Opportunity Zone Workforce Housing Vignette

In collaboration with

Kirkland & Ellis LLP and **Ernst & Young LLP**

November 13, 2018

MILKEN INSTITUTE
CENTER FOR FINANCIAL MARKETS

Our Motivation

More than 50 million Americans live in economically distressed communities, and between 2000 and 2015 more than half of these communities experienced a decline in both jobs and businesses. The Opportunity Zone initiative is designed to assist these areas in their quest for economic growth and improved access to essential services. By affording investors tax incentives, the Opportunity Zone initiative provides the impetus to fund projects that will create jobs, improve education, develop affordable and workforce housing, advance access to health care, expand nutritional options, and ultimately improve lives across more than 8,700 communities.

Since 1991, the Milken Institute has championed initiatives designed to connect people, businesses, and communities to the resources they need to build meaningful lives. Together with Kirkland & Ellis and EY, the Institute has constructed illustrative vignettes to assist the U.S. Department of Treasury during the formulation of proposed regulations for the Opportunity Zone initiative.

The information provided herein is for illustrative purposes only. It is the first of two that explore how Opportunity Fund investments might address specific obstacles facing the Opportunity Zones, such as access to jobs, housing, healthcare, nutrition, or infrastructure. By helping regulators and investors better understand any implementation challenges Qualified Opportunity Funds might face, we hope to expedite the investments that can produce financial returns – and, most importantly, generate positive social impact.

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Part I

Background

IA. About this Reference Tool

Purpose

The purpose of this document is to explain the benefits offered by the 2017 Tax Reform and Jobs Act, Subchapter Z on Opportunity Zones. Through an illustrative “vignette”, this reference tool demonstrates how the Opportunity Zone initiative could impact a potential real estate development project. The vignette traces a transaction from initial capital formation of a Qualified Opportunity Fund through the point of exiting an investment in a Qualified Opportunity Fund.

The Internal Revenue Service (“IRS”) has provided partial guidance to help clarify implementation of the Opportunity Zone initiative, but more guidance is expected and the IRS will need to finalize proposed regulations. Throughout this vignette, we highlight what further information is needed from the IRS before the impact of a particular issue can be fully assessed. In addition, each aspect of the vignette contains references to other areas of law that are pertinent to the issue presented. The Opportunity Zone initiative does not override other areas of law, and readers should evaluate the mechanics of the legislation with that in mind.

Approach to Interpreting the Vignette

Before reviewing the vignette, here are three overarching points that will help readers digest the information and the Opportunity Zone initiative at large:

1. **Qualified Opportunity Fund (“Opportunity Fund”)** – in the financial markets, the word “fund” typically implies the creation of a vehicle that aggregates investor commitments that subsequently will be deployed to many projects by a fund manager. Although some participants have taken this approach, others have suggested reversing the conventional process: the Opportunity Fund manager finds an individual project first and then raises investment for it.

2. **Tax Accounting Treatment** – to follow the vignette, it is best to think in terms of tax accounting treatment. An investor can trigger their participation in the program by selecting an individual capital gain that has been accounted for, and then electing to defer that gain for use in a Opportunity Fund. The investor does not need, for example, to receive the cash from the realized gain or to trace cash from gains to investments in a Opportunity Fund. The taxpayer would simply defer the selected gain and elect to include it in a future tax year–either when their investment in a Opportunity Fund is sold or in 2026, whichever is sooner.

3. **Decision Points** – each situation is different, and beginning in Section 2 of the vignette we present some common decisions that investors may need to evaluate, such as selling interests in their fund at a later stage or using interests in the fund as collateral for loans. After Section 1 of the vignette, the Sections are not inter-dependent and can be reviewed individually based on the interest of the reader.

IB. Overview of the Opportunity Zone Initiative

As part of the 2017 Tax Cuts and Jobs Act, Subchapter Z established Opportunity Zones to encourage investment in low- to moderate-income communities through qualified opportunity funds ("Opportunity Funds") through significant tax incentives. Across the US, more than 50 million people live in economically distressed communities, and the intent of the initiative is to attract investment to these areas in order to improve livelihoods.

An Opportunity Zone is a census tract designated by each state or territory and certified by the U.S. Treasury as eligible to receive private investments via Opportunity Funds. More than 8,700 Opportunity Zones have been designated across all 50 states, the District of Columbia, and 5 U.S. Territories.

An Opportunity Fund is a partnership or corporation set up for investing, either directly or indirectly through subsidiaries, in eligible property located in Opportunity Zones ("Opportunity Zone Property").

Opportunity Fund Summary Tax Benefits	Opportunity Fund Summary Requirements
▪ Temporary tax deferral for all capital gains reinvested in an Opportunity Fund, lasting until the investment is sold or December 31, 2026, whichever is sooner. ▪ A 10% reduction of the original capital gain if the Opportunity Fund investment is held for 5+ years before December 31, 2026; plus an additional 5% reduction if the investment is held for 7+ years before then. ▪ If an investor holds the Opportunity Fund investment for 10+ years, the investor also will permanently avoid capital gains taxes on any proceeds from the sale of the Opportunity Fund investment itself.	▪ Capitalized by capital gains within 180 days of being realized. ▪ Deploys, directly or indirectly through subsidiaries, at least 90% of its capital into Opportunity Zone Property. ▪ Main requirement for Opportunity Zone Property is that it is either (a) substantially improved, defined as the Opportunity Fund (or its subsidiary) doubling its basis in the property over a 30-month period or (b) originally used in an Opportunity Zone by the Opportunity Fund (or its subsidiary).

Note: U.S. Treasury's Community Development Financial Institutions Fund has published a complete list of the designated Opportunity Zones at the following web address: https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx

Part II

Workforce Housing Vignette

IIA. Narrative Overview

Three brothers–Tim, Cory, and Steve–who are experienced real estate developers, hear that a major employer is moving to their town, and decide to spearhead the development of a workforce housing option for employees. The brothers have been learning about the new Opportunity Zone initiative and discover the new employer is going to be located in an Opportunity Zone.

Through their real estate development firm called 3RE they already own a building that has appreciated significantly. 3RE decides to sell the building and use the gains to establish a fund (“Fund”), intending for it to qualify as an Opportunity Fund. Fund then establishes a business (“Business”), intending for it to qualify as a qualified opportunity zone business (“Opportunity Zone Business”) that will undertake the new workforce housing project in the Opportunity Zone. Before Business secures commitments or finds an Opportunity Zone Property, 3RE provides a loan to Business for finding the new property and conducting diligence.

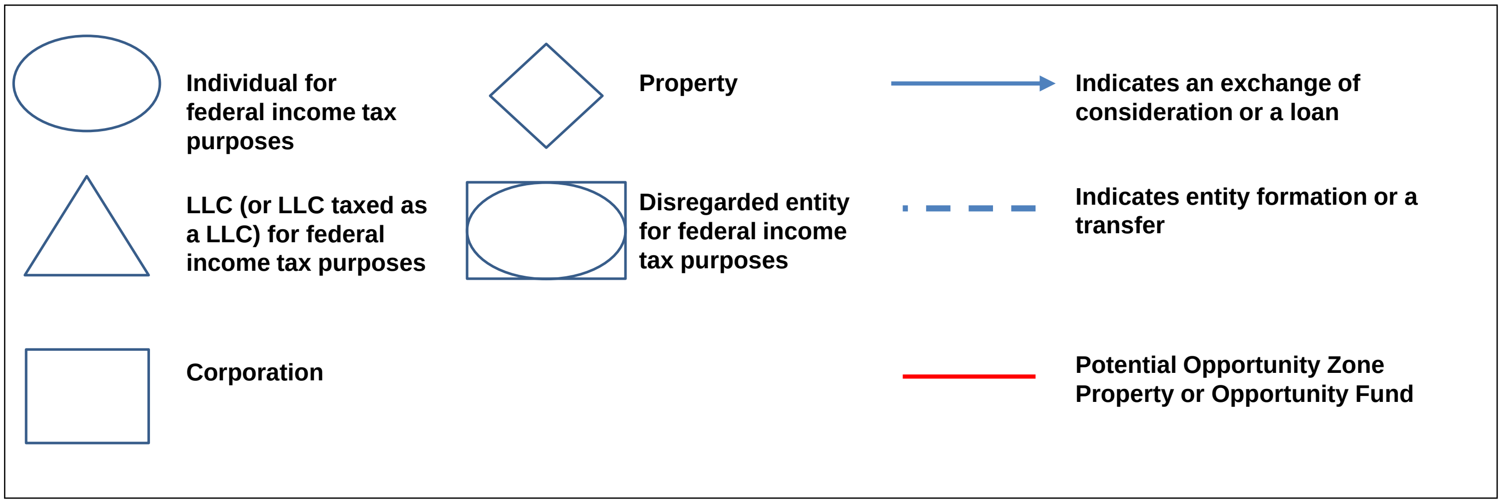
Fortunately, Business identifies a suitable project site consisting of land with some buildings, and 3RE commits equity to Fund to acquire the property. At the same time, the brothers’ friend Sara commits equity to Fund from gains that she realized on her stock portfolio. Business enters into a purchase and sale agreement to acquire the property, and draws on the 3RE loan to fund the pre-development work. At closing, the partners in Fund contribute their equity commitments (within 180 days of realizing gains), Fund contributes the cash to Business, and Business secures a community bank loan to refinance the 3RE loan and begin construction. The workforce housing project is constructed over the next two years, where Business draws the remaining loan proceeds to improve the property, and the partners evaluate whether to sell additional interests in Fund to further develop the project.

Over the course of its ownership in the workforce housing project, Business faces a number of decisions. Needing liquidity for another purpose, Business considers the impact of refinancing the housing project and distributing some of the proceeds to Fund and then to Fund’s partners. Similarly, it evaluates the impact of using interests in the Fund as collateral for a refinancing. In addition, other compelling investment opportunities arise. One of these potential investments is another Opportunity Zone Property, the sale of which would require Business to sell the existing housing project in order to participate. In addition, Business is interested in another investment opportunity that would not require it to sell the housing projects, but it is not in an Opportunity Zone and therefore could have consequences for the overall Opportunity Fund status.

At the end of 10 years, the Opportunity Fund has created thousands of workforce housing options for residents in their town. The Fund’s partners now wish to take advantage of the tax benefits and evaluate the optimal means to exit.

IIB. Legend / Definitions

Legend



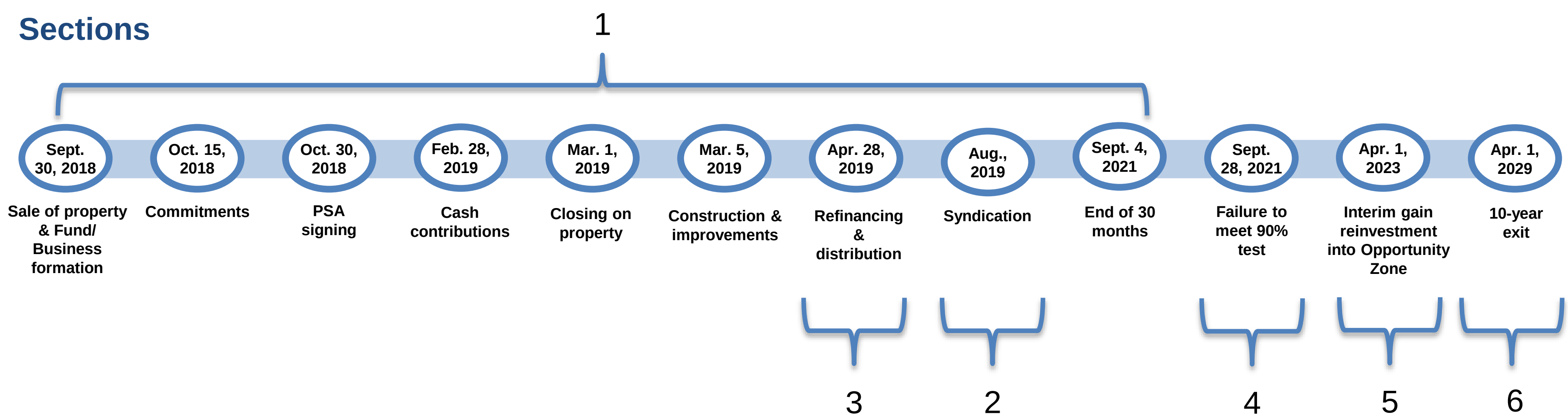
Definitions

"Opportunity Fund" – Qualified opportunity fund
"Opportunity Zone" – Qualified opportunity zone
"Opportunity Zone Business" – Qualified opportunity zone business
"Opportunity Zone Property" – Qualified opportunity zone business property
"Built-in-Gain Property" – An asset with fair market value in excess of tax basis
"IRC" – The Internal Revenue Code of 1986, as amended

IIC. Vignette Timeline

The vignette will be presented in six sections that are typical of a standard real estate development project. Because Opportunity Zone benefits are linked to specific periods of time, it is critical to understand how its timeframes interact with these standard project processes. The vignette timeline is below and individual processes will be highlighted in the header of each section, allowing the reader to place each step in a broader context.

Sections



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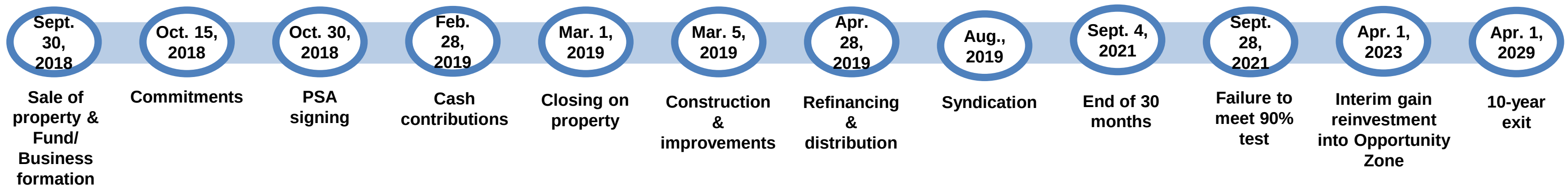
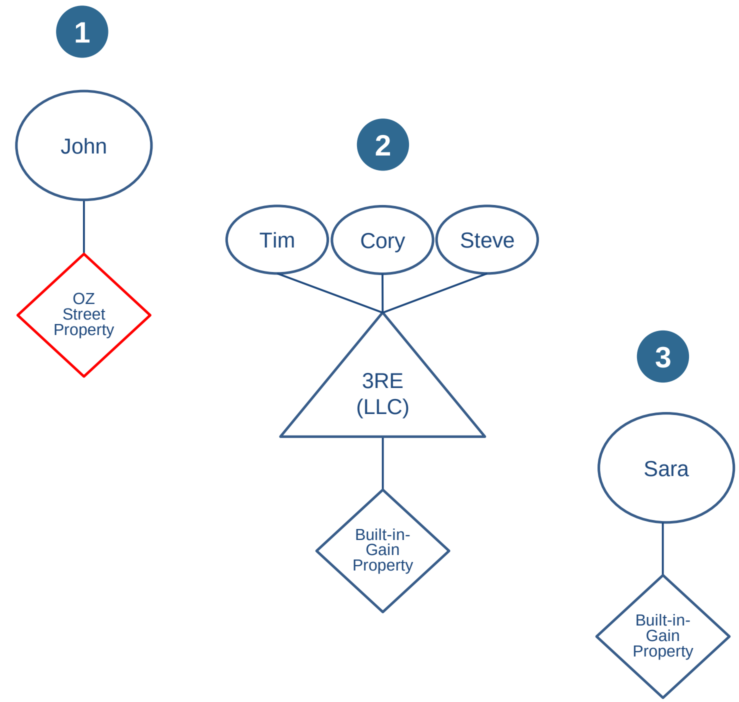
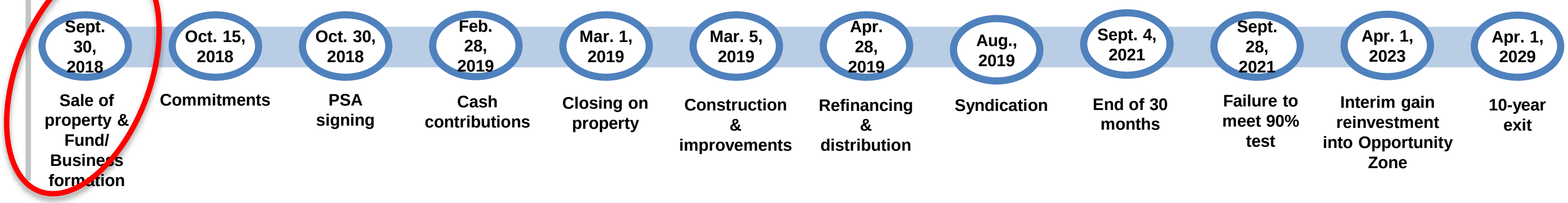
IIC. Section 1: Forming an Opportunity Fund, Opportunity Zone Business & Acquiring Opportunity Zone Property



Pre-Transaction Background Information

1. John holds a fee interest in real estate located in an Opportunity Zone (the "OZ Street Property"). The OZ Street Property consists solely of land a few buildings.
2. 3RE, LLC ("3RE") has 3 partners: Tim, Cory and Steve. 3RE holds assets with a fair market value of \$300 and a tax basis of \$220 (i.e., \$80 of built-in gain). Either 3RE or its partners will choose to reinvest their gains into an Opportunity Fund.
3. Sara holds assets with a fair market value of \$200 and a tax basis of \$80 (i.e., \$120 of built-in gain).

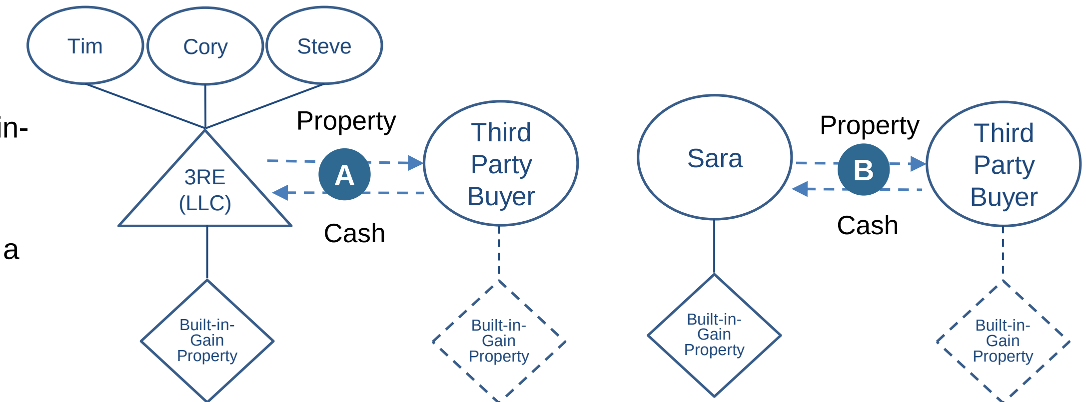




Part 1: Sale of Built-in-Gain Property

Step 1 A On September 30, 2018, 3RE sells its Built-in-Gain Property for $300 and realizes a gain of $80.

Step 1 B Concurrently with Step 1A, Sara sells her Built-in-Gain Property for fair market value and realizes a gain of $120.



IRS Clarifications Needed

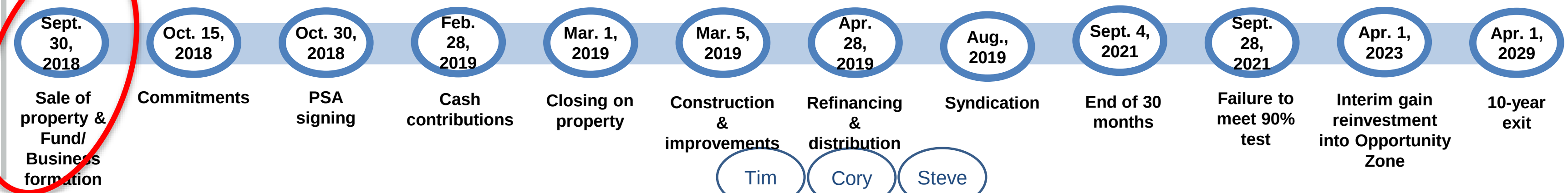
Issue 1: What types of gains may be invested in Opportunity Funds?

Issue 2: Will deferred gains recognized in 2026 have the same character and be subject to the same rate as when the deferral period began?

Existing Clarifications

Clarification 1: Gains eligible for deferral must : (i) be "treated as a capital gain for Federal income tax purposes," (ii) otherwise be recognized before January 1, 2027 for Federal income tax purposes, and (iii) not arise from a sale or exchange with a person that is "related" to the taxpayer that recognizes or would recognize the gain within the meaning of IRC Section 1400Z-2(e)(2). Prop. Reg. 1.1400Z-2(a)-1(b)(2)(i).

Clarification 2: If a taxpayer is required to include in income previously deferred gain, the gain so included has the same attributes in the taxable year of inclusion that it would have had if tax on the gain had not been deferred. These attributes include those taken into account by sections 1(h), 1222, 1256, and any other applicable provisions of the IRC. Prop. Reg. Section 1.1400Z-2(a)-1(b)(5).

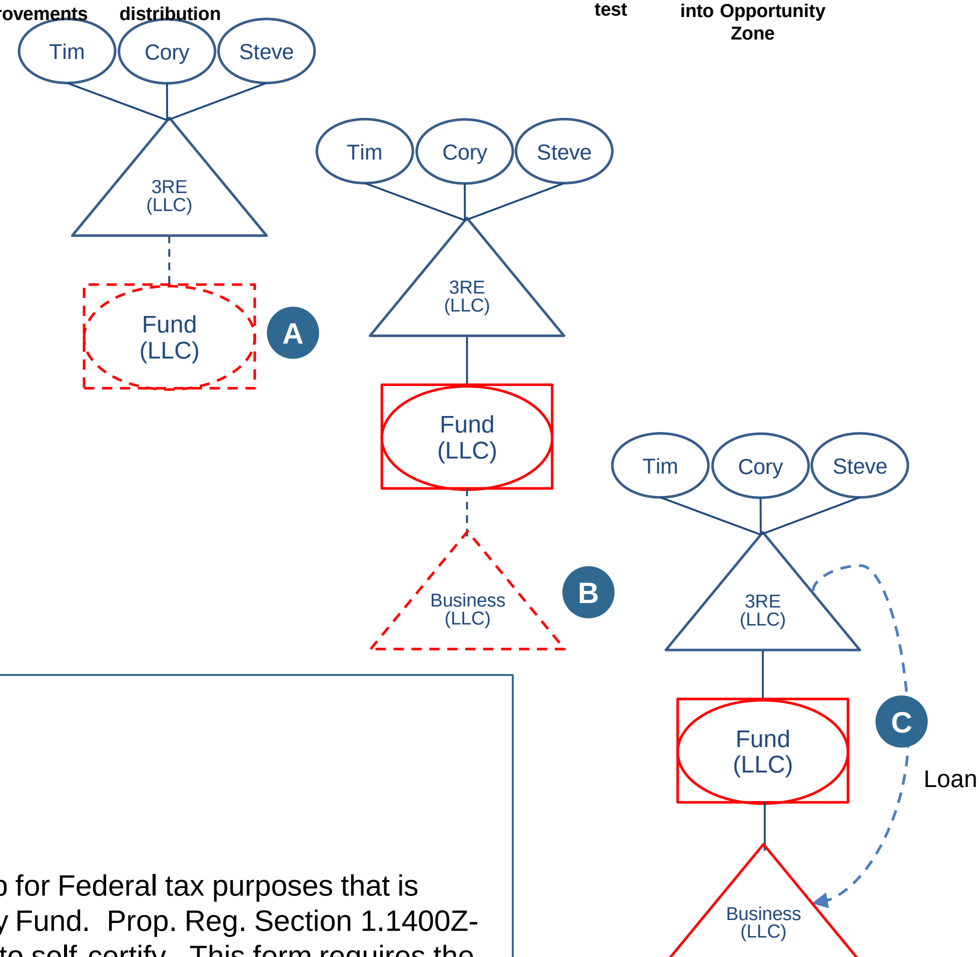


Part 2: Formation of Fund

Step 2 A Immediately after Step 1A, 3RE forms Fund as an LLC. Fund is "organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)" within the meaning of IRC Section 1400Z-2(d)(1).

Step 2 B Immediately after Step 2A, Fund forms Business as an LLC. Steve takes a de minimis interest in Business (not depicted) so Business is a partnership for tax purposes.

Step 2 C Immediately after Step 2B, 3RE lends $60 to Business for pre-development costs.

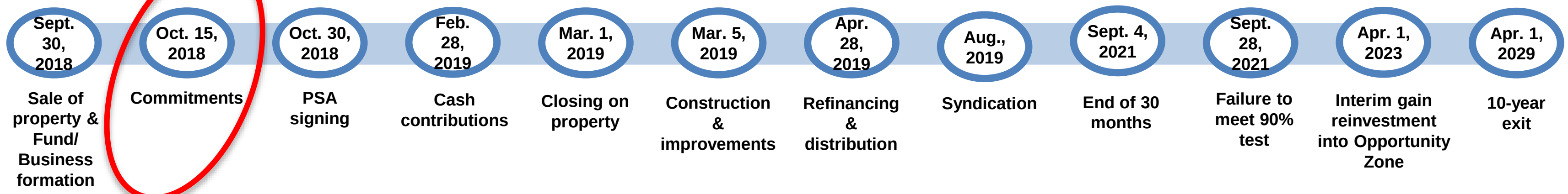


IRS Clarifications Needed

Issue 3: How does an entity become an Opportunity Fund?

Existing Clarifications

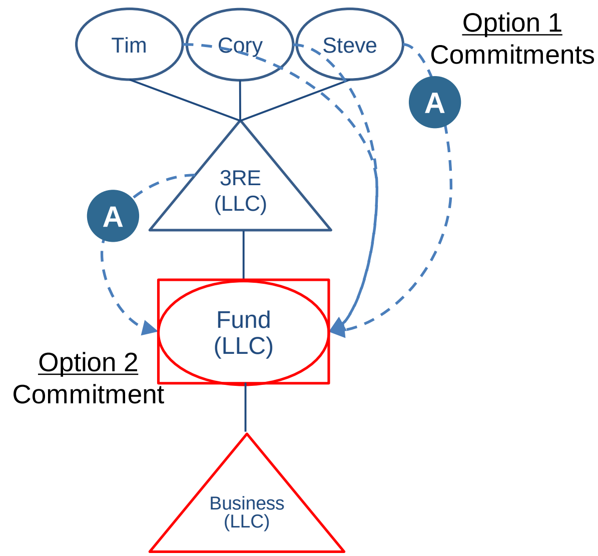
Clarification 3: An entity classified as a corporation or partnership for Federal tax purposes that is eligible to be an Opportunity Fund self-certifies as an Opportunity Fund. Prop. Reg. Section 1.1400Z-2(d)-1(a)(1). The IRS has released (draft) Form 8996 for entities to self-certify. This form requires the entity to verify, among other things, that it is (i) either a corporation or partnership, (ii) "organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)," and (iii) the entity's organizing documents will include the statement of purpose in (ii) and describe the entity's qualified opportunity zone business by the end of the entity's "first qualified opportunity fund year." The form is also used to verify annually that the entity meets the 90% Test or figure the penalty if the entity fails to meet the 90% Test. *See* IRS Form 8996 & instructions.

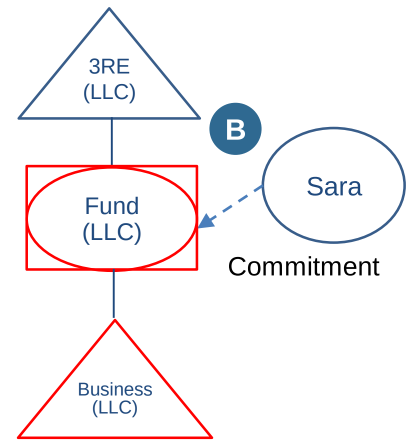


Part 3: 3RE or partners commit to Fund

Step 3 A On October 15, 2018, either (1) 3RE, or (2) its partners, Tim, Cory, and Steve, sign a subscription agreement committing them to contribute $80 of equity in the aggregate to Fund (the remainder of this vignette assumes that 3RE makes the investment).

Step 3 B Concurrently with Step 3A, Sara signs a subscription agreement, committing to contribute $120 of equity to Fund.





IRS Clarifications Needed

Issue 4: Can either 3RE (Option 3A-1) or each 3RE partner (Option 3A-2) be the "taxpayer" that makes the investment into an Opportunity Fund?

Existing Clarifications

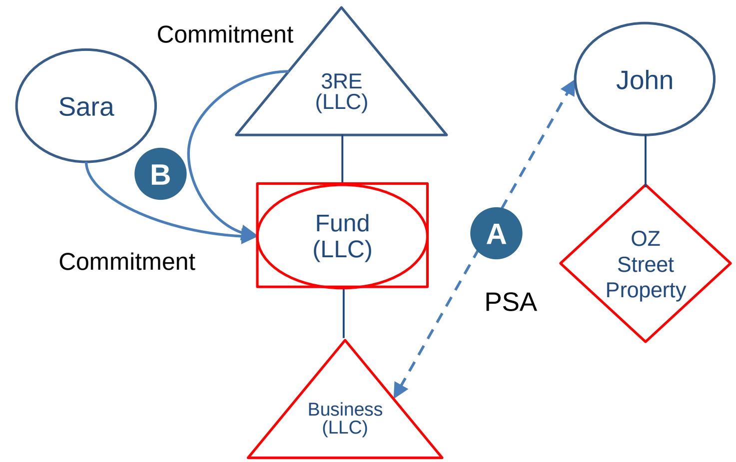
Clarification 4: A partnership may elect to defer recognition of its eligible gains. If it does not elect to defer its eligible gains, the gains are included in the partners' distributive shares under IRC section 702. If a partner's distributive share includes eligible gains, the partner may elect to defer those gains. The 180-day period with respect to the partner's eligible gains in the partner's distributive share generally begins on the last day of the partnership taxable year in which the partner's allocable share is taken into account under IRC section 706(a). However, the partner may elect to treat its own 180-day period as being the same as the partnership's 180-day period. Prop. Reg. Sec. 1.1400Z-2(a)-1(c).

Sept. 30, 2018	Oct. 15, 2018	Oct. 30, 2018	Feb. 28, 2019	Mar. 1, 2019	Mar. 5, 2019	Apr. 28, 2019	Aug., 2019	Sept. 4, 2021	Sept. 28, 2021	Apr. 1, 2023	Apr. 1, 2029
Sale of property & Fund/ Business formation	Commitments	PSA signing	Cash contributions	Closing on property	Construction & improvements	Refinancing & distribution	Syndication	End of 30 months	Failure to meet 90% test	Interim gain reinvestment into Opportunity Zone	10-year exit

Part 4: Entry into PSA with John

Step 4 A On October 30, 2018, Business enters into a purchase and sale agreement with John to purchase OZ Street Property for $220 (the "PSA"). The PSA provides for the sale to occur on March 1, 2019.

Step 4 B After entering into the PSA and prior to Closing, Business uses the $60 lent by the 3RE for due diligence, entitlement work, earnest money (cash deposits), and other pre-development costs.



IRS Clarifications Needed

Issue 5: How much cash is an Opportunity Zone Business (i.e., Business) permitted to have as "reasonable" working capital?

Existing Clarifications

Clarification 5: Working capital is treated as reasonable in amount if: (i) the amounts are "designated in writing for the acquisition, construction, and/or substantial improvement of tangible property" in an Opportunity Zone, (ii) "[t]here is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets," and working capital is spent within 31 months of receipt under the schedule, and (iii) "the working capital assets are actually used in a manner that is substantially consistent" with the plan and schedule. Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(5)(iv).

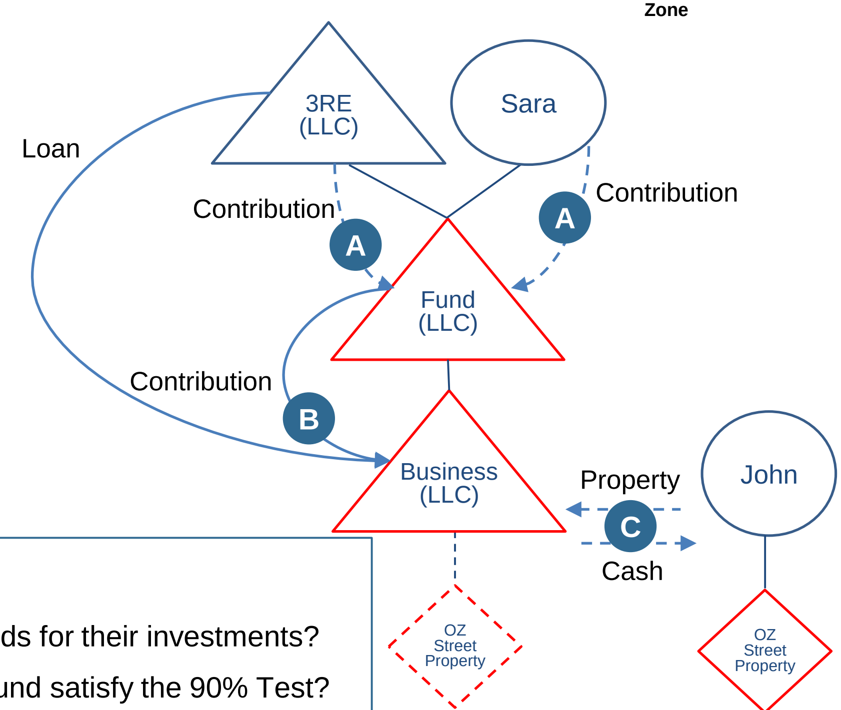
Sept. 30, 2018	Oct. 15, 2018	Oct. 30, 2018	Feb. 28, 2019	Mar. 1, 2019	Mar. 5, 2019	Apr. 28, 2019	Aug., 2019	Sept. 4, 2021	Sept. 28, 2021	Apr. 1, 2023	Apr. 1, 2029
Sale of property & Fund/ Business formation	Commitments	PSA signing	Cash contributions	Closing on property	Construction & improvements	Refinancing & distribution	Syndication	End of 30 months	Failure to meet 90% test	Interim gain reinvestment into Opportunity Zone	10-year exit

Part 5: Closing on OZ Street Property

Step 5 A On February 28, 2019, 3RE contributes $80 to Fund in exchange for an equity interest and profits interest in Fund, and Sara contributes $120 to Fund in an exchange for an equity interest in Fund. 3RE and Sara agree to split all proceeds pro rata until each receives the amount of their initial contributions, and thereafter 50/50.

Step 5 B Immediately after Step 5A, Fund contributes the $200 received to Business. Concurrently, Fund elects to be an Opportunity Fund on IRS Form 8996, designating February as its initial month.

Step 5 C On March 1, 2019, Business uses $220 (received in Steps 5B and 5D) to purchase the OZ Street Property pursuant to the PSA.



IRS Clarifications Needed

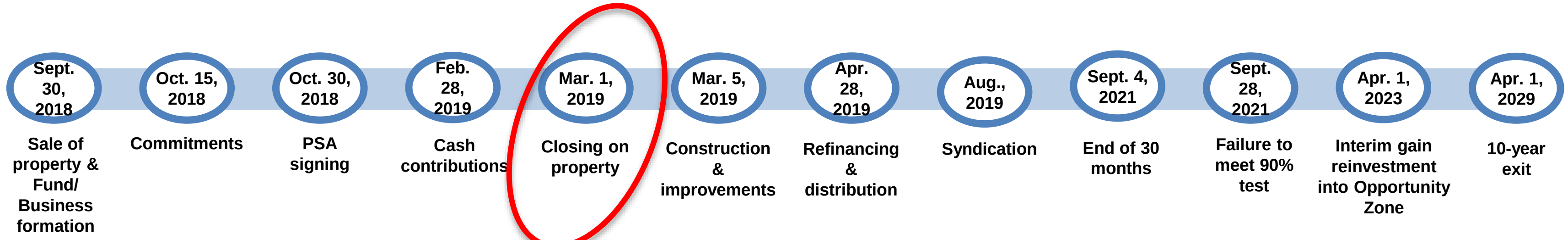
Issue 6: What kinds of interests may investors receive in Opportunity Funds for their investments?

Issue 7: When does Fund qualify as an Opportunity Fund? When must Fund satisfy the 90% Test?

Existing Clarifications

Clarification 6: An “eligible interest” in an Opportunity Fund is an “equity interest” issued by the Opportunity Fund, “including preferred stock or a partnership interest with special allocations.” Prop. Reg. Sec. 1.1400Z-2(a)-1(b)(3).

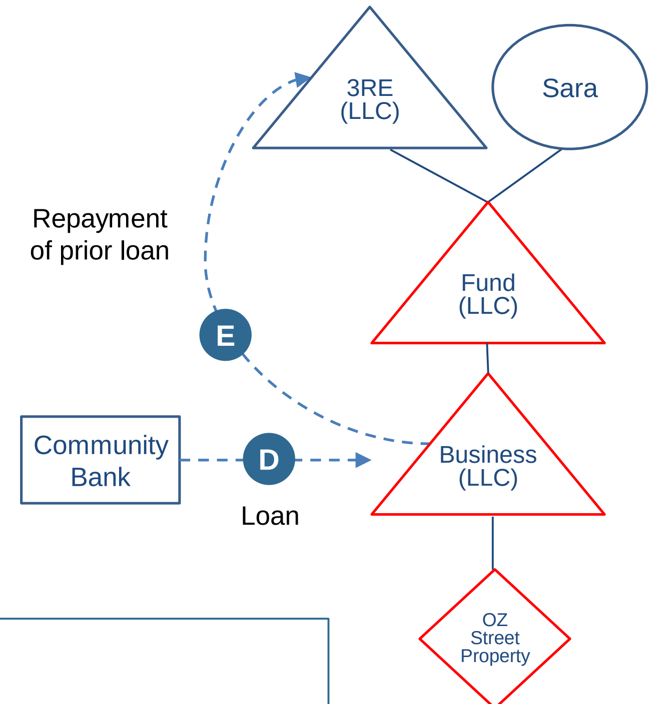
Clarification 7: An entity must identify the first taxable year to be an Opportunity Fund on its self-certification. It may also identify the first month to be an Opportunity Fund. Opportunity Funds are subject to the requirement that they hold at least 90% of their assets in Opportunity Zone Property, measured on certain dates throughout the Opportunity Fund’s taxable year (the “90% Test”). IRC section 1400Z-2(d)(1). The first testing date is the earlier of (i) the last day of the first 6 months each of which is in the taxable year and in each of which the entity is an Opportunity Fund and (ii) the last day of the taxable year. Prop. Reg. Sec. 1.1400Z-2(d)-1(a).



Part 5 (cont.): Closing on OZ Street Property

Step 5 D Concurrently with Step 5A, Business enters into a loan agreement and borrows $20 from Community Bank. The loan agreement also provides that Business can borrow an additional $260 to construct workforce housing on the OZ Street Property.

Step 5 E Immediately after Step 5D, Business uses $60 to repay the loan from 3RE.



IRS Clarifications Needed

Issue 8: If Opportunity Funds (i.e., Fund) and Opportunity Zone Businesses (i.e., Business) borrow money, will debt allocated to the Opportunity Fund's partners cause all or a portion of their investments to be non-qualifying?

Existing Clarifications

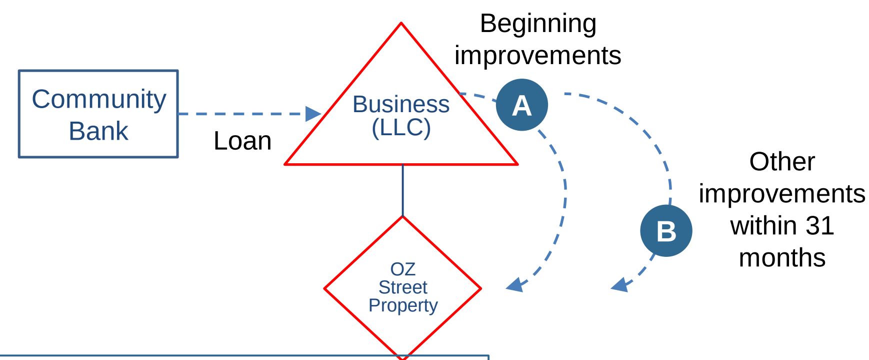
Clarification 8: The deemed contribution of money resulting from an increase in a partner's share of liabilities of a partnership under IRC section 752(a) does not create or increase an "investment with mixed funds" described in IRC Section 1400Z-2(e)(1). Prop. Reg. Sec. 1.1400Z-2(e)-1(a).

Sept. 30, 2018	Oct. 15, 2018	Oct. 30, 2018	Feb. 28, 2019	Mar. 1, 2019	Mar. 5, 2019	Apr. 28, 2019	Aug., 2019	Sept. 4, 2021	Sept. 28, 2021	Apr. 1, 2023	Apr. 1, 2029
Sale of property & Fund/ Business formation	Commitments	PSA signing	Cash contributions	Closing on property	Construction & improvements	Refinancing & distribution	Syndication	End of 30 months	Failure to meet 90% test	Interim gain reinvestment into Opportunity Zone	10-year exit

Part 6: Improvement of OZ Street Property

Step 6 A On March 5, 2019, Business draws a portion of Community Bank's loan and begins improvements and construction of workforce housing on the OZ Street Property.

Step 6 B By September 28, 2021 (31 months from receiving cash in Step 5A), Business draws the remainder of Community Bank's loan and uses the proceeds to make improvements and construct the workforce housing project on the OZ Street Property.



IRS Clarifications Needed

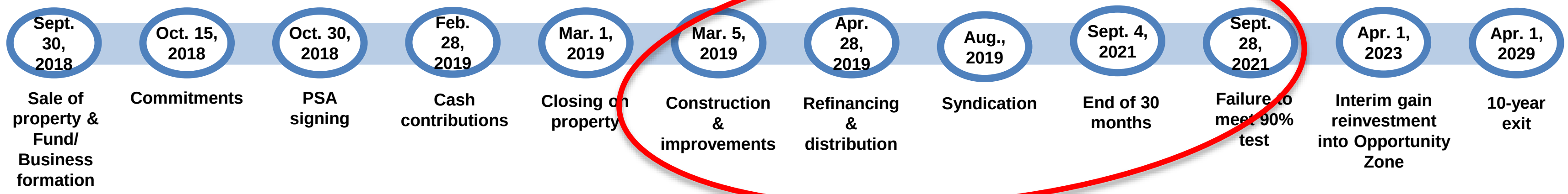
Issue 9: Is substantial improvement of the OZ Street Property measured with respect to the land (i.e., requiring improvements at least equal to the total acquisition cost allocated to land, or $100) or the existing buildings (i.e., requiring improvement at least equal to the total acquisition cost allocated to the buildings, or $180) or both (i.e., improvements at least equal to the total acquisition cost of $280)?

Issue 10: Will property be treated as substantially improved even if the improvements are not complete?

Existing Clarifications

Clarification 9: If an Opportunity Fund purchases a building wholly within an Opportunity Zone, under IRC section 1400Z-2(d)(2)(D)(ii), a substantial improvement to the building is measured by the Opportunity Fund's additions to the adjusted basis of the building. A substantial improvement to the building does not require the Opportunity Fund to separately substantially improve the land on which the building is located. Rev. Rul. 2018-29.

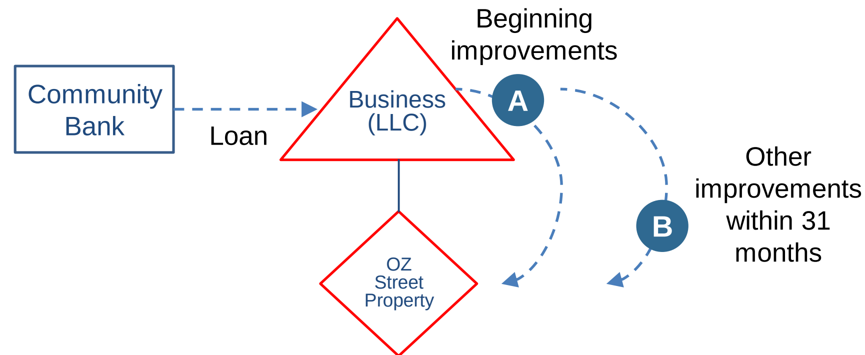
Clarification 10: If working capital is reasonable because of compliance with the safe harbor (see Clarification 5), and if the tangible property is expected to become substantially improved as a result of spending the working capital, then that property does not fail to be substantially improved solely because the scheduled consumption of the working capital is not yet complete. Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(5)(vii).



Part 6: Improvement of OZ Street Property (Cont.)

Step 6 A On March 5, 2019, Business draws a portion of Community Bank's loan and begins improvements and construction of workforce housing on the OZ Street Property.

Step 6 B By September 28, 2021 (31 months from receiving cash in Step 5A), Business draws the remainder of Community Bank's loan and uses the proceeds to make improvements and construct the workforce housing project on the OZ Street Property.



IRS Clarifications Needed

Issue 11: What percentage of Business' property needs to be Opportunity Zone Property? How is this percentage calculated?

Issue 12: Will the lapse of Opportunity Zone status in 2028 prevent 3RE and Sara from receiving the benefits of holding Fund interests for 10 years?

Existing Clarifications

Clarification 11: Substantially all of the tangible property owned or leased by an Opportunity Zone Business must be Opportunity Zone Property. A trade or business of an entity is treated as satisfying the substantially all requirement if at least 70 percent of the tangible property owned or leased by the trade or business is "qualified opportunity zone business property" as defined in paragraph (d)(2) of this section. If the entity has an "applicable financial statement" within the meaning of IRC section 1.475(a)-4(h), then the value of each asset of the entity is as reported on the financial statement for the relevant reporting period. Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(1)-(3).

Clarification 12: The ability to make an election for investments held for at least 10 years will not be impaired solely because, under 1400Z-1(f), the designation of one or more Opportunity Zones ceases to be in effect. Prop. Reg. 1.1400Z-2(c)-1(b).

- Sept. 30, 2018 — Sale of property & Fund/ Business formation
- Oct. 15, 2018 — Commitments
- Oct. 30, 2018 — PSA signing
- Feb. 28, 2019 — Cash contributions
- Mar. 1, 2019 — Closing on property
- Mar. 5, 2019 — Construction & improvements
- Apr. 28, 2019 — Refinancing & distribution
- Aug., 2019 — Syndication
- Sept. 4, 2021 — End of 30 months
- Sept. 28, 2021 — Failure to meet 90% test
- Apr. 1, 2023 — Interim gain reinvestment into Opportunity Zone
- Apr. 1, 2029 — 10-year exit

Section 1 Financial Summary

Equity Investments in Fund/Business

Investor	Gain deferred	Investment in Fund
3RE	$80	$80
Sara	$120	$120
Total	**$200**	**$200**

Business Sources of Capital

Type of investment	Amount
Equity contributed	$200
Borrowings	$280
Total investment	**$480**

Business Uses of Capital (Substantial Improvement)

Cost	Amount	Allocation
Property purchase price	$220	
Pre-development costs	$60	
Total acquisition costs	$280	
Allocation to land		$100
Allocation to buildings		$180
Development costs	$200 (at least equal to buildings allocation)	
Total costs	**$480**	

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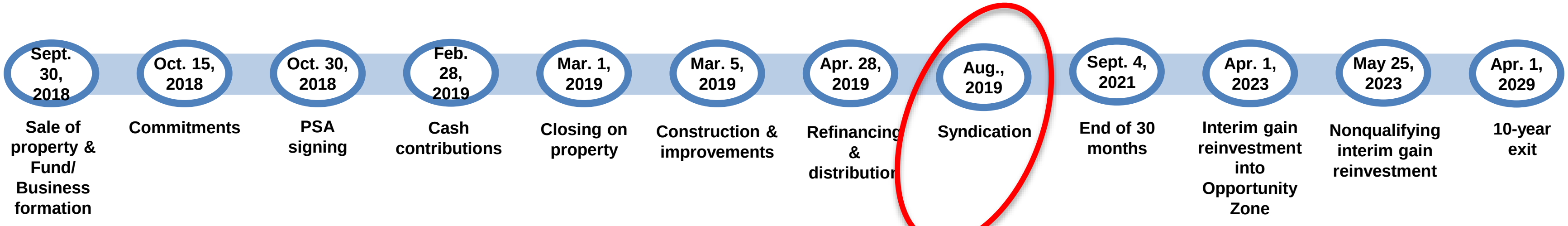
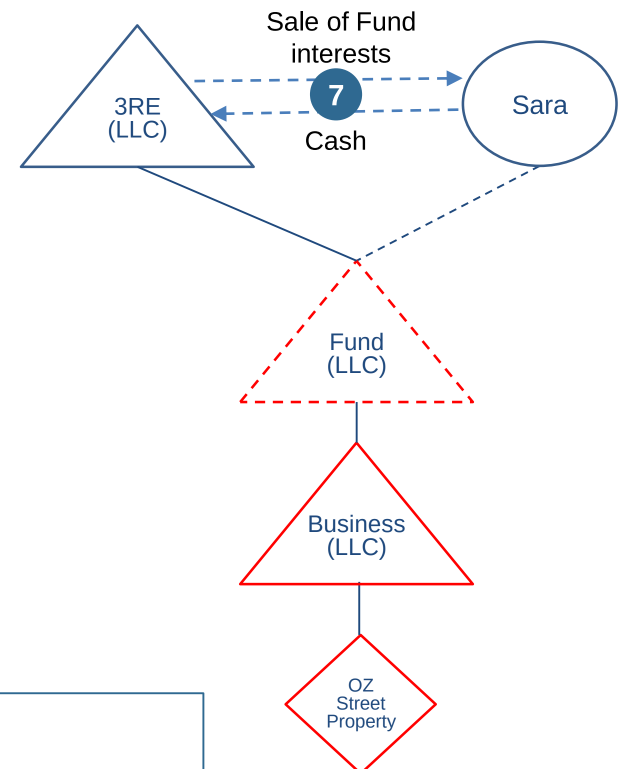
IIC. Section 2: Syndication of Opportunity Fund Interests



(New) Part 7: Syndication of Opportunity Fund interests

Assume Steps 1-4 of Section 1 have occurred, 3RE contributes $200 to Fund in Step 5, but Sara does not make a contribution.

Step 7 In August 2019, 3RE sells a portion of its equity interests in Fund to Sara.



IRS Clarifications Needed

Issue 13: Assuming Fund has already qualified as an Opportunity Fund by August 2019, does the purchase by Sara of the equity interests in the Fund qualify as an investment for purposes of the 180-day requirement?

IIC. Section 3: Interim Refinancing & Distribution

Sept. 30, 2018	Oct. 15, 2018	Oct. 30, 2018	Feb. 28, 2019	Mar. 1, 2019	Mar. 5, 2019	Apr. 28, 2019	Aug., 2019	Sept. 4, 2021	Sept. 28, 2021	Apr. 1, 2023	Apr. 1, 2029
Sale of property & Fund/ Business formation	Commitments	PSA signing	Cash contributions	Closing on property	Construction & improvements	Refinancing & distribution	Syndication	End of 30 months	Failure to meet 90% test	Interim gain reinvestment into Opportunity Zone	10-year exit

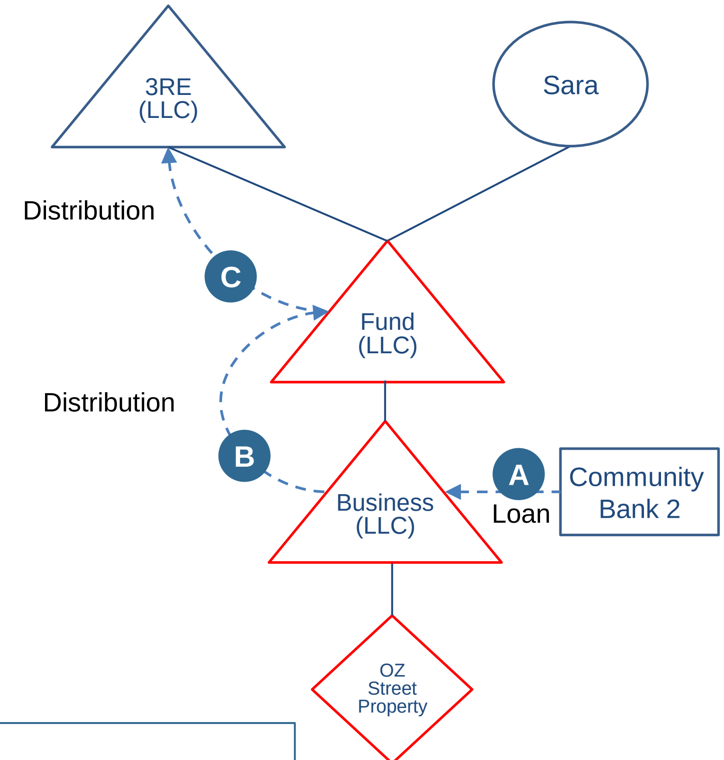
(New) Part 7: Interim refinancing & distribution

The facts are the same as in Section 1.

Step 7 A On April 28, 2019, Business enters into an additional loan agreement. Pursuant to the loan agreement, Business borrows $80 from Community Bank 2 and pledges OZ Street Property as a security.

Step 7 B Immediately following Step 7A, Business distributes the $80 received in Step 7A to Fund and Fund distributes the $80 received to 3RE.

Step 7 C Immediately following Step 7B, Fund distributes the $80 received to 3RE.



IRS Clarifications Needed

Issue 14A: Is the distribution in Step 7C considered a sale or exchange such that 3RE is required to recognize the $80 of gain reinvested in Step 5A?

Issue 14B: If the lender required personal guarantees from Sara and the partners of 3RE would that create a “mixed investment” under the IRC?

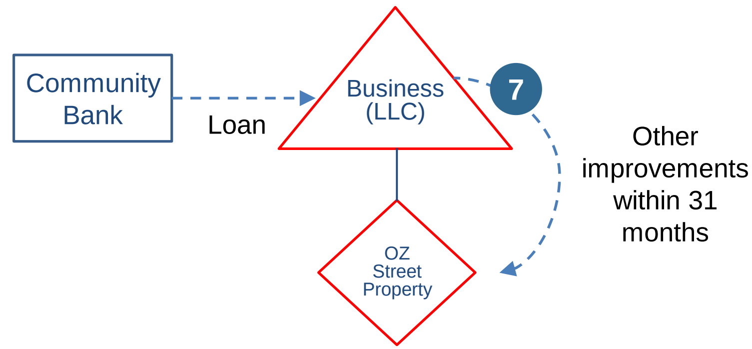
IIC. Section 4: Failure to Meet 90% Test

Sept. 30, 2018	Oct. 15, 2018	Oct. 30, 2018	Feb. 28, 2019	Mar. 1, 2019	Mar. 5, 2019	Apr. 28, 2019	Aug., 2019	Sept. 4, 2021	Sept. 28, 2021	Apr. 1, 2023	Apr. 1, 2029
Sale of property & Fund/ Business formation	Commitments	PSA signing	Cash contributions	Closing on property	Construction & improvements	Refinancing & distribution	Syndication	End of 30 months	Failure to meet 90% test	Interim gain reinvestment into Opportunity Zone	10-year exit

(New) Part 7: Failure to meet 90% Test

Assume that Steps 1-6A of Section 1 have occurred.

Step 7 By September 28, 2021, Business has borrowed and spent $100 constructing workforce housing on the OZ Street Property and improving the existing buildings, but was unable to spend working capital "substantially consistently" within the meaning of Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(5)(iv)(C) with its written plan and schedule within the 31 months after receipt.



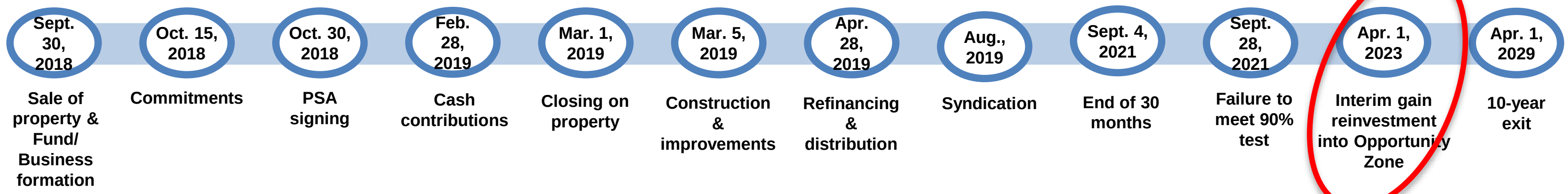
IRS Clarifications Needed

Issue 15: Will Fund be treated as never having been an Opportunity Fund, cease to be an Opportunity Fund, or will it incur a penalty for each month it fails to qualify?

Issue 16: If Fund incurs a penalty, how would the penalty be calculated? For how long may Fund fail to qualify before it loses Opportunity Fund status altogether, if ever?

Issue 17: If Fund failed to qualify as an Opportunity Fund, would 3RE and Sara still be entitled to the deferral of their gains until the end of the 31-month period?

IIC. Section 5: Interim Sale & Reinvestment into Opportunity Zone Property

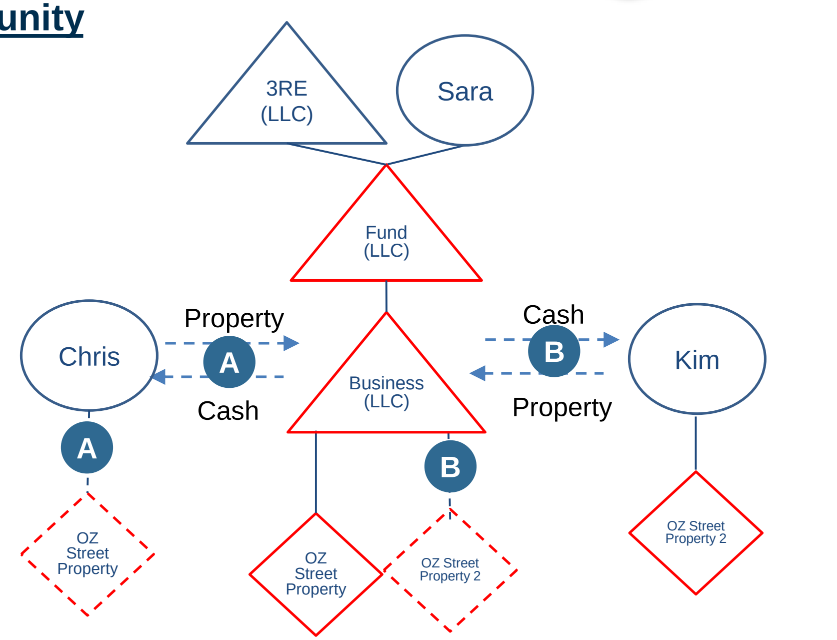


(New) Part 7: Interim sale & reinvestment into Opportunity Zone Property

The facts are the same as in Section 1.

Step 7A On April 1, 2023, Business sells the OZ Street Property (including the housing constructed thereon) to an unrelated buyer, Chris, for $1,000, and realizes a gain of $520.

Step 7B 180 days after Step 7A, Business enters into a purchase and sale agreement to acquire OZ Street Property 2 from Kim, with the sale occurring upon signing.

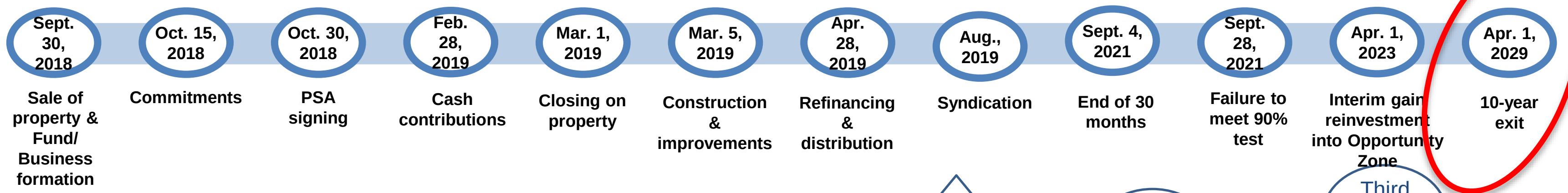


IRS Clarifications Needed

Issue 18: Will there be a grace period for Fund/Business to reinvest the proceeds from Step 7A into Opportunity Zone Property before needing to meet the 90% Test?

Issue 19: Will 3RE and Sara be relieved from immediate taxation when Fund sells property and reinvests the proceeds into Opportunity Zone Property?

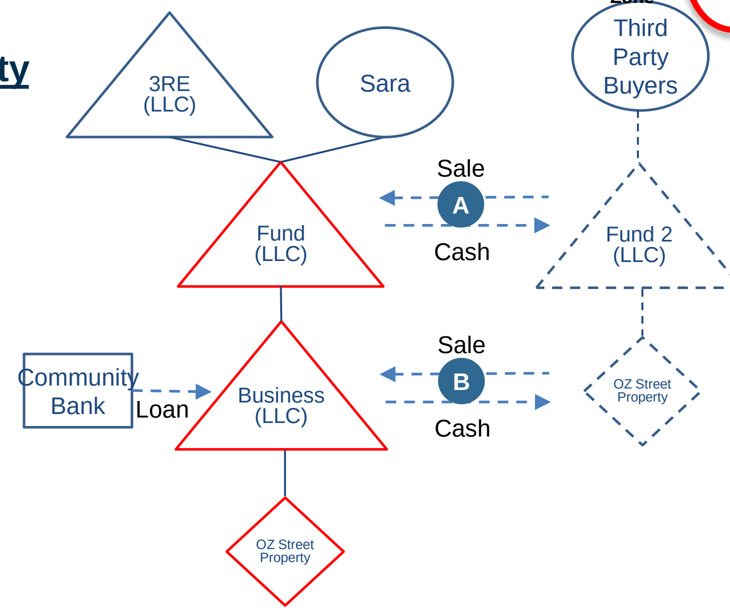
IIC. Section 6: 10-year exit



(New) Part 7: Sale of Fund interests or OZ Street Property

The facts from Section 1 are the same, and on April 1, 2029 either:

Step 7 A 3RE and Sara sell their interests in Fund, OR B Business sells the OZ Street Property. In each case the sale is to unrelated buyers for $1,000, with gain of $520 ($100 of which is attributable to depreciation recapture). After repayment of the $280 of debt, Business has $720 to distribute to Fund and then to 3RE and Sara. 3RE and Sara are entitled to a return of their $80 and $120 initial investments. Of the remaining $520, 3RE and Sara are each entitled to 50% ($260).



IRS Clarifications Needed

Issue 20: Do debt-financed gains realized by 3RE and Sara qualify for the benefits?

Issue 21: If Fund sells the OZ Street Property (i.e. Option B), does gain allocated to 3RE and Sara from that sale qualify for the benefits, or are the benefits only available in Option A?

Issue 22: Will the portion of 3RE and Sara's gain attributable to depreciation recapture qualify for the benefits?

Appendix

Compiled Lists of IRS Clarifications Needed & Existing Clarifications

Compiled Lists of IRS Clarifications Needed & Existing Clarifications

Issue 1: What types of gains may be invested in Opportunity Funds?

Clarification 1: Gains eligible for deferral must : (i) be "treated as a capital gain for Federal income tax purposes," (ii) otherwise be recognized before January 1, 2027 for Federal income tax purposes, and (iii) not arise from a sale or exchange with a person that is "related" to the taxpayer that recognizes or would recognize the gain within the meaning of IRC Section 1400Z-2(e)(2). Prop. Reg. 1.1400Z-2(a)-1(b)(2)(i).

Issue 2: Will deferred gains recognized in 2026 have the same character and be subject to the same rate as when the deferral period began?

Clarification 2: If a taxpayer is required to include in income some or all of a previously deferred gain, the gain so included has the same attributes in the taxable year of inclusion that it would have had if tax on the gain had not been deferred. These attributes include those taken into account by sections 1(h), 1222, 1256, and any other applicable provisions of the IRC. Prop. Reg. Section 1.1400Z-2(a)-1(b)(5).

Issue 3: How does an entity become an Opportunity Fund?

Clarification 3: An entity classified as a corporation or partnership for Federal tax purposes that is eligible to be an Opportunity Fund self-certifies as an Opportunity Fund. Prop. Reg. Section 1.1400Z-2(d)-1(a)(1). The IRS has released (draft) Form 8996 for entities to self-certify. This form requires the entity to verify, among other things, that it is (i) either a corporation or partnership, (ii) "organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)," and (iii) the entity's organizing documents will include the statement of purpose in (ii) and describe the entity's qualified opportunity zone business by the end of the entity's "first qualified opportunity fund year." The form is also used to verify annually that the entity meets the 90% Test or figure the penalty if the entity fails to meet the 90% Test. *See* IRS Form 8996 & instructions.

Compiled Lists of IRS Clarifications Needed & Existing Clarifications (Cont.)

Issue 4: Can either 3RE (Option 3A-1) or each 3RE partner (Option 3A-2) be the "taxpayer" that makes the investment into an Opportunity Fund?

Clarification 4: A partnership may elect to defer recognition of its eligible gains. If it does not elect to defer its eligible gains, the gains are included in the partners' distributive shares under IRC section 702. If a partner's distributive share includes eligible gains, the partner may elect to defer those gains. The 180-day period with respect to the partner's eligible gains in the partner's distributive share generally begins on the last day of the partnership taxable year in which the partner's allocable share is taken into account under IRC section 706(a). However, the partner may elect to treat its own 180-day period as being the same as the partnership's 180-day period. Prop. Reg. Sec. 1.1400Z-2(a)-1(c).

Issue 5: How much cash is an Opportunity Zone Business (i.e., Business) permitted to have as "reasonable" working capital?

Clarification 5: Working capital is treated as reasonable in amount if: (i) the amounts are "designated in writing for the acquisition, construction, and/or substantial improvement of tangible property" in an Opportunity Zone, (ii) "[t]here is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets," and working capital is spent within 31 months of receipt under the schedule, and (iii) "the working capital assets are actually used in a manner that is substantially consistent" with the plan and schedule. Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(5)(iv).

Issue 6: What kinds of interests may investors receive in Opportunity Funds for their investments?

Clarification 6: An "eligible interest" in an Opportunity Fund is an "equity interest" issued by the Opportunity Fund, "including preferred stock or a partnership interest with special allocations." Prop. Reg. Sec. 1.1400Z-2(a)-1(b)(3).

Compiled Lists of IRS Clarifications Needed & Existing Clarifications (Cont.)

Issue 7: When does Fund qualify as an Opportunity Fund? When must Fund satisfy the 90% Test?

> Clarification 7: An entity must identify the first taxable year to be an Opportunity Fund on its self-certification. It may also identify the first month to be an Opportunity Fund. Opportunity Funds are subject to the requirement that they hold at least 90% of their assets in Opportunity Zone Property, measured on certain dates throughout the Opportunity Fund's taxable year (the "90% Test"). IRC section 1400Z-2(d)(1). The first testing date is the earlier of (i) the last day of the first 6 months each of which is in the taxable year and in each of which the entity is an Opportunity Fund and (ii) the last day of the taxable year. Prop. Reg. Sec. 1.1400Z-2(d)-1(a).

Issue 8: If Opportunity Funds (i.e., Fund) and Opportunity Zone Businesses (i.e., Business) borrow money, will debt allocated to the Opportunity Fund's partners cause all or a portion of their investments to be non-qualifying?

> Clarification 8: The deemed contribution of money resulting from an increase in a partner's share of liabilities of a partnership under IRC section 752(a) does not create or increase an "investment with mixed funds" described in IRC Section 1400Z-2(e)(1). Prop. Reg. Sec. 1.1400Z-2(e)-1(a).

Issue 9: Is substantial improvement of the OZ Street Property measured with respect to the land (i.e., requiring improvements at least equal to the total acquisition cost allocated to land, or $100) or the existing buildings (i.e., requiring improvement at least equal to the total acquisition cost allocated to the buildings, or $180) or both (i.e., improvements at least equal equal to the total acquisition cost of $280)?

> Clarification 9: If an Opportunity Fund purchases a building wholly within an Opportunity Zone, under IRC section 1400Z-2(d)(2)(D)(ii), a substantial improvement to the building is measured by the Opportunity Fund's additions to the adjusted basis of the building. A substantial improvement to the building does not require the Opportunity Fund to separately substantially improve the land on which the building is located. Rev. Rul. 2018-29.

Compiled Lists of IRS Clarifications Needed & Existing Clarifications (Cont.)

Issue 10: Will property be treated as substantially improved even if the improvements are not complete?

> Clarification 10: If working capital is reasonable because of compliance with the safe harbor (see Clarification 5), and if the tangible property is expected to become substantially improved as a result of spending the working capital, then that property does not fail to be substantially improved solely because the scheduled consumption of the working capital is not yet complete. Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(5)(vii).

Issue 11: What percentage of Business' property needs to be Opportunity Zone Property? How is this percentage calculated?

> Clarification 11: Substantially all of the tangible property owned or leased by an Opportunity Zone Business must be Opportunity Zone Property. A trade or business of an entity is treated as satisfying the substantially all requirement if at least 70 percent of the tangible property owned or leased by the trade or business is "qualified opportunity zone business property" as defined in paragraph (d)(2) of this section. If the entity has an "applicable financial statement" within the meaning of IRC section 1.475(a)-4(h), then the value of each asset of the entity is as reported on the financial statement for the relevant reporting period. Prop. Reg. Sec. 1.1400Z-2(d)-1(d)(1)-(3).

Issue 12: Will the lapse of Opportunity Zone status in 2028 prevent 3RE and Sara from receiving the benefits of holding Fund interests for 10 years?

> Clarification 12: The ability to make an election for investments held for at least 10 years will not be impaired solely because, under 1400Z-1(f), the designation of one or more Opportunity Zones ceases to be in effect. Prop. Reg. 1.1400Z-2(c)-1(b).

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