Summary of U.S. Conference of Mayors Opportunity Zone Call

November 20, 2018

On November 20, 2018, the U.S. Conference of Mayors (USCM) hosted an Opportunity Zones conference call led by USCM President, Mayor of Columbia, South Carolina, Steve Benjamin. The call featured a number of speakers who addressed Opportunity Fund development, Treasury and IRS regulations, and city marketing strategies for Opportunity Zones. A total of 186 people attended the call.

Mayor Benjamin reviewed USCM's activities to date on Opportunity Zones, including hosting Senators Tim Scott (SC) and Cory Booker (NJ), sponsors of the OZ provisions in the Tax Cuts and Jobs Act of 217 (TCJA), at the Winter Meeting; assisting cities in the OZ nomination and selection process; holding a major OZ briefing session at the Annual Meeting in Boston; submitting comments to Treasury/IRS; and meeting with Treasury Secretary Mnuchin in early September to encourage the Department to issue OZ regulations in an expeditious manner.

Below is a summary of the speakers' comments:

Rachel Reilly, Director of Impact Investing, Enterprise Community Partners

The first speaker of the call was Rachel Reilly, the Director of Impact Investing for Enterprise Community Partners, who spoke to updates on Opportunity Fund Development.

Sizing Interest from Opportunity Funds

Ms. Reilly noted that there has been upwards of $9 billion in announced capital raises throughout the nation for Opportunity Funds — however, Opportunity Funds don't need approval from agencies, Treasury, or the administration in order to operate, so there's probably a lot of undocumented additional activity that is happening. In addition, the capital raises are only announced, indicating interest and intent.

Ms. Reilly cited both Novagradac and NCHSA as organizations that created a list of 30-40 funds on their websites, although she has seen proprietary lists that have upwards of 60 funds. From the current list of funds, she noticed that their general theme revolves around real estate: most notably, multi-family residential, hospitality, and retail. Other points of interests, which were outliers in her research, included a fund that partners with public agencies and officials on redevelopment projects focused on transit-oriented development; a fund focused on defense technology startup; and two funds focused on solar and renewables.

Early Movers

Ms. Reilly highlighted three buckets of funds:
1. Financial institutions
2. Community development practitioners
3. Others

Financial Institutions
The first bucket of funds that Ms. Reilly highlighted was financial institutions. She discovered that

a lot of financial institutions are investing their own gains by establishing their own funds and assessing risk internally by not investing third-party capital. In addition, they are seeking legal opinions on whether Opportunity Zones investments are eligible for CRA credit. She believes financial institutions are taking this approach to build capacity and better understand Opportunity Zones in the early stages, and how to tie it to their private wealth platform further down the road.

She featured PNC for its project in South Bethlehem, Pennsylvania, by Lehigh University, through its redevelopment of a historic warehouse to housing and retail. She also referenced Goldman Sachs for its affordable housing in New York, grocery store in New Jersey, and investment in Baltimore.

Community development practitioners

Although community development financial institutions (CDFIs) are experienced in the field of funding, Ms. Reilly believes the real opportunity for them is in helping investors identify deals: identifying deal flow, helping source pipelines, then doing asset management on the ground.

Opportunity Funds are looking for deals in geographies and in asset classes that they may be unfamiliar with. They are seeking the best ways to identify deals, understand community dynamics and assess risk, and underwrite the investment using informed data points. At the same time, Community Development Financial Institutions are contemplating different ways to engage in the broader Opportunity Zones ecosystem. As financial intermediaries, CDFIs have successfully deployed and managed investor capital in distressed communities for three decades. CDFIs work with Opportunity Funds to facilitate deal flow by identifying investments, invest alongside Opportunity Funds, and mitigate risk through local asset management.

Ms. Reilly is also seeing CDFIs that are early movers on the ground. She highlighted LISC, which is working with Village Capital and Access Ventures to look at investing in businesses, including in Louisville, Kentucky. Her own organization, Enterprise Community Partners, is building out a fund platform around Opportunity Funds, which they will integrate into their policy work, as well as their data and on-the-ground technical assistance for their Emerging Communities fund. They are also working on a pipeline to their national fund.

Others

In the category of 'others,' Ms. Reilly highlighted the work of Fundrise, an online investment platform focused around the democratization of equity investment of real estate. They announced a $500 million fund for real estate, leveraging their online platform. Their fund is available to retail clients. Those investing with Fundrise can invest at low minimums, and they don't have to be accredited to invest — this will be an outlier in the market.

She also shared the example of Virtua Partners and Hotel Equity: they have partnered to do a $500 million fund to hospitality, and embedded in their model a focus on workforce training and mobility. In addition, Ms. Reilly noticed a lot of incubators thinking about creating their own funds, and one in particular: a mixed fund, or a mixed strategy for a fund around a real estate plus business approach. She also noted that businesses are planning and basing their expansion plans around Opportunity Zones themselves.

Philanthropy

Some national foundations and a number of local foundations have begun supporting communities and community development organizations. Thematically, areas of interest include: empowering community partners to create a local Opportunity Zone framework aimed at positive outcomes, building capacity of community leaders to engage the investors, and supporting fund managers to create high-impact products that appeal to investors. Early movers include Rockefeller and Kresge.

John Lettieri, President, EIG

The second speaker of the call was John Lettieri, the President of EIG, who spoke on updates on proposed Treasury/IRS regulations.

General Updates

The US Department of Treasury has released its first tranche of regulatory rulemaking. Mr. Lettieri explained this through a metaphor with a football field: the first tranche puts us on the 10- or 15-yard line. The latest proposed regulations are meant to deal with the lowest of low-hanging fruit to provide some basic definitional clarity, timing clarity, and other basic elements, so those Opportunity Zone projects which are most shovel-ready can move forward with some degree of confidence.

Unaddressed Questions

Mr. Lettieri expressed that most of the marketplace has questions that were unaddressed or not fully addressed by Treasury's proposed regulations.

There has been substantial success in developing a definition of 'substantially all' in the regulations, which means that 70% of operations of a qualified business must be within the zone, allowing 30% to be outside the zone. He stressed that this is particularly important because there are some business operations that, practically speaking, will not be able to take place entirely within the Opportunity Zone. There may be other operations that cross district lines. Providing this margin for error reduces the compliance, risk, and complexity to both businesses and investors, and avoids the big landmine of implicitly disincentivizing business investment.

He also spoke on the large degree of flexibility for real estate project-oriented investors through timing flexibility for how long subsidiaries of Opportunity Funds could hold working capital while developing a project. This is a timing and flexibility issue that is particularly relevant in a real estate-exclusive context: there may be some operating businesses that could take advantage of it, but it is much more oriented around the needs and questions Treasury has been receiving from real estate stakeholders. He acknowledged that there is nothing wrong with this move — however, it is also incomplete in terms of fulfilling the fundamental promise of Opportunity Zones, which is making it useful to businesses.

Concerns

Mr. Lettieri identified the most significant concern to emerge out of the regulations, which relates to a provision that was not in the statute and goes far beyond both statutory and congressional intent: a requirement that 50%, or most of the gross income of a qualifying Opportunity Zone business, has to be derived from activities within the census tract itself. He explained that this would exclude all but, practically speaking, a laundromat and a hardware store that don't sell online, and a restaurant that doesn't deliver outside of the zone — it could have all kinds of limiting implications for the vast majority of types of businesses that would be most primed not just to receive capital, but to improve communities and expand economic opportunity.

To Mr. Lettieri, this is of fundamental concern, and one that everyone should aggressively push back upon during the comment period. He also expressed that the requirement took everyone by surprise. He pushed on needing to make voices heard very clearly as to the implications of this provision and its dramatically limiting effects on the benefits of Opportunity Zones in the targeted community.

Capitol Hill and Opportunity Zones

Mr. Lettieri closed with reminding mayors that this is an important time to weigh in not only with Treasury and the IRS, but also with Capitol Hill as well, especially because there is an incoming crop of legislators, and it is important that they understand how important Opportunity Zones are to communities around the country. He recommended to those thinking about weighing in to Treasury and IRS during this comment period, to also consider doing the same with this new crop in Congress.

He added that Congress is seeking anecdotes from back home as to how Opportunity Zones are playing out in different communities. He believes that positive stories have not been told yet in the media, and that there is a lot of misconception about the program, fueled by the fact that it is pre-regulatory and pre-market clarity. He indicated there has been just a trickle of activity, so far, relative to the actual interest and potential. He stressed that people need to do everything they can to ensure that people understand both the potential impact and necessary direction that this should take that fulfills congressional intent.

Andrew Ginther, Mayor of Columbus, Ohio

The third speaker of the call, Mayor Andrew Ginther of Columbus, Ohio used personal experience to discuss working with businesses on Opportunity Zones.

Opportunity Neighborhoods in Columbus, Ohio

Mayor Ginther began with sharing an update on his work in Columbus, Ohio on what they call Opportunity Neighborhoods: he touched upon working closely with the county government and the private sector to come up with core factors in his Opportunity Zone work and focusing on neighborhoods and needs. He emphasized the focus on finding opportunities for job growth, and census tracts that will have medium- to large-scale projects that can absorb the investment that they are contemplating, and also having them align with the region's high priority transit corridors.

Mayor Ginther explained that Columbus chose to focus on these Opportunity Neighborhoods, as opposed to just downtown, because although most of the community is doing better than they ever have before, most of the Opportunity Neighborhoods have been left out of the success story of the community and so they are a top priority in the administration.

Working with Businesses

Mayor Ginther explained how he has begun working with businesses on Opportunity Zones, receiving calls from developers as soon as the program was announced. His economic development division has been in contact with interested investors along the way, and has developed detailed breakdowns of the Opportunity Zones, including existing project opportunities, potential partners, local transportation, and infrastructure information.

His team knew they would have interest from local developers, based on the collaborative nature of their census tract selection, but they have also been approached from many out-of- state interests. They have already spoken to hundreds of businesses about their Opportunity Zones — about 70% local and 30% out of town. In addition, they have been conducting a lot of community and neighborhood outreach around Opportunity Zones so the residents of Columbus have the opportunity to learn more about what the program can do, but also what it cannot.

Mayor Ginther stressed the importance of keeping the focus on their residents and the quality of life in their neighborhoods. Even though the program provides a great tool for investors to develop new products in cities, their focus remains on making sure they leverage those products in a way that create new opportunities for residents and contributes to the upward mobility of the individuals and families living in and around their Opportunity Zones. To him, keeping the focus on people and not just projects is key.

Greg Fischer, Mayor of Louisville, Kentucky

Mayor Greg Fischer of Louisville, Kentucky followed up Mayor Ginther by further giving examples of working with businesses in his own city.

Marketing Opportunity Zones

Mayor Fischer began by emphasizing the need to start focusing on marketing and telling a city's story, from a mayor's standpoint, then determining how the mayor can lead the development that is taking place in their cities. Referencing Louisville's prospectus on marketing Opportunity Zones, he explained how a prospectus is simply telling a compelling story to interested investors that will be from all over the country. He mentioned it was important to tell the macro story of a city in terms of its identity and uniquenesses, but then drilling it down to micro-projects.

Making Social Impact Attractive

Mayor Fischer believes that cities should skillfully guide people to investments that will be good for cities versus what businesses may be interested in. From personal experience, he has seen a combination of pure venture capital deals and social impact investing. He explained that there are individuals who are purely interested in the maximum return on their capital, and although their purpose is understandable and beneficial for capitalism, cities themselves are more interested in investments that have a social impact within the Opportunity Zone.

Mayor Fischer further explained that his city is looking for businesses whose deals might not pencil out to the maximum return on capital, but are going to give the maximum return on creating opportunities in the city such as creating income in that Opportunity Zone and leaving wealth in the zone — he is not interested in people coming in and making an investment just to have it all accrue to themselves then leave, which leads to further mistrust in communities.

To make social impact investing more attractive to companies, Mayor Fischer suggested that many cities already have the tools they need, such as the development of infrastructure to make a project happen (roads, sidewalks, transit enhancement), and affordable housing tax credits, low-income tax credits, or historic tax credits. While stacking all of these on top of each other to make the deal feasible, cities can combine them with Opportunity Zone investing to send a positive message to social impact investors. Additionally, cities can put the emphasis on hiring local residents, having local participation in the equity stack of local investment, and turning that in over a course of years. He stressed the ultimate goal is to bring creativity to projects so that when transactions are liquidated, part of that wealth stays in the community to regenerate neighborhoods without displacement.

The Role of Foundations

Mayor Fischer finished by touching upon the role of foundations in Opportunity Zones: currently, foundations can play a role in locating good projects and possibly providing some initial funding or enhancements. He introduced the idea of foundations becoming involved with some of the more difficult projects that are "for-profit" social investing. Although most of the country is still figuring out the role of foundations in Opportunity Zones, Mayor Fischer encouraged everyone to share different strategies that they see happening in their communities as time goes on.

Bruce Katz, Director, Norwak Metro Finance Lab, Drexel University

The last speaker on the call, Bruce Katz, explained how he has helped develop an Opportunity Zone prospectus for a small number of cities which can be used as an example by others.

Investment Prospectus

Mr. Katz explained the beginnings of his project, when he and his colleague Jeremy Norwak were asked by Accelerator for America to invent an investment prospectus to help cities communicate their assets and advantages both at the urban and metro level, but more importantly, in different kinds of zones. He explained that currently, Erie and Louisville are the first cities that are out with an investment prospectus, and that Oklahoma City, Stockton, and South Bend will have prospectuses out by December.

With Accelerator for America, Mr. Katz is developing prospectus guides that will help any city put the rudiments of a prospectus together. Adding to what Mayor Fischer said, he reinforced the idea that this is not just a prospectus to attract or raise tax advantage capital from the federal legislation, but rather a prospectus that helps cities organize their actions in a particular way and also unlock philanthropic and other forms of capital to make deals happen.

Typology Zones

To Mr. Katz, it is clear that different kinds of sub-geographies of cities have been designated as zones: many cities have designated their central business district, some hospital districts, some university districts, many industrial districts, particularly around airports and ports, and then many, low-income neighborhoods. These are different kinds of typologies of zones, and they will yield different kinds of market demand and different kinds of product. He and his team will also identify the typology of zones across the county. He anticipates that funds may actually begin to aggregate around different types of zones.

Steps Cities Can Take

Recently, Mr. Katz and his team have put out a paper on 10 steps cities can take to increase employment density; assess public assets, publicly owned land and buildings; align other resources and incentives; and identify the kinds of institutions that exist in low-income neighborhoods or even in central business districts.

Consistent with Ms. Reilly's and Mr. Lettieri's comments, he is hoping by the first quarter of next year to have 50 prospectuses completed. These prospectuses will enable cities, both individually and collectively, to navigate the markets, negotiate with investors, and have a sense of economic and social benefits.

Q+A

Question (from Mayor Robert Reichert of Macon, Georgia): Is the intention of the Conference of Mayors to collect all of these different prospectuses and publish them there? How can we spread a prospectus once we prepare it?

Answer (Mayor Benjamin): USCM is sure we can share them. Because of the early work that Bruce referenced, Mayor Fischer has been very generous in sharing his prospectuses. USCM will collect and share those which are made available from Mayors across the country.

Question (from Mayor David Alvey of Kansas City, Kansas): What talking points would the Conference of Mayors want us to take to our congressional delegation concerning the provision that states 50% of the gross income of a qualifying Opportunity Zone business has to be derived from activities within the census tract?

Answer:

(John Lettieri) EIG is happy to work with USCM closely on that messaging and making sure that key information gets to the right recipients. From EIG's standpoint, the fundamental message is that this is a rule that will inadvertently exclude a number of the most high-potential operating businesses within the zones, and create an explicit bias towards real estate that is fundamentally at odds with the purpose of the statute.

(Dave Gatton - USCM) It's even fundamentally at odds with the 70% substantially all test, which they put in the proposed regulations designed to encourage investments in business development, not just real estate development. The real estate development is the easy nut to crack here, but how you get investment into Opportunity Zone businesses is more difficult. When the mayors met with Secretary Mnuchin, Mayor Benjamin and Mayor Duggan of Detroit made the point that we need investment in actual businesses, and the regulations need to be designed with that in mind. On the "substantially all" 70% rule, Treasury moved our way. When we met with the Secretary, I think it's safe to say they were leaning toward the 90% number. The draft regulations came in at 70% of a business's tangible property must be qualified OZ business property. So Treasury clearly wants to see investment in businesses. We just need to make the strong case that the 50% income test will inhibit that investment and, therefore, merits changing.

(Mayor Benjamin) People on this call are going to have to make sure that the new members of Congress understand that this is something that's important to all of us.

Question (from the City of Seattle): Could someone speak to the 31-month rule after property acquisition?

Answer (John Lettieri): The 31-month rule is to provide as long a runway as Treasury feels they have the statutory authority to provide to allow for projects with a longer lead time to have a runway to draw down capital. The fundamental requirements are the subsidiary entity of the fund has a plan for how it's going to deploy the capital, and that it demonstrates it's taking all necessary steps to meet that plan. It allows them to draw those funds down over a longer period of time. So, I think, a lot of the details still remain to be colored in, because it's just one of the interlocking series of related issues. This should allow for more flexibility and more creativity in the financial structure. It was certainly meant to provide that kind of incentive on the project side, but again, it's still early.

In conclusion, Mayor Benjamin encouraged participants to send information on their Opportunity Zone work to U.S. Conference of Mayor staff Dave Gatton dgatton@usmayors.org.

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