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Ag Decision Maker

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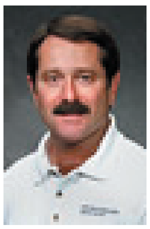

Historical LDP Trends

by Steven D. Johnson, Ph.D., Farm & Ag Business Management Field Specialist, Iowa State University Extension, (515) 261-4215, sdjohns@iastate.edu, www.extension.iastate.edu/polk/farmmanagement.htm

Loan Deficiency Payments (LDPs) are provided by the current federal farm program on qualified commodity crops when cash prices reflecting the Posted County Price (PCP) falls below the established County Loan Rate. An LDP can be claimed by the entity "at risk of production" on those bushels that are harvested and for which beneficial interest is maintained; including corn silage, bushels held for livestock feeding and pre-harvest sales.

The program offers a farmer two ways to increase revenue that can offset low market prices. One is to claim the LDP any time after you've harvested the crop and have beneficial interest in it - up to May 31 of the year after harvest.

LDP vs. the Marketing Loan

Instead of claiming the LDP, qualifying bushels can also be placed under a nine-month marketing loan program that accrues interest at a lower government established interest rate. Should the PCP remain below the County Loan Rate, one can repay that loan at the lower PCP and pocket the difference, which is called a marketing loan gain. The interest accrued on the loan can be waived.

Yet, most farmers opt for the LDP strategy rather than the marketing loan since it is simple to understand, provides access to cash when grain prices are low and requires less paperwork than the marketing loan.

In 2004, U.S. farmers harvested over 11.8 billion bushels of corn. Of this total, LDPs were claimed on 9.6 billion bushels, or more than 80% of the entire crop. The marketing loan was used on just 1.4 billion bushels, or 12% of the respective bushels. Through June of this year, the average LDP payment on last year's crop was 27¢ a bushel vs. just 19 cents thus far for the average marketing loan gain. This gain likely increased late in the summer with the decline in futures price along with a very wide basis.

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Handbook updates

For those of you subscribing to the handbook, the following updates are included.

Pricing Forage in the Field – A1-65 (2 pages)

Farm Costs and Returns Summaries – C1-10 (2 pages)

Costs and Returns – C1-11 (2 pages)

Costs and Returns by Economic Area– C1-12 (2 pages)

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LDP Trends for Iowa Corn

Each marketing year is different as reflected in the chart featuring Iowa Corn LDP over the past 7 years, each represented by a line.

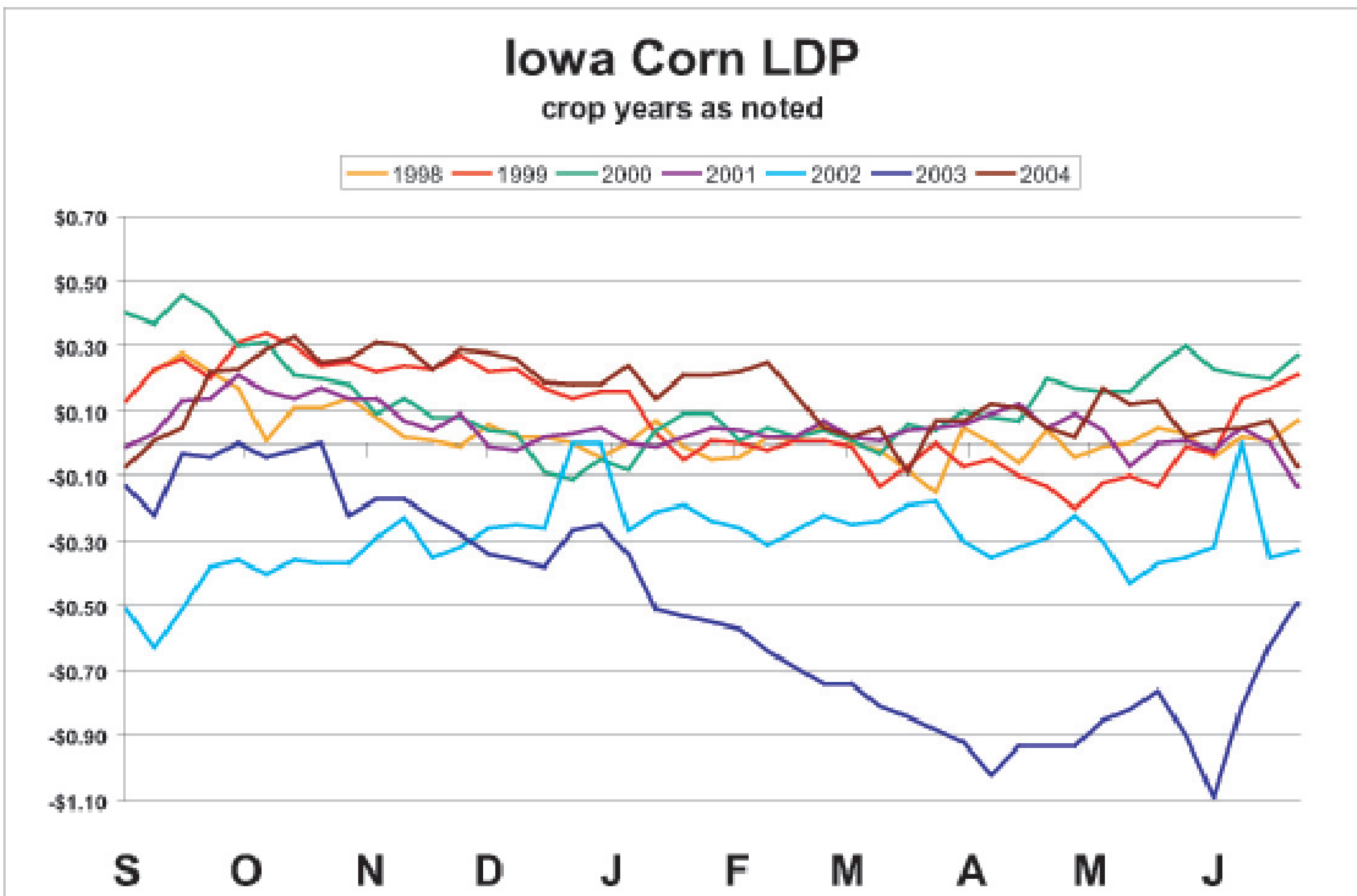
Note that the trend reflects the largest LDP (highest positive price per bushel) that occurs annually early in the market year (September or October). This larger LDP is associated with the harvest pressure that brings lower futures price and wider basis. As the basis improves though late harvest the LDP declines to a level in most years that does not exist (falls below $0.00/bu).

Note in some years the LDP became positive in the late spring and summer months. After May 31st, the LDP can no longer be claimed. However, the use of the marketing loan program can lead to the ability to capture the marketing loan gain and waive the accrued interest on this loan beyond late May.

Reducing Downside Price Risk

With a good 2005 harvest, large LDPs are quite likely for corn. However, claiming the LDP on bushels is the "higher-risk, higher-reward" strategy. That's because bushels on which the LDP is claimed, yet those same bushels are held unpriced, typically have no downside price protection.

The marketing loan strategy in essence acts as a free put option on those bushels covered. It puts a floor under bushels being stored at the county loan rate. In most years, the LDP strategy makes sense for the portion of your corn crop that you plan to feed or won't be storing into the next spring or summer months. The decision likely depends on a farmer's understanding of the marketing loan program, crop price risk assessment as well their own individual marketing strategies.



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One consideration might be to manage price risk by using the LDP on the portion of your bushels that you plan to feed or market in the fall or winter months. The balance of the bushels that you plan to store beyond the winter months might then feature the use of the marketing loan to better manage downside price risk.

Soybean LDP Trends

While Iowa Corn LDP trends favor larger LDP and/or marketing loan gains early and late in the marketing year, the Iowa Soybean LDP trend is much less predictable.

Note that in the past 3 marketing years the LDP was only available for a short period of time. Thus claiming the soybean LDP has been somewhat dependent on one's ability to manage crop price risk.

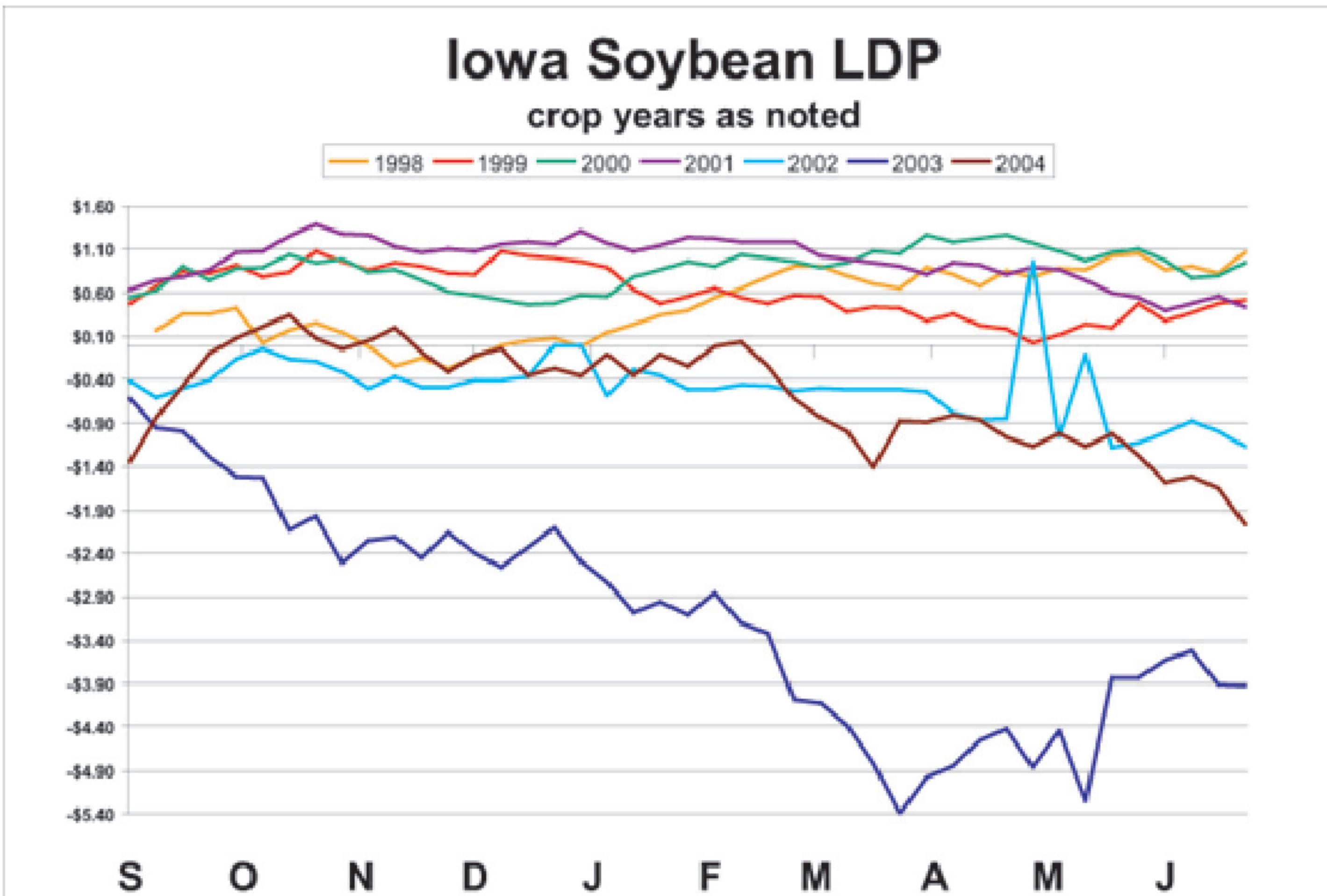
Lock-in of the Posted County Price (PCP)

Farmers that utilize the marketing loan program typically take their grain under loan and receive the established loan rate for those designated bushels. The worst price they should receive for bushels stored under loan in good condition would be their county loan rate and accrued interest. But the federal government offers another tool to enhance downside protection, it's the 60-day lock-in of the PCP.

Remember the marketing loan gives a farmer up to nine months for

1) the cash prices to rally and bushels to be sold in order for the marketing loan to be repaid; or
2) for prices to fall below their county loan rate, thus creating a marketing loan gain (a loan paid off at a PCP level below their county loan rate).

For farmers that are unsure about the best PCP level of which to payoff the marketing loan, they can



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complete form CCC- 697 at their Farm Service Agency office to lock-in the PCP for a period up to 60 days. If the PCP rises any time during those 60 days, they can still pay off the loan at the lower PCP locked in earlier. If the PCP continues to fall, they can ignore their lock-in rate and pay off their loan at the lower PCP for an even larger marketing loan gain.

This strategy includes allowing the lock-in to expire, understanding that the PCP lock-in can only be used once on the same bushels. Thus a farmer can continue to store to the end of the marketing loan and if the PCP continues to decline they can payoff the loan at that lower PCP, not the higher PCP locked in earlier. Remember that under the marketing loan program, a time frame up to 8½ months can be used for the lock-in, since it is not available within 14 days before the marketing loan expires.

Summary

There are several advantages of utilizing the marketing loan versus just claiming the LDP which include:

1) access to marketing loan proceeds represented by county loan rate rather than just the LDP that represents a fraction of the value of the crop;
2) a longer time frame up to nine months for managing price risk for stored bushels; and
3) the added benefit of a strategy to utilize the 60-day lock-in to better manage the PCP level for bushels.

The USDA Farm Service Agency web site posts the latest LDPs for commodity crops covered by the government farm program. These LDPs are updated each weekday morning just after 7 am at: http://www.fsa.usda.gov/dafp/psd/default.htm.

USDA reports loan activity can be found at: www.fsa.usda.gov/dafp/psd/reports.htm.

Historical LDPs can be found at: http://www.card.iastate.edu/ag_risk_tools/ldp/.

The Debate Over Repeal of the Federal Estate Tax: The Income Tax Basis Issue

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The drive to repeal the federal estate tax and the generation skipping transfer tax (GSTT) almost totally ignored the matter of income tax basis until recently. Ironically, for more than 98 percent of U.S. citizens, income basis is actually more important to them economically than either federal estate tax or GSTT. Unfortunately, many do not fully understand

(1) the concept of income tax basis and
(2) the long-term consequences of abandoning the commitment to a new basis at death.

The U.S. House passed an estate tax repeal bill on April 13 that eliminates the rule that assets take on a fair market value basis at death in the hands of the heirs. In its place, the bill creates a modified carry-over basis rule – the heirs receive an income tax basis equal to the decedent's basis in the assets with the estate executor having the authority to allocate additional basis (up to fair market value) of up to $1.3 million per estate and $3 million for property passing to a surviving spouse. Some groups advocating for permanent repeal have claimed that this modified carry-over basis rule sufficiently protects farm and ranch families from transfer taxes at death. That claim is unfounded. The issue is critical because the Senate is scheduled to vote on repealing the federal estate tax in September.

The key question is whether agriculture is better served with a repeal of the federal estate tax with a modified carry-over basis rule, or retaining the tax with higher exemptions and maintaining new basis at death.

The 2001 Tax Act Provisions

Under the 2001 Tax Act, the new income tax basis at death is scheduled to end, for deaths after Dec. 31, 2009, with repeal of the federal estate tax. In its stead will be a one year system of "carryover basis" with the

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