Economic & Policy Update
E-newsletter Volume 24, Issue 5
Editors: Will Snell & Nicole Atherton

Department of Agricultural Economics
University of Kentucky

MAY 2024

Interest Rates and Refinancing

Author(s): Jennifer Rogers

Published: May 24, 2024

It is no secret that interest rates have increased. In fact, the Federal Reserve increased interest rates 11 times between March 2022 and July 2023. This rise in interest rates has increased the cost that consumers and businesses pay on borrowed money at all levels. Our Kentucky farms are no exception to this increase in cost. Farm businesses have been paying more on operating loan interest as well as intermediate and long-term rates. This increase in interest expense affects the profitability of the farm business. However, the struggle does not end there. Increased interest rates affect the ability to use refinancing to manage cash flow issues.

Refinancing has long been a tool to help provide for cash flow. Refinancing can be used to extend the repayment period on a loan, typically reducing the required annual payment amount. Reducing the required annual payment helps to free up cash to use for other purposes. Refinancing may result in paying out more interest over the life of the loan, however, the reduced cash requirements each year may help the consumer to meet their other financial obligations in the current financial year.

Refinancing can be done on any class of debt. Long-term mortgage loans can be refinanced and stretched out over a longer term to reduce the payment. When interest rates are dropping, refinancing a long-term loan for a reduced interest rate may allow the borrower to shorten the length of the loan or significantly reduce the payment amount. Refinancing can also be done to convert short-term debt to long-term, allowing the borrower to payoff the debt over time instead of in the current year.

Many farm businesses in particular have benefited from being able to convert short-term debt into long-term debt to improve cash flow and keep that farm business operating. This practice typically takes operating debt, money borrowed to pay for operating expenses such as seed, fertilizer, and labor, and uses long-term collateral such as land to convert the debt to long-term. This will result in mortgaging a farm to pay off the short-term debt. The payments on the mortgage are typically spread out between 10 and 30 years, making the annual payments affordable and allowing the farm to continue operations. This is never the situation that the farm business would hope for, but given the volatility and risk associated with farming, it is sometimes the only option to stay in business in a bad year.

The increase in interest rates has negatively affected the ability to refinance debt to help with cash flow. Most farm mortgages are currently held at interest rates much lower than the current interest rate. By refinancing the debt, the entire mortgage principle (existing and refinanced) would be

mortgaged at the current higher interest rates. These higher interest rates impact the required annual payment, decreasing or negating the cash flow benefits that refinancing might have provided.

In Kentucky, we have recently seen a decrease in farm profitability. Decreased crop prices along with highly volatile input costs have put many farms in a financial struggle. Higher interest rates impact many costs on the farm. If farms are unable to meet their current financial obligations, these higher interest rates may also prevent farm producers from being able to utilize refinancing to help with cash flow. Cost management, budgeting, and profitability are more important than ever for the survival of the farm business.

Recommended Citation Format:

Rogers, J. "Interest Rates and Refinancing." *Economic and Policy Update* (24):5, Department of Agricultural Economics, University of Kentucky, May 24, 2024.

Author(s) Contact Information:

Jennifer Rogers | KFBM Area Extension Specialist | **jennifer.rogers@uky.edu**