



Economic Toolbox

Farmers Say... Bankers Say...

Lending to farms is not the preferred way for banks to make money. Outside of the Farm Credit System, agricultural lending is synonymous with speciality lending, meaning banks need to set up special departments with special employees and special analyses just for their farm borrowers. Commercial borrowers have their accountants prepare accrual statements for their lenders under Generally Accepted Accounting Principals (GAAP). Since GAAP prepared statements do not lend themselves to good analysis of farm businesses, this time consuming task is left up to the loan officer. This makes lending to farmers expensive and difficult to manage. When a bank is merged with or bought by another bank, speciality lending often is on the chopping block as a way to cut costs and consolidate other easier-managed types of lending.

Loaning money to production agriculture is also risky because farming is risky business. And, generally speaking, farm borrowers lack the business skill bankers find in their commercial borrowers. Does this mean banks will stop lending to farmers? Although many already have, there will probably always be commercial banks willing to lend to agriculture. The question is, will they lend to you? The general feeling is that it is going to be more difficult and you are going to have to do more work preparing information for your loan officer.

During the 1995 Empire Farm Days, 722 farmers responded to the question "Are you happy with the information you provide your lender?" Only 11 percent of farmers indicated that they were not happy with what they gave their lender. 22 ag lenders were asked if they were happy with the information provided by their farm borrowers. The bankers indicated that they were not happy with the information provided by 60 percent of their farm borrowers. It appears that 50 percent of farmers think that they are meeting their lender's information needs when in fact, they are not.

From the result of an informal survey of farm lenders, financial information was ranked by importance. (See Table 1.) It is no surprise to see income tax returns required by all lenders. Tax returns are the "official" financial record for a business, if not the best source of true profitability, especially for farms. A fair market basis balance sheet is the next most important financial statement required by lenders. With a cash basis tax return and a good beginning and ending period balance sheet, your loan officer can make accrual adjustments and can come close to getting to the true profitability of your farm.

One way to keep bankers happy is to provide them with more than what they require. In Table 1, the "nice to have" reports include accrual income statements, financial ratios and cash flow projections. Not by coincidence, these statements also provide you with good information necessary to manage your farm business.

The Dilemma

OK...OK.. Say you're convinced and you want to give your lender everything he or she needs, all completed. If you do not have the skill or tools to complete the financial statements, and most producers do not, how do you get it done? At least in the Northeast, there's not a good answer. CPA's are unwilling to complete an analysis based on Fair Market Value Balance Sheets (it's not GAAP) so don't look for help there soon. Most income tax preparers and bookkeepers are not trained for this type of analysis, and qualified farm business consultants are few and far between.

If necessity is the mother of invention, demand is the father of supply. Begin asking your tax preparer, CPA or business consultant for the type of financial information you and your lender require. Eventually, with enough demand, suppliers of these services will evolve.

The Good News

Finally, providing your lender with more and better information is not necessarily just

another additional cost of doing business. One hundred percent of the farm lenders surveyed indicated that the quality of financial information they receive has an impact on their borrower's interest rate. There is an economic incentive for preparing better financial statements. For example, if your lender were willing to reduce your interest rate on \$250,000 by one half of one percent (.005), you could save \$1,250 per year in interest expense. If it cost \$750 to have the statements prepared, and you saved \$1,250, your return on investment in those financial statements would be 167 percent. Not a bad investment. Start demanding.