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EXCERPT

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The Challenges of OZ Investment on Twinned LIHTC/HTC Developments



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Opportunity zones (OZs) were introduced in 2017 as a means to spur economic development and job creation in low-income communities. There are 8,764 census tracts designated as OZs in which developers are offered incentives in the form of tax deferrals. Since inception of the incentive, billions of dollars have been invested in economically distressed communities across the country.

OZ investments often align with another tax incentive, historic tax credits (HTCs). In each OZ, no matter if they are in a city or small town, historic buildings

present opportunities for developers to find investors looking to move their capital gains into a qualified opportunity fund. In fact, HTC rehabilitations qualify as “substantial renovations,” one of the defined ways in which an investor can receive OZ tax benefits.

Image: Courtesy of Heritage Consulting Group
The American Graphophone Company complex in Bridgeport, Connecticut, was rehabilitated using HTCs and LIHTCs.

Some development opportunities, however, do not present themselves as ideal candidates for combining the OZ incentive with HTCs. For a variety of reasons, most notably due to the use of alternative economic incentives, a developer may choose not to pursue funding of their project through an OZ investment. An excellent example of the challenges in combining incentives is found in the recently completed rehab of the former American Graphophone Company complex in Bridgeport, Connecticut. Upon completion in 2022, the historic sound recording device manufacturing complex was transformed into a mixed-use site, resulting in the introduction of much-needed affordable housing and a charter school to the southwest Connecticut community.

American Graphophone Company

The American Graphophone Company was established in 1887 as a means to produce and distribute Alexander Graham Bell's improved phonograph, the graphophone. Invented at Bell's fabled Volta Laboratory, the graphophone allowed for longer recordings to be played at a vastly superior quality to Edison's phonograph. Throughout the remainder of the 19th century and into the first quarter of the 20th century, the graphophone rose to become one of the most common forms of home entertainment. For much of that time, the American Graphophone Company was the most prominent producer of graphophones. American Graphophone later became Columbia Records.

The Bridgeport complex grew as a result of the company's success, ultimately expanding into the existing full-block-length campus directly adjacent Interstate 95. Throughout its history, the American Graphophone Company served as one of Bridgeport's most important industrial companies. The complex was listed in the National Register of Historic Places in 1985 as a contributing resource to the Railroad Avenue Industrial District.

Historic Rehabilitation

The American Graphophone Company complex was largely rehabilitated into affordable apartments and a school through the twinning of HTCs with low-income

housing tax credits (LIHTCs). When the project began in 2014, OZs were not yet established and developers Gary Flocco and Geoff Ravenstine of Corvus Capital Partners had largely defined their capital structure for both the housing and school portions of the complex. Despite the timing of the project, both Flocco and Ravenstine noted the challenges they would have encountered if they chose to pursue OZ investment. Flocco explained that they largely work in the development of affordable housing, noting that "OZs do not always work well with LIHTCs."

Ravenstine added, "If the deal had begun two years later, we would have certainly been able to benefit from OZs on the charter school portion of the project, but the challenges with financial timelines on all three of the OZs, LIHTCs and HTCs would have been working against one another had we chosen to pursue them all."

For Flocco and Ravenstine, the ability to twin LIHTCs with HTCs, including both state and federal HTCs, was sufficient to complete the rehabilitation without the need for additional financing avenues. As a result, new historically compatible windows, apartment units that showcase the industrial heritage of complex and the restoration of historic skylights highlight the rebirth of what was once among Bridgeport's largest employers. Though many developers find success in combining OZs with HTCs, ultimately, the rehabilitation stands as a testament to the reuse of historic buildings, maintaining one of Bridgeport's most identifiable and visible landmarks.

Conclusion

Although the American Graphophone Company complex is located within the boundaries of an OZ, its rehabilitation did not take advantage of the OZ opportunity. With the amount of housing the rehab produced, however, Flocco and Ravenstine believe that the project will ultimately spur further development in the neighborhood. As Flocco noted, "the rehabilitation added enough housing in a desirable location that may eventually support retail, food and other commercial activity." He continued, "it is easy to envision OZs having an impact on those future investments."

The true impact of a project like the American Graphophone Company's rehabilitation may lie in illuminating a major pitfall in the OZ program. In cities across the country, there is a growing need for housing, and in particular, affordable housing. As the real estate market continues to favor housing, developers will look to add units within OZs. The structuring of OZ investments revolves around a 10-year period, whereas LIHTC has a 15-year compliance period. Ravenstine explained the challenges with this, noting "the OZ would be great at the 15-year expiration of our LIHTC compliance. At that point all of the tax credit investors will be accounted for and we could have capitalized on refinancing through OZ incentives." Succinctly, while the OZ benefits the investor, it does not always benefit the project itself.

This disconnect may have significant impacts on additional LIHTC and HTC projects, many of which can benefit from the additional capital. Flocco expanded on Ravenstine's comments, explaining, "With interest rates so high at the moment, the additional financing could replace the additional debt and OZs would be a huge tool." Changes to the incentive could have significant impacts in markets around the nation, including in Bridgeport and many other Connecticut cities that have a significant need for housing, and underused historic fabric to accommodate that need. As Flocco said, "Now would be the time if changes could be made to expand this program even further." ❖

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Cindy Hamilton is president of Heritage Consulting Group.

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