

The logo for K&L GATES is displayed in white, bold, sans-serif capital letters on a dark blue rectangular background. The background of the entire slide features a complex financial data visualization with a world map, various line and bar charts, and numerical data points in shades of blue and white.

K&L GATES

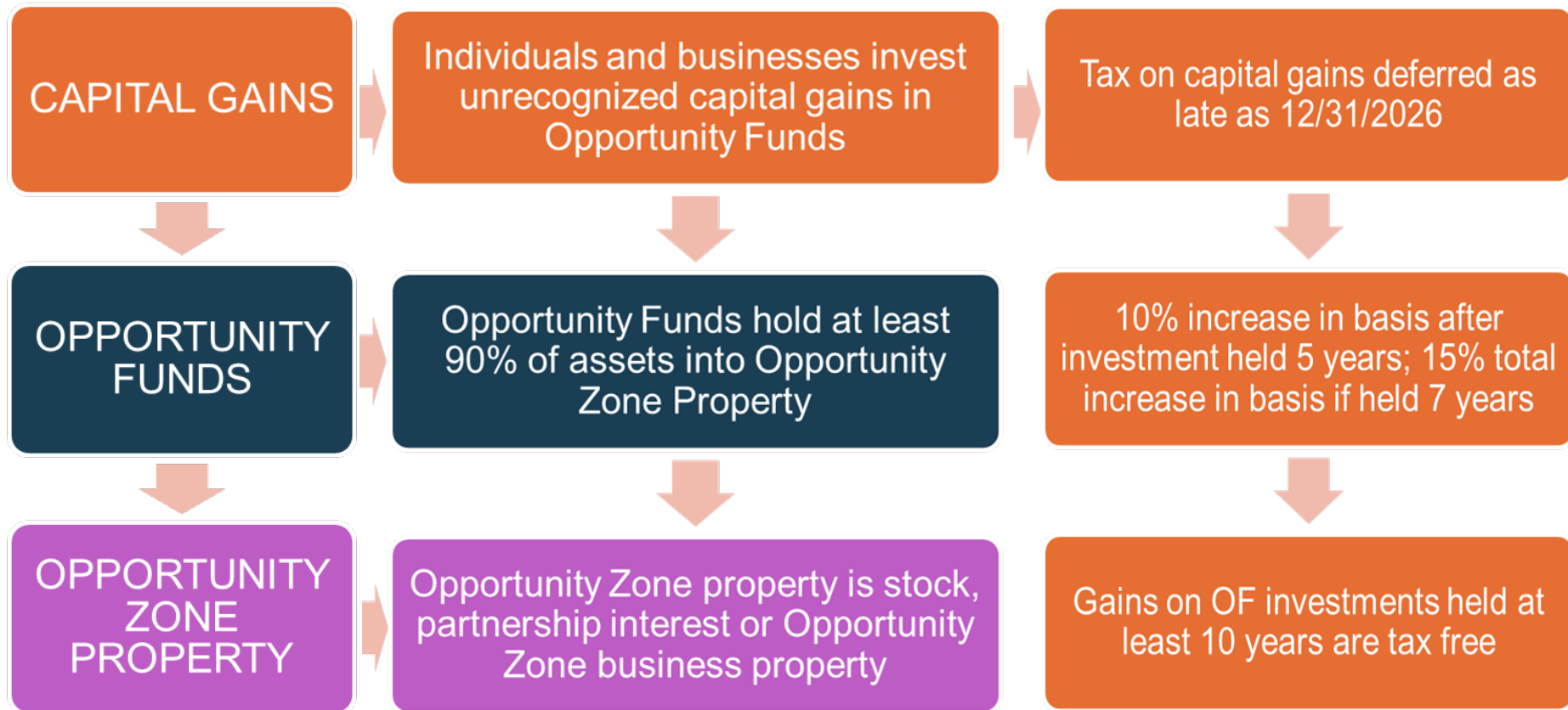
2019 Washington, DC Investment Management Conference

Private Fund Developments – Opportunity Zones

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THE MECHANICS



QUALIFYING OZ ACTIVITIES AND BUSINESSES

- Must be active, not passive
- Real estate (residential, commercial)
- Manufacturing
- Distribution/warehouse
- Retail & hospitality
- Medical clinics, day care facilities
- Energy
- Farming
- Transportation and infrastructure
- Research
- Start-ups & incubators



INVESTMENT TYPES IN OPPORTUNITY ZONES

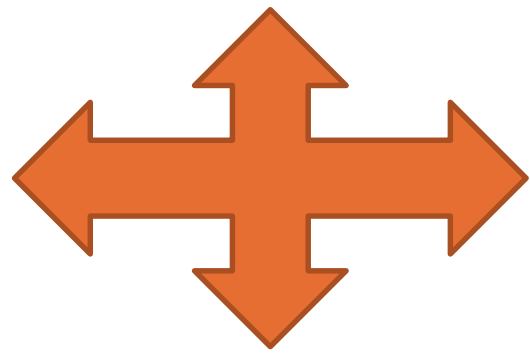
Real Estate Development and Rehab Projects



New Businesses

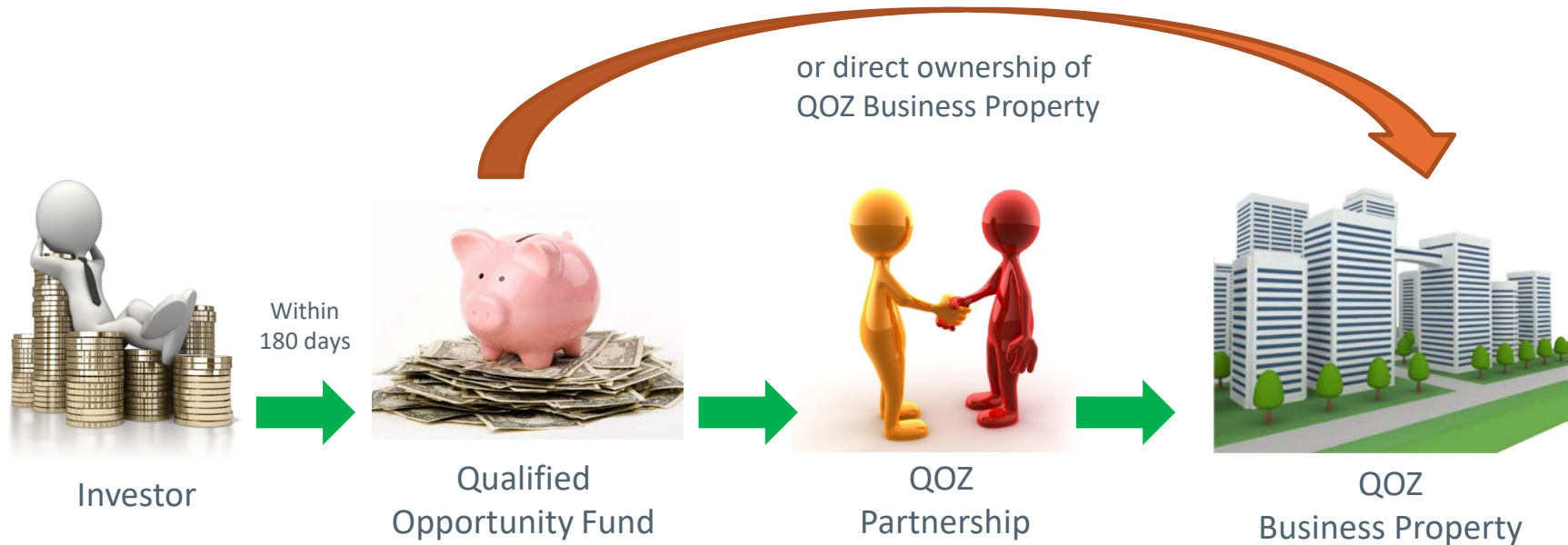


Expansion of Existing Businesses in an Opportunity Zone



Businesses expanding into an Opportunity Zone

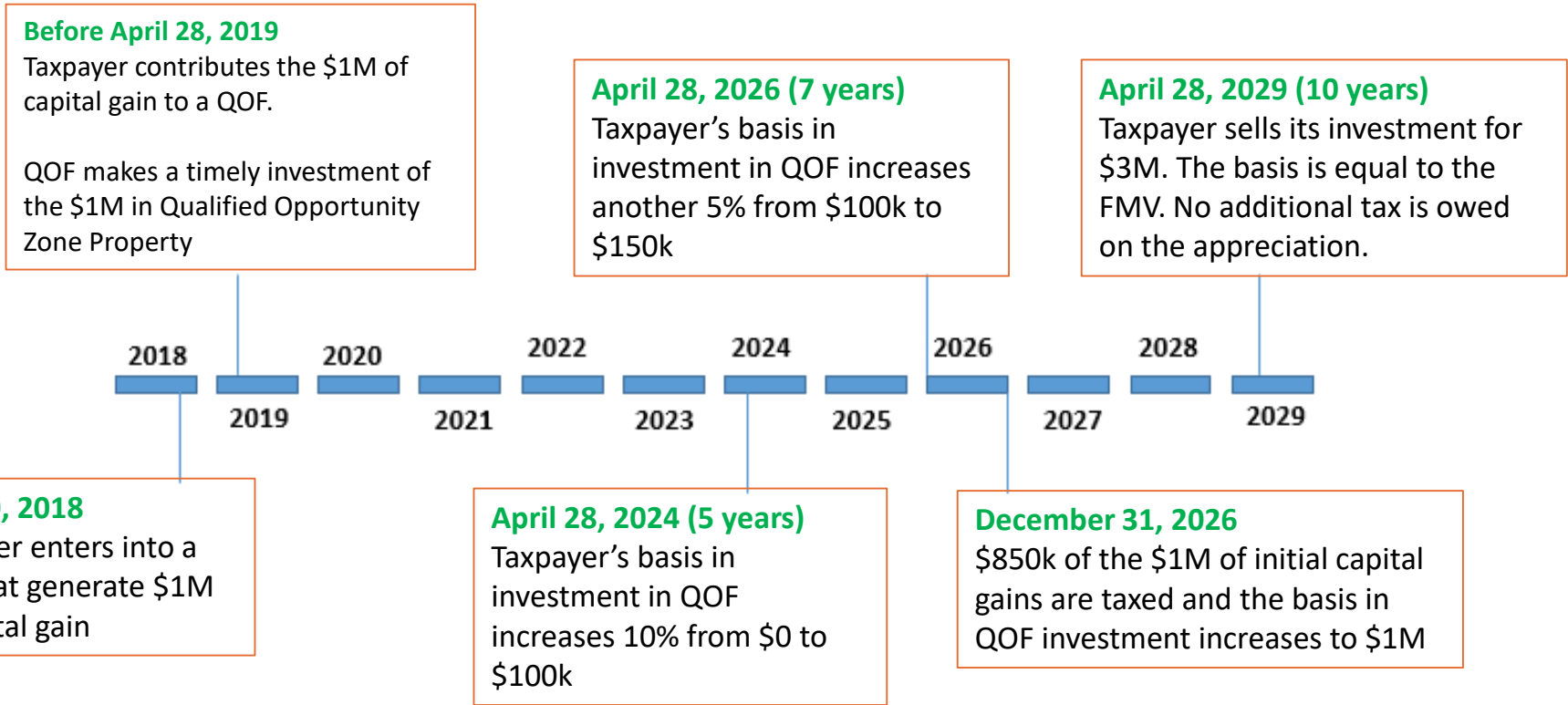
BASIC MODEL FOR REAL ESTATE DEVELOPMENT



Rental Real Estate

- New Construction
- Substantial improvement of adjusted basis excluding land

QUALIFIED OPPORTUNITY ZONE INCENTIVES TIMELINE EXAMPLE



NOTE: For this example, the Taxpayer's initial basis is \$0 in the QOF investment



OZ UPDATE FOR INVESTORS

- We are seeing a lot of activity
 - Closing in on 100 OZ clients
 - Real estate
 - Increasing number of operating businesses
 - Automotive assembly
 - Liquid natural gas
 - Franchise
 - Services
 - e-Waste
 - Movie production
 - Energy
 - Intellectual property



OZ UPDATE FOR INVESTORS

- Leasing has opened up many deals
- December 31, 2019 cut-off for 15% step-up
- Economic development authorities much more active
- More emphasis on impact investing
- Matchmaking services are coming on-line
- Pairing OZ with other incentives
- President's OZ Council – cutting the red tape



OZ UPDATE FOR INVESTORS

- Take-up rate on OZ has fallen short of expectations
 - 10 year holding period
 - Consider 1202, small business stock
 - Difficulty matching investors with projects
 - Affordable housing projects may not pencil out due to substantial improvement test
 - Uncertainty about final regulations
 - End of 2019
 - Trend is toward user-friendly
 - OZ not particularly well-suited to blind pools



OZ UPDATE FOR INVESTORS

- Concerns about the proverbial rug being pulled out from under
 - High profile, negative press articles regarding investors and types of investments
 - High profile, negative press articles about selection of Opportunity Zones
 - Legislative proposals that would undermine the incentive
 - Democratic sweep in 2020



OZ FORECAST

- Many strong supporters
 - White House
 - Mayors
 - Economic development communities
 - Faith leaders
 - Community leaders
 - Tax exempts
- Expect regulations to be more user-friendly
- Constructive tweaks



OZ FORECAST

- Packaging incentives
- Less red tape
- Expedited process time for other incentives
- Reduced fees
- Wave at end of 2019
- Wave in late June 2020
 - Pass-through gains
 - Section 1231 gains
- Still big benefits after 2019



OPPORTUNITY ZONES – INFO + DATA

- Treasury certified **8,766 individual census tracts** across all 50 states, six territories, and the District of Columbia as Opportunity Zones.
- 294 Opportunity Zones contain **Native American lands** and nearly a quarter (23.2 percent) are in **rural areas**.
- This OZ source of risk capital is being used to seed new startups, accelerate business expansions, create jobs, increase and improve housing options, and revitalize the built environment in **distressed communities** across the country.
- Despite these challenges, Opportunity Zones retain many economic assets and are **ripe for revitalization**.
- According to Economic Innovation Group (EIG), zones are home to over 6,000 prime growth businesses poised for **investment and expansion** in the near term.

SOURCE: Opportunity Zones Facts and Figures – Economic Innovation Group



OPPORTUNITY ZONES – INFO + DATA

Sample Industries in Opportunity Zones

- There are 475 **solar energy** installations producing more than 1MW of activity in Opportunity Zones, as well as 127 **wind farms** and 15 **battery plants** of at least the same capacity.
- There are at least 284 entrepreneurship **incubators or accelerators** in Opportunity Zones (and counting; several Opportunity Funds are investing in more such facilities).



SOURCE: Opportunity Zones Facts and Figures – Economic Innovation Group



OPPORTUNITY ZONES – INFO + DATA

Sample Industries in Opportunity Zones

- Opportunity Zones are home to at least 379 **colleges and universities**, with numerous other institutions directly adjacent. Of the 379 zone colleges and universities, 47 are HBCUs, or Historically Black Colleges and Universities. A further 16 are tribal colleges.
- Of the 8,766 total Opportunity Zones, one-third either contain a **hospital** or are within a half mile of a hospital.
- A total of 479 **airports** of varying sizes are located in Opportunity Zones, which many more directly adjacent to them as well.



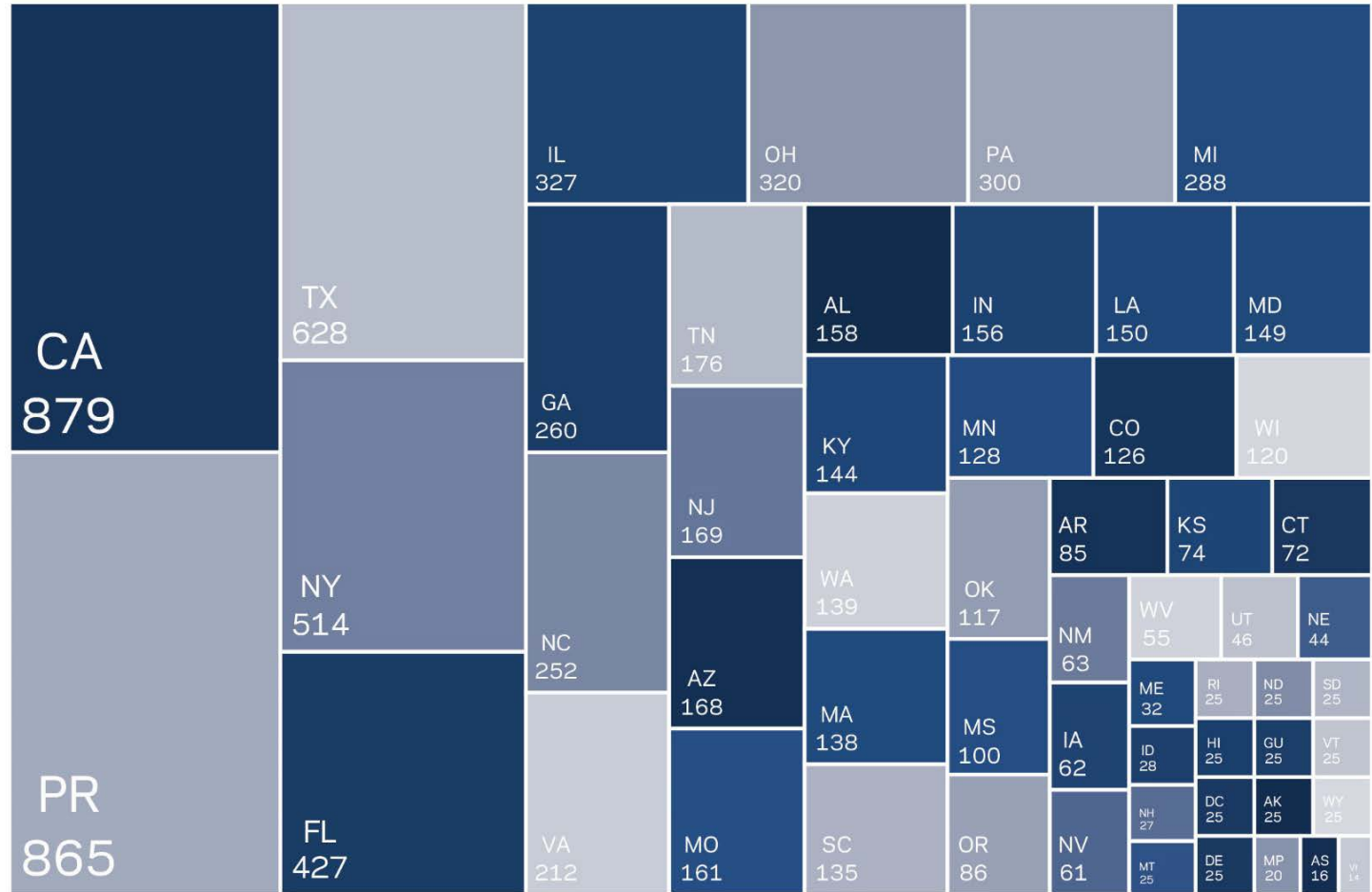
OPPORTUNITY ZONES – INFO + DATA

Brownfield Sites

Opportunity Zones, which represent only 10.7 percent of all U.S. census tracts, contain nearly one-third (32 percent) of the country's **brownfield sites**, which are properties that have been contaminated by prior (often industrial) use and typically stand vacant for years or decades. All together the country's 8,766 Opportunity Zones contain over 14,000 known brownfield sites.



NUMBER OF OPPORTUNITY ZONE CENSUS TRACTS BY STATE



SOURCE: CDFI Fund



VENTURE CAPITAL FUNDS FOR STARTUPS

There has been a significant uptick in activity across both the public and private sectors to support investment in new operating businesses

- **The Pearl Fund** is one of the first “venture capital fund” to have launched a QOF. (Brian Phillips is Managing Partner)
 - Each company that The Pearl Fund(s) invests in must have more than half of all employees and subcontractors working inside one or more OZs.
- **Launch Pad** recently became a QOZB. (Launch Pad is a collaborative workspace and community for startups).

Concern

- A general concern is most funds are being started by entrepreneurial people trying to capitalize off the new incentive instead of existing real estate investors.



CHALLENGES FOR OPERATING BUSINESSES TO BE A QOZB

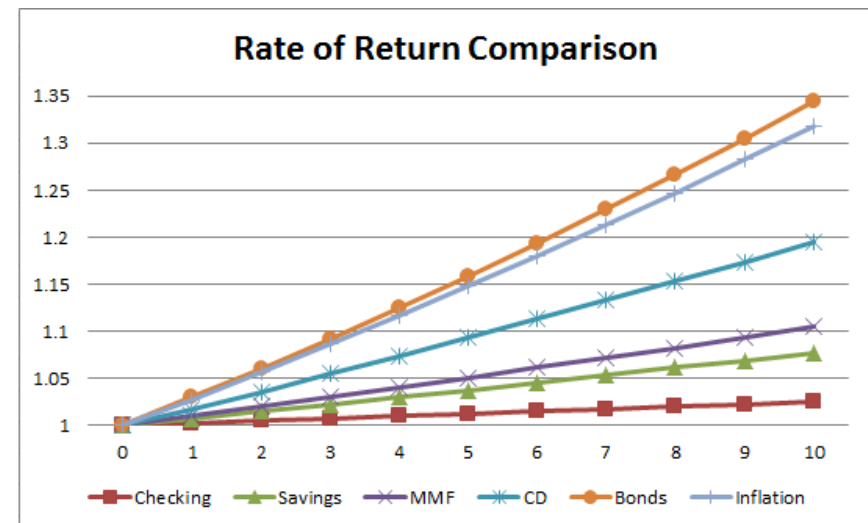
What is the advantage for a startup?

- First, to be a QOZB, 70 percent of the tangible property of the business must be qualified, by being acquired from an unrelated party after December 31, 2017, and meeting either the original use or substantial improvement test (not both). However, leased property can qualify without meeting either the original use or substantial improvement test.
- For example, a start-up or tech business, which has very little tangible property, may be able to meet the 70 percent test without regard to the substantial improvement test simply through its office lease, leasing some furniture, and the purchase of a few computers (which do not have to be new). On the other hand, a business heavy in tangible assets may have to use a leasing strategy until it can either substantially improve enough property or purchase enough new property.



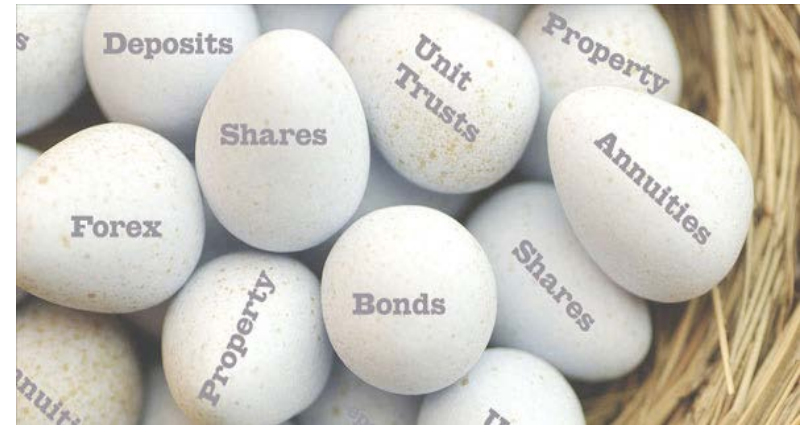
RATE OF RETURN

- While many OZ fund offerings look similar to private equity investments, they are different in that it appears the IRR may not be as attractive as other investments – there is a longer lock-out period.
- Many investors in the real estate OZ funds have been expecting mid-teen returns
- This is a longer-term investment which requires more thought before investment takes place.



DIVERSIFICATION

- It seems that strong real estate performances in recent years and the demand for yield-producing assets is serving to create a strong interest in OZ funds.
- For investors being over-weighted in the stock market, OZ funds allow them to diversify while deferring taxes on market-related gains
- These OZ funds have allowed people to diversify their portfolios for a limited amount of time.



WHAT IS THE WYDEN PROPOSAL?

- A small number of OZ designated census tracts do not meet the intended purpose of the incentive.
- Senator Ron Wyden introduced a legislative proposal to automatically “sunset” a total of 269 tracts which are home to 1.2 million people and spread across 44 states and DC. Only Alaska, Georgia, Illinois, New Hampshire, North Dakota and Utah would be unaffected.
- The targeted tracts are those with especially high median family income and those that do not meet the U.S. Treasury’s definition of a low-income community (but still qualified due to their contiguity with a low income zone).



“TWINNING” QUALIFIED OPPORTUNITY ZONE FUNDS & NEW MARKET TAX CREDITS

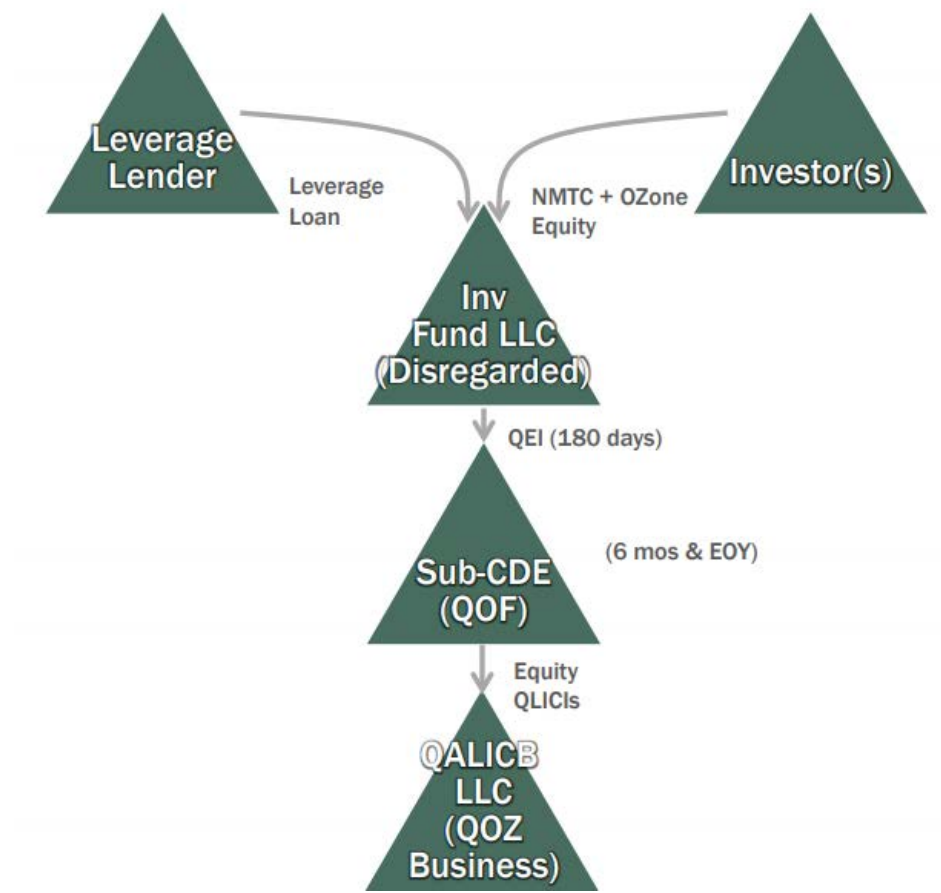
**Opportunity
Zone Funds**



NMTC



NMTC + OZ STRUCTURE



SOURCE: Novogradac 2018 Opportunity Zones Conference



OPPORTUNITY FUNDS + NEW MARKET TAX CREDITS (NMTC)

- Investment holding periods do not line up with the 10-year benefit.
- CDE would need to obtain Opportunity Fund status.
- QALICB and Qualified Opportunity Zone Business definitions have many similarities
- QLICs must be equity under Opportunity Zone
 - May need CDFI Fund approval to change product strategy



NMTC PROGRAM BENEFITS

- May be blended with economic incentives from localities.
- Financing may be available at below-market interest rates for the construction or renovation in qualified census tracts.
- Low cost of capital resulting from the forgiveness of the equity contributions (after seven years) combined with the interest rate on the leveraged loan.
- The portion of equity contributions that is forgiven (typically 25 to 28 percent) are invested in the CDE which is then loaned to the project owner/developer.
- NMTC investor receives significant tax benefits for its investment and therefore willing to forgive indebtedness.
- Subject to a seven-year compliance period.
- Adds additional layers of complexity (multi-tiered transaction) to financing structure.



QUESTIONS?



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