Qualified Opportunity Zones and Qualified Opportunity Funds

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Graham Allison, CEO, Opportunity Zone Development Group

OPPORTUNITY ZONE DEVELOPMENT GROUP

Agenda

I. Overview of Qualified Opportunity Zones (OZ), Qualified Opportunity Funds(QOF) and Qualified Opportunity Zone Businesses (QOZB)

II. Insights and Rules of the Road

Investors

Developers and Property Owners

III. Current OZDG & Cargominiums Opportunity Fund Projects

The Cargominium

V. Questions

OZ Overview

Tax Cuts and Jobs Act of 2017 established new Internal Revenue Code Section 1400Z - Opportunity Zones.

This new tax code section provides a special tax incentive for the **treatment of capital gains** recognized by a taxpayer that **invests through Qualified Opportunity Funds** (QOF) **in areas designated as Opportunity Zones**.

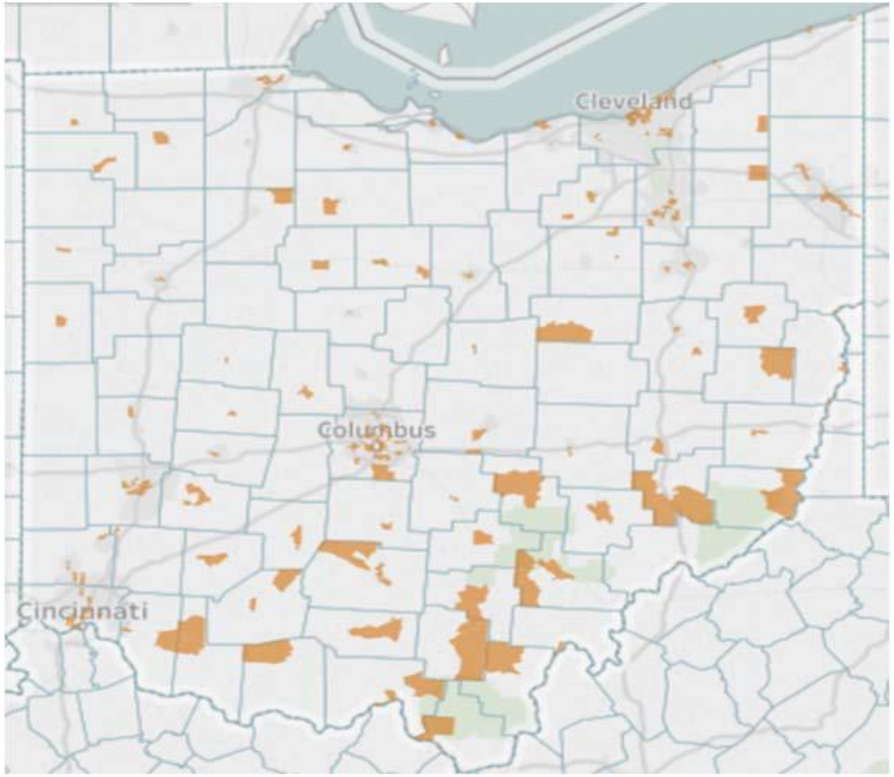
Why?

Opportunity Zones seek to encourage economic growth and investment in designated distressed communities by providing Federal income tax benefits to taxpayers who invest in business located within these zones.

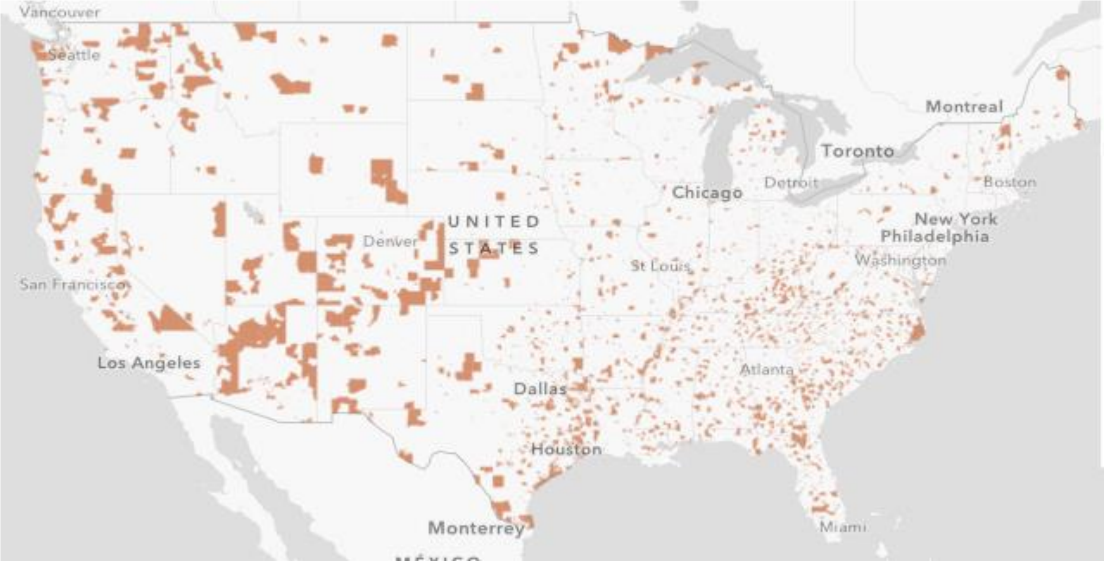
- Low-income census tracts that have been specifically designated by the state and federal government.
- Nationwide, 8,700 census tracts have been qualified as QOZs.
- 320 census tracts are located in Ohio

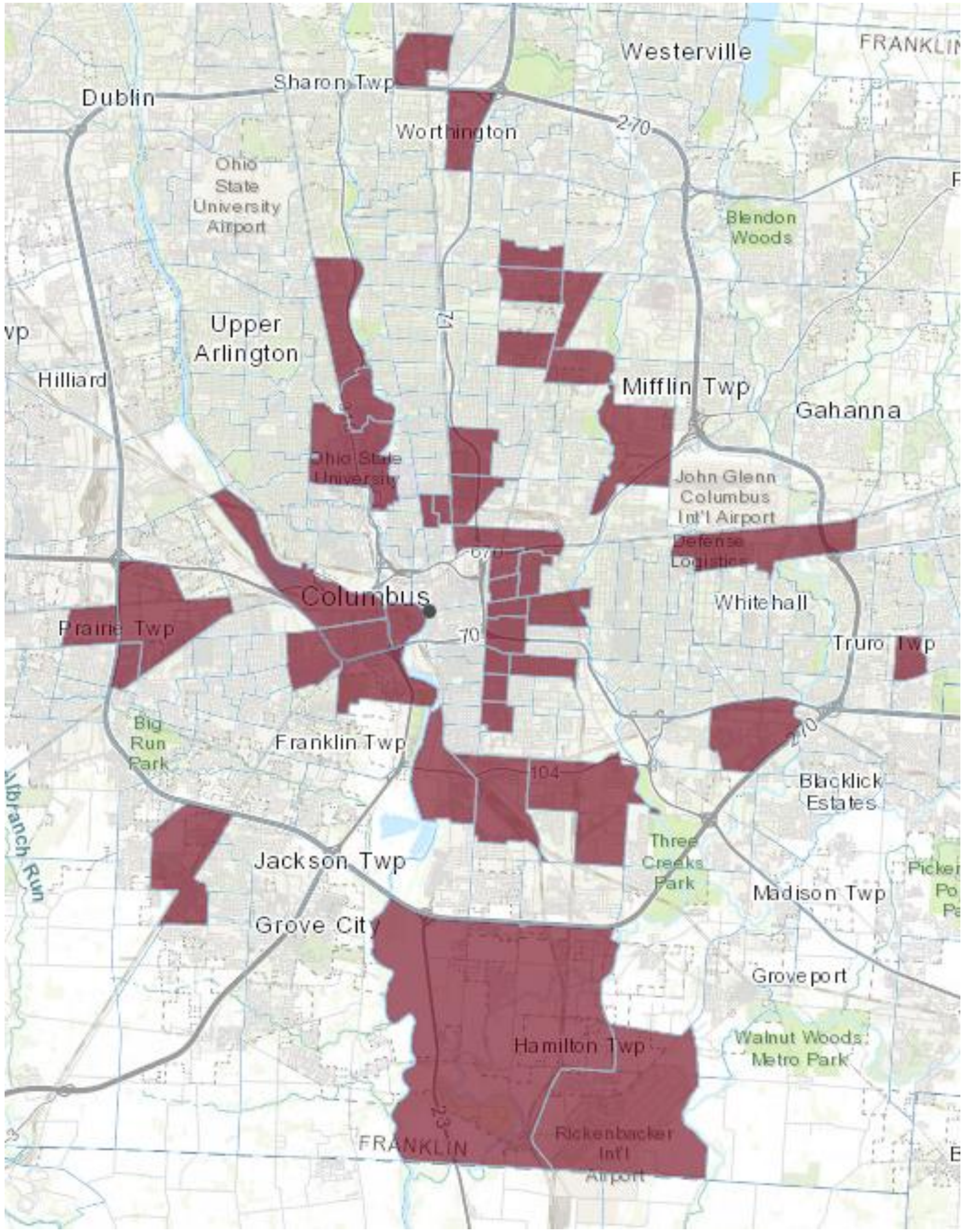
Where are they located?

Ohio Development Services Agency
(https://development.ohio.gov)



Economic Innovation Group
(https://eig.org/opportunityzones)





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What can be invested?

- Capital Gains ONLY
- Any taxpayer that ***recognizes capital gains*** for Federal income tax purposes
    - individuals, C Corps, RICs, REITS, partnerships, S Corps, trusts, and estates
- Capital gain must be recognizable before ***January 1, 2027*** unless deferred through an Opportunity Zone investment
- Capital gain ***cannot*** arise from related party transaction
    - Section 267(b) & 707(b)(1) apply but with 20% threshold
    - If common ownership of 20% or greater then related.
    - Includes unrecaptured Section 1250 gain (held for investment)
    - Includes Section 1231 gain (used in a trade or business)

The Big Picture

- Impose time limitations (must reinvest in QOF within 180 days of sale)
- Substantially all $ of a QOF (90% or more) must be invested in QOZ
- Original use of the property in the QOZ must commence with the QOF investment, or the QOF must substantially improve the property over 30 months after investment

How are capital gains invested?

- Taxpayer must invest capital gains into a **Qualified Opportunity Fund** (QOF) within **180 days** from the date that the gain would be realized for Federal income tax purposes
- A QOF is an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in a QOZ.
- Start date is often the date of the asset's sale or exchange
- An investment in a QOF must be an equity interest and cannot

be a debt instrument under 1275(a)(1)

- May be preferred equity or have a special allocation of cash
- An equity interest is not impaired if used as collateral for a loan (5:1)
- *Taxpayer may have a non-gain investment in the QOF but will*

not obtain the tax benefits on the non-gain investment

Qualified Opportunity Fund (QOF)

Any **investment vehicle** organized as a **corporation** or a **partnership** in 50 states, D.C. or U.S. Possession

• May be an LLC if taxed as a corporation or partnership

• No related party test for the investment

• May be a newly created or a pre-existing entity

• Organized for the **purpose of investing in Qualified Opportunity Zone Property**

(other than another QOF) (QOZP) – No Funder of Funds

• U.S. Possession QOF must be organized for the purpose of investing in QOZP that relates to

a trade or business operated in U.S. possession in which it is organized.

• Entity **self-certifies** as a QOF by filing Form 8996

• Requires organizing documents to state that QOF's purpose of investing *by end of QOF's*

First year

• **Must hold at least 90% of its assets in QOZP**

Qualified Opportunity Fund

Step 1: Sell an appreciated asset

Step 2: Reinvest gain realized from the sale into a QOF

Step 3: The QOF, in turn, must invest that gain into "qualified opportunity zone property".

What are the benefits of Opportunity Zones?

DEFER and ELIMINATE

Benefit No. 1: DEFER: Temporary Deferral

A taxpayer can defer taxes owed on capital gains realized upon sale of existing property until the earlier of:

(a) December 31, 2026, or

(b) the date when the taxpayer disposes of the new QOZ investment.

Investor Benefits

- **Benefit No. 2: ELIMINATE**: Permanent exclusion on QOZ investments held longer than 10 years:
  - Taxpayer still pays tax on original capital gains less any partial step-up in basis
  - After recognition of the original gains, the basis equals the Fair Market Value
  - Results in a "step up' in basis attributable to the appreciation of the original investment
  - Requires a special election upon sale prior to **December 31, 2047**
  - **Depreciation is not recaptured if assets are held 10 years.**

How does the State of Ohio support OZs?

10% Ohio OZ Tax Credit!

- Successful applicants receive a certificate for a non-refundable income tax credit equal to 10% of the amount invested into Ohio opportunity zone property.
- Investments of eligible gains and ordinary after-tax cash qualify for the credit.
- The Ohio OZ tax credit is capped at $2 million per taxpayer, and up to $50 million for all taxpayers, during the 2021-2022 biennium period.
- The tax credit certificate may be used for up to 5 years, or transferred in whole on a one-time basis, meaning they can be sold for an immediate cash return on investment.
- The application period is in January of each year and the tax credits are awarded on a first-come, first-served basis.

Identifying Risks

- How do Opportunity Zone projects compare with conventional projects?

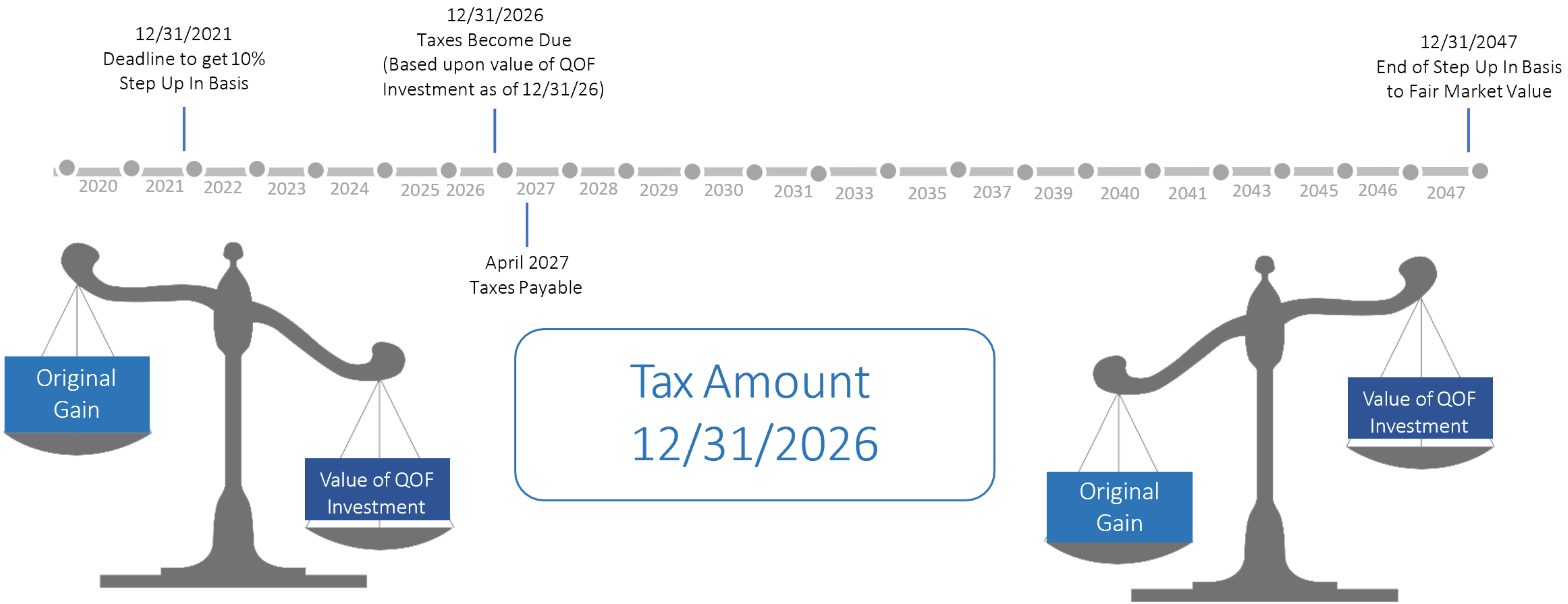
The below sensitivity table demonstrates the after-tax net value of a $1,000,000 re-investment of capital gains in a traditional investment as compared to the re-investment of the same capital gains into an Opportunity Fund.

QOF Sensitivity Analysis

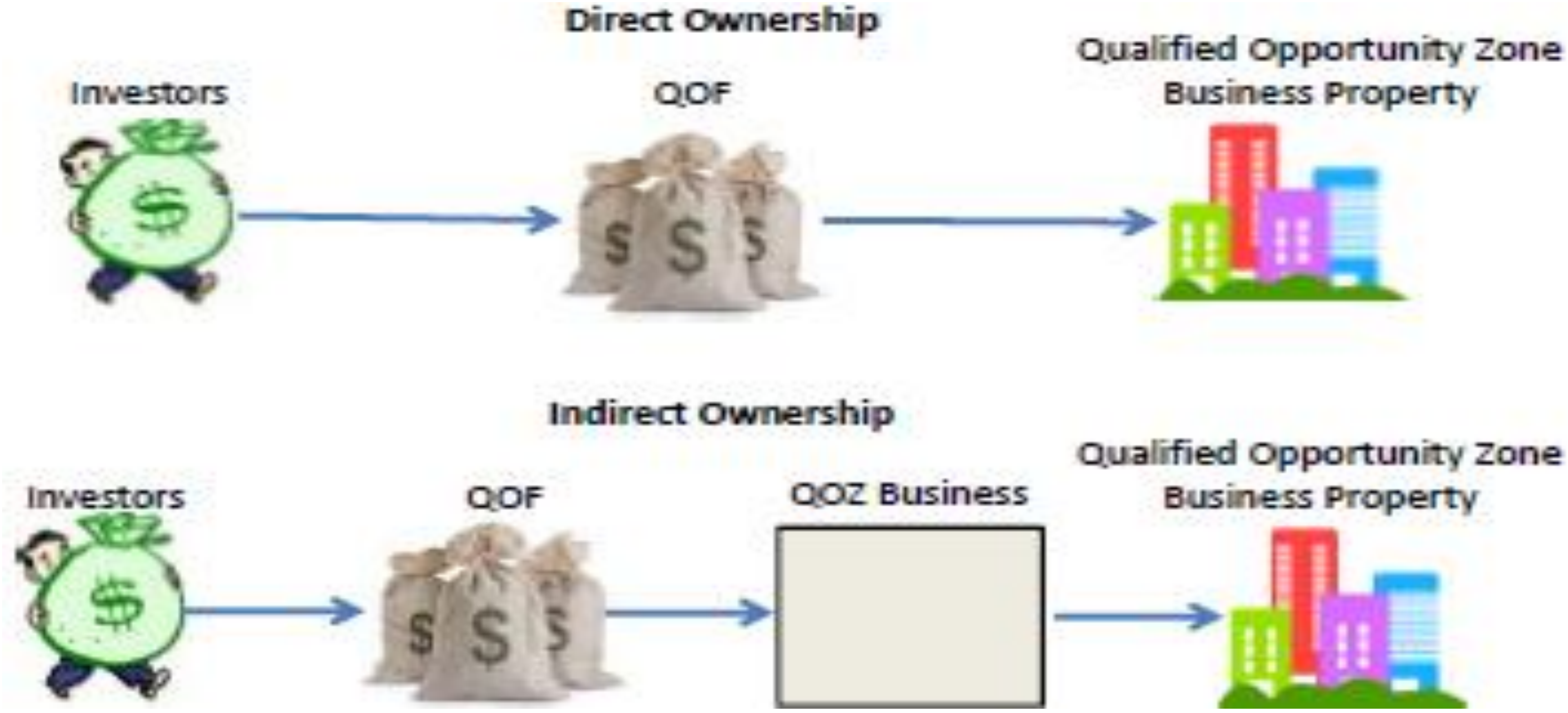
ANNUAL INVESTMENT APPRECIATION	TRADITIONAL INVESTMENT	QOZ INVESTMENT	ADDITIONAL GAIN
4%	$1,040,851	$1,277,944	$237,093
6%	$1,221,201	$1,588,548	$367,347
8%	$1,434,923	$1,956,625	$521,702
10%	$1,687,397	$2,391,442	$704,045
12%	$1,984,748	$2,903,548	$918,800
14%	$2,333,932	$3,504,921	$1,170,990
16%	$2,742,829	$4,209,135	$1,466,306
18%	$3,220,351	$5,031,536	$1,811,184
20%	$3,776,551	$5,989,436	$2,212,886

Note: The amounts shown are not net of fees and carry in either the traditional investment or the QOZ investment. This is to illustrate the tax benefits of QOZ investments prior to any fee structures.

Taxes Due on 12/31/2026 (payable in April 2027)



Types of QOF Investments



QOZB – Qualified Opportunity Zone Business Property

Tangible property ***used in a trade or business*** of the QOF (direct) or QOZB (indirect)

- Acquired **by purchase after December 31, 2017** from an **unrelated party** (20% standard)
- *Either* its **Original Use** of such property in the Opportunity Zone commences with the QOF (direct) or QOZB (indirect); or
- QOF (direct) or QOZB (indirect) must "**substantially improve**" the property
- During *substantially all* of the QOF (direct) or QOZB (indirect) holding period of such property *substantially all* of the use of such property was in a qualified opportunity zone

Original Use Requirement

Original Use of Land

• Rev. Rul. 2018-29: Provides guidance that the Original Use Requirement is not applicable to the land on which a building is located and being substantially improved

• Land must still meet the other requirements (used in a trade or business, purchased after 12/31/2017)

- Original use can be obtained until the point that the asset is "put in service". "Put in Service" is a safe harbor based on facts and circumstance.
  - Active depreciation has not been taken by the previous owner.
  - Cannot have rented it.
  - Not yet received their certificate of occupancy
- What does this mean? You can buy a shopping center or development before it is complete.
- *Note: Abandoned Buildings include anything that was abandoned a year prior to 2017 or 3 years prior to year purchased.*

Substantially Improved Requirement

Tangible property is ***substantially improved*** if, during *any 30-month period* **after** acquisition, additions to the basis of the property exceed an amount equal to the adjusted basis of the property at the beginning of the period.

- Substantial improvement to a building located on land wholly within the QOZ is measured by the additions to the adjusted basis of the building.
- Land on which an existing building is located does not also have to be substantially improved.
- Working Capital Safe Harbor for QOZBs (*indirect only*) allows tangible property not to fail during the expenditure period merely because planned expenditures are not yet made.
- QOZB may need sufficient designated working capital on hand to meet QOZBP test.

Qualified Opportunity Zone Stock or Partnership Interest

Can be any stock in a domestic corporation or any capital or profits interest in a domestic partnership (special rules for a U.S. Possession)

- Must be acquired by QOF from the entity at its original issue for cash **after December 31, 2017**
- No related party test
- Solely in exchange for cash
- The entity must be a "**Qualified Opportunity Zone Business**" ***at the time of investment*** (or was being organized for the purpose of being a Qualified Opportunity Zone Business)
- ***Must continue to*** be a Qualified Opportunity Zone Business during "**substantially all**" of the QOF's holding period (>90%)

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Qualified Opportunity Zone Businesses – Five Tests (All of the following)

- A ***trade or business*** in which ***substantially all*** of the ***tangible property owned or leased*** by the taxpayer is **qualified opportunity zone business property** (QOZBP)

1. *"Substantially all" is satisfied if **at least 70%** of the tangible property owned or leased from an unrelated party is QOZBP*

- **Working Capital Safe Harbor (31 months)**
- Statutory QOZBP Safe Harbor
- Additional business operation requirements

2. 5% Limit on "Nonqualified Financial Property" (cash and securities)

3. 50% "Active" Trade or Business Gross Income Test - *Triple Net (NNN) Leasing traditionally not considered active*

4. Use of "Substantial Portion" of the Intangible Assets in the "Active" Portion of the Trade or Business Test – Goodwill

5. "Sin" Business Prohibition (Casinos, Racetracks, Massage Parlors, etc.)

QOZB's – What about operating businesses?

- Gross Income Test (**Any** of the following)
- At least 50% of total compensation in the business must be paid to employees and independent contractors working in the OZ
- Total hours worked by employees of the QOZB within the OZ must be al least 50% of the hours worked
- Tangible property and management "homeruns" to the OZ (regularly use the OZ office in the course of carrying out their duties, and managed directly and substantially on a day-to-day basis)
- Substantial "Facts and Circumstances" show that 50% of the gross income comes from an OZ

Qualified Opportunity Zone Business Safe Harbor

Working Capital Safe Harbor

Working capital assets must be:

• ***Designate in writing*** the amounts to be held for acquisition, construction, or substantial improvement of property;

• With a ***written schedule*** consistent with the ordinary start-up of a trade or business for the working capital assets to be used within 31 months of receipt of the assets;

• ***Actually used*** the working capital assets substantially consistent with the written designation and written schedule; and

• 70% QOZBP Test: Tangible property being substantially improved ***must be expected*** to satisfy the requirements of QOZBP ***as a result of the planned expenditures*** of those working capital assets.

Statutory Safe Harbor

Tangible property that ceases to be QOZBP shall continue to be treated as QOZBP for

- the lesser of (i) 5 years after the date on which shall it ceases to be QOZBP or

(ii) the date on which it is no longer held by the business

QOZBP Direct Method

Advantages:

- Up to 10% of assets may be held in cash without qualifying as reasonable working capital
- Rev. Rul. 2018-29 applies to QOF's redevelopment of an industrial site for "residential rental property"
- No Additional Operational Tests:
- No "Active" Trade or Business Test
- No 5% Nonqualified Financial Property Test
- Must purchase QOZBP from an unrelated party
- Must carefully structure QOF, its election and property purchases

QOZBP Indirect (Stock) Method

Advantages:

- Only a 70% tangible asset threshold (a 63% total threshold)

= 30 “Bad Asset” bucket is possible

- 5-year Statutory Safe Harbor for QZOBP classifications
- 31-Month Working Capital Safe Harbor
- Additional timing and structuring flexibility

Notes:

- Allows QOZB stock or purchase from a related entity
- Requires additional structuring for operational requirements

Identifying Risks

- What are the risks?
- All the same risks remain, plus Opportunity Zone compliance risk, for developers and fund managers and investors.
- What if you cannot find a project?
- If you do find a project, how do you know it is a good investment?

Identifying Risks

- Not all Opportunity Zones are created equal. How does Whitehall or Linden level the playing field with Franklinton?
- For developers, would you rather be a pioneer, or a settler?
- Think about your community…

…Are some areas receiving more investment than others now? Would those zones receive more rapid natural and forced appreciation and how would that affect a 10-year waterfall exit and overall tax revenues for the City and County?

How does each community mobilize its staff, investors, developers and other stakeholders?

Identifying Risks

- For economic developers, don’t go it alone!
- Public-private partnership (P3) is still essential to mitigate real estate risk, and several tools are available:
  - Expediting permits, abatements, exemptions, tax credits (HTC & NMTC) and financing programs, cost segs., etc.
  - OZ are the catalyst. Developer and communities must still find good projects and good economic developers must also perform their due diligence.
  - *Our philosophy is to find solid to great deals and let the benefits of the Opportunity Zone go to work for our investors. Can cross-pollinate!*

Takeaways and the Future

Get. Professional. Advice.

Tax – Legal – Wealth - Estate

Takeaways and the Future

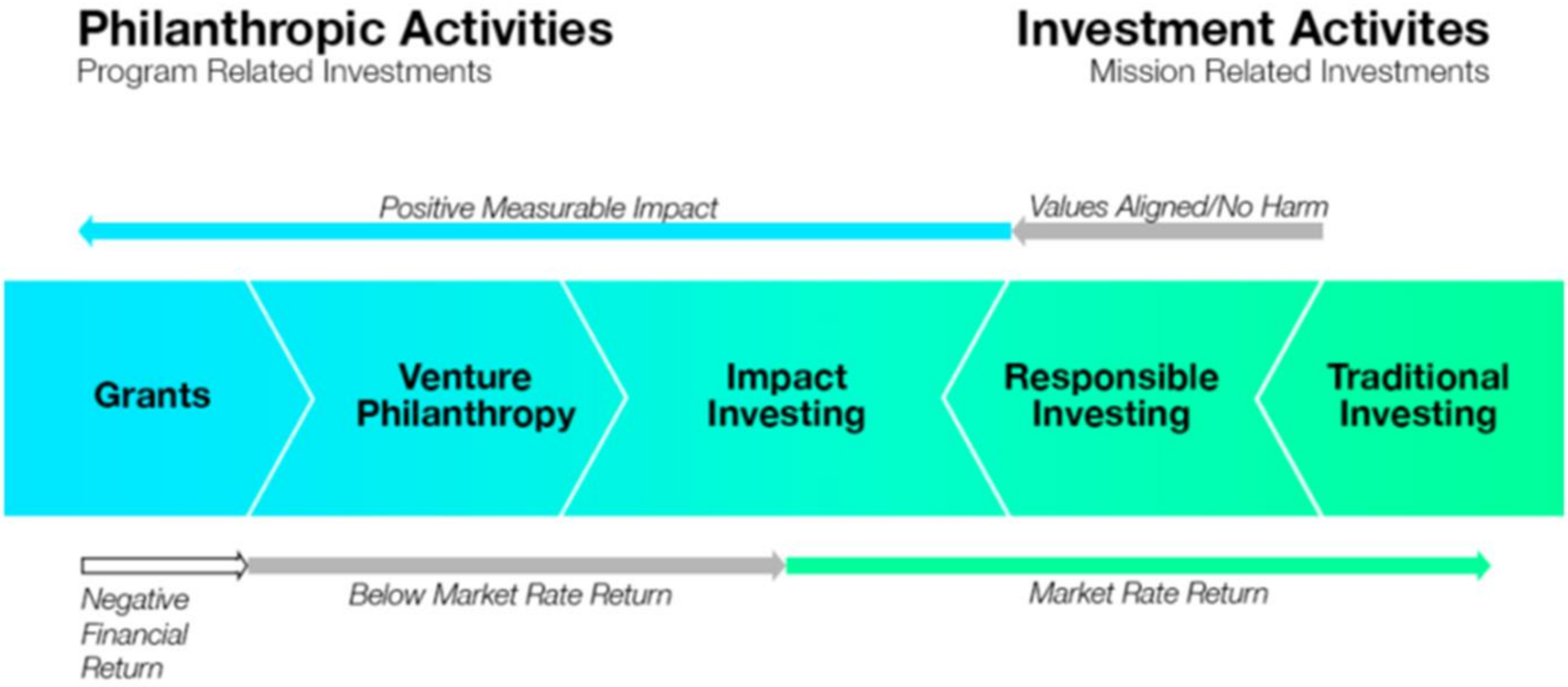
- 2022 should be another big year!
- OZDG – What do we see out there?
- Bi-partisan support – Expect additional reporting on social and economic impact

Takeaways and the Future

- How would it feel to invest in your community?
  - A different mindset…10 years is a long time.
- All things being equal, an OZ deal beats a Non-OZ deal
- NISRE- Social impact. Great returns.

Impact Investing

Creating positive and social and environmental change



EXECUTIVE SUMMARY

$3.00M Total Raise

$1M Annual Rent for 15 years

17.7% Target IRR without OZ benefits

24.43% Target IRR pre-tax equivalent with OZ benefits

Vision

Provide an affordable and sustainable housing solution for a non-profit to reintegrate based on a State government contract + a 24.43% target IRR pre-tax equivalent for community impact investors.

Investment Overview

- **QOZ Property:** Formerly called Cargominiums, The Phoenix Community is an Affordable, Sustainable Community Residential Center
- **Total Raise:** $3.00M capital gains raised from multiple states
- **Type:** 10-year, opportunistic closed-end investment
- **Investment Structure:**
  - Taxpayer-investors invest in Cargominiums Opportunity Fund, LLC
  - Qualified Opportunity Fund-investors invest in Cargominium Partners, LLC
- **Investor Type:** Accredited, subject to verification
- **Opportunity Zone Tax Incentives:**
  - Temporary deferral
  - 15% deferred tax reduction
  - 100% tax-free exit
  - 10% State of Ohio OZ Tax Credit (not included in IRR)
- **Investment Strategy:** Capitalize a qualified opportunity zone business to acquire title to, complete development of, and lease a 50-bed residence to a faith-based non-profit partner under a 15-year lease at a fixed-rent.
- **Investor Exit:** Cross-purchase or redemption by sole tenant after 10-year investment period.

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Opportunity Zone Investment Profile

ECONOMIC INNOVATION GROUP

The Phoenix Community

Location: **Columbus, OH**

Congressional District: **OH-3**

Opportunity Fund Name: **Cargominiums Opportunity Fund, LLC.**

Opportunity Fund Manager: **Opportunity Zone Development Group**

Investment Date: **Q4 2019**

Project Details: **Mixed-use building with reentry housing and support services**

Opportunity Fund Partners with Non-profit, Jumpstarts Stalled Project for Formerly Incarcerated Men

For 13 years, the faith-based nonprofit organization, Nothing Into Something Real Estate, Inc (NISRE), envisioned piloting an innovative solution to address Columbus's growing shortage of affordable homes. In 2016, the development of an affordable housing community commenced on a lot owned by the non-profit, but then stopped shortly thereafter due to third-party circumstances. The project remained stalled until 2019, when the Opportunity Zone Development Group (OZDG) partnered with NISRE to breathe new life into the project and reposition it as a mixed-use building called "The Phoenix Community" which will provide affordable housing and support services to residents transitioning from incarceration.

People who have been incarcerated are up to 13 times more likely to experience homelessness compared to the general public, and pre-pandemic, the unemployment rate among formerly incarcerated individuals was 27 percent. Housing insecurity and unemployment are among multiple contributing factors that lead to the nation's high recidivism rate. By providing affordable homes and support services at The Phoenix Community, OZDG and NISRE are helping to break the cycle of incarceration for individuals transitioning back into communities.

The Phoenix Community is a 50-bed residence with new office space for NISRE on the first floor. The non-profit has a contract with the State of Ohio to operate restorative, supportive housing programs such as this and will lease the property for 15 years at a predetermined rate. Once OZDG exits the investment in year-10, NISRE has first right of refusal to purchase the property so it may remain a beacon of hope in the community.

Projected Impact

Jobs created for restored citizens:	20
Full-time non-profit jobs supported:	40
New office space for non-profit organization:	1,500 square feet
Beds for formerly incarcerated individuals:	50
Formerly incarcerated individuals served annually:	70-100

Community Stats

	Census Tract: 23	MSA: Columbus, OH
Median Family Income:	$33,162	$81,325
Poverty Rate:	14.3%	13.2%
Adults Not Working:	36.7%	14.8%
Minority Population:	82.7%	27.2%
Bachelor's Degree or Higher:	10.9%	36.7%
Housing Vacancy:	30.4%	7.2%

"This social impact project simply would not have closed but for OZDG's innovative approach to Opportunity Zones."

– Andrew Doup, Kegler Brown Hill + Ritter



UBOTA

GRADALL

Ohio OZ Partners, LLC 2022

Takeaways and the Future

- A unique opportunity…

…Let’s make the most of it!

Are there any questions?

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<u>Contact Information:</u>

Graham Allison

CEO and Co-Founder

614-313-9538 Mobile

gallison@ozdevgroup.com

Brian White

CFO and Co-Founder

614-787-2014 Mobile

bwhite@ozdevgroup.com

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