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MEMORANDUM

Date: April 24, 2019

To: Diane Stoddard, Assistant City Manager, City of Lawrence

Cc: Britt Crum-Cano, Economic Development Coordinator, City of Lawrence

From: Jeff Jewell, Director, National Development Council

RE: Opportunity Zone Program- City Capabilities and Constraints

The City has requested a memorandum describing its ability to influence and/or limit investments occurring through the Opportunity Zone (OZ) Program. This program, while still in relative infancy, has promulgated enough rules and regulations to describe program functions and outlines, principal actors and monitoring requirements. Additionally, enough information exists to generally articulate how capital sources will make investments into qualified property or businesses with the Opportunity Zones. The information contained in this memorandum is for informational purposes only and is not legal or financial advice, and NDC is not providing either of these services. The City of Lawrence should consult with its own independent financial, legal, accounting, tax and other professional advisors regarding the conclusions and information delivered.

Program Background and Basics

The Tax Cut and Jobs Act of 2017 established the Opportunity Zone program, which provides a federal tax benefit to investors in the program. Specifically, the investor receives preferential capital gains treatment for investments within designated low-income census tracts throughout the country. Investors can take advantage of the tax incentives offered by the program by investing in qualified Opportunity Funds (OF). Generally speaking, a qualified OF is a private investment vehicle that invests at least 90% of its capital in "qualified OZ property" – which means investments in either OZ businesses or OZ tangible properties. Depending on the investment's time horizon, the program incents investors to re-invest unrealized capital gains by deferring, reducing or eliminating these gains.

Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation of authority to the Internal Revenue Service. The Department of Treasury and Internal Revenue Service (IRS) have issued periodic guidance since the program's authorization to aid taxpayers in participating in the OZ incentive. A recent publication in the Federal Register suggests that comments are being solicited about "what data, metrics, and methodologies can be used to measure the effectiveness of public and private investments in urban and economically distressed communities, including qualified opportunity zones." For more information and detail about the program and latest updates, visit the IRS' Opportunity Zone program page or www.eig.org or refer to the attached fact sheet from the Economic Innovation Group.

Role of Local Oversight

The program's regulatory and monitoring oversight is provided by the Department of Treasury and IRS. Because the program relies on investors to self-certify investments and funds- and partially because there are relatively few regulatory requirements associated with the program- a state or local government's ability to compel is limited to what is currently allowed by state or federal law. It is likely that a city will not even be aware when a QOF is used as a funding source in a development project or operating business.

Most cities do not have the ability to require disclosure of capital funding sources *unless* there is some benefit derived from the local government in the form of tax, financial or regulatory incentives. In most cases, the state has promulgated local planning and development authority to the local municipality, which is where the bulk of the City's implied authority rests in its ability to shape OZ investments within its jurisdictional boundaries. The program does not appear to provide QOFs or investments with an ability to supersede or override the explicit governance powers reserved for most American cities. As such, a local government's role or ability to influence investment decisions is likely limited to its implied or explicit authority at the regulatory level with respect to planning and development entitlements.

However, there is likely significant leeway and authority for a city to exercise some compulsory activities- disclosure, monitoring, and reporting, for example- and influence project scopes if an OZ project *also* receives a locally-designed benefit (such as a tax abatement or fee wavier/reduction). Ideally, an adopted policy would explicitly state these policy goals and other requirements for projects receiving a locally-conferred benefit. In summary, a city likely only has authority to place requirements on projects receiving OZ investments if there is an explicit local benefit conferred on the project or business.

Publicly Administered Opportunity Funds

The statute allows for broad participation in the creation of Opportunity Funds with the goal of drawing a wide array of investors to support the broad variety of needs in low income communities nationwide. Any entity, from large banks to a community development financial institution, from a venture capital group to a developer consortium, as well as regional economic development organizations and even individual tax payers can establish a fund as long as they follow the guidelines set out by the statute and Treasury (in the process of being finalized).

There are approximately 112 multi-investor, Opportunity Zone funds already established. Many of these funds identified targeted investment projects or operating businesses within a desired geographic footprint. This is not inclusive of all the possible funds that have been certified for individual projects or businesses because there is currently no public reporting repository for such information. While establishment of a fund is relatively simple, capital attraction, project selection and investment, administration and reporting are much more complex tasks. This author does not know of a city that has established a QOF, and while it may be appropriate in some narrow instances, there are enough capital sources searching for investment-grade projects.

Role for Municipalities

The potential level of municipal involvement in influencing OZ investments varies. This author would prefer that cities take affirmative actions to organize land use and incentive policies to steer potential OZ investments towards achieving certain policy outcomes. A community should have conversations of how investments in OZs can help meet certain priorities. To realize these outcomes, a city should prioritize the local policy goals- place-making, infrastructure, affordable housing creation and preservation, etc.- and assess how to combine existing tools (i.e. incentives at the City's discretion) with potential OZ investments. It is this author's opinion that the most effective method a city can use to meet its goals will require the strategic use of local incentives for projects or businesses willing to undertake or shoulder – at least partially- the responsibilities of delivering these outcomes for the city. This will require a city to identify the competitive assets and advantages within an OZ area. From there, it can begin to balance rewards, controls, incentives and protections to steer investment into a particular area and towards a particular outcome.

Bruce Katz and Evan Weiss at the Lindy Institute for Urban Innovation at Drexel University have published a primer on how cities can maximize OZs to their investment. In it, they lay out a broad, 10 step approach that will enable cities "to further capital investment in traditionally disadvantaged places in order to spur job creation and broader opportunities—the core objectives of this new tax incentive—as well as sharpen local strategies and modernize the institutions that design and deliver those strategies."[1] This will allow the City to begin a plan to address the potential shortcomings or negative effects of OZ investments and work to mitigate them.

The City of Lawrence, through its comprehensive, neighborhood, downtown, economic development, and capital improvement planning processes, has ostensibly undertaken processes that identified the desired outcomes and policy goals for the City broadly and, as the more individualized a particular area. Its economic development policy, for example, encourages transparency for those deals that receive public subsidy, which is a good principle of any effort to involve OZ guidance. The effort now should be to weave these different elements and plans into a comprehensive prospectus the City can use to guide conversations about how best to leverage existing incentives and tools at the City's disposal. By aggregating the community's desired outcomes into a single document, the City can shape locally designed incentives to its existing OZs to achieve those pre-determined goals and outcomes.

[1] **From Transactions to Transformation:** How Cities Can Maximize Opportunity Zones. Katz, Bruce and Evan Weiss. Accessed at: https://drexel.edu/~/media/Files/lindyinstitute/NowakMetroFinanceLab/NowakLabReports/Drexel_NMFL_10Steps_FullPolicyBrief.ashx?la=en