Financing Your Farm: Guidance for Beginning Farmers

By Hannah Lewis
NCAT Agriculture Specialist
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Contents

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The purpose of this publication is to lay out several financing options available to beginning farmers to start a farm, and to illuminate the step-by-step process of applying for a loan. Small- and medium-scale sustainable farmers and those new to the world of finance are the target audience for this publication. The intention is to help these readers consider a range of options for raising capital and reducing expenses involved in starting a farm, with a bank or government loan as just one tool, albeit an important one, in a whole toolkit of creative possibilities.

These beginning farmers are signing loan forms in an Iowa FSA office after receiving approval for an FSA equipment loan. Photo: Dennis Chamberlin

Introduction

Most business start-up requires more cash than the business owner has on hand. This applies to farmers—even small- and medium-scale farmers—who need access to land, equipment, seeds, and other materials. This publication outlines the traditional lending options available to farmers as well as a variety of less obvious financing possibilities. It concludes with a discussion about creative options for lowering the expenses and risks involved in starting a farm.

The topic of financing is intimately connected to setting goals for a farm enterprise, writing a business plan, keeping records, and establishing access to land, and therefore it must be considered alongside and in relation to these other topics. For instance, if your goal is to start drawing a significant income from your farm in the next five years, then you need to plan for fairly fast growth, which may require higher capital investments (and borrowing) up front. However, if you envision your farm operation to be one part of a diversified household-income strategy that also actively seeks to minimize household and farm expenses through self-sufficiency (such as growing all the food your family eats), then your credit needs will reflect that start-small approach. (See the ATTRA publication *Evaluating a Farm Enterprise* for help with goal-setting and related topics.)

To make the relationship between financing your farm and these other topics crystal clear, note this: in order to get a loan, you must have a business plan and financial statements. To create a business plan, you must be very clear about why you are starting a farm business and what you hope to achieve (your goals). In order to create financial statements, you must have developed a system for keeping accurate, consistent records about your farm and household income and expenses and production yields. Finally, in order to gain access to land, you might need (but not necessarily) a loan to purchase the property.

Let's begin an exploration of farm financing by examining options for a bank or government loan.

Traditional Lenders

Commercial banks

Some commercial banks, though not all, have an agricultural lending department. Banks typically have lines of credit or short-term operating loans to finance seeds and other supplies, which generally are meant to be repaid within a year. Medium-term loans are used for equipment and livestock and are structured to be repaid within a few years. Long-term loans are available to finance the purchase of land or major building projects. Many banks participate in Farm Service Agency's Loan Guarantee program (see below).

Farm Credit System

The Farm Credit System is a national network of cooperative, client-owned banks, designed to provide financial services to farmers and rural residents. As such, these banks provide education and mentoring in financial management to young, beginning, and small farmers. Farm Credit has short-, medium-, and long-term loans as well as refinancing options and loans available to rural residents. Go to www.farmcreditnetwork.com/about/who-we-serve to learn more.

Farm Service Agency

The Farm Service Agency (FSA) is part of the U.S. Department of Agriculture (USDA) and exists to provide financial assistance to farmers, including making loans. FSA makes loans to farmers using federal money set aside for this purpose, including a portion of loan funds designated specifically for beginning farmers. In addition to direct loans, FSA can guarantee a loan made by a bank, meaning that if the farmer is unable to repay the loan and defaults, FSA will step in to repay the bank. This is called the Loan Guarantee program. Like banks, FSA has a variety of loan options, including a farm-ownership loan to purchase land, an equipment or livestock loan, and a loan for the down payment on the purchase of a farm. In addition, because FSA is a federal program designed to support farmers, the agency offers consultation and advice in financial management and business planning. This assistance is available to farmers even during the application process before they have yet been approved for a loan. FSA loan officers will continue to provide assistance as needed throughout the life of the loan through the program's supervised credit initiative.

Think Like a Banker

Let's take a minute to put ourselves in the shoes of a loan officer. Think of your loan officer as a prospective business partner who is willing to put some skin in the game of a new business that stands a reasonable chance of success. If the business succeeds, the bank will recoup all of the money it loaned you, and it also will earn interest on its investment in your business. This is a good deal for the banker. But if it turns out you are not able to earn enough money—either through your farm operation or your off-farm income—to make your monthly loan payments, then you and the banker are both in trouble. Therefore, to get your banker to join you as a business partner, you need to demonstrate that you know how to farm and that you have a good plan for making money farming; you have other sources of income that will help you pay back the loan; and if all else fails, you have something of value (real estate, equipment, etc.) that can be sold for cash to repay the loan.

Related ATTRA Publications
www.attra.ncat.org

Planning for Profit in Sustainable Farming

Evaluating a Farming Enterprise

Market Gardening: A Start-Up Guide

Finding Land to Farm: Six Ways to Secure Farmland

Your banker is likely to be both rational and knowledgeable in agricultural production and finance. However, one thing to consider is how much experience she has with your particular business model. For instance, agricultural lenders in Iowa are going to be quite familiar with what a good business plan and financial statements look like for a conventional corn and soybean farm. They may have much less experience with what a good business plan looks like for a small- or medium-scale diversified farm.

Furthermore, if your loan officer is used to lending money for row-crop agriculture, which requires many hundreds of acres to be profitable, it may be hard to believe 15 acres is all you need for your organic vegetable operation. Some lenders may think you are just a hobby farmer and therefore need a significant source of off-farm income. They may think what you really need is a conventional home loan rather than an agricultural business loan. Finally, your loan officer may be concerned about how you will deal with crop failure without a crop-insurance policy, which isn't always available to small and diversified farmers. Therefore, it is a good idea to come prepared with an example of a successful established farm similar to the one you want to start and to be able to explain that your risk-management strategy hinges on diversification of enterprises and marketing.

Preparing a Loan Application

The first step before you apply for a loan is to prepare a business plan and financial statements, including a balance sheet, cash-flow statement, and an income and expense statement. While a written business plan per se may not be required in a loan application, many of its components will be, including a description of the farm business, your marketing plan, your farming and business-management experience, and your financial statements. Take time to develop your business plan before you go to the bank. (For help on how to evaluate your farm's potential for profitability, see the ATTRA publication *Planning for Profit in Sustainable Farming*.)

If you are young, own very few assets, and haven't taken out a loan before, your chances of getting a loan will be better with FSA than with a bank. FSA offices are located throughout the nation. You can find your local FSA office at the USDA's Service Center Locator at http://offices.sc.egov.usda.gov/locator/app.

You may find it helpful to start by setting up an informational meeting with a loan officer to learn about the application process. In this meeting, you can introduce your plan (either present a written business plan or be prepared to describe your plans), review the loan options available to you, and ask questions if there's anything you don't understand. This may be the first of several meetings you'll have with your loan officer as you work your way through the application process. Dress professionally, be confident, and enjoy the beginning of this new and valuable business relationship.

The next step is to decide what kind of loan to apply for. It might be reasonable to consider a smaller loan at first. Note this observation from University of Vermont Extension:

> "In today's world, it is unusual for a lender to make a first loan to a person looking to buy a farm. More likely, a first loan might be used for livestock or equipment, but probably not for a brand new herd/flock or your first piece of farm equipment as these may be too risky. Most lenders expect to see you make the first investment. Then, after a couple of years of managing the business, you might be able to borrow to expand" (Kauppila, 2000).

You may find it helpful to start by setting up an informational meeting with a loan officer to learn about the application process.

Once you've completed and submitted all the application forms (with assistance as needed from your loan officer), it will probably take a few weeks to hear back about whether your application has been accepted or denied. If it is denied, FSA will tell you the reason for the denial, how you can appeal, and how to re-apply.

If your loan application is approved, congratulations! Remember that now you have the advantage of FSA's "supervised credit," which means your loan officer can help you identify and

USDA Service Center.

resolve problem areas in your operation. How much assistance you receive depends in part on how much you want. Those who ask for a lot of feedback and guidance will receive more than those who prefer to work more independently. At least once a year, though, you can expect FSA to provide you with a financial analysis of your business, along with suggestions for improvement and a review of your goals and how you are moving toward them. The loan officer will even make a few visits out to your farm.

In addition to "in-house" assistance, FSA requires additional borrower training within two years of obtaining a loan. FSA has a list of approved courses that are available, including online and correspondence courses. Applicants who have previously completed college-level production or financial-management courses can request a waiver.

What's In an FSA Application?

The following is a list of forms included in an FSA loan application. While it may look like a lot at first, remember that FSA is there to assist as you work through these forms. Filling out the balance sheet and income-and-expense statement will probably be the most complicated part, and you can ask for help with this. The rest is mostly a matter of gathering together the right information and documents. The forms are available at http://forms.sc.egov.usda.gov/eForms/welcomeAction.do?Home.

- **Request for a Direct Loan**
  A five-page form that requests personal information (such as birth date, Social Security number, and annual income) of the individual(s) applying for a loan. In addition, it requests a short description of the operation, where the farm is located, and the type and amount of the request. It also provides information about special assistance offered to socially disadvantaged, beginning-farmer, and limited-resource applicants and outlines rights, policies, and restrictions related to the loan.
- **Three-Year Financial History**
  Asks for operating income and expense for the previous three years (or as many years as the applicant has records for). If no history is available, FSA will use industry standards. Applicants may provide alternative documents (such as three years of Schedule F tax forms) that provide the same information.
- **Three-Year Production History**
  Asks for three years (or as many years as the applicant has records for) of production history for dairy, livestock/poultry, and/or crops/vegetables. Three-year averages or trends are used for projections about future production and yields. Production should be reported for all species raised on the farm that were used either for sale or home consumption.
- **Authorization to Release Information**
  Serves as a release that allows FSA to obtain information on applicant's employment/income records, bank accounts, credit references, and debt/collateral information as well as order a credit report.
- **Creditor List**
  Requests account number, contact person, and phone number for each creditor to whom the applicant is currently indebted. Alternatively, applicants may provide copies of their last credit card bill, monthly mortgage bill, etc.
- **Property Owned or Leased**
  Asks for location, number of acres, type of lease agreement, and description of the land.
- **Balance Sheet**
  A balance sheet or financial statement is a "snapshot of a moment in time." This form asks for current, intermediate, and long-term assets and liabilities (or debts) as well as personal assets and liabilities. Liability is anything owed, and assets are anything owned, by the applicant. Current assets/debts are things that are easily liquidated to cash (sold) or due and payable within 12 months. Intermediate assets have a life greater than one year to about 10 years. Anything over that, such as buildings or real estate, would be considered a long-term asset.
- **Income and Expense Statement**
  This form should be completed as a projection for a one-year period assuming the loan is obtained and the farm is in operation. It should be based on past history if available or on industry standards. Income and expenses should be realistic, not overly optimistic; the goal is to ensure the applicant will be able to generate sufficient income to pay expenses and make loan payments.
- **Description of Training and Experience**
  Essentially serving as your resume, this form asks for description of any courses or training in production or financial management you have taken, along with a description of farm experience, including the type of operation and duties and responsibilities of the applicant's position at the farm where experience was gained.

Other Ways to Raise Start-Up Capital (a few less obvious farm financing options)

State Agricultural Development Programs

Most states have some type of state-based agricultural finance program. Such programs range from tax credits for landowners who rent land to beginning farmers to direct- and guaranteed-loan programs and Aggie Bonds, which lower interest rates on loans to beginning farmers. Many of these programs are geared toward assisting beginning farmers. Visit www.stateagfinance.org to learn more.

Personal Savings

Farming is often a long-term, lifetime goal for which aspiring farmers save money while working a non-farm job over many years, just as families set up savings accounts for college. Some nonprofits and state agencies can help meet savings goals through Individual Development Accounts (IDAs), which match new farmers' savings account one dollar (or more) for every dollar saved. California Farm Link and Practical Farmers of Iowa (PFI) both have programs like this. PFI's Savings Incentive Program (www.practicalfarmers.org/programs/youth-and-next-generation.html) requires all enrolled beginning farmers to attend PFI's business-management trainings, meet with a farmer mentor, save money regularly for their farm business, and complete or maintain a business plan. Upon completion of these activities over a two-year period, beginning farmers may graduate from the program and receive their match funds to use for purchasing land, machinery, or livestock.

Private Contract with Retiring Farmers

Beginning-farmer and land-link programs across the country connect new farmers with retiring farmers to assist in the transition of land and/or a farm business operation. These programs can facilitate transitions within a family or make matches across families based on a synchronicity of goals, values, personality types, etc. The combination of an older farmer's wealth and experience and a younger farmer's energy can bring about a fruitful farm transition under the right conditions. Clear communication, trust, good will, and fairness on both sides, as well as a written agreement, are critical. A model arrangement of this type is the New Zealand dairy industry, which allows younger farmers to gain equity in the farm through their labor, so their compensation includes shares in the dairy herd, which they eventually come to own.

FSA Transition Incentive Program (TIP)

TIP provides incentives to retiring or retired farmers to rent or sell farmland to beginning farmers. A retiring owner or operator with land coming out of the federal Conservation Resource Program (CRP) is permitted to continue to receive CRP payments for two years if she rents or sells the land to a non-family beginning farmer who will graze or farm the land using sustainable practices. This subsidy might allow the farmer to rent this land at a lower rate to a beginning farmer.

Community Supported Agriculture

Community Supported Agriculture (CSA) allows farmers to develop relationships with their customers and local community members that can be deep and long lasting. At its basic level, a CSA provides operating capital for farmers by requiring up-front payments in return for a weekly share of produce throughout the growing season. This allows farmers to purchase seeds and other inputs and to share the risk of crop failure with their customers. For the CSAs most deeply embedded in the community, customers may also become long-term investors in the farm by lending money to help farmers acquire land or make other significant investments.

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Friends and Family

New farmers can approach friends and family members who believe in their farm business vision and mission for a loan. In the winter before their first year of operation, TableTop Farm in Nevada, Iowa, worked with a lawyer to develop a letter to send to friends and community members requesting small loans of at least $1,000. Lenders had the option of providing loans of two to five years at interest rates of 2% to 4%, with the longer loans receiving higher interest rates.

TableTop used these funds to purchase supplies and make improvements on the farm that their FSA equipment loan would not cover.

Vendor Financing

Some agricultural suppliers have flexible payment terms, allowing farmers to align their payment plan with their cash flow. Shop around for vendors with favorable terms.

Microenterprise Lenders

Microenterprise lenders are nonprofit organizations dedicated to supporting microentrepreneurs who are unable to access business loans at commercial banks. Microenterprise lenders offer smaller loans at higher interest rates (around 10%). They also provide training and technical assistance in business start-up or management. Microenterprise lenders include the following:

- ACCION USA www.accionusa.org
- The Carrot Project www.thecarrotproject.org
- North Carolina Rural Economic Development Center www.ncruralcenter.org/business-programs/microenterprise.html

Starting small forces you to prioritize and focus on your core enterprises.

In addition, there are a range of private financing programs designed to promote local, sustainable agriculture. An example is Whole Foods Local Farmer Loans, www.wholefoodsmarket.com/values/local-producer-loan-program.php.

Reducing Costs and Minimizing Financial Risk

Farming is a profession with unlimited opportunity for creativity. That's what makes it fun and challenging. Creativity is required to build healthy soils, outsmart pests and weeds, and harvest enough of a product (or variety of products) that people will buy at prices that cover your expenses and provide a return on your investment of time and energy. Creativity is also an asset in designing your business model, raising capital, and managing your finances.

While modern industrial agriculture operates on a model of high capital investment—in land, high-tech seed, and state-of-the-art equipment and facilities—and hence, heavy borrowing, new farmers developing operations based on sustainable agriculture and local marketing models are often encouraged to start small. They're encouraged to maintain an off-farm income and to test their production techniques and marketing strategies in small batches at first. The reason is simple. As a new farmer, you're just getting the hang of managing many overlapping systems at once—the agroecosystem of your farm, the social system of your market and greater circle of support and guidance, and the financial systems of your business. Like any business start-up, you're bound to make mistakes. Let them be inexpensive mistakes.

Starting small forces you to prioritize and focus on your core enterprises. When Matt Russell was starting Coyote Run Farm, just outside of Des Moines, Iowa, he and his partner dreamed of all kinds of things for their farm, but limited resources prevented them from implementing all of these ideas. For instance, they thought goats would be a fun addition, but they couldn't afford to just go out and buy them. And it's fortunate for the couple that they didn't buy the goats since they soon realized how much time and energy their core enterprises took, let alone adding side projects that weren't intended as a serious source of income.

"An advantage of not having lots of money to spend at the beginning is that we didn't go down these roads all at once, but had to be more focused and in time became more productive. Even so, we're almost in over our heads," Matt said.

Similarly, there may be items you'd like to buy and own that you don't have the cash for and for which you are considering getting a loan. Many new farmers start their farms on rented land. The cost savings of renting (versus the down payment, insurance, taxes, and mortgage that come with buying land) allow farmers to put more of the money they earn back into the business rather than paying it to the bank. Furthermore, your exit strategy if farming doesn't work for you is much simpler.

The same idea is true for equipment. You may be hankering to buy a tractor, hay cutter, and rake for your 10-acre hayfield. But what if your neighbor has all of this equipment and can do it for you in return for a portion of the harvested hay bales? This arrangement costs you no cash. Even if you hire your neighbor for cash to do some of your field work, this still may be far cheaper than buying and maintaining depreciable new or used equipment.

If you are renting land and making improvements on it (building the soil, implementing conservation practices, or constructing or repairing fences or buildings, for example), you want to spell out in the lease what improvements are needed or otherwise approved, the cost of those improvements, and how those costs will be shared between owner and tenant. For an example of what a reimbursement-for-improvement provision in a lease might look like, go to http://sustainablefarmlease.org/2011/01/reimbursement-for-improvements.

Another way to think about minimizing risk and costs associated with farm start-up is to consider what you will grow. Perhaps the most important consideration is what you will be able to sell and for how much. However, another important consideration is the expense involved in any given enterprise. A good comparison is dairy cows versus broiler chickens. Dairy cows are expensive, complicated animals with significant housing and equipment needs (barn, milking parlor and/or stanchions, bulk milk tank, dairy inspection and lab fees, etc.). Boiler chickens, on the other hand, cost $2 per chick and need nothing more than a "chicken tractor," which you can easily make yourself, a grassy field to pull it through, and corn meal to supplement pasture. Processing fees for the chickens must be considered, but even this could be done at home with a simple set up (although there is a legal limit for home processing). The point isn't that broilers are more profitable than dairy cows—that assessment would take a more careful analysis. The point is that, even if you eventually want to run a dairy farm, you can get practice as a beginning farmer growing livestock and marketing animal products with far less risk and expense if you start with a few poultry.

Conclusion

In conclusion, let's return to the mindset of a banker. Even if you decide not to apply for a bank loan right away, put yourself in the shoes of a banker to get in touch with your financial conscience (your "financial good angel"). The banker is there to help you launch realistic dreams—whether they're big dreams or medium-sized dreams, they should be feasible. If you don't have a good plan with reasonable evidence that you will be able to cash-flow farm and household living expenses, then go back to the drawing board and improve your plan before you launch into action. Then, even if things don't go as expected, at least you'll know you did your best and will learn from your mistakes.

A final word of caution: money costs money, and the most expensive money is accumulated credit-card debt with interest rates around 25%. Would you ever sign on to an automobile loan with an interest rate that high? Avoid using credit cards to finance your farm.

References

Kauppila, Dennis. 2000. Land Link Vermont Fact Sheet: Your First Farm Loan. University of Vermont Center for Sustainable Agriculture. Burlington, VT. Autumn. www.uvm.edu/~susagctr/Documents/firstfarmloan.pdf

Further Resources

Publications

Bittermann, Vanessa. 2007. Plain Language Guide to Applying for a Farm Service Agency (FSA) Loan. Northeast Network of Immigrant Farmer Projects. http://nesfp.nutrition.tufts.edu/downloads/guides/PL_FSA.pdf.

This publication outlines a step-by-step process for applying for a loan from FSA.

Kivirist, Lisa and John Ivanko. 2008. Ecopreneur: Putting Purpose and the Planet before Profits. New Society Publishers: Gabriola Island, BC, Canada.

This book offers examples and suggestions for thinking creatively about starting, financing, and operating a rural enterprise.

Stokes, Jeffrey, et al. 2005. Agricultural Alternatives: Financing Small-scale and Part-time Farms. Penn State College of Agricultural Sciences Cooperative Extension, University Park, PA.

This publication explains why many small-scale farms succeed in Pennsylvania, examines the steps a farmer should take to secure a loan, and discusses the major lenders that serve the small-scale agricultural sector. Available at: http://agalternatives.aers.psu.edu/publications.cfm#FMM, which offers a range of publications on starting and managing an alternative agriculture enterprise.

Websites

Land Link: Strategies for Financing Beginning Farmers By Center for Rural Affairs. www.cfra.org/renewrural/farm

This helpful website for beginning farmers provides an array of information focusing on access to land and financing

Planning Your Farm Businesses
By Cornell University, Northeast Beginning Farmers Project: New Farm Hub. http://nebeginningfarmers.org/farmers/planning-2

This website offers an array of useful resources to help new farmers plan their business, including worksheets, business plan templates and samples, financing information, and more.

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Cathy Svejkovsky, Editor
Amy Smith, Production

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