JAN PERRY
GENERAL MANAGER

CITY OF LOS ANGELES

CALIFORNIA

ERIC GARCETTI
MAYOR

ECONOMIC AND WORKFORCE
DEVELOPMENT DEPARTMENT

1200 W. 7TH STREET
LOS ANGELES, CA 90017

December 4, 2018

Council File: 18-0112-S1
Council District: 1,2,3,4,6,7,8,9,10
12,13,14 & 15
Contact Persons & Phone Numbers:
Samuel Hughes: (213) 744-9723

City Council
c/o City Clerk
Room 395, City Hall

TRANSMITTAL: TAX CUTS AND JOBS ACT OF 2017-- OPPORTUNITY ZONES AND QUALIFIED OPPORTUNITY FUNDS

RECOMMENDATIONS

The General Manager of the Economic and Workforce Development Department (EWDD) or designee, respectfully requests that the City Council, subject to the approval of the Mayor as required:

1. APPROVE the list of recommendations for submittal to the Internal Revenue Service in response to 26 CFR Part 1 rin 1545-bp03 Investing in Qualified Opportunity Funds guidance under new Section 1400z-2 of the Internal Revenue Code; and

2. APPROVE the marketing program provided in this transmittal to promote city projects and investments in Opportunity Zones and qualified opportunity funds.

FISCAL IMPACT STATEMENT

No impact to the General Fund.

BACKGROUND

On October 31, 2018 the City Council introduced a motion (Council File 18-0112-S1) instructing EWDD, with the assistance of the Chief Legislative Analyst, City

AN EQUAL EMPLOYMENT OPPORTUNITY - AFFIRMATIVE ACTION EMPLOYER

Administrative Officer and all other affected Departments to evaluate the proposed regulations for Opportunity Zones, recommend amendments to the regulations to ensure that they facilitate effective investments, and to develop a program for Council consideration to promote City projects to be marketed to designated Opportunity Funds.

SUMMARY

Evaluation of Proposed Opportunity Zones Regulations

Opportunity Zones are a new community development program added to the tax code by the Tax Cuts and Jobs Act on December 22, 2017. The Tax Cuts and Jobs Act created Opportunity Zones to unlock unrealized capital gains by incentivizing private sector investments and development in low income census tracts. Opportunity Zones are designed to spur economic development by providing tax benefits to investors in two ways. First, investors can defer tax on any prior gains invested in a Qualified Opportunity Fund until the earlier of the date on which the investment in a fund is sold or exchanged, or December 31, 2026. If the fund investment is held for longer than 5 years, there is a 10% exclusion of the deferred gain. If the fund investment is held for more than 7 years, the 10% minimum becomes 15%. Second, if the investor holds the investment in the fund for at least 10 years, the investor is eligible for an increase in basis of the fund investment equal to its fair market value on the date that the fund investment is sold or exchanged.

The federal tax bill passed at the end of December 2017 allowed the Governor of California to designate certain census tracts as Opportunity Zones. Investments made by individuals through special funds in these zones would be allowed to defer or eliminate federal taxes on capital gains. The Governor could designate up to 25 percent of census tracts that either have poverty rates of at least 20 percent, or median family incomes of no more than 80 percent of statewide or metropolitan area family income. There are 3,516 census tracts in 54 California counties that would qualify under one or both of the mandatory criteria, allowing the Governor to designate 879 census tracts, of which 194 are located in the City of Los Angeles. The table below provides a breakdown of the number of the designated census tracts in each Council District.

COUNCIL DISTRICT	# of Opportunity Zones	# Shared Zones
1	14	7
2	16	5
3	9	1
4	5	5
5	0	0
6	21	6
7	10	0
8	10	3
9	11	5
10	10	4
11	0	0
12	2	1
13	28	6

14	12	5
15	20	0

As the latest program to provide tax incentives to those who invest in distressed neighborhoods, the goal of the Opportunity Zone program is to mitigate poverty, create jobs, enhance property values and boost local tax revenues by attracting investment capital for new business activity and redevelopment. This new program will provide federal tax advantages to investors in Qualified Opportunity Funds that aggregate and invest capital directly into a Qualified Opportunity Zone Property or a Qualified Opportunity Zone Business (Stock or Partnership Interest) which are, by law, low-income communities or adjacent to such communities. Rules for the Opportunity Funds have not been finalized by the Department of Treasury, but the targeted zones have been chosen.

A Qualified Opportunity Fund is an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in a Qualified Opportunity Zone. An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible f or preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his/her delegation of authority to the Internal Revenue Service.

The Opportunity Zone program rewards investors for pooling money, targeting investment geographically, and allowing long-term use of money. In previous years, there were an array of programs that provided essential resources and incentives to support targeted economic development activities that resulted in job creation and stabilization of distressed communities. However, the elimination of these programs, including the dissolution of redevelopment agencies in 2012, the repeal of State Empowerment Zones in 2013, and the expiration of Federal Empowerment Zones in 2016, created a significant gap in resources, services and incentives available to the City to facilitate and promote economic development options.

It is important to note that although Opportunity Zones are in economically-distressed communities, there is little within the draft regulations that provide direct benefit to people living in the Opportunity Zones.

<u>Recommended Amendments to the Opportunity Zones Regulations</u>

EWDD, with the assistance of all other affected Departments, has prepared recommendations to amend the draft regulations to be submitted to the IRS as part of the public comment process. These recommendations aim to make Opportunity Zones more accountable and to ensure that the benefits and opportunities of the zones are shared with residents. The proposed recommendations are as follows:

- ACCOUNTABILITY
  Add reporting requirements for accountability and program outcomes. Having reporting requirements can ensure that there is transparency regarding who is setting up these funds, the amount of money being placed into these funds, and where the funds are being invested.

- REQUIRE A DECLARATION OF INTENT
  In order to be certified by the U.S. Treasury as an Opportunity Fund, the agency should require Opportunity Funds to declare their investment intentions and commit their investments to specific outcomes as a condition of certification.

- CDFI ELIGIBILITY
  Recommend that an exemption be placed in the definition of Qualified Opportunity Zone Businesses, whereby Community Development Financial Institute's (CDFI's) which require Department of Treasury approval are eligible for investment from Qualified Opportunity Funds.

- CONFORM STATE TAX CODE TO IRS CODE
  The tax benefits of the Opportunity Zone provision may not sway investors to direct their capital to communities in a state if that state's tax code, such as California, does not conform to the Internal Revenue Code. As such, it is necessary to include language within the regulations that encourage nonconforming states to create a comparable tax incentive for investors electing to invest within Opportunity Zones to increase the likelihood of investment.

- OPPORTUNITY ZONE GROSS BUSINESS INCOME PROVISION
  Recommend that for each taxable year an amount less than 50% of the gross income of a qualified opportunity zone business (such as an internet or logistics business) is derived from the active conduct of a trade or business in the qualified opportunity zone be the basis for determining eligibility.

- INVESTMENTS SHOULD PROMOTE HEALTHY COMMUNITIES
  Low-income residents and communities of color within the zones should have an opportunity to benefit from equitable growth and prosperity. Projects should increase services available to vulnerable populations such as affordable transportation options, health-care facilities, healthy food retail, quality education services, and apprenticeship jobs that provide a path towards career advancement for workers and enrich their job training skills.

- LOCAL AND STATE PROVISIONS
  Include provisions that allow local and state governments to develop and implement additional guidelines for Opportunity Zones. The U.S. Treasury should allow local and state governments to create their own set of guidelines for investment. Allowing local governments to play a more active role in the process will ensure that investments adhere to community priorities and protect against displacement.

- OPPORTUNITY ZONE RULE VIOLATION
  The U.S. Treasury should create a system for the public to report if Opportunity Fund investments result in the eviction of tenants or small businesses, dramatically increase rents in the acquired properties, or result in the loss of deed restricted or rent stabilized housing. The IRS should investigate any reported violations and if an investment fund is found to be in violation, the IRS

should have the power to remove the tax exemption from the fund's project and potentially any future projects pursued by the fund.

Opportunity Zone Marketing Strategy

The Federal Opportunity Zones and related Opportunity Funds offer the City the occasion to make Fund Managers and Developers aware of projects in the City that are eligible for investment, and provide information that would support active investment. By providing complementary tax benefits, developing a marketing strategy that includes a targeted Opportunity Zone website and possibly partnering with local employers and anchor institutions, the City can better attract the economic stimulus promised by the new program.

Because the tax provision is designed to divert the flow of capital so that it can migrate to places that might otherwise have been overlooked, it is important that EWDD host an Opportunity Zone focused website, considering the Department's concentration on economic and workforce development programs. The website could include an overview of the program, benefits to participating in investments located in Opportunity Zones, maps showing what areas are designated as Qualified Opportunity Zones, information highlighting Opportunity Zone ready projects already in the pipeline as part of a general or specific plan, and development finance tools that exist today and that might be aligned with Opportunity Zone provision such as Low Income Housing Tax Credits, New Market Tax Credits, Historic Tax Credits, Community Development Financial Institution loans, and Section 108 loan guarantees.

In addition to hosting a website it is vital that the City also provide marketing materials in the form of an investment prospectus to further illustrate the opportunities within various council districts. A City focused investment prospectus allows the City to provide information directly to Opportunity Fund Managers. In addition to the program overview and maps identifying boundaries of various Opportunity Zones within the City, the investment prospectus will detail specific business and development opportunities within council districts located in specific zones in the City. To maximize EWDD marketing efforts each council district must have an abbreviated economic development strategy that should coalesce around Public Works, Department of Transportation, Bureau of Engineering, Metropolitan Transit Authority and other public improvement efforts currently or soon to be underway.

Lastly, Economic Development or Planning Deputies within various council districts should be armed with the aforementioned prospectus to market projects by offering fund managers the opportunity to tour their communities, understand the local pressures and view the project sites. Not only will such tours give fund managers a better sense of how projects might fit into their investment strategy, but also can show how committed the City is to ensuring the success of the projects.

The success of the Tax Cuts and Jobs Act of 2017 which created the Opportunity Zone program will rely on equitable growth, development without significant displacement, and overall healthy community involvement as measured by investors and projects benefiting from a capital investment. If invested in the right type of projects, this new capital infusion could spark sustainable catalytic development that creates prosperity and improves neighborhood quality of life in our economically-distressed communities.

Jan Perry (SH)

JAN PERRY
General Manager

JP:SH