

Fine Tune Your Farm Finances ...What Your Lender Expects in 2017

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Key Questions This Fall & Winter

- Can we close out 2016 with a profit or breakeven?
- What does my balance sheet look like?
- Do I have enough working capital?
- What about land values?
- What are interest rates going to do?
- Can I renegotiate cash rents?
- How else can I adjust expenses?
- What if I have to refinance?

BANK'S FAILURE DAZES A TOWN

By WINSTON WILLIAMS
Published: September 16, 1983

BLOOMFIELD, Iowa, Sept. 15— The green blinds were drawn today on the ground floor of the three-story red brick Exchange Bank. Inside, dozens of clerks and accountants sifted through stacks of papers as they ran their fingers nonstop across a battery of adding machines. A burly sheriff's deputy guarded the door.

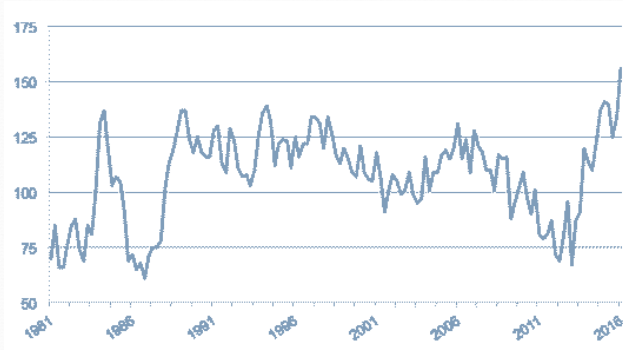
Outside, a hastily posted "out-of- order" sign hung over the night depository chute. A few dazed depositors stood in the steady rain, reading the "closed" notice on the door, confirming for themselves what much of the country had already heard.

The 112-year-old Exchange Bank had been closed by the Iowa banking authorities after a weeklong inspection of the bank's books. In the last year, many banks around the country have been closed, but this case is dramatically different: The depositors' money is uninsured

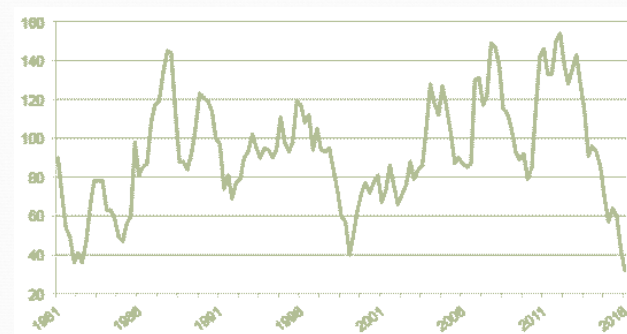
Now vs. the Eighties

- More \$\$\$\$ - size of operations
- Multiple business enterprises and names
- Crop insurance products and usage
- Interest rates are much lower
- More volatility and high frequency trading
- Increased competition for rented land
- Land sellers still about the same as buyers

Chicago Fed – Index of Demand for Agricultural Loans



Chicago Fed - Index of Repayment Rates for Agricultural Loans



In 2017 What Will We Look For?

- Good financial base
- Repayment ability
- Understand production & market risk
- Respect leverage & financial risk
- Practice good management

But what happens when profits are negative and financial position is slipping??

Balance Sheet

- Clear understanding of financial & physical structure of your operation
- Listing of assets and liabilities
 - Assets are items you own or are in process of owning – crops, livestock, feed, vehicles, machinery, accounts receivable, land, etc.
 - Liabilities are any debts you owe – input bills, vet bills, rent, operating, machinery & land loans, etc.
 - Net Worth is the difference

Frank Talk About Working Capital

- Almost everyone's is declining
- It is an absolute value, which can be misleading
- It can change if assets are sold for less than shown
- It does not guarantee payments can be made when due
- The measure of a "good value" will change
 - depending on time of year
 - Type of operation
 - Type of ownership

What About Land Values???

	Land value averages	Corn averages/ marketing year
2003	\$2,275	\$2.43
2004	\$2,629	\$1.99
2005	\$2,914	\$1.95
2006	\$3,204	\$3.09
2007	\$3,908	\$4.40
2008	\$4,468	\$4.13
2009	\$4,371	\$3.57
2010	\$5,064	\$5.46
2011	\$6,708	\$6.35
2012	\$8,296	\$6.94
2013	\$8,716	\$4.63

Source: Iowa State University

THE REGISTER

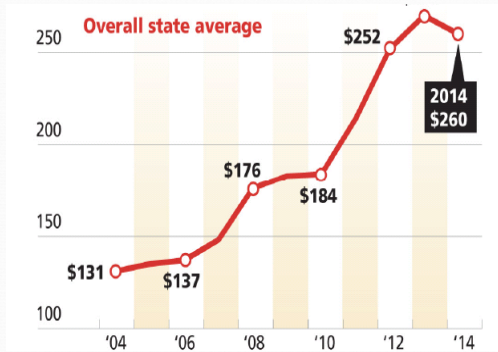
Cash Flow

- Important to match income and expenses
 - Sources of income – crop sales, calf sales, cull cows, salary from off-farm job, etc.
 - Sources of expenses – rent, crop inputs, feed, vet, repairs, interest & principal payments, etc.
- Can use Ag Decision Maker worksheets
- Remember that levels of repayment capacity will vary with prices used

Fine Tuning Your Cash Flow

- Look at crop plans for 2017 crop year
 - Discuss risk management strategies
 - Discuss marketing/forward contracting
- Cost cutting strategies
 - Examine cash rents
 - Examine input costs
 - Examine equipment costs
- Interest rates – time to fix????

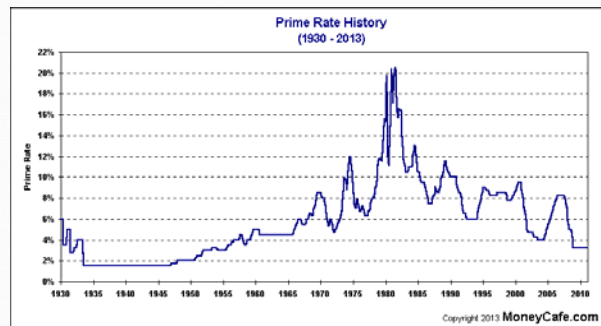
What About Cash Rents?



Can We Lower Cash Rents??

- In the 80s land values fell before cash rents
- Crop insurance makes it more competitive
- Last August some rents were renegotiated
 - Dropped \$25 to \$50 per acre
- Rents need to come down again for 2017
- Share breakeven prices with your landlord
- Share ARC & PLC information with landlord
- Some landlords will accept simple flex leases

Prime Rate History



Breakeven Spreadsheet

Corn Budget 2016	Per acre costs		Cash Rent	
	Per acre costs	Operating Cost	Yields	Breakeven
Land Charge	\$ 206.00	\$ 657.00	30	\$ 21.90
Preplant Exp	\$ -	\$ 657.00	40	\$ 16.43
NH3/Urea	\$ 60.00	\$ 657.00	50	\$ 13.14
P-K	\$ 35.00	\$ 657.00	60	\$ 10.95
Lime	\$ -	\$ 657.00	70	\$ 9.39
Seed	\$ 95.00	\$ 657.00	80	\$ 8.21
Chemical	\$ 42.00	\$ 657.00	90	\$ 7.30
Fuel	\$ 20.00	\$ 657.00	100	\$ 6.57
Repairs	\$ 25.00	\$ 657.00	110	\$ 5.97
Interest	\$ 35.00	\$ 657.00	120	\$ 5.48
Mach'y Payments	\$ 50.00	\$ 657.00	130	\$ 5.05
Labor	\$ -	\$ 657.00	140	\$ 4.69
Custom Hire	\$ 8.00	\$ 657.00	150	\$ 4.38
Crop Insurance	\$ 21.00	\$ 657.00	160	\$ 4.11
Drying	\$ 10.00	\$ 657.00	165	\$ 3.98
Misc	\$ -	\$ 657.00	170	\$ 3.86
Return to Management/Living Exp	\$ 50.00	\$ 657.00	175	\$ 3.75
	\$ -	\$ 657.00	180	\$ 3.65
Total Operating Cost Per/Ac Per/Yr	\$ 657.00	\$ 657.00	185	\$ 3.55
Total Corn Acres Planted	\$ -	\$ 657.00	190	\$ 3.46
Total Cost Per year	\$ -	\$ 657.00	195	\$ 3.37
	\$ -	\$ 657.00	200	\$ 3.29

Managing Risk

- Find a good crop insurance person
 - May want to vary crop mix with type of ground
- Follow advice from Iowa State Extension Experts
 - They are there for advice – not to sell you something
- Find a good marketing newsletter/radio or TV show
 - Bank subscribes to 3, gets 2 free & we “tune in”
- Find a good marketing advisor
 - Ask your lender who others are using
 - Follow the advisors advice



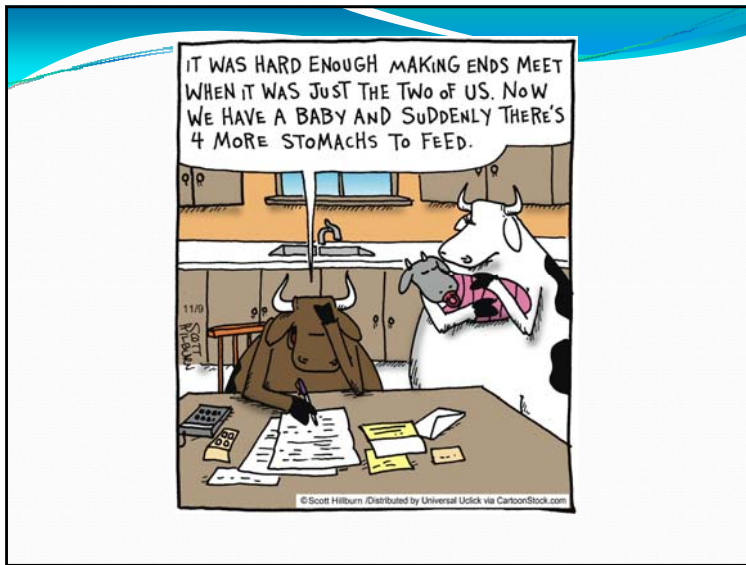
Weather Variables





Pitfalls of Expansion

- Over-using Section 179 rapid depreciation
- Expanding beyond management abilities
- Expanding beyond equipment base
- Expansion consumes more labor leaving little time for planning
- Expansion usually eats or diminishes working capital
- Expansion only to allow the kids to come home



The Inside Scoop on Financial Measures

- Use Farm Financial Standards Guidelines
 - Understand FFS shortfalls
 - Make sure your lender understands them
- Financial Position – provides a benchmark
- Financial Performance – results of external forces, physical actions and management decisions
- Financial measures help in asking the right questions, but they do not provide answers.

Frequently Used Analysis Ratios

- One of the three solvency ratios
 - Debt/asset, equity/asset, debt/equity
- Liquidity (current ratio)
- Repayment Capacity (coverage ratio)
- Profitability (ROA)
- Financial Efficiency (op exp/revenues)

Limitations on These Measures

- Current Ratio Variables
- Debt/Asset Ratio and Interest Rates
- Changes in D/A with Asset Devaluation
- Repayment Ratios Change with Prices
- Acceptable Profitability Ratios Today
- Financial Efficiencies Indicate Resiliency

Dynamics of Leverage

- Easiest to understand when we use the stock market as an example
- Leverage in times of profits:

An investor has \$10,000 to invest in stocks. Let's say that investor wants to buy \$40,000 worth of stocks, so he borrows \$30,000 at 8% to finance the purchase. After one year, the stocks go up 10%. This means that the stock can be sold for \$44,000. The loan is repaid for \$32,400 and the borrower is left with \$11,600 - a 16% return on his original investment.

Dynamics of Leverage

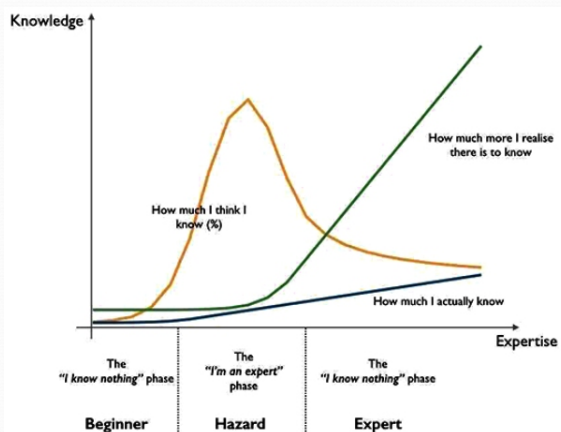
- Leverage in times of adverse price moves:
 - An investor has \$10,000 to invest in stocks. Again, that investor wants to buy \$40,000 worth of stocks, so he borrows \$30,000 at 8% to finance the purchase. After one year, the stocks go down 10%. This means the stock can be sold for \$36,000. The loan is repaid for \$32,400 and the borrower is left with only \$3,600 - a 64% loss on the investment.

Sometimes You Have to Refinance

- Take land debt back to “reasonable cash rent” levels
- Take machinery debt back to \$50 to \$75/tillable acre
- Take cow debt back to \$175 to \$200 per cow
- If these steps don't solve the problem, assets may need to be liquidated

How Can You Survive?

- Borrow on cash flow, not asset values
- Manage risk in production & marketing
- Remember that risk increases rapidly as leverage increases
- Work with your lender to understand your financial position and progress
- Don't be afraid to shed unproductive assets



Where to Get More Information

- Plan to attend seminars put on by the ISU Extension Service and the Iowa Bankers Association
- Be sure to checkout electronic sources:
 - <http://www.ffsc.org>
 - <http://www.extension.iastate.edu/>
 - <http://www.extension.iastate.edu/agdm/>
 - <http://www.card.iastate.edu/land-value/2015/>
 - <http://www.farmdoc.uiuc.edu/>
 - <http://www.finbin.umn.edu/>
 - <http://www.agrisk.umn.edu/Library/Display.aspx?RecID=2727>
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