August 27, 2019

Honorable Gavin Newsom
California Governor
1303 10th Street, Suite 1173
Sacramento, CA 95814

Re: Broaden California Opportunity Zone Program Tax Benefits to Include Community-Sponsored Projects

Governor Newsom:

The Los Angeles County Economic Development Corporation (LAEDC), an organization whose purpose is to collectively advance opportunity and prosperity for all, strongly urges you to maximize the community and economic development potential of the Opportunity Zone Program,[1] which is intended *to subsidize growing businesses in low-income communities* through short- and long-term capital gains tax deferral, by broadening California's Opportunity Zone tax benefits, which conform to federal tax treatment of investments in Opportunity Zones, beyond just incentivizing affordable housing and green technology projects to include a broader range of community-oriented projects that address a critical local economic and/or social need, that have strong community buy-in and support from a governing local public agency, and that demonstrate the potential for significant community and economic development impact.

As you know, the United States Treasury has certified 8,700 census tracts as qualified Opportunity Zones, of which 879 are located in California. Certainly, utilizing this new tool to attract private capital to address California's shortage of affordable housing units is one very sensible use, and so we're extremely pleased that the *California* Opportunity Zone program will be utilized across these 879 census tracts as a way to incentivize the development of more affordable housing projects. However, the creation of additional affordable housing units is just one critical need in these low-income communities.

In addition to affordable housing, these communities need effective mechanisms to ensure the sustainable inflow of private capital beyond the one-time financing of housing developments, to spur the incubation and growth of more "jobs-producing" industries, and to set a long-term path to prosperity that is achieved through for example:

- Aggressive business and capital formation;
- Steady local business product and service development, commercialization and distribution, both within and outside of these communities, bringing dollars back into these low-income areas;
- Increased business hiring, training, upskilling and promotion of local workers; and
- Net income generation and capital appreciation in the form of capital gains that are recycled within and have "spillover effects" onto these low-income communities.

You recently stated, "I'm not just interested in Opportunity Zones, I'm committed to make them work for Californians in our low-income neighborhoods."[2] **Unfortunately, the development of housing alone will not engender long-term prosperity for the existing residents in these low-income communities, as real estate development will not effectively recycle the resultant capital and investment gains within these communities – just the opposite**. In most instances, it is the developers and the apartment management firms overseeing these newly developed rental properties that reap almost all of the benefit and receive the "lion's share" of the windfall from the below-market

[1] Created by the Tax Cuts and Jobs Act of 2017 (Public Law 115-97)
[2] Stanford University, March 18, 2019

purchase, up-zoning (i.e. to residential apartments), management, depreciation and eventual flipping of fallow and/or underutilized properties that are re-zoned and developed for housing.[3] Exacerbating matters, because these real estate development and management firms are more than likely not domiciled, much less headquartered, in these low-income communities that have been designated as qualified Opportunity Zones, most of that windfall (pecuniary gain) will almost certainly not be reinvested in these low-income communities but be pulled out of them, while the existing residents are left to contend with the prospect of gentrification and upward housing cost pressure without the corresponding rise in incomes and available jobs that accrue from also having fast-growing businesses proximately located / clustered in the qualified Opportunity Zone-demarcated area.

This, in turn, will negatively, not positively, change the economic prospects for the many residents living in these census tract areas, amplifying and accelerating the highly distortive (and maleficent) community and social impacts associated with rapid gentrification, while undermining both the legislative intent and long-term accretive economic development value of the Opportunity Zone Program to bring business investment and the resultant indirect and induced economic impacts (aka "multiplier effects") into these economically distressed communities.

And while we also applaud you for including green technology projects, as defined,[4] in your definition of California qualified Opportunity Zone property,[5] **restricting this powerful incentive to one industry sector seems to undercut the foundational premise and promise of your signature "Regions Rise Together" initiative**, under which California's very distinct economic regions are seen as the interlocutors of and keys to inclusive growth across the state. This is because many of the economic regions housing California's 879 qualified Opportunity Zones might not be conducive to and/or have the right mix of inputs or factors of production to germinate and support the long-term, sustainable growth of a green technology sector.

Alternatively, new opportunities are cropping up across each of the state's economic regions in emerging industries, ranging from advanced manufacturing to enterprise software to space commercialization. So, **why not expand – versus limit – local community control over their own economic development and community-oriented strategies and projects, including using the Opportunity Zone program in a way that reflects the economic strengths and/or community priorities of the specific geographic area** and, in so doing, aligning the program with the area's economic, industrial, community and social assets in a way that makes sense based on its distinct productive advantages (e.g., supplier specializations, labor markets) and the potential for significant economic, social and community? As the economic development leadership organization for a county (Los Angeles) with 274 census tracts designated as Opportunity Zones, **we believe that a strategy focused on both an area's strongest industry clusters, which are simply interconnected businesses that operate within a specific geography, and a community's individual and supported priorities should determine the categories that are prioritized as project-candidates for beneficial tax treatment under California's Opportunity Zone program**,[6] not the ones that reflect the "top-down" policy inclinations of Sacramento.

In sum, while the LAEDC commends your efforts to conform California's Opportunity Zone tax benefits with the federal tax treatment of investments in Opportunity Zones for affordable housing and green technology projects, we respectfully urge you, for all of the above reasons, to expand the California Opportunity Zone program's tax treatment

[3] Already, the expectation of a fully operational Opportunity Zone program has triggered developers to quickly snatch up qualified Opportunity Zone-sited parcels and "bid up" property values overall (in anticipation), literally forming single-purpose qualified opportunity funds (QOFs) around the development of lone parcels of land for residential projects.
[4] Primarily engaged in those lines of business described in Codes, 221111 to 221118, inclusive, or 221122, of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition, only if engaged in making, producing, creating, or converting electric power from sources other than a conventional power source, as defined in Section 2805 of the Public Utilities Code
[5] *See, e.g.,* Amendment 3 to Section 18190 of the Revenue and Taxation Code
[6] *See, e.g.,* Howard Wial, "What It Will Take for Opportunity Zones to Create Real Opportunity in America's Economically Distressed Areas", ICIC (April 2019).

to include more industries and community-sponsored projects that matter to state's diverse set of regions and low-income communities. We believe this is the only way to ensure that more of these private investments, which will be made by choice, not via an automatic appropriation formula or earmark, have maximum social, community and economic impact, and don't bypass our state's low-income communities for other states with more wide-ranging and expansive programs.

Sincerely,

David Flaks
President & COO
LAEDC

cc: Lenny Mendonca, Director of the California Governor's Office of Business and Economic Development