



ARE YOU ASKING THE CRITICAL QUESTIONS BEFORE PURCHASING FARM REAL ESTATE?

We hope harvest is going well for you! We have heard varying yield reports, but in general yields sound very good overall so far. It won't be long and producers will be working on year-end business. In that process, there could either be land coming up for sale or some may need to look at refinancing carryover operating debt. This month we thought it would be useful to outline how Security Bank looks at farm real estate loans. Best of luck with the rest of harvest!



3x Thought Leadership Award Recipient

Keith Knudsen
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HOW DOES THE BANK LOOK AT FARM REAL ESTATE FINANCING?

BY **LEE POTTS** | *Vice President / Loan Officer*

A few months ago, we sent out an article describing how the bank generally looks at futures hedging. We thought it would be beneficial to our readers if we put together another "How Does the Bank Look at...?" type of article again, with this one pertaining to financing farm land.

compressed which has eroded working capital for some producers to where their "financial fuel tank" has approached "E". This has made refinancing that carryover operating debt against real estate a possible consideration for some producers to get through these current times. While we do want to be concerned about land values and how that pertains to collateral coverage in any given situation, there are several other areas of importance on which to focus as well.

As we know the land market in terms of sales in our area has been relatively quiet the last few years, but parcels do come up for sale every once in a while. Likewise, it's no secret that in the last few years, margins have become

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Let's look at a scenario for illustration.

The quarter across the road or fence is coming up for sale. It's a little pricey, but you want to take a look at your options nonetheless. It appears to be a nice fit. The price is \$6,000 per acre. Based on recent sales in the area, it may or may not be worth a bit more on an appraisal. You have the ability to pay the closing costs and maybe put \$100,000 down, but have to finance the balance. So you're looking to finance \$860,000. Assuming a 30 year amortization, let's say the payment comes to \$64,835 per year. Taxes are about \$8,000 per year.

While there is a relatively small amount of equity at the start, of course we know that can change year to year depending on how land values actually change. The question to ask oneself is "How will this cash flow?" It makes sense to look at it on a per acre basis. The farm on a stand-alone basis would have a payment and tax per acre cost of \$455 and change.

This may not sound workable on a stand-alone basis, but there might be other considerations:

Do you own other land to where your overall per acre cost of debt service and taxes is lower? Let's say you own two other quarters already on which you owe a relatively small amount of debt, for example, and that payment is about \$20,000 with taxes of about \$16,000. This, added with the new tract would have a per acre cost of debt service and taxes of \$227. Such a cost averaged over all owned acres could look a bit more realistic.

Are there other elements of your operation that give you an advantage? Maybe you utilize manure as part of your fertilizer program and spend \$80/ac less than a typical full commercial fertilizer program. Maybe you have a small amount of debt to where taking on another purchase wouldn't over-leverage the operation. Maybe you collaborate with a neighbor on equipment to keep equipment costs lower than if you owned the full line of equipment on your own. Maybe you have historically been able to average higher yields than other operations. And the list can go on...

Next, compare this cost to cash rent. Ask the following questions: "Can I rent ground cheaper than this?" or "If the tight ag economy persists, can I hang onto the farm long-term by renting it out and make my payment and taxes if I absolutely had to?" or "Am I willing to essentially sign a 20, 25, or 30-year lease for \$X/ac?"

The point of the above example is that when doing this exercise, the final questions should be, "Can I?" but more importantly, "Should I?" As we know, the answers to these two questions could be entirely different. You still might move forward with the purchase, but the benefit of this process is that you looked at it by asking and answering the critical questions.

The main thing to remember with financing real estate, however, is that while we can hope the current down-cycle reverses soon, the operation has to be given the chance to succeed in taking on the new piece from day one. If you would like to visit more, our lenders will be happy to help see what might fit for your operation!



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2018
TUESDAY | DECEMBER 11, 2018

Mark your calendars for our 2018 Ag Conference on Tuesday, December 11th. This year's keynote speaker will be Kevin Van Trump from Farm Direction/The Van Trump Report. Kevin has a very unique perspective on the broader economy and markets.

www.vantrumpreport.com/about/

QUESTIONS? Our lenders are here for you!

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