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# Real Estate Entitlements

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## OPPORTUNITY ZONES


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# Program Background

- Enacted in 2017 as part of the Tax Cuts and Jobs Act
- Purpose: Designed to promote the infusion of long-term capital to low-income communities by using tax incentives to encourage private investment




# What Are Opportunity Zones?

- Opportunity Zone: A census tract which has been designated as eligible to receive private investments through Opportunity Funds
- Criteria requirements:
  - A poverty rate of at least 20%; or
  - A median family income of:
    - No more than 80% of the statewide median family income for census tracts within nonmetropolitan areas
    - No more than 80% of the greater statewide median family income or the overall metropolitan median family income for census tracts within metropolitan areas

## Status of Zones

- Governors nominated tracks as zones in early 2018. The zones were submitted and certified by the U.S. Treasury.
- Zones have an average poverty rate of nearly 31%, and an average median family income of only 59% of its area median, compared to the 80% eligibility threshold
- Zones are home to 31.3 million people; 56% of the residents are minorities
- 75% of zones are located in zip codes that experienced some level of employment growth between 2011 and 2015




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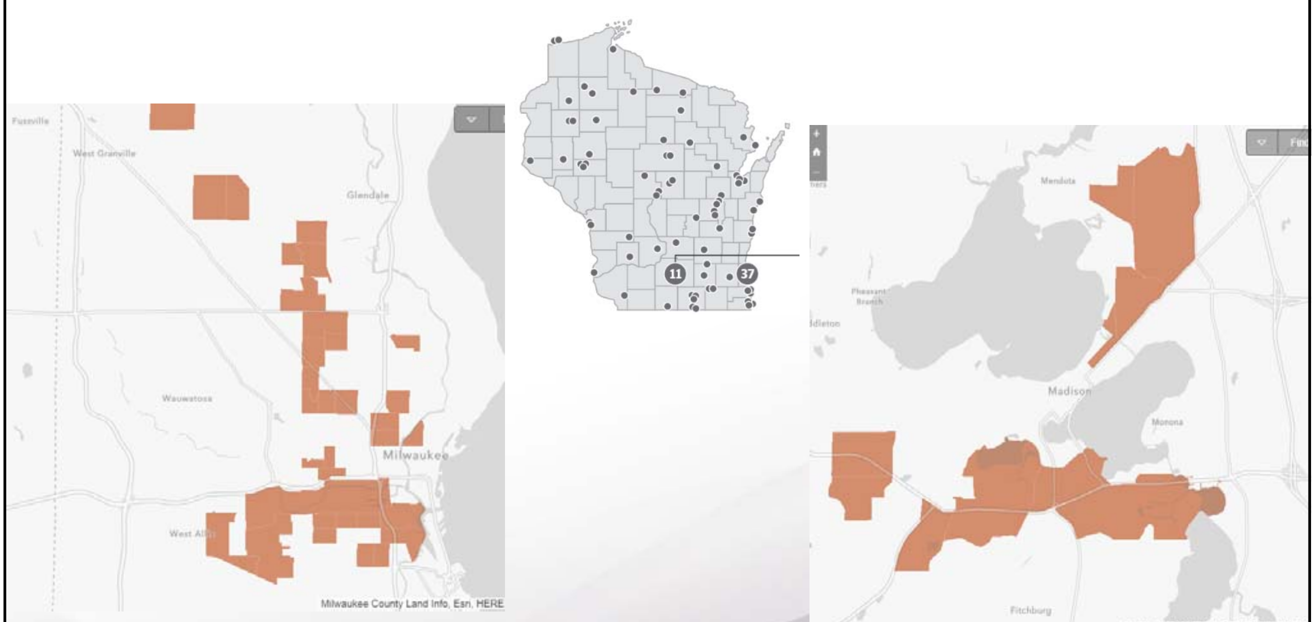





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# Program Mechanics

- STEP ONE: A Qualified Opportunity Fund ("QO Fund") is formed and certified by the Department of Treasury
  - Self-certification process by completing OZ Form 8996
- STEP TWO: An investor(s) with realized capital gain elects to invest the gain into the QO Fund by taking stock or a partnership interest in return
- STEP THREE: The QO Fund uses the investment to acquire Opportunity Zone Property
  - 90% of the QO Fund assets must be invested in Opportunity Zone Property
- STEP FOUR: The investor holds the interest in the QO Fund as long as he/she desires
- STEP FIVE: Deferred gain is recognized upon the earlier of (1) sale of investment or (2) December 31, 2026




# Benefits

| INVESTMENT LENGTH | BENEFITS |
|---|---|
| Fewer than 5 years | Deferred payment of capital gains until date investment is sold or exchanged |
| 5 – 7 years | Benefits above plus 10% of capital gains is canceled |
| 7 – 10 years | Benefits above plus 15% of capital gains is canceled |
| Greater than 10 years | Taxpayer receives a step-up basis in the investment equal to the FMV of the investment |

## Examples

- Taxpayer sells real property for $2 million with a basis of $1 million
  - Sale price – Basis = $1 million in capital gains
  - Taxpayer invests $1 million into QO Fund
- Taxpayer sells the investment before holding for 5 years
  - Scenario 1: Sale price = $1 million
    - Capital gain recognized is $ 1 million
  - Scenario 2: Sale price = $2 million
    - Capital gain recognized is $ 2 million ($1 million in deferred gain + $1 million in asset appreciation)




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## Examples (cont.)

- Taxpayer sells the investment with a holding period of 6 years
  - Scenario 1: Sale price = $1 million
    - Capital gain recognized is $900k (10% basis bump up)
  - Scenario 2: Sale price = $2 million
    - Capital gain recognized is $1.9 million ($900k in deferred gain + $1 million in asset appreciation)
- Taxpayer sells investment after holding for 10+ years
  - In 2026, taxpayer recognizes $850k in capital gains (15% basis bump up)
  - Sell for $2 million in 2030:
    - No gain recognized on appreciation (basis steps up to FMV)


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## Qualification Requirements

- A QO Fund is any investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property that holds at least 90% of its assets in qualified opportunity zone property
- "qualified opportunity zone property" means property which is
  - qualified opportunity zone stock,
  - qualified opportunity zone partnership interest, or
  - qualified opportunity zone business property
- Corporation or partnership must qualify as an opportunity zone business
- “Qualified opportunity zone business” means a trade or business
  - in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property




## Benefits to Low-Income Communities

- "qualified opportunity zone business property" means tangible property used in a trade or business of the qualified opportunity fund if:
  - the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund substantially improves the property
- What is substantial improvement?
  - Proposed regulations state the taxpayer must double his/her adjusted basis in the property after purchase and during any 30-month period he/she holds the qualified opportunity zone property
- QOF purchases a vacant office building located in a zone for $1,000,000. Of the $1,000,000 purchase price, 60% ($600,000) is allocated to the building value and 40% ($400,000) is allocated to the land value. For the first 30-month period after the purchase, an additional $600,000 (the amount allocated to the building at the time of purchase) of substantial improvements are necessary.

# IRS Regulations

- Proposed regulations were issued in October 2018
- Issues clarified
  - Any capital gain is eligible
  - Related party sales do not qualify
  - 70/30 rule created
  - Permit sales through December 31, 2047
  - Working capital exclusion
- February 14 Comments Hearing
  - lack of clarity around whether a fund may sell individual assets it invests in and reinvest the proceeds to disburse to additional opportunity zone projects without losing the tax benefits
  - 30-month safe harbor is not sufficient due to inherent delays in construction, including weather issues and permitting processes
  - Would like to get a similar rule for New Markets allowing up to 12 to 18 months to invest funds if committed to a project
  - pushed the IRS to loosen restrictions on funds investing in businesses located within opportunity zones




# Questions?

# Thank You!

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