Welcome to the Land of OZ: An Overview of the Opportunity Zones Incentive

Understanding Opportunity Zones in Hawaii

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Basic Structure

Taxpayers can get capital gains tax deferral (& more)

for making timely investments in

Qualified Opportunity Funds (QOFs)

which invest in

Qualified Opportunity Zone Property

3 Tax Incentive Benefits

1. Gain Deferral
2. Partial forgiveness
3. Forgiveness of additional gains

Amount Recognized

THE LESSER OF:

1. Amount of gain deferred

   or

2. The fair market value of investment in QOF interest

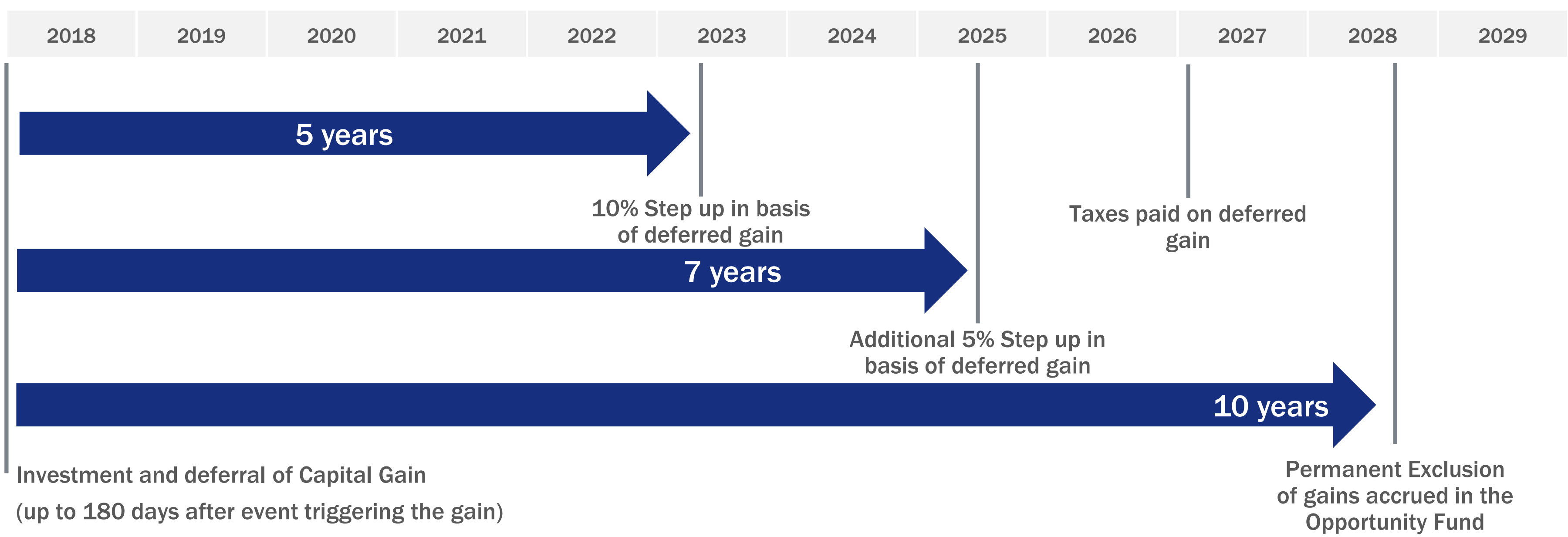
MINUS:

Taxpayer’s basis in the QOF interest

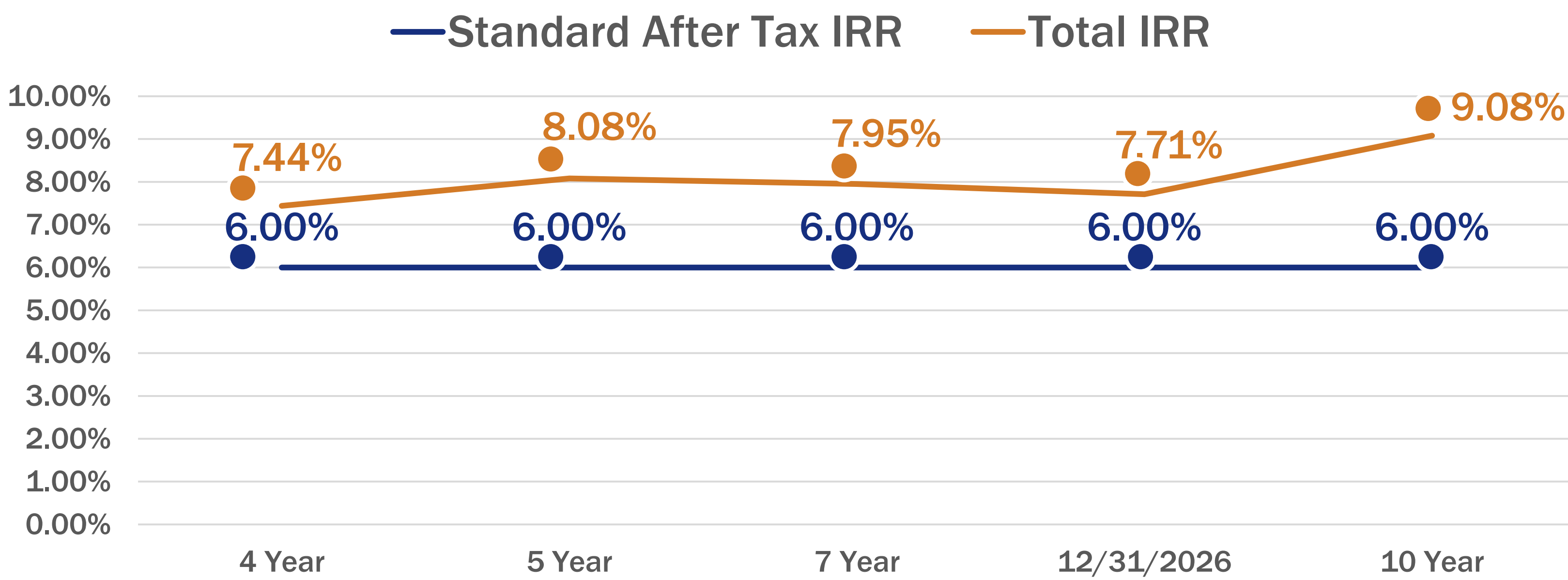
Note: The taxpayer’s outside basis in the Opportunity Fund is initially deemed to be zero.

Tax Incentives Timeline

Maximum benefit is achieved by holding the QOZ investment for 10 years



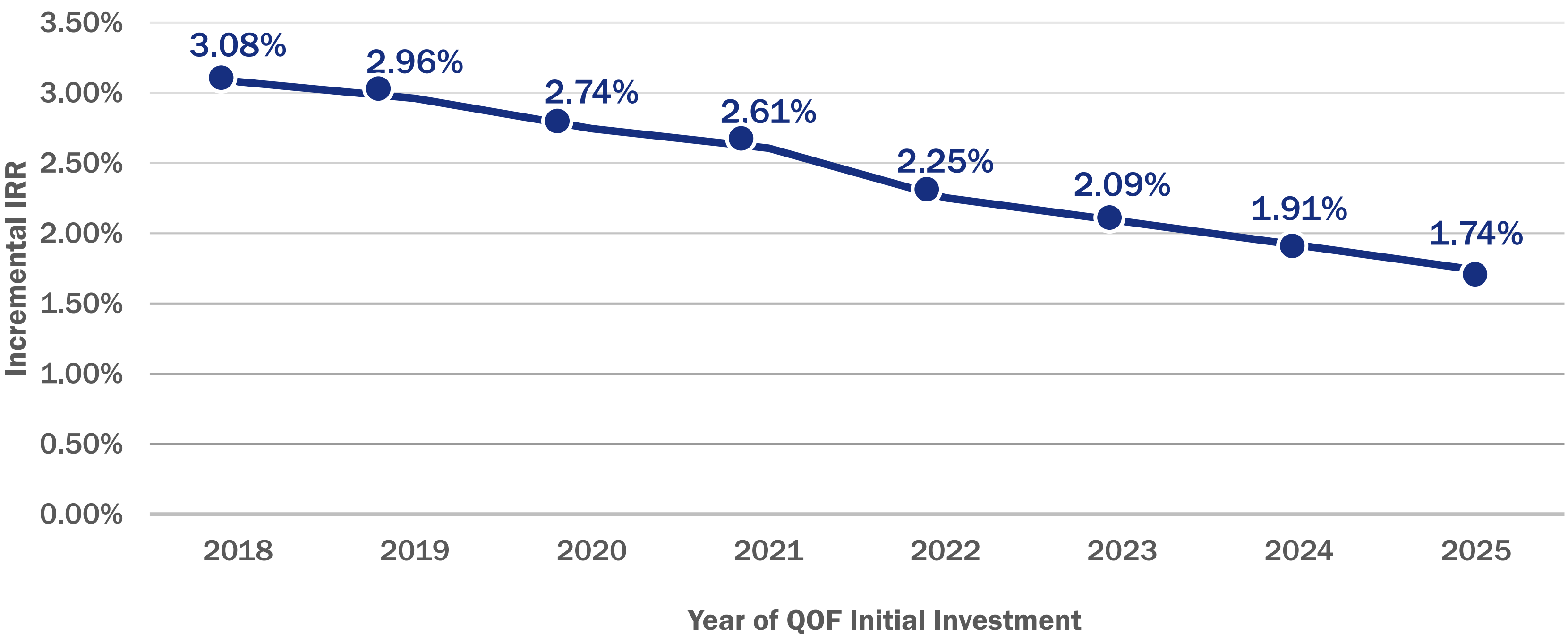
Opportunity Zone Incremental Benefit



23.8% Tax Rate	4 Year	5 Year	7 Year	12/31/2026	10 Year
Standard After Tax IRR	6.00%	6.00%	6.00%	6.00%	6.00%
Incremental OZ Benefit	1.44%	2.08%	1.95%	1.71%	3.08%
OZ Investment IRR	7.44	8.08%	7.95%	7.71%	9.08%
Percentage Increase		35%	32%	29%	51%

***Rates and prices displayed in this and next slides are for demonstration purposes only and may not be indicative of actual figures available at market, depending on type of taxpayer, location of investment, and various other factors.**

Perishability of Incentives



Who are the Likely Investors?

Individuals

Banks

“C” Corporations

Where will "Ozone" capital come from?

Individuals

- For individuals, investing in an "Ozone" fund is a superior strategy to Sec. 1031 since it affords a wider range of eligible investments, potential forgiveness of 15% of the original gain and the potential for tax free appreciation in their Ozone fund investment. The only negative is that the Ozone investment will be limited to the gain being deferred versus 100% of the proceeds from an asset sale
- Any losses from the Ozone fund will shelter income being taxed up to the 37% statutory max rate. However, most individuals are likely to be passive investors meaning that any tax losses or credits generated by their investment will be suspended until their investment is disposed of due to the passive activity limitations

Where will Ozone capital come from?

Individuals

- We expect that Ozone Funds will be offered to individual investors attracted to the idea of investing in low-income areas and building long-term appreciation on a tax-free basis. Individual investors will need to consider that the state tax treatment of their investment may be different
- Developers that own appreciated assets have a significant opportunity to sell such assets to third parties and invest the gains in self-directed opportunity funds that invest in a business or real estate project that constitutes qualified Ozone property.

Where will Ozone capital come from?

Individuals

- A number of developers are considering sponsoring their own opportunity funds and raising capital from various sources. Query whether they will able to raise significant levels of capital, comply with securities laws and asset manage their own funds
- Developers should consider Ozone projects that also qualify for new markets and/or historic rehabilitation tax credits
- We expect a variety of managed Ozone funds organized for individual investors will be offered by registered investment advisors

Where will Ozone capital come from?

Banks

- 85 - 90% of the equity capital invested in LIHTC projects comes from banks subject to the CRA and it is likely that Ozone fund investments that finance affordable housing will earn positive consideration" towards their investment test goals
- However, it appears that most banks do not have capital gains as they are generally not permitted to own equities
- Two important exceptions may be banks with investment banking affiliates and banks that own older LIHTC investments with large negative capital accounts. Triggering "phantom" capital gains for banks that are already planning to make LIHTC investments may be a good strategy

Where will Ozone capital come from?

"C" Corporations

- Publicly traded companies own lots of appreciated assets and they can be expected to be drawn to Ozone projects. However, most "C" corps will likely be attracted to commercial real estate projects, plant expansion, infrastructure and other investments with higher rates of return than will be available from LIHTC investments
- Life insurance companies may be a viable alternative capital source as a number of them were LIHTC investors in 2010 & 2011. As a result, these firms are familiar with the asset class, they like to make large investments and properly structured projects located in opportunity zones should, in theory, offer them premium yields

Opportunity Fund Definitions and Rules

Qualified Opportunity Fund

- Purpose:

  An **investment vehicle** organized as a **corporation** or a **partnership** for the purpose of investing in **Qualified Opportunity Zone Property (QOZP)**.

- Self Certify

Qualified Opportunity Funds (QOFs)

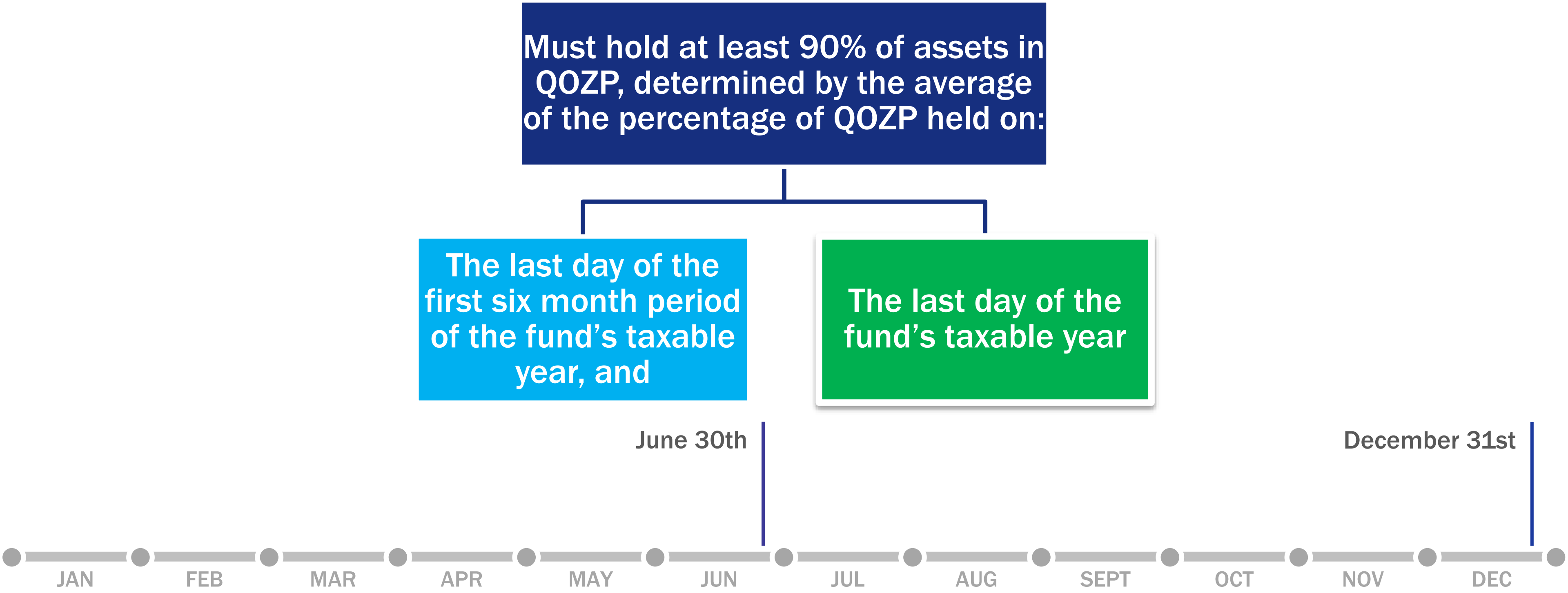
Two requirements for eligibility:

1. Investment vehicle to be organized as a corporation or a partnership for the purpose of investing in Qualified Opportunity Zone Property

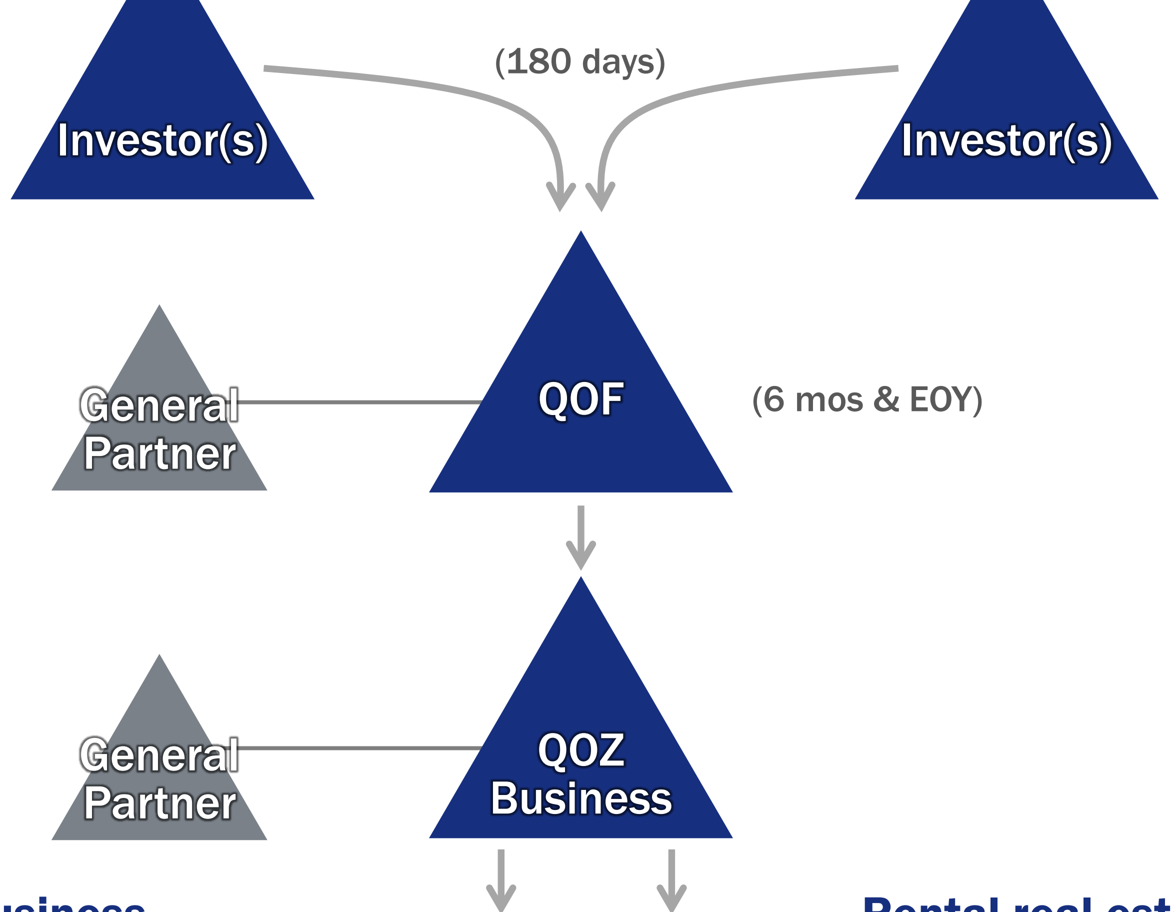
2. At least 90 percent of its assets is held in Qualified Opportunity Zone Property

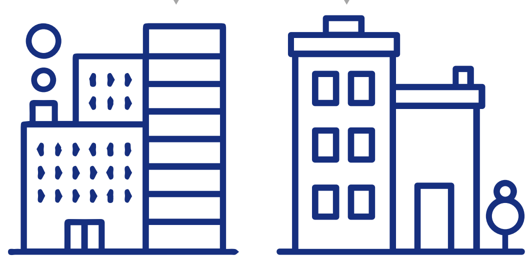
*Funds can be structured to invest in multiple assets, or as a single-asset special purpose vehicle. However, Opportunity Funds cannot be structured to invest in other funds, thereby prohibiting a ‘fund-of-funds’ model.

Qualified Opportunity Fund – Assets Test



Rental Real Estate





Operating Business

- New business
- Existing business expanding into Opp. Zone
- Improving existing business

Rental real estate

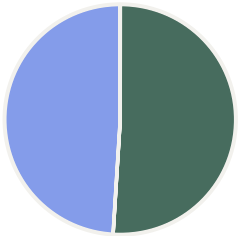
- New construction
- Substantial improvement (100%)

Qualified Opportunity Zone Stock and Partnership Interests

- The investment must be **acquired after December 31, 2017 solely** in exchange for cash;
- Must be a **qualified opportunity zone business**, or is being organized for the purpose of being a qualified opportunity zone business;
- Must remain a qualified opportunity zone business for **substantially all** of the qualified opportunity fund's holding period

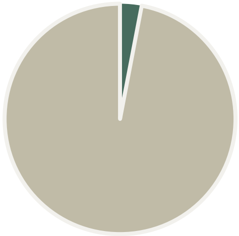
Qualified Opportunity Zone Businesses (QOZB)

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) and:



At least 50% of income derived from Active Conduct

Substantial portion of intangible property used in active conduct of business



< 5 percent unadjusted basis of property is nonqualified financial property

Qualified Opportunity Zone Business Property (QOZBP)

- ✓ **Tangible property** used in a **trade or business**
- ✓ Acquired by **purchase from an unrelated party** (20% standard) after **December 31, 2017**
- ✓ During **substantially all** of holding period, substantially all the use is **in a QOZ**
- ✓ **Original use in the QOZ** commences with the taxpayer

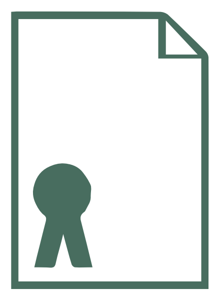
  OR

  - ✓ Taxpayer **substantially improves** the property
    - ✓ during any 30-month period after acquisition, additions to basis exceed an amount equal to the adjusted basis of such property at the beginning of such period

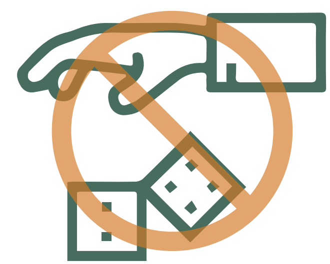
Operating Businesses - Non-qualifiers

- What types of operating businesses are NOT likely to qualify as either a Qualified Opportunity Fund (QOF) or a Qualified Opportunity Zone Business (QOZB)?

Businesses such as financial institutions - hold large amounts of NQFP



Businesses holding intangible property not actively used in the TOB



Sin businesses cannot be QOZBs

Operating Businesses - Non-qualifiers

Businesses that may qualify with clearer guidance and/or structuring finesse:

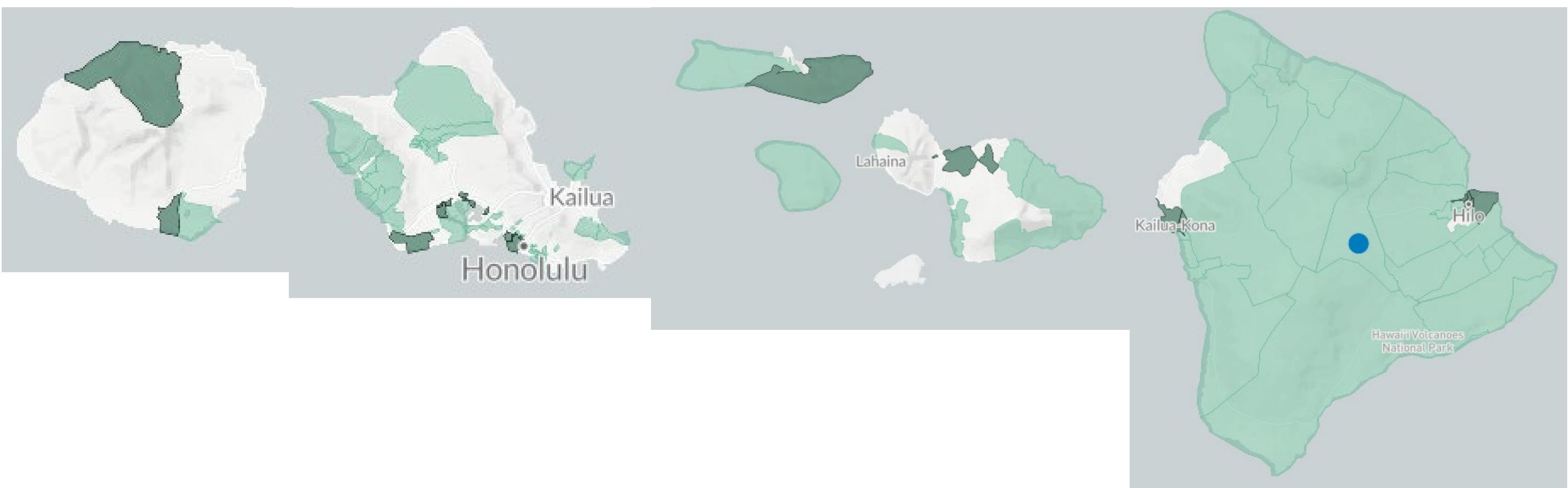
- Businesses which use a substantial amount of their tangible property outside of OZs:
  - Multi-location businesses
  - Businesses with substantial in-house distribution (trucks and other vehicles used outside the OZ)

- Existing Businesses
  - existing in an OZ as of December 31, 2017 (unless a large expansion is planned)
  - existing outside an OZ if it owns substantial tangible assets

- Companies that lease a substantial amount of the property used in their business pursuant to operating leases? (Need guidance)

Certification Process

- An eligible taxpayer self-certifies to become a certified qualified opportunity fund.
- No approval or action by the IRS is required.
- Taxpayer completes a form and attaches that form to the taxpayer's federal income tax return for the taxable year.
- The return must be filed timely, taking extensions into account.



Combining with Other Tax Incentives

How LIHTC Properties Qualify

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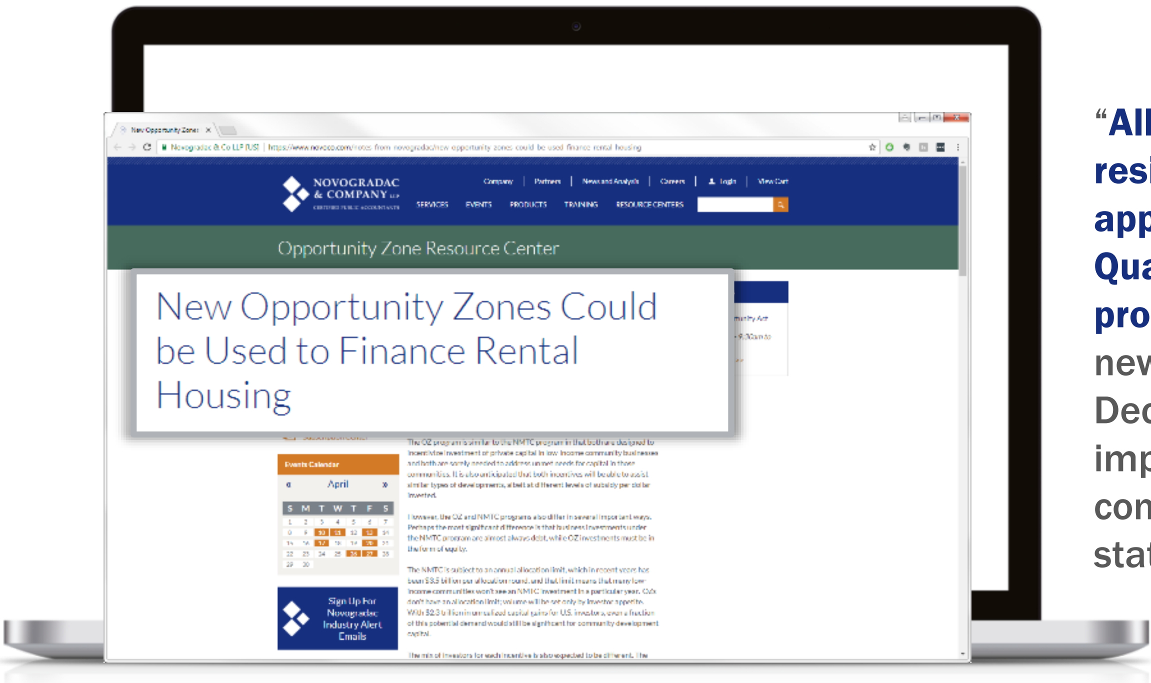

“**All rental real estate, including residential real estate, located in OZs appears to be eligible to be a Qualified Opportunity Zone (QOZ) property** as long as the real estate is newly constructed, or acquired after Dec. 31, 2017 and substantially improved, and meets the active conduct standard provided in the statute.”

Marrying LIHTC & Opportunity Zones

Pros

- Maximizing Opportunity Zones Incentives = at least 10 years
  - LIHTC investments = 15 year holding period
- Housing credit projects in low to median income communities
  - Estimate >500 housing credit properties will be developed in qualified opportunity zones this year
- A negative tax capital account and federal capital gains taxation?
- Reduced investor FMV at 12/31/26
- GP back-end gain elimination?

Cons

- 80-85% of the $16B LIHTC equity market comes from commercial banks
  - Capital gains
- Acquisition and rehabilitation of existing properties and "substantial improvement" test

What kind of projects will we invest in?

- Most acquisition/rehab projects will not work unless they involve some type of large scale adaptive re-use program
- Twinning LIHTC and historic credits
- New construction projects that have 9% housing credit allocations or both 9% and 4% housing credits
- The yield in LIHTC projects located in opportunity zones varies significantly based on the amount of leverage involved

OZ benefit for a $10mm investment

Original income tax basis	$0
Additions to basis after seven year hold	$1,500,000
Adjusted tax basis	$1,500,000
Less: lower of deferred gain or 12/2026 FMV	($3,200,000)
Taxable capital gain as of 12/31/2026	$1,700,000
Capital gains tax at 4/15/2027 at 21% tax rate	$357,000*

**Versus $2,100,000 at 4/15/19*

“Typical” LIHTC project without OZ benefit

Opportunity Zone Fund

Benefit Schedule for Investor 1

9% New Construction (City, ST)

October 2018 - December 2035

Property Cash Needs

	Fully Loaded Investment	Federal Tax Credits	Total Tax Deductions	Capital (Gain) / Loss on Disposition	Tax Benefits at 21.0%	Net Benefits	Cumulative Net Benefits
2018	3,884,884	-	24,040	-	5,048	(1,937,393)	(1,937,393)
2019	10,905,970	577,051	1,167,245	-	822,173	(4,630,812)	(6,568,205)
2020	1,942,140	900,720	458,138	-	996,929	25,859	(6,542,346)
2021	10,928	900,720	466,246	-	998,632	993,168	(5,549,178)
2022	11,256	900,720	470,820	-	999,592	993,965	(4,555,213)
2023	11,592	900,720	480,675	-	1,001,662	995,865	(3,559,348)
2024	11,940	900,720	489,150	-	1,003,441	997,471	(2,561,877)
2025	12,298	900,720	498,434	-	1,005,391	999,242	(1,562,635)
2026	12,668	900,720	503,278	-	1,006,408	1,000,075	(562,561)
2027	13,048	900,720	509,657	-	1,007,748	1,001,224	438,664
2028	13,440	900,720	513,189	-	1,008,490	1,001,770	1,440,434
2029	13,842	323,669	515,830	-	431,993	425,072	1,865,506
2030	14,258	-	521,459	-	109,506	102,378	1,967,883
2031	14,686	-	529,054	-	111,101	103,759	2,071,642
2032	15,126	-	535,786	-	112,515	104,952	2,176,594
2033	15,580	-	543,314	-	114,096	106,306	2,282,900
2034	-	-	-	175,493	36,854	36,854	2,319,754
	16,903,652	9,007,200	8,226,317	175,493	10,771,580	2,319,754	
	Quarterly Effective IRR Quarterly Effective - After Tax: 5.10%						

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Quarterly Effective IRR Quarterly Effective - After Tax: 5.10%

Same project with Opportunity Zone benefit

Opportunity Zone Fund

Benefit Schedule for Investor 1 with Opportunity Zones Incentives

9% New Construction (City, ST)

October 2018 - December 2037

Property Cash Needs

	Fully Loaded Investment	Capital Gains Tax Deferral	Capital Gains Tax	Federal Tax Credits	Total Tax Deductions	Tax Benefits at 21.0%	Net Benefits	Cumulative Net Benefits
2018	5,822,326	406,863	-	-	24,040	5,048	(1,530,531)	(1,530,531)
2019	16,353,805	1,144,045	-	577,051	1,167,245	822,173	(3,486,767)	(5,017,297)
2020	2,907,905	202,811	-	900,720	458,138	996,929	228,670	(4,788,627)
2021	10,928	-	-	900,720	466,246	998,632	993,168	(3,795,459)
2022	11,256	-	-	900,720	470,820	999,592	993,965	(2,801,495)
2023	11,592	-	-	900,720	480,675	1,001,662	995,865	(1,805,629)
2024	11,940	-	-	900,720	489,150	1,003,441	997,471	(808,158)
2025	12,298	-	-	900,720	498,434	1,005,391	999,242	191,084
2026	12,668	-	(298,132)	900,720	503,278	1,006,408	701,942	893,026
2027	13,048	-	-	900,720	509,657	1,007,748	1,001,224	1,894,250
2028	13,440	-	-	900,720	513,189	1,008,490	1,001,770	2,896,020
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2031	14,686	-	-	-	529,054	111,101	103,759	3,527,228
2032	15,126	-	-	-	535,786	112,515	104,952	3,632,181
2033	15,580	-	-	-	543,314	114,096	106,306	3,738,487
2034	-	-	-	-	175,493	36,854	36,854	3,775,340
	25,254,694	1,753,719	(298,132)	9,007,200	8,401,810	10,771,580	3,775,340	
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	Quarterly Effective IRR Quarterly Effective - After Tax: 10.31%							

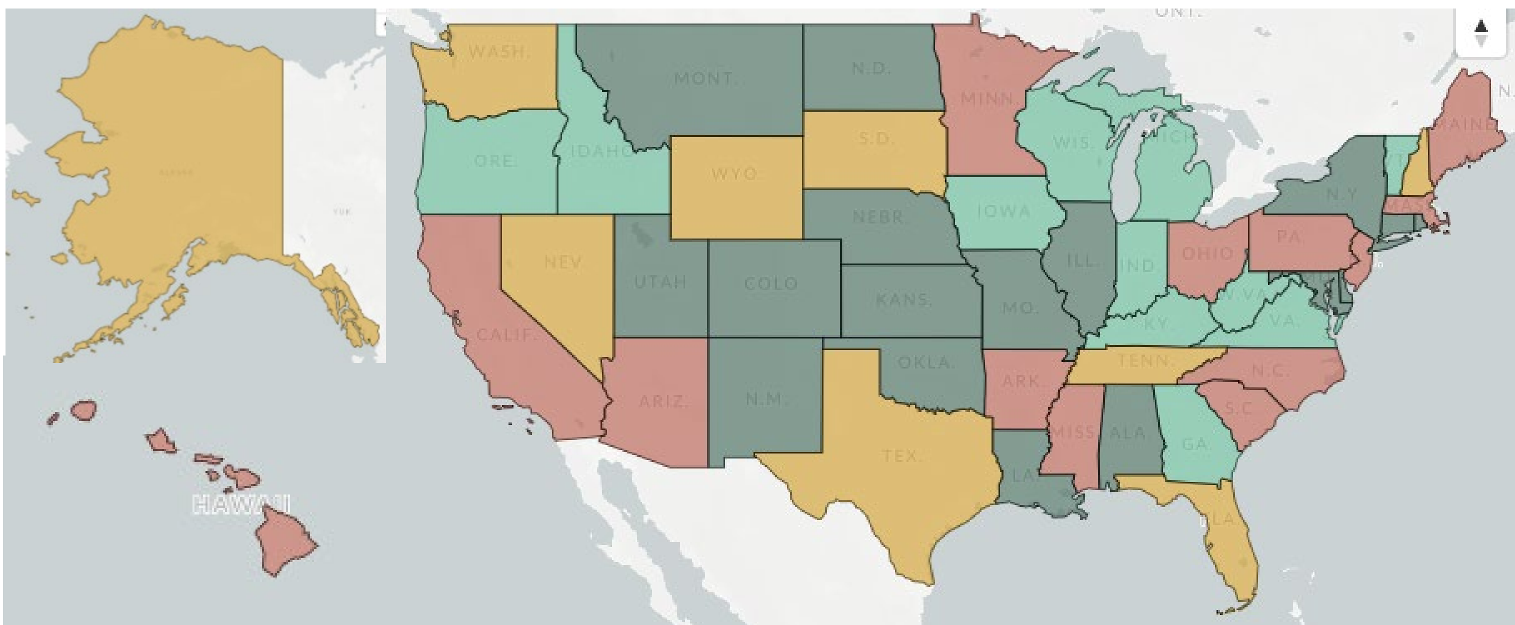
Pending Interpretative Issues

- Does congressional intent mandate demonstration of community benefit?
- Is residential rental property eligible?
- What gains are eligible for deferral? (ordinary? depreciation recapture?)
- What does “substantially all” mean? (70%? 85%)
- Can land satisfy original use test?
- Can vacant building satisfy original use test?
- Is debt basis treated as a separate investment?
- How much time does business have to become OZB?
- Are cash reserves QOZBP?
- How are operating leases treated in the 90% test?

State Income Tax Conformity

- Hawaii has specifically decoupled from federal tax law for purposes of applying IRC 1400Z-1 and 1400Z-2 (Opportunity Zone code sections) for Hawaii state income tax purposes.

- This lack of conformity may make certain Hawaiian opportunity zone investments less attractive to some investors.



Recent Developments & Pending Guidance

- Mark Meadows, R-N.C., introduced legislation on October 27th to allow for the designation of opportunity zones (OZs) every 10 years. **H.R. 6890, the Creating Advancement and Personal Improvement in Targeted American Localities (CAPITAL) Act of 2018** was assigned to the House Ways and Means Committee.

- White House Office Management of the Budget (OMB) received regulatory guidance for review from IRS on September 12th. The proposed rule is expected to clarify several issues, further discussed later in the presentation. The mandatory review is at least 10 days and no more than 45 days.

Q&A