Opportunity Zones and HOME Program

Andelyn Nesbitt-Rodriguez: Welcome to the Opportunity Zones and HOME Program Webinar. My name is Andelyn Nesbitt-Rodriguez with ICF, and I'm joined by my colleague Carrie Kronberg. We will be your presenters today.

Today's webinar will cover using HOME investment partnership funds from HUD's Office of Affordable Housing Programs in opportunity zones, which are census tracts designated by the IRS and which offer capital gains tax relief in order to attract investment.

There is an eGuidebook that serves as a companion piece to this webinar called Using HOME and HTF Funds with Opportunity Zones eGuidebook. The eGuidebook includes a lot more detail on the material covered and is hyperlinked on this slide. Please refer to the Using HOME and HTF Funds Within the Opportunity Zones Guidebook on the HUD Exchange to follow up on any topics on which you'd like more information.

This webinar is intended to educate participating jurisdictions or PJs, opportunity zone investors and developers, and other potential development partners about how HOME projects can be developed in opportunity zones and the benefits of doing so.

Specifically, participants in this webinar will be able to think strategically about using HOME in opportunity zones, identify what motivates investors to improve local government's ability to attract capital and to recruit development partners, and identify and address key opportunities and challenges when using HOME in opportunity zones.

We'll start out by going over some basics of both opportunity zones or OZs and the HOME investment partnership program, which will refer to as HOME, as it relates to opportunity zones.

Then we'll discuss using HOME funds within opportunity zones generally and related opportunities and challenges. We will also take a look at a project in Maryland where HOME funds were used in combination with opportunity zone investment. Finally, we'll review additional resources.

So, let's kick things off by reviewing the basics of opportunity zones. So, what are opportunity zones? Opportunity zones were created by the 2017 Tax Cuts and Jobs Act to generate long-term investments in rural and low-income urban communities across the nation.

The Opportunity Zone program provides a tax incentive designed to attract investors who have realized appreciation in the value of their assets and who would otherwise have to pay a capital gains tax upon sale of those assets.

Based on nominations from each state's governor and shortly after the passage of the 2017 legislation, the IRS designated up to 25 percent of each state's low-income community census tracts as opportunity zones, totaling nearly 9,000 tracts nationwide.

Within the designated opportunity zones, investors can invest in a range of economic development activities, including housing development and business ventures.

Depending on the term of their investment, both individual and corporate investors can defer the payment of taxes and generate additional returns on those investments when they invest in economic development activities in an opportunity zone.

The potential for increased returns is intended to attract investment in communities that may otherwise not attract private capital. The returns to investors in opportunity zone projects increase depending on the time of their investment, with increasing benefits generated after five, seven, and ten years.

If an investor invests funds for at least ten years, any capital gain that is generated after the initial ten-year period can be excluded from their tax obligation. Opportunity zone investments are market driven, and the level of investment and the expected returns are negotiated by the developer and the investor.

So, we just spent some time discussing what opportunity zones are. Now, let's review what opportunity zones are not.

Opportunity zones are not a traditional form of capital for affordable housing development, and the developer doesn't submit an application for a grant, loan, or tax credits. When a proposed affordable housing development is located in a designated opportunity zone census tract, it presents an opportunity zone investment opportunity.

The developer of the housing project can market the investment opportunity and then negotiate terms of an equity investment with an interested opportunity zone investor or with a fund created to invest on behalf of taxpayers that have experience in capital gain and would benefit from the opportunity zones tax relief. We'll talk more about those -- this investment vehicle called qualifying opportunity funds in a few slides.

Unlike tax credits, the capital that can be generated through opportunity zone investments is not limited. There's no cap on the amount of investment that may go into a community designated as an opportunity zone or into a specific opportunity zone project.

However, it's unlikely that the capital generated from an opportunity zone investor will be the only funding source for an affordable housing project. Other sources such as a mortgage, LIHTC or low-income housing tax credit, equity investment, traditional grants, and soft loans will also likely be needed to complete the capital stack.

Opportunity zones don't target or prioritize one type of investment over another. Affordable housing projects are just one of a variety of real estate projects and operating businesses through which the investor can benefit from capital gains tax relief.

So, we've discussed what opportunity zones are and are not. Now, let's review how opportunity zone investments work.

Any eligible taxpayer that has an experience -- has experienced a capital gain can invest that gain in a project located in an opportunity zone, provided the project meets the statutory and regulatory criteria. Taxes that would have been owed on the capital -- on the gain are then deferred and potentially reduced, depending on how long the investment is held.

Eligible taxpayers include individuals, corporations, or qualified opportunity funds, which we'll discuss in just a moment. Eligible equity investments include investments in new or existing businesses located in opportunity zones, as well as real estate and business assets.

So, on the last slide, we introduced the term qualified opportunity funds. Let's dive into that concept a bit more now.

A qualified opportunity fund or QOF is an investment vehicle that's organized for the purpose of investing in opportunity zone properties or businesses. In other words, it's a pool of funds for opportunity zone investments.

A qualified Opportunity Fund provides professionally managed investment services which permit investors to capture the benefits of opportunity zone investments without the investors having to evaluate the feasibility of individual projects.

A qualified opportunity fund also eliminates for the investor the ongoing responsibility of asset management that's typically associated with equity investments. At least 90 percent of the investments of an -- of a qualified opportunity fund must be eligible opportunity zone investments.

The National Council of State Housing Agencies, or NCSHA, estimates as of March 24, 2022, there were 242 qualified opportunity funds that have raised $49.18 billion for opportunity zone eligible investments. Roughly 60 percent of these targeted investments were in housing and community development.

So, what real estate projects are eligible for opportunity zone investment? The key IRS requirement for real estate investment in an opportunity zone relates to land and building ownership and use.

When an opportunity zone investor invests in real estate, as opposed to other eligible business activities, the property must be a qualified opportunity zone business property. This means it must meet the following IRS requirements.

The property is used in a trade or business of the qualified opportunity fund or in a qualified opportunity zone business. This requirement may sound confusing, but the idea is that only new investment in an opportunity zone is eligible for tax relief that the opportunity zone program provides.

Other IRS requirements for being a qualified opportunity zone business property include the property having been purchased after December 31st, 2017, the original use of the property commenced with the qualifying opportunity fund or the qualifying opportunity zone business, or

qualifying opportunity zone business or the property was substantially improved by the qualifying opportunity fund or the qualifying -- qualified opportunity zone business.

During substantially all of the time the qualified opportunity fund or the qualified opportunity zone business held the property, substantially all of the use of the property was in a qualified opportunity zone. Another IRS requirement is that new construction improvements or rehabilitation qualifies as an existing, tangible property that requires an additional investment.

In addition to the requirements that I just stated, the Qualified Opportunity Fund must substantially improve the property within 30 months of acquisition. Remember that affordable housing developments are an eligible business for opportunity zones.

All right. Affordable housing funding can be combined with opportunity zone investments. Opportunity zone investments can be used in conjunction with public funds or with other investment vehicles, such as LIHTC, low-income housing tax credits, new market tax credits, or historic tax credit programs. These sources can help ensure that investors have a reasonable rate of return and can help minimize project risk.

The net effect of combining public funds or tax credits with an opportunity zone generated investment is an increase of capital available for the transaction and helping to fill the financial gaps in affordable housing transactions such as those that include HOME funds in the capital stack.

Opportunity zones are still relatively new. To date, only a few investors have developed affordable housing projects. As developers and investors learn more about affordable housing development opportunities, there is potential for more to be done.

Additional opportunity zone resources include HUD's Opportunity Zones website, which houses resources like the Opportunity Zone Best Practices Report. You can also join the HUD Opportunity Zone mailing list, and you can explore your community's opportunity zones here.

The IRS CDFI website allows you to pull financial -- final regulations and to view frequently ask questions. You can also find a list of designated qualified opportunity zones here.

HUD has a Community Leaders Opportunity Zones Toolkit, and this toolkit offers two volumes. Volume one serves as an introductory guide, and volume two offers local best practices and case studies.

The IRS has an opportunity zone frequently asked questions website where frequently asked questions or broken down into specific categories for convenient access to important information.

And finally, NCSHA, or the National Council of State Housing Agencies, Opportunity Zone Fund Directory is a compilation of publicly announced funds formed to attract investments in opportunity zones.

Now, we'll transition to discuss the HOME program basics, specifically as they relate to opportunity zones.

So, let's begin with the question, what is the HOME program? For those of you from participating jurisdictions, you probably already have some base knowledge of the HOME program. This section of the presentation will review the HOME requirements you need to ensure potential opportunity zone investors are aware of for projects in which they're considering purchasing an equity stake.

Start by making sure they understand foundational elements of the HOME program. It's a formula block grant that provides annual allocations to state and local participating jurisdictions or PJs. And the primary intent of the HOME program is to produce affordable housing for very-low and low-income houses -- households.

So next, let's explore what potential opportunity zone investors need to know about the HOME program. Opportunity Zone investors may not be familiar with the HOME program and its requirements to ensure housing affordability for low and very low-income households.

So, when meeting with potential partners for an opportunity zone investment, HOME PJs will want to brief them on HOME requirements and the PJ's process for making awards. PJ staff should explain their process for identifying and reviewing potential projects and point out any specific requirements that could impact a project's timeline or costs.

The eGuidebook that we referenced earlier in the presentation includes a checklist for topics to cover. Specifically, the PJ should review an overview of the HOME PJs and allocations, eligible activities under HOME, HOME eligible and ineligible costs, eligible and prohibited fees, eligible forms of HOME assistance, project review requirements, key HOME rental housing requirements, and other federal requirements.

So, as mentioned on the previous slide, PJs should explain the -- to potential partners that the HOME investment partnership program is a formula-based entitlement program whose primary purpose is to provide affordable housing for low and very low-income households.

PJs may also want to explain some of the basic mechanics of the program, such as that HUD makes an annual HOME allocation of funds to eligible localities, states, and consortia of local jurisdictions that join forces to receive and administer HOME funds, the amount of each PJ's allocation is based on the annual congressional allocation and distributed through a needs-based formula, and they should know that state PJs always receive a minimum of $3 million annual allocation.

So, as many attendees probably know, HOME has four primary eligible activities. Those are rental housing acquisition, new construction or rehab, homeowner or homeowner-occupied rehabilitation, homebuyer housing acquisition, new construction or rehab, including direct assistance to eligible homebuyers to purchase housing, and tenant-based rental assistance or rental subsidy.

Opportunity zone investors tend to seek out large-scale projects in order to invest substantial capital gains and to earn sufficient returns on their investments. The HOME eligible project type that best fits what the opportunity zone investor needs and is most likely to be attracted to is rental housing.

While HOME ownership investments are not prohibited by the opportunity zone program, the long-term nature of an opportunity zone equity investment would present a challenge in the event the owner needs to sell the property before the investment period is complete.

Identifying deals where this could work and explaining the terms to inexperienced HOME assisted homebuyers would be extremely difficult. So, in other words, opportunity zone investments in HOME funded home ownership housing may be infeasible.

Depending on the PJ and the potential project under discussion, HOME PJs may want to explain that the PJ could administer its HOME program itself, or it can partner with state recipients, sub-recipients, or contractors. HOME PJ's can also work directly with owners, nonprofit or for-profit developers, or sponsors to carry out HOME activities.

As opportunity zone investors consider where to target their funds within the project, they should be aware of what HOME can pay for. HOME eligible project costs include housing hard costs and soft costs, and again, that pertains to new construction, rehab, conversion, or reconstruction.

Eligible project costs also includes site improvements, refinancing of existing debt when the project includes HOME funded rehab, rehabilitation, acquisition of land, vacant, improved and unimproved as long as construction will begin within 12 months.

Eligible project costs also include demolition. Again, construction must begin within 12 months. Relocation costs, if there are existing eligible residents that will have to move because of the project under the Uniform Relocation Act, and initial operating reserve during lease-up and pre-development costs.

So, now, let's review some HOME ineligible costs and prohibited activities under the HOME program. While this list is not exhaustive, this slide lists ineligible costs that are most relevant for discussion with potential opportunity zone investment partners, such as project reserve accounts and operating subsidies, rental assistance for existing Section 8 housing, assistance to a project previously assisted with HOME funds.

Acquisition of property owned by the PJ, excluding property that's acquired by the PJ with HOME funds and delinquent taxes, fees, and other charges for the PJ are all ineligible costs, costs that are not directly allocable to HOME assisted housing, such as commercial space in a mixed-use development or market rate housing units within a mixed-income housing development. Those are ineligible.

PJs also cannot charge servicing, origination, or other fees for the purpose of covering costs of administering HOME. You can review the HOME regulations at 24 CFR Part 92.214 for a complete list of prohibited activities and costs.

Opportunity zone investors will be interested in the fact that nearly all forms of assistance are eligible. HOME PJs determined the form of assistance and the terms of assistance that they find most appropriate for their program. HOME permits PJs to provide financial assistance as interest or non-interest-bearing loans, which include traditional amortizing loans with rates and terms determined by the PJ, deferred loan payment -- payment loans, and loans that are forgiven over time.

HOME also permits PJs to provide financial assistance as -- in the form of grants, interest subsidies or interest rate write-downs, loan guarantees, equity investments, construction financing, permanent financing, and other forms of assistance with HUD approval.

PJs should make potential opportunity zone investors aware of the restrictions on HOME projects to ensure the housing meets the intent of the program. Before reviewing the restrictions that apply to the HOME assisted units, PJs should explain that HOME funds and related restrictions are targeted to specific units. PJ should describe its method of determining the number of units in a project.

So, said another way, the income and rent restrictions don't necessarily apply to 100 percent of the units in a rental project, and the opportunity zone investors should understand how the HOME units are determined. They should also understand that HOME funds may be used in mixed-income housing or in mixed-use development. So, the opportunity zone project does not have to be 100 percent affordable housing.

The PJ should also review the key HOME rental housing requirements. First, for HOME assisted units, eligibility is restricted by income. HOME assisted rental housing is primarily targeted to low-income and very low-income houses and must never be occupied by tenants that are not low income at initial occupancy.

Low-income and very low-income households are defined as those that have an annual gross income that does not exceed 80 percent and 50 percent of the area median income, respectively. However, because of the HOME program rule which requires that 90 percent of rental units assisted in a year -- in a year with HOME funds served -- serve under -- serve households under 60 percent AMI, many PJs restrict all HOME assisted units to households earning no more than 60 percent AMI.

So, to say that again, there is a HOME program rule that requires that 90 percent of all of the PJ's rental units within that year serve households under 60 percent AMI. So, even though households could be served at 80 or 50 percent AMI, many PJs restrict all HOME assisted rental units to households earning no more than 60 percent AMI to ensure that their portfolio meet that HOME program role. Depending on the PJ's policy, they may want to simplify and only mention the 60 percent AMI limit.

The PJ should also address the project rule and that at least 20 percent of the units must serve very low households earning no more than 50 percent of area median income, if the number of HOME units in the project exceeds four.

So, for HOME projects that have HOME units of five or more, at least 20 percent of the units must serve very low-income households, earning no more than 50 percent of the area median income.

Finally, the PJ should ensure that potential opportunity zone investors understand that owners must verify tenant income at initial occupancy and must re-determine income eligibility annually during the affordability period.

The HOME program also has certain rent restrictions. The financial feasibility of the project will be important to the opportunity zone investor. So, it's critical that they understand HOME rent restrictions so that they can project performance.

As PJ's are well aware, owners must not charge rents that exceed the HOME rent limits for that unit size. As we mentioned -- as we just mentioned, in projects with five or more HOME assisted units, at least 20 percent of the units must be restricted at affordable -- and affordable to households at or below 50 percent area median income.

These units are designated as low HOME rent units, and the remaining units that serve low-income households are designated as high HOME rent units. The unit rent may not exceed the applicable HUD published high and low HOME rents for those unit types.

PJs determine how many units in a project are high or low HOME units in accordance with the HOME program requirements. Owners must maintain this unit mix throughout the affordability period.

Keep in mind and ensure the opportunity zone investor understands that the rent limit includes utility costs. If the tenant pays for any utilities, the owner must deduct a utility allowance from the rent -- from the HOME rent limits to determine the maximum rent that can be charged. Also, ensure that the investor understands that the PJ must approve rents annually.

So, I've mentioned a couple of times the affordability period. HOME assisted rental housing must remain affordable, so within the income and rent restrictions that we just talked about throughout the affordability period.

This period ranges from five years to 20 years and is determined by the activity, whether it's acquisition, rehab, new construction, or refinancing, and in all cases, except for rental new construction, which has a minimum of 20-year affordability period, regardless of the level of HOME investment, the amount of the average HOME assistance per unit in the project.

In many cases, unless the per unit HOME investment is smaller and only triggers a five- or ten-year affordability period, the minimum HOME affordability period will exceed the minimum length of time that the investor will need to hold an ownership interest in order to realize maximum benefits from the opportunity zone program. So, we'll discuss the affordability -- HOME affordability enforcement on the next slide.

The opportunity zone investors should also know that, upon completion, HOME assisted housing must meet state and local codes and other HOME specific property standards and that ongoing property conditions standards also apply throughout the affordability period.

Once the PJ completes a pre-commitment review and before it disperses HOME funds to a project, the PJ must commit funds to the project by executing a legally binding written agreement with the project owner. To ensure the opportunity zone investor understands their responsibilities, PJs should review the required provisions with the opportunity zone investor much earlier in the process than the point at which it's sent for signature.

PJs will want to review the recordkeeping and reporting requirements that they will impose on the ownership entity, of which the opportunity zone investor will be a part, so that they understand their documentation responsibilities. PJs and their partners must maintain records that demonstrate compliance with all HOME requirements.

PJs may want to provide potential investor -- potential partners with copies of the reports that they will require during the affordability period. At a minimum, this is going to include a rent and occupancy report and financial statements that demonstrate the property's financial performance and viability.

So, during the affordability period, PJs must monitor properties to ensure continued compliance with rent restrictions and income eligibility requirements. So, the table on this slide indicates the applicable affordability period based on the type of activity and the level of HOME investment.

The affordability period is generally enforced through a covenant, sometimes called a restrictive covenant or deed or use restriction, that is recorded against the project -- the property. This restriction remains in force throughout the affordability period. If the HOME affordability requirements are not met for that full length of time, the PJ is responsible to repay the HOME investment in the project to HUD.

Now, in most cases, because the PJs do not want to be on the hook to find a nonfederal source to repay HUD, the HOME written agreement will require that the project owner repay the HOME funds invested for the PJ to return to HUD. A potential opportunity zone equity investor should understand this repayment requirement if the property does not meet the HOME affordability provisions.

PJs should also ensure that the opportunity zone investor not only understands the HOME program requirements contained within the HOME rule but also all the other federal requirements that will apply to the project. These requirements are also called cross-cutting requirements, and they include requirements to ensure applicants and tenant civil rights, such as nondiscrimination and affirmative marketing, environmental review, and ensuring that the project has the appropriate clearance prior to any choice limiting actions.

Since the acquisition of a property will likely be part of the project, opportunity zone investors should understand the notice requirements associated with acquisition as well as any existing tenants' rights to relocation benefits. If applicable, the potential opportunity zone investors

should know about prevailing wage and Davis-Bacon and associated requirements, as well as lead-based paint for buildings constructed prior to 1978.

Potential opportunity zone investors should also understand the parameters around conflicts of interest. And finally, they should know their responsibility under the VAWA or Violence Against Women Act, to protect and serve people fleeing domestic violence and related situations.

More information on each of these federal requirements can be found in the eGuidebook referenced earlier.

Additional HOME resources include the Building HOME Online Training. This is a self-paced online training that provides a comprehensive overview of the HOME program, eligible activities, and the associated requirements.

Of course, the HOME Final Rule at 24 CFR Part 92 is your source document when looking for HOME program requirements.

And finally, since we anticipate opportunity zone investors would largely, if not exclusively, be interested in HOME funded rental housing, we've pointed you to that topic on the HUD Exchange with lots of rental housing focused guidance, resources, and trainings.

So, now, I'll turn it over to Carrie Kronberg to give an overview of using HOME with opportunity zones. Carrie?

Carrie Kronberg: Great. Thank you, Andelyn.

So, there we go. So, now that we've covered the basics of what opportunity zone investors should know before they combine forces with HOME funds in an affordable housing project, let's move on to what PJs should know and understand about using HOME funds within opportunity zones.

So, what types of projects and activities can PJs seek out in the opportunity zone? So, generally, there are two ways that PJs can take advantage of the HOME investment opportunities presented when combined with opportunities on capital.

Most directly, PJs can help HOME projects secure opportunity zone generated funds to help develop affordable housing in the opportunity zone. By including an opportunity zone investment in the capital stack, the HOME funds needed for the project will be reduced, and that can help stretch limited public funds for affordable housing.

HOME funds are for affordable housing; right? And they can help finance 100 percent affordable properties. But because of the way funds are targeted to specific units, as Andelyn covered earlier, they can support a wide range of rental and homeownership housing project types, large and small projects, mixed-use and mixed-income developments.

HOME funds can pay for the affordable units and a fair share of common costs, and they can also pay a proportional share of some limited infrastructure development to support these ventures. Opportunity zone equity and other sources would need to fund costs that aren't HOME eligible.

Also, keep in mind that many large institutions and companies benefit from housing development that helps stabilize the neighborhoods near their campuses. In addition, these housing developments can provide a source of affordable housing for their lower income employees. So, corporations with a prominent presence in the community may have their own capital gains that they wish to invest in opportunity zones for tax purposes.

So, then combining HOME financing and workforce housing can be a way for participating jurisdictions to tap the resources of certain institutional investors and ensure that some of the workforce housing is targeted to low-income and very low-income households.

Keep in mind that PJs may only limit beneficiaries or give preferences to particular segments of the low-income population if that's described in their consolidated plan and annual action plan. So, therefore, PJs that pursue workforce housing must make sure those tenant preferences are included in those planning documents.

Indirectly, if appropriate housing development projects don't immediately exist, PJs may wish to work with other agencies or developers and investors to support other investments in an opportunity zone that could benefit residents of nearby HOME assisted housing.

So, continuing on with this topic, another activity -- a category of activities to consider advocating for is economic development activities that complement existing or planned affordable housing, such as infrastructure improvements or maybe working capital for local businesses.

Opportunity zone investors may provide an influx of capital to the community, which is the intent of the program, and that can stimulate and support both economic and housing development.

So, PJ's may want to identify and encourage economic development activity that complements or supports existing or planned HOME financed housing and its residents. So, PJ's can seek out or encourage investors to capitalize economic development initiatives that will support nearby affordable housing developments and their residents, such as grocery stores or other commercial services.

PJs may also encourage investment in businesses in the opportunity zone that could generate jobs for nearby affordable housing residents. Remember, while opportunity zone equity is often invested in real estate, that's not a requirement. PJs and investors can identify other economic development initiatives in the opportunity zones, such as working capital for new or existing businesses.

PJs can also coordinate infrastructure improvements to support affordable housing and opportunity zone investments. So, jurisdictions can also target local capital improvement funds to upgrade existing infrastructure to maximize the redevelopment impact in the opportunity zone.

Many successful redevelopment strategies begin with significant and coordinated investment of public funds, which then spurs additional private investments; right? Money attracts more money. That's leverage. PJs can work within their jurisdictions to coordinate these investments and ensure they support the PJ's affordable housing investments as well.

So, how can a PJ find potential opportunity zone investors who might be motivated to invest in HOME projects?

If the right network exists, PJs may be able to identify and recruit high wealth individuals or corporations with capital gains that may be interested in investing in opportunity zones within the PJ's jurisdiction. But without an existing relationship, identifying and approaching specific individuals and companies could be challenging or awkward.

We introduced qualified opportunity funds earlier in the presentation, and it might be easier for a PJ to approach an established qualified opportunity fund for investment. These funds were specifically created to take advantage of the flexibility opportunity zones provide to investors, and their administrators will likely be open to discuss potential investment opportunities in the PJ's community.

There are existing online resources that can help PJs identify qualified opportunity funds operating in their communities. So, for instance, the National Council of State Housing Agencies, or NCSHA, maintains a database of qualified opportunity funds that have been publicly announced.

There's also an opportunity zone database that lists the qualified opportunity funds that chose to register with that system. So, the functionality differs between these two databases, but they both allow the user to filter by location and the focus of investments. So, an opportunity fund could be focused on real estate and affordable housing, or it might just be focused on economic development.

We'll get more into investor motivation on the next slide, but when approaching any opportunity zone investor, remember their primary motivation is to invest capital gains and minimize the associated tax burden.

So, promised we'd talk about motivation. Opportunity zone investors may be motivated by multiple purposes, but most, as mentioned, are primarily driven by either profit or mission, as investors will look for financially sound projects, but mission driven investors may be willing to accept lower rates of return in exchange for public benefits.

Most opportunity zone investors will likely fall into the profit driven investors category in which they seek to maximize the financial return on their investment. In order to do this, to maximize

their return and receive the greatest benefit from the capital gains provisions associated with an opportunity zone project, the investor has to remain in the partnership for at least ten years.

Profit driven investors will likely want to exit the partnership as soon as that minimum period is complete because there are no additional financial benefits to them if they leave their funds in the investment for a longer period. So, PJs and developers working with a profit driven opportunity zone investor will need to consider the investor's exit strategy during underwriting.

We'll talk more about this when we get into challenges a bit later. But in short, the 15-year low-income housing tax credit and up to 20-year HOME affordability periods complicate the use of opportunity zone investment funds in tax credit and HOME affordable housing projects, given that misalignment in the minimum investment and compliance periods.

So, PJs may therefore want to consider finding mission minded investors who are willing to forgo shorter term gains by leaving their investment in the property for longer than that ten-year opportunity zone requirement.

Additionally, these kinds of investors, particularly if they're local or regional, they may already have ties to the community and may be driven to engage the community for input and ensure that opportunity zone investments have a broader benefit.

Mission minded investors operate both locally and nationally, and you can find local and regional investors in this category by using the databases linked from the previous slide. But here we've also listed two national mission driven investors, the Local Initiative Support Coalition and Enterprise Community Partners. You can access their sites from the links here.

So, now, let's talk specifically about how to find and take advantage of opportunities for using HOME funds in combination with opportunity zones. We'll go step by step through a number of considerations and actions that PJs can take.

So, how can PJs identify opportunity zone investment potential? So, for PJs seeking to work with developers and investors in opportunity zones, it's critical to be proactive. First, PJ staff should learn as much as they can about the opportunity zone program and the location of any opportunity zones in their communities, if staff are not already involved in efforts related to opportunity zones within the jurisdiction

In many cases, especially in large states and large local jurisdictions, the department or agency involved in attracting and facilitating development in the opportunity zones may be different from the department or agency that administers the HOME program. So, HOME program staff may need to get up to speed on the local efforts and program.

As part of this, PJs should identify the boundaries of the opportunity zones within their area and determine whether any proposed HOME projects in the pipeline are located within the opportunity zone. That's a -- that would be a really great opportunity if there was already a project coming down the pike.

If there are planned potential HOME projects within the boundaries of the local opportunity zone, then the PJ may want to encourage developers to seek opportunity zone equity as an additional source of gap financing, if they're not already considering it.

But in many cases, housing developers lead the effort to identify affordable housing sites and attract funding sources, and that includes submitting competitive applications for HOME funds. So, they may already be aware of the opportunities presented by locating a project in an opportunity zone.

Next, PJs can assess the viability of affordable housing in the opportunity zone. So, while the PJ is going through its planning and consolidated planning processes, the PJ can evaluate opportunities for affordable housing investment. PJs might use charrettes and other planning tools to seek input on strategies for future investments within opportunity zones.

When reviewing potential affordable investment opportunities in opportunity zones, PJs can look for potential sites and potential partners and investors. So, they can identify vacant land that might be well suited to new construction. They could also look for older or deteriorating structures in need of rehab that are situated in the opportunity zone and assess whether these sites are appropriate for residential use.

Additionally, PJs should look at whether the local jurisdiction owns any land within the opportunity zone that could be suitable for housing development. When evaluating sites, the PJ's considerations may include things like, what type of housing makes sense here? Is the site more appropriate for rental or homeownership? Low density? High density? What fits in with the surrounding context?

And then looking at that zoning and context to determine the appropriate size and scope of the project, PJs should do preliminary financial calculations. Do those suggest that a HOME assisted project is feasible on the site? And then if a site isn't already publicly owned, does a preliminary site control assessment indicate that the site could be attainable for affordable housing development? So, if it's privately owned, is there likely to be a willing seller?

And next, we'll look for potential development partners. So, typically, the opportunity zone investor seeks investment opportunities but is not the developer. For PJ's working to attract affordable housing development in a local opportunity zone, they should identify potential project sponsors or developers interested in pursuing a project. Once identified, the PJ can facilitate introductions to opportunity zone investors, especially if they're mission minded.

And there are a number of resources to identify potential opportunity zone investors. There's guidance provided in the eGuidebook that is a companion to this webinar, and that includes a section on, how can the grantee find potential OZ investors who might be motivated to invest in HOME or HTF projects?

And then PJs might also consider providing incentives to developers who propose projects in the -- in opportunity zones, such as those discussed in the eGuidebook in the section called, how can

grantees create incentives for developers to construct and rehabilitate affordable housing in the opportunity zones?

So, collaboration is critical, as all key team members need to understand the various funding sources, motivation of each of the partners, and the requirements associated with HOME and opportunity zone funding.

So, a little earlier in the presentation, we talked about what opportunity zone investors will need to know about the HOME program. During this collaboration stage, PJs can educate opportunity zone partners about HOME requirements to ensure that these potential partners understand the opportunities and limits of these financial resources. This effort should combine education about the program with promotion of the benefits of HOME to investors and developers.

PJs can share examples of existing HOME funded affordable housing to demonstrate both the quality and stability of well-managed rental projects that have been underwritten and funded to ensure long-term viability. Based on available data, the PJ may also be able to demonstrate the need for affordable units and the challenges low-income households face to find decent, affordable housing in the local market.

So, the eGuidebook includes a section HOME Program 101 Basics, and that can help provide key information that opportunity zone investors need to know.

Additionally, you want to educate participating jurisdiction staff about the opportunity zones, and then PJs may need to educate development partners as well about opportunity zones, how the incentive works, what motivates the opportunities zone investor.

This understanding will help PJs and their development partners ensure that HOME projects are structured so opportunity zone equity investments meets IRS requirements. The Opportunity Zone Basics 101 section in the eGuidebook provides guidance on IRS requirements.

To explore the viability of using HOME in the opportunity zone for a specific project, PJs and their partners can access several tools provided in the guidebook that will help guide collaboration efforts.

So, how can PJs create incentives for potential partners to construct and rehabilitate affordable housing in opportunity zones? There are several ideas that PJs can apply when incentivizing opportunity zone investments in housing.

When the PJ uses a competitive funding process to award HOME funds, they could consider giving preference or additional points to projects that leverage opportunity zone equity investments. They could also seek site specific proposals that align with the comprehensive strategy in the PJ's consolidated plan. That's something we discussed in step two above.

PJs can engage other public departments within their jurisdiction to develop a package of public sector support, such as waiving fees or requirements, for instance, parking requirements, offering density bonuses, or deferring taxes.

PJs should also emphasize the minimization of risk created by including HOME in the financial package. It lowers the amount of private debt that is needed for the project. It helps to ensure more sustainable project financing, and then the PJ may also want to emphasize their own experience administering and complying with federal programs and requirements.

So, there are a number of challenges associated with using HOME funds and in opportunity zones. The HOME program and opportunity zones were created at different times with different objectives. And as mentioned, those -- some challenges will exist when you're combining these resources. So, in this next section, we'll raise some potential challenges and strategies for PJs to overcome them.

When considering HOME investments in an opportunity zone, PJs and their financial partners need to understand there are potential obstacles to address in order to execute a successful transaction. The opportunity zone industry, as we mentioned earlier, is new, and the relationships between parties may be new. So, by addressing challenges up front, at least those that you can identify up front, the parties are more likely to accomplish their mutually beneficial goals.

So, the first challenge may be the learning curve for all parties on the opportunities and challenges that the combination of resources may offer. PJ staff and the affordable housing developer's team may need to educate themselves about opportunity zones, how they work, what motivates opportunity zone investors.

Then, in turn, opportunity zone investors need to learn the basics of HOME and other affordable housing funding sources that could be used in the project so that they're aware of the associated requirements.

Coordinating the requirements of many funding sources may present challenges. Partners will need to communicate needs, concerns, and requirements to each other clearly, and project details will need to be negotiated carefully.

Another potential challenge is the opportunity zone investor might not be used to a high level of government involvement in projects in which they invest. To attract opportunity zone equity to affordable rental housing projects, the grantee may need to emphasize, again, their experience administering federal programs, complying with federal requirements.

The grantee and developer should also be prepared to smartly execute the applicable federal requirements in an effective and non-threatening way.

As we've discussed, the affordability period is up to 20 years for HOME projects. Opportunity zone investors seeking to maximize their financial return will typically invest in projects for a period of 7 to 10 years. If an investor requires that maximum financial return, as we've talked about a little bit earlier, they may seek a viable exit strategy that includes the financial restructuring of the project at a period that's consistent with their objectives.

So, some mission minded investors -- I think we've also mentioned this -- may be willing to leave their funds in the deal long enough to match the full extent of the HOME affordability period when the project is rental new construction. However, this is something you want to think about at the outset.

If the parties anticipate that the opportunity zone investor will exit the project before the termination of the HOME affordability period, the PJ, the developer, and the opportunity zone investor will need to agree upon and carefully map out that exit strategy.

An opportunity zone investor has its own constraints to manage once a capital gain is recognized. The investor generally has 180 days to invest in eligible gain in an opportunity zone qualified project, if they're investing in an individual project, or they have that period of time to put their money into a qualified opportunity fund.

And of course, PJs can't make a commitment of HOME funds until all other funding sources are identified and the PJ has done a pre-commitment review of the project's feasibility, including an environmental review and underwriting and subsidy layering review.

So, PJs, developers, and opportunity zone investors will need to plan for and manage these timing considerations for an equity investment to be effectively executed with an individual opportunity zone investor. Effective communication about the constraints of PJs and the timing of their processes is very important for the success of a project.

Likewise, opportunity zone investors will need to communicate clearly about their deadlines, and PJs may need to adjust their processes to prioritize opportunity zone projects and address those timing needs.

Lastly, a high rate of return may not be realized in affordable housing projects. So, when they can, PJs should seek mission minded investors for this activity and could also consider creating mixed-use or mixed-income projects that could potentially foster higher returns to attract more profit motivated investors.

The sources in a capital stack for an affordable rental project that uses HOME funds will vary depending on the nature of the project. In some cases, there may be only one or two sources of funds, but it's far more likely that there will be three or more.

So, typically, sources include debt or a first mortgage loan, at least one source of soft debt from the government, which will include the HOME funds, a third-party equity investor such as the opportunity zone investor, and in many cases a general partner or developer will contribute equity as well, including a deferred developer fee from the developer.

Ensuring that the requirements for each funding source are met can be challenging. And, as always, collaboration, communication is the key to success. So, partners need to understand the needs and requirements of each funder, and project details should be carefully negotiated so all requirements are met. Thoughtful and patient coordination is especially important if the parties have not worked together in the past.

So, the HOME affordability period, as we've mentioned, differs from the opportunity zone investment period. So, let's talk a little bit more about that. PJs may be able to identify projects where the affordability period matches the investment period, or they may be able to structure projects to limit the affordability period.

The affordability period for HOME rehabilitation projects, remember, is based on the per unit HOME investment. So, projects that require only modest rehabilitation or that are able to secure additional funding to reduce the HOME per unit investment below $40,000 per unit, those will carry a shorter affordability period, ten years or less, and that could potentially coincide or at least align more closely with the opportunity zone investment period.

So, rehabilitation projects might be more feasible and might help those affordability and investment periods align.

And note, too, that some opportunity zone investors or qualified opportunity funds may shy away from investing in HOME assisted projects that require low-income housing compliance periods that extend for time periods greater than that required for an OZ investment. So, that challenge may be too much for them to stomach.

We touched on this earlier, but let's dig in a little bit more on the timing considerations. So, when an investor has a capital gain that they want to invest in an opportunity zone or qualified opportunity fund to take advantage of tax deferment, they have 180 days from when the gain is realized to close on the investment. And that's a pretty tight timeline in the affordable housing industry.

The low-income housing tax credit application process often takes several months before the developer will know if they've secured an allocation of credits. And as PJ staff are aware, HOME funds can't be committed to a project until it has been thoroughly underwritten, the environmental review is complete, and all other sources are committed.

So, the developer will need to carefully choreograph these timing considerations to ensure all applicable deadlines and milestones are met by closing. And the PJ, as we talked about earlier, should do what they can to help their process account for these deadlines.

So, though Congress has waived the HOME commitment deadline for the past several years, typically, in the past, PJ had only 24 months to commit funds from the time HUD signed the grant agreement. Some PJs run annual or biannual competitive application rounds, and that timing could conflict with the tight deadlines for the opportunity zone investment.

Relatedly, if a project will seek low-income housing tax credits, the developer must also coordinate the application within the timetable of the state agency administering the low-income housing tax credit program.

Developers need to budget for their total development costs based on the assumptions of the opportunity zone and other project equity, such as low-income housing tax credit equity, if

applicable, that may be available to the project. So, as mentioned earlier, HOME gap funding must be committed last after all other sources are committed, and that's also the point at which the amount of HOME funds is finalized.

So, as we've said and just to reiterate, grantees, developers, and opportunity zones will need to plan for and manage these timing considerations for an equity investment to be effectively executed.

Again, clear and open communication about the constraints of grantees and the timing of their processes, such as an environmental review, subsidy layering reviews, and related requirements that must occur prior to commitment is very important for the success of the project.

And then, as we've said, opportunity zone investors need to be open and clear about their deadlines and, as suggested, grantees prioritizing opportunity zone projects may want to look at their processes to accommodate those timing needs.

So, we're going to close this session by presenting a case study, which is an adaptive reuse project that successfully combined HOME funds with opportunities zone equity. The Ox Fibre Apartments in Frederick, Maryland, is an 83-unit adaptive reuse project, and it transformed a 19th century warehouse into affordable housing.

Given the site's location in an opportunity zone census tract, the developer was able to access $830,000 of opportunity zone equity to help finance the approximately $27 million historic property renovation.

In addition to the opportunity zone investment, the capital stack included a tax-exempt bond financed first mortgage loan from a private sector lender, equity investments that resulted from both historic tax credits and 4 percent low-income housing tax credits that were available through that tax-exempt bond issuance, $2.5 million of HOME funds, and local Frederick County debt.

The conversion of the Ox Fibre warehouse into a vibrant resource for the community was a long-held priority in the Frederick community, and the developer of the property, Equity Plus, was a driving force in marshaling the varied financial resources necessary to facilitate the renovation of the property.

The designation of the site in an opportunity zone was key to securing that opportunity zone equity, and that helped to fill financial gaps and spur the development of the property. The project created a new source of affordable rental apartments for the area residents and provided a viable next chapter for this historic structure.

So, the developer shared that one of the lessons learned in combining equity made available to the project as a result of LIHTC with the equity generated because of the location of the project in an opportunity zone was the importance of understanding the varied motivations of each of the respective equity investors.

So, the motivation of a low-income housing tax credit equity investor is driven from the tax benefits associated with future earnings; right? They're getting tax credits to offset their tax liability over ten years in the future. And that investment is dependent on projecting a profitable earning position during the period of project operations, and that's over 15 years of the compliance period.

In contrast, the OZ investor's motivation is dependent on receiving financial benefits from deferring the payment of capital gains generated from a prior investment and generating additional returns as a result of an investment in an opportunity zone property.

So, developers of future low-income housing tax credit properties located in opportunity zones similarly may have to generate equity investments from investors that have diverse needs and motivations, and that knowledge will be key to attracting capital investment in properties similar to the Ox Fibre Apartments.

One final thing to keep in mind is that an infusion of opportunity zone equity is not likely to be the primary source for an affordable housing project because profit driven opportunity zone investors in particular expect higher returns that limits the amount they're willing to invest. Opportunity zone funds should be viewed as a gap source, likely contributing only 5 to 10 percent of the total development costs.

So, finally, we've shared a few resources throughout the presentation, and we have one more slide with some final additional resources for you to access.

So, HUD has an opportunity zone website, and that includes resources and maps.

Of course, the IRS oversees the opportunity zone program, and they have their final regulations, as well as frequently asked questions available on their website.

The Economic Innovation Group or EIG has an activity map that shows activities that have taken place in opportunity zones around the country.

There are also lists of opportunity funds available on Novogradac and NCSHA's websites. I think we've mentioned at least NCSHA earlier in the presentation.

And then, of course, Building HOME. These training modules provide valuable training and basics on the HOME program itself to potential investment partners.

And then if you're looking for opportunity zones in your jurisdiction, there are a number of additional resources to map those opportunity zones, and those are linked here. So, you have the Enterprise Opportunity 360 site, policy map, Urban Institute's Community Impact Assessment Tool, as well as the MasterCard Inclusive Growth Score.

So, that's the conclusion of this presentation. We want to thank the U.S. Department of Housing and Urban Development's Office of Affordable Housing Programs for sponsoring this webinar,

as well as attendees who watched this presentation and made it to the end. I hope you all have a wonderful day, and thanks again for joining.

(END)