LEE & ASSOCIATES
COMMERCIAL REAL ESTATE SERVICES

All About Opportunity Zones

A valuable breakdown of the benefits

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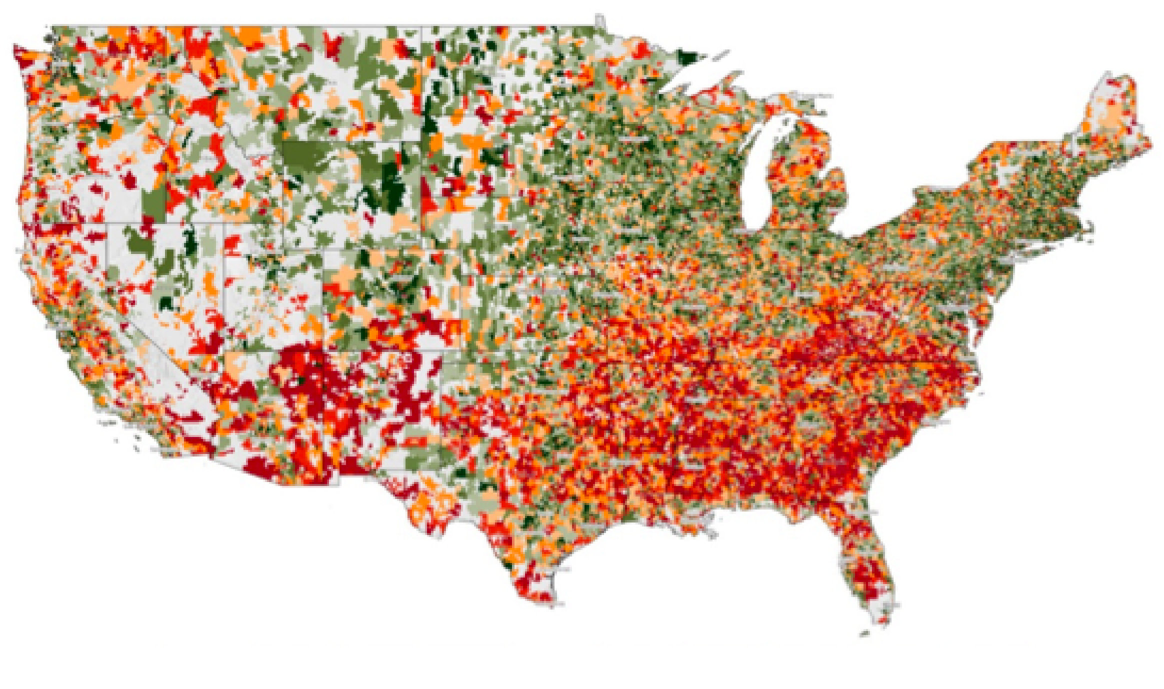

Outpost. Rendering courtesy of Parkview Financial

WHAT IS THE OPPORTUNITY ZONE PROGRAM?

The Opportunity Zone program is a tax incentive program that was brought to the public through the Tax Cuts and Jobs Act of 2017 with the goal of bringing long term investment capital into low-income areas to stimulate local economies and rehabilitate distressed cities. Through the program, governors of the 50 states and 4 territories were tasked with nominating zones with low incomes, high poverty rates, and high unemployment rates to be approved and designated as Qualified Opportunity Zones by the US Department of Treasury.

WHAT ARE THE OPPORTUNITY ZONES COMPRISED OF?

A total of 42,176 census tracts were eligible for Opportunity Zone Designation. Of these 42,176 census tracts, 8,762 were designated as Qualified Opportunity Zones. The average Opportunity Zone has a median household income of $33,345, a poverty rate of 31.75%, and an unemployment rate of 13.41% (the current national unemployment rate is 3.8%). There are about 31.3 million people in designated Opportunity Zones across the United States, 56% of which are people of color. Out of the 8,762 designated Opportunity Zones, 294 possess Native American lands.

TAX BENEFITS OF OPPORTUNITY ZONES

In an effort to encourage capital investment into these impoverished communities, the Opportunity Zone program offers 3 main tax incentives:

(1) Tax Deferral: The first benefit is the deferral of tax on capital gains that are re-invested into a Qualified Opportunity Zone Fund. The deferred gain is recognized on December 31, 2026 or at the disposal of the Opportunity Zone investment, whichever occurs first.
(2) Reduction of Tax Liability: The second benefit is a step-up in tax basis for capital gains re-invested into an Opportunity Zone Fund. If the investment is held for 5 years or more, the tax basis of the investment is increased by 10%. If the investment is held in the Opportunity Zone Fund for 7 years or more, the tax basis is increased by 15%.
(3) Tax Exclusion: The third and greatest benefit is a permanent exclusion from any tax on the appreciation of the Opportunity Zone investment if the investment is held for at least 10 years.

WHAT ARE SOME OF THE REQUIREMENTS TO RECEIVE THE TAX BENEFITS OFFERED BY THE OPPORTUNITY ZONE PROGRAM?

1. The tax benefits will only apply to the re-investment of any gain recognized from 2018 through 2026 by an individual or entity with no more than 20% overlapping ownership of the subject property or business.
2. The subject property must have been acquired after December 31, 2017.
3. You must acquire interest in the Opportunity Zone Fund within 180 days after the gain is recognized. If the property is sold for a note and a gain is reported on the installment method than the 180 day clock starts running on the receipt of each payment of the note.
4. The Qualified Opportunity Zone property must be substantially improved by 100% of the buildings value within a 30 month period.
5. After the first six-month period of a Qualified Opportunity Zone Fund's tax year, the fund must hold at least 90 percent of its assets in Qualified Opportunity Zone property.

ASSUMPTIONS	
Capital Gain from Asset Sale	$1,000,000
Long-Term Capital Gains Tax Rate	26.00%
Qualified Opportunity Fund Annualized Return	7.00%
Traditional Investment Fund Annualized Return	7.00%

TRADITIONAL INVESTMENT **VS.** **OPPORTUNITY ZONE INVESTMENT**

TRADITIONAL INVESTMENT

2018	
Gain	$1,000,000
Taxes	$ (260,000)
After Tax Gain	**$ 740,000**
Amount available for investment: $740,000	

2026	
Current Value of Investment: $1,271,458	

2029	
Current Value of Investment: $1,557,590	
Sale of Traditional Investment	
Before-Tax Income from Sale	$1,557,590
Taxes Due	$ (404,973)
Earnings You Are Taking Home	**$1,152,617**

Ending Net Value of Investment	
Taxes Paid Since 2018	$ (664,973)
Net Value of Investment	**$1,152,617**

OPPORTUNITY ZONE INVESTMENT

2018	
Gain	$1,000,000
Taxes	$ -
After Tax Gain	**$1,000,000**
Amount available for investment: $1,000,000	

2026	
Current Value of Investment: $1,718,186	
Pay taxes on deferred gain (with a 15% increase in tax basis)	
Deferred Gain x 0.85	**$ 850,000**
Taxes Due	$ (212,000)

2029	
Current Value of Investment: $2,104,852	
Sale of Qualified Opportunity Zone Investment	
Before Tax Income from Sale	$2,104,852
Taxes Due	$ -
Earnings You Are Taking Home	**$2,104,852**

Ending Net Value of Investment	
Taxes Paid Since 2018	$ (221,000)
Net Value of Investment	**$1,883,852**

TALKING TO THE EXPERTS

When asked what to look for when searching for a good Opportunity Zone investment property, Lee & Associates Opportunity Zone Specialist Garrett Sholer said, "When we are looking for viable Opportunity Zone investments for our clients, the first and most important thing we look for is property that can be re-developed; at minimum, it needs to support a substantial increase in the rentable square footage. If an Opportunity Zone investor is contemplating making improvements to an existing structure, potential rents must be raised by a dramatic amount in order for the project to have any chance of making sense under the Opportunity Zone requirements. The Opportunity Zone investor must improve the property by 100% of the "Improvement Value" at purchase under the guidelines. Therefore, these improvements must dramatically improve the desirability of the building and its income potential. As a "rule of thumb" we tell our clients those capital improvements must raise the income potential by an order of magnitude in the 50%+ range in order to justify the cost of the average project. Afterall, the primary reason for participating in the Opportunity Zone program is creating tax free federal capital gains. There is absolutely no point in making improvements that are not likely to result in significant capital gains. Additionally, given today's commercial real estate climate in California, our Opportunity Zone team has observed that certain types of redevelopment projects are attracting the lion's share of attention; sites which support hotels and various forms of multi-residential (i.e. apartments, senior housing, assisted living and affordable housing), have received most the focus thus far. The program certainly can be used for the redevelopment of industrial, retail, and mixed-use sites, but it is much more difficult to transform those properties enough to justify the efforts."

Sources: IRS.gov, urban.org, taxpolicycenter.org, opzones.ca.gov

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