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# KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

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## **Credit for 2009**

Jennifer Rogers

Apprehension is in the air as we look forward to 2009. Input costs are up significantly over 2008 levels, crop output price projections are down, and the sinking U.S. economy and credit crisis has many producers concerned with the availability of borrowed funds for the upcoming crop year.

While good management and strategic planning can assist producers when dealing with input costs and output prices, having good, timely records could have a significant impact on your lending situation during the upcoming year.

While segments of Kentucky have been hurt by the credit and housing markets in the recent past, the majority of rural Kentucky has not felt as big a hit. Several Ag Lenders in Kentucky have indicated that there is still money to be borrowed; however, more information may be required from borrowers in order to get it. Being a member of the Kentucky Farm Business Management Program provides you with all of the information that your lender should need to determine if you are eligible for a loan. A Lender Information Packet is now included in the front of your year-end binder. If you will take this packet to your lender, they should have all of the information needed to assess your financial situation.

Two of the factors that a lender will look at to determine your borrowing capacity are Liquidity and Solvency. Liquidity is a measure of your

ability to meet current (within the next year) payment obligations with current sources of cash. Current assets include cash, savings, grain inventories, market livestock, as well as other assets that are quickly converted to cash without selling the productive ability of the operation. Solvency is a measure of the ability to pay all debts in the case of liquidation. Lenders also look at many more pieces of information when evaluating your financial situation. If you have questions about your financial picture your KFBM specialist can provide you with further, personal, explanations and analysis.

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### **Low Capital Gains Give Opportunity**

Rush Midkiff & Suzy Martin

With current discount rates and low capital gain tax rates, now might be the time to “cash out” your FSA tobacco buyout quota contracts. First, taxpayers whose federal ordinary income tax rate is 10% or 15% have a reduced long term capital gain rate of 0% for 2008, 2009, and 2010. Secondly, the FSA tobacco buyout payments are exempt from Kentucky income tax. Therefore, cashing them out would be tax free for people in the lowest two ordinary income tax brackets. Furthermore, current discount rates are averaging roughly 87%. A taxpayer with \$10,000 remaining on their contract could receive a lump sum payment of \$8,700 and pay no taxes on that income. Please, keep in mind that the 0% capital gain rate is only for people in the 10 or 15% income tax bracket. Those paying higher rates are subject to the 15% capital gain rate. Another point to remember is that this tax treatment is only for the quota contracts. Grower contracts will always be taxed at your ordinary income tax rates and are likely to be subject to self-employment tax. As always, it is a good idea to consult with your tax preparer prior to making changes to your income.

### **A Check List for Check-In**

Christa Hofmann

The end of the year will be here before any of us realize it. For those of you on who send your bank statements to the office, please get them in to the office as soon as you can. Here is a list of at least 10 things you should do before our meeting:

1. Finish posting all 2008 income and expenses into your book. This includes any checks that were dated in 2008 but may not have cleared your December bank statement.
2. If you need to send any W-2 and/or 1099's make sure to have your information completed and ready for processing (Remember to bring your Form 943 & K-3)
3. Crop Production should be completed
4. Collect Crop, Livestock, and Feed inventories
5. If you have money borrowed, call your bank and have them fax us your loan histories. If you deal with multiple banks, make sure you request histories from each bank
6. Bring any 1099's you may have received
7. Record your ending Bank Balance on 12/31/08 (including non-cleared checks)
8. Have information on Pre-paid expenses, Accounts Receivable, and Accounts Payable
9. Bring ending balances on Life Insurance, Stocks, and Hedging Accounts
10. Review the list of capital sales and purchases, indicating any equipment traded with the purchase. If a new loan has been set-up have the paperwork available.

Having these 10 items completed should make your check-in visit go smoothly.

## Budgeting Issues

Michael Forsythe and Evan Conrad

As we have seen in the last two years, crop prices are extremely variable. For example, we have seen soybean prices as low as \$6 and as high as \$14. As we have seen this year, crop prices will eventually start to fall again after they reach a certain point. This is just one of the many issues that need to be examined when you are planning for next year.

Another major issue and concern that must be addressed is the rising input costs. As input prices continue to rise, it is very important to look at the cost per acre for each crop. All variable costs should be factored into this calculation, not just the obvious seed, chemical, and fertilizer. It is very important to also include fuel, labor (hired and operator), crop insurance, cash rent, and operating interest. The following calculations are based on using \$150 cash rent and including P and K in the fertilizer expenses for soybeans. Projected per acre variable costs for each crop are \$531, \$353, and \$651 for corn, full season soybeans, and double crop wheat and soybeans respectively.

When these costs are expanded to figure a total variable cost for your farm, you should show a positive return above variable costs. Although, the return above variable costs should be positive next year, this result can be mistaken for profit. Many other costs such as land, machinery, and buildings are not accounted for. There are a few options you can look into to help decrease the costs of production. Each operation will vary, however some methods of decreasing costs are; saving wheat seed, not renting less profitable ground, or whether or not to apply P and K to your soybeans.

Land Rent is another hot topic as we look forward to 2009. Land rents have become highly variable as commodity prices increased and tobacco growers lost ground to new housing and business. It is easier to justify paying higher rent when crop prices are also high, but as we discussed earlier, crop prices are very volatile. As input costs continue to rise, it is even harder to justify paying high cash rent. You may be able to make enough

income with good crop prices and in good crop years, but you must ask yourself if you can justify paying the high rent prices in average or below average years with lower crop prices. You must also consider the quality of land before deciding it is worth paying higher cash rent. If the land averages 170-180 bushel of corn in a normal year, you can justify paying more than if it averages 140-150 bushel corn in a normal year. You must remember that once you agree to higher cash rent, it will be hard to convince the landlord to reduce the rent if you realize you can not afford paying the higher price.

Each operator will have different issues and concerns when looking ahead to 2009. Please contact your specialist with any additional questions that would pertain to your area.



## Understanding the ACRE Program

Suzy Martin and Rush Midkiff

The Average Crop Revenue Election (ACRE) is a new commodity program out of the Food, Conservation and Energy Act of 2008. The ACRE program is an optional, revenue-based program. However, electing to participate in the ACRE program reduces direct payments and lowers marketing assistance loan rates. The reduction is 20% for the direct payments and 30% for the marketing loan rates. It also eliminates any potential counter-cyclical payments. Producers can enroll any year during 2009-2012. Upon

making the election, the farm is enrolled in the ACRE program for the remainder of the farm bill. The decision to sign up for the ACRE program is a farm to farm decision and affects all crops grown, as well as, all individuals receiving payments on that farm.

The ACRE program provides producers a revenue guarantee similar to a combination of Group Risk Income Protection (GRIP) and Crop Revenue Coverage (CRC). For a farmer to receive an ACRE payment, two conditions must be met:

- 1) *Actual State Revenue* must be less than the *ACRE State Revenue Guarantee*, and
- 2) *Actual Farm Revenue* must be less than the *ACRE Farm Benchmark Revenue*.

*ACRE Actual State Revenue* is defined as the ACRE actual state yield per planted acre multiplied by ACRE national average market price. *ACRE State Revenue Guarantee* equals 90% of (ACRE benchmark state yield multiplied by the ACRE guarantee price). The ACRE benchmark state yield is the state-level, 5-year Olympic average yield per planted acre. The ACRE guarantee price is the national average market price for the 2 preceding crop years. *ACRE Actual Farm Revenue* is defined as the actual commodity farm yield multiplied by the national average market price. *ACRE Farm Benchmark Revenue* equals the 5-year Olympic average farm crop yield per planted acre multiplied by the ACRE program guarantee price plus crop insurance premiums per acre.

The per-acre payments under the ACRE program equal the difference, if positive, between the ACRE guarantee and actual state revenue. ACRE payments are capped so that if the difference between the revenue guarantee and actual revenue is greater than 25% of the ACRE guarantee, then the ACRE payment equals 25% of the ACRE guarantee. ACRE payments are issued October 1 after the crop is harvested and there are no advance payments. The per person ACRE program payment limitation may not exceed \$65,000 plus the 20% reduction in direct payments under ACRE.

Clearly, producers have a big decision to make for each farm. The expected payments under the ACRE program need to be greater than the payments they are giving up. Remember, there is a decrease in direct payment and marketing loan rates and a forfeiture of the counter-cyclical payments when a farm enrolls in the ACRE program. There are numerous factors that will affect producers' decisions, such as variability in state level yields and national price. To help in this decision making process, the University of Kentucky's Agricultural Economics Department is working on an analysis tool to assist producers. Keep in mind the USDA has not released a date for sign up yet. In fact, the USDA has not released the final regulations. The analysis tool will be ready when sign-up begins, however it is likely that won't happen until early next year.

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## Good Luck Rick

On January 2<sup>nd</sup> our current most senior specialist, Rick Costin, from the Lincoln Trail Association will be retiring. Upon his retirement Rick will have been an employee of the University of Kentucky for 31 and half years, spending the last 18 years of that time as an Area Farm Analysis Specialist.

While Rick will be leaving his "official" specialist position, he has agreed to stay around in a post-retirement role to help fill some of the extension responsibilities as well as help get his replacement started off on the right foot. During retirement Rick also plans to have a personal business as well as do "Rick" things (catching up on all of those chores that he has been neglecting). When asked what he will miss most, Rick responded, "paid vacations". Rick said that his favorite part of the job has been the feeling that what he has worked so hard at doing has possibly made a difference in someone's life to help them get to a better place. Rick will be missed by the group for his experience as well as his own way of adding light to any situation. We wish Rick the best of luck in his retirement.