INSIGHTS REPORT

VOLUME 02 WHAT'S INSIDE

Interest rates expected to increase. Have you locked in a fixed rate? With rates at historic lows, now may be the time to lock in a rate before rates rise.

2015 farmland prices pause and decline. The larger trend clearly shows the boom in farmland prices has at least paused or is initiating a correction.

Bulletproof your balance sheet. Think liquidity and asset utilization during the times of reduced margins.

Every farm, business and community is unique. How can you adapt to changing local risks and opportunities while also keeping an eye on global trends and the nation's economy? With nearly 100 local offices and more than 1,200 employees, Farm Credit Mid-America is constantly working to help farmers in Indiana, Ohio, Kentucky and Tennessee leverage the economics of change in their favor. This report shares some of our insights to help you manage your operation and stand strong in today's competitive, ever-changing marketplace.

Matthew Monteiro
Vice President, Finance and Treasurer

HAVE YOU LOCKED IN A FIXED RATE?

INTEREST RATES EXPECTED TO INCREASE

The Federal Reserve has kept interest rates low to support the U.S. economy since the 2008 financial crisis. This has allowed businesses, including farms, to borrow low-cost money for expansion and operating capital. But how long before rates start to rise? Nobody has a crystal ball for predicting exactly when the Fed will start raising rates, but the signs of an imminent rate raise have been accumulating for nearly two years. With rates at historic lows, now may be the time to lock in a loan rate before rates rise.

A look at 10-year treasury rates — what the government pays to borrow money — shows that they haven't been this low since the 1950s, when rates began a steady march upward. During the stagflation era of the 1970s and early 1980s, rates rose. Soon thereafter inflation cooled and rates started trending down, and have continued to do so for more than 30 years. There have been upward bumps on the chart along the way, with the Reserve adjusting every few years in response to economic events, but the long-term trend has been downward. The short end of the yield curve has fallen significantly since 2007, when they were above 5%, to near zero today. Considering the long-term trend of interest rates and the unsustainability of the historic lows since the 2008 economic crisis, we may be on the verge of an increase in rates.

Listen to the Fed

Charts only look at the past. What about the future of interest rates? Beyond guessing, the best we can do is to watch subtle changes in language from Federal Open Market Committee (FOMC) reports. Recent reports have made statements such as "job gains picked up," and while the Reserve wishes "to support continued progress toward maximum employment and price stability, the Committee reaffirmed the view that the current 0 to ¼ percent target range is appropriate for rate increases."

Employment and inflation, the Federal Reserve's dual mandate and the main decision-making mechanism in conducting monetary policy, are key indicators of what the Reserve might do. The FOMC aims for inflation at 2% with a goal toward full employment.[1] In recent years, inflation has stayed below the 2 percent target, but historically, rising wages and increasing employment and consumer prices have been harbingers of imminent inflation. That's what we've been seeing recently.

What can farmers do?

Farmers should lock in a low rate, because they won't be this low forever. Many of our Farm Credit customers have taken advantage of our loan conversion program. A conversion fee of $350 lets you lock in today's low rates on any size loan. You don't need to gamble on interest rates. Use this opportunity to convert a variable-rate loan to a fixed rate to provide peace of mind. If you haven't converted yet, you can still do so even after rates start to rise, but improved employment figures and Reserve statements are indicating that the window of opportunity for locking in the lowest rate is shrinking for refinancing or taking out new loans.

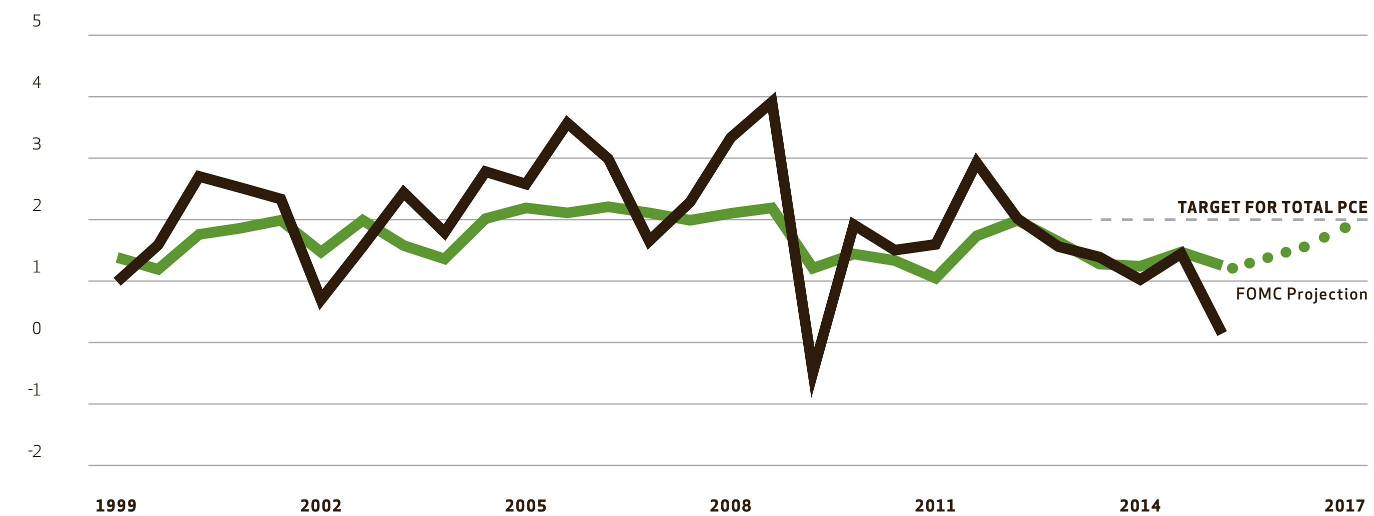
At a recent speaking engagement in Cleveland, Federal Reserve Chair Janet Yellen pointed to an improving economy and moderate inflation. In her July 10 outlook for the economy statement, Yellen said that she "…expects that it will be appropriate at some point later this year to take the first step to raise the federal funds rate and thus begin normalizing monetary policy."[2]

Farm Credit is committed to being a reliable source of capital for customers in any economy. We advise them to always make borrowing and buying decisions based on opportunities and business need. For more information, visit www.e-farmcredit.com.

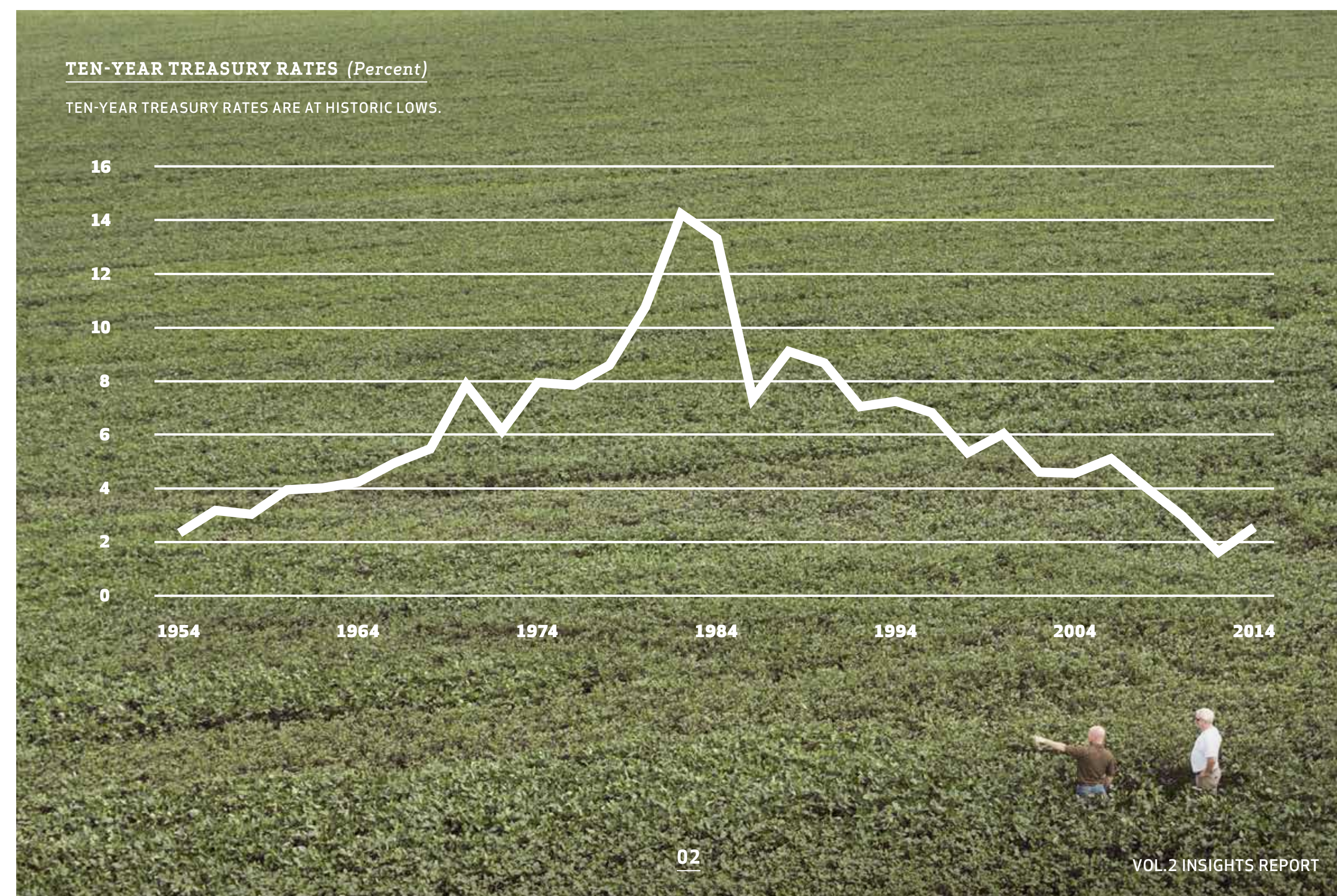
> "It will be appropriate at some point later this year to take the first step to raise the federal funds rate and thus begin normalizing monetary policy."
>
> *– Janet Yellen, Chair of the Board of Governors of the Federal Reserve System*

INFLATION AND UNEMPLOYMENT *(Percent)*

UNEMPLOYMENT RATES ARE NOW BELOW FED PROJECTIONS, WHICH MAY INDICATE AN INTEREST RATE RAISE IS MORE LIKELY.



Source: Haver Analytics and Economic Projections of the Federal Reserve Board Members and Bank Presidents.



Dennis Badger

Vice President, Collateral Risk Management

GRAIN MARKETS DRIVE LAND VALUE, BUT OTHER FACTORS MODERATE CHANGE

2015 FARMLAND PRICES PAUSE AND DECLINE

I recently participated as a panelist at the July 2015 Purdue Top Farmer Conference. During the conference, Purdue presented its annual survey of Indiana farmland values. It was interesting to see the ways in which the data mirrors what our appraisers have been observing on farmland price trends. Prices for land and rents in Indiana stopped their climb in 2014, with most regions in the state exhibiting lower sales volume and prices pulling back.

Looking at the Purdue survey and the Farm Credit Mid-America sales data, some regions maintained land value better than others. But the larger trend clearly shows that the boom in farmland prices, while not turning into a bust, has at least paused or is initiating a correction. The largest declines tended to be primarily in intensive cash grain areas, while land near industrial or urban areas maintained more of its value.

Changes in farmland prices can lag behind declines in grain prices by several months. Another challenge for landlords and farmers is that even as prices start declining on land sales, property tax rates will continue to escalate over the next two to five years, yet will vary based on local tax jurisdictions. This could make negotiations between landlords and tenants more difficult.

Is there a "right" price for land?

Despite high land prices, we have seen farmers with significant cash reserves continue to purchase land. We've also seen landlords holding onto their high rental rates. Farmers who are leasing are reluctant to let their property go. If they don't renew their lease, another operator could obtain those farming rights. What other options do farmers have? Many may choose to weather the storm and farm at a loss, at least for a while. Because markets are unpredictable, all it might take is a drought and grain prices could quickly rebound and support land prices.

On the other hand, further declines in farmland are possible. Several things could pressure land prices. For example, land demand could decline if farmers reach a point where they've depleted their cash reserves, grain prices remain low and interest rates start rising. However, as with the stock market and most other investments, it's usually unwise to try timing farmland purchases based on market cycles. Farmers should stay focused on what they do best – raising crops as profitably as possible. Visit ag.purdue.edu for Purdue economist Craig Dobbins' 2015 Purdue Crop Cost & Return Guide. Dobbins lays out expected returns per acre on low, average and high productivity soils at estimated 2015 grain and input prices for corn, soybeans and wheat.

Farm Credit recommends buying land when the opportunity presents itself and when expected returns make sense for you and your balance sheet. Large, nearby tracts of quality land don't come up for sale often, so the quality and location of the land could make it worth a premium for you. The question to ask is, will the land add enough to your production capacity to make it worth a premium price?

We encourage you to work with your business or farm management team and ask questions to find your opportunity. The answer is different for every farmer. For more information, visit www.e-farmcredit.com.

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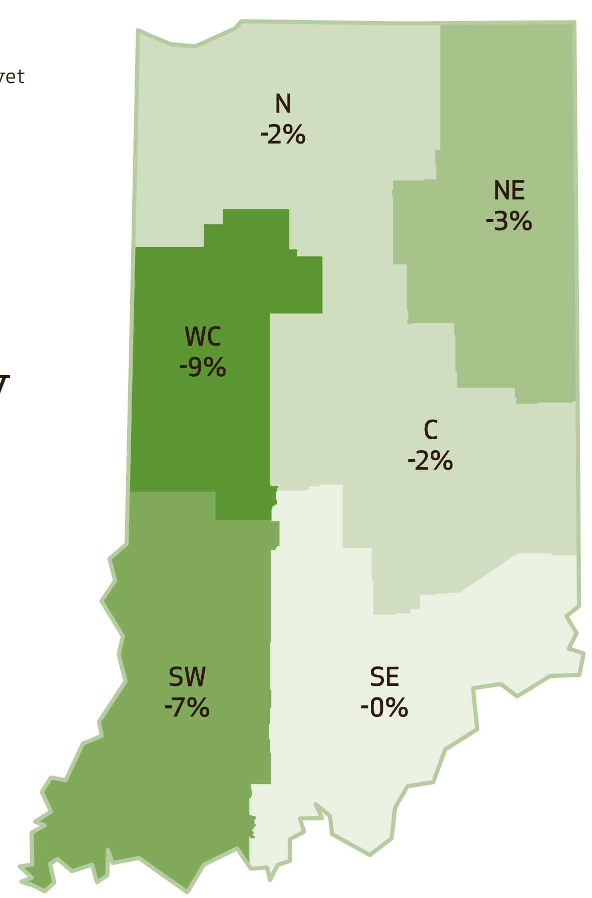
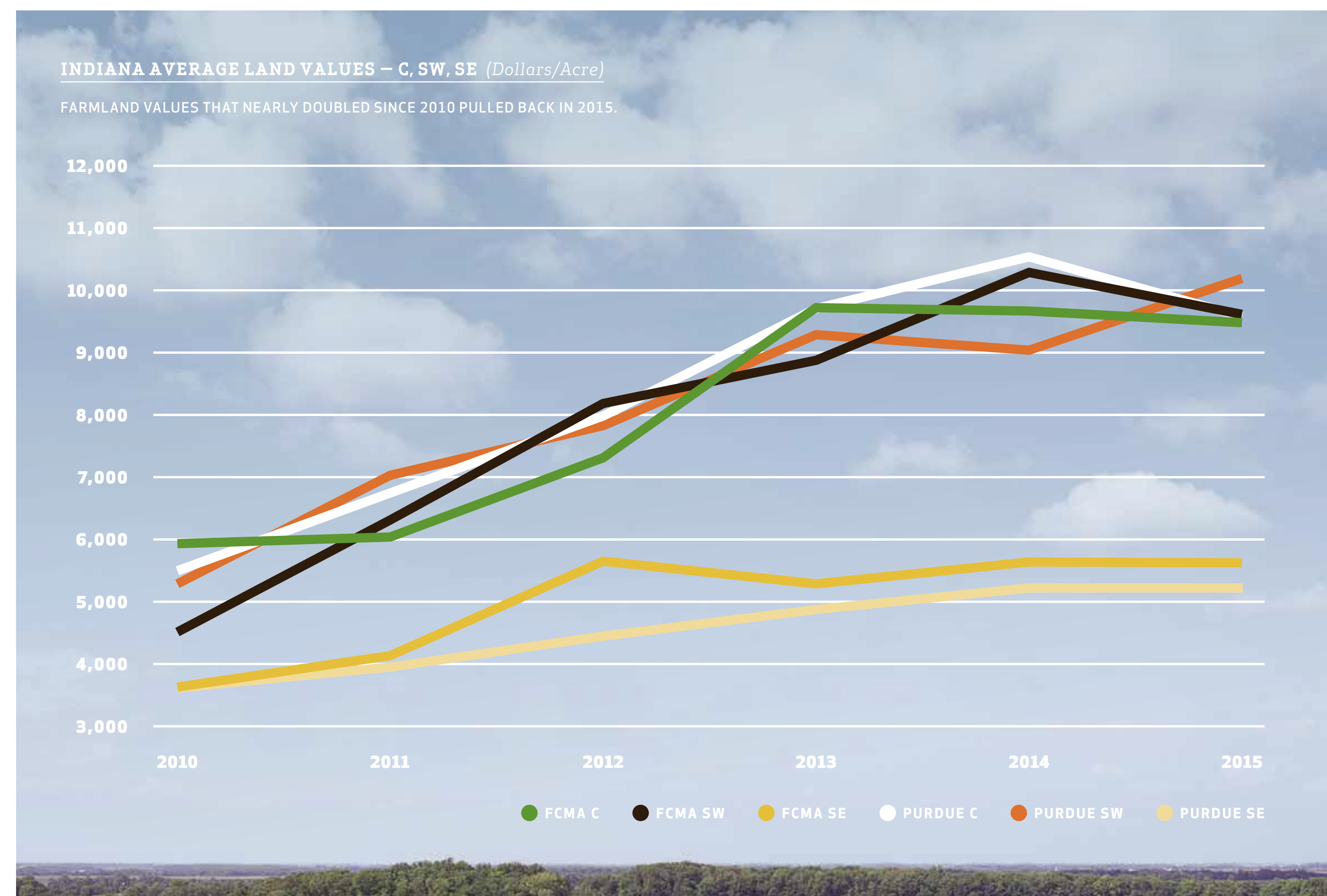


Location matters.
Land price changes in Indiana varied by region.



Vince Bailey
Regional Vice President, Agribusiness

THINK LIQUIDITY AND ASSET UTILIZATION DURING TIMES OF REDUCED MARGINS

BULLETPROOF YOUR BALANCE SHEET

Whether crop prices are high or low, it's wise to watch balance sheets closely and check how you stack up to performance benchmarks across the industry. With grain prices trending lower, the focus for many has shifted from expansion to maintaining what they currently have. This holding position may be prudent. However, production must continue and new opportunities will present themselves despite the fact that you're managing finances with a sharp pencil.

At Farm Credit, we encourage growers to keep an eye not only on expenses, but also on asset utilization and fixed costs as they relate to GFI (Gross Farm Income). Consider various fixed cost ratios using capital interest, principal payments and land rents as a percent of GFI to measure how effectively you are utilizing assets.

Especially when margins are tight, farmers need to dig deep into how fixed costs and inputs relate to production capacity. We're talking about utilization of equipment and fixed assets. Are you getting the right kind of utilization? Are you over-equipped? Are you under-equipped? Do you have more labor than what you really need? What inputs give you the best value? Capital is a finite source, so every dollar allocated to an underutilized asset is a dollar that can't be deployed to liquidity or working capital when needed.

Evaluating your balance sheet isn't just about the information or analysis Farm Credit uses to approve loans. Fiscal awareness is valuable for any grower who is trying to stay efficient during times of low crop prices and tight margins. In 2015, low commodity prices means there will be farmers who have to operate at a loss for a year or two. The more knowledge you have of your cash burn rate (cash required to cover shortfalls in cash flow), the more confident you can be of how long you can operate at a loss until crop prices turn around. Understanding your burn rate will also help determine what new opportunities you can take advantage of. The key thing to remember is you can't burn what you don't have.

How do you stack up?

Working with operations of all shapes and sizes has given us experience seeing what success looks like for each operation, as well as how individual farms can start to slip into financial trouble. In addition to looking at each farm's profit and loss numbers, we can benchmark farms and see how they compare against the key financial metrics of successful farms.

The chart to the right shows a few common financial ratios for grain farms. These are guides and not absolute measures. Each farming operation is unique, but being significantly outside these measures will often create challenges.

Working capital (current assets minus liabilities) is a measure of the amount of funds available to meet the payment of all current liabilities. Working capital compared to VFP (Value of Farm Production) relates the amount of working capital to the size of the operation. The higher the ratio, the more liquidity the farm operation has to meet current obligations and, more critically, how much adversity can you withstand before asking your lender for additional operating funds. Another way to think of this is working capital per acre, which equates to commodity price and bushels per acre and eventually how you develop your risk management plans. The ratio varies across farm types and other farm characteristics. Further explanation of how to calculate ratios is available from the University of Illinois at http://www.farmdoc.illinois.edu/finance/financialcharacteristics/ratios.htm.

Find your balance

When grain prices drop as they have recently, growers are motivated to renegotiate cash rents, but don't want to lose land and production capacity. Many are relying on liquidity to hold on and produce at a loss until the grain market or rental market adjusts. But you have to ask tough questions. If you're burning working capital at a rate of $50 an acre per year, for example, how long can you withstand that before you have to go back and renegotiate?

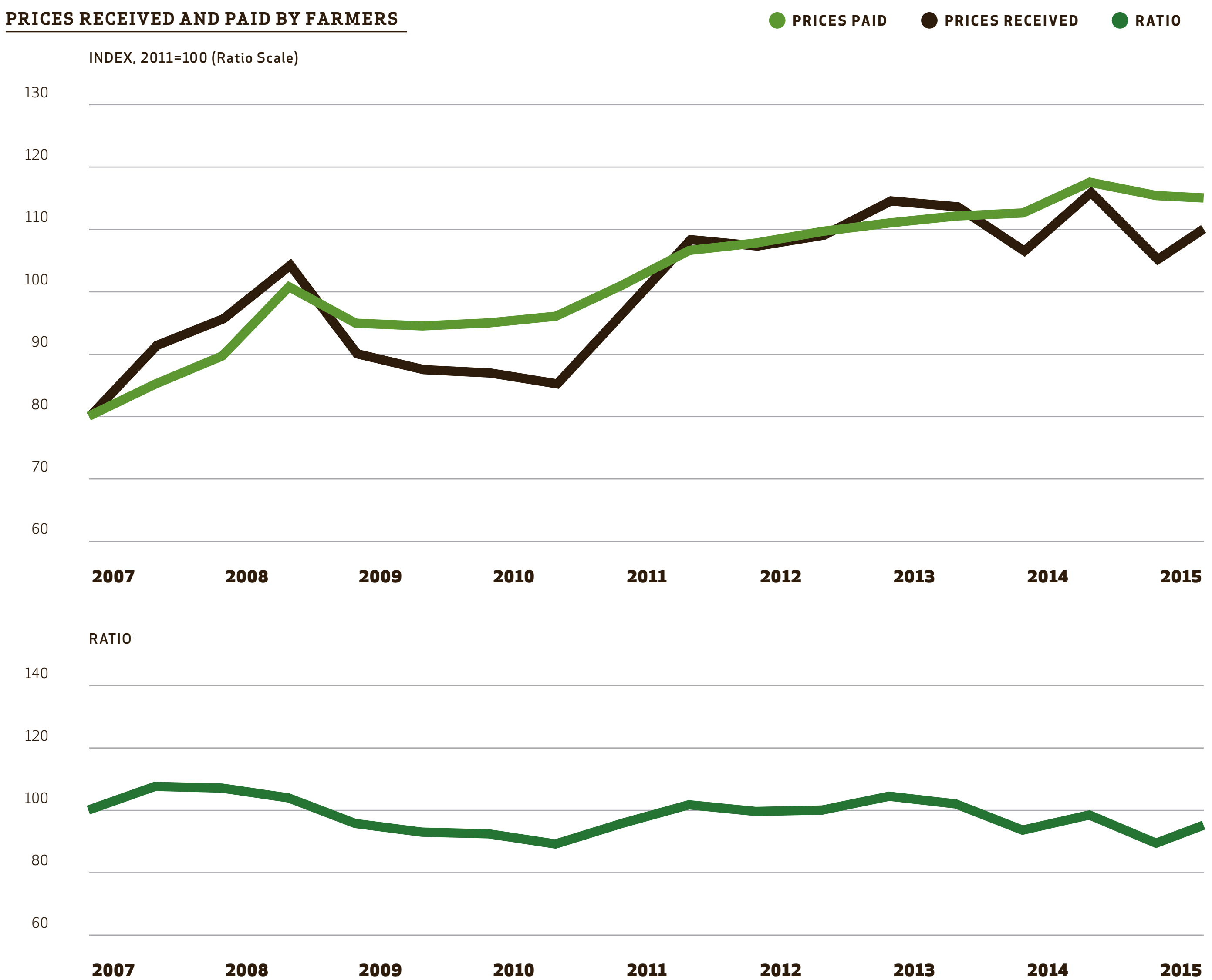
The following USDA chart of farm expenses versus farm income shows you're not alone if your farm expenses exceed income in 2015.

Can you cut back on expenses or delay expansion plans? How long can you burn working capital before you have to increase operating lines of credit? The answers are different for every farm. For more information, visit www.e-farmcredit.com. ❖

COMMON RATIOS FOR GRAIN FARMS

CATEGORY	TARGET	YOUR NO.	GOOD	CAUTION	ATTENTION
Liquidity (Working Capital/VFP)	20%		≥20%	20%-5%	<5%
Owner Equity (Net Worth/Total Assets)	55%		≥55%	55%-45%	<45%
Net Farm Earnings as % of VFP	20%		≥20%	20%-5%	<5%
Debt Coverage Ratio	130%		≥130%	130%-100%	<100%
Land Costs (P&I and Land Rent)/VFP	<30%		≤30%	30%-35%	≥35%
Equipment Costs (P&I and Lease)/Acres Farmed	≤$65		≤$65	$65-$85	≥$85

PRICES RECEIVED AND PAID BY FARMERS



[1]Ratio of index of prices received to index of prices paid.
Source: Department of Agriculture.

NEXT ISSUE

- Harvest recap and strategies for the 2016 production season.
- Farm Bill one year later. How is the transition from direct payments to crop insurance subsidies affecting farmers?
- A look at debt load: Are you over- or under-leveraged?

[1]http://www.federalreserve.gov/faqs/economy_14400.htm

[2]http://www.federalreserve.gov/newsevents/speech/yellen20150710a.htm

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