MEMO

Subject: **Opportunity Zones – Vacant Property Threshold**
From: **John Lettieri, President & CEO, Economic Innovation Group**
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Background

Section 1400Z-2, added by Public Law 115-97 (the Tax Cuts and Jobs Act), provides tax incentives for investors to make equity investments in qualified opportunity funds (QOFs) that will in turn invest in qualified opportunity zone business property (QOZ Business Property), either directly or indirectly through qualified opportunity zone businesses (QOZ Businesses) operating in qualified opportunity zones (QOZs). To qualify as QOZ Business Property, tangible property must be acquired by the entity after December 31, 2017, by purchase from an unrelated person, and either its original use in the QOZ commences with the QOF or QOZ Business or the QOF or QOZ Business substantially improves the property.[1]

The proposed regulations define original use as occurring when property is first placed in service in the QOZ.[2] The proposed regulations further provide that the use of vacant property in the QOZ qualifies as original use if the property has been vacant or unused for an uninterrupted period of at least five years.[3]

The Problem: A Five-Year Vacancy Period is Too Long to Achieve the Goals of the QOZ Statute

If the use of property that is currently sitting vacant and unused satisfies the original use requirement, it would encourage businesses to use and invest capital in dilapidated or underutilized property consistent with the purpose of the statute. However, a five-year period for vacancy is unnecessarily long and impedes valuable economic activity in areas struggling with vacancy, blight, and an eroding tax base.

- When the QOZ incentive was originally introduced in Congress as the Investing in Opportunity Act, the bill was intended to "develop blighted properties" and combat "the crisis of closing business[es]."[4] Revitalization of a depressed community includes the conversion and new use of abandoned storefronts and other vacant commercial space. The introduction of a new business to use currently vacant property results in new capital investment and economic activity in the low-income community.

[1] I.R.C. § 1400Z-2(d)(2)(D)(i).
[2] Prop. Treas. Reg. § 1.1400Z2(d)-1(c)(7)(i).
[3] Prop. Treas. Reg. § 1.1400Z-2(d)-1(c)(4)(i)(B)(6), (c)(7)(i), (d)(2)(i)(B)(6), (d)(2)(i)(C).
[4] "Senator Scott Introduces the Bipartisan Investing in Opportunity Act," (Feb. 2, 2017), https://www.scott.senate.gov/media-center/press-releases/senator-scott-introduces-the-bipartisan-investing-in-opportunity-act.

- As noted in the comment letter submitted by the National Community Stabilization Trust,[5] research has shown links between property vacancy and crime[6] and violence,[7] negative community health outcomes,[8] fire risk,[9] and neighborhood property values.[10] Thus, the surrounding community is better served if the period a property is vacant is minimized.
- Congress intended this incentive to be implemented promptly. From the timeframes for nomination of the QOZs by state governors and designation by Department of the Treasury, to the expiring incentives that place a premium on investments made within the first two years, the statute evidences congressional intent that this provision be used to catalyze investment quickly.
- An example of how the five-year vacancy rule is negatively impacting projects was recently brought to our attention by a member of the EIG Opportunity Zones Coalition. The project involves a plan to develop a 1960s vintage office building that has been vacant since 2015. The sponsor is converting the building into a mixed-use project with workforce housing, retail, and parking. Because the property has only been vacant for four years, the only way to obtain the QOZ benefits would be to wait and purchase the building next summer, the point at which the building will have been vacant for five years and qualify under the rule in the proposed regulations. This would delay the development of the workforce housing and associated benefit to the community by at least a year while the building sits unused. Furthermore, because the QOZ investment would not be made until 2020, the investors will fail to receive the seven-year basis step-up.[11]

Recommended Vacancy Period

Final regulations should provide that the use of property in a QOZ that has been vacant or unused for an uninterrupted period of at least one year, *including the date of designation of that QOZ*, is treated as original use. This is the same standard used in the Enterprise Zone context,

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[5] National Community Stabilization Trust, *Proposed Rule Regarding "Investing in Opportunity Funds," REG-120186-18*, at 1-2 (July 2, 2019).
[6] Lin Cui, Randall Walsh, "Foreclosure, vacancy and crime," Journal of Urban Economics, Volume 87 (May 2015), available at https://www.sciencedirect.com/science/article/pii/S0094119015000029; Eric Klinenberg, "The Other Side of 'Broken Windows,'" The New Yorker (Aug. 23, 2018), available at https://www.newyorker.com/books/page-turner/the-other-side-of-broken-windows.
[7] Charles C. Branas, David Rubin, Wensheng Guo, "Vacant Properties and Violence in Neighborhoods," ISRN Public Health (Sept. 2013), available at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3693396/.
[8] Kyungsoon Wang, Dan Immergluck, "The Geography of Vacant Housing and Neighborhood Health Disparities After the U.S. Foreclosure Crisis," Cityscape, Volume 20 No. 2 (2018), available at https://www.jstor.org/stable/26472173?seq=1#page_scan_tab_contents.
[9] SE Schachterle, D Bishai, W Shields, et al, "Proximity to Vacant Buildings is Associated with Increased Fire Risk in Baltimore, Maryland Homes," Injury Prevention Volume 18 (2012), available at http://injuryprevention.bmj.com/content/18/2/98.
[10] Hye-Sung Han, "The Impact of Abandoned Properties on Nearby Property Values," Housing Policy Debate, Volume 24, 2014, available at https://www.tandfonline.com/doi/abs/10.1080/10511482.2013.832350.
[11] Section 1400Z-2(b)(2)(B)(iv).

which requires that if property has been vacant for at least one year, *including the date of zone designation*, it is treated as original use.[12]

Including the Date of Zone Designation Within the Period of Vacancy Would Alleviate Treasury's Concerns

- The preamble to the proposed regulations rejected recommendations for a one-year period of vacancy, citing the potential for owners of property already situated in a QOZ to intentionally cease occupying the property for 12 months to increase its marketability.[13]
- However, this concern is inapplicable if Treasury and the Service adopt our recommended approach. Under this approach, the property would be required to have been vacant at the time the QOZ was designated. Requiring that the one-year period of vacancy include the date of zone designation would prevent abuse from investors intentionally keeping property vacant. Property owners would have been unaware prior to the QOZ designation that the property would qualify for the QOZ incentive, and the rule would only benefit property that had been vacant at the time of designation due to causes unrelated to the tax incentive.
- The office building in the example above has been vacant since 2015 and would fall under this rule. Because the building was vacant at the time of designation of the QOZ, its vacancy at that time likely stems from its undesirability in the market, possibly its 1960s vintage architecture, rather than any action by its owner to make the property vacant in order to qualify for QOZ benefits. Yet the action to keep the property vacant for another year would be an action undertaken in order to qualify for QOZ benefits, and seems directly contrary to the purpose of the current vacancy rule.
- We note that since the last QOZ designations occurred on June 14, 2018, any vacant property placed in service after finalization of the regulations would have to have been vacant more than 12 months to qualify. For example, vacant property that is placed in service on December 1, 2019, in a QOZ that was designated on June 14, 2018, would have to have been vacant since at least June 14, 2018, to qualify under our recommendation.

Final Regulations Should Also Permit De Minimis Use

- Many "vacant" buildings have some minimal occupation of the building to serve a maintenance function, e.g., to ensure that the pipes do not burst. In addition, some buildings are substantially vacant—for example, a small convenience store in the corner of an otherwise vacant multi-story building. We believe that final regulations should clarify that some small amount of use will not prevent the building from being considered vacant.

[12] Treas. Reg. § 1.1394-1(h).

[13] 84 Fed. Reg. 18,652, 18,654, *Explanation of Provisions*, § I.B. (May 1, 2019).

- The Enterprise Zone regulations disregard de minimis incidental use in determining whether property is considered vacant. For example, renting the side of a building for a billboard does not prevent the property from being treated as vacant.[14]

[14] *Id.*