OPPORTUNITY FINANCE NETWORK

June 26, 2019

Ms. Erika C. Reigle
Mr. Kyle C. Griffin
Internal Revenue Service
CC:PA:LPD:PR (REG-120186-18), Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Re: REG-120186-18 Proposed Regulation on Investing in Qualified Opportunity Funds

Dear Ms. Reigle and Mr. Griffin:

Thank you for the opportunity to comment on the second tranche of proposed regulations for investing in Opportunity Zones and Opportunity Funds. I am writing on behalf of Opportunity Finance Network (OFN), a national association of nearly 270 Community Development Financial Institutions (CDFIs) investing in opportunities that create affordable housing, vital community services, and entrepreneurial capital in rural, urban, and Native communities. OFN members have cumulatively provided more than $65 billion in responsible lending to help low-income, low-wealth, and otherwise disinvested individuals and communities nationwide.

OFN requests ten minutes to testify at the public hearing on July 9, 2019. Mary Scott Hardwick, Senior Associate, Public Policy will provide comments on the community impacts of Opportunity Zones and will generally cover the topics outlined in this comment letter. Please contact her at mshardwick@ofn.org or 202-318-0847 with any questions.

The Opportunity Zone tax provision could result in nearly $100 billion in new capital investment flowing into the 8,700 disinvested census tracts across the country that were designated as Opportunity Zones. This is a tremendous opportunity for communities across the country, but also a tremendous risk if the provision is not implemented properly or if the regulations do not provide sufficient guidance. Key items still within Treasury's purview include comprehensive data collection and reporting requirements and the establishment of bad actor provisions to protect the integrity of the tax incentive and prevent fraud. Another high priority for OFN is ensuring the provision works well for investment in operating businesses.

Data Collection and Reporting Requirements

We were pleased to respond to Treasury's recent Request for Information regarding data collection and reporting requirements but are disappointed that this important issue has not been addressed in either set of regulations published by Treasury. An RFI is a step in the right direction, however, 18 months have passed since the enactment of the Tax Cuts and Jobs Act and a year has passed since the designation of Opportunity Zones by governors across the country. With Opportunity Funds being created and beginning to make their investments, Treasury must act quickly to ensure sufficient data is being collected to determine the effectiveness of the provision in generating economic opportunity and to provide transparency to the public about the impact of these investment in their communities. Baseline data about the economic situation in each of the Opportunity Zones, as well as those eligible census tracts that were not selected are essential to evaluating the effectiveness of the provision at generating real economic growth. A review by

Zillow found that property values in Opportunity Zones have risen simply as a result of the designation and that it is unclear if the increase in value has any correlation to actual investments.[1] With these changes happening prior to the investment of any Opportunity Fund capital, it will require transaction level data collection to be able to directly connect any rise in property value to distinct Opportunity Fund investments. This example of the fluctuation in property value illustrates that general census tract level economic data will not be sufficient to measure the impacts of investment.

OFN is supportive of collecting comprehensive data that will show where the investment is being made, the results of the investment, and the impact on the targeted community. The data collection by Treasury should be significantly expanded to get the full picture of the impact of investments on communities. This data collection should include the:

- Size of the investment
- Location of the investment
- Type of investment
- Community impacts of the investment o Housing units created (affordable and market rate)
    - Permanent, seasonal and construction jobs created
        - Whether those jobs went to residents of the Opportunity Zone
    - Square footage of commercial real estate
    - Number of new small businesses created
    - Other appropriate measures based on asset class (childcare spots created, patients served via a medical facility etc.)

We also recommend that Opportunity Funds provide a brief narrative description of each project investment, which would include: the nature of the project; the benefits to the community; the degree to which the project was developed in consultation with the community residents and/or mitigated against displacement; and the extent to which the project connects with local workforce development efforts for low- and moderate-income residents. OFN supports the use of an online portal managed by the CDFI Fund for the collection of this data. The CDFI Fund has experience managing similar sets of data and will be best equipped to do so for Opportunity Fund investments.

<u>Anti-Abuse Provisions</u>

OFN encourages Treasury to develop strong anti-fraud and abuse provisions. The reporting and transparency requirements outlined above are the first and best way to discourage fraud and abuse. With strong data collection and public transparency, both Treasury and the public will be able to evaluate transactions and identify instances of fraud. Once the reporting requirements are enacted, there are several other ways to help combat fraud and prevent bad actors from taking advantage of the tax incentive.

Beyond the reporting requirements, we ask Treasury to clarify the requirements for improvements on vacant land to further explain what improvements are required and what constitutes an active trade or business. The current proposed regulations state both that vacant land does not need to be substantially improved but also that it must be improved more than an insubstantial amount.

[1] Sales Prices Surge in Neighborhoods with New Tax Break, Zillow, March 18, 2019 https://www.zillow.com/research/prices-surge-opportunity-zones-23393/

This leaves the situation murky for investors and provides the potential for abuse. Although the regulations discourage land banking, there is nothing to stop someone from acquiring several acres and doing some minimal commercial activity or improvements, such as constructing a small shed for an attendant and charging people to park in the vacant lot, other than concern that Treasury may deem that to not meet their standards in the future. Clarification on this issue will help investors understand what they need to do with vacant land while also preventing abuse from any unscrupulous actors.

Treasury should recognize the Congressional intent to ensure accountability of Opportunity Funds to achieve community development impacts through their investments in Opportunity Zones. As noted in the Conference Report that accompanied H.R. 1:

> *"The provision intends that the certification process for a qualified opportunity fund will be done in a manner similar to the process for allocating the new markets tax credit. The provision provides the Secretary authority to carry out the process."* [2]

OFN recommends that Treasury consider including references to the requirements in other programs, such as the New Markets Tax Credit, that require fund managers to certify that they have not been indicted or convicted of fraud, embezzlement, forgery, theft or other offenses within the past three years. This requirement would only apply to fund managers and would in no way impede a returning citizen from accessing capital to start up a new business but would provide consistency with other programs and make sure fund managers have not recently been convicted of fraud or other financial crimes.

Consistent with the language of the Conference Report, it would also be appropriate for Treasury to require Opportunity Funds to identify, at the time of certification, one or more outcomes from a list of desirable community development outcomes that they intend to achieve with their investments. These could include, for example: creating quality jobs for low-income individuals; developing affordable housing for low-income families; investing in community facilities that provide services benefitting low-income community residents; etc. Any Opportunity Fund that is being created will already know their target investment market and will be able to simply select from the pre-prepared options. This will encourage Opportunity Funds to think intentionally about how their investments will produce positive outcomes for community residents and will provide Treasury with a way to compare an Opportunity Fund's investments to their stated intention when investigating any potential abuse of the provision.

Treasury should also consider holding Qualified Opportunity Zone Businesses to the same standard as Qualified Opportunity Funds with regard to investing in a "sin business". Without this clarification and consistency, an Opportunity Fund could just form a subsidiary to avoid that requirement, making it an ineffective provision.

The proposed regulations currently state that for each month that an Opportunity Fund fails to meet the 90 percent asset test, it must pay a penalty unless the failure is due to reasonable cause. Treasury should define what a reasonable cause is and how the standard can be met. A lack of definition may cause investors to hold back on investing in an Opportunity Fund or to direct Opportunity Funds to concentrate on more straightforward and safer investments so that they do

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[2] Conference Report (115-466), Tax Cuts and Jobs Act https://www.congress.gov/congressional-report/115th-congress/house-report/466/1?overview=closed

not run the risk of facing a penalty. The penalty should be targeted to bad actors and not overly broad in a way that would discourage investors from deploying capital.

Investment in Operating Businesses

We are pleased that the second round of proposed regulations provides significant clarifications on the treatment of investments in operating businesses. Job creation is an essential part of community development. OFN remains concerned that pre-existing businesses will find it difficult to take advantage of the new source of capital that is available through Opportunity Funds. This would advantage new startups or existing businesses moving into an Opportunity Zone over those businesses that have been providing jobs in the community for years and may also need capital to expand.

OFN broadly supports the comments of the Economic Innovation Group for technical improvements needed in the regulation to provide certainty for investors to invest in operating businesses and encourages Treasury to look for additional ways to make capital available to existing businesses

OFN looks forward to working with you to support economic opportunity for all and to presenting testimony at the public hearing on July 9th. Please feel free to contact us with any questions.

Sincerely,

Mary Scott Hardwick

Mary Scott Hardwick
Senior Associate, Public Policy