

ESO 1684

# **PIK AND ROLL**

EDUCATIONAL MATERIALS

by

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# "PIK and ROLL"

## I. What is it?

**PIK** - Use of PIK Certificates to  
redeem corn under loan

**ROLL** - Resell Redeemed Corn  
(generally to elevator  
where stored - hence  
the roll)

## **II. Some Issues Surrounding Certs**

### **1. Farmer Issues**

#### **A. Increased Income Opportunities**

- 1) Avoid Storage Costs**
- 2) Avoid Interest Charges**
- 3) Sell Certs for Premium**
- 4) Crop/Livestock Producer use of loan**
- 5) PCP - Loan Spread**
- 6) PCP - Cash Spread**
- 7) Avoid Storage Losses**

#### **B. Farmers Desiring Low Prices**

## 2. Market Issues

### A. Loan Rate No Longer Price Floor

1) Certs Appear to be Marketing  
Loan

- a) Many of same effects
- b) Downward price pressure  
controllable
- c) Certs Program Cheaper

2) Changed Traditional Price  
Relationship

- a) Oats Higher than Corn
- b) Beans 3 times Corn

## B. Certs Tend Toward Price

Disequilibrium rather than equilibrium

1)  $P \downarrow$  below loan rate  $\Rightarrow$  PCP  
PIK and Roll to Capture  
PCP-Loan Spread  $\Rightarrow \uparrow$   
Supply  $\Rightarrow \downarrow$  Cash Price  $\Rightarrow \downarrow$   
PCP  $\Rightarrow \uparrow$  PIK and Roll  $\Rightarrow \dots$

2)  $P \uparrow$  Toward loan rate  $\Rightarrow$   
PCP  $\Rightarrow \downarrow$  PIK and Roll  
(less PCP-Loan spread to capture)  $\Rightarrow \downarrow$  Supply  $\Rightarrow \uparrow$   
Cash Price  $\Rightarrow \uparrow$  PCP  $\Rightarrow \dots$

3) Past -- Price near loan  $\Rightarrow$   
 $\uparrow$  sales  
Now -- Price near loan  $\Rightarrow$   
 $\downarrow$  sales

## C. Certs ↑ Uncertainty

- 1) What is CCC going to do?
- 2) What does CCC want?
- 3) Surprise CCC Adjustments
- 4) CCC Adjustments Lumpy
- 5) Wheat and Corn Catalogs  
(CCC Auctions)

## D. Re-emergence of Carrying Charges

- 1) Before Certs market brought cash up to redeem loans
- 2) Now futures more than loan redemption price (i.e. real market expectations) => creates possibilities for storage income => elevators more competitive

## **E. Increased Marketing Opportunities for Merchandisers**

- 1) Price Arbitraging**
- 2) Could result in focusing on certs instead of grains**

# 3. Congressional Issues

## A. Lack of Checks and Balances

- 1) Popular
- 2) Too Much of a Good Thing
  - a) Tighter Budgets
  - b) "Non-dollar" tool
  - c) Certs became more popular
    - Export Enhancement
    - Targeted Export Assistance
    - Farm Income Support

## B. Lack of Regulatory Oversight

- 1) USDA Sole Regulator
- 2) USDA Regulatee
- 3) Concern



## **4. USDA Issues**

### **A. CCC Reduced Costs (also FOR) (Regular loan and inventory)**

- 1) Storage**
- 2) Handling**
- 3) Transportation**

### **B. Basis for Adjusting Co. Loan rates**

### **C. CCC Inventory Mgt.**

- 1) Liquidity at Competitive Prices**
- 2) CCC Inventory Auction**

## D. Daily Estab. of PCPs

- 1) 10,000+ Values Daily
- 2) System not self adjusting if Basis changes

## E. Catnip Effect

- 1) ↑ Pressure to use PCP control to accomplish market control
- 2) Exports, storage, use, substitution
- 3) Power difficult to give up

# **5. Future Issues**

## **A. Continue Issuance**

- 1) Feed Grain**
- 2) Wheat**
- 3) Rice**
- 4) Upland Cotton**
- 5) None, One, Some, All**

## **B. Commodity Specific vs. Generic**

- 1) Yes/No**
- 2) How Much**

## **C. Appropriate Volume**

- 1) Supply**
- 2) Demand**
- 3) Price**

## **D. Modify Utilization Rules**

- 1) New vs Old Crop**
- 2) Original Recipient Use**

# III. Critical Variables In Decisions

## 1. Prices

- A. County Loan
- B. Net Loan for Farm  
Stored
- C. Posted County Price
- D. Local Cash Price
- E. Corn Delivered to Farm
- F. Buy Certs
- G. Sell Certs

## **2. Costs**

**A. In/Out**

**B. Pik and Roll**

**C. Storage**

## **3. Grain**

**A. On Hand**

**B. Fed**

**C. Under Loan**

**D. On Hand Not  
Loan Eligible**

## **4. Cert Face Values**

**A. Original Issue In-  
Hand**

**B. Purchased In-Hand**

## **5. Time (Months)**

**A. In Storage**

**B. Remaining Loan**

**C. Between Harvest  
and Sale**

# IV. An Example

## 1. Grain Producer

Grain stored at elevator

All Under Loan (100 bu)

PCP = \$1.79

Cash Price = \$1.83

Loan = \$1.92

7 mo. remaining on loan • \$0.03 / mo.

PIK and Roll Cost \$0.03 / bu.

Certs sell • 104

Certs Buy • 105

Have \$590 Original Issue Certs

Alternatives: PIK and Roll or Forfeiture

### Relevant Information

1000 bu.\* 1.79 = \$1,790 Certs needed

\$1790 - 590 = \$1200 Certs to Buy

\$1200 \* 1.05 = \$1260 Certs Cost

Redeem 100 bu. under loan

Sell 100 bu. • \$1.83 = \$1,830

Pay PIK and ROLL charge • \$0.03 = \$30



## A. Total Revenue Approach

	<u>PIK and ROLL</u>	<u>Forfeiture</u>
a) Loan Value (\$)	1.92	1.92
b) PCP (\$)	1.79	1.79
c) Cash Price (\$)	1.83	1.83
d) Bu. under loan	1000	1000
e) Mo. remaining on loan	7	7
f) storage cost/mo. (\$)	.03	.03
g) PIK and ROLL charge (\$/bu)	.03	---
h) Face Value Certs on hand (\$)	590	590
i) Certs needed (\$) (d*b)	1790	---
j) Certs must buy (\$) (i-h)	1200	---
k) Certs Price/100 (\$)	1.05	1.04
l) Cost of Certs bought	1260	---
m) Bu. PIK'd [(j+h)/b]	1000	---
n) Bu. Forfeited (d)	---	1000
o) Storage on forfeited corn (d*e*f)	---	210
p) Corn sold	1000	---
q) PIK and ROLL Cost (m*g)	30	---
r) Cert Sale (h*k)	---	613.60
s) Loan Receipts (d*a)	1920	1920
t) Receipts form corn sale	1830	---
u) Net Receipts s+t+r-q-o-l	2460	2323.60
v) Gain	136.40	

## B. Partial Budget Approach

(PIK and ROLL vs. Forfeiture)

Increased Costs (-)      Decreased Costs(+)

Buy Certs	\$1260	Storage	\$210
ROLL Charge	30		

Decreased Receipts      Increased Receipts

Cert		Corn Sale	
Premium	23.60		1830
Cert Sale	590.00		

	<u>1903.60</u>	(-)	(+)	<u>2040</u>
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Net Gain in Favor of PIK and ROLL  
\$136.40

## C. Per Bushel Allocation Approach

(PIK and ROLL vs. Forfeiture)

+	\$ .04	PCP-Cash Price Spread
+	.21	Storage Savings
-	.03	ROLL Charge
-	.06	Buy Certs Premium
-	.0236	Cert Premium Lost

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+	\$ .1364	Net Gain/Bu.
*	1000	Bu.

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\$ 136.40 Net Gain for PIK  
and ROLL