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Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

To Whom It May Concern:

We are writing regarding the proposed regulations implementing the new Opportunity Zone tax incentive on behalf of the members of the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) who represent the \$1.3 trillion apartment industry and its nearly 39 million residents. We would like to congratulate the Treasury Department and Internal Revenue Service for proposing extraordinarily thoughtful guidance to effectuate the Opportunity Zones program and, in particular, thank you for responding to the issues we raised in our June 8, 2018, letter. While we believe the proposed regulations will help drive considerable investment in Opportunity Zones, we wanted to take this opportunity to recommend that several additional issues be clarified or addressed as part of final regulations.

For more than 20 years, NMHC and NAA have partnered to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of 160 state and local affiliates, NAA encompasses over 75,000 members representing 9.25 million rental housing units globally.

To make the Opportunity Zones program as effective as possible, the multifamily industry recommends that final regulations clarify or address the following issues:

Original Use and Substantial Improvement of Opportunity Zone Property

Clarify Land Itself Need Not Be Improved to Meet Original Use Requirement

The proposed regulations appropriately take the position that the basis of land can be excluded from a requirement to double basis when a taxpayer acquires and subsequently improves property. However, it remains unclear how land must be treated for purposes of original use. Prop. Treas. Reg. §1.1400Z-2(d)-1(c)(8)(i) and (ii) outlines an example pertaining to the working capital exception and appears to conclude that land itself need not be improved to meet the original use requirement.

Recommendation: NMHC/NAA request that the Treasury Department and the Internal Revenue Service clarify in a specific example in the final regulations that land itself need not be improved to meet the original use requirement so long as development occurs on the land. We also request that the Treasury Department and Internal Revenue specifically state that the land may have been acquired prior to 2018 and still qualify as Opportunity Zone property so long as development on that land occurs after 2018 consistent with Opportunity Zone rules.

Provide Property Vacant At Least A Year Qualifies as Original Use Property

In our June 8 letter, we raised the concern that it could be difficult for an Opportunity Fund to meet the requirement to double the basis of an acquired property within 30 months. We are extremely pleased that the proposed regulations attempt to address this issue by excluding the basis of land from the required improvement threshold. That said, there is a strong argument to be made that even with an exclusion of the basis of land, it could still prove challenging to double the basis of the structure.

Recommendation: To incentivize additional multifamily rehabilitation projects and address our nation's workforce housing shortage, we once again respectfully request that the Treasury Department and Internal Revenue Service allow a waiver to the "double the basis" rule if property has been vacant for a period exceeding one year. Notably, the Treasury Department and Internal Revenue Service took exactly this approach in T.D. 8673, final regulations pertaining to Enterprise Zone Facility Bonds issued by state and local governments: "The final regulations provide that if real property is vacant for at least a one-year period including the date of zone designation, use prior to that period is disregarded for purposes of determining original use."

While beyond the scope of final regulations, the multifamily industry also urges the Trump Administration to support statutory modifications to reduce the basis increase necessary to qualify a multifamily rehabilitation project for Opportunity Zone purposes. It is noteworthy that to qualify for an allocation of Low-Income Housing Tax Credits, owners must commit to rehabilitations valued at the greater of: (1) 20 percent of adjusted basis of a building; or (2) \$6,000 per low-income unit (Internal Revenue Code Section 42(e)(3)(ii)).

Clarify Furniture, Fixtures and Equipment Placed in Multifamily Buildings Qualifies as Opportunity Zone Property

The proposed regulations refer to the term "tangible property" in several contexts. For example, the proposed regulations require that at least 70 percent of tangible property owned or leased by a taxpayer be located in an Opportunity Zone. For purposes of the of the substantial improvement test, the basis of tangible property must also be doubled within 30 months. The regulations note tangible property qualifies for purposes of these tests if three conditions are met: (1) the property was acquired after 2017; (2) the original use of the property in the Qualified Opportunity Zones commences with the Qualified Opportunity Fund of the Fund substantially improves the property; and (3) substantially all of the use of the property was in an Opportunity Zone during the period the Qualified Opportunity Fund held the property.

Recommendation: NMHC/NAA request that final regulations clarify that any tangible property that meets these conditions will qualify for purposes of these rules. Specifically, the multifamily industry wants to be clear that furnishings, fixtures and equipment placed in service with respect to, or in support of, a residential rental property should be taken into account for purposes of the double basis rule in addition to the costs associated with the structure itself.

Tax Treatment of Debt-Financed Returns of Capital

Partnerships developing real estate often refinance their assets after a period of time while taking a distribution of proceeds. It is unclear how proceeds that do not exceed a partner's basis in an Opportunity Fund would be treated for tax purposes. If they are treated as a sale or exchange, that would mark the end of the tax deferral period otherwise available through 2026, as well as result in the loss of

a potential associated partial basis step-up. This would significantly diminish the attractiveness of an Opportunity Fund investing in real estate.

It is critical to point out that current law generally exempts debt-financed returns of capital to the degree that a distribution does not exceed a partner's basis in a partnership. Instead, the distributions reduce the partner's share of partnership liabilities under the terms of Internal Revenue Code Section 752. This result is critical to ensure that debt borrowed inside of a partnership and allocated to a partner is treated like debt borrowed outside a partnership and collateralized by a partner's interest in the partnership.

Recommendation: NMHC/NAA request that the Treasury Department and Internal Revenue Service use final regulations to clarify that debt-financed returns of capital that do not exceed a partner's basis in an Opportunity Fund are not treated as a sale or exchange.

Flexible Opportunity Fund Investment Reinvestment Rules

Investors often enter and exit multifamily real estate investments as they look to take advantage of new opportunities and reposition assets. NMHC/NAA believe that the more flexibility Opportunity Funds have to invest in real estate located in Opportunity Zones, the greater number of dollars can potentially flow to distressed economic areas. With this in mind, we would offer recommendations in two specific areas:

Reinvestment of Qualified Opportunity Fund Interests by Individual Investors

Recommendation: Individuals may wish to exit one Opportunity Fund to invest in another. We recommend that the Treasury Department and Internal Revenue Service allow such reinvestments without negative consequence to the five-, seven-, and 10-year basis adjustment thresholds so long as proceeds from exiting a Qualified Opportunity Fund are reinvested in another Qualifying Opportunity Fund within 180 days.

Sales of Properties Within Opportunity Fund and Multiple Properties Held Within Single Opportunity Fund

Recommendation: NMHC/NAA are concerned that the proposed regulations do not address the ability of an Opportunity Fund to: (1) dispose of a qualifying multifamily asset and acquire or construct another qualifying asset; and (2) own multiple multifamily assets within a single Opportunity Fund.

We recommend that the Treasury Department and Internal Revenue Service address the first issue by providing Opportunity Funds the ability to reinvest capital from a sale without adverse Opportunity Fund tax consequence to either the Fund or its investors. This could be done by treating proceeds from a sale as working capital eligible for the 30-month working capital rule.

We also request that the Treasury Department and Internal Revenue Service allow for multiple properties to be held within a single Opportunity Fund and that Opportunity Funds be allowed to divide into two funds in the case that a property is sold and the Fund does not reinvest the resulting capital in a qualifying Opportunity Fund asset. In such case, investors would still be able to realize Opportunity Fund tax benefits with regard to assets remaining in the original Opportunity Fund.

Additional Safe Harbors for 90 Percent Asset Test Working Capital and Substantial Improvement

In our June 8 letter, we requested that the Treasury Department and Internal Revenue Service provide sufficient time for Opportunity Funds to invest capital in Opportunity Zone property before a penalty is triggered pursuant to the 90 percent asset test. We noted that developing new multifamily real estate can run “well past one year and can approach three years.” We are extremely pleased that the proposed regulations permit Opportunity Funds to take up to 31 months to deploy capital so long as the taxpayer has a comprehensive plan for the funds. Finally, we note that taxpayers may take up to 30 months to double the basis of property they have acquired for rehabilitation.

While the 31-month Working Capital Safe Harbor and 30-month rule for rehabilitation should, in most cases, provide multifamily real estate developers with sufficient time to deploy capital to construct or rehabilitate real estate, factors beyond a developer’s control can at times delay activity. For example, a developer may experience delays in securing land entitlements, local zoning approval or permits. Should these types of factors occur, a developer may not be able to deploy 90 percent of Opportunity Fund capital in a timely manner and could, therefore, be subject to penalty.

Recommendation: NMHC/NAA request that the Treasury Department and Internal Revenue use the reasonable cause exception under Internal Revenue Code Section 1400Z-2(f)(3), as well as regulatory authority under Internal Revenue Code Section 1400Z-2(e)(4)(A), to provide penalty relief in cases in which construction is delayed because of factors outside of the control of a developer. Specifically, we recommend that Opportunity Funds be granted up to one additional year to deploy capital for either new construction or rehabilitation purposes upon demonstrating to the Internal Revenue Service that a state or local government or authority delayed development. A taxpayer could demonstrate a reasonable cause delay by looking to the development schedule in the plan required for the Working Capital Safe Harbor and comparing it to the actual time frame. For a taxpayer to be able to demonstrate a reasonable cause exception to the otherwise-applicable 30-month period for rehabilitation, the final regulations could simply require a written development plan to be maintained at the outset of a project.

Investment of REIT Capital Gain Dividends and Internal Revenue Code Section 1231 Gains into Opportunity Funds

Under the proposed regulation, taxpayers have 180 days to invest a REIT capital gain dividend into an Opportunity Fund. The 180-day period is measured from the time the REIT capital gain dividend is paid. Unfortunately, the character of the REIT dividend might not be known when the dividend is paid and instead only becomes clear when a Form 1099-DIV is issued after a taxable year concludes. A similar issue can arise with respect to Internal Revenue Code Section 1231 gains whereby the character of Section 1231 income might be unknown until the end of a taxable year when gains and losses can be netted.

Recommendation: To ensure Opportunity Funds are able to attract the largest amount of possible capital, NMHC/NAA request that the Treasury Department and Internal Revenue Service provide taxpayers with 180 days following the end of a REIT’s taxable year to invest capital gain dividends into Opportunity Funds. NMHC/NAA also request that final regulations provide taxpayers with 180 days from the end of a taxpayer’s taxable year to invest Internal Revenue Code Section 1231 gains into Opportunity Funds.

Treatment of Infrastructure and Property Used Inside and Outside Opportunity Zones

One area the proposed regulations do not address but request commentary is how should property be treated for Opportunity Fund tax purposes that is both used inside and outside of an Opportunity Zone. In developing multifamily property, investments are often made in property, including sewer systems and broadband, which serve a development. It is likely that such investments could involve property that is located both within an Opportunity Zone and outside its borders.

Recommendation: NMHC/NAA request that final regulations clarify that improvements undertaken as part of a multifamily property development should be a qualified Opportunity Zone investment. Guidance should include proration methodology for the amount of investment that is within and outside of the Zone.

NMHC/NAA thank you for considering our views. We hope to work with you to make Opportunity Zones as successful as possible. Please do not hesitate to contact Cindy Chetti, NMHC's Senior Vice President of Government Relations, at 202-974-2300 should any questions arise.

Sincerely,



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