Opportunity Zones

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Agenda

• Introductions
• Real Estate Terms
• Opportunity Zones 101
• What is the Role of the Community?
• Real Life Examples
• Q&A
MRB Group: Engineering, Architecture and Surveying, D.P.C.

- Founded in 1927
- Almost 100 design professionals
- Rochester, Syracuse, Geneva & Saratoga, NY
- Austin & Temple, TX
- Services:
  - Engineering
  - Site Development
  - Architecture
  - Municipal Consulting
Economic Development:

• Strategic Planning
• Market Analysis
• Economic and Fiscal Impact
• Funding, Incentives & Financing, including Opportunity Zones
Real Estate Terms
“Capital Stack”

- Senior Debt
- Mezzanine Debt
- Preferred Equity
- Common Equity

Potential Risk & Return

High

Low

Equity

Debt
“Internal Rate of Return”

“...it is the expected compound annual rate of return that will be earned on a project or investment. In the example below, an initial investment of $50 has a 22% IRR. That is economically equal to earning a 22% compound annual growth rate.
## “Risk Profile”

<table>
<thead>
<tr>
<th></th>
<th>Low Risk</th>
<th>Moderate Risk</th>
<th>Speculative</th>
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</thead>
<tbody>
<tr>
<td>Profile:</td>
<td>• Safety First!!!</td>
<td>• Potential for Capital Gains</td>
<td>• Build It And They’ll Come!!!</td>
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<td>• Muni Bond Returns</td>
<td>• Low Leverage</td>
<td>• High Leverage</td>
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<tr>
<td></td>
<td>• Minimal Capital Gains</td>
<td>• Possible Significant Tax Depreciation</td>
<td>• Maximum Capital Gains Potential</td>
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<tr>
<td></td>
<td>• Possible Significant Tax Depreciation</td>
<td>• 5%-10% IRR</td>
<td>• 15%++ IRR</td>
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<td>Example Projects:</td>
<td>• Wastewater Treatment Plants</td>
<td>• Equipment Leases</td>
<td>• New-To-Market Developments</td>
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<td>• City Hall Renovations</td>
<td>• Lease-In-Hand Tenant</td>
<td>• Venture Capital</td>
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<td>• Operating Businesses</td>
<td>• China’s Ghost Cities</td>
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Opportunity Zones 101
Maps
Tax Benefits

1. Defer Existing Gain
2. Reduce Existing Gain
3. Eliminate Future Gain
1. Defer Existing Gain

The **Investor** has a pre-existing capital gain. Instead of paying today, pays in 2027 when filing 2026 return.

**Time-value-of-money (@9% ~ 50% reduction)**
Tax Benefits

2. Reduce Existing Gain

The Investor has a pre-existing capital gain. If QOF held at least 7 years, a 15% step-up in basis, therefore a 15% reduction in tax. If QOF held at least 5 years, a 10% step-up in basis.
Tax Benefits

3. Eliminate Future Gain

If the Investor holds to QOF investment for at least 10 years, the gain on the OZ investment can be fully sheltered from tax.

(cost basis raises to FMV)
Tax Benefits

What does this mean?

IRR could be increased by 2-4 percentage points.

  e.g. IRR of ~6% becomes ~8-10%

Marginal project becomes an investment-worthy one.
# Tax Benefits – Why Not Do 1031?

<table>
<thead>
<tr>
<th></th>
<th>QO Fund</th>
<th>1031</th>
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<tbody>
<tr>
<td><strong>Rollover Amount</strong></td>
<td>Capital Gain only</td>
<td>Principal and capital gain</td>
</tr>
<tr>
<td><strong>Exchanged Property</strong></td>
<td>Generally, any sale or exchange of capital property</td>
<td>As of January 1, 2018, only real property</td>
</tr>
<tr>
<td><strong>Structure</strong></td>
<td>Can pool funds and make multiple investments</td>
<td>Generally, a single asset swap</td>
</tr>
<tr>
<td><strong>Deferral</strong></td>
<td>Deferred until sale of QO Fund or 12/31/2026</td>
<td>Deferred until a taxable sale</td>
</tr>
<tr>
<td><strong>Tax Reduction</strong></td>
<td>10% after 5 years 15% after 7 years</td>
<td>No tax reduction</td>
</tr>
<tr>
<td><strong>Tax Free Gains</strong></td>
<td>After 10 years, investment gains are tax-free</td>
<td>No tax-free gains, except stepped up basis upon death</td>
</tr>
<tr>
<td><strong>Third Party Requirement</strong></td>
<td>None (Self-certification)</td>
<td>Qualified Intermediary</td>
</tr>
<tr>
<td><strong>Timeline</strong></td>
<td>180 days after sale to decide and fund QO Fund Further deferral until testing date for investment 31-month working capital exception for investments with a written plan</td>
<td>45 days to identify replacement property 180 to close on acquisition of replacement property</td>
</tr>
<tr>
<td><strong>Related Party Restrictions</strong></td>
<td>No deferrals from sales to related parties</td>
<td>Property can be sold to a related party, subject to 2-year holding period for replacement property</td>
</tr>
<tr>
<td><strong>Expiration</strong></td>
<td>December 31, 2026</td>
<td>None</td>
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Definitions and Deal Structure

Investor with a Capital Gain to Shelter

$ → QOZ Fund

QOZ Business via Partnership or Stock

$ → QOZ Business Property

Tax Benefit

Business investment return

$
Definitions and Deal Structure

1. **Qualified Opportunity Zone (QOZ)** - Census Tracts as designated by Treasury

2. **Qualified Opportunity Fund (QOF)** - Investment vehicle taxed as partnership or corporation, formed to invest in qualified OZ property. Self-certifies to IRS and meets tests annually (90% of assets in OZ property).

3. **Qualified Opportunity Zone Property (QOZP)** - Can be either (a) ownership of stock or partnership interest in a qualified OZ business, or (b) qualified OZ business property

4. **Qualified Opportunity Zone Business Property (QOZBP)** - tangible property purchased after 2017, either new construction or substantial renovation, used in OZ
Definitions and Deal Structure

5. Qualified Opportunity Zone Business (QOZB)
   
a) 70% of tangible property is QOZBP - i.e. construction/renovation after 2017 in an OZ

b) 50% of gross income derived from OZ: (a) 50% of labor hours, (b) 50% of compensation, (c) tangible property and corporate HQ are both in zone and necessary to general 50% income, (d) “facts and circumstances” catch-all

c) “Substantial portion” (40%) of intangible property used in the conduct of business

d) Less than 5% of property is non-qualified financial property (think: securities, but excludes working capital held as cash or cash-equivalent)

e) Not a “sin business”
QOZ Fund (QOF)

Investor

180 days from gain*

$\downarrow$

QOZ Business via Partnership or Stock

QOZ Business Property

Cannot be a disregarded entity

Benefit #3 – Elimination of Future Gain (early sale w/reinvestment and wind down special cases)*

“Original Use” or Substantial Renovation (excludes leased assets)

90% rule six months after first QOF month (6 month grace period)

70% rule, Up to 31 months

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New Regulations

1. **Leased property**: leasehold improvements qualify as “purchase” if after 2017 and used in an OZ for substantially all of the lease period; no requirement to “substantially improve”; can be acquired from a related entity under certain circumstances.

2. Safe harbor for working capital for **operating businesses** to hold cash for payroll, inventory, occupancy costs, development of the business, etc.

3. Investor can contribute cash or property to QOF.

4. **Transfer upon death** to deceased owner’s estate will not trigger tax impact (but a gift will).

5. **Early distribution allowed**: QOF can return capital to partners as long as it is less than or equal to the partner’s basis in the QOF, will not trigger tax impact for original sheltered gain.
New Regulations

6. **Six months for QOF to invest**: 90% test ignores any investment in a QOF of fewer than 6 months.

7. **Twelve months to re-invest**: if OZ property is sold, QOF has 12 months to reinvest, penalty free. However, interim gain on OZ property sold is taxable unless held for 10 years.

8. **Wind down**: Exit approach of winding down a QOF allows capital gain of underlying investment to be excluded from income, provided it was held 10 years.

9. **Vacant buildings**: if vacant 5 years, treated as “original use” if placed back into service.

10. **Government-related delays**: 31 month grace period extended if delay by government
Example Deal for Manufacturer

**2019**
Manufacturer wants to expand, needs to make a $40mm investment in real estate. Investor has a $10mm capital gain from sale of stock in Jan 2019, forms QOF in Apr 2019 and invests $10mm – can now defer tax until Dec 31, 2026

**2019-2021**
In May 2019, QOF creates RealEstateCo and invests $10mm. RealEstateCo borrows $30mm, buys land, builds $40mm building, leases it to Manufacturer on a gross lease (not NNN)
Example Deal for Manufacturer

Dec 31, 2026
Investor pays capital gain on only 85% of original gain (i.e. $8.5mm vs $10mm)

2029
Investor sells interests in QOF for large gain. Because held more than 10 years, basis is stepped up to FMV, so gain is zero. No tax due.

Return w/o tax benefits = 9%, investor says “no”
Return w/tax benefits = 12%, investor says “yes”
What Can My Community Do?
Where’s the Money?

1. National OZ Real Estate Funds
2. Venture Capital Funds
3. “Self-Help”
4. Local Funds (single-investor)
5. Local Funds (multi-investor)
6. Philanthropic and Social Impact Investors
Steps to Accessing the Money

1. Solid business plan - duh!

2. Stipulate you will not violate any of the key QOZB rules:
   - The Tangible Property Requirement;
   - The Gross Income Requirement;
   - The Intangible Property Requirement;
   - The 5% Financial Property Limit; and
   - The Sin Business Prohibition.
Steps to Accessing the Money

3. Structure the exit to suit the investor, the investee or the OZ?
   - 10-year hold?
   - Return of capital?
   - Sell the QOF, Sell the QOZB, Sell the Assets?
Steps to Accessing the Money

4. Consider carving out OZ chunks:
   • Real estate acquisition?
   • Leasehold improvements?
   • Capital equipment?
   • Subsidiary/JV?
How do EDO’s Participate?

1. Stakeholder engagement and education - today
2. Complete vision into graphics: Website & prospectus
3. Shop to developers/investors
4. Continue marketing plan

Option - should we create a local OZ Fund? (multi-investor, multi-project)
Real Life Examples
ABOUT REDBURN

- Focus on multi-family, mixed-use, hospitality
- Over 150 employees across family of companies, over 20 on the development/capital team
- Currently have over $100M of development in active construction, working a future pipeline of over $150M, deals ranging in size from $5M - $40M
- Roughly 900,000 square foot owned across all asset classes
- Proven entrepreneurs with successful exit events in real estate and other markets.

PICTURED FROM LEFT TO RIGHT: Jeffrey Buell, Principal Redburn Development Partners; Mark Eagan, President, Capital Region Chamber of Commerce; Mike Yevoli, Regional Director, Empire State Development; Gary McCarthy, Mayor, City of Schenectady, NY
SECONDARY AND TERTIARY MARKETS
Utilizing strategies above and techniques below, Redburn creates significant value in underserved markets.

WORKFORCE HOUSING - RETURNS WITH LOWER RISK
During a full scale economic downturn, value is retained in never boom/never bust locales.

FOCUS
Redburn invests in multi-family, urban mixed-use, and hospitality with following criteria:

<table>
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<tr>
<th><strong>HISTORIC PRESERVATION</strong></th>
<th>Historic buildings have the sought after amenity of irreplaceable charm. Utilizing Historic Tax Credits (40% of cost) bolsters the bottom line returns to investors</th>
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</thead>
<tbody>
<tr>
<td><strong>GREEN ENERGY AND ENVIRONMENTAL SUSTAINABILITY</strong></td>
<td>Redburn futureproofs its projects by using the latest in green energy building techniques to increase returns and attract residents. Many of the systems are designed and built in-house.</td>
</tr>
<tr>
<td><strong>COMMUNITY PARTNERSHIP</strong></td>
<td>We know it is vital to be a good neighbor and part of growing communities. Redburn works closely with municipalities and neighborhoods, fostering goodwill, speeding up approvals, and helping to obtain grants and tax abatements.</td>
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</table>
INNOVATIVE ENERGY SYSTEMS
Designed and installed over the past 5 years in five separate projects exclusively with Redburn owner's capital.

ALL-IN-LIVING
Through green energy techniques and our internet/telecom company, we can provide all utilities/services the resident needs for convenience and cost savings over traditional providers.

ADDITIONAL RETURNS
Our systems add substantial profit. Systems add between $70-$100 profit per unit per month while lowering the typical cost for the resident.

MARKETING
Generates significant buzz and PR utilizing social media and news outlets to reach target audiences.
REDBURN DIFFERENTIATION: All-In Living®

THE VISION OF ALL-IN LIVING®
Redburn residents have the option of choosing an All-In Living® package designed to reduce cost, hassle and environmental impact. Using green-energy development, sustainable building techniques and wireless technology, now all your utilities can be on one low monthly bill, paid with the rent, and consistent year-round.

FOR A FLAT MONTHLY FEE, RESIDENTS CAN RECEIVE UNLIMITED:

- **FIBER OPTIC INTERNET**
  Connect wirelessly from every room. Great for streaming movies, television or playing games.

- **HD DIRECT TV**
  Includes the family package, over 50 channels including local channels (in SD and HD).

- **ELECTRICITY**
  The convenience of not dealing with a separate bill from the utility.

- **HEATING & COOLING**
  An innovative energy system and smart thermostats in each apartment puts residents in control of their comfort.

- **HOT & COLD WATER**
  Unlimited usage, based on apartment size.
WHO IS INVESTING & WHERE?

**WHO**
- High Net Worth Individuals
- Family Offices
- Need to consider attitude & risk
- Not institutional

**WHERE**
- Excluding NYC which is already very competitive for these properties, only 4 NY cities are larger than 100,000 people, meaning the opportunity in NY is secondary & tertiary markets
WHO WILL BE SUCCESSFUL?

- National Development Companies like Avalon Bay, Bozzuto, Mill Creek, etc.
- Regional Operators like Redburn Development

WHO WILL NOT BE?

- Slumlords & Big Talkers
  - Too difficult for first project
- Unsophisticated or Smaller Developers
  - While they are important to revitalization efforts they will struggle with this
What about public projects?
What about non-profit projects?

City of Oneonta
- Property tax abatement
- Historic rehabilitation tax credits
- DRI Grant
- CFA Grant (pending)
- Opportunity zones (?)
Resources

CDFA Guidance:
www.cdfa.net/cdfa/cdfaweb.nsf/resourcecenters/OZ.html

Articles, Content, Investor Fund Lists:
www.novoco.com/

Best Maps:
go.bakertilly.com/contactbtc0618

Best Explanations of New Regulations:
1. **Forbes**: “IRS Releases Latest Round Of Opportunity Zone Regulations: Where Do We Stand Now?
2. **Duval & Stachenfeld, LLP**: “A Clearer Path to Opportunity Zones” et al.
Contact Information

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