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OPPORTUNITY ZONES, COLLABORATIVE CAPITALISM, AND COMMUNITY BANKS: A PROPOSAL

Rashmi Dyal-Chand[*]

INTRODUCTION

This Essay proposes a very specific strategy for leveraging Opportunity Zone (OZ) funding to alleviate poverty, limit the harms of gentrification, and support the expansion of income-generating opportunities in OZs. The strategy builds on important work in urban cores that has been ongoing for decades. Briefly described, this Essay proposes significantly greater regulatory and programmatic support for community banks to leverage OZ funding to support local business networks. Part I of this Essay describes the importance of local business networks as drivers of poverty alleviation and economic development in urban cores, a good number of which have been designated as OZs. Part I argues that OZ funding should support such networks, and further that community banks have the potential to play a uniquely powerful role in these efforts. Part II of this Essay

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proposes a regulatory approach for enhancing opportunities for community banks to fulfill this potential.

At the outset, it is important to state a core assumption underlying this Essay that I and others have elaborated elsewhere in broader discussions of poverty alleviation and economic development.[1] The assumption begins with the recognition that the goals and strategies for poverty alleviation and local economic development can and do regularly conflict. It also acknowledges that the OZ program and predecessor programs such as the Clinton-era Empowerment Zones program may well have articulated the coequal prioritization of both goals, but that in practice they have prioritized economic development.[2] By contrast, this Essay assumes that it will be necessary for the OZ program to explicitly prioritize poverty alleviation above economic development.[3] This Essay's focus, therefore, is on programmatic and regulatory reforms to the OZ program that enhance its ability to alleviate poverty in areas designated as OZs.

I. COLLABORATIVE BUSINESS NETWORKS IN OPPORTUNITY ZONES AND THE VALUE ADDED BY COMMUNITY BANKS

Despite the newness of the Opportunity Zone program, there is already a growing consensus that OZ funding is not currently reaching those who most need it and would benefit from it.[4] This is because, as presently structured, OZs are too indirect a mechanism

1. *See generally* RASHMI DYAL-CHAND, COLLABORATIVE CAPITALISM IN AMERICAN CITIES: REFORMING URBAN MARKET REGULATIONS (2018) (discussing extensively, especially in Chapter 3, the reasons underlying this assumption and the literature discussing such reasons).

2. *See* Ellen P. Aprill, *Caution: Enterprise Zones*, 66 S. CAL. L. REV. 1341, 1344 (1993).

3. *See* DYAL-CHAND, *supra* note 1, at 57. For discussions of the goals of community development organizations, see WILLIAM H. SIMON, THE COMMUNITY ECONOMIC DEVELOPMENT MOVEMENT: LAW, BUSINESS, AND THE NEW SOCIAL POLICY 3–5 (2002); Rashmi Dyal-Chand & James V. Rowan, *Developing Capabilities, Not Entrepreneurs: A New Theory for Community Economic Development*, 42 HOFSTRA L. REV. 839, 851–52, 894 (2014); Scott L. Cummings, *Community Economic Development as Progressive Politics: Toward a Grassroots Movement for Economic Justice*, 54 STAN. L. REV. 399, 400–02 (2001); Michael E. Porter, *The Competitive Advantage of the Inner City*, HARV. BUS. REV., May–June 1995, https://hbr.org/1995/05/the-competitive-advantage-of-the-inner-city [https://perma.cc/DN39-UGTZ].

4. Robert Frank, *'Opportunity Zones' Fall Short on Helping Low-Income Communities, Study Finds*, CNBC (June 17, 2020, 12:50 PM), https://www.cnbc.com/2020/06/17/opportunity-zones-fall-short-on-helping-low-income-communities-study.html [https://perma.cc/AHP5-QQ4R].

for poverty alleviation. They rely too much on the assumption that investments in larger businesses without direct ties to neighborhoods designated as OZs will spread the benefits of those investments to local residents.[5] In reality, according to a mid-2020 report:

> Almost 97% of the more than $10 billion raised by opportunity funds so far has been raised by funds focused on commercial or residential real estate . . . . Much of that money likely will be spent on projects that have been in the works for years and have a high expected return, such as high-end apartment buildings.[6]

A recent, detailed analysis by Michelle Layser supports this conclusion.[7] Analyzing data from the New Markets Tax Credit (NMTC) program, Layser concludes that both the NMTC program and the OZ program will likely produce "inefficient and inequitable" outcomes, often because they invest in gentrifying neighborhoods.[8] In short, the OZ program assumes too much that beneficial spillovers will occur from investments tied only to geography.[9]

Reports such as this indicate that it is imperative that the OZ program be reformed to provide substantial investments directly to

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5. A 2020 Urban Institute report notes, "The OZ incentive is distinctive in that . . . it allows [Qualified Opportunity Funds] to self-certify, meaning they are not required to have a social-impact mission, nor to be governed or advised by community members . . . . [T]he OZ program provides no opportunity for citizen input about proposed projects, or even a role for a state or local government . . . to prioritize the types of projects that should receive incentives once the state government has selected its Zones." BRETT THEODOS ET AL., URB. INST., AN EARLY ASSESSMENT OF OPPORTUNITY ZONES FOR EQUITABLE DEVELOPMENT PROJECTS: NINE OBSERVATIONS ON THE USE OF THE INCENTIVE TO DATE 12 (2020), https://www.urban.org/sites/default/files/publication/102348/early-assessment-of-opportunity-zones-for-equitable-development-projects.pdf [https://perma.cc/884A-QB65].

6. Sophie Quinton, *Black Businesses Largely Miss Out on Opportunity Zone Money*, PEW (June 24, 2020), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2020/06/24/black-businesses-largely-miss-out-on-opportunity-zone-money [https://perma.cc/9U3Y-4P6V].

7. Michelle D. Layser, *Subsidizing Gentrification: A Spatial Analysis of Place-Based Tax Incentives*, UC IRVINE L. REV. (forthcoming 2021) (manuscript at 60).

8. *Id.* (finding "the Opportunity Zones law overwhelmingly rewards profit motive and are more likely than NMTC investors to actively seek profit opportunities in gentrifying areas").

9. As one commentator recently observed about Opportunity Zones: "The initial idea was that they're going to be opportunity zones, and that it would be targeted towards low- and moderate-income communities, and it is by geography, but by no other targeting." Lydia O'Neal & David Hood, *Local Lenders Stay Sidelined as Cash Flows to Opportunity Zones*, BLOOMBERG TAX (Nov. 30, 2020, 4:46 AM), https://news.bloombergtax.com/daily-tax-report/local-lenders-stay-sidelined-as-cash-flows-to-opportunity-zones [https://perma.cc/ME47-4S4W] (quoting Michael Swack, director of the University of New Hampshire's Center for Impact Finance).

the long-time residents of OZs. Furthermore, such financial investments must include investments not only in housing but also in the development of local jobs and other income-generating opportunities. While affordable housing is crucial, the OZ program (like the Enterprise Zones and Empowerment Zones programs before it) must play a significant role in providing long-term financial support for the development of stable, income-generating opportunities.[10] In particular, as has been argued elsewhere, by supporting small, local businesses started and owned by local residents, such programs can provide deep systemic support for the creation and maintenance of local jobs, career ladders, and local business ownership.[11]

Given its limitations as a tax benefit program, it is good news that OZ investments do not have to be made on a blank canvas. The primary task of the OZ program need not be to find market opportunities and support the creation of new businesses or business clusters. Successful small businesses already exist in urban cores across the country.[12] However, while some of these businesses have been successful for decades, most are under-capitalized. In a recent book, *Collaborative Capitalism in American Cities: Reforming Urban Market Regulations*, I used a case study methodology to examine such businesses, focusing in particular on what I termed "collaborative business networks."[13] Collaborative business networks, which exist in many OZs, could certainly benefit from financial investments. Thus, a highly efficacious use of OZ funding would be to target such networks with long-term financial investments. To develop this argument, it is important first to

10. Like the OZ program, the Enterprise Zones and Empowerment Zones programs were tax benefit programs intended to channel private dollars into urban cores, with the explicit intent to fuel business development among other goals. Indeed, business and job development were the explicit goals of the Enterprise Zone program, though it is widely described as producing mixed results. *See* Aprill, *supra* note 2, at 1344; *see also* Audrey G. McFarlane*, Race, Space, and Place: The Geography of Economic Development*, 36 SAN DIEGO L. REV. 295, 324–25 (1999).

11. *See* Dyal-Chand & Rowan, *supra* note 3, at 901; *see also* Roger A. Clay, Jr. & Susan R. Jones, *What Is Community Economic Development?*, *in* BUILDING HEALTHY COMMUNITIES: A GUIDE TO COMMUNITY ECONOMIC DEVELOPMENT FOR ADVOCATES, LAWYERS, AND POLICYMAKERS 3, 11 (Roger A. Clay, Jr. & Susan R. Jones eds., 2009). *See generally* Susan R. Jones, *Small Business and Community Economic Development: Transactional Lawyering for Social Change and Economic Justice*, 4 CLINICAL L. REV. 195 (1997).

12. *See generally* DYAL-CHAND, *supra* note 1.

13. *See id.* at 1–13. Portions of this Part originally appeared in the book and are being published with permission but have been revised for this Essay.

describe such networks more fully and also to consider why they are particularly well-suited to poverty alleviation efforts.

While collaborative business networks vary widely in their structures, industries, locations, and other characteristics, there is a clear pattern in their approach. As I wrote in the book,

> The most important commonality is that the ventures involve networks of businesses that collaborate with each other. Their collaboration typically entails the sharing of key resources — such as training and vocational education, labor, financing, market data, suppliers and supplies, management expertise, and physical space — as a means of reducing costs for the network as a whole and for each business in the network. The sharing also typically makes use of local ties to instill a strong connection to a local community. Often this means that the businesses in the network have multiple "bottom lines." And the sharing within these networks consistently produces long-term, stable income for the workers.[14]

In particular, collaborative business networks have six defining features.[15] While all of these criteria seem critical to the operation and success of collaborative business networks, they do not necessarily constitute an exhaustive list. The first three criteria describe the particular form of collaboration of these networks. First, businesses involved in collaborative business networks typically share extensively within a closed network that operates in a discrete market, defined both geographically and by industry or market sector.[16] Within this literal and figurative space, the businesses involved in the network act in a coordinated or collective manner.[17] They share a great deal of information and other resources that each business would typically have to acquire and manage on its own, but the businesses instead share within the entire network.[18]

A second core feature of such networks is that they involve one or more institutions that serve as the glue among the businesses, helping them to share and to act in a coordinated manner.[19] Regularly such institutions, which include local nonprofits, unions, and financial institutions, act on the collective behalf of the small businesses. They

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14. *Id.* at 5.
15. *Id.* at 61.
16. *Id.* at 61–64.
17. *See id.*
18. *Id.*
19. *See generally* Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism*, *in* VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1 (Peter A. Hall & David Soskice eds., 2001).

also regularly support the ability of such businesses to prioritize goals beyond profit making.

The third feature, which also fundamentally defines the form of collaboration, is that the businesses within the networks coordinate in a way that lowers their individual costs of doing business.[20] They also regularly manage risk in a coordinated manner.[21] Again, by doing so, they externalize to the network as a whole the costs and risks that each individual business would otherwise bear. It is reasonable to expect that this behavior has helped many of the businesses involved to perform better than they otherwise would have, including by surviving for longer than the average start-up small business.[22]

The other three core features of such networks are not definitional of the form of collaboration, but rather seem crucial to the success of these networks in alleviating poverty, providing stability to their workers, and even spurring stable economic development in urban cores. The fourth feature is that the businesses involved in these networks seem to prioritize goals other than, and in addition to, profit making.[23] These goals can include poverty alleviation, local hiring, worker democracy, environmental sustainability, neighborhood revitalization, and other priorities.[24] The explicit prioritization of these multiple bottom lines seems to drive many of the decisions of these businesses, including at times by providing an incentive to share.

The fifth feature is that the various stakeholders in the businesses, including the management, workers, financing sources, customers, and suppliers are predominantly insiders.[25] The status of insider is very often defined geographically.[26] It is also regularly defined by social and ethnic ties.[27] While the multiple and close forms of connection within these networks seem related to the successful definition of market niches and other business imperatives, these connections also provide a level of investment in, and even

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20. DYAL-CHAND, *supra* note 1, at 66.
21. *See id.*
22. *See id.* at 51–55 (reviewing the literature on small business success in the United States).
23. *See id.* at 66–67
24. *See id.*
25. *Id.* at 67.
26. *Id.*
27. *Id.* at 61.

accountability to, the local communities in which these networks operate.[28]

Finally, and relatedly, a core feature of these networks is that they typically operate within a niche market or industry.[29] Moreover, these market niches typically are responsive to local community needs, providing special products or services for such communities.[30] Often the particular niches are also especially responsive to the coordinated behavior of the businesses.[31]

As to the question of why collaborative business networks are so well-suited to poverty alleviation, the answer is straightforward: these networks tend to focus on maximizing value for the benefit of the long-term, often low-income, residents of the area.[32] The businesses in the network cut the costs of doing business by sharing resources so that each can have a better chance of success. The fact that they do so alongside a commitment to hiring local and low-income residents allows these successes to accrue to those in the urban core most in need of the public and private investments in that network. This approach has been especially efficacious in markets where competition has traditionally involved cutting wages to remain competitive in the pricing of services.[33]

Thus, this collaborative form of doing business is a better choice for urban core contexts because of the multiple bottom lines that involve a worker-centered approach. By supporting collaborative business networks that have succeeded in promoting a fuller range of goals, policymakers can respond more directly, accurately, and successfully to the needs of residents in OZs. In short, collaborative business networks are an ideal choice for Opportunity Zone investments.

The final piece of the argument about an ideal strategy for leveraging OZ funding is not only that the OZ program should target collaborative business networks in OZs but that it should rely on community banks both to find such networks and to channel OZ funding to such networks. Indeed, my book examines the role of community banks, focusing specifically on a case study in which a major community development bank, ShoreBank in Chicago,

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28. *Id.* at 67.
29. *Id.* at 68–69.
30. *Id.*
31. *Id.*
32. *Id.* at 69.
33. *See id.* at 43. *See generally id.* at 17–49.

supported a network of residential apartments-rehabbing businesses for decades.[34]

As the research underlying the book suggests, banks situated within collaborative business networks may well be the most powerful means of supporting such networks, because community banks have a unique potential to support the early development as well as the ongoing stability of businesses participating in collaborative business networks.[35] For example, because of its multiple bottom lines, ShoreBank worked as a collaborative partner alongside the rehabbing businesses in the network.[36] It provided a steady stream of capital that was readily accessible without many of the usual constraints imposed by private banks. It grew clients over the course of decades. It tailored repayment terms to its borrowers' needs, thereby making debt financing less risky overall. In the United States, a community bank of this sort may well be the ideal financing source for an urban collaborative business network.[37]

By extension, it is reasonable also to conclude that banks situated adjacent to such networks, even if not necessarily within them, are well positioned to support the businesses in such networks and beyond. Reliable studies indicate that community banks provide significantly more financing to small businesses than their aggregate lending share.[38] Thus, it is likely that such banks are more informed about local businesses than other financing sources would be.

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34. *See id.* at 75–117.

35. *Id.* at 177, 260. For a far more extensive discussion of this issue, see Chapters 4, 7, and 10. *See id.*

36. *Id.* at 230.

37. *See id.* at 114 (explaining that, from "lowering critical costs, to prioritizing a focus on local neighborhood development, to finding and exploiting an ideal niche market, [Shore]Bank . . . did the work that several coordinating intermediaries typically do together in national coordinated economies").

38. *See* FED. DEPOSIT INS. CORP., FDIC COMMUNITY BANKING STUDY 4-1 (2020), https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf [https://perma.cc/79ND-GC78] (finding that, although "community banks tend to be relatively small, . . . their lending far exceeds their aggregate lending share"); *see also* Frank Sorrentino, *Community Banks Play Critical Role in Helping America's Small Businesses Get Back to Business*, FORBES (Apr. 24, 2020, 2:21 PM), https://www.forbes.com/sites/franksorrentino/2020/04/24/community-banks-play-critical-role-in-helping-americas-small-businesses-get-back-to-business/?sh=5c1fa4c514af [https://perma.cc/ZS6X-YB3X] ("[I]t's no surprise that community and regional banks were better positioned to service their clients efficiently amidst COVID-19. Community banks have established relationships with clients, can be nimble and operate through a relationship banking model, have deep personal knowledge of clients and the communities they serve, which in turn allows faster and more efficient engagement.").

Moreover, even if such banks are not aware of local networks, they have the means to become aware of them, so long as they receive proper resources and incentives. By hiring and training local loan officers, who are from the communities they serve, community banks can access local knowledge and networks in order to find businesses that have the potential to succeed.[39] Indeed, there is every reason to believe that local loan officers would do a better job of finding worthy borrowers, and accurately assessing their creditworthiness, than other local institutions such as policy or planning agencies. Not only would such officers have the ability to develop the necessary knowledge to do so, they also would have the incentive.[40] Thus, in terms of raw impact, the best way to generate something akin to patient capital, namely financing that is maintained "even in the face of adverse short-term conditions,"[41] for collaborative business networks may be to channel financing through local banks.

II. REGULATORY REFORMS TO HARNESS THE POWER OF COMMUNITY BANKS

This Part takes up the challenge of how best to harness the power of community banks as a mechanism for providing direct, long-term financial investments to collaborative business networks and other successful — but undercapitalized — businesses in OZs. While policymakers and scholars have raised promising regulatory approaches, they lack the programmatic efficiency of providing OZ funding directly to community banks, which is what this Essay proposes. This approach also has the benefit of requiring minimal and straightforward regulatory changes.

Presently, community banks and other lenders cannot be OZ businesses.[42] This is because a business can only qualify as a "qualified opportunity zone business" if "substantially all of the

39. *See* Kylee Wooten, *Measuring What Community Banks Bring to the Table,* ABA BANKING MKTG. (Apr. 24, 2019), https://bankingjournal.aba.com/2019/04/measuring-what-community-banks-bring-to-the-table/ [https://perma.cc/QS3W-TAD7]; Mark Scott, *Making a Difference: The Role of a Community Bank*, SMART BUS. (Nov. 1, 2016, 12:14 AM), https://www.sbnonline.com/article/making-difference-role-community-bank/ [https://perma.cc/52HR-48XK].

40. This is exactly the expectation that was articulated by ShoreBank employees and borrowers on the basis of decades of experience. *See* DYAL-CHAND, *supra* note 1, at 80.

41. Richard Deeg & Iain Hardie, *'What is Patient Capital and Who Supplies It?,'* 14 SOCIO-ECON. REV. 627, 627 (2016).

42. *See* O'Neal & Hood, *supra* note 9.

tangible property owned or leased by the [business] is qualified opportunity zone business property."[43] This in turn, requires that less than 5% of the property owned by an OZ business be "nonqualified financial property."[44] However, a large portion of the assets of community banks are loans, which are deemed "nonqualified financial property" by the Internal Revenue Code.[45]

It is a significant lost opportunity that community banks cannot qualify as OZ businesses, because they are unable to receive the greatest and most direct benefit of the OZ program. Specifically, the OZ program provides a vehicle for direct, long-term, financial investments in businesses in areas designated as OZs.[46] Because community banks cannot qualify as OZ businesses, they cannot receive these investments.

It is reasonable to ask why it is so important for banks to be OZ businesses. What could justify investing directly in community banks rather than in the businesses and residents to whom such banks provide financial services? Indeed, these questions seem particularly salient because community banks can still support the OZ program in significant ways. For example, and perhaps most importantly, community banks can boost the value of OZ investments by providing additional financing to businesses that receive such investments.[47] Relatedly, banks can facilitate OZ financing to local businesses by serving as advisors and brokers, especially when OZ financing is part of a complex financing package that may involve New Markets Tax Credits or other similar programs.[48] They can also

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43. I.R.C. § 1400Z-2(d)(3)(A)(i).

44. *See id.* § 1400Z-2(d)(3)(A)(ii).

45. *Id.* § 1397C(e) ("For purposes of this section, the term 'nonqualified financial property' means debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property specified in regulations . . . .").

46. *See* RACHEL REILLY CAROLL, ENTER. CMTY., OPPORTUNITY ZONES PROGRAM: AN EARLY OVERVIEW OF PROGRAM DETAILS AND WHAT'S AHEAD 2 (2018), https://www.enterprisecommunity.org/download?fid=8856&nid=6212 [https://perma.cc/YM2A-3P8R]; *see also* John Sciarretti, *What's Next for Opportunity Zones?*, NOVOGRADAC (Oct. 22, 2020, 12:00 AM), https://www.novoco.com/notes-from-novogradac/whats-next-opportunity-zones [https://perma.cc/BD43-GN5G].

47. David Black, *Leveraging Qualified Opportunity Funds in Bank Community Development Strategies*, *in* COMMUNITY DEVELOPMENTS INVESTMENTS: STRENGTHENING COMMUNITIES WITH OPPORTUNITY ZONE INVESTMENTS 4, 5 (2021), https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-investments/jan-2021/pub-ca-cdi-newsletter-jan-2021.pdf [https://perma.cc/SW4T-895H].

48. *See id.*

provide financing to other participants in an OZ transaction, such as investors in an OZ Fund, or to the Fund itself.[49] However, as the remainder of this Part explains, direct OZ investments in community banks are crucial because they increase both the likelihood that OZ investments will reach the neediest recipients of OZ funds and the efficiency with which such recipients can access OZ support.

Indeed, this recitation of the currently available modes for community banks to participate in the OZ program also reveals its major weaknesses: the OZ program is currently too indirect and too complex to be an effective vehicle for investment in OZ areas.[50] It is time consuming and expensive for community banks to participate in the indirect ways described above. For one thing, banks require capital to provide financing for OZ deals. However, such capital is hard to come by and often is not risk free. In 2019, the average asset size of community banks, which the Federal Deposit Insurance Corporation (FDIC) defines as banks that provide "traditional banking services in their local communities,"[51] was $0.47 billion.[52] Meanwhile, the average asset size of noncommunity banks was $38.4 billion.[53] This difference in asset size has typically meant that community banks have to play it safe in their lending portfolios in order to continue to meet safety and soundness requirements.[54] Thus, for example, even though community banks provide more debt financing to small businesses than that provided by national banks,[55] the majority of investments made by such banks still prioritize safety

49. *See id.* at 5.

50. *See, e.g.*, Quinton, *supra* note 6.

51. FED. DEPOSIT INS. CORP., *supra* note 38, at I.

52. *Id.* at 2–8.

53. *Id.* ("[F]rom 1984 to 2019 community banks grew roughly in line with the U.S. economy. The average asset size of noncommunity banks in 2019, however, was more than 38 times their average size in 1984, since their growth during that 35-year period far outpaced that of the broader economy . . . . Between 2012 and 2019, the share of banking industry assets held at community banks declined from 14 percent to 12 percent of the total, down from a high of 38 percent in 1984.").

54. *See* Arthur E. Wilmarth, Jr., *A Two-Tiered System of Regulation Is Needed to Preserve the Viability of Community Banks and Reduce the Risks of Megabanks*, 2015 MICH. ST. L. REV. 249, 341–42 (2015); *see also* Clifford Rosenthal, *Credit Unions, Community Development Finance, and the Great Recession*, 22, 43, 46–47 (Fed. Rsrv. Bank of S.F., Working Paper No. 2012-01, 2012).

55. FED. DEPOSIT INS. CORP., *supra* note 38, at VII ("Despite holding only 15 percent of total industry loans in 2019, community banks held 36 percent of the banking industry's small business loans.").

and soundness principles in ways that overly limit their ability to take risks in supporting small businesses.[56]

Moreover, while banks have the expertise to serve as advisors for OZ deals, the financial incentive to do so is lacking.[57] Meanwhile, the need for community banks to serve as advisors bespeaks the difficulty that local businesses and residents have in accessing OZ funding without the help of knowledgeable advisors.[58]

Recent data about who exactly has been able to make productive use of OZ financing bear out my analysis. Perhaps most troublingly, very few Black-owned businesses have been able to take advantage of OZ financing.[59] One commentator likened OZ funding to the Paycheck Protection Plan in that it "failed to reach many minority small-businessowners, who lack banking relationships."[60] Brett Theodos of the Urban Institute captured the overarching sentiment of investors evaluating OZ opportunities: "What we found, looking at community benefit projects, is they're just hard to do, period."[61] The perceived difficulty, an obvious version of the long-entrenched information asymmetries that worry lenders and investors in urban cores,[62] has resulted in very few investments in businesses that are truly local.[63]

Similarly, the apparent assumption made by federal policymakers that community banks could lend their expertise to create an efficient pipeline of OZ financing directly to local businesses also seems unfounded. A November 2020 article in *Bloomberg Tax* opened with the following observation: "Lenders that have historically provided capital to underserved areas — the focus of the opportunity zone tax breaks — have struggled to get involved in the burgeoning market for

56. *See, e.g.*, Lee Grayson, *Community Bank vs. Commercial Bank*, CHRON, https://smallbusiness.chron.com/community-bank-vs-commercial-bank-42524.html [https://perma.cc/KJ92-Q96U] (last visited Sept. 5, 2021) ("Community banks frequently operate under legal restrictions to avoid investments that put your business money at risk.").

57. Wilmarth, *supra* note 54, at 341–42.

58. *See* Quinton, *supra* note 6.

59. *See id.*

60. *Id.*

61. *Id.*

62. *See generally* Michael Klausner, *Market Failure and Community Investment: A Market-Oriented Alternative to the Community Reinvestment Act*, 143 U. PA. L. REV. 1561 (1995); Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981).

63. *See* THEODOS ET AL., *supra* note 5, at V–VII. "OZ incentives are not structured to encourage resident or community engagement . . . ." *Id.* at V.

the tax-advantaged investments."[64] As the article described, of the 1,100 community development financial institutions (CDFIs) in the United States, "just a handful have managed to participate, and they cite a laundry list of barriers, including an inability to take investments themselves."[65] The article cited the design of the OZ program and other IRS regulations as impeding access for CDFIs.[66] Meanwhile, OZ financing has generated billions of dollars, much of which has not reached the neediest of communities despite giving OZ investors significant tax benefits.[67]

These reports about the early effects of the OZ program all lead to the conclusion that it would make a tremendous difference to allow community banks to qualify as OZ businesses. As one commentator has noted: "Unless you have more specific targeting of who the beneficiaries are, it's not going to work."[68]

"Someone needs to underwrite the underwriters." This was a phrase that originated among the managers of ShoreBank, which was the biggest community financial development institution in the country before it closed in 2010.[69] Although this phrase originated well before the OZ program was created, it captures the need for access to *low-risk financing* for those institutions that are best positioned to provide financing to long-time residents of OZ communities. To demonstrate the enormous utility of underwriting the underwriters using OZ funding, let me address each of these pieces in turn, beginning with the utility of direct OZ financing for community banks and then turning to the importance of lowering risk.

Currently community banks, including CDFIs, have significant capital limitations that prevent them from fulfilling the roles that the OZ program seems to expect of them — namely to provide financing

64. O'Neal & Hood, *supra* note 9.

65. *Id.*

66. *Id.*

67. *See, e.g.*, Jesse Drucker & Eric Lipton, *How a Trump Tax Break to Help Poor Communities Became a Windfall for the Rich*, N.Y. TIMES (Sept. 27, 2020), https://www.nytimes.com/2019/08/31/business/tax-opportunity-zones.html [https://perma.cc/2P8X-SH84].

68. O'Neal & Hood, *supra* note 9 (quoting Michael Swack, director of the University of New Hampshire's Center for Impact Finance).

69. *See* DYAL-CHAND, *supra* note 1, at 100; *see also* James E. Post & Fiona S. Wilson, *Too Good to Fail*, STAN. SOC. INNOVATION REV. 66, 66 (2011), https://ssir.org/articles/entry/too_good_to_fail# [https://perma.cc/SSW6-HJ29] ("On Aug. 20, 2010, the Illinois Department of Financial & Professional Regulation closed ShoreBank, the nation's first and leading community bank . . . .").

that facilitates and supports direct OZ funding.[70] Despite these constraints, federal and state programs continue to target community banks with other forms of funding and assistance. The recent passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act is a noteworthy example because it allocates $12 billion to CDFIs.[71] However, this financing is not risk free. This allocation will be distributed to individual CDFIs as debt that must be repaid.[72] Moreover, the money comes with additional strings that limit the opportunity to create incentives and spread risks, such as restrictions on executive compensation, share buybacks, and dividend payments.[73] Thus, while the CARES Act allocation is a powerful beginning, it does not remove the very real constraints on CDFIs to meet safety and soundness requirements and avoid risk. These limitations of the CARES Act can be expected to translate directly into fewer dollars for local small businesses, which again are perceived as riskier lending targets, whether rightly or wrongly.

The second important aspect of underwriting the underwriters is closely related: it is crucial to remove some of the risks just described. It is essential for federal policy to encourage investment by local banks in local businesses rather than to discourage such investment by imposing requirements that are meant to avoid risk. What is required today is a set of banking regulations that acknowledge the real risk of lending to small, local businesses but that develop ways to *manage* such risk. While such regulations may well take time to develop in order to balance the interests of both lenders and borrowers, the obvious beginning point is to find ways to provide financing to lenders with no, or at least fewer, repayment strings attached.

This is where the OZ program could make an enormous difference. If such regulations were modified to allow long-term investments in

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70. *See supra* text accompanying notes 51–56.

71. *See $12 Billion in Cares Act for CDFIs*, CREDIT UNION STRATEGIC PLAN. (Dec. 22, 2020), https://www.creditunionstrategicplanning.com/post/12-billion-in-cares-act-for-cdfis [https://perma.cc/5T3D-USJ3].

72. *See id.*

73. *See* Sarah G. Lutzke, *Consolidated Appropriations Act Sets Aside $12 Billion for CDFIs and MDIs*, WIPFLI (Jan. 20, 2021), https://www.wipfli.com/insights/articles/fi-covid-19-caa-provides-12-billion-for-cdfi-fund-and-ecip [https://perma.cc/V8MZ-3Y9X]. While these restrictions are doubtless intended for the laudable purpose of ensuring that the funds are used for community development, they preclude opportunities for creative financing and are imposed on (at least some) institutions that likely have proven track records of deep community engagement.

"the underwriters," the risks of lending could be significantly alleviated for community banks. It would be a means of leveraging the CARES Act allocation to community banks, providing both a soft guaranty of repayment as well as additional capital to support lending efforts. It would eliminate the often-unnecessary hurdles imposed on both banks and local businesses that currently impede access to OZ funds.[74] Most importantly, it would allow funds to be funneled directly to communities.

As the range of efforts to increase OZ participation for community banks suggests, as a regulatory matter, it should be a straightforward proposition to allow community banks to qualify as OZ businesses.[75] The primary regulatory changes would be made to Internal Revenue Code provisions concerning OZs. In particular, I would propose three changes. First, the definition of "qualified opportunity zone business property" should be amended to include "local" loans. "Local" here should be defined as commercial loans made to small businesses owned by individuals who have been residents of an OZ for ten or more years, as well as residential loans to such residents. Such a definitional change would allow loans, which are typically the largest asset held by community banks, to qualify as OZ business property. It would also increase the incentives for such banks to make loans to local businesses that might previously have been perceived as too risky.[76]

Second, either the Internal Revenue Code itself or IRS guidance should include special opportunities and incentives for community banks embedded in collaborative business networks to qualify as OZ businesses *and* to benefit from such participation. For example, IRS guidance could provide for a streamlined process for community banks to qualify as OZ businesses for a period of years for any local loans they make if they can meet certain criteria at the point of making the first loan. Such criteria could include capitalization and

74. *See supra* text accompanying notes 51–56.

75. *See* O'Neal & Hood, *supra* note 9 ("There are already calls from some Democrats to make changes. A bill (H.R. 7262) from Rep. Gregory Meeks (D-N.Y.) would allow CDFIs to take opportunity fund investments by designating them businesses eligible for such financing. Still, only Democrats have backed the measure so far. Think tanks and other organizations unsuccessfully lobbied the IRS and Treasury to give CDFIs this big exception from some of the policy's requirements while officials were crafting the rules in 2018 and 2019.").

76. *See id.* ("While impact-minded opportunity funds certainly exist, the incentives grow with profits, not with hiring, wages, or other measurable community impact — making already hot, fast-growing neighborhoods an easier play."); *see also* THEODOS ET AL., *supra* note 5, at 23 (explaining that a company was unable to raise OZ equity because advisors saw the investment as "risky" and "oddball").

asset levels and other markers for proving safety and soundness, but they should also include proof of long-term investment in the community.[77] The idea here would be to reduce the difficulty of making a stream of successive OZ investments in local businesses, thereby increasing the stability and accessibility of local capital for such businesses. As for incentives to the banks themselves, these should include tax incentives that are useful to community banks, which cannot currently make much use of incentives that target equity investments.[78]

Third, as I have discussed elsewhere, banking regulations issued by the Federal Reserve Board should be amended to allow community banks and their parent holding companies to make both debt and equity investments in local small businesses.[79] While this may seem like a radical suggestion, current regulations already permit bank holding companies to make equity investments in community development projects.[80] Thus, the only necessary rule change should be to allow such investments in the *same* projects that also receive debt financing from the bank subsidiaries of such holding companies.[81] This need has already been identified by industry participants: "One of the most commonly cited problems for CDFIs trying to get involved in the market is that opportunity funds make equity investments, taking ownership of the businesses and projects they're financing, rather than providing loans as CDFIs often do."[82] By removing the constraint on simultaneous debt and equity financing, banking regulations can provide greater incentive and support for investment in OZs and, more broadly, across a range of urban cores.

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77. For detailed discussion of such criteria, see DYAL-CHAND, *supra* note 1, at 85, 92, 257–60.

78. O'Neal & Hood, *supra* note 9 ("'A new tax incentive is needed — one where the decision on what to finance rests with entities that are accountable to the community: community development financial institutions,' said Lisa Mensah, president and CEO of the Opportunity Finance Network, an association of more than 300 CDFIs.").

79. *See* DYAL-CHAND, *supra* note 1, at 258–59.

80. 12 C.F.R. § 225.127 (2019) (allowing bank holding companies to invest in "projects designed primarily to promote community welfare" and "community development corporations").

81. *See* Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927, 1949–51 (1993) (contrasting German banks from U.S. banks in this regard).

82. O'Neal & Hood, *supra* note 9.

CONCLUSION

By harnessing the potential for community banks to serve as engines of financial support for successful, small, local businesses in OZs, the Opportunity Zone program can make a world of difference. Crucially, it can support poverty alleviation and the development of stable jobs, thereby fulfilling the uniquely important roles that tax benefit programs such as this have been created to fill. The regulatory and programmatic changes required to implement such a strategy are straightforward. All that is required now is the political will.