THE
NATIONAL LAW REVIEW

Opportunity Zones Create Funding Alternative for Social Infrastructure Projects

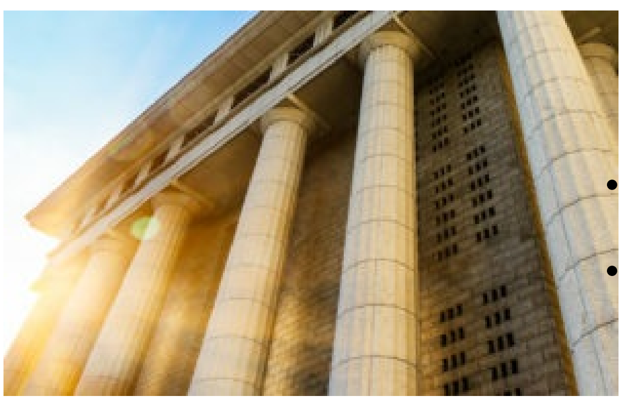
Friday, January 18, 2019

Article By Andrej Micovic
Albert E. Dotson, Jr.Bilzin Sumberg
New Miami Blog

Tax
Construction Law
Real Estate
Florida

Under current legislation, tax-exempt and other low cost financing solutions are not typically available for social infrastructure projects. The resulting higher cost of capital for social infrastructure projects raises viability concerns when the public sector procures projects with private sector-driven financings. As a result, historically, social infrastructure P3s have been outpaced by their surface transportation counterparts in the U.S. market. At the same time, deferred maintenance plagues public service facilities nationwide. For example, the National School Board Association estimates that $550 billion in investment is needed in order to bring U.S. school buildings up to standard.

However, federal tax legislation aimed at developing low-income neighborhoods may spur social infrastructure growth. During the past year, each state, in cooperation with the U.S. Department of Treasury, has designated certain census tracts as "opportunity zones." Under the opportunity zone rules, a taxpayer can elect to defer certain capital gains if those gains are invested in a qualified opportunity zone fund. Qualified opportunity zone funds, in turn, are required to invest at least 90% of their assets in certain qualified opportunity zone property, which can include the substantial improvement of existing assets or the construction of new assets on greenfield properties. In addition to a temporary deferral of capital gains, opportunity zone legislation provides taxpayers with



- a partial step-up in tax basis on the invested capital gains if certain holding periods are satisfied and
- a permanent exclusion of all gains generated by the qualified opportunity zone fund if the investment is held for at least 10 years.

Unlike large surface transportation projects, such as managed lanes or light rail, social infrastructure projects are uniquely positioned to benefit from the opportunity zone legislation due to their small footprint. Significant portions of the urban core of major U.S. cities have been designated as opportunity zones, and those same city blocks are most ripe for social infrastructure development. If properly structured, social infrastructure development in opportunity zones could benefit from significantly increased returns on equity.

Certain benefits of the opportunity legislation may be difficult to implement in a traditional P3 procurement. For example, the temporary deferral of capital gains, generally, must be elected by the taxpayer within 180 days of the relevant realization event. With typical P3 procurements lasting one year or more from launch to financial close, timing restricts the ability of P3 investors to maximize this benefit. However, equity investments in qualified opportunity zone funds are not limited to capital gains. Given the long-term nature of P3 investment, the ability to permanently exclude all gains generated by a qualified opportunity zone fund if the investment is held for over 10 years presents a significant incentive, and significantly increase potential returns. As a result, social infrastructure projects in opportunity zones could see increased viability due to favorable tax treatment.

Source URL: https://www.natlawreview.com/article/opportunity-zones-create-funding-alternative-social-infrastructure-projects