Taking the Opportunity: A Guide to NMTCs & Opportunity Zones

July 24, 2018

NADO
NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

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An Introduction to NMTCs and Opportunity Zones

An affiliate of LISC
NMSC
New Markets Support Company

National Equity Fund INC
an affiliate of LISC

LISC
Helping neighbors build communities

New Markets Tax Credits: Basics

Purpose:	**Encourage the investment of private & patient capital in low-income communities**
What is it:	**Tax credit** ($0.39 for every $1) on the equity capital invested in a Community Development Entity (CDE). **Seven year** investment period and compliance period.
Who is eligible for the credit?	Only a **CDE** can apply for an allocation of federal tax credits Only **investors** who make a qualified investment in a CDE can claim the credit
Who benefits from the credit?	Investors get **return** through tax credits CDEs further **mission** Businesses/projects get **financing** in form of loans or equity
Eligible property types:	Low-income community businesses Commercial, community or mixed-use projects

New Markets Tax Credits: Key Definitions

New Markets Tax Credit (NMTC): A 39% credit taken in installments over 7 years (5% for the first 3 years and 6% for the last 4 years)

Allocatee: A CDE that has received an allocation of NMTCs from the CDFI Fund

Qualified Equity Investment (QEI): Amount paid to the CDE to acquire equity in the CDE. Investor is able to take NMTCs in an amount equal to 39% of the QEI

Qualified low-income community investment (QLICI): A loan or investment by a CDE to/in a Qualified Active Low Income Business (QALICB)

Low Income Community (LIC): A census tract with
(1) Poverty rate more than 20%, or
(2) Median family income less than 80% of area median income

New Markets Tax Credits: Key Parties

Community Development Entity (CDE): Acts as intermediary between Investor/Leverage Lender and QALICB. Applies to CDFI Fund for NMTC allocation (CDFI, affiliate of bank, affiliate of municipality, other nonprofit or for-profit entity with mission to serve low-income communities)

Qualified Active Low-Income Community Business (QALICB): Receives loan or equity investment from CDE

Investor: Invests equity capital and receives tax credits (often a major bank)

Leverage Lender: Makes loan to investment fund that is combined with investor equity capital to make Qualified Equity Investments (can be a bank, CDFI or project sponsor)

Leveraged Financing

•NMTC leveraged financing **fills a 15% - 25% gap** in a project's capital budget, with the percentage filled depending upon:

1. **Amount of financing provided**
2. **Pricing of NMTC equity**
3. **Whether ongoing NMTC fees & expenses are reserved at closing or paid out from project operating income**

The funding sources for the 75 – 80% of leveraged capital must be willing to accommodate the requirements of a NMTC financing.

Compared to 9% LIHTC projects, where the tax credit equity can be as much as 50% of the total development cost, NMTCs are a relatively shallow subsidy.

Eligible Uses of NMTCs

Commercial Real Estate

Community Facilities

Industrial and Distribution

Business Financing

Ownership & operation of rental housing is specifically excluded; however, mixed-use projects are permissible if less than 80% of gross revenue is from dwelling units (or if the project is separated into residential and non-residential components) and at least 20% of the units must be affordable to tenants earning no more than 80% of the area median income.

Ineligible activities include “sin” businesses (golf course, country club, gambling facility, massage parlor, liquor store, etc.), farming, and acquisition or refinance of non-owner occupied rental property without substantial rehabilitation.

New Markets Tax Credits: Activities to Date

As reported by the Treasury Department in 2017:

- **$42 billion** of NMTC equity investments in CDEs
- **4,980 businesses** and real estate projects financed

  - 29% commercial, mixed use and retail real estate
  - 19% health care facilities
  - 11% manufacturing facilities
  - 10% educational facilities

- **75%** of dollars invested in **severely distressed communities**
- **18%** of dollars invested in **non-metropolitan areas**
- **Over 700,000 jobs** (permanent and construction-related) created or maintained
- **178.5 million square feet of real estate** developed or rehabilitated.

Opportunity Zones

The Opportunity Zones tax incentive was established by Congress in the 2017 Tax Cut and Jobs Act as an innovative approach to spur long-term private sector investments in low-income urban and rural communities nationwide. This economic development initiative is based on the bipartisan **Investing in Opportunities Act**.

What are Opportunity Zones?

Opportunity Zone: A low-income census tract **(LIC)**, as determined within New Markets Tax Credits legislation, is designated as an Opportunity Zone **(OZ)** by the governor of the of the state or territory in which it is located. Designations will stay in place for 10 years.

Up to 25% of LICs in a U.S. state or territory may be designated as OZs.

States or territories in which there are fewer than 100 LICs may designate up to 25 LICs as OZs.

Up to 5% of census tracts contiguous to LICs may be designated as OZs, if the median family income of the census tract does not exceed 125% of the median family income of the LIC to which the tract is contiguous.

Designated Opportunity Zones

All states and territories have officially designated their Opportunity Zones, as of June 14, 2018.

8,762
census tracts designated

24 million
current jobs in designated tracts

1.6 million
businesses in designated tracts

Rural census tracts	1,858
Average poverty rate	31%
Average unemployment rate	14.4%
Average family income in OZ census tracts relative to area median income (AMI)	60%

Definitions

Opportunity Fund: An investment vehicle organized as a corporation or partnership for the purpose of investing in Opportunity Zone property.

Opportunity Funds will be self-certified per IRS guidelines. They must be organized for the purpose of investing in Opportunity Zones

Opportunity Funds are required to invest 90% or more of their capital as EQUITY in Opportunity Zone property

Opportunity Zone property includes stock, partnership interest, or business property in an Opportunity Zone

Investor **Incentives**

U. S. investors currently **hold $2.3 trillion in unrealized capital gains**, representing a significant untapped resource for economic development. Opportunity Funds will allow these investors throughout the country to pool and deploy their resources as Opportunity Zone investments.

>

OPPORTUNITY ZONE INVESTMENTS PROVIDE AN IMMEDIATE BENEFIT

to investors of deferring payment of the capital gains tax that would be paid in 2018 until 2026. Further incentives are linked to the duration of an investor's commitment to Opportunity Fund investments.

THE OZ TAX INCENTIVE WILL ALLOW

a modest reduction in capital gains taxes in exchange for holding Opportunity Fund investments for five to seven years.

IF INVESTMENTS ARE HELD 10+ YEARS,

gains accrued on the Opportunity Fund investment during that 10-year period will not be taxed, further incentivizing patient capital.

Timeline for Opportunity Zone Investments

	Investment Year 2018	Year 5 2023	Year 7 2025	Year 8 2026	Year 10 2028
Tax on Capital Gain Invested	Gain realized and invested in Opportunity Fund **within 180 days***	10% reduction of capital gains tax	15% reduction of capital gains tax	All taxes due on 12/31/26. Investor pays tax on 85% of original gain	

*** Tax is deferred until the earlier of investment liquidation (return of capital) or 12/31/26**

	Investment Year 2018	Year 5 2023	Year 7 2025	Year 8 2026	Year 10 2028
Tax on Opportunity Fund Investment		Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment **is tax free****

**** Any appreciation on Opportunity Fund investment is tax free if held > 10 years**

Eligible **Investments**

Only equity investments are eligible for the Opportunity Zone tax incentive.

1 **Business investments**

can include investments in new stock issuance for corporations and ownership interests in partnerships and LLCs.

2 **Investments in real estate**

must include an ownership interest of new construction or assets that will be **"substantially improved"** within 30 months of acquisition by the Opportunity Fund.

3 **New equipment and other assets**

are also eligible investments.

Economic Development Examples

1 **Business infrastructure real estate funds:**

- *Industrial*
- *Retail*
- *Mixed use*
- *TOD*

2 **Venture capital funds:**

- *Seed stage investments*
- *Series A investments*

3 **Operating business private equity:**

- *Equity recapitalizations*
- *Growth capital investments*

4 **Enhancement for other federal tax credit transactions:**

- *NMTCs*
- *Historic Tax Credits*

Strengths

Local

Designations are made by states and localities, rather than Federal agencies, ensuring more local buy in and coordination.

Flexible

The flexibility of the investment tool can support investments in any type of asset class.

New Investor Class

The incentive has the ability to attract high net worth individual investors to community development finance.

Potential

The incentive could attract hundreds of billions of private sector capital into low-income communities (compared with about $10 - $12 billion annually under LIHTC and $3.5 billion annually under NMTC).

Straightforward

The tool is relatively straightforward from an investment and compliance standpoint, in comparison to LIHTC and NMTC.

Potential Concerns

Lack of Oversight

Lack of oversight from government entities could lead to program abuses.

Lack of Impact Incentives

Incentives focus on back-end returns, rather than investments that will result in community impacts.

Gentrification and Displacement

The tool might aid in the gentrification and displacement of residents and businesses in Opportunity Zone communities.

Future of Other Tax Incentives

The new incentive might be used as an excuse to diminish or eliminate other community development tax incentives, such as the NMTC program.

Key Points

Investors

- Tax incentive is most valuable for 10 year investments in appreciating assets
- Six months to invest after realizing a capital gain
- Another six months to deploy 90% of capital in Zones
- Capital is required to be an equity investment – loans from investors are not eligible for the tax incentive

Funds

- All capital must flow through an Opportunity Fund to be eligible for the tax incentive
- Funds are self-certified via an IRS tax form
- Fund must be established for the purpose of investing in Opportunity Zones
- 90% of fund assets must be invested in Zones to maximize the tax incentive

Eligible Investments

- Must be equity investments
- Real estate investments must include substantial rehabilitation – doubling basis within 30 months
- “Sin businesses” are not eligible
- Other requirements include property use in “active conduct of business” and limits on assets held in cash

LISC's Role

Fund Management

Fund Administration

LISC Program Work: Thought leadership, community engagement and coordination, state and local policy

The Growing Rural Communities Fund

The **Growing Rural Communities Fund**, in partnership with Northern Trust, ensures that rural companies and nonprofits have access to affordable capital. The GRC Fund offers low-interest financing for real estate projects to support job creation and economic opportunity.

Out of 8,762 designated Opportunity Zones, **1,858 are located in rural census tracts – just over 21% of all designated Opportunity Zones.** The Opportunity Zones tax incentive has the ability to further strengthen our existing work in America's rural communities.

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OPPORTUNITY ZONES

What might the Opportunity Zone Program mean for Regional Development Organizations?

Questions We're Thinking About

- **What role should my organization play in implementing the Opportunity Zone program in our region?**
  - Should we convene a planning process around Opportunity Zones?
  - Should we try to run a Qualified Opportunity Fund ourselves?
  - Should we focus on a specific subset of tracts (e.g., rural vs. urban tracts)?

Questions We're Thinking About

CAPCOG

- **The types of projects that could be eligible for investment from an Opportunity Fund are extremely broad. How do we establish project priorities?**
  - What's the right mix of stakeholders?
  - Is there a focus area for project that aligns with the organization's broader strategic vision?
  - Is it possible to articulate meaningful priorities without controlling a fund?

Questions We're Thinking About

- **Where will productive projects come from?**
  - *Concern*: Private sector probably isn't leaving lots of productive projects on the table.
  - *Possible Concern:* Are we going to overheat real estate markets in some Opportunity Zones by accelerating projects that would happen anyway?
  - *Possible Value Proposition:* Are RDOs uniquely situated to bring together stakeholders to develop new projects?

Questions We're Thinking About

- **What could the Opportunity Zone Program mean for my RDO?**
  - Potential funding for projects in existing program areas?
    - CEDS project lists
    - Senior/Affordable housing
    - Rural startup/entrepreneurship support
  - Potential to use an Opportunity Fund investment as matching funds to leverage additional grant resources?
  - Potential to manage an Opportunity Fund and generate revenue through administration fees?

Thank You

Capital Area Council of Governments

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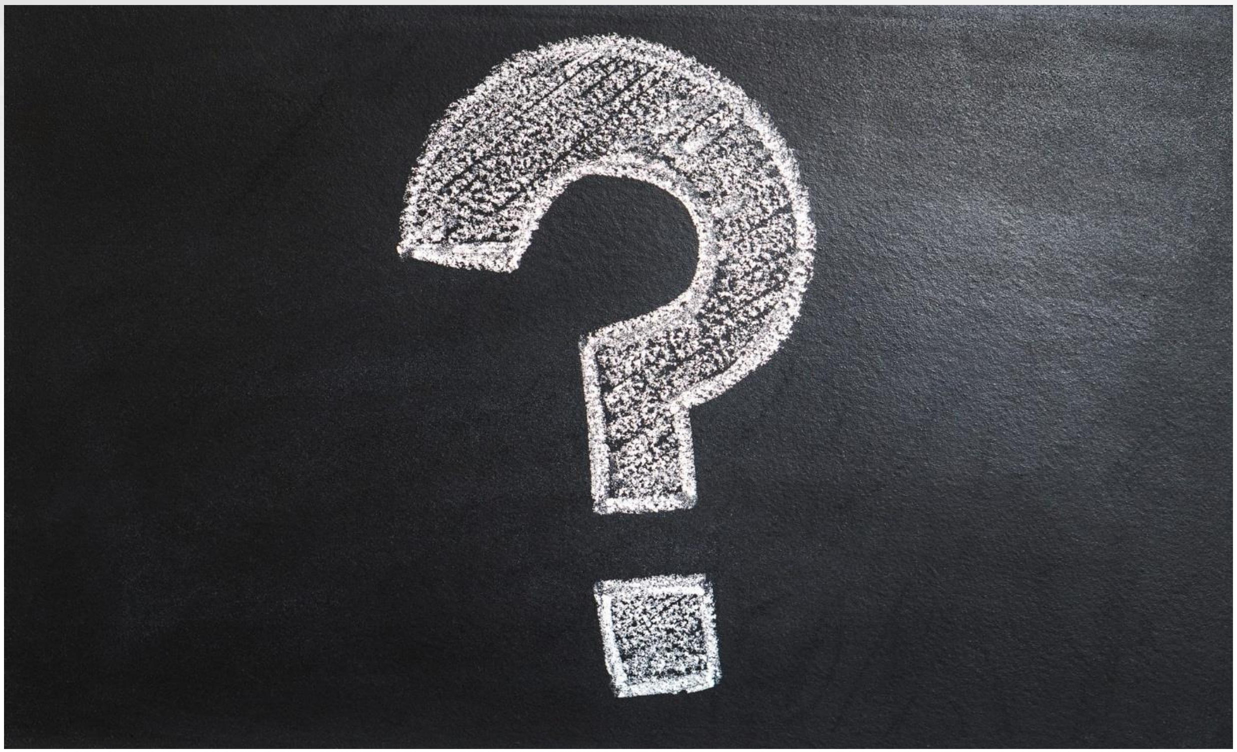
Questions?



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