

# Today's seminar will begin shortly

National Assembly of  
State Arts Agencies

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# L<sup>3</sup>Cs and State Arts Agencies

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# Your Hosts

National Assembly of  
State Arts Agencies

KNOWLEDGE ★ REPRESENTATION ★ COMMUNITY



**Eric Giles**

Learning Services Manager



**Wesley Taylor**

Director of Administration  
and Finance

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# Tech Tips

- **View all participants** in the roster to the right
- **Use the “Chat” box at any time** to submit a question or get technical help
- **During the Q&A break** presenters will answer chat questions

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# Today's Format

## I. L<sup>3</sup>Cs and State Arts Agencies



**Bob Lang**

L<sup>3</sup>C creator and founder  
Americans for Community Development



**Michael Martin**

Attorney at Law  
Martin & Stilwell, LLP



**R. Bernard Hall, Jr**

Arts administration graduate student  
Savannah College of Art & Design

## II. Your Questions and Comments

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## II. Your Questions and Comments



# The L<sup>3</sup>C & The Arts

*The For Profit With The Nonprofit Soul*

Introducing the new, socially responsible  
solution for the arts.

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## Overview

- **Nongovernmental resources come in two types:**
  - **For Profit Sector Resources:** Market Driven - making money & building wealth - normally require rate of return of over 5%
  - **Nonprofit Sector Resources:** Market incentives are inadequate or non-existent - rate of return of 0 to -100%
- **How do we access the trillions of dollars of market driven wealth to invest in ventures that fall into the gap between the 0 and over 5% - Low-profit businesses that can be self sustaining if they have adequate capital?**





## Overview

- How do we provide the public and investors with the assurance that the entity will perform the charitable services it promises?
- How can we bring together disparate groups that have a common goal but incompatible structures?
- How do we avoid the operational pitfalls of a nonprofit venture?
- We form an L<sup>3</sup>C!
- The L3C can be legally operated in all 50 states



## Why the L<sup>3</sup>C?

- Operates in the space between the nonprofit and the pure for profit organization to perform a social mission.
- A variant form of LLC, the L<sup>3</sup>C (Low-Profit Limited Liability Company) has the liability protection of a corporation and the flexibility of a partnership.
- Able to bring together a mix of elements of foundations, trusts, Donor Advised Funds, endowments, pension plans, individuals, corporations, nonprofits & governmental entities and others.
- Its structure provides for layered or tranching financing. The foundation(s) or DAF(s) take first risk position at low cost thereby lowering the cost of funds for the whole structure.
- Able to achieve social objectives while operating according to for profit metrics.



## What Makes the L<sup>3</sup>C Work?

- The L<sup>3</sup>C performs functions often reserved for a nonprofit but as a for profit it can also expand its operations to activities that are strictly revenue generating if the profits from those revenues are used to support the charitable purpose.
- The L<sup>3</sup>C does not use the charitable dollars it receives from foundations or DAFs to subsidize operations. It receives a subsidy in the form of the lower cost of capital resulting from the foundation investment.



## The Limited Liability Company (LLC)

- Governed by an operating agreement.
- In addition, the L<sup>3</sup>C operating agreements will include provisions that guarantee the charitable or public benefit orientation of the enterprise.
- Management flexibility: Members may participate or be 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.
- The L<sup>3</sup>C is designed for PRIs (Program Related Investments) by foundations – it leverages limited foundation dollars to access trillions of market driven investment dollars through (tranching) layered investing, which lowers the risk to other investors while increasing their potential rate of return.



## What are the Parameters of the L<sup>3</sup>C?

- The Company significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the IRS Code of 1986, 26 U.S.C. Section 170 (c)(2)(B); and would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.
- No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.
- No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the IRS code of 1986, 26 U.S.C. Section 170(c)(2)(D).



## Program Related Investments (PRIs)

- The tax code allows foundations to directly invest in for profit ventures under limited circumstances.
- To qualify, these investments (PRIs) 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 high risk/low reward profile is outside the parameters for foundation endowment investment.
- PRIs apply towards a foundation's five percent annual payout requirement.



## Donor Advised Funds (DAFs)

- The tax code allows individuals to create donor advised funds which can be used in the same way as foundation dollars.
- DAFs can replace foundation PRIs in L<sup>3</sup>Cs.
- A DAF can be created in 24 hours and the donor gets a tax deduction at public charity rates.



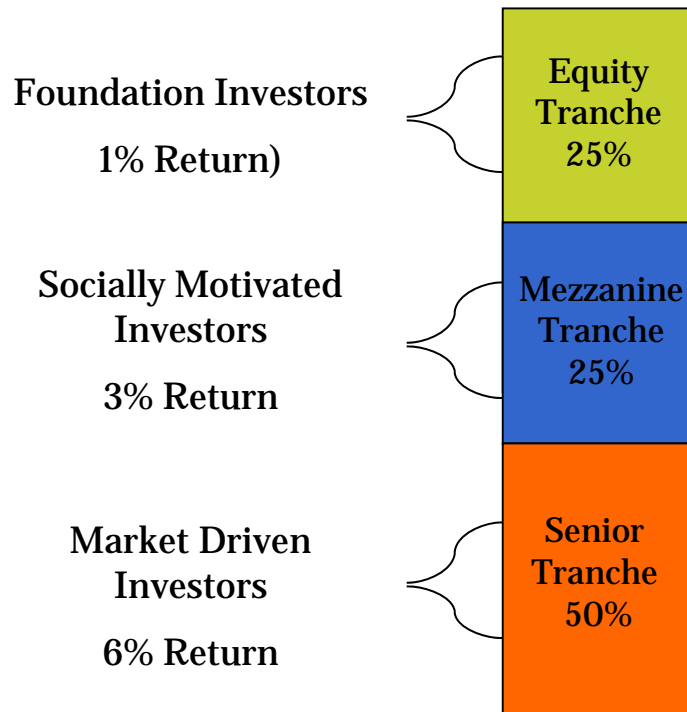
## PRI — A Few Examples

- Historic preservation and community revitalization.
- Support for the arts.
- Low-interest loans to disadvantaged business owners.
- Economic development, brownfields mitigation, and land conservation.
- Direct investment in businesses, property in distressed neighborhoods and loans to nonprofits.
- Job creation.





## Layered Investment – An Example



- Foundations or 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 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<sup>3</sup>C to generate the needed income.



## Governance and the L<sup>3</sup>C

- The L<sup>3</sup>C is designed to operate as a private business. This for-profit aspect of the L<sup>3</sup>C helps to make the business self-regulating.
- Managers of the L<sup>3</sup>C will enjoy the freedom and flexibility of a for-profit with marching orders that ensure they maintain their nonprofit souls.
- The L<sup>3</sup>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.



## L<sup>3</sup>Cs and the Arts - Examples

- Production of a stage show with a message.
- Development of new actors, artists, musicians, etc.
- Revitalizing and updating an old theatre into a modern arts center.
- A multi purpose building which uses normal profit components to support arts activities.
- A museum as an educational and entertainment center.
- A museum which is also an art gallery with art for sale.
- Using the L<sup>3</sup>C to expand arts funding.

# Audience Questions

Use the “chat” box.

## Save the Date!

### Nonprofit Finance Fund

September 12, 2012

*Check the NASAA website for updates!*

# Thanks for participating!

Questions or comments about this session? Contact Eric Giles,  
Learning Services Manager ([eric.giles@nasaa-arts.org](mailto:eric.giles@nasaa-arts.org)).

Many thanks to NASAA's member states and today's guests for making this session possible. The work of NASAA and of state arts agencies is also supported and strengthened in many ways through funding and programming partnerships with the National Endowment for the Arts.