



Opportunity Zones



Opportunity Zones

What are the basics?

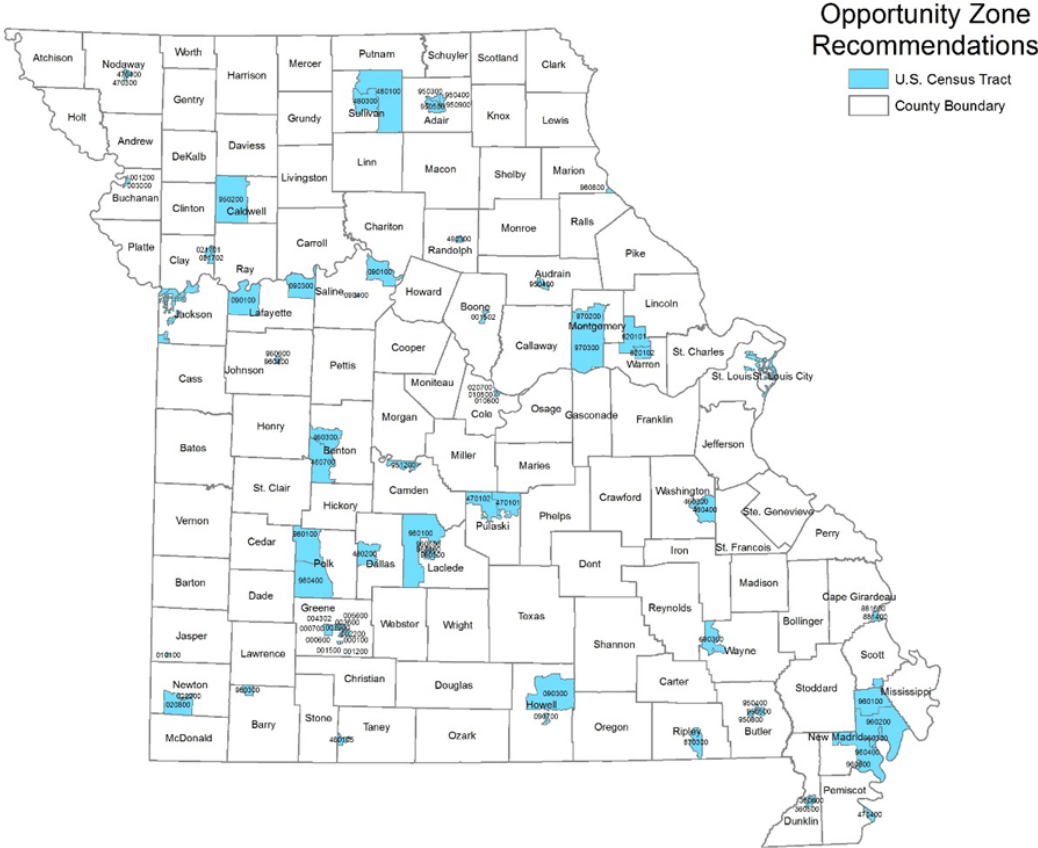
- New stimulus tool created by Tax Cuts and Jobs Act (2017)
- Purpose – encourage investment in economically-distressed areas
- Vehicle – tax benefits for equity investment in Opportunity Zone Business or Opportunity Zone Fund

Opportunity Zones

- Opportunity Zones were designated by State Governor and certified by IRS in 2018
 - No new Opportunity Zones can be created (absent change in legislation)
 - Low-income census tracts
 - Or census tracts contiguous to low-income census tracts

Opportunity Zones

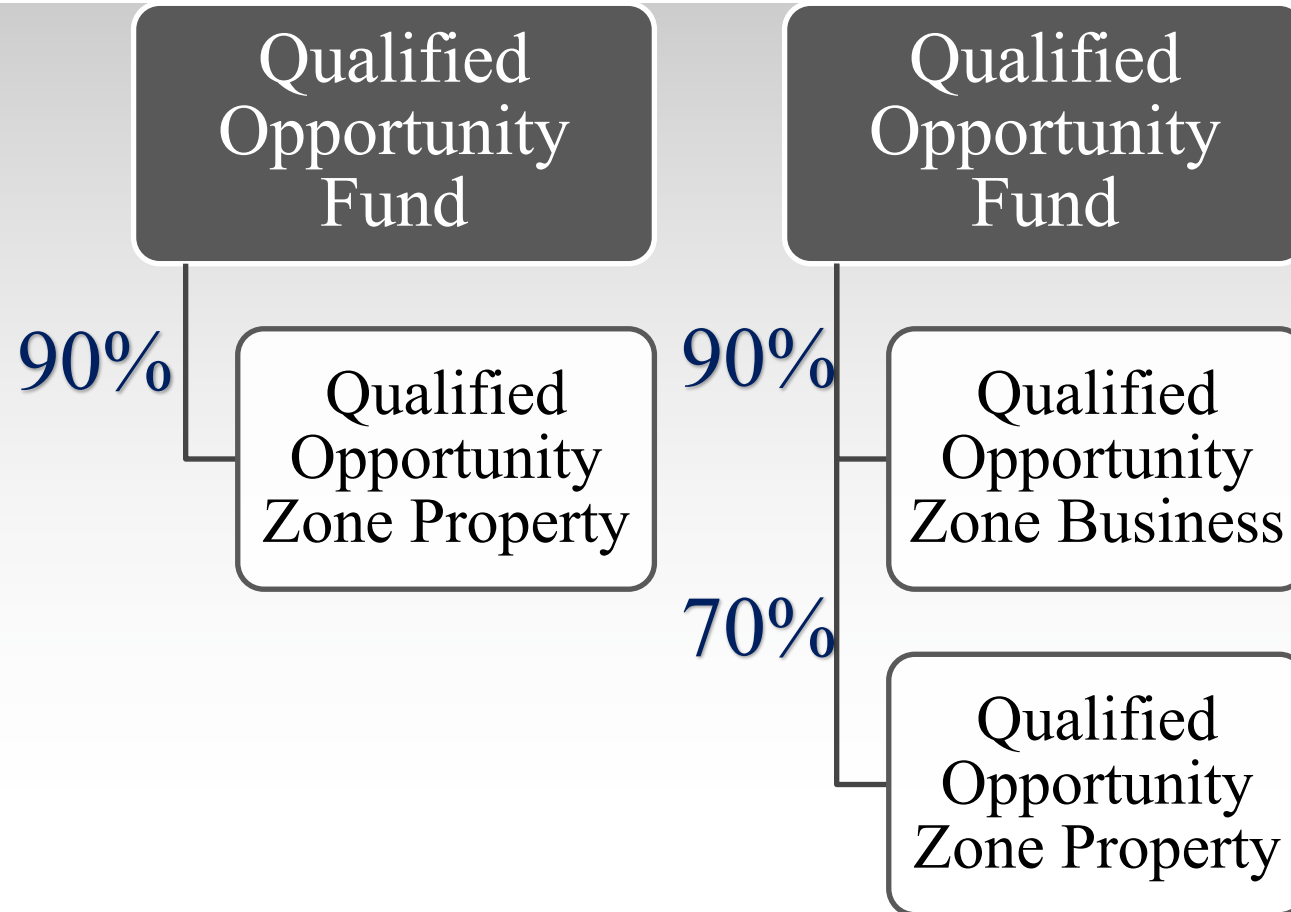
Missouri



Qualified Opportunity Zones

- Specific geographic areas selected by State Governor
- See <https://www.cdfifund.gov/pages/opportunity-zones.aspx>
- Interactive map:
https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml

Investment in QOF



Basic Requirements

- Active Trade or Business (Including Rental Real Estate)
 - But no “triple net” leases
- No “Sin” Businesses
- Qualified Opportunity Zone Property
 - “Original Use” vs. “substantial improvement”
- Many “Technical” Tax Questions Still to be Addressed

Investor Tax Benefits... 1,2,3

1) Deferral of Capital Gain

- Investors may *defer* capital gain until 12-31-26 by making *equity investment* in Opportunity Zone Fund
- Investment must be made within 180 days of transaction giving rise to capital gains

Investor Tax Benefits... 1,2,3

2) Forgiveness of Portion of Capital Gain

- 10% of deferred capital gain *forgiven* if the investment is held for 5 years
- Additional 5% of deferred capital gain (15% total) *forgiven* if the investment is held for 7 years
- Investment should be made by 12-31-19 for full benefit

Investor Tax Benefits... 1,2,3

3) Forgiveness of Gain Associated with OZ Fund Appreciation

- Any gain attributable to appreciation of the investment *in the Opportunity Zone Fund* is forgiven if the investment is held for at least 10 years

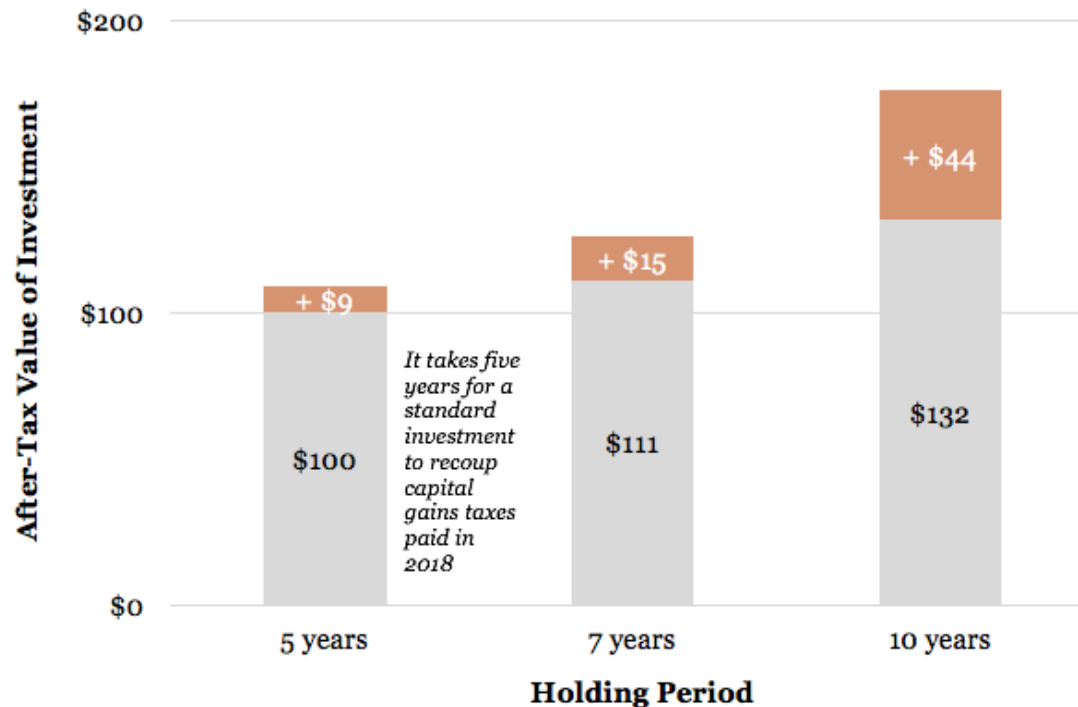
- Example

Investor Tax Benefits

- Top long-term capital gain tax rate is 20%.
 - High earners also pay a “net investment income tax” of 3.8%
- So if an individual in top tax bracket had a \$1,000,000 LTCG
 - Would pay \$238,000 in tax ($= \$1,000,000 \times 23.8\%$)
- With OZ investment, same individual can:
 - Defer payment of capital gain tax until 12/31/26
 - Avoid payment of tax on \$150,000 of LTCG (saves \$35,700)

Qualified Opportunity Zones vs. Normal Investment

| Incentives Offered by the Opportunity Zones Program | | |
|---|---|---|
| Deferral + 10% step-up in basis | Deferral + additional 5% step-up in basis | Deferral + total 15% step-up in basis + permanent exclusion of O-Fund gains from taxes |



The **Opportunity Zones** program offers the most upside to patient investors who hold their O-Fund investments for at least 10 years.

All else equal, come 2028 an investor will be **\$44 better off** for every \$100 of capital gains they rolled over into an O-Fund in 2018 than if they had chosen a more traditional stock portfolio instead.

■ Standard Portfolio Investment ■ Excess Returns Offered by an O-Fund Investment

Opportunity Zones & Local Government Economic Development

- Opportunity Zones can encourage equity investment – but there must be a viable business & real potential for profits
- Some states and municipalities are compiling prospectuses to provide to potential investors regarding potential investments in specific opportunity zones
- Municipalities should ask developers to pursue OZ investment in appropriate projects (condition for other incentives)

Opportunity Zones & Local Government Economic Development

- Traditional economic development tools (tax-exempt bonds, tax abatement, sales tax exemption, tax credits, TIF, Special Taxing Districts, IRB's, etc.) can be used along with OZ equity
 - These tools are not mutually exclusive
 - Ex. Missouri reserving \$30MM of Historic Preservation Tax Credit for allocation in OZ
 - Ex. Michigan adding point system to QAP for OZ investment



Another tool...

- Ready capital – supply outweighs demand
- Another source of funds (conventional equity, private financing, public financing, government incentives) to make up the “capital stack”
- Another economic development tool for state and local governments (tax credits, bonds, tax abatement)

... but keep in mind

- There is real economic risk when investing in an Opportunity Fund
 - Examples assume a set rate of annual appreciation on investment
 - THIS IS NOT HOW EQUITY WORKS – generally lots of fluctuation
 - Examples assume willing buyer would “show up” after 10 year period expired
 - NOT LIKELY – could be difficult to find new purchaser to allow developer to exit
 - Examples assume tax rates would remain the same
 - Change in tax rates could either lessen (or increase) impact of tax deferral and avoidance
- Traditional eco-devo tools can be used along with OZ equity
 - Not mutually exclusive (tax-exempt bonds, tax credits, TIF, abatement, etc.)

Headlines!!!



- A) CIM Group to Launch \$5B Opportunity Fund
- B) Introducing ‘Opportunity Zones’: The Trump Administration’s New Tax Break for Art Collectors
- C) Opportunity Zones are a State of Mind
- D) How Opportunity Zones could bring Kimmy Schmidt’s sweet Netflix cash back to Middle America