Using EB-5 capital to maximize Opportunity Zone benefits

Opportunity Zone Magazine Staff

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With the recent reauthorization of the EB-5 Regional Center, investors may want to take a closer look at the advantages of both the EB-5 and Opportunity Zone programs together to maximize their benefits. The EB-5 and Opportunity Zone programs are compatible, and EB-5 developers and fund managers can work in Opportunity Zone projects to meet investor interests and needs, experts say.

"Opportunity Zones and the EB-5 Regional Center program are similar in that they are both Congress sponsored initiatives that are intended to have a positive impact in communities in need," says Reid Thomas, Chief Revenue Officer and Managing Director, JTC Americas.

The EB-5 program and Opportunity Zone programs both stimulate economic development in underserved areas and offer specialized benefits.

"Impact project funding can be complicated and usually requires project sponsors to have to work with a range of capital source to fill out the capital stack. With the EB-5 program now being renewed, EB-5 capital is now another tool available to achieve the positive impact in communities that project sponsors are focused on," says Thomas.

HOW THE EB-5 AND OPPORTUNITY ZONE PROGRAMS CAN COMPLEMENT EACH OTHER

The EB-5 Targeted Employment Area (TEA) is comparable to an Opportunity Zone. Thomas says EB-5 and OZ line up in many key ways.

"First, many Opportunity Zone Funds are real estate-focused, as are a lot of EB-5 investments; second, if the project falls within an area that is both an EB-5 Targeted Employment Area and a Qualified Opportunity Zone, investors will be able to take advantage of the lower investment amounts TEA's offer," says Thomas.

EB-5 is focused on the benefit of immigration, whereas the Opportunity Zone program is attractive for its benefit of tax deferral and tax exclusion while providing a return on investment. Thomas says EB-5 and OZ capital can be used in the same project as different parts of the capital stack.

"OZ capital must be deployed as equity. EB-5 can be more flexible but has historically been used most commonly as mezzanine debt," says Thomas.

After nearly nine months, the Regional Center Program was reauthorized by Congress, which passed the $1.5 trillion omnibus package that contained the EB-5 Reform and Integrity Act of 2022 on March 10. The reauthorization of the regional center program has brc more opportunities for investors to use both programs.

“The new legislation will clearly enhance the ability to raise EB-5 capital in TEA locations,” says Ronald R. Fieldstone, Saul Ewing Arnstein & Lehr LLP. “Many TEA locations will be located in opportunity zones. Therefore, both programs will complement each other since they both are supposed to promote the raising capital for development in higher unemployment and disadvantaged areas.”

HOW TO FULFILL THE CRITERIA OF BOTH EB-5 AND OPPORTUNITY ZONES

Catherine DeBono Holmes of Jeffer, Mangels, Butler & Mitchell LLP says while it is possible to use EB-5 and Opportunity Zone financing in combination, a challenge will be finding designated Opportunity Zone census tracts that qualify as TEAs under the new EB-5 requirements.

“The next challenge would be to locate investors who have qualified capital gains to invest, because only qualified capital gains are eligible for the tax benefits of Opportunity Zone investment, and those investors would have to make investments in equity of the project,” says DeBono Holmes.

“The project itself would have to satisfy all of the requirements necessary to be “qualified opportunity zone property,” including that the project be either “new use” or “substantially improved” within 31 months.”

In addition, she says the project would have to meet all of the requirements that apply to EB-5 investments, such as the new job creation requirements, which would mean most multifamily apartment projects will likely not qualify for EB-5 financing, due to not having enough direct jobs.

“That leaves hotels, restaurants and other operating businesses that have some direct employees that will qualify for EB-5 financing,” says DeBono Holmes.

Fieldstone says there are many synergistic effects between EB-5 and Opportunity Zones, which include that all jobs created can be allocated to the EB-5 investors since the OZ Program has no job creation requirement.

“OZ investors are looking to take advantage of the tax advantages of deferring the recognition of capital gains realized that enable the funding of capital under the program and if the investment is maintained for 10 years there will be a step up of basis upon sale to fair market value that in effect eliminates a recognition of the capital gains,” says Fieldstone.

Further, he notes that the EB-5 program generally has a loan model at favorable rates and does not affect the allocation of the ownership interests of the OZ investors. And, he says all depreciation tax benefits are allocated to the equity investors. He also says the EB-5 investment can be repaid upon a refinancing within a five or six year period without having to sell the property that would negate the 10 year holding period.

He adds that senior lenders typically view EB-5 subordinated financing as a form of equity, which means that the combination of both could reduce the amount of senior financing.

“As to funding, both programs now provide about five years of continued existence to fund moneys subject to extension,” says Fieldstone.

He says certain projects before June 30th, 2021 have used both programs in raising capital for hotels, multifamily and mixed use projects throughout the U.S.

He notes that the Opportunity Zone program is appealing, mainly to US investors, due to the U.S. tax benefits and that the EB-5 program only applies to foreign investors, so there is no conflict in the obtaining of funds for each source.

“There is clearly substantial capital available to fund OZ projects, including funds that raise significant capital in the billions of dollars,” says Fieldstone.

“The EB-5 program has the potential to continue to raise substantial equity as well. The ultimate results of this combination remain to be seen.”

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