WHATiF 88 WHITE PAPER – ECONOMIC AND SOCIAL IMPACT – MARCH 2019

HOW TO CREATE AND MEASURE BOLD NEW SUSTAINABLE STRATEGIES FOR ECONOMIC GROWTH AND SOCIAL IMPACT IN DISTRESSED RURAL AND URBAN COMMUNITIES

Under the guidance of the Trump Administration, there are significant new tax incentives focused on economic investment in displaced communities throughout the United States. As our country has recovered since the Great Recession of 2008; unfortunately, there exist communities that are struggling with poverty, crumbling infrastructure, drugs and crime, limited employment and career advancement opportunities, and a lack of confidence in their futures.

Stressed communities are found in both rural and urban areas in every state within our nation. They require bold new sustainable strategies to grow their economies and to generate social impact through capital investment, job creation, enrichment, entrepreneurship, improved education, wellness and housing. They also need to include a combination of private capital, grants, foundations, local, state and federal government with various incentive programs. However, any successful sustainable strategy must have both a stewardship and measurement, both economic improvement and social impact.

The Wharton Alumni True Impact Focus 88 ("WHATiF 88") was established by a diverse group of 1988 MBA classmates residing in different regions of the country. The partners have known one another for more than 30 years and have held leadership positions in economic development, finance, management consulting, government, education, and nonprofits. WHATiF 88 seeks to work with struggling communities and their various stakeholders to create bold new sustainable strategies, to assist in the financial structure of projects, to de-risk such projects, and to quantitatively and qualitatively measure the outcomes.

OPPORTUNITY ZONES CREATES A FOCUS ON INVESTMENTS IN LOW-INCOME COMMUNITIES

The creation of Opportunity Zones as a result of the 2017 Tax Cuts and Jobs Act (TCJA) provides an attractive incentive for taxable investors, including individuals and corporations, to invest in a Qualified Opportunity Zone Fund (QOF). As of December 14, 2018, there are 8,763 Qualified Opportunity Zones for all States, with the official list to be published by the IRS.

Opportunity Zones are designed to spur economic development by providing tax benefits to investors. First, investors can defer tax on any prior gains invested in a QOF until the earlier of the date on which the investment in a QOF is sold or exchanged, or December 31, 2026. If the QOF investment is held for longer than five years, there is a 10% exclusion of the deferred gain. If held for more than 7 years, the 10% becomes 15%. Second, if the investor holds the investment in the Opportunity Fund for at least ten years, the investor is eligible for an increase in basis of the QOF investment equal to its fair market value on the date that the QOF investment is sold or exchanged.

A Qualified Opportunity Fund is an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is in a Qualified Opportunity Zone.

The statute requires at least the same amount of capital to be invested in a project from a QOF. For example, if a QOF acquires a property in a QOZ for the purchase price of $50 million, a minimum of $50 million of additional investment needs to be made. This additional investment can include equity, mezzanine, grants, other incentive programs and debt financing. Presently, there are hundreds of groups establishing OZFs including some of the biggest names in real estate and private equity along with some entrepreneurs.

Opportunity Zones are just the most recent tax incentive program. Since the end of World War II, as our government focused on the recovery and rebuilding of the domestic economy, Presidential administrations created bold new economic strategies. Federal government spending on infrastructure, the military, and social programs and a progressive tax policy for wealth redistribution.

During the postwar economic boom, the Treasury developed favorable tax policy for specific industries, especially the real estate industry, which benefited from tax deductions on interest and depreciation. Changes to tax policy has resulted in the growth and specialization of tax lawyers and accountants who best understand how their clients can benefit. Over the past 30 years, tax incentive programs developed to stimulate investment in depressed communities have included New Market Tax Credits, EB-5 Immigrant Investor Program, Historic Tax Credits, urban and transportation economic zones, and traditional and alternative energy incentives. If used properly and with oversight and transparency, these programs will produce meaningful and measurable benefits.

MEASUREMENT OF ECONOMIC AND SOCIAL IMPACT

While there is no clearly defined and widely accepted methodology to track economic and community impact of private investment through QOF along with debt financing, state and local incentives, and municipal bond financing, WHATiF 88 believes this is a critical area that needs to be further pursued.

MIT has an online calculator to measure Living Wage Index (http://livingwage.mit.edu/). Families and individuals working in low-wage jobs make insufficient income to meet minimum standards given the local cost of living. The calculator can estimate the cost of living based on typical expenses. Such tools help employers, employees and communities determine a local wage rate that allows residents to meet a minimum standard of living. The calculator was created in 2004 by Dr. Amy K. Glasmeier of MIT, who is a faculty member of MIT Urban Planning.

Health care institutions and foundations produce studies on issues including opioid addiction, level of lead in the water (Flint, MI), obesity, and many other illnesses that impair residents.

WHATiF 88 believes each investment project needs to include comprehensive local measurements such as change in annual earnings, quality of health and environment, crime levels, enrichment programs and job training/workforce job development, and housing affordability. WHATiF 88 and its program partners will customize measurements depending upon the history and present-day situation of the community.

DEBT FINANCING THROUGH THE MUNICIPAL BOND MARKET

States and local communities benefit from having the ability to raise low cost bonds through the municipal bond market, which provides tax benefits for the trillions of dollars of investment in the sector. Morningstar, Inc., a reputable ratings firms, divides the municipal bond universe into 12 major economic spheres. General obligations (GO) are plain-vanilla municipal bonds issued by state government or local municipalities. GOs are some of the safest municipal bonds that allow state and local borrowers to raise relatively low-cost long-term financing Apart from advance refunded and state appropriated tobacco bonds, some sectors can be integral in the financing of economic and social impact for communities. They include education (local school districts and higher education), health (assisted-living and hospice facilities, hospital projects and equipment), housing (preparing land, sewer, road and other systems for single and multi-family housing, public housing), industrial (pollution clean-up and private-activity bonds), transportation (roads, bridges, tunnels, airport and seaport construction), utilities (power plants, electrical grids, telephone grids), water and sewer, and miscellaneous revenue bonds.

As part of any bold new sustainable strategy, the local community and its stakeholders need to consider how to include municipal bonds along with other government and government agency sources of low-cost lending.

NONPROFITS PLAY A CRITICAL ROLE

Within stressed communities, nonprofits and foundations play critical roles for local communities to provide services and support in the absence of established local business involvement and limited resources supplied by local, state and federal government. Nonprofits support and manage social and economic programs including after-school activities in tutoring, sports, and wellness; workforce development; food banks; and local religious and higher educational institutions that offer community engagement.

Donations to nonprofits historically have favorable tax treatment by the IRS. This tax treatment has encouraged the creation and growth of preeminent family foundations such as the Bill and Melinda Gates Foundation, the Ford Foundation, and Bloomberg Philanthropies, and charitable trusts through financial service providers like Charles Schwab, TD Ameritrade, and Fidelity Investments. In fact, in 2017, Fidelity Investments Charitable Gift Fund was the second-largest Grantmaker in the country, after the Bill and Melinda Gates Foundation. Fidelity stated,

> *"Fidelity Charitable gave an unprecedented $4.5 billion across more than 1 million donor-recommended grants, to nearly 127,000 nonprofit organizations."*

Each non-profit organization has specific goals and missions related to their grants. They can become significant stakeholders for QOFs, and local governments given their due diligence process and well-regarded reputations.

A recent example of a creative involvement by a foundation. The Kresge Foundation announced on March 18, 2019 that it will partner with two established impact fund managers and provide $22 million in investments to anchor their emerging QOFs, after these managers have agreed to a level of transparency, accountability, and disclosure. This bold and innovative approach will in-essence provide risk mitigation and first-loss protection to these QOFs, making them more attractive to investors seeking social and financial returns, along with the benefit of principal protection through the foundation's guarantees.

ROLE FOR WHATIF AS ADVISOR AND FINANCIAL MANAGER

WHATiF 88 focuses on creating and measuring social impact investments in underserved rural and urban communities. We provide stewardship, strategy, and financial expertise to bring these investment opportunities to market. WHATiF 88 remains close with the education and research taking place at Wharton Social Impact Initiative (WSII) on campus in Philadelphia. WSII is looking for engagement projects for its undergraduate and MBA students.

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