TOP FIVE WAYS TO COMBINE OPPORTUNITY ZONES AND LIHTC TRANSACTIONS

By Kathie Soroka and Forrest Milder

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Wondering if your LIHTC transaction can benefit from being in an Opportunity Zone but overwhelmed by the breadth of information and don't know where to start?

Of course, this short piece can't be a comprehensive look at Opportunity Zones, but if you want a quick cheat sheet on the kinds of deals that might work or how to structure your transaction to take advantage of Opportunity Zones, read on.

With so much information out there, with the regulations and guidance still evolving, and with practitioners just starting to implement these funds in projects, there are lots of potential ways to use Opportunity Funds and to structure your transaction. Tax law is complicated and a lot depends on the particular variables specific to your transaction, so there is no guarantee any particular structure will work for your project. And, remember that there are a lot more tax considerations than the five listed here. This summary is meant to provide a high-level view of how opportunity zones and LIHTC's might work together.

With those caveats out of the way, here are the Top Five ways to use Opportunity Funds in your LIHTC transaction.

1. LIHTC INVESTOR FUND = OPPORTUNITY FUND INVESTOR

One way to combine Opportunity Funds with LIHTCs is to have your LIHTC Investor Fund be an Opportunity Fund (as opposed to looking for a separate Opportunity Fund to also invest). In LIHTCs, the tax credits and the losses follow ownership interests, which is why we see LIHTC Investor funds holding 99.99% of the ownership interests in entities created to own LIHTC properties. In this traditional structure, there really isn't room for another separate investment fund to come into the transaction, too—partnership tax rules create a challenge because the Opportunity Fund's capital account would likely cause them to eat into the LIHTC fund's share. Still, one of the big challenges with Opportunity Fund investment is convincing investors that there's a return beyond the Opportunity Fund capital gains tax deferral that makes it worth staying in for the 10-year period. LIHTC transactions, with their 10-year credit period make that an easy argument.

2. GET THE RIGHT LIHTC INVESTOR

The next key is to target the right investors. A lot of LIHTC investors are banks, motivated by the Community Reinvestment Act (CRA), which requires them to invest in areas they want to grow in. Opportunity Funds invest capital gains. Banks often don't have capital gains. You need an investor that has capital gains with a sufficiently large other income tax liability that they can use the LIHTC tax credit and losses it provides. Large corporate investors could be a good fit. So could family offices (the latest term for wealthy families that have taken their money management in-house). Family offices offer great potential in this space. They haven't as of yet done a ton of investing in LIHTC properties, so they're an untapped source of investment. Plus, they don't have the bureaucracy of typical LIHTC investors, like banks and large corporations, so they may be more directly motivated by the mission of investing in their communities and can be more nimble than the big bureaucracies. Here, you'll need your tax advisor to pay attention to the rules that apply to closely held investors, but that can be made to work.

3. START SMALL AND USE A SINGLE INVESTOR... OR AS FEW AS POSSIBLE

Can you have many investors in an Opportunity Fund? Almost certainly yes. If you're going to be one of the first LIHTC sponsors to combine an already complex project with Opportunity Funds, and do this even before the guidance has had a chance to solidify and the tax lawyers have seriously weighed in, then you will likely be better off with the relative simplicity of a single investor. If I'm going to be one of the first, I want to keep it as simple as possible.

4. START WITH A NEW CONSTRUCTION PROJECT

You can use LIHTCs for projects involving new construction or substantial rehabilitation. To get the tax benefit of being in an Opportunity Zone, the Opportunity Fund's initial investment must be matched by the project's appreciation during the 30-month period after acquisition. That can be tough in traditional acquisition rehab LIHTC transactions because those are traditionally structured to maximize acquisition price to maximize LIHTC calculation, which makes it harder to meet the Opportunity Zones 30-month rehab requirements. Plus, both LIHTC and Opportunity Funds rules require acquisition from an unrelated party, but the threshold for LIHTCs is 50% while it's 20% for Opportunity Funds. The more straightforward slam dunk on Opportunity Funds is going to be with new construction. You're less likely to have acquisition issues and you're almost guaranteed to meet the 30-month rule.

5. KEEP YOUR EXPECTATIONS LOW... FOR NOW

There's a lot of talk about the potential for Opportunity Zones. Rightfully so. This is an exciting opportunity to create a whole new vehicle for investment. But let's remember that the first years of LIHTCs saw pricing in the $0.40s. It took a few years for the market to mature, investors to become comfortable with the risks and rewards and the tools and structures to standardize. It's the same with Opportunity Zones. For the first LIHTC deals using Opportunity Funds, the economic benefit above the LIHTCs will likely be modest. Get it done, put a notch on your belt and let's keep talking about how we'd like to see Opportunity Zones develop.

IF YOU'D LIKE A REFRESHER ON OPPORTUNITY ZONES, CHECK OUT THE FOLLOWING RESOURCES:

— **IRS Opportunity Zones FAQs**
https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions

— **NP Rundown on Opportunity Zones**
https://www.nixonpeabody.com/en/ideas/articles/2018/10/22/irs-proposed-regulations-on-opportunity-zones

— **Proposed IRS rule on investing in qualified opportunity funds**
https://www.federalregister.gov/documents/2018/10/29/2018-23382/investing-in-qualified-opportunity-funds

— **Forrest Milder in Bloomberg: A dozen things you should know about setting up an opportunity fund**
https://www.bna.com/insight-dozen-things-n57982094227/

— **U.S. Treasury map: Find out if your property is in an Opportunity Zone**
https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx

FOR MORE INFORMATION, PLEASE CONTACT:

Forrest Milder
Partner, Community Development Finance
617-345-1055
fmilder@nixonpeabody.com

Kathie Soroka
Counsel, Affordable Housing and Real Estate
212-940-3736
ksoroka@nixonpeabody.com

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