Bookkeeping Basics: Financing the Business

SRDP Farm Advisory Service

National Advice Hub
T: 0300 323 0161
E: advice@fas.scot
W: www.fas.scot

Most farm businesses will have some form of finance but each different finance type has different implications, including for how you record these transactions in your books. Here's what you need to know.

The most common types of finance in a farm business are:

- *Loan*
- *Overdraft*
- *Asset finance*
- *Mart finance*
- *Supplier credit*

Loan

A loan from a bank or agricultural mortgage provider is a common form of agricultural lending.

- Repayments are calculated based on a fixed term, e.g. 5, 15, or 25 years.
- The interest rate may be **fixed** (set for a specified time) or **variable** (fluctuates as base rate changes).
- Normally agricultural loans are secured against an asset, usually property or land. If the loan repayments are not met then the asset can be sold to repay the debt.

The **base rate** is the rate the Bank of England charges lenders when they borrow money. The rate is reviewed regularly. www.bankofengland.co.uk

Lenders generally won't lend more than a percentage of the value of the assets being offered as security, 60 - 70% is common. However they also want to be sure the repayment are **affordable —**no lender wants to be put in the position of repossessing land or property. **In practice** affordability is often the limiting factor in determining how much can be borrowed.

Overdraft

Many farm businesses have an overdraft. An overdraft is a flexible facility allowing access to a pre-agreed amount of finance as and when required.

- The overdraft facility is normally agreed and reviewed annually. Typically there will be a fee for the arrangement of the overdraft, and for the subsequent renewal.
- The interest rate is fixed and renegotiated annually.
- An overdraft may be unsecured or secured.
- Unlike a loan there is no requirement to make

An overdraft is 'repayable on demand' which means that the bank can require you to repay the money at any point.

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The European Agricultural Fund for Rural Development
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Asset Finance

The most common form of asset finance is Hire Purchase (HP).

- HP is commonly used for the purchase of machinery & equipment, e.g. tractors, combine harvesters, farm vehicles, milking & dairy equipment, renewable or biomass projects.
- A finance company buy the machine for you & hire it to you for an agreed period. You have the option to purchase the asset at the end of the term.

With HP you reclaim all the VAT at the outset (the date of supply is the date of purchase). With lease finance you are charged VAT on each monthly hire charge.

There are tax implications of a decision to hire purchase or lease equipment or vehicles—you should discuss this with your accountant.

- You are not normally the legal owner until the last payment is made, when ownership is transferred.
- You are responsible for repairs and maintenance from the outset.
- Repayments can be structured to take into account your cashflow, e.g. monthly, quarterly, annually.

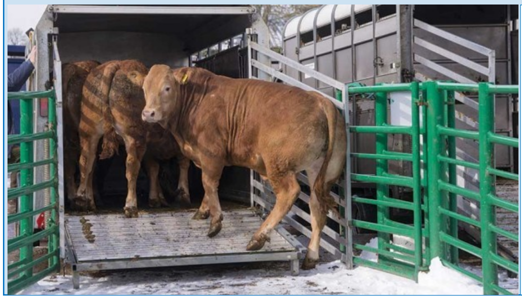
Hire Purchase is different to **leasing**. Leasing is a form of hire. The leasing cost will be based on the difference in value of the asset between the start and end of the lease, together with the cost of the credit. You never own the vehicle and normally at the end of the term you return it. In a leasing arrangement you are normally provided with a VAT invoice for each month and reclaim each month or quarter, where appropriate.

Mart Finance & Supplier Credit

Mart finance & supplier credit are very similar. They are a common source of **working capital** for a farm business.

- Mart finance may be interest-free credit on small sums for short periods, or involve larger amounts for a longer period, with an agreed interest rate payable.
- The mart will normally retain ownership of the livestock until they have been fully paid.
- In mart finance some arrangements specify that the livestock must be sold back through the same mart, with repayment of the mart taking place at sale.

- Many suppliers offer 30 days interest free credit.
- Credit charges or interest may be applied. The invoice will make the credit terms clear.



Working capital is the difference between a business' current assets (e.g. cash, stock, debtors) and current liabilities (e.g. creditors). It represents the capital available for the day-to-day running of the business. A business with insufficient working capital is likely to be unable to make important purchases.

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