

White Paper



Opportunity Zones

What do they mean for local government?

While the idea behind Opportunity Zones has been in the works for nearly 10 years, it was the passage of the 2017 Tax Cuts and Jobs Act that finally brought them into being.

Opportunity Zones are an economic development tool—designed to spur economic development and job creation in distressed communities.

Last year when Congress passed the Opportunity Zone program one of their main goals was to help investor's capture unrealized capital gains by investing those dollars into low-income neighborhoods, in return for a significant tax advantage.

While the idea behind Opportunity Zones has been in the works for nearly 10 years, it was the passage of the 2017 Tax Cuts and Jobs Act that finally brought them into being.

The original idea for creating Opportunity Zones was largely influenced by the real estate community as a tool to support investments in real estate projects, so the legislative language is tailored to favor those types of projects.

However, the Opportunity Zone program does allow monies to flow directly into businesses located within a zone to serve as an equity investment or to help them purchase tangible property.

But because there are still a lot of unknowns about investor appetite for Opportunity Zones, many believe it is unlikely that high wealth individuals will be interested in making investments in an Opportunity Zone business or an Opportunity Zone Fund if their return is limited to the tax benefit only. Therefore, communities should be prepared for investors to expect market rate returns at a minimum, but more likely they'll seek higher returns than what they would otherwise may have received from these types of investments.

Some of the advantages of the Opportunity Zones over other Federal tax credit policies is that they offer (1) Greater flexibility, in choosing investment options; (2) Scalability, since there is no cap on the amount of private capital that may be invested in a Zone; and (3) Simplicity, because there is no governmental pre-approval process for Opportunity Zone Funds to make their investments.



Opportunity Zones

What is an Opportunity Zone? If I don't have one...can I get one?

Last summer, the Internal Revenue Service (IRS) with guidance from each States Governor, designated up to 25% of a state's low-income Census tracts as Opportunity Zones. Eligible low-income communities were defined as being:

- Census tracts in which the poverty rate is at least 20 percent, or
- Census tracts in which the median family income does not exceed 80 percent of the statewide median family income if located outside of a metropolitan area, or
- Census tracts in which the median family income does not exceed 80 percent of the statewide median family income or the metropolitan area median family income, whichever is higher.

The designation process for Opportunity Zones is now complete and that status will last until 2028. Unfortunately, no new zones can be created unless by a specific act of Congress.

What is the role for communities in developing an Opportunity Zone Project?

Since Opportunity Zones are targeted to the private investor, what can local governments do to encourage investment in projects that it deems important?

To begin with, a community can identify potential development projects in their jurisdiction and make sure that they are "investment ready." Being investment ready is a similar concept to having a "shovel ready site," where a community does all the planning, zoning, code enforcement, due diligence, infrastructure design or other investments to make a site/project as valuable to a potential investor as possible. Also, by gaining site control through an option agreement or by direct purchase, a municipality can guide development projects that support community needs or match long-term strategies, rather than letting the investor lead the process.

States were able to designate up to 25% of their low-income Census tracts as tax-favored opportunity zones. Unfortunately, no additional zones will be created unless by Congress.

Remember that since the program was designed for the investor in mind, there are no guarantees that Opportunity Zone investments will benefit the local community, its residents or serve their public interests. By being proactive and being “*investment ready*,” a community is more prepared to guide a potential project to meet its public interests.

Here’s a list of other things that local governments that are seeking to be strategic and take full advantage of their Opportunity Zone designation can do:

- Conduct planning and pre-development activities that are consistent with public goals.
- Make investments in public transportation or other infrastructure that demonstrate a commitment to supporting development projects in an Opportunity Zone.
- Develop a business investment strategy that establishes guidelines for the use of Tax Increment Financing (TIF), Tax Abatement or the potential use of other incentives to entice businesses to expand or locate in the Opportunity Zone.
- Create an “Investment Ready” Prospectus to market potential projects and sites to OZ developers, Real Estate investors, certified-investors, high-wealth individuals and OZ Funds. As part of this effort, you’ll need to understand what their investment risk profile is and if they have a desired exit strategy. Remember, the only reason an investor would be willing to put their dollars into an Opportunity Zone is to make more money than they would make with their current investment strategy. So, understanding their motivations is part of your job.
- Develop a network of civic-minded local and regional business leaders/investors to promote your Opportunity Zone.
- Watch out for speculators or Opportunity Funds that are not focused on public interests. By making sure that potential developers have secured all their financing before conveying key property to them and establish claw-back provisions so that you can reacquire property in case the developer fails to perform.

What’s next?

The public comment period ended December 28, 2018 for the draft investor rules that the IRS released in October. With the Federal Government Shutdown, you can anticipate that they will take an additional 30-60 days after they go back to work to review all the comments before they release the final Opportunity Zone program rules.

Also, in 2019 we should expect to see the bulk of the Opportunity Zone Funds to be created and capitalized in order to take full advantage for the program’s statutory life-span.

Look for Opportunity Zone Funds to start making their investments in late 2019 with most investments taking place in 2020 and 2021 and the first signs of real impact occurring by 2026.

Who should I call to get more information or help?

The Springsted Housing and Economic Development (HED) team is available to assist your community in developing the policies and “Investment Ready” prospectus to help you take advantage of your Opportunity Zone. You can reach our staff at HED@springsted.com or 1-800-236-3033.

Opportunity Zone Program

...allows
investors to
avoid the
usual tax on
capital gains
by putting their
profits into
Opportunity
Zone Funds

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