New Entrants to Farming Fact Sheet

Funding Your Dream Factsheet

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Investing in equipment and livestock can prove costly for the new entrant, but with multiple finance options including hire purchase, contract hire and mart finance available, funding the dream can be achievable.

Insignificant interest rates make it a good time to borrow money, but you should tailor the borrowing to the asset to ensure it makes financial sense and is the most tax efficient method. Currently, there are generous tax reliefs on the full purchase price of plant and machinery but less so on building acquisitions (buy or build), so it is vital to know which 'box' your purchase falls into in the farm accounts.

What do you want to fund?

Some common assets farming businesses seek to fund are a farm purchase, building construction, plant and equipment, livestock (funding is available for a range of species including cattle, sheep, pigs, poultry, and others) and crop inputs e.g. seed, fertiliser, and sprays. Traditionally most farm businesses have relied on an overdraft, but banks are now more inclined to match the asset with the funding type. Overdrafts are reviewed annually and are repayable on demand so should be reserved for short term expenditure. A regular review with the bank may lead to reassessment of the most suitable funding type for the asset you require. Therefore, it is essential to know whether you want to fund a long-term, medium-term, or short-term asset.

Long term		Medium term		Short term	
Asset	Typical repayment period	Asset	Typical repayment period	Asset	Typical repayment period
Land	20 – 25 years	Buildings	10 years	Farm machinery	3 – 5 years 3 years is typical for 2nd hand machinery
		Breeding livestock	>3 years	Trading livestock, especially pigs and finishing cattle	1 year
		Fruit plants	5 years	Seasonal crops	1 year

The European Agricultural Fund for Rural Development
Europe investing in rural areas

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468308LH / 17.08.2021

How do banks/lenders decide who to lend to and how much to lend?

When assessing an applicant for funding many banks and lenders use the CAMPARI acronym to assess suitability and how much to lend. CAMPARI stands for character, ability, management/means, purpose, amount, repayment, and insurance/security.

Character, ability, and management are the three most important aspects they will consider. Although many new entrants will not have a trading history for banks/lenders to assess, their experience of the sector and their track record is considered. Having a summer job as a student and saving wages, counts as valuable experience of your character and capability. If taking over an existing business, the trading history of it can be considered.

Banks and lenders will want to know what you wish to fund (purpose). Is it working capital e.g. finishing stock, seed, fertiliser, day to day running costs or capital expenditure e.g. machinery, breeding stock, land, infrastructure? Regardless of how much you borrow or the type of funding, repayment is essential, and you should ensure you can service and repay any additional debt from profit generated, sale of assets or family. It is good practice to set targets to when repayments will be achieved.

The last aspect banks and lenders will consider is insurance which is sometimes referred to as security. You should always have a plan B in place in case you are unable to service the debt. It is advisable to base any predictions on average market prices over the previous 12 – 18 months which can be obtained from various industry publications and organisations e.g. Farmers weekly, AHDB, QMS, Farm Management Handbook and local marts.

All predictions should also be sensitised for 10% to 20% increases and decreases in market prices to ensure you can still repay the debt. A key part of budgeting is knowing the cost of production, which can be influenced, unlike the price received for goods sold that can't. For assistance with budgeting, contact your local agricultural advisor or accountant.

Types of funding

Before approaching banks or lenders, you should consider what funds you have yourself or what funds you can obtain from family members. However, it is essential that you know if funds received from family is a gift or if it will need to be repaid and what the interest rates will be. It is strongly recommended that a loan agreement is drawn up with a solicitor to avoid any problems with family funding. In addition to providing loans and overdrafts, most banks offer hire purchase and livestock finance.

When dealing with banks, the better your relationship with the bank manager the more likely you are to be successful in securing funding, so it is a good idea to get to know them by picking up the phone. There are also specialist funders for plant and machinery or livestock.

Hire purchase (HP)

At the end of the HP repayment period, the asset is 100% owned by the business and tax relief is currently available on the HP interest. A key point to remember is never to finance a piece of equipment longer than you will have it on the farm. Repayments are made by standing order and include capital and interest on a fixed rate basis.

When negotiating repayment periods with the lender, it is worth considering when most of the income comes into the business to allow matching of payments to these periods and avoid ending up short on cash flow in some months. Interest rates for hire purchase can be similar to bank loans if you have a good asset and deposit, and typically range from 2 % - 7.5% depending on who you borrow from and your relationship with them.

If you would like a newer model or machinery repair costs are becoming unjustifiable for a piece of equipment during the HP agreement, it is possible to stop the existing HP agreement and start a new one following negotiation with the lender. While early repayment clauses are uncommon on HP, it is worthwhile carefully scrutinising the terms and conditions of any agreement.

Contract hire

An increasingly common way of farmers funding equipment is contract hire. Equipment on contract hire is not owned by the business and it is simply taken away at the end of the contract period, removing the uncertainty of asset value. During the contract hire period farmers are responsible for repairs, maintenance, and insurance but many agreements include a service and maintenance contract. The cost is often expressed per likely running hour and payable monthly. Although this increases the cost it does avoid any large, unexpected repair bills. Unlike HP, the business never owns the asset or benefits from its equity value.

There are two types of contract hire and leasing agreements: finance lease and operating lease. A finance lease must be accounted in the balance sheet as it is simply a form of borrowing. Payments are usually fixed for a defined period, often 2 – 5 years, and at the end you can continue to use the asset at a nominal rent (often 0% - 1.5% capital cost) or buy it.

By contrast an operating lease does not appear on the balance sheet of the farm accounts as payments are written off against the profits which can improve the financial performance of the business and release equity for other projects. An operating lease is not likely to be available for used equipment. It offers use of equipment for less than the full economic life and can be more expensive than a financial lease. The rental value is based on the value of the machine less its expected residual value and hours of working. Also, if purchasing a piece of equipment at the end of an operational lease, some or all of the rentals will be rebated and be fully taxable.

Contract leasing is also available for breeding livestock, although this is currently uncommon.

Irrespective of the funding option used to finance machinery, it is advisable to buy the best you can afford and take the full service and warranty package.

Mart finance

Most marts provide livestock finance for up to 12 months and during this period the livestock remain property of the mart and must be resold through the mart or an associated processor. Interest rates vary depending on the term and amount borrowed but is typically 1% - 2% more expensive than hire purchase as a buffer is factored in for the risk of animals dying during this period. Interest is charged during the period you have the stock and deducted from the sale price. A deposit is payable to cover fluctuations in market prices throughout the year. In the event of livestock selling for less than their purchase price, the mart will pursue sole traders or partnerships for the debt and expect it to be repaid over a period of time from other assets. Tax relief is also available on interest payable for livestock finance. Always seek professional advice from your accountant, advisor, or bank manager before making significant financial decisions.