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CDFA Food Finance White Paper Series:

# Food Systems & Investment Tools

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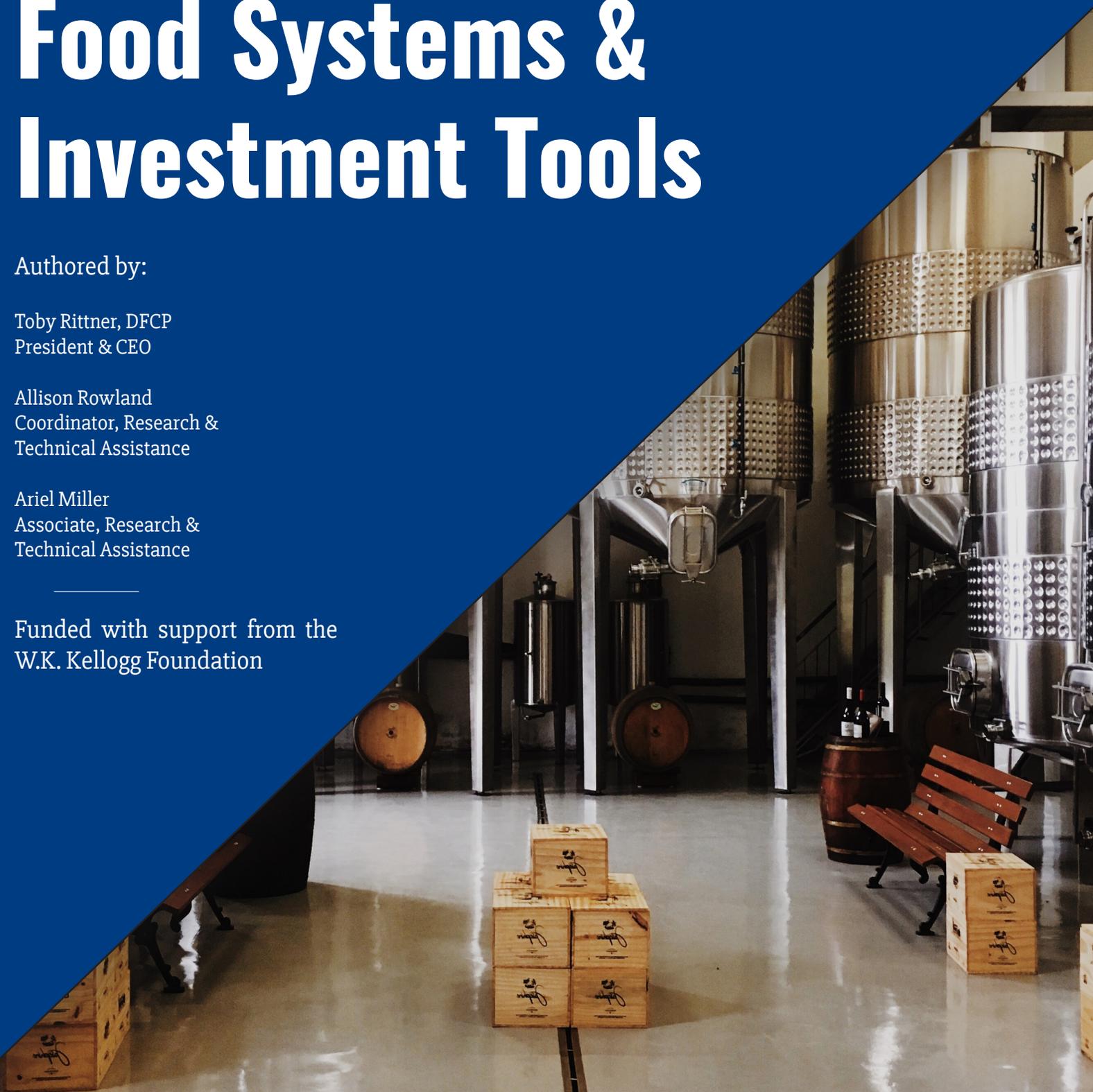
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# Food Systems & Investment Tools

Food serves as a foundation for neighborhoods, towns, and cities of all sizes - as a building block of local economies, and as a determinant of human and environmental health, as a medium of cultural expression, as a feature of the physical landscape. It can also act as a catalyst in places where there is great potential yet to be realized, where new investment is welcomed for new or continued progress. Although there has been hesitation in years past to direct financing to food businesses or food-related projects, the opportunity to rebuild local and regional food systems for the wellbeing of communities exists throughout the country.

This paper continues a white paper series demonstrating the ways in which traditional development financing is already supporting food systems, with a focus on finance tools that help to stimulate investment. An overview of this category of tools is provided, with examples of current programs as well as an extensive collection of case studies to illustrate how these tools can make an impact.



## What is Development Finance?

Development finance is used by local communities to encourage, support, and catalyze the physical development, redevelopment, or expansion of a business or industry. This is done through both public and private investment in projects that benefit the long-term health of a community.

Development finance agencies (DFAs) act as a conduit for channeling these investments to both private and public purpose projects through both direct and indirect lending programs. DFAs provide support for economic development through various financing programs, and they are central players in connecting projects and businesses with financing. They can be formed at the state, county, township, borough, or municipal level, and a wide variety of organizations classify as DFAs, including port authorities, industrial development authority, economic development authority, development corporation, and more.

## Defining a Food System Asset Class

In order to establish reliable, affordable, and traditional streams of financing for a wide variety of food-related work, there must be a shift in perspective that understands individual people and projects in the context of the broader food system. CDFA has identified six distinct areas of activity that exist within a comprehensive food system and which could be recipients of investment.

Although there is often overlap between these areas of activity, this white paper series is oriented around the defined categories below:

- **Social Enterprise (addressing scarcity)** – An organization or initiative that works to support social objectives, such as increasing access to healthy affordable food, sustainable food, or other socially beneficial food objectives.
- **Agriculture (rural & urban)** – The cultivation and harvesting of primary consumable food products (plants, animals and their byproducts), as well as the acquisition and management of agricultural land, research & development, production, support, and operations, regardless of physical location or scale.
- **Entrepreneurs** – Individuals who create and operate businesses in the food system, such as culinary, technology, distribution, agriculture or processing businesses, in order to meet market needs and gain profits from the business.
- **Industry** – The broad range of actors who contribute, or facilitate, the process of food production and distribution to consumers. This may include food retailers, food service, processors, packagers, distributors, producers of related inputs, and more.
- **Institutional Buyers** – Public or private institutions, such as schools, universities, hospitals, or prisons, that purchase wholesale, prepare and serve large amounts of food to meet internal demand within the food system.
- **Infrastructure** – The physical facilities, as well as the organizational, technological, and relationship networks that allow for the production, processing, storage, distribution, transportation, transfer, and retail of food.

This new definition of the food system takes a more comprehensive look at the greater economic ecosystem around food, food enterprises and food infrastructure to reinforce the concept of an investible asset class.

\*Research assistance provided by The Ohio State University, Knowlton School, City & Regional Planning 5890 course of Spring 2017.



# Investment Tools

Investment tools work to support businesses and projects by incentivizing and enabling investment in construction, equipment, machinery, technology, and other major developments. While each of the types of financing tools and programs described below function differently, they all have a shared outcome: catalyzed investment. In the food system, investment tools can be transformational for the role that they can play in building up the infrastructure needed at all levels of the supply chain for processing, distribution, scaling-up operations, consumer sales, packaging, and more.

## Types of Investment Tools

The following explains these individual financing approaches and case studies of each follow to demonstrate the application of investment tools to food-related businesses and projects.

### Tax Credits

Tax credits are one of the most accessible tools in the development finance toolbox; however, tax credits are widely underutilized, in large part because they can be complex and difficult to understand. There are a vast amount of tax credit programs available at the federal, state, and local levels, and these programs can easily be deployed to creatively fill a financing gap in the capital stack for many agriculture and food-related businesses.

#### **Overview of Tax Credits**

In order to mobilize investment on the local level using tax credits, it is critical to understand their history and impact. Tax credits have become increasingly popular as federal resources have diminished over the past several decades. As federal and state governments recognized the benefits of tax credits and incentives, they developed programs to address economic development needs. Over time, these programs have helped to provide a wide range of financing options for brownfields redevelopment, historic rehabilitation, low-income housing, emerging markets, venture capital, and job creation in a wide range of industries.

Tax credits can be used for several purposes in development projects: to provide an increased internal rate of return for investors, to reduce the interest rates on a particular financing package, and perhaps most importantly, to provide a repayment method for investors in place of cash. In the latter case, tax credits can often be transferred on the secondary market to generate income.

Tax credits are flexible. They can be used in urban, rural, and suburban communities, and in some cases, they can be applied on a regional basis. They can also provide a targeted impact by addressing many different community sectors, such as low-income neighborhoods, historic districts, and underserved markets that present opportunities for new investment. Food systems development is one such market that offers a diversity of projects in which tax credits can be used to support a project and further investments.

Tax credit programs bring many different stakeholders to the table, thus leveraging their impact. They may attract investors, businesses, government entities, nonprofits, community development organizations, industrial development authorities, economic development corporations, financial institutions, pension funds, universities, foundations, state governments, and the federal government.

In addition, tax credits do not disappear during economic downturns, unlike many other financing programs. Tax credit programs tend to be both dependable and politically popular.

## How Tax Credits Work

A tax credit is a dollar for dollar reduction of a taxpayer's liability. A tax credit is different from a deduction because it works by directly reducing tax liability. For example, if a taxpayer has \$100,000 of tax liability (after deductions are considered) and \$10,000 in tax credits, the taxpayer will then have \$90,000 of net tax liability.

Tax credit programs allow businesses and investors to claim a tax credit for committing resources to a project or business. The resources committed to the project could be an investment in a brick and mortar real estate project or a cash investment in a business. The distributor of the tax credit must evaluate the resources committed by the business or the investor based on the specific qualifications outlined for that tax credit. If the project qualifies, the distributor may then issue the tax credit to the business or investor.

Tax credits are government vehicles designed to encourage investment in socially or economically disadvantaged areas, industries, or activities. This allows for tax credit programs to act as a catalyst for public-private partnerships and achieve public policy objectives.



## Federal Tax Credits

Tax credit programs cover dozens of industry and business types - including many of the sectors that make up the food system, such as processing plants, commercial kitchens, and markets - and they differ between states. This section will cover the primary federal tax credit programs that are best suited for food system development projects.

### *New Markets Tax Credits*

The New Markets Tax Credit (NMTC) program was created to generate additional capital for economic development projects in low-income communities. The Community Development Financial Institutions Fund (CDFI Fund) allocates NMTCs to Community Development Entities (CDEs). The CDE then leverages the allocation of NMTCs to raise equity from investors. An investor receives a federal income tax credit equal to 39% of a Qualified Equity Investment (QEI) made into a CDE which is then invested in a targeted low-income community.

The NMTC is taken incrementally over a seven-year period, where a 5% annual credit is taken for the first three years, followed by a 6% credit over the last four years, for a total of 39% of the initial investment. NMTCs can represent 15% to 25% of the project's capital stack, which helps to achieve lower interest rates and potential equity stakes at the end of the credit period, enhancing the project and incentivizing more investment.

NMTC investments may include loans to businesses, to commercial, industrial and/or retail developments, and to developing for-sale housing. For the purpose of the NMTC program, low-income communities are considered to be census tracts in which the median family income is below 80% of the area median family income.

### ***Historic Preservation Tax Credits***

The Federal Historic Preservation Tax Incentives program was established by Congress with the Tax Reform Act of 1976 and is administered by the National Parks Service and Internal Revenue Service (IRS). The goal of the program is to discourage unnecessary demolition of historic buildings and to slow capital flight from historic urban areas. This type of incentive offers a tax credit against the total federal income taxes owed and is taken over a period of five years. The tax credit is equal to 20% of qualified rehabilitation expenditures devoted to the rehabilitation of a certified historic structure.

Federal Historic Tax Credits are available through a non-competitive, open application process. There are several basic criteria that must be met to claim the credit, such as the building must be income-producing and a registered Certified Historic Structure by the National Register of Historic Places. There are also requirements for rehabilitation unique to each building that must be done according to the Secretary of the Interior's Standards for Rehabilitation. The purpose of the criteria to claim Federal Historic Tax Credits is to ensure the rehabilitation is done in a way that preserves the historic integrity of each unique, individual building.

Historic rehabilitation tax credits are popular and widely used, especially in states where there are state programs that aim to complement the federal program. These state-level programs are typically used in conjunction with the federal historic tax credits on a given project to provide additional incentive to invest in historic rehabilitation projects within that state.

### **State Tax Credits**

Nearly every state, as well as the District of Columbia, offers an array of tax credit programs that can often be combined with federal tax credit programs for maximum investment. These programs address a number of different investment areas, including venture capital investment, low-income housing, job creation, machinery and equipment, targeted area redevelopment, brownfield cleanup, wage adjustment credits, and other industry-specific credits - including food system development projects. State tax credit programs have grown significantly over the past ten years, and innovative and targeted programs are spread throughout the country.

Below are examples of state tax credit programs that have been used to support businesses within the food system:

- **Minnesota Beginning Farmer Tax Credit** provides tax credits for the rental or sale of farmland or farm assets to farmers who have entered into farming within the last 10 years.
- **New York Farm to Food Bank Tax Credit** provides a refundable tax credit to New York State farmers who make qualified food donations to a food pantry, food bank, or other emergency food program. The credit is equal to 25% of the fair market value of the donation.
- **Virginia Historic Rehabilitation Tax Credits** are available to reimburse 25% of eligible rehabilitation expenses as tax credits for qualified historic properties.
- **Pennsylvania Resource Enhancement & Protection Program (REAP)** allows farmers to earn 50% to 75% of project costs in tax credits for implementing "Best Management Practices" that will enhance farm production and protect natural resources.
- **Rebuild Rhode Island Tax Credit** is a 20% — and in some cases 30% — redeemable tax credit for a variety of real estate projects, including food manufacturing, that needs assistance filling the financing gap.

## Opportunity Zones

Created as part of the 2017 Tax Cuts and Jobs Act, Opportunity Zones (OZ) are a federal economic development tool aiming to improve the outcomes of distressed communities around the country. Opportunity Zones are low-income census tracts that offer tax incentives to groups who invest and hold their capital gains in an OZ asset or property. By investing in Qualified Opportunity Zones, investors stand to gain a temporary deferral on their capital gains taxes if they hold their investments for at least 5 years and a permanent exclusion from a tax on capital gains from the OZ investments if the investments are held for 10 years.

Specific Opportunity Zones were designated by the governor or chief executive of a given state, district, or territory. All 50 states, the District of Columbia, and U.S. territories were eligible to designate Opportunity Zones and these areas can be viewed on an interactive map maintained by Enterprise Community Partners.

Opportunity Zones offer communities exciting new ways to access capital and generate economic development in areas that have experienced disinvestment for decades. Understanding how to use capital from Opportunity Funds is critical to realizing a successful investment strategy that drives economic and social impact directly into communities. Because Opportunity Funds can be used to support both business and real estate projects in Qualified Opportunity Zones, it is important for communities to be proactive in identifying potential investments and coordinating with multiple stakeholders.

Although Opportunity Zones are still relatively new, there is one Opportunity Fund that is solely dedicated to agriculture. The **Harvest Returns Opportunity Zone Fund** is a national investment platform for agriculture to assist farmers in OZs. This fund aims to unlock opportunities for job creation and to strengthen the food system with investments in sustainable agriculture in economically disadvantaged regions.



## In Summary

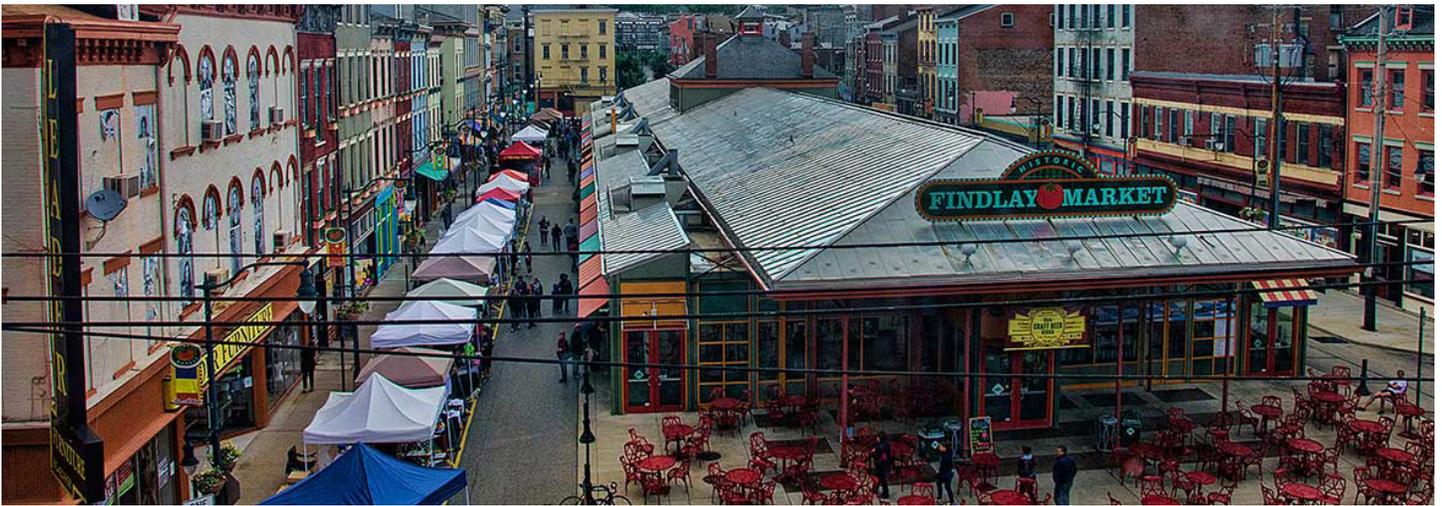
Investment tools are the most complex tools in the development finance toolbox, and also the most underutilized. Investment tools appear complex and difficult to administer to many economic development professionals, yet they are critical tools and should not be ignored. Tax credits help to support projects while providing benefits to a wide range of investors, developers, banks and other key players. Putting such programs to work in a community takes time, patience, and dedication to program development. However, once established, these investment tools will prove critical to fostering economic development.

# Case Studies

## Social Enterprise

### Jobs Café at Findlay Market – Cincinnati, OH

A \$25.2 million project in historic Findlay Market - located in the Over-the-Rhine neighborhood of Cincinnati, Ohio - began in 2014 to convert 11 buildings into 68 mixed-income apartments and 22,000 square feet of commercial space. The redevelopment was primarily financed with \$4 million in New Markets Tax Credits, \$3.7 million in Federal Historic Tax Credits, and \$2.5 million in State Historic Tax Credits. Included in the commercial space is Jobs Café, a social enterprise restaurant that provides job training and placement in the local restaurant industry. The Jobs Café pays a livable wage with benefits and aims to train and place 75 to 100 individuals in the local culinary scene each year.



### Food Lifeline's Hunger Solutions Center - Seattle, WA

In late 2015, \$2.6 million in New Markets Tax Credits via US Bank and CCG Community Partners, LLC was used as part of the capital stack to finance the construction of Food Lifeline's Hunger Solution Center in South Seattle. The project consisted of a new 117,500 square foot facility that includes warehouse space, storage and freezer space, classrooms, and office space for Food Lifeline's food distribution efforts. The build-out of the facility was completed in two phases, totaling about \$34 million in total project costs. Food Lifeline calls themselves the "food bank to the food banks" and they needed a new, larger, and consolidated space to increase efficiencies and meet demand.



# Agriculture

## Gourmet Mushrooms, Inc. - Scottville, MI

In 2000, a green bean cannery plant closed after nearly 100 years of operation in the small town of Scottville, causing the town to lose hundreds of jobs from both the plant and the farms that had been growing green beans. The State of Michigan awarded \$750,000 in tax credits in 2004 to cover the cost of demolishing the plant and cleaning up the leaking fuel tanks left behind. Although this mushroom farm was purchased in 2015 by another company, Gourmet Mushrooms, Inc. continues to produce mushrooms on this site today. The current farm produces mushrooms indoors to sell to restaurants and retailers in the region.



## Limehouse Produce - North Charleston, SC



Greenville New Markets Opportunity II, a CDE managed by Tax Advantage Group, allocated \$9 million of New Markets Tax Credits for the development of agribusiness Limehouse Produce located in the former site of the Charleston Naval Exchange Building. Limehouse Produce provides conventional row crops, local specialties, herbs, and dairy products to local restaurants, and is also a food hub with rental space, a cold storage hub, and a produce distribution facility. The total facility occupies over 175,000 square feet and created 145 direct quality jobs in a community with a 47.3% poverty rate. In addition, Limehouse provides considerable donations to local food banks, including over 400,000 pounds of food to Lowcountry Food Bank in just three years.

## Entrepreneurs

### Modern Times Beer - San Diego, CA

Modern Times produces, packages, and distributes beer and coffee out of their facility in the Point Loma neighborhood of San Diego. They expanded production with support from a \$60,000 California Competes tax credit and a sales tax exemption to purchase six new fermenting tanks that increased production and a can and bottling line that increased efficiency and reduced waste. With this new equipment, Modern Times increased its production from 12,000 barrels to over 40,000 barrels. The California Competes program is geared toward bringing businesses into the state or incentivizing them to grow in the state. Since this expansion, Modern Times has also become partially worker-owned, with 30% of their equity held in an Employee Stock Ownership Plan.



### Town Hall - Florence, SC

In 2017, over \$1 million in Federal and State Historic Tax Credit equity was used to preserve and retrofit an iconic downtown building that was built in 1876. The total project cost was \$3.8 million, where \$634,262 in Federal Historic Tax Credit equity and \$569,483 in State Historic Tax Credit equity was used to turn this historic Zeigler's Drug Store and Allen's Hall, a civic gathering space, into Town Hall, a family-owned restaurant. Also used in the capital stack was nearly \$600,000 of South Carolina Abandoned Building Tax Credit Equity. Today, the building is home to Town Hall, a 5,800 square foot farm-to-table restaurant that uses ingredients from the nearby family farm on the first floor, as well as offices on the second floor.



### 17 Alfred Street - Biddeford, ME

A combination of State and Federal Historic Tax Credits were used for the renovation of 17 Alfred Street in the town of Biddeford, Maine in 2017. The original three-story building was constructed in 1860 and then renovated to create two stories of apartments, with the first floor dedicated to retail and commercial space. A quarter of the \$1 million total project cost was supported by \$160,000 in Federal Historic Tax Credits and \$200,000 in State Historic Tax Credits. The remaining capital stack included a \$330,000 construction loan from a community development bank, \$662,300 in equity from the developer, a \$15,000 grant from the town for the building facade, and a \$4,700 from Efficiency Maine Energy Rebates. One of the commercial spaces now houses a specialty market and café called Part & Parcel, offering produce, grocery items, prepared foods, wine, and beer. Since the completion of the project, both the apartments and storefronts have been fully occupied. In a downtown that struggled with high vacancy rates in decades past, this development project is now prompting further economic development of the city center.



## Industry

### Fresca Mexican Foods - Caldwell, ID



New Markets Tax Credits supported a \$34.7 million project to construct a 190,000 square foot production plant for Fresca Mexican Foods, a manufacturer of flour and corn tortillas and tortilla chips. The tax credits were allocated through a program with MoFi, an organization that provides financing and consulting to entrepreneurs and small business owners across the Northern Rockies. This new plant also serves as a headquarters for Fresca and was sought out by the town of Caldwell, ID as an anchor for their Sky Ranch Business Park because of the hundreds of quality jobs it brought to the area. The NMTC equity provided \$6 million towards the total capital stack, which addressed the funding gap and helped the project move forward.

## Infrastructure

### Portland Mercado - Portland, OR



A project to consolidate the Hacienda Community Development Corporation's three separate offices into a single site, Portland Mercado, secured \$10 million in federal New Markets Tax Credits and \$7 million in Oregon NMTC allocation. This new 11,000 square-foot headquarters serves as administrative headquarters for the organization as well as Portland's first Latino public market. The Mercado hosts 19 small food businesses, the majority of which are minority-owned, and Hacienda also runs programs such as the Food Innovation Center program that helps train new food-business owners with workshops, seminars, and training in both English and Spanish. This project created 110 new jobs and retained 71 jobs.

### The Heights Public Market - Tampa, FL



In 2017, a historic streetcar maintenance building in Tampa's Riverfront District was renovated using \$20 million in New Markets Tax Credits to create Armature Works, a co-working space with an events venue, several bars and restaurants, and the Heights Public Market. The Florida Community Loan Fund provided the NMTCs for the 76,000 square foot redevelopment of the Armature Works building. The Heights Public Market offers vendor space for more than 15 local restaurants, bars, and cafes, as well as a community gathering space for visitors and culinary demonstrations.

## Sears Building - Butte, MT

In 2010, Kujawa Development, a local firm in Butte, Montana, used \$1.9 million of New Markets Tax Credit equity and \$1.4 million of Federal Historic Tax Credit equity to renovate the historic Sears Building in Downtown Butte. The total project cost was just over \$9 million and included a \$1.3 million low-interest loan from the Butte-Silver Bow Urban Revitalization Agency. The historic Sears Building was constructed in 1910 as the Hennessy Department Store, which also featured a grocery store at street level with cold storage and a bakery in the basement, as well as small apartments on the higher floors for local miners. In 1941, Sears, Roebuck and Co. took over the site and transformed the building into a Sears Department Store. After Kujawa Development undertook the complete renovation, the historic Sears Building now houses the Hennessy Market, a nonprofit science museum, and 34 market-rate apartments.



## Pearl Food Business Development Center - Dorchester, MA

Dorchester Bay Economic Development Corporation worked with Commonwealth Kitchen to utilize \$3.7 million in New Markets Tax Credits for the redevelopment of a former meat factory into the Pearl Food Business Development Center. This redevelopment is now home to 5 food businesses, including Commonwealth Kitchen's new headquarters. Also included in the \$14.8 million capital stack was a \$3.2 million loan from the Department of Housing and Urban Development's 108 Loan Program, \$3 million in CDFI debt, and over \$3.5 million in grants. Commonwealth Kitchen, which occupies 50% of the development, is a commercial kitchen incubator that hosts more than 55 small food businesses. They also operate a commissary kitchen for small-batch contract manufacturing that enables farms and other food businesses to scale their value-added production. The Pearl Food Business Development Center's businesses employ over 200 people in a neighborhood with an unemployment rate double the national average.



## ShopRite of Parkside - Philadelphia, PA

The Parkside Shoprite received \$7.5 million in New Markets Tax Credits financing from The Reinvestment Fund for construction, as well as a \$1 million grant from the Fresh Food Financing Initiative for start-up costs. The supermarket was opened in 2008 by a fourth-generation Philadelphia grocer with a commitment to community engagement, to ensure that his stores benefit their neighborhood and fit the needs of their clientele. This full-service supermarket has nearly 70,000 square feet dedicated to healthy food retail, as well as a pharmacy and community gathering room. Local hiring efforts filled the more than 300 permanent jobs created by the construction of this ShopRite primarily with residents from the surrounding neighborhoods.



# Red Lake Trading Post Grocery Store - Red Lake Indian Reservation, MN



The Red Lake Band of Chippewa Indians expanded to a new grocery store that opened in 2019 to better serve the Red Lake Reservation and surrounding community. The \$10.6 million project more than doubled their physical space and increased produce, dairy, meat and grocery options. Travois New Markets, LLC allocated \$10 million in New Markets Tax Credits for the completion of this project. Native American Bank and their partners provided a loan to build the new grocery store on the Red Lake Reservation, and this was the first deal of its kind to combine New Markets Tax Credits with a USDA Business & Industry Loan Guarantee on a project located on tribal trust land using the ground lease as collateral. The expansion also created 20 new permanent jobs in addition to the retention of 30 permanent jobs from the previous store.

## Ponce City Market – Atlanta, GA



The former Sears, Roebuck & Co. headquarters in Atlanta was redeveloped in a large adaptive reuse project that employed \$50 million in Federal Historic Tax Credits and \$300,000 in State Historic Tax Credits paired with a \$180 million loan. The first-floor food hall that was created in the renovated features 35 local eateries, bars, bakeries, and cafes, while also offering gathering spaces that make it the heart of Ponce City Market. The structure was built in 1926 and operated as the Sears headquarters until closing in 1979 and becoming entirely vacant in 1989. The City of Atlanta bought the building intending to rehabilitate it for a new City Hall, but the project was too expensive. In 2011, the City sold to development company Jamestown Properties, who also redeveloped Chelsea Market in New York City, turned this historic nine-story structure into space for restaurants as well as retail, offices, and apartments. The entire project is estimated to have had a \$1 billion impact on the eastside of Atlanta, spurring additional development and creating over 1,500 jobs.

## Conclusions and Next Steps

This is the fifth paper in a series seeking to define the food system as an asset class worthy of receiving traditional development financing. An overview of food systems and development finance as a whole was provided in the first paper, while the last four have focused on specific categories of tools used by development finance professionals. The second paper argued that food-related businesses are as reliable in accessing capital to support their growth and expansion as other types of small businesses. The third paper looked into the foundation of development finance, bonds, and how they can be employed by food and agriculture businesses. The fourth paper explored various targeted tools, such as TIF, special assessment, and PACE, which create districts in order to channel financing toward certain sectors and activities. This paper on investment tools is the last to focus on a particular area of development finance, with the final paper in this series exploring the future of food system financing and the innovative approaches that businesses and communities are pursuing.

# More Information

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Members are state, county and municipal development finance agencies and authorities that provide or otherwise support economic development financing programs as well as a variety of non-governmental and private organizations ranging from regional and large investment banks to commercial finance companies to bond counsel, bond insurers, trustees, venture capital companies, rating agencies, and other organizations interested in development finance.

The Council was formed in 1982 with the mission to strengthen the efforts of state and local development finance agencies fostering job creation and economic growth through the use of tax-exempt and other public-private partnership finance programs. Today, CDFA has one of the strongest voices in the development finance industry and regularly communicates with Capitol Hill, state and local government leaders and the Federal Administration. The Council provides a number of avenues for assisting the development finance industry including education, advocacy, research, resources and networking. Learn more and join at [www.cdfa.net](http://www.cdfa.net).

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