ECONOMIC INNOVATION GROUP

Opportunity Zones: An Overview

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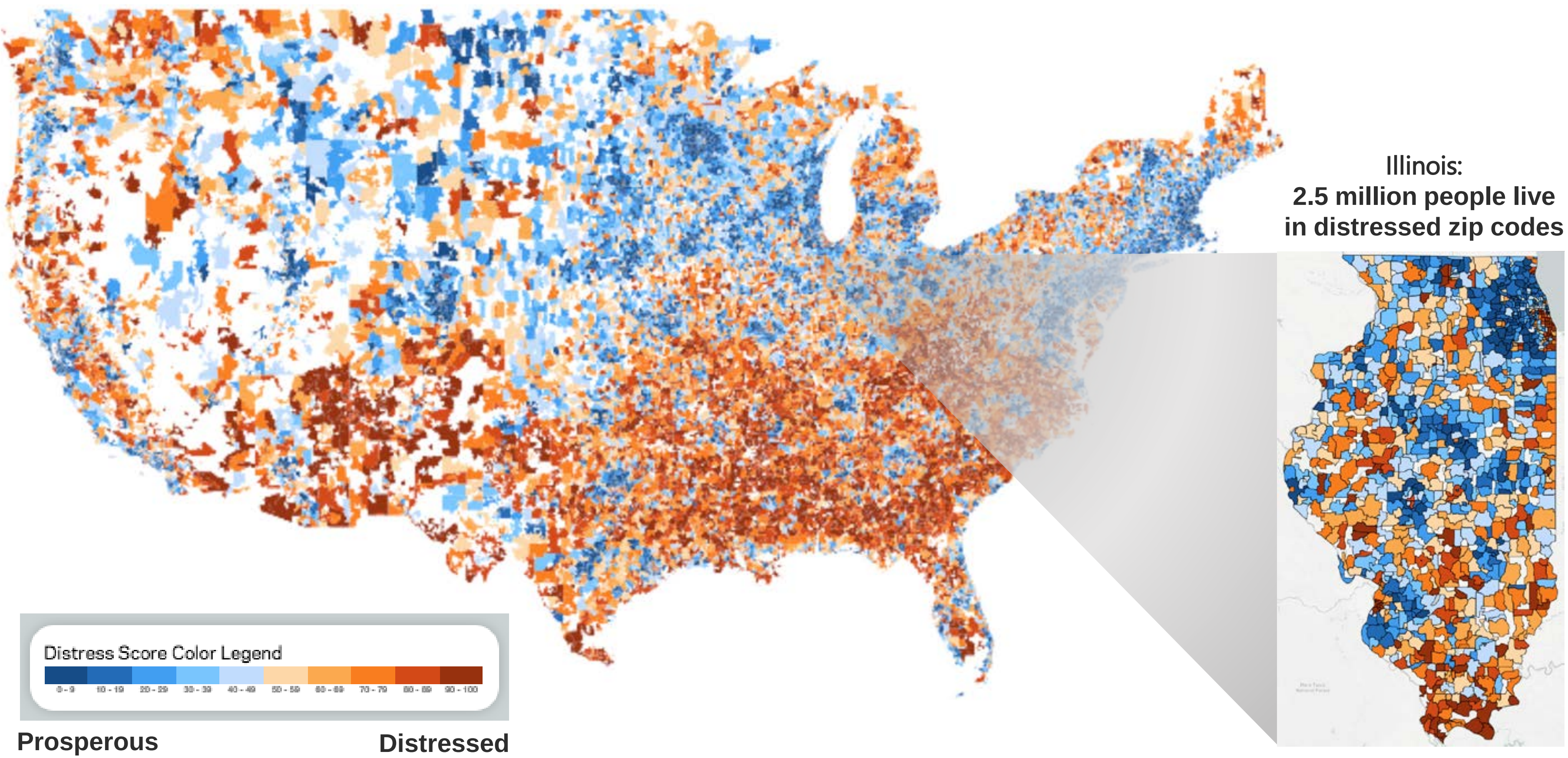
Why Opportunity Zones and why now?

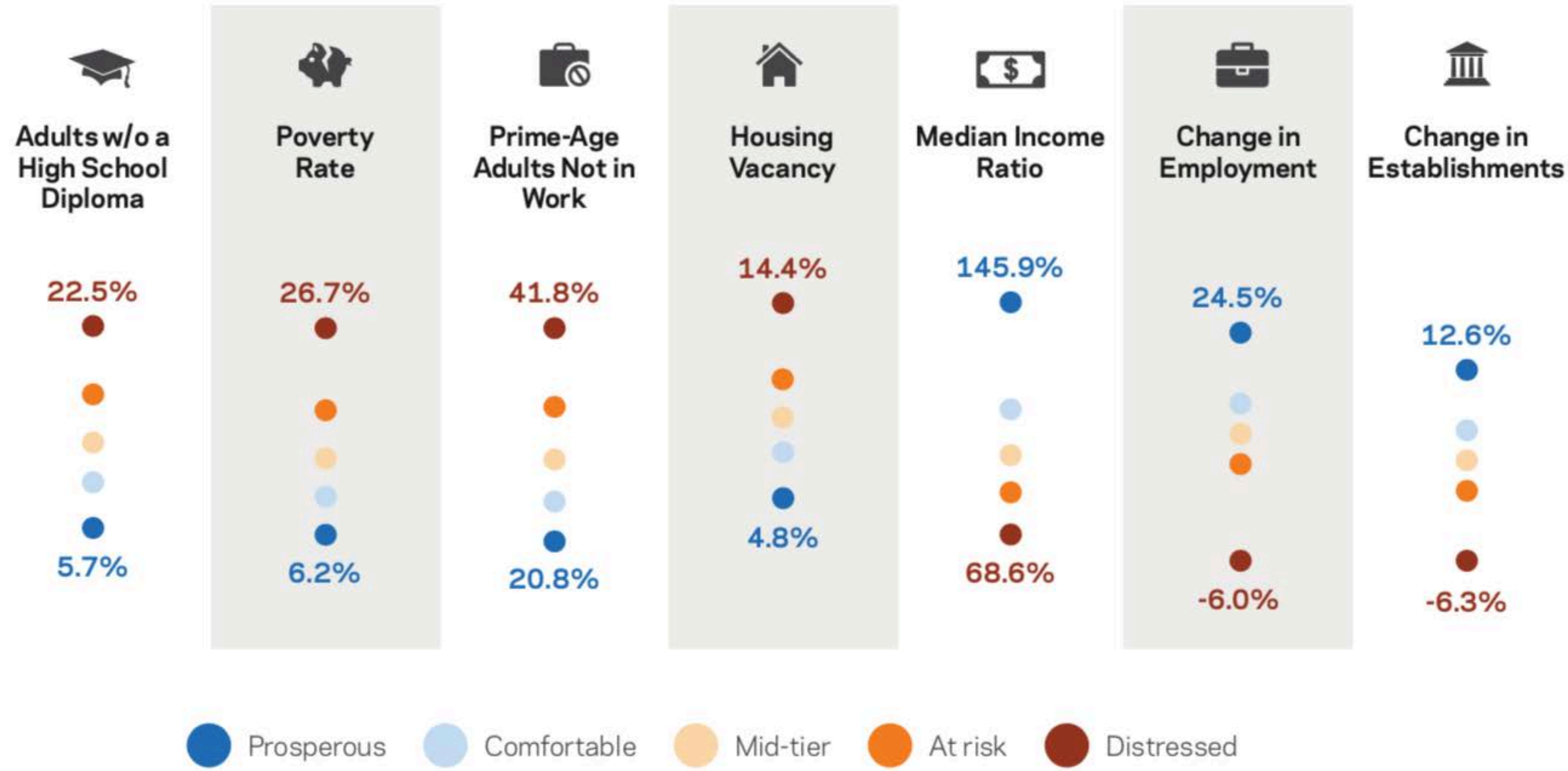
52 million Americans (1 in 6) live
in economically distressed communities.



Learn more at eig.org/dci

Among the many gaps separating U.S. communities, the growth gap may be the most consequential.

Average performance of zip codes in each quintile across the seven component metrics of the DCI (2011-2015)



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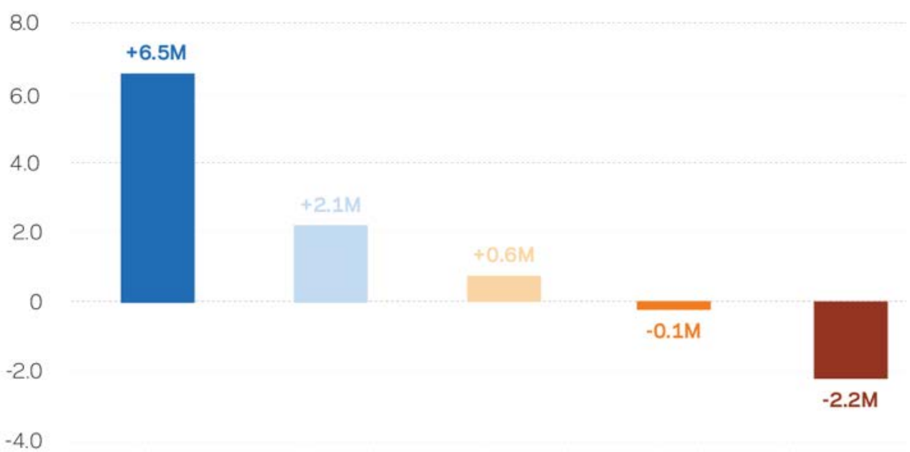
Source: EIG's "Distressed Communities Index"

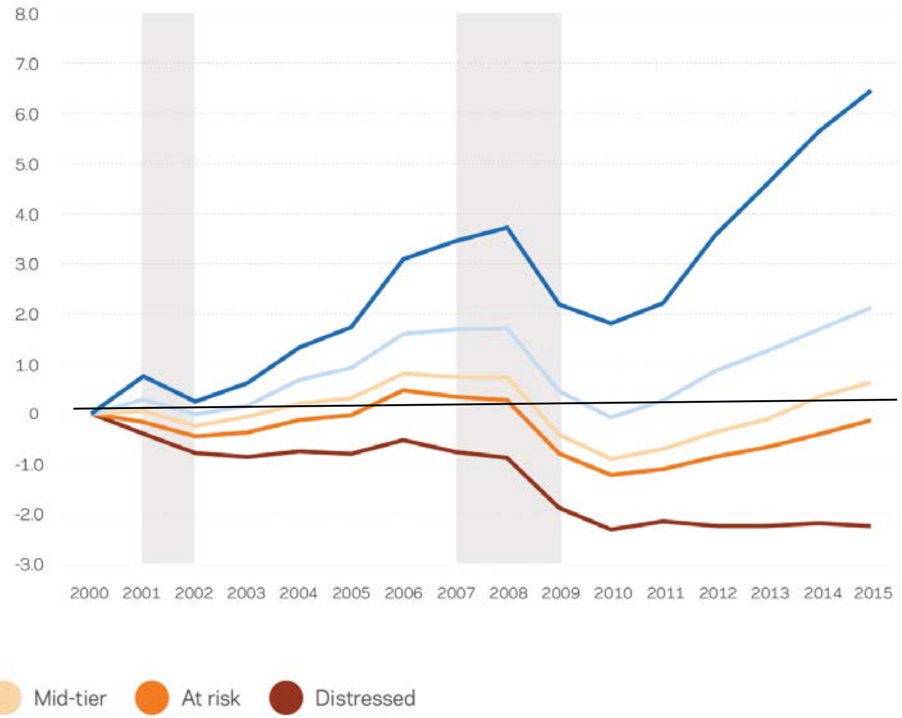
While the top 20% has never done better, the bottom 40% still feel the Great Recession

- **6.5 million** of the net total **6.8 million new jobs** that have been created since 2000 **have gone to the top 20%** of zip codes

Change in employment from 2000 to 2015 by quintile



Cumulative change in employment by quintile

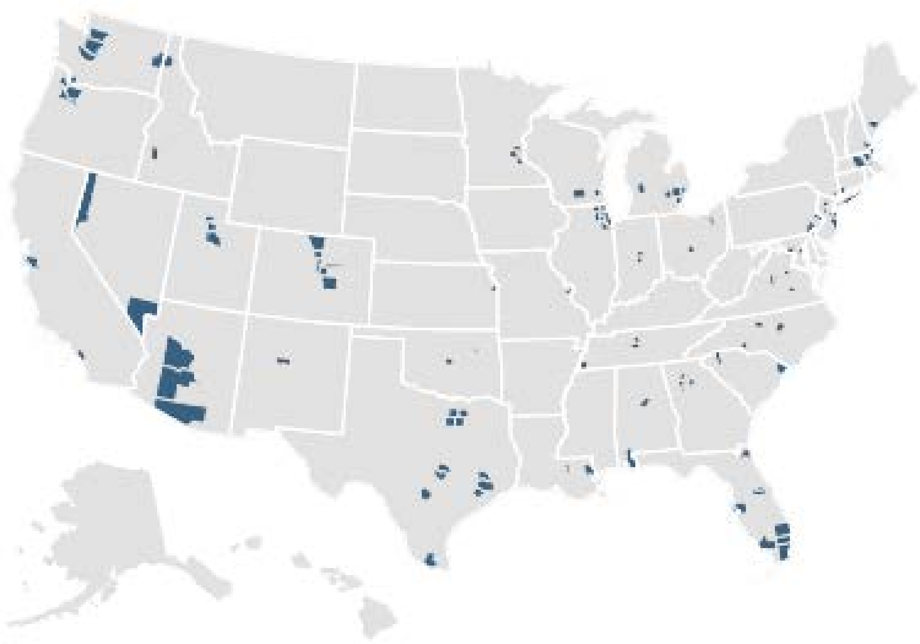


Source: EIG's "Escape Velocity" zip code level data

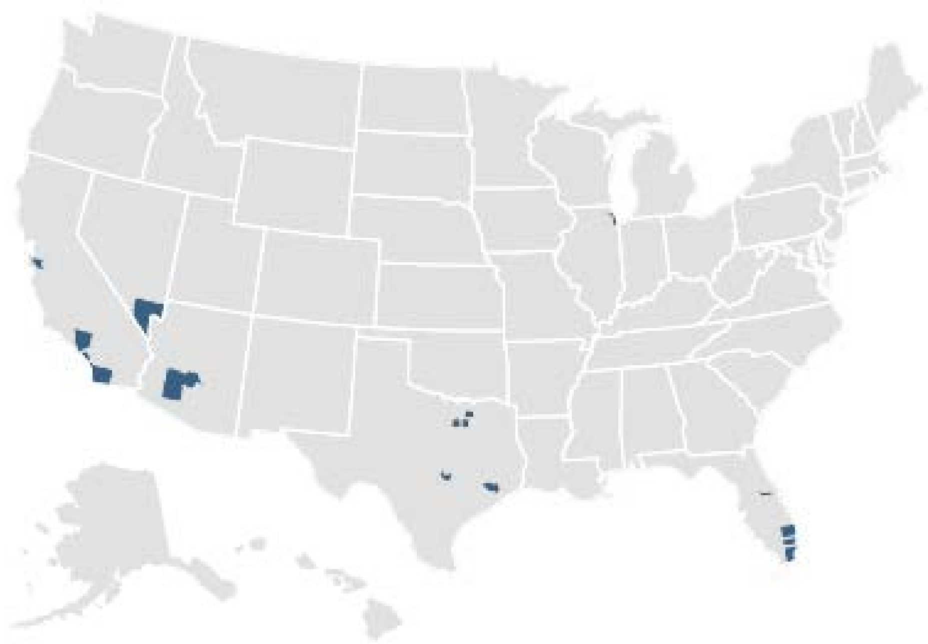
The rising economic tide no longer lifts all boats in America

- In the 1990s, it took 125 counties containing nearly a third of the country's population to power half of the national increase in business establishments.
- By the 2010s, it took only 20 counties with 17 percent of the population to achieve the same result.

1992-1996



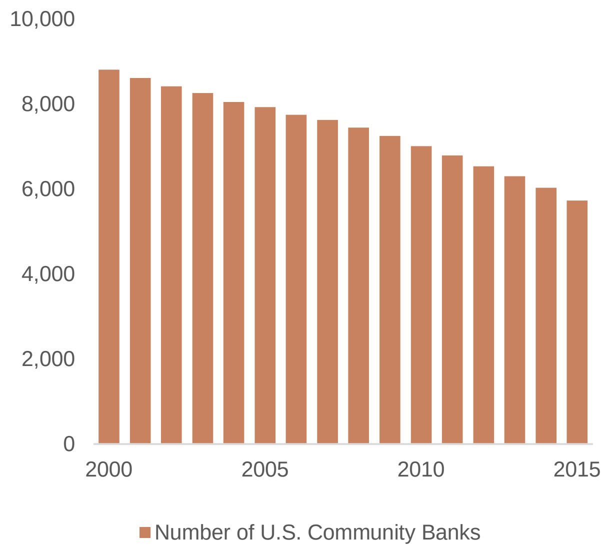
2010-2014



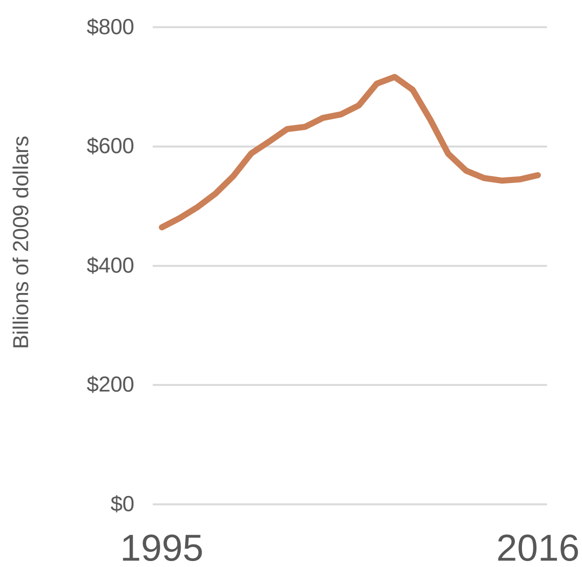
Source: EIG's "New Map of Economic Growth and Recovery"

Inadequate access to capital limits opportunity in much of America

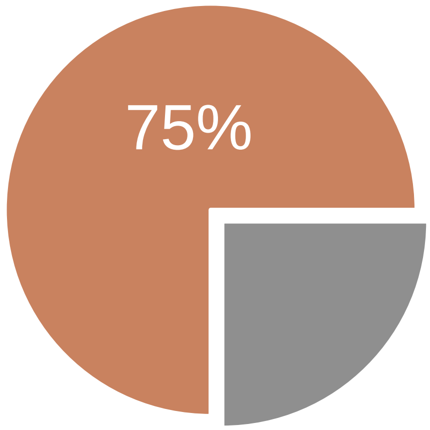
Nearly **one out of every four** community banks has disappeared since 2008



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



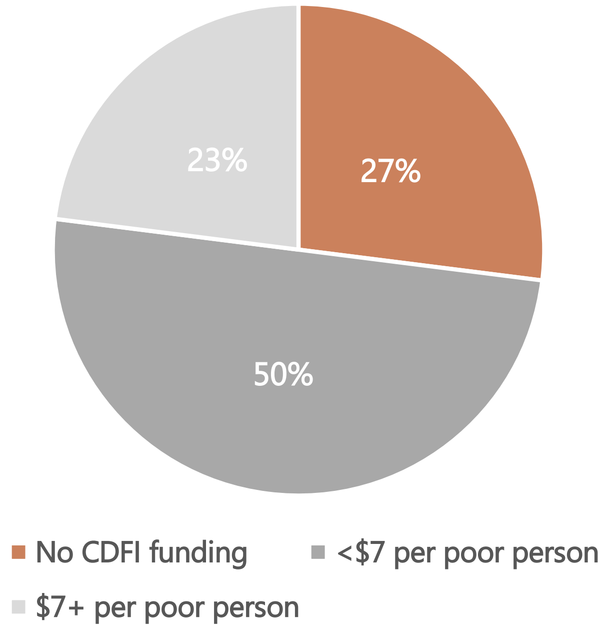
75% of all venture capital concentrates in three states: California, New York & Massachusetts



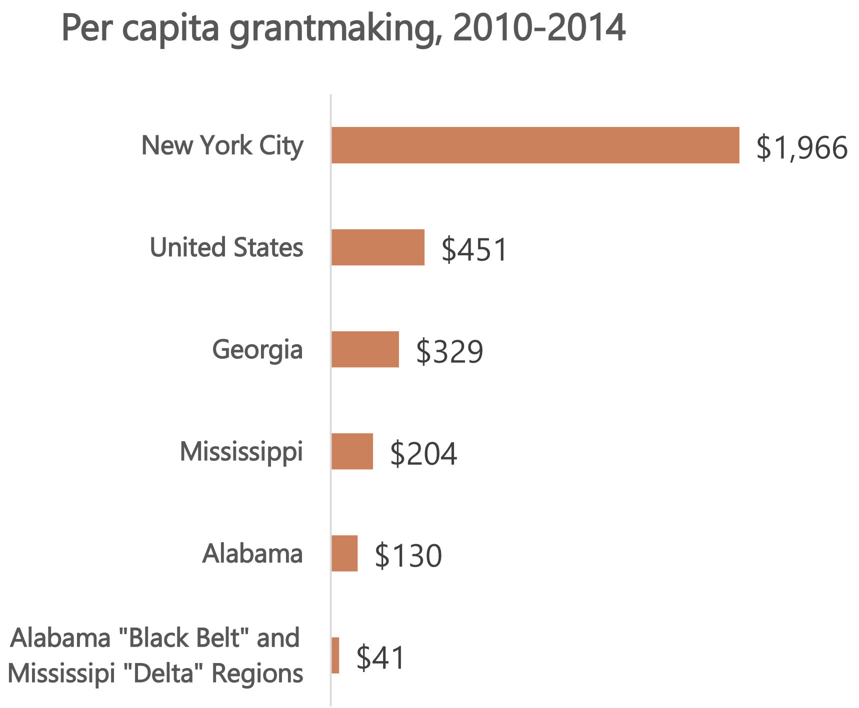
Sources: FDIC and National Venture Capital Association

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



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Sources: The Urban Institute and National Center for Responsive Philanthropy

Opportunity Zones are an innovative, flexible, and bipartisan solution for harnessing capital in service of community development.

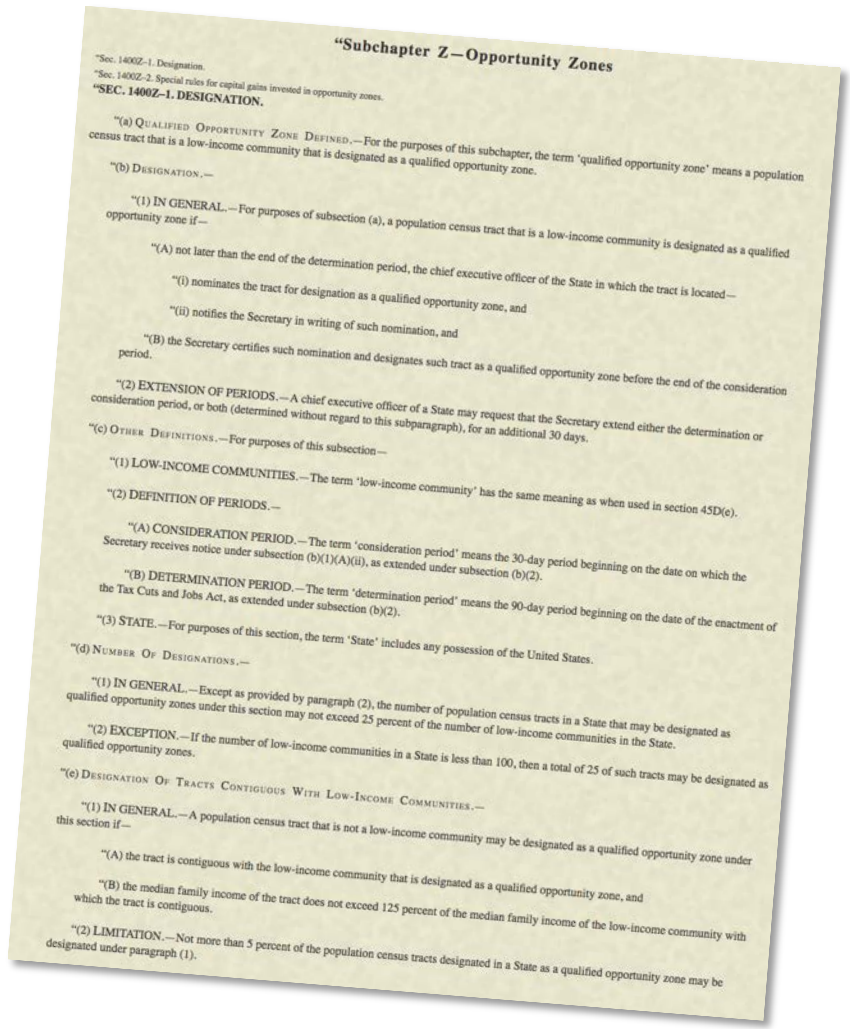
Opportunity Zones were established by Congress in the Tax Cuts and Jobs Act of 2017.

The new provision is based on the bipartisan **Investing in Opportunity Act**, which was championed by Senators Tim **Scott** (R-SC) and Cory **Booker** (D-NJ) and Representatives Pat **Tiberi** (R-OH) and Ron **Kind** (D-WI) and attracted more than 100 bipartisan cosponsors.

EIG originally developed the concept in a 2015 working paper authored by **Jared Bernstein** and **Kevin Hassett**.

Opportunity Zones can help catalyze growth and opportunity in communities around the country.

- Opportunity Zones are designed to **spur long-term private sector investments** in low-income communities nationwide.
- They offer a frictionless way for investors to **reinvest capital gains** into distressed communities through Opportunity Funds, in exchange for a graduated series of incentives tied to long-term holdings.
- It is the first new community investment program in over 15 years and has the potential to **scale** into the country's largest economic development initiative (households and corporations currently sit on an estimated **$6.1 trillion** in unrealized gains*).
- It is specifically designed to channel more patient **equity capital** into overlooked markets.



"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).

* *Based on EIG's analysis of the Federal Reserve's Survey of Consumer Finances and Financial Accounts of the United States*

Opportunity Zones stands out from past federal attempts at community revitalization in several respects.

- ✓ It is **flexible**: The program is specifically designed to fit the many different investment needs of struggling communities.
- ✓ It is **scalable**: There is no appropriated cap on how much capital it can move.
- ✓ It is **simple** and avoids the micromanagement of business models that limited the uptake of past programs.
- ✓ It is **fast** and can move at the speed of the market.
- ✓ It is **targeted** and designed to concentrate capital to increase the likelihood of success.
- ✓ It rewards **patient capital**: All incentives are tied to the longevity of the investment.
- ✓ It provides **no up-front subsidy** and doesn't pick winners.
- ✓ It is designed more for **startups** than incumbents.
- ✓ It makes investors, not taxpayers, bear the **risk**.
- ✓ It gives investors a **stake in communities' future**: Most programs reward individual projects; this one ties investor payoff to community success.

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 in practice?

There are three major components to Opportunity Zones:

Investments - Opportunity Funds make equity investments in businesses and tangible property in Opportunity Zones.

Funds - Opportunity Funds are investment vehicles organized as corporations or partnerships for the specific purpose of investing in qualified assets in Opportunity Zones.

Zones - States and territories designated 25 percent of their eligible census tracts as Opportunity Zones.

What assets are eligible for investment?

There are three types of business property eligible for investment:

Stock of a qualified opportunity zone **corporation**

Interest in a qualified opportunity zone **partnership**

Tangible property used in qualified opportunity zones

- Stocks and interests qualify if they are **original-issue** and substantially all of the tangible property of the underlying business is located in a zone. The business must also meet a few additional basic tests.
    - Funds-of-funds, sin businesses, and financial institutions are among those that do not qualify.
- If the investment is not made into a **new** business or a **new** development, then a **substantial improvement** test also applies.

What are Opportunity Funds?

- Opportunity Funds are the critical intermediaries of investment into zones. **All investments** that seek to benefit from the tax advantages of the program **must be made through an O-Fund**.
- Funds must invest at least **90% of their capital** in qualified investments in zones and will be audited twice yearly to ensure compliance.
- The private sector and other stakeholders **are responsible for establishing O-Funds**.
- O-Funds will come in **many shapes and sizes**:
  - Some will invest nationally, others locally. Some will have many investors, others few.
  - Some will specialize in startups, others in housing. Some will specialize in commercial developments, and others will diversify across many different asset types.
  - Some will be closely-held by investors, others will have professional managers.
  - Some may form around a single investment opportunity, others will be diversified.
- Funds will have to **self-certify** but should expect few restrictions or prescriptions beyond the statutory requirements.

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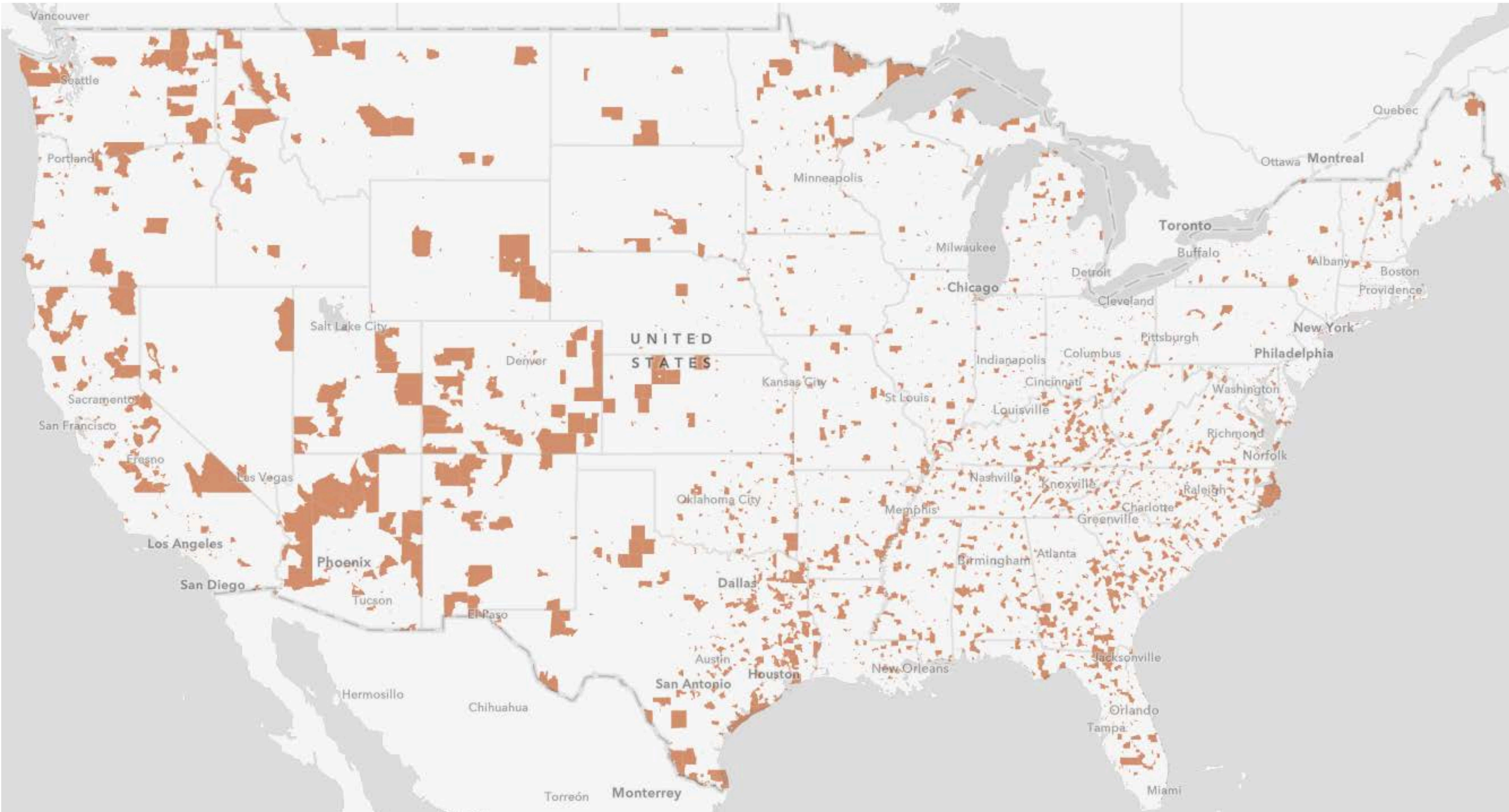
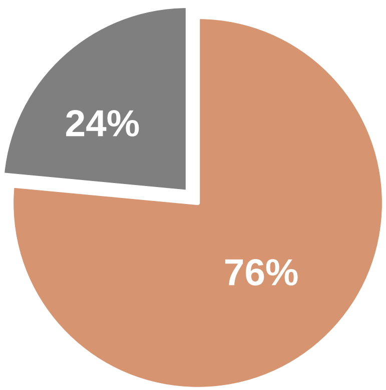
Over 8,700 census tracts across all 50 states, DC, and Puerto Rico are now certified Opportunity Zones.



A profile of the country's new map of Opportunity Zones

¾ of Opportunity Zones lie within metro areas



■ Metropolitan

■ Non-Metropolitan

10 percent of the country's population resides within a zone

31.3 million residents

35.0 million including Puerto Rico and the other territories

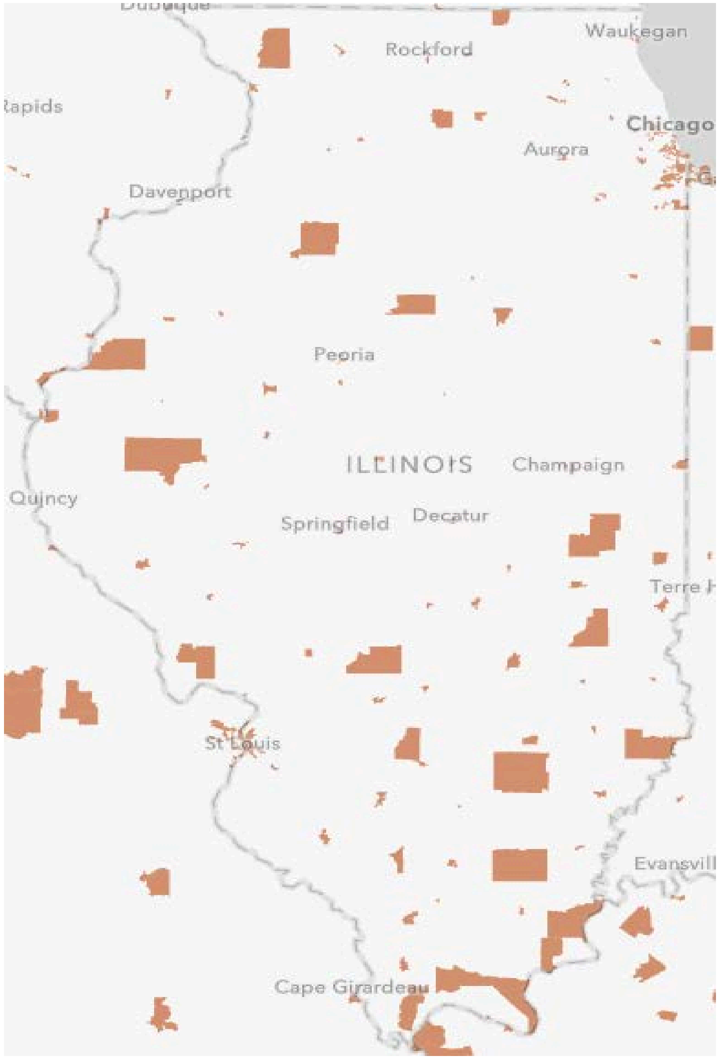
There's a strong foundation on which to expand

1.6 million business establishments

24 million jobs

Sources: U.S. Census Bureau and ESRI Business Data
Note statistics are for the 50 states and the District of Columbia

Opportunity Zones in Illinois



327
Opportunity Zones

1.2 M
Zone Residents

499 k
Zone Jobs

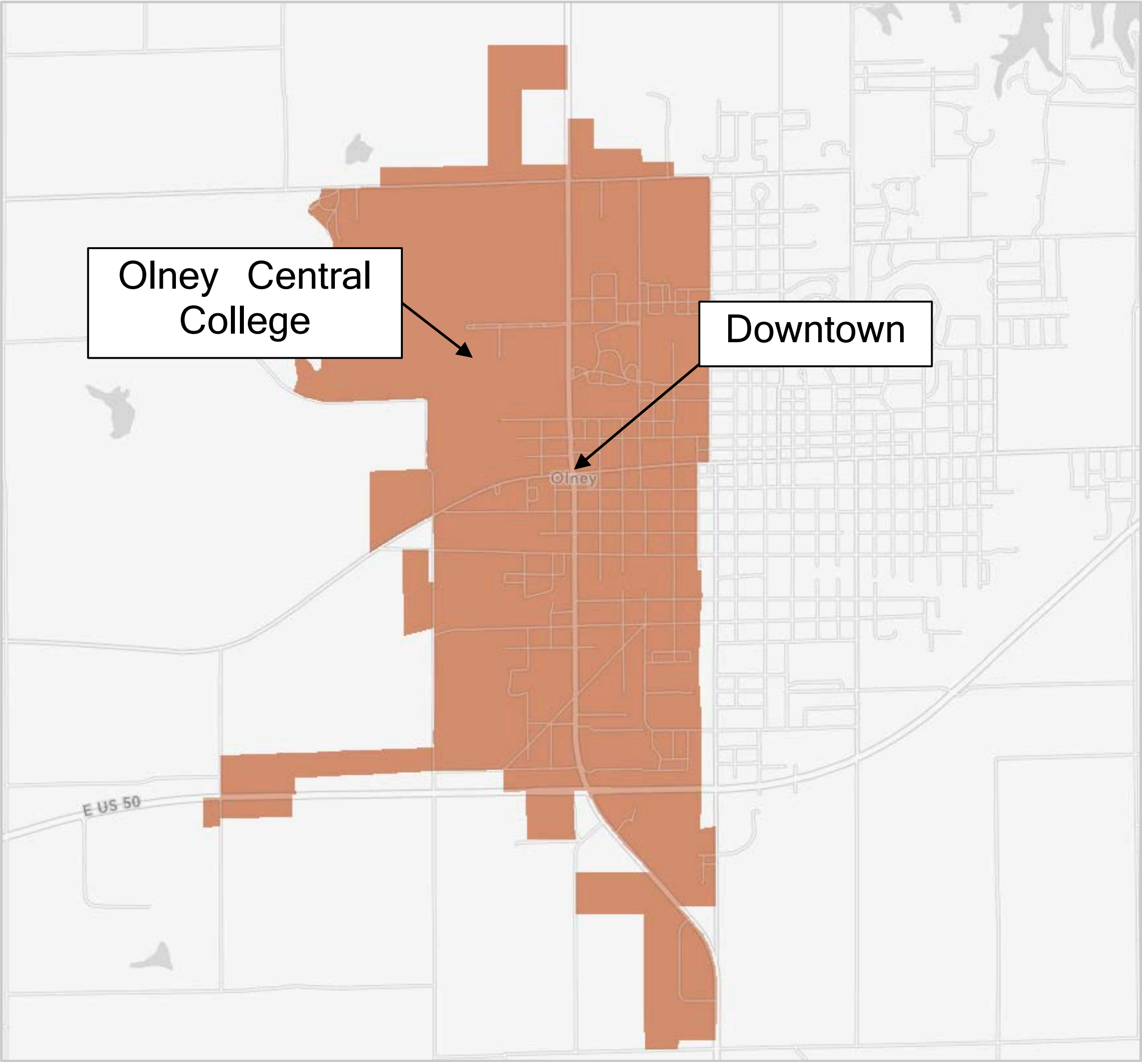
34 k
Zone Businesses

41%
Adults Not Working

34%
Poverty Rate

$35,443
Median Income

Opportunity Zone in Richland County, Illinois



1
Opportunity Zone

2.3 k
Zone Residents

2 k
Zone Jobs

217
Zone Businesses

33%
Adults Not Working

29%
Poverty Rate

$42,800
Median Income

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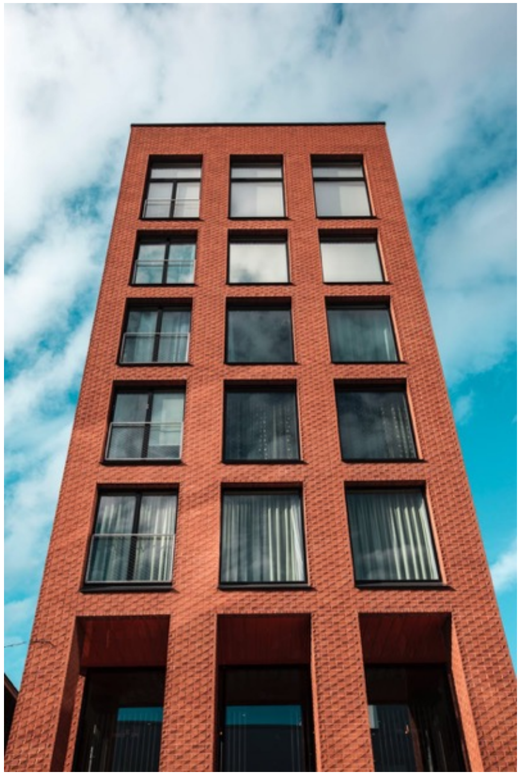
Put it all together and Opportunity Zones can help finance any number of projects in urban, rural, and suburban areas alike.

Startups



Housing

Commercial Developments

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Opportunity Zones can help finance any number of projects in urban, rural, and suburban areas alike.

Innovation Districts

Brownfield Redevelopment

Energy Assets

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Capital alone is *not* a strategy.

Opportunity Zone investment is not guaranteed.

- Local stakeholders need to work together to facilitate the emergence of an **ecosystem** of investors, investees, fund managers, and partner organizations.
- Stakeholders should consider what resources can be **aligned** in support of Opportunity Zones and how they can **further de-risk** the most needed types of investment into zones.
- Real estate investment will likely take care of itself. What are you doing to make sure this **unlocks startup and expansion capital** for new ventures?

Inclusive outcomes will require partners to step up.

- Funds, philanthropies, local government, non-profits, and other civic partners will have to work hard to **make sure that investment translates into jobs and opportunities** for Zone residents. The good news: Investor behavior is about to switch from headwind to tailwind.
- Local governments in particular also need to **prepare for success**: What potential impacts of a capital influx do you need to get ahead of?

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How are things likely to proceed from here?

2018

- ✓ Zones certified and final map in place
- Q3: IRS releases O-Fund self-certification form
- Q3-Q4: IRS/Treasury release further guidance
- Q3-Q4: Early-mover funds form and capitalize

2019

- Bulk of funds form and capitalize
- Investment starts to flow

2020 and 2021

- Funds begin to invest at scale
- Funds reach 90 percent thresholds
- Investors continue to pile on in advance of the 2021 deadline to get the 5-year step-up by 2026
- First real picture of impact takes shape

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

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