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*Knowledge for the Commonwealth*

## Family Living Cost Major Factor Driving Business Size

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Estimating family living costs on farms and small businesses can be one of the most difficult challenges facing the farm and small business manager, as well as the professionals working with these businesses. Typical reasons for this difficulty include poor accounting practices and a lack of agreement by professionals and business owners on which costs should be included in family living costs.

### Current Level of Family Living Cost

When conducting producer, small business, and lender workshops, one of the most frequently sought numbers is family living cost. Historically, there has been little information as to what costs are included in family living expenses. Table 1 contains data that were collected by the Nebraskaland Farm and Ranch Management Education Program. It provides an excellent reference point on levels, trends, and what expenses are included in family living costs. In 1995, the average family living cost for 64 producers with an average family size of 2.2 was approximately \$32,000 before income taxes, with food and health-related costs comprising nearly one-third of the total. Other data from Cornell, Minnesota, and Illinois farm records suggest similar family living costs with a \$32,000 pre-tax average and a variation of \$4,000. Family size and needs, such as education and health care, also have a large impact on these costs.

### Trends in Cost

Table 1 illustrates that total nominal family living expenses have increased approximately 60 percent in the last nine years (1986-95) from \$20,000 to \$32,000. In 1978 these costs were \$7,800 for similar size families. As expected, health care costs nearly doubled since 1986, while expenditures for personal and miscellaneous items increased dramatically over the period. People who attempt to reduce family living costs find that miscellaneous costs are frequently the most difficult to control. If not monitored closely these "other" costs can create tremendous overruns in family budgets. People frequently comment that it is easier to manage the larger costs in family budgets than the smaller costs.

It is interesting to note that food expenditures were nearly 16 percent of the budget, higher than the national average of 10 to 12 percent. Also, according to USA Today, 46 percent of all meals are eaten outside the home, nearly double from 20 years ago. It appears similar habits are found in farm families. Research conducted at Virginia Tech by Dr. Alex White found that farm living costs have increased 7 percent annually in recent years, although in the last 2 years, it has slowed to a 4 percent annual increase. Also, a recent USA Today poll indicated that a typical 65-year-old family in retirement is spending 125 to 157 percent more than the 35-year-old couple. Thus, spending habits are not reduced with age.

## Greater Fool Zone

Many producers and business people are surprised when they actually construct a family budget. Research suggests that 12 to 17 percent of family expenses are included in business expenses. Also, credit card and personal debt have been excluded from these budgets and, when included, provide a more accurate representation of actual family living cost. An exercise Dr. David Kohl has done with his lender groups is to have them play "Top This Credit Amount!" In recent seminars, it was very common to hear figures such as \$60,000 or more on 20 to 25 credit cards. The all-time high was a \$345,000 balance on 19 credit cards. Thus, an accurate accounting of true costs is necessary to determine if the family is living within the lifestyle that earnings from the business and off-farm salary can sustain.

Family members who are over-extended on their budgets often reduce insurance coverage or increase the deductibles on health, disability, and other insurance. If this is the case, it is recommended that two to six months of family living costs be placed in a "rainy day fund" for emergencies. Some families take out a home equity or farm equity loan, or withdraw funds from tax deferred retirement accounts to meet living needs. This strategy only postpones the inevitable equity depletion.

## Implications

The increase in family living costs that exceed the rate of inflation in recent years has some serious implications to the farm family.

First, most businesses are required to have the necessary size and bottom line profits to meet expanded lifestyles. Generally speaking, a business will have to gross at least \$200,000 to \$250,000 in sales or \$40,000 to \$70,000 of net income to generate sufficient earnings for the living needs of one family unit. It is interesting to note that only 33 percent of all farm businesses and one-half of all small businesses surpass these figures.

Second, if the business does not generate sufficient earnings, employment outside the business will be necessary. Nearly 70 percent of all farmers report earnings from a non-farm job. Research suggests that 50 percent of non-farm income comes through wages and salary, 25 percent through Social Security and pensions, and 25 percent with earnings from other businesses. It is also estimated that 50 percent of all small businesses require earnings outside the business to generate a sufficient income for the lifestyle of the owners.

Third, remember the old adage -- "It's not how much you earn, it's how much you spend." To really know what your spending habits are, monthly budgeting is a necessity. There are many computer programs available to assist a family in this task; however, the bottom line is the Nike slogan -- "Just do it!"

White, Alex B. "Farm Family Living Expenses," unpublished document, November 1993.

<b>Table 1. 1986 and 1995 Family Living Summary</b>		
<b>Expense Item</b>	<b>1986</b>	<b>1995</b>
Food	\$3,850	\$5,010
Clothing	1,426	2,167
Personal Items	910	3,927
Education	416	788
Recreation	740	1,767
Utilites and Fuel	1,562	1,330
Minor Repairs	595	789
Insurance (Life and Home)	1,769	1,926
Gifts	774	1,477
Medicines	2,481	4,580
Doctor, Hospital, Health Insurance		
Church and Charity	1,338	2,010
Personal Interest	236	405
New Furniture and Equipment	590	246
Home Improvements	516	-----
Miscellaneous	1,897	3,833
Personal Auto	838	1,449
Total	\$19,938	\$31,704
Number of Families Included in Average	60	64
Average Family Size	3.9	2.7

Source: Nebraska Farm Business Association, 6-10-96.

1995 data includes data collected from Nebraskaland Farm and Ranch Management Education Program.

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