



# Opportunity Zones *Lynchburg Seminar*

October 31, 2018

# Today's agenda

- What do you need to know?
- Where are we today?
- How to ensure this delivers?

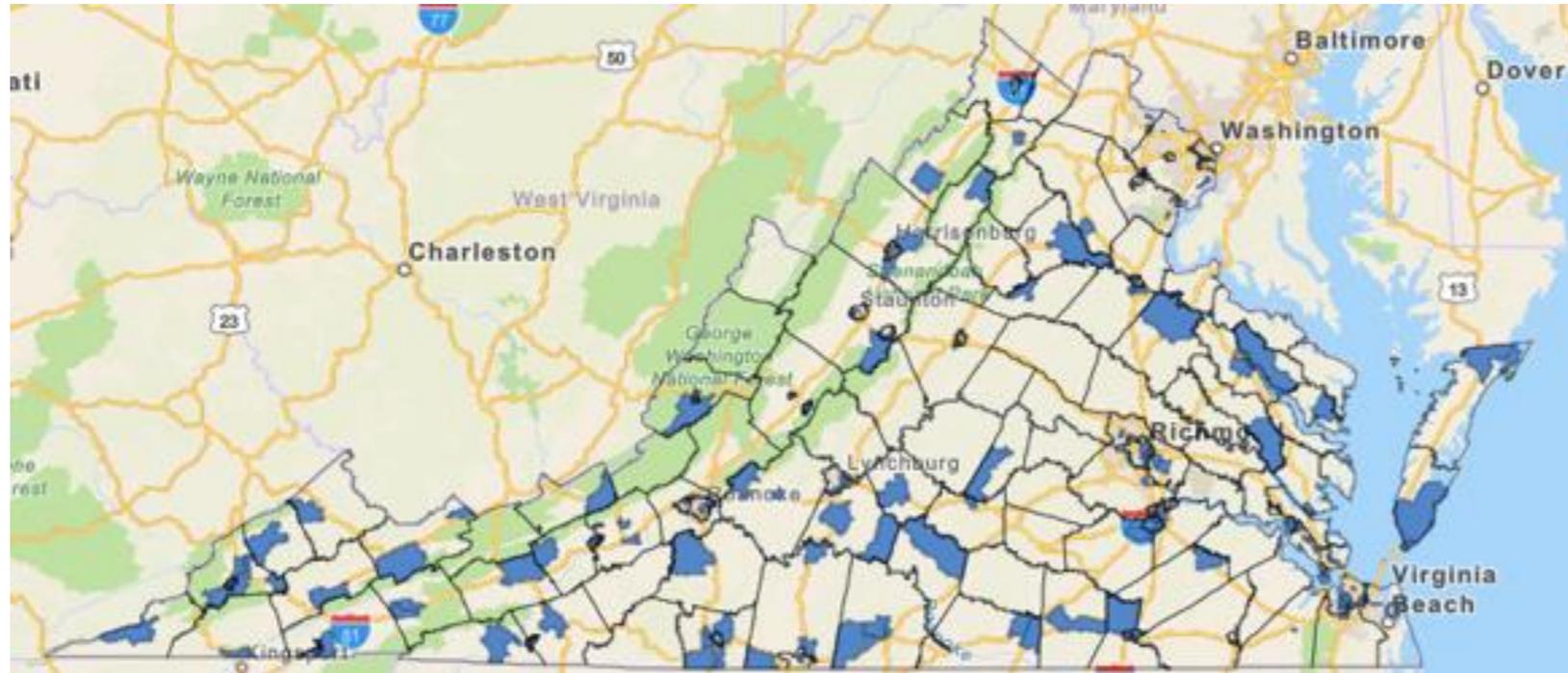
# Passage of the Tax Cut & Jobs Act in December of 2017 established the Opportunity Zone tax incentive program

## The basics

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- Intended to spur economic resurgence, job creation, and wealth building in low income and distressed communities:
  - States designate specific "Opportunity Zones" for investment
  - Investors get tax benefits from investing in the Opportunity Zones via a "Qualified Opportunity Fund" (think 1031 exchange with some steroidal boost)
  - Investment must flow to an "Opportunity Zone Property" in an Opportunity Zone
- First new community development program enacted since the millennium that potentially taps into trillions of dollars in unrealized capital gains
- No community impact requirements for investors or businesses – designed purely to stimulate capital flow

# Each state governor designated Opportunity Zones based on qualifying census tracts



**Low-income census tracts:** individual poverty rate of at least 20 percent and median family income no greater than 80 percent of the area median



**Contiguous census tracts:** median family income does not exceed 125 percent of the median family income of the contiguous tract. Only 5% or less tracts may qualify under this exemption

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**Total tracts:** Up to 25 percent of the total number of census tracts that qualify as an Opportunity Zone can be designated as an Opportunity Zone

- In June, Treasury approved Opportunity Zones in all 50 states, 5 U.S. possessions & the District of Columbia – including 212 in Virginia
- Designations remain in effect for 10 years
- Tracts overlay with other place-based tax credit programs (e.g. NMTC, LIHTC, HTC, Empowerment Zones, etc...)\*

# Financiers get tax benefits from investing in Opportunity Zones via Qualified Opportunity Funds

## Key statute parameters for Opportunity Funds

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- Organized as a corporation or partnership for purpose of investing in Qualified Opportunity Zone Property
- Self-certified by taxpayer (IRS is expected to release form in next few weeks)
- Must hold at least 90% of assets in Qualified Opportunity Zone Property (computed based on average amounts held as of June 30<sup>th</sup> and December 31<sup>st</sup> each year):
  - Per month penalty starting at test failure
  - % shortfall x 4% penalty (federal short term rate + 3%)
  - No penalty if failure shown to be reasonable cause

# The program offers three tax incentives to investors over a ~10 year horizon

## Deferral

Temporary deferral of capital gains re-invested in a Qualified Opportunity Zone Fund

Investment must flow to Opportunity Zone Fund within 180 days of realization

Must be recognized on the earlier of disposition of the investment or December 31, 2026

## Reduction

Step up in basis for capital gains if held for 5 years of 10%

Step up in basis for capital gains of an additional 5% if held for 7 years

Total potential reduction of 15%

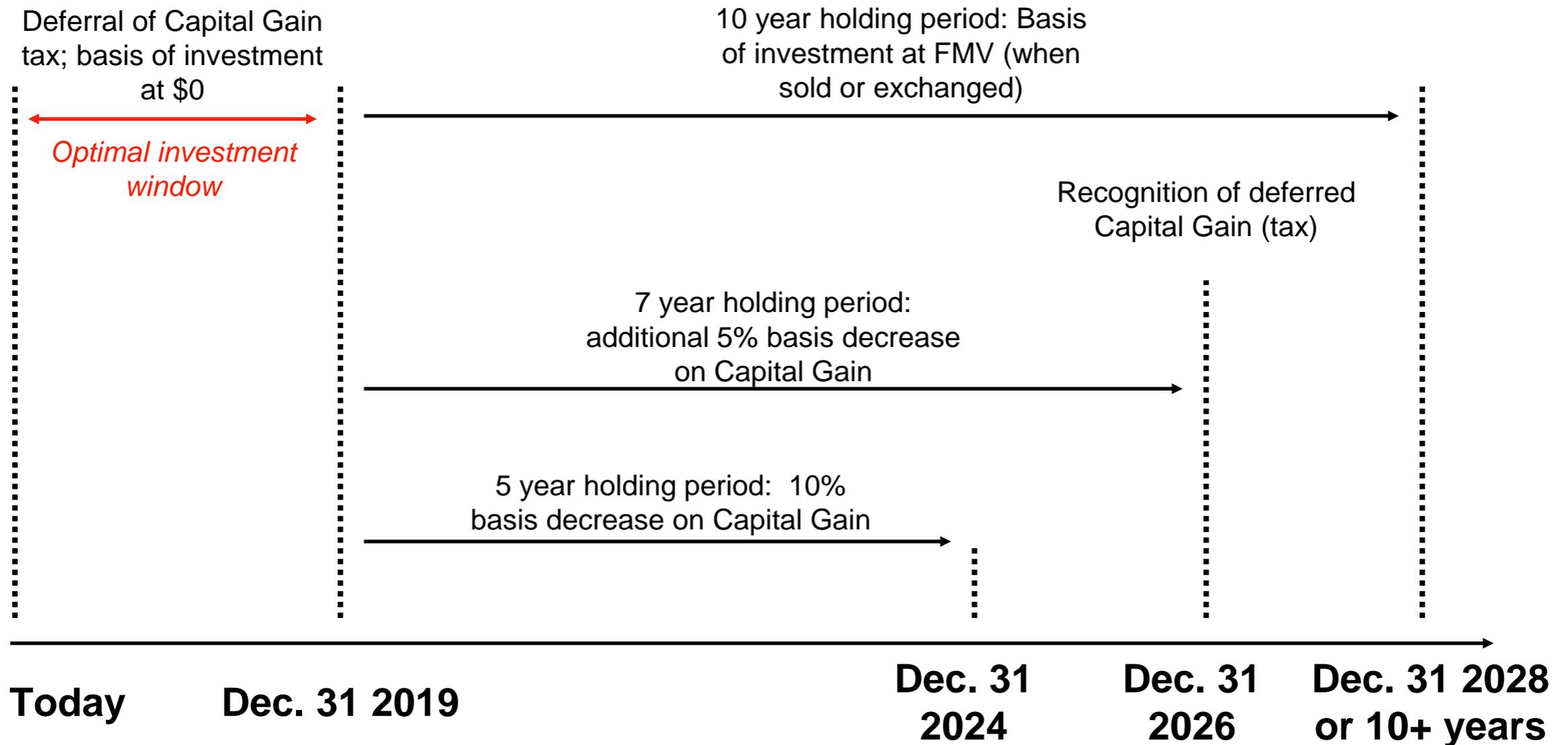
## Avoidance

Permanent exclusion of gains from initial investment if held for at least 10 years

Initial investment already taxed on December 31, 2026

Basis of investment at time of sale (after 10 years) is increased to FMV

# Per statute, there is a brief window to maximize the financial benefits of the OZ program



# Opportunity Zone Funds must invest in Qualified OZ Property

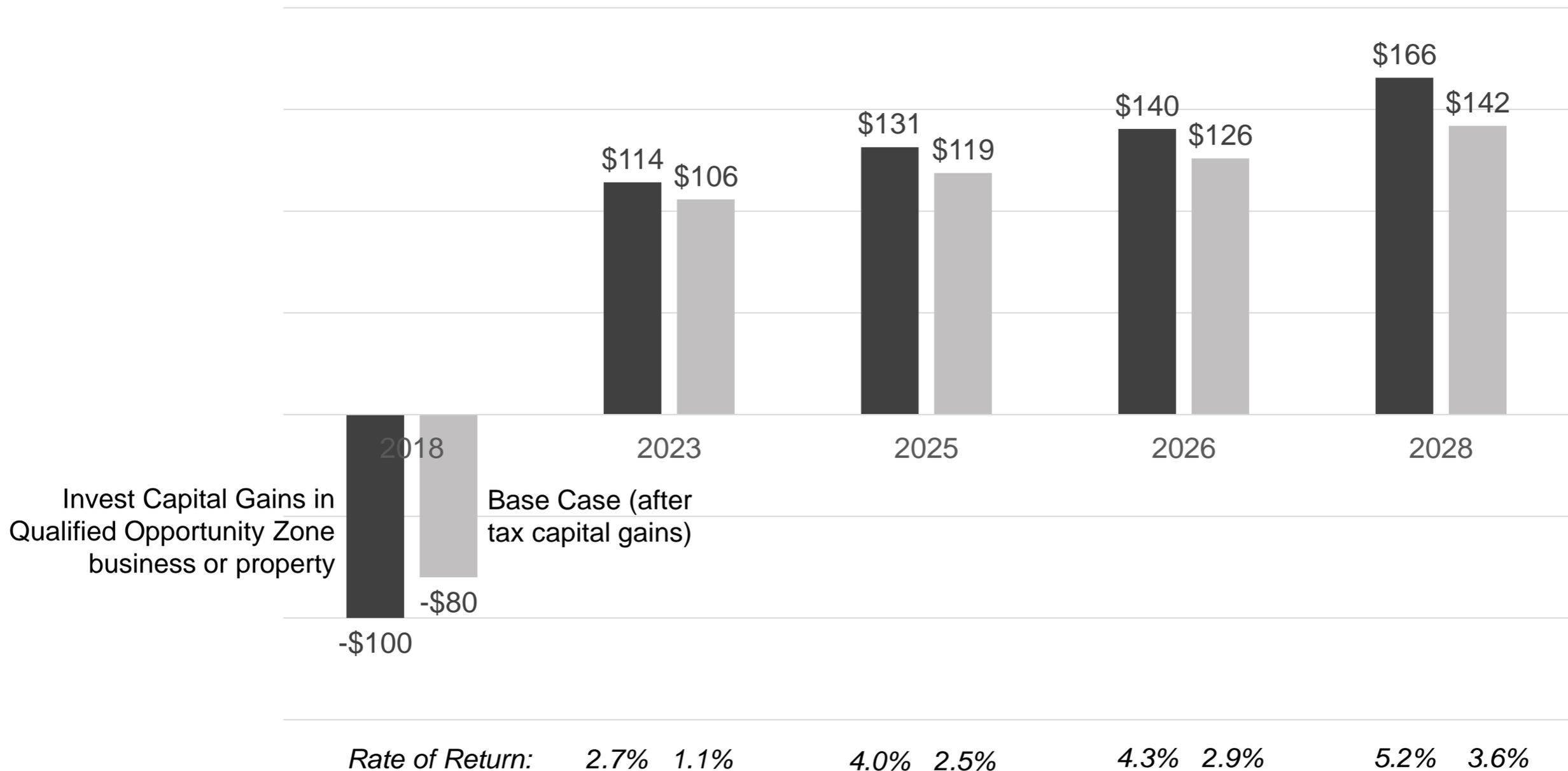


- Trade or business in which at least 70% the tangible property owned or leased is Qualified Opportunity Zone Business Property
- During holding period, substantially all the use is an Opportunity Zone
- At least 50% of income derived from active conduct of business
- Substantial portion of intangible property used in active conduct of business
- < 5 percent unadjusted basis of property is nonqualified financial property
- No “Sin Businesses” (golf courses, sun tan facilities, gambling, etc...)

# The Opportunity Zone tax incentives offer significant advantages over paying the taxes on gains today

Illustrative

## After Tax Cash Flows at Disposition



Key Assumptions	
Capital Gains to Invest	\$100
Capital Gains Tax Rate	20.0%
Annual Investment Appreciation	7%

# Treasury and the IRS released (proposed) “business-friendly” clarifying rules and regulations

## Opportunity Zone Funds:

- Any taxpayers that recognize “capital gain” for federal income tax purposes eligible (Individuals, Trusts, REITs, Corporations, LLCs, etc...)
- Two page self certification IRS form
- 10-year basis step-up election preserved until 2047
- 90% asset test calculated from audited financials or cost basis

## Opportunity Zone Business & Property:

- Working capital safe harbor of 31 months
- Land not considered in the calculation of substantial improvement
- **No** clarifying guidance regarding “at least fifty percent of annual gross income derived from the active conduct of a trade or business opportunity zone”

# There is significant Opportunity Zone action starting across the country

## Large scale OZ funds announced

- Crowd-sourcer FundRise announced creation of public \$500M OZ fund
- Slew of national private ~\$500M real-estate funds announced (e.g. EJP Capital, Youngwoo & Associates)
- Bridge Housing, a nonprofit affordable housing developer, creating a \$500 million OZ fund to finance affordable housing in West Coast markets
- Regional players declaring funds, e.g.: Virtua Partners (Phoenix) and Keith Rubenstein (Bronx, NY) each at \$200M+

## Emerging business interest

- Enterprise believes it can generate \$1 billion in Opportunity Zone investments deals
- LISC intends to steer funds to invest in multifamily housing, health clinics, charter schools and workforce housing in OZs across the country
- Factory OS (San Francisco) modular home builder to raise roughly \$20 million via OZ program to buy factory tooling
- Obsidian (Oregon) creating Opportunity Zone fund to focus on solar projects

## Local convening and marketing

- “Louisville Prospectus” released that markets both Opportunity Zones & potential projects
- Norfolk held an “Opportunity Zones Day” – with specific detail on local programs to leverage
- “Oregon Opportunity Zone Initiative” and “Opportunity Alabama”, led by philanthropy/non-profit, to create a clearinghouse for investors and businesses to connect
- \$250M “Emergent Communities Fund” announced focused on Virginia and North Carolina

For example

# Opportunity Zones are generating lots of energy, but significant challenges exist

## Opportunity Zone investments will be in high demand

- Plenty of Opportunity Zone capital will be available – from national scale banks & private equity to local high net worth individuals & families
- Outside of large, urban-centric real estate pipeline, shovel-ready project demand is not prepared for the Opportunity Zone capital inflow
- Without Treasury or legislative intervention, the investment window will be short

## Mission-driven financing activity is slower to develop

- Lagging Opportunity Zone energy and knowledge in the communities themselves
- Outside investors & business interests lack understanding of scale, prospects & challenges in the Opportunity Zones
- Rural Opportunity Zone tracts and non-real estate businesses getting relatively minimal attention
- Primary focus on financial returns rather than community revitalization and wealth generation

## Immature investment ecosystems hinder efficient capital flow

- Established market-places of business interests and investors largely do not exist in the Opportunity Zones
- Plenty of players wanting to engage and spur activity (philanthropy, economic development, CDFIs, local government, etc..), but lack connective tissue
- Access to full range of capital including, equity, debt, grants, tax incentives, etc... not readily available

# Leadership from across the stakeholder spectrum is needed to fully realize the OZ opportunity for these communities

## Key next steps

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- Convening local business leaders, community activists, economic development institutions, financial players, and other stakeholders
- Aligning key constituents on local community needs and investment focus areas
- Developing an investment plan/”pitch book” with both project ideas and potential financing sources
- **Building a market-place for stakeholders to engage and get deals done**
- Gathering additional incentives (philanthropic grants, local tax relief, public/private partnership, housing vouchers, infrastructure improvement commitments, etc...)
- Pushing localities to fast-track project bureaucracy (zoning, permitting, etc...)
- Ensuring wealth building and economic growth in the community vs. displacement (e.g. local hiring requirements with grants, land trusts/bank focus)

# Questions?