ECONOMIC INNOVATION GROUP

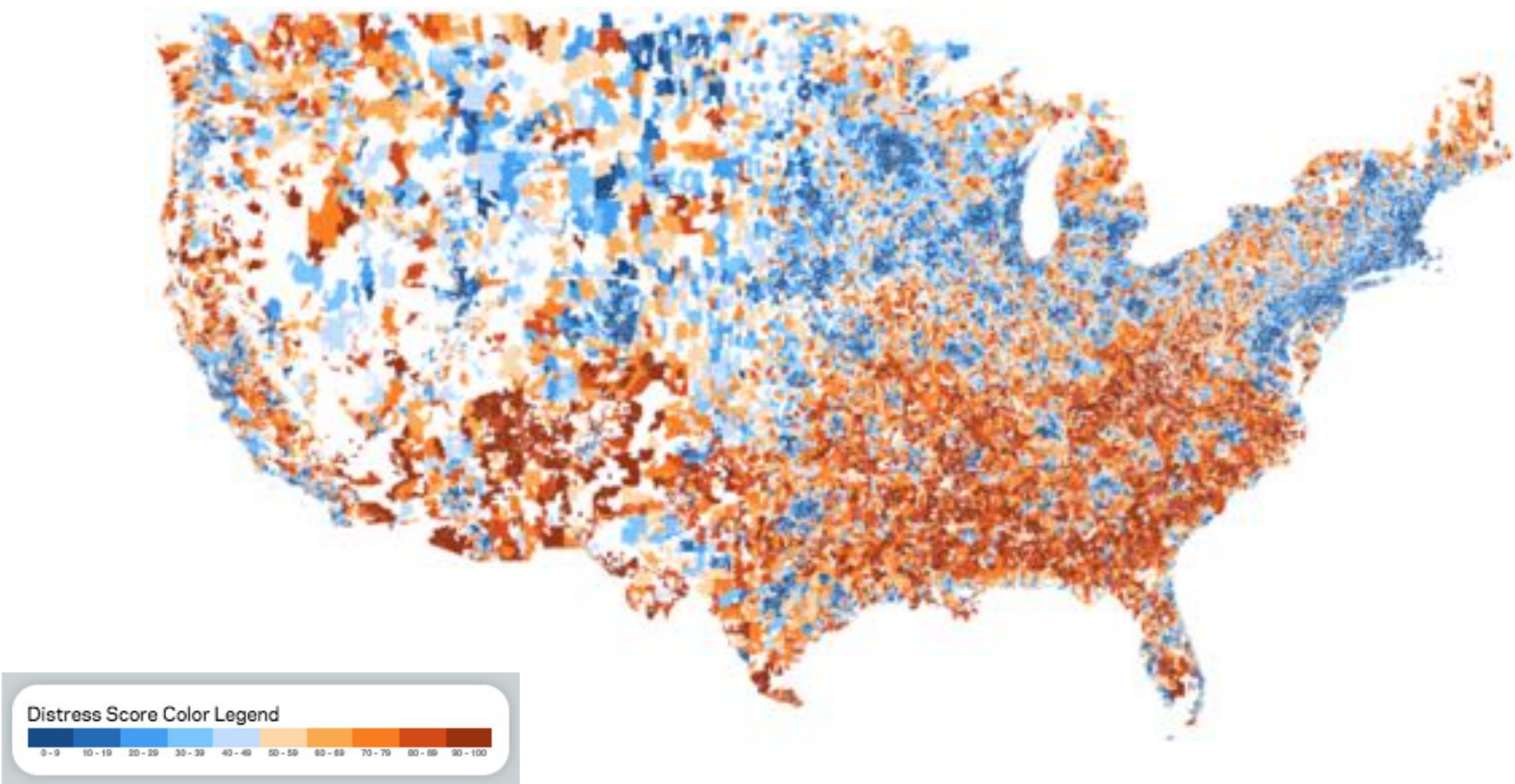
Opportunity Zones Overview

Kenan Fikri, Research Director

ECONOMIC INNOVATION GROUP / Washington, DC / @kenanfikri

Why Opportunity Zones and why now?

52 million Americans (1 in 6) live in economically distressed communities.

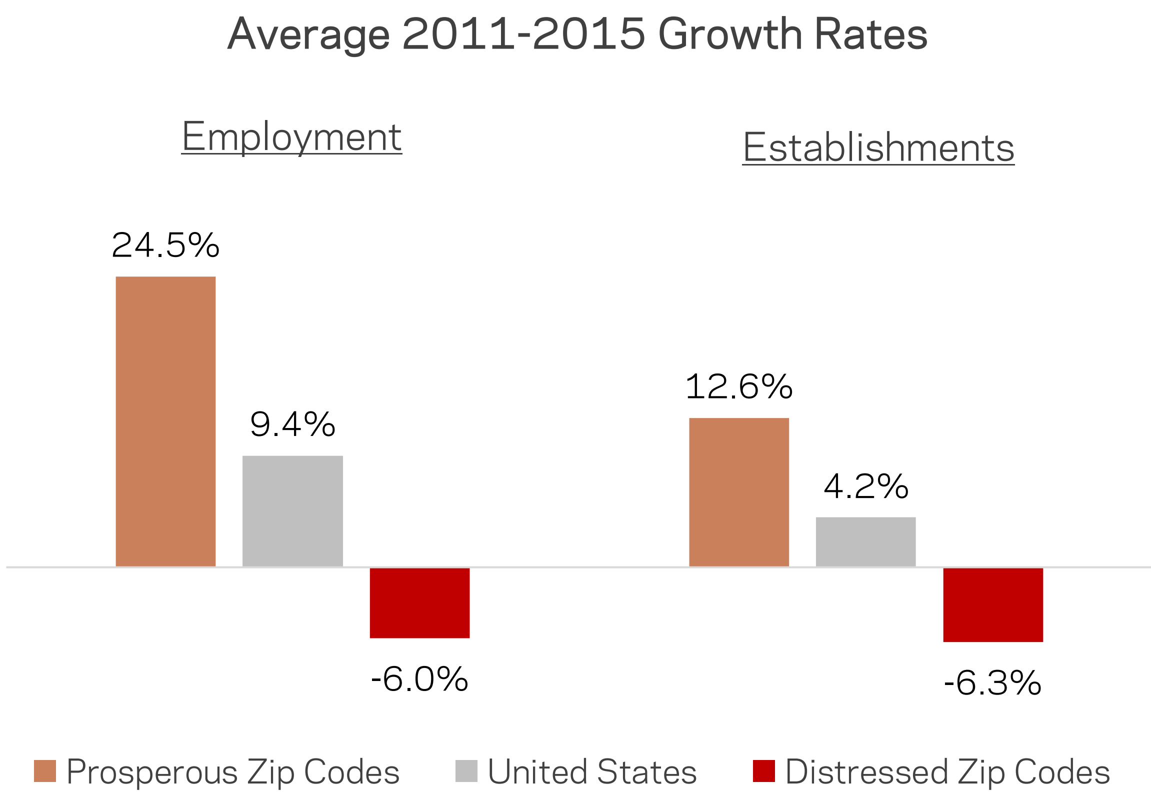


Prosperous Distressed

EIG

National economic growth is not a tide that lifts all boats.

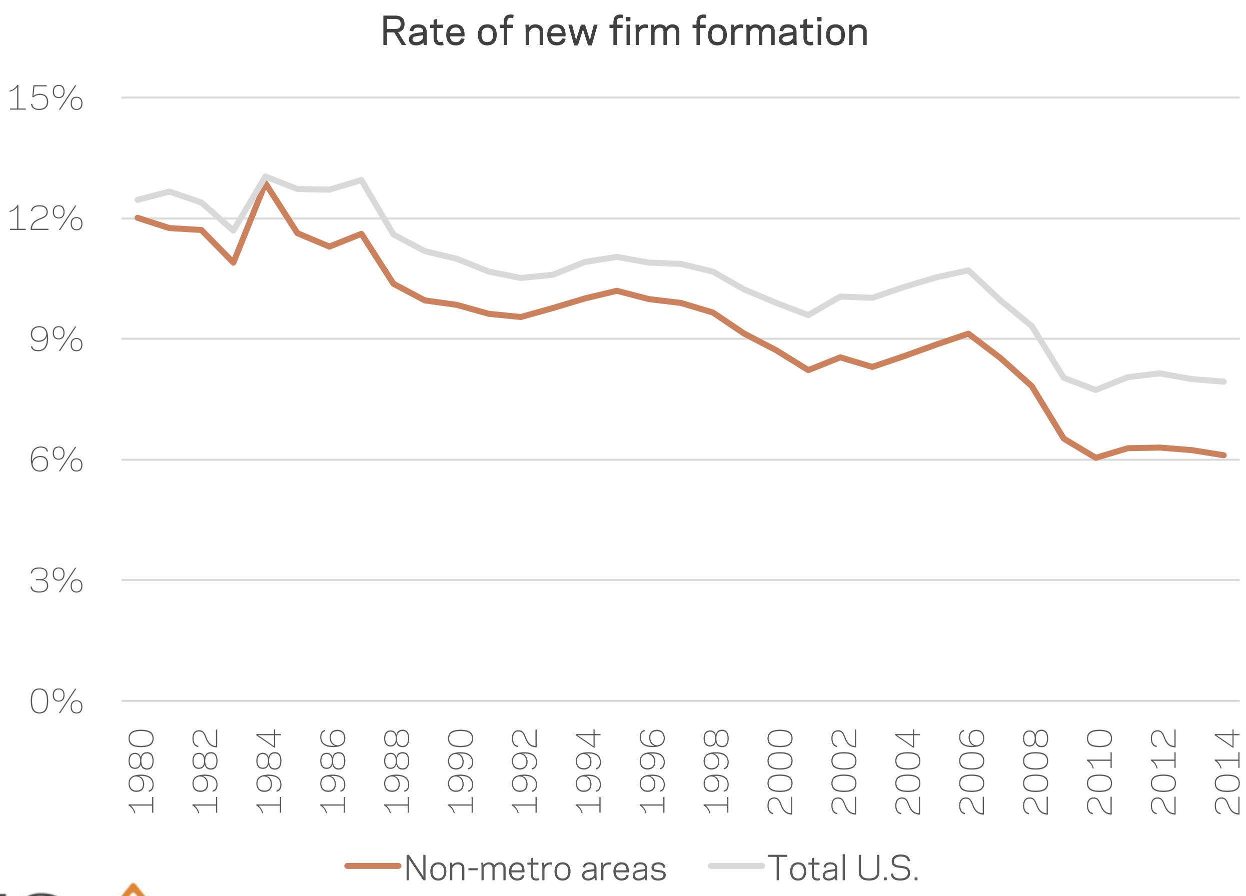
- More than half of the country's distressed zip codes contained **fewer jobs and places of business in 2015 than they had in 2000**.



EIG

The country is facing a related crisis in entrepreneurship and new business formation.

- The U.S. is **missing about 100,000 startups a year** right now, and entrepreneurial activity has dried up fastest in places that can least afford it.

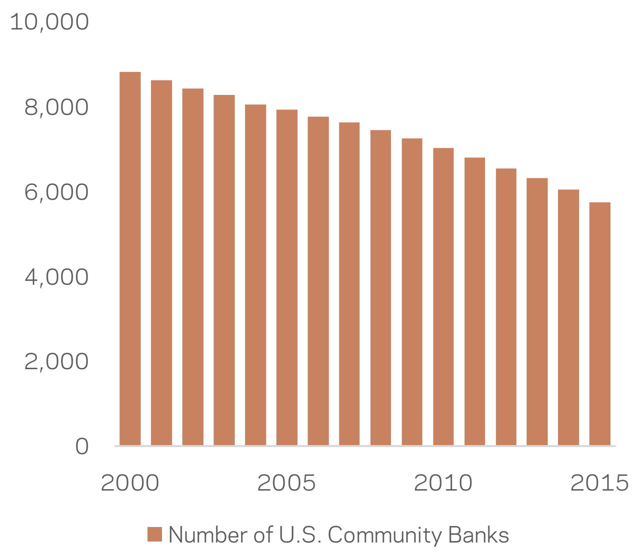


The startup slowdown has been even greater in non-metro areas, which launched fewer than 50,000 new firms for the first time ever in 2014.

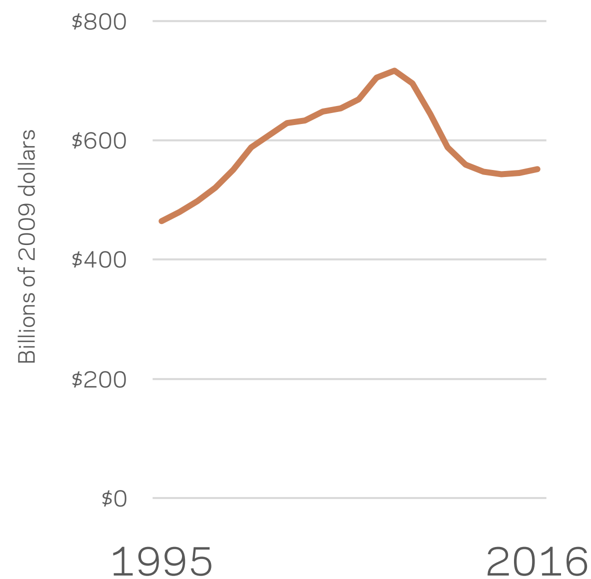
EIG

Uneven access to capital is now a threshold issue for addressing business formation in America.

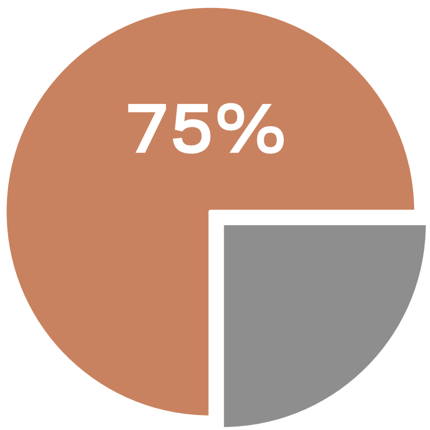
Nearly one out of every four community banks has disappeared since 2008



In real terms, small business lending remains **down by a quarter**



75% of all venture capital concentrates in three states

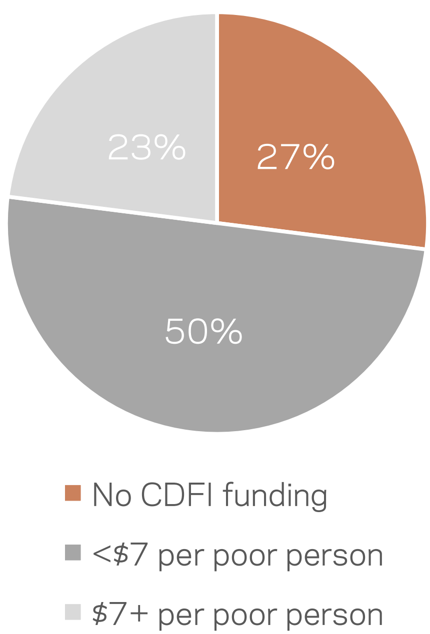


EIG

Sources: FDIC and National Venture Capital Association

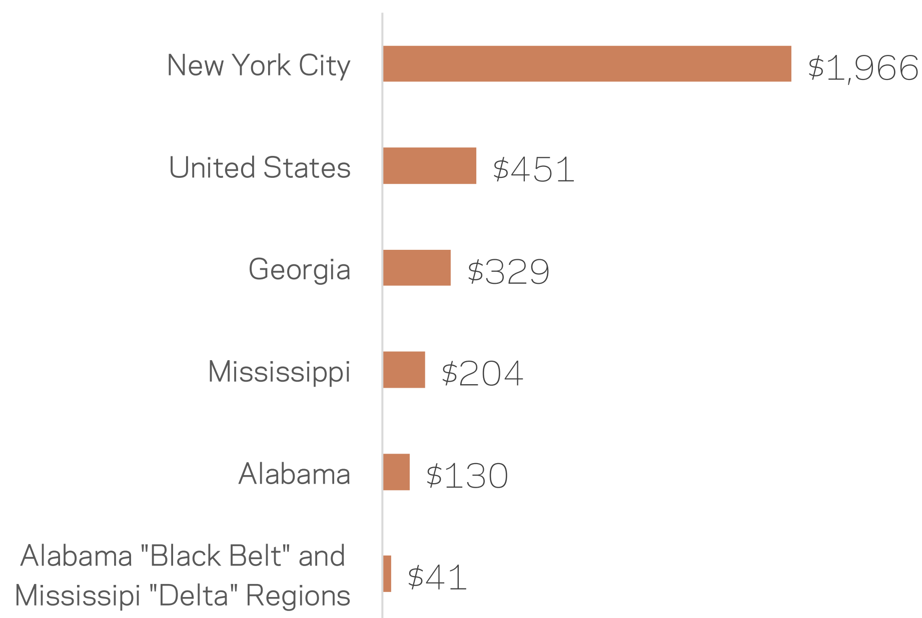
Even capital targeted toward distressed communities suffer from market gaps, information asymmetries, and other biases

27% of counties received **no CDFI funding** from 2011 to 2015



Philanthropies and foundations bypass some of the country's neediest communities

Per capita grantmaking, 2010-2014



Sources: The Urban Institute and National Center for Responsive Philanthropy

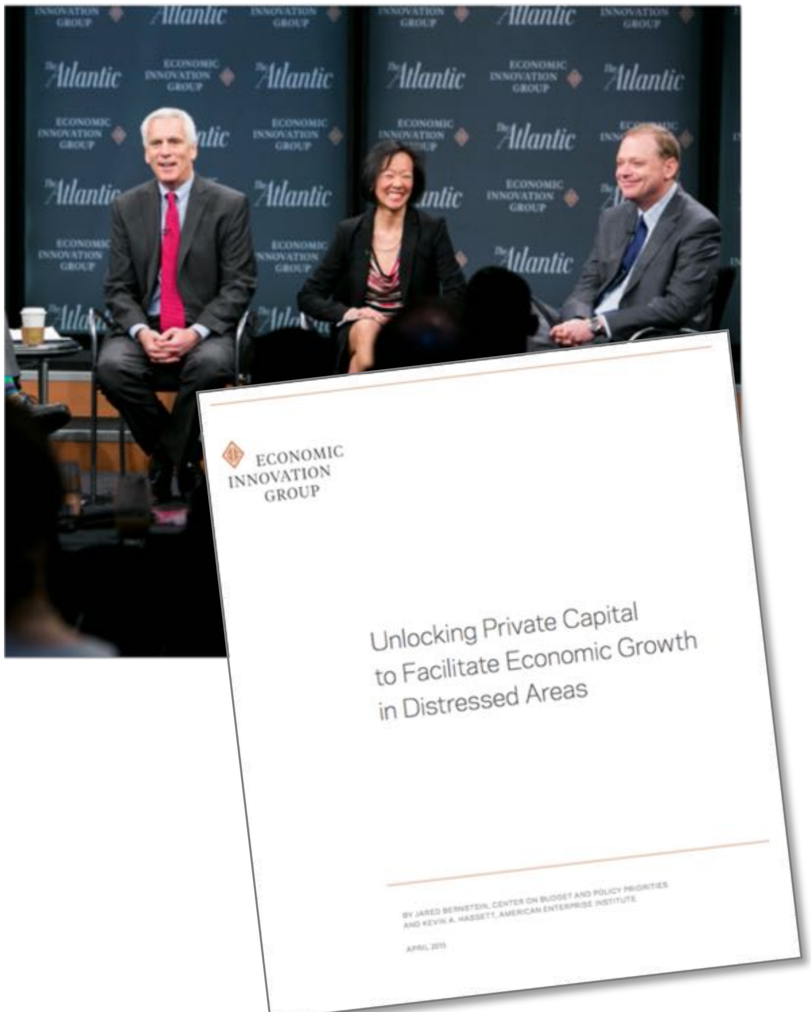
How do we start to address these problems? Plugging the capital gap through Opportunity Zones.

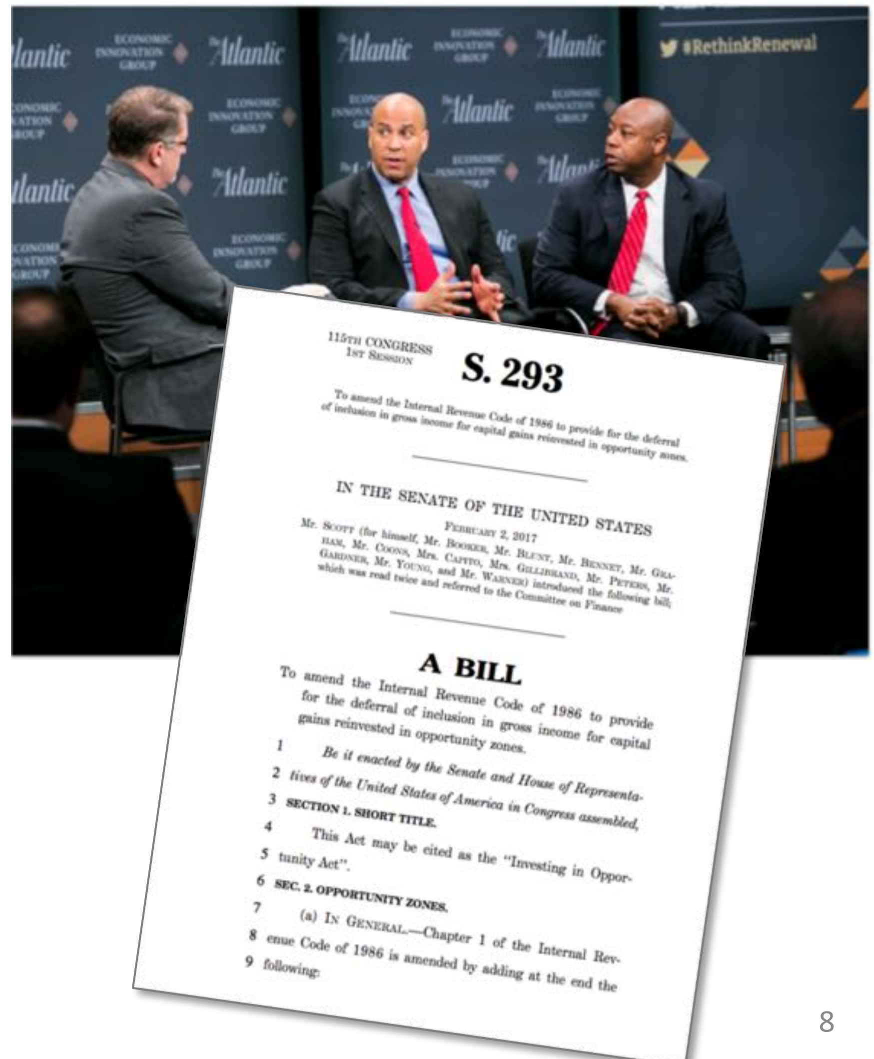
- The **U.S. is a capital rich country**, and investors are sitting on historic gains from a record breaking stock market. Yet, we have tremendous scarcity faced by the communities in need.

- Opportunity Zones will **connect investors with low-income communities** by creating a new national network of deal opportunities in much the same way that we systematically invest in foreign emerging markets now.

- We believe this will ultimately lead to the creation of a **new industry of community-based investments - a new asset class**. This could change the way investors look at opportunities outside of their bubble and how communities think about how they attract private sector investment and create jobs.

Opportunity Zones are a bipartisan, innovative, flexible solution for catalyzing private sector-driven economic growth.



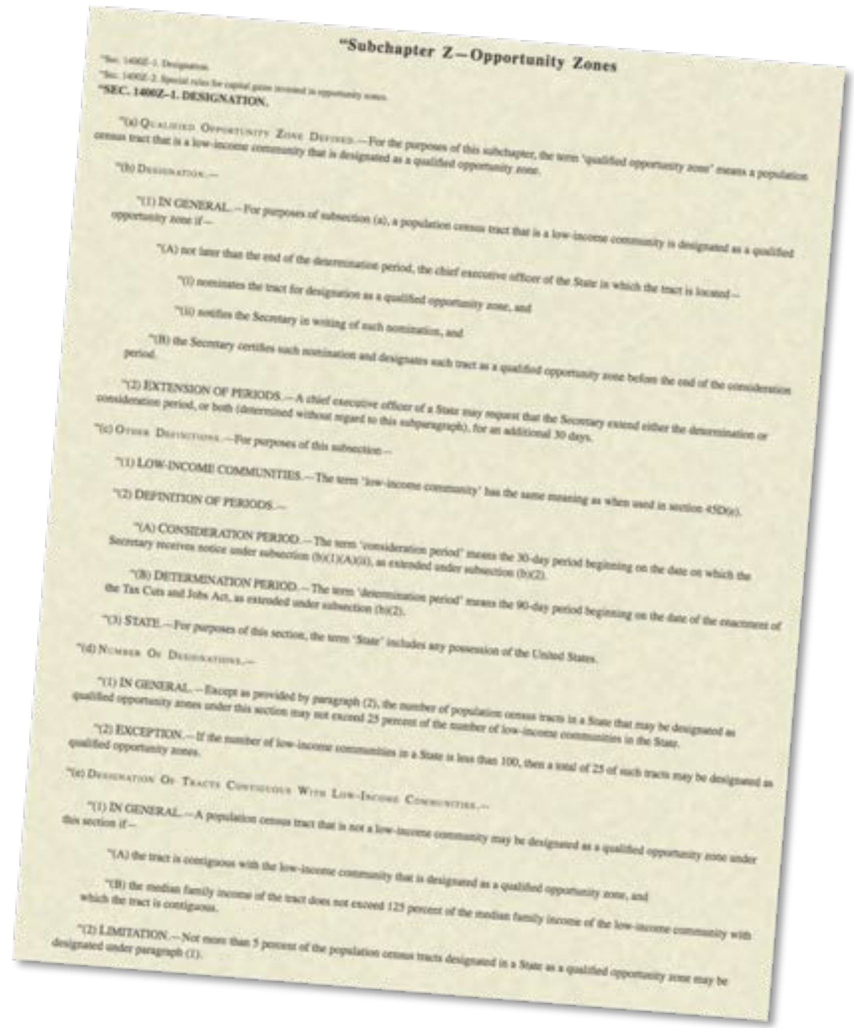


It's a scalable tool that incentivizes private investors to re-deploy their capital gains into low-income communities.

- The program offers a frictionless way to **reinvest capital gains** into distressed communities through **Opportunity Funds**, in exchange for a graduated series of incentives tied to long-term holdings.

- This program will **unlock new sources of capital** and increase the financial firepower we direct towards communities in need of a catalyst.

- It is the **first new national community investment program in over 15 years,** and has the potential to be the largest economic development program in the U.S.



"Subchapter Z—Opportunity Zones

"Sec. 1400Z-1. Designation.
"Sec. 1400Z-2. Special rules for capital gains invested in opportunity zones.

"SEC. 1400Z-1. DESIGNATION.

"(a) Qualified Opportunity Zone Defined.—For the purposes of this subchapter, the term 'qualified opportunity zone' means a population census tract that is a low-income community that is designated as a qualified opportunity zone.

"(b) Designation.—

"(1) IN GENERAL.—For purposes of subsection (a), a population census tract that is a low-income community is designated as a qualified opportunity zone if—

"(A) not later than the end of the determination period, the chief executive officer of the State in which the tract is located—

"(i) nominates the tract for designation as a qualified opportunity zone, and

"(ii) notifies the Secretary in writing of such nomination, and

"(B) the Secretary certifies such nomination and designates such tract as a qualified opportunity zone before the end of the consideration period.

"(2) EXTENSION OF PERIODS.—A chief executive officer of a State may request that the Secretary extend either the determination or consideration period, or both (determined without regard to this subparagraph), for an additional 30 days.

"(c) Other Definitions.—For purposes of this subsection—

"(1) LOW-INCOME COMMUNITIES.—The term 'low-income community' has the same meaning as when used in section 45D(e).

"(2) DEFINITION OF PERIODS.—

"(A) CONSIDERATION PERIOD.—The term 'consideration period' means the 30-day period beginning on the date on which the Secretary receives notice under subsection (b)(1)(A)(ii), as extended under subsection (b)(2).

"(B) DETERMINATION PERIOD.—The term 'determination period' means the 90-day period beginning on the date of the enactment of the Tax Cuts and Jobs Act, as extended under subsection (b)(2).

"(3) STATE.—For purposes of this section, the term 'State' includes any possession of the United States.

"(d) Number Of Designations.—

"(1) IN GENERAL.—Except as provided by paragraph (2), the number of population census tracts in a State that may be designated as qualified opportunity zones under this section may not exceed 25 percent of the number of low-income communities in the State.

"(2) EXCEPTION.—If the number of low-income communities in a State is less than 100, then a total of 25 of such tracts may be designated as qualified opportunity zones.

"(e) Designation Of Tracts Contiguous With Low-Income Communities.—

"(1) IN GENERAL.—A population census tract that is not a low-income community may be designated as a qualified opportunity zone under this section if—

"(A) the tract is contiguous with the low-income community that is designated as a qualified opportunity zone, and

"(B) the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tract is contiguous.

"(2) LIMITATION.—Not more than 5 percent of the population census tracts designated in a State as a qualified opportunity zone may be designated under paragraph (1).

EIG

What is the benefit to investors?

The Opportunity Zones program offers investors three incentives for putting their capital to work rebuilding economically distressed communities:

Temporary Deferral

1. A **temporary deferral**: An investor can defer capital gains taxes until 2026 by putting and keeping unrealized gains in an Opportunity Fund.

Step-Up In Basis

2. A **reduction**: The original amount of capital gains on which an investor has to pay deferred taxes is reduced by 10% if the Opportunity Fund investment is held for 5 years and another 5% if held for 7 years.

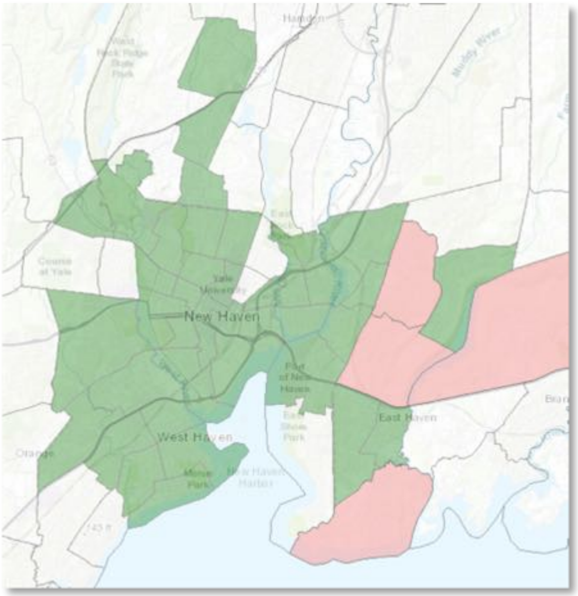
Permanent Exclusion

3. An **exemption**: Any capital gains on investments made through the Opportunity Fund accrue *tax-free* as long as the investor holds them for at least 10 years.

How does it work?

There are three major components to Opportunity Zones:

Zones



Funds

Investments

A look at Vermont's Opportunity Zones

Population: 91,600

Poverty rate: 20%

Median family income: $50,850

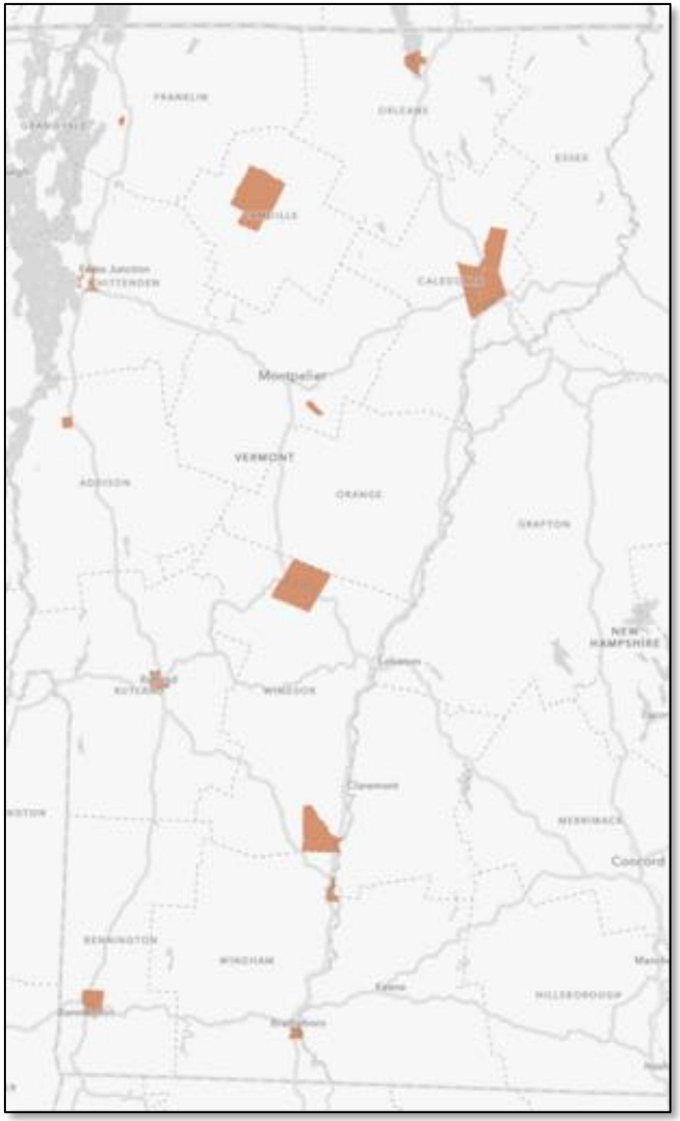
Adults w/o a high school diploma: 12%

Adults with a BA or higher: 28%

Prime age adults not working: 30%

Employment: Over 80,000

Business establishments: Over 6,800



How do Opportunity Funds work?

- Opportunity Funds (**O-Funds**) are investment vehicles organized as corporations or partnerships for the purpose of investing in qualified Opportunity Zones.
  - Funds must invest at least **90% of their capital** in Zones and will be audited twice yearly to ensure compliance.
  - **All investments** that seek to benefit from the tax advantages of the program ***must* be made through an O-Fund**.
- **Who can invest? Anyone with unrealized capital gains** -- institutional investors and investment banks, impact investors, CDFIs, multifamily offices, venture capital partnerships, angel groups, REITs and more can **invest in or establish their own** Opportunity Funds.
  - We expect funds to **differentiate themselves** along multiple lines, from geographic scope to investment type to management style.
  - Funds will have to **self-certify** but should expect few restrictions beyond the statutory requirements.

EIG

How do Opportunity Zones differ from previous "zone models" of community investment programs?

The Opportunity Zones builds on past place-based economic development incentives in several important ways:

- It is an **investor incentive** that pertains exclusively to **capital gains**.
- It is **targeted** and designed to concentrate capital to increase the likelihood of success.
- It is **scalable**: There is no appropriated cap on how much capital it can move.
- It is **simple**: After meeting basic qualifications criteria, investors and businesses face none of the micromanagement that limited the uptake of past programs. It can move at the speed of the market.
- It is **flexible**: The program is specifically designed to foster different types of investment.
- It provides **no up-front subsidy** and doesn't pick winners.
- It rewards **patient capital**: All incentives are tied to the longevity of the investment.
- It unlocks scarce **equity** capital.
- It is **designed more for startups** than incumbents.
- It gives investors a **stake in communities' future**: Most programs reward individual projects; this one ties investor payoff to community success.

Capital alone isn't a strategy: Which is why we're here today

Opportunity Zone investment is not guaranteed.

- States and localities now need to work with their economic development, financial, and civic partners to facilitate the emergence of an ecosystem that will ensure the potential of your zones gets realized. What's your Opportunity Fund strategy?
- What resources can be aligned in support of Opportunity Zones? How can the public sector further de-risk investment in these zones for potential investors?
- What's your strategy to make sure that capital reaches promising entrepreneurs and growth companies, not just real estate projects?

Inclusive outcomes are not guaranteed.

- States and localities have work to do to make sure that the new economic activity stimulated in Opportunity Zones provides employment opportunities for those who need them.
- States and localities also need to lay the groundwork for success: What potential impacts of a capital influx do you need to get ahead of?

What happens next?

2018

- **May:** Final zone map in place
- **June/July:** Fund certification questionnaire and guidance released
- **Q3:** Additional IRS/Treasury guidance pertaining to funds
- **Q3**: Investments into clearly qualifying projects start to flow, tentatively
- **Q4:** First big wave of funds formed and significant capital flows in

2019

- First significant investments made
- Funds continue to form and get capitalized

2020 and 2021

- Funds reach 90 percent thresholds
- Capital continues to flow in
- Late movers pile on in advance of the 2021 deadline to get the 5-year step-up by 2026
- First real picture of impact takes shape

EIG

EIG brings together leading entrepreneurs, investors, economists, and policymakers from across the political spectrum to address America's economic challenges.

WEB **eig.org** EMAIL **kenan@eig.org**

facebook.com/EconomicInnovationGroup

linkedin.com/company/economic-innovation-group

twitter.com/InnovateEconomy

EIG