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Local Foods

A Guide for Investors & Philanthropists

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Introduction

Enthusiasm and demand for locally grown food has increased tremendously in recent years. The rapid growth of farmers' markets, community-supported agriculture farms, and top selling books on local food and farming systems are strong indicators of this rising demand. As both an emergent industry and an important social and environmental movement, local food systems are beginning to catch the attention of profit-seeking and philanthropic investors alike, as well as existing food businesses considering greater participation in this sector.

Given how quickly the local food movement is developing, it can be challenging to characterize the state of the industry. California Environmental Associates (CEA) has assembled the following analysis of the local food supply chain, in the hopes of distilling the opportunities we see for investors with discrete goals.

This paper outlines the opportunities in each of the major steps along the food supply chain: production, processing, distribution & aggregation, sales & marketing, and retail. Table 2 provides a summary. The analysis is informed heavily by three local food economy assessments (in Vermont, New Orleans and Wisconsin) which CEA conducted on behalf of Slow Money. It has also been informed by past engagements with investors and intermediaries working across the food chain with a broad range of objectives (e.g. the Walton Family Foundation, Roots of Change Fund, California Fisheries Fund, and the Sea Change Investment Fund).

Note: California Environmental Associates is not a financial advisor. The material contained in this paper should not be considered financial advice.

Overview

Local food markets are booming across the U.S. Farmers' markets have nearly tripled since the mid-1990s, growing from 1,755 in 1994 to 4,685 in 2008, and this growth rate doubtless understates the rise in aggregate gross sales at these markets.¹ Community-supported agriculture farms (CSAs) have grown from one in 1986 to an estimated 600 in 1996 to over 4,000 in 2007.² A few regions in the country are poised to begin filling wholesale supply chains with locally grown food, offering grocery stores, food service providers, and restaurants a reliable supply of local product, and potentially converting a significant share of household food expenditures from conventional to local foods.

Simultaneously, a wide number of stakeholders have realized that the growing financial toll attributable to unsustainable environmental practices in large-scale monoculture systems is too onerous to bear. Top soil stores depleted from erosion and over-fertilization, waterways contaminated from pesticide and fertilizer run-off, and crops that are losing natural disease resistance due to decreasing wildlife habitat and biodiversity in farm environments are increasingly adding real costs to our agricultural sector. Additionally, current agricultural practices contribute significantly to our country's greenhouse gas (GHG) emissions profile. In the U.S.,

the agricultural sector is responsible for 6% of GHG emissions, primarily from soil and manure management. An additional 17% of U.S. emissions come from land use, land use change, and deforestation.³ These carbon inventories do not include the energy used by farm equipment or in transporting the average American meal 1,500 miles from field to plate.⁴

Advocates of local foods see a number of social and environmental benefits to small-scale, diversified food systems including: improved habitat health (soil, air, waterways, and wildlife), enhanced viability of family farming and rural communities, and biological and economic diversity and resiliency. That said, "local" does not necessarily equate to "sustainable." For example, there are many sustainable food systems that are not geographically limited in their markets (e.g. Alaska's wild salmon fishery), and there are many farms selling to local markets that are not committed to sustainable practices. Sustainable food production explicitly calls for long term stewardship of environmental, financial, and human resources. Though local food production does not explicitly embrace the sustainability mandate, it is often broadly aligned, and for purposes of this paper, we have assumed such general alignment.

Slow Money

Launched in 2008, Slow Money is a rapidly growing network of local foods investors and entrepreneurs. Slow Money's mission is to:

- Steer significant new sources of capital to small food enterprises, appropriate-scale organic farming and local food systems; and,
- Catalyze the emergence of the nurture capital industry—entrepreneurial finance supporting soil fertility, carrying capacity, sense of place, cultural and ecological diversity, and nonviolence.

Inspired by the vision of "nurture capital" presented in *Inquiries into the Nature of Slow Money: Investing As If Food, Farms, and Fertility Mattered*, written by founder Woody Tasch, Slow Money is bringing investors together across the country, asking new questions about the

relationship between capital markets and soil fertility, and exploring strategies for investing in local food systems. Its Slow Money Alliance has 800 members and 165 Founding Members who helped launch the organization during its first national gathering in Santa Fe, New Mexico in September 2009. Slow Money chapters are emerging in a number of regions and several Founding Members are exploring the feasibility of regional slow money funds.

Slow Money may soon be raising for-profit capital for a "micro" fund-of-funds as well as philanthropic capital to support its network building activities.

Source: *Slow Money marketing materials & Slow Money Alliance website* <http://www.slowmoneyalliance.org>

Even though consumer interest in local foods is growing, the field is still in its infancy, and has yet to reach the radar screens of most philanthropic and profit-seeking investors. As such, this paper will focus explicitly on growth and investment opportunities in local foods.

As the local foods sector grows, it will offer fertile ground for both philanthropic and profit-seeking investors, who will likely find opportunities across the supply chains of a range of food sectors in regional markets around the country. One entry point is Slow Money, a rapidly growing network of investors and entrepreneurs seeking to catalyze investments into local food enterprises around the country.

Some investors will see local foods primarily as an important environmental and social movement and ask, “What needs to be done to enhance the local food system and secure its benefits for the greater good?” Others will see it as an emerging industry and ask, “How can I participate in the growth of the local food economy in order to achieve compelling financial returns?” We believe strongly that there is room for investors across this wide spectrum to play a collaborative and constructive role, and this paper attempts to distill the opportunities we see for investors with discrete investment goals.

¹ USDA, Farmers Market Growth: 1994-2009.
<http://www.ams.usda.gov/AMSV1.0/FarmersMarkets>

² Phone interview with Erin Barnett, Local Harvest.

³ US EPA, 2009 US Greenhouse Gas Emissions and Sinks: 1990-2007

⁴ <http://www.nrdc.org/health/foodmiles/>

Table 1. Financial Tools: Spectrum of Returns

-100%	1-5%	5-10%	10-15%	20-30%
<p>Grants</p> <ul style="list-style-type: none"> • programmatic alignment • tax benefit 	<p>PRI's</p>	<p>Conventional and Unconventional Debt: senior debt, subordinated debt, mezzanine debt</p> <ul style="list-style-type: none"> • asset base • consistent cash flows • long operating history • strict financial covenants 		<p>Risk Capital: convertible debt, common stock, preferred stock</p> <ul style="list-style-type: none"> • negative cash flows in early years • strong growth potential • willingness of owner to sell equity and share operational / governance decisions

Grants

Grants can only be made to non-profit organizations and should be used to support discrete market building activities that would otherwise be unfunded.

Program Related Investments (PRIs)

As the name implies, PRIs were developed as a way for the programmatic arms of foundations to make for-profit investments related to their programmatic goals. PRIs can be made into any revenue generating operation using a for-profit, non-profit or cooperative structure. Investments must offer below-market returns and are often structured as loans and made into businesses that are unproven, high risk, and have high social/environmental value.

Conventional Debt

Conventional debt of all kinds (senior, subordinated, mezzanine) can be invested into businesses with a range of corporate structures (for-profit, non-profit, cooperative). Investments are structured to receive market-rate returns and in most cases are made into stable, low-risk businesses with strong cash flows and/or strong asset bases.

Unconventional Debt

Unconventional debt is usually structured in the same way as conventional debt, but is focused on niche borrower groups that may not be able to access conventional debt products because their businesses or markets are not well understood. Lenders who develop debt products tailored for specific market segments may be able to reduce risk in a variety of ways, or may offer concessionary debt in exchange for high social/environmental returns.

Risk Capital

Risk capital describes the range of investment tools that require an ownership stake in the business, or the option for one. The most common forms of risk capital are equity investments through common and preferred stock offerings. Convertible debt or debt with royalties are also options for early stage businesses. Because ownership is required, risk capital can only be used with for-profit businesses, and with founders who are open to sharing governance.

Production

As agricultural production has evolved to serve regional, national, and global markets over the last several decades, most producing regions in the U.S. have narrowed their focus to a few commercial items. This focus allows them to take advantage of their most dominant agricultural assets and to participate in increasingly global markets (e.g. dairy in Wisconsin, shrimp in Louisiana, apples in Washington, hogs in Iowa, citrus in Florida). Outside of those historically dominant crops, commercial production has fallen off precipitously. What little “non-core” production remains is sustained primarily at the household level.

As demand for locally grown food rises, and concern over the preservation of America’s agricultural roots and rural communities grows, two parallel imperatives have emerged: 1) the need to diversify regional production; and 2) the need to stem the attrition of existing farmers.

Diversify regional production

The rising demand for a range of local products and the interest of many stakeholders in having regional growth tailored to a large number of small- and mid-scale farms requires a generational investment in farmers and their practices. In order for farmers to build successful local production systems, training must focus not only on the recovery of agricultural skills that have been de-emphasized over the years, but also on the latest research and best practices in sustainable and organic farming. Additionally, it is critical that prime agricultural land threatened by development is preserved so that urban markets can continue to be served by nearby farms.

Stem the attrition of existing farmers

With increasingly global competition, leading agricultural sectors across the U.S. have seen tremendous consolidation of production over the past few decades. While some small-scale farms have been buoyed by direct markets, mid-scale farms that are too big to be supported by local markets and too small to compete on price with global commodities, have been disappearing. The challenge is to stem further consolidation by developing alternative markets that can provide premium prices to producers for environmental, health, taste, or locality attributes. Since many small- and mid-sized producers can no longer compete on price as a global commodity, they must

begin to compete on quality. Hope lies in taking these producers “off the grid”⁵ by developing specialty markets for their products along with supply chains that are able to retain the higher value product attributes. Mid-scale farms, or “agriculture-of-the-middle,” in particular, require not just an expansion of direct markets, but a significant scaling-up of local and regional wholesale markets and “mid-scale food value chains.”⁶ While this transition primarily requires investments in processing, distribution, and marketing, there are a few important ways to invest in the production base of these sectors.

Financing Options

Philanthropic investments

- Support technical assistance, training, and business planning for farmers to accelerate the growth and success of a diverse producer pool at the regional level.
- Support technical assistance and training to help the production base of large commercial crops develop a range of sustainable practices (e.g. help producers transition to organic dairy, grass-fed beef, sustainable fishing practices, etc.)
- Support research on regionally-appropriate crop development and sustainable farming practices.
- Support working lands conservation by donating directly to land trusts or by lobbying state and federal agencies to increase conservation funds that land trusts can leverage.

Conventional and unconventional debt or PRIs

- Lobby governmental agencies to increase below-market rate loans available to young or new farmers, and/or farmers transitioning to more sustainable practices.
- Encourage the federal government to remove subsidies that create harmful market distortions. In 2008, the United States Agriculture Department (USDA) spent \$5.18 billion on direct and countercyclical payments to eligible commodity crops including wheat, corn, rice, and soybeans.⁷ If just 1% of this capital base was shifted to provide loan guarantees, \$500 million could be made available to farmers pursuing local markets

and sustainable practices (assuming a 10:1 leverage on a loan loss reserve of \$50 million).

- Enhance the capacity of the few non-profit financial services providers (e.g. Northeast Organic Farming Association of Vermont, Seedco Financial, California Fisheries Fund, The Carrot Project) that offer unique debt products to the sustainable foods industry.
- Support locally-oriented producers with direct loans or loan guarantees that can help them secure additional financing for farm-based businesses or for farmland. There is a growing opportunity for conventional lenders (commercial banks, community banks, agricultural lenders) to develop programs specifically for new growers, growers transitioning to organic, or transitioning gear and practices for better sustainability outcomes. With some effort to better understand the relevant markets, such programs could fit within conventional lenders' risk/return frameworks.

Equity investments

- Invest in companies that are poised to develop high-value markets for a large number of growers.
- Make direct or indirect investments into farmland. Investors could work with land trusts to facilitate a transition between farm owner-operators by buying at-risk land and holding it until conservation and/or agriculture buyers can be identified. Alternatively, investors could buy and hold land, earning a dividend from leasing to a farm enterprise. The latter model

is being pioneered by Wisconsin-based New Spirit Ventures and California-based Farmland LP.

Investments by existing businesses

Existing food companies whose supplier base includes farmers might extend loans, or favorable payment terms to those that meet locality and/or sustainability criteria.

⁵ A term Richard McCarthy, Executive Director of the New Orleans-based Marketumbrella, used to describe their efforts to help Louisiana shrimpers find premium and direct markets through, for example, their White Boot Brigade program.

⁶ See <http://www.agofthemiddle.org/>

⁷ USDA FY 2010 Budget Summary and Annual Performance Plan. <http://www.obpa.usda.gov/budsum/FY10budsum.pdf>

New Spirit Ventures UPPER MIDWEST

New Spirit Ventures, LLC (NSV) is a start-up financial intermediary focused on facilitating farmland access and preservation. NSV plays a unique role by connecting values-driven investors with sustainable and organic farmers to provide land-security through long-term lease agreements, land preservation through partnerships with land trusts and conservancies, and reliable returns for investors through careful due diligence and deal structuring.

To date, three pilot land transactions have been completed: two in Minnesota and one in Iowa. All three land purchases were made by a single investor, who now has

direct ownership in three separate land parcels valued at about \$1.5 million and encompassing 435 acres. Long-term leases are in place with three different farmers, paying on average 4% in cash rent.

NSV has played a brokering role in the transactions to date, but is conducting research on launching a non-profit investment fund.

Source: New Spirit Ventures marketing materials

Processing

Growth in local foods to date has been dominated by fresh fruits and vegetables, products which by definition do not require processing. However, dairy, meats, seafood, and value-added fruit, vegetable, nut and grain products do require processing, and local foods pioneers in these sectors have often found processing to be a bottleneck. Though additional capacity is necessary, it will be important to manage the growth of this capacity to avoid tying up capital in idle or highly-seasonal assets. It will be important to thoroughly inventory existing assets on a regional basis before making investments. Where new processing is in fact needed, opportunities exist for a range of investors.

The challenges, needs, and opportunities for processing vary greatly by food sector as well as by region.

Dairy

In recent years, a range of specialty and artisanal dairy products have grown in popularity: milk, yogurt, butter, ice cream, and, perhaps most significantly, cheese. Specialty and artisanal dairy businesses are important growth sectors because they provide premium markets for dairy farmers. Critical players will be small- and mid-scale processors that can either provide custom processing for specialty dairy brands, or through their own brands, can provide a market for dairy farmers in their region.

Meats

Though meat processing capacity varies widely by region, it has become a major bottleneck for local meats as most of the country has seen several decades of decline in small-scale operators. Meat processing is heavily regulated, capital intensive, challenged with thin margins, and often plagued by seasonality. However, maintaining and growing viable small- and mid-scale processing options is critical for local meats. This is because large-scale meat processors will typically not do custom jobs or offer transparency, animal identification, or dedicated services for natural, organic, and grass-fed meats. As demand for these types of meats grows, opportunities for processors dedicated to local markets and sustainable practices should grow as well. A number of hurdles must be overcome to ensure the financial health of small- and mid-scale meat processors: 1) ensure effective implementation of the new federal law that allows meat from state-inspected facilities to be sold across state lines; 2) help producers deliver a consistent supply of meat, so that processors face less severe seasonality; 3) develop markets for end cuts of meat to increase the profitability of each animal; and 4) rebuild a skilled labor pool. None of these efforts necessarily require direct investments into meat processing facilities. Yet, each could significantly improve the economics of small-scale meat processors, making them more financially sustainable and able to access conventional sources of capital.

Vermont Smoke and Cure SOUTH BARRE, VERMONT

Vermont Smoke and Cure (VSC) operates a small (3,000 square foot) smoke house that has been in operation since 1962. In recent years, new management has been growing revenues, now running at an annualized rate of \$2 million. VSC has a dual mission of continuing smoking services for local farmers and creating a strong market for Vermont's end cuts – smoked ham, bacon, sausages, hot dogs, and pepperoni – through its brand, Vermont Smoke and Cure. In order to support the growth of its branded products and increase its profitability, the company is looking for financing to move into a 14,000 square foot

facility. According to CEO Chris Bailey, “Vermont and New England as a whole are in dire need of processing facilities at a scale that can be more efficient and enable products to get to market reliably and at lower prices. Improved access to equity capital is crucial for this.”

Source: Interview with CEO Chris Bailey and Vermont Smoke and Cure website - <http://www.vtSmokeandCure.com>

Seafood

Over three-quarters of the seafood in the U.S. marketplace is imported, largely from the Asia Pacific region. Given the enormous demand for seafood in the U.S. and limited domestic production of the most popular seafood items, such as farmed shrimp, this ratio is unlikely to change much in the near term. Nevertheless, it remains important to develop reliable markets for locally-caught seafood in coastal communities, for example, through community-supported fisheries (CSFs). Similar to the CSA concept, CSFs provide fresher seafood to consumers while ensuring a higher price for fishermen by taking out the middleman. When fishermen get higher prices for their catch, they can afford to fish less aggressively. Fishing cooperatives that supply certain CSFs require members to use more sustainable fishing methods.

However, many U.S. cities do not have the luxury of sourcing local seafood. Instead, consumers, investors, and companies working along the seafood supply chain should focus on implementing strong sustainability practices: sourcing from healthy fisheries, developing transparent chains of custody, and educating institutional buyers and end customers. Investments into companies that are developing strong sustainability practices, and NGOs that are supporting the field will help improve the environmental health of the seafood industry.

Fruits and Vegetables

Few regions have robust markets for downgrade, local produce for use in value-added products (soups, sauces,

ciders, jams, etc.) It is unclear if the economics for such products are viable as they are still unproven at any significant scale. Developing processing options and finding or building markets for such products will likely be most viable where there is a reasonably high volume of product. For example, where once-strong industries have been flagging and tend to over produce their fresh markets.

Grains

Grains have become the quintessential large-scale commodity crop. However, the value-added portions of the supply chains of a few major grain-based sectors have disaggregated considerably in recent years with the rise of craft brewing and artisanal bakeries. These niche sectors are potential markets for small-scale or heirloom grain producers and processors. Craft brewing in particular offers a promising market for small-scale grain production given the higher-value nature of the sector and the general loyalty consumers provide to local breweries. A few craft brewers around the country are beginning to experiment with locally-grown wheat, hops, and barley. For example, Madison, Wisconsin's Capital Brewery has recently developed a beer called Island Wheat, made with wheat from Washington Island, Wisconsin. In its first year of production, 2005, Island Wheat accounted for a 20% growth in Capital Brewery's revenues.⁸ "Island Wheat has had a very favorable impact on our image, the growth of our brewery, and the Washington Island psyche and economy," explains brewmaster Kirby Nelson.

Driftless Foods HIGHLAND, WISCONSIN

The Iowa County Area Economic Development Corporation (ICAEDC) in Wisconsin is incubating Driftless Foods, a business dedicated to local food processing. The company's first project, which is far along in the planning stages, is an individual quick freeze (IQF) facility that it hopes will support the expansion of the local produce market. The IQF facility should help institutional buyers in the region access affordable, storable, local produce, while creating a market for downgrade crops that are currently composted, thus improving the utilization of farmers' assets and working capital.

- The IQF facility plans to process approximately 1 million pounds of food in its first year of operation.

Driftless Foods has letters of intent and verbal commitments for most of the first year's output.

- The smallest vegetable processing plants currently operating in Wisconsin produce approximately 1 million pounds of food per day. These facilities typically contract with farmers in >60 acre increments.
- Downgrade crops that never get harvested currently comprise approximately one-third of total crop.

Source: Interview with Rick Terrien - Executive Director, ICAEDC

Contract packers

Contract packers (co-packers) are food manufacturers who produce packed food products. Consumer brands that have strong sourcing requirements but that do not wish to invest in their own processing capacity require co-packers who can meet their needs. Currently the field is limited. There is significant opportunity for co-packers to improve and expand services to local and sustainability-oriented food brands and to help increase the transparency in the food supply chain.

Financing Options

Philanthropic investments

- Support technical assistance and training to help build a strong labor pool where labor is a constraint (e.g. meat cutting).
- Support technical assistance, business planning, and product development for producers looking to transition from commodity production to specialty production (e.g. Wisconsin's Dairy Business Innovation Center).

Conventional and unconventional debt or PRIs

Because of the asset base inherent in processing companies, they are usually able to secure bank debt. New facilities that are located in under-developed communities are often eligible for low-interest loans or tax-breaks from a range of government programs. Mission-oriented investors may find investment opportunities with high potential for social/environmental impact where their

concessionary investments can be used to buy down the risk for other more conventional investors.

Equity investments

- Processors that require specialized or “special use” facilities and equipment can find that they are not able to use these assets for collateral. This limitation on their ability to secure debt, combined with their high capital needs, means that their businesses will require equity investments. However, equity investors often shy away from this part of the supply chain since the growth potential of a processing facility is typically limited by the capacity of its facilities and operating margins tend to be thin. Herein lies an important challenge for mission-oriented investors who might use their funds to help attract conventional lenders.
- Businesses that are vertically integrated, combining sales and marketing with processing, and possibly other parts of the supply chain, may prove to be attractive equity investments.

Investments by existing businesses

Existing processors might also invest in dedicated services for local producers, as this sector may represent a strong and growing market.

⁸ Phone interview with Kirby Nelson, Capital Brewery.

Distribution & Aggregation

The local food systems that have developed so far have relied primarily on the direct markets and short supply chains of CSAs, farmers' markets, u-pick farming, and those restaurants and natural food coops that are willing to engage in direct relationships with farmers. Sophisticated aggregation and distribution models are the crux for growing beyond direct markets and accessing a wider range of wholesale markets. Distribution models that can handle a disaggregated production base and still meet the needs of most grocers, food service providers, and restaurants are a major challenge for the local food industry. Most wholesale markets require a certain level of infrastructure from their suppliers, including food safety assurance, packing and labeling, insurance, consistent quality, and reliable volumes. This level of infrastructure can be prohibitively costly for small-scale growers. Some economies of scale are necessary given the capital requirements of running even a small fleet and warehouse (let alone a technologically sophisticated operation), and the importance of keeping the trucks and coolers full to make such investments profitable. Small farmers and community-oriented retailers are likely best served by distributors that have moved beyond grassroots. As with other nodes on the food supply chain, there is a need to (re)build mid-sized distribution businesses, especially companies that can provide a reliable service at a scale between direct farm delivery (CSAs) and the major natural foods distributors.

Development of this kind is most critical for fresh products as many specialty products are less dependent on trucks and local markets. Specialty cheeses, meats, and grocery items can be more easily shipped than fresh produce, and may be able to better access existing specialty distributors or distributors who serve a wide range of natural foods markets (e.g. Tree of Life, UNFI)⁹. However, in most markets there is plenty of room for improved distribution and brokerage services for specialty goods as well.

Though the critical question for this node on the supply chain is "who drives the truck?" there are a host of innovative and important efforts underway across the country to improve distribution efficiencies and information flows for local markets, independent of and complementary to the actual movement of goods. Produce auctions, collective restaurant purchasing, online data exchanges, collective producer aggregation and marketing, technical assistance, farm-to-chef networks, and other efforts are often vital to effective distribution of local foods.

While a number of successful distribution companies that service local food economies do exist, few models have been effectively replicated to date, and no region can yet claim significant penetration into mainstream wholesale markets. Distribution and aggregation are a part of the local foods supply chain that is currently very dynamic,

Veritable Vegetable SAN FRANCISCO, CALIFORNIA

Launched in 1974 with the mission of bringing affordable, nutritious food to neighborhood coops and community storefronts, Veritable Vegetable (VV) is the nation's oldest distributor of certified organic produce. Today, VV has over 90 full time employees, over \$35 million in annual sales, a 25,000 square foot warehouse, and over 300 active customers. The company buys from over 1,000 farms, always providing the best price possible to farmers, and distributes food across California and the southwest 7 days per week, 365 days per year.

Over the years, VV has helped develop organic certification standards, helped pilot San Francisco's city compost

program, and has been active with a range of efforts to bring healthy food to low-income communities. VV has also taken substantial measures to green its own operations, successfully reducing its landfill waste from 60% to 1% and energy use from the grid by 40%.

Originally structured as a collective (or coop), the company is now privately owned by four women, two of whom are founders, and has grown through debt and sweat equity.

Source: Interview with Nicole Mason (sales) and Veritable Vegetable website - <http://www.veritablevegetable.com>

complex and fertile for innovation. Utilizing existing infrastructure, and developing a range of complementary distribution, aggregation and brokerage services will be important to establishing robust distribution of local foods across the U.S.

Financing Options

Philanthropic investments

In some parts of the country, new distribution models and ancillary services are being incubated by non-profit organizations. Early support for such efforts can come in the form of grants to the parent NGOs.

Conventional and unconventional debt or PRIs

Because of the asset base inherent in distribution companies, they are usually able to secure bank debt. New warehouses that are located in under-developed communities are often eligible for low-interest loans or tax-breaks from a range of government programs. However, because the capital needs are so high, many new operations will not be able to sufficiently capitalize on bank and government debt. Founder equity, outside equity, or concessionary loans may be necessary. Mission-oriented investors may well find investment opportunities with high potential for social/environmental impact where their concessionary investments can be used to buy down the risk for other more conventional investors.

Equity investments

Equity investment opportunities will depend greatly on the particulars of the businesses engaged in this segment of the supply chain. The greatest opportunities are likely to be found with distributors who also aggregate product under their own brand.

Investments by existing businesses

There are a large number of mid-sized food distribution companies, many of which are already adept at serving niche markets and handling perishable items. Given the start-up investments required, it is important for the industry to make use of the existing asset base. Existing small- and mid-sized food distributors that already have expertise and infrastructure might consider investing resources to explicitly serve local food economies.

⁹ While the idea of a farmstead cheese maker in Oregon FedEx-ing its product to a high-end cheese retailer in New York may run counter to many people's idea of local, others believe that if the production remains environmentally sustainable, the producer is earning viable margins on the product, and there is transparency to the consumer along the supply chain, that the geographic scope of the marketplace is of less concern. We do not attempt to define local by any geographic limits.

Sales & Marketing

The effort to grow a sustainable food system based around local markets is an effort to persuade consumers to pay a premium for a range of quality, sustainability and locality attributes, and simultaneously to provide opportunities for producers to shift from selling into commodity markets to selling into specialty markets. Fundamentally this is a sales and marketing challenge. The ultimate goal of investments into this part of the supply chain is to develop robust markets that can support a wide-scale transition of production practices (e.g. from monoculture to diversified, from concentrated animal feeding operations to grass-fed, from long-line to troll, from conventional to organic) along with the requisite supply chains to preserve the value created at the production level all the way to the end consumer. Brands that can aggregate from a large number of regional producers, creating a premium market for them, are critical to the growth of such markets and should be a high priority for investors.

Building the sales and marketing capacity of individual brands can be incredibly costly and risky, but complementary financial and market-building pay-offs can follow. Regardless, the investment burden does not need to be shouldered by a single set of investors. There are many ways to participate in the broad effort to build the market for local and sustainable foods.

Financing Options

Philanthropic investments

- Help build consumer awareness generally (e.g. Monterey Bay Aquarium sustainable seafood cards, Buy Local programs, etc.)
- Support certification programs or eco-labels that can be used across industries to indicate a certain set of sustainability or locality commitments (e.g. Marine Stewardship Council, FairTrade, Something Special from Wisconsin).
- Build industry groups or trade associations within the local foods industry.

Conventional and unconventional debt or PRIs

Various debt instruments can be used effectively for sales and marketing companies, depending on the structure and needs of the business and stage of growth (e.g. inventory or equipment loans). PRIs or other forms of unconventional debt might be needed if the business falls outside of the lending parameters of conventional lenders.

Equity investments

Sales and marketing is the part of the supply chain that is typically the best fit for equity investors. This is

CROPP Cooperative LA FARGE, WISCONSIN

CROPP Cooperative started in 1988 as a small, organic farming cooperative with seven members. Today, CROPP sells a wide range of organic products, including dairy (responsible for 90% of sales), eggs, meat, juice, soy and produce under the Organic Valley and Organic Prairie brands. It is the largest farmer coop in North America with 1,327 farmer members and 2008 sales of \$528 million. One of CROPP's core sustainability tenets is price stability. Over the past 20 years, CROPP has typically only moved liquid milk prices once annually, while conventional liquid milk prices are set monthly, and has paid at least a 10%-50% premium over conventional milk.

Although Organic Valley has national distribution, CROPP practices regionalism by grouping their members into producer pools and processing and distributing those products regionally.

Although CROPP is cooperatively owned and therefore cannot sell conventional equity, the company requires investments from its members (a percentage of annual delivery to the coop) which it can treat as equity, and has also raised over \$22.3 million in redeemable Class E stock to non-members, paying a 6% dividend.

Source: CROPP Cooperative 2008 Annual Report & website <http://www.organicvalley.coop>

because consumer brands tend to have higher growth potential and higher profit margins than other parts of the supply chain, and because sales and marketing companies typically have extended periods of operating losses in the early years which make it challenging for them to service debt payments.

- Equity investors interested in investing in local foods should be aware of the inherent tension between the common preference among stakeholders, including consumers, for companies that are focused on local markets to be “locally owned” (e.g. independently owned by the founder(s)) and the need for equity investors to earn a financial return through a sale of the company. There are several possible models for both providing equity investors with a sustainable exit (e.g. company buy-back, employee stock purchase, sale to a like-minded buyer, conversion to a consumer coop) and for providing companies with risk capital that performs like equity in some ways, but which does not

require a sale of stock (e.g. concessionary debt with a grace period and royalties, structuring as a coop and raising equity through membership, subordinated debt with a conversion option). However, most of these models have not been commonly used and adherence to them does imply higher risk.

- Even when entrepreneurs are open to a sale of their company, the perceived risk by conventional equity investors may be too great given the nascent and niche nature of the local foods sector. Investor groups that are early entrants into this field may need to leverage philanthropic dollars as a way to prove the market and, ultimately, attract more conventional funders to the field.

Investments by existing businesses

Existing food brands can invest in new product lines that commit to a set of sustainable sourcing practices and carry a range of certifications or eco-labels including organic, FairTrade, or Marine Stewardship Council (MSC).

Sea Change Investment Fund

SAN FRANCISCO, CALIFORNIA

The Sea Change Investment Fund is a growth equity fund that was launched in 2005 to make environmentally-driven investments in seafood-related companies that promote market access to seafood from environmentally preferable sources.

The fund is capitalized by a \$10 million program related investment from the Packard Foundation, matched by a private equity investment in a unique blend of philanthropic and private capital. To date the fund has made investments into six companies.

Source: Sea Change Management website
<http://www.seachangemanagement.com/fund>

RSF Social Finance

SAN FRANCISCO, CALIFORNIA

Inspired by the life and work of Rudolf Steiner, RSF Social Finance is a non-profit financial organization that offers investing, lending, and giving services. RSF currently serves a community of over 1,000 clients, and has invested over \$200 million in loans (to both for-profit and nonprofit social enterprises) and \$85 million in grants since 1984 in three focus areas: Food & Agriculture, Education & the Arts, and Ecological Stewardship. RSF combines high social impact requirements with strict risk management practices, and has never failed to repay investors.

In addition to having made close to \$20 million in loans to projects in Food & Agriculture that promote diversification (both biological and economic), place-based business models, and sustainability, RSF is committed to innovating new investment models that foster closer connections between donors, investors, and food-focused social entrepreneurs.

Source: Interview with Strategic Development Manager, Elizabeth Ü and RSF Social Finance website
<http://rsfsocialfinance.org>

Retail

This end of the supply chain is in many ways the counterpoint to distribution, with retail channels split between direct and wholesale. Again, direct markets (CSAs and farmers markets) have been the point where local foods have been gaining momentum in recent years. In many ways, the sales and marketing effort of the local foods industry to date has been about increasing the share of food bought from direct channels over wholesale channels, emphasizing enhanced freshness and relationships with farmers. While there is certainly still room to expand direct channels, and to innovate within them, traditional retailers offer access to a wide range of consumers currently not participating in the local food economy. Reaching under-served communities that have serious food access and dietary health challenges is one of the imperatives of bringing local foods to the range of wholesale channels. Though many of the business challenges of expanding local foods are common across wholesale channels, each has a particular set of needs and opportunities.

Grocery

Expanding the supply of local foods in grocery stores depends largely on developing more mid-sized growers who can work profitably within the wholesale price point and that have a sophisticated enough infrastructure to meet the needs of their grocery partners. As noted above, growth in local sourcing beyond coops to both natural and conventional groceries may also depend on the maturation of distribution and aggregation services in this sector. Grocers around the country are starting to pay attention to the trend towards local, and some are using it as an opportunity to launch and grow regionally successful stores and chains (e.g. New Seasons Market in Portland, Bi-Rite Market in San Francisco).

Food service

Institutional buyers including hospitals, schools, and caterers are also beginning to pay attention to the trend towards local foods (e.g. Bon Appétit Management Company). Some food service providers find that they are limited in their ability to source locally because of their limited capacity to process food. Many institutional kitchens have lost the capacity to even chop carrots. Reinvesting in processing capacity and/or developing suppliers who can deliver lightly processed food would

help open up this channel to local sourcing. As noted above, food safety, insurance, and consistent quality and quantity are all issues that will need to be addressed as well.

Restaurants

Across the country, chefs have been some of the most important champions of local food. However, the early adopters have largely been white table cloth restaurants that can afford to pass the additional cost of handling dozens of suppliers on to their customers. Here again, better distribution models or locally oriented brokers would help. Also, finding ways to help restaurants that cater to middle-income customers source more local foods would expand the customer base for local foods. Pizza seems to be a good model for reaching this demographic since the primary ingredients are relatively inexpensive. American Flatbread in Vermont and Ian's Pizza in Wisconsin have both proven that pizza with local ingredients can be a successful and franchisable business.

Schools

Schools are a particularly important institutional buyer base because of the considerable educational and behavior forming impact they have on children. Integrating local sourcing with nutrition, cooking, and gardening curriculum can have positive long-term health impacts on the next generation. Schools are also an incredibly important channel for reaching under-served populations, many of which are facing serious health risks due to poor nutrition. Local sourcing in schools is a tremendous challenge both because of the limited federal reimbursement for school lunch programs, and because most have lost the capacity to cook or process food and instead rely on pre-processed meals, often purchased through district-wide systems. There are opportunities to make inroads into these systems, for example through the USDA's afterschool snack program, but there are also opportunities for new service providers to take over school lunch contracts. Revolution Foods, an Oakland-based company, has done just that and has grown from serving just three schools in 2006 to serving over 100 in 2008.

Financing Implications

Philanthropic investments

- Support for non-profit school lunch or snack programs, funded in part by the USDA's afterschool snack program.
- Support for non-profit efforts to provide nutrition, cooking, and growing/gardening curriculum to school-aged children.
- Lobby state governments to provide grants and loans to fresh food retailers that operate in underserved communities where available conventional financing may not be adequate. Pennsylvania's Fresh Food Financing Initiative serves as a useful model for such work.
- Lobby the federal government to provide better support for healthy school lunch programs.

Conventional and unconventional debt or PRIs

- If the business owns a store or restaurant, the asset base can be used to secure conventional debt.
- Unconventional loans, including PRIs, might be used to help prove new retail models, especially those that are focused on underserved communities.

Equity investments

- Equity investments may be appropriate for this segment of the supply chain if there is adequate growth potential (e.g. groceries that aspire to developing multiple stores, restaurants looking to franchise or spin off consumer brands, or new food service providers).

Investments by existing businesses

Existing retailers, including established grocery chains, restaurants, and food service companies in the conventional and natural food sectors may find profitable opportunities to build out services dedicated to local foods.

Pennsylvania's Fresh Food Financing Initiative PHILADELPHIA, PENNSYLVANIA

The Pennsylvania Fresh Food Financing Initiative (FFFI) is an innovative program that works to increase the number of supermarkets or other grocery stores in underserved communities across the Commonwealth of Pennsylvania. The initiative provides financing for supermarkets that plan to operate in underserved communities where infrastructure costs and credit needs cannot be filled solely by conventional financial institutions.

The FFFI makes available a \$120 million multi-faceted funding pool: \$30 million is from PA state legislature appropriations and \$90 million has been committed by The

Reinvestment Fund (TRF), a community development intermediary, which has successfully raised funds from a range of sources including New Market Tax Credits.

As of March 2009, the FFFI has committed \$63.3 million in grants and loans to 68 stores across the state, ranging in size from 1,000 to 69,000 square feet. These projects are expected to bring 3,734 jobs and 1.4 million square feet of fresh food retail across Pennsylvania.

Source: *The Reinvestment Fund website*
<http://www.trfund.com/financing/realstate/supermarkets.html>

Conclusion

Although local foods is a nascent sector, it is gaining traction among a range of stakeholders from community advocates to publically-traded food businesses. The trend may have staying power given its relevance to an accompanying set of issues gaining attention from U.S. consumers including: carbon impact of food miles, food security, biodiversity, community economic resiliency, and childhood obesity. Particularly in the wake of the global recession, consumers and investors are increasingly interested in ways to decrease their exposure to global markets. We believe that local foods provide fertile ground for investors with a range of financial and mission-related returns expectations, and is likely to be a growing hotbed for entrepreneurship in the coming years. Significant questions remain, however: What does risk capital look like for local foods? Is it appropriate at the base of the supply chain for producers? Are there equity-like structures that can provide risk capital but also risk-appropriate returns? What are risk-appropriate returns for debt and equity investments in this sector? What does it mean to “scale-up” local food markets? How can successful models be best replicated across regions? What would success for this sector look like? What financial and impact benchmarks and metrics can we use?

Answers will come only from wading in, making bets, and tracking progress.

Table 2. Local food investing summary**Production**

Need	Type of financing	Description	Target investment examples
new farmer training	grants	farmer training programs, technical assistance, new university curriculum or research	Intervale, Marketumbrella, Community Alliance with Family Farmers
investing into new or existing farms	debt	conventional or unconventional debt to targeted sets of producers	direct or indirect investments (e.g. The Carrot Project)
farmland investing	grants	agricultural land trusts or land-use policy work	American Farmland Trust, Vermont Land Trust
	debt or equity	direct land investments for the purpose of transitioning to a new farmer, or offering land security to leasing farmers	New Spirit Ventures, Farmland LP

Processing

Need	Type of financing	Description	Target investment examples
technical assistance	grants	enhancing the skill base of local food processors	Dairy Business Innovation Center
dedicated processors	debt	infrastructure or equipment investments from conventional lenders, federal agencies, or through PRIs	Driftless Foods Coop
vertically integrated processors or dedicated processors	debt or equity	equity or PRIs to leverage conventional debt or provide risk capital for sales and marketing	Vermont Smoke & Cure, Cedar Grove Cheese

Table 2. Local food investing summary (continued)**Distribution & Aggregation**

Need	Type of financing	Description	Target investment examples
aggregation, distribution, and/or brokerage for small-scale produce growers and specialty foods	grants	NGOs incubating new models	Red Tomato, FoodHub
	debt	infrastructure and equipment loans	Veritable Vegetable
	equity	equity or PRIs for start-up businesses, to leverage conventional debt, or to support sales and marketing if vertically integrated	Keewaydin Organics

Sales & Marketing

Need	Type of financing	Description	Target investment examples
general industry support	grants	consumer education programs, or certification and eco-label programs	Marine Stewardship Council, Buy Fresh, Buy Local
vertically integrated or mature sales and marketing companies	debt	conventional or unconventional debt may be appropriate depending on the structure and stage of the company (e.g. equipment loans, working capital loans)	The Cellars at Jasper Hill, Peak Spirits
early or expansion stage brands	equity	growing consumer brands that are focused on sourcing locally	CROPP Cooperative, Wild Planet

Table 2. Local food investing summary (continued)**Retail**

Need	Type of financing	Description	Target investment examples
curriculum and local-sourcing at schools; general education	grants	NGOs helping implement healthy school lunch and snack programs; nutrition, cooking, and growing curriculum	Slow Food USA, New Orleans Food and Farm Network, Wisconsin Homegrown Lunch
retail, grocery and restaurants	debt	conventional debt may be appropriate depending on the structure and stage; PRIs may be necessary to help prove new retail models, especially those in underserved communities	Hollygrove Market & Farm, Central City Grocery
franchisable models	equity	equity investments into scalable retail, restaurant, and food service models	RevolutionFoods, American Flatbread, SPUD

Cross-sector

Need	Type of financing	Description	Target investment examples
intermediaries working to build the local foods sector	grants or debt	grants, debt or PRIs to support intermediaries that are making direct investments into a range of local foods businesses, building networks, advocating for policy changes, and/or sharing best practices	Slow Money Alliance, RSF Social Finance, Roots of Change, Slow Food USA

About the author

More recently, California Environmental Associates (CEA) has developed deeper experience in the food chain, working with investors who have a broad range of objectives. CEA analyzed three regional food economies (Vermont, New Orleans and Wisconsin) on behalf of Slow Money.

Over the years, CEA has assisted several foundations and non-profit organizations with sustainable seafood and sustainable agriculture program strategies (including the David and Lucile Packard Foundation, Roots of Change, Environmental Defense Fund, the Walton Family Foundation, and the Ocean Conservancy).

CEA also manages the Sea Change Investment Fund, a small profit-driven growth equity fund that invests in seafood-related companies while promoting the adoption of sustainable sourcing practices.

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