UW Growing
Beginning Farmers & Ranchers

Getting Started In Ag: Credit and Financing

People are drawn to a life in production agriculture for numerous reasons. These include values like lifestyle, family aspects or owning your own business. Becoming well-versed in financing and its nuances is not a topic on the list of reasons for getting into farming or ranching for most.

If you are getting started or have been in the business a while, it is important to arm yourself with as much financial information as possible. Production agriculture is an expensive business. The price of capital entry is high (land, machinery, livestock), it often takes lots of expensive inputs, and margins can be low. Most producers require some financing to operate, whether it is an operating line of credit, loans for livestock, machinery, or land.

It is important to familiarize yourself with the many aspects of financing, both in general terms and those specific to your individual business. This research can be thought of as a form of risk management. You are better prepared to take advantage of opportunities when they arise, as well as stand ready for challenges and issues as they appear.

FINANCING BASICS

Most financing is divided into three types: short term, intermediate term, and long term. Short term financing is usually defined as one year or less and includes credit cards, lines of credit, and operating notes. Lines of credit or operating notes usually include terms of repayment that are either fixed or variable depending on cash flow and other factors. Interest may be set at a fixed or variable rate. Intermediate financing is usually somewhere between two to ten years. This type of financing is often used for bigger purchases that would otherwise not be paid for within an operating year, such as livestock, machinery/equipment or other non-real estate capital purchases. Long term financing can be anywhere from five to 30 years and is usually obtained for real estate purchases such as land, buildings or other long-term improvements.

Loans are almost always based on an amortization schedule. Payments are calculated using an interest rate, number of years and the number of payments per year. Interest is calculated for each payment, Figure 1. A loan of $25,000 financed for five years with monthly payments at five percent interest will require a monthly payment of $471.78.

Enter values	
Loan amount	$ 25,000.00
Annual interest rate	5.00 %
Loan period in years	5
Number of payments per year	12
Start date of loan	3/1/2021
Optional extra payments	$ -

Loan summary	
Scheduled payment	$ 471.78
Scheduled number of payments	60
Actual number of payments	60
Total early payments	$ -
Total interest	$ 3,306.85

Lender name: Example Bank

Pmt No.	Payment Date	Beginning Balance	Scheduled Payment	Extra Payment	Total Payment	Principal	Interest	Ending Balance	Cumulative Interest
1	4/1/2021	$ 25,000.00	$ 471.78	$ -	$ 471.78	$ 367.61	$ 104.17	$ 24,632.39	$ 104.17
2	5/1/2021	24,632.39	471.78	-	471.78	369.15	102.63	24,263.24	206.80
3	6/1/2021	24,263.24	471.78	-	471.78	370.68	101.10	23,892.56	307.90
4	7/1/2021	23,892.56	471.78	-	471.78	372.23	99.55	23,520.33	407.45
5	8/1/2021	23,520.33	471.78	-	471.78	373.78	98.00	23,146.55	505.45
6	9/1/2021	23,146.55	471.78	-	471.78	375.34	96.44	22,771.21	601.90
7	10/1/2021	22,771.21	471.78	-	471.78	376.90	94.88	22,394.31	696.78
8	11/1/2021	22,394.31	471.78	-	471.78	378.47	93.31	22,015.84	790.09
9	12/1/2021	22,015.84	471.78	-	471.78	380.05	91.73	21,635.79	881.82
10	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Figure 1. Loan amortization schedule

THE IMPORTANCE OF FINANCIAL STATEMENTS

There are some basic steps to consider before applying for any kind of loan to increase your chances of repaying the loan. The first is assembling financial statements. This is important because you need a comprehensive view of your financial situation before you accept any debt. It is much more difficult to convince a lender to make a loan when you don't have a good grasp on your financial situation. Financial statements provide a picture of what a lender considers when evaluating credit needs. They allow you to better understand your business's financial position, as well as overall performance, offering opportunities to make adjustments for success.

The four key financial statements include the cashflow statement, an income statement, balance sheet, and statement of owner equity. The cashflow statement illustrates the sources and uses of cash, as well as the monthly inflows and outflows. There are two types of cashflow documents: 1) statement or historical, using actual data from a past period and 2) budget or forecast, which attempts to predict inflows and outflows for a future period, Figure 2. Formulating a cashflow budget helps to identify when cash deficits might occur and how they will be addressed, making it an important tool for both borrowers and lenders. Income statements show all income and expenses for a given year and provides the measure of profitability for your business. The balance sheet shows the values of your total assets and liabilities. The owners' equity statement builds off the balance sheet and income statement to indicate the change in equity or net worth compared to a previous period.

IMPORTANT FINANCIAL RATIOS AND CREDIT SCORING

Lenders consider many aspects of the financial statements and the overall business by using ratio analysis when assessing a loan application. These ratios provide a snapshot of the business standing and performance; they cover business liquidity, solvency, profitability, repayment capacity and financial efficiency, Figure 3. The analysis associated with these ratios may seem daunting at first, however, it is important to familiarize yourself with as many of these as possible. Knowing and understanding the financial strengths and weaknesses of the business can make you better prepared for questions and concerns that may be raised by the lender.

FOR MORE INFORMATION

Visit RightRisk.org for more resources to learn about obtaining financing. RightRisk.org is a premier risk management education site designed to assist producers with risk management planning. Numerous tools and resources are available to learn more about financing and evaluate alternatives. Visit farmanswers.org for additional tools and resources tailored to new and beginning farmers and ranchers.

Credit scoring approaches vary by lender. They are generally a combination of financial ratios and other factors; including loan collateral, character assessment, repayment capacity, and other factors that may be external to the business, such as commodity and input prices. The better prepared you are to address these factors, the better are your chances of obtaining approval for the loan.

SOURCES OF CREDIT

Numerous resources are available for new and beginning producers. There is no single, best source for credit; it depends on individual needs and identifying a lender who is willing to work with you. The USDA Farm Service Agency (FSA) has both direct and guaranteed loan programs for new and beginning producers. Guaranteed loans are made with a commercial lender and with FSA backing for the loan, enhancing the loan from both the borrower and the commercial bank's perspective. FSA also offers small project loans that can provide young producers access to capital. Farm Credit Services (FCS) offer Young & Beginning Farmer Loans, as well as Development Funds designed to enhance working capital and assist with livestock facility expansions for young and beginning producers.

In addition, many states, including Wyoming, have beginning farmer/rancher loans available for real estate purchase that include a reduced interest rate. State-based or federal grant programs or subsidy programs are other possible sources of financing. Some managers can combine sources of credit and other financial backing to springboard their business to success. The key is to understand your business structure and performance and how outside financing will help it move it forward.

Projected Cash Outflows

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL
Cash Outflows													
Seed & Plants													
Fuel & Lube													
Insurance													
Supplies													
Utilities													
Labor													
Storage													
Miscellaneous													
Subtotal													
Total Loan Payments													
Total Cash Outflows													

Figure 2. Example cashflow budget form

		Beginning	Ending
Off/On	**Liquidity**		
	Current Ratio	1.63	1.56
	Working Capital	$54,034	$48,554
Off/On	**Solvency**		
	Debt/Asset Ratio	0.134	0.122
	Equity/Asset Ratio	0.866	0.878
	Debt/Equity Ratio	0.16	0.138
Off/On	**Profitability** <<<Accrual Basis Income Statement>>>		Ending
	Rate of Return on Business Assets		0.76%
	Rate of Return on Business Equity		-0.07%
	Operating Profit Margin Ratio		0.05
	Net Business Income		$47,681
Off/On	**Repayment Capacity**		
	Term Debt and Capital Lease Coverage Ratio		1.07
	Capital Replacement and Term Debt Repayment Margin		$5,975
Off/On	**Financial Efficiency**		
Mouse Over to see Ratio Formulas.	Asset Turnover Ratio		0.14
	Operating Expense Ratio		0.74
	Depreciation Expense Ratio		0.11
	Interest Expense Ratio		0.06
	Net Farm Income From Operations Ratio		0.08
	Check Sum		100.00%

Figure 3. Example financial ratio analysis

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