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What State and Local Governments Can do to Support Federal Opportunity Zones Investments

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Developers and investors in affordable housing and community development have continued to find ways that the federal opportunity zones (OZ) incentive can be used to provide affordable and mixed-income housing options in low-income census tracts.

In this article, affordable and workforce housing are defined as housing for families and individuals earning up to 80 percent of the area median income (AMI).

The affordable housing community has relied on the low-income housing tax credit (LIHTC) incentive to create new low-income housing units. In fact, LIHTC has supported more than 2 million units of affordable housing for families earning 60 percent of the AMI or less since its inception in 1986. Alternatively, the OZ incentive does not have specific affordability requirements and does not create a subsidy or incentive to provide low-income housing.

The OZ incentive brings new sources of capital to low-income neighborhoods. It relies on investors with capital gains dollars to invest into real estate–and, as we know, this set of investors does not always overlap with the long-standing LIHTC investor base–mainly banks and insurance companies that invest in affordable housing partly to meet Community Reinvestment Act (CRA) obligations. However, with public policy initiatives and the right investors, the OZ incentive can be used to provide affordable housing to families earning up to 80 percent of the AMI, with targeted local support in place

So, how can cities and states incentivize developers to ensure that OZ developments have some set-aside

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of affordable units? Market-rate multifamily developers are motivated to maximize cash flow, and capital gains investors want to maximize the value of the property in Year 10 to obtain the maximum tax benefits. But, restricting units at a specific income level does the opposite, reducing cash flow and profits and potentially reducing the appreciated value in Year 10 (cornerstones of the OZ program). To bridge that, state and local governments can create incentives that encourage a set- aside of affordable (80 percent AMI) units, provide a structure that attracts profit-motivated developers and investors, and meet the goals of the community as well.

Following are examples of what local governments have done to incentivize the provision of affordable/ workforce housing in OZs:

1. **Leasing city-owned land to developers:** One of the larger costs of construction is the cost of the land. In Charlotte, N.C., the city decided to provide a long-term lease on specific city parcels at a minimal amount ($1,000 annually) if the developer agreed to restrict 50 percent of the units to families earning at or below 80 percent of AMI for a 20-year period. The developers could rent the remaining units at market rents. This structure reduced development cost and debt, improved cash flow and offered the possibility of appreciated value, all while providing a market rate of return for a social-impact-oriented investor.
2. **Providing city-owned land for $1.** This is another option for cities with additional land inventory in OZs by again agreeing to provide land for a minimal cost, but only in exchange for the set aside of 20 percent to 50 percent of the units at restricted rents and for income-restricted tenants.
3. **Property tax abatement.** Some municipalities will offer property tax abatement to developers that set aside a percentage of units for households that are at or under a specified AMI. In Seattle, the Multifamily Property Tax Exemption (MFTE) program provides a tax exemption on eligible multifamily housing in exchange for the developer setting aside at least 20 percent of the units as income- and rent-restricted for at least 12 years. Restricted units (up to 85 percent of AMI) are allocated proportionally across all unit sizes. This program is one way that the city supports mixed-income residential development in the urban centers. Other municipalities have agreed to provide partial tax abatement if units are rent restricted at 80 percent of AMI for a specified period or if there is a nonprofit partner involved in the development.
4. **TIF dollars as soft financing.** Municipalities that have tax increment financing (TIF) dollars can use those funds to provide soft financing to a project at low interest rates or can provide the dollars to a developer to be used to fulfill its general partner capital contribution requirement (usually between 5 percent and 10 percent of the total equity in the deal). Both scenarios, again, help to reduce the amount of the amortizing first mortgage and allow the municipality to require a set aside of affordable units in the proposed development.
5. **CDBG funds.** Cities or states with Community Development Block Grant (CDBG) dollars may want to allocate them for site improvement work at OZ projects, but only if there is a set aside for affordable units.
6. **HOME funds.** U.S. Department of Housing and Urban Development (HUD) HOME funds can be provided as low-cost loans to a property that is setting aside units at 80 percent of AMI for a specified period. This will help to reduce the permanent loan, allowing for sufficient cash flow, even with rents at restricted levels. The issue here is the term of the HOME funds, the term of the restrictions, and the ability of the developer to

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sell or refinance at the end of the 10-year OZ investment period.

7. **Reduction in permitting costs.** In some municipalities, permitting costs are a way to bring in additional tax dollars. However, a municipality may provide for a reduction in permitting costs in exchange for a minimum set aside of units as affordable.
8. **Prospectus on developable site in OZs within the city or county.** Some cities or counties have put together a list and map of all of their OZ areas within their boundaries, identifying those sites that the city or county is prioritizing for development within its city or neighborhood improvement plans. States could assist with this planning as well. This helps to direct developers to areas that a city deems to be most important for development. Cities can also agree to expedite zoning and permitting approvals for these sites. And, they can agree to sell city-owned parcels for minimal price or to lease the properties in exchange for a set-aside of income and rent-restricted units.
9. **State technical, grant, loan assistance.** Oregon recently approved additional funding for the Greater Oregon Housing Accelerator program, which helps local governments increase workforce housing in conjunction with local companies, through technical assistance, grants and/or small loans–especially in rural communities. This initiative was passed at the end of 2019 and is being administered through Oregon Housing and Community Services.

The Local Initiatives Support Corporation (LISC), in conjunction with the Council of Development Finance Agencies and with the support of the Ford Foundation, has published an online Playbook: Navigating the Opportunity Zones: Community Partners that is also a good resource for state and localities to review when considering how they can use their resources to support developments in Opportunity Zones. See www.lisc.org/opportunity-zones/community-partners-playbook/.

With planning and with the right programs in place, local and state governments can help incentivize developers to include more affordable housing units in OZ developments. Because the federal OZ incentive does not require specific targeting for affordable/workforce housing or for employment of local residents, states and local governments must instead rise to the occasion to create these benefits for their communities.

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