Financing Your Vineyard

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Culpeper Office
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?

Cash Operating Expenses – Interest Expense*
Gross Farm Income

Example: $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 0.10
  - Danger: 0.10 or greater
Debt to Asset Ratio

Calculations:

\[
\frac{( \text{Total farm debts} )}{\text{total farm assets}} \times 100 = \% \text{ D/A}
\]

Example:

\[
\frac{\$200,000 \text{ debt}}{500,000 \text{ assets}} \times 100 = 0.40 \text{ Debt to Asset Ratio}
\]

\[
= 40 \% \text{ D/A}
\]
Expense Ratio + Interest Ratio

- If expense ratio + interest ratio = or > .80
- Business may have trouble meeting all financial obligation
# Debt to Asset Ratio

<table>
<thead>
<tr>
<th>D/A ratio</th>
<th>Financial position of business</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 40 percent</td>
<td>Strong</td>
</tr>
<tr>
<td>40 - 55</td>
<td>Possibly stressed</td>
</tr>
<tr>
<td>56-69</td>
<td>Stress Likely</td>
</tr>
<tr>
<td>&gt; 70</td>
<td>Very Stressed</td>
</tr>
</tbody>
</table>
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

• TDCR = \frac{Available \ Cash}{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 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