HB 4010 – Oregon Disconnect from Opportunity Zones: Look Before You Leap

Background

An Opportunity Zone ("OZ") is an economically-distressed community where private investments, under certain conditions, may be eligible for deferral of capital gain taxes. OZ's were created to stimulate economic development and job creation by encouraging long-term (10 year) investments in areas with largely low-income residents.

Since the implementation of OZ's, many stakeholders have worked to understand the mechanics of these capital gains deferrals and the costs and benefits to the state based on this federal incentive program. Oregon is again considering disconnecting from the federal code (HB 4010). While the federal regulations were finalized in late 2019, both Republicans and Democrats in the US Senate have proposed changes to add oversight and protections to the OZ program.

How were Oregon's OZ's created?

The Federal OZ Program was created in December 2017. Governor Brown then worked with Business Oregon to identify and nominate Oregon's 86 Zones. Oregon's process for creating our rural and urban OZ's has been recognized as the best in the country. Smart Growth America's LOCUS program gave Oregon the best-in-the-nation score for identifying zones "positioned to bring positive social, environmental, and economic returns."

What are capital gains?

Capital gains are the positive difference between the sale price of an asset and its original purchase price. Federal and state taxes are levied on capital gains once (and only when) an asset has been sold and, as a result, the taxpayer has "realized" the gain in the form of income. Capital gains taxes can be avoided by holding an asset or, for real estate assets, exchanging that asset for a similar asset. Unlike income or property taxes, there is no certainty over when capital gains are realized and therefore may be taxable.

What are the benefits of Oregon's OZ's?

OZ's create an incentive for investors to invest capital in communities by allowing a deferral of the capital gains taxes. This encourages investors to re-deploy capital rather than hold assets to avoid being taxed. OZ's seek to seed capital in these disadvantaged communities through "Opportunity Funds." These funds hold newly acquired assets such as capital in a corporation or partnership, or in real-estate holdings. This facilitates investment in local businesses, as well as real-estate development, that spurs construction jobs and increased property tax revenues to local communities across Oregon.

OZ's create a reason to invest in these communities and encourage the sale of assets that may otherwise sit idle in existing securities or real estate. OZ's are an attractive alternative to paying capital gains immediately or, more likely, just sitting on the assets in order to totally avoid capital gains tax.

Instead, through an Opportunity Fund in an OZ, capital can be reinvested in equity in local businesses and real property that creates housing and employment opportunities. In return, Oregon and our local governments will receive income tax benefits through new jobs, increased property taxes, system development charges, construction excise taxes, permit fees, other “fees-in-lieu” and other revenues.

Of particular value for rural areas, OZ’s allow investors to deploy capital locally, as opposed to making other investments (or keeping capital) in other assets (stocks, real estate, etc.). In urban OZ’s, cities can use local ordinances (such as inclusionary zoning) to require public benefits or negotiate significant payments to be deployed for such public benefits (such as affordable housing). Even for some high-profile OZ projects, this has been the case. Any single large project generated from an OZ which generates long-term sales would raise significant property tax revenue for the local governments and generate revenue through state taxes.

Finally, OZ projects aren’t as sensitive to current market cycles (overbuilding). To receive the benefits of OZ’s investors must hold the asset for at least 10 years. As a result, contractors, tradespeople, architects, and other construction-dependent industries can remain more consistently employed as Oregon faces an economic downturn.

What are the risks of disconnecting?

Disconnecting will create added complexity and confusion, particularly for the Oregon investor who is willing to focus on smaller and rural community projects in Oregon. The added complexity will also make it more difficult for local and regional agencies to establish programs that leverage the incentive to achieve broadly targeted goals.

Disconnecting from the federal OZ incentive will not eliminate OZ’s in Oregon. Disconnection only changes the eligibility of Oregon tax payers to realize the capital gains incentives in future years for investments made in Oregon. Out of state tax payers or multistate corporations can still invest in, and receive tax benefits from, Oregon’s OZ’s and Oregon investors can invest in out-of-state funds or properties in OZ’s in other states.

How will disconnect affect local Oregon investors and taxpayers?

As noted by the Legislative Revenue Office “Bottom line, only Oregon taxpayers are affected by a disconnect.”[1] Disconnecting from the federal code will penalize Oregon investors. HB 4010 would treat Oregon investors differently, and will not give Oregonians investing in their <u>own</u> communities the same benefits as those who invest elsewhere, or out-of-state investors spending the same money in our communities. At-best, this will lead to out-of-state ownership and control of Oregon assets at the expense of local ownership and control.

At worst, disconnecting Oregon from the federal tax code means no investment in our neediest areas. Disconnection may simply discourage Oregon taxpayers from making local investments in Oregon companies and properties. Any potential benefit of OZ’s will be lost, and place Oregon as the national outlier.

Whether or not OZ’s incentivize investment that may not otherwise occur is an open question, but there is no question that Oregon’s disconnect can only disincentivize local investment by Oregon taxpayers.

Are there benefits to disconnecting Oregon from the OZ program?

Unclear. Unlike income taxes or property taxes, which are relatively predictable, there is no certainty that capital gains taxes foregone as part of the OZ would otherwise be realized by the state—it’s just as likely if not more so that investors will keep capital in assets to avoid taxation.

Investors already have access to strategies for deferring and even eliminating capital gains. The OZ incentive won’t change that. Simply put, the OZ program is not an alternative or reduction of capital gains, it is designed to encourage assets to be deployed rather than held by offering a deferral.

Secondarily, with a new, nation-wide program, Oregon will be unable to gage the returns from OZ’s if we unilaterally disconnect from the program. Disconnection could also risk the value created by local governments who can negotiate with developers for additional fees designated for public benefits.

If you have any questions please contact:
Rocky Dallum at rocky.dallum@tonkon.com or 503-830-5098;
Gwenn Baldwinn at gwenn@baldwinconsulting.biz or 503-975-9517; or
Mike Stober at mikestober@oregonbusinessindustry.com or 503-576-4863.

[1] LRO Presentation to House Revenue Committee, March 11, 2019. *See OLIS, HB 2144, 2019 Legislative Session*

CITY OF LA GRANDE
THE HUB OF NORTHEASTERN OREGON

OFFICE of the CITY MANAGER P.O. BOX 670 LA GRANDE, OREGON 97850 Phone (541) 962-1309 FAX (541) 963-3333

February 4, 2020

The Honorable Representative Nancy Nathanson
Oregon House of Representatives
900 Court St NE, H-279
Salem, OR 97301

Dear Representative Nathanson,

On behalf of the City of La Grande, Oregon, I am writing in opposition of HB 4010. This Opportunity Zone is a federal tax credit program that allows for qualified projects to defer capital gain taxes if invested in federally recognized Opportunity Zone Areas. This program not only gives us the ability to attract local investment and out-of-area investment, but also provides a mechanism through which the local government can negotiate a community benefit.

We recognize that many rural communities including La Grande, have been slow to utilize the Opportunity Zone. Upon advice from professionals working with the OZ, we were encouraged to wait until rules of this program were finalized by Congress in 2019. We understand that there was broad bi-partisan support for this program, which started being developed under the Obama Administration. La Grande believes so strongly in the benefits of this program that we are currently working with a consulting group to maximize our capacity to attract investment.

As one of Oregon's 86 federally-designated Opportunity Zones, our local economic development professionals worked closely with Business Oregon to identify the qualifying Census tract that would be most beneficial. Our zone is in an area that contains commercial properties in both La Grande and Island City, as well as Industrial properties in Union County and La Grande's Urban Growth Boundary. These areas of developable land are top priorities for economic growth in our remote and rural area.

The Opportunity Zones are federal, not state tax credits that are literally attracting billions of dollars in investment. Instead of waiting for development to find us, the Opportunity Zone gives us a way to pro-actively seek out investment. We believe that some of this investment will come from people right here in Union County, who want to make a difference in their own community while realizing a tax credit.

This legislation can only harm Oregon. It sends a message that says, "We don't want you to invest in Oregon, our communities or our people." HB 4010 could have a devastating long-term impact on economic development in Oregon. Please vote NO on HB 4010.

I am available for any comments or questions that you may have. I can be reached by phone at (541) 962-1309 or by email at: rstrope@cityoflagrande.org.

Sincerely,

Robert A. Strope
City Manager

Comment from McMinnville Economic Development Partnership:

In its short history, Oregon has done a tremendous job of recognition and implementation of Opportunity Zones across the state. They are proving highly valuable as an economic development tool. In McMinnville these zones have spurred the early visioning for Rivergate, which is a 28-acre mixed used industrial site. In an environment where economic development is very much tied to local investment and "grow your own" strategies, it would seem placing an impediment for the opportunity to invest locally to be disadvantageous. Let the process continue to work and promote more options for smaller and rural community projects.

Scott G. Cooper, CEcD
Executive Director, McMinnville Economic Development Partnership

McMinnville
ECONOMIC DEVELOPMENT
PARTNERSHIP

Comment from City of Salem Urban Development on HB 4010 (*In Opposition*)

There are four designated Opportunity Zones in Salem, within those there are groups not only looking at investing in our community because of these benefits we have one project under construction and another slated to break ground in fall 2020 utilizing these benefits as well. These are Oregon citizens and businesses choosing to invest locally. None of these projects were in the works prior to the establishment of the Opportunity Zone Program. The locations involved are properties that have been vacant ranging from a year up to well over a decade and some are what would be considered blighted and derelict properties. The types of projects range from those which would be job creators to housing, and all would benefit the community and increase property tax revenue.

City of Salem Urban Development Department

CITY OF Salem
AT YOUR SERVICE

City of Albany

Albany is currently working on Opportunity Zone projects in its historic downtown that struggled to progress for 20 years+. The long-term hold incentive of Opportunity Zone projects are key for finding investors who are committed to the long term success of this community. Recruitment interests over the last year have specifically looked for property in Albany within Opportunity Zones that would otherwise not have been considered. Taken together this represents significant new activity for this community directly tied to Opportunity Zones.

CITY OF ALBANY
OREGON

MELVIN MARK

EST. 1945

February 5, 2020

To whom it may concern:

On behalf of Melvin Mark Companies, I am voicing my opposition to House Bill 4010, which proposes that Oregon disconnect from the federal Opportunity Zone Incentive Program.

For 75 years, Melvin Mark has taken measures to invest in the Portland community and as a third-generation company leader, I believe this ability has helped create a more sustainable and integrated city. Through the OZ program, taxpayers and investors are able to maximize their philanthropic efforts and better their local societies, leading to increased job opportunities and overall economic progress.

Oregon has more designated OZs than nearly half of U.S. states, which puts us in the position to be a model for success. By maintaining our connection to the OZ program, we can create chances for high-profile projects to improve public benefits through significant capital investment. Many of the proponents of the measure to disconnect the OZ in Oregon point to the downtown Ritz Carlton development project, but that project alone will create significant long-term property taxes, thousands of construction and ancillary jobs, and a developer contribution of $8 million to the City of Portland for affordable housing, as required by the Inclusionary Zoning.

As noted by the Legislative Revenue Office, "Bottom line, only Oregon taxpayers are affected by a disconnect."[1] By disconnecting from the OZ program, it would allow out-of-state taxpayers to invest in and receive Oregon tax benefits, including the opportunity to avoid any capital gains that Oregon may add back after disconnection. This will effectively discourage only the potential Oregon-based investors and further decrease our state's local investment, ownership, and control. It seems to me that Oregon should be encouraging its own citizens to invest in the state.

Disconnection only discourages Oregon taxpayers from potentially considering selling an asset, property, or business, and providing them an opportunity to reinvest that capital in Oregon. Out-of-state taxpayers or multistate corporations will still be able to invest in and receive tax benefits from Oregon's OZs, and Oregon investors can invest in out-of-state funds or properties in OZs in other states.

I strongly urge you to consider the consequences and underlying issues with HB 4010.

Sincerely,

Jim Mark

[1] LRO Presentation to House Revenue Committee, March 11, 2019. *See OLIS, HB 2144, 2019 Legislative Session*