a good question, particularly after the 2020 election.

Even with additional Federal aid, longer-run profitability is questionable on corn and soybean farms. Farm returns have been low since 2013 when corn use of ethanol declined. Export demand growth for soybeans continued to be a bright spot for farms rotating between the two crops until 2018. Trade disputes and COVID-19 control measures have disrupted the already stressed demand side for corn and soybeans and now brings into question future use levels for both soybeans and corn. Soybean exports may not return to pre-trade dispute levels in the near future. Similarly, corn use in ethanol may not rebound in 2020 or for several years into the future, if ever.

Consideration should be given to efforts to increase the uses of both corn and soybeans. Ethanol and biofuels policies have impacted returns in the recent past, and efforts to sustain and continue that growth would aid corn and soybean returns. Similarly, efforts to keep U.S. exports competitive with other countries likely would have longer-run benefits for farmers.

If uses do not grow, ad hoc Federal aid could continue into 2021 and beyond, but it seems unlikely that this aid will continue indefinitely. When this aid ends, farmers will need to make financial adjustments, and cash rents will need to fall if uses do not grow in the meantime. Farmers may wish to begin to prepare for this possibility, making changes in financial structure and cash rents currently.

Schnitkey, G., K. Swanson, J. Coppess, N. Paulson and C. Zulauf. "MFP and CFAP Payments, Corn and Soybean Uses, and Future Farm Profitability." farmdoc daily (10):106, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, June 10, 2020.

3 traits for post-COVID farm business success

Writer David Kohl tells us that resiliency, agility and entrepreneurship can help your farm weather the coronavirus storm.

Resiliency

The farmer's balance sheet must have productive assets that are fully deployed. In the future, the capital asset turnover ratio will be critical in measuring resilience. This ratio is calculated by dividing total revenue by total assets.

Income statement and cash flow resiliency may be measured by cost of production benchmarks. Another good ratio to measure resilience is the operating expense to revenue ratio, excluding interest and depreciation expenses. Being a low cost, efficient producer is one step to making a business globally competitive in the long-term. Marketing, risk management, production, and operations must also be part of an effective management strategy.

Agility

Agility in both the income and cash flow statements may be measured by different sources of productive revenue streams utilizing assets, management, labor and capital resources. For some smaller farms, pre-COVID outside revenue streams included off-farm employment. However, this strategy will be impacted by high unemployment rates and demand destruction in the general economy.

Entrepreneurship

Global and domestic consumer trends will change. The competitive forces between large business concentration and innovative entrepreneurship will be mainstream in this decade. Ultimately, the consumer in the marketplace will be the deciding factor, with involvement from government and society. Is there a place for both? Can agility and innovation, with some financial management and resiliency, compete with economic optimization and concentration of business? The U.S. economy was built by small businesses and entrepreneurship. Will a combination of both business models carry the economy into the future? Only time will tell.

Kohl, David. "3 traits for post-COVID farm business success." Accessed July 16, 2020.
https://www.farmprogress.com/farm-business/3-traits-post-covid-farm-business-success

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Contact Annette Pickrel for your ag treasury management needs. She is a Certified Treasury Professional® and provides the highest level of expertise in treasury management to our ag and business customers.

Some positive news for a change

The June Acreage and Grain Stocks reports often create a lot of market buzz, usually in the downward direction. But this year's reports provided a positive lift for a change. While corn disappearance did decline dramatically this spring, corn stocks on June 1 were roughly the same as they were in 2019. Soybean stocks were 22% lower this year. And while acreage was up for both corn and soybean this year, compared to last year, the increases were not big as the markets anticipated.

So short-term supplies are at or below last year's levels and long- term supply projections are now smaller than first feared. Combine that with some positive signs on the demand side with ethanol plants continuing to bring back production and some movement on soybean export sales, and both the corn and soybean markets gain 10 to 20 cents.

Hart, Chad. "Some positive news for a change." Accessed July 23, 2020. https://www.extension.iastate.edu/agdm/articles/hart/HartJul20.html

Cash Rents in 2020 and 2021

State-level cash rents released in early August by the National Agricultural Statistical Service (NASS) indicate 2020 cash rents were virtually unchanged from 2019 across states in the Corn Belt. While corn and soybean prices have been lower since 2019, total crop returns have been supported by ad hoc Federal payments. Without ad hoc payments, cash rents would have faced more downward pressures when 2020 rents were set. A significant question is whether ad hoc Federal aid will continue into 2021. If this aid does not continue, farmers most likely will have losses in 2021 if cash rents are not significantly lowered.

2020 Cash Rents

NASS reported Illinois' cash rent for 2020 at $222 per acre, continuing a string of years in which Illinois' cash rents varied in a narrow band. In 2014, Illinois' average rents reached an all-time high of $234 per acre, and then declined to $221 per acre in 2016. From 2016 to 2020, state cash rents varied from a low of $218 per acre in 2017 to a high of $224 per acre in 2019, a range of $6 per acre. Average cash rents have been stable in the last five years.

2016-2020 Plateau Corresponds to Lower Corn and Soybean Prices

The 2016-2020 plateau corresponds to a period of lower corn and soybean prices that began in 2014. From 2006 to 2013, national average corn prices averaged $4.49 per bushel and soybean prices averaged $10.63 per bushel, higher than the years leading up to 2006. Expansion in corn use played a

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large role in price increases throughout the 2006 to 2013 period.

From 2014 to 2017, corn prices have averaged $3.51, down by $0.98 from the 2006-2013 average. Soybean prices averaged $9.46 from 2014-2017, down by $1.17 from the 2006-2013 average. These lower prices began as corn use in ethanol reached a plateau in 2012, resulting in slowing increase in corn demand.

Ad Hoc Federal Aid Supports Farm Revenue and Cash Rents in Recent Years

Additional Federal aid in the form of Market Facilitation Program (MFP) and Coronavirus Food Assistance Program (CFAP) payments has supported crop returns since 2018. MFP and CFAP programs are ad hoc payments because these payments are outside the usual farm safety net) and because the levels of payments are not legislated to continue in the future.

Without this aid, there would be much greater pressures placed on cash rents to move downwards.

2021 Cash Rents

For 2021, operator and land returns for a 50% corn 50% soybeans rotation is projected at $224 per acre based on several key assumptions:

- 2021 prices are $3.40 per bushel for corn and $8.50 for soybeans, representing an economic recovery that is V-shaped.
- Commodity title payments total $30 per acre. This $30 per acre includes roughly $60 per acre of Price Loss Coverage (PLC) payments on base acres in corn. No payments are included on soybean base acres.
- 2021 yields are at trend levels of 217 bushels per acre for corn and 68 bushels per acre for soybeans.
- 2021 non-land costs are $568 per acre for corn and $360 per acre for soybeans
- There are no ad hoc Federal payments.

Those assumptions result in an operator and land return of $224 per acre. At our projections, a continuation of a $275 per acre cash rental rate in 2021 would result in a loss to the farmer of $51 per acre. Obviously, without reductions in cash rents or other costs, $51 per acre or more of ad hoc aid is needed to get farmers to break-even returns near $0 per acre.

When setting 2021 cash rents, two factors are important:

1. **Farmer returns have been low since 2014:** Farmer returns in central Illinois on high-productivity farmland have averaged $17 per acre from 2013 to 2018. From a return standpoint, $17 per acre is a low return for engaging in the risk of farming a cash rent acre. A number of reasons can be given for largely stable cash rents in recent years including competitiveness within the farmland market, farmers' fears of loss of competitiveness if rental acres are lost, build-up of financial reserves during the high return years from 2006 to 2013, and optimism about prices in the future.
2. **COVID-19 likely will have long-ranging downward impacts on prices.** Trade concerns also likely contribute to downward expectations for prices. Over the next five years, it seems reasonable to expected corn prices to average closer to $3.50 per bushel than $4.00, and for soybean prices to average closer to $8.60 per bushel than over $9.00 per bushel.

Summary

Ad hoc Federal aid has been an important source of revenue since 2018. Without these payments, cash rents or non-land costs would have to decline by $35 per acre, or 12.5%, to have farmer return to be near $0. While breakeven levels are an improvement over losses, larger declines than $35 per acre would be needed to reach a sustainable level of income for a farmer to continue operations. In anticipation of both continuing lower prices and reductions in ad hoc Federal aid in 2021, it appears time to lower cash rent levels that are average-level or higher.

Schnitkey, G., K. Swanson, C. Zulauf, N. Paulson and J. Coppess. "Cash Rents in 2020 and 2021." farmdoc daily (10):147, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, August 11, 2020.