Map created by OpportunityDb.com

PDP Community Series   Blog 14 - Funding Options

One of the main options available for funding of the Pilot Demonstration Project is to show sites that could be used for Opportunity Zone investments (see Opportunity Zones map above). The objective in doing this is to show how sites could be used using Pilot Development Projects (PDP) as the development project.

Place Based Projects

The information shown here about Opportunity Zones was obtained on the internet as *Opportunity Zones Explained - Wealth Management* by Adam Hooper, October 2, 2019. There are many articles about Opportunity Zones on the internet if you want additional information. Anybody investing will probably use professional advisors, so the main purpose of this paper is to provide an introduction of Opportunity Zones and development options using the PDP concept. Hooper noted:

> Governments use place-based incentive programs to subsidize firms or investors who operate in specific areas, often with the intent to revitalize economically depressed communities. In the U.S., place-based incentive programs occur at all levels of government and are often (but not always) called "Enterprise Zones."
>
> These zones operate in areas with some mixture of high unemployment, population decline, vacant buildings, or residents with low income or low education levels. They usually require

qualifying firms or investors to create a specified number of jobs or maintain a certain level of wages for residents within the zone. In return, firms and investors receive benefits like corporate income tax credits for job creation and investment, sales tax exemptions, or financial assistance through low interest rate loans. Some programs also provide benefits like workforce development within these areas.

Several theoretical rationales underpin these programs. First, the cost of doing business in economically distressed areas is higher for several reasons, including less access to skilled labor and transportation, as well as higher crime. Theoretically, subsidies offered by place-based incentive programs can offset these costs and encourage businesses to locate in distressed areas.

The use of place based tax incentive programs has a clouded history regarding their benefits for helping the poor and a historical perspective is discussed in detail in an Abstract written by M. Layser titled *THE PRO-GENTRIFICATION ORIGINS OF PLACE-BASED INVESTMENT TAX INCENTIVES AND A PATH TOWARD COMMUNITY ORIENTED REFORM.* This Abstract (article) will be referred to quite often since it provides such an in depth analysis on the subject of Opportunity Zones (OZ) and the use of place based sites within the OZ. The problems of Opportunity Zones for fulfilling their intended function of helping the poor is described in the abstract. This should be read in full to understand a different view of Opportunity Zones development practices. Conversely, in order to understand the tax benefits provided for an investor the following information is provided.

Opportunity Zones Explained

What advisors need to know about this new policy and the tax benefits for their clients.
Oct 02, 2018. By Adam Hooper

Opportunity Zones is a new community development program established by Congress in the Tax Cuts and Jobs Act of 2017 to encourage long-term investments in low-income urban and rural communities nationwide. The idea originated from tech billionaire Sean Parker, the former president of Facebook and creator of Napster. In 2013, Mr. Parker enlisted powerful allies and formed the Economic Innovation Group, a Washington think tank to help him press the policy into law. The program essentially rewards reinvestment of profit into “Opportunity Zones” defined as low-income census tracts selected by state governors and certified by the U.S. Treasury Department.

There are roughly 8,700 Opportunity Zones throughout the U.S., providing real estate investors with the opportunity to defer or even eliminate capital gains tax.

The Triple-Threat Tax Treatment

Capital gains tax deferral, step-up in basis, and capital gains tax elimination are the triple-threat tax advantages real estate investors may see with investment in Opportunity Zones.

Derek Uldricks, President of Virtua Partners, a global private-equity real estate investment firm that recently created its first opportunity zone fund, demonstrates the tax benefits that can be realized by investors.

Assume an investor has a $1 million gain in Apple stocks and decides to sell. To keep it simple, let's also assume the investor is in a 20 percent tax bracket, totaling $200,000 in capital gains tax. But instead of paying, the investor reinvests the $1 million in an Opportunity Fund.

Here's what happens next:

- Deferment of gains: By investing those gains in the Opportunity Fund, the tax due on those gains is deferred until the earlier of selling the investor's interest in the Fund or December 31, 2026.
- If the investor holds the investment for 5 years: That payment of $200,000 is completely deferred, plus the investor gets a 10 percent step-up in basis on the original gain deferred. So now the investor pays $180,000, saving $20,000 in capital gains taxes.
- If the investor holds for 7 years: They receive an additional step-up in original basis of 5 percent, and the capital gains tax bill goes down to $170,000, saving $30,000 on the taxes owed from the investor's initial gain.
- If the investor holds for more than 10 years: the investor pays ZERO capital gains tax on the appreciation of that asset.

Let's break down the last point.

If the investor holds the $1 million investment for 10 years, any gains made on that investment are tax-free. The investor pays ZERO capital gains tax on all of the appreciation above and beyond the $1 million. So even if the $1 million turned into $3 million, that $2 million in lift achieved through investing in the Opportunity Fund is tax-free.

Essentially, the federal government is allowing the investor to keep the capital gains at 0 percent interest and use those funds to invest in one of these Opportunity Zone projects for 10 years. After 10 years, the investor pays no capital gains tax on the appreciation of the asset.

Does It Beat a 1031 Exchange?

Some have called the 1031 exchange "a perpetual deferral until the ultimate exit." If at any point an investor sells an asset, they are on the hook for the gains. This leaves most investors holding their real estate until death (the ultimate exit) so that at least their heirs get the step-up in basis.

With Opportunity Zones, investors don't have to die to eliminate the capital gains tax burden. After 10 years, the entire basis automatically steps up. And investors don't have to jump through hoops to get it.

This includes saving taxes on any depreciation of the asset, unlike the 1031, where an investor may have to pay “depreciation recapture.” In essence, an investor can use depreciation to offset income in the rest of the portfolio.

Due to the nature of the investment vehicle, Opportunity Zone investments allow more creative use of capital. With a 1031, it’s all or nothing. The initial investment is locked in along with the capital gains accrued over the life of the investment. And it all goes into the rollover asset chosen next.

This is not the case when investing in Opportunity Zones. Going back to the Apple stock example, there was a theoretical gain of $1 million. But that’s just the gain. The investor may have had another $200,000 in there that was the initial investment or “initial basis”: the investment principal that can be taken out without penalty.

This is another huge advantage compared to the 1031. Investors can take the initial basis out, in this case $200,000, to do with it what they want.

Breaking Down the Investment Vehicle: The Opportunity Fund

We’ve now explained how Opportunity Zones came into being and what the tax advantages are. But how exactly do investors go about investing in these zones? The answer is “Opportunity Funds.”

According to EIG:

“Opportunity Funds are private sector investment vehicles that invest at least 90 percent of their capital in Opportunity Zones. The fund model will enable a broad array of investors to pool their resources in Opportunity Zones, increasing the scale of investments going to underserved areas.”

So, investors can’t just purchase a property in an Opportunity Zone and expect the tax advantages. Nor can they team up with a Sponsor or Fund Manager who doesn’t abide by the guidelines for Opportunity Funds that will be set forth by the Treasury Board and IRS.

The tax incentive is for investors to re-invest their unrealized capital gains into Opportunity Funds within 180 days. And these funds must be dedicated to investing into Opportunity Zones designated by the Governors of every U.S. state and territory.

This new investment vehicle will be organized as a corporation or a partnership and can be any array of equity investments in a variety of different sectors. EIG explains.

“This is critical, because low-income communities have a wide range of needs, and Opportunity Zones at their best will recruit investments in a variety of mutually enforcing enterprises that together improve the equilibrium of the local community.”

There are certain rules that are still being fleshed out. What we know so far in terms of guidelines, the Opportunity Funds:

- Must be certified by the U.S. Treasury Department.
- Must be organized as a corporation or partnership for the purpose of investing in Qualified Opportunity Zone property.
- Must hold at least 90 percent of their assets in a Qualified Opportunity Zone property, which includes newly issued stock, partnership interests or business property in a Qualified Opportunity Zone business.
- Must have investments are limited to equity investments in businesses, real estate and business assets that are located in a Qualified Opportunity Zone. Loans are not eligible for the tax incentives. Opportunity Fund investments in real estate are subject to a substantial rehabilitation requirement.

Ultimately, Opportunity Zones is a game changer that will provide significant tax benefits for real estate investors while looking to revitalize America's depressed communities through social impact investments.

Key Findings

- The Tax Cuts and Jobs Act created the Opportunity Zones program to spur investment in economically distressed census tracts. Opportunity zones reduce capital gains taxes for individuals and businesses who invest in qualified opportunity zones.

- Opportunity zones were estimated to cost $1.6 billion in revenue from 2018-2027. New regulations stipulate that the program’s benefits would continue through 2047, meaning the program’s revenue impact could increase over time depending on how many investors utilize the program.

- Research suggests place-based incentive programs redistribute rather than generate new economic activity, subsidize investments that would have occurred anyway, and displace low-income residents by increasing property values and encouraging higher skilled workers to relocate to the area.

- While opportunity zones present certain budgetary and economic costs, it is unclear whether opportunity zone tax preferences used to attract investment will actually benefit distressed communities.

The Tax Cuts and Jobs Act (TCJA) created the Opportunity Zones program to increase investment in economically distressed communities. The program provides preferential capital gains treatment for investments within designated low-income census tracts. Policymakers hope opportunity zones will unleash investment in low-income communities throughout the country.

This analysis describes opportunity zone program incentives, reviews both academic and government evidence on the effects of place-based incentive programs, and

discusses possible outcomes for opportunity zone residents. Overall, we find opportunity zones will present certain budgetary and economic costs to taxpayers and investors, but based on evidence from other place-based incentive programs, we cannot be certain opportunity zones will generate sustained economic development for distressed communities.

Capital Gains Taxes

A capital gain is the profit earned when an asset, such as an investment or property, is sold. Short-term capital gains, or profits on assets sold within one year of purchase, are taxed at a taxpayer's ordinary income tax rate. Long-term capital gains, or gains from assets held longer than a year, are taxed at either 0 percent, 15 percent, or 20 percent, based on a taxpayer's income. Individuals with income above $200,000 ($250,000 for married filers) are subject to an additional 3.8 percent tax on their net investment income.

Consider an investor who bought shares in a company for $25,000. Ten years later, the value of those shares has increased to $50,000. The investor then sells those shares, realizing a capital gain of $25,000 on the original investment. Assuming the investor's income triggers a 15 percent tax on this capital gain, their tax liability would be $3,750. This brings the investor's total post-tax earnings to $21,250.

Table 1. Sample Calculation of Traditional Capital Gains Tax

Traditional Investment	
Original Investment:	$25,000
Sold for:	$50,000
Capital Gain:	$25,000
Capital Gain Tax Rate:	15%
Capital Gain Tax Due:	$3,750
Post-Tax Earnings:	$21,250
Source: Authors' Calculation	

The Opportunity Zones Program attracts investment to economically distressed communities by modifying this standard tax treatment of capital gains in several ways. These modifications either delay or reduce the capital gains tax liability of

investors. But to qualify for these benefits, investors must reinvest one or more capital gains in a Qualified Opportunity Fund (QOF).

Qualified Opportunity Funds

The TCJA describes a QOF as any investment vehicle organized as a partnership or corporation that holds 90 percent or more of its assets in qualified opportunity zone property, other than another qualified opportunity fund. Proposed regulations would require 70 percent, or "substantially all," of a business's tangible business property be in an opportunity zone to qualify for QOF funding. Combining the 90 percent asset requirement for opportunity funds with the 70 percent tangible property requirement for qualifying businesses means that a QOF may be as minimally invested in a zone as 63 percent. These proposed regulations would also require that "50 percent of the gross income of a qualified opportunity zone business [be] derived from the active conduct of a trade or business in the qualified opportunity zone."

Tax Treatment of QOF Investments

An investor can receive up to three tax benefits by reinvesting capital gains in a QOF. The first is temporary tax deferral on any capital gains reinvested in a QOF within 180 days of realization. Tax payment is deferred until the investment is sold or exchanged, or until December 31st, 2026, whichever comes first.

The second benefit is a 10 percent step-up in basis for capital gains reinvested in a QOF if the investment is held for five years. The basis is increased an additional 5 percent for any investments held for seven years. This step-up in basis means taxpayers can exclude up to 15 percent of the value of their reinvested capital gains from their taxable income, decreasing the investor's tax liability when they sell or can no longer defer taxation.

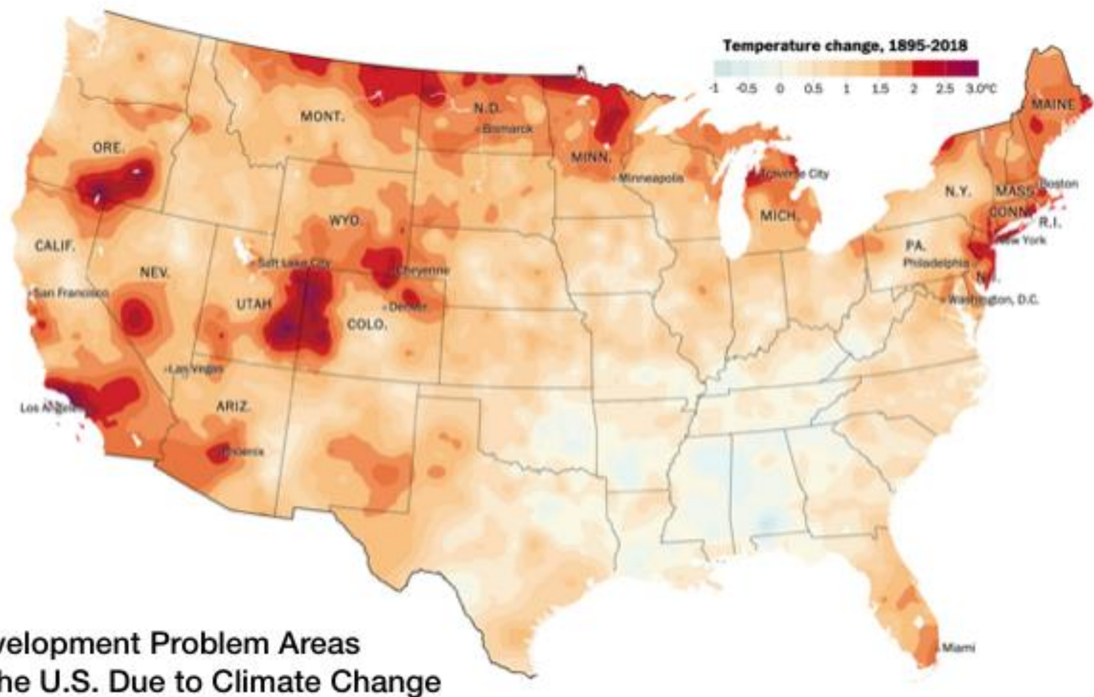
Finally, QOF investors can permanently exclude from taxation any capital gains that accrue *after* their investment in a QOF, if the investment is held for at least 10 years. Opportunity zones increase the basis of any investment held in a QOF for 10 years to 100 percent of its fair market value on the date it is sold or exchanged.

Become a TCJA Expert With Our 2-week Crash Course! (See internet for this article and information)

Table 2 provides an example of the tax savings opportunity zones can provide to an investor who holds an investment in a QOF for seven years. This sample investor had originally invested $1 million and sold it for $2.5 million, for a gain of $1.5 million. Under the traditional system, they would owe $357,000 in capital gains taxes. However, if the investor invested the $2.5 million in a QOF, they would save $53,550 in capital gains taxes. This is because the step-up in basis means they pay taxes on

just $1.275 million in capital gains rather than the original capital gain of $1.5 million.

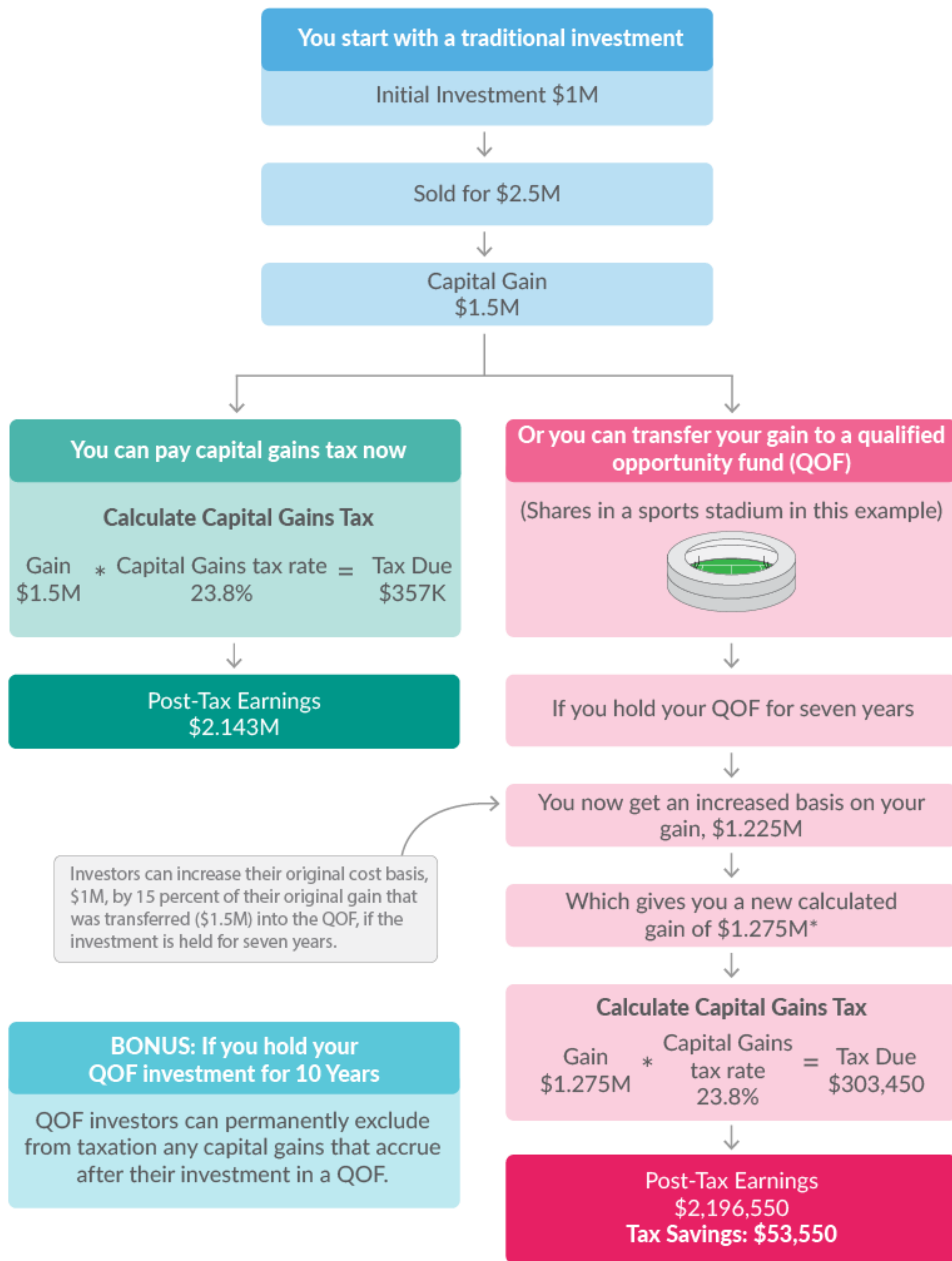
Table 2. Sample Calculation of Capital Gains Tax on a QOF Investment Held for Seven Years



Traditional Investment	QOF Investment Held for Seven Years

Original Investment:	$1,000,000	Original Investment:	$1,000,000
Sold for:	$2,500,000	Sold for:	$2,500,000
Capital Gain:	$1,500,000	Capital Gain Transferred to QOF:	$1,500,000
Capital Gain Tax Rate:	23.80%	Increased Basis:	$1,225,000
Capital Gain Tax Due:	$357,000	New Calculated Gain:	$1,275,000
Post-Tax Earnings:	$2,143,000	Capital Gain Tax Rate:	23.80%
		Capital Gain Tax Due:	$303,450
		Post-Tax Earnings:	$2,196,550
		Tax Savings:	$53,550

Note: Investors can increase their original cost basis, $1M, by 15 percent of their original gain that was transferred ($1.5M) into the QOF, if the investment is held for seven years. This calculation does not include any earnings made from the QOF investment.
Source: Authors' Calculations



How do Qualified Opportunity Fund Investments Work?
Sample Calculation of Capital Gains Tax on a QOF Investment Held for Seven Years
You start with a traditional investment
Initial Investment $1M
Sold for $2.5M
Capital Gain $1.5M
You can pay capital gains tax now
Calculate Capital Gains Tax
Gain $1.5M * Capital Gains tax rate 23.8% = Tax Due $357K
Post-Tax Earnings $2.143M
Or you can transfer your gain to a qualified opportunity fund (QOF)
(Shares in a sports stadium in this example)
If you hold your QOF for seven years
You now get an increased basis on your gain, $1.225M
Investors can increase their original cost basis, $1M, by 15 percent of their original gain that was transferred ($1.5M) into the QOF, if the investment is held for seven years.
Which gives you a new calculated gain of $1.275M*
Calculate Capital Gains Tax
Gain $1.275M * Capital Gains tax rate 23.8% = Tax Due $303,450
Post-Tax Earnings $2,196,550
Tax Savings: $53,550
BONUS: If you hold your QOF investment for 10 Years
QOF investors can permanently exclude from taxation any capital gains that accrue after their investment in a QOF.
*New Calculated Gain is selling price of gain invested minus increased basis ($2.5 million-$1.225 million).
This calculation does not include any earnings made from the QOF investment.
TAX FOUNDATION
@TaxFoundation

Table 3 shows that any gain accrued after the $1.5 million investment in the QOF is exempt from taxation if it is held for 10 years or longer. Assuming the investor made another $500,000 over the decade of the QOF investment, the investor would save an additional $119,000 in taxes.

Table 3. Sample Calculation of Capital Gains Tax on Accrued Earnings of QOF Investment Held for Ten Years

Traditional Investment		**Earnings Accrued from QOF Investment Held Ten Years**	
Original Investment:	$1.5 million	Original Investment:	$1.5 million
Sold for:	$2 million	Sold For:	$2 million
Capital Gain:	$500,000	Capital Gain:	$500,000
Capital Gain Tax Rate:	23.80%	Capital Gain Tax Rate:	0%
Capital Gain Tax Due:	$119,000	Capital Gain Tax Due:	$0
Post-Tax Earnings:	$381,000	Post-Tax Earnings:	$500,000
Tax Savings:	$0	Tax Savings:	$119,000
Source: Authors' Calculations			

In total, this sample investor saves $172,550 in taxes by reinvesting their $1.5 million capital gain in an opportunity zone and holding that investment for 10 years.

Budgetary and Economic Costs of the Opportunity Zone Program

The Joint Committee on Taxation (JCT) estimates the Opportunity Zones program will cost $1.6 billion between 2018 and 2027. The program is estimated to decrease revenue between 2018 and 2025 but generate revenue in 2026 and 2027, as investors can no longer defer taxes on the capital gains they reinvested in QOFs.

Table 4. Annual Cost Estimates of Opportunity Zones

Opportunity Zone Cost (Billions of Dollars)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	-1.2	-1.7	-1.6	-1.7	-1.6	-1.5	-1.5	-1.6	8.1	2.7
Source: Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, The 'Tax Cuts and Jobs Act.'"										

Importantly, new regulations stipulate that the program's benefits would continue through at least 2048, meaning the revenue impact of the program could increase over time depending on how much activity occurs within opportunity zones.

We also know that, as with any tax provision, the economic cost of the program will exceed its budgetary cost. Navigating the program's new set of rules and regulations will generate direct compliance costs for investors, and investors will forgo investments in other areas of the economy to take advantage of the program's tax incentives. (Become a TCJA Expert With Our 2-week Crash Course! -Adam Hooper)

The "spatial mismatch" theory argues people can become trapped in low-income areas for several reasons, such as an inability to incur the cost of moving to and living in a more productive area. In theory, place-based incentives can draw investment that will generate employment opportunities for immobile residents.

Some have also argued place-based incentive programs can attract highly-skilled people to productive urban centers where they can experiment, innovate, and learn from other highly skilled people. These productive "agglomeration economies" then generate benefits that "spill over" to other areas of the economy.

However, measuring the effectiveness of place-based incentive programs is challenging. For one, program boundaries are not always delineated by census tracts or zip codes, making data collection difficult. And even when data is available, oftentimes, multiple place-based programs intervene in the same area, making it difficult to isolate the effects of one program relative to another. Making matters more complicated, it is difficult to find areas that are similar to zones but have not received benefits. Without a counterfactual, it's difficult to measure success.

Perhaps unsurprisingly, given these measurement difficulties, there is no academic consensus on whether place-based incentive programs work as intended. In fact, research suggests programs fail to generate new employment often because subsidized firms replace nonsubsidized firms, or because firms simply shift their current business activities for tax purposes. *Research also suggests the benefits of place-based incentives accrue primarily to landowners and higher-skilled mobile workers who can travel for employment, effectively displacing the low-income residents the programs are meant to help.*

Displacement Effects

Opportunity zone tax breaks will attract investment (at least in the short term) and this capital will require labor. But investors are not required to create jobs that fit the skills of zone residents. If these investments generate employment

opportunities that do not match the skills of existing residents, workers from outside the jurisdiction could take the employment opportunities instead.

Evidence shows that this skills mismatch problem does occur. For instance, Maryland's Department of Legislative Services (DLS) found "a significant mismatch between the skills of those who fill[ed] the private jobs within enterprise zones and those who reside[d] in or near the zones." Overall, DLS estimated only about one in eight enterprise zone jobs, or 12 percent, were filled by community residents. DLS concluded:

While enterprise zone tax credits may incentivize some businesses to create additional jobs within enterprise zones, the tax credit is not effective in providing employment to zone residents that are chronically unemployed and/or live in poverty. A number of factors contribute to this problem, including skills mismatches for new jobs created, lower than average educational attainment levels of zone residents, and labor mobility.

Place-based incentives can also pressure nonsubsidized firms out of business by providing subsidies to their competitors. For instance, in a 2010 report, Louisiana Economic Development cautioned that of the 9,379 jobs attributed to the state's Enterprise Zone program in 2009, only 3,000 jobs could be considered new. The report cautioned many of the projects associated with the program would have occurred regardless of the incentive, and many new jobs simply replaced others.

Place-based incentive programs could displace low-income residents by increasing property values. As capital and labor move into a zone, this could put upward pressure on wages and housing prices. While this would benefit landowners in a region, it could be problematic to low-income individuals if it makes housing unaffordable. In the case of opportunity zones, the site-selection process which places zones in gentrifying areas could exacerbate this effect.

Opportunity Zone Data is Necessary to Compare the Program's Outcomes with Alternative Approaches

Given that there is no consensus on the efficacy of place-based incentive programs, gathering data on opportunity zones is crucial. Senators Corey Booker (D-NJ) and Tim Scott (R-SC) had originally included provisions for annual data collection beginning five years after the bill passed, but those provisions were dropped in the final version of the TCJA.

Without data, it is impossible to judge the merits of place-based incentive programs relative to other economic development approaches. Take the federal government's experience with Empowerment Zones, Enterprise Communities, and Renewal Communities, all place-based incentive programs that subsidized firms for locating in particular areas to help develop distressed communities. In 2010, the Government Accountability Office found:

[D]ata limitations make it difficult to accurately tie the use of the credits to specific designated communities. It is not clear how much businesses are using other EZ, EC, and RC tax incentives, because IRS forms do not associate these incentives with the programs or with specific designated communities.… making it difficult to begin assessing the impacts of these tax benefits.

Fortunately, future rounds of opportunity zone regulations will likely include reporting requirements that would allow economists to evaluate program impacts. The White House has also created an Opportunity and Revitalization Council that will, among other things, assess "what data, metrics, and methodologies can be used to measure the effectiveness of public and private investments in urban and economically distressed communities, including qualified opportunity zones." Both developments can help policymakers assess the effectiveness of opportunity zones relative to other economic development policies.

Conclusion

With opportunity zones, and any other place-based incentive program, it's important to consider what we know, as well as what we don't. We know the program will attract at least some investment to low-income census tracts designated as zones. We also know that this investment will come at both a budgetary and economic cost.

But we don't know how effective opportunity zones will be at improving the lives of low-income people in economically distressed communities. Both research and state level experience raise concerns that opportunity zones could actually be counterproductive to generating sustained development in these communities.

For now, policymakers should emphasize the data collection necessary to measure the effects of this program. Without it, we will be unable to measure the merits of this place-based approach compared to other alternatives that could more effectively develop economically distressed communities.

M. Layser's Abstract which was mentioned earlier should be read before investing in opportunity zones, since it describes how most in-place Opportunity or Enterprise investments do not help the poor and many times the poor people are driven out of the zones by gentrification. The projects generally help the developers, real estate agents and other wealthy people associated with the development activities. There are four types of in-place benefit projects and only one is community orientated. This type is rarely used. (See Abstract)

This abstract is divided into five parts which she describes as follows:

Part I of this Article explains why spatial inequality, including concentrated poverty , is an important area of inquiry for tax law research, and it introduces place-based investment tax incentives as the subject of study . Part II describes the current landscape of place-based investment tax incentives and demonstrates that neither

theory nor evidence supports the optimistic rhetoric that drives the bipartisan popularity of these tax incentives. The central problem presented by current place-based investment tax incentives is this contradiction between rhetoric and reality; though they are presented as laws that benefit low-income communities, the dominant types of place- based investment tax incentives are not designed for this purpose. Understanding the reasons for this disconnect is key to assessing the limits and potential of place-based investment tax incentives as anti-poverty tools.

Part III confronts this problem by tracing the development of today's dominant types of place-based investment tax incentives to their pro- gentrification origins in order to provide an explanatory theory about their development. Namely, it argues that the hidden objective of these types of laws is to support gentrification for the benefit of place entrepreneurs and other wealthy parties. Part IV argues that most current place-based investment tax incentives should be abandoned as bad policy. Even if gentrification is a legitimate policy goal, most current place-based investment tax incentives are less efficient or equitable than alternative types of incentives.

Accordingly, Part V argues that lawmakers should introduce alternative types of place-based investment tax incentives designed to improve neighborhood conditions in poor communities *for the benefit of poor communities*. After analyzing imperfect models of these types of incentives under current law, it presents a theoretically and empirically grounded roadmap for using mental mapping techniques to design community oriented investment tax incentives that are more likely to benefit poor communities. Until these community oriented investment tax incentives are tested, our understanding of the potential for place-based investment tax incentives to fight concentrated poverty will remain incomplete.

Community Land Trusts

Another alternative not mentioned in the discussions about Opportunity Zones is the use of designating the placed based project as a Community Land Trust. The following information is from the website Sharable. As much as possible, it provides a method of preventing Gentrification occurring within the projects

According to community-wealth.org, there were 242 community land trusts in the United States in 2011 with about 10,000 housing units serving over 12,000 residents. A majority (82%) of those residents had incomes below 50% of area median, had 31% were non-white.

The CLT model works by purchasing land on behalf of the community and holding it in trust in perpetuity. The CLT can sell the land and structures on the properties, with option to repurchase, or enter into a long-term lease, typically a ground lease, during which the tenant can make improvements to the property, and during which

time the CLT maintains an interest in maintenance of the structures and property. If the buyer chooses to sell, the CLT retains the right to re-purchase the structures for an agreed-upon formula giving the buyer partial equity. The remaining equity stays with the CLT, and the structure is re-sold below-market rate. The cost of the land is forever retained within the trust.

The National Community Land Trust Network provides resources and coordination for CLT's in the United States.

Steps for Establishing a Community Land Trust

1. Determine Rationale

Several rationales exist for starting and supporting a CLT. When establishing a CLT, one or more of the following rationales are commonly identified:

- Developing communities without displacing people (avoiding gentrification and displacement of low-income residents),
- Perpetuating the affordability of privately owned housing (avoiding market-rates on housing that was developed intentionally for affordability by public or private measures)
- Retaining the public's investment in affordable housing (avoiding market-rates on housing that was developed for affordability by with public dollars)
- Protecting the occupancy, use, condition, and design of affordable housing (ensuring occupancy, stewardship and maintenance of affordable housing over time)
- Assembling land for diversity of development (assembling land under which CLT tools can be used to develop multiple types of development within the CLT's service area)
- Enabling the mobility of low-income people (providing additional routes to housing for lower- and moderate-income people beyond what the market offers)
- Backstopping the security of first-time homeowners (stepping in to cure defaults and prevent foreclosures, protecting the homeowner, the housing, the bank and the community)

2. Determine Sponsorship

CLTs generally get their start from some sort of impetus initiated by one of the following four potential sponsors:

- **Individuals and institutions** at the grassroots level (typically faith-based and community organizations). Advantages of grassroots organizations include acceptance by the community being served, legitimacy in the eyes of lenders and funders, market insight, and a lack of baggage from other of organizations. Disadvantages include challenges in building staffing and

financial capacity, credibility, competition with existing organizations, and difficulty in selecting beneficiaries.

- **Governmental** officials at the local, regional, or state level (typically municipal government), Advantages include access to public community development funds, staff support, regulatory assistance, and a view f the entire housing non-profit local landscape to establish the appropriate niche for a CLT. Disadvantages include public distrust of government, political tainting, a top-down approach that may be perceived to be out of touch with community needs, and resistance to including community members in the CLT governance structure.
- **Other nonprofit organizations** operating within the CLT's service area (typically community development corporations, social service organizations or housing non-profits, which may convert, spin-off, adopt a CLT as a program, or establish an affiliate organization). Advantages can include foundational capacity form the existing nonprofit, increased productivity, credibility, compatibility within the nonprofit housing network, and diversification and renewal of an exsting nonprofit.. Disadvantages can include political baggage attributed to the parent non-profit, difficulty in adjusting leadership and board structure to accommodate the need for a CLT to be accountable to leaseholders and the community, divided loyalties and lingering control.
- **Local businesses and banks** (typically businesses concerned about the ability of lower-income employees to secure affordable housing).

Advantages can include early capacity and sponsorship, provision of starter homes for working families, and leveraging of private dollars for public funds. Disadvantages can include control and power concentrated at the business, failure to embrace the CLT model where it contrasts with traditional business models, and a tendency to target higher on the income scale (towards working families and above the structurally unemployed).

3. Identify Beneficiaries

The CLT must decide early on who its target beneficiaries are, as this will determine the type and tenure of housing, the amount of subsidy the CLT will need to provide to make housing affordable to the targeted beneficiary, the types of funds the CLT can access, and design of the resale formula, marketing plan, selection criteria, and organizing strategy.

When determining beneficiaries, an assessment of community need revolves around three main decision points:

- Where on the income scale to begin
- Whether future sales should target lower on the income scale (increasing affordability) or at the same level (to maintain affordability)
- Whether other factors beyond income (families, disability, age, geography of residence or work) be factored into a decision

Targeting higher incomes will mean challenges with nonprofit incorporation and securing means-tested public funding, greater resistance in lower-income neighborhoods, and less risk of default and maintenance issues resulting in lower administrative costs.

Maintaining affordability may mean a better equity share for sellers; expanding affordability may speed the rate at which a CLT can expand and meet its mission, as resources that would go into subsidy on subsequent rounds of sale can be used instead to acquire new properties.

Advantages of taking other factors beside income I to account can include neighborhood development objectives, broadening appeal, and tailoring developments to meet the unique needs of specific targeted groups. Risks include losing out on public funding targeted towards low-income persons, running afoul of equal-protection housing laws, and perpetuating patterns of discrimination based on income an color.

4. Delineate Service Area

CLT's are place-based organizations and must define the geography within which they will operate and serve. A CLT can operate at the scale of a neighborhood, a city, and metropolitan area, or a state.

Advantages of operating over a large geography include mobility for low-income people, establishing a "fair share" of affordable housing in the suburbs, securing lower-cost land for development outside of the urban core, a wider pool of applicants allowing increased selectivity, opportunity to build a broader constituency, increased opportunities for collaboration and funding, and opportunity to participate in regional smart growth planning and development.

Disadvantages of going large include increased management costs, loss of accountability, perception as absentee landlord, competition from other organizations operating locally, NIMBY-ism, contributing to sprawl, and less community development and organizing.

5. Organize

Key constituencies of CLTs include grassroots community advocates, nonprofits, and government agencies, housing professionals, public officials, private lenders and donors.

The three key organizing principles for a CLT include:

- **Community organizing:** campaigning at the grassroots level within a neighborhood. Advantages include early awareness and acceptance, recruitment, marketing, and fundraising, Disadvantages include time

consumption, engendering high expectations in the community, and opening up for criticism before the CLT is established.

- **Core group organizing:** approaching influential institutions and individuals to engender support. Advantages can include faster support, faster development, credibility, borrowing capacity; disadvantages can include the burden of elitism, borrowed baggage, and increased market risk.
- **Resource organizing:** a few advocates secure resources (funds and/or ands) from donors to seed the fund and staff the CLT, then staff commences community or core group organizing, Advantages can include acceptability, early staffing, and leveraging of resources. Disadvantages can include guilt by association with a donor who has earlier been perceived to have wronged or neglected a community, building projects before the organization has time to develop, too much money at once risking misuse of funds by forcing development into a single direction, possibly a bad one, quickly.

6. Develop or Improve Land

Some options for CLT land development include:

- **CLT-Initiated Projects**: CLT acts as developer. Issues include role of the CLT, conflicts, capacity, and resources.
- **Buyer-Initiated Acquisition**: CLT purchases land and building from the seller and executes a ground lease with the buyer. Issues include pre-qualification for homebuyers, source and amount of subsidies, neighborhood targeting, types of housing accepted, and inspection and maintenance.
- **Developer-Initiated Projects:** Developer approaches CLT and assumes risk during construction. Issues include protections for CLT and evaluation of projects.
- **Stewardship Projects with Partners Doing all Development:** CLT makes parcels available to developer partners, taking an active role in land assembly and stewardship but not developing. Issues include sources of funding for the CLT of developer fees are foregone, CLT's role in ensuring quality development, and partnerships.
- **Municipality-Initiated Projects:** Municipality conveys land to CLT for a specific purpose (typically for the CLT to develop affordable housing). Issues include cost of land, allocation of risks, and any reversion clauses.
- **Municipally mandated units (inclusionary zoning):** CLT monitors and enforces inclusionary requirements on behalf of municipality. Issues include compensation for services to the municipality and responsibility for units not on CLT-land.
- **Public Housing Authority:** Divested Property: Land is conveyed from the PHA to the CLT to ensure continued affordability. Issues include CLT's role in managing existing tenants, price of land, and post-conveyance services to residents.

7. Secure Funding

CLT's need funding to pay for a variety of functions related to land acquisition, construction, and subsidies. Sources of project funding include:

- Federal Programs: CDBG and HOME Funds- may require special designation of CLT as a Community Housing Development Organization by Local Participating Jurisdiction. HUD Funds for organizational planning and development are also available.
- Federal Tax Credits: Low Income Housing Tax Credits and Historic Preservation Tax Credits
- Federal Home Loan Bank
- Private Lending Institutions
- State Housing Finance Agencies
- Institute for Community Economics' Revolving Loan Fund
- Housing Trust Funds
- Tax Increment Financing
- Municipal Real Estate
- Private Developer Exactions
- Pension Funds
- Private Foundations
- Private Land Donations
- Development Fees
- Lease Fees
- Add: Opportunity Zones - Capital Gains Funding

Specially based tax Credits: New Market Tax Credits (NMTC) - Low Income Housing Tax Credits (LIHTC)

Sources of Operational Funding:

- CDBG & HOME
- Private Institutions
- Private Donors
- Grassroots Fundraising
- Development Fees, Rental Income, & Lease Fees

Project funding issues include avoidance of subsidy erosion over time; a CLT seeks to retain the subsidy in the housing stock, acquiring grants to subsidize both land costs and building construction, and strong partnerships with local lending institutions. Issues in securing operational funding include competition with other nonprofits, surviving foundation fads, and staffing levels.

It takes about three years for a CLT to establish itself within a community. It's may seem like a lot of work and time, but CLTs offer a lasting, systemic solution for affordable housing.

This how-to is based on the publication, *Starting a Community Land Trust: Organizational and Operational Choices*, by John Emmeus Davis. Highly recommended if you need more detail.

This is one way to use possible funding from Opportunity Zones to fund the Pilot Demonstration Project (PDP) so that the funding is used for community benefits rather than just providing a way for the wealthy to become richer. The forming of a Community Land Trust will help insure that this ideal will last a long period of time. The governing structure established within the community itself can provide additional safeguards that this goal is possible.

The funding will have to come from people wanting this to be used in this manner as well as any people or organizations associated with its development. The multi-use adaptability of the project will add to the project's viable lifespan. This is not found in other projects and it will take visionaries and innovators to make it happen. The training aspect of the community will insure that this type of community can be formed and developed in other areas so that it is continually reinventing itself to meet changing social and environmental conditions.

Additional information about this process of development will be discussed in later blogs showing how the Pilot Demonstration Project (PDP) would be used in Opportunity Zones. The climate map of the U.S. on page 8 shows what areas would have climate problems.

Rather than to continually adding information and ideas to the book, *Toward Self-Sufficiency*, I will use the website to show what alternatives and options could be available that would make the project better by fulfilling different needs. This will include suggestions from the readers of the blogs. This is important because other viewpoints are necessary, since they reflect opinions from people that are innovative and have lived in different situations which should be mentioned. We not only need to know what conditions people are living in but what circumstances caused them to be where they are - both good and bad.

George Hunt