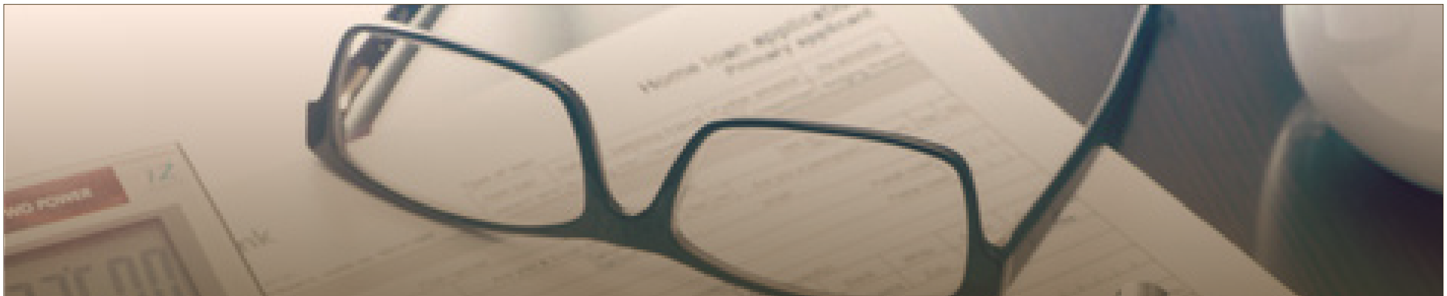

BEGINNING FARMERS
10 STEPS TO LOAN READINESS

Introduction

At some point, most farmers need to make some changes and grow to sustain their business. Based on his lending work with hundreds of Michigan farmers over 28 years, Mike Jordon developed the following 10 steps to guide the growth of farming operations that have been in business for at least several years and where:

- The business has exhausted all its owner capital and needs to borrow.
- The operators have a sound grasp of their production and marketing.
- There is ample land available for any planned expansion; if not currently owned, it can be acquired.
- The operation has a good records system, preferably computerized, that is up to date.
- The operators are comfortable using their records to guide their expansion.
- The operation generates a small profit.
- The operators realize changes and/or modest expansion in production and sales are critical to their farm's future.
- The operators have identified new markets or market potential that can be tapped without overextending existing staff or marketing resources.

These are all critical elements that must be in place before undertaking growth. Trying to grow the farm without addressing these elements greatly reduces the chances of success. So, now what? If you are confident you have covered all the factors above, follow these steps.

10 STEPS TO LOAN READINESS

1: Perform Cost/Benefit Analysis

At the end of the most recent sales season, the operator(s) should sit down and go through their records looking for things that clearly worked and those that didn't work. This analysis should be performed from an overall cost/benefit approach for each type of sales, i.e. farmers market, CSA, direct roadside stands, restaurants, and wholesale. Also, if possible, further break down each type of sale into an individual item sale—heirloom tomatoes, carrots, cabbage, corn, etc. Which type of sale was most profitable? Least profitable? Which items made the most money? This analysis provides critical information to help decide where and how to expand. While whole-scale expansion may be of some benefit, a targeted expansion is likely to pay bigger dividends.

2: Run "What-if" Scenarios

Run some "what if "scenarios—trials involving the planned crop expansion. For example, how much would it cost to add a hoop house of cherry tomatoes, and how much would they generate in sales? You need to determine the net return potential from the increased production after any increased costs are removed. Part of this analysis also may consider eliminating crops that didn't work or severely cutting them back in favor of crops generating more income.

3: Develop Expansion Plan

Based on the results from Step Two, develop your expansion plan and its cost so you know how much capital and what type will be needed. Keep in mind expansion may require more than one type of capital: additional annual operating to cover the cost of any increased expenses; short-term funding for equipment and/or livestock; and/or long-term financing for real estate and real estate improvements. Be quite conservative in estimating how much additional production and income you expect to generate, as disasters can strike from many fronts. Plan for some unforeseen expenses. Also remember additional income may come from unexpected sources; treat these as a gift, as they may not materialize in the future. Run your credit report to see if anything is out of order.

4: Meet with Lender

Schedule an appointment with a lender who typically makes agricultural loans. Bring your historical records—income and expense and/or a TRENDS Report[1], your analysis of the expansion and a breakdown of capital needs. Lay out and discuss your plans; try to get some idea if the lender is willing to make these loans and at what rates and terms. Some lenders may make loans for service-based and production-based operations; others may work with production only. Ask what security the lender might need for the loans, the amount of down payment, and how much loan payments would be. Find out, if you submit an application, exactly what the lender needs in the way of forms and supportive documents—application, balance sheet, income and expense projection, tax records, etc.

5: Plug Loan Payments into Expansion Plan

Plug the loan payments into your income and expense projection to get an idea of the cost of the expansion. Negotiate the purchase of the capital assets; leasing with an option to buy may be better than a purchase agreement at this time. Check with local township officials for any limitations, zoning ordinances, conditional usage, property split requirements, setbacks, etc. that could restrict your plans for using the property. Prepare your forms for submission to the lender and double-check to make sure everything is included. This step is probably the most difficult to navigate; keep in touch with the lender and follow through. Remember, your goal here is to build a long-term relationship with the lender; obtaining the current loan is only the first step. This is important especially from a real estate loan perspective. If you seek only a short-term machinery-type loan, more sources such as credit unions and dealer programs may offer advantages over conventional banks.

1 A TRENDS Report is a historic document comprised of two or more years of year-end financial data. It allows for some analysis as to where the operation may or may not be headed from a financial standpoint. It helps to smooth over some of the hiccups that an operation can experience in any given year.

6: Complete Loan Application

If everything looks good—the proposed operation still has a positive cash flow and the loan payments fit well within the cash flow without penalizing other uses—schedule an appointment with a loan officer and submit a complete application. Be prepared to answer any questions the loan officer or the lender's representative may have. You alone know the most about your operation and how it functions. It is up to you to make a convincing argument that this is a good opportunity for the lender to make some money. Ask about the timeframe for a decision; this mostly will depend on the lender's workload at the time. To have the best chance, submit your loan request outside the lender's normal busy time, which is usually January through March.

7: Respond to Loan Approval or Disapproval

The lender responds with a decision.

With a favorable decision, prepare for a loan closing. This may take several weeks to months, especially if real estate loans are involved. The lender will need to obtain a real estate appraisal and title work before the closing. Multiple issues may stall the closing, so be prepared for potential delays. Stay in communication with the sellers so they are in the loop and aware the delay is not on your end.

With an unfavorable decision, schedule a meeting with the decision-maker to go over the data and try to understand the reasons for the denial. If it was related to your records or information you submitted, ask the lender for input on correcting the problem. If the problem is related to the credit report, ask to see the document and which specific entries were used to make the decision. **As an applicant, you have the right to review a credit report and correct any data that is incorrect.** Ask about a timeframe for resubmission or reconsideration. Consider another lender; however, keep in mind another lender may look at the same "non-credit report" data in a different manner.

8: If Favorable Decision: Close the Loan

Close the loan. Make sure you understand the repayment schedule, the loan term, interest rate, and potential changes if a variable rate is used, how the payment will be applied—interest then principal, pre-payment penalty, etc. Read the documents over and ask for an explanation for anything you don't understand.

9: Obtain Loan Funds & Necessary Assets

Obtain loan funds and complete the development or asset purchase as agreed between you and the lender. Keep in mind, any changes—different land, different structures, different machinery, etc.—are a valid reason for concern on the part of the lender. The sooner you discuss these changes, the better off you will be. Failure to discuss these changes can result in the loan being terminated by the lender.

10: Plan Your Work & Work Your Plan!

Plan your work and work your plan! Hopefully, everything falls into place and you can make your payments as planned. Lenders prefer to work with operators who meet their planned repayment. Servicing loans does not generate that much income for a lender; only loan-making generates income.

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About the Author

Mike Jordon grew up on a small dairy/cash-crop farm in Jackson, Michigan. He attended Michigan State University and graduated with a B.S. in Dairy Science in 1973. As he worked on his parents' farm, he realized the prospects of operating a small dairy farm were not very promising in the long term without a significant investment. He worked for the Farmers Home Administration (FmHA) in Adrian County for 28-1/2 years as an assistant county supervisor, a farm loan officer and manager until his retirement in 2016.

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