Avoiding Gentrification, How to Use Opportunity Zones to Benefit Communities

By Rikha Sharma Rani, FUSE contributing writer
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Oakland, California, perched across the bay from sterling San Francisco, is an urban bellwether for America’s roller coaster economy. Home to a vibrant, diverse community of people of all different colors and classes, the city has lived through the boom and bust cycles throughout the decades, from the postwar heyday to the steep heights and sharp declines of the ’80s, ’90s, and 2000s.

Today, Oakland straddles a familiar paradox in the U.S.: Despite gentrification in many neighborhoods, where home values have easily busted through the million-dollar range and tech startups have been swooping in to grab downtown real estate, other areas have remained stagnant. Many of the city’s legendary music venues that defined its creative roots have been replaced by warehouses, and vacant lots are populated by some of the city’s largest homeless encampments.

Oakland is far from alone in this paradox. As some areas were recovering from the Great Recession, which ended in 2009, nearly 60 percent of counties nationwide have seen more businesses close than open. Blighted neighborhoods have often fallen into greater disrepair as residents left to seek opportunity elsewhere, a flight that has fueled a cycle of disinvestment and poverty.

Lawmakers are hoping to change that by passing a tax incentive as part of the Tax Cuts and Jobs Act of 2017. Tucked into the law are rules that encourage investment and job creation in designated “opportunity zones,” economically distressed communities left behind by the post-Great Recession recovery.
Civic leaders across the country are intrigued — but they also have concerns. In some urban areas, for example, where gentrification has already priced out long-time residents, investments could exacerbate the issue and displace even more of the people meant to benefit from the incentives. “We would like to see whole census tracts lifted up,” said Anne Fadullon, director of Philadelphia’s Department of Planning and Development. “But not just because new wealthy people moved in.”

Still, Fadullon and other city officials remain cautiously optimistic. They believe that by taking steps now to support and guide opportunity zone investments, they can help turn these monies into a boon for struggling communities.

Oakland is working on an investment prospectus that includes such details as descriptions of its opportunity zones and the local economy in those areas.

The Basics of Opportunity Zones

When an investor sells an asset for a profit — such as stocks, bonds, or property — it’s called a capital gain, and the investor has to pay taxes on the profit. If an asset goes up in value but the investor doesn’t sell, it’s an unrealized capital gain. The investor has money on the books that is not being used or reinvested.

In recent years, there’s been an explosion in unrealized capital gains. The Economic Innovation Group, a public policy organization focused on addressing economic challenges, estimates that investors are sitting on as much as $6 trillion. Opportunity zones were created to encourage
the reinvestment of these monies in communities desperately in need of funds (see sidebar, “Same Old, Same Old, or Something New?”). Investors who sell assets at a profit and then reinvest that money in a qualified opportunity fund (QOF) — a special fund set up for the purpose of investing in opportunity zones — can defer taxes owed on capital gains (see sidebar, “How the Opportunity Zone Tax Works”).

More than 8,700 opportunity zones, nominated by states and approved by the U.S. Treasury and IRS, span every major metropolis in the country. Of these, 78 percent are in metropolitan areas, and 97 percent are in low-income communities. Of course, not all of that $6 trillion will flow to opportunity zones, but the Treasury anticipates $100 billion in private capital investment. Projects might include commercial and industrial real estate, housing, infrastructure, and the development of existing or new businesses.

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— Brady Meixell, Urban Institute

At the same time, a number of issues concerning opportunity zones still need to be resolved. Unlike past programs, few federal regulations dictate where profit-oriented investors have to put their money in order to reap the tax benefits. For example, nothing prevents investors from converting low- or mid-income housing into luxury condos or investing in businesses, such as a high-end clothing store or restaurant, that don’t serve the most pressing needs of the community and can lead to gentrification. Additionally, while funds must report finances to the IRS for tax purposes, they currently are not obligated to provide information about specific investments, which again precludes insight into whether projects are actually benefiting communities.

“In past economic development programming, you had a federal entity overseeing investments, and you had certain restrictions. This has none of that,” said Brady Meixell of the nonprofit Urban Institute, which performs economic and social policy research. “It’s an incentive, rather than a program. There’s a lot more chance for projects to be built that aren’t necessarily going toward the best interests of the community.”

An analysis by the Urban Institute, for instance, found that just under 4 percent of the selected zones are in areas that appear to be gentrifying. Because they’re already on the upswing and therefore less risky, these areas could divert funds from truly needy communities. Final guidelines from the Treasury are expected in early 2019. Whether any changes or additions will be made remains unclear, but stakeholders from across sectors are advocating strongly for reporting requirements for investments, including location, type, and amount.
The Need for Public Investments

Despite these unresolved issues, civic leaders are starting to prepare. Governments will play a crucial role in attracting opportunity zone funding and laying the groundwork for new investments. An influx of private capital alone is unlikely to reverse the fortunes of struggling communities, many of which have been in economic decline for decades. Savvy public investments can help channel opportunity zone funding into certain areas and catalyze projects that might otherwise be considered unviable.

“A city is best positioned to take advantage of their opportunity zone designations if they’ve also made their own investments in infrastructure and transportation to get ready,” said Alea Gage, economic development project manager for Vallejo, where officials are making public investments to increase the viability of projects that align with the city’s long-term goals. For example, Vallejo invested in a multi-modal facility, Vallejo Station, for bus and ferry connections to accommodate increased usage of these services as area jobs and housing grow. The city also made streetscape improvements to its downtown to signal its readiness for revitalization and to enhance urban design and make the public realm more pedestrian friendly.

In Oakland, construction has begun on an express bus line along International Boulevard, a corridor that runs through many of the neighborhoods now designated as opportunity zones, notes Marisa Raya, who leads special projects for Oakland’s Department of Economic and Workforce Development. The new line will decrease travel times to downtown.

Officials in Cleveland are investing strategically in affordable and middle-income housing in opportunity zones located close to the city’s major healthcare clusters. East Cleveland, an economically depressed area that was one of the nation’s hardest hit during the Great Recession, is less than ten miles from the Cleveland Clinic, one of the most respected hospitals in the country. David Ebersole, Cleveland’s director of economic development, believes that the city can leverage proximity to the healthcare nerve center to attract investment. “There’s a great opportunity to take advantage of the fact that investors interested in developing healthcare products might want to be close to that ecosystem,” Ebersole said.

Public investments can also help ensure that residents and business owners are prepared for opportunity zone projects. Philadelphia, for example, is investing in education and workforce development programs and working with stakeholders to develop prospectuses that provide detailed information about potential investments. Officials are also on the lookout for opportunities to enhance local participation in projects.
“If an investor wants to put money into a coffee shop, for instance, we want to know where they’re buying their paper cups or their coffee from,” said Fadullon. “If they want to buy locally, that’s an opportunity for us to find or support a company in the community that can meet that need.”

Other cities, such as Oakland and Stockton in California, are also working on prospectuses. These reports can help with such factors as determining which projects might attract investors, how the projects could benefit communities, and what governments can do to encourage these investments. “In Oakland, we’re working on an investment prospectus that describes the opportunity zones themselves, the local economy in those areas, what their assets are, and what we would like investments in those places to look like,” Raya said.

**Hard and Soft Power**

In some cities, certain projects will require government participation. In this case, officials have leverage to require a social return on investments. “In Philadelphia, a lot of projects need some kind of assistance from the government, whether it’s zoning, land, or financing,” said Fadullon. “If that is required, then we are going to ask for some kind of social impact in return for that support.”

But even in cities where direct participation from government isn’t required, local community leaders can influence opportunity zone investments through actions such as job-creation and local-tax credits, land swaps, and other incentives. For example, the city of Montrose, Colorado, is offering investors a $5,000 cash payment for every job created and held for at least one year in one of its opportunity zones. Cities should also note state-level initiatives related to opportunity zones, which could provide additional incentives on which cities can capitalize.

“There is hard power and soft power that cities can wield,” said FUSE executive advisor Ann Rogan, who is working with the mayor’s office in Stockton, California, to build a workforce and economic innovation portfolio for the city. “The hard power is in the incentives,
In addition to outside investors, Stockton is working to engage local investors who have connections to the city in hopes that they will support projects that benefit communities. Photo Credit: Wayne Hsieh

“It’s really important when we’re looking at opportunity zones that we’re developing a sense of ownership within the community,” she said.

Meixell of the Urban Institute agreed, saying cities and counties should take stock of their opportunity zones and discuss goals with residents to align with community needs. “What sorts of investments do they want to be drawing? Where do they want to go with the neighborhood? Is gentrification a concern? If so, they’ve got to figure out how to maintain affordability and not have an investment overheat the market. Or is it an area that really could use any sort of investment?” Meixell said. “Cities need to think through that process, and then determine what levers they control that they could exert to influence and incentivize investors or regulate investors to stay within those guardrails.”
Leaders also need to consider ways to monitor and report on developments in these communities, regardless of what the new federal guidelines might require. “We need to be able to understand how residents are benefitting from these investments, whether that’s a new or preserved housing unit, a job opportunity, a grocery store, better connectivity, or investment in a business that nobody was interested in before,” said Raya of Oakland. “We don’t want this to become a house flipping opportunity.”

“Cities need to figure out how to be as involved as possible in these developments, particularly those on public land,” added Gage of Vallejo. “We should be working on the ground with developers that are making use of opportunity zone investments, creating those benefits that the community needs most.”

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[Photo credit: Michael MM]*