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## Talking About Local & Organic Money--Starting a Conversation about Investing in Local & Organic Farms & Food

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## Starting a conversation about investing in local and organic food

We've all heard the phrase "put your money where your mouth is". This document is designed to do the reverse. There seems to be a number of people with money to invest who are interested in local and organic food and farm ventures, but there doesn't seem to be enough talk/dialogue, and wisdom about how to invest. This dearth of knowledge includes what would make a good or bad investment and how to go about finding ventures to invest in. If you want to buy stock, information abounds; if you want to buy farmland, then you join The Chicago Farmers; but, if you want to invest in local and organic farm and food, a logical question is where do you begin to even have a conversation about it?

This document seeks to begin a conversation about the issues involved. So welcome to the conversation about local and organic food and farm investing. My hope is that this will be an ongoing dialogue where readers become contributors and contributors become readers and the whole information base on investing in local and organic food and farm grows and grows. As I've observed, there can be no organic farms without organic farmground and organic farm owners. Some of these will be owner operators but many will be investors. There also can be no organic farms without organic farmers. Some of these farmers will own and operate the farmland they farm and some will rent.

I've asked people I know of to contribute their thoughts on topics related to these issues: What farmers should know the people issues in investing, insurance, accounting, lender's perspectives, legal and regulatory issues, angel investor's perspectives, food safety and farm food safety issues. There are clearly areas that could and should be addressed beyond these.

For example, the section by Walter Lynn helps make the business case for investing in local and organic food systems. The demand is there and the market potential is vast indeed. As the Leopold Center demonstrated so convincingly the possible market for "local" in Illinois alone is in the hundreds of millions (e[http://www.leopold.iastate.edu/research/marketing\\_files/Midwest\\_032910.pdf](http://www.leopold.iastate.edu/research/marketing_files/Midwest_032910.pdf)). And the organic market is showing robust growth even in a very sluggish economy.

If you are a contributor thanks very much. If you are a reader, I hope you enjoy reading this document, and you are motivated to continue the conversation. If you'd like to begin the conversation with me please be in touch at: [rschell@wagnerschell.com](mailto:rschell@wagnerschell.com) or by watching my blog for developments at <http://schellacres.typepad.com/> or on twitter at [re\\_schell](#). If you'd like to begin chatting with the contributors, their email addresses follow their respective sections. I'm posting this on my blog, and I've asked the contributors who have blogs to post it on theirs.

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### Intro to Five Important Points for Local Producers

Organic and local food and farm investing differs from investing in conventional farms and farming. In the case of local and organic, the most important element in the deal is the producer/farmer. In addition to making sure there's a good fit between the investor and farmer there also has to be a superb fit between the farmer and the market. This section gives some key insights into that from Dan Anderson who is a blogger at Organic Horizon at <http://virtualfarmer.wordpress.com/>, and a Sustainable Ag Specialist with the College of ACES at U of I, and a keen observer of local and organic production in the Midwest. This section raises key points that a farmer and investor should be aware about before investing or producing.

### **Five Important Points for Local Producers By Dan Anderson**

Farming for the local food system is a different game than farming for grain commodity markets. The distance between you and the customer is shorter and the connection stronger. These interactions are the key to success for smaller farmers operating in the local food system. But there are challenges as well.

1. *Before you put the seed in the ground, know where you are going to sell the harvest.* Know your market. Being successful in the local food system requires multiple skill sets. Not only must you be a good farmer, but you must also be a good marketer, and good communicator, a real people person. It's not for everyone. If you don't enjoy interacting with people, building relationships, nurturing potential customers and thinking creatively about marketing your product, you have to seriously question whether this is for you. Maybe you're not good at that stuff, but your spouse or child or business partner is. That works too. Someone in the operation has to commit serious time and effort to selling what you raise. And ideally, you should have your crop sold before you put the seed in the ground. Don't waste too much time or space growing your favorite obscure vegetables if your core customer base is going to turn up their collective noses to it. On the other hand, if you have a passion for Jolokia peppers, that's OK. Find or develop a niche market of others who love Jolokias, so you can sell a few.
2. *Diversify everything.* Ever hear the saying, 'don't put all your eggs in one basket'? Sounds corny, but it's the smart approach to your production and marketing strategies. If you grow nothing but one, specialized variety of watermelon, and you have a drought, or disease that wipes that variety out, all your eggs are broken. Grow and raise lots of products and then grow several different varieties of those products. Think about diversity in your processing and marketing as well. Sell fresh, can it, or process it into a sauce. Are you selling at farmers markets only? Investigate restaurants,

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or consider starting a buying club. Diversity is nature's way of providing insurance. If one strategy fails, you have others to fall back on.

3. *Spend as much time developing relationships as you do growing crops.* People are the key to your business. Make a serious effort to know everyone in your area who might benefit your business. Everyone eats, so everyone is a potential customer. If people are going to buy food directly from you, they will need to trust you. Your reputation is critical to your success. Employ an open-gate policy. Welcome anybody on the farm anytime. Become an active and visible member of the community, promoting the farm and your products where ever you go.
4. *Natural, organic or chemical-free?* Organic is still the fastest growing segment of the food market, but is it for you? If you have a strong base of customers who know you and trust you, do they really care if you have the certification? On the other hand, if you are looking to sell to organic processors, the certification will be crucial. If you are not certified, you cannot call it organic, but you can always use other terms and phrases to distinguish your product – natural, chemical free, holistic, farm fresh...the list goes on. Know your customer. Whatever you raise, and however you raise it, be radically devoted to *quality*.
5. *Let the customer do the work.* Why haul your products around the county, when many of your customers will come to you. For “city folk” a trip to the country is more than just running an errand to pick up a bag of apples. It's an adventure. U-pick operations shift labor costs to the customer. In fact, it magically transforms that labor cost into an income stream. Many CSAs trade subscription fees for hours spent working on the farm. Check out all your local ordinances first, but turning your farm into an agritourism enterprise can be very lucrative. Do you have a farm that people would like to visit? Think creatively and turn it into an asset.

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### Intro to Processed Food Issues

Food Safety for processed food is a key issue for the investor because the consequences of getting it wrong can be catastrophic and deadly for both the customers and the brand and ultimately the enterprise. Anunaya Banstola is a graduate student in food science from Nepal who brings an international perspective to this issue. Matt Botos is an experience food safety professional who has presented to groups as diverse as the Chinese FDA and Illinois farmers. Sandy Streed helped organize the first farm to fork event in Illinois and was also at the Illinois Food Safety Center.

### **Processed Food Safety Issues By Anunaya Banstola With Matt Botos and Sandy Streed.**

Essential component of any food business – preparation and delivery of safe food products

- ❑ Cleanliness is a fundamental step and applies to a company's sanitary programs, manufacturing practices and employee hygiene
- ❑ Cooking is the process of determining whether or not your product needs a thermal process, determining the pertinent micro-organisms that need to be controlled or eliminated, selecting and utilizing the correct process, and developing a record keeping method.
- ❑ Chilling food slows down and can even stop bacterial growth. Provide and utilize the necessary tools to determine ideal temperature for food storage, refrigeration and shipping.

Cross-contamination occurs when bacteria or allergen-free food is contaminated during food preparation, cooking, serving or storage. Appropriate guidelines for proper handling must be identified, established, implemented and monitored.

### Good Manufacturing Practices (GMPs)

- ❑ Personnel
- ❑ Buildings and Facilities
- ❑ Plant and Grounds
- ❑ Sanitation Operations: Pest Control
  - Sanitary Facilities and Controls
- ❑ Equipment
- ❑ Production and Process Control

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Sanitation Standard Operating Procedures (SSOPS)

- General Equipment Cleaning
- Cleaning of Facilities

Good Agricultural Practices (GAPs)

- Agricultural Water
- Animal Feces
- Worker Health and Hygiene
- Field Sanitation
- Trace Back

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Intro to Investing in Organic-The People Factor

As noted in the intro to the previous section, there is no element more important, INMHO, than the people in the deal. The three authors of this section bring a rich background in organic farming as writers and producers. Ryan Erisman is one of the very few people in the Midwest who can say he grew up on an organic farm. Jack Erisman is an organic grain and livestock farmer in Central Illinois and has been on the forefront of Illinois organic production. Gary McDonald has experience in both organic farming and corporate recruiting and has a keen sense of the importance of getting the right farmer in the deal.

**Investing in Organic-The People Factor**

**By Ryan Erisman**

**With**

**Jack Erisman and**

**Gary McDonald**

**Why Organic?**

You are environmentally conscious, sustainably inclined, and in love with the idea of owning land for quality food production. You'd like to invest in Illinois farmland and align your money with your values.

**Before you start looking for a farm and a farmer**

You may have an image of what you want, money set aside to invest, and even a template for a lease agreement. You may even have the land –either farmed conventionally or in CRP. Before you jump into organic production, you should assess yourself and your potential tenant to see if both of you possess the acumen for the organic business.

**The People Factor**

From the land buyer's perspective, investing in organic reverses the normal process of investing in conventional, corn-belt agriculture. In the conventional model, if you have the land, you will have your pick of farmers; they will literally knock on your door. In organic production, you need the right people before you focus on the land.

*The right people* describes the investor, the farmer, and their relationship –three pillars required to support the rest of the business model.

**The Investor/landlord.** Before you invest in organic farmland, ask yourself if you:

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- Think long-term. Organic farming techniques focus on building natural soil fertility –a process that may take years. Like compound interest, early contributions to soil building will pay greater dividends over time. Land converted from conventional, row-crop production may take 5-10 years to yield abundant organic crops. Focusing on the long-term payoffs puts early efforts and results into perspective.
- Are Financially Resilient. Assuming that you are transitioning conventional land to organic, you won't see great returns in the first few years. At a minimum, you should be financially prepared to weather the transition period –the three years between ceasing synthetic chemical and fertilizer use and getting organic certification. Since the transition period also produces less income for the tenant, he may ask you to fund the cost of transition.

**The Farmer.** The profile for a successful organic farmer looks like the profile for almost any successful entrepreneur. You want someone who:

- Thrives on a challenge.
- Enjoys problem solving.
- Thinks long-term.
- Is driven to succeed

The above traits don't separate organic from conventional farmers. However, an organic farmer applies these traits towards different values compared to his conventional counterpart. Conventional farming values the number of acres farmed and bushels produced while downplaying or ignoring negative impacts to the soil, wildlife, water table, and to the food system itself.

*Sustainable* organic farming strives to produce food and products through methods with environmentally positive or, at least, neutral impacts. The people who commit themselves to organic farming not only think about production and process; they consider how their actions impact the environment, their local economy, and their community.

**The Relationship.** Two qualified individuals don't necessarily make a team. Chances for success improve if the landlord and farmer work well together and share a common vision. Each of you should outline your goals for the farm and how you intend to reach them. Going through this exercise before you make any binding agreements will help both of you assess if and how well you can work together.

Once you have formulated mutually agreed-upon goals and a business arrangement, you can focus on the farming itself. Unless the farmer is already a successful organic producer, you may need to seek outside assistance from someone who *is or has been* a successful organic producer.

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Be wary of farm managers. Most managers charge a fee based on the *gross* profits and lack any “skin in the game” –they still make money if the farmer and landowner fail. Look for a manager who operates like a mentor. A mentor will steer you in the right direction, like a parent teaching a child to ride a bike. A mentor will also let go once you can get by on your own. The wrong farm manager will want to sell you training wheels for a lifetime.

### **Do you have any business getting into the organic business?**

If you and your farmer possess the traits to succeed, share common values and goals, and can work well together, you have a solid foundation for the business.

However, even if you think your business model is morally superior, it still has to make money. It's not sustainable if it's not economically viable.

Once you have the right people, you need a good plan.

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Intro to What Investors Should Know About On-Farm Food Safety

Farm safety issues are certainly an area of interest for investors in local and organic food. Warren King has an MBA and experience working for a very large player in global food. He is the Chairman of FamilyFarmed.org, and he has been at the forefront of where farm food safety issues are going.

**What Investors Should Know About On-Farm Food Safety  
By Warren King**

- ❑ Good Agricultural Practices (GAPs) and Good Handling Practices (GHPs) are recommendations to minimize the risk of food contamination at the farm level.
- ❑ GAPs and GHPs are based on FDA guidelines and cover a wide range of products.
- ❑ The implementation of these guidelines is totally voluntary
- ❑ The certifications last for one year
- ❑ The certification costs vary by farming operation. Typically small farms pay \$500-\$1000 for certification
- ❑ Audits of practices are carried out by FDA, USDA and private certifiers
- ❑ GAPs and GHPs are really two sides of the same coin; with GAPs more focused on field production/harvest and GHPs more focused on post-harvest handling and processing.
- ❑ They are very common-sense approaches to reducing contamination risks.
- ❑ Understanding and implementing both are important for any farm operation.
- ❑ Having a farm plan and keeping good records are the two most important elements of managing GAP & GHP.
- ❑ Successful farm operations are already using most of the GAP & GHP recommendations, whether certified or not
- ❑ GAPs focus on four key areas of farm production to reduce contamination risks:
  - Soil - contamination prevention considers the use of raw manures, composted manures and treated municipal “biosolids” as fertilizers
  - Water - contamination prevention considers the use of irrigation water, its sources and application methods in crop production
  - Handling - contamination prevention considers the use and availability of equipment for personal hygiene by workers that come in contact with food crops
  - Surfaces - contamination prevention considers what food crops come in contact with during the harvesting process.
- ❑ Training and technical advice is available to farmers through state extension services, not-for-profit organizations and independent contractors.

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- The recently passed Food Modernization Act will place some new mandatory regulation on smaller farming operations. The focus of the regulation is on processing, transporting and storing of farm products. The legislation allows generally for exemptions for farms selling less than \$500,000 annually or selling directly to consumers.
- Nearly all commercial wholesalers, processors and retailers require farm product suppliers to have some type of food safety certification. This may include Hazard Analysis and Critical Control Point (HACCP) programs for the farms they purchase from.

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Intro to Individual Investors Finance Local Food

This section discusses the role of the angel investor in local food. Unless the venture is one of the rare and lucky ones that can truly run and grow on only its internal resources, the role of outside money becomes a make or break issue. As such, this section contains great insights for the investor and producer in the form of the goals articulated by the writers in what SLoFIG hopes to accomplish through its investments

**Individual Investors Finance Local Food  
By Teri Lowinger & Karen Lehman**

With the number of new enterprises serving the demand for local food growing, the question is, are those with the capacity to finance start-ups or expansions jumping in? Private investors may wish to invest, but there are no easy vehicles through which to do so.

At least until now. The Sustainably Local Food Investment Group (SLoFIG) is an emerging investment network whose mission is to nurture the growth of a sustainable, local food system in the Chicago region. SLoFIG consists of individual angel investors united in the mission of SLoFIG and interested in financing privately held companies or ventures in various stages of development.

The purpose of SLoFIG is to support businesses that contribute to re-localizing the Chicago region food chain, while realizing a profitable return. SLoFIG defines a sustainable local food system as one that (1) increases the health of the people who consume the food, (2) enhances the economic viability of the communities in which it is grown and processed, (3) improves the fertility of the land on which it is grown, and (4) ensures the humane treatment of livestock. SLoFIG imagines this food system, which spans a radius of approximately 150 – 200 miles from Chicago, to be self-perpetuating and vibrant.

The seven founding members of SLoFIG have been meeting over the past year with the support of Fresh Taste, a funder collaborative dedicated to relocalizing the food system in the Chicago foodshed and improving equity of access to good food. In March 2010, when Woody Tasch came to speak at Financing Farm to Fork, Fresh Taste convened a group of funders and investors to talk with him about Slow Money and his ideas for a financial system that would support the food system. A small working group formed to explore options in this region. While they decided not to formally identify with Slow Money (the name SLoFIG coincidentally evokes Slow Money and Slow Food), SLoFIG nonetheless identifies social return as equally important with financial return in its priorities.

What could be most interesting about SLoFIG to the larger community of those supporting local food is the role they are playing in identifying the pipeline of food system businesses ready for financing. Through sponsorship of a business plan competition at Financing Farm to Fork, SLoFIG attracted 17 businesses willing to

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complete applications. As part of a larger finance community that includes foundations, public agencies, banks, and community development finance institutions, SLoFIG has the capacity to leverage other financing. Foundations that lack the staff to do due diligence on food system businesses may feel more inclined to invest if SLoFIG has already vetted a business. USDA Rural Development may have a new place to send businesses that don't qualify for their programs, but might attract a loan from SLoFIG.

All of this remains to be seen. For now, we can be thankful that SLoFIG has joined the local food scene.

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Intro to Investing in Organic/Local Foods Systems

Walter I. Lynn, Jr., is an accountant with a focus on agriculture with an eye toward how local and organic farming and food ventures can be sustainable and profitable. He understands the value proposition of local and organic food and farm as an enterprise, and he understands that profitability and sustainability have to go together.

**Investing in Organic/Local Foods Systems**  
**By Walter Lynn**

Investment in organic or locally grown food production systems has recently gained increased public interest. However, traditional investment during the last twenty years has been a roller coaster of emotions, economic pressures, conscience and values. One important item to any investor is long-term growth of asset value. Growth is a function of profit and investment value, and, to investors, growth is also a function of a sense of long term commitment, economic integration, resilience and the attitude of meeting personal values.

Organic or locally grown food production systems have gained public interest because they have become more viable in meeting some of these investment goals. People believe that this type of investment is the “right thing to do.” Despite feeling good about an investment, people need to realize that economic viability is a simple necessity. People who invest in something because it is the right thing to do must also realize that profit is the cornerstone to maintaining that goal.

Profit cannot be viewed as a four-letter word. Therefore, organic or locally grown food investments must be economically sustainable to be realistic in today’s economy. Profitability is highly achievable when business systems are effectively put into place.

As with other agricultural systems, investment in organic or locally grown food production can be viewed similar to investment in a growth stock. Returns are derived from two sources: **long term growth** in agricultural investments has traditionally been set at 4% per year, and **long term return on investment** has traditionally been set at 4% per year. Agricultural investments have been recognized as very stable opportunities, especially in stressed economic times. Viewing with great conservatism, agricultural investments should theoretically double every 9 years when the rule of 72 is applied, when considering 8% return per year as a constant.

The economic viability of organic or locally grown food production seems to be stable, but being able to finance these systems is the real challenge. These systems are in relative infancy when compared to other traditional agricultural systems. New business approaches are necessary when embarking on innovative systems in organic or locally grown food production.

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Basic financing principles, however, cannot be ignored and must be followed, as with any business venture. They involve: start-up capital, adequate operating capital, adequate cash flow from operations, and disciplined risk management. Planning is mandatory with these operations involving: adequate turnover to keep cash flowing, limitation of overhead, control of perishable losses, and creating utility and reliability as a food source.

Organic or locally grown food producers must be dynamic in the community and must set positive examples: being innovative with regard to environmental stewardship, being diverse in production of attractive products, leading with inventive promotion of good and services, and champion holistic incorporation into community food systems.

Organic or locally grown food production can be supported by professional support systems. There is local assistance from accountants who can integrate business planning with proper legal assistance in entity choice, accounting systems, bookkeeping assistance, tax preparation, financial planning, and back office support system.

Organic or locally grown food production's time has come to the forefront. Its popularity is increasing. As the Illinois Local and Organic Food and Farm Task Force has reported in their report, ***Local Food, Farms & Jobs: Growing the Illinois Economy—A Report to the Illinois General Assembly***, in March, 2009, "Illinois consumers spend \$48 billion annually on food. Nearly all of this money leaves the state. To retain a larger share of Illinois food dollars, public, private, and civic sectors must work together to build a farm and food system that meets consumer demand for 'local' food." The report goes on to say, "Meeting this demand will require construction of a supply chain that shortens the geographic distance between the farm gate and the food plate."

The time is ripe for developing organic or locally grown food production systems. Investment opportunities are developing and support systems are in place to allow for economic potential. If they are managed properly, these investments have huge possibilities to fulfill long-term financial goals.

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### Intro to Insurance Overview

Investors naturally want to know the answer to two questions: How do I get the money out? What happens if something goes wrong? Doreen Morris is an experienced insurance/risk management professional with AJ Gallagher. Arthur J Gallagher is a global risk management company with direct experience in helping food companies with their risk exposures.

### **Insurance Overview By Doreen Morris**

Undertaking any business venture involves some level of risk. One of the first steps one should take is that of assessing the risk to which one is exposed and deciding how deal with those risks. One such risk is exposure to financial loss, and within this extremely broad category includes, but is not limited to risk of loss due to;

- Loss of or damage to physical assets
- Legal obligations arising from your business activities
- Meeting statutory requirements arising from your activities – such as providing protection for your employees, obtaining statutory auto insurance

As with any risk assessment, one may choose to be passive or active in controlling such risk. One solution to dealing with such risk is through use of insurance. Insurance involves transferring your risk to a third party such as an insurance company. The insurance company in return for a premium issues a contract - in the form of an insurance policy by which it promises to provide protection in event of certain occurrences.

#### Loss Of Or Damage To Physical Assets

In the food/farm industry insurance is often not an option but a necessity. Often your physical assets are financed by banks who will require evidence of Property insurance to cover fortuitous loss or damage to that property such as fire, theft, flood and earthquake, and also important, loss of income that may arise should damage to your property prevent you from operating and thus meeting the venture's financial obligations.

#### Legal Obligations Arising From Your Business Activities

Business owners are expected to provide product that will not harm those who

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uses it, but as we all know things happen and the food venture could be faced with law suits stemming from the food venture's actions that causes bodily injury or property damage to others as a result of negligent actions. Then there are the associated expenses such as legal cost for defense. Many small business operations have been forced out of business as result of not being able to withstand law suits filed against them as a result of their negligent action.

Insurance can also be required to meet statutory requirements arising from business activities - such as Workers Compensation Insurance and financial responsibility associated with owning and operating an automobile.

There are those situations where the law requires that the venture simply must have insurance, such as Workers Compensation insurance and financial responsibility associated with owning and operating an automobile. The States mandate that that businesses depending on the industry and size, secure Workers Compensation insurance - providing protection in event their employees are suffer work related injuries. Likewise each state has minimum insurance requirements that operators of automobiles are required to obtain to meet the states financial responsibility.

The availability of insurance has facilitated commerce, and is possibly the most effective method to transfer a company's liability to a third party - an insurance company. This transfer mechanism is just one way of dealing with risks to which business owners are exposed. When coupled with risk control, risk transfers are effective methods to deal with exposures facing business owners.

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Intro to Key Expectations of Lenders

Pete Petges is an experienced farm credit lender with experience loaning money to agricultural enterprises. He offers a great deal of wisdom on what it will take for a local/organic food/farm venture to secure bank financing.

**Key Expectations of Lenders**  
**By Pete Petges**

- **Personal Integrity/Management Ability** - Integrity of the applicant and their ability to manage the enterprise being financed. Integrity is based on historic handling of debt and stress while management is based on demonstrated ability/experience.
- **Repayment Ability** - Payment ability of applicant/operation based on past personal history, past performance of the business and a realistic forward business plan.
- **Financial Condition** - Current and past financial balance sheets listing all assets and liabilities. These will provide information on ownership equity, total debt obligations, financial structure of the applicant/operation and liquidity/equity ratios.
- **Loan Parameters** - Constructiveness and practicality of the loan terms include loan amount, purpose, repayment plan and conditions. Conditions may or may not be governed by covenants added to the loan.
- **Collateral** - Adequacy and appropriateness of the collateral/security offered/ required to guarantee the loan repayment. This is property controlled by applicant/operation that may be chattels or real estate or both.

**Evaluating Personal Integrity and Management Ability**

The lender will determine if the applicant is of sound character and has the management ability to run the operation and repay the loan. Loan applications contain documents showing financial positions, earnings (past and projected) and available collateral, but these documents do not reflect the applicant's capacity for business decisions or ability to withstand financial or emotional stress. This individual factor may be the most important as it is the driver that transforms hopes, dreams and projections into realities.

Personal integrity is the applicant's willingness and determination to repay the loan regardless of unforeseen adversity. This requires applicants who are honest, open, self-disciplined and willing to keep the lender informed at all times of both positive and adverse situations. How past adverse situations were handled is a good determination of how future similar events will be handled.

How individuals handle themselves in good times may be very different than when under stress. The lender will assess the applicant's ability to handle many different sources of stress (financial, personal, and emotional) and still make sound business decisions required for the operation to succeed.

Regardless of personal integrity, only earnings can repay loans. Therefore, the ability to manage the operation successfully is very important. The lender needs to understand the goals motivating the applicant and the applicant's attitude toward risk. The lender will want to understand how past production, marketing, personnel and financing decisions were made. The lender will want to know what those decisions may look like in the future in both positive and stressful situations. They will also want to know what long-term goals will be driving those decisions. The lender will look at results over the past few years to assess the success of management to date. They may also want to assess management across different areas, such as production, marketing and risk control. The ability of the applicant to handle adverse economic times will also be evaluated. Lenders will look for some financial reserves, generally in the form of current assets and insurance, where applicable, to reduce risk. They will also want to know the plans for business continuity in the event of disability or death of those key to ongoing success of the operation.

### **Repayment Ability**

This is the ability of applicants to repay loans when due over a given period of time. In the short run, repayment may be derived from the sale of current year production, sale of inventory produced in prior years or sale of capital assets. However, few lenders are looking for short-term relationships. Loan repayments that come from sale of capital assets, and possibly from the sale of built-up inventories, may indicate less than a long run successful applicant/operation. This means the operation over time must be able to generate sufficient cash flow to meet all expenses, replace required depreciating assets (machinery, equipment, facilities, etc.) and provide for family living. Lenders will look for 3 to 5 years of earnings history. They also want cash flows that are built off the current and past results of the business and use realistic numbers for expenses and income.

Operating loans are expected to be repaid from the current production cycle and not require the sale of capital assets or sale of built-up inventories. Lenders generally will not lend more than 75% of the projected gross revenue for the current production cycle. Repayment time of loans for capital assets are spread over time, generally based off the expected usable life of the asset and range in an amount of 70% to 80% of the appraised value of the asset. Those repayments need to come from the applicant's/operation's profits. Lenders look for 15% margins after these repayments from profits as acceptable risk. That means they will take average net incomes over 3 to 5 years, minus family living, and add back interest and depreciation on capital assets to establish capital debt repayment capacity. From this calculation they will subtract principal and interest on capital asset debt along with some amount of annual capital replacement allowance (generally close to the depreciation amount that was added back) to

calculate the capital debt replacement. They want the capital debt replacement capacity to be 15% above the actual capital debt replacement amount. Lenders will not consciously approve loans that cannot be repaid from earnings.

### **Financial Condition**

Evaluating the applicant's current financial position is helpful, but the lender will want to look at 3 to 5 years of year-end balance sheets to assess trends. They will also look for business plans that are realistic and built on the current financial position. They want balance sheets broken into current, intermediate and long-term assets and liabilities. The lender will look for stability, growth and increased owner equity into the operation. They use these trends to analyze liquidity, solvency and profitability. Lenders generally look for ownership equity of 50%. They may consider down to 40% owners equity if other factors are strong. They also look for liquidity. That means they want current assets to be 1 ½ to 2 times current liabilities or working capital (the difference between current assets and current liabilities) to be 15% of the applicant's average gross income. Lenders also want to see that the operation has been profitable on average over the last 3 to 5 years. Positive financial trends are important as they are an additional measure of management ability.

### **Loan Parameters**

These include variables such as loan purpose, loan amount, repayment plan, maturity date, covenants and security offered/required. Lenders will want a firm understanding and in some cases detailed breakdown of loan purpose and loan amount. The purpose of the loan in most cases will dictate the maturity date and repayment plan. Repayment plans may require monthly, quarterly, semi-annual or annual payments or some combination of these. Maturity dates less than 1 year, annual or longer will depend on loan purpose. Covenants may require certain financial benchmarks, ratios, profit levels, etc. to be achieved for the loan to continue. Lenders may call loans if covenants are broken. Collateral/security taken will be subject to ongoing maintenance requirements that may include inspections for verification. Lenders want parameters that minimize their risk while meeting the needs of the applicant. Serious problems arise when the terms and conditions of a loan cannot be reasonably met by the applicant/operation. It is important that lenders understand the applicant/operation and that they can establish parameters that provide the lender an acceptable level of risk while still meeting the needs of the applicant/operation. If this cannot be established, the transaction should not be completed. Poorly structured loans lead to repayment, liquidity and solvency problems. These in turn can ultimately lead to liquidation of the business.

### **Collateral**

It is important to lenders to have a fall back position to secure their loan should the applicant/operation not be able to fulfill the loan obligation. Therefore, lenders look to have assets of the applicant/operation pledged in support of a loan and these are referred to as collateral. The lender has the right to take and

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hold or sell the property of the applicant/operation that has been pledged as security or payment for a loan. Applicant's assets that serve as collateral for a loan provide the lender a secondary means of repayment for the loan. Collateral is in the form of security interest taken on assets by the lender creating a lien through use of financing statements on growing crops, machinery, equipment and livestock, and mortgages on real estate and facilities. The value of these assets is generally determined by outside evaluators/appraisers. Other assets that may be used, but may be less desirable from a lenders view, are stocks, bonds, certificates of deposit, accounts receivable, and life insurance policies. Lenders want loans secured in the range of 65% to 75% loan to appraised value and will require security in that range by placing liens on some or all assets depending on the loan purpose, value of the asset, terms of the loan and strength of the overall applicant/operation.

### **Summary**

All of the above areas are important to lenders as they make their decision on a loan request. If the operation has strengths in some areas but is short in others, it may be possible for the applicant and lender to look for guarantee programs available through government agencies to strengthen the loan request enough to obtain a positive decision. But remember, these agencies will look for the same general information but their standards may be broader and allow them to issue a guarantee for this request. It is important to recognize that reputable lenders do not generally charge to do the analysis and do not gain financially when their decision is negative. The only positive they have when denying a request is the feeling that they did not get an applicant/individual into what they believe is an untenable situation.

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Intro to Legal & Regulatory Issues and Local and Organic Food & Farm

By way of introduction, I am going to note two key points; I have farmed, grew up in a multigenerational farm family, and have practiced international law related to these kinds of issues of food, green and farm. So my own perspective is that managing the legal and regulatory risk is both a local and global issue in a sense.

It is a global food and farm economy and local and organic have compelling advantages in that marketplace. However, it is also local, for local food and farm startups, zoning is one of the most important issues and for organic ones, U.S. law in the form of the federal organic statute and regulations is one of the most important legal issues to be addressed. Investors should know that if the legal and regulatory issues in local and organic food go badly, they have the potential to go very badly. Organic food and farm ventures are, of course, regulated by the federal government, and local food issues are subject to basic food safety regulation as well. The checklist below is a basic guide to the essential points an investor should see addressed by the venture.

**Legal & Regulatory Issues and Local and Organic Food & Farm Ventures  
By Rich Schell**

1. Business Entity--How will I run this business: as a proprietorship, corporation, limited liability entity, or other kind of entity?
2. Employees--Will I have them or is it just me? If it's just me, what's plan B if I can't do the work? If I hire others, do I know what I need to know to be a lawful employer?
3. Insurance--An ounce of insurance may be worth a ton of lawsuit. Am I insured? Should I be?
4. Liability --Do you know the potential business, financial and legal downsides to starting a food business?
5. Markets--What will I have to do navigate the terrain involved in selling wholesale? Retail? Directly to consumers?
6. Organic Products--Am I willing to stay current to be certified organic? Is it a necessary element for my business?

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7. Processing--How much processing do I need? Where will I obtain it?  
What do I need to be compliant?
8. Rules & Regulations--Federal, State, Local? Who regulates me?  
Washington D.C.? Springfield or the County?
9. Taxes--Income? Sales?--Is there a compliance plan in place?
10. Zoning/Appropriateness of business and licensing issues--Not every food  
business is a good fit for every locale--know before you open for business  
if you can operate your business in your location.

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