Debunking Risk in Food System Lending

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Executive Summary

Food and agriculture-related enterprises are essential to every community, and providing access to capital for this sector plays a key role in strengthening local economies. There is a common perception among economic developers, community stakeholders, and lenders that these types of investments are too risky for traditional lending approaches - yet data collected by CDFA from dozens of revolving loan funds across the United States tells a different story.

CDFA has secured, aggregated, and analyzed data from over a thousand loans made to food-focused enterprises, and this first-of-its-kind research has resulted in one undeniable outcome:
CDFA's research demonstrates that food system loans perform and that revolving loan funds can successfully support local food system borrowers in their communities.

This data shows low default rates among food and agricultural enterprises, in line with the performance of traditional revolving loan fund portfolios.

Loan performance:	***7%*** *default rate on average across food and agriculture enterprises*
	3% *default rate among RLFs focused on food system borrowers*
Portfolio makeup:	***33%*** *food or agriculture enterprises*

CDFA's research also found loan sizes, rates, and terms on par with traditional loans for small businesses.

Loan size:	***$168,025*** *(average)*
Interest rate:	***4.7%*** *(average)*
Term length:	***10.7*** *years (average)*
Collateral:	***90%*** *of loans require some form*

Based on this research, food-related enterprises are strong borrowers that can be well-suited for traditional lending approaches like those offered through revolving loan funds. Funds that focus on serving food system businesses with flexible lending approaches and direct technical assistance see even better performance among their borrowers. Development finance agencies can become more aware of the role that food and agriculture already play in their local economy and recognize the businesses already growing their local food system. These lenders should also look for opportunities to increase their outreach to food-related enterprises, particularly among historically underserved borrowers who are working to grow and launch businesses in the food system. Every community has small food enterprises worthy of financing and essential to creating thriving, livable, resilient places.

What is a Revolving Loan Fund?

A revolving loan fund (RLF) is a flexible source of capital that can be used to help grow small and mid-sized enterprises. An RLF is a self-replenishing funding pool that recycles payments from existing loans to fund new loans. This structure requires that RLF programs balance the desire to offer affordable interest rates with the need to earn a sustainable rate of return since the fund must be replenished in order to make future loans. RLF loans are usually issued at competitive rates, though they also tend to offer flexibility with collateral and terms to ensure accessibility to a wider range of borrowers. The majority of RLFs support a variety of small business types, though some creative loan funds target specific areas like local food or minority-owned enterprises. This is a popular development finance tool, with over twenty thousand operating throughout the country. When a fund is managed sustainably, the RLF can be maintained and grown over time to provide an evergreen source of accessible financing.

There is a critical need for more affordable capital to be directed toward helping grow and develop local food systems. This, combined with the performance data confirmed by CDFA, demonstrates that RLFs are a suitable source of funding for food-related enterprises.

How Did We Collect This Data?

CDFA collected, aggregated, and analyzed data from 58 different loan funds operated by 22 organizations across 20 states with experience lending to food-related borrowers. The goal was to better understand what lending opportunities food system enterprises currently have access to and to assess how the performance of loans made to food and agriculture-related enterprises compare to other loans within these funds. This included two broad types of data:

- ***Portfolio performance data, from historical lending***
- ***Loan-level data from 1,000+ current food system loans***

Data was collected from April to September in 2021, with historical data from up to ten years prior. The vast majority of the participating RLFs lend to small enterprises of all kinds, although a handful of the funds (7%) work exclusively with food and/or agriculture enterprises, specializing in the needs of these borrowers and offering additional technical assistance for the local food sector. Loan fund managers that shared data with CDFA did so voluntarily and were contacted through CDFA's network of finance professionals and local food system practitioners.

On average, only seven percent of loans to food and agriculture enterprises default **7%**

What Did We Learn About Loan Performance?

CDFA asked participating organizations to aggregate their last 5 to 10 years of performance data for each loan fund to show how food system lending compares to industry standards. The general RLFs who lend to a wide variety of enterprises reported an average default rate of only 7% on loans made to food and agriculture-related enterprises.

Across these loan funds, an average of 33% of their portfolios has been made up of a business connected to the food system. Although not every RLF will have this high percentage of their lending dedicated to local food firms, it makes the low default rate more notable. CDFA's research on revolving loan funds has established that a well-managed RLF typically has a default rate between 6-8% across its portfolio. Among the lenders who lend exclusively to the food and/or agriculture-related sector through their fund, the default rate was even lower at 3%. Though these funds made up a smaller portion of this dataset (7%), it suggests that the specialized attention offered through food system-focused lending programs helps borrowers succeed in paying back their loans.

These findings support the premise of this research: that traditional lending approaches can be successfully directed toward local food system borrowers and debunks the perception that food-related firms are inherently riskier than other enterprises.

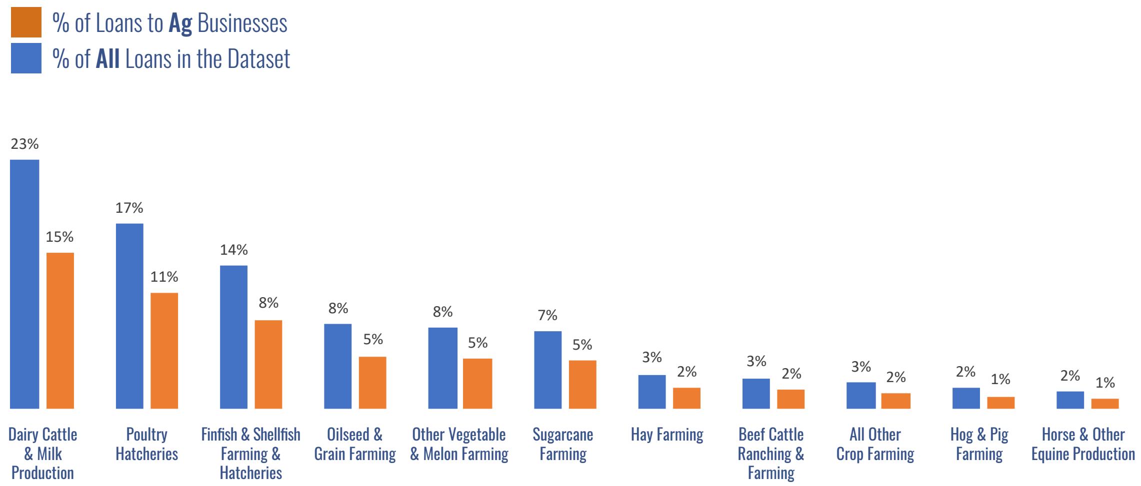
Data collected from over 1,000 loans to food and agriculture-related enterprises **1,000+**

What is the Current Food System Lending Landscape?

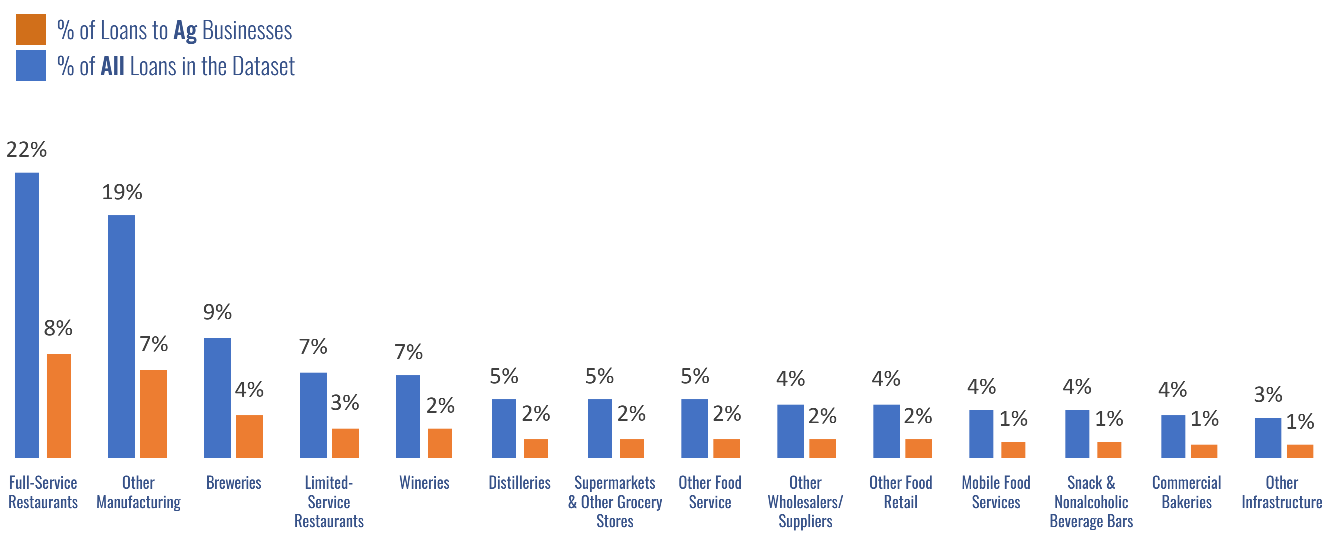
The data collected on outstanding loans provides a snapshot of the lending available to food system enterprises in the present. Loan-level data includes loan amounts, interest rates, terms, and collateral requirements. The summary data is presented in averages across the dataset and by the separation between agriculture-related enterprises and all other food-related enterprises, although most averages between food and agriculture-related lending did not differ greatly. Charts depicting the range or distribution of certain loan characteristics provide a more nuanced understanding of the larger dataset.

Based on the NAICS (North American Industry Classification System) code of each borrower, individual loans to enterprises engaged in direct food production or agricultural support industries are identified as 'agriculture-related' to help differentiate between these two major parts of the food system. The charts below further specify the sectors represented in this data, using NAICS codes to show the types of enterprises represented in the 'agriculture-related' and 'non-agricultural'. The percentages show how much of the CDFA dataset is made up of enterprises in each industry, within the category of agriculture-related/ non-agricultural enterprises and across the entire dataset. All industries that made up at least 1% of the full dataset are included in the following charts.

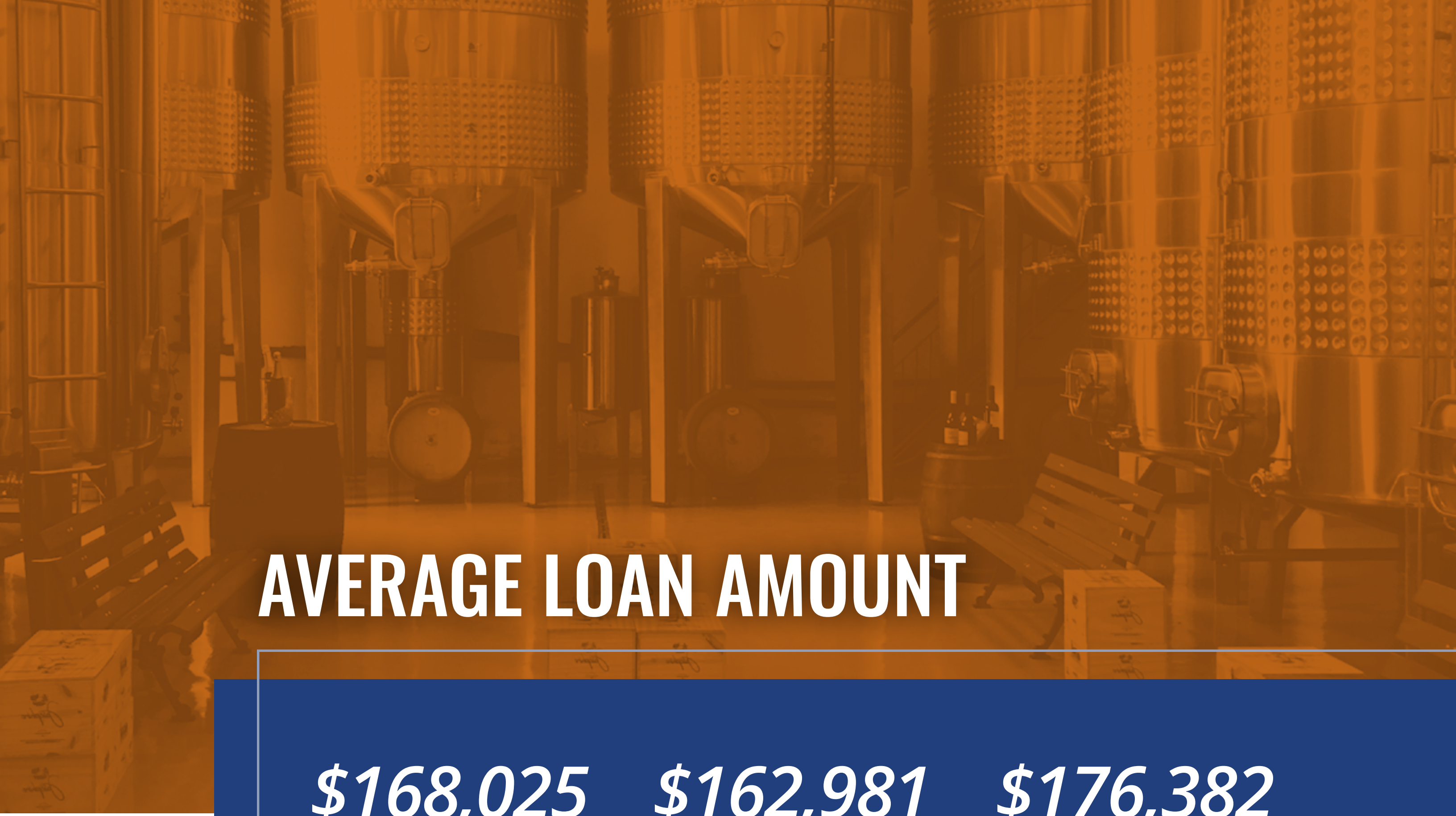
Types of Agriculture-Related Businesses in the Dataset (by >1%)



Types of Non-Agricultural Food Businesses in the Dataset (by >1%)

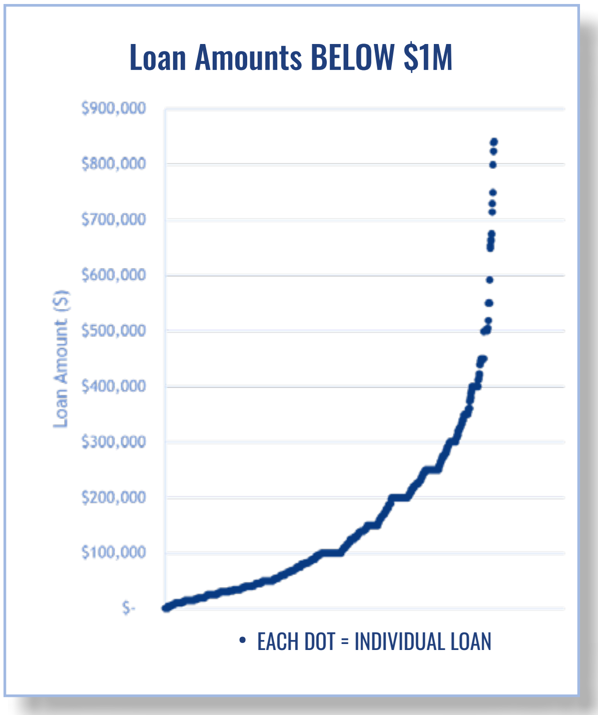


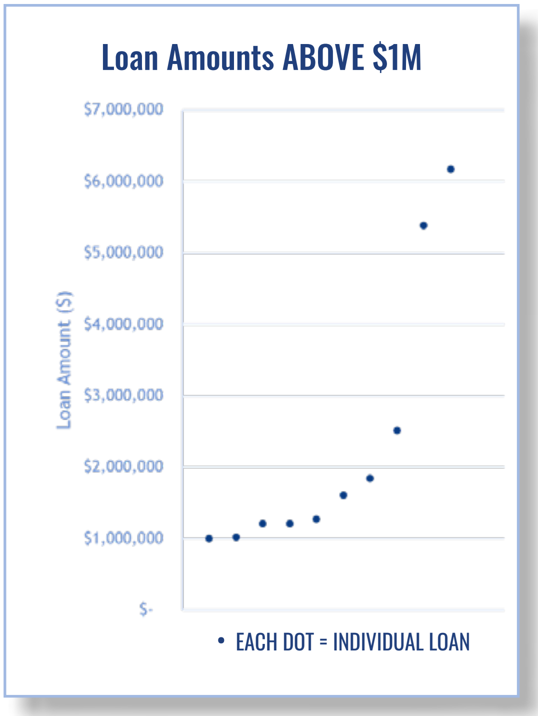
Due to the variety across non-agricultural food business lending, some of the data is grouped by industry into combined categories. This applies to: Other Manufacturing, Other Food Service, and Other Food Retail.



AVERAGE LOAN AMOUNT

$168,025	$162,981	$176,382
All Loans	*Agriculture Loans*	*Non-Ag Food Loans*



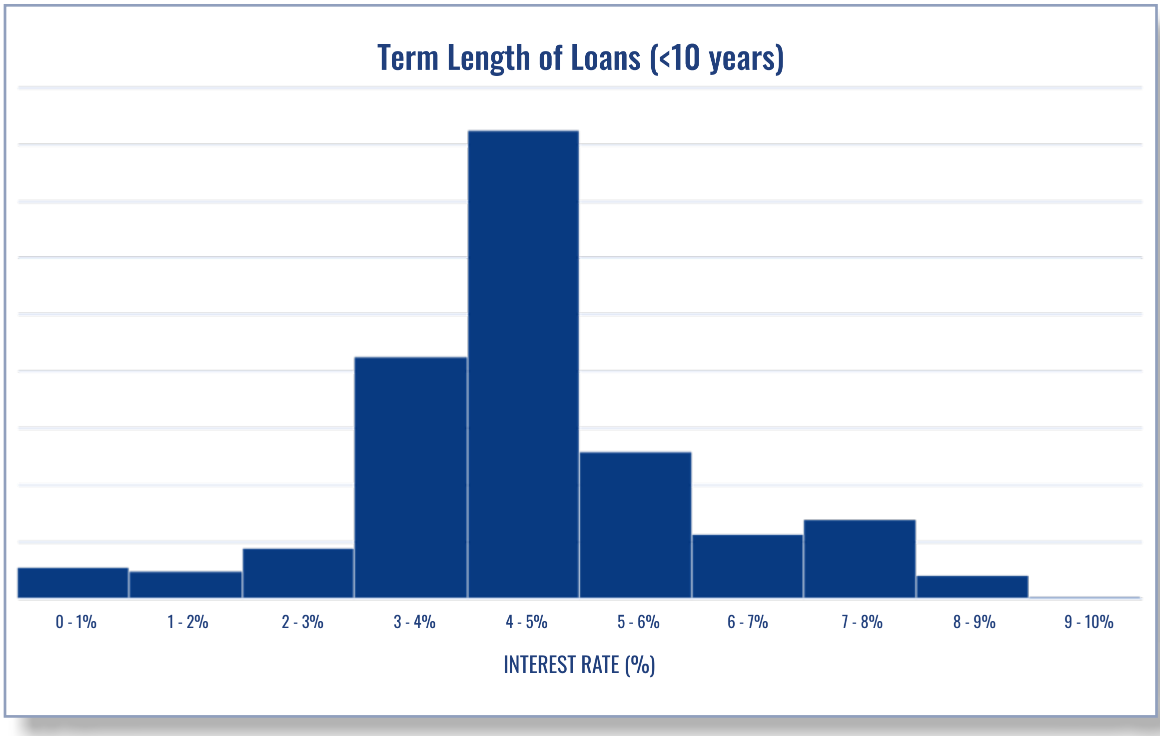


AVERAGE INTEREST RATES

4.7%
All Loans

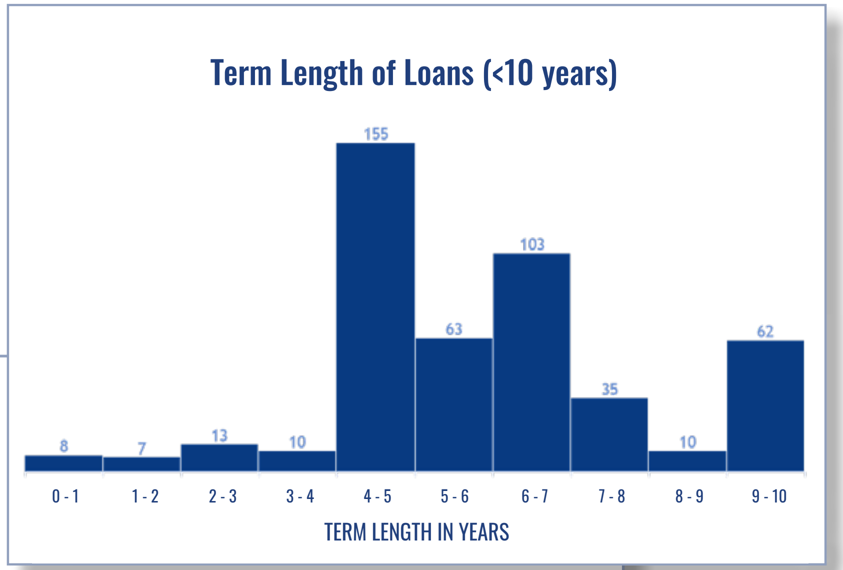
4.5%
Agriculture Loans

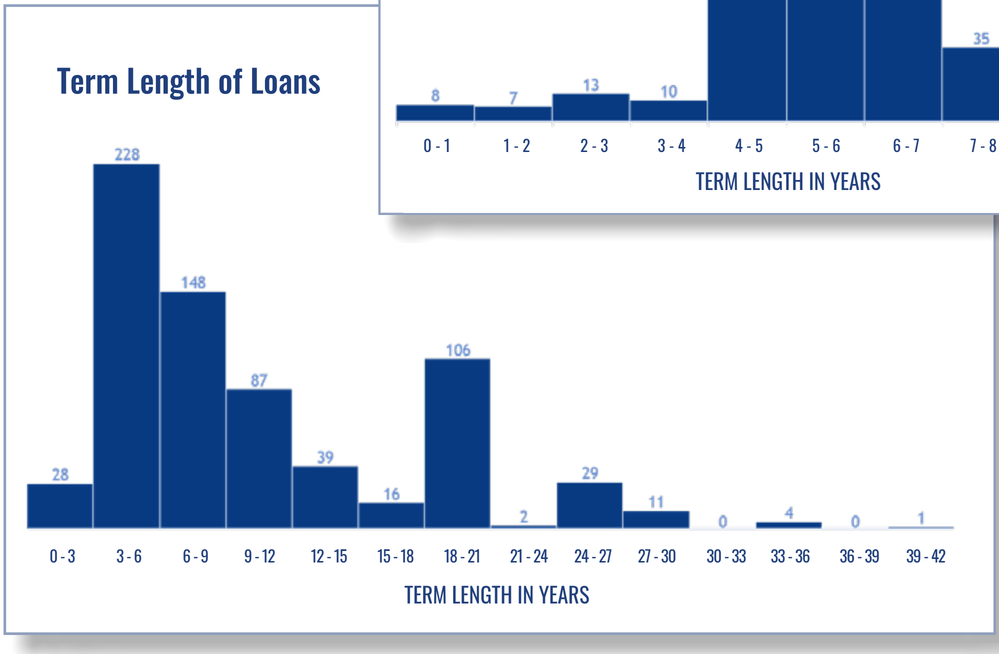
4.9%
Non-Ag Food Loans

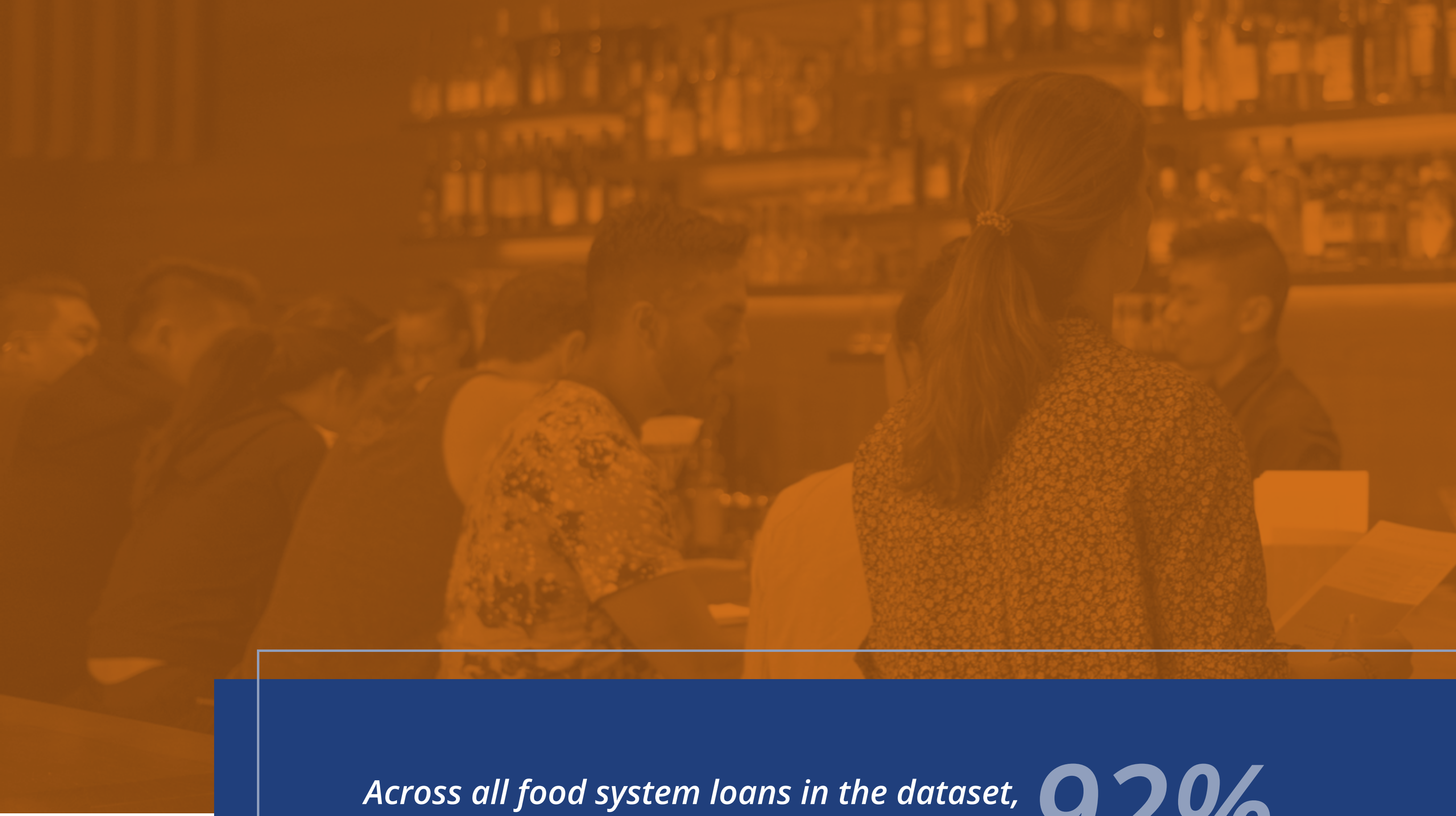


AVERAGE TERM LENGTH

10.7 yrs	*11.8 yrs*	*9.6 yrs*
All Loans	*Agriculture Loans*	*Non-Ag Food Loans*







Across all food system loans in the dataset, 9 out of 10 require some form of collateral **92%**

Collateral Requirements

The majority (92%) of loans in this dataset include some form of collateral requirement for borrowers. This average is slightly lower among loans made to agriculture-related enterprises (88%) and higher for loans made to all other non-agricultural food system businesses (95%).

The most common types of collateral include both business and personal real estate, in the form of buildings and/or land; equipment and vehicles; and personal guarantees from the business owner(s). Many RLFs who reported data for this research also accept inventory and other business assets as collateral. Personal life insurance from the business owner(s) and corporate guarantees are also accepted by some loan funds.

In addition, some RLFs in this dataset act as co-lenders with another lending institution and have taken both primary and secondary positions on repayment of their loans.

Takeaways

Organizations that operate RLFs can become more aware of the role that food and agriculture already play in their local economy. Enterprises of this kind are often in fund portfolios without being recognized as part of the "food system" by lenders. Reframing food system investment as economic development creates the opportunity for supporting small food enterprises by situating their efforts in a larger strategy. Food can be integrated into other economic development strategies focused on growth, diversification, or resilience. While a restaurant or an independent grocery store might normally be seen only as a small business, defining the food system as its own market sector demonstrates the value of all the projects and enterprises within this broader system. This perspective also identifies where there are gaps and possibilities for further expansion.

RLFs can also look for opportunities to increase their outreach to food-related enterprises and ways to connect these borrowers with technical assistance in coordination with financing. Doing so creates a pathway for strengthening place-based economic development strategies and ensuring that such small enterprises are able to launch and grow. This requires building effective relationships and partnerships across the entire food system and might also include creating new funds or technical assistance programs that address gaps in the current lending landscape. Among the organizations that participated in this research, only 16% collected their borrowers' ages, 68% gathered data on race, and 89% had a record of the borrower's gender.

It is critical for loan funds to understand the social equity impacts of providing affordable capital to the local food system as well. Not only does supporting these enterprises make for more resilient food systems less prone to economic crises, but there is also a significant opportunity to focus attention on lending to underserved borrowers in this sector. Generating economic prosperity while advancing racial and social equity in the food system can be achieved by intentionally unlocking capital for food-related enterprises and projects led by women and minority entrepreneurs, small enterprises and microenterprises, and projects or enterprises located in low-income or rural communities. There are countless character-based lending practices and approaches to RLF program design that help reduce barriers to lending for underserved borrowers. In regard to this research and loan-level data collection, it is critical for funds to collect information about their borrowers in a way that allows them to more easily identify gaps in service.

Food system borrowers have unique needs, as with any small business or specific industry sector. This research demonstrates that food and agriculture-related enterprises are not inherently riskier than any other small business, though these types of borrowers often need a degree of specialized attention and flexibility in order to be successful. CDFA's research illustrates how many RLFs are successfully serving this sector of our local economies already, and a broad spectrum of financing solutions is still necessary to continue supporting food system development. Every community has small food enterprises - grocery stores, restaurants, processors, manufacturers, caterers, bakeries, breweries, food hubs, markets - that are worthy of financing and essential to creating thriving, livable, resilient places.

Acknowledgements

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