

Dennis Kauppila

Farm Business Management Specialist
University of Vermont Extension



Your First Farm Loan

If you are looking at your first farm loan, chances are you need some money to capitalize the start-up of a new farm business or to increase the inventory (livestock, for example) or otherwise expand an existing farm.

Getting that first agricultural loan can be a challenge. Sometimes it is hard to even get in the lender's door. The paperwork they need doesn't seem realistic. Why do they want so much information? Why did they give a loan to that person and not to me? This factsheet will help answer these questions as well as give some tips to keep in mind as you explore agricultural financing options.

Types of Loans

Banks and other lending institutions think about loans as being either for personal or for business purposes. Personal loans include a home mortgage or loans for a car or truck or other personal purchases. Business or commercial loans may be used for buying real estate, equipment, working capital, or a line of credit for a business.

Which loan department will you go to? If your home or car is the collateral for the loan and your wages are going to make the payments, you need to go to the personal loan department. Even if you are starting a business, your home may still be considered collateral for the loan, and your wages may continue to make payments until your business gets off the ground. Once your business is in good shape, then the lender may choose to move you over to the business department.

Getting Approved for a Loan

Approval for a loan will depend upon how well you present yourself, your business and your financial needs. The first step is to ask yourself exactly how much money do you need? Why do you need it? How will you pay it back? Your chances of receiving a loan

In most cases, approval will depend upon how well you present yourself, your business and your financial needs.

will depend on how prepared you are to answer these questions. Lenders will look at your credit worthiness, your experience and training, and business management skills. When reviewing your loan application, a lender will likely use the "Five C's of Credit" to assess your business (see page 2).

Business Plans

A loan proposal or business plan is the best way you can demonstrate to a lender your understanding of and commitment to the success of your business. Before you approach any lender, it is important to prepare this paperwork to convince them you're a good risk.

Lenders expect that you know your business and understand your finances. The more informed you are, the better your chances of getting the financing you need. If you want to borrow money, you must be

The Five C's of Credit

A lender will likely use the following “Five C's” when reviewing your loan application.

- **Capacity** to repay the loan. *The lender will look at the financial ability that you and your farm has to pay back the loan based on the history of the farm, on-going cash flow, and assets you hold.*
 - **Capital** or the money you have already invested in your business. *Do you have sufficient capital to support ongoing operation of the farm as well servicing debt? Better still, do you have enough capital to operate the farm during tough times?*
 - **Character** or the general impression you make on the lender. *This is a subjective judgement on the part of the lender as to whether you and your business idea will succeed. They will look at your qualifications, experience and management skills, as well as your personal credit. The better you are prepared before you meet with a lender, the better your chances of making a good impression on the lender with regard to character.*
 - **Collateral** are the assets you own that the lender uses as a backup to recover funds if you happen to default on the loan. *Think about the assets that you will put up as collateral. Is the liquidation value of these assets sufficient to pay back the lender in case of default?*
 - **Conditions** surrounding the intended purpose of the loan. *How risky is your farm enterprise? What are the current economic trends of the farm's commodity and/or markets? Do they make your future success more or less likely?*
-

able speak the language of finance. So it is important that your proposal or business plan include basic financial statements like a *Balance Sheet* (or Net Worth Statement), *Operating Statement* (or Profit and Loss), and *Cash Flow Statement*. Most lenders will also want to see income tax returns from previous years.

What Do Lenders Look For?

Above all, lenders think about risk. Are you a good risk for their money? Should they invest in you? Most lenders have a goal of making a profit for their shareholders. All lenders have a primary goal of getting their money back, with interest. To ensure these goals are met, lenders will measure the amount of risk you pose. Higher risk may mean that you need to offer more collateral, pay a higher interest rate, or that you will not be able to receive the loan.

How is your credit history? Are you up-to-date on payments, loans, credit cards, and taxes? If not, you aren't a very good risk. If for some reason you don't have a good credit history, you may have to prove yourself for a few years, then return with another proposal.

All lenders expect to be paid back. They want to know that the business they lend to will generate enough cash to pay back the loan and make additional money (for paying their costs of operation and for profit). No lender will loan you all of the money you need for a project; they expect you to be risking some money as well.

Lenders will take the information that you give them, study it, and make a decision as to whether or not they want to take a chance on you. They will need to have their names on more collateral than just the asset that you buy with the borrowed money. This gives them some security that their money will be recovered if you default on the loan. As a rule of thumb, they need to have about \$150 worth of collateral for each \$100 that they loan. This is how

they can be reasonably assured of getting the \$100 at auction for that piece of now-used equipment even if it's raining on auction day. Most lenders will also want to see that you have at least \$110 available to repay \$100 of principal and interest, above and beyond all other operating expenses and family living expenses.

Your First Agricultural Loan

In today's world, it is unusual for a lender to make a first loan to a person looking to *buy* a farm. More likely, a first loan might be used for livestock or equipment, but probably not for a brand new herd/flock or your first piece of farm equipment as these may be too risky. Most lenders expect to see you make the first investment. Then, after a couple of years of managing the business, you might be able to borrow to expand. Or after successfully operating equipment for a few years, you may be able to borrow to get additional equipment or a newer tractor.

In today's world, it is unusual for a lender to make a first loan to person looking to buy a farm.

Start up businesses are very risky. It only takes a few hours for a top-notch animal to end up a cull, equipment can turn into spare parts after just a little poor maintenance, and crops can be instantly unmarketable due to damage caused by a mis-identified insect. Always think about a "Plan B". Think about your risks and how you will address them before they occur.

Your Loan is Denied--Now What?

If your loan application is turned down by a lender, federal law requires that the lender tell you, in writing, the specific reasons for the denial. You may be denied because one of your "Five C's" is weak,

you have poor credit, or simply that the financial institution isn't familiar with the type of agricultural business in which you are interested.

Don't lose heart. Each time you bring your plan or proposal to a lender, you gain experience.

If your loan is turned down because of a poor credit report, you may request a free copy of the report from the credit report company. Check it for accuracy and completeness as you have the right to dispute any errors. If you have a poor credit history, start repaying outstanding balances on time to re-establish an acceptable record and then try to apply for a loan again.

If you are still unable to get credit, you can try get a loan with other lender as different lenders have a slightly different qualifying standards. Or you might consider asking a friend or relative with an established credit history to act as a co-signer for you.

Some farmers with whom I have worked have taken several years to get the loan they want for their farm. Don't lose heart. Each time you bring your plan or proposal to a lender, you gain experience. Sometimes it is a good idea to go to a lender to just get information, not money. I have seen this work with farmers on rented farms, who want to buy a place. They worked for several years with a couple of lenders, and finally, after a number of denials, they got the money to buy a farm.

So, getting that first agricultural loan can be a challenge. It may even seem like more work than farming is. But if you think about your farm as a business and prepare before you meet with a lender, you will have a better chance of long-term success on the farm.

The following table compares some organizations that lend to the agricultural community in Vermont. This is not an exhaustive list but may give you some ideas of the types of organizations available for farm financing.

Type of Lender	Examples	Types of Loans Offered	Take money on deposit?	Offer checking?	Mandatory to buy shares/stock?	Source of their money
<i>Commercial Bank</i>	<i>Chittenden Lyndonville Savings Merchants Peoples Trust Company (For Internet sites for these and other banks, see http://www.compasscg.com/banking_links/vermont.html)</i>	<i>Operating Chattels Real Estate Home Equity Lines of Credit</i>	<i>Yes</i>	<i>Yes</i>	<i>No</i>	<i>Deposits</i>
<i>Cooperative Farm Lender</i>	<i>Yankee Farm Credit (802) 879-4700 http://www.yankeeaca.com/</i>	<i>Operating Chattels Real Estate Lines of Credit</i>	<i>No</i>	<i>No</i>	<i>Yes</i>	<i>Wall Street bonds</i>
<i>State Agency</i>	<i>Vermont Agricultural Credit Corporation (formerly VEDA) (802) 828-5627 http://www.state.vt.us/veda/</i>	<i>Operating Chattels Real Estate</i>	<i>No</i>	<i>No</i>	<i>No</i>	<i>State of VT appropriation and bonds</i>
<i>Federal Agency</i>	<i>Farm Service Agency (formerly FmHA) (802) 658-2803 http://www.fsa.usda.gov/</i>	<i>Real Estate and Operating for Beginning Farmers Loan Guarantees</i>	<i>No</i>	<i>No</i>	<i>No</i>	<i>Federal treasury</i>
<i>Community development financial institution</i>	<i>Vermont Community Loan Fund (802) 223-1448 http://www.vclf.org/</i>	<i>Real Estate Line of Credit Operating</i>	<i>Yes</i>	<i>No</i>	<i>No</i>	<i>Private investors</i>
<i>Non-profit development corporation</i>	<i>Area and Local Revolving Loan Funds</i>	<i>Operating</i>	<i>No</i>	<i>No</i>	<i>No</i>	<i>Federal monies matched with local sources</i>

Many thanks to Sarah Isham and Charles Keeler, Vermont Agricultural Credit Corporation, and Mary Peabody, UVM Extension, for reviewing this factsheet.

This publication is one of a series developed for the Land Link Vermont, a program of the University of Vermont Center for Sustainable Agriculture. Land Link Vermont connects farm seekers and farmland owners and provides them with information to make informed decisions about farm transfer in Vermont.



LAND LINK VERMONT
 UVM Center for Sustainable Agriculture
 590 Main Street
 Burlington, Vermont 05405-0059
 (802) 656-0233 or (802) 656-5459
<http://www.uvm.edu/landlinkvt>



Printed Autumn 2000

Published and distributed in furtherance of Acts of Congress of May 8 and June 30, 1914, by University of Vermont Extension and the U.S. Department of Agriculture cooperating. Cooperative Extension and other agencies of the USDA provide equal opportunities in programs and employment.