Workshop: Farm Viability, Business Planning, and Transfer
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Can the Farm Business survive a transfer to the next generation or owner?

“Equity” is the value of an ownership interest in property. Unfortunately, many retiring farmers view generational transfers of farm businesses as a problem of extracting the value of their equity from the business while simultaneously finding a way for the next generation to take on enough debt to buy them out.

This usually means that the focus is more on the transfer of equity than on the continuing operation of the farm business. It seems that everybody takes their eye off the primary goal, which is to keep the farm business operating profitably for the next generation. But the survival of the farm business depends on continued earnings, and that won’t happen unless there’s a plan for transfer of business management skills.

There’s nothing wrong with borrowing money to buy out the older generation—as long as there’s a good plan on how the loan is going to get paid back. In order to finance a buy out by the younger generation, a lender wants to see demonstrated business operating capacity. There is no substitute for business skills, and there is no better way to demonstrate ability than historical records of achievement. Plain and simple, the younger farmer has to have had real supervisory responsibility on the home operation or working for someone else in a management position. That means that transition planning has to include a few years’ time where the younger generation actually has to run things in order to develop a track record.

Furthermore, the younger farmer has to be able to show their executive talents by communicating the knowledge and judgment they’ve gained in a business plan. It’s not that lenders don’t want to take any risk, it’s that they want to minimize risk as much as they can by knowing the borrower’s likelihood to earn money from the farm business and then manage it well enough to pay back the loan.

Lenders want to see young farmers who are willing to put some of their own money at risk. Ideally, that means having 30 to 50% net worth (what you own minus what you owe on it). But that can be lower if there is a track record of earnings, cosigners on the loan, pledging of assets by others, gifts of money or property, or a combination of factors that shows there is the ability to withstand things going wrong in the business. There should be a 60 day reserve of cash, and enough excess borrowing capacity so that an operating line of credit never has to rely on borrowing the last dollar available.

You’ve heard it before and if you are going to transfer a farm business to the next generation you’ll hear about it again: Lenders are interested in the 5 C’s of credit: Capacity to repay from earnings, Capital you are willing to risk, Collateral pledged, Conditions that mitigate risk, and Character of the borrower.