



Memorandum

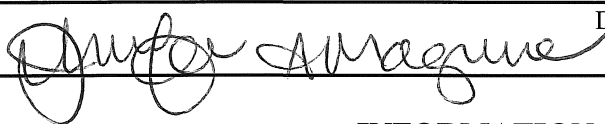
TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Walesh

SUBJECT: UPDATE ON OPPORTUNITY
ZONES IN SAN JOSE

DATE: August 16, 2018

Approved



Date

8/16/18

INFORMATION

The purpose of this information memorandum is to update the City Council on the implementation of Opportunity Zones, a new federal tax program created to spur investment in low income communities. The State of California has designated 11 Opportunity Zone census tracts in San José, and City staff is now exploring how to best position the City to capture investment that aligns with the goals of our General Plan and Council priorities.

BACKGROUND

The Tax Cuts and Jobs Act of 2017 created the Opportunity Zone program to spur investment in designated low-income census tracts throughout the country. In return for investing in these zones, investors can realize a delay, reduction, or elimination of their capital gains tax obligations. According to the Economic Innovation Group, about \$6 trillion in unrealized capital gains nationwide could be reinvested into Opportunity Zones.

The federal legislation tasked states with choosing which census tracts should be designated as Opportunity Zones. Tracts met minimum qualifications based on poverty rate or median family income levels, but each state's final submission was capped to 25% of those census tracts that qualified. Earlier this year, City staff provided feedback to the California Department of Finance, considering zoning, amount and viability of business property, and alignment with City needs for jobs and housing.

On March 22, the California Department of Finance released the state's list of nominated tracts and forwarded them to the U.S. Treasury. On June 20, Treasury published the final list of approved census tracts in all 50 states plus Puerto Rico. However, investors are still awaiting federal regulations spelling out key details of how the program will work and clarifying technical issues.

ANALYSIS

Investment within Opportunity Zones is flexible. It may take the form of real estate acquisition or development, business capital equipment, or direct investment in a qualified business. Infrastructure investment (in the context of public-private partnerships) is also contemplated. No local tax incentive or subsidy is required under this program.

For investors, the tax benefit occurs in three parts: First, capital gains invested into “Opportunity Funds” (the vehicles that invest in Opportunity Zones) receive a tax deferral as long as the investment is held, up to 2026. Second, depending on how long the investment is held, investors may also receive a step-up in basis of up to 15%, reducing the eventual tax obligation. Third, if investors hold their investment for 10 years, they can receive a permanent exclusion from capital gains when it is sold. This benefit applies to gains that accrue *after* the investment in the Opportunity Fund. More information is available at <https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>.

Staff believes that San José’s 11 designated Opportunity Zones census tracts could be attractive to Opportunity Funds. The tracts contain approved and proposed development projects, zoning supportive of future projects, and existing business property. The chart on page 3 identifies the zones and provides additional context on the commercial/residential possibilities and business environment in each one.

There is substantial interest in the Opportunity Zone program as a potential new source of investment capital for real estate development projects, primarily market-rate and affordable residential projects. Experts surveyed by staff suggest that the program is unlikely to be a “silver bullet” in getting projects built, but rather could function as an investment-attraction tool. That could be particularly helpful in San José, where financing has become more difficult to obtain as construction costs have increased and yields have flattened.

Aside from residential development, staff is keenly interested in the program as a source of investment for operating businesses, including industrial oriented employers, since an Opportunity Fund could acquire land or buildings for a new factory or office, as well as for capital equipment. Several of the San José zones have substantial industrial capacity, making them a potential fit for this type of employer. Businesses located in Opportunity Zones can also take on investment capital, making the zones potentially more attractive for business site-selection.

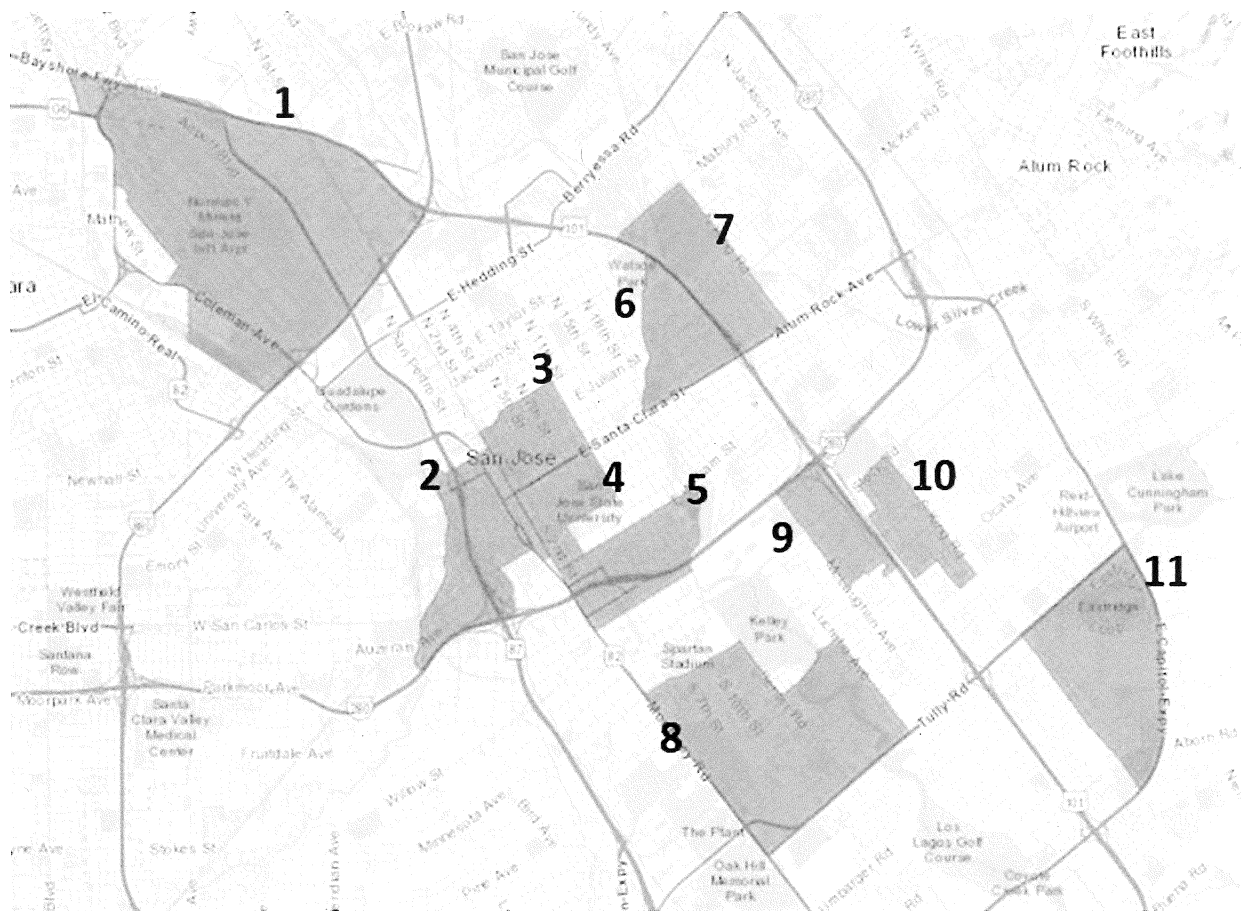
Capitalizing on Opportunity Zones

The federal tax legislation does not spell out a formal role for local governments with respect to Opportunity Zones. However, to encourage investment that aligns with the City’s priorities, staff is exploring strategies that could include:

- Designing an “investment prospectus” to collect and promote potential projects and business locations within the zones.

- Promoting industrial Opportunity Zone sites to businesses in sectors that traditionally bring middle-wage jobs.
- Establishing a San José Opportunity Zones landing page on the SJEconomy website to provide better visibility for San José in search results related to the program.
- Regularly engaging with other cities in the region with Opportunity Zones to share information and emerging best practices for engaging stakeholders.
- Aligning Work2Future workforce development programs (and related state programs) to better involve Opportunity Zone residents in job opportunities within the Zones.
- Providing a single point of contact for investors interested in leveraging the Opportunity Zone program.

The state selected 11 census tracts in San José as Opportunity Zones.



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No.	Tract	Council District	Notes
1	5051	3	Portion of North San José, including North First and North Fourth street corridors between Highway 101, I-880 and Highway 87. Includes urban village area, numerous surface parking lots, Mineta San José International Airport, and the airport office submarket.
2	5008	3	West side of downtown, including the bulk of downtown's pipeline housing projects and potential redevelopment sites. Also includes downtown's Class A office market.
3	5010	3	Downtown north of Santa Clara Street between First and Tenth streets, including St. James Park. The area includes numerous development sites and potential business locations.
4	5009.01	3	South of Santa Clara Street, including much of SoFA and San José State University. In addition to development sites, numerous small-business-oriented retail locations.
5	5016	3	Additional section of SoFA and Martha Gardens neighborhood, on either side of I-280, including portions of the South First and South Second streets business corridors.
6	5014.01	3	Alum Rock tract including BART station site. Includes an affordable pipeline project and contains a portion of an approved urban village plan.
7	5036.01	3	Continuation of Alum Rock urban village area, as well as industrial business district just south of Berryessa BART station.
8	5031.22	7	The heart of San José's Monterey Corridor industrial/manufacturing district between Alma and Tully north of Monterey Road to the Coyote Creek.
9	5031.10	7	Includes the Olinder Court industrial pocket between McLaughlin Avenue and Highway 101.
10	5034.01	7	Includes the Tropicana retail center between Highway 101 and South King Road.
11	5031.17	8	Includes Eastridge Center, as well as a planned urban village and a planned retail center.

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FOLLOW UP

Staff will provide an update to the Community and Economic Development Committee in the January-June 2019 workplan.

/s/
KIM WALES
Deputy City Manager
Director of Economic Development

For questions, please contact Nathan Donato-Weinstein, Business Development Officer, at (408) 535-8178.

