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Dealing With The Credit Crisis Down On The Farm

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Over the past several weeks we have been asked numerous times about the impact of the financial/credit crisis on farmers. While acknowledging that it is a complicated issue we start out by noting that farm incomes are at an all-time high and the debt-to-asset ratio for farmers is very low.

That being said, we have some real concerns.

Traditionally a significant number of farmers have depended upon credit to finance inputs from seed to fertilizer to farm chemicals. Some of the credit is due in 60-90 days, while some of it comes due after harvest. This kind of flexibility has allowed farmers to manage the sales of their old-crop commodities to capture a higher price than if they had to sell the crop immediately to finance early order inputs like seed.

Some of the credit has been provided by input sellers who have been willing to delay the payment date in order to lock in the sale. To the extent that those companies are experiencing a credit lock-up of their own, they may tighten up the credit terms they offer to farmers.

For those farmers who have saved some of the income from the high prices of the last year, they may be able to self-finance much of the coming year's input needs. But those farmers who need to go to the bank or depend on the input suppliers for credit may find themselves under considerably more financial scrutiny than in years past. And, even for the most credit worthy, the terms may read differently compared to last year.

This whole downward spiral has taken oil prices with it. For farmers, lower oil prices should result in a decrease in the price of major inputs like diesel fuel, fertilizer and farm chemicals. That would be a welcome event for farmers who have been facing skyrocketing fuel and fertilizer prices. These lower input prices will be of less value to those who have already contracted ahead at higher prices to assure the input availability.

While the lower input prices is the good news, the bad news is that crop prices took a tumble along with oil prices. Unless farmers have locked in higher prices for a significant portion of their '08 and '09 crops, they face lower prices at harvest than they anticipated at planting time.

For the '08 crop many may be faced with harvesting a low-price crop that was produced with high-priced inputs. That combination could prove to be stressful for farmers caught in those circumstances. Like some home buyers they could be caught upside down, in that the crop cost them more to produce than they can sell it for.

A second impact of the downward trend in commodity prices is the impact of lower prices on land prices. The record high crop prices of the last year coincide with record high prices being paid for farmland. That would suggest that as crop prices fall, we may see a decline in land prices as well.

If that were to happen, the debt-to-asset ratio for farmers could increase without their borrowing an extra dime. Depending upon individual circumstances, that increased debt-to-asset ratio could result in a smaller line of credit and higher interest rates for things like inputs.

Our recommendation for the past two years has been for farmers to play it especially conservatively.

Don't give into the temptation to go on a buying spree just because your checking account is fatter than you have ever seen it. Or because you would rather have a new machinery compliment than deal with Uncle Sam come income tax season. You may very well need that money next year or the year after that to just survive.

Our approach would be to squirrel away any extra money not required to pay out-of-pocket operating expenses. If next year's profit is good, funnel much of that into this separate account as well and make machinery or other long-term investments and exceptional household purchases with "last year's money."

In times like these, that year's cushion may prove to be a life-saver. Two years of cushion would be even better as we all wait to see which direction this financial/credit crisis is going to take us. ∆