

Tips for Building a Successful Lending Relationship

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If you are farming, chances are that a day will come when you need to approach a lender about getting a loan. Maybe you'll need a mortgage to buy land. Perhaps you'll need funds to construct a new building or buy machinery. You might want to set up a line of credit. Regardless of your needs, there are a few things to consider when starting and building a lending relationship.

It's important for farmers to develop a strong relationship with their lenders, even if their needs for funding are modest. A lender who knows you and understands your farming operation can be a great resource. He or she will be able to help you better understand your financial position, cash flow, and borrowing capacity. A really good lender will not just tell you "yes" every time you apply for a loan; they will tell you "no" when a loan is likely to put you in a precarious financial situation.

From a farmer's perspective, borrowing money is a lot like renting a piece of equipment. However, instead of renting a machine to help you accomplish a physical task more quickly and efficiently, you are renting the use of money to help you achieve a financial goal more quickly. And, just as using a rented machine can be dangerous if you don't know how to handle it, using rented money can be risky too. You wouldn't operate a dangerous piece of machinery without first reading the operator's manual. You don't want to borrow money before careful consideration of the pros and cons.

From a lender's perspective, lending money to a farm is not really selling a loan, it is buying a farm's debt. The lender approaches a debt-buying decision very carefully, and really doesn't want to make a mistake that could prove costly down the road for either the borrower or the lender. He or she is making a long-term investment that needs to benefit the farmer and the lending institution.

It is essential to find a lender that you like and trust, and who understands the business of agriculture. You want one with whom you can easily communicate and who takes the time to understand your operation. He or she should ask good questions, be a good listener, and be willing to learn about production or marketing methods that they might not see every day. Your lender should be able to clearly explain all of the terms and conditions of a loan commitment. He or she should be willing to explain how their lending decisions are made.

The best way to narrow your search for a lender is by asking other successful farmers in your area which lender they use. You should be able to generate a short list of potential lenders pretty quickly.

Your first meeting with a prospective lender could take place either in their office or on your farm. It's a good sign if the loan officer offers to meet on your farm. They are saving you the time and trouble of getting cleaned up and driving into town, and are showing a genuine interest in learning more about your farming operation by seeing it. You'll also be more likely to have all of the financial or production records you might need at your fingertips.

You don't need to have a formal business plan and loan request ready to present at the first meeting. Part of the first meeting will be the lender explaining what they need to gather to consider a loan request. However, you and your lender will both find it helpful to have a good idea of your financing needs, a recent balance sheet, and at least a rough projection of the farm's cash flow.

When you are ready to submit a loan application, the lender will consider a combination of quantitative and qualitative measures to make a loan decision. These measures are commonly called the “Five Cs of Credit,” and include Character, Capacity, Capital, Collateral, and Conditions.

Character is all about you as a potential borrower. The lender will consider your farming experience, education and training, and the historical financial performance of your farm. A credit bureau report will be ordered. The report will be compared with your balance sheet to see if all liabilities match up. Your credit bureau score will be considered as an indication of your propensity to pay all of your financial obligations on time.

Capacity is all about the farm’s cash flow. Is there enough cash coming in to cover all operating expenses, family living costs, loan payments (including payments on the new loan being proposed), and still have some cash left over to both reinvest in the farm and put something into savings.

Capital is where your balance sheet comes into play. The lender will consider all of the farm’s assets and liabilities, and your owner’s equity position. He or she will calculate the farm’s “working capital” position (short-term assets and liabilities), and consider its strength relative to the farm’s annual gross income. Most lenders will want to see that the borrower is willing and able to advance some of their own funds or equity to support a loan request.

Collateral is the asset or assets that are formally pledged by a borrower to secure a loan. In a worst case scenario in which the borrower isn’t able to follow through on their loan commitment, the collateral is sold and the sale proceeds are used to pay off the loan. The loan amount that a lender will be able to approve will be limited by the value of the collateral. For example, if you are buying a tractor worth \$50,000 and are simply pledging the tractor as collateral, the lender may only be able to provide a loan of \$35,000.

Conditions are stipulations that are included in the loan agreement after a lending decision has been made. For instance, a lender may require you to carry property and casualty insurance on your tractor as long as the tractor loan is in place.

A good relationship with a lender will give you more than just a farm loan. It will provide you with a better understanding of your farm’s financial position and performance, and it will help you position your farm for long-term success.

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