

*Making the most of long-term grain ownership opportunities requires an approach similar to income-producing real estate.*



# Long-term ownership offers attractive returns to space

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**M**any of the recent opportunities in elevator management have come from holding grain ownership long-term. This requires you to think in terms of returns to space available for long-term storage. Three factors determine your return to space: basis differences, futures spreads and commodity interest.

Return to space can be calculated as: futures carries + sell basis (vs. nearby futures) at the end of the holding period - sell basis (vs. nearby futures) at the beginning of the period - commodity interest.

Note that we use sell basis at the beginning of the holding period, not buy basis. Return to space doesn't include the handling margin or "elevation" available when you buy grain.

Tables 1, 2 and 3 review returns to space since the 1998 crop harvests in three major

markets: barge corn at St. Louis, MO, barge soft red wheat at Memphis, TN, and rail hard red wheat at the Texas Gulf. The futures carries used in the tables are the spreads from expiring months to the next futures months just before the delivery periods. The two scenarios considered in each market are:

1. Grain held continuously from the 1998 harvest to mid-February 2000; and

2. Grain held from the 1998 harvest to three months before the 1999 harvest. This grain is then replaced during the 1999 harvest and held to mid-February 2000.

These tables show decent returns to space, ranging from 2.3 cents to 4.6 cents/month over an extended period.

## Looking ahead

Futures carries continue to look good for long-term ownership. In late February, the carry after subtracting interest from March 2000 futures to March 2001 futures was around 24 cents in corn, 33 cents in Chicago wheat and 28 cents in Kansas City wheat. Grain Service Corp. is optimistic that futures carries closer to delivery periods will be somewhat better than this. The good returns to space are largely due to government farm programs that encourage production even in the face of low market prices. There's little political opposition to this approach. Assuming average weather, we should continue to have big stocks and good demand for storage.

With any long-term asset class such as grain storage, there's a risk of overbuilding when times are good. That doesn't seem to be happening now. The returns over the past few years are encouraging some elevators to add space, but returns haven't been good enough to cause a rush to build space. New steel space generally costs from \$1 to \$1.50/bushel depending on site preparation, bins sizes and conveyance equipment. The current

## tableOne

Corn returns to space  
at St. Louis, MO, from fall 1998.

### Holding through 1999 harvest

|  |       |
|--|-------|
| + Futures carries December 1998 to March 2000: | + 55¢ |
| + Mid-February 2000 barge basis:               | + 7¢  |
| - Mid-October 1998 barge basis:                | + 11¢ |
| - 16 months interest:                          | - 24¢ |
| Return to space:                               | + 49¢ |

### Liquidating mid-July 1999 and replacing during harvest

|  |       |
|--|-------|
| + Futures carries December 1998 to September 1999: | + 28¢ |
| + Futures carries December 1999 to March 2000:     | + 13¢ |
| + Mid-July 1999 barge basis:                       | - 2¢  |
| + Mid-February 2000 barge basis:                   | + 7¢  |
| - Mid-October 1998 barge basis:                    | + 11¢ |
| - Mid-October 1999 barge basis:                    | + 7¢  |
| - 13 months interest:                              | - 20¢ |
| Return to space:                                   | + 44¢ |

returns to space offer good, but not great, returns on this investment. (Soft red wheat return excepted.)

New commercial space is being built, but at a conservative pace, and some older space is being abandoned. In the current tight labor market, managers want space where operating efficiency is high.

The USDA recently announced a program of loan guarantees for

on-farm space. A similar program back in the 1970s caused many farm bins to be built. There was a strong bullish sentiment then and farmers built bins in order to bet on higher futures. Today's farmers know numerous ways to manage grain marketing without having bins. We don't expect a flood of new on-farm space to result from this program.

## tableTwo

Soft red wheat returns to space  
at Memphis, TN, from summer 1988.

### Holding through 1999 harvest

|  |        |
|--|--------|
| + Futures carries July 1998 to March 2000: | + 115¢ |
| + Mid-February 2000 barge basis:           | + 1¢   |
| - Mid-June 1998 barge basis:               | + 3¢   |
| - 20 months interest:                      | - 40¢  |
| Return to space:                           | + 79¢  |

### Liquidating mid-March 1999 and replacing during harvest

|  |       |
|--|-------|
| + Futures carries July 1998 to May 1999:   | + 56¢ |
| + Futures carries July 1999 to March 2000: | + 48¢ |
| + Mid-March 1999 barge basis:              | + 2¢  |
| + Mid-February 2000 barge basis:           | + 1¢  |
| - Mid-June 1998 barge basis:               | + 3¢  |
| - Mid-June 1999 barge basis:               | + 15¢ |
| - 17 months interest:                      | - 34¢ |
| Return to space:                           | + 91¢ |



## Managing long-term ownership

In the current environment, managing space for long-term returns is a big part of an elevator manager's job. The mind-set should be more of a real estate property manager and less of a typical grain trader. As with any space manager, whether it's an

apartment building or a grain elevator, high occupancy is critical.

Grain traders tend to focus on short-term basis changes. "The basis is up 5 cents this month and grain is beginning to move. I better sell some." A focus on short-term basis swings is fine in a short-term trading environment. However, it can be costly if the real money is in

capturing long-term carries. It's easy to lose ownership too soon. Unoccupied space is a drain on cash flow. Look at the calculations for the three markets in the tables. The returns to space largely came

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*When planning capital improvements, keep in mind that fast shipping capacity converts short-term space into long-term space.*  
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from futures carries. In short-term ownership, futures provide the hedge while you capture basis swings. In long-term ownership, cash gain provides the hedge while you capture future carries. When long-term futures carries are good, your goal isn't to catch the little swings but to capture the long-term returns.

Don't try to squeeze every last cent out of futures spreads. In times like these, futures carries tend to be best close to delivery periods. That's when most of the risk that grain will

## table Three

Hard red wheat returns to space at the Texas Gulf from summer 1998.

### Holding through 1999 harvest

|  |        |
|--|--------|
| + Futures carries July 1998 to March 2000: | + 101¢ |
| + Mid-February 2000 rail basis:            | + 12¢  |
| - Mid-June 1998 rail basis:                | - 27¢  |
| - 20 months interest:                      | - 40¢  |
| Return to space:                           | + 46¢  |

### Liquidating mid-March 1999 and replacing during harvest

|  |       |
|--|-------|
| + Futures carries July 1998 to May 1999:   | + 46¢ |
| + Futures carries July 1999 to March 2000: | + 45¢ |
| + Mid-March 1999 rail basis:               | + 20¢ |
| + Mid-February 2000 rail basis:            | + 12¢ |
| - Mid-June 1998 rail basis:                | - 27¢ |
| - Mid-June 1999 rail basis:                | - 15¢ |
| - 17 months interest:                      | - 34¢ |
| Return to space:                           | + 47¢ |



tal improvements, keep in mind that fast shipping capacity converts short-term storage space into long-term space. **EG**

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*Editor's note: In Merchandisers'*

*Corner of the February/March issue, there was a typographical error in the nine theoretical spread quotes. The list should have read 1 cent, 1 cent, 1 cent, 1 cent, 1 cent, 2 cents, 3 cents, 50 cents and \$1. This gives a mean of 17.9 cents and a median of 1 cent.*

tighten is gone. As long grain doesn't tighten, you'll tend to get better carries by keeping short hedges in nearby futures months and rolling them forward as delivery periods approach. However, there's always the risk that the market will take away the returns its offering. Again, think like a real estate manager. If you owned an apartment building, you probably wouldn't want all your leases to be short-term, expiring every few months. As long as rental rates are good, you'd want some long-term leases although it means giving up the chance of higher rents later. For grain space, having some hedges out in far-deferred futures months is similar to having long-term leases.

It sounds strange, but the ability to ship fast can pay off by allowing you to avoid shipping too soon. Most country elevators are able to fill space fast. They must in order to capture grain during harvest. The advantage of being able to empty space fast is less appreciated. Many elevators have to start clearing space shortly after one harvest in preparation for the next. When returns to space are good, this is costly. When planning capi-