



KANSAS FARM MANAGEMENT ASSOCIATION

Your Farm - Your Information - Your Decision

N E W S L E T T E R

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ESTATE PLANNING BASICS

What is “Estate Planning?”

We’ve all heard the term “estate planning” before, but what does it actually mean? To most of us, it sounds more complex and confusing than it genuinely is. Your “estate” is simply everything that you own. Therefore, estate planning is the process through which you plan for what happens to your assets when you die. A good estate plan, though, also protects you (and your assets) in the case of incapacity, and enables you - not a court of law - to maintain direction over your assets, business decisions, and even health care decisions should you become unable to handle your affairs.

The estate planning process would be quite simple if we knew the answers to two questions. First, when are we going to die? And second, what will the federal and state estate tax laws look like in that year of death? Unfortunately, we do not know the answers to these questions. Some clarification of the direction in which the federal estate tax laws will proceed in the near future will come this fall, but Congress has a track record, especially in the last decade or so, of changing estate tax laws.

Who Needs an Estate Plan?

Anyone with children or property needs an estate plan. The estate plan can be very simple, possibly consisting of only a will. However,

nearly everyone should go through this process. Estate planning is certainly not just for “wealthy” people. Furthermore, the estate plan should be drafted sooner rather than later, as we truly never know what tomorrow may bring.

The Will

A will is the basic part of every estate plan. It directs your survivors as to who will handle your affairs after you die (the executor) and outlines where your property is to go. Additionally, for those with minor children, it names the individual you have chosen to serve as your children’s guardian until they reach majority age. Although these are the main functions of the will, it can also be used to outline your wishes for your funeral, burial, and other final plans. This information can serve as a comfort to surviving family members, as they can then be confident that they are truly honoring your last wishes.

Most assets that are passed on to your heirs through your will go through probate. Probate is necessary in order to change title to any assets after your death. However, there are some aspects of probate that many people do not like. There is a cost associated with probate, commonly ranging from 2-5% of the probated assets’ value. Additionally, the probate process may take longer than an estate settlement without probate. Finally, information regarding the assets passing through probate is a matter of public record.

Life insurance proceeds payable to a beneficiary named in the policy and retirement accounts with named beneficiaries are not probated.

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Also, if an asset is jointly titled with the right of survivorship, it does not go through probate and will immediately proceed to the surviving joint owner regardless of what the will states. The same can be said for assets that are titled “transfer on death” or “payable on death.” The title of an asset is paramount in estate planning, and the proper titling of assets to suit your needs and wishes is just as important as what is contained in the will.

Living Trusts

Another way assets will avoid probate is if they are titled in a living trust. Living trusts can be very complex or relatively simple, depending upon one’s wishes. Assets placed in a revocable living trust, although formally titled in the trust’s name, are still controlled by you serving as the trustee of the trust while you are alive. Living trusts can be utilized to accomplish special things after you are gone, such as certain charitable contributions, and can retain ownership of the assets until a certain time in the future after you have passed, caring for a surviving spouse or minor children, for example. In some manner, then, although it is true that you can’t “take it with you,” a living trust can allow you to set up the rules for controlling your assets after you are gone! Also, for those who do have estates large enough where the federal estate tax could be a problem, proper usage of living trusts can possibly help alleviate estate taxes, particularly for married couples.

Contrary to wills, living trusts are not a necessary part of the estate planning process for everyone. They help in many situations, but are not an essential part of all estate plans.

Durable Power of Attorney

Another important component of the estate plan is the durable power of attorney. This is a document that allows for someone other than

yourself to make decisions on your matters should you be unable to do so. It is very common for individuals to have durable powers of attorney for business, personal, and health care decisions. As the will does not begin to direct anything until your death, a durable power of attorney is needed in order to give someone other than a court of law the authority to make decisions for you while you are alive, but incapacitated. Obviously, careful thought should be put into the selection of the individual(s) to whom you are granting the power of attorney.

Conclusions

The United States Congress will deliberate what to do with an expiring federal estate tax this fall. As of January 1, 2010, there is no federal estate tax for a period of one year. Therefore, expect Congress to change this before we reach that date. Although many congressional leaders have stated they do not want the estate tax to expire and would like to establish an exemption amount similar to what it currently is (\$3,500,000), anything is possible, particularly with huge projected budget deficits over the next ten years. Regardless, though, we will at least be armed with better information to proceed through the estate planning process once Congress acts this fall.

Don’t make the concept of estate planning more difficult or confusing than it needs to be. Communicate with your loved ones and your attorney what your wishes are. If you understand the basics and arm yourself with information about the process, you will be well on your way toward implementing a sound estate plan.

*Craig Althausen
Extension Agricultural Economist
Kansas Farm Management Association, NE*

BEEF BACKGROUNDING IN UNCERTAIN TIMES

The past year and a half has not been kind to those in the cattle business. After several profitable years in all sectors of the beef industry, margins have been squeezed by several factors. First, high feed and energy costs ate into profits, then as these costs began to fall, the current financial crisis began, leading to decreased demand for beef and falling prices.

The backgrounding sector has not been immune to these forces. Kansas Farm Management Association statewide data show the beef backgrounding enterprise lost \$120.31 per head in 2007 and \$87.12 per head in 2008, which includes accounting for fixed costs and operator labor. Returns through 2009 so far have been generally running at a loss as well.

This article examines potential returns for backgrounded cattle coming on feed in late August at approximately 500 pounds. These cattle are assumed to be fed in a dry lot for approximately 150 days and with an average daily gain of 2.25 pounds per day are expected to weigh approximately 840 pounds in late January. The analysis below was conducted using an Excel spreadsheet tool developed by Mark Dikeman and Clay Simons.

It is assumed that the steers fed during this period will be purchased at \$114 per cwt. The ration fed to the cattle is a typical ration used by backgrounders in the central Flint Hills. The ration and the assumed per unit costs of ingredients are outlined in Table 1. A feed conversion ratio of 14.67 pounds of feed per pound of gain was used, which is the performance expected by the nutritionist who developed this ration for this type of cattle.

Yardage charges were calculated using per head costs taken from the 2008 Statewide KFMA Profitcenter Beef Backgrounding enterprise analysis. This includes an average charge for operator labor. They are outlined in Table 2.

The yardage charge per head for this example comes to \$0.44 per head per day when including operator labor, and \$0.29 per head per day when operator labor is not included in the yardage calculation.

The selling price used is a forecast for late January, 2010 modeled by the website beefbasis.com (www.beefbasis.com). The sales price determined by the model was \$94.60 per hundredweight, which was rounded up to \$95.00 per hundredweight. The results and expected returns are outlined in Table 3. The expected returns per head over total costs are a loss of \$76.31 per head with a projected breakeven price of \$104.40 per hundredweight. If unpaid operator labor is not considered in the yardage charge, then the expected per head returns over total costs are a loss of \$54.52, with a projected breakeven of \$101.70 per hundredweight.

Table 4 illustrates the changes that would occur in returns over total costs as average daily gain and sales price change. Producers don't need a couple of economists to tell them that as daily gain or sales price received improves, profitability improves; however, it is interesting to see just how much returns are impacted as these factors change. Unpaid operator labor is accounted for in Table 4.

Table 5 looks at how changes in feed conversion and average daily gain change the total costs of putting a pound of gain on an animal. All yardage charges are included in the total cost of gain. It is interesting to note how small changes in efficiency can change the total cost per pound of gain, remembering that these changes can be management factors controlled by the producer or factors beyond the producer's control such as the genetics of the cattle after purchase or weather.

What are the opportunities, threats and risks in

the current backgrounding environment, keeping in mind that opportunity may not be the best word to use in the cattle business at this time? First, there is still oversupply in the beef sector. There are just too many cows producing too many calves, which will put downward pressure on prices. However, James Mintert indicated at the recent Risk and Profit Conference at Kansas State University in Manhattan while beef production will be unprofitable in the near future, especially in the fed cattle sector, the cow herd is starting to shrink. He also made one comment that could be an opportunity for those that background cattle. Mintert commented that even though cattle feeders are losing money, they are still paying more than they should for feeder cattle; probably because there is excess yard capacity, and excess yard capacity combined with decreased feeder cattle numbers mean that feedyards are bidding up cattle to keep numbers in their lots. There is also typically a rally in the feeder cattle market through sometime between

now and late September that could give producers the chance to lock in prices on the February feeder cattle board at higher levels than would normally be seen during the mid to late winter months. This, combined with the falling cost of gain, could give backgrounders an opportunity to become more profitable (or at least minimize losses). Any opportunity to lock in margins at a price greater than the cost of gain should be studied carefully and taken advantage of.

In conclusion, backgrounding cattle continues to be have limited profit potential given the weakness in the cattle sector in general. Backgrounders should operate as efficiently as possible and try to take advantage of any opportunities that come their way during this time of very limited profitability.

*Clay Simons and Mark Dikeman
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Table 1. Harvested and Purchased Feed Ration

Silage	50.0%	\$29.00/ton
Brome Hay	26.5%	\$60.00/ton
Distillers	10.0%	\$130.00/ton
Corn	12.0%	\$3.05/bu
Supplement/Mineral	1.5%	\$433.00/ton

Table 2. Per Head Costs Used to Compute Yardage

Facilities and Equipment Depreciation	\$ 7.68/hd
Facilities and Equipment Repairs	\$12.17/hd
Machine Hire	\$ 1.79/hd
Fuel and Oil	\$ 8.71/hd
Hired Labor	\$ 3.74/hd
Unpaid Operator Labor	\$21.79/hd
General Farm Insurance	\$ 1.72/hd
Utilities	\$ 3.46/hd
Personal Property Tax	\$ 0.20/hd
Real Estate Tax	\$ 1.02/hd
Professional Fees (legal, accounting, etc.)	\$ 1.44/hd
Interest	\$ 2.08/hd

Table 3. Returns Per Head Including Unpaid Operator Labor and 3% Shrink

Market animal (Includes 3% Shrink)	812.4 lbs @ \$95.00/cwt	\$ 771.76	
Less cost of animal	500.0 lbs @ \$114.00/cwt	\$ 570.00	
Less death loss		\$ 11.40	
GROSS RETURNS PER HEAD			\$ 190.36
COSTS PER HEAD			
Feed			
<i>Drylot</i>			
Silage	1.238 t @ \$ 29.00 /t	\$ 35.90	
Brome Hay	0.656 t @ \$ 60.00/t	\$ 39.36	
Distillers	0.248 t @ \$ 130.00/t	\$ 32.18	
Corn	10.610 bu @ \$ 3.05/bu	\$ 32.36	
Supplement/Mineral	0.037 t @ \$ 433.00/t	\$ 16.08	
<i>Total Drylot</i>		\$155.88	
Total Feed Cost			\$155.88
Veterinary, drugs, and supplies			\$ 30.00
Yardage	150 days @ \$ 0.44 /hd/day		\$ 65.80
Interest on 1/2 Variable Cost + Purchase Price			\$ 14.98
TOTAL COSTS			\$ 266.66
RETURNS OVER TOTAL COSTS			\$(76.31)
Total gain			312.4
Feed cost/pound gain			\$ 0.499
Total cost/pound gain			\$ 0.854
Breakeven price			\$ 104.40

Table 4. Sensitivity of Returns Over Total Cost to Changes in ADG and Sales Price

Drylot ADG		1.91	2.03	2.14	2.25	2.36	2.48	2.59
Drylot Gain		287	304	321	338	354	371	388
Grass ADG		1.65	1.65	1.65	1.65	1.65	1.65	1.65
Grass Gain		0	0	0	0	0	0	0
End Weight		787	804	821	838	854	871	888
Sales Price (\$/cwt)	\$ 93.50	\$(110.76)	\$(103.34)	\$ (95.92)	\$ (88.49)	\$ (81.07)	\$ (73.65)	\$ (66.23)
	\$ 94.00	\$(106.94)	\$ (99.44)	\$ (91.94)	\$ (84.43)	\$ (76.93)	\$ (69.42)	\$ (61.92)
	\$ 94.50	\$(103.13)	\$ (95.54)	\$ (87.96)	\$ (80.37)	\$ (72.78)	\$ (65.20)	\$ (57.61)
	\$ 95.00	\$ (99.31)	\$ (91.64)	\$ (83.98)	\$ (76.31)	\$ (68.64)	\$ (60.97)	\$ (53.30)
	\$ 95.50	\$ (95.50)	\$ (87.75)	\$ (80.00)	\$ (72.25)	\$ (64.50)	\$ (56.75)	\$ (49.00)
	\$ 96.00	\$ (91.68)	\$ (83.85)	\$ (76.02)	\$ (68.18)	\$ (60.35)	\$ (52.52)	\$ (44.69)
	\$ 96.50	\$ (87.86)	\$ (79.95)	\$ (72.04)	\$ (64.12)	\$ (56.21)	\$ (48.30)	\$ (40.38)

Table 5. Sensitivity of Total Cost of Gain to Changes in ADG and Feed to Gain Ratio

Drylot ADG		1.91	2.03	2.14	2.25	2.36	2.48	2.59
Drylot Gain		287	304	321	338	354	371	388
Grass ADG		1.65	1.65	1.65	1.65	1.65	1.65	1.65
Gain Less Shrink		263	280	296	312	329	345	361
Feed to Gain Ratio	16.9	\$ 0.999	\$ 0.973	\$ 0.950	\$ 0.929	\$ 0.911	\$ 0.894	\$ 0.878
	16.1	\$ 0.974	\$ 0.948	\$ 0.925	\$ 0.904	\$ 0.885	\$ 0.869	\$ 0.853
	15.4	\$ 0.949	\$ 0.923	\$ 0.900	\$ 0.879	\$ 0.860	\$ 0.843	\$ 0.828
	14.7	\$ 0.923	\$ 0.897	\$ 0.874	\$ 0.854	\$ 0.835	\$ 0.818	\$ 0.803
	13.9	\$ 0.898	\$ 0.872	\$ 0.849	\$ 0.828	\$ 0.810	\$ 0.793	\$ 0.778
	13.2	\$ 0.872	\$ 0.846	\$ 0.824	\$ 0.803	\$ 0.785	\$ 0.768	\$ 0.753
	12.5	\$ 0.847	\$ 0.821	\$ 0.798	\$ 0.778	\$ 0.760	\$ 0.743	\$ 0.728

POTENTIAL IMPACT OF CREDIT CRISIS ON PRODUCTION AGRICULTURE, PART III

This article is the third of a three part series that examines the impact of the current credit crisis on production agriculture. The first part of the series discussed why production agriculture is vulnerable to the current macroeconomic environment and contrasted current average liquidity and solvency measures to those in the 1970s, 1980s, and 1990s (see December 2008 KFMA newsletter). The second part of the series examined long-term trends in agricultural interest rates and in farm loan repayment rates (see March 2009 KFMA newsletter). This part of the series updates average liquidity and solvency measures, and discusses trends in interest rates and farm loan repayment rates.

Table 1 illustrates trends in five-year averages of the current ratio, debt to asset ratio, and financial stress from 1973 to 2008. Given variability in weather, it is often useful to examine five-year average financial measures rather than examining the averages for a single year. The five-year average current ratio for KFMA farms for the 2004-2008 period was 2.59 which was the highest average since the 1994-1998 period. Using Table 1, the debt to asset ratio peaked during the 1985-1989 period at 0.330. The average debt to asset ratio for the 2004-2008 period, 0.268, was the lowest average since the 1979-1983 period.

Negative earnings and a debt to asset ratio above 0.70 are used in Table 1 to define financial stress for KFMA farms. Earnings are computed by subtracting unpaid operator and family labor from net farm income. Approximately 16 percent and 8 percent of the farms had negative earnings and a debt to asset ratio above 0.70, respectively, for the 2004-2008 period. Combining these two items, approximately 4.1 percent of the KFMA farms were financially stressed during this period. The level of financial stress is substantially lower than that experienced in the mid 1980s, but is still higher than the averages experienced in the 1970s. The percentage of farms with negative earnings and a debt to asset ratio above 0.70 were 45 percent and 15 percent during the 1985-1989 period, the peak financial stress years.

Farms with negative earnings and/or a high debt to asset ratio are more vulnerable to increases in inflation and interest rates. Currently, agricultural interest rates are relatively low compared to historical interest rates. Table 2 presents annual agricultural interest rates for operating, intermediate, and real estate loans in Kansas from 1988 to 2008. Interest rates in the second quarter of 2009, the latest quarter available, were 6.93, 6.88, and 6.51 for operating, intermediate, and real estate loans, respectively.

A longer term perspective on interest rates is provided in Figure 1 which illustrates trends in the prime interest rate since 1949. The average prime interest rate for the first six months of 2009 was 3.25 percent. The annual prime interest rate has not been this low since 1955. The information presented above, illustrates that the interest rates faced by producers today are relatively low. If interest rates migrate towards the long term average or those experienced in

the early 1980s, farms with high levels of debt will be financially vulnerable. Given recent monetary policy, many economists predict that inflation will increase rather dramatically in one to two years. This increase in inflation would likely lead to substantially higher interest rates.

Figure 2 presents a diffusion index of loan repayment rates derived from a survey of agricultural lenders conducted and summarized by the Federal Reserve Bank of Kansas City. Agricultural lenders respond to each survey question by indicating whether conditions during the current quarter are higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of agricultural lenders responding "lower" from the percent that responded "higher" and adding 100. Thus, a decrease in the index suggests that repayment rates are worsening. In response to strong financial performance of farms and ranches, the index increased from the fourth quarter of 2006 to the first quarter of 2008. Since that time, the index has deteriorated. However, the index is still considerably higher than it was in 2001 and 2002, when farm incomes were below the long-run average.

The current credit crisis has increased uncertainty. Fortunately, KFMA farms, on average, are in a relatively strong position to weather the financial storm. However, it is particularly important during uncertain times, to use benchmarks of key financial measures to gauge a farm's competitive position and have a contingency plan that addresses a scenario in which interest rates are substantially higher than current levels.

*Michael Langemeier, Professor
Department of Agricultural Economics*

Table 1. Trends in Liquidity, Solvency, and Financial Stress.

Years	Current Ratio	Debt to Asset Ratio	Financial Stress
73-77	2.23	0.217	0.69%
74-78	2.06	0.225	0.01%
75-79	1.97	0.236	1.38%
76-80	2.03	0.237	1.45%
77-81	2.08	0.245	1.83%
78-82	2.08	0.256	2.31%
79-83	2.16	0.265	3.14%
80-84	2.12	0.281	6.73%
81-85	2.06	0.294	7.61%
82-86	2.11	0.304	8.77%
83-87	2.13	0.313	9.49%
84-88	2.17	0.320	10.10%
85-89	2.24	0.330	10.84%
86-90	2.36	0.320	8.51%
87-91	2.51	0.310	8.34%
88-92	2.50	0.306	7.29%
89-93	2.56	0.302	7.21%
90-94	2.56	0.301	8.10%
91-95	2.52	0.304	9.20%
92-96	2.55	0.299	6.87%
93-97	2.58	0.295	6.79%
94-98	2.61	0.291	8.15%
95-99	2.54	0.290	6.98%
96-00	2.51	0.296	7.03%
97-01	2.43	0.301	8.20%
98-02	2.35	0.301	9.67%
99-03	2.31	0.301	9.47%
00-04	2.32	0.302	9.11%
01-05	2.34	0.299	9.89%
02-06	2.36	0.293	8.92%
03-07	2.42	0.285	5.69%
04-08	2.59	0.268	4.09%

Source: 2008 KFMA Databank.

Table 2. Historical Agricultural Interest Rates.

Year	Operating Loans	Intermediate Loans	Real Estate Loans
1988	11.92	11.85	11.29
1989	12.58	12.51	11.81
1990	12.21	12.12	11.42
1991	11.20	11.15	10.37
1992	9.70	9.72	8.94
1993	8.99	9.01	8.33
1994	9.41	9.41	8.86
1995	10.33	10.32	9.62
1996	9.98	9.79	9.08
1997	10.03	9.87	9.20
1998	9.81	9.61	8.81
1999	9.72	9.55	8.83
2000	10.46	10.24	9.53
2001	8.88	8.73	8.06
2002	7.86	7.87	7.39
2003	7.29	7.31	6.75
2004	7.35	7.37	6.92
2005	8.18	8.13	7.58
2006	9.08	9.01	8.33
2007	9.05	8.89	8.18
2008	7.40	7.34	6.91

Source: Federal Reserve Bank of Kansas City, Kansas rates.

Figure 1. Prime Interest Rate

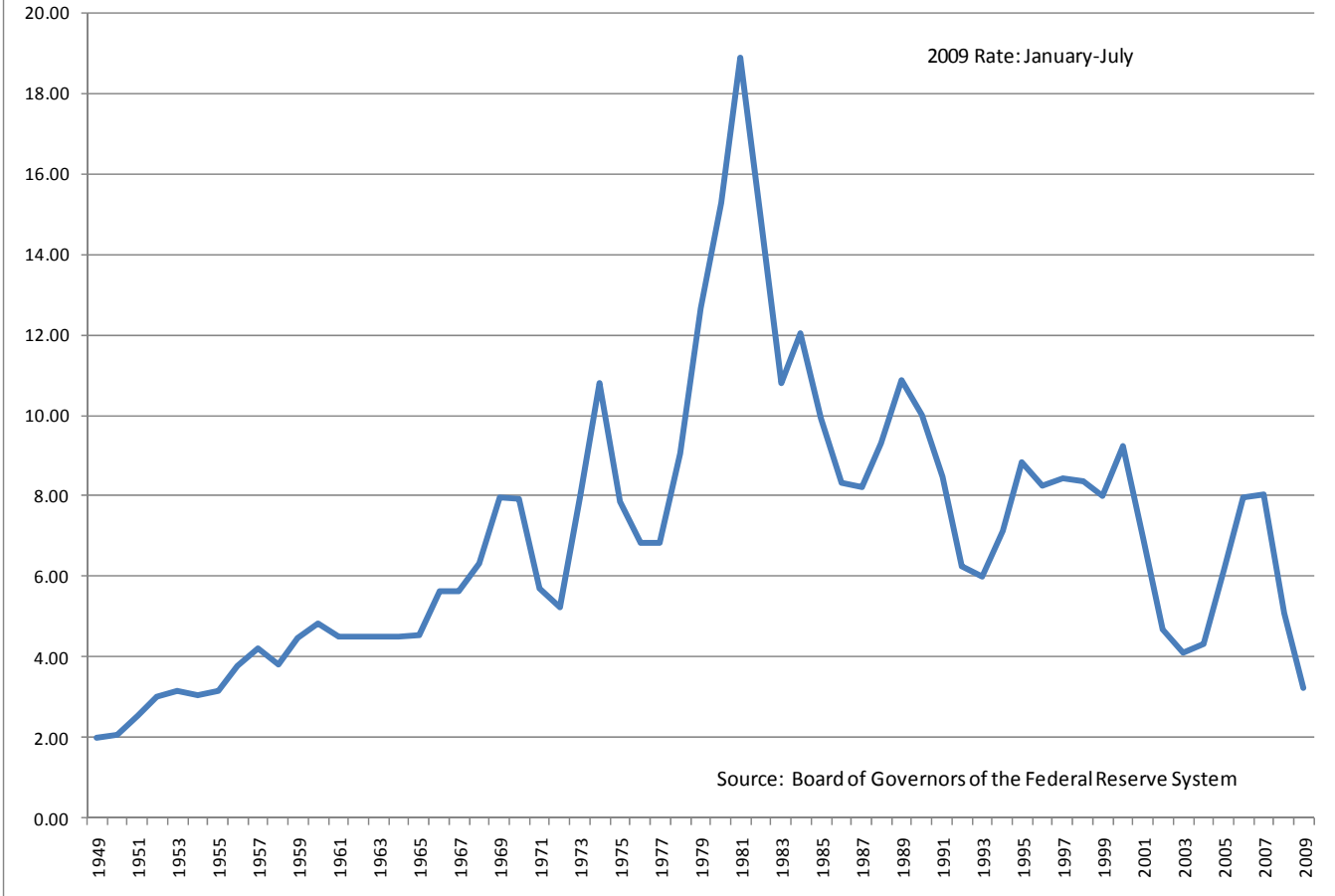
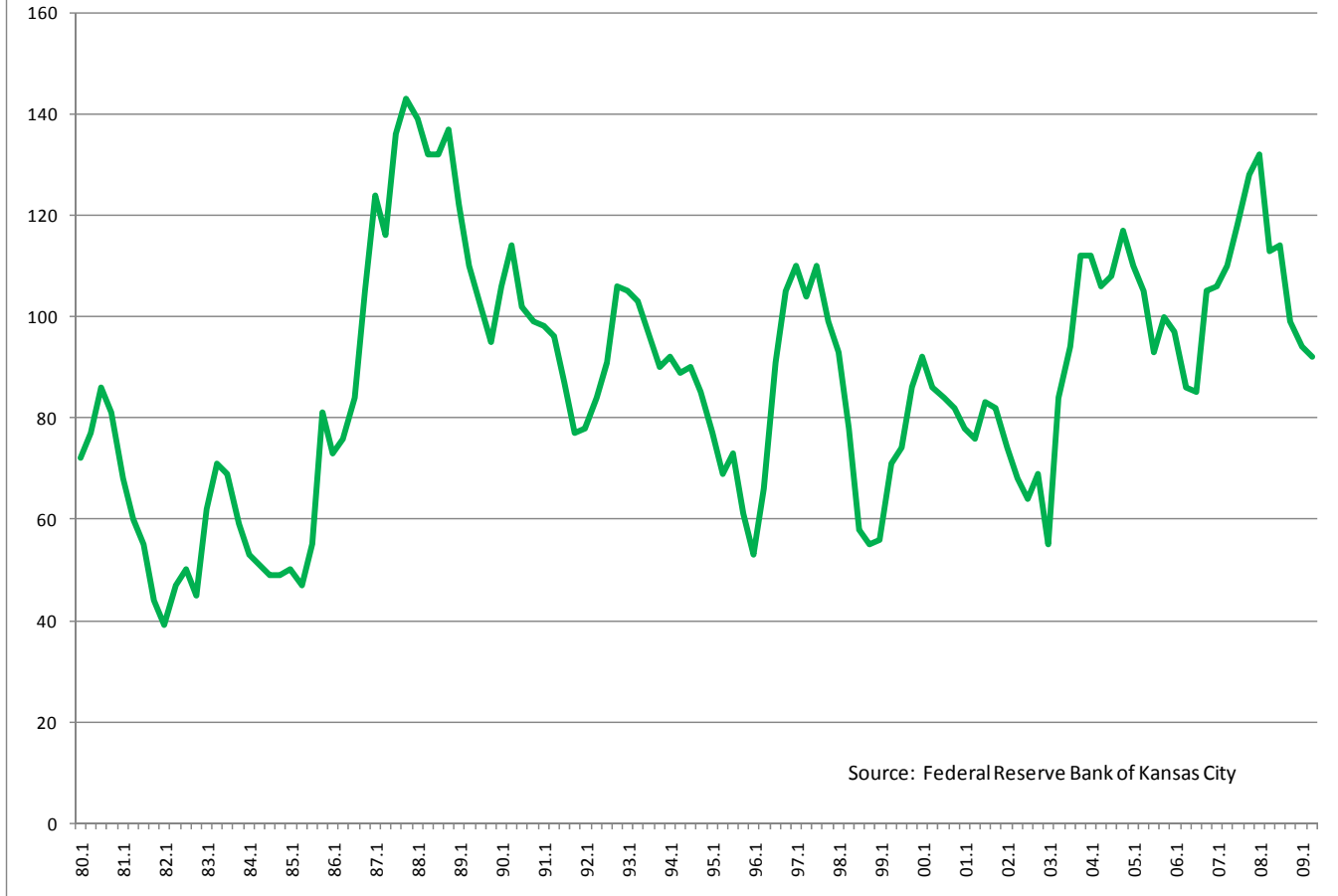


Figure 2. Loan Repayment Rates, Diffusion Index



RECOMMENDATIONS FOR FURTHER READING

The purpose of this section of the newsletter is to briefly discuss articles and web sites that may be of interest to readers. In general, the articles discussed will not report on original research. Rather, the articles will contain citations to web sites and articles that discuss topics of general interest.

In December of 2008, the Farm Foundation published an issue report entitled *Agricultural's Strategic Role in Feeding and Fueling a Growing World*. As noted by the authors of this report, agriculture in the United States and around the world faces a difficult challenge: how to feed a growing world. Global population is expected to reach 9 billion by

2040. This along with rising incomes will increase demand for food, fiber, and energy produced by the agricultural sector and put increasing pressure on global resources. The 30-year challenge of producing enough to meet increasing demands was discussed in the report using the following six broad categories: global financial markets and recession, global food security, global energy security, climate change, competition for natural resources, and global economic development. Themes discussed in the report include uncertainty, public understanding, unintended consequences, trade-offs, research and development, infrastructure, trade, and the absence of a clear strategy for U.S. agriculture. This report can be accessed on

my contributor site under “Recommendations for Further Reading”.

A recent study by the Brookings Institution (Bordoff et al., 2009) discusses several policy proposals that could potentially improve the long-run competitiveness of the United States. The authors argue that the United States needs to adapt to three fundamental global changes. First, we live in a global economy and it is here to stay. Second, the global balance of economic influence has shifted dramatically. The United States, Europe, and Japan are increasingly sharing the stage with Brazil, China, and India. Third, climate change is a central global challenge of our time. The four part competitiveness agenda proposed by the authors includes: investing in infrastructure, investing in people, investing in ideas, and investing in green transformation. For those that want more information, I have posted the article on my contributor site under “Recommendations for Further Reading”.

Attention economic geeks and gurus (or do I repeat myself). A recent journal article by

Holcombe discusses the importance of product differentiation to economic progress. The author argues that rather than simply a means to provide variety to consumers, product differentiation is often used to improve products. This improvement in products is an important engine of economic growth. Of course, product differentiation can also be an important competitive advantage for firms. This article can be accessed on my contributor site under “Recommendations for Further Reading”.

The Foundation for Economic Education (FEE) was founded in 1946 to study and advance the freedom philosophy which includes the sanctity of private property, individual liberty, the rule of law, the free market, and the moral superiority of individual choice and responsibility over coercion. The Foundation publishes several periodicals including *Ideas on Liberty*, *Notes from FEE*, and an e-mail commentary entitled *In Brief*. The Foundation’s web site is as follows: www.fee.org.

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The Kansas Farm Management Association (KFMA) Newsletter is distributed monthly to provide farm management information to farm decision makers. Further farm management information can be found on the KFMA program website: www.agmanager.info/kfma; and, on the Extension Agricultural Economics website: www.agmanager.info. The Newsletter is edited by Michael Langemeier, Professor, Department of Agricultural Economics, Kansas State University.



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