# Financing Your Vineyard

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# Sources of Capital

- Yourself
- Family and Friends
  - Watch out - Money strains relationships!
- Banks
- Farm Credit
- Farm Service Agency

# What does a loan officer look for in a potential borrower?

## Assets

- Savings, stocks, bonds
- Household goods
- Vehicle
- Retirement accounts
- Home
- Vacation home – cottage at the lake or mountains
- Rental property

# Liabilities

- Credit card
- Vehicle
- Home equity loans
- Home mortgage

# Credit card debt

- Farmers and students are the largest users of credit cards – credit cards are easy money!!
- Using credit cards to pay for farm expenses is a serious problem – indicates that the business is not generating sufficient cash flow to pay accounts on a timely basis

# Credit Worthiness – Bank reviews the applicant's credit report

- Prompt payment record
- Number of times payments were late
- Accounts sent for collection

# Experience

- Does the applicant have the ability to carry out the endeavor?

# Preparing for the Lender

- Business Plan
  - Usually required or highly recommended!
- At the very least
  - Current Balance Sheet
    - Business and personal
  - Projected Cash Flow Statement

# Feasible plan

- Production and financial records to justify income and expenses.
- Income and expenses are realistic?
- Non farm income – does the borrower work at a full time or part time job
- Realistic family living expenses (FLE). How were FLE determined?  Average family of four FLE 60-70+K per year.

# If financial and production records are not available

- Use benchmarks established by VA Tech
- County averages for yields
- Prices of inputs – fungicides, fertilizer, labor
- Crop Prices for non traditional markets are a challenge
- Wholesale
- Retail
- Direct farm marketing
- Marketing methods determine prices - producer needs to do homework.
- Farm loan officer will do research to determine, "average crop yields", input prices, wholesale and retail prices

# Key Financial Ratios

- Operating Expense Ratio
- Interest Expense Ratio
- Debt to Asset Ratio
- Term Debt Coverage Ratio (Debt Service Margin)

# Operating Expense Ratio

- *What does it tell us?*

❖ What's available for loan payments and family living as well as improvements and savings

❖ Are expenses in line – are we paying too much for inputs relative to our outputs

# Schedule F

# Operating Expense Ratio

*What figures do we need?*

Cash operating expenses –
Total expenses less depreciation
Line #35 on Sch. F - line #16 on Sch. F

Interest expense –
Line #23 on Sch. F

Gross farm income –
Gross income
Line #11 on Sch. F

# Operating Expense Ratio

*How do we calculate it?*

$$\frac{\text{Cash Operating Expenses} - \text{Interest Expense*}}{\text{Gross Farm Income}}$$

*Example:* $\dfrac{\$220{,}000 - 20{,}000}{290{,}000} = 69\%$

***note: Depreciation is not included here, it is not a cash expense**

# Operating Expense Ratio

- *Where Should We Be?*

| | |
|---|---|
| ❖ Competitive | 0.65 or less |
| ❖ Caution | 0.65-.80 |
| ❖ Danger | 0.80 or higher |

# Operating Expense Ratio

- *Implications*

  - Lower ratio, more funds available for debt, living, improvements, & savings

  -If higher than 65%, probably need to reevaluate all costs

    - Start w/ largest expense

      -what can we do to lower the expense?

# Interest to Income Expense Ratio

- Interest Expenses/ income (Gross)
  - Comfort 0.05 or less
  - Caution 0.50 to .10
  - Danger 0.10 or greater

# Debt to Asset Ratio

*Calculations:*

**( Total farm debts**

÷ **total farm assets )**

= **Debt to Asset Ratio**

x **100**

= % D/A

*Example:*

**$ 200,000 debt**

÷ **500,000 assets**

= **0.40 Debt to Asset Ratio**

x **100**

= **40 % D/A**

# Expense Ratio + Interest Ratio

- If expense ratio + interest ratio = or > .80
- Business may have trouble meeting all financial obligation

# Debt to Asset Ratio

| *D/A ratio* | *Financial position of business* |
|---|---|
| **< 40 percent** | **Strong** |
| **40 - 55** | **Possibly stressed** |
| **56-69** | **Stress Likely** |
| **> 70** | **Very Stressed** |

# Term Debt Coverage Ratio (Debt Service Margin)

- Measure ability to generate sufficient revenues to meet all expenses and principal and interest payment
- Does NOT include depreciation
- Requires realistic budget

# Calculation of Term Debt Coverage Ratio

- Beginning Cash
- + Cash Income
- + Non-farm income
- - Operating Expenses
- - Capital Expenses
- - Family Living Expenses
- - Taxes
- + Loans
- + Interest Expense
- = Available Cash

# Term Debt Coverage Ratio

- $\text{TDCR} = \dfrac{\text{Available Cash}}{\text{Principal \& Interest Due}}$
- Comfort 1.15 or greater
- Danger < 1.00 - 1.10

# Advantages of Term Debt Coverage Ratio

- Farm's debt repayment capacity is a function of cash available for debt service
- Profitable businesses can service higher debt loads because there is sufficient cash available to for principal and interest payments

# Disadvantages of Term Debt Coverage Ratio

- Requires a realistic cash flow – **ACCURATE** projection of farm income, farm expenses, **family living expenses** and INCLUDING ALL debt payments

# Selecting a Lending Institution

- What is the lender’s commitment to agriculture?
- What percentage of the loan portfolio is agricultural loans?

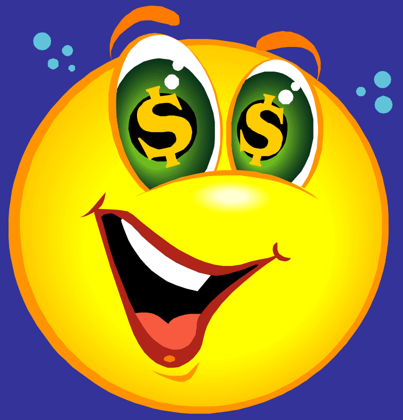
# Working with Your Loan Officer

- Search for a loan officer you can work with
  - Knowledgeable, confidential, honest, open
- Work **WITH** your loan officer
  - Treat him/her like a partner
  - Provide financial and production information on a timely basis!
  - Schedule annual farm visit
- Open communication is critical !
  - Talk with him/her before the problems start
  - Don’t hide during the bad times

# Under reporting income

- Not recording all income on tax return shows a lack of repayment capacity
- **Under mines the producer's credibility with the lender!**
- Remember, **YOUR LENDER IS YOUR BUSINESS PARTNER**

# What is the bottom line?



Non-farm income

+ Farm income

= Total income

-Family living expenses (include savings, retirement, college tuition, debt payments – mortgage, vehicle, credit card, travel etc.)

-Farm expenses

=Balance used for farm debt service and capital investments ( farm)

A positive ending cash balance is required to meet all financial obligations

# Questions?

- Drive your business, let not your business drive you.

  - Benjamin Franklin