Opportunity Zones and the Preservation Community

• Alexander Flachsbart, Founder and CEO, Opportunity Alabama;
• Merrill Hoopengardner, President, National Trust Community Investment Corporation;
• Bonnie McDonald, President and CEO, Landmarks Illinois;
• Forrest David Milder, Nixon Peabody; and
• Anthony Veerkamp, National Trust for Historic Preservation

Moderator: Jim Igoe, Executive Director, Preservation Massachusetts

JANUARY 17, 2019
New Report Released

Available:

https://forum.savingplaces.org/state-htc
Today’s Roadmap

1. Hear from Speakers
2. Wrap-Up Comments
3. Q&A with Speakers
Alexander Flachsbart, Founder and CEO, Opportunity Alabama
Bonnie McDonald, President and CEO, Landmarks Illinois
Merrill Hoopengardner, President, National Trust Community Investment Corporation
Anthony Veerkamp, Director of Policy Development, National Trust for Historic Preservation
Overview of Qualified Opportunity Funds

Forrest David Milder | January 17, 2019
617-345-1055 | FMilder@NixonPeabody.com
What is the Fundamental Objective?

• There is $6.1 TRILLION of appreciated property in the US.

• The OZ provisions are intended to get taxpayers to sell some of these appreciated assets and invest the resulting gain in designated low income communities, called “opportunity zones,” by delaying the tax that they would otherwise pay on the sale of the asset that they sold to make the investment, and eliminating the tax on increase in value of their OZ investment.

• To take advantage, taxpayers must invest in “Qualified Opportunity Funds, and these funds must, in turn, acquire opportunity zone business assets, and hold their Opportunity Fund investment in accordance with specified percentages and timetables.
The Tax Incentives -- 1

• **Defer Tax on Capital Gains.** An investor can postpone paying tax on capital gains by as much as 8 years where an amount equal to this gain is invested in an Opportunity Fund. The drawbacks: the investor gets a 0 basis in its investment, and the gain is taxable at December 31, 2026, or on sale of the investment if earlier.

• **Example:** A has a basis in publicly traded stock of $1m, which she sells for $5M. She would normally pay tax on the $4M of gain. If she invests $4M in an Qualified Opportunity Fund, she delays paying the tax.

• Then investment must be made within 180 days
Tax Incentives -- 2

• **Partial forgiveness.** The investor’s basis in investment is increased from 0 to 10% for investments held for 5 years, and another 5% for investments held for 7 years, provided these dates are before 12/31/26. This effectively reduces the tax by 15%. Basis is also increased by the amount of gain recognized at December 31, 2026.

• **Example:** A has a gain of $4M on November 2018 which she immediately invests in an opportunity fund. She gets back a membership interest in the fund with a zero basis. If she sold that interest in 2019, she would pay tax on the full sales price. In November 2023 (five years later), her basis is stepped up to $400K. If she sold that interest, she would pay tax on the sales price less $400K. In November 2025, her basis gets stepped up by another $200K, and in December 31, 2026, she becomes liable for tax of $4M (or the value of the investment, if less) less her basis of $600K. In a typical case, this would be $4M less $600K, or $3.4M.
The Tax Incentives -- 3

• Forgiveness of additional gains. The investor’s basis in its investment is increased to fair market value for sales or transfers of the investment in the Fund after 10 years (until 12/31/47). Under current law, this step-up does not apply to a sale of assets owned by the Fund.

• Example 1: A has a gain of $4M on November 2018 which she immediately invests in an opportunity fund. She gets the step-ups and pays taxes as described in the preceding slide. In December 2030, when she has a basis of $4M in her interest in the fund, she receives an offer of $10M for her interest. If she elects, her basis is stepped up to $10M, so that she pays no tax on this sale ($10M sales price less $10M of basis is zero).

• Example 2: Same facts as Example 1, except that in December 2030, the FUND owns property with a basis of $4M that it sells for $10M. This generates a $6M TAXABLE gain, and A will have to report her share.
The Timeline

SALE of “other property” generating ORIGINAL GAIN

Investment in Opportunity Fund within 180 days. Investor gets 0 basis in investment

Held for 5 years

- Basis increased by 10% of the deferred gain

Held for 7 years

- Basis increased by 5% of the deferred gain

Held for 10 years

- Pay tax on ORIGINAL gain with 2026 tax return

Basis is increased to Fair Market Value AT THE TIME OF TRANSFER/SALE of the Fund interest. Must be at least 10 years later

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028

Pay tax on ORIGINAL gain with 2026 tax return
Where are the Opportunity Zones?

• OZs are 25% of a state’s “low-income communities” (“LICs”) as designated by the governor. The designation period is OVER.

• There are 8,700 OZs; about 11% of all census tracts.

• Full list of Opportunity Zones can be found on the CDFI Fund’s website. The links are in the document on the right.
What is the law?

• Section 1400z-1 of the Tax Code provides the rules for designating the OZs, and Section 1400Z-2 provides the rules for Opportunity Funds


• There are also FAQs at https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions

• Further Regs are expected soon.

• Even with the Code provision and the other guidance, the rules have lots of holes and uncertainties.
A Few Important Details

• None of the like kind exchange rules apply -- There is no “tracing of the funds,” There are no “qualified intermediaries.” Taxpayer can sell one kind of asset (e.g., stock), and invest in a completely different asset (e.g., real estate).

• Property must be acquired after 2017 to qualify. There are very stiff related party tests (20% or less).

• Used property must be rehabilitated to qualify, with a basis increase over 30 months equal to or exceeding basis at the start of the 30 month period.
Direct vs Indirect Investments

• The Fund can only make certain investments. It must invest in one of these:
  • Direct Ownership: The Fund can own (A) tangible assets directly and (B) Subsidiary entities. There’s a 90% test here.
  • Indirect Ownership: The Fund can own “subsidiary entities,” partnerships or corporations. There’s a 70% test at the subsidiary level, but there are also several additional tests.

• Illustrations on following slides
Basic Structures

INVESTORS

Qualified Opportunity Zone Fund

DIRECT Ownership

Qualified Opportunity Zone Business Property

INDIRECT Ownership

Qualified Opportunity Zone Partnership Interest

(90% test here)

Qualified Opportunity Zone Stock

(70% test here)

Qualified Opportunity Zone Business
Comparing the 90% and 70% Tests

• **Example 1**: Opportunity Fund has $1M, it invests $900,000 in a partnership, receiving back a partnership interest. Partnership uses the cash to buy a $700,000 new building in an OZ, and a $200,000 building *not* in an OZ. So, 7/9, or 77% of its assets (more than 70%) are good, and therefore, the entire $900,000 partnership interest qualifies. Finally, 900K/1M of the Opportunity Fund’s assets, or 90%, are good, and it meets the 90% test.

• **Example 2**: Opportunity Fund has $1M, it buys a $700K new building in an OZ, a $200K building *not* in an OZ, and keeps $100K of cash. This FAILS, because only 70% of its assets are qualified.
More On Indirect Ownership

• A subsidiary entity must pass these tests:

  • 70% of the entity’s tangible property must be in the OZ
  
  • At least 50% of income is derived from Active Conduct of a trade or business (proposed Regs add “in the OZ”)
  
  • Substantial portion of its intangible property must be used in active conduct of business
  
  • Less than 5% of the unadjusted basis of its property is nonqualified financial property (e.g., cash, securities, other entities)
  
  • Not a “sin business” (golf courses, tanning parlors, etc.)
Rehabilitating Used Property

• If a Fund starts with used property, then, over a 30-month period, an Opp Zone business must incur additions to basis with respect to used property equal to the property’s basis at the start of the 30-month period.

• When computing the required capital expenditures for used property, you do NOT include land.

• Example: Fund acquires property for $5M, consisting of $1M of land and $4M of building. It must have capital expenditures with respect to the project of $4M.

• There’s a “safe harbor” if a subsidiary entity builds or rehabs a project within 31 months, pursuant to a written plan.
Illustrations of Rehabilitating Used Property

• **Example 1:** Opportunity Fund has $2.4M, it invests $2.3M in a partnership, receiving back a partnership interest. Partnership uses cash to buy land for $200K, a building with a basis of $1M in an OZ, and it will use the other $1.1M in cash to do a $1.1M rehab pursuant to a written plan. This passes the 70 percent test, even though half its assets consist of cash. Finally, 2.3/2.4 of the Opportunity Fund’s assets, or 95.8%, are good, and it meets the 90% test.

• **Example 2:** The partnership owns land with a basis of $200K and a building with a basis of $1M, and it has $1.1M in cash and a written plan to do a $1.1M rehab. This passes the 70% test, even though half its assets consist of cash.
CREATING AN OPPORTUNITY ZONES ECOSYSTEM

ALEX FLACHSBART
THE NATIONAL LANDSCAPE

Downtown Seattle
Bay Area
Denver
Austin
Detroit
Manhattan
Downtown Atlanta
North Miami Beach
How do we build an ecosystem to maximize Opportunity Zone investment in Alabama?
KEY COMMUNITY TAKEAWAYS

Develop Project Pipeline
Develop Local Investor Pipeline
Develop Local OZ Marketing Strategy
Develop Local OZ Ecosystem
WHAT YOUR INTERMEDIAR(IES?) SHOULD DO

• General OZ Education / Project Assessment / Fund Information
• Institutional Partner Engagement / “Concierge” Service
• Fund / Deal Introductions
• Community Ecosystem Working Group
• Community Prospectus Development
• Needs Identification / Impact Tracking
• Direct Community Investment Mechanisms
ACCOMPLISHMENTS TO DATE

**Education**
- 35 Presentations
- 1,000+ People receiving instruction

**Marketplace**
- $120m In equity need on 10 immediate projects
- 50+ Projects in pipeline ($1bn+ total)

**Promotion**
- 42% of AL OZs convening OZ-specific planning
- 28% of AL OZs have “investor guide” under development

**Data Tracking**
- 100+ Data points being tracked for communities + projects
- 100% of project sponsors have agreed to share data
QUESTIONS?

ALEX@OPPORTUNITYALABAMA.COM
334.425.4166
Evaluating the Launch of a Qualified Opportunity Fund (QOF)

An tool for nonprofit preservation organizations

Bonnie McDonald, President & CEO, Landmarks Illinois - January 17, 2019
About Landmarks Illinois

• Formed as a grassroots advocacy organization in 1971 in Chicago
• Statewide nonprofit preservation org since 1979
• Chicago HQ and Springfield Field Office
• 37-member board and nine staff
• $2.3M budget
• Services include advocacy, technical assistance, public policy, trainings and lectures, networking events, publicity, grantmaking and revolving loans
O-Zones - A New Preservation Incentive in IL?

- 327 Opportunity Zones in Illinois (82% metro)
- Over half (181) in Cook County (Chicagoland)
- One-by-one, researching alignment with Landmarks Illinois projects statewide
  - Findings: No such luck…

- November 2018 Board of Directors training
- December 2018 Reinvestment Committee (revolving loan fund) training
- Hosting a preservation incentives training in Chicago on February 20, including Opportunity Zones
The Frustration with Opportunity Zones

Former Anthony Overton Elementary School
221 E. 49th Street, Chicago
Perkins and Will, 1963
Listed in NRHP
Photo used with permission - copyright Sandra Steinbrecher
The Frustration with Opportunity Zones

Laramie State Bank Building
5200 W. Chicago Avenue,
Chicago Meyer and Cook, 1929
Chicago Landmark
Photo by decopix.com from
www.pinterest.com/pin/31095954
9248010155/?lp=true
Evaluating the Launch of a Qualified Opportunity Fund (QOF)

Question 1: What is the organization’s goal?

Question 2: Do you have a project? (Answer “yes” to all)
  - Do you have a project in a QOZ?
  - Can the QOF acquire the property or was it acquired after 12/31/17 from a non-related party?
  - Will 90%+ of QOF assets be spent on the QOZ property?
  - Will the property meet the substantial improvement test or commence its original use with the investment?
  - Will the investment be made by 12/31/2026?
  - Are you willing to hold the property for 10 years and bear the risk?
  - Can we sell the investment at the end of the holding period?
  - Will the property provide a (non-guaranteed) return to the QOF investors?

Question 3: Do you have the capacity? (Answer “yes” to all)
  - Do you have legal counsel available to set up your QOF as an LLC?
  - Do you have accounting assistance to file your QOF self-certification (IRS Form 8996) with the org’s IRS Form 990?
  - Do you have the human resources and expertise to manage the investment and the property long-term?

Question 4: Do you have investors?
  - Do your existing donors have large capital gains (sale of property, stocks)?
  - Can you develop an informative solicitation about the QOF and have experts available to explain the program?
Landmarks Illinois Launch a Qualified Opportunity Fund (QOF)? No.

<table>
<thead>
<tr>
<th>Question 1: What is the organization’s goal?</th>
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<tbody>
<tr>
<td>Facilitate historic property reuse.</td>
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<tr>
<th>Question 2: Do you have a project?</th>
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<tbody>
<tr>
<td>No, but we know of projects</td>
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<tr>
<th>Question 3: Do you have the capacity?</th>
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<tr>
<td>Yes to legal and accounting, no to acting as a bank</td>
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<tr>
<th>Question 4: Do you have investors?</th>
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<tbody>
<tr>
<td>Yes, we know donors likely to have capital gains</td>
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How can we facilitate historic property reuse through the O-Zone Program?
An Alternative Option to Drive Resources to Preservation Projects

How can we facilitate historic property reuse through the O-Zone Program?

**Option A: Create QOF**
- Investors → Projects
  - Direct impact
  - Administrative fees
  - *Higher risk*

**Option B: Assist QOF**
- Projects → Investors
  - Less risk
  - Finder’s fees
  - *Indirect impact*
Bonnie McDonald
President & CEO
Landmarks Illinois
bmcdonald@landmarks.org
(312) 922-1742
@LIPresident
www.landmarks.org
Paving the Path for Pairing Incentives

Combining Opportunity Zone Funds and Tax Credit Equity

Merrill Hoopengardner - January 17, 2019
NTCIC’s Mission and Role

• NTCIC is a wholly owned for-profit subsidiary of the National Trust for Historic Preservation (The Trust), the leading nonprofit advocate for historic preservation in the United States.

• NTCIC finances sustainable economic development in communities nationwide by providing:
  • tax credit syndication
  • technical assistance
  • advocacy

for the preservation of historic properties, especially in low-income communities, and the promotion of renewable energy.
Preservation Opportunities

• Historic Tax Credits
  – 58% of Part 2 applications received in 2018 overlap with Opportunity Zones

• Main Street
  – 46% overlap with one or more Opportunity Zones

• Likely influx of capital from non-preservationists

• Balance opportunity with risk of new “Urban Renewal”
Investments in Opportunity Zones

• NTCIC made 27 Historic and/or New Markets Tax Credit investments between 2017 & 2018
• Of those investments, 52% were located in Qualified Opportunity Zones

• 49% of investments in our active pipeline are located in Opportunity Zones
The Pythian Building – New Orleans, LA
The Duncan BioTech Center – St. Louis, MO
Preservation Opportunities Utilizing Opportunity Zones

Existing and future historic preservation projects can benefit from the new incentive
Future Historic Tax Credit Projects
Catalytic Possibilities of Combining Opportunity Zones and Tax Credits

• Attract more capital to close the persistent financing gap of historic rehab in low-income areas

• Ensure “guardrails” to promote preservation and community impact
  • HTC's and NMTC's have track record for preservation, job creation, and other quality community outcomes
Opportunity Zone Hurdles

• No grant or debt options through Opportunity Zones
  • Compare to NMTC which provides for debt or equity
  • Likely not attractive for low-return but high-impact operations (e.g. community facilities)

• Risk profile varies
  • Tax credit investors prioritize compliance
  • Opportunity Zone investors will have standard capital market return and underwriting requirements

• Regulations present limitations for OZ investments to be easily combined with other financing tools such as the NMTC or HTC
Key Technical Barriers

• Property must be acquired by purchase after 12/31/17
  • Impacts basis used for substantial improvement calculation
  • May eliminate “grandfathered” HTC deals from incentive eligibility

• Uncertainty regarding leases
  • Active conduct requirement for QOZB may prohibit master lease structure without NMTC-like guidance
  • Valuation for substantially all requirement

• Zero basis requirement
  • May impair ability to claim the HTC in single entity structure
  • May require suspension of losses
Next Steps

How you can help shape the future of Opportunity Zones
Shaping Opportunity Zones to Support Preservation & Community Impact

- **Stay Tuned**: Executive Order encourages agency collaboration…how will NPS and Treasury participate?
- **Collaborate**: NTCIC working with HTCC and industry leaders to remove technical barriers…how will final regulations support our goals?
- **Partner**: Local & state support are key to ensuring OZs will be used to benefit the community…who is participating in your transactions?
Advocate: If regulatory efforts are unsuccessful, legislative fixes may be necessary…will these be viable within OZ itself or will changes to HTC and/or NMTC be more effective?

Educate: The greatest common multiple will shape the transactions…how can potential projects take advantage of other resources that will provide additional subsidy and require community impacts?
Opportunity Zones: Key Points and National Trust Tools

Anthony Veerkamp, National Trust for Historic Preservation
Opportunity Zones in San Francisco Bay Area

- Area designated an opportunity zone
- Area experiencing gentrification*

Source: Bloomberg Businessweek
Data: US Census Bureau, Urban Institute, Redfin

Median home sales prices in this part of Oakland have jumped 189% in the last five years.
Urban renewal in San Francisco’s Filmore District

Melrose Record Shop circa 1950

Photo by David Johnson
Mall of America, Bloomington, MN

Source: www.startribune.com
Council bans development, demolition in east Boulder opportunity zone

Moratorium in place until June 2020, but hope is bits will chipped away as regulations are firmed up

By Shay Castle
Downtown Augusta, Maine Opportunity Zone

Source: Mainebiz; Credit: Maureen Millekin
Questions?

Use Chat Box (to right of the screen)

Upcoming Webinars:

• **January 30th at 3pm ET:** The Rosenwald Schools GIS Mapping Project
  - [https://register.gotowebinar.com/register/7840637604615931650](https://register.gotowebinar.com/register/7840637604615931650)

• **March 14th at 3pm ET:** Congressional Appropriations
  - [https://attendee.gotowebinar.com/register/3974856976377318147](https://attendee.gotowebinar.com/register/3974856976377318147)
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