Massachusetts

Opportunity Zones Overview
What are Opportunity Zones?

The Opportunity Zone tax incentive is a bipartisan initiative to spur long-term private investment in low-income urban and rural communities, established by Congress in the 2017 Investing in Opportunities Act.

- **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.

**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 state or territory in which it is located. Designations will stay in place for 10 years.
Massachusetts Designations

- 138 census tracts designated
- 79 municipalities

<table>
<thead>
<tr>
<th>Category</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural census tracts</td>
<td>7</td>
</tr>
<tr>
<td>Average poverty rate</td>
<td>26.2%</td>
</tr>
<tr>
<td>Average unemployment rate</td>
<td>12.4%</td>
</tr>
<tr>
<td>Average family income in OZ census tracts relative to area median income (AMI)</td>
<td>53.1%</td>
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</tbody>
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18% Rural
48% Gateway Cities
Investors receive a return on their investment through a seven-year stream of tax credits (totaling 39%).

**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.
A taxpayer has 180 days to invest unrealized capital gains into a QOZ Fund.
Investor Incentives

Deferral of taxes
On capital gains invested in Qualified Opportunity Zone Funds

Reduction of taxes
On investments held in Qualified Opportunity Zone Funds 5+ years

Cancellation of taxes
On new gains made through Qualified Opportunity Zone Fund investments held 10+ years
### Timeline for Opportunity Zone Investments

<table>
<thead>
<tr>
<th>Investment Year</th>
<th>Year 5 2023</th>
<th>Year 7 2025</th>
<th>Year 8 2026</th>
<th>Year 10 2028</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax on Capital Gain Invested</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>Gain realized and invested in Opportunity Fund within 180 days*</td>
<td>10% reduction of capital gains tax</td>
<td>15% reduction of capital gains tax</td>
<td>All taxes due on 12/31/26. Investor pays tax on 85% of original gain</td>
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<td><strong>Year 10 2028</strong></td>
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<tr>
<td>2028</td>
<td></td>
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* Tax is deferred until the earlier of investment liquidation (return of capital) or 12/31/26

** Tax on Opportunity Fund Investment

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<tr>
<td>2018</td>
<td>Any gain realized on Opportunity Fund investment is fully taxable if liquidated</td>
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<td>Any gain realized on Opportunity Fund investment is tax free**</td>
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** Any appreciation on Opportunity Fund investment is tax free if held > 10 years
### 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
### Ex. 10 Year Investment: Fully Taxable vs. Opportunity Zone Fund

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

<table>
<thead>
<tr>
<th><strong>Fully Taxed Investment</strong></th>
<th><strong>Opportunity Zone Investment</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Gain</strong></td>
<td>$100,000</td>
</tr>
<tr>
<td>- Tax payable (24%)</td>
<td>$24,000</td>
</tr>
<tr>
<td><strong>Total Capital to Invest</strong></td>
<td>$76,000</td>
</tr>
<tr>
<td><strong>Sales Price after 10 years</strong></td>
<td>$197,000</td>
</tr>
<tr>
<td>- Tax on Appreciation (24%)</td>
<td>$29,070</td>
</tr>
<tr>
<td><strong>After Tax Funds Available</strong></td>
<td>$168,054</td>
</tr>
<tr>
<td><strong>Deferred Capital Gain Tax (24%) paid in 2026</strong></td>
<td>$20,480</td>
</tr>
</tbody>
</table>
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.
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.
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:
   - Businesses moving or expanding into an Opportunity Zone
   - Equipment financing

4. Enhancement for other federal tax credit transactions:
   - NMTCs
   - Historic Tax Credits
Sample Economic Development Deal

Office Supply Company

New office development for a minority-owned business creating 80 quality, accessible jobs for community residents

<table>
<thead>
<tr>
<th>Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Debt</td>
<td>$8.0 MM</td>
</tr>
<tr>
<td>CDFI Loan</td>
<td>$3.0 MM</td>
</tr>
<tr>
<td>NMTC Equity</td>
<td>$3.0 MM</td>
</tr>
<tr>
<td>Opportunity Fund Equity</td>
<td>$2.0 MM</td>
</tr>
<tr>
<td>Sponsor Equity</td>
<td>$400 K</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$16.4 MM</strong></td>
</tr>
</tbody>
</table>
Economic Development: Issues to consider

• The “substantial rehabilitation” rule requires all OZ investments to double the basis of the property that the QOF invests in
  • Works for new development and significant improvement of real estate assets
  • Scope of business investments expected to be limited to early stage business investment and established businesses relocating or expanding to Zones

• 50% of the QOZB’s gross income must be derived from the active conduct of a trade or business in the Opportunity Zone

• 70% of the QOZB’s tangible assets must be located in the Opportunity Zone

• Awaiting guidance regarding ability to recycle investments within a QOF
Affordable Housing Examples

1. Pairing with LIHTC or the HTC
   - Tax credit investments providing housing for families at or under 60% AMI
   - 15 year investment period
   - Investors = corporate investors with capital gains to invest and tax credit appetite (may be a limited investor market).

2. Workforce Rental Housing
   - Providing housing for families at 80 – 120% AMI (Middle Income Housing that is needed in many communities).
   - 10 year investment period
   - Investors = individuals or corporations

3. Lease-to-own Housing – maybe???
   - Single family or multi-family
   - Investors = social impact focus
   - Requires ability to revolve ozone equity capital.
• New Construction of 116 units for families with rents at 90-110% AMI
• Proven project in market (prior phases in non-Ozone locations)
• Expect this to be Single Asset Opportunity Fund with High Net Worth Individuals as investors
• Capital Stack: Between 40 – 60% from ozone equity depending on return required by investor. Remainder of financing from non-recourse first mortgage.
• Investors to get preferred annual cash payments
• Exit scenario in year 10 - either sale or refinancing. Return of capital plus split of sales proceeds
Technical Issues

• 90% invested rule
  • 180 days to invest 90% of fund capital in QOZBP per statute
  • Regulations provide for a 31 month investment period through a working capital safe harbor

• The “substantial rehabilitation” rule
  • OZ investments to double the basis of the property that the QOF invests in within 30 months of investment; land is excluded so that only the value of buildings needs to be doubled

• “Substantially all” rule
  • QOZ business is one in which greater than 70% of the tangible property owned or leased is located in the Opportunity Zone

• Early disposition
  • If an OZ Fund investor sells all of its interest in an OZ Fund before 12/31/26, the investor can maintain the original gain deferral by reinvesting into another OZ Fund within 180 days
  • Further guidance is expected regarding the ability to recycle investments within an OZ Fund
The Impact of Opportunity Zone Designation is Limited

- Ozone investments are equity investments.
- They are subject to typical business and/or real estate risks.
- In most cases, the Opportunity Zone tax benefits will not make a deal worth doing if it was not otherwise attractive to investors.
Community Strategies to Attract Desired Investment

Land
- Public Land
- Current Owners
- Acquire Key Sites
- Partner with Developers
- Infrastructure/Site Prep

Zoning
- Zone for Desired Uses
- Mixed Uses
- Inclusionary Zoning

Planning
- Community Engagement
- Master Plan/Vision
- Urban Revitalization Plan
- Housing Production Plan
- Infrastructure

Incentives
- City/State Funds
- Philanthropic Investment
- Tax Abatement/TIF/HDIP
- Community Benefits
- Business Imp. District
- Accelerated Permitting

Plus outreach, collaboration, connection and marketing.
How Can Communities Position Themselves?

- Develop Community Vision and Priorities
- Use Municipal and State Tools to Attract/Incentivize
- Have a Point Person
- Consider Aggregating Resources
- Bring Anchor Institutions and other Stakeholders to the Table
- ID and Market Investment Opportunities
Strategies for Massachusetts Communities

LISC is developing a toolkit for Massachusetts communities containing designated opportunity zones, to build their capacity to define community-driven strategies for investment and growth.

Contact us to share your strategies and potential deals.

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number of Opportunity Zones where LISC, NEF and NMSC have made investments
LISC’s Roles

- Fund Manager
- Service Provider
- Debt Financing
- Industry Leadership
Contact Information

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