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Should I Quit Dairying Because of the Drought?

The decision to leave the dairy industry is never an easy choice. Certainly, drought conditions and feed shortages cause dairy farmers to wonder about continuing. There are many factors that make the decision especially difficult. For many families, dairying has been part of the family heritage for many generations. Also, the dairy farm may be the only job an aging farmer has ever known. Make no mistake, these are gut-wrenching decisions. Yet, the decision often must be looked at purely from a business point of view. The worst case is when the family continues to operate the dairy farm at a loss and erodes equity that has been built up over a lifetime. If carefully examined, the decision to exit sooner may preserve assets and wealth earned by the operators.

Unfortunately, only the individual dairy farmer – hopefully after much discussion with their spouse and other family members, with input from lenders and other key advisors – can make the decision to exit. But that decision should be made while carefully examining options. Even with low feed supplies and high feed prices, some farms are making a profit – especially farms that have retired most debt and are operating with low input costs. Typically, widespread droughts are accompanied by at least some gains in milk prices, though this might not occur when drought conditions cover only a local area. Profitability must never be assumed. Consider your farm-specific costs of production or seek help in calculating them. Such help can come from dairy industry consultants and county Extension offices.

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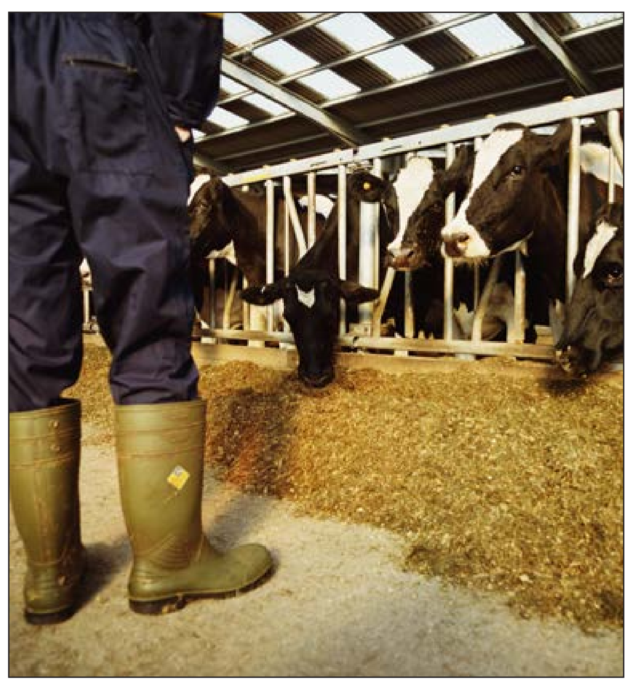
There are many reasons why dairy farms make the decision to exit the dairy industry:

- *Retirement.* Many farms go out of business when the father retires or slows down and no family member chooses, or is able, to continue the dairy enterprise.
- *Lifestyle.* When labor is scarce some dairy farmers choose to alter their lifestyle so they no longer must feel "married" to the farm.
- *Excess debt*. Especially in times of low milk prices and/or high feed costs, farms may not be able to generate enough income to repay loans, and so are forced out of business.
- *Health problems*. Sometimes even minor injuries or illnesses can force operators out of business, especially in the case of small farms where there may be too few cows to allow employment of non-family labor.
- *Urban pressures*. These can force dairy farm exits, either through pressures from an encroaching residential neighborhood, or through land price offers that are too good to turn down.
- *Poor profitability*. If any business is not profitable, it ultimately will fail. Many dairy enterprises continue to operate at the expense of other, more profitable, enterprises on the farm.
- *Lack of infrastructure*. If there are few dairies nearby, milk hauling costs and prices paid for supplies might rise to the point that the dairy enterprise is no longer profitable.
- *Lack of proper estate planning*. Though wills are in place, the death of a dairy farm owner/manager may force the sale of the unit to generate the price of inheritance taxes. Further, farm assets may be split equally among all siblings in probate court if no will is present.
- *Expensive or inadequate feed*. Feeds, especially forages, may be in short supply and expensive for long periods of time. As in 2002 and 2003, if forage supplies are scarce and expensive and milk prices are low, it might not be possible to access loans to purchase additional feed inventories to keep dairy cows in production.
- *Lack of access to capital*. When access to capital to purchase additional inputs (for example, feed) is limited, oftentimes a hard look at the present financial state of the farm and industry is warranted, to determine if seeking alternative sources of capital is a wise business decision.

If the costs of production are higher than milk revenue, margins are small even when feed supply is adequate, price increases are not imminent and equity is not able to withstand operational losses for an extended time, perhaps it is time to exit. Even if equity is able to withstand anticipated short-term losses, the question of whether operating at a loss is the best option for the family and business, even in the short term, must be considered. Alternatively, if milk prices allow margins to remain strong, feed is available at an affordable price and costs of production are typically low, then the decision may be postponed.

Either decision involves some risk, but those risks can best be reduced by fully understanding costs of production. If based on sound information, there is no shame in exiting the dairy industry; it is simply a business decision. Nearly all non-agricultural businesses of substantial size have exit strategies that were initiated as part of the startup



business plan. Those strategies include description of the signals that warn of lost profits and eroded equity, and outline the process to sell or shut down the business.

When making the decision to exit the dairy industry, the key source of income will be generated from the sale of cattle. There may be additional revenue generated from the sale of machinery and equipment, and remaining feed inventories. On the other hand, if market conditions are part of the reason to consider exiting, others may be doing so, as well. Therefore, it is easy to over-assess the value of cattle, machinery and equipment. Be sure to value assets at a reasonable level. Work with a tax planner to be sure that generated revenues can be used to full advantage. Often it may be possible to maintain ownership of some assets until the subsequent year, to spread income over multiple tax years and lower the associated tax implications.

Financial consultants can advise on investments and the suitability of tax-deferred savings plans. A Cornell study found that deferred taxes on the sale of farm assets can erode 20-40 percent of the farm's equity.

Remember to consider costs of living when deciding whether the farm remains profitable. In 2011, average family cost of living in the U.S. was $43,000 per year, requiring around $48,000 before income taxes. While it is tempting to dip into household income to remain viable in the dairy business, this is not a sustainable business decision in the long term. Cash infusions into the dairy from household income – or even off-farm income – could sustain the business for a while longer, but careful consideration should be given as to whether a dire situation is being prolonged, or the farm is being helped through a one-time challenge.

There are likely to be other alternatives for income, including:

- Focusing on an alternative agricultural enterprise such as raising heifers, producing forages, managing dry cows or concentrating on grain production.
- Conducting in-home business.
- Seeking employment off the farm. Agricultural employment rates have remained very strong even during recent economic downturns.
- Leasing facilities to others to generate some income. In many cases, opportunities for aging facilities might be limited and return little more than the costs of utilities and maintenance.

The availability of an alternative source of income to support the family is a key consideration in when to sell. David Kohl of Virginia Tech lists other important considerations:

- Spouse's employment status. Is the spouse employed and able to at least provide fringe benefits such as health insurance? Also, what is the stability of the employment and the long-term outlook for continued employment?
- What point of your life cycle are you in? Can you easily seek other employment and possibly even go through retraining to learn new skills?
- Contact creditors to obtain releases of security agreements and find out about payback arrangements.

- Are you close enough to retirement? If so, do you have adequate savings to supplement Social Security payments for a comfortable living? Contact your local Social Security office to learn about your expected benefits. If the dairy enterprise has not been profitable, you may not have contributed substantially to Social Security. Lifestyle will partly dictate the amount of retirement savings required. To maintain a $30,000 per year income, a person retiring at age 60 and having a 20-year life expectancy would require the availability of $600,000 from Social Security and retirement savings.

- Consider the costs of sale. Auction managers and clerks typically will charge 5-10 percent to manage sales. There also will be costs associated with assuring the health of dairy cattle (Johne's, mycoplasma, *Staph aureus*, brucellosis, etc.). Be conservative in estimating which animals will sell. If selling the entire herd, the buyer may reserve the right to refuse some animals, which then will bring little more than cull prices.

- Where will the family live? If the farm is sold as part of the exit strategy, a move to alternative housing may be needed. In that case a down payment of as much as $40,000-$50,000 may be needed to purchase a house. Moving costs also must be considered.

Other issues that must be thought through include the expenses of emptying and potentially filling in manure storage pits and lagoons, and examining lease arrangements and other long-term contracts.

The decision about when to leave the dairy business, or any other family business, is difficult and one that must be made based on one's own situation. It can be a very lonely time. Please seek advice and find other ways to remain connected and active, and maintain a positive outlook. The personal impact that leaving the dairy industry can have on one who has been involved in the industry for a lifetime is very great indeed.

Reference

Loren Tauer and Jonathan Dressler, 2010. *When to Exit Dairy Farming: The Value of Waiting*. http://dyson.cornell.edu/outreach/extension pdf/2010/Cornell_AEM_eb1001.pdf

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