M E M O R A N D U M

TO: Mayor and City Council

FROM: Brie Franco, Director, Intergovernmental Relations Officer
Rebecca Giello, Interim Director, Economic Development Department

DATE: March 9, 2018

SUBJECT: Opportunity Zones

This memorandum serves to provide City Council with information about a provision in the newly enacted 2017 Tax Cuts and Jobs Zones that created a new Federal program that provides a tax incentive for investors to re-invest their unrealized capital gains into Opportunity Zones.

It is critical to note the U.S. Department of the Treasury has not completed its rulemaking on this program at this time. Information provided by the staff is for planning purposes only and may be subject to change based upon the Department of the Treasury's final rule. Due to the lack of information, staff in the Intergovernmental Relations Office and Economic Development Department have sought additional guidance from multiple parties to include the Governor's Office in an effort to inform Council of available information, recognizing there are numerous unanswered questions at this time.

Summary: Opportunity Zones

Information regarding this new Federal tax incentive program was released by the Treasury Department last month with little guidance other than an outline of a State Governor-led process for qualifying census tracts for Treasury to designate as Opportunity Zones. The Governor's Office has communicated a deadline of March 21st for communities to submit eligible census tracts. The process allows the Governor of each state to nominate certain census tracts as "Opportunity Zones".

Opportunity Zones are low-income census tracts in which:

> (1) The tract has a poverty rate of at least 20%; or
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> (2)(A) For a census tract in a metropolitan area, the tract's median family income does not exceed 80% of the greater of (A) the metropolitan area median family income or (B) statewide median family income; or
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> (2)(B) For a census tract in a non-metropolitan area, the tract does not exceed 80% of the statewide median family income. However, in the case of a census tract located within a high migration rural county, low-income is defined by reference to 85% of statewide median family income.

A “high migration rural county” is any rural county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net outmigration of inhabitants from the county of at least 10% of the county population at the beginning of such period.

The Act establishes a new section of the Internal Revenue Code that outlines a process for designating Opportunity Zones and makes possible tax incentives to encourage investors to invest in Opportunity Zone Funds (OZ Funds). The OZ Funds are to serve as a source of capital for investment in Opportunity Zones, areas of higher concentrations of poverty and little new investment. In exchange for tax relief from capital gains tax, investors are incentivized to invest in the OZ Funds and keep funds invested over a 10 year time horizon. The OZ Funds, in turn, make investments in a wide range of economic development initiatives in the Opportunity Zone.

Below are highlights staff has identified through research regarding the Fund and the Zone:

- Only census tracts where 20% or more of the population live in poverty or make 80% or less of the State median family income are eligible for Opportunity Zone designation. These “low income community” (LIC) census tracts serve as geographic program eligibility criteria for other Treasury Department programs and can be found here: https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx
- The Governor nominates eligible census tracts to the Treasury Secretary who reviews and makes final designation.
- The Governor is limited to nominating only 25% of eligible LIC census tracts in the state, which for Texas is approximately 500 census tracts statewide.
- Conversations with Governor’s staff and the City of Austin Intergovernmental Affair (IGA) have further clarified that the Governor will exclude tracts near universities or South Congress, seeking census tracts that are struggling to get new investment.
- No formal application process exists. Private and public entities can nominate qualified census tracts to the Governor by emailing the qualified census tracts and justification by the deadline.
- The Governor will accept limited justification narrative as well as letters of recommendation and support from potential investors or development partners.

Opportunity Zone Funds

Opportunity Zone Funds are investment vehicles set up as corporations or partnerships that hold at least 90% of its assets in opportunity zone assets. This private fund invests in a business, real estate or other enterprise in the Zone. Gains on OZ Fund-invested capital are sheltered from federal capital gains tax.

As noted above, little is known about how Opportunity Zone Funds will operate as the Treasury has yet to issue guidance or rules, anticipated by end of the calendar year. The list below itemizes just a few of the unknowns that significantly impact the effectiveness of delivering community beneficial investment in Austin should Austin have a designated zones:

- The role –if any – of a local government has not been determine, nor has it been determined if a city will have a role in influencing the privately operated fund.
- It is not known what entity that would manage the Opportunity Zone Fund or Funds in the State nor the process by which would determine the management of the fund.
- The investment criteria that guides Opportunity Zone Fund investment decisions is not established.
- Requirements that ensures the OZ Fund investment delivers any benefits other than capital are not known at this time.
- The cost of that capital and terms of investment on a business enterprise is not known.

- It is not known if Opportunity Zones can be "de-designated" should the local government determine that activities of the Fund in the community are not delivering a public benefit.

Methodology

EDD staff in conjunction with IGA staff will reach out to Council offices the week of March 12 to offer time to those offices interested in understanding more about this program, and potential eligible census tracts in their districts.

To this end, EDD and NHCD have worked collaboratively to develop a suggested methodology that could be used to identify qualified census tracts to present to the Governor for consideration. Staff recommends limiting the maximum number of qualified census tracts consideration to at least match the State's statutorily set cap of 25% of eligible census tracts – this equates to 17 or fewer census tracts citywide. Staff recommends an initial filter of qualified census tracts utilizing readily available data based on City Council priorities and stated policy:

- LIC census tracts determined "eligible" through the CDFI Fund Information Resource
- Imagine Austin Centers and Corridors
- Food insecurity indicator developed by the Office of Sustainability that encompasses poverty rate, unemployment rate, home ownership rate, African American and Latino population
- The presence of recent commercial building permit activity over the last year

Staff can provide additional analysis should information be desired.

Again, we would stress that there is very little information about this new Federal program, and communities are under no obligation to submit information to the Governor's Office. As of now, cities would have no identified role in in the creation or management of these private, tax-sheltered funds.

Please do not hesitate to contact Christine Maguire, 512.974-7131; or Brie Franco, 512-974-2285 for more information.

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