

# LISC Houston Opportunity Zone Briefing

January 18, 2019

An affiliate of LISC

**NMSc**

New Markets Support Company



**LISC**  
*Helping neighbors  
build communities*

# What are Opportunity Zones?

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The Opportunity Zone tax incentive is a bipartisan initiative to spur long-term private investment in low-income urban and rural communities, established by Congress in the 2017 **Investing in Opportunities Act**.



*U.S. investors currently hold \$2.3 trillion in unrealized capital gains, representing a significant untapped resource for economic development.*

# Why now?

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Data from the Economic Innovation Group. Read more at [eig.org/opportunityzones](http://eig.org/opportunityzones)

More than half of America's most economically distressed communities contained both **fewer jobs and businesses in 2015 than they did in 2000.**

New business formation is near a record low. The average distressed community saw a **6 percent decline** in local businesses during the prime years of the national economic recovery.

The U.S. economy is increasingly dependent on a handful of places for growth. **Five metro areas** produced as many new businesses as the rest of the country combined from 2010 – 2014.

# What are Opportunity Zones?

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**Opportunity Zone:** A low-income census tract (**LIC**), as determined within New Markets Tax Credits legislation, is designated as an Opportunity Zone (**OZ**) by the governor of the of the state or territory in which it is located. Designations will stay in place for 10 years.

**Up to 25% of LICs**  
in a U.S. state or  
territory may be  
designated as OZs.

**States or territories  
in which there are  
fewer than 100 LICs  
may designate up to  
25 LICs as OZs.**

**Up to 5% of census tracts  
contiguous to LICs**  
may be designated as  
OZs, if the median family  
income of the census  
tract does not exceed  
125% of the median  
family income of the LIC  
to which the tract is  
contiguous.

# Designated Opportunity Zones – National Stats

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**8,762**

census tracts designated



**24 million**

current jobs in designated tracts



**1.6 million**

businesses in designated tracts

Average poverty rate	<b>31%</b>
Average unemployment rate	<b>14.4%</b>
Average family income in OZ census tracts relative to area median income (AMI)	<b>60%</b>

# Houston Designations

92

census tracts designated

Average poverty rate

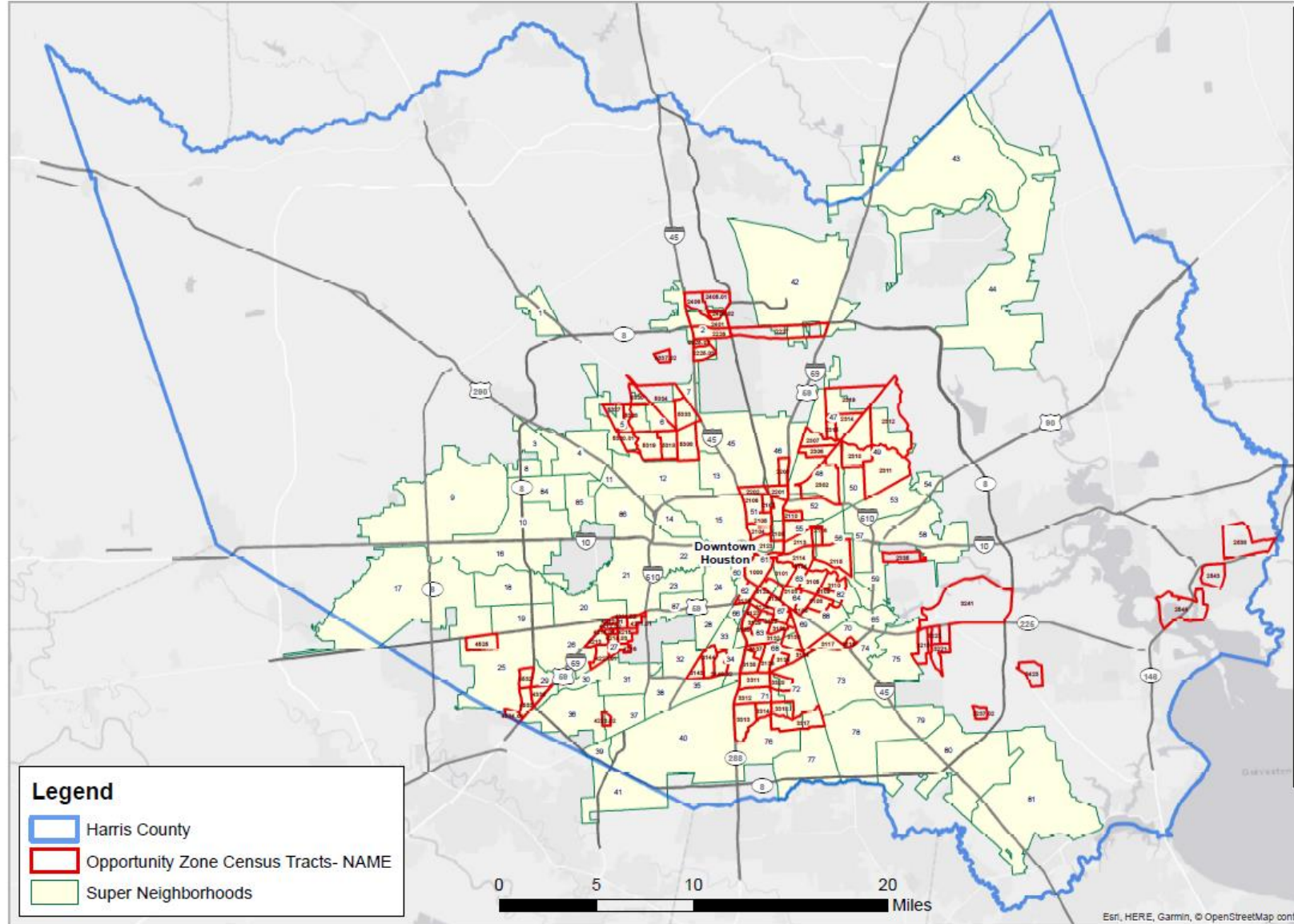
33.5%

Average unemployment rate

13.3%

Average family income in OZ census tracts relative to area median income (AMI)

56.4%



# Opportunity Funds

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**Opportunity Fund:** An investment vehicle organized as a corporation or partnership for the purpose of investing in Opportunity Zone property.

**Opportunity Funds will be self-certified per IRS guidelines. They must be organized for the purpose of investing in Opportunity Zones**

**Opportunity Funds are required to invest 90% or more of their capital as EQUITY in Opportunity Zone property**

**Opportunity Zone property includes stock, partnership interest, or business property in an Opportunity Zone**

OPPORTUNITY ZONES

# Investor Incentives

## Cancellation of taxes

## Reduction of taxes

## Deferral of taxes

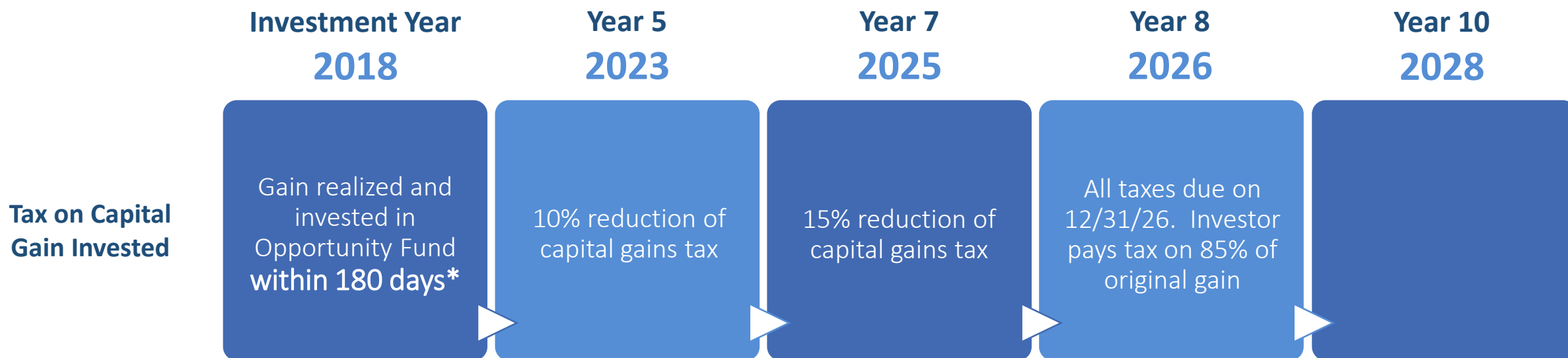
On capital gains  
invested in Qualified  
Opportunity Zone Funds

On investments held in  
Qualified Opportunity  
Zone Funds 5+ years

On new gains made  
through Qualified  
Opportunity Zone Fund  
investments held 10+ years



# Timeline for Opportunity Zone Investments



\* Tax is deferred until the earlier of investment liquidation (return of capital) or 12/31/26

## Tax on Opportunity Fund Investment



\*\* Any appreciation on Opportunity Fund investment is tax free if held > 10 years

# Ex. 10 Year Investment: **Fully Taxable vs. Opportunity Zone Fund**

## Assumptions:

- 10% annual investment appreciation
- 24% capital gains tax (federal only)

Fully Taxed Investment		
Capital Gain		\$100,000
- Tax payable (24%)		\$24,000
Total Capital to Invest		\$76,000
Sales Price after 10 years		\$197,000
- Tax on Appreciation (24%)		\$29,070
<b>After Tax Funds Available</b>		<b>\$168,054</b>

Opportunity Zone Investment		
Capital Gain		\$100,000
- Tax payable		\$0
Total Capital to Invest		\$100,000
Sales Price after 10 years		\$259,374
- Tax on Appreciation		\$0
Deferred Capital Gain Tax (24%) paid in 2026		\$20,480
<b>After Tax Funds Available</b>		<b>\$238,974</b>

# Key Points

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## Investors

- Tax incentive is most valuable for 10 year investments in appreciating assets
- Six months to invest after realizing a capital gain
- Another 6-31 months to deploy 90% of capital in Zones
- Capital is required to be an equity investment – loans from investors are not eligible for the tax incentive

## Funds

- All capital must flow through an Opportunity Fund to be eligible for the tax incentive
- Funds are self-certified via an IRS tax form
- Fund must be established for the purpose of investing in Opportunity Zones
- 90% of fund assets must be invested in Zones to maximize the tax incentive

## Eligible Investments

- Must be equity investments
- Real estate investments must include substantial rehabilitation – doubling basis (excluding land) within 30 months
- “Sin businesses” are not eligible
- Other requirements include property use in “active conduct of business” and limits on assets held in cash

# Eligible Investments

*Only equity investments are eligible for the Opportunity Zone tax incentive.*

- 1 Business investments**  
can include investments in new stock issuance for corporations and ownership interests in partnerships and LLCs.
- 2 Investments in real estate**  
must include an ownership interest of new construction or assets that will be "**substantially improved**" within 30 months of acquisition by the Opportunity Fund.
- 3 New equipment and other assets**  
are also eligible investments.

# Strengths

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## Local

Designations are made by states and localities, rather than Federal agencies, ensuring more local buy in and coordination

## Flexible

The flexibility of the investment tool can support investments in any type of asset class

## New Investor Class

The incentive has the ability to attract high net worth individual investors to community development finance

## Potential

The incentive could attract hundreds of billions of private sector capital into low-income communities

## Straightforward

The tool is relatively straightforward from an investment and compliance standpoint, in comparison to LIHTC and NMTC

# Concerns

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## Lack of Oversight

Lack of oversight from government entities could lead to program abuses

## Lack of Impact Incentives

Incentives focus on back-end returns, rather than investments that will result in community impacts

## Gentrification and Displacement

The tool might aid in the gentrification and displacement of residents and businesses in Opportunity Zone communities

## Future of Other Tax Incentives

The new incentive might be used as an excuse to diminish or eliminate other community development tax incentives, such as the NMTC program

# Economic Development Examples

## 1 Business infrastructure real estate funds:

- *Industrial*
- *Retail*
- *Mixed use*
- *TOD*

## 2 Venture capital funds:

- *Seed stage investments*
- *Series A investments*

## 3 Operating business private equity:

- *Businesses moving or expanding into an Opportunity Zone*
- *Equipment financing*

## 4 Enhancement for other federal tax credit transactions:

- *NMTCs*
- *Historic Tax Credits*

## Economic Development: **Issues to consider**

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- The “substantial rehabilitation” rule requires all OZ investments to double the basis of the property that the QOF invests in
  - Works for new development and significant improvement of real estate assets
  - Scope of business investments expected to be limited to early stage business investment and established businesses relocating or expanding to Zones
- 50% of the QOZB’s gross income must be derived from the active conduct of a trade or business in the Opportunity Zone
- 70% of the QOZB’s tangible assets must be located in the Opportunity Zone
- Guidance regarding ability to recycle investments within a QOF expected by year end



# Affordable Housing Examples

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## 1 Pairing with LIHTC or the HTC

- Yield boost for tax credit investments providing housing for families at or under 60% AMI
- 10-15 year investment period
- Investors = corporate investors with capital gains to invest and tax credit appetite

## 2 Workforce Rental Housing

- Providing housing for families at 80 – 120% AMI
- 10 year investment period
- Investors = individuals or corporations

## 3 Lease-to-own Housing

- Single family or multi-family
- New construction or rehab
- Investors = social impact focus

# Housing: **Issues to Consider**

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- **Project risk/return – opportunistic vs. stabilized assets**
- **Focus on affordability - Rents at 80 – 120% AMI**
  - Unless there is an investor willing to take a lower return or city or state willing to provide soft secondary financing to allow for lower rent structure
- **Perm debt preferred to be structured as non-recourse**
- **Exit issues – plan for liquidity event, continued affordability**

## Investors in Opportunity Zones

The Opportunity Zones tool is structured to work with a wide range of potential investors, including:

- Banks and institutional investors that have previously invested in other tax credits
- Corporations with capital gains exposure – insurance companies, anchor institutions, others
- High net worth individuals
- Partnerships
- Social impact investors

# Technical Issues

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- **90% invested rule**
  - 180 days to invest 90% of fund capital in QOZBP per statute
  - Regulations provide for a 31 month investment period through a working capital safe harbor
- **The “substantial rehabilitation” rule**
  - OZ investments to double the basis of the property that the QOF invests in within 30 months of investment; land is excluded so that only the value of buildings needs to be doubled
- **“Substantially all” rule**
  - QOZ business is one in which greater than 70% of the tangible property owned or leased is located in the Opportunity Zone
- **Early disposition**
  - If an OZ Fund investor sells all of its interest in an OZ Fund before 12/31/26, the investor can maintain the original gain deferral by reinvesting into another OZ Fund within 180 days
  - Further guidance is expected regarding the ability to recycle investments within an OZ Fund

# Investor market and deal structuring issues

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## •Investors:

- Risk/return
- Timing issues
- 10 year hold issues
- Indemnity/guarantee requirements
- Impact focus/reporting

## Deal structures / capitalization:

- Warehouse financing
- Straight equity vs. leverage structures
- JV equity vs. preferred equity
- Project debt to be structured as non-recourse to provide QOF investors with tax basis
- Structuring projects for 2026 tax payment and sale or refinancing after 10 years

# Marketing Projects to Investors

## Marketing Plan Considerations:

- Product positioning
- Community buy-in
- Investor risk mitigation
- Timing

## Local Impact Investor Sourcing:

- City/county government
- Community foundations
- Anchor institutions
- Chambers of commerce
- Investment clubs



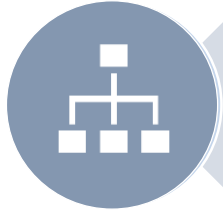
# Opportunity Zones: **What's Next**

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1. **Sixty day comment period for Proposed Regulations issued on October 19 and ended December 18. Until final rules are issued, investors are allowed to rely on proposed rules to start investing.**
2. **We expect to see a number of Opportunity Zone Funds with a variety of products in early 2019.**
3. **What will be built? What is the social impact? There is much to be determined from a community development perspective.**

# LISC's Roles

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Fund Manager



Service Provider



Debt Financing



Industry Leadership



# RESOURCES

OPPORTUNITY ZONES

## Resources and Tools

[lisc.org/opportunityzones](https://lisc.org/opportunityzones)

- Visit [LISC's Opportunity Zones pages](#) for:
  - A [mapping tool](#) of designated census tracts
  - Federal and state [government resources](#) and updates
  - [LISC and partner resources](#), including presentations and webinar recordings
  - Opportunity Zones and Opportunity Funds [FAQ](#)
  - A sign-up form for our Opportunity Zones [email updates](#)

Other Opportunity Zones resources:

- The [Investing in Opportunity Act](#)
- Community Development Financial Institutions [\(CDFI\) Fund Opportunity Zones updates](#) and resources
- Economic Innovation Group [\(EIG\) Opportunity Zones pages](#) for related news, background information, and a list of bipartisan supporters

# Contact Information

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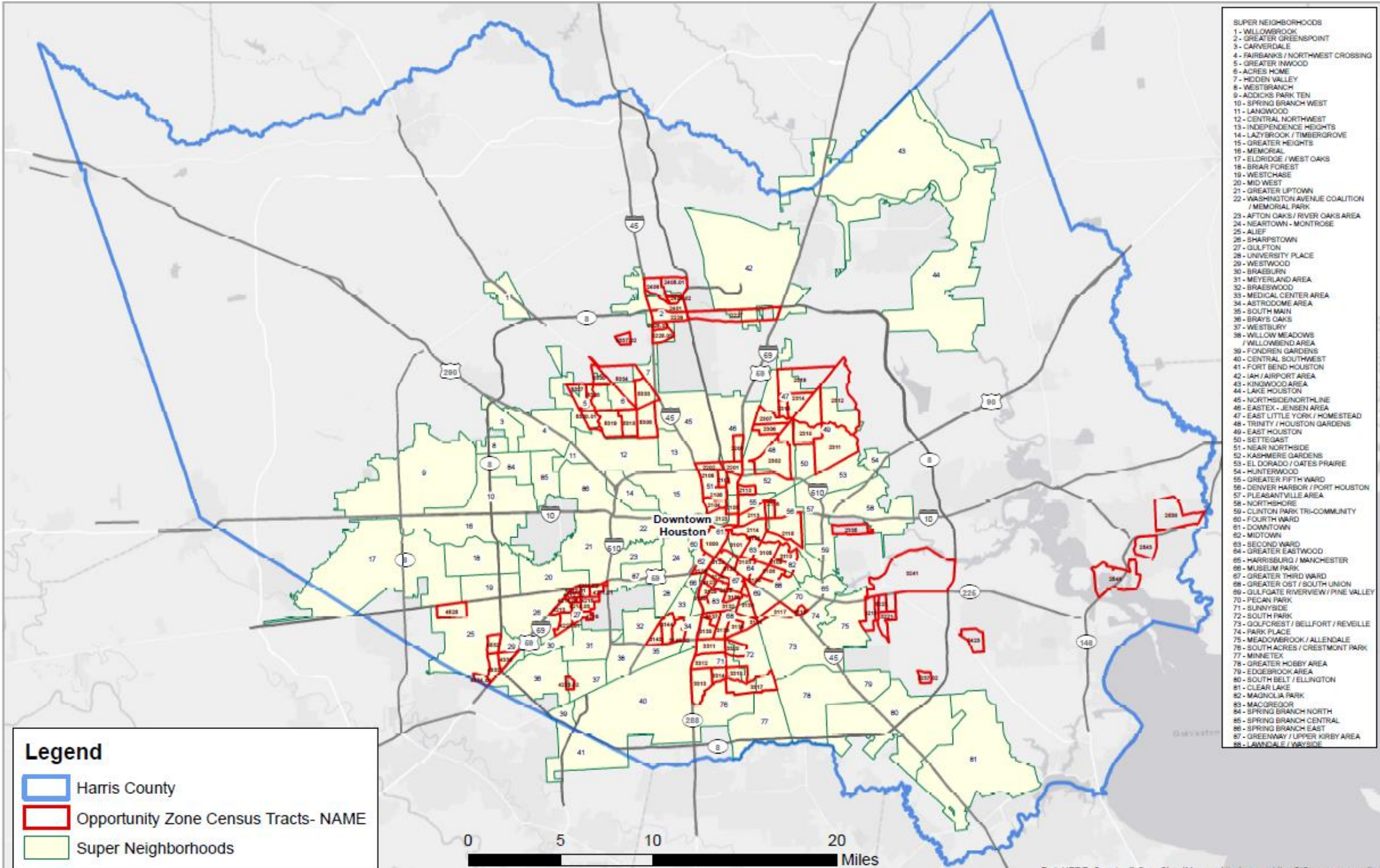
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Houston LISC



- SUPER NEIGHBORHOODS**
- 1- WILLOWBROOK
  - 2- GREATER GREENSPRING
  - 3- CARVERDALE
  - 4- FAIRBANKS / NORTHWEST CROSSING
  - 5- GREATER INWOOD
  - 6- ACRES HOME
  - 7- HIDDEN VALLEY
  - 8- WESTBRANCH
  - 9- ADDICKS PARK TEN
  - 10- SPRING BRANCH WEST
  - 11- LANGWOOD
  - 12- CENTRAL NORTHWEST
  - 13- INDEPENDENCE HEIGHTS
  - 14- LAZYBROOK / TIMBERGROVE
  - 15- GREATER HEIGHTS
  - 16- MEMORIAL
  - 17- ELDRIDGE / WEST OAKS
  - 18- BRIAR FOREST
  - 19- WESTCHASE
  - 20- MID WEST
  - 21- GREATER LIPTOWN
  - 22- WASHINGTON AVENUE COALITION / MEMORIAL PARK
  - 23- AFTON OAKS / RIVER OAKS AREA
  - 24- NEARTOWN - MONTROSE
  - 25- ALIEF
  - 26- SHARPSTOWN
  - 27- GULFTON
  - 28- UNIVERSITY PLACE
  - 29- WESTWOOD
  - 30- BRAEBURN
  - 31- MEYERLAND AREA
  - 32- BRAESWOOD
  - 33- MEDICAL CENTER AREA
  - 34- ASTRODOME AREA
  - 35- SOUTH MAIN
  - 36- BRAYS OAKS
  - 37- WESTBURY
  - 38- WILLOW MEADOWS / WILLOWBEND AREA
  - 39- FONDREN GARDENS
  - 40- CENTRAL SOUTHWEST
  - 41- FORT BEND HOUSTON
  - 42- IAH / AIRPORT AREA
  - 43- KINGWOOD AREA
  - 44- LAKE HOUSTON
  - 45- NORTHSIDE/NORTHLINE
  - 46- EASTEX - JENSEN AREA
  - 47- EAST LITTLE YORK / HOMESTEAD
  - 48- TRINITY / HOUSTON GARDENS
  - 49- EAST HOUSTON
  - 50- SETTEGAST
  - 51- NEAR NORTHSIDE
  - 52- KASHMERE GARDENS
  - 53- EL DORADO / OATES PRAIRIE
  - 54- HUNTERWOOD
  - 55- GREATER FIFTH WARD
  - 56- DENVER HARBOR / PORT HOUSTON
  - 57- PLEASANTVILLE AREA
  - 58- NORTHSHORE
  - 59- CLINTON PARK TRI-COMMUNITY
  - 60- FOURTH WARD
  - 61- DOWNTOWN
  - 62- MIDTOWN
  - 63- SECOND WARD
  - 64- GREATER EASTWOOD
  - 65- HARRISBURG / MANCHESTER
  - 66- MUSLIN PARK
  - 67- GREATER THIRD WARD
  - 68- GREATER OST / SOUTH UNION
  - 69- GULFGATE RIVERVIEW / PINE VALLEY
  - 70- PECAN PARK
  - 71- SUNNYSIDE
  - 72- SOUTH PARK
  - 73- GOLFCREST / BELLFORT / REVELLE
  - 74- PARK PLACE
  - 75- MEADOWBROOK / ALLENDALE
  - 76- SOUTH ACRES / CRESTMONT PARK
  - 77- MINNETEK
  - 78- GREATER HOBBY AREA
  - 79- EDGEBROOK AREA
  - 80- SOUTH BELT / ELLINGTON
  - 81- CLEAR LAKE
  - 82- MAGNOLIA PARK
  - 83- MACGREGOR
  - 84- SPRING BRANCH NORTH
  - 85- SPRING BRANCH CENTRAL
  - 86- SPRING BRANCH EAST
  - 87- GREENWAY / UPPER KIRBY AREA
  - 88- LANNDALE / VAYSIDE

**Legend**

- Harris County
- Opportunity Zone Census Tracts- NAME
- Super Neighborhoods

