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Top 10 “Jackpots” from the Qualified Opportunity Zone Expo in Las Vegas

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Given our law firm’s expanding deal work with real estate and private equity/venture capital clients making Qualified Opportunity Zone (QOZ) investments, we recently attended the OZ Expo in Las Vegas to network and collaborate on the latest developments. The conference was attended by hundreds of representatives from leading sponsors, investors and advisors in the space. Wagers are being placed, and some of early results are:

The Biggest Jackpot: No capital gains on a 10+ year hold! While the capital gains deferral aspects (up to 7 years) of the QOZ program are appealing, the ability to sell a QOZ investment after a 10-year hold with no capital gains tax is extremely compelling. Depending on the gain amount, this could be a significant IRR (Internal Rate of Return) boost to the investment.

Time to Place a Big Bet : The QOZ program has the potential to become one of the more significant U.S. economic development programs. Some commentators believe the end result could be over $1 to $2 trillion dollars of capital put to work in opportunity zones.

Real Estate Investors Wagered Early: In commercial real estate, we are already seeing QOZ investments in (1) ground-up construction, and (2) redevelopment transactions. This development is not surprising given that, until recently, there was more regulation clarity for real estate focused QOZ investments.

Know When to Cash in Your Chips (Especially with Stabilized Real Estate Projects): Everyone is pleased that the latest proposed regulations provided clarity that, after at least a two year hold, a sponsor should be able to arrange a debt financed distribution (recap) to investors (without triggering investor loss of QOZ benefits). Given it often takes at least 2 - 3 years to complete and stabilize a real estate project, this timing should work well.

Company Investors Starting to Wager: The latest set of regulations provided further clarity on a couple of significant operating business benefits:

- Venture Capital (VC): Everyone expects to see more start-up businesses (“original use” property) locate themselves in a QOZ.
- Private Equity (PE): For the acquisition of certain active businesses located in a QOZ, a purchaser / PE firm may be able to “substantially improve” the target business by doubling the basis of the tangible assets.

As the regulatory guidance become clearer, it is expected that more VC and PE funds will look to maximize QOZ benefits for applicable transactions.

No Limit Hold'Em: Unlike some other tax advantaged government programs, QOZ investments are not subject to any sort of allocation cap. As long as the investment takes place in a QOZ census track and either the applicable "original use" or "substantial improvement" test is met, then the investment should qualify for QOZ tax benefits (subject to adhering to any other QOZ compliance requirements).

Tracking Your Bets: A recurring theme of the QOZ conference was that sponsors should work closely with qualified counsel, accountants and other advisors (who are well versed in the QOZ program) to ensure proper structure and administration of the QOZ investment. Among other things, some of the key technical requirements include:

- Making sure investors timely invest their capital gains (depending on the circumstance, either 6 months from a sale or 6 months from the end of calendar year),
- Proper structuring of project entities to facilitate the program benefits,
- Meeting the various QOZ asset tests (i.e., fund must have 90% of assets in QOZ property, etc.),
- Timely filing of IRS Form 8996,
- Developing a written plan to satisfy any applicable 30 month test, and
- Not running afoul of any "related party" (20%) tests.

Increases Your Odds with More Equity / Less Debt: Given the equity focused nature of the program, several commentators expect sponsors doing QOZ deals to have a more conservative capital stack than a non QOZ deal.

The Dealer will be Watching: Given that the primary goal of the QOZ program is to spur long term capital investment in certain census tracks, expect legislation to pass to enable the government to track the job creation and community impact of the underlying investment.

Seek Out the Best Bets: Even with the tax benefits, investors should still do the usual vetting of any investment opportunity … or as one conference commentator stated: "don't let the 'tax tail' wag the dog."