OWNERSHIP ECONOMY POLICY BRIEF

September 2024

ASHOKA

OWNERSHIP Capital Lab

FEDERAL POLICY RECOMMENDATIONS
FINANCE THE GROWTH OF THE OWNERSHIP ECONOMY

Growing ownership opportunities in the U.S. economy is one of the most promising ways to expand financial freedom and chip away at the country's enormous wealth gap. What does that mean exactly? It means making it easier for Americans — especially those at lower income levels — to grow their household balance sheets by developing assets and equity, for example through home ownership or by having an ownership stake in the company where they work.

As we wrote recently in Forbes, one of the biggest barriers to broadening this "Ownership Economy" is the lack of big capital to facilitate the purchase of assets and equity. For example, a $10 billion fund would enable millions of Americans to finance the purchase of the companies they work for, at a moment when many retiring owners are looking to sell. The right kinds of investors — and patient capital — will be essential for moving this work from the periphery to the mainstream.

The public sector will also play a central role in both enabling or inhibiting the rapid expansion of the Ownership Economy. How might it enable? By providing tax benefits for investments into single family homes for low-income families, to parallel the existing tax credits for multi-family low-income housing. How might it inhibit? By maintaining barriers to financing for broad-based employee ownership, such as the personal guarantee requirement on the SBA 7a small business loan guarantee.

Six social entrepreneurs, together with Ashoka, had a discussion on this precise topic in early 2024 and identified seven important policy changes that would immediately support a transition toward a more equitable Ownership Economy.

1.
REQUIRE DONOR ADVISED FUNDS (DAFS) TO GET THE DOLLARS OUT TO 501C3S AND MAKE IT EASIER FOR THEM TO INVEST THE CORPUS IN CATALYTIC INVESTMENTS.

WHY IT MATTERS

Donor-advised funds (DAFs) have fast become one of the most dominant forces in philanthropy, with more than $230 billion now collectively sitting in more than two million individual accounts. Donors can contribute to a fund as often as they like, and then release grants to their favorite organizations on their preferred timeline. The money in the funds, meanwhile, are mostly managed by mainstream investment firms (e.g. Fidelity, Vanguard and Schwab) with little of the corpus utilized for catalytic impact investing.

Here's the problem: unlike foundations, which are required to give away a minimum of 5% of their endowment each year, DAFs have no reporting and payout requirements. So you can conceivably get your tax benefit today, but not need to distribute a grant for ten years, or even ever in your lifetime. As more and more philanthropic capital is funneled into DAFs (last year they accounted for 10 percent of all philanthropic giving in the United States), it means that larger sums of money — for which the federal government has already provided a tax benefit — sit in growing funds without producing the social value that the tax benefit was intended to pay for.

Similar to the call to foundations to invest their corpus in their mission instead of in the mainstream financial market (which often includes investments that fund some of the very problems their stated mission is working to mitigate, like fossil fuels), the vast DAF corpora should be moved from the mainstream market into catalytic impact investing. After all, the purpose of the DAF is to get money out to causes, not to maximize the growth of the corpus. The Institute for Policy Studies reports that DAFs can be a vehicle for the ultra wealthy to invest in for-profit companies and ventures using DAF funds that they have received a tax break for[1]. What if, instead, it was required that the DAF corpus be invested into some baseline level of social impact?

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Requiring DAFs to report on how and where they are giving and investing their funds would also bring transparency to an opaque system. As the saying goes, "What gets measured, gets managed." Combining reporting (on both gifting and how the corpus is invested) with a minimum gift threshold would create pressures on the DAF system to put this money to work, rather than just having it sit and grow and provide revenue to the major investment firms that hold most of the DAF funds.

[1] https://ips-dc.org/inequality-expert-chuck-collins-discusses-the-business-of-billionaire-philanthropy-on-scripps-newss-giving-tuesday-broadcast/

HOW POLICY CAN ADDRESS

A way to remedy this problem is to require donor advised funds to gift a minimum percentage of their corpus each year. In addition, we'd like to see a reporting requirement for both gifting and investing, and a requirement that at least a meaningful portion of the DAF corpus be invested into impact, rather than the mainstream market.

Draft legislation to address some of the challenges with DAFs exists—the Accelerating Charitable Efforts Act (ACE). Similar legislation should address the investing side. After all, these dollars have already been granted a federal tax break based on the promise of them being put to work for charitable purposes. Shouldn't the full amount of these tax break-endowed funds be applied to charitable purposes?

2. LEVEL THE PLAYING FIELD FOR THE COMMUNITY REINVESTMENT ACT (CRA)

WHY IT MATTERS

The Community Reinvestment Act (CRA) was established in 1977 to counteract redlining—a discriminatory approach that banks took to deciding which communities (typically lower-income communities of color) they did not want to lend to. The regulation applies to "FDIC-insured depository institutions, such as national banks, savings associations, and state-chartered commercial and savings banks. CRA regulation requires institutions to provide lending, investment and service across ALL of the communities they service, including low- and moderate-income communities. CRA does not [currently] apply to credit unions insured by the National Credit Union Share Insurance Fund (NCUSIF) or nonbank entities supervised by the Consumer Financial Protection Bureau (CFPB)."[2] To offer a sense of scale, nearly $285B in business loans were tracked as CRA investments in 2022.[3]

The financial sector has gone through dramatic shifts since 1977 when the CRA was established. The Sorenson Impact Center advocates for a need to expand who is covered by CRA and shares this data to illustrate the need:

- 75% of financial assets in the U.S. are held in non-bank financial institutions.
- >50% of home loans (56%) and refinance loans (58%) were made by independent mortgage companies in 2019,
- Credit unions (not currently under CRA) have expanded their business lending to $71B in 2018 from just $4B in 2000, and
- Insurance companies collected $1.2T of premiums in 2018, over half of which were from property and casualty insurance.

[2] https://thehousingfund.org/wp-content/uploads/2024/04/pub-fact-sheet-cra-reinvestment-act-mar-2014.pdf
[3] https://www.fdic.gov/news/press-releases/2023/pr23108a.pdf

HOW POLICY CAN ADDRESS

By expanding the CRA to cover the 75% of financial assets held in non-bank financial institutions, to independent mortgage companies, credit unions and insurance companies, this policy would level the playing field for financing and insurance needs in these communities.

Three specific steps are outlined in the Sorenson Impact Center's publication, *Policy Priorities to Unlock Catalytic Capital*:

> Expand the application of the Community Reinvestment Act (CRA) to include the non-bank financial sector;
> Define catalytic capital investments as a qualifying activity under CRA; and
> Define qualifying CRA expenditures for technical assistance hours, grants, or investments to improve, standardize and scale local capacity and impact measurement practices.

These changes would help ensure access by all communities — especially low- and moderate-income communities — to financing to grow their ownership stakes in the Ownership Economy.

3.

REMOVE BARRIERS FOR EMPLOYEE OWNERSHIP FINANCING

WHY IT MATTERS

Employee ownership is a powerful business model that creates outsized impacts for employees, small businesses and local economies. It is highly underutilized, in part because of barriers to financing the ownership transition when a business owner is ready to sell their company. The "Silver Tsunami" of retiring business owners affects nearly three million small businesses across the U.S., creating an urgency to retain these business assets and their jobs in communities. Employee ownership transitions are a path to business ownership for the everyday American small business employee, and to realize this opportunity, we must ensure that financing (lending and investment capital) is available.

The SBA 7a loan guarantee program is what has, in essence, enabled most bank small business lending, by backstopping (i.e. guaranteeing) banks' loans to small businesses. The 7a loan guarantee requires a personal guarantee by any borrower with 20% or more ownership interest in the business. However, for loans to employee-owned businesses, it is unlikely that any individual owner would own 20% of the business. Thus, having a single person guarantee the loan on behalf of a much larger group of owners doesn't make sense. The employee ownership space was hopeful

[2] https://thehousingfund.org/wp-content/uploads/2024/04/pub-fact-sheet-cra-reinvestment-act-mar-2014.pdf

[3] https://www.fdic.gov/news/press-releases/2023/pr23108a.pdf

with the passage in 2018 of the Main Street Employee Ownership Act, that the SBA — having been instructed by Congress to look at alternative ways to mitigate the risk of these loans — would modify this rule. In 2023, the rule was partially modified to remove the personal guarantee requirement for Employee Stock Ownership Plans (ESOPs) but not for worker coops and Employee Ownership Trusts, which are often the best ownership models for companies with fewer than 40 employees.

Another way the SBA opens up small business financing is through the SBIC program (Small Business Investment Companies). Of the ~300 SBICs that exist today that are eligible to receive low-cost matching capital of up to two times what the funds raise from the private capital markets, only one has a focus on employee ownership. This is a model for how the federal government can open up access to meaningful loan capital to finance employee ownership, in structures that pay for themselves, meaning that they are a net zero cost (zero subsidy) to taxpayers. A key opportunity for employee ownership is to bridge the deep employee ownership experience among existing employee ownership fund managers with the deeper private markets experience expected of SBIC applicants.

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HOW POLICY CAN ADDRESS

SBA 7a loan guarantee. The Capital for Cooperatives Act illustrates an approach that would open up the SBA 7a loan guarantees for the worker cooperative form of employee ownership. We'd like to see this legislation written to also include Employee Ownership Trusts, another important form of broad-based employee ownership.

Employee Equity Investment Act. The federal Employee Equity Investment Act (EEIA) would preserve the legacy of local businesses and create quality jobs with retirement security by helping companies transition to employee ownership. By supporting private investment funds, this legislation can support the private market to finance the sale of privately-held small- and medium-sized businesses from business owners to their employees through credit enhancement capabilities at zero subsidy cost to the taxpayer. (See a press release about previous legislation introduced in 2023 designed to create a facility within the SBA's SBIC program).

4. PASS THE NEIGHBORHOOD HOMES INVESTMENT ACT (NHIA) TO ESTABLISH THE NEIGHBORHOOD HOMES TAX CREDIT (NHTC)

WHY IT MATTERS

In the same way that the Low Income Housing Tax Credit (LIHTC) provides incentives for low-income, multi-family rental housing, the NHIA is designed to provide incentives for single-family or up to four-unit family housing in communities that most need reinvestment into this critical housing stock. And, to qualify, the homes must be purchased by qualifying buyers based on an income threshold of up to 140 percent of the area median family income.

The urgency of this is multifold:

- 40% of our existing housing stock is over 50 years old;
- Investment incentives for low-income neighborhoods are focused on multifamily housing, leaving behind single family housing, which can be sources of blight, further burdening neighborhoods that are already distressed; and
- Private equity and corporate ownership of single family homes surged after the housing crash, then again during the pandemic, albeit with positive trends in more recent years.[4]

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HOW POLICY CAN ADDRESS

NHIA would create a federal tax credit designed to incentivize new equity investments for the development or renovation of 1-4 unit housing in distressed urban, suburban, and rural neighborhoods. It is designed to sit alongside the Low-Income Housing Tax Credit (LIHTC) which has proven effective in closing the development gaps for low-income, multi-family rental housing. What is needed is a tool to close the "value gap" for our declining 1-4 unit family housing stock. This gap contributes to three challenges in our neighborhoods: (1) blight, vacancy and abandonment, (2) rise in absentee landlord neighborhoods, and (3) racial inequity.

[4] https://www.businessinsider.com/average-americans-beating-wall-street-new-homes-real-estate-homebuying-2023-11

The Neighborhood Homes Coalition estimates that each $1 billion in investment would result in:

- 25,000 homes built or rehabilitated,
- $4.25 billion of total development activity.
- 33,393 jobs in construction and construction-related industries,
- $1.82 billion in wages and salaries, and
- $1.25 billion in federal, state, and local tax revenues and fees.

5. PASS THE NEW MARKETS EXTENSION ACT OF 2023 (S.234/ H.R.2539)

WHY IT MATTERS

The New Markets Tax Credit (NMTC) has been an extraordinarily successful tool in driving capital to low-income communities and businesses. Since its inception in 2000 the credit has incentivized more than $130 billion in private investments in more than 8,000 businesses and facilities in economically distressed communities throughout the United States. However, the credit has never been designated a permanent part of the tax code and must be extended by Congress.

HOW POLICY CAN ADDRESS

The New Markets Extension Act of 2023 (S.234/H.R.2539) would make the NMTC a permanent part of the federal tax code, provide an inflation adjustment in out-years, and broaden the investor market by providing NMTC investors relief from the Alternative Minimum Tax.

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We would like to see policy to:

Make the New Markets Tax Credit permanent

It is due to expire at the end of 2025. Given its track record of incentivizing more than $130 billion in private investments to low-income communities and to businesses, now is the time to make it permanent.

Index the Credit to inflation

The total allocation available for the Credit in 2024 and 2025 is $5 billion annually. The NMTC Extension Act would continue the credit at $5 billion and would index that amount to inflation going forward.

Exempt the NMTC from the Alternative Minimum Tax (AMT)

Under the current law, the Credit is only suitable for institutional investors, as individual investors would be taxed on gains under the AMT. This change would open the Credit to individuals consistent with the goals of the Ownership Economy.

6.
EXTEND AND OPEN UP OPPORTUNITY ZONES TO SMALL BUSINESS TRANSITIONS TO BROAD BASED EMPLOYEE OWNERSHIP.

WHY IT MATTERS

The Investment in Opportunity Act was passed by Congress as part of the Tax Cuts and Jobs Act of 2017. The concept was novel; it provided a federal capital gains tax reduction if gains were invested as equity in low-income Qualified Opportunity Zones (OZs) throughout the country.

According to the Economic Innovation Group, "U.S. investors currently hold trillions of dollars in unrealized capital gains in stocks and mutual funds alone—a significant untapped resource for economic development. Opportunity Zones offer investors three specific incentives for cashing out of these investments and putting their capital gains to work supporting the economic development of low-income communities.

- The taxes due on any capital gains placed into an Opportunity Fund may be deferred until December 31, 2026.
- Investors who keep their money in an Opportunity Fund for five years receive a 10 percent step-up in basis on that original investment and an additional 5 percent after seven years.
- Investors who hold their investments in Opportunity Zones for at least 10 years face no capital gains taxes on the new investments when they sell them."[5]

However, when the OZ provisions were finalized, they tilted heavily toward incentives to move to or start new businesses in the OZs and limited the potential for investing growth capital into existing small businesses already located in the zones. The rules require strict tracking of assets purchased or developed with the proceeds of these investments and don't provide for investments in stock or other forms of equity investments that are the crucial risk capital needed to grow small businesses. Many of these businesses are owned by Black and Brown Americans, who rely on business loans but need additional equity to grow. In addition, the rules do not enable investments in ownership transitions to broad-based employee ownership, which (as discussed earlier), create business ownership opportunities for the full base of workers in these companies.

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[5] https://eig.org/opportunity-zones/about-ozs/

HOW POLICY CAN ADDRESS

Now is the time to modernize this tax provision to include existing small businesses that are unlikely to access investments from Qualified Opportunity Funds. In September 2023, sponsors introduced the Opportunity Zones Transparency, Extension, and Improvement Act.

Among other things, the bill revises rules and reinstates reporting requirements relating to qualified opportunity zones (economically distressed communities where new investments, under specified conditions, may be eligible for preferential tax treatment).

However, it does not go far enough. It should be modified to incentivize equity investments that promote the growth of existing family-owned and employee-owned small businesses and to support debt and equity investments for ownership transitions of small businesses, including through broad-based employee ownership. By including non asset-based investments in the bill, these types of businesses could also have the chance to grow and create community wealth.

7.

MAKE IT EASIER FOR FEDERAL DOLLARS TO BE PUT TO WORK IN COMMUNITIES.

WHY IT MATTERS

Community-based nonprofit organizations innovate some of our country's most cutting edge and effective solutions to pressing problems of economic inequality and social injustice. Yet most of these same organizations struggle for financial survival. Foundations are a common source of financial support, but grants are often capped between $50,000-$250,000 depending on the funder requirements. State and local support for these organizations is limited. Highly competitive federal grants are often one of the largest sources of funding. Once (and if) secured, the administrative burden is high with heavy reporting requirements and audits being common. Even when federal funds are competitively procured, very few of these funds can be used for general operations such as turning on the lights and paying for insurance (let alone covering payroll and financial administration costs). Loosening red tape could prove catalytic for the Ownership Economy movement.

Streamlining administrative grant management may not be the sexiest issue, but it is an important — and often overlooked — aspect of how the Ownership Economy can expand.

Many federal funding programs available to nonprofit organizations were created during LBJ's Great Society during the 1960s. It's not uncommon to encounter other programs which stretch back to the New Deal of the 1940s. Updated flexibility is needed in the face of a more complex modern economy.

During the 1980s and 1990s tax credits became a more popular form of federal subsidy. These are very complex financial instruments and have ended up mostly under the control of for-profit developers and lenders.

HOW POLICY CAN ADDRESS

More recently, new programs funded by the American Rescue Plan Act and the Inflation Reduction Act do, in fact, provide more flexibility for nonprofit recipients. This is a move in the right direction. Yet it's important to remember these programs are highly competitive. The majority of new federal funding still flows through state and local governments, which prevents dollars from getting on the ground and closer to the needs of distressed and marginalized communities.

Streamlining administrative grant management may not be the sexiest issue, but it is an important — and often overlooked — aspect of how the Ownership Economy can expand.

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