

# Funding the New Harvest

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Overcoming Credit Barriers for North Carolina's  
Sustainable Farming Enterprises

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CREATING OWNERSHIP AND ECONOMIC OPPORTUNITY

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# Executive Summary

What are the barriers to appropriate credit for the growing sustainable farming movement in North Carolina and how can these barriers be overcome?

This study uses a literature survey, expert interviews and a survey of 400 sustainable farmers. The target population is the group of N.C. farms and related businesses that a) are small-scale, b) use ecological farm practices like organic, c) produce for local markets and/or d) produce specialty items. This study is not focused specifically on certified organic or any one production system. “Small” is defined as less than 50 acres.

## Findings

√ Small, sustainable farm enterprises are multiplying in N.C., reflecting growth both in demand for their products and infrastructure to deliver them. North Carolina has 25,000 farms of less than 50 acres. There are 80 to 100 certified organic farms in N.C. and many more that actively employ sustainable methods, particularly in and near the Triangle, Asheville and Boone. Farmers markets, subscription sales and other direct sales are growing.

√ Private lenders, government lending agencies and their regulators are too often confused as to whether sustainable farm enterprises are farms, hobbies or non-farm specialty businesses. This has occurred as farmers have become more entrepreneurial to reach specialty markets, while more and more non-farm small businesses have entered the farm/food arena seeking markets.

√ The size, production methods and/or product offerings of these enterprises may disqualify them for or hinder their access to government *farm loan* programs. Farm loan programs have evolved to better serve commodity agriculture, not entrepreneurial farmers or non-farm specialty businesses that have some connection to agriculture.

√ The farm-like qualities of these enterprises may disqualify them for or hinder their access to government *small business loan* programs. While the Small Business Administration and related programs typically do not forbid access by farm-related businesses, these programs are generally not prepared to serve hybrid businesses that blend agricultural and entrepreneurial activity.

√ Many sustainable farms are *start-ups* and as a result may have difficulty qualifying for government farm or small business loan programs. Requirements that a farm or business have three to five years of operating history shuts out promising new entrepreneurs.

√ The debt aversion of sustainable farm entrepreneurs, borne of years of watching painful farm foreclosures, may hinder practical use of debt to grow the industry. While farm families can be understandably reluctant to mortgage farm property, real estate collateral is commonly and effectively used by many non-farm entrepreneurs. In addition, debt for other needs such as equipment may be underutilized due to lack of comfort with the lending process or lack of knowledge of loan programs and products.

√ The farmers we surveyed expressed little knowledge of USDA Farm Service Agency programs, a primary federal source of assistance to farms.

√ Sustainable farm enterprises have small-scale capital needs, indicating an opportunity to explore micro-credit programs. Two-thirds of farmers surveyed who expressed a need for loans desired less than \$50,000. The funding needs of sustainable farms are diverse and include equipment, buildings, land, marketing and R&D.

√ Overall capital demand for these enterprises represents a substantial potential market for lenders. Since these operations expect to match debt to equity 50-50, if each of North Carolina's 25,000 small farms borrowed the median amount from our survey (\$16,500) demand would top \$200 million. Demand from the 400 sustainable farms surveyed would top \$3 million.

√ Sustainable farm enterprises believe that cash flow and weak markets are major hurdles to financing, and not that lenders are biased against them, organic or their lifestyle choices.

## **Recommendations**

√ 1. The lending community should facilitate farm entrepreneur access to outside training and technical assistance regarding capitalization and business plan development. Lenders can learn about, network with and support these technical assistance providers.

√ 2. A third party institution should oversee data collection on specialty and organic crop production and prices so that farmers and lenders can use them in business planning and underwriting. The NC Department of Agriculture currently does this for conventional farmers.

√ 3. Lenders should actively support efforts to improve the infrastructure needed to bring niche and organic products to market. For example, lenders could provide financing and other support to community farmers' markets, farmer cooperatives and retailers selling organic/local produce.

√ 4. Financial institutions should undertake efforts to become better educated about sustainable agriculture and the resulting business opportunities. Lenders will need to monitor the rapid pace of developments in this business sector. Self-Help has developed materials that outline how financial institutions can better underwrite to this sector and will share those materials with the financial sector.

√ 5. The USDA Farm Service Agency, Farm Credit System institutions, the U.S. Small Business Administration and other lenders should investigate ways they might improve marketing of their programs and products to sustainable farmers, encourage entrepreneurial farming through collaboration and training, and reform underwriting and program rules to increase access to credit by sustainable farmers.

√ 6. Federal/state government officials, community development financial institutions (CDFIs) and other interested funders should investigate incentives such as dedicated loan capital and/or credit enhancements. CDFIs should explore the opportunity to be a new conduit for small farm finance to the extent that this fits their historic mission of rural development, new enterprise development and bridging credit gaps.

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For copies of the study:

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# Purpose

The primary purpose of this report is to identify potential credit barriers to sustainable farming enterprises in North Carolina. As background, this report describes and documents trends in agriculture and farm credit as well as sustainable agriculture. The report provides an overview of institutional sources of credit in North Carolina and discusses the results of a survey conducted by Self-Help of sustainable farmers' credit needs and practices. The report concludes with recommendations for how institutions like the Farm Service Agency, Farm Credit System, banks and Community Development Financial Institutions (CDFIs) like Self-Help can help enhance financing opportunities for sustainable farm enterprises.

Self-Help is a North Carolina-based CDFI engaged in a variety of community lending and policy activities, including home and commercial lending. Our mission is to support wealth creation and entrepreneurship among low-wealth, minority, female and rural populations. Self-Help sees small farm entrepreneurship as one part of a strategy to assist hard-hit rural communities, where poverty is high and economic opportunities have been fading.

## Sustainable Farm Enterprise

**Note: In the text, we use the term “sustainable farm enterprise” to denote a farm or farm-related business that a) is small-scale (less than 50 acres), b) uses sustainable practices like organic, c) sells locally and/or d) produces and sells specialty, niche items. Due to the**

**rapidly changing farming economy, we are concerned with farms that fit any or all of these criteria. (Note: The USDA defines small farms as those with gross revenues under \$250,000.)**

# Methodology

We conducted a literature review and interviews with relevant individuals and organizations, including farmers, loan officers, academics and staff at technical assistance, advocacy, and educational organizations. Most interviews were conducted over the phone. A list of interviewees is included at the end of the report. A mailed survey of organic farmers was also conducted and its methodology is explained in Appendix B.

As part of our literature review, we hoped to identify other studies or reports that examine barriers to credit for sustainable farmers. We did not find any reports of this type.<sup>1</sup> We were also interested in figuring out whether or not it would be feasible to adapt methods used in other studies of bias in rural and farm lending practices. There are at least two such studies in North Carolina. In 1997, the Community Reinvestment Association of North Carolina (CRA-NC) examined how well the largest financial institutions in the South are serving the credit needs of small farms in the communities where they do business. CRA-NC reviewed compliance data

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<sup>1</sup> One such study was recently completed in Minnesota and Wisconsin. The 30-page document has the results of a survey to farmers, lenders and educators. “Getting a Handle on the Barriers to Financing Sustainable Agriculture: The Gaps Between Farmers & Lenders in Minnesota and Wisconsin,” Land Stewardship Project, June 2003, [www.landstewardshipproject.org/pdf/edsurvey.pdf](http://www.landstewardshipproject.org/pdf/edsurvey.pdf).

reported by large banks to the Federal Financial Institutions Examination Council (FFIEC) under the Community Reinvestment Act (CRA). CRA-NC found that the CRA data did not include information about individual applicants, and thus it was impossible to discern disparities in lending based on farm size or type. A more thorough evaluation of lending practices within banks could be conducted if the CRA data were improved to require reporting of farm type, including operations methods.

A review of lending practices within USDA's Farm Service Agency was conducted in preparation for *Pigford vs. Glickman*, the 1999 class-action lawsuit filed by African-American farmers against the USDA. The methodology employed by the plaintiffs in the suit was to review loan applications submitted by African-American farmers to the Farmers Home Administration. Lawyers reviewed, in particular, the dates of submission and approval and race of applicants. The process revealed that African-American farmers were denied loans with little justification or documentation, promised loans that were never received, and/or received loans too late in the growing cycle. This methodology, although effective for the purposes of *Pigford vs. Glickman*, did not focus on the types of crops planted or methods of production, as it was focused on proving discrimination on the basis of race, not on production methods or choices.

# Part One:

## Conventional vs. Sustainable Farming

### A. Trends in U.S. Agriculture

The 20<sup>th</sup> century witnessed massive structural changes in U.S. agriculture. In 1900, 40 percent of the U.S. population farmed, but by 1997 that figure had dropped to two percent. This was in large measure due to increased mechanization and the use of government price supports, which encouraged farmers to enlarge the size of their farms to gain efficiencies. Technology improvements required greater cash outlays for farm equipment and inputs, necessitating both increased specialization and greater farm debt. More recently, increases in the costs of production with relatively little increase in the prices farmers receive have further contributed to a decline in the number of farm operators. Today, there are fewer than 2 million farmers compared to over 6 million after World War II (NASS 2003).

In the last decade, consolidation and integration have been the dominant trends in agriculture. Consolidation, defined as production in the hands of fewer and fewer farmers, is being driven by

producers taking advantage of larger economies of scale (Lamb 1999). Financing is increasingly being provided by agricultural businesses (e.g., chemical, seed and equipment companies) that are diversifying to include lending as a profit-making venture.

### The Economics of Small Farms

In Elliot Coleman's classic work The New Organic Farmer, the noted small farm expert says, "The weakness of small farms has not been one of scale." He asserts: "Two and a half acres is more than sufficient land to grow a year's worth of vegetables for 100 people. Anyone feeding that many folks can honestly consider himself to be running a highly productive farm." Ideally, he suggests, five acres of land is what is needed in cultivation.

Regarding capital needs, he proposes that a mere \$15,000 is sufficient investment in small-scale machinery. Figuring \$1,200 in operating expenses per acre per year, such a five acre farm could make \$30,000 profit in a good year, after paying loan costs.

Source: Coleman, Elliott, The New Organic Grower, Chelsea Green Publ., 1995, p.21

Integration is production and processing within a closely linked supply chain. It is largely prompted by downstream companies such as food processors that increase profits by engaging in contracts with farmers to produce raw products. Contract agriculture is most familiar in the livestock sector. Poultry integrators such as Perdue and Tyson Foods are familiar examples. The hog industry has become highly integrated. Since 1975, the number of farms with hogs decreased 85 percent, despite continued expansion in pork production (Lamb 1999). The meatpacking industry has also consolidated, with four major packers responsible for 80 percent of total industry slaughter. Integration is eliminating traditional commodity markets, in which farmers sell products on an open market (Lamb 1999). An increasing number of crops in North Carolina are being grown under contract; 80 percent of tobacco production has shifted to contract arrangements and contracts are on the rise for peanuts, cucumbers, and grains (Bailey 2002).

Under contract arrangements, farmers produce a product without ever owning it. While this can help insulate them from price risk, contracting usually requires farmers to make large investments in single-purpose buildings or crop-specific equipment. This kind of capital investment and the associated debt make it difficult for farmers to diversify, a cornerstone of sustainability. Furthermore, contracting companies reassure farmers that once their investments are paid off, they will be in position to make a considerable profit. However, usually before the loan is fully paid off, contractors require farmers to retrofit equipment and/or make another capital investment (Bunting 2002). Debt enables the integrator to have maximum leverage in the contract relationship (Wolfram 2001). In North Carolina contract arrangements, farmers have limited legal rights and often shoulder all of the risk (Bailey 2002).

The specialized, high-tech, industrial model of agriculture, as it is practiced today, would not be possible without credit. Agriculture's use of credit has fluctuated substantially over the past 50 years. For example, during agriculture's rapid expansion in the 1970s, agricultural debt from all sources quadrupled in 14 years to \$194 billion by 1984. As agricultural real estate values fell and the farm crisis of the 1980s hit, demand for credit fell. Agricultural credit from all sources dropped to \$139 billion in 1991 (Blank 1998). Farm debt has risen each year for the past ten years, reaching close to \$202 billion in 2002 (Stam et al 2003).

The financial outlook for many U.S. farmers remains grim. Commodity prices have been at all time lows. Forty percent of all farm income comes from government subsidies at a cost of \$19 billion annually (Egan 2002). Competition from foreign producers is steep. Most farmers can no longer support themselves and their families on farm income alone and rely on off-farm jobs. The contribution of off-farm income is highest for small farms near metropolitan areas and is lowest for high sales volume farms (Stam et al 2002). This does not mean that "bigger is always better," but instead indicates that small farmers under the current system are hurting. This also points to the potential for a large-scale sell-off of marginal small farms for suburban development unless higher value-added agricultural systems boost small farm incomes.

For small and medium size farmers, one bright light on the agricultural horizon is the growth in direct marketing and organic and specialty crops. Organic food sales, for example, have increased at an astounding 20 percent per year for the past 10 years and are about to exceed \$10 billion annually. Consumers are demanding food with "face, place and taste (Bailey 2002)," and farmers are responding. Despite the fact that ten major grocery store chains control half of all fresh produce sales and "big box" retailing is growing, farmers' markets have increased 80 percent since 1994 to over 3,000 markets and 67,000 farmers nationwide, reaching three million Americans per week (Egan 2002). In California, the 330-odd markets are so popular that there are waiting lists for farmers to join them.

## **B. A Review of Sustainable Agriculture**

In contrasting sustainable agriculture with conventional commodity farming, this discussion addresses organic production, niche/direct marketing and farm size, three inter-related criteria of sustainability. These factors get at the heart of what is wrong with conventional farming. Due to the scope of the study, we do not analyze issues related to social justice, labor practices and ownership patterns. However, we would not want to diminish their importance. While we hope

that small, organic, niche market farms will have high standards of social justice, there is no guarantee that this will be the case.

Organic agriculture is legally defined and regulated by the U.S. Department of Agriculture and numerous individual states. Organic food production is an important mechanism for farmers to be recognized in the marketplace for the use of more ecologically-oriented production practices and for consumers to consciously support such practices.

A national definition of organic agriculture was adopted in 2002 by the U.S. Department of Agriculture through their National Organic Program (NOP). In general, organic production systems are described by the USDA to respond to site-specific conditions by integrating cultural, biological, and mechanical practices that foster cycling of resources, promote ecological balance, and conserve biodiversity.

More specifically, the NOP states that any farm, wild crop harvesting, or handling operation that wants to sell an agricultural product as organically produced must adhere to the national organic standards. (Handling operations include processors, manufacturers, and re-packers of organic products.) For a description of the national organic standards, see Appendix A.2.

## **1. Production and Marketing Trends**

Organic farming is the fastest growing sector of the agricultural economy. Since 1990, U.S. sales of organic food have increased by 20 percent per year (Dimitri & Greene 2002). U.S. organic sales figures for 2001 were estimated at \$9-\$9.5 billion. Combined retail sales of organic food and beverages in all major world markets (e.g., U.S., Europe, and Japan) almost doubled in four years, increasing from \$11 billion in 1997 to \$21 billion in 2001 (Greene & Kremen 2003). Industry observers expect demand for organic products and commodities around the world to continue to increase rapidly.

Almost one-third of the U.S. population currently buys organically grown food products. Over two-thirds of conventional grocery stores carry organic products. In fact 49 percent of all organic products are now sold in conventional supermarkets. Forty-eight percent are sold in health and natural products stores and three percent through direct-to-consumer methods (e.g., farmers' markets) (Dimitri & Greene 2002).

Fresh produce is the most popular type of organic food, followed by nondairy beverages, breads, grains, packaged foods, and dairy products. For the past 10 years, farm stand, wholesale, and retail price data indicate that organic foods receive a substantial premium. Often organic prices are double those of conventional (Greene & Kremen 2003).

A total of 2.34 million acres of land are now certified organic, which is 0.3 percent of U.S. cropland and pasture. Two percent of land used to produce vegetables in the U.S. is certified organic (Greene & Kremen 2003). The percentage of total land area farmed organically is much higher in European countries, which have been focusing on expanding organic production and markets for the past 20 years in order to achieve environmental benefits and support rural development. Through consumer education campaigns and financial support for farmers,

organic production now occurs on between six and nine percent of agricultural land in countries such as Switzerland, Austria, Italy and Sweden (Greene & Kremen 2003).

In the U.S., federal farm policies are still almost entirely geared toward subsidization and support for conventional agriculture. However, the 2000 Farm Bill included a number of programs directly targeting technical and financial support for organic farmers. Funds for organic research and education were increased. All organic growers are eligible for a cost-share program that pays for up to 75% of the certification costs (not to exceed \$500). In 16 states, not including North Carolina, funds were made available to assist growers in making the transition from conventional to organic production. An individual producer in these states can receive up to \$50,000 in assistance. Farmers who grow organic exclusively are now exempt from payment of an assessment under commodity program laws. In the area of risk management, organic farmers and those in transition to organic are for the first time able to get the same crop insurance policies as conventional farmers. Coverage includes production losses from damage due to insects, diseases, and/or weeds.

## ***2. Sustainable Farming Trends in North Carolina***

Agriculture as a whole is North Carolina's number one industry, contributing 22 percent of the state's income and employing 20 percent of its workforce. Approximately 76,000 farmers farm on over 9 million acres. North Carolina agriculture is one of the most diverse in the country, producing over 80 different products. Historically, North Carolina was known for its row crop production, particularly cotton, tobacco, corn, soybeans and peanuts. Today, most of North Carolina's top ranking commodities are livestock, including hogs, broiler chickens, and turkeys. North Carolina also leads the nation in sweet potato production and ranks as one of the top five producers of nursery crops, cucumbers, blueberries, bell peppers, strawberries and snap beans (NCDACS 2003).

During the past five years, the economic situation for many North Carolina farmers, particularly row crop and livestock producers, has been difficult. Between 1997 and 1999, for example, cash receipts generated by North Carolina farmers fell by close to one-fifth, from \$8.2 billion to \$6.7 billion. Overall crop sales and livestock sales fell by the same proportion. This is largely attributable to natural disasters, tobacco quota cuts, low commodity prices and high energy prices. Large supplies and reduced demand for many of the traditional crops—cotton, corn, soybeans and wheat—have resulted in lower farm prices. It is unlikely that commodity prices will recover in the short term and government emergency assistance and farm program payments will continue to be a significant portion of farm receipts for conventional operations. In 2000, government payments comprised almost 10 percent of gross farm receipts for North Carolina farmers. Nursery and vegetable crops are the notable exception to an otherwise financially distressed situation in conventional agriculture. Since 1980, nursery crops have increased twelve-fold and vegetable production has doubled (Benson 2001).

Small farms continue to disappear in North Carolina, although a new census method shows that there are more small farms than previously thought. According to the latest Census of Agriculture, in 2002 North Carolina had nearly 25,000 farms with less than 50 acres, a loss of 1,864 farms from 1997 to 2002. There were 38,000 such farms in 1974. The Census now shows more 10 - 49 acre farms than 50 - 179 acre farms (20,270 versus 19,120). Previous censuses

have shown many more 50 - 79 acre farms than 10 - 49. However, a newly established “undercount” methodology estimates that, for example, over 5,500 10 - 49 acre farms were not counted in the 1997 Census. Medium-sized farms (180 to 999 acres) continue on a steady but gradual decline, while large farms over 1000 acres continue their steady, slow increase. The average size of a farm in N.C. is 167 acres

Like the national figures, organic produce sales are among the fastest growth sectors in the North Carolina food industry. The latest figures available date back five years and undoubtedly greatly underestimate current sales figures. During a fifteen-month period in 1997 and 1998, according to a survey of retailers and wholesalers, organic sales for poultry, dairy products and produce exceeded \$1.5 million (Estes et al 1999). Unfortunately for local producers, over 90 percent of the organic products sold in North Carolina are imported from out of state, despite the fact that many of these products can be grown locally (NCSU 2003).

There are roughly 80 certified organic farmers producing on approximately 1200 acres in North Carolina (Kleese 2002).<sup>2</sup> A wide range of crops and livestock are produced organically. Virtually everything produced conventionally in North Carolina is also raised organically. Organic production occurs in all regions and climates of the state.

The market infrastructure for local and organic agriculture in North Carolina is gaining ground, but is far from perfect. In 1998, there were 27 natural food store retailers and five wholesale operations that carried extensive lines of local and organic fruits and vegetables. Because of strict requirements from retailers regarding supply (four season), appearance and volume, local farmers continue to have difficulty selling to these retailers and wholesalers.

While difficult to measure, there is no doubt that direct marketing is growing at a fast clip in North Carolina. In addition to the four farmers’ market facilities operated by the state, there is a growing array of roughly 80 community farmers’ markets that operate on a seasonal basis throughout the state. Attendance at these markets is strong and getting stronger. The Carrboro Farmers Market is packed with hundreds every Saturday, while the new Durham Farmers Market has grown from a few dozen customers to a large crowd in just three years. Local farmers also develop seasonal subscriptions with local consumers, a system known as community supported agriculture (CSA). As is the case nationally, the number of CSAs is increasing in North Carolina every year. Local and organic farmers also market directly to restaurants. Farmers involved in direct marketing are using branding to differentiate their products from commodity goods and to charge higher prices. The products have “a sense of place, a face and taste.” “Goodness Grows in N.C.” is the N.C. Department of Agriculture’s well-received direct marketing support effort.

Technical support for sustainable farmers in North Carolina is strong and among the best in the country. Private organizations such as CFSA organize an annual conference on sustainable agriculture and conduct regional grower schools to provide growers with basic organic production and marketing information. The Center for Environmental Farming Systems (CEFS) conducts extensive research into organic farming systems. Approximately 80 acres are certified for organic production at CEFS, the largest research facility of its kind in the nation. Located in Goldsboro, CEFS is sponsored by N.C. State University, the North Carolina Department of

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<sup>2</sup> This underestimates total organic production since a number of smaller farmers decided not to get certified when the national program went into effect, citing concerns about the cost and added paperwork.

Agriculture and Consumer Services and North Carolina A&T University. NCSU has received funding to train county extension agents about sustainable and organic farming systems. Efforts are also underway to develop an organic-systems training manual to help county agents provide information about organic farming. In Chatham County, NCSU has an extension agent dedicated to assisting organic farmers. The Central Carolina Community College (CCCC) in Pittsboro has established, in collaboration with N.C. Cooperative Extension, a sustainable farming curriculum that helps farmers develop the technical and entrepreneurial skills necessary to operate sustainable agriculture enterprises (Estes et al 1999). This program and several others (Warren Wilson College and CFSA training) are creating a strong cadre of young and very enthusiastic farmers who are ecologically-minded.

With tobacco settlement money, the N.C. Golden Leaf Foundation awards millions in grants to economically distressed and tobacco-dependent communities. Many of the grants awarded by the foundation are supporting tobacco growers in transition to alternative crops and businesses. Sustainable production and direct marketing initiatives are substantial portions of Golden Leaf's portfolio. Examples include the establishment of a meat processing facility for small and independent pork producers, development of sustainable medicinal herbal markets, and creation of markets for North Carolina-grown specialty crops.

Finally, it is worth noting a new hybrid business model: farm tourism. While tourism related to farms has been a common practice for many years (e.g., roadside farm stands), the push to connect these two industries is accelerating rapidly. This development has been spurred by farmers and their advocates, as well as tourism officials and academics. Innovative farmers now can derive as much income from tourism activities like farm home stays, school tours, corn mazes and festivals as from traditional crops. Self-Help produced a lenders' guide to agri-tourism in 2002.

### ***3. Challenges to Widespread Adoption***

There are obstacles to sustainable farming, some of which have important implications for the role of credit extension. These obstacles include: 1) managerial demands and risks of shifting to a new way of farming, 2) lack of technical expertise in new farming systems, 3) lack of marketing infrastructure, 4) inability to capture marketing economies, 5) limited access to crop insurance and other federal programs, and 6) fees charged for state and national certification (Greene & Kremen 2003).

A major challenge for the sustainable farmer is overcoming obstacles during the initial start-up or transition phase. Conversion to organic, or for that matter, any new crop or method of production, involves innovation and risk-taking. This necessitates information-gathering as well as development of new markets and marketing skills. The average age of a farmer in North Carolina is now 56 years. Many older farmers, even those who may have suffered under the conventional system, may lack the energy and motivation to engage in wholesale reinventing of their farm practices. Results of a survey of over 1,200 North Carolina tobacco growers show that farmers perceive significant barriers to growing other crops and developing new enterprises. Lack of processing and places to sell new products were viewed as barriers by over 80 and 70 percent of respondents, respectively. Lack of capital and low interest loans were viewed as

barriers by close to 70 percent of respondents. Over 50 percent found the need to add new skills to be a barrier (Rural Advancement Fund International 2002).

Despite some recent advances in technical and financial support, as noted above, most state and federal agricultural programs and infrastructure, including disaster relief, research, and education, are geared toward assisting conventional farmers.

# Part Two:

## Credit Access for Sustainable Farming

### A. Overview of Agricultural Lending Institutions

Five major institutional sources of agricultural credit serve North Carolina, including: 1) commercial banks, 2) the Farm Credit System (FCS), 3) the USDA Farm Service Agency, 4) life insurance companies, and 5) the North Carolina Agricultural Financing Authority. Nationally, commercial banks held just under 40 percent of farm debt in 2002 and the FCS held just over 30 percent. Life insurance companies hold over six percent and the FSA holds 3.5 percent. The remaining 20 percent is held by private corporations, often agribusiness companies that sell seed and other inputs to farmers. An additional amount of farm credit exists in the form of nontraditional debt. For example, some organic farmers have indicated that they use personal credit cards to finance cash flow.

A brief description of each institution is offered below and is summarized in Table 1.

#### **1. Commercial Banks**

For many years in North Carolina, there were banks whose portfolios were dominated by agricultural loans. Following national trends in the 1990s, North Carolina banks with heavy concentrations in farm lending merged and diversified their portfolios. While most commercial banks in North Carolina continue to offer agricultural loans, the amount of agricultural lending varies depending on the region. Banks in eastern North Carolina continue to provide a significant number of agricultural loans (Edward 2003).

Commercial banks offer farmers either general operating loans to cover such annual expenses as seed, chemicals and fuel or longer-term loans to purchase land or make infrastructure changes (e.g., retrofitting a poultry house or an irrigation system). Nationwide, less than one-third of commercial agricultural loans go toward general operating expenses (Talmadge 2002).

In North Carolina, commercial banks typically make loans only to established farmers. Southern Bank in the eastern part of the state, for example, rarely makes a loan to a new farmer (Robinson 2002). To be eligible for a loan, a farmer must demonstrate experience, have sufficient collateral and show that the operation will produce positive cash flow. This would be virtually impossible for a new farmer. Commercial banks do make loans to existing clients, however, who are starting up new kinds of operations (Robinson 2002).

In some cases, commercial banks will guarantee their loans through the USDA Farm Service Agency (described below), particularly if a farmer is not well-established or has credit problems. FSA provides a generous 90 percent guarantee on qualifying farm loans, a solid incentive for farm lenders. While many farms have failed and suffered foreclosure, actual bank losses have remained low due to the sale of failed farms and the use of guarantees.

Commercial banking is by nature a conservative business. Lenders often use formulas and draw on past experience to minimize their risk. These practices, while protecting the bank, may hinder

## Disheartening

“I want to raise beef on 100% pasture, not grain. I have ten cows on eleven acres and want 100 on 150 acres. My FSA lender is very sympathetic, but his bosses are skeptical. They are looking at the Chicago Board of Trade prices which don't apply to pasture-raised. I have markets lined up and can support my family with these cows, but the banking system is not set up for the little farmer. It is real disheartening.”

-- a cattleman in eastern North Carolina

innovation when an industry is experiencing rapid change. For example, when sustainable farm enterprises build their business plans on the anticipation of higher than conventional prices, they may find banks are unwilling to accept anything but the standard commodity price. This formula lending can effectively shut out many sustainable, organic and/or direct market farmers.

## 2. *Farm Credit System (FCS)*

The FCS is a network of federally chartered, borrower-owned cooperatives specializing in agricultural loans. The FCS was created in 1916 as a government sponsored enterprise (GSE) in order to increase the ability of farmers to obtain credit. The FCS is the only GSE with direct, retail lending authority. The FCS does not take deposits but originates and services both long

and short-term credit for farmers, including loans for farm production and real estate purchases. The FCS can also make loans to farm cooperatives, farm-related businesses, fisheries, rural housing, rural utilities, and for agricultural exports. Most of its loans are made directly to individual farmers and about half of its loan portfolio is in long-term real estate loans (ERS 2002). The average farm real estate loan size is \$138,000. Gross loan volume in 2003 was \$91 billion with a half million borrowers in the system.

Each FCS bank and association has specific lending authorities and chartered territories. As a result, FCS institutions compete directly with commercial banks and other farm lenders within their service areas (and within the scope of their charters), but they generally do not compete with other FCS institutions (ERS 2002). Farmers may choose FCS institutions rather than banks due to the perception that FCS will better understand their farm operation. In addition, FCS institutions market heavily to their target audience of conventional farmers.

North Carolina has several FCS chartered associations. Carolina Farm Credit (CFC) is the largest of these and services the bulk of the state, including Orange and Chatham Counties and counties in the west and east. Tarheel Farm Credit is based in Raleigh and services coastal areas. East Carolina Farm Credit services Wake, Wayne, Johnston and other eastern counties.

Each FCS institution is required by law to create programs for young, beginning and small (YBS) farmers. Young farmers are defined as less than 35 years old, beginning farmers as those having less than 10 years of relevant experience, and small farmers as generating less than \$250,000 in annual gross agricultural sales (ERS 2002). There is no acreage designation. The FCS reports that approximately 10, 15 and 25 percent of their new loans are for young, beginning and small farmers, respectively. However, commitment to lending to these underserved borrowers has varied widely amongst different FCS lenders. Agricultural census

data compiled by USDA suggest that FCS reporting may overstate lending to YBS. Recently proposed regulations would require the FCS to more effectively target YBS borrowers (Stam 2003).

FCS lenders are governed by underwriting rules much like a commercial bank, ensuring that the assets of the members are not jeopardized. According to Frankie Coble, a loan officer with Carolina Farm Credit, FCS as an institution is a conservative lender. In a small percentage of cases, Carolina Farm Credit will pursue government backing through the FSA guaranteed loan program. Other Farm Credit System lenders interviewed said that they made decisions on a case-by-case basis and would not turn down a loan simply because it was organic or involved direct marketing. However, like commercial banks, FCS lenders do use formulas and follow traditional patterns when underwriting loans, putting innovative business models at a disadvantage. Farm tourism, as noted above, is one example of a business model that can raise concerns for FCS lenders.

### **3. Farm Service Agency**

The U.S. Department of Agriculture (USDA) administers federal credit programs designed to serve agriculture through the Farm Service Agency (FSA). The FSA provides direct loans to farmers as well as guaranteed loans through qualified lenders. The FSA provides up to a 95 percent guarantee to qualified loans originated by commercial banks, cooperative lenders (e.g., Farm Credit System) and non-profit lenders. The FSA is considered the lender of last resort for farms unable to obtain credit from conventional sources at reasonable rates and terms.

In a typical year, the FSA loans or guarantees from \$3 to 4 billion, with three dollars going toward guarantees for every one going toward direct lending. The FSA is an important lender for new and restructuring farmers. By one measure, the FSA provided 70 percent of start-up lending in 2000. A portion of FSA funds are reserved for socially-disadvantaged family farmers and beginning farmers; in 2001 this portion was estimated at \$1 billion. In North Carolina, the FSA works with about 3000 farmers with its direct loan and guarantee programs. In fiscal year 2000, the agency made 767 loans for \$89 million.

FSA county staffers service the direct loans. In order to be eligible for an FSA direct loan a farmer must have been turned down at least twice by another lender. FSA provides: a) farm ownership loans, which can be used to acquire, enlarge, or improve a farm or ranch; b) operating loans, which provide short- to intermediate-term production or chattel financing; c) emergency disaster loans, which help farmers recover from losses inflicted by natural disasters; and d) beginning farmer loans, which provide low-interest loans for farm or ranch purchases.

Loss rates on direct loans have historically been below 15%; losses on guaranteed loans are in the 1 – 2% range. Direct and guaranteed loan programs offer subsidized interest rates that can be as low as 3.75 percent (ERS 2002).

In conversations with farmers, lenders and FSA officials in N.C., it became clear that FSA is not very comfortable with non-traditional business models such as value-added direct marketing. Several farmers expressed that they have been unable to convince FSA direct loan staff and/or their superiors that their sustainable farm projects were viable. FSA officials, it was reported, questioned the accuracy of projections, which were based on prices higher than commodity

prices and which utilized non-traditional marketing methods. FSA officials expressed no bias against organic methods per se, just the higher pricing typically brought by organics. FSA officials also communicated to our researchers that a small farm operation (e.g., ten acres) would likely be disqualified as a hobby operation, even when it was intended as a business to support a family. “Those aren’t real farms,” one official said. In the lingo of the small business assistance community, micro-enterprises were frowned upon. Also, operations that involved tourism raised serious concerns for FSA officials. FSA officials did express that personally they were supportive of organic and other innovative efforts. However, lack of data and familiarity as well as various FSA rules and guidelines prevented them from putting FSA funds at risk.

#### **4. Life Insurance Companies**

Nationally there are approximately 20 life insurance companies that hold 12,000 agricultural loans, all of which are in agricultural real estate. Six companies (AEGON USA, Citigroup Investments AgriFinance, Lend Lease Agri-Business, Metropolitan Life, MONY Life Insurance, and Prudential) account for 90 percent of the life insurance industry’s farm mortgages. These companies are reported to have totally withdrawn from the small-to-medium sized farm mortgage market in favor of loans to agribusiness, timber and specialty enterprises. They focus on large farms, particularly specialty crops and livestock, and on large loans (\$500,000 or more). The average size of their loans is now over \$1 million.

Life insurance companies are also now major purchasers of farmland, holding close to \$3 billion in farm real estate (Stam 2003).

#### **5. North Carolina Agricultural Financing Authority**

The North Carolina Agricultural Finance Authority (NCAFA) was created in 1986 by the General Assembly to provide credit to North Carolina farmers and agribusinesses unable to meet their credit needs from local sources. In 2002, NCAFA made \$4 million in loans and the total number of loans was less than 200. Most NCAFA loans are guaranteed by the FSA and thus applicants need to have been first turned down by other lenders. Guaranteed loans are capped at \$730,000 and the minimum loan is \$25,000. Unlike the FSA, the NCAFA does not provide operating loans. Instead they offer a “Series I” loan to buy, improve or enlarge farms and a “Series II” loan for beginning farmers to purchase farmland. To be eligible, a beginning farmer must have operated a farm for at least three years but not more than ten, have access to adequate working capital and have no other debt. These restrictions likely would disqualify many beginning sustainable farmers. The agency receives no state appropriation and is self-sufficient. NCAFA has no website and does no marketing, relying on word of mouth referrals.

A vast majority (75 to 89 percent) of NCAFA loans are for poultry houses. This primarily includes growers with a contract. Prior to the statewide moratorium on new hog operations, their portfolio was dominated by swine production contracts. It is unclear why the NCAFA has not been more aggressive in pursuit of lending to the new wave of direct marketing farmers.

**Table 1: Sources of Farm Credit**

| <b>Lender</b>  | <b>Percent of Total Farm Loans Nationally (2002)*</b> | <b>Notes</b>   |
|--|---|--|
| <b>Commercial Banks</b>                              | <b>39.4%</b>  | Provide annual operating and long-term loans. Limited lending to young and beginning farmers.  |
| <b>Farm Credit System (FCS)</b>                      | <b>30.3%</b>  | Federally chartered, borrower owned cooperatives; provide annual operating and long term loans; limited lending to small, young and beginning farmers. |
| <b>Other (merchants, dealers, individuals)</b>       | <b>20+%</b>   | Private agribusiness corporations that focus on loans for purchase of new equipment.   |
| <b>Life Insurance Companies</b>                      | <b>6.1%</b>   | Focus on purchase of agricultural mortgages for large diversified farming operations.  |
| <b>USDA's Farm Service Agency (FSA)</b>              | <b>3.5%</b>   | Guarantees and direct loans for farmers unable to get other loans; targets socially disadvantaged family farmers and beginning farmers                 |
| <b>North Carolina Agricultural Finance Authority</b> | (200 loans total)                                     | State chartered lender authorized to make FSA guaranteed loans; no annual operating loans; mostly livestock and poultry infrastructure loans.          |

\*Stam, Jerome, Daniel Milkove, Steven Keonig, James Ryan, Ted Covey, Robert Hoppe and Paul Sundell. 2003. Agricultural Income and Finance Annual Lender Issue. Electronic Outlook Report. Economic Research Service. [www.ers.usda.gov](http://www.ers.usda.gov).

## **6. Non-traditional Sources**

Sustainable growers utilize a number of important non-institutional sources of credit. We have heard reports of organic growers, large and small, utilizing credit cards to finance start-up or expansion needs. For example, Stephan Hartman, an established organic grower near Wilmington, owns his land and reports using a credit card on a semi-regular basis. He believes that he can get a better rate on a personal credit card than through a bank.

Home equity loans are another option. For example, a new Chatham County farmer who also teaches recently purchased her own land and has been looking into options to finance pre-farming work, such as farm renovation and infrastructure. One option is to refinance her current mortgage. Although she has not used her credit card yet, she may consider doing so since she is on a teacher's salary.

One creative financing option for sustainable farmers is to establish a subscription "community supported agriculture" enterprise (CSA). CSAs typically involve local individuals who purchase

annual shares of a farm's products (e.g., vegetables, fruits, eggs and/or meat), providing working capital prior to the planting season. (This also provides farmers with market security going into the planting season.) Shares are provided on a weekly basis, using a variety of delivery methods. Members often have the option to visit and work on the farm. CSAs charge roughly \$400-500 per year per share and can serve up to 100 families from one farm, producing a substantial income for the farmer and an injection of capital when it is most needed. A popular CSA in North Carolina unites approximately 200 employees of Research Triangle Institute (RTI) and 18 area farmers who provide a range of predominantly organic products, including meat, dairy, flowers, and produce. Considering that in our survey sustainable farmers listed "cash flow problems" as their number one obstacle to growth, it is likely no accident that this innovative credit system has evolved.

## **7. Community Development Financial Institutions (CDFIs)**

Another potential source of farm credit is the large cadre of CDFIs, many serving rural areas and offering micro-credit, guaranteed loans and technical assistance. There are about 1000 CDFIs in the United States including more than 200 community development loan funds, 50 venture capital funds, 250 community development credit unions and 40 community development banks. Their lending pool is estimated at over \$8 billion.

Many CDFIs have as a stated mission the revitalization of rural communities, which presumably would include supporting farm entrepreneurship and boosting family farm incomes. Rural CDFIs like Coastal Enterprises in Maine, California Coastal Rural Development Corp. in

### **California Rural Coastal Development Corporation**

Rather than try to fit small farms into the SBA mold, Cal Coastal is one of a few CDFIs to fully embrace small farm lending. In operation since 1982, this rural CDFI has a portfolio of \$30 million in direct farm loans backed with FSA 90 percent guarantees. With two full-time agricultural lenders, Cal Coastal has established a model working relationship with the FSA. The CDFI has made loans to a number of organic and small, niche operations and considers them on average a better risk than conventional farms, which navigate the competitive world of wholesale brokers. Cal Coastal lenders caution that it can be tough to document sales from direct marketing and that California's small farmers benefit greatly from year-round growing.

California and ShoreBank Pacific in the Northwest have embraced this strategy. However, historically many CDFIs have shied away from farm lending, viewing it as a specialized area outside their expertise. Many CDFIs hire lenders proficient in SBA-type lending and structure programs to take advantage of SBA guarantees and SBA micro-loan programs. Moreover, some of the CDFIs that have sought to do farm loans (for example, Coastal Enterprises) have seen small initial loan volume and have shifted to small farm technical assistance and market development. The lack of loan volume could be a result of the nascent nature of the market, lack of knowledge of the programs and/or a miss-match between small farm credit needs and the programs designed to address them.

In North Carolina, CDFIs with an interest in farm-related lending include Self-Help as well as the N.C. Rural Center; and more distantly, SJF Ventures, a socially-responsible venture capital fund. Self-Help is a good example of a CDFI that recognizes the importance of small farm credit to rural revival, but has developed as a non-farm

lender with strong ties to the SBA and not the FSA. Interest in a market does not translate into immediate capacity to serve it. On a demonstration basis, Self-Help has recently made two micro-loans to small farm operations, one a ten-acre organic farm west of the Triangle and the other a greenhouse operation east of Asheville. Self-Help has had approximately a dozen farm loan inquiries per year since 2002, both start-up, direct marketing operations and conventional farmers seeking (in some cases, desperately) to restructure debt in order to transition from conventional to sustainable farming. Reasons that Self-Help was unable to help these operations included poor credit, lack of collateral, weak business planning and inexperienced management. Some were simply too large and/or conventional. Self-Help has also supported farm tourism development and hosts a state email listserv. The CDFI is in the process of assessing what future role to play in small farm credit in North Carolina.

The N.C. Rural Center operates a small loan fund with loans up to \$25,000. The program has flexible underwriting standards and could be a good source for small loans. Like Self-Help, the organization has limited experience with farm lending per se. SJF Ventures based in Durham and Philadelphia seeks venture level returns on its environmentally and socially-responsible investments. The fund has explored investing in the growing food processing industry that is serving sustainable farmers and which produces high value added products. The fund has no desire to finance farms.

## **B. Capital for Sustainable Farm Enterprises**

Our research painted a complex picture of the credit needs of sustainable farmers. Interviews with industry experts and farmers told a story of seasonal, start-up and expansion needs. Tony Kleese, Executive Director of the Carolina Farm Stewardship Association (CFSA), has as much contact with sustainable growers as anyone in North Carolina. He believes that most organic and specialty growers need some kind of credit every year to purchase inputs prior to having crops to harvest. New organic farmers need loans to purchase land and build the infrastructure (e.g., irrigation, cooling facilities) necessary to bring quality crops to market. Existing organic growers often need loans to expand or enhance their operations as market demand grows and bootstrapped methods give way to more sophisticated operations.

To get a better understanding of organic farmers' capital needs and practices, Self-Help conducted a survey of 500+ organic growers in North Carolina and received over 100 responses. Some of the responses provide insight into organic farmers' credit needs and practices. Interestingly, 40 percent of the respondents state that they have no debt. Another 40 percent responded that their debt load is manageable, whereas 11 percent state that their debt load is difficult to manage. Less than five percent state that their debt load is a serious problem. This indicates that roughly 20 percent of the organic farmers surveyed are concerned about debt and a significant majority is not.

Unlike debt, access to cash flow was ranked as a serious problem by many. Respondents were asked an open ended question about their perception of future opportunities to grow in revenue and/or profits through diversification and/or expansion. They were then asked to rank a list of obstacles to achieving their plans. The following barriers were ranked in order of priority: 1) cash flow problems, 2) pests and/or weather, 3) marketing issues, 4) lack of equipment, 5) lack of workers, 6) low prices, 7) lack of technical know-how, 8) competition, and 9) access to loans.

Organic growers appear to be highly debt averse. John O’Sullivan of North Carolina A&T University noted that, “... farmers are willing to spend money if it’s a grant, but they don’t want to get into debt. They see it as a risk that could jeopardize their land and other assets and don’t want to do it.” When asked about their concerns about debt financing, survey respondents prioritized the following issues. Seventy-seven percent were concerned about exacerbating cash flow problems; 76 percent were concerned about putting their farm at greater risk; 56 percent said that debt financing is not compatible with their philosophy of sustainability; 45 percent do not believe that lenders understand them or their farms; and 44 percent are concerned about increased paperwork and hassles.

In terms of future operational or expansion needs, 25 percent of respondents do not need any new sources of outside funding; 27 percent of respondents stated that they don’t know how much new outside funding they need; 15 percent need less than \$25,000; 13 percent need less than \$10,000; and 15 percent need between \$25,000 and \$100,000.

The demand for capital for these enterprises represents a potential market for lenders, although it is difficult to determine how large that demand will be. Of the organic growers who foresee a need for financing in the future, 53 percent plan to meet their future financial needs with debt financing and 47 percent plan to use equity financing. Thus, if each of North Carolina’s 25,000 small farms borrowed half of the median amount from our survey (\$16,500) demand would top \$200 million. Demand from just the 400 sustainable farms surveyed would top \$3 million.

## **C. Barriers to Credit for Sustainable Farm Enterprises**

Going into this study, we suspected that there might be a lender bias against organic growers: some variation of “We don’t lend to hippy farmers.” We have discovered that by and large this is not the case. Instead, lenders are more concerned with true measures of risk than any particular label or production method. Established farms can access credit. Unproven or poorly presented operations, whether organic, transitioning or conventional, will have more difficulty. Small farms of any kind are less attractive loan customers. Hence, overcoming specific risk-related barriers will be the best avenue to better credit access.

The following are highlights of some of our major findings.

### ***1. Established organic, sustainable farmers have access to credit***

We spoke with seven organic farmers, most of whom said that they could easily get a loan from an institutional source once they were established and could demonstrate the financial profitability of their operations. However, not one of them was able to get a loan when they first started out. Problems accessing credit during the early phases of developing their operations were more about being new than about being organic. Indeed, for some growers, lenders are not necessarily aware that their customers are using a specific production practice such as organic. This theory was bolstered by conversations with lenders. Of nine institutional lenders with whom we spoke, few were aware of servicing loans to organic farmers. This partly relates to the low number of established organic growers utilizing credit, but also to the fact that those who are well-established do not necessarily discuss the details of their farming practices.

Three examples illustrate these dynamics. Alex and Betsy Hitt operate Periwinkle Farms, a successful diversified organic vegetable and flower farm in Chatham County. When they first began, they had no land and limited capital and were unable to get a loan. Instead, they figured out that they could create a sub-S corporation and ask friends/family to invest. After amassing eighteen investors, they had the capital they needed to purchase land and begin farming. Over the course of seven years, the farm grew and the Hitts were able to buy out their investors. After that, the Hitts' experience and financial track record enabled them to get necessary credit through the FCS. Their organic status did not deter their FCS lender.

Ted Burch is a third generation farmer in eastern North Carolina who produces both organic and conventional vegetables on 4,000 acres. Because of his farm's size, the diversity of his operation and his long track record, he has found that commercial banks solicit him for loans. In all of his dealings with FCS and commercial banks, organic production methods were never discussed.

Richard Parker in northeastern North Carolina started out growing ten acres of organic vegetables and he now has 200 acres, with 150 certified organic. Parker is the largest organic producer in the state. Early on, he was unable to get a bank loan because, according to Parker, banks didn't want to finance anything unproven. Now that he is established, however, he borrows a quarter of a million dollars a year. Each year he expands his acreage, adds new crops, and borrows more. Since the banks see that he is succeeding, they are happy to loan to him.

## ***2. New and smaller farmers face credit obstacles***

Interviews with both growers and lenders indicate that organic growers who are just starting out or are in transition face numerous hurdles, some of which are experienced by any type of small, beginning, and/or young (SBY) farmer.

### **a. Small loans not as profitable for lenders**

Because of increased regulation following the 1980s farm crisis, lending standards have changed. Due to increased paperwork, lenders' loan preparation costs have increased dramatically. Lenders earn income from the interest collected on loans, the loan application fees and the origination fees. Since the preparation costs are virtually the same regardless of the size of the loan, lenders prefer to make well-secured loans of at least \$500,000. The net result is that many lenders no longer find it profitable to pursue the business of small or new farmers (Blank 1998).

### **b. Small farmers need professional business plans**

Our interviews with farmers and loan officers revealed that a major obstacle for small farmers is the lack of sound business and marketing plans. Farmers get into the business of farming because they enjoy the independent lifestyle, working outdoors and in connection with the land and/or carrying on a family tradition. Business and marketing skills tend to be limited – few farmers possess accounting or formal marketing skills or can put together teams with such expertise. Training, while available, may not be substantial enough to meet the needs of these entrepreneurs. Farmers generally are not familiar with the form and content needed for a convincing business plan.

When applying for a loan, it is more important for organic growers than conventional growers to have sound business and marketing plans in hand. Production and marketing practices for commodity crops and conventional livestock operations are a relatively known quantity in

lending circles. Lenders feel some security in working with a familiar system. Niche farmers, on the other hand, often operate highly diverse businesses and market their products outside of commodity exchanges. Of the respondents to the Self-Help survey, 60 percent market their products at farmers' markets versus 42 percent at wholesale markets. Other market outlets cited in the survey included restaurants (38%), CSAs (30%), roadside stands (22%), pick your own operations (14%), and food co-ops (12%). Some lenders, for example, may not even know what a CSA is, let alone be comfortable lending to one. Operations (inputs, labor costs) will look different as well and need to be explained in a well-prepared written business plan.

The following example illustrates these issues well. Dick Brevier from Siler City wanted to transition from a successful grass-based meat cattle operation to a grass-based dairy. He approached lenders for start-up capital and was turned down flat. Although Brevier maintains that he was turned down because grass-based dairy is not capital intensive, he did sense a disadvantage in talking with lenders due to his lack of business experience. After taking a REAL Enterprises business course where he learned to develop a business plan, create spreadsheets that illustrated his cash flow, and speak "banker language" Brevier returned to the banks. This time he told them that he was "allowing them to invest in his operation." Brevier feels strongly that he was treated differently. The information had not changed, but because he was able to present it in their language, bankers took him more seriously and made him the loan.

### **c. Those without a farm number are at a disadvantage**

Most commodity crop growers (corn, soybeans, cotton, tobacco, peanuts) have been participating in government programs for decades and have been given a "farm number." Once a farm number is assigned, the USDA requires farmers to submit annual data on production costs, prices paid and other crop parameters. Failure to submit these records means a farmer cannot receive price support or disaster assistance payments. Farms with farm numbers are automatically participating in a nationwide data collection and synthesis process that provides important crop history information. A farm can change ownership but the number and associated crop history data will remain intact with the farm. A farmer can purchase additional acreage and it will be subsumed under the existing farm number.

When reviewing a loan application, an FSA loan officer will review a farm's crop history to determine likely production and revenue. Commodity crop growers who begin to diversify their operations and add some organic production (e.g., tobacco growers who start producing organic tomatoes on some acreage) will still have a farm number and be a part of the data gathering system. However any new grower who buys a piece of land without a farm number is at a disadvantage because they are out of the USDA crop history data collection system.

### **d. Lenders underwrite using commodity-based budgets and prices**

An important underwriting criterion is the ability of the planned operation to generate positive cash flow, producing revenue to pay back the loan and provide for family living expenses. In reviewing a farming operation, a loan officer will require the development of a budget sheet that includes information about the prices farmers are likely to receive for their harvested products. Unless a contract is in place, farmers are required to use enterprise budget sheets developed by N.C. State University and/or an annual updated listing of unit prices for agricultural commodities. These sources do not include prices received by organic and niche growers who receive a premium for their products making it difficult for such growers to demonstrate that their operations will be profitable.

#### **e. Sustainable growers are unaware of FSA programs**

Fifty-four percent of our survey respondents had never heard of FSA programs and 26 percent rated their awareness as low. Given that the FSA is the agency within the USDA that has a federal mandate to target young, beginning and small farmers, small growers appear to be estranged from an important source of credit enhancement. While FSA officials have expressed interest in these farmers, better outreach efforts are needed to spread awareness. To put this into the context of entrepreneurial assistance, a similar sample of non-farm entrepreneurs would likely find a high awareness of SBA programs. This difference would partly be due to the SBA's extensive outreach efforts. It may also be due to that fact that the SBA does a good job of integrating technical assistance and loan programs. The FSA apparently sees its role as more narrowly defined as lending assistance and may fail to attract clients with multiple needs.

#### **f. FSA guarantees are limited to small start-ups**

FSA guidelines require three years of operating history for loans over \$50,000. Although sustainable farms ideally hold their debt to low levels, there may be cases where promising start-ups require more than \$50,000. For example, demand might be high for a new winery or organic dairy near a metropolitan area. The cost of land, improvements, equipment and working capital could easily exceed \$50,000, disqualifying the loan for an FSA guarantee. SBA guarantees are routinely sought for start-ups well over \$50,000.

#### **g. The FSA may view small farms as hobby farms and decline service**

Conversations with various FSA officials indicated that the agency was sensitive to the issue of issuing guarantees for farm loans to operations that are in fact "hobby farms" or simply large gardens. For example, one official commented that farms under fifteen acres are likely to be hobby farms and would be questionable. While this is a valid concern, sustainable farms often range from five to twenty-five acres, yet function as profitable farm enterprises. Large acreage is not a requirement for sustainable operations and may in fact be a hindrance to success. Value-added per acre is much more important than the sheer acreage. Local FSA officials need to be given assurances from state and federal officials that they will not be sanctioned for assisting small operations. The SBA does not withhold assistance to very small businesses that may offer only supplemental income to a family. Such "garage" businesses can be an important source of income for a family, and some grow into major operations.

### **3. Hybrid operations face credit barriers**

While sustainable farms can benefit greatly by straddling the lines between a farm and a non-farm business, this can lead to trouble when seeking financing. Several farm lenders interviewed expressed concern about financing hybrid operations like a bed and breakfast on a farm, agritainment operations (corn mazes, fee fishing, tastings) and certain kinds of food processing. Even if a loan officer is sympathetic, such projects may not be viewed by regulators and managers as sufficiently farm-related. Underwriting may be ill-prepared to evaluate a hybrid project, and the use of funds may be unusual and outside of guidelines. The ability to utilize FSA guarantees is put into question. By the same token, non-farm commercial lenders may be uncomfortable with and unable to successfully lend to projects that they perceive require knowledge of farm issues. Although not strictly forbidden, lenders may think that the SBA will not want to guarantee such projects. Self-Help lenders have spoken with several hybrid entrepreneurs who felt that neither system was prepared to offer financing and that they would fall between the cracks.

# Part Three:

## Recommendations

***1. The lending community should facilitate farm entrepreneur access to outside training and technical assistance regarding capitalization and business plan development. Lenders can learn about, network with and support these technical assistance providers.***

Growers need access to technical training to help them develop sound business and marketing plans. Both the Rural Advancement Fund International (RAFI) survey of tobacco growers and the Self-Help survey of organic growers indicate that marketing assistance is a critical barrier for conventional growers interested in diversification and organic growers interested in improving profits and/or expanding. Sound and creative business and marketing plans are needed, both to help these farmers and to convince lenders to extend credit.

Due to lender liability issues, lenders do not want to directly provide technical support outside of what is needed to explain the loan process. Lenders need to ensure that outside training resources are available, relevant and of high quality. They should be ready to refer a client to these resources in conjunction with putting a loan in place. For example, RAFI provides technical assistance to tobacco growers switching to other crops and peanut growers reducing chemical use and costs. Other technical assistance organizations include the N.C. Agricultural Extension Service, Central Carolina Community College, Carolina Farm Stewardship Association and the Appalachian Sustainable Agriculture Project. Lenders' websites should offer easy links to technical assistance providers.

Farmers also need training around capital raising and deployment strategies; this training can come directly from the lending community. Lenders should be out in the farming community, reaching out to sustainable and transitioning farmers, and encouraging entrepreneurship. Key questions include: Which lenders should farmers approach for financing and when? How much and what type of information should they have available? How can they be prepared to deal with issues of collateral, personal credit and guarantees, and equity requirements? Some part of the debt averseness of these farmers can be attributed to their lack of knowledge of financing issues, which can be corrected.

***2. A third party institution should oversee data collection on specialty and organic crop production and prices so that farmers and lenders can use them in business planning and underwriting. The NC Department of Agriculture currently does this for conventional farmers.***

A third party should collect price data to help farmers develop business and marketing plans and to help lenders trust sustainable enterprises. While niche farming and its marketing venues can sometimes be more art than science, lenders still should rely on data to make prudent decisions.

For example, N.C. State's Department of Agriculture and Resource Economics teamed up with the Carolina Farm Stewardship Association and recently published an organic vegetable production cost study. The study is based on actual records kept by organic growers and organizes the information in the form of traditional enterprise budgets. While this type of budget provides valuable data on real costs and activities for organic, it only represents one season of data (Estes et. al. 2003). Continued data collection and synthesis in this manner is warranted.

Debbie Roos, a Chatham County Extension Agent, for a time collected data on organic prices from three farmers' markets and several major retail outlets in the Triangle. She posted it on her web page, and this information was mentioned by an FSA official as being potentially very useful for reviewing loan applications from organic growers.

An NCDA official expressed interest in exploring a State role in collection of data pertaining to organic prices. The NCDA currently collects and tracks data for conventional produce. Because organic grower numbers are smaller, the official felt that rather than data collection on a weekly basis, it might be more efficient to do it on an "as-need" basis. Farmers could request a letter from the NCDA with official organic prices when applying for a loan. The official suggested that if demand grew, the NCDA could put the information on its website.

***3. Lenders should actively support efforts to improve the infrastructure needed to bring niche and organic products to market. For example, lenders could provide financing and other support to community farmers' markets, farmer cooperatives and retailers selling organic/local produce.***

Lenders should look for opportunities to provide donations and loan capital where it can enhance the infrastructure for specialty farm products grown in North Carolina. This would include investing in and/or supporting various co-ops, farmers' markets, training programs and associations. In this way the lending community becomes an active partner in building a thriving network of business growth and entrepreneurship. An example is the new ECO label and marketing company established by the Carolina Farm Stewardship Association. ECO acts as a brokering and delivery service for organic growers in eastern North Carolina selling to restaurant and grocery store buyers. Self-Help Credit Union has assisted the start-up of this entity as a part of its efforts to ratchet up the organic industry in eastern North Carolina. Self-Help has also volunteered to manage the fundraising for the new pavilion for the Durham Farmers' Market. Banks and farm lenders across the state have the opportunity to make such donations to local farmers' markets and support organizations which will fuel the growth of these farm entrepreneurs.

***4. Financial institutions should undertake efforts to become better educated about sustainable agriculture and the resulting business opportunities. Lenders will need to monitor the rapid pace of developments in this business sector. Self-Help has developed materials that outline how financial institutions can better underwrite to this sector and will share those materials with the financial sector.***

Our interviews with lenders and others taught us that while there does not appear to be overt bias against non-conventional production and small producers, there exists a significant amount of subtle skepticism about their viability. Loan officers, government employees and resource organizations indicated a lack of awareness about the growth in organic and specialty production/markets and the resulting opportunities for North Carolina farmers. The lending community needs to raise the staff awareness about the many hybrid farming models, including the growth of agritourism and its fit into the bigger picture.

CDFIs have the opportunity to educate their loan officers and officials within commercial banks, the FSC, and the FSA about trends in organic and specialty production and opportunities to lend profitably. A summit meeting bringing together lenders, sustainable growers and resource organizations would be of great value. Also it would be helpful to educate lenders through articles and outreach in trade journals such as *Carolina Banker* and *Journal of Agricultural Banking*, and at gatherings of lenders such as workshops and conferences. The Center for Agriculture and Rural Banking of the American Banking Association could be a helpful resource in these endeavors. As a part of this process, Self-Help will make publicly available the underwriting guidelines that it has developed to prudently lend to this sector.

***5. The USDA Farm Service Agency, Farm Credit System institutions, the U.S. Small Business Administration and other lenders should investigate ways they might improve marketing of their programs and products to sustainable farmers, encourage entrepreneurial farming through collaboration and training, and reform underwriting and program rules to increase access to credit by sustainable farmers.***

While staff at both the Farm Service Agency and Farm Credit System institutions expressed interest in serving the needs of niche farmers, too often we heard that official rules were perceived as creating roadblocks to fully embracing these farmers. Hence, officials and lenders need to more closely examine their policies to find areas where rules may be unnecessarily shutting out sustainable farmers. Areas of concern include acreage standards, farm diversity, and crop budgets.

Lenders should feel comfortable to lend and, where appropriate, to seek FSA guarantees on small farms. We know that viable farms can exist on as little as three to five acres. Yesterday's "hobby farm" is today's profitable niche grower. Likewise, officials should recognize that successful farms are diverse and may include non-farm elements such as tourism activities. Such diversity should be seen as strengthening, not hindering loan dollars. If a decision is made to turn down a loan because it is considered a "non-farm enterprise," the system should work with the applicant and other lenders to find an appropriate referral.

The FSA and FCS lenders need to adjust their evaluative criteria so that premium prices for specialty products are factored into underwriting decisions. Forms that automatically carry over crop history and crop pricing information from previous lower-margin operations need to be changed to allow for more flexibility. In this way, those transitioning from commodity to specialty crops can be fairly evaluated.

FSA officials should be allowed the flexibility to offer guarantees on larger start-up projects. Currently, FSA rules require three years of operating history in order to guarantee loans over \$50,000. Policies allowing more flexibility can be evaluated to ensure that underwriting standards remain high and that loan losses are kept to a minimum.

Federal farm lending programs in general need to address the issues of micro-credit head-on and provide funding and incentives for lenders to make loans to small entrepreneurial projects. These efforts should be coordinated with the SBA and other rural development agencies to avoid duplication of effort. The model of the successful SBA Microloan program, with loans under \$35,000, should be examined.

The FSA and FCS lenders have the opportunity to more aggressively market their products to young and niche farm entrepreneurs through their websites and networking with associations and educators. While we hear uniform concern about the aging of the American farmer, young eager farmers can be found in droves at sustainable farming events. FSA and FCS officials have an easy opportunity to reach this young audience better. In addition, the FSA and FCS can learn from the example of the SBA's website, which does an excellent job of integrating entrepreneurial training with information about its programs. The SBA thus drives home the point that successful enterprises need both entrepreneurial skills and sufficient capital.

***6. Federal/state government officials, community development financial institutions (CDFIs) and other interested funders should investigate incentives such as dedicated loan capital and/or credit enhancements. CDFIs should explore the opportunity to be a new conduit for small farm finance to the extent that this fits their historic mission of rural development, new enterprise development and bridging credit gaps.***

If CDFIs are to make an impact in sustainable farm lending, they will need to do more than simply becoming better informed about the issues. Tangible assistance to create incentives to assist these farmers is also needed. One such incentive is the allocation of capital funds to CDFIs to be used for farm lending. Such funds could come from the CDFI Fund or other federal sources, as well as program-related investments and grants from foundations. Deposit programs, linked to environmental goals, are another source of capital. A second form of incentive is grant funding for credit enhancement programs such as in-house guarantee funds. It is likely that smaller projects will not be able to use FSA or SBA guarantees due to the high relative transaction costs involved. In-house guarantee funds at CDFIs can be a more appropriate way to shore up weak collateral for these small projects. Trade association and government leaders should explore what incentives would be most helpful and from where funding could be acquired.

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# Individuals Interviewed

## Farmers

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Dick Brevier, Chatham County, North Carolina  
Richard Parker, Pasquotank County, North Carolina  
Rachel Burton, Chatham County, North Carolina  
Stephan Hartman, Pender County, North Carolina  
Alex Hitt, Chatham County, North Carolina  
Aubrey Roper, Carolina Organic Growers Association  
Ted Burch, Johnston County, North Carolina

## University / Nonprofit Sector

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John O'Sullivan, Agricultural Economist, A & T  
Gary Gumz, Appalachian Sustainable Agriculture Project  
Ed Estes, Extension, N.C. State University  
Carol Kline, Handmade in America  
Greg Walker, Mountain Microenterprise Fund  
Betty Bailey, Rural Advancement Fund International  
Benny Bunting, Rural Advancement Fund International  
Scott Marlow, Rural Advancement Fund International  
Tony Kleese, Carolina Farm Stewardship Association  
Paul Williamson, National Center for Appropriate Technology  
Peter Skillern, Community Reinvestment Association of North Carolina  
Kathy Ozer, National Family Farm Coalition  
Debbie Roos, Chatham County Extension, N.C. State University  
Mike Linker, Dept. of Entomology, N.C. State University  
Robin Kohanovich, Central Carolina Community College  
Janine Davis, Cooperative Extension, N.C. State University

## Government

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Doug Sutton, North Carolina Department of Agriculture  
Smithson Mills, North Carolina Department of Agriculture  
Al Edward, North Carolina Office of the Commissioner of Banks

## Lenders

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Ayden Lee, Four Oaks Bank  
Ronnie Wren, Four Oaks Bank  
Brian Johnson, Raleigh Farm Credit  
Ronnie James, First Citizen's Bank  
Liz Clemet, FSA Raleigh  
Janet Whyatt, FSA, Chatham  
Jeffrey Robinson, Southern Bank  
Frankie Coble, Carolina Farm Credit  
Mickey Cochran, North Carolina Agricultural Financing Authority  
Billy Price, North Carolina Agricultural Financing Authority  
Karen Hoskins, Small Business Administration, Charlotte

# Appendix A:

## Further information for the reader

### **1. The Definition of Sustainable Agriculture**

The concept of sustainable agriculture emerged in the 1970s and was born out of a concern on the part of farmers, researchers, consumers and policy makers that as agriculture continues to become increasingly industrialized, natural resources, rural communities and family farm profitability will be jeopardized. Sustainable agriculture is best viewed as a goal rather than a rigid set of practices. As such, sustainable agriculture grapples with broad environmental, economic, and social issues such as conservation of natural resources and open space, population mobility and community food security, and farm profitability.

An agricultural system that is sustainable is one that meets the needs of the present without compromising the ability of future generations to meet their own needs. Sustainable agriculture is often discussed in terms of being ecologically sound, economically viable and socially responsible. Most importantly, these three dimensions are viewed as interconnected and equally critical for long-term sustainability (SARE 1991).

A more specific definition is offered in the 1990 Farm Bill and referenced by North Carolina State University's Sustainable Agriculture Research and Education Program:

*"... an integrated system of plant and animal production practices having a site specific application that will, over the long term, satisfy human food and fiber needs; enhance environmental quality and the natural resources base upon which the agricultural economy depends; make the most efficient use of nonrenewable resources and on-farm/ranch resources; and integrate, where appropriate, natural biological cycles and controls; sustain the economic viability of farm/ranch operations; and enhance the quality of life for farmers/ranchers and society as a whole."* (Subtitle B of Title XVI of the Food, Agriculture, Conservation and Trade Act of 1990)

The Act further states that sustainable agriculture includes conventional, organic, low input and other alternative farming methods if they conserve resources and address economic, environmental and social concerns about farming systems.

## **2. The National Organic Standard**

The national organic standards address the methods, practices, and substances used in producing and handling crops, livestock, and processed agricultural products. The requirements apply to the way the product is created, not to measurable properties of the product itself. Although specific practices and materials used by organic operations may vary, the standards require every aspect of organic production and handling to comply with the provisions of the Organic Foods Production Act (OFPA). These requirements include operating under an organic system plan approved by an accredited certifying agent and using materials in accordance with the National List of Allowed Synthetic and Prohibited Non-Synthetic Substances.

Land must have no prohibited substances applied to it for at least 3 years before the harvest of an organic crop. The use of genetic engineering (included in excluded methods), ionizing radiation and sewage sludge is prohibited. Soil fertility and crop nutrients are to be managed through tillage and cultivation practices, crop rotations, and cover crops, supplemented with animal and crop waste materials and allowed synthetic materials.

Crop pests, weeds, and diseases are to be controlled primarily through management practices including physical, mechanical, and biological controls. When these practices are not sufficient, a biological, botanical, or synthetic substance approved for use on the National List may be used.

The livestock standards say that animals for slaughter must be raised under organic management from the last third of gestation, or no later than the second day of life for poultry. Producers are required to feed livestock agricultural feed products that are 100 percent organic, but may also provide allowed vitamin and mineral supplements. Producers may convert an entire, distinct dairy herd to organic production by providing 80 percent organically produced feed for 9 months, followed by 3 months of 100 percent organically produced feed. Organically raised animals may not be given hormones to promote growth or antibiotics for any reason.

Preventive management practices, including the use of vaccines, can be used to keep animals healthy. Producers are prohibited from withholding treatment from a sick or injured animal; however, animals treated with a prohibited medication may not be sold as organic. All organically raised animals must have access to the outdoors, including access to pasture for ruminants. They may be temporarily confined only for reasons of health, safety, the animal's stage of production, or to protect soil or water quality.

### **3. Organic: More or Less Profitable than Conventional?**

A number of studies have been conducted in the past ten years that illuminate the economics of organic production systems. Some studies suggest that organic price premiums are critical to making organic farming systems comparable or higher in terms of whole-farm profits than conventional, more chemical-intensive systems, particularly for crops such as processed tomatoes and cotton. This situation exists for North Carolina soybeans. Research trials conducted at CEFS indicate that while organic soybean production results in the lower yields compared to conventional production, organic soybeans routinely receive a 27 percent price premium. When the premium is taken into account, organic production becomes the most profitable (Wossink 2002). Other studies have found that organic systems are more profitable than conventional systems, even without the price premium, including organic grain and soybeans grown in the Midwest and apples grown in California and the Pacific Northwest (Dimitri & Greene 2002). The difference appears to be crop and region dependent. Indeed a review of the literature in 1990 indicated that the variation within organic and conventional farming systems is likely as large as the differences between the two systems. No studies have been published recently that indicate that organic farming is less profitable than conventional farming (Dimitri & Greene 2002). A further dimension rarely assessed in conventional economic terms is the environmental benefits to society associated with organic production systems, including reduced: 1) human and wildlife exposure to pesticides, 2) nutrient-related pollution, 3) energy consumption, and 4) global warming via carbon sequestration in soil.

# Appendix B:

## Survey and Results

### 1. Survey Methodology

The confidential survey was mailed in February 2003. The pool of survey recipients came from a database of friends and members of the Carolina Farm Stewardship Association (CFSA). CFSA is a membership-based organization committed to sustainable agriculture and the development of locally based, organic food systems. From an initial list of 5000 names, we selected those who identified themselves as farmers or farm-related businesses; this yielded a survey pool of 450 for our mailing. Forty-two of the surveys were subsequently identified as duplicate addresses and/or returned as undeliverable, leaving 408 enterprises which received the survey. One hundred ten (110) surveys were returned to us for a 27% response rate. To boost participation, the survey was preceded by an introductory letter and followed by a reminder postcard.

### 2. Survey Overview

The survey was divided into two parts and consisted of 27 questions. In *Part A: Farm Profile*, 14 questions were used to gather basic information about the respondent's enterprise. In *Part B: Financing Needs and Issues*, 13 questions were directed at specific financing needs and concerns associated with the respondent's farm/business. The survey ended with a request to provide "additional comments" on the back of the last page.

#### Part A. Farm Profile

1. Location
2. Production Information
3. Certified Organic
4. Marketing Methods
5. Acreage Farmed
6. Years in Operation
7. Lease vs. Own
8. Farming as a Percent of Family Income
9. Tourism Activities
10. Legal Structure
11. Gross Revenue
12. Net Worth
13. Self-Reported Growth Trend Over Last Three Years
14. Technical Assistance

#### Part B. Financing Needs and Issues

15. Opportunities for Growth
16. Obstacles to Growth
17. Desire to be Debt Free
18. Concerns About Debt Financing

19. Benefits of Debt Financing
20. Current Debt Load
21. Potential Collateral Sources
22. Knowledge of FSA Loan Programs
23. Capital Demands In Next Three Years
24. Use of Funds From Outside Sources In Next Three Years
25. Debt vs. Equity Financing
26. Obstacles to Financing Future Plans
27. Loan Denials

## Part A: Farm Profile

### 1. Location

North Carolina: 95 respondents (87%)

South Carolina: 14 respondents (13%)

The researchers chose to include farms from S.C. due to the close links between the farming communities in the two states. The numbers roughly reflect the relative distribution of organic farms in North and South Carolina.

### 2. Production Information

|                     | Actual<br># | Percent |
|---------------------|-------------|---------|
| Crops Only          | 68          | 63%     |
| Crops and Livestock | 33          | 30%     |
| Livestock Only      | 8           | 7%      |
| Total Responses     | 109         | 100%    |

We were not surprised to find our sample was predominantly crop farmers. Livestock is a small (but fast-growing) segment.

| Production Method | Actual<br># | Percent |
|-------------------|-------------|---------|
| Bio-Dynamic       | 5           | 5%      |
| Conventional      | 14          | 13%     |
| IPM               | 20          | 18%     |
| Low-Input         | 21          | 19%     |
| No-Till           | 16          | 15%     |
| <i>Organic</i>    | 89          | 82%     |
| Permaculture      | 18          | 16%     |
| Total Responses   | 109         | n/a     |

While the sample is largely organic growers, some conventional growers are present. This latter group presumably is considering shifting to more sustainable practices or is in the process of doing so. IPM stands for “integrated pest management.” Permaculture and bio-dynamic are holistic growing systems which represent a more far-reaching ecological approach to farming.

| <b>Production Method - Livestock</b> | <b>Actual #</b> |
|--------------------------------------|-----------------|
| Hormone/Antibiotic Free              | 33              |
| Pasture Based Animal Management      | 35              |
| Not Applicable                       | 27              |

The livestock producers in the survey were using the typical sustainable livestock practices.

### 3. Certified Organic

| <b>The farm or business grows or sells some products that are certified organic:</b> | <b>Actual #</b> | <b>Percent</b> |
|--|-----------------|----------------|
| YES  | 24              | 22%            |
| NO   | 72              | 67%            |
| Plan Certification in 2004   | 12              | 11%            |
| Responses  | 108             | 100%           |

Sustainable farmers may be practicing organic or other ecological methods, yet not be certified due to cost or philosophical issues.

### 4. Marketing Methods: Popularity and Intensity of Use

|                          | <b>Number of Respondents</b> |          | <b>Intensity Profile</b> |          |
|--------------------------|------------------------------|----------|--------------------------|----------|
|                          | <b>Actual #</b>              | <b>%</b> |                          | <b>%</b> |
| Co-op                    | 12                           | 12%      |                          | 40%      |
| CSA                      | 30                           | 31%      |                          | 47%      |
| Farmers' Markets         | 59                           | 61%      |                          | 49%      |
| Pick Your Own            | 14                           | 14%      |                          | 35%      |
| Restaurants              | 37                           | 38%      |                          | 38%      |
| Roadside Stand           | 22                           | 23%      |                          | 35%      |
| Wholesale                | 41                           | 42%      |                          | 51%      |
| Total Responses Received | 97                           |          |                          |          |

The survey listed seven alternative distribution methods and asked the respondents to identify, on a percentage basis, the method(s) they employ. On any given survey, the sum of the individual line items should have equaled 100%.

Of the seven methods listed, the most popular were Farmers' Markets (60.8%), Wholesale (42.3%), and Restaurants (38.1%). Notably, direct marketing only was used by 58% of the sample. The third column above shows an intensity profile: using a formula, we determined how much a farm would use a particular method amongst its mix of various methods. For example, while wholesaling is the second most popular method, those that use it, use it 50% of the time, the most intense usage of the group.

## 5. Acreage Farmed

|                             | Responses |     | Actual Acreage | Average Acreage | Median Acreage |
|-----------------------------|-----------|-----|----------------|-----------------|----------------|
|                             | #         | %   |                |                 |                |
| Cultivated Crops            | 92        | 86% | 1,731          | 19              | 3              |
| Livestock Production        | 36        | 34% | 1,291          | 36              | 15             |
| Forested Land               | 52        | 49% | 2,704          | 52              | 24             |
| Fallow Land due to Rotation | 32        | 30% | 922            | 29              | 3              |
| Other                       | 46        | 43% | 1,004          | 22              | 4              |
| Total Survey Responses      | 107       |     | 7,653          | 71              | 13             |

The acreage farmed is quite small, as we expected. Note the median numbers, which unlike the averages, avoid skewing the numbers too high.

## 6. Years in Operation

|                                      | Total Responses | Total Years | Avg. Years | Median Years |
|--------------------------------------|-----------------|-------------|------------|--------------|
| Years in operation: total            | 105             | 1,278       | 12         | 6            |
| Years in operation: not conventional | 83              | 716         | 9          | 5            |

Question six asked the respondents to identify both the number of years they have been in operation as well as the number of years part or all of their production has not been conventional. The typical (median) farm has been in operation for a little over six years. Of the subset who responded, they have employed non-conventional methods over five years. One can construe from these data that the group, on average, is not conventional farmers who switched to organic, but instead farmers who began their careers as sustainable growers.

## 7. Lease vs. Own

|                        | Responses |     | Acreage |     | Average Acreage | Median Acreage |
|------------------------|-----------|-----|---------|-----|-----------------|----------------|
|                        | #         | %   | Actual  | %   |                 |                |
| 100% Leased            | 5         | 5   | 307     | 4   | 61              | 7              |
| 100% Owned             | 84        | 82  | 4,917   | 65  | 59              | 13             |
| Combination            | 13        | 13  | 2,333   | 31  | 179             | 15             |
| Total Survey Responses | 102       | 100 | 7,555   | 100 | 74              | 13             |

The average profile indicates that 87% of the acreage farmed is owned, while the remaining 13% is leased. Two points are worth noting. Land as collateral is an option for most of these farmers if they choose to put this asset at risk. Sustainable farmers may be reluctant to lease land as their soil improvements would ultimately benefit another.

Of those responding, 82% owned their farm outright, 5% leased all of their property and the rest owned a portion of their property and leased a portion. But while the latter group represents about 13% of the population, it was associated with over 30% of the acreage farmed. Of the 2,331 acres farmed by those owning and leasing their property, 1,727 acres (74%) are leased.

## 8. Farming as a Percent of Family Income

| Percent of Family Income | Responses |          | Total<br>(3) | Acreage<br>Average<br>(4) | Median<br>(5) |
|--------------------------|-----------|----------|--------------|---------------------------|---------------|
|                          | #<br>(1)  | %<br>(2) |              |                           |               |
| A. 0%                    | 15        | 13.6     | 368.75       | 25                        | 3             |
| B. 0 - 9.9%              | 20        | 18.2     | 1,231.6      | 62                        | 13            |
| C. 10%                   | 13        | 11.8     | 691.5        | 53                        | 28            |
| D. 10.1 - 25%            | 18        | 16.4     | 715.8        | 40                        | 31            |
| E. 26 - 50%              | 18        | 16.4     | 1,065.0      | 59                        | 10            |
| F. 51 - 99%              | 13        | 11.8     | 1,692.6      | 130                       | 8             |
| G. 100%                  | 13        | 11.8     | 1,887.4      | 145                       | 20            |
|                          | 110       | 100.0    |              |                           |               |

32.9 Average Percent of total family income for all records

20 Median Percent of total family income for all records

38.2 Average Percent of total family income for all records with income > 0%

25 Median Percent of total family income for all records with income > 0%

Mirroring national farming data, many sustainable farm families derive only a small percentage of their family income from the farm. This is not to diminish the value of extra income to a rural family and the value of micro-enterprise. It is unclear whether these families like this income arrangement or would rather find a way to derive more income from the farm. Acreage is not the determining factor here; the intensity of the farm operation and choice of crop are likely the key variables.

## 9. Tourism Activities

| Tourism Activity                 | Actual<br># | Percent<br>% |
|----------------------------------|-------------|--------------|
| Corn Maze                        | 0           | 0            |
| Hay Rides                        | 0           | 0            |
| Overnight Stays                  | 2           | 2            |
| School Trips                     | 12          | 11           |
| Petting Zoo                      | 1           | 1            |
| Other                            | 20          | 18           |
| None                             | 42          | 42           |
| Not Applicable                   | 32          | 32           |
| Total Activities                 | 109         | 100          |
| Total Non-Blank Surveys Received | 101         |              |

It is significant that so few sustainable farms we surveyed had chosen to diversify into tourism activities. This could be related to lack of awareness, fear of liability and contamination from visitors, or a conscious choice to have a calmer farm life. A respondent could check multiple activities. The median acreage of a farm engaged in at least one of the tourist activities is eight.

## 10. Legal Structure

| Structure           | Actual # | Percent % |
|---------------------|----------|-----------|
| Sole Proprietorship | 80       | 73%       |
| Partnership         | 11       | 10%       |
| Corporation - LLC   | 7        | 6%        |
| Corporation - S     | 7        | 6%        |
| Corporation - C     | 0        | 0%        |
| Other               | 4        | 4%        |
| Total               | 109      | 100%      |

Nearly three out of four farmers identified their respective farm/business as a *sole proprietorship*. These farmers may be missing out on the tax or other advantages of more complex ownership structures or may be consciously choosing the simplest form of ownership. For financing purposes, some farmers will want to divide their operations into different corporate operating units. This could help them take advantage of federal programs that only fund the farming portion of a larger enterprise or satisfy bank or investor requirements.

## 11. Gross Revenue

| 2002 Estimated Gross Revenue     | Actual | Percent |
|----------------------------------|--------|---------|
| \$0 - 24,999                     | 76     | 70      |
| \$25,000 - 74,999                | 17     | 16      |
| \$75,000 - 149,000               | 9      | 8       |
| \$150,000 - 249,000              | 3      | 3       |
| \$250,000 - 499,000              | 2      | 2       |
| \$500,000 - 1 MM                 | 0      | 0       |
| \$1 MM+                          | 1      | 1       |
| Total Non-Blank Surveys Received | 108    | 100     |

Note: The data would provide suppressed figures if some respondents confused gross revenue with gross profit.

The responses were further broken down to look for correlations of gross revenues with total farm acreage.

While there is not a strict relationship between total farm acreage and potential revenue, there is a presumption that larger farms generate larger revenues. As a rough indicator of the existence of this bias within the survey data, a simple cross tab on total acreage was generated. The largest of farms (99.9+ acres) are indeed associated with some of the higher revenue ranges. (This is particularly true in the case of the \$75,000 - \$149,000 range.) The fact that the lowest revenue range (i.e., < \$25,000) dominated each acreage category however, should give some pause to the notion that bigger is better. Also noteworthy is the fact that some small farms generated reasonably large revenue.

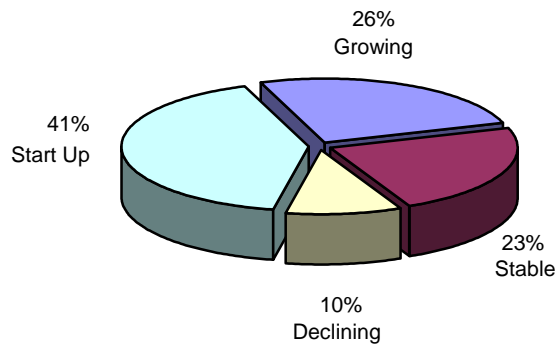
| Gross Revenue       | Acreage |         |           |           |       | Revenue<br>Total |
|---------------------|---------|---------|-----------|-----------|-------|------------------|
|                     | 0-4.9   | 5 - 9.9 | 10 - 19.9 | 20 - 99.9 | 99.9+ |                  |
| \$0 - 24,999        | 24.1    | 10.2    | 10.2      | 17.6      | 8.3   | 70.4             |
| \$25,000 - 74,900   | 3.7     | 6.5     | 1.9       | 1.9       | 1.9   | 15.7             |
| \$75,000 - 149,000  | --      | --      | 0.9       | 0.9       | 6.5   | 8.3              |
| \$150,000 - 249,000 | 0.9     | --      | --        | 0.9       | 0.9   | 2.8              |
| \$250,000 - 499,999 | --      | --      | --        | --        | 1.9   | 1.9              |
| \$500,000 - 1 MM    | --      | --      | --        | --        | --    | --               |
| \$1 MM+             | --      | --      | --        | --        | 0.9   | 0.9              |
| Blank               | --      | --      | --        | --        | --    | --               |
| Category Total      | 28.7    | 16.7    | 13.0      | 21.3      | 20.4  | 100%             |

## 12. Net Worth

| Estimated Net Worth                 | Actual<br># | Percent<br>% |
|-------------------------------------|-------------|--------------|
| Negative                            | 4           | 4%           |
| \$ 0 - 9,999                        | 20          | 20%          |
| \$ 10,000 - 49,999                  | 15          | 15%          |
| \$ 50,000 - 149,999                 | 19          | 19%          |
| \$150,000 - 499,999                 | 33          | 33%          |
| \$500,000+                          | 8           | 8%           |
| Total Non-Blank Surveys<br>Received | 99          | 100%         |

Our group of sustainable farmers has substantial net worth, useful for leveraging financing. The accuracy of the net worth figures are subject to how well the farmers are able to estimate their assets minus liabilities and what they choose to include therein. A crosstab showed that net worth is not just a function of how large the farm is.

### 13. Self-reported growth trend over last three years



Compared to the gloom of conventional farming, the survey finds a relatively optimistic group of growers. Also, a large portion of the farmers define themselves as start-ups. (N = 108)

### 14. Technical Assistance

| Provider                                 | Actual # | Percent % |
|--|----------|-----------|
| Ag Extension Service                     | 80       | 73        |
| Farm Bureau                              | 6        | 6         |
| Carolina Farm Steward Association (CFSA) | 59       | 54        |
| Other Farmers                            | 74       | 67        |
| Other University Based Farm Programs     | 28       | 26        |
| Other County Govt. Programs              | 14       | 13        |
| Other (please specify)                   | 31       | 28        |
| Total Non-Blank Surveys Received         | 110      | 100       |

Almost three-quarters of the farms identified the Ag Extension Service as the primary source for technical or business assistance. This, however, is not a blanket endorsement of Extension, but more likely a thumbs up for specific extension agents (e.g., Chatham and Watauga counties in N.C.) that have supported sustainable farming. Two other services identified by a majority of the respondents were "other farmers" (67.3%) and the Carolina Farm Steward Association (53.6%). Peer learning is a key to this industry.

## Part B: Financing Needs and Issues

### 15. Opportunities for growth

| Top Opportunities                            | Actual # |
|--|----------|
| <b>New products (berries, flowers, e.g.)</b> | 20       |
| None desired                                 | 13       |
| More acreage                                 | 12       |
| Value-added processing                       | 12       |
| Greenhouses / season extension               | 9        |
| CSAs   | 8        |
| Farmers' Markets                             | 7        |
| Farm Tourism                                 | 7        |
| Adding more labor                            | 6        |
| U-pick and farm stands                       | 4        |

New products, more acreage, value-added processing and greenhouses were the top opportunities cited by our survey when asked for comments regarding opportunities for farm diversification and growth in the period 2003 to 2005. These choices point to clear opportunities for capital investment. Comments varied greatly in length and detail. Some interpreted the question in general terms (“there is an opportunity for me because the demand for organics is growing”), while most described some type of concrete project they were planning. A few offered that these opportunities were hindered by a lack of capital. Thirteen commented that they had no interest in growth or diversification, whether or not it existed. Only a few farmers mentioned the Internet, ethnic markets, wholesaling, co-ops and restaurants.

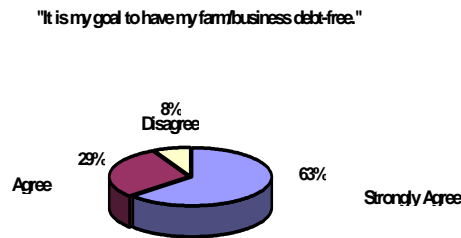
### 16. Obstacles to Growth

| Type of Obstacle           | Ranking |         |         | Marked but not ranked (%) | Total (%) |
|----------------------------|---------|---------|---------|---------------------------|-----------|
|                            | # 1 (%) | # 2 (%) | # 3 (%) |                           |           |
| 1. Cash Flow Issues        | 30.2    | 12.7    | 4.8     | 33.3                      | 81.0      |
| 2. Pests/Weather           | 17.5    | 11.1    | 11.1    | 33.3                      | 73.0      |
| 3. Marketing Issues        | 7.9     | 14.3    | 9.5     | 30.2                      | 61.9      |
| 4. Equipment               | 4.8     | 7.9     | 9.5     | 31.7                      | 54.0      |
| 5. Lack of Workers         | 9.5     | 7.9     | 7.9     | 27.0                      | 52.4      |
| 6. Other                   | 6.3     | 3.2     | 4.8     | 30.2                      | 44.4      |
| 7. Low Prices              | 7.9     | 3.2     | 9.5     | 22.2                      | 42.9      |
| 8. Tech know-how           | 7.9     | 9.5     | 4.8     | 14.3                      | 36.5      |
| 9. Competition             | 3.2     | 3.2     | 6.3     | 19.0                      | 31.7      |
| 10. Access to Loans        | 3.2     | 6.3     | 3.2     | 15.9                      | 28.6      |
| 11. Regulations            | 0.0     | 6.3     | 4.8     | 14.3                      | 25.4      |
| 12. Land Use/Zoning        | 0.0     | 0.0     | 1.6     | 9.5                       | 11.1      |
| <b>* Total Responses =</b> |         |         |         |                           | <b>63</b> |

Cash flow and pests/weather are perceived as the key obstacles to future growth. Over only one of these two factors does the business have much control. These farmers may be reluctant to spend the money to

purchase a cash flow cushion in the form of a line of credit or operating term loan. Rounding out the majority of responses were concerns with marketing (61.9%), equipment (54.0%) and lack of workers (52.4%). Neither "Low Prices" nor "Access to Loans" were considered serious obstacles to growth by a majority of the respondents. It is probably not a stretch to say that capital issues are hidden in some of these responses. So, while the farms may sense that they have access to loans and not see this as a problem, their choice to avoid debt could be the key obstacle to their growth.

### 17. Desire to be Debt-Free



There are a number of factors that could lead to debt aversion amongst sustainable farmers. Reasons could include the much-publicized wave of bank foreclosures on family farms, “hippy” antipathy toward buttoned-down collar bankers and the bootstrapping mentality of organic farmers. Hence, it is not surprising that 92% of the farmers agreed or strongly agreed with the phrase, "It is my goal to have my farm/business debt-free." It is of course possible that a given farmer is quite comfortable with debt, yet would still *rather* be debt-free. Overall though this seems to indicate a crippling unwillingness to recognize debt as a tool just like a tractor or greenhouse.

### 18. Concerns About Debt Financing

| Concerns                            | Ranking |         |         | Marked but not ranked (%) | Total (%) |
|-------------------------------------|---------|---------|---------|---------------------------|-----------|
|                                     | # 1 (%) | # 2 (%) | # 3 (%) |                           |           |
| a. Payments stress cash flow        | 32.0    | 13.3    | 5.3     | 26.7                      | 77.3      |
| b. Puts my farm at risk             | 18.7    | 26.7    | 8.0     | 22.7                      | 76.0      |
| c. Does not fit my philosophy       | 22.7    | 10.7    | 8.0     | 14.7                      | 56.0      |
| d. Lenders don't understand me/farm | 9.3     | 10.7    | 9.3     | 16.0                      | 45.3      |
| e. Paperwork and hassles            | 5.3     | 5.3     | 8.0     | 25.3                      | 44.0      |
| f. Gives power to outside interests | 2.7     | 8.0     | 13.3    | 13.3                      | 37.3      |
| g. No concerns                      | 8.0     | 0.0     | 5.3     | 13.3                      | 26.7      |
| h. Reduces my privacy               | 0.0     | 2.7     | 4.0     | 18.7                      | 25.3      |
| i. Other                            | 2.7     | 0.0     | 2.7     | 13.3                      | 18.7      |
| j. Encourages me to grow too fast   | 0.0     | 6.7     | 0.0     | 5.3                       | 12.0      |
| * Total Responses                   |         |         |         |                           | <b>75</b> |

Cash flow stress, losing the farm and philosophical differences top the list of concerns that sustainable farmers have with debt financing. Why would sustainable farmers respond this way? Is it possible that the farmers are not thinking enough about how debt could be structured or that lenders they have dealt

with in the past have structured debt poorly? Appropriate amounts of well-timed, well-structured debt should not stress cash flow, but enhance it. Such debt would not need to put the overall farm at undue risk. This points out that lenders need to do a better job of educating sustainable farmers as to how they can successfully use debt to leverage their growth. (It is also possible that the question is too vague to be useful: a farmer might interpret this as asking “How do you feel about mortgaging your farm for a little extra money?”) The responses also reveal a gulf between the farmers and lenders (“Lenders don’t understand me/my farm.”)

**19. Benefits of Debt Financing**

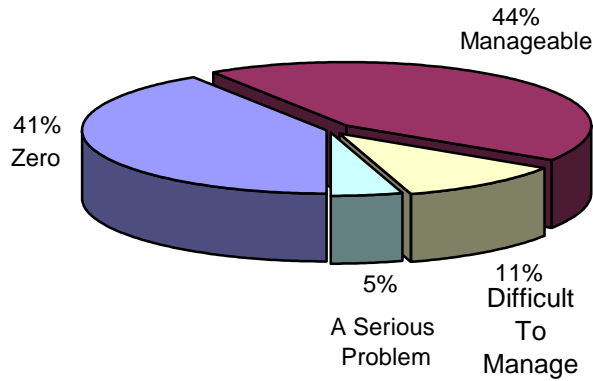
| Benefits                                      | Ranking |         |         | Marked but not ranked (%) | Total (%) |
|---|---------|---------|---------|---------------------------|-----------|
|   | # 1 (%) | # 2 (%) | # 3 (%) |                           |           |
| a. Helps me to upgrade equipment              | 40.0    | 21.8    | 7.3     | 25.5                      | 94.5      |
| b. Allows me to grow faster                   | 27.3    | 25.5    | 3.6     | 20.0                      | 76.4      |
| c. It's affordable with interest rates so low | 12.7    | 14.5    | 16.4    | 10.9                      | 54.5      |
| d. Stretches my dollar further                | 14.5    | 9.1     | 10.9    | 14.5                      | 49.1      |
| e. Other                                      | 9.1     | 0.0     | 0.0     | 12.7                      | 21.8      |
| f. Helpful feedback from lender               | 1.8     | 0.0     | 3.6     | 1.8                       | 7.3       |

**\* Total Responses = 55**

Almost 95% of the farmers indicated that debt financing would help them upgrade their equipment, while three out of four indicated that it would allow them to grow faster. Some farmers recognized the benefit of historically-low interest rates. Few farmers expected to get any helpful feedback from their lender. This is a shame considering that, in a highly-functional economic network, financial professionals can be an excellent source of information, strategic thinking and project feedback.

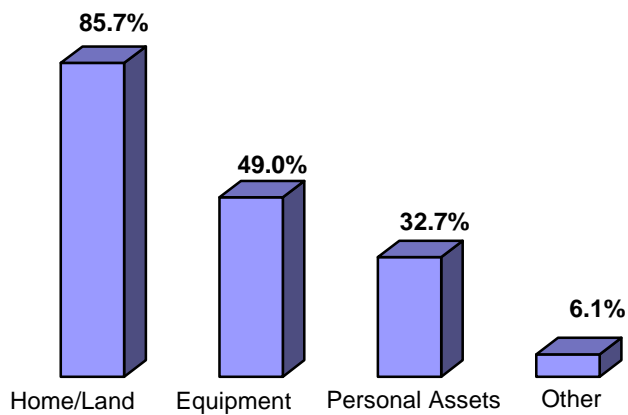
In reviewing the responses received for questions 18 and 19, it is worth noting that 75 participants chose to identify at least one concern that they had with debt financing while only 55 chose to highlight some form of benefit.

## 20. Current Debt Load



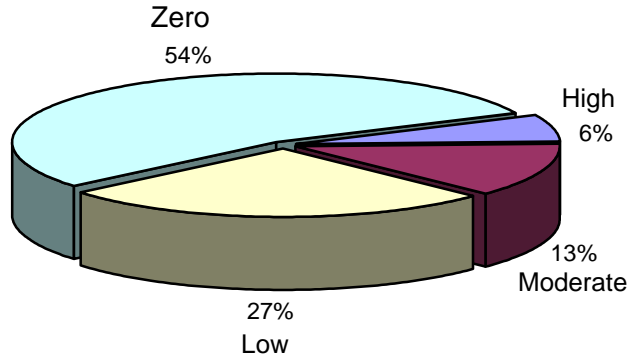
Forty-one percent (41%) of those polled indicated that the debt load of their farm/business was zero. The figures here indicate that there is likely a capacity for debt, if needed to finance expansion projects. N = 108

## 21. Potential Collateral Sources



Given the relatively high percentage of farmers who indicated their debt level was either manageable or zero, it is not surprising that almost 86% of those responding indicated that their home/land could be used to secure additional debt. N = 98

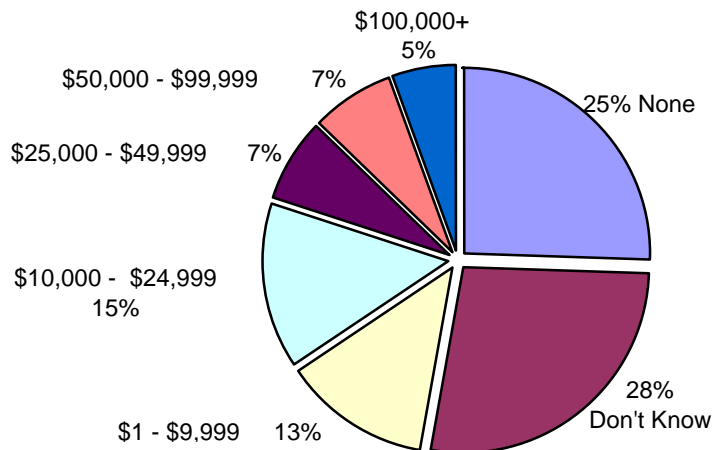
**22. Knowledge of Farm Service Agency (FSA) loan programs**



These findings bear out our concern that The Farm Service Agency, the primary federal program for financing assistance for struggling farmers, has failed to do any concerted marketing to sustainable farmers in the Carolinas. Even with the debt aversion of these farmers, the lack of knowledge is cause for concern.

The responses to Question 22 were broken out by county and state, but did not demonstrate any significant concentration.

**23. Capital Demands in the Next Three Years**



The average response was \$67,000. The median financing need was \$10,000 to \$24,999.

The following three charts provide a break out of the responses for new funding requirements using growth categories.

**Recent Growth and Future Funding  
Expressed as a Percent of Growth Type**

| Funding Requirements for<br>the Next Three Years | Growth Over the Past Three Years |                 |               |                |                              |                         |
|--|----------------------------------|-----------------|---------------|----------------|------------------------------|-------------------------|
|  | Declining<br>(%)                 | Start-up<br>(%) | Stable<br>(%) | Growing<br>(%) | No<br>Answer<br>Given<br>(%) | Funding<br>Total<br>(%) |
| Don't know                                       | 27.3                             | 26.7            | 24.0          | 28.6           | 100.0                        | 27.3                    |
| None   | 27.3                             | 24.4            | 32.0          | 21.4           | --                           | 25.5                    |
| \$1 - \$ 9,999                                   | --                               | 20.0            | 8.0           | 10.7           | --                           | 12.7                    |
| \$10,000 - \$ 24,999                             | 18.2                             | 13.3            | 12.0          | 17.9           | --                           | 14.5                    |
| \$25,000 - \$ 49,999                             | 9.1                              | 2.2             | 16.0          | 7.1            | --                           | 7.3                     |
| \$50,000 - \$ 99,999                             | 18.2                             | 13.3            | --            | --             | --                           | 7.3                     |
| \$100,000 - \$249,999                            | --                               | --              | --            | 7.1            | --                           | 1.8                     |
| \$250,000 - \$499,999                            | --                               | --              | 8.0           | 3.6            | --                           | 2.7                     |
| \$500,000 - \$1MM                                | --                               | --              | --            | 3.6            | --                           | 0.9                     |
| Growth Total                                     | 100.0                            | 100.0           | 100.0         | 100.0          | 100.0                        | 100.0                   |

**Recent Growth and Future Funding  
Expressed as a Percent of Funding Totals**

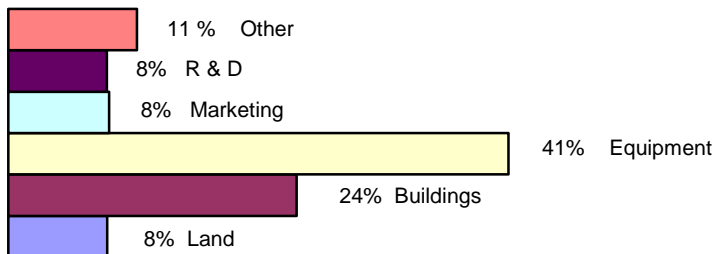
| Funding Requirements for<br>the Next Three Years | Growth Over the Past Three Years |                 |               |                         |                              |                         |
|--|----------------------------------|-----------------|---------------|-------------------------|------------------------------|-------------------------|
|  | Declining<br>(%)                 | Start-up<br>(%) | Stable<br>(%) | Steady<br>growth<br>(%) | No<br>Answer<br>Given<br>(%) | Funding<br>Total<br>(%) |
| Don't know                                       | 10.0                             | 40.0            | 20.0          | 26.7                    | 3.3                          | 100.0                   |
| None   | 10.7                             | 39.3            | 28.6          | 21.4                    | --                           | 100.0                   |
| \$1 - \$ 9,999                                   | --                               | 64.3            | 14.3          | 21.4                    | --                           | 100.0                   |
| \$10,000 - \$ 24,999                             | 12.5                             | 37.5            | 18.8          | 31.3                    | --                           | 100.0                   |
| \$25,000 - \$ 49,999                             | 12.5                             | 12.5            | 50.0          | 25.0                    | --                           | 100.0                   |
| \$50,000 - \$ 99,999                             | 25.0                             | 75.0            | --            | --                      | --                           | 100.0                   |
| \$100,000 - \$249,999                            | --                               | --              | --            | 100.0                   | --                           | 100.0                   |
| \$250,000 - \$499,999                            | --                               | --              | 66.7          | 33.3                    | --                           | 100.0                   |
| \$500,000 - \$1MM                                | --                               | --              | --            | 100.0                   | --                           | 100.0                   |
| Growth Total                                     | 10.0                             | 40.9            | 22.7          | 25.5                    | 0.9                          | 100.0                   |

As indicated in the tables above, and highlighted in gray in Table 23d (below), there is a sizable group of enterprises which have the potential for sustained growth but are in need of a relatively modest amount of funding in order to meet their near term diversification/expansion requirements. (Even if the higher risk start-up operations are eliminated from consideration, this group would still account for over 17% of the total responses received.)

**Recent Growth and Future Funding  
Expressed as a Percent of Total Responses**

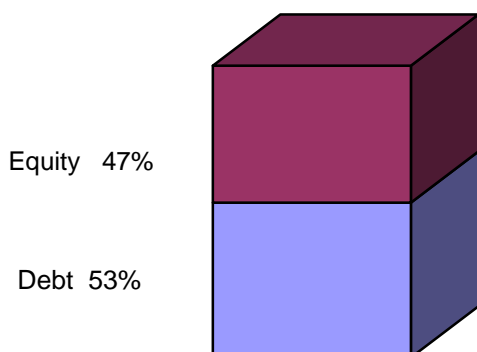
| Funding Requirements for the Next Three Years | Growth Over the Past Three Years |              |            |                   |               | Grand Total (%) |
|---|----------------------------------|--------------|------------|-------------------|---------------|-----------------|
|   | Declining (%)                    | Start-up (%) | Stable (%) | Steady Growth (%) | No Answer (%) |                 |
| Don't Know                                    | 2.7                              | 10.9         | 5.5        | 7.3               | 0.9           | 27.3            |
| None  | 2.7                              | 10.0         | 7.3        | 5.5               | --            | 25.5            |
| \$1 - \$ 9,999                                | --                               | <b>8.2</b>   | <b>1.8</b> | <b>2.7</b>        | --            | 12.7            |
| \$10,000 - \$ 24,999                          | 1.8                              | <b>5.5</b>   | <b>2.7</b> | <b>4.5</b>        | --            | 14.5            |
| \$25,000 - \$ 49,999                          | 0.9                              | <b>0.9</b>   | <b>3.6</b> | <b>1.8</b>        | --            | 7.3             |
| \$50,000 - \$ 99,999                          | 1.8                              | 5.5          | --         | --                | --            | 7.3             |
| \$100,000 - \$ 249,999                        | --                               | --           | --         | 1.8               | --            | 1.8             |
| \$250,000 - \$ 499,999                        | --                               | --           | 1.8        | 0.9               | --            | 2.7             |
| \$500,000 - \$1MM                             | --                               | --           | --         | 0.9               | --            | 0.9             |
| Grand Total                                   | 10.0                             | 40.9         | 22.7       | 25.5              | 0.9           | 100.0           |

**24. Use of Funds (from Outside Sources in Next Three Years)**



Most respondents indicated that additional funding would be used to purchase fixed assets. Anticipated funds are earmarked for equipment (41%), buildings (24%) and land (8%). Soft needs (e.g., marketing, and research and development) rounded out the remainder. N = 77

## 25. Debt versus Equity Financing



The enterprises are planning to use 53% debt and 47% equity to finance their short-term needs. The survey defined debt as "repayable loans, leases, mortgages, bonds" and equity financing as "owner/shareholder investment, government/foundation grants."

## 26. Obstacles to Financing Future Plans

| Concerns                                 | Ranking    |            |            | Marked but<br>not ranked<br>(%) | Total<br>(%) |
|--|------------|------------|------------|---------------------------------|--------------|
|  | # 1<br>(%) | # 2<br>(%) | # 3<br>(%) |                                 |              |
| a. Poor cash flow                        | 11.5       | 6.9        | 2.3        | 11.5                            | 32.2         |
| b. None, I will be able to get financing | 10.3       | --         | 1.1        | 18.4                            | 29.9         |
| c. Uncertain markets                     | 3.4        | 11.5       | 2.3        | 12.6                            | 29.9         |
| d. Lack of collateral                    | 6.9        | 2.3        | 1.1        | 10.3                            | 20.7         |
| e. Poor knowledge of financing sources   | 3.4        | 2.3        | 2.3        | 10.3                            | 18.4         |
| f. Uncertain prices                      | 1.1        | 3.4        | 5.7        | 6.9                             | 17.2         |
| g. Won't pledge certain collateral       | 5.7        | 1.1        | 3.4        | 5.7                             | 16.1         |
| h. Unproven methods                      | 3.4        | 1.1        | 2.3        | 8.0                             | 14.9         |
| i. Bias by lender against organic        | 1.1        | 3.4        | 3.4        | 6.9                             | 14.9         |
| j. Other                                 | 4.6        | --         | --         | 10.3                            | 14.9         |
| k. Credit history                        | 2.3        | 1.1        | 4.6        | 5.7                             | 13.8         |
| l. Bias by lender against my lifestyle   | --         | --         | 2.3        | 2.3                             | 4.6          |
| m. Management capacity                   | 1.1        | --         | 1.1        | --                              | 2.3          |
| n. Declining sales                       | --         | --         | --         | --                              | --           |
| Total Responses =                        |            |            |            |                                 | 87           |

Our respondents' concern about cash flow may indicate a need for seasonal lines of credit or more strategic use of working capital loans. The farmers also are legitimately concerned about volatile market conditions and prices. Collateral concerns may highlight a need for better access to loan guarantees, either from existing SBA or FSA sources or from new specialized guarantee pools directed at sustainable farms. About one in five expressed a poor of knowledge of financing sources, reflecting earlier findings.

## 27. Loan Denials

| <b>Financing experience</b>                     | <b>Actual #</b> |
|---|-----------------|
| Poor credit history led to denial               | 8               |
| Strongly debt averse                            | 6               |
| No loan requests to comment on                  | 5               |
| Use home equity, credit cards, dealers          | 3               |
| Have had problems with collateral               | 2               |
| Have experienced anti-organic bias              | 2               |
| Use self-financing from business profits        | 2               |
| Insufficient equity to leverage a loan          | 1               |
| Their conventional bank rarely did farm lending | 1               |

In the last three years, only 9% of the enterprises reported having been denied loan requests. We also asked for comments on loan denials and any other general comments about financing their businesses. These comments are summarized in the table above. (N = 102)