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Department of Agricultural Economics
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OWNING NEW-CROP CORN AND SOYBEANS

The prices of new-crop corn and soybeans have declined low enough that selling is not a practical alternative for most producers. In central Illinois, for example, bids for new-crop corn are about 50 cents under the Commodity Credit Corporation (CCC) loan rate. Bids for new-crop soybeans are running 5 to 10 cents under the loan rate. With most producers eligible for the corn loan and all producers eligible for the soybean loan, current prices are not attractive. As long as prices remain low, producers should turn their attention to evaluating alternatives for ownership.

In the case of corn, the most straightforward alternative is to store that portion of the crop that has not already been sold. The cash price is below the CCC loan rate by more than the cost of storage, even if the crop is stored commercially. A crop placed under loan or purchase agreement and forfeited or sold to the CCC in 9 months would return a higher net price than if it were sold now. Retaining ownership allows the producer to benefit if prices eventually rally above the loan redemption price (CCC loan rate plus accrued interest cost). In addition, commodity certificates currently owned could be sold at a substantial premium to the face value.

Where commercial storage rates must be paid or where crop size exceeds storage capacity, producers should evaluate the PIK and ROLL alternative. That is, the producer could arrange for a warehouse receipt for the crop, place the crop under loan, immediately redeem the loan with certificates, and sell the crop. This procedure allows the producer to receive the loan value for the corn crop without using long-term storage. Producers considering this procedure should check with the county ASCS office and the local elevator for details and for information about potential hurdles in the process.

Producers who must purchase certificates to complete the PIK and ROLL process can apply simple formulas to calculate the most that can be paid for certificates. Where storage is an alternative, the formula is: Maximum value = (cash price + storage cost - cost of warehouse receipt) ÷ posted county price. Where storage is not available at any price the formula is: Maximum value = (loan rate - cost of warehouse receipt) ÷ posted county price.

The PIK and ROLL strategy can be applied in a variety of combinations, even for producers who have adequate storage space. For example, producers expecting a postharvest price rally could store the crop, place it under loan, redeem the loan with certificates, and continue to store the crop until prices increase. This strategy obviously involves price speculation.

When the PIK and ROLL strategy is completed, producers give up ownership, and they would not benefit from an unexpected price rally. To benefit from such a rally, producers could buy futures contracts or call options to replace the corn that has been sold. Futures contracts are cheaper but do not protect the producer from a further decline in prices. Call options limit the loss to the amount of the premium paid for the option. On August 14, for example, March corn futures traded at $1.795. A March $1.80 call option could have been purchased for about 9.5 cents per bushel. In this case, owning a call option would be preferred over owning futures if the producer saw a risk of March futures declining by more than 10 cents.

Alternatives for soybeans are easier to evaluate because price relationships make PIK and ROLL unattractive. In addition, the difference between the cash price and the loan rate is considerably less than the cost of commercial storage. For producers with on-farm facilities, storing the crop under CCC loan or purchase agreement is the best strategy. Price risk is eliminated and costs are low. Where commercial storage rates must be paid, producers may want to consider selling soybeans and owning futures contracts or call options. With only a 19-cent spread between November and July futures, the latter two alternatives are probably cheaper than paying storage.

Deciding whether to buy futures contracts or call options is a function of the producers' perception of downside price risk and the cost of the option. On August 14, for example, March futures closed at $5.15. A March $5.25 call option could have been purchased for about 19.5 cents. The call option is preferred to the futures contract if downside price risk is seen as more than about 30 cents.

Darrel Good

Issued by Darrel Good
Extension Specialist
Prices and Outlook

Cooperative Extension Service
United States Department of Agriculture
University of Illinois
At Urbana-Champaign
Urbana, Illinois 61801

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