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# Assets Drive Your Farm Business Plan



# Partners in Tax Education

California FarmLink is proud to offer this webinar with financial support provided by the USDA Farm Service Agency Tax Education and Asset Protection Initiative using funds Congress allocated for this purpose in the American Rescue Plan Act (ARPA).



# About the Instructor

Poppy Davis is a business and policy adviser to agricultural enterprises, nonprofits, and local governments. She works through programs around the country to deliver trainings on topics including agricultural taxation, accounting, credit, and cash-flow.

She began her career as a California CPA, and later worked for the USDA.

She holds a Juris Doctor with a certificate in Food and Agricultural Law from Drake University Law School, and a BS in Agricultural Economics from the University of California at Davis.



# Overview

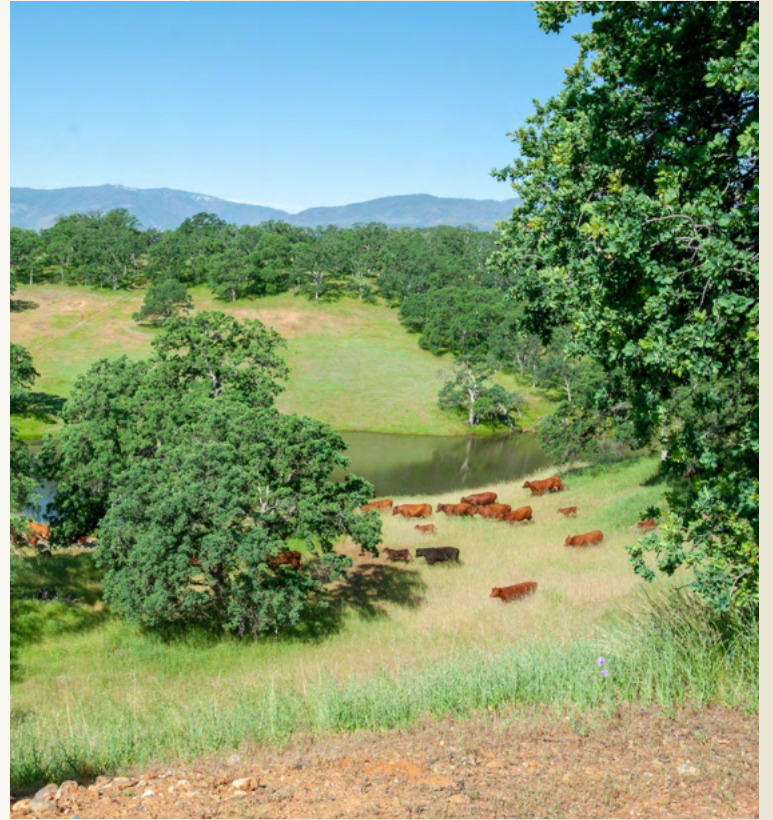
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1. Capital and Assets
2. Assets as Drivers of Profitability
3. Planning for Asset Acquisitions
4. Planning for Asset Maintenance and Replacement



# Capital and Assets

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# Capital

**Capital is a broad term meaning both an investment intended to generate income, and the financial, intellectual and physical resources needed to offer goods or services.**

Capital includes cash, human labor and know-how, and physical assets such as land, buildings, and equipment.

- Assets unique to agriculture include working and breeding animals, and permanent crops such as orchards or vineyards.
- Assets unique to fishing include fishing permits or quotas.



# Capital and Assets

**Business capital** includes tangible and intangible assets *owned, directed, or controlled by* the business.

- Labor and leased property are examples of business capital that are directed or controlled but not owned.

**Business assets** are *owned by* the business, and have an economic value that is established or can be reasonably estimated.

- Assets are usually valued at purchase price or cost to create.
- The value of a business' name, reputation, business practices, established customers etc. is called "goodwill." It is an asset of the business but it cannot be valued until the business is sold.
  - Usually goodwill is only considered an asset if it has been purchased by acquiring an established business for a price greater than the total value of all the physical assets.

# Assets on a Business Balance Sheet

Business assets are shown on the **balance sheet** of the business if the business has legal ownership and the value can be reasonably estimated.

- Short term business assets are cash and things that can be quickly converted to cash.
- Long term assets include buildings and equipment and things expected to benefit the business for more than a year.

*A business **balance sheet** lists everything a business owns (assets) and owes (liabilities) and the value of each owner's investment.*



# Assets (and Liabilities and Equity)

## Cash

- Invested by owners (offset is owner's equity)
- Borrowed by business (offset is loan payable)

## Buildings, Equipment, Permanent Crops

- Asset is valued at purchase price or cost to construct. (Associated debt shown as a liability.)

## Leases

- Formal - a balance sheet asset (right to use) and liability (obligation to pay)
- Informally - not shown on balance sheet, payments are expensed on income statement.



*Note: "Lease-to-own" is treated as a financed purchase / a purchase and a debt.*

# Assets On and Off the Balance Sheet

## Intangible Assets Shown on Balance Sheet

- Patents, trademarks, copyrights
  - Contributed to the business by owners
  - Created and owned by the business
  - Licensed to the business (the business may use but another owns)

## Assets too intangible to show on Balance Sheet (not owned, cannot be valued until sold)

- Business practices, policies, procedures,
- Network, reputation, customer base (“goodwill”)



# Non-asset Capital

**Labor and Services are capital in that they are the “means of production” for a businesses, but they are not assets.**

- The cost of labor is shown as an expense on the income statement.
- Payments on contracts for goods and services are expensed to the income statement.
- A great workforce may be called an asset, but since it is not owned and cannot be valued it is not an actual asset on the balance sheet.
- The same is true of valuable contracts with service providers.

# Capitalizing a Business

A business plan includes a specific plan for how a business will be *capitalized*.

- How owners will invest
- How credit will be used to supplement the owners' investments

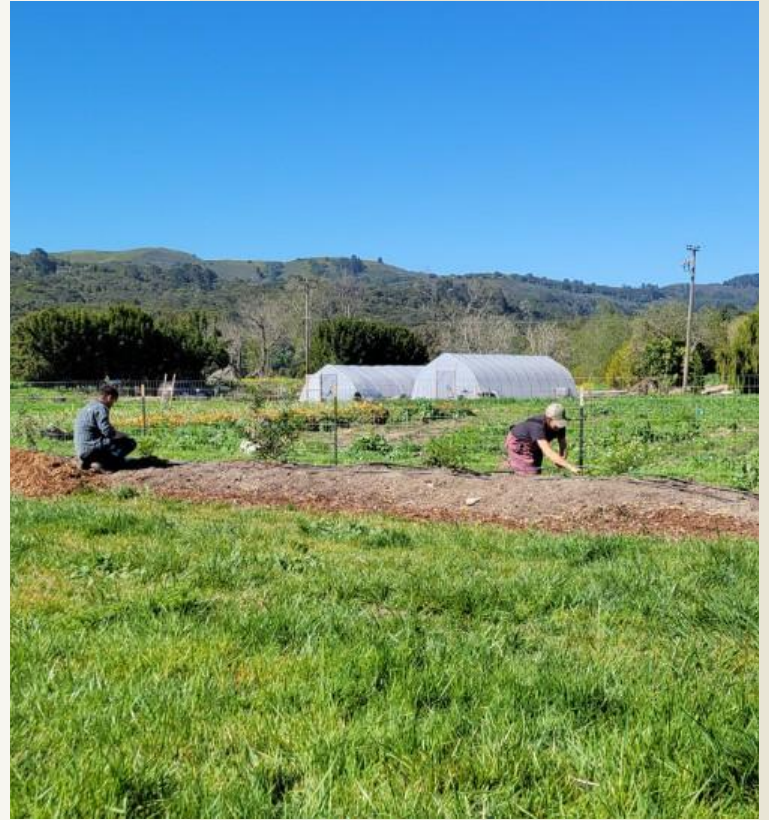
**Invested capital is owned by the investor.**  
**An investor may or may not be an owner.**

- An *investment* is a commitment of capital with the expectation (but not the certainty) of a future return of capital plus profit (interest or other profit).



# Assets as Drivers of Profitability

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# Asset-Driven Businesses

**A business plan identifies the key assets needed for the business and identifies when and how those assets will be acquired.**

- Agriculture and fishing rely on natural resources and other specialized assets.
- A lender who understands your industry expects a business plan to discuss key assets
- A lender who does not understand your industry is even more in need of a discussion of key assets.



# Assets and Labor

## Many assets are substitutes for labor.

- Labor is an expense - you pay as you go.
- Assets are an investment, you pay up front, they save you expenses month to month, and then eventually they need to be replaced.
- *But if you finance asset purchase or acquisition you pay month to month - so it may be just as affordable as labor if you qualify for fairly priced credit.*



# Assets and Labor

**Assets versus labor is one of the most important decisions you will make as a farm owner, and you will make it over and over again.**

- Your own labor or hired labor?
- Your own labor or equipment?
- Hired labor + more labor or + more equipment?
- Cheaper land & more drive time or more expensive land and less drive time?



# Land

## Land is the main driver of and constraint on profitability

- Location
  - Distance to market / Quality of market
  - Distance to services and inputs / Quality of available services
  - Distance from workforce / Quality of workforce
  - Local government - attitudes, support, hindrances
  - Housing availability
  - Neighbors
- Productive capacity (soils, acres, water access)
- Climate and microclimate

# Buildings and Equipment

- **Buildings**
  - Packing and Cooling
  - Storage for equipment and supplies
  - Office
  - Other needs?
- **Equipment**
  - Planting, weeding, harvesting
  - Packing, and transportation
  - Selling (market stand)



# Permanent Crops and Land Improvements

- **Permanent Crops**
  - Orchards
  - Vineyards
- **Land Improvements**
  - Wells, ponds
  - Hedges, wind breaks
  - Irrigation
  - Roads
  - Fences
  - Septic
  - Electric



# Direct and Indirect

What is the direct contribution each asset makes to your theory of profitability?

- **Fences**
  - You can't have cows without them - direct
  - You grow tomatoes - indirect
- **Painted wooden fences**
  - Cows or no - the paint does not increase current profitability
  - But it may maintain the fences longer and increase long term profitability



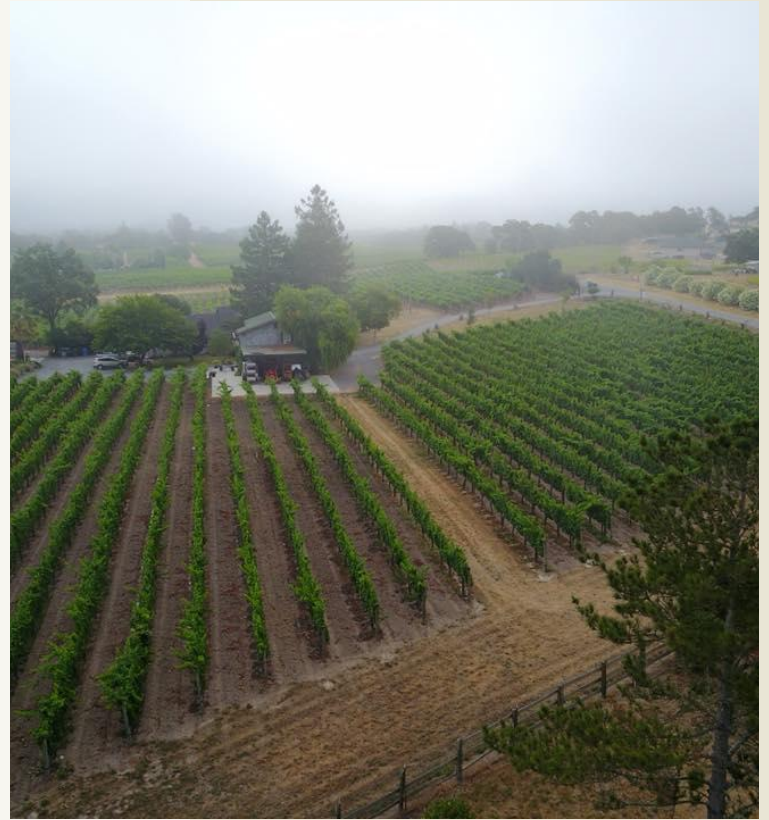
# Your Business Plan Should Discuss

- What are the assets you will need to manifest your vision for your business?
- How does an asset contribute directly to your plan?
- If the asset does not contribute directly, how is it still necessary?



# Planning for Asset Acquisition

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# Cash or Credit?

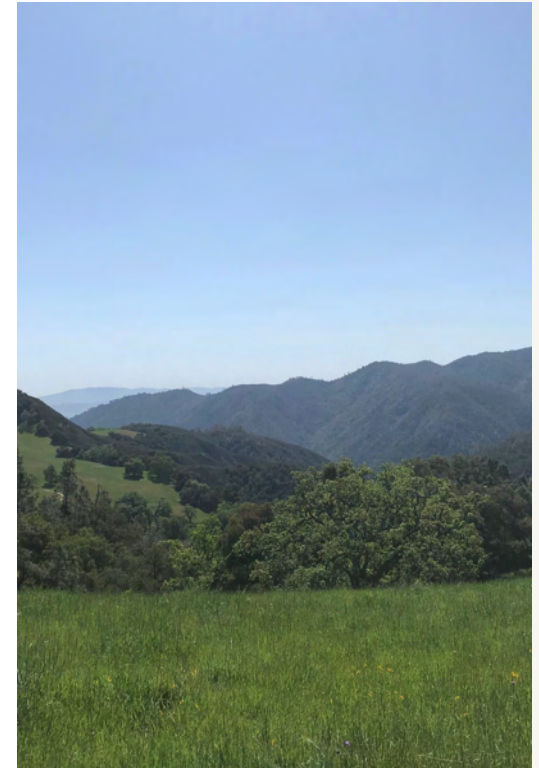
- It is relatively easy to get a loan for an asset because the loan is secured by the asset.
- It is relatively difficult to get an operating loan because even though the lender takes a lien on the crop - the lender does not want the crop.
- One of the biggest mistakes beginning farmers make is using cash on assets and then coming up short on operating cash.



# Cash or Credit?

**If you are short on operating cash and have to get a loan It may be too late in the season to get a loan from a lender focused on agriculture, and loans from other lenders offer fewer protections, and less expert guidance and may have higher rates.**

- Some people end up using credit cards with 20% interest rates - it's an expensive mistake!



# Cash or Credit?

Advantages of Cash	Advantages of Credit
Fast	Leaves working cash for operations
No interest	Requires insurance
<b>Disadvantages of Cash</b>	Shares risk with lender
Uses cash you need for operations	
You bear all risk	



# Lead time

- How long will it take to:
  - Research the asset you wish to acquire?
  - Obtain financing if needed?
  - Find the right asset at the right price?
  - Negotiate and complete the sale?
  - Transport the asset and place it in service?



# Timelines and Benchmarks

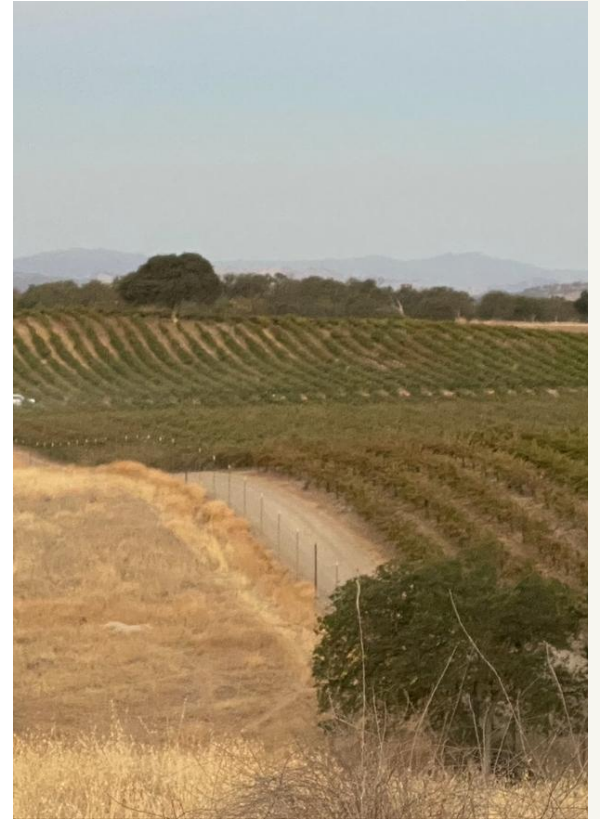
- A business plan should include reasonable timelines for critical events
  - In the start up (pre-operational) phase
  - In the first year of operations
- A business plan should also have key benchmarks to indicate progress



# Asset Acquisition Plan

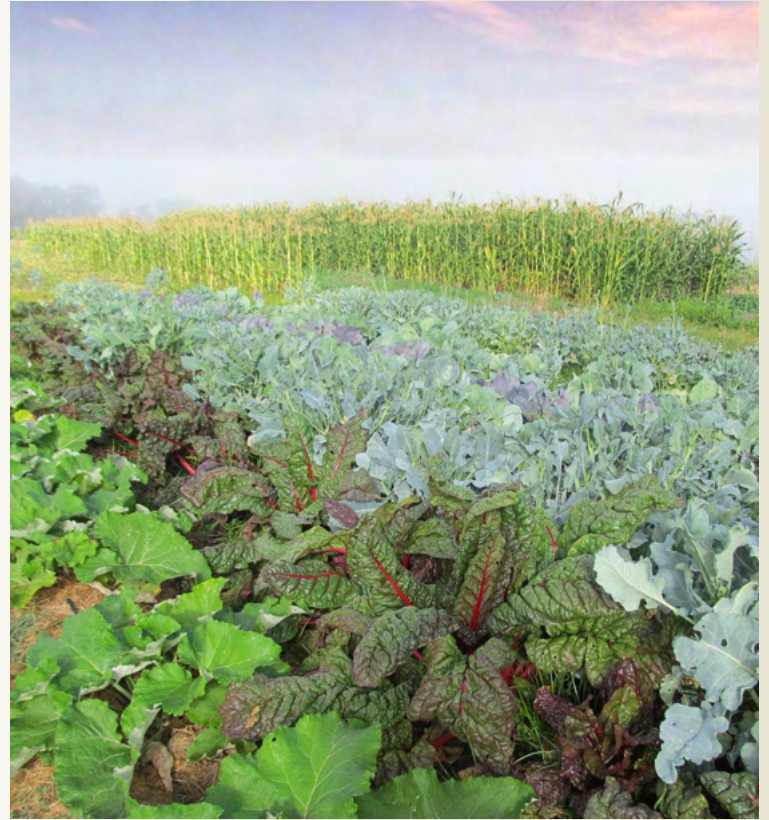
For each of the assets that are essential to your business:

- How will you research it?
- How will you pay for it?
- How long will it take for the asset to pay for itself?



# Planning for Maintenance and Replacement of Assets

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# Maintenance Schedules

- What is regular maintenance for each asset?
- When does it occur?
- What does it cost?
- Who is responsible for ensuring that it happens?



# Replacement

- What is the true estimated useful life of the asset?
- Will the asset wear out?
- Will the technology change?
- How long will it take to research the replacement?
- Will the replacement need to be financed?
- Can you save enough to self-finance the replacement?



# Transferring Assets

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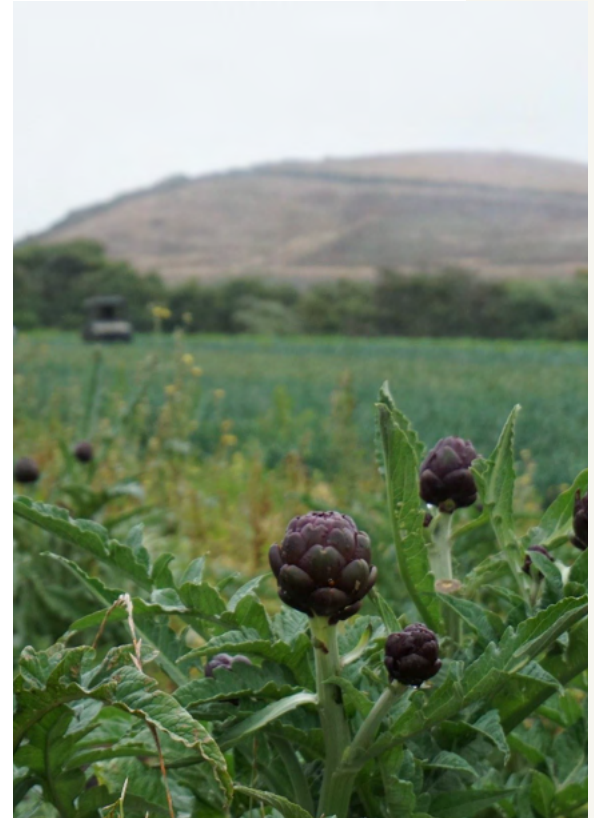


# Transferring Assets

**When an asset is no longer in use it may be scrapped for parts, or sold or gifted.**

- Depending on the assets, a business plan may discuss disposing of obsolete assets, especially if that will occur regularly.
- For budget (and tax and accounting purposes) if an old asset is used as a down payment for a new asset treat it as a sale for the amount of the down payment and a purchase at full price.

For more information, see [Tax Issues for Asset Transfers in FarmLink's Tax Toolshed](#).





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# Questions?

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# Thank you!

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