

Kentucky Farm Business

Management Program State

Newsletter

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DANGER LURKS IN DENIAL OF THE CURRENT FARM ECONOMY

by Craig Gibson

Many farmers have stated that 1998 has been the most frustrating year in their career. All commodity markets have been "on the skids" since the beginning of the year. Portions of Kentucky had by far the worst planting season that can be remembered. Is the worst over? Probably not! The message must be shouted loud and clear . . . Get prepared!

An immediate turnaround of the current situation is not likely. During the mid-1980's, it took several years to find a "bottom." Commodity prices only surged upward with the drought of 1988 combined with payment-in-kind (PIK) program. Demand must surface for U.S. commodities to change the current farm economy. However, anemic foreign economies, the existing strength in the U.S. dollar, and world commodity production must change if the U.S. farm economy is to improve.

Are doom and gloom imminent? It is not for any farmer that faces the current situation as an opportunity. However, in order to do this, a "game plan" must be developed. The starting point becomes anticipation of the future.

Based upon the 1997 Kentucky Farm Business Management Program data and cost and commodity price outlooks, earnings can be forecasted for 1999. The following table presents the forecasts for "farm types" and geographic locations within Kentucky.

Forecasted 1999 Net Incomes By Farm Type and Geographic Location (Per Operator)

	Purchase	
	Grain	Livestock
'97 Net Income	\$ 81,464	\$ 82,594
'99 Net Income	59,035	54,386
Difference	\$ -22,429	\$ -28,208
(Per Acre)	(\$ -17.41)	(\$ -30.46)

	Ohio Valley	
	Grain	Livestock
'97 Net Income	\$ 35,994	\$ 41,655
'99 Net Income	20,951	8,568
Difference	\$ -15,043	\$ -33,087
(Per Acre)	(\$ -11.18)	(\$ -30.05)

	Pennyroyal	
	Grain	Livestock
'97 Net Income	\$ 88,117	\$ 82,594
'99 Net Income	54,184	70,729
Difference	\$ -33,933	\$ -11,865
(Per Acre)	(\$ -21.33)	(\$ -24.31)

	Central Kentucky		
	Grain	Hog	Beef
'97 Net Inc	\$ 42,621	\$ 28,616	\$ 14,634
'99 Net Inc	29,968	17,506	13,210
Difference	\$ -12,653	\$ -11,110	\$ -1,424
(Per Acre)	(\$ -11.91)	(\$ -20.02)	(\$ -3.91)

Note: Forecasted 1999 prices are as follows: \$2.25/bu. corn; 5.50/bu. soybeans; 3.00/bu. wheat, 2.70/bu. white corn; \$40/cwt. hogs; 65.00/cwt. beef.

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Some of the forecasted commodity prices are actually higher than current market prices. For producers that did not forward price sufficient amounts of 1998 production, it naturally follows that 1998 net farm incomes will be lower than 1997 incomes. Regardless, given the forecast of reduced earnings, producers must adjust production costs as well as other expenditures to counter the anticipated earnings reduction.

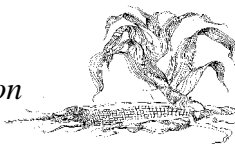
However, this is only achieved through further planning!

A plan to reduce costs and other expenditures requires thinking. It requires a disregard for "spending habits" developed over recent years. It requires investigation of alternatives. It requires the employment of tools that cushion risk. It may even require a reassessment of "wants" and "needs." What better opportunity to use data from the Kentucky Farm Business Management Program, your Specialist, and your County Extension Agent!

There is a myriad of ways to reduce spending. It requires tough choices. In the process, do not dwell on "what I should not have done," concentrate on "what I should do." More than likely, your future depends upon this!

LDP's

by *Bart Peterson*



With harvest beginning, Loan Deficiency Payments present an opportunity to pocket several cents a bushel on corn and soybean crops this fall. The LDP rate is the difference between the County Loan Rate and the Posted County Price. The Posted County Price must be below the county loan rate for LDP's to be available. The Posted County Price is the terminal market price adjusted by CCC's County Average Location

Differentials to reflect the local cash

price. The Posted County Price is available each business day from the **county FSA office.**

Highlights of "LDP's" are included below:

1. Producers may receive up to \$75,000 on LDP's and marketing loan gains.
2. You need to do some paperwork before your crop is delivered.
3. There are two types of payments: Regular (CCC-666) and Field Direct (CCC-709)
4. Beneficial Interest must be possessed to be eligible. If you DP your crop, you have given up beneficial interest.
5. You cannot get an LDP and a CCC loan on the same bushels.
6. The producer picks the date to claim his LDP payment or repay his CCC loan.
7. The Posted County Price is a designated terminal price less an adjustment for transportation.

The main difference between the Field Direct and the Regular stored is the storage. On a Field Direct contract, you get the LDP on the day it is dumped. Each day you deliver it could result in a different price. This is the only option you have if you have no storage. If you have any storage and plan to keep it, maybe only a few days, the Stored LDP gives you more options.

The LDP is based on the calculation that benefits you the least. Example: Today's Elevator corn is \$1.82, making the PCP (Posted County Price) \$1.72 (10 under). The Gulf Price is \$2.08 making the PCP \$1.71 (37 under). Your payment is then \$2.00 - \$1.72 or \$.28. The potential is there that the market might drop another \$.25. Each county has a different loan rate and may have a different adjustment factor, but should

not be different by more than a few cents.

If you normally put your corn and beans under loan and plan to do so this year, you may benefit from a marketing loan gain. In other words, receiving the \$2.00 loan, but only paying back the PCP. You may also lock in your repayment rate when you feel the market has bottomed. You only have 30 days after you lock the rate to pay the loan. If you do not lock it in at some point, the repayment price will be the PCP on the day you repay the loan. We could have some good lock in rates. Keep in mind that any gain you get from this will be income reportable to the IRS and also counts against the \$75,000 limitation.

OPERATOR ONLY ANALYSIS

by *Rick Costin*

As has been noted in previous newsletters, the times, they are "a-changing". Beginning with fiscal year 1998 the Kentucky Farm Business Management (KFBM) Program will be utilizing University of Illinois year-end analysis software. This change will become more evident at check-in time and when receiving "year-end analysis and reports" for 1998. The most noticeable change in format will be due to the conversion from a "Total-Farm Analysis" which KFBM has used since its inception to an "Operator-Only Analysis". The following is an attempt to briefly explain Operator Only Analysis.

The Illinois year-end analysis software uses "per operator acre" in lieu of tillable acres with operator acres defined as the number of acres from which the operator receives an equivalent share of the crops. The basic premise is that costs are shared in the same manner as crop returns. Therefore, the "per operator acre" coefficient should be the same as the

“per tillable acre” coefficient calculated from the total farm information.

On the return side of the equation, “crop returns per operator acre” should be quite comparable to the per tillable acre figure that we now calculate. The “livestock return above feed cost” will be a larger figure per operator acre than per tillable acre any time there is crop share lease involved. Nevertheless, livestock returns on any per acre basis are just a relative figure, and one should review the detailed livestock analysis to really study that part of the business. “Custom Work” and “Other Farm Receipts” will similarly be larger figures on a per operator acre basis, but may be more helpful in that we know that it all occurred to the operator.

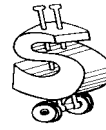
To get accurate crop costs, landlord cash settlements need to be divided into at least five accounts - seed, pesticide, fertilizer, drying and other. Each cooperator will have to post any settlement receipts that he receives from the landlord into the proper account. The program will then subtract the posted figure from the operator’s corresponding expense account before the per operator acre figures are calculated. “Other” will be subtracted from “Machinery Repairs”.

Problem areas may occur where the tenant is required to pay for inputs on acres from which he does not receive the crop. These “leasing costs on non-revenue acres” will have to be identified by expense category. Livestock operations that are on a share arrangement will need adjustments also. These adjustments for those involved will be explained by your specialist!

While a major software change is never “seamless” nor “painless”, with your cooperation, your specialist will attempt to make the conversion as seamless and painless as possible. It

is felt that the end result will be worth the cost of conversion.

DID KENTUCKY FARMERS MAKE MONEY IN 1997?



by Russ Morgan

For Kentucky commercial farmers, 1997 was a year where profitability varied greatly by location within the state and type of enterprises on a specific farm. Net Management Returns were positive for only two groups of the Kentucky Farm Business Management Groups. Net Management Returns were down from 1996 for all groups but the Bluegrass Association.

Farms located toward the western part of the state tended to be more profitable and those farms more reliant upon grain and field crop enterprises tended to be more profitable than those more reliant upon livestock enterprises. There is a relationship between these observations; due to topography and soil types, farms in the western portion of the state tend to be larger with more emphasis on grain production than those located toward the central part of the state. Of the livestock enterprises, dairy appeared to fare the worst in 1997.

While the most comprehensive and accurate measure of a farm business’s economic success or profitability is Net Management Returns, probably the most common measure used is Net Farm Income. (Net Management Returns is calculated by subtracting a charge for unpaid family and operator labor as well as an “opportunity cost” charge for the equity invested in the farm business from Net Farm Income.) Net Farm Income was down in 1997 from 1996 in all but the Bluegrass Area - which saw an increase of 26%. The greatest

decline, relatively speaking, occurred in the Lincoln Trail Area - a fall of 58%; other areas incurred declines of 35% to 57% from 1996. However, even though Net Farm Income declined in most cases, it remained positive in all areas for the eleventh consecutive year.

With the most notable exception of the Bluegrass Area, Gross Farm Returns were lower for the average farm in all areas. Obviously, this was a reflection of the lower crop and livestock prices received by Kentucky farmers in 1997. Additionally, Total Operating Expenses and Depreciation tended to be higher across the state as well. The combination of lower prices and higher input costs squeezed Kentucky farms from both sides in 1997.

A complete report of summarized 1997 performance data (financial and physical) on 300 farm businesses participating in the Kentucky Farm Business Management Program can be found in “The Kentucky Farm Business Management Program 1997 Annual Summary”. This report should be available at your county extension office.

SOCIAL SECURITY PART TWO: PLANNING AND STRATEGIES

by Waylon Ramming

It is important to know where you are at in terms of past contributions when planning for the future. Once you have received your Personal Earnings and Benefits Statement you can begin to assess whether you will want to minimize, maintain or increase your contributions to the Social Security System. Remember retirement benefits are calculated on the highest 35 years of earnings. Anytime you continue to add earnings history once

you have reached 35 years paid in, you eliminate the possibility of any return on the contribution year kicked-out of the formula.

Lets say you are approaching retirement age, have been blessed with steady farm profits or off farm job, and good tax planning. If you began paying into Social Security at age 25, you would have 35 years' histories at age 60. For comparison we can say the lowest indexed earnings amount is \$15,000. If you pay in social security tax between now and retirement based on any earnings greater than that you kick out the lower year. The tax from the year eliminated is then of no value.

Worse is having earnings less than your previous 'low' year. If self employment earnings were \$12,500, than you would owe \$1912.50 in SE tax. Since the earnings amount for that year are less than the previous low, your contribution will not increase (or decrease) your eventual retirement benefit.

The taxpayer with a full earnings history should avoid having self-employment earnings near his low years. All that does is replace one low with another while paying in additional tax without raising their benefit. For taxpayers that project moderate incomes during their final working years, it may pay to bunch self-employment earnings every-other year. If legitimate tax planning can push two years of \$15,000 in earnings into one tax year, then only one year of earnings history (along with the taxes already paid) has to be eliminated. The high year will go into the formula to increase retirement benefits. This strategy works best if other sources of income such as capital sales, interest or dividends can be manipulated into the alternating years to make use of personal and standard deductions while staying within the 15% federal tax bracket each year.

Although SE tax and social security planning most significantly impact the primary owner/operator of the farm business, there are spillover effects to the spouse and children. Once a spouse meets some eligibility factors, they are automatically eligible for either their own retirement or one half of their spouse's benefit at age 65 whichever is greater. With many farm families choosing to have a stay at home parent during their child-rearing years, it is common to see larger monthly benefits by receiving half of the self-employed spouse's benefit. The upside to one-income families is paying social security tax in one taxpayer's name also 'buys' future retirement benefits for the stay at home spouse. Thereby the one income family is potentially getting 50% more for their money. When paying children for labor they provide to the farm, the manager should be aware that his children under the age of 18 are exempt from social security tax. This exemption is only available to sole proprietors.

Retirement age impacts the calculation of your monthly retirement benefit. The full retirement benefit is now available to those who sign up for retirement benefits on or after they obtain 65 years of age. For those who choose to retire early, 80% of the full benefit is available. Qualified spouses can receive 50% of the amount that their spouse receives for those retiring at 65 or older. Qualified spouses receive only 37.5% of the full amount if their spouse retires at age 62. The general rule of thumb says if you retire early you will make up the 20% monthly discount in 10 to 14 years. The majority of retirees choose to start retirement before 65. From purely a financial stance it pays to retire early. The exception is if you are unwilling to truly retire from farming and continue to have high net earnings. Under these situations the retiree will have to repay benefits or may find them taxable.

As indicated there are limitations on the amount you can earn immediately after retirement and still remain eligible for retirement benefits. These limits are on the amount of income you can earn from your farm, other business or from wages. Other sources of income such as interest, dividends, rents or capital sales are not included in these limitations. The younger a retiree is the more restrictive the earnings limitations are for them. For those under age 65 the limit is \$9120 for 1998. Between the ages of 65 and 70 the limit is \$14,500 for 1998. Once you reach age 70, and are still working you are rewarded with no limitation on the amount of earned income you can have.

Again I would encourage everyone to request their Personal Earnings and Benefits Statement either at their local Social Security Office or over the Administrations web page at www.ssa.gov. Error rates are estimated at more than 5%. This could cause a considerable flaw in your future benefits. Social Security experts recommend that you review your Personal Earnings and Benefits Statement every five years at a minimum.

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