Ag Business Management
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Financial Help for Beginning Minnesota Farmers

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Introduction:

Every farmer, when starting a farm business, has had to deal with how to finance his/her operation. Parental financing, the local bank or Farm Service Agency (FSA - formerly FmHA) financing and state government financing are all possible funding sources.

Parental Financing:

Parents often directly or indirectly help with financing. Many give direct help through gifting of assets such as feed, machinery, grain or livestock as well as possibly providing down payment money for land purchases. Others loan money to their children for various farming needs.

When lending money to children it is important to:

- Write up a promissory note which stipulates the terms of the agreement including interest rate, repayment schedule, and default remedies.
- Charge a reasonable interest rate which is similar to market place loans. You can charge less than commercial interest rates and also less than the Applicable Federal Rates (AFR). The AFR change monthly and can be determined by contacting your accountant or going to www.irs.gov and doing a search for AFR. If you charge less than the AFR, the difference will be considered a gift and may trigger gift tax consequences and Medicaid ineligibility.
- Expect and demand payments when due.
- Be prepared to write off the debt if it is not repaid. The Internal Revenue Service will not let you deduct it as a bad debt. Most bad debts to family members are considered gifts by the IRS and are not deductible to you as the lender. *See Transferring the Farm Series #6-Gifting Farm Assets.*

Direct lending of money to relatives is often the cause of broken relationships. Misunderstandings often occur. Proceed with caution when lending money to your children.

Another way parents can help is to give a loan guarantee to the local lender through the use of a co-signature. One could also assign collateral to secure the loan for a child. If the child pays off the note as agreed, loan guarantees can work well. However, if adversity strikes and the loan is not repaid by your child, you must be ready to make the payments.

If you decide to make a loan guarantee for your child, limit the dollar amount you will guarantee. Don't co-sign an unlimited loan. It's like signing a blank check. Ask the lender to notify you immediately if payments are not made on schedule.

FSA Loans:

A better approach may be to encourage the use of FSA loans. You may be better off giving some cash or equity to your child so they can qualify for a FSA loan. Doing so can limit your risk of loss to what you gave your child rather than having to pay off an entire co-signed loan.

FSA has long been a source of funding for younger, beginning, low equity farmers. Availability and terms of loans vary as programs are started and terminated. Contact your local county FSA office about your particular financing situation and current financing availability.

Local Banks:

Local banks are excellent sources of financing for young farmers. Young farmers are most successful getting loans if they start early in their career, borrowing money and repaying it in a timely fashion. Establishing a good credit history and a good bank relationship, even while in high school, can result in good financial support from that bank as financing needs develop.

In addition, your local bank can enter into loan agreements with FSA and RFA (explained in the following paragraph) to better serve your credit needs.

The Minnesota Rural Finance Authority (RFA):

The Minnesota RFA is a department within the Minnesota Department of Agriculture. RFA has several financial programs available for beginning farmers. They include programs for the purchase of real estate,

purchase of livestock equipment, livestock expansion, farm debt restructuring, farm improvements, purchase of value-added coop shares, and more.
To be eligible for any RFA programs, you must be a Minnesota resident purchasing Minnesota property. You must farm the land being purchased and have a financial need for the loan. In addition, you must have the educational background to succeed in farming, be enrolled in a farm business management program and file a soil and water conservation plan with local SWCD offices.

Interest rates, net worth requirements, and participation levels change annually in the RFA program. RFA also works with connecting retiring farmers with beginning farmers. It hopes to link up suitable retiring farmers with appropriate entering buyers, renters, leasers, or share arrangements. If you are interested in this program and others mentioned, contact:

MN Department of Agriculture
625 Roberts Street N.
St. Paul, MN 55155-2538
Phone: 800-627-3529 651-201-6556

Internet website: http://www.mda.state.mn.us. Once there, click on "Grants, Loans & Financing", then click on "Loan Program".

Procedure When Applying For a Loan:

1) Be Well Prepared: Whenever you approach a lender for money it is best to be well prepared. This is especially true if you are approaching a lender who does not know you or your business. To have the best chance of getting your loan, you should clearly and professionally show the lender where you stand financially and how the money will be used and repaid. You can greatly influence a lender psychologically if you are well prepared and present yourself and your case well.

2) Items to Prepare in Advance: Your lender would like to see several statements. They include a net worth or financial statement, a projected cash flow, the last three year's income tax returns and a complete business analysis if possible. In addition, your particular lender may have other specific requests for information such as a business plan including goals.

When applying for a loan to add a new enterprise or expand a current enterprise, be sure to have accurate cost data on assets you will be purchasing. Secure certified bids or good estimates and bring them with you.

3) Records: If you have good records, assembling all of the above information is much easier. If you have a set of good records, you may wish to briefly show them to your lender during your presentation to further convince him or her of your business skills.

What It Takes To Get A Loan Approved:

Not all loans get approved. Following are some of the most common reasons loans do not get approved.

- You are not able to **provide a substantial part of the asset value** from your own funds. Many lenders will have lending limit percentages on the market value of land, machinery, livestock and buildings. Lenders generally insist that you share a portion of the purchase and therefore share some of the risk.
- If your cash flow projections show a **poor repayment capacity**, getting the loan will be difficult.
- If you're **net worth is small** and you have nothing to lose if you default on the loan, you will have a more difficult time getting the loan.
- If you have a **history of bad credit** or **late payment** on previous loans, expect some difficulty in getting a new loan. Bankers will check out your credit reports. **Protect your credit rating** by paying off all loans (including credit cards) on time.
- If your business profit projections show a **low profit or a loss**, your lender will also hesitate to give you the loan.

Where To Get Help:

Your local adult farm management instructor may be able to help you get started in the process of applying for a loan. You can find that local person in MN. by going to www.mgt.org , selecting "farm business management" then selecting "instructors" and selecting your location in the state.

Your local MN Extension Farm Management Association field person can also provide you with some help. Contact Jim Kurtz at 507-372-3904.

Your accountant is another person who can help you prepare the above forms. You can also purchase FINPACK financial planning software through the Center for Farm Financial Management, University of Minnesota, by phoning 1-800-234-1111. The software will enable you to do cash flow planning, long-range planning, and year-end analysis.

Caution: This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.