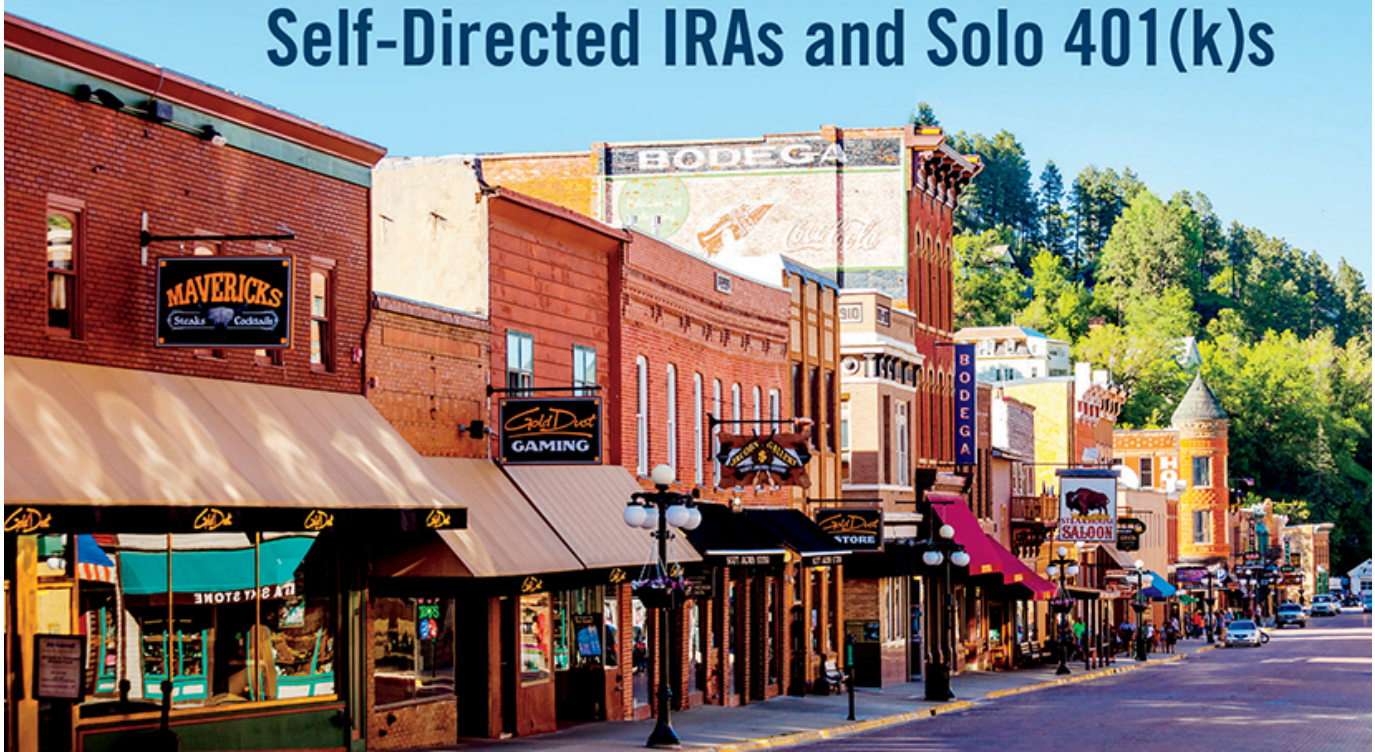
MICHAEL H. SHUMAN
Bestselling author of *The Small-Mart Revolution*

PUT YOUR MONEY WHERE YOUR LIFE IS

How to Invest Locally Using Self-Directed IRAs and Solo 401(k)s



CONTENTS

INTRODUCTION

Pop quiz! Please answer the following three questions:

- Have you mindfully bought local goods and services over the last week? For example, were you drawn to a farmers' market, a locally owned hardware store, or a local crafts fair?
- Do you have a checking or savings account at a locally owned bank, thrift, or credit union?
- If you have any savings for your retirement, have you invested at least 1 percent in your local businesses, your city's newest development projects, or your neighbors?

For the past twenty-five years, I've put these questions to more than a thousand audiences across North America—in all, probably several hundred thousand people. And the results are always the same.

- The vast majority care deeply about their local economies and have dramatically shifted their buying habits. They are flocking in expanding numbers to local brew pubs, farm-to-table restaurants, credit unions, cooperatives, and businesses proudly proclaiming themselves as "Locally Owned."

- Fewer than half bank locally. The Move Your Money campaign launched after the 2008 financial meltdown convinced more than a million people to shift their money from Wall Street banks to local banks and credit unions. But most Americans continue to conduct their daily financial transactions at a few increasingly powerful global banks like Citigroup, JPMorgan Chase, and Wells Fargo.
- On the last question about retirement funds, the answer is stunning. Typically one or two hands pop up, and—honestly—these folks turn out to be mistaken. Even though local businesses comprise 60–80 percent of our economy (depending on how we define "local"), and many are highly profitable and competitive, Americans don't think twice about placing more than 99 percent of their life savings in global businesses they don't know and often distrust.

We care deeply about the shops and people in our daily lives, but we do not know how to apply this intention to our own money. All of us, even the most resolute anti-globalization activists, systematically overinvest in Wall Street and underinvest in Main Street. We want to support our local businesspeople, our city's infrastructure, our neighbors, and our kids, and yet when it comes to our money, we happily surrender it to financiers hundreds or thousands of miles away.

Imagine pulling off the highway and finding the House of Broc, a diner that serves only broccoli. To be sure, many variations of broccoli are on the menu—broccoli salads,

broccoli casseroles, broccoli shakes, broccoli ice cream—but you might feel inclined to point out the obvious. Where are the other vegetables like carrots, zucchini, and spinach? How about beef, chicken, and fish? This book is about pointing out how many delicious and healthful alternatives can and should be on the investment menu.

It's tempting to ascribe our habit of keeping our money as far away from our lives as possible to a sinister conspiracy involving greedy bankers, corrupt politicians, and gullible citizens. I won't. The real explanation is more interesting. It's a story of good intentions gone awry. We enacted securities laws in the 1930s designed to protect investors from fraudsters, but the perverse effect was to create a system of finance so complex that only the biggest players—big investors on one side, big business on the other—could afford to jump through the expensive legal hoops and play. Over time, innovations like mutual funds pried open this system for the rest of us, and today we participate in this system through workplace plans like 401ks and private Individual Retirement Accounts (IRAs). But the system still funnels money almost exclusively into large, publicly traded companies.

In recent years two revolutions have taken place in the world of finance, one well known and the other largely invisible. The first revolution concerns the mission of business and investment. The traditional view was well articulated by the noted conservative economist Milton Friedman, who wrote in 1970, "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits."[1]

Almost half a century later, the Business Roundtable released a statement from 181 top CEOs redefining "corporate responsibility" as needing to incorporate not just shareholders but also stakeholders like workers, suppliers, the home community, and the environment. Jamie Dimon, chair of JPMorgan Chase and chair of the Roundtable, said, "The American dream is alive, but fraying. Major employers are investing in their workers and communities because they know it is the only way to be successful over the long term. These modernized principles reflect the business community's unwavering commitment to continue to push for an economy that serves all Americans."[2]

The Business Roundtable declaration is just the latest example of a revolutionary new view about business. In 1997, the author John Elkington coined the term "triple bottom line" to refer to the performance of a company not just in terms of its profitability but also its benefit to workers, suppliers, communities, and ecosystems.[3] Since then commentators sometimes refer to these bottom lines as the three Es (economy, equity, and ecology) or the three Ps (profit, people, and planet).

The concept of "corporate social responsibility" was initially defined in negative terms. The first socially responsible investment funds, like Calvert and Pax World, screened out investments in manufacturers of weapons or cigarettes, or firms doing business in apartheid South Africa. Over time, these screens became positive, so that "impact investors" could focus on companies that were delivering renewable energy, affordable housing, or pollution cleanup. One recent estimate is that about a quarter of all investment worldwide—$20 trillion—is being done through screens

factoring in environmental, social, and governance (ESG) concerns.[4]

As investors have rethought their priorities, so have businesses seeking responsible investors' money. Companies like Ben & Jerry's, The Body Shop, and Stonyfield raised the bar on social responsibility, and dozens, then hundreds, of companies followed.[5] Today, more than three thousand companies have gone through a rigorous process to become "B Corps" (the "B" stands for beneficial), the best-known standard of high corporate good behavior, and tens of thousands of other companies regularly use the B metrics to improve their social performance.

"Impact investing," however, is largely about big investors putting their money into big companies. Which brings us to the second revolution that few know about and even fewer have acted on—the grassroots investment revolution. It's now considerably cheaper and easier for local businesses, cities with development projects, and even individuals to raise money from customers, residents, and neighbors. Perhaps the most important date marking this revolution was April 5, 2012. That's when President Obama signed a revolutionary law legalizing crowdfunding called the Jumpstart Our Business Startups (JOBS) Act.

The term "crowdfunding" refers to many people each putting small amounts of money into an exciting business or project. (See adjacent box.) Before the JOBS Act, crowdfunding was mostly about making donations on websites like Kickstarter or interest-free loans through nonprofits like Kiva. You could get a perk like a T-shirt or a product sample, but actually making money—what most investors seek to accomplish—was forbidden.

Four Flavors of Crowdfunding

The term "crowdfunding" refers to at least four different flavors of local investment, all of which allow many people to put small amounts of money into businesses. The first flavor, donation crowdfunding, is arguably not an investment at all, since you get only a community rate of return, not a private one. Sites like Kickstarter or Indiegogo allow you to contribute $1, $25, $1,000—whatever you want—to an exciting business or project idea. While you don't get any of your money back, you might get a perk like a branded shopping bag or water bottle. Some beer companies name new beers after their top donors. Because donations are not regarded as "securities," these sites are largely unregulated. There are now literally thousands of these donation sites on the Internet and they attract billions of dollars in mostly local donations every year.[6]

The second flavor of crowdfunding is interest-free lending to businesses. The best example is Kiva, which allows you to find great microentrepreneurs around the world, learn about their businesses, and help them get started and grow. Because loans without interest also are not regarded as securities, this kind of lending has proliferated as well. Again, you might get some perks from your loan, in addition to getting your principal back, but the main satisfaction is personal. If you find an entrepreneur in your community, you will also enjoy a social return from the business's success.

The third flavor of crowdfunding is peer-to-peer lending. Sites like Prosper and LendingClub provide individuals and businesses the opportunity to borrow as much as $35,000–$40,000 from small investors. These lending platforms pay interest rates of about 10 percent these days, though the loans are risky. The problem for a local investor, however, is that you can see only the state in which the borrowers live. The community location is hidden.

The fourth flavor is what Title III of the JOBS Act of 2012 legalized and is often called "investment crowdfunding." Small businesses can put up an offering on a federally licensed portal, like Wefunder, and you can invest as much as $2,200 per year (or more if your income is over $107,000).

Introduced by Tea Party Republicans, with the enthusiastic support of young techies and local-economy advocates like myself, the JOBS Act created an affordable, legal pathway for small businesses to get investment capital from any American. Unlike donation crowdfunding, investment crowdfunding allows businesses to borrow money from their fans and pay them interest. Or sell them stock and pay dividends. Or provide royalty payments on revenues or profits. Or enter into dozens of other kinds of investment arrangements. Now everyone can play in the sandbox of business finance, not just rich people. Small businesses can seek grassroots investors, and grassroots investors can put their money into small businesses.

According to the most recent assessment of investment crowdfunding, between 2017 and 2018 the number

of unique offerings grew from 474 to 680, the annual total raised increased from $71 million to $109 million, and the number of investors rose from 77,558 to 147,448.[7] Six in ten companies that tried crowdfunding succeeded, with an average raise of $270,966.

These numbers will grow, but in the larger scheme of things, this revolution is still a mouse. Of the 330 million people living in the United States, fewer than one in a thousand have participated in crowdfunding. There are lots of explanations why. News travels slowly. People resist change. Novel concepts need time to prove themselves. But the most significant explanation, I believe, is quite specific: The only real savings most of us have—the dollars we might be able to invest locally—are locked away in our pension funds, IRAs, and 401ks. And if we have bothered to ask about other options, we have been told by our financial advisors and other experts that local investment is impossible within these accounts.

This advice is wrong. Most advisors are unaware of recent changes in the law that have expanded local investment options. Nor are they familiar with the tax tools for tapping retirement funds for local investment that have been available for decades. This book is all about two of the most important tools: the Self-Directed IRA and the Solo 401k. While there are differences between the two, they are sufficiently similar to be discussed together in one book. I call them, for simplicity, Do-It-Yourself (DIY) Accounts.

If you've ever listened to experts talking about these tools, you may have heard them say, "The Self-Directed IRA is really expensive." "The Solo 401k is too complicated." "Finding companies that offer these products is way too difficult."

These pronouncements pile on top of the other commonly heard refrain: "Don't bother investing in local businesses, because they usually fail." As we will discuss later, this is all ill-informed nonsense.

All investment is risky, whether you invest in Wall Street or Main Street. But if you approach local investment with prudence and common sense, you can earn a rate of return that matches or exceeds what you would get on the stock market, while being sure your money is supporting your community and your local economy. This book aims to give you all the basic information you need to open your own DIY Accounts and to start investing locally.

While I've tried to write a book that's informative, interesting, and occasionally entertaining, my mission is not just to provide a good read. I want you to act. *I want you to make a commitment to start moving your money back into your life.*

To help you follow through, I have teamed up with the Sustainable Economies Law Center and LIFT Economy to create a website, called The Next Egg (*www.thenextegg.org*), that puts all the tools you need in one place. Through webinars, reports, peer support, and specific services, The Next Egg can help you unlock everything you read about in the pages that follow.

I've written this book for people without a lot of investment experience. I explain in simple terms concepts like "liquidity" and "diversification" that often sound complicated but are not. If you already know a lot about investment, you'll be able to skim some sections. But even if you are as experienced as Warren Buffett, I invite you to rethink everything you know about the field. How might you bring

more meaning and satisfaction to the deployment of your money?

The book begins with some examples of how the DIY Accounts work (Chapter 1). It then proceeds to describe the importance of local business (Chapter 2), introduce the field of local investment (Chapter 3), and present a dozen specific kinds of local investment options (Chapter 4)—some of which are very likely to generate better returns than Wall Street. The rest of the book introduces everything you need to know about Self-Directed IRAs and Solo 401ks. Here are the questions these remaining chapters seek to answer:

- What are the basics of the DIY Accounts? (Chapter 5)
- How do you set up a DIY Account? (Chapter 6)
- How do you begin identifying local investment opportunities? (Chapter 7)
- How should you evaluate these opportunities? (Chapter 8)
- How can you prevent yourself from swimming in legally dangerous waters? (Chapter 9)
- How do you keep your DIY Account operating successfully? (Chapter 10)
- What's happening next in the field of local investment? (Chapter 11)

Here are a few caveats before we proceed:

- Any honest book about investment needs to dispel the fantasy that you are going to get rich quick. Instead, I repeat this warning: *Any investment, even a local investment, carries risk*. And while this book provides

you with tools and strategies for conducting due diligence and making smart investment decisions, you should still try to get other informed opinions before committing your precious savings. There are plenty of other great books out there designed specifically to sharpen your investment skills.

- You also might consult the other books that have been published on Self-Directed IRAs and Solo 401ks—as you will see in the notes and resources—though none focus on local investment per se. They all delve more deeply into the legal fine print. If you are interested in using your DIY Account to invest in special kinds of opportunities not linked to your community—like housing liens or precious metals—please consult these books and other experts for guidance on how to do so.
- This book is not a legal textbook, and consequently I won't bore you with extensive explanations on whether this or that rule comes from a piece of legislation, an IRS ruling, or case law. As a lawyer, I've tried to capture the essence of the law, regulations, and court holdings in plain language. For those who are eager to learn more about these questions, I've added notes.
- Please be mindful of the 2020 publication date. Laws and regulations concerning taxes, pension savings, and investment always change, and huge overhauls are always possible. If you happen to pick up this book in 2021 or later, please double-check The Next Egg website for updates.

- Finally, I want to give a special, supportive shout-out to the hundreds of thousands of professionals currently working in the financial industry. I know that most of you are trying to do your best to serve the needs of customers to protect and grow their savings. Even though I'm critical of some of the industry's practices, I hope you won't take these criticisms personally. Instead, I would like you, too, to see the fabulous new opportunities to incorporate the tools and practices of local investment into your business. Change is hard, but in your case, it also could be enormously profitable.

Okay, enough throat clearing. Let's get on with your new life as a local investor!

1

PUTTING YOUR MONEY IN YOUR LIFE

Local investment may sound exotic, but opportunities for putting your savings to work in your community are becoming more common and more lucrative. At this point, most authors of investment books will spin stories that show their financial brilliance. Here's how I transformed powdered moose antlers into a $100 million health-food empire! Instead, I will tell you an embarrassing story of my own short-sightedness that almost drove me into bankruptcy. If I knew then what I know now, I could have prevented more than a decade of serious financial struggle. My mistake, however, is now your opportunity.

One of my favorite Gary Larson cartoons is of a crisis clinic on fire, floating down a river, about to plunge over a waterfall. That's what my life was like in 2008. That was the year I had decided to divorce, start paying child support for two young children, move into a new house, and take a new job. Then the financial crisis hit. My new job vanished, and

opportunities for consulting work were drying up. Having been married to a talented law professor with an expertise in family law—please don't laugh—I was struggling to keep up with punishing custody payments and lawyer bills.

The one financial bright spot was that my spouse had accumulated a significant pension, and we agreed, as part of our divorce settlement, that half would be transferred to me. Normally, you cannot touch tax-deferred funds like these until you retire, and if you do, you will be sacked by the Internal Revenue Service (IRS) with a 10 percent penalty. But when a court orders the redistribution of marital assets, you can use them immediately without penalty. Ordinary taxes are taken out of money you withdraw, and then the funds are yours. I decided to use the proceeds to pay off all my debts—credit cards, automobile, various personal loans. I thought it would be smart to begin my new life with a clean financial slate.

About a year later, as I was doing my taxes, I learned something the divorce attorneys never warned me about. The transfer of funds pushed me into a substantially higher income bracket, and the much-dreaded alternative minimum tax kicked in. Suddenly I owed Uncle Sam about $80,000. I paid off some of this debt with credit cards, and the rest went into an IRS payment plan. After paying over 20 percent interest and penalties for several years, my debt situation was far worse than it had been before I divorced!

I have since learned about an option that could have saved me all this grief. A Solo 401k is a retirement savings account designed for self-employed individuals, which is what I was in 2009. I could have transferred my former wife's pension into that account and given myself a five-year, $50,000 loan

to pay off all my debts. There would never have been an awful tax bill from the IRS. In fact, no taxes would have been taken out of the transfer at all, because I would have rolled it over directly into another tax-deferred account. And instead of paying over 20 percent interest to credit card companies for years, I could have paid my Solo 401k back at 5 percent interest over five years, and the literally tens of thousands of dollars of interest I had paid to Visa and Mastercard would have instead gone straight into my retirement account. Rather than being broke with massive debts in front of me, I would have paid everything off in five years and had a healthy nest egg for retirement. Smart local investing in myself would have paid huge dividends.

Okay, I was a fool. But then again, no one in my life—not my lawyers, not financial advisors I consulted, not my many Ivy League–educated friends—knew about the Solo 401k either. Neither did you, I bet. Live and learn. You, however, will never have to repeat this mistake. Because I'm now about to introduce you to the huge, unappreciated potential of DIY Accounts.

Right now, chances are good that your life savings are locked away in Individual Retirement Accounts (IRAs) and their workplace equivalents (401ks or 403bs). The government incentivizes you to maximize your retirement savings in these accounts by deferring taxes until you withdraw the money in retirement. Unfortunately, your investment options in these accounts are almost entirely global corporations. But with the Self-Directed IRA (which anyone can use) or the Solo 401k (which is designed for self-employed people), you can save for your retirement, defer your taxes, and invest locally.

Local investment means putting your money to work in your local businesses, your community, your neighbors, and even yourself. We can quibble about whether your community is your region, your town, or your neighborhood, but for the moment let's underscore one basic truth: The closer to home you invest, the more benefits you are likely to enjoy and the more informed you will be about the risks.

Let me give you some hypothetical examples of what local investment looks like and how the Self-Directed IRA and Solo 401k can unlock its full potential.

- George is a forty-year-old software engineer who has steadily put away $5,000 per year in his IRA. He has accumulated about $80,000 and manages his investments online through TD Ameritrade. He worries that all his money is supporting Fortune 500 businesses he knows little about, and he now wants to put some of that money into his local food cooperative. The co-op, which has operated for twenty years, is building another store and is prepared to pay members 7 percent per year for loans above $1,000. George decides to set up a Self-Directed IRA through PENSCO Trust, one of several dozen companies that provide this tool, and directs his appointed representative, called his "custodian," to lend the co-op $10,000. The note from his IRA is payable over five years, and every year the co-op pays $2,495 back into his IRA. The cost of setting this up? About $250 per year.
- Ashley is thirty and has a smaller IRA than George. She has a friend who is launching a nearby clothing

business and is crowdfunding on the website Honeycomb Credit for the $250,000 she needs in start-up capital. Ashley also sets up a Self-Directed IRA, rolls over funds from her original IRA, and then directs her custodian to write a $2,000 check to Honeycomb Credit. She now is thrilled that she—along with 550 other people—has loaned her friend's company the capital it needs to get going.

- Maureen, fifty, is excited about a new museum dedicated to local civil rights activism. Her city has issued municipal bonds to support the museum, but instead of selling the bonds through Wall Street investment banks, it is encouraging residents to buy the bonds directly. According to the mayor, "We are promoting local investment because it's giving the city a new tool for underwriting municipal projects without raising taxes." Maureen sets up a Self-Directed IRA, rolls over her savings, and buys $5,000 worth of bonds.
- Ken, thirty-eight and single, has been a self-employed musician. He barely has been making ends meet, but this past year, he recorded a single that's getting wide play on YouTube and SiriusXM. Six months of wildly successful concerts have netted him $196,000, significantly more than he needs for expenses. He decides to set up a Solo 401k and place his maximum annual contribution, $56,000, into it. Instead of paying roughly $44,000 in taxes on $196,000 worth of income, he pays only $26,000 on $140,000.[1] Since it's a Solo 401k, he doesn't need to hire a custodian. Instead, he purchases a license to an agreement from the IRS called

a "prototype" from a trust company and uses it to govern a new account he sets up in the name of his Solo 401k at his own bank. At a cost of about $300 per year, he can be his own custodian. A self-proclaimed "solar enthusiast," he then invests in a half-dozen promising renewable energy projects around his city.

- Robin has worked for the Foreign Service all her life and has steadily built up a million dollars in her Thrift Savings Plan (TSP), the federal government's equivalent of a 401k. Her investment options, when she was working for the federal government, were mostly global stocks and bonds. When she decides to retire at fifty-six, she sets up her own online knitting business. After she sells her first piece and reports that income on Schedule C of her taxes, she opens up a Solo 401k. She then directs her TSP representative to transfer the million dollars into her Solo account, and she begins to invest in affordable housing projects in her community.
- Robin's neighbor, Gwen, came over for dinner and shared the awful news that she had breast cancer, had been slammed by huge medical bills, and recently had racked up $25,000 in credit card debt. She was practically in tears, not knowing how she would ever pay it back with annual interest rates over 20 percent. Robin said, "Look, I can help. Right now, I've got $25,000 in retirement savings sitting in my bank and earning about 2 percent interest per year. How about I pay off your credit card, and then you pay me back at 5 percent per year over the next five years? You can write me into

your life insurance for collateral." Robin uses her Solo 401k, enters into an agreement with Gwen on behalf of her account, and then cuts her the $25,000 check.

All these examples show how anyone can take money sitting in a tax-deferred account and use DIY Accounts to reinvest it locally. Investing locally, of course, doesn't mean the investments will pay off as promised. With any investment, whether local or not, the people mentioned here—George, Ashley, Maureen, Ken, and Robin—could lose everything. But local investing gave these people an opportunity to put their money in people, projects, and businesses they really cared about. And it gave them the potential of generating higher returns with lower risks than the typical Wall Street stocks and bonds.

Local Milk and Beyond in Washington State

"I thought it was important to move our money from Wall Street and get our money back into our local community," says Judith Culver of Bellingham, Washington, who set up a Self-Directed Roth IRA with New Standard IRA in 2011. The lowest start-up fee she could find was $1,300 but she has paid only $80 per year since. She joined a local investment club that has helped her think through her investment decisions.

Her first investment was a $15,000 loan to a local dairy processing company so it could add a bottling facility. "This was at a time when it was really difficult for people to get money from the conventional banking system," recounts Judith. By bypassing Wall Street, she reasoned, she could foster economic growth in her own community.

"We went to the farm twice, learning about the baby calves [and] the milking as we sat and ate zucchini bread with the business owner," Judith says. The farmer was so adamant about paying her back that he said, "I would put this in my will if I could."

Her investment did well, paying her returns of about 6 to 12 percent per year. She decided to make another loan to a local business focused on a food distribution network for local farmers. That investment also did well. And she followed with investments in a local wind farm, a local author (who needed funds to publish his book on community yoga), and a local manufacturer of ergonomic chairs.

As far as Judith is concerned, New Standard made the process very easy. But her local investment group was invaluable as well in helping her find local investment opportunities.

ABOUT THE AUTHOR

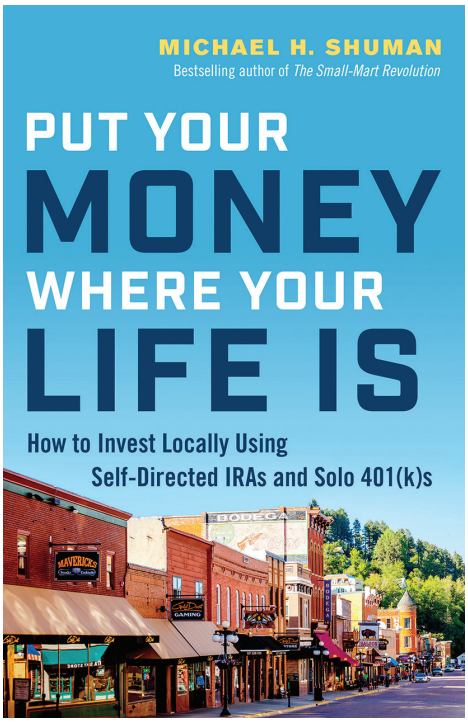
MICHAEL H. SHUMAN is an economist, attorney, author, and entrepreneur, and a leading visionary on community economics. He's director of local economy programs for Neighborhood Associates Corporation, a nonprofit affordable housing company, and currently an adjunct instructor at Bard Business School in New York City. He performs economic analyses for cities and businesses through Council Fire, where he's a senior associate. He is credited with being one of the architects of the 2012 JOBS Act and dozens of state laws overhauling securities regulation of crowdfunding.

He has authored, coauthored, or edited nine other books besides this one. One of his previous books, *The Small-Mart Revolution: How Local Businesses Are Beating the Global Competition* (Berrett-Koehler, 2006), received a bronze prize from the Independent Publishers Association for best business book of 2006. He also wrote a pioneering book on local investment called *Local Dollars, Local Sense: How to Shift Your Money from Wall Street to Main Street and Achieve Real Prosperity* (Chelsea Green, 2012).

A prolific speaker, Shuman has given an average of more than one invited talk per week, mostly to local governments and universities, for the past thirty years in nearly every US state and more than a dozen countries. He has appeared on numerous television and radio shows. Shuman has written nearly one hundred published articles for such periodicals as the *New York Times,* the *Washington Post,* the *Nation,* the *Weekly Standard, Foreign Policy, Parade,* and the *Chronicle on Philanthropy*. In 1980, he won first prize in the Bulletin of the Atomic Scientists' Rabinowitch Essay Competition on "How to Prevent Nuclear War."

Shuman received an AB with distinction in economics and international relations from Stanford University in 1979 and a JD from Stanford Law School in 1982. Between 1987 and 1990, he was a W. K. Kellogg National Leadership Fellow. He is also a member of the District of Columbia Bar.

We hope you enjoyed this excerpt from Michael Shuman's
Put Your Money Where Your Life Is



[BookShop]
[Berrett-Koehler]
[Barnes and Noble]
[IndieBound]
[Amazon]