

Sustaining Farming on the Urban Fringe



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Excess Farm Indebtedness is Not a Sustainable Practice

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When farms fail, causes usually include financial resources—indebtedness—as well as natural resources farms depend on, like soil. Farm financial resources and natural resources are intimately linked. Both contribute and are required to sustain healthy farms. Excess debt and resource degradation are both implicated in farming failures. Since high indebtedness is the leading cause of failures in our country's historical experiences with agricultural sustainability, let's explore some issues related to debt.

First, recognize farming costs and prices are biased

Market prices of urban fringe farming resources are distorted. On one hand, we know farms provide local food, open space, beauty, ground water recharge, freedom from sprawl, and wildlife habitat. But, these public benefits are never included in the prices we pay when purchasing farm products, or selling farmland. Likewise, policies often ignore and distort *economic externalities*; hidden long-term costs of farming resource degradation (e.g., sprawl, large lot development, soil erosion, over-grazing, or ground water depletion). We don't factor these either into market prices we pay for farm products. In this manner, **all farming resource failures are economic**, or rather bad economics. In managing resources for the long-term, a farmer I recently spoke with remarked, "*Farmers should not depreciate their soil biological capital, or financial capital.*"

Farming endeavors don't mix well with high leverage

Debt-to-Equity ratio is a quick measure of financial leverage risk, helping assess a farm's long-term



viability. Farms use owner equity plus borrowing. Debt-to-equity ratio is simply total farm liabilities divided by farm owners' equity (measured differently than for public companies). Borrowing has multiple benefits when farming returns on debt far exceed costs. Moderate debt enables farmers to use their farming resources efficiently.

What lesson does sustainable farming history teach us about debt?

Table 1 (on page 2) reveals leverage risk changes dramatically with modest changes in debt. **Over the long-term, farms with debt exceeding 60-65% of capital-leverage of 1.8:1 or above—are less viable.** They are not resilient facing the five resource risks buffeting farms: Production, Economic/Financial, Markets, Human, and Legal. Yes, human management and a predictable legal framework, like property rights, are essential farming resources too. An astute

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farmer said, “If you can write a check for it, you don’t have a problem. You can’t express a sustainable farming vision from an empty checkbook.” Leverage ratios guide us in lessons about sustainable farming, about life, and even the fate of nations.

Interestingly, farms are far less viable with leverage non-farm wage earners feel comfortable living with. As shown in Table 1, if you purchased a family home (or farm or farmland) with a 20% down payment and 80% mortgage, you begin with 4:1 leverage. What happens if you pay off just 5% of debts—to 75%? Leverage declines from 4:1 to 3:1, a big move. If your family or farm reduces debts another 15%—from 75% to 60%—you cut leverage in half, at 1.5:1. Conversely, if you began with 10% equity instead of 20%—seemingly not a great difference—you farm with double the leverage risk of 9:1. If you bought a house with 5% down, you began ownership leveraged 19:1!

How many risks can a farm withstand at one time?

A well-managed and financed farm is able to withstand adversity from one, maybe two, risks at once. When two or more risks bear on a farm, only the lowest indebted remain viable. *It is unstable stewardship to saddle farms, buffeted by volatile short-term biological and resource uncertainties, with long-term, ‘time certain,’ financial liabilities.* Excessive leverage prevents farms from adapting to changing farming technologies or markets. Like any enterprise, leverage subjects a farm to rising interest payments during periods of rising rates. But, farms are additionally subjected to unpredictable natural events like hail or flood, drought or frost, unpredictable declines in prices from surpluses, sudden loss of markets, and other failures. While leverage is beneficial in predictable enterprises, it is a key association with unsustainable farms.

Implications for starting your commercial urban fringe farm & leasing

An observation from successful low debt-to-equity farms is that a sound path to starting farming includes training yourself for a higher earning non-farming profession, which does not depend on heavily borrowed capital to enter. The future farmer saves a ‘grubstake’ to begin farming, with equity. Beginning farmer and rancher intern experiences, ‘how to farm,’ remains an avocation until farming investments begin.

Table 1. Wide changes in debt-to-equity leverage ratio, in response to small percent changes in farm indebtedness, are a measure of sustainability risk.

% Borrowed debt	% Equity (down payment)	Debt-to-Equity Leverage Ratio	May be found in:
110+	-10+	Incalculable	Wall Street & investment banking? Little equity ‘skin in the game.’ Leverage may work here, not farming!
100	0		
97	3	32:1	Beginning homeowner or consumer? Hopefully not a beginning farmer.
95	5	19:1	
90	10	9:1	
80	20	4:1	Beginning, part-time, or established farms? Main street enterprises?
75	25	3:1	
65	35	1.8:1	
60	40	1.5:1	
50	50	1:1	
25	75	.33:1	Farms & enterprises on a durable path; withstanding uncertain risks?
10	90	.11:1	
0	100	0	Eschewing <i>all</i> debt not necessarily most resource efficient

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Another observation is that *due to extraordinarily high urban fringe farmland prices, the future must include policies ‘taking farmland equity off the table’ as a barrier to entry for a younger new generation of farmers.* Farmland sale prices have two components; the farming value plus the speculative value for alternative uses. On the urban fringe, the speculative value of farmland far exceeds the farming value. The next generations of urban fringe farmers, and farmland owners, must design alternative leasing arrangements so beginning farmers can start on rented farmland, with longer-term 10-20 year incentive leases. These leases must not overly proscribe management practices and leave flexibility and freedom for wildlife damage control, constructed investments, and associated needs.



Don't farm-away your *urban fringe land equity*

Urban fringe farmers experienced decades of rising land values. Some increased their borrowing. Those who did not also raise their sales per acre, marketing efficiency, and repayment ability became known as ‘equity farmers.’ Their farmland assets, appreciating faster than the farm was losing money, masked underlying problems...for a while. These farms’ become threatened when future land use policy changes like down-zoning or regulatory takings reduce their equity value. Indebted urban fringe farms, caught on high value farmland with changing land use policies, hopefully must earn sufficient net farm income. Their exit strategy of selling the farmland for alternative uses is removed without public compensation. Intergenerational transfer of farms is also weakened by excess debt.