Virginia Cooperative Extension

Farm Business Management Update
February 2005 – March 2005

To: Extension Unit Directors, Extension District Directors, Extension Program Directors, and Farm Management Agents, and ANR Specialists

Dear Co-Workers:

Farm Business Management Update is a joint effort of the Agricultural and Applied Economics faculty and the area farm management agents. Subject matter areas include timely information on farm management, marketing, tax management, finance, credit, labor, agricultural law, agri-business, estate planning, 4-H and economic education, natural resources, and CRD. Please use this information in your on-going Extension programs and circulate to all Extension staff. **Farm Business Management Update** is electronically accessible via the Virginia Cooperative Extension World Wide Web site (at http://www.ext.vt.edu/). To see the articles listed in the reverse chronological order, select "News," then select "Farm Business Management Update" listed under the heading "Periodicals."

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Virginia Tech
VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY

Issued in furtherance of Cooperative Extension work, Virginia Polytechnic Institute and State University, Virginia State University, and the U.S. Department of Agriculture cooperating. Patricia Sobrero, Director, Virginia Cooperative Extension, Virginia Tech, Blacksburg; Lorenza W. Lyons, Administrator, 1890 Extension Program, Virginia State, Petersburg.

VIRGINIA STATE UNIVERSITY

Some Implications of the Tobacco Buyout

By Dixie Watts Reaves (dixie@vt.edu), Associate Professor, Agribusiness Management and Marketing, Agricultural and Applied Economics, Virginia Tech

With the passage of the Fair and Equitable Tobacco Reform Act of 2004, the federal tobacco program ended. After years of considering numerous different proposals with many different payment amounts, funding sources, and degrees of regulation, Congress passed the tobacco buyout as a part of the American Jobs Creation Act, which President Bush signed into law on October 22, 2004. Despite widespread news coverage of the buyout, some individuals are still not aware of the details and implications of the buyout.

What exactly does the buyout do?

As of the 2005 production season, there is no longer a quota system. No restrictions are on who can grow tobacco, and no limits are on how much can be produced. No geographic limitations are placed on production, no price support levels, and no "no-net-cost assessment." Basically, the tobacco program as it has been known since the 1930's no longer exists.

The Farm Service Agency (FSA) of the United States Department of Agriculture (USDA) is responsible for drafting the regulations to implement the buyout. FSA will determine the application procedure and guidelines for the disbursement of the funds.

What is not included in the buyout and what is lost?

Although earlier buyout proposals included oversight of manufactured tobacco products by the Food and Drug Administration (FDA), FDA is not a part of the tobacco buyout. Earlier proposals also included dollars for community development in selected tobacco-dependent regions, but this proposal too was eliminated from the final language. Because the buyout is funded by a quarterly assessment on manufacturers of tobacco products, Phase II payments end. This wording is not due to the buyout legislation, but rather to wording in the initial Phase II agreement where it was stated that if and when a manufacturer-funded buyout occurred, obligations to Phase II payments would end. As of the enactment date of the tobacco buyout, manufacturers had already made payments into a trust fund for the first three quarters of 2004. With the passage of the buyout, the companies sued to get those payments refunded, arguing that they were not required to make payments in 2004 once the buyout passed. Grower representatives argued that 2004 payments should be made, since no buyout payments would be forthcoming until 2005, or that at least the first three quarters of payments should be made since the buyout legislation was not signed by the President until October. The courts sided with the manufacturers, and the case has been appealed to the North Carolina Supreme Court.

How much will growers and quota owners receive?

The $10.14 billion buyout includes $500 million for disposition of stocks, with the remaining amount going to growers and quota holders. Quota owners as of the date of enactment (October 22, 2004) are eligible to receive $7 per pound based on basic quota levels in 2002. Equal installments will be offered over a ten-year period, resulting in payments of 70 cents per pound, starting in Fiscal Year 2005 which ends September 30. Thus, initial payments can be expected some time before the end of September. An estimated 416,000 people own quota, including about 57,000 active producers and 359,000 landlords. Total expected payout to quota owners is

$6.7 billion. Producers will receive $3 per pound if they produced in 2002, 2003, and 2004. Payments are tied to 2002 effective quota levels. Any year during 2002-2004 a producer did not produce, payments are reduced by one-third. Thus, producers will receive 30 cents per pound over a ten-year period if they produced in all three years. Approximately 57,000 producers are in the United States, and the total expected payout to producers is $2.9 billion.

An option available to buyout payment recipients is to assign their ten years of payments to a financial institution in return for a lump sum payment from that institution. The amount of the lump sum payment will depend on the discount rate offered by the financial institution. Discount rates are chosen based on the level of certainty associated with the ten-year stream of payments, the institution's cost of doing business and desired profit margin, among other factors. If the discount rate were 4%, a producer/quota owner who would have received $10,000 for ten years (for a total of $100,000 at the end of ten years) could instead elect to take approximately $81,000 as a lump sum. At a higher discount rate, for example 7.5%, the recipient would only receive approximately $68,000. It is anticipated that a number of financial institutions will be offering the lump sum payment option. Producers and quota owners are encouraged to shop for the best discount rate if considering the lump sum payment option.

The tobacco buyout is different from the Phase II payments. Some producers and quota owners are expressing concern that the ten years of payments might not last, similarly to the current situation with Phase II payments. However, producers knew that Phase II payments would end in the event a manufacturer-funded buyout occurred. The buyout, on the other hand, is the result of legislation that indicates payments of $7 per pound to owners and $3 per pound to producers. All reasonable expectations are that the payments will continue for the full ten years. Therefore, an individual should NOT make a decision to take the lump sum JUST BECAUSE of a fear that the payments will not last. Depending on financial situation, tax bracket, and offered discount rate, a producer or quota owner may decide that the lump sum is in his/her best interest.

It is anticipated that quota payments will be taxed as capital gains, the difference between the current value of quota ($7 per pound as of the date of enactment of the buyout) and its basis (in essence, its original value). Thus, one of the challenges for owners will be to determine their basis in quota. Depending on how the quota was obtained, determination of basis will vary. If quota was purchased, the basis is the purchase price for the entire "lot" of quota. For example, if a farmer purchased 50,000 pounds of quota in 1997 for $2 per pound, the basis for that lot of quota is $100,000. As of the date of enactment of the tobacco buyout, due to quota cuts, the producer now owns only 25,000 pounds. The value of that 25,000 pounds is the $7 per pound offered through the buyout for a total value of $175,000. Since the basis was $100,000, the capital gains on the quota is the $7,500 ($175,000 minus $100,000), and the farmer will pay capital gains tax on that $7,500.

If quota is inherited, basis is the fair market value at the time of death. If the farmer inherited a farm that had quota on it, the fair market value must be divided between value of quota and value of land. For example, suppose a farm was appraised at a value of $150,000 at the time of death. The farm included 25,000 pounds of quota, which, at the time, was valued at $2 per pound. Basis would be $50,000, and the remaining $100,000 would be designated as the value of the farmland.

Finally, if quota is gifted, the basis of the previous owner is passed along to the new owner.

If a farmer acquired quota over a period of time, basis will need to be determined for each "lot" of quota obtained. If personal farm records do not include values of quota at the time of acquisition, other sources of information could be used to document basis: county appraisers office, real estate agents, or the USDA publication on farm real estate values in the U.S. by county.

Producer payments are expected to be treated as ordinary income. Thus, producers will pay federal, state, and self-employment tax.

Accepting payments over the ten year period versus one lump sum could have a substantial impact on the amount of taxes paid. Guido van der Hoeven, North Carolina State University, has developed an Excel spreadsheet that allows a person to compare the lump sum payment (at a chosen discount rate) to the ten-year payment stream in terms of total taxes paid and total dollars delivered to the producer or quota owner. The spreadsheet can be accessed at *http://www.ag-econ.ncsu.edu/faculty/vanderhoeven/Tobacco_NPV_calc.xls*. Individuals will enter the number of pounds of quota owned, basis in that quota, the number of pounds rented, the discount rate, and marginal tax rates.

The tobacco buyout legislation is the biggest change in farm policy in decades. The tobacco industry has been shrouded in uncertainty in recent years and has faced unprecedented challenges. Even though a number of unanswered questions and a period of adjustment to production and prices in a post-buyout world exist, producers and quota owners no longer have to wonder if and when a buyout will occur. The time has come to make decisions about wise investments to put the buyout dollars to good use.

Tax Considerations for the Tobacco Buyout

By Daniel Osborne (daosbor3@vt.edu), Extension Agent, Farm Business Management, Smyth County

With the passage of "The Fair and Equitable Tobacco Reform Act of 2004," also known as the "Tobacco Buyout," comes the payment to quota holders of $7 per pound and the payment to producers of quota tobacco of up to $3 per pound. Almost inevitably when farmers receive a payment, tax consequences follow. For Tobacco Buyout payments, the tax treatment and considerations vary depending on whether the payments are received as a quota holder or as a producer. Below is a brief overview of the tax considerations that must be made. If you find these considerations difficult to decipher, you may prefer to share and discuss them with your tax preparer. Keep in mind, the IRS may issue rulings after the writing of this article that may alter the considerations listed herein.

Tax Considerations for Quota Holders

- Payments will be taxed as long term capital gains (5% or 15% for years 2005-2008 and 10% or 20% after 2008) if held more than 1 year.
- Payments will be taxed as short term capital gains (ordinary tax rate) if held 1 year or less.
- The taxable gain, whether long term or short term, equals the total payments less the cost basis. (Determining the cost basis of tobacco quota is beyond the scope of this article; however, questions on the subject may be directed to the author.)
- Payments will not be subject to self-employment taxes unless the quota holder is a dealer of tobacco quota.
- The transaction must be reported as an installment sale on Form 6252 unless a lump sum is received or an election is made to recognize the income in the year of sale.
- For installment sales with the total of all payments over $3,000, part of each payment must be allocated to interest based on the federal applicable rate. The interest portion will be taxed as ordinary income.
- Taxes may be reduced or eliminated by using a section 1031 like-kind exchange. Tobacco quota could qualify for a like-kind exchange for real property, improved or unimproved, that is used for business or investment purposes. A qualified intermediary or qualified escrow account should be used to conduct a like-kind exchange transaction. (Some banks, lawyers, or real estate companies will serve as qualified intermediaries.)

Tax Considerations for Producers of Quota Tobacco

- Payments will be taxed as ordinary income (10% - 35% for the years 2005-2010 and 15% - 39.6% for years 2011 and later).
- Payments will be subject to self-employment taxes unless the share of risk as a "producer of quota tobacco" was for rental income without material participation.
- The maximum earnings subject to the social security part (12.4%) of self-employment taxes are $90,000 for 2005.
- Tax liability resulting from tobacco buyout payments for producers of quota tobacco may be reduced or deferred by using tax strategies applicable to ordinary farm income. Examples of such strategies include income averaging, the section 179 deduction, contributions to traditional IRAs or retirement plans, and others. See Publication 225 for more information on these tax strategies.

Not only will these consideration help with tax compliance, but hopefully they will also help address the questions of whether to take a lump sum or installments and how to minimize the tax liability resulting from buyout payments. Feel free to direct questions regarding this article to the author at daosbor3@vt.edu or (276) 783-5175.

Farm Credit Gives to Establish David M. Kohl Chair

By Lori Greiner (lgreiner@vt.edu), Communications Manager, College of Agriculture and Life Sciences, Virginia Tech

(left to right) Charles W. Kackley - Board chairman for Valley Farm Credit, J. N. Mills, Jr. - Board chairman for Colonial Farm Credit, W. W. Sanford, III - Board chairman for Farm Credit of the Virginias, Stanley O. Forbes, Sr. - Board member for Colonial Farm Credit and Chairman of the fundraising committee for the Center for Farm and Agribusiness Management, Dr. Sharron Quisenberry - Dean of College of Agriculture and Life Sciences, and Dr. Herbert Stoevener – Department Head of Agricultural and Applied Economics.

Blacksburg, Va., January 27, 2005 -- Virginia Tech's College of Agriculture and Life Sciences received a $60,000 contribution from Farm Credit of the Virginias, Colonial Farm Credit, and Valley Farm Credit to assist in establishing the David M. Kohl Chair in Agribusiness Management and Finance. Holder of the David M. Kohl Chair will direct the Center for Farm and Agribusiness Management that seeks to address the needs of farmers, agribusiness, and rural entrepreneurs in the areas of management, marketing, taxation, and legal issues.

"It is critical that we are able to provide individuals in our rural and agricultural communities the management and entrepreneurial skills necessary to survive and succeed in today's business climate," said Sharron Quisenberry, Dean of the College of Agriculture and Life Sciences. "Farm Credit's gift is the first step in helping us provide this assistance. This center will provide the foundation to expand and strengthen our responsiveness to the educational and research needs of rural communities in the areas of management and marketing."

"As the financial partner with rural America, the Virginia Farm Credit Associations are pleased to be involved in this at the ground level," said Stanley O. Forbes Sr., member of the Board of Directors, Colonial Farm Credit. "We have the highest respect for Dr. Kohl and his work and see this as an opportunity to recognize him as well as help establish a foundation for education, research, and extension in the area of agribusiness and management."

The endowed chair within the center is being named after David M. Kohl, professor emeritus of agricultural and applied economics. Kohl taught more than 10,000 students agri-finance and agri-business entrepreneurship during his 25-year tenure at Virginia Tech. He is a two-time recipient of the prestigious American Agricultural Economics Association Outstanding Teacher Award. He has also received 14 public service awards and has published more than 400 articles on financial and business-related topics in journals, extension, and popular publications.

"I'm really excited and humbled about the development of the chair and the farm and agribusiness management center," Kohl said. "Hopefully, the center can carry on some of the good work that we, that being the industry and my colleagues, have done in the past and carry it on in the future. As Peter Drucker, the famous management guru of Claremont University, says, 'We are knowledge workers,' and this center is designed to help and assist knowledge people in the agricultural industry."

The center will financially and intellectually support the land-grant mission of teaching, research, and extension in farm and agribusiness management within the Department of Agricultural and Applied Economics.

Interim Department Head and Professor Emeritus of Agricultural and Applied Economics, Herbert Stoevener said the hallmark of the center will be the delivery of information and skills required to convert data into the knowledge necessary to solve problems facing the farm, agribusiness, and rural business sectors. The center also will foster an environment where new knowledge and approaches are created to address underlying problems and opportunities facing the people, businesses, and institutions that serve the commonwealth. Stoevener concluded: "We are grateful to the Virginia Farm Credit Associations for their help in initiating this very exciting opportunity."

An external committee of Virginia agribusiness leaders is being formed to help define the center's mission and goals and to identify and contact potential key contributors. Forbes has agreed to chair this committee. More than $2 million is required to establish the David M. Kohl Chair and the Center for Farm and Agribusiness Management.

In addition to their gift for the David M. Kohl Chair, the Farm Credit organizations also have pledged $50,000 to establish an endowed undergraduate scholarship in the Department of Agricultural and Applied Economics. This scholarship supports students interested in finance and entrepreneurship and will help the center to build on Kohl's legacy of excellence in undergraduate student involvement in applied research and extension programs.

Consistently ranked among the top 10 institutions in agricultural research by the National Science Foundation, Virginia Tech's College of Agriculture and Life Sciences offers students the opportunity to learn from some of the world's leading agricultural scientists. The college's comprehensive curriculum gives students a balanced education that ranges from food and fiber production to economics to human health. The college is a national leader in incorporating technology, biotechnology, computer applications, and other recent scientific advances into its teaching program.

Founded in 1872 as a land-grant college, Virginia Tech has grown to become one of the largest universities in the Commonwealth of Virginia. Today, Virginia Tech's eight colleges are dedicated to putting knowledge to work through teaching, research, and outreach activities and to fulfilling its vision to be among the top research universities in the nation. At its 2,600-acre main campus located in Blacksburg and other campus centers in Northern Virginia, Southwest Virginia, Hampton Roads, Richmond, and Roanoke, Virginia Tech enrolls more than 28,000 full- and part-time undergraduate and graduate students from all 50 states and more than 100 countries in 180 academic degree programs.

The Management Calendar

By Gordon Groover (xgrover@vt.edu), Extension Economist, Farm Management, Agricultural and Applied Economics, Virginia Tech

Over the last two weeks I was fortunate to have the opportunity to talk with farmers, extension agents and specialists, and many others about profitable forage and fencing systems at five of the area Virginia Forage and Grassland Council Conferences. I'm always convinced I'm the one on the learning end of these speaking engagements. The questions and discussions help me formulate the practical questions for research and extension work. So I would hope that getting out to meetings and workshops to listen and ask questions of others farmers, service provides, and speakers will help you critique your farm business and formulate new plans and options to improve profitability. This concept is nothing new; some 2,400 years ago Socrates used questioning to help Athenians gain knowledge.

Remember the first day of spring is less than two months away and federal taxes for most farmers are due to the IRS by March 1. Listed below are the items that need to be included on the farm business managers' calendar for the first quarter of 2005.

- Tax management and basic federal income tax information - George F. Patrick in the Department of Agricultural Economics at Purdue University updates his extension publication titled "Income Tax Management for Farmers" annually. You can find the 2004 edition at http://www.agecon.purdue.edu/extension/pubs/taxplanning.asp.
- Now is the time to think about starting a new financial record keeping system. The Ohio and Oklahoma extension systems offer instructional guides on the internet to get you started with Quicken® an inexpensive record keeping software package. Ohio's instructional package is found at http://ohioline.osu.edu/b920/ and Oklahoma's can be found at http://agecon.okstate.edu/quicken/Using%20Quicken.htm.
- Get the farm's 2004 financial records closed out: Post all income and expenses paid during 2004 in your record book or accounting software. You still have time to conduct an end-of-the-year inventory of all the farm assets and liabilities to provide data for the farm's net worth statement.
- Using your 2004 records, develop an itemized list of income and expenses. The categories found on the IRS Schedule F can serve as a starting point for estimating net income for the farm business. Compare your results to previous years, looking for both weakness and strengths.
- Decide how much you'll contribute to an IRA for 2004 and set goals for 2005. If you do not use a certified financial planner (CFP), consider his/her usefulness in helping plan for retirement, college, insurance coverage, and other items. Visit the web site for the CFP organization to get information on services and standards required for planners. You can also search or a CFP in your area at http://www.cfp.net/
- Seek assistance from Virginia Cooperative Extension's farm business management agents, lenders, or your accountant to develop a detailed financial analysis of your farm

business, including the major 16 financial ratios. These ratios and a detailed financial analysis can be generated by using the Center for Farm Financial Management program FINAN. FINAN and other computer programs can be purchased annually for approximately $100 or the whole analysis and planning package of three computer programs for $395. Details are at http://www.cffm.umn.edu/Software/FINPACK/

- Using last year's financial and production records, finalize your projected budgets, cash flow, and income statements for 2005. If you use Quicken® or QuickBooks® make use of the budget section to create a 2005 budget based on 2004 records. 2004 budget entries can all be modified to reflect anticipated changes in 2005, like higher fertilizer prices.
- Take your 2004 financial records and 2005 projected whole-farm budgets and cash flow statements to your lender to discuss line-of-credit needs and plans for 2005. Using the FINPACK programs or your Quicken® or QuickBooks®can help with this process.
- Grain and livestock producers should have their marketing strategies/plans in place for 2005 marketing year. Be sure to check with your local Farm Service Agency for changes in government programs and signup deadlines. Be sure to visit Purcell's Weekly Agricultural Commodity Market Report for market updates. The report is posted at http://www.ext.vt.edu/news/periodicals/purcell/.
- The end of February and March 15 are the cutoff dates for signing up for most crop insurance polices in Virginia (dates depend on insurance product and where you live). Detailed listings of all policy closing dates are listed at the following site: http://www.rma.usda.gov/data/sales-closing-dates/. Details on crop insurance are best discussed with a local agent. You can locate a local agent by visiting the following web site http://www3.rma.usda.gov/apps/agents/.
- Make sure your federal taxes are mailed by March 1 unless you pay estimated taxes, then the deadline is April 15. Virginia income tax returns must be postmarked by May 1.
- Prepare your crop and livestock record keeping system for a new year. If you are interested in a listing of agricultural related software packages go to: http://www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/econ4118?opendocument.
- Interested in value-added resources on the web? Take a look at the Ag Decision Maker web site at Iowa State http://www.extension.iastate.edu/agdm/vdmarketing.html. It has sections on Marketing Research, Direct Marketing, Promotion, and Brands.
- Looking for a general article on non-traditional land-based activities? Take a look at the article titled "Wildlife Recreation: Rural America's Newest Billion Dollar Industry." This article can be found on the Iowa State web site http://www.extension.iastate.edu/agdm/articles/others/HenJan05.htm.

Conservation Security Program in Virginia

By Jim Pease (peasej@vt.edu), Extension Economist, Farm Management, Agricultural and Applied Economics, Virginia Tech

You may have heard that in December 2004, NRCS announced the watersheds that would be eligible for participation in the 2005 signup for the Conservation Security Program (CSP) (see http://www.va.nrcs.usda.gov/news/newsrelease.html). The selected watersheds include the Mattaponi and Lower Rappahannock in eastern Virginia, and the South Fork of the Shenandoah River in the Valley. The Mattaponi watershed includes parts of Orange, Spotsylvania, Caroline, King William, and King George counties. The Lower Rappahannock includes parts of Spotsylvania, Stafford, King George, Caroline, Westmoreland, Lancaster, Essex, Richmond, and Middlesex counties. The South Fork/Shenandoah includes parts of August, Rockingham, Warren, and Page counties.

CSP is a voluntary conservation program that provides incentive payments to farmers for existing, maintained, and enhanced conservation practices on their farm. Conservation practices include (but are not limited to) crop rotations, cover crops, conservation tillage, managed livestock access to streams, nutrient management, and prescribed grazing. Three progressive 'tiers' of enrollment range from soil and water protection on one portion up to all of the farm. Payments are determined by tier of participation. Participation ranges from 5-10 years, and payment limits range from $20K-$40K depending on tier of participation.

Signup will begin early this spring, possibly as early as March 15. In early March, a water quality extension specialist team from the CSREES Mid-Atlantic Regional Water Quality Program will offer training to extension educators who wish to conduct programs on CSP in their counties. The 1-day training will be delivered in Frederick, Maryland or Gettysburg, Pennsylvania. Some travel support will be available for extension educators. I should learn the details of that this week. My purpose in this note is to inform you about the training, and to poll your potential interest in attending the session. No commitment is necessary until we find out about travel support. Please let me know if, given at least partial travel support, you would be interested in receiving this training. Contact me at peasej@vt.edu or (540) 231-4178.

Risk Management-Fitting Insurance Needs to the Farm

By Bill Whittle (wwhittle@vt.edu), Extension Agent, Farm Business Management, Page County

Risk management is a hot topic throughout the agriculture industry. Farming is a tough business that deals with varied production risks including weather, markets, insects, disease, and labor supply. Other risks to the farm include health and liability issues. On a family farm, risks that affect the farm have an immediate impact on the family so it is vital to consider risks that may impact either.

The management of risk entails the use of tools to avoid, reduce, share, or transfer liabilities. Marketing and production practices such as hedging, forward cash contracting, enterprise diversification, and irrigation are useful tools for management to use to minimize the affect of certain risks common to the farm business.

You can use insurance to transfer certain risks to a third party for a fee. Insurance can commonly be purchased to partially or wholly protect the financial status of the farm and family and includes coverage for personal and farm property, liability, crop, health, life, and long-term care. You should determine the type and amount of insurance necessary to meet the needs of farm and family. The initial step for any management decision is to determine both personal and business goals. Where are you and where do you want to go with your business and family? Then you should address the next questions of “which risks are the farm and family willing and able to accept?" and "at what level of risk does it become prudent to pay someone else to accept?" This last question requires determining if adequate cash reserves and assets are available to continue farming and care for your family if a catastrophic event occurs. These are tough questions to wrestle with. Some farmers choose to self-insure all or part of the family and the farm. Self insurance is an acceptable way of managing risk as long as one understands the need to have enough cash reserves and assets to handle worse case scenarios. Other farmers realize that to maintain a viable operation they must have an infusion of money when disaster strikes, and this infusion probably will come from insurance.

Purchasing insurance is similar to buying a vehicle with many different models and options. Determining family and business goals will provide you with the reasoning to select a specific insurance policy without undue influence from outside sources. Your insurance agent can then explain specifics, such as coverage, exclusions, deductibles, and costs that help you achieve your goals.

Whether you have long purchased policies or are purchasing new coverage, you should be familiar with a policy. Your insurance agent has a responsibility to explain your policies, but you also have the responsibility to take the time necessary to understand this explanation. A yearly review of all policies is important to determine if the policy adequately addresses your goals that may change over time and if you should add, drop, or change coverage. At these yearly reviews, your insurance agent can become a useful member of your farm's management team by making sure the coverage meets but does not exceed your goals and the deductibles fit into your management program. Buying more insurance than needed can be as costly as not having enough insurance. You should be aware of policy limitations. Your agent should be able to address concerns prior to a catastrophic event, not after. Last, a regular review of your policies forces you to evaluate your needs. If you address your goals, you will seldom be in the situation of waiting until insurance is too expensive or you are no longer insurable.

Managing Your Credit Worthiness

By Bill Whittle (wwhittle@vt.edu), Extension Agent, Farm Business Management, Page County

Today's farm manager contends with volatile prices and accelerating input and land costs that have combined to make financial management as important to survivability as production management. The ability to obtain credit is a valuable tool in managing finances in today's business climate. As you seek financial assistance, you should be prepared to "sell your story" to the lending institution. The Agriculture Lenders Handbook discusses how you can best prepare for requesting credit. These suggestions are not just for a one-shot attempt to obtain credit but are integral parts of a sound farming operation.

First, you must have a good set of records. An accurate, complete, and properly organized set of statements such as net worth, operating results, and cash flows are essential. If developed annually good records will show you and your loan officer how profitable the business is, which individual enterprises are profitable, and the money available to make payments, to meet family living expenses, and to provide for new investments. The records can tell you when sales are expected, expenses are scheduled, and payments due.

You need to prove that you are an above average manager capable of generating the cash flow needed to borrow large amounts of capital. Many lenders have standard guidelines to measure the farmer's overall management ability. It is vital to know these guidelines and attempt to measure up to them. (Your success can be measured in the production of livestock, crops, and general resources such as land, labor, and capital.)

Don't wait till the last minute to request a loan. Plan ahead and develop budgets, including projected incomes, expenses, and investment costs, and be prepared to discuss these with your lender. Show the lender how your request fits your overall goals and objectives.

Your lender is a partner in your farming operation; invite your loan officer to see your operation so he/she can understand your specific circumstances: your goals, objectives, skills, strengths, and any limitations to your business. Your job is to educate the lender regarding the on-the-farm aspects that can change rapidly.

Agricultural lenders frown upon having credit from numerous places; therefore, keep your debt consolidated. Past due accounts with agri-supply firms often create suspicion regarding a borrower's repayment and financial management ability. If problems arise, keeping numerous lenders informed is more difficult than keeping one lender informed.

Discuss problems and unfavorable situations such as weather, prices, costs, and disease with your lender before these problems escalate and create difficulty meeting debt obligations. If you are having problems meeting scheduled payments, immediately have frank discussions with your creditors so that a solution can be worked out.

Share credit decisions your wife, partner, and family members involved in the operation. Open communication and cooperation allow a lender to better understand how a loan request fits into both your goals and your family's goals and lifestyle.

Farming is unique because it represents a large investment with small cash incomes. You must be willing to sacrifice to build cash reserves in favorable years that provide working capital and living expenses in unfavorable years. You must continue to live modestly and keep personal consumption and farm capital expenditures within reason even in favorable years.

In conclusion, remember that reputation is still important in the farming world; make every effort to maintain the reputation of being honest and dependable. A good reputation will not guarantee you credit at low rates, but it will enhance your ability to work with lenders.

Calendar of Events

February

18 Farm Transition and Planning: How to get the next generation farming? Rockingham County Young Farmers Meeting; Mt. Crawford, Virginia. Contact: Alex White at (540) 231-4368 or E-mail: axwhite@vt.edu

23-26 2005 Mid-Atlantic Direct Marketing Conference & Trade Show, The National Conference Center; Lansdowne, Virginia. Contact: Cathy Belcher at (804) 786-4046 or E-mail: cbelcher@vdacs.state.va.us, or visit the conference website at http://www.madmc.com

May

16 Farm Transition Workshop; Wakefield, Virginia. Contact: Jesse Richardson at (540) 231-7508 or E-mail: jessej@vt.edu

17 Farm Transition Workshop; Hickory, Virginia. Contact: Jesse Richardson at (540) 231-7508 or E-mail: jessej@vt.edu