

Avoid Year-End Operating Loan Pitfalls

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Nov. 11, 2024

CAP Series 24-1101

As the year draws to a close, many producers rely on operating loans, or lines of credit, to finance essential expenses when cash flow is tight. These loans function like credit cards but usually come with lower interest rates. An operating loan is a short-term financing tool — often lasting less than a year — designed to help manage business cash flow. Borrowers are usually granted a pre-set limit they can draw from and repay multiple times throughout the year, primarily for purchasing inputs rather than long-term assets like land or equipment.

However, as the year ends, it's crucial to navigate the potential pitfalls associated with these loans. Here are some key considerations to keep in mind:

1. Understand Your Loan Limit

As many farmers and ranchers take advantage of pre-paying expenses to minimize tax liability, it's essential to know your operating loan limit. Ensure that your planned purchases align with this limit to avoid unexpected complications.

2. Know Your Annual Percentage Rate (APR)

Pre-paying expenses can lead to carrying costs for several months. Familiarize yourself with the APR (annual percentage rate, interest expense) for each loan. It is often prudent to select the loan with the lowest APR.

3. Avoid Too Many Lines of Credit

In addition to banks, many suppliers may offer lines of credit to facilitate input purchases. Managing multiple credit sources can become overwhelming. Develop a system to track each line of credit that you have. Stay informed about the terms and APR of these offers, as they may be less advantageous than those provided by your bank. Additionally, ensure that any outstanding balances are accurately reflected as liabilities on your balance sheet.

4. Use the Right Loan for Each Purchase

Operating loans should be reserved for input purchases. Avoid using these loans for personal expenses, purchasing intermediate and long-term assets such as equipment or land, or using them to make payments on other loans. Misusing operating loans can lead to financial strain down the line.

5. Don't Use Loans as a Substitute for Income

Utilize operating loans for expenses that are necessary and that can be covered by income generated throughout the regular production season. It's essential to consider all outstanding debts and have a solid repayment plan in place to maintain financial stability.

By staying informed and cautious, producers can effectively navigate the challenges of year-end financing and set themselves up for success in the upcoming year.

Cite this work:

Groskopf, J. “Avoid Year-End Operating Loan Pitfalls” *CAP Series* 24-1101, Center for Agricultural Profitability, University of Nebraska-Lincoln, Nov. 11, 2024. DOI: [10.32873/unl.dc.cap052](https://doi.org/10.32873/unl.dc.cap052).