Qualified Opportunity Zone (QOZ) Funds

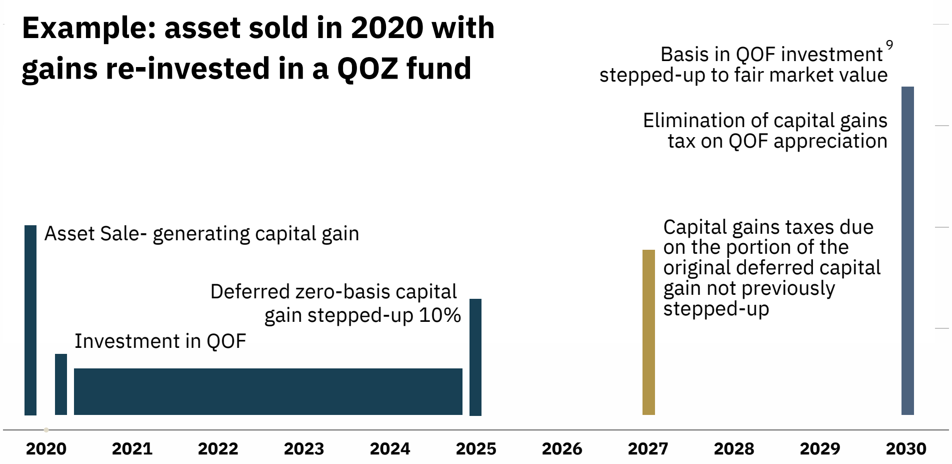
A QOZ fund is an LP, LLC or REIT that invests in properties located in Qualified Opportunity Zones (QOZs). Per the “Invest in Opportunities Act” of 2017, a QOZ is a neighborhood designated by the government to offer certain federal tax incentives for development or revitalization.[7] As of April 2022, there are over 8,700 QOZs in the United States.[8]

1. QOZ funds are offered as private placements (see page 15 regarding private vs. public offerings)
2. QOZ funds aggregate capital from investors to acquire and complete development/revitalization projects in these zones
3. Most of these funds include multiple projects across different zones. Some funds have contractually secured their projects before commencing their offering, while other funds have not “tied up” all projects in advance of raising capital

To designate specific zones, government officials applied QOZ criteria in 2018 to census data from 2010—when many census tracts had not yet bounced back from the Great Recession. It is likely that many of these zones would have exceeded the maximum income thresholds if the boundary-drawers had been required to use 2018 data. As a result, many QOZ projects likely would be built regardless of the zone boundaries, on the basis that economic and demographic conditions already supported the demand for the proposed apartment building or hotel or self-storage facility.

Most QOZ funds generate no income during the first several years of the fund. However, because construction is at the far end of the real estate risk-reward spectrum, the potential total return from a QOZ fund may be higher than other non-traded alternative investments. Typical offerings range from $100 to $500 million of equity raised. Some programs include a plan to refinance the project and provide partial liquidity to investors for the purpose of paying deferred capital gains taxes.

7. https://www.irs.gov/credits-deductions/businesses/opportunity-zones
8. https://opportunityzones.hud.gov/resources/map



TAXATION NUTSHELL—QOZ rules allow taxpayers to sell any appreciated asset that would otherwise trigger a capital gain, and defer the taxes by reinvesting the gains into a QOZ fund. This is distinguished from a 1031 exchange, whereby one must replace the entire asset that was sold in order to completely defer taxes. To receive the tax-deferral benefit, taxpayers have 180 days to reinvest their gains into a QOZ fund, notwithstanding an emergency declaration. Once invested in a QOZ fund, there are three separate and distinct tax benefits:

- Federal capital-gains taxes deferred until after December 31, 2026. This date may be extended for future groups of investors under amended legislation.
- If a taxpayer holds a QOZ fund investment for ten years, any capital gains produced by the fund will be disregarded for federal tax purposes.
- For those who invested in a QOZ fund before the end of 2021 and hold the investment for five years, there was effectively a 10% discount on deferred federal capital gains taxes. It is possible that this timeline could be updated. A handful of states, including California, have chosen not to conform with federal QOZ laws; residents may defer federal capital gains tax but not their state tax.

9. https://www.irs.gov/newsroom/opportunity-zones

QOZ funds typically have no operating history. QOZ funds offer and sell interests pursuant to exemptions from the registration provisions of federal and state law and, accordingly, those interests are subject to restrictions on transfer.

There is no guarantee that the investment objectives of a QOZ fund will be achieved. Investment in a QOZ fund require a long-term commitment, with no certainty of return. There can be no assurance that a QOZ fund will complete the acquisition of any of the investments that have been identified as potential acquisition targets.

An investment in a QOZ fund may not qualify under Code Section 1400Z-2 for tax deferral. A QOZ fund is subject to risks related to qualifying under Code Section 1400Z-2 as a QOF, including, but not limited to: failing to maintain its qualification as a QOZ fund or being decertified; there being no clear guidance on “reasonable period of time to reinvest the return of capital” by a QOZ fund; complying with the working capital safe harbor; complying with the “original use” test; complying with various restrictions on transactions with related parties; and complying with the 90% Test. Changes in tax laws related to Code Section 1400Z-2 may adversely impact the Fund. Nothing herein should be interpreted as offering tax or financial advice, and investors must consult their own experts prior to making the decision to invest.

To be eligible for QOZ tax benefits, prospective investors must generally invest an amount of cash up to their Eligible Gain (which is generally defined as gain treated as a capital gain for U.S. federal income tax purposes) within 180 days of the date of the sale or exchange that gives rise to such Eligible Gain. For certain Eligible Gain (e.g., capital gain dividends from a REIT or RIC, Code Section 1256 contracts, installment sales, Code Section 1231 gain from partnerships), the 180-Day Period may begin on the last day of the taxpayer’s taxable year.
A QOZ fund’s income tax returns may be audited by the IRS. An audit may result in the challenge and disallowance of some of the deductions described in such returns. QOZ funds typically do not have distributable income until its investments have been stabilized, which may take a substantial amount of time. The actual amount and timing of distributions paid by a QOZ fund is not guaranteed and may vary. There is no guarantee that investors will receive distributions or a return of their capital. A QOZ fund depends on tenants for their revenue and may suffer adverse consequences as a result of any financial difficulties, bankruptcy or insolvency of their tenants. The financial performance will depend on the ability to attract and retain tenants.

Disruptions in the financial markets, evolving regulations and challenging economic conditions could adversely affect any QOZ fund. Property acquisitions are subject to mitigation of all environmental issue resolution and may impact project design. Future legislation could negate or dissolve any tax benefits an investor expects to receive. The Fund and its subsidiaries may be exposed to substantial risk of loss arising from investments involving undisclosed or unknown environmental, health or occupational safety matters, or inadequate reserves, insurance or insurance proceeds for such matters that have been previously identified. In addition, environmental concerns may result in specific restrictions or requirements related to the design and construction of projects.

The success of a QOZ fund will depend, in large part, upon the skill and expertise of key involved persons. These individuals are not required to devote all of their time to the fund’s affairs. QOZ fund investors have no opportunity to control the day-to-day operations, including investment and disposition decisions of the Fund.

If structured as a limited partnership, the General Partner of a QOZ fund and certain of its affiliates will receive certain compensation from the fund and the portfolio entities for services rendered in some cases, regardless of whether any sums are distributed to limited partners.

* The hypothetical example is for illustrative purposes only and does not guarantee results. Individual results may vary.

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