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Developers Still Exploring Possibilities of Opportunity Zones

By Lisa Rubenson
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One of the more bipartisan aspects of the Tax Cuts and Jobs Act of 2017 passed last December was the creation of the Opportunity Zones Program. Investors willing to put their capital gains to work in some of the country's most vulnerable communities may defer their tax obligations to as late as the end of 2026. Those willing to stay invested in these areas for ten years or more may be relieved of their capital gains tax burden altogether.

ULI South Carolina invited tax and government affairs experts to help demystify the Opportunity Zones Program at the 10th Annual Capital Markets Conference held in September at the Sanctuary Resort on Kiawah Island.

Moderator Mark Cooter, who serves as accounting firm Cherry Bekaert's managing partner in South Carolina, introduced three panelists who have become well versed in the program in a very short time: Mary Burke Baker, a government affairs counselor at K&L Gates in Washington, D.C.; Michael Elliot, director of tax services at Cherry Bekaert; and Bobby Werhane, assistant vice president in the Charlotte, North Carolina, office of Bellwether Enterprise Real Estate Capital. (Download Presentation)

Baker kicked off the discussion with a primer on the program, defining Opportunity Zones as low-income areas in a given census tract with a 20 percent poverty rate or a median income less than 80 percent of the surrounding area. Governors and local officials determined which areas in their state should become Qualified Opportunity Zones and submitted their list to the U.S. Department of the Treasury for approval. (See the list by state here.)

Opportunity Zones need capital. Individuals and businesses with windfalls from the sale of assets need tax-friendly places to put their capital gains. The program gives these investors 180 days from the sale of the asset to put their capital gains into an Opportunity Fund. Those managing the Opportunity Fund have another 180 days to invest in Opportunity Zone Property, which Baker defined as "either a direct interest in tangible property

located in an Opportunity Zone, or an investment in stock of a business or partnership interest operating in an Opportunity Zone."

Since the purpose of the program is to "incentivize new activity and create jobs" in these low-income areas, Opportunity Funds are required to hold at least 90 percent of their assets in Opportunity Zones Property.

"They don't want to see passive investments," explained Baker. "The property has to be newly used by the Opportunity Fund or . . . substantially improved . . . within a 30-month period."

Here's where it gets good for the long-range investor.

The program offers tax incentives on the initial capital gains investments in a number of ways, and the longer you stay, the less you will pay in taxes. Those who hold on to their Opportunity Fund investments for five years get a 10 percent increase in basis; those who hold on for seven years get a 15 percent increase in basis. Those who hold on for ten years before selling their interest do not pay any taxes at all on their initial investment.

And there are other benefits, and not just for developers.

"Opportunity Zones also have relevance for retail and manufacturing, for warehouse, for startups, for incubators, for renewable-energy projects," Baker explained. "They're urban, they're rural, they're everywhere. If you have clients interested in these other areas, they provide another hook."

If the Opportunity Fund itself generates capital gains, said Baker, "they can be reinvested, but that's considered a different tranche, on a different timeline."

"And, unlike the 1031 exchange, where you can't get any cash back, here you can reinvest your full gain," Elliot said. "You can get your basis back, keep that cash, and reinvest it elsewhere."

Elliot also said that if you sell your investment in the Opportunity Fund before 2026, you will pay taxes on that gain. If it goes down in value, "you only have to recognize the lesser of your original per gain investment."

According to Elliot, "all things being equal, this program lets you come out ahead."

Though certain elements of the program are necessarily political, the panelists emphasized that it came together in a spirit of bipartisanship. It began when impact investor Sean Parker—of Napster and Facebook fame—approached lawmakers about ways to bring investors and community stakeholders together for mutual gain.

"It started as freestanding legislation, introduced by South Carolina's own Senator Tim Scott," Baker said, "and included 81 bipartisan co-sponsors in the House and 14 in the Senate."

Once the program was swept up in the tax bill, it was fast-tracked, leaving unanswered questions and plenty of room for well-documented controversy and skepticism. While the Treasury Department is expected to deliver new guidelines by the end of 2018, there's no telling which of the "fixes" the federal government will be able to address and which ones will require additional legislation.

Despite all the unknowns, the panel agreed that the potential benefits associated with Opportunity Zone investing were substantial and worth pursuing, albeit with considerable caution and under the guidance of experts who can stay current on every aspect.

"This is a completely new type of capital that excites us," said Werhane, echoing the sentiments of Elliot, Baker, and Cooter, "especially when we overlay that with the idea of bringing mission-based, communal change to areas."