Date of Hearing: April 2, 2019

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY
Sabrina Cervantes, Chair
AB 1479 (Cervantes) – As Introduced February 22, 2019

SUBJECT: Opportunity Zone Credit Enhancement Act

POLICY FRAME: Opportunity Zones represent a possible new community development tool to attract new investors to historically underserved areas of the state. California faces a significant challenge, however, in demonstrating that projects can be delivered on-time and with no expensive surprises. If California is serious about attracting some of the billions of dollars which will likely become available through Opportunity Fund investments, the state needs to bring forward its best community developers and most creative financial innovators.

All that creativity can be challenging for state agencies. Fortunately, the California Infrastructure and Economic Development Bank (IBank) has one of the best records of public finance in the nation. Since inception, the IBank has loaned, financed, or participated in the financing of over $40 billion of infrastructure and economic expansion projects, including green bonds. AB 1479 establishes a new project-based credit enhancement to expedite infrastructure related development and reduce overall project risk.

The policy committee analysis includes information on the California small business economy, state rulemaking practices, and studies on the cost of regulations to small businesses. Suggested amendments are included in Comment 6.

SUMMARY: AB 1479 requires the California Infrastructure and Economic Development Bank (IBank) to provide credit enhancements to projects that support the development of an economic development facility, as defined, within a federally designated Opportunity Zone.

In considering the issuing of a credit enhancement for a project under the provisions of this bill, the IBank is required to determine all the following:

1) The project is located in California.

2) The applicant is capable of meeting the obligations reflected in the IBank finance agreement.

3) The proposed financing is appropriate for the specific project.

4) Development of the project will provide economic opportunity for individuals currently residing in the Opportunity Zone, including wealth creation and asset formation.

5) Development of the project will not displace lower income residents.

EXISTING LAW:

1) Establishes the IBank within the Governor’s Office of Business and Economic Development (GO-Biz) and authorizes it to undertake a variety of infrastructure related financial activities including, but not limited to, the administration of the Infrastructure State Revolving Fund (ISRF), oversight of the Small Business Finance Center, and the issuance of tax-exempt and taxable revenue bonds.

2) Establishes the ISRF for the purpose of providing financing to public agencies and non-profit corporations, sponsored by public agencies, for a wide variety of infrastructure and economic development facilities. Development of housing infrastructure is an eligible project; financing of the building or mortgage of a house is not eligible.

3) Defines an "economic development facility" to mean real and personal property, structures, buildings, equipment, and supporting components thereof that are used to provide industrial, recreational, research, commercial, utility, goods movement, or service enterprise, community, educational, cultural, or social welfare facilities and any parts or combinations thereof, and all facilities or infrastructure necessary or desirable in connection therewith, including provision for working capital, <u>excluding housing</u>.

4) Defines a "project" to mean designing, acquiring, planning, permitting, entitling, constructing, improving, extending, restoring, financing, and generally developing public development facilities or economic development facilities within the state. These projects may be funded through the ISRF. Projects for the purpose of financing transition costs or the acquisition of transition property, or both, may be funded through a financing order by the Public Utilities Commission, as specified.

5) Defines a "public development facility" to mean real and personal property, structures, conveyances, equipment, thoroughfares, buildings, and supporting components thereof, excluding any housing, that are directly related to providing the following:

   a) City streets, county highways, and state highways, as specified;

   b) Drainage, water supply, and flood control, as specified;

   c) Sewage collection and treatment, as specified;

   d) Solid waste collection and disposal, including, but not limited to, vehicles, transfer stations, recycling centers, sanitary landfills, and waste conversion facilities;

   e) Water treatment and distribution; as specified;

   f) Educational facilities, including libraries, child care facilities, and employment training facilities;

   g) Environmental mitigation measures, as specified;

   h) Public safety facilities, including, but not limited to, police stations, fire stations, court buildings, jails, juvenile halls, and juvenile detention facilities;

   i) Parks and recreational facilities, as specified;

   j) Port facilities, including, but not limited to, airports, landports, waterports, railports, docks, harbors, ports of entry, piers, ships, and marinas, as specified;

   k) Power and communications, including facilities for the transmission or distribution of electrical energy, natural gas, and telephone and telecommunications service.

   l) Public transit, including, but not limited to, air and rail transport, airports, passenger stations, maintenance and storage yards, and related structures, as specified;

   m) Defense conversion, including, but not limited to, facilities necessary for successfully converting military bases consistent with an adopted base reuse plan;

   n) Military infrastructure, including, but not limited to, facilities on or near a military installation that enhance the military operations and mission of one or more military installations in this state; and

o) Goods movement-related infrastructure, including, but not limited to, port facilities, roads, rail, and other facilities and projects that move goods, energy, and information.

6) Defines persons and families of low or moderate income to mean persons and families whose income does not exceed 120% of area median income, adjusted for family size and revised annually, as specified.

7) Defines "very low income households" to mean persons and families whose incomes do not exceed the 50% of area median income, adjusted for family size and revised annually, as specified.

FISCAL EFFECT: Unknown

COMMENTS & CONTEXT:

1) **Opportunity Zones**: New tax provisions in the federal Tax Cuts and Jobs Act of 2017 could provide an incentive for investors to deploy capital in lower income neighborhoods. Provisions in the federal Tax Cuts and Jobs Act of 2017 authorized the establishment of Opportunity Zones (OZ) in low income areas of a state for the purpose of attracting private investment capital. Governors were authorized to nominate up to 25% of their respective states' eligible low income census tracts for designation. Up to 5% of the 25% of the nominated census tracts could be from census tracts adjacent to the eligible low income census tracts. Once approved by the U.S. Treasury, census tracts remain designated for a term of 10 years.

   - ***Eligible Census Tracts***: An Opportunity Zone is defined as any census tract that has either: (1) a poverty rate of at least 20%, or (2) a median family income that does not exceed 80% of statewide median income.

   - ***California Eligible Areas***: Based on guidance from the U.S. Treasury, California had 3,516 eligible low income census tracts, meaning California was able to nominate up to 879 census tracts. As census tracts are designed to capture geographic areas of approximately 4,000 people, more than 3 million Californians are potentially living within an Opportunity Zone. Link to online resources related to designated census tracts:
   http://www.dof.ca.gov/Forecasting/Demographics/opportunity_zones/index.html

   Federal law authorizes a broad range of business investments, including investments in stock, partnership interest, and business property. A qualified OZ business property investment may include new and substantially improved tangible property, including commercial buildings, equipment, and multifamily housing complexes. The essential eligibility requirement of the tax incentive is that the investment must be made through a qualified Opportunity Fund. For investors who properly place moneys in a qualified Opportunity Fund, they will receive:

   - A temporary deferral of inclusion in taxable income for capital gains reinvested in an Opportunity Fund. The deferred gain must be recognized on December 31, 2026, or earlier if the Opportunity Zone investment is disposed;

   - A step-up in basis for capital gains reinvested in an Opportunity Fund. The basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least five years and by an additional 5% if held for at least seven years, thereby excluding up to 15% of the original gain from taxation; and

- A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund if the investment is held for at least 10 years. This exclusion only applies to gains accrued after an investment in an Opportunity Fund.

Recently enacted legislation, SB 635 (Hueso), Chapter 888, Statutes of 2018, calls for the establishment of a California website to assist communities, investors, and community development partners: https://opzones.ca.gov/. AB 1479 expands on this bill by providing a credit enhancement to help local communities attract Opportunity Zone investors.

2) **Community Conversations Around Opportunity Zones**: Opportunity Funds represent a new community reinvestment opportunity for California lower income neighborhoods. As such, they are sparking conversations and collaborative engagements between economic and business development professionals. California Forward, who serves as the secretariat for the California Economic Summit, is a lead partner in several of these conversations, as well as organizations like the Milken Institute's Center for Regional Economics. The Assembly Committee on Jobs, Economic Development, and the Economy (JEDE) has both attended and hosted a number of these events. JEDE has also dedicated committee-sponsored web pages to facilitate discussions among the members and staff of the Legislature, as well as stakeholder groups: https://ajed.assembly.ca.gov/content/opportunity-zones/.

   The primary focus of these conversations has been on how California can maximize the use of the Opportunity Zone to direct private capital investment into lower income communities across the state. Also of importance has been discussions on how to assist communities with practical ways to protect themselves from investments that may lead to development inconsistent with the neighborhoods' or communities' interests.

   While the Opportunity Zone tax incentive has no mandate for community benefits, communities can use their existing authorities and resources to identify priority projects, remove regulatory impediments, and potentially provide local incentives to be more attractive to investors, such as permit streamlining, approvals of master land use plans, and dedicating community development funds. Below is a short overview of the top-five recommendations from the California Forward-facilitated discussions, based on notes from a meeting hosted by the Bay Area Council and which reflect contributions from numerous meetings around the state.

   1. State programs and resources should be reviewed and made ready for layering with Opportunity Zone investments in order to bolster their effectiveness in achieving community benefits. [*This is a potential key outcome from the enactment of AB 742 and the new credit enhancement in AB 1479 could further reduce project risk.*]

   2. State tax laws should be amended to conform with the new federal capital gains rules to meet state policy objectives. It is reported that 34 other states have revised their tax structures to conform their treatment of capital gains to the new federal rules. [*This is a focus of Administration discussions with the Legislature related to the budget.*]

   3. State financial assistance is needed for local capacity building in order for communities to be "Opportunity Zone Ready." [*Small-size local planning grants are being discussed – most likely a potential 2018-19 budget discussion.*]

   4. Where possible, state and local regulatory processes should be streamlined, as well as other actions to create a short pathway to project implementation. [*GO-Biz's Office of Permit Assistance already has a track record for effectively working with regions and locals on similar project issues.*]

5. Results should be measured using performance-based models so that outcomes can be tracked over time to ensure new investments are actually improving local conditions. [*One possibility and also a major recommendation from the 2018 Economic Summit is to use the [California] Dream Index, an interactive index being developed to track key indicators related to upward mobility and inclusive growth.*]

The Milken Institute, a nonprofit and nonpartisan economic policy think tank known for developing financial innovations, also believes that states can play a vital role in the deployment of Opportunity Fund moneys within their respective states. While investors are already seeking deals, it is in the best interest of states to "align incentives for the spectrum of deals (e.g., mixed-use real estate, new business formation) in order to structure deal flow with smart exits. In doing so, states are building community benefit prerequisites into the process, creating a mechanism that retains the intended tangible benefits of the investment." Ideally, according to Milken, states will benefit from having a pipeline of shovel-ready projects. One component of that is having a state framework to direct how Opportunity Zone deals and develop ways to de-risk projects.

3) **Background on the IBank**: The IBank was established in 1994 to finance public infrastructure and private development that promote a healthy climate for jobs, contribute to a strong economy, and improve the quality of life in California communities. Housed within GO-Biz, it is governed by a five-member board of directors comprised of the Director of GO-Biz (chair), the State Treasurer, the Director of the Department of Finance, the Secretary of the Transportation Agency, and an appointee of the Governor. The day-to-day operations of the IBank are directed by the Executive Director who is an appointee of the Governor and is subject to confirmation by the California State Senate.

The IBank does not receive any ongoing General Fund support, rather it is financed through fees, interest income and other revenues derived from its public and private sector financing activities. State contracts to small business financial development corporations are supported through an annual General Fund appropriation of approximately $860,000.

The IBank administers four core programs: (1) the ISRF which provides direct low-cost financing for public infrastructure projects and economic development facilities; (2) the Revenue Bond Financing Program which provides tax exempt and taxable bond financing for manufacturing companies, public benefit nonprofit organizations, public agencies and other eligible entities; (3) the California Small Business Finance Center which assists small businesses (up to 500 employees) in accessing private financing through credit enhancements – including loan guarantees, direct loans, and performance bond guarantees; and (4) the California Lending for Energy and Environmental Needs Center (CLEEN Center), which provides financing for municipal governments, public universities, schools, and hospitals (MUSH).

Since its inception through March 2017, the IBank has loaned, financed, or participated in over $40 billion in infrastructure and economic expansion projects, including $426.9 million in industrial development bonds. This includes over $600 million to local and state agencies, developing a high-level of expertise in the financing of public infrastructure.

The IBank also serves as the state's only general purpose financing authority with broad statutory powers to issue revenue bonds, make loans, and provide guarantees. There is no pledge of IBank or state general funds for any of the conduit revenue bonds. Over $38 billion in conduit revenue bonds have been issued by the IBank since 2000.

The IBank estimates that, since inception, it has supported the creation and retention of over 100,000 jobs, including over 22,000 from the ISRF program; 37,000 from bond financing activities; and 41,000 through the Small Business Finance Center.

4) **Highlights from 2017-18 Annual Report**: In November 2018, the I-Bank issued its annual report for the 2017-18 fiscal year. Among other accomplishments in the report year, the IBank financed over $1.1 billion, leveraging $21.7 million, which resulted in 1,993 jobs (construction, retained, and created). Additional details on these projects and other highlights are provided below:

   a) ***Clean Energy Finance Center***: Established in 2014-15, the IBank approved criteria, priorities, and guidelines for the selection of projects financed through the CLEEN Center. The goal of the CLEEN Center is to support the state in meeting its greenhouse gas emission reduction goals by providing low-cost financing to eligible state agency and MUSH entities. Among other clean energy and environmental projects, the new center will finance projects that support energy generation, distribution, transmission, and storage of electrical energy, energy conservation measures, environmental mitigation measures, and water treatment and distribution. The CLEEN Center currently operates the:

      i) Statewide Energy Efficiency Program (SWEEP), which will provide low-cost financing to state and local governments for energy efficiency projects.

      ii) Light Emitting Diode (LED) Street Lighting Program, which finances the installation of LED street lights.

   The first CLEEN Center project was approved in November 2016, a $7.7 million loan to the City of Huntington Beach for the purchase of 11,000 high pressure sodium streetlights and the retrofit and installation of LED lighting technology. Annual energy savings is expected to be about 3.5 million kilowatt-hours in the first year. Over the next 20 years, savings to Huntington Beach's General Fund is anticipated to be as high as $14 million. In 2016-17, two loans were financed for a total of $3.9 million, supporting the creation of 55 jobs. There were no new CLEEN Center Financings in 2017-18.

   b) ***Infrastructure Funds***: The IBank issued $141.6 million in ISRF Bonds to recapitalize the revolving loan fund in 2015-16, which provides low-cost financing to local governments and nonprofits to build roads, city halls, fire stations, and water treatment facilities, among other projects. The 2016 ISRF bonds received Moody's Investor Services' highest rating of "AAA." This strong rating resulted in the IBank selling these bonds at a premium and receiving $171 million, nearly $30 million above the bonds' face value.

   In 2017-18, The ISRF approved seven projects for $62.4 million in loans for infrastructure and economic expansion projects. These projects are expected to result in 723 new jobs, with 383 gained in the construction phase, and will leverage an additional $17.4 million in other funds.

   c) ***Conduit Revenue Bonds***: The IBank issued $610 million in conduit revenue bonds for qualified 501(c)(3) nonprofit entities. Key projects funded through bond proceeds included, but were not limited to, refunding and remarking of bonds for the Los Angeles County Museum of Natural History facilities in Los Angeles and Newhall and bonds for a new campus facility at the University of San Francisco. The total bands issued in 2017-18 leveraged an additional $4.3 million and had an anticipated impact on employment of 1,270 jobs.

   d) ***Green Bonds***: The IBank issued $410.7 million of public agency revenue bonds (Green Bonds) in 2015-16. The proceeds will be used to recapitalize the State Water Board's Clean Water State

Revolving Fund Program. In 2017-18, the IBank issued another $1.05 billion in public agency revenue bonds to recapitalize a portion of the California Clean Water State Revolving Fund Program.

e) ***The Small Business Finance Center***: The Small Business Finance Center recruited 13 new lenders to participate in the Small Business Loan Guarantee Program, guaranteed 400 small business loans for $122 million, which provided $283 million in loans. Financings at the Small Business Finance Center are provided through a network of seven small business financial development corporations. In addition to assisting businesses in obtaining loans, under terms and conditions not otherwise available, the FDC provide technical assistance to businesses to ensure they are prepared to be a successful borrower. During the report year, the FDCs provided technical assistance to 181 businesses for a total of 493.5 hours. Due to the wildfires in 2017, the IBank board activated the Disaster Relief Loan Guarantee Program and expanded its direct loan program, Jump Start.

5) **The Clean Energy Job Market – Governor Priority for Opportunity Zone Investments**: California's clean energy and technology economy encompasses a broad range of products and services, touching upon multiple industry sectors. This includes clean technology such as alternative energy generation, wastewater treatment, and the production of environmentally-friendly consumer products. Although some of these industries are very different, they all use innovative technologies, products, and services that have environmental benefits. The Governor's 2019-20 budget proposes prioritizing clean technology projects, as well as housing, for Opportunity Zone investments.

Growth in the cleantech industry largely comes from the convergence of two disparate factors: one, recent advances in new technologies, research methods, manufacturing, and communications that lower the cost of environmentally sensitive technologies; and two, an increasing number of consumers and businesses that are looking for ways to reduce energy costs, increase clean water supply, and meet new environmental regulatory requirements at the local, state, and global levels. Governments, in turn, have adopted new regulatory frameworks that require greater use of recyclable materials, increased the use of renewable energy, and lowered air pollution and GHG emissions.
The chart below, developed by Cleantech San Diego, illustrates the wide range of industries engaged in the cleantech industry cluster.

Examples of Cleantech Industries	
Agriculture	Bio-based materials; farm efficiency technologies; micro-irrigation systems; bio-remediation; and non-toxic cleaners and natural pesticides.
Air & Environment	Air purification products and air filtration systems; energy efficient HVAC; universal gas detectors; multi-pollutant controls; and fuel additives to increase efficiency and reduce toxic emissions.
Materials	Biodegradable materials derived from seed proteins; micro-fluidics technology for conducting biochemical reactions; nano-materials; composite materials; thermal regulating fibers and fabrics; environmentally-friendly solvents; nano-technology components for electronics, sensor applications and energy storage; electro-chromic glass; and thermoelectric materials.
Manufacturing & Industrial	Advanced packaging; natural chemistry; sensors; smart construction materials; business process and data flow mapping tools; precision manufacturing instruments & fault detectors; and chemical management services.
Energy	*Energy Efficiency*: Energy management systems; systems that improve output of power generating plants; intelligent metering; solid state micro refrigeration; control technology for HVAC systems; and automated energy conservation networks. *Energy Generation*: Distributed and renewable energy and conversion, including wind;

	solar/photovoltaic (PV); hydro/marine; biofuels; fuel cells; gasification technologies for biomass; and flywheel power systems. Energy Infrastructure: Wireless networks to utilities for advanced metering; power quality monitoring and outage management; integrated electronic systems for the management of distributed power; and demand response and energy management software. Energy Storage: Batteries, e.g. thin film and rechargeable; power quality regulation; flywheels; and electro-textiles.
Recycling & Waste	Recycling technologies; waste treatment; internet marketplace for materials; hazardous waste remediation; and bio-mimetic technology for advance metals separation and extraction.
Transportation	Hybrid vehicle technology; lighter materials for cars; smart logistics software; car-sharing; and temperature pressure sensors to improve transportation fuel efficiency; telecommuting.
Water & Wastewater	Water recycling and ultra-filtration systems (e.g. UV membrane & ion exchange systems); sensors and automation systems; and water utility sub-metering technology; desalination equipment.
	Source: Cleantech San Diego

A March 2019 fact sheet on advanced energy jobs from the Advanced Energy Economy Institute states that advanced energy employs 3.5 million U.S. workers, which is more than retailers, double the jobs in hotels and motels, and three times the jobs in coal and oil.

In 2017-18, job growth within the advanced energy sector totaled 125,000 new jobs, and growth in 2019 is expected to be 6%. For comparison, employment growth in the U.S. during the same time period was 1.5%.

6) **Proposed Amendments**: Below is a list of amendments the committee members may wish to review when considering the bill.

   a) Update the legislative findings to reflect more current data on poverty.

   b) Add legislative finding and declarations that cities and counties are encouraged to post on their websites Opportunity Zone eligible census tracts, including information on vacant land, zoning, and entitlement status of available properties within such census tracts.

   c) Clarify that the provisions in the bill only apply to credit enhancements for economic development facilities located in Opportunity Zones.

7) **Related Legislation**: Below is a list of bills from the current session relating to Opportunity Zones.

   a) ***AB 791 (Gabriel) Housing in Opportunity Zones***: This bill authorizes additional Low Income Housing Tax Credits and allows transferability of those credits under certain specific conditions when those housing units are located within Opportunity Zones. Status: Pending in the Assembly Committee on Revenue and Taxation.

   b) ***AB 1479 (Cervantes) Credit Enhancements in Opportunity Zones***: Requires the California Infrastructure and Economic Development Bank (IBank) to provide credit enhancements to projects that support the development of an economic development facility, as defined, within a federally designated Opportunity Zone. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.

   c) ***SB 25 (Caballero and Glazer) Opportunity Zone and Environmental Permitting***: This bill establishes specified procedures for the administrative and judicial reviews under the California Environmental Quality Act that are funded, in whole or in part, by specified public funds or public agencies for projects located with a qualified Opportunity Zone. Status: Pending in the Senate Committee on Environmental Quality.

d) ***SB 315 (Hertzberg) Reporting Framework***: This bill establishes a comprehensive reporting framework for investments in Opportunity Zones and Promise Zones. Any taxpayer who seeks a deferral or reduction of any tax liability for capital gains pursuant to a provision of the 2019-20 budget, as specified, is required to comply with this reporting framework. This applies to any deferral or reduction of tax liability under the personal income tax or corporate tax. Status: Pending in the Senate Committee on Business, Professions, and Economic Development.

e) ***SB 635 (Hueso) Opportunity Zone Tax Conformity***: This bill conforms the Personal Income Tax Law and the Corporation Tax Law to provisions of the Internal Revenue Code that allow for specified tax treatment for income derived from activities within a qualified Opportunity Zone, including the deferral of a capital gain. Status: Pending in the Senate Committee on Rules.

8) **Double Referral**: The Assembly Committee on Rules has referred this measure to the Assembly Committee on Jobs, Economic Development, and the Economy and to the Assembly Committee on Revenue and Taxation (R&T). Should this measure pass the committee, it will be referred to R&T for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

None on File

Opposition

None on File

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