# MEMORANDUM

**TO:** Mayor and City Council

**FROM:** Rebecca Giello, Interim Director
Economic Development Department

**DATE:** May 17, 2019

**SUBJECT:** Response to City Council Resolution No. 20181018-039
Recommendations for City Actions to Use Opportunity Zones to Leverage Council Goals

The purpose of this memorandum is to revise the May 16, 2019, memo to clarify that on page 11 of the report under Recommendations and Leveraging Opportunities, a wording change has been revised on the last sentence of the first paragraph to clarify that staff is recommending 4, not 5 as previous memo stated.

This memorandum, and the attached Report, serves as a response to City Council Resolution No. 20181018-039 seeking recommendations for leveraging available incentives and City resources to encourage responsible investment resulting in the improvement of the quality of life for City of Austin residents living in the communities in and around Opportunity Zones.

The Opportunity Zone Program was created by the 2017 Tax Cuts and Jobs Act. The Opportunity Zone tax provisions provide investors the ability to re-invest capital gains into projects located in designated census tracts to decrease and defer tax liabilities. On March 21, 2018 the Governor submitted the State's Opportunity Zone designations to the US Treasury Secretary. These designations include four census tracts submitted by the City of Austin. On June 14, 2018, the US Treasury Secretary designated these four census tracts as Opportunity Zones, thereby initiating a 10-year designation period for investors to benefit from this tax program. A map of the designated Opportunity Zones within the corporate city limits of Austin can be found at http://austin.maps.arcgis.com/apps/webappviewer/index.html?id=e49000a25cf749b88c4be0c6730fe621.

Per Resolution No. 20181018-039, such recommendations will take into consideration the following:

- The development of a program to encourage and oversee responsible development in Opportunity Zones located in Austin;
- The expressed needs of Austin residents in and around Opportunity Zones that can be addressed through private investment in their communities, Including and particularly the need for accessible and affordable high-quality grocery store options;
- Any additional engagement strategies needed to understand residents' needs

throughout the life of the Opportunity Fund investments;

- Existing and proposed economic incentive programs or tax credits available to investors in Austin that can be used in conjunction with Opportunity Fund investment;
- Approaches considered and enacted by other local jurisdictions and states;
- Analysis of the capacity of financial institutions serving the Austin area to establish and certify Opportunity Funds;
- Incorporation of any additional guidance that may come from relevant regulatory agencies or legislation; and
- Identification of need for additional regulatory guidance from the federal government to ensure the effective use of Opportunity Funds to realize the needs of Austin residents

City staff made the recommendations contained in the Report based on analysis and research of national and local best practices which were applied contextually to Austin. The recommendations encompass a range of municipal responses from monitoring the development of Opportunity Zone projects to actively engaging with an Opportunity Zone Fund to invest in projects that meet Council objectives. City staff seek Council direction on the extent to which the City should proactively encourage and market projects to Opportunity Zone Funds. In the meantime, City staff will update the City's website to provide baseline information on Opportunity Zones. In addition, City staff will continue the development of a local incentive policy that more directly facilitates the delivery of community beneficial development investment through Resolution 20180830-058 addressing the Location Based Chapter 380 Incentive Program.

Please feel free to contact me with further questions at 512-974-3045 or Nicole Klepadlo, Redevelopment Project Manager at 512-974-7739.

xc: Spencer Cronk, City Manager
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# Response to City Council Resolution No. 20181018-039
# Recommendations for City Actions to Use Opportunity Zones to Leverage Council Goals

## Introduction

In order to provide recommendations regarding how the City can use the Opportunity Zone (OZ) tax provisions to encourage community beneficial investment, Staff explored key elements of the tax provision and how these elements influence investors. The OZ tax provision provides no explicit role for local government whose jurisdictions encompass OZs. However, cities have sought to find ways to encourage OZ Funds to invest in priority projects, specific types of development, and targeted industries. This Report outlines the best practices of other cities and the approaches used to encourage investment and provides recommendations for City Council consideration. The Report specifically addresses the eight (8) considerations taken from Resolution No. 20181018-039.

## Tax Provision Overview

The OZ tax provisions in the 2017 Tax Cuts and Jobs Act (Act) provide capital gains tax incentives for investments made in designated OZs. The Act allows capital gain tax incentives for both capitalizing Qualified Opportunity Zone Funds (QOZ Funds) and then deploying QOZ Fund capital into investments located in OZs. The QOZ Funds may make investments in residential and commercial real estate, and business development initiatives in an OZ. The Act reduces and defers capital gains tax liability on money invested in QOZ Funds and then potentially eliminates capital gains tax liability on gains made from QOZ Fund investments, pending investments meet timing thresholds. The Act identifies two (2) goals to influence investment decisions:

1) To encourage investment in these designated "low income communities" that have not seen private equity investment coming out of the Great Recession, particularly in the country's rural communities; and,
2) To spur investment in new business formation and expansion that diversifies the economy and creates jobs and housing opportunities in "low income communities."

The Act allowed governors of each state to nominate no more than 25% of the state's low-income census tracts as defined by federal requirements. Staff provided the Mayor and City Council with the IRS rules regarding OZ designations in a Memorandum dated March 9, 2018. In order to meet the minimum criteria for OZ designations, City-nominated census tracts have the following characteristics:

a) 20% of the population within the census tract lives in poverty; or
b) The annual median family income of the census tract is 80% or less than the State's annual median income.

During the nomination process and selection, the Governor established the following additional designation criteria below:

a) Chronic unemployment;
b) Lower population density; and/or

c) Significant economic disruptors within the past two years (i.e. natural disasters).

The Governor allowed public and private entities to make nominations of census tracts during a two-week nomination period. It was during this time that the City nominated four (4) census tracts located in the southeast area of the City. The Governor nominated an additional seventeen (17) Census Tracts within the City's corporate limits.

Most designated census tracts are located to the east of the Interstate 35 corridor. Please see **Exhibit A – City of Austin Opportunity Zones** to review designated census tracts and the City limits.

## Investor Motivation

Determining how the City can use OZs to encourage investment in ventures that accomplish City policy and stated community benefits requires understanding how the OZ tax provisions influence investment decisions. The preferred tax treatment provisions are intended to motivate investors to invest capital gains in QOZ Funds and to retain that investment in the QOZ Fund over a 10-year time horizon. The longer the investor retains the initial investment in the QOZ Fund, the greater the reduction in taxes the investor would otherwise have had to pay on the investor's capital gain. The following tax benefits and their deadlines constitute the key motivators for potential investors:

- **Incentive lifespan** - The US Department of Treasury designated OZs in 2018. The Act limits the life of OZs to 10 years. Thus, all OZs will expire on **December 31, 2028.**

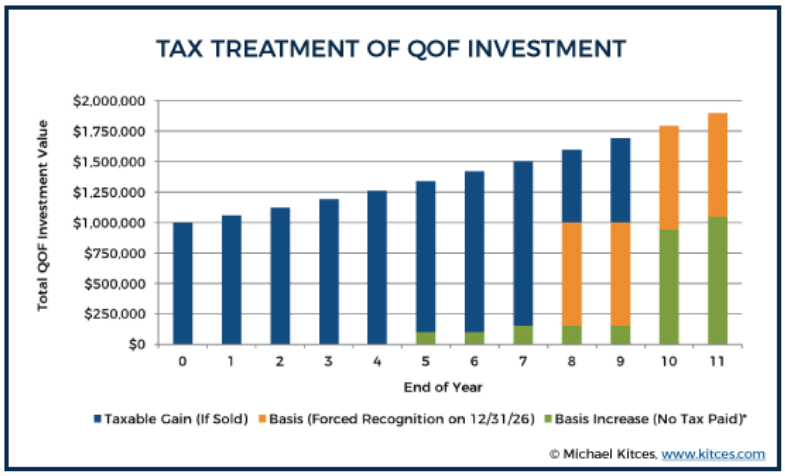
- **Temporary Tax Deferral** – An investor may defer recognizing capital gains tax liability if the investor reinvests into a QOZ Fund within 180 days of the initial sale of the capital asset. The capital gains tax liability must be reported on whichever occurs first: the date the investor exits the QOZ Fund or **December 31, 2026.**

- **Step-Up in Basis**– An investor may realize a step-up in basis for the deferred capital gains on the original funds invested in the QOZ Fund, if the investment in a QOZ Fund meets investment timeline thresholds. A step up in basis equates to a reduction in capital gains tax. The basis is increased by 10% if the investment in the QOZ Fund is held by the taxpayer for at least 5 years, and an additional 5% if held for at least 7 years, thereby excluding up to 15% of the original deferred gain from taxation. To receive the 15% tax exclusion, an investor would need to invest in a QOZ Fund no later than **December 31, 2019**.

- **Permanent Exclusion** – An investor may permanently exclude from income capital gains realized from the sale or exchange of an investment in a QOZ Fund if the investment is held for at least 10 years. This exclusion only applies to gains accrued from investments made through the QOZ Fund. There is no permanent exclusion possible for the initial deferred capital gain. Proposed IRS Regulations state that the 10 year holding period in the QOZ Fund can extend after the expiration of the OZ on December 31, 2028.

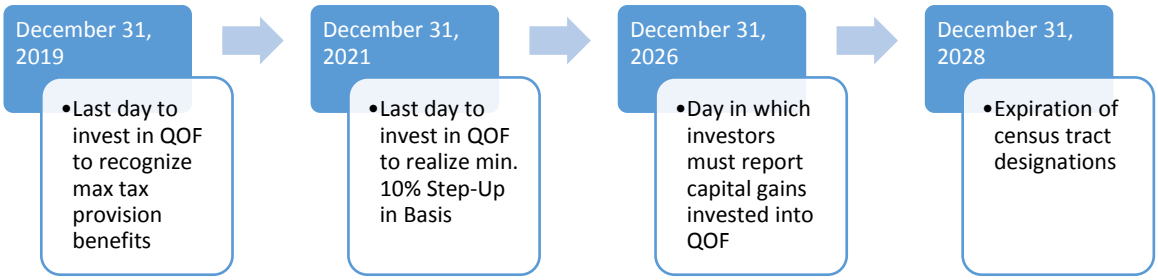
**Chart 1:** Tax Treatment of QOF Investment

Chart 1, to the right, represents the tax treatment of a QOZ investment of $1,000,000 and demonstrates the incentives if the investment if held for 10 years.




The following timeline outlines dates specific to the step up in basis that are provided within the existing guidance of the OZ Program and serve as the framework for recommendations and leveraging opportunities as Council requested in Resolution No. 20181018-039.

Chart 2: Tax Provision Deadlines




## Approaches enacted by Other Local Jurisdictions and States

Cities and states are challenged in engaging directly in QOZ Fund creation or directing investment of QOZ funds. The Internal Revenue Service (IRS) guidance and statutory law authorized state and local governments to nominate census tracts for OZs. The authority to invest in OZs and the ability to obtain benefits from those investment in OZs appear to be left to the private sector. Staff research on best practice at a national, state, and local level validates this understanding and provides guidance on the available range of City Council action underpinning the recommendations that follow.

To understand how peer cities have responded, Staff conducted best practice internet research and reached out to cities messaging activity in this space. Additionally, Staff attended the Texas Opportunity Zone Summit presented by the Federal Reserve Bank of Dallas and several webinars led by leadership councils such as the National Development Council, African American Mayors Association, and Urban Land Institute. Staff researched best practices and conducted interviews with communities, investors, real estate developers, and other partners to form recommendations. The Section below summarizes that research.

*State Context*

Nationally, the most comprehensive state legislation proposed has been developed by the State of Maryland, where the legislature is considering approximately $52 million in funding for task

force development, fast track development strategies (expedited permitting), tax incentives/tax credits for creation of new jobs, redevelopment of workforce development programs, incentives specific to cyber and life science industries, housing development, and the creation of an information exchange website to track projects, locate businesses, and provide incentive information. In Texas, during the 86th Regular Session, Legislators have introduced bills to provide state incentives within designated OZs[1]. Staff has not found any statewide statute or approach in which cities can operate OZs or QOZ funds.

*Local Government Response*

Staff researched and reviewed OZ approaches from Texas and other municipalities. Research focused on municipalities that met similar size and market contexts, as well as municipalities that have implemented comprehensive OZ strategies. *Chart 3: City Approach Best Practice Summary* below captures the results of the best practice research based on the extent to which municipalities attempt to influence QOZ Fund investment decisions.

| City | State | Baseline | Mid-Level | High |
|---|---|---|---|---|
| Austin | TX | x | x | |
| Dallas | TX | x | | |
| El Paso | TX | x | | |
| San Antonio | TX | x | | |
| Indianapolis | IN | x | | |
| Birmingham | AL | x | | x |
| Louisville | KY | x | x | |
| Memphis | TN | x | | |
| Minneapolis | MN | x | | |
| Oklahoma | OK | x | x | |
| Phoenix | AZ | x | | |
| Seattle | WA | x | x | |
| St. Louis | MO | x | x | |

| Baseline |
|---|
| OZ Census tract maps |
| OZ Basics |
| Federal resource links |
| Press releases and media |
| Internet links and contact |
| **Mid-Level: Prospectus** |
| OZ Basics |
| City goals |
| Demographics |
| Community assets |
| Specific projects seeking funds |
| Interactive maps |

- **"Baseline level":** Cities provide information on their websites as a means to educate the public and QOZ Fund managers equally on OZs in their jurisdiction. The majority of all benchmarked cities fall within this "Baseline" category.
- **"Mid-level":** Cities develop mechanisms to directly influence QOZ Fund investment Decisions. The most common is a municipality issues an investment "prospectus" that features specific projects ready for QOZ Fund investment. The City of San Antonio has assembled a technical working group, which serves as liaisons and subject matter experts within various City and State Departments to guide and support OZ projects. Additionally, the City of San Antonio created an external advisory group of representatives from Community Development groups, developers, investors and real estate professionals to serve as a sounding board to ensure city strategy is informed by stakeholder needs.

[1] Senate Bill 826 and companion House Bill 826 address the development of an insurance tax credit program for investments made in rural or designated OZs to be administered by the Governor's Office of Economic Development. House Bill 2397 relates to the development of a sales and use tax refund as well as franchise tax credit for certain businesses that make investments in designated OZs to be administered by the State of Texas Comptroller's Office.

- **"High level":** A municipality that directly manages or directs OZ Fund investment would fall under this category. To date, Staff has identified only one municipality (Birmingham, AL) that is seeking to establish its own QOZ Fund as a place for investors to reinvest their capital gains. Staff has not secured confirmation by the date of issuance of this Report as to whether Birmingham has been successful in the development of this Fund.

Based on research, the most common best practice by municipalities has been under the baseline approach, which provides basic information on geographic locations and OZ programmatic information. The development and adoption of the investor prospectus is becoming more common across the nation with its ability to serve as a general informational guide on cities and OZs as well as incorporating research on economic market conditions specific to their geography.

*Austin Context relative to Peer State and National Cities*

The OZ tax provisions treat all OZs equally regardless of rural, urban, or suburban settings, and of current market context within the OZs. However, QOZ Fund investors may perceive certain OZs to be more attractive to place QOZ Funds based on local and current market context. Any QOZ Fund can invest in any OZ regardless of where the OZ Fund manages daily operations. Thus, current local market conditions in an OZ can significantly influence the attractiveness of QOZ Funds to seek projects in that OZ. Austin's market context differs significantly from that of its peer cities that have OZs: its economy overall is one of the strongest in the nation and the majority of census tracts fall within federal definition of "urbanized area."

Contrast this profile with the majority of OZs nationally and in Texas that are partially or fully located in rural areas[2]. Interviews with the investment community indicate that Austin attracts a significant amount of capital relative to national and state peer cities. Rural areas have historically been at a competitive disadvantage to urban areas in attracting capital. Best practice demonstrated that rural cities have taken a more aggressive stance to market QOZ Fund investment into their communities than urban areas that face other market challenges.

At issue, therefore, is whether the local needs of the community in specific OZs in Austin can attract the types of investment to bring them to fruition. Most importantly for the purposes of addressing the Resolution, is whether QOZ Fund capital is the type of capital that can address those needs or whether other types of funding resources are needed. The next section addresses these questions and serves as the foundation for recommended City Council action.

## Opportunities to Leverage Opportunity Zone Designation in Austin

*Desired Community Benefits in Austin Opportunity Zones*

Numerous Council-approved policies predicated on significant stakeholder input provide clear guidance as to what community benefits Council seeks to achieve in locations that have designated OZs. Staff looked to those Council-approved documents as vetted sources of expressed needs for the purposes of this Report. The following policy documents are foundational to community expression of need that can be leveraged through appropriate private investment:

[2] Opportunity Zones in Texas: Promise and Peril, https://www.dallasfed.org/cd/pubs/opportunity.aspx

- Imagine Austin Comprehensive Plan: https://www.austintexas.gov/imagineaustin
- Adopted Neighborhood Plans: http://www.austintexas.gov/page/adopted-neighborhood-planning-areas-0
- East Riverside Corridor Small Area Plan: http://www.austintexas.gov/sites/default/files/files/Planning/erc_final.pdf
- Lamar / Justin Lane Transit Oriented Development Plan: http://austintexas.gov/sites/default/files/files/Planning/Urban_Design/Lamar-Justin_Final_SAP_Lo_Res.pdf
- Austin Strategic Housing Blueprint: http://www.austintexas.gov/sites/default/files/files/Housing/ASHBI_Book_2_4_19_FINAL_VERSION.pdf
- City Council Resolutions related to Music and Creative Ecosystem stabilization: https://www.austintexas.gov/sites/default/files/files/Music_and_Creative_Ecosystem_Stabilization_Recommendations__June_2016_.pdf
- Healthy Food Access Initiative: http://austintexas.gov/sites/default/files/files/Sustainability/07-27-16_Memo_to_MC_re-_Response_to_Food_Access_Resolution_20160303-020_....pdf
- Chapter 380 Incentive Policy: http://austintexas.gov/department/business-expansion-incentive-program
- Austin Strategic Direction 2023: https://austinstrategicplan.bloomfire.com/posts/3301043-austin-strategic-direction-2023-final
- 2016 Mobility Bonds: https://data.austintexas.gov/stories/s/2016-Mobility-Bond/9krn-a66r/
- City Council Resolutions governing the desired use of City-owned land in OZs: http://www.austintexas.gov/edims/document.cfm?id=310155

Some of these policy documents address community needs specifically tailored to a particular geography, such as small area plans or plans predicated on fulfilling unmet needs in certain parts of Austin that have low access to important needed community goods – employment offering a living wage, healthy food retail, affordable commercial space for creative businesses, quality affordable housing and neighborhood serving retail. *Chart 4: City of Austin Opportunity Zone Policy Alignment* provides a crosswalk between the designated OZ and the adopted policy document geographically aligned with the OZ.

Other policy initiatives, particularly the recently adopted Chapter 380 Incentive Policy, clearly identify community beneficial ventures that merit incentive support regardless of geography. All Opportunity Zones would benefit from the establishment or growth of these types of ventures. **Exhibit B - Expressed Community Needs Suitable for Private Investment by Council Policy** in the appendix to the report provides an enumeration of the general community benefits that the City seeks the private sector to deliver in exchange for City support.

Widely expressed community concern over the displacement of Austin's lower income residents and small businesses has significantly influenced recent policy development, particularly evident in the Chapter 380 Incentive Policy and the Strategic Housing Blueprint. Locally and nationally, there is a concern that OZ capital may propel projects catering to more affluent income classes in areas already witnessing gentrification and displacement, thereby exacerbating the problem. The University of Texas Report, *Uprooted (2018),* has identified areas vulnerable to

gentrification and displacement. The UT Report analyzes census tracts and assigns a type of gentrification as it relates demographic changes to the census tract, average residential value, and expected appreciation, over a five-year period from 2011-2016.

Exhibit C - City of Austin Opportunity Zones – Gentrification Study, illustrates the alignment of OZ designation with the UT Report's assessment of the likelihood of gentrification (defined in Chart 3 below).

**Chart 4: City of Austin Opportunity Zone Policy Alignment**

| | | | | | | | | | | Status of Gentrification | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Council District | Census Tract | Imagine Austin Center | Imagine Austin Corridor | Neighborhood Plan | Sidewalk Master Plan | E. Riverside Corridor Small Area Plan | Lamar / Justin Lane TOD Plan | Healthy Food Access Initiative | Strategic Housing Blueprint | Susceptible | Early Type 1 | Dynamic | Not Available or Present |
| 1 | 21.11 | X | X | | | | | | X | | | X | |
| | 22.09 | | | | X | | | | X | | | | X |
| | 21.12 | | X | X | | | | | X | X | | | |
| | 21.09 | | X | X | | | | | X | | X | | |
| | 21.06 | | X | X | | | | | X | | | | X |
| | 18.32 | | X | | | | | | X | | | | X |
| | 18.42 | X | X | | | | | | X | | | | X |
| 2 | 24.35 | X | | | X | | | X | X | | X | | |
| | 23.19 | | | | X | | | | X | | | | X |
| | 24.27 | | X | | X | | | | X | X | | | |
| | 24.33 | X | | | X | | | X | X | X | | | |
| | 24.32 | X | X | X | X | | | X | X | X | | | |
| | 24.36 | | | | | | | X | X | | | | X |
| | 24.11 | X | X | X | X | | | | X | X | | | |
| | 24.1 | | X | X | X | | | | X | X | | | |
| | 24.13 | | X | X | | | | | X | | | | X |
| 3 | 23.12 | X | X | X | X | X | | | X | | X | | |
| | 23.07 | X | | X | X | | | | X | X | | | |
| | 23.13 | X | X | X | | | | | X | X | | | |
| 4 | 18.04 | X | X | X | | | X | | X | | X | | |
| 5 | 17.12 | X | X | X | | | | | X | | X | | |

The City's nomination of only four (4) out of the twenty-one (21) designated OZs stems from the dual concern over the impact of OZ designation on exacerbating gentrification and displacement and on the City's ability to influence QOZ Fund investment in community beneficial projects. The four (4) census tracts highlighted in Chart 4 in yellow are in need of investment directed specifically to deliver a full-service grocery store that would carry everyday household goods in addition to healthy food. City Council advanced the nomination of these four (4) census tracts due to minimal existing evidence of displacement but absence of healthy food choice. Other designated OZs are characterized by different local market dynamics.

*Desired Outcomes from the Investor Perspective*

Through discussions with developers, real estate professionals, and land owners the specific challenges that are influencing decisions of investors to invest into OZs have been identified for the Austin context.

- *Austin Development and Permitting Timelines:* As investors evaluate OZ's, markets and projects in which they anticipate deploying capital, timing considerations specific to City operations around development timelines and permitting approvals may delay or prohibit projects from accessing full program benefits and meeting the milestone dates outlined in the IRS guidance. Feedback received shares that the current Austin development and permitting timeline is prohibitive to the OZ Program and investor's interest in investing or providing responsible development or specific community benefits. The outcome of many discussions also revealed that current timelines exceeding eight (8) months for development and permitting approvals have deterred investors from City of Austin OZs. Concerns regarding these potential delays attributable to waiting on government action, were addressed in the release of additional guidance on investments, on April 17, 2019. In response to the need to deploy working capital within a 31-month safe harbor, additional time will be granted to QOFs who can demonstrate delays in deployment of funds due to governmental action, with no penalty.

- *Perception of Risk and Required Rate of Return:* Research has noted that the presence of a project in a designation OZ does not lower the perception of risk – and therefore the need for a competitive rate of return. Other factors, including the adequacy of area-serving infrastructure, proven market support for rent to cover high construction and land costs, and market competition, drive return requirements of capital, including privately managed QOZ Funds. The Act does not require QOZ Funds to offer a higher rate of return. Therefore, QOZ Funds behave much like private equity funds that have focused locations for investment.

- *Combining QOZ Funds with Existing Federal Tax Credit Programs.* A specific project can layer QOZ Fund equity investment with other state, federal and local investment vehicles. However, QOZ Funds must invest directly in an OZ project. Eligibility requirements for OZ designation mirror census tract eligibility for New Market Tax Credit investment and target areas for US Department of Treasury Certified Development Entities, including Community Development Financial Institutions (CDFIs). There are a number of CDFIs that actively finance projects in Austin: https://ofn.org/cdfi-locator.

- *Linking Projects Seeking Capital with Capital:* Linking community beneficial projects in need of capital to the appropriate sources of capital remains a barrier, according to interviews and stakeholder input through the Chapter 380 Policy development process. Certain QOZ Funds do possess a social mission and as a result, generate lower rates of return. A brief inspection of QOF Funds found on the internet appear to indicate that social benefit funds are the exception and not the rule. QOZ Funds are not required to disclose any information to the public. Projects seeking QOZ Fund capital from more socially guided QOZ Funds demand time and effort to identify from what QOZ funds choose to publicly disclose. State and municipal governments will need to robustly engage investors that align with specific community benefits to determine partnerships critical to making responsible development and community benefits a reality.

Extensive input from the development of this policy indicates that encouraging the private sector to deliver projects that provide community benefit requires incentives that lower the overall cost of development, enabling the private sector to achieve a market rate of return relative to the risk. Projects that deliver community benefits require capital that is low cost and more "patient"

in how much time it takes to realize a return on the investment. Public participation in community beneficial private sector led projects lowers the overall cost of capital and makes community beneficial projects viable in Austin's strong economy.

## Recommendations and Leveraging Opportunities

OZ investment is occurring without government intervention or strategy. To influence QOZ Fund investment decisions within the tight statutory deadlines outlined in the Act, state and local government response needs to be quick, innovative, and easy to implement to meet approaching deadlines. The recommendations are classified according to the two (2) categories legally permissible to Texas cities and that conform to national and state best practice: baseline (information sharing) and mid-level (influencing QOZ Fund investment decisions). At a minimum, Staff recommend proceeding with Recommendations 1- 4 and seek Council guidance on additional recommendations outside of those in this report.

### *A. Baseline Approach: Information Sharing and Education*

1. *Continued Best Practice Exploration:* Continued efforts in engaging with communities and participating in educational webinars and or events on OZs will ensure that the City is on pace with other cities and their efforts currently underway. Staff would continue to meet with developers, investors, and cities, and will continue to monitor how local communities can favorably influence QOZ Fund investment decisions.

2. *Creation of a Website with general OZ information:* Staff can provide general information and education materials to the general public, QOZ Fund investors, and local projects seeking QOZ Fund investment. Education of and communication with the community ensures transparency of the City's response to this evolving OZ program. Specific Staff actions would be to:
   - Create a web page on OZs that contains basic information on the OZ tax provisions, recent IRS guidance and rules, local news related to OZs, links and references to general information on active QOZ Funds, and maps of designated OZs in the City of Austin.
   - Conduct educational webinars, specifically targeting residents and investors. An outline of the webinar content can be found as Exhibit D - Opportunity Zone Background Presentation.

### *B. Mid-Level Approach: Influencing Investment Decisions*

3. *Identify and make more visible to potential QOZ Fund investors potential OZ projects: S*taff can take a proactive role in influencing QOZ Fund manager decision making and linking potential local projects with QOZ Fund investment. The City could make clear City Council policy and adopted community goals for designated OZs as well as elevate the profile of specific OZ projects to better attract QOZ Fund investment. Staff could take the following actions:
   - Create specific OZ profiles on the City's QOZ Fund program website, expanding upon the general information as stated in the above recommendation. The profiles would include maps, news on emerging projects, demographics, market information and Council approved policy documents.

- Based on open land development cases, make businesses and developers with active projects in OZs aware of their location in an OZ and that QOZ Funds could be a potential private source of funds for their project based on open land development cases.
- Identify specific projects in OZs and create an investor prospectus on those investment opportunities. Shop these projects to QOZ Funds.

4. *Create a Incentive Program to Deliver Community Benefits:* As previously stated, QOZ Fund capital behaves like private equity capital. Projects that provide important community benefits require the "patient capital" that stems from public incentives, such as low interest loans, tax incentives, and grants. Offering this type of patience capital drives private investment decisions, including QOZ Funds. Creating a "Location Enhancement Incentive Policy," in accordance with City Council Resolution 20180830-058, will take into account the designation of OZs in addition to local market context, the needs of the community and private investment. The program development set to kick off in fall of 2019 will require the expertise of a market economist to shape recommendations to accomplish responsible development and the above noted goals. Concentrating policy development effort on a City Council-controlled public investment framework directly will more directly result in delivering community beneficial projects. The following goals would be achieved through the development of this program.
   - Support the creation and retention of vibrant centers of commerce, culture and residences.
   - Provide a stable location for specific types of tenants (small and local business including creative and music related businesses and nonprofits) and target market industries that advance City Council goals.
   - Increase the availability of diverse affordable commercial spaces.
   - Promote projects that strengthen the local economy, sustain economic activity and build resilience against economic downturns.
   - Engage an equitable lens in projects and project locations, to ensure City-wide community benefits.
   - Provide basic services and amenities for all communities but particularly those that have been historically underserved.
   - Ensure displacement or gentrification are not unintended consequences of specific real estate projects.

## Regulatory Challenges and Need for Additional Guidance

Resolution 20-181018-039 requests the identification of additional regulatory guidance that could increase the beneficial impact of delivering project that are beneficial to the community as previously expressed in Council-approved policy. Below are several key challenges that, if addressed, could help investors place capital gains into QOZ Funds and to improve the likelihood of those QOZ Fund investments facilitating delivery of community beneficial projects.

- Across all communities **the absence of final guidance** has caused hesitancy from investors due to the uncertainty of how the tax provisions will be administered. All stakeholders are responding to the continued release of evolving guidance, with the latest set of investment provisions being released on April 17, 2019. QOZ Fund managers, investors, and developers have leaned on the expertise of hired consultants to provide recommendations on how to move forward with investments.

- Another challenge noted is the **OZ tax provision deadline** for QOZ Funds investment in OZ projects is December 31, 2019, to receive the maximum tax benefits. This tax incentive benefit then diminishes, reducing the return on investment, which may increase the need for additional incentives to meet targeted returns. The result is a short window of opportunity for cities and states to influence QOZ Fund investment decisions into locally beneficial projects, new policy or adjusted processes.
- Additionally, the OZ program requires that capital gains realized from a sale of an asset must be **re-invested into a QOZ Fund within 180 days, and, the QOZ Fund is required to deploy those funds received within 180 days of receipt.** The aggressive timeline requires QOZ Funded projects to have fully secured all capital needed to finance the project and to have all governmental approvals in place.
- Lastly the Act provision **does not require QOZ Funds to disclose information** on actual or planned investment activity. This makes it a challenge for states and cities to learn how to help facilitate capital placement in projects that advance local policy. The State and City currently do not have the ability to track projects and create community benefit interventions, as deemed appropriate.

## Conclusion

In respect to the items that City Council put forth for in Resolution No. 20181018-039 the immediate consideration and challenge is the timing associated with the Opportunity Zones tax provisions. Action on any Recommendation put forth in this Report will require immediate consideration by City Council to allow for potential leveraging or City participation in Opportunity Zone projects.

**Exhibits –**

Exhibit A – City of Austin Opportunity Zones

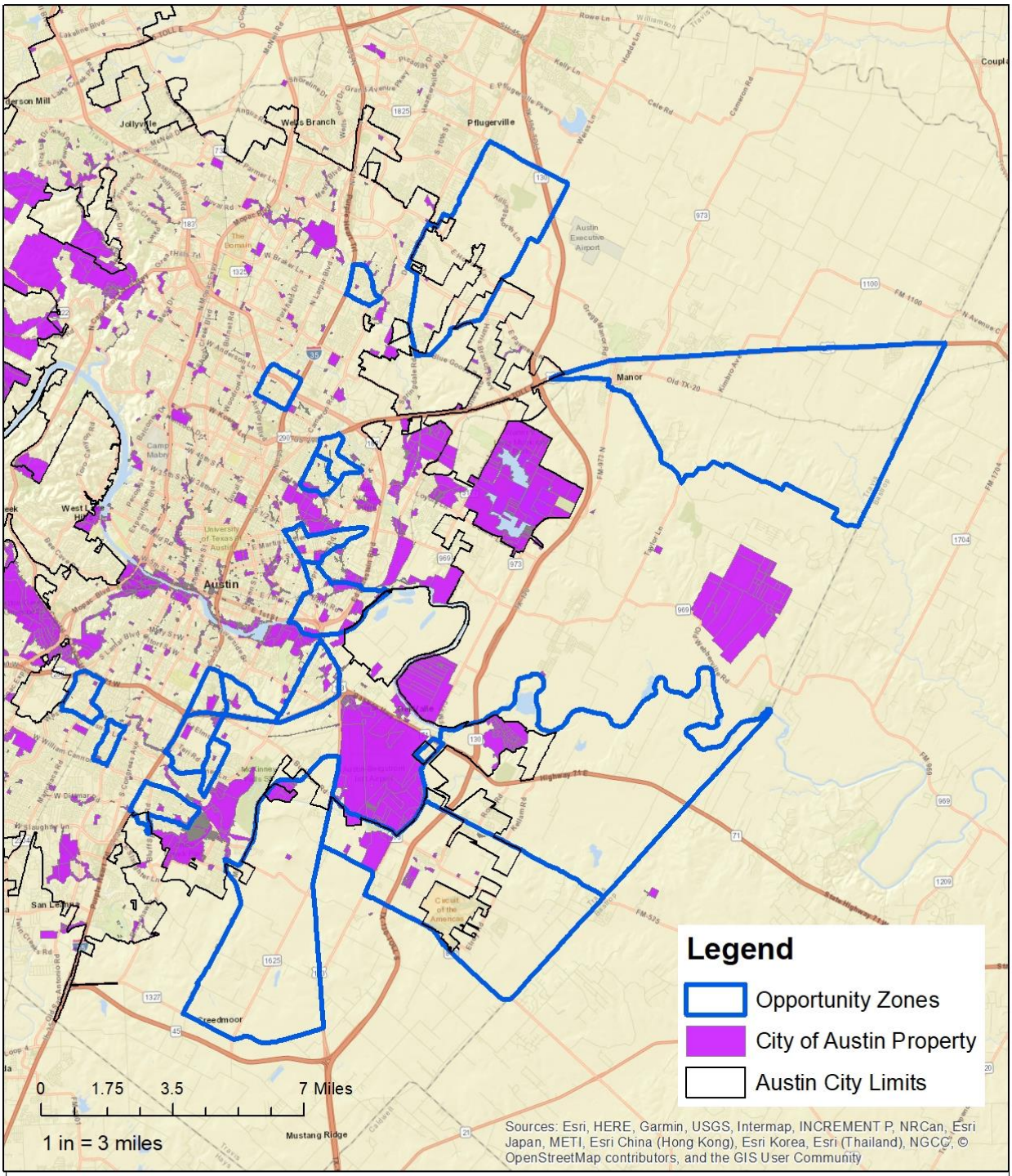
Exhibit B – Expressed Community Needs Suitable for Private Investment

Exhibit C – City of Austin Opportunity Zones – Gentrification Study

Exhibit D – Opportunity Zone Background Presentation

Exhibit A

City of Austin Opportunity Zones




**Opportunity Zones**

**City of Austin Property**

Redevelopment
CITY OF AUSTIN ECONOMIC DEVELOPMENT

Created By: D Jackson
Revised: March 12, 2019

## Exhibit B
## Expressed Community Needs Suitable for Private Investment by Council Policy

Imagine Austin
- Promoting music, art, and cultural programming and facilities
- Creating "complete communities" that offer basic day-to-day needs within a walkable, transit-connected neighborhood framework
- Promoting ecological and sustainable practices, green infrastructure, renewable energy, and carbon emission reduction

East Riverside Corridor Small Area Plan
- Provision of permanently affordable housing and preservation of existing affordable housing
- Retail space focused on smaller retail (under 50,000 sf)

Lamar/Justin Lane TOD Plan
- Flexible live/work spaces

Neighborhood Planning Area Plans
- Preservation of single-family housing
- Preservation and creation of neighborhood-scaled affordable housing
- Promotion of businesses that are neighborhood-serving
- Commercial space tailored to small business specifically
- Walkable, mixed-use areas along major streets

Council Resolutions on Music and Creative Ecosystem Stabilization
- Creation of affordable creative space through inclusion in city planning processes
- Expand the supply of venues available to creatives through activation of rental space
- Creation of affordable creative space through bonds, public investment, and private development

Council Resolutions on City-Owned Land in Opportunity Zones
- Creation of affordable creative space through inclusion in city planning processes
- Expand the supply of venues available to creatives through activation of rental space
- Creation of affordable creative space through bonds, public investment, and private development

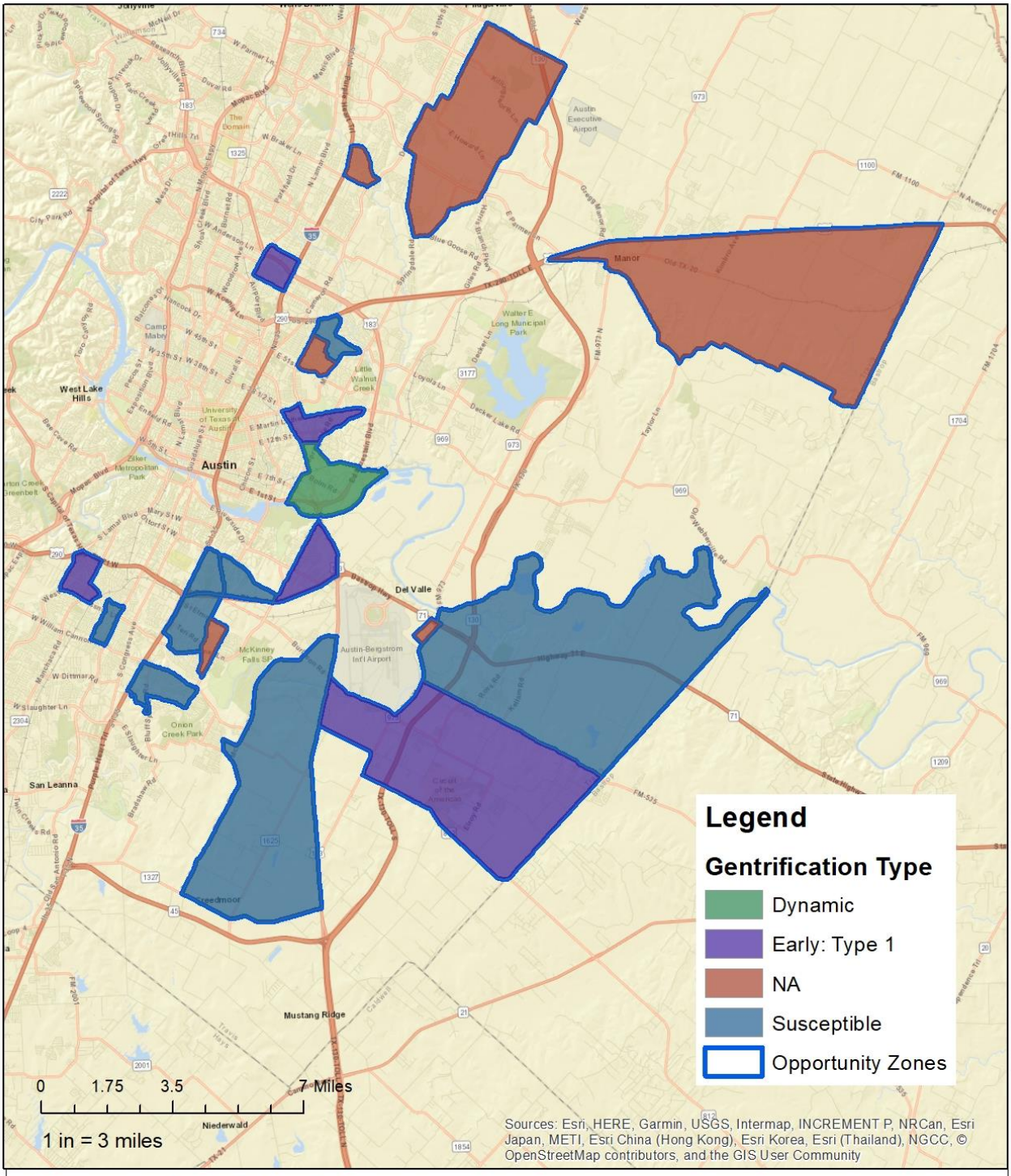
Healthy Food Access Initiative
- Increase access to healthy, nutritious food in low food access areas
- Increase high quality grocery store options in low food access areas

Chapter 380 Incentive Policy
- Middle income jobs and career ladders for harder-to-hire constituencies
- Integrate workforce housing development or communal green space and parks
- New investment in a new industry to potentially create a new cluster or bring additional types of industries to Austin

Austin Strategic Direction 2023
- Expand and preserve both market-rate and dee-restricted or subsidized affordable housing
- Promote multimodal transportation options and multimodal infrastructure such as complete sidewalks, bike lanes, and transit systems
- Improving resilience to climate change and reducing the carbon footprint of the city
- Supporting the vibrancy and sustainability of creative industry ecosystem

Strategic Housing Blueprint
- Specific affordable housing production goals by Imagine Austin Corridors

## Exhibit C




**Opportunity Zones**
**Gentrification Susceptibility**

Redevelopment
CITY OF AUSTIN ECONOMIC DEVELOPMENT

Created By: D Jackson
Revised: November 13, 2018

Exhibit D
Opportunity Zone Background Presentation




## Background

- Established by Congress in the Tax Cuts and Jobs Act of 2017
- Encourages long-term investment in low-income urban and rural communities
- Provides tax incentive for investors to re-invest their capital gains into Opportunity Funds dedicated to investing in Opportunity Zones
- Goals of Opportunity Zone Funds:
  - -Address the uneven economic recovery
  - -Spur new business formation
  - -Diversify geographic footprint of economic opportunity and growth

## City of Austin – Council Resolution

On October 18, 2018, the City of Austin City Council passed Resolution No. 20181018-039, which charged the Economic Development Department to research and provide comments and recommendations regarding eight (8) key points, specific to the Opportunity Zone Program:

- Program Development
- Community Needs
- Engagement Strategies
- Leveraging Opportunities
- Best Practices
- Partnerships
- Monitor Federal Guidance
- Identify Additional Guidance Needs

- Response due to City Council on **April 28, 2019**



## Program Offerings

The Opportunity Zones program offers investors three tax incentives for encouraging investments in federally designated Opportunity Zones through qualified Opportunity Funds.

- **Temporary Tax Deferral** – A temporary deferral of inclusion in taxable income for capital gains reinvested into an Opportunity Fund. The deferred gain must be recognized on the earlier of the date on which the Opportunity Zone investment is disposed of or December 31, 2026.



- **Step-Up in Basis** – A step-up in basis for the deferred capital gains reinvested in an Opportunity Fund. The basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least 5 years and by an additional 5% if held for at least 7 years, thereby excluding up to 15% of the original deferred gain from taxation.



- **Permanent Exclusion** – A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund if the investment is held for at least 10 years. This exclusion only applies to gains accrued on investments made through an Opportunity Fund. There is no permanent exclusion possibly for the initially deferred gain.



## Benefits of Qualified Opportunity Funds



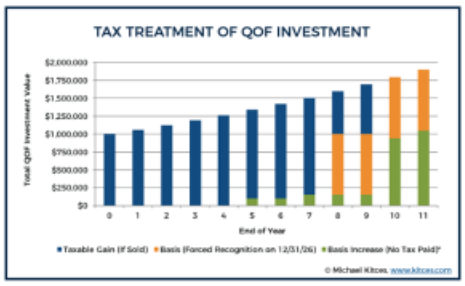



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## Important Investment Dates

- **December 31, 2019**
  Last day to invest in QOF to recognize maximum program offerings
- **December 31, 2021**
  Last day to invest in QOF to realize at least 10% Step-Up Basis
- **December 31, 2026**
  Last possible day or reinvested gain recognition (Forced Recognition of Gains)

*Guidance still needed to confirm tax treatments of Post-2019 QOF Investments in regards to Permanent Exclusion




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## Qualified Opportunity Zone Funds

A qualified Opportunity Fund is an investment tool organized as a corporation or partnership with the specific purpose of investing in Opportunity Zone assets

- Qualified Opportunity Zone Funds can be established by any entity
- Funds are self-certifying by completing IRS Form 8996, and submitting with annual federal income tax returns
- Opportunity Funds are required to hold at least 90% of their assets in qualified opportunity zone businesses and/or business property



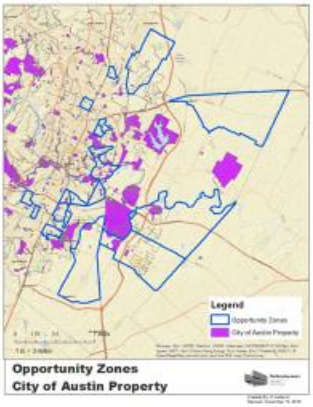
## What are Opportunity Zones?

Opportunity Zones are low-income census tracts designated by the Secretary of the Treasury through a nomination process involving the Governors of each U.S. state and territory

- Initial thresholds established by Section 45D of the Internal Revenue Code
  - -Poverty Rates of at least 20 percent; or
  - -Annual Median Family Income no greater than 80% of surrounding areas
- Governor may nominate up to 25% of their low-income census tracts to be certified
  - -Public and Private entities allowed to provide input
  - -Additional Zone Considerations:
    - -Chronic Unemployment
    - -Lower Population Density
    - -Significant Economic Disruptors within past 2 years (i.e. Natural Disasters)
- Designated Zones are set to expire on **December 31, 2028**

## Opportunity Zones and the City of Austin

The City of Austin has twenty-one (21) designated Opportunity Zones significantly impacting census tracts located to the east of Interstate 35.



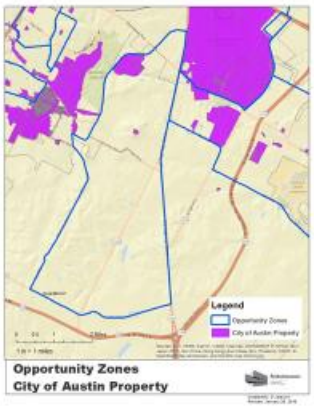

The City of Austin specifically nominated four (4) census tracts located in the Southeast area of the City. All nominated census tracts were certified.

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## Sample Profile

**General Characteristics**

- Square Miles
- Population
- Median Household Income
- Average Household Income
- Per Capita Income
- Median Age
- Residential Profiles
- Poverty Status
- Educational Profile
- Labor Force and Employment Profiles
- Zoning Profiles
- Residential and Commercial Vacancy
- Emerging Projects




- What is the message we want to/can develop for each zone?

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## San Antonio Case Study

On Jan. 8, 2019, the City of San Antonio and the Office of the Governor announced the "first" Opportunity Zone investment made in the State of Texas with the development of a $16-million, climate controlled self-storage facility with flex space at the Brooks master-planned community of San Antonio's South Side.

## Lessons Learned

- No State or Municipal role in the deal development
- Taxpayer established Qualified Opportunity Zone fund as sole investor
- Investor commissioned five (5) studies to determine land's best use, which did include community input
- Based on investors tax consultant, projects must be FULLY FUNDED for realization of investment benefit






## Research Methods

- Review of National Best Practices –
  - Texas: Dallas, El Paso, San Antonio
  - National: Indianapolis, **Louisville**, Memphis, **Minneapolis**, Oklahoma City, Phoenix, St. Louis
- Monitoring State Legislative Actions
  - Grocery Access Act
  - Texas Rural and Opportunity Zone Act
- Focus Groups (*In Development*)
  - Internal
  - External
- Stakeholder Conferences, Webinars, and Calls
- Monitoring release of final program guidance (Expected Mar. 2019)

## Research Findings

- Program Development and Leveraging Opportunities
  - Lack of State or Local programs specific to incentivizing Opportunity Zones
  - Potential to design/influence programs to incentivize investment for target markets
  - Utilization of existing incentive programs on State and Local level to leverage OZ investments
- Community Needs and Engagement Strategies
  - Need to identify gaps in services for census tracts
  - Engaged through mapping strategies of available market and engagement data
  - Identify existing plans for community benefits
- Best Practices
  - Profiling Census Tracts to attract appropriate investment
- Potential Partners
  - Need to identify Qualified Funds/Investors/External Stakeholders who align with CoA values
- Federal Guidance and Regulations
  - Lack of role for municipal involvement
  - Lack of oversight on investment
  - Final Guidelines not releases



## Draft Strategy Recommendations

- Development of Opportunity Zone website
- Development of maps identifying Opportunity Zone tracts
  -City Limits
  -Zoning
  -City-owned Property
  -Emerging Properties
- Research existing plans that include community benefits
- Identify Qualified Opportunity Zone Funds that align with City of Austin goals
- **Engage Internal/External focus groups**
- Development of Census Tract prospectus

## What does this all mean?

- Investments are happening now (whether we are aware of them or not)
- Need for municipal interventions increases as tax incentives diminish over course of program
- Development of **executable** strategies are vital
- Collaboration and Communication



## Significant Dates:

- Texas Opportunity Zone Summit – March 6, 2019
- Response to Council Resolution – April 28, 2019

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