QUALIFIED OPPORTUNITY ZONES

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Using Qualified Opportunity Zones to attract private investment for "campus-edge projects"

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The issue is a familiar one. The well-being and prosperity of a university is inextricably tied to the community in which it operates. The institution has neither the capital nor the expertise sufficient to improve the surrounding area beyond its campus. But the trustees and administration agree that *something* needs to be done to avoid a well-appointed campus from becoming an island. Fortunately, the Tax Cuts and Jobs Act (the Act) of 2017 includes a powerful provision aimed at redirecting investment profits into funding for impact projects in low-income communities—which could be a valuable program for higher education institutions interested in partnering with the private sector to redevelop the "campus edge." Well-managed institutions facing these challenges should acquaint themselves with the possibilities afforded them by so-called "Qualified Opportunity Zones (QOZs)."

The challenge for colleges and universities is not identifying QOZs—state governors and the Treasury Department have already done so. Rather, the question is how do you make your campus-edge projects attractive to Qualified Opportunity Fund organizers and so positively influence the future of your campus? Considering a Qualified Opportunity Fund, whether formed by a higher education institution or by a third-party investor or investors—is another "tool in the toolbox." In addition, new markets tax credits, historic tax credits and other state and local economic incentives could mean the difference between a project that remains on the drawing board awaiting a major donor or next capital campaign and one that can move toward construction within the near term.

Learning about QOZs

The relevant portions of the Act can be found in Sections 1400Z-1 and 1400Z-2 of the Internal Revenue Code. The Act became effective on December 22, 2017, and some guidance has been published by the IRS in the form of FAQs.

The creation of QOZs provides investment opportunities within "low-income communities," as defined in Code Section 45D(e). The QOZ designation lasts ten years. Your first step is to ascertain whether any of your desired areas of development are QOZs.

The governors of each state were required to submit nominations for the establishment of QOZs to the Treasury Department, and the final listing of approved zones was recently released. Information about which census tracts qualify as QOZs can be found here. Out of nearly 32,000 census tracts nationwide that meet the criteria of "low-income census tracts," over 8,000 were nominated. The vast majority of these are now included in the Treasury Department's designations. Hundreds of these sites are located near public and private college and university campuses.

What is the tax incentive that attracts investors to provide capital for these QOZs?

The law allows investors to form "Qualified Opportunity Funds," which then invest in projects in QOZs. Developers and the government are still developing their full understanding of the relevant tax benefits to investors.

The law provides an opportunity to invest proceeds from the sale of capital assets in the development of QOZs by purchasing an interest in a Qualified Opportunity Fund, thereby delaying and perhaps even avoiding federal income tax. A qualifying investment held for seven (7) years is eligible for a 15% step-up in basis, so that upon sale (or December 31, 2026, whichever comes first), the investor would only have to pay tax on 85% of the gain deferred. In addition, for investments held for ten (10) years, the investor can obtain a stepped-up basis that may eliminate tax on the additional value created over the original investment. There are no "caps" or limits on project size or region and projects in most asset classes (excluding certain specifically identified assets like golf courses, casinos, etc.) are eligible. Projects financed from Qualified Opportunity Funds can also include various types of tax-credit financing, such as new markets or historic tax credits.

How does your institution work with a Qualified Opportunity Fund promoter to steer investments to your campus-edge projects?

We see opportunities for higher education institutions to promote the commercial development of sites close to the campus in ways sympathetic with their strategic goals. By promoting the creation of Qualified Opportunity Funds and attracting third-party capital to them, the institution can better assure development in a manner that poses little risk to the institution and imposes no financial drag on institutional resources.

Recently, The Governance Project, a nonprofit organization that assists state and local governments in attracting private capital, issued a thoughtful "policy brief" (authored by Bruce Katz, Jeremy Nowak, Jamie Rubin and Dan Berkovits) titled "How States Can Maximize Opportunity Zones." One of the major recommendations of the white paper is to encourage higher education institutions located in urban areas, particularly public universities, to maximize the commercial impact of their role as "anchor institutions" in their communities, by focusing on strategies involving tech transfer, business incubators and accelerators and student housing.

Nixon Peabody LLP, building on its experience in tax syndication and higher education facilities development, is well acquainted with both the new law and the players in this field. We expect that college and universities, along with their related development foundations, will actively seek local investment, including from high net worth alumni and other supporters. Some institutions may even form their own Qualified Opportunity Funds, possibly preempting interests unknown or less sympathetic to the college or university from taking advantage of these opportunities.

Nixon Peabody LLP is an AmLaw 100 firm with a multidisciplinary Qualified Opportunity Zone team comprised of attorneys from our Higher Education, Community Development Finance, Affordable Housing and Real Estate, Tax, Business and Finance, Public Finance and Project Finance practice groups. Our lawyers are at the forefront of this new program keeping abreast of the changes and regulatory issues as they continue to develop. Members of our team are thought leaders and often speak on this topic at national conferences. We are also involved in various working groups and have been in communication with the IRS and Treasury regarding the implementation of this program.

If you think that your institution may benefit from our experience, please contact:

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