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# Cooperative Land Purchasing and Financing Guide: Hypothetical Case Study

Granja Sol Naciente, LLC's Farm Ownership  
Application

Written by Farm Commons

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## The History of Granja Sol Naciente

Years ago, two friends began managing a community garden at a local church. Elena Cruz and Maria Lopez connected instantly after trading stories about their abuela's gardens back home. After some time, they cooked up a plan to start a community garden to carry on this tradition and eventually convinced the pastor to let them convert a grassy, sunny side yard on the church grounds into a garden space accessible to community members.

The two raised funds and community awareness for several seasons, and the community garden blossomed into a neighborhood landmark. People would stop by the garden's cooler on their way home from work to pick up some veggies, often offering monetary donations in exchange. After about two and half years, though, Maria and Elena realized that they were doing most of the work to keep the cooler stocked— weeding other folks' plots and harvesting seemingly abandoned vegetables. They both were tired from trying to fit the garden in around their full-time jobs and keep community gardeners engaged.

One sweaty summer Friday morning, Elena had a crazy idea. She had come out to the garden right at daybreak to get a harvest into the cooler before she had to leave for her paying job. She had been working quickly for about an hour on her own plot and was about ready to finish up. Then, she looked up over the rest of the garden, watching the sun finish its rise over the church's steeple, and surveyed the other plots. She sighed. There was still so much to do! And, she was pretty certain other gardeners weren't going to show up that day to harvest all the ripe vegetables for the weekend rush on the cooler.

Wishing she could stay all day to keep veggies from going to waste, she began to pack up when it hit her. What if she *could* stay all day? What if the entire garden was hers and Maria's, and they stopped trying to get other gardeners to engage? What if they really worked hard and started selling at the farmer's market and getting more than donations from neighbors? What if they could turn this into a viable business!? Elena was so excited by this idea that she immediately texted Maria that they needed to talk.

That was the seed of what is today Granja Sol Naciente, LLC. The idea was born at daybreak on a random Friday when Elena was frustrated with the endless work of the community garden.

The path to going from a charity-based community garden to a for-profit business wasn't linear or completely smooth. In the end, Elena did quit her full-time job first. After six months, they had enough experience to know that they should continue pursuing the farm as a for-profit business, and Maria went down to part-time at her off-farm job so she could start developing a CSA.

In the meantime, Alejandro, who lived down the street from the church, saw Elena and Maria changing and expanding the community garden with hand tools. He stopped by one day, offering them his tractor's use. They happily agreed. Eventually, Alejandro also started working on the farm a few days a week for a small wage—mostly running his tractor and helping out with other equipment.

The three of them began to talk about finding land of their own—where they could expand and build more infrastructure than a cooler. The church was happy to host them, but they were feeling a bit cramped by the land the church had available. Also, as they were now fully committed to being a for-profit business, it didn't feel right to be using the church property.

During this time, Maria started dating a guy named Mateo, who had taken an organic farming certificate course at the local community college and was looking for a place to test out his skills. The four of them began meeting twice a month to discuss what a collaborative farming business model could look like and what they envisioned for their lives in the next 5-10 years.

After many months of meeting and Mateo and Alejandro picking up more slack at the farm, the four of them concluded that they wanted to form an LLC and get a real estate agent to start looking for affordable, local farmland.

By this time, Elena and Maria had started the community garden four years prior, and Elena had been full-time on the farm for almost 2 years. Farmer's market sales were steady, but Elena was getting a little burnt out because she had done most of the fieldwork on her own for almost two years. In her spare time, Elena had recently taken a few food safety courses through her local extension and had learned about the on-farm processing of jams, jellies, and dried herbs. She was interested in putting effort towards developing a value-added line of products for Sol Naciente but needed help with the fieldwork to be able to make that happen.

All four of them were interested in equal ownership of the farm and were discussing ways to split duties and contributions to the business in a way that seemed fair. All four wanted to work full-time on the farm, too. A lot of planning had to be done! The first step was to write up how they were going to govern themselves—how did they make decisions? Who contributed what to the business? What happens if someone wants to leave? How do they handle conflict?

## Sol Naciente's Business Structure According to the Operating Agreement

The four friends wanted to have equal ownership and control over the business. They had always decided things by consensus but knew they needed a way to break a stalemate if one were ever to occur. Sol Naciente had some big decisions coming up (going into debt with the land purchase most prominently!), and they knew they needed a very clear, foolproof way to make decisions and resolve conflict.

So, in their Operating Agreement, they assigned each member one equal vote. In the case a unanimous decision couldn't be reached, a supermajority (75% or  $\frac{3}{4}$ ) vote would suffice for a decision to move forward. Any fewer votes and no action could be taken. However, for any decision where more than \$10,000.00 in debt would be taken on, only a unanimous vote would suffice.

The group appointed one of the four members as an authorized representative of the business for a rolling 2-year period. This duty would change every two years. The authorized representative would be in charge of signing any documents on behalf of the business, maintaining the Annual Reports, paying the annual fees, and housing the business documents and financial files. Alejandro was the business's authorized representative for the first 2-year term. The entire member-owner team had to authorize his actions at their monthly meetings. This decision was made simply to streamline business transactions. Alternatively, the group could have hired a manager to fulfill this role or required that they ALL sign for business transactions. Often, at least two people must sign to authorize payments or take on debt.

The Operating Agreement also spelled out issues like who they hired to mediate conflicts and what process was initiated if someone wanted to exit the business.

Also, in the Operating Agreement was a clear delineation of duties and responsibilities. Their end goal was for each owner to have a 'sphere of influence,' wherein that person would have decision-making control. Their interests were already breaking down along clear lines. So, for the Operating Agreement, they had to spell out what responsibilities each member-owner has. They attached self-written job descriptions to the Operating Agreement to avoid any confusion.

Here's a snapshot of how they broke down farm duties so they all had about a quarter of the business's responsibility:

Alejandro owns the tractor the farm will use and is interested in doing most of the tractor work on the farm and being responsible for maintaining it and all the equipment on the farm. He also loves figuring out plumbing issues, so he is eager to manage the irrigation system on the farm and develop a watering and fertilizing schedule for the farm.

As suggested earlier, Elena was tired of managing the fieldwork alone and wanted to turn her attention to developing a value-added product line. Maria had started the seeds of a CSA program and wanted to grow that program. Mateo was ready to increase his hours and take over the farmers' market management from Elena and

Maria. He was also eager to manage the seeding schedule and greenhouse. All four of them collaborate on the production schedule, cultivation, harvesting, and post-harvest activities as needed. In short, they developed what they consider to be an even split of duties and responsibilities where everyone has their own area of control. For example, Thursdays are CSA pack days, so Maria lets the others know at the Monday weekly meeting when she needs help harvesting and how many people she might need to help with packing boxes on Thursday. Likewise, Mateo plans what he will take to market and organizes Friday's harvest and pack list.

An issue related to the ongoing breakdown of duties and responsibilities is how much each member-owner initially contributed to the business. The group decided that the contributions needed to be equal, as does the ongoing work of the farm. Elena's two years of managing the fieldwork on her own earned her a contribution of 'sweat equity,' as she was making very little money during that time and really contributed a lot to the initial growth of the business. Alejandro retitled his tractor into Sol Naciente's name, which was sufficient for his portion of initial business capitalization. Maria had added a lot of value to the farm with labor in the early days, building a reputation at the market and supporting the birth of Sol Naciente. Her sweat equity contribution wasn't as high as Elena's, so she also offered a cash payment to "buy in" to the business. Mateo bought into the business with a payment of cash.

## Why Form an LLC?

We already know the group decided to form an LLC. But how did they come to this conclusion?

Alejandro owned a house down the street from the church and had savings from his off-farm job that he was nervous about losing. Farming full-time still seemed like quite a risky venture to him. He had heard somewhere that working with folks without creating a formal business structure was legally and financially risky. He didn't understand exactly why, but he knew enough to know that his own savings and property might be at risk if they didn't file to be a formal business. He was definitely the most risk-averse

of the group and suggested early on that they start to look into forming a business structure that could limit their personal liability if anything were to go wrong at the farm.

Elena immediately jumped in to support Alejandro on this because she was already thinking about the risks value-added products might add to the business. She had already started looking into insurance for the cottage foods she wanted to produce, but she was also supportive of the liability protection a business structure provides.

Working with others without a formal business structure means you have formed a **general partnership**. These entities can have **partnership agreements**, but the general partnership does not protect personal assets from business liabilities.

Maria and Mateo were less concerned about liability protection since they both still rented and didn't have extensive savings. They were on board, though, because forming a business structure created an air of seriousness about the business. They were very invested in ensuring everyone was committed to this new collaborative farm business!

In the beginning, the group considered maintaining the charity-based beginnings of the farm and creating a non-profit, educational farm that still provided free vegetables to the community. They also debated the benefits of choosing not to file for a formal business entity, which mostly amounted to not having to pay the state an annual fee. Corporation, cooperative, LLC? They considered it all!

In the end, they chose the limited liability company (LLC). This was the easiest business structure to form, and they found out, after consulting with a business coach, that an LLC could be structured much like a cooperative. Their governance document – the Operating Agreement– could spell out how they will fund the business, what happens if someone wants to leave, what needs to be done if they want to purchase big assets, and so much more! This document could be changed as needed. They all like the flexibility the LLC structure offers. In their state, the annual fees are \$300/year. They decided they would continue to work on developing their governance document in their bi-monthly meetings but would wait one more year to file for their LLC. That is, unless they found the perfect property they wanted to buy before then!

## Finding Their Property

About nine months later, their real estate agent called them about a piece of property on the higher end of their budget at \$300,000.00. This property had an eight-acre field, with two more acres on the north side that hid a small pond under some scrubby overgrowth and was capped by a stand of hardwoods on the northern property line. Maria and Mateo were very excited about this property, especially, because they could envision building a little house just to the side of the pond after clearing away some of the scrubby overgrowth. Furthermore, the land was just a mile from the church, and the farm could continue serving the same community.

Both Alejandro and Elena were settled in their separate homes and weren't interested in living on the farm, so this property seemed to suit everyone's needs. The goal was to do intensive market gardening, and even with four owners, they didn't anticipate ever needing to cultivate more than six acres. After positive results from a soil test, they were all in!

As soon as they felt confident about the piece of property, they told Alejandro to go ahead and file their LLC with the state. They knew they'd need the banks and institutions they would be working with to perceive them as a single unit, so they knew it was time to start coughing up those annual fees. After having met so many times, they had made a lot of decisions about governance, so writing the Operating Agreement was a pretty straightforward process.

But the group needed financing. They didn't have enough money to pay for the land outright. Alejandro and Elena both spoke to their banks and got bad news back—one bank refused to work with a group such as theirs, calling it too risky, and the other bank offered a loan at an outrageously high interest rate. With that, the group headed over to talk to their local FSA Loan Officer.

## Approaching FSA

Sol Naciente scheduled a meeting with their local FSA Loan Officer to discuss a Farm Ownership loan. Before going into the office, they read this guide and FSA's "[Your Guide to FSA Farm Loans](#)." Here's a list of items everyone gathered up to bring to the meeting:

1. The LLC's Operating Agreement,
2. The business account's bank statement for the last two months,
3. Sol Naciente's past three Schedule F forms,
4. Sol Naciente's business plan and sales records,
5. Sol Naciente's profit and loss statement for the previous year,
6. Documentation of annual business expenses for the last three years,
7. All four members also brought their personal bank statements for the past two months and pay stubs from the past two months,
8. All four members brought identification—including documentation of citizenship,
9. All four members brought a summary of their personal annual expenses and their overall net worth.

All the business records were together in a three-ring binder. Each individual owner of Sol Naciente organized their own personal documents.

These four friends knew what they were attempting was unconventional. Most farms are run by a single person or a married couple, and this is what financial institutions have come to expect. They wanted to be very prepared to speak with the loan officer. Two of them had already talked to their own bank and applied for loans, so they shared their wisdom with the group as to what to expect. The group was anxious because they knew the loan process could take a long time with the FSA. Being hopeful that they could get a low-interest rate and buy this land, they were ready to move forward!

Maria spoke to a farmer friend whose land was financed through an FSA loan to get some insight, though that person wasn't part of an entity application. The information she gathered was still helpful, though. The group wanted to have a clear idea of what to expect from the FSA so they could spot issues if the process starts to go off the rails.

## How Would Sol Naciente's Application be Processed?

The actual applicants for the FSA Farm Ownership loan would total five! Granja Sol Naciente, LLC would be one, and the four individual members would be the other four 'applicants.' This is because the LLC is applying for the loan, but each individual owner of the LLC must agree to **personally guarantee** the loan. In the end, the agent of the LLC and each of the four individual members will sign what is called the **promissory note**.

A promissory note is a document in which one party (or several) agree to pay an amount of money to another under the terms and conditions specified in the document.

You might be saying, wait! Isn't that why they became an LLC in the first place so that they wouldn't be personally liable for business debts!? Well, yes. But, in some instances, there are institutions with the power to ask owners to waive that protection.

It is very difficult for a business to build enough of its own credit to be able to secure a loan without a personal guarantee from some or all of its owners. No financial institution will agree to loan money if they don't think they will be able to recover the loaned money later. In the case of land financing, it is very common for business owners to have to personally guarantee the loan. And, yes, that means that if the business cannot repay the loan, the FSA will come after each of the individual owners (and their personal assets) to fulfill the loan obligation. This is a trade-off of getting financing!

On paper, however, the 'borrower' will be **Granja Sol Naciente, LLC**. Remember how Sol Naciente decided to appoint one member as the company's authorized representative for two years? That means that the person who is currently the authorized representative (Alejandro) would sign on behalf of the LLC to bind the LLC on the promissory note. In effect, he would be signing first as "**Alejandro Reyes, Owner and Authorized Representative of Granja Sol Naciente, LLC.**" and then again as, simply, "Alejandro Reyes." He is signing as the Authorized Representative the first time and the second time, just as himself—that's that personal guarantee. All the other owners will sign as themselves, with no fancy titles, just their names.

In the list of documents that the group prepared to bring to the meeting with the FSA, you'll see that they all gathered their citizenship and credit-related documents. All four individuals of Sol Naciente must be (and be able to provide documentation of being) a US citizen, noncitizen national, or qualified alien,' such as a lawful permanent resident. Review Section 2, Criterion 1 of this guide for more detail on what type of documentation is sufficient.

Furthermore, each owner's credit will be reviewed. That means the FSA Loan Officer will review bank statements and will pull a hard credit report on each owner. FSA will need written permission to do this and will use either a social security number or your name, date of birth, address, and employment history to verify identity with one of the major credit reporting agencies. The owners of Sol Naciente would need to make sure that none of them have any of the additional disqualifying aspects to their history, including:

- Convictions for controlled substances
- Age younger than 18 or suffering from mental incompetency,
- Delinquency on federal debt,
- Outstanding judgments, or
- Had an FSA FO loan previously or within ten years.

As far as the business's creditworthiness, FSA will review the business's profit and loss statements, business expenses, and Schedule Fs that have been filed in the last five years. The business doesn't necessarily have to be returning a profit, but if it is not, then there must be a strategic plan to do so within the foreseeable future. In short, the FSA has to have faith that the business model will yield enough money to repay the loan and continue to sustain the business. Accurate projections of yield and income from sales will be paramount here. Sol Naciente is an intensive market farm, which isn't as common for FSA. Strong sales records and market research for any projections must be provided in this case.

FSA is concerned as well with something they call **proportionality**. This looks less at profits and more at gross income. The FSA wants the gross income of Sol Naciente to match the annual payment of the farm's mortgage. In this way, the business' income will be considered *proportionate* to the purchase price of the land. For a purchase price

of \$300,000.00, Sol Naciente can estimate that they must gross at least \$30,000.00 to qualify for a FSA loan. More is better! The group is eager to speak to their Loan Officer about how they can help prove the business is financially sound enough to support FSA's extension of credit.

One question that will come up for the group is: who will actually own the land? What we mean here is whose name or names will be on the **deed** to the land? There are several options here, which is great because we know that Maria and Mateo have plans to build a house in the wooded area of the property.

The **deed** to land is a document that lists the owners of the land. This is the document that grants exclusive rights to a piece of property!

FSA would allow Sol Naciente to form a separate LLC to hold the land. However, if this is the strategy, no members who aren't in Sol Naciente can be added to this new, separate, land-holding entity. However, that doesn't mean that every Granja Sol Naciente, LLC member must join the new separate land-holding entity. The rule is that if a land-holding entity were to be formed, the resulting owners of that entity must also own 50% of Granja Sol Naciente.

The land could also be owned by individual members of Granja Sol Naciente in any combination. However, the owners of the land financed by the FSA FO loan must also own at least 50% of the operating entity. Therefore, in this scenario, unless ownership in Granja Sol Naciente shifted, at least two members would need to hold title to the land.

We know that Maria and Mateo want to build a personal residence on the land. Because of this, they would like to have the land deeded to them personally and lease the farmland to Granja Sol Naciente via a long-term lease. That way, the farm's biggest asset, the land, is held as a personal asset of two of its members. The farm's use of the farmland is protected by a long-term lease. The group will have to decide how payments for the loan are handled if this were the set-up. The farm would pay Maria and Mateo rental installments that could be used to pay mortgage installments to FSA. Maria and Mateo would also likely be responsible for a greater share of the mortgage since they would have exclusive rights to the non-farmland portions of the land.

This setup does meet the FSA's 50% requirement. Maria and Mateo each own 25% interest in the business, so together, they own 50% of Granja Sol Naciente.

## What if the Ownership of the Business Changes?

Say Alejandro got offered a lucrative off-farm job and wanted to remain a member of Granja Sol Naciente but could no longer participate in the farm's day-to-day operation. Due to his new job, he could no longer contribute labor to the business but wanted to remain an owner. He continued to maintain the equipment during off-hours or on weekends. In order to account for his absence, the other owners decided they would shutter their farmers' market sales and concentrate on building up the CSA program. No longer compensating Alejandro for labor (though he is still entitled to a share of the profits), the farm can now hire a laborer to help pick up the slack in irrigation planning, planting, cultivation, and harvesting that Alejandro's absence created. Would their application have been affected if Granja Sol Naciente had been structured this way when applying for the loan?

**No, this wouldn't impact the loan.** But, this is true only because Alejandro's ownership only accounts for  $\frac{1}{4}$  of the operation. If anyone in Alejandro's position (an owner but a non-operator) owned more than 50% of the farm, then the application would not meet the 'family' farm definition for entities. Recall from the guide that in order for an entity to meet the definition of 'family farm,' the majority interest owners (at least 50%) must be farm operators.

If the loan is secured and then Alejandro steps back, the farm still meets the definition of a 'family' farm. The operational decisions and strategic management decisions are made by the members of the entity. Alejandro stepping back is only 25% of the ownership. If three of the members step back and leave only one member operating the farm, then that is an issue that would need to be resolved with the FSA loan officer.

## What if One Member Had Wanted to Own the Land?

If, say, Mateo wanted the deed to the farm they are purchasing to be in his name alone? This might be desired because he planned to build a house where he would reside on the land and wanted to lease the farmland to Granja Sol Naciente.

**This would cause an issue with the loan.** Remember that the deed must be either to the entity itself or the majority-interest-operators of the farm. Mateo could be on the deed, but not alone.

## Does Every Member Have Farm Experience Enough to Satisfy the FSA?

In the case of entity applicants, this criterion requires that the majority interest holders of the entity must have participated in the business operations of a farm for at least three out of the past ten years. Let's see how this group stacks up.

With four members owning 25% each, we need two of them to have the requisite managerial experience.

Elena and Maria had just celebrated the three-year anniversary of starting and running Sol Naciente together. All the Schedule Fs that Sol Naciente filed showed both of them as owners.

Alejandro had only been working at Sol Naciente for two years, but he had significant management experience in a non-agricultural field where he managed personnel decisions, payroll, and inventory. This latter quality is one that can substitute for one of the three years. Therefore, Alejandro also meets the managerial experience criterion!

Mateo has worked on the farm for a year and a half, just a little less than Alejandro, but also has an agricultural degree from the community college. If the degree includes at least 16 credit hours, Mateo can substitute one of the required three years with that coursework. Unfortunately, though, he isn't quite at two years experience at Sol Naciente, so he doesn't fulfill the managerial experience requirement.

However, this is not an issue for Granja Sol Naciente, LLC's entity application because 75% of the owners fulfill this requirement.

## What if Sol Naciente Wants to Hire More Labor?

Eventually, Sol Naciente may want to hire more labor to get the work on the farm done. To remain within the definition of a 'family' farm, full-time hired laborers (that aren't owners) are allowed to supplement labor by the entity owners. Market farming is very labor intensive, and Elena starts to wonder what will happen if they hire more than just the one laborer who replaced Alejandro. She can anticipate needing to hire at least two other hands, which would mean there would be three owners working on and managing the farm and three hired laborers supplementing that work. When does 'supplementation' become replacement?

The FSA loan officer will have discretion here to determine if the 'family' farm is outgrowing its family-like nature. There are written policies that allow farms producing high-value, labor-intensive crops like specialty fruits and vegetables to be granted exceptions from the supplementation-only labor rule. This should be a discussion Elena (and other owners) have with their FSA loan officer during the application period so that they fully understand the labor limitations, if any, that will be placed on them in the future.



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