2018 Dairy Margin Protection Program Update

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Largely considered a failure by dairy farmers, changes to the Dairy Margin Protection Program (MPP) included in the 2018 Bipartisan Budget Act earlier this year may be helpful for some farmers.

Dairy farmers should re-evaluate the use of the 2018 MPP before the June 1 signup deadline. Originally initiated by 2014 Farm Bill legislation , the MPP intended to provide dairy farmers with a tool to manage risk by insuring a margin between the Statistical Uniform Milk Price and a calculated feed cost based on a set equation and monthly corn, soybean and hay prices. This program replaced the MILC and support price programs. Now farms can choose to participate in either the MPP, the Livestock Gross Margin Insurance Program, or neither.

Farmers that choose to participate in the MPP pay a $100 administrative fee and receive coverage for a $4 per cwt "catastrophic margin" (CAT), on 90% of their production history. They can also choose to "buy up" coverage up to an $8 margin for 25% to 90% of their production history.

Changes Made

Administration Fee:
Farms that participate must pay a $100 administration fee. Now this fee will be waived for limited-resource, beginning, veteran, and disadvantaged farmers.

Premiums: Tier 1 premiums now cover the first 5 million pounds of production history. Previously, they applied to the first 4 million pounds. Tier 1 premiums are also substantially less, offering new opportunities for farms covering up to 5 million pounds of milk. Tier 2 premiums are unchanged. See Table 1 for old and new premium rates. Note that on the first 5 million pounds (Tier 1), coverage up to a $5.00 margin is now available at no cost.

Table 1: Old and New MPP Premiums

	Old Tier 1	New Tier 1	Tier 2 (same)
Margin	< 4 million pounds	< 5 million pounds	> 5 million pounds
$4.00	None	None	None
$4.50	$0.01	None	$0.02
$5.00	$0.025	None	$0.04
$5.50	$0.04	$0.009	$0.10
$6.00	$0.055	$0.016	$0.155
$6.50	$0.09	$0.040	$0.29
$7.00	$0.217	$0.063	$0.83
$7.50	$0.30	$0.087	$1.06
$8.00	$0.475	$0.142	$1.36

Production History: No changes here. Production history (PH) is based on the highest annual production from 2011, 2012, or 2013. Farms that participated previously and paid their fees in a timely manner receive annual production increases with rates announced annually by Farm Service Agency (FSA). Farms that started milking cows after 2013 should work with their FSA office to establish their farm's production history.

Indemnity Calculations: Will be made and paid monthly in 2018. Previously, margins were calculated and announced each month, but for program purposes, 2 months were averaged together and any indemnity payments were made on those 2-month averages. For example, under the old rules the indemnity for January/February would have been based on an average of the January margin of $8.11705 and February's $6.88349, or $7.50027. If a farm had bought up coverage for an $8 margin, the indemnity payment on covered pounds would be $8 - $7.50027, or $0.49973 per cwt.

Under 2018's revised rules, the indemnity for January is zero since the actual margin was more than $8. February's is ($8 - $6.88349) or $1.11651 per cwt, resulting in a higher overall indemnity payment for a farm that buys up coverage to the $8 margin. These monthly calculations and payments can increase the dollars received by the farm, and result in faster payments to the farm.

No Play, No Pay: Last fall, this option was initiated by the Secretary of Agriculture, and continues under the new rules. Even if a farm had signed up for coverage prior to 2018, it may opt-out of the program for 2018.

Sign-ups reopened: The original sign up period for 2018 coverage opened and closed in 2017. With the rollout of the new rules, a new sign-up period opened April 9th and continues through June 1. If you signed up in 2017, even at the minimum level, you must sign up again! If you do not, you will not be enrolled in the program for 2018.

Retroactivity: The sign up period is for January 1 through December 31, 2018, and coverage is retroactive to January 1. This puts us in the interesting position of knowing the margins for January, February, and March before making a program decision. By the end of May, we will also have a pretty clear idea of what the April margin will be plus or minus a few cents.

Making Decisions: The Margin Protection Program Decision Tool is updated with the new rules and Tier I Premiums. Futures market data is updated daily by Mark Stephenson's group at the University of Wisconsin which developed the tool. Find it at https://dairymarkets.org/MPP/. Plug in your production history and use the "Select Coverage" feature to see the administrative fees and premiums, expected payments and expected net returns for each margin coverage level at the percent of PH coverage that you select.

Projections: Using futures market data available on April 30th, the MPP Decision Tool is projecting that the margin will stay below $8 per cwt through June. If this is what actually happens, the decision tool projects an expected payment of $24,082 for a farm with a production history of 5 million pounds buying up coverage for an $8 margin on 90% of their production history (4,807,827 pounds of milk is covered). The administrative fee and premiums for this coverage will cost $6,927 with the $100 administrative fee due at sign up, and the balance due by September.

If milk price improves, and/or feed prices decline, the expected payment could be considerably less. The projections do not guarantee the actual performance of the program. It projects what will happen based on yesterday's futures market data. Each farm has to make a final participation decision based on today's information and your expectations of what will happen in the market place for the rest of 2018.

What we know for sure: What we do know for sure is that for a farm purchasing coverage at the $8 level, there will be indemnity payments for February ($1.11651) and March ($1.23163). A logical next question is, "how much of the fees and premiums will that cover?"

For our example farm covering 90% of their 5 million pound beginning PH, the covered annual production is 4,807,827 pounds. (A farm participating each year receives an annual increase to their PH, so their 2018 program PH is 5,342,030.) To calculate monthly payments, the covered PH is divided by 12, regardless of when milk is actually produced on the farm. Continuing with our example above, the farm's monthly covered PH is 4,807,827 lbs/12 = 400,652 lbs or 4,006.52 cwt.

February	$1.11651 x 4,006.52 cwt =	$4,473
March	$1.23163 x 4,006.52 cwt =	$4,935
		$9,408
Estimated 6.6% sequestration deduction		- 621
Feb/March Payment to the farm		$8,787

Note: Farm Bill payments are subject to a sequestration deduction related to budget-balancing efforts. Current estimates are that the deduction rate for MPP payments will be around 6.6%.

For our example farm, we know that the payments for February and March will return more than the $6,927 administrative fee and premiums. It appears very likely that the margin forecasted for April will also be well under $7 with May and June currently forecasted above $7 but less than $8. So, in this case, a farm can sign up knowing that the fees will be covered, and there will be some net return to assist with a few bills.

More than 5 Million Pounds: Our example farm at 5 million pounds of PH would be representative of a farm milking 200 cows selling 25,000 pounds of milk per cow per year. How does MPP look for farms with more than 5 million pounds of milk?

Here we have to consider two important factors.

1) Tier 2 premiums for milk over 5 million pounds are considerably higher than the Tier 1 premiums for the first 5 million pounds of milk. For example, $8 coverage costs 14.2¢ per cwt for the first 5 million pounds, and $1.36 per cwt for any milk above that level.
2) Only one level of coverage can be selected for the first 5 million pounds, and any milk above 5 million pounds.

Because of this stipulation, farms with more than 5 million pounds will want to cover whatever percent of their PH that gets their covered milk as close to 5 million pounds as possible. If your farm has more than 20 million pounds of PH, even at 25% coverage, you will be purchasing some Tier 2 protection. Those high rates can quickly eat up any indemnity payments. Use the MPP Tool to see what coverage optimizes net returns for your farm.

Because of the higher Tier 2 premiums on the milk over 5 million pounds, some farms will find that the February and March payments will cover less than half of the fees and premiums. These farms will want to look carefully at the cost and probability of the program helping their farm business, factoring in their own market projections.

It is likely that farms with over 25 million pounds of production history will find that the fee and premiums will cost more than the projected indemnities. Run the Decision Tool again shortly before the sign-up deadline as market projections will change.

Bottom Line:

- Significant changes were made to the 2018 Dairy Margin Protection Program.
- Farms who signed up in 2017 for the 2018 program must sign up again by June 1.
- Sign up is retroactive to January 1, 2018 and coverage is for January through December 2018.
- Sign up at your County Farm Service Agency office.
- Farms should use the Margin Projection Program Decision Tool to evaluate their farm's participation. Your County Extension Educator can assist you with the tool.
- The MPP Decision Tool is updated with new futures markets information daily. Results and projections change because results are projections based on yesterday's market data.
- Combine MPP Decision Tool projections with your projections about this year's markets and what we already know about January, February, and March margins to make the best decision for your farm.

- Premiums must be paid in full by September 1. It makes sense to pay off the premium with indemnity payments received before using MPP payments to pay other bills.

The good news is that these changes may bring a few dollars to cash strapped farms. Will it substantially help with pervasive cash flow issues? No. However, for 2018, it might help pay a bill or two.

Resources:

Program on Dairy Markets and Policy Website https://dairymarkets.org/

Margin Protection Program Decision Tool https://dairymarkets.org/MPP/Tool/

Farm Service Agency Margin Protection Program for Dairy including announced prices and margins, you can also access the Decision Tool from this site https://www.fsa.usda.gov/programs-and-services/Dairy-MPP/index

USDA MPP Terms and Conditions Update https://forms.sc.egov.usda.gov/efcommon/eFileServices/eForms/CCC782_APPENDIX.PDF