35 Keys to Success

Securing a Land Resource

No Cheap Tickets

Increasing demand for agricultural land and historically high prices make admission to the cattle business tougher than ever.

by ***Wes Ishmael,*** *freelancer*

"Increasing land values make landowners wealthy, but they make it prohibitive for young ranchers to enter the sector without equity contribution from parents or off-ranch income," says James McGrann, a noted livestock economist and professor emeritus at Texas A&M University who owns Ranch Management Economist, a ranch business consulting firm.

McGrann made that comment four years ago as part of a presentation he and folks from the Noble Foundation at Ardmore, Okla., gave to young members of the Texas and Southwestern Cattle Raisers Association (TSCRA).

Even if it's land one generation plans to pass along to the next, McGrann notes, "The high cost of estate transfer means it is difficult to hold ranches together between generations."

This reality helps explain the fact that many of what USDA classifies as beginning farmers and ranchers are older than dogma may suggest.

Post-middle age is the new young

Although beginning farmers tended to be younger than established ones, 32% of beginning farms in 2007 had a principal operator 55 years old or older. That's according to *Beginning Farmers and Ranchers* (BFR), a 2009 report from USDA's Economic Research Service (ERS).

That same year, 17% of beginning operations had a principle operator younger than 35 years old. Of established farmers in 2007, 63% had a principle operator 55 years old or older; more than 25% were 65 years old or older. Only 2% of established farms had a principle operator 35 years old or younger. In 2007, beginning farms and ranches represented 15% of all farms.

Incidentally, USDA defines beginning farmers and ranchers as those who have operated a farm or ranch for 10 years or less, either as a sole operator or with others who have operated a farm or ranch for 10 years or less.

For perspective, the 22% of all farms that were classified as beginning farms in 2007 accounted for 10% of the value of all agricultural products and less than 10% of the total land in farm operations. The average beginning farmer in 2007 operated a farm that was less than half the size of the average established farmer's: 174 acres vs. 461 acres, respectively.

Similarly, according to *The Diverse Structure and Organization of U.S. Beef* (DSO), published by ERS in 2011, the average age of producers was 60 years.

The DSO report summarizes data from an in-depth survey of U.S. beef cow-calf producers, which was conducted as part of the 2008 Agricultural Resource Management Survey.

In the DSO report, more than 40% of producers with solely cow-calf operations were older than 65. The average age of cattle producers with more than 500 cows was 57 years old. For those with fewer than 100 head, it was 60 years. In fact, 38% of cattle producers with fewer than 100 cows were at least 65 years old, compared to 22% with 500 or more cows.

ERS analysts caution that interpreting producer age distribution in these types of studies can mislead because the general population, farmers included, are living longer.

Saving for a stake

"There are good reasons why so few

PHOTO BY LYNSEY MEHARG

farmers are young and many beginning farmers are middle-aged," ERS analysts explain. "Foremost among these reasons is that the startup costs in agriculture present a barrier to entry for some. Farming commonly requires control over a significant amount of land and capital, and beginning farmers and ranchers face significant startup requirements. For example, it is only when farms gross at least $50,000 in value of production that most farms make a profit, and the average asset base of farms with sales of $50,000 or more in 2007 was over $1.9 million."

In other words, a fair percentage of new farmers and ranchers must wait until they accumulate the necessary economic stake from other careers in order to buy land.

Although the BFR study lacked the information necessary to assess land acquisition preferences, specifically, ERS analysts note, "It may very well be that beginning farmers would like to rent more acres, but the rental acres are not available because leases in their area are based on long-term relationships between established parties."

According to the ERS report, the most common way beginning farmers acquire land is through purchase from a nonrelative, rather than inheriting the land or buying from a relative.

"More than 90% of farms in most regions used private pastureland for grazing beef cattle, although the acreage and stocking rate varied significantly among the regions," ERS analysts note in the DSO study.

Land prices for agriculture, of course, blasted through the roof a while back and show little signs of significant softening (see "Higher and Higher," page 102).

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Average pastureland value increased from $1,070 per acre in 2009 to $1,200 per acre in 2013 nationally, according to USDA's *2013 Summary of Land Values.* Nationally, the average cost to rent pastureland was $12 per acre in 2013.

McGrann is quick to point out that average values like these offer little use by themselves. What matters is the ultimate cost per animal unit of production (AUP). Determining the value requires both the purchase or lease cost per acre, as well as the stocking rate. Consequently, pasture value is site-specific.

Conversely, cropland values are typically based upon historic production capacity.

For what it's worth, the average farm net worth of beginning farm households that produced agricultural products in 2007 was $428,894, according to the BFR report. The average farm net worth of established farms that same year was $840,125. Both groups averaged more than $200,000 in nonfarm equity.

"For young people today, securing adequate land to begin farming or expand an established farm or ranch is a major challenge," emphasizes Jake Carter, a Georgia farmer who serves as national chairman for the American Farm Bureau Federation's (AFBF) Young Farmers and Ranchers program (YFR). "Another major challenge is figuring out how to excel — not just survive — in today's economy."

In this year's annual survey, YFR participants identified securing adequate land to grow crops and raise livestock as the top challenge.

That's one reason the federal government developed financial assistance programs for beginning agricultural producers (see "Caution Pays," page 110). Some states and individuals are also finding creative ways to give young ranchers a way to earn the equity to get started.

"Although beginning farmers are just as likely as established farmers to own farmland, they are more likely to have debt associated with farmland ownership, as indicated by the greater share with debt-to-asset ratios over 10% and the greater incidence of real estate debt," according to the Beginning Farmers study.

For anyone considering starting in the

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cattle business from scratch — even if they don't plan for it to be their sole living — prices and equity requirements mean throwing the dice has never come with more financial risk.

Pay to play

"No one can start a ranch business with ranch earnings and expect to earn $60,000 before self-employed and income taxes. With a 2% return on investment in ranching, it would require $3 million in equity. Assets earning 2% can service only limited debt," McGrann told young producers at the aforementioned seminar.

More specifically, McGrann says, "Buying land is a question of the buyer's repayment capacity. Because of the high market value relative to operating earnings, there must be other sources of income — repayment capacity — to make payments on land purchases."

He explains that repayment capacity from operations is influenced by scale of the operation, necessary living withdrawals and sources of non-ranch income to support debt.

With the above in mind, McGrann emphasizes, even with low interest rates, land purchases these days, generally speaking, will not cash flow with only income derived from beef production.

Land is just part of the equation, of course. As of the end of June, commercial cows are costing north of $2,000. Lightweight calves to stockers were pushing $300 per hundredweight (cwt.). Equity requirements are typically in the 25% range for strongly positioned borrowers. McGrann notes that cattle values are often discounted by lenders, meaning the equity requirement is actually higher. Put your operating and production costs against the cattle and especially against the land investment and you can start to get a feel for how many head you need and how much positive cash flow is required just to service the debt.

Since you're reading this in *Angus Journal*, yes, the seedstock business is different. The cost of a registered bred cow or that of a commercial cow carrying an Angus embryo will likely cost more in actual value but will be discounted the same by lenders. As one veteran seedstock producer and bull marketer told me years ago, "If you want to play this game, you'd better have plenty of jam." In this case, "jam" applies equally well to guts and jingle.

In the information McGrann provided young TSCRA members, these are other points that should be considered:

- "These operations really have to operate as a business first. Finance, marketing and personnel management just have to be priorities," McGrann says. "Good analytical skills demand good data … and that is one reason some cow-calf producers avoid marketing and retained ownership. The business model I envision must be strong in these areas."
- "Truly profitable enterprises provide retained earnings that can be used for savings, capital investments, withdrawals or [to] reduce debt," McGrann explains. "All costs and taxes are accounted for. Always question what is included in cost and income reports or projections for cattle operations."
- Financial sustainability of a business is measured by the ability to maintain equity and to generate a net after-tax positive income and cover withdrawals for owner-operator labor and management," McGrann says. "The reason withdrawals and distributions are important in evaluation of business sustainability is because frequently the ranch business must provide income for living withdrawals.
- "The low rate of operating return on farm and ranch assets creates a major debt-service challenge for borrowers," McGrann says. "When producers make an investment, the returns generated should be greater than the cost (interest rate). In order to pay the cost of capital, the producer must use after-tax return from equity or other sources of income to pay the difference between cost and earnings. Ranches just have a very low repayment capacity and must avoid high leverage."
- "Likely, the biggest threat ranchers have is often self-inflicted in that the ranch is not treated as a business," McGrann says. "Too much emphasis is placed on the lifestyle. If capital or off-ranch earnings are inadequate to support the family living and meet debt payments, the business is not financially sustainable."

Subsidizing the dream

"In reality, less than 4% of the beef cow-calf operations make their sole living from the cow-calf enterprise," McGrann says.

"This means that the industry can produce at least 50% of the feeder cattle and not be profitable to owners. These calves support the feedyard and packing industry and lower consumer cost of beef."

Despite that reality, along with high startup costs and a lack of available land for purchase or rent, though, entry rates in farming are not significantly different from entry rates for other industries. Annual entry rates in farming ranged from 8% to 11% between 1978 and 1997, compared with 7.7% for manufacturing between 1963 and 1982.

In the aforementioned BFR study, approximately 32% of beginning farms reported no production compared with 20% of established farms. However, the average income of beginning farm households (from both farm and off-farm sources) was similar to the average income of established farm households: $87,004 and $90,866, respectively.

According to the *2012 Census of Agriculture* published in May this year, 81.64% of all beef cow operations have fewer than 50 cows and accounted for 29.79% of the total beef cow inventory. At the other end of the spectrum, 3.58% of operations had herds of 200 head or more and accounted for 37.26% of all beef cows.

One reason such concentration exists is the proliferation of rural-residence farms.

According to the DSO report, "Operators of more than a third of beef cow-calf farms worked off-farm in 2008, and half of beef cow-calf farms are classified as rural-residence farms. These farms are small operations that specialize in beef cow-calf production but report off-farm earnings as the primary source of household income."

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Conversely, ERS analysts explain, "Commercial farms with beef cow-calf enterprises are mostly diversified farm operations on which cattle are a secondary enterprise that accounts for about a fourth of farm product value. On intermediate farms, which have annual farm sales under $250,000 and report farming as the main occupation, the beef-cattle enterprise accounts for over half of farm product value. Intermediate farms are among the most financially vulnerable to the input and output price variations of beef cattle production."

Even as a place to retire or as a rural-residence farm, equity can bleed away in a hurry if cattle business reality is ignored.

McGrann emphasizes that business financial sustainability depends on the ranch's ability to maintain equity and generate a positive after-tax income while including the expense of owner-operator labor and management.

By that measure, McGrann says folks often fool themselves into thinking the industry is more profitable than it actually is. One reason, he says, is that cash costs and cash profit often reported in the industry ignore depreciation and withdrawals for living expenses or compensation to the owner-operator. He explains depreciation is typically one of the four largest ranch expenses.

"Be very cautious when using reported cattle industry breakevens, net income and profit projections," McGrann says. "Most frequently, beef-cattle breakevens do not include all costs, and profit values overstate true financial profitability. Developers of these values often ignore self-employment and income taxes, returns to management, and labor and overhead costs."

Editor's Note: *Wes Ishmael is a freelance writer from Benbrook, Texas.*