

# Plain Dirt Financing

Financial Information for Amish Farmers  
October 2007

## 2007...a year to remember

By John Mylin

This summer I'm not sure if we spent more time talking with farmers about crops or milk prices. As you can imagine the conversation for both crops and milk price was very positive. One conversation I had went like this:

**Farmer:** Here is a check to pay down on the principal of my loan. These milk prices sure have made milking cows more interesting.

**Loan Officer:** It's hard to believe the turn around in the milk price since last year. The futures are predicting above average milk prices throughout 2008

**Farmer:** I guess we will appreciate these prices while they last. At times like these I always think about what my Dad used to say:

**“It's not the bad times that get you in trouble, it's the good times you have to worry about.”**

I certainly don't think this gentlemen's father had anything against higher milk prices, although his comment may lead you to think that. I believe it was his way of suggesting caution when times are good and profits are above average.

It is human nature to find ways to spend or consider additional borrowing when times are good and funds are plentiful. The decision seems wise as long as funds are plentiful and profits remain above average. The difficulty comes when spending decisions made based on above average profits are faced with average or below average profitability. In the dairy business we have come to expect wide swings in the milk price. When Farm Credit considers loan requests we always base cash flow estimates on at least three years of income and expense. This levels out the periods of high and low profits and provides a more accurate picture of what the business can be expected to do in an average year.

All dairymen, and especially those who have started in 2007, would do well to keep in mind ups and downs of milk prices when considering spending and borrowing decisions. Many times I have heard older farmers express concern for start up dairymen who may become accustomed to higher milk prices and not be prepared for lower milk prices.

Managing funds during up and down cycles in milk price will be very important in determining which dairymen will be successful in the long run. Given that up and down cycles in milk price is a certainty, good management of extra dollars when times are good will better prepare dairymen for when milk prices are poor.

So, maybe it is beneficial to review how we manage extra dollars when times are good. It basically boils down to making use of extra funds during periods of above average milk prices that will help to build a cushion and enhance the ability of the operation to maintain a positive cash flow during periods when milk prices are low.



(Continued on page 2, column 1)

There are many ways to do this. Here are a few ideas:

1. If you had bills back up when milk prices were low, your first priority must be to get them paid in order to ensure you get the discounts available to you. This can result in 24% savings. First, pay all surplus funds towards bills and consider borrowing to consolidate bills. Make sure payments on a new loan will not again result in inability to keep bills paid current in the future.
2. If you extended credit lines when milk prices were low, you should begin to repay them so that credit is available should it be needed during periods of low milk prices in the future. A credit line, if used correctly, is an excellent tool for managing milk price cycles and providing a cushion when needed.
3. Build a cash reserve. There is nothing wrong with keeping a cash reserve as a cushion against future periods of low prices.
4. Make extra principal payments on farm, livestock, and equipment loans. By making extra payments during profitable periods you may have the ability to rework debts and lower payments if needed in the future. Even if it is not necessary to rework debts you will save interest and build your credit reputation by paying debt faster than required. Often there is a question on which debt to pay extra principal. My advice is usually to pay extra principal toward the debt you can pay off in the shortest period of time. When a debt is paid off the total amount needed for monthly debt payments is less thereby improving cash flow.
5. Carefully consider each investment – why it is important to the business – and the return it will bring to the business. What is the payback period for your investment, and will it improve profits and better enable you to weather periods of lower profits in the future.
6. Be careful to avoid the mistake of spending too much on things that contribute nothing to the ability of the operation to weather low prices in the future. This is not to say that if the manure spreader always needs repair you shouldn't replace it. A spreader is a necessity, however, recognize that it does nothing to improve profits and better enable the operation to weather periods of low prices in the future.

Milk prices have never been higher than they are in 2007. Higher milk prices are always welcomed, however higher prices may result in increased income taxes for some dairymen. We would like to thank our friend Walter Sinclair for his willingness to provide some suggestions on managing tax liability in the following article.

## **Year End Tips for a Good Income Year**

*Provided by Walt Sinclair and Elaine Kinard, Sinclair Business Support*

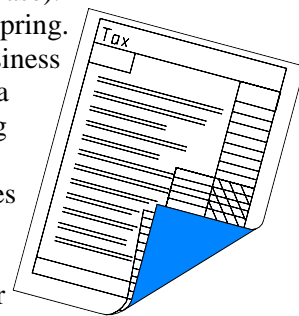
Most dairy farmers had a good year in terms of income dollars per hundred pounds of milk shipped in 2007. Taxes are the punishment for having a good year.

Before panicking, look into your personal deductions. A married couple with four children under the age of 17 is allowed to make taxable income (generally interest, dairy and beefing profits) of about \$63,000 before owing Federal tax. The limit for Pennsylvania tax for this family would be \$51,000. At \$63,000 profit, no Federal tax and about \$2,000 due to Pennsylvania and \$630 to \$1,175 local tax, depending on the township you live in. Maryland tax would be about \$3,400.

So, if you want to lower your taxes, first try to get an idea if you are going to owe. Roughly figure your profit based on income (tobacco, milk, product, etc.) minus various daily farm-related expenses (feed, fuel, fertilizer, supplies, repairs, vet, etc.). Then subtract an amount for depreciation. Look on the Schedule F, line 16 from 2006 to get an estimate. Then estimate the remainder of the year (if you do this about November 1, adding 1/12 more for December might come close). Now add up new depreciation items in the way of cows, equipment, silos and greenhouses (not buildings). If you subtract this from "profit" from above, can you get below Federal tax limit?

Ways to lower "profit":

1. Be sure that all day-to-day farm expenses are caught after December 31 (check in the mail that date – January 1, 2008 paid items are of no value for 2007).
2. Buy cows or equipment necessary for spring. These do not have to be paid in full, but you must OWN them (a small down payment with promise to pay with tobacco check allows you to deduct full cost of purchase).
3. Purchase feed and fertilizer for the spring. Remember that there must be a "business benefit" from this, so be sure to get a discount from your dealer for paying ahead.
4. Pay your rent ahead. If landlord does not want the extra income for 2007, mail him a check on the last day of the year (even if he lives in the other end). You paid in 2007; he doesn't count it as income until he receives it in 2008.
5. Pay your children who are under the age of 18 up to \$3,400. They may be paid a reasonable amount for work actually done. Records of work and payments should be kept. The amount that is federally tax free (state and local may be due, usually at same rate as parent) may be deducted from income and must actually be paid (open a savings account and deposit it there or right an interest bearing note for the child, payable when they come of age. Some give the children the calf checks or part of the tobacco checks.



- Buy the farm. I am listing this last, as this can have little effect if done at end of year. The major deductions in owning a farm are: interest, taxes, and depreciation. These are all calculated on a yearly basis, so a December purchase will only give 1/12 of a normal year’s benefit (or less if first payment isn’t until next year). **BUT: some items on the farm may be taken entirely in the year of purchase.** This would include equipment, silos, manure pits, and other storage and greenhouses. Be sure to get a list (equipment bought along with farm should not be included in Real Estate Purchase Price, but subtracted out and bought as “Personal Items,” – this could save 2% transfer tax). This does not include the house, never a farm expense, not the land, which doesn’t depreciate, and not the buildings which depreciate over 20 to 30 years.

Items 2, 3, and 4 could result in larger problems next year, as you may find yourself in the same position next year and need to pay ahead just to get even for last year’s pay-ahead. If you feel this was an exceptional year, or if twins are expected in 2008, go ahead, otherwise move cautiously.

The table below is a rough estimate. For your specific case, consult your tax professional.

Married Couple + Children	Greatest Amount for \$0 Federal Tax	PA Tax on that amount + local	MD Tax on that amount, local incl.	Greatest Amount for \$0 PA Tax	Local PA 1 to 1.65%
0	17,000	525	675	13,000	
1	37,000	1,150	1,500	22,500	Depends
2	42,500	1,300	2,100	32,000	on
3	53,500	1,675	2,800	41,500	where
4	62,500	1,950	3,300	51,000	you
5	73,500	2,300	4,000	60,500	live
6	82,500	2,575	4,400	70,000	

**Notes:** a family of Mom and Dad and four children in Pennsylvania with total profits of \$50000 could have no Pennsylvania tax and no Federal tax, only local (inescapable with more than \$100 profit).

Maryland is a stepped tax, the more you earn, the higher the percentage due (like Federal). Pennsylvania and Pennsylvania local are flat taxes, percent due stays the same no matter how much earned.

Remember, these are general ideas and for specific answers you should consult your tax professionals. He or she might have other ideas that would help in your particular case.

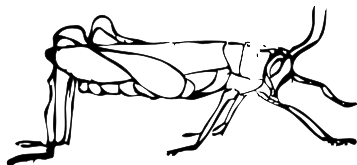
### The Ants and the Grasshopper

The ants were spending a fine winter’s day drying grain collected in the summertime. A grasshopper, perishing with famine, passed by and earnestly begged for a little food. The ants inquired of him,



“Why did you not treasure up food during the summer?” He replied, “I had not leisure enough. I passed the days in singing.” They then said in derision: “If you were foolish enough to sing all the summer, you must dance supper-less to bed in the winter.”

Author & Source: unknown



### Quotations to Ponder

Hard work spotlights the character of people: some turn up their sleeves, some turn up their noses, and some don’t turn up at all.

*Sam Ewing*

Success is one percent inspiration and ninety-nine percent perspiration.

*Thomas A. Edison*

# Rental/Investment Property or Owner Occupied?

By Dale Peifer

Most of you know that we can finance non-farm properties. One of the questions we're often asked is if we can finance a rental, or an investment property. If it's four units or less, and is residential, the answer is "yes." However, there are some stipulations that make this type of lending a little more restrictive than if you purchasing a house to live in. The best mortgage rates available are for single-family, owner-occupied homes. In a future newsletter I'll go into more detail on some of the lending restrictions for investment properties. In the meantime, if you're looking to finance a house, whether it's a rental or you're planning to live there, give us a call.

The following chart are the current rates for qualifying residential mortgages – owner occupied, single family dwellings. There are a number of factors that need to be considered when determining the final rate such as; the loan-to-value ratio, whether it is a purchase or refinance, etc. We are always happy to answer questions – so don't hesitate to contact us with any you might have.

## Residential Mortgage Rates Effective September 14

Term	Rate	APR
15-year fixed	5.875%	5.906%
20-year fixed	6.125%	6.150%
30-year fixed	6.250%	6.269%

*What is the APR? The APR (Annual Percentage Rate) is designed to measure the true cost of a loan, and is required by The Federal Truth in Lending law to be published, enabling borrowers to compare offers.*

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## Perfect Peace

There once was a King who offered a prize to the artist who would paint the best picture of peach. Many artists tried. The King looked at all the pictures, but there we only two he really liked and he had to choose between them.

One picture was of a calm lake. The lake was a perfect mirror for the peaceful towering mountains all around it. Overhead was a blue sky with fluffy white clouds. All who saw this picture thought that it was a perfect picture of peace.

The other picture had mountains too. But these were rugged and bare. Above was an angry sky from which rain fell, in which lightning played. Down the side of the mountain tumbled a foaming waterfall. This did not look peaceful at all.

But when the King looked, he saw behind the waterfall a tiny bush growing in a crack in the rock. In the bush, a mother bird had built her nest. There, in the midst of the rush of angry water, sat the mother bird on her nest...perfect peace.

Which picture do you think won the prize?

The King chose the second picture. Do you know why? "Because," explained the King, "peace does not mean to be in a place where there is no noise, trouble, or hard work. Peace means to be in the midst of all those things and still be calm in your heart. That is the real meaning of peace."



Author: unknown

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*The following article was written by Devan Drabik, a senior at Shippensburg University. Devan spent several weeks this summer as an intern for MidAtlantic Farm Credit. MidAtlantic is pleased to offer internship positions to college students as it affords them the opportunity to gain experience in a business environment and in their field of study. During this time Devan had the opportunity to become acquainted with our Amish friends and neighbors. We hope you enjoy her observations.*

*~Jerry Phillips*

## **A Look from the Outside**

*By Devan Drabik*

Do you close your eyes at night lulled by the chirp of crickets or the gentle sound of wind rustling through the grass? I never have. In my experience, nighttime noises involved the not so soothing sounds of screaming sirens and deafening traffic congestion. The chirping of a cricket or the noise of the wind as it rustles tall grass, are as foreign to me as the word "farm." Welcome to Washington, DC, a world in which the sounds of nature are replaced with the blaring of car horns. A world where eggs, milk, and cheese come to the supermarket from some far away land; through some magical process. I never once wondered where the milk in my cereal came from.

My world was one of busy streets and busy lives. Parents worked nine-to-five jobs and children learned to plop down on the couch in front of their favorite cartoon after school, until mom got home from work, with McDonalds.

Growing up in the city I had eight good friends who I spent my free time with. Since five of them came from single-parent families, there was always at least one friend who had to go to their other parent's home for the day, so we were rarely all together. Single-parent families seemed more common than "traditional" families. In my experience, growing up in the city, a family was no longer defined as a close community in which fathers trained their sons to take over the family business, and mothers taught their daughters how to be good homemakers.

During my internship with MidAtlantic Farm Credit – sometime between the financial teachings and the client visits, I stumbled upon a world that I had previously believed to be extinct.

The Amish community is nothing like I expected. Although I had heard of a group called the Amish, the true Amish are nothing like what had been described to me. The Amish that I met have preserved a safe, innocent, family-oriented way of life that strives to follow and please the Lord. While my city friends work towards the dream of purchasing \$1,500 purses, the Amish grow crops and are rich in the things that truly matter – family and friends. And in truth, the Lord has looked after them and they prosper.

The Amish community's school system is an interesting one and their teacher to student ratio is wonderful. After interviewing an Amish school teacher, I learned that one school averages about 30 scholars. My high school averaged 45 students to a class room and had 4,000 students in the school. The Amish schools teach not only reading, writing, arithmetic, and history, but they also teach patience, honesty, and kindness. If a child misbehaves, his or her parents will deal with their child and "train him in the way he should go." (*Proverbs 22:6*) At my high school, we didn't learn about character virtues or God, in fact we were not allowed to pray out loud. And when a child misbehaved in my school, they typically just got away with it.

In the Amish school system, women of good character are sought after and chosen to teach the next generation. In my school, anyone who could pop a movie into the VCR could be a substitute teacher, and anyone with a college degree could be a full-time teacher. Teachers were not hired based on character, but rather solely on credentials.

Perhaps the most fascinating and inspiring thing I witnessed in the Amish community is the family-focused atmosphere felt on every farm I visited.

Everywhere one looks in the Amish community, one can see examples of selfless acts of kindness. Families support one another and couples stay true to their vows of marriage all their lives. Children mix working on the farm with playing with their siblings. Amish children enjoy the feel of the sun on their faces and of the earth beneath their toes. They don't need to worry which parent will get custody of them if separation comes. They spend their Sunday morning worshipping a loving God, who they are taught to recognize in the nature that surrounds them.

This internship was an amazing experience, not only because of the financial information I have learned through MidAtlantic, but also because I was allowed to witness the peace and harmony of a small Amish community in Pennsylvania.

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**MidAtlantic**

*Farm Credit*

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## **Pennsylvania Dairy Profitability Forum**

*Hosted by the Center for Dairy Excellence*

*November 1, 2007 ~ 8:30 a.m.—3:30 p.m.*

Registration due by 10/22/07—seating is limited at each location

Register early by calling 717.346.0849

### Topics:

- Growing PA Dairy
- Managing Liquidity & Protecting Cash Flow
- Understanding & Using numbers that matter
  
- Building your herd & heifer management
- Using PA Dairy Tool
- Adding Perspective

### Locations:

**Lancaster County Extension Office** (Multi-Purpose Room)

1383 Arcadia Rd, Lancaster PA

For directions call: 717.392.4922

**Lebanon County Extension Office** (Rooms 2 and 3)

2120 Cornwall Rd, Lebanon PA

For directions call: 717.270.4391

**Penn State Harrisburg** (Olmstead Room E308)

777 Harrisburg Pike, Middletown PA

For directions call: 717.948.6377