



# Financing the Farm

*A law bulletin series on legal arrangements for farm financing*

April 2021

## Understanding Farm Operating Loans

*Peggy Kirk Hall, Associate Professor  
Jeffrey K. Lewis, Research Specialist  
OSU Agricultural & Resource Law Program*

Farming is a capital-intensive business, often requiring high cash outputs long before receiving any sales income. An operating loan, also called a line of credit, can be a lifeline for providing the farm's capital. This bulletin explains operating loans and highlights what a beginning farmer should understand about using them.

### What is a farm operating loan?

A farm operating loan is a line of credit that typically follows a farm's production cycle. Unlike a term loan, an operating loan is not a single lump-sum disbursement repaid over a long period of time. Instead, a farmer draws on operating loan funds as needed. Repayment is usually due at the end of the production cycle, when the farmer sells the commodity produced, but could also be set up on a periodic schedule.

A **revolving** loan allows a farmer to borrow funds repeatedly as the farmer repays the loan balance. This arrangement might continue for several years and is common for farm operating loans. A **non-revolving** loan is a one-time loan that is not available again after its pay-off.

### When do farmers use operating loans?

An operating loan is typically used to provide liquidity to fund a farming activity in the short-term. For example, an operating loan can provide the capital necessary to purchase seed, fertilizer, pesticides and other inputs for planting a crop. After harvest, the producer repays the loan funds. An operating loan can provide start-up funds to diversify the operation or make improvements, such as purchasing livestock, adding an orchard, produce crop or agritourism activity. A loan can also cover general operating expenses when cash flow is limited. This type of loan is not for funding long-term purchases such as land and facilities, which typically involve lump-sum disbursements and term loans repaid over a long time period.

There are benefits to using an operating loan rather than a traditional term loan. The short-term nature of an operating loan minimizes interest charges only to funds actually used and over a short time period. The infusion of capital to grow the operation and quick pay-off can enhance the farm's balance sheet.

### How does an operating loan work?

As with other loans, an operating loan or line of credit requires a borrower to submit a loan application to a lender. Farm operating loans are available through government agencies such as the Farm Service Agency, which specifically targets beginning farmers



*This bulletin is based upon work supported by the National Agricultural Library, Agricultural Research Service, U.S. Department of Agriculture. The information contained in this bulletin is provided for educational purposes only. It is not legal advice, and not a substitute for the potential need to consult with a competent attorney licensed to practice law in the appropriate jurisdiction.*

who are unable to receive loans from other sources. Institutional and commercial lenders also provide farm operating loans, and some of these loans may be backed and guaranteed by the government. **Loan features** such as interest rate, how funds are accessed, and renewal terms can vary.

**Loan approval** may depend on factors such as credit history, program eligibility, production history, farm management experience, and a farm business plan. As with other types of loans, the parties will enter into a written **loan agreement** that sets the approved maximum loan amount and covers other terms such as interest, repayment, access to funds, and default.

A lender will seek to secure an operating loan with a **security interest** in collateral. The commodity produced with the operating loan is a likely source of collateral, and a lender may seek security interests in additional collateral such as stored grain, livestock, farm goods, accounts receivable, or farm machinery and equipment. A lien or a Uniform Commercial Code (“UCC”) filing consisting of a security agreement and financing statement will secure the assets pledged as collateral. (Learn more in our *Secured Transactions* bulletin in this series).

It is common for a farm operator to obtain a revolving operating loan from the same lender from season to season. Annual price and market fluctuations will affect how much capital is needed each year. A lender and operator in a revolving loan situation usually conduct an **annual review** in anticipation of the next year’s operating loan.

### Using farm operating loans

A farm operating loan is a useful tool for managing cash flow through the capital-intensive periods of a farming operation and avoiding long-term debt obligations. Operating loans can vary from lender to lender, making it important to compare different types of farm operating loans. Although a farm operating loan plays out in short-term periods that repeat with production cycles, an operating loan sets up a long-term relationship with a lender. A farmer should carefully review lenders and their operating loan products to ensure a loan arrangement and lender relationship that works best for their operation.

### Other titles in the *Financing the Farm* law bulletin series

To learn more about common legal documents for farm financing, see our law bulletins on Mortgages, Promissory Notes, Installment Contracts, Leasing Arrangements, Secured Transactions, Statutory Liens and Personal Guarantees, available in OSU’s Farm Office library at <https://farmoffice.osu.edu/ag-law-library/farm-finance-law>.

### References and additional resources

“Farm Operating Loans,” Farm Service Agency, U.S. DEPT. OF AGRICULTURE, <https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/farm-operating-loans/index>.

“Finance and Credit,” NATIONAL AGRICULTURAL LAW CENTER, <https://nationalaglawcenter.org/research-by-topic/finance-credit/>.

Phillip L. Kunkel and Jeffrey A. Peterson, “Financing the Farm Operation,” Agricultural Business Management Farm Legal Series, UNIVERSITY OF MINNESOTA EXTENSION, <https://hdl.handle.net/11299/213009>.

Robert E. Mikesell and Lynn Kimes, “Financing Your Farm Business or Enterprise,” PENN STATE EXTENSION, <https://extension.psu.edu/financing-your-farm-business-or-enterprise>.