

# Plain Dirt Financing

Financial Information for Amish Farmers  
December 2008

## Does it pay to add that extra cow?

By Dave Stutzman

Operating a profitable dairy farm involves making operational decisions that make good financial sense. For example, if you decide to add 10 cows to your 40 cow herd, what financial questions have to be answered to determine if the operational decision is also a sound financial decision?

Due to the last run of very profitable milk prices, we as Ag lenders had that question posed to us many times throughout the past 18 months. These are some questions you may want to consider and can be used for any decision to make a capital investment on the farm:

- If I spend the money what is the profit - “*Return on that Investment*” to capital (the money spent).
- What “*Labor Resources*” will be needed to support the investment and what “*Return to Labor*” will be realized.
- Does the investment “*Complement (agree with) the Goals*” for my farm/business.

### Return on Investment

The rate of return on the investment (cost to purchase the asset) measures the net income generated as a percentage of the dollars invested. For example consider the following assumptions:

Operational decision: Add 10 cows to herd to increase the herd from 40 to 50 cows

Investment required: Purchase 10 cows @ \$2,000 ea; add 10 stalls at \$1,500 ea

(Cow investment: 5 year depreciable life; Stall investment: 15 year depreciable life)

Gross income per cow (average for herd): 65 lb per day x \$15 per cwt milk x 305 day = \$2,974 income per cow per year (1)

Variable expense per cow per year (does not include fixed costs) = \$1,550 variable expense per cow per year (2)

- (1) Based on average of 65 lb per cow per day. This is the average for PA herds and many Amish herds
- (2) \$1,550 per cow per year – This number is the average variable cost to keep one cow in the herd (includes feed expense, crop expense to produce feed, 50% of fuel costs, vet/breeding and supplies expenses). Based on average costs incurred over last three years on five SE PA Amish herds

Return on Investment calculation:

- Income per added cow (1). . . . . \$2, 974
- Less, variable annual operating expense for one added cow (2). . . . . \$1,550
- Less, annual depreciation on stall cost investment (\$1,500/15 yrs). . . . . \$ 100
- Less, annual depreciation on cost of cow purchase (\$2,000/5 yrs). . . . . \$ 400

Net farm income (not including interest, labor, and fixed costs). . . . . \$ 924

Rate of Return to assets investment:  $\frac{\$924/\text{cow} - \text{net income}}{\$3,500/\text{cow} - \text{total investment}} = 26.4\%$

Each farm will have different numbers based on management, capital resources available (is the investment made with borrowed funds or from cash on hand?) and the current economic situation. Milk prices and feed costs are currently declining, as well as cow prices and construction costs, therefore the numbers used in the above example will change, but the formula to calculate “Return on Investment” will remain the same.

A 26% return on capital is better than what any savings account will earn for you so it would appear to be a sound financial decision to add the 10 cows, if labor resources are available and the operational decision complements the goals of farm and family

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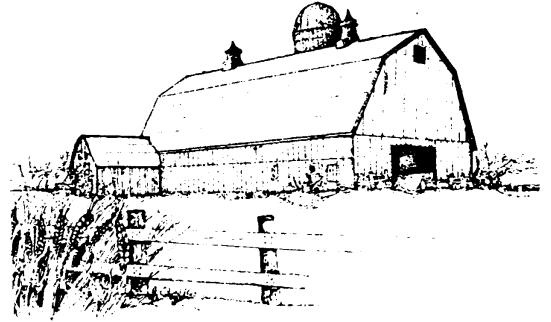
## What's up (and down) with real estate values?

By Jerry Phillips

A recent article in the *Lancaster Intelligencer Journal* highlights what is happening locally with home sales and home values. According to the most recent data provided by the Lancaster County Association of Realtors, home sales were down 13.7 percent in October compared to the same month a year ago. In addition, the average home sale price fell 3-5 percent in October compared to the same period in 2007. The average price of homes sold in Lancaster County in October was \$188,464, down from the average price a year ago of \$195,267. However, comparing 2008 home prices to what they were 10 years ago, prices are up almost 60% from the 1998 average of \$118,146.

In looking at new construction contracts for single and two-family houses and apartments, according to McGraw- Hill Construction, new projects have dropped right around 84 percent from a year ago.

Several factors are contributing to these statistics. Concern about the US economy and how quickly it can recover is probably the leading factor. A lot of mortgage lenders made bad lending decisions over the past several years, in extending too much credit to too many folks who simply could not afford the payments. Some of those borrowers may have been counting on second or part-time income to make the payments. With the downsizing that some businesses made to remain competitive and profitable, some of those jobs and income were lost. Lenders were forced to foreclose on a lot of homes, resulting in more homes for sale than there were qualified buyers to finance. Credit standards and requirements have also tightened and interest rates – while still attractive – may not be as affordable as they were a year ago, reducing the number of potential new buyers.



However, when we shift our focus to farm values, we have not seen a similar type of drop in value or demand. Farm sales this fall in Lancaster County have continued to bring average or above average prices, and there continues to be strong interest in buying farms. One of the reasons may be that there are only so many farms available. Another reason may be that for the most part farmers are very conscientious in making their debt payments and are a lower risk for lenders.

Compared to some lenders that jump in and out of agricultural lending, due to the economy or change in lending philosophy, MidAtlantic Farm Credit has made a practice of lending the right amount, for the right purpose, to the right people. We continue to live up to our commitment to serve agricultural and the rural communities. We continue to have a reliable source of funds to lend for farming operations and farm purchases, and we continue to offer competitive rates and terms to qualified borrowers.

If you're in the market for a farm, part-time farm or rural home, give us a call; we'll find a convenient time to sit down at the kitchen table to discuss your ideas.

Markets at a Glance		
	As of 12/1/2008	2007
Corn	\$3.83/bu	\$4.06/bu
Soybeans	\$7.78/bu	\$9.80/bu
Alfalfa Hay	\$175.00/ton	\$160.00/ton
Milk Futures	\$15.38/cwt	\$16.25/cwt
Interest Rates*	5.375%	6.00%

\* 30-year fixed rate/residential

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# Colorado... “It’s beautiful out here”

By Dale Peifer

Recently, I made a trip to Westcliffe, Colorado to visit a former school mate and long-time friend. Westcliffe is in the Wet Mountain Valley at the base of the Rocky Mountains. The Valley has been called the Crown Jewel of the Rocky Mountain Empire. It sits at an elevation of around 8,000 feet; and is flanked by the Wet Mountains and the Greenhorn Mountain wilderness area to the east, and the magnificent Sangre de Cristo Mountain Range to the west. The Sangres hold claim to being the longest, straightest, and highest mountain range in the world – home to ten peaks towering 14,000 feet or more.

Westcliffe and the Wet Valley are known for its hay, cattle ranching, and tourism. It has a history of gold and silver mining. The valley is about 12 miles wide, 25 miles long, and home to around 1,500 head of cattle, depending on the time of year. The primary crop is timothy/alfalfa hay, with average production at about two tons per acre. The average annual rainfall is about 15 inches. Many, many years ago the Valley was also known for potatoes and cold weather produce, which were shipped north by rail to Colorado Springs and Denver. The area is serviced by Farm Credit of Southern Colorado.

A number of Amish from Indiana and Iowa have moved into the valley in the past few years, and I decided to drop in on one of the families for a visit. I had never met Mr. and Mrs. Yoder, but it was a very nice visit, and I appreciated their hospitality. They were middle-aged grandparents, with an empty nest, like us. Having made a trip to visit some friends here in the New Holland area a number of years ago, they were somewhat familiar with Lancaster and Chester Counties. Currently there are seven Amish families in the valley. They are involved with hay production, horse breeding and training, some farrier work, construction, and a furniture/craft store in town.

In addition to having their own church services, they occasionally have a joint service with some Amish families from the Monte Vista area (Farm Credit has an office there), about 50 miles to the southwest. That Amish settlement consists of about 30 families, and the area is known for its produce and good quality, irrigated alfalfa. Some of that hay has been shipped here to our area in Pennsylvania.

Within 200 feet of the guest house where I was staying, I saw a bull elk and a mule deer buck, both of which would look good on any of our walls, trust me. My friend’s collection of mounts, hides, skulls, feathers, and sightings that were taken or found on his 81-acre property include elk, mule deer, bear, antelope, cougar, coyote, bobcat, turkey, golden eagle, bald eagle, ring-tail, porcupine, and jack rabbit.

When I was driving out to leave for my trip back home, I met my new Amish friend on his Sunday afternoon walk with three other men. I said, “Is there anything you want me to tell the folks back in Pennsylvania?” He said, “Tell them it’s beautiful out here.”

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## Forming a winning Partnership

By John Mylin

If you are a Farm Credit customer you received a letter several months ago from MidAtlantic’s chairman of the board, Fred Moore, Jr. Mr. Moore informed our customers that one of our neighboring Farm Credit associations – Valley Farm Credit approached MidAtlantic about merging operations.

The president of Valley Farm Credit recently retired and they were interested in partnering with a strong Farm Credit Association that would result in mutual benefits. Valley Farm Credit services five Virginia counties and three West Virginia counties that border MidAtlantic’s territory to the west.

Agriculture in the Valley territory consists of crops, beef cattle, and orchards. Partnering with Valley Farm Credit results in a larger territory and an increased variety of agriculture in our loan portfolio. Larger territory and increased variety of agriculture reduces risk in the loan portfolio – in other words we are keeping our eggs in more baskets.

In mid November all customers received information in the mail and an opportunity to agree or disagree on merging operations with Valley Farm Credit. We are happy to report that customers from both MidAtlantic and Valley agreed to merge our operations. Partnering with Valley will benefit both MidAtlantic Farm Credit and Valley Farm Credit and we look forward to continued service for all customers in this expanded territory.

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## Farm Credit still rock solid

By John Vogel, *American Agriculturalist*

Despite financial sector turmoil, Farm Credit System institutions remain solid. That's the word from a former Farm Credit Council farmer-leader and from Ken Auer, CEO of the council.

One reason, suggests the farmer, is that farmland is the core asset. And agriculture's booming economy still inspires confidence when Farm Credit goes to Wall Street for bonds.

"Farm Credit continues to tap national debt markets to bring capital to agriculture, and it remains financially strong," affirms Auer. "A key strength of Farm Credit's cooperative structure is that customer-elected directors keep these institutions focused on serving their mission and maintaining the financial strength necessary during difficult times." In other words, its directors are fiscal conservatives.

### No link to Farmer Mac

While the Farm Credit System and the Federal Agricultural Mortgage Corporation, known as Farmer Mac, share authorizing legislation, "they're separate entities with very different operating structures," clarifies Auer.

"Farmer Mac is a secondary market credit provider and isn't integral to the operation or business profile of any Farm Credit institution. If something happens to Farmer Mac, it won't impact the system," he adds.

Early this year, Farm Credit banks increased their own credit lines to accommodate higher credit needs of farmers, cooperatives and agribusinesses. Those credit needs were handled outside of Farmer Mac, notes Auer.

Unlike Freddie Mac and Fannie Mae, Farmer Mac's troubles aren't credit-driven, points out the Farm Credit Council president. "The problems, brought on by the Lehman Brother's failure, are capital-driven."

### Midyear Review

Here's a glimpse of midyear numbers posted by the Farm Credit System:

- 2007 net income surpassed a record \$2.7 billion
- Net income through June 30, 2008, increased to \$1.55 billion, up from \$1.29 billion for the year-earlier period
- Credit quality, as of June 30, remained favorable with 98.4% of all loans ranked in the highest loan quality classification
- Capital reached \$27 billion-plus by June 30, up from \$21.5 billion on December 31, 2007
- Capital as a percentage of assets was 13.1% on June 30
- Farm Credit's self-funded insurance fund protects its institutions and is controlled by the Farm Credit System Insurance Corporation, an independent U.S. government controlled entity. On June 30, the fund held \$2.7 billion

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### *Does it Pay to add that extra cow?*

*Continued from Page 1*

### Labor Resources/Return to labor

Questions to ask in regard to labor include:

- Can the cows be added with no additional labor added, if so, no allowance for labor costs need to be made and the full "Return on Investment" can be retained by the operator
- Is the labor family or hired labor? If hired, the cost of the labor needs to be deducted as an additional expense
- What other opportunities are available to engage your time or the time of your family and/or hired labor? Would other operational changes/investments/ventures be more profitable to utilize labor resources?

### Complementing Farm and Family Goals

Questions to ask in regard to farm business and family (personal) goals include:

- Will the time to manage 10 extra cows take away from the personal time needed for family and community/church activities
- Are you positioning the operation to add younger family labor or to transition the farm operation to the next generation
- How will the operational decision affect quality of life for you and your family

## Credit at the Crossroads

### What's next for farm loans after Wall Street's panic attack?

By Marcia Zarley Taylor

Monumental losses on mortgage debt and fearful financial markets mean all borrowers – including farmers, medium grain elevators and even giant agribusinesses – will be paying premiums on their loans for the foreseeable future.

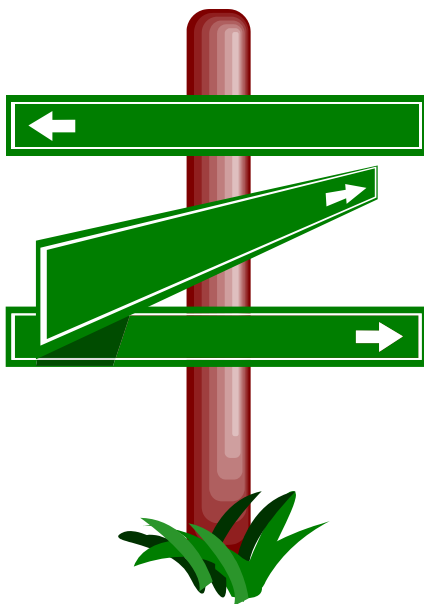
Jamie Stewart, president of the \$170 billion Farm Credit System's Funding Corporation, believes history will ultimately compare the 2008 panic on Wall Street to that of 1907, not 1929 or the Great Depression. That was a year when stocks plunged more than 50 percent, banks failed and there was no Federal Reserve to restore calm to the markets.

When trust crumbles, no one has the confidence to bet long term. Some days in September, buyers for 20-year debt vanished, Stewart says. To access capital, all lenders had to adjust their Wall Street offerings to shorter terms, making fixed-rate mortgages harder to get.

A representative with the American Bankers Association, puts it this way: In a best case scenario, regulators will be taking a much closer look at all loans, rates will be rising as lenders rebuild their capital and you'll need to be a top-notch borrower to qualify for credit. "Any producer who can't show an ability to manage price risk, input risk, technology risk – and be able to present sound financial statements – could have difficulty finding credit, he states.

Farm loans were not the cause of the lending community's current woes. "But when a hand grenade lands, it throws debris on everybody, he says.

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## Events and Meetings

### January 19

New Holland Vegetable Day  
9:00 a.m.-3:30 p.m.  
Yoder's Restaurant

### January 22 & January 23

Soil Seminar presented by Oregon Ag  
D&J Farm Store  
8:30 a.m.-Noon

Pesticide Meeting  
D&J Farm Store  
12:30 p.m.-2:30 p.m.  
2 core and 2 category points

### January 23

Study session for the 1/30/09 test.  
9:30 a.m.-noon  
Gideon King Hardware  
**Note:** If you have a blue study book, bring it with you.

### January 28 and January 30

Gideon King Hardware  
12:30 p.m.-2:30 p.m.  
2 core and 2 category points  
**Note:** On January 30, a representative from the state will give the test from 12:30 p.m.-3:00 pm. Location will be the basement of the hardware store.

### January 29

Lancaster Crop Day  
Farm and Home Center, Lancaster  
9:00 a.m.-3:00 p.m.  
Soil fertility & crop production topics to benefit producers  
1:00 p.m.-3:30 p.m.—2 core and 2 category points  
Cost for lunch - \$5.00

### February 5

Pequea Planter  
Corn Planter Clinic/No Till Session  
9:00 a.m.-2:30 p.m.  
Lunch provided

### February 12

Penn State Lancaster Pesticide Points Meeting  
Hoffman Building, Quarryville  
9:30 a.m. – 12:00 noon and 7:00 p.m.-9:00 p.m.  
Timely crop production and pesticide safety topics  
2 core and 2 category points  
Contact Axel Linde (529.6963) or Jeff Graybill (394.6851)  
\$3.00 to cover cost of facilities, handouts and refreshments

### February 12

Workshop: Making no-till work on your farm"  
Hoffman Building, Quarryville  
1:00 p.m.-3:00 p.m.  
Presented by Jeff Graybill, Lancaster County Cooperative Extension  
**Note:** if you attend the pesticide meeting in the morning and stay for the workshop—free pizza will be offered to all attendees!



**MidAtlantic**

*Farm Credit*

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We take time to  
wish you and your  
family a blessed  
holiday season  
and a bountiful  
New Year

