INSIGHTS REPORT

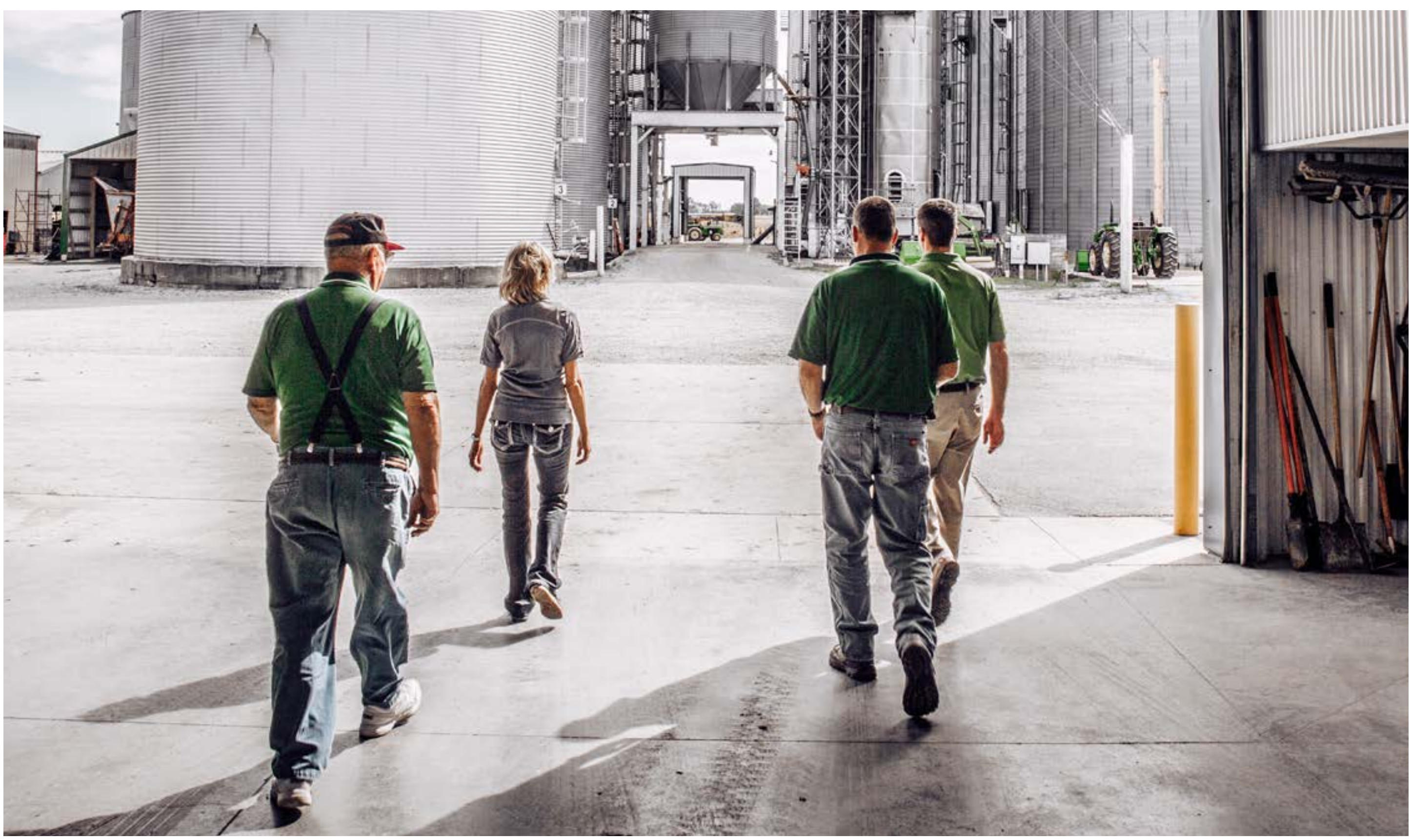
VOLUME 05 WHAT'S INSIDE

There are key steps young farmers can take to shape a successful future for their operations.

After researching thousands of land sales in our territory, it's clear that land values are holding steady.

The Fed's decision to keep interest rates unchanged signals additional opportunities for farmers.

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.



Jessica Lehman
Associate Vice President,
Business Segments,
Growing Forward

KEY BUSINESS PRACTICES YOUNG FARMERS CAN IMPLEMENT TO HELP ENSURE LONGEVITY AND SUCCESS

YOUNG FARMERS: ARE YOU PREPARED FOR FINANCIAL SUCCESS?

As a young farmer growing your farm operation, you may find yourself facing many challenges in today's financial climate: current commodity prices, rising interest rates and uncertain growing conditions can all cause financial stress for a beginning farm operation. Finding a lender that is willing to work with your operation as a financial partner is critical to the success of your operation no matter how large or small it may be. Fortunately, there are a few key steps and business practices you can implement to ensure the longevity and future success of your operation.

1: Understand and manage your margins

Margin is the income left over after you have accounted for all debt service, taxes and family living expenses. The higher the margin, the better. Monitoring your margins will allow you to better analyze future capital purchases, farm cash flows and your family living budget. Prior to any major investment or purchase, an adequate margin must be present to allow a cushion for any short- or long-term risks.

If you haven't done so already, now is the time to sit down with your lender to create and review your financial statements. Your balance sheets, income statements and cash flow statements provide not only your available margins, but show you an overall snapshot of your operation's financial position. By completing this step with your lender, you can be proactive on additional credit needs and gain their perspective on the operation's financial health.

When assessing your current margins, focus on a couple of important areas. First, determine your current portion of term debt and interest. Ensuring your debt levels are in line with the size of your operation is key. If they are not, it may be prudent to retire or restructure any term notes in question.

Second, pay special attention to your family expenditures. Any personal debt you take on,

including mortgages and car loans, affects the bottom line of your business and should be carefully weighed as non-income-producing assets.

Finally, be mindful of the cash burn rate or cash build rate of your operation. Cash burn or build rate simply refers to your operation's ability to conduct business at a cash flow deficit or cash flow build. This measure directly impacts your working capital position, and adequate forms of capital should be present if there is a deficit. In years of declining crop prices this is especially important to evaluate as it can be the first indication of financial stress in the coming year.

In years of cash flow deficits, three things can be done to mitigate any negative effects.

- Control fixed costs, including land, buildings, equipment, employees, family living expenses and taxes.
- Rethink liquidity. Monitor your working capital position and how current loan structures, down payments on real estate and equipment purchases impact this measure.
- Line up operating financing now. Starting conversations with your lender early in the season allows your operating needs to best align with the operation's needs, and allows your business to secure opportunities for discounted inputs as they arise.

2: Write a business plan every year

The effectiveness of physically writing down personal goals is undeniable. The same holds true for your business: Commit to writing an annual business plan.

The beginning of a new year is an ideal time to assess learnings from the previous year's expenses to build a projection for the year ahead. Look at your net income versus your net expenses from the past year and consider the crop or livestock plans you have in mind. Using this assessment, make an informed estimate based on what you know and predict if your revenue will increase or decrease.

Once you have a projection in place, you can then evaluate how this revenue will impact your operational goals and balance sheet. Can you invest in your operation? Do you need to make cuts anywhere? Is your asset list adequate for your operation's success?

Document your plan for any investments or necessary expenditure reductions and regularly revisit it throughout the year to keep the business on track and make necessary adjustments as any unforeseen circumstances occur. With programming created specifically for young farmers, Farm Credit can pair you with a team of specially trained credit analysts who understand beginning farmers and their specific needs.

3: Get a financial mentor

As a farmer, you are in a unique position as a business owner. You fulfill all leadership positions: chief executive officer, chief operating officer, chief financial officer…the list of demands goes on and on. There is no shortage of resources on the production side that can provide you guidance, from master agronomists to experts in herd health to a trusted mechanic; however, what you may be neglecting is mentorship and guidance for financial management.

A financial mentor can be anyone from a farmer you know who runs a successful operation to a lender or financial advisor who can provide guidance at key decision points. The most important quality is that they commit to helping you build the future of your operation.

The earlier you can tap into an expert financial resource, the better position you will be in. From understanding how to use risk mitigation tools like crop insurance to early estate planning, having a mentor help you with financial statements and investments will only strengthen the business decisions you make.

Financial success takes planning and consistency in business practices. By taking proactive steps to understand your margins, create an annual written business plan and find a financial mentor, you can set up your operation, your family and yourself for a viable future.

Dennis Badger
Vice President Collateral Risk Management

WILL FARMLAND IN OUR REGION FOLLOW COMMODITY PRICES LOWER?

MID-AMERICA LAND VALUES HOLDING STEADY

After nearly a decade of following commodity prices up, farmland values throughout the Midwest have started to decline in response to lower grain prices. Not surprisingly, the biggest declines in land values have occurred as a correction in Corn Belt states where the biggest gains in land values previously occurred. How has our four-state area of Indiana, Ohio, Kentucky and Tennessee compared? To find out, Farm Credit Mid-America appraisers researched and analyzed 8,000 land sales in 2015 and compared them to over 100,000 land sales in our proprietary historical database.

Agricultural property values have declined significantly in Midwestern corn and soybean states. In Iowa, farmland prices fell an average of 15 percent over 2014-15, so we expected that farmland values in Indiana would be hit hard, too. But, the decline in Indiana was less than three percent from 2014-15. Ohio, Kentucky and Tennessee actually increased slightly in that period. We believe income diversification and less reliance on commodity prices have helped moderate land values in our area.

Though retail non-ag sales have provided some protection for land values, commodities are still a factor, and land prices could still face pressure in the future due to general economic uncertainty, rising interest rates and other factors. Moreover, a general trend in farmland price declines in the Corn Belt may eventually affect land values here.

2016 expectations

In our four-state area, we don't expect a rapid rebound in commodity prices or land values anytime in the next few years, so farm incomes and balance sheets could be pressured. There will likely be fewer land buyers, which means increased marketing time for listed properties with stable-to-declining farmland property values. Land owners who don't need to sell are likely to hold onto land, resulting in a decreased number of properties on the market.

FLEXIBLE FARM LEASE EXAMPLE – CORN

- Cash rent will be equal to 25 percent of the gross crop revenue.
- The actual yield of corn is 160 bushels per acre, and the actual price is $4 per bushel.
- The gross income is equal to (160 x $4), or $640.
- The cash rent is equal to (25% x $640), or $160 per acre.

Cash rents may need to be negotiated if commodity prices stay low, so landlords and farmers may want to consider a flexible farm lease agreement tied to gross farm income. Some owners and tenants use flexible lease agreements where the rent is not determined until after the crop is harvested. The final rental rate is based on actual prices and/or yields attained each year. Above is one example of a flexible lease agreement that provides farmers some relief if commodity prices stay low, and gives landlords greater opportunity when commodity prices and farm incomes rebound.

Stay conservative

Many farmers have taken advantage of strong incomes and reduced debt levels over the past few years, but USDA projections for 2016 indicate slightly higher debt compared to last year. An increase in operating loans and declining land values may create more risk with higher debt-to-asset levels in the future. Now is the time for farmers to watch their balance sheets closely and maintain a cautious approach in pursuing any land purchase or rental opportunities. Treat land as a capital purchase – if it doesn't make financial sense on the bottom line and won't make a profit in the next five to 10 years at expected commodity price levels, then consider holding off on the purchase.

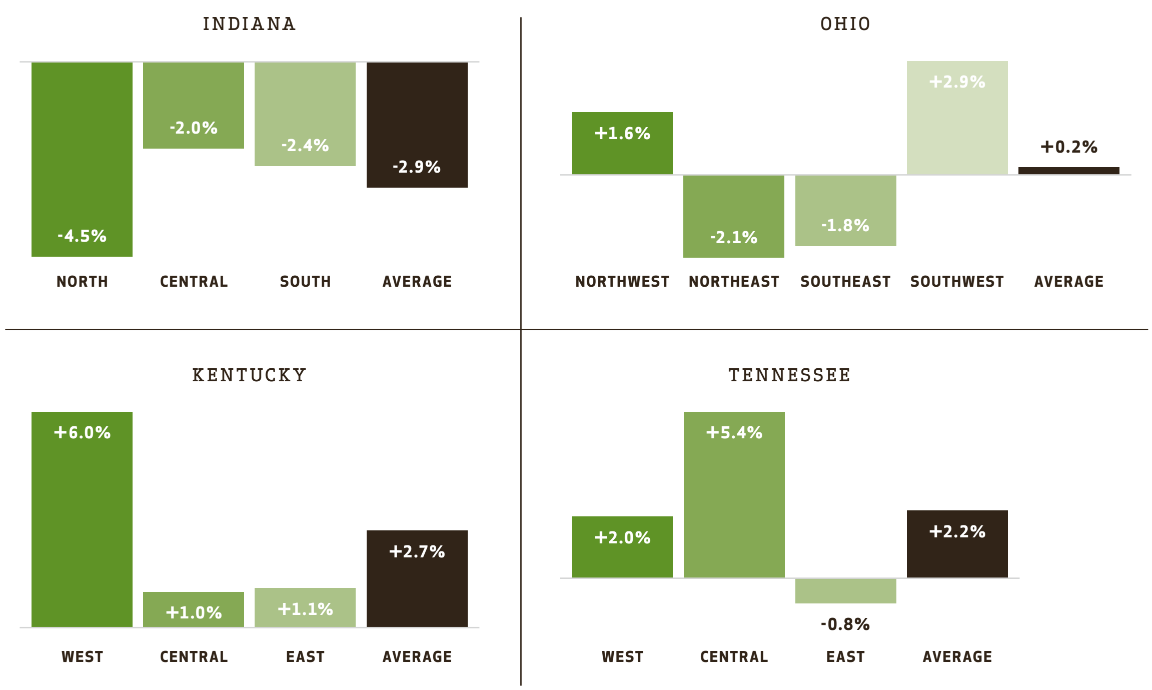
A focus on production efficiency, cost reduction and flexible lease negotiations is more advisable than expansion right now. Rather than buying more land, a safer investment might be adding improvements such as tile drainage or irrigation to your current land. Quality land holds its value better than marginal land, and improvements that enhance yield and income potential also help.

Farm Credit is committed to being a reliable source of credit for customers in any economy. We encourage you to always make borrowing and buying decisions based not only on opportunities but also business need.

FACTORS THAT AFFECT LAND VALUES

- Location
- Crop and livestock prices
- Production yields and weather situations
- Land quality
- Land improvements
- Declining net farm income
- Interest rate changes
- Oil/gas leasing
- Timber
- Recreational/hunting uses
- Rural residential demand
- Investor speculation
- Proximity to linkages such as grain terminals, rail and interstate

2015 – 2016 FARMLAND VALUE CHANGES



Matthew Monteiro
Vice President Finance and Treasurer

HOW INTEREST RATES WILL IMPACT YOUR OPERATION AND AGRICULTURE

THE FOMC TAKES ACTION BY NOT TAKING ACTION

In March, during one of its eight scheduled meetings in 2016, the Federal Open Market Committee (FOMC) announced it will hold the current Federal Funds rate steady at 0.25 to 0.50 percent. This comes three months after the December announcement that the Federal Funds rate increased from near zero percent. By leaving the rate unchanged, the FOMC brought policymakers' projections into alignment with investor and economist expectations and strengthened the ability to follow through with future rate increases.

In FOMC material accompanying the March announcement, policymakers' expectations of 2016 rate increase frequency dropped from four increases to just two. This closely aligns with what the Wall Street Journal Survey of Economists and futures markets had been predicting for several months. When the FOMC increased rates in December 2015 and policymakers' expectations averaged four rate increases in the upcoming year, market and economist predictions already assumed two increases in 2016. The March announcement brings FOMC projections into alignment with widely held expectations.

The FOMC's decision to keep rates unchanged eases the pressure on the dollar, the strength of which has been a drag to the U.S. economic recovery. Even with near record low yields on U.S. Treasury securities, these rates are attractive to investors compared to even lower rates in most developed countries. When the Bank of Japan moved to negative rates to combat deflation and the European Central Bank went deeper into negative territory, the U.S. became more attractive to investors. Since global demand for U.S. Treasury securities requires the purchase of U.S. dollars using foreign currency, this increases the strength of the dollar.

Steady rates signal future increases

Holding rates steady for now makes future rate increases even more plausible. The decision to increase rates is driven by many factors, one of which is recent market performance and how those markets may respond to rate changes. If markets continue to perform well, the likelihood of a "Yellen call" increases. This newly coined term represents the potential of future market increases influencing the likelihood of policy action being taken to increase rates. All else being equal, the equity markets tend to be negatively impacted by higher interest rates, thus the "call," which implies a ceiling on returns. Holding rates steady now strengthens markets across the board, which in turn makes the economic environment more conducive to additional rate increases.

In a recent survey, The Wall Street Journal Survey of Economists indicated that 60 percent of those surveyed predicted an additional .25 percent increase in June 2016. Additionally, the March announcement has significantly lowered rate expectations for 2017 as the FOMC has made it clear that while more rate increases are coming, they will be gradual. As stated in the press release accompanying the announcement, "The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data."

What does this mean for agriculture?

In short – what does this mean for the agriculture industry? After coming off a historic decade of low interest rates, the impact will be felt more by operators with higher debt levels, particularly short-term debt. While the rate increases are expected to be gradual, the effect on earnings already under pressure from low commodity prices will be more impactful than during the peak of the ag cycle. The most immediate impact farmers may see is in short-term rates for credit like operating loans, so operations should take care to plan cash flow.

Now is still an ideal time to take advantage of current lull rates. Farm operations should increase their consideration of refinancing long-term loans and converting variable-rate loans to fixed rates prior to future increases – rates will not be this low forever.

There is no need to gamble on interest rates. In fact, many adjustable-rate loans may be converted to a fixed rate for a flat $350 conversion fee, which allows farmers to lock in today's low rates on any size loan, and is a benefit of membership in our cooperative. The FOMC has given every indication that rates will continue to rise gradually, so converting a variable-rate loan to a fixed rate today can give farmers peace of mind for the future.

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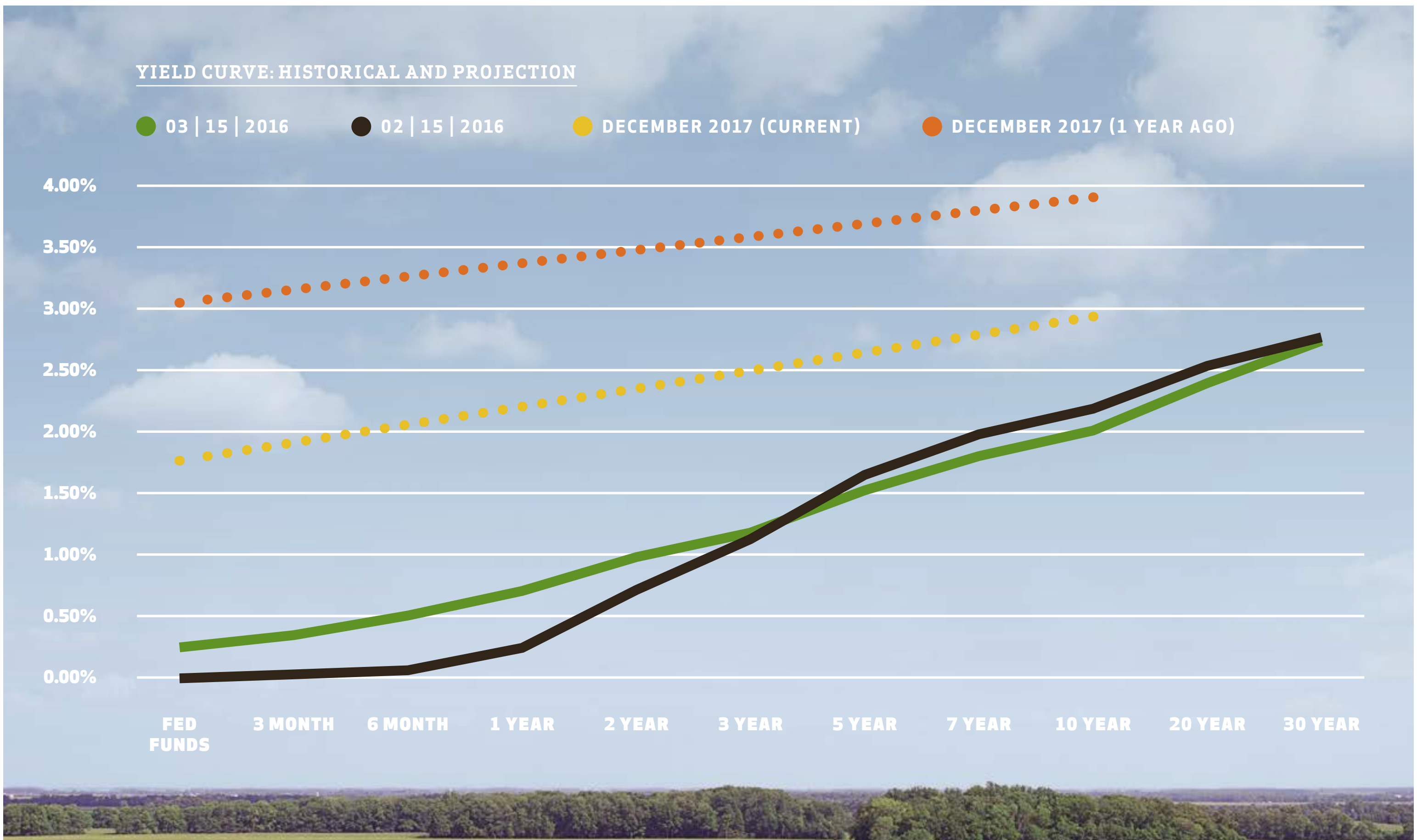

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