Building Better:

Connecting Opportunity Zones to Urban Infrastructure

Co-Authors: Patrick Sabol and Bruce Katz

DREXEL UNIVERSITY
Nowak Metro Finance Lab
Lindy Institute for Urban Innovation

ACCELERATOR FOR AMERICA

EXECUTIVE SUMMARY

Opportunity Zones (OZs), a tax incentive created through the Tax Cuts and Jobs Act of 2017, were not specifically designed to tackle America's many infrastructure challenges. However, the flexible nature of the program and cities' broad ability to regulate and guide project development present numerous opportunities for cities to increase investment in public buildings, transit, water, energy, freight rail, broadband, roads, and more. To help cities realize the full potential of this unique tax incentive, this brief lays out nine steps that cities can take to use OZs to improve their infrastructure assets:

1. *Enact strong public private partnership (PPP) authorizing legislation that includes public buildings to help attract new private capitalOZs bring a new type of investor to the community development table.*
2. *Create an empowered and skilled team capable of negotiating PPPs or other innovative infrastructure procurements that serve the public interest.*
3. *Proactively reach out to developers to communicate existing infrastructure policies, particularly on issues like stormwater management, transportation, energy efficiency, and renewable energy*
4. *Craft specific zoning, permitting, and incentive overlays for OZs that incorporate infrastructure improvements*
5. *Assign staff to serve as liaisons between infrastructure asset owners and OZ investors to identify specific opportunities for collaboration*
6. *Work with communities to map specific needs in OZs and be prepared to negotiate community benefit agreements that include infrastructure improvements*
7. *Actively identify, map, and facilitate opportunities for land assembly that include properties owned by utilities, railroads, transit agencies, ports, and other infrastructure asset owners*
8. *Communicate past or planned infrastructure improvements to OZ investors to increase the attractiveness of specific areas by highlighting critical transit routes, grid enhancements, broadband deployments, highway or freight rail access, or other projects*
9. *Actively work to integrate economic development, public utility, environmental, and transportation departments to identify infrastructure needs and opportunities*

Cover: Schuylkill Yards, a development master plan for parcels controlled by Drexel University and Brandywine Realty Trust adjacent to Amtrak 30th Street Station in West Philadelphia, is situated within an Opportunity Zone. The first phase of development involves the construction of Drexel Square, which Brandywine anticipates will generate public realm activity and catalyze the development of the adjacent parcels. While Drexel Square did not benefit from the OZ incentive, future OZ deals here and elsewhere may include provisions for public space or other infrastructure assets that are mutually beneficial for both public and private parties.

BACKGROUND

Created through the Tax Cuts and Jobs Act of 2017, Opportunity Zones (OZs) are primed to catalyze economic development in nearly 9,000 communities across all fifty states, the District of Columbia, and Puerto Rico, directly impacting the lives of over 35 million Americans.[i]

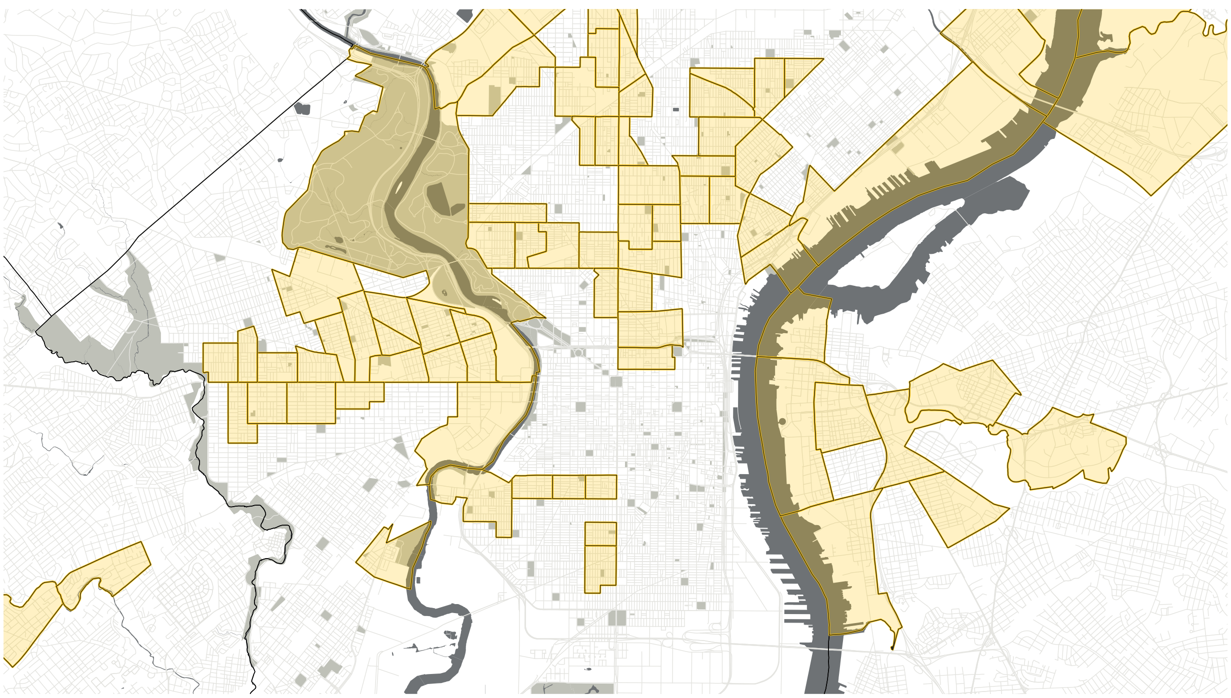
With over $6 trillion in potentially investable private capital, the program is poised to become one of the most powerful economic development incentive programs the federal government has ever created.[ii] Unlike most federal, state, or local tax incentives, OZs have very few limitations on their use and limited direct oversight beyond basic IRS compliance.[iii]

Most discussions around OZs are focused on straightforward residential and commercial real estate transactions or general business development.[iv] This excludes the billions of dollars of desperately needed investments in core urban infrastructure, including public buildings, transit, water, energy, freight rail, broadband, highways and roads, ports, and airports.[v] While there are challenges in deploying OZ capital in public infrastructure, cities have multiple opportunities to leverage the program to make investments in these assets.

Overview of OZ Capital Rules

Section 1400Z of Internal Revenue Code, amended by The Tax Cuts and Jobs Act of 2017, allows a taxpayer to defer paying federal capital gains tax on the sale of property if that gain is invested in a Qualified Opportunity Fund ("QOF").

A QOF must invest at least 90% of its assets in businesses or property in designated low-income communities known as "Opportunity Zones." In addition, taxpayers that hold investments in those funds for at least five years receive a 10 percent reduction in their original capital gains tax obligation; holding investments at least seven years adds an additional 5 percent reduction for a total of 15 percent; finally, holding an investment a full ten years means taxpayers do not have to pay any capital gains tax on the appreciation of the new investment.



Opportunity Zones in the Philadelphia region.

OVERARCHING PRINCIPLES[vi]

As cities seek to attract OZ investment dollars, it is critical that they do not repeat the mistakes that have driven significant pushback to recent economic development incentive packages.[vii] Due to the inherently public nature of infrastructure and its intergenerational impact on urban environments, it is especially important for cities to:

1. **Engage in Systems Thinking:** One off infrastructure improvements tied to any OZ project will impact the entire system, whether it's traffic flow, wastewater management, transit service, or anything else. When designing projects, mandates, or incentives, cities must examine and address the way new investments will alter the demand on existing systems.
2. **Ensure that Equity is Part of the Decision-Making Process:** While an essential component of America's economic success, major urban infrastructure investments are haunted by a legacy of divided cities and disparate impacts on minority and low-income communities. Neighborhood level input must be an essential part of the way infrastructure resources are allocated to OZ specific projects, as well as a top consideration before breaking ground.
3. **Link Investments to Human Capital:** Infrastructure related jobs are disproportionately well paid compared to similar professions in other fields, particularly for workers with lower educational attainment levels.[viii] By tying infrastructure improvements to job training programs or deliberately supporting minority and women owned businesses, cities can leverage OZ capital to create inclusive economic opportunities for all of their residents.

KEY CHALLENGES TO DEPLOY OZ CAPITAL FOR INFRASTRUCTURE PROJECTS

While there are numerous ways for OZ investments to flow into urban infrastructure, the program was not designed to specifically address transportation water, or other challenges in the built environment.[ix] Specific barriers to entry include:

1. **Ownership Rules:** The program requires equity investment in projects, meaning that assets fully owned by the public sector or quasi-governmental agencies are unlikely to be strong candidates for OZ funds without privatization or a public private partnership structure.[x]
2. **Profit Motive:** Many investors are focused on projects that will not only appreciate over time, but also provide ongoing revenue and profit. This immediately excludes non-revenue generating or break-even public infrastructure.
3. **Geography:** The inflexible geographic boundaries imbedded in the program do not easily accommodate infrastructure systems that can span entire neighborhoods, cities, counties, or beyond.
4. **Investment Timelines—Investments need to be made and deployed within 30 months of project acquisition.**[xi]: Many major infrastructure projects are either too far into their development timeline or too early in the planning process to effectively take advantage of the subsidy.

These issues do present challenges to direct OZ investment in infrastructure, but they are by no means insurmountable. Furthermore, cities have multiple direct and indirect avenues to leverage OZ projects to improve their built environment.

THREE PATHS TOWARD TRANSFORMATIVE INFRASTRUCTURE IMPACT

Despite these challenges, cities have at least three paths to driving OZ capital into infrastructure—creating direct investment opportunities, mandating or incentivizing investments, and facilitating investments. Within each category, there are specific steps that cities can take to leverage the program to address their core infrastructure needs.

Direct Investment

Creating direct investment of OZ funds in public infrastructure will require cities to take active steps to create formal agreements with the private sector to take full advantage of the tax subsidy. These infrastructure projects will likely have to be structured as formal public private partnerships (PPPs) and thus require a dedicated source of user revenue in a location that is primarily within an OZ.

Specific PPP infrastructure investments that may work with OZs include:

- Community broadband
- Large scale distributed storm water management
- Privatized drinking or wastewater facilities
- Court houses, civic centers, schools, and other public buildings

Key recommendations for direct investments:

- Enact strong PPP authorizing legislation that includes public buildings
- Create an empowered and skilled team capable of negotiating PPPs or other innovative infrastructure procurements that serve the public interest

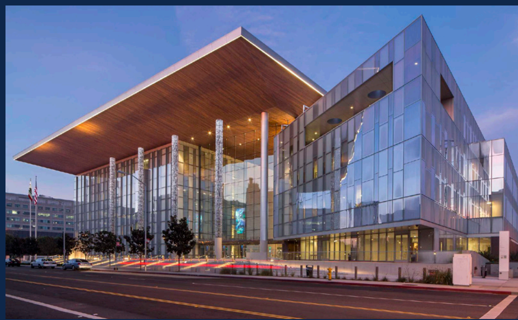
NoMa-Gallaudet U Station in Washington D.C. Future OZ deals could incorporate provisions for public transit improvements, which can be mutually beneficial to public and private actors alike.
Photo Credit: Amanda Bowen Photography

EXAMPLE PROJECT: TRANSIT IMPROVEMENTS

As the economic benefits of transit improvements become more quantifiable, cities have greater opportunities to leverage the development of new business, entertainment, mixed-use, and housing districts to provide funding for public transportation.

For OZ investors, this can take the form of cost shares or full funding for new bus or bus rapid transit routes, light rail stations, highway off ramps, bike infrastructure and more. As the public sector is ultimately responsible for the ownership, management, and construction of these projects, partnerships with the private sector need to be tightly managed, but flexible enough to develop a mutually beneficial transportation improvement.

Examples of projects that may have benefited from OZ driven partnerships include Cleveland's HealthLine bus rapid transit route, Detroit's QLine light rail system, and Washington, DC's NoMa- Gallaudet U New York Avenue Metro Station.



The Governor George Deukmejian Courthouse, located in Long Beach in Los Angeles County, is one example of a public building that could have benefitted from the OZ tax incentive had it been available when it was constructed. Photo Credit: AECOM

EXAMPLE PROJECT: PUBLIC BUILDINGS

Performance based building contracts are a public private partnership where the government procures a structure, like a court house or civic center, by working with a private sector partner to design, build, finance and/or operate a building for a set period of time. The private sector then assumes all the construction, financing, and operational liabilities of the project and the public sector agrees to a set fee to use the facility over a number of years with penalties or incentives based on the condition of the building.

OZ capital is a particularly strong fit for these kinds of projects, as typical performance-based building contracts fit within the five to ten-year investment horizon built into the Tax Cuts and Jobs Act of 2017 legislation. Additionally, in many cities these facilities already fall within Qualified Opportunity Zones.

A recent example of a project that could have benefited from the OZ program is the Long Beach Courthouse, which is administrated by California's Administrative Office of the Courts (AOC). After an extensive value for money analysis and bidding process, the state decided to enter into a long-term contract in which a consortium of private sector firms would design, build, finance and operate the facility and the AOC would pay a monthly fee based on the condition and availability of the courthouse over 35 years. By passing the construction and operational risks to the private sector, the project came in 15 percent under budget and was delivered eleven days early. While OZ financing was not available when the Long Beach Courthouse was developed, the fundamental structure sets a strong example for future projects.

Mandates and Incentives

Like any other urban development, cities have a broad array of powers to encourage or compel OZ investors to make specific infrastructure upgrades. Examples of specific asset types include:

- Small-scale distributed storm water management
- Energy efficiency retrofits
- Distributed energy storage
- Renewable energy production
- 5G small cells
- LEED certified construction
- Grid improvements
- Low income housing
- K-12 schools
- Transit oriented development
- Transit improvements or stations

Key recommendations for mandates and incentives:

- Proactively reach out to developers to communicate existing infrastructure policies, particularly on issues like stormwater management, transportation, energy efficiency, and renewable energy
- Craft specific zoning, permitting, and incentive overlays for OZs that incorporate infrastructure improvements
- Work with communities to map specific needs in OZs and be prepared to negotiate community benefit agreements that include infrastructure improvements

Facilitation

Cities can serve an essential role as intermediaries between OZ investors and both public and private infrastructure owners. By connecting the relevant parties, key public infrastructure priorities that enhance equity, sustainability, resilience and economic development can be achieved without cities committing financial resources or resorting to enforcement. While facilitation will be an essential part of all OZ work, there are areas where it may be particularly relevant:

- 5G small cells
- Micro-grids
- Intermodal freight facilities
- Post-secondary or vocational educational facilities
- Transit oriented development

Key recommendations for facilitation:

- Work with communities to map specific needs in OZs and be prepared to negotiate community benefit agreements that include infrastructure improvements
- Actively identify, map, and facilitate opportunities for land assembly that include properties owned by utilities, railroads, transit agencies, ports, and other infrastructure asset owners
- Communicate past or planned infrastructure improvements to OZ investors to increase the attractiveness of specific areas by highlighting critical transit routes, grid enhancements, broadband deployments, highway or freight rail access, or other projects
- Actively work to integrate the planning processes of economic development, public utility, environmental, and transportation departments to identify infrastructure needs and opportunities

Cira Green, a publicly accessible green roof project in West Philadelphia's University City neighborhood. The City offers attractive incentives for developers who incorporate stormwater improvements like green roofs such as FAR bonuses and a green roof tax credit covering up to 50% of the roof's construction cost.

EXAMPLE PROJECT: STORMWATER MANAGEMENT

Building standards are nothing new in urban environments, but the push to extend these regulations beyond safety and into the realm of infrastructure ownership are increasingly common. From energy efficiency standards, to renewable energy mandates and stormwater management plans, cities are recruiting private property owners to be active participants in creating public infrastructure.

Through targeted permitting, zoning, and incentive programs, cities can compel or encourage OZ developers to incorporate best in class infrastructure improvements into their existing site plans to mitigate or even create net benefits for stressed energy or water systems. While renewable energy improvements are tied to complex grid and siting issues, water management is an area where cities and utilities can set and enforce clear standards for OZ projects.

Clear examples of developments where cities could have and can influence future water management in OZs include Philadelphia's Green City, Clean Water plan, Las Vegas' WaterStart pilot projects, and Prince George's County Maryland Clean Water Partnership program.

CONCLUSION

Opportunity Zones have the potential to reshape cities in big ways and small—through everything from startup investments in neighborhood business all the way up to multi-billion-dollar redevelopments. Regardless of whether infrastructure is formally brought into the conversation, transportation, water, energy, and public spaces will be impacted by these investment decisions. Cities can choose to passively accept and manage the consequences of OZ investment or to become active partners in steering capital into the projects that will serve the greatest public good.

ABOUT THE AUTHORS

With a background in infrastructure policy research, consulting, and investing, ***Patrick Sabol*** serves as the Deputy Director and Co-Founder of Infrastructure Week—the largest and most diverse coalition dedicated to renewing and rebuilding America's infrastructure. Prior to Infrastructure Week, he led grid scale energy initiatives at Groundswell and served as a senior infrastructure researcher at the Brookings Metropolitan Policy Program. He also spent time as a transportation policy consultant to the Clinton Global Initiative and as an investment associate at a cleantech focused venture capital firm. Patrick holds a bachelor's degree from Colgate University and a master's degree from Duke's Sanford School of Public Policy.

Bruce Katz is the inaugural director of the Nowak Metro Finance Lab at Drexel University and the co-author (with Jeremy Nowak) of The New Localism: How Cities Can Thrive in the Age of Populism. Bruce also leads New Localism Advisors, whose mission is to help cities design, finance and deliver transformative initiatives that promote inclusive and sustainable growth, in addition to serving as a Partner in the Accelerator for America. In all these roles, he regularly advises global, national, state, regional and municipal leaders on public reforms and private innovations that advance the well-being of metropolitan areas and their countries.

Patrick Sabol, Deputy Director & Co-Founder
Infrastructure Week

Bruce Katz, Director
Nowak Metro Finance Lab, Drexel University

ENDNOTES

i. Estimated market size and geographic reach calculations were calculated by the Economic Innovation group and can be found at https://eig.org/news/opportunity-zones-tapping-6-trillion-market

ii. ibid

iii. General tax guidance is available from the IRS at https://www.irs.gov/pub/irs-drop/reg-115420-18.pdf, but many details of the program are still in development.

iv. While many organizations are performing detailed and thoughtful work on Opportunity Zones, the primary focus remains on the direct economic development aspects of projects, not the infrastructure assets that may benefit from the program. More general best practices and research by the Nowak Lab can be found at https://drexel.edu/nowak-lab/publications/overview/. Enterprise Community Partners https://www.enterprisecommunity.org/financing-and-development/opportunity-zones-program and the Economic Innovation Group https://eig.org/opportunityzones are also excellent sources for insightful research geared towards a wide range of practitioners.

v. Calculations of the cost to maintain and improve America's infrastructure investment needs vary widely and include a number of assumptions that are open to debate. Furthermore, fragmented and overlapping ownership structures for public infrastructure, which may include federal, state, county, local, and sometimes private sector ownership further complicate need assessments. While not comprehensive, national calculations by sector with state breakdowns are compiled by the American Society of Civil Engineers and can be found at https://www.infrastructurereportcard.org/americas-grades/.

vi. For more general principles to guide all OZ investments, see https://drexel.edu/nowak-lab/publications/reports/opportunity-zones/.

vii. The recent outcry against projects like Amazon's HQ2 in New York City https://www.citylab.com/equity/2019/02/amazon-hq2-new-york-long-island-city-incentive-resistance/582631/ and Foxconn's manufacturing facility in Wisconsin https://www.bloomberg.com/news/features/2019-02-06/inside-wisconsin-s-disastrous-4-5-billion-deal-with-foxconn demonstrate the need for economic development officials to take a more balanced, transparent, and equitable towards attracting businesses.

viii. Beyond short-term construction, infrastructure related jobs cover a huge variety of fields ranging from maintenance work to engineers, planners, accountants, and attorneys. Also, at lower educational attainment levels, jobs in infrastructure related sectors have disproportionately high pay compared to other professions. See this Brookings Report for more details https://www.brookings.edu/research/expanding-opportunity-through-infrastructure-jobs/.

ix. The two driving forces behind the OZ program, Senator Tim Scott and Senator Corey Booker, discuss their influences and goals here https://www.naco.org/resources/senators-tim-scott-and-cory-booker-discuss-opportunity-zones-nation%E2%80%99s-counties.

x. For more details and recommendations on PPP best practices see https://www.brookings.edu/research/private-capital-public-good-drivers-of-successful-infrastructure-public-private-partnerships/.

xi. See proposed Treasury Regulations at https://www.irs.gov/pub/irs-drop/reg-115420-18.pdf for more details on investment timelines.