Novogradac
Journal of Tax Credits
News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits
June 2019 • Volume X • Issue VI
Published by Novogradac & Company LLP

Treasury Guidance Expected to Launch Increase in OZ Investment

BRAD STANHOPE, SENIOR EDITOR, NOVOGRADAC

When the Treasury Department released its second tranche of proposed guidance for the opportunity zones (OZ) incentive April 17, the investment community took notice.

It's go time.

"Now that we have that level of clarity, I think you're going to start to see [investments] accelerate through the end of the year," said David Lissek, senior vice president of Caliber Companies, during a panel presentation at the Novogradac 2019 Opportunity Zones Spring Conference in Denver. "There's a clock running and if you want to get the full benefit of the 15 percent basis step-up, you have to transact this year. From this point through the end of the year, I think you're going to see a pretty significant acceleration in the amount of capital that's raised in this space."

The OZ market is unique. The incentive became part of the tax code in late 2017, but many significant investors waited for Treasury guidance, even after the first tranche came in October 2018.

Some in the industry thought the wait was unnecessary.

"Frankly, I believe we had sufficient guidance to properly structure a fund with the guidance we received last October, but I understand the compulsion on the part of investors to seek greater clarification," said Kevin Shields, chairman and CEO at Griffin Capital Companies, which has $12 billion in assets and sponsors an opportunity fund. "It's been a bit of a start and stop since October. The second tranche of guidance certainly provided additional clarification on important issues such as the ability to provide debt-financed distributions and flexibility around rotating capital within the 10-year holding period."

At the Novogradac OZ conference and in conversations with those in the investment community, the April guidance is seen as significant.

continued on page 2

continued from page 1

"This new guidance is going to make a huge difference," said John Sciarretti, partner in Novogradac's Dover, Ohio, office and head of the Opportunity Zones Working Group. "The new rules, among other things, give funds more time to hold investor funds before they have to invest to meet compliance tests, provide clarity on the rules governing operating businesses and allow investors to enjoy the 10-year hold benefit by selling the property or business in which they invested. Previously, the exit strategy was limited to selling interest in a fund."

Growing Investment World

The OZ incentive will drive significant investment dollars into low-income communities, but must be done in the context of an evolving set of regulations and looming deadlines–most specifically, the requirement to invest before the end of this year to get the full tax benefits provided investors.

Sciarretti said the OZ investor community has grown since the incentive was introduced.

"Many more funds have been organized over the last year, providing opportunities in the billions of dollars for investors to take advantage of the incentive," said Sciarretti. "However, even though there has been tons of interest, the lack of clarity has been a major hurdle to converting that interest into investment. The new regulations provide the necessary clarity and as a result, I expect that investments in our disadvantaged communities a year from now will be measured in the billions [of dollars]."

Doug Wolf, managing principal at Opportunity Asset Group, said a significant issue is education. Investors in OZs are likely to be high-net-worth individuals, unlike investors in tax incentives such as the low-income housing tax credit (LIHTC), new markets tax credit and historic tax credit, which focus on institutional investors.

"What I've seen with wealth managers and other advisers is because [the OZ incentive is] new and it's been an evolving situation, advisers have been reluctant to advise their clients to go into OZ investments," Wolf said. "Wealth managers in particular–many of whom have never advised their client to go into a real estate investment–are being pushed more from the bottom up from their clients, who have a taxable event and are saying, 'I heard about the opportunity zones, what do you have for me?' … I don't think that will be the case in the future. I think this will be a very large capital market and it will start building very quickly."

Real Estate Fits

One of the simplest areas in which to invest is real estate, as pointed out by Wolf.

Jun Sakumoto, a partner at Avanath, an investment firm with more than $1.7 billion in assets and 10,000 units of affordable and workforce multifamily housing, said his group didn't wait for the latest tranche of guidance to get going.

"Our focus is on affordable and workforce housing," Sakumoto said. "We're raising capital for opportunity zones projects. We have four assets we're pursuing with our opportunity fund and all are affordable and workforce housing. Three are in our existing portfolio. We're going to build more units, to double the basis [as required by OZ regulations]."

Sakumoto said combining LIHTCs and the OZ incentive is a natural combination, simplifying it for investors.

"We think this is a good fit," Sakumoto said. "One reason is the limitations of the opportunity zones incentive is that you have to own [the investment for] 10 years for the full benefit, which kind of matches LIHTC deals

continued on page 3

continued from page 3

of 10 years taxes and losses. Also, the purpose was to invest capital in low-income communities and that's our mission: we acquire and manage properties in low-income communities."

Bright Future

Following Treasury's proposed regulations, those involved see an almost limitless capacity for investment.

Sakumoto compared the current market to the early years of the LIHTC.

"There is increasing interest from individual investors with potential capital gains and from even some institutional investors," Sakumoto said. "People are trying to figure out the program and there's certainly a lot of excitement. Some people say this is a generational move and it seems to me a lot like when the LIHTC came into play in the late 1980s and early 1990s. People were trying to figure it out and it eventually became well-established."

Shields has a recommendation for those waiting for further clarity from Treasury.

"Do it now, don't wait," Shields said. "We have ample clarity now. If we're having this same conversation in a year, a big part of the opportunity as a sponsor will have been lost and you run the risk of being crowded out of the market."

Shields gave a word of advice to investors: Be aggressive in seeking opportunities, but be careful with whom you invest.

"Now is the perfect time to launch and invest in a qualified opportunity fund," Shields said. "But preform your diligence and make sure you invest with the right sponsor that can raise the capital, execute the development plan and maintain a strict compliance protocol." ❖

Novogradac Services Contact
John Sciarretti, CPA
john.sciarretti@novoco.com
330.365.5403

This article first appeared in the June 2019 issue of the Novogradac Journal of Tax Credits.

NOVOGRADAC™

CONTACT

CORRESPONDENCE AND EDITORIAL SUBMISSIONS
Alex Ruiz
alex.ruiz@novoco.com
415.356.8088

ADVERTISING INQUIRIES
Christianna Cohen
christianna.cohen@novoco.com
925.949.4216

EDITORIAL MATERIAL IN THIS PUBLICATION IS FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE CONSTRUED OTHERWISE.

ADVICE AND INTERPRETATION REGARDING THE LOW-INCOME HOUSING TAX CREDIT OR ANY OTHER MATERIAL COVERED IN THIS PUBLICATION CAN ONLY BE OBTAINED FROM YOUR TAX ADVISOR.

ISSN 2152-646X