Enhancing Returns from Opportunity Zone Projects by Combining Federal, State, and Local Tax Incentives to Bolster Community Impact

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The opinions expressed in this article are those of the authors and do not necessarily reflect the views and policies of HUD or the U.S. Government.

Abstract

Skeptics may call the federal Opportunity Zone (OZ) program a tax dodge for the wealthy, but there is strong bipartisan support for the program at the federal, state, and local levels. Furthermore, underserved communities (and the small businesses therein) could benefit from billions of dollars in new investments in long-term capital that they might not have received through conventional bank loans or government programs—especially given the current unique and challenging economy. The findings noted in this article are based on the authors' presupposition that President Biden's proposed tax increases have increased interest in the deferral and ultimate tax exemption aspects of the OZ program, and investment momentum is likely to continue for the foreseeable future.

The authors' data and interviews show that because the OZ program is not structured for real estate speculators and flippers to trade during the OZ reinvestment period, the long-term investment requirement of the OZ program makes it stand out from other place-based incentive programs that have generally failed to live up to expectations. Furthermore, the authors dispute the notion that the OZ program only benefits real estate investors. They believe that OZ investments have funded hundreds of clean energy projects, biotechnology and medical infrastructure projects, active businesses, solar energy projects, and many successful public-private partnerships.

Abstract (continued)

The authors also show that Congress placed no limits on the amount of federal, state, and local tax benefits, grants, or other incentives that can be layered into the OZ investment. As a result, OZ structures are being used in combination with Low-Income Housing Tax Credit (LIHTC) projects, New Market Tax Credit (NMTC) projects, Historical Tax Credit (HTC) projects, research and development, solar energy, cost segregation, and other alternative energy projects that generate accelerated depreciation and credits. This is generally referred to as "twinning" of various tax programs.

The authors anticipate further extensions of the OZ investment window that will give taxpayers and fund managers sufficient time to make important investment decisions that result in significant economic impact for underserved communities. How many other economic development initiatives can generate win-win results for underserved communities, municipalities, small businesses, and investors alike?

Introduction

The federal OZ program is arguably one of the most flexible, impactful, and bipartisan tax programs for helping disadvantaged communities in half a century. Although the OZ program was bundled into the landmark Tax Cut and Jobs Act (TCJA) passed in late 2017, the OZ program architects had developed the program's framework years earlier with support from the Obama-Biden Administration, as outlined in a 2015 report by the Economic Innovation Group, "Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas" (Bernstein and Hassett, 2015).

Skeptics call the OZ program a "tax dodge" for the wealthy, but there is strong bipartisan support for the program at the federal, state, and local levels. Investment commitments appear to be ahead of schedule. More importantly, the OZ program is creating new businesses, jobs, and affordable housing at a time when the pandemic-ravaged economy has been particularly cruel to minorities and low-income communities.

Researchers from the University of Wisconsin-Madison, Rutgers, and the University of North Carolina found that the OZ program has indeed had a positive impact on job creation (Arefeva et al., 2021). Using establishment-level employment data for 2015 to 2019 from Your-economy Time Series, a database tracking private and public institutions and their jobs, the authors discovered that the OZ program increased employment growth by 2.5 percentage points and establishment growth by more than 2 percentage points.

Today, nearly 8,800 census tracts in all 50 states and most U.S. territories are eligible for OZ investment into real estate projects and operating businesses. Not all tracts have received funding, but according to the White House Council of Economic Advisors (CEA), among other sources, an estimated $75 billion of OZ capital had been committed to Qualified Opportunity Funds (QOFs) by year-end 2020 (CEA, 2020). Granted, the CEA estimate is partially based on extrapolated data, but even the widely followed Novogradac Opportunity Zones Investment Report (Novogradac, 2021) stated that more than $15 billion in equity capital had been committed to the OZ program by year-end 2020—up 20 percent from August 2020 alone, and those numbers are conservative. Novogradac concedes that it tallies commitments only for the minority of QOFs that report their equity amounts.

The pages that follow indicate that the true level of OZ investment may be closer to the White House's CEA $75 billion estimate. That is because a typical real estate project has a 4:1 ratio of debt to equity. Thus, a $75 billion equity investment in QOFs will likely be coupled with an additional $300 billion of debt in what developers call the "capital stack." Considering highly volatile stock, real estate, and cryptocurrency markets experienced since COVID-19 surfaced in early 2020, there are billions of dollars' worth of 2020 gains that had a reinvestment window as late as September 10, 2021, under the liberal "180-day" rule—which can actually be as long as 20 months under certain circumstances.

Taxpayers had to meet a key deadline of December 31, 2021, to obtain the 10-percent basis step-up, which would reduce their reportable gain on December 31, 2026—absent a legislative extension.

Regardless of which figures are used to track adoption of OZ investment, the 3-year-old program is well on its way to meeting the 10-year, $100 billion investment goal set by program organizers. Despite an uncertain economic future caused by the pandemic, substantial new investment into QOFs continues as investors, financial advisors, and municipalities learn more about the OZ program. In fact, adoption may accelerate because interest rates and long-term capital gains taxes could rise for the wealthy under the Biden Administration.

Quick Example of OZ Mechanics

As other experts in this symposium may have mentioned, the OZ program allows investors to defer paying taxes on their capital gains for up to 7 years if they timely reinvest those gains in qualifying OZ projects. Until the OZ program surfaced 3 years ago, investors could generally only defer gains from real estate and certain stock investments—and only if they reinvested those gains quickly into similar (such as "like kind") property. Now gains from all types of investments—even from cryptocurrency and collectibles—can be reinvested tax advantageously into QOFs, which can reinvest that money into a wide variety of diversified asset classes as long as the investor remains patient. Furthermore, investors receive a mid-investment step-up in basis, saving them potentially 10 percent more—and any gains resulting from their reinvested monies are fully tax-free if they hold their investments in place for the full 10-year period.

If tax rates for capital gains and regular income go up during the Biden Administration, the OZ program will become even more attractive for investors seeking a holding place for their gains because the stock, cryptocurrency, and real estate markets could remain volatile near-term (Christian and Darby, 2021).

Matching Investor Incentives with Community Development Needs and Timing

Under current law, capital gains generated through December 31, 2026 can be reinvested into a QOF as late as September 10, 2027. In February and August 2021, however, bipartisan Representatives Tim Burchett (R-TN) and Henry Cuellar (D-TX) introduced the Opportunity Zone

Extension Act of 2021 (Office of U.S. Representative Tim Burchett, 2021), and Representatives Burgess (R-UT), Steele (R-CA), Salazar (R-FL), and Gimenez (R-FL) introduced the Growth and Opportunity Act (H.R. 4608) in July 2021 to extend the deadline for reinvesting gains by 2 years to December 31, 2028, from the current of December 31, 2026 (Utah Policy, 2021). Such an extension, which continued to have strong bipartisan support as this article went to press, will further benefit investors. That is because a QOF investment funded by December 31, 2021, would now have the opportunity to meet the 7-year holding period by the December 31, 2028 recognition date—thereby receiving the full 15-percent basis step-up. The Burgess bill, still pending at press time, would also allow new OZ census tracts to be designated every 10 years, dramatically extending the program.

Real World Example

By meeting the 7-year holding requirement, OZ investors would see their tax basis increase to 15 percent (it is 10 percent after 5 years) when they report their deferred gains. For example, if an affluent real estate investor sold a property in late 2020 for $1 million and it had cost her only $300,000 to purchase the property years ago, she would have to report a long-term capital gain of $700,000. At her high-net-worth tax bracket, she would owe 23.8 percent of that gain at the federal level ($166,600).

The investor will not want to reinvest her entire $1 million gross proceeds into a QOF as equity because only $700,000 will receive the aforementioned OZ program benefits. She can, however, place the remaining $300,000 into the project as a loan. Assuming the deferred gain recognition date gets extended to 2028, and she makes her QOF equity investment by December 31, 2021, if she holds that investment for 7 years or longer by the recognition date, her tax basis would be raised 15 percent to $105,000. Thus, her taxable gain would be reduced to $595,000 from $700,000. At current federal rates, her tax liability would be reduced to $141,610 from $166,600—a savings of nearly $25,000.

All but five states—California, Massachusetts, Mississippi, New York, and North Carolina—are fully conforming to the OZ program at the state level. Only Massachusetts limits OZ benefits to C corporations, not to S corporations, partnerships, or individuals. Otherwise, adoption of the OZ program has been swift and widespread.

In January 2021, the Internal Revenue Service (IRS) issued IRS Notice 2021-10, which gave taxpayers until March 31, 2021, to invest certain 2020 gains (IRS, 2021; in some cases, taxpayers could even invest section 1231 gains from 2019; Christian and Darby, 2021). The extra time to invest and improve property clearly attracted additional investment dollars to the OZ program.

OZ is Not Just for Real Estate Projects

Regulations have expanded application of the OZ program to energy projects, infrastructure, active businesses, and public-private partnerships. The aforementioned energy projects are just the tip of the OZ iceberg. According to the Economic Innovation Group (EIG), there are nearly 300 entrepreneurship incubators or accelerators in OZs (EIG, n.d.). One of the authors has worked with a number of OZ incubator platforms, including Long Beach Accelerator (for which the author was a founding board member) (Munguia, 2019); Hall Labs, a Provo, Utah-based family office and tech accelerator that has been operating within an OZ for decades; and Conscious Venture Labs in Baltimore, Maryland.

EIG research found that numerous clean energy projects are also taking root in OZs. For instance, there are approximately 475 solar energy installations producing more than 1MW of activity in OZs, as well as 127 wind farms and 15 battery plants of at least the same capacity. The firm of one of the authors is involved with at least six large solar projects—with many more solar projects in the discussion stage.

Who Is Being Served by the OZ Program?

In a nutshell, underserved communities (and small businesses therein) are seeing billions of dollars of new investment in long-term capital that they might not have received through conventional bank loans or government programs—especially in this difficult economy.

Some media outlets like to focus their criticism of the program on a small number of OZ projects located in upscale neighborhoods, such as the Los Angeles Arts District, Chapel Hill in North Carolina, and Hell's Kitchen in New York City. Controversy boosts ratings and readership, but in most cases, the OZ program is targeting underserved communities. An Urban Institute analysis of the designated OZs showed that, overall, OZ tracts have a median household income (HHI) of roughly $33,000—much lower than the $44,000 for eligible nondesignated tracts and the $60,000 median HHI for all U.S. census tracts. Each state governor can designate which census tracts within their borders receive OZ designation, but designated OZ tracts to date have overall poverty rates of nearly 32 percent (compared with 21 percent for eligible nondesignated tracts and 16 percent for all tracts). Furthermore, those OZ-designated tracts have an average unemployment rate of 13 percent (compared with 9 percent for eligible nondesignated tracts and 8 percent for all tracts).

Bottom line: The OZ program is not for "flippers" and other real estate speculators. It is for long-term investors who are willing to make multiyear commitments to disadvantaged communities. As mentioned earlier, OZ equity investors must be willing to keep their capital invested for at least 5 years to earn a 10-percent reduction in their tax liability, and they must hold for 7 years to receive a 15-percent reduction in their capital gain. In addition, 90 percent of assets held in a QOF must be invested in qualified OZ property (QOZP) at all times—a threshold that is monitored semiannually by the fund manager. It is not enough for investors and QOFs to acquire property in underserved areas. They must also *substantially improve* that property, or it will not qualify for favorable tax treatment.

"Substantial Improvement" Requirement

For property that has previously been depreciated, taxpayers must generally double its tax basis or allocable cost during the first 30 months of ownership simply to satisfy the "substantial improvement" test. Although neither raw land nor ground-up development needs to meet the substantial improvement rule, any property containing existing structures that have been depreciated is subject to the substantial improvement test. For a property to be considered substantially improved, there must be evidence showing that during any 30-month period (beginning after the property is acquired), additions to the basis of the property exceed an amount equal to the adjusted basis at the start of the 30-month period.

Note that IRS Notice 2020-39[1] *and* IRS Notice 2021-10[2] *suspended the Substantial Improvement period through March 31, 2021, due to COVID-19's ongoing business disruption—and it may get suspended again.*

Minimal Red Tape and Self-Certification

The OZ program was designed to expedite the formation and funding of projects and to minimize federal government interference. Rather than having taxpayers and investors jump through hoops trying to get projects approved, the OZ program architects implemented a "self-certification" process. A QOF simply completes IRS Form 8996[3] and files it with its first year QOF return and subsequent year filings. The statute and regulations provide relatively simple oversight, and the program is self-policing. Investors who meet the requirements do not have to submit endless applications or wait on a protracted government approval process.

Combining Other Statutory Tax Incentive Programs with the OZ Program ("Twinning")

Another interesting facet of the OZ program is that Congress placed no limit on the amount of federal, state, and local tax benefits, grants, or other incentives that could be layered in. Therefore, we are seeing OZ structures used for Low-Income Housing Tax Credit (LIHTC) projects, New Market Tax Credit (NMTC) projects, Historical Tax Credit (HTC) projects, research and development, solar energy, and other alternative energy projects that generate accelerated depreciation and credits. This is generally referred to as *twinning* of programs. There are even some OZ projects that incorporate QOZ-situated oil and gas projects that can generate myriad other tax incentives.

All the tax credits referenced previously, as well as other tax benefits available to specialized projects such as these, can be combined with the already powerful OZ program to attract additional private investor funds. Doing so means more funding for deserving projects and even higher potential return for investors in terms of after-tax return on investment (ROI). Although seldom discussed, the OZ program does not require these credits or depreciation amounts to be recaptured into the taxpayer's income upon sale when they are wrapped into a QOF Qualified Opportunity Zone Business (QOZB) structure. That provides another layer of ROI.

Some people confuse the OZ program with the federal NMTC because many of the OZ provisions borrow from the NMTC statute; however, the NMTC is much more difficult to navigate. It is primarily a debt-focused program and is generally not well suited for investments other than for

[1] IRS Notice 2020-39 can be found here: https://www.irs.gov/pub/irs-drop/n-20-39.pdf.

[2] IRS Notice 2021-10 can be found here: https://www.irs.gov/pub/irs-drop/n-21-10.pdf.

[3] The form is here: https://www.irs.gov/pub/irs-pdf/f8996.pdf.

large real estate projects and limited non-real estate operating businesses. By contrast, the OZ Program permits investment in a wider array of operating businesses as long as those enterprises are not "sin" businesses, such as liquor stores, hot tub facilities, and private golf clubs (IRC §45D).

A favorite twinning project of one of the authors is a startup company called ClearSkies, which installs solar farms on regional airport properties. ClearSkies strives to lower the energy costs for the developing electric airplane industry—a rapidly evolving sector. Approximately 10 percent (479) of the 5,000 public use airports are located in OZ census tracts, according to a tabulation provided by Southern Sky Aviation.

ClearSkies brings together all elements of an impactful OZ project, including alternative energy, support for a new industry, and job creation. Meanwhile, investors benefit from the recently extended 26 percent solar tax credits, bonus depreciation asset expensing, and an OZ deferral and exemption. Projects such as Clear Skies produce some front-loaded tax benefits and compelling after-tax internal rate of return for investors, all while supporting alternative energy for a new industry.

Non-Statutory/Negotiated Tax Incentives: State and Local Taxes

In addition to statutory place-based incentives such as NMTC, Empowerment Zones, Enterprise Communities, and Renewal Communities, most state and local jurisdictions offer "negotiated" incentives geared toward new businesses, relocating businesses, or expanding businesses. Benefits can often be negotiated by the taxpayer based on job creation, capital investment, or other economic factors.

Other somewhat common negotiated incentives include payroll tax, sales tax, and property tax exemptions, and holidays for limited time periods. These exemptions can be very attractive incentives for companies seeking to relocate. Amazon's "HQ2" regional headquarters search is a perfect example of how large corporations use their clout to reduce future taxes. Smaller companies are often unaware of these incentives. Some incentives are statutory, and others must be negotiated with the city, county, or state. Making businesses aware of those incentives can be highly beneficial for the company, the municipality, and job seekers therein. Speaking with the applicable economic development group at the government level or hiring a CPA firm that specializes in these matters will often clarify these incentives.

Unlike other place-based programs, the OZ incentive has no cap. As mentioned earlier, QOFs can self-certify, which eliminates some of the regulatory burdens and obligations that hindered earlier programs. Unlike historical place-based programs, OZs do not combine tax benefits with grants, although localities may target other grants, such as Community Development Block Grants (CDBGs) and CDBG-Disaster Recovery, in their OZs. Some of these differences reflect insights derived from experience. The regulatory flexibility incorporated into OZs reduces barriers that the OZ architects believed impeded broader participation in other place-based programs. Furthermore, the absence of a cap on OZ investments removes an additional barrier that restricts greater investment into the most challenged communities.

Although the OZ program already offers significant federal benefits to incentivize investors, numerous projects may not "pencil out" even after generous federal tax breaks are considered. In addition, many deserving projects are in census tracts unfamiliar to many developers, entrepreneurs, and investors. As a result, state and local economic development personnel must find ways to attract OZ projects to their jurisdictions.

One of the authors, a CPA, rarely goes a day without receiving at least one call or email from someone asking about solid OZ projects to invest in—or which state or city is the best place to make OZ investments. With a few exceptions—such as Riverside County, Long Beach, and Santa Ana, California; the state of Ohio; Erie, Pennsylvania; and rural Colorado—very few jurisdictions are aggressively promoting their OZ investment opportunities. So far, most do not do more than mention the OZ program on their websites as part of their economic development outreach. That said, these state and local agencies still have time to build a low-cost, high-impact OZ program. Here are five good ways to do so:

Five Ways that State and Local Agencies Can Assist the OZ Program, Communities, and Investors

1. **Form OZ advisory committees.** States, counties, cities, and tribal lands need to form OZ Advisory Committees composed of selected internal staff members (such as economic development, planning and permitting, finance, and city/county council staff), as well as private industry members from real estate, business incubators, law firms, and accounting firms. In addition to forming committees, larger cities should consider adding an OZ ombudsman to fast-track every viable OZ project within their borders and should consider reducing, deferring, or waiving permits and fees.

   Advisory committees can develop strategic plans to get the word out to the local and national business community that their jurisdiction is "open for OZ business." Investors can make OZ investments in any state, the vast majority of counties and cities in highly populated states (which have more OZ census tracts), and even higher percentages in U.S. territories, such as Puerto Rico, U.S. Virgin Islands, and Guam. OZ advisory committees can provide case studies showing the OZ successes in their region and develop social media campaigns around their OZ success and OZ resources. Their investor audience is not just local but truly national.

   An early example of this approach is the Fresno DRIVE Initiative, in which a 300-member steering committee set clear priorities for an inclusive and sustainable 10-year investment plan in the greater Fresno, California, region. In the authors' opinion, the initiative significantly streamlined the development process for Fresno's OZ plan.

   Cities with other federal designations, such as Promise Zones, should check where their Promise Zones and OZs may be overlapping. In San Diego, for instance, the OZ boundaries and Promise Zone boundaries are nearly identical. These overlapping neighborhoods have a head start over other areas because they may have already undertaken organizing and planning efforts. As a result, they can use the OZ incentive to *supercharge* their economic development plans. For cities that are early in the OZ process, Promise Zone incentives are a great template to follow. The upside potential is huge when stakeholder priorities, policies, and development incentives are properly aligned.

2. **Promote OZ properties in their districts.** Governors, mayors, city councilmembers, and economic development personnel should be inventorying and promoting their OZ properties—whether raw land, commercial, office, or residential—that is available for lease or purchase. Municipalities should also verify the condition of the properties so investors can easily determine the degree of substantial improvements required.

   Because many municipalities were slow or have not been very proactive about raising the profile of OZ properties within their districts, potential developers and investors are looking for proverbial needles in the haystack. However, it shouldn't be hard for municipalities to assemble databases of properties available for OZ investment. In many cases, local commercial realtors will help compile these databases because they are equally incented to find investors.

   Riverside, California, is an example of a municipality that has been very proactive about raising awareness of OZ properties within its borders. Opportunity Riverside, which lists properties available for sale or lease in an OZ on Zoom Prospector, also has layers to show where all available place-based incentives overlap. Riverside worked with the county to create detailed overviews of Riverside's OZ communities—and most importantly, local incentives and favorable zoning—to direct potential developers and investors to the desired areas and projects that would be most desirable to the community.

   To maximize OZ benefits, the authors recommend that local leaders determine which areas within their borders are willing to be placed into a special incentives district and determine which incentives make the most sense to include. Those incentives could include Tax Increment Financing (TIF), density bonuses, parking concessions, expedited review, or a mix thereof.

   Local government economics and public finance advisor Larry Kosmont of Manhattan Beach, California-based Kosmont Companies, serves nearly 100 public entities, many of which have multiple OZ areas. Larry told the authors recently that when it comes to attracting new investment to a community, one of the most compelling benefits of the OZ program is that it can be "accelerated and leveraged" when a public agency "doubles down on OZ by wrapping those areas with other local incentives." Kosmont added that an OZ is especially effective when a city has concluded that additional incentives "will generate improved results and public benefits."

3. **Approach local owners who have been unwilling to sell their properties to see if they are open to partnering on projects.** For example, raw land owners might consider entering a long-term ground lease or partnering with developers. There may also be opportunities to develop public-private partnerships to develop community centers, homeless shelters, workforce housing, trade schools, solar farms, urban farms, and so forth. Another approach is to contact recent property sellers who may have triggered capital gains within the past 6 months to find potential QOF investors. With this two-pronged approach, a marketplace for local development can be created entirely from within the community.

4. **Seek discounted advice from socially motivated CPAs, attorneys, and other OZ advisors.** There are many project developers who have excellent ideas but who lack the financial resources to hire knowledgeable attorneys and CPAs to guide them through the OZ formation and operation process. Therefore, cities, counties, and states should evaluate ways to provide micro-grants or loans to OZ project promoters who meet certain economic criteria. Furthermore, those amounts could be paid directly to attorneys, CPAs, and other OZ advisors to get projects kicked off. The service providers, however, would need to agree to perform the start-up services at 50 percent of their standard rates.

   Participating government agencies and service providers could then be repaid for the grants, loans, and discounted fees when the project is funded by OZ investors, making the support programs sustainable for other projects.

5. **Raise awareness of tax incentives at the state or local level.** State and local jurisdictions can often provide state- or local-level tax incentives to OZ projects in areas, such as the following:

   - State tax credit as a percentage of the QOF investment.
   - Payroll tax credits for jobs created by the QOF and QOZB.
   - Job training grants for new employees.
   - Equipment credits or sales tax exemptions for qualifying equipment placed in service in the OZ.
   - Property tax exemptions or TIF programs.

Examples of state and local incentives that the authors think work:

- The City of El Cajon, California, is currently evaluating the potential for TIF and other incentives within their various OZs. Santa Ana, California, is in the process of considering entitlement support for key projects.
- The Ohio Opportunity Zone Tax Credit (OOZTC) illustrates a prime example of combining state and local incentives with the federal OZ benefit. The additional Ohio credit provides a nonrefundable tax credit against individual income tax equal to 10 percent of the amount of funds invested by the Ohio QOF in QOZP located in one of the 320 designated Ohio OZs. Qualifying taxpayers can earn up to $1 million in tax credits for eligible investments.

The Erie (Pennsylvania) Downtown Development Corporation (EDDC) convinced a Fortune 500 firm, Erie Insurance Company, to provide $58 million in qualified capital gain equity to invest in a local QOF (including $8 million earmarked for Pittsburgh). This has contributed to the revitalization of multiple downtown properties in a struggling market—a great example of local government leveraging relationships with local business leaders (for more about this revitalization effort, see Martin, 2020).

- In Colorado, the state Office of Economic Development and International Trade has launched an OZ Accelerator Program in which the Colorado Center for Innovation for Community Capital has helped 12 local businesses in disadvantaged areas with their technology and business plans. Additionally, the center has facilitated connections to Colorado OZ investors, thus opening the door to a new funding source. These actions ultimately led to a national OZ fund that is dedicated to investing in rural startups and to investing in a new aerospace industry firm called Proximity Space (Kiser, 2020).

Cities and counties commonly own land at the government agency entity level. Rather than owning land at the entity level, they should consider contributing city- or county-owned land to appropriate OZ projects. For example, municipalities can contribute the land in exchange for an OZ fund's commitment to build a community center on the land. The city or county could enter a long-term lease on the building with a purchase option.

Yes, Public-Private Partnerships Can Work

Public-private partnerships (P3) are well suited for the OZ program because government projects are usually long term and OZ investing requires "patient capital." As mentioned earlier in this article, the Biden Administration will likely expand the use of the OZ program to capitalize on infrastructure and P3.

The OZ program has attracted widespread support among mayors, city managers, and county executives as both a tax-saving tool and as an economic development tool. One of the authors (Blake Christian) is working with various California counties, cities, universities, and incubators to use the OZ program to attract investment and to develop P3 arrangements.

Incubators help city governments and universities provide platforms for early business development. Informed advisors can encourage their team to layer in the OZ benefits to attract OZ equity dollars and debt financing into the business ventures. This model can be replicated throughout the country.

One such firm experienced in OZs and other sources of capital from a business perspective is Blended Impact Labs, based in Riverside, California. Blended Impact Labs has worked with the U.S. Department of Housing and Urban Development (HUD), the California Governor's Office, and others on OZ strategy and implementation at the local level.

Stacy Cumberbatch, managing director of Blended Impact Labs and founder of Opportunity Riverside, noted in an interview for this article that she finds OZ capital exciting due to the "patient nature" of OZ incentives, the flexibility of sources, and the creativity used to structure custom terms. "OZ capital can be a powerful financing tool, particularly in rural communities," Cumberbatch said. "It's also effective for expanding ventures for those that embrace it, growing both entrepreneurship and job opportunities within communities," she added.

A relevant example would be a local city government interested in developing a new cogeneration plant, water-treatment plant, or events center on vacant land that it owns. If that land is located within an OZ census tract, the project becomes even more attractive. The city can partner with an OZ fund and have the fund build and own the project, which entitles the fund to claim depreciation. It is worth noting that leases to government organizations preclude certain bonus depreciation and other accelerated depreciation—but, as previously discussed, the depreciation is not "recaptured" as taxable income by the investors after 10 years.

With proper planning and drafting, the parties can even institute "put" and "call" options that allow the project to be transferred to the cosponsoring municipality after 10 years. Furthermore, the fund might even agree to structure an "installment sale" at the end of the investment term to provide financing to the municipality. This assures investors with nearly guaranteed ROI before breaking ground and secures desired projects with built-in financing for municipalities.

Diffusing OZ Skeptics

QOFs are also partnering with universities because many university neighborhoods contain a high percentage of students who technically meet the OZ program's low-income threshold. For a census tract to qualify as a QOZ, two basic low-income requirements must be met:

1. There must be a poverty rate of at least 20 percent.
2. The median family income must be less than 80 percent of the statewide (or relevant metropolitan) median family income.

The following is an explanation of why these criteria are not bending the rules but instead making smart use of P3.

698 Prospect Phase I is a student housing, commercial, and retail development adjacent to the University of North Carolina Pembroke. Pembroke is a Native American-founded university that serves primarily low-income students. The project will create housing for nearly 200 students, more than 50 full-time equivalent jobs, and 30-plus construction jobs, and it will generate almost $3 million in wages in Pembroke. That is a substantial win for a small, economically distressed rural town that is the political, economic, and cultural center of the Lumbees, the largest Native American tribe east of the Mississippi.

In the non-real estate arena, a sampling of QOF-university projects includes very early-stage biotech research projects, aerospace initiatives, and tech or software projects that might not have received funding via traditional bank and venture capital sources. There are a growing number of incubator platforms used primarily for non-real estate projects.

For example, Agile Space Industries, a small aerospace company based in the small town of Durango, Colorado (home to Fort Lewis College), is creating 50 jobs directly and more than 200 jobs indirectly (Mullane, 2021). The investment will enable Agile to attract highly skilled engineers to Durango. This, in turn, will spur local economic activity and further contribute to the diversification of the town's economy, which had been heavily reliant on tourism and oil and gas before COVID-19. Agile is committed to training and hiring residents and will train two dozen members of underrepresented populations over the next 4 years. In fact, more Agile employees have graduated from Durango's Fort Lewis College than from any other college or university.

As with any community development program, there are concerns about OZ-induced gentrification, property tax hikes, minimal transparency, and minimal oversight. A widely cited 2019 New York Times article outlined how investors were reaping breaks on projects that were already underway or that only served well-off communities. More recently, a critical NBC News report neglected to cite facts from the Organisation for Economic Co-operation and Development (Strickler and Alexander, 2020). The Urban Land Institute also released a June 2020 report critical of the program's shortcomings (Theodos et al., 2020).

What each of these detractors overlooked was the fact that the 3-year-old OZ program is still in the early stages of its 10-year planning horizon. In the authors' opinion, rational observers would say the program is ahead of schedule—even more encouraging when one considers that three sets of complex OZ regulations were not finalized until December 2019, 24 months after the program was launched. Then COVID-19 created additional investment delays beginning in early 2020. Real estate projects generally take at least 2 to 4 years to complete after factoring in the entitlement process and construction time.

Bottom line: Expecting the OZ program to show significant community impact after just 30 months is highly unrealistic. But if the program's early wins continue at the same trajectory as the investment capital committed, the authors think that the program should far exceed its initial goals when the 10-year planning horizon ends later this decade. As mentioned earlier, independent research confirms the OZ program—even in its infancy—has had a positive impact on job creation (Arefeva et al., 2021; CEA, 2020; Novogradac, 2021).

Author's Experience as an OZ Business Owner and Investor

One of the authors, Blake Christian, has specialized in place-based tax incentives for most of his career. He has promoted economic development through various public-private partnerships, including leadership board positions with various chambers of commerce and CalOZ, a nonprofit trade organization dedicated to maximizing the transformative potential of OZs in California. He has also consulted to various states, counties, and cities about the OZ program. When the OZ program surfaced in early 2018, he received frequent questions about the new "OZ credits." He spent a great deal of time explaining that the OZ program was not a tax credit program but something, in his opinion, much more powerful, flexible, and beneficial to communities in need.

He has helped establish approximately 85 QOFs nationwide and a larger number of QOZBs. Roughly 70 percent of his OZ projects are real estate developments, and 30 percent involve operating businesses located in one or more OZ census tracts.

Projects range from as small as $1 million to as large as $6 billion, and the fund equity in those projects ranges from $250,000 to $120 million. Real estate projects range from manufacturing facilities to multifamily rentals, office buildings, a casino reuse project, mixed-use developments, and medical/tech facilities. Operating businesses range from COVID-19 research, a COVID-19 disinfectant company, manufacturing, agricultural, mining, solar projects, pharmaceutical companies, technology, wholesale, and retail.

He is also establishing an OZ manufacturing facility in Provo, Utah, for a business that he started several years ago. Park City Base Camp and Gorilla Design repurpose shipping containers into affordable housing units for the area's homeless population and seasonal workers, among others. The entities have formed a new QOF that will operate under the name of Modular Innovation Technologies in the Provo, Utah area. It is important to know that existing businesses can be started, purchased in, or relocated into an OZ census tract and obtain full OZ tax benefits with proper planning.

Conclusion

The authors anticipate further extensions of the OZ investment window that will give taxpayers and fund managers sufficient time to make important investment decisions that result in significant economic impact for underserved communities. How many other economic development initiatives can generate win-win results for underserved communities, municipalities, small businesses, and investors alike?

> *"Creating a stronger, fairer [society] begins with expanding opportunity equally across all communities; the Opportunity Zone Program will be a vital resource in stimulating long-term economic growth and investment in cities and towns that need it most, and more importantly, in generating economic opportunities for our residents."*
>
> **– Phil Murphy, Governor of New Jersey**

> *"Opportunity Zones are an exciting new tool for building economic development in underserved communities. These grants will help guide us as we implement the program to maximize the benefits of job creation and neighborhood improvement in the most vulnerable areas of our city."*
>
> **– Keisha Lance-Bottoms, Mayor of Atlanta**

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