Opportunity Zones

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Create Opportunities

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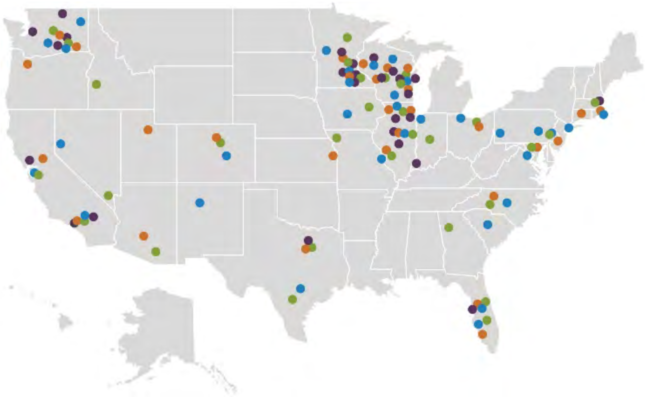
About CLA

- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 6,100 employees
- Offices coast to coast



Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC.

Opportunity Zone Program

Created by the Tax Cuts and Jobs Act of 2017

Formed to generate economic activity and job creation in low-income communities

Encourages investment of unrealized capital gain into these low-income community projects/businesses

Opportunity Zones

Benefits

- Deferral of capital gains
- Reduction of deferred gain over time
- Permanent gain exclusion on appreciation of investment

Types of Gains and Taxpayers

Types of gains allowed

- Capital gains – short term and long term
- Gain cannot be generated via a related party sale

Types of taxpayers

- Trusts
- Individuals
- Partnerships
- Corporations

What Can Opportunity Zones Invest In?

- Real Property
  - Original use must be with fund or must be substantially improved
  - Substantially improved = at least 100% of adjusted basis in property
- Operating Businesses
  - Equity investments or stock purchase
- Equipment

Opportunity Zone

By Jimmy Atkinson

October 1, 2018

Secretary of Treasury Steven Mnuchin was interviewed by The Hill's editor-in-chief Bob Cusack during a live event last week. The interview was wide-ranging, but briefly covered the new Opportunity Zones tax incentive, where Mnuchin expressed his optimism in the program.

Mnuchin said:

"I think there's going to be over $100 billion of private capital that will be invested in opportunity zones."

Debt Refinancing and Distributions

Debt financed distributions are allowed, but care should be taken

- Must make sure Opportunity Zone investors have basis to take distributions
- Distributions cannot be a return of capital
- If return of capital, would trigger a partial disposition of QOF investment

Need to be wary of inclusion rules.

Risks For Consideration

Development Risks

- Cost overruns
- Environmental issues
- Lease up risk
- Unknowns
- Servicing debt

Compliance Risks

- Meeting 180 day window
- 6 month tests on project
- Project meets regulatory requirements

Location/Project

- The old saying in real estate (location, location, location)
- Some property types offer lower risk (i.e. apartments)

Ways to Manage Risk

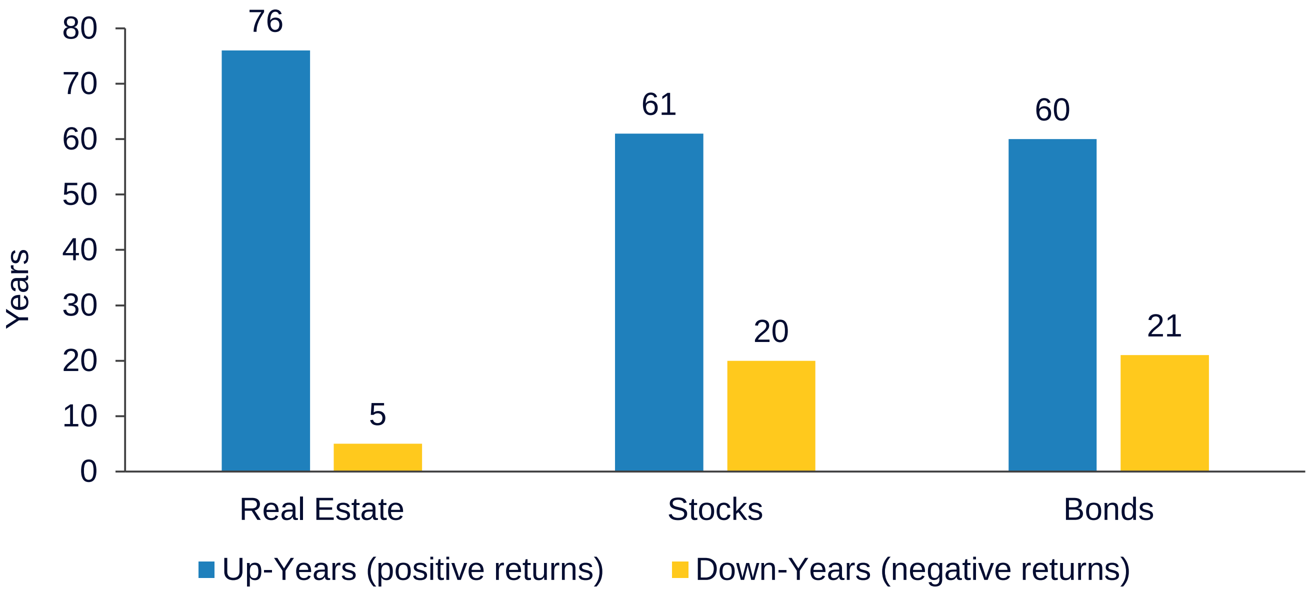
Work with a high quality, experienced and reputable developer

Work with an advisory group that has deep expertise in Opportunity Zones and taxation to assure governance matters are being monitored and complied

Invest in projects that are pre-leased or apartments projects that are in high demand areas (apartment units are in demand nationally)

Positive and Negative Return Comparison

"Up" and "Down" Years for Real Estate, Stocks and Bonds (1934 to 2015)



Sources: NCREIF (National Council of Real Estate Investment Fiduciaries) and Bloomberg. Past performance is not a guarantee of future results. Real estate is represented by the NCREIF Property Index (NPI), an index of quarterly returns reported by institutional investors on investment grade commercial properties owned by those investors. The NPI is used as an industry benchmark to compare an investor's own returns against the industry average. NCREIF data is based on institutional investments and is presented without leverage or fees. Institutional investors often invest on substantially different terms and conditions than individual investors, which may include lower fees, expenses or leverage. Stocks are represented by the S&P 500 Index, an unmanaged index of the 500 largest stocks (in terms of market value), weighted by market capitalization and considered representative of the broad stock market. Bonds are represented by the Barclay's Capital Aggregate Bond Index, an index of securities that are SEC-registered, taxable and dollar-denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. The prices of securities represented by these indices may change in response to factors including: the historical and prospective earnings of the issuer, the value of its assets, general economic conditions, interest rates and investor perceptions. All indices are unmanaged and do not include the impact of fees and expenses. An investment cannot be made directly in any index.

Direct Project

Know what you own

On average lower fees

Higher risk than diversified fund due to lack of diversification

Typical project is $10 - $50 million of equity

Minimum investment $250,000 to $1 million depending on project

Returns on average range from 10% annualized to 15%

Typical fee structure

- 7 to 8% preferred return
- 80/20 waterfall or greater above pref
- Developer fee 3 to 5%

Robbinsdale, MN Multifamily QOF

Saint Paul, MN Mixed Use QOF

South St. Paul, MN Multifamily QOF

Columbia Heights, MN Multifamily QOF

Diversified Fund

Diversified across multiple properties which reduces risk

Lower minimum investment

Surety of close within 180 day window

Typical fund ranges from $100 million to $1 billion in size

Typical fund will own 5 to 20 projects

Typical fund fees

- 6% preferred return
- 1.50% - 2.00% management fee
- 85/15 waterfall

Qualified Opportunity Zone Fund Example

Key Terms	
Investment Objective	Protect principal and generate cash flow and asset appreciation by investing primarily with experienced, top local developers
Geographic Focus	Qualified Opportunity Zones in and around top 50 US MSAs
Diversification	No single investment to exceed 25% of total committed equity capital
Target Size	$500,000,000, as part of a series of opportunity zone funds
Investment Minimum	$100,000
Preferred Return	7% simple Preferred Return on Invested Capital
GP Commitment	Minimum of 2% of the total Capital Commitments of the Fund up to $5 million
Fund Term	Up to July 31, 2036, plus three consecutive one-year extensions
Commitment Period	Until December 31, 2021 or 3 years from the Fund Closing
Distributions	Cash Flow: 100% to LP's until Preferred Return is paid; Next, 50% to LP's and GP until GP receives 15% of Preferred Return distributions; Thereafter, 85% to LP's and 15% to GP Capital Events: 100% to LP's until 100% of capital is returned; Next, to LP's up to any remaining accrued Preferred Return; Next, 50% to LP's and GP until GP receives 15% of Preferred Return distributions; Thereafter, 85% to LP's and 15% to GP
Management Fee	1.5% of total capital commitments
Organizational Costs	The Fund will bear the Organizational Expenses incurred in its formation, up to $2 million. If organizational expenses exceed $2 million, the excess will reduce the Management Fee.

Opportunity Zone Economics

Typical Terms In Market On Opportunity Zone Funds

- 8-10% annualized return pre-tax
- 1.7x multiple of invested capital over 10 year hold
- 1.5-2% management fee
- 80/20 waterfall (profit split with manager over pref)
- preferred return 6-7% to LP investor
- $200 million-$5 billion

Typical Terms On Opportunity Zone Projects

- Hotel (12-14% pre-tax IRR)
- Office (10-13% pre-tax IRR)
- Apartment (8-12% pre-tax IRR)
- Multi-Use (office, retail mix)- (9-13% pre-tax IRR)

Typical fees at project level

- 3-5% developer fee
- 7-10% preferred return
- 80/20 waterfall (split on profits over preferred return between developer and investor)
- If project has high enough IRR may be room to negotiate second waterfall at 15%

Things to Consider When Investing

Be clear of whether the developer is using pre-tax or after tax data (the marketplace is still working to establish standardization on this reporting)

Understand if the developer plans a crystallization that would allow them to capture some of their carried interest during the life of the project (waterfall profit)

Understand who is personally guaranteeing the debt during the construction period

Assure that the project has been certified in an Opportunity Zone and that a reputable CPA firm or law firm has provided guidance on the project meeting all Opportunity Zone regulations and qualifies

Be aware of when the project will go shovels in the ground and open for business as some of these projects could take years before they come out of the ground and produce revenue

Best projects are those that are already under construction as they will reduce the J curve and begin to produce cash flow quickly

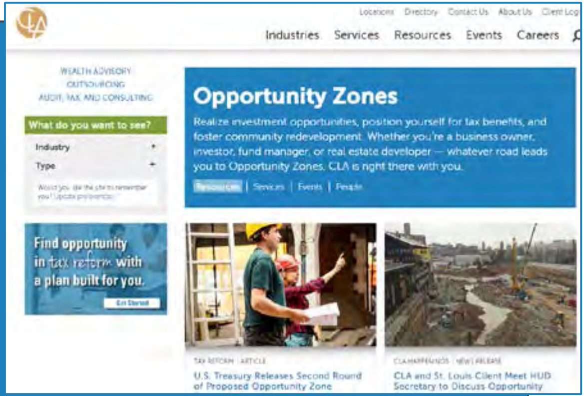
Ideally one wants to invest in projects that will produce significant cash flow distributions during the life of the fund and will re-finance back most of an investors equity by 2026/2028

Understand if the QOF has the ability to re-cycle the money if they are able to sell at a significant profit once property is stabilized and re-invest proceeds into another project

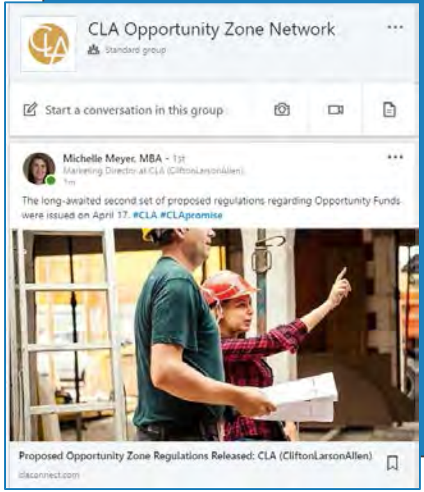
Ask the developer if they plan to do a cost segregation study to accelerate depreciation on the project

Whatever road leads you to *Opportunity Zones,* CLA is right there with you.

Stay Connected with CLA



Opportunity Zone Resource Center
claconnect.com/opportunityzones



Join the CLA Opportunity Zone Network on LinkedIn!
https://www.linkedin.com/groups/12225875/

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Questions?

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