Advice from the Experts on Working with Your Ag Lender

By John Paterson, Executive Director of Education

When you borrow money, the lender becomes your partner and has a vested interest in your business success. As your partner, the lender will want to know as much about your business as possible. He’ll ask a lot of questions and may even play the devil’s advocate—just to make sure you have a well-conceived business plan.

Are there specific tips that can increase our chances of having a successful and long-term partnership with our Ag Lender? Dr. David Kohl, an Ag Economist from Virginia Tech University, provides insight on issues that are important in evaluating successful lending:

- **Cash Flow** – the importance of preparation of a cash flow projection. If one thinks through his or her plans on paper, including resources needed for production marketing, and finance, this builds confidence between the borrower and lender.
- **Sensitivity Analysis** – the importance of sensitivity analysis related to price, cost and production changes. For example what happens if the price of weaned calves drops ten percent or better yet increases 10 percent?
- **Liquidity** – a topic that everyone compares is financial liquidity versus equity. While older producers are often stronger in equity, younger individuals with less time in the business will often not have as much net worth or equity. Financial liquidity is the ability to generate cash by selling short-term assets without disrupting normal operations.
- **Business Plan** – a plan that contains goals, production, marketing and finance details. Individuals need to invest in productive assets such as land, livestock, machinery and human assets that will generate a positive bottom line. A business can quickly get sidetracked with non-productive assets, i.e. killer toys such as vacation homes, high priced vehicles, and other withdrawals from the business for personal purposes. Everyone needs to enjoy the fruits of life, but keep it in balance.

Dr. Kohl continues with advice to the younger producer about the importance of building a strong credit score. “Young producers need to check their credit scores because it is a baseline that creditors, insurance companies and potential employers regularly use to evaluate risk,” he says. Creditors and employers examine your character through your credit score.

Also, have 4–6 months of cash reserves to live on. Unfortunately, the average American only has 13 days of cash reserves and is living from paycheck to paycheck. The Five Cs of Credit Worthiness Used by Lenders

- **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 the ongoing operation of the farm, servicing debt, and operating 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. Lenders 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 will use to recover funds if you happen to default on the loan. 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?

Dr. Don Hofstrand from Iowa State University provides these additional tips for working with a lender:

**Establishing a lasting relationship.**

**Apply for the loan early.** Don’t wait until you need funds to apply for the loan. This puts pressure on the lender and increases the likelihood of loan rejection. Making a loan request well in advance of the need for funds shows the lender you have good planning skills.

**Get to know your lender.** Invite your lender to visit your business. Introduce the lender to your employees.

**Don’t surprise your lender.** If you foresee repayment problems, tell your lender right away. There may be a solution and the lender can be a helpful resource. Lenders would rather restructure loans for repayment than have to foreclose on the loan.

Repay your credit obligations promptly. Prompt repayment of obligations, when possible, will establish a good credit record for the future.

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**Neil sold 200 calves while saddling his horse.**

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