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July 1, 2019

*Submitted electronically through www.regulations.gov*

Ms. Kirsten Wielobob
Deputy Commissioner for Services and Enforcement
Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20055

Re: Public Comment in response to Investing in Opportunity Zones Notice of Proposed Rulemaking [REG-120186-18]

Dear Deputy Commissioner Wielobob:

The Center for Community Progress ("Community Progress") is grateful for the opportunity to comment on the Treasury Department's Notice of Proposed Rulemaking on Investing in Opportunity Zones ("NPR"), Docket No. REG-120186-18.

The mission of Community Progress is to foster strong, equitable communities where vacant, abandoned, and deteriorated properties are transformed into assets for neighbors and neighborhoods. A national leader in land policy and land banking, Community Progress works with communities across the country to assess and reform the underlying policies and practices that govern the use and reuse of land.

Founded in 2010, Community Progress is the leading national, nonprofit resource for urban, suburban, and rural communities seeking to address the full cycle of property revitalization. The organization fulfills its mission by nurturing strong leadership and supporting systemic reforms. Community Progress works to ensure that public, private, and community leaders have the knowledge and capacity to create and sustain change. It also works to ensure that all communities have the policies, tools, and resources they need to support the effective, equitable reuse of vacant, abandoned, and deteriorated properties.

Given our organization's work in disinvested communities and expertise in developing strategies for revitalizing vacant properties and struggling neighborhoods, our comments will focus on the components of the NPR that address the disposition and treatment of vacant land and vacant structures.

## General Opportunity Zone Concerns

Community Progress has deep concerns about the Opportunity Zone tax incentive program generally. With over 8,700 census tracts designated as Qualifying Opportunity Zones ("QOZ") nationally, the program will impact a range of urban, suburban and rural geographies. Many of these census tracts are already experiencing dramatically increased levels of investment, resulting in gentrification and displacement:

- **41 percent of these QOZ census tracts were already deemed to be "rent burdened"** before their qualifying designation, and an influx of private investment will likely lead to higher costs and further displacement.[1]

- **Median real estate sales prices have already risen more than 20 percent** year-over-year in QOZ census tracts, spiking after the QOZ designations were announced.[2]

- **Development site sales volume in QOZ tracts jumped over 60 percent** after the QOZ designations were finalized.[3]

With few oversight mechanisms in place at the federal level, we fear that already "hot" and rising QOZ markets will receive the lion's share of investment dollars, and the thousands of genuinely struggling geographies starved for economic investment will be entirely overlooked. In those QOZ communities that do receive private investments, we are wary about the degree to which local governments and stakeholders will retain control over, or even a say in, their own economic development strategies. We share the concerns expressed by many stakeholders, including the Center on Budget and Policy Priorities, that Opportunity Zone incentives could amount to a "subsidy on gentrification" instead of an engine of economic revitalization for areas most in need.[4]

We are encouraged, however, by the thoughtful approach that Treasury has taken to considering how vacant and abandoned property – both improved and unimproved – should be treated for purposes of Opportunity Zone tax regulations. Given our expertise in reclaiming vacant properties, Community Progress offers the following recommendations.

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[1] "Opportunity Zones – The Risk Of Worsening The Rent Burden," SPGroup, http://www.spgroupusa.com/single-post/Opportunity-Zones-The-Risk-Of-Worsening-The-Rent-Burden, wherein SP Group "analyzed the rent levels in Opportunity Zone (OZ) census tracts to identify the degree to which the median gross rent currently exceeds the 'burdensome' threshold, i.e., 30 percent of median household income."

[2] Alexander Casey, "Sale Prices Surge in Neighborhoods with New Tax Break," Zillow, March 18, 2019, https://www.zillow.com/research/prices-surge-opportunity-zones-23393/

[3] Noah Buhayar and Caleb Melby, "Real Estate Investors See Riches in a Tax Break Meant to Help the Poor," Bloomberg, January 15, 2019, https://www.bloomberg.com/news/features/2019-01-15/opportunity-zone-fever-spreads-as-debate-over-tax-break-deepens

[4] Samantha Jacoby, "Potential Flaws of Opportunity Zones Loom, as Do Risks of Large-Scale Tax Avoidance" Center on Budget and Policy Priorities, January 11, 2019, https://www.cbpp.org/research/federal-tax/potential-flaws-of-opportunity-zones-loom-as-do-risks-of-large-scale-tax#_ftn1, quoting Adam Looney, "Will Opportunity Zones Help Distressed Residents or Be a Tax Cut for Gentrification?" Brookings, February 26, 2018, https://www.brookings.edu/blog/up-front/2018/02/26/will-opportunity-zones-help-distressed-residents-or-be-a-tax-cut-for-gentrification/

**All Vacant Structures Should Be Substantially Improved.**

The proposed regulations allow tangible property – including structures – to be considered "original use" by an Opportunity Zone fund or business if that property has been vacant for a minimum of five (5) years. All other vacant buildings/structures must be "substantially improved", requiring the business to double the basis of the improvement – but not the land – within 30 months.[5]

Community Progress appreciates the consideration Treasury has given to the very real prospect that property owners, in efforts to make their properties more attractive to Opportunity Zone investors, could deliberately cause them to become vacant. This type of strategic vacancy is particularly harmful in the residential rental housing and small business contexts, creating an economic incentive for landlords to displace tenants to enhance the market value of their buildings. We agree that some measures to mitigate the danger of strategic vacancy should be implemented.

Setting a minimum number of uninterrupted years – five (5) years as proposed – that a building must be vacant to be deemed "original use" might help avoid the strategic vacancy problem. Offering more favorable tax treatment for properties that have been vacant for 5+ years as compared to other vacant buildings could lead to the "worst of the worst" nuisance properties that have plagued struggling communities for years attracting investors for acquisition and possible redevelopment. How an Opportunity Zone fund or business would prove this or any other threshold of uninterrupted vacancy is unclear, particularly given that the fund or business will be relying on records from the prior owner.

We expect that Opportunity Zone businesses will acquire properties that qualify for the "original use" designation specifically to avoid performing substantial improvements. Investors would receive a windfall in the form of tax incentives, for essentially buying and holding improved parcels they would have no obligation to substantially improve. This could lead to speculative land acquisition that yields no tangible benefit to Opportunity Zone communities, and locks responsible developers and municipalities out of accessing long-vacant buildings that will continue to plague neighborhoods.

While the NPR correctly identifies "the potential for owners of property already situated in a qualified opportunity zone to intentionally cease occupying property for 12 months in order to increase its marketability to potential purchasers," a threshold longer than 1 year is not necessarily a solution to this problem. The incentive to increase the value and marketability of real estate by strategic vacancy is unchanged; all the owner of the property will need to do is hold it vacant for a significantly longer period of time. This long-term vacancy will damage communities and harm neighbors and local markets, particularly in already fragile or struggling neighborhoods.

However well-intended the proposed 5-year threshold might be, Community Progress recommends that Treasury consider a different approach. If Opportunity Zone investments are truly designed to spur economic investments that positively transform historically disinvested communities, why eliminate the "substantial improvement" requirement at all? We strongly recommend that Treasury treat all vacant structures and buildings acquired by Opportunity Zone funds or businesses the same, requiring substantial improvement in all

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[5] §1.1400Z(2)(d)(1)(c)(4)(ii) and §1.1400Z(2)(d)(1)(c)(8).

cases involving improved real property.[6] The tax incentives and advantages available to Opportunity Zone businesses and funds are already vast.

If Treasury's objective in setting the 5-year threshold was to create an added incentive to spur Opportunity Zone development of particularly problematic, long-term vacant nuisance properties, we encourage Treasury to develop some other form of tax incentive that **does not** waive the requirement that the building be substantially improved. Treasury could offer greater tax incentives for property that has been foreclosed upon and reverted to a local government or community land bank.[7] Land banks are non-profit, community-based and deeply plugged into local market dynamics and community needs.[8] They also have the flexibility to evaluate proposed redevelopment projects and make property disposition decisions that best meet the community's needs and vision, and are not beholden to transfer properties strictly to the highest bidder. Again, we do not believe that the form of the additional incentive should be a release from the obligation to substantially improve the property.

Community Progress also proposes broadening the exclusion from Section 162's definition of "activities giving rise to a trade or business" prohibiting unimproved land speculation, to also exclude all real estate speculation. The holding of land – whether improved or unimproved – for purposes of Section 1400Z-2 should not give rise to a trade or business, and such real property should not be deemed qualified Opportunity Zone business property and the tax incentives otherwise provided under section 1400Z-2 should not be available.

If Treasury is disinclined to accept these recommendations and determines that "original use" treatment should be granted to certain structures that have been vacant for some minimum threshold of years, Community Progress urges Treasury to conduct a careful analysis to determine the appropriate threshold. We expect that a number of public commenters will recommend a 12-month threshold, as many did in comments to the prior rulemaking. Setting the "clock" for the vacancy threshold to run backwards from the date of the property's designation as a Qualified Opportunity Zone could mitigate the risk of strategic vacancy. This will ensure that only buildings that were vacant before the designation qualify, thereby eliminating the incentive for a property owner to strategically cease occupancy of the building.

If Treasury finalizes any regulations that create different treatment for vacant properties based on the length of vacancy, we also urge Treasury to clarify in the regulations how a taxpaying Opportunity Zone business or fund will demonstrate to the Internal Revenue Service that a structure has been vacant for an uninterrupted period of X years or more.

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[6] Community Progress takes no position on the "original use" versus "substantial improvement" distinction as it pertains to intangible, tangible or personal property unrelated to real estate.
[7] The Unites States Environmental Protection Agency's Office of Brownfields and Land Revitalization's June 12, 2019 public comment letter in response to this NPR also proposes more favorable treatment for incentives to acquire properties from land banks, however, we disagree about the form of the incentive.
[8] To learn more about land banks, please visit the Community Progress Frequently Asked Questions page, available at https://www.communityprogress.net/land-banking-faq-pages-449.php.

## Substantial Improvement Should Be Measured on an Asset-by-Asset Basis

The proposed rules show that Treasury is contemplating allowing Opportunity Zone funds or businesses to satisfy the substantial improvement test based on improvements to a portfolio of "tangible property to be grouped by location in the same or contiguous Qualified Opportunity Zones" rather than on an asset-by-asset basis.[9] The substantial improvement test requires investors to spend as much improving properties as it cost to purchase them within 30 months of acquisition.[10]

Permitting aggregated substantial improvement could easily allow considerable portions of tangible property to languish unimproved while Opportunity Zone funds focus their investments on a few or higher priced assets. It also would allow Opportunity Zone funds to focus their substantial improvements on the most economically vibrant and gentrifying Opportunity Zones while allowing purchased assets to remain unimproved in less economically vibrant Opportunity Zones.

For example, an Opportunity Zone fund could purchase ten multifamily apartment buildings priced at $10 million each (for a total of $100 million); allowing aggregated substantial improvement would allow a QOF to make $100 million in upgrades to 5 of the purchased buildings to make them luxury apartment buildings while letting 5 of the buildings remain unimproved, leaving the tenants in those buildings and the surrounding community without any benefit from those 5 Opportunity Zone investments.

An asset-by-asset substantial improvement requirement will ensure that every parcel of tangible real property would receive substantial improvements within 30 months. Treasury should not pursue provisions that would allow Opportunity Zone funds or businesses to leave assets in certain areas unimproved while meeting an aggregate substantial improvement test. At a minimum, if Treasury determines to permit aggregated substantial improvement measurement, this should be inapplicable to real property or improvements upon land, and limited only to tangible personal property like equipment and inventory.

## Unimproved Land Should Be Substantially Improved.

Treasury recognizes that the proposed regulatory treatment of unimproved land "could lead to tax results that are inconsistent with the purposes" of the Opportunity Zone program and asks if special "anti-abuse rules" are needed to prevent these transactions that amounted to what the proposed rulemaking refers to as "land banking". The Treasury should close this loophole and require investors to make substantial improvements to unimproved land.

We also urge Treasury to use different terminology to refer to speculative parcel assembly that can lead to blight and harm communities. As currently proposed, the rulemaking uses the undefined term "land banking", presumably to refer to the purely profit-driven investment strategy of buying and holding real estate. Community Progress has been an

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[9] 84 Fed. Reg. 84 at 18655.

[10] §1.1400Z(2)(d)(1)(c)(4)(ii) and §1.1400Z(2)(d)(1)(c)(8).

instrumental partner in the formation of the approximately 170[11] community-focused, non-profit land banks and land reutilization corporations around the country.[12] To avoid confusion between the good work these land banks do and the investment practice Treasury is appropriately wary of incenting through Opportunity Zone tax rules, we propose replacing the phrase "land banking" with either "warehousing" or "stockpiling".

If Treasury is disinclined to eliminate the unimproved land loophole entirely, it should substantially strengthen the anti-abuse provisions for unimproved land. The proposed anti-abuse provisions are vague and unenforceable, and state that investors might lose tax benefits "If the land is unimproved or minimally improved and the QOF or the QOZB purchases the land with the expectation, an intention or a view not to improve the land by more than an insubstantial amount within 30 months."

These provisions must be strengthened. First, the IRS should establish a threshold for "more than insubstantial amount" (such as 33 percent of basis, or increasing the value by one-third, far lower than the 100 percent basis requirement for "substantial improvement"). Secondly, the test should be based upon improvement outcome and not expectation or intent of the Opportunity Zone fund or business, which would require the IRS to prove not only that the investors did not improve the land but also *intended* to leave the land unimproved or minimally improved. Finally, additional anti-abuse measures must be established to prevent funds or businesses from trading the unimproved parcel within the 30-month window unless more than insubstantial improvements have been made.

**Conclusion**

We appreciate the opportunity to comment on this NPR on Investing in Opportunity Zones and the Treasury Department's consideration of the above recommendations. Community Progress believes that properly regulated Opportunity Zone investments could have an enormous impact in the bona fide disinvested communities they are intended to revitalize. Ensuring that investments are made not just *for* but also *with* resident participation is central to our work of creating equitable communities. Please let us know if you have any questions, or if we can be of further assistance.

Sincerely,

Akilah Watkins-Butler
President and CEO
Center for Community Progress

[11] An interactive national map of currently operating land banks can be found on the Community Progress website at the following link: https://www.communityprogress.net/land-bank-map-pages-447.php.

[12] To learn more about land banks, please visit the Community Progress Frequently Asked Questions page, available at https://www.communityprogress.net/land-banking-faq-pages-449.php.