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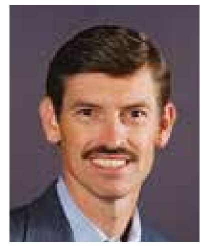
State, Local Governments Work to Steer Opportunity Zones Investment



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Opportunity zones (OZs) are a federal tax incentive that has generated unprecedented levels of interest among investors and have enormous potential local and regional impact.

States and municipalities realize the potential power of OZs, which is why there has been and continues to be so much activity at the state, region, county and city level since the enactment of the federal OZ incentive in late 2017.

Many state and local governments have fully embraced the incentive and made it clear that they're open for business and want OZ investment in their communities. Others have expressed concerns about the potentially adverse effects of the incentive on their local communities, and have sought to dampen and more strictly regulate the flow of such capital into their communities and the corresponding impact of the incentive.

State Tax Code Conformity

One crucial way for states to encourage use of the OZ incentive is to conform state tax law to the federal Internal Revenue Code–offering a deferral and reduction in state tax on capital gains that are invested in qualified opportunity funds (QOFs).

Most states have done so–as this issue went to press, 41 states either conformed to the federal OZ provisions or lacked a tax on capital gains, making the point moot. That leaves nine states that treat capital gains invested in QOFs differently than the federal tax code. North Carolina and Hawaii specifically opted out, presumably in an effort to dampen the effect of the incentive or concluding that any revenue loss to the state exceeded the marginal

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benefits from allowing the incentive. Other currently nonconforming states include California, Pennsylvania and New Jersey–all big states. At least one currently conforming state, Oregon, is considering repealing conformity.

Beyond tax conformity, several states are considering additional financial incentives to encourage and direct OZ investments within their states.

State Tax Credits

From coast to coast, state-level legislation was introduced in the past six months to incentivize OZ investment. The variety is wide, but the goal is the same:

- A South Carolina bill would create a 25 percent state tax credit for investments in OZs, with a cap of $50,000 per taxpayer.
- Rhode Island legislation would provide a 10 percent tax credit for investments in QOFs that invest in Pawtucket and Central Falls.
- In Washington, legislation would create a tax credit against the state insurance premium tax for contributions to QOFs that invest in rural areas.
- Maryland saw a bill introduced to make OZ investments eligible for three existing tax credits. Those credits–the Job Creation, One Maryland and Businesses that Create New Jobs tax credits–all focus on similar objectives to the OZ incentive.
- A Texas bill was introduced to create a 25 percent state tax credit for businesses that invest in remodeling, rehabilitating or building a structure in an OZ, as well as a business that purchases equipment or machinery for an OZ building. It also would allow a one-time 25 percent tax refund for businesses that spend money on labor, materials and equipment for buildings in an OZ or $50,000, whichever is less.
- Another Texas bill would create a 25 percent tax credit for contributions to state-approved rural QOFs that make investments that meet certain job-creation and job-retention standards.
- In Ohio, a bill was introduced to create a nonrefundable 1 percent tax credit for investments of $250,000 or more in Ohio QOFs, which must hold all of their assets in Ohio OZs. An additional 2 percent credit could be claimed if the OZ projects reach certain levels of tax increase.
- A Kentucky bill would provide tax credits for investments in rural counties and OZs. The annual cap would be $35 million and most of the investments would be required to go to small businesses in small counties.

Other State Incentives

Tax credits aren't the only state incentive option. Bills in several states take other approaches.

Maryland has aggressively pursued OZ investment, as Gov. Larry Hogan has made OZ investment a prime focus. In January, he announced a series of initiatives to offer tax credits, job training programs, small business loans and affordable housing incentives, all tied to the OZ incentive. One bill, introduced in early March, would create a state low-income housing tax credit, but allow it only in certain areas, including OZs.

West Virginia legislation would exempt new qualified OZ businesses from corporate net income tax and personal income tax during their first decade–a significant benefit for the operating business.

In Florida, Gov. Ron DeSantis paired the OZ with one of his pet projects. His budget proposal would add OZs to areas where state-funded charter schools could be built. That would increase the number of communities where the schools could be built from 47 to about 300, meaning about 85 percent of the neighborhoods where charter schools could be built are OZs. Also in Florida, a bill would revive the expired Florida Enterprise Zones incentive and change the definition of enterprise zones to match OZs. It includes several state incentives for those investing there.

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A Nebraska bill would give priority to OZs in awarding state Affordable Housing Trust Fund and other programs.

Local Efforts

State efforts don't stand alone. Cities have different incentives than the federal and state governments and many jumped in with both feet. Often, the most important role has been promoting their OZs and local opportunities.

Bruce Katz of Accelerator for America is a leader of the promotional movement. Katz has championed the idea of creating a prospectus that helps communicate what makes a city distinct and promotes the advantages of their OZs. Katz encourages localities to highlight potential projects and propositions, giving a unified vision to promote investment.

Whether it's with Accelerator for America or otherwise, many cities have taken this approach.

In Erie, Pa., for instance, the regional Chamber of Commerce and the Growth Partnership formed the Pennsylvania Flagship Opportunity Zone Development Company to focus on economic development and promotion efforts in local OZs. Their efforts include a vibrant website, promotional efforts and a list of 17 community partners willing to assist with OZ developments. The company pledges to help quantify deal flow and availability of local capital, identify potential partners–including funds–and promote projects within the OZs. Erie also created a prospectus that is used to pitch the city to developers.

Roughly 400 miles west, in Benton Harbor, Mich., a city of about 10,000 residents on the east coast of Lake Michigan, there is a similar commitment. Benton Harbor collaborated with Cornerstone Alliance to publish a prospectus detailing real estate prospects within the city's three OZs, as well as those in neighboring cities in Berrien County.

Maryland has championed the OZ incentive and Baltimore doubled down. The city has a designated OZ coordinator in the city's nonprofit Baltimore Development Corporation, who is working to help promote and make connections for the city's 42 opportunity zones.

Farther south, in Birmingham, Ala., the city created the Birmingham Inclusive Growth (BIG) Fund to attract OZ investments to the city. The mayor jumped in to promote the incentive, which the city hopes will be used to revitalize aging buildings and spur economic growth.

Out west in Sacramento, Calif., city leaders hope to use part of a special sales tax to increase city staff to help promote and encourage OZ investment. Fifty miles south, Stockton, Calif., created an OZ portal that works as an interactive map of the 19 OZs in the city, with detailed demographic information. The city also published a prospectus to promote opportunities.

Those cities aren't alone. Throughout the nation, aggressive city leaders are finding ways to both bring OZ investment to their area and influence the type of development in those low-income communities.

Not Universal

Not every community fully embraces OZ development. Some are concerned that OZs will attract the wrong type of development. Boulder, Colo., for instance, imposed a moratorium on OZ development in January, concerned about projects proposed there. Since then, the city has allowed several exemptions–primarily for affordable housing–but the concern and moratorium remain.

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The Boulder moratorium contrasts with a more needs-based growth option for local and state officials: Incentivizing the *type* of development desired in OZs. That's what Nebraska and Maryland are attempting with affordable housing and Florida is attempting with charter schools. The same principle is available locally: Cities and counties can use zoning policy and local incentives to encourage the type of development they want in OZs, using local needs and concerns to help inform decisions on how to direct the flow of investment.

Lessons Learned

The involvement of local and state leaders in pursuing OZ investment in their communities is smart, in both attracting and directing investment. The incentive is a work in progress, but the benefits of bringing billions of dollars of investment to low-income communities can be a game-changer.

Whether it's through promoting their city or region or directing the type of investment wanted, state and local governments considering whether and how to promote and incentivize investment in local OZs should consider the words of Roman philosopher Seneca, spoken nearly 2,000 years ago.

"Luck is what happens when preparation meets *opportunity*." ❖

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