



Summer 2018

from F&M Bank

Message from Mike Holloway

There's been uncertainty lately in agriculture as escalating trade issues between the U.S. and many of our trading partners continue to affect the outlook in ag markets.



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Sincerely,

J. Michael Holloway

Senior Vice President and
Senior Loan Officer
NMLS# 742271

Has the Era of Decreasing Per Acre Corn Costs Come to an End?

Since 2014, non-land costs of producing corn on high-productivity farmland in central Illinois declined from \$617 per acre in 2014 to \$569 per acre in 2017, a decrease of \$48 per acre. Three costs – fertilizer, drying, fuel and oil – contributed more than the \$48 per acre to the total non-land cost decrease, meaning that other costs increased from 2014 to 2017. Levels of fertilizer, drying, and fuel costs are highly related to energy prices. Energy prices have been rising in recent months. Rising energy prices could signal the end to declines in non-land production costs for corn.

Non-land Costs for 2017

Final costs for 2017 crop production are now available in a publication entitled *Revenue and Costs for Corn, Soybeans, Wheat, and Double-Crop Soybeans* which is available in the management section of *farmdoc*. This document summarizes revenue and costs from farms enrolled in Illinois Farm Business Farm Management (FBFM). **Table 1** shows a table from that publication for corn grown in central Illinois on high-productivity farmland.

In 2018, non-land costs totaled \$569 per acre. As can be seen in **Table 1**, non-land costs included direct costs (fertilizer, pesticides, seed, drying, storage, and crop insurance), power costs (machine hire/lease, utilities, machine repair, fuel and oil, light vehicle, and machinery depreciation), overhead costs (hired labor, building repair and rent, building depreciation, insurance, miscellaneous, and interest on non-land items). All financial costs except those related to farmland control are included in non-land costs. Land control costs are separated into the "land costs" category.

Non-land costs reached a high of \$617 per acre in 2014. The 2017 non-land costs of \$569 per acre are \$49 less than the 2014 high. Obviously, large cost reductions of cost have occurred since 2014.

From 2014 to 2017, fertilizer had the largest decline,

continued on page 2

Table 1. Corn Revenues and Costs, Central Illinois -- High Productivity Farmland, Actual for 2011 through 2017, Projected for 2018.¹

	Year							
	2011	2012	2013	2014	2015	2016	2017	2018P
Yield per acre	174	126	197	231	200	228	227	205
Price per bu	\$6.24	\$6.93	\$4.52	\$3.76	\$3.79	\$3.47	\$3.50	\$3.60
Crop revenue	\$1,086	\$873	\$890	\$869	\$758	\$791	\$795	\$738
ARC/PLC or ACRE	0	0	0	4	45	12	1	0
Other gov't payments	24	24	22	0	0	0	0	0
Crop insurance proceeds	23	295	61	10	31	2	6	0
Gross revenue	\$1,133	\$1,192	\$973	\$883	\$834	\$805	\$802	\$738
Fertilizers	159	200	193	171	166	154	135	130
Pesticides	50	49	66	67	66	64	73	73
Seed	96	108	114	120	118	116	115	114
Drying	19	16	24	28	15	13	16	16
Storage	8	7	8	12	14	11	15	15
Crop insurance	30	25	27	24	24	22	24	24
Total direct costs	\$362	\$405	\$432	\$422	\$403	\$380	\$378	\$372
Machine hire/lease	8	10	11	12	12	13	13	13
Utilities	4	5	5	5	5	5	5	5
Machine repair	17	22	22	24	22	22	24	24
Fuel and oil	18	23	24	24	17	14	15	15
Light vehicle	1	2	2	2	1	1	1	1
Mach. depreciation	39	55	63	65	67	65	64	63
Total power costs	\$87	\$117	\$127	\$132	\$124	\$119	\$122	\$121
Hired labor	14	14	16	16	17	17	18	18
Building repair and rent	5	8	6	6	5	4	5	5
Building depreciation	6	9	5	11	12	12	12	12
Insurance	8	9	10	10	10	10	10	10
Misc	8	8	8	9	8	8	9	9
Interest (non-land)	13	11	11	11	13	13	15	16
Total overhead costs	\$54	\$59	\$56	\$63	\$65	\$64	\$69	\$70
Total non-land costs	\$503	\$581	\$615	\$617	\$592	\$563	\$569	\$563
Operator and land return	\$630	\$611	\$358	\$266	\$242	\$242	\$233	\$175
Land costs	248	270	290	293	278	273	267	264
Farmer return	\$382	\$341	\$68	-\$27	-\$36	-\$31	-\$35	-\$89

¹Results for 2011 through 2017 are summarized from grain farms enrolled in Illinois Farm Business Farm Management. Projections are made for 2018.

Prepared by: Gary Schnitkey, University of Illinois, schnitke@illinois.edu, 217 244-9595, June 2018. Available in the management section of *farmdoc* (www.farmdoc.illinois.edu).

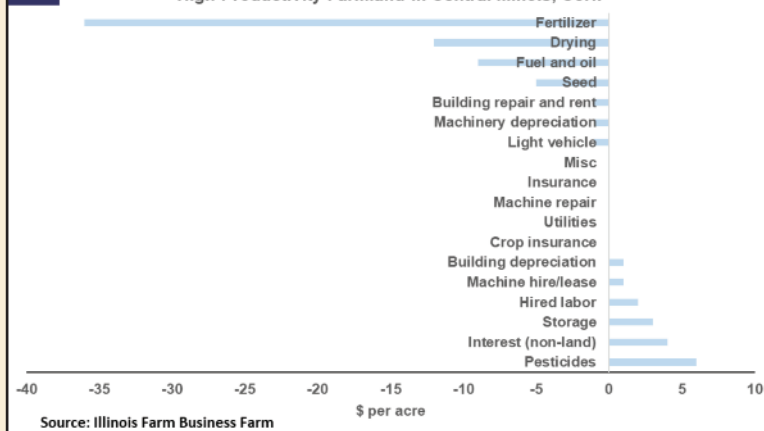
decreasing from \$171 per acre to \$135 per acre, a decrease of \$36 per acre (see Figure 1). The next two categories with the largest cost decreases were drying (\$12 per acre decrease) and fuel and oil (\$9 per acre decrease). The values of these three costs are highly related to energy prices. The correlation coefficient between fertilizer costs and crude oil prices is .84 for the years from 1995 to 2017, .74 for drying, and .61 for fuel and oil. According to the U.S. Energy Information Administration, the spot price of a barrel of crude oil at Cushing, Oklahoma averaged \$94 per barrel in 2014. Crude oil prices average \$49 per barrel in 2018, \$43 in 2016, and \$51 in 2017.

The three costs of fertilizer, drying, and fuel taken together declined by \$57 per acre from 2014 to 2017. Total non-land cost decreased by \$49 per acre, less than the \$57 decline in energy-related costs, meaning that some cost categories increased. The largest increase was associated with pesticides, which increased \$6 per acre (see Figure 1). Interest costs increased by \$4 per acre, storage costs increased \$2 per acre, hired labor increased by \$2 per acre, machine hire by \$1 per acre, and building depreciation by \$1 per acre.

Variability in Energy-Related Costs

In recent years, much of the year-to-year variability in non-land costs is due to variability in energy-related

Figure 1. Change in Non-Land Cost from 2014 to 2017, High-Productivity Farmland in Central Illinois, Corn



costs. To illustrate, Figure 2 shows total non-land costs from 1990 to 2017. Note that total non-land costs went from \$209 per acre in 1990 up to \$280 in 1997. From 1997 to 2003, non-land cost decreased by \$39 per acre to \$241 per acre in 2003. Non-land costs more than doubled from 2003 to 2009, reaching \$534 per acre in 2009. Non-land costs then fell to \$452 in 2010 before rising to \$581 in 2012 and \$617 in 2014. Then, non-land costs fell to \$592 per acre in 2015 and \$563 in 2017, before increasing slightly to \$569 in 2018.

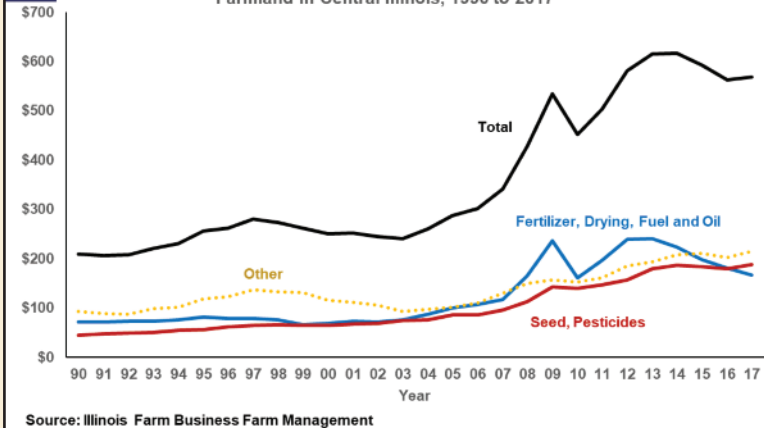
Figure 2 also shows divisions in total non-land costs in three categories:

1. Fertilizer, drying, and fuel — energy-related costs.
2. Seed and pesticides — the two other major production inputs.
3. Other costs — machinery-related costs, crop insurance, storage, hired labor, interest, and other overhead costs.

Energy-related costs were the only category with major variability from year-to-year. For example, the energy-related costs decreased between 2009 to

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Figure 2. Non-land Costs and Components, Corn on High-Productivity Farmland in Central Illinois, 1990 to 2017



Source: Illinois Farm Business Farm Management



2010, then increased from 2010 to 2013 before falling each year since 2013 (see **Figure 2**). Total non-land costs follow the energy-related costs.

Since 2003, costs in the seed and pesticides and in the other categories have generally been increasing. There have been some years of small declines. Take 2016 as an example. From 2015 to 2016, seed and pesticides declined by \$4 per acre and costs in the other category declined by \$8 per acre. This decline is somewhat unusual. From 2003 to 2017, seed and pesticide increased an average of \$8 per year while costs in the other category increased by \$9 per year.

Implications

In recent years, non-land costs declines have mostly occurred because of decreases in energy-related costs. Non-energy-related costs have generally been increasing. Therefore, some of the energy-related declines have been muted by increases in non-energy-related costs.

Energy prices now appear to be rising. During the week from June 11 to June 18, crude oil prices were near \$65 per acre (U.S. Energy Information Administration), above the high \$40 to low \$50 per barrel averages during 2015 to 2017, but still below the \$94 per barrel average during 2014. If historical patterns hold, higher energy prices will result in increasing energy-related costs. At this point, declines in seed, pesticide, and other costs seem unlikely. Rising energy prices could signal the end of decreasing non-land costs.

Source: Schnitkey, G. "Has the Era of Decreasing Per Acre Corn Costs Come to an End?" *farmdoc daily* (8):114, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, June 21, 2018.

2018 Income Projections After Recent Price Declines

In recent weeks, cash corn prices have declined by \$.50 per bushel and soybean prices by \$1.80 per bushel, resulting in much lower 2018 income expectations. Crop revenue and returns are projected for corn and soybeans on high-productivity farmland in central Illinois. These per acre returns then are used to project 2018 net income on a 1,500 acre grain farm. At prices of \$3.40 for corn and \$8.45 for soybeans, 2018 net incomes could approach the average for the past two years if three conditions are met: 1) a significant amount of grain produced in 2017 was sold in 2018 for a marketing gain, 2) at least 25% of 2018 expected production was forward contracted at prices above those currently offered by the market, and 3) yields are at high levels similar to those in the past several years. Not meeting any of these conditions could result in much lower incomes. Of course, price increases could change the income outlook.

Crop Revenue and Return

Most farm income statements are calculated using modified cost principles. Under this approach, gross revenue from crops include 1) crop revenue and 2) change in crop inventory values beginning and ending of the year. Often, differences between the beginning of the year inventory values and old-crop sales prices have significant impacts on gross revenue. Those marketing gains will be a significant source of income on many farms in 2018.

Table 1 shows an example of income calculation for corn and soybeans grown on high-productivity farmland in central Illinois. Several assumptions are used in the construction of gross revenue. The first set

Table 1. Estimates of Crop Revenue and Operator and Land Return, High-Productivity Farmland In Central Illinois, 2018 Projection

	Corn			Soybean		
	Bu	\$/bu	\$/acre	Bu	\$/bu	\$/acre
Old crop						
Sale of old crop	110	\$3.55	\$391	33	\$9.75	\$322
less 2017 EOY inventory value	110	\$3.20	352	33	\$9.10	300
Gain/loss on old crop			\$39			\$22
New crop						
Already priced	50	\$3.75	188	20	\$9.90	198
Unpriced sales	65	\$3.40	221	15	\$8.45	127
2018 EOY inventory	110	\$3.40	374	33	\$8.45	279
New crop sales and ending inventory	225	\$3.48	\$783	68	\$8.88	\$604
Crop revenue and inventory change			\$822			\$626
Non-land costs ¹			563			354
Operator and land return			\$259			\$272
Average operator and land return ²						\$265

¹ Taken from Revenue and Costs of Crop Production, June 2018, http://www.farmdoc.illinois.edu/manage/actual_projected_costs.pdf

² Assume 50% of acres in corn and 50% in soybeans



relates to gains on old crop sales. The farm is assumed to have had 110 bushels per acre of corn in storage at the beginning of the year. The 110 bushels value represents about one-half of 2017 production. For 2017 income statement preparation, this inventory was valued at \$3.20 on the 2017 end-of-year balance sheet. The \$3.20 was near the cash value at the end of 2017 and was used by Illinois Farm Business Farm Management (FBFM) for valuing unsold corn inventory at the end of 2017. From the beginning of the year, corn prices rose and were higher than \$3.20 throughout much of the first half of 2018. Cash corn prices in central Illinois averaged \$3.55 per bushel. A \$3.55 sale on old crop would result in a \$.35 gain per bushel on old crop inventory. For 110 bushel of unsold corn, a \$.35 per bushel gain results in a \$39 per acre gain for corn (see **Table 1**).

For soybean, 33 bushels per acre were assumed to be in inventory at the beginning of the year, roughly half of production. Cash prices in central Illinois averaged \$9.75 during the first six months of the year, and Illinois FBFM inventory value was \$9.10 per bushel, resulting in an estimated gain of \$22 per acre on old crop soybean sales (see **Table 1**). The old-crop corn and soybean gains will have large positive impacts on 2018 income.

Yields for 2018 are projected to be very good at 225 bushels per acre for corn and 68 bushels per acre for soybeans. The 225 bushel corn yield is near averages for farms enrolled in Illinois FBFM for the last two years: 228 bushels per acre in 2016 and 227 bushels per acre in 2017. Similarly, the 68 bushels per acre soybean yield is near the averages in the last two years: 69 bushels per acre in 2016 and 68 bushels per acre in 2017. Both 2016 and 2017 were excellent years, with average yields in central Illinois being near the highest on record. At this point, these yield projections are very preliminary as the key yield setting weather periods are not over. High yields are used because a certain amount of optimism exists concerning 2018 crop yields. As shown in a later section, lower yields will have a large, negative impact on incomes.

Most farmers likely priced some of 2018 production earlier in the year. A survey earlier in the year suggests that farmers hedged about 25% of expected corn production by this point in time (*farmdoc daily*, May 15, 2018). Hedging 25% of corn on high-productivity farmland is about 50 bushels per acre. The average bid price for fall delivery in central Illinois during the first half of 2018 was \$3.75 per bushel. Given these

values, already priced new crop sales of corn has \$188 per acre of crop revenue (see **Table 1**).

For soybeans, 20 bushels are assumed to be priced for new crop, or about 30% of expected production. This value is slightly higher than for corn. The average fall delivery price during the first half of the year was \$9.90, resulting in \$198 per acre of priced new crop sales for soybeans (see **Table 1**).

In recent weeks, corn and soybean prices have fallen dramatically. As of July 9, new crop bids in central Illinois are near \$3.40 per bushel for corn and \$8.45 per bushel for soybeans. These prices will be used for the remaining 2018 production. Given 225 bushels of total 2018 production, there are 175 bushels of corn to sell after taking into consideration the 50 bushels of already sold grain. The 175 bushels is divided between unpriced sales of 65 bushels per acre and end-of-year (EOY) inventory of 110 bushels per acre. Since both unpriced sales and EOY inventory are valued at \$3.40 per bushel, the division between the two does not matter in 2018 income projections. Unpriced soybeans of 48 bushels per acre are similarly valued at \$8.45 per bushel.

New crop sales and ending inventory are \$783 per acre for corn and \$604 per acre for soybeans (see **Table 1**). Adding old crop grain to new crop results in 2018 crop revenue and inventory change of \$822 per acre for corn and \$626 per acre for soybeans. Note that this is the only revenue likely from the 2018 crop as ARC likely will not make payments.

Non-land costs of \$563 per acre for corn and \$354 per acre for soybeans are subtracted from crop revenue to arrive at operator and land return (see **Table 1**). Non-land costs are taken from 2018 Illinois Crop Budgets. Crop revenue less non-land cost then give operator and land returns of \$259 per acre for corn and \$272 per acre for soybeans (see **Table 1**). Given that 50% of farmland is in corn and 50% is in soybean, the average operator and land return is \$265 per acre.

Variability of Operator and Land Returns Across Farms

The operator and land return of \$265 per acre represents a return to farmer and landowner. Under a cash rent situation, the farmer will pay the landowner a cash rent. In central Illinois, cash rents for high-productivity farmland are projected to average \$264 per acre in 2018. A \$264 cash rent yields a \$1 per acre return to the farmer (\$1 = \$265 operator and



Table 2. Operator and Land Return Estimates Under Different Price and Yield Scenarios¹

Price Scenario ² (Corn/Soybean)	Yield Scenario		
	Trend 205/63	Mid 215/65	High 225/68
	\$ per acre		
\$3.40/\$8.45	210	235	265
\$3.75/\$9.80	266	295	328

¹ Calculated using Table 1.

² The prices below are used on unpriced grain. A total of 50 bushels of corn is priced at \$3.50 and 30 bushels of soybeans is priced at \$9.90.

land return – \$264 cash rent), a break-even situation for the farmer.

The \$265 operator and land return will vary depending on previous marketing decisions made by the farmer. For example, old crop sales significantly impact operator and land return. If no 2017 EOY inventory existed, gain on old crop sales would be \$0 per acre (see **Table 1**) and average operator and land return would be reduced from \$265 per acre to \$235 per acre. Furthermore, the 2018 priced grain has a significant impact on returns. If all grain was priced at \$3.40 for corn and \$8.45 for soybean, average operator and land return is further reduced to \$211 per acre.

Yields and prices impact income as well. **Table 2** shows operator and land returns at different yield and price scenarios. A 225 bushels per acre corn yield and 68 bushels per acre soybean yield gives a \$265 per acre average operator and return for prices of \$3.40 for corn and \$8.45 for soybeans. Lower yields of 215 bushels per acre for corn and 65 bushels per acre for soybeans results in a \$235 per acre operator and land return (see **Table 2**), down by \$30 from the \$265 per acre at higher yields. The \$235 return includes the gains on old crop sales and 2018 priced grain as shown in **Table 1**. Trend yields of 205 bushels per acre for corn and 63 bushels per acre for soybeans result in a \$210 operator and land return. This would be a very low return and would result in negative and very low net incomes on many farms.

Table 2 also shows operator and land returns for bid prices of \$3.75 per bushel for corn and \$9.80 for soybeans, roughly the level of prices before recent declines. In this case, high yields of 225 bushels per acre of corn and 68 bushels per acre for soybeans results in a \$328 of operator and land return, \$63 per acre higher than the \$265 estimate at a \$3.40 corn price and \$8.45 soybean price. Recent reductions in prices have caused a significant decrease in operator and farmland returns.

Income Projections

The \$265 operator and land return is used to project income for a 1,500 grain farm with 16% of the farmland owned, 42% cash rented with a \$264 cash rent, and 42% share rented with a 50-50 modified arrangement. Owned land has property tax and interest costs totaling \$120 per acre. In this case, income would be projected at \$77,000 per farm, near the average income for the last 2 years.

The \$77,000 net income is built on three key assumptions that will vary from farm-to-farm:

1. The farm has inventory gains of \$39 per acre for corn and \$22 per acre for soybeans. Eliminating these gains reduces income projections by \$35,000 to \$42,000.
2. The farm has priced 50 bushels per acre of corn at \$3.75 and 20 bushels of soybeans at \$9.90. Eliminating this priced grain and valuing all corn at \$3.40 for corn and \$8.45 for soybeans results in a \$27,000 reduction of per farm income to \$50,000 per farm.
3. Yields will be near 2016 and 2017 averages. Lowering yields to trend levels of 205 bushels per acre for corn and 63 bushels per acre for soybeans result in a \$65,000 income reduction to \$12,000 per farm.

A combination of any of the three impacts listed above is additive.

Summary

Recent price declines have lowered grain farm income prospects for 2018. There still is some possibility of having near average incomes given 1) marketing gains occurred on old crop, 2) over 25% of expected production has been priced at average fall delivery bids earlier in the year, and 3) relatively high yields occur. Not meeting any of those three conditions will result in lower incomes. Rebounds in crop prices are possible, which could increase income prospects. Time will tell on this matter.

As is the usual case, there will be variability in income across farms. This year, the amount of pre-harvest hedging will be a key variable explaining differences in revenue across farms.

Source: Schnitkey, G. "2018 Income Projections After Recent Price Declines." farmdoc daily (8):126, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, July 10, 2018.

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Iowa farmland ownership and tenure

The *Farmland Ownership and Tenure in Iowa 1982-2017: A Thirty-Five Year Perspective* study focuses on forms of ownership, tenancy, and transfer of farmland in Iowa in 2017, as well as characteristics of landowners. The purpose of the study is to document the current situation with respect to Iowa farmland. While the study was conducted in Iowa, we don't expect the results in western- and central-Illinois to be much different.

The 2017 survey was sponsored by the Iowa State University College of Agriculture and Life Sciences (CALs). Below are some of the highlights:

- Eighty-two percent of Iowa farmland is owned free of debt, which represents a significant increase from 62 percent in 1982 and 78 percent in 2012.
- Sixty percent of farmland is owned by people 65 years or older and 35 percent of farmland is owned by people 75 or older.
- Forty-seven percent of farmland is owned by women, 13 percent is owned by female landowners over 80.
- Twenty-nine percent of Iowa farmland is primarily owned for family or sentimental reasons.
- There is a continuous shift away from sole ownership and joint tenancy to trusts and corporations, which accounted for 20 percent and 10 percent of land, respectively, in July 2017.
- Over half of Iowa farmland is owned by someone who does not currently farm, of which 34 percent is owned by owners with no farming experience, and the remaining 24 percent is owned by retired farmers.
- Eighty percent of land was owned by full-time Iowa residents, seven percent was owned by part-time residents, and 13 percent was owned by those who do not live in the state.

Several major trends in the ownership, tenure, and transfer of Iowa farmland are worth noting from the 2017 survey. The first major change is the continuation of aging farmland owners in Iowa. In 2017, over half the farmland (60 percent) in Iowa was owned by people over the age of 65. This was five percentage points higher than in 2007, and twice the level in 1982. In addition, farmland owners who were 75 years or older owned a record 35 percent of all acres in Iowa as of July 2017. The aging farmland owner issue is not just unique to Iowa and not unique to landowners either. The U.S. Census of Agriculture has revealed

aging farm operators, which is consistent with the aging workforce in non-agricultural sectors across the nation, too. However, the continuation of aging farmland owners does pose significant challenges for access to land, especially by beginning farmers.

One of the major trends is the increasing relevance of family or sentimental reasons for owning land. Farmland is owned for three primary reasons: (a) half of the land is owned for current income; (b) 19 percent is owned for long-term investment; and, (c) 29 percent is owned for family or sentimental reasons — an increase from 22 percent in 2012, and a change from 2007 when more people owned their land as a long-term investment versus for current income. This is concurrent with the increasing amount of land held by late-stage landowners and land owned debt free.

Another major trend is a continuing shift away from sole ownership and joint tenancy towards more institutionalized ownership structures such as trusts and corporations. In particular, trusts accounted for 20 percent of all acres in Iowa as of July 2017, while three decades ago almost no land was owned in that fashion. In contrast, the share of farmland owned by sole owners or joint tenancy declined from 80 percent of farmland in 1982 to only half in 2017. Most of the trusts were revocable trusts that last for one generation, which suggests that key motivations for the increasing use of trusts were estate planning, transition planning, and tax management.

All these trends have significant implications for when and how farmland is intended to be transferred to the next generation. Willing or giving the land to family remained the most popular method of intended land transfer, accounting for more than half of all acres of Iowa farmland. The second-most popular intended method of land transfer was putting it into a trust. Only seven percent of Iowa farmland was intended to be sold to a non-family member. The recent federal and state tax policy changes, especially the reinforcements of stepped-up basis for farmland transition and 1031 exchanges for farmland, likely will continue to make the farmland market tight with limited land sales.

For questions about trusts and estate planning as it relates to your farm, call Jon Holthe at (563) 262-3124 and he will be happy to visit with you.

Source: Zhang, Wendong. "Iowa farmland ownership and tenure survey 1982-2017: a thirty-five year perspective." Accessed July 25, 2018. <https://www.extension.iastate.edu/AgDM/articles/zhang/ZhaJul18.html>



*Jonathan D. Holthe
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