

Setting Up Farmer Microloans in Three States 2011

Summary

In collaboration with its partners, in 2009 and 2010, The Carrot Project made 15 loans totaling \$185,000 to a diverse group of farmers, while supporting others with business planning or financial management services. This work was carried out through three different loan programs whose shared goal is providing financing for small and mid-sized start-up farms and expanding farm businesses with limited or no access to capital. The programs are premised on the assumption that there is an unmet need for loans to such farm businesses, and the collaboration of at least two organizations with private investors is an effective way to fill the gap. This report focuses on Case Studies and Lessons Learned, which are organized around four key components of micro-loan programs: 1) knowledge of, and connections to, the targeted farming population; 2) availability of capital; 3) provision of financial and business technical assistance; and 4) lender capacities. All four components need to be present for a successful loan program; the importance of these factors is highlighted in the Lessons Learned section.

Introduction

Setting Up Farmer Microloans in Three States describes farmer microloan programs in Maine, Massachusetts, and Vermont. The goal of each program is to provide financing for small and mid-sized start-up farms and expanding farm businesses with limited or no access to capital. The purpose of this report is to share what The Carrot Project has learned in its first two years as it has established and operated the programs. This report was made possible through a 2009 Northeast SARE Sustainable Community Grant.



Chuck and Katie Landry, with farmhands Jonah and Zach at Hiland Farm in Dayton, Maine, 2010 loan recipient.

Photo: Lily Peil

The microloan programs discussed in this report grew out of research to identify and describe financing gaps for small and mid-sized farms in the Northeast (described in *Are Northeast Farmers in a Financing Fix*, which was funded by a 2006 Northeast SARE Sustainable Community Grant). The study indicated that financing gaps were a problem for approximately 25% of smaller farms. Those farms were most likely to be

The Carrot Project fosters a sustainable, diverse food system by supporting small and mid-sized farms and farm-related businesses through expanding accessible financing and increasing these operations' ability to use it to build successful, ecologically and financially sustainable businesses.

start-ups or operations looking to expand, and the median need for short- and intermediate-term loans was \$30,000. This need was not significantly different across the six New England states and New York, nor did it differ based on type of production.

The Carrot Project fosters a sustainable, diverse food system by supporting small and mid-sized farms and farm-related businesses through expanding accessible financing and increasing these operations' ability to use it to build successful, ecologically and financially sustainable businesses.

Project Overview

This section sets the context for the Case Studies and the Lessons Learned by describing the crucial skills and knowledge that, when combined, can produce a successful loan program for a specific population of farmers. It describes the types of farms and farmers our program serves, the four key components of farm lending programs, and the kinds of entities or organizations involved.

The Farms and Farmers Served

The farmers that have benefited from The Carrot Project's microloan programs are diverse—except in their challenges in accessing credit. Loan recipients include a

community supported agriculture (CSA) operation, a goat farm, a berry grower and cordial maker, a greenhouse herb business, a pickling operation, dairy farmers and on-farm bottlers, cheese-makers, a grassfed beef operation, a baker, and a rope-cultured mussel farmer. The farms range in size from a 2,750-square-foot greenhouse to a few acres to 420 acres. Most are USDA Certified Organic or using organic or other sustainable techniques, such as integrated pest management; a few are biodynamic. Seventy percent of the farms are run by beginning farmers, of which approximately one-third of the farmers are 55 or older, reflecting national averages. The remaining 30% are seeking to expand their operations or increase their financial viability. The majority of farmers gross less than \$250,000 per year. Most loans are used for capital investments, such as equipment, vehicles, and physical structures.

Four Key Components of a Microloan Program

For loan programs to meet the needs of farmers successfully, the following capacities need to be fulfilled.

- Knowledge of and connections to the targeted farming population
- Availability of capital
- Provision of financial and business technical assistance
- Lender capacities

Knowledge of the farming community is important to the identification of the type of financing and technical assistance services most helpful for a particular population. If the lender's orientation and expertise are not well matched with the features of the targeted farm population, this gap will need to be bridged for successful marketing. If the lender lacks the capacity to underwrite farm loans because of unfamiliarity with the types of farm businesses in the community, this knowledge will be necessary for the assessment of farm applicants.

Availability of capital is important across the three kinds of capital needed to operate a loan program—operating, lending/loan, and risk. In a business, operating capital is generated from the business activities; for non-profits, charitable contributions play a significant role (although there are opportunities to generate some revenue when providing financing). Loan capital



Red and yellow raspberries, Bug Hill Farm, Ashfield, MA, 2010 loan recipient

Photo: E. Ferry



Ron Weaver, America Agro Products,
Greenfield, MA, 2010 loan recipient

Photo: E. Ferry

comprises the funds lent to the borrower. Risk capital provides cash security or collateral in case of default; it is, essentially, a guarantee pool. Depending on the lender and a program's history, security requirements can range from 5–100% of the total loan amount. If investors require different risk tolerances, risk capital may be subdivided into first-loss and second-loss categories. First loss is the category of funds accessed first in the event of default. It acts as a cushion so that the funds in the second-loss category are more secure; they are accessed only if the funds in the first-loss category are depleted.

Financial and business technical assistance helps ensure that farmers are preparing “investment ready” business information. In The Carrot Project's programs, such information from an applicant's business can function as an alternative to the more-traditional litmus of a strong financial position, or substitute for lack of historical information in the case of a new business, allowing us to assess the likelihood of success. This information provides a clear indicator of a farm's goals and priorities, as well as financials (business historical information and projections) based on realistic assessments that reflect the resources of the farm business—human skills and knowledge, land, facilities, equipment, and markets.

Financial and business technical assistance can be provided in many different ways and targeted to a specific farm sector or stage of business. The end product of these activities is usually a business plan and financials. Some forms of technical assistance are more advisory and guide a participant; others rely more on the trainer or consultant to prepare the necessary information. The important outcomes are that the end result is an accurate reflection of the farm business, and that the farmer is a full partner in its development. Limited availability of these technical assistance resources—designed to meet a variety of different learning styles, stages of business, and schedules—can limit the number of applicants able to assess whether using debt financing, or any form of financing, is in their best interest.

Lender capacities—loan origination, underwriting, and servicing—are three key functions that need to be fulfilled. Loan origination includes farmer outreach and working with the applicant to prepare an application; this may or may not include technical assistance. The underwriting process includes analysis of a farm business, determination of the soundness of the business plan and whether credit is a good option for the operation, and subsequent provision of loan documents



Kate Kerivan, Bug Hill Farm, Ashfield, MA, 2010 loan recipient

Photo: E. Ferry

that detail the arrangement and disbursement of funds. Servicing is the follow-up after the loan has closed, including invoicing and post-closure communication. This is likely to include annual financial reports from the farmer, and may include loan modification in case of difficulty on the part of the borrower.

The capacities and skills described above are provided by our organization and a combination of lenders, investors, donors, and technical assistance service providers. The role we play in each program is based on the capacities of our collaborators. The Carrot Project has played each of the roles described above, except for a portion of the underwriting tasks—providing legal loan documents and invoicing, as we are not legally a lender. Our origination and underwriting capacities include: farmer outreach, various levels of technical assistance, assistance with the application process, recruiting and staffing a volunteer loan review committee, loan analysis, and site visits.

Program Partners

The Lenders

We have worked with three different types of lenders — a regional bank, a community development financial institutions (CDFI), and an economic development agency. The lender type for each program was chosen because of lenders' interest in participating in the program and supporting farmers in their service area. The motivation for lender participation can vary, depending on the nature of the institution, and interest may arise from a social mission, as is typical for CDFIs. The primary motivator for commercial lenders seems to be community involvement. In the case of microloans (and depending on projected volume), it is unlikely to be a profitable activity. In all of The Carrot Project's programs, lenders are performing at least a portion of the underwriting process and servicing the loans. The amount and type of capital varies with each lender. In our work, only one of the lenders, a CDFI, has the capacity to provide financial and business technical assistance as well as to originate, underwrite, and service all loans. This capacity may not be available with all CDFIs.

The Investors

The investors are interested in investing in and supporting local, regional, organic, and/or sustainable agriculture. Some have long supported community investment opportunities or are established socially responsible investors. Others have been inspired by ideas such as Slow Money or other projects focused on investing locally. Their motivation is not simply the financial return, which in the case of The Carrot Project falls into the "community investment" financial return range of 0–3%. Our investors are highly motivated by their desire to realize the non-financial returns gained with a more sustainable food and agriculture system.

The Technical Assistance Service Providers

The availability of business and financial management technical assistance is a critical aspect of the program, especially for beginning farmers or those using new and innovative business models. There is no predominant model for how these services are provided, and frequently they are offered in a fairly piecemeal fashion. In states with farm viability programs, there is usually a network of trained technical service providers (who may or may not work together in a coordinated fashion).

Another source of low-cost or free technical assistance is the network of Small Business Development Centers (SBDCs), which may not offer services specific to agriculture and seem to serve this sector best when connected with the agricultural community. Non-profits, cooperative extension, and universities are other potential sources for these services.

Case Studies

The three Case Studies described below provide examples of how The Carrot Project has collaborated with different entities to provide financing to farmers. In each program, at least one organization is always taking the lead either to launch or to operate the program. The Carrot Project's loans programs include two distinct operating models. One model provides 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 the benefit of a lending partner, who in turn uses its own capital for lending up to an agreed-on amount. In all programs, borrowers are required to provide collateral, though how it is valued varies. Table 1 describes the three programs.

VERMONT

Strolling of the Heifers Microloan Fund for New England Farmers

Partners: Strolling of the Heifers and People's United Bank

Target Audience: Small farms having difficulty accessing financing or unable to do so

Type of Loans: Up to \$15,000,¹ 1–5 year terms, with a fixed market interest rate set twice a year

Total Capital: \$150,000

Overview

The Strolling of the Heifers Microloan Fund for New England Farmers began in 2009 by offering loans to small farmers for operations, capital expenses, and/or emergency needs. The program started when

Strolling of the Heifers approached The Carrot Project to partner in the launch of a microloan program. People's United Bank (formerly Chittenden Bank) wanted to help start the program and became the lending organization. It acts as a servicing agent to other non-profit loan programs and sees their participation as a community service. For The Carrot Project, launching its first program in Vermont was optimal because of significant community interest in finding creative ways to meet farmers' needs; this provided a perfect learning environment.

Use of Capital

Our lending partner was willing to move forward, in the first year, with 1:1 cash security held at the bank (with the agreement that this would decrease, by 25% each

Table 1: Chart of Loan Fund Relationships

	VT LOAN FUND	MA LOAN FUND	ME LOAN FUND
Started	2009	March 2010	March 2010
Lending Partner	People's United Bank	MassDevelopment	Coastal Enterprises, Inc.
Total Capital	up to \$150,000	\$150,000	\$170,000
Sources of Capital			
Donations	\$42,000	\$12,500	
Investments	\$110,000	\$12,500	\$170,000
Lender		\$150,000	
Loan Loss Reserve	\$42,000	\$25,000	5–10% based on loan
Financial ROI	1–2.75%	.25–.5%	1.5%
Minimum Investment	\$25,000	\$10,000	\$10,000
Maximum Loan Amount	up to \$15,000	up to \$15,000	up to \$35,000
Loan Review	shared	shared	CEI
Loan Servicing	People's United Bank	MassDevelopment	CEI
Rate to Farmers	Set based on applicant	2.75% + 5-year Treasury Rate	7.5–9%
Loan Term	1–5 years	1–5 years	1–5 years
Technical Assistance	Carrot Project & Referrals	Carrot Project & Referrals	CEI & Referrals
Number of Defaults	0	0	0

year, to a 1:2 cash security—assuming things went well.) This meant that in Year 1, for every loan we made, the same amount of money needed to be held at the bank. Using tools available to our lending partner, we placed the risk capital in interest-bearing accounts (in this instance, Certificates of Deposit, or CDs); at least 25% of that risk capital was in a first position in the event of default.

Program administration

Strolling of the Heifers, People's United Bank (PUB), and The Carrot Project worked closely to develop the tools and infrastructure for the program. We drafted agreements that outlined all aspects of our relationship and our respective roles. For the project's first year, the group met regularly to discuss the loan fund progress. After the early stages of the fund, the three organizations held the following roles: Strolling of the Heifers took the lead on media publicity and subsequent benefit concerts, which provided funds for the first-position loan loss reserve. PUB continued in an advisory role and worked to close and then service the loans recommended by The Carrot Project. The Carrot Project acted as program coordinator, raised the second-position risk capital, and conducted loan origination and some of the tasks related to underwriting. In all instances, close and regular communication between all parties was required for the program to function well.

Vermont has an excellent network of technical service providers that are well coordinated and aware of one another's strengths. Vermont also has a variety of training programs and classes designed for different types of farm businesses at different stages of operation. Almost all applicants from Vermont have been "investment ready," meaning we've needed to provide very little technical assistance.

Purple cabbage, Village Farm, Freedom, ME, 2010 loan recipient



Photo: Lily Piel

MASSACHUSETTS

MassDevelopment/The Carrot Project Small Farm Loan Program²

Partner: MassDevelopment

Target Audience: Small and mid-sized farms having difficulty accessing financing or unable to do so

Type of Loans: Up to \$15,000, 1–5 year terms, with a fixed interest rate (with a floor of 6.5%)

Total Capital: \$150,000

Overview

The MassDevelopment/The Carrot Project Small Farm Loan Program began in 2010. The Carrot Project sought a lending partner that could service the entire state and had a commitment from the top to support the state's small farmers. MassDevelopment's motivation to participate in the program was to strengthen the economic viability of the Commonwealth's agricultural sector and protect open space.

Use of Capital

MassDevelopment uses its own capital to make loans, but requires that The Carrot Project provide 25% of the total loan amount as security. That risk capital is placed in a low interest-bearing bank account and can be accessed in the event of default. These funds include charitable donations and investments. The first-loss

funds were raised at a “5% Day” sponsored by the Whole Foods Market in Cambridge. Additional funds are held, at a regional bank for the benefit of the program, as second-position collateral to secure the loans in the event of losses.

Program administration

The Carrot Project undertakes loan origination and a portion of the underwriting activities. Many Massachusetts applicants have participated in a Massachusetts Department of Agricultural Resources business planning training, and their applications include modified versions of the materials prepared during these courses. As the appropriate technical assistance services are not always available, a significant portion of applicants require extensive work prior to completing an application. Once they’ve acquired a clearer picture of their needs, some ultimately choose not to apply for loans (or not to apply immediately). In addition to conducting a portion of the underwriting activities and servicing the loans, MassDevelopment assists with media outreach.

MAINE

Maine Farm Business Loan Fund

Partners: Coastal Enterprises, Inc.

Target Audience: Small and mid-sized farms and value-added businesses

Type of Loans: Up to \$35,000, 1–5 year terms, with a fixed interest rate

Total Capital: \$170,000

Overview

Launched in 2010, the Maine Farm Business Loan Fund is a collaboration between The Carrot Project and Coastal Enterprises, Inc. (CEI). The Carrot Project was very interested in working with CEI because it is a well-known and established community development financial institution with a long history of natural resource lending. CEI has recently refocused on agriculture, including value-added production and distribution. The Carrot Project collaboration offered CEI an opportunity to expand their capacity for servicing the agricultural sector.

Use of Capital

The Carrot Project worked with a group of investors to aggregate the capital used for the program. The

funds are loaned to CEI in a promissory note. The interest from the fund is shared by the investors and The Carrot Project.

Program administration

The Carrot Project and CEI designed the loan program, but CEI is responsible for loan origination, underwriting, and servicing. CEI also provides or connects farmers to business and financial planning, as needed. CEI provides quarterly updates to The Carrot Project on new applicants and on the status of existing loans. The Carrot Project maintains the primary relationships with the investors.

Lessons Learned

The Lessons Learned described below reflect: the need for the four key program components described in the Project Overview; the necessity of a lead facilitator and close collaboration if multiple organizations are involved; and creativity in arranging for and securing capital to support a loan program.

Program Administration

- Depending on the capacities of the lender and technical assistance services available, the lead organization can be called on to play a variety of roles or will need to determine how to fulfill the functions needed for a successful program.
- We are most successful with partners that share the common goal and value of supporting small and mid-sized farms and have the motivation to focus resources on the program. Where possible, we seek to partner with a lender that has a social or community economic development mission.
- The success of a program is predicated on a clear understanding of each party’s roles and on open communication.
- Careful thought and commitment are needed, on the part of organizations whose primary goal is not farm lending, on the best ways to integrate a new program into an already robust, large, and dynamic organization.
- Assisting farmers that do not have access to more-traditional forms of financing means supporting a higher level of technical assistance; taking more risks (such as working with start-ups); building in flexibility when valuing capital; and having a keen understanding of the farm businesses that are applying



Flowers, Village Farm,
Freedom, ME 2010 loan
recipient

Photo: Lily Peil

for loans and the community or region in which they are located.

- The availability and type of technical assistance are extremely important for applicants.
- Volunteer loan review committees consisting of technical service providers, traditional agricultural lenders, and farmers make well-equipped teams to evaluate loans when goals of the program and evaluation criteria have been determined.

Farmer Feedback

- Our experiences confirmed the findings of our research (carried out in 2007–2008) that short- or intermediate-term loans of up to \$30,000 or \$35,000 (and possibly more) are more likely than loans of \$15,000 (or less) to meet the needs of farmers and enable them to secure the resources necessary to increase their farms' viability.
- Some farmers found our interest rates too high, especially in a time of low interest rates, and our process slower than that of traditional lenders.
- Because we use a volunteer loan review committee, we started with two application rounds per year; this was expanded to three for the 2010–2011 season. This seems sufficient, but more-frequent deadlines, though no longer critical, would be helpful.

- Beginning farmers found our programs especially useful because of our “farmer-friendly” methods and willingness to work with their businesses. However, lack of business asset insurance or inability to get landlord letters of confirmation (affirming a tenant farmer’s right to remain on the land for the term of the loan when there is no formal lease) can sometimes be a stumbling block.

Technical Assistance

- Participation in a business or farm-business planning course (whose end product is a business plan) may not be sufficient if the plan was produced when the farmer was not in the current situation or if the plan simply no longer represents the farmer’s goals and intentions. There is sometimes a knowledge gap between such courses and an applicant’s ability to apply course learning to a situation outside the class environment.

These case studies highlight three important experiences that allow the creation of loan programs to meet the needs of a specific population of farmers unable to access existing capital markets.

- Under the right conditions, lenders are interested in participating in collaborative lending programs, and able to do so.
- Private investors are willing to join in this effort and provide a flexible source of capital.
- Borrower financial literacy is an important component for the success of any financing program.

Endnotes

- 1 The loan program with Strolling of the Heifers ended in March 2011 and was replaced by The Carrot Project Agriculture Loan Fund. Our new lending partner is the Vermont Community Loan Fund. People’s United Bank continues to hold the financial assets of the loan loss reserve account. Most aspects of the program are the same except that the maximum loan amount has been increased to \$35,000, the maximum term to six years, and the target audience has been expanded to include medium-sized farms and farm-related businesses.
- 2 In April of 2011, we raised the maximum loan amount to \$35,000, and it is available to small and midsized farms.