Financing the Farm

A law bulletin series on common financial agreements in farming

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About the *Financing the Farm* Law Bulletin Series

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New farmers are exposed to a number of different finance and credit instruments when they start to build their farm businesses. Fortunately, this allows them access to capital for purchasing land, equipment, livestock, inputs and supplies. Unfortunately, lenders do not always explain the legal components and implications of these documents to a beginning farmer.

The *Financing the Farm* law bulletin series provides new and beginning farmers with an overview of the most commonly used documents in agricultural finance. Each law bulletin covers a different type of financial agreement, and explains basic terminology, fundamental legal requirements, and how the arrangement is used in farming operations. In this bulletin, we begin with a quick explanation of finance law and the role an attorney can play in your financing arrangements.

What is Finance Law?

When we talk about finance, we are referring to cash loans and extensions of credit for purchasing goods. One of the most highly regulated areas of law is finance law. Why? Because it deals with money, and our society values having rules in place on how money is owned, loaned, and transferred. Finance law refers to a wide array of topics and a complex mixture of state and federal law. For the purposes of the *Financing the Farm* law bulletin series, we primarily stay close to state contract law.

Contract law governs how people and businesses enter into legally binding agreements to purchase goods and services. A legally binding agreement is an agreement that someone can take to a court in order to have the court enforce the individual's rights under the contract.

Contract law has largely been a creature of state law, meaning that each state gets to decide how contracts are governed in its state, even between private parties. Fortunately, most states have adopted the **Uniform Commercial Code (UCC),**

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USDA United States Department of Agriculture
National Agricultural Library

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which has helped standardize much of state contract law across the United States.

The Uniform Law Commission designed the UCC with the purpose of encouraging states to voluntarily adopt standard laws and rules in commercial law, which governs many of the financial documents discussed in this series. If a certain law is standard in every state, this means that courts in every state should reach the same or a similar decision on a given issue. This makes it easier to conduct business across state lines because it requires you to know one set of rules rather than 50 different laws.

We mention the UCC throughout the *Financing the Farm* law bulletin series. When you see it referenced, you'll know that the law referred to is intended to be standard across the United States. To learn more about the UCC, visit: http://www.uniformlaws.org/acts/ucc.

Topics in this Series

In this series of law bulletins, we focus on the agreements and tools that a landowner, manufacturer, bank, credit cooperative, or public entity like the USDA use to provide the financing that helps you buy land, machinery, equipment, livestock, and supplies for your farming operation. You will formalize these financial arrangements with legal documents that establish the rights and responsibilities of all parties to the transaction.

Regardless of the source of your finance, a particular type of financial agreement is likely to involve the same types of documents. For instance, if you are seeking a large loan to purchase real estate, you are likely to enter into a mortgage and promissory note regardless of whether you go to a private lender, a cooperative, or the USDA. The details of those agreements may vary, but the basic purpose, legal implications, and processes for using the agreements will be the same.

Here are the law bulletins we've included in this series, and what you can learn about in each:

1. Mortgages. A mortgage secures a loan by granting a lender title to real estate and voiding the title upon repayment of the loan. Our first law bulletin explains the legal requirements for mortgages, how farmers use mortgages, the rights a lender receives through a mortgage, and what happens when two or more lenders claim a mortgage interest in the same property. We also examine the relationship between mortgages and promissory notes.

2. Promissory Notes. Commonly confused with a mortgage, a promissory note serves as a buyer's promise to repay a loan. Our law bulletin explains provisions and clauses commonly included in promissory notes and how farmers use promissory notes. We also discuss interest rates, legal limits on interest, what happens in the event of default, a lender's right to assign the promissory note, and a promissory note's relationship with a mortgage.

3. Installment Contracts. In an installment contract, the buyer repays a loan in a series of payments that typically includes the purchase price plus interest. Our third law bulletin explains installment contracts and how they're used, and addresses the tax consequences of selling depreciable assets, such as machinery and equipment, under an installment contract and using installment contracts with family members. The law bulletin also compares installment contracts to leases and lease-to-own agreements.

4. Leasing Arrangements. Leases play an important role in facilitating the agricultural economy. This fourth law bulletin explains what is required to enter into a lease, how farmers use leases, and notes different types of leases used in farming. It also highlights why leases should be in writing, discusses lease-to-own agreements and compares leases to installment contracts.

5. Secured Transactions. Secured transactions allow a farmer to secure a loan by granting a lender a security interest in collateral. This fifth law bulletin explains what secured transactions are, how farmers use them, and how they work. In this bulletin, we explain priority of interests, default and redemption, and which creditor has priority to collateral in which other creditors also have an interest.

6. Statutory Agricultural Liens. A statutory agricultural lien can protect the provider of agricultural goods or services in the event of non-payment. In this bulletin, we explain how these liens work, examples of different types of statutory agricultural liens across the states, and their relationship with the Uniform Commercial Code.

The importance of working with an attorney

The general information we provide in this series does not replace the need to have an attorney review or create your financial agreements. Because you will be legally bound to an agreement that you sign, you want to be sure that you understand what you are promising, what your rights are, and the rights and obligations of the lender with whom you are contracting. An attorney can help you understand the agreement and its terms, and can also help you negotiate the agreement by offering alternative provisions that address your needs and protect your interests. An attorney's involvement might require several hours of his or her time, but the cost for this legal oversight provides an extra layer of assurance that your financial agreements will be sound and in your best interest.

Resources on Agricultural Finance Law

"Beginning Farmers and Ranchers Loans," *Farm Service Agency*, UNITED STATES DEPARTMENT OF AGRICULTURE, https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/beginning-farmers-and-ranchers-loans/index.

"Farm Legal Series," UNIVERSITY OF MINNESOTA EXTENSION AGRICULTURAL BUSINESS MANAGEMENT (June 2015) https://conservancy.umn.edu/handle/11299/199846.

"Farm Loan Programs," *Farm Service Agency*, UNITED STATES DEPARTMENT OF AGRICULTURE, https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/.

"Farm Operating Loans," *Farm Service Agency*, UNITED STATES DEPARTMENT OF AGRICULTURE, https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/farm-operating-loans/index.

"Finance and Credit," THE NATIONAL AGRICULTURAL LAW CENTER, https://nationalaglawcenter.org/research-by-topic/finance-credit/.