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NONPROFIT PARTICIPATION IN PLACE-BASED TAX INCENTIVE TRANSACTIONS

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INTRODUCTION

In a marketing presentation to investors, real estate investment fund Airo Capital Management described its vision for a new, multifamily residential development in Baltimore, Maryland.[1] The market-rate rental project would include 423 residential units, 212 parking spaces, and "additional amenities."[2] Full-color "design concept" photos depicted a rooftop bar; a long outdoor pool glowing in night lights; a game room featuring retro Pac-Man machines and a grey pool table; and a mirrored gym full of aspirational new exercise equipment.[3]

The proposed location was "in the heart of Baltimore City . . . and minutes from Johns Hopkins, the University of Maryland, and Mercy Medical Center."[4] According to the developer, the area is "one of Baltimore's fastest growing areas with new large-scale developments surrounding the site underway."[5] The neighborhood has "consistently attracted more tourists, higher incomes and greater retail spending compared to inland locations," and its recent population growth has been fueled primarily by "well-educated millennials, with Baltimore's highest earning income brackets being clustered around the waterfront."[6]

The neighborhood is also an Opportunity Zone, a specially designated area where projects are eligible for tax-subsidized financing under a new federal tax law.[7] The Opportunity Zones law was originally pitched as a tool to help fight urban poverty and improve distressed communities.[8] But nothing in the law prevents developers like Airo from forming a specialized investment entity called an Opportunity Fund to finance its luxury project with tax-subsidized capital. So, it did. Seeking to take advantage of the tax

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1. *See The Village at Fallsway: Multifamily Development, Baltimore, Maryland*, AIRO CAP. MGMT. 1, https://ce-helium-production.s3.amazonaws.com/uploads/fundmeeq/document/file/906a7977-c7a3-4e47-84cd-667a4de44919/NEW+BOOK+The+Village+at+Fallsway_Multifamily+Development_10.06.pdf [https://perma.cc/B8A8-AK6T] (last visited Sept. 23, 2021).
2. *Id.* at 3.
3. *See id.* at 23.
4. *Id.* at 3.
5. *Id.* at 9.
6. *Id.*
7. *See Opportunity Zones*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/opportunity-zones [https://perma.cc/28CU-TX5Q] (last visited Sept. 23, 2021); *see also* I.R.C. § 1400Z-1.
8. Robert Frank, *'Opportunity Zones' Fall Short on Helping Low-Income Communities, Study Finds*, CNBC (June 17, 2020, 12:50 PM), https://www.cnbc.com/2020/06/17/opportunity-zones-fall-short-on-helping-low-income-communities-study.html [https://perma.cc/AHP5-QQ4R].

preference, Airo created an Opportunity Fund and began seeking Opportunity Zone investors through an online platform that connects developers with investors.[9] At the time this Essay was written, Airo was seeking $34,000,000 in Opportunity Fund equity to help finance the $113,000,000 project.[10]

It is not hard to see why many anti-poverty advocates are skeptical of the new Opportunity Zones tax preference and the tax incentive approach in general. Yet, long before there were Opportunity Zones, there were New Markets Tax Credits (NMTCs).[11] Like Opportunity Zones, the federal NMTC program subsidizes investment in low-income areas.[12] And like Opportunity Zones, the NMTC has been criticized for funding projects that may be more likely to spur gentrification than to benefit low-income communities.[13] But unlike Opportunity Zones, the NMTC has often been used to support a variety of impact-investment projects, including community facilities like YMCAs; nonprofit activities like soup kitchens, youth centers, and job training sites; and, sometimes, housing (always with an affordable component).[14] So far, there is little indication that Opportunity Funds have been used to support many of these types of projects.[15]

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9. *See The Village at Fallsway*, OPPORTUNITY EXCH., https://www.theopportunityexchange.com/projectDetail/1148/ [https://perma.cc/C79C-YV8Z] (last visited May 7, 2021).

10. *Id.*

11. I.R.C. § 1400Z-1; I.R.C. § 45D.

12. DONALD J. MARPLES & SEAN LOWRY, CONG. RSCH. SERV., RL34402, NEW MARKETS TAX CREDIT: AN INTRODUCTION 1 (2019), https://sgp.fas.org/crs/misc/R45152.pdf [https://perma.cc/7F48-WV35].

13. *See generally* Roger M. Groves, *The De-Gentrification of New Markets Tax Credits*, 8 FLA. TAX REV. 214 (2007) (arguing the NMTC subsidizes gentrification).

14. *See infra* notes 37–43 and accompanying text.

15. Due to low program transparency, it is difficult to know how many Opportunity Funds are being used for mission-driven investment. It is clear that most Opportunity Fund money is being used for real estate development. *See* Mary Burke Baker, *Opportunity Zones Aren't Just for Real Estate Development*, NAIOP (2019), https://www.naiop.org/Research-and-Publications/Magazine/2019/Spring-2019/Business-Trends/Opportunity-Zones-Arent-Just-for-Real-Estate-Development [https://perma.cc/K29M-FTDR]. It is also clear that at least some mission-driven investors exist, but that they have faced significant challenges attracting funding. *See* BRETT THEODOS ET AL., AN EARLY ASSESSMENT OF OPPORTUNITY ZONES FOR EQUITABLE DEVELOPMENT PROJECTS: NINE OBSERVATIONS ON THE USE OF INCENTIVE TO DATE 18 (2020), https://www.urban.org/sites/default/files/publication/102348/early-assessment-of-ozs-for-equitable-development-projects_0.pdf [https://perma.cc/3J94-9UU7] ("A key challenge[] smaller community-oriented high social impact projects have faced is the inability to attract OZ capital at below-market returns."). Google searches related to nonprofits and

This Essay explains one reason why these two tax incentive programs look so different: where the design of the NMTC creates opportunities for nonprofits to participate in the impact-investment process, the design of the Opportunity Zones law creates barriers. Nonprofit participation in NMTC deals is supported by specific incentives for debt investment in low-income communities, the use of tax credit monetization, and favorable treatment under banking regulations. The absence of parallel features in the Opportunity Zones context creates significant barriers to nonprofit participation in Opportunity Zones deals. Ultimately, these barriers limit the types of projects pursued by most Opportunity Funds.

This Essay proceeds as follows. Section I.A describes how the NMTC has been used to subsidize mission-driven investment in projects that serve low-income populations. It argues that one reason the NMTC program can support mission-driven investment is that nonprofit organizations are common program participants. Section I.B describes three ways that nonprofits participate in NMTC deals as borrowers, nonprofit parents of financial intermediaries, and leverage providers. Part II analyzes whether similar opportunities exist for nonprofits to participate in Opportunity Zone deals, and it argues that, for the most part, they do not. It identifies several barriers to nonprofit participation in Opportunity Zone deals, including statutory limitations that prohibit debt investment in low-income communities, the absence of monetization, and uncertainty about how Opportunity Zone investment will be treated under banking regulations. This research is essential not only for understanding how structural features of the Opportunity Zones law affect program outcomes but also for informing the design of future place-based tax incentives.

I. MISSION-DRIVEN INVESTMENT AND THE NEW MARKETS TAX CREDIT

A. Impact Investment and the NMTC

The phrase "place-based policy" refers to strategies that "direct capital and resources to locales through a selection or designation process,"[16] often with the goal of alleviating poverty through mission-driven investment in place.[17] As used in this Essay, "mission-driven investment" refers generally to investment by actors who are "driven primarily by a

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Opportunity Zones reveal some commentary and marketing materials but no data to suggest that Opportunity Funds are engaging nonprofits with any regularity.

16. Edward W. De Barbieri, *Supporting Small Businesses in Place*, 48 FORDHAM URB. L.J. (forthcoming Oct. 2021).

17. *See* Nestor M. Davidson, *Reconciling People and Place in Housing and Community Development Policy Essay*, 16 GEO. J. ON POVERTY L. & POL'Y 1, 1 (2009).

community development mission" and who seek "to engage residents and local leaders in decisionmaking about development in their communities."[18] An important goal of placed-based policy is increasing the rate and amount of mission-driven investment. This investment may include affordable housing construction or other projects to rehabilitate the built environment or improve local amenities.

In theory, either for-profit or nonprofit investors may participate in mission-driven investment. On the for-profit side, mission-driven place-based investment is a focus of many "social impact investors," who claim to marry private profits and public benefits in "a 'win win' arrangement that will allow private investors to solve pressing social problems while simultaneously accruing a market or near-market rate of financial return."[19] Social impact investment is often supported by public policies, including the use of place-based tax incentives like the Opportunity Zones incentive, which provide tax-based subsidies to private investors who invest in low-income areas.[20]

However, some researchers have argued that social impact investment often fails to deliver the promised benefits to low-income communities.[21] For example, one scholar argues that the "strategy extends the imposition of market rather than community-driven logics of poverty management, reproducing and legitimating a financialized system . . . that reproduces impoverishment instead of eradicating it."[22] Similarly, the Opportunity Zones law has been described as "extractive," whereby profit-seeking investors capture more value from low-income communities than they confer to them.[23] Such critiques cast doubt on whether incentives like Opportunity Zones can effectively promote mission-driven investment by for-profit taxpayers.

Experience with the NMTC, however, suggests that place-based tax incentives can effectively promote mission-driven investment by for-profit

18. THEODOS ET AL., *supra* note 15, at V.

19. Emily Rosenman, *Capital and Conscience: Poverty Management and the Financialization of Good Intentions in the San Francisco Bay Area*, 40 URB. GEOGRAPHY 1124, 1125 (2019).

20. *See* Valerie Grunduski & Casey Veach, *Opportunity Zones Offer Tax Incentives to Impact Investors*, PLANTE MORAN (Sept. 26, 2018), https://www.plantemoran.com/explore-our-thinking/insight/2018/09/opportunity-zones-offer-tax-incentives-to-impact-investors [https://perma.cc/Z6QZ-NNRR].

21. *See* Rosenman, *supra* note 19, at 1126.

22. *Id.* (internal citations omitted).

23. *See* Bruce Katz & Ross Baird, *From Extractive Investment to Community Wealth*, PUB. SQUARE (Sept. 9, 2019), https://www.cnu.org/publicsquare/2019/09/09/extractive-investment-community-wealth [https://perma.cc/R8YJ-XDGV].

taxpayers — provided that the incentives create meaningful opportunities for nonprofits to participate in the transactions. Here, some background may be helpful. The NMTC was enacted in 2000 to provide an incentive for investment in low-income areas.[24] The tax credit is claimed by for-profit investors who contribute capital for use in projects located in low-income areas.[25] As described below, the size of the tax credit equals 39% of the value of the investor's qualified equity investments, claimed over a seven-year period.[26] These tax credits serve as an incentive to investors and a capital subsidy to developers and businesses.[27] The mechanism by which the tax credits are delivered, however, is somewhat complicated.

The complexity relates to annual limitations placed on the program's size[28] and the administration of the tax credits. The NMTC is administered by the Community Development Financial Institutions (CDFI) Fund, which is an office within the Department of Treasury.[29] The CDFI Fund permits entities that it certifies as Community Development Entities (CDEs) to apply for NMTC allocations.[30] As explained below, the CDEs act as intermediaries between investors and project developers or businesses in low-income communities, and as between investors and the CDFI Fund.

Specifically, CDEs apply for tax credit allocations through a competitive application process administered by the CDFI Fund.[31] If a CDE receives an award, it solicits investors who make so-called qualifying equity

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24. *See* I.R.C. § 45D(c)(1)(A); *see also* Groves, *supra* note 13, at 217−18.

25. Groves, *supra* note 13, at 217−18.

26. For each of the first three years, the investor receives a credit equal to 5% of the total amount paid for the capital interest, and for the remaining four years it receives 6% annually. HOLLAND & KNIGHT LLP, NEW MARKET TAX CREDIT BASICS 1 (2013), http://services.housingonline.com/nhra_images/NMTC%20Basics.pdf [https://perma.cc/G348-PWXG] [hereinafter NMTC BASICS]. Note that the investor does not own a direct interest in the project and, therefore, the costs of the project do not affect the credit amount. *Id.*

27. Michael Eickhoff & Steve Carter, *Accessing Capital Through the New Markets Tax Credit Program*, 29 J. ST. TAX'N 17, 17 (2011) (explaining that the company receives a capital contribution and the investor receives a tax break).

28. In 2020, the law authorized $5 billion in tax credits to be allocated that year among projects nationwide. Notice of Allocation Availability (NOAA) Inviting Applications for the Calendar Year (CY) 2020 Allocation Round of the New Markets Tax Credit (NMTC) Program, 85 Fed. Reg. 59,853, 59,853 (Sept. 23, 2020).

29. MARPLES & LOWRY, *supra* note 12, at 1.

30. *CDE Certification*, CMTY. DEV. FIN. INST. FUND, https://www.cdfifund.gov/programs-training/certification/cde [https://perma.cc/5LJZ-QKBV] (last visited July 14, 2021).

31. *See* MARPLES & LOWRY, *supra* note 12, at 2.

investments (QEIs) in the CDE.[32] The CDE is required to use that capital to make debt or equity investments in development projects or businesses in low-income communities.[33] The phrase "low-income community" is defined by statute and generally includes census tracts that have at least a 20% poverty rate or have a tract median income that does not exceed 80% of the area's median income.[34]

Like the newer Opportunity Zones incentive, the NMTC has long been criticized for failing to ensure that benefits flow to residents of low-income communities. In my own research, I have described how developer lobbies and powerful market actors have helped drive place-based investment tax incentives, including the NMTC.[35] The NMTC helps provide large infusions of capital into projects, enabling new construction, rehabilitation, and large development projects. Apart from the location requirements, the statute itself places few restrictions on the types of projects that can be supported through the program, which has been blamed for subsidizing projects like museums and opera houses that are not well targeted to benefit low-income communities.[36]

Nevertheless, my analysis provides strong evidence that the NMTC has successfully promoted mission-driven investment that is likely to benefit low-income communities. Specifically, I collected the addresses of 443 NMTC projects funded between 2003 and 2018 in five cities (Chicago, Los Angeles, New Orleans, New York, and Philadelphia).[37] I then used a combination of Google satellite images, Google Maps, and general Google searches of the addresses to determine what businesses or organizations occupied the properties at those locations as of 2019.[38] This method yielded project-level data that was not otherwise available, providing new insight into how NMTC financing has been used. For example, data

32. *See id.* at 1. This investment immediately entitles the investor to tax credits equal to 39 cents per dollar of QEI, to be earned over a seven-year period. I.R.C. § 45D(a)(2)–(3).

33. I.R.C. § 45D(b)(1)(B).

34. I.R.C. § 45D(e)(1).

35. *See* Michelle D. Layser, *The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform*, 2019 WIS. L. REV. 745, 791 (2019).

36. *See* Groves, *supra* note 13, at 225.

37. Michelle D. Layser, *NMTC Project Types* [hereinafter Layser, *NMTC Project Types*], https://libguides.law.illinois.edu/ld.php?content_id=62879347 [https://perma.cc/A285-NWHN] (last updated July 16, 2019) (on file with University of Illinois College of Law Library Research Guides). Project addresses were obtained from a dataset maintained by the private accounting firm Novogradac LLP. *See QLICIs by State*, NOVOGRADAC, https://www.novoco.com/resource-centers/new-markets-tax-credits/qlicis-state [https://perma.cc/VV35-6JH3] (last visited May 10, 2021).

38. *See* Layser, *NMTC Project Types*, *supra* note 37.

available from the CDFI Fund described many projects simply as "redevelopment,"[39] but this method shed light on how the redeveloped property was being used — whether as a large retail store like Target, a community center like the YMCA, a medical facility, or a general office space.

The projects were described in detail and hand coded to categorize the type of project at that location.[40] Each project was assigned a single code.[41] This method revealed that the most frequent types of project in the sample were education facilities (21%), most of which were charter schools.[42] The next most frequently appearing project types were mixed-use apartments and condos (12%), retail and restaurants (9%), medical facilities (11%), and homeless and social services (10%).[43]

While the impact of any given project will depend on how well the project advances solutions to problems faced by a community,[44] two points are clear from the data: not all of the projects supported by the NMTC program were likely to generate significant profit for investors, and many appeared to be predominantly mission-driven. Examples of such mission-driven investment included homeless shelters, job training centers for low-income people, employment agencies for low-income people, religious missions, social-services nonprofits, family/youth services, food kitchens, disability support services, anti-poverty organizations, housing assistance organizations, nonprofit law centers, homeless services organizations, anti-addiction nonprofits, and assisted living facilities. Few, if any, of these projects are the type normally pursued by the for-profit sector.

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39. The CDFI fund releases public data annually, but the data includes only minimal information about the types of projects that have been funded. *See CDFI Fund, Data Releases*, CMTY. DEV. FIN. INST. FUND, https://www.cdfifund.gov/documents/data-releases [https://perma.cc/KT8W-PM5U] (last visited May 10, 2021). For example, a release may describe a project as "Business Financing" or "Real Estate-Rehabilitation-Commercial," but it does not describe the type of business that received financing or the type of commercial development. *See, e.g.*, *CDFI Fund, NMTC Public Data Release: 2003–2019 Data File*, CMTY. DEV. FIN. INST. FUND, https://www.cdfifund.gov/sites/cdfi/files/2021-05/FY_2020_NMTC_Public_Data_Release.xlsx [https://perma.cc/RHA3-DSW7] (last visited May 10, 2021).

40. The following 12 codes were used: Apartment/Condos; Community Centers; Education; Grocery; Homeless/Social Services; Manufacturing/Wholesale; Medical; Museum/Theater/Arts; Office Space; Retail/Restaurants; Other; Unknown. The table in Appendix A describes the types of projects included under each code heading. Data on file with University of Illinois College of Law Library. *See supra* note 38.

41. *See* Layser, *NMTC Project Types*, *supra* note 37.

42. *Id.*

43. *Id.*

44. *See* Michelle D. Layser, *How Place-Based Tax Incentives Can Reduce Geographic Inequality*, 74 TAX L. REV. (forthcoming 2021) (manuscript at 42).

Most likely, the results of this analysis of NMTC projects suggest that nonprofit organizations have participated in many deals, helping to ensure that the NMTC promotes mission-driven investment that is likely to benefit low-income communities. The remainder of this Essay is concerned primarily with identifying ways that the NMTC and Opportunity Zone incentives do — and do not — create opportunities for nonprofits to participate in tax-subsidized transactions. The next Section describes how the NMTC creates opportunities for nonprofits to participate in deals, and later parts will examine how the different design of the Opportunity Zones incentive creates barriers to nonprofit participation.

B. Opportunities for Nonprofit Participation Created by the NMTC

Notwithstanding the recent popularity of social impact investment, mission-driven investment has traditionally been the domain of the nonprofit sector.[45] However, many nonprofits are tax-exempt organizations with little need for tax deductions and credits.[46] This fact presents a challenge when designing tax incentives to promote mission-driven investment. How can tax preferences be used to support the activities of nonprofits that have little use for tax breaks? The NMTC solves this problem by providing tax preferences to for-profit investors who contribute to projects that are — at least sometimes — consistent with the missions of tax-exempt nonprofits. Nonprofits participate in these mission-driven NMTC deals as borrowers, as the nonprofit parents of financial intermediaries, and as leverage providers. As this Section explains, these roles for nonprofit participation are supported by specific features of the law that create incentives for debt investment in low-income communities, opportunities for tax credit monetization, and favorable treatment under banking regulations.

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45. *See* Michelle J. Stecker, *Revolutionizing the Nonprofit Sector Through Social Entrepreneurship*, 48 J. ECON. ISSUES 349, 350−52 (2014) (explaining that the "nonprofit sector provides goods and services that public sector governmental actors do not provide, and that private for-profit entities do not adequately — or are not able to — provide," and that "social entrepreneurship" is a more recent development).

46. *Id.* at 350. For this reason, tax-based subsidies for charities have generally taken the form of tax preferences for taxable donors. For example, the charitable donations deduction, which is claimed by taxpayers who donate to tax-exempt charities, presumably functions partly as an incentive — to encourage generous donations or investments that would not otherwise occur — and partly as a subsidy to nonprofit entities that produce pro-social goods and services. *See* Linda Sugin, *Tax Expenditures, Reform, and Distributive Justice*, 3 COLUM. J. TAX L. 1, 23–25 (2011) (distinguishing between subsidies and incentives and explaining that "[i]f the deduction is an incentive that causes donors to increase their gifts by at least as much as the tax benefit, it is an incentive to the donor and a subsidy to [the] charity" (internal citations omitted)).

1. Debt Investment Incentives Create Opportunities for Nonprofit Borrowers

As explained above, the NMTC statute requires CDEs that receive NMTC allocations to invest in qualified low-income community investments. The statutory definition of qualified low-income community investment includes "any capital or equity investment in, or loan to, any qualified active low-income community business."[47] However, as a practical matter, almost all qualified low-income community investments take the form of a loan.[48] In other words, the most common types of investment subsidized by the NMTC are loans (usually with below-market-rate interest) to a business or developer,[49] some of which are extended to nonprofit borrowers.[50] Nonprofits can use these loans to pursue their charitable activities.[51] It is likely that many of the mission-driven projects described above — e.g., homeless shelters, food kitchens, religious missions — reflect loans made directly to nonprofit organizations.[52]

Nonprofits hoping to receive low-interest loans subsidized through the NMTC program may reach out directly to CDEs, or they may work with consultants who connect them with CDEs that might fund their projects.[53] If a nonprofit's project is consistent with the CDE's investment strategy, the CDE may be willing to loan capital to the nonprofit at below-market rates.[54] Nonprofits across the United States have recently used NMTC-subsidized capital to fund a wide array of projects. For example, Wheeler Mission Center for Women and Children in Indianapolis is expanding its

47. I.R.C. § 45D(d)(1)(A).

48. *See* OFF. OF THE COMPTROLLER OF THE CURRENCY, NEW MARKETS TAX CREDIT: UNLOCKING INVESTMENT POTENTIAL 7 (2013), https://www.novoco.com/sites/default/files/atoms/files/occ_insights_nmtc_unlocking_investment_potential_0613.pdf [https://perma.cc/Z7KC-DUHJ].

49. *See id.* at 3 n.16.

50. *See* Michael I. Sanders, *How Nonprofit Organizations Can Use the New Markets Tax Credit*, BLANK ROME LLP 8–9 (2009), https://www.blankrome.com/siteFiles/publications//27E9C61B6D14DB754B19C370C53231B8.pdf [https://perma.cc/6GFK-3JUF].

51. *See id.* at 15–16.

52. *See supra* notes 40−43 and accompanying text.

53. *See* Gordon Goldie & Terri Salas, *New Markets Tax Credits Can Fill the Gap in Your Capital Campaign Caused by COVID-19*, PLANTE MORAN (June 22, 2020), https://www.plantemoran.com/explore-our-thinking/insight/2020/06/new-markets-tax-credits-can-fill-the-gap-in-your-capital-campaign [https://perma.cc/A7ED-25W8].

54. NMTC BASICS, *supra* note 26, at 2 (explaining that CDEs often make loans at below market rates).

facilities to serve the homeless population in Indiana.[55] In Las Vegas, the nonprofit Strong Start Academy Wardelle plans to use NMTC-subsidized capital "to develop and construct certain improvements to be operated as a childhood education facility, a physical and mental health wellness center, and other community facilities."[56] Amidst the COVID-19 pandemic, Greater Pittsburgh Community Food Bank used NMTC funding to help expand its food bank facilities.[57]

2. Tax Credit Monetization Makes Mission-Driven Investment "Profitable"

In addition to participating in NMTC transactions on the borrower-side of the transaction, nonprofits also participate by facilitating the investment process itself. In this capacity, a nonprofit may participate (i) as the nonprofit parent of a CDE subsidiary or (ii) as leverage providers to support for-profit equity investment. In both cases, the CDE's qualifying low-income community investment must be consistent with the nonprofits' tax-exempt purposes. Often, such mission-driven investment is not likely to generate significant profit for investors. In fact, most NMTC investors do not expect the underlying projects to generate significant economic returns. Why, then, do for-profit investors participate in these mission-driven deals? One reason is that a technique called tax credit monetization makes mission-driven investment "profitable."

Tax credit monetization refers to the process by which a future stream of value from anticipated tax credits is converted into dollars that can be used currently.[58] This is accomplished when an investor obtains the rights to claim the tax credits when they are available.[59] In the context of the NMTC, when investors make a qualified equity investment, they effectively purchase the right to claim NMTCs as they are earned. Under the statute, the tax credit always equals 39 cents per dollar of qualified

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55. *See Wheeler Center for Women & Children (2020)*, NEW MKTS. TAX CREDIT COAL., https://nmtccoalition.org/project/wheeler-center-for-women-children/ [https://perma.cc/TP3A-Z8KM] (last visited June 24, 2021).

56. *Strong Start Academy Wardelle (2020)*, NEW MKTS. TAX CREDIT COAL., https://nmtccoalition.org/project/strong-start-academy-wardelle/ [https://perma.cc/5NV6-8YYB] (last visited June 24, 2021).

57. *See Greater Pittsburgh Community Food Bank (2020)*, NEW MKTS. TAX CREDIT COAL., https://nmtccoalition.org/project/greater-pittsburgh-community-food-bank/ [https://perma.cc/K497-3UYF] (last visited June 24, 2021).

58. *See* Thomas W. Giegerich, *The Monetization of Business Tax Credits*, 12 FLA. TAX REV. 709, 769−71 (2012).

59. *Id.*

equity investment, earned over a seven-year period.[60] This amount provides a 5% return on investment for the first three years and a 6% return on investment for the last four years — a rate of return that, standing alone, would be insufficient to motivate most investors.[61]

The tax credit monetization process provides an opportunity for investors to structure their investments in ways that increase the rate of return.[62] Specifically, investors add leverage to the tax credit monetization structure.[63] If enough leverage is added, investors can profit from the tax credits themselves, even if a CDE's underlying investments are unprofitable.[64] To do this, investors form a leverage fund and make the qualified equity contribution through the fund.[65] In this way, the investor can "purchase" each dollar of (tax credit generating) qualified equity investment at a discount. NMTC "pricing" is generally quoted in terms of this discount.[66] In 2021, NMTC pricing is currently 74 cents per credit in the wake of the COVID-19 pandemic.[67] The balance of the qualified equity investment is financed through leverage.[68]

The leveraged monetization technique is best illustrated with an example.[69] Assume that an investor creates a leverage fund. A Lender loans $0.69 to the fund, and the investor contributes $0.31 of equity to the fund, yielding one dollar of capital to be contributed to a CDE. The fund then contributes that dollar to a CDE as a qualified equity investment, which generates $0.39 of tax credits to be claimed by the investor. In other words, the equity investor paid just under 80 cents per credit ($0.31 invested / $0.39 credit = $0.795).

The CDE uses that dollar of investment to make a below-market-rate loan to a business or organization that serves a low-income community. The leverage fund will use any economic returns from interest collected on

60. NMTC BASICS, *supra* note 26, at 3.

61. *See* I.R.C. § 45D(a)(2).

62. Giegerich, *supra* note 58, at 771 (explaining that in both LIHTC and NMTC deals, tax monetization is used to provide investors with a targeted internal rate of return).

63. *See* Eickhoff & Carter, *supra* note 27, at 77.

64. *See New Markets Tax Credit (NMTC) Program Summary*, SBFRIEDMAN [hereinafter SBFRIEDMAN], https://sbfriedman.com/sites/default/files/download/NMTC%20Guide%202018.pdf [https://perma.cc/A6Y8-5KM4] (last visited Sept. 23, 2021).

65. *Id.*

66. *Id.*

67. *See* Brad Elphick, *How the Pandemic Has Affected NMTC Equity Pricing and Investments*, 12 NOVOGRADAC J. TAX CREDITS 1 (2021).

68. *See* SBFRIEDMAN, *supra* note 64, at 2.

69. This example is adapted from a hypothetical described in SBFRIEDMAN, *supra* note 64, at 2.

the loan to pay debt service to the Lender, leaving little, if any, economic returns for the investor.[70] However, the entire value of the tax credits ($0.39) will flow to the investor (who initially contributed only $0.31).[71] In other words, the value of the tax credits to the investor is 125% of its original equity contribution. Even if the contribution is never repaid, the investor would receive a 25% rate of return on the investment — generated solely from the tax credits — over the seven-year period. Through structures like these, investors can derive an acceptable rate of return entirely from the tax credits themselves, and in some cases the initial equity contribution may not even need to be repaid.[72] The amount of leverage required depends on the deal, and the "tax credit markets [have] historically set a price of 70 to 80 cents per dollar of tax credit," with a lower valuation in years when credit markets are tight and corporate profits are small.[73]

The table in Appendix B shows the rates of return that investors derive solely from the tax credits, comparing the unleveraged structure to the leveraged example presented above. Note that under both structures, the qualified equity investment is $1 and generates the same 39 cent return. By adding leverage, however, an investor can increase the rate of return from 5–6% annually to 16–19% annually.

These monetization structures create at least two significant opportunities for nonprofit organizations to participate in NMTC deals. First, a nonprofit can create a for-profit subsidiary certified as a CDE.[74] The subsidiary CDE can receive NMTC allocations and solicit qualified equity investments from for-profit investors to help fund its mission-driven projects. Even though the CDE's investments may be low profit, these investors may be willing to invest through a leverage fund.[75] Because tax credit monetization can be used to provide investors with an acceptable rate of return, nonprofit-controlled CDEs are able to attract investors for their mission-driven projects.

Second, a nonprofit may participate as the leverage-provider in the monetization structure. In this structure, the for-profit investor creates a leverage fund (as described above) and a nonprofit provides the leverage.[76] The nonprofit has the least control over its investment when it functions as the leverage-provider; however, the CDE must provide legal assurance to

70. *See id.*
71. *Id.* at 2.
72. *Id.*
73. *See* MARPLES & LOWRY, *supra* note 12, at 7.
74. *See* Sanders, *supra* note 50, at 12.
75. *Id.*
76. *Id.* at 14.

the nonprofit that its activities will be consistent with the nonprofit's charitable purpose.[77] As such, the participation of a nonprofit in these deals increases the likelihood that the NMTC will be used to subsidize mission-driven projects. Figure 1 in Appendix C describes the three roles that nonprofits play in NMTC deals: (1) as borrowers of tax-subsidized loans extended by CDEs, (2) as the nonprofit parent of a CDE, and (3) as a leverage-provider to facilitate a leveraged tax equity investment.

3. Financial Regulations Make Low-Profit Mission-Driven Investment Worthwhile

Whether a nonprofit participates as a borrower, the parent of a CDE, or as a leverage provider, the CDE's qualified low-income community investments must be consistent with the nonprofit's tax-exempt purpose. In many cases, that means that an investor must be willing to invest indirectly in a project that is unlikely to generate significant economic returns. As this Section has demonstrated, many for-profit investors are willing to take this risk because they derive value from the NMTC itself, even when the underlying investment is not profitable. However, one additional feature of the NMTC legal framework is also worth noting; NMTC investment is promoted by the Community Reinvestment Act (CRA). [78]

The CRA requires financial institutions to extend credit and invest in low-income communities within their assessment areas.[79] Financial institutions that fail to meet their CRA obligations may lose privileges, such as the right to expand their business.[80] Since financial institutions receive CRA "credit" for NMTC investments, they are often willing and

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77. *Id.*

78. 12 U.S.C. §§ 2901–08. The CRA requires financial institutions to invest in the low-income communities they service. *See id.* § 2903. Today, nearly all investment in tax-subsidized affordable housing and community development projects comes from financial institutions motivated primarily by the CRA. JOINT CTR. FOR HOUS. STUD. OF HARV. UNIV., THE DISRUPTION OF THE LOW-INCOME HOUSING TAX CREDIT PROGRAM: CAUSES, CONSEQUENCES, RESPONSES, AND PROPOSED CORRECTIVES 19 (2009), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/disruption_of_the_lihtc_program_2009_0.pdf [https://perma.cc/YA4Z-AMKA] (explaining that the LIHTC investor market has narrowed over time to include primarily financial institutions motivated by the CRA); *see also Investor Trends*, NEW MKTS. TAX CREDIT COAL., https://nmtccoalition.org/progress-report-2019/investor-trends/ [https://perma.cc/4TTX-K8UL] (last visited July 14, 2021) (noting that most NMTC investors are financial institutions subject to the CRA and motivated by CRA compliance).

79. Cassandra Jones Havard, *The Community Reinvestment Act, Banks, and the Low Income Housing Tax Credit Investment*, 26 J. AFFORDABLE HOUS. & CMTY. DEV. L. 415, 418 (2017).

80. *See* 12 C.F.R. § 25.02 (2020).

able to invest in NMTC projects, even if the expected rate of return is relatively low.[81] In fact, the overwhelming majority of NMTC investors are seeking credit under the CRA.[82]

Here, it is worth noting that in the broader context of affordable housing and community development, financial institutions are often willing to invest in CRA-eligible projects even if they do not expect the investment to be profitable. A striking example of this is sometimes seen in the context of the Low-Income Housing Tax Credit (LIHTC), which employs monetization structures similar to those used to monetize the NMTC.[83] As in the case of the NMTC, LIHTC investors usually size their tax credit investments to ensure a positive return on their investment.[84] In effect, they purchase the tax credits at a discount, thereby building in an acceptable rate of return.[85]

However, during some particularly competitive periods, some LITHC investors have been willing to purchase LIHTCs at a *premium* — paying more than a dollar for each dollar of anticipated tax credits.[86] These investors know from the outset that their investment is likely to be a money-loser. Yet, these LIHTC investors are not motivated by profits; they are motivated by the CRA and the promise that they will receive CRA credit for investing in affordable housing.[87]

Most NMTC investors are also motivated by the CRA.[88] While these investors would presumably *prefer* to receive a positive return on their investment, they may be willing to invest in low-profit projects because CRA compliance alone has value. It seems likely that the CRA may affect

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81. *See* MARTIN D. ABRAVANEL ET AL., URB. INST., NEW MARKETS TAX CREDIT (NMTC) PROGRAM EVALUATION 65–66 (2013), https://www.urban.org/sites/default/files/publication/24211/412958-new-markets-tax-credit-nmtc-program-evaluation.pdf [https://perma.cc/UQ4Y-6WCA].

82. *Id.* at 66.

83. Giegerich, *supra* note 58, at 771.

84. *See* H. Blair Kincer & Mark O'Meara, *A Look at the LIHTC: Past Pricing Trends, the Current Market and Future Concerns*, 11 NOVOGRADAC J. TAX CREDITS 1, 3 (2020) (describing LIHTC pricing trends over time and explaining that, in most markets, LIHTCs are purchased at discounted prices).

85. *Id.*

86. *See* Donna Kimura, *LIHTC Prices Climb and Climb*, AFFORDABLE HOUS. FIN. (Aug. 16, 2016), http://www.housingfinance.com/Finance/lihtc-prices-climb-and-climb_o [https://perma.cc/TX2F-ZQXU] (describing LIHTC pricing at $1.03 per $1 of tax credit in August 2016); *see also* Kincer & O'Meara, *supra* note 84, at 3 (describing CRA-driving LIHTC pricing between $1.05 and $1.10 per dollar of credit prior to the 2017 tax reform legislation).

87. Kincer & O'Meara, *supra* note 84.

88. NEW MKTS. TAX CREDIT COAL., *supra* note 78.

NMTC pricing in the same way that it increases LIHTC pricing, reflecting investors' willingness to accept lower rates of return. In other words, the favorable treatment under the CRA may help make mission-driven investment worth it, even if it does not generate much profit.

In sum, several features of the NMTC create opportunities for nonprofits to participate in tax credit deals. These include the inclusion of loans among qualified low-income community investments, the use of monetization structures, and the availability of CRA credit for NMTC investment. Theoretically, similar structures could be used by nonprofits to take advantage of tax-subsidized financing raised by Opportunity Funds. However, the structure of the incentive — and its current status under the CRA — make it much more difficult for nonprofits to participate in Opportunity Zones deals. The next Part will analyze the barriers to nonprofit participation in Opportunity Zones transactions. Ultimately, these barriers limit the capacity of the Opportunity Zones law to support mission-driven projects.

II. NONPROFIT PARTICIPATION IN OPPORTUNITY ZONES DEALS

This Essay has demonstrated that the NMTC has been used to promote mission-driven investment by providing opportunities for nonprofits to participate in NMTC deals. Early research suggests that similar mission-driven investment is less common in the context of Opportunity Zones deals.[89] A recent study showed that Opportunity Zone investment is "overwhelmingly concentrated in equity investments in businesses that specialize in real estate, construction, and finance."[90] This investment "gravitates toward tracts with relatively higher educational attainment, income, density, and pre-existing upward income and population growth trends,"[91] and mission-driven real estate investment, like affordable housing, is relatively uncommon.[92]

One reason that Opportunity Zone investment differs so dramatically from NMTC investment is that fewer opportunities exist for nonprofits to participate in Opportunity Zones deals. In the NMTC context, several

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89. *See* Patrick Kennedy & Harrison Wheeler, *Neighborhood-Level Investment from the U.S. Opportunity Zone Program: Early Evidence* 4 (U.S. Cong. Joint Comm. on Tax'n, Working Paper, 2021), https://static1.squarespace.com/static/57a3c0fcd482e9189b09e101/t/607893b915858d7bd0d198ba/1618514881004/oz_kennedy_wheeler.pdf [https://perma.cc/3JCM-NX8B].

90. *Id.*

91. *Id.* at 9.

92. *See* Michelle D. Layser, *Financing Affordable Housing Through Opportunity Zones*, 19 PITT. TAX REV. (forthcoming 2021) [hereinafter Layser, *Financing Affordable Housing*].

features of the law create opportunities for nonprofit participation, including incentives for debt investment in low-income communities, its suitability for monetization, and favorable treatment under the CRA. In contrast, this Part identifies several barriers to nonprofit participation in Opportunity Zones deals, including the requirement that Opportunity Funds make equity investments in Opportunity Zones, the absence of monetization, and uncertainty surrounding the CRA. As a result, fewer opportunities exist for nonprofits to participate in Opportunity Zones transactions.

A. Comparing Opportunity Zones to NMTC

1. Capital Gains Relief Versus Tax Credits

To understand the barriers to nonprofit participation in Opportunity Zones transactions, it is helpful to review the structure of the law itself, including ways that the Opportunity Zones incentive differs from the NMTC. The first key distinction is that, where the NMTC uses tax credits to promote development in low-income areas, the Opportunity Zones incentive takes the form of tax deferrals and exemptions. Specifically, the Opportunity Zones law provides three possible tax benefits for taxpayers who contribute to Opportunity Funds, all of which confer capital gains tax relief.[93]

Normally, when an appreciated asset is sold, the profits — called capital gains — are subject to tax at capital gains rates, which in recent years have ranged from 0% to 28%.[94] The first tax benefit under the Opportunity Zones law is to permit taxpayers to *defer* paying tax on their capital gains from an asset sale until December 31, 2026, provided that they are contributed to an Opportunity Fund within 180 days of the sale and all other statutory requirements are met.[95] The second possible tax benefit is the *partial exclusion* of pre-contribution capital gains. To receive this benefit, taxpayers must leave their money in the fund for specified holding periods.[96] Depending on when the taxpayer invested in the fund and how

93. *See* I.R.C. § 1400Z-2(a)(1) ("In the case of gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer, at the election of the taxpayer — [] gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of such sale or exchange . . . .").

94. *See id.* § 1(h).

95. *See id.* § 1400Z-2(b).

96. Specifically, a taxpayer who remains invested in the fund for five years may increase its basis by 10%. A taxpayer who remains invested in the fund for seven years may

long the investment was held, the statute provides for the exemption of up to 15% of pre-contribution capital gains.[97] The third — and potentially most significant — benefit is the *total exclusion* of post-contribution gains from investments held in an Opportunity Fund for at least ten years.[98] These three benefits are unlimited in size and potentially available to *any* taxpayer who invests in an Opportunity Fund.[99]

While the initial deferral and potential to partially exclude pre-contribution capital gains are attractive incentives, it is worth noting that a successful project that generates post-investment gains, compounded over ten years, could provide taxpayers with tax-free returns that eclipse the tax savings associated with the initial deferral. Taxpayers who anticipate significant profits from an investment may find this third benefit particularly attractive. In contrast, taxpayers who do *not* expect their investment to generate significant profit — such as those pursuing mission-driven investment like affordable housing — may not be as motivated by the third incentive. As a result, the Opportunity Zones law provides the strongest incentive package to taxpayers who plan to pursue highly profitable projects.

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increase its basis by an additional 5% (note that this benefit is only available to taxpayers who invested by the end of 2019). Understanding these benefits requires some familiarity with the tax basis rules applicable to Opportunity Funds. Under the rules, taxpayers receive zero basis for their initial investment in Opportunity Funds. *See id.* § 1400Z-2(b)(2)(B)(i). The practical effect of this rule is that if a taxpayer invests $100 in an Opportunity Fund (thereby receiving $0 basis) and then sells its fund interest for $100, the taxpayer would immediately recognize $100 in capital gains. *See id.* §§ 741, 1001. Without this rule, a taxpayer would ordinarily receive $100 basis for that same investment, allowing the investor to sell the interest for zero gain and permanently avoid the capital gains tax. *See id.* §§ 358(a)(1), 722. In the same way, the basis step-up rules allow the taxpayers to permanently exclude tax on the pre-contribution gains to the extent of the step-up.

97. *See id.* §§ 1400Z-2(b)(2)(B)(iii)–(iv).

98. In other words, taxpayers are always required to include at least 85% of capital gains from the initial asset sale in 2026, but to the extent that their investment in the Opportunity Fund appreciated, those gains are eligible for complete exclusion after ten years. The cost to the Treasury of this appreciation exclusion was not included in the original expense estimates for the law since it fell outside the ten-year budget window; however, this feature of the law could ultimately deliver significant tax breaks to third-party investors who hold their investments for the full ten-year period. *See* SEAN LOWRY & DONALD J. MARPLES, CONG. RSCH. SERV., R45152, TAX INCENTIVES FOR OPPORTUNITY ZONES 9 (2020), https://fas.org/sgp/crs/misc/R45152.pdf [https://perma.cc/BKT9-9RXS].

99. This structure stands in sharp contrast to the NMTC. As mentioned, the law caps the amount of NMTCs that can be allocated each year, and the credits are therefore awarded to eligible entities by the government on a competitive basis. *See* I.R.C. § 45D.

2. Equity Subsidy Versus Debt Subsidy

To receive the capital gains relief described above, the taxpayer must invest in a Qualified Opportunity Fund that meets statutory requirements related to asset holdings. To qualify under the statute, Opportunity Funds must either (i) directly own property located in the zones (Opportunity Zone Business Property) or (ii) own such property indirectly through entities that that own a qualified opportunity zone business.[100] In either case, the key is that an Opportunity Fund is required to *own* — directly or indirectly — property located in an Opportunity Zone. A fund cannot meet its asset holding requirements by making debt investments. In other words, unlike the NMTC, which is primarily used to subsidize *debt* investment, the Opportunity Zones law was designed to subsidize *equity* investment in low-income areas.[101]

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These two structural differences between the NMTC and Opportunity Zones incentive help ensure that the tax incentives are not duplicative, and they help the Opportunity Zones incentive reach a different pool of potential investors than the NMTC can reach. However, these differences also present distinct barriers to nonprofit participation in Opportunity Zones deals. As the remainder of this Part will show, nonprofit participation in Opportunity Zone deals is likely chilled by the equity investment requirement, the absence of monetization, and uncertainty about how Opportunity Zone investments will be treated under the CRA.

B. Barriers to Participation in Opportunity Zones Deals

1. Equity Investment Requirement

The requirement that Opportunity Funds make equity investments presents a significant barrier to using Opportunity Funds to support the activities of tax-exempt nonprofit organizations. Many nonprofits are organized and operated as tax-exempt organizations under section

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100. If the fund owns property directly, then substantially all (90%) of the fund's assets must be comprised of property located in the Opportunity Zone. *See* 26 C.F.R. §§ 1.1400Z2(d)-1(b)(1)(i), 1.1400Z2(d)-2(d)(3)(i) (2020). If it owns property indirectly, then substantially all (70%) of the entity's assets must be located in an Opportunity Zone. *See id.* §§ 1.1400Z2(d)-1(b)(1)(ii), (d)(2) (2020).

101. John Sciarretti, Michael Novogradac & Peter Lawrence, *New Opportunity Zones Could Be Used to Finance Rental Housing*, NOVOGRADAC (Feb. 23, 2018, 12:00 AM), https://www.novoco.com/notes-from-novogradac/new-opportunity-zones-could-be-used-finance-rental-housing [https://perma.cc/T67Y-QKSN].

501(c)(3) of the Internal Revenue Code.[102] This category of nonprofits is commonly referred to as "charitable organizations."[103] Among the requirements applicable to a charitable organization is that no part of the organization's net earnings may "inure[] to the benefit of any private shareholder or individual."[104] As a practical matter, the anti-inurement requirement means that charitable organizations are prohibited from raising capital through equity investment. This prohibition makes it impossible for an Opportunity Fund to satisfy its asset-holding requirements (which must be met through equity investments) by providing capital to nonprofits. As a result, the most straightforward way that nonprofits participate in NMTC deals — as borrowers of loans obtained from CDEs — is completely unavailable in Opportunity Zones transactions.

2. Absence of Monetization

A second significant barrier to nonprofit participation in Opportunity Zones deals relates to the form of the incentive, which does not require (or enable) monetization. There are at least two reasons why monetization structures are not used in this context. First, tax credit monetization is used to advance the value of future benefits to be received. However, a major benefit under the Opportunity Zones law is the current deferral of capital gains. That deferral is earned when taxpayers contribute the sheltered dollars in an Opportunity Fund. No monetization is necessary.

Second, to the extent that Opportunity Zones do provide future benefits — the exemption of post-contribution gains — those benefits are highly speculative and not susceptible to monetization. Monetization is possible in the context of the NMTC because the anticipated value of the tax credits is relatively certain, as it is clearly defined by the size of a CDE's tax credit allocations. In contrast, the value of Opportunity Zones tax preferences depends on how profitable an Opportunity Fund turns out to be in the future. Investors will not be willing to contribute cash in exchange for a benefit that may never materialize.

Without monetization, two common ways that nonprofits participate in NMTC deals are less viable in the context of Opportunity Zones. First, recall that nonprofits participate in NMTC deals as owners of CDEs that solicit for-profit investors who claim the tax credits. In theory, a nonprofit could form an Opportunity Fund to pursue its own projects — but without

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102. *See* Stecker, *supra* note 45, at 350.

103. *See, e.g.*, Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 512–13 (2010).

104. I.R.C. § 501(c)(3).

monetization, many mission-driven projects will be unattractive to investors.[105] Second, recall that nonprofits participate in NMTC deals as leverage providers. But, here too, the investors may be unwilling to pursue mission-driven projects if they do not expect them to be profitable.

To be clear, there are no legal barriers to either of these structures. Nevertheless, for either structure to work, the Opportunity Fund must commit to investing in projects consistent with a nonprofit's exempt purpose, and investors must be willing to invest in those mission-driven projects. Ultimately, the absence of monetization means that investors cannot rely on monetization to produce an acceptable rate of return. Instead, they must bet on the performance of the Opportunity Fund's investments. Leverage can be added to increase the profits derived from a successful investment — but it cannot be used to hedge against the risk that an investment may *not* be successful. No amount of leverage can ensure that Opportunity Zone investors receive a return on their investment even if the underlying investment fails.[106]

For this reason, investors may be reluctant to participate in transactions with nonprofits when the mission-driven projects will be less profitable than for-profit endeavors.[107] As described below, this barrier is further exacerbated by uncertainty surrounding the treatment of Opportunity Zone investments under the CRA.

3. Uncertainty About CRA Credit

When a financial institution is able to claim CRA credit for a mission-driven investment, it may be willing to accept a low rate of return. In the contexts of the NMTC and LIHTC, the CRA has proven to be highly motivating to financial institution investors.[108] However, the CRA is likely

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105. *See, e.g.*, Tracy A. Kaye, *Ogden Commons Case Study: A Comparative Look at the LIHTC and OZ Tax Incentive Programs*, 48 FORDHAM URB. L.J. (forthcoming Oct. 2021) (explaining that affordable housing developer, "[t]he Habitat Co., had a great deal of trouble attracting qualified opportunity zone funding because 'mission-oriented projects struggle to compete for attention with higher return projects'" (citation omitted)).

106. In contrast, if enough leverage is added to an NMTC deal, an investor may receive more value in tax credits than the size of its initial contribution. In such case, the underlying investment could become worthless, but the investor would still receive an acceptable return. *See* SBFRIEDMAN, *supra* note 64, at 2.

107. In fact, some observers have estimated that only about 5% to 10% of Opportunity Funds will be operated with philanthropic or social-impact missions. *See* Lydia O'Neal, *Cottage Industry in Opportunity Zone Data Forms to Fill Vacuum (1)*, BLOOMBERG TAX (Apr. 18, 2019, 5:04 PM), https://news.bloombergtax.com/daily-tax-report/cottage-industry-in-opportunity-zone-data-forms-to-fill-vacuum [https://perma.cc/4SBP-FGYQ].

108. *See supra* notes 78–88 and accompanying text.

to be less motivating in the Opportunity Zones context because the status of Opportunity Zone investments under the CRA is less certain. When the Opportunity Zones law was first introduced, there was substantial uncertainty as to whether *any* Opportunity Zone investment would satisfy CRA obligations.[109] Since then, the Office of the Comptroller of the Currency (OCC) has issued regulations confirming that Opportunity Zone investment *may* qualify under the CRA, but only if the underlying investment is a type expected to benefit low- or moderate-income populations.[110]

In the preamble to the regulations, the OCC explained that "[w]hether an activity benefits an [low- or moderate-income (LMI)] qualified opportunity zone will depend on the facts and circumstances of the activity, including whether it is responsive to the needs of LMI individuals, families, and communities in the opportunity zone."[111] Though the new regulations provide some assurance that Opportunity Zone investment can satisfy CRA obligations, the facts and circumstances approach makes the treatment of such investments far less certain than in the context of the NTMC or LIHTC.

Meanwhile, the Federal Reserve has yet to clarify whether Opportunity Zone investment satisfies CRA requirements for banks under its regulatory jurisdiction. A proposed rule published in October 2020 did not mention Opportunity Zones,[112] and some commenters have asked the agency to "make clear that investments in Opportunity Zones . . . that align with the intent of the Community Reinvestment Act . . . in benefitting low- and moderate income ("LMI") individuals and communities are eligible for CRA credit."[113] The uncertainty about how the CRA applies to Opportunity Fund investment creates an additional barrier to nonprofit participation in Opportunity Zone deals. This is because it dulls an incentive that could otherwise help induce financial institutions to

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109. *See* Bob Ibanez, *Opportunity Zones — Giving CRA Credit Where Credit Is Due*, NOVOGRADAC (Nov. 13, 2018, 12:00 AM), https://www.novoco.com/notes-from-novogradac/opportunity-zones-giving-cra-credit-where-credit-due [https://perma.cc/V6ZJ-AY53].

110. *See* Qualifying Activities Criteria, 12 C.F.R. § 25.04(c)(11) (2021).

111. Community Reinvestment Act Regulations, 85 Fed. Reg. 34,734, 34,747 (June 5, 2020) (to be codified at 12 C.F.R. pts. 25, 195).

112. *See generally* Community Reinvestment Act, 85 Fed. Reg. 66,410 (proposed Oct. 19, 2020) (to be codified at 12 C.F.R. pt. 228).

113. Letter from Catherine Lyons, Dir. of Pol'y & Coals., Econ. Innovation Grp., to Anne E. Misback, Sec'y, Bd. of Governors of the Fed. Rsrv. Sys. 1 (Feb. 16, 2021), https://eig.org/wp-content/uploads/2021/02/EIG-OZ-Coalition-Comment-Letter-on-CRA-ANPR-2.16.21.pdf [https://perma.cc/SP3T-N66T].

participate in deals involving nonprofits, notwithstanding the economic risks.[114]

Thus, the Opportunity Zones incentive is unlikely to be used to support the activities of nonprofits — and this may significantly limit the program's potential to benefit low-income communities. In short, the mission-driven investment that is relatively common under the NMTC program is simply unlikely to be seen to the same degree in the context of Opportunity Zones.

C. Layering Opportunity Zones and the NMTC

At least one other option remains for nonprofits to participate in Opportunity Funds deals: layer Opportunity Zones with the NMTC. An important commonality between Opportunity Zones and NMTC is that the programs significantly overlap in the places that they target. The Opportunity Zones statute made all NMTC-eligible tracts eligible for Opportunity Zone designation, as well as certain contiguous census tracts and tracts located in Empowerment Zones.[115] A subset of those eligible tracts were designated by state governors as Qualified Opportunity Zones.[116] As a result, a significant number of Qualified Opportunity Zones are also NMTC eligible.[117]

Because many census tracts are eligible for *both* NMTC and Opportunity Zone investment, the two incentives are occasionally paired.[118] For example, it is possible for a CDE to meet the definition of a Qualified Opportunity Fund if it satisfies the asset holding requirements.[119]

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114. However, note that even with CRA credit, many financial institutions may be unable to participate in Opportunity Zones deals because they typically do not have capital gains to invest in Opportunity Funds. *See* Dirk Wallace & Michael Novogradac, *Treasury Should Revise Opportunity Zones Guidance to Encourage Affordable Rental Housing*, NOVOGRADAC (Sept. 30, 2019, 12:00 AM), https://www.novoco.com/notes-from-novogradac/treasury-should-revise-opportunity-zones-guidance-encourage-affordable-rental-housing [https://perma.cc/WV4L-QKK3]; *see also* Layser, *Financing Affordable Housing*, *supra* note 92.

115. *See* I.R.C. § 1400Z-1(e).

116. *See* I.R.S. Notice 2018-48, I.R.B. 2018-28. While the I.R.S notice notes a state's Chief Executive Officer may nominate census tracts, a state's Chief Executive Officer is the state governor. *See* LOWRY & MARPLES, *supra* note 98, at 1 (stating that a state's chief executive officer is "generally the governor").

117. *See* Brian Blacker, *Stacked Incentives: NMTC Eligibility and Opportunity Zones*, POLICYMAP (Sept. 16, 2019), https://www.policymap.com/2019/09/stacked-incentives-nmtc-eligibility-and-opportunity-zones/ [https://perma.cc/ZZ6Q-DN77].

118. *See* THEODOS ET AL., *supra* note 15, at 26.

119. *See* George Barlow & John Sciarretti, *Pairing NMTCs with Opportunity Zone Incentives*, NOVOGRADAC (Apr. 5, 2018), https://www.novoco.com/periodicals/articles/pairing-nmtcs-opportunity-zone-incentives [https://perma.cc/3R4N-6UXH].

Alternatively, it may be possible for an Opportunity Fund to create its own CDE subsidiary, in which the CDE meets the definition of a qualified opportunity zone business. In these cases, nonprofits may be able to participate in the transaction in the same ways that they would participate in any other NMTC deal.

However, "CDEs seeking to pair OZ incentives with NMTCs will be required to make their qualified low-income community investments (QLICIs) in the form of equity investments . . . which may not be generally consistent with their approved business strategy."[120] Since most CDEs specialize in loans, the CDE may need to seek approval from the CDFI Fund in order to make these equity investments.[121] At a minimum, these transactions will be more complicated than deals that use only one incentive, requiring more advisors — and higher expenses — to close the deals. For these reasons, it is unlikely that investors will seek to pair the incentives often enough to create significant opportunities for nonprofits to participate in Opportunity Zones deals.

CONCLUSION

When tax incentives are designed in ways that create opportunities for nonprofits to participate in investments, a wide variety of mission-driven investments can be supported. This Essay has analyzed nonprofit participation in NMTC transactions in order to gain insights into the barriers to nonprofit participation in Opportunity Zones investment. It has identified several barriers, including the requirement that Opportunity Funds make equity investments, the absence of monetization structures, and uncertainty about how the investments will be treated under the CRA. Together, these barriers make it more difficult for nonprofits to participate in Opportunity Zone deals.

This is not to say that nonprofits *never* participate in Opportunity Zone deals or that Opportunity Funds are never mission-driven. To the contrary, philanthropies and other nonprofits do participate in Opportunity Zones deals, and some Opportunity Fund investors are highly committed to mission-driven investment.[122] Nevertheless, this Essay has demonstrated that the design of the tax incentive makes it more difficult for nonprofits to participate in Opportunity Zones deals than in NMTC deals, despite

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120. *Id.*

121. *See id.*

122. *See generally* THEODOS ET AL., *supra* note 15 (describing the use of Opportunity Zones for mission-driven investment); Kaye, *supra* note 105 (describing how an affordable housing project was financed using Opportunity Fund equity).

similarities between the two incentives. For this reason, it is likely that the mix of investments subsidized through the Opportunity Zones law will include fewer mission-driven projects than what could be promoted under an alternate tax incentive design.

APPENDIX A

Type Codes	Includes:
Apartments/Condos	Construction of for-sale or rental housing, Mixed-use residential buildings, Mixed-income housing, Single-family residence
Community Center	Family centers, community gardens, youth centers, recreation centers, church community centers, Salvation Army community centers, YMCA community centers, Boys & Girls Club community centers
Education	Charter schools, childcare/early learning centers, schools for the disabled, libraries, university buildings, children's science centers, after-school programs
Grocery	Full-service grocery stores, butcher shops, food co-ops
Homeless/Social Services	Homeless shelters, job training centers for low-income people, employment agencies for low-income people, Religious missions, social-services nonprofits, family/youth services, food kitchens, disability support services, anti-poverty organizations, housing assistance organizations, nonprofit law centers, homeless services, anti-addiction nonprofits, assisted living facilities
Manufacturing/Wholesale	Manufacturers, wholesalers, distributors, warehouse storage space, industrial tenants, meat packers, food distribution, food catering
Medical	Medical facilities, rehab centers, Diabetes relief clinics, pharmacies, specialized medical clinics, family health centers, HIV/AIDS clinics, health and wellness centers (excluding recreation centers), health literacy centers, health and wellness centers for the elderly, hospitals, medical transit, medical supply stores
Museum/Theater/Arts	Performing arts centers, concert halls, fine art centers, cultural museums, art museums, galleries
Office Space	Office buildings, office space (unknown tenants), creative community space (e.g., makers space / small business owners)
Retail/Restaurants	Malls, strip malls, small retailers, restaurants, fast food, auto repair, financial services (e.g., banks)

Other	Hotels, laboratories, events facilities, bus terminals, transportation services, self-storage facilities, military tenants, business community centers, shipping docks, movie/production studios, recording studios, funeral homes, dog spas
Unknown	Property use inconclusive based on Google Satellite images and Google searches of address

APPENDIX B

Year	Tax Credit per Dollar QEI	NMTC Value as a Percentage of Taxpayer's Equity Contribution	
		Non-Leveraged Structure ($1 equity + $0 debt)	Leveraged Structure ($0.31 equity + $0.69 debt)
y_1	0.05	5%	16%
y_2	0.05	5%	16%
y_3	0.05	5%	16%
y_4	0.06	6%	19%
y_5	0.06	6%	19%
y_6	0.06	6%	19%
y_7	0.06	6%	19%

APPENDIX C

Figure 1: Sample NMTC Structures Engaging Nonprofits