Opportunity Zones, Taxes, Urban Revitalization

By Daniel Rose

"Doing good while doing well," a phrase first applied to missionary families in 19th century Hawaii, will be possible soon for the real estate world through an exciting new federal program for urban redevelopment. Unparalleled tax breaks will be granted to appropriate new investment in government-selected high-poverty areas.

The Opportunity Zone program, a feature of our 2017 federal tax bill, has been hailed as a game-changing new tax-deferral vehicle designed to encourage private investment capital to flow into economically-distressed, deprived districts. Capital gains taxes on unrealized previous investments in stocks, bonds, art works, closely-held businesses, etc. can be reduced by 10% if the appropriate new investment in an Opportunity Zone is held for five years and cut by 15% after seven years; they will be tax-free after ten years.

Aid for forsaken rural areas in the mid-west or for urban basket cases like Detroit or Milwaukee were evoked by the program's proponents. Skeptics see Opportunity Zones as lavish tax breaks for the rich, who hope to build in already gentrifying areas, with little risk to themselves but with few new benefits for the truly needy.

The challenge for local officials is to ensure that public benefits are real and that they are properly distributed. The challenge for investors is to be sure that their investments are sound.

National investment advisors are salivating at the prospects for their clients, calling the program "almost too good to be true" and a "once in a lifetime opportunity." Many see it as the probable "method of choice for high net worth individuals and family offices to make inter-generational transfers of wealth."

Not all the key details of the program have been announced and some important aspects are likely to be modified when the new Democratically-controlled House of Representatives convenes. For example, Bill Clinton's Empowerment Zone program of the 1990's (which expired in 2016) gave employment subsidies for poor residents and block grants for investing in local infrastructure; and the program was for only truly impoverished areas.

As of today, of the 74,000 census tracts in the United States, 56% qualify as potential Opportunity Zones. 8,700 such zones have been proposed by state governors and approved by the U.S. Department of Treasury. These include 274 districts in Los Angeles County, 67 in Miami-Dade and 306 in New York City (including the Long Island City area selected by Amazon for its new headquarters). A report from the Brookings Institute on the already-approved districts noted that over one quarter were either "not poor, were college campuses or were areas where no one lived. A fraternity house looks like a bunch of poor people in a neighborhood…students appear in the data because they are in school, don't have jobs and live off-campus." Another commentator, the Urban Institute, has concluded that "capital investments in actual Opportunity Zone designations indicate only minimal targeting of the program toward disadvantaged communities with lesser access to capital relative to all eligible tracts."

Most national discussion to date has focused on proposed projects in areas ripe for development and already attracting investment. Many of these will undoubtedly be pursued, but some may be reconsidered.

John Lettieri, one of the creators and planners of the program, advocates great flexibility of conditions in each specific case. In due course, his concerns for the investor may be modified or overridden by those more concerned with demonstrable public benefit that would not have taken place without the federal tax advantages.

Until all final details of the program are determined, revealed and publicly debated, skepticism by critics is justified and demands for reasonable transparency are legitimate, reflecting the adage of British Common Law, “Justice must be done and must be seen to be done.”

To improve the chances of their projects actually being accomplished, groups planning to engage in Opportunity Zone programs would do well to include in their teams not only legal, financial, construction and physical planning experts but also some with experience in dealing with the poor, marginalized and truly disadvantaged.

The Opportunity Zone concept is perfectly valid. History will judge its soundness by the impact of its developments on those truly in need, and at what cost to the public at large from forgone revenues.