Student 5: Low Achieved

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The XXXs have owned their 250-hectare sheep and beef farm for the past 30 years. The farm has a current valuation of $4,000,000, is partly irrigated and has no debt. At present the ownership structure is a partnership with Bill and Nancy each having a 50:50 share. Bill and Nancy's daughter Emily recently sold one of her houses and is keen to return to the family farm. Emily is going to invest $400,000 into the partnership, becoming a third partner with a 10% share, taking her parents' shares to 45% each.

The family wants to convert the sheep and beef farm into a dairy farm. The total cost will be $4,030,000. They will be able to sell their livestock for $400,000. Also taking Emily's $400,000 into account, they will have a shortfall of $3,230,000 and are looking at how they can raise this money. 4

BANK LOAN 1

A bank loan is an amount of money loaned with interest by a bank to a borrower, using security, for a certain period. If the XXX family borrow $3,245,000 at an interest rate of 5% from ASB Bank they would be repaying the amounts shown in the table below, depending of the term of their loan. 4

Term	Monthly payment	Annual payment	Total interest	Total cost of loan
5 years	$60,954	$731,448	$427,254	$3,657,245
10 years	$34,259	$441,108	$881,099	$4,111,099
15 years	$25,543	$306,516	$1,367,674	$4,597,674
20 years	$21,317	$255,804	$1,885,977	$5,115,977
25 years	$18,882	$226,584	$2,434,678	$5,664,678

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The XXXs will be paying off the loan over however many years they choose. For example, if they choose a 10-year term they would be paying $34,259 per month, or $441,108 each year and over the 10-year term they would pay $881,099 in interest.

Choosing a 25-year term for the loan makes the monthly payments easier to manage which could be less worrying for the family, but they would end up paying almost 75% more than the $3,245,000 they originally borrowed. Also, the bank might not let the XXXs have such a long term because the parents are already in their 60s. 3

CROWDFUNDING 1

This is a way of funding a project by many people contributing money for the project. The XXXs could look at the Pledge Me Projects website to see how crowdfunding works. The problem with the farm using Pledge Me is that it could take a very long time for enough contributors to sign up to pledging, or that people cannot see any benefit to them for investing in the XXX's farm. This option would be a last resort if the family cannot access funds any other way.

EQUITY PARTNER 1

Bill, Nancy and Emily could try to interest one or two wealthy people to join their partnership as equity partners. This would mean that until their contributions are paid back, the equity partners own part of the value of the farm and will be entitled to part of the profits, but they will not be involved in decision-making or day-to-day farm matters. More than one equity partner would be needed but things could become very complicated if there were too many equity investors. Two would be best as this would give enough of an investment to convert the farm.

RECOMMENDATION

Borrowing from the bank would mean that the XXXs keep 100% ownership of their farm and it is the fastest way to raise the money they need. The repayments to the bank are known and fixed. If milk production drops and the XXXs can't pay their repayments the bank might lengthen the term of the loan because the farm is being used as a security blanket. 5

Crowdfunding is just a waiting game and could take years to raise enough money although the XXXs would also keep full ownership of their farm.

Equity partnership could be good, but it might take a while to find partners with so much money to invest in the farm. An equity partner might want out of the deal before the agreed time is up so another equity partner would need to be found. Or the equity partner could die. Therefore the XXXs would need to pay a lawyer to write a contract that covers all those things that could go wrong.

So I recommend that the XXXs borrow the $3,230,000 from the bank for, say, 15 years and hope that the farm's income is enough to keep up with the monthly repayments.