Black Farmer Financing Association Feasibility Assessment

Executive Summary

The objective of the proposed Black Farmer Financing Association (the Association) is to support underserved agricultural producers in 12 southern states (primarily, African American farmers) with accessible short term financing for their operations. This study assesses the feasibility of creating and sustaining an institution under three scenarios – Worst Case, Most Likely Case, and Best Case. In the Most Likely Case, the Association would break even 4 years after being created, with a loan volume of $96 million.

An important caveat to this estimation is that the funding required to start this operation in year one is approximately seven times higher than the "seed money" currently available for it ($8 million). The rest of the funds required to make this a financially viable operation by year 4, would need to be secured through access to the American Rescue Plan Act relief funds approved by Congress, specifically to support the same customer segments targeted by this institution, or through partnerships/sponsorships from Farm Credit System institutions, and/or philanthropy outreach efforts focused on organizations/individuals aligned with the objective of serving these farmers.

Description of Products and Target Customers

The Association will have a fairly narrow product portfolio, consisting mostly of short and intermediate term loans to finance operations of agricultural producers. In order to maximize accessibility for the targeted customers, the institution will secure loan guarantees from the Farm Service Agency (FSA) and establish partnerships with insurance companies that would offer attractive terms to them.

This institution will focus on underserved African-American farmers in 12 southern states (Texas, Mississippi, Alabama, Louisiana, Georgia, South Carolina, Florida, North Carolina, Oklahoma, Virginia, Arkansas, and Tennessee). These farmers tend to be highly leveraged and/or not own the land they work. Because of that, they often have issues meeting the loan requirements of financial institutions for creditworthiness and/or collateral.

Marketplace / Competitive Landscape

The Association will compete with various financial institutions that offer essentially the same services, among many others. These include the FSA, commercial banks, and Farm Credit associations. In addition, two private sector regional lending alternatives are currently serving the same market space the Association plans to enter. Ag Resource Management, formed in 2009 and headquartered in Fort Worth, TX, and FarmOp Capital, founded in 2018 and headquartered in Minneapolis, MN. Both entities target underserved farmers with operating loans. Furthermore, both count with automatic or "streamlined" approval of loan guarantees by the FSA, and offer lenders crop insurance, income protection insurance, hazard insurance, and related services directly or via partnerships. The targeted customers for both Ag Resource Management and FarmOp Capital have loan requests significantly higher than the projected average loan for the Association borrowers. As such, direct competition with the entities is not expected.

The Association's main differentiating factors with its competition would be its cooperative ownership structure as well as its affiliation with, and support from institutions that have established, strong relationships with African American farmers. These institutions can serve as a "reference" for the Association and help bridge the initial trust gap, given that the Association would be starting from zero and have no name recognition/established reputation. Moreover, these institutions could connect the Association with the customers it targets in a very effective manner, given the information they hold on their members and the communities they serve. Lastly, these institutions would be able to share with the Association deep customer insights that would allow the Association to tailor its products and marketing for this specific customer segment.

Marketing Strategy

In order to achieve viability, the Association will need to establish itself early on as a lender that is trustworthy, “easy to deal with”, and has a unique knowledge of, connection with, and ownership by African American farmers. Leveraging the support of African American farmer groups, and that of well recognized African American leaders in the targeted states, will be key to make this happen.

The Association will utilize any insights and data from the affiliated African American organizations to craft highly relevant and targeted marketing outreach efforts. This approach will maximize the effectiveness of the limited Marketing budget. Local venues and events should be prioritized when possible (e.g. county fairs, sector-specific expositions and, possible, churches). The objective will establish “personal relationships” as soon as possible, and promoting word-of-mouth marketing.

Organizational Structure and Operations

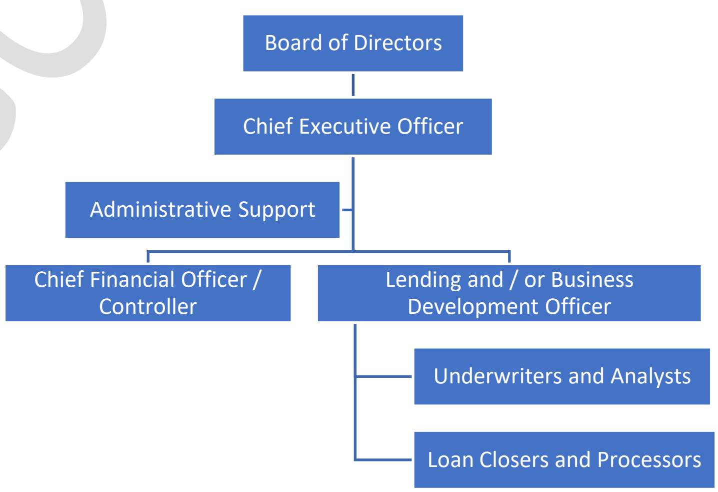
Funding Model

Initially, the Association will be partially funded with unclaimed settlement money from the Black Farmer Discrimination Litigation Settlement, estimated at $8 million. However, the analysis shows that the funding needed to start this institution is approximately $55 million (Most Likely Case scenario). Other scenarios, which require less capital to start the Association, were explored, however viability (breakeven) was not viable within five years after startup. Therefore, securing additional funding for approximately $47 million is critical for the viability of this institution.

Potential funding sources to explore are financial institutions interested in supporting the Association’s goals, for example, commercial banks, a Farm Credit bank or local Farm Credit association(s). Given the Association’s objectives, philanthropy should be explored as well, both in the form of donations from individuals, NGOs, etc., and as access to grants from entities, foundations, or to funding allocated by state and federal government programs to uses that closely align with the mission of the Association (e.g. American Rescue Plan Act relief funds specially-designated to help African American farmers).

Organizational structure

The minimal structure needed to start the Association is discussed below.



- **Board:** The Association Board will initially consist of three individuals, one of which will have the credentials to be deemed a financial expert appointed by the Federation and/or Black Farmer Council for a term not to exceed three years. Future Board members will be selected in a manner prescribed by the Association's bylaws. As a non-regulated financial institution, the CEO may be considered as one of the board members. To the extent possible, unpaid or paid advisors with banking skills will be utilized to provide expertise to the Board.
- **Chief Executive Officer:** Until the Association breaks even, the CEO may serve a dual role either as the Chief Credit/Lending Officer or Chief Operations Officer, with Board approval. The dual roles would be eliminated when the Association becomes profitable.
- **Chief Financial Officer or Controller:** Initially, the CFO role could be filled by a Controller who has earned the designation of Certified Public Accountant (CPA).
- **Lending and/or Business Development Officers**: The number of Lending Officers will be determined by the geographic footprint and the projected number of minority farmers within that footprint.
- **Underwriters and Analysts:** The number of underwriters and analysts will be proportional to the number of loans forecasted in the Business Plan, and managed by the Chief Credit/Lending Officer. Should the Association have an automated underwriting tool, the number of underwriters and analysts needed will be reduced.
- **Loan Closers and Processors:** Initially, it is assumed the senior staff will have sufficient experience and skills to handle the underwriting, analysis, closing, and processing of loans, with the support of approved outside legal counsel. As the number of applications increases, staff will be added as deemed appropriate by senior management. Industry metrics will be applied in determining the number of loans an experienced employee can underwrite/analyze/process prior to hiring additional employees. Seasonal employment for roughly 4.5 months during the busiest season is assumed in the first few years of operations.
- **Administrative Support:** Administrative support should initially be limited to one employee with experience as an executive assistant and/or paralegal until the Association has grown to a size that warrants additional support staff. In the start-up year, it is anticipated that officers will be self-sufficient, to the extent possible.
- **Outsourced functions:** In order to reduce costs, Accounting, Credit Underwriting, HR/Payroll, and Information Technology will be outsourced during the first five years of operations.

Governance

The Association will be governed by a Board of Directors (Board). Ownership will consist of members/stockholders and, possibly, investors who have a vested interest in the Association via a prescribed stock requirement. The Association's corporate structure will be that of a cooperative. The name and geographic footprint of the Association will be defined by its charter. While the charter will not be issued by a governmental entity, it will be developed by the Board of Directors with assistance from outside counsel. Likewise, bylaws will be established by the Board with guidance from outside counsel. The Board will hire management and establish management's roles and responsibility through policies and delegated authorities. The Association will be a non-regulated lender, however if it receives funding from the Funding Corporation, it will be under the same state and federal regulations as other lenders in the Farm Credit System.

Financial Analysis

The financial viability of the Association was analyzed under three scenarios: Worst Case, Most Likely Case, and Best Case. The assumptions and variables in the model were changed accordingly in each scenario. Below is a summary of the key “levers” that impact the Revenue and Cost sides of the model.

		Y1	Y2	Y3	Y4	Y5	Y1	Y2	Y3	Y4	Y5	Y1	Y2	Y3	Y4	Y5
Revenue Side	Average Loan Size			$50,000					$80,000					$120,000		
	% of Borrowers Approved for Loan	5%	6%	7%	8%	9%	4%	5%	6%	7%	8%	3%	4%	5%	6%	7%
	Average Spread			2.50%					2.50%					2.50%		
Cost Side	Average Salary: Management	$ 160,000		2% increase p.a.			$ 160,000		2% increase p.a.			$ 160,000		2% increase p.a.		
	# of Management Employees	3	3	3	4	5	3	4	5	5	5	5	6	6	6	6
	Average Salary: Operations	$ 70,000		2% increase p.a.			$ 70,000		2% increase p.a.			$ 70,000		2% increase p.a.		
	# of FTE Operations Employees	3	3	4	5	5	2	3	3	4	5	2	2	3	3	4

Average Loan Value is the single most important variable on the Revenue side of the model. On the Cost side, the labor cost of Management and Operations employees makes up almost two thirds of all Operating Expenses for the Association. These variables are discussed in more detail below.

Main Model Variables

The Average Loan Value assumes the loans will be for operational, livestock, and equipment purposes. Typical uses include buying inputs ahead of the crop planting season, purchasing cows, calves, breeding stock, farm equipment, and other necessary supplies to support operating and equipment loans. The operating loans will have a repayment period of nine months to one year on average. The cattle loans will have an average term of one to three years. The equipment loans will have an average term of five to seven years.

Market Capture Rate

The most current data shows that there were 35,000 African American principal producers in the targeted states. Based on the current understanding, it is assumed that 65% of those farmers will be “on the market” for operational loans on any given year. The Market Capture Rate reflects the percentage of those potential customers that the Association attracts (i.e. the number of them that apply for a loan with the Association). Given that the mission of the Association is to help those African American farmers that needed it the most, it is assumed that all applicants are approved, so the Market Capture Rate applied to the number of potential borrowers yields the number of loans approved.

Average Spread

The Average Spread is set 250 basis points, based on market data and industry experts’ opinion. The Association wants to make its loans as accessible as possible for the largest amount of potential borrowers. At the same time, it needs to be profitable on an ongoing basis in order to exist, so the spread needs to reflect a balance between these two objectives, and be roughly in line with what competitors offer.

Default Rate

Similarly to most other variables in the model, the Default Rate was set based on industry experts’ opinions and industry data. A 6% default rate was set for all scenarios. If the American Rescue Plan Act relief package for farmers of color is effectively disbursed (at the moment is being contested in courts), it is possible that the default rate could be lower, since the this package would “wipe out” most/all agricultural loan debts for the targeted farmers, effectively improving their financial situation. This assumption can be adjusted based on the credit worthiness of the borrowers.

Loss Given Default

The Loss Given Default is set at 10% for all scenarios. This assumes the Association is able to secure loan guarantees from the Farm Service Agency, or other institutions.

Labor

Compensation for Management employees was modeled at $160,000/yr., plus a 30% company burden. This estimation applies to all scenarios. The number of Management employees however, does vary with the different scenarios depending of the size of the operation and the need to manage/oversee.

Similarly, compensation for Operations employees, was modeled at $70,000/yr. plus a 30% burden for all scenarios. The number of full time equivalent (FTE) employees in Operations varies for each scenario and was modeled based on industry standards for productivity and the expected loan volumes. It is also assumed that the loan officers will be seasonal employees for roughly three months of the year during the busy season, and it illustrated in all scenarios.

Back office/support functions are assumed to be outsourced for the first five years of operations.

Scenario Analysis

Scenario A – Worst Case

In the Worst Case scenario, the Interest Income generated is not enough to support the minimum structure needed to run the operation. The key factor in the reduced Interest Income is the lower Average Loan Amount assumed ($50,000/yr. vs. $80,000/yr. in the Most Likely scenario). The model shows an expected loss for each of the five years and there is no clear trend towards breaking even.

		Year 1	Year 2	Year 3	Year 4	Year 5
Scenario A: Worst Case	Average Loan Amount	$50,000	$50,000	$50,000	$50,000	$50,000
	Market Capture	5%	6%	7%	8%	9%
	Number of Loans	1,150	1,380	1,610	1,840	2,070
	Average Loan Volume (in thousands)	$43,125	$51,750	$60,375	$69,000	$77,625
	Operating Expenses (in thousands)	$1,714	$1,709	$1,847	$2,188	$2,588
	Net Income (in thousands)	-$901	-$475	-$398	-$525	-$711

Scenario B – Most Likely Case

The table below outlines the main assumptions for the Most Likely Scenario. The Average Loan Amount is held constant $80,000 for the five years of the analysis, and the Market Capture is increased by 1% each year. Under this scenario the Association would become profitable in year four, and its profitability grow in year five.

		Year 1	Year 2	Year 3	Year 4	Year 5
Scenario B: Most Likely	Average Loan Amount	$80,000	$80,000	$80,000	$80,000	$80,000
	Market Capture	4%	5%	6%	7%	8%
	Number of Loans	920	1,150	1,380	1,610	1,840
	Average Loan Volume (in thousands)	$55,200	$69,000	$82,800	$96,600	$110,400
	Operating Expenses (in thousands)	$1,576	$1,819	$2,178	$2,303	$2,478
	Net Income (in thousands)	-$535	-$187	-$203	$15	$180

<u>Scenario C – Best Case</u>

The main driver of change in the Best Case scenario is the Average Loan Amount, which increases to $120,000/yr. from the $80,000/yr. modeled in the Most Likely Scenario. With the increases in the Average Loan Volume, there is a corresponding decrease Market Capture values, given that the number of approved borrowers for this higher loan amount is expected to be lower than that of approved loans at the $80,000 amount. In the Best Case scenario the Association becomes profitable in year three.

		Year 1	Year 2	Year 3	Year 4	Year 5
Scenario C: Best Case	Average Loan Amount	$120,000	$120,000	$120,000	$120,000	$120,000
	Market Capture	3%	4%	5%	6%	7%
	Number of Loans	690	920	1,150	1,380	1,610
	Average Loan Volume (in thousands)	$62,100	$82,800	$103,500	$124,200	$144,900
	Operating Expenses (in thousands)	$1,858	$2,143	$2,290	$2,418	$2,596
	Net Income (in thousands)	-$688	-$210	$156	$537	$868

Limitations of this Financial Analysis

The values used in the different scenarios are based on industry standards and the opinion of industry experts. Nonetheless, the number of data points used in this analysis was fairly low, given the reduced scope of it. This study is meant to provide visibility to the main variables impacting the P&L of the Association, and show their approximate impact. The next step in obtaining a more detailed and accurate financial picture under different scenarios would be to write a business plan, and develop the corresponding set of pro-forma financial statements.

Major risks and considerations

Physical presence and proximity to potential borrowers will play a role in the Market Capture Rate. The Association should consider setting up operations in a single state before expanding, to limit the operating expenses. Operating in a single state would slow growth of the institution but could help make it profitable sooner, and it would require much less capital at the onset.

The amount of capital needed to start the Association with a structure that can deliver profitability within five years is significantly higher than the capital currently available. Given this big current funding gap, alternative ideas/business models should be considered to utilizing the available capital in other ways, while staying true to the Association's mission.

The financial results modeled could be heavily impacted by the $5 billion allocated to relief for farmers of color from the American Rescue Plan Act, specifically by the $1 billion set aside to help farmers of color, including African American farmers. If this $1 billion is funneled by the USDA to other institutions, the Association would have a much harder time competing with those. On the flipside, given the strong alignment of the Association's mission with the purpose of these specially-allocated funds, the Association is well positioned and should try to obtain funding through this new mechanism.