Americans for Community Development

"Where the L^3C was Born"

The L^3C Explained

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What is an L^3C?

It is *the for profit with the nonprofit soul*. It is a for profit organized to perform a charitable mission which must come before making a profit. A type of LLC, the L^3C (Low-profit Limited Liability Company), is able to bring together a mix of foundations, DAFs (Donor Advised Funds), pension plans, endowments, individuals, corporations, nonprofits, trusts, governmental entities and others in order to achieve charitable objectives while operating according to for profit metrics. It is structured to be an ideal vehicle for PRIs (Program Related Investments by Foundations.)

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The Limited Liability Company (LLC)

- Members of an LLC create a contract among themselves called an operating agreement.
- The L³C operating agreement 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 members own particular needs – profits may be allocated in proportions that are different from capital contributions.
  - Simple Structure: The LLC combines liability protection with the flexibility of a partnership.
  - Flexible Ownership Rules: Ownership rights under an L³C can be adjusted an infinite number of ways, ensuring each partner enjoys a role that fits their unique needs.
  - Pass Through Entity Election: Profit and loss flow through the L³C to its members and are taxed according to each investors particular tax situation, making it easier for nonprofits and for profits to partner together.
  - State Based: Once a single state adopted the L³C, just like any LLC, an L³C was legal to be formed in that state to be used in any other US state or territory.

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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.

Legal Construct,
Governance
&
Fiduciary Responsibilities

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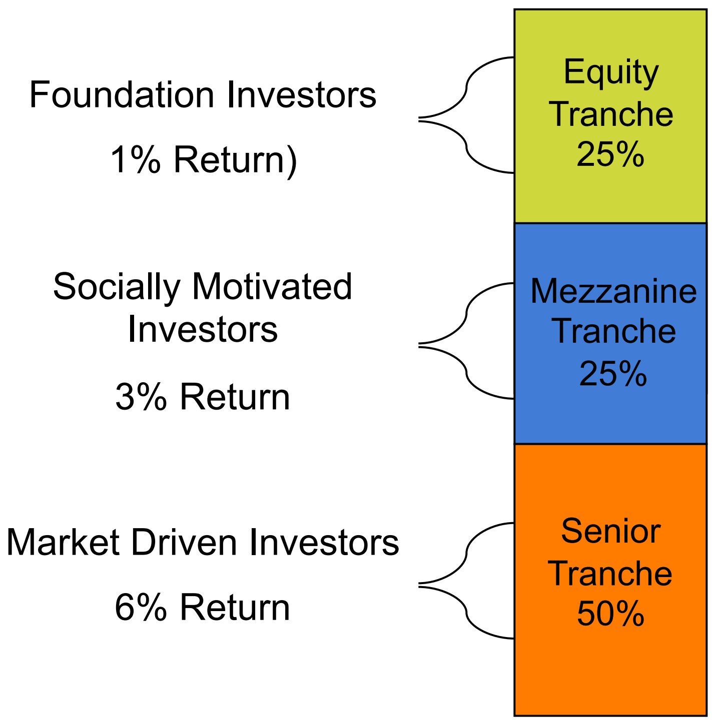
Some Layered Investment Examples



- 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.

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More Examples - Layered Investing at Work

Development Agencies and other partners

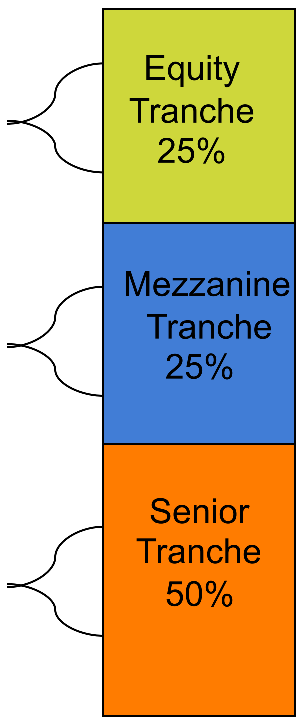
0% Return

Foundation PRIs

2% Return)

Market Driven Investors

7% Return



- 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.

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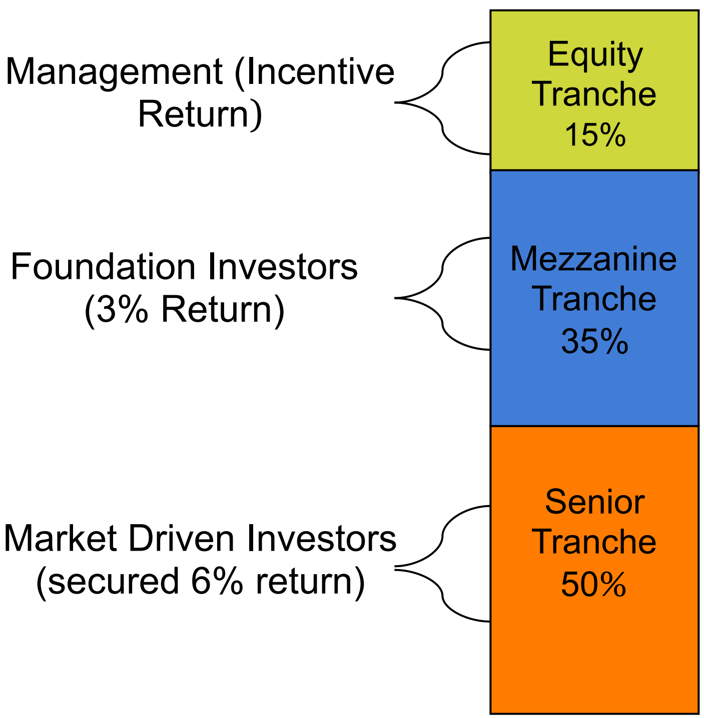
More Examples – Layered Investing



- 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 L³C 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.

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L^3C 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 L^3C's flexible ownership structure allows for any number of ownership combinations.
- More or less than 3 layers possible.

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How Can You Help?

- Register at 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:

  https://americansforcommunitydevelopment.org/