Tuesday, February 16, 2016 Volume 8, Number 7

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Crop Insurance as a Risk Management Tool

Due to tight margins in crop production this year, some farmers are contemplating reducing their crop insurance coverage in order to save on premium costs. While there may be a small savings in the premium costs per acre, this tactic could add considerable risk to a farm operation going forward.

Many producers remember when insurance coverage virtually guaranteed a profit from crop production in a given year. Crop price guarantees have changed and that is no longer possible. However, the risk protection provided by crop insurance coverage may be more important than ever.

The price guarantee for revenue protection (RP) crop insurance coverage for corn in 2012 was $5.68 per bushel and $5.65 per bushel in 2013. At those price guarantees, a farm operator with a 180 bushel per acre, actual production history (APH) yield could guarantee over $860 per acre with an 85 percent RP insurance policy, and over $815 per acre with an 80 percent RP policy. The average corn cost per acre on rented land in southern Minnesota (for direct expenses, overhead costs, and land rent) was approximately $825 per acre in 2012 and $884 per acre in 2013, according to the University of Minnesota.

The situation with soybeans and RP insurance coverage for 2012 and 2013 was similar to corn. The price guarantee for RP soybean crop insurance was $12.55 per bushel in 2012 and $12.87 per bushel in 2013. Using those price guarantees, a farm operator with a 50 bushel-per-acre APH yield could guarantee approximately $533 per acre in 2012 and $547 per acre in 2013, with an 85 percent RP insurance policy.

The average soybean cost per acre in southern Minnesota (based

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on: direct expenses, overhead costs, and land rent) was approximately $508 per acre in 2012 and $540 per acre in 2013, according to the University of Minnesota.

The revenue guarantees per acre provided by RP crop insurance policies in 2012 and 2013 virtually covered direct and overhead expenses, as well as land rental costs, and in some cases provided a profit margin. Things have changed in 2015 and 2016. By 2015, the corn price guarantee had dropped to $4.15 per bushel, which lowered the dollar guarantee with a 180 bushel-per-acre APH yield to nearly $635 per acre with 85 percent RP insurance coverage, and $597 per acre with 80 percent RP coverage.

Last year's corn expenses for land rents, along with direct and overhead expenses, exceeded $800 per acre in many instances. Similarly for soybeans, the RP price guarantee for 2015 was $9.73 per bushel, lowering the guarantee to about $413 per acre with a 50 bushel per acre APH yield and 85 percent RP insurance coverage. The 2015 average expense for land rent, direct and overhead costs was likely near $525 per acre.

For the 2016 crop year, the RP crop insurance price guarantees will likely erode even further. As of February 15, the RP price estimates were $3.88 per bushel for corn and $8.85 per bushel for soybeans. Using a 180 bushel per acre APH corn yield, the resulting revenue guarantee would be approximately $593 per acre with an 85 percent RP policy and $558 per acre with an 80 percent RP policy. If we assume a 50 bushel per acre APH soybean yield, the resulting revenue guarantee would be $376 per acre with an 85 percent RP policy and $354 per acre with an 80 percent RP policy. Estimated 2016 production costs for land rent, along with direct and overhead expenses are still expected to be $750 per acre or higher for corn, and $500 per acre or higher for soybeans in most instances.

Some producers have a tendency to overlook crop insurance as an important risk management tool, since the available revenue guarantees are lower than the cost of production in many situations. However, the overall financial risk in 2016 may be far greater than it was in 2012 or 2013, when more favorable guarantees existed.

Crop insurance premiums for 85 percent RP coverage are much

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more favorable than they were in previous years. Some producers have been able to increase their APH corn and soybean yields in recent years by using the trend-adjusted yield (TA-APH) endorsement for their crop insurance coverage. This has helped expand the insurance guarantee with only a minimal premium cost increase.

As recently as the 2014 crop year, many farm operators in southern Minnesota saw the benefits of having 80 percent or 85 percent RP crop insurance coverage for corn and soybeans. In many areas of the region, 2014 featured some of the lowest corn and soybean yields in many years, which were combined with rapidly declining crop prices. The corn price in 2014 dropped from a RP price guarantee of $4.62 per bushel in February to a harvest price of $3.49 per bushel in October. Similarly, the 2014 soybean price dropped from a price guarantee of $11.36 per bushel to a harvest price of $9.36 per bushel. The average crop insurance revenues in southern Minnesota for 2014 were over $148 per acre for corn and over $50 per acre for soybeans. Without the added crop insurance revenue, most crop producers would have shown a large loss per acre in 2014.

As we enter 2016, we have very tight crop margins for the coming year and in some cases negative margins on cash-rental acres to cover land rents, along with direct and overhead costs. Before reducing crop insurance coverage for 2016, a producer needs to assess whether they want to take on the extra risk of the reduced revenue guarantee of a lower coverage level. Reducing from an 85 percent RP policy for corn to a 75 percent RP policy will reduce the insurance guarantee by $70-$80 per acre. As a farm operator, is that a risk you are willing to take in 2016?

The deadline to purchase crop insurance for corn and soybeans for the 2016 crop year is March 15. For more information on various crop insurance policies and alternatives for 2016, producers should contact a reputable crop insurance agent.

More information on 2016 crop insurance decisions can be found here.

Kent Thiesse has written an information sheet titled: *2016 Crop Insurance Decisions*. To receive a copy of this information sheet, please email to: kent.thiesse@minnstarbank.com.

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