Opportunity Zones

An Educational Overview

Updated for 2024

CIM

Educational Overview:

An Introduction to Opportunity Zones

An Opportunity Zone is an economic development tool designed to boost job creation and other economic advancements in distressed areas in the United States. The funds invested into Opportunity Zone projects are used to help improve housing, businesses and the community as a whole.

25% Every U.S. state and territory nominated up to 25 percent of qualifying areas to be certified as Opportunity Zones.[1]

The Opportunity Zones provision grew from a desire to drive investment in high-potential communities across the United States through a more effective economic incentive program than those previously available to private investors.[1]

Please see important disclosure and footnotes on page 19.

Opportunity Zone History[1]

Opportunity Zones were conceived as part of an innovative approach to spurring long-term private sector investments in high-potential communities nationwide.

The concept behind the Opportunity Zone program was first introduced in a 2015 paper by the Economic Innovation Group titled "Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas."[2]

In 2017, a group of lawmakers championed the Investing in Opportunity Act, which created the foundation for the Opportunity Zones provision. Senators Tim Scott (R-SC) and Cory Booker (D-NJ) along with Representatives Pat Tiberi (R-OH) and Ron Kind (D-WI) led a regionally and politically diverse coalition of nearly 100 congressional co-sponsors to pass the bill.

Congress established the Opportunity Zones incentive in the Tax Cuts and Jobs Act of 2017. By receiving favorable tax treatment, investors are now incentivized to deliver new or "substantially improved" assets to neighborhoods designated as Opportunity Zones. The program's vision is to spur economic growth and bring new jobs and businesses to up-and-coming communities.

Business, real estate and public policy experts have praised the Opportunity Zone provision.[1] While other incentives or tax credit programs are often heavily regulated, the Opportunity Zone concept has less red tape and is considered simpler to execute.[3]

Please see important disclosure and footnotes on page 19.

Nearly

48

Million Americans

live in economically distressed communities.[4]

Opportunity Zones Defined

Opportunity Zones are census tracts which have been designated by each state or territory and certified by the U.S. Treasury as eligible to receive private investments through Qualified Opportunity Funds (QOFs).[5]

A census tract could be designated as a Qualified Opportunity Zone if it had either a poverty rate of at least 20 percent or median income of no greater than 80 percent of the surrounding area.[6]

To concentrate capital and increase the likelihood of meaningful economic development, only a portion of each U.S. state's or territory's qualifying census tracts were eligible for the Opportunity Zone designation. The governor or chief executive of every state and territory nominated up to 25 percent of such areas within their jurisdiction to be certified as Opportunity Zones. They also focused on tracts adjacent to more established areas to capitalize on synergies in the broader market.[1]

The Opportunity Zones typically have proven growth potential in addition to unrealized opportunities.[7] The zones were identified based on U.S. Census Bureau data from the 2011-2015 American Community Survey, and many areas have already made notable progress. For example, hotel and apartment development has begun to transform traditionally industrial areas within many Opportunity Zones.[8] This is particularly true of Opportunity Zones in or near submarkets in booming metropolitan areas, like Los Angeles, Oakland and Atlanta.[9]

Please see important disclosure and footnotes on page 19.

64%

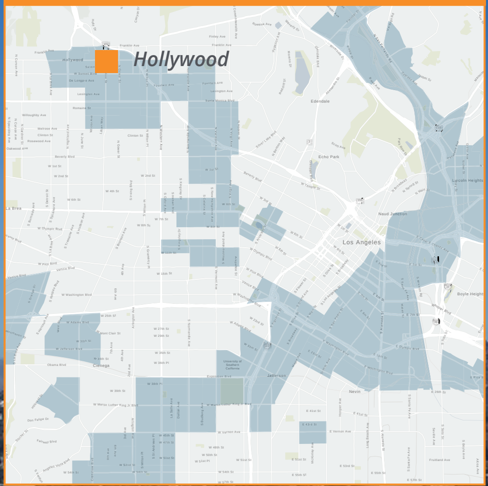
of Job Growth

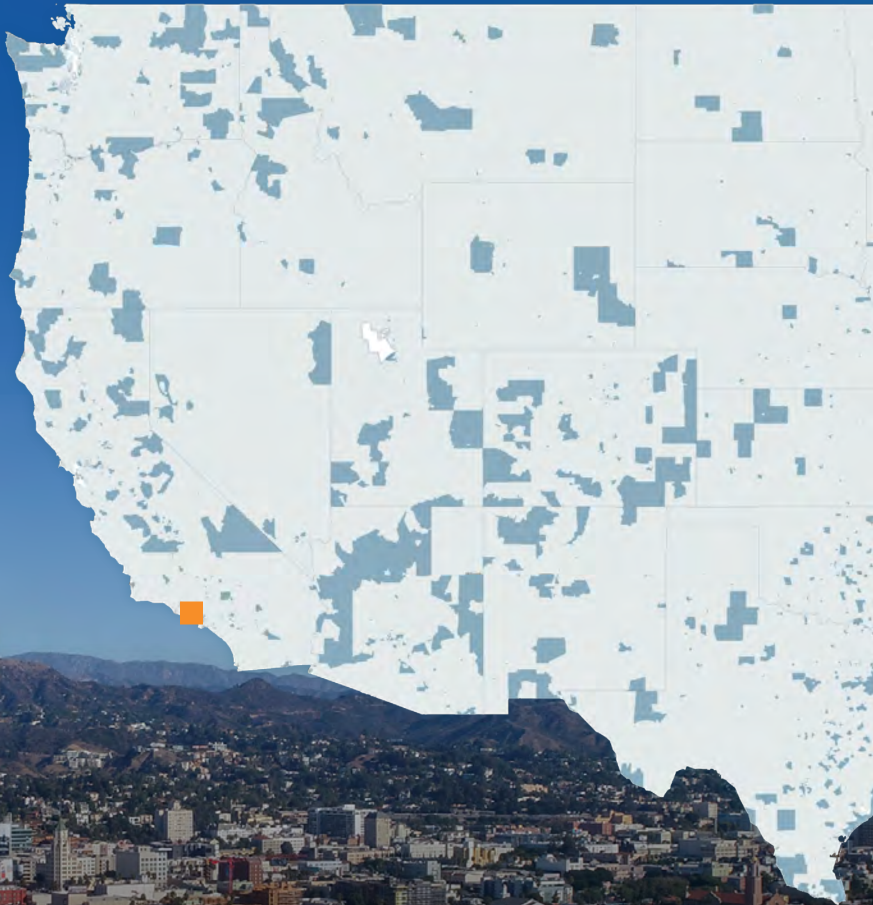
comes from small businesses, for whom the most important variable for success is access to capital.[4]

Opportunity Zone Characteristics[1]

- Nominated from among eligible census tracts by state or territory leadership and certified by the U.S. Treasury
- Up to 5% of nominated tracts could be in areas adjacent to low-income census tracts
- High need for economic growth

Los Angeles Designated Opportunity Zones





"The Opportunity Zone program enables individual investments to **improve lives and create jobs in underserved communities."**

Avi Shemesh, Co-Founder, CIM Group

+8,700 Opportunity Zones

have been designated across **all 50 states,** the District of Columbia and five U.S. Territories.[1]

Atlanta Designated Opportunity Zones

Please see important disclosure and footnotes on page 19.

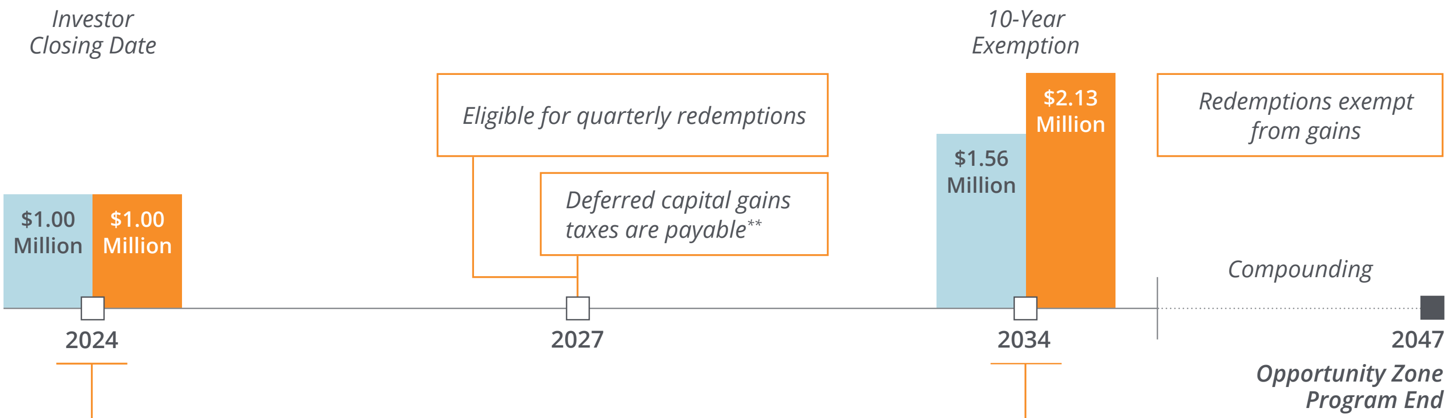
Qualified Opportunity Fund Investor Benefits*

Qualified Opportunity Funds (QOFs) are generally private sector investment vehicles created as a partnership or corporation for the purpose of investing in eligible property and businesses located in Opportunity Zones. Investors in these funds may receive favorable tax treatment on capital gains from past investments and investments going forward.[1] The greatest potential benefits are available to those who hold their QOF investment for 10 years or more. Potential tax incentives fall into two main categories:

Deferral and **Exclusion.**

Investment in a Qualified Opportunity Fund
Tax deferral begins at time of investment through 2026.

Investment not in a QOF and subject to capital gains
Non QOF investor must pay an upfront capital gain.



Deferral*

Temporary deferral

Investors receive a temporary tax deferral for all capital gains reinvested in a QOF, which lasts until the investment is sold or December 31, 2026, whichever comes first. Investors seeking to maximize temporary deferral may realize a gain today and pay taxes in 2027.

Exclusion*

Permanent exclusion

Investors may elect to use a permanent exclusion from taxable income on capital gains (including depreciation recapture) from the sale of an investment in a QOF. In addition, if the QOF sells an asset and the investor has held its QOF investment for at least 10 years, the investor can exclude its share of the capital gain from taxable income.

***For illustrative purposes only.**
Not representative of an actual investment and there is no guarantee that any investment strategy will meet its objectives. Assumes: appreciation rate of 9%; federal capital gains rate of 23.8%; no taxable income generated by Fund during the holding period.

The information is not to be construed as tax advice; please consult your tax advisor regarding your specific tax consequences. Please see important disclosure and footnotes on page 19.
**Assumes that investors will meet deferred capital gain taxes liabilities from own sources.

The **greatest potential benefits** are available to those who hold their QOF investment **for 10 years or longer.**

The Impact of Opportunity Zones: An Initial Assessment

Published August 2020

The full report can be viewed at: www.novoco.com/sites/default/files/atoms/files/white_house_the_impact_of_opportunity_zones_an_initial_assessment_report_082220.pdf

In August 2020, the Council of Economic Advisers (CEA) prepared its initial report on the effectiveness of Opportunity Zones (OZs) in meeting the objective of spurring investment in economically distressed communities. The CEA qualified the effect of Opportunity Zones on investment, finding a large increase that has benefitted communities and their residents while potentially having only a small effect on the Federal budget. Among the key findings:

» The CEA projects that the capital already raised by QOFs could lift 1 million people out of poverty into self-sufficiency, decreasing poverty in OZs by 11 percent. This decline in poverty, and with it a reduction in transfer payments, may be sufficient to make the OZ incentive nearly revenue neutral.

» The CEA estimated that QOFs raised $75 billion in private capital by the end of 2019, most of which would not have entered (approximately 70 percent) OZs without the related incentives. This new capital represents 21 percent of total annual investment in OZs and helps explain why the CEA also found that private equity investment in OZ businesses grew 29 percent relative to eligible communities that were not selected as OZs.

» Growth in OZ investment has already made these areas more attractive to their residents as reflected the prices buyers are willing to pay for homes located in OZs. The CEA estimates that OZ designation alone caused a 1.1 percent increase in housing values. The greater amenities and economic opportunity behind this housing value increase will be broadly enjoyed, and for the nearly half of OZ residents who own their homes, the increase provides an estimated $11 billion in new wealth.

- Regarding effects on the Federal budget, the CEA found that each $1 raised by QOFs through 2019 has had a direct forgone Federal revenue effect of 15 cents. By comparison, each dollar in investment spurred by the New Markets Tax Credit, an existing Federal program with similar goals, resulted in 18 cents in forgone revenue. Including indirect effects, the CEA estimates that the Opportunity Zone incentive could be revenue neutral, with economic growth in OZs communities reducing transfer payments and offsetting forgone revenues from taxes on capital gains.
- Investment data from the Securities and Exchange Commission (SEC) show that OZ designation led to a 29 percent increase in equity investments in businesses whose principal place of business is in an OZ, compared with businesses in eligible-but-not-selected census tracts.

So, are Opportunity Zones working? Based on a recent state of the marketplace report by the Economic Innovation Group, the answer appears to be yes. While more time is needed to assess the full impact of the program and its impacts, OZs do appear to be having a positive impact as intended in areas that had been lacking economic development.

Pre-COVID-19 evidence suggests that the OZ model can help spur economic recovery in thousands of underserved communities across the United States. The program has shown the ability to mobilize investors, engage State and local stakeholders, and improve the outlook for under-served communities—all with limited prescription from the Federal Government. In other words, we believe the OZ provision of the Tax Cuts and Jobs Act of 2017 appears to be working as intended.

Steve Glickman
CEO of Develop LLC

"The Qualified Opportunity Zones program presents a compelling occasion for private investors to realize valuable tax incentives while supporting communities that most need assistance. The infusion of investor capital into economically distressed communities with high growth potential can result in far-reaching effects for investors and residents."

Mr. Glickman is the Co-Founder and former CEO of the Economic Innovation Group (EIG), the bipartisan research and policy organization that conceptualized the Qualified Opportunity Zones program and drafted the underlying legislation.

90%

of Held Assets

by QOFs must be invested into Opportunity Zones.[4]

Understanding Qualified Opportunity Funds

QOFs are generally funded by unrealized capital gains, and the underlying incentives relate to the tax treatment of capital gains. Investors must first roll investment gains from the sale of real estate, stocks, bonds or other assets into a QOF within 180 days of the sale.[10] Among other requirements, QOFs must invest 90 percent of held assets into Opportunity Zones.

Factors to Consider When Selecting a QOF

Experience level of the QOF sponsor

A recent article titled "A 10-Step Roadmap to Selecting an Opportunity Zone Fund" highlights the importance of sponsor experience, emphasizing that a history of executing successful real estate business plans in transitioning neighborhoods and significant development experience can be key differentiators among QOF sponsors. Additionally, diversification is an important factor in a QOF, and sponsors with development and management experience across a diverse range of property types may be best suited to assess the needs and opportunities within communities and implement appropriately.[11]

Fund strategy

Does the sponsor intend to develop a property and manage it for 10 years in an effort to maximize the value of the asset? Or will the sponsor successively flip properties by selling them soon after development and then recycle the capital into further development? The latter structure largely removes the need for management experience, but it also increases risk.

Fund structure

Sponsors of an open-end fund may allow limited partners to either redeem their shares at the end of 10 years or remain in the fund for the foreseeable future and leverage the potential longer-term advantages of core real estate investing, such as appreciation and relative stability. On the other hand, a closed-end fund lacks such optionality and will liquidate all shares upon a sale. The fact that closed-end funds may be required to liquidate their entire portfolios after 10 years could create a potential property glut in many markets in 2029 and can negatively impact the total returns of the fund's investors.

Debt levels

We believe that while utilizing a higher amount of debt certainly allows funds to ramp up quickly and can inflate yield, it heightens the risk of fund failure in the event of a recession or an unforeseen event. Conversely, we believe employing too little leverage can result in lower returns. Thus, we believe prudent sponsors will work to develop a strategy that deploys the right blend of equity and debt to effectively manage the fund and maximize returns on a risk-adjusted basis.

There is no guarantee that any sponsor will meet its objectives or that real estate will appreciate in value.
Please see important disclosure and footnotes on page 19.

What kinds of capital gains qualify?*

Capital gains earned through a variety of investment scenarios are eligible for deployment into a QOF.

Real Estate

Tom and the 1031 exchange

After deferring taxes on his real estate sales for several years through the 1031 program, Tom has begun to find it challenging to identify properties he's comfortable with just to maintain the tax deferral. In addition, the requirement to move both the basis and the gains into a new property made it difficult to scale back the investment and further diversify his portfolio. He chose to sell his investment property and separate the proceeds from the gain.

Equities

Mark and his mutual funds

Since the S&P 500 reached a low of 666 in March of 2009, Mark has seen the value of his mutual fund portfolio increase four-fold. He's concerned about current valuations in the equity markets and doesn't believe their returns over the next decade will be as strong as in the last.

Real Estate

Randy and his rental properties

Randy and his wife have owned and managed a portfolio of rental properties for years. They had discussed selling several of their rental properties as they approached retirement. The values had appreciated substantially since each property was purchased, but the couple wasn't yet ready to pay taxes on the capital gains.

Other Capital Gains

Patricia and her partnership gain

As part of her diversified portfolio, Patricia has several partnership investments that report gains on a K1 every tax year. After understanding how the partnership rules work with the Opportunity Zone program, she was able to move some of the gains into a QOF. This enabled her to defer the gains through 2027 and invest in a vehicle that matched her long-term investment objectives.

*The following hypothetical scenarios are for illustrative purposes only and are not meant to be construed as investment of tax advice. Investors should consult with their tax and investment professionals before making any investment decision. Please see important disclosure and footnotes on page 19.

Equities

Louise and her low basis stock

Louise has worked as an executive for a Fortune 500 company for over 25 years and holds highly appreciated stock with a low basis. For years, she had considered reinvesting the funds into other asset classes but hadn't made a decision. The Opportunity Zone program gave her the incentive to sell some of the stock and defer taxes on the gains until 2027 while benefiting from the favorable tax treatment of staying in a QOF for more than 10 years.

Real Estate

Vicki and her vacation home

Vicki bought a Cape Cod vacation home 20 years ago that she and her family used regularly when the kids were younger. Now that they've grown up and live further away, the home usually sits empty. After learning about the Opportunity Zone program, Vicki sold her vacation home and redeployed its gains into a QOF. She and her husband have used some of the principal from the sale toward trips to visit their grandchildren.

Other Capital Gains

Aaron and his art pieces

Aaron inherited an art collection from his father that has since appreciated significantly. Because he is not comfortable having the art on display or paying for safe keeping, he identified the Opportunity Zone program as an opportunity to move the gains from the sale of the appreciated art into an asset class he understands better: real estate. Aaron used the gains to fund a QOF, as he has little need for this money over the next 15 years and would prefer to take advantage of the tax incentives offered by the program.

Business Capital Gains

Brad and his business sale

Brad recently sold the billion-dollar technology company he founded and realized a large gain. As part of his plan to diversify the proceeds of the sale, he identified the portion of the gains that he did not need to be liquid and placed them into a QOF.

Equities

Edward and his exchange fund

Several years ago, Edward had a large percentage of his assets in the stock of a firm he previously worked for. Because he did not want to sell the stock, he moved the position into an exchange fund (also known as a swap fund) so he could exchange his concentrated position for a pool of more diversified holdings. Knowing he eventually wanted to unwind this impending capital gains tax, he liquidated his position in the exchange fund and invested its gains into a QOF in 2024. This enabled him to defer taxes through 2027.

Frequently Asked Questions About Opportunity Zones[5]

Can an investor invest directly into an Opportunity Zone business to qualify for associated tax benefits?

No. Investors must invest through a Qualified Opportunity Fund (QOF) to qualify for the associated tax benefits.

Do I need to live in an Opportunity Zone to take advantage of the tax benefits?

No. There is no requirement for investors in QOFs to live, work or operate a business in an Opportunity Zone.

What can QOFs invest in?

A QOF must invest 90 percent of its assets into Qualified Opportunity Zone Property. Qualified Opportunity Zone Property is ownership interests of corporations, partnerships or businesses that have substantially all of their tangible assets located in an Opportunity Zone. Certain entertainment, leisure or “sin” activities, including massage parlors, liquor stores, suntan booths, casinos, racetracks and golf courses, are ineligible.

Can a QOF make investments in multiple Opportunity Zones?

Yes. As long as 90 percent of the QOF’s assets are invested in a qualified Opportunity Zone Property, there is no limit to the number of opportunity zones involved.

How long do investors have to invest their gains into a QOF?

Investors generally have 180 days from the date a capital gain is recognized for income tax purposes to invest it in a QOF. Investors that receive an allocation of capital gain from a partnership or S corporation and investors that receive capital gain dividends from a RIC or REIT can elect to have the 180-day-period begin on the last day of the entity’s tax year.

Can Opportunity Zone tax incentives be realized beyond 2026?

Yes. QOF investors who hold their investments for at least 10 years may still exclude gains realized on exit from the QOF, even if realized after 2027.

How long can investors stay in a QOF to maximize the permanent exclusion?

The Opportunity Zone regulations allow for investors to receive a permanent exclusion of taxes of their QOF until December 31, 2047.

What safeguards are in place to prevent abuse of the tax incentives?

The Opportunity Zone program includes several provisions designed to mitigate the potential for abuse and market distortion. For instance, QOFs cannot simply purchase and hold real estate because investors are required to substantially improve the asset in order to receive benefits from the incentive.

Additionally, The U.S. Treasury Department has drafted rules and regulations intended to prevent abuse of the incentive and will conduct twice-yearly tests to ensure that funds maintain at least 90 percent of their assets in qualified property. In addition, related party restrictions apply to ensure QOFs are making investments in new businesses within the opportunity zones. Businesses whose assets are primarily financial, such as banks, funds of funds, or holding companies, would likely not qualify as Qualified Opportunity Zone Businesses.

Do QOF investments received through inheritance or upon death lose the favorable tax treatment?

No. QOF interests received through inheritance and other transfers upon death retain the tax benefits under the statute.

Important Disclosure

The forward-looking statements are based on CIM's current expectations, estimates, forecasts and projections, and are not guarantees of future performance. Actual results may differ materially from those expressed in these forward-looking statements, and you should not place undue reliance on any such statements.

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