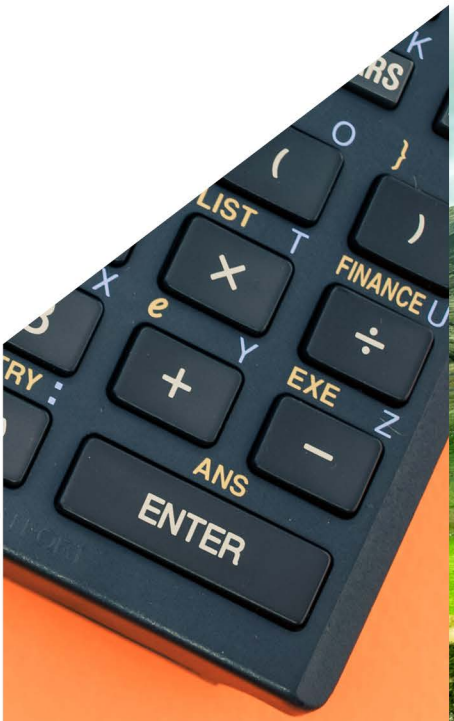
The Farm Management Handbook

Farm Advisory Service

Credit



The UK reference for farm business management

SAC CONSULTING

Part of Scotland's Rural College (SRUC)

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Amortisation Table

The table below can be used to estimate the annual charge to service the repayment of loan capital and interest per £1,000 borrowed.

	Percentage rate of interest								
Years	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
1	1,020	1,030	1,040	1,050	1,060	1,070	1,080	1,090	1,100
2	515	523	530	538	545	553	561	568	576
3	347	354	360	367	374	381	388	395	402
4	263	269	275	282	289	295	302	309	315
5	212	218	225	231	237	244	250	257	264
6	179	185	191	197	203	210	216	223	230
7	155	161	167	173	179	186	192	199	205
8	137	142	149	155	161	167	174	181	187
9	123	128	134	141	147	153	160	167	174
10	111	117	123	130	136	142	149	156	163
11	102	108	114	120	127	133	140	147	154
12	95	100	107	113	119	126	133	140	147
13	88	94	100	106	113	120	127	134	141
14	83	89	95	101	108	114	121	128	136
15	78	84	90	96	103	110	117	124	131
20	61	67	74	80	87	94	102	110	117
25	51	57	64	71	78	86	94	102	110
30	45	51	58	65	73	81	89	97	106
40	37	43	51	58	66	75	84	93	102

Example:
The annual charge to service the interest and capital repayments on £8,000 repayable over 10 years at 5% would be £130 x 8 = £1,040. The payment at 6% would be £136 x 8 = £1,088.

The annual charge is given by:

$$C \times \left(\frac{r(1+r)^n}{(1+r)^n - 1} \right)$$

where: C = capital investment
r = rate of interest (to 2 decimal places)
n = years of repayment

Sinking Fund Table

The following table can be used to estimate the capital accruing to a regular annual investment of £100.

	Percentage rate of interest								
Years	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**10**	**12**
1	100	100	100	100	100	100	100	100	100
2	202	203	204	205	206	207	208	210	212
3	306	309	312	315	318	321	325	331	337
4	412	418	425	431	437	444	451	464	478
5	520	531	542	553	564	575	587	611	635
6	631	647	663	680	698	715	734	772	812
7	743	766	790	814	839	865	892	949	1,009
8	858	889	921	955	990	1,026	1,064	1,144	1,230
9	975	1,016	1,058	1,103	1,149	1,198	1,249	1,358	1,478
10	1,095	1,146	1,201	1,258	1,318	1,382	1,449	1,594	1,755
11	1,217	1,281	1,349	1,421	1,497	1,578	1,665	1,853	2,065
12	1,341	1,419	1,503	1,592	1,687	1,789	1,898	2,138	2,413
13	1,468	1,562	1,663	1,771	1,888	2,014	2,150	2,452	2,803
14	1,597	1,709	1,829	1,960	2,102	2,255	2,421	2,797	3,239
15	1,729	1,860	2,002	2,158	2,328	2,513	2,715	3,177	3,728
20	2,430	2,687	2,978	3,307	3,679	4,100	4,576	5,727	7,205
25	3,203	3,646	4,165	4,773	5,486	6,325	7,311	9,835	13,333
30	4,057	4,758	5,608	6,644	7,906	9,446	11,328	16,449	24,133

Example:
The capital accruing after 10 years to the regular annual investment of £600 at 5% would be £1,258 x 6 = £7,548. At 6%, the capital accrued would be £1,318 x 6 = £7,908.

The terminal sum is given by:

$$d \times \left(\frac{(1 + r)^{n} - 1}{r} \right)$$

where: d = regular annual investment
r = rate of interest (to 2 decimal places)
n = years of repayment

Approximate Annual Percentage Rates of Annual Nominal Rates

As an aid to assessing finance deals, the following table estimates the equivalent annual percentage interest rates (APR's) for a range of nominal annual rates (e.g. 2% above base rate of 1% = 3%) and various charging regimes.

	Approximate annual percentage rate equivalent (%)		
Annual nominal rate (%)	**Monthly charging**	**Quarterly charging**	**Half-yearly charging**
2	2.0	2.0	2.0
3	3.0	3.0	3.0
4	4.1	4.1	4.0
5	5.1	5.1	5.1
6	6.2	6.1	6.1
7	7.2	7.2	7.1
8	8.3	8.2	8.2
9	9.4	9.3	9.2
10	10.5	10.4	10.3
11	11.6	11.5	11.3
12	12.7	12.6	12.4
13	13.8	13.6	13.4
14	14.9	14.8	14.5
15	16.1	15.9	15.6

Example:
A nominal interest rate of 5% with monthly charging gives an approximate annual percentage rate of 5.1%. A nominal rate of 6%, gives an annual percentage rate (APR) of 6.2%.

The approximate annual percentage rate is given by:

$$\left[\left(1 + \frac{n}{p}\right)^{p} - 1\right] \times 100$$

where: n = nominal interest rate (expressed as a decimal)
p = number of instalments per year

Approximate Annual Percentage Rates of Annual Flat Rates

Where interest on finance is quoted as flat rate on the original amount borrowed, the following table can be used to estimate the equivalent annual percentage rate (APR) for equal monthly repayments of interest and capital.

Annual flat rate (%)	Approximate annual percentage rate equivalent (%) for loans over: 1 year	5 years	10 years	15 years
4	7.5	7.6	7.3	7.0
5	9.4	9.5	9.0	8.6
6	11.4	11.4	10.7	10.1
7	13.4	13.2	12.3	11.6
8	15.4	15.0	13.9	13.0
9	17.4	16.8	15.5	14.4
10	19.5	18.7	17.0	15.8
11	21.6	20.5	18.6	17.2
12	23.6	22.3	20.1	18.6

Example:
The APR for a loan at an annual flat rate of 6% repaid by monthly instalments over 5 years will be 11.4%.

Compounding Table

This table estimates the future monetary value of £100 after *n* years at various interest rates.

	Percentage rate of interest									
Years	**3**	**4**	**5**	**6**	**7**	**8**	**10**	**12**	**14**	**16**
1	103	104	105	106	107	108	110	112	114	116
2	106	108	110	112	114	117	121	125	130	135
3	109	112	116	119	123	126	133	140	148	156
4	113	117	122	126	131	136	146	157	169	181
5	116	122	128	134	140	147	161	176	193	210
6	119	127	134	142	150	159	177	197	219	244
7	123	132	141	150	161	171	195	221	250	283
8	127	137	148	159	172	185	214	248	285	328
9	130	142	155	169	184	200	236	277	325	380
10	134	148	163	179	197	216	259	311	371	441
11	138	154	171	190	210	233	285	348	423	512
12	143	160	180	201	225	252	314	390	482	594
13	147	167	189	213	241	272	345	436	549	689
14	151	173	198	226	258	294	380	489	626	799
15	156	180	208	240	276	317	418	547	714	927
20	181	219	265	321	387	466	673	965	1,374	1,946
25	209	267	339	429	543	685	1,083	1,700	2,646	4,087
30	243	324	432	574	761	1,006	1,745	2,996	5,095	8,585

Example:
The value of £1,200 at 5% after 8 years would be £148 x 12 = £1,776. At 6%, it would be £159 x 12 = £1,908.

The compounding factor is given by: $(1 + r)^n$

where: r = rate of interest (expressed as a decimal)
n = number of years

Annuity Tables

Discount factors for calculating the present value of future cash flows where cash flows are **regular**.

	Percentage											
Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
1	0.99	0.98	0.97	0.96	0.95	0.94	0.94	0.93	0.92	0.91	0.90	0.89
2	1.97	1.94	1.91	1.89	1.86	1.83	1.81	1.78	1.76	1.74	1.71	1.69
3	2.94	2.88	2.83	2.78	2.72	2.67	2.62	2.58	2.53	2.49	2.44	2.40
4	3.90	3.81	3.72	3.63	3.55	3.47	3.39	3.31	3.24	3.17	3.10	3.04
5	4.85	4.71	4.58	4.45	4.33	4.21	4.10	3.99	3.89	3.79	3.70	3.61
6	5.80	5.60	5.42	5.24	5.08	4.92	4.77	4.62	4.49	4.36	4.23	4.11
7	6.73	6.47	6.23	6.00	5.79	5.58	5.39	5.21	5.03	4.87	4.71	4.56
8	7.65	7.33	7.02	6.73	6.46	6.21	5.97	5.75	5.53	5.34	5.15	4.97
9	8.57	8.16	7.79	7.44	7.11	6.80	6.52	6.25	6.00	5.76	5.54	5.33
10	9.47	8.98	8.53	8.11	7.72	7.36	7.02	6.71	6.42	6.15	5.89	5.65
11	10.37	9.79	9.25	8.76	8.31	7.89	7.50	7.14	6.81	6.50	6.21	5.94
12	11.26	10.58	9.95	9.36	8.86	8.38	7.94	7.54	7.16	6.81	6.49	6.19
13	12.13	11.35	10.64	9.99	9.39	8.85	8.36	7.90	7.49	7.10	6.75	6.42
14	13.00	12.11	11.30	10.56	9.90	9.30	8.75	8.24	7.79	7.37	6.98	6.63
15	13.87	12.85	11.94	11.12	10.38	9.71	9.11	8.56	8.06	7.61	7.19	6.81
20	18.05	16.35	14.88	13.59	12.46	11.47	10.59	9.82	9.13	8.51	7.96	7.47
25	22.02	19.52	17.41	15.62	14.09	12.78	11.65	10.67	9.82	9.08	8.42	7.84
30	25.81	22.40	19.60	17.29	15.37	13.76	12.41	11.26	10.27	9.43	8.69	8.06

	Percentage											
Years	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**	**25**	**30**	**35**	**40**
1	0.89	0.88	0.87	0.86	0.85	0.85	0.84	0.83	0.80	0.77	0.74	0.71
2	1.67	1.65	1.63	1.61	1.59	1.57	1.55	1.53	1.44	1.36	1.29	1.22
3	2.36	2.32	2.28	2.25	2.21	2.17	2.14	2.11	1.95	1.82	1.70	1.59
4	2.97	2.91	2.86	2.80	2.74	2.69	2.64	2.59	2.36	2.17	2.00	1.85
5	3.52	3.43	3.35	3.27	3.20	3.13	3.06	2.99	2.69	2.44	2.22	2.04
6	4.00	3.89	3.78	3.68	3.59	3.50	3.41	3.33	2.95	2.64	2.39	2.17
7	4.42	4.29	4.16	4.04	3.92	3.81	3.71	3.60	3.16	2.80	2.51	2.26
8	4.80	4.64	4.49	4.34	4.21	4.08	3.95	3.84	3.33	2.92	2.60	2.33
9	5.13	4.95	4.77	4.61	4.45	4.30	4.16	4.03	3.46	3.02	2.67	2.38
10	5.43	5.22	5.02	4.83	4.66	4.49	4.34	4.19	3.57	3.09	2.72	2.41
11	5.69	5.45	5.23	5.03	4.84	4.66	4.49	4.33	3.66	3.15	2.75	2.44
12	5.92	5.66	5.42	5.20	4.99	4.79	4.61	4.44	3.73	3.19	2.78	2.46
13	6.12	5.84	5.58	5.34	5.12	4.91	4.71	4.53	3.78	3.22	2.80	2.47
14	6.30	6.00	5.72	5.47	5.23	5.01	4.80	4.61	3.82	3.25	2.81	2.48
15	6.46	6.14	5.85	5.58	5.32	5.09	4.88	4.68	3.86	3.27	2.83	2.48
20	7.02	6.62	6.26	5.93	5.63	5.35	5.10	4.87	3.95	3.32	2.85	2.50
25	7.33	6.87	6.46	6.10	5.77	5.47	5.20	4.95	3.98	3.33	2.86	2.50
30	7.50	7.00	6.57	6.18	5.83	5.52	5.23	4.98	4.00	3.33	2.86	2.50

Example:
The present value of £350 received each year for 6 years at 5% discount rate is £350 x 5.08 = £1,778. At 6%, the present value is £350 x 4.92 = £1,722.

The discount factor is given by:

$$\frac{1 - (1 + r)^{n}}{r}$$

where: r = rate of discount
n = number of years

Discount Tables

Discount factors for calculating the present value of future cash flows where cash flows are **irregular**.

	Percentage											
Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350	0.317	0.287
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	0.286	0.257
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	0.258	0.229
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	0.232	0.205
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	0.209	0.183
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149	0.124	0.104
25	0.780	0.610	0.478	0.375	0.295	0.233	0.184	0.146	0.116	0.092	0.074	0.059

	Percentage											
Years	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**	**25**	**30**	**35**	**40**
1	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	0.800	0.769	0.741	0.714
2	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	0.640	0.592	0.549	0.510
3	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	0.512	0.455	0.406	0.364
4	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	0.410	0.350	0.301	0.260
5	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	0.328	0.269	0.223	0.186
6	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	0.262	0.207	0.165	0.133
7	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	0.210	0.159	0.122	0.095
8	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	0.168	0.123	0.091	0.068
9	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	0.134	0.094	0.067	0.048
10	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	0.107	0.073	0.050	0.035
11	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	0.086	0.056	0.037	0.025
12	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	0.069	0.043	0.027	0.018
13	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	0.055	0.033	0.020	0.013
14	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	0.044	0.025	0.015	0.009
15	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	0.035	0.020	0.011	0.006
20	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026	0.012	0.005	0.002	0.001
25	0.047	0.038	0.030	0.024	0.020	0.016	0.013	0.010	0.004	0.001	0.001	0.000

Example: To find the present value of the following cash flows at 5% discount rate of interest.

Year	Cash flow (£)	Discount factor	Present value (£)	
1	250	0.952	238	
2	300	0.907	272	The Present Value of
3	180	0.864	155	this series of cash
4	400	0.823	329	flows is £995

The discount factor is given by

$$\frac{1}{(1+r)^n}$$

where: r = rate of discount

n = number of years

Long-Term Loans

Long-term finance might be obtained from banks, mortgage providers, insurance companies, finance companies, solicitors, or by private arrangement. These loans are generally secured against the value of existing property and other business assets.

Long-term loans tend to be used for purchasing fixed assets and are structured as an agricultural mortgage or secured loans typically extending between 5 and 25 years at fixed and/or variable interest. Interest payments can be arranged to tie in with cashflow but would usually be charged monthly or quarterly, however, there are alternative options e.g. of paying interest in half-yearly or annual instalments although this tends to be more expensive. Interest only periods are potentially available prior to moving to capital repayments. Frequency of capital repayments will be subject to negotiation with the lender. Capital repayments are generally packaged together with accrued interest in monthly payments. It maybe agreeable with the lender to defer capital repayment or repay a lump sum on a fixed date each year.

It is necessary for the business borrowing the money to be deemed financially secure and demonstrate the ability to service the loan. This will be determined based on past financial performance, an updated balance sheet, cash flow budgets and perceived risk of the proposed venture.

Long-term loans can typically pass from generation to generation. In other words a loan is not repayable on the death of a borrower and cannot be recalled for the term of the loan provided that obligations continue to be met.

Medium-Term and Short-Term Credit

Banks

Banks, the primary source of medium and short-term capital, may agree to grant farmers an overdraft to meet business financial requirements.

Overdrafts are reviewed annually; the interest rate, subject to the security available, is competitive, and interest is charged daily only on the daily balance outstanding. Generally, an arrangement fee will be charged and, in some cases, a renewal fee.

In terms of medium term loans, 10-year term loans are most common. Interest is related to commercial and market factors but have historically been lower than overdraft rates (particularly if adjusted for any overdraft rearrangement fees).

Merchants and tradesmen

A popular form of short-term financing. Finance is often in the form of credit allowed by merchants, auctioneers, tradesmen and dealers over a

wide range of commodities and farm requisites, including livestock and implements. Rates of interest vary widely and can be relatively cheap over one or two months, but can rise to as high as 4% per month on accounts outstanding for several months.

Mart credit

Farmers buying livestock can obtain up to 12 months credit. Interest rates quoted vary depending on term and amount borrowed. Other arrangements are possible whereby a farmer may borrow capital from a mart for finishing stock purchased from the mart. Interest will be charged on the stock during the finishing period which is then deducted from the sale price achieved for the stock. The stock remains the property of the mart and must be resold through the mart or to an associated abattoir/meat processing company.

Hire purchase

Hire purchase is currently the most popular form of finance used by UK farmers. This type of finance covers identifiable products such as plant and machinery, and livestock. It offers 100% ownership at the end of the repayment period.

Credit is supplied by a finance company but the arrangements are often carried out through the dealer who made the sale. Repayment periods are usually from two to four years with payment by standing order. Payments are for capital and interest and are usually offered on a fixed rate basis. However, this form of finance can be more expensive than an overdraft, because the lender is offering less security.

Contract hire and leasing

Leasing is usually used for equipment or vehicles. Breeding livestock can also be leased. However, leasing costs can vary considerably and the details of a contract should be studied carefully before entering into an agreement. The tax aspects should be discussed with an accountant. Two types of leasing exist:

Finance Lease - Offers use of an asset for an agreed period without ownership. Payments are normally fixed for a defined period of time (usually 2 to 5 years). After this period, the farmer can either continue to use the equipment at a nominal rent (which can vary from nothing to 1.5% of capital cost), or, with the finance company's permission, sell the equipment. Dependent on arrangements, the farmer may obtain 90% to 100% of the sale value to be used as a refund or a down-payment.

Operating Lease - Appropriate for the use of equipment for less than its full economic life. The farmer takes the risk of the equipment becoming obsolete and is responsible for all repairs, maintenance and insurance. The residual value of the asset is usually set at the outset, based on the estimated use throughout the term. In most cases, this is more expensive than a finance lease.

The advantages of leasing schemes (machinery and livestock) depend on the individual's circumstances. Leasing is a complex subject and it is advisable to seek professional advice to assess the best financial alternative.