farm CREDIT MID-AMERICA

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Making Wise Borrowing Decisions

When you apply for financing, it's reasonable to expect a clear explanation of how your lender is using the information you provide. Additionally, you want to know more about how the decision is made and the key factors that influence that decision.

At Farm Credit Mid-America, we want you to know more about the whole process. Because either way – whether your loan is approved or denied – the analysis and information that result can be very helpful to managing your farm operation. Our lending philosophy is rooted in extending dependable, constructive credit to farmers and farms of all types, sizes and backgrounds.

We attempt to use the same yardstick each time in approaching credit decisions, believing that if a loan cannot help the customer, make them stronger and more financially sound, then it is not a loan we should make. Financing should be a tool to improve cash flow and generate new income and positive earnings.

We choose not to extend credit simply on the basis of worth of an asset, knowing that we could recover our risk if the loan goes bad. Our customers and our cooperative are served best when credit is used as a tool to make farmers stronger for the long haul.

Five Credit Factors

Lending decisions are based upon analyzing the five credit factors to determine if the credit risk is acceptable.

Character - The customer's honesty and integrity as evidenced by previous contractual performance and credit references and the customer's management ability, including financing, production and marketing skills.

Capital - The balance sheet. Important measures are net worth and working capital. Also asset quality, debt structure and financing trends.

Capacity - The customer's profitability and ability to repay debt from ongoing earnings, while providing an adequate margin for capital expenditures and contingencies.

Collateral - Security requirements are based on analysis of the other credit factors and the loan risk. Collateral alone is not relied upon when considering an application.

Conditions - Includes loan purpose, amount, structure, etc. and are based on the customer's cash flow, management skills and financial condition, as well as the economic life of the asset being financed.

Underwriting Standards

Underwriting standards assure your application gets fair and equal treatment regardless of personalities and situations. Part of the reason for having several underwriting standards is to look for balance.

For example, a farm profitability ratio that exceeds standards may compensate for some weakness in capital or collateral standards. Other times, strong individual factors aren't enough. Strengths in capital or collateral values cannot offset inadequate profitability. The point is it's a blended picture, aimed to provide a comprehensive not a singular view of your farming operation.

Here are more details on our standards and how they are applied.

Liquidity - This is a measure of your farm's working capital divided by your average gross farm income. Working capital is your current farm assets less your current liabilities. It answers the question, "Can I pay my bills?" We look for a liquidity of 15 percent or greater for crop producing operations and at least 10 percent or greater for dairy and livestock producers.

Solvency - Your net worth divided by your total assets. For examples, your assets total $1.5 million. Your net worth is $850,000, thus your solvency equals 56 percent. We look for customers who have a solvency ratio of 50 percent or more. Lower solvency can sometimes be offset by strength in other factors.

Profitability - Consider all your farm and off-farm income, your interest expense on term debt and depreciation and divide that by all your demands, including expenses, principal debt repayment, short term interest expenses and replacement needs. The outcome is your profitability. Generally, we look for customers to demonstrate 115 percent profitability.

Collateral - This is your loan amount divided by the value of the property you are financing or the value of other assets pledged as collateral. If you borrow $100,000 to buy a property for $150,000 your loan is 66 percent. For operating and equipment/capital loans, we generally lend up to 75 percent. For real estate purchases under $100,000, we provide up to 75 percent financing. And for real estate purchases over $100,000, we provide 65 percent financing.

More About Profitability

To calculate a profitability ratio, your farm and non-farm earnings are combined to arrive at a 'net earnings.' The net earnings figure subtracts depreciation charges, income taxes and family living expenses. Typically Farm Credit uses three years of historical earnings from your farm operation to arrive at an average earnings. This helps level out bad years and losses due to drought and other unpredictable circumstances. The average earnings figure is used in our repayment analysis and profitability ratio calculation.

We also make exceptions when there has been a material change in your operation (such as a major expansion or moving into a new type of operation). In both examples, it's reasonable to change the number of historical years used or warrant using a projection for income based on the expansion.

Summary

Making decisions on loans is both art and science. Good farmers and good business people know that numbers speak to an operation and cannot be ignored. At the same time, decision makers must respect the character of individual farmer, their history and their ability to weather trying times even when the numbers aren't so encouraging. One of the first and best steps customers can do to assure the fastest and highest quality on a loan decision is to provide good information. Understand your balance sheet. Take time to think "Why did I make or lose money last year?"

Our desire is to provide credit that makes you more profitable and more successful. We encourage you to ask questions about your loan analysis and the numbers.