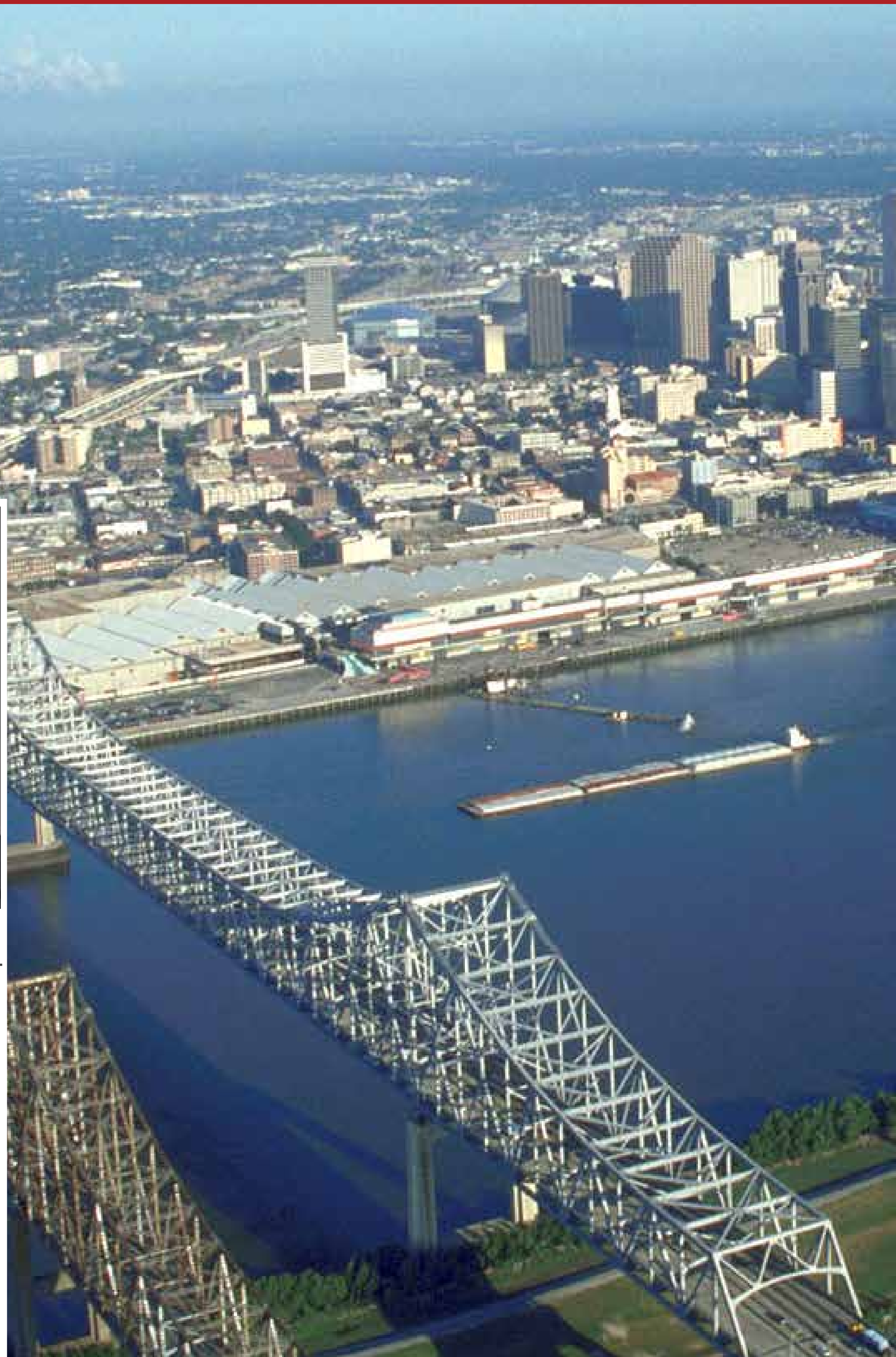
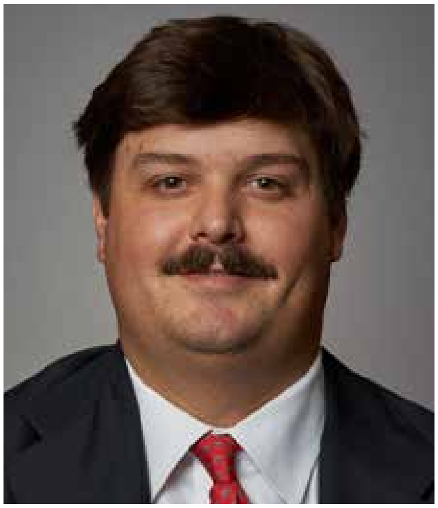
Opportunity Zones And New Orleans:
A Chance For Affordable Housing Growth





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INTRODUCTION

In the year and a half since their introduction, Opportunity Zones have quickly become one of the hottest topics in real estate development. This exciting program offers a new chance to revitalize distressed communities around the country by significantly broadening the pool of potential investors and providing them with enticing incentives to pull their money out of the market and into these locales. The success or failure of the program will hinge on the ability of public-private partnerships to bridge an often fraught line between outside investment and local community. In addition to providing an overview of the Opportunity Zone Program, this article examines the history of these partnerships in New Orleans and identifies the areas of the city that may benefit most from a new, aggressive approach to bringing in previously untapped resources to meet the needs of local residents.

OPPORTUNITY ZONES: AN OVERVIEW

Created by the 2017 Tax Cuts and Jobs Act, Opportunity Zones have attracted a tremendous amount of interest since their introduction. Designed to spur investment in distressed communities across the country, the tax incentive program called on the top officials in each state and territory to designate low income census tracts that best presented opportunities to increase investment and economic prospects. By providing benefits in a similar fashion to a 1031 exchange, the program allows investors, upon the sale of an asset, 180 days to re-invest the capital gain proceeds (not including the original basis) into a Qualified Opportunity Fund ("QOF") that in turn must invest these funds into Qualified Opportunity Zones. These zones, numbering over 8,700 census tracts that have been certified by the United States Department of the Treasury, present a unique opportunity that would allow investors to take advantage of the estimated $6 trillion in unrealized capital gains held in the U.S. market and to guide these funds into some of the most economically depressed areas of the country. If investments of QOFs are held for at least five years, the basis on the original gain is increased by 10 percent. If the same investment is held for at least seven years that percentage increases to 15 percent. Investments held longer than ten years will be eligible to be marked up to the fair market value of such investment on the date the investment is sold. Essentially, this amounts to an exclusion of capital gains taxes on any gains earned from an investment in a QOF over ten years when the investment is sold or disposed.

While the rules are not yet finalized, in October 2018 the IRS released a set of proposed regulations guiding investments in QOFs that have begun to allow the overall process to take shape and have provided encouragement to investors. For instance, investors were concerned with the initial stipulation that it was necessary for QOFs to have 90 percent of their assets invested in qualified Opportunity Zone property within 180 days. Given the uncertain nature of timing in the development of either operational businesses or real estate, many investors were wary of being able to meet this requirement, however the proposed IRS regulations apply working-capital safe harbor rules that contemplate allowing a QOF up to 30 months after acquiring a tangible asset in which to improve that asset substantially (IRS–Proposed OZ Guidelines). Although the program's eligible investments include existing businesses and startups, it is uniquely tailored to appeal to those in the real estate industry.

Opportunity Zones are not unique in the sense that the United States, at both the federal and state level, has designed numerous programs over the last several decades intended to boost investment in economically distressed communities. Critics of the program contend that Opportunity Zones are just another tax incentive that will not do much to move the needle of investment in these underserved communities. Other incentives, such as New Market and Low Income Housing Tax Credits (NMTC and LIHTC, respectively) have been in place for years with mixed success. Additionally, many of the communities designated as Opportunity Zones have been neighborhoods in close proximity to areas that have seen considerable investment and are already themselves in the process of transitioning. How, the critics ask, will the residents of these zones be able to remain in place and be able to partake in the upside in the face of significant outside investments that may increase property values and rents to unsustainable levels? The answer is not completely clear. Opportunity Zones are at the intersection of one of the country's foremost cultural, political, and economic challenges: how to bring new investment to distressed areas without entirely displacing or excluding existing residents.

INVESTORS RISING TO THE CHALLENGE

Doubts about the viability of the program and the lack of finalized regulations has not tempered the enthusiasm of the real estate community. According to the National Council of State Housing Agencies (NCSHA), as of February approximately $24 billion has been raised by 105 Qualified Opportunity Funds. Of these funds, ninety percent intend to focus on commercial real estate investments. Encouragingly, approximately half of the funds intend to focus on community revitalization, including affordable housing or workforce housing. While the NCSHA offers a fairly comprehensive view of existing funds, the broadness of the proposed regulations allow for individuals to create QOFs supporting individual projects. As regulations continue to take shape and are finalized and investors become more comfortable with the process, more funds should be created.

The enormous potential of Opportunity Zones lies in the unrestricted cap on the amount of capital that can be invested through a QOF. Even if a small portion of the trillions of dollars' worth of unrealized capital gains flow into these funds, the size of investment will dwarf that of programs with similar goals, such as the LIHTC program, which allocates funds to state housing finance agencies based on population. The process of awarding funds through this program is complex and lengthy, requiring coordination across federal and state levels. The level of sophistication naturally limits the willing participants in the market and is estimated to cost the government approximately $9.0 billion annually. No such limits currently apply to those willing to invest in QOFs. The potential of investors in stocks, bonds, and other asset classes to make long term real estate investments, while deferring or altogether foregoing taxable gains, opens up a broad and diverse pool of capital that has clearly demonstrated a willingness to attack the massive problem of housing affordability.

The challenge facing investors in Opportunity Zones is the learning curve associated with investments in distressed communities that in most instances over the last several decades have consistently seen these types of efforts fail to meet expectations. The real estate development landscape during this time has constantly shifted and expanded. The number of "stakeholders" in the development of any major project (and many minor ones) has multiplied as the world has become a more open and global place. The activist culture that grew out of the Civil Rights and peace movements of the 1960s manifested itself in local advocacy groups and grassroots neighborhood organizations that hold wide ranging beliefs and push specific agendas, leading to a much more fractured and complicated development process. Coupled with the fact that Americans have become increasingly less likely to chase opportunity and jobs outside of their natural birthplace (a characteristic that defined the country for much of its history), neighborhoods have developed distinct identities and senses of place that these groups seek to maintain. As a result, the ultimate success or failure of Opportunity Zone Funds will depend upon their ability to balance the needs and demands of the local community with overall investment goals and targeted returns required by investors. Fortunately, a framework for this type of engagement already exists.

COMMUNITY DEVELOPMENT CORPORATIONS

Over the same time period that saw the emergence of a plethora of local advocacy groups, the U.S. has developed a wide ranging framework of entities whose stated goal is to foster community building and guide funds into such distressed areas. These entities, be they community development corporations (CDCs), community land trusts (CLTs), local economic development corporations, or similarly structured organizations collectively have a mixed track record at successfully bridging the gap. Of these various organizations, the CDC is most suited to the task of serving as an intermediary between the emerging QOFs, the local community, and local government.

A community development corporation is comprehensively defined as "a nonprofit, community based urban development organization that engages in economic development activities such as housing production, commercial property development, business development, and/or job creating for the benefit of community residents" (Krigman, 2010). The model seeks to bring local leaders concerned with community building and well-being together with a professional service staff capable of working with both the private sector and government to bring investment into under-served communities. They emerged in the 1960s and '70s when local activists made the decision to embrace an approach rooted more in capitalistic traditions than protest (Scally, 2012). This approach allowed CDCs to gain significant funding from a variety of federal, state, and philanthropic sources as they have grown into one of the largest providers of affordable housing in the country. An estimated 4,600 CDCs exist in some form or another today (Varady, Kleinhans, & van Ham, 2015). The large majority of these organizations have little funding and small staffs. They have developed a broad range of services such as homeowner counseling or budget/credit counseling to go along with a "high level of sophistication in packaging financing from multiple sources and savvy in dealing with other neighborhood organizations, local government, and intermediaries" (Varady, Kleinhans, & van Ham, 2015). This last skill is particularly important considering local engagement will be a critical component of any real estate development pursued by QOFs.

Critics of the Opportunity Zone program contend that funds will only flow to projects that would have already been financially viable or were on the brink of financial viability. While this observation is undoubtedly true, the sheer number of potential zones and the demonstrated interest of investors suggests that, once these first targeted deals are engaged, the opportunity exists for investment to overflow into other zones. Investors will be willing to make larger investments and pursue projects in new areas – provided they have the buy-in of the local community and the proper economic incentives to bridge the gaps that will inevitably exist. This area is precisely where CDCs, with their unique blend of community roots and financial capabilities, should be able to step in and meet this need. Perhaps no city presents a greater opportunity than New Orleans.

NEW ORLEANS' PRE AND POST KATRINA DYNAMICS

Internationally recognized for both its dynamic history and cuisine, New Orleans is one of the most culturally rich and diverse cities in the United States. Drawing from French, Spanish, Creole, and Caribbean influences, among others, the city has developed an unrivaled mixture of architecture, food, and music that draws an enormous number of visitors each year. The local population is intensely proud of this culture and is heavily invested in maintaining it, a fact underscored by census data that shows Louisiana contains the highest percentage of native born residents in the country (Aisch & Gebeloff, 2014). While residents and visitors alike revel in the unique and vibrant lifestyle the city affords, significant challenges exist–some unique to New Orleans and others similar to trends across the country.

Like many cities in the country, New Orleans is struggling mightily with the problem of housing affordability. According to HousingNOLA, a broad local coalition of public and private housing interests, New Orleans is in need of approximately 33,600 units of affordable housing over the next ten years (HousingNOLA, 2015). While New Orleans boasts one of the largest and busiest ports in United States, for most of the last forty years the economy has revolved largely around tourism. The city has developed nascent industries that include technology, healthcare, and aerospace, but there has simply not been enough activity to close the ever widening income gaps that exist.

Much of the problem is due to loss in the core income-producing population. Since its peak at 627,525 in the 1960 census, the city saw its residency decline by over twenty percent by 2000 to 484,668. This population loss was driven by the development of surrounding parishes through the draining of swampland to accommodate suburban housing, the construction of the Pontchartrain Expressway, Interstate 10, and Veterans Memorial Highway. By the 1970s over forty percent of the metropolitan area population resided outside of the city. A significant portion of this population was middle to upper income residents, further draining the tax base of the city (Lowe & Bates, 2013). The oil crisis of the 1980s all but sealed the fate of the local economy as most of the remaining oil and gas companies fled to Houston as that city surpassed New Orleans as the energy hub of the country. This disinvestment, coupled with the corrupt nature of Louisiana politics, led to a city that was in decline well before Hurricane Katrina wreaked havoc on the Gulf Coast Region in 2005.

Although various non-profit and philanthropic organizations operated in the city during this period, it was not until the 1990s that the problems of vacancy and blight caused by population loss were recognized and there were no community-based organizations engaging in any type of scaled affordable housing or real estate development (Lowe & Bates, 2013). Some twenty years after community development corporations had established themselves nationally, encouraged by Mayor Marc Morial's administration, several new CDCs emerged locally to rise to the task of redeveloping these blighted areas. Led by a newly formed local development partnership called the New Orleans Neighborhood Development Collaborative (NONDC), by 2000 nine CDCs had developed 625 housing units.

Throughout this progress, however, many of the same conflicts inherent in the growth of CDCs throughout the country also challenged the capacity of New Orleans organizations. CDCs exist in a constant state of tension brought about by competing interests. Local grassroots activists expect a CDC to use its capacity to promote the social well-being of local residents and empower them to take control of their own communities, a goal that is not easy to define (Knotts, 2006). On the other hand, the private philanthropic interests that provided most of the funding (in addition to federal Community Block Development Grants) expected to see quantifiable gains in areas such as housing and job programs. These challenges lead to issues in gaining the support of the numerous and separate neighborhood organizations whose buy-in is crucial to the success of any potential development. After the initial successes that led to positive gains in affordable housing, moving into the new millennium support for CDCs in New Orleans waned as national organizations pulled funds in pursuit of other goals and the NONDC changed its focus from a community partnership that brought together organizations across the city to a real estate developer focused exclusively on the Central City Neighborhood (Lowe & Bates, 2013). In the years leading up to Hurricane Katrina little was done at the community level to further affordable housing development and progress stagnated.

Hurricane Katrina, which impacted New Orleans and the Gulf Coast Region in August of 2005, forever altered the city's future. The five years prior had seen the City's population continue to shrink; the estimated pre-Katrina population in 2005 was 452,170, down from 484,668 in 2000. The extent of the damage varied greatly by neighborhood and generally favored the City's original historic footprint built along high ground near the Mississippi River. These areas, in addition to the entire West bank of the city, were largely spared. Still, over eighty percent of the City flooded, damaging 134,000 housing units – roughly 70 percent of the occupied housing stock at the time.

The first five years after the storm were a crucial period in shaping how the city would respond, however disorganization in the distribution of recovery funds and lack of a true all-encompassing redevelopment strategy held back progress. Plans were proposed by Mayor Ray Nagin's Bring New Orleans Back Commission (BNOBC), the City Council (the New Orleans Neighborhoods Rebuilding Plan – NONRP), and private philanthropic sources (Unified New Orleans Plan - UNOP). Each plan varied widely and in some cases were completely contradictory, with the BNOBC plan calling for almost an entirely redrawn map clustering development in key areas, the NONRP putting redevelopment decisions into the hands of individual neighborhood residents and ensuring the return of every pre-Katrina neighborhood, and the UNOP plan following a middle road, proposing a clustering of remaining residents and businesses within each specific neighborhood. All three plans, including an additional two provided by the community, were adopted—without reconciliation—as the official recovery plan by both the New Orleans City Council and the Louisiana Recovery Authority (Ehrenfeucht & Nelson, 2013). The result was an uneven distribution of population and resources that were stretched across a city that, despite a shrinking population, increased its developable footprint from 36.8 square miles in 1960 to 66.7 square miles in 2000. Today, New Orleans' population stands at 393,292, approximately 86 percent of it's pre-Katrina population.

DOWNTOWN'S RESURGENCE

Despite the lack of a unified direction, Downtown New Orleans and many of its surrounding neighborhoods have witnessed an unprecedented surge of investment over the course of the last decade. As the rest of the country plunged into recession in the aftermath of the 2008 Financial Crisis, New Orleans had already hit bottom in the wake of Katrina. Taking advantage of generous state and federal historic rehabilitation tax credits, developers began converting many of the existing buildings in the Downtown and Warehouse district areas into condominiums and apartment buildings, doubling the number of units in the market transforming the area into a 24/7 residential hub. The approximately $6.5 billion in investment over the prior decade has expanded options across Downtown. Projects such as the Domain Companies' South Market District, a $500 million

Figure 1. A view of the World Trade Center. The building is currently being renovated into a Four Seasons Hotel. Source: Wiki Images.

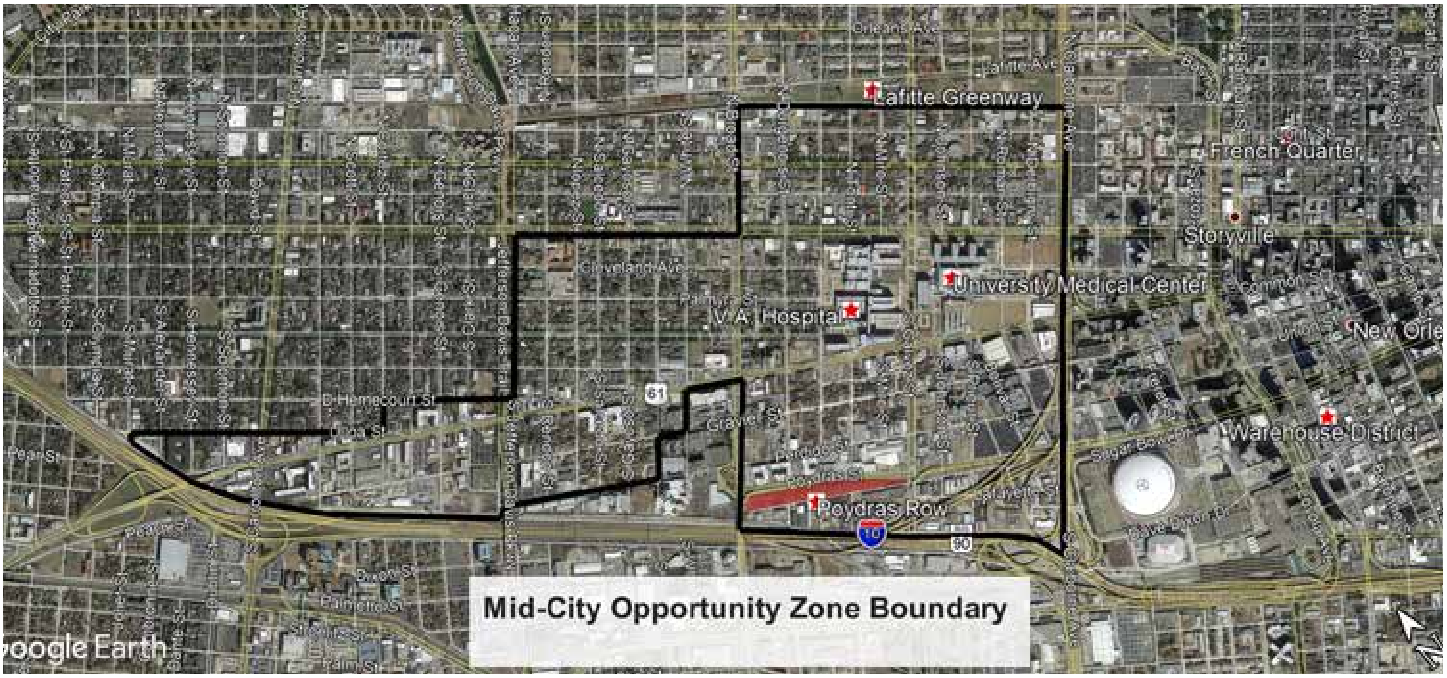

Figure 2. An aerial view of Mid-City New Orleans. Opportunity Zone locations are outlined in black. Source: Google Earth.

project consisting of nearly 1,000 luxury apartments and condominiums, 200,000 square feet of retail space, and a 40,000 square foot luxury grocer, have forever altered the landscape of the city. Currently underway is the $450 million re-development of the New Orleans World Trade Center into a Four Seasons hotel and condominium property. Charity Hospital, which was at one time the second oldest and second largest free hospital in the United States prior to being closed after Hurricane Katrina, is in the midst of a $250 million re-development process that could further add another major source of market-rate and affordable housing to the stock.

While the scope and scale of these developments have been impressive, much of the increase in supply during this period is attributable to hotel rooms catering to the ever-dominating tourism industry and higher end apartments and condominiums. This momentum has not carried over to the problem of affordable housing and in many instances has exacerbated it. Prior to the storm much of the city's lowest income residents were housed in one of five large public housing sites: B.W. Cooper, C.J. Peete, Lafitte, St. Bernard, and Iberville. Collectively these sites accounted for approximately 6,000 units of affordable housing. Due to the irreparable damage done to these buildings by the storm, in addition to the fact that they had become a constant source of crime and disruption, a decision was made to demolish them in favor of new, lower density mixed-income developments. These efforts have succeeded in decentralizing poverty but at the loss of thousands of affordable units closer to the city core. The former residents instead rely on voucher programs to use for private residences. Community groups

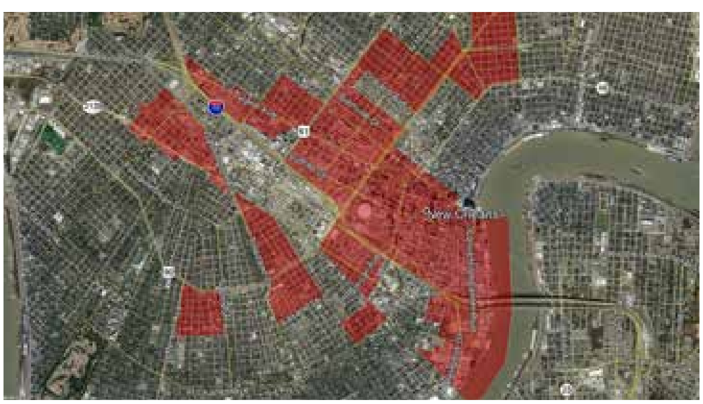

Figure 3. A close aerial view of New Orleans Opportunity Zones. Source: Google Earth.

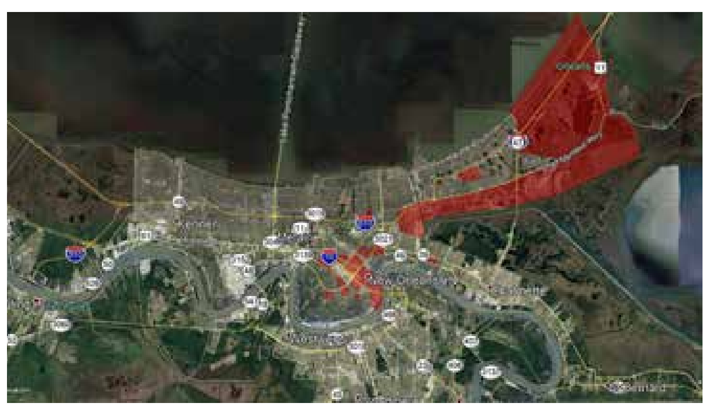

Figure 4. A far aerial view of New Orleans Opportunity Zones. Source: Google Earth.

and developers have had modest success in building single-family affordable homes on the thousands of blighted lots that checker the city, with demand far outstripping supply. This continuing imbalance reinforces the fact that more large-scale affordable residential development is needed. The Opportunity Zone program, if properly used, presents this kind of chance for New Orleans.

NEW ORLEANS' OPPORTUNITY

In reviewing the areas of New Orleans that have been designated as Opportunity Zones, the city appears to be well positioned. Of the 23 designated Opportunity Zones in New Orleans, 16 are in neighborhoods within a 5-10 minute drive time of Downtown New Orleans. The biggest impediment to development in these areas, however, is that the majority of these neighborhoods are typical to New Orleans: low density single family homes with scattered small multi-family apartments. There are simply not many contiguous development parcels that would support a large scale development project. In hindsight, in the years immediately following Katrina, had the City been able to effectively "right-size" at least some areas in order to open up areas for future growth, the potential for massed investment through the Opportunity Zone Program would be much greater. For obvious and legitimate political and socio-economic reasons, however, this was not a viable option (Ehrenfeucht & Nelson, 2013). Despite these challenges, a significant opportunity does exist in the four zones that cover a significant portion of the Mid-City Area of New Orleans.

Much like the majority of neighborhoods, the Mid-City area of New Orleans suffered significant flood damage due to Hurricane Katrina. Although a majority of the district is residential in nature, its area directly Northwest of Downtown New Orleans and the French Quarter have seen a surge of investment in the last three years. Two major investments changed the course of this area. First, the $2 billion construction of the University Medical Center and Veterans Affairs hospitals permanently altered the trajectory of the neighborhood. Built on approximately 70 acres of land that was expropriated from a historic district, the controversial project was completed in 2015 and has dramatically shifted investor sentiment on both the Tulane Avenue and Canal Street corridors, bringing in thousands of full time jobs in the medical and bio-medical industries. Further to the Northeast, the second project, the Lafitte Greenway, also opened in 2015. A city sponsored project, an old railroad right of way was repurposed into 2.6 miles of bicycle and pedestrian trails, athletic courts, playgrounds, and green space that connects the French Quarter with the Bayou St. John neighborhood, one of the cultural bastions of Mid-City. Considering their location close to the tourist hub of the downtown area, the areas surrounding these projects are ripe for further development that could take advantage of opportunity zone locations to the benefit of local residents. The project has spurred significant investment and development along the entire greenway and, at a cost of $9.1 million, is a testament to the ability of municipalities to foster economic growth with little up-front investment.

Despite the disarray with which it pursued recovery in the years immediately following Katrina, in 2010 New Orleans took a major step forward with the adoption of a Master Plan. Up until that point in its history the city had relied on a hodgepodge of local zoning ordinances that did not give much thought to any over-arching, long-term idea of what the city might be. Most recently updated in 2015, the Master Plan, while not ground-breaking by any means, provides an in-depth view of the future potential for development. Most encouragingly, it seeks to embrace high-density mixed use developments, identifying ten "opportunity sites" across the city that have the potential for such projects and indicating that the city would be willing to work with interested developers in pursuit of these goals.

Only one of these sites, a 6 acre parcel of land called Poydras Row, is located within the Mid-City Area and also in an Opportunity Zone. The city's call for action from developers should be noted, however, for this is where the intersection of Opportunity Zone investors and CDC's can come together to find creative development solutions across the board. Poydras Row is not the only potential developable site in the Mid-City Opportunity Zone area. Large portions of Mid-City are industrial in nature or are surface parking for the hospitals and medical school. Tulane Avenue itself has many sites that are ripe for re-development, although surging land prices around the hospitals may preclude affordable housing. The City's willingness to identify opportunity sites and open the door for development suggests an inclination to help make these denser projects a reality through various creative means. CDCs, in addition to the numerous other public/private organizations in New Orleans such as HousingNOLA, Greater New Orleans, Inc., and Friends of Lafitte Greenway have a unique opening to work with local stakeholders and match potential sites with QOFs.

The immense interest and attention the Opportunity Zone Program has received since its inception is well-deserved. The program has great potential to transform some of the country's most historically down-trodden areas. As the regulations are finalized in the coming months more investors will continue to come to the table. The long term success or failure of the program rests in the ability of public-private partnerships to bring all stakeholders together and match incentives to investment with the needs of the community. New Orleans, having made significant progress in the last three years, is poised for future growth. Opportunity zones, if worked correctly, present a chance to bring this growth to all members of the community.

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