Opportunity Zones 101

August 19, 2019

INTERNATIONAL
ECONOMIC DEVELOPMENT
COUNCIL

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What are Opportunity Zones?

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.

OPPORTUNITY ZONES

Why now?

Data from the Economic Innovation Group. Read more at 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?

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

8,762
census tracts designated

24 million
current jobs in designated tracts

1.6 million
businesses in designated tracts

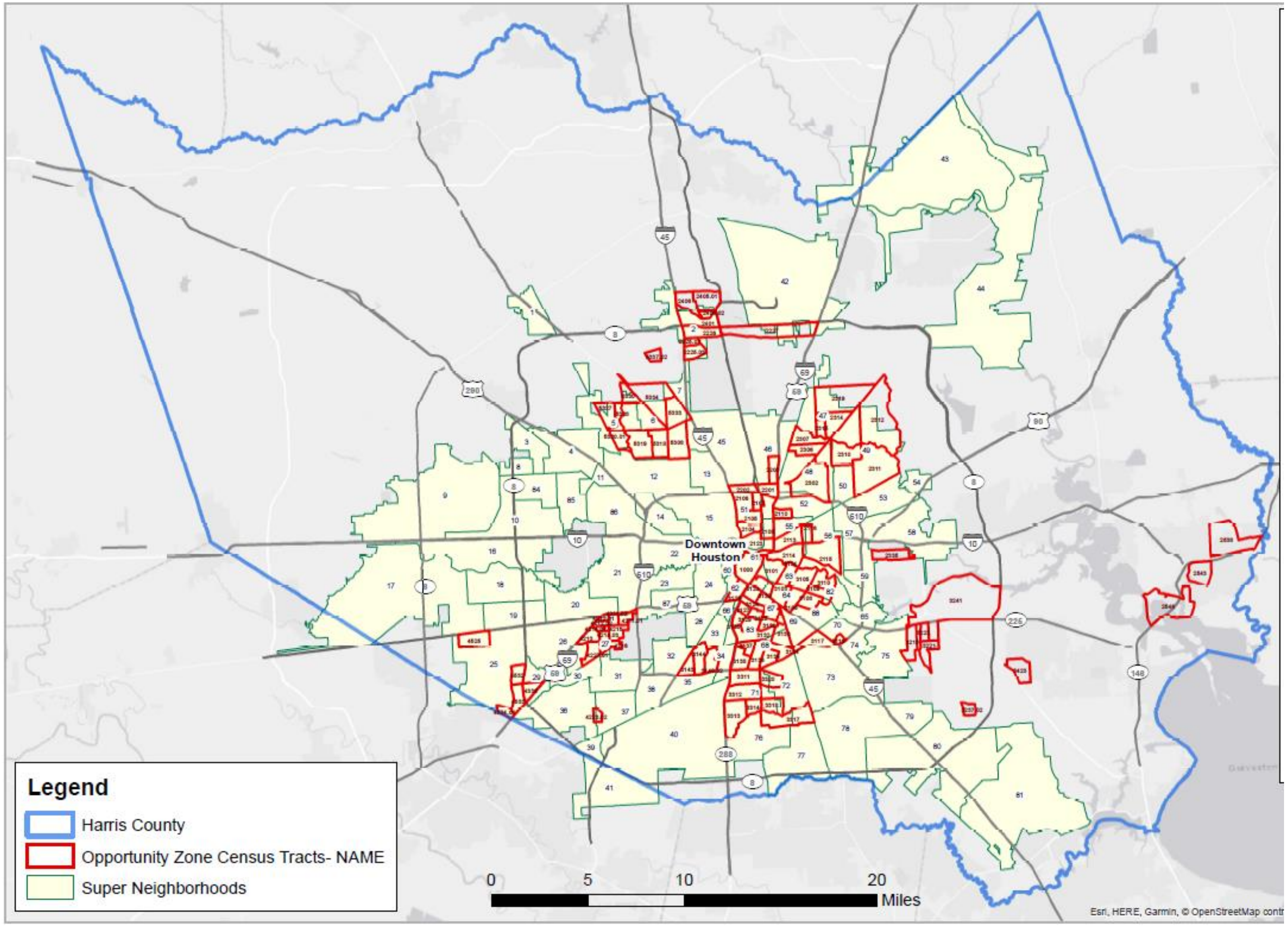
Average poverty rate	31%
Average unemployment rate	14.4%
Average family income in OZ census tracts relative to area median income (AMI)	60%

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

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**

Deferral of taxes

On capital gains invested in Qualified Opportunity Zone Funds

Reduction of taxes

On investments held in Qualified Opportunity Zone Funds 5+ years

Cancellation of taxes

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

Timeline for Opportunity Zone Investments

	Investment Year 2018	Year 5 2023	Year 7 2025	Year 8 2026	Year 10 2028
Tax on Capital Gain Invested	Gain realized and invested in Opportunity Fund **within 180 days***	10% reduction of capital gains tax	15% reduction of capital gains tax	All taxes due on 12/31/26. Investor pays tax on 85% of original gain	
Tax on Opportunity Fund Investment		Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is tax free**

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

**** 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
After Tax Funds Available		**$168,054**

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
After Tax Funds Available		**$238,974**

Key Points

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

Local	Flexible	New Investor Class	Potential	Straightforward
Designations are made by states and localities, rather than Federal agencies, ensuring more local buy in and coordination	The flexibility of the investment tool can support investments in any type of asset class	The incentive has the ability to attract high net worth individual investors to community development finance	The incentive could attract hundreds of billions of private sector capital into low-income communities	The tool is relatively straightforward from an investment and compliance standpoint, in comparison to LIHTC and NMTC

Concerns

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**

- 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

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**

- **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**

NVESTORS

OPPORTUNITY FUNDS

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

- 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

•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**

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.**

Roles

- Fund Manager
- Service Provider
- Debt Financing
- Industry Leadership

RESOURCES

OPPORTUNITY ZONES

Resources **and Tools**

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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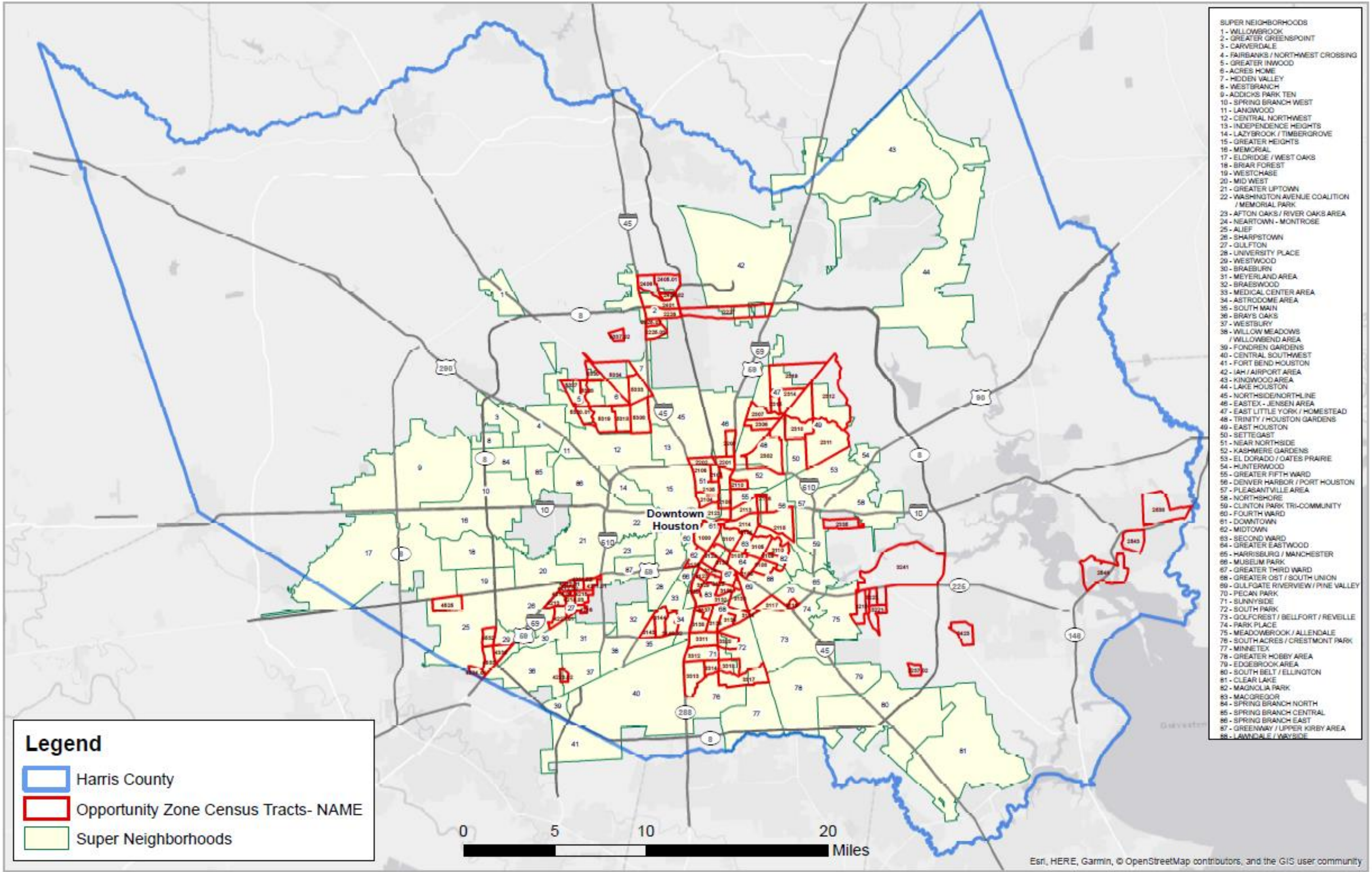
SUPER NEIGHBORHOODS
1 - WILLOWBROOK
2 - GREATER GREENSPOINT
3 - CARVERDALE
4 - FAIRBANKS / NORTHWEST CROSSING
5 - GREATER INWOOD
6 - ACRES HOME
7 - HIDDEN VALLEY
8 - WESTBRANCH
9 - ADDICKS PARK TEN
10 - SPRING BRANCH WEST
11 - LANGWOOD
12 - CENTRAL NORTHWEST
13 - INDEPENDENCE HEIGHTS
14 - LAZYBROOK / TIMBERGROVE
15 - GREATER HEIGHTS
16 - MEMORIAL
17 - ELDRIDGE / WEST OAKS
18 - BRIAR FOREST
19 - WESTCHASE
20 - MID WEST
21 - GREATER UPTOWN
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 - MUSEUM 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 / REVEILLE
74 - PARK PLACE
75 - MEADOWBROOK / ALLENDALE
76 - SOUTH ACRES / CRESTMONT PARK
77 - MINNETEX
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 - LAWNDALE / WAYSIDE
Downtown Houston
Legend
Harris County
Opportunity Zone Census Tracts- NAME
Super Neighborhoods
0
5
10
20
Miles
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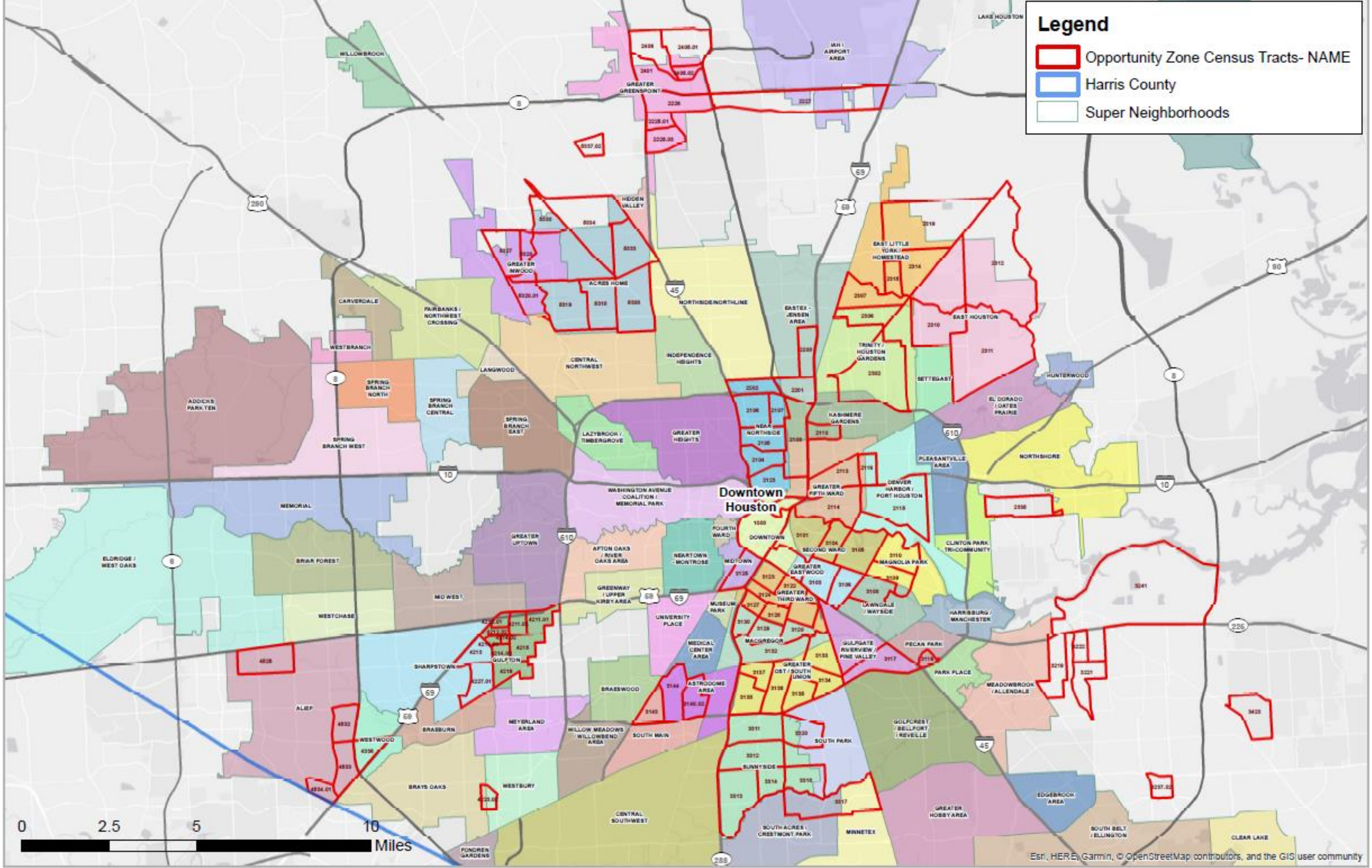

Legend
Opportunity Zone Census Tracts- NAME
Harris County
Super Neighborhoods
Downtown Houston
0
2.5
5
10
Miles
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