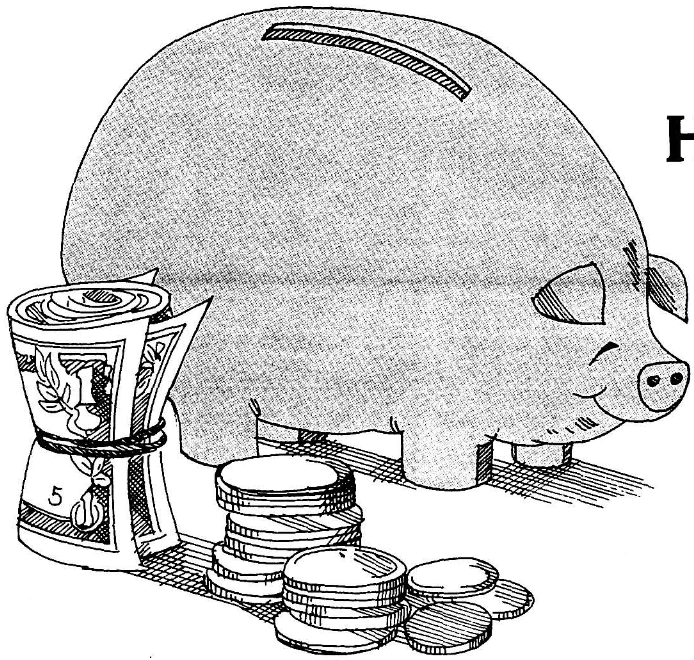

How and Where To Get A Farm Loan

Borrowing money is a necessary but trying process for most farmers and ranchers—especially in today's money market. Knowing where to go and how to approach a lender can ease the aggravation.

Lenders use several important criteria in evaluating a loan request, according to Bruce Hottel, formerly with USDA's Economic Research Service and now with the Federal Crop Insurance Corporation.

The first is what Hottel calls the "human factor"—the applicant's personal integrity and business skills. Personal integrity involves a borrower's honesty, determination to meet obligations, and cooperativeness.

Management skills include how well the farmer handles record-keeping, personnel, time, and production and financial planning. Most farmers can show adequate short-term management, but lenders are more likely to look at how borrowers handle their long-term goals.

"Many lenders are concerned about the farmer who is unable to see the total picture," Hottel says. "These farmers are too often concerned with short-term problems they can't control, while more important items, such as long-term earnings, production, and marketing programs, are overlooked."

Lenders are also interested in the purpose of the loan. Loan requests are classified as immediate necessities, long-term needs, and wants. Although not a hard-and-fast rule, the more necessary or essential the request, the more likely the loan will be granted, according to Hottel.

Attention to the Balance Sheet

Even with the attention given to the human factor and the purpose of the loan, the farmer's balance sheet is still the bottom line.

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In examining a farmer's finances, lenders look for full disclosure of all amounts owed and realistic evaluations of assets. There are two types of liabilities that lenders look at but borrowers frequently overlook—accrued liabilities (expenses that accumulate over time but have not been paid, such as taxes) and contingent liabilities (potential expenses, such as responsibility for the debts of others and potential taxes on assets sold in the future).

Most lenders evaluate borrowers' credit standings by the leverage ratio, the amount of debt relative to net worth. For example, if a farmer's debts were $200,000 and net worth $400,000, the ratio would be 0.5—generally considered a good range. A ratio of 1.0 would be fair, and 1.5 could raise some concern.

Lenders also examine liquidity. That's a measure of the borrower's ability to generate sufficient cash to meet short-term financial commitments without disrupting the ongoing business. In determining liquidity, another ratio is used—current assets (cash and assets that can be converted to cash within a year) to current liabilities (amounts due within a year).

For this ratio, 2.0 is considered good, while 1.0 is fair. So, a farmer with $50,000 in current liabilities would need $100,000 in current assets to get a good rating.

Current assets include cash, securities, inventory, and receivables, while current liabilities comprise trade credit and short-term obligations.

Lenders also look at borrowers' cash flow projections (estimates of monthly or annual cash inflow as compared with cash outflows) to determine credit eligibility.

"Lenders like to see farmers monitor their cash flows on a monthly and a year-to-date basis by comparing projected and actual flows as the year progresses," Hottel says. "This helps both parties spot potential problems and allows for adjustments."

The last important item is collateral. Lenders need collateral to cover the loan in case of default, death, or other problems that prevent repayment.

How much collateral is adequate? "It's adequate if, under the worst conditions, enough of it can be located and repossessed in an acceptable condition so that it can be sold for sufficient cash to repay the loan in full and cover the costs involved," Hottel says.

Want to anticipate the questions on a lender's mind when the lender sits down with a prospective farm borrower? Ask yourself these questions:

Does my personal credit history show that I'm a good risk?

Are my records in good order? Can I show that I understand and use them properly?

Do I have effective production and marketing strategies?

Do I get along well with my employees? Do I manage my labor force efficiently?

Am I prepared to discuss long-term goals for my farm? Are they realistic, or am I expanding too quickly?

Have I prepared an updated, year-end balance sheet?

Is my financial statement complete? Are all assets and liabilities listed?

Will I have the cash to service debt payments? Is the repayment period long enough?

Can I come up with the required collateral? Is it insured against loss?

Will the lender view the purpose of my loan as necessary and realistic?

Also, every lender expects a borrower to carry sufficient casualty and liability insurance to protect the value of the assets put up as collateral.

"No lender wants to see the collateral vanish in a fire, windstorm, drought, or law suit, unless it can be replaced by insurance proceeds," he points out. According to Hottel, the expanding federal crop insurance program will play an increasingly important role in farmers' risk protection in the future.

Where to Get a Loan

After settling on the best approach, the next decision is where to go to get the loan. The most obvious possibility is a commercial bank.

Banks are the leading source of nonreal estate loans and a major avenue for real estate loans. However, there can be several drawbacks—especially for rural banks.

If deposit growth is slower than the demand for loans, banks may have difficulties satisfying borrowers. Small rural banks have particular problems, because many have limited access to funds outside their local markets.

The legal limit on the size of loans to individual borrowers is another problem. And, with the increasing number of large farms, some rural banks don't have the capital to meet all the borrowing needs of their larger customers.

In addition, the loan demand on rural banks is seasonal by nature. So, banks may be short of funds during peak times, such as the planting season.

There are ways banks can get around these problems. A smaller bank can become a "correspondent" with a larger one. If the smaller bank can't handle a loan, it can request a participation or direct loan from the correspondent bank.

Under loan participation, the correspondent bank buys from the originating bank either a portion or all of the loan, along with a proportionate share of the interest. Direct loans are similar, except the correspondent bank loans money directly to the customer.

Commercial banks aren't the only source of farm loans, of course. The Farm Credit System is an agricultural credit cooperative owned by member-borrowers. It comprises federal land banks, which supply long-term loans through local federal land bank associations; federal intermediate credit banks, which function as short-term and intermediate-term lenders through their local production credit associations; and banks for cooperatives, which lend to farmer cooperatives.

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Lenders look at a borrower's leverage ratio, liquidity, cash flow projections, and collateral.

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Life insurance companies, another lending source, provide financing primarily through first mortgages on farm real estate. These loans are typically for large amounts, and most companies set a minimum size limit.

"Life insurance companies also tend to be selective in terms of the areas of the country in which they concentrate their loan activities," Hottel says. "They select areas where a reasonable degree of safety is combined with a large volume of business, such as in some Delta and western states."

Federal Funding

The federal government can also be a source for loans. USDA's Farmers Home Administration (FmHA) is a rural credit agency that lends money to farmers, ranchers, and rural residents who can't get adequate financing from other sources. To be eligible for an FmHA farm loan, the borrower must:

- have sufficient experience or ability to succeed in farming and be recognized in the community as a farmer.

"Scrutinizing Borrowers"

"Money is generally plentiful but expensive, and banks are scrutinizing their borrowers more carefully," says Stan Forbes, agribusiness director for Virginia National Bank.

"I think we'll be facing 1 or 2 more years of difficult times, because of the sluggish economy and a tightening of federal programs for agricultural funding," Forbes projects. "Also, many banks are pulling out of agricultural lending."

According to Forbes, lenders will have to resort to some innovative techniques to help finance agriculture. For example, Virginia has a Governor's Agricultural Credit Committee made up of federal programs, banks, businesses, and others who extend credit to farmers. The committee studies the economic situation and makes 5-year projections on the financial needs of Virginia's farmers. Using this information, it makes recommendations to meet those needs.

"This information allows us to prepare in advance for dealing with the growing financial requirements of our state's largest industry—agriculture," he says.

Forbes' advice to borrowers who are starting or expanding their farm operations is to enlarge gradually. Be sure the repayment period allows enough time to meet obligations while still retaining a safety margin in your cash flow for the unexpected, he says.

- be unable to obtain sufficient credit elsewhere. (Farmers who can get sufficient credit from outside sources may qualify for FmHA emergency loans.)
- be eligible to incur the obligations of a loan.
- be able to carry out the terms and conditions of the loan.
- be a U.S. citizen.

The FmHA extends farm operating loans for annual production purposes; farm ownership loans to buy, improve, or enlarge farms; limited resource loans for farmers who can't pay normal interest rates on other FmHA loans; and emergency loans.

But funds for some FmHA loan programs are getting tighter, and recently some loans have been reduced or curtailed. Lending authorizations through October 1, 1982, were lowered for farm ownership and emergency loans, but were increased for farm operating loans.

Under the Commodity Credit Corporation (CCC), farmers, sugar processors, and some cooperative marketing firms can place their farm products in CCC-approved storage for a set time period and receive a nonrecourse loan equal to the loan rate times the amount of product in storage.

The loan is nonrecourse because, if farm prices fall below the loan rate, the commodity pledged as collateral can serve as full payment of the principal and interest on the loan, thus assuring farmers of a minimum price for their products.

The CCC also makes recourse loans for storage facilities and for drying and other handling equipment.

CCC interest rates have risen considerably since April 1981, because the CCC is now required by law to charge the same interest rates that it receives from the Treasury. Previously, the CCC issued loans at rates that were lower than the Treasury's. For new loans placed during February 1982, the rate was 14 percent, compared with a fairly steady 3 to 4 percent during the 1940's through 1960's.

Additional sources of credit are merchants and dealers, and seller financing. Because of today's sluggish economy, many merchants who sell farm machinery provide credit for their purchases. These credit programs can be a convenient source of financing, but they are usually more costly than loans from other lenders.

Individual seller financing can be a source of long-term credit for real estate purchases. Most of this type of lending occurs when a retiring farmer is willing to finance a land sale with a contract for a deed, first mortgage, or second mortgage lien. The costs, terms, and repayment schedules can vary widely.

*(The material in this article is based on **Farmers' and Ranchers' Guide to Borrowing Money,** by Danny A. Klinefelter of the Texas Agricultural Experiment Station and Bruce Hottel. For a free copy, write to EMS Information, USDA, Rm. 0054 South, Washington, D.C. 20250. Ask for the report by title.)—FARMLINE, USDA*