FINANCING FARMING IN THE U.S.

OPPORTUNITIES TO IMPROVE THE FINANCIAL AND BUSINESS ENVIRONMENT FOR SMALL AND MIDSIZED FARMS THROUGH STRATEGIC FINANCING

A REPORT ON SIX WORKING SESSIONS

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Executive Summary

This report chronicles the coming together of a diverse group of people from across the country over a six-month period to explore (1) the reasons for the chasm between an emerging sector of smaller-scale agriculture producers and access to capital, and (2) workable strategies to create successful farmer-lender relationships. Because this group represents individuals and groups across the country, it was our hope to promote capital access among small and mid-scale farmers nationally. The report shares the discoveries we made, and offers an invitation to others to participate in creating successful lending relationships among farmers and lenders in the years to come.

This effort, conducted in six Sessions — five exploratory Sessions and a sixth dedicated to recommendations — was organized by The C.S. Mott Group for Sustainable Food Systems at Michigan State University (MSU) and The Carrot Project.

Session I attempted to describe these small-scale farmers and emerging agricultural models, and generated three unifying themes: (1) these farms use organic, sustainable, or ecologically oriented production practices; (2) they produce more-diversified products to differentiated markets than do larger and/or more traditional farm operations; and (3) they are not producing mono-crop commodities (in whose markets the lowest prices are the defining factor), but are instead emphasizing localized markets, connection between farm and community, freshness, healthfulness, taste, and striving for a larger share of every food dollar. Describing this rapidly emerging agriculture sector in a coherent way is the first step in helping lenders understand the sector into which they are potentially lending.

Session II identified the key obstacles faced by borrowers and lenders. Most of these borrowers have insufficient personal capital; may not be able to convey farm production knowledge or management experience; may have poor or insufficient personal credit histories; and generally lack a business plan and the ability to project a realistic cash flow. Lenders experienced in community development financing, particularly community development finance institutions (CDFIs), stressed that they have the skills to analyze and make loans to this emerging sector, but what they do *not* have is the ability to assess the information presented to them. Lenders want to know a viable business when they see it, to be able to understand the metrics, and to grasp the economic value of the production methods used.

Session III focused on identifying the most commonly used risk management strategies as described by farmers, exploring whether those practices already in use by farmers could be a useful starting point for developing a "scorecard" or new type of analytical tool to help lenders better assess the risks associated with lending into this new sector. Their strategies were organized around five types of agricultural risks: production, marketing, financial, legal and environmental, and human resource.

Session IV sought to learn from organizations that are successfully bridging the relationship and knowledge gaps between willing farmers and lenders. Each of the profiled organizations is a "hybrid" — a purposeful coalition of resources essential for farm viability — that serves as an intermediary between such resources and the farmers who need them. Generally, these hybrids share three key assets: (1) access to capital and land; (2) specific product technical assistance; and (3) farmer networking. They also share three challenges: (1) The Great Recession, or the stress on lending generated by the current slumping economy; (2) securing funding for operations and re-lending; and (3) finding enough qualified technical assistance providers and mentors for the farmers in this emerging sector.

Session V was organized around meetings with two federal agencies and two national associations that participants believed could be most helpful in securing capital and providing technical assistance at the local level for smaller-scale farmers: the CDFI Fund at the U.S. Department of Treasury, Opportunity Finance Network, the Small Business Association (SBA) Association of Small Business Development Centers, and USDA's Farm Service Agency (FSA). Research opportunities for these entities addressed questions related to accessing capital and credit, including: Where is it falling short for farmers and lenders? Who is being denied, and why? And which institutions are making loans, and which loans are successful? Presentation opportunities also emerged; especially noted was the annual Opportunity Finance Network conference for the CDFI industry, taking place in October 2010 in San Francisco.

Session VI was dedicated to producing main findings and specific recommendations. The main findings from the Sessions were: (1) capable agriculture borrowers need access to specialized business support; (2) financing entities need to possess significant knowledge about newer agriculture operations; and (3) access to capital could be improved by opening up new sources and improving linkages to existing sources.

Recommendations were organized into three categories: research, policy, and practice. Research questions include: quantifying the extent to which small farmers profiled in Session I are being turned down for loans, and why; and understanding what data are needed to develop a reliable "risk index" or "scorecard" to help determine loan qualification. Policy recommendations include: replicating successful public programs that address newer farmers, such as the USDA Beginning Farmer and Rancher Development Program; and the possible creation of a modest (though competitive) public fund, possibly housed at USDA, to test and replicate successful hybrid programs such as The Carrot Project, the Land Stewardship Project, and others. Practice recommendations include: facilitating the development of farmer-to-farmer lending pools; developing technical assistance specifically tied to production methods that enable wise land use and product expansion; and developing "pro-formas," or templates, on projections, capital needs, marketing strategies, etc. for farmers' use and then training them to use these resources.

There was broad consensus that these Sessions succeeded in meeting their objective: to bring a diverse group of stakeholders together to begin to bridge the gap between this emerging sector of farmers and the capital they need to start or grow their operations. But it was also agreed that this effort achieved something much larger, as well: it tapped into and contributed new knowledge, ideas, and relationships to some of the country's larger food-related issues, including hunger, obesity, health, water shortages, and poorly targeted agricultural subsidies. More broadly, by advancing the economic viability of these smaller and localized farming operations, the Sessions are helping to overcome some of the most significant challenges the U.S. faces at this moment in our history: creating jobs, reducing corporate consolidation, revitalizing rural America, and promoting a culture that rewards conservation and stewardship, small-scale ownership, entrepreneurship, families and local communities, and the ability to define yourself not by what you consume, but by what you produce. These challenges are significant; the potential solutions and progress on them are exciting.

I. Introduction

Securing local financing for new enterprises has long been a struggle in the U.S., whether for a small mom-and-pop grocery, a cleaning service, or a small farm. All of them are at a disadvantage when dealing with suppliers or banks, or whenever they must access an infrastructure that is increasingly geared toward larger firms.

However, our agriculture and food systems have been front-and-center lately, both for health and food safety reasons, and because the agricultural sector is faring somewhat better than the broader economy, according to Congressional Oversight Panel Chair Elizabeth Warren. Yet, getting capital into higher-value food production for local consumption has been lagging.

The predominant wisdom has been that the larger the farm operation's scale the more profitable the operation is, based on price efficiency within the global marketplace. However, the national increase of profitable, smaller-scale farms using primarily local markets is giving rise to the notion that profitable sustainable agriculture, supported by more-localized markets, might be a realistic option. And if these smaller-scale farms are generating on-farm income, why can they not secure capital to grow their enterprises?

The number of U.S. farms smaller than 49 acres grew from 1997 through 2007. These farms also represented a larger *portion* of total farms during the same time period (a 15% increase in the number of farms, and a 4% increase as a portion of total farms). It is particularly those small- and medium-scale farmers — who are finding themselves with new opportunities for innovative production and marketing techniques that can be realized only with access to adequate capital — whose needs the current system of debt finance frequently fails to meet. Indeed, this would not be an issue worthy of ongoing attention if problems in financing farming were isolated to examples in a specific locale or state.

Access to financial capital — loans and equity — persists as the chief obstacle for farm start-up and, according to a recent USDA Economic Research Service (ERS) report, a leading factor for why so few beginning farmers are young. Based on an increasing number of groups conducting assessments of capital access (The Carrot Project, 2008; Cocciarelli, 2009; RAFI-USA [Rural Advancement Foundation International-USA], 2006), many across the country working to build farm viability are attesting to the inadequacy of existing capital.

Michael Pollan has provoked the nation into thinking about where our food comes from, and Woody Tasch and others have pressed us to think about the financial sustainability of industrial agriculture. We are trying to reshape and build a food and agriculture system that creates opportunities for smaller farmers, provides healthful, locally produced food for citizens, is good for the environment, and boosts local and regional economies. One could say that the notion of "food sovereignty" — growing and eating our own food — is important for nutritional, social, economic, climate, and even national security reasons.

But the key question at this moment for us is, *How do we do make farming economically viable at a scale that satisfies the goals of localizing our agriculture and generating a return on investment for both farmers and lenders*? Is there an agriculture-responsive financing system that is not region specific? Can those of us in this emerging agriculture sector bring more clarity to what lenders are lending into?

This report documents the outcomes of a series of six conversations (Sessions) among stakeholders throughout the country. Participants in these meetings explored the reasons for the chasm between the capital needs of agricultural producers in the emerging smaller-scale agriculture sector and access to capital, and workable strategies to create successful lending relationships between these producers and lenders. Our hope was and is to promote capital access among small and mid-scale farmers nationally. Our report is the opening chapter in what promises to be an exciting story. Here we share the discoveries we made and invite others to participate in creating successful opportunities for farmers and lenders in the years to come.

II. Methodology: An Overview of Financing Farming in the U.S.

In order to bring attention to the financing dilemma faced by both lenders interested in understanding new agricultural markets, and an increasing number of successful, innovative farmers hesitant to approach mainstream lenders, an effort is being made to bridge this gap. Two organizations involved in this work undertook an in-depth exploration of farm viability and its relationship to capital access: The C.S. Mott Group for Sustainable Food Systems at MSU (Mott Group), through its most recent W.K. Kellogg Foundation-sponsored Food and Fitness Linkages activity; and The Carrot Project, a non-profit focused on increasing the availability of capital, and its wise use, to ecologically and financially sustainable small and midsized farms and farm related businesses in New England and New York.

An overwhelmingly positive audience response to a presentation by The Carrot Project in October 2009, funded by Northeast SARE (Sustainable Agriculture Research and Education), inspired the Mott Group and The Carrot Project to forge a working group to explore more deeply the issue of financing farming. What resulted was a series of six facilitated national conversations entitled, "Financing Farming in the U.S." These included five in-depth sessions on a range of topics, plus a final session focused on key points and recommendations

Focal Questions for the Six Sessions
December 2009 – April 2010

Session I: What are the new, emerging agriculture models?

Session II: What are the major obstacles to bringing more financial capital to smaller-scale farms?

Session III: What are the metrics by which lenders evaluate risk in agriculture? Can these metrics be modified to reflect increased knowledge among lenders and the risk mitigation strategies now practiced by small farmers?

Session IV: What "hybrid" models could serve as examples of intervention strategies designed to close the knowledge and service gaps between small-scale producers and lenders?

Session V: What national institutions might add value to local financing entities' efforts?

Session VI: What are the key points and recommendations?

Participants in these conversations represented a cross-section of the sustainable farming and finance field (see Appendix A). The themes of Financing Farming in the U.S. underscored opportunities to change and improve the financial wherewithal of, and the business environment for, small and midsized farms through strategic financing mechanisms.

Financing Farming in the U.S. consisted of five, 90-minute monthly conference calls and one meeting in Washington, DC between December 2009 and May 2010. Approximately 18 organizations were represented, with 10 individuals consistently attending five of the six sessions. Susan Cocciarelli and Dorothy Suput coordinated preparation for the series and co-facilitated the calls. Each 90-minute Session was divided into three components: (1) an introduction to the topic; (2) a review and discussion of topical materials prepared and distributed prior to the meeting; and (3) a summary of the Session, which also included input relative to the next Session's agenda.

Each Session focused on understanding financing and farming: What type of agriculture are we addressing? How can capital be responsive to meet demand for agricultural products? What brings lenders and farmers closer together so that capital works for both? Participants acted as advisors in preparing for the Sessions, provided insight from their work and personal experience, and helped craft recommendations for strategies to improve relationships between, and opportunities for, farmers and lenders. The group believed that their consensus-driven recommendations would be valuable not only to particular regions, but also to practitioners across the country.

III. The Sessions

SESSION I

DECEMBER 2009

WHAT ARE THE NEW, EMERGING AGRICULTURE MODELS?

During the last decade, and especially in the last few years, efforts have been made to describe the "new farmers" and "emerging agricultural models" that a rapidly increasing number of Americans rely on for local, and often organically produced, fruits, vegetables, and meats. What are these models, and could such business models help small farmers gain fuller and more adequate access to the capital and technical assistance they need to grow and sustain their operations?

Why Understand This Emerging Market?

As one might guess from trips to Whole Foods Markets or farmers' markets in many large urban areas, small to mid-scale farms are finding robust markets that often provide generous margins for their products. These types of farms have the potential to provide livelihoods because their products are differentiated from the products of the larger-scale farms that compete on the global market. And though they have identified many successful strategies to penetrate local and regional markets, they are not coming to lenders with business plans that describe their operations. Instead, they often choose to finance their small farms with pricey (and sometimes abusive) credit cards or by undercapitalizing their businesses.

At the same time, some lenders serving other types of small businesses are asking, "How can we enter the field and enrich our communities?" But such lenders can find it difficult to do so until a question posed by participant Denise Dukette is addressed: "What are we lending into?" Ultimately, lenders were hopeful that these non-conventional, smaller farms could be organized and described as a "sector cohort," i.e., an operation easily identified by a descriptive business plan. What follows are some attempts to do exactly that.

Describing the Emerging Sector and Its Operators

The USDA, in its efforts to address the changing demographics and scale of farming, has offered new programs for specific, targeted farmers, as well as changes in farming typology to reflect the emerging sector. The USDA Beginning Farmer and Rancher Development Program (BFRDP) describes beginning farmers and ranchers as any principal operators farming for fewer than 10 years. The USDA ERS recently created a new category and included in it "small farms" with annual sales of $250,000 or less. Both of these descriptions capture a large number of the farmers discussed in this report. Beyond these descriptions, however, the USDA typology provides little information that differentiates this sector from more conventional farming practices. This has created an opening for several groups that offer farmer education and business development support across the county to describe in greater depth this emerging sector of smaller-scale, more local-market oriented farms.

The Northeast Growing New Farmer Consortium (GNF) categorizes new and beginning farmers separately. A "new farmer" encompasses the universe of people who are considering becoming farmers, whereas beginning farmers are those who have *actually* been farming for 10 years or fewer. GNF then describes six particular types of beginning farmers. These six GNF farmer types are distinguished by their current engagement with, and commitment to, farming.
Other farm development organizations — such as the Intervale Center in Vermont, Farm Beginnings in Wisconsin, and Coastal Enterprises, Inc. in Maine, among others — describe emerging farmer operators as those having farming knowledge, skills, and management expertise, but who, because many are first-generation farmers, lack farming knowledge handed down through a family business, access to land, and capital needed to begin their operations. In the first three years of start-up operations, beginning farmers are still discovering what they need, and require different services than those re-establishing their farms after six or seven years of operation. Recognizing these distinct phases of farmer development enables capacity-building programs to address the needs of their clients more successfully, and to acknowledge the experience gained during different stages of farming.[i]

Michigan Case Study

A Mott Group case study of four Michigan beginning farmers revealed similarities to the description of the GNF farmers. These Michigan farmers, having completed a comprehensive beginning farmer program in SW Michigan and now entering their fourth year of farming, are first generation, have college educations, manage their own farms, cut costs by doing all their own labor, rented land before owning, and are taking advantage of booming local markets for fresh-grown food. They worked others' farms, saved money, pieced together capital from a variety of sources, worked off farm, received contracts up front to grow food for others, and invested any profit into their farm rather than pay themselves the first two years.

None applied for conventional financing, anticipating that they were non-bankable. Two of the four anticipate 100% of their personal income will come from their CSA operations within four years of operation by accessing up-front consumer and institutional contracts. Two took over other farmers' successful operations and now derive half the family income from the farm. These farmers represent a growing number of farmers in Michigan who have not received conventional financing.[ii]

Several farm development groups were able to describe further the characteristics and challenges facing new farmers, as summarized in the table below. In this effort, what became clear is that there are challenges in which the farmer has significant control (e.g., deciding what to grow based on polling of markets), challenges that require research, training, or technical assistance (e.g., cash flow modeling and incorporation into business practices), and challenges — across all five identified risk areas (production, marketing, financial, legal and environmental, and human resource) — that are outside of an individual farmer's control (e.g., food safety regulations, market saturation, or access to slaughter facilities). Table 1 summarizes these characteristics and challenges.

Table 1

EMERGING FARM SECTOR PRINCIPAL OPERATORS:
CHARACTERISTICS & CHALLENGES

CHARACTERISTICS	CHALLENGES
Limited Start-up Capital, Cash, and Profits • Young/new farmers start business with limited initial investment • May never get to the scale or the capitalization at which efficiencies kick in • May have difficult time earning profits or paying manager better	**Production** • Furthering production expertise • Focusing on profitable parts of business
Preference for Credit Cards over Conventional Loans • Increasing numbers of new and first-generation farmers are maximizing credit card debt rather than approach financial institutions • They are reluctant to take out loans from more-mainstream lenders (e.g., USDA FSA or Farm Credit Services [FCS]) • Reasons include: many new farmers have little equity in their businesses or no assets at all; some expect to be turned down and may consider the process onerous • Many newer farmers have undercapitalized start-ups that present performance challenges or cause them to miss market opportunities	**Financial** • Start-up or expansion capital • Lack of understanding of how capitalization helps the farm • Higher margins are possible for products; this is not yet believed by financial industry • Funds for capital investments — nursery stock, equipment, farm stands, storage • Access to credit • With banks, there is often no hand-holding, follow-up on projections, etc. • Lack of confidence that lenders will take farm businesses seriously
Leased Land, Limited Assets • Young farmers leasing land and/or equipment may put all their income/resources into operating costs and never develop any equity that they can leverage for future credit • Whether by choice or circumstance, failure to re-invest in the business may result in poor balance sheet	**Marketing** • Marketing orders make it hard for smaller farmers • Entering competitive markets • Direct market saturation or seasonal limitations • Product seasonality • Fresh-frozen market • Finding the right balance of different markets in terms of volume of sales and effort
Limited Financial Education • Poor understanding of how credit/debt tools can support business development or bridge cash flow issues may prevent some people from ever making an attempt to access credit	**Other Challenges** • Difficulty securing land for purchase or long-term tenure • Lack of slaughter and butcher facilities and other infrastructure • Lack of management, easily disrupted due to death, disability, divorce • Existence and interruption of food processing standards

Summary: Common Themes and Characteristics of the Emerging Farming Sector in the U.S.

Agriculture, like any successful sector, is changing and expanding in response to changes in demand. Agriculture is obviously a broad term and, thankfully, increasingly encompasses more than commodity farming.

The diversity of these new, emerging farmers is considerable, and includes: beginning farmers entering the agriculture community; existing producers who need better or more cost-effective infrastructure in order to enhance production and distribution; farmers transitioning from conventional business models to diversified and/or direct markets; organic farms; farmers incorporating novel season-extension technologies; and urban farmers retrofitting old buildings for aqua-culture or hydroponics farming or rooftop or vertical urban farming. In short, this emerging sector includes farms that differ over a range of characteristics: stage of business development, degree of operator experience, and acreage held or in cultivation/active use, for example, but primarily comprises small and midsized farms as measured by sales. However, a large portion of these farms is operated by beginning farmers (10 years or fewer in farming), and includes very small farms with intensive production methods per acre.

Though the exact capital needs of each naturally vary, potential lenders will find useful three overarching themes common to operations in this sector:

1. They use organic, sustainable, or ecologically oriented production practices.
2. They produce more-diversified products to differentiated markets.
3. They are not producing commodities (in which lowest prices are the defining factor), but rather, emphasizing localized markets, connection between farm and community, freshness, healthfulness, taste, and striving for a larger share of every food dollar.

Using these three themes as a foundation, both loan "prototypes" and farm development programs (tools, technical assistance, training, etc.) could be tailored to specific types of farms — dairy, cash crops, season extension, farm incubators, and livestock. This approach is far superior to that of individual lenders trying to devise capital and credit products on a case-by-case basis without knowledge of these innovative practices and markets.

More specifically, case studies of emerging farmers revealed these additional shared characteristics. These farmers generally:

- are small to mid-scale[iii] in size
- need access to land beyond the number of acres in cultivation for ongoing soil management
- grow/produce a diverse range of items for differentiated markets
- have low-cost inputs, including: less equipment usage in start-up operations, personal and networked labor, cooperative information and resource sharing, and leased rather than purchased land
- seek out agreements with purchasers of products prior to planting, such as up-front commitments through community supported agriculture operations (CSAs), product agreements with restaurants, institutional procurement, or vendor arrangements at farmers' markets
- obtain information about markets, farm management, and innovative production practices through internet-based networks due to the lack of single-source information centers within their states
- choose this form of farming to achieve dual goals of ecological practice and food production

Combined, these descriptions provide a starting point from which to build a more comprehensive and accurate picture of emerging, innovative farming in the U.S. Developing a descriptive classification system will help bring coherence to this rapidly emerging agriculture sector, thus enabling efforts to provide capital to match the stage, scale, and farming experience of operations for both beginning farmers and emerging but experienced farmers.

Session II

January 2010

What are the major obstacles to bringing more financial capital to smaller-scale farms?

There is a knowledge gap between lenders and farmers. They don't understand each other and there seem to be few "icebreaker" tools that stimulate the relationship. — Mark Canella, The Intervale Center

To overcome this gap and ultimately increase access to capital for small farmers, participants in this Session reviewed recent studies by the Mott Group at Michigan State University[iv] and The Carrot Project.[v] In a word, these studies show that lenders are concerned about the riskiness of agricultural lending, while farmers have supplied little information to alter that perception. This is not surprising, given the lack of incentives, language, and tools for effective communication and cooperation

Borrower Obstacles

We wish that we had another option for operating capital beyond ye olde credit card, but we never bothered to apply for fear of being laughed right out of the bank! — Rebekah, Vermont farmer, in response to a survey by The Carrot Project

Rebekah's comment captures well the feeling of many of these small farmers; that sentiment is frequently a function of farmers' lack of preparedness to address lenders' concerns, and lenders' lack of the tools and knowledge (about farmers' needs) that enable good decisions. The Mott Group study mentioned above, echoing the findings summarized in the previous Session, describes the specific obstacles faced by borrowers:

- They lack personal capital. Most first-generation farmers, particularly beginning farmers, have little or no personal equity and very limited cash flow.
- They are unable to convey farm production knowledge or management experience.
- Their personal credit histories are poor or insufficient to secure loans.
- They lack business plans and the ability to project realistic cash flow.

Lender Obstacles

How do I know if this business is going to make it? — Summary of lenders' views

In attempting to explain the lack of lending to smaller farmers, The Carrot Project cited as significant obstacles farmers face in securing farm loans: (1) a decline in numbers of financial institutions providing agricultural loans; (2) decreases in lender staffing levels; (3) fewer staff with agriculture expertise even in rural areas; and (4) lenders' unwillingness to venture outside their specialty areas. More broadly, commercial lending is moving away from agricultural lending, and the commercial lending that does take place is based on standardized loan packages. In this environment, it is difficult for smaller-scale operations to meet larger commercial lenders' bottom-line requirements.

Those lenders *wanting* to work with these new, smaller farms stressed that they have the skills to analyze and make loans to this emerging sector, but what they do *not* have is the ability to assess the information presented to them. When listening to an entrepreneur's business idea, lenders want to hear details and numbers, but in order to understand the business details, they need context and background information to understand the plan and how realistic is it. Denise Dukette, Director of Lending at Western Massachusetts Enterprise Fund, put it this way: "So that I can make these loans, tell me about these farmers; describe, if you can, businesses within this sector as turnkey operations."

The group recognized that there is significant information available to understand and analyze large and commodity operations, but this information has questionable relevance to these emerging smaller farms. Mark Canella, Success on Farms Manager at the Intervale Center in Vermont, asks, "Are standard agricultural ratios applicable? Aren't ratios going to be significantly different with the age of the business and with other factors that may nor may not be tied to viability?"

In addition to the tools and information that lenders need to assess individual loans, the group also recognized that lenders are in business to make loans. They want to know a viable business when they see it, to be able to understand the metrics, and to grasp the economic value of the production methods. They would like to see model business plans, such as those emerging models or "portfolios" described in the previous Session — CSA farms of different sizes, aquaculture or high tunnel (e.g., solar-heated hoop houses) operations, dairy farms, and the like.

Lenders were clear that they are *not* in the business of framing the discussion or building the infrastructure to address knowledge gaps.

Other Obstacles

Many session participants also cited recent changes within the banking industry that have resulted in the tightening of credit standards and, therefore, reduced access to capital at the community level. Moreover, few could predict with any confidence the influence of this trend on future capital availability. However, most were concerned that agricultural lending programs may be more diminished than general lending for enterprise development nationally.

Adding to this uncertainty in the banking sector are both the depth and length of what is now called The Great Recession — lenders will always be reluctant to make loans if they are worried about suppressed consumer demand — as well as the financial services overhaul legislation now in Congress. This legislation, which could become law by summer 2010, is poised to alter significantly the types of loan, savings, and transaction products offered by major financial institutions, as well as the regulatory environment governing those products.

To convert sustainable production practices into relevant economic values, the lending industry requires translation tools and a map or guidelines on what is needed to serve this sector — the focus of the next Series in this report.

SESSION III

FEBRUARY 2010

WHAT ARE THE METRICS BY WHICH LENDERS EVALUATE RISK IN AGRICULTURE? CAN THESE METRICS BE MODIFIED TO REFLECT INCREASED KNOWLEGE AMONG LENDERS AND THE RISK MITIGATION STRATEGIES NOW PRACTICED BY SMALL FARMERS?

With the first two Sessions under our belts, we recognized that a piece was missing: What is the basis for starting the conversation between farmers and lenders that would lead to successful lending?

In order to see where common ground might be cultivated, participants were presented with a side-by-side comparison of five debt-based financial ratios and five areas of agriculture risk that could be mitigated by specific production practices and market strategies. With this as a basis, participants discussed the possibility of developing a "scorecard" that combines traditional agricultural ratios measuring production efficiency, profitability, etc. with five areas of risk management, including financials, to see if a hybrid tool might be possible. This tool could then help lenders determine credit-worthiness and assist farmers in describing the economic value of their production practices.

Agricultural Risk and Risk-Mitigation Strategies

From a lender's perspective, certainly a traditional lender, the concern is, if I lend to a particular farm and I'm secured by a tract or I can sell the tract, I'm essentially OK regardless. But if I'm lending to a farm on the promise of them selling their produce effectively, then they've got that marketing arm they are responsible for. Can the farmer get product to market before it spoils, and *get a fair price? So the farmer's capacity to produce is only one risk element out of several to look at. To really bring lending capital into the agriculture sector, we have to be able to address the continuum of risk farms present.* — Denise Dukette, Associate Director, Western Massachusetts Enterprise Fund

The first steps in the process — using case studies, business plans, and experiences of participants — were to identify the most commonly used risk-management strategies as described by farmers and explore whether those practices already in use could be a useful starting point for the scorecard. The types of farms examined were diversified vegetable operations such as CSAs, small dairies, vegetable farms using season extension, and small animal operations.

This session produced the following table, which describes the five types of agricultural risk and the strategies small farmers are using to mitigate each type of risk. Table 2, whose value was widely affirmed by participants, could help farmers cover their bases as well as help lenders understand these emerging types of farms.

Table 2

AGRICULTURAL RISKS AND MITIGATION STRATEGIES[vi]

AGRICULTURAL RISK	RISK-MITIGATION STRATEGY USED BY SMALLER FARMERS
Production • Weather, including drought, freezes, excessive rainfall at harvest • Pests, including insect and disease damage	• Enterprise and crop diversification • Technology to protect crops (season extension) • Production methods yield per-acre return that would be higher than evidenced through USDA Ag. Census data • On-farm production of as many inputs as possible — e.g., fertilizer, hay • Knowledge of other production in area or cooperation with other farmers: e.g., Lancaster Farm Fresh Cooperative • Production of what grows well — skills and soils • Access to variety of seeds, locally adapted varieties
Marketing • Price risk due to increases in supply, or changed demand • Loss of market access due to the relocation or closing of a processing plant • Loss of marketing power due to small size of farm sellers relative to buyers, etc.	• Direct markets • Winter and summer markets/products • Market plans • Informal cooperatives/relationships • Up-front contracts • Internet savvy • Multiple markets • Mix of wholesale and retail markets • Online wholesale lists with support for aggregation and distribution • Demand forecasting • Special market niches, e.g., cut flowers for wedding planning • Testing markets before making huge investment • Customers as personal references or brokers • Knowledge sharing with other farmers and through farm organizations
Financial • Production risks and price risks from above • Inflation, especially cost increases on key inputs • Changes in interest and exchange rates	• Financial ratios and expenses monitoring • Family expenses control • USDA loans, grants, Individual Development Accounts (IDAs), micro-financing • State Farm Viability programs • Cost center calculations lower due to production practice • Use of sustainability practices as a way to cut costs • Off-farm income • Leased or creative farm tenure deals to reduce expenses • Bootstrapping farm growth for few years/investment of sweat equity • Focus on the money makers and those that support them • Tax filing and schedules that are appropriate • Boundaries between family and farm expenses • Debt reduction in good years to increase solvency • Debt pre-payment or establishment of capital reserve fund to enable a move into new arena • Improved understanding of the difficulties of undercapitalization
Legal/Environmental • Tort liability — being subject to a civil suit — is of special concern to direct marketers • Legal risk also relates to environmental liability and business structure	• Investment in good neighbor relationships • Use of sustainable practices to limit environmental risks • Knowledge of regulatory approval bodies and processes • Knowledge of food safety regulations • Knowledge of labor rules and regulations, i.e., housing and wages
Human Resource • The three D's: divorce, death, or disability of an	• Investment time in training labor • Use of family labor • Acquisition of business and financial management training • State Farm Viability programs

essential owner, manager, or employee • Risks related to poor communications and people-management practices • Increasingly, generational transfer of farm property brings into play non-farm interests that can, without adequate prior consideration, force a sale or reduction of farming enterprises	• Training on other farms • Sharing of marketing niche information through farmer networks

Bridging the Gap Between Risk Management and Financial Soundness

To help connect these risk reduction strategies to stronger financial footing by farmers, two questions were posed to participants:

Question 1: Can traditional agricultural ratios — measurements of liquidity, solvency, profitability, repayment capacity, and financial efficiency — and the five areas of risk management mentioned above be used to develop a hybrid scorecard or tool?

Though this question prompted some theorizing about how to translate production management techniques into an economic value, the conversation quickly moved into what types of templates, indexes, or matrixes might be used to quantify these practices. The group moved toward an affirmation that, as one participant put it, "It will still come back to a dollar return. A farmer can be productive and do a beautiful job, but if he or she doesn't generate enough production or the right kind of production to meet market demand, then it won't generate enough income for the lender to be confident in making a loan." — Barbara Wenglikowski, Frankenmuth Credit Union, MI

However, the group agreed that it was important to understand what magnitude of "swing potential" some of the strategies to mitigate production or marketing risks might have. Lenders with this type of knowledge — combined with farmers' understanding of marginal financial impacts and what parts of their operations are losing money — could have a positive impact in facilitating farmer-lender relationships.

Question 2: Can lenders entertain different farm ratios if the cash flow, using traditional economic metrics, does not meet the bottom line? What is most important to your agency or business?

The responses to this question varied in the nature of different lenders' consideration of the non-financial components of farmers' business plans. The lenders' responses were based on their organizations' lending criteria and practices, and varied with whom they were representing: an agricultural credit association (e.g., Farm Credit Services), a CDFI, or an economic development agency. Community lenders indicated that they look at the economic viability of an operation and the probability of its success, and not at absolute compliance with ratios. Denise Dukette remarked, "We do not generally have standardized benchmarks for our borrowers."

What all the lenders shared was the need to be repaid; they look closely at cash flow, collateral, and the likelihood of repayment. In general, it was the interplay of these factors and strength in one particular area that allowed a lender more latitude in another. For example, if the enterprise is more speculative and repayment capacity is questionable, then security becomes more important. A dramatic example of excellent repayment capacity is the presence of crop insurance, which mitigates the risk to the lender. As Jon Jaffe of Farm Credit East, ACA (Agricultural Credit Association), observed, "If money is borrowed to start a new crop, with 100% insurance, and the crop fails, the lender is compensated and will care less because they are not relying on the success of the farm." This also serves as an example of an infrastructure gap — suitable crop insurance is not available to many of the farmers being considered for loans.

In general, lenders base their decisions on many factors, including the lenders' experience and what they called "the art of lending" — the consideration of subjective factors, such as whether a farmer has the right mix of temperament, skills, and experience to lead this particular business. Lenders will also look at other financial variables, such as the type of farm and how it makes business decisions. For example, if a farm is primarily dependent on a product, such as milk, with highly variable pricing, lenders expect to see a balancing farm enterprise that provides more reliable cash and can be justified in separate enterprise budgets.

It is hoped that a better understating of agricultural risks, and the specific strategies small farmers now use to mitigate those risks, could help reduce the knowledge gap between lenders and small farmers and lead to a new type of tool — something concrete that could be used by farmers and lenders across the nation. Further research and investigation into the development of this tool is highly recommended.

At the same time, can we learn from successful "hybrid" models in this emerging sector — organizations that are bridging the relationship and knowledge gap between willing farmers and lenders — in development of this and other tools and services? That is the subject of our next Session.

Session IV

March 2010

What "hybrid" models could serve as examples of intervention strategies designed to close the knowledge and service gaps between small-scale producers and lenders?

Innovative farm-financing programs have sprung up around the country in response to the difficulty that some small and midsized farms are having in accessing adequate financing. These programs are not only models for others to learn from, but embody the key elements of successful financing programs.

Four Model Programs Connecting Farmers to Capital

The history and specific goals of the four programs and organizations described below vary, but they all focus on meeting the needs of small-to-midsize farmers unable to work within the traditional lending market as they begin or transition to specialized, higher-value agricultural enterprises. These organizations are public, non-profit organizations that sometimes partner with for-profit organizations as intermediaries. Each is organized around similar groups or characteristics of farmers — size, the non-commodity nature of production, access to business and financial management and production-specific technical assistance, capital, and farmer networks and markets.

- **Coastal Enterprises, Inc. (CEI)** is a private Community Development Corporation (CDC) and CDFI founded in 1977 to develop job-creating natural resources and small business ventures in primarily rural regions of Maine. CEI offers a technical assistance program that enables farmers to develop quality business plans. CEI works closely with SBA's Small Business Development Centers and Extension services, both of which are steeped in relevant knowledge and skills for the populations they serve.

- **California FarmLink** is a land-link program that moves committed farmers to the land through financing. Technical assistance is focused on getting farmers on the land. The organization addresses the urgency of shrinking farmland through nurturing direct linkages between newer farmers and the farm succession plans of existing farmers. California FarmLink is also unique in that it connects the assets of mainstream banks with the goals of a partner CDFI to enable risk-averse lending.

- **The Land Stewardship Project** incubates successful dairy operations in northwest Minnesota. Its Farm Beginnings program helps separate people interested in agriculture from those who can and will make a commitment to agriculture. Intensive technical assistance and non-interest-bearing loans help farmers get their businesses started, increase cash flow, and breed stock to gain equity in their businesses. The program's loan fund protocols and application process were developed by farmers.

- **The Carrot Project** serves to close the financing gap in the northeastern U.S. through collaborations with investors, lenders, and farm-support organizations. The Carrot Project raises funds in partnership with farm-support organizations to serve both as an underwriter for lenders who want to set up partnerships (by initiating and servicing loans) and develop the capacity to lend, and as an intermediary for capital aggregation. Once the capacity of the local financial institutions grows, the Carrot Project can pull back. The Carrot Project has agreements with a public economic development entity, a bank, a CDFI, and individual investors and foundations, and has secured five years' worth of patient capital to build both commitments with local lenders across New England and New York, and the capacity of farmers to borrow.

Common Features and Challenges of Model Programs

The four models programs described above are "hybrids" — purposeful coalitions of resources essential for farm viability — that serve as intermediaries between such resources and the farmers who need them. Those resources include (1) access to capital and land; (2) product-specific business planning and technical assistance; and (3) farmer networking.

A discussion of each of these follows:

1. Access to capital
Capital is needed at each stage of the farm enterprise, and the capital needs of farms change as they develop. This means that capital must be tailored or flexible enough to meet the needs of the largest number of farms. Capital needs are shaped by: the stage of the farm business (how long it has been in operation); the experience of the farm manager; the type product produced; the time it takes for a product(s) to be market-ready; types of markets; and the cost and value of land. Each farm-financing model program described above emerged out of necessity: new, smaller-scale farmers were having trouble reaching emerging market opportunities and accessing capital for all the reasons outlined in earlier Sessions.

2. Product-specific business planning and technical assistance
Presenters for these programs were all clear that capital without technical assistance — especially training focused on product-specific, long-term business planning — is insufficient. Technical assistance, however, goes way beyond the business plan. Ideally, it includes production assistance and ongoing support, particularly for beginning farmers, as they deepen their understanding of their businesses and the many factors that influence success. Some programs also help build the larger infrastructure (such as provision of access to crop insurance) for farm viability.

3. Farmer networks and markets
Each model program cultivates networks, which open doors to knowledge about land availability, market access, and successful farmers willing to share hands-on, practical advice about managing their enterprises. The Land Stewardship Project in Minnesota captured the essence of networks for all the programs: "Our model is based on the commitment of farmers to grow the next generation of farmers. We are farmer led; farmers are the mentors and provide the training. Committed farmers rely on successful farmer-mentors who can share experiences that aid in the developmental stages of farming. How we bring people into agriculture is so important."

The model programs also share three challenges:

1. The Great Recession
The struggling U.S. economy and the accompanying turbulence in the banking industry have tightened lending and cast a shadow on the viability of many markets, including agriculture. As Gary Harris of Coastal Enterprises, Inc. remarked, "Due to the economy, I have seen a lot of market opportunity but

people [farmers] don't want to take risks and invest. So lots of people do not want to borrow. We have lots of market opportunity but less borrowing, and less lending."

2. Securing funding for operations and re-lending

All of the programs must raise loan and operating funds. For some, sources of those loans are drying up because the fundraising efforts by others are failing or states and municipalities are slashing their budgets. To recover this funding, some programs are considering levying fees on farmers for services or training, additional fundraising aimed at generating loan guarantees from mainstream lenders, and moving lending operations in-house. One program, The Carrot Project, has secured loan capital from investors.

3. Finding enough qualified technical assistance providers and mentors

Programs are increasingly challenged in finding enough qualified people to provide technical assistance, business planning, and mentorship. In fact, many are deeply concerned that the knowledge and skills associated with agriculture will, due to the aging of the farming population, be extinct unless they are soon instilled in the next generation of farmers. Cooperative extensions services, too, are becoming more limited. Similarly, many newer farmers are first generation and cannot rely on the prior generation to hand down knowledge and skills. In response to these training and mentoring challenges, several programs are partnering with Small Business Development Centers.

We are grateful that promising programs such as these have been created around the U.S. It is helpful to understand the common assets and challenges that underlie these efforts as we learn from them and draw encouragement for growing these kinds of intermediary institutions. In addition to these non-profit hybrid models, there are national institutions that can help enable local financing for small farms — the subject of Session V.

SESSION V

APRIL 2010

WHAT NATIONAL INSTITUTIONS MIGHT ADD VALUE TO LOCAL FINANCING EFFORTS?

Meetings in Washington, DC were held with the three federal agencies and two national associations that participants believed could be most helpful in securing capital and providing technical assistance at the local level for smaller-scale farmers: The CDFI Fund at the U.S. Department of the Treasury, the SBA Association of Small Business Development Centers (ASBDC), and USDA's Farm Service Agency (FSA).

CDFI Fund and the Opportunity Finance Network
The Community Development Financial Institution (CDFI), housed in the U.S. Department of the Treasury, promotes economic revitalization and community development through investment in and assistance to local CDFIs. CDFIs could help bridge a gap in lender knowledge about agriculture and the capital needs of small farmers. Three key questions were addressed:

1. How can CDFIs interested in agricultural lending better understand these farmers and the markets in which they operate?
2. How might effective lending to this sector be incorporated within the overall services provided by CDFIs and the CDFI Fund?
3. How might we begin to build the network and capacity of technical assistance (TA) providers to include those knowledgeable about small-scale agriculture?

Also in attendance was the CDFI industry's non-profit membership organization, the Opportunity Finance Network (OFN), which is "the leading network of private financial intermediaries identifying and investing in opportunities to benefit low-income and low-wealth people in the U.S." OFN has originated more than $23.5 billion in financing in unconventional markets often overlooked by conventional financial institutions.

Association of Small Business Development Centers
The SBA's Association of Small Business Development Centers serves as a critical resource for many local or regional small-farm development programs by facilitating partnerships that promote access to business and financial technical assistance. ASBDCs are accordingly poised to help bridge gaps between small farmers and the technical assistance and business planning they need to start or grow their operations. This meeting began to address these questions:

1. How familiar is the ASBDC with some of the model partnership programs (Coastal Enterprises, Inc., The Carrot Project, California FarmLink, and the Land Stewardship Project) shared in the meeting?
2. How might we work with the national Small Business Development Centers to build technical capacity and increase program-level knowledge about the availability of SBDC expertise and services?

USDA Farm Service Agency
USDA's Farm Service Agency has made great strides in helping to meet the capital needs of small farmers. However, gaps still exist. This meeting addressed the following issues:

1. What are some of the current FSA programs that address the capital gap for smaller-scale farmers?
2. How does FSA get input about farm businesses and the markets in which they operate? Does that process vary by region and state?
3. How can intermediaries providing lending to small and mid-scale farmers tap into the knowledge, skills, and expertise of FSA?
4. How might FSA work with established intermediaries to improve access to capital?

Meeting Results: Research and Presentation Opportunities

These meetings were most successful in building relationships and identifying the key issues that must be addressed going forward. After all the meetings were held, participants discussed ways to maintain these relationships and move the agenda along through research and presentations. (See Appendix D for the full list of research and presentation opportunities discussed).

For meeting participants, research opportunities would address the following questions related to accessing capital and credit: Where is it falling short for farmers and lenders? Who is being denied, and why? Which institutions are making loans, and which loans are successful? What is the impact of FSA loan guarantees? And could we develop a "risk index" or "scorecard" to determine loan qualification — a tool to translate production techniques into an economic value — that can be shared by farmers and help close the knowledge gap between farmers and lenders?

Presentation opportunities included the annual OFN conference, for CDFIs, in October 2010 in San Francisco, in particular a possible session on "New and Innovative Ways to Lend." Representatives of the SBDC and FSA also offered to contact state and local offices to arrange presentations, roundtables, and workshops.

These opportunities were then synthesized with the opportunities gleaned from the previous Sessions into a summary of key points and overall recommendations — the final part of our report, to which we turn next.

Session VI

MAY 2010

Key Points and Recommendations

Our final discussion was dedicated to reviewing what we had learned from one another, generating consensus on commitments we had made to national organizations, and determining the extent to which we could follow through with the recommended next steps generated from our Washington meetings with the national entities.

Key Points

There was consensus among participants on the following overview of the key points of the first five Sessions in the series:

KEY POINTS

Main Findings

- Capable agriculture borrowers need access to specialized business support.
- Financing entities need to possess significant knowledge about newer agriculture operations.
- Access to capital could be improved by opening up new sources and improving linkages to existing sources.

Obstacles to Financing the Agriculture Sector

Regarding the borrower:

- Farmers lack personal capital or equity base.
- Farmers lack business plan tools that convert farm production plans to cash flow projections.
- Farmers have no or poor personal credit histories.

Regarding the financing industry:

- Lending on a smaller scale typically does not meet commercial lenders' bottom-line requirements.
- There is a perception among lenders that all farms have access to programs that mitigate risk, but these are typically available only to larger-scale, commodity-driven farm operations.
- There are few lenders familiar with newer agriculture operations.
- Recent changes in the banking industry tighten credit flow to smaller financial institutions.

Opportunities and Promising Models

- State public/private partnerships show promise in comprehensive approaches to community economic development and viable farming operations.
- Local/regional intermediaries offering integrated capital, land access, technical assistance, and business planning hold potential.
- Farmer-driven pooled lending and technical assistance models show promise.

Fundamental Strategies

- Access to capital can be maximized through strategic and efficient partnerships to address gaps in the availability of capital or appropriate support services.
- Viable agriculture enterprises are sustained by integrated services, responsive infrastructure, and accessible, relevant capital.
- Significant gaps in public and private services warrant further exploration and action.
- Converting sustainable production practices into relevant economic cash flow projections requires renovated tools for the lending industry.

Recommendations

Specific recommendations, gleaned from each of the five Sessions, can be organized into three categories — research, policy, and practice.

Research Questions

- As part of quantifying this emerging sector for public, private, and non-profit lending agencies, to what extent are the small farmers profiled in Session I being turned down for loans, and why?
- What data are needed to develop a reliable "risk index" or "scorecard" to help determine loan qualification?
- What inputs are needed to translate farmers' production management techniques into an economic value that can be understood and shared by farmers and help fill lenders' knowledge gap? What types of templates, indexes, or matrixes might be used to quantify these practices?
- How can farmers access more equity-led strategies (such as Individual Development Accounts or other saving-based strategies) to reduce their reliance on credit cards, loans, or other debt products in the development of their farms?
- Are there ways to bring crop insurance to more small farmers? How has crop insurance reached some small markets and not others?
- Where are loans or loan guarantees from SBDCs, CDFIs, and FSA for farmers and lenders falling short? Who is being denied, and why? Which loans are successful, and why?

Policy Recommendations

- Consider expanding, in other relevant agencies, the public programs that address financing gaps, starting with the USDA Beginning Farmer and Rancher Development Program.
- Propose the creation of a modest (though competitive) public fund, possibly housed at USDA, to test and replicate successful hybrid programs such as The Carrot Project, the Land Stewardship Project, etc.

Practice Recommendations

- Present at the annual CDFI conference in October 2010 in San Francisco. OFN offered to support this session.
- Present at workshops, roundtables, etc. at the state and local offices of the SBDC and FSA.
- Facilitate the development of farmer-to-farmer lending pools — pooling of capital within agriculture sectors (such as fruits and vegetables, or dairy and livestock) that would be available for farmers on a rotating or as-needed basis.
- Develop technical assistance specifically tied to production methods that enable wise land use and product expansion.
- Develop pro-formas or templates on projections, capital needs, marketing strategies, etc. for use by farmers, and train farmers to use these resources.
- Develop funding strategies to sustain existing, and help launch new, "hybrid" model programs such as those described in Session IV — The Carrot Project, California FarmLink, Coastal Enterprises, Inc., and the Land Stewardship Project.

IV. The Larger Context and Contribution of This Report

As we look back over these recommendations and the broader Sessions conducted from December 2009 through May 2010,, it is easy to see that the Sessions succeeded in meeting their objective: to bring a diverse group of stakeholders together to begin to bridge the gap between this emerging sector of farmers and the capital they need to start or grow their operations. The Sessions advanced this young field by connecting previously unconnected people who share this goal, clarifying the key issues, generating recommendations and next steps, and expressing a desire to continue to work together over the months and years ahead.

But this effort achieved something much larger, as well: it contributed new knowledge, ideas, energy, and relationships to some of this country's larger food-related challenges. Consider this comment by Karl Weber, editor of *Food, Inc.: How Industrial Food is Making us Sicker, Fatter and Poorer — and What You Can Do About it* (2009):

> [S]omething bigger is happening in America today, represented not just by the tens of thousands who attended the [Slow Food] conference in 2008 in San Francisco but also by the millions of other people around the country who are engaged in similar activities: shopping at organic food stores, at local farmers' markers, or through CSAs; ordering fair-trade coffee when they get their morning caffeine fix; asking their kids' schools to get junk food out of the cafeterias; planting community gardens; and writing their representatives to call for changes in farm subsidies, better regulation of meat production, and clearer food labeling standards. Thanks to concerned Americans such as these, food-related issues — hunger, childhood obesity, rising food prices, water shortages, soil depletion, and many others — are finally achieving a critical mass of attention from the media and general public.

In our view, however, the significance of the Sessions goes even further. By advancing the future economic viability of these smaller, localized, health-oriented farming operations, the Sessions are helping to overcome a few of America's most significant, daunting, yet exciting challenges at the beginning of this century by:

Creating Jobs

It is well known that small businesses are the main source of job creation in the U.S., yet we are facing a prolonged jobs deficit and are undergoing what has been called a weak "jobless recovery." The Great Recession has brought us double-digit unemployment, with even higher rates of under-employment. And the decade of 1999–2009 produced *zero* net job creation. We have destroyed jobs at rates consistent with those of prior decades, but simply have not created enough new jobs. Without new and expanding small businesses, the task of restoring hundreds of thousands or millions of jobs — to get us nearer to full employment — looks to be fairly impossible.

Reducing Corporate Consolidation

As documented in Barry Lynn's new book, *Cornered*, consolidation in the food and agriculture sectors has reached unprecedented levels. In the U.S., for example, two companies control more than 80% of dairy production, and one company controls more than 80% of the corn seed used domestically. This level of concentration, according to Lynn and others, has destroyed jobs, reduced profits of or run out of business critical suppliers of goods and services, stifled innovation, and thwarted entrepreneurship — and thus job creation — by erecting barriers for independent producers trying to enter new markets.

Revitalizing Rural America
As documented in their recent book, *Hollowing Out the Middle: The Rural Brain Drain and What It Means for America,* Patrick Carr and Maria Kefalas describe the exodus of youth from middle and rural America and its devastating effects on those communities. While significant challenges exist to reducing this brain drain, Carr and Kefalas see America's heartland becoming a hub of sustainable agriculture and green energy.

Promoting Ownership and a Producer Culture
As the President acknowledged in 2009, we no longer can count on American consumption — which makes up about 75% of U.S. gross domestic product and 25% of the world's GDP — to drive economic growth in the years and decades ahead. We must move, instead, to a "save and invest" economy in which Americans would generate more savings and more ownership — leading to a greater ability to *produce* the goods and services that Americans and the rest of the world want to buy.

In the end, we can also learn from the accomplishments of America's Progressive Era (roughly 1890 to 1920), which was defined by two broad ideas: thrift and yeomanry. In modern parlance, these Progressive Era values would likely include: conservation and stewardship of natural and financial resources; governance and control by families, communities, and local institutions; and an economy driven by (and a government organized around the needs of) small-scale, independent owners and producers. Today's smaller-scale farmers, the ones described in this report, are clearly setting a new example, and laying a foundation for a possible New Progressive Era — a model our consumer-driven economy would be wise to follow.

APPENDICES

APPENDIX A

SESSION PARTICIPANT LIST

1. Amy Bacigalipo, Land Stewardship Project, MN
2. Maura Schorr Beaufait, Tufts University, MA
3. Valerie Berezin, Initiative for Responsible Investment, Boston, MA
4. Janie Burns, Meadowlark Farm, ID
5. Mark Cannella, Intervale Center, VT
6. Susan Cocciarelli, Mott Group for Sustainable Food Systems at MSU, MI
7. Denise Dukette, Western Massachusetts Enterprise Fund, MA
8. Gray Harris, Coastal Enterprises, Inc., ME
9. Jon Jaffe, Farm Credit Services, MA
10. Scott Marlow, Rural Advancement Foundation International, NC
11. Sue Milshaw, Chester County Economic Development Council, PA
12. Richard Ness, Land Stewardship Project, MN
13. Beth Rasgorshek, Canyon Bounty Farm, ID
14. Steve Schwartz, California FarmLink, CA
15. Tom Spaulding, Angelic Organics, IL
16. Susan Stokes, Farmers' Legal Action Group, CA
17. Dorothy Suput, The Carrot Project, MA
18. Chris Wendel, SBDC/NW Michigan Council of Governments, MI
19. Barbara Wenglikowski, Frankenmuth Credit Union, MI

APPENDIX B

METRIC TOOL CONCEPT PAPER

"Agricultural Risk Metric Development"
May 7, 2010

Issue
There is a need for improved access to capital for small and emerging farming enterprises across the country. Commercial capital is constrained by several factors, outlined below, but one key element is the difficulty in assessing risk of loss within the sector.

Having a risk metric tool (similar to consumer or small business credit scoring) would: allow a more standardized approach to a highly diverse sector; allow streamlined underwriting and loan processing; and provide for a longer-term modeling method of monitoring changing requirements in, and risk factors of, the sector itself.

Sector
The small and emerging farming sector, for this purpose, is broadly defined as family owned or individually owned enterprises; local cooperatives comprising family owned or individually owned enterprises; and production or processing operations that are regional in nature. This definition is not meant to preclude other enterprises, but to focus this concept on the enterprises that have both the most difficulty obtaining loan capital and the most potential for creating a stronger localized economy and a more vigorous and resilient domestic agricultural sector.

Impediments to Small Agricultural Loan Capital

- Smaller loan sizes require a relatively high amount of underwriting, documentation, and oversight work for conventional lenders, who are focused on return on investment.
- Smaller enterprises often have a higher degree of seasonality associated with the product(s) raised or grown, and may have a more variable income stream and cash flow, creating a higher risk profile.
- There is a limited knowledge base in the lending community, outside of specialized agriculture lenders, of the agriculture industry in general, making it more difficult and time consuming for lenders to underwrite loans effectively and efficiently. This also makes the approval process more difficult because the approving body likely also lacks solid industry knowledge and expertise.
- These businesses are marketing products to a diversity of outlets other than conventional commodity outlets. Lenders' lack of familiarity with pricing, contracts, and volume potential in these outlets can make these loans appear more risky.
- Farm income often requires a heavy emphasis on farm marketing activities. Lenders inability to judge the marketing capacity within a business can make these loans appear more risky.
- Small farms typically have a more diverse product mix, which makes crop insurance prohibitively expensive, thereby eliminating access to a material credit management tool.
- Small farms often rely heavily on the skill, knowledge, and labor of one or a few individuals, creating a higher enterprise risk if one individual is removed from the operation for any significant length of time.
- Small farms are perceived to have limited resources (human, financial, and time) and often do not have the skills or resources to perform business functions outside of the core crop/product production, e.g., research and development, cost analysis, development of plans to pursue marketing or distribution opportunities, etc. This may limit opportunities for revenue and profit enhancement, further diminishing access to capital.
- In a risk-averse lending arena, outlier industries and transactions are curtailed more aggressively than others, and agriculture is seen as a volatile sector due, in part, to limited expertise in the lending community.

Concept
Given the documented barriers that hinder credit access for businesses in the small-farm sector, a functional risk metric tool could be used by both lenders and farm managers to quantify the risk position of these businesses objectively. A comprehensive risk metric tool would more accurately examine both the robust and vulnerable attributes relevant to these emerging business models. Farm managers could use such a tool to evaluate the business position, monitor changes over time, and communicate the businesses risk position more clearly. The same tool is expected to enhance agricultural lenders' risk management evaluation of businesses when evaluating credit applications.

The risk metric tool would be designed for use by a wide range of users:

- farmers looking for a risk self-assessment tool
- technical assistance providers looking for a diagnostic tool to hone in on the key risk elements of a situation and provide constructive support
- alternative lenders or investors looking for streamlined underwriting and comparative evaluation among competing investment opportunities
- conventional lenders looking for a cost-effective way to assess risk and lend into a sector with some degree of risk prediction
- industry analysts or researchers tracking change in the sector

The tool would be:

- statistically relevant by utilizing a diverse pool of small farm cases on an ongoing basis
- modeled econometrically to allow the large pool to be divided into subsets over time, thereby increasing the ability to match a specific farming loan applicant in the metric with high statistical probabilities of like performance and, therefore, of a predictable risk profile
- inclusive of a wide range of business elements such as farm/enterprise type, marketing activities, geographic region, and credit risk mitigants

Project Development Requirements

- Determine the appropriate resources (financial, data collection, industry knowledge, farmer participants, organizations) to provide input, support, a communication platform, a beta-testing platform, and roll-out platform) so that those elements are engaged timely and at the appropriate stage of development.
- Identify the appropriate participants to capture data elements in a consistent manner and use a method that allows entry into a database for meaningful modeling.
- Determine the phases of the project to define the ultimate working tool so that each phase progresses effectively toward the ultimate goal, and each phase provides a working tool to participants.

Tool Development Requirements

- Identify components of the sector and narrow the field as appropriate to workable target sets or subsets (i.e., sectors in small agriculture from crop producers, animal husbandry, etc.)
- Identify the range of data elements that could be incorporated into modeling (i.e., what data may have relevance, how they can be captured, how they can be refreshed over time).
- Narrow the range of data elements for the first phase set to those that are obtainable and provide the strongest risk-metric foundation.
- Determine the appropriate modeling techniques to create statistically relevant and useful outcomes.

APPENDIX C

PROPOSAL FOR SESSION AT CDFI ANNUAL CONFERENCE

Submitted May, 2010 to The Opportunity Finance Network, Philadelphia, PA in preparation for the CDFI Fund Annual Meeting (October 2010)
Facilitator – Denise Dukette, Associate Director of Western MA Enterprise Fund

Proposed Session: Tools for Lending in into small and developing agricultural enterprises – the need for CDFI's to engage!
Format: Panel discussion with facilitator and 3 panelists having a range of expertise:
Panelists are TBD but will cover specific areas of expertise:

- Lending into the agriculture sector – what are some of the inherent challenges and risk mitigation strategies
- TA for the agriculture sector – providing value added knowledge to ensure a solid business plan
- Agricultural Support Programs – what resources are out there to help link farmers with qualified lenders

Facilitator will frame the issue relative to limited access to commercial credit and the need for accessing good, local TA resources to work closely with lender.
Panelists will each spend 15 minutes highlighting areas of relevance to the discussion
Facilitator will discuss possible next steps including working in close partnership to develop network of resources and development of better risk assessment tools
Q&A Session Will Follow

APPENDIX D

RESEARCH AND PRESENTATION OPPORTUNITIES
Arising from Meetings with USDA, The Department of the Treasury, and The SBA

RESEARCH OPPORTUNITIES

I. Research opportunities regarding access to capital and credit
   a. Where is it falling down for farmers and lenders?
      i. Quantifying borrowers: Is this a growing cohort?
         - volume
         - who is being denied
         - why are they being denied
            1. One-year study: monitor people who apply for loans; get at least 200 cases
            2. What are reasons for not lending: preparation?
               a. Yes: on the farmer side for business plan development
               b. No: on lender side, what are lender issues
            3. What institutions are making loans?
               c. What makes loans successful
            4. Case for validating alternative lending institutions
               d. Impact of FSA loan guarantee preferences
            5. Where are the markets moving
            6. Where are farm incomes coming from
            7. (SARE Research Multi-state Grant)

   b. Development and Testing of Risk Index/Scorecard
      i. Development of risk index or scorecard (that produces a score) to determine loan qualification (how to translate production management techniques into an economic value that can be understood and shared by farmers, and fill lenders' knowledge gaps)
         1. Quantify subjective attributes of farming production methods; merge this value with training and other aptitudes farmers have; convert it to loan-worthiness; metric (tool) quantifies resilience of diversified farm system
         2. Ultimately used as technical assistance (TA) tool to evaluate operations; could do pre- and post-TA
         3. Self-assessment tools for different operations (dairy, poultry, livestock, diversified fruit/vegetable production
      ii. Start with existing tools: CDFI (Community Development Financial Institutions), FSA (USDA Farm Service Agency), Farm Credit Services, banks. What risk rating tools do they use? Get their current agriculture risk rating components/tools to look at common elements
      iii. Look at universe of other agriculture risk management tools
      iv. Create a scorecard that addresses performance metrics; adapt it to different farm models
      v. Test out with 30–50 farms

vi. Test out with 30–50 financial institutions, including credit unions, banks, SBDC micro-lenders; CDFIs; other loan funds; FSA/FCS
vii. Use for "training of the trainer" with lenders
viii. Move from anecdotal to cohort/prototype farming
ix. (Premise: Many people coming in to FSA for loans are credit risks. FSA not always sure where to send these cases.) Questions: Is this a critical sector niche? FSA willing to explore alternative financial institutions lending capacity? Could help take some burden off FSA

c. Need a key research partner
d. Continuum of Financing Needs
    i. Capital needs based on scale, stage, and product
    ii. Identification of sources of available capital

PRESENTATION OPPORTUNITIES

I. CDFII? AND Office of Finance Networks
    a. Annual Conference (October 2010, San Francisco)
        i. New and Innovative Ways to Lend
            1. There is increasing activity in rural and urban agriculture that fits CDFI mission, and an expanded scope of lending that requires partnership development within CDFI. Here are different lending niche models that have worked:
            2. Outcomes: examples of how lending works
            3. Contact points for the industry
            4. Linkages among those in the audience
            5. Understanding of the spectrum of what is doable; what are the types of agriculture that seem to be a niche; how do we move this to a larger scale

II. SBDC
    a. Follow up at state level SBDC offices:
        i. Opportunities to strengthen TA capacity within SBDC at local/regional levels by including agriculture in overall business planning assistance
            1. Value to SBDC: increased capacity and numbers
        ii. Request that we get information about areas of state that lack linkages
        iii. Ask state SBDC administrator to put in request to have a session on linking SBDC-Agriculture at state conference
        iv. Get data from SBDC administrator: Are there requests coming in about agriculture TA? Are there examples in the state that are really good models of interface? Would the administrator be willing to share this with other state SBDC administrators in a national call?

III. USDA FSA
    a. USDA was very supportive of the risk management metric/tool. Thought we were onto something that no one else was doing and that RMA would be perfect support for this
    b. USDA was also supportive of the deeper dive to try to describe who the market is, and why farmers are being turned down

c. In order to work closely with lending partners nationally, it is important to be able to describe who is lending, what's the potential, and how this information might help FSA get loans and guarantees out the door
    i. How does partnering with new lenders help FSA
d. Activity to get FSA connected with these ideas
    i. Put together farmer-lender-FSA workshops
    ii. Include state FSA directors and key DC people

[i] Listening to New Farmers: Findings from New Farmer Focus Groups, the Northeast New Farm Network, New England Small Farm Institute, June 2001, page 5

[ii] Michigan New Farm Development: Case Studies from the SW Michigan Emerging Farmer Program, (March 2009); www.mottgroup,msu.edu

[iii] Small scale as defined by the National Commission on Small Farms (annual gross sales below $250k), and midscale as defined by the Agriculture of the Middle Project (www.agofthemiddle.org) farm operations operating in the space between the vertically integrated commodity markets and the direct markets.

[iv] Susan Cocciarelli, "Financing Sustainable Agriculture in Michigan" (unpublished white paper, C.S. Mott Group for Sustainable Food Systems, Michigan State University, December 2009); www.mottgroup.msu.edu.

[v] John Moukad, "Small Farms in a Changing Credit Landscape" (unpublished white paper, The Carrot Project, 2009); beginningfarmers.org/carrot-project-beginning-farmer-loan-update.

[vi] Adapted from a previous version by: Jerry White, Department of Applied Economics and Management, Cornell University