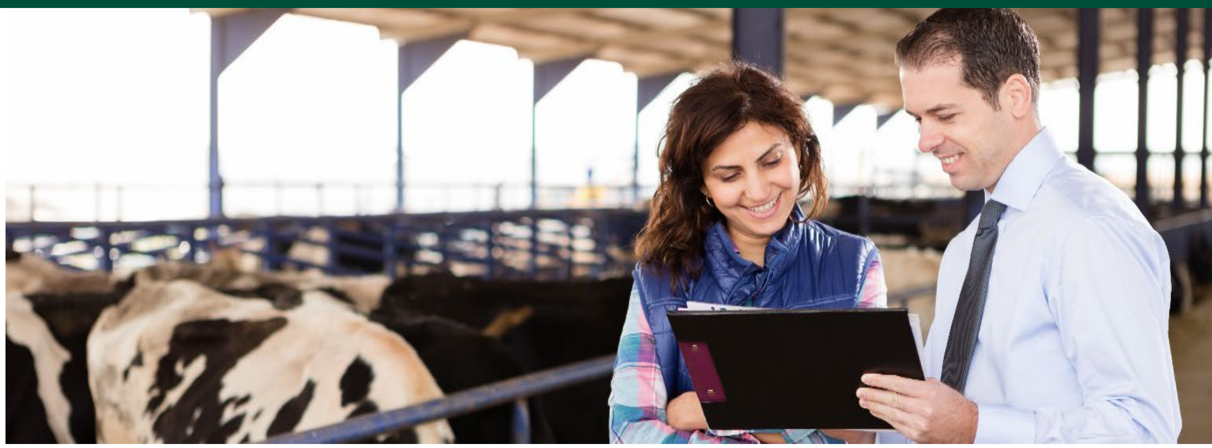
DEMaND

Developing and Educating Managers and New Decision-makers



Are you planning to be the next generation farm operator? Whether you represent the transition of generations, or that of employee to owner or as a new entrant to the business, a fresh look at management will be necessary. Michigan State University Extension offers help to beginning farmers with this transition through the Beginning Farmers DEMaND series offering articles, workshops and additional resources.

How to Motivate Your Lender to Say, "Yes"

Understanding the Lending Process

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Making your first request for a farm loan is an important moment for you as a young or beginning farmer. It's when the whole idea of running your own business truly becomes real for you. It is something you have thought about and worked hard for a long time to achieve. You want the lender to understand and acknowledge your commitment as well as be impressed with your ideas for the farm. Simply put, you want that lender to say, "yes!" to your plan and make an investment in your farm.

Believe it or not, lenders think about their impact on a young business every time they get a loan request. They know that there is a lot more to that request than just the money being requested. Lenders want nothing more than to see these new operations be successful.

Lenders also know that newly established farms carry more risk than more established operations. This means that lenders often proceed with caution and require added assurances that the loan will be repaid. This is not only for the well-being of the lender but also for your benefit as well. They need to know that you understand all the risks involved and are prepared to assume the role of farm manager in future dealings with them. Knowing how to provide these assurances can make the loan process much easier and better ensure a "yes" to your loan request.

How can you provide assurance to the lender? Start by understanding the parts of the loan process and what the lender wants to see.

Knowledge & Experience

One of the key phrases that you will hear is "management experience." Beginning farmers need to be aware of this important topic. This can stop your loan request before a lender has looked at a single piece of financial information. They need to know that you understand the production and management responsibilities on the farm. Have you made decisions that have had a significant impact on the farm's production, financial success or both?

Were you involved in deciding what seed would be planted? What feed mixture and rations would be fed to the livestock? Did you have any input in the crop protection plan for the farm? What about the fertility plan used in the greenhouse or nursery?

If your answers to these questions is "no," the first step is to seek out opportunities on the farm to begin building your management experience. Speak with the current manager at your own farm and express your desire to build your experience as a decision-maker. A helpful resource is the Michigan State University (MSU) Extension bulletin *Transitioning From Labor Force to Decision-Maker* (E3406), which offers helpful suggestions on the steps you can take to gain the necessary knowledge and experience you'll need to be successful.

Be prepared to discuss your experiences in making decisions when meeting with the lender and highlight the impacts your actions have had on the business. The lender needs to have confidence that you can manage key situations.

Credit History

A credit report is a collection of information about your borrowing or credit history. Lenders look at an individual's history as a predictor of his or her repayment habits in the future. Have you paid on time? Do you carry large amounts of debts? Are there any outstanding collections for debts you stopped paying on? All of these questions are collected and summarized in your credit score. Get a copy of your credit report and familiarize yourself with its contents. Knowing what is in your history prepares you to discuss any problem areas or concerns ahead of time.

Remember that a score of 700 or above is considered good credit by a lender, while anything below 600 is considered high risk. Number of credit inquiries, amount of outstanding debt, amount of late payments and even the type of debt you have outstanding can affect your credit score. Be familiar with your credit score prior to meeting with your lender so you can talk about your score as part of your credit history.

To obtain a copy of your credit report, go to www.annualcreditreport.com, call 1-877-322-8228 or write to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. Be sure to obtain a credit report from each of the three bureaus (Experian, Equifax and TransUnion) as each one reports differently and may contain information the others do not have available.

Risk Management

Risk management plans are as important as production and marketing plans. Many factors or events happen throughout the year that the farm has little or no control over. Many of these are unexpected when they are experienced (such as poor weather, low market prices and other issues). You should prepare to discuss how you plan to work through or minimize these unexpected conditions. Do you have insurance? Are you using marketing tools for your product? If available, are you working with a broker or commodity trader? The lender needs to know you are prepared for unexpected events that could affect your business.

Your risk management plan is especially important when discussing your projected income or *margin* remaining on your projection. This is the amount of money left over after expenses and debt payments. If the income or margin remaining is less than 10% of your total gross farm income, this indicates the operation is more vulnerable to unexpected events. The farm needs to pay more attention to how it will minimize the impacts of these events if they were to occur. Discussing your plan to manage risk provides assurance to the lender that you are prepared for the challenges of managing a farm.

Financial Statements

Spend the time to put together well-prepared financial statements. These statements include a balance sheet, income statement and cash flow statement. A balance sheet lists the value for all that you own (*assets*) and the amount of all that you owe (*liabilities*). An income statement looks at what happened in the farm's checkbook (*transactions*), what inventory changes occurred during the year (such as pre-paid expenses, feed used from storage) and any depreciation on farm assets that had an impact on profitability. A cash flow statement pulls information from the other financial statements to understand how cash was spent during the year and its impact to the value of your farm business. Were funds spent to cover operating expenses, investing into the farm or on financing activities?

Financial statements are extremely important for a potential borrower to understand, because together they tell the whole story of the farm business. The lender needs to know that you understand where your farm stands financially. Understanding also gives you confidence in your ability to be successful as you project the repayment of the loan.

Profitability & Cash Flow

One of the keys to successfully getting a loan is to have a realistic projection. This is your expectation of what the season or year will look like. It shows the money aspects of your farm business from cash expenses all the way to the marketing of your products.

This is another opportunity to showcase your knowledge and experience as a decision-maker – not only that you know about the production side of your farm, but also that you have a working understanding of profitability and cash flow. Generally, if the season is "normal," the projection should show enough income to pay for expenses (*profitability*) and debt repayments (*cash flow*). If the projection does not demonstrate that cash flow is positive and the loan will be repaid, then think about what needs to happen for the farm to be successful. The lender can be part of this process as you work through possible strategies to consider and discuss alternatives with him or her. Ultimately, you need to be objective as a farm manager and decide if the loan is worth pursuing or if you should walk away. Sometimes not getting a loan can be the best decision you make for your farm's future.

A word of caution: Be careful about being too optimistic or overconfident in your projection. The yields or production outputs should be within the farm's ability to reach and based on proven historical performance. Any overstated numbers or production values could reflect poorly on your management ability and realistic understanding of your proposal. The same is true of business plans or proposals based solely on internet searches or theoretical research; for example, "I'll sell lavender oil for $30 an ounce on eBay. Lavender grows like a weed, so this plan makes complete sense." If the information used is unrealistic, the lender will question your ability as a decision-maker and wonder if your loan request is worth pursuing.

Don't forget the nonfarm or "family living" parts of the projection. Lenders know that you have bills outside of the farm and will want to include those values in your projection. These family living expenses include your groceries, house rent or payments, utilities, vehicle payments and even your personal property payments. If you don't have enough income "off the farm" to cover these costs, it becomes important to show that the farm can make these payments and still repay the loan.

Collateral & Security

Lenders manage the risk to their loan investments similar to how farms manage risk to unexpected events. They obtain insurance guaranteeing that if the farm is not successful, the loan can be repaid by the acquisition or selling of a material item such as equipment, livestock or land. These *collateral* items or assets provide the lender with security that, in a worst-case scenario, the loan will be repaid.

Lenders typically require collateral or security between 80% to 150% of the loan value. These should be "debt-free" assets that do not have any existing liens or loans placed on them. If those are not available, lenders will use assets that have significantly more value than the liens (liabilities) already placed on them. They may even take a *blanket lien* or a lien against everything you own if significant debt exists. This is so they can feel confident that in a worst-case situation, the loan will be covered.

This can be an area of concern for beginning farmers. As you prepare a balance sheet for the loan request, consider what assets you have to offer as security or collateral. If other assets have liens and little value remains, consider asking a family member to assist you in providing added security.

A balance sheet is a financial snapshot in time. It shows what you think the market value of your assets are worth on that date. The value of equipment, land and even inventory will change over the course of time. These changes will influence how comfortable a lender is with making a loan, especially if your debt-to-asset ratio (*https://www.canr.msu.edu/news/financial_ratios_part_4_of_21_debt_to_asset_ratio/*) is above 70%. Become familiar with the assets on your balance sheet and notice how their values change over time. Keep in mind that values should reflect the true sale value of those assets, not necessarily the value you think it should be worth.

Farm Management Plan

A farm management plan can be a useful document when seeking a loan request from a lender. It outlines the details of experience, knowledge and ability to be successful at your farm business. It can also provide many of the statements and information previously described that a lender needs to feel confident that you will be able to repay the loan.

Many resources are available to assist in developing a farm management plan. AgPlan through the Center for Farm Financial Management at the University of Minnesota (*www.AgPlan.com*) offers sample plans and additional resources. MSU Extension also provides farm management educators (*https://www.canr.msu.edu/farm_management/*) who are available across the state to work with you individually to develop your own management plan.

Sources of Financing

Many sources of financing are available to beginning farmers. Some local lenders focus primarily on farm businesses, which can be helpful for new farms. There are also commercial banks that have a division dedicated to or are willing to make farm loans. Check with your local bank to see what loan programs are available for farm businesses. If you already use the bank for your savings and checking accounts, you may already have a relationship with the lender. It may be beneficial to start with whom you know first.

Outside of local options, there are financing programs specifically available to beginning farmers through the U.S. Department of Agriculture (USDA) that offer lower rates and special terms. The USDA has a website specifically for assisting beginning and new farmers. The site offers information on financing resources offered through the Farm Service Agency, Rural Development and the Small Business Administration. The Farm Service Agency offers loan opportunities for beginning farmers who have at least 1 to 10 years of management experience on the farm. This includes operating loans, equipment or livestock term loans, and long-term loans for the purchase of land or buildings. The Small Business Administration offers loans similar to the Farm Service Agency, but may be more appropriate depending on the type of business you are planning to operate. Start-up costs, working capital and opportunities for those interested in producing value-added products are available there.

Find details on these programs at https://newfarmers.usda.gov/, at the USDA Newsroom under Factsheets at https://www.fsa.usda.gov/ or through the Small Business Administration website at https://www.sba.gov/funding-programs/loans.

Prepare to Make the Loan Request

As in any activity on the farm, preparation is often the biggest key to success. To successfully obtain a loan, you need to spend some time preparing for the meeting with the lender. Take some time today and put together your farm's business projection for the coming year.

- Think about your knowledge and experience as a decision-maker. What examples demonstrate your skill and ability as a manager on the farm?
- Review your credit history. Are there any concerns on your credit history you will need to talk about?
- What risks exist that you need to think about managing? What areas of concern should you focus on? How do you plan to manage them?
- Is the farm profitable? Does it pay its debts and cash flow? If not, what changes should you make to your plans to ensure debt repayment?
- Think about what assets you have to offer for collateral. Do you have enough collateral? If not, what steps will you take before meeting with the lender to address this?
- Talk to a trusted mentor or advisor. Ask them to review your projection and discuss with them any concerns you have and your plan to approach each one. MSU Extension educators are also available to review and discuss the details of your projected business plan. Use the available

expertise around you to help answer some of the questions you have, or review your intended plans, prior to going into the meeting with your lender.

If you follow these steps and are prepared to discuss the details of your farm business prior to the meeting for the loan, the lender will feel more confident and motivated to say “yes” to your request.

Resources:

GreenStone Farm Credit Services – Farm Forward Mentorship
https://www.greenstonefcs.com/resources/young-beginning-and-small-farmers/farm-forward-mentorship
Program designed to help the next generation learn from the experience of others by partnering young, beginning and small farmers with experienced mentors to share experiences and knowledge.

Michigan Corn MI CENT (Corn Education Networking Training) Program
http://www.micorn.org/news-events/MI-CENT
Program designed to provide educational opportunities for the next generation of Michigan corn farmers. Topics include agronomy, technology, farm management and more.

Michigan Farm Bureau Young Farmer Program
https://www.michfb.com/mi/youngfarmer/
Program that identifies and serves the needs of young farmers, ages 18–35, to assist them in their personal and professional lives. Learning opportunities include leadership training, management skills, and business and family relationships.

MSU Beginner Farmer Webinar Series
https://www.canr.msu.edu/beginning_farmer_webinar_series/
Educational series covers basic, startup information for beginning farmers interested in engaging in new agricultural enterprises. Participants are mostly current or future growers who represent small farms.

MSU Extension Farm Business Management
https://www.canr.msu.edu/farm_management/
Team of MSU Extension educators and educational resources providing support to those in agriculture through an educational process of applying management, production and economic knowledge to critical issues, needs and opportunities.