Opportunity Zones in Colorado

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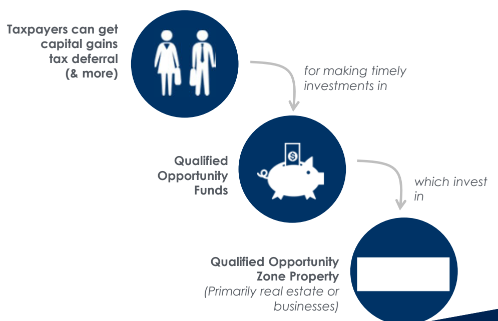
What are Opportunity Zones?

- New **federal incentive** designated in the 2017 tax reform bill
- Incentive for investors to **support distressed communities** through **long-term, equity investments** in businesses and real estate ventures
- Incentive is **deferral, reduction and potential elimination of certain federal capital gains taxes**
- If properly executed, Opportunity Zones may help address a number of challenges in Colorado:
  - **Promoting economic vitality** in parts of the state that have not shared in the general prosperity over the past few years
  - **Funding the development of workforce and affordable housing** in areas with escalating prices and inventory shortages
  - **Funding new infrastructure** to support population and economic growth
  - **Investing in startup businesses** that have potential for rapid increases in scale and the ability to "export" outside the state of Colorado

How does it work?



Source: Novogradac and Company

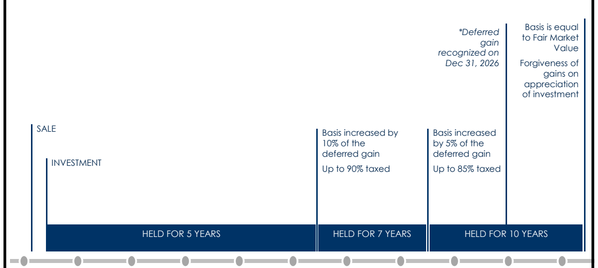
Taxpayer Benefits

1. **Deferral of capital gains tax** until sale or Dec 31, 2026
2. **Partial reduction of deferred gain**
   - Tax basis increases by 10% if investment is held for 5 years
   - Tax basis increases by additional 5% if investment is held for 7 years
3. **No capital gains tax on appreciation** if investment is held for 10 years

Qualified OZ Fund

- **Taxpayer has 180 days to move gain into the OZ Fund**
- **Fund must be a partnership or corporation (LLC is allowed)**
- **Fund must be 90% deployed into Qualified Opportunity Zone Property 180 days after it takes in capital**
  - **Safe harbor for reasonable working capital**
- **Declaration and deployment test will be self-certified and subject to audit (IRS Form 8996)**

Investment Timeline



Qualified OZ Property

- **Must be an equity investment**
- **Property must have been purchased by an unrelated party after Jan 1, 2018**
- **Businesses must have a majority of their a) employee hours b) revenues OR c) management and operations within an OZ to qualify**
- **"Sin businesses" are excluded, marijuana companies probably not allowed**
- **Most property must be substantially improved = doubled in value within 31 months (with safe harbor for government delays)**

Qualified Opportunity Zone Business Property

- "Original use"
  - means property is first placed in service for purposes of depreciation/amortization in the zone
  - abandoned property (5+ years) meets original use requirement
  - improvements by lessee satisfy original use requirement
- Substantial improvement
  - tested on an asset by asset basis
- Land
  - does not need to meet original use or substantial improvement test, but must be used in a trade or business
  - does not qualify as QOZ business property if unimproved or minimally improved, and purchased with expectation of not improving by more than an insubstantial amount

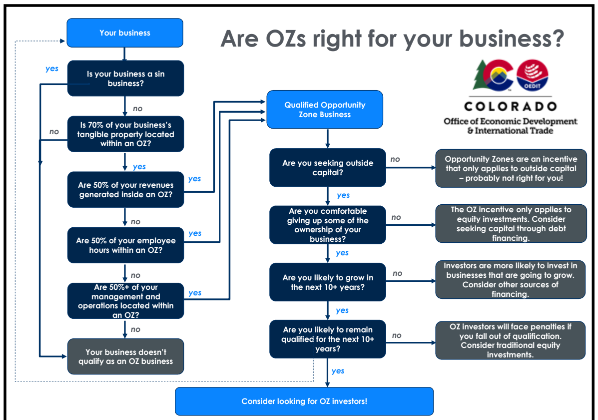
Qualified Opportunity Zone Business

- Triple net leasing does not constitute an active trade or business
- Safe harbors provided for purposes of meeting requirement that 50% of gross income derives from the active conduct of a trade or business in the Zone
  - at least 50% of services performed (based on hours) for business by employees/ICs are performed in the Zone
  - at least 50% of services performed (based on amounts paid) for business by employees/ICs are performed in the Zone
  - both the tangible property and management functions in the Zone are necessary to generate 50% of gross income of the trade or business
- Substantially all for purposes of IP is 40%
- Real property can straddle Zone

Leases

- Leased property counts for purposes of 90% test and as QOZ business property
  - must be market rate, begin after 2017, substantially all of the use is in a QOZ for substantially all of the leasehold
  - no original use or substantial improvement requirement
  - can be from related parties (but no prepayment of more than 12 months)
- Anti-abuse rules prevents leases from circumventing substantial improvement rules (if at the time the lease was entered into, there was a plan for purchase to occur for other than fair market value)
- Triple net leasing does not constitute an active trade or business

Are OZs right for your business?



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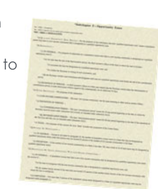
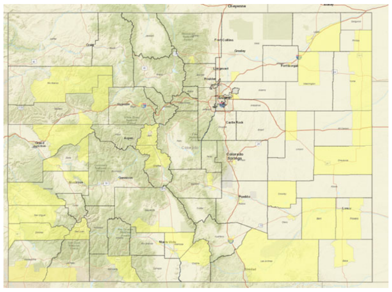
What makes Opportunity Zones so unique?

- It is an **investor incentive** that pertains exclusively to **capital gains**.
- It is designed to **concentrate capital** rather than diffuse it.
- It rewards **patient capital**: All incentives are tied to the longevity of the investment.
- It unlocks scarce **equity** capital.
- It provides **no up-front subsidy** and doesn't pick winners.
- It can move at the speed of the market.
- It gives investors a **stake in communities' future**: Most programs reward individual projects; this one ties investor payoff to community success.



Colorado's Opportunity Zones



Interactive map: www.choosecolorado.com/oz

CO Opportunity Zone Program

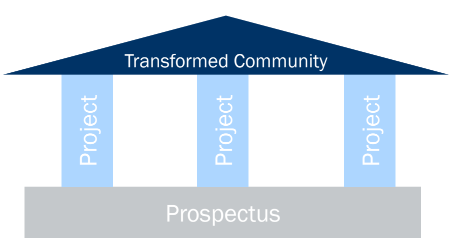
The Mission: Position Colorado as a leading destination nationally for capital investment in Opportunity Zones, and use this investment to benefit distressed communities

- **Nomination**
  - *Designating 126 Opportunity Zones across the state*
- **Education**
  - *Spreading the word to investors, community leaders, developers and other stakeholders*
- **Community Support**
  - *Empowering communities to understand how Opportunity Zones work and how they can benefit*
- **Investment Facilitation**
  - *Helping capital and projects find each other*

Community Strategy

How (Most) Investors think about an OZ Investment

- Excellent tax incentives to invest, but still seeking risk-adjusted market-rate returns (12% - 15%)
- Will attract long-term investments within portfolios, patient capital
- Focus project-by-project, since current rules make multi-asset funds difficult
- For investors approaching new places, it's not always clear how to find viable projects
- Business investment recently became more clear, but implications still unknown



What is a Prospectus?

- Investment memorandum designed to attract capital to a community
- Tells data-backed story of a community based on the interplay of three factors: sectors, communities, and institutions
- Identifies specific developable projects, and make a case for why those projects will see a return, including additional incentives that are applicable (Opportunity Zone, TIF, Enterprise Zone, NMTC, etc)
- *Not* a pure marketing document – highlights opportunities, risks, and mitigation strategies
- See choosecolorado.com/oz for examples + grant application

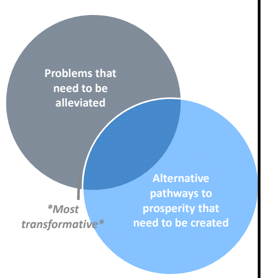
Identify your general OZ strategy

Which strategy best describes your community?

Part 1: Needs + Assets = Opportunity

Identifying Needs

1. **Targeted data is necessary to gauge needs:** Local officials should engage universities and state offices to retrieve such data.
2. **Convene stakeholders to establish zone priorities:** Community leaders should bring local parties together to get on the same page about what they want for the zone. This process should make clear that *now* is the time to act and should focus on projects with demonstrated community buy-in.
3. **Focus on lowering unintended consequences:** Community leaders should guide stakeholders to projects that carry low displacement risks while addressing



Identifying Assets

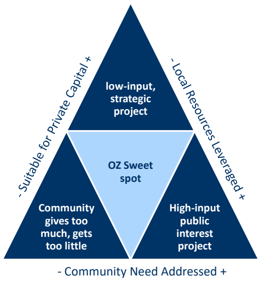
- **Anchor Institutions:** Higher education, hospitals, churches, natural resources, existing industry, etc.
- **Government- Controlled Assets:** City-owned land, buildings, or tax districts
- **Key Partnerships:** Non-profit/community groups, chambers of commerce, local champions, etc.
- **Human Capital:** Demographic trends, workforce strengths, etc.
- Regulatory Resources: Zoning codes, planning approval processes, additional incentives, etc.
- **Sources of Capital:** Investors, philanthropy, family offices, government funds, etc.
- **Success Stories:** Positive examples of transformative growth

Part 2: Identifying Projects

Triangulate Projects

Where does project fit within intersection of needs, resources, and suitability

- Community needs addressed: how deeply or broadly does this project address prioritized community needs?
- Local resources leveraged: how much are you willing to put on the table, and for what outcomes?
- Suitable for private investment: how likely is this project to attract private capital?



Understand/Strengthen the Appeal

Economic Fundamentals

- ❑ Does the city control the key resources?
- ❑ Is there strong community support?
- ❑ Is this likely to appreciate over 10 years?
- ❑ Is there a clear exit from investment?
- ❑ What type of investor is likely to be attracted to this project?

Need-Resource Overlap

- ❑ Where in the planning process is this project?
- ❑ Has a project champion been identified?
- ❑ Is the story likely to appeal to the mission-orientation of investors?
- ❑ How do these investments fit within the municipality's broader development strategy?
- ❑ Who benefits from this investment? Who is harmed?

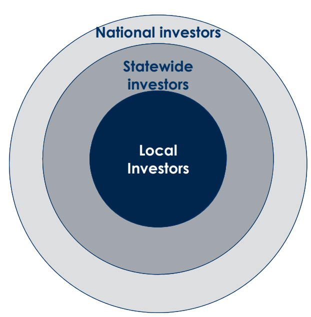
THE BEST PROJECTS MEET SOME UNDERSTOOD, SPECIFIC, LOCAL NEED AND KEEP ALL STAKEHOLDERS (COMMUNITY, LOCAL GOVERNMENT, DEVELOPERS, INVESTORS) ACTIVE AND ENGAGED.

Part 3: Connecting with Investors

Debt vs Equity

Basis for comparison	DEBT	EQUITY
Meaning	Borrowing a fixed sum from a lender which is paid back with interest	Selling a percentage of the business to an investor in return for capital
Creates	An obligation	Ownership
Term	Usually a fixed, comparatively short term	No fixed term
Types	Bank loans, credit cards, bonds, convertible notes, etc	Shares, preferred shares
Return	Fixed and regular	Variable and irregular
Nature of Returns	Interest + repayment of principal	Dividends + proceeds from sale
Collateral	Secured against the assets of the business	Unsecured

Target investors



- OZ Events
- Financial Service Providers
- Co-Invest.co
- Online lists of funds (i.e., Novogradac, EIG)

Consider layering additional programs and incentives

Part 4: Bringing it all together

Achieving the Potential of OZs

- **Changing** the story of development: investors & community coming together to build something that is locally beneficial
- **Advancing** the right projects, which can unite investors, the community, and the local government
- **Creating** a more even playing field between municipal government, developers, and investors.
- **Understanding and developing** creative financing mechanisms for community projects.

Financial Service Providers
Entrepreneurs
Banks / CDFIs
Developers
Property Owners
Wealthy Individuals
Foundations / Philanthropy

Opportunity Zones can be a hook to begin conversations with critical stakeholders

Consider having an OZ Convening if you haven't already

Guiding Questions

- Overall:
  - What types of investment does the community need? (i.e., housing, infrastructure, entrepreneurship)
  - What assets does the community have available? (i.e., town-owned land, anchor institutions, infrastructure, workforce)
  - What would be the top ~5 most developable projects that would benefit the community?
- For particular OZ projects:
  - What is the projected rate of return?
  - What can the community add to make them more attractive? (i.e., additional incentives, fast-tracked permitting, etc.)
  - Who are the participants we need to be involved? How and where can we reach them?

Important Resources

Data Sources
- Opportunity360 - https://www.enterprisecommunity.org/opportunity360
- State Demographers Office - https://demography.dola.colorado.gov/
- Census Bureau Site - https://www.census.gov/
- Bureau of Economic Analysis - https://www.bea.gov/

Grants
- DOLA Planning Grants - http://choosecolorado.com/wp-content/uploads/2018/08/OppZone-1.pdf
- OEDIT Technical Support Grants - https://choosecolorado.com/wp-content/uploads/2019/03/OZ-Technical-Support-Grant_March-2019.pdf
- EDA Grants
- HUD Grants

Policy Frameworks
- OZ Impact Framework - https://ozframework.org/
- Equitable Economic Development - http://www.policylink.org/sites/default/files/
- OZ Policy Strategies and Opportunities - http://choosecolorado.com/wp-content/uploads/2018/08/Opportunity-Zones-Policy-Strategies-Opportunities-updated.pdf

Fact Sheets
- Opportunity Zone Fact Sheet - https://eig.org/wp-content/uploads/2018/07/Opportunity-Zones-Fact-Sheet-7.6.18-Update.pdf
- IRS FAQs - https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions

Thank you

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