Opportunity Zones

A powerful new tax incentive for real estate investors, venture capital, private wealth, family offices and private equity

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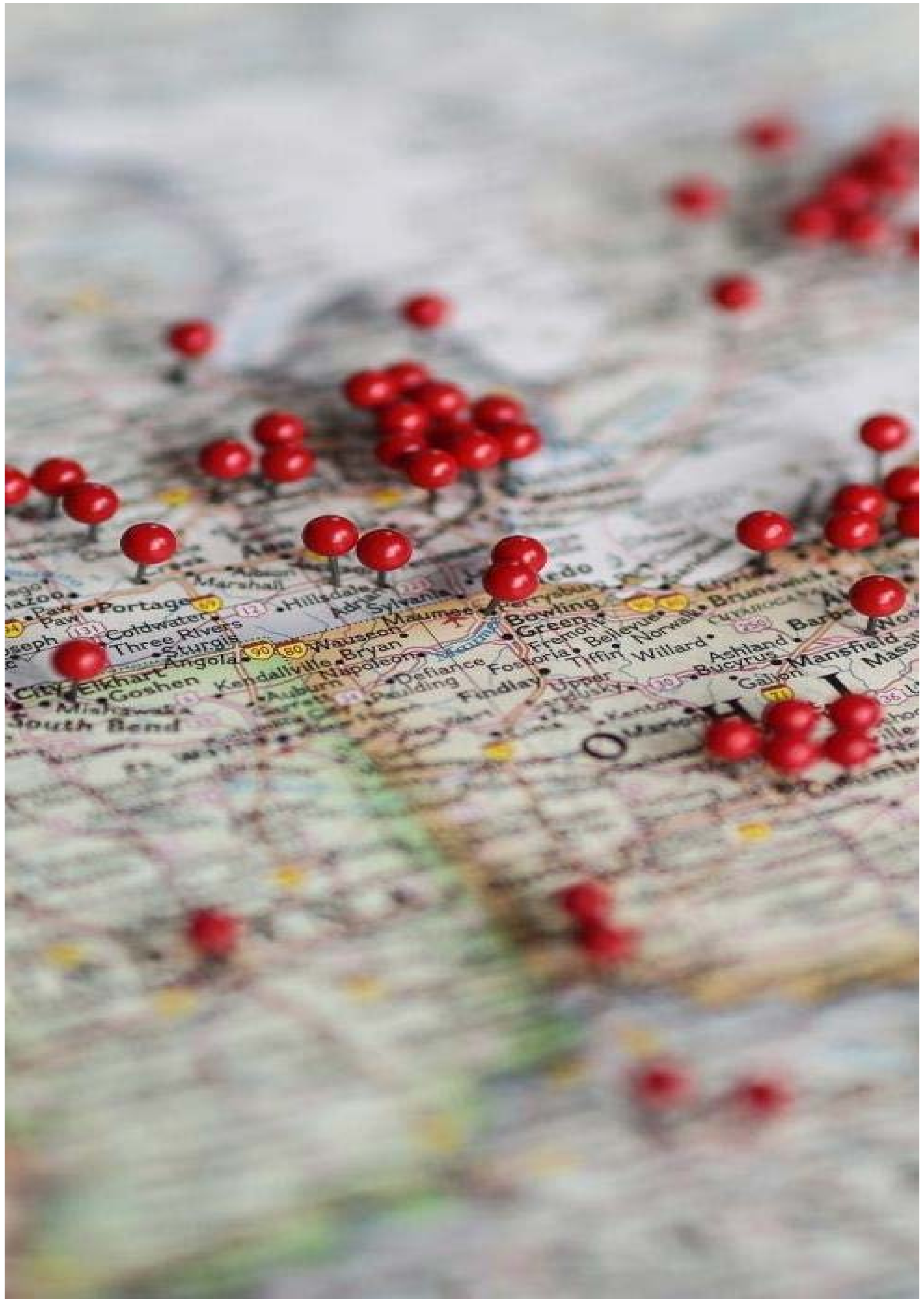

What investment types does the OZ program favor?

Commercial real estate	Works well since the program is focused on long-term investment and real estate is not going to grow out of compliance (outside of the OZ) like an operating business could potentially
New business startup in an OZ after Dec. 31, 2017	Application is possible, indeed it is what the program intended to benefit but continue to need guidance by Treasury as to how to apply the OZ legislation to start-up businesses
Expanding an existing business into an OZ	This investment type should also benefit from the legislation, but if the business outside of the OZ is a substantial part of the overall business, may have to set up a regarded entity to run operations inside the OZ to ensure compliance
Small business already in an OZ with large expansion	If the business is already in an OZ on Dec. 31, 2017, none of those assets would be Qualified Opportunity Zone Business Property. As a result, the business expansion would have to meet the “substantial improvement” requirement. The question is, how do you quantify “substantial improvement” when looking at an operating business? Treasury needs to clarify although the new 70/30 rule for qualified Opportunity Zone businesses affords some leeway

BUILDING A CAPITAL STACK

Pairing OZs with other credits and incentives

Our team of **80 professionals** has experience in municipal, state, federal and international incentives programs and negotiations. Many of these programs can be paired with **Opportunity Zones** to decrease project sponsor equity.

Comprehensive credits and incentives solutions:

- New Markets Tax Credits (NMTC)
- State and local credits and incentives
- Job creation and retention credits
- Tax Increment Financing (TIF)
- Property Assessed Clean Energy (PACE)
- Historic Tax Credits (HTC)
- Opportunity Zones
- EB-5 Immigrant Investor Program
- VA Loan Guarantee Program

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REQUIREMENTS FOR QUALIFIED OZ BUSINESS PROPERTY

"Qualified Opportunity Zone Business Property" means tangible property used in a trade or business of the fund as long as:

- (1) The property was acquired by the QOF *by purchase* from an *unrelated* party (20%) after December 31, 2017, and
- (2) The *original use* of such property in the QOZ commences with the QOF or the QOF *substantially improves* the property, and
- (3) During *substantially all* of the QOF's holding period for such property, *substantially all* of the use of such property was in a QOZ
  - What "substantially all" means in this context has not yet been defined

Original use or substantial improvement

The original use of the Opportunity Zone property must commence with the fund or there must be "substantial improvement" to the property.

- The Opportunity Fund has a 30-month window to improve the property, such that the basis of the property increases by an amount that exceeds the amount of the adjusted basis at the beginning of the 30-month period
- The basis of the land is excluded from the underlying calculation
- For example, an Opportunity Fund acquires a building for $10 million, $4 million attributable to the land and $6 million attributable to the improvement; at the end of 30-month period, improvements of $6 million + $1 must be made

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REQUIREMENT FOR QUALIFIED OZ BUSINESS

This is the two-tiered structure with the fund having equity (stock or partnership interest) in the lower tier project. The term qualified opportunity zone business means a trade or business:

- In which *substantially all* of the property owned or leased by the taxpayer is QOZ business property (70/30)
- At least 50% of the gross income from the business "is derived from" the *active* conduct of a trade or business
- If there is intangible property, that a substantial portion of it is used in the trade or business
- There is no more than 5% non-qualified financial property + reasonable amount of working capital
  - Regulations provide a 31-month safe harbor for working capital held by the business if certain requirements are met. Significantly reduce risk for QOF for failing to met 90% test
- (5) The QOZ business is not engaged in a "sin" business as described in Section 144(c)(6)(B)

CHALLENGES FOR OPERATING BUSINESSES

50% of gross income derived from the active conduct of a trade or business “in the Opportunity Zone”

- Proposed regulations seemingly require predominately localized sales for a qualified OZ business
  - Question: Does the majority of income have to be derived from a single point of sale in an OZ?
- This restrictive interpretation would disqualify most of e-commerce, manufacturing and other businesses that sell outside of an OZ, consider:
  - Insurance company with policy sales outside of OZ
  - For an IT company, effect of using licensing agreements with parties outside the OZ and receipt of revenue for licensing outside the OZ.
- This issue should be addressed in the next set of regulations

No working capital safe harbor for operating business to deploy proceeds not related to tangible assets

- Currently have a safe harbor for deploying cash to construct, acquire or substantially improve tangible property
- Do not have a safe harbor period during which a start-up is using the cash investment toward operations and not engaging in the active conduct of a business
- Adopting a working capital safe harbor that allows for invested cash to be absorbed in operations (non-real estate development) over an extended period is needed
- Problem where a limited amount of cash is used towards tangible property purchase or expansion, and the bulk of the investment is applied towards operation (non-real estate development). This includes using the invested cash towards license costs and wage expense.
- Without the safe harbor, fund will be penalized for not having proceeds invested in OZ business that has its assets in “qualified property”

CHALLENGES FOR OPERATING BUSINESSES

10-year hold required for achieving tax-free appreciation – realistic?

- Investors reluctant to hold a stake in a single company for 10 years given all the forces that could intervene in that period

- Investors cannot divest from less-than-successful companies to keep their capital working productively in an OZ under current rules and get tax-free appreciation on sale of fund interest

  - 80% of small businesses with employees will survive past their first year, 70% in year two, and only 50% will survive their 5th year in business*

- Should require that an investor hold its interest in a OZ fund, as opposed to a specific business, for 10 years

*Bureau of Labor Statistics (2017)

CHALLENGES FOR OPERATING BUSINESSES

Tech company challenges

- If your business involves intangible property, a “substantial portion” has to be used in the active conduct of “any such business”
- What does “substantial portion mean”? 40%, 51% or even 70%?
- What does it mean to “be used in the active conduct”?
- Does the sole use of the intangible property have to be in the geographic confines of the OZ? How do you determine the situs of intangible property?

How does the often referenced $6 trillion of capital find the deals to invest in?

What tools are employed for investors to locate prospective projects?

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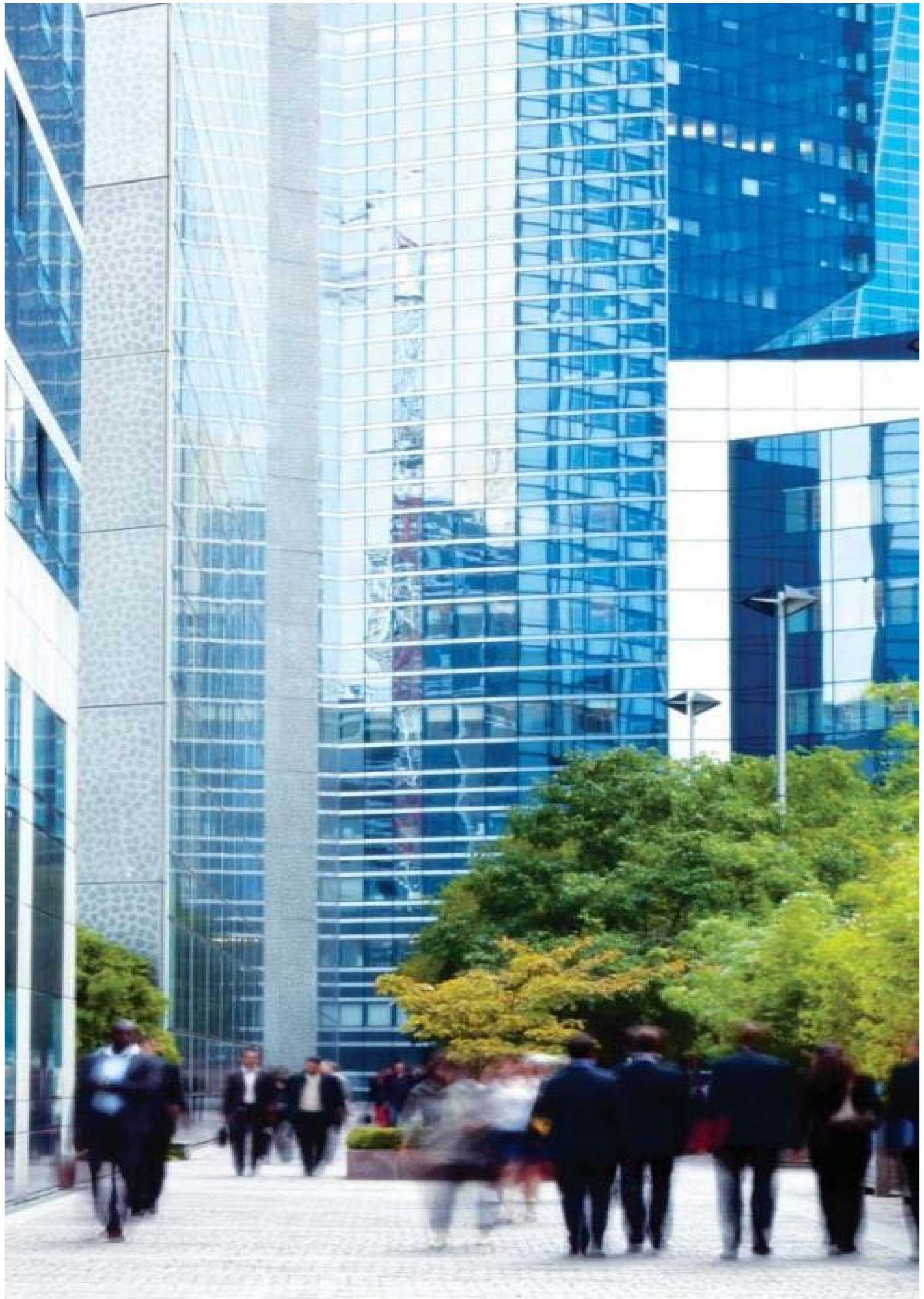

NATIONAL COUNCIL OF STATE HOUSING AGENCIES (NCSHA)

Opportunity Zone Fund Directory

"The Opportunity Zone Fund Directory is an **informational tool for the growing community of investors, developers, and public agencies** interested in realizing the promise of Opportunity Zones to generate new investment in economically distressed communities," said Stockton Williams, executive director of NCSHA. "State Housing Finance Agencies across the United States are targeting their resources, convening their partners, and assessing their local markets to help achieve this goal."

*https://www.ncsha.org/ncsha-news/ncsha-releases-opportunity-zone-fund-directory Published on October 24, 2018

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CONNECTING THE PLAYERS

OPPORTUNITY INVESTMENT CONSORTIUM INDIANA

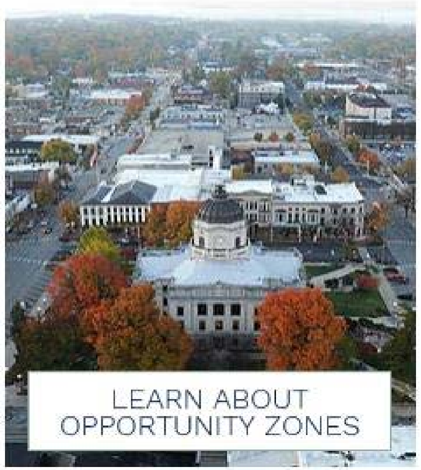
Encouraging investment in Indiana communities

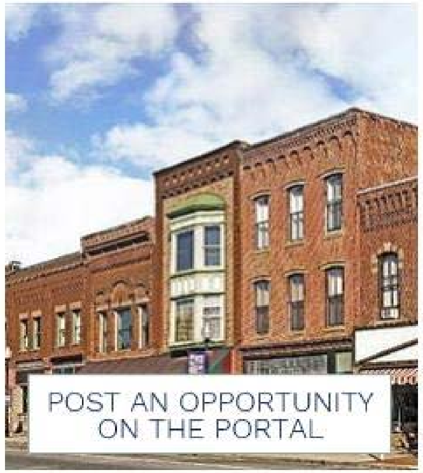
ABOUT | POST AN OPPORTUNITY | INVESTORS | PROFESSIONAL SERVICES | TRAINING AND RESOURCE PARTNERS

Opportunity Zones were designated throughout the country in 2018 in response to bi-partisan legislation at the federal level. The goal of the Opportunity Zone initiative is to encourage long-term private capital investment in low-income urban and rural communities. The program offers long-term federal tax deferral on capital gains for investments in designated Opportunity Zones, with additional tax exclusion from new capital gains achieved from those investments.

The goal of the Opportunity Investment Consortium of Indiana is to help more intentionally encourage the transformation of Opportunity Zone neighborhoods into vibrant places for residents and businesses. The consortium is comprised of a public/private collection of investors and community partners poised to support and invest in Opportunity Zones through the facilitation of this online pairing tool.

In addition, stakeholder roundtables meet regularly to discuss support for advancing projects, and the training and professional resource partners further assist the effort by providing access to critical legal and financial services, training and information.





THE SINGLE ASSET FUND

The leading OZ investment vehicle (for now)

- Unresolved questions about the multi-asset fund
  - Treatment of gains generated from disposition and redeployment before liquidating the QOF
  - Step-up in basis occurs at the QOF level, not at the underlying asset level
- Easier to demonstrate compliance and instill investor confidence
- Investors decide on an identified tangible project
- Inefficient for conventional approach to raising and deploying large amounts of capital over a diversified pool of assets
- Multi-asset funds will be part of the program, uncertainty of the management of those assets is causing delays

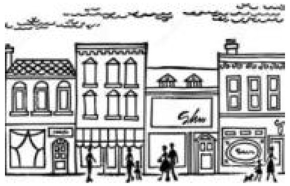
INVESTMENT STRUCTURE

Options for direct or indirect Qualified Opportunity Fund (QOF) investment

Qualified Opportunity Fund

1 Indirect Ownership

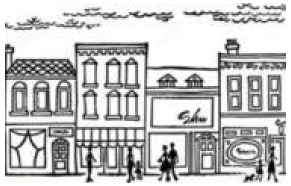
Qualified Opportunity Zone Stock



Invested in a Qualified Opportunity Zone Business

2 Indirect Ownership

Qualified Opportunity Zone Partnership Interest



Invested in a Qualified Opportunity Zone Business

Qualified OZ Property

3 Direct Ownership

Invested in Qualified Opportunity Zone Business Property

Fund certification

Statutory requirements for QOF

- Must be a corporation or partnership-LLC qualifies
- QOF organized for the purpose of investing in QOZ property
- 90% of assets must be QOZ property on two measuring dates—6 mos and end of calendar year

Certification process

- QOF self-certification on Form 8996/No formal IRS approval

Noncompliance penalty for failure to meet 90% test

- Federal short-term rate plus 3%
- No penalty if it is shown failure is due to “reasonable cause”
- Reasonable cause has yet to be defined for this purpose

The regulations clarified that QOF interests can be common or preferred, as long as equity

- Debt is not eligible for the tax benefits

LAYERING OF STATE INCENTIVES

It's competitive out there - some states are discovering that they need to up their game to attract projects, including:

- MD-Property tax abatement
- MD-Tax credits for each newly created job
- MD-Additional funding sources
- MO-Modification of caps such as HTC award limits
- MD-Fees reduced or waived for business recording/filing
- MD-Workforce training for employees
- NJ-Rent assistance for tenants in OZs
- ND-Priority in allocating state affordable housing funds to OZ projects
- CA-Exempt OZ projects from environmental constraints
- MI-State required to purchase supplies and services from OZ businesses

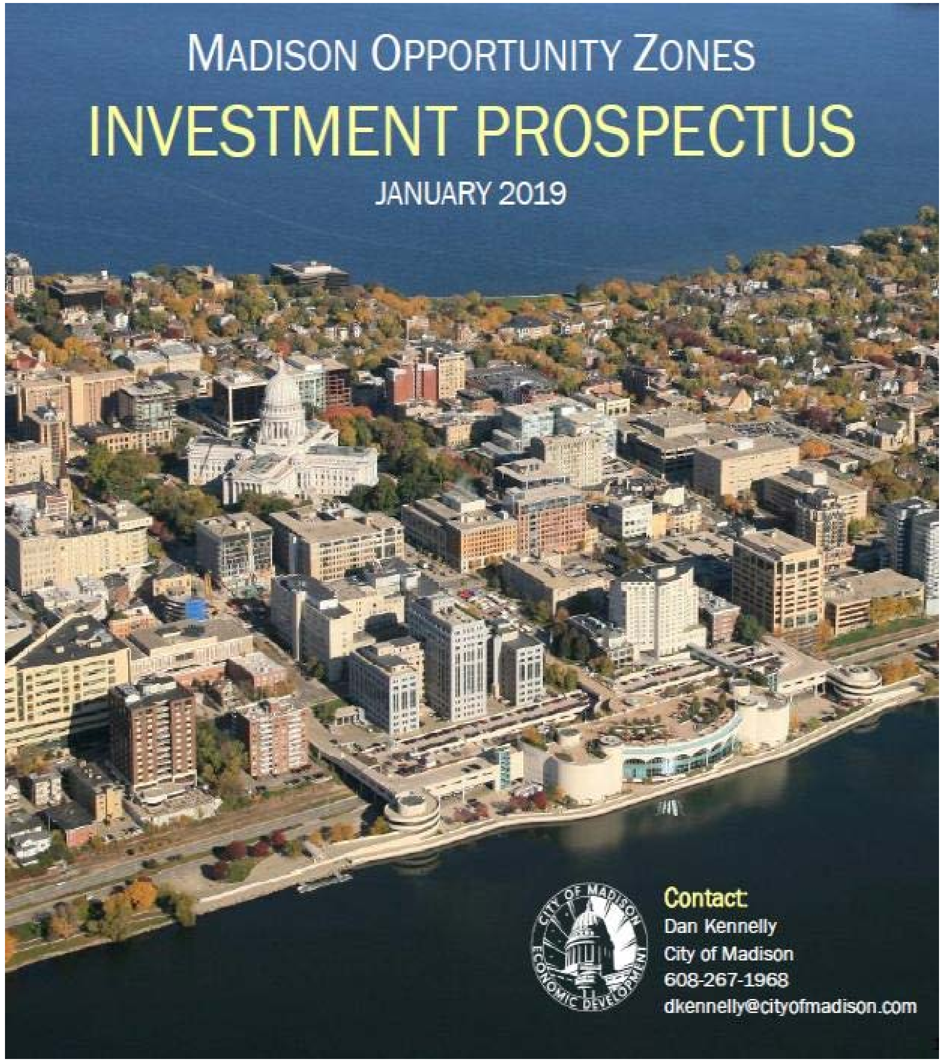
Maryland governor proposes committing $56m to OZs

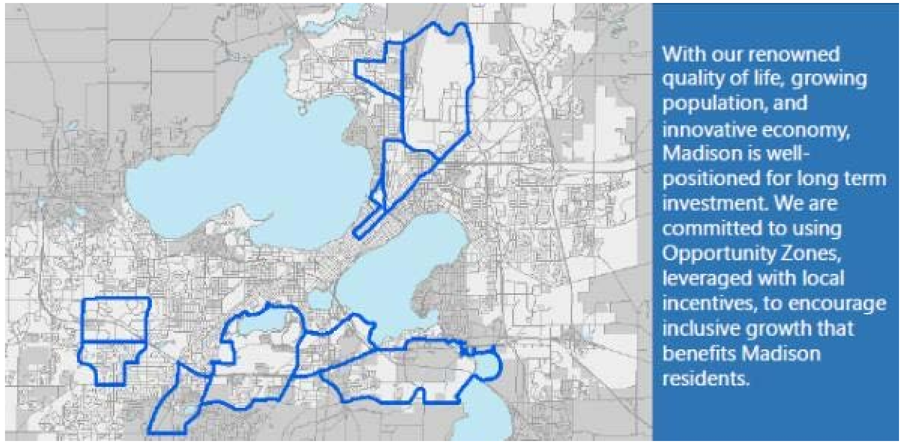
"So we plan to do everything in our power to utilize new and existing state and federal programs, grants and funding sources, and to have all of our state agencies work together with our county and municipal governments and the private sector to supercharge our Opportunity Zone revitalization. Our plan is to make Maryland's 149 Opportunity Zones the most competitive in America."*

*The Washington Post – Hogan to bolster 'opportunity zones' with state investments 1/3/19

CONNECTING THE PLAYERS

Madison, WI: Opportunity Zones





Madison, Wisconsin has created a “prospectus” for investors to facilitate interest in its Opportunity Zones

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