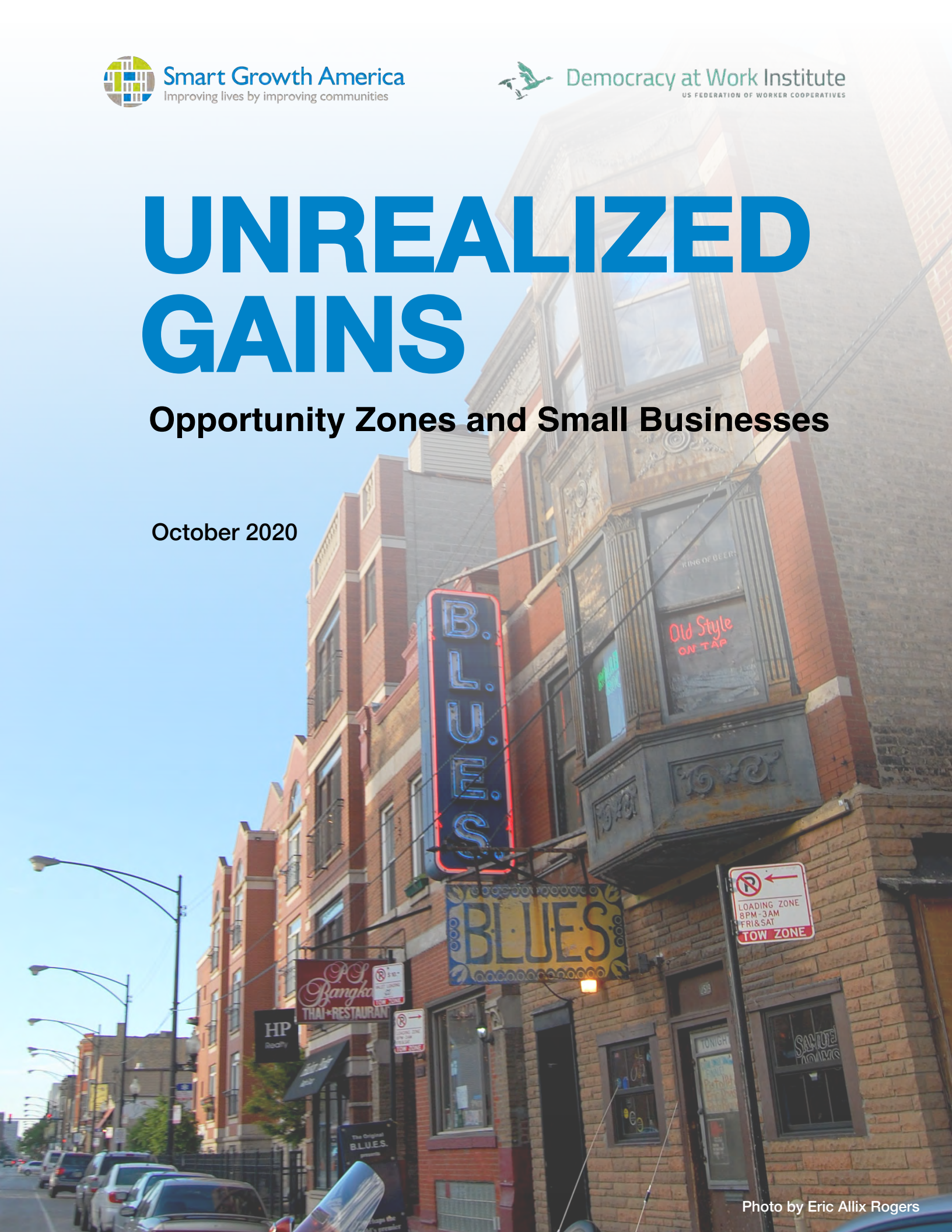


# UNREALIZED GAINS

## Opportunity Zones and Small Businesses

October 2020





# Acknowledgments

This groundbreaking project would not have been possible without the valuable contribution from the individuals and organizations listed below.

The content of this document is largely based on our conversations with elected officials and other public workers, business owners, and qualified opportunity fund managers and investors who volunteered their time to share their insight with us.

Thank you.

**Smart Growth America** advocates for people who want to live and work in great neighborhoods. We envision a country where no matter where you live, or who you are, you can enjoy living in a place that is healthy, prosperous, and resilient.

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**Smart Growth America**  
Improving lives by improving communities



**Democracy at Work Institute**  
US FEDERATION OF WORKER COOPERATIVES







Photo by Jacob Peters-Lehm

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# Glossary of terms

## **CAPITAL INVESTMENT**

Refers to monetary funds used to purchase tangible assets such as equipment, land, or buildings.

## **CENSUS TRACT**

Subdivisions of a geographic location, typically a county or equivalent, that serve to provide a stable set of geographic units for statistical purposes.

## **EMPLOYEE OWNERSHIP**

An option business owners use when they retire or exit their business. Rather than selling to a third party they sell the businesses to their employees.

## **EQUITY CAPITAL**

Capital (such as stock or surplus earnings) that is free of debt, especially capital received for an interest in the ownership of a business.

## **LEGACY BUSINESS**

Typically, a business that has operated in a given municipality for 10+ years in a single location (establishment) or 15+ years in two or more locations, with no break in operations exceeding two years, and has contributed to the neighborhood's history and/or the identity of a particular neighborhood or community.

## **MINORITY-OWNED BUSINESS**

The US Small Business Administration (SBA) defines these as firms that are owned and controlled at least 51 percent by socially and economically disadvantaged individuals.

## **OPPORTUNITY ZONE**

Low-income census tracts nominated by chief executive officers of states and US territories and certified by the U.S. Department of the Treasury in which investors can finance new projects and enterprises in exchange for certain federal capital gains tax advantages.

## **QUALIFIED OPPORTUNITY FUND**

An investment vehicle organized as a corporation or partnership for the purpose of investing in property located within an Opportunity Zone that holds at least 90 percent of its assets in Opportunity Zone property.

## **TANGIBLE ASSET REQUIREMENT**

For a business to be qualified as an Opportunity Zone business, 70 percent of its tangible assets (including things like land, buildings, and equipment) must be acquired or substantially improved after 2017, when the regulations were enacted.

## **UNREALIZED GAIN**

Potential profit generated by the increase in value of an asset that has not been sold yet. The gain remains unrealized as long as it exists on paper, and becomes realized once the investment is sold for liquid assets.



# EXECUTIVE SUMMARY

The Investing in Opportunity Act (amended to the 2017 Tax Cuts and Jobs Act), which created the new Opportunity Zone tax incentive, was conceived as a tool to promote economic development, job creation, poverty reduction, and support for new businesses in areas of concentrated poverty by incentivizing new capital investments in selected census tracts with high poverty rates, low incomes, and a lack of private investment. The intent was to allow investors to avoid sizable capital gains taxes by reinvesting those gains into long-term development projects in underserved or disinvested zones that have been in need of more investment than the market has been providing.<sup>1</sup>

This report sought to document both the current activity of Opportunity Zones and Funds, the motivations behind various kinds of investors, and the impact on communities, their markets, and their businesses; and answer a few key questions:

- 1. Are Opportunity Zone capital investments supporting small business stability and growth, achieving the stated goal of place-based economic development and job creation in distressed communities?**
- 2. If not, what are the obstacles and challenges preventing this?**
- 3. What are the risks and rewards for minority-owned legacy businesses within Opportunity Zones?**

To answer these questions, we looked at Opportunity Zone activity and investment trends in four cities in different regions: Miami, Florida; Atlanta, Georgia; Louisville, Kentucky; and Washington, DC. We interviewed the different stakeholders involved in those investment decisions and looked at demographic and economic data reported by various public sources (cited throughout the report) to contextualize the findings of our conversations.

## Why minority-owned legacy businesses?

Small businesses in these cities help create the kind of value that builds sustainable competitive advantages and enduring enterprises. This gives people jobs and, perhaps more importantly, it creates long-term wealth. But there are serious challenges for these legacy and small businesses—especially those that are minority-owned—due to limited access to capital, lack of investment in community infrastructure, the continued challenges of a globalizing economy, and now an unforeseen pandemic fueling a new economic crisis. So it is vital to determine whether or not this new incentive is helping to close economic gaps—or widen them further. Now is the time to transform businesses, workers, and communities toward a more equitable—and more resilient—economy where everyone has the opportunity to prosper.

1. Booker Statement on Treasury Department Opportunity Zone Guidelines, 2019

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# Findings

Based on our interviews and research, there are some fundamental aspects of the incentive's design that prevent it from attracting more investment to businesses in general, but especially to minority-owned small businesses and legacy businesses. **Most investments have therefore gone to real estate developments which more easily align with requirements of the tax incentive.**

**The design of the tax incentive makes it difficult for existing businesses to qualify for and secure investment.** Equity investments, the tangible asset requirement, and the ten-year investment timeline have driven a majority of Opportunity Zone Funds and investments towards real estate. This has pushed business investments—especially existing small businesses, which the tax incentive is expressly intended to support—to the periphery. One barrier to small business investment is that the tax incentive does not allow Opportunity Zone investors to invest Opportunity Zone capital in the form of debt. Debt is the primary source of capital for small business growth, but the tax incentive is structured to favor longer term equity investments with higher return requirements than can typically be offered by low-growth small businesses.<sup>2</sup>

**There's often a mismatch between the investment targets of Opportunity Funds and the investment opportunities and needs of minority-owned and legacy businesses.** To meet tax incentive rules and their investment goals, Opportunity Funds tend to target start-ups with large capital investment needs and equivalent equity to offer in return. Small business owners have smaller capital needs and want investors to provide social capital and business expertise in addition to their investment.

**There's a spatial mismatch between who is investing in Opportunity Funds and who is most affected.** Successful investments in minority-owned legacy businesses usually require unique knowledge and familiarity that only a locally-based investor or deal broker would possess. Most investors, however, are not located within the Opportunity Zones where they are seeking to invest. Accordingly, a centralized and easily accessible match-making ecosystem dedicated to minority legacy businesses is needed to close this spatial mismatch.

**A lack of impact or reporting guidelines has encouraged investors to seek out stable, high-rate-of-return investment opportunities such as commercial real estate that may or may not bring the social impacts desired by the community or legislators.** Fund managers reported that investors are rarely solely motivated by the idea of garnering positive social impact. While not surprising given that it follows the typical strategies and priority of real estate investors, it also means that other policy guidelines would be needed to fully realize the incentive's other goals, such as long-term job creation, poverty reduction, and support for existing and new businesses. Above all, existing regulations do not mandate any sort of monitoring or evaluation process to track investments, projects, or community impacts, making it hard to prove or disprove whether or not these investments fuel displacement in any form.

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2. The Long Odds of Getting Opportunity Zone Capital to Opportunity Zone Businesses. [Next City](#), 2019

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# Recommendations

There are several changes that could be made, from within the federal legislation down to action at the municipal level, to better support **minority-owned**, legacy businesses and guide meaningful Opportunity Zone investment in their communities. The report makes the following recommendations:

## 1. Create a new class of investment priorities to elevate investments in existing businesses

**a. Allow investments to be made in the form of debt:** Opening up investments through debt will allow existing small, minority-owned and legacy businesses to access Opportunity Zone investments without giving up equity in their businesses.

**b. Change the tangible asset requirements for some existing businesses:** Rather than having to meet the 70/30 tangible asset requirement, businesses which already, and exclusively, existed in Opportunity Zones prior to their designation should qualify as Qualified Opportunity Zone businesses.

**d. Streamline legacy and minority-owned business designations:** The creation of a nationally recognized legacy and minority-owned business designation would be an important first step in making reliable business data widely available.

**e. Offer a guarantee of the tax benefit to those investing in existing small businesses within Opportunity Zones:** The exact tax benefit is only clear once investors exit their Opportunity Zone investment. A predictable, guaranteed benefit level could be offered for those who invest in small, minority-owned and legacy businesses.

## 2. Give residents and employees the opportunity to be investors

Empower those who live and work in Opportunity Zones to benefit from the tax incentive and shape their community by waiving the requirement that investments be made only through unrealized capital gains, which only a small slice of Americans even possess.

## 3. Require investments to reinforce local plans

Tighten Opportunity Zone legislation to require Opportunity Zone designations to be based on existing community planning efforts and frameworks.

## 4. State and local governments should be actively guiding investments

State and local governments should play an active role in prioritizing and fostering investments that are in line with community goals in Opportunity Zones, including providing explicit support for innovative broad based ownership models.

## 5. Prepare businesses for potential investment

Implement or support technical assistance for businesses to better prepare for Opportunity Zone investment. One method would be to create an academy or incubator program for minority-owned businesses within Opportunity Zones in high-growth industries.



## 6. Encourage investments in vehicles focused on employee buyouts

Allowing investments to be made in the form of debt (recommendation #1a) creates more opportunities for business investments. Specifically, investment vehicles should prioritize the transition of equity ownership from founding entrepreneurs of Qualifying Opportunity Zone businesses to the employees.

## 7. Improve transparency and accountability to track the impact of Opportunity Zone investments

In order to do so, a system must exist that publicly keeps a record of projects that have benefitted from the funds in order to disaggregate and understand the data. In addition, communities need to have a way to have input and/or hold investors accountable.

## 8. Center community benefit

Positive community impact, guided by the community itself, should be a priority. For example, a requirement that Opportunity Funds investments be connected to or in line with existing plans and goals that are based on community input is one way to ensure that development is meeting community needs in some way.

As Opportunity Zone investments continue and their impact is more pronounced and tangible, these recommendations can help the tax incentive bring benefits to communities in ways that support current residents, mobilize local economies, provide job opportunities, and protect legacy businesses.

Photo by Thomas Hawk



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# Who we are

**Smart Growth America** (SGA) advocates for people who want to live and work in great neighborhoods. We envision a country where no matter where you live, or who you are, you can enjoy living in a place that is healthy, prosperous, and resilient. We believe smart growth solutions support thriving businesses and jobs, provide more options for how people get around and make it more affordable to live near work and the grocery store. SGA has a strong track record of working with communities around the country and at the state and federal level to support economic development, policy change, transportation reform, and the tools needed to realize our vision of livable places, healthy people, and shared prosperity.

SGA recognizes that with the enormous excitement amongst investors and local policymakers, there's also enormous concern among local policymakers and community groups who are afraid that this tax incentive will crowdsource unmanaged gentrification and displacement or accelerate climate change. But there is a better way to invest. SGA's National Opportunity Zones Ranking Report ranks each of the designated Opportunity Zones based on its Smart Growth Potential as well as its Social Equity + Vulnerability Index score.<sup>3</sup> This study creates a "Smart Growth Potential" filter for investors to identify which Opportunity Zones should be prioritized for investment from a triple-bottom-line perspective that can deliver positive economic, environmental, and social returns. Additionally, this study is intended to provide local policymakers and community groups with a policy framework to manage and ensure equitable, inclusive development in Opportunity Zones.

**The Democracy at Work Institute** (DAWI) was founded by the US Federation of Worker Cooperatives as the only national organization dedicated to ensuring the field of worker cooperative development in economically and socially marginalized communities is adequately supported, effective, and strategically directed.

Amidst the overlapping crises of a post-COVID recession and the Silver Tsunami, the United States is at risk of losing its small businesses forever. Business owners are being forced into choices that will devastate local economies: sell to larger corporate competitors or private equity that will consolidate and downsize, or retire and close their businesses for lack of a buyer. These transitions of locally owned small and medium businesses will likely result in large scale job losses, decrease in local ownership, and growth in economic inequality. But there is another choice.

DAWI helps preserve locally-owned "legacy" businesses by supporting small business owners to sell to what is often their best buyer: their employees. For the past several years, DAWI has been working with partners like the National League of Cities and the National Urban League to explore systems-level supports for these business transfers, including local, state and federal policy, economic development incentives, and targeted financing. Thoughtful and innovative approaches are required to overcome the exponential effects of the interplay among the wealth gap and the credit gap. We undertake this project in the hope that Opportunity Zones may be one of the interventions that can be used to retain small businesses and the critical services, goods and jobs they provide. More information on employee stock ownership plans (ESOPs) can be found in the appendix.

The recommendations and views included in this report are those only of the authors.

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3. LOCUS National Opportunity Zones Ranking Report. [Smart Growth America](#), 2018



# INTRODUCTION

## What are Opportunity Zones?

The Tax Cuts and Jobs Act of 2017 included a new and potentially powerful economic development tax incentive—the Investing in Opportunity Act—designed to encourage long-term private **capital investment** in America’s low-income communities and “spur economic development and job creation in distressed communities.”<sup>4</sup> The approach was originally presented by an Economic Innovation Group (EIG) advisory group as an alternative to previous federal efforts targeting distressed communities; namely Empowerment Zones, Renewal Communities, Enterprise Communities, and the New Markets Tax Credit. These were generally considered to be overly-complex and underutilized, relied on weak or misaligned incentives, had restrictive scopes, and lacked force multipliers.<sup>5</sup> The legislation was led by Senators Tim Scott and Cory Booker, with support from a bipartisan group of policymakers and organizations. With over 8,700 Opportunity Zones—scattered across the continental US, the District of Columbia, and US territories—now eligible to tap into trillions of dollars of **unrealized capital gains** to support redevelopment projects and new businesses, there is tremendous interest among both investors and local policymakers.

The tax incentive allows investors to reinvest unrealized capital gains into long-term revitalization projects in underserved zones. Put another way, anyone expecting financial returns on the sale of assets that have grown in value—real estate, stocks, bonds, etc.—could dramatically reduce their long-term tax exposure by investing those returns instead into specific **census tracts** that have been in need of more investment than the market has been providing. This would help incentivize new capital investments in selected census tracts with high poverty rates, low incomes, and a lack of private investment.

The chief executive (i.e., governors) of each U.S. state, U.S. territories, and the mayor of the District of Columbia were tasked with identifying eligible zones within their states at the census tract level and selecting up to 25 percent of the roster to participate in the program, thus designating each as Qualified Opportunity Zones. These elected leaders were given 90 days to nominate the participating tracts within their respective jurisdictions, becoming official after the Treasury Secretary certified each. The criteria that made a census tract eligible for the designation, typically identified as low-income communities, were based on Section 45D(e) of the tax code. These include: (a) tracts in which the poverty rate is at least 20 percent; or (b) tracts in which the median family income does not exceed 80 percent of the statewide median family income if located outside of a metropolitan area; or (c) tracts in which the median family income does not exceed 80 percent of the statewide median family income or the metropolitan area median family income, whichever is higher.<sup>6</sup>

Governors were directed by the legislation to aim at “geographically concentrated and contiguous clusters of census tracts and pay particular consideration to areas that are currently the focus of mutually reinforcing State, local, or private economic development initiatives to attract business and foster startup activity; have demonstrated success in geographically targeted development programs, such as promise zones, new market tax credit, empowerment zones, and renewal communities; and have recently experienced significant layoffs due to business closures or relocations.”<sup>7</sup>

4. Opportunity Zones. [Internal Revenue Service](#), 2020.

5. Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas. [Economic Innovation Group](#), 2015.

6. Opportunity Zones: A New Economic Development Tool for Low-Income Communities. [Economic Innovation Group](#), 2018.

7. S.293 - Investing in Opportunity Act. [115th Congress](#), 2017.

The Council of Economic Advisers (CEA), an agency within the Executive Office of the President focusing on economic policy, estimated in August 2020 that existing Qualified Opportunity Funds accounted for \$75 billion in private capital by the end of 2019.<sup>8</sup> The Department of Treasury estimated a total of 1,500 Opportunity Funds in 2018 based on preliminary Form 8996 filings, but as there are currently no federal reporting standards for Opportunity Funds, a definitive count has not been generated. Although the CEA estimates that 70 percent of the total \$75 billion raised by Opportunity Funds is a direct result of the incentive, there are currently no widely-accepted methods to determine how much of the total investment going into Opportunity Zones would have occurred without the incentive.

CEA's figures are based on data collected from Novogradac, a national professional services organization that has tracked funds since May 2019, and tax filings from the Securities and Exchange Commission (SEC). Novogradac's publicly available Opportunity Funds List includes a wide spectrum of fund sizes and foci, from global investment firm SkyBridge Capital's \$3 billion fund pursuing real estate development nationwide, to Aliquippa Renaissance Fund's \$5 million fund dedicated exclusively to community development projects in the only Opportunity Zone in Aliquippa, PA.<sup>9</sup>

## Types of Opportunity Zone investments

According to the Investing in Opportunity Act (Deferral for Capital Gains Invested in Opportunity Zones, Sec. 1400-2.c), there are four (4) types of investments a person can make to Qualified Opportunity Zone funds:<sup>10</sup>

### Qualified Opportunity Zone Property:

1. Qualified Opportunity Zone Stock: Stock that is acquired from a corporation that is a Qualified Opportunity Zone business.
2. Qualified Opportunity Zone Partnership Interest: Any capital or profits interest in a domestic partnership that is a Qualified Opportunity Zone business
3. Qualified Opportunity Zone Business Property: Tangible property of which the original use commences with substantial improvements to the property, and is located within an Opportunity Zone.

**Qualified Opportunity Zone Business:** A trade or business in which substantially all of the tangible property owned or leased is qualified Opportunity Zone business property.

Qualified Opportunity Funds are considered any investment vehicle organized as a corporation or partnership for the purpose of investing in Opportunity Zone property. In order to qualify for the tax incentive, 90 percent of the available money in each Fund must be invested directly in projects within Opportunity Zone boundaries. About a third of all projects featured in the Opportunity Exchange, a major privately-owned hub curating active Opportunity Zone projects, are businesses seeking equity investments.

8. The Impact of Opportunity Zones: An Initial Assessment. [Council of Economic Advisers](#), 2020.

9. Opportunity Funds List. [Novogradac](#), 2020.

10. 26 USC 1400Z-2: Special rules for capital gains invested in opportunity zones. [Internal Revenue Service](#), 2020.



While incentives can certainly be beneficial, they can also threaten the economic security and stability of local residents and businesses—particularly those who were already vulnerable.



## What's at risk with Opportunity Zones?

Fiscal incentives can attract investments that strengthen tax bases, activate social and commercial public spaces, and increase access to economic opportunities for local residents. **While incentives can certainly be beneficial, they can also threaten the economic security and stability of local residents and businesses—particularly those who were already vulnerable.** Policies that promote new market-rate development and other investments can make land values rise, which in turn can have an enormous impact on housing affordability. Similarly, the introduction of new economic stakeholders to the local market can have a devastating impact on local small businesses as they often lack the resources that would allow them to survive the transformation of their commercial landscape.

There are no federal mechanisms in place to ensure that investors are framing their projects and goals around positive impact in the community, making Opportunity Zones a powerful tool for potential displacement in high growth markets. Today, most of the responsibility of integrating the tax code into the local fiscal structure and aligning it to local development goals falls on overworked or understaffed municipal governments—an existing problem that will be exacerbated as their budgets are likely decimated by the COVID-19 pandemic. Displacement will remain a serious threat as long as programs and policies to counteract the negative effects of gentrification within Opportunity Zones are inadequate and fail to support low- to moderate-income households and businesses. This is a particular concern for the low-income people living in communities from which the government has historically and systemically disinvested.

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# Opportunity Zones and small businesses

The Opportunity Zone tax incentive provides avenues for investors to invest in real estate or business opportunities. The combination of the COVID-19 pandemic, subsequent recession, and the associated psychological toll is likely to cause a meaningful segment of business owners to seek a way out, resulting in a flood of businesses being put up for sale and even more shutting down for good. Regrettably, many of the businesses that will close are inherently high-quality firms that would have recovered post-crisis. A recent report published by California Santa Cruz Economics Professor Robert Fairlie found that COVID-19-related business closures have taken a disastrous toll across racial groups, with minority-owned businesses suffering disproportionately in a crisis that's also killing nonwhite Americans at higher rates and eliminating more of their jobs. The total number of active business owners has dropped 22 percent from February to April, based on granular data from the federal government's employment surveys that were made available May 2020, and the number of working African American business owners in the United States plummeted more than 40 percent.<sup>11</sup>

The combined impact of COVID-19-related closures coupled with a generational wave of Baby Boomers (sometimes called the "Silver Tsunami") considering retirement will continue to widen the asset ownership gap in this country—accelerated by the prolonged shutdown of retail corridors across the country. Tens of thousands of legacy businesses are now at risk of closing, especially in low-income neighborhoods. When **legacy businesses** close—longstanding businesses owned by community members—people lose jobs, neighborhoods lose economic anchors, and communities lose beloved institutions. The employees of many companies are best positioned to keep them running and locally-owned and often, they may be the only buyers. Like all commercial buyouts, either debt, equity, or some combination thereof is used to acquire shares or assets from the existing owner. While most employees of small, locally owned businesses don't have the personal capital to purchase the business from the owner, the business itself may have inherent value—real estate, equipment, customer lists, recurring cash flow—that could be leveraged to provide some, if not all, of the needed acquisition financing. The existing world of impact funds that utilize an employee buyout strategy

in minority communities recognize the inherent value of these businesses and look to balance this value with the risks of small business investment.

One fundamental mismatch between **Opportunity Zones** and small businesses is that equity is the only form of capital mobilized under current regulations. Historically, equity has been relatively inaccessible to small business owners—particularly those identifying as a racial minority. Modest amounts of **equity capital** are often provided to small businesses by owners' friends and family. The wealth gap across racial groups is vast across the United States, resulting in an enormous disadvantage for Black and Brown business founders and owners even without considering incentives like Opportunity Zones.

When it comes to small, legacy businesses, equity capital can pose an additional layer of management challenges. When equity capital is provided, business owners are often required to prioritize their investors' interests when making business decisions in order to remain legally complicit, which presents a barrier for those who intend to maintain the character of their long-standing, neighborhood business. Equity investments also demand larger shares of businesses' profits as they are considered to carry higher risk than a lending transaction, making this channel of funding impractical for many small businesses.

Business owners that resort to investment firms or other entities they might have not previously had a relationship with can face a series of obstacles in doing so, mostly from the overwhelming financial implications of the process. Acquiring legally-compliant equity investments can be extremely financially demanding — and many times prohibitive — because of extensive quality controls and other compliance standards involved in the process. The fund structures involved in applying for Opportunity Zone capital, and even the fees involved in managing a **Qualified Opportunity Fund**, are not currently standardized. Businesses' access to Opportunity Zone funding involves a two-tier structure: (1) forming or converting an existing business into a Qualified Opportunity Zone Business (QOZB) (2) through a Qualified Opportunity Fund. Producing an application and necessary documentation for an equity investment can cost a business owner up to \$50,000 when considering management and performance fees, among other components of the process.

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11. The Impact of COVID-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey. National Bureau of Economic Research, 2020.



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## Our research

Much of the discussion on Opportunity Zone investments has focused on community impacts through the real estate market. With the high level of activity, interest, and excitement around Opportunity Zones and their potential for community development, SGA and DAWI set out to assess the risks and rewards for minority-owned legacy businesses within Opportunity Zones. While there are data limitations and various ways of categorizing businesses, the research team established the standard of legacy business as operating for 10 or more years—a timeframe commonly used around the country—and relied on businesses to self-identify as minority-owned.

As a community development tool, Opportunity Zones have also been discussed as a way to help business owners and community members extract value and build community wealth from future Opportunity Zone capital investments. As the Opportunity Zone tax incentive matures, investments have the potential to close economic gaps—or further widen the economic and social stratification nationally. As discussed above, there are serious challenges for legacy and small businesses due to a lack of access to capital, lack of investment in community infrastructure, and a changing global economic structure—which have been exacerbated by the COVID-19 pandemic.

**The question we sought to answer was whether Opportunity Zone capital investments are being made to support legacy business stability and growth, and therefore achieving the incentives goal of place-based economic development and job creation in distressed communities. If not, what are the obstacles and challenges preventing this?**

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The groundwork for this research was conducted in early 2020, and the interviews with business owners, municipal staff, and Opportunity Zone fund managers were conducted in March and April of 2020, before we fully understood the longevity and impact of the COVID-19 pandemic in the U.S. and around the world. The data on businesses and other economic trends was collected pre-pandemic and includes information from the 2018 American Business Survey, American Community Survey, and other sources. It does not reflect the full impact of the economic crisis that has resulted. As the project proceeded, it became clear that the consequences of the pandemic would be extremely relevant to businesses struggling to operate in such a challenging and unprecedented time, and that Opportunity Zones could be a tool for recovery for both businesses and local economies.

To understand the specific impacts on minority-owned legacy businesses, the SGA and DAWI research team began by identifying four cities in different regions of the United States: Miami, Florida; Atlanta, Georgia; Louisville, Kentucky; and Washington, DC. From these four cities, the research team sought to form an understanding of Opportunity Zone activity and investment trends.

To build a nuanced perspective, the team reached out to three groups who interact with, implement, or may be target recipients or otherwise impacted by the tax incentive: municipal staff in economic development or planning departments who are providing local oversight, Opportunity Zone fund managers who have focused their fundraising and projects in the city of interest, and small business owners in Opportunity Zones.

For each individual contacted and subsequently interviewed by an SGA or DAWI staff member, we worked to answer the following questions:

### **1. Are opportunity zone funds investing money in the “right” places?**

From the introduction of the tax incentive, Opportunity Zones have been characterized as a system to incentivize revitalization in low-income communities. In the two years that the tax incentive has been operating, which communities are benefitting from the incentive and how?

### **2. What investments are being made? How are they impacting commercial space and existing businesses?**

This is a study of Opportunity Zone investment trends. For communities that have been successful in attracting investment using Opportunity Zone funds, is there a dominant investment product type? What is the split between commercial, multi-use, and residential? Further, what are the measurable impacts of these investments in the greater community?

### **3. How can Opportunity Zones support minority-owned legacy businesses?**

In its current form, in what ways can the Opportunity Zone tax incentive be of use to longstanding businesses?

To supplement the interviews, national Opportunity Zone investment trends were tracked for each city. These trends supplied the dominant product types and average Opportunity Fund sizes. In addition, the research team spoke with leaders in the field and those with broader, national perspectives on the Opportunity Zone tax incentive.



The interviews and the national trends uncovered discrepancies in how the Opportunity Funds have been administered, the types of investments occurring, and those whom would ideally benefit from the tax incentive. In early 2020, the House Committee on Small Businesses held a hearing titled, “Can Opportunity Zones Address Concerns in the Small Business Economy?” In this hearing, representatives from The Urban Institute, the Kresge Foundation, the Opportunity Finance Network, and the Economic Innovation Group prepared statements indicating a bleak future for the Opportunity Zone tax incentive and its relationship to small businesses.<sup>12</sup> Witnesses cited insufficient reporting and data collection, fundraising limitations, regulatory barriers to investing in small businesses, and limited place-based targeting as some of the major challenges of the Opportunity Zones tax incentive—findings that also square with the findings in this report. Proposed solutions—many of which line up with our findings and recommendations in this report—include:

1. Tightening of eligible zones by removing all contiguous census tracts. Instead, Opportunity Zones should be designated by the census block group to allow for increased specificity in investments.
2. Establishing new restrictions on Opportunity Zone investments. For instance, only authorizing real estate transactions if the business is the owner/occupant or where housing is sold at or below market-value.
3. Preferential treatment for investments directly made into Community Development Financial Institution (CDFIs).
4. A transparency requirement by Congress for transaction-level reporting that answers all questions related to who, what, why, when, and where in regards to the investors, investment locations, and the size of the investment.
5. A restructuring of the tax incentive to create a sliding scale for allocation of benefits, which would be dependent on the level of economic distress, which would include factors such as poverty and employment rate, educational attainment, and median household income, within an Opportunity Zone.

Another legislative effort was made through the COVID-19 Impacted Small Business Opportunity Zone Act (H.R. 6529). This bill, introduced to the House in April 2020, would enable all small businesses to be designated as qualified Opportunity Zone businesses. If implemented, the designation would make tax benefits, such as capital gains treatment, available to small businesses experiencing significant disruptions during the ongoing crisis. Since April, no further action has been taken on the legislation.

Funds such as the Small Business Investment Fund have made attempts to foster an environment that is suitable for small businesses. Managed by DelCam Holdings, this \$10 million private equity investment fund intends to revitalize small manufacturing companies in the Northeast and Mid-Atlantic by generating “superior” internal rates of return for investors.<sup>13</sup>

12. Can Opportunity Zones Address Concerns in the Small Business Economy? [Committee on Small Businesses](#), US House of Representatives, 2019.

13. DelCam Holdings Announces Launch of Innovative New Investment Fund Targeting Small Businesses in Opportunity Zones. PR Newswire, 2019.

# CASE STUDIES

## Demographic and economic trends

There are 93 Qualified Opportunity Zones among the four municipalities analyzed in this report. Out of the four focus cities, Miami has the greatest number of Opportunity Zones and therefore the highest percentage of individuals and households within the city who are located within an Opportunity Zone. Washington, DC has the greatest household income difference between Opportunity Zone designated census tracts and the city as a whole with a 76.8 percent difference, but it also has the lowest rates of poverty as expressed both in the percentage of individuals under the poverty line and in the difference between poverty rates in Opportunity Zones and the city as a whole.

Census tracts that have been designated as Opportunity Zones generally consist of disinvested areas that have higher rates of poverty when compared to their encompassing cities. The starkest economic disparities are captured through the employment status of individuals living within Opportunity Zones compared to the general population. Residents of Louisville's Opportunity Zones are experiencing an unemployment rate over three times higher than the city on average, with over 10 percent of the workforce without a job in 12 of the 19 opportunity zones.

Although the racial composition of the four analyzed cities is vastly different, the share of the population identifying as Black or African American is considerably higher in Opportunity Zone designated tracts compared to the general population in each of the study case cities. This demographic group accounts for the largest share of the population living in Opportunity Zones followed by White alone (not Hispanic or Latino) in all cities except for Miami where 43.0 percent of those living in opportunity zones identify as Hispanic or Latino of any race. This pattern of racial segregation becomes even more evident when analyzed proportionally—Black or African American individuals make up 15.3 percent of the total population in Miami but account for over half of those living within one of the city's Opportunity Zone designated tracts.

The majority of housing units located within Opportunity Zones are occupied by renters in the four analyzed cities. Louisville shows the sharpest contrast in housing tenure: A mere 23.1 percent of housing units across the city's 19 Opportunity Zones are owner-occupied compared to 60 percent in the Louisville-Jefferson County Metro Government area.

### CHART 1

Population and economic data for case study cities

	ATLANTA		LOUISVILLE		MIAMI		WASHINGTON, DC	
	City	OZs	City	OZs	City	OZs	City	OZs
<b>POPULATION</b>								
Census Tracts		24		19		24		26
Population	498,073	82,246	617,032	58,785	470,911	113,694	702,455	99,939
Households	211,819	31,618	246,382	23,086	182,631	39,078	287,476	37,597
Avg Household Size	2.2	2.5	2.4	2.3	2.5	2.8	2.3	2.5
<b>ECONOMIC</b>								
Median Household Income	\$36,832	\$26,140	\$51,307	\$23,201	\$36,638	\$24,974	\$50,978	\$39,178
Poverty	20.0%	37.0%	17.0%	43.0%	22.0%	36.0%	16.0%	28.0%
Labor Force Participation	65.7%	58.0%	65.2%	55.3%	62.4%	57.0%	70.7%	57.6%
Unemployment	5.7%	16.0%	4.2%	13.9%	4.3%	14.0%	7.5%	16.0%

Source: American Community Survey 2018, 5-Year Estimates

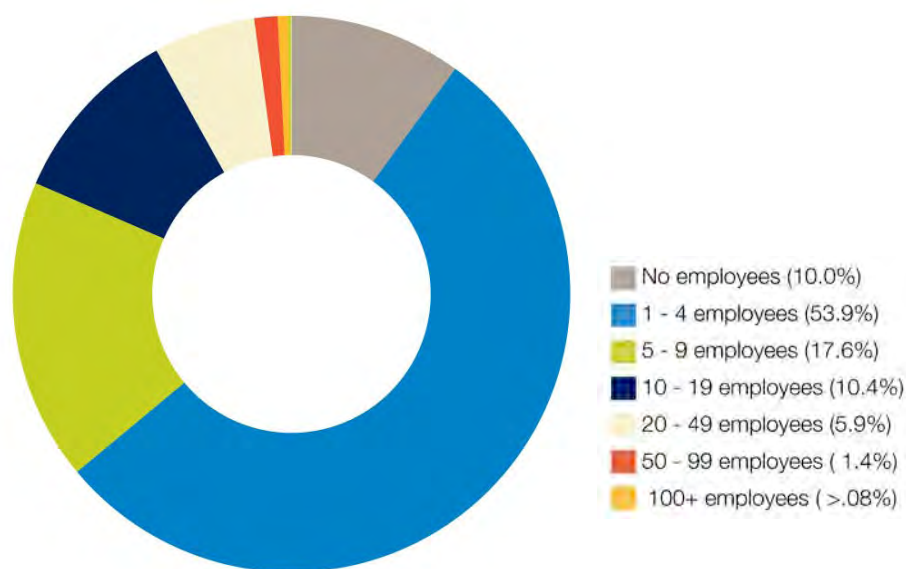


## National business trends

The U.S. Census Bureau conducts the Annual Business Survey (ABS), providing annual data on select economic and demographic characteristics of employer businesses based on the Survey of Business Owners and the Annual Survey of Entrepreneurs, among others. The 2018 ABS was published in May 2020 and references 2017 for the most recent information available, including data on minority- and women-owned businesses at the national level.

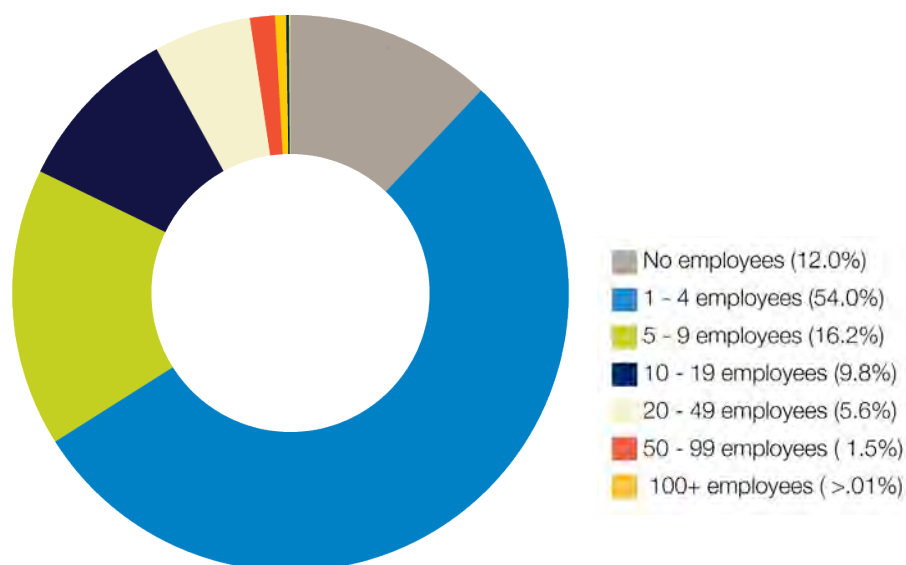
### CHART 2

Racial minority-owned businesses by size



### CHART 3

Women-owned businesses by size



# Our findings on Opportunity Zone investments

Based on interviews with business owners, municipal staff, and Opportunity Zone fund managers in four cities, the research team drew the following conclusions about the impact of Opportunity Zones on the ground and how these stakeholders are interacting with them. Key components of the Opportunity Zone tax incentive regulations have naturally favored real estate investments over business investments. Our findings below explain why this is the case and detail the specific challenges businesses face in mobilizing capital through the tax incentive. The conclusions drawn in this report are the result of interviews with a mix of local government officials, Opportunity Zone fund managers, and legacy business owners in the cities of Atlanta, GA, Louisville, KY, Miami, FL, and Washington, DC.

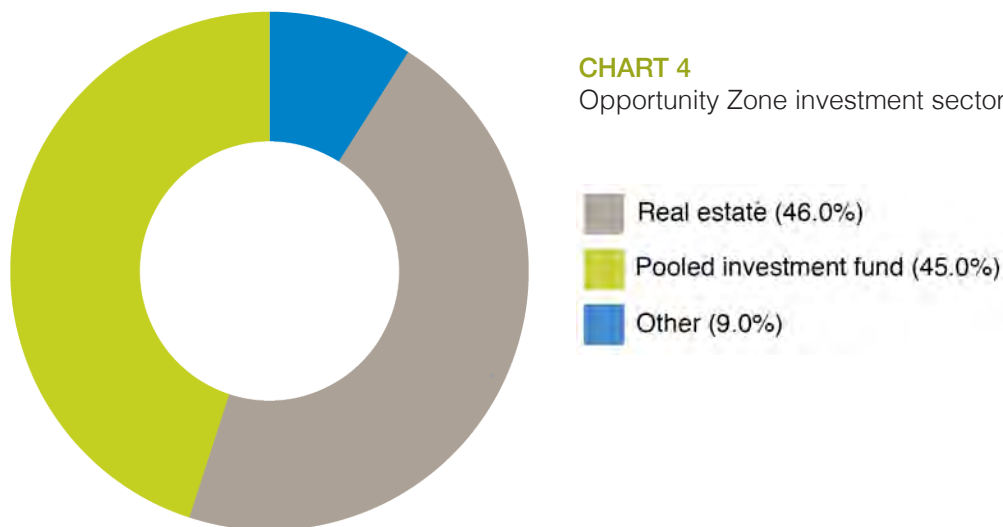
## Most Opportunity Zone Funds are invested in real estate, not businesses

Though the tax incentive permits capital to be invested in qualifying real estate opportunities or existing businesses, **the vast majority of projects both seeking and receiving Opportunity Zone funding are real estate development projects.** Opportunity Zone fund managers and business owners both described the tax incentive as a “land grab” given the large amount of real estate investment it has garnered.

Though there is no centralized database to track investments, the following figures from national trends and patterns in our focus cities help quantify this trend. At a national level, data from the Securities and Exchange Commission (SEC) provides some insight into the sectors of investment Opportunity Zone funds are operating within. In total, 46 percent of Opportunity Zone funds reported to be investing in real estate, while 45 percent reported to be operating as pooled investment funds and therefore have investments across different sectors, while the remaining 9 percent

reported to be investing in other industries which includes healthcare, technology, construction and investments. At the time of research, the City of Atlanta had 40 projects featured on its Opportunity Exchange page and nine on its OppSites page seeking Opportunity Zone funding. Of the 40 projects on the Opportunity Exchange, 30 projects were seeking funding for real estate project opportunities, over half of which (16/30) were multi-family housing developments. The remaining ten projects listed were businesses, five seeking investment for real estate expansion or acquisition, and five seeking investment for other business expansion efforts. The total investment sought by all projects was \$409 million, with a minimum investment of \$500,000 and an average of nearly \$12 million.

Similarly, in Washington DC, there were 12 projects listed on the DC Opportunity Zone Marketplace with investment equity sought totalling \$38 million and an average of \$3 million sought per project.





Ten of these projects were real estate ventures while only two were operating businesses. Similar to Atlanta, half of the real estate projects were multi-family housing developments while the rest were retail, arts, or manufacturing.

In Miami, investment patterns are similar with multi-family housing developments constituting the majority of real estate investments, however there is no online portal to facilitate or help track such investments. Kentucky has an online portal where potential Louisville projects could be listed, but as of yet, none have been added, including potential business investments. This does not preclude Opportunity Zone funding from being deployed, but it does mean that Louisville does not have the same information about projects which may have been funded.

**There is currently no centralized tracking portal or reporting guidelines for Opportunity Zone funds or projects. Because of this, many cities—and sometimes states—have opted to make use of online matchmaking portals which list Opportunity Zone funds, projects and businesses seeking investment.**

*Some of the most utilized portals include The Opportunity Exchange, which has over 400 Opportunity Zone projects and businesses listed, and The National Opportunity Zones Marketplace OppSites with 1,030 projects and businesses listed. While a project or business listing on one of these sites may increase visibility and therefore chances of attracting potential investors, there is no guarantee. Even though some cities choose to promote investor and project presence on one of these sites, there is no regulation that requires that projects or funds be tracked or listed.*



SGA Opportunity Zones Marketplace

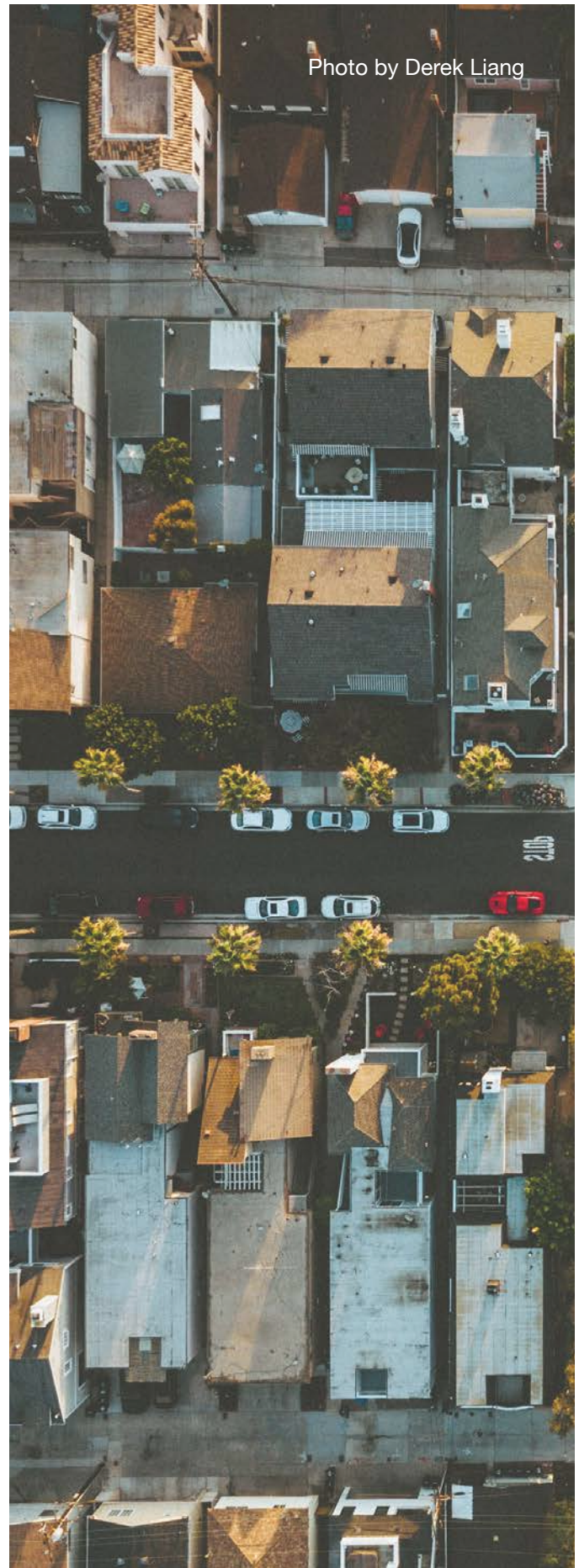


Photo by Derek Liang

## The design of the incentive makes it difficult for existing businesses to qualify for and secure investment

Investments in existing small businesses and minority-owned legacy businesses—longstanding businesses owned by community members—create and maintain jobs within the community and provide critical goods and services. To neglect these businesses is to neglect a vital force in local economic development.

These investments are often more challenging and may require more specialized expertise, however the following key factors only prove to compound the desirability of real estate investments over business investments.

### 1. Small, minority-owned and legacy business owners find it difficult to relinquish equity to investors

Debt and equity financing offer distinct advantages and disadvantages for different investment scenarios. For small businesses that are not interested in losing significant shares of equity or selling their business completely, financing through debt is often the preferred option. Debt financing for businesses ensures that lenders do not have control over business decisions, the relationship has an end date when the debt has been paid off, payments are predictable and interest is tax deductible. It is a straightforward exchange of capital for capital plus interest in return.

In contrast, financing through equity means the business owner must offer up shares of equity, though all risk is assumed by the investor and the business owner does not have loan payments. Equity investments are generally more favorable for start-up businesses that require cash for working capital and have more difficulty securing loans from banks, and especially for those in high growth industries where investors incur risk with the potential for high profit. Legacy businesses, which are more likely to experience slow growth, are thus inherently less desirable for investors. While equity can offer more flexibility and are well suited for some scenarios, investors are likely to require high rates of return and remain shareholders until they can be bought out. There are however, several private investment vehicles that recognize these difficulties with

third-party equity investment in small and medium locally-owned businesses, and look to address them through employee buyout strategies that utilize debt, equity, and mezzanine type investments.

The investment vehicles, which may in structure look like traditional private equity or private debt funds, also work on a timeline which is conducive to successful ownership transitions. Specifically, these funds have lifespans of 8-10 years, allowing them to both find and make investments, and to work closely with the firm's management teams and the workforce to successfully build the internal leadership and systems that allow for long term business growth and resilience.

These models directly address the concerns that legacy business owners have about selling equity to third-party buyers. By anchoring the acquired business and its related jobs in the community by transitioning some or all of its ownership to its local workforce, the founding owners are provided with the capital they need to either retire from the business or grow the business. While employees are provided with equity ownership of a healthy commercial enterprise.

**The vast majority of business owners interviewed disclosed the challenge of relinquishing equity in their business as a way of bringing on new investors.** Opportunity Zone regulations contribute to a system in which business owners, to offset the predetermined risk by Opportunity Zone Funds, must sacrifice significant shares of ownership. While relinquishing shares of equity is better suited for start-ups or those looking to sell, it is burdensome for small, minority-owned or legacy businesses who are often not looking to give up ownership. Legacy and minority-owned businesses voiced the preference of obtaining investments in the form of debt rather than equity.

This same subset of business owners also explained the desire for angel investors who could contribute not only monetarily but also in social capital and in other technical or business-related knowledge.



In addition to the demand for capital, business owners explained that at times it is equally important to have access to social capital and business support and training programs. For legacy businesses specifically, the need for business support was especially apparent as many did not have the capacity or skills to adapt to the technological demand brought on by the pandemic for businesses to make their products and services available through online platforms.

In the context of the ongoing COVID-19 pandemic, businesses in need of capital to survive could utilize investments in the form of debt. Further, the likely economic recession to follow will make higher risk investments less attractive to investors, while the need for investment in distressed communities, local businesses, and job creation will be higher than ever.

## 2. The tax incentive encourages investment in newer, less-established businesses

After initial uncertainty, the IRS guidelines for business investments under the tax credit were clarified in April of 2019, a year and a half after the original guidelines were published, and again in June 2020. Under these guidelines, 70 percent of any tangible assets owned by an existing business must be “substantially improved” or be “new use” assets.<sup>14</sup>

This presents a challenge because so much investment must be made in “new” assets—purchasing new equipment or space may be the only way to meet with the requirement. In addition the business must satisfy one of three safe harbor requirements to satisfy the 50 percent gross income test outlined in the IRS regulations.<sup>15</sup> **For businesses already existing within Opportunity Zones, these regulations pose yet another barrier, but allow for businesses outside of Opportunity Zones or start-ups to access Opportunity Zone funds with comparative ease.**

When asked about the type of business that would be a good fit for investments from the tax incentive, **municipal staff and Opportunity Zone fund managers suggested that start-ups, more specifically tech start-ups, would be the best fit and most likely to receive investments through the tax incentive.** This preference primarily relates to the **tangible asset requirement**, as startups typically have significantly fewer tangible assets for businesses investments under the tax incentive. These requirements put legacy businesses especially at an extreme disadvantage given the difficulty in satisfying the tangible asset requirements.

## 3. Ten-year investments are naturally more desirable for high-value assets like real estate, rather than business investments

**The regulatory framework of the Opportunity Zone tax incentive has created an environment in which real estate development provides a much more desirable opportunity for interested investors.** Current regulations were created with the intent to incentivize long-term investment. As such, Opportunity Funds must maintain their investment in a qualified project(s) for 10 or more years before they see a complete cancellation of the capital gains tax.<sup>16</sup> **This required time commitment has naturally detracted from the desirability of business investments as investors there often seek the flexibility to disinvest within a shorter time period.** The regulations surrounding proof of operation within an Opportunity Zone also prove more onerous for business investments than for real estate investments. Over the ten-year period of investment, the reporting requirements for small businesses in an Opportunity Zone require a level of diligence that creates a restrictive investment environment.

14. The research team had limited ability to discern the impact of the COVID-19 pandemic on business investments and/or utilizing the statutory ability to make multiple investments and exits in qualified Opportunity Zones within the 10 year period.

15. This requirement outlines that at least 50 percent of a businesses' gross income is derived from the active conduct of the business in the Opportunity Zone.

16. Opportunity Zones. *New Markets Support Company, Local Initiatives Support Corporation*, 2020.

## Investor interests and community needs are often mismatched

Investments in businesses have not been as common not only because of the time commitment and desired project characteristics, **but also due to a motivational mismatch between the needs of existing small business owners and current investment activity in Opportunity Zone tracts.**

Other challenges mentioned by business owners, fund managers and municipal staff: 1) investors seek larger and more predictable investment opportunities, 2) investors rarely share the same goals as the communities in which they invest and 3) the tax incentive is difficult to understand, especially for small business owners.

### 1. Investors generally seek larger, and more predictable, investment opportunities

Existing Opportunity Zone regulations do not state an explicit capital baseline for funds, however attracting capital investment into funds presents a major hurdle for smaller-scale or mission-based projects. Fund managers explained that it is unlikely for projects seeking smaller investment amounts to receive funding due to the increased risk and diminished opportunity for significant returns on investment. For investors seeking significant returns on their investments, large real estate projects offer the greatest certainty for these returns. Existing businesses interested in seeking investment through Opportunity Funds understand this challenging dynamic.

**For one business owner operating in Atlanta hoping to expand operations through the purchase of two separate parcels of land, conversations with potential investors made it clear that they were not interested in investing unless the business was going to acquire at least five new parcels of land for expansion.**

According to fund managers, investors express little to no interest in projects or investment opportunities of less than \$1 million. Unable to produce projects of this size to investors, this real estate business joins many other businesses who have been excluded from taking advantage of the Opportunity Zone tax incentive.

Another business owner in Atlanta who had created an Opportunity Fund for his real estate business also expressed frustration with investors being unwilling to take on smaller projects, citing investor desire to “write big multi-million dollar checks.”

**Investors stated that from their perspective, it does not make financial sense to split up their capital gains to invest in multiple small business ventures when they could invest the entire amount in one real estate opportunity with far greater return potential.**

*The unofficial investment baseline is even reflected in projects listed on both Washington D.C. and Atlanta’s Opportunity Zone portals where the average investment sought in Atlanta was \$12 million while the average in Washington D.C. was \$3 million.*

### 2. Investors rarely share the same goals as communities in which they invest

Since the introduction of the Opportunity Zone tax incentive, two dominant types of Opportunity Zone funds have emerged: 1) funds that were formed independently from any existing businesses with the purpose of seeking out desirable projects (real estate and/or business) that are in alignment with the goals of those who create funds and their investors and; 2) funds that are connected with existing real estate businesses that serve as an avenue for potential (often new) investors. An Opportunity Zone fund manager in Atlanta, who owns a real estate business, explained that new Opportunity Zone investors are uninterested in encouraging the real estate business to delve into new development territory. They instead insist on businesses maintaining their success with projects that are already within the purview of the business.

**When asked about the intentions of investors, fund managers reported that investors are rarely solely motivated by the idea of garnering positive social impact.** While the added tax incentives are of interest to investors, the tax incentive has reportedly not caused a shift in investor decision-making either in the types of projects they seek out, or in the magnitude of returns they expect.



Investors are still seeking return percentages in the mid-to-high teens and are rarely interested in projects that cannot provide such returns. Given that there are many real estate projects that provide these high returns, investors are financially incentivized to make these investments. Some business owners understood this to be a factor and stressed their efforts to present their business as an appealing investment opportunity while others viewed their attempts to attract investors as futile solely due to the small amount of capital they were seeking. The tax incentive has not made investors any more readily available or accessible by businesses and fund managers are often tasked with preparing a portfolio of investment opportunities before they are able to secure investors. **Multiple business owners expressed discontentment with the fact that those with the capital gains to invest are not the same people who live in the designated Opportunity Zone tracts and, by extension, are not the people who understand what the community needs to thrive.**

### 3. The tax incentive is difficult to understand, especially for small business owners who often lack the resources and time to review the regulations

**Prior to the Opportunity Zone tax incentive, the vast majority of developers were well versed in structuring projects to incorporate a variety of tax credits and incentives, while small businesses rarely had comparable technical skills or capacity on similar topics.** This gap in knowledge has been exacerbated by the OZ program. The vast majority of business owners reported a lack of knowledge about the Opportunity Zone tax incentive though they had interest in attracting investors through an Opportunity Zone fund and in many instances were even listed on one of the cities' portals. Business owners who knew a considerable amount about the tax incentive or had created an Opportunity Zone fund for their business either had existing knowledge and experience with similar regulatory environments, or learned more about the tax incentive through their relationships with municipal staff. Additionally, even business owners who had created their own Opportunity Zone funds emphasized the difficulty of understanding and benefiting from the Opportunity Zone tax incentive, with one business owner/fund manager saying “even successful entrepreneurs don’t understand the program” and “they didn’t write [the Opportunity Zone tax incentive framework] for people to understand.” The difficulty in understanding the incentive as it relates to businesses has been well documented and is highlighted by the fact that two clarifications have been published by the IRS since the initial regulations were published.



Photo by Joshua J. Cotten



Photo by Sally Neate

## There are challenges in assessing the impacts of current Opportunity Zone projects

In August of 2020, The Council of Economic Advisors released a report assessing the initial impact of Opportunity Zones. Given the lack of reporting requirements, methods and assumptions involved in estimating the total fund sizes and impact of investments are detailed in the report and are based on extrapolations of tax filings and elective self-reporting to Novogradac. The Council estimated that \$75 billion had been raised in private capital by the end of 2019 “most of which” would not have entered Opportunity Zones otherwise.

A key component of these extrapolations included the assumption that “investors would be willing to accept a lower pretax return because of lower effective tax rates in OZs” (p.18). Our conversations with fund managers, investors, and businesses made it clear that this is generally not the case. **Investors view the tax incentive as an added benefit rather than a reason to seek lower returns.** The Council of Economic Advisors also made assumptions and extrapolations regarding the type of investments that have been made. They found that 45 percent of funds belonged to “pooled investment funds” (which were categorized as separate from real estate investments) and assumed that investments therefore spanned various industries. In our research, we found that pooled investments were often still in real estate opportunities, though they were not single projects and they combined funds from different investors. Fund managers explained the practice of creating portfolios of eligible projects before they even secured any investors so they could have a competitive advantage.

Based on these potentially flawed assumptions and extrapolations, The Council of Economic Advisors then found that with funds already raised (an estimated \$75 billion) the tax incentive “could lift 1 million people out of poverty and into self-sufficiency, decreasing poverty in Opportunity Zones by 11 percent” and add \$11 billion of new wealth for homeowners who are living in Opportunity Zones (pg. 2). But “lifting people out of poverty” requires more than just extensive new capital flowing into low-income areas that can displace existing residents without careful guardrails.

**Putting more wealth into the pockets of people who already own homes is insufficient to narrow the alarmingly large wealth gap that exists within many Opportunity Zones where, as our research has shown, a large proportion of residents are renters.**

Ownership of productive assets, like a business, has been shown to be an effective strategy for building wealth. **Employee ownership** is one way to do this, while at the same time preserving local businesses. As shown by the Federal Reserve Board of St. Louis, **business and financial assets provide greater diversification and higher average returns over time than tangible assets such as homes and cars.**<sup>17</sup> The tax incentive has been promoted as a strategy to provide jobs to economically distressed areas, however it is unclear how new real estate developments and increased home values equate to long-term high-quality jobs. Job creation is a critical part of economic stability and short-term construction jobs should not be held up as a longer-term job creation strategy.

### 1. The lack of reporting requirements makes it difficult to impossible to track project impacts

To understand the impact of Opportunity Zone projects on existing businesses, projects vying for Opportunity Zone investments were analyzed and interviews were conducted with businesses and business support organizations. **The lack of reporting requirements, in combination with the lack of investments in existing businesses, has resulted in a landscape where project impacts have primarily been left to the discretion of investors and fund managers.**

Existing Opportunity Zone regulations do not mandate a monitoring or evaluation process to track Opportunity Zone investments, projects, or community impact. As a result, the four cities studied assumed different roles in their interactions with those seeking investment and those supplying investment. The lack of public reporting requirements for Opportunity Zone projects, paired with differing levels of city involvement with the Opportunity Zone tax incentive, has severely limited public access to Opportunity Zone investment records.

17. The Demographics of Wealth. [Federal Reserve Bank of St. Louis](#), 2018.

There are few national options for Opportunity Zone investment tracking. Smart Growth America, in partnership with The Rockefeller Foundation, created the National Opportunity Zones Marketplace. The marketplace enables like-minded investors and communities to seek out or display investment opportunities from cities all over the country. The platform, however, is not intended to serve as a Opportunity Zone investment reporting and monitoring portal—meaning that much of the activity happening, even using this tool, is somewhat unknown. Cities interviewed for this report differed in their capacities to mobilize resources and people to guide Opportunity Zone funding, as well as facilitating interactions between potential projects or businesses and investors.

The City of Atlanta utilizes *The Opportunity Exchange* portal to assist in facilitating interactions between Opportunity Funds and projects. Those seeking to be listed on the portal are able to access a formal application through the city, which includes social impact projection requirements. While a project or business listing on the portal does increase visibility, which may increase chances of attracting potential investors, there is no guarantee. Each project listed on Atlanta's portal has the opportunity to describe the expected social impact of their project in terms of affordable housing units built or construction and long-term jobs created. Not every project listing on the portal opted to include these estimates; those that did projected the creation of 312 long term jobs, 544 construction jobs, and 1,677 units of housing, of which 68 percent would be offered below market rate.

Similar to Atlanta, Washington, DC has created their own portal called the *DC Opportunity Zone Marketplace*. All projects listed on the marketplace are required to provide semi-annual updates on financing received, project updates, and employment totals. The DC Opportunity Zone Marketplace, like Atlanta's portal, gives projects the ability to advertise growth projections in relation to affordable housing and job creation. Projects can also identify anticipated improvements to local business support and community amenities.

## 2. Real estate focus & lack of transparency make impacts invisible to most business owners

Funders working with small businesses and small business owners did not report any impacts on their businesses as a result of Opportunity Zone projects.

**This lack of noticeable impact experienced by such entities is likely due to a combination of factors including the types of investments being made and the lack of transparency in the process.**

As previously stated, the main product type for investments has been in multi-family real estate development. Consequently, the first line of impact will likely be observed through rent changes for tenants living within the designated Opportunity Zone tracts. Opportunity Zone tracts were only designated as such beginning in April of 2018, which means the indirect impacts of existing projects on demand for commercial space and existing businesses has yet to be fully realized. The impact of the pandemic on the economy as a whole, as well as the real estate market, has come at a time when a number of development projects were set to either begin development or become operational.

Considering the small amount of direct investment in businesses through the tax incentive, the impacts on businesses are generally indirect. **For business owners to have an awareness of what these indirect impacts are, they must have an understanding of the tax incentive and of the projects that have received investment.** None of the business owners interviewed for this report could name a single Opportunity Zone project in the immediate community.<sup>18</sup> One business owner in Atlanta assumed an increase in development due to the tax incentive, but found it difficult to ascertain exact funding sources and the social impacts. Another business owner who had created an Opportunity Fund for his business explained that after they realized the Opportunity Zone tax incentive was a “land grab,” he created a fund of his own which built upon his existing expertise in multi-family real estate development.

**Other business accelerators shared the difficulty in tracing the Opportunity Zone tax incentive back to development projects and additional concerns about the benefits of the provision given that the investments came from sources outside the communities.** There are still many unknowns about the tax incentive and the resulting investments. Small business owners have felt as though the tax incentive was not designed to support them and has instead helped to propel real estate development and provide tax breaks for wealthy investors. Whether or not this perspective is true can't be easily proven or disproven because of the poor national requirements for transparency and reporting that make it virtually impossible, allowing this narrative to perpetuate itself.

18. Not including the businesses that had created their own Opportunity Zone funds.



# RECOMMENDATIONS

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Throughout the research and interviews conducted by SGA and DAWI, it was made clear that existing businesses in Opportunity Zones were generally not benefitting from the Opportunity Zone tax incentive. The challenges and limitations of utilizing the investment tool have been outlined in this report. The research team considered how changes to the Opportunity Zone tax incentive would shift the outcomes. As the nation shifts into a state of economic recovery, the communities intended for receiving investment dollars from the Opportunity Zone tax incentive are in greater need. Higher risk investments are less attractive, especially in a recovery, but there is a distinct need to invest in economically distressed communities and local business development.

Recognizing that many of the Opportunity Zones' limitations must be addressed at the federal level, the project team makes the following recommendations for both changes in the tax incentive itself, as well as for municipal agencies to better direct Opportunity Zone investments to low income communities and minority-owned legacy businesses.



## Changes to legislation

### 1. Create a new class of investment priorities to elevate investments in businesses:

**a. Allow investments to be made in the form of debt:** Opening up investment through debt will allow existing small, minority-owned and legacy businesses to access Opportunity Zone investment without surrendering equity in their businesses. In addition, it expands the types of businesses that could benefit from Opportunity Zone funds.

**b. Change the tangible asset requirements for some existing businesses:** Current tangible asset requirements greatly hinder existing businesses in Opportunity Zones from accessing Opportunity Zone investments. To address this, businesses which already, and exclusively, exist in Opportunity Zones prior to their designation could become Qualified Opportunity Zone Businesses by right. Rather than meeting the 70/30 tangible asset requirements as for start-ups or relocating businesses, businesses existing solely in Opportunity Zones prior to the designation would be able to forgo this requirement.

**c. Streamline legacy and minority-owned business designations:** The creation of a nationally recognized legacy and minority-owned business designation would be an important first step in making reliable business data widely available. In states and cities with limited attention towards legacy businesses, providing targeted support such as succession planning and Opportunity Zone education & training is extremely difficult.

**d. Offer a guarantee of the tax benefit to those investing in existing small businesses within Opportunity Zones:** Current Opportunity Zone regulations involve some level of uncertainty regarding the tax benefit investors will ultimately realize. In order to receive the full benefit, they must leave their investment in place for 10 years, and ensure that the real estate or business meets requirements set forth for their own eligibility. The exact tax benefit is only clear once investors exit their Opportunity Zone investment. Therefore, to incentivize investments in existing small, minority-owned and legacy businesses, a predictable guaranteed benefit level could be offered for those who invested in such businesses.

### 2. Give residents the opportunity to be investors

Empower those who live and work in Opportunity Zones to benefit from the tax incentive and shape their community by allowing them the opportunity to invest in Opportunity Zone funds. This can be done by waiving the requirement that investments be made through capital gains for these residents. Less than 17 percent of Americans have unrealized capital gains, with the median value sitting at only \$5000, and only around 6 percent of all Americans will ever pay capital gains tax, which makes it a very limited incentive for investment, particularly for riskier business investments.<sup>19</sup>

### 3. Require investments to reinforce local plans

Opportunity Zone legislation should be tightened to require Opportunity Zone designations to be based on existing community planning efforts and frameworks. If additional Opportunity Zones are designated, the legislative language should be tightened to require Funds to make investments where state or local plans are already in place—guiding investment to areas that have identified need and strategies in place to receive growth.

18. Learning from Opportunity Zones: How to improve place-based policies. [Brookings institution](#), 2018.

## Recommendations for states and localities

### 4. State and local governments should actively guide investments

State and local governments should be active in identifying investments that should be prioritized and fostered through the Opportunity Zone tax incentive, including providing explicit support for innovative broad based ownership models. For instance, local leaders desiring a revitalization of their business districts can offer greater incentives to potential investors to make local business development a more attractive investment. An example of this kind of guidance is Atlanta's Opportunity Zones Reporting Framework.<sup>19</sup>

### 5. Prepare businesses for potential investment

The current Opportunity Zone investment ecosystem for real estate deals and start-ups is relatively organized and matured in comparison to the investment ecosystem for existing small, minority or legacy businesses. Without a type of match-making system specific to these businesses, Opportunity Zone investments will continue to have a spatial and product type mismatch due to the increased difficulty for Opportunity Funds to identify, assess and choose financially viable small, minority owned and legacy business investment opportunities. To address this, in addition to the creation of minority and legacy business registry outlined previously, cities can implement or support technical assistance for businesses to better prepare for Opportunity Zone investment. One method would be to create an academy or incubator program for minority-owned businesses within Opportunity Zones in high-growth industries. The program would support minority-owned businesses by providing coaching, strategic business planning, and play matchmaker with sources of Opportunity Zone capital.



19. [OZ Framework](#), 2020.



## **Align the goals of the tax incentive with those of the communities that comprise Opportunity Zones**

### **6. Encourage investments in vehicles focused on employee buyouts**

Allowing investments to be made in the form of debt (recommendation #1a) creates more opportunities for business investments. Specifically, investment vehicles should prioritize the transition of equity ownership from founding entrepreneurs of Qualifying Opportunity Zone businesses to the employees. The community benefits of these kinds of investments are multifold as they (1) allow for retirement & exit of successful community entrepreneurs, (2) provide for business and community stability through the continuity of valuable commercial assets, services, and jobs, and (3) create a pathway to wealth building and financial resilience for workforces who might otherwise have none.

### **6. Improve transparency and accountability and track the impact of Opportunity Zone investments**

In order to track the impact of Opportunity Zones on real estate and community development, a system must exist that publicly keeps a record of projects that have benefitted from the funds in order to disaggregate and understand the data. In addition, communities need to have a way to have input and/or hold investors accountable. Given that the goals of the tax incentive are to “spur economic development and job creation in distressed communities,” the best methods to achieve these outcomes are known by those that live and work in the neighborhoods designated as Opportunity Zones. Although there are many open databases reporting active Opportunity Zone projects, the task of compiling a reliable list of projects and funds was challenging due to the absence of reporting requirements and standards. This is because the Investing in Opportunity Act specifies that reporting practices will only be enforced starting January 2023 (five years after the program came into effect). Legislation has been introduced to strengthen reporting requirements, but has not been passed.

### **7. Center community benefit**

Positive community impact, guided by the community itself, should be a priority. For example, a requirement that Opportunity Funds investments be connected to or in line with existing plans and goals that are based on community input is one way to ensure that development is meeting community needs in some way. Another way is to include broad-based ownership, including community and employee ownership, as a priority. In addition, community benefits agreement where the community has direct say into where Opportunity Zone funding goes could be implemented. Opportunities to require local, long-term job creation, affordable housing units, quality open space, etc. would deliver on the intent of the tax incentive for investors to frame their projects and goals around impact and bringing the intended benefits to distressed communities.



# Conclusion

## **We know money is being mobilized**

Since 2017, the Opportunity Zone tax incentive has become central to discussions regarding community development and revitalization. The tax incentive has guided millions in new real estate investments, but neglects small, minority-owned legacy businesses, and has created a system in which it is nearly impossible for them to benefit.

## **There is excitement and potential**

The investment trends from the last two years of Opportunity Zone activity present a case where there is persistent interest from municipalities and investors to make use of the tax incentive. This interest has the potential to be shifted towards small, minority-owned legacy businesses—but only if the barriers to making such investments are removed. There needs to be proactive change to ensure that the Opportunity Zone tax incentive fulfills its intended purpose of supporting the revitalization of low-income communities.

## **There needs to be proof or a guarantee that the benefits are reaching the communities; not just that dollars are flowing**

Federal, state, and local governments have a distinct role in incentivizing the investment in small and minority-owned businesses located within Opportunity Zones. There needs to be a concerted effort to improve reporting guidelines, maximize state and local oversight, center community benefit, and prepare businesses with the tools they need to utilize the tax incentive.

# APPENDIX

## I. Benefits of employee stock ownership plans (ESOPs)

The combined impact of COVID-19 related closures coupled with a generational wave of Baby Boomers (sometimes called the “Silver Tsunami”) considering retirement will continue to widen the asset ownership gap in this country—accelerated by the prolonged shutdown of retail corridors across the country. Tens of thousands of legacy businesses are now at risk of closing, especially in low-income neighborhoods. When legacy businesses—longstanding businesses owned by community members—close, people lose jobs, neighborhoods lose economic anchors, and communities lose beloved institutions.

We know these closures can be prevented by selling businesses to their employees. In the process, broad-based business ownership models can be used to bridge the racial wealth gap and provide a transformative boost to minority small businesses. The lack of available and appropriately structured investment capital is a significant barrier to more companies becoming employee-owned.

There are 6,000 companies utilizing the most common form of employee ownership, the employee stock ownership plan (ESOP), and around 460 companies organized as worker co-ops. While these employee-owned businesses make up a small fraction of the U.S. economy, the business, economic and human case for an expansion of employee ownership, specifically for black and brown workers, is hard to overstate. Examples of ESOPs range from community-based small businesses to large corporations including Publix Supermarkets, the nation’s largest ESOP, with more than 200,000 employee-owners.

U.S. ESOPs currently hold nearly \$1.4 trillion in pre-COVID plan assets with an average employee ownership stake worth \$130,000. When looking at the most marginalized worker groups, the impact of employee ownership is profound, according to independent research by the National Center of Employee Ownership and the Rutgers School of Management and Labor relations. On average employee-owners making less than \$30,000 have 17 percent greater median household net worth and 22 percent higher median income from wages than their non-owner peers.<sup>20, 21</sup>

As employees enhance the business through their own efforts, they create the kind of incremental value that builds a sustainable competitive advantage and enduring enterprises. This not only preserves jobs, it creates wealth. Employees that work in an ESOP own shares in the business—shares that become more valuable as the business grows or increases in value. These shares are held in a retirement-like account and when an employee leaves or retires, they are able to sell their shares to the business and receive a cash payout.

For workers generally, these shares represent down payments for homes, tuition for a child or grandchild, additional healthcare coverage or an enjoyable retirement—in short, they represent a piece of the American dream. For workers of color, the value of this opportunity cannot be overstated. Relatively few minority workers are employed in high paying industries that lend themselves to long-term wealth attainment. Yet, many of these workers are, in fact, the same essential workers keeping the nation moving today. Employee ownership, when targeted towards workers of color, expands the middle class, closes the racial wealth gap and strengthens the economy. It also roots local businesses locally, increasing their resilience and the resilience of communities.

The ideal solution to the crisis of closures caused by the pandemic is one that provides an owner with a dignified offramp, captures the underlying value of their business, and positions that business and its workers with the cash reserves needed to survive the upcoming downturn—saving jobs in the process. As the investing community looks to build institutions that remedy racism and produce real equity, impact investors can and should work with the diverse and expanding world of employee-ownership start-up and buy-out practitioners to scale this solution and make it broadly available. Now is the time to transform businesses, workers and communities toward a more equitable—and more resilient—economy where everyone has the opportunity to prosper.

20. [National Center for Employee Ownership](#).

21. Building the Assets of Low and Moderate Income Workers and their Families. [Institute for the Study of Employee Ownership and Profit Sharing](#), Rutgers, 2019.



## II. Legacy business registry benefits and San Francisco case study

A legacy business registry can assist a city to: 1) normalize the concept of legacy business preservation to a wider community, 2) increase business owner interest in providing relevant and necessary data that is not otherwise easy to obtain, maintain, complete, or access by cities and their partners, and 3) create a targeted database of small businesses that meet the profile of a candidate in need of investment and succession planning services, including the employee buyouts.

The City of San Francisco's Legacy Business Registry can serve as an example. In 2014, a report by the City's Budget and Legislative Analyst's Office showed the closure of small businesses had reached record numbers. Commercial rents in most neighborhoods had risen significantly. The report drew connections between the city's high level of commercial evictions and skyrocketing rents. While rent control laws shield many residents from extreme rent hikes, no such laws exist for businesses.

Inspired by programs in cities such as Buenos Aires, Barcelona and London, San Francisco Supervisor David Campos proposed legislation and a ballot proposition that would become the Legacy Business Registry and the Legacy Business Historic Preservation Fund which provides business assistance grants and rent stabilization grants to landlords that extend leases of legacy businesses for at least 10 years.

The City of San Francisco defines a legacy business as having operated for 30 or more years, has contributed to the neighborhood's history and/or identity and is committed to maintaining its physical features or traditions that define its business. Businesses that have operated for more than 20 years or less than 30 years but are at significant risk of displacement are also eligible for legacy business status. Businesses apply to join the registry and are sponsored by a district Supervisor (Councilmember equivalent). The application is reviewed by the City's Small Business Commission and if accepted, the business joins the registry and becomes eligible for the City's business assistance and rent stabilization grants.

If prohibited from accessing business license data, Cities can create their own legacy business registry using a low-cost, opt-in model similar to San Francisco's program: create a legacy business brand with a webpage, window sticker, and other cross-promotional incentives or tie-ins with other city and community programs, 2) promote the brand through a communications campaign that welcomes businesses that meet your city's definition of a legacy business to apply and provide key information including an opt-in offer to receive future information on relevant services and resources, and 3) applicants that meet criteria and submit a completed application are approved and then promoted through the city's communication channels.