

2010 Illinois Farm Economics Summit

The
Profitability
of Illinois
Agriculture:
*Managing in a
Strong Ag
Economy*

Sponsored by:



Dates/Locations

- ♦ Monday, December 13, 2010 - Champaign, IL
 - ◊ I Hotel and Conference Center
- ♦ Tuesday, December 14, 2010 - Sycamore, IL
 - ◊ Center for Agriculture
- ♦ Wednesday, December 15, 2010 - Galesburg, IL
 - ◊ Best Western Prairie Inn
- ♦ Thursday, December 16, 2010 - Bloomington, IL
 - ◊ Doubletree Hotel
- ♦ Friday, December 17, 2010 - Mt. Vernon, IL
 - ◊ Holiday Inn



ILLINOIS
UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

2010 Illinois Farm Economics Summit

The Profitability of Illinois Agriculture: Managing in a Strong Ag Economy

7:45 – 8:00 am.....Registration and Coffee

8:15 – 8:30 am.....Introduction and Overview
- *Todd Gleason*

8:30 – 9:00 am.....Crop and Livestock Price Prospects for 2011
- *Darrel Good*

9:00 – 9:30 am.....Incomes in 2010 and 2011: Evaluations and
Introduction of a New FAST Spreadsheet
- *Gary Schnitkey*

9:30 – 10:00 am.....When to Sell Corn and Soybeans in Illinois
- *Scott Irwin*

10:00 – 10:30 am.....Break

10:30 – 11:00 am.....The Good, Bad, and Ugly of 2010 Tax
Legislation
- *Gary Hoff*

11:00 – 11:30 am.....Illinois Farmland Rent Factors and Trends
- *Nick Paulson*

11:30 – 12:00 pm.....Crop Insurance Decisions: Updates and
Issues for 2011 and Beyond
- *Bruce Sherrick*

12:00 – 12:30 pm.....Question and Answer/Wrap-Up

12:30 – 1:30 pm.....Lunch (Included)



Crop and Livestock Price Prospects for 2011

Darrel Good, Professor Emeritus

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CROPS

Crop prices have traded in a wide range over the past year, reflecting factors ranging from production uncertainty to energy prices and currency values. This rapidly changing environment is expected to continue in 2011.

The smaller than expected 2010 U.S. **corn** crop along with expanding ethanol production point to marketing year ending stocks at a 15 year low near 830 million bushels. Major market uncertainties center on the potential for China to import corn, the fate of the ethanol blenders' tax credit, and the acreage responses of U.S. producers in 2011. Add uncertainty about U.S. and world monetary policy, economic growth, and southern hemisphere weather and we have the ingredients for wide swings in prices. The 2010-11 marketing year average farm price may be in the upper \$4 to lower \$5 range. Longer term, average corn prices in the low \$4 range seem most likely.

The record 2010 U.S. **soybean** crop was met with extremely strong export demand. Exports are expected to be record large for the year, with China accounting for much of the growth. Stocks of soybeans at the end of the 2010-11 marketing year may not be much larger than the 150 million bushels at the start of the year. Depending on how the South American crop turns out, the U.S. may need a few more acres of soybeans in 2011. Some additional double cropped acreage may result from a rebound in soft red winter wheat acreage. The 2010-11 marketing year average farm price may be in the low \$11 area. Longer term, average soybean prices in the mid \$10 range seem most likely.

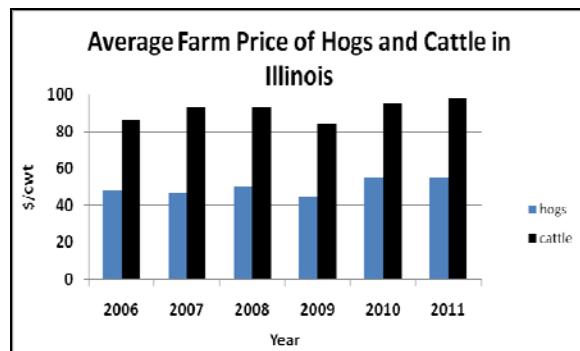
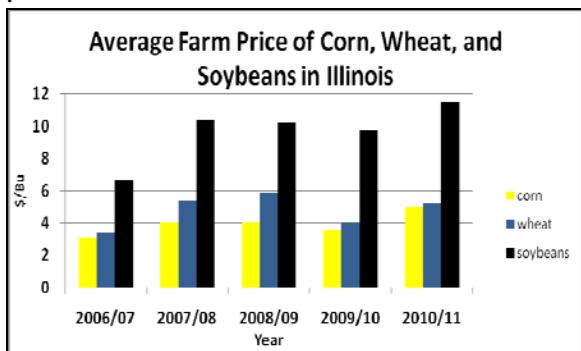
Wheat acreage in the U.S. declined sharply in 2010. The U.S. average yield was record large

resulting in a crop near the same size as the 2009 harvest. Wheat production declined in Canada, Russia, and Kazakhstan. U.S. exports got a boost from the shortfall and are expected to be near the high of the past 18 years. Year ending stocks in the U.S. and world will decline this year, but are expected to be fully adequate. The focus is now on the southern hemisphere crops, the U.S. winter wheat crop, and the Russian winter wheat crop. Most of the 2010 wheat crop in Illinois has been sold, with an average price of about \$5.25. Longer term, average Illinois wheat prices in the low to mid \$5 range seem most likely.

LIVESTOCK

After reaching a peak of 23.35 billion pounds in 2008, U.S. **pork** production declined to 22.23 billion pounds in 2010. Production is expected to stabilize at that level in 2011. Exports of U.S. pork increased from 3 billion pounds in 2006 to a projected 4.7 billion in 2011. Domestic pork supplies had a recent peak of 50.8 pounds per capita in 2007, but are projected at only 46.7 pounds in 2011. The average price of hogs in Illinois reached a six year low of \$45 in 2009, but will exceed \$55 in 2010 and hold at that level in 2011.

U.S. **beef** production peaked at 26.6 billion pounds in 2008, but is expected to total 25.9 billion pounds in 2010 and only 25.4 billion pounds in 2011. U.S. beef exports reached a 19 year low of 460 million pounds in 2004, but rebounded to 2.3 billion pounds in 2010 and will be near that level in 2011. Per capita beef supplies in the U.S. are projected at 57.8 pounds in 2011, down from 59.1 in 2010 and 65.8 pounds in 2006. The average price of fed cattle dropped to \$83 in 2009, but is expected to be near \$95 in 2010 and approach \$100 in 2011.



Notes

Additional Resources

The slides for this presentation can be found at:

http://www.farmdoc.uiuc.edu/presentations/IFES_2010

For current outlook information, see:

<http://www.farmdoc.uiuc.edu/marketing/newsletters.html>

<http://www.agmanager.info/livestock/marketing/default.asp>

<http://www.agecon.purdue.edu/extension/prices/index.asp>

<http://cattlemarketanalysis.org/>



Incomes in 2010 and 2011: Evaluations and Introduction of a New FAST Spreadsheet

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Incomes on Illinois grains farms have changed greatly over the past several years. Illinois Farm Business Farm Management (FBFM) summarizes average incomes from farm enrolled in its service. Grain farms, which receive the majority of their income from grain farm operations and which average close to 1,100 acres, had average incomes over \$200,000 in 2007 and 2008. Income levels fell in 2009 to close to \$90,000 per farm.

On most farms, income levels in 2010 will be above 2009 levels. In certain situations, 2010 incomes could approach 2007 and 2008 levels. While 2010 corn yields were below 2009 yields on most farms, two factors contributed to higher 2010 incomes. First, fertilizer and drying costs were lower in 2010 as compared to 2009. Second, grain prices were significantly higher in 2010. Current WASDE estimates indicate that corn will average \$5.00 per bushel and soybeans will average \$10.75 per bushel during the 2010 marketing year. This compares to a \$3.55 corn price and \$9.59 soybean price for the 2009 marketing year.

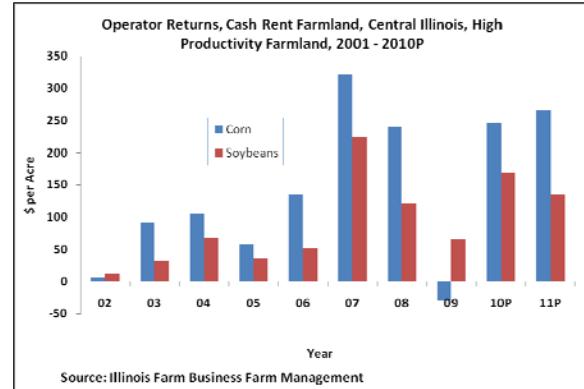
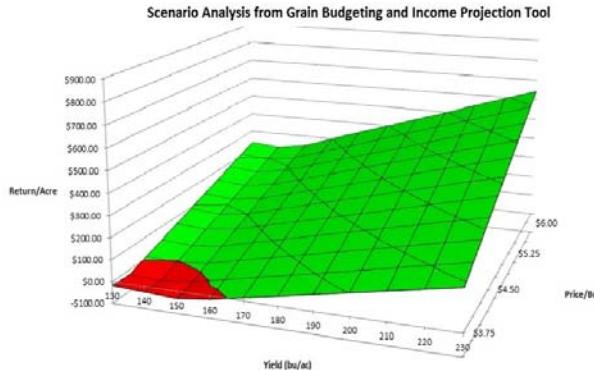
Incomes will vary across Illinois. In general, farm incomes will be low in western Illinois where yields were significantly below average. Farm incomes will be higher in northern Illinois where corn yields were nearer their historical averages. In addition, market timing will impact incomes. Those farms that marketed a great deal of grain prior to harvest will have lower incomes than those that waited to price grain. Also, farms with low yields that did not purchase crop insurance could have low incomes.

At this point, projections point to a profitable 2011 year. These projections are based on corn prices that are in the mid to high \$4 range per bushel and soybeans that are in the mid to high \$10 range. Prices in these ranges would cause income to approach 2007 and 2008 levels.

Much can happen between now and harvest. One key point that will determine whether high farm incomes will be realized comes with the setting of base prices for crop insurance. Projected prices are used to set guarantees on crop insurance based on settlement prices of futures contracts. If the price for corn is near or above \$5.00 and the base price for soybeans is near or above \$11, farmers will be able to purchase crop insurance such that downside income risks are significantly reduced.

One of the new FAST Microsoft Excel spreadsheets that we have developed is the “Grain Farm Budget and Projection Tool”. This tool is easy to use and can be used to quickly assess income possibilities for the next year. It allows entry of crop insurance products and marketing alternatives to evaluate risks of low incomes. This tool is available from the FAST section of farmdoc.

Projections for 2011 using the Grain Farm Budget tool indicate that 2011 could be a profitable year. Moreover, if futures stay high through February there will be a chance of locking in profits using crop insurance. Results from the tool also indicate that marketing a portion of 2011 grain now at high levels will protect against low yields.



Notes

Additional Resources

The slides for this presentation can be found at:

http://www.farmdoc.illinois.edu/presentations/IFES_2010

Links:

Crop budget and production information are available in the management section of farmdoc.

<http://www.farmdoc.illinois.edu/manage/>

B-weekly estimates of fertilizer prices in Illinois are available at:

http://search.arms.usda.gov/mnreports/gx_gr2

FAST Tools are available at:



When to Sell Corn and Soybeans in Illinois

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Corn and soybean producers have long identified marketing as one of the most difficult aspects of the farm business. A major source of frustration is the extreme variability in corn and soybean prices, not only across years, but within years. Price-determining factors can and often do change dramatically, making the decision about when and how much of the crop to price extremely difficult. In the current environment of higher prices and more diverse price-determining factors (e.g., crude oil prices) the challenge and frustration of pricing corn and soybeans is all the greater. The gyration of prices the last several months is only the most recent example of this challenge.

Where should a producer start when thinking about corn and soybean marketing? The following statement by Tom Hieronymus is just as true today as when he wrote it over 40 years ago: “Choosing the time to market grain is a difficult and important task. Here is the key question in deciding when to sell corn, soybeans, wheat, and oats: *Will the price rise enough from harvest to the time of selling to more than cover the costs of holding grain?*” Answering this question depends on a thorough knowledge of seasonal price patterns.

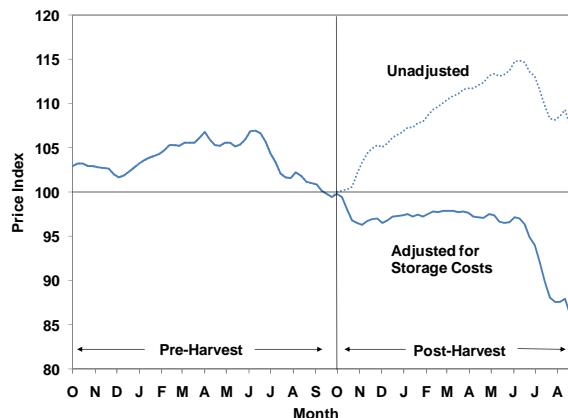
Economic theory provides concrete guidance regarding the seasonal price pattern one should expect for a storable commodity like corn or soybeans. At the most basic level, pre-harvest

bids for harvest delivery should, on average, equal the harvest cash price and post-harvest spot prices should increase at a rate equal to storage costs. Any other outcome would result in prices that are unbalanced from the perspective of buyers and sellers.

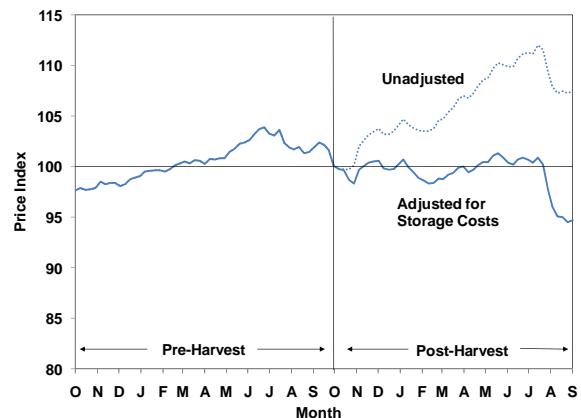
A measure of seasonal price trends for corn and soybeans in central Illinois is developed based on: i) a marketing window for each crop that consists of the 12 months before and after harvest, ii) 1973-2009 as a representative time period, iii) daily central Illinois forward bids for harvest delivery and daily central Illinois spot (cash) bids during and after harvest, and iv) adjustment of post-harvest prices for storage costs that include commercial physical storage costs and interest opportunity costs. The resulting seasonal price index conforms quite well to the pattern predicted by economic theory.

Five practical rules emerge from analysis of the seasonal price patterns: i) there is a modest pre-harvest premium for pricing corn but not soybeans, ii) storage pays in soybeans but not corn, iii) avoid holding grain into the next summer, iv) the seasonal component of prices is highly variable, and v) be skeptical of any “seasonal” trading systems.

Seasonal Price Index for Corn in Central Illinois, 1973-2009



Seasonal Price Index for Soybeans in Central Illinois, 1973-2009



Notes

Additional Resources

The slides for this presentation can be found at:

http://www.farmdoc.uiuc.edu/presentations/IFES_2010

Links to additional materials:

Seasonal Price Patterns for Crops

<http://www.ag.ndsu.edu/pubs/agecon/market/eb61w.htm>

When to Sell Corn, Soybeans, Oats, and Wheat

<http://www.farmdoc.illinois.edu/irwin/archive/papers/When%20to%20Sell.pdf>

Economics of Futures Trading for Commercial and Personal Profit

http://www.farmdoc.illinois.edu/irwin/links_archive_book_Hieronymus1977.asp



The Good, Bad, and Ugly of 2010 Tax Legislation

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2010 has been a bumper year for tax legislation. At the time of publication, there have been six major bills which have provisions that affect farm taxation. Some of the legislation will result in lower tax bills while others could cause substantial increases. This presentation will cover a few that could have a major impact.

It is always important to do tax planning before the end of the year. This year is no exception. As a cash basis taxpayer, you can virtually tell the IRS how much you want to pay. As long as you do it before December 31, 2010, you can sell commodities or make purchases that will affect your net farm income.

Depreciation. The Section 179 expensing election has been given a substantial boost for 2010 and 2011. For assets purchased and placed into service before December 31, 2011, you can elect to take a direct deduction of up to \$500,000. This is an increase from \$250,000 in prior years.

For new assets acquired in 2010, you can also claim a first year depreciation deduction for 50% of the cost, if the asset is qualified new property.

Self-Employed Health Insurance. For 2010 only, if you pay for you and your family's health insurance, you reduce your self-employment income which then reduces your self-employment tax by 14.13%. Furthermore, the Health Care Bill allows you to deduct any health insurance premiums you pay for your child under age 27. It does not matter if the child can be claimed as your dependent.

Form 1099 Reporting. There are three important changes to the Form 1099 reporting. Beginning with payments made in

2011, you must include payments made to corporations as well as individuals. In addition, the total payments for purchases of \$600 or more are also reportable. In the past, you only reported payments for services.

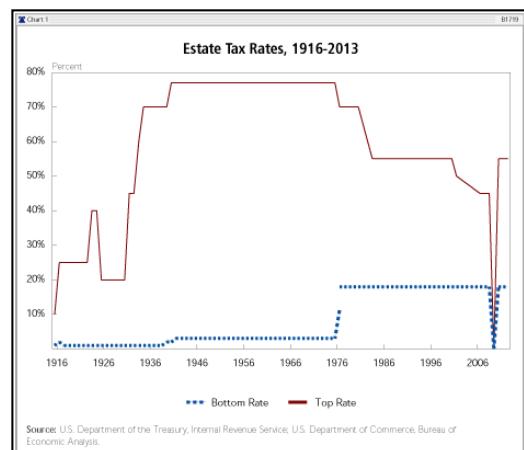
You are penalized for failing to send 1099s to the IRS. The penalty for filing less than 30 days late is \$30; between 30 days and August 1, the penalty is \$60; and for filing after August 1, the penalty is \$100 per Form 1099. A second penalty is assessed if the 1099s are not timely sent to the recipient. The penalty is the same as assessed for not filing timely with the IRS. A third penalty of \$250 per 1099 is assessed for intentional disregard of the law, meaning you did not file a 1099 at all.

Federal Estate Tax. Congress never got around to addressing the federal estate tax for 2010. Therefore, there is no estate tax for deaths occurring in 2010. To ease part of the revenue shortfall this creates, there is also only a limited stepped-up basis for those assets. If you have a large estate (greater than \$3.5 million) this is good news. However, if the estate is greater than \$1 million, this may be bad news. The step-up in basis is limited to the lesser of \$1.3 million or the fair market value on the date of death, except for assets bequeathed to the spouse where the step-up is limited to \$3 million.

These are only a few of the changes. You should check with your tax advisor for additional factors that can affect your tax planning.

Because of the changes from the November 2 election, tax legislation is even more uncertain.

History of Federal Estate Taxes		
<u>Year</u>	<u>High Rate</u>	<u>Exclusion</u>
2002	50%	\$1 million
2003	49%	1 million
2004	48%	1.5 million
2005	47%	1.5 million
2006	46%	2 million
2007	45%	2 million
2008	45%	2 million
2009	45%	3.5 million
2010	0%	N/A
2011	55%	1 million



Notes

Additional Resources

The slides for this presentation can be found at:

http://www.farmdoc.uiuc.edu/presentations/IFES_2010

For current tax information, see:

<http://www.taxschool.illinois.edu/taxbookarchive>

<http://ruraltax.org>

<http://www.irs.gov>



Illinois Farmland Rent Factors and Trends

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This session will focus on trends in rental markets for Illinois farmland. The increasing levels of cash rents and other production costs have been an issue of primary concern for Illinois farmers. Currently, land costs represent approximately 30% of total production costs for Illinois grain operations. Furthermore, over the past decade there has been a shift away from share rental agreements to cash rent arrangements in Illinois, resulting in greater farm-level risk exposure. The session should be of particular interest for producers who rent land through either share or rental agreements, producers who are considering expansion by renting additional acres, landowners, and lenders and suppliers who work with farmers.

First, historical trends and relationships between cash rent levels and a number of factors ranging from crop yields, prices, and revenues to soil productivity will be discussed. As illustrated in Figure 1, cash rents have been trending upward along with crop revenues, production costs, and land values. For example, revenues and the non-land production costs associated with corn production have more than doubled since 1990 while cash rent levels have increased by approximately 70%.

Rent levels tend to exhibit a relatively large benchmarking effect based on previous crop years' levels. Differences in soil productivity are also found to impact cash rent levels. Finally, farm size is found to be positively related to cash rent levels but have a relatively

small effect in practical terms. Significant increases in commodity futures prices throughout this fall, along with other factors, suggest that expectations are for cash rents to continue to increase at least over the short-term.

Second, trends in the types of land tenure arrangements used by Illinois farmers will be discussed. As shown in Figure 2, there has been a dynamic shift away from share rental arrangements towards cash rent agreements in Illinois, while the land ownership rates of farmers has remained relatively constant. Factors which may have contributed to this shift will be discussed, including the expansion of crop insurance availability and participation, the design of Federal commodity programs, and the changing landscape of farmland ownership.

This trend has significant implications for both farm profitability and the risk exposures facing both the producer and the landowner. One would expect a risk premium to be built into the expected returns for cash rented land relative to that under a share rent agreement. However, evidence of cash rented land earning higher returns is limited. Finally, the amount of risk reduction offered by risk management options such as crop insurance is illustrated and compared under both cash and share rental agreement types. These results are then related to the variability observed in Illinois farm-level returns reported by FBFM farms using both types of rental arrangements.

Figure 1. Illinois Cash Rent, Land Value, Revenue, and Production Cost Indexes, 1990-2010

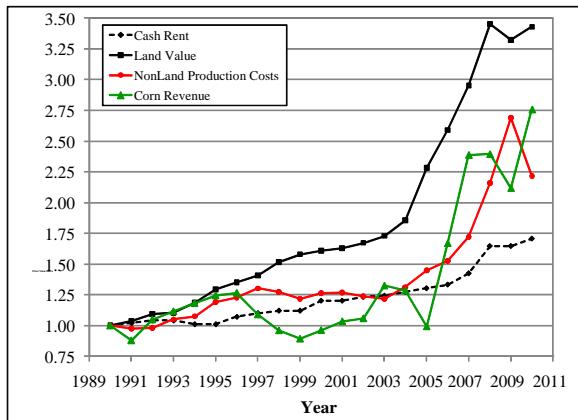
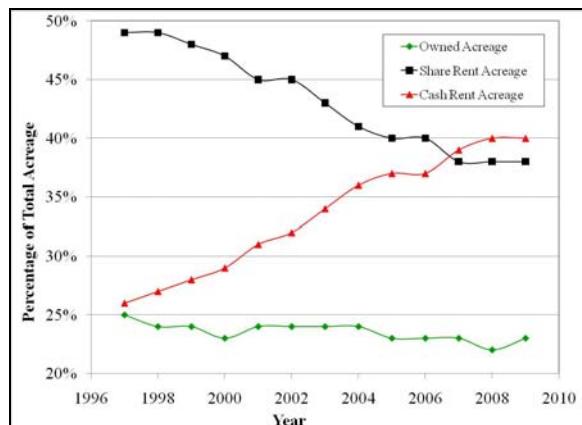


Figure 2. Proportion of Owned and Rented Acres on IL FBFM Farms, 1997-2009



Notes

Additional Resources

The slides for this presentation can be found at:
http://www.farmdoc.illinois.edu/presentations/IFES_2010

Additional Resources

Agricultural Land Values and Cash Rents Annual Summary (various issues). National Agricultural Statistics Service, United States Department of Agriculture. 2010 summary available online at: <http://usda.mannlib.cornell.edu/usda/current/AgriLandVa/AgriLandVa-08-04-2010.pdf>

Farmland Lease Analysis Fast Tool. Available in the FAST Tools section of the farmdoc website:
<http://www.farmdoc.illinois.edu/pubs/FASTtool.asp?section=FAST>

Historic Corn and Soybean Returns and Illinois Farmland and Price Rent Data. Available in the Management section of the farmdoc website: <http://www.farmdoc.illinois.edu/manage/index.asp>

Schnitkey, G. 2010. "Farmland Price Outlook: Are Farmland Prices Too High Relative to Returns and Interest Rates?" Farm Economics Facts and Opinions, FEFO 10-17. Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign. Available online at: http://farmdoc.illinois.edu/manage/newsletters/fefo10_17/fefo10_17.html



Crop Insurance Decisions: Updates and Issues for 2011 and Beyond

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The current high prices and volatility levels in commodity markets have increased the importance of making good crop insurance decisions. Further complicating the evaluation process is the fact that RMA fundamentally altered the crop insurance options with the conversion of traditional yield and revenue policies to the Combination Policy (Combo) for crops beginning with fall 2010. Additionally, farmer subsidy rates were increased for enterprise units in previous years and underwriting support for group policies has changed which some have argued have changed the sales and commission incentives for those selling crop insurance. The newly renegotiated SRA has provisions that might also affect the relative desirability of group versus revenue and yield products, and also revised the exposure that an insurance company has when originating crop insurance in 2011 and beyond. While Group insurance products are not directly affected by the conversion to the combo, the higher indemnity prices expected will also affect the relative attractiveness and performance of group products relative to new and largely untested options in the Combo product. In total, it is both more important and more complicated to make good crop insurance decisions than in the past.

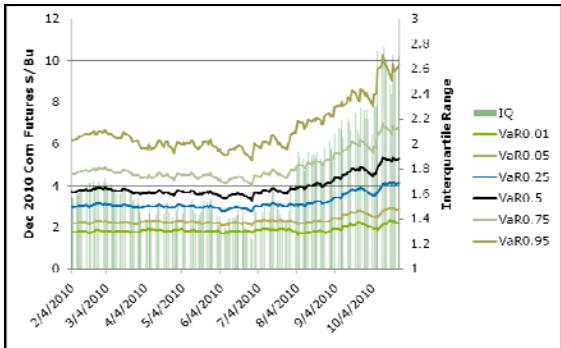
The Combo product has three basic choices that correspond to previous types of insurance. First, the Combo will offer Yield Protection policies which share many of the features of traditional

APH MPCI. Second, Combo allows an election to cover Revenue insurance with a harvest price option that includes many of the features of RA-HP or CRC with the harvest revenue option. Third, the Combo allows an exclusion of the option for the harvest price increase resulting in coverage that closely resembles old RA and base price policies, or the less used IP policy.

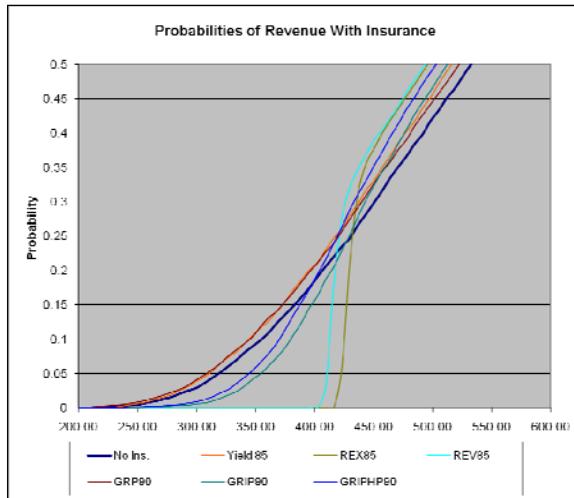
While the rating details are only recently being released, it appears that the rating features of the Combo more closely resemble those of the RA approach than the CRC approach for revenue policies and thus, there is some concern that the relative attractiveness of revenue policies may be diminished. Countervailing this concern somewhat is that the increased market volatility would be expected to increase the attractiveness of the harvest option policies.

This session begins with an examination of the market's estimates of volatility in corn and soybean markets and illustrates the impact of alternative crop insurance decisions on individual farm cases. The expected policy price structures under the new Combo policy for corn and soybean farmers in Illinois are used to estimate premiums and a framework provided for evaluation of the risk and revenue impacts of alternatives. In addition, several new and revised *FAST* tools available to support the crop insurance selection decision are introduced and demonstrated for use in the upcoming crop insurance year.

Corn Futures and Volatility Plot, CZ2010



Alternative Revenue Positions, COMBO and Group Products



Notes

Additional Resources

The slides for this presentation can be found at:
http://www.farmdoc.uiuc.edu/presentations/IFES_2010

farmdoc Crop Insurance main page: <http://www.farmdoc.illinois.edu/cropins/index.asp>

Premium calculator: <http://www.farmdoc.uiuc.edu/cropins/cropinstoolsmain.asp?num=1>

Insurance Evaluator: <http://www.farmdoc.uiuc.edu/cropins/cropinstoolsmain.asp?num=2>

“What-If?” evaluator: <http://www.farmdoc.uiuc.edu/cropins/cropinstoolsmain.asp?num=4>

Risk Management Agency Home page: <http://www.rma.usda.gov/>