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Determining Farm Custom Rates

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CORNHUSKER ECONOMICS

Determining Farm Custom Rates

Market Report	Yr Ago	4 Wks Ago	3/26/10
<u>Livestock and Products,</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.....	\$83.49	\$90.00	\$94.00
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	111.58	122.03	129.10
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	93.21	102.16	108.43
Choice Boxed Beef, 600-750 lb. Carcass.	134.73	149.62	161.73
Western Corn Belt Base Hog Price Carcass, Negotiated.	57.22	69.93	65.95
Feeder Pigs, National Direct 50 lbs, FOB.	*	70.22	*
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean.	58.63	72.93	72.39
Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct.	89.75	*	*
National Carcass Lamb Cutout, FOB.	248.76	260.35	273.75
<u>Crops,</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Imperial, bu.	4.73	3.90	3.60
Corn, No. 2, Yellow Omaha, bu.	3.74	3.61	3.45
Soybeans, No. 1, Yellow Omaha, bu.	8.94	9.38	9.34
Grain Sorghum, No. 2, Yellow Dorchester, cwt.	5.70	5.71	5.46
Oats, No. 2, Heavy Minneapolis, MN, bu.	2.00	2.21	2.12
<u>Feed</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	190.00	135.00	135.00
Alfalfa, Large Rounds, Good Platte Valley, ton.	77.50	87.50	87.50
Grass Hay, Large Rounds, Premium Nebraska, ton.	85.00	*	*
Dried Distillers Grains, 10% Moisture, Nebraska Average.	128.00	105.00	100.00
Wet Distillers Grains, 65-70% Moisture, Nebraska Average.	49.25	35.00	31.00
*No Market			

As I write this, there is still snow in some ditches and fence rows, and many fields look like they are just about right for rice planting rather than corn or soybeans. Nonetheless, spring fever has hit and the field work will soon be going at full throttle. This raises a frequently asked question: "What are custom rates this year?" The Nebraska Custom Rate Survey is conducted every two years, and we are in the process of analyzing the data from our 2010 survey. We will publish those numbers as soon as possible. At this point we are working on the data for Part I, Spring and Summer Activities, and surveys are still coming in for Part II on Fall and Miscellaneous Operations. We thank all responders who helped out by completing surveys and sending us their information. We conduct a relatively extensive survey across the state, and as a result, it takes considerable time to get the data entered and analyzed by region.

Preliminary Rates for 2010

In the meantime, Table 1 on the next page shows the average rates for a few operations reported in the 2010 Iowa Farm Custom Rate Survey and the 2008 Nebraska State Average Rates. All rates are per acre.

The Iowa rates are reported to be up about one to two percent from 2009. The Iowa labor rates for the operator were reported as \$12.80 per hour for spraying and harvesting and \$11.70 for other operations. By comparison, the average labor rate reported in the 2008 Nebraska survey was \$12.01 per hour.

Reported custom rates reflect the rates charged in a particular area under certain conditions. The charges for providing custom machinery services reflect a local supply and demand situation. A number of factors go into the rate operators set. These include the distance traveled to perform the field operations, the field sizes,

Table 1.

	2010 Iowa Average	2008 Nebraska State Average
Disking, tandem	\$11.60	\$10.35
Planting, no-till	15.70	12.69
Drilling soybeans	14.25	11.94
Drilling soybeans, no-till	15.35	14.20
Spraying, ground, self-prop	6.50	5.70
Fertilizer applied, dry bulk	4.15	5.46
Fertilizer applied, liquid spraying	6.00	6.10
Anhydrous, injecting with tool bar	9.75	9.47

Source for Iowa rates: William Edwards. "2010 Iowa Farm Custom Rate Survey." *Ag Decision Maker*, File A3-10. Iowa State University.

terrain and other field conditions, the total amount of work done, that is, the size of the job, and possibly the trading of field services for other machinery services or labor.

Calculating the Costs Involved in Custom Operations

There are four factors which have major impacts on the rates charged. The purpose is not to take either the side of the custom operator or the farmer receiving the service, but to open the discussion of setting fair charges that will keep custom operators in business and provide the convenience of their services to farm owners.

1. Machinery Cost Components

There is an economic principle of production that says an operator is better off to stay in production, in the short-run, as long as the operating costs are being covered and some contribution is being made to the fixed or ownership costs. This may occur in custom rates where many operators who do custom work purchase machinery primarily to complete the operations on their own farm, but then do some custom work to supplement their income or assist other local farmers. This often results in what we refer to as "the good neighbor rates." The point is that the purchase of new machinery is expensive and machines have to be replaced at some point. Depreciation is not an annual out-of-pocket cost, but the replacement cost is major when a new machine is purchased. And the new machine will probably cost significantly more than the machine being replaced. If money is borrowed to purchase a machine there will also be interest costs or forgone interest on the investment (opportunity cost) if it is paid for with cash. There are also other costs which may be partially hidden including insurance, taxes and housing.

Machinery, as an asset, costs money. Machinery typically does not appreciate in value, but is necessary to get the work done and can generate income through custom operations. But make sure all the costs involved are covered.

2. Labor Costs

The assumed rate or the rate operators calculate into the rate they charge for a particular operation is about \$12 per hour. An online source of calculated costs of machinery operations is the University of Minnesota website: http://www.extension.umn.edu/distribution/business_management/DF6696.pdf. This was last updated in June, 2009. In calculating estimated costs of machinery operations, \$17.50 per hour for planting and harvesting and \$14 per hour for other operations was used. In calculating the time spent, the Minnesota calculations also include "overhead" time for tasks such as making machinery adjustments and filling sprayers and planters. These adjustments are in addition to the time actually spent in operation in the field. These adjustment rates range from two percent for tillage to 33 percent for spraying. Operating most farm machinery requires a high skill level and the compensation should be calculated accordingly. The labor rate represents the custom operator's contribution to family living costs. Custom operators are selling their skills to effectively perform field tasks for their farmer-customers. The labor rate portion of the custom rate charged is their salary.

3. Margin for Risk and Management

This may be considered the profit margin, but there are risks such as breakdowns and weather interruptions causing lost time, and the management of the custom business such as scheduling and record keeping. These may be

considered a part of the labor rate, but regardless, it needs to be considered as a cost of doing business.

4. Convenience and Opportunity Cost Factors

There is a risk of timeliness in hiring custom operators. The operation may not get completed exactly when the farm owner or manager would prefer, but with the typical size of machines currently being used and the speed at which operations can be completed, timeliness risk may not be as significant as it once was. On the other side of the ledger, hiring custom operators eliminates the need to own and maintain machinery. As one farmer recently blogged, “not owning machinery releases capital that I can use to buy more land.”

As pointed out earlier, the custom rate charged is based on local supply and demand for the services. It is an equilibrium between the rate operators feel covers their costs and provides a profit for them, and the rate farm owners or managers are willing to pay for the service they receive, compared to the rate other operators are charging.

In addition to considering the custom rate surveys, I recommend operators calculate what their actual costs are. There are a number of easy to use spreadsheets available to do this. The website addresses for two that I recommend are:

<http://www.extension.iastate.edu/agdm/crops/xls/a3-29machcostcalc.xls>

<http://www.apec.umn.edu/faculty/wlazarus/documents/Machdata.xls>

Summary

The Nebraska 2010 Custom Rates will be published as soon as the data is collected and analyzed by region of the state. When they are available, an announcement will be made on *Market Journal*. They will also be posted on the Department of Agricultural Economics website at: www.agecon.unl.edu under the “Resources and Publications” menu. The expected publication dates are late April.

Remember, these surveyed rates are intended only as a guide. There are many reasons why the rate charged in a particular situation should be above or below the average. These include the timeliness with which operations are performed, quality and special features of the machine, operator skill, size and shape of fields, number of acres contracted, the condition of the crop for harvesting and the availability of custom operators in a given area.

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