NC General Convening on Opportunity Zones

What is an “investment ready” real estate project, and how do you get there?

Tyler Mulligan and Sarah Odio

Agenda

• DFI @ UNC School of Government

• What is an “investment-ready” project and why is it important in the context of Opportunity Zones?

• Getting to an “investment-ready” project

• Case Study: Durham County
UNC School of Government

- Largest university-based local government training, advisory, and research organization in the U.S.
- Serves 12,000+ public officials each year through courses, webinars, and specialized conferences, publications, calls, and emails.
- Values: Nonpartisan, policy-neutral, responsive.
- “In the bloodstream” of state and local government.

Development Finance Initiative

The Development Finance Initiative (DFI) is a program of UNC Chapel Hill’s School of Government and collaborates with communities in NC to attract private investment for transformative projects by providing specialized finance and real estate development expertise.

Expertise:
- Real estate development
- Architecture
- Public and private finance
- Public-Private Partnerships (P3)
- Public development law
- Community engagement
- Land use & market analysis
Typical DFI Projects Involve Public-Private Partnerships

REACTIVE
• Private Owner needs government partner

PROACTIVE
• Government Owner needs private development partner

DFI Projects

End of 2017
118 Projects since 2011
Over 30 class projects at no charge

Size of Community
>50,000  23
<50,000  26
<20,000  51
<2,500   18

Economic Development Tier
Tier 1    33
Tier 2    45
Tier 3    40
NC Opportunity Zones

- NC Opportunity Zones: 252
- US Opportunity Zones: 8,700 (12% of US census tracts)

Counties with the most OZs:
- Mecklenburg: 17
- Wake: 13
- Guilford: 12
- Forsyth: 11
- Cumberland: 9
- Gaston: 9
- Robeson: 7
- Durham: 7
- Rowan: 5
- Pitt: 5
- Edgecombe: 5
- Buncombe: 5

DFI Projects in OZs:
- Concord
- Durham
- Gastonia
- Kannapolis
- Morganton

10 Year Hold: Advantage for Real Estate

Assumptions:
- 20% capital gains tax
- 10% OZ asset appreciation (annual)

OZ Investment Example

- Sale of Tar Heel Inc Stock
- Capital Gains Tax Due
- Sale of OZ Asset
- $1.6 Mil Capital Gain Tax Free

Tar Heel Inc Stock Gains
- Capital Gains Tax
- Tar Heel Real Estate Dev. (OZ Investment)
Why “Investment Ready” Is Important

- OZ designation is not a strategy
  - Capital flows to “ready” projects
  - Best practice for P3 (OZ or not)
- OZ timing
  - Max benefits if invest by 2019
  - Short period to invest cap gains in OZ
    - Investor has 180 days to invest in “Opportunity Fund”
    - **No outside “fund” is required;** developer or investor can simply “self-certify” as “Opportunity Fund”
    - “Opportunity Fund” must hold OZ property for semi-annual 90% test

What is an “investment-ready” project?
Private Real Estate Development Process

What is an investment-ready project?

- Site control (of well-located and development-ready site)
- Financially feasible
  - Strong market for desired product type
  - Returns that exceed financial “hurdle rates”
- Good private partner: Experienced developer
- Good public partner: Low barriers to entitlement

Sources: Miles et al., Peca, Peiser & Hamilton
An investor opens up a prospectus...

NORTHERN EDUCATION DISTRICT
Multi-university district walking distance to downtown

ZONE TYPOLOGY TYPE
Tier 2 Job Center & Mixed Job/Residential

OPPORTUNITY ZONE JOBS
2010: 3,648
2011: 3,599
-1% change

TOP 5 INDUSTRIES
1. Health Care and Social Assistance (24%)
2. Educational Services (16%)
3. Professional, Scientific & Technical Services (12%)

OPPORTUNITY ZONE RESIDENTS
2010: 4,911
2011: 4,848
-2% change

VACANT RESIDENTIAL PROPERTIES
2010: 323 (17%)
2011: 41 (11%)

VACANT BUSINESS
2010: 84 (15%)
2011: 76 (11%)

The Assets
- Establishing a university district, distinct from the University
- Spurking University—focusing largely on in-demand healthcare and business fields.
- 88 million Jefferson Technical & Community College
- Manufacturing and Information Technology
- Simmons College—Louisville’s rapidly growing HBCU.

Investment
- Invest in student housing, retail, and office uses.
- Invest in business start-ups aligned with research and entrepreneurship of each university.

Please go to pollev.com/tmulligan and respond
...and another prospectus...

Please go to pollev.com/tmulligan and respond
Getting to an “investment-ready” project (advice for governments)

How Can Local Governments Be Proactive?

- Prepare the area for private investment:
  - Invest in public infrastructure
  - Invest in streetscape improvements
  - Reduce blight, code enforcement, clean up
    - Sends a market signal that promotes development
  - Identify appropriate district designations
    - URA (Urban Redevelopment Area), MSD (Municipal Service District), Historic, Special Assessment District

- Create an investment-ready project
Case Study

Getting to an investment-ready project in Durham County
Idea

- Two County-owned surface parking lots in downtown Durham. One lot located in opportunity zone.
- Initial plans to build just parking decks on the sites received considerable push back from well-organized advocacy groups who saw a missed opportunity for affordable housing.
- DFI engaged to conduct pre-development process.
  - **Goal:** Attract private development partner to execute the County's vision.

Site Control
DFI Feasibility Analysis

Feasible Project

Site Analysis

Public Interests

Market Analysis

Financial Analysis

Public Engagement on Public Interests

Engagement included:
- Ongoing listening sessions with local stakeholder groups
- Four public input sessions
- Regularly updated project page on County website
- Online feedback form
- County employee survey
Market Analysis

Pipeline Office Supply

<table>
<thead>
<tr>
<th>Development Project</th>
<th>Office Space (SF)</th>
<th>Less Prelease</th>
<th>Total Pipeline</th>
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<tbody>
<tr>
<td>One City Center</td>
<td>130,000</td>
<td>(123,000)</td>
<td>7,000</td>
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<tr>
<td>Durham I.D.</td>
<td>270,000</td>
<td>(162,000)</td>
<td>108,000</td>
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<tr>
<td>555 Magnun</td>
<td>180,000</td>
<td>200,000</td>
<td>480,000</td>
</tr>
<tr>
<td>Golden Belt Campus</td>
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Retail Trade Area

Despite the addition of office space remains feet based on base properties are:

- 9,800 Households
- $38,000 Median Income
- 32 Years Median Age

Project Annual Growth (2017 - 2022)

- Population: 1.1% vs. USA: 0.8%
- Households: 1.1% vs. USA: 0.8%
- Median Household Income: 4.2% vs. USA: 3.9%

Site Analysis

Design Requirements

- Downtown Durham UDO Code
- Downtown Durham Historic District
- NC Housing Finance Agency Qualified Allocation Plan
- Construction Type
- Stormwater Requirements
- Regulations for specific uses (i.e. daycare, pre-K, grocery store)
Financial Analysis

1. Identify program
2. Estimate development costs
3. Forecast project income
4. Size supportable loan
5. Fill gap with equity and other funds
6. Model base case returns
7. Test project assumptions
8. Layer in public participation as needed

Do OZs make a difference?

<table>
<thead>
<tr>
<th></th>
<th>Outside OZ (Market Rate)</th>
<th>Inside OZ (Market Rate)</th>
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<tbody>
<tr>
<td>Equity</td>
<td>$10M</td>
<td>$10M</td>
</tr>
<tr>
<td>Loan</td>
<td>$23M</td>
<td>$23M</td>
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<tr>
<td>Total Sources</td>
<td>$33M</td>
<td>$33M</td>
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Estimated OZ Capital Gains Benefit (Assuming 20% Rate)

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<tr>
<th></th>
<th>5-Year Hold</th>
<th>10-Year Hold</th>
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<tbody>
<tr>
<td>5-Year Hold</td>
<td>$0</td>
<td>$200,000*</td>
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<tr>
<td>10-Year Hold</td>
<td>$0</td>
<td>$2,200,000*</td>
</tr>
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</table>

*Speculative
Public-Private Partnership
- For affordable housing:
  - Ground lease
  - Parking construction & operation
  - Loans/Grants
- For market rate:
  - Shared parking deck

Public-Private Partnerships (P3s)

P3s are helpful when:
- Government has site control over a project but requires private investment to achieve public goals.
- Private owner has project that provides public benefits. Public participation needed to secure the public benefits.
Next Steps

- Identify a private development partner or partners.
- With an investment-ready project and public-private partnership in place, the developer is well-positioned to begin attracting investors (OZ or otherwise).

Conclusion

- Opportunity Zone designation, by itself, is not a strategy
- Governments can proactively complete steps in the private real estate development process to make important projects “investment ready” (inside or outside of OZs)
- Best practices for real estate development are best practices for Opportunity Zones.