



THE ASPEN INSTITUTE

Economic Opportunities

P R O G R A M

**Expanding inclusive development
through employee share ownership in
opportunity zones**

Webinar technology

- Webinar is being recorded
- Listen-only mode
- Please chat in your questions!
- For technical issues, please use the chat box or email dan.lebiednik@aspeninstitute.org



EOP team



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Ownership and Profit Sharing at
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Today's discussion

- Welcome and introductions
- ESOPs and their value in advancing inclusive development
- The OZ statutory and regulatory context and ESOPs
- How communities are working to advance employee ownership in OZs
- Q and A

About EOP

The **Economic Opportunities Program** advances promising strategies, policies, and ideas to help low- and moderate-income Americans connect to and thrive in a changing economy. Over its 25 years of work, EOP has focused on expanding individuals' opportunities to connect to quality work, to start businesses, and to build assets and economic stability.

Communications

Applied Research
& Documentation

Evaluation, Idea
Testing, Tools
Development

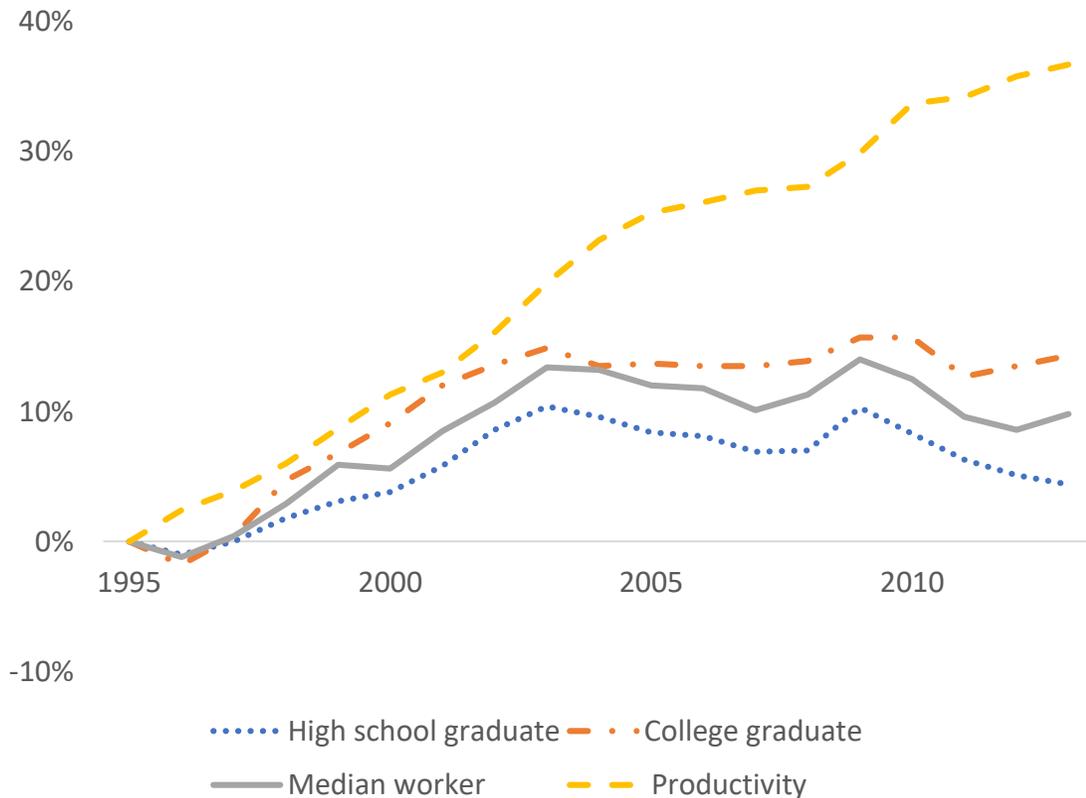
Leadership
Development /
Network Building

Peer Learning /
Capacity Building

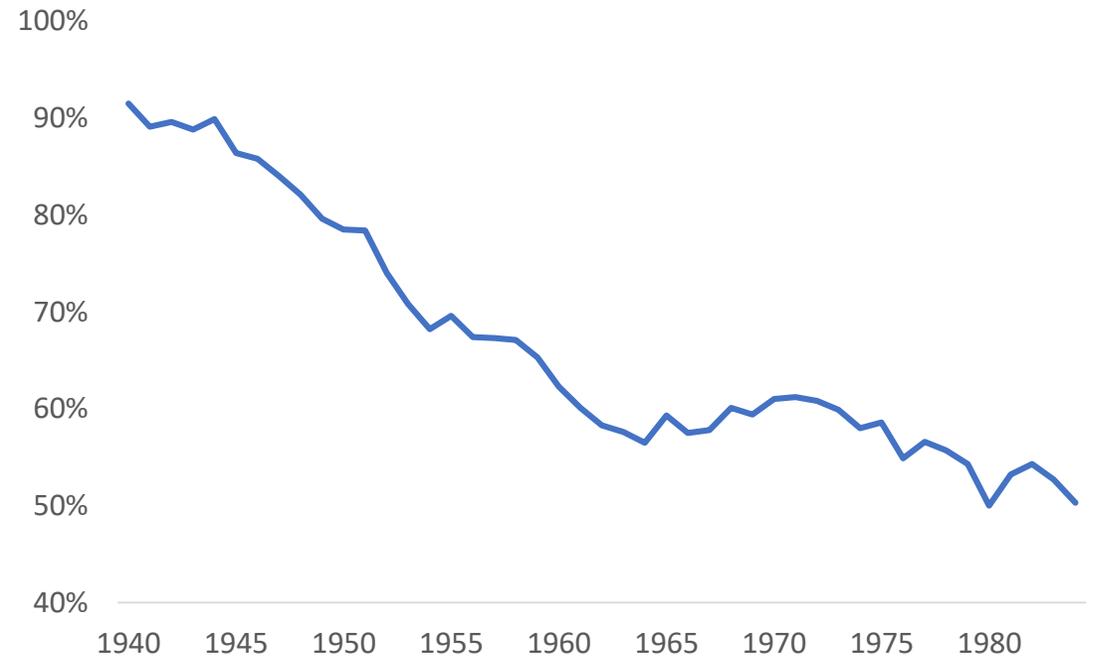
Shaping the
Discourse (Events
& Public Opinion
Pieces)

Productivity rising, wages flat and the fading American dream

Cumulative change in total economy productivity and real hourly compensation of selected groups of workers, 1995–2013



Baseline Estimates of Absolute Mobility by Parent Income Percentile and Child Birth Cohort



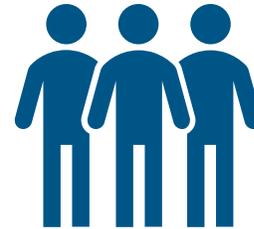
Source: Chetty et al., "The Fading American Dream: Trends in Absolute Income Mobility Since 1940"

Source: EPI analysis of unpublished Total Economy Productivity data from Bureau of Labor Statistics Labor Productivity and Costs program, Bureau of Economic Analysis National Income and Product Accounts data, and Current Population Survey Outgoing Rotation Group microdata

Economic insecurity and inequality

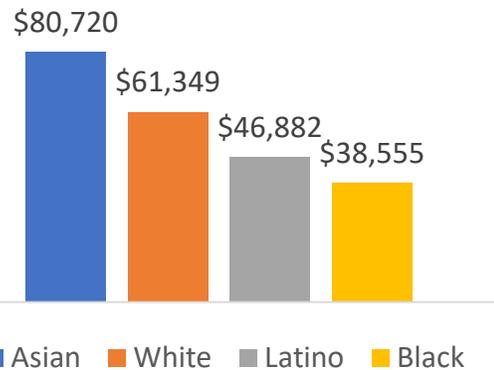


46%
of U.S. families can't manage a
\$400 emergency expense.¹

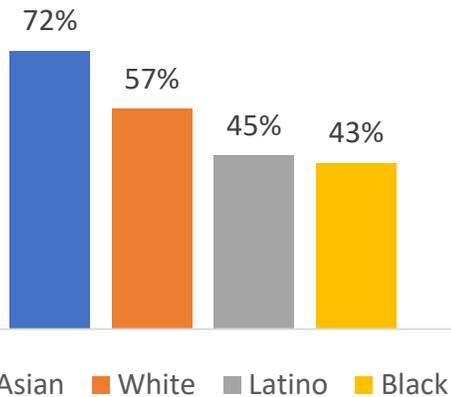


1 in 3
working Americans has
no retirement savings.²

Median Household Income³



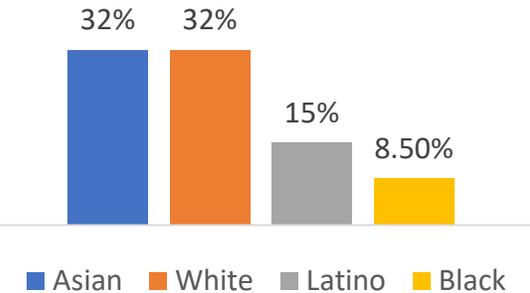
Home Ownership⁴



Median Wealth⁵



Median Share of Total Assets Invested in Financial and Business Assets⁶



Sources:

¹ Economic Well-Being of U.S. Households, 2015. Federal Reserve. <https://www.federalreserve.gov/2015-report-economic-well-being-ushouseholds-201605.pdf>

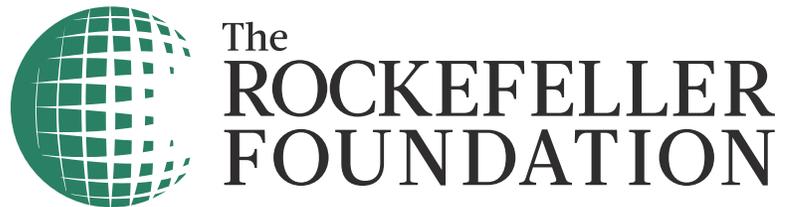
² Board of Governors of the Federal Reserve System (May 2015). Report on the Economic Well-Being of U.S. Households in 2014. Available at: <https://www.federalreserve.gov/econresdata/2014-report-economic-well-being-ushouseholds-201505.pdf#page45>

³ American Community Survey, U.S. Census Bureau, 2016. <https://www.census.gov/content/dam/Census/library/publications/2017/acs/acsbr16-02.pdf>

^{4,5} Pew Research Center, <http://www.pewsocialtrends.org/2016/06/27/1-demographic-trends-and-economic-well-being/>

⁶ Federal Reserve Board of St. Louis (Feb 2013). https://www.stlouisfed.org/~media/files/pdfs/hfs/essays/hfs_essay_1-2018.pdf

Rachel Korberg
Associate Director
The Rockefeller Foundation



What are Employee Stock Ownership Plans (ESOPs)?

- An ERISA qualified defined contribution benefit plan (like a 401k) that can buy equity of the company sponsoring the plan for the benefit of its employees.
- The only ERISA qualified plan permitted to borrow money to purchase employer stock; not required to be diversified.
- Shares can be purchased from selling shareholders or from company (as newly issued shares).
- Enacted by Congress in 1974 to provide a way for employees to participate in their company's equity appreciation; legislation provides significant tax benefits to selling shareholders *and* sponsoring corporations.

Key facts about ESOPs

- There are approx. 6,000 closely held ESOPs in the US covering close to 2 million employees.
- In most cases, ESOPs are created when business owners convert their equity to ESOPs when they retire.
- Most conversions to ESOPs are financed with debt (*leveraged ESOPs*), but some transactions use or include equity or equity-like investments (structured or preferred equity).
- Given the complexity of establishing and managing ESOPs, smaller firms (fewer than 50 employees) can convert to worker ownership via cooperatives.

Benefits of ESOPs – for workers

- Across ESOPs in the US, average asset wealth in shares per employee is \$134,000; it is close to a quarter of a million dollars for employees who have been with the firm > than 20 years.
- Employee share ownership, combined with a supportive corporate culture, is associated with higher quality jobs, as measured by compensation, benefits, employee retention and satisfaction.
- Companies with employee shares, such as through an ESOP, have shown greater resilience in economic downturns and have performed better than peer companies. In the most recent recession, companies with employee share ownership were less likely to lay off employees or close than companies without employee share ownership.

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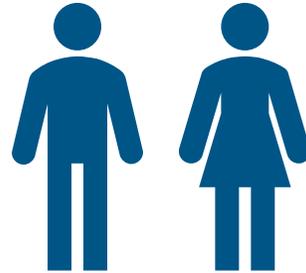
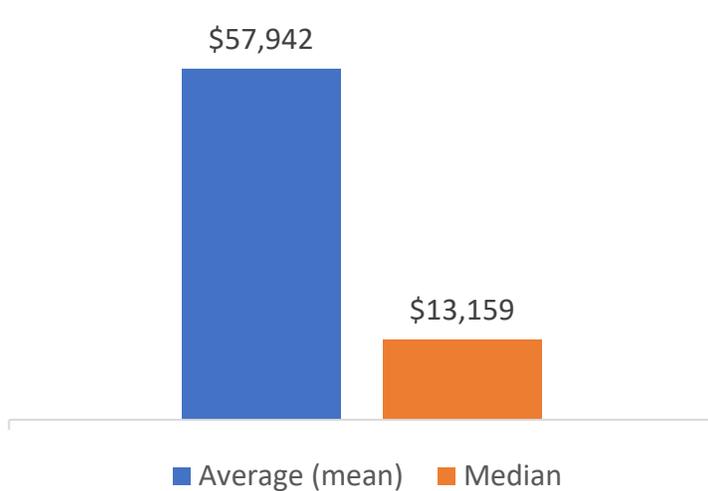
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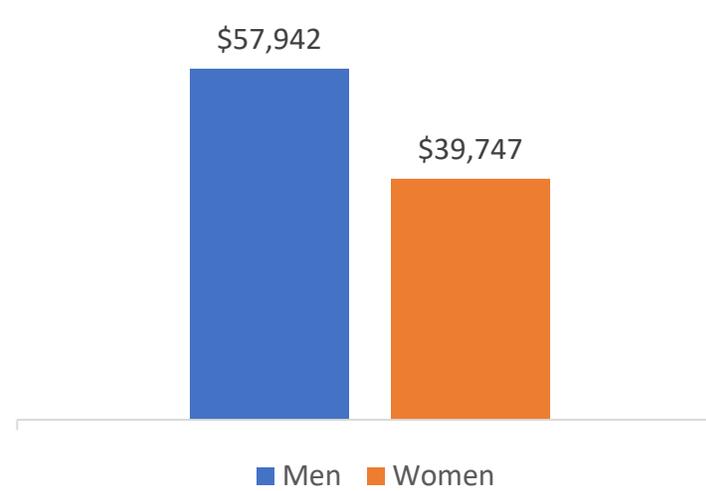
Equity considerations in ESOP participation



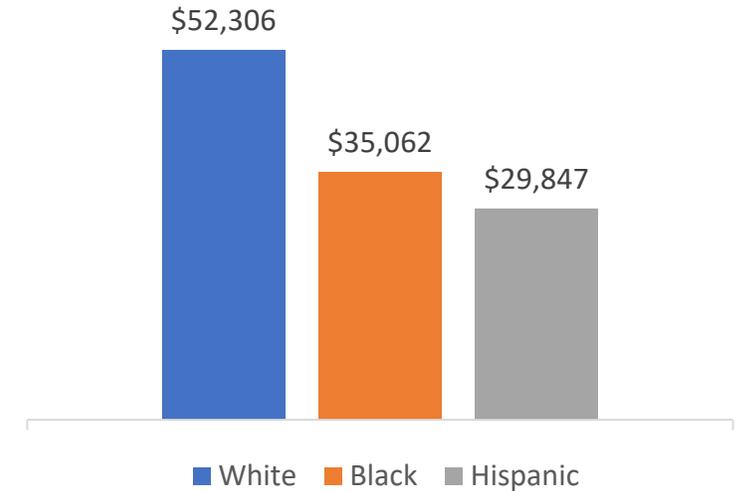
Value of Employee Share Wealth among Male Worker Owners



Average Value of Employee Share Wealth by Gender



Average Value of Employee Share Wealth by Race/Ethnicity



Benefits of ESOPs – for communities

Across the country, including in Opportunity Zones, there are **2.34 million small- to medium-sized businesses** owned by Baby Boomers who can be expected to retire in the next 10 years (Project Equity). These firms could involve...



24.7 million jobs



\$1 billion in payroll



\$1 billion in sales

What types of firms might create ESOPs in OZ communities?

- Grocery stores
- Convenience stores
- Fast-food and casual dining
- Drug stores
- Emergent health care
- Home health care
- Logistics/warehousing
- Hotels
- Apartment/property management
- Security services
- Manufacturing

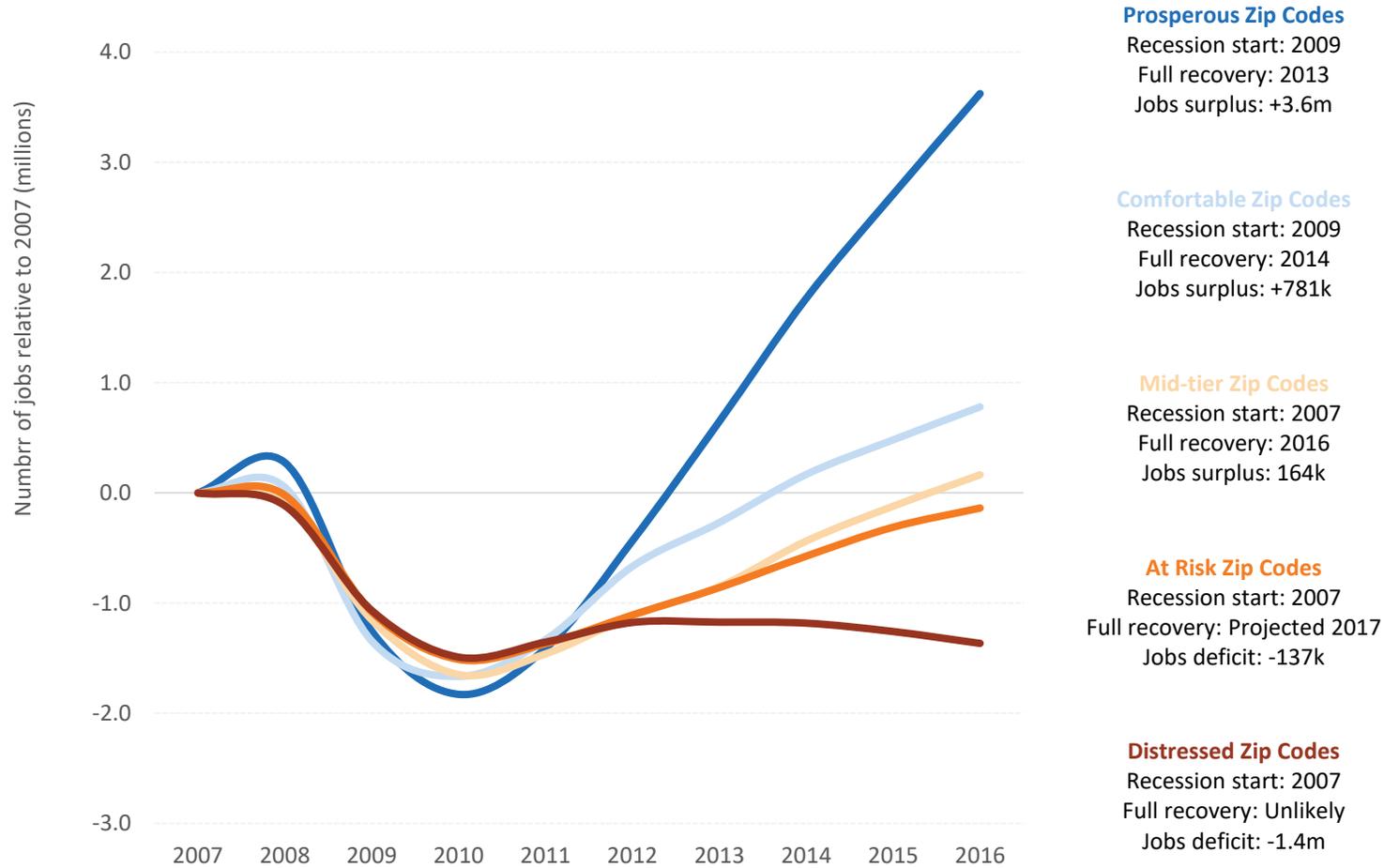
Catherine Lyons
Manager of Policy and Coalitions
Economic Innovation Group

ECONOMIC
INNOVATION
GROUP 

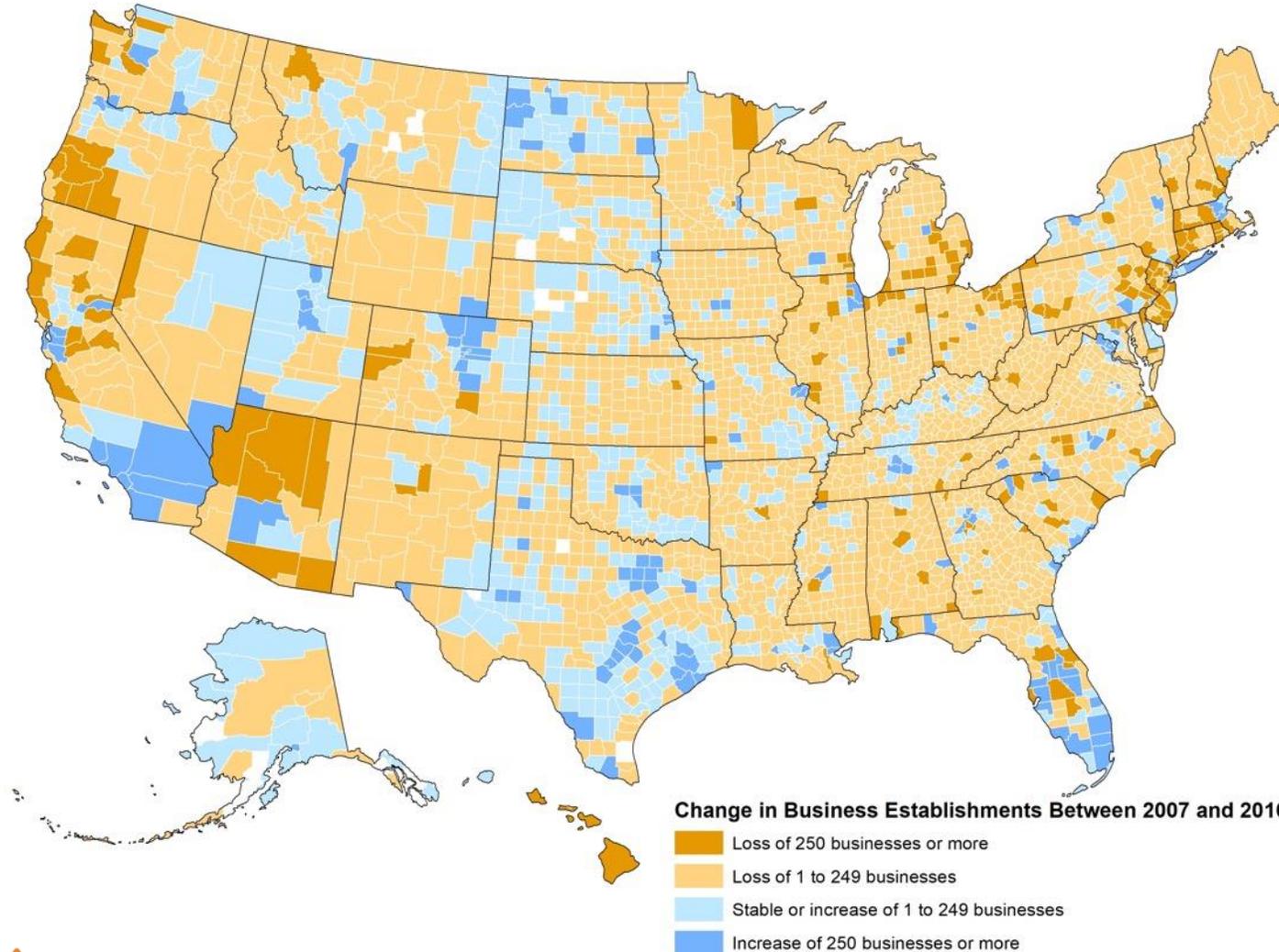


The basic concept of Opportunity Zones was forged in the fractured recovery.

Total change in employment since 2007 across zip code quintiles

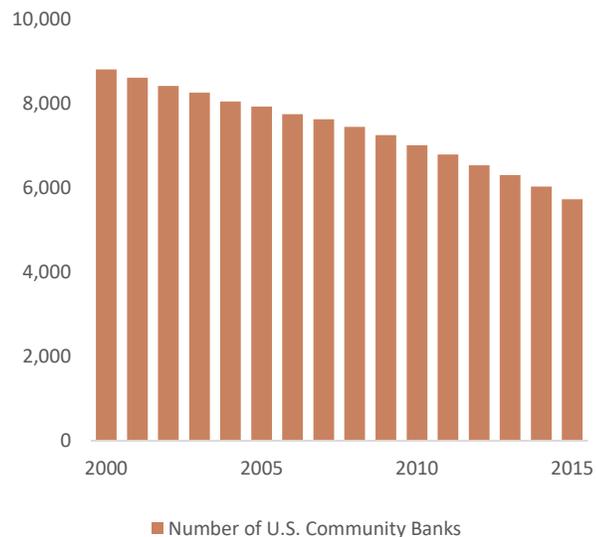


Three-quarters of counties have not recovered from the business closures of the recession.

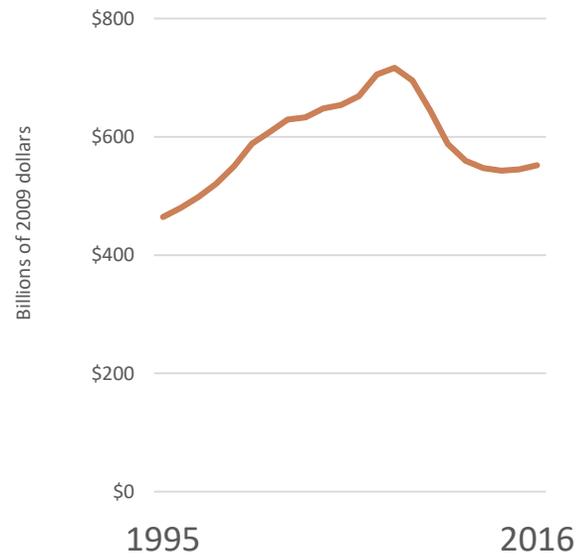


Uneven access to capital is now a threshold issue for addressing business formation in America.

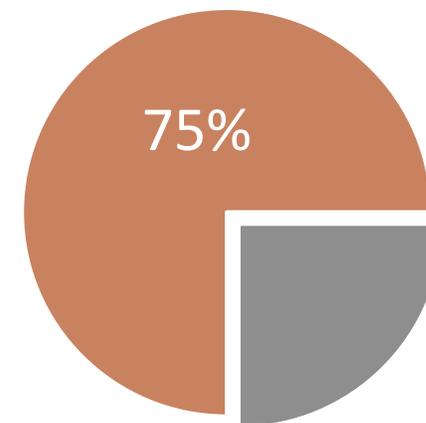
Nearly **one out of every four** community banks has disappeared since 2008



In real terms, small business lending remains **down by a quarter**



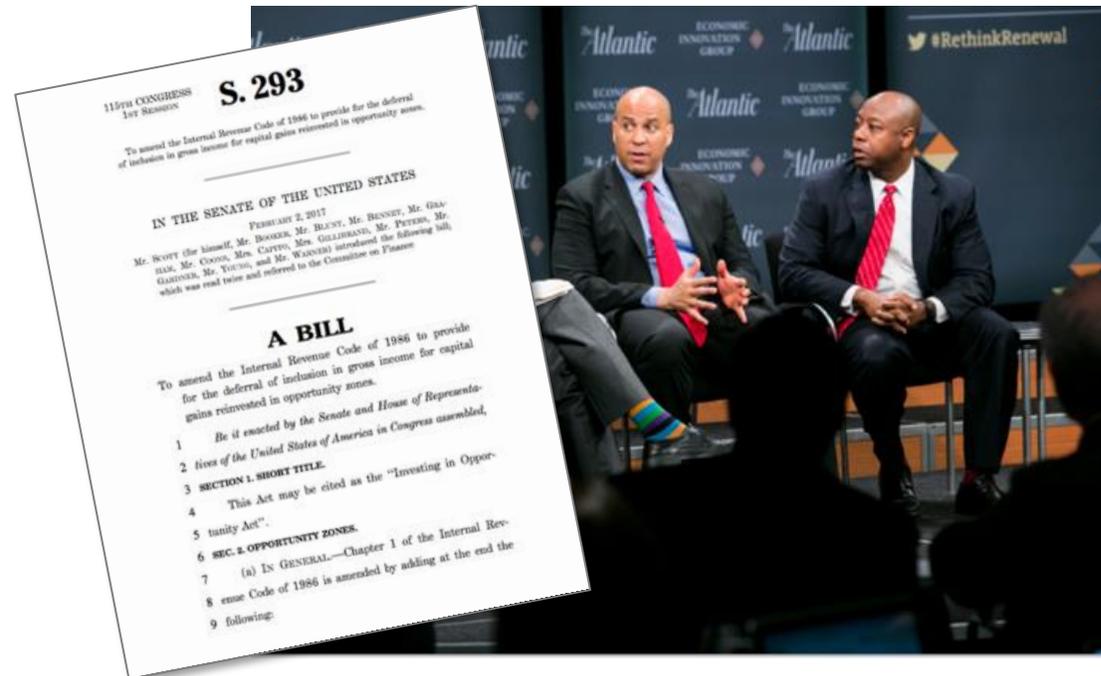
75% of all venture capital concentrates in three states: California, New York & Massachusetts



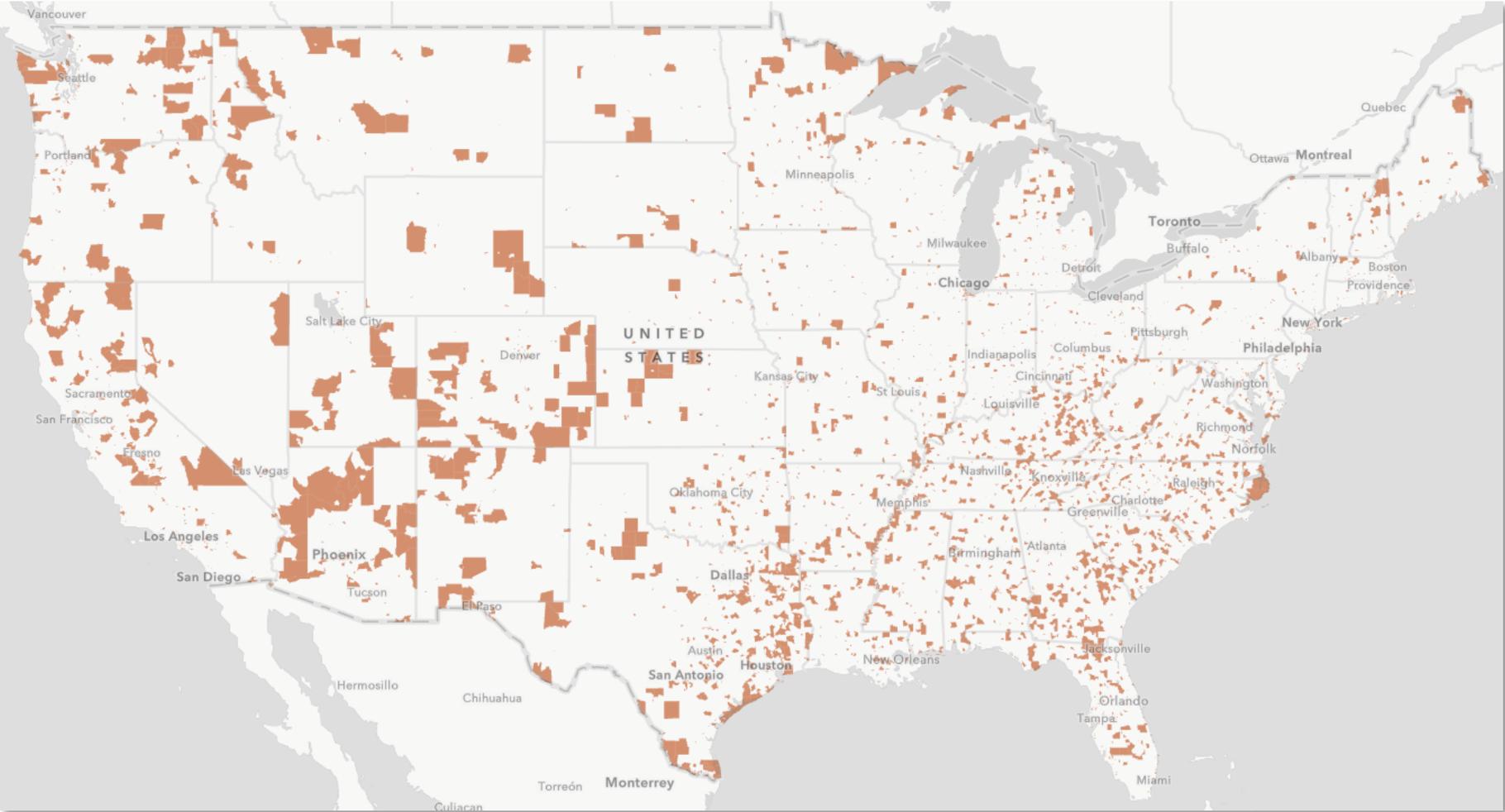
Opportunity Zones is designed to harness the returns of the recovery for investment into the communities it bypassed.

"Too many American communities have been left behind by widening **geographic disparities**... [Opportunity Zones] will unlock new private investment for communities where millions of Americans face the crisis of closing business, lack of access to capital, and declining **entrepreneurship**."

- *Senators Tim Scott and Cory Booker, Representatives Pat Tiberi and Ron Kind*

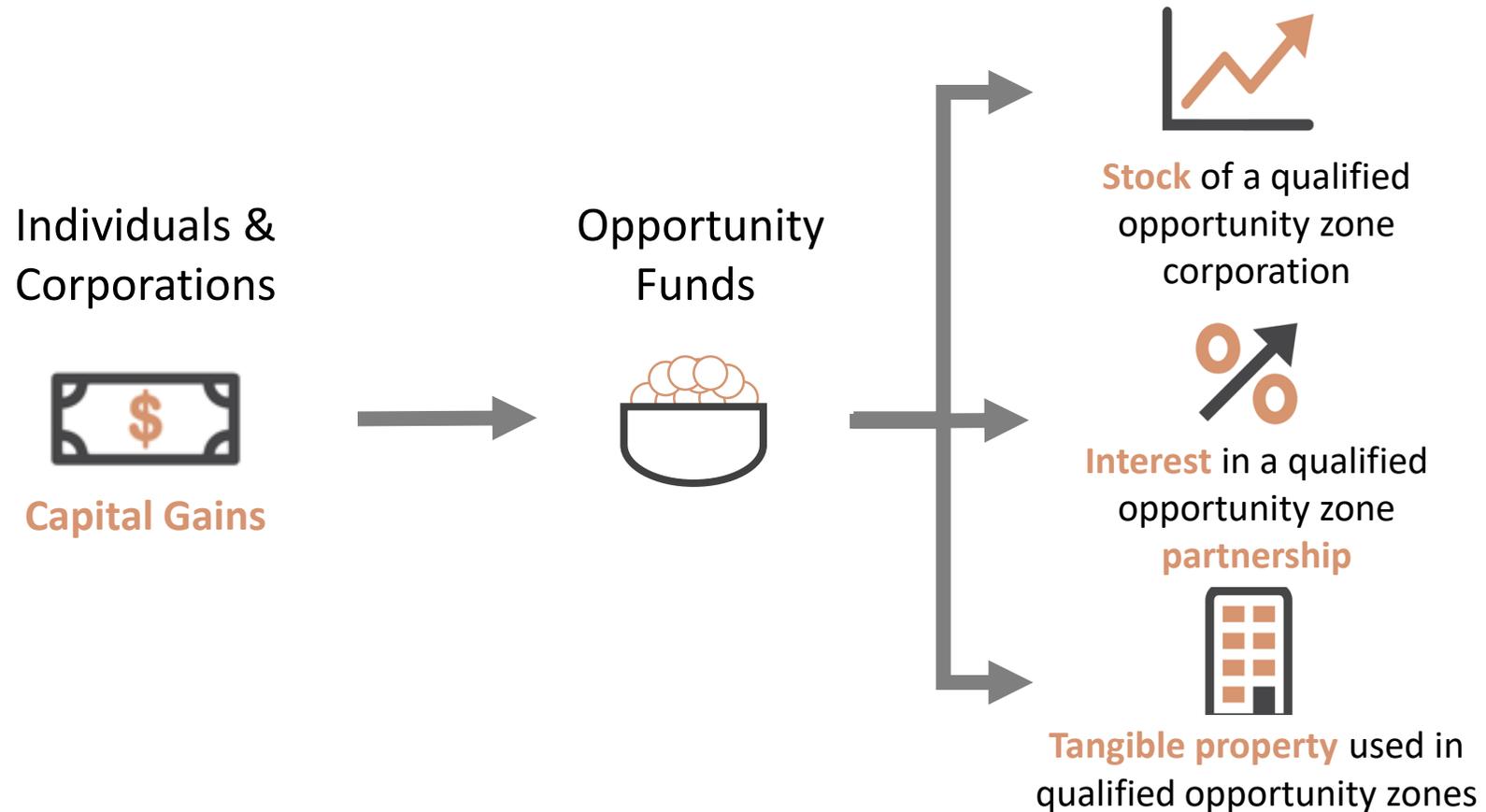


Over 8,700 census tracts across all 50 states, DC, and Puerto Rico are now certified Opportunity Zones.

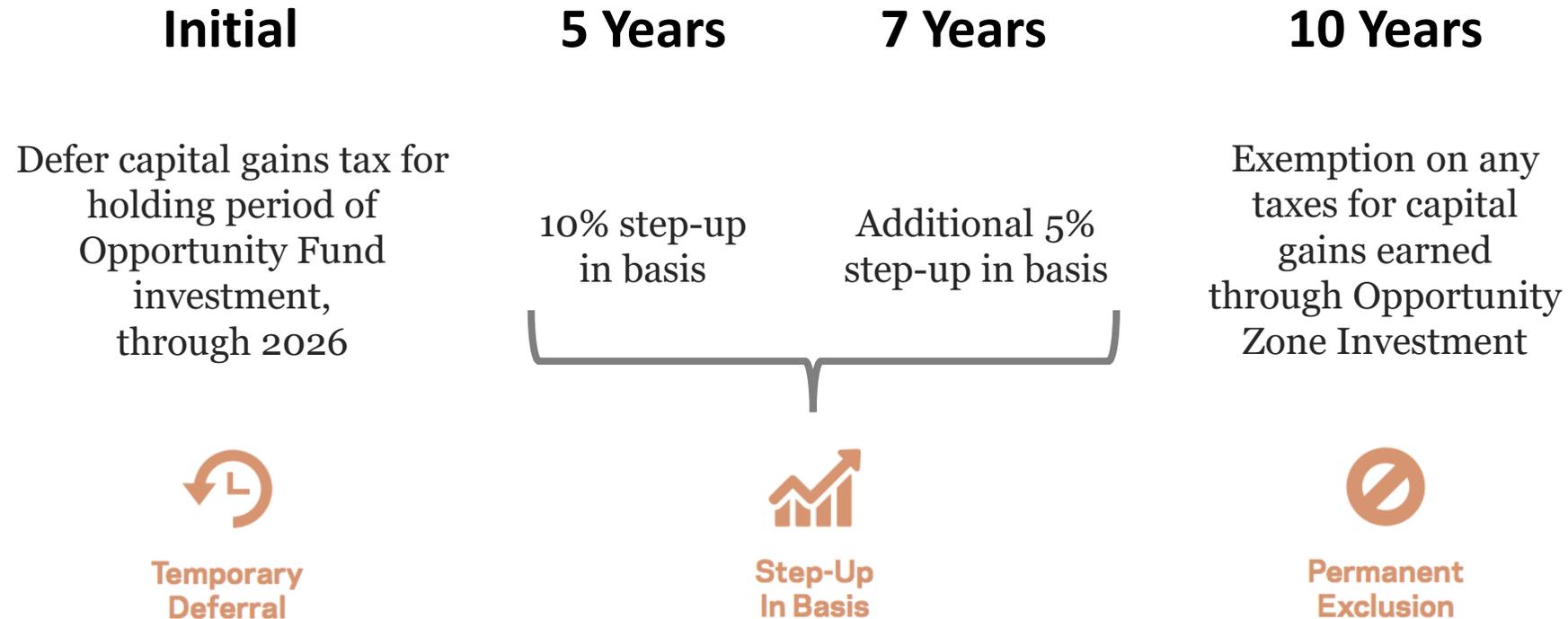


How does the incentive work?

Designed to spur the reinvestment of capital gains into underserved communities across the country.



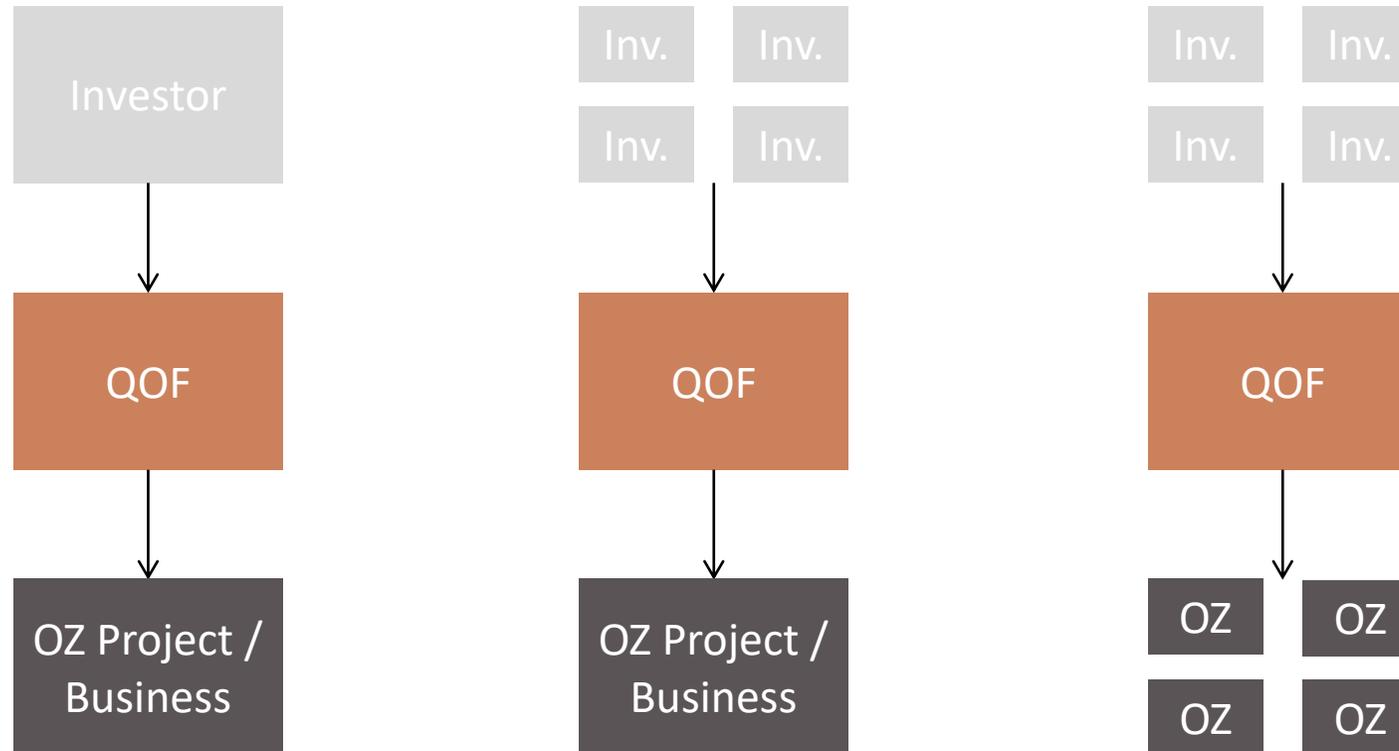
Incentive structure rewards patient capital.



Opportunity Funds are **the** critical intermediary.

- **All investments** that seek to benefit from the tax advantages of the program **must be made through an O-Fund.**
- The private sector is **responsible for establishing O-Funds**, although some public or civic sector entities may as well.
- Funds must **self-certify** to the IRS but face few restrictions or prescriptions by the IRS beyond basic compliance.
- Funds must invest at least **90% of their capital** in qualified investments in zones and will be audited twice yearly to ensure compliance.
- O-Funds will come in **many shapes and sizes**:
 - Some will invest nationally, others locally.
 - Some will have many investors, others few.
 - Some will specialize in particular asset classes,
 - Others will diversify across them.

A range of fund models are possible and will emerge as the market matures.



Opportunity Funds can finance a variety of investments in urban, rural, and suburban areas alike.



Startups



Housing



**Commercial
Developments**

Opportunity Funds can finance a variety of investments in urban, rural, and suburban areas alike.



Innovation Districts



**Brownfield
Redevelopment**



Energy Assets

Important Steps for Local Economic Development Leaders on Opportunity Zones

There are many entry points for local economic development leaders:

- Rallying investors to **commit capital**
- Nurturing **fund formation**
- **Activating** the business, philanthropic, and other communities
- Raising awareness among **entrepreneurs and growth companies**
- Raising awareness among **developers and real estate holders**
- Not just building a pipeline, but **charting a vision**
- Forging the **connective tissue** between capital and community
- Delivering the **workforce**
- **Protecting** long-time residents and managing growth
- **Anchoring** Opportunity Zones in something bigger

Next Steps for Opportunity Zones Regulations

The first round of proposed regulations were released by Department of the Treasury on October 19, 2018. The public has until December 28, 2018 to issue comments on the draft regulations. The draft rulemaking provided much-needed clarity on several issues, including:

- Clarification on partnership rules, types of funds (LLCs), and types of gains (capital gains only) that are eligible for the benefit
- Qualified Opportunity Fund timing
- Definition of “substantially all” for an Opportunity Zone business’s tangible property as 70 percent
- Clarification that the substantial improvement test requires the doubling of original basis of the building only, not the land

We need additional clarity on these issues to ensure successful implementation of OZs:

- 50 percent gross income test
- Determination of original use, other substantially all definitions, and substantial improvement for an operating business
- Timing for Qualified Opportunity Fund investment and reinvestment

Key questions about using Opportunity Funds in OZs

- To what extent can Opportunity Zone/Fund capital be used to invest in existing businesses (versus startups)?
- What types of regulatory or statutory changes are needed to enable Opportunity Funds to provide the types of capital used in ESOP conversions?
- How might ESOPs be used alongside or integrated into transactions or projects financed with Opportunity Fund capital?

Tomás Durán
President
Concerned Capital

**CONCERNED
CAPITAL**



Tomás Durán

President, Concerned Capital

- The value of workers owning their jobs
- How Concerned Capital supports employee share ownership
- How Opportunity Funds might fit into ESOP conversions (examples)
- Caveats and considerations

Questions?

For more information

- EOP: <https://www.aspeninstitute.org/programs/economic-opportunities-program/>
- EOP event and background information on employee share ownership: <https://www.aspeninstitute.org/events/having-stake-potential-employee-share-ownership-workers-businesses/>
- EIG info on Opportunity Zones: <https://eig.org/opportunityzones>
- Catherine Lyons contact: catherine@eig.org

Key takeaways

- There appears to be some potential to use Opportunity Fund capital to invest in some transactions that involve ESOPs.
- Regulatory clarity and perhaps statutory change is needed to allow Opportunity Fund capital to apply to a broader range of ESOP transactions.
- There is a lot of opportunity for creative thinking about approaches to integrating broad forms of employee ownership into development that takes place in Opportunity Zones:
 - Encourage real estate investment corporations created to manage real property in Opportunity Zones to create ESOPs to give employees an ownership stake in those investments?
 - Encourage existing corporations in Opportunity Zones to use ESOPs to allow employees to benefit from growth enabled by new capital investment?
 - Use ESOPs to exit from QOF investments at the end of the investment period?

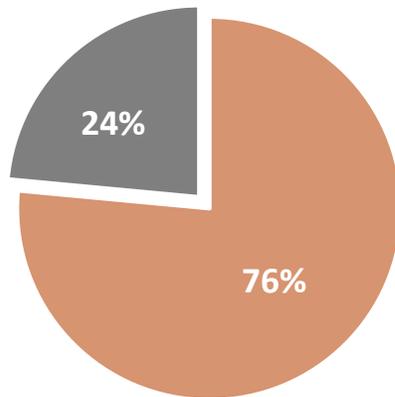


Opportunity Zones: Appendix

ECONOMIC INNOVATION GROUP / Washington, DC

Governors selected high-need, demographically diverse, and politically inclusive places with investment opportunity.

¾ of Opportunity Zones lie within metro areas



■ Metropolitan
■ Non-Metropolitan

10 percent of the country's population resides in zones



31.3 million residents

35.0 million including Puerto Rico and the other territories

There's a strong foundation on which to expand



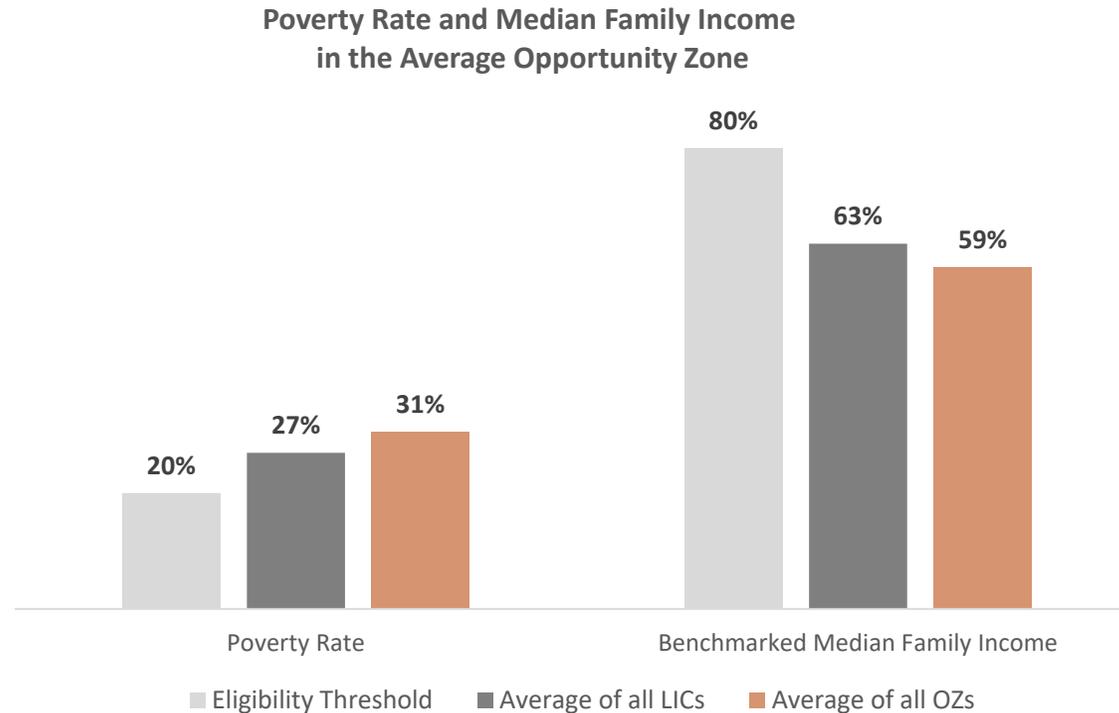
1.6 million business establishments



24 million jobs

Opportunity Zones far exceed the baseline eligibility requirements for economic need.

- Almost **70%** of the population in Opportunity Zones resides in a census tract that is “**severely distressed**” according to the CDFI Fund, meaning in a community with especially high poverty or unemployment rates, or especially low median family incomes.



How is Opportunity Zones different?

- ✓ It is **flexible** and designed to fit the full range of communities and needs.
- ✓ It is **scalable**: There is no appropriated cap on how much capital can move.
- ✓ It is **simple** and avoids the micromanagement of business models that limited the uptake of past programs.
- ✓ It is **market-oriented** and there are no applications to complete for individual projects. Investors can move at the speed of business.
- ✓ With no up-front subsidy, it shifts the **burden of risk** from taxpayers to investors.
- ✓ The fund model allows for **broad participation**.
- ✓ It can provide an **anchor** for local economic development strategies.

Frequently Asked Questions

Q: How were Opportunity Zones designated?

A: Low-income community census tracts are the building blocks of Opportunity Zones. Generally, low-income census tracts either have poverty rates of at least 20% or median family incomes no greater than 80% of the surrounding area's according to the 2011-2015 American Community Survey. Governors nominated up to 25% of all low-income census tracts in a state, territory, or commonwealth as Opportunity Zones.

Q: Do I need to live in an Opportunity Zone to take advantage of the tax benefits?

A: No. All you need to do is invest in a Qualified Opportunity Fund.

Q: I don't have capital gains. Can I still invest in an Opportunity Fund?

A: Yes, but only reinvested capital gains are eligible for the tax benefits.

Q: In practice, how do I actually defer my gains and begin investing in Opportunity Zones?

A: An investor has 180 days from the point of sale of an asset to re-invest all or part of the gain from that sale into a Qualified Opportunity Fund. Whatever portion of the gain that is invested into a fund is the portion on which taxes are eligible to be deferred. In practice, the election will be made on the taxpayer's Federal Income Tax return for that year.

For more, visit: <http://eig.org/opportunityzones/faq> or
<https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>