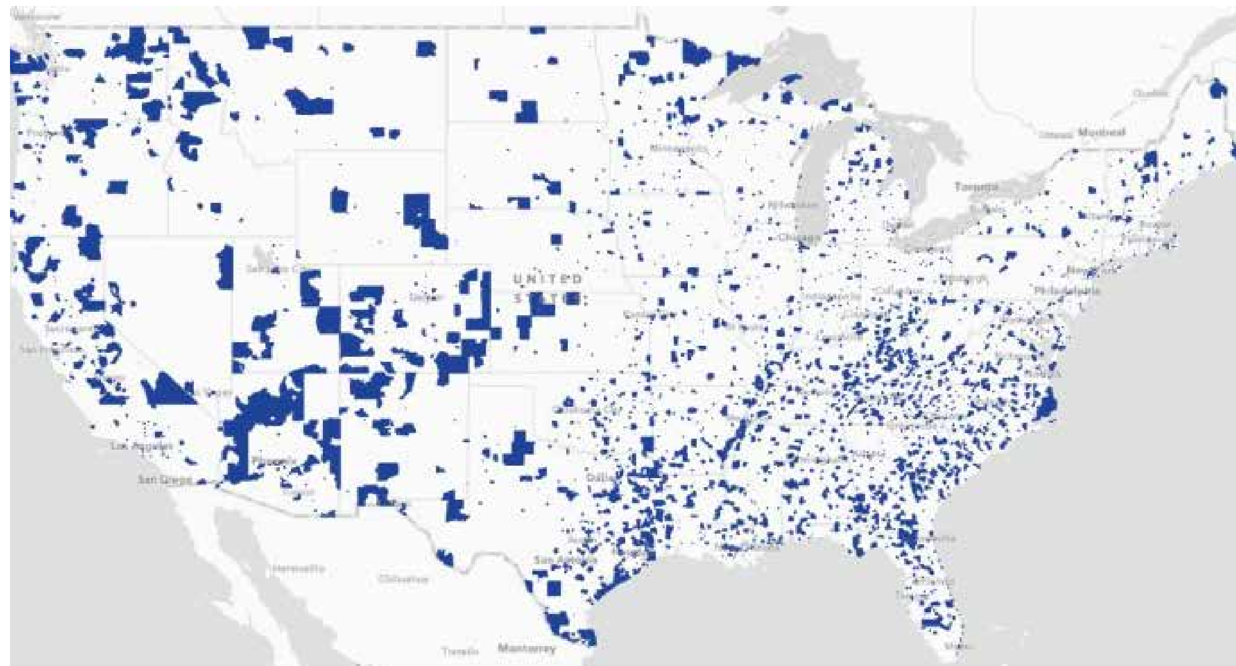
# Opportunity Zone outlook:

## Expert Craig Bernstein outlines his expectations for the program's future

BY BRANDI SMITH



### Opportunity Zones By the Numbers

Over **8,700** zones

**31.4** million residents

**24** million jobs

**1.6** million businesses

Urban **38%**

Suburban **22%**

Rural **40%**

Craig Bernstein

As this article goes to press, the clock is ticking on two of the first significant deadlines connected to Opportunity Zones. The countdown is on to Dec. 31.

"The first issue is the 15-percent step-up in basis, which effectively gives you a 15-percent discount on your initial Capital Gains taxes that would be due in December 2026. An example would be the sale of Netflix stock," explains Craig Bernstein, Principal and Chief Investment Officer at OPZ Bernstein, a Washington, D.C.-based real estate private equity fund that specializes in Qualified Opportunity Zone fund investments ("QOF").

That step-up in basis is a huge selling point of the Opportunity Zone program, created by the 2017 Tax Cuts and Jobs Act. By reinvesting Capital Gains in Qualified Opportunity Zone funds, investors are able to defer, reduce and, in some cases, eliminate any Long-Term Capital Gains taxes on the Opportunity Zone Fund investment.

To receive the full benefit of the legislation, investors must invest their proceeds into an Opportunity Zone Fund by Dec. 31, 2019. However, even if that deadline is not met and an investment is made after Dec. 31, 2019, the program still offers very compelling incentives. Investors would still be able to receive a 10-percent step-up in tax basis if the investment is made between Jan. 1, 2020 and Dec. 31, 2021. If the investor then holds the new Opportunity Zone Fund investment for at least 10 years, the tax rate on any new Capital Gains taxes generated from the Opportunity Zone Fund investment are slashed to zero.

The second issue linked to Dec. 31 is for investors who created an Opportunity Zone Fund using Capital Gains generated from partnership-interests in calendar year 2018.

"If you had a K-1 gain in 2018, the investor had until June 28, 2019 to invest into a Qualified Opportunity Zone fund. If they were unable to identify a suitable reinvestment option, the investor could establish their own Opportunity Zone Fund. This essentially bought them another six months and established a new drop-dead date of approximately Dec. 31," Bernstein says.

Continued on Page 12>

# Opportunity Zone outlook:

< Continued from Page 10

As the finite deadlines outlined in the legislation approach, so it seems does a more tangential political deadline. Opportunity Zones have gained the attention of members of Congress, who expressed concern about the program in a letter to the U.S. Government Accountability Office.

"Given the breadth of the Opportunity Zone incentive, the lack of reporting requirements under current law, as well as the high levels of reported interest from taxpayers, we believe it is critical that the Government Accountability Office assist Congress in evaluating the incentive and monitoring its implementation and outcomes," Sen. Cory Booker (D-N.J.) and Sen. Ron Wyden (D-Ore.) wrote in the November letter, which was also signed by U.S. Reps. John Lewis (D-Ga.) and Richard Neal (D-Mass.).

The letter follows accusations that some investors are abusing the program, which was created with the intention of spurring development in economically distressed areas. Booker, an early champion of Opportunity Zones, wants more oversight. He introduced a proposal to do that earlier this year. Meantime, that's also precisely what's offered in proposed legislation sponsored by Rep. Ron Kind (D-Wis.), Rep. Terry Sewell (D-Ala.) and Rep. Mike Kelly (R-Pa.). Introduced in early November, the bill would create more structure and framework for the program, which has already received new guidance from the U.S. Treasury Department on two occasions since its inception.

"...additional reporting requirements."

As he monitors the progress of this legislation on Capitol Hill, Bernstein remains optimistic about the future of Opportunity Zones.

"While I think that there will be additional reporting requirements, I firmly believe that the program as we know it will stay intact. The legislation initially passed with strong bipartisanship support," he says. "Given the work that governors, both Democratic and Republican, have put forth into the program, I don't see any widespread adoption of legislation that would adversely affect the long-term viability of the program."

"...more than $44 billion in investment..."

Analysis backs Bernstein up. According to the National Council of State Housing Agencies, it has 183 Qualified Opportunity Zone Funds in its directory, which are expected to raise more than $44 billion in investment — "nearly triple the amount projected at the start of the year."

"There is still a significant amount of interest and pent-up demand for institutional-quality real estate from ultra-high net worth individuals and family offices. A majority of these investors remain under allocated in real estate (as an asset class), given the sustained appreciation in equity markets," Bernstein says. "At the end of the day, though, it all comes down to the deal and we're very conservative in the deals that we execute upon. At this point, it's harder for us to identify quality deals versus capital."

He suspects that investor interest could be even higher if investors put more effort into learning about the program.

"There are a lot of nuances with the program, specifically relating to the regulations and timing. This has made it very difficult for investors to understand. When a new investment vehicle is difficult for people to understand, it's very easy for them to say, 'You know what? I'm going to take a pass,'" says Bernstein before adding, "I still believe this program is a once-in-a-lifetime opportunity, but there is no question that the program has had slower adoption and uptake rates across the board."

Looking ahead, he adds that he sees tremendous opportunity for not just real estate investors, but for companies that relocate to Opportunity Zones.

"By being classified as an Opportunity Zone business, they would also get the same exact benefits that would be afforded if it were just a real estate deal," Bernstein says. "Effectively in Texas, as an example, if you invest into a start-up business located within an Opportunity Zone and hold that investment for at least ten years, there would be no Capital Gains taxes due when you sell your partnership-interest in the business."

In the second round of guidance issued by the Fed, companies were granted even more flexibility in ways in which to qualify as an Opportunity Zone business.

"They provided different criteria that allowed you to check the box for it to work," summarizes Bernstein, explaining that the original interpretation of the legislation was very limited.

"...'safe harbors' for the Fed's '50-percent Test'..."

Now there are three so-called 'safe harbors' for the Fed's "50-percent Test" for businesses operating within Opportunity Zones, the first being whether the employees or contractors of said business spend at least 50 percent of their time physically working within the zone. The other qualifiers involve 50 percent of receipts, meaning at least half of the company's revenue must be generated within the Opportunity Zone. Finally, if 50 percent of a company's physical assets are within the Opportunity Zone, it would also be able to capitalize on the benefits of being an Opportunity Zone business.

By providing incentives for investors to invest long-term capital into, the program has the potential to spur revitalization in communities and neighborhoods that need it most.

"We have already seen that this program has the ability to deliver compelling risk-adjusted returns to our investors in a tax-efficient manner, while also positively impacting thousands of lives across America," says Bernstein. ■