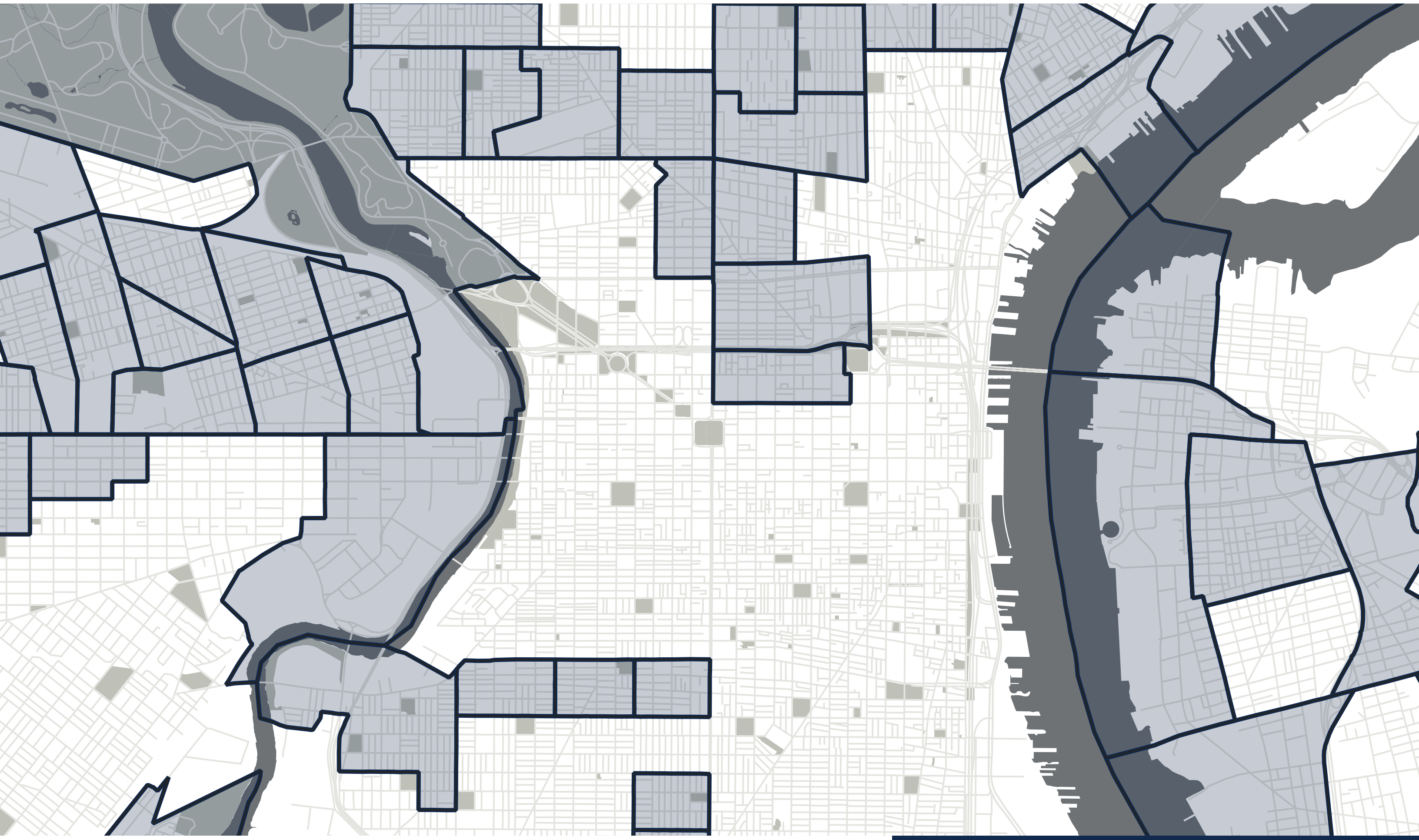
EXECUTIVE SUMMARY

From Transactions to Transformation:

How Cities Can Maximize Opportunity Zones

Co-Authors: Bruce Katz and Evan Weiss



Drexel University
Nowak Metro Finance Lab
Lindy Institute for Urban Innovation

In Partnership With:
Accelerator for America

ABOUT THE AUTHORS

Bruce Katz is the founding director of the Nowak Metro Finance Lab at Drexel University and the co-author (with Jeremy Nowak) of The New Localism: How Cities Can Thrive in the Age of Populism. Previously he served as the inaugural Centennial Scholar at the Brookings Institution, as chief of staff to the secretary of Housing and Urban Development, and as staff director of the Senate Subcommittee on Housing and Urban Affairs. Katz co-led the Obama administration's housing and urban transition team.

Evan Weiss is Director of PEL Analytics, a 501(c)(3) research and advisory firm that develops and fully implements financial recovery and economic development strategies for government and non-profits across the United States. He previously served as Budget and Operations Advisor in the Office of Newark Mayor Cory Booker and has worked closely on all aspects of the Opportunity Zone program since its inception, helping states and cities implement the program and design several place-based and sector specific Qualified Opportunity Funds, focused on infrastructure and workforce housing, as well as higher education and philanthropic partnerships.

ABOUT ACCELERATOR FOR AMERICA

Accelerator for America is a non-profit organization created by Los Angeles Mayor Eric Garcetti in November 2017. It seeks to provide strategic support to the best local initiatives to strengthen people's economic security, specifically those initiatives that connect people with existing jobs, create new opportunities and foster infrastructure development.

ABOUT DREXEL UNIVERSITY NOWAK METRO FINANCE LAB

The Nowak Metro Finance Lab was formed by Drexel University in July 2018. It is focused on helping cities find new ways to "finance the inclusive city" by making sustained investments in innovation, infrastructure, affordable housing, quality places, and the schooling and skilling of children and young adults. It is situated within the Drexel's Lindy Institute of Urban Innovation.

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The Tax Cuts and Jobs Act of 2017 provides a new tax incentive—centered around the deferral, reduction, and elimination of capital gains taxes—to spur private investments in low-income areas designated by states as Opportunity Zones. This provision is based on the bipartisan Investing in Opportunity Act (S. 1639) introduced by Senator Cory Booker (D-NJ) and Senator Tim Scott (R-SC). Given the significant interest among investors, it is possible that this new incentive could attract hundreds of billions of dollars in private capital, making it one of the largest economic development initiatives in U.S. history.

The broad objective of this incentive—expanding economic opportunities for places and people left behind—cannot be achieved by the market and outside investors alone. Cities in the broadest sense—local governments, urban institutions, networks, and civic leaders—will need to act decisively if Opportunity Zones are to engender not only a large volume of individual transactions but broader growth that is inclusive, sustainable and truly transformative for each city's economy. The promise of Opportunity Zones is not just to match private capital to investable projects but to inspire cities to reexamine and rediscover the fundamentals of economic development for all by channeling the resources of their own communities. Cities who are able to coordinate and focus investment will drive not just growth in the near term but institutional and financial reforms that will reposition cities for success over the long haul.

The new incentive differs from other federal tax incentives in several ways. First, it is more market driven; it does not use a federal or state agency to distribute the incentives but rather relies on the decisions of individual investors and fund managers, meaning local governments will likely not be even aware of most Opportunity Zone investments in their communities. Secondly, it can be used for a wide variety of projects—residential, commercial, industrial, infrastructure—rather than being restricted to a relatively narrow purpose like low-income housing or historic preservation. Third, there are no requirements for investors to ensure a certain outcome, such as job creation or local financial matches. Finally, there is no cap on the amount of the benefit if regulations are followed.

The federal law governing the Opportunity Zone incentive does not provide any guidance on the role of cities, yet city governments and other local entities can shape markets and maximize economic and social outcomes by smartly deploying their complex set of powers, resources, assets and relationships. Cities, unlike the federal government and state governments, are networks of institutions and individuals that can "think like a system and act like an entrepreneur." In this way, cities are primed to aggregate and align public, private and civic capital for strategic investments in economic development, schools and skills, infrastructure and affordable housing, the critical ingredients for long-term inclusive growth.

Since the Opportunity Zones incentive was introduced, two dominant, overly simplistic narratives have taken hold. On one hand, there is the view that all cities should merely compile and bundle a list of investable projects and reveal the true strength of the market for some distant investor on Wall Street or in Silicon Valley. This perspective treats the market failure that Opportunity Zones was intended to resolve as one primarily involving information and marketing rather than underlying business demand and economic realities. On the other hand, there is fear that Opportunity Zones will put gentrification on steroids, spiking housing prices and displacing residents. This perspective assumes that the principal challenge facing all cities is excessive value appreciation rather than poverty, high vacancy and low demand.

This policy brief advocates for a more balanced approach that reflects the market variance and complexity within and across cities, organized around Seven Principles to guide city analysis and strategy for leveraging newly established Opportunity Zones. The principles are designed both to 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. To actualize these principles, we offer 10 Steps to leverage local advantages, knowledge and experience to fully realize the economic and social potential of this unique tax incentive.

> Section 1400Z of Internal Revenue Code, amended by The Tax Cuts and Jobs Act of 2017, allows a taxpayer to defer paying federal capital gains tax on the sale of property if that gain is invested in a Qualified Opportunity Fund ("QOF"). A QOF must invest at least 90% of its assets in businesses or property in designated low-income communities known as "Opportunity Zones." In addition, taxpayers who hold investments in those funds for at least five years receive a 10 percent reduction in their original capital gains tax obligation; holding investments at least seven years adds an additional 5 percent reduction for a total of 15 percent; finally, holding an investment a full ten years allows taxpayers to avoid any capital gains tax on the appreciation of the new investment.

OVERARCHING PRINCIPLES

Principle One: See the big picture

Investors naturally focus on the merits associated with individual transactions or financial products. Cities, by contrast, can think about impacts beyond the tradeoffs involved in a particular transaction to advance systemic goals, like enhancing the public sector's fiscal capacity or strengthening the regional economic ecosystem. Cities should create the conditions for long-term growth rather than chase capital for short-term outcomes.

Principle Two: Act as networks, not as governments

Cities are more than governments and elected officials. They're networks of institutions and leaders who co-produce the economy and co-govern many aspects of urban life. Maximizing the potential of Opportunity Zones requires the full engagement of different sectors and stakeholders who can leverage their collective assets and align their decisions.

Principle Three: Identify the distinctive competitive assets and advantages of Opportunity Zones

To reduce friction in the market, cities should be an engaged, reliable source of intelligence about their overall economies and each of their Opportunity Zones. Each city should be able to state definitively what gives disparate Opportunity Zones their market traction and potential.

Principle Four: Balance rewards and controls, incentives and protections

Opportunity Zones are a market driven incentive; most cities won't know how much or where Opportunity Fund investments have been made. Cities can use public resources to steer market investment, particularly towards historically disadvantaged areas. Cities should ensure that every Opportunity Zone is included in a citywide inclusive zoning, procurement, and development policy that focuses on residents and require data transparency for deals that receive public subsidy.

Principle Five: Structure strong, inclusive partnerships

Opportunity Zones could catalyze the aggregation of smart public, private and civic capital for a positive, compounding effect. Smart public and civic investments in community infrastructure and human capital can provide a platform for private sector investment. In low-demand Opportunity Zones, smart public, private and civic financial instruments can attract and de-risk tax advantaged capital.

Principle Six: Link market investments to investments in human capital and other strategies that maximize impact for lower income residents

Cities have a unique potential, given the localization of many schools and skills institutions and initiatives, to focus on human capital by giving students and residents who live in or near Opportunity Zones the ability to access existing and future employment opportunities. Cities can go further and drive inclusive growth through supporting minority owned businesses, homeownership, affordable housing and neighborhood amenities.

Principle Seven: Use Opportunity Zones as a catalyst for modernizing local institutions

In many communities, fragmented local governments simply do not have the capacity or professional expertise to design, finance and deliver sophisticated market and social initiatives. On the private and civic side, most communities collaborate through loosely organized informal networks that do not have sufficient capital or capacity, or with a scope too limited to drive sustainable broad impact. Cities should use Opportunity Zones as a vehicle for modernizing and redefining their institutions to act with purpose and discipline to maximize economic, social and environmental impact.

TEN STEPS

Step One: Design and market an Investment Prospectus to showcase the distinctive assets and investable projects in a city's Opportunity Zones

Set the context of the regional market, offer detail on local organizations and projects, and the advantages of individual opportunity zones through a marketing tool with a strong, cohesive narrative.

Step Two: Maximize the economic impact of anchor institutions, particularly institutions of higher learning

Spread the word to community anchors about Opportunity Zones and seek to understand their needs that the incentive might meet; encourage their own formation of Opportunity Funds or to serve as a clearinghouse for potential investors and projects.

Step Three: Maximize the economic impact of publicly owned assets

Ensure each public entity's assets are widely known and easily identifiable; agencies should use their own property holdings to shape and incentivize markets to serve the broader public as part of a city-wide strategy.

Step Four: Accelerate employment density, business demand and smart place-making

With careful rezoning and planning, cities can spur the co-location of corporations, university assets, start-ups and scale-ups, driving the enhancement of commercialization and tech transfer efforts in ways that support the regeneration and animation of public and private spaces.

Step Five: Ensure that Opportunity Zone related infrastructure is high quality and meets performance and sustainability standards

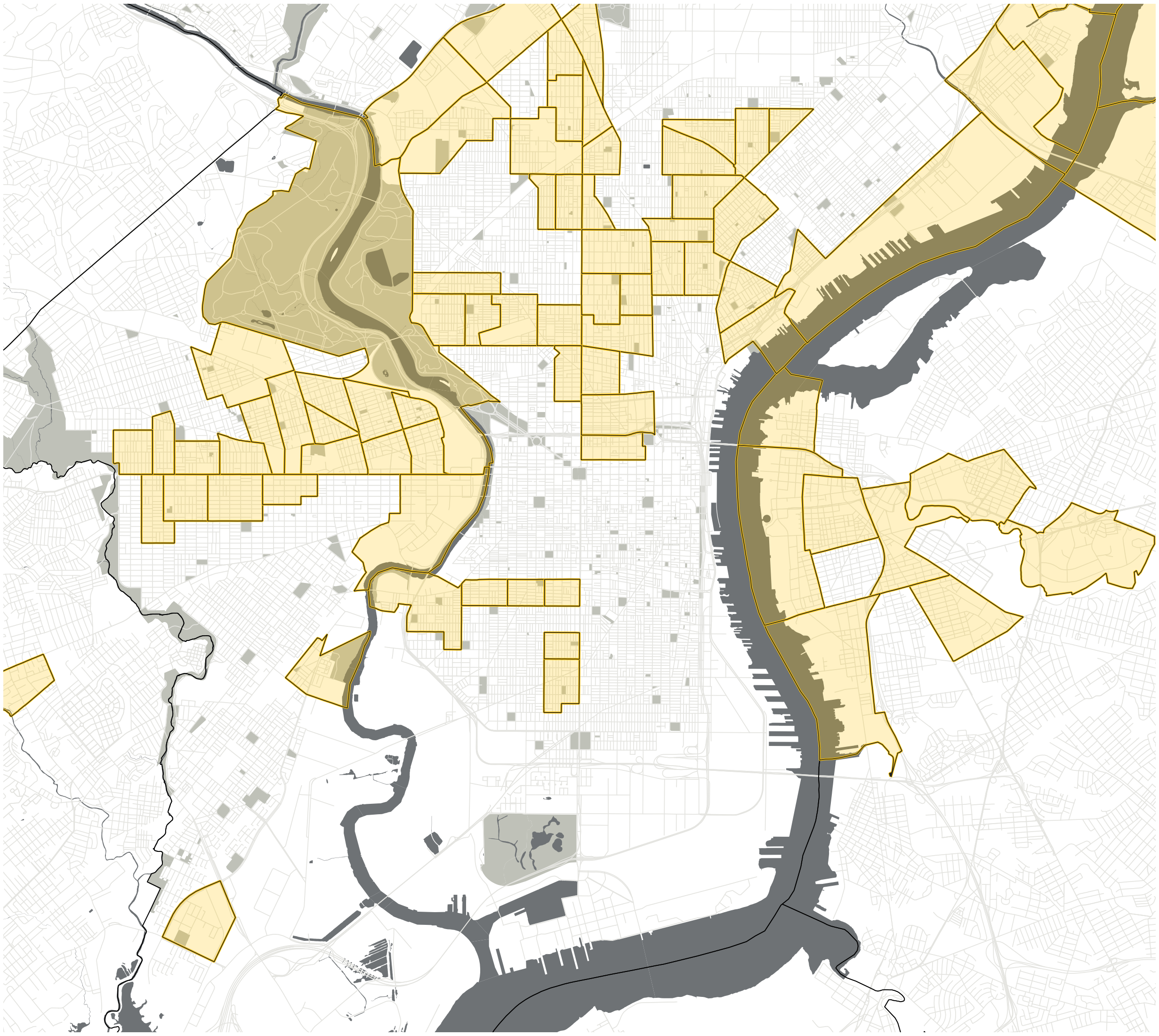
Cities should market their infrastructure, including freight rail, wastewater, and storm water investments, and align tax increment financing opportunities from Opportunity Zone investment to ensure project and community infrastructure is high quality and meets performance and sustainability standards.

Step Six: Align city investments, procurement, tax preferences, zoning, and other decisions with the distinctive competitive assets of each Opportunity Zone

Available local incentives should be well-publicized and easily accessible to potential investors to determine eligibility; cities can also use incentives as regulators to monitor Opportunity Zone investments. Fast tracking entitlements, given the time limitations of the Opportunity Zone incentive, offers a significant competitive edge.

Step Seven: Support local entrepreneurs and developers (particularly female- and minority-owned businesses) gain access to capital, technical assistance, mentoring, legal services and other resources

Spur inclusive growth through a legal and financial entrepreneurship clinic to help community members gain access to capital and technical assistance, including mentoring, legal services and other resources, to support citywide inclusionary development and purchasing policies.



Step Eight: Help local residents obtain the skills or competencies necessary to meet existing or future labor demand

Work closely with local school districts to create “cradle-to-career initiatives” and better link anchor employers to workers; cooperation should be incentivized.

Step Nine: Support the production and preservation of affordable/workforce housing

Maximize impact of existing housing institutions and intermediaries and leverage other tax incentives that support housing, such as Low Income Housing Tax Credits and New Markets Tax Credits.

Step Ten: Repurpose existing institutions and build new institutions to carry out core missions

Understand existing institutions and explore new governance structures to create a suite of adequately-resourced modern institutions. Move quickly and get started by offering a front door to investors, a clear lead, and an engaged community.