Fact sheet

FINANCE BASICS FOR AGRIBUSINESS

Understanding your business's financial needs is crucial for sustaining operations and fostering growth. Whether you're seeking finance to expand your ventures or manage revenue fluctuations, assessing the risks and rewards is vital. The big question you must ask is: What return on investment can you expect? It should far outweigh the interest costs. Additionally, consider how you'll repay the loan and the impact on your cash flow.

Typically, banks serve as the primary source of finance. However, structuring finance facilities requires thoughtful deliberation to align with your business objectives.

HOW DO BANKS FUND THEMSELVES?

Your bank accumulates funds predominantly from households through deposits, comprising a significant portion of its funding. It also taps into savings by issuing bonds and accessing domestic and overseas money markets for additional resources (source: rba.gov.au).

WHAT INFLUENCES BANKS FUNDING COSTS?

The Reserve Bank of Australia (RBA) has an important role in determining the interest rates on banks funding sources.

Changes in the cash rate are typically transmitted quickly to an important group of interest rates called 'market reference rates'. Market reference rates are based on transactions between participants in a financial market that happen often enough to reliably measure those rates. Because market reference rates are reliably measured, they are often used as a benchmark for pricing bonds and other debt securities, including those issued by banks. An example of an important market reference rate for bank funding costs is the bank bill swap rate (BBSW). *Source rba.gov.au*

WHAT MAKES UP THE INTEREST RATE?

The total interest rate a customer pays is made up of various components.

- The first component is the base cost of funds for the bank. Banks obtain funding from various sources. The source funding can be at different rates, and have different timing of maturity, depending on where it came from. Competition in the marketplace is also a contributing factor. It's a complex equation the bank works through.
- The second component is the banks cost of doing business. Essentially, the banks cost of running its own operations. Banks are always looking to reduce their costs.
- The last component, and the part the customer can influence, is the customer margin. This is where a professionally run agribusiness can negotiate with the bank to reduce the customer margin.

This guide aims to give you an in-depth understanding of the various bank finance options available for your farming business. By gaining insights into the key features of different forms of bank finance, you will be better equipped to make informed financial decisions tailored to your business needs. This fact sheet covers the basics of bank finance, its different forms and their suitability in a farming business.

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FORMS OF FINANCE

The security offered for equipment finance, is the piece of plant itself. For all other types of lending, the bank will require security in the form of land.

Product	Advantages	Disadvantages	Other
Overdraft	Very flexible. Suitable for day-to-day banking.	Generally, more expensive than a business loan.	In addition to the interest rate, there may also be a line fee that is calculated on the limit, not the outstanding balance
Variable rate loan	Rates are normally lower as compared to a fixed rate loan. Can be paid back at anytime without penalty. Has the ability to move excess funds from an overdraft into the business loan to reduce overall interest paid. Can be interest only, or principal and interest.	Interest rates increase or decrease in line with the general interest rate market.	Most common form of business lending.
Fixed rate loan	The rate is fixed for the term of the loan. Loan terms are generally between 12 months and five years.	The interest rate is normally higher than for a variable loan. Limited ability to pay down principle. If the loan is paid out in full prior to the end of the loan term, there is normally a penalty.	
Capped rate loan/ hedging	Can nominate a maximum interest rate. This provides certainty around what the maximum interest rate can be.	There is a monthly or quarterly premium payable for the privilege of having a capped rate.	
Equipment finance loan	Terms are normally between two and five years. Fixed rate for the term of the loan. Repayments can be monthly, annually, or staggered. A balloon can be included at the end of the term. A balloon is a fixed amount due at the end of the term. The maximum balloon is normally 40% of the purchase price. The balloon can be either paid out, or refinanced at the end of the initial term. A balloon allows for lower repayments during the initial term of the facility.	If the loan is paid off early, there are normally penalties. No ability to make extra payments during the course of the loan term.	Security is the item of plant or machinery only.
Livestock mortgage	Quick and easy to organise. The only security is the livestock.	Mainstream banks don't offer this facility. Interest rate is usually much higher as compared to business loan from a bank.	
Business market loan	Traditionally, these loans have been the cheapest form of business finance. That's not always the case now.	These products are normally rolled over every 30/90/180 days. You can only normally pay off principal at the roll date. Not as flexible as a business loan based off the cash rate. Cash rate linked loans have the ability to manage excess funds in and out of loans via internet banking.	These are the traditional bank bill loans. Now called market rate loans, or a variation of this depending on the bank.

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FREQUENTLY ASKED QUESTIONS

Fixed or variable rate loans?

Most loans are variable, and over time these types of loans are normally (but not always) cheaper.

Fixed rate loans are suitable for business owners that like to have certainty around their loan repayments

Should I be paying principal or interest only?

Interest only loans assist with cashflow management, as only the interest component is payable. The downside being that there is no principal being paid off the loan.

Over time it's prudent to pay down principal, as this leaves the business with more room in its balance sheet to fund further expansion, and reduces risk from interest rate rises.

HOW CAN I IMPROVE THE RELATIONSHIP WITH THE BANK, OR IMPROVE MY CUSTOMER RISK GRADING?

Communication is the key. As is the ability to provide accurate information in a timely manner. Banks are negotiable, if the client is proactive. The customer has more control than what they think.

The key to reducing the customer margin is to give the bank evidence to show the business should be placed in a lower risk grade category. This is done by providing a suite of professionally prepared information to show the historical and projected financial performance of the business.

The level of equity in the business is important. This may mean obtaining an external valuation of land held. The cost of the valuation can normally be recouped quite quickly as the interest rate is reduced.

The ability to service debt is a major consideration. Banks will want to know what the businesses year-in-year-out cash position looks like. For a business that is still building up its production, this maybe in the future. This is where a credible plan to achieve this is paramount.

Other subjective areas the bank takes into consideration include the long-term vision of the business, and what its succession looks like. Agribusinesses that engage quality external advisors are also looked upon favourably.

WHAT DOES THE BANK REQUIRE?

There are a series of things that make up a professional finance submission, including accountant prepared financial statements, ATO reports, and a detailed projected cashflow that includes production assumptions.

Banks also look at the overall professionalism of the business. Examples include a long-term vision for the business.

OUR TEAM

At Pinion Finance, Michael Bagshaw leads the way with 18 years of dedicated experience delivering finance solutions to the agricultural sector. With a solid background in farming, Michael brings invaluable hands-on experience to the table.

Our finance team collaborates closely with our production, farm business, and sustainable services team to provide you with a comprehensive and holistic service.

WHY WORK WITH US

With over two decades of dedicated experience fostering business development and growth, our holistic methodology integrates technical, production, and management aspects to cater to your needs.

At our core, we offer a professional, independent, innovative approach and a genuine desire to help you achieve your goals.

For more information
contact us on **1300 746 466**
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