Underwriting Natural Food Cooperatives

Margaret Lund, Co-Opera

November 14, 2012
Winter Webinar Series
Winter Webinar Series

- Nurture the growing healthy food financing sector
- Provide webinars to CDFIs and CDFI partners interested in healthy food financing
Today’s Webinar

• Understand the structure and unique nature of cooperatives

• Learn about the “nuts and bolts” of underwriting cooperative food retail outlets
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Underwriting Natural Food Cooperatives

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Margaret’s Background

• Ran a CDFI for cooperatives for 16 years
• Underwritten dozens of food co-op projects starting in 1992
• Served nine years on the National Cooperative Business Association board
• Awarded national service award in 2008 from the Consumer Co-op Managers Association
Basic Elements of a Natural Foods Cooperative:

- Owned and controlled by its (usually consumer) members
- Adhere to international set of cooperative principles and values (see www.ica.coop)
- Governed by an elected board, managed by hired staff
- There are 300+ consumer food co-ops in the U.S.; the largest 125 are members of the National Cooperative Grocers Association (NCGA)
- NCGA members have **annual sales of $1.4 billion, membership of 1.3 million**
- Many formed in the 1970’s-1980’s; lots of recent start-up activity
Not the ‘70’s Anymore . . .

Nurturing Healthy Food Financing
Market Trends and Developments in the Natural Foods Sector

• Sales of organic product have grown from $1 billion in 1990 to $26.7 billion in 2010;
• Double-digit sales growth every year for the last 20 years up until 2009 (7.7%)
• Largest seller of organic foods in U.S. is Walmart; top 5 are conventional chains, Whole Foods is #6
• It is a significant, growing, and increasingly mainstream segment of the market
• Food co-ops have more than held their own during the recent recession; growing part of the market
National Context

- *Cooperative Grocer* industry publication since 1985
- NCGA was formed in 1999; provides business services and group purchasing for member co-ops (acts like a “virtual chain”)
- Savings from group purchasing has allowed the organization to fund a variety of specialized TA services, including its own development arm and financial benchmarking system (CoCoFiSt)
- Specialized TA also available from private consulting firms, primarily Cooperative Development Services – CDS
- Food Co-op Initiative founded to assist start-ups
Key Underwriting Differences from Conventional Grocery Stores

• Gross margin is higher: 36 – 39%
  – Mix of products
  – Margin on products
  – More artisan products, organics, bulk
  – Commonly offer deli and prepared foods

• Labor expense is higher: 23 – 25%
  – High expectation of service and knowledge
  – Fund member services and education functions
  – High road employers, good benefits etc.
  – Offer much greater number of SKUs etc.
More Differences Between Co-ops and Conventional Food Stores

• Market draw is often much wider than regular grocery stores

• Education, rather than income, is the key variable in natural foods purchasing; race is not

• Personal guarantees are generally not feasible collateral; need to underwrite, have confidence in the operation itself

• More diverse product mix (some hybrid natural-conventional food stores)
  – Food co-ops are often key players in, and builders of, existing healthy foods infrastructure
The “Locovore” Advantage

- YOU SAVED $0.40
  - 0.75 oz Elbow Noodles 16oz Bfam 1.99 $1.54
  - YOU SAVED $0.40

-- PRODUCE --
  - Lettuce Green Leaf Organic 2.49 $2.04
  - *APPLES 3 lb Bag Braeux Hill Org 4.99 $4.49
  - *APPLES 3 lb Bag Braeux Hill Org Mbr special -0.51 $0.00
  - Lettuce Red Leaf Organic 2.49 $2.04
  - Lettuce Red Leaf Organic -2.49 $0.00

-- REF GROCERY --
  - *Hummus Tahini 7oz Holyland 3.19 $2.69
  - *Greek Pita Bread 4ct Holyland 2.59 $2.59

MEMBER DISCOUNT
- 3 @ -2.50 $7.50
  - SUBTOTAL 80.43
  - TAX 0.89
  - TOTAL 81.32

CHARGE 81.32

-------- YOUR SAVINGS --------
DISCOUNTS: $7.50
SPECIALS: -$0.51

You Saved $6.01
* Local Products/Companies: $31.98 *
  - 35.96% of purchase

Member 264172

Thank You!!!
- Returns accepted with receipt within 30 days of purchase
- Visit us at:
  - www.wedge.org
- Explore our online store of gifts, housewares, clothing
  - www.WedgeWorldwide.com

Cardholder Copy
What is *Not* Different . . .

- Average profit margin is around 1 to 2%
Understanding Membership

• Members provide the base capital in terms of a set share price
  – Understand how the co-op’s membership system works
  – Most co-ops moving away from a discount structure to an annual patronage dividend

• Members typically (depending on state law) also offer subordinate “quasi-equity” members loans for start-up or expansion
  – Co-op structure is governed by state law; state securities laws vary regarding how member investments are treated
Understanding Membership

• Members should provide a solid percentage of sales
  – This amount will vary by market – over 50% and less than 100% is best
• Membership should be growing
• Members elect the board of directors from among themselves
  – Food co-ops typically do not have outside directors
  – Look for mix of skills, mix of tenure
  – Ask about board turnover
What is this CoCoFiSt?

Not this . . .
...But This!

**Common Cooperative Financial Statements** – a unique peer comparison and support system

- All NCGA members share a common chart of accounts
- Finance managers send monthly data to CoopMetrics, who return reports comparing each store’s performance to a selected peer group
- Can also get comparison reports by department, region, size etc.
- Has spawned several subsidiary groups (CoCoBuds, CoCoHabana, CoCoMamas) whereby department managers at different co-ops can both compete with and support each other
### Some National CoCoFiSt data

<table>
<thead>
<tr>
<th></th>
<th>Small</th>
<th>Med-Small</th>
<th>Med-Large</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>2,025,732</td>
<td>6,156,301</td>
<td>8,895,379</td>
<td>12,285,258</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>35.80%</td>
<td>39.29%</td>
<td>37.74%</td>
<td>37.16%</td>
</tr>
<tr>
<td>Personnel</td>
<td>23.45%</td>
<td>25.08%</td>
<td>22.75%</td>
<td>24.33%</td>
</tr>
<tr>
<td>Occupancy</td>
<td>3.97%</td>
<td>3.54%</td>
<td>4.07%</td>
<td>2.95%</td>
</tr>
<tr>
<td>Net Income</td>
<td>1.44%</td>
<td>0.98%</td>
<td>2.21%</td>
<td>0.81%</td>
</tr>
</tbody>
</table>

4th Quarter 2007
Underwriting Issues

• There is COGS, labor and everything else
• Real estate costs do not drive the deal; location does
• Quite a bit of variability by store size
• Sales growth trajectory slower in rural markets
• Deli can add a lot of margin, also potential for loss (TA)
• Market studies based on conventional grocery comps are often not accurate; G2G has database specific to co-ops
• These are not hard collateral loans
  – Your key security is the co-op’s ability to turn inventory and know where they are making their money
Food Co-op Expansions

- Look to current comparable CoCoFiSt data for projections
- Make sure market study is for natural foods co-ops, with comps to similar-size, similar market food co-ops
- Ask what kind of TA/support they are getting from NCGA, peers, consultants
- Make sure members are sufficiently vested
- Don’t tie up their cash
- Very typical to lose $ first year, 18 months before it cash flows
- Discounts, terms from vendors can be substantial
- Expect it will take 6 months or so to stabilize margins etc.
  - Strong sales can cover a lot of mistakes
Food Co-op Start-Ups

All the same thoughts as expansions plus . .

- National support organization the Food Cooperative Initiative has lots of data, technical assistance
- 50 new food co-ops have started in the last five years, 50 more in some kind of development;
- Only five of these have failed so far
- Strong and growing interest in local foods; is this the new organic? Too soon to tell . . .

Nurturing Healthy Food Financing
Lexington Food Co-op, Buffalo, NY
At the Time of Expansion

- Co-op founded in 1971
- 1,200 sq. ft. retail; self-described “worn-out hole-in-the-wall”
- In 1997, co-op sustained a loss of $50,000 on sales of $800,000; on top of eight years of flat sales, equity near zero; finance staff recommended closing
- Instead, key board and staff members worked on turnaround – staff began wearing nametags, had customer service training - sales grew, first at 10% a year, then 30%; almost $2 million by 2004
- In 2001, started planning expansion, hosting member forums, working with consultants, building vision
New Store Projections

- 4,500 sq. ft. retail (3 times as big)
- New construction building
- Addition of a deli
- Projected first year sales increase of 75%
## Project Sources

<table>
<thead>
<tr>
<th>SOURCES</th>
<th>TOTAL</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Reserve</td>
<td>121,000</td>
<td>3.5%</td>
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<tr>
<td>Cash from Operations</td>
<td>84,412</td>
<td>2.4%</td>
</tr>
<tr>
<td>New Member Equity</td>
<td>65,000</td>
<td>1.9%</td>
</tr>
<tr>
<td>Donations, Sale of Equipment</td>
<td>15,000</td>
<td>0.4%</td>
</tr>
<tr>
<td>Member Loans</td>
<td>574,347</td>
<td>16.6%</td>
</tr>
<tr>
<td>Owners Contribution</td>
<td>859,759</td>
<td>24.9%</td>
</tr>
<tr>
<td>Vendor Credit</td>
<td>27,198</td>
<td>0.8%</td>
</tr>
<tr>
<td>Free Fill</td>
<td>30,000</td>
<td>0.9%</td>
</tr>
<tr>
<td>LEAF</td>
<td>100,000</td>
<td>2.9%</td>
</tr>
<tr>
<td>BERC Forgiveable Loan</td>
<td>200,000</td>
<td>5.8%</td>
</tr>
<tr>
<td>NCDF</td>
<td>300,000</td>
<td>8.7%</td>
</tr>
<tr>
<td>ECIDA &amp; BERC</td>
<td>360,000</td>
<td>10.4%</td>
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<tr>
<td>2nd Position Debt</td>
<td>1,017,198</td>
<td>29.4%</td>
</tr>
<tr>
<td>NCB - Equipment and Working Capital</td>
<td>480,000</td>
<td>13.9%</td>
</tr>
<tr>
<td>NCB FSB</td>
<td>1,100,000</td>
<td>31.8%</td>
</tr>
<tr>
<td>1st Position Debt</td>
<td>1,580,000</td>
<td>45.7%</td>
</tr>
<tr>
<td><strong>Total Sources</strong></td>
<td>3,456,956</td>
<td>100.0%</td>
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</tbody>
</table>
# Project Uses

<table>
<thead>
<tr>
<th>USES</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition - Land</td>
<td>618,000</td>
</tr>
<tr>
<td>Builder's Risk, Electrical Service Install</td>
<td>35,000</td>
</tr>
<tr>
<td>Construction</td>
<td>1,219,989</td>
</tr>
<tr>
<td>Equipment</td>
<td>550,000</td>
</tr>
<tr>
<td>Additional Inventory</td>
<td>110,000</td>
</tr>
<tr>
<td>Fees</td>
<td>461,025</td>
</tr>
<tr>
<td>Start-up Promotion</td>
<td>14,322</td>
</tr>
<tr>
<td>Start-up Staffing</td>
<td>14,322</td>
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<tr>
<td>Business Disruption</td>
<td>12,788</td>
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<tr>
<td>Holding/Site Costs</td>
<td>45,298</td>
</tr>
<tr>
<td>Interest during project</td>
<td>111,212</td>
</tr>
<tr>
<td>Working Capital 1st Year</td>
<td>125,000</td>
</tr>
<tr>
<td>Subtotal Uses</td>
<td>3,316,956</td>
</tr>
<tr>
<td>Overrun Allocation (10% of project costs-purchase price)</td>
<td>140,000</td>
</tr>
<tr>
<td>Total Uses</td>
<td>3,456,956</td>
</tr>
</tbody>
</table>
Risk Issues

- Store size over 3 times as big
- Added element of deli operation
- New building construction
- Limited collateral
- Recovering, but still not really strong balance sheet
- Site has limited parking
- Overall economy of Buffalo stagnant to declining
Elements of Success

• Over $250,000 in member loans raised before securing site; average size of $3,000 indicating deep member commitment

• Strong general manager with years of experience building vision and relationships

• Very strong local neighborhood market (walkable, mixed-use, lots of independent businesses); very limited competition
## Lexington Food Co-op Results vs. Projections

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</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>1,948,029</td>
<td>2,116,333</td>
<td>4,483,561</td>
<td>5,272,556</td>
<td>6,319,454</td>
<td>9,400,000</td>
</tr>
<tr>
<td>Growth</td>
<td>9%</td>
<td>112%</td>
<td>18%</td>
<td>20%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td>(5,324)</td>
<td>(238,243)</td>
<td>38,410</td>
<td>87,108</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Projected</td>
<td>3,500,000</td>
<td>4,025,000</td>
<td>4,427,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth</td>
<td>75%</td>
<td>15%</td>
<td>10%</td>
<td></td>
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</tr>
</tbody>
</table>
Lexington Food Co-op Today

Nurturing Healthy Food Financing
Happy Shoppers – 6,500 members with 20 more joining every week
Resources

Natural foods cooperatives:
- Ncga.coop
- Cooperativegrocer.coop
- Foodcoopinitiative.coop

On cooperatives, generally:
- Ica.coop
- Ncba.coop
- Go.coop

CDFIs who know co-ops:
- Cooperativefund.org
- NCDF.coop
- Leaffund.org
Additional Resources
Upcoming Winter Webinars

- **Underwriting Small and Emerging Farms**
  - November 29, 2012 @ 2pm ET

- **Financing Healthy Food Retail: Program Design and Social Impact Measurement**
  - December 6, 2012 @ 2pm ET

- **The Grocery Gap**
  - December 12, 2012 @ 2pm ET

- **Underwriting Supermarkets and Grocery Stores**
  - January 15, 2013 @ 2pm ET

- **CDFIs and Public Health**
  - January 24, 2013 @ 1pm ET

- And more...

To register: opportunityfinance.net/fhfwwebinars
Financing Healthy Food Options Resource Bank

I. Training Curriculum

- Food Systems Overview
- Healthy Food Retail Financing
- Financial Services for Mid-Tier Food Chain Enterprises
- NMTC & Urban Supermarkets
- Understanding the Grocery Industry
- Underwriting Supermarkets & Grocery Stores
- Mid-Tier Food Chain Enterprises Overview & Underwriting
- Capitalizing Healthy Food Retail Initiatives
- Identifying Optimal Areas for Supermarket Development
- Understanding the Food Production Sector
- Credit Skills for Lending to the Food Production Sector
- Food Producers Case Studies
- Identifying Partners and Convenering Stakeholders

II. Training Webinars

III. Additional Resources

- Searching for Markets: The Geography of Inequitable Access to Healthy and Affordable Food
  - Executive Summary
  - Full Report
- Financial Resources Catalogue

IV. Food Desert Mapping Tools

- USDA Food Desert Locator
- PolicyMap
Connect with OFN

http://www.opportunityfinance.net/industry/industry_locator.asp
Connect with OFN
For CDFIs: Become a Member

How to Apply

OFN welcomes all CDFIs that are committed to performance to apply for Membership. Our standards for Membership are different and generally higher than the CDFI Fund’s requirements for CDFI certification. Not all OFN Members are CDFI Fund-certified and not all CDFI Fund-certified CDFIs qualify to be OFN Members.

To apply please complete OFN’s new online membership application. You will be able to provide all necessary attachments when completing the application. If you want to work on the membership application prior to submitting it online please download a practice copy. We recognize that not all CDFIs are ready for or interested in OFN Membership. We invite these CDFIs, as well as non-CDFI organizations and individuals who support OFN's mission, to become OFN Allies.

Do you want more information?

- Download our Membership Guidelines.
- Read our Membership FAQs.
- Contact our Membership Department at membership@opportunityfinance.net.
Connect with OFN
For CDFI Partners: Become an Ally

OFN Allies

OFN Allies actively support OFN’s mission and the important work that OFN does on behalf of the opportunity finance industry. CDFIs—including those that do not currently meet OFN’s Membership requirements—as well as individuals and organizations that are not CDFIs, are invited to become OFN Allies.

Alliance benefits include:

- Participation in OFN’s policy and advocacy efforts on behalf of the opportunity finance industry.
- Policy Action Alerts at key times in the legislative process when your participation in advocacy can make a real difference.
- Regular policy updates and analysis.
- Free participation in Quarterly Ally Calls led by OFN’s policy team.
- The Member discount to attend OFN Regional meetings.
- Subscription to OFN’s E-newsletter, quarterly CDFI Market Conditions Report, and a complimentary copy of the annual Opportunity Finance Institutions Side by Side publication.
- Recognition on OFN’s Web site list of Allies.
- Allies that aspire to become OFN Members are invited to participate in Member Staying Connected calls, a valuable peer learning opportunity for any CDFI.

Annual Ally dues are $75 for individuals and $250 for organizations.

Become an OFN Ally Today.
Contact OFN

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Christy Bare, Senior Associate
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