CoBANK

OUTLOOK

ECONOMIC DATA AND COMMENTARY

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Agriculture and the New Tax Law

What Cooperatives and Farmers Can Expect from the Tax Cuts and Jobs Act of 2017

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President Trump earlier this month hailed the new Tax Cuts and Jobs Act of 2017 as a major step forward for U.S. agriculture. "Our nation was founded by farmers," Trump told a farming audience in Nashville on January 8. The doubling of the estate tax exemption will keep farms in the same families for generations, while enhanced ability to deduct capital purchases will help farmers grow their businesses.

For Charles F. ("Chuck") Conner, president and chief executive officer of the Washington-based National Council of Farmer Cooperatives (NCFC), the final bill was notable as much for what it didn't do as what it did. Conner says he and NCFC's members for months had feared the bill would result in higher taxes for farmers already challenged by depressed commodity prices. In the end, changes to the bill, driven by legislators from agricultural states, helped maintain key tax benefits for the nation's agricultural producers, Conner said. He spoke with OUTLOOK about what cooperatives and farmers can expect from the new tax law, who is most likely to benefit, and what they can do to prepare.

OUTLOOK: What's your bottom-line assessment of the new tax law? Do you gauge it as a positive or negative for cooperatives and their members?

Chuck Conner: Overall it's going to be positive. We were very nervous when Congress started talking about tax reform. Our concern was that Congress wouldn't recognize the unique role and tax structure of cooperatives. It's fundamental to our existence that co-ops be taxed primarily not at the co-op level but rather at the level of individual members. I informed our executive committee that if we could get through tax reform without co-ops and farmers being worse off than they are under the current tax code, I would consider that a victory. I think we've achieved that, and may even have come out a little bit ahead.

This Month's Expert

As president and chief executive officer of the Washington-based National Council of Farmer Cooperatives (NCFC) since 2009, Chuck Conner is a leading voice in helping to advance the business and policy interests of American cooperatives and farms. From 2005 to 2009, Conner served as deputy secretary for the U.S. Department of Agriculture, working with President George W. Bush and senior staff on food, trade, security and energy policy.

From 2001 to 2005, Conner served as a special assistant to President Bush, helping transfer several USDA agency functions to the newly formed Department of Homeland Security. Before joining the USDA, Conner served as president of the Corn Refiners Association from 1997 to 2001. A graduate of Purdue University, Conner is the recipient of Purdue's Distinguished Alumni Award.

OUTLOOK: What relieved your fears?

Conner: One of the biggest issues was the repeal of the Section 199 deduction, which applies to proceeds from agricultural products that are manufactured or marketed through cooperatives. Since 2004, that deduction has provided major benefits to co-ops and their members. Most farmers won't benefit from the tax bill's major change—reducing the top corporate tax rate from 35 percent to 21 percent—and the loss of the 199 deduction could have left many of our members paying higher taxes. Fortunately, it has been replaced by Section 199A, which allows most farmers to deduct up to 20 percent of their income. That new deduction, along with the lower tax rates for individuals and the new rules on business interest deductibility, expensing, depreciation—all of those changes add up to co-ops and farmers being able to retain more of their money in rural America, where they can reinvest it in facilities and operations. That can only be positive for us.

OUTLOOK: In light of several of the articles published recently about cooperatives gaining an unfair advantage with section 199A, what is your stance on what should happen next?

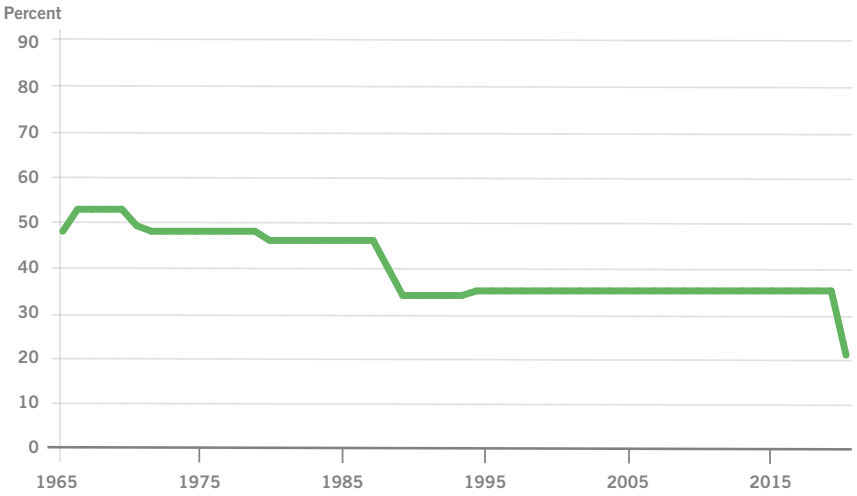
Conner: NCFC is currently participating in talks with the National Grain and Feed Association and non-cooperative grain companies to develop changes to 199A to address concerns about unintended impacts the provision may have on the competitive balance in the grain sector. Those negotiations remain ongoing, but NCFC believes that an agreement is possible which addresses these concerns while not increasing taxes for farmers.

OUTLOOK: In December, after the tax bill was signed, you said this legislation "recognizes the key role that farms, co-ops and their members play in spurring economic growth across rural America." How so?

Conner: Once tax dollars from rural America go to Washington, not much of that comes back into those areas. So having this legislation keep more of those dollars out there is very positive, and recognizes the role that farmers and co-ops play in communities and towns across the heartland.

The process of creating this bill was trying and not hugely transparent. In many cases, we couldn't be sure until the very last minute whether the provisions we wanted would be included. But in the end, this is a law that's going to make sure there are ample resources for co-ops and our members to invest in rural America. That's a good thing for this nation's food-growing economy.

CORPORATE TAX RATE SINCE 1965



Source: EPI.com

OUTLOOK: What should co-ops and their members be doing to prepare themselves for the bill this year?

Conner: It's important to remember that there is a lot of implementation and rule-making still to be done by the Treasury Department and the IRS. That will take a while and everyone needs to be patient. And it will continue to be very important to consult with your tax professionals before making any decisions based on what's in this law.

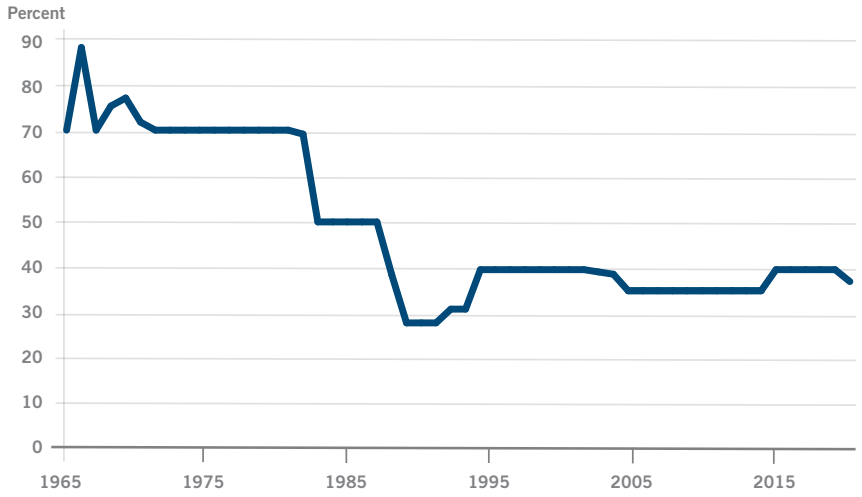
OUTLOOK: The new law almost doubles the standard deduction, to $24,000 for couples, while taxpayers who continue to itemize will have the deduction for state and local taxes capped at $10,000? How will those changes affect farmers and ranchers?

Conner: Most of our members will now take the standard deduction—and because it's larger, that should reduce their personal taxes. But those who live in high-tax states such as New York, California and Connecticut may continue to itemize, and the cap on that deduction could mean that some of them will end up paying more.

OUTLOOK: How will the new 20 percent income deduction for pass-through businesses affect cooperatives and individual farm and ranch owners?

Conner: For those who are organized as S-corporations or as similar entities, it will provide significant tax benefits. Meanwhile, corporations get a 40 percent reduction in their tax rate—and that's a permanent cut, unlike many temporary provisions in the bill.

HIGHEST INCOME TAX BRACKET SINCE 1965



Source: EPI.com

OUTLOOK: Which of your members is most likely to benefit from the ability to write off as much as $1 million in capital improvements?

Conner: They all will, in one way or another. That can fund a lot of capital improvements in rural America, where $1 million goes much further than it would in the heart of New York City. Economic growth in rural America typically doesn't keep pace with growth in the more urban regions of the country. This deduction provides a large incentive for investment, and anything that spurs development can only help us keep up.

Our co-op members that handle commodities could really benefit from being able to make these kinds of investments. With the weather patterns we've had, the window for farmers to get their crops harvested just gets smaller and smaller. So they have to move faster and faster. That means the co-op has to invest in new equipment and processes to handle things better and more quickly. The ability to expense those large deductions is critical in serving the interests of our farmer members.

OUTLOOK: Will the doubling of the estate tax exemption, to $22.4 million for couples, help farms stay in the family?

Conner: For years, estate taxes were always the number one issue for farmers. It has been a slow process, with some ups and downs, but over time we have changed that equation dramatically. The exemption for couples under the old law, of more than $11 million, eliminated the estate tax burden for the vast majority of farmers across the country. For the few who still faced that issue, the new changes should essentially take death, as a taxable event, off the table when it comes to agriculture and farming. That has always been the goal. Farmers want to pay their fair share of taxes, but ultimately the fact of passing along a farm from one generation to the next should not produce massive tax consequences. Now it no longer will.

> "This is a law that's going to make sure there are ample resources for co-ops and our members to invest in rural America. That's a good thing for this nation's food-growing economy."

OUTLOOK: Much of this law, as it involves individuals, families and small businesses, is set to expire in 2025. How does that affect your members and their ability to plan for the future?

Conner: It will have an impact. Agriculture is a long-term investment business. We typically look much further down the road in the co-op world than the investor-owned community. Eight years is still a good long time, but we were disappointed that a lot of the provisions that were important to us are scheduled to end after that—compared with the permanent corporate tax rate reduction, which is less important to co-ops. I wish that wasn't the case, but we will deal with it accordingly.

I do think that the number of provisions that expire in 2025 is extensive enough that Congress's hand will be forced and it will have to pass an extension bill. That doesn't mean everything will get extended, but there will at least be a debate about which provisions need to stay in effect. Once again, as it was in the discussion of this bill, our top priority will be the 199A deduction.

OUTLOOK: At the same time that President Trump was pushing for tax reform, he has talked about reforming or even eliminating the North American Free Trade Agreement. Is that also a concern for your members?

Conner: It's potentially huge in terms of how any changes in NAFTA might affect immigration. We estimate that more than a million workers on our farms and ranches don't have proper documentation, and we have been concerned that changes to the law could mean not only that we won't get new guest workers coming into the country but also that we might lose those workers who are already here—and without those people we absolutely could not continue to feed and provide for America as we now do so well. But in his remarks in early January to the American Farm Bureau, the president said he believes changes to NAFTA won't hurt agriculture in any way, and that he might even consider providing some kind of legal status for those one million workers. That was good news for us.

If NAFTA negotiations are unsuccessful and lead to American withdrawal from the trade agreement, the consequences for American agriculture would be devastating. Canada and Mexico combined account for just under 30 percent of all US agricultural exports; any loss of market share to competitors outside of North America would mean billions of dollars lost by American farmers and their co-ops. ■

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 12/31/17. They are intended to provide rate or cost indications only and are for notional amounts in excess of $5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Forecasts courtesy of Bloomberg and Blue Chip Economic Indicators

				US Treasury Securities	
2018	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.30%	2.20%	1.47%	1.91%	2.56%
Q2	2.60%	1.80%	1.68%	2.07%	2.69%
Q3	2.40%	2.10%	1.76%	2.21%	2.79%
Q4	2.30%	2.20%	1.90%	2.34%	2.88%
2019	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.00%	2.20%	1.95%	2.50%	2.98%

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	1.70%	1.92%	2.18%	2.27%	2.34%	2.42%
0.25	1.83%	2.03%	2.23%	2.28%	2.34%	2.43%
0.50	2.01%	2.12%	2.28%	2.31%	2.37%	2.47%
0.75	2.13%	2.22%	2.31%	2.36%	2.42%	2.50%
1.00	2.17%	2.27%	2.34%	2.36%	2.41%	2.49%
1.50	2.32%	2.32%	2.37%	2.42%	2.47%	2.54%
2.00	2.30%	2.37%	2.37%	2.42%	2.47%	2.54%
2.50	2.31%	2.37%	2.39%	2.45%	2.49%	2.56%
3.00	2.32%	2.37%	2.41%	2.49%	2.51%	2.58%
4.00	2.36%	2.39%	2.45%	2.52%	2.57%	2.61%
5.00	2.42%	2.47%	2.52%	2.60%	2.62%	2.65%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

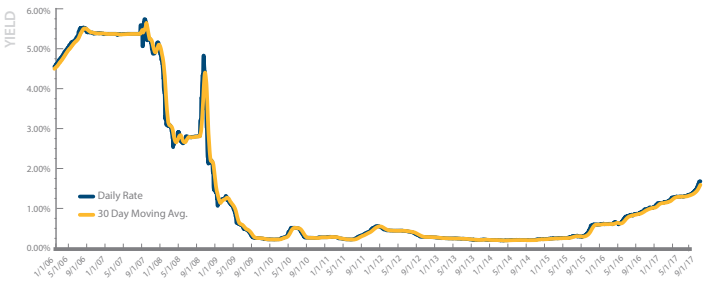
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	5	5
90	8	8	8	7
180	14	14	15	12
365	20	24	25	21

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

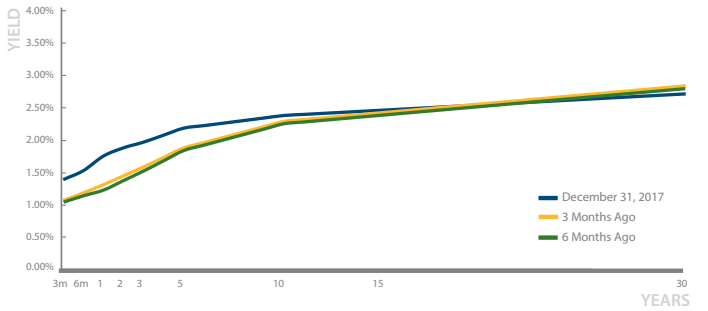
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE



COBANK UPDATE

CoBank Announces 2018 Board Officers

DENVER (December 13, 2017) – CoBank, a cooperative bank serving agribusinesses, rural infrastructure providers and Farm Credit associations throughout the United States, today announced board officers for 2018. The CoBank board elects its officers to serve a one-year term commencing January 1 and expiring December 31 each year.

Kevin Riel

Kevin Riel will serve as board chair, succeeding longtime board chair Everett Dobrinski. A director since 2014 and first vice chair in 2017, Riel is the president and chief executive officer of Double 'R' Hop Ranches, Inc., a diversified farming operation primarily growing hops, together with apples, grapes and row crops, and of Tri-Gen Enterprises, Inc., an agricultural marketing operation, and managing partner of WLJ Investments, LLC, a land holding and management company, all located in Harrah, Washington. He is a former director of Northwest Farm Credit Services, one of CoBank's affiliated Farm Credit associations, where he served as vice chair and chair, and is board president of the Hop Growers of America, a non-profit association promoting the interests of U.S. growers.

Jon Marthedal

Jon Marthedal will serve as first vice chair. Marthedal is the owner and operator of Marthedal Farms in Fresno, California, a grape, raisin and blueberry farming operation. He is also president of Marthedal Enterprises, Inc., a provider of farm management and custom agriculture services, and owner and operator of Keystone Blue Farms, a blueberry farming operation. He serves on the board of The Farm Credit Council. Marthedal is a director of Sun-Maid Growers of California and of the California Blueberry Commission. He also serves as president of the California Blueberry Association Board and vice chair of the California Raisin Marketing Board and the Raisin Administrative Committee. Marthedal has served on the CoBank board since 2013, and served as second vice chair in 2017 and as Governance Committee chair in 2016.

Kevin Still will serve as second vice chair. Still is president and chief executive officer of Co-Alliance, LLP, a partnership of five cooperatives supplying energy, agronomy and animal nutrition, producing swine and marketing grain in Avon, Indiana. Still is also chief executive officer and treasurer of Midland Co-op, Inc., IMPACT Co-op, Inc., LaPorte County Co-

About CoBank

CoBank is a $124 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states. The bank also provides wholesale loans and other financial services to affiliated Farm Credit associations serving farmers, ranchers and other rural borrowers in 23 states around the country.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture, rural infrastructure and rural communities. Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore.

For more information about CoBank, visit the bank's web site at www.cobank.com.

CoBank Announces 2018 Board Officers *(continued)*

Kevin Still

op, Inc., Frontier Co-op, Inc., and Excel Co-op, Inc., and president of Michiana Agra, LLC, which are agricultural retail cooperatives. He is chair of Local Harvest Food, a food broker, vice president and director of Connexities, LLC, a technology provider, and an advisory board member of Wholestone Farms, a food company. Still is also an officer of Agronomy Services, LLP, and president of Northwind Pork, LLC, a pork producing operation. He is the owner and president of Still Farms, LLC, a grain farm. Still has served on the CoBank board since 2002; he has served as the Risk Committee chair since 2008 and served as second vice chair in 2015 and 2016.

"I look forward to working closely with Jon, Kevin and the rest of our directors in the coming year," Riel said. "Our board and executive management team are fully committed to preserving and building the long-term financial strength of the bank so it can continue fulfilling its mission and delivering dependable credit and financial services to our customers."

Riel thanked Dobrinski for his 10 years of service as chair. Dobrinski, a farmer from North Dakota who remains a member of the board with a term expiring in 2019, was first elected as a director in 1999 and has served as chair since 2008. "Everett has been an outstanding board chair throughout a period of tremendous growth and change for CoBank," Riel said. "All of us are deeply indebted to Everett for his wise and humble leadership and for his steadfast commitment to the mission of CoBank and the Farm Credit System."

Riel also thanked directors Gary Miller, Ken Shaw and Stephanie Herseth Sandlin, all of whom will be stepping down from the CoBank board on December 31, 2017. Miller, who is president and chief executive officer of GreyStone Power Corporation in Douglasville, Georgia, and Shaw, who is a rancher and stockman from Mountainair, New Mexico, are stepping down as part of a previously announced board downsizing process. Herseth Sandlin, an appointed director and a former congressional representative from South Dakota, was recently named president of Augustana University in Sioux Falls, South Dakota. "We are deeply grateful to Gary, Ken and Stephanie for their service to CoBank and wish them the best in their future endeavors," Riel said.

CoBank's 2018 board will consist of 21 directors elected by customer-owners from six voting districts around the country, as well as two outside directors and one appointed director. ■