Center for American Progress

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December 21, 2018

Re: Treasury request for comment on guidelines for the Opportunity Zone Incentive program

To: Steven Mnuchin, Secretary of the Treasury, Charles Rettig, IRS Commissioner, and David Kautter, Assistant Secretary for Tax Policy:

The Center for American Progress ("CAP") welcomes the opportunity to comment on potential guidelines for the Opportunity Zone Incentive program ("OZ"). CAP is an independent nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action.

As part of the Tax Cuts and Jobs Act in 2017 (TCJA), the Opportunity Zone incentive program was established to spur economic development in low-income neighborhoods by encouraging private capital to flow to those areas. Investors can receive a tax deferral and other tax benefits if they rollover capital gains into an Opportunity Zone fund. To partake in this project, investors must set up a partnership or corporation (called a Qualified Opportunity Fund) that functions as a vehicle for investments in Opportunity Zones. If investors hold the investment in an Opportunity Zone for at least five years, they qualify for a 10 percent tax exclusion on their original deferred gain, and if they hold it for seven years, a 15 percent exclusion.[1] Plus, any capital gains on the Opportunity Zone investment are fully tax exempt if the investment is held at least 10 years. Tax on the original amount invested is deferred until December 2026—or earlier, if the Opportunity Zone investment is sold.

Concerns

While this program's ostensible goal of boosting economic development in economically distressed areas is important, there are at least four concerns with this program:

1. **The tax benefits of Opportunity Zones program for investors are tangible and uncapped, while the professed social outcomes for the communities are difficult to measure.** The open-ended nature of the Opportunity Zones program is such that investments in distressed communities are most likely to prioritize benefits to investors rather than local residents. With over 8,700 census tracts designated as Opportunity Zones, investors are going to focus on tracts that will return the highest yield, not the tracts that

are most in need of capital. Furthermore, this capital probably would have gone to those eligible tracts anyway, thus costing the Federal government revenue that would have been received in the absence of the incentive.[2] Unlike other economic development programs, such as the New Markets Tax Credit, which requires community development entities to apply to Treasury's Community Development Financial Institutions (CDFI) Fund for tax credit allocations, and the Low-Income Housing Tax Credit, which is administered by state housing finance agencies according to various rules ensuring supply of affordable housing, Opportunity Zone tax benefits can be claimed by investors in a potentially limitless range of projects that in certain cases don't even have to be entirely located in a zone.[3] Although Congress failed to specifically address these issues during its consideration of TCJA, it authorized the Treasury Department to prescribe rules to carry out the purposes of the OZ incentive, including rules for certifying funds and preventing abuse.[4] Thus, Treasury is empowered to place appropriate guardrails on the tax incentive to ensure it fulfills its purpose.

2. **The zone selection process has resulted in the creation of Opportunity Zones in many tracts that are** relatively well off or already gentrifying.[5] The 8,700 census tracts that have been designated as Opportunity Zones include many that are either already well off or already gentrifying. In these tracts, the forfeited tax revenue will simply provide windfalls to those who already invested there before the program began rather than to community residents. In fact, certain developers have already cashed in due to their property being in a tract that was designated as a zone.[6] An egregious example is the zone that includes the future location of the Las Vegas Raiders professional football stadium, which was planned well before the enactment of TCJA.[7] Providing money to areas that don't need it gives a taxpayer-financed windfall to investors and subsidizes gentrification that was already occurring while exacerbating both residential displacement and other long-observed inequitable trends[8]—all while failing to incentivize new investment in distressed areas that would otherwise not have occurred – as noted in this study by the Urban Institute on OZ-designated communities in Indian Country.[9] While there are guidelines for the choice of census tract eligible for the investment based on poverty and median family income, the guidelines are not strict enough to ensure investment occurs most in distressed neighborhood with in the greatest needs. Especially concerning is that 245 designated tracts that do not even meet the poverty or income criteria.[10] It's possible that these tracts will receive the bulk of the tax-favored investments.

3. **The program does not require Qualified Opportunity Fund to meaningfully engage or sustainably partner with designated distressed communities throughout the life of the investment.** At the end of the day, the Opportunity Zone program was designed to improve outcomes for the individuals who live in low-income, under-resourced, and low-opportunity neighborhoods.[11] However, there is nothing within the Opportunity Zone program that guarantees that current residents in the selected tracts will: **1)** get better job opportunities; **2)** get better quality housing and other essential community amenities; or **3)** in the event that the community infrastructure improvements occur, that current, longtime

residents will be able to afford remaining in their respective neighborhoods and enjoy the newfound benefits. This issue is not just about whether the individuals in these neighborhoods benefit, but whether they've had and will have a meaningful say in how the initiative is rolled out, what kind of investment projects come into their communities, how these private projects will be made accountable to local residents, and how to ensure that community members share in the opportunities and prosperity created by these projects. As it stands, the OZ program does not require any analysis of what the designated community's needs are.[12] As a result, the program does not take into account the unique needs of low-income communities – e.g. some need vital investments in housing, education, while others in energy, infrastructure, transportation or all of the above for areas ravaged by both economic crises and natural disasters like Puerto Rico which has been entirely designated as an Opportunity Zone. Ostensibly, by virtue of the initiative's proclaimed intent, OZ investments in Puerto Rico should not lead to furthering gentrification with displacement and should result in development benefits that Puerto Ricans residing in the island not only dictate but enjoy an outsized share of. Lastly, the initiative also erroneously implies that the reason these communities are distressed is solely based on capital deficiencies and not more systemic issues.[13] And by the nature of the program, which is designed to match investors with significant means to areas long deprived of development resources, the investors are very unlikely to live within the neighborhood boundaries and therefore even less likely to have any authentic connection with local community residents or knowledge of their socioeconomic context.[14]

4. **The Opportunity Zone program does not guarantee the development of essential community infrastructure and services.** Without guardrails calling for socially conscious investing, Opportunity Zone developers are likely to invest in development projects that come at the expense of vital community amenities that local residents need like the building of more high-end luxury apartments/condominiums, hotels,[15] office spaces, and restaurants instead of local grocery stores, health centers, and recreation centers. Examples of the kinds of investment projects that would benefit the surrounding communities and their residents include the construction of affordable housing in Charlottesville, Virginia,[16] the creation of a tech incubator in Stockton, California,[17] or health care facilities in Indianapolis, Indiana.[18]

Recommendations

If Congressional intent behind the Opportunity Zone program is to revitalize low-income communities, we believe the best way is to develop the already existing resources in these communities, namely the people who live there. If we invest in individuals in these communities through the development of locally-owned businesses, this can spur further investment and sustained economic growth. For this incentive to work, investors need to be motivated by more than financial returns and there are investors who are thusly motivated. They want their investments to have social and environmental impacts, thus creating a new kind of investing called "impact investing."[19] Low-income communities can benefit from impact investing if Treasury and

Congress take steps to promote equitable community development. There is an appetite for socially conscious development. We can take advantage of this movement towards impact investing.

The Opportunity Zone incentive program can be leveraged to promote sustainable, equitable, and community-appropriate investment by:

- Explicitly defining goals to align with equitable economic development and requiring that OZ investments follow and demonstrated fidelity to the UN Sustainable Development Goals where possible[20]

- Require that all QOFs formally assess what the designated community's equitable development needs are, outlining which needs the OZ investments will address in a proposal that will be approved by and made available to local community representatives before investing can occur[21]

- The newly-formed White House Opportunity and Revitalization Council[22] should establish a community of practice[23] for Opportunity Zones designees and QOFs to encourage peer-to-peer learning and sustained partnership between local residents and private investors/developers

- Explicitly defining abuse (Section 1400Z-2e4C) to include behaviors that lead to displacement of zone residents

- Requiring that funds track and report appropriate performance metrics,[24] including:
  - number of living wage jobs created;
  - number of living wage jobs created for zone residents;
  - number of affordable housing units built, including as a percentage of total units;
  - and level of subcontracting with local businesses owned by people of color, women, and other socioeconomically marginalized resident groups, especially in light of the new Morgan Stanley report[25] documenting still rampant investor and lender bias against people of color- and women-owned business ventures.

- Require QOFs to work with CDFIs or other local community development entities with proven, verifiable ties to the community for the life of the investment.

Certifications for Community Development Entities (CDE) provide a model[26] of what effective guidelines could look like. They include a primary mission test and an accountability test. A primary mission test states that the entity is providing capital for low-income communities or low-income individuals. An accountability test states that any governing board has community representatives. These kinds of tests could ensure that investment capital does not simply lead to gentrification that displaces existing community members.

In addition, the original Opportunity Zone legislation included language requiring Treasury to provide a report on Congress reporting and assessing various metrics on Opportunity Zone investments, including the impacts and outcomes of Zone investments on job creation, poverty reduction, and new business starts.[27] Ultimately, the congressional reporting requirement[28] was excluded from the final version[29] of TCJA. But even without a statutory requirement, Treasury and White House Opportunity and Revitalization Council can still take the initiative to compile relevant data, properly monitor, and periodically provide analysis and assessments of the program's impact in these areas. Reporting requirements for funds, such as those outlined above, will be essential for this purpose.

Through this public comment letter, CAP has identified four core issues with the Opportunity Zones program and has suggested several recommendations that Treasury should consider before issuing a second set of guidelines. Although this public comment letter does not cover the full list of issues that CAP expects to arise as the program goes into full effect, the Center would like to reiterate the flawed premise that serves as the foundation of the Opportunity Zone program: the notion that communities are economically distressed simply due to a lack of capital investment. As an economic development program, Opportunity Zones fail to acknowledge and address the structural inequities[30] that create economically distressed communities. While CAP acknowledges that Treasury does not have the authority to fix this fundamental flaw in the opportunity zone program, the Center does believe that Treasury has a responsibility to address documented entrenched bias[31] and systemic inequality[32] to create an economy that is not only strong but equitable as well.

Any questions on this comment letter or on related issues should be directed to Olugbenga Ajilore at gajilore@americanprogress.org and/or Rejane Frederick at rfrederick@americanprogress.org.

Sincerely,

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