Financial Planning Considerations for Beginning Farmers

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Setting Financial Goals

When considering all of the expenses related to agriculture and farming the first step is to consider what your farm financial goals are. Are you planning to farm part time or full time? Will it supplement the family income or will it be the main source of income? By creating financial goals beginning farms can plan for the future and income can contribute to the household, farm and debt expenses.

A good place to start is to create a household budget. What income and expenses do you have on a monthly and yearly basis? A household budget can help when making enterprise decisions and estimating how much income and farm production will be necessary. Think about your personal financial goals. These could include paying for education, saving for retirement, making purchases, travel expenses etc. If you plan to supplement income with a farming enterprise you will need to pay for the farm expenses and make a profit. Having a clear picture of what amount of money the family needs to pay bills and meet debt requirements will help with the success of the farm business and your overall profitability.

Creating a Balance Sheet

A balance sheet can be completed right away. It is completed on a specific date and lists business and personal assets and liabilities. This financial statement is often requested by lenders and is used to measure your net worth using a listing of assets and liabilities.

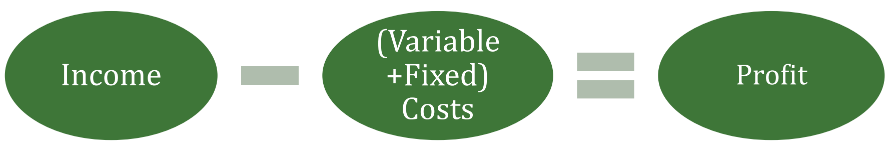
An asset is anything owned by the business. This can be cash, equipment, land, stocks, accounts receivable, livestock and inventory. A liability is what is owed by the business. This can be credit debt, accounts payable and loans. Most often both categories are divided into current, short term and long term. Current is one year or less and includes items that can easily be converted to cash. Short term are items like equipment that have a shorter loan term and usable life. The last is long term which are items like land that take some time to convert into cash and have longer debt terms.

When all assets and liabilities have been listed the net worth can then be calculated by subtracting the liabilities from the assets. Your net worth will be used by banks to make decisions on how much money they can safely lend you. It is a good practice to do a balance sheet each year on the same date so you can compare and see changes over time.

Enterprise Budgeting

Enterprise budgeting is another financial document that is helpful to farm financial planning. Enterprise budgets outline and estimate the income and expenses related to a particular enterprise. Budgets are created on a unit basis such as per acre, pound, square foot, bushel, or per animal. Using the best estimates possible for yield, price, variable costs and fixed costs a farmer can predict profits. This is very helpful when starting a farm or new enterprise.

For the income section the estimated yield and price will calculate possible income for the enterprise. Expenses are divided into two categories: variable costs and fixed costs. The variable costs vary with the level of output. More acres of crop or head of livestock the higher the variable costs. They will help you to estimate the amount of seed, fertilizer, pesticides, planting or harvesting supplies, fuel and labor associated with the crop. These will be important because a farm will want to at least make enough income to cover the expense of variable costs. Fixed costs are the overhead or farm expenses that will need to be paid regardless of the enterprise. Examples include insurance, interest, taxes and equipment. Once the estimates are made for income and expenses a farm can estimate the profit per unit selected.

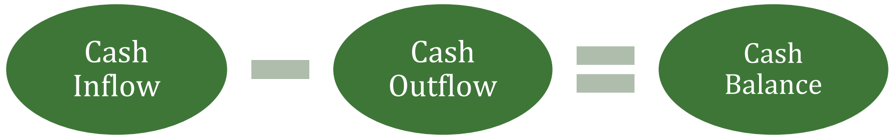


Cash Flow Planning

Cash flow is often considered the checkbook of the business and monitors the inflows and outflows of cash in the farm. Seasonality and risk are major reasons why cash flow should be a major consideration since debt and production expenses will be necessary. The cash flow statement is a great way to organize income and expenses and to ensure that funds will be available to pay expenses when they come due. Cash flow planning can be done monthly, quarterly or annually. Income will list all income sources which includes crop sales, payments, off-farm income and capital sales. Expenses included all production and operating expenses as they are incurred such as seed, fertilizer, feed, marketing, utilities, fuel, labor, living expenses and more.

There are two cash flow statements. The first is the actual cash flow. It is a checkbook register of income and expenses. The second is the projected cash flow which takes the actual and makes projections to the future income and expenses the farm will incur.

A projected cash flow statement cannot be created without estimations. This is one reason why enterprise budgets are so helpful since they list out the production expenses for each crop on the farm. The projected cash flow statement will often be requested by lenders as they make decisions on how much money to lend and if that loan can be repaid.



Financing

There are a variety of financing options for buying a farm and starting a farm business. Funding will be needed to start farming, working capital will be needed to get the product going and expansion or mechanization will need additional funding. The most popular source is self-financing. This is using personal funds such as savings to invest in the farm. Friends and family are another possible source of funds. These investors should understand your farm plans and have the agreement in writing.

Bank loans are another popular source of financing. Along with the farm mortgage there could be a loan for equipment purchases, startup expenses, farm structures, animals and more. Often a lender will want to see a business plan, proof of concept or another way of understanding what the funds will be used for and your ability to repay the debt.

Short term credit, lines of credit, or operating loans are often used for operating expenses. This is a way to get funding upfront so that a crop can be grown and repaid after the crop is sold.

Credit cards are another source of funding but should be used with caution. These generally are easy to acquire however charge very high interest rates. Credit cards should be used as a tool for short term purchases and not relied upon for the long term financing.

A few other sources of financing include the Small Business Administration microloans, USDA Farm Service Agency loans, Farm Credit Associations and investors. All three of these will have important considerations and should be researched thoroughly. These programs sometimes partner with other lenders, are contingent upon availability and what is funded and require a process to approve.

There is a common misconception that grant funding is readily available to buy, start or operate a farm. That is not necessarily the case. There are a limited number of farm programs that provide low interest and funding for farm acquisition or expansion. However, grant funding or "free money" to purchase a farm and startup expenses is very rare. Most grants that are available to farms are through a cost share program or a new innovative practice. The most common grants are through the USDA and SARE.

As the farm dream gets closer and financing becomes necessary it will be important to get personal finances in order. A household budget and review of your credit report are two ways to do this. The household budget will help estimate how much profit the farm needs to generate to pay debts and living expenses. Credit reports should be reviewed annually and provide important details about individual credit history.

Recordkeeping

Keeping records will be part of the day to day tasks of a farm from production activities to spray applications to financial records. It will be necessary to create a system whether paper, computer or app based to record and organize farm records. Some records will be required by law while others will be helpful in making farm decisions. For financial records take time to review the IRS Farmers Tax Guide publication to learn more about how to categorize income and expenses as well as your tax liability. Make it a habit to start keeping records and schedule time to create a system that makes record keeping a part of the farm routine.

Final Thoughts

When considering financing be sure to have realistic view of your financial position and ability to meet loan obligations. Using a business, production and marketing plan will help with the farms financial success. A comprehensive listing of the startup expenses will provide you and the lender with vital information along with the financial statements discussed in this section. Working capital will outline the variable costs of annual production expenses and lastly a buying schedule will outline future needs and expansion of the business.

A business planning template, budgets, spreadsheets and case study are available at:
https://extension.umd.edu/mredc/business-modules/farm-business-planning-workbook