

Program Description

The City of Newark, under the leadership of the Honorable Mayor Ras J. Baraka and in partnership with Newark CEDC and private investors, is implementing the development of employee-owned businesses as a community wealth-building strategy. Our employee ownership initiative is designed to change the economic landscape for residents of Newark, NJ through the conversion of existing businesses to employee ownership. Historically, employee-owned businesses have served as a powerful tool for addressing economic inequality by providing employees with better working conditions and the potential to increase family wealth. According to the National Center for Employee Ownership, “employee-owners were four times less likely to be laid off during the recent recession” and employees at employee-owned businesses have “2.5 times greater retirement accounts than equivalent employees elsewhere” (www.esopinfo.org/infographics). In addition, employee-owned companies experience “25% higher job growth than comparable companies.” The standard structure for employee ownership in the United States is an employee stock ownership plan (ESOP), which is regulated under federal law to protect employee assets and enjoys substantial tax benefits.

Benefits for Business Owners

Business owners will receive cash at the time of sale. They will avoid the cost of business broker fees that can range up to 10% of company value. If the business is a C-Corp, or converts to a C-Corp, the seller can defer the capital gains tax on any sale proceeds reinvested in domestic securities, e.g., a mutual fund (www.nceo.org/articles/esop-tax-incentives-contribution-limits). If the sale proceeds are reinvested until death, then no capital gains tax is paid and the transaction becomes tax-exempt. The sale will occur on the timeline, and at the convenience of, the seller. Owners may choose to continue to work at the business and Newark CEDC is open to providing a consulting or employment agreement with the seller. Newark CEDC would also seek to establish employment agreements with key executive management personnel upon consent from the selling owner. Finally, the program offers sellers an opportunity to preserve their legacy in Newark.

Transaction Structure

Newark CEDC will generally seek to transition the company to a 100% (or, otherwise, a majority) S-Corp ESOP and finance the sale through a combination of subordinated debt and warrants, which will allow Newark CEDC and partnering investors to secure a moderate return. An S-Corp ESOP does not pay any taxes for the portion of the company owned by an ESOP (www.nceo.org/articles/esops-s-corporations). A C-Corp ESOP does not pay taxes on any income used to pay principal and interest on a loan for the purpose of an ESOP sale (www.nceo.org/articles/esop-employee-stock-ownership-plan). ESOP tax benefits should provide Newark CEDC and its partners with some assurance that, moving forward, the company will be able to meet its repayment schedule on the loan, for the sale price, transaction fees, and accumulated interest, and any amounts due upon execution of the warrants.

Steps

1. Newark CEDC signs a nondisclosure agreement.
2. Newark CEDC obtains tax returns for the past three years and financial projections from seller.
3. Newark CEDC and seller agree on a range for the company value based on an industry-appropriate multiple of EBITDA.
4. Newark CEDC and seller agree on an independent trustee. The National Center for Employee Ownership offers a directory of ESOP trustees at <http://www.nceo.org/pages/directory.php>.
5. The agreed-upon trustee will be hired at the expense of Newark CEDC. In turn, the independent trustee will select an attorney and an independent appraiser, also to be hired at the expense of Newark CEDC.
6. The parties agree on the exact terms of the sale through a three-way negotiation between the seller, Newark CEDC, and the independent trustee. The independent trustee is legally obligated under federal law to a sale at fair market value.
7. Newark CEDC, in partnership with commercial lenders and private investors, finances the acquisition of your business by the ESOP trust.
8. The parties execute the sale, delivering cash to seller, and transferring business ownership to the ESOP trust.
9. The employees are made aware of their new status as owners after the transaction is complete. Moving forward, the company trains employees about employee ownership and their new roles and responsibilities as owners. Training costs may be subsidized by the City of Newark.

About

Founded in 2007, the Newark Community Economic Development Corporation (Newark CEDC) is the primary economic development catalyst for the State of New Jersey's largest city, Newark. It is organized to retain, attract, and grow businesses, enhance small and minority business capacity, and spur real estate development throughout the City's 20 diverse neighborhoods. As a business development company whose sole client is the City of Newark, Newark CEDC collaborates with the Newark Department of Economic & Housing Development to initiate and execute economic development activities, to produce and sustain economic growth, generate jobs, and create wealth for the citizens of Newark.

Contact

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