NOVOGRADAC TAX CREDIT TUESDAY PODCAST

Summary: July 21, 2020

In this week's Tax Credit Tuesday podcast, Michael J. Novogradac, CPA discusses the 2019 new markets tax credit awards from the CDFI Fund. Then, he shares highlights from the Novogradac 2020 Opportunity Zones Virtual Conference, and he shares panel discussions from Novogradac's Affordable Housing Friday Forum. Next, he talks briefly about the Economic Justice Act—a legislative proposal that would create a minimum 4 percent low-income housing tax credit. He then shares highlights from the National Low-income Housing Coalition's 2020 Out of Reach report on housing affordability. He wraps up with updates from Louisiana regarding the state's new markets tax credit, historic tax credit and opportunity zones incentives.

Summaries of each topic:

GENERAL NEWS

Last week on Wednesday, the Community Development Financial Institutions Fund, or CDFI Fund, announced more than $3.5 billion in new markets tax credit allocation issuance authority. That allocation went to 76 community development entities. The awards were made under the calendar year 2019 round.

The 76 awardees were selected from a pool of 206 applicants, and those 206 applicants requested an aggregate $14.7 billion in allocation authority. That means demand for the tax credit allocation authority is about four times the supply.

Of the allocatees, 12 minority- or Native-owned CDEs received $543 million in allocations. 14 CDEs met the criteria for rural CDE and received $740 million in allocations.

Of the over $3.5 billion in allocations, approximately $2.6 billion is expected to be used to finance and support loans to or investments in businesses in low-income communities. Approximately $882.8 million will likely be used to finance and support real estate projects in low-income communities. Awardees span 30 different states and the District of Columbia.

We at Novogradac wish congratulations to all of the awardees this year.

To put this year's allocations into context, let's consider some historic data. In the 16 rounds to date, the CDFI Fund has made nearly 1,300 allocation awards totaling $61 billion in tax credit authority. $52.5 billion in new markets tax credits have been invested in low-income communities through fiscal year 2019.

Looking ahead to the next round, the 2020 round of the new markets tax credits awards is expected to open soon. If you need assistance with a new markets tax credit application, please contact a Novogradac office near you.

We'll be discussing the 2019 awards, this upcoming round and more at the Novogradac 2020 New Markets Tax Credit Virtual Conference that's being held this Thursday, July 23. If you haven't already registered, I encourage you to do so today and reserve your spot at the conference. We'll have a keynote address by Rep. Richard Neal, chairman of the House Ways and Means Committee. He's a longtime champion of the new markets tax credit and we're looking forward to his insights from Washington. There will also be a CDFI Fund Q&A panel and plenty of opportunities for networking in our Novogradac Nexus.

I'll include a link to register for the conference in today's show notes and tweet it out as well. Remember to register early to avoid delays with same-day registration.

OZ Virtual Conference

Speaking of virtual conferences, thanks to all of you who joined us for our first-ever virtual opportunity zones conference last week. We had a terrific turnout and had many fruitful discussions.

Sen. Tim Scott from South Carolina, the author of the original opportunity zones legislation, provided our conference keynote address. Sen. Scott spoke about the transformative changes that opportunity zones have made in communities through affordable housing, historic rehabilitation and other investments. Sen. Scott cited data from the Novogradac Opportunity Funds Listing, which includes more than $10 billion in equity reported raised for opportunity zones investments.

Sen. Scott recapped recent opportunity zones updates, including the extension of the 180-day investment window until the end of the year. This gives participants more time to meet the substantial improvement test and more time to invest in opportunity zones.

Sen. Scott said the COVID-19 pandemic makes investment in distressed communities even more crucial. To that end, he said an extension of the opportunity zones incentive is more needed now than ever. More particularly, extending the 2026 by-date to 2028.

Sen. Scott also mentioned opportunity zones reporting legislation he introduced during this congressional session called the IMPACT Act. IMPACT is an acronym that stands for Improving and Reinstating the Monitoring, Prevention, Accountability, Certification and Transparency Provisions of Opportunity Zones Act. The IMPACT Act would implement opportunity zones reporting requirements so that lawmakers and policymakers can be better informed when making decisions about the incentive.

After Sen. Scott's keynote address, I had a one-on-one discussion with Dan Kowalski, who is the counselor to U.S. Treasury Secretary Steven Mnuchin. Dan has been instrumental in drafting and releasing opportunity zones guidance and regulations. It was great having him share his observations about opportunity zones investments and whether Treasury has any plans for additional opportunity zones guidance in the near future.

Let's start with guidance.

Dan said that Treasury considers the regulations complete, in the sense that opportunity zones participants have sufficient guidance to use the incentive. For now, Treasury wants to let the incentive "run" so that Treasury can gather data on the incentive's effectiveness.

One area in which Treasury <u>may</u> release additional information or guidance eventually is on the topic of census tracts. New census tract data derived from the American Community Survey can make the borders of opportunity zones bigger, smaller or stay the same. Treasury will keep an eye on that census data and the redrawing of census tract lines to determine to what extent any additional guidance is needed.

Dan and I also discussed <u>if</u> and <u>how</u> the pandemic has affected opportunity zones investment. He did acknowledge that while the pandemic may have slowed some investments, the pandemic does provide the chance to look at opportunity zones through a different lens—through the evolving patterns of commerce.

For example, warehousing and delivery services are becoming increasingly important as people rely more on online shopping and e-commerce. There's also an opportunity to bring pharmaceutical companies back to the United States so that those products are more readily available domestically. We discussed the clear opportunity those considerations present for commercial real estate. Those facilities also indirectly benefit operating businesses by giving them space to work.

I asked Dan how he compares opportunity zones to other economic incentives. Dan said most economic development programs are grants or debt, but the opportunity zones incentive is different because it incentivizes equity investment. He said opportunity zones change the conversation about what you need to do in order to build up a low-income community.

I do want to express my thanks to Dan Kowalski for sharing those insights with us.

Our Novogradac opportunity zones conference featured other panels, as well. We had panels or sessions on structuring opportunity funds and building a transaction pipeline, investing in opportunity zones real estate and operating businesses and measuring social and community impact.

My partner John Sciarretti led a discussion with representatives from the IRS on opportunity zones regulations. John and his IRS panelists covered a myriad of topics, including non-qualifying property issues and triple-net lease guidance. John asked his panelists about a particular issue that has come up in preparing 2019 tax returns related to the investment standard test. The investment standard test requires that a qualified opportunity fund hold at least 90 percent of its assets in qualified opportunity zone property at the end of a six-month period.

John said he has found a number of qualified opportunity funds could be failing the 90 percent test. They're failing because the numerator includes earnings on permitted temporary investments of contributions and the numerator contains capitalized organizational or start-up capitalized costs that are associated with a start-up fund.

Treasury regulations do allow qualified opportunity funds to disregard recently contributed property to determine compliance with the 90 percent investment standard by excluding that contributed property from both the numerator and denominator if certain specific requirements are met. However, regulations do not address treatment of any earnings on that property or capitalized organizational or start-up costs that I just mentioned

John suggested that Treasury allow funds to exclude earnings on the temporary contribution. He said funds should be allowed to ignore any capitalized costs related to the start-up. As such, you would avoid having a numerator and a denominator.

To that end, panelist Alfred Bae of the IRS responded that it's reasonable for funds to disregard the earnings on contributions that were otherwise being disregarded under the Treasury regulations.

Furthermore, he said that the start-up costs should also be able to be ignored. This then means that the resulting ratio is zero over zero because you have no assets in the numerator and no assets in the denominator. He did go on to say that it's reasonable to report that zero over zero ratio as 100 percent on Form 8996.

The guidance on both the earnings on disregarding funds, the guidance on excluding start-up costs and the guidance on zero over zero being reported as 100 percent was pretty significant and good to hear.

If you manage a qualified opportunity fund and you are encountering this issue or have any other questions on your Form 8996, please contact John Sciarretti for assistance. His contact information is in today's show notes.

Allow me to once again give thanks to all of our esteemed speakers and panelists. I also want to thank our co-hosts, sponsors and attendees for making our first virtual opportunity zones conference such a success. A particular thanks to NES Financial, a co-host of the conference.

If you registered for the conference, you do have access to recordings to each conference session for 90 days after the event. If you missed the conference, there's still time to watch the conference. You can purchase those conference recordings from Novogradac's on-demand training page. I'll include a link to the training page in the show notes and tweet it out as well.

Friday Forum

The opportunity zones virtual conference was not the only virtual event last week. Novogradac also hosted the third session of our affordable housing Friday Forum series.

Each of these three virtual events focused on a different topic concerning low-income housing tax credits and affordable housing. The first two forums covered such things as: the outlook for low-income housing tax credit federal legislation, a panel of HUD multifamily officials describing the COVID-19 response and future guidance from HUD, an update on the tax credit equity and debt markets, and a bonus session on affordable housing in California.

Last week's forum included discussion about COVID-19's impact on compliance and underwriting issues.

Concerning compliance, our panelists discussed the implications of IRS Notice 2020-53. That notice provided relief in areas of affordable housing compliance due to COVID-19. This notice clarified that annual recertifications of tenants due between April 1 and the end of this year are not required. The notice also ruled that state agencies are not required to conduct inspections or reviews during the period from April 1 to the end of this year.

This clarifies matters for many owners and managers of low-income housing tax credit properties. Before the IRS Notice, it was unclear whether recertifications and inspections were required. There was a temporary delay until July 15, but IRS Notice 2020-53 extends it until the end of the year.

While major issues were addressed in the notice, our panelists pointed out that there are still some outstanding issues.

One of the most important issues is to determine new deadline for recertifications and inspections. In other words, is the new deadline a full year after the previous deadline or Jan. 1? Obviously, a Jan. 1, 2021, deadline for every property with a due date between April 1 and Dec. 31 of 2020, seems untenable—it just doesn't make sense. However, the IRS guidance did not specifically say that deadlines would be pushed back one full year.

Some state agencies that have addressed the issue have said they will resume the schedule on the next annual due date. But many states haven't specifically said that and the IRS guidance did not make that a specific provision.

A second outstanding issue is how state agencies will address properties that were scheduled to be inspected in 2020. With inspections required once every three years, does that mean some properties could go six years without an inspection? That seems unlikely, but has not been clarified.

A provision in the IRS Notice 2020-53 that brought some additional discussion is the provision that allows medical personnel and other essential workers to live in low-income housing tax credit properties. Those workers are considered displaced persons under Revenue Procedure 2014-49. The IRS Notice said those workers are eligible to live in low-income housing tax credit properties through Dec. 31, 2020. Again, this is something that property owners and managers <u>can</u> do, and it's not something they <u>must</u> do.

Panelists pointed out that medical personnel and essential workers are slightly different from the displaced people normally covered by this provision. During a natural disaster, many of the displaced people would otherwise qualify for low-income housing tax credit property tenancy. They are local residents who lost their homes. But essential workers and medical personnel may be different. For example, many medical workers earn well above the maximum for normal eligibility for many low-income housing tax credit properties.

There are two specifics about this provision that panelists emphasized. One is potentially negative, the other is positive.

The down side is that the end date for eligibility is Dec. 31 of this year, so unless the IRS extends the provision, the covered workers could only live in a low-income housing tax credit property for the next five months.

The potential benefit is that this provision could apply to a low-income housing tax credit property resident who might otherwise become income <u>ineligible</u>. In other words, someone who isn't eligible to live in a low-income housing tax credit apartment can stay if they are an essential worker, through the end of the year, at least.

In addition to IRS Notice 2020-53, our compliance panel discussed updated guidance from Treasury on inspections by state agencies. The major takeaway, as we've discussed previously, is that the IRS is proposing to allow state housing agencies to return to inspecting the <u>lesser</u> of the required sample size based on a Real Estate Assessment Center chart sample size of units or 20 percent of units. Earlier guidance said the <u>greater</u> of those figures had to be inspected. The current proposal is a return to what had long been the long-standing practice.

While this change was good news to state agencies and property owners, panelists stressed that this is still technically a <u>proposal</u>. There is a 60-day comment period before the IRS moves forward with the proposal.

Panelists also pointed out other new provisions in the updated regulations remain standing. Those changes include that a state agency cannot notify the owner of a review more than

15 days in advance. Another change is the requirement for inspection of each building and The third change is limiting the owner's ability to know which apartments will be inspected.

As a reminder, the IRS is accepting comments on this proposal. This is the time to weigh in and make sure your voice is heard.

Another reminder to call a Novogradac office near you if you have questions about how the updated guidance applies to your property. Whether it's following the COVID-19 relief standards or what to expect in state housing agency inspections, we can help.

The second panel during last Friday's housing forum concerned underwriting issues.

Our panelists shared how COVID-19 has affected their ability to underwrite affordable housing properties.There are some matters affected by a lack of in-person inspections, particularly such things as the ability to confirm unit mixes. But panelist said that most of their work has not been tremendously hampered.

Panelists did, however, address several issues of importance for property owners concerning COVID-19 and the recession. Panelists said that the current recession has not significantly altered their long-term view for rent increases. There is a general feeling that there will continue to be rent increases of about 2 percent per year over the longer term.

Concerning rent collection, there is some effect, particularly as extended unemployment benefits begin to run out. However, panelists said market-rate apartments seem to be more affected in rent collection. The biggest concern for our panelists is what will happen with future shutdowns, particularly without more stimulus funding for residents.

For properties under construction, panelists said the most important thing is to extend timelines, due to supply chain problems and labor availability. There was also a reminder that some properties should consider getting updated market studies to include the impacts of COVID-19.

To that end, Novogradac can help. Novogradac has a full-service valuation team that can perform market studies, whether it's a new study or an updated one. If you need help, call one of our offices.

A very special thanks to all the participants in the three affordable housing Friday Forums. Whether you helped present the sessions or were an attendee, it was great to see so many people who care about affordable housing.

If you missed one or more of the forums, recordings will be available soon. I will share how to order them once they are available.

OTHER NEWS

Shifting to other news, you likely heard last week about the $350 billion proposal from Senate Democrats to invest in communities of color.

The proposal, called the Economic Justice Act, calls to establish a minimum 4 percent low-income housing tax credit, among many other proposals for consideration in the next COVID-19 relief bill. I'll keep an eye on that legislation and will report on any relevant updates in future podcast episodes.

Next, I have some highlights from the National Low-Income Housing Coalition Out of Reach 2020 report from last week. This report provides further insight into the national affordable housing crisis.

According to the report, rent for a modest two-bedroom home at fair market rent is too expensive for someone working a standard 40-hour week at the minimum wage. This is true in every state, metropolitan area and county in the United States. The hourly wage needed to afford a market-rate, two-bedroom apartment ranges from $14.19 in Arkansas to $38.76 in Hawaii.

The report states that 71 percent of extremely low-income renters spend more than half of their income on housing costs. The authors call for reform and investment to help ease the financial burden on low-income renters. I'll include a link to the full document in today's show notes and tweet it out as well.

Next, I have three announcements from the state of Louisiana.

First, Gov. John Bel Edwards last week signed legislation that extends the sunset date of the state historic tax credit until the end of 2027. The legislation also establishes an annual statewide cap at $125 million.

Second, the Louisiana governor also signed legislation that expands the Louisiana New Markets Jobs Tax Credit program. The legislation creates an additional $75 million of qualified equity investment issuance authority for the incentive. The additional round of allocation authority is for businesses with 250 or fewer employees through community development entities that have invested at least $100 million in Louisiana.

The third piece of good news from Louisiana is the enactment of an enhanced Angel Investor Tax Credit for investments in federal opportunity zones. S.B. 24 allows a 35 percent tax credit taken over two years for opportunity zone investments. The Angel Investor Tax Credit is usually for 25 percent. There will be an annual cap of $7.2 million for additional credits.

The expansion of these incentives will hopefully drive more community development and historic rehabilitation investment in the state. I'll include links to the three Louisiana bills in today's show notes.

And if you need help with your application for the Louisiana historic tax credit, the additional state new markets tax credit allocation authority or the Angel Investor Tax Credit for opportunity zones, I encourage you to reach out to a Novogradac office near you.

Related Resources

2019 New Markets Tax Credit Awards

New Markets Tax Credit Program Award Book CY 2019

Register for the Novogradac 2020 NMTC Virtual Conference

Novogradac NMTC Services

OZ Virtual Conference

Novogradac 2020 Opportunity Zones Virtual Conference

Contact John Sciarretti

On-Demand Recording of OZ Virtual Conference

National Low-Income Housing Coalition Report

Out of Reach: The High Cost of Housing

Louisiana Tax Incentive Legislation

Louisiana HTC H.B. 4

Louisiana NMTC S.B. 13

Louisiana OZ S.B. 24