Opportunity Zones in Colorado

Jana Persky
jana.persky@state.co.us
303-892-3707

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

Opportunity Zones

How does it work?

Taxpayers can get capital gains tax deferral (& more)

Qualified Opportunity Funds

for making timely investments in

Qualified Opportunity Zone Property (Primarily real estate or businesses)

What are Qualified OZ Funds?

• 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

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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

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Source: Novogradac and Company

Deferred gain recognized on Dec 31, 2026

Investment Timeline

Taxable

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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 test, but must be used in a trade or business
- Triple net leasing does not constitute an active trade or business

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.

Are OZs right for your business?

- Is your business a “sin business”? Are you likely to remain an OZ?
- Is your business a “sin business” that pertains exclusively

6/5/2019
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

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

Education

Investment Facilitation

Nomination

Community Support

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

Community Strategy

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?

- Seeking any capital to counter disinvestment
- Seeking capital for specific project or area
- Trying to constrain certain investments to avoid displacement

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 problems that need to be alleviated

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

WHERE DO NEEDS AND ASSETS OVERLAP TO CREATE OPPORTUNITY?

Part 2: Identifying Projects
THE BEST PROJECTS MEET SOME UNDERSTOOD, SPECIFIC, LOCAL NEED AND KEEP ALL STAKEHOLDERS (COMMUNITY, LOCAL GOVERNMENT, DEVELOPERS, INVESTORS) ACTIVE AND ENGAGED.

**Triangulate Projects**

Where does project fit within interaction 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?

**Part 3: Connecting with Investors**

**Debt vs Equity**

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

**Target investors**

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

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/opp
  - State Demographers Office - https://census.gov/data/demographics.html
  - Census Bureau Site - https://www.census.gov/
  - Bureau of Economic Analysis - https://www.bea.gov/

- **Grants**

- **Policy Frameworks**
  - OZ Impact Framework - https://ozframework.org/

- **Fact Sheets**
Thank you

Jana Persky
jana.persky@state.co.us
303-892-3707

Jamie Hackbarth
jamie.hackbarth@state.co.us
303-892-3764