

## **Hart's Mill, LLC FAQ**

### **Generally speaking, what is an LLC?**

LLC is a common abbreviation for Limited Liability Company. An LLC is a hybrid business enterprise that blends the benefits of a partnership with the limited liability of a corporation. Like owners of a partnership, **LLC members report their share of business profits or losses on their personal income tax returns.** That is, the LLC is not itself a taxable entity. Like shareholders of a corporation, **LLC members are largely protected from personal liability for business debts and claims.** The ground rules for the structure and operations of a specific LLC are spelled out in a document called an Operating Agreement.

### **Specifically, what is Hart's Mill, LLC?**

Hart's Mill, LLC (abbreviated here as HM LLC) is the legal entity which was established in November 2013 to serve the legal and financial requirements for the development of the Hart's Mill Ecovillage. It is registered with the North Carolina Secretary of State. At present, it is Hart's Mill's only legal entity and is expected to be in place through the construction process, when it will be superseded by a permanent homeowners' association or cooperative.

### **The purposes of the HM LLC are to:**

- Serve the Vision, Mission & Aims of Hart's Mill Ecovillage
- Manage the development process
- Enter into contracts
- Buy & sell property
- Borrow money
- Manage member investments
- Administer the financial & tax matters relating to the LLC
- Protect individual members from liability

### **Where can I learn the details about the Hart's Mill, LLC?**

Details concerning the rights and responsibilities of LLC members are set forth in a legal document called an **Operating Agreement (OA)**. We have recently updated the HM LLC Operating Agreement with the assistance of our attorney and it is available upon request. If you are considering becoming an investor in the HM LLC you will want to examine this closely and have an accountant or attorney review it. The OA is a legal document and reads like one. To assist you, **an Appendix to this FAQ briefly**

**summarizes in layperson language the purposes of the various Articles of the HM LLC Operating Agreement.**

### **What's the relationship between Hart's Mill Ecovillage and Hart's Mill, LLC?**

Hart's Mill Ecovillage is currently an **informal group** of people identified by their level of membership in the community and the roles they play in advancing the Vision, Mission and Aims of the Hart's Mill Ecovillage. These statements are spelled out in documents accessible through the Hart's Mill website: [www.hartsmill.org](http://www.hartsmill.org).

Hart's Mill LLC, on the other hand, is a **formal legal** entity with a Federal EIN and North Carolina registration. Its Operating Agreement sets forth the ground rules under which it operates and guides the financial and legal aspects involved in the development of the ecovillage project. The HM LLC contractually protects the personal resources of individual LLC investors and contractually obligates the investors in the LLC to serve the interests of the Hart's Mill Ecovillage.

### **What is the relationship between making an investment in the LLC and membership in the Hart's Mill Ecovillage community?**

These are currently independent activities. ***Becoming an investor in the HM LLC is separate from meeting the HM community's membership requirements.*** However, becoming an LLC investor certainly demonstrates a commitment to the HM Ecovillage Vision, Mission, Aims, Principles & Intentions and would be taken as strong evidence of your desire to be part of the overall project.

However, as we get closer to securing financing and beginning construction, financial investment will become a requirement for those reserving a residence in the community. In a self-development model, the members must put up the equity required by lenders. There is no outside developer putting money into the project – or taking profits out!

Our updated Operating Agreement defines ***three LLC member/investor categories:***

- 1) Member/Managers,
- 2) Members who are not managers, and
- 3) Persons with an economic interest who are not members of the LLC

These member/investor categories correspond informally to the membership categories in the HM Ecovillage community: (1) Engaged, (2) Associate and (3) Exploratory.

Note that there is no correlation between the amount of investment and category of LLC membership.

## **Who are the present members of the HM LLC?**

There are currently 8 members who hold equity in the HM LLC: Katy Ansardi, Jeffrey Goodrum, Johanna Janssen, Amy Halberstadt, Hope Horton, Carol St. John, Paul Voss and Anthony Weston. Some of these members also are LLC Managers, which makes the HM LLC a “member-managed” LLC, as opposed to one which hires an outside professional manager. This group of Member-Managers is jointly responsible for managing the legal and financial affairs of the LLC as specified in the Operating Agreement.

## **Can I become an investor or member of HM LLC?**

Yes! ***One of our goals for 2016 is to grow investments and membership in the HM LLC.*** The objectives are: (1) to recognize that the Hart’s Mill community has grown dramatically since the LLC was established and new members should be encouraged to become a larger part of the formal operation and financial life of the Hart’s Mill enterprise; and (2) to raise the substantial amount of money necessary to facilitate the early stages of the development process.

## **How do I become an investor in HM LLC?**

You become an investor in Hart’s Mill, LLC by making a capital investment and by signing the HM LLC Operating Agreement. Our Operating Agreement requires that a few simple steps be followed.

**Step 1.** You contact the HM Treasurer, currently Paul Voss ([voss@hawkweed.net](mailto:voss@hawkweed.net)), expressing your intention to invest in the HM LLC and stating the anticipated amount you wish to invest.

**Step 2.** The current LLC Members will then meet to approve your application and affirm that there are no irregularities.

**Step 3.** You are notified of the result. If the Members unanimously consent, you then would sign the Operating Agreement and write the check.

## **How much money will I need to become a HM LLC investor?**

The current minimum initial investment (“initial capital contribution”) is \$5,000. More is better. For reference, some of the present HM LLC members have invested more than \$20,000. Section 11.2(h)(ii) of the HM LLC Operating Agreement outlines the rules for payment on an installation basis in the event a new investor cannot pay the Initial capital contribution commitment in cash.

## **What happens to this money?**

These equity investments in the LLC will go toward purchasing the land and funding Hart’s Mill pre-development activities, e.g., architectural design, surveying, engineering

services, etc.). Note that most of these costs are booked as assets, rather than expenses, since they could potentially be transferred to another entity to complete development of the project. In other words, our pre-development costs have ongoing value, unlike a basic operating expense such as rent or utilities.

Three related questions need to be addressed:

***First, what happens to this money if I decide to leave the community?***

This has happened twice already. In both instances, an existing member stepped forward and purchased the LLC equity of the departing member. After accounting for profit/loss, the departing member was made whole. But note that the OA states (Section 8.3(a)) that members do not have the right to withdraw all or part of their capital contribution. As indicated above, however, these matters have been previously accommodated under the rules set forth in Section 11.2 of the Operating Agreement, and we would make every effort to do the same for any withdrawing Member.

If you withdraw from the HM LLC, the options are, in this order:

- You offer to sell your economic interest to the HM LLC
- If the LLC declines to purchase your economic interest, you may offer to sell it to other member(s)
- If another member does not purchase your economic interest, you may sell it to an LLC-approved 3<sup>rd</sup> party, and this 3<sup>rd</sup> party would become a non-member with an economic interest

***Second, what happens if Hart's Mill folds?***

If the Hart's Mill project is not able to move forward and the LLC is dissolved, all assets would be sold. Assets may include loans owed to the LLC, the land, prepaid expenses, and any transferable development rights, engineering studies, designs, etc. Equity holders would most likely recover all or most of their investment in due time. While this outcome is unlikely, we are prudently attempting to keep aggregate personal equity in the LLC below the value of assets so that full reimbursement remains the goal. This recovery of owners' equity would take some time while the land is reappraised and placed on the market for sale. If HM LLC were to be dissolved, all assets after expenses would be **distributed in proportion to member equity interests**. Details are in Sections 11.3 through 11.6 of the Operating Agreement.

***Third, what happens if (when!) Hart's Mill succeeds?***

This clearly is the goal! When the Hart's Mill Ecovillage is constructed and ready for occupancy, a permanent "blanket" mortgage for the entire community will be put in place and the LLC will be dissolved. The value of your LLC equity at that time will:

- be purchased outright if you do not intend to live at Hart's Mill, or
- applied toward your upfront cost of moving to Hart's Mill. For example, if a housing cooperative becomes our home ownership model, as we plan, your LLC equity would be applied to your share in the co-op.

### **How are my investments with HM LLC tracked?**

Each LLC owner is assigned a capital account where capital contributions and adjustments are itemized and tracked (see Section 8.2 of the Operating Agreement). The amount of your equity defines your economic interest in the HM LLC. It represents your proportionate ownership share of the overall LLC assets. Profits and losses are also distributed to the owners' capital accounts in proportion to ownership share. Therefore, the value of owners' equity and their ownership share will vary over time. Owners will receive periodic reports itemizing their capital account.

### **What are the tax implications of investing in the HM LLC?**

An LLC is a "pass-through" entity, meaning that LLC owners recognize their portion of any profits or losses on their personal income tax returns. Following the end of each calendar year, you will receive a Schedule K-1 from the LLC to file with your personal income tax return. While the numbers typically are small, your share of any financial losses to the LLC is generally tax deductible. Similarly, your share of LLC financial profits is taxable. However, there are different rules for active and passive profits and losses, so advice from a tax professional is strongly advised.

### **What are the benefits of becoming an investor in the HM LLC?**

Certainly, the Hart's Mill Ecovillage *project* benefits financially from your equity contributions. But there are significant *personal* benefits as well. In addition to a sense of ownership in something you feel strongly about and are committed to, there are these benefits:

- You are helping to raise some of the early capital needed by Hart's Mill to breathe life into the Community's Vision, Mission & Aims
- When you become a member in the HM LLC, you participate in its governance process
- When you become a manager of the HM LLC, you participate in its operation
- Although not guaranteed, your investment is backed by tangible assets

- Any annual losses are generally tax deductible
- Your liability is limited

### **What are the risks of becoming a member of the HM LLC?**

The list is pretty short:

- LLC profits are taxable
- The deductibility of LLC operating losses may be limited depending on your role in the LLC and overall tax situation
- In the event of gross misconduct by the LLC managers, there could be some liability to members.

## **APPENDIX**

### **OVERVIEW OF HM LLC OPERATING AGREEMENT**

***Note: This summary is provided as an orientation for convenience only. Only the full Operating Agreement document should be relied upon for binding legal representations.***

#### **GENERAL**

The HM Operating Agreement applies only to Hart's Mill LLC and is in place purely for legal and financial purposes, such as holding property and managing the interests of the HM Ecovillage through the development process. While the Operating Agreement is necessarily long and complicated, you may feel that it leaves out a lot of detail regarding community life at Hart's Mill. Stay tuned, as those details will follow in documents like community bylaws, occupancy agreements and several other legal necessities. The Operating Agreement applies only to management of the LLC, the legal structure for Hart's Mill during the development phase.

#### **ARTICLE I – DEFINITIONS**

A helpful glossary when reading the Operating Agreement. These terms are legally nuanced and have been carefully considered both by the members of the Hart's Mill Financial/Legal Functional Circle and by our attorney.

#### **ARTICLE II – FORMATION OF THE COMPANY**

This required section is consistent with the Articles of Organization filed for Hart's Mill, LLC, with the NC Secretary of State. Among other general details, it specifies the Purposes and Powers of the Company (Section 2.6).

#### **ARTICLE III – RIGHTS AND DUTIES OF MANAGERS**

Managers of the LLC are responsible for attending to the affairs of Company. Article III specifies how Managers are elected and removed, how vacancies are dealt with, and how Managers may organize to their duties.

#### **ARTICLE IV – MEETINGS OF MANAGERS**

This Article has considerable detail, but follows the items legally required of Operating Agreements.

## **ARTICLE V – MEMBERS**

Members of the LLC are those who have made an equity investment and have voting rights. People who have attained at least Associate Membership in the Hart’s Mill Ecovillage are eligible to become voting members of the LLC. They play a significant role in important LLC matters – for example, as outlined in Article VI, they elect the managers – but the responsible day-to-day running of the LLC rests with the managers.

## **ARTICLE VI – MEETINGS OF MEMBERS**

This Article provides detailed guidelines for calling and holding meetings of members. Section 6.6 specifically authorizes governance and decision-making rules that depart from standard organizational practice – including the choice to adopt Sociocracy for these purposes.

## **ARTICLE VII – LIMITATION OF LIABILITY AND INDEMNIFICATION OF MANAGERS AND MEMBERS**

This Article protects Members and Managers from personal liability for business debts and claims – a feature known as “limited liability”. This means that if the company owes money or faces a lawsuit, only the assets of the business itself are at risk. Creditors usually can’t reach the personal assets of the LLC Owners such as a house, car or savings.

LLC members and managers can lose this protection by acting illegally, unethically, or irresponsibly. Consequently, there is some liability exposure for LLC members and managers. However, misconduct must be proven to be willful acts of fraud, not just unfortunate or ill-conceived decisions. The commitment to transparency (part of our Sociocratic governance structure) will help us to all remain involved and informed in any LLC-related activities and decisions.

Persons who are not members of the LLC, but have an economic interest in the LLC, generally have less exposure to risk resulting from illegal or unethical behavior as they would not have participated in the decisions leading to that behavior.

## **ARTICLE VIII – CONTRIBUTIONS TO CAPITAL AND CAPITAL ACCOUNTS; LOANS**

The previous Articles mostly dealt with organizational details, conduct of meetings and legal protections. Here we begin talking about money. The Article deals with capital investments and loans, capital accounts and profit/loss matters. Section 8.3 is important, as it specifies that withdrawal as an owner does not carry with it the ability to immediately “cash out” of the LLC. See the above question in the FAQ, “*First, what happens to this money if I decide to leave the community?*”



In order to become an investor in the HM LLC, one must contribute cash, property, or commercially valuable services to the company. If the capital reserves of the company are insufficient, the company may send out a call for additional contributions.

Members may make loans to the LLC. However, loans are not considered to be capital contributions and will not affect percentage of ownership interest.

Each owner will have a capital account which records the initial and any subsequent capital contributions. These accounts will be maintained according to applicable Treasury Regulations. No owner shall be liable for any company debts beyond these capital contributions, except in the case of malfeasance, as discussed above.

The work involved in maintaining the capital account of each owner is significant. This is the reason that we are requiring a \$5,000 minimum for initial capital contributions.

#### **ARTICLE IX – ALLOCATIONS, DISTRIBUTIONS, ELECTIONS AND REPORTS**

While Article VIII deals primarily with the methods by which money comes to the LLC, this Article outlines how Hart's Mill, LLC funds will be accounted for and reported for operational and tax purposes. Accounts will be maintained, business expenses will be tracked and reimbursed if money is available, and tax returns will be filed in accordance with Treasury Regulations.

Because this LLC exists for the purpose of funding our HM pre-development process, we don't expect there to be profit distributions or any significant tax liability. However, before investing in the HM LLC you may wish to ask your tax accountant review this section to ensure that this will work for your personal situation.

#### **ARTICLE X – TRANSFERABILITY OF MEMBERSHIP INTERESTS; ADMISSION ON MEMBERS**

Your membership interest may be transferred to a 3<sup>rd</sup> party provided that such a transfer is approved by a Majority (67+%) of the managers and that it doesn't violate the law in any way. Transferee's of membership Interest do not automatically become members. A transferee may apply to be admitted as a member. The application must be approved unanimously by the members.

#### **ARTICLE XI – WITHDRAWAL AND DISSOLUTION**

There are three ways to withdraw from HM LLC in this order:

1. Sell your economic interest to HM LLC
2. If declined, sell to other member(s)
3. If declined, sell to a 3<sup>rd</sup> party

Also included is language regarding the involuntary expulsion of a member (Section 11.2(k)). All transactions will comply with processes/procedures in this Article.

HM LLC will most likely be dissolved voluntarily once the development phase is complete and we transition to a permanent entity such as a housing cooperative or homeowners' association. The process we must go through, as well as guidelines for distribution of any assets are outlined here.

## **ARTICLE XII – ECONOMIC INTEREST OWNERS**

This Article is new and was not in our original Operating Agreement. It introduces a category of Economic Interest Owners who have acquired an ownership interest in the LLC but are not members. The category accommodates investors who are relatively new to the Hart's Mill Ecovillage project (e.g., Exploratory Members) or other individuals who wish to invest in the HM LLC but not be actively involved in the management or decision-making of the organization.

Economic interest owners may convert their economic interest into membership interest with the unanimous consent of the LLC members. Note that only Hart's Mill Ecovillage (HMEV) members at the Associate level or higher are eligible for LLC member status, but the relationship between informal HMEV membership and formal membership in the LLC is not addressed in the Operating Agreement. It is a policy which has been jointly adopted by HMEV and the HM LLC.

This Article also addresses the matter of transferability of economic interest as well as withdrawal from the LLC of an economic interest owner.

## **ARTICLE XIII – MISCELLANEOUS PROVISIONS**

This Article covers a number of legal and other practical matters not elsewhere addressed. It contains language about transparency, access to information, and truthfulness in disclosures. It devotes several sections to the matter of notices, demands or request, and it specifies how these are dealt with.

Section 13.8 specifies that the Operating Agreement may be amended from time to time, and Section 13.12 clarifies the clumsy matter of verb tense and gender language that some of us occasionally vex over.

## **SCHEDULE I**

Here is where we record capital contributions to the HM LLC by name of owner. Ownership status is identified and eligibility to be a manager is indicated. This Schedule will be updated from time to time.