Small-to-midsize farms form the backbone of a sustainable food chain. Large funding gaps exist, however, where traditional lenders pass over farmers in need of a loan. Massachusetts nonprofit The Carrot Project (including co-founders Suput and Sautnier) works to close these funding gaps and support local agriculture through microlending. The organization partners with a small pool of investors and lenders to make loans that give small-to-midsize farms, and farm-related businesses, the boost they need to expand and succeed. The use of microlending to address gap financing has a unique set of costs and risks, and each microfinancing program has to decide how to balance the needs of the borrower, the investor, and the lender. This article describes The Carrot Project’s approach.

**Farm Funding Gaps Present Hurdles**

Financing continues to be a challenge for small-to-medium-sized farms and farm-related businesses. In a 2011 report, the National Young Farmers Association called access to capital a “major obstacle” for young and beginning farmers.

A number of other reports (including some that we co-authored) show inadequate access to capital for beginning, expanding, or transitioning farms. This situation can make it difficult for these farmers to use innovative production and marketing techniques to meet increasing consumer demand for sustainably raised food.

The Carrot Project is focused on meeting the needs of these farms through gap financing. For most of our applicants, this is a temporary situation; perhaps they are a new business, or perhaps they’ve run a profitable farm but have run into difficulties accessing more traditional forms of credit.

For example, one of our first loan recipients was a beginning farmer/owner from a certified organic farm in Vermont. When she approached The Carrot Project, she had already established a growing and profitable Community Supported Agriculture project of nearly 200 members. Her organic produce was popular at local farmers’ markets. She had valuable relationships with nearby restaurants, as well as a history of increasing profits, market opportunities, and membership. The farmer was ready to expand her farm but struggled to access credit through credit cards and bank loans. But without much credit history, she was unable to secure the needed capital to continue to grow her successful business. This is just the type of business with which The Carrot Project works.

**Jumping the Hurdles: Microlending**

The Carrot Project supports sustainable farmers and farm-related businesses through alternative financing programs combined with business technical assistance. We also work to increase the availability of financing, document and share what we learn, and conduct collaborative research. Financing, which is our chief focus, makes this work possible.

We see our work as making long-term investments in the building blocks of our food and agriculture economy—the farmers—in order to provide healthful food for consumers, replenish the environment, and contribute to regional and local economies.

Right now we, along with our lending and investing partners, are making loans to small farms in Massachusetts. In Vermont, Maine, and the Greater Berkshires (including Berkshire County, Mass., Litchfield County, Conn., and Dutchess and Columbia Counties, New York) we are providing services to small and midsize farms and farm-related businesses. We are also exploring other ways that financing can be used to support farms and changes in our food and agriculture system and participating in collaborative research to increase the sector’s knowledge base.

Lisa MacDougall of Pownal, Vermont’s Mighty Food Farm has been helped by The Carrot Project.

**The Carrot Project's Lending Programs**

Our average loan size has been just shy of $12,000; however, we now offer loans up to $75,000 in the Berkshires and $35,000 in all other programs, so we expect the average loan amount to increase over time. The use of our loans, along with a tremendous amount of hard work from the borrower, has begun to lead to improvements in borrowers’ operations. Borrowers are paying off their loans, and in some cases are now working with traditional agricultural or commercial lenders. Perhaps most importantly, they are beginning to realize their dreams for their businesses through expansion, land purchases, or paying themselves a wage.

**The Brewers**

Investments come from individuals and foundations interested in investing and supporting local, regional, organic, or sustainable agriculture. Some are long-time supporters of community investment opportunities, or are established socially responsible investors. Others have been inspired by ideas and projects that focus on investing locally, such as Slow Money. Their motivation is not just the financial returns – which in the case of The Carrot Project falls into the “community investment” financial return range of 0 - 3% – but the non-financial returns as well.

**Investing in Success**

Since we started making loans in 2009, The Carrot Project has made 25 loans totaling almost $300,000. Our average loan size has been just shy of $12,000; however, we now offer loans up to $75,000 in the Greater Berkshires and $35,000 in all other programs, so we expect the average loan amount to increase over time. The use of our loans, along with a tremendous amount of hard work from the borrower, has begun to lead to improvements in borrowers’ operations. Borrowers are paying off their loans, and in some cases are now working with traditional agricultural or commercial lenders. Perhaps most importantly, they are beginning to realize their dreams for their businesses through expansion, land purchases, or paying themselves a wage.

**The Carrot Project**

In our most common investment model – used with our partners the Vermont Community Loan Fund, Salisbury Bank and Trust Company, and MassDevelopment – lending is made possible by two types of risk capital: loan loss reserves and investments. Together, they build lending capacity, as illustrated in the diagram below: **Building Lending Capacity**

- **Loan Loss Reserve (or Risk) Capital**: The loan loss reserve account acts as a first-loss pool and carries at least 10 times its value in lending capacity. These funds are usually donated.
- **Investments**: These funds, provided by investors, are used as guarantees for the loans made to borrowers and placed in an interest-bearing account. The investment funds are accessed only in the event that the loan loss reserve is depleted.

In our second model – used with Coastal Enterprises, Inc. in Maine – The Carrot Project gathers capital from multiple investors and lends it to the lender, who in turn manages the pool to make loans, and decides how to cover for losses.

**The Nuts and Bolts of The Carrot Project’s Loan Programs**

The Carrot Project’s lending programs would be impossible without our partners – investors and lenders. Together, we bring to each program:

- **Knowledge of, and connections to, the targeted farming population**
- **Access to capital**
- **Provision of financial and business technical assistance**
- **The ability of lenders to make loans**

**Loan Operating Models**

The Carrot Project’s loan programs include two distinct operating models. The first model involves providing capital to a lender, who in turn issues a promissory note and commits to lend out the borrowed capital. In the second model, money is posted as collateral to a lending partner, who in turn uses their own capital for the loan.

**Availability of Capital**

There are three types of capital needed to operate a loan program: risk, return, and risk capital.

**• Operating capital is generated from business activities.** (For non-profits, charitable contributions play a significant role in generating operating capital, although there are opportunities to generate some revenue when providing financing.)

- **Lending capital describes the funds lent to the borrower.**
- **Risk capital is essentially a guarantee pool; it provides cash security or collateral in case of default.**

Depending on the lender and a program’s history, risk capital can range from 5% to 100% of the total loan amount. If different risk tolerances are needed, risk capital may be further subdivided into two categories: first loss and second loss. First loss refers to the first funds accessed in the event of default. Second loss refers to backup funds that are only accessed if the first loss funds are depleted. The first loss funds act as a cushion to increase the security of the second loss funds.

**Investment Models**

In our most common investment model – used with our partners the Vermont Community Loan Fund, Salisbury Bank and Trust Company, and MassDevelopment – lending is made possible by two types of risk capital: loan loss reserves and investments. Together, they build lending capacity, as illustrated in the diagram below: **Building Lending Capacity**
The Unique Costs of Microlending

It’s also important to note that it is difficult to cover the full costs of lending with microlawns. All else being equal, it requires a similar amount of time for a lender to evaluate and make a $10,000 loan as it does to make a $500,000 loan. In the latter case, the lender will have more than cover the costs of the loan; in the former case, it is difficult to cover costs unless the interest rate paid by the borrower is very high (See box).

Consider the example of a $10,000 and $500,000 loan. On a $10,000 loan for 3-years at 6.5%, the borrower will pay a little more than $1,000 in interest. If the borrower had a loan for $500,000 for 3 years at 6.5%, the total interest over the life of the loan would be over $50,000. The larger loan size with time from the applicant to prepare his or her material skills and experience, and their system of support.

Balancing Borrower, Investor and Lender Needs

In essence, these loans are built on establishing a relationship with the borrower. The most straightforward applications involve a basic level of monitoring after closing of the loan, and the borrower’s business thrives. Other situations we handle are more complicated and can require greater attention and care. This can range from a friendly ear to bounce ideas off of, to assistance with revamping books, to reconsideration of projections. In some cases, borrowers need monitoring and technical assistance during the life of the loan. Additionally, unexpected events can throw a business into turmoil; illness, accidents, or other emergencies can result in credit counseling or changing loan terms, requiring a re-evaluation of the business at a difficult time.

These are all costs that need to be considered when lending, especially given that the cost of the loan to the borrower – the interest rate – does not cover the cost of making a microlawn. A non-profit that makes microlawns needs to cover its costs, and usually does so with a combination of grants, gifts, and revenue from financing.

Balancing the needs of the borrower (who needs as low an interest rate as possible) with the needs of the investor (who wants as high an interest rate as possible) and the non-profit lender (who wants to cover costs) can be difficult. Reducing costs to as low as possible) and the non-profit lender needs to make a $500,000 loan. In the latter case, they may need to cover the support they need to reach their business goals while contributing to their communities and the larger food and agriculture culture economy, it makes us all stronger.

So, is investing in small farms and farm-related businesses right for you? That is up to you and your desire and ability to balance financial return with non-financial returns. For some people it will be desirable and possible, for others it won’t be. Is it worth it for the borrower, for the greater community, and growth of a sustainable food and agriculture sector? Yes. If borrowers can get the support they need to reach their business goals while contributing to their communities and the larger food and agriculture culture economy, it makes us all stronger.

If you would like more information about The Carrot Project’s please visit our website at: thecarrotproject.org. More information about how our programs are set up is described in ‘Setting Up Microlawns in Three States’ at: http://thecarrotproject.org/programs/report.

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