



www.agmanager.info
abarnaby@agecon.ksu.edu
(785) 532.1515 (phone)
(785) 532.6925 (fax)

G.A. "Art" Barnaby Jr.

Copyright 2004. All rights reserved. Contact Art to be added to e-mail list

Disclaimer: This web page is designed to aid farmers with their marketing and risk management decisions. The risk of loss in trading futures, options, forward contracts, and hedge-to-arrive can be substantial and no warranty is given or implied by the author or any other party. Each farmer must consider whether such marketing strategies are appropriate for his or her situation. This web page does not represent the views of Kansas State University.

Why would anyone execute an HTA¹

Dear Art,

Why would anyone execute an HTA (Hedge-to-Arrive) when they can simply sell futures and buy out of the money calls to participate if prices spike up during the growing season? Once an HTA is signed a yield commitment is established and essentially the crop insurance is assigned to the elevator...using the futures eliminates "non-delivery" risk.

We have contracted grain into the elevator and feed yard using HTA's since the 70's from others but use futures for our own production....we also completely explain the "non-delivery risk" and never intend to leave unhedged the probability of upside price risk, i.e. cover with at the money calls, out of the money calls, or now days with a combination weather hedge and calls. Execute a HTA with a grain company and/or feedyard and you become "captive" to excessive transaction costs, service fees, and manipulated cash basis quotes; which to me is a big part of the "non-delivery risk" which many farmers pay for by not margining their individual futures.

Grain Buyer

Dear Buyer,

The non-rolling HTA is nothing more than a forward contract with an open basis to be set later. The non-delivery risk is only slightly higher with HTA than futures. In both cases

¹Prepared by G. A. (Art) Barnaby, Jr., Professor, Department of Agricultural Economics, K-State Research and Extension, Kansas State University, Manhattan, KS 66506, April 12, 2004, Phone 785-532-1515, e-mail – abarnaby@agecon.ksu.edu.

the grower will cancel out of the contract if the crop fails. It is just easier to cancel out of futures. So selling futures does NOT eliminate the non-delivery risk. If the crop fails and price increases, in both cases the grower will have to use the crop insurance payment to either cover margin losses or pay cancellation penalties. So the only question is will the cancellation penalty be greater than the margin losses?

If the market really spikes the grower does not have to tie up his credit to meet margin calls. The elevator will make those margin calls for the grower. There are also a number of ag lenders who may be little “shy” about funding margin calls.

There are two major downsides risks for an HTA over futures. First, the grower is committed to delivery at that elevator so there is only one buyer to negotiate the basis. Selling futures allows growers to negotiate the basis with many buyers. So it is possible the “hidden” fees in the HTA may be higher than the margin calls as you suggest. But that is also true with a forward contract.

The second risk is one of contract default. If the elevator were to be forced into bankruptcy then the HTA would be worthless. This is a very small risk if the HTA is with a large and established buyer but with “small” independent elevators or feed lots, there have been bankruptcy cases that made their forward contracts or HTAs worthless. It is very important to understand the financial condition of the firm offering the HTA or forward contract.

Under a futures contract both the buyer and selling must post performance money referred to as margin money. This funding will insure that both the buyer and selling will reform on the contract making contract default impossible. However, growers that do not have sufficient credit reserve or timely credit should not use futures. This is a major advantage for some growers. Growers would not want to be forced out of a futures position because they ran out of margin money.

The other major reason some growers prefer HTA over futures is they simply don't like dealing with margin calls. The HTA or “open basis” contract used to sell new crop for harvest delivery have nearly the same risk as the forward contract. HTA's that allow the grower to cancel and then roll the contract forward is very different and carry the additional risk caused by old crop-new crop price spread.

Futures clearly give growers more flexibility. If prices fall and a grower's crop fails then it is not necessary to buy grain to deliver as would be necessary under a forward contract or HTA to capture the gain. The grower would simply liquidate the futures position and capture the gain. Futures will allow the grower to liquidate the position and not deliver at harvest time. The grower could then take advantage of gains from storage (if available) while a forward contract or HTA would require delivery.

ART