Opportunity Zones

Moderator: Napoleon Wallace
Don Dwight
Jeanne Milliken Bonds
Tyler Mulligan
Thomas Stith

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Napoleon Wallace

Don Dwight
Executive Director, Tax
Raleigh, North Carolina
Ernst & Young LLP

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Opportunity Zones Introduction

- Background
  - Created through the Tax Cuts and Jobs Act and codified in Internal Revenue Code (IRC) Sections 1400Z-1 and 1400Z-2.
  - Designed to incentivize long-term investments in economically distressed communities designated as Opportunity Zones.
  - Taxpayers receive preferential tax treatment in return for investing capital gain in Opportunity Zones through investment vehicles called Opportunity Funds.
  - Many potential Opportunity Zone investors and Opportunity Fund managers have been waiting for guidance before transacting.
  - October 19, 2018 the IRS published proposed regulations (REG-115420-18), a revenue ruling (Revenue Ruling 2018-29), and an update to its FAQ page clarifying certain key aspects of Opportunity Zone tax benefits.
  - More to come…

Capital Gain

- Receiving any Opportunity Zone tax benefits begins with investing capital gain into an Opportunity Fund.
- The capital gain must stem from a sale or exchange with an unrelated party that occurred within the previous 180 days.
- Investing other money alongside capital gain is permissible, but only the capital gain portion of the investment will give rise to tax benefits.

Step 1: Realize capital gain

Taxpayer realizes capital gain from a capital gain triggering event (e.g., taxpayer sells corporate stock).

Step 2: Invest capital gain

Taxpayer creates (or finds) an Opportunity Fund and invests capital gain into the Opportunity Fund within 180 days.

Opportunity Funds

- Opportunity Funds are investment vehicles organized as corporations or partnerships, created for the purpose of investing in Opportunity Zones.
- Opportunity Funds must be self-certified.
- Opportunity Funds must hold at least 90% of their assets in Opportunity Zone Property, calculated by averaging the percentage invested at the mid-point and end-point of the Opportunity Fund's fiscal year.

Step 3: Opportunity Fund invests in Opportunity Zone Property

Taxpayers cannot invest in Opportunity Zone Property directly. All investments must be through Opportunity Funds.

Opportunity Zone Property (Part 1)

- Opportunity Funds can acquire two types of Opportunity Zone Property:
  - Opportunity Zone Business Property
  - Opportunity Zone Stock or Partnership Interest
- Opportunity Zone Business Property
  - Must be tangible property, such as real estate or equipment, acquired from an unrelated party after December 31, 2017.
  - During "substantially all" of the Opportunity Fund's holding period of the property, the property must be used within an Opportunity Zone.
    - The Community Development Financial Institutions (CDFI) Fund provides a mapping tool for identifying designated Opportunity Zones
  - Either the "original use" of the property in the Opportunity Zone must be with the Opportunity Fund or the Opportunity Fund must "substantially improve" the property within 30 months.

Opportunity Zone Property (Part 2)

- Opportunity Zone Stock or Partnership Interest
  - Must be stock or a partnership interest in a domestic company, acquired with cash after December 31, 2017.
  - Upon acquisition and during "substantially all" of the Opportunity Fund's holding period of the investment, the company must be considered an Opportunity Zone Business.
- Opportunity Zone Businesses
  - "Substantially all" of the business's owned or leased tangible property must meet the requirements for Opportunity Zone Business Property.
  - At least 50% of the business's total gross income must be derived from the "active conduct" of the business.
  - A "substantial portion" of the business's intangible property must be used in the "active conduct" of the business.
  - Less than 5% of the average bases of the business's property is attributable to nonqualified financial property (e.g., stocks).
  - The business cannot be a "sin business," such as a country club, hot tub facility, racetrack, or liquor store.

Tax Benefits

- Upon investment of capital gain into an Opportunity Fund, the invested gain is deferred from inclusion in the taxpayer's gross income until the earlier of the taxpayer selling the Opportunity Fund investment or December 31, 2026.
- When the deferral period expires, if the Opportunity Fund investment was held for 5+ years, the gain included in gross income is reduced by 10%; If the investment was held for 7+ years, the gain included in gross income is reduced by 15%.
- When the taxpayer eventually exits the Opportunity Fund, if the Opportunity Fund investment was held for 10+ years, the taxpayer is permanently exempt from paying capital gains tax on gain realized from the sale of the Opportunity Fund investment.

Step 4: Tax deferral

Investment of capital gain → tax bill deferred until 12/31/2026 at the latest.

Step 5: 10% tax reduction

Taxpayer holds Fund investment for 5+ years → 10% tax bill reduction.

Step 6: 15% tax reduction

Taxpayer holds Fund investment for 7+ years → 15% tax bill reduction.

Step 7: Tax exemption

Taxpayer holds Fund investment for 10+ years → No taxes on capital gain from appreciation of Fund investment.

Frequently Asked Questions

- 1. What 'gains' are eligible?
- 2. What 'taxpayers' are eligible?
- 3. When does the 180 day rule begin if you're a partner?
- 4. How does basis step up work after the OZ designation expires?
- 5. Can an LLC serve as an Opportunity Fund?
- 6. How does debt impact Opportunity Fund tax benefits?
- 7. How does an Opportunity Fund meet the 90% test?
  - What about working capital needs?
- 8. Can a pre-existing entity qualify as an Opportunity Fund or Opportunity Zone Business?

Jeanne Milliken Bonds

Jeanne.Bonds@rich.frb.org

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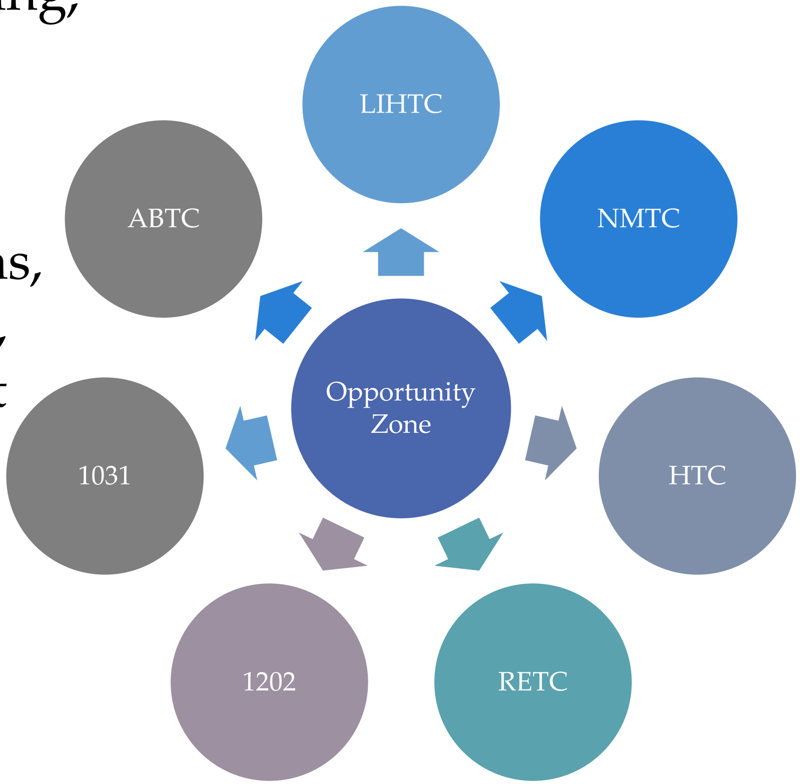
Innovative and Responsive

- Opportunity Zones are low-income census tracts
- The same definition of a "low-income community" that is used by Treasury CDFI Fund's New Markets Tax Credit (NMTC) program is the basis for defining eligible Opportunity Zone census tracts.
- The Community Reinvestment Act (CRA) focuses on low- and moderate-income.
- The policy goals of the Opportunity Zone tax incentive
  - **Drive long-term private sector investments**
  - **Channel equity capital into overlooked and underserved markets**
  - **Reinvest realized capital gains into distressed communities**
  - **First new national community investment in more than 15 years**
  - **May scale to the largest economic development program in the country**

Community Development Finance

- Pair with other funding streams that support stronger and more resilient communities.
- New opportunities--affordable housing, small businesses, and jobs--that specifically benefit low-income neighborhoods and people.
- Collaborate with financial institutions, CDCs, CDFIs to help meet the credit, housing, and economic development needs of communities.
- Use with other State, Federal tax incentives
- Use with Local tax incentives



Economic Conditions and Impact

- Massive influx in capital and the ability of a community to absorb it
- Few guardrails
- No “owner”
- Gentrification and Displacement
- Hot spots and Deserts
- Concentration in high-cost cities
- Unwelcome or harmful investments in communities
- Displacement of existing Community Development investments
- Lack of reporting requirements and metrics
- Incentives race
- Stakeholder engagement

OZ Strategies for Local Communities

Many local community stakeholders have begun conversations to both capitalize on the potential of the Qualified Opportunity Funds and develop strategies to mitigate possible harm i.e. S.C. Do no Harm

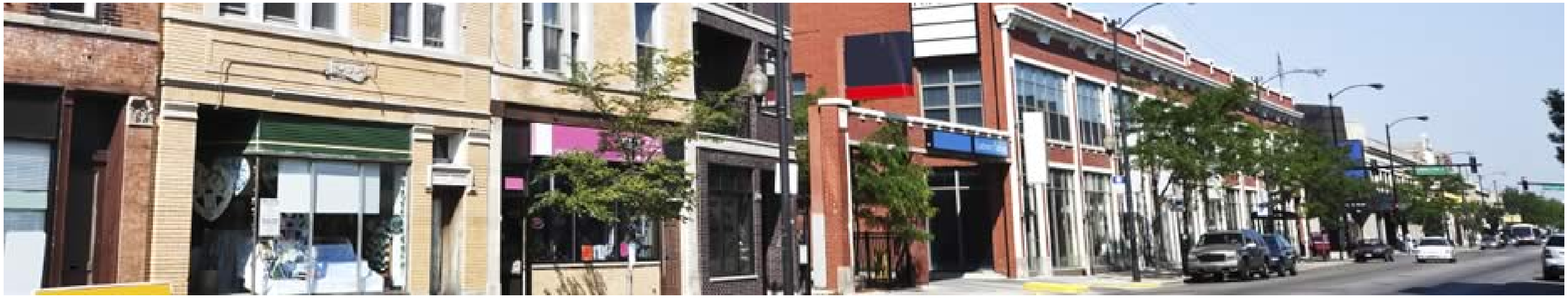
- Partnerships to raise and deploy funds (HBCU QOF, Knight Foundation West End Charlotte)
- National vs local vs regional Qualified Opportunity Funds
- Mission-oriented institutions' sponsorship of Qualified Opportunity Funds (Enterprise, Foundations)
- Qualified Opportunity Funds paired with other impact investing products
- Pairing Qualified Opportunity Funds with existing tools and credits
- Local government-driven funds
- Zoning Overlays
- Community vision and the capacity to plan

Guiding Principles for Investors & Communities

- Synergy and Balance
- Social Equity
- Impact Investing
- Collaborative Partnerships
- Transparency

Resources

- Urban Institute Opportunity Zones Investment Score Dataset
- Urban Institute Community Development Financial Flows
- Council of Development Finance Agencies Opportunity Zones page
- Novogradac Company Resource Center (Opportunity Funds)
- Federal Reserve Webinar
- Federal Reserve Bank of Richmond East Baltimore Financing



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Tyler Mulligan

mulligan@sog.unc.edu
919-962-0987

UNC Development Finance Initiative (DFI)

DFI assists **local government owners of property** with attracting private investment for transformative projects by providing specialized finance and real estate development expertise.

Expertise:

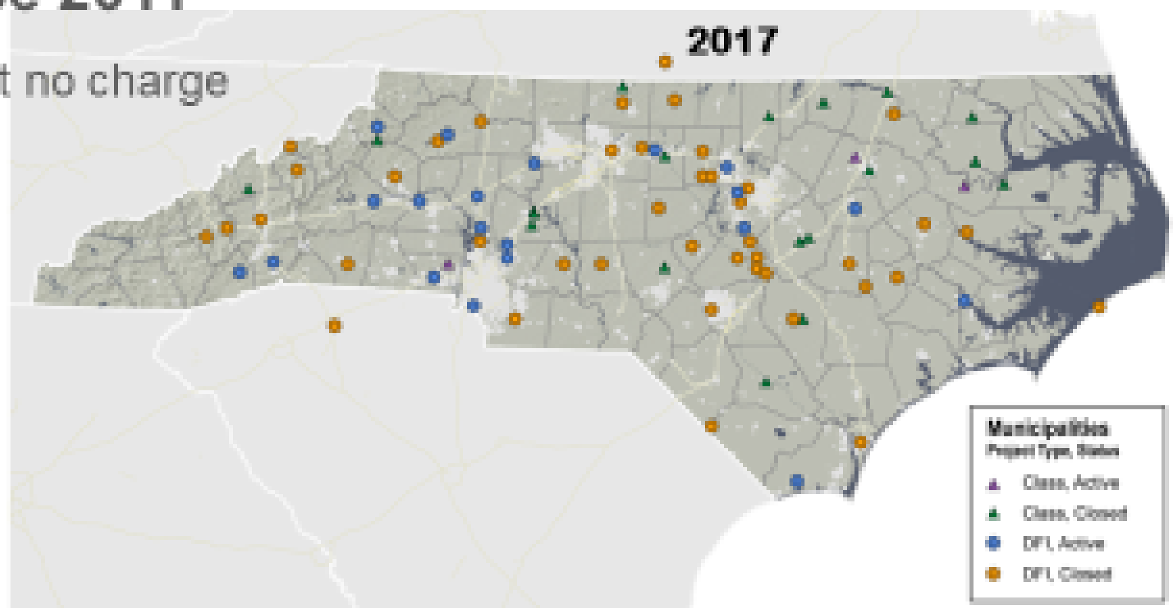
- Real estate development
- Architecture
- Public and private finance
- Public-Private Partnerships (P3)
- Public development law
- Community engagement
- Land use & market analysis

dfi

DFI Projects

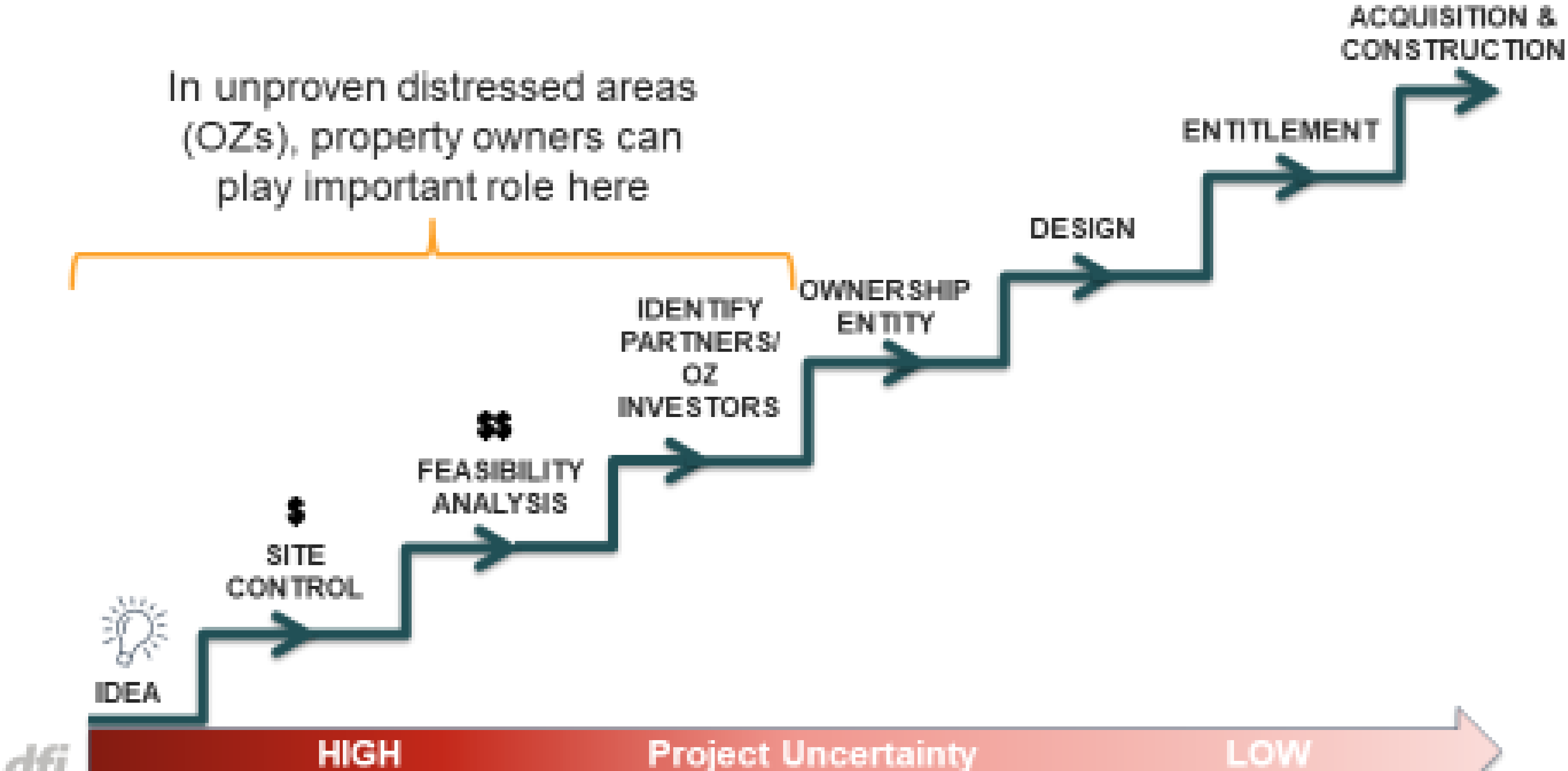
132 Projects since 2011

Over 30 class projects at no charge



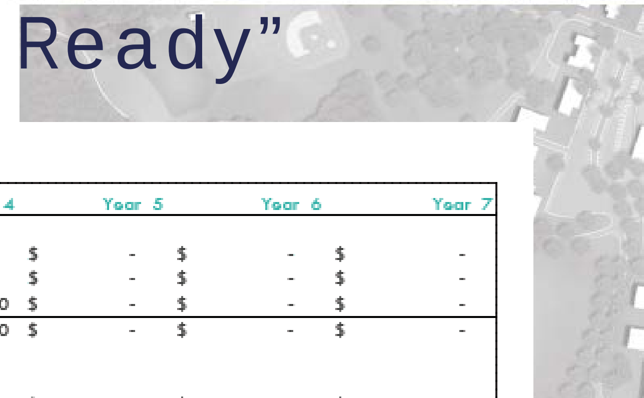
<u>DFI Projects in OZs</u>
Concord
Durham
Gastonia
Kannapolis
Morganton

Roles of OZ Owners & Development Process



Sources: Miles et al., Peca, Peiser & Hamilton

Making OZ Projects "Investment Ready"



TOTAL PROJECT RETURNS

Project Year	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Residential							
Equity Contributed	$ (4,140,551)	$ (909,400)	$ -	$ -	$ -	$ -	$ -
Before Tax Cash Flow from Sale - Townhomes	$ -	$ -	$ 4,346,367	$ -	$ -	$ -	$ -
Before Tax Cash Flow from Sale - Single-Family	$ -	$ -	$ 1,007,200	$ 2,900,700	$ -	$ -	$ -
Total Cash Flows	$ (4,140,551)	$ (909,400)	$ 5,353,567	$ 2,900,700	$ -	$ -	$ -
Commercial							
Equity Contributed	$ (2,602,546)	$ -	$ -	$ -	$ -	$ -	$ -
Before Tax Cash Flow from Operations	$ -	$ 103,459	$ 202,961	$ 135,403	$ 147,671	$ 171,007	$ 195,043
Before Tax Cash Flow from Sale	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,843,901
Total Cash Flows	$ (2,602,546)	$ 103,459	$ 202,961	$ 135,403	$ 147,671	$ 171,007	$ 3,038,943
Master Development Cash Flows	**$ (6,743,097)**	**$ (805,940)**	**$ 5,556,528**	**$ 3,036,103**	**$ 147,671**	**$ 171,007**	**$ 3,038,943**

IRR	**16%**
Equity Multiple	**1.6x**

Development Budget	Percent	Per GSF	Total
Acquisition	4%	$ 12	$ 555,750
Hard Costs & Contingency	79%	$ 235	$ 10,642,461
Soft Costs	17%	$ 51	$ 2,296,616
Total Development Costs		**$ 298**	**$ 13,494,826**

Permanent Capital Sources	Percent	Per GSF	Total
Historic Tax Credit Equity	24%	$ 72	$ 3,256,572
Primary Loan	52%	$ 156	$ 7,079,958
Seller Note	4%	$ 12	$ 555,750
Equity	19%	$ 57	$ 2,602,546
Total Sources		**$ 298**	**$ 13,494,826**

Commercial Operating Cash Flow		Year 1	Year 2	Year 3	Yea[r 4]
Gross Revenues (NNN)		$ 815,400	$ 839,862	$ 865,058	$ 891,010
	$/SF	$ 18	$ 19	$ 19	$ 20
Vacancy (%)		41%	10%	10%	10%
Vacancy ($)		$ (335,250)	$ (83,986)	$ (86,506)	$ (89,101
Gross Effective Income		$ 480,150	$ 755,876	$ 778,552	$ 801,909
Operating Expenses		$ 14,405	$ 22,676	$ 23,357	$ 24,057
NOI		$ 465,746	$ 733,200	$ 755,196	$ 777,851
	$/SF	$ 10	$ 16	$ 17	$ 17
	NOI Valuation	*$5,821,819*	*$9,164,994*	*$9,439,944*	*$9,723,142*
Total Ownership Expenses		$ (465,746)	$ (530,239)	$ (619,793)	$ (630,180
Before Tax Cash Flow with Reserve		$ 103,459	$ 202,961	$ 135,403	$ 147,671

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Thomas Stith

tstith@rivermont.com

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CAPITAL

Rivermont Capital is …

A real estate investment company

- Successor entity to Greenfire Development
- Founders: Michael Lemanski & Andrew Holton
- Based in Downtown Durham

Focused on Opportunity & Non-Opportunity Zone investments

Focused on creating diverse, dynamic and sustainable city centers

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A Distinctive Proposition

Thesis + Pipeline

- Secondary + Tertiary markets in Southeast
- Public private partnerships
- Mixed-use, walkable → rebuilding main streets

Strategic partnerships = Maximized adaptations

- National expertise on Op.Zones and similar credits
- Proprietary fund model built for Op.Zones
- Institutional-grade back office

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Questions?