dairy info

8. Financing cattle

Borrowing to buy or expand a dairy herd requires critical evaluation of financing options and associated costs. Money lenders seek assets which can be used as security against a loan, and property continues to be the most desired form of security for a financier. However, with increasing competition, there is now a range of finance products that offer money under a variety of terms for the purpose of financing dairy cows.

Finance options

In Western Australia, dairy cattle are most often sold on 'vendor terms' which can be advantageous to the borrower as well as the vendor as it facilitates the progressive transfer of ownership of a dairy herd, without the added costs of using a third party.

Vendor finance is not a mortgage agreement but a legal contract drawn up between two parties to provide a loan that is re-paid over a set time frame at a pre-determined interest rate. It can offer significant tax advantages to the vendor whilst offering the borrower greater flexibility in achieving ownership of the herd.

If vendor finance is not an option, the purchase of a new herd or expansion of an existing herd can be achieved by way of the following methods:

1. Property secured loans are the most conventional form of bank finance and usually the most competitive, charging an interest rate which is negotiable depending on credit history. For farmers with high equity (80 percent) and a history of profitability, an interest rate of two percent above the 'bill rate' is achievable.
2. A stock mortgage is based on a three year loan term and uses the equity in owned breeding stock to restock and rebuild the herd. The livestock belongs to the borrower. These loans commonly ask for interest only payments in year one (no principal), some principal payments in year two and total repayment by the end of year three. Applications are considered on a case by case basis and a mortgage over the stock is held as security. Note, stock mortgages are not usually offered to clients who have their main borrowings secured against land with an alternative financier. Minimum loans are around $50,000.
3. 'Stocklease' gives ownership of the herd to the financier with the dairy farmer (lessee) obligated to make regular payments for the right to use the dairy cows. The stock is leased over an agreed time period (up to six years) with monthly lease payments that fit with the dairy's production program. 'Stocklease' can provide up to 90 percent of the value of the cows, freeing up capital and improving cash flow, and cows can either be owned by the farmer or purchased. Progeny, as well as all management and marketing decisions pertaining to the cows, belong to the dairy farmer. Interest rate is dependent on credit history and charges apply.

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Success Story

Neville Haddon runs more than 1100 cows and has actively sort and fulfilled vendor finance agreements in order to build his herd.

"We have successfully set up private financing agreements to buy cattle which have allowed for payments to be carried over six or 12 months, making it a better tax proposition for the vendor whilst providing us with greater cash flow," Neville said.

"Communication and regular payment is the key. The day the milk cheque arrives is the day the repayment is made to the vendor."

Neville Haddon

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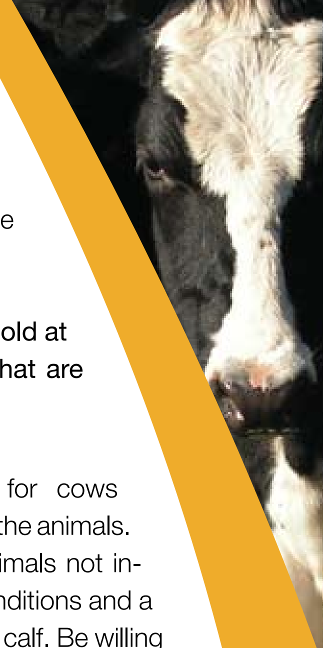
4. Leasing cows through the 'cowbank' model involves a five year lease, which represents 60 monthly payments direct from the milk cheque, using the full market value of the herd as security (minimum asset is 100 cows). A competent share farmer can grow equity in the herd whilst paying off the principal. The lease deal can be up to 100 percent of the value of the herd. With the 'cowbank' model, the lessee is obligated to replace 20 percent of the herd each year of the lease; to agree to an annual audit to assess body condition and identification tags; and to ensure the lease agreement is fulfilled. 'Cowbank' charges an interest rate that is six percent above the 'bill rate' together with a monthly fee and an annual assessment fee.

5. Independent bank finance requires a sound business plan and usually 50 percent minimum equity already in the herd. Agribusiness companies will lend up to 50 percent of market value against livestock, subject to normal banking terms and conditions and, in particular, serviceability. Larger herd purchases are generally financed against a combination of land and cattle security. This model allows the borrower to gradually build equity in the herd through stock purchases whilst simultaneously financing the start-up debt, despite a lag in cash flow at the start of the agreement.



Building the Herd

Once the terms of the finance agreement have been drawn up, it is important to carefully consider the method by which the herd will be built. Options include:

- Purchasing cows in-calf;
- Purchasing cows not in-calf (often sold at a considerable discount to those that are in-calf); and
- Breeding replacement heifers.

If purchasing, ensure the price paid for cows accurately reflects the potential income of the animals. It can make good sense to purchase animals not in-calf, allowing them to get used to new conditions and a new herd without the burden of carrying a calf. Be willing to pay more if cows are in-calf and/or lactating.

Careful assessment of each of the animals to be purchased should be carried out by a vet. Pregnancy testing cows is good practice and provides a guarantee if buying cows in-calf. Also, be mindful of the conditions in which the animals have been raised in comparison to the conditions at their new home. Survivability can be negatively impacted by poor feet and an inability to do well on gravel country as opposed to soft loams.

Further information:

Local farm consultants, agribusiness companies and banking institutions are a recommended source of information.

Tips for Success

- Determine your long term position and the most effective financing method to build the herd.
- Critically assess the cost of money throughout the term of the loan by calculating the establishment fee; exit fee; interest rate; and assessment fees.
- Evaluate your assets, keeping in mind that property is a more attractive form of security than plants and machinery or stock.
- Draft up a sound business plan incorporating both short term and long term objectives.
- Commit to regular monthly or bi-monthly loan repayments that coincide with the milk cheque.
- If there is a problem with payment, notify the vendor straight away.
- Treat a cow loan like a machinery loan – the cow will depreciate with age, so pay back the loan while she is still producing an income.
- Before buying a herd, assess the herd in terms of quality. Are you buying the best or the worst of the herd? Don't rely solely on herd records – ask how many cows were milked 12 months prior.
- Be cautious of lease and lease purchase arrangements that involve more than the cow and require payment in progeny and money. This strategy can dilute priorities and change the focus from milking to rearing.
- With private vendor finance, it is often less predictable and less stable and can be more or less flexible than bank or agribusiness finance.
- Seek independent taxation advice.

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