



Councilmember Ben Bartlett

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CONSENT CALENDAR

To: Honorable Mayor and Members of the City Council
From: Councilmember Ben Bartlett
Subject: **Berkeley Qualified Opportunity Fund**

SUBJECT

Creation of a Municipal Qualified Opportunity Fund to invest in Berkeley's Qualified Opportunity Zones

RECOMMENDATION

Short Term Referral to Planning Commission
City Manager
City Economic Development Officer
Housing Advisory Commission
Office of Economic Development

That the City Council create a municipal Qualified Opportunity Fund to invest in Qualified Opportunity Zones to stimulate economic growth and develop more affordable housing in Berkeley. The Opportunity Fund and related development of Opportunity Zones will serve the goals of shared economic development, more affordable housing, and economic inclusion by incentivizing investors to direct capital gains toward economically vulnerable neighborhoods in Berkeley while allowing the city to stipulate conditions on the structures built and jobs created.

Qualified Opportunity Funds give investors the opportunity to ~~defer~~ ~~delay~~ capital gains taxes by investing in property sited in Qualified Opportunity Zones. After holding the investment for five years investors can exclude 10% of the deferred gain, After seven years investors can exclude 15% of the deferred gain, and after ten years 100% of the post-acquisition gain. ~~and after ten years investors can exclude from income the post-acquisition gain.~~¹.

Creating a Municipal Qualified Opportunity Fund will give the City of Berkeley a means of enhancing the existing Opportunity Zone Legislation. A Berkeley Opportunity Fund enables the City to compete with market driven investment by offering alternative models of community-centric, equitable investment in neighborhoods. A Berkeley QOF would feature:

- 1) Enhanced affordability requirements
- 2) Growth in good jobs and business opportunities for historically disadvantaged groups
- 2)3) ~~Next-generation sustainability~~ ~~Sustainable development to satisfy fundamental human needs~~

CURRENT SITUATION

Specific areas of Berkeley have been selected by the State of California and certified by the U.S. Treasury Department as Qualified Opportunity Zones. The State of California selected these zones in economically-

¹ <https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>

distressed areas. Provided investors meet certain requirements, they can defer capital gains taxes and eventually exclude value appreciation on investments from taxes.~~the tax on value appreciation when investing in these zones.~~

BACKGROUND

The Tax Cuts and Jobs Act of 2017 created a vehicle for individuals to invest in their communities while realizing tax savings. When an individual sells an investment which generates capital gains, that person can invest any portion of those gains into a Qualified Opportunity Fund within 180 days. The deferred capital gains will be taxed on the date the investment in the Qualified Opportunity Fund is sold, or on December 31, 2026, whichever comes first. Qualified Opportunity Funds must invest in property, ~~either directly or indirectly~~, in distressed communities designated as Qualified Opportunity Zones by the IRS². Such zones in Berkeley that have been designated by the California Department of Finance as qualified Opportunity Zones include the Alameda County tract numbers 4232, 4235, 4239.01, and 4525. These areas include several blocks surrounding Shattuck Avenue from University Avenue to Ashby Avenue, several streets surrounding Adeline Street until 52nd Street (often referred to as the “Adeline Corridor”), and a rectangular shape of land bordering University Avenue north and San Pablo Avenue to the east and terminating at Dwight Way³.

Qualified Opportunity Funds can invest in ~~be invested into~~ specific Qualified Opportunity Zones which have been selected by the Internal Revenue Service and state governments across the United States. Qualified Opportunity Zones are eligible investments for Qualified Opportunity Funds anywhere within the state they exist, and from other parts of the U.S. By establishing a municipal Qualified Opportunity Fund, the city of Berkeley will take a proactive approach to its development and be able to tailor that development to meet the specific needs of current Berkeley residents.

Investors can defer capital gains which are invested into Qualified Opportunity Funds. Moreover, investments in Qualified Opportunity Funds held longer than 5 years allow taxpayers to exclude 10% of the deferred gain, those held longer than 7 years allow taxpayers to exclude a total of 15% of the deferred gain, and those held longer than 10 years allow the taxpayer to exclude the post-acquisition gain on the investment in the Funds.

These new Qualified Opportunity Funds are not without critiques, however. As structures in the Qualified Opportunity Zones become replaced or refurbished and the neighborhood itself becomes more appealing, there is a risk that housing prices will rise, driving out the existing low-income residents and people of color in Berkeley. Furthermore, locally-owned small businesses could face increased competition from large franchises and may also be unable to meet rising rental costs from the developing Qualified Opportunity Zones. New locations of existing franchised businesses may bring new jobs, but those jobs may not pay a living wage or benefits that allow Berkeley workers to support themselves. In short, the city of Berkeley must also leverage the creation of the Qualified Opportunity Fund to ensure that current Berkeley residents living in Qualified Opportunity Zones are able to benefit from the revitalized and new buildings.

The City of Berkeley should consider the following policies in the creation of a Qualified Opportunity Fund to protect current Berkeley residents from adverse effects of the expected development:

- 1) Leverage tax incentives to ensure jobs created in Qualified Opportunity Zones go to local residents, pay a liveable wage, and offer worker protections and benefits that protect families
- 2) Ensure historically disadvantaged businesses have access to contracting opportunities in Qualified Opportunity Zones

² <https://www.congress.gov/bill/115th-congress/house-bill/1>

³ <https://opzones.ca.gov/oz-map/>

- 3) Require 50% of housing built in Qualified Opportunity Zones to be affordable to those making 60% of ~~less than~~ median area income and less to support local inhabitants already living in Qualified Opportunity Zones
- 4) Ensure that populations in Qualified Opportunity Zones have access to critical services such as healthcare, transportation, healthy food, and quality education services
- 5) Take steps to include historically underrepresented groups in every aspect of the QOZ process including investment, construction, operation, and purchase.
- 6) Ensure Opportunity Funds provide sustainable development satisfies fundamental human needs

In short, a municipal Qualified Opportunity Fund should ensure integration-forward housing

REVIEW OF EXISTING PLANS, PROGRAMS, POLICIES, LAWS

Qualified Opportunity Funds and Zones were created as part of the Tax Cuts and Jobs Act of 2017.

ACTIONS/ALTERNATIVES CONSIDERED

Because Qualified Opportunity Funds and Zones are new, there are no other jurisdictions to draw from as an example.

CONSULTATION/OUTREACH OVERVIEW AND RESULTS

External stakeholders include residents and businesses in the Qualified Opportunity Zones, their neighbors, potential investors, and contractors. Internal stakeholders include the Berkeley City Office of Economic Development, City Manager, City Planner, and Zoning Advisory Board.

RATIONALE FOR RECOMMENDATION

Qualified Opportunity Funds can exist independently of a municipal Fund set up by the city of Berkeley. It is legal, however, for the city to set up its own Qualified Opportunity Fund to compete with other Funds to invest in Qualified Opportunity Zones. If the city sets up its own Fund it can direct investments in a deliberate manner, using its municipal Qualified Opportunity Fund to set de facto housing and planning policy through which properties it invests in and how it chooses to renovate those properties. Creating a municipal Qualified Opportunity Fund will give the city of Berkeley greater influence over how investments into its neighborhoods are directed, and how those neighborhoods develop. This is an avenue through which the goals of economic inclusion, affordable housing, and continued neighborhood authenticity and character can be achieved.

Investors can and will create Qualified Opportunity Funds to invest in Berkeley's Qualified Opportunity Zones independent of a municipal Qualified Opportunity Fund. The purpose of creating a municipal Qualified Opportunity Fund is to allow the city of Berkeley to centralize and focus investments into the city, leveraging those investments to ensure current Berkeley residents realize the benefits of Qualified Opportunity Zones. The San Francisco Bay Area has a large community of impact investors, those desiring their investments to benefit communities, and a municipal Qualified Opportunity Fund will serve as a vehicle to centralize and direct these investments.

IMPLEMENTATION, ADMINISTRATION AND ENFORCEMENT

The City of Berkeley would create a Qualified Opportunity Fund to serve as a "bucket" for funds to invest in Qualified Opportunity Zones designated by the State of California and certified by the U.S. Treasury Department.

ENVIRONMENTAL SUSTAINABILITY

Creating a municipal Qualified Opportunity Fund will allow the city of Berkeley more influence in how Qualified Opportunity Zones are developed. Though new construction and renovation can offer environmental risks and hazards, the City can use Qualified Opportunity Funds to set specific terms for development, such as requiring buildings be carbon neutral. Thus, establishing a Qualified Opportunity Fund could yield a positive environmental effect relative to allowing purely independent Qualified Opportunity Funds to develop the same areas of Berkeley.

FISCAL IMPACTS

The potential revenue capture for the city of Berkeley is difficult to calculate, but increased property taxes, sales tax revenue, and other forms of revenue for the city are extremely likely outcomes. As Qualified Opportunity Zones are refurbished or developed and new housing and shopping is created, the city of Berkeley will benefit from the economic stimulation created by development.

OUTCOMES AND EVALUATION

To be determined by an impact study.

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ATTACHMENTS/SUPPORTING MATERIALS

Qualified Opportunity Funds: Options for the City of Berkeley



March 19, 2019

Christopher Karachale
Hanson Bridgett LLP





GENERAL BENEFITS OF QUALIFIED OPPORTUNITY FUNDS





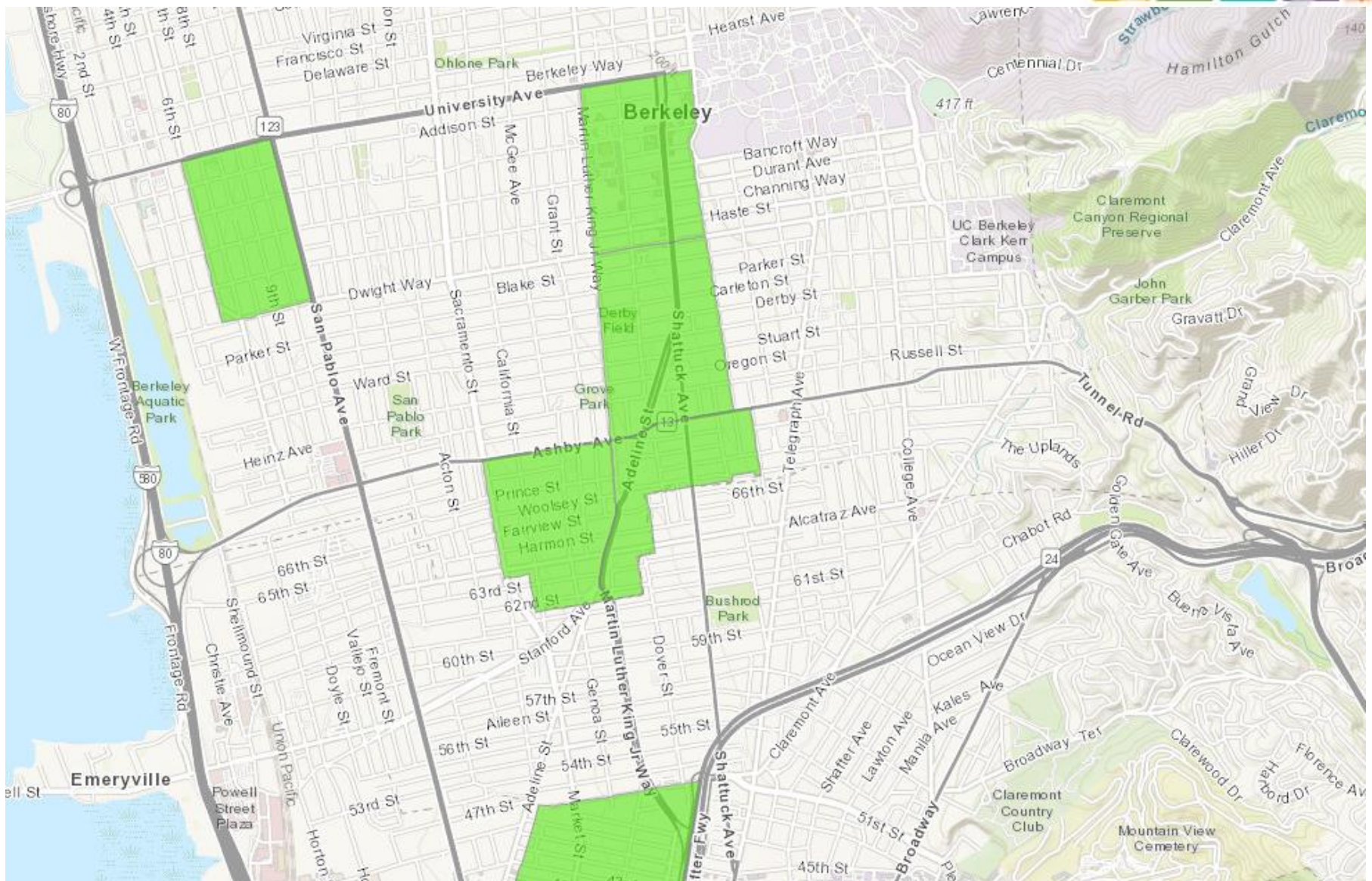
General Benefits

- Taxpayers may elect to defer the recognition of capital gain to the extent of amounts invested in a Qualified Opportunity Fund, provided that the gains are invested during the 180-day period beginning on the date such capital gain would have been recognized by the taxpayer.
- The deferred capital gain will be taxed on the date the investment in the Qualified Opportunity Fund is sold, or on December 31, 2026, whichever comes first.
- Qualified Opportunity Funds must make direct or indirect investments in distressed communities designated as qualified opportunity zones.
- The IRS has designated 8,761 communities in all 50 states as qualified opportunity zones.



General Benefits

- For investments in a Qualified Opportunity Fund held longer than five years, taxpayers may exclude 10 percent of the deferred gain.
- For investments in a Qualified Opportunity Fund held longer than seven years, taxpayers may exclude a total of 15 percent of the deferred gain.
- For investments in a Qualified Opportunity Fund held longer than 10 years, taxpayers may also elect to exclude from income the post-acquisition gain on the qualifying investment in the Qualified Opportunity Fund.





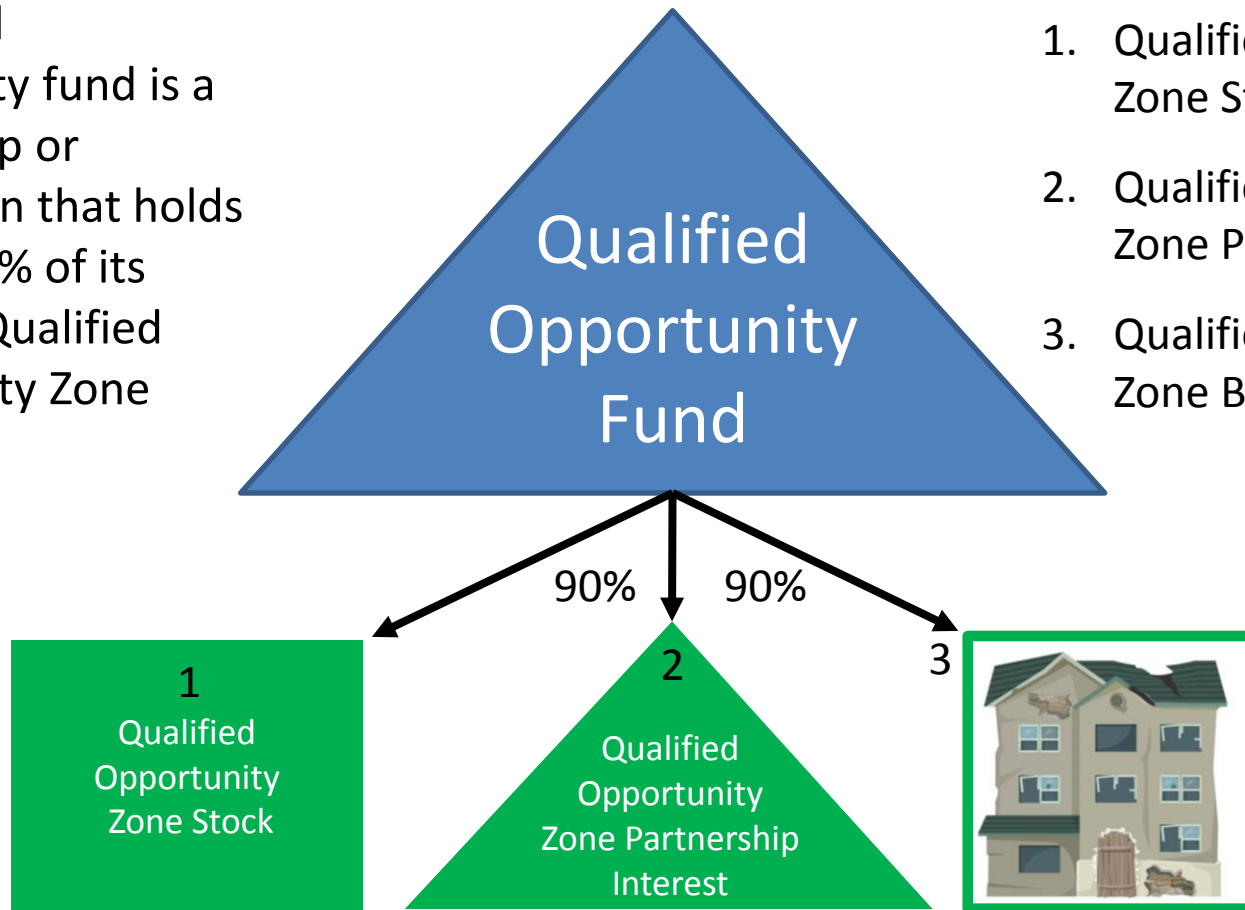
POTENTIAL STRUCTURE FOR BERKELEY QUALIFIED OPPORTUNITY FUND





Qualified Opportunity Zone Fund

A qualified opportunity fund is a partnership or corporation that holds at least 90% of its assets as Qualified Opportunity Zone Property.



1. Qualified Opportunity Zone Stock
2. Qualified Opportunity Zone Partnership Interest.
3. Qualified Opportunity Zone Business Property



Qualified Opportunity Zone Business Property



Qualified Opportunity Zone Business Property



Tangible Property used in a trade or business if

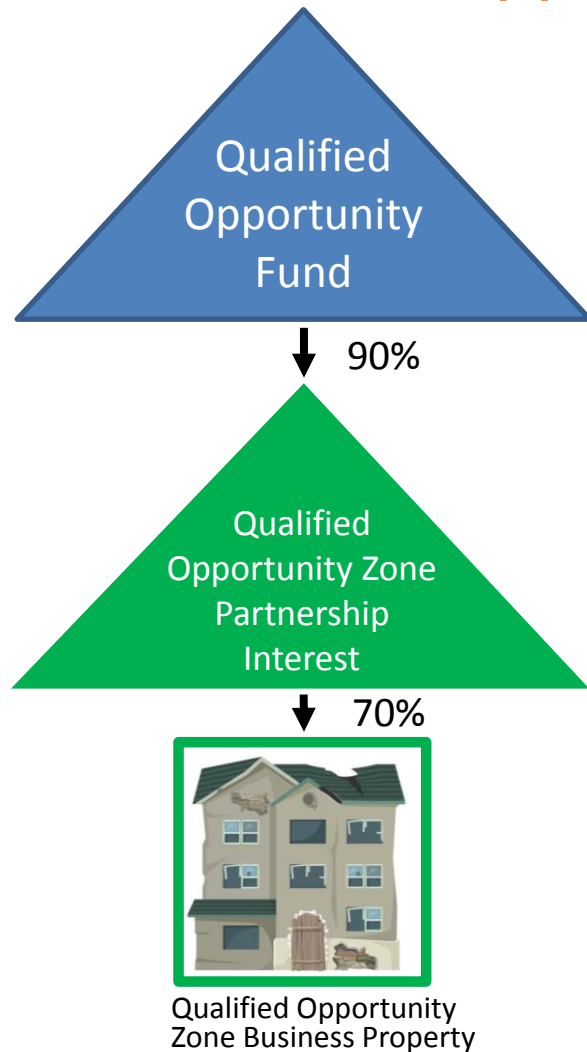
1. Qualified Opportunity Fund purchased after 12/31/17,
2. Qualified Opportunity Fund commences original use of property in the zone or substantially improves the property,
3. During substantially all the Qualified Opportunity Fund's holding period of property, substantially all use of property was in a zone.

Substantially Improve Property in Zone



- A building located on land within a QOZ is treated as substantially improved if, during any 30-month period beginning after the date of acquisition of the building, additions to the taxpayer's basis in the building exceed an amount equal to the taxpayer's adjusted basis of the building at the beginning of such 30-month period.
- The cost of the land within the QOZ upon which the building is located is not included in the taxpayer's adjusted basis in the building.

Qualified Opportunity Zone Business

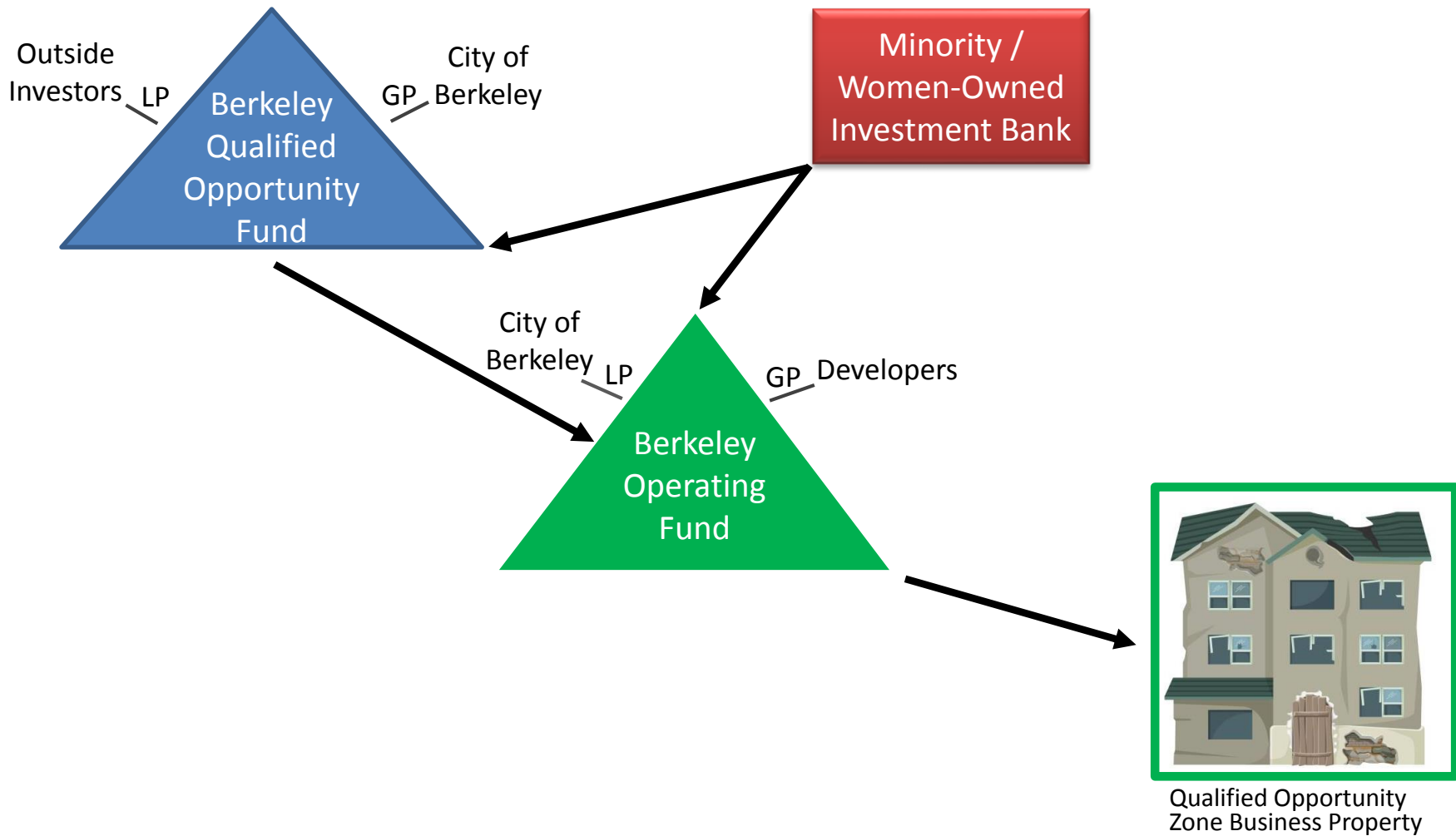


A trade or business if

1. "Substantially All" (i.e. 70%) of tangible property owned or leased is Qualified Opportunity Zone Business Property,
2. 50% of gross income from active conduct of business in the zone,
3. Less than 5% of Qualified Opportunity Zone Business' property is debt, stock, partnership interests, and similar property,
4. No golf courses, county clubs, massage parlors, hot tub facility, sun tan facility, race track, casino, liquor stores.



Proposed Structure for Berkeley QOF





Questions?





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Christopher advises individuals and business entities on a broad range of tax planning and tax controversy matters. He counsels taxpayers on federal income tax issues, California state property and sales and use tax issues, and a variety of local tax issues. He regularly works with individuals and start-up on qualified small business stock issues.

Christopher assists clients with international tax compliance, including voluntary disclosures and related planning matters. Christopher has represented individuals and an array of business entities in controversy matters before the IRS and California state tax authorities.

Christopher is certified as a legal specialist in taxation law by the California Board of Legal Specialization.

Honors

Northern California Super Lawyers, Rising Stars (2013-2017)

Professional Affiliations

The Tax Adviser, Board Member

Education

LL.M., Tax, New York University School of Law (2007)

J.D., University of San Francisco School of Law (2006)

M.A., Stanford University (1998)

B.A., *cum laude*, Middlebury College (1995)

Admissions And Courts

California

New York

U.S. Tax Court