New Opportunities, Inc. and CT Food 4 Thought

A CAPLAW social enterprise case study

Social Enterprise:
CT Food 4 Thought: A hydroponic farm growing lettuce, kale, and arugula

Location:
Torrington, CT

Year Founded:
New Opportunities - 1964

CT Food 4 Thought - 2018

Type of CAA:
Private, non-profit

Service Area:
A large swath of rural, northwestern Connecticut

CAA Programs:
35 programs, including early childhood education, case management and benefits assistance, emergency shelter, supportive housing, rental assistance, LIHEAP, WAP, therapeutic foster care, diaper bank, food pantry, senior meals and in-home services

CAA Clients:
49,830

Budget:
$44,128,438

Leadership:
Bill Rybczyk, President & Chief Executive Officer

Toni Hirst, Chief Administrative Officer

Mark E. Kovitch, Chief Financial Officer

Rachel Perez, Board Chairperson

Documentary:
View a short video for an overview of the project

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Introduction

Community Action Agencies (CAAs) often consider how they can help low-income individuals become self-sustaining and thrive in emerging industries, but they may not always prioritize the same goals for their own operations. New Opportunities, Inc., however, has created a social enterprise that addresses both: the CT Food 4 Thought hydroponic farm in Torrington, Connecticut. CT Food 4 Thought increases the availability of locally grown produce in the CAA's region, provides training and employment opportunities, and will generate unrestricted revenue to support New Opportunities' social services programming. This case study explores some of the legal, governance, and financial choices New Opportunities made in service of this venture and is intended to provide insight for CAAs considering similar projects.

A Green Vision

Like many good ideas in the world of Community Action, New Opportunities' inspiration for a social enterprise came from identifying a need in its community. Though the agency's service area includes agricultural pockets of rural, northwestern Connecticut, its clients struggled to find affordable, fresh produce to feed themselves and their families. New Opportunities also struggled to meet its substantial food-related needs as a provider of meals in its early childhood education program and residential halfway house.

Bill wondered if there was a way to provide food for the agency and its clients while creating local jobs in the green economy. As he surveyed the agency's service area, he saw assets like an agricultural high school, farms, and a University of Connecticut extension school with a focus on agriculture, health, and natural resources. In this environment, farming seemed like a natural solution. Perhaps a farm could even provide safe, entry-level jobs for underserved client groups like formerly incarcerated individuals and those with developmental disabilities.

The vision for CT Food 4 Thought was originally conceived in the mid-1990s by New Opportunities' long-time President and CEO, Dr. James H. Gatling. Dr. Gatling started taking steps to make his vision a reality in 2012, when he assigned Bill Rybczyk (then Director of Research, Planning, and Development) to find out why produce prices were so high in the area. Bill soon learned that over a third of the country's vegetables and two-thirds of the country's fruits and nuts are grown in California.[1] Produce that isn't from the West Coast likely travels even further, from international destinations like Mexico and Central America. The cost of transporting these goods to the shelves where New Opportunities' clients could find them was passed on to them, making it more expensive to buy healthy food.

Due diligence is a critical component of the early stages of any business, so under Dr. Gatling's leadership, an investigative process began. New England's harsh winters limit the outdoor growing season in Connecticut, so the investigation focused on farming methods that could be practiced indoors. Being an avid fisherman, one of the methods that piqued Dr. Gatling's interest was aquaponics, a form of agriculture that integrates fish and plant cultivation. In an aquaponic system, crops are grown hydroponically (in water, as opposed to soil) in tanks fed by the wastewater generated by raising fish. The waste from the fish creates a natural fertilizer that the crops absorb as food, which filters and cleans the water to be recirculated to the fish.

[1] California Agricultural Production Statistics, CA Dept of Food and Agriculture, https://www.cdfa.ca.gov/Statistics/.

Seed Stage

After conducting an initial investigation, Dr. Gatling and the project leadership team presented their idea to the governing board. New Opportunities' board members were excited by the prospect of an innovative project that would address the needs of their clients, create job opportunities, and generate income, but they needed to address some unanswered questions to make an informed decision. The board decided to create a working group that would conduct additional research and put together a business plan. The working group consisted of the board Treasurer (an accountant), New Opportunities staff, and outside experts from the private sector. The agency contacted New Tech Haven, a startup consulting team run by retired executives through the University of New Haven. For a small fee, the consultants provided a business plan, market research, and funder presentations. The working group also hired an aquaponics consultant to advise them on technical questions related to aquaponic farming.

New Opportunities' aquaponic farm working group met on a biweekly basis and provided quarterly updates to the board. After about 9 months, Dr. Gatling mentioned the project to the newly appointed Commissioner of the state Department of Social Services. The Commissioner was so excited by the idea that he convened a gathering of fellow state agency leaders from the Departments of Labor, Agriculture, Energy, and Environmental Protection. The New Opportunities team presented the working business plan to the group and received feedback on how they might facilitate partnerships with local government departments and programs. Through these channels, a number of potential funding sources were identified to support implementation of the project. One of these sources was the Urban Act Grant Program from the Connecticut Department of Economic and Community Development (DECD). It was ultimately these funds that were identified and secured as the initial source of project funding. A $1 million loan with a low interest rate was approved through the state Bond Commission in February of 2018.

Laying the Groundwork

In addition to strategizing about business operations, the New Opportunities working group explored some of the legal and tax implications of their new venture. They invited the agency's attorneys and accountants to participate in these discussions and answer questions.

New Opportunities is a tax-exempt, 501(c)(3) nonprofit, so one critical question was whether to create a for-profit subsidiary to serve as the legal owner and manager of the business. Many CAAs choose to create a subsidiary when starting a social enterprise, but some prefer to run their business as an agency program. Both options have advantages, but they each also present certain challenges from a compliance perspective.

A CAA can protect its charitable operations and assets from the liabilities of its social enterprise by moving the business to a legally separate, taxable subsidiary that operates independently from its parent. However, forming a subsidiary and maintaining its independent existence is costly and requires ongoing oversight. The CAA may incur legal fees for drafting articles of incorporation and bylaws, and the subsidiary must maintain its own board of directors, organizational policies, and bank accounts.[2] The subsidiary may procure services (such as a mailing address or staff) from its nonprofit parent, but it should draft and negotiate the contracts for such arrangements at arm's length.[3] CAAs that choose to operate a social enterprise without creating a separate legal entity do not need to make the same up-front investment of time and money, which can be useful given that social enterprises usually take years to start earning a profit. However, CAAs operating a social enterprise within their nonprofit will be held legally responsible for its actions. With no organizational separation, the charitable organization will be liable if the social enterprise breaches one of its contracts or defaults on a loan.

Once established, social enterprises operated by a corporate subsidiary have some tools for attracting and retaining employees that are not available to nonprofits. A

corporation may offer equity (for example, stock options) to employees as part of their compensation package, which increases the value of employee compensation without the need to increase salaries.[4] A corporation can also compensate its executives at higher rates, since it is not subject to the Internal Revenue Service (IRS) rule that tax-exempt charities must pay reasonable compensation to those in a position to exercise substantial influence over the affairs of the organization.[5] On the other hand, managing employees and their benefits can be administratively and financially burdensome for a corporate subsidiary in its startup phase, which has led some social enterprises to procure HR-related services from their nonprofit parent. A CAA that runs a social enterprise venture in-house can more easily take advantage of its established operational structure and organizational capacity until the venture is robust enough to operate independently. The challenges with relying on in-house operations – properly accounting for restricted funds and not over-extending staff – are not new ones for CAAs that run multiple programs.

The structure of a social enterprise also has implications for taxation. If a CAA forms a corporate subsidiary to operate a social enterprise, the subsidiary's income (minus any deductions) will be taxed at the corporate rate, but may then be passed tax-free to its nonprofit parent through a dividend or grant. Social enterprises operated by a nonprofit may be operated tax-free if they are substantially related to the charitable purpose of the nonprofit (and thus do not generate unrelated business taxable income (UBTI)). UBTI is income generated from an unrelated trade or business regularly carried on by a tax-exempt organization.[6] The IRS imposes a tax (known as unrelated business income tax, or UBIT) on UBTI at the corporate tax rate and may revoke a nonprofit's tax-exempt status if it devotes too much time to generating UBTI or UBTI becomes a substantial portion of its income[7]. CAAs with a charitable purpose related to economic or workforce development may seek to provide employment opportunities for low-income individuals as part of their social enterprise, which would connect it to their tax-exempt purpose. A CAA may also exclude certain proceeds from its UBTI, such as those from the sale of donated merchandise or a business where substantially all the work is performed by volunteers.[8]

New Opportunities' attorneys suggested it form a for-profit subsidiary to operate CT Food 4 Thought, since the farm would be navigating an unfamiliar industry and incurring various liabilities through purchase order contracts. However, the bank financing construction of the greenhouse facility insisted on obtaining a guaranty secured by New Opportunities' unrestricted real estate assets. The contractual guaranty negated the liability protection New Opportunities hoped to receive from operating the venture from a subsidiary. The project also missed out on some grant opportunities, which caused Bill Rybczyk and the New Opportunities board to eventually reconsider its structure. See *Growing Forward*.

[2] The CAA may retain the power to appoint members to the board and may even share some overlapping board members with the subsidiary, but the board of the subsidiary should not be identical to the board of its parent.

[3] An arm's length transaction is one in which the parties are unaffiliated and act in their own self-interest. Demonstrating that fair market value was exchanged and the parties acted independently can help show that a transaction was conducted at arm's length.

[4] Unlike a nonprofit organization, which by definition does not have owners or shareholders, a for-profit corporation can also sell its stock—shares of its business—to outside investors, allowing it to tap into a valuable source of cash. This can be particularly helpful during the startup phase of a business, when it is often difficult to obtain other types of financing because the business lacks credit history or a consistent income stream. Remember, though, that selling shares will result in shifts in ownership, so it is important to consult with corporate counsel when considering this option.

[5] The IRS considers compensation reasonable if it is consistent with what is ordinarily paid for similar services by a similar enterprise.

[6] See 26 U.S.C. § 512(a)(1), available at https://www.law.cornell.edu/uscode/text/26/512.

[7] The IRS will examine the facts and circumstances of each case to determine whether UBTI constitutes a substantial portion of an organization's income, but some practitioners use 20% as a rule of thumb. See Taxation of Unrelated Business Income (UBIT), Hurwit & Associates, available at https://www.hurwitassociates.com/taxation-of-unrelated-business-income/taxation-of-unrelated-business-income/.

[8] See Publication 598, Tax on Unrelated Business Income of Exempt Organizations, p. 7, available at https://www.irs.gov/pub/irs-pdf/p598.pdf.

A Ponic Pivot

One of the most daunting aspects of starting a social enterprise for many CAAs is venturing into the for-profit sector. Just like the world of government grants, the business realm is full of specific vocabulary and data that can be overwhelming to staff and board members who are not accustomed to working outside nonprofits. New Opportunities confronted this challenge by creating a network of trustworthy local experts, from attorneys to aquaponics experts, but it still didn't have a leader for the project who could take the helm and maximize its investment.

In 2016, Jon Jensen was working for a local commercial real estate brokerage that was advising New Opportunities about potential properties for their aquaponics facility. He attended one of the working group's public presentations and asked to take home a copy of the proposed financials for the project. "Once I started to put my nose in them, I couldn't make the numbers work," Jon says. Something wasn't adding up. The projected returns from selling basil, which the working group had identified as the most suitable crop for the project, could not support the significant rent and utility costs of running an aquaponic farm indoors throughout the year. To operate sustainably, the farm's facilities would have to be bigger by an order of magnitude than what New Opportunities was considering.

Jon raised his concerns with the working group, who—to their credit—were not discouraged by his suggestion that their crop or farming method might need to change. Instead, they turned to the network of local farmers they had consulted during their initial research to ask about alternative farming strategies. Some local greenhouse farmers suggested that New Opportunities pivot into hydroponic farming, which would remove the expense of maintaining the fish used to fertilize the crops. In hydroponic farming, chemical fertilizer is used instead of fish waste, thereby reducing the amount of electricity needed to maintain the water source cycling through the crops. Hydroponic farming is suited to growing lightweight, fast-growing crops like lettuce, which are more versatile than basil. The farmers also suggested that CT Food 4 Thought contact American Hydroponics, a consultant and manufacturer of hydroponic growing systems.

American Hydroponics was excited to hear about New Opportunities' project. Their team had installed over 200 commercial hydroponic systems throughout the US, but they were particularly interested in developing hydroponic farms close to major markets on the East Coast. It seemed like a perfect match.

CT Food 4 Thought entered into a contract with American Hydroponics whereby American Hydroponics would help the CAA set up the farm, provide a head grower to supervise operations for the first 12 months, and purchase their entire crop on behalf of a kosher food distributor based out of New Jersey. Growing for the kosher market would entail some unique conditions, such as regular visits from a rabbi to inspect the product, but the project leadership team determined that ensuring a market for their crops in the first year of operations was in the best interest of the CAA and the business.

Jon Jenson's commercial real estate experience paid off in the summer of 2018 when the working group found an ideal site for their hydroponic project. The property was in a small, undeveloped corner of an industrial park with easy access to interstates 91 and 95, which would help the farm ship its produce as quickly as possible. To save on upfront costs and give the enterprise time to grow without making long-term commitments, CT Food 4 Thought agreed to lease the property with an option to buy. They used the proceeds of the DECD loan to start construction on the greenhouses. Jon's business partner George Benedict leveraged the project's guaranteed purchase arrangement with the kosher food distributor to set up a construction loan with the Savings Bank of Danbury, secured by New

Opportunities' unrestricted real estate assets. The bank was so excited about the project and the benefits for the community that it agreed to add additional phases to the financing agreement, anticipating future expansions of the project.

An additional unexpected partner materialized in the Winter of 2019. Captured Time Productions, a film company founded by award-winning filmmaker Harvey Hubbell, heard about the project from Jon and George. Five days before the first greenhouse structures were to arrive at the site location, Harvey met with Bill and Dr. Gatling. He was so excited about the project (especially given that he has his own farm) that he and his team mobilized to begin documenting the New Opportunities/CT Food 4 Thought story. Days later, they were on-site, filming the arrival of the greenhouses. Captured Time has gone on to create multiple videos, both long- and short-form, to document and market the implementation of the project.

Jon Jenson was so passionate about CT Food 4 Thought that Bill asked him to come on board as a full-time consultant overseeing the enterprise. Jon is a consistent advocate for the quality of the farm's product and makes sure that others appreciate it. Once CT Food 4 Thought's greenhouses were constructed and its hydroponic system installed, New Opportunities hired the farm's first four full-time employees to handle inventory and growing operations. The farm hired additional temporary workers, including clients from its halfway house, to increase its capacity during its first harvest.

Do Be Aware of DBAs

A "doing business as" name—also known as a DBA, a trade name, or a fictitious name—is a name used for transacting business that is different from the organization's registered name. DBAs do not provide any liability protection or create a separate legal entity, but they may be useful to CAAs running a social enterprise out of their 501(c)(3) nonprofit:

- Segregating the finances of a social enterprise and a CAA may be easier with a DBA. A CAA may choose to open a separate bank account using its DBA to help track its funds internally and make sure restricted funds are not being used to support the social enterprise, which could lead to issues such as program income or improper use of restricted funds.
- CAAs can conduct business under their DBA instead of their agency name, which allows the business some flexibility and an opportunity to be creative. Most states require that an organization's registered name be unique, but some states allow multiple businesses to go by the same DBA (subject to federal trademark laws).
- If your CAA conducts business under a DBA, remember to include it on the "Doing Business As" line on your CAA's Form 990. Also, your state may require that you register your DBA for a small fee. For more information, check your Secretary of State's website.

Growing Forward

Today, the CT Food 4 Thought team feels more ready than ever to make strategic decisions for their business. They recently decided to pivot once again by offering their produce on the open market instead of renewing their purchase agreement with American Hydroponics. Jon was concerned that the buyer wanted almost exclusively kale and arugula, which are lighter products than lettuce. In an industry where produce is sold by the ounce, the business earns less profit from selling lightweight products than heavier ones. Since CT Food 4 Thought has limited space in which to grow their crop, they need to maximize their profit per square foot of their facility.

This decision has presented some new challenges. The CT Food 4 Thought team realized that they would need to print their own labels now that the kosher buyer was not providing them. They would also need a universal product code, an FDA-approved food safety plan, and a strategy for promoting their produce to wholesalers and grocery stores. Under the terms of the purchase agreement, CT Food 4 Thought is prohibited from competing in kosher markets for 12 months after its termination or expiration. Fortunately, the team has found a new partner, CT Food Share, which supplies food for emergency shelters and food pantries across Connecticut. CT Food Share has been purchasing all the produce harvested on a weekly basis since the beginning of July, but the farm is still looking for new buyers.

The team is also working to dissolve the corporate subsidiary it created and operate CT Food 4 Thought out of New Opportunities. Bill first considered this approach during the planning stage, when he tried to get a guaranty on a loan for the farm from the local U.S. Department of Agriculture (USDA) office and discovered that for-profit corporations could not participate in the program.[9] CT Food 4 Thought was also unable to take advantage of some funds earmarked by their congressperson due to their for-profit status. Also, as noted earlier, New Opportunities became a guarantor on the farm's loans with DECD and the Savings Bank of Danbury, which meant the CAA was not receiving liability protection—the main reason for establishing a for-profit subsidiary. When Bill brought these considerations to the board of New Opportunities, it decided that the agency should dissolve the corporation and transfer any supplies it had acquired (which were very few) to the parent nonprofit.

For now, the New Opportunities board is not concerned about incurring unrelated business income tax by operating CT Food 4 Thought at the CAA level. The business is not yet bringing in substantial profit, and the board (along with the agency's attorneys) has determined that the farm's activities support the CAA's charitable purpose of addressing the causes and consequences of poverty, since it has provided employment and training opportunities for clients from the CAA's halfway house and summer youth program. Keeping the farm's income-producing activities closely aligned with New Opportunities' mission will help the CAA avoid unrelated business income tax or jeopardize its tax-exempt status.

[9] USDA does provide loans to for-profit corporations under some of its programs.

Lessons Learned

Prepare to pivot

Throughout the process of planning and launching their social enterprise, the staff and board of New Opportunities have demonstrated remarkable flexibility and willingness to adjust their plans when presented with new information. CT Food 4 Thought pivoted from an aquaponic to a hydroponic farming model after Jon presented his concerns about the sustainability of the aquaponic business plan, and the board decided to change the farm's legal structure when they realized a corporate subsidiary wasn't the best choice. They even gave up their guaranteed purchasing agreement because it was not helping to maximize the farm's profitability. These pivots, though somewhat risky in the short term, have made the business more likely to succeed over time. A successful social enterprise expects that it will need to adjust its strategy in response to market or organizational changes and creates a culture of innovation and creativity that will enable it to make those adjustments.

Sustain leadership's commitment

It has taken CT Food 4 Thought and New Opportunities a decade to get to where they are now, but the unity and commitment of their leadership has not wavered. Dr. James H. Gatling passed on his vision for the project to Bill Rybczyk, and each President worked closely with New Opportunities' board to set a course that protects the interests of the CAA. To persevere through the research, development, and implementation stages of launching a social enterprise, a CAA must have buy-in from senior leadership and the board of directors. That commitment should be passed on as positions and seats turn over.

Build on your community's assets

New Opportunities is located in an area with educational institutions that focus on agriculture and farming. The agency built on those assets by creating new connections with local farmers, which led to their purchase agreement with American Hydroponics. CT Food 4 Thought's experience demonstrates that a social enterprise is more likely to thrive if it fits into the existing economy of its geographic community.

Leverage your agency's relationships

Both Bill and his predecessor connected with local government officials early on while planning their social enterprise, which eventually helped CT Food 4 Thought obtain financing for some of its construction costs. Their receipt of grant funding and tripartite board structure gives CAAs unique connections to people with local influence in the public and private sectors. Agencies pursuing a social enterprise should consider leveraging those connections to benefit from specialized expertise that may not be available in-house.

Bring in business-minded individuals

New Opportunities has consistently sought and benefitted from the advice of community members with experience in the private sector. The initial working group hired consultants from New Tech Haven to help with their business plan, then relied on the expertise of American Hydroponics to set up the farming operation. Ultimately, they found long-term business mentors in the form of Jon Jenson, George Benedict, and the Savings Bank of Danbury. Starting a business can be confusing and overwhelming for nonprofits, even if they navigate the complexity of federal grants every day. CAAs embarking upon social enterprise projects should consider teaming up with experienced local businesspeople to ease their transition into the for-profit sector.