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KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM
STATE NEWSLETTER

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Are You Burning Equity?

By: Jennifer Rogers

Farm incomes have recently taken a significant downturn. This is the result of drastic declines in crop prices and slow to react input costs for fertilizer, seed, and chemicals as well as locked in prices for farm rents. Through this turn of events, there have been some instances of negative farm incomes. When these farm losses are coupled with non-farm demands for cash such as family living and debt repayments, negative cash flows result. Negative cash flow can result in the use of equity, thus the term “burning equity” when current expenses must be paid with retained earnings from another year. This can be accomplished using cash reserves or by converting short term debt into long term debt.

<u>What is Equity?</u> Equity, or otherwise referred to as Net Worth, is defined as Assets minus Liabilities or Liabilities plus Equity Equals Assets. In simple terms, equity is the amount of assets that are paid for. Having a strong equity position can enable one to sustain losses over a short term basis. Strong equity positions make you a reduced risk borrower as well because there is more collateral available to secure new debt if needed. The strength of your equity position is typically measured using to the Debt to Equity ratio, in which total debt is divided by total equity. The smaller the number the better the equity position. Farm financial standards typically consider a Debt to Equity ratio of less than 43% to be in the good range.

Equity as a Tool. While using equity can be seen as a negative, one of the benefits of having equity is that it can be used as a tool. Having an asset "paid for" allows you to use that asset to purchase or upgrade something else. Equity in your home is often used in the form of a home equity loan. This allows you to borrow off of the portion of your home that is paid for to make upgrades, additions, or other purchases. Using equity to build your business can be a great and very valuable tool. However, using equity to pay for things that have already been used, such as paying for last year's fertilizer and seed that crop receipts couldn't cover, or to pay for family living expenses or credit card debt would be considered "burning equity". You are not using the equity to invest in an asset, it is simply covering expenses.

Using Equity. There are circumstances that require the use of equity. When farm profits are negative, if you have any equity, it could allow you to stay in business and ride out the losses so that you can take advantage of the gains that are hopefully coming in the near future. Otherwise, if equity is not available to cover unpaid operating funds, you may be facing bankruptcy or liquidation or using some other types of financing. You are in danger of burning equity when you don't realize what is happening or you don't try to limit the amount of equity that is being used. Losses can be significant in just one year. You must use good records, budgeting and attention to money going out versus income expected to come in. These losses could put you in an undesired situation where you have to make some unwanted decisions. The use of equity is a tool to help you in your business, but it is a tool that should be used with proper guidance and control.

Record Keeping in Tough Times

By: Amanda Jenkins

Spring, the time of year farmers look forward to and start to get the itch to begin field work. As farmers make way to their tractors, they have more to ponder on with crop prices on the decline and the forecasted outlook not very promising for the next few years. Margins are tighter this year and producers are aware; however, awareness and action are not the same. All the expenses mentioned in "A Concerned Economist's Perspective-Liquidity and Budgeting" in the January edition of the UK Ag Economics Department BlueSheet series will be easier to track over time with good records. The importance of record keeping will increase as farming heads into tight times and action needs to be taken.

The better records are kept, the easier it will be to make sound business decisions going forward. There is no clear cut answer for all operations. To make good use of your records, it will benefit farmers to keep up with income items along with cash expenses and economic costs. Economic cost is the opportunity cost of using the resource for something other than farming.

Yield monitoring from year to year will assist in having an actual average yield to use in calculating breakeven costs. Watching prices of commodities and market fluctuations will play a vital role in profitability. Some cash income will be harder to estimate; for instance, government payments are projected to be less in the coming years than they were in 2015. Crop insurance may become less of a protection if income is projected to be low and there is not a decrease/fall in revenue during the crop year.

As you track cash expenses from year to year, trends will form and you can see where excess expenses can be cut. For instance, having good soil fertility records on different farms will allow for more variable rate application of crop inputs to possibly reduce those expenses in the upcoming years. Researching machinery leases versus owning equipment could be one way to reduce machinery repairs and depreciation, if the cost of the lease per acre is less than the repairs. Knowing what the total cash expenses are will allow one to calculate the minimum price needed to breakeven.

Meeting economic costs is as important as meeting cash expenses to sustain the operation during tight times. There is an opportunity cost of tying up money in inputs, owning land, and equipment. A charge for operator labor needs to be accounted for because you don't want to work for nothing. As everyone knows farming is not cheap, and if your money was not tied up in farming, it would be invested in something else. A breakeven price would ideally include these economic costs.

Other items that need to be covered over time are a margin to grow the operation in the future and family living expenses. Some families have become accustomed to these high incomes in the last few years and it will be hard to pull those expenses back down.

Having good records for the whole operation should lead into better records by farm and enterprise. Now is the time to understand whether each farm is making a profit or at least able to cover cash costs. If a rented farm is not producing, decisions will need to be made whether to keep the farm or let it go. The rental agreement may need to be negotiated or options for making the farm more efficient may need to be considered. When looking at cutting acres, fixed costs will need to be monitored more closely because as acres decrease those costs will increase. For example, machinery expenses will need to be addressed to see if downsizing some equipment will lower that cost. Next, looking at enterprising budgets allows a farmer to know if each crop or livestock enterprise is making money. This will allow the farmer to decide if a new direction is needed or where they can improve for each enterprise.

As net farm incomes decreased this past year and predictions are similar for the next couple of years, it is important to analyze the operation and see where we can "pinch pennies". This task is much easier done if accurate financial records are kept and realistic projections are made.

H-2A Labor Audits

By: Michael Forsythe

As the tobacco growing season starts for Kentucky tobacco farmers, it's also the season for H2A labor audits. All tobacco farmers cringe at even the thought of this, but it is something that everyone needs to be prepared for. Below are several observations from recent audits of which H-2A employers should be aware.

- Paycheck deductions, such as for providing uniforms, must be specified and approved in the H2A contract, and it must be clearly explained to the H2A workers that this is being done and why it is being done.
- All fuel used by H2A workers must be paid for by the farmer, even if it is for personal use that is unrelated to the farm work.
- Work hours offered must be included on each paystub or the worker must be given a copy of the timesheet or other document that has hours offered listed on it.
- All vehicles H2A workers have access to must be in good working order. Any repairs, such as broken windshield wipers, busted or broken lights, balding tires, etc. must be fixed immediately. The farmer can still be fined if they have taken that vehicle out of service until the needed repairs can be completed.
- There cannot be any holes in window/door screens or broken glass in the H2A housing.
- H2A workers must have a bed and a mattress to sleep on. They are not allowed to sleep on the floor or put their mattress directly on the floor even if it is of their own choosing to do so.
- It is the farmer's responsibility to fix any and all plumbing issues and properly train their employees on how to prevent future plumbing issues.
- A non-H2A worker hired to do the same task as an H-2A worker, such as cutting tobacco, must be treated the same as an H2A worker. This includes providing him with a time sheet, being covered under worker's comp insurance, and providing housing if the non-H-2A worker lives approximately 50 miles away from the work site.
- Employment posters must be clearly posted for everyone to see.

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OSHA's Field Sanitation Guidelines are applicable to "any agricultural establishment where eleven or more employees are engaged on **any given day** in hand-labor operations in the field", not just to H-2A employers. The Field Sanitation Guidelines provide specific regulations regarding availability of handwashing facilities, potable water, and toilet facilities for your employees. Please go to www.osha.gov and search on "Field Sanitation Guidelines" for specific guidelines. Examples include:

- One toilet facility and handwashing facility for each 20 employees (or fraction thereof)
- Separate handwashing facilities and drinking water stations available while workers are in the field
- Employer must allow for reasonable use of sanitation and hydration facilities.

These are just some of the issues that have been discussed during labor audits, but there are many other issues of which farmers should be aware. One good resource to keep up-to-date on the code of federal regulations is www.ecfr.gov. Employee Benefits is listed under Title 20.

Upcoming KFBM Events:

July 12	Pennyroyal Farm Analysis Group Summer Board Meeting – TBD
July 26	2016 Summer KFBM Board Meeting - TBD