The Credit Review Office provides some information for Farms considering funding a Capital Project from 'Own Funds' or working capital

Farm lending has been one of the strongest sectors for Banks' lending over recent years, however experience from Farm lending appeals to the Credit Review Office suggests that there is also a high degree of self-investment in the Industry. It may be that there is further unmet demand for Bank credit from Farms which is not being realised, as it is in the SME sector.
A separate piece of research is being commissioned by the Credit Review Office to explore whether changes in banks' physical distribution networks is adversely affecting demand for credit.

Many Farms are planning to grow capacity through herd expansion or building work, and/or replace ageing capital equipment. The above research indicates that many of these projects will be self-funded.

Self-funding is of course the cheapest form of finance available to Farms and this should always be considered as an option, there are however some pitfalls in pursuing this option which we have observed from previous credit appeals. Remember, having available cash is king in terms of business survival.

The main danger in self-funding is in running out of working capital for your existing core farming business. A farm which is struggling to meet its own operating bills, will have little surplus cash to complete the capital project.
A good farm can run out of cash to fund a project either through an unexpected increase in the capital cost of the project, or an unexpected shock to the core farm's finances, say from a change in market prices, or poor weather affecting output; or more dangerously high reliance on the farm's creditors as a source of funding. If such shocks happen, you risk having cheques bounced on your farm business account, with all the reputational damage with creditors on which you may be relying for feed etc. There is also the impact on the farm's credit bureau records on which future financing decisions by banks will be made.

In such viable cases presented to the Credit Review Office we have been able to successfully show the lending bank the strengths of the core farming business, and to identify the sunk costs in the capital project together with the projected costs to finish it out; and then show that there would be enough cash generated by both the core farm business, and eventually the outputs of the project itself to cover term loan repayments. But bear in mind, before the Credit Review Office had been involved the lending bank had already said 'NO' twice to the borrower's application – the process to get credit may have taken over two months, and some farm businesses may not be able to survive that long.

A secondary aspect that has been observed in the Credit Review Office is that when applying for credit, banks will look back at the financial performance of the farm business over the past three or more years and will give little or no recognition for the funds which have been self-invested. The performance of the farm may be better than the financial accounts suggest if profits are being used to fund investment projects.

Some things to consider if you are contemplating using ‘own funds’ to finance a project.

a. When planning the project, think about a funding plan for the project, which should reflect the costs and duration of the Project, and how much and when it will generate its own cash. This will be an input to your overall cashflow planning – if you don’t have a cashflow for at least the duration of the project, then it is a scary prospect to commit own funds to any project. All banks have blank cashflow templates on their websites.

b. Assuming you have a cashflow, this should reflect the funding plan outlays on the project, and you should carefully consider buffers for any of the financial shocks mentioned earlier which may occur along the way, to both your core business or to the project.

c. Farms historically have relied too heavily on bank overdraft funding for working capital, and in some cases have relied on overdrafts to fund capital expenditure and herd expansion. Any funding plan should have an appropriate loan structure for the nature of the project. Overdrafts are not a suitable vehicle for long term credit needs. Such funding should be by term loan.

d. If the farm business is considering self-funding a project, it may be that part of the overall funding requirement is relying more on your creditors than it should be. Any change in the relationship or goodwill with your creditors can jeopardise a good business.

e. It is easier to get credit before the event than if you subsequently encounter difficulties; even if that is just to agree a suitable overdraft limit with your bank to cover cashflow contingencies. You will only have to pay interest if the facility is required.

f. If you decide to go ahead and fully self-fund, it may be at the least advisable to meet with your bank’s relationship manager to let them know what you are doing and show them the funding plan, and ask them to record the meeting on your file – just in case you need to get some help during the project.

g. From the funding plan/cashflow, you may feel that you can partially self-fund the project but will also need some bank finance – bearing in mind that banks will now typically fund only up to 70% of a project costs on viable proposals. The term of the loan will reflect the nature of the project and the expected cashflows from it.

h. If you have self-funded previous projects, including herd expansion, that are now part of the core business, make sure that you advise the bank of the prior outlays and the financial outcomes of the project. If the bank isn’t told this, they are unlikely to recognise the self-funding from your financial accounts and may underestimate the performance of your business.

   The Credit Review Office has found that only after a farm visit is made by one of the bank’s agricultural advisers, is the degree of past self-investment properly understood, and credit is made available, however there are limited number of farm advisers in the banks and getting a farm visit can be difficult.

And if all else fails, contact the Credit Review Office and we will designate one of our Agri-Specialist Reviewers to do our best to secure credit for viable Farms.