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ORGANIZING TAX-ADVANTAGED CAPITAL FOR HOUSING AND COMMUNITY DEVELOPMENT: LESSONS FROM OPPORTUNITY ALABAMA

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Organizing Tax-Advantaged Capital for Housing & Community Development: Lessons from Opportunity Alabama

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Summary

As the contours of the new administration's federal housing policy emerge, Opportunity Zones (OZ) are receiving significant attention as a core pillar of what might come next in housing and economic development.

Given the likelihood that OZs could be extended and expanded in the 2025 tax bill, there is substantial interest in lessons learned from places that were able to take full advantage of the tax incentive in purposeful ways, by smartly leveraging public, private and philanthropic investments since its inception in 2017.

Opportunity Alabama (OPAL) is a best-in-class model demonstrating how states and communities can mobilize local corporations, high-net-worth individuals, universities, hospitals, foundations, and government agencies to coordinate efforts, invest at scale, and attract outside capital. OPAL serves as the critical intermediary making it all possible.

The results are impressive: Alabama ranks in the top ten nationally in the aggregate (not just per capita) in the level of OZ investment; a dramatic change from where Alabama typically finds itself on national ranking lists and a testament to the state getting ahead of this incentive early and aggressively.

As in other communities, housing production represents a major focus of OPAL. In Birmingham's downtown, for example, Market Lofts is bringing 192 units of workforce housing without other forms of subsidy to serve residents who make too much income to qualify for subsidized housing but too little to afford much of the available residential housing in the city center. The project has revitalized a 140,000 square foot historic building vacant since the American Red Cross left in 1998.

Alabama's success offers a blueprint for what's possible when innovative thinking meets strategic execution. As OZs stand on the brink of legislative extension and enhancement, lessons from Opportunity Alabama provide relevant guidance for states seeking to leverage this program to bring in unprecedented capital while creating the infrastructure for sustained inclusive growth.

The Challenge This Tool Solves

Private capital that utilizes public incentives, such as those with OZs, may not provide what the public needs or wants. Additionally, private capital is often siloed, with investors, financial

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institutions, and philanthropy operating with their own set of criteria, timelines, and objectives. By creating an intermediary to organize and pool private capital, while at the same time preparing and strengthening projects for that capital to invest in, Opportunity Alabama brings together investors and those who need investment toward a better coordinated and higher impact approach.

Types of Communities That Could Use This Tool

States and localities of all sizes and capacity levels can utilize an intermediary and governance model like Opportunity Alabama. However, its effectiveness requires understanding and plugging current capacity gaps in the ecosystem while strengthening existing organizations toward the goal of better coordinated capital. In some communities a new intermediary may be the answer, and in others, empowering and restructuring an existing group may be more expeditious.

Expected Impacts of This Tool

Organizing capital, providing technical assistance to entities to receive investment, and strengthening the CDFI and investment ecosystem in a community can create a flywheel effect for positive impact. While the OZs program was the catalyst to OPAL's creation, communities can use other catalysts, such as the creation of a new housing trust fund or investment program, to organize the community towards coordinated impact.

Background

After bipartisan standalone legislation introduced the concept of OZs, they were codified for the first time as a short and nearly obscure provision of the Tax Cuts and Jobs Act of 2017. Focused on attracting private investment to economically distressed communities, the incentive allows people or corporations to defer taxes on capital gains by investing those gains in Qualified Opportunity Funds ("QOFs") that target their investments to state-designated OZs. If investors stay in a Fund for ten years, any additional gains from Fund investments are also exempt from taxes on capital appreciation.

The new tax incentive differs from other federal tax incentives in several ways. First, it is more market driven, relying on individual investor and QOF manager decisions rather than a federal or state agency to distribute the incentives. Second, it can be used for a wide variety of projects (e.g., residential, commercial, industrial, infrastructure) rather than narrow purposes like low-income housing or historic preservation. Third, there are no requirements for investors to ensure certain outcomes such as job creation or local financial matches. Finally, there is no cap on the amount of the benefit if the regulations are followed.

OZs differ markedly from traditional federal community redevelopment efforts by relying on equity investments rather than traditional debt, tax credit, and subsidy instruments. OZs, if purposefully implemented, can integrate disparate public, private and civic institutions, investments, and initiatives rather than dispensing compartmentalized resources via traditional government programs. By catalyzing patient capital through tying the most substantial incentives to a longer time horizon, OZs provide enormous incentives for investors, intermediaries, states and localities to work together to make sure there's a significant benefit for all involved.

Unlike programs such as Low-Income Housing Tax Credits or New Market Tax Credits, which allocate tax credits through highly competitive, government-controlled processes, OZs enable local leaders to organize capital voluntarily, without caps, quotas, or predetermined outcomes. This flexibility creates significant potential but also requires a much stronger local ecosystem to be effective.

The authorizing federal law provided one explicit role for sub-national actors: it directed governors to select OZs from an eligible group of economically distressed census tracts. As of April 2018, Governors in all 50 states, the District of Columbia and Puerto Rico had designated more than 8,700 OZs nationwide.

Seven years on, the real-world impact of OZs is beginning to be understood. Since their inception in 2017, OZs have attracted nearly $100 billion in private capital, according to the Economic Innovation Group (EIG). These investments have catalyzed the creation of more than 500,000 jobs, demonstrating their efficacy as a tool for economic development. Notably, multifamily housing developments account for substantial portions of OZ funded projects, addressing the nation's 7-million-unit housing shortage. As the Economic Innovation Group (EIG) reported earlier this year, "Opportunity Zones are home to about 10 percent of the country's population but now account for 20 percent of all new market-rate multifamily apartment units being developed in the country, up from 8 percent prior to legislation passing." By bridging financing gaps, OZs have enabled construction of thousands of units that might not have been built otherwise.

OZs are getting renewed attention for other reasons. The Tax Cuts and Jobs Act of 2017 was a signature achievement of the first Trump Administration, and tax reform is an early focus of the new Administration since key provisions of the 2017 Act are set to expire on December 31, 2025. Senator Tim Scott (R-S.C.), now the Chair of the Senate Banking Committee and a senior member of the Senate Finance Committee, was an original co-sponsor of the OZs legislation (with Senator Cory Booker (D-N.J.)). And Scott Turner, the new Secretary of Housing and Urban Development, ran the White House Opportunity and Revitalization Council during Trump's first term (which sought to coordinate federal investments in OZs).

Proposed Solution: Opportunity Alabama

Opportunity Alabama was formed in the summer of 2018 as Alabama's Opportunity Zone designations were finalized. The story, however, stretches back significantly further. For decades, Alabama faced chronic capital access issues for real estate development and business investment in its low-income communities. The Community Development Financial Institution (CDFI) movement that helped close that gap in many other states over the last 20-30 years never took off in Alabama. At the time of OZ designation, the state had only three certified non-bank CDFIs headquartered in AL, with none focusing on real estate. Consequently, Alabama ranked 50th of the 52 states and territories for per-capita CDFI Fund financial assistance awards. And the number of private foundations making grants and program-related investments (PRIs) to solve the access to capital problem in Alabama was similarly limited; from 2011 to 2015, Alabama received only $30 per resident in grantmaking activity from national and local sources (compared to $194/pp in New York or $107/pp on average nationally). This represents the lowest figure even within the chronically underinvested South.

Against this backdrop, Alabama's corporate and philanthropic communities understood the need to mobilize private capital to help close these gaps. They realized that the OZs incentive could work for anyone with a capital gain — from tech investors exiting seed investments to rural landowners who cut and sold timber. Given Governor Kay Ivey's designated zones (at least one in every county), there were openings to start conversations about "local capital for local deals" throughout the state. Beyond that, OZs offered potential to attract net new capital to Alabama if the right infrastructure was established to identify national Opportunity Funds interested in investing in the state.

Led by Alex Flachsbart, one of our coauthors, the state's largest utility (Alabama Power), largest bank (Regions), and several other corporate and philanthropic partners coalesced around the creation of a new nonprofit organization serving as a "one stop shop" for capital access through the OZs incentive. The objectives of this new nonprofit were to help originate investment opportunities, identify capital sources, and train project sponsors and capital allocators alike on leveraging OZs while combining that incentive with dozens of others at the state and federal level that could drive investment. With OZs as the catalyst for discussion, Alabama could potentially turn the tide on accessing grant capital, PRIs, CDFI Fund dollars, and other community development sources previously lacking.

Proposed Solution: Lessons from Opportunity Alabama

With Opportunity Alabama operational for several years, a broad leadership network of leaders has identified five signature lessons that can guide other states and cities choosing an organized approach to OZs capital or a similar ecosystem level approach:

Get the Word Out: For Opportunity Alabama's first two years of existence, staff spent enormous amounts of time on the road, meeting with the community, deal sponsors, and investor representatives who would form the basis of the state ecosystem. The goal was to put boots on the ground in every county by hosting educational events, listening sessions, and deal talks across Alabama over two years. Opportunity Alabama had large ambitions: positioning Alabama at the forefront of national conversations around OZs investing and, over time, using the same infrastructure that delivered OZs capital to channel non-OZs dollars into the same low-income geographies.

Build the Network: As noted above, Alabama now ranks in the top ten nationally in OZs capital deployed. More importantly, however, is the network that has been painstakingly built over the last six years. Alabama now operates a functioning capital access ecosystem that includes hundreds of banks, family offices, high-net-worth individuals, corporations, foundations, and many others. Some have capital gains and are interested in OZs; some are tax-exempt and like the idea of their corpus dollars being reinvested in the communities they are chartered to support; some are only interested in tax credits, some want market rate returns, and some are willing to be concessionary—but collectively, they form the foundation for a capital allocation infrastructure that totally transcends the OZs incentive that brought them all together initially. OZs were the catalyst, but now many ties bind them together

This evolution from having almost no capacity around capital deployment in underserved communities to having a fully-functioning, integrated capital access infrastructure statewide in just six years represents a remarkable and replicable accomplishment. The results can be observed in a series of memorable projects. Opportunity Alabama has enabled a $36 million naturally occurring affordable housing development in a blighted, 20+ year vacant property and a $500,000 redevelopment of a neighborhood theater into a new home for a nonprofit and a music venue. It also facilitated investments in woman-owned, Black-owned, Hispanic-owned, and veteran-owned businesses, helping close deals from Birmingham (194,000) to Heflin (population 3,500).

Controlling Capital Allows Control of Destiny: Opportunity Alabama evolved over time from an intermediary model to a capital allocator model. The benefits of the initial phase were a key part of the evolution: networks were built, projects were identified. But the organization realized early on the limitations of the "connector" model: you can lead capital allocators to opportunities, but you cannot make them invest. The organization ultimately decided that it would rather pool capital within an infrastructure it controlled and could allocate, spending the next twelve months partnering with Blueprint Local to build out a whole new investment shop. Opportunity Alabama launched the endeavor in 2021, began deploying capital in 2022, and has invested in over $500 million of deals through that infrastructure over the last three years—the majority of which are deals creating "missing middle" (80-120% AMI) housing across the state.

Transitioning from an intermediary to capital allocator model (while retaining nonprofit ownership of the corporate infrastructure) enabled the organization to: (A) focus on deals mixing the desired returns and impact; and (B) create a sustainable organizational model. With capital under management, Opportunity Alabama could charge management fees, with the cash flow from the deals paying those management fees, which covers overhead and obviates the need for general operating subsidies from government and philanthropy. OZs have proven to be the door-opener and enabler to much larger capacity and impact. Opportunity Alabama receives many calls from individuals who have a capital gain and are interested in OZs investing. Once these individuals hear about the totality of the pipeline and investment infrastructure (which includes everything from tax credit investment and bridge fund products to a debt fund run by the organization's own emerging CDFI), they may ultimately place OZs capital and additional investment in a mezzanine debt offering, a bridge-to-perm financing loan, or a Historic Tax Credit purchase.

Technical Assistance, Not Capital, Unlocks Catalytic Deals: Opportunity Alabama has learned that it cannot close deals without capital access, but capital allocators will not invest in real estate deals without a clear pathway to viability. Establishing that pathway to viability requires building out a comprehensive redevelopment plan (design, architecture, engineering, etc.), the right tenant mix (how many apartments at 80% AMI, who occupies the retail storefronts, etc.), and an ideal capital stack. The typical property owner or local organization looking to tackle a major placemaking project on their own might have the capacity to handle one, maybe two, of these big categories. But local resident developers or property owners handling all three, and then executing on all three, without third party help is extraordinarily rare because of required costs and expertise.

To address this gap, Opportunity Alabama reverse-engineered a technical assistance program to help local residents and community-centric developers execute on catalytic projects, providing comprehensive development assistance work—from pro forma creation and capital stack modeling to design and tenant recruitment. Opportunity Alabama offered this wraparound TA support (called Property Development Assistance Program (PDAP)) through a competitive application process running 2-3 times annually and has far more demand than available slots; during the last round, the organization could only accept 30% of applicants. Because the organization spent the time, energy, and effort to ensure that a deal is ready for capital when it goes to market, the deals that successfully complete PDAP have (thus far) been able to attract capital more consistently. Notably, there is no cost to participate in PDAP, but OPAL does reimburse its own time and expenses if the deal closes as part of the flow of funds at closing. There are no charges up front and no charge to a community if a project does not close.

Getting High Impact Deals Done — Particularly in Rural Areas — Is Possible but Extraordinarily Hard: Every capital allocator has their particular set of return requirements and risk thresholds that will not move. Rather, successful high-impact projects must find enough risk-mitigating elements to unlock the capital. Candidly, that's why Opportunity Alabama invented PDAP; going through the "de-risking" process is long and laborious, and almost always involves pulling in multiple subsidy sources at the local, state, and federal levels. But the nature of high-impact rural deals makes them, given experience, more challenging to complete than their urban counterparts. Negative population growth dynamics, generational disinvestment, and private market rents that are nearly always far below what could be achieved even in underserved urban neighborhoods all meld together to make deals exceptionally tricky to structure. Deals are smaller, both because they can't support more costs and because the square footage needs are not as great. And, local capacity gaps are even more exaggerated in rural areas, where there may not be capital, labor, or talent within a 2-hour drive to fill in each element of the team needed to get a high- impact deal done.

To consistently support deals in rural underserved places, PDAP is almost a base-level requirement, rather than a complete solution, as even with the perfect plan, the deal may still be too small, too risky, or not attractive enough for private capital allocators to take notice. Having a thriving local-vesting ecosystem is part of the solution here, but we'd encourage anyone looking at what federal and state tax/incentive policy looks like 2025 to think carefully about how their proposals will ultimately impact our ability to solve the rural challenge.

Diffusion and Scaling Opportunity Alabama

States and localities seeking to adapt the Opportunity Alabama model should focus on three major pieces of guidance:

Pick a Lane and Hire or Contract Around It: The skills needed to support consumer-centric small businesses are completely different from those needed to back great high-growth biosciences or tech startups. And, any of these skills are totally different from those needed to effectively underwrite or help "scale" real estate deals (where knowing how to build single-family housing is entirely different from supporting mixed-use historic revitalization projects). Trying to be a connector across all capital needs in low-income places all at once was, in Opportunity Alabama's experience, excessive. This guidance involves working with community stakeholders to identify the largest ecosystem gap that can be paired most readily with potentially available capital and focus there for building out your internal team talent. Alabama has multiple organizations providing technical assistance and access to capital for small businesses, and an emerging venture ecosystem to support our growth companies. What the state had absolutely lacked was catalytic real estate support—so over the last few years (and thanks to the revenue stream provided by their fund vehicles), Opportunity Alabama built out an in-house team of real estate experts who can both help scale deals and deploy capital.

Focus on Aggregating Local Capital: Opportunity Alabama initially expected that much of its capital (both operating foundation support and private investment) would come from national investors and philanthropy. While the entity had some success with both (thanks to entities like Woodforest, Arctaris, Lumina Foundation and EFA), it was a drop in the bucket compared to what Opportunity Alabama was able to achieve locally. Only after Opportunity Alabama fully built an investment infrastructure, hired a strong management team, deployed millions in capital, and received consistent local buy-in could it attract the kind of non-OZs-motivated national capital it hoped would "crowd in" from the start. The lessons learned are to find or create an incentive powerful enough to make every single local capital allocator listen to your pitch, get as many of them as possible into your infrastructure, and THEN go big with it. If local legislative advocacy is present in your state, consider what incentive at the state level might motivate collaboration, and push your state house, or your local/regional government, to create it.

Have a "Hook" to Build Your Ecosystem: Opportunity Alabama would not exist without OZs. Over the last 20 years, various efforts to start CDFIs, leverage the State Small Business Credit Initiative, create local-vesting venture funds, etc. all ran into the same problem: they didn't provide a big enough "tent" to draw in all the possible capital allocators, communities, and project sponsors, and/or they didn't offer a compelling enough incentive to make them stay to listen. In Alabama, OZs acted as the center tentpole, but that's not to say that a special "local-vesting" oriented state tax credit could not do the same thing in other communities. And with what we think will be a favorable setup for OZs renewal in 2025, there may be a second opportunities for leveraging a "revamped" OZs 2.0 to build a new Opportunity Alabama anywhere.

Expand the New Ecosystem's Focus and Impact: Today, Alabama has achieved outsized results in the OZs space, and the broader ecosystem is developing as well. As of the writing of this piece, Alabama now has double the certified CDFI loan funds compared to 2018 (supported by the first CDFI Fund TA awards made to Alabama in years) and multiple local philanthropies, and increasingly, multiple national philanthropies have developed program-related investment strategies around attracting capital to place, and are deploying them for millions in game-changing, loss-leading investments across the state.

The ecosystem that began as an idea now generates investors in Historic Tax Credits that are preserving the fabric of rural communities, philanthropic lending to nonprofits that are scaling solutions to social ills, blended capital investment in new housing production, and whole new small business support ecosystems to generate the next round of commercial district revitalization in urban centers and small towns alike. Jamie Dimon – the CEO of the world's biggest bank – even mentioned Alabama as a top target on a recent earnings call.

OZs are not cure-alls, but when paired with local leadership, technical capacity, and intentional alignment of capital, they can be the foundation for a new era of housing and place-based development.

__Alex Flachsbart__ is the President & CEO of Opportunity Alabama. __Bruce Katz__ is the Founding Director of the Nowak Metro Finance Lab at Drexel University. __Ross Baird__ founded Blueprint Local, which has invested $250M in Opportunity Zone capital in projects that now have an estimated ~$2B in value across the country.