Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# The L3C

*The For Profit With The Nonprofit Soul*

## Introducing the new, socially responsible limited liability company

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Overview

- Private sector resources come in two types:
  - For Profit Sector Resources: Market Driven - making money & building wealth - normally require rate of return of +5%
  - Nonprofit Sector Resources: Market incentives are inadequate or non-existent - rate of return of 0 to -100%
- Challenge: How do we access the vast pools of market driven wealth to invest in ventures that fall into the gap between the 0 and +5?

# Overview

- Many worthy causes can be self-sufficient in the 0 to + 5% zone.
- They offer a return on investment but the return is insufficient to attract most market driven investors.
- They fall into the gap between the for profit and nonprofit worlds – what we call the "Low-Profit Zone."
- The $L^3C$ was designed to fill that gap – it lives in the Low-Profit Zone.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# What is an L3C?

- It is the for profit with the nonprofit soul. It operates in the space between the nonprofit and the pure for profit organization to perform a social mission. A type of LLC, the L3C (Low-Profit Limited Liability Company), is able to bring together a mix of foundations, trusts, DAFs, endowments, pension plans, individuals, corporations, nonprofits, governmental entities and others in order to achieve social objectives while operating according to for-profit metrics. Just like any LLC, an L3C has the liability protection of a corporation and the flexibility of a partnership. It is structured to be an ideal vehicle for PRIs (Program Related Investments by Foundations
-

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Program Related Investments (PRIs)

- The tax code allows foundations to directly invest in for-profit ventures under limited circumstances.
- To qualify, these investments – called Program Related Investments – must have a socially beneficial purpose and be consistent with and further a foundation's mission.
- A PRI can enjoy profits, but profit cannot be the primary motivation for the investment. The risk/reward profile must be outside that of a normal, market-driven investment.
- PRI's apply towards a foundation's five percent annual payout requirement.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# PRIs – A Few Examples

- Low-interest loans to needy students.
- Equity investment or loans for low-income housing projects.
- Low-interest loans to disadvantaged business owners.
- Brownfields mitigation and land conservation.
- Direct investment in businesses, non-profits and property in distressed neighborhoods.
- Job creation.
- Nonprofit support organizations.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Current Challenges to PRIs

- Does the investment qualify?
  - To address this uncertainty, many foundations either forego the investment or spend valuable time and resources acquiring a costly Private Letter Ruling from the IRS.
- How to attract market driven capital?
  - PRI transactions are often one off situations. Market capital likes repetitive, easily identifiable, brandable opportunities

Americans for
Community Development

*"Providing Nonprofits with For Profit Solutions"*

# The L$^3$C Addresses These Challenges

- The L$^3$C's operating agreement specifically outlines the PRI-qualified purpose for which its being formed, helping ensure that the nonprofit partner's tax exempt status is secure.

- The L$^3$C has flexible membership rules that allow all the partners to structure them in such a way as to satisfy their unique needs.

- As a replicable, recognizable brand the L$^3$C can actively market memberships to market driven members as well as other foundations, trusts, pensions, and individuals, making it easier for socially-motivated investors to locate the L$^3$C that fits their needs.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# The Limited Liability Company (LLC)

- As a special form of a LLC, the L$^3$C enjoys the same flexible rules that have made the LLC so successful, including:
  - Simple Structure: The LLC combines liability protection with the flexibility of a partnership.
  - Flexible Ownership Rules: Ownership rights under an L$^3$C can be adjusted an infinite number of ways, ensuring each partner enjoys a role that fits their unique requirements.
  - Pass Through Entity Election: Profit and loss flow through the L$^3$C to its members and are taxed according to each investor's particular tax situation, making it easier for non-profits and for-profits to partner together.
  - State Based: Since once a single state, Vermont, had adopted the L$^3$C, just like any LLC, an L$^3$C can be formed in Vermont to be used in any US state or territory.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# The Limited Liability Company (LLC)

- Members of an LLC create a contract among themselves called an operating agreement.
- The L$^3$C operating agreements will include provisions that fundamentally guarantee the charitable or public benefit orientation of the enterprise.
- Other Advantages:
  - Management flexibility:  Members may participate or may be completely passive.
  - Ownership Flexibility: Each operating agreement can be tailored to meet each member's own particular needs – profits may be allocated in proportions that are different from capital contributions.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# The L$^3$C – Other Advantages

- The L$^3$C is more than just a better Program Related Investment – it leverages limited foundation dollars to access trillions of market driven investment dollars through layered investing.
- The ability of the foundation to invest at less than the market rate while embracing higher risk levels, lowers the risk to other investors while increasing their potential rate of return.
- The L$^3$C is a profit-making entity with a social mission. As such, it has the ability to operate in a territory with a profit/risk profile that would scare off normal investors.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# An L3C Example– The Problem

- A corporation closes a furniture factory in a small town and puts 200 people out of work. The business bases its decision on the ultimate cost of keeping the factory open compared to the other uses for that money:
  - Factory Investment: $10 million capital investment with an expected 3 percent rate of return ($300,000).
  - Alternative Investment: Similar risks with an expected 6 percent annual rate of return ($600,000).
- The company invests elsewhere - 200 jobs are lost.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

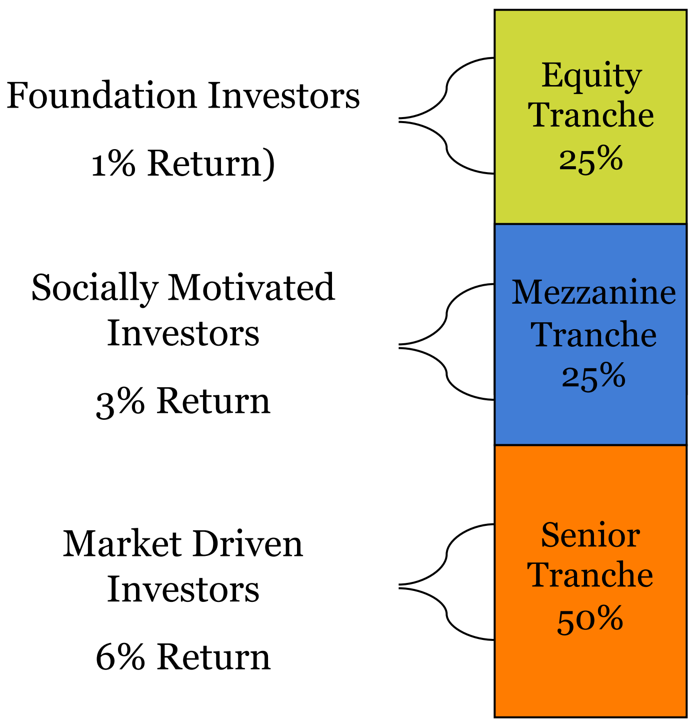
# An $L^3C$ Example – The Solution

- A foundation dedicated to serving the local community organizes an $L^3C$ specifically dedicated to buy the factory and save the jobs.
- The foundation's $L^3C$ membership stake provides for a very low rate of return (as little as zero) and is subordinate to the other investors.
  - If the investment is sold, the foundation's interests would be paid last.
- The remaining $L^3C$ memberships could then be marketed at rates of return and risk levels necessary to attract market driven investors.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Some Layered Investment Examples

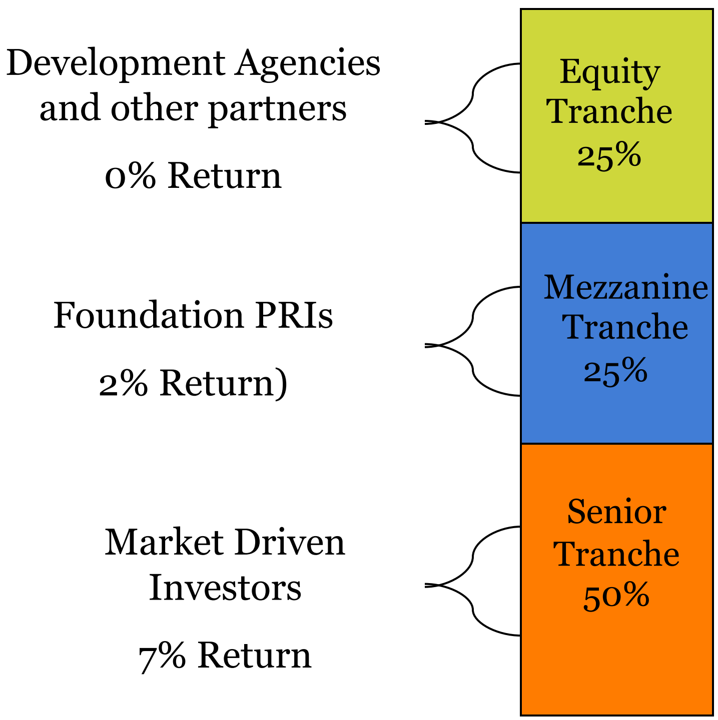



- Foundations make a 25% investment. They buy the Equity tranche or layer and receive a 1% return.
- Mezzanine Investors (corporations, trusts, banks seeking to fill their Community Reinvestment Act obligations, and other investors whose social interests allow them to take a less-than-market rate of return) accept the middle level of ownership with less than market rates of return -3%.
- Pension funds and others requiring safety and market return invest a safe 6%
- The blended rate of return is 4% which is within the capacity of the L$^3$C to generate the needed income.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# More Examples - Layered Investing at Work

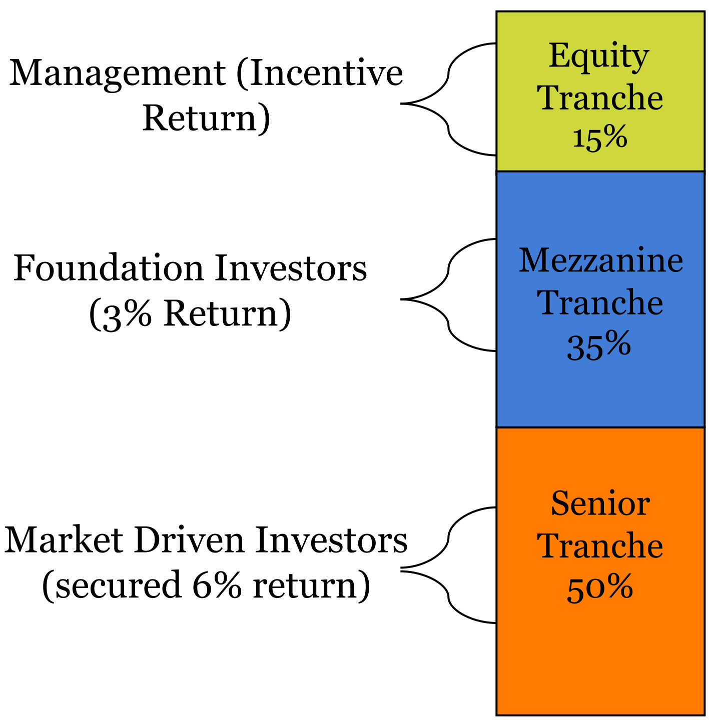



- Another possibility is that development agencies and other governmental partners take the equity tranche at 0% return, essentially making a grant.
- The foundation takes the mezzanine tranche at a 2 % return.
- The balance is then marketed to outside investors at 7%.
- Again we have a 4% blended return.
- The membership rights of this portion can be adjusted to meet the needs of potential investors.

Americans for Community Development

*“Providing Nonprofits with For Profit Solutions”*

# More Examples – Layered Investing




- Equity (management) tranche receives 15% ownership but only gets return if profits exceed 6% of total capital. Foundations may also share in this excess profit.
- Foundation: The foundation invests 50% of the L$^3$C capital ($5 million) but its ownership stake is 35% and subordinate to the Senior Tranche.
- The market driven investors put up 50% ($5 million). Their ownership stake is 50% and is senior to the other shares. They receive all returns up to 3% of total capital ($300,000 or 6% of their investment) per year.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# L³C Examples – Benefits

- The ability of the foundation to invest at less than the market rate and at higher risk lowers the risk to other investors while increasing their potential rate of return.
  - The foundation is able to further its mission while making an investment rather than a grant.
  - Entrepreneurs/management can have incentive opportunities.
  - The for-profit investor is able to make a market-driven investment where none existed previously.
  - Foundation leverages its capital to increase the overall investment.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# L3C Examples – Flexible Financing

- What about socially motivated investors?
- For many firms and individuals, an investment with a reasonable level of risk and a moderate return is attractive because they are willing to trade some income and security for philanthropic satisfaction.
- These socially-motivated investors could assume ownership levels in a mezzanine position at or below market rates.
- The L3C's flexible ownership structure allows for any number of ownership combinations.
- More or less than 3 layers possible.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Advantages to the Foundation

- Confidence that its share of the L3C is a PRI-qualified investment.
- Leveraged its investment to attract additional capital to the project.
- Attracted new partners with the expertise to make the investment work.
- Retained its investment to further the foundation's mission in the future and potentially enjoy capital gains.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Advantages to the For-Profit Investor

- New world of potential investments to explore.
- Is able to make socially motivated investments at a market based risk and return.
- Is able to structure the membership levels to reflect its priorities.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Governance and the L$^3$C

- The L$^3$C is designed to operate as a private business. This for-profit aspect of the L$^3$C helps to make the business self-regulating.
- Managers of the L$^3$C will enjoy the freedom and flexibility of a for-profit with marching orders that ensure they maintain their nonprofit souls.
- The L$^3$C will operate with a board, officers, and members or other structure to help ensure it complies with the goals set out by its founders and its operating agreement.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# What's Next for the $L^3C$?

- On April 30, 2008, Vermont's Governor Jim Douglas signed the nation's first law to authorize the formation of $L^3Cs$. Since then it has become law in Michigan, Illinois, Wyoming, Utah, The Crow Indian Nation, Louisiana, Rhode Island, Maine, North Carolina and the Oglala Sioux Tribe. The bill is pending in many more states.
- Now that some states have acted, $L^3Cs$ may be formed under their state laws to operate in all 50 states, the District of Columbia and all U.S. territories.
- We have model operating agreements which are available to ACD members on our website

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# Expanding the Ability of Foundations to Invest in Their Communities

- The L³C offers America's foundations a powerful new tool to achieve their mission.
- It gives businesses a wholly new vehicle to make socially responsible investments.
- It expands the capital available for foundations and other nonprofits to continue their important work.
- It's the perfect marriage of the for-profit and nonprofit world.

Americans for Community Development

*"Providing Nonprofits with For Profit Solutions"*

# How Can You Help?

- Join Americans for Community Development and help stimulate socially motivated investment in the United States!

- Contact us at:

  info@americansforcommunitydevelopment.org

- Or visit our website at:

  http://americansforcommunitydevelopment.org/default.asp