Profiles of Successful Strategies for Small Farm Dairies
A project of the Northern New York Agricultural Development Program

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Conservation Easement to the Rescue: Dairyman Finances Start-Up Farm by Selling Development Rights

The Transition

John Farmer* grew up and worked on a small dairy in Northern New York. He attended the University of Vermont, got married, and came home after graduation in 1988 with a "few ideas," which he began to implement.

His family's farm, which had been converted to a heifer farm with a sawmill, had only 30 tillable acres, 75 acres of pasture, and 200 acres of woods. Mr. Farmer set up a rotational grazing system for heifer raising, and baled hay and raised corn on rented land in several locations.

Mr. Farmer worked hard and dreamed of starting his own dairy. But how would he finance it? He needed enough cash to support his family while he grew the farm.

A neighbor with 155 tillable acres, 15 pasture acres, a dairy barn and a tenant house put his farm on the market, and Mr. Farmer wanted it. He went to Farmers' Home Administration (FHA) and explained his equity in the home farm, the new home he had built from timber on his property, the college degree he had earned in animal science and his equity in the 155 heifers he had raised.

* *an alias, farmer requested that his name not be used.*

FHA gave Mr. Farmer the loan in 1996 with affordable monthly payments, and he bought the nearby farm for $145,000. He started milking 55 of the fresh heifers that he had raised.

By now he had two sons and was thinking even bigger. Mr. Farmer decided not to spend a lot of money on tractors but to invest first of all in things to increase milk production. Mr. Farmer contracts out the heavy or specialized work such as plowing, spraying, hauling manure and chopping. He must manage his money to pay the contractors. But, importantly, he has more time to spend with his cows, and he saves on labor and equipment depreciation.

"Fixed costs must be paid for," he says. "I prefer to invest in better management per animal to improve the cash flow."

Here are just a few of the improvements Mr. Farmer has made – all on cash flow – in the cow management area: He installed a scrape alley and manure storage system, developed a comprehensive nutrient management plan, bought a new bulk tank and plate cooler, put in cow water troughs, and lowered and smoothed the feed troughs.

Mr. Farmer has increased cow and heifer numbers by keeping a low cull rate and raising all his heifers.

Even with all of his planning and evaluation, cash flow was still tight as he grew equity and expanded. But Mr. Farmer wanted to build his farm even more, expecting that the business would eventually have to support two families if one of his sons comes home to farm. If this happens, Mr. Farmer would have to buy more land to ensure enough crops to feed his expanding herd. How would he finance this?

Mechanics, Management & Resources

In 2000, Mr. Farmer weighed the pros and cons of selling conservation easements on his farmland. After much thought, he applied for a Farmland Conservation Grant. First, he applied to the local Agriculture and Farmland Protection Board. It, in turn, applied to the New York State Department of Agriculture and Markets for the grant on his behalf.

In 2002 after submitting three applications, Mr. Farmer received a $66,000 conservation sale on the 150 acres of the "new farm." That computes to about $400 per acre for land that he paid $850 per acre, which included a barn and house.

Viable soil types and the percent of tillable acres are major factors in the Department of Agriculture and Markets awarding conservation grants.

Seven factors influenced Mr. Farmer's decision to sell the conservation easement or development rights, rather than pursuing other options such as selling lots for houses:

1. He is in farming for the long haul. Mr. Farmer expects to turn the farming operation over to his children as a viable, profitable business. He doesn't want neighbors who might object to odors or noise from his dairy operation. If he sold off building lots for needed cash, he could have complaints about noise, smells or operating procedures in the future. In addition, he would have fewer acres to farm.

2. He believed that through his management he could increase the value and profitability of his farm faster than the real estate market would increase the development value.

3. The value of the development potential was low to him. "I am not in the lot-selling business," Mr. Farmer says. "I am in the farming business. It is logical for this land to stay open." It made sense to sell something that he didn't want to help reduce the debt on the farm and make some needed improvements.

4. "The value to the community of doublewides will not pay the taxes to put their children through school," Mr. Farmer says. "Our community is becoming a bedroom community to Middlebury, VT. We need viable businesses to keep our community strong." Real property taxes to the community remain the same as with the Ag- Use Value Exemption, so there is no real property tax reduction to the community.

5. Mr. Farmer has seen the cash infusion of conservation easement money significantly help farmers in other states. And he wanted to convert this fixed asset to a liquid asset that could be invested for his future. Farmland with conservation easements is selling at very reasonable rates. Once a group of farmers in an area have all sold their development potential, then other farmers want to move there. It's appealing as they don't have to deal with neighbors who don't understand the needs of agriculture.

6. Mr. Farmer could still expand his farm, raise different crops or sell his land to another farmer.

7. The capital gains taxes on the sale of development rights isn't too high since Mr. Farmer bought the land just six years earlier so his basis was significant.

Mr. Farmer used the conservation easement money to pay down his FHA loan. Though he wanted to use some of the money for cow management improvements, Mr. Farmer's loan officer wanted all of the money toward the principle.

He had hoped to use the money for tunnel ventilation and a mixer wagon. He believed that the two would cost a total of $20,000 and return 5 additional pounds of milk per cow. That would bring in an additional $400 per week, meaning Mr. Farmer could pay off the mixer wagon and ventilation system in a year.

However, his bank thought differently and applied all of the money to the principle. So now Mr. Farmer owes only $59,000 on his FHA loan and should pay it off in seven years, given his current payback schedule. This will save significantly on interest over the original loan of $145,000 for 40 years.

By 2002, Mr. Farmer was financially secure enough to buy another neighboring farm with 200 tillable and 110 pasture acres. The cost: $135,000, or $435 per acre. Since he had so much equity in the rest of the farm he was able to finance the new loan through a local bank at an even lower rate than the initial FHA loan.

The Future

Mr. Farmer has applied to sell the development rights on this “new” property. If he could get the same $400 per acre, his investment in the land would be very low and his potential for production very high. However, the easement program is slow and hard to come by. Mr. Farmer now has 120 milk cows, 100 heifers and a tiestall barn. He milks twice a day, uses no bovine somatotropin (bST), and sells substantial tonnage of crops. He is situated to add more cows in the future and to buy that mixer wagon and tunnel ventilation. He’s dreaming of a heifer barn, too. By purchasing nearby land he has more control and security than when he was renting.

Mr. Farmer wants to “set it up so his son can take over and have an easier time of it. The farm will need to support two families for a time, so I need to grow even more and watch the debt load at the same time,” he says.

Transition Tips

Mr. Farmer has a few words of caution if you’re thinking of selling conservation or development rights. “This program is not for everyone,” he says. “Make sure this is the right decision for you. It is a brass ring if you need it, but if I were 55 and did not have kids, it might not be so attractive.

“Don’t expect a sale to save your farm,” he adds. “It takes a long time. You need to be committed and patient.”

The Northern New York Agricultural Development Program

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