FINANCING FARMING IN THE U.S.

Strengthening Metrics and Expanding Capital Access

MSU CENTER for REGIONAL FOOD SYSTEMS

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FINANCING FARMING IN THE U.S.

Financing Farming in the U.S. (FFUS) is a project designed to help increase the flow of capital into the small- and midscale farming sector. The FFUS network has grown because of the nature and value of the original research findings to include over twenty-five national and community-based entities. From its humble beginnings as an exploration into the obstacles and opportunities associated with financing farming production, the network now includes policy-makers and practitioners across the country.

THE MICHIGAN STATE UNIVERSITY (MSU) CENTER FOR REGIONAL FOOD SYSTEMS

The mission of the MSU Center for Regional Food Systems is to engage the people of Michigan, the United States and the world in applied research, education and outreach to develop regionally integrated, sustainable food systems. Its vision is a thriving economy, equity and sustainability for Michigan, the country and the planet through food systems rooted in local regions and centered on food that is healthy, green, fair and affordable. For more information, contact Michael W. Hamm, director, at mhamm@msu.edu; or Rich Pirog, senior associate director, rspirog@msu.edu

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ABOUT THIS REPORT

In 2009-10, a number of small-farm lenders and advisers from across the country came together to explore strategies for improving the flow of capital to small diversified farms. The group's report, "Financing Farming in the U.S.: Opportunities to Improve the Financial and Business Environment for Small and Midsized Farmers through Strategic Financing," summarizes its findings. The report brought attention to the challenges that lenders interested in this growing crop of agricultural borrowers face and to the increasing number of such farmers that have bankable operations but are unprepared or hesitant to approach mainstream lenders[1].

"Financing Farming in the U.S.: Strengthening Metrics and Expanding Capital Access" is the group's second report. It illustrates successful lending practices among community development financial institutions and their strategic partners. Specifically, this paper synthesizes information from training materials and case studies that the Financing Farming in the U.S. (FFUS) project has developed in concert with the federal Healthy Food Financing Initiative (HFFI). It also summarizes steps toward expanding capital flowing into the sector.

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EXECUTIVE SUMMARY

Nic Welty, 30, employs himself full-time year-round raising lettuce, spinach and other leafy greens. He does it with three low-cost passive solar greenhouses, which together cover less than 1 acre of land. Welty's Nine Bean Rows farm is one of many small, diversified, often first-generation farms in the country that defy expectations, particularly among bankers and others with money needed to finance farms and other new food enterprises. Most find it difficult to pencil out the possibility that such a niche farm business could reliably make enough money to grow. Yet as Welty explains, "This business is good enough to take a cash advance on a credit card and run with it."

The fact that many small niche farmers must do just that is alarming to a growing group of innovative lenders and small-farm business advisers. The Financing Farming in the U.S. project is a national focus group of these leaders, convened by the Michigan State University Center for Regional Food Systems. This report is the group's second publication on issues in financing the nation's small and midsized diversified farm entrepreneurs and steps needed to line up resources behind the new jobs, food security, ecosystem services and local commerce they can generate. Specifically, it points to the need for a national learning community of lenders, investors and technical assistance providers to share and advance knowledge as well as connect limited resources for greater efficiency and effectiveness.

The "Strengthening Metrics and Expanding Capital Access" report advances the conversation that many community and national leaders are having about farm financing and its role in building a food system that not only produces healthy food for all but is also socially just, economically robust and environmentally sustainable.

The report:

— Presents an approach to underwriting farm loans that supports the more relationship-based lending required of financial institutions, which commonly operate on a more transactional, credit-scoring basis.

— Provides examples from the field of community development financial institutions involved in or entering farm lending. Examples cover capacity-building issues and include the range of activity that such lenders may undertake as they work to assure a borrower's success, such as making strategic investments in sector development and building technical assistance networks and capital partnerships.

— Offers a view of next steps needed for building the farm financing capacity and confidence of lenders and their investors to smooth and increase the flow of capital into the small and midsized diversified farming sector.

The Financing Farming in the U.S. project zeroes in on entrepreneurial, diversified farming because the sector is perhaps the most difficult for lenders to manage and rationalize. Although farm production is clearly an essential component of building health, wealth and resilience in the food system, it is a difficult sector that falls outside the interest area and capacity of many efforts to finance new healthy food chains. Farm financing is difficult because of the transaction costs of often small loans; the emerging nature of the local and regional food markets that many of the farms are forging; and the infinite variety of farm types and approaches with practically no reliable benchmarks or other metrics to reference. It is much easier, in short, to finance a corner store, food processor or distributor, for example, because their business models are more similar to one another and easier to analyze, even in emerging local and regional systems.

The Financing Farming in the U.S. project, therefore, calls for the development of a national network of learning communities for sharing knowledge and connecting limited resources for farm financing. Many practitioners have expertise, perspective and resources to share, including a raft of new financing mechanisms and investors such as the Slow Money network and Internet crowd-funding sites. At the same time, many bankable farm enterprises are falling through the cracks, relying on credit cards because financial institutions and others are not prepared or willing to work with them.

The time is ripe for a concerted, collaborative farm financing capacity-building effort. The future of the nation's food supply, farmland, regional economies and public health depends on it.

PURPOSE OF PAPER

The purpose of this paper is to increase the flow of capital to a growing small- and midscale diversified farming sector by sharing lessons that lenders involved in the sector are learning and approaches they are taking.

The opportunity now exists to address serious gaps in lender capacity, technical assistance to borrowers and available capital. The opportunity is to build peer-to-peer learning, technical assistance networks and collaboration among interested lenders and strategic partners such as social investors and philanthropists.

This paper endeavors to equip interested lenders and partners with information about capacity-building approaches, assessment tools and risk mitigation strategies that others have used. The authors do not debate whether access to capital is needed but focus rather on sharing effective practice and stimulating further discovery and tool building.

This work is important for several reasons:

— In many regions of the country, agricultural enterprises focused on meeting local and regional food demand are a functional and growing part of the economy. In addition to early direct marketing outlets, such as farmers' markets, the demand for food from local and more sustainable sources (environmental practices, etc.) is opening opportunity in wholesale markets as well. Most of the farms involved, however, fall outside the mainstream of the otherwise well-financed commodity agricultural industry. These agricultural operations — highly weather-, land- and management-dependent — also fall outside the more predictable world of small business loans, where one daycare center or doughnut shop is pretty much like another.

— Business and community leaders increasingly recognize the small farming sector's value and its present need for capital access. Financing new, diversified farms offers the opportunity to simultaneously address myriad other issues that confront communities[2]. The term "community food security" captures the connections between food and a host of community concerns. Mike W. Hamm, director of the Center for Regional Food Systems at Michigan State University, defines community food security as, "All community residents obtaining a culturally acceptable, nutritionally adequate diet through a sustainable food system that maximizes community self-reliance and social justice."

— New resources are aligning behind the imperative that many, including USDA leadership, acknowledge: financing a new generation of farming for local economic development and community food security. Examples include a nationwide network of investors focused on sustainable food and farming called Slow Money (http://www.slowmoney.org) and new financing commitments coming from philanthropists involved in the Sustainable Agriculture and Food System Funders' Network (http://www.safsf.org/). Like lenders, these investors face the challenges of assessing and engaging in farm lending effectively[4], given the emerging nature of local and regional food markets and the relatively unconventional approaches of small-farm entrepreneurs.

THE EMERGENCE OF AND ATTENTION TO FOOD AND FINANCE

Interest in a new entrepreneurial sector of agriculture involving mostly small- and midscale operations with differentiated products and marketing is growing because of a recognized role that the operations can play in community revitalization[5]. Researchers acknowledge the potential for the emerging sector to figure positively in efforts to address related issues such as land use, retail growth, healthy food access, employment, viability of entrepreneurs and capital access[6].

> **New England agriculture is evolving along two distinctly different paths, each of which presents its own set of opportunities and challenges...**
>
> *Steve Taylor, former New Hampshire Commissioner of Agriculture, Food and Markets*

The number and range of small-scale farms and their growth and vitality are evident nationally[7]. Though regions of the United States may have distinct growing patterns and consumer appetites, a common profile of these farms is emerging along with their significance as a growth sector in agriculture. Indicators include strong demand for organic products, which many in this sector offer; the rise in farmers' markets and other direct marketing venues; and the extent to which the food supply chain infrastructure is beginning to include farms and products from this highly differentiated sector.

- Once available only in natural product stores and farmers' markets, organic foods are now found in conventional supermarkets, value-priced big-box chain stores and an expanding array of direct-to-consumer markets. According to the Nutrition Business Journal, U.S. organic food sales are were expected to reach $25 billion in 2010, up from $3.6 billion in 1997[8].
- Direct marketing of farm products through farmers' markets continues to be an important sales outlet for agricultural producers nationwide. As of mid-2011, there were 7,175 farmers' markets operating throughout the United States, a 17 percent increase from 2010.[9]
- The marketing of local foods through both direct-to-consumer and intermediate channels grossed $4.8 billion in 2008, about four times higher than projections based solely on direct-to-consumer expenditures[10].
- Though the number of young farmers is increasing, the average age of farmers nationwide continues to creep toward 60, according to the 2007 Census of Agriculture. The census, administered by the U.S. Department of Agriculture, found that farmers over 55 years old own more than half of the country's farmland[11]. Tom Vilsack, U.S. secretary of agriculture, has been supportive of beginning ranchers and farmer replacement of older farmers as they retire. The 2008 Farm Bill provided for as much as $18 million in USDA loans and programs to help educate and strengthen farm development. The problem, the young farmers say, is access to land and money to buy equipment. Many new to farming also struggle because they lack basic business and financial skills[12].

> **We need to be even more creative than we've been to create strategies so that young people can access operations of all sizes.**
>
> *Tom Vilsack, Secretary, U. S. Department of Agriculture*

FARMING'S PLACE IN THE FOOD CHAIN

The renewal and growth of the nation's small and midsized diversified farm sector is occurring as part of a larger evolution in the food system itself. Public health, environmental, social and economic concerns with the current consolidated, industrialized food system are mounting. Issues include the system's reliance on fossil fuels, diet-related chronic diseases, safety and nutritional quality of food, loss of farmland, economic concentration, and soil and water degradation. Private and public actors are taking market and civic steps to move the food system to a new equilibrium that is more environmentally sustainable, socially just and economically robust.

The food system consists of the processes and infrastructure needed to grow, process, aggregate, distribute, market and sell food. It also includes the inputs needed at each stage of the chain and the management of waste at the end of the chain[13]. Opportunities are growing for community-based small and midsized farms in the food system's current evolution because of the ecosystem services, local commerce and community food security, including social cohesion, they can provide. Their success, however, depends on simultaneous growth and development of needed services and facilities, such as small-scale food processing and distribution, across the system.

Farming has an essential place in the food supply chain. It also relies on and supports the feed and seed suppliers, equipment manufacturers, food processors, distribution warehouses and truckers, management and marketing services, compost producers, and many more facilities, services and functions in the supply chain, which wraps from farm to table and back. For lenders and their investors, therefore, needs and opportunities for financing system-shifting entrepreneurs are many and interlinked.

CAPITAL CONCERNS

Yet capital access for emerging small and differentiated farms is a concern. In its 2010 report, "Financing Farming in the U.S.: Opportunities to Improve the Financial and Business Environment for Small and Midsized Farmers through Strategic Financing," the FFUS project found challenges on both sides of the farm lending table. New farm borrowers lack personal capital or an equity base, need tools and training to convert farm production plans to cash flow projections, and have little or no credit. Lenders lack assessment tools to help them lend with confidence to new, unconventional farm businesses, particularly after two generations in which farming has become an increasingly smaller part of a community bank's portfolio because a smaller number of larger farms now produce the vast majority of the country's agricultural output. Lenders also find it challenging to take on small, diversified farm loans that can be costly to service; and they have been further restricted in recent years by the tightening of credit in the financial industry.

Discourse about financing small-scale agriculture is increasing across the country and at the national level[14]. At the macro level, discussion is about both the extent to which traditional agriculture lenders may be starting to realize the investment potential in emerging localized food systems[15] and promising activity through the Obama administration's Healthy Food Financing

Initiative (HFFI). The HFFI brings together a range of interventions for increasing access to healthy foods with an intergovernmental partnership among the federal departments of Treasury, Agriculture, and Health and Human Services.

SECTOR CATEGORIES AND CHARACTERISTICS

In a sector with few absolute benchmarks, there is no rulebook available with cut-and-dried answers to business lending questions about small and emerging agricultural enterprises. Yet profiles of these operations and their approaches are taking shape. It's known, for example, that small-scale farms are often diverse in their production and marketing. Not being dependent on any one crop reduces their vulnerability to weather influences, even though seasonal challenges are always a factor. Operational stage and scale are significant factors in how well the farms manage various risks and reach market potential.

An FFUS team has developed a baseline matrix for the range of operations in the new, small- and midscale diversified farming world and factors that influence success.

The matrix is built around three broad categories of farms in this sector:

- Small farms, defined as having annual revenue of less than $50,000, accounted for 81 percent of farms reporting local food sales in 2008 and were likely to rely on direct-to-consumer marketing outlets such as farmers' markets.
- New or start-up farms are typically focused on retail and value-added products and may be small in scale as they become established or focus on one or a few specialty products. They may sell into readily accessible venues such as farmers' markets and community-supported agriculture operations (CSAs) that have modest retail or direct-sale exposure. The farmers may be young entrepreneurs entering the niche out of personal commitment or hobby farmers transitioning into an independent commercial enterprise.
- Transitioning farms are generally more mature operations, although still small or midsized in scale and acreage. These farms are often modifying or changing their business model to increase profitability through scale, product diversity, a change in target market or value-added products relating to the core production. They frequently rely on a mix of retail and wholesale markets and therefore have a more complex marketing model in both outreach and logistics.

Common characteristics that align these farms as a sector include the following:

- Organic, sustainable or ecological production practices.
- Significant product diversity.
- Significant amount of marketing effort required to move products through new and emerging, identity-preserved (not commodity) channels.
- One or two specialty products or a diversified operation offering produce, eggs, etc.
- Emphasis on local markets, connection between farm and community, freshness, healthfulness, taste and keeping food dollars in the local economy.
- A few highly differentiated markets, conditioned to the entrepreneurial demands of finding or helping create market demand with their product offerings.



Each farming situation has unique characteristics relative to the product growth cycle, the cash flow cycle from production to sale and the unique aspects of successfully growing that product in the face of external factors. Community development financial institutions (CDFIs) depend on a strong array of partnerships for targeted knowledge on successful farming. The ratios underlying a specific farm application are indicative of where the farm is today but may not be representative of where the farm can be tomorrow or what its potential might be. Underwriting loans to this sector requires a coherent process of analyzing the applicant's current situation as well as actively pulling together resources to help understand the applicant's potential based on the characteristics of the business.

FIVE C'S OF CREDIT

Without clear-cut ratios and underwriting formulas, lenders must use the tried-and-true "five C's of credit" — character, capacity, collateral, capital, conditions — to evaluate risk and repayment in small-scale agriculture. The five C's of credit is a method used by lenders to determine the creditworthiness of potential borrowers. The system weighs five characteristics of the borrower to attempt to gauge the chance of default. This method of evaluating a borrower incorporates both qualitative and quantitative measures.

The first factor is character, which refers to a borrower's reputation. "Capacity" measures a borrower's ability to repay a loan by comparing income against recurring debts. Assessing cash flow and farm business management skills is fundamental to understanding a farm's capacity. The lender will consider any capital (equity or cash on hand) that the borrower puts toward a potential investment because a large contribution by the borrower will lessen the chance of default. Collateral, such as property or large assets, helps to secure the loan. Finally, the market conditions of the loan and the borrower's ability to get to market and understand the market will influence the lender's desire to finance the borrower[16].

> **"The issue we're finding in lending is that banks and major institutions are going to scored lending. You have to fit some-where in the matrix. Our lending is relationship lending. We do things the old fashioned way. We want to get to know the borrower, know the industry."**
>
> *Karl Zalazowski, CEO, CalCoastal*

The distinction here is that the five C's of credit will have some unique attributes specific to the farming sector and, therefore, cannot be weighted equally but must be assessed in importance in keeping with the norms of the applicants. Certain risk elements in this sector must be gauged against the sector's common characteristics and not against a conventional small-business model. As businesses in small-scale and emerging agriculture evolve, so will the process of analyzing the five C's of credit, but to fully support these agricultural enterprises at this time of significant growth in the sector, we must understand their current characteristics and circumstances.

WEIGHTING THE C'S

New England Bank vice president and FFUS team member Denise Dukette has contributed to the lending industry by developing an underwriting approach that weights the five C's by primary and secondary considerations[17].

The primary considerations — strong indicators of potential success in the sector — are the first cut — if the applicant cannot pass the first cut, the secondary factors do not come into play.

PRIMARY FACTORS – DEAL BREAKERS

Capacity: cash flow

Cash flow, the crux of this sector, is one of the more challenging aspects to this industry and the most important to understand in relation to risk and business viability. Cash flow covers the ability of the borrower to pay on time and over time. Cash flow is different from cash on hand, which is a form of equity capital.

Often small farms have multiple sources of cash flow, some of which are consistent and reliable, and some of which are not. Credit scores are often low and may not be representative of repayment patterns. Collateral is typically minimal — in many cases, consisting primarily of the crop or product being sold. Therefore, primary viability is based on the cash flow resulting from successful deployment of the loan – increased crop diversity, increased yield, extended growing season, expanded acreage, access to new markets and the like. The applicant's viability is not likely to be based on historic performance or any independent cash flow support. It is more likely to be based on a track record of agricultural experience but entails taking that experience to a new level and describing its complexity, scale and capital investment.

A farm's aggregate cash flow is a complex model because it needs to break each major or defined product into its own production cycle and its own cash flow cycle. Some crops can be produced quickly (in weeks) with modest cash requirements upfront. Some require modest cash requirements upfront but continual cash outlays for irrigation and fertilizers before being brought to market months later. Some require years of growth before maturity and full output. Major products need to be broken down into their own cash flow models, and those individual cash flows then need to be overlaid into the farm's aggregated model. Looking at the overall performance will not identify the specific risks to each component, but the farming model typically works only if each component performs or yields according to plan. The lender must be able to engage the applicant both verbally, to "hear" the story, as well as to provide support resources and technical assistance, as necessary, to help the applicant create a realistic cash flow model.

Although the first step in assessing an application is through a well thought out and detailed cash flow model, getting this from the farmer is a challenge. The small-scale farmer may not see the value in understanding the cash flow model — the farmer is intent on growing or nurturing the product or livestock and does not view each crop or animal as a budgetary number the way a store owner or factory owner views inventory and accounts receivable. Helping the farmer understand the value in managing his/her business with a strong cash flow model against which to track performance also provides a core skill and will create a stronger lifetime entrepreneur. There is often a very high need for technical assistance to create a representative budget as well as to assist the farmer in using the budget as a working tool and for maintaining good data. Cash flow is a critical component because any future financing requests will require the history of timely repayment as well as evidence that the borrower can develop and manage a realistic budget.

Capacity: farm business management skills
A successful farmer's expertise is strong in product, business operations and market assessment. Beyond the set of skills common among successful farmers, several of the case studies noted that a good farming applicant is also a risk taker who is looking for unmet needs in the market and will then expand or adapt his/her farm endeavor to fill that gap. This entrepreneurial spirit is a key element to a successful small farm, which must continually adapt to a changing marketplace.

A dilemma for lenders is that strong farm business management skills are often difficult to assess, and a young farmer is unlikely to have a resume that identifies practical experience in each skill area. The business management skills necessary for farming have historically been acquired and transferred between generations and from established farmers to newer ones, and that has worked well in stable and localized markets. However, growth in the small-farm sector is often targeted to more unconventional products and aims to access unmet demands for goods. This makes it difficult to apply the more traditional skills and knowledge used so commonly in the past. Instead, this sector needs to be directly and actively supported by qualified technical assistance resources and through networks of peers producing like products to address specific needs and be responsive to the ever-changing landscape.

Rather than proven skill or established experience, this reality requires a lender to assess the applicant's commitment to the lifestyle, and his/her ability to access knowledge-based resources as needed, to have enough of the fundamental skills to manage a farm operation, and to rapidly identify and respond to issues related to crop/product, regulatory policy, the environment or changing market opportunities. As stated earlier, the lender benefits from tapping a range of qualified resource people who help weigh the farm's individual merits to assess the viability of the complete farming model.

Conditions: getting to market and understanding which market is appropriate
One of the logistical challenges facing many farming enterprises is getting to market effectively. Growing a marketable product and reaching the appropriate market are not one in the same but are integral to farm success. The farm scale may determine market options. Direct markets – e.g. farmers' markets or CSAs[18] – enable direct product access to consumers. Selling to institutional buyers, wholesalers, large retailers and institutional markets requires both infrastructure (aggregation, distribution and storage) and access to that infrastructure. In turn, procurement demand needs to be consistent to provide meaningful market stability and predictability for the small- to midscale producers. As in all aspects of this sector, sufficient loan capital will be necessary to finance aggregation and distribution business models.

In assessing an applicant's ability to get to market, a lender can use the following checklist to ascertain the farmer's understanding of market factors and also increase the lender's sector knowledge:

- Demand strength within a geographic scope for the product?
- Market diversity: direct, wholesale, retail? Each will likely have its own requirements for quality, volume, timeliness, payment methods and timeline for payment as well as risk of non-payment.
- Price margins in the region based on market?
- Infrastructure (aggregation/distribution) status?
- Transportation needs: market range and transportation support?
- Shelf-stability for the product, i.e., stored for future sale, or highly perishable?
- Product volume sufficient to support independent direct sale or institutional sale, or more suited to farmers markets?
- Farmer compensation and farm cash flow?

To a certain extent, farmers control their operations. However, beyond the farm gate are regional and local market factors that are already in place or are in active development that may affect the borrower. Assessing market conditions requires asking borrowers the right questions:

1. Is there a trend in institutional procurement of local or regional farm products?
2. Are new producers emerging that will affect the marketplace and your applicant?

Broader infrastructure issues that affect production and delivery costs can be assessed by asking:

1. Are there USDA-inspected slaughter facilities for livestock nearby, or does the borrower have to drive 40+ miles each way to deliver the animals and then to pick up the meat?
2. Are accessible cold storage facilities being built to extend growing seasons and add capacity?
3. Is a regional aggregator present or in development that is accessible and competitive in the distribution infrastructure?
4. Are there marketing resources that heighten awareness of local products and draw consumers and buyers to producers, such as:
   a. Agritourism programs that meet the broad economic needs of an area but can directly facilitate local producers.
   b. "Buy local" campaigns that strengthen marketing and market identification.
   c. Organized institutional buyer programs.
   d. Networks of successful farmers and knowledge-based programs including extension services and consultants who can provide immediate advice and counseling if needed.
   e. Established systems for getting produce into urban centers with coordinated delivery systems and schedules and established market outlets.

A farmer's access to programs and infrastructure and regional economic development activity related to agriculture and food systems increases farm viability potential.

Character

Character is always a challenging topic in the economic development arena. Conventionally, character includes a strong credit score, demonstrated financial success in the subject business or in a comparable niche, strong experience, including peer references, and financial capacity in the form of meaningful collateral or other financial resources. In the small agricultural sector, most of the applicants will not have those common measures. Newer farmers may operate a farming enterprise that is commensurate to a side business but is not sufficiently established to carry the proposed debt. They may be branching into a new niche with little track record.

In many cases, an applicant may have a low credit score or no credit score; alternative payment records such as private store credit, phone bills, rent payments and the like may be helpful to understand how the individual treats existing obligations. Knowledge of external factors that affect credit score, such as illness, job loss or divorce, is important. Personal liquidity is often insufficient to support the requested loan amount, but requesting some level of personal assets to bolster a financing request, such as a car or equipment, will typically ensure that the borrower is fully committed to success and full repayment. Case studies indicated that CDFIs took into consideration the borrower's commitment to the application process; his/her finishing homework assignments that described production, markets, cash flows and other farm operations; and track record of prior ventures as valid character indications. The small farmer needs to be resourceful and dedicated to succeed. Within reason, knowledge can be gained by both lender and farmer through the process.

A character benchmark is the extent to which the prospective lender would actively support and advocate for the applicant to a third party or internal decision makers. If the applicant provides a modicum of comfort—i.e., a sense that "they get it" and can accomplish operational goals, even if it's not possible to put it into a spreadsheet or refer to a successful financial history — it may still be worthwhile to gather more information to help make the case. If the lender's perception is that the borrower has not expressed a commitment to farming, hasn't done the research or doesn't have any networking connections in the field, then it may be appropriate to provide constructive and tangible recommendations for improvement and hold off on the lending opportunity until progress is more evident.

Strengthening the lender-farmer relationship is a long-term goal. A significant shortcoming in any of the above requirements should prompt a lender to recommend support through the technical assistance network to help the borrower focus on debt readiness. Understandably, making a loan to an applicant who is not prepared to effectively utilize and repay the funds and who is not fully committed to achieving success is not to anyone's benefit. Conversely, not fully exploring ways to make a properly structured loan to a viable and committed applicant does not further the goals of the lender or the regional agriculture and food system whose economic mainstay is successful food producers.

SECONDARY FACTORS

A borrower who cannot put in 20 percent cash or equivalent equity is often construed as not fully vested in the project or likely to walk away if times get tough. This is considered a deal breaker in conventional lending decisions. CDFIs, however, considered equity capital or other evidence of collateral to be secondary in importance in their underwriting consideration. These CDFIs generally provided two reasons for categorizing these as secondary:

1. In the on-going relationship development between lenders and small-scale farm borrowers, neither cash/equity nor collateral gaps have been found to be direct indicators of farm success potential. Rather, they are fallback arrangements. In this emerging sector, in which the profile of farmers reflects their newness to the vocation, collateral and cash equity are least likely to be present in a financing application.

2. Secondly, effective lending necessitates an active support network within which an applicant can tap available resources and use through the application process. Very few small farmers can find all the appropriate resources independently, either in the early stages of getting established or through fundamental growth phases. Successful farmers determine their strongest skills set and focus on the specific agricultural or husbandry niche but may not have developed a broader resource pool that supports knowledge and skill building. Participation in a network of successful farm businesses and related farm development organizations provides a framework for successful loan repayment and was offered as more valuable a determinant of loan repayment than the secondary factors outlined below.

Capital: equity or cash on hand

A typical pattern for a small farm is to bootstrap. Owners often start with a small range of product in crops or livestock on a small parcel of land, and sell that product through somewhat defined markets such as farmers' markets, CSAs or on-farm sales (in the case of livestock), or to small institutional procurers such as schools, resorts, or independently owned grocers and upscale restaurants. They often rely on credit cards to make purchases and then retire the card balances once sales occur in what is typically a highly seasonal fashion. If there is an issue with the crop or animals, they have limited fallback, and their personal financial capacity often depends on the cash balance remaining after products are sold and bills are paid. The funds that farmers do amass in one season are usually fully reinvested in the farm, meaning that as the farm grows, the farmers continue to live on a very limited personal budget and do not build liquidity. And because of the integrated business model of the small family farm, producers and the farm are one financial entity and are highly subject to the risk of crop or product failure.

The goal is to recognize this practical reality and to determine how a loan can assist the farmer to actively strengthen farm cash flow. As previously discussed, there may be many positive outcomes: increased product diversification to broaden the cash flow cycle or to generate cash flow over a longer season;

production of shelf-stable products to allow off-season sales; growing or raising higher margin products; reaching a larger scale, which increases net cash flow; or reaching into new markets that better suit the farm's capacity and niche. In the assessment of the cash/equity contribution in an application, inadequate liquidity, as indicated by traditional benchmarks (10 percent to 20 percent or more), will rule out many viable transactions. By maintaining an emphasis on understanding the primary factors referenced above, the lender will develop a strong and well-qualified opinion on the viability of the concept or products being funded, the associated direct cash flow and, therefore, overall benefit to the farming model.

Assessing a loan using primary factors will help a lender assess the need for cash equity versus owner commitment and contribution to the project. Utilizing primary factors helps work out practical and creative solutions that advance the loan application in the absence of defined liquidity.

Collateral

Collateral is traditionally a benchmark used to ensure that, in the event of loan failure, the lender can liquidate tangible assets and be repaid in full. CDFIs may have a higher tolerance for undercollateralized loans than conventional lenders, but they are often still uncomfortable with collateral of indeterminate value. In farming enterprises, collateral offered will likely be insufficient in market value and may consist of assets that cannot be readily liquidated. For example, a maple sugaring operation may need miles of tubing to tap maple trees and a physical and segregated sugar shack for boiling down sap. Neither of those assets can be easily retrieved, broken down into salable components or sold in a strong secondary market. A barn or shed built for livestock and feed storage cannot be moved and adds value to the farm only on a going-concern basis as a working farm. However, the value of the assets in place, captured in a demonstrated or validated business plan, is significant because the enterprise cannot expand without those capital investments. In many cases, the capital investment required for a growing or changing farm will not have a clear market value (beyond purchase cost) or be easily liquidated. And the sale of assets from a distressed farm will likely be further diluted in value as prospective buyers look for bargains.

Collateral is not necessarily a core component of the lending decision. Many of the CDFIs use either more generous ratios or specific loan loss reserves allocated to the lending program to support the higher inherent collateral risk if an agricultural lending program is going to be successful. As discussed above, we have found that the key factors in success are engaging in in-depth analysis of the business model and the associated cash flow cycles, ensuring functional skills to produce/grow/process the products, and ensuring that there is an identified market that can be accessed for sale of the product in a reasonable and cost-effective manner. The goal is not to make loans with no collateral support or financial fallback position, but the reality is that the fallback position in this sector is focused analysis and strong technical assistance to ensure that projected cash flows materialize as anticipated.

CASE STUDIES

Case studies as a methodology allowed FFUS to consider the complex question of loan making within the context of regional influence. Case studies were considered the most effective way to enable knowledge transfer among peers, transcending storytelling through the collection of both underwriting practices and perspective that evolves through trial and error.

CDFIs were chosen because of their nonprofit, mission-based approach to lending in underserved areas and because CDFIs are on the forefront of the U.S. Treasury's Healthy Food Financing Initiative. Each of the nine CDFIs profiled a successful loan transaction.

APPROACH

Between June and July 2011, representatives of nine CDFIs took part in 90-minute phone interviews designed to capture effective farm production lending practices. All conversations were taped. Each CDFI was asked to review the case study for accuracy prior to release and use in Opportunity Finance Network training.

The community-based lenders were asked questions about their mission, capacity to enter the farm production sector, information needed for analyzing and mitigating loan repayment risks, and how their farm borrowers prepared for debt access. Each of the nine CDFIs profiled a successful loan transaction. The majority of their farm borrowers were small-scale, limited-resource farmers with working capital obstacles that limited development and growth.

Anticipated benefits from the case studies included the potential to provide financial institutions with guidance for entering the sector and small-scale farmers with perspective on lenders' decision making.

Three themes emerged from the project's discussions with CDFI farm lenders. They point to ways in which other lenders could develop their capacity to finance newer and beginning farmers that operate small- to midscale farms:

1. Relationship lending.
2. Sector commitment and development.
3. Asset building and community engagement.

THEMES

The case study themes illustrate the types of skills that lenders need to be successful with new, entrepreneurial, small-farm borrowers. Most in the financial industry are not set up for the high-touch relationship lending, infrastructure development and asset-building needs of the sector. Even CDFIs, which specialize in bootstrap community development financing, lack understanding of farming in general, let alone of new and specialized types of operations. As the number and profitability of farmers have fallen over the years with industry consolidation, lenders have across the board reduced their engagement with agriculture and their technical understanding of it.

Relationship Lending

In all cases, the lenders interviewed take the time to get to know the borrowers, their businesses and their communities. Each confirmed the need to engage in higher touch

> **"My only challenge was in understanding what the borrower's needs were and structuring the loan around those needs rather than using a standard approach."**
>
> *Ellen McHenry, Loan Officer, UCEDC*

relationship lending rather than more common transactional lending, which is based primarily on credit scores and collateral. The common denominator was the lenders' willingness to suspend such transactional judgment, dig under the surface and seek assistance.

Example: UCEDC is a statewide economic development corporation and CDFI in New Jersey that recently made its first agricultural loan. UCEDC lender Ellen McHenry researched the borrower's capacity extensively through farm visits, stakeholder interviews and help from a nonprofit involved in building the borrower's business and markets. She recruited another loan fund, also new to agriculture, to participate in the total $35,000 deal. UCEDC believes agriculture serving local and regional markets is a growth sector and intends to build the organization's capacity to serve it, including the potential to make government-guaranteed loans.

Sector Commitment and Development
All CDFIs interviewed approach agriculture lending as a core part of their work — they do not position themselves marginally as a "lender of last resort." Many also engage in the sector strategically and proactively, making loans that can advance the sector itself, not just the borrower, and engaging with partners to address challenges such as limited processing and distribution infrastructure for local and regional markets.

Example: The Natural Capital Investment Fund (NCIF) is a CDFI serving North Carolina, West Virginia, and Appalachian regions of Ohio, Kentucky and Tennessee. Its staff is involved in development of the sustainable agriculture and small-farm sector as a way to improve the economic outlook for the business/farm owners, their rural communities and the region. In one instance, a loan for a well-qualified tobacco farmer's diversification into organic dairy production was in part an effort to draw the services of an organic dairy processor and distributor to the region. In turn, NCIF hopes to build opportunity for additional organic dairies to locate in the Southeast, which is a net importing region for organic milk. Financing farmers transitioning to sustainable agriculture production practices enabled NCIF to learn more about the infrastructure of agriculture at that scale, develop relationships with the independent, limited-resource farming community, and ultimately allowed them to determine how capital could best serve these enterprises. According to NCIF CEO Marten Jenkins, NCIF is building the capacity to finance agricultural production by partnering and finding ways to cover its costs for developing and servicing such loans.

> **"RAFI-USA documented that North Carolina farmers face a gap in appropriate financing for agriculture. We see ourselves as helping to fill the niche. We have an institutional commitment to sustainable agriculture."**
>
> *Rick Larson, CEO, NCIF*

Asset Building and Community Engagement
Rather than reject a borrower for lack of assets and equity, the CDFIs interviewed are engaged in helping borrowers build up their assets. They work creatively and collaboratively with other community resources and partners to develop loans and packages of assistance that improve the borrower's financial position and business prospects.

Example: Craft3, formerly Enterprise Cascadia, is a CDFI with a long history of supporting the natural resource-based rural economies of Oregon and Washington. Its current work to finance new-generation farm businesses in the region is a logical outgrowth of this history. Craft3 does so by engaging a broad range of partners and community members in the process. In one case, a promising young farmer's need to purchase land motivated Craft3 to develop an innovative arrangement with a land trust in the region. Rather than saddle the young farmer with a large mortgage or give up on her land prospects, Craft3 instead gave the mortgage to a separate nonprofit that the land trust formed. The deal involved the young farmer leasing the property from the nonprofit organization. The loan specified that her lease payments would reduce the mortgage and build her equity in the land at the same time. The deal had further benefits, too. One was the ability of the farmer to obtain a working capital loan from the region's Farm Credit Services institution because she had only lease payments and not a major mortgage on her balance sheet. Others involved local residents and customers making smaller direct loans to the farmer on the basis of the due diligence and effort that Craft3 took with her business.

"We call it 'capital plus.' In the daily course of lending we provide our expertise: an extensive network of relationships ... and a high level of advice and counsel to businesses through the process of seeking financing."

Maggie Kirby, CEO, Craft3




The growth and potential of the diversified farm sector are strong, with evidence of profitable enterprises across the country in all manner of market environments. To increase capital flowing into the sector, lenders must build their capacity to serve it confidently.

Capacity building among lenders is an integral part of the solution. It involves skills and investment in the three themes found in FFUS case study research along with technical assistance as a fourth capacity-building component.

Checklist for Entering Sector

Entering the small- and midscale diversified farming sector requires a willingness by lenders to pursue loan opportunities in an emerging sector and an understanding, or mission-based purpose, that they have a role in developing the farm entrepreneurs and their opportunities. It also requires a dedication of resources to the sector and its borrowers, which are unique and diverse enough to warrant special in-house capacity and/or significant partnering with other organizations and resources in the community.

The FFUS project has produced a self-assessment checklist for lenders interested in serving the sector. It covers questions to ask about the lender's existing or required capacity, its internal and external resources, and its understanding of the sector's local needs and opportunities and which parts are the best fit for the lender's portfolio. (See appendix.)

RELATIONSHIP LENDING

CDFIs interviewed by FFUS equated relationship building as capacity building for both the CDFI and the borrower. Getting to know borrowers meant exploring their business track records, relationships in the market, public and private sector partnerships, and the extent to which they sought business and other technical assistance. The CDFIs reported that building relationships with new farmers opened up new partnerships for the CDFIs as well.

Small, community-based commercial lenders report the same benefits of relationship building with farm borrowers. A 2009 study of agricultural lending in Michigan found that, although labor-intensive, personalized services ultimately reduced financial risk to the institution[19]. Smaller banks and credit unions overwhelmingly cited the value of building a relationship with the borrower. Working with the borrower to assess and then present farm finances is valuable to the lender as well as the borrower[20].

Relationship lending, however, requires resources that many financial institutions no longer have. Few have staff members familiar with agriculture or the resources to evaluate loan applications beyond credit scores, which cannot show the whole operation, or common ratios that rarely reflect the know-how or business prospects of most small- and midscale diversified farming operations.

Two CDFIs interviewed, FORGE and the California Coastal Rural Development Corporation (CalCoastal), have long histories with local agriculture and in-depth knowledge of the borrowers and sector of regional agriculture that they finance. Both offer examples of what relationship lending means to the financial institution and the borrower. Their experiences demonstrate that relationship lending ranges from personal knowledge and appreciation of the farmer and his/her markets to high-touch structuring and monitoring of loans to support the borrower and protect the lender. Another lender profiled here, the New Mexico Loan Fund, demonstrates that relationship lending for agriculture is similar to the highly involved community development lending that CDFIs already do — it just requires more familiarity on a case-by-case basis with individual farms and their businesses.

FORGE

FORGE is a community development financial institution located in the Ozark Mountains of northwestern Arkansas that serves the region's small farms and rural businesses with a focus on building sustainable agriculture and communities. Founded by organic farmers and supporters, FORGE (Financing Ozarks Rural Growth and Economy) makes agricultural loans on the basis of the principle of increasing the productive capacity of a piece of land. Healthy land means healthy livestock and orchards, which in turn keep people on the land and maintain agriculture as part of the region's economy and culture.

> **"FORGE doesn't look at agriculture as a sector. It's part of the culture. ... Its just part of trying to help the smaller business community and residents of small towns stay alive."**
>
> *Charlie Stockton, CEO, FORGE*

FORGE has made a total of 270 loans since 1989 with $1,800,000 in debt circulation. Its lending niche is in the $10,000 to $70,000 range. Agricultural production loans represent 30 percent of its portfolio. FORGE has logged a default rate of less than 1 percent.

Charlie Stockton, senior loan officer/director, explains that making a successful farm loan requires getting to know the farmer, not just the farm operation, and structuring the loan in a way that fits the farmer's realities and the farm's particular business cycle and markets.

"Regional farms tend not to cash flow out, so there is a need to look at off-farm income," Stockton says. "It's important to address the person's whole life package, not just the farming project." In such cases, that means structuring a loan so that payments are affordable for the farmer, even if that means extremely low payments for a long period of time. FORGE in such cases allows for the farmer's current financial situation while providing the bootstrap financing needed to move the farm business forward.

Making those kinds of judgments and loan deals requires a gut-level understanding of the borrower and the farm business plan and prospects.

"The person who currently has a 30- to 40-head dairy operation and needs a shed, you know they are going to gross $40,000 to $50,000 that year. Not hard to make that loan," Stockton says. "Another farmer who wants to buy cattle but doesn't own anything and has no infrastructure, this is a much harder loan to make. I have to determine whether they would grind it out if conditions got bad."

CalCoastal

The mission of the California Coastal Rural Development Corporation (CalCoastal) is to help small-farm enterprises grow, thrive and prosper, and contribute to the overall economic development of its Central Valley region. Formed in 1982 to help finance refrigeration for Latino strawberry farmers, CalCoastal lends primarily (roughly 85 percent) to small-scale commodity strawberry farmers who sell to fresh market shippers and to frozen berry processing companies. The remainder of its lending goes to organic row crop vegetable growers. The majority of these sell to direct markets such as farmers' markets in San Francisco and other metropolitan areas. Whether direct-market or commodity, CalCoastal's small-farm borrowers are unable to obtain regular bank financing, mainly because of the labor intensity involved in servicing small-agricultural loans.

At its prerecession peak in fiscal 2009, CalCoastal made $35 million in direct farm loans to about 60 clients, a portion of which involved the use of state loan guarantees that are no longer available. In 2010-11, loan volume was approximately $15 million to about 30 farmers. Its "sweet spot" for lending is a loan range from $300,000 to $1.1 million, which is large by most standards but small in the context of California agriculture.

Agriculture is our business; it's number one. We've developed it over the last 30 years. It's based on relationships, and marketing is primarily word of mouth among farmers here.

Karl Zalazowski, CEO, CalCoastal

Executive director Karl Zalazowski explains: "In many cases in California, that [$300,000] often isn't enough capital to get some borrowers started. For most strawberry farmers, the 'all-in' cost is from $10,000 to $15,000 per acre, just to get you to the point of harvest. Compare that to vegetable crops at about $2,000 per acre all-in."

This range in borrowers and their markets also influences how CalCoastal structures loans. Loan officer Jose Guerra explains: "You have to understand the crop, the industry and the cycles to determine how to structure a loan. A long-term crop — e.g., in the ground for three years — will give you more leeway in collections. With a short-term crop like spinach — 35 to 45 days in the ground — you really have to be on the spot from start to finish."

Making the loan then comes down to the individual farmer and his/her particular scale, stage and crop plan, he adds.

"You have to consider the whole picture because all these farms are different in size and where they are financially. Other than credit rating and debt coverage ratio, it's tough to say where a particular farm should be because the next person could be asking for the same amount of money but have a completely different crop plan."

To manage the borrower's needs and its own needs, CalCoastal structures and monitors loans in ways that follow crop and marketing patterns and keep lender and borrower in relatively close connection through the term of the loan. CalCoastal's loans look a lot like lines of credit in that borrowers draw on them as needed in the crop preparation/planting side of the year and pay back later in the selling season as revenue exceeds expenses.

"In a budget, we show the need for expenses much less in the summer and excess revenue applied to principal," Guerra says.

With loans to commodity strawberry growers, CalCoastal generally requires a "crop assignment," which involves the shipper that buys the crop to include CalCoastal on the grower's checks. Guerra explains: "With a crop assignment, we can monitor the loan as money comes in. We also require the borrower to bring in expenses [receipts] during the term so we can look at it and make sure we're getting repayment (revenue above expenses). But also it's a way of catching any red flags: is the farmer having an issue with growing, is he/she behind schedule on harvest, maybe the plants need attention? It's extremely labor-intensive to monitor. It's done on a weekly basis during harvest time. During the growing time, it's needed more like once a month."

The Loan Fund

The New Mexico Loan Fund is a new entrant into the small- and midscale farming sector. In 2011, it had one direct farm production loan in addition to value-added food business loans. The Loan Fund in 2010 marked its 20th year of financing and supporting entrepreneurs throughout New Mexico by making $6.4 million in small-business loans, compared with $3.3 million in 2008.

The Loan Fund decided that getting involved in small-farm lending and development was one way to increase the return on an outreach investment in its rural geographic service area. Eighty percent of the Loan Fund's outreach is in rural areas, where 40 percent of the population lives on 85 percent of the land area. George Kenefic, New Mexico Loan Fund's director of enterprise empowerment, described New Mexico as a primarily rural state with predominantly small producers with small acreages, small herds and small crop yields — in essence, small rural business development.

Relationship lending is just part of the Loan Fund's core business of community development, Kenefic said. In the case of its initial farm production loan, that involved digging into nuts-and-bolts farm business questions: "Should you have 10 hives or 100 hives? You need to embark on strategy attainable for you … we made numerous visits, phone calls, e-mails, etc. — whatever it took to center him on the largest opportunity center he could handle and that would still appreciate uniqueness of his product and pay him what it is worth."

SECTOR COMMITMENT AND DEVELOPMENT

Community-based lenders consider farm borrowers valuable and integral components of the local economy's sustainability, which is the cornerstone of their mission. Lending is partly motivated by the potential to address other needs in their communities by helping to build an agricultural sector that connects with local issues such as affordable access to fresh and healthy food or protection of farmland, water and related environmental assets.

When asked about their role in this sector, most CDFI lenders responded that they were primary lenders for these small-scale farm operations. Responses ranged from playing a key role in supporting farm income during a shift to sustainable practices to seeking out other partners to fill the gap to acting as an advocate for agriculture as part of the community's overall economic development planning strategies.

Craft3 in the Northwest, the Fresno CDFI in California and the Progress Fund in Pennsylvania offer examples of sector investment through small-farm lending.

Craft3

Craft3, which serves Oregon and Washington, is engaged with agriculture as a highly purposeful and strategic part of its broader work to build sustainability in the region. It is the largest non-bank CDFI in the Pacific Northwest, with more than $164 million in capital assets under management. Although agriculture is just one part of its portfolio, Craft3 is the leading lender to small- and midscale diversified farming operations in the region.

Senior lender Mark Bowman explains Craft3's purpose and process: "Meeting triple bottom line metrics. That is important, and that's our story. We work toward being able to tell how our investment has multiple benefits and how it leverages other activity, such as lending and other investment from the community."

Craft3 will target geographic areas, for example, to accomplish its land, community and economy objectives.

"An example is an area on the Olympic Peninsula where two valleys come together," Bowman said. "Our goal with partners is to preserve this land for farming and forestry opportunities because of great soils, water resources, etc. We don't want housing development to move up those valleys. So we target those valleys as a focused area of work, developing relationships with farmers and foresters there, working with partners that provide services to make existing farms more viable, including retaining agriculture there to supply our local markets."

Fresno CDFI

The Fresno CDFI is another community-based lender on the West Coast involved in agriculture because of its value for community development and sustainability. The Fresno CDFI has focused since its start in 1994 on small refugee and immigrant farms and, since 2009, has broadened its lending to other limited-resource farmers and small businesses. Its typical borrower raises 10 to 12 varieties of crops, primarily vegetables, on 6 to 12 acres. The smaller farms in the portfolio are 5 to 10 acres, and the largest two or three have 50 to 60 acres.

Fresno CDFI has established two farmers' markets in the city with grant funding from the USDA's Farmers' Market Promotion Program. The markets benefit low-income residents as well as limited-resource farmers. The farmers' markets are located downtown; one is close to the county's WIC office, so low-income families can purchase fresh produce and easily redeem their fresh fruits and vegetables vouchers. Also, these outlets provide alternative market channels for the farmers. Other major markets are three hours away (Los Angeles and Oakland/San Francisco Bay areas). Traveling to the distant markets comes with high business and personal costs for the farmers.

Fresno CDFI, through partnerships with Citibank and Montana Vista, is also working to establish a marketing cooperative and needed infrastructure — cold storage, transportation and marketing/sale support — for local small farmers by combining public and private resources. This collaborative effort intends to leverage funds through the Healthy Food Financing Initiative and provide distressed communities with access to fresh and healthy food and help local producers build farm viability by gaining access to larger volume institutional markets interested in healthy food and sustainability, such as schools and hospitals.

The Progress Fund

The Progress Fund is a Pennsylvania-based, certified community development financial institution that supports farmers and producers of locally grown products. It services a rural area of northern Appalachia including 40 counties in Pennsylvania, all of West Virginia, mountain Maryland and southeastern Ohio. From 1997 to 2011, the Progress Fund made 378 loans totaling more than $41.5 million, helping with both business creation and the retention of more than 2,618 jobs. Loans range from $20,000 to $750,000.

> **"We are losing farmland in Pennsylvania at an alarming rate. To have an effective rural development strategy, we had to begin to serve the agricultural industry."**
>
> *David Kahley, CEO, Progress Fund*

The Progress Fund entered into agricultural lending after being asked to finance a critical piece of a large loan package for a successful and expanding organic cooperative. The lack of start-up financing for new local foods ventures became apparent, and the Progress Fund has continued to lend in this market. The Progress Fund has also loaned to wineries, produce growers, a dairy operation that branched into cheesemaking and, most recently, an equity-like investment in community-supported agriculture (CSA) enterprises.

The Progress Fund was formed in 1997 to provide loans to tourism businesses measurably underserved by banks and government loan programs. Tourism and agriculture are the two largest industries of Pennsylvania and, for many rural communities, are considered an economic lifeblood. The Progress Fund determined that, to serve its rural region, it had to include agriculture in its rural lending strategy.

CEO David Kahley explains: "There is too much at stake in Pennsylvania. We are losing our farmland at a faster rate per capita than any other state in the union. Maybe our financing of locally grown products can slow the tide and these new agricultural ventures will encourage others to follow. While we are being strategic with our resources by focusing on local foods production, we think it's critical to our region's economic future. We are still in the trial-and-error phase; each new loan we make is a learning experience."

ASSET BUILDING

Across the board, lenders found that small- and midscale diversified farms typically have to bootstrap their growth to a degree that can impede the farm's longer term growth and viability. These lenders also found that these farmers typically know what they do but are unlikely to have the range of business skills and investment-ready business plans that conventional lenders require. By understanding both the farm operations and the markets within which these farms operate, and through strategic partnerships, lenders were able to help farmers reduce some of their overall costs as well as reach other market opportunities previously unknown to the farmers.

Farmers build assets that they can bank on in the process of going through the business planning, market research and production enhancements needed to move forward with lenders. Some lenders, such as Craft3, can almost calculate the business value of certain environmental conservation practices that they help a farm entrepreneur develop, which the farm can also market to consumers. For example, Craft3 partners with the local conservation district and others. These organizations work with farmers to rehabilitate property for salmon habitat, for example, which builds the farm's environmental and marketing assets.

Specific equity-building examples harvested from CDFI interviews include California FarmLink's extensive Individual Development Account program and the steps that UCEDC loan officer Ellen McHenry took to make sure that her first small-farm borrower built a business credit history for future loans through the Credit Builders Alliance.

Individual development accounts (IDAs) are matched savings programs that offer newer farmers business planning support and a savings regimen that helps them pay for small purchases or property taxes rather than incur debt. Helping new farmers avoid unnecessary debt was a key lesson for farmers in a Michigan agriculture IDA program offered through the Mott Group for Sustainable Food Systems at Michigan State University[21] and through the California FarmLink[22]. Agriculture-based IDAs also help farmers secure higher eligibility ratings for additional loan sources, such as the USDA Farm Services Agency.

California FarmLink

California FarmLink operates a land-linking program that matches retiring farmers and landowners with beginning and aspiring farmers, thereby promoting continued agricultural production and the protection of farmland. Since 2001, equity building has been at the heart of the organization's land-linking work through two complementary programs: the IDA program and the Farm Opportunities Loan program, which provides low-interest USDA Farm Service Agency-guaranteed loans to farmers who may not be bankable immediately by traditional lenders.

Since 2005, California Farmlink closed 26 loans with 14 borrowers through its Farm Opportunities Loan Program, with loans ranging from $5,000 to $100,000. For three years, California FarmLink partnered with a CDFI, which cut the checks and served on loan committees; California FarmLink performed loan origination and servicing. The total loan portfolio is $1.4 million. California Farmlink is applying to become a CDFI.

For its IDA program, California FarmLink raises private funding to match federal funding available to match a farm's savings. The farmer saves an agreed-upon amount of money over a period of time during which he/she is also obliged to obtain training in business and financial management. The farmer's IDA savings and the two-to-one match must go toward building an asset for the farm operation.

Example: California FarmLink worked closely to help an IDA program participant purchase a 10-acre organic farm in its fourth year of operation in southern Monterey County, offered at $250,000. FarmLink assisted the farm family in writing a business plan for potential lenders, then helped identify needs of the title company, and find an appropriate attorney to solidify a purchase agreement and interface with lenders. The family used IDA account funds for the down payment. By securing a land-use attorney to assist the family, California FarmLink helped save the family at least $9,000 in realtor fees. Altogether, this helped the family obtain an FSA-guaranteed loan of $175,000 from partner California Coastal Rural Development Corporation.

UCEDC

UCEDC is a well-established economic development corporation serving New Jersey.

"In 2010, the U.S. Economic Development Administration (EDA)-UCEDC partnership supported 45 businesses across New Jersey with over $1 million in loans. This assistance, which is expected to leverage over $2.3 million in total investment in the state's economy, is helping to spur the creation of nearly 200 new jobs and ensure the retention of more than 230 existing jobs. Of the businesses assisted, 10 are minority-owned, 19 are women-owned and 14 are start-up companies." *Ellen McHenry, Senior Director of Financial Programs, UCEDC.*

UCEDC made its first agricultural loan in 2011 as part of a planned move into agriculture in recognition of growth in the region's small- and midscale farming sector's prospects for providing fresh and local foods to urban markets. Loan officer Ellen McHenry said, "We feel if we have a couple of these loans going forward, we can put together more of a marketing plan and have dollars set aside for agricultural loans." Part of the successful outcome so far for that loan is the ability of UCEDC to enter the farm into a credit reporting service for small-scale entrepreneurs.

The Credit Builders Alliance is a nonprofit organization dedicated to building the credit records of limited-resource business operators so they can more easily gain access to financing in the future. Seeded by the Association for Enterprise Opportunity and the Center for Financial Services Innovation, the Credit Builders Alliance helps community lenders report loan repayment data to the major credit bureaus.

Getting her first farm borrower into the system was an important outcome for McHenry because of the asset-building power of a strong business credit record.

"Our farm loan helped a farmer get into a system that enables future loans," she said.

TECHNICAL ASSISTANCE

CDFIs interviewed emphasized the critical need to provide business and financial support to this sector to help it grow, prosper, and meet its economic and production potential. Rather than reject a borrower for lack of assets and equity, the CDFIs interviewed are engaged in helping borrowers build up their assets. They work creatively and collaboratively to develop loans and packages of assistance that improve the borrower's financial position.

Necessary business supports include the development, regionally and nationally, of a network of accessible and qualified technical assistance resources that provide business guidance such as financial modeling, legal advice and marketing, as well as product-specific agricultural knowledge. Necessary financial supports include financial counseling, direct lending, and partnership lending with other organizations such as banks, public sector loan fund entities, credit unions, social investor groups, philanthropic organizations and similar mission-driven entities to increase access to funding opportunities and ensure that borrowers enter into appropriate financial arrangements.

CDFIs stress the role of technical assistance in the overall success of the loan. Planning out the technical assistance strategy and aligning appropriate resources strengthen the CDFIs' ability to lend into emerging small- and midscale farming. CDFIs suggest that effective technical assistance increases the business viability of the borrower and mitigates risk considerations of the lender. Technical assistance in this context is broadly defined as business development support — in particular, business plan development and financial management capacity building.

> **"There is not a cookie cutter approach to lending because there are so many variables. That is one of the lessons. A CDFI really needs to do a business plan to understand if there is a role for you and where in the supply chain it makes sense to lend. It's critical to know the whole sector and understand where the funding sources are for rural and urban agriculture. You will find your niche as you build partnerships and offer loans to borrowers trying to make it."**
>
> *Rick Larson, CEO, NCIF*

The timing of technical assistance is critical. The most effective technical assistance is proactive: it is delivered before a potential borrower even fills out a loan application. It is also preemptive: it is a resource available to the borrower before problems arise or at the first hint of trouble brewing.

THE NATURAL CAPITAL INVESTMENT FUND

Staff members at the Natural Capital Investment Fund (NCIF), which serves West Virginia, North Carolina, Virginia, and the Appalachian regions of Ohio, Kentucky and Tennessee, first set out to learn about the markets in which farmers saw themselves as competitive. NCIF personnel believed that increasing staff understanding and board knowledge of agricultural sectors and lending was critical to making good underwriting decisions about sustainable agricultural enterprise opportunities.

NCIF built its capacity to review projects by developing an understanding of the role, capacity and value of strategic partnerships in those markets.

For example, NCIF's strategic partnership with the North Carolina Department of Agriculture and Consumer Services (NCDA & CS) led to the development of a special lending program for limited-resource and minority farmers growing commodity grains. With the close cooperation of a range of partners such as NCDA & CS, black farmer cooperatives, state and local resource providers, and private sector representatives, NCIF crafted a joint microloan/grant program that made on-farm grain storage affordable for limited-resource farmers. NCIF utilized a wide range of funding sources, from foundations and the NC Tobacco Trust Fund

Commission to a farmland preservation trust fund, to finance the project. The grain bins funded through the program have given 20 farmers the ability to utilize futures contracts and sell grain when the market is most favorable. NCIF's long-term goal is to help these farmers use their increased farm revenues to explore diversification into sustainable agricultural practices.

Ultimately, the unique nature of farm financing led NCIF to create a dedicated agricultural loan committee composed of lenders and technical assistance providers familiar with the sector. Loan applications are assessed by applying NCIF's underwriting standards and the enterprise's technical assistance needs, and looking at how the loan could be packaged using applicable resources. The committee has enabled NCIF to create a "continuum of lending" in which partnerships are vital. NCIF can either make the loan outright or take a position in the loan that offer other lenders or agencies a role that helps accomplish their objectives and make deals happen.

In this rapidly changing small- and midscale agricultural sector, agricultural sector lenders are increasingly dedicating staff time and creating review committees with people who understand and promote agricultural lending. Coastal Enterprises, Inc., a CDFI in Wiscasset, Maine, chose to create an in-house agricultural technical assistance program to target agricultural sector development work in Maine.

Gray Harris, director of sustainable agriculture at Coastal Enterprises, Inc., and an FFUS team member, offers this guidance for developing an in-house agriculture program:

The Point Person

As the direct connection to the agricultural sector in the region served, the point person functions as an agricultural borrower "pipeline builder," offers initial applicant assessment, coordinates technical assistance and engages the resource network; understands the broad economic context and the agricultural sector's place in it; acts often as liaison between the borrower and the lender; and serves as a clearinghouse to improve sector-specific capacity building.

Agricultural Sector Network: Engagement and Collaboration

Technical assistance will likely come from more than one source, with the ultimate goal of having farmers produce financially viable business plans and cash flow projections.

Effective technical assistance is coordinated with the ultimate goal of having farmers produce a reliable business plan and useful cash flow projections. CDFIs acknowledge that this sector requires on-going knowledge building and expanded networking as markets evolve.

Dedicated Agricultural Lending Staff Members

Many community-based lenders do not have the luxury of one dedicated agricultural lender, yet they must build in-house knowledge to increase their capacity to lend into the sector. Sector-specific knowledge and dedication and commitment to mobilizing capital for the evolving small- and midscale agricultural sector are necessary to ensure a successful deal structure, an efficient approval process and effective capital deployment.

Loan Review Committee Strengths

CDFIs acknowledged that the right mix of sector knowledge on the loan review committee is key to serving the small- and midscale farm operations effectively.

"I cannot overstate the importance of business planning and the coordinated, focused technical assistance effort to develop investment-quality business plans," Harris says. "It's the very first step to being able to access financing for farms." Lenders need to be engaged with a network of technical assistance resources to facilitate business planning for borrowers and, ultimately, loans for their portfolios.

Harris, the agricultural point person for Coastal Enterprises, adds, "I'm only as good as the network of people I work with; I could not do this job without collaborating very closely with other service providers in the state that are also committed to and focused on agricultural development." Those resource providers include Cooperative Extension staff members, small-business development agencies, independent agricultural consultants and nonprofits focused on the success of the sector and the viability of local food systems.

A coordinated and committed network of service providers and other partners is essential not only for technical assistance but also for expanding capital available to the sector. Community-based lenders such as CDFIs are uniquely positioned to move capital into the sector because of their mission-based approach and extensive experience in helping businesses develop their plans and leverage resources for success. In addition to linking technical assistance resources, they are also in good position to pull together capital resources and pull in more lenders through participation loans and other approaches.

Andrew McIntosh, a trust administrator with The Sustainability Group, is among those who think that CDFIs are important connectors.

"There is definitely a lot of interest in investing in farms, but it's a matter of trying to coordinate and work with the farmers to understand what investors need," he said. "CDFIs play a great role in that they are such a good 'middle man' between farmers and investors."

Investors, such as social investment funds, which make capital available to lenders, also must be able to measure and monitor how effective intermediaries such as CDFIs are in generating desired outcomes with their lending. Many socially responsible investors, for example, are eager to underwrite business and market development needed to make small-scale local farming more viable, and more healthy food options and regional economic resilience possible. Yet to move their capital forward, these investors must be able to evaluate lending intermediaries for their ability to produce triple bottom line outcomes.

This is especially true given the fact that even the most successful small farm is not a high-return, fast turnaround deal for investors — those moving capital into the sector must be patient and motivated by more than money. Socially responsible investors are key also because of the upfront subsidization needed to cover risks and transaction costs inherent in making small-scale loans into an emerging and under-resourced sector.

Socially responsible investment is fundamental to the sector's development, says Anthony Chang, director of lending at California FarmLink in Santa Cruz, who also has 10 years' experience at the Opportunity Fund, a CDFI in San Jose.

"Unless social investors underwrite and take the risk on a loan under $50,000, someone else has to do it, and it has to be subsidized," Chang said.

He does not suggest that the sector is high-risk, only that patient upfront capital is needed, along with strategic and proactive approaches to lending into the sector. He further notes that lenders can be most effective in the sector and with their investors by taking a targeted market approach. Rather than position themselves as lenders of last resort, offering standard financial products and waiting for borrowers to approach them, lenders can instead design financial products and services to fit borrower realities and target outreach to those most bankable. Many such farms exist in the broad field of small- and midscale diversified agriculture. Yet many go without financing because lenders are not looking for them and are often unable to tell bankable from non-bankable opportunities because of lenders' previously mentioned lack of familiarity with the sector and their reliance on credit scores and ratios that do not tell the whole story.

“CDFIs need to go out and find markets,” Chang said. “They need to put effort into selling financial services and products, and targeting the market of borrowers with capacity.” Some tips for doing that include seeking out opportunities to meet experienced farmers who can become advisers. Through experienced farmers lenders can also find accountants and other professional service providers familiar with the sector as well as input suppliers, such as equipment dealers. These contacts can help lenders understand farming activity in their region, find bankable operations, and develop products and services that meet farm borrower needs.

Lenders that take such proactive, targeted steps will be more effective in making loans as well as attracting capital. The need and opportunity to piece together many sources of capital are also relevant. The practice of loan packaging, or aggregation of capital from multiple sources to make a loan deal work, is common in the financial industry. The practice is critical to building access to capital for small- and midscale diversified farm entrepreneurs because assessing risk and servicing loans in the sector is such a challenge. CDFIs are in fact building strategic partnerships with financial capital sources such as banks, community loan pools, public entities and philanthropic investors. The goal is to develop cost-effective, cost-efficient packages of capital.

On the capital side, new interest in agriculture is showing up across a broad spectrum. Social investor networks such as the Slow Money organization and others such as the Business Alliance for Local Living Economies (BALLE) are developing pools of capital to finance sustainable food and farming. Traditional economic development financing programs have also begun to set up new pools of funding for small- and midscale farms. Nontraditional sources such as Internet-based matching of individual investors with food and farm entrepreneurs are also proliferating.

Example: In its inaugural approach to including agriculture as part of its economic development portfolio, the Michigan Economic Development Corporation in 2009 began offering low-interest loans between $5,000 and $15,000 to family farms or nonprofit 501(c)(3) organizations for installing passive solar greenhouse systems, also known as hoop-houses. The Michigan Legislature cited the loans as a great opportunity for farmers or nonprofits to extend Michigan’s growing season when making the loans, which the legislature made possible with Public Act 242 of 2009. It brings together a partnership of the Michigan Economic Development Corporation, the state Department of Agriculture and Michigan State University (MSU). MSU offers business planning and technical assistance to help farmers understand how the passive solar systems can generate gross and net sales at a rate that can make a loan repayable in one to four years.

Example: The Business Alliance for Local Living Economies (BALLE) is a growing network of socially responsible businesses across North America. Its Accelerating Community Capital webinar series (http://

www.livingeconomies.org/events) targets community investors, instigators, organizers, foundations, innovative bankers, businesses looking for capital and anyone committed to unleashing local money to build local living economies, with a focus on family farms.

Example: Crowd funding is emerging as an alternative method to raise funds for small agricultural enterprises. In addition to enabling individuals to help finance small agricultural enterprises, a crowd-funding platform can be a way to share information about sustainable agricultural methods. ShadeFund (http://www.shadefund.org) combines philanthropic and corporate capital with individual tax-deductible contributions to fund loans to sustainable agricultural enterprises and other small green businesses nationwide.

Slow Money is a spreading network of investors focused on building the health and resilience of communities by financing sustainable local development. Food and farming is a fundamental component of the Slow Money focus. Slow Money chapters across the country have strong potential to link their members to the small farm and local food economy deals that community-based lenders can help orchestrate.

Anthony Chang is among those working to build pathways for investors involved with Slow Money. He found that such investors face the same challenges as most lenders related to this sector. Bridging gaps in business planning and risk assessment requires the kind of facilitation that Chang was able to provide in several San Francisco-area deals. He helped facilitate a $37,500 farm loan in February 2011 from six individual Slow Money investors and three smaller Slow Money farm loans (two for $5,000 and one for $12,000) from six individual Slow Money investors.

Mark Reed, financial adviser with RBC Associates, manages a portfolio of loans to nonprofits on behalf of private capital sources. He suggests that collaborations among social investors, community lenders and others can result in innovative tools and resources. One example is the New York Acquisition Fund, which serves the nonprofit housing development sector. The Acquisition Fund is a $100 million fund capitalized with initial risk capital from various foundations. The Acquisition Fund's role is to help nonprofit housing developers to maintain a competitive edge in property acquisition.

Philanthropic dollars are also circling around the sector as organizations such as the Sustainable Agriculture and Food System Funders Network explore ways to deploy dollars in support of healthy food systems most effectively. USDA Farm Services Agency and Farm Credit Services, whose missions and regulatory responsibilities are agriculture-specific, have products and programs that uniquely position them as allies and partners in expanding sources of capital.

The potential to leverage this interest and investment will require increased partnership development, attention to needed benchmarks, food system awareness and related infrastructure development.

"The problem is not attracting capital. The more important piece is finding flexible capital so that the farmer has the chance to pay it back."

Anthony Chang, Director of Lending, California Farmlink

The multiple benefits of family-scale, locally based farms in the food business are drawing attention and investment to the sector. The private and public institutions and initiatives involved recognize the triple bottom line value of having such enterprises on the land, in the economy and at work generating healthy options in the current industrialized and consolidated food system. The increasing successes of such farms and tremendous innovation in the sector are additional attractors.

Much of the early capital is coming from patient sources. Yet, this emerging farm sector experiences trial and error capacity development among lenders new to financing farming, and uncertain pathways between those desiring to make investments in the sector and expected outcomes. As the FFUS project research and case studies demonstrate, most lenders and organizations involved in small-farm production lending are feeling their way, relying on relationships and partners and building knowledge and systems as they go.

Moving pent-up capital forward and stimulating a stronger overall flow to the sector will require investment in research, training, and other means of building the capacity and confidence of investors and lenders. Future success calls for a concerted, collaborative effort to link and support those with expertise and those who are learning and engaging as lenders in the sector.

A national network of learning communities is a potentially powerful and effective approach. Funding and facilitating such a network is a bigger question. But it's one that stakeholders could more easily answer if they come to it with a common understanding and approach.

Learning circles and communities of practice are common across emerging areas of interest and engagement. Such knowledge-sharing activity can be highly local, but the potential exists to seed such action at the local and regional levels and then connect the resulting nodes of practitioners and their learning nationwide.

Example: In the Traverse City region of northwestern lower Michigan, a recent meeting at the region's annual Orchard and Vineyard Show brought lenders from the area together with a number of established and start-up wineries to examine gaps in capital available to them.

With actual business examples and local industry data, the session highlighted a problem in the way that lenders appraise the value of a winery's land and other assets. Lenders recognized the need to become more familiar with the winery industry to adjust standard approaches that do not accommodate sector-specific information and have disqualified many bankable wineries.

Lenders encouraged the session's convener, the Agriculture and Food System Sector Alliance of Northwest Michigan, to facilitate more meetings of local farm businesses and area lenders to build lenders' familiarity with the sector and their ability to finance bankable operations that they would otherwise overlook.

Financing of farming in the United States would benefit from focused, funded efforts to connect these investigators and innovators and to synthesize and disseminate their learning. Such an effort would also support development of benchmarks and other metrics needed to facilitate the flow of capital to the sector and evaluate results.

Lending into the small- and midsized diversified farming sector will never approach the cookie-cutter transactional model that has become common in the financial industry, with credit scores and ratios the primary determinants. Though these tools and measures are important, the research shows that they do not provide a complete or reliable picture of the diversified farm's prospects and potential.

Similarly, investors that make capital available to lenders need better measures and monitoring of the outcomes they expect. To move capital into the sector, they need to know which lenders are most effective in generating whatever it is that represents positive return on investment for them: jobs, environmental benefits, access to healthy food, local economy resilience, etc. This is particularly important given that farming in general does not generate fast or high financial returns — the investor must have other reasons for putting money into the sector and the ability to measure outcomes.

Such financial and nonfinancial metrics for the small- and midscale diversified farming sector are emerging piecemeal and in anecdotal, ad hoc ways. The opportunity is to systematize the collection and dissemination of information so that every learning experience adds to the whole knowledge base and results, eventually, in metrics that can assist with assessment of risk, repayment and return on investment.

CONCLUSION

The time is ripe for a concerted effort to build lender capacity to both make loans into the small- and midscale diversified farming sector and demonstrate to capital sources their effectiveness in achieving triple bottom line outcomes. Capital will begin to flow more smoothly to the sector once these needed financial and non-financial benchmarks become more widely available for lenders and investors stepping into the highly variable, relationship-based mode of farm lending.

Next steps include:

— Supporting the work of local practitioners, such as community-based lenders, to pull together the technical assistance and capital resources needed to develop a comprehensive and collaborative approach to financing the sector.

— Connecting networks of practitioners so they can share their experience with small- and mid-scale farm borrowers and turn this learning into broadly applicable tools and metrics for other lenders and investors.

The time is ripe because, in regions across the country, small-scale, demand-driven agriculture has achieved a new level of credibility:

— Community development lenders are seeking out this sector, building their capacity to bring in other partners and developing risk assessment capacity.

— Public sector policy is taking on the public health and economic development potential of small, local agriculture with investment, for example, in regional food hubs and local food policy councils.

— National initiatives such as HFFI are bringing attention to financing needs of the emerging healthy food system.

— Many private initiatives, such as Slow Money, are engaging networks of private and philanthropic capital sources.

— Small and emerging agriculture in the United States has demonstrated vitality and economic potential, but its resource base is highly fragmented. Agriculture does not operate under a common business model like that of a bodega, a hair salon or a small apartment building. These unconventional factors demonstrate the need for the sector to build a commonality of knowledge and experience to ensure that producers, entrepreneurs and the technical assistance resource pool have the tools that are necessary for continued growth and expansion.

Community development lenders are perfectly positioned to support this specialized niche. CDFIs, for example, take lending approaches that have economic development at their core, relying more heavily on future performance than on historic benchmarks. They also work upfront to provide the technical assistance support that significantly increases a project's likelihood of success.

Finally, the time is ripe for greater attention to the financing needs of small- and midscale diversified farming because the sector has moved from the fringes to the mainstream of the food economy. It is still small, but a shift is under way that has the potential to bring agriculture back into lenders' portfolios. After several decades of small farms shutting down, a new crop of small farms are in fact opening up and expanding.

CDFI Self-Assessment Tool: Determining Sector-Lending Capacity

CDFI Self-Assessment Tool: Small/Medium Scale Agriculture Sector Lending					
I. Mission					
Is an agricultural lending program in alignment with CDFI's core mission?	⊇ yes	⊇ no			
Has the CDFI designated the agriculture (ag) sector as a strategic priority?	⊇ yes	⊇ no			
II. Market Analysis--the Landscape					
Is there demand from the market/sector to engage in agricultural lending?	⊇ yes	⊇ no			
Is there competition from other lenders/financial institutions in the sector?	⊇ yes	⊇ no			
Is there competition from other lenders/financial institutions for funding for the ag lending program?	⊇ yes	⊇ no			
What is the size of the borrower market?	⊇ many	⊇ avg	⊇ few		
What is the risk profile of the average borrower?	⊇ high	⊇ medium	⊇low		
Does the CDFI have connections with TA, business development services (BDS) and other resources in the ag sector?	⊇ yes	⊇ not currently			
What is the political environment?*	⊇ highly favorable	⊇ favorable/neutral	⊇not favorable		
III. Capacity					
Does the CDFI have internal resources to do market outreach and data collection to develop ag lending program?	⊇ yes	⊇ no			
Does the CDFI have internal operational capacity to manage an ag lending program?	⊇ yes	⊇ no			
Does the CDFI have internal lending staff resources to develop an ag lending program?	⊇ yes	⊇ no			
Does CDFI have agricultural underwriting/lending experience?	⊇ yes	⊇ no			
Is the CDFI willing to develop ag lending capacity--through training, hiring staff, etc?	⊇ yes	⊇ no			
Does the CDFI have a staff champion for the ag sector?	⊇ yes	⊇ no			
Does the CDFI currently have staff with industry knowledge of the ag sector?	⊇ yes	⊇ no			
Will the CDFI need to raise funds for ag lending program?	⊇ yes, to support lending staff	⊇ yes, to capitalize loan fund	⊇no		
Would the CDFI consider developing an ag TA program in house?	⊇ yes	⊇ no			
IV. Financial Analysis					
What is the risk tolerance of the CDFI in ag lending?	⊇ high	⊇ medium	⊇low		
Does the CDFI have financial resources to develop an ag lending program?	⊇ yes	⊇ no			
Does the CDFI have internal loan capital for an ag lending program?	⊇ yes	⊇ no			
Does the CDFI have internal loan loss reserves for an ag lending program?	⊇ yes	⊇ no			
Potential sources of ag lending funds	⊇ federal	⊇ state	⊇financial institution	⊇ foundation/donor	⊇ other
Annual projected interest income from ag lending activity?	⊇ high	⊇ medium	⊇low		
What is the organizational risk?	⊇ high	⊇ medium	⊇low		
Are their costs associated with source of ag lending funds?	⊇ yes	⊇ no			
Are you able/willing to do multiple deal structures in this sector (e.g. sub-debt, othe partnerships, direct, pari passu)?	⊇ yes	⊇ no			
Can you provide flexible repayment schedules based on borrower cash flow?	⊇ yes	⊇ no			
*"Political environment" refers to such things as pressure or support to enter the sector from the industry; of 'turf' issues around engagement with the sector from other organiations, lenders; or if the literal political environment (e.g., legislature, etc.) is positive or negative for sector involvement					

The self-assessment tool is designed to walk a lender through an evaluation of critical organizational capacity requirements that enable lending to the emerging and small-scale agricultural sector. A lender may use this tool to evaluate the skills and resources it has already established or would like to develop, and can help target those efforts. It is important to distinguish that a lender may provide loan capital or technical assistance or both, and should evaluate its commitment and capacity to target its best fit rather than trying to meet all needs. Questions to ask include:

- Sector support: Is there a subset that it would like to support in this sector, either by type of borrower, based on the spectrum shown above, or local market needs?
- Specialized technical assistance support: Is there an in-house skill such as negotiating land leases or contracts, special crop expertise, specific loan agency guaranty programs and the like?
- Partnered technical assistance support: Are there close ties with refugee agencies or other nonprofits that provide access to small plots of land; extension services; specialized agricultural agencies or technical assistance resources; business support services such as SCORE, SBDCs, and local business professionals such as accountants, attorneys and the like?
- Direct lending: Is there a need in the community that the lender can support; are there adequate loan capital and risk-appropriate reserves; and is there lending expertise?

- Partnered lending: Is local support, such as through foundations, agencies, or other nontraditional lenders, local banks and conventional lenders, or other loan capital available?

Effective lending requires a good and broad knowledge of the sector and a articulated, strategic commitment to reaching that sector. The following core elements should be assessed:

- Commitment from the board and/or senior management.
- Identification of and understanding of how local/regional resources support this sector.
- Designated loan and loan loss reserve capital for the lending program.
- Aggregate size of the loan pool.
- Range of individual loan sizes (minimum and maximum).
- Partnered lending arrangements to allow a diversity of transactions.
- Specific loan loss reserves as a percentage of the portfolio.
- Defined lending capacity, staffing resources and operational capacity.
- Are there dedicated lending personnel who have or can develop knowledge in this sector? Are learning resources available to lending staff members who need skill development?
- Is there a defined approval process to ensure timely lending decisions, particularly given the need for funds in specific seasonal time frames? Is there a specific loan committee that can be responsive to the unique aspects of this sector?
- What is the staff capacity to support billing, payment and reporting activity for a number of small loans that may be single-season or multiyear?
- Can the loan system support a flexible repayment schedule and, depending on the lending niche, cash payments?

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