

INVESTING IN OPPORTUNITY ZONES: IS IT WORTH YOUR WHILE?

Assessing Risk and Reward with your Wambolt Advisor



ASSESS RISK AND REWARD

Although questions remain, the stage is set for a potential increase in Opportunity Zone investments in economically distressed communities. Like all investments, there is no guarantee of returns.

Find out whether an Opportunity Zone investment might be worth your while using the Wambolt Opportunity Zone Calculator with your Wambolt Advisor.

Along with the Tax Cuts and Jobs Act of 2017 came some generous tax breaks to encourage investment in economically underserved markets. The program provides preferential capital gains treatment for investments within designated low-income census tracts known as opportunity zones. In all, nearly 9,000 low-income communities have been [designated](#) as qualified opportunity zones.

On April 17, 2019, the IRS and U.S. Treasury issued proposed [guidance](#) providing much needed clarity on how to form, operate and exit Opportunity Zone funds with greater confidence. These proposed regulations also provide more details on who qualifies and how to take advantage of—and remain eligible for—the related credits.

Read more

- [Early Opportunity Zone investments qualify for greater tax savings](#)
- [New in 2018: Opportunity Zone investments](#)
- [IRS issues more guidance on investor tax breaks in opportunity funds](#)

METHODOLOGY FOR THE OPPORTUNITY ZONE CALCULATOR

The Opportunity Zone calculator compares two investment scenarios for an investor with capital gains.

- Scenario One: Reinvest capital gains into an Opportunity Zone Fund.
- Scenario Two: Pay taxes on capital gains and reinvest the proceeds in an alternative investment.

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CALCULATING CAPITAL GAINS

Adjusting the following inputs for reasonable assumptions discussed with your Wambolt advisor calculates an estimate of the capital gains rate. Figures to be adjusted are visualized in blue on the forms below.

Capital Gains	
Initial Investment (Taxable capital gains, if invested)	\$10,000,000
Long-Term Federal Capital Gains Tax	20.0%
Net Investment Income Tax	3.80%
State Income Tax	4.54%
Total Capital Gains	28.3%

Toggle	
Annual Appreciation of Opportunity Fund / Investment	5.8%
Annual Return of Alternative Investment	7.0%
Annual Rate of Return Delta	
10-Year	30.2%
7-Year	8.25%
5-Year	6.58%

Adjusting and calculating these figures creates an estimate of the effective capital gains tax rate in each scenario. Consult with your Wambolt advisor as rates vary by state and income levels.

CALCULATING INVESTMENT INCOME

The net value each investment vehicle provides is based on income parameters. Since most Opportunity Zone funds invest in business property as the underlying assets, rental income on a yearly basis must be assumed. Also, the calculation assumes an annual increase in rental income to account for yearly growth.

The alternative investment is typically bonds, equity, real estate, and niche asset classes that return a yearly dividend to the investor. The calculation assumes that dividends are reinvested into the alternative investment, but taxes are paid in the year revenue is recognized.

To compare the Opportunity Zone investment to an alternative investment, add yearly asset appreciation and income assumptions based on adjustable inputs, as visualized in blue.

Investment Income Opportunity Zone (Annual)

Income: Opportunity Zone (Rent)	\$400,000
Growth Rate: Opportunity Zone	1.5%
Pro-Rated First Year	50.0%
Rental Income Tax	18.0%
Medicare Surtax	3.8%
Total Rental Income Tax	21.8%

Investment Income Alternative Investment (Annual)

Income: Alternative (Dividends)	3.9%
Dividend: Federal Income Tax	23.2%
Dividend: State Income Tax	4.6%
Total Dividend Income Tax	27.8%

Depreciation of the underlying asset and financing structure are also variables that must be taken into consideration to compare an Opportunity Zone investment and an alternative investment. Add final assumptions to the form below, highlighted in blue.

Depreciation: Asset value and useful life are already predetermined since it's based on the initial capital gains and the LTV ratio specified. Also, buildings and other real estate almost always depreciates on a 27.5-year timeframe.

Financing: Enter information here if you plan on using leverage for the opportunity zone investment. Something that is important to not is most Opportunity Zone Funds will have a leverage / refi component which means you should include them as well if you plan on investing in a fund rather than self-certifying. LTV is the loan to value ratio, construction loan interest is the interest on the original loan taken out to build the property, and stabilized loan interest is the rate on the refinanced debt.

Refinance: The amount listed in the "Refinanced Loan Amount" row is the loan that will be taken to refinance the construction principal. Debt to yield is the rate the user specifies which will give them the loan amount. This metric is not uniformly useful for every investor and it could give an inaccurate loan amount. Year of refinance is the year the new loan will be activated to pull out equity from the real estate to help with inherent liquidity issues.

Opportunity Zone Asset Depreciation

Asset	Book Value	Useful Life
Building	\$21,250,000	27.5
Depreciation Recapture		25.0%
Financing		
LTV		40.0%
Construction Loan Interest		5.0%
Stabilized Loan Interest		4.0%
Refinance		
Debt to Yield		7.0%
Year of Refinance (End-of-year)		7
Refinanced Loan Amount		\$8,337,114.49

DEFINITIONS

Alternative Income (Dividends): Dividends income from alternative investment fund or portfolio. Calculator assumes reinvestment each year for compounding effect.

Annual Appreciation of Opportunity Zone Fund / Investment: Year over year growth in asset value (Opportunity Zone capital gains).

Annual Return of Alternative Investment: Year over year growth in alternative investment (Alternative investment capital gains).

Dividend: Federal Income Tax: Fed tax rate on dividend income from alternative investment.

Dividend: State Income Tax: State tax rate on dividend income from alternative investment.

Initial Investment: Capital gain being reinvested into an Opportunity Zone or Alternative Investment.

Long-term Federal Capital Gains Tax: Federal capital gains tax rate, which varies by state.

Medicare Surtax: Standard rate levied on investment income for certain income levels.

Net Investment Income Tax: Additional tax on high earners.

Opportunity Zone Income (Rent): Rental Income generated. Can also be business dividends in the case of an Opportunity Zone equity investment.

Opportunity Zone Growth Rate: Projected annual growth in rental income.

Rental Income Tax: Opportunity Zone investors must pay taxes on income received from the Opportunity Zone. Listed is the applicable income tax rate.

State Income Tax: Capital gains tax at the state level.

The methodology for this calculator is solely for informational purposes and should not be construed as tax or legal advice. It is only intended to provide education about the financial industry. Results and future estimates of back-tested performance are hypothetical. Investing in opportunity zones are extremely limited and not suitable for all investors as they may face heightened risk due to the illiquid nature of investment opportunities available through the Tax Cuts and Jobs Act of 2017 (TCJA). To determine whether investing in opportunity zones is appropriate for you, we urge you to please consult your financial advisor prior to investing.

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