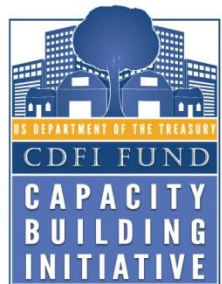




# How to Effectively Underwrite Small & Emerging Farms

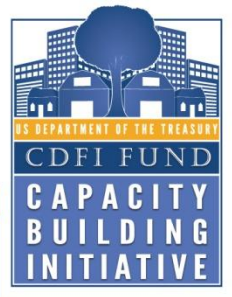
Gray Harris & Denise Dukette

June 27, 2012



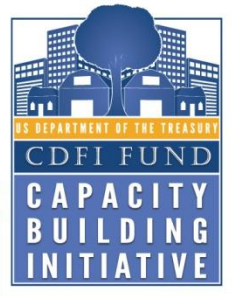
# Introduction

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



# Today's Webinar Topic

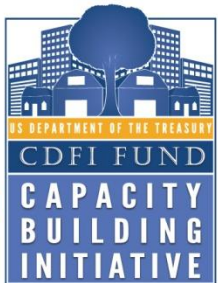
- Understanding the unique nature of loans to food producers
- Redefining the 5 C's of credit for the food production sector
- Assistance in understanding how underwriting factors may change as farm grows



# Denise Dukette



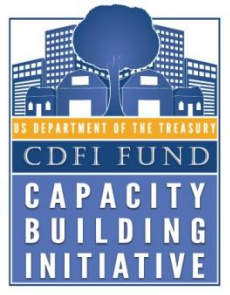
Vice President  
New England Bank  
[ddukette@live.com](mailto:ddukette@live.com)



# Gray Harris



Director, Sustainable Agriculture  
Coastal Enterprises, Inc.  
[gharris@ceimaine.org](mailto:gharris@ceimaine.org)

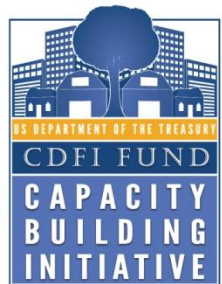




# How to Effectively Underwrite Small & Emerging Farms

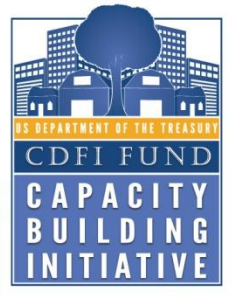
Gray Harris & Denise Dukette

June 27, 2012



# Lending to Small Farms:

- Requires solid lending skills and clear understanding of the sector
- Each farming situation will have unique characteristics
- No rule-book with cut and dried answers to business lending questions
- Critical to have strong partnerships to provide targeted knowledge

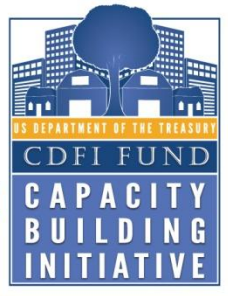


# What is a Small Farm?

We consider a small farm to be:

- Less than \$250,000 in revenues
- Owned and operated by the farmer/farm family
- Fewer than 10 employees

These are farms which are reaching viability or may be viable at current scale but are looking for new markets, are adding new products, or are changing production methods. There are elements of growth and change.



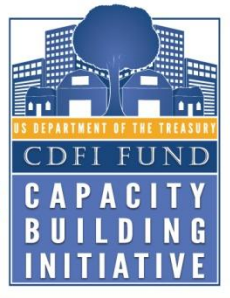


# 5C's of Credit – Redefined!

- The 5 C's are common tools for lending
- Typically they are evenly weighted to make lending decisions

## ***We redefine them:***

*to reflect the realities of the small farm production sector and to better weight them to this sector's risks*



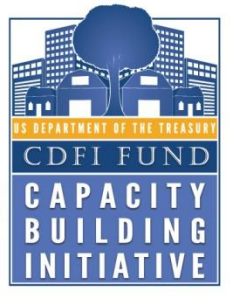
# The 5 C's Redefined:

## *Primary Factors*

- Cash Flow Modeling
- Capacity/Character:  
Farm Management  
Skills
- Conditions: Know the  
Market

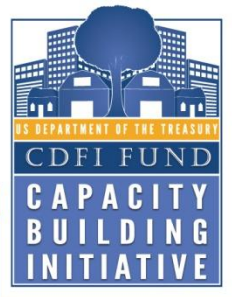
## *Secondary Factors*

- Cash/Equity
- Collateral



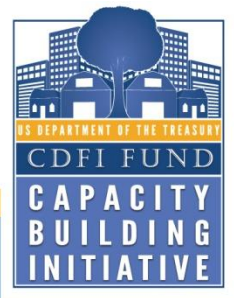
# Primary vs. Secondary

- Primary factors may be deal breakers. They are critical to success.
- Primary factors identify skill and knowledge gaps which may require TA.
- Secondary factors help fine tune a loan decision but do not “fix” issues with primary factors.



# Primary

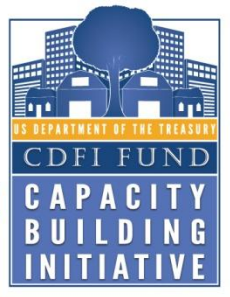
- Cash Flow Modeling – know the cash flow!
- Capacity/Character: Farm Management Skills – not a day job!
- Conditions: Know the Market – if you grow it, you need to sell it!



# Cash Flow Modeling

## *Cash Flow Repays Loans!*

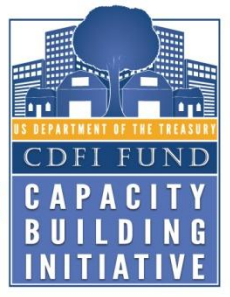
- The loan needs to create increased cash flow in some way – crop diversity, yield, growing season, acreage, access to new markets
- Applicant's viability is likely **not** based on historic performance or independent cash flow support
- Viability is based on taking agriculture experience to a new level (products, growing methods, scale, etc.)



# Understanding Cash Flow Components

## Simple Cash Flow Model:

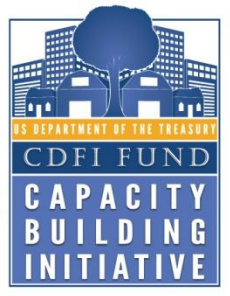
- Single crop or animal breed, clearly defined cash flow cycle
- Cost to plant/buy young animals (cash outlay)
- Grow/raise to maturity (cash outlay)
- Harvest/slaughter and sell (cash inflow)



# Understanding Cash Flow Components

## More complex:

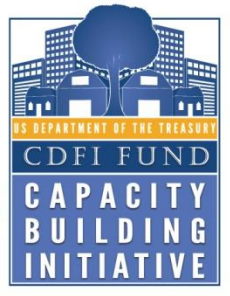
- Multiple crops or animal breeds, each with clearly defined cash flow cycle
- Costs may be staggered depending on when each crop or animal is “started”
- Duration to salable maturity may vary
- Harvesting schedule may vary
- Capital and technology requirements may vary with more farm complexity and more sophisticated markets



# Cash Flow – Complex Small Farm

## A more complex small farm:

- More crops/products may require more capital (barns, tractors, irrigation)
- May require seasonal staff beyond friends and family (payment method, taxes, housing)
- Accurate tax reporting affects access to certain funding programs; running at a loss precludes future lending

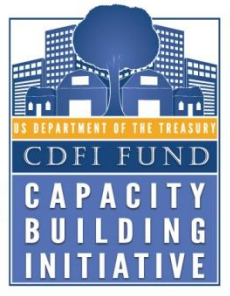




# Cash Flow – Complex Small Farm

## Complexity may be due to nature of product

- Orchard may have disease, insect, or weather issue which impacts entire season
- Livestock may have illness or product scare which affects demand
- Cost, accessibility, and necessity of processing (slaughtering beef if slaughterhouse closes)

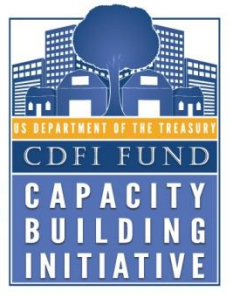


# Cash Flow – Entering New Markets

**Entering new markets will have direct impact on cash flow**

*It is critical to:*

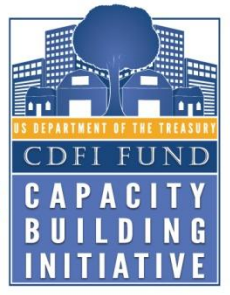
- Determine when to enter a new market
- Assess market demand, pricing, alternative suppliers
- Find entry point into that market
- Analyze costs (time, fuel, packaging) to ensure that pricing targets/profits are achieved



# Cash Flow – Entering New Markets

## Understand changing requirements dictated by market:

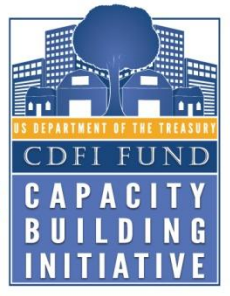
- Bar coding / packaging / branding
- Confirmed quality and quantity on delivery schedule
- Route density to make cost effective/reliable delivery vehicles
- Larger inventory requires storage space
- Excess inventory may warrant processing



# Cash Flow Tools

## Combine products in baseline cash flow

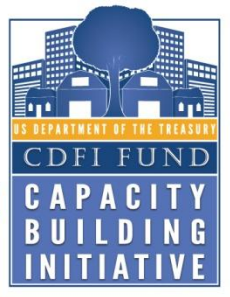
- Need to overlay each existing major product cycle into cash flow
- Overlay new product cash flows into cash flow model
- Monitor overall cash flow as well as by product
- Look for cash flow issues in core operation
- Assess profitability of product lines – not just of aggregate model



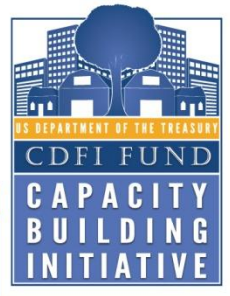
# Cash Flow Tools

## Combine products in baseline cash flow

- What will loan accomplish? Pro forma cash flow model
- Capital expenditures for planned production; long term viability
- Unplanned expenses – disease control, weather, vet bills, repairs, equipment breakdown, increased utility costs
- Major variable costs – fuel to transport product, “raw materials”, fertilizers/feed



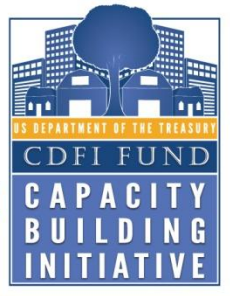
# Capacity/Character: Farm Management Skills



# Farm Management Skills

*Range of critical skills is broad and highly specialized:*

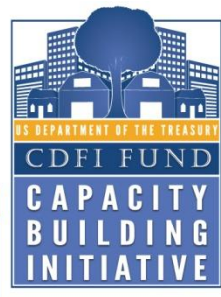
- **Product Expertise** – raise/grow product, weather, disease/illness, changing demand, product development
- **Marketing** - identify markets, determine accessibility, product and sale requirements, payment cycle and method
- **Practical Skills** - equipment maintenance, mechanical ability, resourcefulness
- **Logistics** - get to market, route density, accessible markets



# Farm Management Skills

*Range of critical skills is broad and highly specialized:*

- **Staffing** - seasonality, cost, housing, payroll processing
- **Financial Management** – cost controls, cash flow modeling, financial reporting, invoicing and receivable collection, budgeting
- **Capital Needs** – understanding equipment/facility needs
- **Regulation** - regulatory, zoning, land use requirements
- **Sector Knowledge** – changing requirements, regional and national trends, food habits

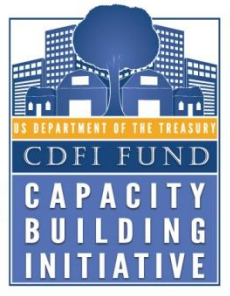




# Farm Management Skills

## **As farm grows, so does the needed skill set:**

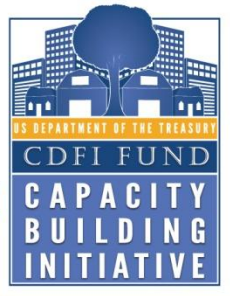
- Production, crop rotation, land management
- Equipment needs, multi-year debt
- Fencing, irrigation, storage
- Delivery logistics – quality and quantity
- Larger cash seasonal demands
- Human resource management



# Farm Management Skills

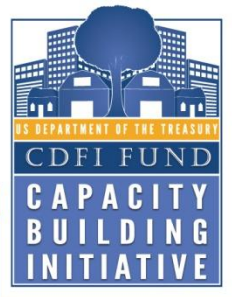
## **As farm grows, so does the needed skill set:**

- Insurance/financial/legal resources
- May be difficult to keep all the balls in the air
- Individuals are still critical to success – illness or incapacitation can be big issue
- May not have time to access needed TA resources – too busy in the day to day
- Can over-extend physically, financially or to customers. Hard to retrench or regroup



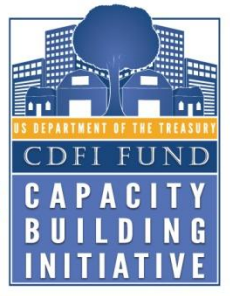
# Farm Management Skills: some considerations

- Business management skills are difficult to assess
- Young farmer is unlikely to have resume showing practical experience in skill areas
- Knowledge historically acquired from established farmers, prior generations
- Growth in small farm sector reflects new products, new demand, new methods
- Difficult to apply traditional knowledge relied on in the past



# Farm Management Skills

- No single skill will provide the basis for success but lack of a critical skill can be a recipe for failure
- A good farmer-borrower is a risk-taker, identifies unmet needs, and expands/adapts to fill that gap in an appropriate and planned way
- Entrepreneurial spirit is critical to successful small farms which must continually adapt to a changing marketplace and landscape



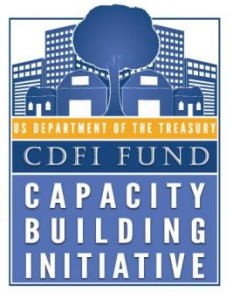
# Farm Management Skills

## Lender needs to assess Borrower's:

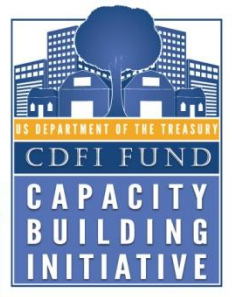
- Commitment to the lifestyle
- Ability to access industry resources as needed
- Critical farm management skills
- Ability to respond to change: crop/product, regulatory policy, environment, markets

## If a more complex farm, need to assess:

- Capacity to handle larger operation



# Conditions: Know The Market



# Know the Market

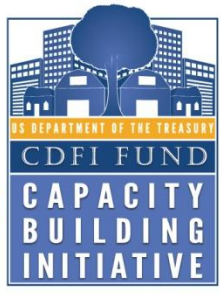
## Common Markets for Simple Farms - Direct Retail: *CSAs and Farmers Markets*

### Pro

- Easy access for many types and scales of farm activity
- Can sell in small quantities and as product is available
- No future commitments or obligations
- Fits well with other markets such as restaurants, farm stands
- Cash basis; no complex payment terms

### Con

- No control over the market, limited pricing leverage
- Doesn't facilitate entry to larger or institutional markets
- Limited marketing/branding outside of market
- High time/cost to get product to "customer"; low yield



# Know the Market

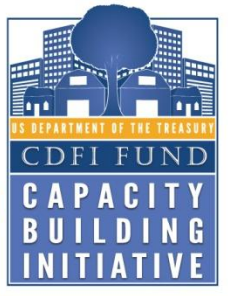
## Common Markets for Complex Farms – *Institutional Buyers / Wholesale / More Diverse Customers*

### Pro

- More reliable cash flow
- Larger dollar, single deliveries; route density
- Committed product demand
- Less time spent at markets waiting for buyers

### Con

- Stricter requirements (quality, quantity, packaging, delivery)
- Wait for payment; invoicing, collection efforts
- Changing staff in institution requires new connections

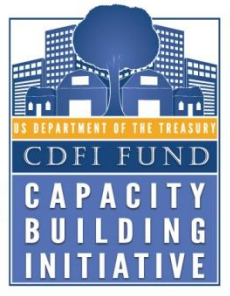




# Know the Market

**Farm scale may dictate the market; market accessibility may also direct farm scale.**

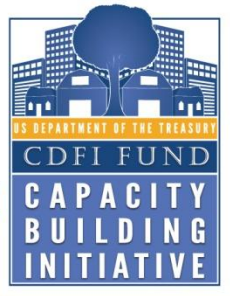
- Strong marketing skills necessary to assess and gain entry to new markets
- Must identify optimal markets, determine proper pricing, obtain contracts, ensure that delivery goals are met
- Lack of aggregation and distribution infrastructure places burden on farmer to develop marketing approach and logistics planning to get to market.
- Cooperative approach may be achieved but requires development of marketing approach and logistics strategy among participants



# Know the Market

## Assessing applicant's ability to get to market:

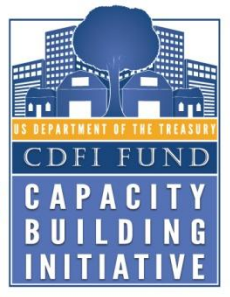
- How shelf stable is the product? Can it be stored for future sale or is it highly perishable?
- What volume is being produced for sale, within a saleable timeframe?
- Distance to sell product? Adequate delivery vehicles or sell on-site and expect a reasonable demand?
- How strong is the demand for the product? Geographic reach? How does price vary within the region? Are there buyer groups who will pay a premium or create consistent demand? Are there institutional buyers who will purchase in bulk?



# Know the Market

## Assessing applicant's ability to get to market:

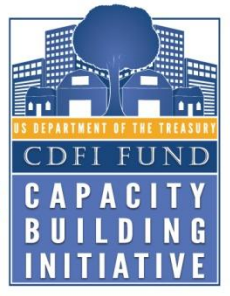
- Are there any selling groups or aggregation/distribution organizations which can provide a larger marketing outlet for the individual?
- How do target customers typically pay? Under contracts, open account, credit card, COD, cash, etc.
- What markets are being sold into – retailers? Restaurants? Consumers? Institutions? Each will have requirements for quality, volume, timeliness, payment methods, and timeline for payment as well as risk of non-payment.



# Secondary Factors

## *Why Are These Secondary Factors?*

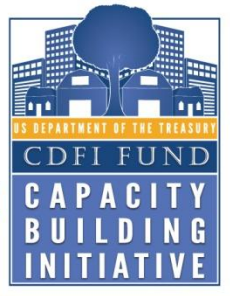
- Not direct indicators of potential success; are fallback positions
- In a young and emerging sector, are least likely to be present in a financing application
- Reliance on fallback reduces emphasis on critical support needs
- Over-weighting will eliminate consideration of viable opportunities



# Secondary Factors

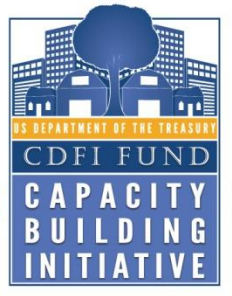
***Rather, success is driven by active support network to access critical resources as needed***

- Very few small farms find appropriate resources on their own; they need TA
- Farmer's strongest skills are specific agricultural or husbandry niche, not necessarily business skills

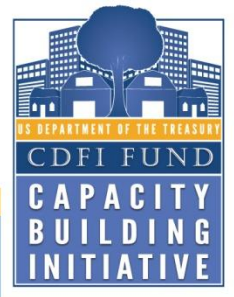


# Secondary

- Cash/Equity – Do you have liquidity to carry a farming loss?
- Collateral – Can you sell assets to generate cash or repay debt?



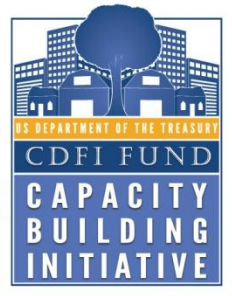
# Cash/Equity



# Cash/Equity

What's the problem?

- Small farms are micro and small enterprises
- The principals often do not have strong liquidity to support enterprise
- Lending decisions often require base liquidity or minimum equity investment
- This can eliminate viable loan candidates

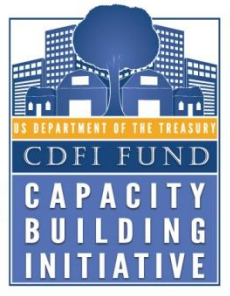




# Cash/Equity

- Small farms typically boot-strap
- Use credit cards for purchases; pay after seasonal sales
- Liquidity is net cash after products sold and bills paid
- Funds are reinvested in the farm; farmers live on limited budget and do not build liquidity
- Farmer and farm are one financial entity; no fallback
- Farmer is core employee – illness or interruption affects production and cash flow

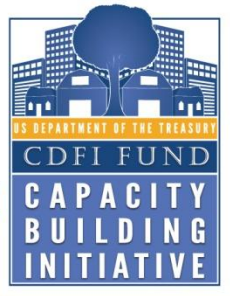
*Lending goal is to strengthen farm cash flow and ensure farm viability and living wage for farmer/family*



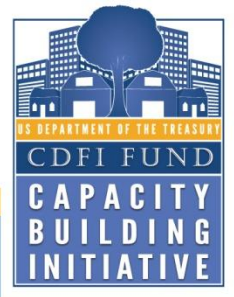
# Cash/Equity

## Mitigants

- May have sweat equity versus cash contribution
- May have co-signer or guarantor
- Fully committed to farming and farming lifestyle
- Can accept and make full use of TA help
- Can adapt to changing environment
- Can leverage growth in sector through entrepreneurial spirit



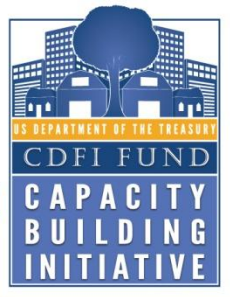
# Collateral



# Collateral

Collateral should be obtained if available BUT is unlikely to be a strong loan fallback if repayment fails

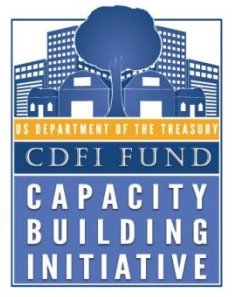
- **Value in farming is of the value of the final product, in its best state of health**
- Maximum asset value is as “going concern” enterprise
- Removal of assets may directly impair farm production
- Interrupted growth cycle may impair product value (i.e., wilted produce, unhealthy livestock)



# Collateral

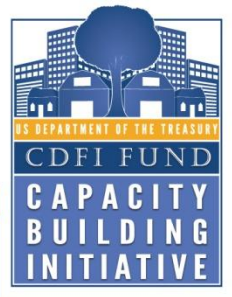
Asset Liquidation Values are hard to define:

- Farm equipment of limited value – small market; individual assets of low value; old or in disrepair
- May not be moveable – a barn, tubing for maple sap collection, irrigation system, HVAC
- Limited secondary market; hard to assign realistic value
- May need to sell through non-traditional methods such as Craig's List.



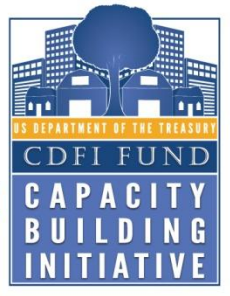
# Collateral

- Standard collateral advance rates may not support loan request
- Small farms typically have limited capital to provide down payment; needed advance rates may be 80% - 100%
- Collateral risk may be mitigated by guarantees, loan loss reserves or other credit support
- Lending requires creative loan structure

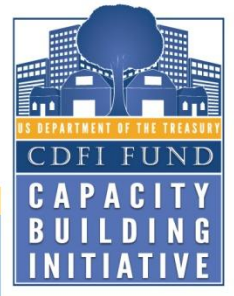


# *Keys to Overall Success: Engage with the Sector*

- *Get to know the Ag sector in your communities:* a strong TA program and network of agricultural service providers help lenders evaluate risk and ultimately help the borrower to obtain credit.
- *Base lending decisions on appropriate lending benchmarks and measures,* weighted to the realities of this sector.
- *Test the fundamentals:* cash flow, market knowledge and conditions, farm management and production capacity.



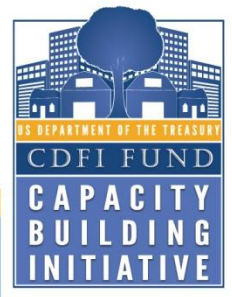
# Question & Answer







# Additional Resources



# Financing Healthy Food Options Resource Bank

[http://www.cdfifund.gov/what\\_we\\_do/FinancingHealthyFoodOptionsResourceBank.asp](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](http://www.cdfifund.gov/what_we_do/FinancingHealthyFoodOptionsResourceBank.asp). The page features a blue navigation menu on the left with the following items: WHO WE ARE, WHAT WE DO, IMPACT WE MAKE, NEWS & EVENTS, and HOW TO APPLY. The main content area has a yellow header with the text "COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND" and "UNITED STATES DEPARTMENT OF THE TREASURY". Below this is a section titled "Financing Healthy Food Options Resource Bank" with three sub-sections: I. Training Curriculum, II. Training Webinars, and III. Additional Resources. A fourth section, IV. Food Desert Mapping Tools, is also present. A yellow banner on the left side of the page reads "The CDFI Fund Has Moved".

- 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](#)
- [Understanding the Food Production Sector](#)
- [Credit Skills for Lending to the Food Production Sector](#)

#### II. Training Webinars

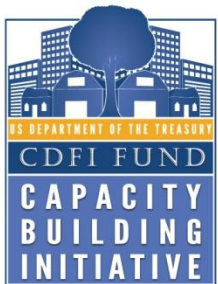
#### III. Additional Resources

- Searching for Markets: The Geography of Inequitable Access to Healthy and Affordable Food
  - [Executive Summary](#)
  - [Full Report](#)
- [Financial Resources Catalogue](#)

#### IV. Food Desert Mapping Tools

- [USDA Food Desert Locator](#)
- [PolicyMap](#)

The CDFI Fund Has Moved



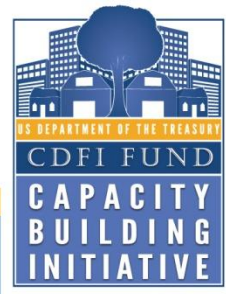
# Financing Healthy Food Options Webinar Archive

[http://www.cdfifund.gov/what\\_we\\_do/FHFOResourceBankWebinars.asp](http://www.cdfifund.gov/what_we_do/FHFOResourceBankWebinars.asp)



The screenshot shows a web browser window with the URL [www.cdfifund.gov/what\\_we\\_do/FHFOResourceBankWebinars.asp](http://www.cdfifund.gov/what_we_do/FHFOResourceBankWebinars.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: Webinars" and includes a note: "Relevant Training Curriculum chapters can be found on the Resource Bank's [main page](#)." The page lists four main sections of webinars, each with a list of resources:

- 1. PolicyMap and Using Limited Supermarket Analysis in Your Target Market**
  - [Webinar 1 Presenter Biography](#)
  - [Webinar 1 Accompanying Presentation](#)
- 2. Healthy Food Options Program Design and Social Impact Measurement**
  - [Webinar 2 Presenters Biographies](#)
  - [Webinar 2 Accompanying Presentation](#)
  - [Sample Retail Loan Pre-Application Design](#)
  - [Sample Retail Loan Application Design](#)
  - [Sample Retail Loan Template for Data Collection \(.xls\)](#)
  - [The Grocery Gap: Who Has Access to Healthy Food and Why it Matters](#) (Food Trust and PolicyLink)
- 3. Green for Greens**
  - [Webinar 3 Presenters Biographies](#)
  - [Webinar 3 Accompanying Presentation](#)
  - [Green for Greens: Finding Public Financing for Healthy Food Retail](#) (Public Health Law & Policy)
  - [Getting to Grocery: A Toolkit for Attracting Food Retail to Underserved Neighborhoods](#) (Public Health Law & Policy)
- 4. New American Foodshed**
  - [Webinar 4 Presenters Biographies](#)
  - [Webinar 4 Accompanying Presentation](#)
  - [Field Guide to the New American Foodshed](#)
    - [Field Guide: One Page Planning](#)
  - [National Good Food Network](#)
  - [Farm Credit Council](#)



# Upcoming TA Webinars

## **Using PolicyMap & Limited Supermarket Access Analysis in your Target Market**

•Thursday, July 12, 2pm EDT

## **Figuring Out Food Hubs**

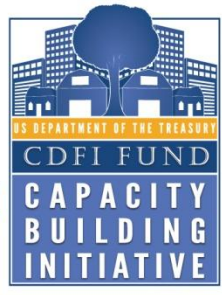
•Thursday, July 19, 2pm EDT

## **Huff Analysis**

•Tuesday, July 31, 2pm ET

**MORE WEBINARS TO COME – STAY TUNED!**

Visit [www.opportunityfinance.net/FHFOwebinars/](http://www.opportunityfinance.net/FHFOwebinars/) to register for one or all of the TA webinars



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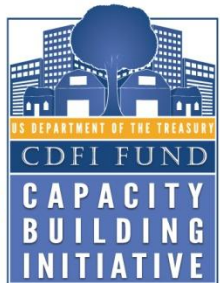
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# How to Effectively Underwrite Small & Emerging Farms

Gray Harris & Denise Dukette

June 27, 2012

