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## Understanding the “opportunity” with opportunity zones - by David De Lise

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Recently, there has been a lot of conversation and media coverage surrounding “opportunity zones,” and the race towards raising private equity monies and the formation of private investment funds to pursue opportunities in communities with designated zones throughout New Hampshire and the U.S. This new program, created by the Tax Cuts and Jobs Act of 2017, offers federal tax incentives to developers and investors who deploy capital in areas that have been designated as opportunity zones. These zones share some common characteristics, including a poverty rate of more than 32%, a median family income approximately 37% below the area (or state) median income level and an unemployment rate which is almost 1.6 times higher than the national average. The program is administered by the Internal Revenue Service, a branch of the U.S. Department of Treasury.

The primary initiatives of the program are to create, enhance and promote economic growth and development in designated low-income census tracts through investments in businesses and real estate. A clear advantage investors will find attractive is the fact that they can defer capital gains on earnings reinvested in opportunity zones. Another advantage is that long-term investments held and maintained for more than 10 years do not have to pay additional capital gains taxes on earnings from investments in these zones.

The Treasury Department approved the final nominations for designated opportunity zones in June 2018. In New Hampshire, 23 communities were nominated for zones.

There are some very interesting possibilities within the list of towns and communities designated as opportunity zones in N.H., and understanding the economic and socio-economic forces at play may prove to provide compelling investment and development opportunities. For instance, there are certainly areas within the state that we might expect to be designated as an opportunity zone, the designation is based solely on census tract figures, demographic information and forecasting models. Berlin, Claremont, Newport, Easton, Livermore and Success New Hampshire are all included in the list of opportunity zones. What is very interesting, and perhaps opportunistic for the astute investor, is that the designation also includes areas such as Dover, Manchester, Durham, Nashua, Rochester and Seabrook.

You likely have heard or read about the proliferation of “opportunity funds” being formed to take advantage of this new program, but, what does that mean? Quite simply, that means an investor(s) is creating an investment vehicle called a fund, which has been organized as a partnership or a corporation for the purpose of raising money and deploying those monies towards projects in qualified opportunity zone properties and businesses. While some of these funds are focused nationally, others are focused on a particular region and some entrepreneurs are solely focused on local opportunity zones.

There has been considerable enthusiasm regarding the potential that these zones may bring; think billions, or even trillions, of dollars of private equity money pursuing these opportunities. It’s still new though, and there are some wrinkles to iron out before we all go out and start raising equity and forming funds on our own. Is the excitement over the potential of what opportunity zone investing may or may not bring with it warranted? We have not heard nor read much insight regarding the potential set-backs or downfalls with the program.

Without a doubt there are several potential negative risks. The original set of regulations came with a cloud of ambiguity hovering over them, and while the newly released set of regulations is sure to tie up some of the loose ends, the Treasury and IRS have been rather slow to provide additional insight and guidance on several important issues before investors can confidently move forward.

I believe that the government shutdown earlier this year was in large part responsible for causing a clog in the information pipeline. With the release of the second set of regulations on April 17, we are seeing more people weigh in on opportunity zones and the potential they hold.

Speaking with BisNow Stephen Sharkey, a partner with global law firm DLA Piper, believes that these regulations remove the cloud of doing it. “In my assessment, this gives us something that can make this work and make investments happen,” he said. I think that once even more clarity is achieved and the private equity investors feel more confident (and their risk can be somewhat mitigated) there will be an abundance of funds pursuing zone investment. Zones throughout the U.S. include rural, urban, and suburban areas –more than 8,700 opportunity zones have received their designation and are open for business.

There has been noted concern in several areas including the lack of transparency in how the legislation was written and enacted and inexperienced sponsors (those raising the funds) getting into the pool. Also, the financial incentives being offered could very likely end up hurting the communities and areas that it was intended to serve and help. It has been suggested that the zones may be a huge windfall for the rich and wealthy, and could further perpetuate a terrible downward spiral – in fact called a “disastrous idea” for those areas classified as low-income. Prior to the release of the second set of regulations, the opportunity funds did not have to maintain, track or report on community benefit requirements. In fact, there have been no guidelines surrounding reporting requirements nor has there been any indication of any state oversight at all. This new set of regulations could change that, however it will be some time before people have had time to read and fully digest them.

Another concern is that development will not produce the intended benefits of the program as it was first envisioned. It has been suggested that the exact opposite may occur and the continued erosion of affordable housing inventory and the revitalization of neighborhoods could displace residents. If this were to happen, it would have a significant negative impact on the socio-economic benefits that were touted to the public when the program was first introduced. In order to preserve its long-term sustainability, the program must include goals which are measurable and transparent and there must be the ability to clearly articulate the benefits of each project to the residents of the community it serves. There will need to be metrics and methodology to measure the impact and success of the tax incentives, otherwise, how will these incentives promote the social impact of the program to every community it was intended to help? While we may not have the answers just yet, we can only gain additional clarity as more information is released to the public.

Without metrics and transparency, the perception will remain that the federal government has rolled out another special-interest, government-supported program with the intention of providing only the high-net-worth individuals in the country with yet another tax incentive. This would hardly be the anticipated stimulus for the low-income communities it was designed to assist and support.

As may be the case when venturing into uncharted territories, there may be pitfalls with the opportunity zone program while in its infancy. However, working with qualified professionals such as commercial real estate advisor's, CPA's, and legal counsel to navigate the landscape with you is a great first step towards familiarizing yourself with the details of the program, and developing a strategy to pursue these opportunities while mitigating your risk.

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