Understanding the Lender's Share of Grower Contract Pay

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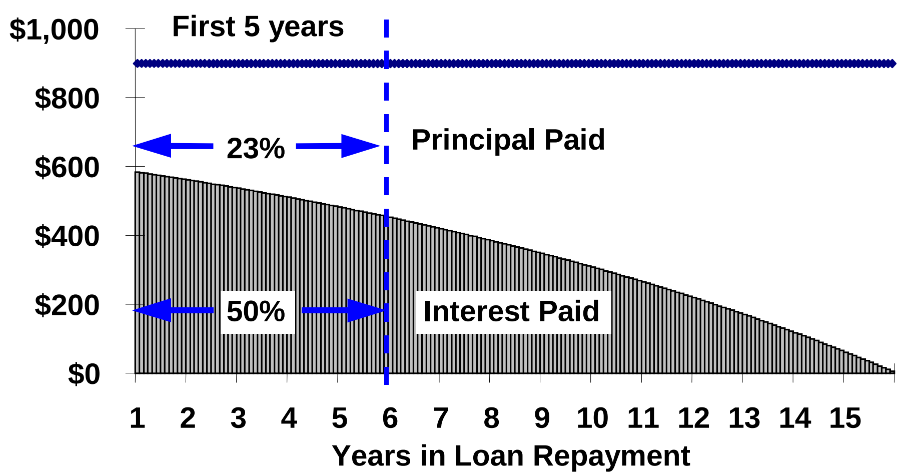
Contract broiler growers take on a large debt load when they build broiler houses. Lenders have incentives to make new loans. Poultry companies have incentives to bring new growers and houses into their complexes. Contract growers, however, are on their own when it comes to understanding the financial impacts of their debt and reducing that debt with income they receive from contract production. Grower debt can be a barrier to the successful operation of their business. The lender's share of a broiler grower's settlement (interest on the principal) can approach 30 percent of a grower's check. New financing programs that reduce grower debt are needed to increase grower net farm income and aid the financial health of the entire sector.

15-year, Fixed Loan Fundamentals

The lender's share of a broiler grower's settlement check is driven by the dynamics of long-term debt. Monthly payments on long-term, 15-year loans (180 months) are made in even increments, but interest and principal are not paid off evenly over the life of the loan. Half of the interest on a 15-year note is paid in the first five years.

To fully understand the cost of borrowed money, it is helpful to look at an example of a loan on $100,000, borrowed at an interest rate of 7 percent for 15 years. The diagram below shows a repayment schedule for 180 months. Each monthly payment is $899 (bold horizontal line). In the first monthly payment, two-thirds ($583) of it is interest with the other third going toward the principal. The interest portion of each monthly payment decreases over the next 179 months.



Over the course of the first five years (60 months), the borrower will have made payments that total nearly $54,000.

In that same 5-year period, half ($31,000) of the total interest on the 15-year loan ($62,000) will have been paid. However, less than one fourth ($23,000) of the grower's total $100,000 debt will have been repaid. If the loan were refinanced at this time, the balance of the principal ($77,000) would be rolled into another 15-year loan. Building upgrades made after five years, that are 20-25 percent of the original investment and rolled into the existing principal, will send the grower back to the start of their debt challenge without having made any progress on the long-term debt load.

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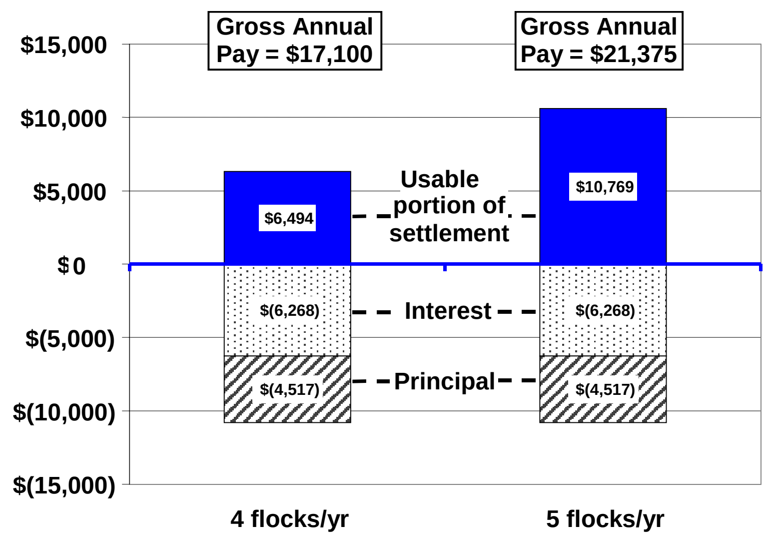
Estimating Grower Revenue

There is very little reliable public data on grower revenue. The good news is that estimating grower revenue is not rocket science. Settlement ranking systems and broiler complex priorities create a system in which everyone's payment is a little different. However, using a value of five cents-per-pound on a 4.5-pound bird produces a return of 22.5 cents-per-bird. If 19,000 birds are caught and processed from each flock, the gross pay per flock, is $4,275. The number of annual flocks vary, but if four flocks go through a house in one year, the gross, annual grower pay, per house, is $17,100. If five flocks are raised in a house in one year, the gross, annual grower pay, per house is $21,375.

Paying Rent on the Borrowed Money (the Lender's Share)

Based on the fifteen-year loan payment plan just described, growers pay the lender an average of $10,785 each year for the first five-years. The average, annual interest payment for the first five years is $6,268. The annual principal payment for the same five-year period is $4,517. The four-flock, grower pay of $17,100 drops immediately to $6,494 (before any other costs are deducted). The usable portion of a five-flock grower pay drops from $21,375 to $10,769.



The $6,268 interest, or 'rent,' on this borrowed money accounts for about 30-35 percent of the gross, annual grower pay. This is a problem by itself, but it gets worse because:

- Growers have only limited security that there will be chickens put in their houses fifteen years out. The bank payment is still due regardless of whether there are birds in the house.
- These numbers do not reflect the additional cost of borrowing money for upgrading houses.
- These numbers do not reflect any of the normal costs of operation that a grower must pay out of the remaining usable portion of the settlement (electricity, equipment, labor, natural gas, litter management). Any short term, operating loan, including those that address the high costs of energy in 2000 or the increasing cost of environmental compliance, would be an additional debt.

The bottom line is that even before getting into discussions of alternative contract settlements, excessive broiler house debt is not in the grower's financial best interest. Given the severe economic stress of the industry, high grower debt loads threaten the financial health of both lenders and broiler companies. Incentives and programs must be developed to reduce grower reliance on borrowed money for the integrated U.S. poultry industry to survive in the long run.

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