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How Philanthropy Can Ensure Opportunity Zones Ensure Widespread Economic Renewal

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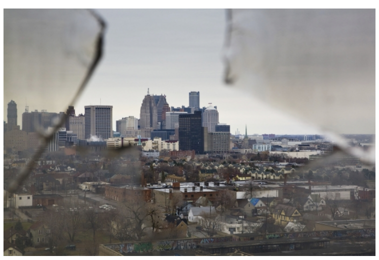

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The 2017 federal tax law got attention for many changes that affect charity donors and companies. But what was largely overlooked may be that the law is also one of the largest economic-development efforts in American history, potentially providing billions of dollars in private capital to neighborhoods where poor people live.

Here is how it works. The tax law allows investors to defer paying federal capital-gains tax on the sale of property if those gains are invested in a qualified opportunity fund, which then invests in low-income census tracts designated as Opportunity Zones.

The original capital-gains tax obligation is reduced the longer the investment remains in the zone. Taxpayers that hold investments for at least five years receive a 10 percent reduction in their original capital-gains tax; holding investments at least seven years adds a 5 percent reduction for a total of 15 percent. The real benefit: Holding an investment a full 10 years eliminates the need to pay any capital gains tax on the appreciation of the new investment.

The new tax break differs from other federal tax incentives in several ways.

First, it is more market driven; it does not use a federal or state agency to distribute the incentives but rather relies on the decisions of individual investors and the teams who manage investments in Opportunity Zones. Second, it can be used for a wide variety of projects — residential, commercial, industrial, infrastructure — rather than being restricted to the relatively narrow purposes of other incentives for low-income housing or historic preservation. Third, investors aren't required to achieve a certain outcome, such as job creation or local financial matches. What's more, investors face no caps on how much they can invest in exchange for an incentive.

The new Opportunity Zone incentive also differs from historic federal community-development efforts because it relies on equity investments rather than traditional debt and subsidy instruments. If put in place appropriately, these new tax incentives could integrate money from a disparate range of public and private sources rather than dispensing compartmentalized resources through traditional government programs. By tying the most substantial tax relief to investors who are prepared to stay for the long haul, the Opportunity Zone incentive provides an enormous impetus for financiers, states, localities, and others to work together to make sure there's a significant benefit for all involved.

The federal law provided only one explicit role for the states, directing governors to select Opportunity Zones from an eligible group of low-income census tracts. As of April 2018, governors in all 50 states, the District of Columbia, and Puerto Rico had designated more than 8,700 Opportunity Zones across the nation.

The law does not provide any guidance on the role of cities or localities. Yet cities in the broadest sense — local governments, private and civic institutions, community networks — will need to take meaningful action if Opportunity Zones are to spur growth that is inclusive, sustainable, and truly transformative for each city's economy.

A Key Role for Foundations

Given this perspective, it is clear that philanthropies have a critical role in helping cities realize the full economic and social impact of Opportunity Zones. Foundations often possess the prestige and stature needed to gather disparate players to deal with hard challenges and intriguing possibilities in their communities. They have the discretionary capital needed to make investments in community-development enterprises and other local institutions so these organizations can take advantage of Opportunity Zones. They also have the kind of capital needed to attract other investors: Foundations can tolerate more risk and take a long-term view. What's more, they have the respect for evidence-driven decision making that is conducive to catalyze, capture, codify, and communicate new norms and approaches as they emerge.

Philanthropies are beginning to play important roles as the Opportunity Zone market evolves. Following are the key ways they can make a difference:

Gather everyone with a stake in improving a poor neighborhood. Philanthropies can help cities organize for success by coordinating efforts involving governments, businesses, and leaders in other spheres. They can help everyone understand the potential of Opportunity Zones and lead people through honest conversations about what they can contribute and what they need. No one player is large enough or has sufficient resources or power to do all that is necessary to realize the full economic and social potential of this tax incentive. We must all work together in networks. The Arthur M. Blank Family Foundation, for example, gathered major government, business, and nonprofit leaders in Atlanta last December to consider how they, collectively and individually, could seize on the possibility of Opportunity Zones. This meeting has already driven a range of deliberate actions and strategies by city and metropolitan institutions.

Map out a region's assets. Foundations can finance the work needed to develop strong investment prospectuses for Opportunity Zones. That will enable cities, counties, and states to communicate their competitive advantages, spur local partnerships, and identify sound projects that are ready for public, private, and civic capital. To date, Los Angeles Mayor Eric Garcetti's Accelerator for America and I have worked with over 30 cities to develop investment prospectuses that show the real strengths of a region. Philanthropies can pay for outside expertise, specialized data collection and analysis, and the design of print and web-based marketing material. The Kauffman Foundation engaged national and local firms to help develop and promote an investment prospectus for Kansas City in close collaboration with the city government and leading private, civic, and community leaders and institutions.

Build markets. A philanthropic investment can fill the gap that arises between the amount of debt supportable by the project and available equity. This role — known in the finance world as concessionary capital — will be critical in projects in which the Opportunity Zone deal wouldn't otherwise make sense to investors. Rather than traditional grants to a city-supported cause, these impact investments can generate a return financially and a return socially and can be a substantial part of a foundation's general investment strategy as well as a program-related investment plan. The Kresge Foundation has been quite innovative in this type of investment, providing $22 million to two Opportunity Funds to mitigate risks and cover first losses in exchange for extensive accountability and disclosure agreements.

Empower local residents. Philanthropies can help residents who live in or near Opportunity Zones express their preferences, obtain skills, start businesses, and improve the quality of life in the neighborhood. As part of their broader effort to build an Opportunity Zone Investment Prospectus, the Kauffman Foundation funded several efforts to engage community residents in several neighborhoods that have long been ignored by financial institutions as well as identify neighborhood serving businesses that are prime for growth and expansion.

Bolster institutions. In many communities, local governments simply do not have the capacity or the professional expertise to design, finance, and deliver sophisticated programs that transform the local economy. In addition, many nonprofit organizations are either too small to bring systemic change or too limited in focus to make a far-reaching difference. Cities should use Opportunity Zones as a way to modernize and redefine their institutions to maximize economic, social, and environmental impact. To this end, the Erie Community Foundation has enabled the creation of a new organization, the Flagship Opportunity Zone Development Company, to be a one-stop shop for investors and project sponsors. The company is housed at the Erie Regional Chamber and Growth Partnership.

Encourage innovation. By using challenge grants and other mechanisms to encourage urban residents to devise pathbreaking ideas or coalesce to support neighborhood investment strategies, foundations can promote a reimagination of what's possible. The Bloomberg Philanthropies Mayors Challenge might be a model for others to follow. As currently designed, it "is a competition for city leaders that identifies and elevates next-generation solutions that have the potential to transform the way city halls work and improve the lives of citizens." Opportunity Zones are tailor- made for a version of this challenge that focuses on how to spread great new ideas.

Share information. The adoption of Opportunity Zones will be as much about codifying local norms and approaches as promulgating federal rules and guidance. Opportunity Zones are one of the first federal tax incentives to evolve Wikipedia-like from the bottom up rather than the top down. Philanthropies could provide additional support to regional and national organizations so they have the bandwidth to share information with key players in cities nationwide. Grant makers have a long track record of supporting groups that share knowledge and expertise in emerging parts of the economy, such as the American Council for an Energy-Efficient Economy and the Institute for Market

Transformation. The substantial support of MasterCard's Center for Inclusive Growth to advance the work of Accelerator for America is the best example of philanthropic leadership to make sure information about options is widely available.

The Opportunity Zone tax incentive has the potential to channel private capital to communities that have suffered from neglect by financial institutions and government. That potential will only be realized if philanthropies and other players help shape this new incentive so that it provides at least as much benefit to the public as it provides in private gain — if not more. Now is a key moment for philanthropies to stimulate economic growth for everyone who lives in places long left behind.

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