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Can Trump's Tax Break Turn Distressed Areas Into 'Opportunity Zones'?

David Dragoo's two companies own 164 acres of former farmland along the Uncompahgre River near downtown Montrose, Colorado. He's planning to redevelop the area by adding a hotel, apartments, space for outdoor recreation businesses and a path along the river.

It's an unusually ambitious project for a sleepy town of about 20,000, known mostly for an airport where the glitterati disembark on their way to Telluride. And the project is attracting an unusual amount of attention, because it's in a federally approved "opportunity zone" where investors can get a tax break for spending money on certain businesses and property.

"There are now investors reaching out to us from all around the East Coast," Dragoo said. He's heard from businesses looking to relocate and developers aiming to build apartments. "There are groups that are looking at it and saying, 'We just want to buy the whole thing.'"

The tax break, created under the tax law President Donald Trump signed last year, could be a game changer for towns in rural areas such as Montrose. The zones are expected to attract billions of dollars from people eager to reduce their tax bill on money they've made selling stocks, bonds or property.

Nationally, there are over 8,700 such census tracts, nominated by states for their combination of economic distress and growth potential and approved by the U.S. Treasury Department and IRS earlier this year.

But as investors start to open their wallets, some local leaders and national economic development experts worry most of the cash will be spent in booming cities. When it does flow to rural places, they warn, it's more likely to flow to real estate projects such as Dragoo's rather than to local startups desperate for capital.

"I'm worried that none of this money is going to flow where it's really needed," said Paul Major, president and CEO of the Telluride Foundation, a philanthropic organization that focuses on Western Colorado. "You can see 99 percent of the money going to urban redevelopment projects and accelerating gentrification."

For instance, one of Amazon's chosen sites for its new headquarters is in an opportunity zone in Queens that's close to a low-income census tract but is already dense with pricey condos.

Past tax incentives intended to spur growth in distressed areas, such as the New Markets Tax Credit program, have had mixed success. About 83 percent of New Markets money from 2001 to 2015 went to cities, according to research by Rebecca Lester, an assistant professor at the Stanford Graduate School of Business who studies tax policy.

That may be because more people live in cities, because city projects are better-known, or because urban economies are stronger, Lester said. But she expects opportunity zone money to end up even

more concentrated in cities than New Markets money, because there are fewer restrictions on how the money can be spent.

Economic developers in rural Colorado remain hopeful that with enough preparation and marketing savvy, they can attract investment dollars — and not just to large, downtown real estate deals.

“The money has always flowed to the cities, so that’s something that we’re used to,” said Deana Sheriff, economic recovery coordinator for the West End Economic Development Corporation, which works in the outer reaches of Montrose County. “We just have to work a little harder to make sure our voices are heard as well.”

The Latest, Greatest Economic Incentive

Unlike other economic development incentives, opportunity zones aren’t a program with a federal, state or local approval process for projects. Congress created some parameters — for instance, investors can’t just buy a building in a zone, they must improve it.

But the program is designed to give investors a tax break simply by investing in a given area. “You could rehab affordable housing and turn it into luxury condos and still get an incentive,” said Brady Meixell, senior research assistant at the Urban Institute. “There’s no rule against that.”

To get the tax benefit, people must invest their capital gains in an opportunity zone fund, which in turn invests in businesses or property in a zone. Investors can defer paying taxes on their gains right away. They earn a 15 percent tax cut on those gains if they hold on to their shares for seven years.

And if they hold on to their shares for 10 years, they don’t have to pay income taxes on money they make when the shares increase in value.

“Those tax benefits are huge,” said Chris Montgomery, founder and managing director of Four Points Funding, a real estate investing group based in Steamboat Springs, at a recent conference for economic developers in Estes Park, Colorado.

“They’re not big enough to make a bad investment good,” he said, “but they’re really significant.”

The IRS released some guidance last month but has yet to clarify all the details of the tax break. Until it does — probably early next year, lobbyists say — many investors are holding off on taking an equity stake in a business or building a structure in an opportunity zone.

In hot real estate markets such as the Denver area (Montrose is located on the other side of the state), however, opportunity zones already have set off a fundraising frenzy.

Andrew Klein owns 750 acres in an opportunity zone in Aurora, not far from Denver International Airport. The land around the airport, once home mostly to prairie dogs, is now filling up with subdivisions, hotels and business parks.

Klein’s company, Westside Investment Partners Inc., is planning to construct industrial buildings that could house businesses such as data centers and logistics companies.

He said he’s talked to many investors, from wealthy Coloradans to national groups that handle family fortunes. The people he’s talked to are, collectively, willing to spend some $100 million on his project, he said.

“I’m currently out in New York City meeting with people who want to develop in opportunity zones,”

he said when he spoke to Stateline last week.

Yuriy Gorlov, a vice president of the Aurora Economic Development Council, said that some local landowners and developers are putting together seven- and eight-figure investment funds.

The money flowing in will help accelerate development around the airport, he said. “Instead of taking the next 20 years to build out a large swath of land out there, maybe it’ll take 10 years.”

Rural Investment

Rural Colorado presents investors with fewer obvious moneymaking opportunities. While Denver and other cities along Colorado’s Front Range have rapidly added people and jobs in recent years, many rural places are shrinking as farming and some mining jobs disappear.

Recognizing that rural places such as Montrose County need a boost, the Colorado Office of Economic Development and International Trade gave the federal government a list of opportunity zones skewed toward rural areas.

Only 40 percent of the state’s 126 zones are in the Front Range, according to Jana Persky, strategic initiatives manager for the development office.

Persky has been crisscrossing the state for months, speaking at conferences and meeting with local leaders to explain the opportunity zone incentive and encourage communities to start promoting themselves and lining up projects to pitch to investors.

“Investors are finding it,” she said of the incentive. “We want to make sure that communities are equally informed and equally prepared.”

Montrose hasn’t had to do much to market itself, thanks to a July Forbes article that name-dropped the county and called opportunity zones “the most unbelievable tax break ever.”

After the article was published, “the phone started ringing off the hook,” Montrose’s mayor, Roy Anderson, said, adding that he expects multiple businesses to relocate to the town in the next six to nine months, partly because of the opportunity zones.

Smaller towns west of Montrose haven’t gotten as much attention. Sheriff of the West End Economic Development Corporation is working with three tiny communities in a remote and rugged region near the Utah border: Naturita (population 500), Norwood (600), and Nucla (700).

Both Nucla and Naturita’s main streets look like stretches of highway, Sheriff said. “The town of Naturita literally does not have sidewalks.” The towns are hoping their zone designations will lead to improving sidewalks and renovating buildings.

Her office also is compiling data to convince investors that there’s demand for housing in the area. “We’ve got folks that want to move into the region, but there’s simply no place” to house them, she said.

In many rural places, investors likely will have to take advantage of not just the opportunity zone but layers of other incentives to make money, economic development experts say.

“Deals aren’t just going to surface,” said Major of the Telluride Foundation. They’ll need to be put together using everything from foundation grants to state job training assistance, state tax credits, and a state and local program that pays companies up to $10,000 for every new job created, he said.

Communities may need to go the extra mile to draw investment to needed projects that aren't particularly lucrative, such as a day care center or affordable housing, Major said. "Are there parcels of land that nobody thought about, that the town owns? The town could donate that to do a housing project that opportunity zone capital can invest in."

Businesses Need Not Apply (Yet)

The architects of the opportunity zone incentive intended capital gains to flow to businesses as well as real estate. But investors have shown less enthusiasm in taking an equity stake or partnership interest in businesses.

This is partly because it's harder to make money that way and partly because the IRS has yet to finalize how such investments must be structured.

According to the IRS rules so far, investors must put their money into businesses that generate half their gross income within the zone. That's a problem, because investors are most interested in growth businesses that sell regionally or nationally, said Montgomery of Four Points Funding.

Even though he's hoping his fund will invest in real estate and businesses, he said it'll likely invest more in real estate.

"Most people that are raising money are doing it just for real estate," he said. "It's an easier path forward."

Major noted that it's hard to make a profit investing and growing a business, particularly in a rural area. "You're not going to have a Google, or Amazon, or a Facebook in a distressed, rural community.

"What you're going to have is small, medium-sized businesses that grow slowly."

Major has been helping Natalie Binder, a vacation rental manager based in Telluride, look for funding for her passion project: a camp near Nucla and Naturita that could become a destination for people who want to escape Colorado's increasingly crowded mountain towns.

She's envisioning cabins, platforms for tents, a vintage bus used as a check-in desk, and funky art made of junk — "kind of like a Burning Man meets Marfa meets Colorado," she said, adding that she reached out to some investors working on opportunity funds, but they didn't bite.

"They were too busy to even talk," she said. She's hoping to find investors who are interested in the project with or without the zone designation.

If the final IRS rules skew the incentive almost entirely toward real estate, "then that's a big failure," said John Lettieri, president and CEO of the Economic Innovation Group.

The Washington, D.C.-based organization, created by Napster founder Sean Parker, came up with the opportunity zone idea and lobbied Congress to include the incentive in the tax law.

But real estate development can be beneficial, Lettieri said, if it sets the stage for businesses to move to and expand in distressed communities. "For many of these communities, the built environment is the first step to broader economic growth."

That's why Montgomery sees potential in Dragoo's project, which would cluster apartments, businesses and amenities such as restaurants — creating an attractive place for people to live and

work.

And that’s why Sheriff is confident that more attractive main streets will encourage mountain bikers and ATVers to linger in the area. “We’ve seen it happen in other communities,” she said. “You have to go out and spend the money first.”

By Sophie Quinton

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