

LENDING REQUIREMENTS CRITERIA

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Introduction

Farming and banking is constantly evolving which requires farmers and bankers to evolve at the same rate. Expectations are now higher than relying on your banker to solely complete a budget/cashflow for your business, and it is expected farmers have a good handle on not only the production side of the business but also the financial management and performance.

Lending requirements from a banking perspective are not as clear cut as a pass or fail as most people think. Whilst banks have lending guidelines we have to adhere to, these are assessed on a case by case basis and the outcome of the decision can be influenced by the preparation, personal factor, knowledge and passion of the applicant.

How to approach the bank

Treat the bank as if you are asking them to invest as a major shareholder in your business – this is what they are in most cases. You need to make a detailed case why you are a good candidate for a loan, having clear answers for basic questions such as how much money is needed, how it will be spent and how and when it will be repaid.

For clients approaching a bank which they have no current relationship with, it is expected you are prepared with:

- Current Statement of Position (assets and liabilities)
- Most recent set of financial accounts (if possible)
- Milking Contract
- Budget(s)
- CV with references
- 6 months bank statements (to show account conduct)
- Goals (short, medium and long term)

Notes:

You must show you have the passion and ability to make your plan work. All banks are generally supportive of Contract Milkiers, LOSM's and Sharemilkiers but it's not a given you will get lending – you have to prove you deserve a chance. Most banks will provide an overdraft for you if you can demonstrate this ability to them.

Main criteria required to satisfy before the bank will approve an application

1. Security

This is one of the main focus points for the bank when assessing a lending application. Is the loan going to be adequately secured if it is approved? If the answer is no then we need to look outside the box to see if there is an alternative way we can satisfy our security criteria, whether it be a guarantee from a family member, employer etc.

General rule of thumb is the bank will lend up to 60% on rural assets, whether it be land or stock, based on a bank valuation. This is compared to 80% for residential lending. Although each bank's values can differ and independent valuations can often add value.

For entry level clients into the dairy industry such as contract milkiers, security is generally the main hurdle. In these cases the strength of the application is usually based on the personal factor of the applicant, as often no security is on offer.

2. Budget/Cash flow/Viability

If the security level is satisfied, then a bank will look at the viability and cash flow of the business. From the budget we assess if the business can sustain the current/proposed debt. If not, we need to look for other ways to make the business more efficient by reducing the cost structure – can we reduce costs such as staffing, do we need to buy all plant this year and does it need to be brand new? Can/Does your partner work off farm?

If a solution can't be found this would indicate a business plan which is not viable, therefore a bank should not go ahead with the proposed deal. Running a business with negative cash flow erodes the equity the owner(s) have worked hard to build and is not a sustainable business model.

Budget as defined by Wikipedia

“A budget is a quantitative expression of a plan for a defined period of time. It may include planned sales volumes and revenues, resource quantities, costs and expenses, assets, liabilities and cash flows. It expresses strategic plans of business units, organizations, activities or events in measurable terms “

Key budgeting tips

- Be realistic and achievable (in line with industry average benchmarks).
- Allow for contingencies as there is often unforeseen expenditure that arises.
- Profit equals tax therefore needs to be included in your budget.
- Be realistic with drawings.

Cash flow as defined by Wikipedia

“Cash flow is the movement of money into or out of a business, project, or financial product. It is usually measured during a specified, limited period of time. Measurement of cash flow can be used for calculating other parameters that give information on a company's value and situation. Cash flow is the movement of money into or out of a business, project, or financial product. It is usually measured during a specified, limited period of time. Measurement of cash flow can be used for calculating other parameters that give information on a company's value and situation. “

Cash flow is a tool which shows how much working capital is required to run the business annually. It spreads out the year's income and expenditure on a monthly basis.

Key cash flow tips;

- Timing of income and expenditure is vital.
- Monitor and update the cash flow on a monthly basis.
- Be proactive rather than reactive if issues arise – result of monitoring.
- Communication with professionals – particularity bank.

3. Personal factor

You may have ticked the security, viability and cash flow boxes but that doesn't necessarily mean you will be successful in getting the finance you require. Whilst the numbers meet the criteria, personal factor weighs largely on any decision as we have to be sure the person running the business is able to achieve the budget/cash flow.

Personal factor considers multiple things;

- Physical ability.
- Financial ability.

Notes:

- Knowledge and/or willingness to learn.
- Passion.
- Demonstrated a proven track record – financially, production etc.

Whilst being strong in all of the above areas would be ideal, it is not realistic as we all have our weaknesses, but people who have good personal factor can identify their areas for improve and mitigate them. For example if you are limited on financial knowledge you should look to build a strong professional team around you such as a farm advisor, farm owner, banker, accountant etc.

Summary

If you can satisfy the three main areas; security, budget/cash flow/viability and personal factor you have a very strong case to have your application approved. Really take ownership and know your financial requirements before you approach the bank with qualitative information so you can install faith immediately with the bank as the first impression is the most important.