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University of Illinois at Urbana-Champaign

WEEKLY OUTLOOK
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# PIK AND ROLL ALTERNATIVES

**As corn harvest begins,** cash prices are once again at a substantial discount to the Commodity Credit Corporation (CCC) loan rate. For cash grain producers who participated in the acreage reduction program and are therefore eligible for the loan program, the large discount makes PIK and ROLL an attractive alternative in many situations. That is, producers may receive the CCC loan on the 1987 crop, repay the loan with commodity certificates, and regain ownership of the corn. The corn can then be delivered on a forward contract, sold at the current price, stored and priced for later delivery, or stored for later sale. Which of these alternatives, if any, should be followed depends on the producer's storage situation, previous pricing decisions, price expectations, and local price relationships.

**Examples.** In each of the following examples the following prices and costs have been used:

| | | | |
|---|---|---|---|
| Loan rate | \$1.82 | Temporary | \$0.05/bu |
| Local cash price | \$1.45 | 3 months | \$ .12/bu |
| January price | \$1.60 | 9 months | \$ .26/bu |
| Posted county price | \$1.40 | 3 months | \$ .03/bu |
| Certificates | 112% | 9-month | \$0.06/bu |

For corn that has been forward priced above the current cash price, PIK and ROLL may provide an opportunity to add to the net selling price. Assume 1000 bushels could be placed under loan, with the producer receiving \$1,820. The loan would then be repaid with certificates at a cost of \$1,568 (\$1,400 worth of certificates bought at a 12 percent premium). The net gain is \$252, or just over \$.025 per bushel. If a temporary warehouse receipt had to be purchased, the gain would be just over \$0.20 per bushel. PIK and ROLL would be an attractive alternative even at very substantial premiums for certificates. The most a producer could pay for certificates is calculated as follows:

$$\text{Maximum value} = \frac{\text{Loan rate - posted county price - cost of warehouse receipt}}{\text{Posted county price}}$$

In this example, the maximum value is 126.4 percent.

For corn which has not been forward priced, two benchmark prices should be established in evaluating PIK and ROLL alternatives. First, is the current cash price--\$1.45 in this example. Second, is the net price received by storing under loan and forfeiting to the CCC--\$1.56 for commercial-stored grain and \$1.76 for farm-stored grain, in this example.

For 1,000 bushels of corn placed under loan (\$1,820), redeemed with certificates (\$1,568), and immediately sold (\$1,450), the net price is just over \$1.70 per bushel. That price would be reduced by 5 cents if a temporary warehouse receipt had to be purchased. If on-farm storage is available, this strategy has no benefit over the benchmark price unless stored grain quality is a major concern. It is more attractive than paying commercial storage rates and is certainly preferable to the current price of $1.45. Where storage is available, the most that a producer could pay for certificates can be calculated as:

$$\text{Maximum value} = \frac{\text{Cash price + storage cost - cost of warehouse receipt}}{\text{Posted county price}}$$

When storage is not available:

$$\text{Maximum value} = \frac{\text{Loan rate - cost of warehouse receipt}}{\text{Posted county price}}$$

For 1,000 bushels of corn placed under loan ($1,820), redeemed with certificates ($1,568), stored commercially ($120) and sold for January delivery, the net price would be $1.73 per bushel. With on-farm storage, the net price would be $1.82 per bushel. The net prices exceed the benchmark prices, but only marginally with on-farm storage. Because the premium for January delivery exceeds the cost of storage, this strategy results in a higher net price than for PIK and ROLL at harvest. The most that can be paid for certificates (assuming storage is available) is calculated as:

$$\text{Maximum value} = \frac{\text{January price + 9-month storage cost - 3-month storage cost}}{\text{Posted county price}}$$

A final strategy to consider is to retain ownership of corn after the loan has been repaid with certificates. This strategy is applicable if prices later in the year are expected to exceed the prices currently being offered for later delivery. This is obviously a speculative strategy and could be accomplished with delayed price contracts or basis contracts if storage is not available.

**Two Cautions.** First, as mentioned last week, where ownership of corn is given up with PIK and ROLL, producers may want to consider other forms of ownership to protect the deficiency payment. Second, *carefully examine the income tax implications of PIK and ROLL.* The IRS currently considers PIK and ROLL to involve a *sale* of grain to the CCC and a repurchase with certificates. The sale may produce taxable income.

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