Americans for Community Development

*"Where the L³C was Born"*

# The $L^3C$ As A Tranched Structure

# The $L^3C$ as a Form of LLC

Americans for Community Development

*"Where the L3C was Born"*

# Challenge: How do we encourage ***trillions of dollars*** of market driven wealth to invest in ventures whose primary purpose is charitable not profit driven?

Americans for Community Development

*"Where the $L^3C$ was Born"*

# Form a For Profit Business Structure That Can Operate With a Below Market Return

- Many worthy causes can be self-sufficient and generate a low profit insufficient to attract market driven capital.
- The $L^3C$ a form of LLC was created to fill that space – that is why it is called a Low-profit Limited Liability Company.
- In order to attract market driven capital the $L^3C$ is best organized as a tranched structure.

Americans for Community Development

*"Where the L3C was Born"*

# What Is a Tranched Structure?

The owners of any LLC are called members. When an L3C (a type of LLC) is organized as a tranched or layered structure it merely means that different members or groups of members each of which have a unique place and responsibilities within the organization. More importantly some are a greater risk than others of losing their investment.

Americans for Community Development

*"Where the L³C was Born"*

# What Does That Mean?

The easiest way to think of it is to compare it to your country home

Americans for Community Development

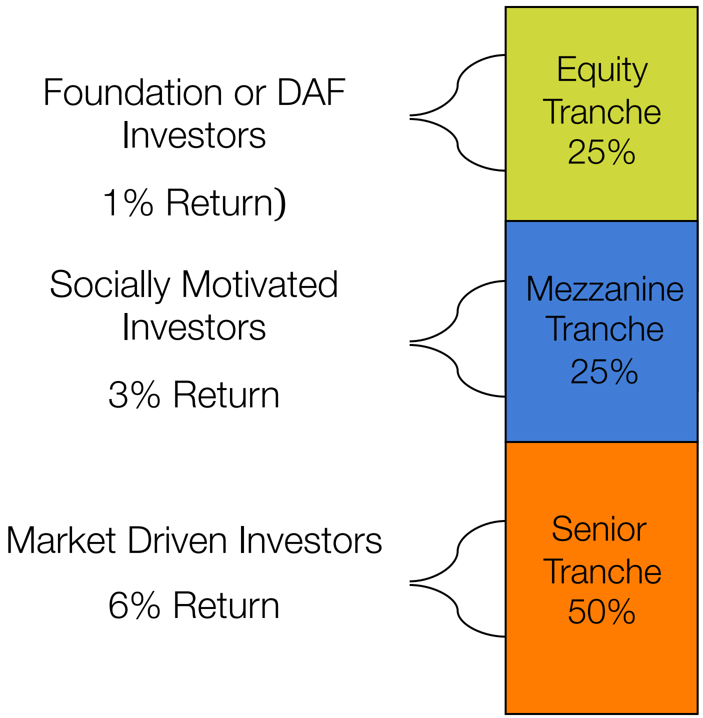
*"Where the $L^3C$ was Born"*

- The title is in your name, you have invested some part of the price and that is your equity. Your position is similar to the "equity" tranche in an $L^3C$. Your equity is a first risk.
- There is a second mortgage. The second mortgage holder occupies the next riskiest position. In an $L^3C$ this is often referred to as a mezzanine position.
- There may be more than one mezzanine position.
- There is a first mortgage. The first mortgage holder takes the least risk. In the $L^3C$ this position would be called the senior tranche.
- If there is a foreclosure and the house is sold and if everyone cannot be paid the last one to be paid and the first one to lose their money is you.

Americans for Community Development

*Where the $L^3C$ was Born"*

# A Simplified, Tranched Investment Example




- Foundations or Donor Advised Funds (DAFs) 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 mezzanine level of ownership with less than market rates of return .
- 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 $L^3C$ to generate the needed income.

Americans for Community Development

*"Where the $L^3C$ was Born"*

# Do All The $L^3C$ Tranches Have to Invest The Same Way?

- No. Each tranche can bring different forms of investment and their investments need not reflect equal ownership. For example, one or more of the tranches may reflect loans, cash investment, contributions of real property, leases, loan guarantees or nothing. Yes, nothing! Some members might receive a portion of the membership just because they are managers or creators, etc. A foundation making a PRI might contribute 20% of the total investment but only receive 10% of the membership. At the same time the foundation may have a clause in the operating agreement which permits them to force other members to buy them out if they feel the $L^3C$ is no longer performing the mission it was created to follow.

Americans for Community Development

*"Where the L$^3$C was Born"*

# What Is This Operating Agreement?

## It is the key to the L$^3$C and all LLCs

- The L$^3$C & all LLCs are built around a document called an operating agreement which specifically outlines what the L$_3$C is all about, how it will operate, what each member will contribute depending on the tranche they occupy, what responsibilities and powers they have, what compensation they will receive if any and under what conditions. 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.

- The operating agreement is a contract among the members and reflects the fact that the LLC and L$^3$C are in effect truly partnerships with corporate protection.

Americans for Community Development

*"Where the $L^3C$ was Born"*

# Features of The $L^3C$ (or LLC)

As a special form of LLC, the $L^3C$ 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 $L^3C$ 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 $L^3C$ to its members and each are taxed according to their particular tax situation, making it easier for non-profits and for-profits to partner together.

Americans for Community Development

*"Where the $L^3C$ was Born"*

- State Based: Once a single state, Vermont, had adopted the $L^3C$ in 2008, just like any LLC, an $L^3C$ can be formed in Vermont and used in any US state or territory. The bill has since been passed in 9 states, 3 Indian Nations and 1 US Territory.
- Members of an $L^3C$ create a contract among themselves called an operating agreement.
- The $L^3C$ operating agreements should 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 members own particular needs – profits may be allocated in proportions that are different from capital contributions.

Americans for Community Development

*"Where the $L^3C$ was Born"*

# The $L^3C$ – Other Advantages

- The $L^3C$ leverages limited high risk dollars such as investments by foundations, DAFs, public charities or tax credits in the equity tranches to access trillions of market driven investment dollars through tranched or layered investing.
- The ability of the foundations, etc. 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 $L^3C$ 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

*"Where the L3C was Born"*

- Contact us at:

  info@americansforcommunitydevelopment.org

- Visit our website at:

  https://americansforcommunitydevelopment.org/