FINANCING CONSERVATION WITH WORKING LANDS

BUSINESS MODEL SUPPLEMENT

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INTRODUCTION

The intent of the Working Lands Program business model described in this document is to supplement the operations of organizations that preserve and manage natural land in Illinois. The business model accompanies the Working Lands Program Framework. There are many value propositions provided by conserving land, including preserving nature for future generations to use and enjoy, while providing educational and volunteer opportunities to citizens of Illinois to better their quality of life. These land conservation activities are primarily conducted by 501(c)(3) not-for-profit charitable organizations incorporated to execute programs to serve this mission. These activities are primarily financially underwritten by foundations with aligned missions, government grants for the same purpose, and individual donations.

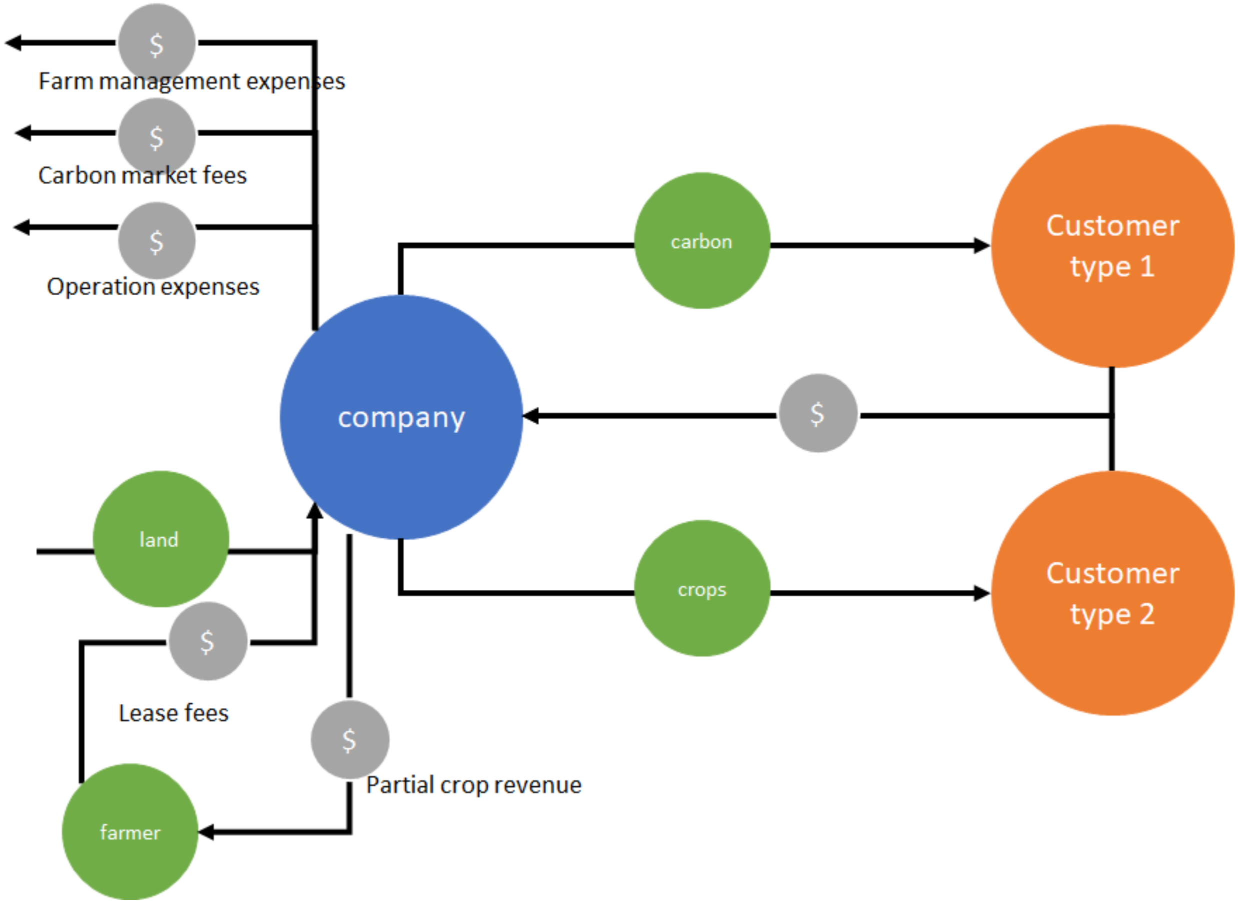
Land trusts may simply rent land to farmers at an average cost of $224/acre, providing approximately $112,000 in revenue for a 500-acre farm. However, many of these farms would be conventionally farmed without strict leasing agreements requiring regenerative agriculture or related conservation principles. Because regenerative agriculture can be more complex in practice than conventional farming, it is not as widely practiced, and land trusts may have difficulty at first finding producers willing to manage a regenerative cropping system. Based on Delta's experience and project findings, regenerative agricultural systems may be more profitable in the long-term, even potentially providing revenue in excess of rent. A business model that accepts some of the risks of converting to regenerative agriculture while sharing the rewards may provide a way to develop the practice in Illinois while providing consistent revenue and mission alignment to land trusts for the use of their land.

This memo establishes the features of the business model as a separate organizational unit (such as a program within another organization or venture) to efficiently manage farmland and organize multiple different farms for more than one land trust. The profits of the entity may be used to supplement the primary mission of one or more organizations and advance regenerative agriculture in Illinois. This memo describes how that may be done.[1]

The business model in Figure 1 focuses on operating farm and forest assets to deliver a value proposition of providing farm management services, selling crops or agroforestry products, and generating and selling greenhouse gas offsets. The business may sell this service to organizations directly or establish members and distribute profits to members if it is incorporated to do so. The business may elect to partner with a farm manager to run operations and enter a contract to profit share or lease the land. These costs and revenues are explained in Figure 1. In the case of creating a separate program or venture, land trusts would enter into agreements to offer their land for use with a single organization. This organization would then manage standard agreements with farm managers and farmers to maintain the land sustainably with regenerative practices. In return, farm managers and farmers would have access to consistent premium markets and potential partners with the program or business to finance the conversion to regenerative agriculture.

[1] Throughout this memo, the term "business" may refer to a business unit within an organization, or a separate organization structured to carry out a specific mission. Functionally, they may be considered the same. Launching the business as its own entity is a structural consideration.

Figure 1. Overview of working lands company business model.



Rather than simply rent land, we suggest that the business be created to operate as close to its customers as possible to increase revenue returning to land trusts. Early discussions centered on providing the land to farmers under a simple lease agreement. While this is both easy to execute and could be a way to test the viability of the business, if the long term profitability of regenerative agriculture accrues to the farm manager, the land trust loses its opportunity to gain revenue from the full value of the regeneratively grown crops.

Negotiating a profit-sharing agreement may be of interest to keep more profits with land trusts. In return, risks of transitioning to regenerative agriculture may also be shared in this way and encourage a shift in practices and allow a greater number of small farmers to participate. Land trusts may be able to borrow against the land in partnership with a farm manager to do so.

Each land trust may use this same model to develop their own program, however, there are several economies of scale that are available if there is one entity. For example, carbon program startup fees are considerable as each organization would need a program manager who is familiar with carbon programs and protocols and knows how to manage farm manager contracts, etc. Over time this expertise can help scale the practice throughout the state.

KEY PARTNERS

Below are the key partnerships that we identified as being typically needed for successful business models.

Land Trusts and Conservation Organizations

Land trusts and conservation organizations quite simply provide the supply of raw material - the land - to the business. The business pays the land trust rent to manage the land, and profits may be retained by the business or distributed as part of agreements.

Farm and Forestry Managers

Land trusts are not in the business of farming and forestry management for sale of timber but may be able to manage this service on small farms with some staff. Farm managers are in this business and could contract to do so. The business would directly contract with a farm manager to provide this service or enter into a cooperative agreement with a farm manager to do so with profits distributed based on the agreement. Similarly, the land trust could do so with a forest manager to selectively harvest timber or other plant material such as nuts or wood chips as part of the management plan of forested acreage, or a farm manager could work with a forestry manager as part of an agroforestry project on land adjacent to a protected natural area.

Farmers

For smaller acreage (less than 300 acres), a single farmer could—and often does—operate as a farm manager. If the farmer is part of a cooperative, the business may engage at the cooperative level. The activities would mirror the farm and/or forest manager arrangement described above.

Distributors and Other Supply Chain Actors

Though normally covered by the farm manager, there may be a benefit for the business to directly contract further up the supply chain. If the business is organized as a cooperative, contracting with suppliers directly may be the most efficient and profitable way to do so. For example, normally a farm manager would enter into an agreement to lease the land and they would retain all the profits from farming. However, an entity could enter into an agreement with a farm manager or farmer directing that all product is sold on behalf of the entity. In return, the farm manager gets a percentage of profits instead of all of it, but has a consistent distribution contract, as well as a potential premium price. These details would be worked out as part of the contracting process.

Natural Land Managers/Ecosystem Resource Aggregators

If the land under management is adjacent to natural lands and is operated by a separate entity, there may be restrictions on farm operations (pesticide management, fertilizer application) that need to be considered. These restrictions would need to be communicated to the business to properly manage the working land.

Volunteer Groups/Volunteers

Volunteer groups often provide in-kind labor to the organization, promotion, and may be early adopters for purchasing end products.

State Agencies and Philanthropic Organizations

State agencies and philanthropic organizations can provide seed funding, continuing grant funding, funding for policy development and can underwrite technical assistance to supplement the business' operations, especially in early stages.

CUSTOMERS

Every business has customers. The customers for this business are consumers, distribution offtakers (such as food processors), or food cooperatives of which the business may or may not be a member.

Customers that purchase food from regeneratively grown sources have many reasons for doing so. Foods that are healthy, environmentally, or socially conscious may be sought after by niche markets and provided at a premium price. The farming operations can grow food directly for distribution in cooperatives, or sold as commodity crops such as corn and soy to food distributors willing to pay a premium for regeneratively grown crops. In the early stages of the business, commodity crops are most likely to be preferred.

VALUE PROPOSITIONS

Every business delivers a value proposition to a customer. This business is structured to deliver the following value propositions:

Value Proposition 1: Regeneratively Grown Food that Directly Funds Conservation

Many businesses deliver products and market that they provide one percent of proceeds to not-for-profit organizations, or that all profits are donated to charity. This business is uniquely positioned to directly benefit land conservation by virtue of its primary operations and can be marketed as doing so.

Value Proposition 2: Carbon Offsets Related to Specific Natural Areas (Small Batch Offsets)

Similar and related to Value Proposition 1, the operations of the business can generate a separately salable commodity, a greenhouse gas offset, which can be aggregated from multiple projects and sold on private, voluntary or compliance markets. The primary mechanism for generating offsets is practicing and documenting regenerative agriculture or forestry.

KEY RESOURCES

The business must have the following key resources to have success in its market.

Land

Through its partnerships or through its structure, the business can provide working lands to deliver its products and services.

Agronomic Expertise

Through contractual relationships or staff capabilities, the business can plan and forecast the growth of its products.

Farm Management

The business can farm its land for production either directly or through contractual relationships with farm managers.

Diversified Farming Operations Provide Market Connections

Through its staff or contractual relationships, the business can connect to the market.

Land Management Policies

Through its staff, the business can manage the land to provide income while maintaining the mission of its suppliers (land trusts/conservation organizations) and stay true to its core values to keep its customers.

Customer Segments

Customer segments include consumers who want to fund conservation indirectly or directly through their purchase of environmentally beneficial food products, or the roughly 25 to30 percent of retail food sales customers that are health conscious and are able to pay a premium to ensure that their purchase has social and environmental benefits.

Customer Relationships

The business will either sell directly to consumers through a cooperative or will indirectly sell as a raw material to a food producer that provides a branded product.

Channels

The business will sell through a cooperative or will enter into agreements with distributors to sell to food producers. For greenhouse gas offsets, the business will need to become an aggregator on greenhouse gas offset exchanges or provide its offsets to an aggregator to sell on an exchange.

Cost Structure

The business will sell its products as commodities ($ per unit of produce or $ per mtCO2e offset[2]).

Revenue Streams

Revenues will include the premium for regeneratively farmed commodities, regenerative agriculture carbon offsets, managed forest carbon offsets, and any seed or continuing foundation or government grants to operate the business.

PRO FORMA

The Conservation Financing - [Working Lands Pro Forma][3] is intended to provide a financial plan for a scaled program or organization to accomplish the following objectives:

1) Manage farm and forestry operations
2) Collect revenue from greenhouse gas offset programs and crop sales
3) Stand up as a standalone venture or operate as a program depending on scale. To operate the Pro Forma as a Program, overhead costs covered by another organization may be removed.

The Pro Forma has several sheets to help organizations determine possible scenarios. Each sheet has a defined purpose and several predefined formulas that can be used or turned off. There are also a few switches that allow a user to turn off revenue and costs to address any financial shortfalls. Each sheet is described below:

1) 'START HERE' describes the sheets in general with some guidance on how to use them. It is intended to be open ended.

2) 'Financials' shows the financials of the organization as structured.

3) 'Funding Requirements' demonstrates the shortfall of funding based on the current scale for the organization as well as the unit (acres under management). This can help determine how much startup funding is required to get the organization or program self-sufficient.

[2] Greenhouse gas offsets are typically packaged as metric tons of CO2 equivalent (mtCO2e)
[3]https://docs.google.com/spreadsheets/d/1Pg0RHEmvayK63Z2j0PfNn47mGcLpwwWLUmgNSSf533o/edit?pli=1#gid=2110317984

4) ‘Rollout’ allows a user to develop scenarios for Base, Low, and High customer uptake by the unit. The breakpoints of scale are also included here, with startup minimum and scaled maximum acres under management. Startup costs are assumed to be higher than scale, with scale maximum representing the point at which unit costs begin to decrease because of economies of scale.

5) ‘Revenue’ provides several different revenue streams. These fall into three categories: Commodity Crop Revenue, Greenhouse Gas (GHG) offset revenue, and Grant Revenue. Commodity Crop Revenue assumes a transition to regenerative organic farming at scale but assumes conventional revenues in the pilot phase. GHG offset revenues include both regenerative agriculture and forest offsets from improved management and planting. Grant Revenue is left open for seed funding and continued support. Not all GHG Offsets will apply. Discounts are provided as Project Multipliers.

6) ‘Costs’ provide both Pilot and Scale costs, with formulas choosing them based on a number of breakpoints that can be changed to suit the tolerance of the growth. Costs include personnel and research and development for Costs of Goods Sold as well as operating personnel and other direct costs. The following costs should be considered depending on the revenue streams chosen:
    a) GHG Program startup and verification costs should be included if GHG revenue streams are included.
    b) Farm Management costs should be included if a contracted manager is used to run farm operations. The revenue share for a farm manager is included as a cost. That is, if a farm manager keeps 80 percent of the profit from farm operations, this is a cost to the Program or Organization. A fixed/acre lease term may also be used instead or in addition to a profit share.
    c) Spiffs for signups may be added to encourage organizations to participate.
    d) Target gross margins may be set for both pilot and scale to review how costs affect gross margin.

7) ‘Market Sizing’ provides the rationale for the total number of acres under management at scale, determined as 15percent of available land in Illinois based on research conducted by Delta Institute and partners. The Pro Forma leaves room to expand this, as the program scales in Year 3.

8) ‘Sources’ provides some additional information to back up the numbers used.

BUSINESS STRUCTURE

The Conservation Financing for Working Lands business may be operated as a program within an organization or as a standalone business. Operating as a stand-alone business would allow land trusts to contract with the business and/or be members of the business to take advantage of redundancies and economies of scale. Businesses could be incorporated with constraints, (e.g., incorporating an LLC as a benefit corporation), that preserve the mission of the organization. There are a few possibilities for structure:

Cooperative

Land trusts and related organizations can form a cooperative organization to cover the labor and expenses of managing the operations of the venture. Farm operations may be outsourced to one or more farm managers who may be paid a fixed fee or a percent of profits, or a mix of both. These contractual arrangements would be provided by the co-operative.

Advantages of cooperatives are that they tend to be open and democratic, allowing members to make decisions that affect the organization that are in alignment with their mission, but may also allow them to leave freely if there are disputes they are not able to resolve. However, cooperatives can have significant liability depending on how much members invest (though this is typically only up to the dollar value of the investment), but each member only gets one vote. Members are accountable for all other members, and therefore major decisions cannot be made without a majority vote in most cases. Democracy in this case can create issues, as decisions may be made that are counter to the member organization's mission.

Member-Managed LLC

A Member-Managed LLC can operate the business, distributing assets to Members of the LLC. Members would be composed of the land trusts and related organizations, and rights are set out in the LLC agreement. Member-Managed LLCs could create disputes among organizations, as one or more organizations may have priority or more voting rights. This could be resolved by electing a Manager and leaving organizations as Members of the LLC with voting rights under certain circumstances.

Advantages include the ability to have a member with more control over the direction of the organization, with other members subordinate. If there are organizations that are larger and want to retain control, subordinate members may be able to take advantage of the benefits if they are willing to be subordinate. Disadvantages would need to be reviewed further. Depending on the structure, the LLC may need to pay taxes before distributions to its members. Taxes may be assessed on the value of equity, which can have consequences on the cash flow of the organization. Distributing and then assessing taxes could have consequences for the member organization depending on the size of the distribution.

Separate Member-Managed LLCs

Each organization may also elect to create a Member-Managed LLC to run operations on a particular plot or small number of related plots, or be a member of another LLC, or to allow the LLC to purchase services from a Co-Op or LLC as above. This would potentially allow land trusts to reduce their liability and separate the operations of the farm from the other mission-related operations of the organization.

501(c)(3) Not-for-Profit

The organizations could elect to help structure a separate 501(c)(3), with executive directors of interested organizations as founding board members. The organization could be set up as an affiliate of another organization, with the parent organization controlling the board of the affiliate organization, or the organization could be a separate entity.

501(c)(3)s have several advantages and disadvantages. The advantages of running an operating organization as a 501(c)(3) is that it does not pay income taxes if its mission is aligned with the profits generated by the organization. It also does not pay shareholders. All profits would return to the organization to further its mission. Additionally, 501(c)(3) organizations can accept grants from foundations.

Disadvantages of 501(c)(3) include the need to maintain and manage a separate board of directors, which may elect to change its operations unless multiple organizations are willing to consent to directors and restrict changes to its by-laws. Excessive non-mission related business could trigger taxation or put the organization's status as a not-for-profit organization at risk. This situation may be mitigated by creating an LLC that operates for this purpose and distributes some or all its profits to the parent not-for-profit organization after paying taxes.