NORTH CENTRAL REGION
SUSTAINABLE AGRICULTURE RESEARCH AND EDUCATION

# FIELD NOTES

The Newsletter of the NCR-SARE Program

# Ag Loans and the Sustainable Farmer

Remember when a farmer could support a family with seeds saved from the year before and a lot of hard work? When a farmer's livelihood depended on the weather, the soil, and his own labor, when success or failure was a matter of luck, pluck, and nature? Of course not. Farmers have depended on their materials, machinery, and markets for two hundred years. Farmers support their families with cash income because subsistence level farming in America is almost universally dead. Even deliberately insulated farming communities, like those of the Amish, have a profit motive.

Sustainable farmers have several profit motives and only one of those profits refers to money — but that's the one that keeps the farm operational. That's what makes a farm a


of Plainview, Minnesota, a bank president who once conducted a farm business planning workshop in his bank lobby. "Big farms with traditional crops have more federal funding with an income floor and market range stability, even without income floor." Even the way lenders make ag loans has changed. Twenty years ago, banks were likelier to make loans on collateral and a handshake; now they're more interested in the surety of loan repayment, as well they should. But government supports and changes in banking don't explain why farmers feel they have trouble getting loans. The best explanation for the issue is lack of knowledge, on both sides.

Conventional agriculture has been around for a long time and the financial comrancher, and Farm Business Management instructor. "Lenders feel sustainable farmers are less knowledgeable about lending, balance sheets, income/cash flow statements, business management — the business *and* production side. Also, they think sustainable farmers are new to the business and have too little experience."

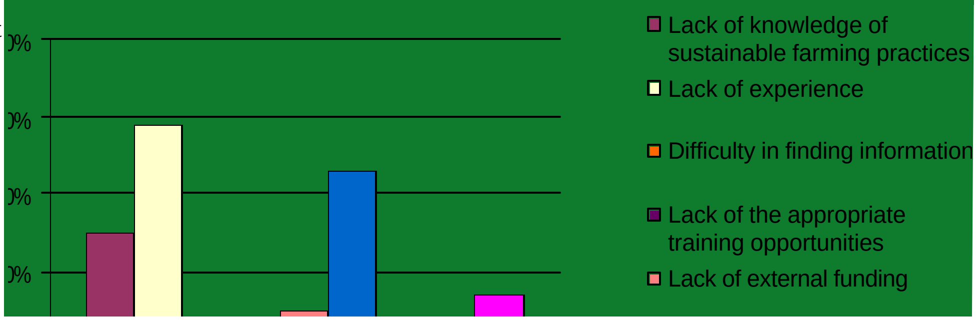
At its most pernicious, ignorance poisons the well for everyone because it fosters unspoken assumptions and unexamined consequences. It also means that sustainable farmers don't apply for or don't get the loans they need. This is dangerous, because lending is critically important to sustainable farmers.

> "Not knowing and not accepting gets in the way. It's more than unhelpful, it's hurtful."
>
> *John Bedtke*

Why? Because sometimes, sustainable farmers need loans whether they want them or not. Depending on the operation, becoming sustainable can be expensive, and the upfront costs are prohibitive. That's what bank loans are for — to spread a financial hit over the course of months or years, instead of weeks. "Sustainable farmers fear that owing money is an obstacle, but it's not," says John Bedtke, an organic grass dairy farmer in Altura, Minnesota. "Money is a tool."

And as much as some farmers need loans, rural banks need the income from loans. In the last 25 years, the number of chartered U.S. banks has dropped by a third; they've closed down or been bought by larger bank chains. Returns on ag investments aren't what they used to be. All rural banks face increasing pressure to make a profit. That should be

*What are the **major challenges** you faced in implementing the sustainable agricultural practices you have tried? Please check all the answers that apply. (Asked of farm-*




is one method among many of sustainable ag production, but it's a well known one, and may be a bellwether for other sustainable markets. Organic food sales have grown between 17% and 21% every year since 1997 in the United States. Sales of pasture poultry alone increased 25% in 2002. Contrast that with profits from all other foodstuffs — sales of food and beverage commodities grew 4% in 2003, and total U.S. food sales have only grown 2%-4% a year since 1997. In the meantime, conventional farmers are leaving the business in droves because they can't make a living on the farm — and when they go, banks lose current and potential customers.

Still, this only amounts to a heap of speculation and general opinions. There has been little research into sustainable farm lending in the North Central region. Yet banking is so integral to farming that the situation demands attention. One organization, the Land Stewardship Project, decided that only a sweeping, multi-level, multi-year study could begin to grasp it.

### Survey in the Field

The Land Stewardship Project (LSP) is a nonprofit group, founded in 1982, that works to encourage a sense of farmland stewardship and actively promotes sustainable agriculture. When LSP decided to turn its attention to lending, they applied to NCR-SARE (the North Central Region Sustainable Agriculture Research and Education program) for a grant to explore the issue in depth. The grant application was the result of a need for precision — and the creation of a wedge.

an incredibly valid source of information — to speak to lenders. We want to open doors between lenders and sustainable ag.” The survey project, *Getting a Handle on the Barriers to Financing Sustainable Agriculture: The Gaps Between Farmers and Lenders in Minnesota and Wisconsin*, received a $69,043 NCR-SARE grant in 2002.

It took two years to design, test, administer, and analyze the survey, which was done in Wisconsin and Minnesota. “I relied heavily on our steering committee, and we very much took to heart what we wanted to learn and how to get there,” said van Schaik. The 567 respondents included lenders (the majority of whom, 62%, were independent bankers), sustainable farmers, and Extension and Farm Business Management/ Production educators. It included paper surveys that were written expressly for each of the three groups, face-to-face surveys, and finally, roundtable discussions (for survey methodology, view the report at http://www.sare.org/reporting/report_viewer.asp). The survey results qualify, perhaps as much or more so than quantify, lending in the sustainable community.

“Lenders survive by being cautious and not getting stung. They’re risk averse and pessimistic about the future of sustainable farming because they don’t know much about it.”

*Dan Miller*

### What They Said

The report (which can be viewed on the SARE database at http://www.sare.org/projects/) starts with the results of the surveyed farmers. Over half (52%) of them say they

Agriculture, Rural Finance Authority, the Agriculture Utilization Research Institute, or a state or federal conservation program. Clearly, a huge number of sustainable farmers don’t need to or would rather not seek a loan — but those who do think of a bank first.

That doesn’t mean lenders think of sustainability first. When asked, “Was the loan officer knowledgeable about your sustainable farming/marketing practices?” 38% of farmers didn’t respond at all, 32% said yes, and 14% said no. Sixteen percent said that they couldn’t tell. However, farmers do say loan officers seem relatively open to ideas about sustainable ag practices. Although 40% of farmers didn’t answer, 39% said their banker was open to sustainable ag. Only 5% said no, but again, 16% said they couldn’t tell.

When asked about the future of sustainable farming, sustainable farmers — no surprise — were quite optimistic. Eighty-nine percent said that, in their experience, sustainable farming is as or more profitable than conventional farming. Sixty-two percent said the future of sustainable ag is bright, and only 11% said it’s “dim.”

But what do lenders think of sustainable farming? Forty-six percent said they have a “good working relationship” with sustainable farmers. Eighty-two percent said they would be open to financing a sustainable enterprise, 18% said they would be “somewhat” open to the idea, and no lender said they will be more biotechnology in their region. And quite a few lenders expect sustainable ag to grow: 45% expect to see more sustainable farming, 43% predict organic farming will grow. Only 19% foresee growth in conventional farming.

However, only 35% of lenders said sustainable farming is as or more profitable than conventional farming. Thirty percent of lenders say it's less profitable. Thirty-five percent admit they don't know.

### The Gap

Sustainable farmers *should* be optimistic about their livelihood. Lenders *should* be cautious about where they loan money. But that doesn't explain the 59 percentage point gap between farmers and lenders in their expectations of long-term profitability in sustainable ag. That gap signifies miscommunication. Farmers don't know what lenders want, and lenders don't know what sustainable farmers are doing.

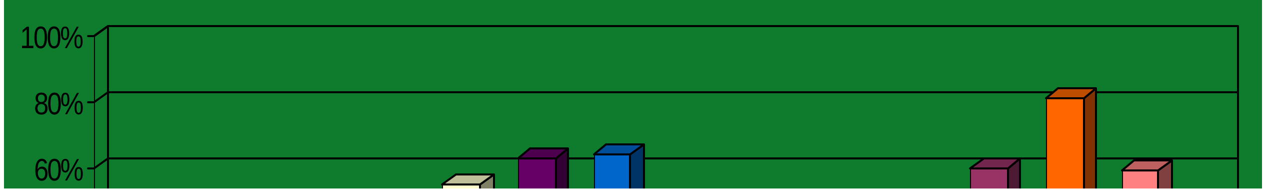
> "It's a chicken and egg thing. Lenders won't loan until sustainable ag proves itself, and farmers can't prove themselves without operating capital."
> *Dean Harrington*

A generation ago, lenders didn't need an education in farming, and farmers didn't need to document everything down to their shoe size to get a loan, or so goes the conventional wisdom. Whether or not that's true or ever was, the fact remains that lenders and farmers are not on the same page. Stuart Shelstad, Minnesota Farm Service Agency Ag Credit Director, says, "As a whole, lenders view sustainable farmers as being a higher risk. There's less information about the input costs, yields, and marketing challenges of sustainable farming on the lenders' side. We all need more education."

Many sustainable farmers claim that they do business planning and reporting, but it may not be the kind bankers are looking for. Fewer than half, 43%, of the surveyed sustainable farmers said their record keeping could be called "whole farm," 21% said they keep whole farm and individual enterprise accounts, 34% said their bookkeeping doesn't extend past what the IRS demands, and only 2% said they do enterprise budgeting.

But when you ask lenders what, when reviewing a sustainable ag loan application, they consider important, 85% said they need price and/or production histories, 76% said a marketing plan, 70% want a business plan, 62% want a current enterprise analysis, 59% say projected balance sheets, and 78% look for projected income statements. (Incidentally, lenders consider all of these criteria more or less equally important for conventional ag loans, and many of them prefer to create these plans with the loan

*What is the minimum number of years for which the following historical and projected financial statements should be provided, according to your institution? (Asked of lenders).*



applicant.) However, lenders say 40% of farmers prepare financial statements, 57% of farmers are familiar with financial terminology, 16% of farmers prepare business plans, and 15% prepare marketing statements. And what are lenders' top three reasons for denying loans? Lack of cash flow, equity, and credit. Though it's quite possible that many sustainable farmers don't have cash flow, equity, and credit, it's also possible that they aren't sufficiently proving that they do.

"We asked lenders about criteria," says van Schaik, "and found they distinguish between sustainable and conventional farmers by noting they want market plans, sales contracts, business plans, and business skills from sustainable farmers. When we asked why, lenders defended the practice by saying it's not a bias, it just reflects their need for more information — lenders are much more exposed to conventional farming. It's a valid response, but not the only response."

## Burden of Proof

Clearly, sustainable farmers and lenders have very different expectations. In the end, however, lenders are the ones with the ready cash, so the burden of proof is on farmers. John Bedtke is among the ranks of farmers who have begun an alternate career in accounting, marketing, and economics, though he's quick to point out he'd much rather farm. But he gets loans. He provides his lenders with what they need so that they can provide Bedtke the money he needs. "Some of us were well-informed when we started, and we're taking off. We take out the right amount of money — not too much, and not too cautiously little, thinking the bank will like that when in fact that loan actually hurts more than it helps — and we're paying off our debts. That's what bankers want," said Bedtke.

Getting bankers what they want isn't just a matter of rustling up some production histories and marketing plans. Harrington recommends farmers learn about benchmarking and come prepared with data, and bring a formal and organized business plan to loan meetings. Shelstad says he looks for enterprise analysis and information on the availability, stability, and reliability of markets of sustainable ag markets. Dan Miller says farmers need to prove that they're "knowledgeable about lending, ROA, balance sheets, income and expense records income/cash flow statements, business management — the business and production side." Fair enough.

However, if lenders want sustainable farmers' business, it would behoove them to learn about sustainable ag. And that, of course, is where the trouble lies and always has. Many lenders don't know enough about sustainable farming to fund it and don't have time to get an education. Thus, once again, the burden of proof is on the sustainable farmer. But help is not hard to find.

## Farm School

One of the reasons sustainable farming can be so profitable is because sustainable farmers can often conduct direct marketing. There are lots and lots of guides and books on the subject, but none that explain how sustainable farmers can direct-market sustainable agriculture itself. It's a shame, because that may be exactly what farmers need to do to lenders.

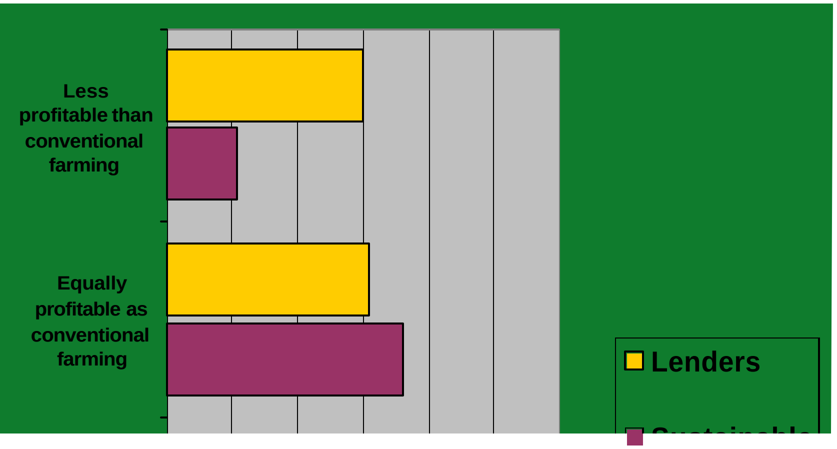
Ag product consumers, like every consumer of any kind, need a message tailored to them, a delivery system at their convenience, and the product they need at the precise moment they want it. Lenders are no different. They want information about sustainable farming, but they are unlikely to table their jobs to go get it. Only 25% of lenders have attended a class or seminar on sustainable farming, according to the survey. Lenders need information brought to them, in a format they can digest.

> We ask sustainable farmers for their patience. Our learning curve is steep.
> *Stuart Shelstad*

Lenders say sustainable ag educators and organizations are helping to fill in the gaps. But what lenders need more than classes, more than extension instruction, more than publications from groups like NCR-SARE, are records from farmers — lenders, it should be no surprise, get more mileage out of a balance sheet than a brochure. "We require records because they give us our realistic expectations," said Shelstad, "We learn from them. They have a lot of predictive power." Well written, well considered, meaningful bookkeeping indicates a good risk, and that's what lenders are really interested in. So the litany of sustainable farmers' requirements — benchmarking data, business planning and management, enterprise and market analysis, ROA expectations, balance sheets, income and expense records, income/cash flow statements, etc. — do more than help farmers get loans. They subtly teach lenders what they need to know about sustainable ag. Furthermore, there's a cumulative effect: the more lenders grow to trust the business planning of sustainable farmers, the easier it will be for sustainable farmers to get loans. "All it takes for lenders to grow more open to sustainable agriculture are a few very successful operations with great records that lenders can observe. Their minds will change," Miller says. "Some of the big movements — direct marketing, grass-based, organic — are already engaging lenders."

So farmers need to take the game to lenders. Of course, farmers don't become farmers because they enjoy accounting so much. And the aims of lenders and farmers are fundamentally different — farmers are raising crops and sustaining a lifestyle, while lenders are

*According to your own experience and that of those you know, do you think sustainable farming is:*



looking for a return on investment. However, there are a variety of ways for sustainable farmers to learn the language of lenders and lenders to learn about sustainable agriculture.

The Land Stewardship Project, as a result of the survey, is offering several educational opportunities for farmers, including business planning workshops, farm business management program scholarships, credit liaison training, field days, and several publications. SARE has several books and bulletins, most of which are free. Farm Business Management obviously offers advice on farm business management. It's not free, but it is worth it, says Miller. "The farmers who attend business planning education are motivated to learn, and they're generally very successful. They've had good ROA and good average net worth change." Extension educators are an excellent resource and what little they can't provide, the USDA probably can. In fact, a little research can uncover an ocean of information (see page 7-8 for contact information). Every one of these sources can provide lenders with an excellent education in sustainable agriculture, as well.

> Some lenders are beginning to see farming as more than a way of making a buck, as long as the bank gets their bucks back.
> *Caroline Van Schaik*

### All Together Now

The value of projects like *Getting a Handle on the Barriers to Financing Sustainable Agriculture: The Gaps Between Farmers and Lenders in Minnesota and Wisconsin* is that it quantifies what had been conjecture. According to the Land Stewardship Project's final report to NCR-SARE, "The surveys allowed us to pull aside the protective curtain of distance from some serious issues related to credit and sustainable farming. While it is not all ugly, the picture that emerged suggests that the words "myth and bias" are not too strong for characterizing the barriers that stand in the way."

Everybody has always known that lenders tend to view sustainable farmers as being a higher risk. We've always known that lenders need financial information from farmers, and that farmers need lenders to understand their operations. We've always known there was a gap, but not how deep or how wide. We're starting to know now. What we also need to understand is the effect of a stable and mutually profitable relationship between lenders and sustainable farmers.

As was mentioned, conventional farmers are bailing out of agriculture because the work is too hard, the income is too low, and the risks are too high. This has had a devastating effect on rural economies — according to the U.S. Census Bureau report, *Poverty in the United States: 2002*, the poverty rate is 11.6% in metropolitan areas, and 14.2% in rural areas. Seven of the 12 poorest counties in America are in one NCR state, Nebraska. All of them are farm communities and one, McPherson, used to be near the top of the wealthiest county list, back when cattle prices were better. Increasing rates of poverty isn't good for farmers, or lenders, or anyone else in the North Central region. Family farms, banks, and the businesses that serve both are vital to every farming community, and they all suffer when agriculture does.

One of the aims of sustainable farming is to create sustainable communities. Banks are an important part of any community. Keeping rural banks solvent would go a long way to keeping the community functioning. Helping sustainable farmers create going businesses would do even more. "Myth and bias," or lack of communication and information, are more than detrimental. Myth and bias push all family farms -- sustainable or not -- a little closer to the fate of subsistence farms.

### Farm Financial Management and Planning Information for Sustainable Farmers

**Sustainable Agriculture Network Books and Bulletins:**

- *Farm Business Management Program scholarships*
- *Credit liaison training*: for educators
- *Field days*: for the farming, lending, and educator communities

515.294.3711, http://www.leopold.iastate.edu/

### Education for Sustainable Farmers *and* Lenders

North Central Region Sustainable Agriculture Research and Education
402.472.7081, http://www.sare.org/ncrsare/

[3]**State Sustainable Ag Coordinators in the North Central Region:**

*Illinois* - Deborah Cavanaugh-Grant
217-968-5512, cvnghgrn@uiuc.edu

*Indiana* - Rick Foster
765.494.9572, rfoster@purdue.edu

*Iowa* - Jerry DeWitt
515.294.7836, jdewitt@iastate.edu

*Kansas* - Jana Beckman
785.532.1440, jabeckma@oznet.ksu.edu

*Michigan* - Susan Smalley
517-432-0049, smalley3@msu.edu

*Minnesota* - Beth Nelson
612.625.8217, Schre002@umn.edu

*Missouri* -
K.B. Paul
573.681.5531, paulK@lincoln.edu
James (Sandy) Rikoon
573.882.0861, RikoonJ@missouri.edu
Jose Garcia
573.884.3794, garciajl@missouri.edu

*Nebraska* - Jim Peterson
402.426.9455, jpetersm@unlnotes.unl.edu

*North and South Dakota* - Bradley Ruden
605.688.4596, ruden.brad@ces.sdstate.edu

*Ohio* -
Mike Hogan
330.627.4310, Hogan.1@osu.edu
Alan Sundermeier
419.354.9050, sundermeier.5@osu.edu

*Wisconsin* - Fred Madison
608.263.4004, fredmad@wisc.edu

*Center for Rural Affairs*
402.687.2100, http://www.cfra.org/

*Alternative Farming Systems Information Center (AFSIC)*
http://www.nal.usda.gov/afsic/, 301.504.6559

*Appropriate Technology Transfer for Rural Areas (ATTRA)*
www.attra.org, 800.346.9140

*Land Stewardship Project*
www.landstewardshipproject.org, 612.722.6377

*Leopold Center for Sustainable Agriculture*
www.leopold.iastate.edu, 515.294.3711

*Minnesota Institute for Sustainable Agriculture*
www.misa.umn.edu, 612.625.8235

*Midwest Sustainable Agriculture Working Group*
http://www.msawg.org/, 202.547.5754

*National Campaign for Sustainable Agriculture*
www.sustainableagriculture.net, 845.361.5201

*The New Farm*
www.newfarm.org, 610.683.1414

*USDA Cooperative State Research, Education, and Extension Service*
http://www.csrees.usda.gov/index.html, 202.720.7441

North Central Region Sustainable Research and Education
1734 N. 34th Street, 13A Activities Building
PO Box 830840
Lincoln, NE 68583-0840

non-profit permit goes here