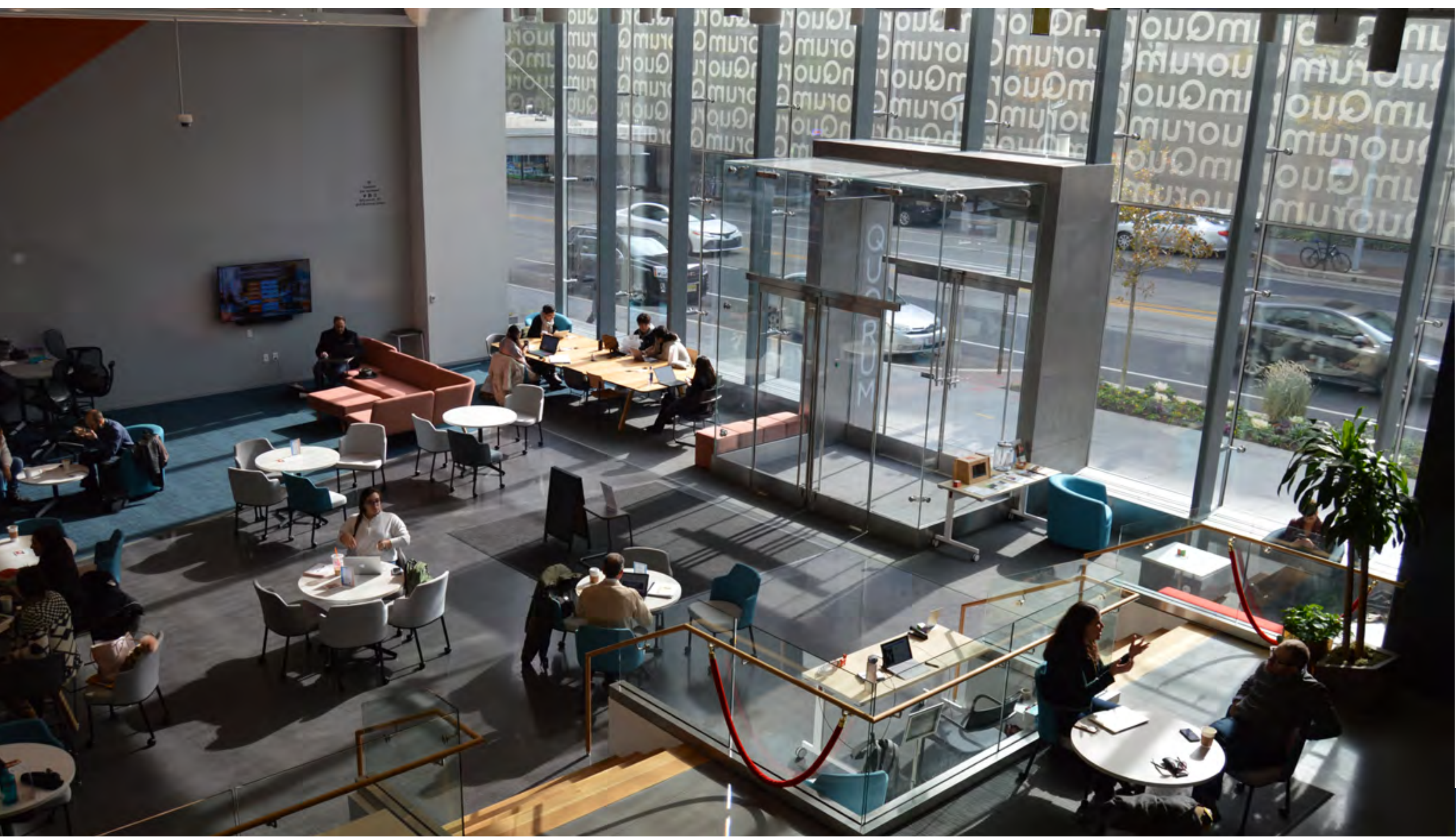
Realizing the Transformative Potential of Opportunity Zone Business Investing

A Guide for Practitioners

Co-Authors: Evan Weiss & Bruce Katz



DREXEL UNIVERSITY
Nowak Metro Finance Lab
Lindy Institute for Urban Innovation

Ben Franklin
Technology PArtners
Southeastern Pennsylvania

ACCELERATOR FOR AMERICA

ABOUT THE AUTHORS

Evan Weiss is the Senior Advisor for Public Finance in the administration of Governor Phil Murphy of New Jersey. He has published several articles on Opportunity Zones and has worked on early initiatives to use the incentive to build schools, affordable housing, and invest in high-potential tech, life sciences, and small businesses in order to build community assets.

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. The mission of the Nowak Lab is to help cities design, finance and deliver transformative initiatives that promote inclusive and sustainable growth. Bruce also serves as a Partner with 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.

ADDITIONAL CONTRIBUTORS

Lisa Starczewski, Esq.
Shareholder and Chair, Tax; Opportunity Zones
Buchanan Ingersoll and Rooney PC

Margaret Berger Bradley
Director of Strategic Initiatives
Ben Franklin Technology Partners of Southeastern PA

Agnes Dasewicz
Fellow
The Rockefeller Foundation

ACKNOWLEDGEMENTS

Drexel University Nowak Metro Finance Lab

The Nowak Metro Finance Lab was formed by Drexel University in July 2018. It is focused on helping cities find new ways to "finance the inclusive city" by making sustained investments in innovation, infrastructure, affordable housing, quality places, and the schooling and skilling of children and young adults. It is situated within the Drexel University's Lindy Institute of Urban Innovation.

Ben Franklin Technology Partners of Southeastern PA

Ben Franklin Technology Partners combines the best practices of early stage investing with a higher purpose – to lead the region's technology community to new heights, creating jobs and transforming lives. For over 35 years, Ben has been the leading seed stage capital provider for the region's technology sectors, investing over $200 million in more than 2,000 regional technology companies, many of which have gone on to become industry leaders. Ben Franklin has also launched university/industry partnerships that accelerate scientific discoveries to commercialization, and has seeded regional initiatives that strengthen our entrepreneurial community.

Accelerator for America

Accelerator for America is a non-profit organization created by Los Angeles Mayor Eric Garcetti in November 2017. It seeks to provide strategic support to the best local initiatives to strengthen people's economic security, specifically those initiatives that connect people with existing jobs, create new opportunities and foster infrastructure development.

Special thanks to the Economic Innovation Group, the Rockefeller Foundation, and the Commonwealth of Pennsylvania for their contributions and insight to this white paper. This publication was made possible with the generous funding support of the United States Economic Development Administration.

EXECUTIVE SUMMARY

More than a year since each Opportunity Zone was formally designated, Opportunity Fund capital has been flowing increasingly faster into real estate, while investment in businesses trickles in. Given the critical role businesses play in the economic growth of underserved areas, the potential of the Opportunity Zones incentive for businesses' investment is too great to ignore. Structural differences between business and real estate investment are doubtlessly part of why investment levels vary; investing in businesses will always require a more tailored approach and a higher-touch process than real estate. This gap is worsened by inscrutable Opportunity Zone rules that can make taking advantage of the incentive seem like more trouble than it's worth. Despite this, investment in businesses located in Opportunity Zones is one of the best ways we can live up to the promise of the legislation by creating quality local jobs, greater community wealth, and stronger local economies.

Facilitated by United States Economic Development Administration and Rockefeller Foundation grants, a collaborative group of Accelerator for America, Drexel University's Nowak Metro Finance Lab, and Ben Franklin Partners of Southeastern Pennsylvania has been working to chart a practical and replicable framework for Opportunity Zone business investment and community wealth building. We believe that both changes and clarification to the legislation and support for intermediary activities are urgently needed to unlock investment in both start-up and longtime Opportunity Zone businesses across a variety of sectors.

While we believe more guardrails, strong reporting requirements, and ensuring all designated Opportunity Zones genuinely meet the intent of the law are critical to living up to the potential of Opportunity Zones, the focus of this analysis is business investment. As such, though we consider these changes as fundamental, they are not addressed here but rather viewed as foundational to the incentive's long term success in general, not just for business investment. The most critical change needed to catalyze investment in Opportunity Zone businesses may be statutory:

1. ***Exempt taxes on interim gains incurred by an Opportunity Fund that buys, sells, and reinvests in different businesses during the ten-year hold period.*** *It is uncommon for business investors to buy and hold an investment in a single business for ten years. Opportunity Fund investors should, for example, be allowed to invest in a first business, sell their stake at a gain, reinvest that gain in a second Opportunity Zone business, and, finally, sell their stake in the second business and the Opportunity Fund after ten years and pay no capital gains tax at either the business or the fund level. Exempting interim gains maintains the central incentive of Opportunity Zones and follows the on-the-ground rhythm of business investing.*

In addition, a few well-placed regulatory adjustments could make a substantial difference:

2. ***Clarify the 40 percent intangible property test to ensure investors feel confident investing in high-potential capital and IP-intensive businesses, like advanced manufacturing and life sciences.*** *Following the path developed in the April 2019 regulations for the 50 percent gross income requirement would be a strong solution, allowing businesses to choose between different testing methodologies. Failure to clarify how the 40 percent is calculated will dampen IP-intensive business investment due to compliance concerns.*

3. ***Drop the "asset by asset" substantial improvement requirement and allow business-level investments to count towards the substantial improvement test.*** *The goal is to ensure investment in businesses, not just their tangible assets individually. An investment that allows a business to hire should count as much as an investment in equipment.*

4. ***Provide greater clarity for the "facts and circumstances" methodology for the 50 percent gross income test to help sectors, like life sciences, that depend on contract research and manufacturing.***

5. ***Offer greater flexibility for the 31-month working capital safe harbor and new rounds of Opportunity Fund investment.*** *For some Opportunity Zone businesses in sectors such as life sciences and advanced manufacturing, adding additional time to the 31-month working capital safe harbor period could encourage investment in companies that take a longer time to start and scale. Similarly, allowing for infusions of additional capital in the Opportunity Fund as the business matures without restarting the ten-year clock could also better conform to the timelines and lifecycles of IP-intensive businesses.*

Regardless of any statutory and regulatory changes, cities, states, nonprofits, and other economic development organizations (EDOs) must step up and act as intermediaries between investors, Opportunity Funds, entrepreneurs, business owners, and residents to truly build community wealth, with the following support systems:

6. ***Routinize technical assistance.*** *Opportunity Fund rules are easier than many other tax incentive and economic development programs, but they are still difficult to interpret. Starting an Opportunity Fund, especially early on, will require the assistance of accountants and attorneys to ensure a business qualifies. Developing and distributing simple guidelines on whether businesses qualify, how they can maintain ownership, and even how to create an Opportunity Fund will help avoid the need for expensive professionals. In addition, because Opportunity Funds require equity investments, businesses that may have limited expertise with capital must understand how and if equity makes sense for their investment.*

7. ***Provide wrap around compliance services.*** *Ongoing Opportunity Zone compliance, for many businesses, will be difficult and expensive, discouraging smaller businesses from even trying to take advantage of the resources. Incubators and accelerators should consider ways to secure and allocate funds to add Opportunity Fund compliance services to their existing business- assistance programming, and government and foundations should encourage Opportunity Fund managers and other intermediaries to do the same with grants or other incentives.*

8. ***Develop a business focused marketplace.*** *Without the ability to evaluate aggregated data according to quantitative and qualitative measures, it will be difficult for many Opportunity Fund investors—especially those operating at a regional or national scale—to identify potential business investments or for businesses to find investors. While online solutions like OppSites and the Opportunity Exchange exist, getting businesses to take advantage of them will likely require local intervention and facilitation. Real estate assets have been aggregated on various online platforms for years now, while analogues for business investment are smaller in scale and scope.*

9. ***Create continuums of space.*** *Many successful businesses that start in Opportunity Zones might need to leave them to scale, impacting investors who need the business to remain in compliance to receive Opportunity Zone benefits and removing the wealth from the community that Opportunity Zones were intended to support. On the local and regional level, economic development organizations, developers, and financial institutions should work to ensure that qualified step-out and scale-up space exists in their Opportunity Zones beyond early incubation and accelerator spaces. There is a great opportunity nationally to frame out how companies could easily locate qualified step-out and scale-up space in Opportunity Zones around the country.*

10. ***Standup business intermediaries.*** *The federal government, states, cities, and nonprofits have invested enormous financial and operational resources into institutions that aid or undertake real estate development, like housing authorities and development corporations. While analogous institutions exist for businesses, they often offer generally available favorable financial products or have comparatively fewer resources (e.g., the entire federal Small Business Administration budget is one-third that of the New York City Housing Authority). Government economic development organizations and foundations fluent in the patterns of local business should fund and prioritize intermediary institutions in order to identify, assist, and scale emerging and growing enterprises that generalized financial products have trouble reaching.*

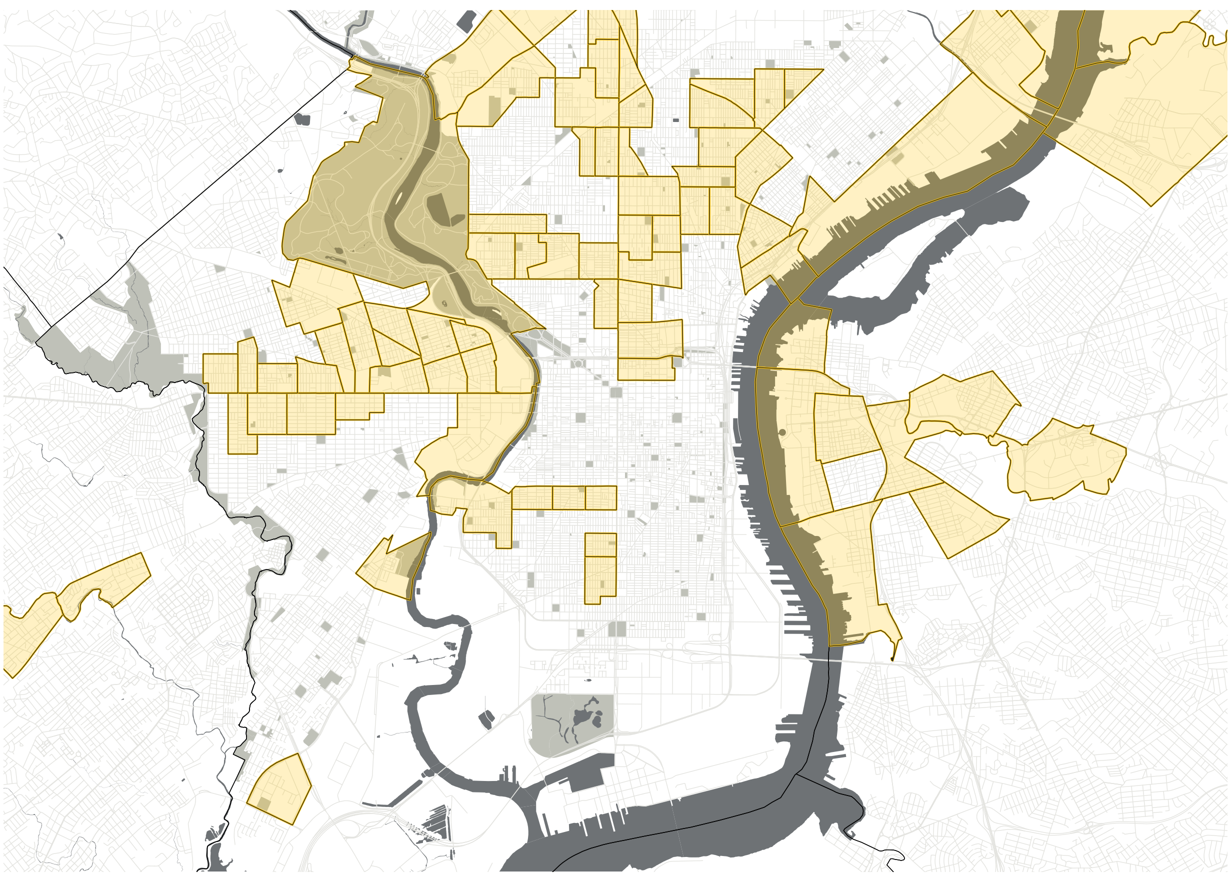
INTRODUCTION

To date, Opportunity Zones have been almost entirely focused on real estate. The majority of closed deals have involved conventional real estate investments, mostly in predictable markets, and some would have happened regardless of the Opportunity Zone incentive. The market for more geographically and product-diverse Opportunity Fund investments grows every day, along with the sophistication and savvy of community stakeholders and investors. More than one year in, a number of stand-out deals have clearly met the community and local wealth-building intent of the legislation. With this inventive energy blossoming around the country, there is real potential for this tool to be a once-in-a-generation catalyst for lasting economic growth in the nation's distressed communities.

Opportunity Zones, however, were supposed to be just as much about business investment as real estate investment—if not more. After all, many of the incentive's most complicated and controversial potential implications—from gentrification to a lack of opportunity for residents of Opportunity Zone communities—are far less problematic in the context of business investment.

Not only do businesses have far more potential to create jobs for residents of Opportunity Zones than real estate alone, but they present a gateway to wealth creation within reach. Access to capital, however, is not evenly distributed; at least 83 percent of entrepreneurs do not access bank loans or venture capital. In fact, venture capital is used by just 0.5 percent of entrepreneurs, disproportionately white and male, supporting a small fraction of new businesses.

Throughout most of the Opportunity Zone incentive's one-and-a-half-year existence, many investors have been wary of making business investments because of several key regulatory questions. While the IRS provided clarity on some key areas of concern, other questions remain unanswered, and investment in businesses has yet to pick up significantly. Difficulties mount once the concept of Opportunity Fund business investment meets the reality of business investing. Based on pure numbers, real estate will likely always be the larger sector; it is formulaic—a building is a building is a building. But, while a smaller sector overall, Opportunity Zone business investing, and business investment funds, promises to be more transformational.



Map of Opportunity Zones in Philadelphia and surrounds.

Facilitated by United States Economic Development Administration and Rockefeller Foundation grants, a collaborative group of Accelerator for America, Drexel University's Nowak Metro Finance Lab, and Ben Franklin Partners of Southeastern Pennsylvania has been working to chart a practical and replicable framework for Opportunity Zone business investment and community wealth building.

Focusing on a variety of target sectors and types of investors, this policy brief is an attempt to elucidate key issues of Opportunity Fund investing, identify solutions, and underscore remaining issues. It's critical to remember that this piece attempts to weave together many disparate aspects of Opportunity Zone business investment and to make universal what is often localized and particular." It is hard to break down Opportunity Zone business investing choices into clear dichotomies. Instead, most businesses, investors, and intermediaries will face a matrix of decisions. The complexity of those decisions' individual applicability should be kept in mind while going through this analysis.

In this policy brief, we seek to harmonize the mutual interests of different types of investors and owners, from new entrepreneurs to longtime businesspeople. Within that framework, we deeply studied two broad business sectors, each with unique characteristics, entrepreneurial ecosystems, and investors: existing small and medium-sized businesses ("SMEs"), which comprise 99.9 percent of all firms in the United States, and emerging and growth-oriented tech start-ups. This latter category includes a wide variety of advanced technology enterprises, including everything from fintech to life sciences, medical devices to additive manufacturing, software to artificial intelligence.

Indeed, small and medium size businesses (SMEs) are recognized both by experts and the local communities in which they thrive as the drivers of economic growth and stability. They provide local employment and much-needed services such as affordable groceries, clean energy installations, health clinics, accessible financial services, and educational opportunities. Supporting SME formation and growth in underserved areas in the U.S. could bring progress and opportunity back to impoverished neighborhoods. Importantly, SMEs can grow and thrive in varied places, serving local, regional and even global markets as they scale and thrive.

Additionally, emerging, high-growth enterprises are key to a community's ability to transform and position itself

KEY TERMS WITH GENERAL DEFINITIONS:

Opportunity Zone (OZ)
One of 8,700+ low income census tracts chosen by states and certified by the federal government. Qualifying investments in Opportunity Zones are eligible for federal capital gains tax deferral, reduction, and exemption; and, because many states conform to federal tax statutes, Opportunity Zone tax benefits will also be available on the state level.

Qualified Opportunity Fund (QOF)
Investors can't make investments into Opportunity Zones directly; they have to go through a QOF, which must have 90 percent of its assets invested in Qualified Opportunity Zone Property.

Qualified Opportunity Zone Property (QOZP)
May be the qualified stock, partnership interest, or business property of a Qualified Opportunity Zone Business.

Qualified Opportunity Zone Business (QOZB)
Substantially all of the tangible property owned or leased by the Qualified Opportunity Zone Business is Qualified Opportunity Zone Business Property; 50 percent of the income of the QOZB is derived from the "active conduct" of the business; a substantial portion of the intangible property is also used in the active conduct of the business; it does not have more than 5 percent of its property held in nonqualified financial property.

Qualified Opportunity Zone Business Property (QOZBP)
Property acquired by the Qualified Opportunity Fund by purchase after December 31, 2017; the original use of such property in the Qualified Opportunity Zone commences with the Qualified Opportunity Fund or the Qualified Opportunity fund "substantially improves" the property, and; during substantially all of the Qualified Opportunity Fund's holding period for such property, substantially all of the use of such property was in a Qualified Opportunity Zone.

for the jobs of tomorrow. They attract the talent and capital that bring new vibrancy and opportunity to their communities. Start-ups are also far more geographically diverse than their reputation suggests. Small cities like Bridgeton, New Jersey; Wilkes-Barre, Pennsylvania; and Youngstown, Ohio have all established unique niches in high-tech businesses in food processing, internet marketing, and additive manufacturing respectively, while larger cities like Philadelphia and Indianapolis have grown into advanced tech centers thanks to partnerships among stakeholders in government, higher education, investment, and corporate communities. While advanced technology makes up a far smaller share of total businesses in absolute terms, it represents the lion's share of venture investment and the potential for growth. Still, start-up risk capital in communities outside of New York (City), Massachusetts (Boston), and California (the Bay Area), which make up 78 percent of venture investment, remains hard to find. The tech scenes outside of "the 78 percent" is often the result of university involvement, state or federal intervention, or a founder-turned-investor who happens to be from the area. Creating a self-sustaining tech-entrepreneurial ecosystem with access to venture capital is a key challenge that Opportunity Zones may be able to help solve.

For most types of business, the critical issue inhibiting potential Opportunity Zone business investment is taxation of interim gains, which effectively nullifies their greatest incentive: the exemption from capital gains taxes after holding an Opportunity Fund investment for at least ten years. Most business investors move in and out of investments, often holding them for three, five, or seven years and exiting by selling their stake after achieving, ideally, a strong return. Since these investors are making their returns through significant appreciation from an often relatively small investment, they are less interested in the deferral and reduction of the initial capital gain. Prior to the second round of regulations, many believed that if an investor invested in a Qualified Opportunity Fund, which then invested in a first qualified business, the QOF could sell its stake in the first qualified business after three years and, as long as the QOF reinvested the sale proceeds into a second qualified business, its ten-year holding period clock would not be broken and the investor would not be taxed on the gains from selling the first business. Unfortunately, the IRS determined that Congress did not grant it the authority to exempt these interim gains from taxation, seemingly against the Opportunity Zone incentive's intent; therefore, it is critical that Congress pass legislation making this authority clear. Without it, the greatest advantage of Opportunity Zone investing disappears for most business investment, with limited exceptions.

Photo Credit: Rachel Wisniewski for Ben Franklin Technology Partners.

A FRAMEWORK FOR OPPORTUNITY ZONE BUSINESS INVESTING

This policy brief asks as many questions as it provides answers and is meant to focus research and discussion on the lynchpins of any Opportunity Zone business investing. Through this study, we have identified three organizing questions for Opportunity Zone business investing analysis:

1 What does the investor want?
- A tax shelter (deferral and reduction of initial capital gain)
- Exclusion of Appreciation (exemption of investment capital gain)
- Community development/impact

2 What is the business opportunity?
- Existing asset light (e.g., service, tech)
- Existing asset heavy (e.g., manufacturing)
- Tech or IP start up
- Other start up

3 What does the existing owner want?
- Owner wants to sell
- Owner wants to maintain stake

What does the Investor want?

Beyond financial returns, Opportunity Zone investor goals often include tax shelter (deferral and reduction of initial capital gain), exclusion of appreciation (exemption of investment capital gain), and community development and/or broader social impact. Although these goals can overlap and many investors seek to achieve all of them, each represents a specific bearing towards investment strategy worth examining.

Through Opportunity Zone investing, investors can receive three potential tax benefits: deferral, reduction, and elimination of capital gains. The deferral and reduction both apply to the initial investment—i.e., to the capital gain invested into the Opportunity Fund—while the elimination applies to the investment the Opportunity Fund makes. The deferral and the reduction of capital gains are investment agnostic, meaning that even if the Opportunity Fund's investment never increases in value, the investor would still receive the same capital gains tax deferral and reduction on her previous investment's capital gains tax liability simply by having invested. By contrast, the value of the exclusion incentive increases in proportion to how well the Opportunity Fund investment performs. If an Opportunity Fund investment barely appreciates, then the deferral and reduction may be the most valuable component of the incentive; if the Opportunity Fund investment has a 3x, 5x, 10x, etc. return, then the value of the exclusion quickly eclipses that of the deferral and the reduction.

This underscores the key difference between the Opportunity Zone incentive and the majority of other state and federal tax incentives. Historic, Low-Income Housing, and New Markets Tax Credits are specifically used to make a project work economically that would not have otherwise "penciled" by filling a gap through what is, in effect, a grant or subsidy. Moreover, it is relatively rare for one of those tax credit projects to appreciate substantially or perform significantly better than what was expected at groundbreaking (especially Low-Income Housing Tax Credit projects), and even if it surpassed expectations, that would not mean investors would make more money, since credits are awarded on the basis of a project's cost. Opportunity Zone investors, by contrast, are rewarded for how well a project performs—and potentially at significant multiples—making the potential for business investment so exciting when compared to the major federal and state tax credit programs.

It is worth noting that Opportunity Fund investors fall within an already narrowed field: those with taxable realized (or about-to-be-realized) capital gains who are also willing to use those realized capital gains to make at-risk equity investments. Most investing does not come from taxable realized capital gains—especially when considering that some of the largest investors with capital gains, like pension funds and endowments, do not generate tax liabilities in the traditional sense—and lending is an equally if not far more common form of investment. More than that, given that there is a relatively short time period between when an investor realizes capital gains and when those gains have to be deployed in a specific investment (not just an Opportunity Fund), the investor who can most easily take advantage of the Opportunity Zone incentive will be an investor that can generate capital gains "at will," such as large institutional investors and high–net worth individuals. Unless an Opportunity Fund can absolutely commit to deploying capital within the 6 to 12 month testing period, investors who happen to have a capital gain and need to invest it will likely go to a more known, predictable, and generally larger sector of investment than business: real estate.

Tax Shelter

Some investors may be investing in Opportunity Funds primarily for tax sheltering benefits, with the elimination of gains on the appreciation viewed as "gravy," likely because of a specific need to shelter their gains and/or an aligned investment strategy. As discussed above, these investors might be less concerned about the final rate of return on their investment, since the main benefit they seek will materialize regardless of how well the investment ultimately performs. As such, the potential of this class of investor to make a significant impact on the success of a given business is substantial. Unfortunately, it is unknown how many of these investors are really out there. Many may also look to the perceived greater stability and predictability of real estate.

For example, PNC has sought to make preferred-equity Opportunity Fund investments that prioritize the deferral and reduction of capital gains tax liability generated from PNC's related private equity activity. PNC is in somewhat of a unique position for a bank, since income from the actual business of banking is treated as ordinary income for federal tax purposes; thus, traditional banking does not generate capital gains eligible for Opportunity Zone investment. Other large financial institutions, like insurance companies, do generate capital gains through their investments since investing is treated as a secondary line of business. When PNC sought projects to invest in, it issued a very specific series of qualifications, including a tight timeline, eligibility for Community Reinvestment Act credits, and that PNC must be the senior lender in the project. The timeline was there to make sure that the investments would qualify for the deferral and the reduction of capital gains, since the maximum 15 percent reduction can only be granted if the investment in the Opportunity Fund is made on or before December 31st, 2019 (investments can receive a 10 percent reduction if made on or before December 31st, 2021). Like all major banks, PNC has significant obligations to meet the terms of the Community Reinvestment Act, which requires financial institutions to make loans, provide services, and make investments in low- and moderate-income communities; meeting those obligations with Opportunity Fund investments helped PNC meet both a regulatory and financial objective. Finally, as senior lender, PNC could maintain strong control over projects it invested equity in to better ensure the projects had downside protection. Although this has turned out to be a successful strategy for PNC so far, not many others have followed suit, and, importantly, PNC's Opportunity Fund activity seems to be restricted to real estate.

Another example of a potentially viable sector for "tax shelter" investors is energy, since the majority of energy assets depreciate over time. While investments in energy share qualities with those in business and real estate, there is no reason that equity invested in the project could not come from Opportunity Funds and that the incremental 15 percent or 10 percent benefit could be enough to get the deal over the finish line. As with PNC's deals, most energy deals are likely going to be paired with other energy tax credits, making them foundationally financially viable.

Appreciation

Appreciation-oriented investors are likely going to be the most common Opportunity Fund business investors because the relative financial benefit of business equity investment over real estate equity investment is the potential to generate a far higher multiplier of return if the investments are in high growth enterprises. Otherwise, the incentive to invest in real estate may be too great—it is a far more common, stable, and formulaic asset class, making real estate assets easier to aggregate. Specific sector expertise is limited to fewer variations (e.g., commercial, residential, and low-income housing/tax credit investing) and once basic geographic differences in costs and market rents are factored in, real estate investments can be made relatively uniformly.

In addition, a great deal of business financing comes in the form of debt, which can greatly reduce the risk of business investing but markedly lower the rate of return. While this security is attractive given the volatility of business investing generally, it is unfortunately not available to Opportunity Fund investors since investments into Opportunity Funds must be in equity. Securities such as convertible debt and warrants, which become equity, are also not allowed.

Appreciation Opportunity Fund investors are accordingly most interested in the third incentive: the elimination of tax liability after holding an Opportunity Fund investment for at least ten years. But if an Opportunity Fund sells its stake in a given investment prior to year ten, the investor will be taxed on the capital gain of that sale, thus eliminating much of the Opportunity Fund's appreciation tax incentive benefit. The only way around this issue, short of a change of law, is to hold the investment in a single company for ten years. Business investment exits tends to be more dynamic and must be responsive to market conditions that attract follow on investment to grow the enterprise or even sell or merge it. Finding those who promise to meet this exact time requirement is a challenge. It can depress the value of the initial investment, discourage follow on investors, slow the growth of an enterprise and simply discourage "first in" investors who can find themselves in a company unable to attract follow on capital.

Community Development/Impact Investor

In the Opportunity Zone business investment context, community development and impact investors (defined as those who seek to have a positive social impact in addition to generating a financial return) might be tax shelter– or appreciation-driven investors as well. These investors will vary in the extent to which they are willing to sacrifice return for impact, but even if they are unwilling to change their return goals, it is likely that they will have a higher risk tolerance, be willing to consider more complex deals, and look deeper into a deal before saying no.

Given all the caveats and narrow lanes of this discussion and the sheer difficulty and cost of complying so far, the early Opportunity Fund business investor is likely going to be an impact investor, who are often motivated to invest in a particular geography or sector. Opportunity Zone real estate investors, on the other hand, can more easily derive the tax benefits without becoming deeply involved with the impact, geography, and mechanics of a particular deal. Whether or not they are a tax shelter or appreciation investor, the level of complexity required for an Opportunity Fund business deal requires a level of commitment. Even with the tax incentive, there appear to be many obstacles to make a singularly return-driven strategy practical, at least at this point. While the market will mature and become more sophisticated, the statutory and regulatory framework will remain static. Like the New Markets Tax Credit before it, designed to be as much about business investment as real estate investment but which is now almost entirely a real estate–focused program, Opportunity Zone business investment may remain challenging at scale, especially compared to the relative simplicity of real estate.

What is the business opportunity?

Unlike most tax incentives, there are no real policy requirements applicable to the type of business that is allowed to benefit from the Opportunity Zone incentive (other than a prohibition on "sin" businesses), so the type of business is less important than many other tax incentives or economic development programs. Congress structured the incentive this way to promote the maximum amount of innovation in the Opportunity Zone marketplace and avoid dictating outcomes. There are no jobs requirements or any other limitation with respect to the type of community impact a given investment might have. And, unless and until the proposed Opportunity Zone monitoring legislation makes its way through Congress, investments will not be tracked federally either. Although there are no policy mandates with respect to the types of businesses' investments, there are several limitations stemming from the Opportunity Zone statute and regulations that practically limit the categories of businesses that can meet the requirements. We found that each of the four main types of businesses has its own special Opportunity Fund investing considerations: existing light-asset businesses (e.g., service, tech), existing asset-heavy businesses (e.g., manufacturing), tech or IP start-up businesses, and other start-up businesses.

Existing light asset (e.g., service, tech)

While existing businesses that are able to meet a somewhat difficult series of technical tests can qualify for Opportunity Zone investment, the Opportunity Zone incentive itself targets investments in new projects or substantially rehabilitating old ones. At its core, one of its foundational policy objectives was to encourage start-up formation outside of traditional markets by incentivizing investors to leave those markets and invest in Opportunity Zones. This start-up-friendly bearing shows itself in a requirement that essentially requires the property to have been built or substantially rehabilitated after December 31, 2017. Instead of jobs created, revenue generated, or the type of industry, the Opportunity Zone's most fundamental qualifier for a given business are its assets, in particular, its tangible property, such as real estate, furniture, equipment, and vehicles. This essentially means that most existing businesses will not be able to qualify. Those businesses have two options: either substantially improve each asset individually or get rid of assets acquired before 2018 and acquire new ones.

To date, the IRS has not allowed aggregation of assets with respect to the substantial improvement requirement—that is, it has not allowed a business to aggregate the value of its existing assets and invest that same value in overall improvement or acquisition of new assets (e.g., meet the substantial improvement test for its headquarters building and so not have to worry about substantially improving its vehicles, computers, and every other asset). The current substantial improvement test seems to promote investment in a business' property rather than the business generally; why shouldn't new investment in hiring, training, product development, sales, and marketing—all central to the growth of the company—count as much as investment in tangible property?

The second option for these existing businesses is a sort of "cleaning," where a business uses some of its own funds or new Opportunity Fund investment to buy new tangible property, which would now necessarily have its original use begin after December 31st, 2017. In either case, this significantly advantages businesses with less tangible property, like tech companies and service businesses, over those with significant tangible property, such as manufacturing or laboratories.

In many cases, leases can represent the single biggest asset of otherwise property-light firms. The April 2019 regulations provided that leases could satisfy the asset tests, but that they had to be entered into after December 31st, 2017. It is unclear whether and to what extent an existing lease can qualify even if it is materially modified, which will not always be possible or beneficial to the business. In most cases, the lease rule will require an existing business to break the unqualified lease and enter into a qualified lease for new space. This rule becomes even more difficult if the company owns the building, which, again, will likely not qualify as a good asset.

Many existing asset-light businesses are not dependent on creating or controlling IP; they are small and medium-sized businesses (SMEs), from neighborhood-serving businesses to nationally active firms with as many as 500 employees. SMEs are key employers. They constitute 99.9 percent of all firms in the United States, 47.5 percent of the private workforce, 41.2 percent of private payroll and prove to be steady employers during economic downturns. SMEs not only provide jobs, they often provide much-needed services in underserved communities—education, health care, fresh food. But the transaction costs of reaching small businesses are prohibitive for many national scale financial institutions, and even successful SMEs may not offer opportunities for high growth multiples and clear investor exit strategies, particularly neighborhood-serving businesses.

Intermediaries who provide capital to SMEs are often too small themselves to be operationally sustainable, provide attractive returns, and deliver impact at scale; those that are successful tend to be highly focused on a particular city or region. Those businesses that do receive financing also often need technical assistance: investment advice, business training, or worker training. This assistance is in high demand according to the location, size, and industry of the business, making it difficult to standardize, especially across different government jurisdictions (even within states). Newer community-rooted fund managers often do not have a sufficient demonstrated track record of investment returns or do not fit the parameters expected by traditional investors.

Existing heavy asset (e.g., manufacturing, real estate-aligned)

The issue with property-heavy businesses (i.e., businesses with significant tangible property) is the asset test that requires a business with significant real estate or equipment needs to either replace or substantially improve that property. In contrast to a business with little tangible property (e.g., the tech or services businesses discussed above), meeting the requirements are far more onerous than replacing some computers, tables, and working through the lease issue. It could mean substantially improving a blast furnace or buying a brand-new fleet of 18-wheelers. That means that the most viable Opportunity Fund investments in existing asset heavy businesses will be in businesses that are looking to expand or reinvest in existing plant In this case, the Opportunity Fund might serve more as a recapitalization tool, rather than start-up or scale-up capital. As discussed above, since the Opportunity Fund needs to acquire the property "by purchase" through an equity investment, the existing owners will need to dilute their stake.

While real estate in itself constitutes a separate asset class, many Opportunity Funds are looking for ways to pair real estate investment with business investment—often by identifying businesses that can serve as commercial tenants. Already there are many efforts underway to co-locate community-serving businesses, growth companies, and health-oriented enterprises around "street corners" and commercial corridors. Blueprint Local has been pioneering the "street corner thesis" in Texas, and Streetlight Ventures has focused on empowering local businesses through its "Connected Neighborhood" approach. Philadelphia has several organizations that have been taking this comprehensive approach for decades, from the Philadelphia Industrial Development Corporation to Shift Capital to Ben Franklin Technology Partners, in many neighborhoods that are now Opportunity Zones. Although these are primarily commercial real estate plays, they are forcing a new look at neighborhood economies and helping to establish a pipeline of entrepreneurs and businesses. Adding the real estate component not only provides comfort to the many investors who are more familiar with real estate but also offers a chance to investors to "dip their toe" into business investment. Pairing business and real estate investment can also help some businesses meet the asset test by offering those businesses a chance to enter into a lease with the Opportunity Zone–qualified real estate development. Much of what groups like Blueprint Local and Streetlight Ventures do is technical assistance, providing mentoring to the businesses they identify, helping them participate in the deals themselves. To achieve desired outcomes at scale, these early "concentration/co-location" efforts can take hold and are subsequently able to be routinized and paired with state and local government programs.

Tech or IP intensive start up

Opportunity Zone investment compliance tests applicable to tangible property, as well as compliance tests in general, are much easier for new businesses to meet. There will almost always be no issues related to the timing-based test, since all of the business' assets will be placed in service after December 31, 2017. The specific difficulties with new businesses are the initial valuation, how money flows into the business over time, and matching the business needs with Opportunity Fund–eligible capital.

For investors in many types of new businesses, the interim gains issue remains central. A significant portion of investing in start-ups increasingly comes in the form of convertible debt, which both adds security to the investor for inherently riskier start-ups and avoids the major problem of providing for a firm's initial valuation. Because the Opportunity Fund rules require that the Opportunity Fund invest equity into a start-up company, convertible debt does not qualify. It also creates challenges for other common start-up investing instruments, like warrants. Instead, some fund managers have taken to using preferred equity—and, more specifically, participating preferred equity—to mirror some of the attributes of convertible debt. Taking this approach is less familiar and thereby more expensive, which will disincentivize smaller investments. Most providers of participating preferred equity will want to be the most senior investor, meaning they might not let any senior debt into the deal at all. Still, many Opportunity Funds might find it easier to come in at the Series A phase or the point at which the firm is looking for its first round of broader-equity financing and has already passed the initial start-up phase.

For many businesses, investment does not just come in once at the beginning in a lump sum and last through the life cycle of the business; investment often comes in tranches, at start-up, growth phase and scale-up phase. For example, we might see this with a life science business that needs money to work through an idea that may have come from university research. It will then need funds to further test the potential product and build out business operations more generally, identify contract partners, and manufacture prototypes. Finally, if the prototype is successful and the business has become sustainable, it will need funding to manufacture the product and bring it to market. As the rules stand today, it would be necessary for each new investment in the Opportunity Fund to begin a new holding period clock each time. I.e., the $1 million start-up investment made in 2019 would be on one ten-year clock concluding in 2029 and a $3 million growth investment made in 2022 would be on a second ten-year clock concluding in 2032.

This issue is critical since the regulations' requirement of the taxation of interim gains otherwise incentivizes investors to look into business sectors that have a naturally longer holding period, such as life sciences. But if the Opportunity Fund investor has to keep adding new timing tracks for each round of investment, the investor might be dissuaded from making Opportunity Fund investments after the first round. Indeed, the exit from the company may occur after the tenth year of the investment, given the business rhythms of an industry like life sciences. But an exit that occurs at year twelve, for example, when the benefit for the largest amount of appreciation will not occur until year fourteen, limits the benefit of the program. Still, this would be a successful exit for an investor, and the failure to achieve the maximum available tax incentive would not dissuade an investor from selling or investing in the first place—though it might dissuade an investor from attempting to work within the Opportunity Zone box. Similarly, these investors generally will not have a problem giving up the maximum deferral and reduction benefits by making these investments up to the December 31st, 2026 deadline, since the appreciation incentive is likely the most important for this strategy.

Much of the concern prior to the publication of the second set of regulations related to a gross income test, which seemed to require that 50 percent of the revenue derived from the business had to be attributable to the active conduct of the business in an Opportunity Zone. The intention of this requirement was primarily to prevent abuse and, specifically, a means to limit businesses from opening shell businesses in Opportunity Zones and claiming the tax benefit. While the regulations provided a great deal of clarity and overcame what was one of the major general stumbling blocks for business investing by providing significantly more flexibility, issues remain as the considerations of key sectors and particular businesses are scrutinized.

In the life sciences or tech context, for example, the number of employees who work in the Opportunity Zone might be fairly limited, with much of the work of the company performed through contracted research, service provision, or manufacturing. The employment, compensation, and "facts and circumstances" safe harbors for the gross income test were meant to address some of these issues, but the 50 percent cutoff may be too high. For many life sciences firms, the vast majority of work will take the form of sponsored research at a university, whereas for a device company work may be contracted-out protype development manufacturing. This may be achievable in some instances where research will be conducted in an Opportunity Zone—e.g., the University City area in Philadelphia—but will be challenging in many, if not most, instances. Once manufacturing has begun, this will be even more of a challenge and necessitate the formation of an essential supply chain of manufacturing companies that sit in Opportunity Zones and can keep the firm qualified.

Many start-ups' business models are dependent on their intangible property, most importantly intellectual property, as well as other "intangibles." While real estate, equipment, and people are all necessary to run intellectual property–intensive businesses, what truly sets these businesses apart and makes them successful is their unique intellectual property. Prior to clarification in the April 2019 regulations, the 50 percent gross income test gave business investors pause due to uncertainty of where and how that income would be counted; a similar threshold issue remains for intangible property intensive businesses, since the Opportunity Zone regulations require that Qualified Opportunity Zone Businesses use a substantial portion (40 percent) of their intangible property in the active conduct of a trade or business in an Opportunity Zone. But how do we determine where the IP is being used and how do we measure the amount of use? How will the active conduct test be applied in the context of tech start-ups that develop software to be sold and licensed? Much like the April regulations offered a series of tests to determine whether a business meets the 50 percent gross income test—based on business characteristics like employment, contracted services, and the location of tangible property and management—investors and businesses need clarity regarding how the 40 percent intangibles test will be applied and also need broad, flexible safe harbors.

Other start up

Unlike the significant features that differentiate property light and property heavy existing businesses in the context of Opportunity Zone compliance, other forms of start-ups maintain much the same profile as the tech start-up. Since all of their property will be new, it makes no difference whether the business' property consists of tables and computers or blast furnaces and 18-wheelers. The basic issue around non-tech start-ups is that there is typically much less of a venture community—and even a government support community—oriented around them. The growth and exit strategy for tech start-ups is now relatively familiar; many start-ups in other sectors, especially neighborhood serving and smaller businesses, may not seem to offer the same appreciation and exit potential as their tech counterparts. There are several other types of businesses that exist outside of the traditional tech space that offer return opportunities on par with tech investments. Food is a particularly exciting sector, where several small entrepreneurs have been able to turn homemade baked goods, drinks, or restaurant concepts into successful, nationally marketed products and brands. The challenge of this sector will be to ensure that investors can find entrepreneurs in a variety of the non-tech sectors looking to scale up, even though the playbook is not nearly as clear. Ensuring that intermediaries exist, especially focused incubators and accelerators, will be critical for breaking down some of the barriers to this kind of investment.

Photo Credit: Rachel Wisniewski for Ben Franklin Technology Partners.

What Does the Owner Want?

Due to its structure, Opportunity Fund investment will almost always come at an inflection point: start-up, growth, or a management transition, such as the retirement of a longtime owner. Fundamentally, owners will have to agree with the Opportunity Fund's approach and understand where they stand in the Opportunity Fund's vision. While there are some pathways to use Opportunity Fund investment to make capital investments in particular equipment or real estate, Opportunity Fund investment is usually based upon an investor taking an equity stake in a given firm.

For many businesses, particularly high-growth-potential start-ups, this will not be a significant issue: taking on new partners or issuing new equity is common as the company positions for growth. For existing businesses with an owner who wants to maintain her or his ownership or management position, it is more complicated. For the owner of an otherwise qualified business—e.g., the business can meet the original use or substantial improvement tests—the ability to take advantage of the program is largely dependent on whether or not the owner wants to continue to maintain an interest in the business and the extent to which the owner is willing to dilute that interest.

If the owner is willing to sell the business, the owner can do so, perhaps earning a premium on the sale because of its existence in an Opportunity Zone or even its qualification as an Opportunity Zone Business. Alternatively, the owner can take a new stake in the business of up to 20 percent—but no more—due to the application of the Opportunity Zone's related-party rules. If the owner does not sell the business but instead takes on new partners or issues new stock, the owner necessarily has less of an equity interest going forward. In all cases, the existing owner owns a smaller percentage of the business.

An existing business must benefit from the Opportunity Zone incentive to truly realize the intent of the law. After all, existing businesses have been investing in places now deemed Opportunity Zones long before any such designation—communities should share in the benefits. In the context of an existing business with substantial tangible property that does not meet the Opportunity Zone requirements, there are essentially two paths available for an owner to qualify the business while preserving his or her interest beyond 20 percent: buying and/or improving newly acquired tangible property or working through a related-party lease.

An Opportunity Fund can acquire stock or a partnership interest in a business and at any amount so long as the underlying business the Opportunity Fund invests in is qualified. The business' qualification as a Qualified Opportunity Zone Business is crucial because, on the Opportunity Fund's testing dates, at least 90 percent of the Opportunity Fund's assets (which would include its equity interests in businesses) must be qualified in order to avoid a penalty under the 90/10 good property, bad property test.

In order for property to be qualified, it has to be acquired by the Opportunity Fund or Opportunity Zone Business after December 31st, 2017 and either needs to have its original use commence in the Opportunity Zone after that date or be substantially improved. In order for a business to be qualified, at least 70 percent of its tangible property must meet these requirements (the 70/30 substantially all test). The Opportunity Fund investor has to be sure, therefore, that a sufficient amount (70 percent or higher) of a business' tangible property, such as equipment, meets these requirements and is placed in service in time to qualify the business by the Opportunity Fund's testing dates. In addition to being able to acquire new equipment, the April 2019 regulations allows used equipment to qualify as long as it is used in that Opportunity Zone for the first time. This regulation allows used property to meet the original use test by being placed in service in a particular Opportunity Zone for the first time and it avoids application of the substantial improvement test.

Passing the 70/30 substantially all test can be difficult for businesses that happen to own their building or have other high-value real estate assets combined with other tangible business assets that are low-value (e.g., computers and furniture); it will not be easy for those businesses to acquire sufficient qualifying property to meet the 70/30 substantially all test. In this scenario, meeting that test may only be possible through use of a related-party lease—i.e., the business owner forming a new Qualified Opportunity Zone Business entity that utilizes Opportunity Fund investments to operate and expand the business and leases the business assets from the original business entity. The owner need only double the value of the business' tangible personal property (like furniture equipment), not real property, in order to have the lease considered as qualified property; the new Qualified Opportunity Zone Business entity will also have a 31-month time period over which it can acquire new tangible personal property, which can be helpful when trying to ensure that the Opportunity Fund passes the 90/10 good property, bad property asset test.

Some owners may be seeking an exit from a longstanding business. Such succession planning both meets this regulatory challenge and accomplishes a vital Opportunity Zone policy objective. An outsized number of SME owners are nearing retirement and do not have a successor in place, even though many are successful businesses that could continue to operate even after the owner retires. However, many successful SMEs do not either generate sufficient revenue or demonstrate likely growth trajectories to easily attract the interest of traditional private equity investors—despite the fact that they may have significant free cash flow relative to their overall business. Since many of these businesses also never planned for sale, creating the foundation for an investor exit is often outside of their experience. In some cases, the owner of the business can truly be an invaluable part of the business itself, with a deep and very useful knowledge of the communities it serves, suppliers, and customers, which adds to the difficulty of shifting to a majority ownership of equity investors from outside the business' network.

Using many of the "matchmaking" tools that have arisen organically that are meant to capitalize on the Opportunity Zone incentive could be a way to overcome the traditionally high barriers between private equity and otherwise successful SMEs to allow business owners who want to bring on new investors or retire to find investors. In the same way data aggregation has changed the real estate sector and vastly broadened the universe of potential investors, SME-operating business investing could be opened up by applying the same tools. But business owners tend to be far more resistant to top-down or bureaucratic, government-sponsored economic development efforts than the owners of real estate or developers. Identifying trusted neighborhood ambassadors and intermediaries to serve as a bridge between investors and businesses could be a critical step, as could using more "gateway" economic and community development programs like business façade improvement grants.

To be a viable investment, the owner also has to be willing to take part in the complicated work of compliance with the Opportunity Zone statute and regulations. For small businesses, this cost alone could be a significant part of the business' operating budget or could take the form of fees levied by an Opportunity Fund manager. The closer a business gets to noncompliance—whether due to low capacity or just the nature of the business—the higher the monitoring costs will be. Businesses that routinely contract out some element of operations or use a significant amount of tangible property will need to ensure that they are staying within the boundaries set by the statute and regulations. In either case, the cost of compliance means that smaller investors and investments will find business investing complicated and costly unless it is clear the business will stay within the bounds of the Opportunity Zone rules. This is yet another reason why investing in real estate fits easily within the Opportunity Zone rules: once a real estate project conforms, its status will rarely change. Once again, this issue incentivizes the development of a vertically and horizontally integrated Opportunity Zone business investing paradigm, so that investors can be sure the business or businesses will remain in compliance throughout the ten-year hold period. Management, research, assets, and production of many different kinds of businesses will all stay within the bounds of Opportunity Zones (even if they are located in different parts of the country).

THE NECESSITY OF MARKET MAKING

Ensuring that SMEs and start-ups can take advantage of Opportunity Fund investors necessarily depends upon the businesses being qualified, which will likely require a corresponding investment by government or philanthropy to identify qualified businesses or help others become qualified. For many SMEs or start-ups, the cost of compliance can be hard to justify—let alone the cost of learning what to do. Governments, nonprofits, CDFIs, and other economic and community development institutions should work to not only provide technical assistance but create unified ways of managing Qualified Opportunity Zone businesses and provide interface with Opportunity Fund investors. It is up to these institutions to create a genuine Opportunity Zone business market in which the ground rules are familiar, easy enough to abide by, and friction is reduced between investors, entrepreneurs, and businesses; the longer every Opportunity Zone business deal remains "high touch" the harder it will be to realize the potential of Opportunity Zones.

Whether through intermediaries like an incubator/accelerator, an economic development agency, a more informal network of universities and businesses, or a combination, it will be critical to create a one-stop-shop where Opportunity Fund managers can identify qualified businesses and ensure they are in compliance throughout the life of the investment and business. For many start-ups, this means being part of a horizontally and vertically integrated marketplace. On the vertical side, as companies grow, they can either find Qualified Opportunity Zone businesses elsewhere to include in their supply chain or within the "campus" of the intermediary. On the horizontal side, certain areas will want to sponsor clusters of similar businesses to maximize collaboration and intrasector knowledge sharing and reduce friction for interested investors. For SMEs, given their inherent variation and decentralization, the key will be ensuring that neighborhood ambassadors and facilitators exist, allowing businesses to build up trust with potential Opportunity Fund investors and for the Opportunity Fund investors to have someone to trust for information about the neighborhood. Ideally, a scaled-up version will exist, allowing businesses to upload information about their enterprise and investors to search for them based upon relevant criteria, but a centralized database is unlikely to be available for most SMEs without a lot of base-building work from trusted ambassadors, whether from government, local nonprofits, or business organizations.

GOING FORWARD

Investing in Opportunity Zone businesses will be a challenge as the rules stand today, but this type of investment no doubt provides one of the best chances to achieve the policy objectives of the incentive, making it worth the work required to comply. The key is to be realistic about what can qualify and allocating resources to those areas, based upon the type of investors, businesses, and owners in a given sector or place. Above all, two steps are critical: advocating for some crucial statutory and regulatory changes discussed above and providing a substantial amount of market making—at least at the beginning.

As the media fills up with example after example of investors who appear to be taking advantage of Opportunity Zones rather than positive stories of Opportunity Zones genuinely advantaging communities, the stakes for getting business investment right have never been higher. Successful business investments are one of the most direct ways to grow community wealth and create jobs. There are certainly examples from across the country of outstanding and impactful Opportunity Zone deals, but they are the minority. These Opportunity Zone deals also tend to be more complicated, bespoke, and an amalgamation of other difficult federal, state, and local incentives. Even if changes to the Opportunity Zone law or regulations make business investing easier for some, it cannot just be easier for those who already have the resources to hire a tax attorney, accountant, and other financial professionals. Building an ecosystem of Opportunity Zone business entrepreneurs, experts, and investors must be supported by governments, foundations, and other institutions to truly realize the transformative potential of the incentive. Opportunity Zones could be a transformative tool for business investing, but it will take a lot of work to get there.

RECOMMENDATIONS

While we believe more guardrails, strong reporting requirements, and ensuring all designated Opportunity Zones genuinely meet the intent of the law are critical to living up to the potential of Opportunity Zones, the focus of this analysis is business investment. As such, though we consider these changes as fundamental, they are not addressed here but rather viewed as foundational to the incentive's long term success in general, not just for business investment. The most critical change needed to catalyze investment in Opportunity Zone businesses may be statutory:

1. **Exempt taxes on interim gains incurred by an Opportunity Fund that buys, sells, and reinvests in different businesses during the ten-year hold period.** It is uncommon for business investors to buy and hold an investment in a single business for ten years. Opportunity Fund investors should, for example, be allowed to invest in a first business, sell their stake at a gain, reinvest that gain in a second Opportunity Zone business, and, finally, sell their stake in the second business and the Opportunity Fund after ten years and pay no capital gains tax at either the business or the fund level. Exempting interim gains maintains the central incentive of Opportunity Zones and follows the on-the-ground rhythm of business investing.

In addition, a few well-placed regulatory adjustments could make a substantial difference:

2. **Clarify the 40 percent intangible property test to ensure investors feel confident investing in high-potential capital and IP-intensive businesses, like advanced manufacturing and life sciences.** Following the path developed in the April 2019 regulations for the 50 percent gross income requirement would be a strong solution, allowing businesses to choose between different testing methodologies. Failure to clarify how the 40 percent is calculated will dampen IP-intensive business investment due to compliance concerns.

3. **Drop the "asset by asset" substantial improvement requirement and allow business-level investments to count towards the substantial improvement test.** The goal is to ensure investment in businesses, not just their tangible assets individually. An investment that allows a business to hire should count as much as an investment in equipment.

4. **Provide greater clarity for the "facts and circumstances" methodology for the 50 percent gross income test to help sectors, like life sciences, that depend on contract research and manufacturing.**

5. **Offer greater flexibility for the 31-month working capital safe harbor and new rounds of Opportunity Fund investment.** For some Opportunity Zone businesses in sectors such as life sciences and advanced manufacturing, adding additional time to the 31-month working capital safe harbor period could encourage investment in companies that take a longer time to start and scale. Similarly, allowing for infusions of additional capital in the Opportunity Fund as the business matures without restarting the ten-year clock could also better conform to the timelines and lifecycles of IP-intensive businesses.

Regardless of any statutory and regulatory changes, cities, states, nonprofits, and other economic development organizations (EDOs) must step up and act as intermediaries between investors, Opportunity Funds, entrepreneurs, business owners, and residents to truly build community wealth, with the following support systems:

6. **Routinize technical assistance.** Opportunity Fund rules are easier than many other tax incentive and economic development programs, but they are still difficult to interpret. Starting an Opportunity Fund, especially early on, will require the assistance of accountants and attorneys to ensure a business qualifies. Developing and distributing simple guidelines on whether businesses qualify, how they can maintain ownership, and even how to create an Opportunity Fund will help avoid the need for expensive professionals. In addition, because Opportunity Funds require equity investments, businesses that may have limited expertise with capital must understand how and if equity makes sense for their investment.

7. **Provide wrap around compliance services.** Ongoing Opportunity Zone compliance, for many businesses, will be difficult and expensive, discouraging smaller businesses from even trying to take advantage of the resources. Incubators and accelerators should consider ways to secure and allocate funds to add Opportunity Fund compliance services to their existing business- assistance programming, and government and foundations should encourage Opportunity Fund managers and other intermediaries to do the same with grants or other incentives.

8. **Develop a business focused marketplace.** Without the ability to evaluate aggregated data according to quantitative and qualitative measures, it will be difficult for many Opportunity Fund investors—especially those operating at a regional or national scale—to identify potential business investments or for businesses to find investors. While online solutions like OppSites and the Opportunity Exchange exist, getting businesses to take advantage of them will likely require local intervention and facilitation. Real estate assets have been aggregated on various online platforms for years now, while analogues for business investment are smaller in scale and scope.

9. **Create continuums of space.** Many successful businesses that start in Opportunity Zones might need to leave them to scale, impacting investors who need the business to remain in compliance to receive Opportunity Zone benefits and removing the wealth from the community that Opportunity Zones were intended to support. On the local and regional level, economic development organizations, developers, and financial institutions should work to ensure that qualified step-out and scale-up space exists in their Opportunity Zones beyond early incubation and accelerator spaces. There is a great opportunity nationally to frame out how companies could easily locate qualified step-out and scale-up space in Opportunity Zones around the country.

10. **Standup business intermediaries.** The federal government, states, cities, and nonprofits have invested enormous financial and operational resources into institutions that aid or undertake real estate development, like housing authorities and development corporations. While analogous institutions exist for businesses, they often offer generally available favorable financial products or have comparatively fewer resources (e.g., the entire federal Small Business Administration budget is one-third that of the New York City Housing Authority). Government economic development organizations and foundations fluent in the patterns of local business should fund and prioritize intermediary institutions in order to identify, assist, and scale emerging and growing enterprises that generalized financial products have trouble reaching.

KNOWING WHAT WORKS AND WHAT TO LOOK FOR

Distilling down each and every Opportunity Zone business compliance question into one diagram is a challenge. The below is not meant to be exhaustive, but a guide for businesses, investors, governments, and economic development organizations to make more informed decisions about whether or not to pursue an Opportunity Zone business investment strategy.

1 What does the investor want?
- A tax shelter (deferral and reduction of initial capital gain)
- Exclusion of Appreciation (exemption of investment capital gain)
- Community development/impact

2 What is the business opportunity?
- Existing asset light (e.g., service, tech)
- Existing asset heavy (e.g., manufacturing)
- Tech or IP start up
- Other start up

3 What does the existing owner want?
- Owner wants to sell
- Owner wants to maintain stake

Who	What	Where	When	How
The investor has no financial or familial relationship with the business or entity owning the business or its assets. The business is open to issuing new stock or partnership interest in a primary transaction in exchange for cash (i.e., the cash is not providing liquidity to the owners through a sale of their existing interests).	The business is not a "sin business", derives the majority of its income from actively doing its business in Opportunity Zones, its intellectual property is used for that business and in Opportunity Zones, and it holds only working capital or a small amount of financial property (i.e., it can't be a bank).	Located in an Opportunity Zone and does its business in that or other Opportunity Zones; no assets, inventory, or services are held or provided outside an Opportunity Zone.	Did not exist prior to 12/31/17.	The business' facilities were completed and acquired (or leased) after 12/31/17. The business' furniture, fixtures, and equipment were acquired (or leased) after 12/31/17. Leased real estate is Opportunity Zone property.
The investor has some financial or familial relationship to the business and thus must ensure it meets the related party requirements (e.g., through structuring interests in related parties to be less than 20%). The business is willing to issue stock or issue partnership interests, in each case, in a primary transaction in exchange for cash, but only in limited amounts (i.e., the business does not need a meaningful cash infusion)	The business is not a "sin business". It does not meet one or more of the following criteria, but believes it can meet all of them very soon: derives the majority of its income from actively doing its business in the Opportunity Zone, its intellectual property is used for that business, and it holds only working capital or a small amount of financial property (it can't be a bank).	Facilities are located in Opportunity Zone(s) but some portion of the business' tangible and intellectual property is used outside of Opportunity Zones (e.g., a trucking company or a company that outsources production and/or maintains an inventory outside an Opportunity Zone). Some services are provided outside the Opportunity Zone but most services are located in an Opportunity Zone.	Existed prior to 12/31/2017 but is highly mobile and could acquire qualifying property.	The business can easily move out of its leased or owned facilities into a facility completed and acquired (or leased) after 12/31/17. The business can be substantially improved with capital expenditures in the Opportunity Zone equal to its basis within 30 months. The business only has small amounts of furniture, fixtures, and equipment that could easily be replaced, if necessary (e.g., computers and furniture)
Investor in the business is a related party in financial and/or familial terms. Owners not willing to issue stock or issue partnership interests in a primary transaction in exchange for cash (i.e., business does not need a cash infusion and/or owner does not want to water down stake).	The business does not and will likely never meet one or more of the following requirements: is not a "sin business", derives the majority of its income from actively doing its business in the Opportunity Zone, its intellectual property is used for that business, and it holds only working capital or a small amount of financial property (can't be a bank).	Facilities are not located in Opportunity Zone(s) and large amounts of business and intellectual property are used outside of Opportunity Zone(s) or large amounts of services are provided outside of an Opportunity Zone.	Existed prior to 12/31/2017 and is not mobile.	The business cannot relatively easily begin a new lease or purchase qualified real property, moving its facilities there if necessary (e.g., a manufacturing plant or laboratory equipment-intensive company). The business cannot relatively easily begin a new lease or purchase qualified furniture, fixtures, and equipment (e.g., a manufacturing plant or server farm).