

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 scattered numerical values in shades of blue and white.

K&L GATES

2019 NEW YORK INVESTMENT MANAGEMENT CONFERENCE

Private Fund Developments

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Developments in Seeding Arrangements



DEVELOPMENTS IN SEEDING ARRANGEMENTS – OVERVIEW

- Seeding Arrangements Fall Along a Spectrum, with Features Including:
 - Making a Significant Capital Commitment to a Fund Manager at the Initial Closing of the Fund
 - Assisting with Fund Structuring Issues and Proposing Market Terms and Conditions
 - Assisting with Fundraising and LP Introductions
 - Providing Financing to the Manager for Startup Costs or Working Capital
 - Receiving Certain Economic Benefits in the Initial Fund and in Certain Subsequent Funds



DEVELOPMENTS IN SEEDING ARRANGEMENTS – ECONOMICS AND GOVERNANCE

- Economic and Governance Rights Can Include:
 - The Right to Invest in the Initial Fund and Certain Subsequent Funds on a No-Fee, No-Carry Basis
 - The Right to Receive a Share of the Management Fee and Other Income of the Management Company
 - The Right to Receive a Share of Carried Interest Payable to the General Partner
 - Governance Rights (including LP Advisory Board and Investment Committee Participation as well as Decision making at GP and Manager Level)



DEVELOPMENTS IN SEEDING ARRANGEMENTS – ADDITIONAL ISSUES

- Commitments from Seeding Investors may be Subject to a Sliding Scale or “Ratchet”
- Seeding Investors may have the Right to bring in Additional “Introduced Investors” upon Preferential Terms
- Seeding Investors may have Put Options, Drag and Tag Rights and other Similar Rights with respect to their Interests in the GP and Manager





Opportunity Zones Update



OVERVIEW OF OZ RULES

- The OZ program was created by the Tax Cuts and Jobs Act, enacted in December 2017 to help direct economic resources to low-income communities, spurring economic growth and job creation.
- The Opportunity Zones program provides three main tax incentives to taxpayers who invest capital gains in a Qualified Opportunity Fund (QOF):
 - Temporary Deferral. The taxpayer may defer recognition of eligible capital gains invested into a QOF until the earlier of the date on which the OZ investment is disposed of, or December 31, 2026.
 - Step-Up in Basis.
 - If a taxpayer holds an interest in a QOF for at least 5 years, then no more than 90% of the capital gains will be included in the taxpayer's federal taxable income.
 - If a taxpayer holds an interest in a QOF for at least 7 years, then no more than 85% of the capital gains will be included in the taxpayer's federal taxable income.
 - Permanent Exclusion. If a taxpayer holds an investment in a QOF for at least 10 years, all gains accrued after the investment in a QOF will not be subject to tax when the taxpayer disposes of the investment.



OVERVIEW OF OZ RULES (CONT'D)

- In order to be eligible, capital gains must have arisen from the sale or exchange of property with an unrelated party before December 31, 2026 and must be invested in the QOF within 180 days of recognizing the gain.
- A QOF is any investment vehicle organized for the purpose of investing in OZ property, and may be classified as a corporation or partnership (which can include LLCs).
- At least 90 percent of a QOF's assets, calculated on two semiannual testing dates, must consist of OZ property. OZ property consists of:
 - Stock in an OZ business
 - OZ partnership interest (capital or profits) in an OZ business (includes LLCs)
 - OZ business property
 - Tangible property used in a trade or business of the QOF
 - Acquired by purchase after 12/31/2017
 - Original use in the OZ begins with the QOF
 - Substantially improved property (improvements exceed adjusted basis)
 - Substantially all the use is in an OZ
 - Also includes leased property

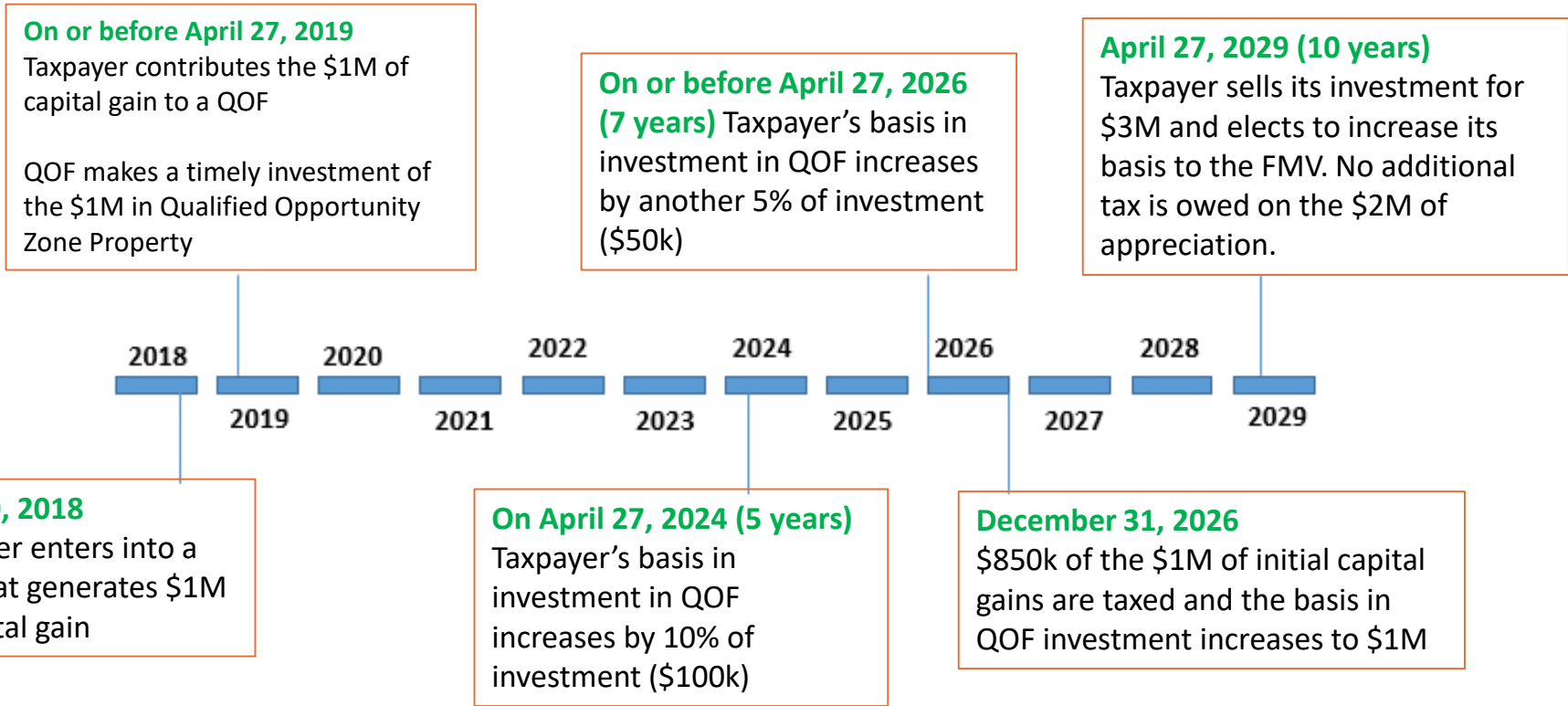


OVERVIEW OF OZ RULES (CONT'D)

- OZ Business:
 - Substantially all the tangible property owned or leased is OZ business property
 - At least 50% of gross income derived from active trade/business
 - Substantial amount of any intangible property is used in the active trade or business
 - Limits on financial property (deter passive investment)
 - No “sin” businesses



OZ PROGRAM TIMELINE EXAMPLE

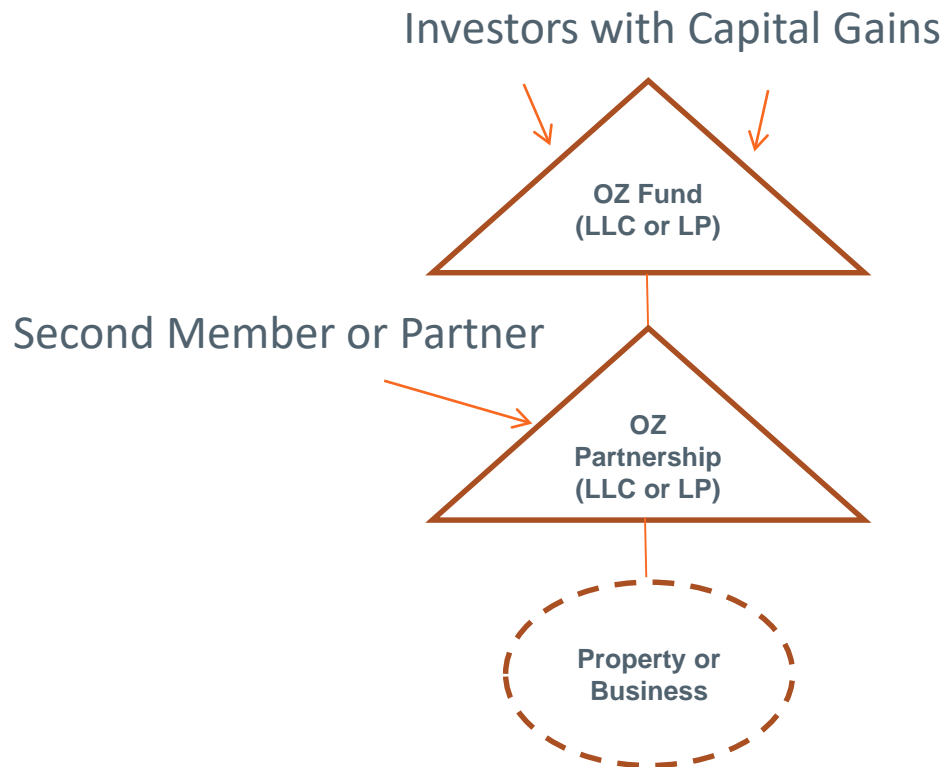


NOTE: For this example, the Taxpayer's initial basis is \$0 in the QOF investment and that the Taxpayer's basis in its QOF interest is not adjusted for any reason other than as a result of the steps shown above. Please note that a Taxpayer's basis in its QOF interest may be increased or decreased for other reasons under generally applicable rules of U.S. federal income tax law.



FUND STRUCTURING FOR SINGLE AND MULTIPLE INVESTMENT FUNDS

- Basic OZ Fund Structure
- Single asset, or multiple assets using mirrored structure
- Asset specific or blind pool



Benefits

- Provides for exit event flexibility
- Offering can be pursuant to a subscription program and allow for multiple projects under mirrored structures
- Tiered structure provides for better OZ qualification flexibility

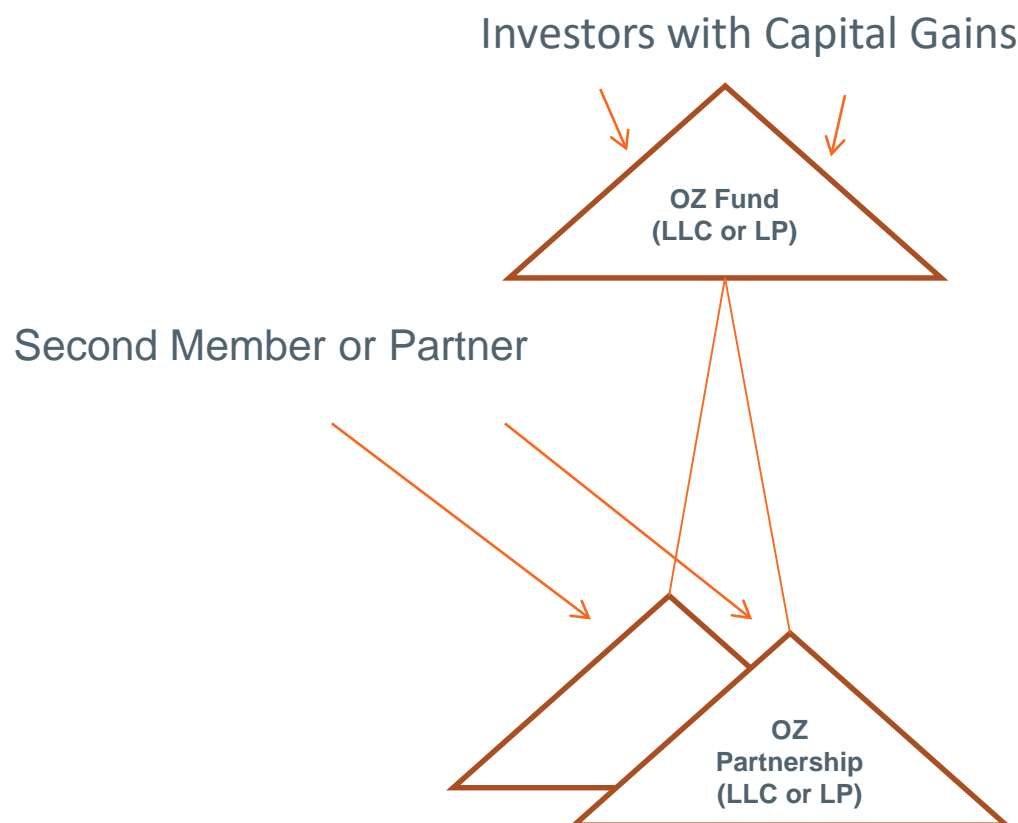
Limitations

- K-1s at both OZ Fund and OZ Partnership levels
- If long offering period with multiple projects, managing capital calls and rebalancing could be challenging



FUND STRUCTURING FOR SINGLE AND MULTIPLE INVESTMENT FUNDS (CONT'D)

- Comingled OZ Fund Structure



Benefits

- Traditional fund structure
- Easier to manage offering/commitment process
- Less administrative burden
- Diversification

Limitations

- Potential exit issues

FUND STRUCTURING FOR SINGLE AND MULTIPLE INVESTMENT FUNDS (CONT'D)

- Issue: Statute provides that exit can only result from the sale of an interest in a QOF.
 - Proposed regs allow a QOF to sell its assets.
 - Lower-tier QOZB can't sell its assets.
- Notwithstanding the proposed regs:
 - Concerns about reliance
 - Differences in depreciation recapture
 - Projects that become unqualified could taint the QOF/other projects, require a restructuring



FUND STRUCTURING FOR SINGLE AND MULTIPLE INVESTMENT FUNDS (CONT'D)

- Single asset: Provides the most flexibility
- Notwithstanding the proposed regs:
 - Can't rebalance/manage traditional capital structure
 - Need to appropriately allocate capital
 - Better for one or limited closings with small offering periods
 - Crossing and calculating an aggregate preferred return problematic



ESG Reporting Standards

Assessing ESG Investments

A look at a hot-button issue in ESG investing: Investment standards for ESG Investing

ENVIRONMENT, SOCIAL, GOVERNANCE (ESG)

- The ESG concept has evolved in the past five years as both a refinement and an expansion of –
 - CSR: Corporate Social Responsibility
 - SRI: Socially Responsible Investing
- It has long been accepted by corporate leaders that corporations have a responsibility not to engage in practices that harm the environment or society, and many have instituted internal policies to that effect
- ESG expands this concept to the investment industry, responding to increasing demands from society in general



ESG (CONT'D)

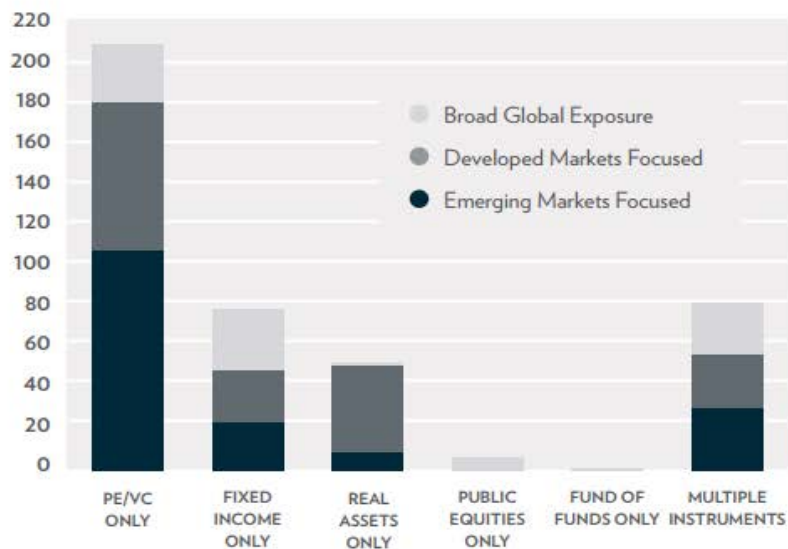
- Shareholders now demanding that corporations adopt ESG-based principles in their governance policies
- Investors, including funds and fund managers, increasingly incorporating ESG criteria in their investment strategies



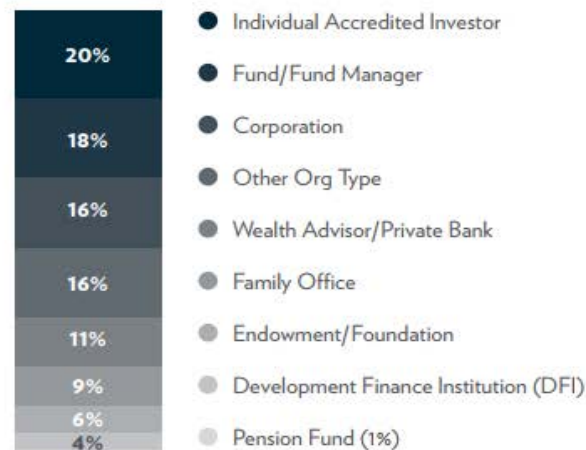
ESG (CONT'D)

Who is active in impact investing?

NUMBER OF FUNDS/PRODUCTS



SUBSCRIPTIONS BY INVESTOR SEGMENT



Source note: ImpactBase, data as of August 2017.



ESG (CONT'D)

- Key hurdle to ESG investing is assessing the value and risk of ESG investments
- How assess the economic value of an ESG investment's impact on the environment or society?
- How assess the risks associated with an ESG investment?
- 50+ industry and government-affiliated organizations currently developing varying versions of standard criteria
- At present, no universally accepted set of standards exists
- No government-mandated or approved set of standards exists
- Investors must choose data and analytical approaches from the currently available options



THE GOAL

- Universally accepted ESG impact standards



PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

- Origin of organized ESG investment effort
- Principles developed by a public/industry group
- Mission: develop sustainable global financial system



PRI (CONT'D)

- Six Principles:
 - Investment analysis and decision-making process
 - Ownership policies and practices
 - Disclosure
 - Promote Principles
 - Enhance effectiveness
 - Report on activities and progress



PRI (CONT'D)

- Provides framework of broad principles
- Serves as an industry hub
- Signatories carry out PRI mission
- Offers resource materials, including guide for PE fund managers



GIIN – IRIS+ (CONT'D)

- IRIS+ reporting metrics
- Data for Core Metrics Sets obtained from three sources:
 - Open calls
 - Biennial GIIN survey
 - Internal agenda



SUSTAINABILITY ACCOUNTING STANDARDS BOARD (SASB)

- Mission: Sustainability
- Industry standards
- Globally applicable industry-specific standards
- Engagement Guide



TRENDS

- Industry:
 - Public: Morningstar
 - Private: Preqin



TRENDS (CONT'D)

- Legal:
 - UK Financial Reporting Council stewardship code
 - The SEC viewpoint:
 - Materiality-based approach
 - Industry efforts more effective and appropriate



CONCLUSION

- Which standards to employ?
 - Currently, investor's choice
 - Government not likely to impose its own standards in the near future, if at all
 - Industry itself working to consolidate and unify standards – ongoing effort





QUESTIONS?



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