The fmsi REPORT

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FMSI Summer Update

It has been 16 years since wheat farmers collected a **Loan Deficiency Payment** (**LDP**). We started receiving phone calls within the last two weeks and it is interesting to note that young farmers had never heard this terminology. Everyone is trying to decipher the future in light of the rapidly changing ag environment. First and foremost today, our industry is going through an adjustment period coming off record farm incomes, record farm input costs and multiple years of increasing land values. The land price movement has been in the forefront for farmers, landowners, and lenders for a decade now during this historic run-up of land values. The important thing that we all know is that **higher land values** may look good on paper, give us borrowing capacity, but it doesn't add to cashflow or pay the bills unless you sell the land. Overall demand for good land remains solid, but interest in lower quality cropland and grassland is declining in most areas. We have actually had several public auctions that have resulted in a "no sale" and the land is still on the market.

Grain and livestock prices have moved sharply lower impacting farm incomes across the board. Bankers have been asking for more security for loans. This year many operators have had to re-establish secured line-of credit/operating note for input costs at their local bank or vendor. In some cases, operators were asked to seek Farm Service Agency (FSA) loan guarantees to secure debt. It is important to know your production costs: seed, fertilizer and crop production inputs. So this brings me to the question which hasn't been an issue for many years: "***Do you know your breakeven point***?".

We work with a large number of farmers with a wide range of farm sizes and it is still surprising how many farmers are not able to answer this question. It is not that uncommon to ask a farm client how their year went and their response will be "well, there is still money in the checking account." If you do not have a good grasp on the farm finances it is extremely difficult to make good strategic decisions for the future including when to sell crops, when to expand, when to upgrade equipment, etc.

The table on the back of this newsletter provides a good example of different expenses that should be included in your total cost per acre and how to calculate a breakeven point. I highly encourage you to estimate your own total cost per acre. Many farmers we work with have a strong disdain for the financial / administrative side of the business and if you are one of those farmers, **We are available to help work with you through the process.** Amongst all the other summer time tasks – establishing what your true break-even is should be a priority. Where are yours in comparison?

The two "**great variables**" in this table are **Land Costs** & **Family Living** which are the least discussed on many farms. If you're cash renting ground, the $100/acre will probably cover your land cost – but if you've purchased land within the last few years and are making payments on it, your land costs may be closer to $200/acre. Family Living can also vary greatly…..if you farm 1,000 acres the $40/acre would equate to $40,000/year for Family Living. But, if you only farm 750 acres and your Family Living is $50,000 year – your per acre cost is now $67/acre. Driving your costs down to improve your break-even can be worked on every day and has to be on every producers "top of mind." In order to make good marketing decisions for your grain, knowing your break-even is critical. Start by updating your cost of production numbers, and with good records, keep updating them. When you know and have confidence in your break-even you can follow the markets and pull the trigger when it is best for your operation.

In this example, using 120 bushel/acre **CORN - $3.88/bushel break-even**; using 45 bushel/acre **SOYBEANS - $7.96/ bushel break-even**; and using 60 bushels/acre **WHEAT - $5.30/bushel break-even**. Which side of $466/acre corn; $358/acre soybeans; and $318/acre wheat are you?

Once in place, this is not a static amount but something that should be reviewed periodically and actual results should be compared against these estimated amounts. This will help you fine tune your estimates but can also help you identify areas of large variances and potential areas to save cost.

References: Kansas State University & University of Nebraska
http://cropwatch.unl.edu/economics/budgets
http://www.agmanager.info/farmmgt/fmg/nonirrigated/default.asp

Ten Worst Management Practices for Young Farmers

The following list was compiled from a presentation by Dr. David Kohl, Professor Emeritus of Agriculture Economics at Virginia Tech:

- **Investment in non-productive assets:** One of the things that we often see, particularly in good economic times, is people investing in so-called "killer toys". In other words, those investments outside of the farm or ranch business that actually bring the overall profit picture down. Examples include boats, campers, vacation homes, timeshares, etc.

- **High family living costs:** It is expensive to live in today's world with the conveniences we're accustomed to (cell phones, cable TV, vacations, $50,000 vehicles, etc.). Every dollar of family living expense is another dollar of **profit** the farm has to generate. It's very difficult to bring family living costs down after everyone is accustomed to a certain lifestyle. Not developing or adhering to a personal budget will result in failure almost every time.

- **Spending your way out of income tax:** It's not all bad to pay income tax – because that means you're profitable. Prepaying for input costs (seed, fertilizer, chemicals) before December 31st for the next operating year might be a good decision – the same goes for deferring income into January of the next year. But buying a new piece of iron just to avoid tax isn't necessarily the best practice. The equipment dealers know when farm incomes are high and price their equipment accordingly. If you purchased a new combine within the last 3 years, how much is that machine worth today? Was the income tax savings greater than the decline in the combine's value over the last 3 years?

- **Poor financial systems:** Not having good financial records can be devastating to any business. If the financial reports don't give you an accurate assessment as to where the business is – management has little chance to take corrective action. On the other extreme, you can have audited financial statements – but if they're not being used in decision-making, they are worthless.

- **Co-mingling business and personal expenses:** Often times personal expenses are co-mingled into the farm business. When that occurs, it becomes impossible to determine an accurate cost of production. Additionally, it gives you an inaccurate picture of the family living cost.

- **"Bigness on the brain":** Those with this condition tend to focus on growth and growth only, rather than efficiency. If I can generate a $75,000 profit 1,000 acres of land……why would I want to farm 2,000 acres for the same $75,000 profit? Getting better before getting bigger is critical to long-term success.

- **Mismanagement of the family member's return:** Often times a family member returns to the operation on a manager's salary, but performs a hired employee's work. That doesn't cut it.

- **Attempting to hit a home run every time:** Having "bragging rights" at coffee of selling $4.00 corn may impress your neighbors. However, it doesn't impress your banker if you sold 1,000 bushels at $4.00 and the other 50,000 bushels at $2.75. Developing and adhering to a marketing plan is critical to the long-term success of your farm. One of the great fallacies of the profitability we've experienced over the last 10 years is that people without a marketing plan profited, but times have changed. Success is often a series of base hits, not home runs.

- **Not having a profit plan:** We made a profit, now what? Successful farms tend to follow the 60-30-10 rule. 60% of the profits will be invested back into the business for efficiency & growth, 30% building a financial cushion (working capital and liquidity), and the other 10% will be spent. Not having a plan of how to spend profits will ensure the farm will not make financial progress – and many times you'll even look back and ask yourself, "where did the $$$ go?"

- **Refusal to learn or listen:** Stay away from two sets of people, the victims and the know-it-alls. The victims will blame everybody else for the problems, and the know-it-alls have forgotten how to learn. Historically, being a farmer meant being ***in***dependent. But, the future generation of farming must be ***inter***dependent in order to succeed. Having a "team" of experts helping you make management decisions is critical.

New Overtime Rules in Effect December 1, 2016

On May 18th, the Department of Labor issued new regulations concerning overtime pay……which will have an impact on many of our clients. Most farmers assume that they are not required to pay overtime for any farm work performed by their employees. Although this is correct, we need to make sure that farmers understand what work is exempt under the Agricultural Work exemption and what work might be exempt under other provisions.

First, **Agricultural Work is exempt from overtime**. However, this work needs to be "directly" related to farming. Work performed on the farm for *management* or *administrative purposes* usually does not count. For example, someone who drives a tractor full-time is exempt. Someone who does the farm bookkeeping is not exempt. If someone does a combination of both exempt farm labor and non-exempt work, then usually the worker will be subject to overtime rules. To read further guidance on Agricultural Employers please review the following website**: https://www.dol.gov/whd/regs/compliance/whdfs12.pdf**

Non-farm work done by farm employees may still be exempt under other standards. Usually, most management and administrative functions will be exempt, however, they are only exempt if the annual salary falls over a certain level. The old salary level was **$23,600** or $455 per week. The Department of Labor's new rules have increased this salary level to **$47,476** or $913 per week. Frequently Asked Questions from the Department of Labor on the new rules can be reviewed here:
https://www.dol.gov/whd/overtime/nprm2015/faq.htm#s1

Therefore to not pay overtime, the employee must perform an exempt function AND have a salary over the required level.

Let's look at an example:

Farmer Johnson has four employees (1 manager, 2 farm laborers, and 1 bookkeeper). The manager receives a salary of $50,000 per year; the 2 farm labors get a salary of $35,000 per year, and the bookkeeper gets a salary of $30,000 per year.

Under the old rules, all four employees met both requirements. All positions were exempt from overtime rules (manager & bookkeeper meet the Executive & Administrative exemptions and the 2 farm laborers are exempt as Agricultural Employees). Additionally, all were paid a salary over $23,600. Therefore, no overtime was required to be paid.

Under the new rules, three employees would be subject to overtime since they only meet one of the two requirements. They all still meet the exempt function requirement; however, the annual salary of the 2 farm laborers and the bookkeeper is under the minimum requirement of $47,476. The manager would meet both requirements as his salary is above the minimum requirement. ***Farmer Johnson would be required to pay overtime to the farm laborers & bookkeeper for any hours exceeding 40/week.***

***Options for Compliance* -** *Farmer Johnson has a few options to choose from in order to comply with the new rules:*

Raise Salaries – pay all of his employees at least $47,476/year. This might work well if an employee is near that level already.

Pay the Overtime – pay overtime for hours in excess of 40 hours per week.

Adjust Schedules – reorganize workloads & employee schedules to make sure they don't exceed 40 hours per week.

Adjust Wages – Employers can adjust the amount of an employee's earnings to reallocate it between regular wages and overtime so that the total amount paid to the employee remains largely the same. Regular wages cannot fall below the Federal & State minimums ($7.25/hour for Kansas). The employees' hours worked must still be recorded, and overtime must be paid according to the actual number of hours worked each week.

Again, Farmer Johnson is simply an example and if you think this might apply in your situation, make sure to discuss this with your Fieldman. Not complying with these new rules could become very costly as the employer could be found liable for unpaid overtime compensation, legal fees, and also face significant fines. The new overtime rules go into effect **December 1, 2016** so begin planning for them **today**.

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Estimated Cost of Production Including Land Costs and Family Living

Expense Estimate/Acre	**Corn (Dryland)** No-Till, SmartStax RIB Complete	**Soybeans (Dryland)** No-Till, Roundup Ready	**Wheat** No-Till, Cert & Treated Seed
Seed	97	60	28
Fertilizer	65	21	57
Chemical	46	35	20
Insurance – Crop	10	9	5
Custom Hire/Crop Consulting	15	12	5
Operating Interest	9	4	4
Labor @ $20/hour	10	9	6
Machinery – Fuel/Oil	6	6	5
Machinery Repairs	18	17	11
Machinery Depreciation/Interest	30	25	17
Overhead (Acct, Office, Vehicle Cost)	20	20	20
Total Non-Land Expense/Acre	**326**	**218**	**178**
Plus Land Costs/Rent/RE Taxes	100	100	100
Family Living/Operator Draw	40	40	40
Total Land Costs/Rent/Draw	140	140	140
Total Expense Including Land & Draw	**466**	**358**	**318**