AG-VISOR BLOG

Qualifying for Favorable Lending Terms in a Financially Stressed Market

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Uncertainties in agricultural markets continue to impact lenders' financing decisions as well as loan terms and conditions.

But there are ways to qualify for favorable lending terms even in a time of financial stress and challenging markets. A prospective borrower should review farm-operation goals and how to achieve those goals as well as credit needs. He or she should provide documentation of how plans have been successfully managed in the past.

When goals are identified, start conversations with prospective lenders well before loan funds are needed. Early conversations with a lender help both borrower and lender improve the understanding of credit needs and how a loan fits into overall financial plans.

Most agricultural loans are categorized as short-term, intermediate-term or long-term.

Short-term loans

- generally require repayment three to 18 months from the loan date. Short-term loans are usually for operating expenses and likely correspond to an agricultural-production cycle. They are frequently created as a line of credit; it can either be non-revolving or revolving. All money is advanced at once in a non-revolving line of credit. The borrower pays a down payment on the revolving line of credit but can draw against it multiple times.

Intermediate-term loans

- generally require repayment be completed 18 months to 10 years from the loan date. Intermediate-term loans are often for equipment purchases or improvements. They can also be used to restructure a borrower's balance sheet.

Long-term loans

- generally have repayment periods of more than 10 years. They are commonly used to acquire real estate, or construct or improve buildings. While intermediate-term loans are primarily secured by equipment or other depreciable assets, long-term loans are almost always secured by real estate being acquired, or buildings being constructed or improved.

Loan applications can be time-consuming because of required supplemental documentation. An appraisal, survey, environmental report, accounting information, tax returns and other information might be needed before a loan application can be approved. A credit, lien and title search may also be necessary. All take time and money to obtain.

Lenders have different methods of analyzing creditworthiness of a prospective borrower. But basically a financial statement will be required — including a balance sheet and income statement. The statement must have sufficient details so a lender can confidently determine past profitability, solvency, liquidity, repayment history, and other information of interest about a prospective borrower's business.

Most lenders look beyond a basic financial statement. If a borrower is a dairy farmer, a lender may also want current herd-health and production records as well as cow-flow and nutrient-management information. That's according to Josh Rynes of Bremer Bank in Menomonie, Wisconsin.

He said he also needs sufficient accounting detail to determine key ratios. Think about what gives a lender a better understanding of a particular operation. A debt-per-cow ratio may be useful. Or debt-per-hundredweight of milk may be a better measure.

Some borrowers have a formal business plan that includes information helpful to a lender evaluating a credit application. But not all lenders require a formal business plan.

Paul Salm of BMO Harris Bank in Chippewa Falls, Wisconsin, recommended a borrower have a good understanding of his or her business. The borrower should be able to answer a lender's questions on key aspects. A lender might have questions about a farm's customers, suppliers and competition. The lender might want details about the skills of the management team or how risk is managed.

Some business plans multi-faceted

Depending on the business, some aspects of a business plan may be quite simple while others may be complex. A large grain operation's risk-management plan might address property, life, crop and liability insurance. It might include a marketing plan, forward contracts, options and a succession plan as well as interest-rate, foreign-currency and environmental risks.

A farm borrower may be asking a lender for hundreds of thousands or even millions of dollars in credit. A lender needs to understand whether or not a borrower will be successful paying back a loan. The better a borrower's plan and presentation of information supporting how the plan will be achieved, the better the chances of qualifying for a loan with favorable terms and rates.

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