Ag News

Spring 2019 *from F&M Bank*

Message from Mike Holloway

Mike Holloway

Farmers play an important role at F&M Bank. As a community bank, we are committed to helping the farmers in our community grow and prosper.

We encourage you to visit with us about your 2019 farm operation. Whether you need financing for daily operations or to fund growth and expansion, F&M Bank has a full suite of products to meet your needs.

The key issues of estate and succession planning are some of the most important, especially for farmers. The lack of proper planning can be costly if it results in additional taxes, investment losses, or expenses you or your heirs could have avoided. We strongly encourage you to visit with our senior trust officer, Jon Holthe, because there are many factors to consider in creating your financial and estate plan. Our long term goal is to preserve and protect the value of your farm for both current and future generations.

Thank you for your business; we look forward to serving you for years to come.

Sincerely,

J. Michael Holloway
Senior Vice President and
Senior Loan Officer

Seven Tips for a Strong Marketing Plan

There is no one-size-fits-all approach to marketing and for many producers it can be the worst part of the job, but having a plan in place will take some of the risk off the table. The American Bankers Association Agricultural and Rural Bankers Committee recommends the following to help producers tackle the complicated task of marketing:

1. Know your break-even costs. Factor in all of your costs including input, debt service and family living expenses. To get a better idea of what your yield might be, take your 3-year, 5-year or Olympic average (eliminate the high and low of the last five years and average the rest). You can also find ballpark figures from university agricultural extension services or an advisory firm. Use an excel spreadsheet to add up and track your costs.

2. When there's an opportunity to profit, act on it. Once you understand your production costs, you'll have a better idea of when you can sell for a profit. You're not always going to hit the high, but selling at a profit—even a small one—takes some of the risk off the table. One of the biggest mistakes can be inaction because you think prices are going to go up or you're going to miss a rally.

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3. Set a goal and stick to it. You could set a date to have all of your marketing completed, plan to market 10 percent each month, or set a goal to market 1, 2 or even 3 years out. Creating a plan will help you stay on track. With so much volatility in agriculture, no one can be totally sure what's going to happen, but having an organized plan can help.

4. Take the emotions out of it. Finding the right person or company to work with can go a long way to remove your emotions from the mix. Talk to your banker for recommendations and understand your options. Whether it's a marketing advisory firm, programs offered by your local co-ops and elevators, or your in-house financial manager—find someone you trust and are comfortable with.

5. Keep things simple. You don't have to do a lot of fancy footwork to make a profit. You may not always hit a homerun but sticking to your marketing plan can help you stay in business.

6. Avoid spot markets. Don't wait until you need to make a loan payment or you need cash. That will leave you vulnerable to what the market can give you at that time. Keep track of your local basis and understand the benefits of forward pricing.

7. Understand the tools available. Hedge to Arrive contracts, forward pricing, marketing loans to cover hedging expenses, hedging lines of credit, the role of crop insurance—it's complicated, but your banker is there to help you make sense of the options. Don't be afraid to ask questions and find the best solution for you and your operation.

Source: American Bankers Association. https://www.aba.com/Press/Pages/111218AgMktgTips.aspx#. Accessed February 12, 2019.

The difference between liquidity and core equity burn rates

Fall and winter renewal season appears to be setting up to be a tough one. With commodity prices tanking and extreme volatility regarding tariff and trade negotiations, crucial conversations about financial statements will be a high priority between producers and lenders. So what is the difference between financial liquidity and core equity burn rates?

The financial liquidity burn rate focuses on working capital on the top half of the balance sheet. Working capital is a measure of liquidity calculated using current assets minus current liabilities. Some producers build a working capital buffer through profits. Others have done it by restructuring debt to replenish their working capital. In either case, if your business shows a loss, the financial liquidity burn rate can be calculated by dividing the losses into working capital.

The next line of defense is core equity, usually in land assets. In some cases, the majority of equity might be in machinery, equipment, or livestock. This is particularly true if producers are renting and leasing land or strategically controlling assets rather than owning assets.

To calculate core equity, sum the value of non-current assets such as land and buildings. Then, you must determine what loan maximum your lending institution would extend in credit, known as the advance rate. Typically, advance rates will be between 50 and 80 percent. Then, take this number and deduct your liabilities against these assets. The result is called core equity excess reserves. Then, the business owner would divide any losses into this number to ascertain the core equity burn rate in years.

Kohl, David. "The difference between liquidity and core equity burn rates." Accessed February 15, 2019. https://www.farmprogress.com/management/difference-between-liquidity-and-core-equity-burn-rates

Evaluating Your Estate Plan: Federal Estate Taxes

Property owned by a person at the time of death is known as the decedent's estate. When the estate is transferred to the recipients (known as heirs), the federal government may impose a tax on the right to transfer that property. That is the federal estate tax. The tax is owed by the estate of the decedent and is paid by the estate prior to the transfer of the remaining property. Heirs who receive money or property from an estate do not pay the estate tax, nor do they pay any income tax on the value of the inherited property.

What estates are subject to a federal estate tax?

The amount of the estate tax is based upon the value of the estate at the time of death. Federal law allows a certain amount of property to be transferred at death without any tax obligation. The amount that can be transferred to others without tax is known as the "unified credit."

In December 2017, the Congress passed and the president signed the Tax Cuts and Jobs Act (TCJA) of 2017. The provisions of this law were effective on January 1, 2018. The TCJA increased the exemption amount from $5 million to $10 million–indexed for inflation from 2010. This increase in the TCJA is effective until January 1, 2026 when the amount will revert to 2017 levels (an expiration or "sunset" provision) unless the law is extended or modified. In early 2018, the IRS announced that the 2018 exemption amount is $11.18 million (or $22.36 million for a married couple). Again, the exemption will be adjusted for inflation in subsequent years.

How many estates are subject to federal estate tax?

For 2017 deaths, when the exemption was $5.49 million, the Tax Policy Center estimated there would be about 5,500 taxable estates with total estate tax liability of around $19.9 billion. Putting this in perspective, the TPC pointed out that of the approximately 2.7 million deaths in 2017, only 1 in 487 deaths would pay any estate tax. For 2018, the TPC estimates that the number of estates subject to federal estate tax will fall to about 1,700 which is equal to less than 0.1 percent (1/10th of 1 percent) of all deaths; and the amount of estate tax owed will be reduced to $13.6 billion. For 2017 deaths, the TPC estimated that perhaps 80 small farms and closely held businesses would pay any estate tax. With the increased exemption amount for 2018, that number will decrease significantly.

How is property valued for purposes of federal estate tax calculations?

Property included in the gross estate is valued at its fair market value (FMV) as of the decedent's date of death. For certain types of property, a qualified appraisal may be necessary to determine the appropriate value. In unusual cases, an alternate valuation date within six months after death may be used—typically done if property values have declined after the date of death.

Under certain conditions, land used in farming or other closely held (family) business may be valued at a special use value, which may be lower than FMV.

Jonathan D. Holthe CFP® Senior Vice President & Senior Trust Officer

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How is the federal estate tax calculated?

The executor of an estate must file a federal estate tax return within nine months of a person's death if that person's gross estate exceeds the exempt amount ($11.18 million in 2018, with this amount continued to be indexed for inflation). The estate tax is applied to the decedent's gross estate, which generally includes all of the decedent's assets, both financial (such as stocks, bonds, and mutual funds) and real (homes, land, and other tangible property). It also includes their share of jointly owned assets and life insurance proceeds from policies owned by the decedent. After the gross estate is valued, deductions are subtracted to arrive at the net taxable estate. Federal estate tax law allows an unlimited deduction for transfers to a surviving spouse and to charity. Other deductions are allowed for debts, funeral expenses, legal and administrative fees, and state inheritance taxes paid. Therefore, the gross estate less the allowable deductions equals the net taxable estate. Once the amount of the net taxable estate is determined, the applicable credit exempts a large portion of the estate–again, $11.18 million for 2018 deaths. Any remaining value of the estate over that amount faces a tax rate of 40 percent.

In summary, the steps in calculating the Federal Estate Tax are:

1. Determine the value of the gross estate.
2. Subtract allowable deductions.
3. Add the value of taxable gifts made after 1976 if not already included in the gross estate. (Remember that the estate and gift tax rate is based on cumulative transfers. The gift tax paid on taxable gifts made after 1976 is subtracted in Step 5.)
4. Consult tax tables for the unified rate schedule for

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Estimating costs of crop production vital for 2019 farm businesses

Estimating costs of crop production for 2019 will be extremely important. With a market outlook for 2019 similar to 2018, there are challenges ahead from a marketing perspective. Marketing strategies for farmers include forward pricing, setting a quantity-only marketing plan, or using the spot market. The price consequences of these decisions are substantial. Having a firm handle on one's cost of production provides a key piece of information in any strong marketing plan.

The estimated costs of production for continuous corn are $3.93, $3.91, and $3.88 per bushel for expected yields of 164, 182, and 200 bushels per acre, respectively.

The estimated costs of production per bushel for corn following soybeans are $3.39, $3.39, and $3.38 assuming 178, 198, and 218 bushels per acre, respectively. Recent projections for the 2019 marketing year average price for corn are near $3.90 per bushel, showing the potential for a slight profit for most yield levels.

Cost of production estimates, per bushel, for herbicide tolerant soybeans are $9.21, $9.04 and $8.86 assuming 50, 56, and 62 bushels per acre, respectively. The total cost per bushel of soybeans is projected at $9.13 for non-herbicide-tolerant beans at 56 bushels per acre, according to the report. Recent projections for the 2019 marketing year average price for soybeans give a more negative outlook at $8.75 per bushel.

The significant increase in reference yields between the 2018 and 2019 reports more than offsets the six to seven percent increase in total costs per acre, resulting in lower total costs per bushel. When looking at specific categories, costs increased for chemical and fertilizer inputs, while seed and fuel costs saw slight decreases.

Figure 1. Corn following corn, 2019 estimated costs of production

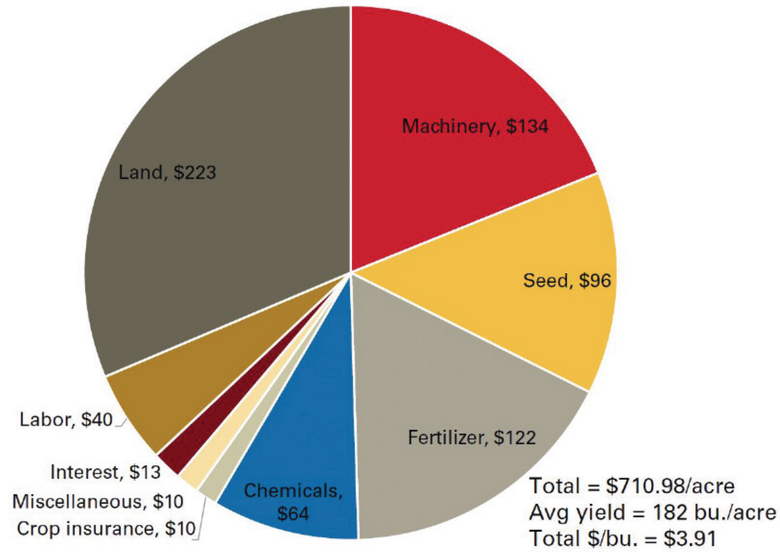
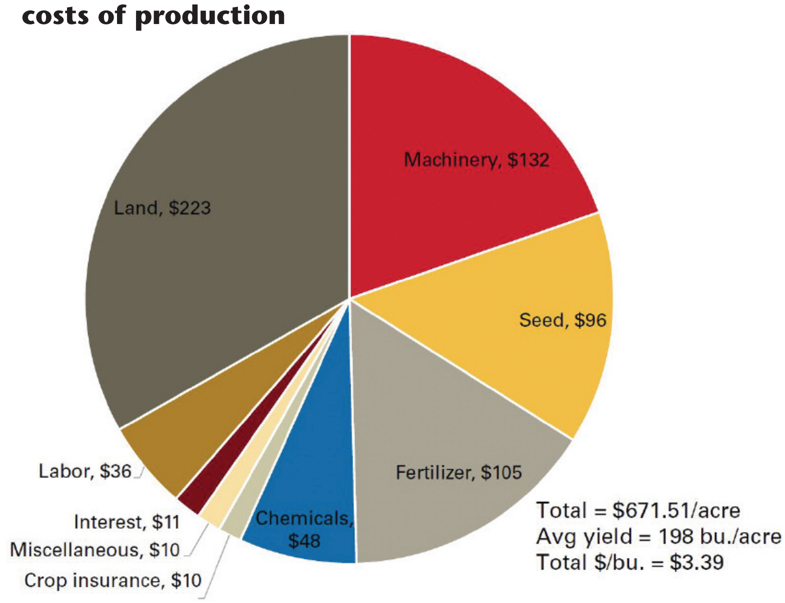


Figure 2. Corn following soybeans, 2019 estimated costs of production



Very large or small farms may have lower or higher fixed costs per acre.

Breakdown of costs for 2019

For corn, land represents approximately 30 percent of the total costs of production *(Figures 1 and 2)*. Values of $185, $223, and $258 per acre rent charges for the low, medium, and high quality land were assumed. The variable costs represent just over 50 percent of the costs of

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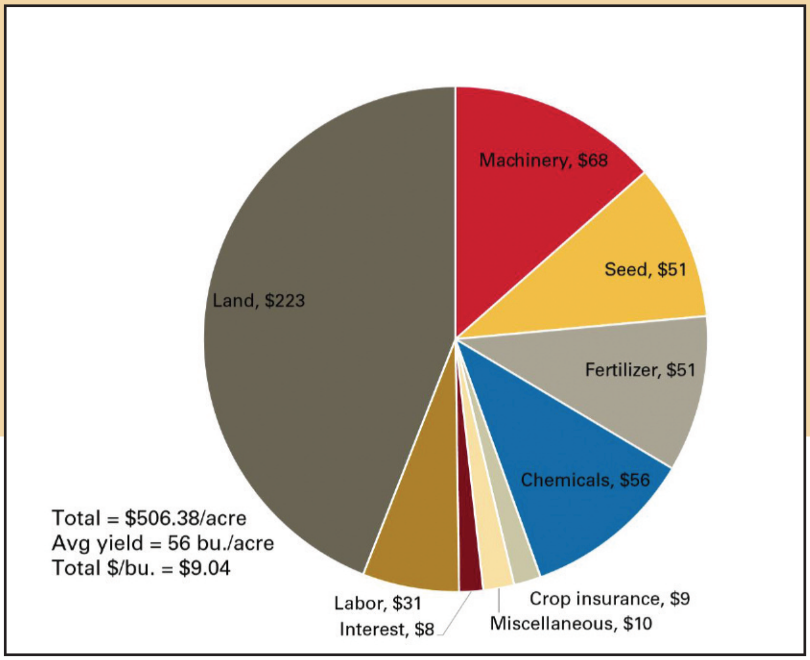

production. Of the variable costs, nitrogen and seed costs are almost half the costs for either continuous or rotated corn. Nitrogen increased 26 percent from 2018, at $.38 per pound and seed was assumed to cost approximately $256 per bag, a 2 percent decline.

Land represents just over 44 percent of the costs of production for soybeans *(Figure 3)*, while the variable costs represent 42 percent. Seed and fertilizer are almost half of the variable costs. Phosphorus was charged at $.42 per pound and potassium at $.31 per pound, an increase of seven and 14 percent, respectively. Machinery costs were two percent lower compared to 2018 primarily due to lower fuel costs.

Breaking even in 2019

Current costs of production along with a well-planned marketing plan have the potential to result in small but positive profit margins in 2019 for corn but the outlook is not quite as promising for soybeans. Using recent price projections for 2019/20, a rented acre of corn following soybeans would need to produce 172 bushels of corn to breakeven, and a rented acre of genetically modified soybeans would need to produce 58 bushels of soybeans to breakeven. However, a rented acre of corn following corn would need to produce 183 bushels of corn to breakeven.

The margin of error in these projections is directly proportional to the margins of error on projected yields, costs, and prices. Given such uncertainties, it is highly recommended that producers visit with trusted agronomists on how to cut costs without hurting revenue potential.

Knowing the operation's cost per acre is critical for creating solid marketing plans and making the necessary arrangements (such as securing operating loans, restructuring machinery or real estate loans, adding non-farm income) to cash flow an operation in 2019.

Conclusions

When using the ISU cost of production estimates for 2019, keep several things in mind. First, fertilizer and lime costs include volume and early purchase discounts. Second, farmers paying land rents higher than the ones projected in the report might face higher costs of production. Finally, starting in 2019, reference yields for the crop budgets line up with 30- year yield trends.

While total costs per bushel may look lower in the latest cost of crop production publication due to higher reference yields, total costs per acre are estimated higher than in 2018. Although there is variability across most input categories, increased fertilizer and chemical prices and lower seed and crop insurance costs were among the most variable.

Producers need to have a strong grasp of their own production costs. Costs of production are not seeing the rapid fluctuations that were seen in recent years, but current prices still create a lot of uncertainty when it comes to profitability on individual operations. Knowing costs is key.

Plastina, Alejandro. "Estimating costs of crop production vital for 2019 farm businesses." Accessed February 15, 2019.
https://www.extension.iastate.edu/agdm/articles/plastina/PlaJan19.html

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the applicable rate of tax and apply the unified estate and gift tax rates.

5. Subtract the amount of gift taxes paid on taxable gifts made after 1976.
6. Subtract the allowable unified credit and any other allowable credits. The resulting amount is the net federal estate tax owed by the estate.

For questions about estate planning as it relates to your farm, call Jon Holthe at (309) 343-0002, extension 20605, and he will be happy to visit with you.

Note: This article is a basic overview of concepts related to the federal estate tax and is intended to give individuals points to consider as they engage in the estate planning process. This article is considered educational in nature and should not be considered legal advice. Consult with qualified legal and tax professionals who can provide expert advice on specific needs.

O'Rourke, Melissa. "Evaluating Your Estate Plan: Federal Estate Taxes." Accessed February 13, 2019. https://www.extension.iastate.edu/agdm/wholefarm/html/c4-24.html

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