GOOD FAITH FUND

Policy Points

VOLUME 2

OCTOBER 19, 1998

By: Angela Duran
Director of Policy Development

INSIDE THIS ISSUE:

Individual Development Accounts

WHAT ARE INDIVIDUAL DEVELOPMENT ACCOUNTS?

Individual Development Accounts (IDAs) are dedicated savings accounts, similar in structure to Individual Retirement Accounts, that can be used for purchasing a home, education or job training expenses, or capitalizing a small business. They are managed by community organizations, and accounts are held at local financial institutions. Contributions made by low-income participants are matched using both private and public sources. All participants receive economic literacy training to learn how to manage their money and credit, set up a budgeting and savings schedule, and participate in the new global economy.

WHY ARE IDAS NECESSARY?

The theory behind past social policy has been to provide people with food, shelter, and clothing, but such assistance does not necessarily help people escape from poverty. Michael Sherraden, the Washington University Professor who is credited with inventing the IDA concept, notes that "income may feed people's stomachs, but assets change their heads." In the United States, the top 10% of Americans command 40% of national income, and the top 1% control 90% of assets. Fully one-third of American households have no or negative investable assets; more than half have negligible amounts.

National policy reinforces asset inequality. The federal government subsidizes asset acquisition for the non-poor by over $200 billion annually in the form of home mortgage deductions, preferential capital gains, and pension fund exclusions. Meanwhile, the federal government has penalized asset acqui-

HIGHLIGHTS

- *1% of the U.S. population controls 90% of the assets*
- *IDAs help low-income families build assets*
- *There are at least 100 IDA programs around the country*
- *States are passing legislation to support IDAs*
- *Federal funding for IDAs was included in the 1998 Omnibus Budget Bill*

Good Faith Fund
2304 W. 29th Avenue
Pine Bluff, AR 71603
Phone: 870-535-6233
FAX: 870-535-0741

Material for this paper has been drawn from documents prepared by the Corporation for Enterprise Development, the Center for Social Development at Washington University, and the states and programs participating in IDA demonstra-

sition by the poor through the denial of eligibility to welfare recipients who exceed the $1000 asset limitation because of their savings or accumulation of other assets.

WHAT CAN ASSETS DO FOR PEOPLE?

Owning assets gives people a stake in the future – a reason to save, to dream, to invest time, effort, and resources in creating a future for themselves and their children. Professor Sherraden's research has pinpointed nine effects of asset-building. Assets improve household stability; psychologically connect people with a viable, hopeful future; stimulate development of other assets, including human capital; enable people to focus and specialize; provide a foundation for risk-taking; increase personal efficacy; increase social influence; increase political participation; and enhance the welfare of offspring.

IDAs address the deficiencies of the current system by returning to the asset-based policies responsible for America's greatest periods of economic growth and prosperity. Our long history of asset-building policies includes the Homestead Act of the 19th Century, which provided land on the frontier to stimulate economic growth, and the GI Bill of the 20th Century, which subsidized college tuition for war veterans.

IDAs also build on a growing shift in national policy to bring such asset-based policies back. Some examples include the shift from defined benefit retirement plans to 401(k)s and IRAs, Super IRAs that can be used for home ownership and education, and Medical Savings Accounts. IDAs create a way for low-income individuals to share in these asset building policies, therefore bringing these families into the economic mainstream as productive workers and contributing citizens and taxpayers.

ARE IDAS JUST A CONCEPT OR ARE THEY BEING TESTED?

A privately-funded, multi-year, $15 million national IDA demonstration is being sponsored by the Corporation for Enterprise Development. The Downpayments on the American Dream Policy Demonstration is funding 13 demonstration sites around the country that will establish 2000 accounts. The demonstrations are located in Austin, TX; Barre, VT; Berea, KY; Chicago, IL; Fond du Lac, WI; Indianapolis, IN; Ithaca, NY; Kansas City, MO; Portland, OR; San Francisco, CA; Tulsa, OK; and Washington, DC. The movement in support of IDAs is growing. More than 100 groups in 23 different states are operating IDA programs now.

Local demonstrations are being operated by a range or organizations including community action agencies, community collaboratives, community development banks and their non-profit affiliates, and credit unions. The sites have linked IDAs to their existing missions, whether they are about homeownership, education and training for decent-paying, career-ladder jobs, or small business development.

States across the country are realizing the importance of IDAs and are creating statewide demonstrations through legislation and by accessing existing funding streams. Indiana, North Carolina, and Pennsylvania are just some of the states that have moved forward to test the concept of IDAs with state legislation. For a summary of these laws, see the section on state and federal laws below.

WHAT DO WE KNOW ABOUT THE SUCCESS OF IDAS?

Because IDAs are a relatively new concept, extensive evaluation data from existing programs is not yet available. The Corporation for Enterprise Development's 13-site national IDA demonstration includes an evaluation that will closely track the performance and the effects of IDAs on participating individuals and families.

However, several studies have already shown the importance of asset-building on the economic and social well-being of individuals and the resulting positive impact on the American economy. Furthermore, recent reports have documented the ability of low-income families to save, purchase homes, and start businesses. The following summarizes what we know.

1. ***IDAs reward work and produce benefits for individuals, government, and society substantially greater than investment costs.***

   IDAs are a positive and promising idea because they reward work, a concept that has almost universal support in our country. A Corporation for Enterprise Development study shows that a national investment of $291 million in public and private funds into IDAs is estimated to produce net returns of $1.6 billion within a decade. Annual rates of return for all investors would exceed 23%. Every 100,000 IDAs are estimated to produce 7050 businesses, 68,800 job-years of employment; $730 million in additional earnings; 6000 new and 6000 rehabilitated homes; $287 million in savings in community financial institutions; $188 million in increased assets of low-income families; 11,667 families off welfare; and 32,000 additional high school and college degrees.

2. ***Asset-building programs similar to IDAs have been extraordinarily successful.***

   More than 10 million WWII and Korean War Veterans used the GI Bill to get an education, and the GI Bill loan programs made 9.8 million loans totaling $141 billion for veterans' homes and businesses. The income differential for veterans who received an education under this program reached an average of $19,000 per year.
3. **Education raises individual earnings.**

According to the Bureau of the Census, individuals who have received bachelor's degrees earn an average of $600,000 more over the course of a lifetime than those who have earned only a high school diploma.

4. **Education also increases business productivity.**

A 1995 University of Pennsylvania study found that a 10% increase in the average level of education of workers within an establishment can be expected to boost productivity 8.6%, compared with a 3.4% productivity boost from a 10% increase in the book value of capital equipment

5. **Homeownership is a viable option for low-income families and has shown to have positive social impacts on poor children.**

The NeighborWorks Campaign for Home Ownership has enabled 8310 families to own new homes in 100 cities. A profile of the participants shows that: 41% are female household heads, 61% are ethnic minorities, 68% earn less than $30,000, 95% received homeownership counseling, 97% are first-time homebuyers, 78% of new homeowners pay less than 30% of their annual household income for their housing costs, homeownership is less costly than renting for 28% of the new homeowners, and, homeownership is either less costly than renting or only marginally more costly (1-10% above their previous rent) for 40% of the new homeowners.

Children of homeowners have lower dropout and pregnancy rates than do children of renters with identical socioeconomic characteristics. At incomes below $25,000 per year, the average high school dropout rate is 11.7 higher for children of renters than owners.

6. **Microenterprise programs for the poor are successful in creating jobs and decreasing welfare dependency.**

The Aspen Institute's Self Employment Learning Project, a demonstration of seven microenterprise programs around the country including Good Faith Fund, found the following results. At Good Faith Fund, 80% of the businesses assisted were still in operation in years 2 and 3; 44% of businesses increased profits between year one and year three; 54% of businesses increased their net worth; 46% of participants reported an increase in annual household income; and 50% reported an increase in household assets.

7. **Low-income families can and do save money.**

The U.S. household savings rate, across all income levels, is less than 5% and is among the lowest in the world. However, there is strong evidence that low-income families can save. The National Federation of Community Development Credit Unions reports that their members serve nearly four savers for every borrower. The average savings balance is more than $1000, and the majority of members come from households with annual incomes of less than $25,000.

During its first eight years, Good Faith Fund ran a group savings program as part of its microenterprise program. Over 300 individuals voluntarily participated, enabling them to become depositors at mainline banks and to make savings a habit.

8. **IDAs can help alleviate growing credit card debt in low-income communities through economic literacy.**

Credit card debt reached close to $400 billion in the U.S. by the end of 1996, and personal bankruptcies rose to an all-time high. IDAs help solve the credit crisis through economic literacy and credit counseling. IDA participants learn to save for asset acquisition rather than go into debt.

WHAT STATE AND FEDERAL LAWS EXIST TO SUPPORT IDAS?

State Legislation. Several states around the country have passed laws in support of IDAs. These states include Indiana, Iowa, Maine, Maryland, North Carolina, Ohio, Oklahoma, Pennsylvania, Tennessee, and Texas. And at least 25 states have included IDAs in their welfare reform plans. Following are summaries of the types of legislation passed or being considered around the country.

Indiana **–** In 1997, the Indiana legislature established a $6.48 million, four-year IDA demonstration. The state will support the establishment of 800 new accounts per year, matching $3 for every $1 a participant saves, up to a maximum of $900/year. IDAs can be used for paying education expenses at an accredited institution of higher education, a vocational school, or an accredited or licensed training program; starting or buying a business; or buying a home. IDAs are not subject to taxation if they are used for allowable reasons, and they do not count as assets when determining eligibility for government benefits. To be eligible to establish an IDA, an individual must be receiving public assistance or have an annual income of less than 150 percent of the federal poverty level.

Community development corporations, including microenterprise development programs, run the programs locally. Their responsibilities include determining eligibility, administering the accounts through a financial institution, managing requests for withdrawals, and providing economic literacy training. Accounts are deposited in state-chartered financial institutions. The state agency that operates the program is the Commerce Department.

An additional feature of the Indiana law is that individuals, financial institutions, corporations, and other entities can contribute to a fund at a particular community development corporation and receive a tax credit worth 50% of the amount donated. For an individual, the donation must be between $1000 and $50,000. The total cap on tax credits is $500,000.

Missouri - The state has considered legislation that would allow IDAs (called Family Development Accounts or FDAs) to be established for individuals and families with incomes at or below 200 percent of the federal poverty level. The bill would set aside $4 million in tax credits annually for contributors to an FDA matching fund. Contributors would receive a 50% tax credit on all donations to the fund, up to $50,000 per year.

Total annual contributions to an FDA (family savings and matches) could not exceed $2000. All money deposited in the accounts, interest accrued, and money withdrawn would be exempt from state tax. All private contributions would be held in reserve funds, from which community based organizations would match individual savings and administer and manage the program. The Department of Economic Development would authorize organizations, on a competitive basis, to oversee FDA reserve funds and implement the program, and it could award up to $100,000 for an evaluation.

North Carolina - North Carolina has pursued the funding of IDAs through two different avenues. First, the Division of Community Assistance set aside $250,000 of its Community Development Block Grant funds for small cities to be used for IDAs for homeownership. Through this effort, 4 community-based sites will run IDA programs, offering 25-50 accounts per site. Second, in their 1997 session, the legislature made an appropriation to the state Department of Labor, working in conjunction with the State Department of Health and Human Services for an IDA demonstration of $300,000 per year for 2 years.

Under the legislation, IDAs can be used for home purchase, investment in a business, or postsecondary education and training. Participants have up to three years to save for their designated use; state funds will match individual savings at a 2:1 ratio. Savings must come from earned income and cannot be counted as assets for TANF or Food Stamps determination. To be eligible, participants must have incomes equal to or less than the area's median income, adjusted for family size.

At the local level, consortia of service providers are working together to structure and administer the demonstrations. Eligible applicants for administering the program include municipalities, county governments, local departments of social services, or community-based organizations.

Pennsylvania - In 1997, The Pennsylvania legislature established a 2-year, $1.25 million program that will establish 1800 IDAs. Account holders save $10 per week for a period of 18 to 24 months. The state matches every $1 deposited by a participants with $.50, for a maximum of $600 over 2 years. Low-income individuals with a household income at or below 200% of the federal poverty level are eligible to participate. Accounts can be used to purchase a home, repair an existing home, fund a business, pay for higher education for adults or children, or save for retirement. Successful account holders can accumulate enough money to finance, for example, a $57,000 home, one year's tuition at a Pennsylvania community college, or equity in a business to obtain a microloan.

Non-profit, community based organizations (CBOs) manage the programs locally, providing basic financial management workshops in personal budgeting, credit and credit repair, banking products and options, loans and grant resources, and basic financial planning. The CBOs work with the participants to develop an approved plan that specifies a minimum savings amount and how much money the saver intends to contribute to the account. Five percent of the state's appropriation for IDAs has been set aside for administrative costs incurred by the CBOs.

Participant deposits and matching funds are deposited in financial institutions, defined as federal or state-charted banks, bank and trust companies, savings banks, savings and loan associations, trust companies, or credit unions. The CBO makes the match deposit from grant funds awarded to the CBO by the state. When the participant has met his or her savings goal, the funds are paid to the entity where they asset goal will be met such as the education institution or mortgage company. The Department of Community and Economic Development is managing the demonstration for the state.

Federal Assets for Independence Act. At the federal level, the Assets for Independence Act (AFIA), has strong bipartisan support. Funding for IDAs has just passed as part of the Omnibus Budget Bill. AFIA, which is co-sponsored by Representatives John Kasich (R-OH) and Tony Hall (D-OH) and Senators Dan Coats (R-IN) and Tom Harkin (D-IA), would set up and fund approximately 50,000 IDAs. AFIA authorizes the U.S. Department of Health and Human Services to conduct a 4-year, $25 million per year IDA demonstration through which grants will be made to non-profit organizations on a competitive basis. Applicants are required to raise a 1:1 match from public or private sources.

Eligible participants in the demonstration include TANF recipients and others who qualify for the Earned Income Tax Credit and meet a net worth test. As participants make deposits in their accounts, matches will be made from non-federal funds at rates between $.50 and $4.00 for every dollar saved. The federal match will equal the non-federal match, creating a match of between $1 and $8 for every dollar saved. The maximum federal match funds cannot exceed $2000 per individuals or $4000 per household.

IDA funds must be paid directly to the asset provider (the mortgage provider, the university, or the business capitalization account). Participants can access their savings for emergency uses, working with the community based-organization, but they cannot access the matched deposits for emergencies. All IDAs must be held by a federally insured financial institution. All funds deposited into an IDA, including interest, will be disregarded in determining eligibility for any federal or federally-assisted programs based on need.