



Spring 2016

from F&M Bank



Message from our bank president

We work hard to embrace the financial needs of our ag customers. F&M's team of advisors extends beyond lenders to cash managers, and financial and estate planners. Our long-term goal is to preserve and protect the value of your farm for both current and future generations.

Whether you're looking for a checking or savings account, loan, investment or trust advice, or growing your farm operation, we're confident that our associates will be able to help you.

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Sincerely,

Doug Sanders
President & CEO F&M Bank

Five ways to control farm machinery costs in 2016

Lower grain and livestock prices decreased farm profits in 2015 and working capital reserves are disappearing. This situation is likely to persist through the upcoming year, so some belt tightening will be in order for many producers.

Machinery and equipment costs are one major area where some adjustments can be made. Data from the Iowa Farm Business Association records show that high profit farms spent only \$152 per acre on machinery costs in 2014 while low profit farms spent \$189 per acre. Likewise, high profit farms had an investment in machinery of \$435 per acre compared to \$592 per acre for low profit farms.

Here are five alternatives for reducing costs during the coming year:

1. Lease rather than buy equipment
2. Custom hire some work done or do custom work for others
3. Own machinery jointly or trade use
4. Invest in used equipment
5. Own machinery longer

Leasing equipment

An operating lease allows producers to use equipment for a period of time, usually 3 to 5 years, for a fixed annual or monthly payment. At the end of the lease period the producer can return the equipment to the dealer or lease company, or exercise a purchase option to acquire it at roughly its fair market value. Lease payments are typically around 18 percent to 23 percent of the new value of a machine, and are often lower than payments on a loan to buy the same machine would be. For example, for a new tractor with a purchase price of \$200,000 the annual lease payment might be about \$40,000. If the same tractor were 100 percent financed for 4 years at an interest rate of 6 percent, the payment would be \$57,718 per year, almost \$18,000 more.

Of course, when the lease expires the farmer has no equipment or equity to show for it. Conversely, when a purchase loan is repaid the farmer has full ownership and no more payments until time to trade again. Leasing can be advantageous in times of below average revenue and the payments do not show up as liabilities on the balance sheet. However, the leased equipment cannot be listed as an asset and the payments still create a cash flow obligation.

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Custom hiring

Smaller cash grain operations can lower costs by custom hiring some operations done rather than owning a full line of machinery. Cash costs are known in advance and you pay only for the number of acres actually planted or harvested. Moreover, custom operators often have newer equipment and are more skilled at operating it. Current studies have shown that a cash grain operation needs to harvest about 1,200 acres or more per year for owning a new combine to be cheaper than custom hiring harvesting done. The down side to custom hiring, of course, is some loss of control over when and how work is completed. A balance needs to be struck between economics and convenience.

Farmers with smaller acreages should also consider doing custom work for other operators. Adding more acres lowers fixed costs per acre and adds a low-risk source of income. In the corn belt, cash grain farmers can count on about 25 field days for completing tillage and harvesting each year, and about 30 field days to complete harvesting in the fall. If extra days are available, striking a deal with another operator may benefit everyone.

Joint ownership

Some of the same advantages from custom hiring can be realized by trading the use of machinery or owning it jointly. For example, one operator may own the combine unit and another may own the harvesting heads and grain cart. It is important to keep good records of who owns which equipment, who provides labor and who pays for fuel and repairs. At the end of the year a rental rate per acre or per hour can be calculated so that each operator pays a fair share of the costs. Ag Decision Maker



File A3-34, Joint Machinery Ownership, gives some examples of how this can be done.

A more formal arrangement can be created where some or all machinery is owned in common. This allows fuller use of the equipment resulting in lower cost per acre. Operators who have tried joint ownership often find that two or more people working together are much more efficient than each one working independently. They often find that it is possible to own larger and newer machinery with a joint agreement. Examples of how to set up a joint ownership arrangement and allocate costs fairly can be found in Ag Decision Maker File A3-37, Farm Machinery Joint Ventures.

If jointly owned machinery is financed through a bank or dealer, it is important that the lender fully understands how the assets are owned and who has collateral rights. Leasing rather than owning may be more simple for joint agreements.

Purchasing used machinery

Limited capital can be stretched and liabilities reduced by investing in used machinery rather than new items. A quick look at some used machinery websites show that a full line of four-year-old equipment could be assembled for about two-thirds the cost of a new set. Many operators traded machinery in recent years when cash incomes were good, so inventories of used units are higher than usual. Asking prices vary widely, so a little time spent shopping online could produce significant savings. Used machinery carries a higher risk of breakdowns and repair costs, so having the tools, facilities and skills to maintain equipment is important.

Extending ownership life

Similar to investing in used machinery, keeping machinery longer avoids the high depreciation and interest costs incurred during the first year or two of its useful life. It helps lower the amount of intermediate debt shown on the farm balance sheet and avoids high down payments for new equipment. This is especially true for machinery that does not have a high level of annual use.

Saving a little bit of cost here and a little bit there will add up over time. Your lender will smile more, and the drain on your working capital won't be as severe.

Managing on Thinner Margins

Farm income was down considerably in 2015. Without a material reduction in input costs, 2016 stands a good chance of showing more of the same. This article reviews selected costs from a group of farms in Illinois with an eye on how those selected costs vary by farm size in 2014. A lesser per acre cost of production is thought to occur as farm size increases. The data at hand indicates that per acre costs does vary with farm size, but larger farms do not always lead the way in terms of lower cost per acre.

Table 1 illustrates what many consider to be five of the more significant input costs for a group of Illinois FBFM grain farms. The data represent aggregated data from three acreage ranges from northern, central and southern Illinois.

Table 1. 2014 Selected Cost Per Acre

	Northern Illinois			Central Illinois			Southern Illinois		
	1200-1999	2000-2999	Over 3000	1200-1999	2000-2999	Over 3000	1200-1999	2000-2999	Over 3000
	Acres	Acres	Acres	Acres	Acres	Acres	Acres	Acres	Acres
Fertilizer	\$129.63	\$124.29	\$134.56	\$120.02	\$121.60	\$116.48	\$101.07	\$111.87	\$112.22
Pesticides	\$59.67	\$54.73	\$52.41	\$55.55	\$54.50	\$54.27	\$56.43	\$49.70	\$48.58
Seed	\$106.08	\$105.99	\$97.59	\$99.47	\$97.30	\$91.71	\$81.27	\$88.74	\$81.44
Machine Depreciation	\$76.88	\$73.48	\$71.82	\$63.59	\$60.90	\$62.75	\$69.19	\$72.92	\$58.47
Cash Rent	\$259.27	\$260.75	\$292.78	\$294.65	\$293.48	\$285.92	\$142.96	\$161.05	\$174.53
Owned	19%	20%	17%	11%	12%	16%	24%	25%	17%
Cash Rent	61%	66%	76%	41%	48%	54%	40%	38%	53%
Crop Share	19%	15%	7%	48%	40%	30%	37%	37%	32%

Source: Illinois FBFM

All three geographic groups show the tendency for a larger percentage share of cash rent acres as the farm size increases. The share of acres owned is lowest for the central group (11% to 16%) while the share of acres owned is highest for the southern group (17% to 24%). The percentage of crop share acres in general is higher in central Illinois and lowest in northern Illinois.

Fertilizer costs on a per acre basis are higher on the Over 3000 acres groups in northern and southern Illinois. The three central Illinois groups show a remarkable amount of consistency of per acre fertility costs.

Pesticide costs are lower in the Over 3000 groups in northern and southern Illinois. As with fertility costs, the three central Illinois groups show a remarkable amount of consistency of per acre pesticide costs.

Seed costs are lower in the Over 3000 groups in northern and central Illinois. The three southern Illinois groups show a remarkable amount of consistency of per acre seed costs.

Machinery depreciation as a cost can be controlled but its effect is felt over the life of the assets and those assets have a life of more than one year. Thus, even if

machinery purchases are curtailed for a year or two, the effects of purchases made in earlier years will affect this years' depreciation. Illinois FBFM uses economic depreciation to counter the use of Bonus Depreciation and the IRS Code Section 179 Expense Election and more accurately reflect the recovery of the cost of machinery. Most farm machinery would have an economic life of ten years.

Machinery depreciation is lower in the Over 3000 groups in northern and southern Illinois. The three central Illinois groups show consistent per acre machinery depreciation.

The Over 3000 groups in northern and southern Illinois are higher than the other two groups. The three central Illinois groups show some consistency in cash rent costs with the Over 3000 group showing the

lowest average cash rent of the three groups.

There are many different management styles. The least cost producer strives for the lowest per acre cost while the producer seeking the greatest return on their input investment will

spend input dollar to reap the greatest revenue return for those dollars. Review your input costs to see if you might be 'spending a dollar to make a dime' and evaluate where you have the opportunity to pare costs without affecting your bottom line.

The authors would like to acknowledge that data used in this study comes from the local Farm Business Farm Management (FBFM) Associations across the State of Illinois. Without their cooperation, information as comprehensive and accurate as this would not be available for educational purposes. FBFM, which consists of 5,500 plus farmers and 60 professional field staff, is a not-for-profit organization available to all farm operators in Illinois. FBFM field staff provide on-farm counsel along with recordkeeping, farm financial management, business entity planning and income tax management. For more information, please contact the State FBFM Office located at the University of Illinois Department of Agricultural and Consumer Economics at 217-333-5511 or visit the FBFM website at www.fbfm.org.

Source: Zwilling, B., B. Krapf, and D. Raab. "Managing on Thinner Margins." *farmdoc daily* (5):234, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, December 17, 2015. <http://farmdocdaily.illinois.edu/2016/01/managing-on-thinner-margins.html>

Charitable Giving Charitable Remainder Trust

A trust is a very useful and flexible tool for estate planning. A charitable remainder trust allows the grantor to make a charitable gift and still retain an income stream from the gift. The trust can be set up to provide an income stream for a period of years based on the grantor's life or the life of a beneficiary. At the end of the term, the remaining assets go to benefit the designated charity.

For example, donated land can be retained until the grantor's death, and then the beneficiary would receive an income stream. It is possible to donate other assets such as machinery or grain inventories. An income tax deduction may be possible and the deduction may possibly be carried forward five years. Charitable Remainder Unit Trusts pay out a fixed percentage while a Charitable Remainder Annuity trust pays out a fixed dollar amount.

A trust requires four basic elements—trustee, trust property, trust document, and known or discernible beneficiaries. The trust document specifies the rules of operation for the trust, the powers of the trustee, the beneficiaries to share in the income and principal from the trust, and instructions for distribution of the trust property. To determine if a charitable remainder trust is something you should consider, call Steve Browning at 343-0002, extension 20605, and he will be happy to visit with you.

Source: Leibold, Kevin and O'Rourke, Melissa. "Trusts as an Estate Planning Tool." Accessed March 18, 2016.
<https://www.extension.iastate.edu/agdm/wholefarm/html/c4-59.html>



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