RISK MANAGEMENT PROFILES

Exploring Farm Revenue Protection Options

Alaskans Tim and Kathy Dworak have been heavily invested in the peony business for the last six years. They started with just a half-acre of plants but, once those started generating revenue, they quickly expanded to a full acre.

Their 75 laying-hens produce eggs that they sell through a local coop. Kathy has been taking primary responsibility for the farming operation, while Tim's full-time job at a local construction company provides the couple with health insurance and retirement benefits.

Kathy and Tim have approached their farming activities as a healthy hobby that generates enough cash to pay for itself. However, with the second half-acre of peonies now producing revenue, their dream of being profitable farmers is becoming a reality.

The Dworaks are starting to think big in terms of what their business could look like in the near future. One aspect they did not anticipate was a mutual interest in doing a better job of managing the risk in their operation. Kathy took it upon herself to explore what kind of risk management tools are available as they think about their plans and ambitions for expanding the operation.

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Kathy located the USDA Risk Management Agency (RMA) website (rma.usda.gov) and began exploring what crop insurance programs are available in Alaska. She found that Alaskan producers could buy crop insurance for barley, cabbage, forage production, oats, potatoes, and wheat. She also found that the Whole-Farm Revenue Protection (WFRP) pilot program was available in Alaska.

U.S. Department of Agriculture
Risk Management Agency

Kathy next investigated what programs are available from the USDA Farm Service Agency (FSA) to help manage risk. She discovered that the FSA Disaster Assistance Programs offer a Noninsured Crop Disaster Assistance Program (NAP). NAP provides financial assistance to producers of noninsurable crops when low yields, loss of inventory, or prevented plantings are experienced due to natural disasters. Disasters can include weather events such as drought, hail, excessive winds, excessive moisture, freeze, tornados, hurricanes, and floods, as well as earthquakes and volcanic eruptions.

Kathy decided to first check further into the WFRP program to see if it could be used to manage the risks associated with producing peonies and eggs. Then, she would delve further into NAP to see how it might fit their operation.

Whole-Farm Revenue Protection offers producers an opportunity to insure all eligible farm commodities on under one insurance policy. It uses the operation's whole-farm, historical average revenue and expenses from five consecutive tax-years as the basis for coverage. Adjustments are made according to WFRP policies, but the intent of the program is to match, as best as possible, the whole farm revenue protection needs.

FARM SERVICE AGENCY

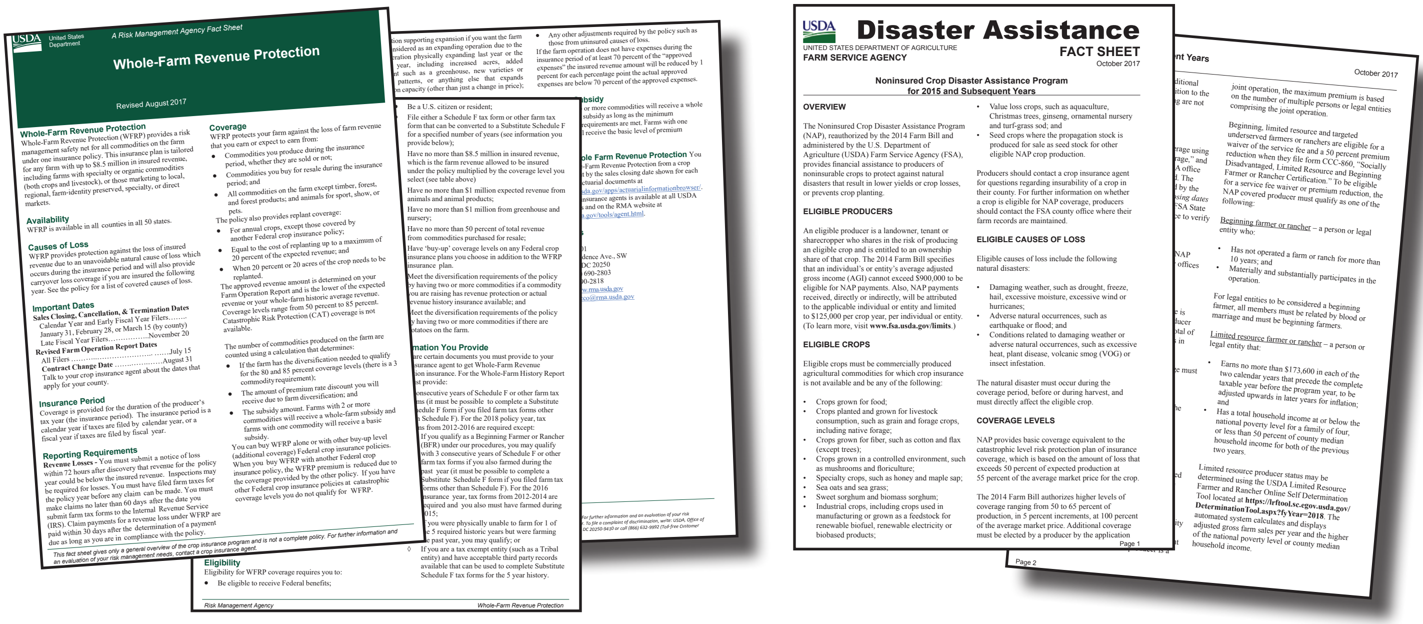
Kathy discovered that up to $8.5 million of revenue could be covered and that it fit well with operations like theirs that are marketing into specialty or direct markets. Expanding operations are accommodated under WFRP with a provision that allows the insurance company to approve the operation as an expanding operation with the potential to produce up to 35 percent more revenue than the historic average. The new value can then be reflected in the insurance guarantee.

The expected revenue from nursery and greenhouse production that can be covered under WFRP is limited to $1 million maximum. Kathy knew the $1 million maximum was not a problem, given that their estimated total annual revenues were closer to $130,000 (Table 1). She also noticed that revenues generated by crops grown in a hoop house are not protected by WFRP.

Kathy learned that diversification of farm production is an important consideration under WFRP in terms of the level of coverage available and what it costs the producer. For example, two or more commodities to count would allow them to receive an 80 percent premium subsidy for any level of coverage between 50 percent and 75 percent of their revenue. If

Table 1: Estimated Annual Revenues

	Units	Unit Price	Number of Units	Total Revenues	Percent of Revenues
Peony stems	stems	$4.00	32,000	$128,000	96.3%
Eggs	dozen	$5.00	975	$4,875	3.7%
Estimated Annual Revenues				$132,875	100%

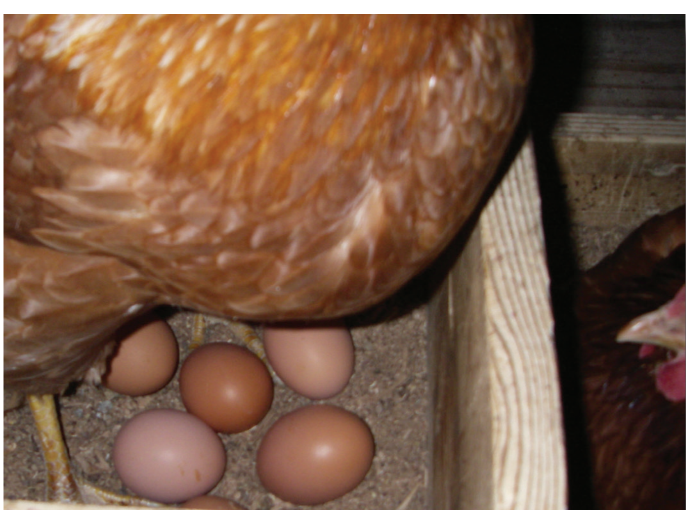


they could count egg sales as a second commodity, it would make a big difference.

Kathy read where the WFRP commodity count is based on achieving 1/3 of the revenue needed for perfect diversification. In their case, a 2-commodity farm would receive 50 percent of its revenue from each commodity for perfect diversification. In order to count, the second commodity must provide at least 1/3 of 50 percent of the revenue or 16.7 percent.

Dworak's egg revenue makes up only 3.7 percent of their expected revenue. Kathy read where commodities can be grouped together to reach the threshold. However, they don't produce anything else.

With only one commodity to count, their premium subsidy would be limited to somewhere between 67 and 55 percent, depending upon the level of revenue coverage selected. Kathy thought this might work for them, but it was time to look at what NAP coverage might offer.



The Dworak's peony crop is eligible for Noninsured Crop Disaster Assistance Program coverage. Basic NAP coverage is offered at the catastrophic (CAT) level for a service fee of $250 per crop. However, CAT coverage provides protection only for the value of any loss over 50 percent of expected production, based on the approved production history (APH). Furthermore, CAT protection only pertains to losses at 55 percent of the average market price for the crop. This didn't seem like much protection to Kathy, but she discovered that buy-up coverage was added to NAP in the 2014 Farm Bill to make it more appealing to producers like she and Tim.

NAP buy-up coverage would allow the Dworak's to cover up to 65 percent of their APH at 100 percent of the expected market price. Furthermore, market price, which historically had been established on a state-by-state basis (within a state everyone shared the same average market price), now more accurately reflected the intended use of the crop.

FSA has the flexibility to establish average market prices based on different markets for producers who elect buy-up coverage and can provide acceptable documentation of those prices. Kathy thought that their marketing agreements for peony stems would help them in this regard to more accurately protect the value of their production.

Buy-up coverage premiums under NAP are estimated based on 5.25 percent of the revenue guarantee. By Kathy's calculation, this means that coverage of their $128,000 of peony revenue would cost them around $4,368 in buy-up premium at the 65 percent coverage level ($128,000 x 65 percent x 5.25 percent), plus the $250 service fee. If their production level dropped below 20,800 stems (32,000 x 65 percent), they could be eligible to collect a NAP payment that would bring their revenue back up to the insured level ($83,200).

Kathy discussed her findings with Tim. They decided that the next step would be to contact their local FSA office and set up an appointment to learn more about how NAP might help them manage their revenue risk. They also decided they should find a licensed crop insurance agent to discuss WFRP.

Right now they are more worried about protecting against yield losses than revenue losses, because they have marketing contracts in place. However, they see how WFRP could provide more overall protection. They feel that they need to learn more about WFRP and how it compares to the protection offered by the NAP program.

Additional Resources:

RightRisk Courses
http://RightRisk.org > Courses

RightRisk Risk Analysis Tools
http://RightRisk.org > Resources

USDA Risk Management Agency
http://www.rma.usda.gov

USDA Farm Service Agency
http://www.fsa.usda.gov