

BL-066

Providing Credit to Farmers and Ranchers Operating in Local/Regional Food Systems

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To: The Chairman of the Board
The Chief Executive Officer
All Farm Credit System Institutions

From: Leland A. Strom
Chairman and Chief Executive Officer

Subject: Providing Credit to Farmers and Ranchers Operating in Local/Regional Food Systems

Summary

This Bookletter provides guidance on how Farm Credit System (FCS or System) associations can effectively meet the credit and related services needs of farmers who market their agricultural products through the local/regional food systems (local food farmers). The bookletter explains how System associations have authority to finance local food farmers and certain farm-related businesses under existing statutes and regulations and prior guidance issued by the Farm Credit Administration (FCA or Agency). It provides further guidance on how the regulations recently adopted by the FCA Board on System strategic business planning and senior officer compensation apply to financing local food farmers.

This bookletter provides specific guidance to the System on:

- Determining eligibility and scope of financing for local food farmers;
- Determining when a local food hub, aggregator, or support business qualifies for financing as a farm-related service business, processing or marketing operation, or similar entity;
- The application of creditworthiness and underwriting standards to local food farmers;
- The role of FCS banks in supporting association lending;
- Educational support for local food farmers; and
- Developing a strategic business plan for emerging agricultural markets.

Introduction

This bookletter applies to FCS associations operating under Titles I and II of the Farm Credit Act of 1971, as amended (Act). It provides guidance on statutory provisions and regulations and supplements previous guidance relevant to furnishing credit to farmers, ranchers and aquatic producers and harvesters (hereafter “farmers”) and farm-related service businesses that operate within the local/regional food systems.

The FCS has a statutory mandate to serve **all** types of agriculture and agricultural producers. Section 1.1(a) of the Act states that one of the objectives of the statute is “improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them . . . and selected farm-related businesses necessary for efficient farm operations.” Section 1.1(b) of the Act requires the System to “be responsive to the credit needs of *all* types of agricultural producers having a basis for credit.” (emphasis added) Other provisions of the Act address eligibility and scope of financing, as well as providing of sound and constructive credit to YBS farmers.¹

Agriculture continues to evolve as the farming population becomes increasingly diverse. The next generation of farmers will come through existing family farms, while others will enter agriculture as first generation farmers. Many first generation farmers are operating farms that market products within the local food systems. Many of these local food farmers are eligible to borrow from the FCS and are also creditworthy. Consistent with FCA regulation 618.8440(b)(8),² many System institutions will identify this market segment and develop lending programs to address credit and related financial services needs of local food farmers. The focus of this booklet is to provide guidance on how FCS associations can effectively serve the emerging market segment of local food farmers using existing eligibility and creditworthiness guidelines.

A. Concepts

For the purpose of this guidance the following concepts apply:

- Local/Regional Food Systems are generally characterized by producers who practice sustainable production methods and whose short supply chain provides a connection between the producers and consumers. As discussed below, local food farmers meet the definition of bona fide farmers. There is no common definition of a Local/Regional Food System. However, the Food Energy and Conservation Act of 2008³ defines a “locally or regionally produced agricultural food product” as one “that is raised, produced, or distributed within less than 400 miles from its origin, or within the State in which it is produced.” According to a U.S. Department of Agriculture (USDA) study,⁴ marketing channels, such as, direct-to-consumer (where farmers sell their products directly to consumers) and intermediated food sales (through regional distributors, grocery stores, restaurants, or other retailers) are considered local foods.
- A food hub is typically a “business or organization that actively manages the aggregation, distribution, and marketing of source-identified food products primarily from local and regional producers”.⁵ A food hub “strengthens the ability of farmers to satisfy wholesale, retail, and institutional demand”⁶ in their local area or region. Food hubs include nonprofit (that develop out of community-based initiatives), privately held (limited liability companies or corporate structures), cooperative (producer or consumer owned), and local government owned entities.⁷
- An aggregator is a form of a food hub where food from more than one farmer is aggregated together and then marketed. Aggregators may or may not be owned by farmers. Farmers normally aggregate their agricultural products with those of other farmers. Non-farmers can either purchase the agricultural products from farmers or provide aggregator services on a commission basis when the farmers retain ownership of their agricultural products.
- A community supported agriculture (CSA) operation occurs when consumers provide upfront funds (buy a share) for a portion of the expected harvest from the farm, typically in the form of weekly harvest deliveries.

Due to their age, farming experience or size of farming operation, many local food farmers will qualify as YBS farmers under section 4.19 of the Act. As discussed in this booklet, the implementing regulation at § 614.4165 and subsequent Agency guidance applies to these farmers.

B. Eligibility and Scope of Financing

The determination of whether to approve a loan to a local food farmer begins with a determination regarding the applicant’s eligibility to borrow. Similarly, lending to farm-related service businesses also starts with a determination of eligibility. This determination must be made before creditworthiness is analyzed, which is discussed later in this booklet.

1. Bona Fide Farmer

Sections 1.9(1) and 2.4(a)(1) of the Act state that "bona fide farmers, ranchers, and producers or harvesters of aquatic products" are eligible to borrow from Farm Credit banks and associations that operate under Titles I or II of the Act, respectively. The term "bona fide farmer or rancher" is defined in FCA regulation 613.3000(a)(1) as "a person owning agricultural land or engaged in the production of agricultural products"⁸ To qualify as a bona fide farmer or rancher, it does not matter what type of agricultural product is produced, or the manner in which bona fide farmers market such products. For example, farmers or ranchers producing timber, vegetables, fruits, cattle, corn or soybeans all qualify as "bona fide" farmers. Similarly, farmers and ranchers are "bona fide" whether they market their agricultural products to grain elevators, marketers or processors, or directly to the consumer or through intermediated marketing channels, as is often the case for farmers who operate farms of smaller size and scale.

Examples of bona fide farmers operating in a local/regional food system include:

- The farmer who raises and processes cattle on rented land that is sold at local/regional farmers' markets as well as directly to restaurants while the farmer and spouse also work off the farm.
- The farmer who grows mixed vegetables on a rented 10 acre parcel and then markets the products through a combination of a CSA, local farmers' markets, as well as to local restaurants directly or through an aggregator.
- The farmer who grows vegetables on a one acre rented plot in a suburban or urban area and routinely sells the produce at local farmers' markets individually or through a cooperative of growers.

Bona Fide Farmer and Location of Agricultural Production

FCA regulations do not specify where agricultural production must occur for the person to qualify as a bona fide farmer. Therefore, if a person is engaged in producing an agricultural product for market in any location (rural, suburban, or urban) that person most likely meets the definition of a bona fide farmer and would be eligible for FCS financing.

Bona Fide Farmer and the Amount of Agricultural Income

FCA's regulatory definition of a bona fide farmer is not contingent on the amount of a farmer's agricultural income or the relationship between agricultural and non-agricultural income. Such limitations and expectations are not part of the general bona fide farmer eligibility determination. However, FCA does expect that a bona fide farmer-producer should routinely produce and market an agricultural product in a manner that demonstrates that agricultural production is the applicant's full-time or part-time vocation.

Scope of Financing

After an association determines that a farmer is an eligible borrower, it must then determine the extent of financing it can provide. FCS associations may extend credit for agricultural purposes to all eligible farmers, to the extent of their creditworthiness. The degree to which a farmer engages, or intends to engage, in an agricultural operation determines the amount of credit that a System association can extend for the borrower's other credit needs.⁹ Most local food farmers seek credit primarily for their agricultural operations. However, the FCA recognizes that there are circumstances where farmers may also have off-farm businesses that provide income necessary to repay agricultural debt and provide for family needs. In a 2007 booklet entitled "Providing Sound and Constructive Credit to YBS Farmers,"¹⁰ the FCA provided guidance to FCS associations on treating a subset of part-time YBS farmers as full-time YBS farmers based on their (1) high degree of commitment to begin, grow, or remain in agricultural production, and (2) demonstrated intent to progress toward agricultural production as their primary business and vocation. System lenders may provide for all of the credit needs of farmers who meet these

criteria so long as such financing assists them to progress toward farming as their primary business and vocation. Many local food farmers are YBS farmers and, therefore, may benefit from FCS associations' usage of the guidance provided in the 2007 booklet. We encourage each System association to review the 2007 booklet and, as appropriate, develop policies and procedures to implement programs to address the credit needs of YBS farmers, including those who are eligible and creditworthy local food farmers in the association's lending service area.

2. Processing or Marketing

Sections 1.11(a)(1) and 2.4(a)(1) of the Act authorize Farm Credit banks and associations to finance processing and marketing operations "directly related" to the operations of bona fide farmers, provided the farmers supply some portion of the throughput. Under § 613.3010, an eligible processing and marketing operation is "directly related" to the agricultural operation of the applicant if it is owned or controlled by bona fide farmers or is a direct extension or outgrowth of an eligible borrower's production operation.

Local food farmers often market their agricultural products in conjunction with other farmers or through food hubs or aggregators. Typically, farmers use these entities to help them deliver their products directly to the consumer,¹¹ or when their agricultural product lacks the needed volume and consistent availability for meeting the demands of the retail and food service customers.¹²

Food hubs and aggregators may qualify as processing or marketing operations if bona fide farmers at least partially own or control them and supply some portion of the throughput, in accordance with § 613.3010. Also, paragraph (a)(5) of this regulation authorizes financing for a legal entity that regularly processes or markets some portion of an eligible farmer's throughput and whose operations are a direct extension or outgrowth of the eligible farmer's operation.

Examples of processing or marketing operations in a local/regional food system context include:

- A local farmer aggregates his vegetables as well as the vegetables from surrounding farmers and markets the aggregated agricultural products through a CSA.
- Food hubs that are owned or controlled by farmers who supply some of the throughput or that are an outgrowth of an eligible farmer's operation.

3. Farm-Related Service Businesses

Sections 1.9(2), 1.11(c)(1), and 2.4(a)(3) of the Act authorize System banks and associations to provide credit to persons furnishing farm-related services to farmers that are directly related to their agricultural production. Such credit may include financing for necessary capital structures, equipment and initial working capital, including capital to lease with an option to purchase equipment or facilities needed for the provision of such services. An eligible farm-related business may provide a service to a bona fide farmer who retains ownership of the agricultural product during the time the service is being provided.

Under § 613.3020, a System association is able to finance all of the borrower's farm-related business activities if the farm-related business owner derives more than 50 percent of its income from furnishing farm-related services to agricultural producers. System financing is limited to only the farm-related service activities if the farm-related business owner derives 50 percent or less of its income from furnishing farm-related services directly to agricultural producers.

Examples of services provided by a farm-related service business in a local/regional food system context include:

- A company that through its web site provides the platform for bona fide farmers to advertise their agricultural products and for consumers (in this case mainly local restaurants) to purchase these products.
- A cold storage facility that provides storage services to bona fide farmers.
- A food hub where local and regional farmers come together to sell their agricultural products either directly to consumers or local intermediaries, such as local restaurants, schools, or small independent retailers.
- A livestock market that provides the facility where bona fide farmers sell their cattle.
- A peanut processor with no farmer ownership or control who weighs and sorts or shells and packages bona fide farmers' peanuts for further sale by the bona fide farmers.
- A beekeeper that provides bees for pollination of orchards and other fruits and vegetables.
- A mobile wine-bottling business that bottles the wine at the vineyard.
- Other examples of farm-related services include, but are not limited to the following:
 - Sheep shearing
 - Agricultural product hauling and delivery
 - Agricultural product storage or processing
 - Fertilizer and chemical application
 - Agricultural equipment repairs
 - Contract slaughterhouse facilities
 - Portable irrigation services
 - Agricultural product grading and cleaning
 - Large animal veterinarian services

4. Similar-Entity Financing

When a processor, marketer, or farm-related service business is not eligible for a System loan as discussed above, but its operations are functionally similar to those of an eligible borrower, it may qualify to receive financing as a similar entity. FCS banks and associations may participate with non-System lenders in credits to similar entities under the requirements of § 613.3300.

C. Creditworthiness/Underwriting Standards

Once the farmer or farm-related business is deemed eligible and scope of lending determined, the association must then analyze the farmer's creditworthiness. Creditworthiness, or having a basis for credit, is the analysis conducted by the association to assess whether it can make a loan to a farmer within its risk tolerance in a safe and sound manner. When analyzing creditworthiness, FCS associations use either their loan underwriting standards adopted under FCA regulation 614.4150 or their customized loan underwriting standards that have been established as a part of the association's YBS program under § 614.4165(c)(4). Some local food farmers who are also categorized as YBS farmers will meet an association's underwriting standards, but others, particularly new entrants into agriculture, may have difficulty meeting these underwriting standards due to their limited equity and collateral positions. However, they may be creditworthy as they typically generate sufficient cash flow from both their agricultural operation and, in many cases, their off-farm income to repay the debt. The FCS association's customized loan underwriting standards established under its YBS program will most likely be the best method to use to evaluate creditworthiness. These customized loan underwriting standards should account for the farmer's strengths as demonstrated by the farmer's business plan that details the production, managerial, financial, and marketing strengths that support the farmer's ability to generate sufficient repayment capacity. The underwriting program should also recognize the start-up nature of these operations where the applicant's capital position is limited and collateral will, in many instances, be the crop or equipment being financed.

As discussed above, some local food farmers sell their agricultural products at farmers' markets. The

income of farmers who sell at farmers' markets is often enhanced by Federal assistance programs¹³ that enable low-income consumers to purchase fresh fruits and vegetables directly from the producer. These programs allow consumers to use their electronic benefit transfer cards or vouchers at designated farmers' markets throughout the country. For farmers who sell at these farmers' markets, the programs effectively increase the pool of potential customers and as a result should increase the farmers' profitability and ultimately improve their creditworthiness.

D. Loan Quality

Loans to local food farmers should be consistent with the institution's loan underwriting standards. However, in many cases these loans will be to borrowers who may qualify under the association's YBS or other special programs. The determination of creditworthiness will typically be supported by the borrower's demonstrated production, managerial, financial, and marketing skills, and that the borrower has sufficient cash flow to service debt. Nevertheless, these borrowers may have limited capital and/or collateral positions and exhibit other potential weaknesses in creditworthiness. The FCA expects that the risk in these loans will lessen over time and will always be consistent with the institution's risk-bearing capacity.

When associations make these loans within their YBS programs, the FCA will not automatically criticize them because of credit quality. However, the FCA will review the loans and the YBS program to ensure that the YBS program policies and procedures and risk factors in individual loans do not adversely affect the institution's safety and soundness. A strong YBS program includes: (1) policies and procedures to market and lend to local food farmers; (2) designated capital committed specifically to support the loans made under the YBS loan program; (3) the use of customized loan underwriting standards, loan guarantee programs, fee waiver programs, and other credit enhancement programs; and (4) appropriate internal controls to assess the effectiveness of, and compliance with, the policies and procedures for the program. The loans to new local food farmers will typically be smaller credits that are in line with the credit needs of start-up or small farm operations. As such, this segment of an association's portfolio of loans should not have a material impact on the overall credit characteristics or risk bearing capacity of the association.

E. Role of Funding Banks

Section 4.19(a) of the Act requires each funding bank to adopt policies for YBS lending for its affiliated associations. The FCA expects that bank policies and the funding of its affiliated associations should be consistent with the guidance in this booklet.

F. Educational Support

As part of their YBS program, many associations provide training services to YBS farmers. Training programs provided directly by FCS associations and other sources (e.g., extension services, community colleges, etc.) augment the credit provided to these farmers and provide an essential service to the agricultural community. Training in management, business planning, and finance are the principal types of educational support that the FCS and other parties offer to YBS farmers. In addition, some associations provide mentoring in concert with the training and use either their own credit staff or an external party for this purpose. We view training and mentoring as critical steps in helping YBS farmers achieve success. System associations should continue managing their YBS farmer lending relationships with these types of support. As you reach out to local food farmers and other new generation farmers, associations should also consider extending these training and mentoring programs to these segments of agriculture.

G. Developing a Strategic Business Plan for Emerging Agricultural Markets

A successful program to lend to eligible and creditworthy local food farmers begins with a commitment by the association's board of directors to lend to these farmers. This commitment is communicated

through the association's business plan and YBS program (as required by FCA regulations [618.8440](#) (b)(8) and [614.4165](#)(c)(2)), which should include specific lending goals and a discussion of these lending programs. As part of its outreach efforts, the association should ensure that its staff is properly trained to recognize and effectively serve the current and future needs of these farmers. At the same time, the association's board and management should ensure that staff compensation and incentive programs support both the association's commitment to its YBS program and its outreach efforts to new and emerging agricultural markets (as required by pending FCA regulation [620.31](#)(b)).¹⁴

If you have questions on this guidance, please contact Mark Johansen, Special Advisor to the FCA Board on YBS and Local Food Systems and Senior Policy Analyst, Office of Regulatory Policy at (703) 883-4064 or JohansenM@fca.gov.

¹Farm Credit Act of 1971, as amended, § [4.19](#), 12 U.S.C. § 2207.

²[77 FR 25577, May 1, 2012.](#)

³P.L. 110-246, 122 Stat. 1651, 1929 (June 18, 2008)

⁴[Direct and Intermediated Marketing of Local Foods in the United States](#), USDA's Economic Resources Report Number 128 by Sarah A. Low and Stephen Vogel, November 2011.

⁵[Regional Food Hub Resource Guide](#), USDA's Agricultural Marketing Services, page 4, April 2012.

⁶Ibid.

⁷Ibid., page 7.

⁸The person must be "a legal entity or an individual who is a citizen of the United States or a foreign national who has been lawfully admitted into the United States either for permanent residency pursuant to 8 U.S.C. 1101(a)(20) or on a visa pursuant to a provision in 8 U.S.C. 1101(a)(15) that authorizes such individual to own property or operate or manage a business or a legal entity." 12 CFR § [613.3000](#)(a)(3).

⁹[Lending Programs for Farmers' Other Credit Needs](#), FCA Examination Bulletin, October 2006.

¹⁰[Providing Sound and Constructive Credit to Young, Beginning, and Small Farmers, Ranchers, and Producers or Harvesters of Aquatic Products](#), FCA Revised Bookletter 040, August 10, 2007.

¹¹Direct-to-consumer outlets typically include farmers' markets, roadside stands, farm stores, and CSA.

¹²Retail and food service customers typically include groceries, restaurants, local businesses, and regional distributors.

¹³These federal programs include the Supplemental Nutrition Assistance Program (SNAP—formerly the Food Stamp Program), Women, Infants and Children's Program (WIC), Farmers' Market Program, WIC

Cash Value Voucher, and Senior Farmers' Market Nutrition Program.

¹⁴Compensation Committees, [77 FR 60582, October 3, 2012](#) (effective date pending).