An Introduction to Opportunity Zones and Funds for *Minnesota Housing Partnership*

August 22, 2018

Local Initiatives Support Corporation (LISC)
Twin Cities, Duluth and Rural

Opportunity Zones



The Opportunity Zones tax incentive was established by Congress in the 2017 Tax Cut and Jobs Act as an innovative approach to spur long-term private sector investments in low-income urban and rural communities nationwide. This economic development initiative is based on the bipartisan **Investing in Opportunities Act**.

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.

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.

Now is the time to diversify.

Designated Opportunity Zones

All states and territories have officially designated their Opportunity Zones, as of June 14, 2018.

8,762
census tracts designated

1,858
rural census tracts designated

31%
average poverty rate

14.4%
average unemployment rate

60%
average family income in OZ census tracts relative to area median income (AMI)

24 million
current jobs in designated tracts

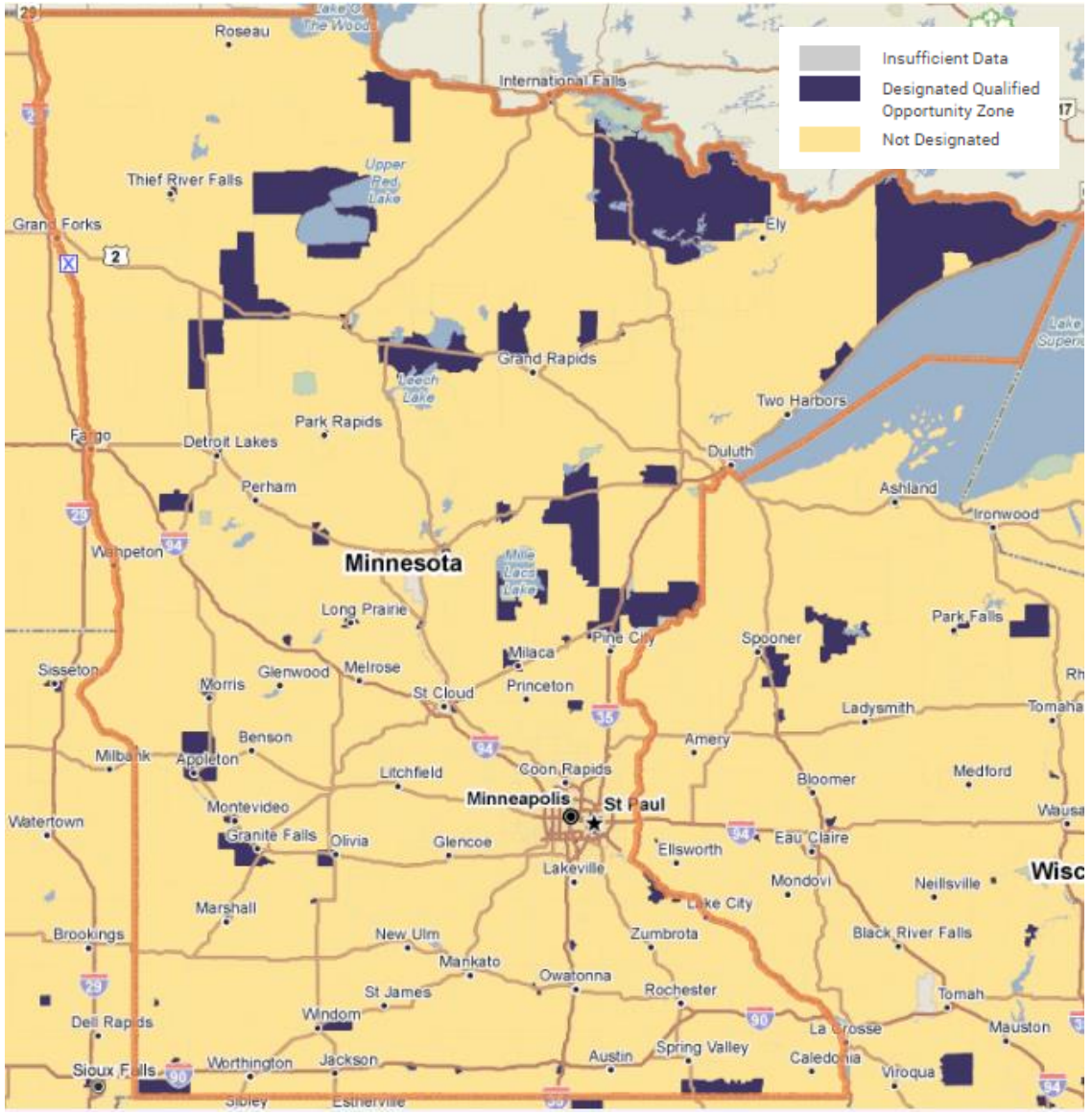
1.6 million
businesses in designated tracts

Minnesota Designations

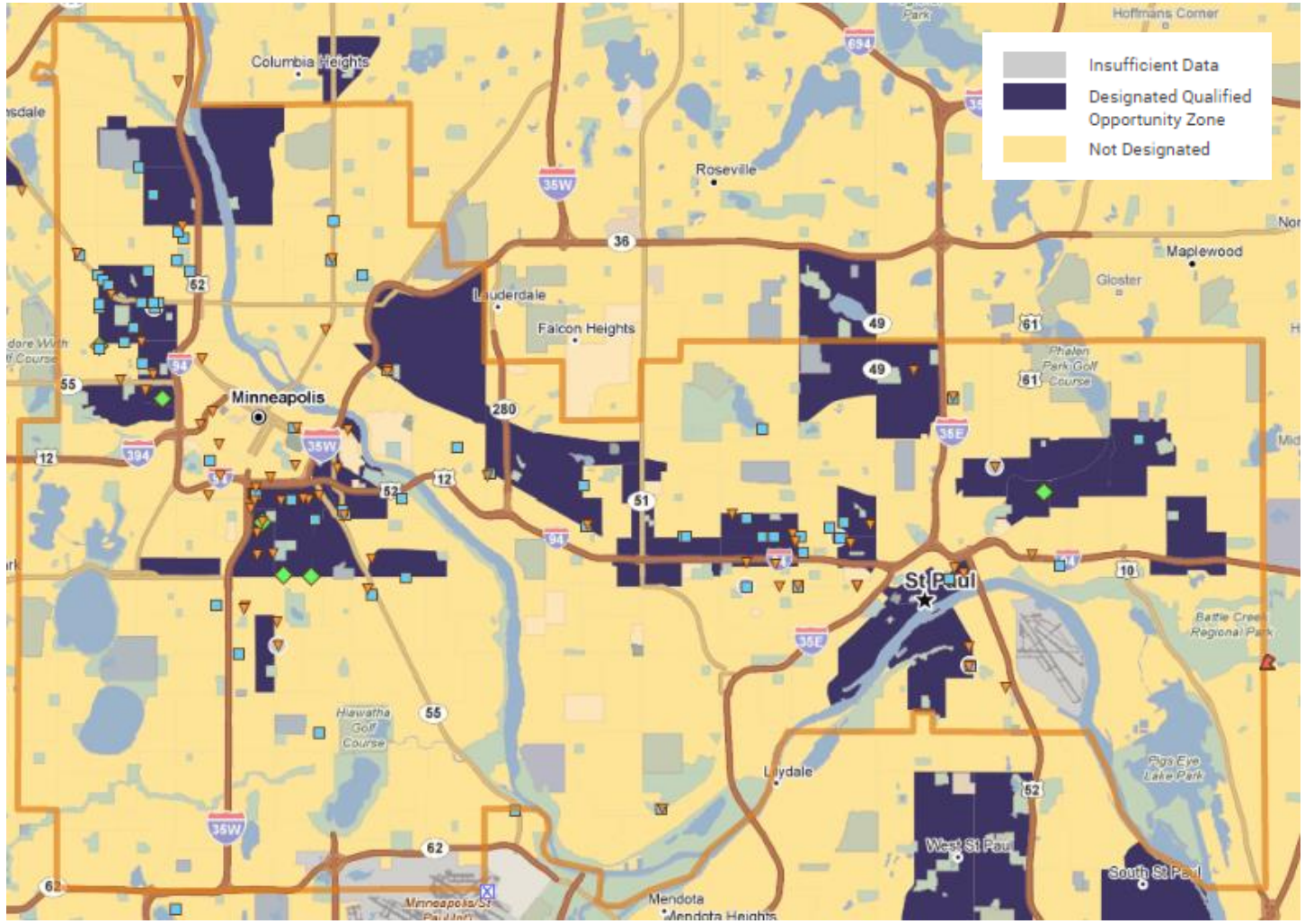
128

census tracts designated

Rural census tracts	50
Average poverty rate	25.7%
Average unemployment rate	9.4%
Average family income in OZ census tracts relative to area median income (AMI)	59.7%



Twin Cities Designations



37

census tracts designated

Average poverty rate	36.6%
Average unemployment rate	13.7%
Average family income in OZ census tracts relative to area median income (AMI)	43.8%

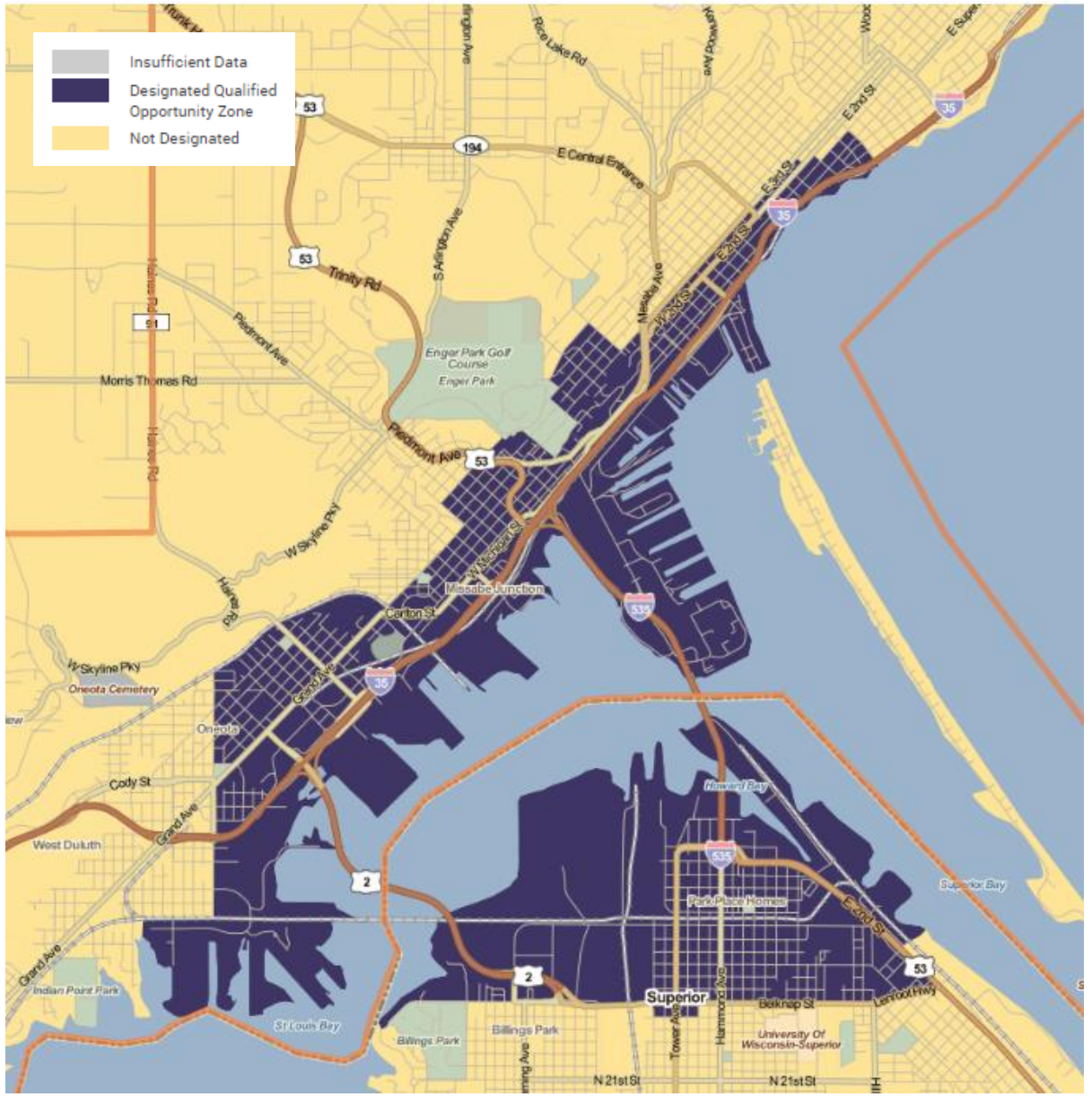
OPPORTUNITY ZONES

Duluth Designations

5

census tracts designated

Average poverty rate	**41%**
Average unemployment rate	**13.8%**
Average family income in OZ census tracts relative to area median income (AMI)	**43%**



LISC Projects in Rural Opportunity Zones

50

rural census tracts designated as Opportunity Zones

Rural Opportunity Zones with LISC activity	**4**
Average poverty rate	**20.9%**
Average unemployment rate	**7.2%**
Average family income in OZ census tracts relative to area median income (AMI)	**71.3%**

Projects

- Trailside Acres I & II
- Healthy Housing Access
- Lakeland Hotel
- Milan Area Healthy Housing Initiative

All projects conducted with Southwest Minnesota Housing Partnership

Definitions

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

Investor **Incentives**

U. S. investors currently **hold $2.3 trillion in unrealized capital gains**, representing a significant untapped resource for economic development. Opportunity Funds will allow these investors throughout the country to pool and deploy their resources as Opportunity Zone investments.

OPPORTUNITY ZONE INVESTMENTS PROVIDE AN IMMEDIATE BENEFIT

to investors of deferring payment of the capital gains tax that would be paid in 2018 until 2026. Further incentives are linked to the duration of an investor's commitment to Opportunity Fund investments.

THE OZ TAX INCENTIVE WILL ALLOW

a modest reduction in capital gains taxes in exchange for holding Opportunity Fund investments for five to seven years.

IF INVESTMENTS ARE HELD 10+ YEARS,

gains accrued on the Opportunity Fund investment during that 10-year period will not be taxed, further incentivizing patient capital.

Longer Term: **Greater Investor Benefits**

Investment Length	Benefits Received
Fewer than 5 years	Deferred payment of existing capital gains until the date that the Opportunity Fund investment is sold or exchanged
5+ years	Benefits above + 10% of tax on existing capital gain is canceled
7+ years	Deferred payment of existing capital gains until December 31, 2026 or the date that the Opportunity Fund investment is sold or exchanged (whichever comes first) + 15% of tax on existing capital gain is canceled
10+ years	Benefits of 7+ year investment + investors pay no capital gains tax on the Opportuity Fund investment (investments are exempt from any capital gains beyond those which were previously deferred)

Note: All capital gains realized by an investor in the **180 days** before an Opportunity Fund investment are eligible for the tax benefits of investment in Opportunity Funds.

Timeline for Opportunity Zone Investments

Gains rolled into an Opportunity Fund within 180 days of sale

Year 5 – 2023: Tax on original gain is reduced by 10%

Year 7 – 2025: Tax on original gain is reduced by an additional 5% (total reduction is 15%)

December 31, 2026 (Legislative date): Deferred tax on original gain is due. Investors pay tax on 85% of original capital gains.

Year 10 and beyond: Upon sale, no tax on capital gains from appreciation of Opportunity Fund investment

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.

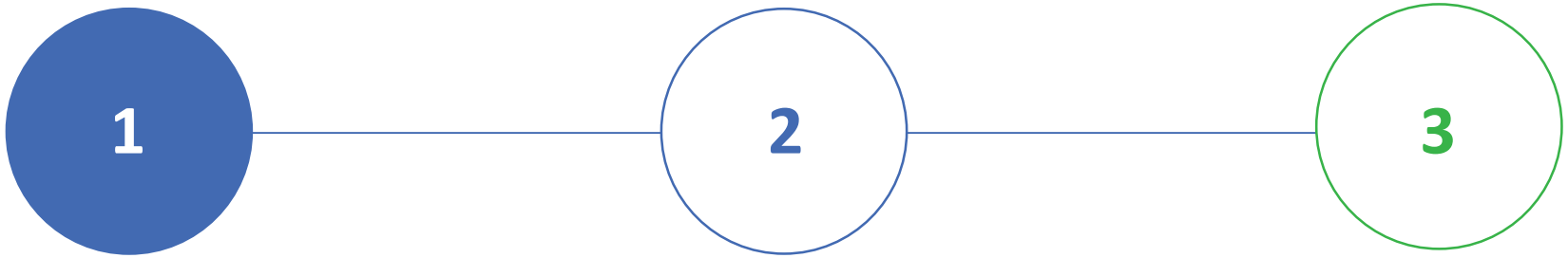
2. **Investments in real estate**

   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.

Steps Toward Implementation



01

ALL OPPORTUNITY ZONES

approved by treasury (10 year designation) as of June 14, 2018.

02

IMPLEMENTATION OF LAW

Treasury Department rulemaking to be issued.

03

INVESTMENT ACTIVITY BEGINS

Currently anticipated to start in Q4 2018/Q1 2019.

Opportunity Fund Roles



DIRECT:

- High net worth individuals
- Corporations

INDIRECT:

- Broker-dealers
- Wealth advisors
- Community foundations
- CDFIs

DIRECT MANAGEMENT:

- Investors + CPAs

INDIRECT MANAGEMENT:

- Private equity firms
- CDFIs
- Fund management companies

EXAMPLES:

- Commercial real estate
- Multi-family housing
- Single family housing
- Operating businesses
- Equipment leasing

Advocacy Work

- Providing recommendations on rule making and encouraging the **Treasury Department and IRS to move quickly to issue guidance and regulations** which provide investors and Opportunity Funds with clarity and certainty, and also help ensure that the legislative intent of O-Zones is being met.

- Engaging with community stakeholders to **determine how Opportunity Zone designations line up with current local community development goals** and begin identifying projects that would benefit from additional equity capital through Opportunity Fund investments.

- Advocating for states and municipalities to **create or utilize existing incentive programs to pair with Opportunity Fund investments** in order to:

    - **Ensure equitable and inclusive economic development** by expanding access to opportunities for low-income residents and existing local businesses while protecting them from displacement.

    - **Enhance the investor benefits of Opportunity Fund investments**, incentivizing investments with high social benefits and driving investment opportunity where capital might not otherwise flow. For example:

        - Further incentivize investments in Opportunity Funds and keep dollars locally invested by **providing preferential tax treatment at the state level.**

Strengths

Local

Designations are made by states and localities, rather than Federal agencies, ensuring more local buy in and coordination.

Flexible

The flexibility of the investment tool can support investments in any type of asset class.

New Investor Class

The incentive has the ability to attract high net worth individual investors to community development finance.

Potential

The incentive could attract hundreds of billions of private sector capital into low-income communities (compared with about $10 - $12 billion annually under LIHTC and $3.5 billion annually under NMTC).

Straightforward

The tool is relatively straightforward from an investment and compliance standpoint, in comparison to LIHTC and NMTC.

Potential 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.

One-LISC Family Roles

Team	Roles
National LISC: Policy	Federal policy advocacy, guide state/local policy, thought leadership
National LISC: Development	Raise foundation and corporate partner capital resources
National LISC: Marketing & Communications / Knowledge Management	External and internal communications, thought leadership
National LISC: Lending	Pre-development and acquisition financing; construction and permanent loans
National LISC: Economic Development	Coordinate business investment and infrastructure investment activity with local program strategies and workforce training activities
Local LISC Programs / Rural LISC	Community engagement, pipeline development, local advocacy and policy, brokering strategic alignment with mission-driven private and public sector partners, thought leadership
National Equity Fund	Fund manager for workforce housing and LIHTC investments
New Markets Support Company	Fund manager for business infrastructure and operating business investment, fund administration services, development consulting services
TBD	Consulting services for local investment strategies, impact reporting services

Foundation Partner Roles

1 **Inclusive investment leadership**

Investing in first movers with scalable investment strategies focused on benefits to residents

2 **Community engagement**

Supporting efforts to educate and engage community stakeholders and advocate for state and local policy that aligns with inclusive investment

3 **Credit enhancement**

Providing financial support to induce investment in mission-oriented real estate development and businesses

Affordable Housing Examples

1 Pairing with LIHTC or the HTC

- Effective for providing housing for families at or under 60% AMI
- Issues: Do institutional investors have capital gains that they want to use to invest in the LIHTC?

2 Focus on Workforce Housing

- Providing Housing for families at 80 – 100% AMI
- Anticipate a 10 year investment
- No ongoing compliance regulations unless required through local funding or zoning
- Ability to attract High Net Worth Individuals or Corporations as investors

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:**
   - *Equity recapitalizations*
   - *Growth capital investments*

4. **Enhancement for other federal tax credit transactions:**
   - *NMTCs*
   - *Historic Tax Credits*

OPPORTUNITY ZONES

Resources and Tools

opportunityzones.newmarkets.org

Visit **NMSC's Opportunity Zones pages** for:

- A mapping tool for census tract eligibility
- 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

Amy McCulloch 651-265-2290

Deputy Director amcculloch@lisc.org

Twin Cities LISC tclisc.org

Pam Kramer 202-302-5388

Executive Director pkramer@lisc.org

Duluth LISC lisc.org/duluth

Kevin Boes 312-697-6467

President/CEO kboes@newmarkets.org

NMSC newmarkets.org