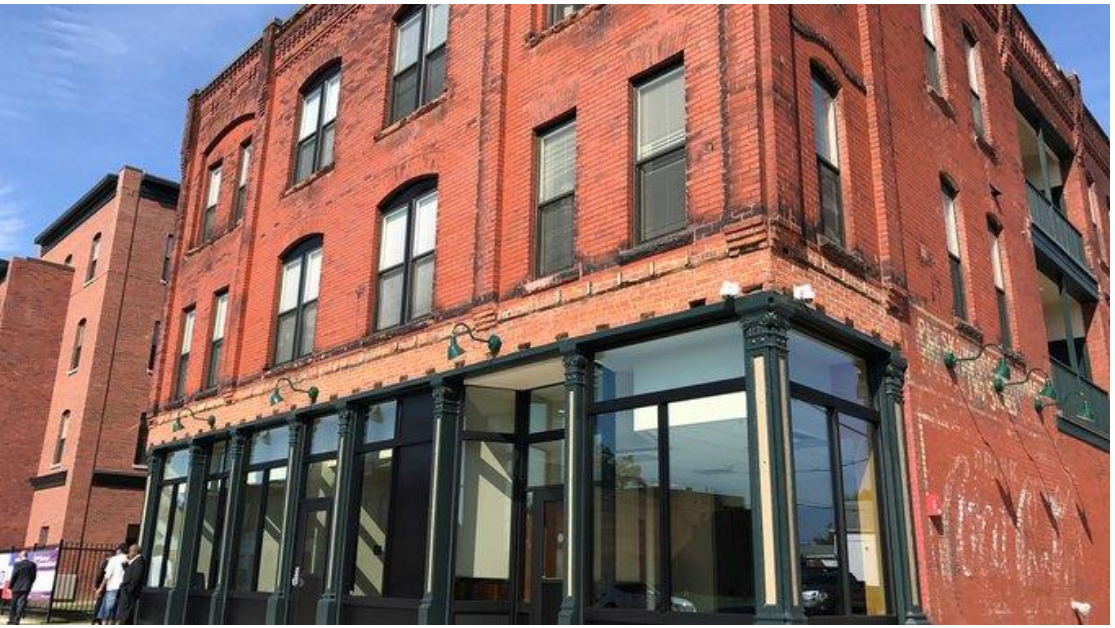
An Introduction to Opportunity Zones and Funds

August 2018

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**.

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.

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.

Designated Opportunity Zones

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

8,762

census tracts designated

24 million

current jobs in designated tracts

1.6 million

businesses in designated tracts

Rural census tracts	1,858
Average poverty rate	31%
Average unemployment rate	14.4%
Average family income in OZ census tracts relative to area median income (AMI)	60%

LISC Activity in Opportunity Zones in the Last Decade

924

number of Opportunity Zones where NEF and NMSC have made investments

10.5%

total number of census tracts designated by the states

36%

percentage of Opportunity Zones accounted for in LISC's Quality of Life planning

LISC Deals in Opportunity Zones since 2008	638
NEF Deals in Opportunity Zones since 2008	178
NMSC Deals in Opportunity Zones since 2008	49

Opportunity Fund Roles

Investor Capital → **Opportunity Fund** → **Eligible Investments**

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

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.

Timeline for Opportunity Zone Investments

	Investment Year 2018	Year 5 2023	Year 7 2025	Year 8 2026	Year 10 2028
Tax on Capital Gain Invested	Gain realized and invested in Opportunity Fund **within 180 days***	10% reduction of capital gains tax	15% reduction of capital gains tax	All taxes due on 12/31/26. Investor pays tax on 85% of original gain	
Tax on Opportunity Fund Investment		Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment **is tax free****

*** Tax is deferred until the earlier of investment liquidation (return of capital) or 12/31/26**

**** Any appreciation on Opportunity Fund investment is tax free if held > 10 years**

Ex. 10 Year Investment: **Fully Taxable vs. Opportunity Zone Fund**

Assumptions:

- 10% annual investment appreciation
- 24% capital gains tax (federal only)

Fully Taxed Investment		
Capital Gain		$100,000
- Tax payable (24%)		$24,000
Total Capital to Invest		$76,000
Sales Price after 10 years		$197,000
- Tax on Appreciation (24%)		$29,070
After Tax Funds Available		$168,054

Opportunity Zone Investment		
Capital Gain		$100,000
- Tax payable		$0
Total Capital to Invest		$100,000
Sales Price after 10 years		$259,374
- Tax on Appreciation		$0
Deferred Capital Gain Tax (24%) paid in 2026		$20,480
After Tax Funds Available		$238,974

Opportunity Funds

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

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.

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*

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

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.

Key Points

Investors

- Tax incentive is most valuable for 10 year investments in appreciating assets
- Six months to invest after realizing a capital gain
- Another six months to deploy 90% of capital in Zones
- Capital is required to be an equity investment – loans from investors are not eligible for the tax incentive

Funds

- All capital must flow through an Opportunity Fund to be eligible for the tax incentive
- Funds are self-certified via an IRS tax form
- Fund must be established for the purpose of investing in Opportunity Zones
- 90% of fund assets must be invested in Zones to maximize the tax incentive

Eligible Investments

- Must be equity investments
- Real estate investments must include substantial rehabilitation – doubling basis within 30 months
- “Sin businesses” are not eligible
- Other requirements include property use in “active conduct of business” and limits on assets held in cash

LISC's Role

Fund Management

Fund Administration

LISC Program Work: Thought leadership, community engagement and coordination, state and local policy

Resources and Tools

opportunityzones.newmarkets.org

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

- A mapping tool of designated census tracts
- 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

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