International Economic Development Council
Webinar: The Power and Promise of Opportunity Zones
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Follow-Up Questions and Answers

Q. Is the capital gains tax rate frozen at 2018 levels (i.e. when the investment is made), or do investors pay the tax rate in effect at time of actual or deemed disposition (e.g. year-end 2026)?

A. The applicable capital gains rate is that at the time of disposition (actual or deemed).

Q. Does the investment have to be private funds? Can a public economic development organization be an investor in Opportunity Funds? Can foreign investment be utilized? What if I, a US taxpayer, invest non-capital gains money in an Opportunity Zone?

A. The tax incentive only applies to investments made from capital gains, so the taxpayer must owe capital gains in order to benefit. No other investments in an Opportunity Zone project will earn the tax benefits.

Q. In states that couple state tax policy to federal tax policy, do the deferrals/reductions/ exemptions apply to state capital gains tax rates?

A. State legislatures will make state tax policy decisions. Many states conform to federal tax policy, but many do not. Check with your own state.

Q. If a project is developed four years from now, will it only have six years of tax deferral benefit? Can you confirm that Opportunity Funds do not have to be pulled out of the project after 10 years or 2026, and that instead the basis is just readjusted?

A. The law as passed requires that the deferred capital gains tax is due on December 31, 2026. Thus, in order to earn the maximum basis reduction of 15%, investments would have to be in place by December 31, 2019.

The requirement to pay the deferred tax does not mean that the investment must be sold. The proposed regulations clarify that there is no time limit on how long Opportunity Zone investments can be held and that earnings on the investment – if made through a Qualified Opportunity Fund – will be exempt from capital gains tax if held for 10 years if the investment is made before December 2026, when the law sunsets. There is no requirement to sell the property, just to pay the deferred capital gains tax.

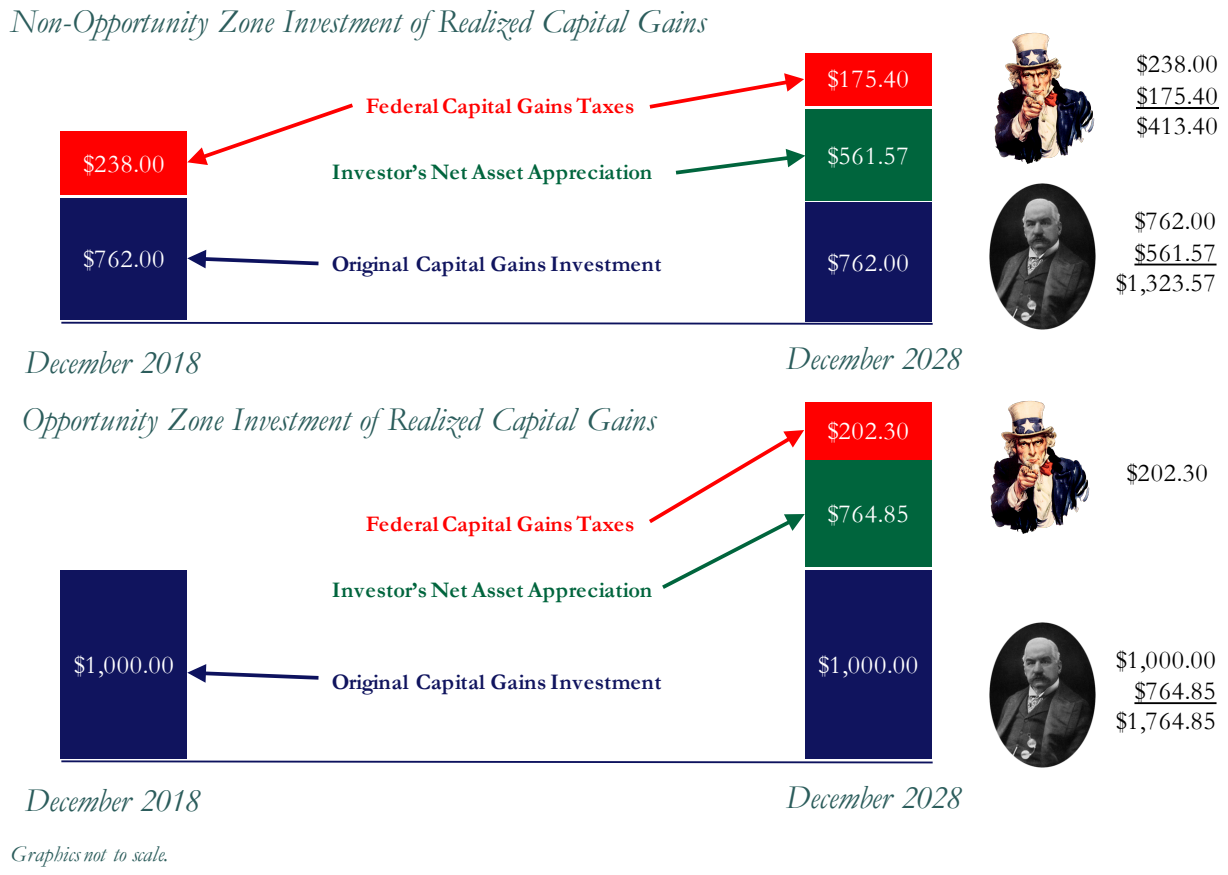
Finally, the proposed regulations create a working capital provision, recognizing that projects take time to be executed. Qualified Opportunity Funds can report investments in Opportunity Zones property even if the funds are not expended as long as there is a written plan for expenditures over 31 months or less and that plan is substantially followed.

Q. What determines the "investor's net asset appreciation"? How are gains realized by Opportunity Zone investors, and what constitutes a project that is viable in terms of return on investment rates?

A. On slide 11 of our original deck (reprinted below), "investor's net asset appreciation" indicates the increase in value of the investor's holdings after tax obligations are met – i.e. how much she actually made at day's end.

Opportunity Zone investors will realize gains through respective stakes in their Opportunity Fund, which in turn (in a best-case scenario) will benefit both from ordinary income and capital gains on their Opportunity Zone businesses, real estate, and other investments.

Because Opportunity Funds are funded investments of capital gains, investors will probably seek *after-tax* returns on investment comparable to assets without such favorable tax treatment. For example, they may be willing to accept a somewhat lower *nominal* rate of return on a new apartment building, knowing that their Opportunity Zone incentives will boost prospective all-in returns to match those available to non-Opportunity Zone investors in another building down the street.



Graphics not to scale.

Q. Who is the typical investor who would benefit from this capital gain tax benefit?

A. The investors who owe capital gains tax are the key market – including high net worth individuals and real estate partnerships.

Q. Can an individual invest in his or her own project or property? How about a corporation that will then invest in that individual's properties? Can a bank holding fund have a vested interest in the property? Are prospective owners of property located in Opportunity Zones excluded from investing in Opportunity Funds with assets therein? For example, can an investor purchase property upon completion of improvements?

A. Opportunity Zone investments must be purchased from unrelated parties in order to qualify for the tax preference. In the governing law (Internal Revenue Code, 26 USC 1400Z-2 (e)(2)) a related party controls 20% or more of the potential investment. The related party rules apply to any kind of investor.

Q. Is the 70% threshold for "substantially all" determined by the property's appraised value or total dollars spent?

A. There are two issues at work here. First, Opportunity Funds are required to invest 90% of their funds in qualified Opportunity Zone property. Each such fund must certify this level of investment every six months. Second, qualified Opportunity Zone businesses must have at least 70% of their tangible property in an Opportunity Zone. Valuations of tangible property must conform to those in financial reports submitted for tax filings, or cost basis if that is not applicable.

The other issue addressed in the regulations is real estate improvement. The rules require a "substantial improvement" be made to property. In this round of regulations, Treasury indicated that the "substantial improvement" test for a real estate investment would be 100% of the original basis of the property minus the cost of the land (i.e. the cost of the building).

Q. Could an economic development organization, city government, or foundation set up or manage an Opportunity Fund? Can cities or other government entities establish Opportunity Funds to invest in properties? Are place-based nonprofits like CDCs creating targeted Opportunity Funds to invest in specific geographies?

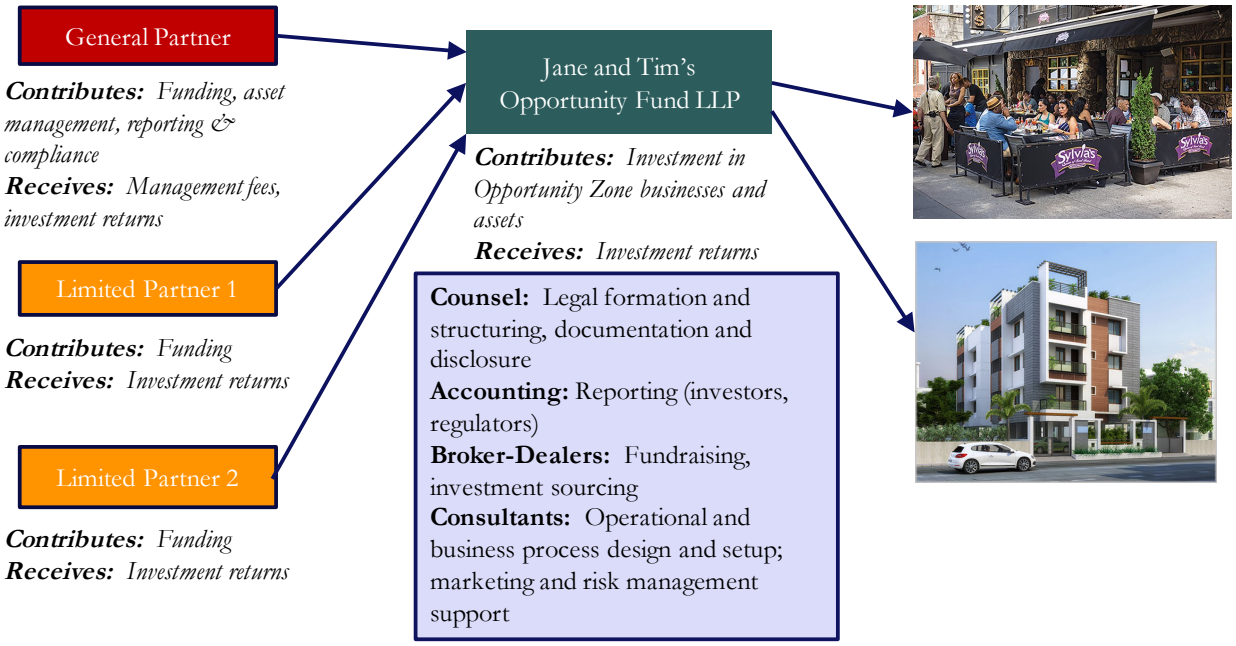
A. According to the Treasury Department, "the proposed regulations generally permit any taxpayer that is a corporation or partnership for tax purposes to self-certify as a QOF." That appears to implicitly exclude tax-exempt organizations. However, economic development entities and local governments can partner with corporations or partnerships to establish and support Opportunity Funds.

Q. Does the fund have to exist prior to the equity investment?

A. In order to qualify as a Qualified Opportunity Zone Investment the equity investment must be made through a Qualified Opportunity Fund. The Treasury guidance specifies that pre-existing entities may become Opportunity Funds. However, only certain investors (i.e. US taxpayers investing realized capital gains) may enjoy Opportunity Fund tax benefits. Existing funds will need the capacity to designate and track such investors and their assets.

Q. How do you set up an Opportunity Fund? Who would be a typical partner in a community to create the fund? Existing investment brokers? Local attorneys? Developers?

A. Below is a *simplified* example diagram of an Opportunity Fund, structured as an investment partnership. This is only one possible fund structure of many permissible options. With respect to formal partners, we indicate likely service providers as well as investors.



Q. Can tribal entities use Opportunity Funds for qualified investment projects?

A. Yes. Both Arizona and the State of Washington intentionally engaged tribal leaders in the Opportunity Zone designation.

Q. Could you comment on the potential investment advice liabilities associated with being an Opportunity Fund?

A. In broad terms, we expect that Opportunity Fund managers will have to meet regulatory requirements that apply to similarly situated fund managers, whether or not registered, with respect to disclosure, fiduciary duties, and investor reporting. Additionally, aside from regulatory mandates, they are also likely to be required to meet industry norms for investor transparency and responsiveness in order to attract funding.

Q. Can the lead investor in an Opportunity Fund also be the fund manager? Who makes the decision on an Opportunity Fund investment? How does someone become an Opportunity Fund manager and what are their qualifications?

A. While the law does not outline qualifications for fund managers, we expect that in many cases the lead investor or general partner (or an affiliate) will serve as fund manager, with the authority to make investment decisions for the fund. The industry is likely to use familiar, proven fund formation templates that exist. As a business matter, we believe that the most successful Opportunity Fund managers will be those that can point to a track record in both (a) management of relevant assets (e.g. small consumer retailers, Middle West multifamily real estate) and (b) local, mission-oriented community development.

Q. Can the 10% of Opportunity Fund assets over and above the 90% asset test be used to pay the fund manager?

A. The 10% not invested in Qualified OZ property can include funds awaiting investment and operating costs, which would include payments to fund managers. We believe investors will be judicious about management fees and seek high quality and low cost management with transparency in reporting.

Q. Is there only one fund manager per Opportunity Zone? Can there be more than one fund manager per property in an Opportunity Zone?

A. There is no formal limit on the number of Opportunity Funds or managers that can invest in any individual Opportunity Zone, or any single business or project therein. For example, two or three separate Opportunity Funds could each obtain equity stakes in an Opportunity Zone business.

Q. We have been approached about a collaborative/multi-state fund. Is it best to form separate funds or pool multiple projects across states?

A. Each approach has merits, and in fact we expect that the long-term Opportunity Fund ecosystem will include both types of funds. Some investors in the space will seek diversification by region, industry and other key characteristics. Others will appreciate the opportunity to invest selectively in specific areas or industries according to their judgment, or simply to participate in the economic renewal of their hometowns. Notably, fund of fund vehicles are prohibited under the Opportunity Fund legislation, so diversified Opportunity Funds will need to make their own investments directly.

The timelines in the law require that capital gains earnings be invested within 180 days of realization and that Opportunity Funds invest the funds within 180 days of receipt into the fund. Thus, successful Opportunity Zone investments will require a healthy pipeline of projects and of investors with the ability to match investors and projects quickly. This need may drive creation of multiple smaller funds for each project.

Q. What is the role of an economic development pro in an Opportunity Zone? How do we as local economic development professionals connect to Opportunity Fund managers to pitch projects? How do we help our own Opportunity Zones stand apart and market them? What are your suggestions for promoting investments in your Opportunity Zones to existing Funds? What role can cities play to use Opportunity Funds or take advantage of Opportunity Zones in their communities? If an economic development authority owns property, how can it attract an Opportunity Fund investor to participate in its site development? Are investors selecting Opportunity Zones and projects to invest in? Should the Opportunity Zone project be well-defined before seeking investment, or should localities pursue investors before pitching ideas to developers?

A. Clear planning for individual Opportunity Zones will make them stand out. Economic development pros are ideally positioned to tell their area's investment "story", highlighting both needs and potential. They can also work with local officials to bring companion investment in housing, infrastructure and schools. Communities can also bring other debt related incentives such as Low Income Housing Tax Credits, New Markets Tax Credits, tax increment financing to a deal.

Additionally, investing in robust data collection and analytics will be exceptionally valuable in making investor assessments easier and more insightful, supporting effective risk management, and promoting transparency to prospective investors (both Opportunity Zone equity investors and companion investors such as municipal bond buyers or federal credit program participants).

We are confident that the ability to tell a unique, authoritative, and well-researched local "story" and a holistic, community-based approach to making local public investments while soliciting private investment will prove, over time, to be most successful.

Q. If an Opportunity Fund invests in property, is there a requirement to develop that property within a certain time period?

A. An Opportunity Zone real estate asset must be either (a) original use (i.e. a new building) or (b) "substantially improved" via investment in renovation and improvement that exceeds the building's original cost basis. The working capital safe harbor detailed under Treasury's guidance allows Opportunity Zone benefits for funds spent on such renovations within 31 months, according to a reasonable written plan.

Q. You said land does not have to be improved, only the building. What does that mean for a vacant lot in an urban setting?

A. Building a new structure on a vacant lot would meet the "substantial investment" test.

Q. What deal structure would you recommend to redevelop a building that is owned by a government (that has no tax liability)?

A. Each deal is different based on the community's needs, business environment, and legal context (e.g. zoning regulations). Some may lease the underlying land to maintain control and sell the building with a potential leaseback. Some may sell the property.

Municipal governments can still expect to work with investors, developers and others to assemble a full financing package. Opportunity Zone provisions are an equity complement to longstanding debt incentives, such as federal lending programs and tax-exempt capital markets.

Q. If there is an equity investment, are there any protections if the business is no longer viable? Any protections or guarantees for the investment, or are only losses on tax returns available? Does the Opportunity Zone program make a good investment better or make a questionable project possible?

A. Qualified Opportunity Zone investments are equity investments that carry an inherent component of risk. As with other equity investments, there are no guarantees. Only losses on tax returns will be available if they lose value. Participation in Opportunity Funds will not substitute for due diligence and good judgment in selecting assets and businesses that will provide appropriate returns on investment in equity.

Q. Do investors need to be accredited?

A. There is no stipulation that investors be accredited. However, as a practical matter, we believe that Opportunity Funds will be oriented toward accredited and institutional investors, as those groups stand to benefit most from the favorable tax treatment.

Q. Can there be multiple funds per Opportunity Zone? Can Opportunity Funds invest anywhere in the 8,700 Opportunity Zones?

A. Yes. No limit exists to the number of Opportunity Funds that can invest in a single Opportunity Zone, nor does any geographical limit exist for investment in Opportunity Zones.

Q. Can Opportunity Fund holdings be used as collateral for debt?

A. Yes, this is actually specifically contemplated by the recent Treasury guidance.

Q. Is the Opportunity Fund required to have control of the assets?

A. No, Opportunity Funds can invest in passive or minority stakes of Opportunity Zone businesses and assets.

Q. How do you see debt being used to complement Opportunity Zone investments?

A. While Opportunity Zone businesses and assets offer equity investors favorable tax treatment, debt will continue to constitute an essential portion of the capital structure for many such investments. Investors, developers and others seeking to assemble a full financing package should look on the Opportunity Zone provisions as an equity complement to longstanding debt incentives, such as federal lending programs and tax-exempt capital markets.

Q. What kinds of equity are eligible? For instance, convertible or mezzanine securities?

A. The recent Treasury guidance specifies that equity investments, including preferred equity or partnership interest with special allocations, are eligible Opportunity Zone investments. Conversely, it specifically excludes debt as defined under the Internal Revenue Code.

Q. What if the project starts outside the Opportunity Zone but goes into an Opportunity Zone (for example, connecting a pipeline)?

A. Here, the most salient provision of the recent Treasury guidance is that "substantially all" (i.e. at least 70%) the tangible assets of qualified Opportunity Zone businesses must reside within Opportunity Zones. The most direct reading of the guidance as it relates to an individual pipeline operation would be that at least 70% of its tangible assets (lines, pumping stations, &c) must lie therein.

Q. I read that Opportunity Funds can invest in property, business or business assets in Opportunity Zones. What is an example of a "business asset" aside from a building or land? Equipment?

A. Tangible assets such as business equipment (e.g. forklifts, walk-in freezers), whether leased or purchased, and inventory also constitute qualified opportunity zone business property under the new Treasury guidance.

Q. Our Opportunity Zone is 90% residential. What's the possible investment in such a case?

A. Obvious candidates for a heavily residential Opportunity Zone include housing and commercial assets to support neighborhood amenities, such as retailers and retail-oriented commercial real estate. Such businesses are generally permissible Opportunity Zone investments.

Q. What types of infrastructure projects are eligible? Can an Opportunity Fund invest in P3 projects? How would investors make a profit on investing in an infrastructure project?

A. The definition of "infrastructure" can be very extensive, covering everything from schools and hospitals to highways and electrical grids. Such projects are eligible for Opportunity Zone treatment, subject to the "substantially all" provisions. Normal economics for infrastructure projects are likely to apply; within those contexts, the Opportunity Zone provisions offer a relative advantage for infrastructure investments therein, effectively making equity return "hurdles" easier to meet. Private investment in infrastructure earns revenue based on either a lease payment from a governmental entity or a fee based structure (like a toll road).

Q. Are hotels with bar/entertainment facilities precluded under the "sin" provisions of the legislation?

A. The "sin" provisions apply to package stores (e.g. retailers selling alcoholic beverages for consumption off-premises). Generally, hotels and restaurants are included among eligible Opportunity Zone businesses. However, golf courses are specifically identified as sin businesses and are not eligible.

Q. Can an investor that already owns the property invest in the opportunity zone by building on it and enjoy the tax benefits on the land purchase and/or construction of the building?

A. Land no, construction yes. The recent Treasury guidance specifically addresses this point. Property investments must be allocated between the land and the building. Investors are eligible for Opportunity Zone treatment, however, on "substantial improvements" made within the required 31-month window and exceeding the cost basis allocable to the building itself. The prohibition on self-dealing applies in all cases.

Q. Can an Opportunity Fund invest in workforce housing located in an Opportunity Zone?

A. Yes.

Q. Can an Opportunity Fund invest in a site and another Opportunity Fund invest in a building on the same site?

A. Yes. In fact, two different Opportunity Funds could each make independent equity investments in the same building.

Q. Can you provide an example of how this might support affordable housing development?

A. The Opportunity Zone tax benefits for equity investors supplement existing incentives on the debt side, such as federal lending programs and access to municipal capital markets. As a result, according to indicative analyses performed by Tim's firm Signet Partners, investors in affordable housing developments located in Opportunity Zones can boost their internal rate of return for equity investments by five or more percentage points compared to similar projects outside Opportunity Zones, potentially making possible new housing investments specifically targeted toward these areas.

Q. Are multi-family the only projects that qualify?

A. While multi-family projects are probably the most straightforward housing-related case for Opportunity Zone investments, no prohibition exists on single-family development or rental businesses. Such efforts, however, would need to remain mindful of the need to comply with the 70% "substantially all" provision in the new guidance.

Q. Can an Opportunity Fund invest in startups?

A. Yes.

Q. Will these funds be used for small projects? Do you anticipate a minimum size?

A. Opportunity Funds may invest in small projects, including small businesses and individual buildings. At this point, we see no reason to believe that Opportunity Fund investments will be limited to larger businesses or projects.

Q. Do you foresee greater clarity coming from future rounds of guidance on how equity investments can be made in early-stage startups that don't have high valuations or tangible property?

A. We encourage stakeholders that wish to support investment in early-stage startups to submit comments to Treasury at CC.ITA.Section.1400@irscounsel.treas.gov or the Web form at https://www.regulations.gov/comment?D=IRS-2018-0029-0001 suggesting or soliciting guidance on this topic. The Comment period on the current proposed regulations is open until noon on December 28.

Q. I note that certain addresses are incorrectly characterized as within Opportunity Zones on the mapping application. Please provide the link for the map again.

A. The Treasury Department-provided map is provided at https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml. Several NGOs, including Local Initiatives Support Corporation and Enterprise Community Partners, also publish Opportunity Zone maps. A number of state governments offer additional mapping resources. If you know of incorrectly mapped places, we encourage you to note them in comments to the Treasury Department at CC.ITA.Section.1400@irscounsel.treas.gov or https://www.regulations.gov/comment?D=IRS-2018-0029-0001.

Q. What is the best method to identify Opportunity Funds on a national level? Will there be a directory of Opportunity Funds, possibly for developers to identify potential investors? How can I identify any local Opportunity Zone funds already in existence prior to starting one? How can I verify that a fund is in fact registered?

A. Neither the law nor the regulations require a national directory of funds. There is a continuing discussion both in the community development world and on Capitol Hill about transparency and reporting.

Right now Novogradac has published a list of funds and the National Council of State Housing Agencies published a list of funds seeking to invest in housing. Each list is based on fund managers reaching out to be listed.

Q. Is there a provision to extend the Opportunity Zones after the initial 10 year period?

A. Currently, no. But there will be many stakeholders keeping an eye on the real-world impact of Opportunity Zones. Successful implementation is likely to inspire continuation of the program.

Q. The industry would benefit from standard guidance forms for municipalities, economic development organizations, and private investors.

A. Both Treasury and the Congressional sponsors indicate preference for "light touch" regulation. At the same time, advocates and some on Capitol Hill are interested in transparency and reporting. We encourage you to provide comments to the Treasury Department on this issue at CC.ITA.Section.1400@irscounsel.treas.gov or https://www.regulations.gov/comment?D=IRS-2018-0029-0001.

The Rockefeller and Kresge Foundations are taking a lead in convening philanthropic interest in meaningful Opportunity Zone investments. Part of that effort is looking at the potential to provide some templates for creation of Opportunity Funds and impact reporting.

Other stakeholder groups may take a constructive leadership role in driving consensus on the question. Tim notes that, in the financial services space, standardized documentation for derivatives contracts emerged through an industry-driven effort.

We appreciate your interest in Opportunity Zones. This document is intended to provide general guidance to a wide range of interested parties on a new policy initiative that continues to evolve. As such, it does not constitute legal, accounting or investment advice to any individual readers. Consult your own advisors for specific guidance regarding your own individual or organizational situations.

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