

NEXT LEVEL

WINSTEAD'S FORUM FOR THE NEXT GENERATION
OF COMMERCIAL REAL ESTATE LEADERS

February 28, 2019

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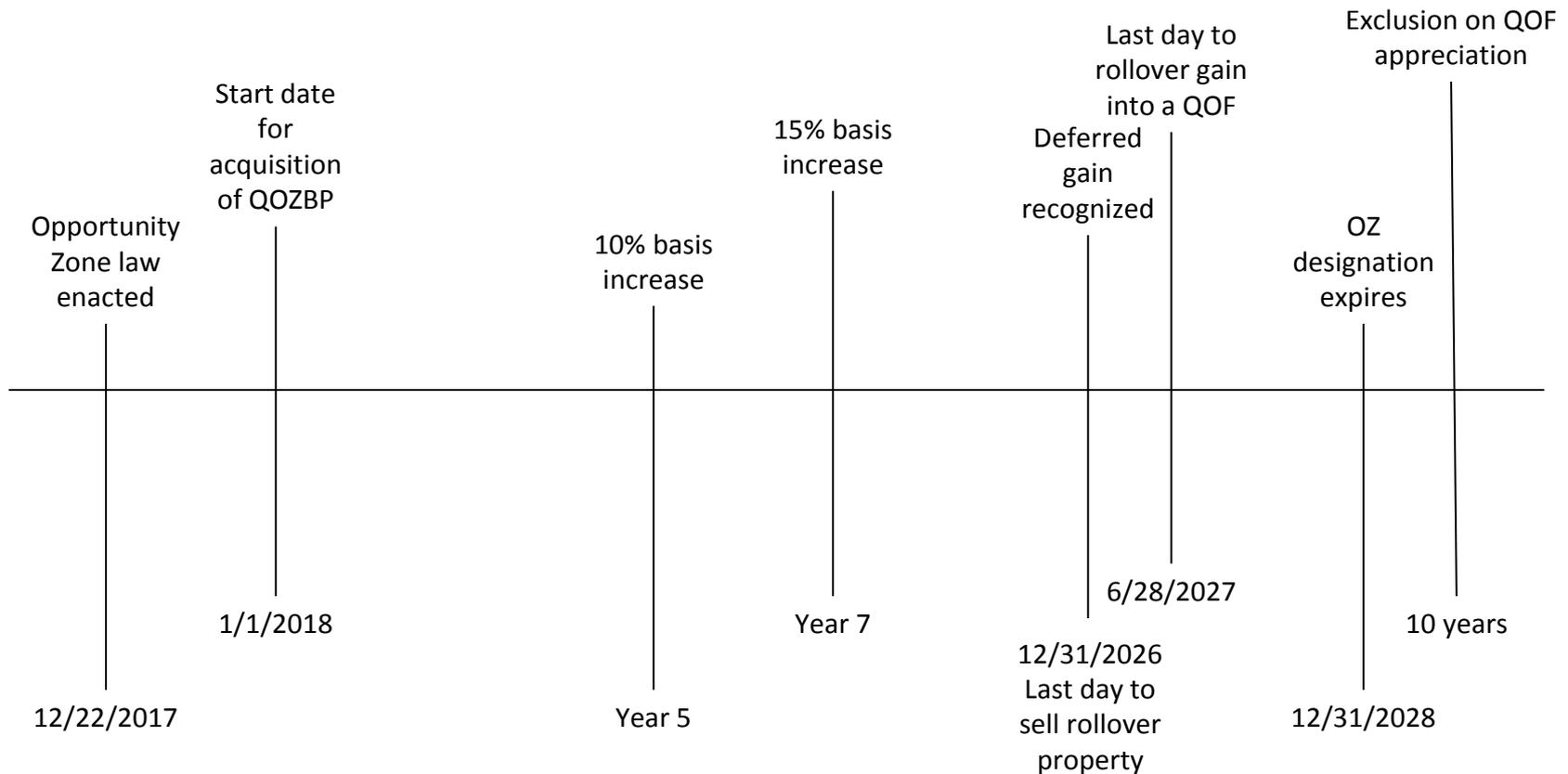
Qualified Opportunity Zones

- A low-income community census tract that is designated as a qualified opportunity zone
- Texas designated 628 census tracts in 145 counties
- Treasury certified the Texas QOZs on April 9, 2018
- A map of the designated QOZs is available at https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml

Tax Incentives

1. A tax deferral on capitals gains reinvested in a Qualified Opportunity Fund until earlier of December 31, 2026 or date investment is sold
2. Potential 10% tax exclusion from taxation if the investment is held for 5 years or 15% tax exclusion if held for 7 years
3. Potential 100% tax exclusion on the appreciation of the investment (but not the original gains reinvested)

Opportunity Zone Timeline



Timing Considerations

Investments made in 2019

- Eligible for all incentives

Investments made after 2019 but before 2022

- The rollover gain will be deferred and 10% may be excluded
- The tax exclusion on appreciation is available if the investment is held for 10 years

Investments made after 2021 and by June 28, 2027

- No step-up in basis on rollover gain
- Exclusion from tax on appreciation is available if the investment is held for 10 years

Example

Suppose a taxpayer realizes a \$1 million capital gain from the sale of stock on January 1, 2018, and properly elects to defer that gain by purchasing a \$1 million interest in an Opportunity Fund on June 1, 2018. A sale of the taxpayer's Opportunity Fund investment for \$2 million on December 31, 2028, should have the following results:

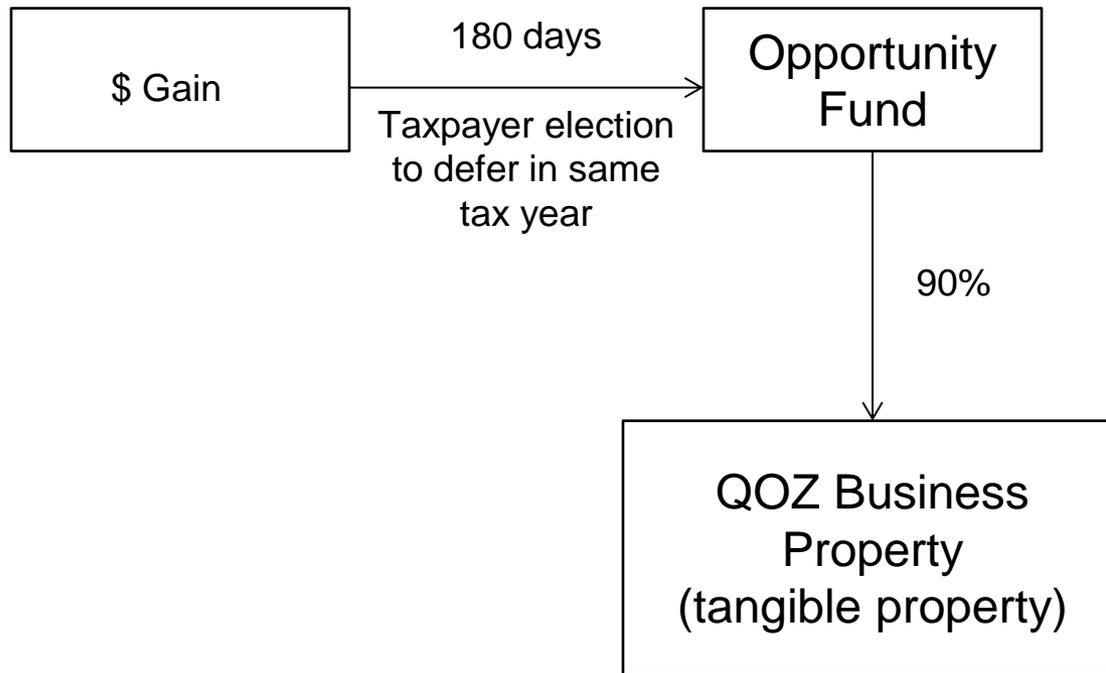
- No tax on the \$1 million of gain that is reinvested in the Opportunity Fund until December 31, 2026.
- 15% of the original \$1 million of reinvested gain is excluded from taxation so that only \$850,000 of gain is recognized and subject to tax on December 31, 2026.
- The additional \$1 million of gain from the December 31, 2028 sale of the Opportunity Fund appreciation is excluded from tax.

Example Tax Savings

- The taxpayer's taxable gain is reduced from \$2 million to \$850,000.
- The taxpayer owes \$170,000 in tax on December 31, 2026, instead of \$200,000 on January 1, 2018.
- On a present-value basis, assuming a 20% capital gains tax and a 5% discount rate, the true economic cost of the taxpayer's tax in 2026 is \$104,600 compared to the \$200,000 tax that would be levied in 2018.
- Total present value savings of \$295,400.

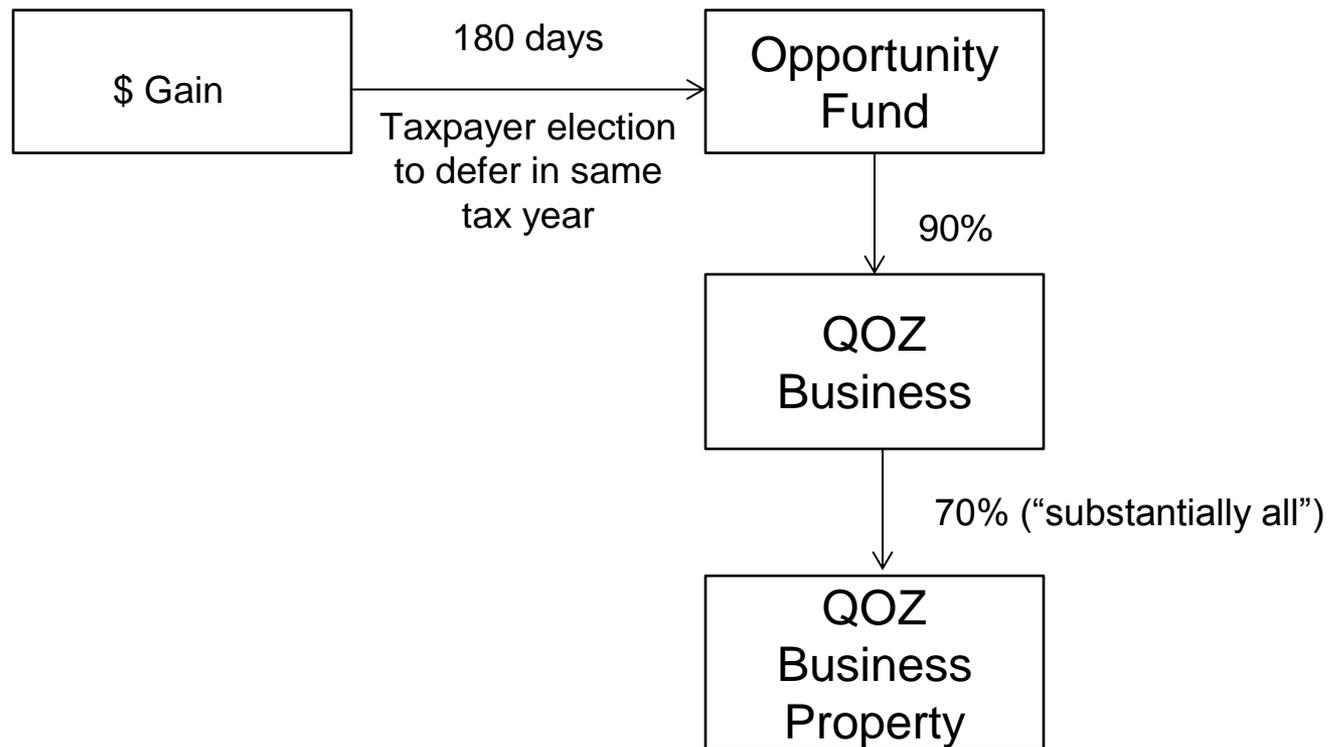
Planning Considerations

QOF Direct Investment in Real Property



Planning Considerations

QOF Indirect Investment in Real Property



Comparison of Direct/Indirect Investment

Direct	Indirect
90% of all assets must be QOZBP	70% (“substantially all”) of <u>tangible</u> property must be QOZBP
No guidance on working capital safe harbor	Working capital safe harbor applies to unlimited amount of cash
No active conduct standard	50% of gross income from active conduct of trade or business
All IP counts toward 10% of non-QOZBP assets	Can own unlimited amount of IP (if substantial portion used in QOZB)
No prohibition on sin businesses	Prohibition on sin businesses
No specific reference to lease of property by a QOF	Property leased by a QOZB subject to QOZBP rules

Opportunity Zone Terms

- Qualified Opportunity Fund
- Qualified Opportunity Zone Property
 - Qualified Opportunity Zone Business
 - Partnership interest
 - Stock
 - Qualified Opportunity Zone Business Property

QOZ Business Property

Tangible property in a QOZ used in a trade or business if—

- acquired ***after December 31, 2017*** and ***original use*** or ***substantial improvement***
 - land can not meet original use test, but land and existing building can with substantial improvement
 - ***substantial improvement*** means rehabilitation or improvement costs in excess of the original cost within 30 months
 - No rules for acquisitions of unimproved land

Construction & Active Business

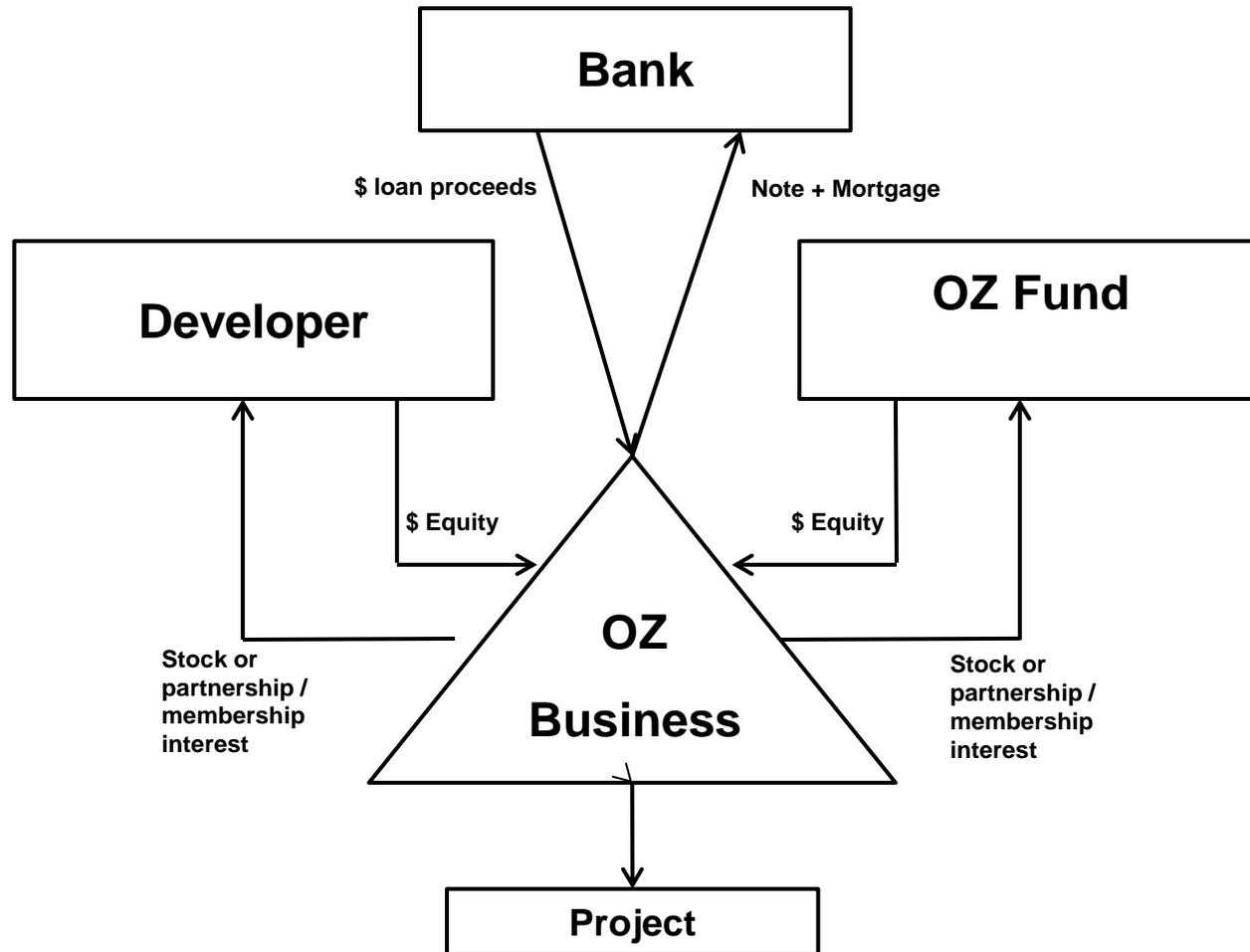
Construction Projects

- 5% limit on “nonqualified financial property”
- Working Capital Safe Harbor - up to 31 months pursuant to a written plan for the acquisition, construction, or substantial improvement

Active Conduct of Business is not defined

- Most real estate activities are expected to qualify
- Concerns about passive activity rental real property / triple net leases

Bank Financing



Lender Considerations

- An equity interest in a QOF can be used as collateral for a loan
- OZ Fund will need liquidity to pay tax on deferred gain in 2026 without a corresponding cash event
- Banks that demonstrate more investments in low income neighborhoods have better standing under the Community Reinvestment Act for purposes for OCC approval for a charter, bank merger, acquisition or branch opening

How can Winstead help?

Winstead Role	Services Offered
Developer's Counsel	Organizing and structuring the OZ business entity, record-keeping and reporting requirements, negotiating with Opportunity Fund investors
Investor's Counsel	Organizing and structuring the Opportunity Fund, negotiating with project sponsors on OZ matters, events of default, and indemnification provisions
Opportunity Fund Sponsors	Organize the fund, ongoing legal services (including information reporting and returns, tax elections, recordkeeping, compliance matters and sale or disposition event)
Landowner's Counsel	Traditional legal services, structuring sale or participation rights
Bank's Counsel	Traditional legal services with available OZ expertise