



M A R Y L A N D OPPORTUNITY ZONES



Opportunity Zone Conference

July 31st, 2018
College Park, Maryland



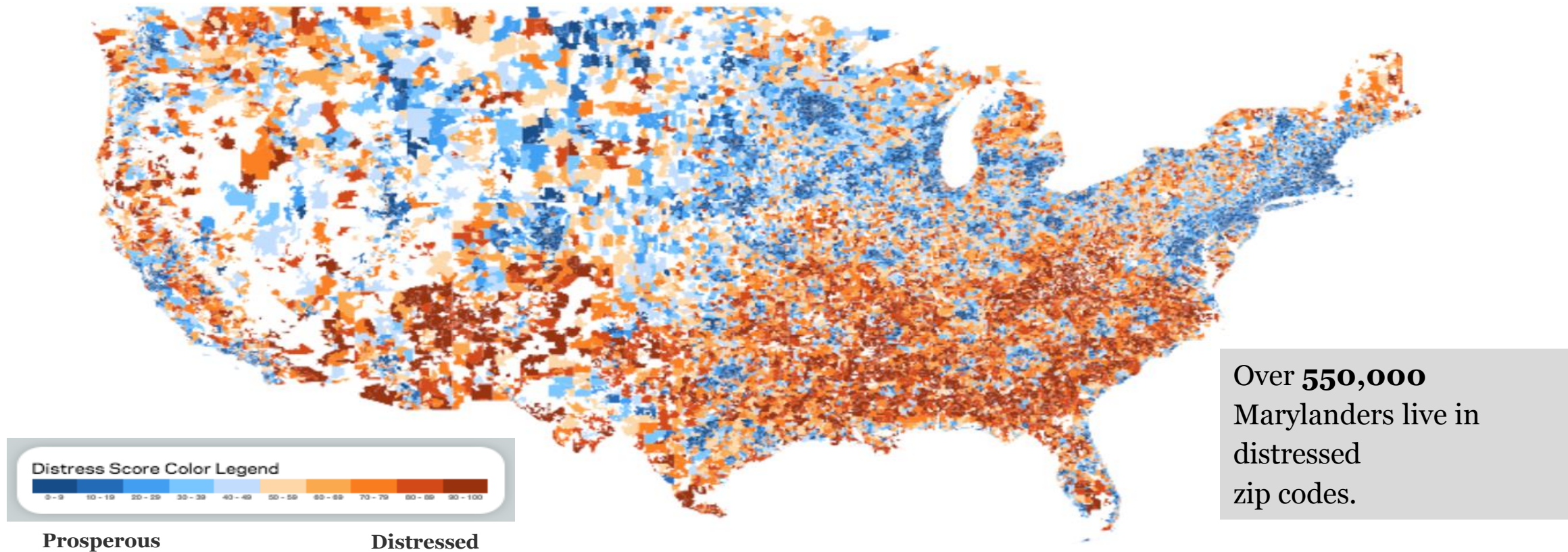
Opportunity Zones Overview

John Lettieri, President and Co-Founder

ECONOMIC INNOVATION GROUP / Washington, DC / @LettieriDC

Why Opportunity Zones and why now?

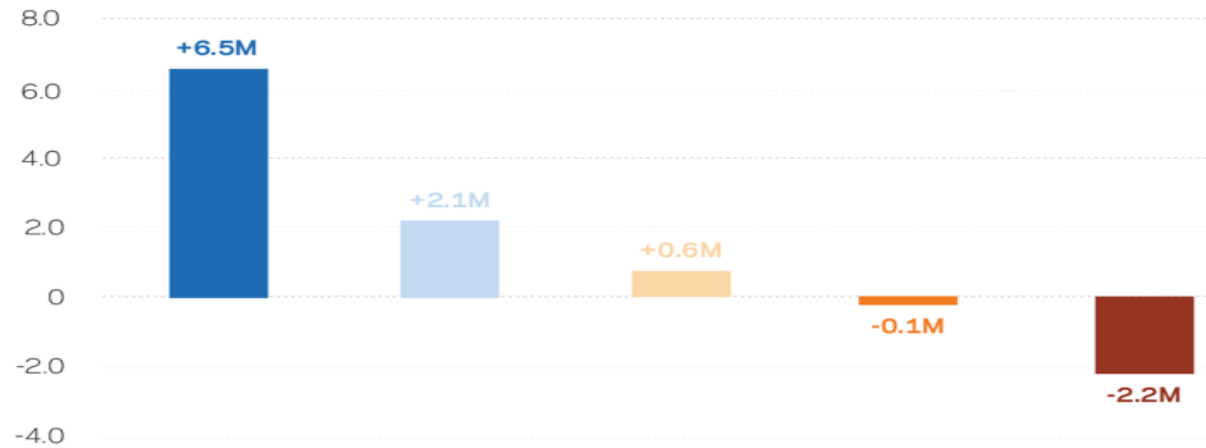
52 million Americans (1 in 6) live
in economically distressed communities.



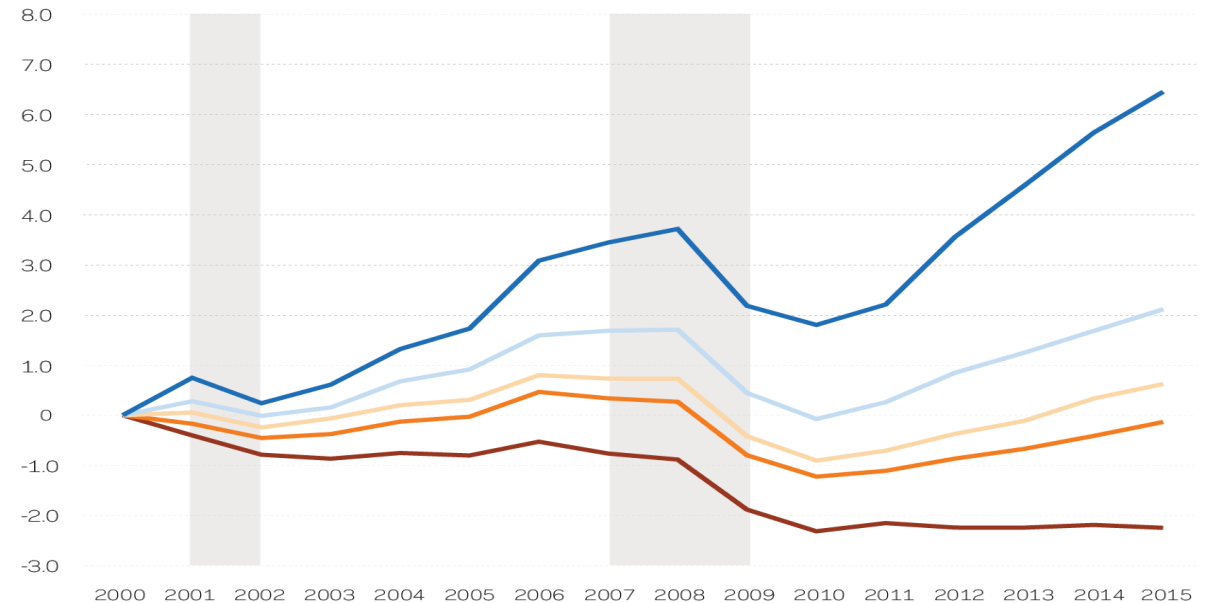
National job and business growth fails to reach most distressed zip codes.

- More than half of the country's distressed zip codes contained **fewer jobs and places of business in 2015 than they had in 2000.**

Change in employment from 2000 to 2015 by quintile



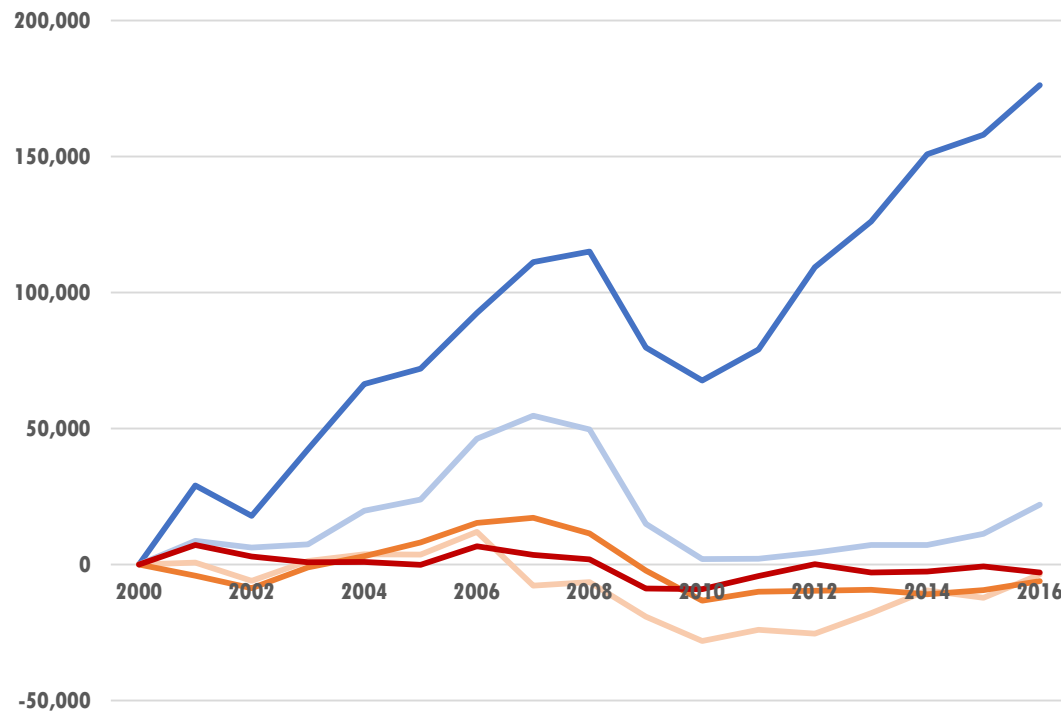
Cumulative change in employment by quintile



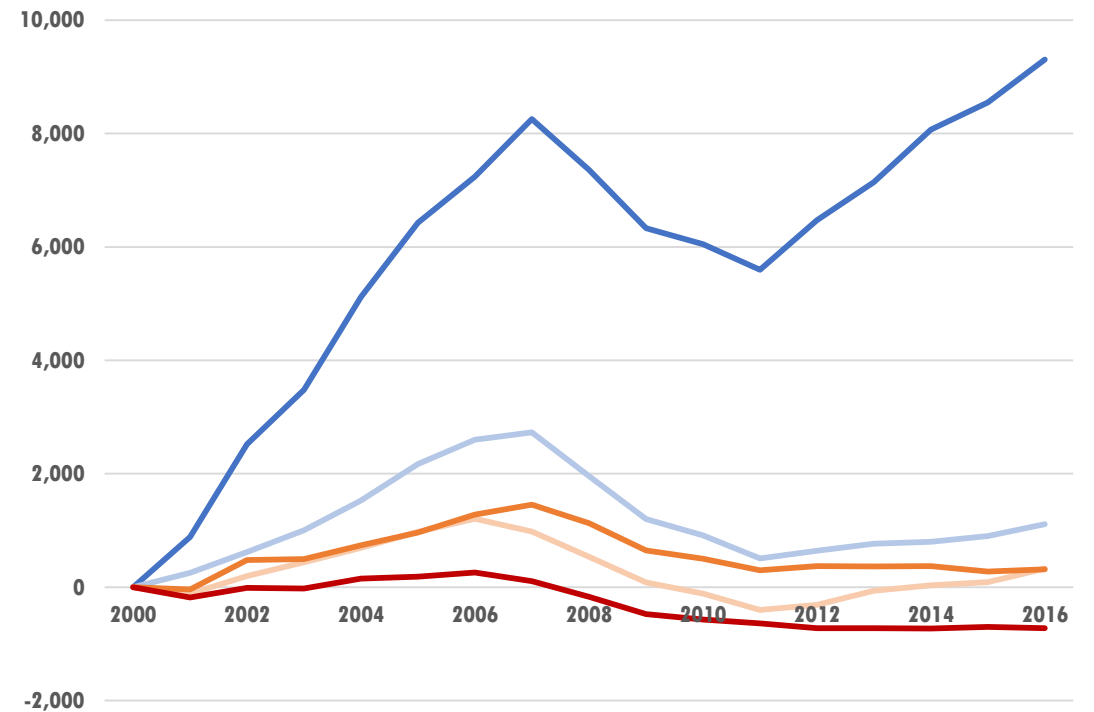
Prosperous Comfortable Mid-tier At risk Distressed

The same holds true in Maryland.

Cumulative change in
employment by quintile



Cumulative change in **establishments**
by quintile

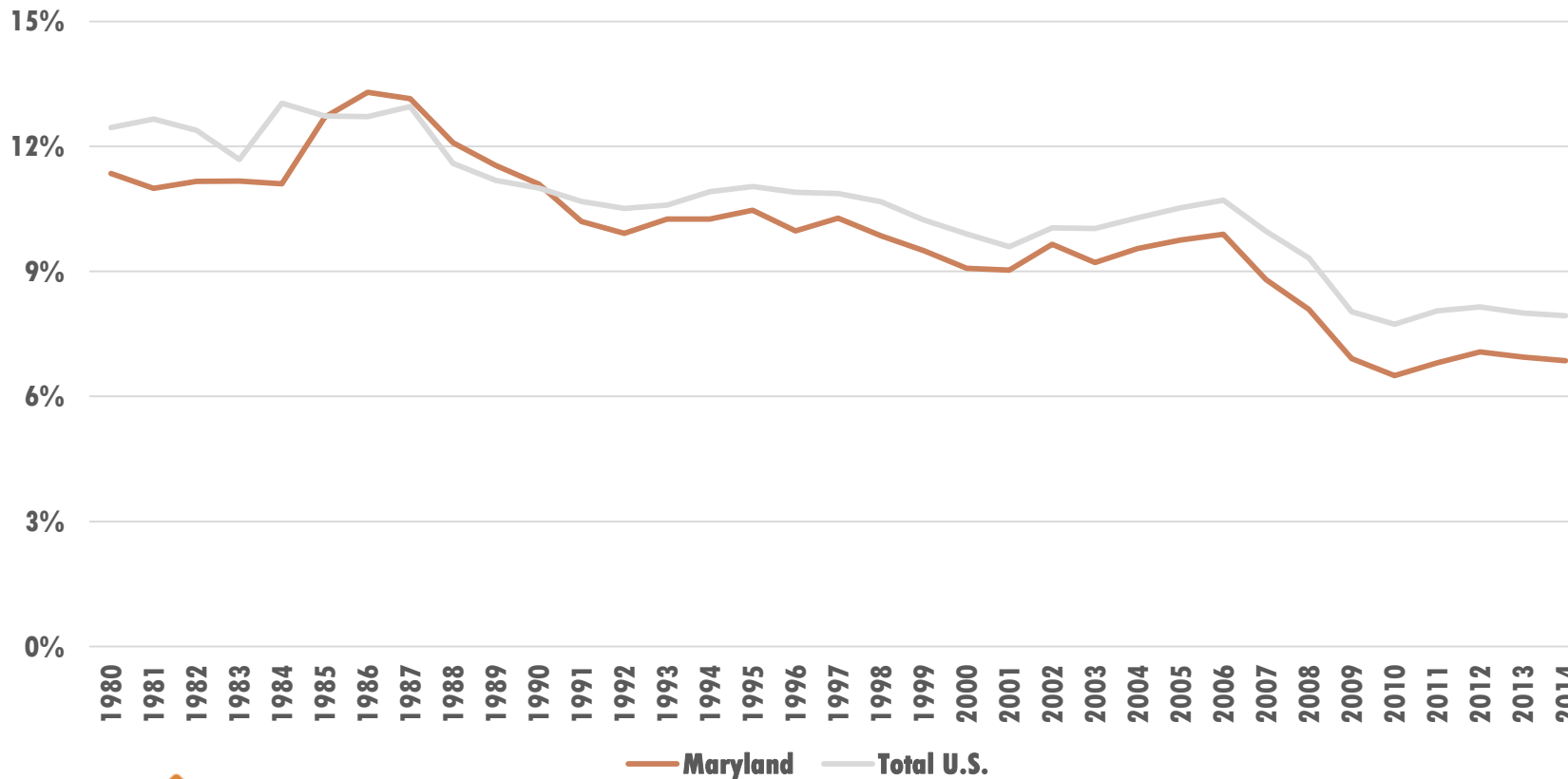


● Prosperous ● Comfortable ● Mid-tier ● At risk ● Distressed

At the same time, the country is facing a related crisis
in entrepreneurship and new business formation.

- The U.S. is **missing about 100,000 startups a year** right now, and entrepreneurial activity has dried up fastest in places that can least afford it.

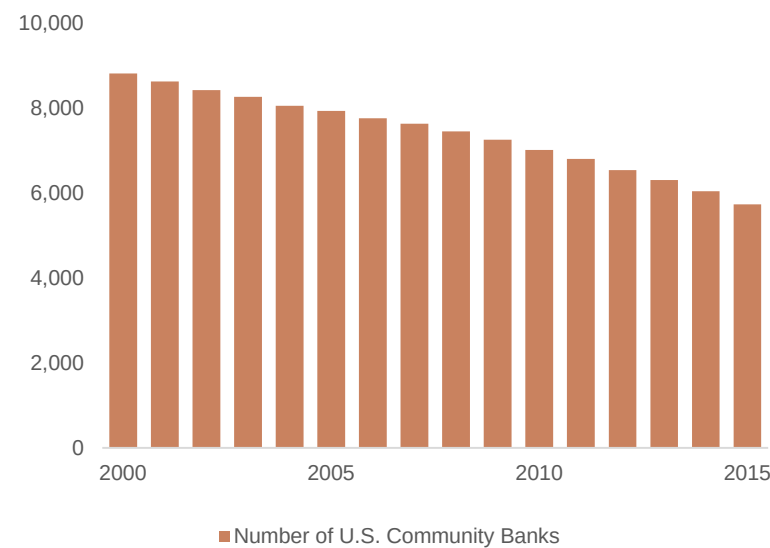
Rate of new firm formation



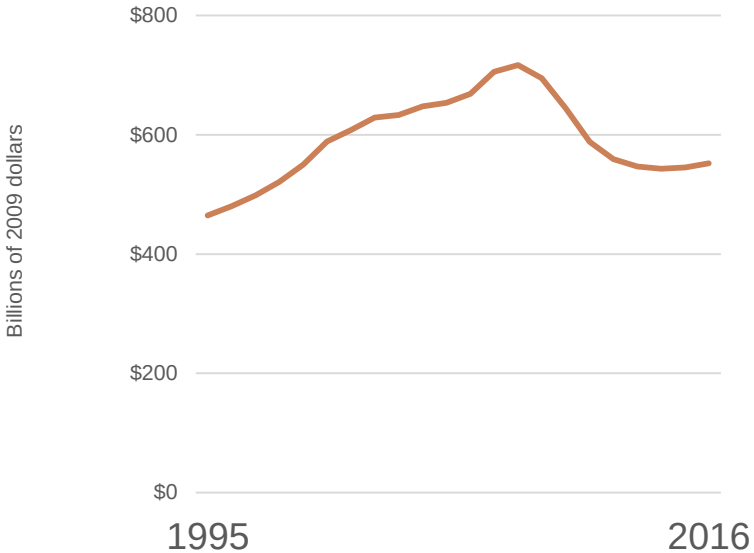
Maryland produced more than **3,000 fewer new firms** in 2014, the latest year for which data is available, than in 2006, prior to the crisis.

Uneven access to capital is now a threshold issue for addressing business formation in America.

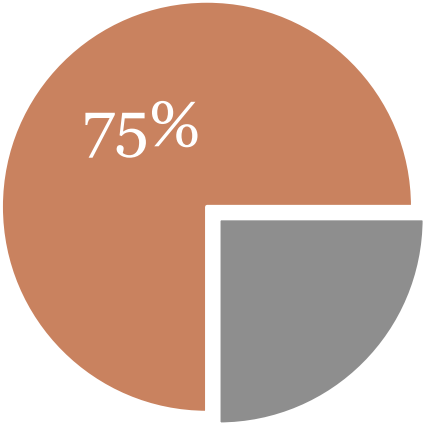
Nearly **one out of every four** community banks has disappeared since 2008



In real terms, small business lending remains **down by a quarter**



75% of all venture capital concentrates in three states

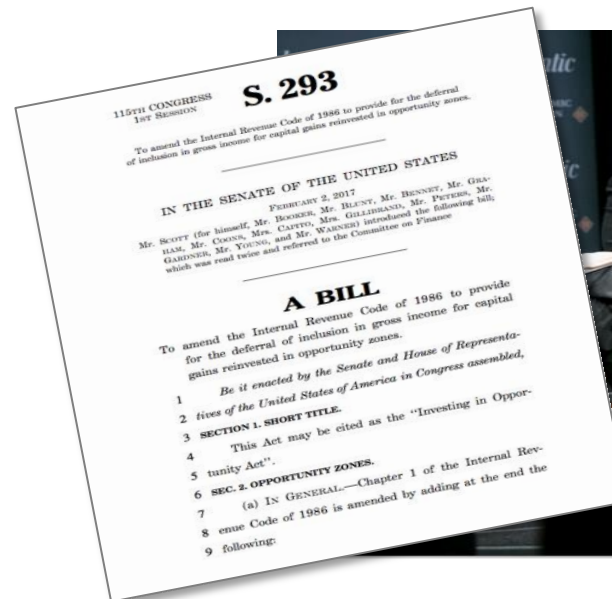


Opportunity Zones are an innovative, flexible, and bipartisan solution for catalyzing private sector-led economic growth.

Opportunity Zones were established by Congress in the Tax Cuts and Jobs Act of 2017.

The new provision is based on the bipartisan ***Investing in Opportunity Act***, which was championed by Senators Tim **Scott** (R-SC) and Cory **Booker** (D-NJ) and Representatives Pat **Tiberi** (R-OH) and Ron **Kind** (D-WI) and attracted more than 100 bipartisan cosponsors.

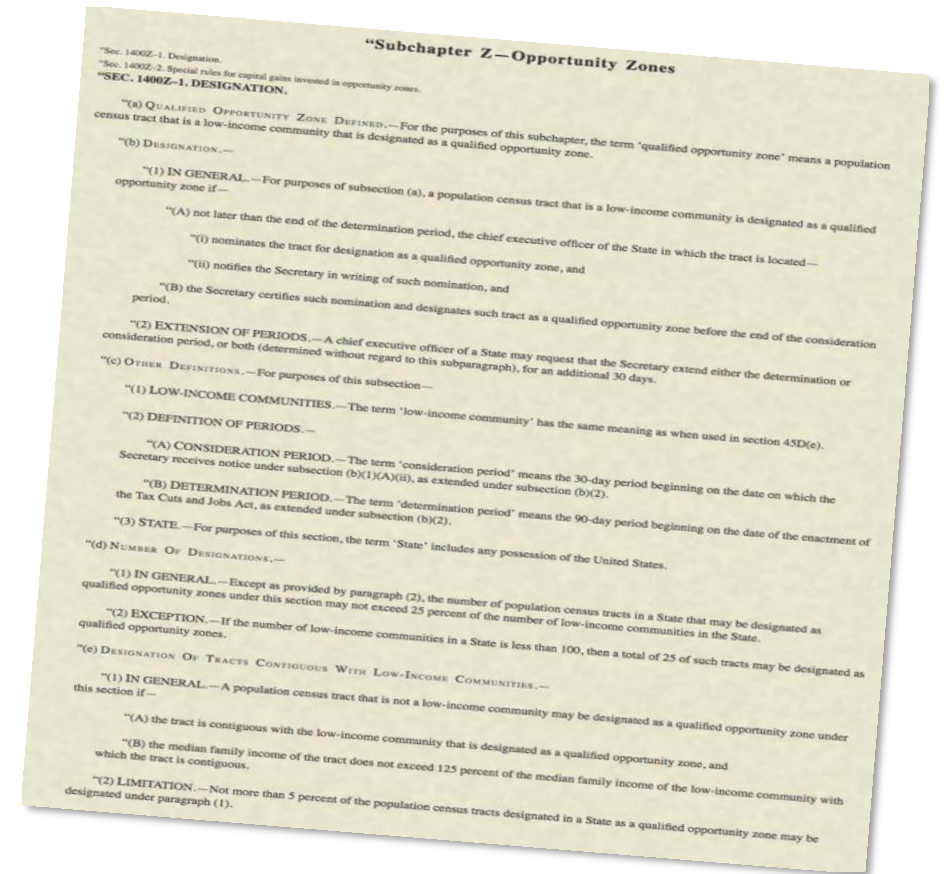
EIG originally developed the concept in a 2015 working paper authored by **Jared Bernstein** and **Kevin Hassett**.



Opportunity Zones will help connect low-income communities with much-needed capital.

 **Capital** – U.S. households and corporations were sitting on an estimated **\$6.1 trillion** in unrealized capital gains at the end of 2017.

- **Connect** – Opportunity Zones offer a frictionless way  for investors to dedicate all or a portion of their winnings to seeding the next generation of enterprise in distressed communities all across the country. In exchange, investors get a graduated series of federal tax incentives tied to **long-term holdings**.



A number of key characteristics differentiate Opportunity Zones from prior federal tax incentives for economic development.

- ✓ **Flexibility:** Low income communities come in many different shapes and sizes and all have different needs. This tool is capable of supporting a variety of mutually reinforcing activities within the same community.
- ✓ **Scalability:** There is no statutory cap on the amount of capital that can flow into Opportunity Zones in any given year. As such, this tool has the potential to help fuel economic renewal on a national scale.
- ✓ **Simplicity:** Opportunity Funds do not compete for fixed allocations of public sector financing and, as a result, do not require pre-approval of their investments. This should lower the cost, time, and risk to business transactions, and encourage broad participation.

EIG brings together leading entrepreneurs, investors, economists, and policymakers from across the political spectrum to address America's economic challenges.

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facebook.com/EconomicInnovationGroup



linkedin.com/company/economic-innovation-group



twitter.com/InnovateEconomy

OPPORTUNITY ZONES – PROVISION BASICS AND CURRENT TRANSACTION STRUCTURES

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BACKGROUND

- Created by passage of Tax Cuts and Jobs Act of 2017
- Codified in IRC §§1400Z-1 and 1400Z-2.
- Designed as revitalization program in economically distressed areas designated as Opportunity Zones.
- Taxpayers receive preferential tax treatment through investment in Opportunity Zone Funds.
- IRS will release serial future guidance clarifying many aspects of the program.



STEPS IN THE INVESTMENT PROCESS IN O-ZONE FUNDS:

- Step 1: Realize gain from any capital gain triggering event (stock, real estate, partnership interests or other property) - must be from a sale/exchange with unrelated party.
- Step 2: Invest capital gain - taxpayer creates/invests in Opportunity Zone Fund within 180 days.
- Step 3: Opportunity Zone Fund invests in Opportunity Zone Property - taxpayer cannot invest in property directly; all investments must be through O-Zone Funds.
- Step 4: O-Zone Fund must hold 90% of its assets in O-Zone Property.



STEPS IN THE INVESTMENT PROCESS IN O-ZONE FUNDS:

Step 5: If taxpayer holds its O-Zone Fund investment for 5+ years, the taxpayer receives an increase to the O-Zone Fund interest basis of 10% of the deferred gain.

Step 6: If the taxpayer holds the O-Zone Fund investment for 7+ years, the taxpayer receives a basis adjustment increase to the O-Zone Fund investment of an additional 5% of the deferred gain.

Step 7: On 12/31/2026, there is a “deemed disposition,” so all deferred gains related to investment into the O-Zone fund ends and gain is recognized. Gain is the lesser of:

- A. Original deferred gain or
- B. FMV of taxpayer; O-Zone Fund investment

Reduced by the taxpayer’s basis in their O-Zone fund investment.



STEPS IN THE INVESTMENT PROCESS IN O-ZONE FUNDS:

Step 8: If taxpayer holds its O-Zone Fund investment for 10+ years, taxpayer is permanently exempt from capital gains realized and recognized from the sale of its O-Zone Fund investment (pertains to post-acquisition gains only).



OPPORTUNITY ZONE PROPERTY

Category 1- O-Zone Property

- Tangible property, such as equipment, buildings, land.
- During substantially all of the O-Zone Fund's holding period of the property, the use of the property must be in the O-Zone.



OPPORTUNITY ZONE PROPERTY

Category 2 - O-Zone Stock or Partnership Interests:

- Corporate stock or partnership units in a domestic operating business.
- Substantially all of the business tangible property must be acquired by an unrelated party purchase after 2017 and used in the O-Zone during substantially all of the business's holding period.

Certain IRC §1397C(b) requirements must be met:

- At least 50% of the business's total gross income is derived from the “active conduct” of the business. §1397C(b)(2)
- A “substantial portion” of the intangible property of such entity is used in the active conduct of a trade or business.



OPPORTUNITY ZONE PROPERTY

Category 2 - O-Zone Stock or Partnership Interests:

Certain IRC §1397C(b) requirements must be met (cont'd):

- The balance sheet should not contain too much financial property that implies the business is more focused on investment speculation than economic development (less than 5% of the average aggregate unadjusted basis of the business's property is attributable to nonqualified financial property). See §1397C(b)(8).
- Certain businesses are expressly prohibited (e.g. golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, gambling facility, sale of alcohol for off-premises consumption).



SUBSTANTIAL IMPROVEMENT REQUIREMENT

- O-Zone Fund has a 30-month window to improve property, and must invest an amount for the improvements that exceeds the acquisition basis of the property.
- We expect the IRS to issue guidance on this requirement.
- Unclear if the 30 month window for substantial improvement must begin upon O-Zone Fund's acquisition of the property.
- Unclear how land is substantially improved.
- Various unknowns in context of operating businesses (does requirement apply? If so, issues if business is not tangible asset focused?).



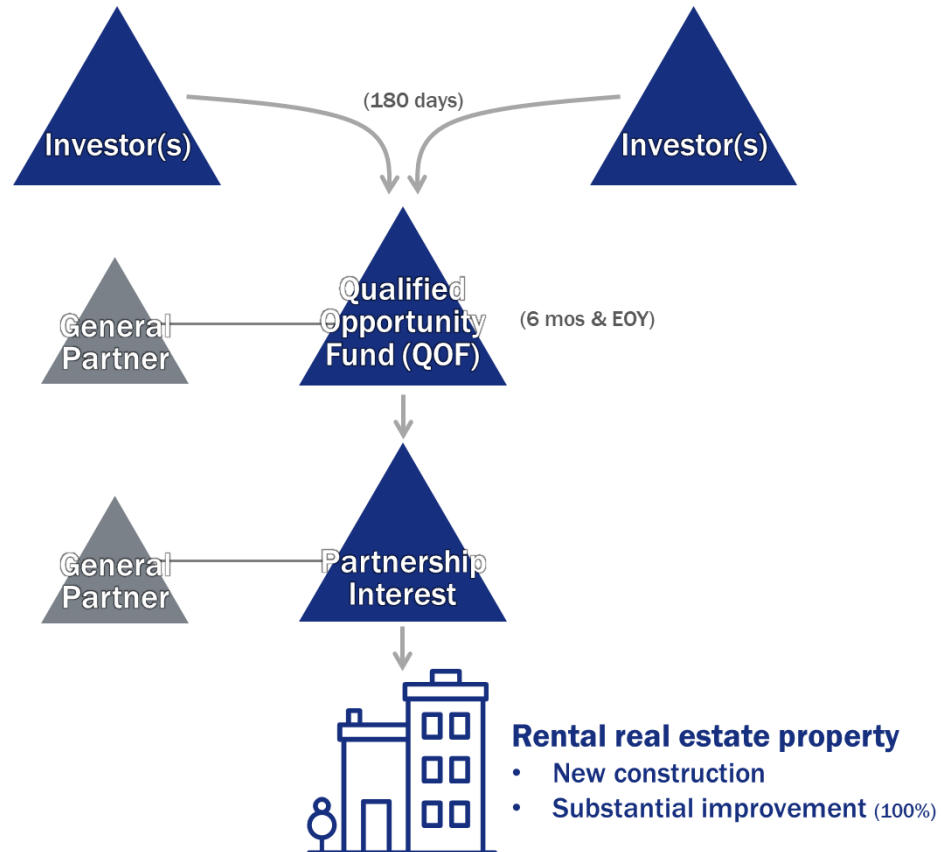
ISSUES FOR CONSIDERATION

1. Incremental benefit - yield enhancement.
2. Perishability of the incentive.
3. State law conformity - some states explicitly decouple from the IRC §1400 series.
4. Who is the taxpayer - this is an issue when S Corporations and partnerships sell property at a gain for purposes of investment in O-Zone Funds. Can the shareholder/partner elect to defer gains, or must the entity elect?
5. What gains are eligible for deferral?
6. Mixed Fund investments - funds not from deferred gains are treated as an investment separate from the deferred gain investment in the O Fund.

Query: Is a partner's share of debt a separate investment?



RENTAL REAL ESTATE ILLUSTRATION



Multi-tenant Office Building with the following characteristics:

- Land < 15% cost of tangible property
- Construction loan/mini perm
- Twelve month construction period
- Ten year hold

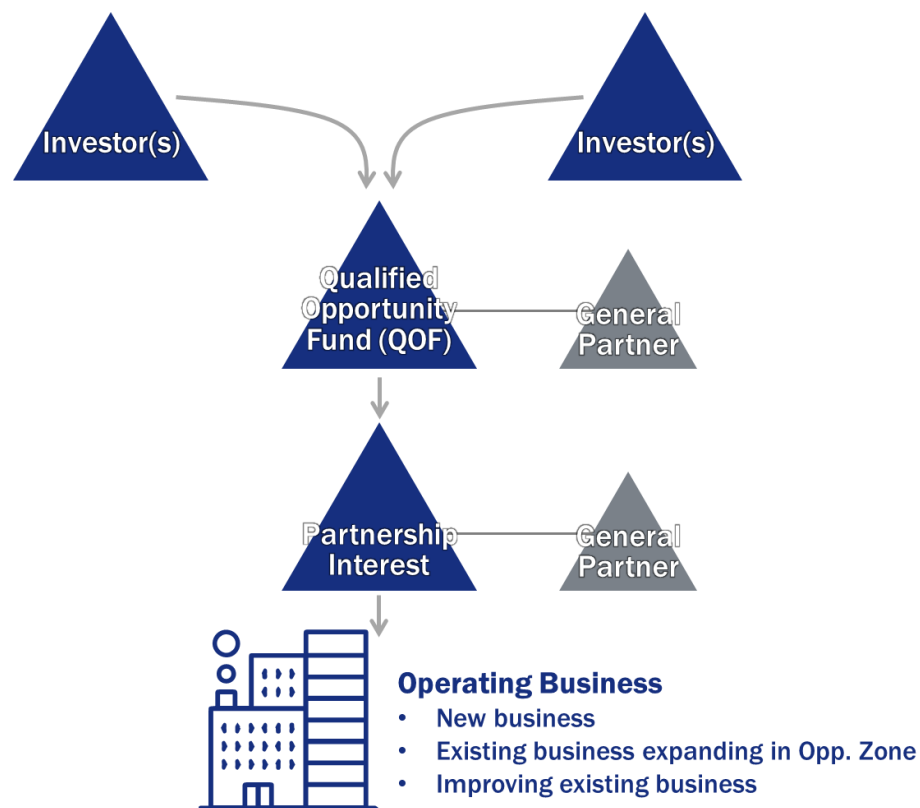


ISSUES TO NAVIGATE

- Debt
 - Treatment of allocable property level debt
 - Treatment of refinance proceeds
- Ability to deduct tax losses
- Distribution of operating cash flow
- Ownership Entity – LLCs allowable?
- Related party test - limits
- Substantial improvement – how to measure the 100%
- Residential Rental
- Structure of Exit



OPERATING BUSINESS ILLUSTRATION



Indoor agriculture “franchise” scenario with the following characteristics

- Technology company “hub” – individual location “spoke” – bottling plant model
- Option A – license model – exit with local buyer – fees paid out to hub.
- Option B - JV model – 75% / 25% for hub and spoke respectively – exit is purchase by hub entity at EBITDA multiple.
- \$3M equity – likely all equity financing with novel technology and business model.
- Multiple locations – real estate platform reliance.
- Fund structure -multi investor and multi asset fund with active “trading.”
- Hold period driven by EBITDA growth.
- Assuming 10-year hold – 850 BPs in yield enhancement predicated on risky asset performance (hence higher than above).



ISSUES TO NAVIGATE

- Start-up vs. expansion
- Fund structure and timing
- Substantial improvement
- Related party
- Inside / outside basis
- Ability to deduct tax losses
- Distribution of operating cash flows
- Structure of exit

OPPORTUNITY ZONES – PROVISION BASICS AND CURRENT TRANSACTION STRUCTURES

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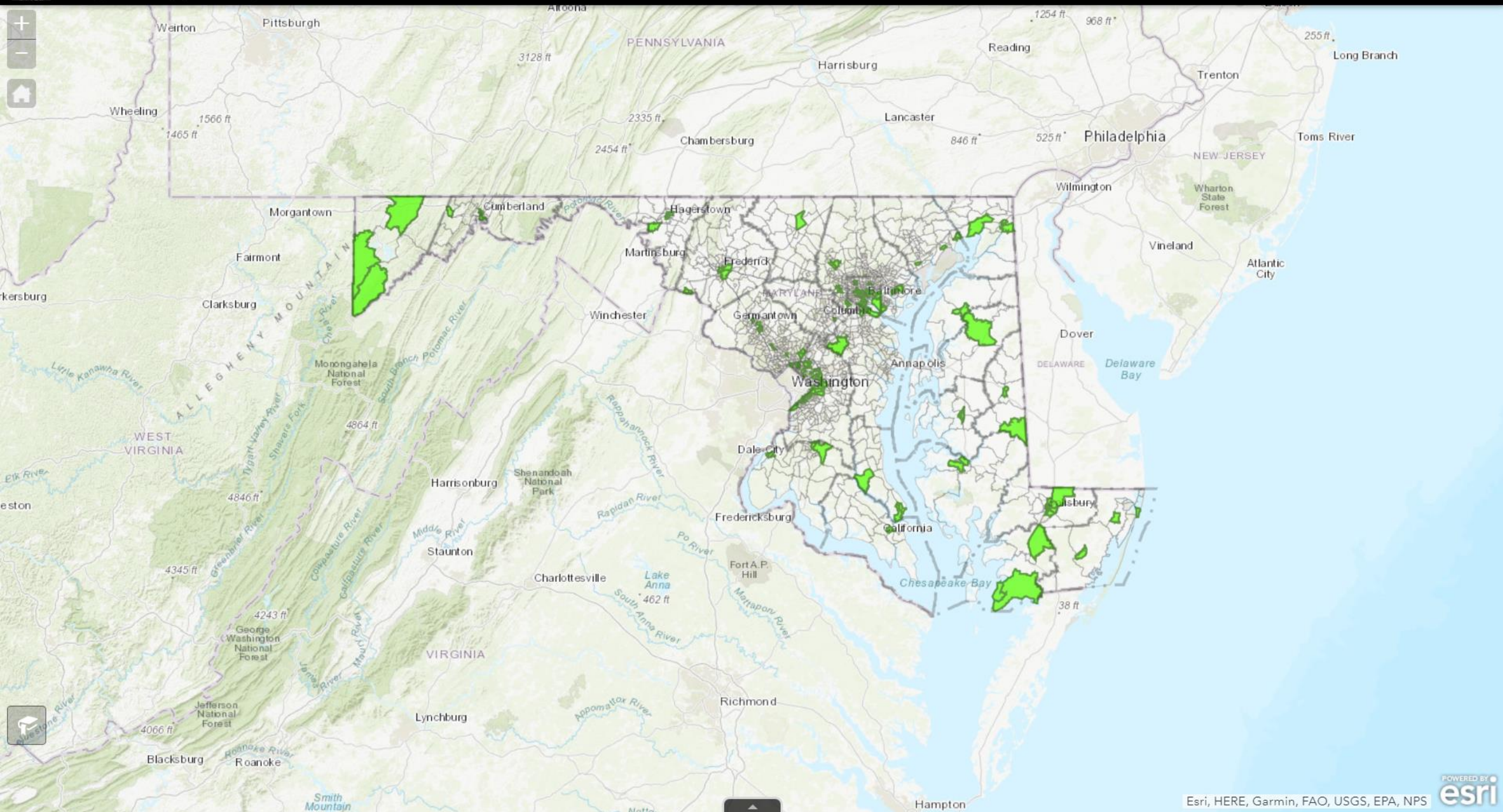
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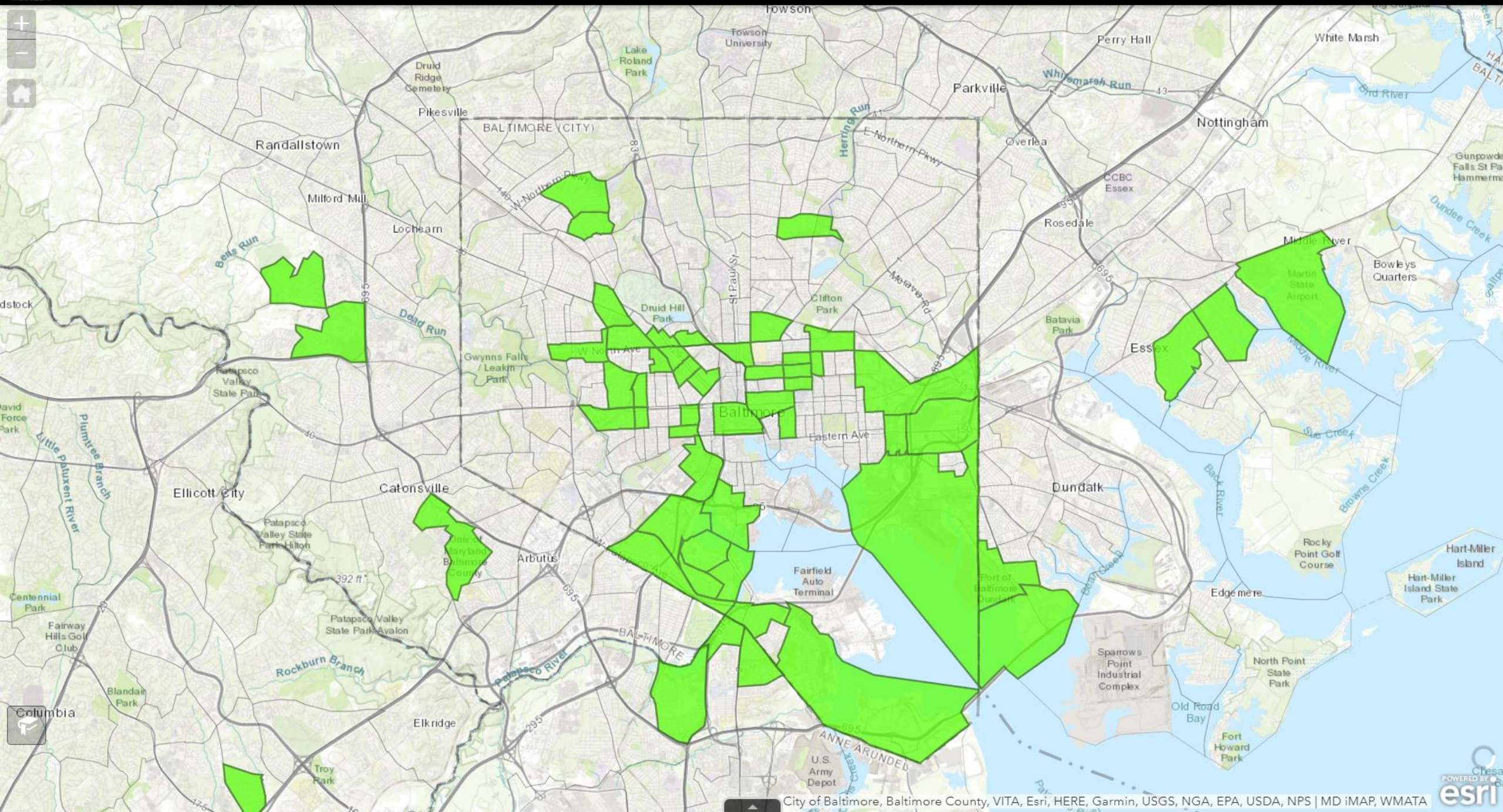


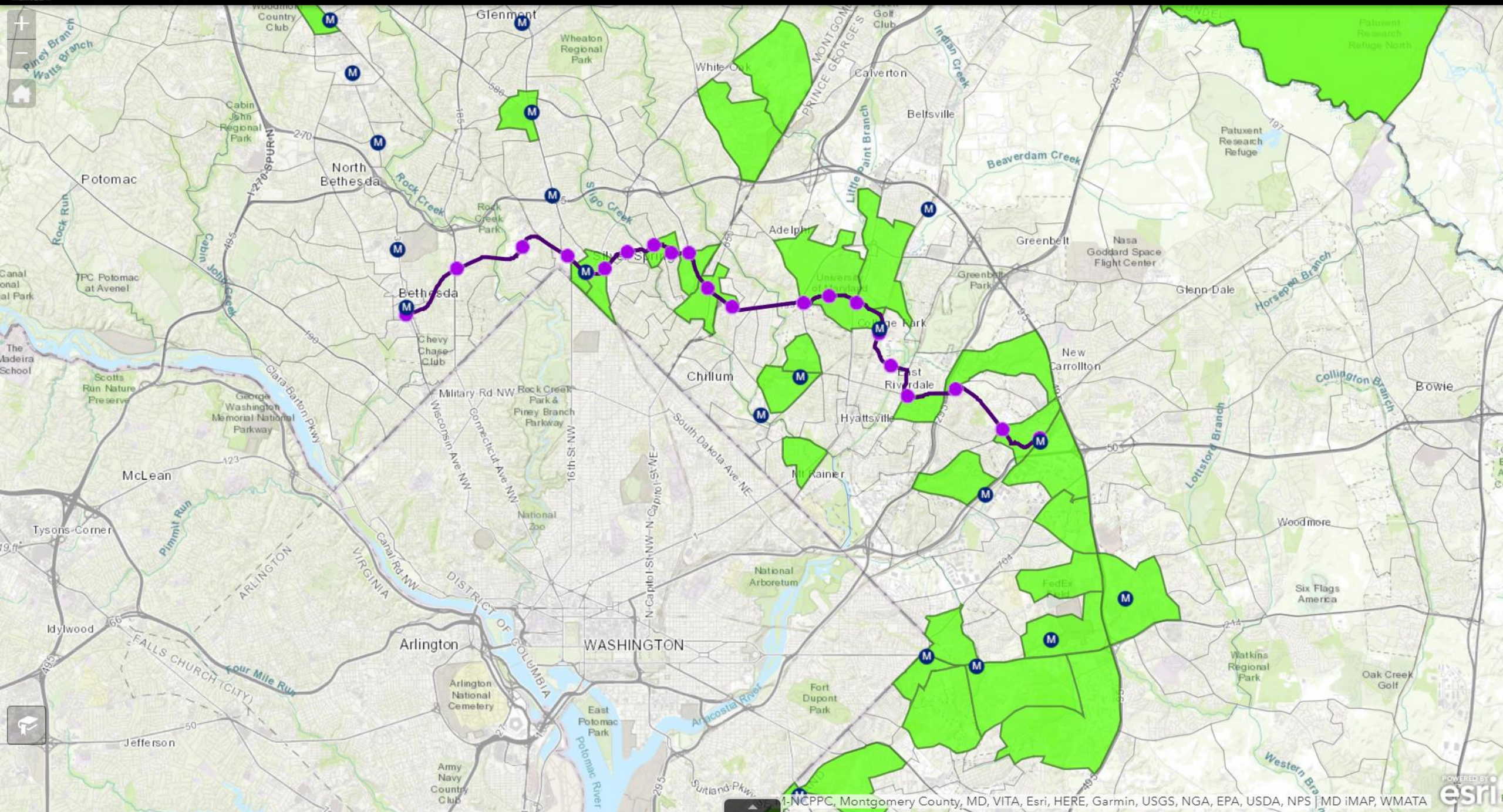
Opportunity Zone Descriptions and Locations

Michael White

CHIEF OF STAFF, MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT









M A R Y L A N D OPPORTUNITY ZONES



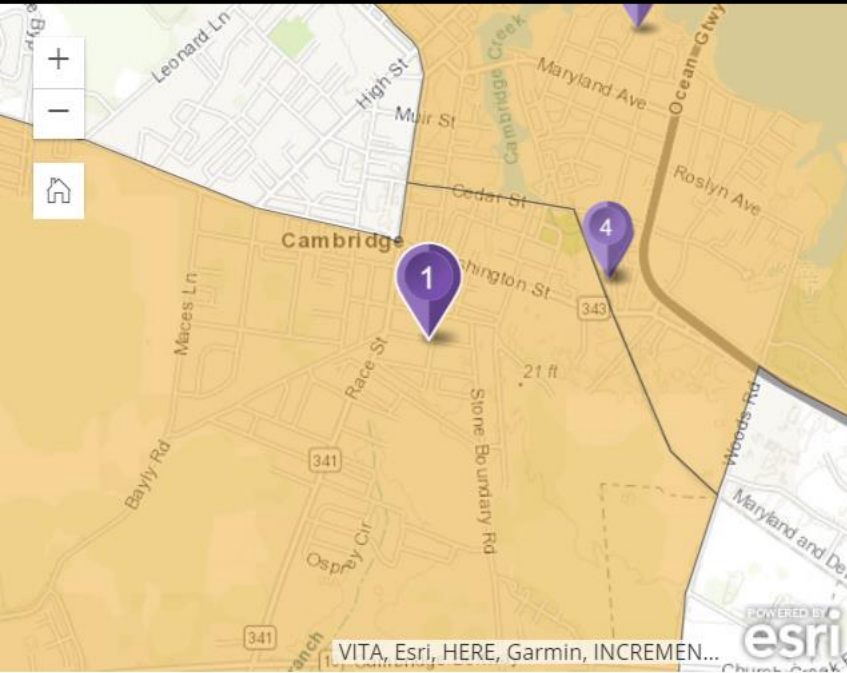
Projects Across Maryland

Frank Dickson

DIRECTOR, MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Steve Pennington

MANAGING DIRECTOR, BUSINESS & INDUSTRY SECTOR DEVELOPMENT, MARYLAND DEPARTMENT OF COMMERCE



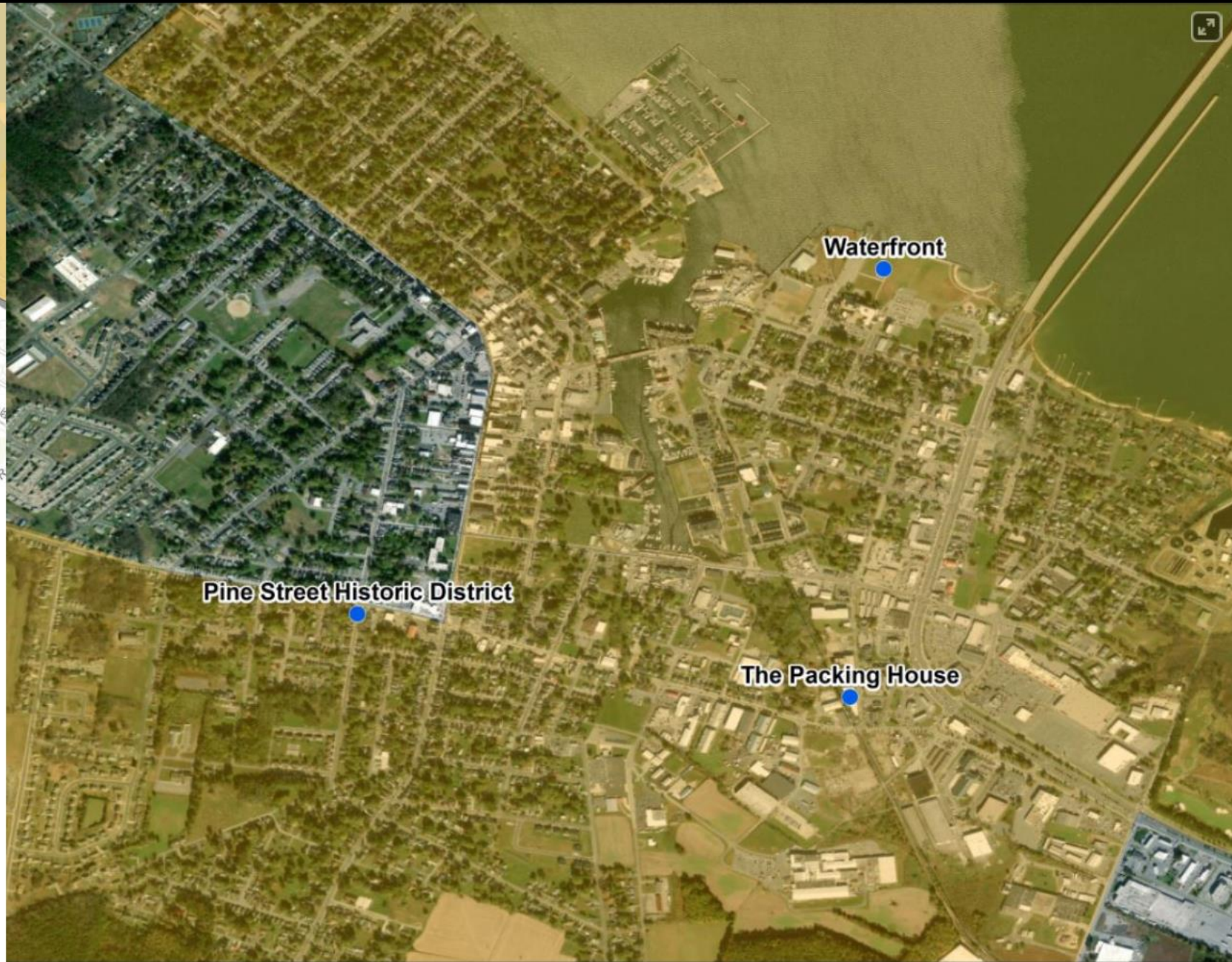
1

Cambridge

Major Organizations - Cambridge International, University of Maryland Shore Medical, Amick Farms, and Hyatt

Growth Businesses - Accommodation and Food Services, Arts, Entertainment, Recreation, and AG Tech

Notable residents - Harriet Tubman, Beatrice Arthur (Maude)





2

Cambridge Waterfront

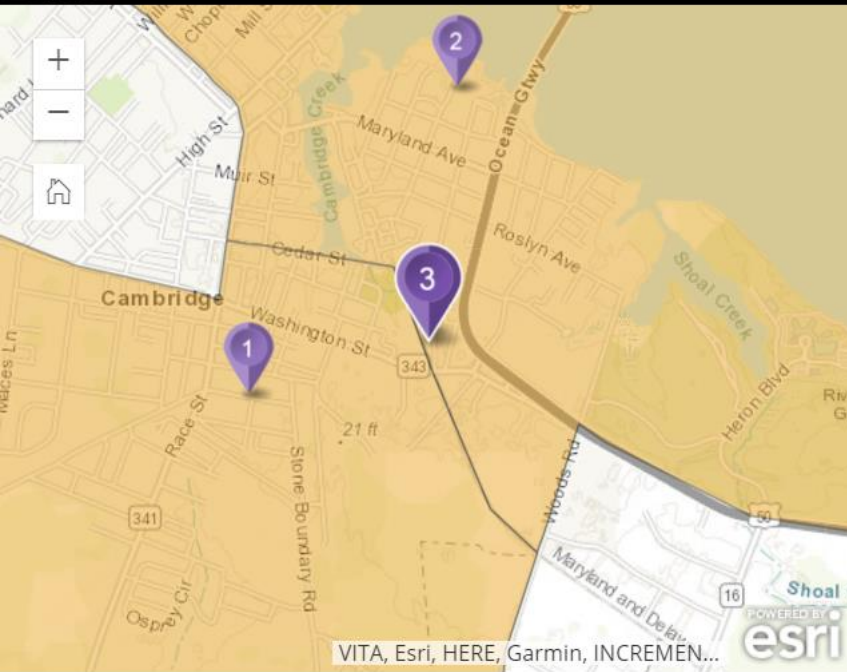


33 Acre waterfront site for residential and commercial development

Second Deepest Maryland port on the Chesapeake Bay

State of MD / City of Cambridge /
Dorchester County / University of
Maryland collaborative to advance this
magnificent property





3 The Packing House

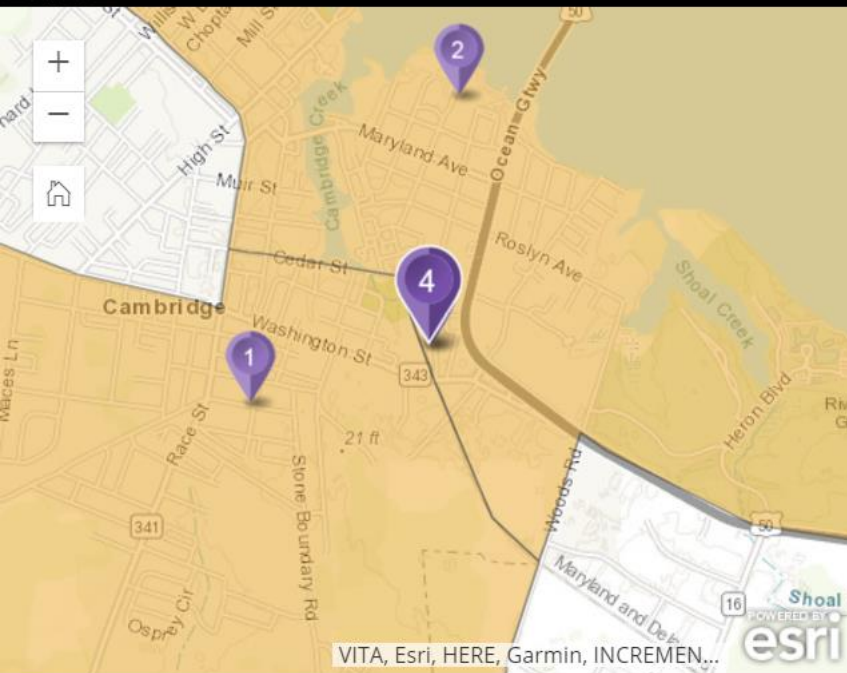


Former Phillips Seafood packing plant

Originally built in 1929 as furniture factory, Phillips Packing empire added to pack seafood for government (WWI & WWII) and retail customers

Closed in the 1960s





4

The Packing House - Rendering

\$20M, 60,000 sq. ft. of mixed-use development

Eastern Shore's emerging businesses, food production and food related retail/eateries (Brewer, Cafe, ..)

Public / Private event space



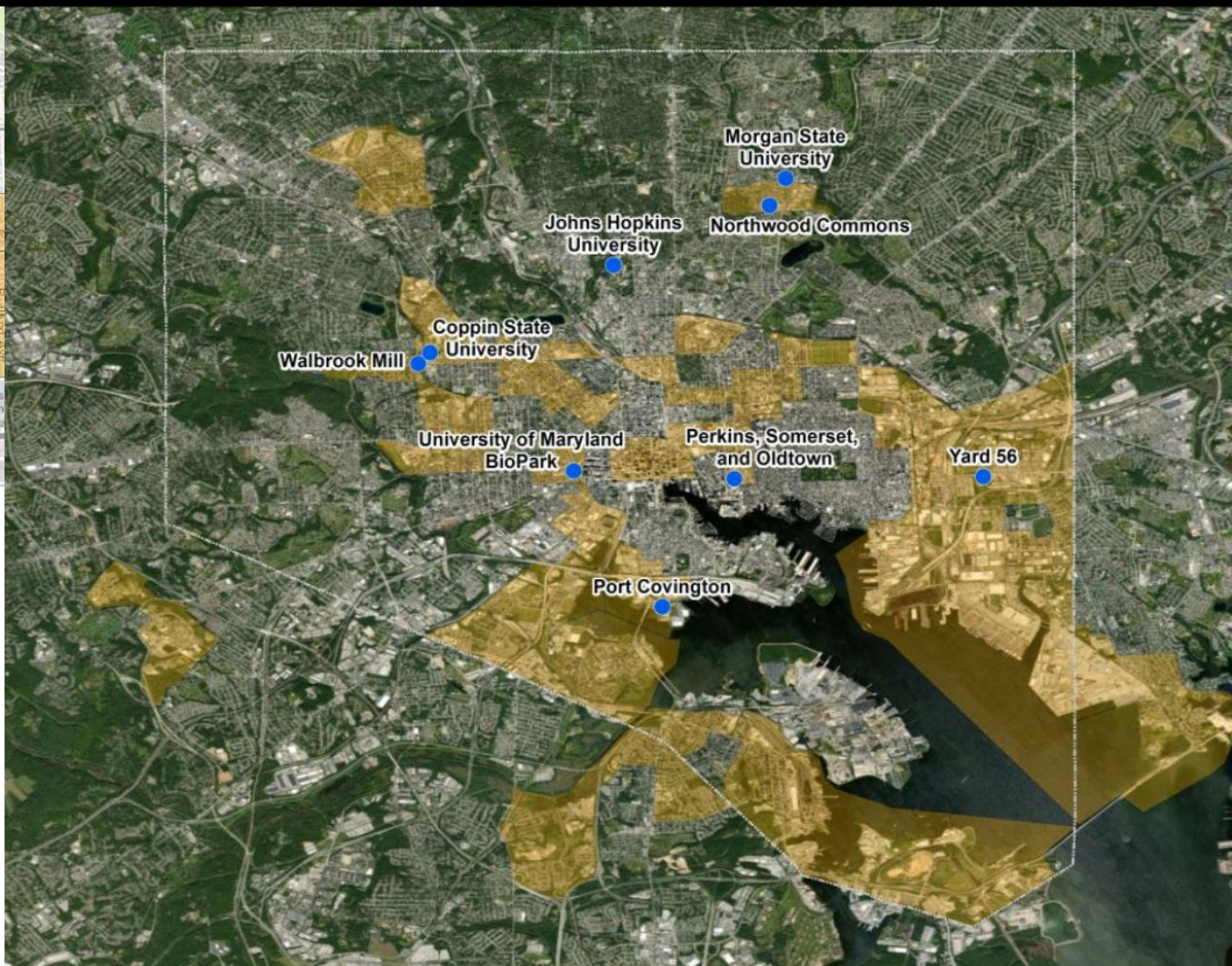


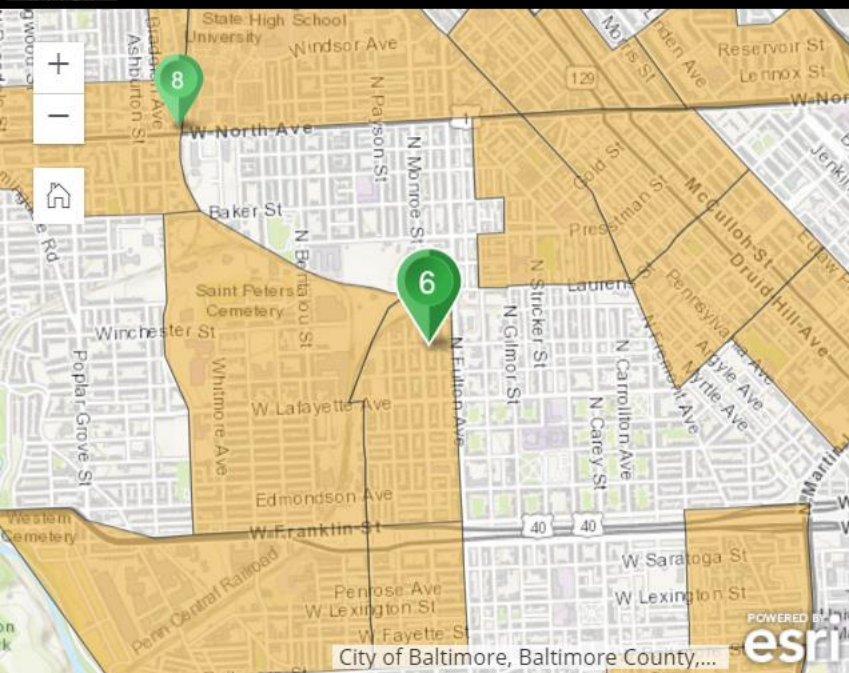
Baltimore City

\$100 Million for blight removal through Project C.O.R.E.

Growth Businesses - Finance, Healthcare, and Education

Emerging Technologies - BioTech, Cyber, and EdTech





6 DHCD Project C.O.R.E. Funding

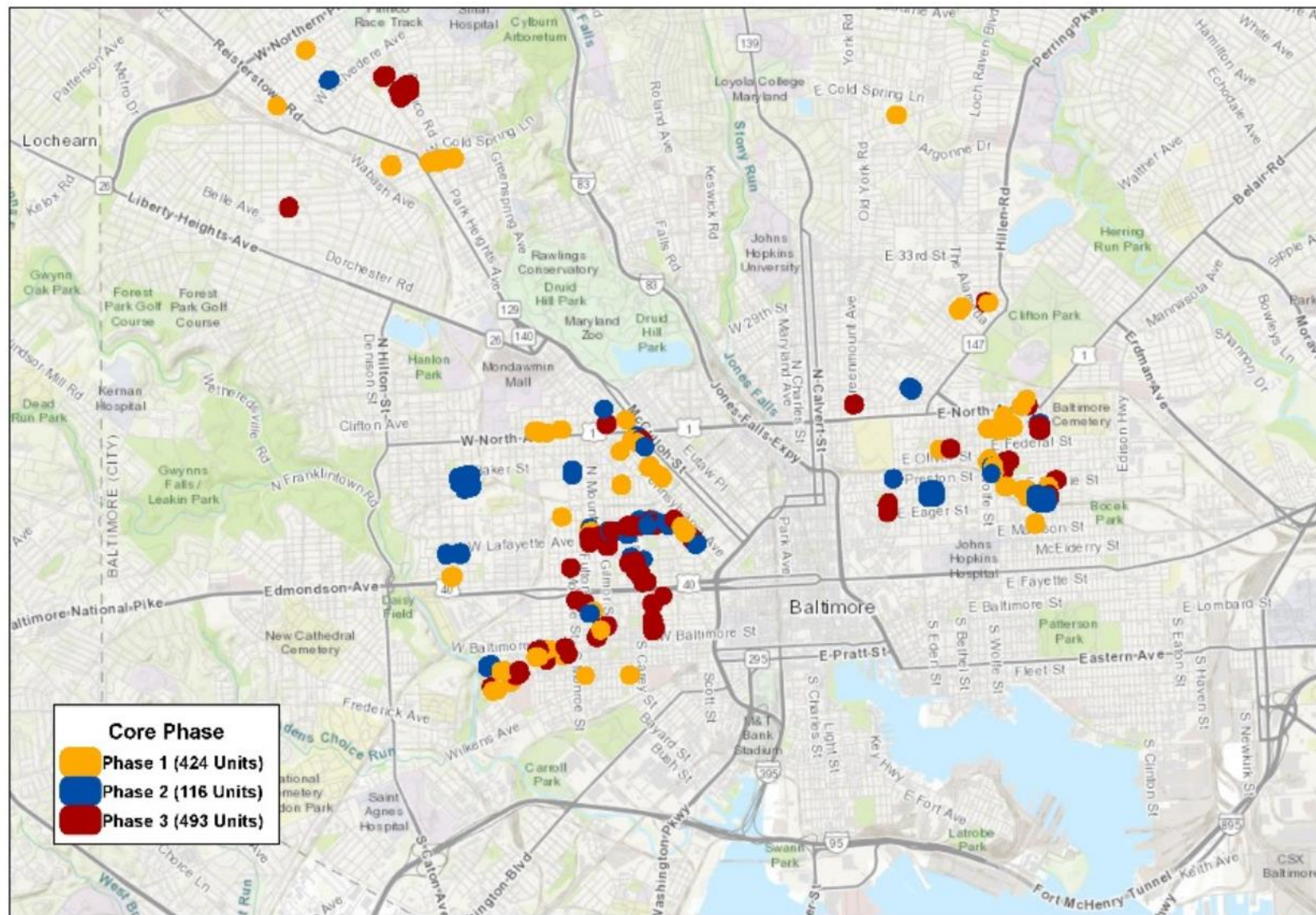
DHCD invested \$75 Million through Project C.O.R.E.

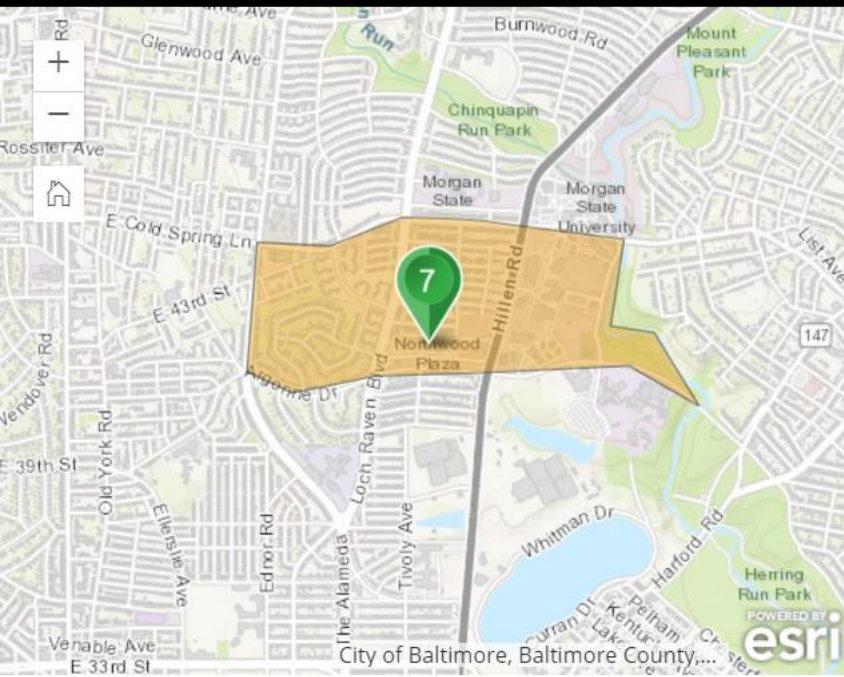
Baltimore City has invested \$25 Million

Demolishing vacant buildings to create green space and redevelopment

\$550 Million of Private Capital to be co-invested in these communities

Project CORE Properties by Phase as of March 2018



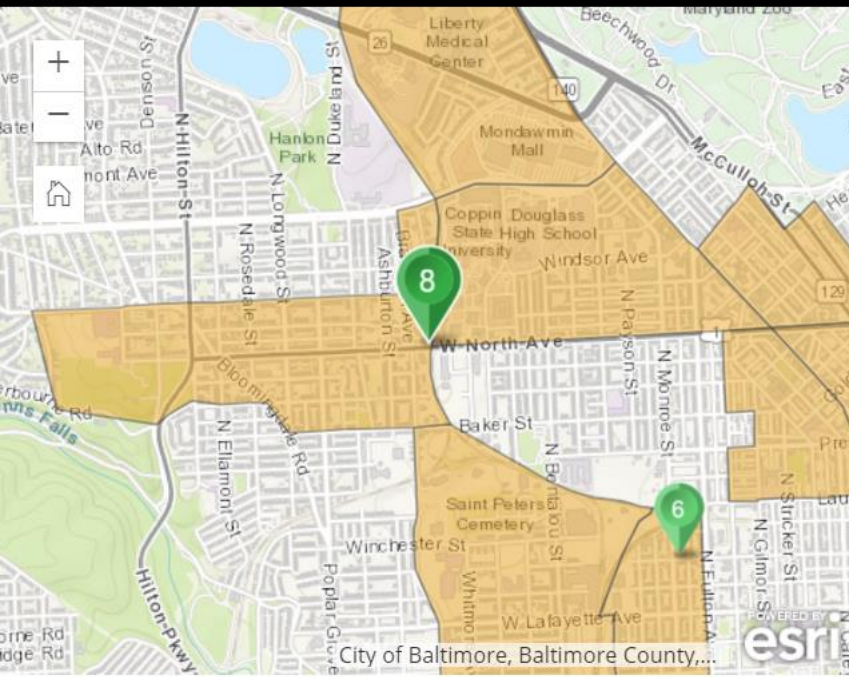


7 Northwood Commons

\$50 Million redevelopment of Northwood Plaza Shopping Center adjacent to Morgan State University

100,000 sq. ft. of retail and commercial





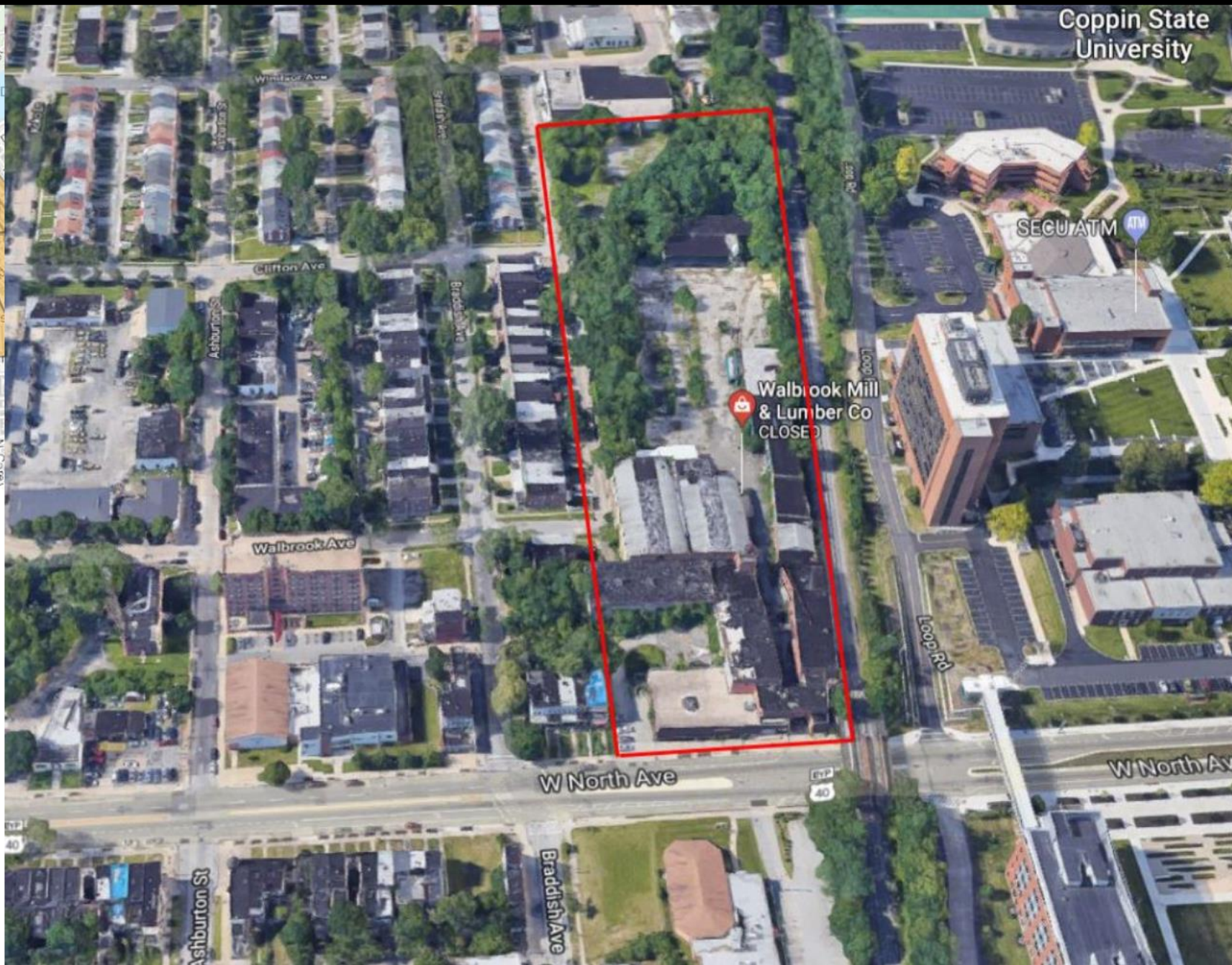
8 Walbrook Mill

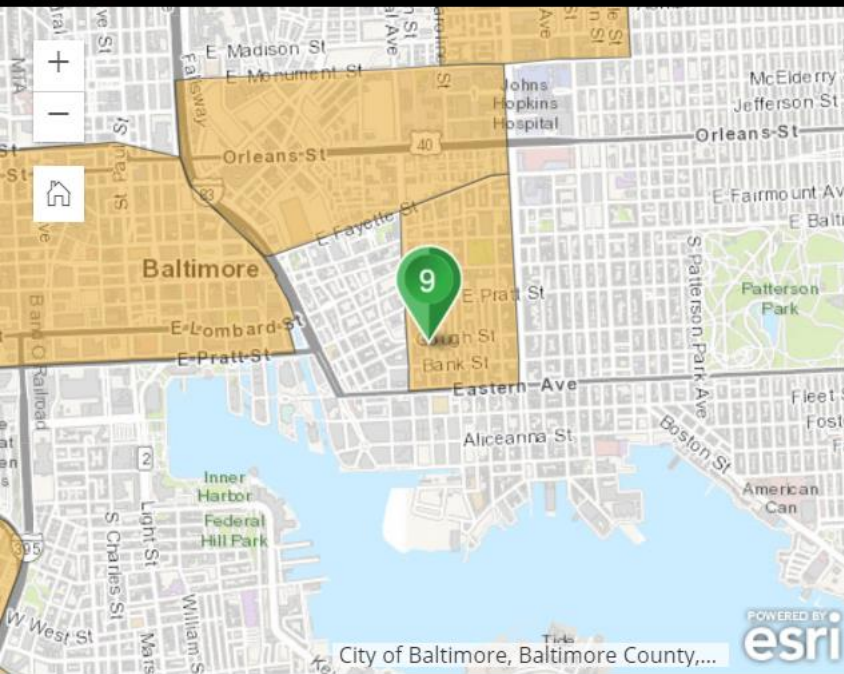
\$26 Million development to revitalize site for apartments, retail and commercial worker space

Adjacent to Coppin State University

DHCD provided \$3 Million in grants to seed revitalization projects

10,000 sq. ft. retail, 22,000 sq. ft. flex space, 65 mixed-income apartments





9

Perkins, Somerset, and Oldtown

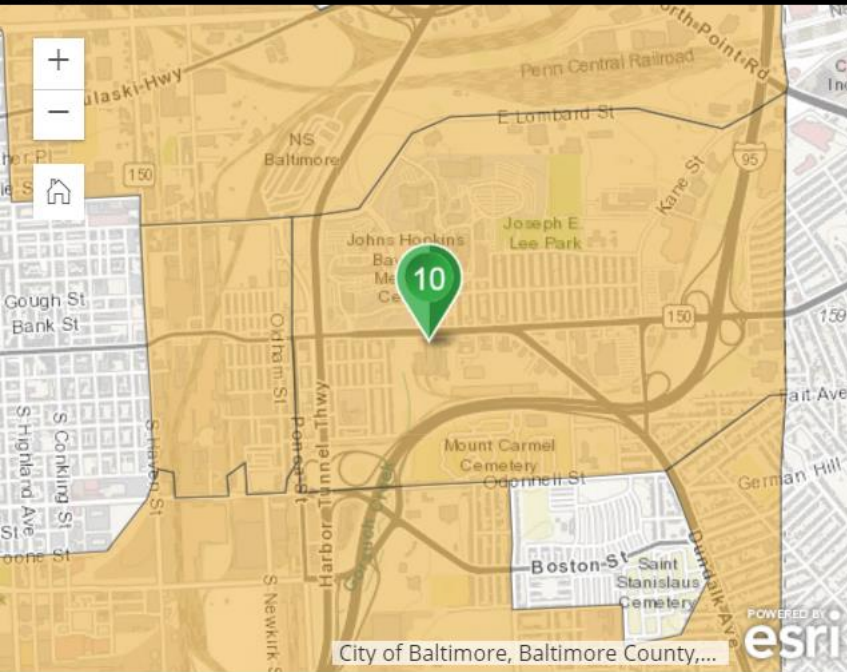


\$30 Million HUD grant for Choice Neighborhoods Implementation funding to leverage \$540 Million from private and public sources

1,345 mixed-income and mixed-use community units

Perkins Homes - currently home to 587 families in 629 units

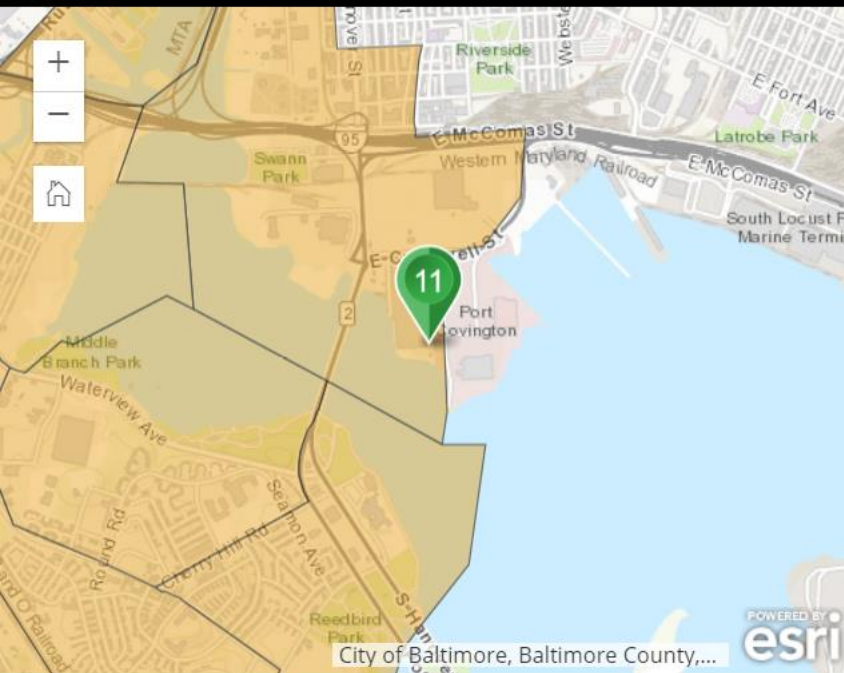




10 Yard 56

\$80 Million mixed-use development site

The development could support as much as 2.2 Million sq. ft. of retail and Class A office space, as well as a full-service hotel and approximately 300 residential units



11 Port Covington - Rendering < >

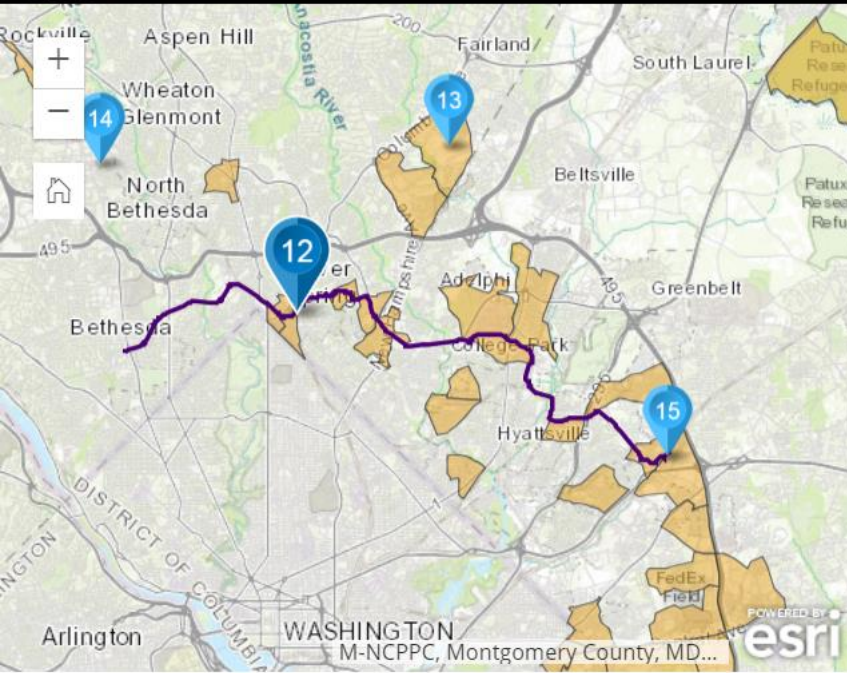
\$5 Billion plus development, 15 Million sq. ft. of office space

Residential and retail

Entertainment venues

Business incubation - City Garage





Source: Maryland Transit Administration

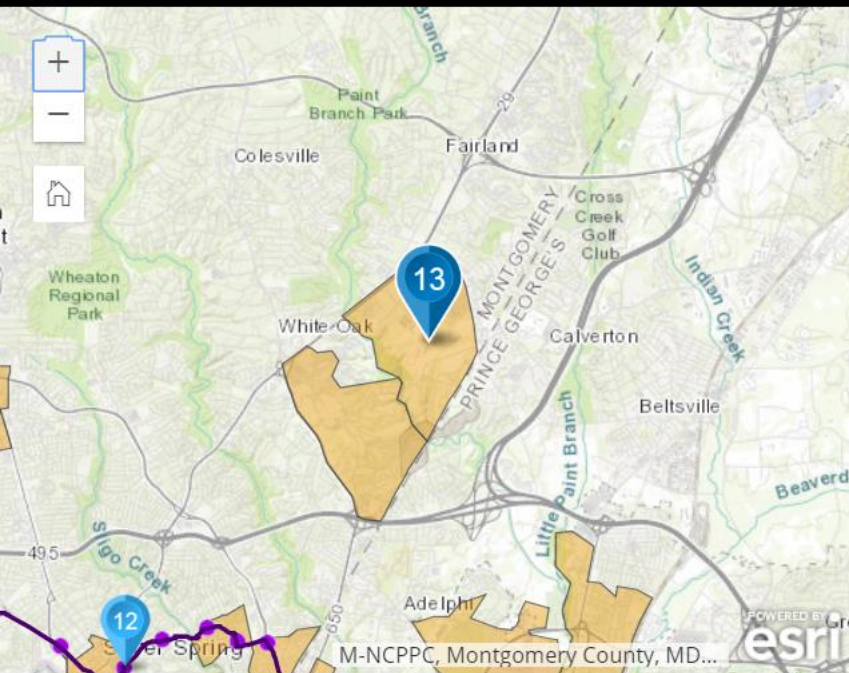
THE WASHINGTON POST

12 Montgomery / Prince George's County Transit

\$5.6 Billion of public funding for Purple Line construction

16 miles of track, 21 stations

Significant development around transit hubs



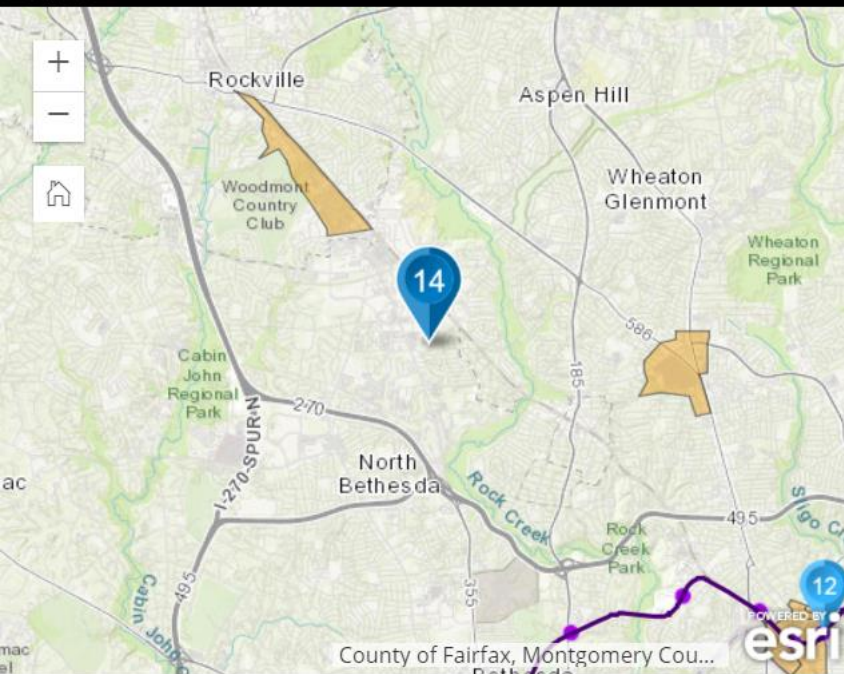
13 Viva White Oak

\$3 Billion investment in life sciences research facility

\$330 Million investment into Adventist HealthCare White Oak Medical Center

Proximity to FDA headquarters and Army research laboratory



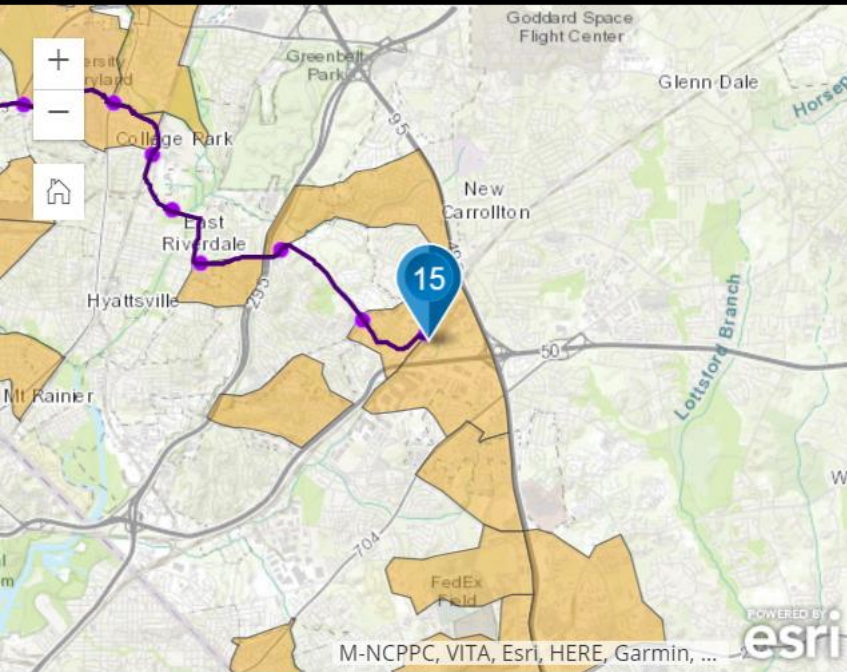


14 Possible Amazon HQ2 Site



Site of former White Flint Mall

Two Opportunity Zones in close proximity to serve site



15 New Carrollton Development Plan

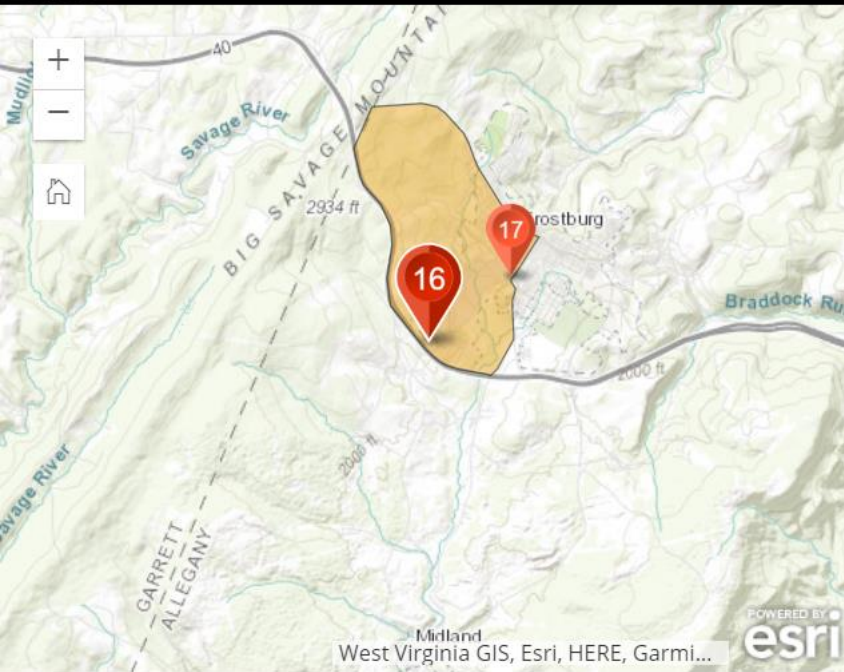
Kaiser Permanente administrative building

200,000 sq. ft. office space

250,000 sq. ft. multifamily residential

20,000 sq. ft. ground floor retail space





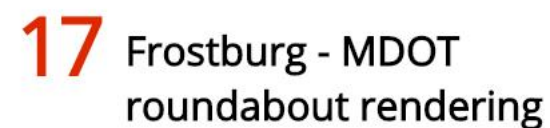
16 Frostburg Redevelopment

Center Street redevelopment using DHCD funds to demolish homes

FSU Allied Health and Education Building (2020 Construction) - \$83 Million

Commercial property (I-68 & MD 736); 12 acres +/- and 2 acres +/-

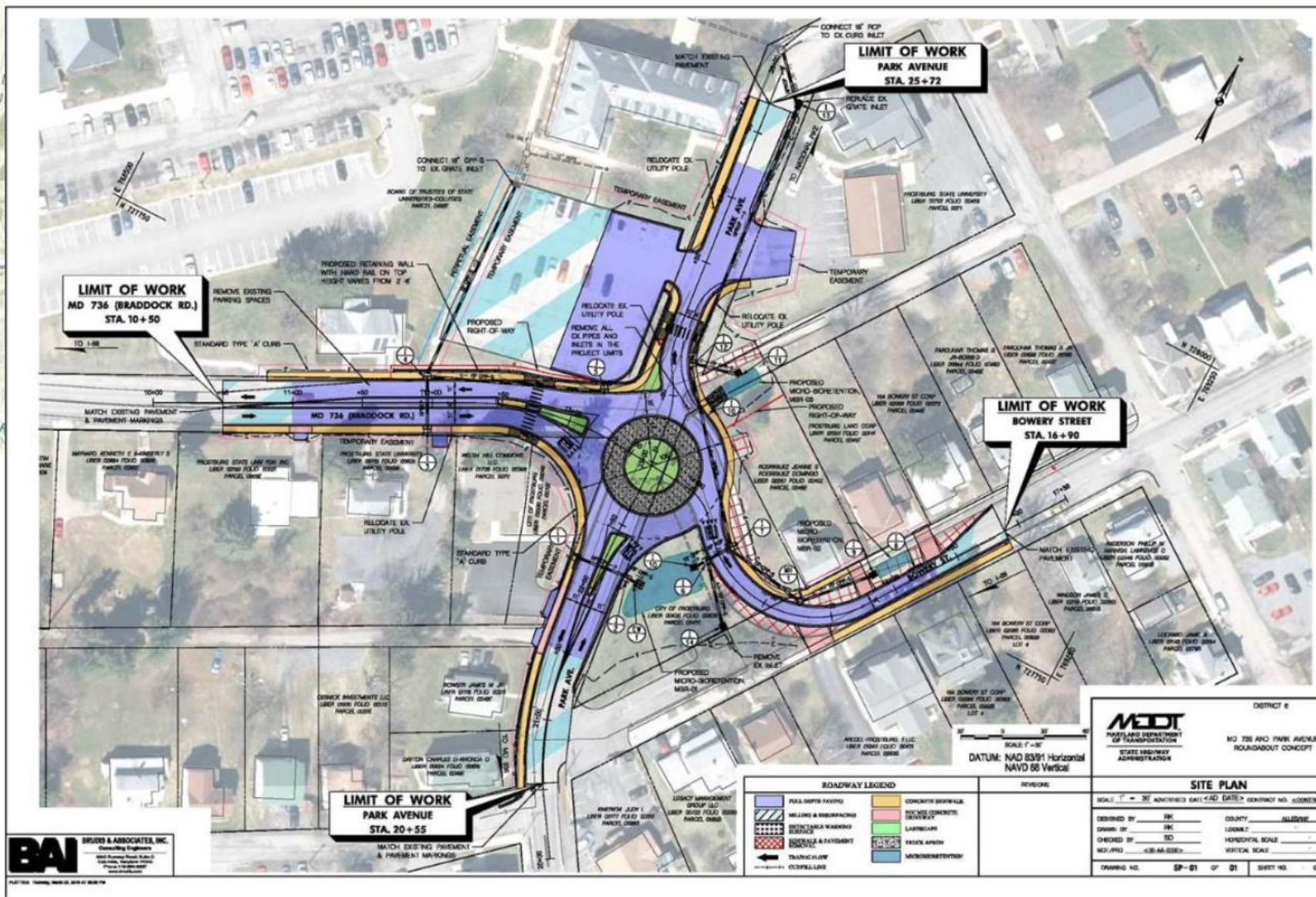


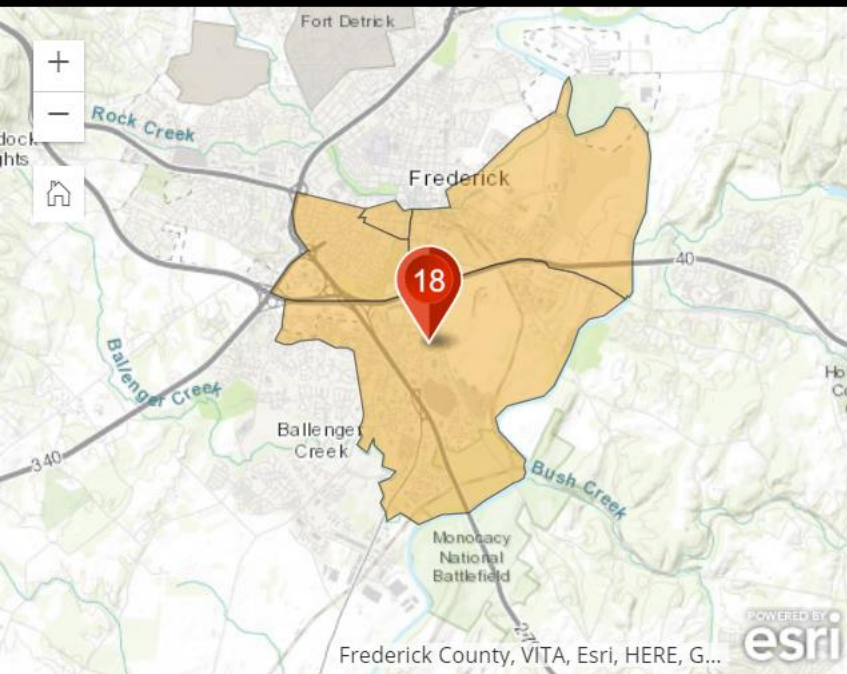


MDOT funding of roundabout

MDOT funding for Braddock Rd
Improvement off I-68

ARC funding with MDOT partner for I-68 & MD 736 interchange





18 Maryland Incentive Programs



For more information on incentive programs in Maryland please visit our websites



<http://dhcd.maryland.gov/Pages/OpportunityZones.aspx>



<http://www.marylandventurefund.com/>



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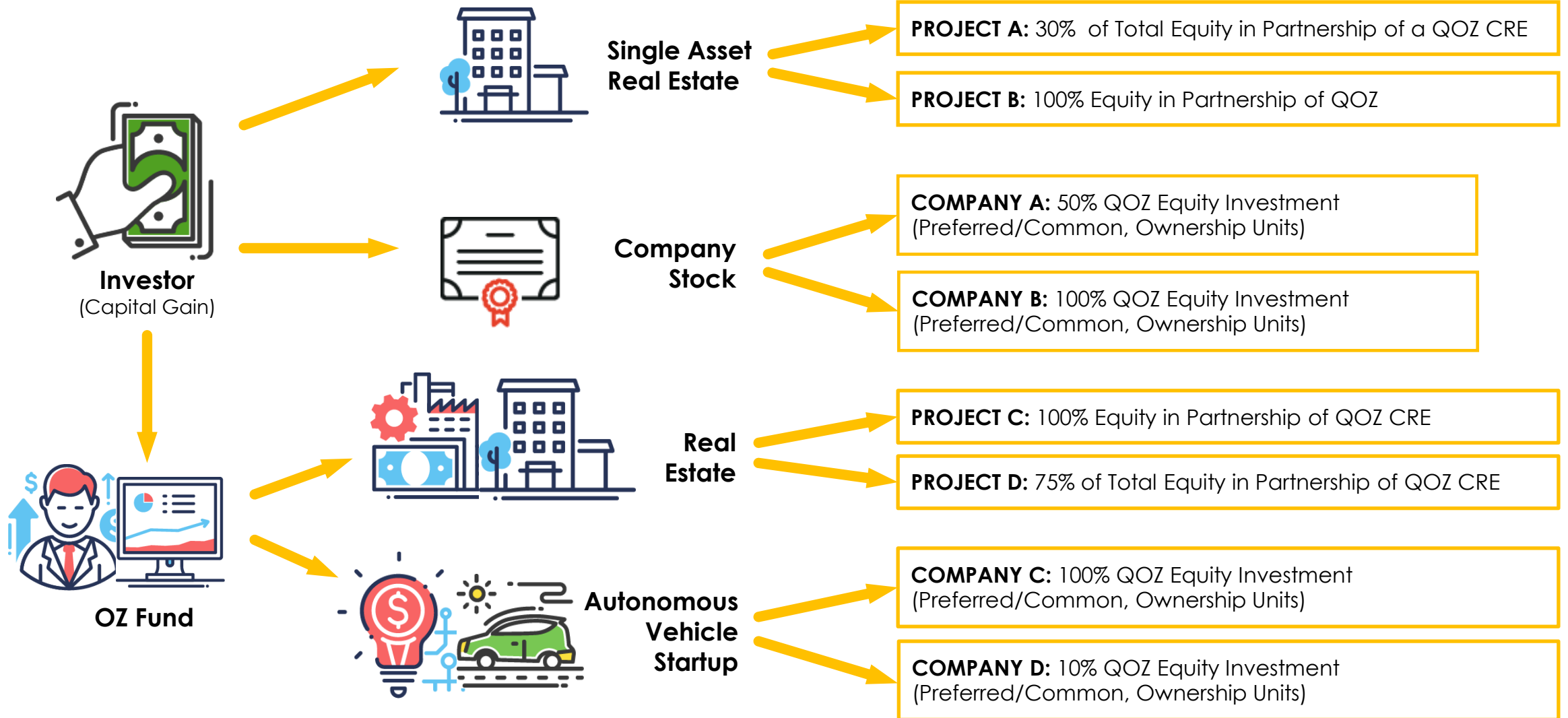
Investment Considerations, Case Studies

Sergei Kuzmenchuk

CHIEF FINANCIAL OFFICER, MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

INVESTMENT EXAMPLES

OWNERSHIP



Qualified Investment Examples

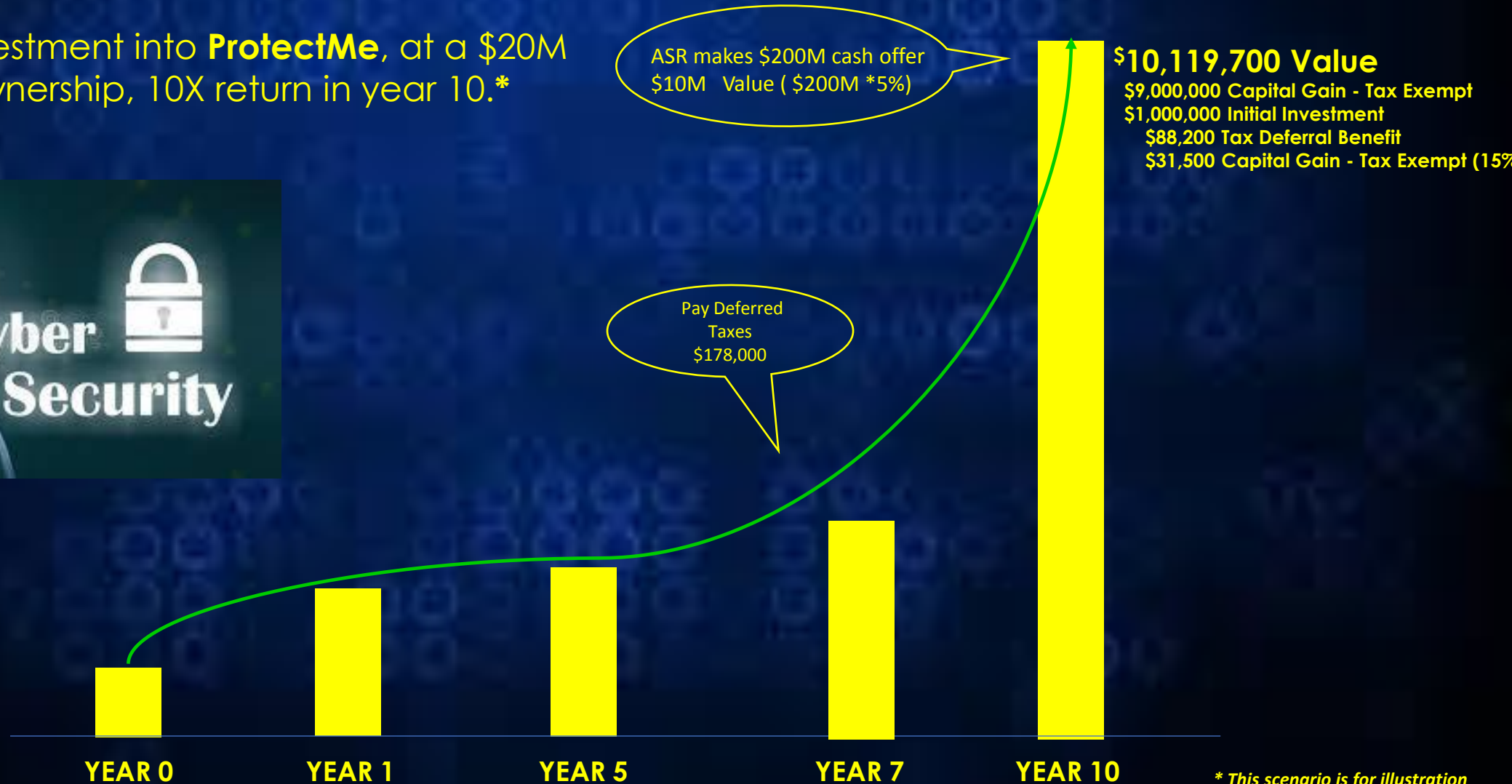
SCENARIO 1:

\$1M Series A investment into **ProtectMe**, at a \$20M valuation, 5% ownership, 10X return in year 10.*



ProtectMe
Hot CyberTech
Company

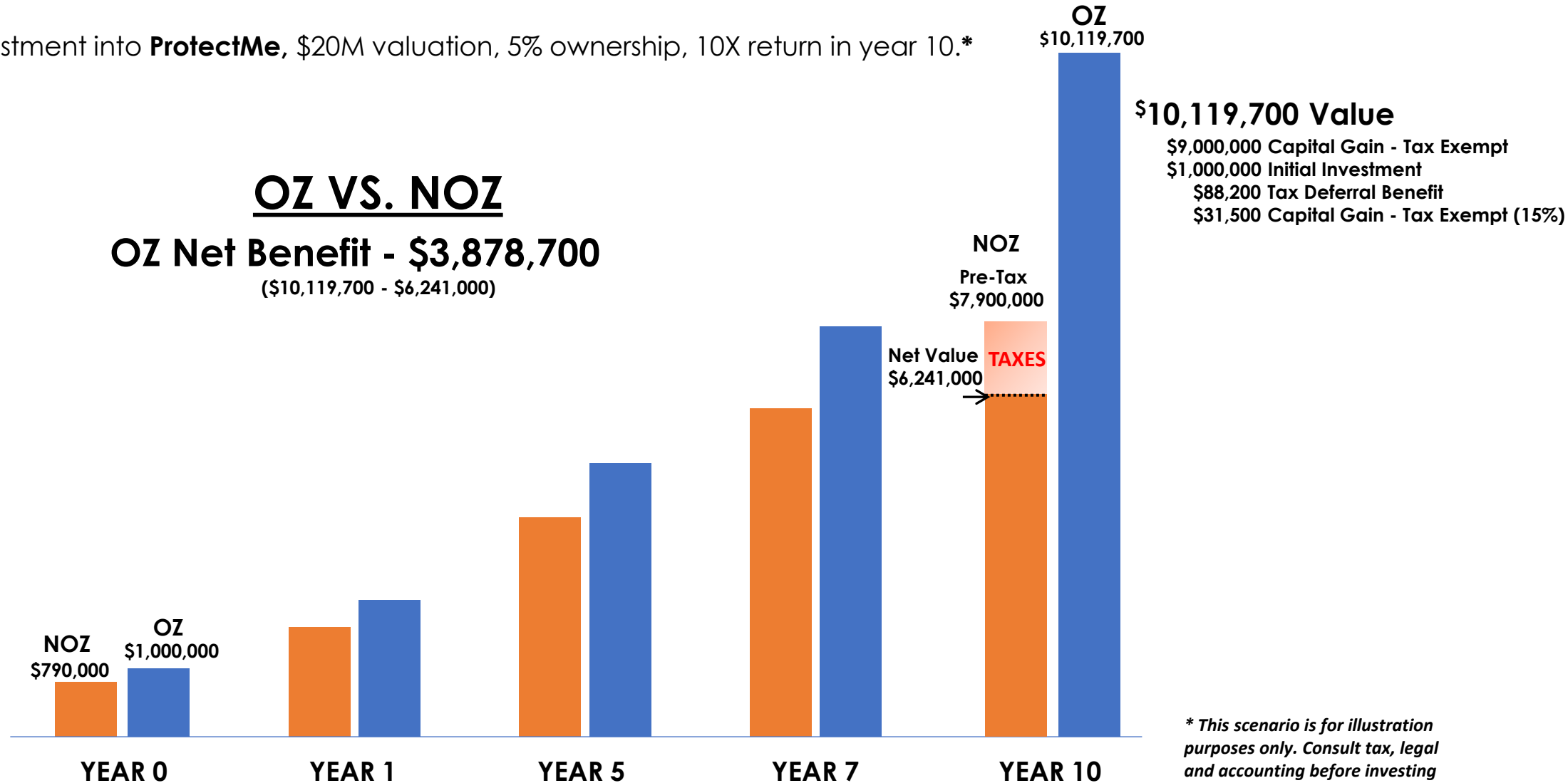
INVESTMENT OF \$1M
SERIES A PFD
5% OWNERSHIP



** This scenario is for illustration purposes only. Consult tax, legal and accounting before investing*

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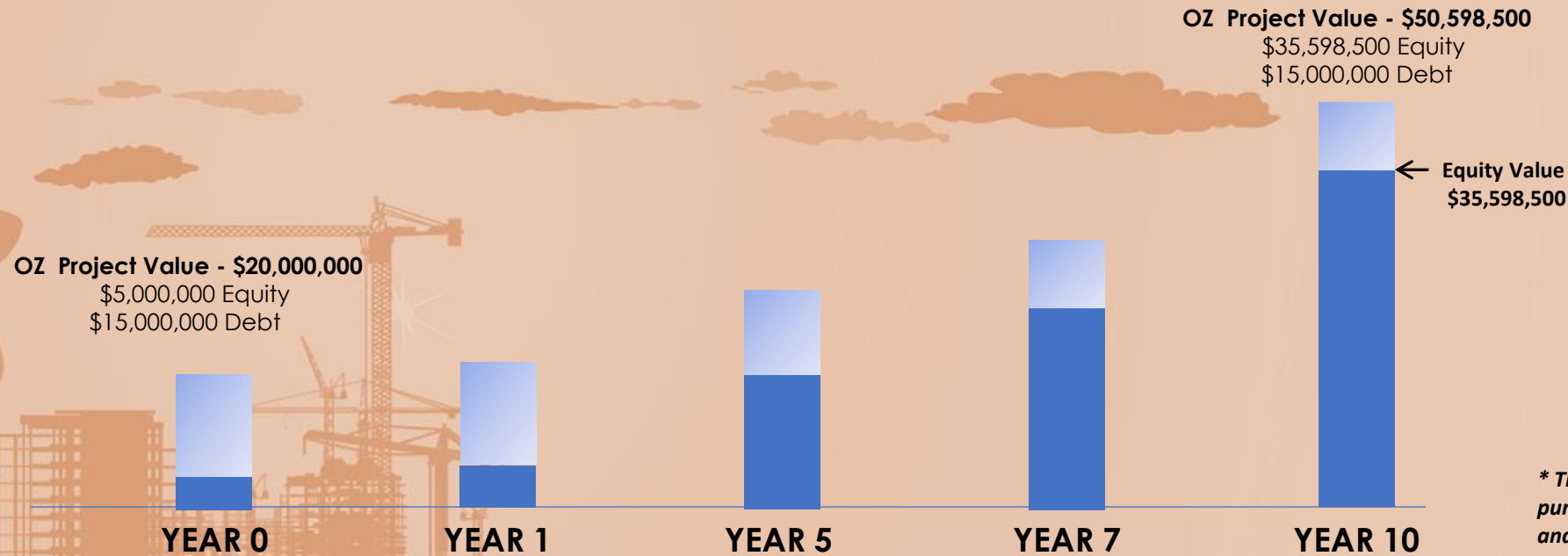


SCENARIO 2:

\$5M OZ Investment + \$15M Debt into Real Estate Project, \$50M Buyout in year 10.*

\$50,598,500 Value

\$30,000,000 Capital Gain - Tax Exempt
\$5,000,000 Initial Investment
\$15,000,000 Debt
\$441,000 Tax Deferral Benefit
\$157,500 Capital Gain - Tax Exempt (15%)



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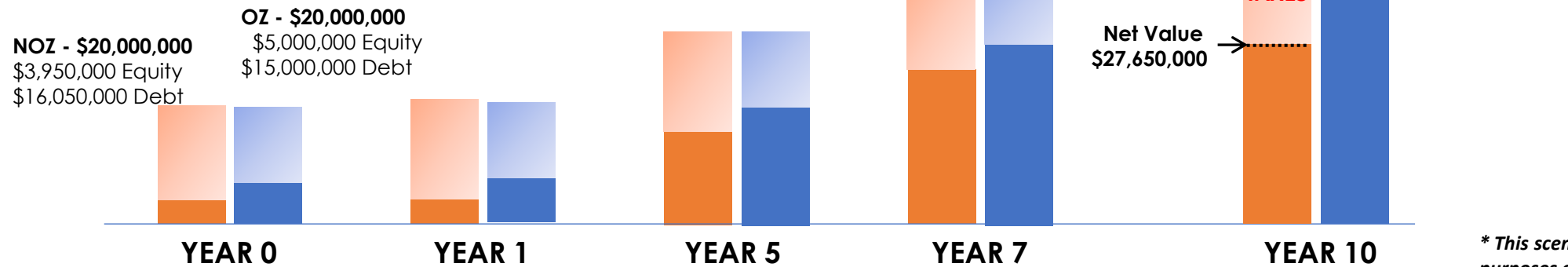
OZ VS. NOZ

Net Benefit – \$7,948,500

(\$35,598,500 - \$27,650,00)

\$50,598,500 Value

\$30,000,000 Capital Gain - Tax Exempt
\$5,000,000 Initial Investment
\$15,000,000 Debt
\$441,000 Tax Deferral Benefit
\$157,500 Capital Gain – Tax Exempt (15%)



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M A R Y L A N D OPPORTUNITY ZONES



Investing in Opportunity Zones – Q&A Panel Discussion

Andrew Potts

PARTNER, NIXON PEABODY

Participants: Ira Weinstein-CohnReznick, John Lettieri - *ELG*, Brian Tracey – *Bank of America Merrill Lynch*, Beth Bafford – *Calvert Impact Capital*, Sergei Kuzmenchuk – *DHCD*, Frank Dickson – *DHCD*, Steve Pennington - *Commerce*