



The L³C

the for profit with a nonprofit soul

Community Foundations & The L³C

The Community Foundations have the potential to play some very important and very unique roles in the use of the L³C. The L³C is a hybrid vehicle designed to bring various types of individuals and entities under the same umbrella. Some may be investors and some may not. In so far as the investors go it provides for different investors to make different types of investments and receive different types of returns. Although it is legally possible to have a hundred investors and have each one have a unique arrangement with the L³C, efficiency says that having 3 to 5 tranches (levels) of investment will be the most efficient. To illustrate let's use a three tranche investment structure. Other NGOs might be members of the L³C but not investors so we are only projecting investors.

- **Equity Tranche** - highest risk, lowest return. Unlike most for profit structures in which the first tranche investors with the highest risk want the highest return, foundations through the use of the PRI structure can take this tranche. Since a PRI is in lieu of a grant no matter how risky the PRI the potential return and income is still better than that from a grant.

- **Mezzanine Tranche** - Because the high risk portion has been taken care of, the mezzanine investor will ask for a lower rate of return since the risk is much lower. Individuals, banks under CRA, corporations with dual objectives of investment return and corporate image are the types of investors who could occupy this tranche.

- **Senior Tranche** - Whether there is real estate, equipment or whatever involved, most L³C transactions will have some hard assets which have value if the transaction fails. This makes the senior tranche very stable and hence investors in this tranche will ask for a lower return because of the low risk and could more likely be long term income directed investors. Pension Funds and other large institutional investors are very possible in this tranche.

The PRI portion of the investment creates both obstacles and opportunities. The opportunity the L³C presents is that with a less expensive, simplified, defined structure it opens the door to PRI investing by thousands of smaller foundations. The L³C by itself still does not remove expenditure responsibility, it still does not simplify individual donations to a project, and large numbers of PRI investors can complicate organization. This is where a foundation created especially to make PRIs or better yet a Community Foundation can come into play.

A Community Foundation or specialized foundation can pool investment from donor advised funds, other foundations and even from individuals to create a PRI fund to be invested in a specific L³C project. As a result, the Community Foundations have great potential as amalgamators, administrators and directors of targeted PRI funds with the following results:

- Eliminate the need for multiple due diligence since the community foundation will do it once. Presumably, they are also better equipped to do it.
- Streamline the L³C so it has fewer members and presumably the community foundation will have more knowledgeable and skilled individuals to monitor and/or serve as part of the management of the L³C.
- Essentially allow individuals, businesses, etc. to make a tax deductible contribution to an L³C by making their actual donation to a qualified nonprofit.
- Create a firewall for all the donors. Since they will be donating to a non profit almost all issues relevant to the donation will be eliminated.
- Help assure market rate and MRI investors that all issues relevant to social mission, etc. have been adequately addressed.

- Simplify bookkeeping and record keeping.

• Allow those who would not otherwise have the opportunity to participate in an L3C project to participate and get a tax deduction.

In addition we looked at the community foundations from the perspective of a paired investment / donation model. In this case an investment house might sell an investor a share of the senior tranche or a mezzanine tranche of the L3C and at the same time direct them to the partnering community foundation to make a donation to be used for the PRI or equity tranche of the same L3C.

Use of either or both of these techniques would not only improve the structuring and governance of L3Cs but substantially contribute to our mission to bring new outside dollars to bear on social problems.

Any comments relevant to the pairing concept may be sent to the above or:

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