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Investors Eagerly Await Trump Rules on Opportunity Zones.

AVONDALE, Ariz. — A hotel groundbreaking ceremony here in an old cotton field not far from Interstate 10 last month featured two United States senators, a hot catered lunch and a stream of speeches about driving economic investment to this corner of the Southwest that is still recovering from the Great Recession.

Whether they were celebrating the beginnings of a wave of investment in distressed parts of America, or just another Marriott property, could hinge on a coming decision by the Trump administration.

A new batch of tax regulations from the Treasury Department will establish the most comprehensive guidelines yet for what sorts of investments qualify for tax benefits associated with opportunity zones, which were created by the 2017 tax law, and how investors must proceed in order to take advantage of them.

Potentially billions of dollars are waiting on the Treasury's decision. Civic leaders in areas like Avondale, which is still hurting from the 2008 housing crisis, are hoping the rules will be broad enough to improve the odds of attracting new businesses that offer well-paying jobs to residents. Investors, eager to put money into the tax-advantaged opportunity zones, are also clamoring for guidelines that could determine the types of projects they can back.

Among the money dependent on the Trump administration's rules is $22 million in investment guarantees, to be announced Monday by the Kresge Foundation, to support two socially conscious investment funds that hope to pour $800 million into manufacturing, clean energy and other business development in Opportunity Zones.

The zones are a creation of President Trump's signature tax law that use tax advantages to lure capital to economically lagging cities, suburbs and rural areas. So far, they have stirred growing investor interest, including from Wall Street, and criticism from some tax experts who worry they will serve mostly as a handout to the rich.

Most of the projects spurred so far by the zone designations are real estate, like condominium developments, or hospitality, like the SpringHill Suites by Marriott project started here in Phoenix's west suburbs by a private equity group called Virtua Partners.

Whether the zones can ultimately spur other types of investment, like small businesses and start-up technology companies, will depend on how the rules are structured. Treasury officials have sent the White House a draft version of what will be the second batch of regulations governing so-called opportunity funds, which invest in Opportunity Zones, and what types of investments can qualify for the special tax treatment.

The tax break works by allowing investors to roll capital gains from other investments into the funds. Taxes on those original gains are deferred and, if the investment is held for several years, can be sharply reduced. Adding to the attraction is the potential for investors who hold their money in the opportunity fund for a full decade to be exempt from any capital gains taxes on that investment.

Conflict over the regulations reflects, in part, a tension among officials concerned most with limiting the potential for investors to exploit loopholes in the program in order to reduce their tax bills, and those most concerned with maximizing investment in struggling parts of America.

In the first batch of regulations, Treasury officials took a more restrictive approach, according to documents obtained through a Freedom of Information request. But those were ultimately overruled by the White House, which prevailed on several points that investors had championed, those records show.

A recent Internal Revenue Service hearing on what will be the second batch of regulations was dominated by investors and civic leaders requesting changes and additions to the rules in several areas that could deter investment in start-up companies.

Those include a provision that currently requires qualifying businesses to earn 50 percent of their income inside the zones, which would seem to limit businesses that make money by exporting goods or selling them online. Investors are also seeking flexibility to sell their stake in a business before the end of a decade and use the proceeds to invest elsewhere in an opportunity zone.

Investors also want to clarify a rule that forces them to “substantially improve” an asset in order to qualify for the tax benefit, to ensure that biotech, software and other start-ups that deal largely with intellectual property can meet the test.

“The second tranche of regulations is a moment of truth for investors and communities,” said John Lettieri, the president of the Economic Innovation Group think tank, who was an architect of the Opportunity Zone concept. The difference in potential investment in the zones between favorable and unfavorable regulations, he said, “is orders of magnitude.”

While investors wait for clarity, the existing regulations have “frozen some of the market for business investment,” said Steve Glickman, another architect of the concept who now runs an Opportunity Zone-related consulting business called Develop L.L.C., and who has produced an Opportunity Zone Index to help investors find and select promising zones for projects.

The Kresge guarantees, for example, are meant to help two funds — run by Arctaris in Boston and Community Capital Management in Fort Lauderdale, Fla. — deploy $800 million into Opportunity Zone projects like solar farm development in Flint, Mich. In exchange, the funds are committing to a set of rules that would require them to invest in creating living-wage jobs, form community advisory boards and seek to avoid displacing residents from those zones. They will also compile and share data on the quality and impact of their investments, which is not currently required by the federal government.

But they are dependent on the outcome of the regulations, and whether they will encourage business projects. “These are practical concerns for us,” said Aaron Seybert, a social investment officer at Kresge. “We need to quantify the risk that we’re taking.”

The existing regulations have made that calculation relatively easy for real estate investors, who are accelerating previously planned projects in the zones and starting new ones that might not have worked without the special tax treatment. That activity has already paid off for incumbent landowners in Opportunity Zones, according to research by the real estate firm Zillow: Average sales prices in the zones jumped 25 percent last fall, compared with the year before.

City officials welcomed the new hotel to Avondale, a majority-Hispanic city of 84,000 people that is still recovering from the burst housing bubble a decade ago. At one point, 40 percent of the city's homeowners were underwater on their mortgage or had fallen into foreclosure.

Conditions have improved, slowly, and developers have added 200,000 square feet of new retail space in the last five years, city officials said. But Kenn Weise, the mayor, said the city still needed help — and real-estate development won't do it alone.

The city, Mr. Weise said, needs to revitalize its historic downtown, which has fallen on hard times, and it needs businesses to employ the more than 80 percent of workers who live here but endure long commutes to other parts of the metro area, where the jobs are.

"This part of it is easy," Mr. Weise said under the shade of a white tent here recently, gesturing toward the row of shovels that were about to break ground on what will be the latest in a recent string of new hotels near the freeway in and around Avondale. "This is the low-hanging fruit."

The more far-flung dignitaries gathered for the ceremony made similar points, even as they praised Virtua and Hotel Equities, the company that will manage the new hotel. "At the end of the day, real estate development is a very important step forward," Senator Tim Scott, Republican of South Carolina and the principal champion of the Opportunity Zone provision in the tax law, said in a brief speech. "Bringing jobs into the community is a leap forward."

Virtua Partners has 15 projects in the works in the Phoenix area alone, including a townhouse development on the site of a crumbling RV park in nearby Surprise, and more than 100 total projects planned in zones around the country. Construction in the Avondale cotton field will create 120 temporary jobs and 30 permanent ones in the hotel, which officials at the groundbreaking promised would provide pathways for employee advancement.

"Our goal is to give everyone the opportunity to move into the middle class," Quinn Palomino, Virtua's chief executive, said at the groundbreaking, which along with Mr. Scott also featured Senator Martha McSally, Republican of Arizona, and Jan Brewer, the state's former governor.

But even real estate investors would like more from the Treasury in the next round of regulations. In an interview, Ms. Palomino said she hoped the government would mandate reporting on metrics such as the number of jobs and affordable housing units created in the zones.

"Everyone's running to this industry," including a lot of people without the background in real estate development, she said. "It's pretty scary out there, some of the projects that are coming in. Kind of, two guys in the back of a van, trying to get an Opportunity Zone project done."

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By Jim Tankersley

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