

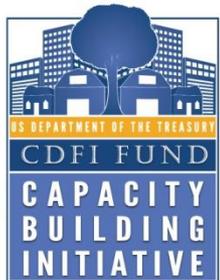


Financing Mid-Tier Healthy Food Enterprises

Tools for Successful Underwriting

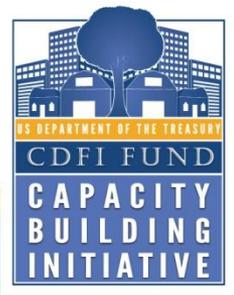
Ginger McNally

May 16, 2012



Introduction

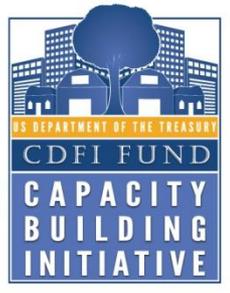
- CDFI Fund's Capacity Building Initiative
 - Financing Healthy Food Options
 - Workshops
 - Technical Assistance – individual and group
 - Resource Bank



Today's Webinar Topic

Mid-Tier Food Enterprises: Tools for Successful Underwriting

- Why?
 - Define and understand Mid-Tier Food Enterprises
 - Learn how to effectively lend to these businesses



Presenter

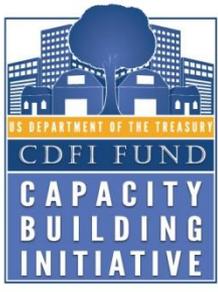


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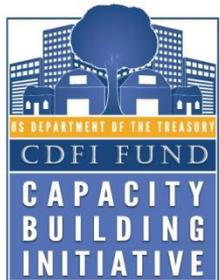


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Tools for Successful Underwriting

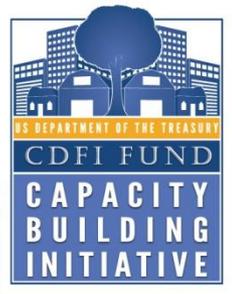
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Overview of Webinar Content

- **WHAT:** Learn how to lend effectively to food-related businesses.
- **WHY (Lender Benefit):** Increase loan volume and diversify loan portfolio, strengthen relationships with low-income communities and build potential access to new markets, improve bottom line – make money.
- **WHY (Public Benefit):** Increase access to healthy food in low-income communities, contribute to sustainable community health - physical, economic, and environmental.



Understanding the Healthy Food Continuum

Food Production

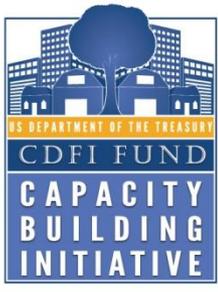
- Farms
- Ranches
- Fisheries
- New Kinds of Farms

Mid-Tier Food Chain Enterprises

- Value-Added Production
- Food Aggregation
- Food Distribution
- Waste Management

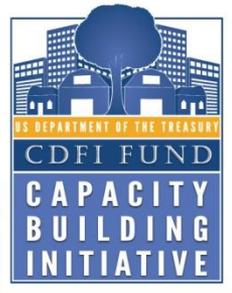
Food Retailers

- Grocery Stores
- Food Co-Operatives
- Public Markets
- Farmers' Markets
- Community Supported Agriculture
- Mobile Vendors



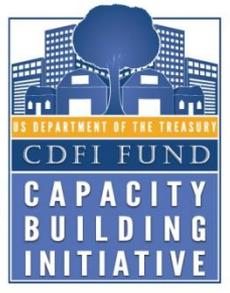
Main Activities of Mid-Tier Food Chain Enterprises

- Value-added production
- Food aggregation and distribution
- Waste management



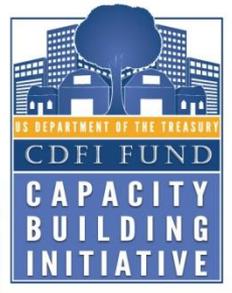
Key Characteristics: Value-Added Production

- Increase value by modifying raw ingredients into new food products
 - Penny Ice Creamery (retail-first)
 - Happy Girl Kitchen (farm-first)



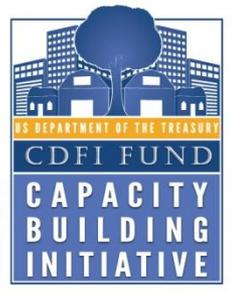
Key Characteristics: Food Aggregation and Distribution

- Putting together food products from multiple providers, or multiple products from several providers, and distributing them to retail and wholesale outlets
 - La Montañita Cooperative



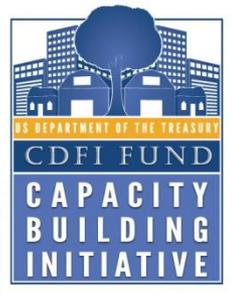
Key Characteristics: Waste Management

- Significant issue for food producers
- Opportunity to create a new product or secondary use of food by-product
 - Phil's Fish Market



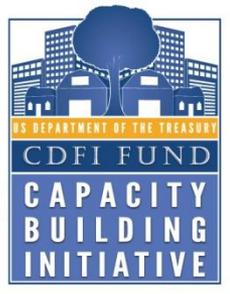
Why Lend to Mid-Tier Food Chain Enterprises - Opportunities

- Opportunities
 - Support start-up and emerging local businesses
 - Serve low-income communities, increase access to new markets
 - Build reputation as a “sustainable” lender
 - Grow loan portfolio
 - Make money



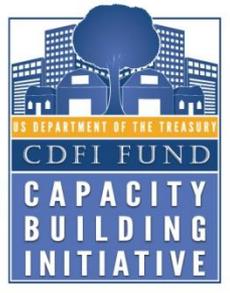
Why Lend to Mid-Tier Food Chain Enterprises – Risks

- Risks
 - Start-up and emerging businesses may need technical assistance and sometimes fail
 - The community may not know to come to the lender with food-related business requests
 - Lenders and supervisors may lack technical skill in food-related businesses or cultural competence working with low-income people and communities of color



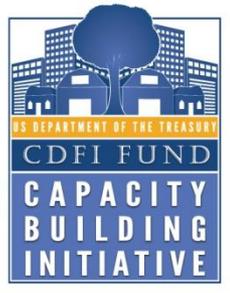
Why Lend to Mid-Tier Food Chain Enterprises - Demand

- Strong demand in many rural and urban communities around the country, but need to verify
 - Ask community partners (Small Business Development Center, Farm Services Agency, Farmers' Market)
 - Attend workshops held by community partners, ask about interest
 - Start small on pilot basis, expand based on customer demand and portfolio performance



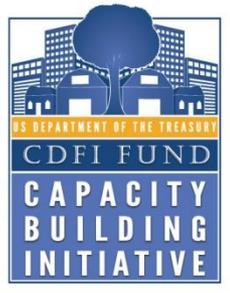
Why Lend to Mid-Tier Food Chain Enterprises – Demand (Continued)

- Potential barriers to demand
 - Competition from other lenders
 - Borrower perception about limited access to credit
 - Lack of readiness by borrower or lender



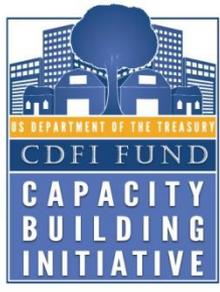
Why Lend to Mid-Tier Food Chain Enterprises – Overcoming Barriers

- Barrier One: Poor or limited credit history
 - Mitigation:
 - Partner with Consumer Credit Counseling, SBDC, others offering workshops and individual counseling
 - Use non-formal credit histories for small loans (utility and rent payments over time)
- Barrier Two: Limited personal identification, especially for informal businesses in immigrant communities
 - Mitigation:
 - Use of ITINs and foreign-issued identity cards (Matrícula Consular)
 - Partner with legal assistance centers and immigrant advocacy groups



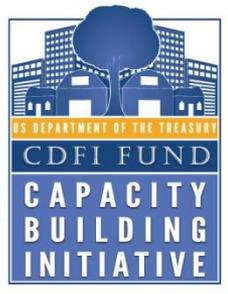
Why Lend to Mid-Tier Food Chain Enterprises – Overcoming Barriers (Continued)

- Barrier Three: Limited collateral or borrower capital
 - Mitigation:
 - Use “stepped credit” starting with small loans, building with successful repayment
 - Peer group lending with group guarantee
- Barrier Four: Limited lender experience with food-related lending
 - Mitigation:
 - You are fixing this!
 - Think ahead to ways to effectively share this knowledge with co-workers



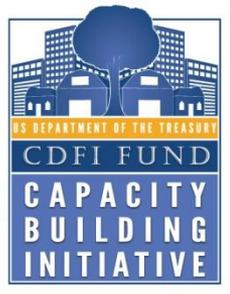
What are the main legal forms for Mid-Tier Food Chain Enterprises?

- Sole proprietorship
 - Most common in U.S., mainly small businesses
 - Easy start-up, hard to raise capital, unlimited personal liability
- Partnership
 - Two or more people, co-ownership of property, may limit liability for some partners
- For-profit Corporation
 - Most common for large businesses, able to raise capital, distribute profits to shareholders, and limit personal liability
- Non-profit Corporation
 - Educational, charitable, social, religious, civic, humanitarian purposes
 - Surplus (profit) not distributed to shareholders, tax exempt status



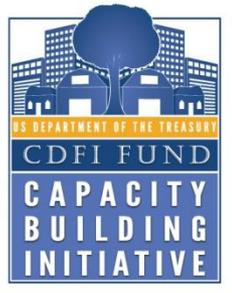
What are the main legal forms for Mid-Tier Food Chain Enterprises? (Continued)

- Cooperatives
 - Voluntary associations for mutual social, economic, and cultural benefit
 - Multiple types of coops and governance structures
- Hybrid Legal Structures
 - Flexible purpose corporation
 - Benefit corporation
 - Low-profit limited liability company (L3C)
 - B corporations



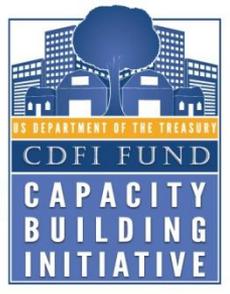
Tips for Underwriting: Assessing the Business Plan and the Borrower

- Encourage the borrower to submit her business plan in her native language and have culturally competent staff
- Listen carefully to the borrower in order to understand her story
- Ask clarifying questions about the business plan to understand if the request makes sense and if it will be viable
- Test borrower's knowledge of the market, analysis of competitive advantage, distribution plan, pricing and break-even, food safety compliance
- Encourage financial education when appropriate



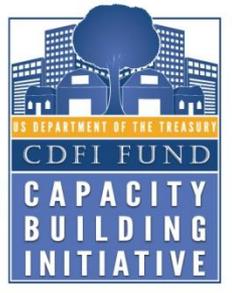
Tips for Underwriting: Evaluating the Loan Request

- Using the five “Cs” of credit
 - Character
 - Capacity
 - Capital
 - Collateral
 - Conditions
- Importance of non-financial as well as financial capacity of applicant
- “Trust but verify”



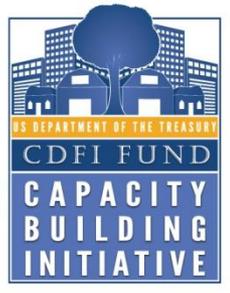
Tips for Underwriting: Looking at the Numbers (Profit and Loss)

- Profit/Loss Statement
 - Provides a snapshot of income and expense over a defined period of time
 - Examine multiple time periods (monthly and annually)
 - Food-related business may experience strong seasonality



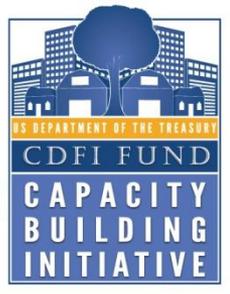
Tips for Underwriting: Looking at the Numbers (Balance Sheet)

- Balance Sheet
 - Shows financial results of business operations since inception, incorporates all profit/loss from business activities
 - Illustrates financial worth of the business in terms of what is owed and what is owned (Assets = Liabilities + Equity)
 - Does not reflect non-financial impacts of its business activities on the community
 - Employment provided
 - Links to educational opportunities
 - Environmental impact



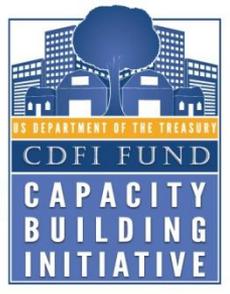
Tips for Underwriting: Looking at the Numbers (Cash Flow Statement)

- Cash Flow Statement
 - Shows the timing and amount of cash flowing in (sources of funds) and cash flowing out (uses of cash) of the business
 - Cash is the source of loan repayment, so important to clearly understand the cash cycles
 - Primary cash flow activity for most food-related businesses is from operations, secondary is investment in equipment, tertiary is from financing activities



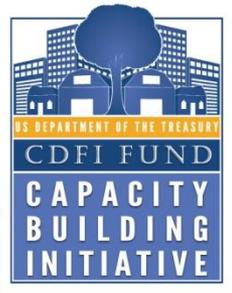
Tips for Underwriting: Looking at the Numbers (Budget)

- Annual Budget
 - Budget is the plan for the business's financial operations for future periods and provides framework for measuring financial performance
 - Important to look for adequate projected expense for food safety compliance – a growing area!



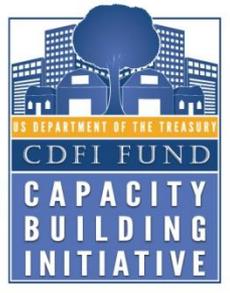
Tips for Underwriting: Looking at the Numbers (Key Financial Ratios)

- Key financial ratios
 - Liquidity
 - Debt Coverage
 - Leverage
 - Operating



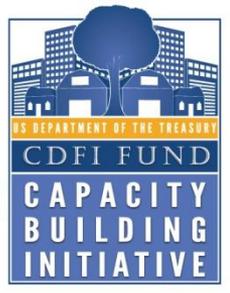
Tips for Underwriting: Looking at the Numbers (Liquidity Ratios)

- Liquidity Ratios
 - Demonstrate the quality and adequacy of current assets to meet current obligations
 - Show the business's ability to quickly convert assets to cash in the case of business failure and liquidation
 - Current Ratio
 - Total current assets/total current liabilities
 - In general, the higher the ratio, the stronger the business
 - Quick Ratio
 - Cash, cash equivalents, and receivables/total current liabilities
 - Tougher measure than current ratio, also known as "acid test" because eliminates inventory and less liquid assets
 - In general, the higher the ratio, the stronger the business



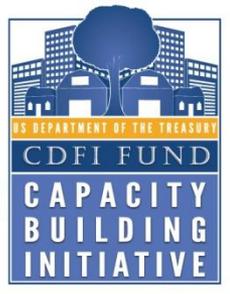
Tips for Underwriting: Looking at the Numbers (Debt Coverage Ratios)

- Debt Coverage Ratios
 - Measure a business's ability to service its debt
 - Earnings before Interest and Taxes (EBIT)/Interest
 - EBIT/Interest Expense shows whether a business is able to meet its interest payments and has the capacity to take on new debt
 - In general, the higher the better



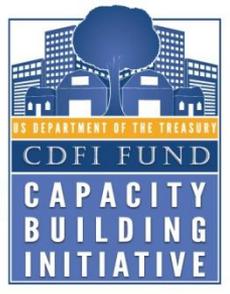
Tips for Underwriting: Looking at the Numbers (Leverage Ratios)

- Leverage Ratios
 - Measure how much of a business's assets are owned by creditors
 - Debt/Equity
 - Total liabilities/tangible net worth
 - In general, lower is better (Conversely, a high debt ratio is “highly leveraged” and undesirable)



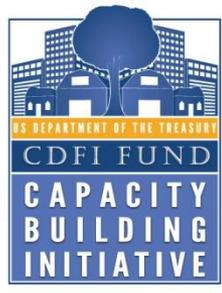
Tips for Underwriting: Looking at the Numbers (Operating Ratios)

- Operating Ratios
 - Help to understand management performance of a business
 - Net Sales/Total Assets
 - Net sales/Total assets shows the business's ability to generate sales in relation to its total assets
 - A high number shows stronger sales relative to assets



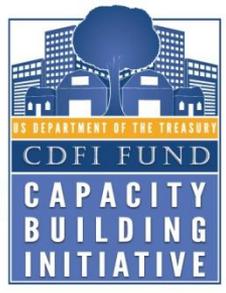
Profile of Value-Added Food Production Enterprise

- Relatively weak current and quick ratios
 - 0.8% current ratio, 0.4% quick ratio
- Quick inventory turn
 - 8.4% cost of sales to inventory ratio
- Decent debt coverage
 - 2.9% earnings before interest and taxes ratio
- Limited debt
 - 2.6% debt to equity ratio
- Moderate sales relative to assets
 - 2.0% net sales to total assets ratio



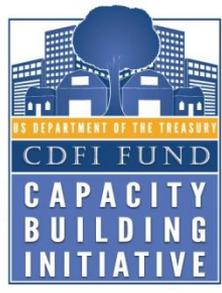
Profile of Food Aggregation and Distribution Enterprise

- Good current ratio but weaker quick ratio
 - 1.5% current ratio, 0.6% quick ratio
- Relatively quick turn of inventory
 - 8.2% cost of sales to inventory ratio
- Average debt coverage
 - 2.8% earnings before interest and taxes ratio
- Carries limited debt
 - 1.6% debt to equity ratio
- Generates relatively strong sales relative to assets
 - 3.0% net sales to total assets ratio



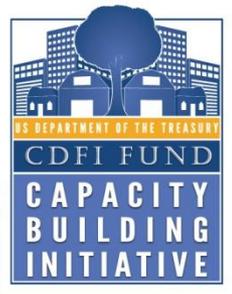
Profile of Waste Management Enterprise

- Relatively strong current and quick ratios
 - 1.4% current ratio, 1.3% quick ratio
- Strong debt coverage
 - 3.7% earnings before interest and taxes ratio
- Carries significantly more debt relative to net worth
 - 4.2% debt to equity ratio
- Generates moderate sales relative to assets
 - 2.5% net sales to total assets ratio



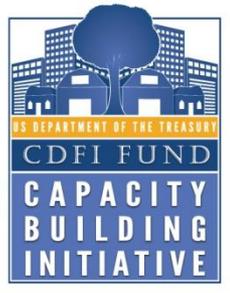
Tips for Underwriting: Loan Products and Structure

- Important to accurately understand credit needs of the borrower and structure the loan appropriately to match source and use of funds
- Loan repayment cycle needs to match cash flow from the business's cash conversion cycle to ensure timely repayment
 - Term loan
 - Longer term credit for purchase of fixed assets such as equipment or real estate
 - Line of credit
 - Shorter term credit for payment of current expenses such as inventory, supplies (working capital)



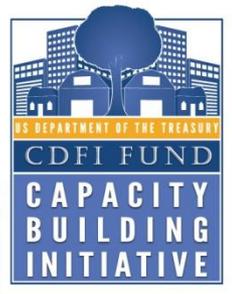
Tips for Underwriting: Mitigating Risk

- All loan requests have risk – try to mitigate when possible
 - Poor credit history or weak business plan – financial education, credit-builder path, technical assistance, mentorship
 - Insufficient collateral or weak net worth - loan guarantees (SBA, USDA, nonprofit development corporations, share secure deposits)
- Limited loan capital available to lender
 - Loan participation – lending partners fund portion of the loan while CDFI retains primary lending relationship with borrower (“Leverage”)



What capabilities and assets does your organization already have or need to put in place to be successful?

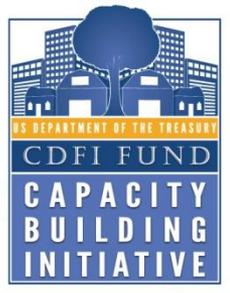
- Strategic considerations
 - Does this fit into the organization's strategic plan?
 - What would the organization have to give up in order to launch this type of lending?
 - How would lending to sustainable healthy food producers benefit the organization reach its broader goals?



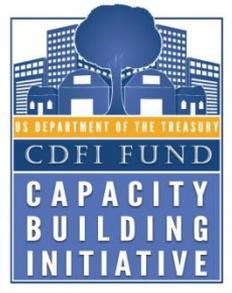
What capabilities and assets does your organization already have or need to put in place to be successful? (Continued)

- Infrastructure considerations
 - Capacity to analyze, underwrite, document, disburse, service, monitor, and collect loans
 - Adequate liquidity to fund approved loans

- Financial considerations
 - Potential cost/benefit to organization
 - Starting slowly, building loan loss reserves
 - Liquidity management



QUESTIONS?





Additional Resources



Financing Healthy Food Options Resource Bank

http://www.cdfifund.gov/what_we_do/FinancingHealthyFoodOptionsResourceBank.asp



The screenshot shows a web browser window with the URL www.cdfifund.gov/what_we_do/FinancingHealthyFoodOptionsResourceBank.asp. The page features a navigation menu on the left with links: WHO WE ARE, WHAT WE DO, IMPACT WE MAKE, NEWS & EVENTS, and HOW TO APPLY. The main content area is titled "COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND" and "UNITED STATES DEPARTMENT OF THE TREASURY". Below this, the page is titled "Financing Healthy Food Options Resource Bank" and lists three main sections: I. Training Curriculum, II. Financial Resources Catalogue, and III. Food Desert Mapping Tools. Each section contains a list of links to various resources. A disclaimer at the bottom states that the documents were funded by the CDFI Fund under Contract TPD-CDF-10-C-0006, Task Order 0001, and that the content is the responsibility of the authors. The page was last updated/reviewed on 12/07/11.

CDFI Fund - U.S. Treasury - [www.cdfifund.gov/what_we_do/FinancingHealthyFoodOptionsResourceBank.asp](#)

Opportunity Financ... CARS™ - Comprehe... Other bookmarks

- WHO WE ARE
- WHAT WE DO
- IMPACT WE MAKE
- NEWS & EVENTS
- HOW TO APPLY

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

UNITED STATES DEPARTMENT OF THE TREASURY

Financing Healthy Food Options Resource Bank

I. Training Curriculum

- [Food Systems Overview](#)
- [Healthy Food Retail Financing](#)
- [Financial Services for Mid-Tier Food Chain Enterprises](#)
- [NMTC & Urban Supermarkets](#)
- [Understanding the Grocery Industry](#)
- [Underwriting Supermarkets & Grocery Stores](#)
- [Mid-Tier Food Chain Enterprises Overview & Underwriting](#)
- [Capitalizing Healthy Food Retail Initiatives](#)
- [Identifying Optimal Areas for Supermarket Development](#)

II. Financial Resources Catalogue

- [Financial Resources Catalogue](#)

III. Food Desert Mapping Tools

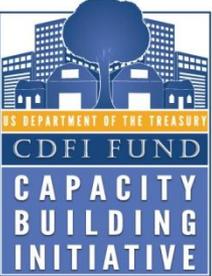
- [USDA Food Desert Locator](#)
- [Policy Map](#)

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Last updated/reviewed: 12/07/11



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CAPACITY BUILDING INITIATIVE
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Final TA Workshops

Farms & Food Production

Boston, MA

May 31st and June 1st

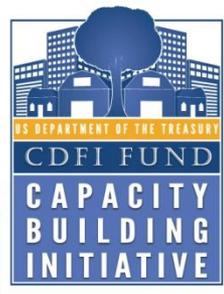
[Link](#) to Training Information & Registration

Food Retailers

Seattle, WA

June 28th and 29th

[Link](#) to Training Information & Registration



Upcoming TA Webinars

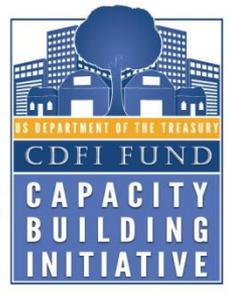
Healthy Food Options Program Design & Social Impact Measurement

•Wednesday, May 23, 2pm EDT

Mind the Gap: Credit Enhancements for Lending to Agricultural Entrepreneurs

•Tuesday, May 29, 2pm EDT

Visit www.opportunityfinance.net/FHFOwebinars/ to register for one or all of the TA webinars



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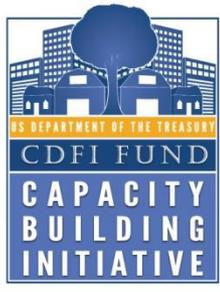
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Tools for Successful Underwriting

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