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An Early Assessment of Opportunity Zones for Equitable Development Projects

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An Early Assessment of Opportunity Zones for Equitable Development Projects

- Equitable Development
- What are Opportunity Zones?
- Findings
- Community Impact Assessment Tool
What Do We Mean by Equitable Development?
Equitable Development

- Economic Development
- Equitable Development
- Community Development
OZs in the 15 SLC States
Investment Score Distribution of Opportunity Zones

OZS OVERVIEW

1 to 3 4 to 7 8 to 10

Alabama  Arkansas  Florida  Georgia  Kentucky  Louisiana  Mississippi  Missouri  North Carolina  Oklahoma  South Carolina  Tennessee  Texas  Virginia  West Virginia
Steps to Making an Opportunity Zone Investment

1. Taxpayer realizes and recognizes a capital gain

2. Taxpayer invests in Qualified Opportunity Fund (up to 180 days or December 31, 2020)

3. Fund makes equity investment in Opportunity Zone Business (up to 31 months)

4. Fund holds 90% of assets in Zones
Tax Break Milestones for Investments Starting in 2019

- **2019**: Taxes on invested gains deferred until 2027
- **2024 (Year 5)**: Liability reduced by additional 5%
- **2026 (Year 7)**: Liability reduced by 10%
- **2027**: Pay taxes on invested gains
- **2029 (Year 10)**: No capital gain taxes on Opportunity Fund investment
What makes OZs Different from Other Federal Community Development Programs?

1. No cap
2. No mechanism for community control
3. No use-based requirements
4. Lack of publicly reported data
Findings
Observations

1. New actors and a new ecosystem of community development
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2. Disconnect between project sponsors and investors
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OZs Have Catalyzed a New Ecosystem of Community Development

FINDINGS
Mismatch Between New Actors

Connections and social networks
Taxable Gains: Distribution by Gross Individual Income

Source: IRS, Statistics of Income Division, August 2018
Taxable Gains: Distribution by Gross Individual Income

 Millions of dollars

Gross income (thousands of dollars)

FINDINGS

Source: IRS, Statistics of Income Division, August 2018
Case Study: The Woodlawn Theatre

Birmingham, AL

Photo credit: Mason Music
Mismatch Between New Actors

Connections and social networks

Track record and experience
Case Study: Fredericksburg Food Coop

Fredericksburg, VA

Photo credit: Peter Chielka / The Freelance-Star
Mismatch Between New Actors

Connections and social networks
Transaction costs
Return on investment
Deal size
Track record and experience

FINDINGS
Return Expectations are not Matching

Internal Rate of Return

Mission

OZs

Market Rate
Return Expectations are not Matching

Internal Rate of Return

0% 2% 4% 6% 8% 10% 12% 14% 16% 18%
Case Study: Norfolk Solar

Norfolk, VA

Photo credit: Bill Tiernan
What is Driving IRR Expectations for OZ Investors?

- **Incentive architecture** that rewards the highest returns
- Need to compensate for the illiquidity of the 10-year hold
Exit Strategies are a Challenge for Mission Projects

Some of our interviewees report having negotiated an option to **buy out their OZ investors** at a set price.

Others are planning to **sell the asset** in its entirety at year 10.
OZs are not Driving Capital Into Operating Businesses

6% Operating Businesses

94% Real Estate

Deployment rules and rigidity around investment time frames make OZs difficult to be used for small businesses

Source: Novogradac’s analysis of 621 Qualified Opportunity Funds
To Drive Impact, OZs Often Need to Be Paired with Other Subsidy Sources

- New Markets Tax Credit
- Low-Income Housing Tax Credit
- Solar Investment Tax Credit
- Community Development Block Grants
- Historic Tax Credit
- Section 108 Loan Guarantee Program
- SBA 504 Loan Guarantee
- Modified Accelerated Cost Recovery System
- HUD 221(d)(4) loans
The Need for OZ Financing is Mixed

The Opportunity Zones program is kind of like salt—it enhances a deal that is starting to make sense and helps it go forward. It doesn’t fundamentally change the structure of a meal, though.

—Real estate developer
Recommendations
What Project Sponsors Can Do

...and receive some support for

Combine multiple subsidies
Partner with anchor institutions
Develop a two-round financing structure
What State and Local Governments Can Do

- State benefits for Qualified Opportunity Funds with impact standards
- Create OZ coordinator positions
- Create local marketplaces with central databases
What Southern State and Local Governments Are Doing

- Alabama’s Incentives Modernization Act
- Louisiana expansion of its Restoration Tax Abatement program
- Norfolk, Virginia’s Opportunity Zone Lead
- Opportunity Acadiana
- Opportunity Appalachia
- Opportunity Alabama
- Opportunity Virginia
Opportunity Zone Community Impact Assessment Tool
Community goals and priorities
Accessible, quality jobs
Community wealth building
Affordable and accessible housing
Environment and open spaces
Health, social services, and community amenities
Transportation and connectivity

www.urban.org/oztool
Scorecard

COMMUNITY IMPACT ASSESSMENT TOOL SCORECARD

Clear View Homes

Very high
92 out of 100

What does your score mean?

Based on your responses, the proposed project receives a "very high" score for expected community impact. If the project conforms to responses when executed, it is likely to provide strong social benefits that are aligned with community priorities.

Your score reflects the level of social benefits and community impacts a project could achieve based on your answers to the community impact assessment tool. Scores depend on the answers provided, and we ask users to respond truthfully and to the best of their knowledge. To the extent that there is uncertainty or disagreement over community priorities or anticipated project impacts, users may receive different scores for the same project. When this occurs, we hope it sparks broader community discussion and closer consideration of the project's impacts and opportunities for improvement. Your score should serve as just one input when considering whether a project is likely to yield social benefits.

The graph above displays the project's raw score in each community impact area. In the community goals and priorities section, we asked you to rank the areas according to the priorities of residents in the Opportunity Zone, based on community engagement and consultation with community plans. Your ranking of the impact areas can be seen in the graph, starting to the right of "community priorities" and going clockwise. A project's overall community impact score is not the average of scores displayed above; it is calculated by weighting the scores for each impact area according to your ranking.
For more information:


If you have questions, email us at:

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