Financing Michigan's Sustainable Agriculture: The Availability and Accessibility of Capital for Beginning Farmers

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Executive Summary

Initiating a farm enterprise is often an extremely difficult undertaking, particularly for first generation farmers. Those who wish to operate a small to mid-size, diversified farm that markets products directly to the surrounding community rather than a large, commodity farm face even greater challenges on two levels:

1. Our resource infrastructure is designed to undergird our global commodity market agricultural system, and therefore relegate smaller scale farming to a status of "niche" or "unconventional", or "non-commercial".

2. The status of farm operations and asset requirements (including land and financial collateral) may position the farmer as high risk based on lending criteria structured around larger scale agri-business.

In a recent study of beginning farmers, Ahearn and Newton concluded that beginning farms are of recognized importance to agricultural productivity growth and land conservation goals for the United States.[1] Limited research and anecdotal studies tell us that capital access tailored to the start up and development of farmers in sustainable or ecologically friendly farming, a growing sector across the country, is inadequate.[2] The focus of this paper is to explore the extent to which private and other sources of capital are available in Michigan to support beginning farmers. The paper also offers recommendations that build upon opportunities and address impediments to grow capital investments in Michigan smaller scale, diversified agriculture.

Michigan's economy is facing huge challenges, with manufacturing in decline. Agriculture, one of its important industries, is growing. According to a report from Michigan State University's Product Center for Agriculture and Natural Resources, Michigan agriculture experienced a 12 percent growth in 2007, with a yearly economic impact estimated to be $71.3 billion, an increase of $7.6 billion from the $63.7 estimate in 2006. [3] However, Michigan faces the challenge of keeping farmers in farming and shaping a food system that works for farmers and consumers while bolstering local and regional economies. The aging of farmers begs the question about who will farm in the future. As the average age of Michigan farmers continues to increase – currently at 56.4 years, - entry-level farmers are needed to replace them. Only 5.2% of Michigan farmers are under the age of 35.

Michigan farmland is shrinking and the cost of farmable land is rising; the average price per farmland acre was nearly 60 percent higher in 2001 than five years earlier and double the price of a decade earlier.[4]

With the demand for organic and local sources of fresh product increasing in Michigan, connecting newer farmers directly with Michigan markets may help meet this growing demand for locally and sustainably grown foods and stimulate Michigan's ailing economy. In order to address the role that capital could play in assisting the growth of viable, smaller scale, diversified farm operations in Michigan, the CS Mott Group for Sustainable Food Systems at Michigan State University (Mott Group) surveyed fourteen Michigan financial institutions, loan funds, and public entities to gather information about the respondents' lending activity as well as their familiarity and engagement with beginning farmers. We found that there is financial capital available in Michigan, but its accessibility by farmers is based on several variables: institutional repayment criteria, lenders' knowledge about smaller scale sustainable farming, whether or not agriculture is an organizational priority, the extent to which financial institutions market their products to potential clientele, and geographical location. A nominal number of financial institutions (4 of 14) were able to describe beginning farmers beyond the USDA description, but such farmers represent a very small portion of their overall lending portfolio. Despite the fact that the majority of financial institutions require a down-payment or collateral to get an operational loan, only one offers asset-building tools to increase net worth.

Recommendations include expanding asset building tools to build net worth of promising beginning farm enterprises, clarifying the link between production agriculture and economic development within the financial services industry, developing strategic linkages between beginning farmers and sources of capital investment, and exploring new visions for capital deployment to scale up Michigan's food production.

Background

"We need a new generation of farmers. This is a huge issue. Who will grow our food in the future? This is urgent! The time is NOW!"

Janie Hipp
USDA

The future health and vitality of agriculture, the food system, and both urban and rural communities depends on the successful entry of all who want to pursue a farming livelihood. A third of all farmland owners are of retirement age, and over the next two decades an estimated 400 million acres of U.S. agricultural land will be passed on to heirs or sold. While a growing number of young people and new immigrants want to enter farming, they face a myriad of challenges such as the rising cost of farmland, a critical shortage of training, and lack of financing.[5] The issue of a new generation of farmers has taken central stage in the discussion of new farm policies because "new farmers bring skill sets to complement and enhance traditional management and production technologies".[6]

To enter farming without the expectation of inheriting land, aspiring farmers may have to be postpone farming until they accumulate significant resources to acquire necessary farm assets, a process that can take years.[7] But because the farm sector depends on a lengthy biological process that generates considerable physical and financial risk, the urgency to finance exists during this gestation or start up period.[8] Financial capital has historically been difficult to come by in the farm sector, especially for beginning farmers.

Government programs designed to encourage beginning farmers to enter agriculture and enhance their chances of surviving as viable farm operators have emerged from the 2008 Farm Bill. The focus of this paper, however, is the question of whether or not private and public sources of capital are available to support what has been cited nationally as "the urgent need to generate new, commercially oriented farmers."[9]

Expanding Michigan's Agriculture Economy

SHRINKING FARMLAND

Farmable land in the U.S. has steadily decreased since 1949, shrinking by 8.4% between 1949 and 2002.[10] The 2007 U.S. Census of Agriculture reported a decline in US farmland acres from 938.3 million in 2002 to 922.1 million in 2007, a loss of 1.7 percent.[11] Michigan is experiencing both farmland shrinkage and affordability issues. The total number of Michigan farms declined by 2/3 between 1950 and 2007[12] and the American Farmland trust has ranked Michigan 9th in the country for most threatened prime farmland due to sprawl.[13] The USDA reported in its "Agricultural Land Values and Cash Rents" that Michigan's farmable land prices increased

more than 7.2 percent during 2008 to an average price of $3,700 per acre. According to USDA statistics, the last time farmland values in Michigan experienced a year-to-year decline was January 1987.[14] The Federal Reserve Bank of Chicago reported that Michigan land prices increased 13 percent from Oct. 1, 2007, to Oct. 1, 2008. All of this points to a severe lack of affordable land for new farms, and a situation in which access to start-up capital is becoming more critical.

AGING FARMERS

The aging of the U.S. farmer population has led to concern about a shortage of beginning farmers. The average age of U.S. farm operators increased from 55.3 in 2002 to 57.1 in 2007. The number of operators 75 years and older grew by 20 percent from 2002, while the number of operators under 25 years of age decreased 30 percent.[15] In Michigan, the farmer profile is brings home this urgency: only 5.2 % of Michigan farmers are under age 35, and the average age of the Michigan farmers is 56.4. While beginning farms are more likely than established farms to be small in scale and operated by younger operators, beginning farmers are not necessarily young farmers. Beginning farmers enter agriculture at all ages, not just young ages. Approximately a third of beginning farmers nationally are 55 years or older. [16] This means that unless significant numbers of new people enter farming, we will continue to face a dwindling population of farmers and will risk greater reliance on imported foods.

The availability of training is a parallel issue. Many of the people who wish to operate a farm business today lack a farming background and experience. The lack of a comprehensive training program for new farmers presents a significant barrier to entry in Michigan. Existing training opportunities are scattered and uncoordinated. No single program covers all core production and business management competencies along with infrastructure support to assist with land, capital and market access. Yet, there are indications that a growing number of people are interested in organic and/or sustainable farming in Michigan. According to Corie Pearce, training instructor at the Michigan State University Student Organic Farm (MSUSOF), the one-year Organic Certificate Program's enrollment has increased steadily over its three years of existence and has a waiting list for 2010. [17] A huge issue, according to MSUSOF lead instructor, Jeremy Moghtader, is whether or not people completing the program can begin farming without access to flexible capital to obtain land.[18]

GROWING DEMAND

Both Wisconsin and Illinois have capitalized on growing demand for differentiated agricultural products by passing legislation that plans for expanding and supporting their states' local and organic food system while overcoming obstacles to increase local and organic food production.[19]

Since the late 1990s, U.S. organic production has more than doubled, but the consumer market has grown even faster. Nationally, organic food sales have more than quintupled, increasing from $3.6 billion in 1997 to $18.9 billion in 2007. More than two-thirds of U.S. consumers buy organic products at least occasionally, and 28 percent weekly, according to the Organic Trade Association. The organic industry has grown by 17 to 21 percent each year since 1997, while overall domestic food sales grew by only 2 to 4 percent during the same period. Industry analysts predict that the organic market will continue to grow at a rapid pace. This fast-paced growth has led to input and product shortages in organic supply chains.[20]

There are several indications that Michigan's consumer demand for more local and organically grown food is growing. Increasing prevalence of farmers markets, roadside stands, pick your own operations and community supported agriculture subscription programs suggests that locally sourced food is no passing fad. The number of Michigan farmers markets tripled from 2000 to 2008.[21] Michigan now has 85 Community Supported Agriculture (CSA) operations,[22] and certified organic tillable acres increased by 166% between 1997 and 2005.[23] Because Michigan currently has only 205 organic farms, of which 88% operate on less than 170 acres, there is potential to capture a greater share of the organic market. [24]

MICHIGAN'S MARKET SHARE

Michigan agriculture is poised for opportunity with increased interest in locally grown food, growing enthusiasm for farm markets, higher-value niche products, opportunities to build processing plants for Michigan-grown products, new farming technologies and new possibilities for season extension.[25]

MSU researchers estimate that just 43% of the foods wholesaled and retailed in Michigan are grown in Michigan (Ferris). With extimated total Michigan retail food sales at $11.602 billion, the $6.613 billion non-Michigan food products sold represent potential markets for many farmers and food businesses (Peterson et al).

A 2008 statewide study demonstrated the potential for agriculture to drive economic growth in Michigan. A team of Michigan State University researchers led by David Conner measured the economic impact of meeting Food Guide Pyramid requirements for fresh fruits and vegetables. They modeled the impact of the following scenario: state residents increase consumption of all fruits and vegetables to meet the guidelines and, when in season, the increased consumption of those items able to be grown in Michigan is sourced from Michigan farmers. This change would result in a projected net increase of 1,780 jobs and $211 million in new income.[26]

A recent joint report by the Michigan Land Use Institute the W.E. Upjohn Institute for Employment Research, and C.S. Mott Group for Sustainable Food Systems at MSU further reveals the market opportunities in transitioning to growing and selling more fresh vegetables and fruits:

- Currently 74 percent of Michigan fruits and 44 percent of its vegetables are sold at relatively low prices as ingredients for canned, frozen, dried, and other processed products.
- The study's projections for up to 1,889 jobs and $187 million in new, personal income could warrant a state economic development investment of at least $9.5 million toward marketing Michigan foods and helping farms and related businesses supply more fresh markets. [27]

The study assumes two necessary market conditions: the elasticity of demand for fresh or direct market fruits, and vegetables, and the change in the level of consumer demand for fresh or direct market fruits and vegetables. Assuming that there would be some changes in price and that those changes might affect the quantity of produce consumer demand, and that Michigan would market Michigan-grown produce, the magnitude of missing market share in fresh product reveals that new farmers could have a major economic impact in Michigan.

BEGINNING FARMERS

The USDA defines beginning farmers and ranchers as those who have operated a farm or ranch for 10 years or less as either a sole operator or with others who have also operated a farm or ranch for 10 years or less. Established beginning farmer and rancher programs have differentiated beyond the USDA definition, determining that understanding newer farmers is the foundation of effective program design. [28]

In 2001, the Northeast Growing New Farmer Consortium (GNF) proposed a typology of new farmers that would enable service provision to commercially oriented agricultural production. [29] The term *new farmer* encompasses the "universe" of people who are considering becoming farmers and those "beginning farmers" who have actually been farming for 10 years or less. GNF defined six "types" of new farmers. These six GNF farmer types are distinguished by their current engagement with, and commitment to, farming. Beginning farmers in their first three years of start up operations are still discovering what they need, requiring different services than those enhancing their farms after six to seven years of operation. Recognizing stage of farm operations enables GNF to more adequately address the needs of their clients and to acknowledge the experience gained during the initial years of farming.[30]

The GNF typology illustrates deliberate efforts by beginning farmer programs to focus on educational, experiential, and resource acquisition to help farmers take advantage of the rising consumer demand for direct marketing of sustainably produced farm product locally and regionally. [31] GNF describes beginning farmers as having acquired farming knowledge, skills, and management expertise, but because many are first generation farmers lacking land access and the capital needed for start up.

A Mott Group case study of four Michigan beginning farmers revealed similarities to the description of the GNF farmers. These Michigan farmers, having completed a comprehensive beginning farmer program in southwest Michigan and now entering their fourth year of farming, are first generation, have college educations, manage their own farms, cut costs by doing all their own labor, rented land before owning, and are taking advantage of local booming markets for fresh grown food. They worked on others' farms, saved money, pieced together capital from a variety of sources, worked off farm, received contracts up front to grow food for others, and invested any profit into their farm rather than pay themselves the first two years. None applied for conventional financing, anticipating that they were non-bankable. Two of the four anticipate 100% of their personal income will come from their community supported agriculture (CSA) operations within four years of operation by accessing up-front consumer and institutional contracts. Two took over other farmers' successful operations and now derive half their family income from the farm. These farmers represent a growing number of farmers in Michigan who have not received conventional financing. [32]

AGRICULTURAL PROFITABILITY

The debate about whether or not smaller scale agriculture is profitable influences risk-averse financing for farm operations. In commodity farming, the predominant wisdom is that the larger the scale of operation, the more profitable because they typically compete on the basis of price and greater size often means greater efficiency.

However, entry rates for small farm businesses are significantly greater than for other farm sizes. Many of the newer farm start-ups have chosen to compete on the basis of customer benefits by marketing a differentiated product such as local or organic. With this market strategy, product price is a factor but not the overriding factor and keeping the business small may be critical to success. Entering farmers make significant contributions to agriculture production, accounting for a share of farm sales generally higher than that reported for beginning manufacturing industries. [33]

Commercial banks finance 41% of all farm debt (2000), and 43% of all small farm debt. The Farm Credit System provides 25% of farm credit nationally.[34] The Comptroller of the Currency regulates agriculture lending by banks. The Comptroller issues the Comptroller Handbook on the fundamentals of agricultural loan underwriting and administration, and provides guidance for examining those activities in national banks. The Handbook's Agricultural Loan Classification section indicates that there are no mandatory rules to direct examiners on how to treat agricultural credit. However, the handbook describes production credit as "perhaps the most volatile form of agricultural lending". [35] It is up to the individual bank to establish a reasonable process to analyze projected cash flow. Close cooperation between lenders and farmers is suggested.

The distinct difference between small and mid-scale farming, based on product differentiation and commodity farming may pose an information and communication gap among Michigan lenders. Lenders who rely on commodity farming metrics to underwrite small and mid-scale agriculture credit risk may be closing the door on farm models that are already addressing financial risk management. Such were the findings in a 2003 study conducted by the Minnesota Land Stewardship Program. Results suggest that lenders think farm business plans are often poorly written with little substantiating data to determine profitability. Newer farmers (0-3 years of operation) have reported that lenders are not convinced about the profit margin potential on farms operating on less than 5 acres. A survey conducted by the Minnesota Land Stewardship Project of 567 lenders, agricultural educators, and farmers in Wisconsin and Minnesota revealed

that 89% of the farmers thought sustainable farming was equally or more profitable than conventional farming, while only 35% of the lenders in the study thought this was true.[36] A quote by an Oregon county commissioner at a debate sponsored by the local Farm Bureau reflects the perspective of many lending institutions: "To think that someone is going to make a living on five acres is ridiculous. That's not a farm."[37]

THE ROLE OF CAPITAL

"Some of these young people do a fantastic job of being realistic. They are sharp people. They are not planning on struggling for 40 years with nothing to show for it. They are a good investment in themselves and for our bank over the next few years. And you know, I haven't lost a nickel in 11 years of lending to start up farmers who are realistic (can produce realistic cash flow projections)."

Small Bank Agriculture Loan Officer

Farm income cannot be ignored as a key factor in determining the success of the next generation of farmers and ranchers.[38] The foremost reason why so few farmers are young is that start up costs in agriculture presents a barrier to entry.[39] Farming commonly requires control over land and capital. Land access and transfer programs connecting farm owners with new farmers are emerging. Yet financing land is a major challenge, and beginning farmers with limited collateral have difficulty finding credit for land acquisition, equipment or operations.

The growth of innovative programs to address capital access has emerged nationally. The Carrot Project (TCP) was established after a multi-state, 700+ farmer survey determined the different financial capital needs of growers based on type and stage of operation, accounting for regional differences. TCP's approach is to finance farmers unable to access more traditional lending sources by providing small loans *and* to improve access to financial resources.[40] The Iowa Beginning Farmer Tax Credit, a tax program that provides an incentive to current and retired farmers who rent agricultural assets to a beginning farmer was initiated in 2007 by the Iowa State University Beginning Farmer Center and approved during the 2006 Iowa legislative session. The program, administered by the Iowa Agricultural Development Authority, makes tax credits ranging from five to 15% available to any eligible Iowa taxpayer who transfers assets to a "beginning" farmer. Farm transfer programs such as California FarmLink and the Vermont Farmlink serve as an intermediary step to applying for conventional financing by offering farm business plan development and small, initial, operational loans.[41]

Capital Availability and Accessibility for Beginning Farmers: Michigan Survey Project

In July 2009, we surveyed fourteen Michigan financial institutions, loan funds, and public entities. Significant agriculture lending institutions across Michigan were identified, including Michigan banks, credit unions, community development loan funds, state agencies, federal and farm credit services entities. The survey tool comprised twenty-five questions designed to gather qualitative and quantitative information about the respondents' lending activity as well as their familiarity and engagement with beginning farmers.

Following the survey, interviews by personal visits and/or telephone conversations were conducted with chief lending officers representing a cross section of conventional and community-based financial institutions across Michigan. From this series of 14 interviews, we compiled and analyzed survey results to address financial product availability and accessibility (see appendix for complete documentation). Following are the most salient findings from the interviews.

CAPITAL AVAILABILITY

Capital availability refers to financial products offered specifically to start-up and beginning farmers. Key questions were asked to determine both product availability and market impetus behind these financial products. The following summarizes the responses that best illuminate the state of financial capital availability in Michigan.

1. **Most financial institutions' concepts of beginning farmers don't go beyond the USDA definition.**

   The majority of respondents used the USDA definition of beginning farmers to describe this market sector. However, some loan officers in small banks and CEO's of small credit unions provided added descriptors based on some of the new farmers to whom loans were given. These descriptors included: college educated, determined, smaller scale, first generation, have vision and plans, understand risks, and direct delivery of agriculture product to the customer.

   The majority of the respondents also described their awareness of a more "localized" food system when talking about beginning farmers. Respondents used such descriptors for this localized food system as: new farmers' markets, urban gardens, Community Supported

Agriculture (CSA), grocery stores advertising local produce. Nevertheless, knowledge of some changes in agriculture was based more on observation rather than first-hand experience lending to these new farmers. In other words, the knowledge of local food was not necessarily related to the number of new farmers served by the majority of institutions.

2. **Beginning farmer loans do not represent a significant portion of lending activity among the majority of financial institutions**

   Except for the Farm Service Agency and Greenstone Farm Credit Services whose mission and regulatory responsibilities are specifically within agriculture, the majority of financial institutions stated that beginning farmers are not an organizational priority. However, in practice, some small banks, one loan fund manager, and both credit unions stated that they did not discriminate based on business enterprise type. Rather, their priority is to work with beginning farmers on a case-by-case basis. Having said that, loans to beginning farmers represented less than 5% of the financial lending portfolio for all financial institution respondents except for GreenStone Farm Credit Service and Michigan Farm Service Agency. Both Greenstone Farm Credit Service and the Michigan Farm Service Agency have mandates to service beginning farmers. Greenstone Credit has implemented a board approved Young, Beginning and Small Farm and Ranchers (YBS) lending program comprised of separate components for YBS farmers. More relaxed underwriting standards and loan terms have been approved for farm operating loans, farm equipment and intermediate term loans, and for real estate loans[42]. The Michigan Farm Service Agency has Congressional targets set each year. According to the Farm Service Agency, the demand for operational loans among beginning farmers was 50% higher in 2009 than it was for the same 6-month time period in 2008.

3. **A more localized food system does not trigger agricultural lending activity**

   To get insight about institutional planning to serve new markets, respondents were asked about the extent to which they linked local food system activity with the potential for new customers. Those lending institutions familiar with more localized food systems described the food system in the context of production methods (organic, sustainable, higher value diversified product), and by more localized markets (farmers markets, Community Supported Agriculture, institutional and restaurant markets). State agencies responded that although they

recognize such activity in other states, or somewhat generically as "the local food movement" cited in print, they haven't determined that it is a growing trend in Michigan. Reasons given were lack of evidence of true income generation/job creation, and the lack of legislative mandates to serve this sector.

For the most part, the smaller the institution, the more inclusive their description of observed food system activity at the local level; banks and credit unions could describe how they are working with individual beginning farmers based on the individual lending officers' history of direct experience with this sector. One credit union has direct experience because of a partnership with a local beginning farmer program. However, the majority of lenders acknowledged that they are aware of the increase in local food activity, citing activity by product, market focus (more local and direct) , and size of farm operations (less than ten acres). However, these lenders pointed out that their awareness was not necessarily caused by an increased demand for loans from beginning farmers in their region.

4. **Smaller financial institutions are better able to tailor their products**

   With the exception of FSA and Greenstone Credit, which is governed by statute, all institutions responded that new product development responds to customer need, though customers must be able to demonstrate repayment of any loan or line of credit. Small banks and credit unions were most able to tailor products, including small amounts of initial loans, if beginning or new farmers were able to demonstrate a positive cash flow. Both credit unions and the community development loan fund manager stated that they base products on what members or customers present to them as a financial need for start up; however, both were quick to point out that they tailor products on a case by case basis, and that return on investment for both the client and the institution is essential.

CAPITAL ACCESSIBILITY

Capital accessibility refers to the user-friendliness or ease of use of financial products available to new and beginning farmers. In order to understand the ease of use, we asked questions related to the assessment of risk, as well as the extent to which financial institutions reached out to potential customers. Responses to the following four subject areas provide the most insight about financial capital accessibility among Michigan financial institutions.

1. Determining risk assessment varies with financial institutional size, regulatory responsibilities, and internal policies

All institutions determine repayment capacity through either historical and/or projected cash flow for startup farmers. The degree of specificity varies based on institutional lending practices. Government regulations influence both FSA and GreenStone Farm Credit Services such that they are formulaic in their calculations of risk which influences the extent to which they can provide loans to beginning farmers that have neither start up capital nor equity in their farm business. GreenStone Farm Credit Services, the largest lender to beginning farmers in Michigan, lending over $1billion (2008) in Michigan and 11 Wisconsin counties, utilizes different underwriting standards for beginning than for established farmers. GreenStone Credit requires that beginning farmer applicants demonstrate 25% equity in their business, which is half of the standard 50% equity position required for farm businesses that fall outside the USDA beginning farmer definition.

Some smaller banks serving a smaller geographic area, credit unions, and loan funds are able to calculate repayment using both current and projected cash flow and off-farm income.

What distinguishes the smaller financial institutions from the larger agriculture lenders is the mindset about risk. The smaller institutional lenders emphasized that they can provide personalized financial services to help build the capacity of a farmer who presents potentially viable start-up or enhancement plans. Personalized services included tailored financial products, flexible payment schedules, credit repair, ease of application process, and some technical assistance in financial statement development. Although labor intensive, such personalized services ultimately lessened financial risk to the institution.

Agriculture-based lending institutions did not seem to have the same flexibility; therefore, proof of repayment was paramount to institutional financial protection. Small loans may be the bread and butter of smaller institutions, but servicing those small loans is thought to be a loss leader by larger financial institutions. Stated a former agriculture lending officer of a smaller bank in southern Michigan that had recently merged with a larger bank, "we are no longer doing small farm loans. Smaller loans are not worth anything. The bank is only providing smaller loans to existing customers." According to this lending officer, his bank, located in a county that farms 3.5% of Michigan's total farm acreage, no longer sees agriculture lending in their future.

2. **The chief obstacle to extending farm credit cited by financial institutions is the relating of current or projected cash flow by farm operators.**

   According to the majority of respondents, unrealistic cash flow projections for startup farms represent the chief obstacle for getting any kind of financial support from lenders. Further, the common denominator for turning down a loan application was lack of cash flow that would enable repayment.

   A second obstacle was lack of personal capital by a start-up or beginning farmer. This is the major obstacle to obtaining a loan from GreenStone Farm Credit Services: regardless of size of the operation, a down payment of between 15%- 25% is standard for farm loans from them.

   The third obstacle is lack of both production and farm management knowledge. Said one small bank lending officer, "If they make a mistake, it can be a very costly mistake. I see other lenders making loans based on collateral, but the person has no experience. So, the lender will get their money, but the farmer is paying the price because the farmer did not really know what they were doing."

   Smaller banks and credit unions factored in two additional indicators of farm success: the knowledge about the farm product and level of farm management experience, as well as the farmer's ability to provide realistic cash flow projections? Credit unions also considered past history of personal credit, which they view as a window into the person's character. The agricultural lenders, Greenstone and USDA, both cited down payment, and unrealistic expectations based on estimates of production as additional obstacles. Both USDA and Greenstone use industry standard formulas to determine expected return.

3. **Community-based and small financial institutions place value on lender relationships with farmers as cost-effective strategies for delivering services**

   Respondents were asked to describe lender attributes valuable to farmers. All respondents cited that forming a relationship with a borrower as a component of successful lending. Responses from small banks and credit unions overwhelmingly cite the value of building a relationship with the borrower by providing some financial counseling as well as providing some tools that enable the borrower to present their farm as a business as the most significant attribute they believe is valued by farmers. One of the smaller bank's lending officer stated that the relationship with a new farmer is key, and that he is concerned about the

bank's future role with new, smaller farm operations when he retires. Credit unions intermixed "ease of application" with "someone the farmer can talk to" as lender attributes that they considered valuable to their customers.

A second attribute that respondents thought was invaluable to a beginning farmer was the lender's knowledge about agriculture, specifically, knowledge about the type of agriculture for which the borrower is seeking financial support. Said one small bank loan officer, "Young farmers are open minded and they are asking questions. They are not into financing tractors; they want to succeed so they ask questions. They know you; you live in their community; they need us to help them think about how to make the cash flow so they are not left with a debt and nothing to show for it, even though there are lenders out there that would finance the tractor whether they needed it or not."

4. **Identification of and marketing to the non-traditional farmer sector is not customary**

Customer engagement refers to the extent to which financial institutions reach out to new and beginning farmers, marketing products, and facilitating interaction with prospective customers. An important finding is that over 70% of financial institutions surveyed rely on word of mouth referrals from current customers. Other customer engagement strategies mentioned include newsletters, satisfaction surveys, and farm visits. These activities were limited to current customers, presentations at strategic conferences, going to farmers markets to deliver their monthly newsletter, and getting referrals from partners and associations.

Engaging customers is an important aspect of financial product accessibility; if financial institutions are relying on word of mouth, reaching beginning farmers may not be an organizational priority. According to the spokesperson for a major agricultural lender, "We publish periodic newsletters of all farm loan-related product information. They may not hit those who do not participate in our database; if you don't participate, you don't get the information."

LOWERING RISK THROUGH PARTNERSHIPS AND SUPPLEMENTARY PROGRAMS

Several questions were designed to explore the extent to which financial institutions were either currently engaged in or open to partnering with organizations offering farm development programs. Integrating

supplementary programs or partnering with organizations who offer these programs may lessen a financial institution's perception of risk associated with start up farming operations. Partnership and supplementary programs are integrated in some International Farm Transition Network (IFTN) member beginning farmers and land transfer programs. These programs create partnerships among many organizations, including financial institutions, to develop new transition and tenure strategies that facilitate the entry of the next generation and the exit of existing farmers. Beginning farmer and land transfer programs such as the California Farm Link Program and Minnesota Land Stewardship program use some of the approaches mentioned below with success.[43]

1. **Financial Institutions rely primarily on internal programs and funding sources for lending**

   None of the respondents intentionally collaborate with land trusts or other groups that are working to create access to farmable land. GreenStone FSC refers customers to USDA Resource and Conservation programs. 7 of the 14 institutions (50%) refer beginning farmers to local MSU Extension, community colleges, and small business development administration programs for business planning assistance.

   Encouraging start up or beginning farmers to take advantage of financial products may depend on the flexibility of the financial institution's capital. None of the respondents use philanthropic funds to supplement or target loan products to specific target borrowers. Of the respondents who offer loan products, 50% use depositors' savings as the only source of available capital. Fifty percent (50%) borrow money through national loan pools, other banks, or through bonds and loans. Several lenders get FSA loan guarantees. One of the financial institutions surveyed lends to an intermediary whose role is to initiative and service loans. One credit union lends to cooperatives that serve farmers. One entity offers loan guarantees to financial intuitions.

2. **Financial institutions describe the significance of underutilized ancillary programs and partnerships**

   None of the respondents strategically partner with an intermediary to market their products, to generate more beginning farmer customers, or to act as a "feeder" or stepping stone program. However, Country Heritage Credit Union acts as the financial institution partner in a beginning farmer program that offers financial incentives to increase farmers' personal savings behavior. All of the respondents stated that

they could see the value of strategically partnering with an intermediary, each for various institutional reasons.

State agencies, especially the Michigan Economic Development Corporation (MEDC), acknowledged that intermediary or partnership relationships are instrumental for them to work within communities. MEDC referenced their work in the Detroit area around fresh food financing as an explicit example of how strategic partnerships *leverage* MEDC funds. MEDC works with partners across the state to determine their capacity as a financial intermediary.

Both credit unions cited working with intermediaries as a way to strengthen their capacity to serve beginning farmers. Frankenmuth Credit Union recently merged with an agriculture credit union in Saginaw. Working directly with a beginning farmer program would create an avenue for them to reach more farmers in their expanded geographic area. Country Heritage Credit union, hosting the Agriculture Individual Development Accounts in SW Michigan, referenced the potential of strategic relationships with area partners to expand services to new and beginning farmers.

Both community development loan funds stated they would welcome working with an intermediary that would increase their knowledge and development potential in urban and rural agriculture.

Smaller or community banks want to serve beginning farmers who can produce sound financial projections for their enterprise. Each bank suggested that working with an intermediary that would help prepare and might even provide supportive financial capital would be well received.

Both government agriculture programs stated that working with intermediaries would be helpful to their programs. FSA is sensitive to the current economic conditions in the banking industry; intermediaries that help farmers prepare for viable business operations enable them to present less risk when applying for products.

3. **Financial institutions recognize the value of asset building**

Asset building is more readily achieved with supportive financial tools that help those with limited incomes build wealth. Wealth building refers to closing the financial gap that prevents entrepreneurs from taking advantage of mainstream sources of capital. Credit unions are

interested in enabling potential borrowers to move forward along a credit path, but without intentional partnerships, none of the financial institutions are involved in this form of equity-based incentives that shrink the capital gap for start up and beginning farmers.

Although all respondents understood the role asset building could play in removing obstacles to obtaining credit through their organizations, only one financial institution was involved in an asset building initiative with beginning farmers. Country Heritage Credit Union partners with Van Buren County MSU Extension to offer low resource farmers a matched-savings account program called Agriculture Individual Development Accounts.

Although other suggestions for asset building included keeping interest rates at lower than market rate and technical assistance through incubator programs that reduce overall operating expenses by sharing access to needed equipment or other services, the remaining financial institutions did not envision creating programs that yielded direct resource- building for beginning farmers.

Summary

Responses to the survey suggest that Michigan financial institutions want to know their business borrower. Financial institutions rely on the information shared by the farmer's business plan, which demonstrates their projection of successful product and marketing and shows them current assets and resources. They also want to know the farmer's skill set, usually translated as the experience the borrower has in farm management. Financial institutions use a variety of tools to determine whether or not the farmer will repay a loan. For the majority of financial institutions interviewed, the farmer's product knowledge and farm experience are of utmost significance in determining the likelihood of farm enterprise success. Net worth is also important in terms of protecting the financial institution against unanticipated loss.

Comparing Lender Requirements and Beginning Farmer Attributes

The list of lender requirements in Table 1 is a compilation of repayment indicators described as having some value by financial institutions in the study. Criteria influencing lending decision-making differed by institutions.

All institutions required that beginning farmers have both knowledge of and experience with their product and production methods, and have a farm management plan. On the assets and resources side, off-farm income, realistic income and expense projections, sound credit history, and a manageable debt to income ratio need to be depicted in a farm business plan. Sixty percent of the institutions required knowledge about and direct farm experience, collateral, and a significant down payment as part of the loan application package. Other indicators listed in the bottom cells added value or strength to the borrower's overall application package if there were weaknesses in mandatory criteria.

Table 1: Lending Requirements for Farmers in 0-3 Years of Operation

<table>
<tr><th colspan="2">Farmer Attributes
Farmers in 1st three years of farm operations</th></tr>
<tr><th>Background and Expertise
Farming knowledge, farm management expertise, farming background</th><th>Assets and Resources
Land, capital, income, markets, family support</th></tr>
<tr><th colspan="2">Lender Requirements</th></tr>
<tr><td colspan="2">***Eligibility criteria required by 100% of institutional respondents***</td></tr>
<tr><td>✓ Knowledge of and experience with product and production methods
✓ Farm management plan</td><td>✓ Total household income
✓ Business plan
✓ Positive Credit history
✓ Current debt to income ratio (20-30% for FSA)</td></tr>
<tr><td colspan="2">***Eligibility criteria required by 60% of institutional respondents***</td></tr>
<tr><td>✓ Non-farm background but experience through employment or apprenticeship (The USDA Farm Service Agency requires one year of farm management experience for an operating loan; three years farm management experience for loans to purchase land
✓ Ability to describe vision</td><td>✓ Collateral: land and equipment
✓ Farm loans (15-25% down-payment standard for GreenStone FCS)
✓ Market research</td></tr>
<tr><td colspan="2">***Additional criteria that influence decision making***</td></tr>
<tr><td>✓ College education
✓ Desired household income fits business plan
✓ Family farm self-start (grew up on farm but starting operation independent of family farm
✓ Inheriting farm</td><td>✓ Farm financial records for 2 years
✓ Crop insurance
✓ Contract for product sales
✓ Family member co-sign loan
✓ Farmer mentor</td></tr>
</table>

Findings of Institutional Support for Beginning Farmers

The recognition of emerging more localized food systems engaging their customer base enabled small banks, credit unions, and loan fund entities to consider the beginning farmer as a potential customer even though the percentage of their overall borrowers in this sector was small. A number of financial institutions could describe attributes of younger, smaller-scale beginning farmers that distinguished them from older, larger scale, experienced farmers. These attributes permitted some small banks, credit unions, and loan funds to review a borrower's business intentions, making lending decisions on a case-by-case basis. Stated one banker, "It's not so much that the trend is organic; it's more about the trend in the farmer profile. They are young, college educated, have some experience working on other farms, not a child of a farmer, have good ideas but not much collateral, needs smaller amount of money for start up but has no working capital. Some have families who can help the young farmer absorb some of the risk. Some do not."

Smaller banks and credit unions do offer tailored financing, however, a beginning farmer must meet certain skills, knowledge, and income generation requirements. The majority of smaller lenders look at relationship building as key to farmer development. Thus they take time to assist beginning farmer borrowers' efforts to strengthen their application package if farmers demonstrate capacity in cash flow projections and production. Beginning farmers may approach smaller banks and credit unions with reasonable production plans accompanied by some farming experience, yet lack personal capital or collateral. If off-farm income is not sufficient to cover repayment of a loan, some financial institutions will work with the prospective borrower, but will not lend without capacity to repay. This relationship-building approach aligns well with a community based food systems approach where economic viability across the food chain is dependent on intentional relationships. Local financial lenders become critical components of those intentional relationships.

All respondents were willing to work with intermediaries who may act as a pipeline for new customers. Even more promising is that each of the financial institutions interviewed could describe the potential impact of an intermediary relationship on their financial institution. It is important to note that intermediaries have to understand how to work with the financial organization, and bring forward creditable customers or projects.

Limitations within Michigan's Financial Services Sector

Relatively large, commodity farming are the scale and management strategy most familiar to financial institutions interviewed in this study. A decision about whether a farming operation has potential to be economically viable, i.e., to provide a living, is influenced by perception of the lender. Their lack of familiarity with smaller scale, diversified product agriculture was a factor in determining the extent to which lenders believed farmers were capable of repaying a loan.

Small banks were more likely to have one person designated as the agriculture lender. The sticking point is the extent to which agricultural lending remains an organizational priority upon retirement of the agriculture loan officer. At least two of the four bank loan officers that continue to offer agriculture loan products voiced concern about the level of attention agriculture might receive by their bank once they retired. Credit unions were noticeably different from banks in this regard. Credit unions were consistent in citing their overall mission to serve their members, which included small enterprise development. Small or beginning farm development was seen as a small enterprise. Therefore, financial products could be tailored to the specific cash flow needs of enterprise. In the case of agriculture, timing of repayment would be based on sales. The bank and credit union respondents were somewhat geographically limited to serving customers. Some of the restrictions were self-imposed in order to maintain direct contact with customers.

Economic development-oriented entities (both community-based loan funds and state agency MEDC) do not necessarily see the link between production agriculture and economic development. However, economic development entities did express interest in the economic potential of postproduction business development (processing; distribution) as opportunities to stimulate Michigan's food system economy.

The majority of the respondents do not market their financial services or tools outside their existing customer and organizational networks. This is not to say that financial institutions interviewed do not market their products; however, marketing tactics such as newsletters, satisfaction surveys, and presentations did not encompass a wide range of audiences. If beginning farmers are not an existing customer or affiliate, the likelihood that they may be unfamiliar with local services are great. This is even more likely when beginning farmers do not come from a farming background.

In as much as financial institutions support the merits of asset building as a measure to help beginning farmers build net-worth, most do not offer equity-building services nor is there the belief that they have the financial wherewithal to offer these tools as part of their continuum of available financial products.

Recommendations

The following recommendations build on the findings of this study. By taking these steps, we will work toward a goal of long-term access to a range of financial services that may serve to stimulate small-scale agriculture start-up and expansion while reducing the financial vulnerability of new and beginning Michigan farmers.

PROBLEM: Most financial institutions use lending metrics based on the scale and type of production with which they are most familiar -- large-scale commodity agriculture; therefore, the problem is the extent to which they understand diversified, smaller scale, and more direct-market farming such that capital availability could be tailored appropriately.

RECOMMENDATION: The CS Mott Group for Sustainable Food Systems at MSU in partnership with organizations such as Northern Initiatives, Michigan Food and Farming Systems, Michigan Organic Food and Farm Alliance, and MSU's Student Organic Farm should provide informational presentations on small-scale farm start up and expansion tailored to financial institutions in four Michigan regions. Components of these presentations should include: producer and grower models by sector, market potential, supportive USDA programs, models of successful beginning farmer and land-access programs, financial pro-forma templates offered to farmers, and examples of capital tools that could accommodate smaller scale, diversified, product-focused farm operations.

OUTCOME: This would introduce financial institutions to product-focused start-up farming situations and provide a basis to ascertain the interest level of financial institutions in creating products for this market.

PROBLEM: Many lenders are not familiar with newer farmers. Our study, echoing national research, found that the smaller the financial institution, the greater the importance of relationship building between the lender and farmer. However, the majority of institutions have little contact with newer farmers, and refrain from marketing

their products outside their current customer bases. Further, beginning farmers are not necessarily seeking services from more established financial institutions.

RECOMMENDATION: The MSU Department of Agriculture, Food, and Economic Resources and the CS Mott Group for Sustainable Food Systems at MSU should convene a gathering of beginning and newer farmers, representing diversity of product and stage of farm development, with financial institutions to discuss the link between farm enterprise development, the capital needs of farm entrepreneurs, and potential economic impact regionally and at statewide. Such a gathering might be part of or linked to the annual agricultural lenders conference sponsored by Michigan State University.

OUTCOME: Building tool kit of financial capital products specifically created for and marketed toward beginning farmers.

PROBLEM: All financial institutions participating in this study require applicants to submit business plans. At this point, there are no business plan courses in Michigan specifically tailored to farm start up, and those courses oriented toward existing farm operations are not offered with regularity.

RECOMMENDATION: Based on feedback from financial institutions and farmers, The Michigan Food and Farming Systems, in partnership with MSU Extension, The CS Mott Group, the MSU Student Organic Farm, and The Michigan Land Use Institute's Get Farming Program should pilot regionally a robust farm business plan course that enables small farm start up or enhancement. Tether the farm business course with existing beginning farmer programs, organic farm certificate programs, and land-access programs. It is our recommendation that farm development programs in Michigan be strengthened through two avenues: MSU should develop academic coursework to prepare students for developing realistic business plans. MSU Extension has offered farm succession programs and could continue lead this effort by integrating successful components of the International Farm Transition Network model.

OUTCOME: Start up farms receive business plan and network support over the course of three years to measure farm income. Financial institutions play a key role in providing "stepping stone" financial capital to match scale and stage of operation.

PROBLEM: Despite the fact that the majority of financial institutions require a down payment or collateral to get an operational loan, only one institution surveyed offers asset-building tools that enable farmers to generate greater net-worth. Agriculture Individual Development Accounts have a successful track record in addressing limited resource farmers' financial net-worth; however, this asset-building tool is limited by the sponsoring organization's ability to raise sufficient funds to match the savings of participating farmers.

RECOMMENDATION: Based on its successful track record, the CS Mott Group for Sustainable Food Systems at MSU and lending institutions offering a range of financial services to beginning farmers should convene philanthropic entities, policymakers, and beginning farmer programs together to discuss the inclusion of Agriculture IDAs as part of the continuum of capital availability for start up, limited-resource farmers. The successful Agriculture IDA program piloted in southwest Michigan would serve as the model for regional expansion.

OUTCOME: Integrate the Agriculture IDAs with the farm business-planning course offered across the state; create an endowment for match funds.

Closing

This paper offers a preliminary exploration of the extent to which private and other sources of capital are available in Michigan to support beginning farmers. On the financial institution side, capital availability becomes more accessible to beginning farmers to the extent that beginning farmers can articulate their farm enterprises through well-written business plans and financial projections that fit the scale of their operation. It is our intent to use the findings of this study to move recommendations that address impediments to grow capital investments in Michigan's smaller scale, diversified agriculture into action.

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Appendix

SURVEY RESPONDENTS

All of the respondents were interviewed. Twelve organizations completed the survey. Two entities chose not to complete the survey.

Choice One Bank, Sparta, MI (Kent County)

Country Heritage Credit Union, Buchanan, Mi (Berrien County)

Frankenmuth Credit Union, Frankenmuth, MI (Saginaw County)

GreenStone Farm Credit Services (statewide)

Local Initiatives Support Corporation, Detroit, MI

Michigan Department of Agriculture (statewide)

Michigan Economic Development Corporation (statewide)

Northern Initiatives, Marquette, MI (Marquette County)

Southern Michigan Bank and Trust, Coldwater, MI (Branch)

Thumb National Bank, Pigeon, MI (Huron)

Eastern National Bank, Crosswell, MI (Sanillac)

USDA Farm Service Agency (Michigan) (Statewide)

OTHER FINANCIAL INSTITUTIONS*

Utopia Foundation Beginning Farmer Micro-Loan Fund, Traverse City, MI (Grand Traverse County)

First Federal Bank, Morenci, MI (Fulton)

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* Met with or phoned both institutions. Both shared some information but chose not to participate in the survey due to either stage of development, or no longer provided agriculture lending.

Map of Respondents