Government Affairs
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CC:PA:LPD:PR (REG-120186-18)
Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Sir/Madam:

On behalf of the approximately 140,000 members of the National Association of Home Builders (NAHB), I am writing to offer comments on the proposed regulations regarding investing in qualified opportunity zones.

Thank you for the incredible amount of work that has gone into issuing the regulations necessary to implement new section 1400Z-2 of the Internal Revenue Code. These proposed regulations provide needed clarity in addition to fair and thoughtful adjustments to the proposed regulations issued in 2018 (REG-115420-18). In particular, NAHB appreciates and supports the agencies' clarification to the working capital safe harbor regarding delays due to governmental approvals.

In summary, NAHB encourages the agencies to:

- Provide additional flexibility for vacant property and reduce the vacancy period from 5 years to 3 years.
- Adopt an aggregate standard for purposes of meeting the substantial improvement test

<u>Commencement of Original Use</u>

The agencies' proposal to commence the original use on the date the tangible property is placed in service for purposes of depreciation or amortization provides a simple and clear definition. NAHB supports the agencies' approach.

<u>Treatment of Vacant Property</u>

Section 1400-Z2(d)(1)(D)(i)(II) requires that for tangible property to be an eligible investment, the original use of the property must commence with the Qualified Opportunity Fund (QOF). Alternatively, the statute allows tangible property to qualify if the QOF substantially improves the property. A property is considered substantially improved when its additional basis is increased so as to exceed its purchase price (excluding land value).

In our comments on the regulations issued in 2018 (REG-115420-18), NAHB argued that the regulations should delineate between tangible property that is already contributing to the economic activity of the Qualified Opportunity Zone (QOZ)—and therefore subject to the substantial improvement test—and vacant or abandoned property. Vacant and abandoned property are not contributing to the economic vitality of a QOZ and should be viewed within the definition of "original use."

NAHB is pleased that the agencies have focused on how the tangible property is being used at the time of acquisition and not just where the property is being used. A property not currently in use can still have "original use" within a QOZ if the QOF restores it to active use. Vacant or abandoned property would therefore not be subject to the substantial improvement requirement but rather viewed as an "original use."

The updated regulations would consider a structure that has been vacant for at least 5 years prior to being purchased by a QOF or qualified opportunity zone business to satisfy the original use requirement. The agencies further note concerns that a shorter vacancy period of 12 months could be subject to abuse.

Specifically, the agencies note "the potential for owners of property already situated in a qualified opportunity zone to intentionally cease occupying the property for 12 months in order to increase its marketability…" NAHB is sensitive to this concern but also recognizes that vacant property can blight a neighborhood and affect future investments. From this perspective, NAHB believes that 5 years does not strike the right balance between promoting repurposing of vacant property and protecting against abuse. NAHB recommends a vacancy length of 3 years.

In addition, as blight removal can be critical to revitalizing communities, and vacant properties represent blight, NAHB would recommend the agencies establish a waiver process by which the chief executive of the appropriate local governmental unit could certify a building as vacant, regardless of duration, to be eligible as an "original use" investment. This will offer a means for communities to repurpose newly vacated buildings but with a degree of governmental oversight to ensure that the building was not deliberately made vacant in order to increase marketability. For example, a town that relied on a single employer, if that employer relocates and vacates their existing space, the local governmental unit head could certify that space as "vacant" and eligible as an "original use" opportunity zone investment. This might allow the town to attract new investment quicker.

The agencies also requested comments on how the vacancy standard may be administered. NAHB suggests the agencies allow a wide range of options to verify vacancy. Some local governments may track vacant property or set property tax rates for vacant property, which could be used as verification. In other cases, there may be little governmental tracking. NAHB recommends that in addition to tax records, real estate sale listings, relevant news articles describing the property as vacant, affidavits from local residents and elected community leaders, foreclosure records, death notices, and utility records (including lack of utility services or usage that is not consistent with an occupied structure) be considered as proof of vacancy.

Determination of Substantial Improvement Requirement on Asset-by-Asset Basis

The proposed regulations currently require assets to be evaluated individually when determining if the substantial improvement test has been met. The agencies have requested comments on applying an aggregate standard that would potentially allow tangible property within the same location or QOZ to be grouped together.

NAHB strongly supports including an aggregate standard. We believe such an approach would continue to ensure appropriate levels of new investments into a QOZ but provide additional flexibility so as not to require "overinvestment" into one asset just to meet the substantial improvement threshold. This is particularly relevant in the context of the development of affordable housing.

Reasonable concerns have been raised regarding the potential for new investments in QOZs to result in dislocation of existing residents. NAHB believes that under certain circumstances, the substantial improvement requirements may result in more displacement. For example, affordable housing is extremely sensitive to capital investment costs, and in certain circumstances it may not be possible to create affordable housing due to the substantial improvement requirements.

An aggregate standard may help residential development investments better serve the existing residents of a community. Take as an example, an investment in two separate apartment buildings. One property requires a significant renovation that greatly exceeds the substantial improvement requirements. A nearby second property may require less renovation work to place it back into service. If these assets are evaluated individually, the developer would be required to make additional, unneeded investments into the second property to hit the substantial improvement threshold, but at the result of higher rents in order to recoup those costs. Allowing these assets to be aggregated would allow the developer to better allocate investment dollars and deliver a more affordable product by minimizing investment undertaken solely to meet the substantial improvement requirement, while ensuring that the aggregate investment fulfills the legislative intent.

Real Property Straddling a Qualified Opportunity Zone

The proposed regulation seeks to provide needed clarity regarding real property that falls both within and outside a QOZ. The agencies propose to follow rules similar to that used for Empowerment Zones. In this case, real property straddling a QOZ would qualify if the unadjusted cost of the real property within the QOZ is greater than the unadjusted cost that falls outside of the QOZ. NAHB believes this is a reasonable and straight-forward approach.

Working Capital Safe Harbor

The agencies' proposal to allow for a 31-month safe harbor for cash used to acquire, construct, and rehabilitate tangible property, as well as to develop a trade or business, is appropriate to meeting the congressional intent of Section 1400Z-2. In our comments on the regulations issued in 2018 (REG-115420-18), NAHB raised concerns that delays outside of the control of the developer—in particular, delays resulting from government approvals—could imperil some investments. In the months since, NAHB has heard from investors that they were excluding areas of the country where the government approval process was known to be lengthy.

In response, the proposed regulations would clarify that exceeding the 31-month period does not violate the safe harbor if the delay is attributable to waiting for government action if the application for such action was made during the 31-month period. NAHB is very supportive of this clarification.

Sincerely,

J.P. Delmore
Assistant Vice President, Government Affairs