PLANNING FOR ON-FARM SUCCESS

A Workbook for Montana's Beginning Farmers and Ranchers

Module 6: Financing

USDA

Community Food & Agriculture Coalition OF MISSOULA COUNTY

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This workbook draws heavily from the following publication, which can be viewed online at misa.umn.edu. In addition to a large amount of the body of the document, all worksheets, unless otherwise noted, come from the following publication:

Minnesota Institute for Sustainable Agriculture. *Building a Sustainable Business: a guide to developing a business plan for farms and rural businesses.* College Park, MD: Sustainable Agriculture Research and Education (SARE), 2003.

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Module 6: Financing

The financing strategy you develop will depend on your choice of business organization and your values as they relate to risk, control, costs and maturity. Historically, farm businesses have financed themselves internally through family equity—relying on debt only when internal equity was not adequate to finance growth of the business. Today, however, external financing through debt, leasing, and outside equity is common.

Where to Start

Obviously, the most inexpensive source of money for your new farm is your own cash - no interest on loans, no home equity, no family loans, and no credit cards. Relying on loans substantially (or entirely) puts your farm dreams at too great a risk. It is worth the patience to build up your own farm start-up account. Personal resources oftentimes wind up being one of the few financial resources available to farmers during start-up.

Many farmers in Montana are seeing competition in the commodity market making business more and more challenging and are looking for ways to diversify their production, add value to their crops, or grow something entirely new to a local market. These are typically seen as great ways to make a business more secure and sustainable. However, with farm financing, it oftentimes also makes the business appear more risky because lenders may not be familiar with the types of production, products, or markets the farmer is proposing.

Deciding how to finance your farm has a lot to do with your business stage and your finances. If you can use personal resources, grants, donations, cost-share programs, leasing, and maybe some family and friends to get yourself to the point where you're selling product and bringing in revenue, a wide array of additional financing opportunities will present themselves to you. You'll have proven that you can produce your product and you'll have proven that there's a market for it that's willing to pay your price. Those pieces of information are critical to a lender and will greatly help your case.

If you're planning a business that will require significant start-up costs before you start bringing in revenue, the playing field will get a little bit tougher. In that case, potential lenders and investors are going to be looking at your marketing plans and financials with higher scrutiny. There's a good chance you'll be dealing with lenders or investors who aren't familiar with your field or your product, so making your business plan as compelling and educational as possible will be crucial. They will also want to know about your team and what it brings to your business that will make it thrive.

Most importantly, lenders and investors whether friends or bankers or wealthy neighbors, want to know that their loan to you or investment in you will either make them money or, at least, be paid back. Therefore, it's of utmost importance that you are comfortable with and confident in your numbers. Consider creating a budget narrative that explains why you've estimated your numbers as you have. Anything you can do to help a financial partner to have confidence in your business will help your chances of walking out the door with money.

If you anticipate the need for financing to pay for start-up, annual operating, or long-term capital expenses, you have several options to consider. Some common internal and external financing alternatives are described in the tables on the following pages. Much of the content in these two tables is derived from resources created by Slow Money Northern California[1] and SunTrust Bank.[2] Note: this chart and set of descriptions describe financing specifically for your business. Real estate financing can be a bit different and is covered later in this section and in Module 8.

As you'll notice from the chart below, business stage plays a key role in what types of financing are available to you. When you have an idea for a business and you're doing market research, product testing, etc., it will be extremely hard to find outside financing. When you're pre-revenue, i.e. spending money to raise cattle but not yet

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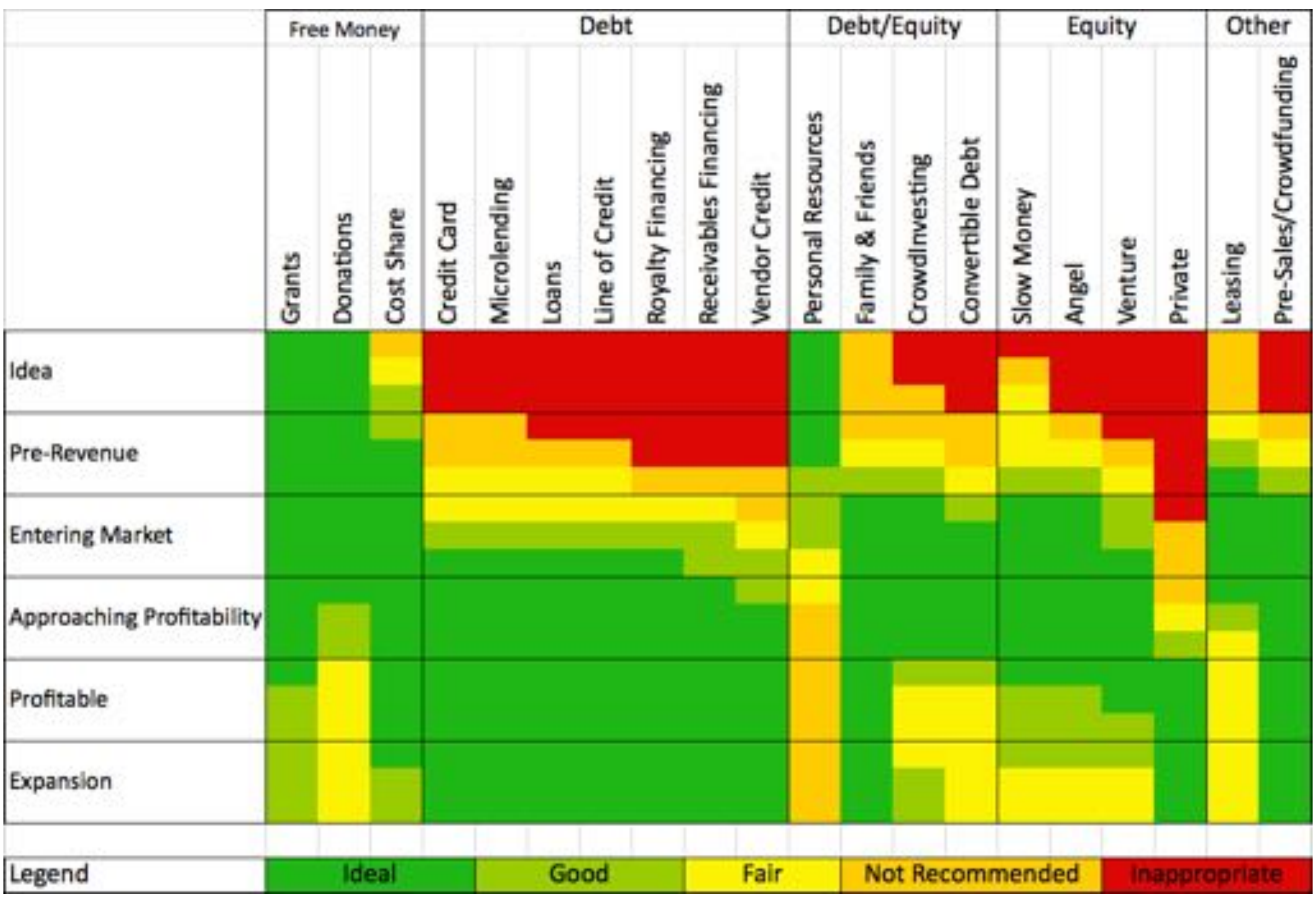
[1] Slow Money Northern California, *Stages and Funding Options*. 2012
[2] SunTrust Bank, *12 Financing Options*. nd.

selling them, you may find a few new avenues that will present themselves because you will have done significant planning and research to get there. By the time you're entering the market and starting to make sales, many more options become available, as you put facts behind the estimates in your business plan.

The stage between entering the market and approaching profitability, meaning that you're making profits overall each year, may take several years. Most businesses try to have start-up cash on hand for the first three years of business because it can oftentimes take that long to start bringing in profits. Once you are approaching profitability or are profitable, certain financing types start to become less ideal. If you're still using your personal resources to finance your business as you're approaching profitability, that may be a bad sign. If however, the business is making enough annual profits to re-invest those into the business, that's a great sign! As you become profitable, you may find it more challenging to acquire donations and grants as some individuals and organizations will feel that you have the ability to stand on your own two feet. Similarly, some equity investors will become less interested because they are typically looking for businesses that they can buy into for low prices and sell high. Until you are ready for dramatic expansion, those financiers may not be viable.

One thing to remember about investors: with the exception of Slow Money investors, investors are typically looking for high-growth businesses that will offer them quick and substantial returns on their investments. If you are starting a farm or ranch because you want that business to be your lifestyle, but you don't have plans of expanding the business and selling it to a major corporation or competitor, equity investors will probably not be a good fit for you.

Types of Financing and Appropriate Business Stages



Further Descriptions of Business Financing Types

		What is it?	Advantages	Drawbacks
Free Money	**Grants**	Awards from private and governmental organizations	Do not have to be repaid	Limited to specialized fields and operations. May come with terms or obligations that must be met.
	Donations	Gifts from private individuals or organizations	Do not have to be repaid	Number of people willing to donate with no return may be limited; Strong appeal required
	Cost Share	Typically associated with NRCS programs; NRCS will pay a portion of the cost of the improvement and you will pay the rest	NRCS does not require repayment as long as you make and maintain the improvement as promised	Must follow specific NRCS specifications; NRCS funds only become available after the improvement has been made and approved
Debt	**Credit Card**	Personally secured business credit cards	Available to owners with credits and assets; May be an option if you are not able to get a loan.	Expensive with high interest rates and oftentimes, variable terms; Not a good option for long-term financing
	Micro-lending	Smaller loans with more flexible terms, underwritten by SBA or delivered by community-based banks; Can also be peer-to-peer lending, which oftentimes has a 0% interest rate	Start-up option; Coaching/ technical assistance may be available; Connects the community with your project	Relatively small loans; nonbank loans (may not be an effective way to improve your credit score)
	Royalty Financing	Selling royalties on use of the name, image, or logo of your product in other licensing (for example, if Kettlehouse Brewing copyrighted the Cold Smoke name and a bakery wanted to make a "Cold Smoke" cupcake, they might need to pay royalties to Kettlehouse)	Provides cash without high expenses (after copyrighting or trademarking is completed)	Must copyright or trademark your brand or product name, image, or logo, which can be an expensive and time-consuming process
	Receivables Financing	Based on "accounts receivable"; Using an existing account or contract to secure financing	Provides cash and reduces collections risk	Relatively risky; Based on expectation that account/ contract will be fulfilled; Limited by volume/customer creditworthiness
	Vendor Credit	Obtaining financing from a vendor you typically sell to in exchange for future sales	Provides a sort of "cash advance" to cover low income periods; Can be an inexpensive credit option and good source of working capital	Because payment is in advance, cash flow may be off when you deliver goods; Limited by business scale and supplier credit

		What is it?	Advantages	Drawbacks
Debt	**Loans**	Loans from banks on standard terms; Can also include loans from government agencies such as the Farm Service Agency or public/private entities like Northwest Farm Credit or Community Development Corporations	Can offer larger loan amounts and favorable terms; Loans from government or public/private entities can have highly reduced rates; Loans from government or public/private entities may be willing to take on business plans with higher risks; Come in a variety of forms and terms	Challenging for risky start-up operations; Can be expensive with high interest rates; Requires clear documentation and business plans; Requires motivated and experienced lender
	Line of Credit	Between a business loan and a credit card; Typically issued a specific amount of credit and you can use and withdraw up to that amount of credit over a set period of time	Available to owners with credit and assets; May be an option if you are not able to get a loan.	Can be very expensive, with high interest rates; Not a good option for long-term financing
Debt / Equity	**Personal Resources**	Financing the business from personal savings or investments; Can be used as debt that the business will repay or an investment in the business	Available to owners with savings and cash flow	Limited by personal assets and savings; Potential risk to retirement/savings
	Family & Friends	Loans or investments from individual's friends and family; If the person expects a financial return, securities law will likely be involved	May be an option if you are not able to get a loan; Offer the possibility of favorable terms	Risk to personal relationships; Control and management can become issues
	Crowd-Investing	Using online tools such as WeFunder, CircleUp or Crowdfunder to advertise and accept debt or equity investments	Allows you to publicly offer and accept investments from non-accredited investors; Simplifies filing requirements; Creates wider pool of potential investors than just local investors	May result in large numbers of investors, which could cause management issues or future problems when you want to take on additional financing
	Convertible Debt	A loan that is converted into equity when your business reaches a certain level of success	Less expensive and time-consuming than filing to create publicly-traded stocks	Unlike straight equity, requires payment until the debt is converted; May have variable terms
Equity	**Slow Money**	Sale of part of the company to a private individual or group of individuals; May invest as debt, convertible debt or equity; Typically invest $5k - $100k	Available to lower-growth or slow-growth companies; May provide governance and advice; May have flexible terms and be open to receiving product as loan payments	Investors will still need an "exit strategy" even though you may have no plans to sell the business; Not a loan; Give up future profits and possibly control

		What is it?	Advantages	Drawbacks
Equity	Angel	Sale of part of the company to a private individual or group of individuals; May invest as convertible debt or equity; Typically invest $50k - $500k	Provides capital for high-growth companies; May provide governance and advice	Not typically an option for start-up or "lifestyle" businesses; Not a loan; Give up future profits and control
	Venture	Similar to Angel Investors, but typically investing $500k to $1M	Provides capital for high-growth companies; May provide governance and advice	Not an option for start-up or "lifestyle" businesses; Not a loan; Give up future profits and control
	Private	Similar to Angel or Venture Capital investors, but Private Equity investors are typically interested in "turnaround" businesses with potential but poorer numbers	Provides capital for high-growth companies; May provide governance and advice	Not typically an option for start-up or "lifestyle" businesses; Not a loan; Give up future profits and signficant control
Other	Leasing	Reduces payments for capital equipment/vehicles by leasing rather than purchasing	Lower payments and improved cash flow	Higher cost typically due to higher interest; May come close to paying off, miss some payments, and lose all investment
	Pre-Sales/ Crowd-funding	Crowdfunding is raising small amounts of money from a large number of people as donations or advanced product sales; Examples include Kickstarter and Indiegogo	May be an option if you are not able to get a loan; If received as donations, do not have to be repaid	Require significant time and cost investment for marketing to be successful; If received as pre-sales, may impact future cash flow and can provide financing beyond a business's capacity to meet demand

The types of financing listed above are specifically related to business financing. However, if you want to start a farm or ranch, you will also need to consider real estate financing. Land and building investments typically account for the largest farm expense and have the potential to make or break your business. Luckily, real estate financing is typically a bit easier because your ability to pay is based on your own income and savings rather than the perceived performance of your future business. If you have a couple of years before you are planning on farming full-time, having an existing off-farm job can be a great way to demonstrate creditworthiness to a lender.

There is more on land access and different types of ownership arrangements (lease, purchase, crop-share, partnerships, etc.) in Module 8. For the purposes of this discussion, be aware that many of the same lenders that would finance your business – banks, Farm Service Agency, and Northwest Farm Credit – may offer real estate loans as well. They have widely varying rates and terms so it's worthwhile talking to several before you allow them to pull a credit report for you (if each one pulls your credit, it will likely have a negative impact on your credit score).

Specific Funding Opportunities

While we've talked broadly about the types of financing available, let's dive into specific resources available in Montana.

Free Money

As you might imagine, free money is hard to come by. Just like with any small business or new enterprise, you can solicit **donations** for your work from friends and family. Now that crowdfunding has become a major phenomenon, there are a number of online resources that can help you cast a wider net with donation-seeking. These are covered below under "Other."

Grants

- USDA Rural Development offers two grant programs: Value Added Producer Grants which provide assistance to farmers who are developing new products, expanding markets, etc. with a value-added product. The Rural Energy for America Program provides grant assistance for purchasing and constructing renewable energy systems and can be used on-farm. Find your local office by visiting http://www.rurdev.usda.gov/MT_offices.html.
- The Western Sustainability Agriculture Research & Education program is a government-funded grant program that provides funding for farmers to conduct research and education projects. These can include projects such as applying new sustainable practices on your farm and sharing the results with your community or conducting new research on your farm. For more information, visit http://www.westernsare.org/.
- The Montana Department of Agriculture's Growth Through Agriculture (GTA) program offers grants and loans for new and innovative agriculture marketing ideas or agribusiness developments. For more info, visit http://agr.mt.gov/agr/Producer/GrantsLoans/.
- The Red Ants Pants foundation. Red Ants Pants is an apparel company based in White Sulphur Springs that hosts a large music festival each year. They reinvest the profits into the community by offering community grants, sometimes given to businesses, for projects that enhance self-reliance in rural communities. For more info, visit http://www.redantspantsfoundation.org/grants/.
- Your farm policy organization may offer grant opportunities, as Montana Farmers Union and Montana Farm Bureau Federation do from time to time. For more information, visit their websites at http://montanafarmersunion.com/ and http://mfbf.org/.

The primary **cost-share** program is offered by the Natural Resources Conservation Service through their Environmental Quality Incentives Program (EQIP). EQIP offers money that does not have to be repaid for on-farm conservation projects. There are a wide range of projects that fit their qualifications, including high tunnels, fencing, tree, wind rows, irrigation, and many more. Contact your local NRCS office for more info.

If you're looking to purchase electric fencing in regions of the state that have wildlife predation issues, consider reaching out to Defenders of Wildlife. They have a program that will match investments in electric fencing up to $500 ($1,000 total). For more information, contact them at (406) 728-8800.

Debt

"Debt" means money that you have to pay back, typically with interest. You may have noticed that on a number of the types of debt outlined in the table above there were notes that "terms" may be more or less flexible. This refers to the interest rate, payment schedule, required collateral, and other bargaining chips

Stories from the Fields

Talking about financing, Connie Surber of the Golden Yoke Dairy in St. Ignatius emphasizes the importance of telling your story, being open to multiple options, and finding the right fit. "We don't hold back on telling our story; we'll tell it to anyone who wants to listen. We don't narrow financing options down to one single place but explore a range of options and try to find someone who wants to work with us."

When Connie was figuring out how to afford tuition at Penn State's Ice Cream Short Course, she asked about scholarships but found that none were available; undeterred, she applied for and received grants from Red Ants Pants Foundation and the Montana Farmers Union, which together allowed her to attend the course. Most recently, she and Laura went through the state to acquire a Grow Through Ag grant that allowed them to purchase a pasteurizer.

For loans, Connie and Laura considered several options, including the Farm Service Agency, Credit Unions, and the Montana Community Development Corporation (MCDC). They decided to work with MCDC because, as Connie puts it, "What you get there is not just a loan with flexibility on interest rates and payment schedule, but also incredible support. They're just awesome." Through word of mouth, Connie and Laura also obtained the support of two private investors, who have set aside funds for Golden Yoke that they can access at whatever future date they need to. A portion of the interest from the loans will go into a Slow Money fund for new farmers in the future.

that are on the table in the lending process. All of the forms of debt outlined above are available through a wide array of sources depending on your capacity. Banks may be the first things that come to mind, but here are a few more:

- The primary ag lender is the USDA Farm Service Agency (FSA). FSA offers an incredible range of loans and funding opportunities and your best bet is to schedule a time to meet with someone in your local FSA office to find out about programs that may apply to you. Their most popular are real estate and operating loans, but they also have a wide ranging disaster assistance program and many other offerings. In addition to direct lending to businesses, FSA also guarantees loans made at other institutions, meaning that they will carry some of the risk so that you can get a reduced interest rate. You can find your local office at http://offices.sc.egov.usda.gov/locator.
- The Montana Department of Agriculture's Beginning Farm & Ranch Loans are available from a tax-exempt bond program that aids financial institutions in assisting Montana's beginning farmers and ranchers. Loans can be used to purchase agricultural land and other depreciable agricultural property. Their GTA program also offers loans. Find out more about both programs at http://agr.mt.gov/agr/Producer/GrantsLoans/.
- Northwest Farm Credit (part of the national Farm Credit system) offers a variety of loans and has a specific program geared towards young, beginning, and small farmers and ranchers. This program offers reduced interest rates and more flexible terms, as well as additional interest rate reductions for attending educational programming focused on business planning and financing. There are currently three specialists on this program in Montana so your local Farm Credit lender may not be familiar with the program, but they should be able to connect you with someone who can help you. For more info, visit https://www.northwestfcs.com/Products-and-Services/Young-Beginning.
- Community Development Corporations and Community Development Financial Institutions are public-private entities around the state that offer business assistance and financing to small businesses. They oftentimes offer a wide range of loan sizes with flexible terms. Although their interest rates are typically a couple percentage points higher than a bank, they are often able to finance riskier businesses so if your bank won't lend to you, consider checking with your local CDC or CDFI.
- Microlending can be defined as small, direct loans like those provided by CDCs and CDFIs, but it can also mean peer-to-peer lending. Peer-to-peer lending often avoids SEC regulations by having 0% interest rates. This can be a great deal but they're often very small loans, like $10,000 or less. Websites like KivaZip can connect you with lenders from your area or around the world. For more info, check out https://zip.kiva.org/.

For a comprehensive list of all funding opportunities offered by the USDA, see their guide, *Building Sustainable Farms, Ranches, and Communities*.

Debt or Equity

While debt is money that is gradually repaid with interest, equity means the sale of ownership of your business. When someone is an equity investor in your business, they become a shareholder in your business. There are extensive federal and state laws about how businesses should deal with investors and equity investing is only allowed in very specific circumstances so it is critical that you consult with an attorney familiar with Securities Exchange Commission (SEC) regulations before taking on any investors. Also note that if you take out a loan from an individual and you are paying interest on the loan, that may cause SEC regulations to apply as well. Think of it this way: if the person who is giving money to your company has any expectation of getting a financial benefit from their gift, SEC regulations may apply. Donations don't count and pre-sales don't count but a loan with a 2% interest rate does.

Nonetheless, it's important to think about the use of your own personal resources and those of your family and friends as being a debt or equity investment in the business. First, it will remind you to track these dollars to ensure that they will be repaid and second, it gives you and your friends a choice of being paid back gradually over time or owning a portion of the business that provides financial returns when the business or stock is sold. Having this conversation before investments are made will help to ensure that relationships aren't ruined in the process! Consider what interest rate you or your friends would like to charge the business and ensure that those elements are part of your financial plans.

Crowdinvesting is an opportunity that only became available to Montanans in 2015. The 2013 Federal JOBS Act and 2015 Montana Crowdfunding Law created a new exemption to SEC regulations that allows businesses to publicly solicit investments, making potential investors much easier to find. The law requires that investors raise no more than $1million each year and no more than $10,000 from each investor. Also, investors must be Montana residents and the business must be based in Montana with sales in Montana. There are still some registration requirements at the state level, but they are significantly less than they once were. Numerous portals have popped up online to help businesses connect with and vet potential investors, including WeFunder, CircleUp, and Crowdfunder. There are currently no Montana-specific crowdinvesting portals. If you're only looking to bring on a limited number of investors (fewer than 25), there may be other exemptions from SEC regulations that would fit your situation as well. As with any type of investment, it's important to talk with a lawyer before jumping in.

Equity

Equity investments are typically not used by farm and ranch businesses because Angel, Venture, and Private Equity investors are generally looking for high-growth companies with a clear exit strategy, such as investing in a start-up juice business with the goal of expanding and being purchased by Odwalla. When the company is sold to Odwalla, the investors sell their stock and "exit." Obviously, these investors take on major risks, but that means they also expect major returns. However, if your business does have high-growth expectations, here are some resources in Montana:

- Frontier Angel Fund is currently in its second round, Frontier Fund 2, of angel investments in Montana businesses. More info is available at www.frontierfund2.com.
- Next Frontier Capital is a venture capital investment fund based in Bozeman. More info is available at http://www.nextfrontiercapital.com/.

As noted in the table above, Slow Money investors oftentimes have financial expectations that are better matched with farming and ranching businesses. In fact, on a national level, Slow Money groups are often focused on investing in food and ag-related businesses. As of 2015, Montana does not have an official Slow Money group. However, Good Works Ventures is a Montana-based fund that makes investments in ag-related businesses and coordinates the Hellgate Venture Network where you can meet other entrepreneurs and investors in the Missoula area. More on Good Works Ventures at http://goodworksventures.com/.

Other

Although leasing and pre-sales/crowdfunding don't quite fit in with any of the other categories, they're still very much worth mentioning. Leasing can fall into two categories: capital or operating. A capital lease can be categorized as a property "rental agreement" when ownership rights are not transferred, and as a "purchase" when the lease gains you ownership of an asset at a reduced purchase price at the end of the agreement (lease-to-own). Capital lease purchase agreements can provide effective control and may reduce costs while building equity. Whether it reduces cost or risk in the long term will depend on the details of the agreement. It is always advisable to have a lawyer look over the details of any agreement that will have such a major impact on your financial future. Operating leases can relate to property rental or to equipment rental, such as renting a tractor (or leasing-to-own) rather than purchasing one outright. The benefit of renting is that you only pay for it when you need it and you don't have to pay for interest, taxes, and repairs. The drawback is that you have to pay for transportation each time you use it and it may not be available when you need it. Also, just like renting versus owning a home, you're putting funds toward a tractor that you can't sell. Nevertheless, if buying isn't in your budget, leasing or leasing-to-own can be a great way to still get the land and equipment you need.

Stories from the Fields

A lot of farms, including us, account for grant income (Kickstarter, gifts, etc) in their budget because they have to. Like a lot of farms, we have some creative side enterprises that make up the need for income like our direct trade coffee and lambs, but these programs require continued investment, in time, money, and other resources. - Sweet Root Farm, Hamilton

Crowdfunding and pre-sales have grown dramatically over the past several years with the success of online fundraising portals like Kickstarter or Indiegogo. There are no Montana-specific resources on crowdfunding, but there is a vast set of information online with recommendations about which site to use (they're all a bit different from one another) and how to structure and market an effective, successful campaign. Just remember not to structure these tools as "donations" in your financial statements. With most crowdfunding campaigns, you will owe people a perk of some kind, so you need to include those expenses fully in your financial planning.

Financing Alternatives

If financing does not fit in your cash flow, there are other options to consider. One way to reduce the cost of purchasing land or equipment may be to **share ownership** with a neighbor or someone else. Shared ownership gives you reduced control, but at half or less of the cost. Timing concerns usually limit the use of this option, as is often the case in Montana, everyone needs the major equipment at the same time of year. One of the more creative solutions that is being used to some degree today is to share ownership with someone who farms in another part of the country where the cropping season is different. Again, you may be able to think outside the box and come up with a creative shared ownership strategy. Whenever shared ownership is used, you should put the agreement in writing to avoid future disputes.

Strategic alliances/networking may be a way of addressing some of your operation's needs without having to buy equipment or hire staff on your own. You may be able to gain access to a specific input into your production process by either investing in someone else's operation or by contracting with that operator. While the most visible use of networking in agriculture has been in large pork production operations, you may be able to think of ways to network with other operators or suppliers that are not as expansive. Businesses have long relied on alliances and joint ventures to reduce individual costs or to guarantee access to inputs or markets. Such reliance on relationships may be vital to the sustainability of both parties.

Another way to think of strategic alliances is through **cooperatives**. If there are multiple people around you who have similar ways of recordkeeping and similar financials and you all

Stories from the Fields

Karl Sutton runs Fresh Roots Farm, a small, diversified fruit, vegetable and seed farm near Polson. Asked how he financed his farm in the early stages, Karl replies, "Spent a lot of money." Karl and his wife Darci worked in other careers before starting Fresh Roots Farm, and they invested savings as well as the revenue from selling their house in order to make a down payment on their farm. Karl says, "The place bought had an old farmhouse and no infrastructure. This was not a very expensive farm. Very expensive farm to fix, but not to buy."

Karl emphasizes that his family has maintained sources of off-farm income to help finance their farm: "It wasn't until probably three years in that I left working full time at my prior work, but then I still work in the winter doing odd contract jobs, and my wife still works full time." Karl and his wife Darci have developed the infrastructure on their farm considerably, and Karl explains, "The reason I work off the farm is because we've been spending the money the farm brings in on the farm, whether it's buying new equipment or building things."

On identifying funding sources, Karl explains, "I don't think, 'What's the best fit for our operation?' I go about it like, 'What do you have for programs?' I'm not afraid of the bureaucracy of federal programs, so I am just like, 'Okay, we'll do it all!' That's probably because of my comfort level with grants, so that's how I approach it."

Fresh Roots Farm has received grants from the Natural Resources Conservation Service Organic EQIP program, which has allowed them to install high tunnels and drip irrigation, to attract pollinator species and grow more diverse grasses, and to improve their water management by analyzing usage and maximizing efficiency. "And it's been great!," Karl exclaims. "We wouldn't have developed the infrastructure we have without them. That's our major support; we haven't taken any external loans for developing the farm besides the mortgage, and we got one mini grant through Grow Through Ag for developing a logo and a farm sign."

Karl's personal preference is not to take on additional external loans. Karl says, "I know there are loan programs like the FSA microloan program for improving handling facilities, and they have really good interest rates, but I don't really want to take on another external loan as I get rid of external loans. I've used Mission Mountain (Food Enterprise Center) for storage facilities last year because we didn't have them and that worked well. When I look at winter usage needs, I also can't forget that that's there, and it is going to cost money to use, but it's cheaper than building our own facility."

Karl also finds creative ways to pay for large purchases. For example, he explains, "One piece of equipment I purchased, I put it out through the Western Montana Growers' Co-op to rent and within a couple seasons I've had a couple growers use it and their rental fees price it down dramatically."

need an accountant, maybe you could form an informal cooperative to hire one accountant together. On a grander level, if several farmers in your area want to serve a larger market like a hospital, but you can't do it on your own, maybe creating a cooperative business could help you aggregate and market product together. The Western Montana Growers' Co-op is a great example of this (http://wmgcoop.com/) and the Lake County Community Development Corporation provides cooperative development assistance to businesses across the state. More info at http://lakecountycdc.org/.

What to Expect When Visiting a Lender

The National Center for Appropriate Technology's ATTRA publication, *Financing Your Farm: Guidance for Beginning Farmers* is a fantastic resource to read when you're preparing to meet with a lender. One of their recommendations is to think like a banker:

> *Think of your loan officer as a prospective business partner who is willing to put some skin in the game of a new business that stands a reasonable chance of success. If the business succeeds, the bank will recoup all of the money it loaned you, and it also will earn interest on its investment in your business. This is a good deal for the banker. But if it turns out you are not able to earn enough money – either through your farm operation or your off-farm income – to make your monthly loan payments, then you and the banker are both in trouble. Therefore, to get your banker to join you as a business partner, you need to demonstrate that:*
>
> - *You know how to farm and that you have a good plan for making money farming;*
> - *You have other sources of income that will help you pay back the loan; and*
> - *If all else fails you have something of value (real estate, equipment, etc.) that can be sold to repay the loan.*

If you've gone through the process of figuring out your finances, market, and strategic goals in the previous five modules, you should have all this information. You may find it helpful to schedule an informational meeting with your lender to learn about the application process and the types of programs they have available. This will also give you an opportunity to introduce yourself and start building rapport with your lender. Although the lending process can be confusing, lenders rely on personal relationships and trust, so putting your best foot forward is critical. If you don't know your lender and/or you're new to the community, it might be helpful to apply for a small loan for a piece of equipment, for example, to demonstrate that you can repay the loan and that you're good to work with.

Stories from the Fields

We looked at a lot of banks and the one we went with really liked seeing growth. Even though it wasn't a lot, it was important to show the two years of prior income and to show that we were growing in size and ability. - Ian and Ellen Farm, Hamilton

For loans with the FSA, there are some specific documents that you can expect to fill out to apply for a loan:

- Loan Request: five-pages with personal information, annual income, short description of the operation, and location of farm.
- Three-Year Financial History: operating income and expense for the previous three years. If no history is available, FSA uses industry standards.
- Three-Year Production History: used to make future projections about yields. Be sure to report production for all animal species and crop varieties including those for sale and those for personal consumption to give a clear picture of the farm's production ability.
- Creditor List: requests account number and contact information for each creditor to whom the applicant is currently indebted.
- Other forms: Authorization to Release Information, Income and Expense Statement (can be a projection), Balance sheet, Property Owned or Leased, Description of Training and Experience.

Your loan officer should be able to help you work through this process and they have specific forms for many of the documents so be sure to do some research and connect with your lender before getting started.

Making a Decision on Your Financing

As you consider financial alternatives, be creative. If you can find a way to get by on grants, donations, and personal resources, when your business is brand new, that's great. If you need to track down other funds, hopefully you've learned about a number of ideas and resources that can help you get there. Creativity is required to deal with any number of large and small problems on the farm, from pest management to soil building, and making sure your business is set up to succeed and thrive financially is just another challenge to be figured out.

If you're looking for a more analytical way to choose between an array of financing options, consider the decision-making points at right.[3] As a few examples of how these decision-making points might apply to different financing options, consider the following. Equity investment options may have an impact on your control and independence in your business as additional shareholders or business partners bring their knowledge to the game. However, that knowledge can also be a tremendous resource that you can tap into. Cost is an obvious consideration and if you are facing a financing opportunity where the true overall cost is unclear, be wary. Make sure you understand the full costs of every option but don't make cost your only consideration. Some financing resources, like friends and family, may appear to be very low-cost, but may turn out to be a major headache.

Each of us has a certain level of comfort or discomfort with risk. Are you risk-averse, feeling stressed out when you aren't sure about your finances, or are you a risk-taker, even feeling excited by risky opportunities? Everyone has their place on the spectrum and it's important to figure out where you fall.

Especially when you are considering a contract, make sure you understand the fine print about maturity and what happens when the loan or investment "matures." Will you be expected to pay the loan back in full in a lump sum payment (balloon payment) in five years? Will you be expected to buy out investors who are ready to divest of their share of your business or will they be responsible for finding a buyer? Get clear on these issues and make sure you're comfortable with whatever you're agreeing to.

After reading this module, you may be able to identify and employ several alternatives to meet your goals, limit risk, and increase financial flexibility. Use Worksheet 6A: Financing Plan to identify one or more financing strategies for your business. You may not be able to answer all the finance questions until after you've completed your business plan— particularly if your purpose for planning is to secure outside financing. Still, you should begin this research and identify the most plausible strategy alternatives for your business.

Financing Strategy Issues

Control. How much control and independence do you want to have in the decision-making process? Many small businesses use internal equity as their major source of finances to maintain control and autonomy. This desire for control may hinder their ability to branch out into more unconventional methods of agricultural financing.

Cost. Which method of resource control will come at a lower cost? The standard comparison here is between lease and purchase options. But there are several other options including such methods as shared ownership and outside equity financing. Look beyond traditional ownership costs to include administrative and legal costs, taxes and licensing fees when evaluating financing opportunities.

Risk. Each financing method comes with its own level of financial risk. Some will expose you to claims on income from partners and investors. Others will place claims on the assets of your business, which may change the size and speed of your equity growth. Still others could open you to certain legal liabilities such as liability for the debts of business partners. And there is the final risk of failure, which can be influenced by the financial structure and method of financing that you choose.

Maturity. Some financing and business structures are short-term in nature and relatively easy to change or dissolve. Others, such as a corporate structure, are more permanent and can be very costly to dissolve. When selecting a finance strategy, consider the importance of business liquidity versus permanence.

[3] Michael Boehlje and David Lins, *Planning the Financial/Organizational Structure of Farms and Agribusiness Firms*. Iowa State University, 1998.

Worksheet 6A: Financing Plan

Use the space below to begin developing your financing strategy for any start-up, annual operating, and longer-term capital and real estate needs associated with each major business strategy alternative. Begin by having each member of your planning team (if appropriate) evaluate the importance of the financing strategy criteria. Next, list money that will be needed to finance start-up, operating, and long-term needs as well as one or more financing strategies for each. If any of your strategies include the use of external financing, be sure to research and record interest rates and financing conditions in the space provided. Be sure to talk with your local lender or accountant - they can help you locate and evaluate the strategy which best fits your personal criteria and business needs.

Strategy Criteria

Rank how important each of the following finance strategy criteria are to you:

Control	_______ Low	_______ Medium	_______ High
Cost	_______ Low	_______ Medium	_______ High
Risk	_______ Low	_______ Medium	_______ High
Liquidity	_______ Low	_______ Medium	_______ High

Financing Needs

List money needed for each expense category. Then, briefly describe one or more financing strategies for each.

	Value	**Strategy One**	**Strategy Two**
One-time start-up needs	$ ____________	________________________	________________________
Annual operating needs	$ ____________	________________________	________________________
Intermediate needs (5-7 years)	$ ____________	________________________	________________________
Long-term needs (7-10 years)	$ ____________	________________________	________________________
Real estate needs	$ ____________	________________________	________________________

Finance Options

If you plan to seek outside financing (including government cost-share payments), research interest rates and other financing conditions (such as easement terms) from up to three sources for each financial need.

Need	**Source/Institution**	**Interest Rate**	**Conditions**
Start-up	____________	________	______________________________
	____________	________	______________________________
Operating	____________	________	______________________________
	____________	________	______________________________
Intermediate	____________	________	______________________________
	____________	________	______________________________
Long-term	____________	________	______________________________
	____________	________	______________________________
Real estate	____________	________	______________________________
	____________	________	______________________________