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Qualified Opportunity Zones (QOZ) and New York State brownfield programs - by Chuck Merritt

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The Federal tax cut and jobs act of 2017 included a section known as Qualified Opportunity Zones (QOZ), which 100% of the people in real estate took notice of since it provided many tax incentives if the parameters of the QOZ were met.

What is an opportunity zone? An opportunity zone is an economically distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities

qualify as opportunity zones if they have been nominated for that designation by the state and that nomination has been certified by the secretary of the U.S. Treasury via his delegation of authority to the Internal Revenue Service.

Since then, there have been many questions posed to the IRS by many different groups and agencies about the roll out of the program. The Federal Environmental Protection Agency (EPA) was one entity that wanted to know if brownfield sites would be included in the QOZ.

What is a brownfield site? A brownfield is a property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant. It is estimated that there are more than 450,000 brownfields in the U.S. Cleaning up and reinvesting in these properties increases local tax bases, facilitates job growth, utilizes existing infrastructure, takes development pressures off of undeveloped, open land, and both improves and protects the environment.

The original tax law does not consider many brownfield sites eligible due to the lack of defining "original use." IRS Revenue Ruling 2018-29 addressed the application of "original use." In the comments to the proposed rule and the recent public hearing, stakeholders urged IRS to clarify its regulations that if a building is unused or vacant for a significant period of time, a new investment in the building should be considered an original use for purposes of qualifying as opportunity zone property.

The EPA Office of Brownfields and Land Revitalization (OBLR) submitted a comment requesting that "original use" be redefined so that it applies to properties that meet the CERCLA definition of brownfield sites, properties that contribute to blight or create barriers to economic vibrancy due to prolonged vacancy or underutilization, that are vacant for at least one year or that have been foreclosed and held by a local government or land bank. EPA further suggested that the underutilized test apply to the entire property or to "a portion thereof ... which is used only at irregular periods or intermittently." According to EPA, this would help facilitate redevelopment. New York State has identified 514 approved designated tracts that may qualify for the QOZ program with approximately 95,000 commercial assets within the NYC jurisdiction. Brownfield sites offer many of their own incentives to developers but including them within the parameters of a QOZ appeared to be natural.

Although the final IRS ruling on original use has not been rendered as of yet, there are still a few ways that sites would be cleaned up within a QOZ. For example, New York City has its own brownfield style program started when Michael Bloomberg was mayor. Using the same concept that blighted properties in the five boroughs could be remediated, redeveloped thus generating tax revenue for the city. Many of these properties are flagged as E-designated and can be uncovered by searching the department of buildings (DOB) records. This designation does not presume contamination is present but obligates the developer to conduct a comprehensive investigation to prove it does not. Once that investigation is completed, it is submitted to the Office of Environmental Remediation (OER) to review and offer a notice of satisfaction. Should contamination be present, a plan on the proposed remediation would be submitted to OER and a Notice to Proceed will be

issued. The developer would then conduct the required work in order to receive the notice of satisfaction as proof all the requirements were met. Although not by design, some of these E-designated sites would also fall in the QOZ so they would have an additional level of environmental scrutiny.

Investors buying into the QOZ should procure a phase one environmental assessment (ESA) that may potentially flag one if not several environmental concerns. This would be the opportunity to further investigate those concerns. In addition, an understanding of what lies beneath the ground is advisable when developing as disposal costs for soil escalates based on what is being hauled away and disposed of. Lenders looking to finance these properties may have a consultant they have approved to conduct a phase one report or review the one procured by the purchaser. So even if the IRS final ruling on original use does not change to include brownfield sites, many of the buildings and vacant land that fall within the QOZ would include an environmental component.

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