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Will New Tax-Law Policy Help Needy Communities or Luxury Condo Developers?

By Alex Daniels

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In Bridgeport, Conn., one of the nation's poorest cities, 100 units of low-income housing are ready for development but need investors.

Opportunity Zones, the latest federal government creation to spur investment in low-income areas, has drawn the interest of a lot of people outside the normal orbit of nonprofit community-development leaders like Elizabeth Torres.

In fact, the first thing Torres thought when she attended a training session on the new tax policy was: Who are all of these people?

They didn't ask about the number of jobs that would be created or how many families would gain access to affordable housing under the new federal policy, things a community nonprofit leader would naturally be curious about.

Instead, she remembers, the participants all seemed to be focused on getting a juicy return on their investment and helping rich clients avoid as much tax as possible.

"There weren't a lot of mission-oriented people sitting around the table," she says. "Fund managers are coming out of the woodwork."

Created by last year's tax overhaul, Opportunity Zones allow investors to reduce their tax burden by putting their capital gains into projects in low-income areas scattered throughout the country. Torres, who leads the Bridgeport Neighborhood Trust, is getting 100 units of low-income housing ready for development, and she's looking for investors. She had traveled to the session in nearby Waterbury, Conn., to find out if the new tax policy could help residents of one of the nation's poorest cities find better homes.

Huge Tax Incentive

One reason Torres didn't see any familiar faces in Waterbury is that Opportunity Zones weren't created as a way to achieve specific social goals but as a way to lower taxes on real-estate ventures and shares of stock that are usually held by the rich.

The idea is to coax investors to deploy assets rather than hold onto them. The incentive: They get to avoid paying some capital-gains tax on returns made on other investments, which is generally 20 percent. By investing in an Opportunity Zone, one of 8,762 low-income census tracts scattered throughout the nation, a taxpayer defers the tax until later. The tax is reduced the longer the investment remains in the zone. If the money remains invested for more than 10 years, 15 percent of the tax on the original, deferred capital gain is canceled and any increases in value during the subsequent decade are exempt from the tax.

Deserving Projects

Over the past 10 months, developers, investors, nonprofit leaders, and government-agency heads have gathered at meetings like the one Torres attended in Connecticut to try to understand how the policy will work.

Torres and other nonprofit community-development leaders fear interest in the zones revolves around their potential to benefit well-heeled investors who are sitting on shares of stock and real estate that have risen in value. By one count, investors hold $2.3 trillion in accumulated capital.

Only a small portion of that money is likely to be invested using the Opportunity Zone deferral. Nonprofit leaders like Torres and foundation professionals can't directly benefit from a reduction in capital-gains taxes. But they're working to make sure that money that is freed up for investment by the benefit goes to projects that deserve them most.

Right now, that's largely a matter of faith. There are scant requirements for the types of investments that qualify under the tax designation. There are no reporting requirements to chart and evaluate any social benefits. And all fund managers have to do to qualify to start an Opportunity Zone fund is self-declare; there are no restrictions on who can manage the investments.

Foundations as Watchdogs

The federal government is expected to release guidelines for Opportunity Zone investments later this year. In the meantime, foundations are working to install a voluntary set of practices that could be used to ensure Opportunity Zones aren't simply used as a tax shelter, says Karen Brown, vice president for innovation at the Fairfield Community Foundation, in Connecticut. The need is especially critical in places like Fairfield County, Brown says, home to Bridgeport and one of the nation's widest income gaps, according to a study by the Economic Policy Institute. The average income of the county's wealthiest 1 percent, the study found, was more than 77 times the average income of the bottom 99 percent.

The community foundation is well placed to confer with its major donors, who are likely to have assets that have increased in value since the recession, Brown says. If they'd like to avoid a capital-gains hit, she knows of a lot of projects in the county that could provide secure homes, jobs, and a higher quality of life for people in need.

"We want to make sure that whatever happens with Opportunity Zones in Fairfield, they are taking account of the community's voice and the community's priorities," she says.

'Several Levels of Fear'

Lisa Green Hall, senior fellow at Georgetown University's Beeck Center on Social Impact and Innovation, has "several levels of fear" surrounding the creation of Opportunity Zones. Like Brown and Torres, she worries that investors will be driven more by tax avoidance than creating businesses and affordable housing in distressed urban neighborhoods and in other places in the country where investors have long since lost interest.

Because Opportunity Zone fund managers can self-certify with minimal oversight, Hall said, the tax benefit could attract fraud and abuse. There's nothing stopping investors from developing projects that can cause direct harm, like industrial sites that foul the air or payday-lending outlets that can trap borrowers in a cycle of debt. And she fears that some investors will put their chips on projects that benefit only a small subset of residents, like fancy condos that can help drive longtime residents out of a neighborhood.

Despite those fears, Hall says there's an upside: As the first tax incentive introduced in years for donors to invest in low-income communities, the creation of Opportunity Zones could invigorate discussions about the lack of investment in distressed areas.

Some of those talks began this summer when Hall was joined by representatives of the U.S. Impact Investing Alliance, the Federal Reserve Bank of New York, Enterprise Community Partners, the Local Initiatives Support Corporation, and other nonprofit groups to discuss ways to make sure the tax initiative serves the broader public.

The group's goal is to develop a common method of tracking the social benefits of the investments, help get input from communities within the zones, and highlight success stories for others to learn from.

Meaningful Evaluation

It remains to be seen whether the zones will actually attract new investments or if investors will simply see a tax benefit for investments they would have made anyway.

Hall is confident the tax break will unlock new flows of capital. One way to ensure that, she says, is to install meaningful evaluations of the social benefits the investments can bring about.

"Assessing and tracking impact is good risk management," she says. "It’s good for business. The opportunity funds that measure and deliver impact for their investors will have the best returns."

Enterprise Community Partners is counting on it. In September it announced that it was creating a new Opportunity Zones fund, with partners Riverfront Capital and Beekman Advisors. Their goal is to raise $250 million and begin making investments as soon as December.

IRS Oversight

Like Hall, Kimberlee Cornett worries that there are few guardrails in place to make sure the tax benefit will help poor communities.

Cornett, who manages the Kresge Foundation’s social-investment practice, says it’s up to nonprofits and socially minded investors to self-police. She doesn’t think the federal guidance expected by the end of the year will add more reporting requirements or investment criteria. The reason? Unlike other development-tax incentives that establish social objectives, such as the New Markets Tax Credit, says Cornett, the Internal Revenue Service oversight of Opportunity Zones will focus on whether individuals fill out their tax forms correctly rather than the number of jobs or affordable-housing units they create.

"That’s not the business they’re in," she says. "They’ll look for compliance."

To help ensure that at least part of the market for Opportunity Zone investments is motivated by a desire to benefit low-income areas, Kresge and the Rockefeller Foundation this summer screened prospective fund managers. The grant makers quizzed them on their experience working in low-income communities, how they planned to work with local organizations, and their understanding of the community needs that they want to address.

The two grant makers received 141 responses. Of those, 20 have been selected to undergo more due diligence and, in some cases, to receive legal and accounting assistance. While no money has been formally committed, both Kresge and Rockefeller are considering putting up as much as $25 million each in loan guarantees to reduce the risk for other investors. Doing so, Cornett says, would allow Kresge to ensure that every investment evaluates its social impact.

"We’re able as a guarantor to require impact reporting," she says. "We can contribute that back to the public."

Deploying Capital

If Opportunity Zones are to thrive, they will have to produce jobs in low-income communities and involve local intermediaries, like existing nonprofit development institutions and larger institutional "anchors" like research centers, says Bruce Katz, co-author of *The New Localism: How Cities Can Thrive in the Age of Populism.*

Working with the Accelerator for America, a project led by Los Angeles Mayor Eric Garcetti, Katz has developed investment prospectuses for cities to identify and promote projects in their Opportunity Zones. He and his co-author, Jeremy Nowak, an urban-investment expert who died in July, completed plans for Louisville, Oklahoma City, and South Bend, Ind.

Community foundations, he says, can play an "intriguing" part in attracting investments from high-net-worth investors, providing predevelopment or evaluation support, and helping determine how to deploy capital in the zones.

"Besides de-risking a project, community foundations may have a new role as a broker," he says. "They have an enormous amount of trust and legitimacy in communities, among corporations, and people of means."

Neutral Adviser

The Toledo Community Foundation is attempting to be such a connector.

In the months after passage of the tax law, a few wealthy donors asked Keith Burwell, the organization's president, for advice on making investments in the city. They came to Burwell because the foundation had played a key part in mapping Toledo's zones.

About 99 percent of the city, which was slow to shrug off the effects of the recession and was hit hard by the 2017 closure of a Jeep Cherokee plant, qualified for the Opportunity Zone designation.

The foundation gathered local community-development nonprofits, the port authority, the chamber of commerce, and the mayor's office in a series of meetings. Serving in what Burwell calls a "Switzerland role," as a neutral adviser, the foundation asked participants to develop business plans for census tracts that were fertile zones for business creation. The grant maker then vetted those plans before sending the governor's office a single blueprint for the whole city that identified 18 potential zones. Ohio Gov. John Kasich approved all but one of them (Governors were allowed to approve up to 25 percent of the qualifying census tracts in their state.)

Managing Risk

As for the potential investors, Burwell says, he "put them on hold for a moment" while the zones were approved and the foundation decided how to get further involved.

Late this summer Burwell was putting the final touches on a plan to create a separate Opportunity Zone fund. The foundation, which would help manage the fund with several other partners, is waiting for further guidance from the Treasury Department before making a formal launch.

The goal is to identify projects where Opportunity Zone investments could complement new businesses and construction projects that use other tax credits to funnel money to low-income areas, creating a "capital stack" that minimizes overall risk and concentrates investment dollars where they are needed.

Perhaps most important, Burwell says, is that the fund’s management will have a say in where the money is directed and will track each investment’s results. Doing so, he says, will attract investors who not only want a tax break but also want to improve the quality of life in areas that have had a hard time attracting investment.

"We’re not going to use this to put up more payday-lending outlets or strip clubs," Burwell says. "If we’re not careful, it will be the wild, wild west."