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Room 5203
Internal Revenue Service
1111 Constitution Avenue NW
Washington, D.C. 20224

To Whom It May Concern:

The Local Initiatives Support Corporation (LISC) is pleased to offer comments in response to the Notice of Proposed Rulemaking for the Opportunity Zones provision of the Internal Revenue Code (Section 1400Z-2).

LISC is a non-profit housing and community development organization and certified Community Development Financial Institution (CDFI) with offices in 33 cities throughout the country, and a rural network encompassing 86 partner organizations serving 44 different states. LISC's work supports a wide range of activities, including affordable housing, economic development, building family wealth and incomes, education, community safety, and community health. In 2017 alone, LISC raised and deployed approximately $1.4 billion of capital into low-income urban and rural communities – including close to $1 billion in private equity capital through federal Low Income Housing Tax Credits and New Markets Tax Credits. We believe that the Opportunity Zones tax incentive has the potential to unleash tremendous amounts of patient, private capital into the underserved urban and rural communities that are the core of LISC's markets.

LISC is pleased to offer comments below in three critical areas: (i) rules for a Qualified Opportunity Fund (QOF); (ii) rules relating to the eligibility of Qualified Opportunity Zone Property (QOZP) and Qualified Opportunity Zone Businesses (QOZB); and (iii) ongoing reporting requirements. LISC offers these comments to augment comments submitted by other coalitions for which we are active participants, including the Economic Innovation Group's Opportunity Zone Coalition; the Novogradac Opportunity Zones Working Group; and the Beeck Center (Georgetown University) Opportunity Zone Working Group.

I. RULES FOR A QUALIFIED OPPORTUNITY FUND

A. Certification of QOFs.

In February of 2018, LISC submitted comments to the IRS encouraging the IRS "to create an administrative structure that protects the integrity of the program without adding unnecessary burden on the users." With respect to certification of QOFs, we specifically recommended that:

(i) The IRS delegate to the Community Development Financial Institutions Fund the authority to certify QOFs, since they have experience certifying Community Development Entities (CDEs) under the New Markets Tax Credit Program, as well as an existing on-line certification portal that would enable the QOF certification process to move forward with minimal delay;

(ii) The certification form include a requirement that the QOF identify one or more anticipated community impacts (e.g., quality jobs for low-income individuals; affordable housing for low-income families; services benefitting low-income community residents; etc.) and that the entity be required to subsequently report data indicating the extent to which these outcomes have been achieved; and

(iii) The Treasury Department provide a list of all certified QOFs, along with a basic description of their anticipated activities (e.g., markets served, proposed asset classes) so that developers and investors alike can align projected activities with potential funds.

We are concerned that the IRS's current approach to certification, which most notably includes a determination to allow QOFs to self-certify without so much as a cursory review of application materials, not only misses an opportunity to encourage the applicant entities to strive to achieve desirable community impacts, but also could open the door for bad or unscrupulous actors to participate in the program who might otherwise have been screened out through basic certifications and attestations.

It is not too late for the IRS to reposition its approach. It is likely that very few QOFs will self-certify in 2018, but rather that the large majority of them will self-certify in 2019 and 2020. This presents an opportunity for the IRS to expand the data collected in IRS Form 8996 (or a related schedule) for tax year 2019 and beyond, to collect additional information to provide a preliminary screen on bad actors and to encourage impactful investments. We strongly encourage the IRS to consider this approach to data collection as QOFs are certified, in addition to also collecting robust data from the QOFs after investments are made (see item III below).

B. Timing for testing the assets of Qualified Opportunity Funds

As specified in the authorizing statute, QOFs are required to demonstrate that 90% of their assets are invested in QOZP. The 90% test is to be met by taking the average of the QOF's assets at two periods: at the mid-point of its fiscal year, and as of the last day of its fiscal year.

Initial Testing:

LISC appreciates that the proposed regulations provide a safe harbor for QOFs to meet this test in their first year of operations, by allowing them to: (i) have the first six month period triggered by the month in which they secured investor capital; and (ii) rely solely on the end of year testing date when initial investments are secured in the second half of a fiscal year. However, we are concerned that this approach creates an artificial timing constraint for QOFs to raise and invest funds. Specifically, it may not be desirable for a QOF to raise funds towards the end of the year unless it is absolutely sure it can fully deploy 90% of the funds before the end of the year.

In order for QOFs to be responsive to the market (both with respect to investors and project readiness), LISC recommends that funds invested in QOFs should be treated as safe assets for up to one year from the date the funds are invested in the QOF.

Ramp-Up Period:

We further believe that QOFs should be provided with a "ramp-up" period so that they can make investments in accordance with a structured schedule. As currently drafted, the proposed rules include a "working capital safe harbor" that allows a QOZB up to 31 months to fully invest capital received from QOFs into QOZP. However, this does not align with standard industry practices. Typically, the investment fund would retain the capital and invest in accordance with a pre-determined schedule (e.g., construction financing usually involves multiple investments as construction milestones are being met), rather than the business holding on to this capital.

LISC therefore recommends that the working capital safe harbor proposed in the regulations for QOZBs should be eliminated or significantly scaled back (e.g., to six months), and instead a similarly structured ramp up period should be provided to the QOF – but only with respect to those dollars which have been closed for investments in a QOZB and for which an initial disbursement has been made.

Example:

Taking full advantage of each of the safe harbors proposed above (i.e., for "initial testing" and during a "ramp up period"), a QOF that receives a \$10 million investment on December 30th, 2018 will have until December 30th, 2019 (one year) to invest at least \$9 million (i.e., 90%) in QOZBs. The QOF may qualify as "invested" all funds that have been closed in a QOZB and for which a partial disbursement has been made. The QOF must fully disburse at least \$9 million in QOZBs by no later than July 31st, 2021 (i.e., 31 months from receipt of investment).

Additional Considerations:

The IRS should consider providing additional guidance to address the deployment of Opportunity Zone funds that are being held for future investment. For example, in order to avoid speculative investments or to further the intents of the legislation, the IRS could specify that such funds must be held in escrow, in low-risk accounts; or else invested in a mission-driven financial institution (e.g., a certified CDFI, a low-income credit union).

<u>C. Reinvestment of proceeds</u>

The proposed regulations indicate that future regulatory efforts may address the "reasonable period" for a QOF to reinvest proceeds from the sale of qualifying assets without paying a penalty. LISC encourages the IRS to follow the model of the NMTC, where CDEs are permitted up to a year to reinvest proceeds without triggering a tax event for the investors. With respect to Opportunity Zones, this grace period is critical for supporting QOFs that wish to focus on shorter term but high impact investments (e.g., homeownership housing for minority and first time homebuyers), as well as investments that have uncertain exit horizons (e.g., venture capital for start-up businesses). Without a reasonable reinvestment period, it is likely that most investors will focus on real estate based assets, at the potential expense of operating businesses.

This is a critical issue that the IRS should address as soon as possible, including through guidance or a revenue ruling if that is the quickest path.

II. RULES RELATING TO THE ELIGIBILITY OF QOZBs and QOZP

<u>A. The "substantially all" test with respect to tangible property.</u>

The proposed regulations require that a QOZB must hold at least 70 percent of its tangible assets in QOZP in order to satisfy the requirement that "substantially all" of its assets are held in such properties.

LISC is generally supportive of this proposal. We believe that this 70 percent threshold will help to facilitate investments in operating businesses by providing protections in the event that the business grows over time to include assets outside of the Opportunity Zones.

However, LISC also notes that this could lead to a potential abuse with respect to businesses that engage principally in the development or leasing of real estate. We don't believe that real estate firms necessarily require the same kind of Opportunity Zone regulatory flexibility as operating businesses, since the real estate is their primary tangible asset and it will remain fixed within the Opportunity Zone for the life of the investment.

Our concern is that a real estate developer seeking to game the rules could take advantage of this provision by accepting Opportunity Zone investments and funneling up to 30% of the funds to projects that are located outside of Opportunity Zones. In fact, a QOF could now, in theory, invest only 63% of its funds in real estate inside the Opportunity Zones, since the statute requires that only 90% of the QOF's funds be invested in QOZBs (i.e., .90 X .70 = .63).

LISC encourages the IRS to consider retaining this 70% threshold with respect to "non-real estate" QOZBs, but adopting a different approach in the case of "real estate" QOZBs (e.g., a higher threshold level; or requiring that all of the real property be located in Opportunity Zones). With respect to defining a “non-real estate” QOZB, the IRS could look to the definition of a non-real estate qualified active low income community business under the NMTC Program [26 CFR 45D-1(d)(10)]:

> *The term non-real estate qualified active low-income community business means any qualified active low-income community business (as defined in paragraph (d)(4) of this section) whose predominant business activity does not include the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate. For purposes of the preceding sentence, predominant business activity means a business activity that generates more than 50 percent of the business' gross income. The purpose of the capital or equity investment in, or loan to, the non-real estate qualified active low-income community business must not be connected to the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate.*

B. Gross Income Test for the QOZB.

The proposed regulations state that 50 percent of the gross income from a QOZB must be derived from activities within the Opportunity Zone. This is an expansion from the statutory requirement that 50 percent of the gross income be derived solely from the active conduct of a trade or business.

The IRS should not expand the definition beyond what is provided for in the statute. The additional screen of determining whether a majority of the income is derived from activities undertaken within the Opportunity Zone will make it very hard for QOFs to invest in operating businesses; particularly those which may be located in Opportunity Zones and are employing residents of Opportunity Zones, but which draw their revenues from activities outside of the zone (e.g., a manufacturing plant whose goods are sold outside of the Opportunity Zone). The tangible property test already ensures that the QOZB is reasonably invested in the Opportunity Zone, so there is no reason to add this additional requirement.

If the IRS is intent on creating a separate Opportunity Zone income test, LISC would advise the IRS to considerably lower the threshold for operating businesses for the reasons noted above, and also to raise the threshold for real estate businesses. Otherwise, a business whose principal activity is the rental of property to others can satisfy this requirement when as much as 49.9% of its rental income is derived from real estate located outside of the Opportunity Zone.

C. Substantial Improvements to QOZP.

LISC is generally supportive of the IRS’s determination that the value of land shall be excluded from the requirement that, in certain instances, the value of the investment must double the basis of the property within 30 months. We feel that this will help to incentivize investments in large underused industrial sites and dilapidated properties. However, we would propose that future IRS regulations also establish minimum investment parameters and timelines in instances where the asset acquired has little to no value outside of the value of the land (e.g., a vacant lot) – in order to deter speculators from minimally restoring the property to productive use (e.g.. installing a billboard) while waiting for the value of the land to appreciate.

D. Clarification that leasing of real property qualifies as the active conduct of a trade or business.

LISC believes that the legislative intent of Opportunity Zones is to spur development of real estate in Opportunity Zones as well as to spur investments in operating businesses; and that investment in real estate that improves communities and provides direct benefits to low-income families (e.g., affordable housing, childcare facilities, workforce training centers, charter schools, and health clinics) would be an exemplary use of the Opportunity Zone incentive.

In order to facilitate these kinds of investments, the regulations need to clarify that the leasing of real property does constitute the "active conduct of a trade or business". The IRS should adopt the position of the NMTC, where the trade or business is considered "active" if it is expected to produce revenues (in this case rental income) within three years of the investment.

III. REPORTING REQUIREMENTS

As we noted in our comments to the IRS in February of 2018, the Conference Report from the Tax Cuts and Jobs Act adopted language from the Investing in Opportunity Act that contemplated QOFs reporting data to the Treasury Department so that the Treasury Department could produce reports detailing the use of Opportunity Zone investments:

> *The Secretary or the Secretary's delegate is required to report annually to Congress on the opportunity zone incentives beginning 5 years after the date of enactment. The report is to include an assessment of investments held by the qualified opportunity fund nationally and at the State level. To the extent the information is available, the report is to include the number of qualified opportunity funds, the amount of assets held in qualified opportunity funds, the composition of qualified opportunity fund investments by asset class, and the percentage of qualified opportunity zone census tracts designated under the provision that have received qualified opportunity fund investments. The report is also to include an assessment of the impacts and outcomes of the investments in those areas on economic indicators including job creation, poverty reduction and new business starts, and other metrics as determined by the Secretary.*

We encourage the IRS to satisfy this legislative intent by including in the regulations (or in related guidance) specific data points that QOFs are expected to provide to Treasury, and to establish an electronic portal for collecting this information. We would recommend that this be delegated to the CDFI Fund through a Memorandum of Understanding (as was done with respect to the certification of Opportunity Zones); since the CDFI Fund currently has electronic systems in place for collecting data under the NMTC Program that could be readily adapted for this purpose.

We offer the following recommendations with respect to specific data points that QOFs should be required to report annually:

1. The dollar amount of the investment.

2. The total project costs (in cases of real estate) or total amount of financing provided (in the case of co-investments).
3. The NAICS code of the business.
4. The census tract of the business.
5. The total square feet of the project (in cases of real estate).
6. The total number of FTEs at the business or at the leasees' businesses (in the case of commercial real estate); to be reported as "anticipated" at the time of initial investment, and then as actual in the following years.
7. The number of "quality jobs" for low-income persons (e.g., with benefits; that pay living wages).
8. The total number of clients served (in the case of non-profit facilities), including the number of low-income persons served.
9. The total number of housing units, and the percentage that are affordable to low-and moderate income persons.

In addition to these discrete data points, we would also recommend that QOFs be required to provide a brief narrative description of each project investment, which would include: the nature of the project; the benefits to the community or a community based organization; the degree to which the project was developed in consultation with the community residents and/or mitigated against displacement; the extent to which the project connects with local workforce development efforts for low and moderate income residents; and the extent to which the project could not have moved forward in the same manner without the Opportunity Zone incentives.

We thank you for considering these comments, and look forward to working with the Treasury Department on implementation going forward.

Sincerely,

Matt Josephs
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