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How Philanthropy Can Catalyze Private Investment in Opportunity Zones

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The U.S. Department of the Treasury expects Opportunity Zones to unlock well over $100 billion in private investment in low-wealth communities across the United States. The tax incentive, which became law as part of the 2017 Tax Cuts and Jobs Act, seeks to encourage patient capital investments in more than eighty-seven hundred designated census tracts across the country by permitting investors to reinvest capital gains in designated census tracts in exchange for tax benefits.

Opportunity Zones represent the first time federal tax policy has sought to tap unrealized capital gains to advance economic and community development. Proponents believe the incentive will help transform low-wealth communities, while skeptics have doubts that funds will flow to the people and places most in need — and, even if they do, that the ensuing transformation will have a positive impact on longtime residents and small businesses.

Against this backdrop, philanthropy should step up and help shape the Opportunity Zone landscape so that benefits of the legislation also accrue to longtime residents and businesses.

Here are six ways philanthropy can help:

1. Shape the rules of the game. Philanthropy can influence IRS guidelines for Opportunity Zones — and, if necessary, follow-on legislation — to ensure that the incentive is implemented in a manner that reflects the interests of communities and the intent of the program. For some foundations, this may include support for developing and tracking metrics, stakeholder interviews to uncover opportunities and issues, and/or deep-dive case studies of specific transactions. The data from these activities can then be used to generate valuable tweaks to the design of the program. As always, data-driven insights will be critical to making the case for modifying, fine-tuning, or extending the incentive.

2. Level the playing field. Foundations are well suited to ensure that communities are poised to attract investor interest and have a seat at the table as Opportunity Zone transactions are negotiated. Organizations such as Accelerator for America are already working with cities across the country to create investment prospectuses, while others such as the Governance Project are working with municipal leadership to develop business cases and strategies for priority projects in communities such as Louisville and San Jose. There is far more that can and should be done, however, and the unique features of rural Opportunity Zones must also be accounted for so that those communities are not left behind.

3. Incentivize investor behavior. Capital is likely to follow the path of least resistance. This does not imply that social returns cannot be integrated effectively into Opportunity Zone transactions. Rather, it is incumbent on philanthropy to help create an environment where community benefits, standardized impact reporting, and related activities become "no-brainers" for investors. The Opportunity Zones Reporting Framework, a voluntary guideline recently introduced by the U.S. Impact Investing Alliance and the Beeck Center for Social Impact and Innovation at Georgetown University, is an important initiative aimed at defining best practices for investors and fund managers looking to deploy capital in Opportunity Zones.

In addition to support for emerging norms and guidelines, we see a few additional ways to create incentives for investors to focus on social returns. Philanthropy can partner with impact-oriented investors to demonstrate what is possible in real-world transactions. A few carefully selected and constructed demonstration deals could begin to unlock practices across similar asset classes in different places. Philanthropy could also support a high-profile annual award for the highest-impact transactions, as well as the equivalent of a "Good Housekeeping Seal of Approval" for Opportunity Zone transactions and funds.

4. Create investable opportunities. Now that the Opportunity Zone incentive exists, the challenge is to develop a robust pipeline of transactions that meet both the needs of communities and the return expectations of investors. To that end, philanthropy can help by identify projects for investment and provide the upfront investment needed to take an idea to the project proposal stage. Once a deal has been conceptualized, philanthropy can play a role in reducing risk exposure for investors so that deals with the greatest potential to drive positive change proceed.

In addition, because Opportunity Zones are a new tool, template agreements and other documentation needed to enable transactions do not yet exist. Philanthropy can help there by investing in efforts to establish a collection of model agreements that could be shared across locations and projects. Such an investment would reduce transaction costs and help establish norms and expectations with respect to social impact.

5. Build wealth for local residents. It's inevitable that new investment dollars will change Opportunity Zone neighborhoods. As such, it's important to minimize displacement risks and create upside for residents, including small business owners, by better meeting their current needs and creating mechanisms for wealth creation throughout the process, including at exit. This could include clauses that commit project sponsors to hiring from within the community, financial upside for local organizations, and/or clauses for business owners to buy back their equity at a pre-agreed price. To do this effectively, philanthropy should engage with investors and local leaders to seed and share demonstration transactions that show the way.

6. Accelerate progress via coordination and knowledge sharing. Ultimately, the strength of the Opportunity Zone program is that it is inherently local. While each of the designated census tracts is unique, there are common challenges and patterns across designated zones. Philanthropy can help accelerate results and improve the allocation of scarce resources by supporting coordination and communication within and across markets. These activities might include seeding "open-source" solutions, sharing learnings across stakeholder groups, and promoting coordination among leading actors across the country. While informal coordination and information sharing happens today, thoughtful investments by philanthropy could truly super-charge impact.

It seems as though Opportunity Zones have captivated all of us working to build more equitable communities and a more inclusive economy for all Americans. Though the debate about the incentive's long-term impact will continue, the reality is that Opportunity Zones are here to stay. Whether you are an optimist or skeptic, now is the time for philanthropy to step up and demonstrate how this new source of private capital can shape the evolving market landscape and positively impact communities in need of a boost.

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PND by Candid.

Originally published by Philanthropy News Digest.
https://philanthropynewsdigest.org/commentary-and-opinion/how-philanthropy-can-catalyze-private-investment-in-opportunity-zones

Opportunity Zones: What Role for Philanthropy?

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Opportunity Zones: What Role for Philanthropy?

- What are Opportunity Zones (and how does the incentive work)?
- What are we seeing in the market?
- How can philanthropy engage to shape outcomes?

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Opportunity Zones Overview

Economic development tool intended to spur economic growth and job creation in distressed communities

~$6T

Three incentives for investors to put private capital to work across asset classes in economically distressed communities…

- Temporary tax deferral
- Step-up in basis of up to 15%
- Permanent exclusion of taxable income of capital gains

…and to hold those investments for long-term

- Maximum value of incentive when investment held for at least ten years

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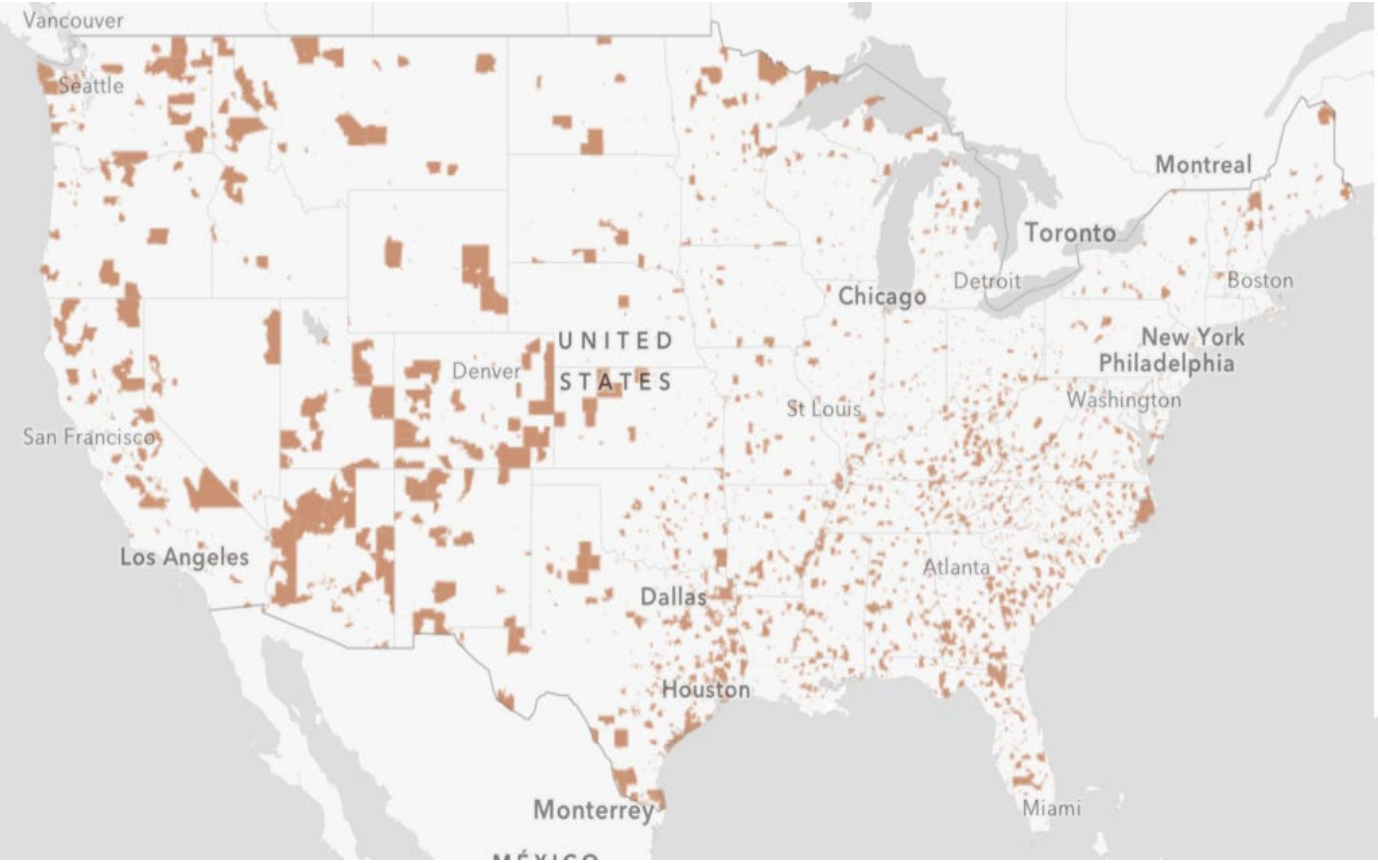
Where are Opportunity Zones?



Source: Economic Innovation Group

Opportunity Zones

- 8,700 designated census tracts in all 50 states, DC + territories (12% of all US census tracts)
- On average, poverty rate of 29% (~2X national average)
- Median family income in median designated Opportunity Zone is $42,400 (vs national average of $67,900)
- 56% of Opportunity Zone residents are People of Color

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What's the Opportunity for an Investor?

$200,000 of capital gain from sale of property

	TRADITIONAL INVESTMENT	OPPORTUNITY ZONE INVESTMENT
2019 Year of Investment	Pay tax on capital gain of $200,000 ($46,000). $154,000 left for reinvestment*	Defer tax on full $200,000 of capital gain and invest in qualified Opportunity Fund*
2026 Year of gain recognition	Investment appreciates to $330,113	Rollover investment taxed with basis increased by 15% ($170,000); tax due: $39,100. Investment (less tax due) worth $389,618
2029 Year of sale	Sell investment for $500,000 Gain of $346,000 Tax due: $79,580 **Total tax due since 2019 = $125,580**	Sell investment for $500,000 Appreciation of $300,000 is tax free since invested in opportunity zone. **Total tax due since 2019 = $34,000**

*Assumes 10 percent annual rate of return and 23 percent capital gains rate

How are Opportunity Zones Different?

	Opportunity Zone Incentive	"Traditional" Programs*
Funds Available	• No cap	• Finite pool of appropriated funds (~$3.5B allocated per year)
Eligibility	• Any investor (individual or institutional) with realized capital gains	• Competitive process to allocate
Management	• IRS oversight	• Administered by federal government (e.g. NMTC) or state housing authorities (e.g. LIHTC)
Compliance & Reporting	• TBD – Request for information issued by Treasury/IRS in April 2019 • Expect "light touch"	• Transaction level data collection • 50+ page program compliance FAQs

*New Markets Tax Credits (NMTC) or Low-Income Housing Tax Credit (LIHTC) for example

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What's Happening?

Federal Rule-Making

- Opportunity Zones enacted in December 2017 as part of Tax Cuts and Jobs Act 2017
- Treasury certified designations in June 2018
- Treasury released the first tranche of guidance and a revenue ruling on October 19, 2018.
- Treasury released the second tranche of guidance in April 2019 along with a "Request for Information" on reporting

Market Activity

- Landscape **emerging and evolving**
- **Funds forming and transactions have closed**
  - Primarily single asset **real estate until rules clearer**
  - Target fund sizes range from **$1M - $3B** with a **median target fund size of $110M***
  - **~40%** are **multi-state** or regional funds*
  - **26% national** geographic scope*
  - **11%** focused on a **single city***

*For a sample of 88 funds identified via public search

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6 Ways Philanthropy Can Play

Shape Rules of the Game
Influence Opportunity Zone follow-on legislation and IRS guidelines

Create Investable Opportunities
Stuff the investment pipeline to reflect Foundation priorities

Level the Playing Field
Ensure communities are poised to draw investor interest and have (an outsized) seat at the table

Build Wealth for Residents
Minimize displacement risks to current residents including small business owners by better meeting current needs and creating mechanisms for wealth creation

Incentivize Investor Behavior
Create environment where community benefits, common impact reporting, and related activities become "no-brainers" for investors

Accelerate Progress via Coordination & Info Sharing
Seed "open source" solutions, cross-pollinate stakeholder groups, promote coordination among leading actors

Philanthropy Can Play Critical Role

Illustrative Sample

Action	Foundation	Description
Shape rules of the game	The Parker Foundation	Support for Economic Innovation Group leadership on Opportunity Zones
Create Investable Opportunities	The Rockefeller Foundation	Support for Accelerator for America
Level the Playing Field	Abell Foundation	Funding to establish "Opportunity Zone Czar" (coordinator) in the Baltimore Mayor's Office
Build Wealth for Residents	Inherent Group	Designed and funded social impact bond to train community residents for high-value jobs*
Incentivize Investor Behavior	The Kresge Foundation	Provided $22M guarantee to two best-in-class funds in exchange for impact covenants
Accelerate Progress via Coordination and Info Sharing	JPMorgan Chase Foundation	Support for multi-stakeholder strategy and coordination in Cleveland

*Long Island City in with Pursuit, a 501(c)3 prior to termination of Amazon HQ2 deal

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