Steptoe

Opportunity Fund Structures: An Overview

July 22, 2019

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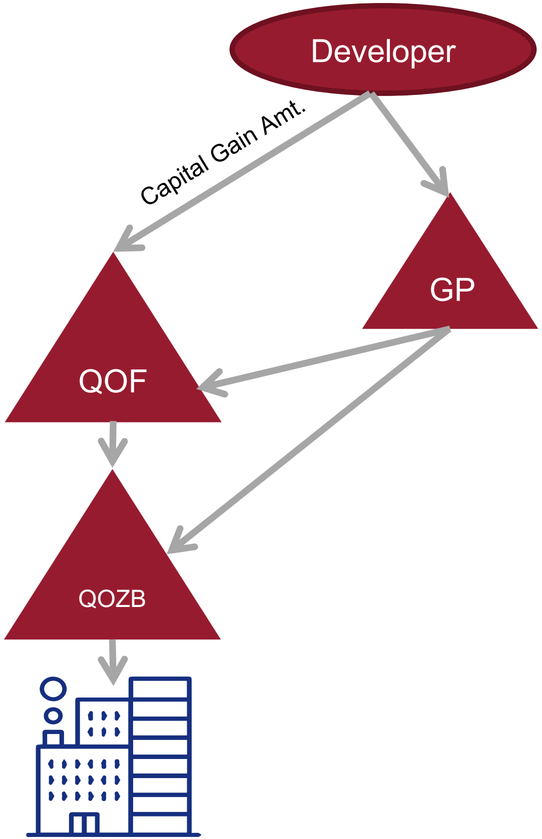
Example 1 – Investment in Ground-Up Real Estate Development

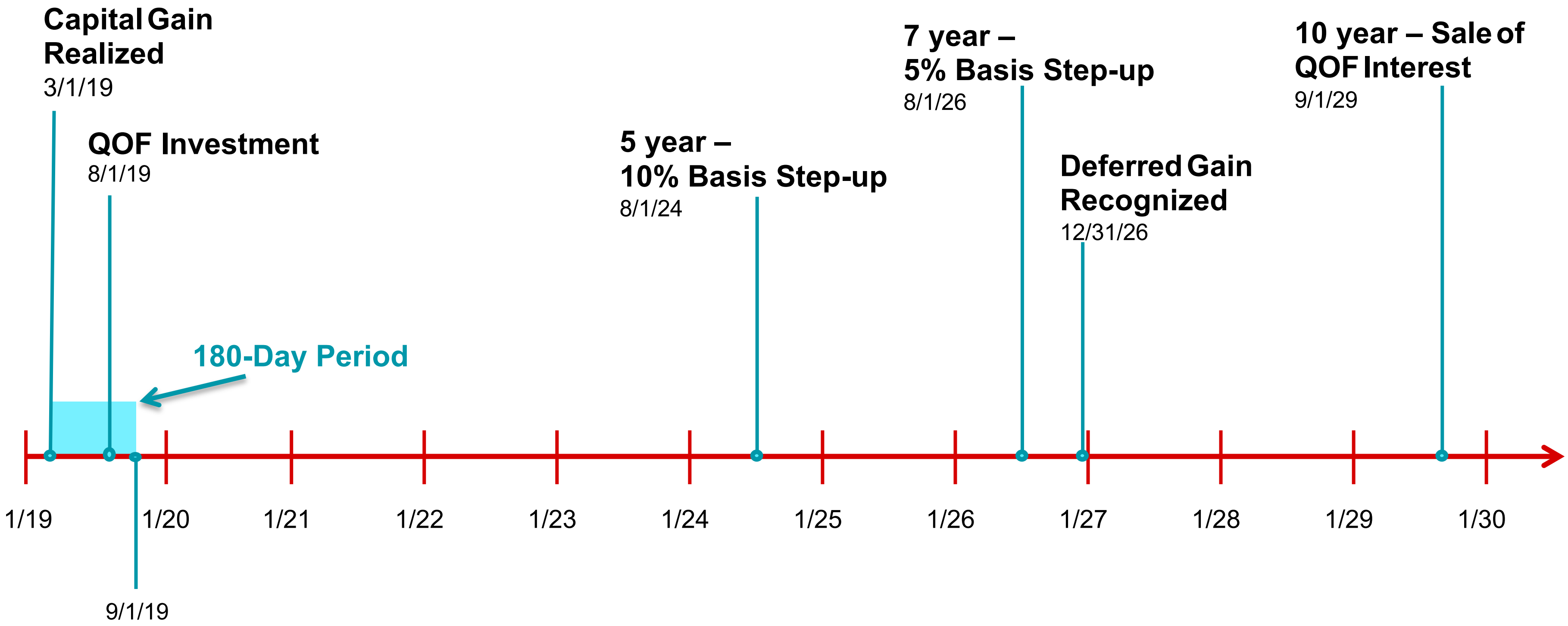


- On March 1, 2019, Developer, a real estate developer, recognizes a $1 million capital gain.
- On August 1, 2019, Developer invests the proceeds into a newly formed qualified opportunity fund ("QOF").
- On April 1, 2020, the QOF contributes $1 million into a newly-formed qualified opportunity zone business ("QOZB").
- On April 30, 2020, QOZB purchases land in a QOZ from an unrelated party for $50,000.
- QOZB borrows another $1 million and has a written schedule for a ground-up development of a commercial building that will be completed by March 31, 2022.
- What if Developer owned the land prior to January 1, 2018?
- What if Developer anticipated the project to take 4 years to complete?

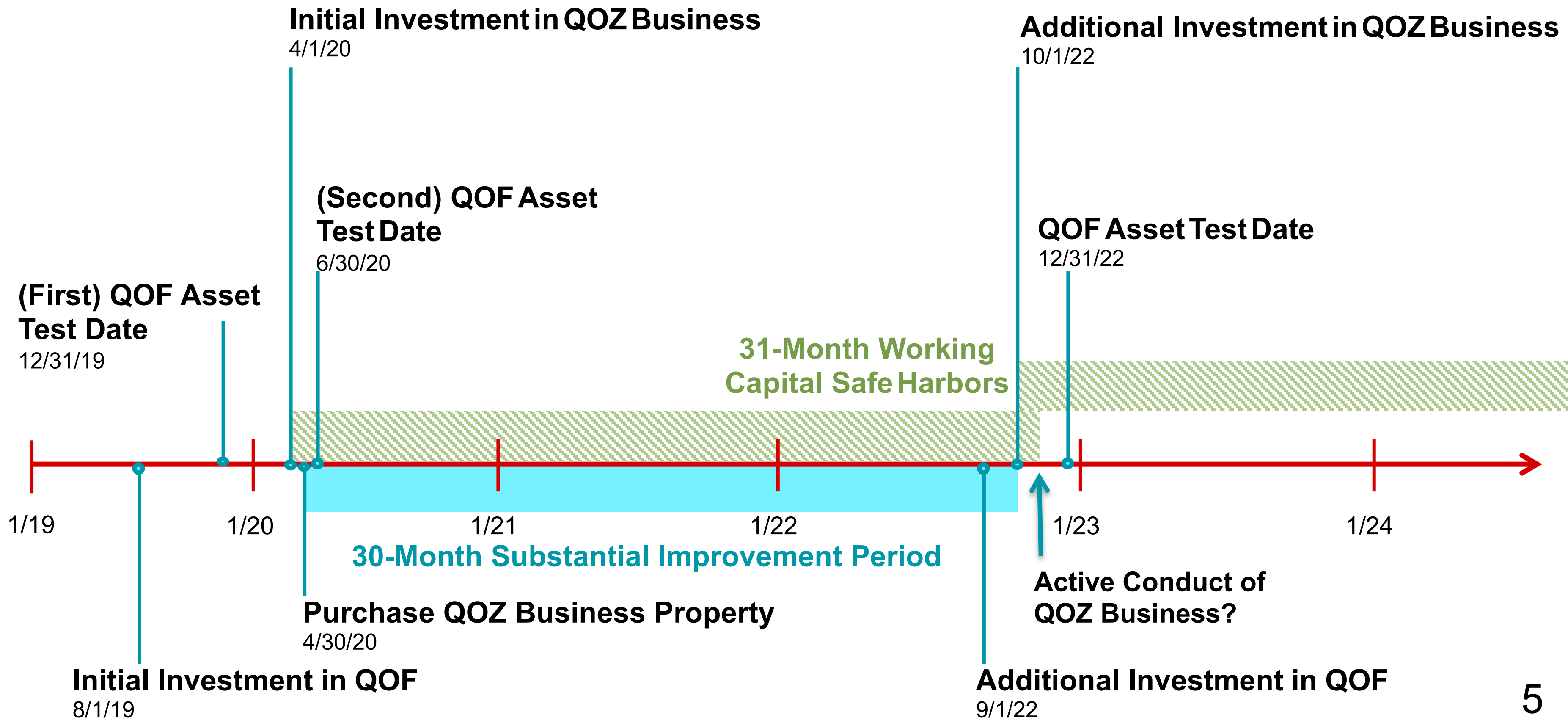
Example 1 – Considerations

- Investment timeline.
  - 180-day period for eligible gain.
  - 6-month option to disregard property contributed to QOF.
  - 30-month substantial improvement safe harbor.
  - 31-month working capital safe harbor.
- One vs. two tier structure.
- Application of 70% tangible property test.
  - What property counts?
  - Related-party limitations.
  - Lease work-around.
- Active conduct of a real estate trade or business.
- Treatment of operating income and distributions.
  - Flow-through of income and deductions.
  - Debt-financed distributions.

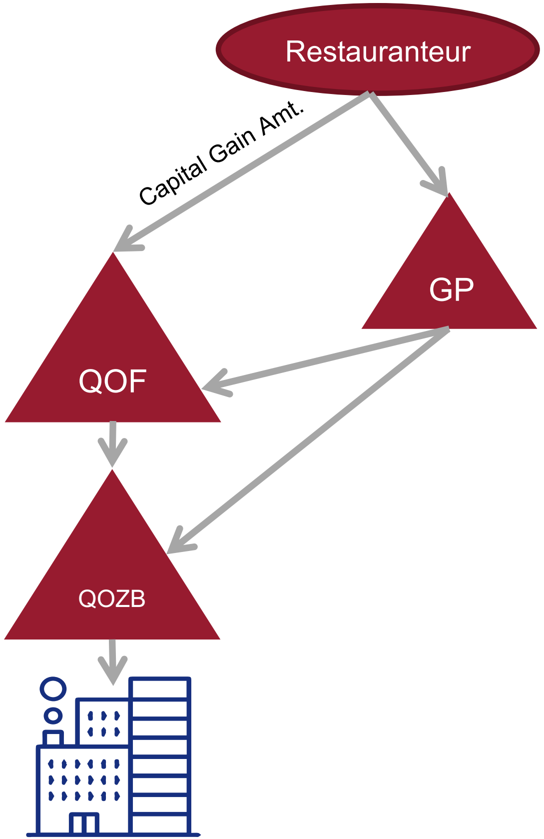
Investor Timeline



Investment Timeline



Example 2 – Investment in a New Operating Business

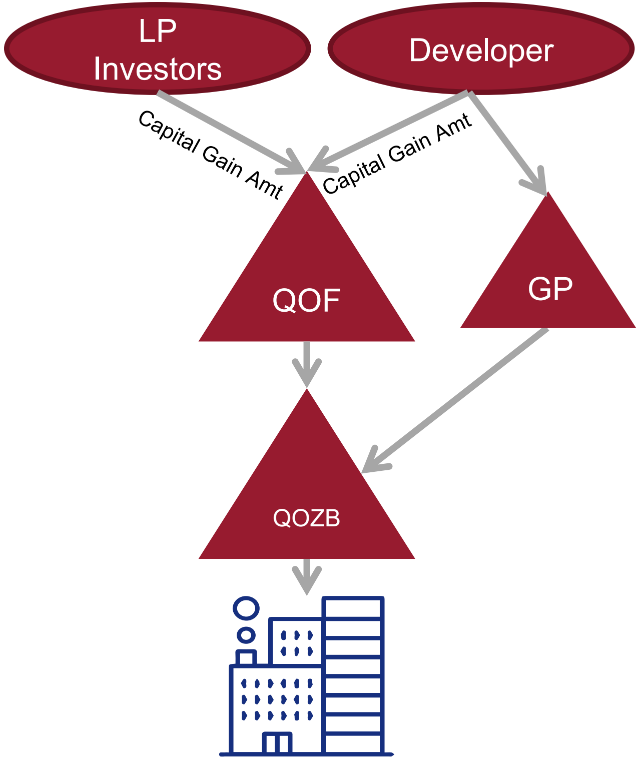


- The facts are similar to Example 1, except that QOZB invests in the creation of a restaurant located in a QOZ.
- With the $2 million contributed/borrowed, QOZB enters into a lease for space and builds it out, obtains the proper permits (including a liquor license), and purchases kitchen equipment, tables/chairs, and office equipment necessary to operate a restaurant.
- What if QOZB acquired an existing restaurant and renovated and expanded it?
- What if Restauranteur already operated the restaurant in the QOZ?

Example 2 – Considerations

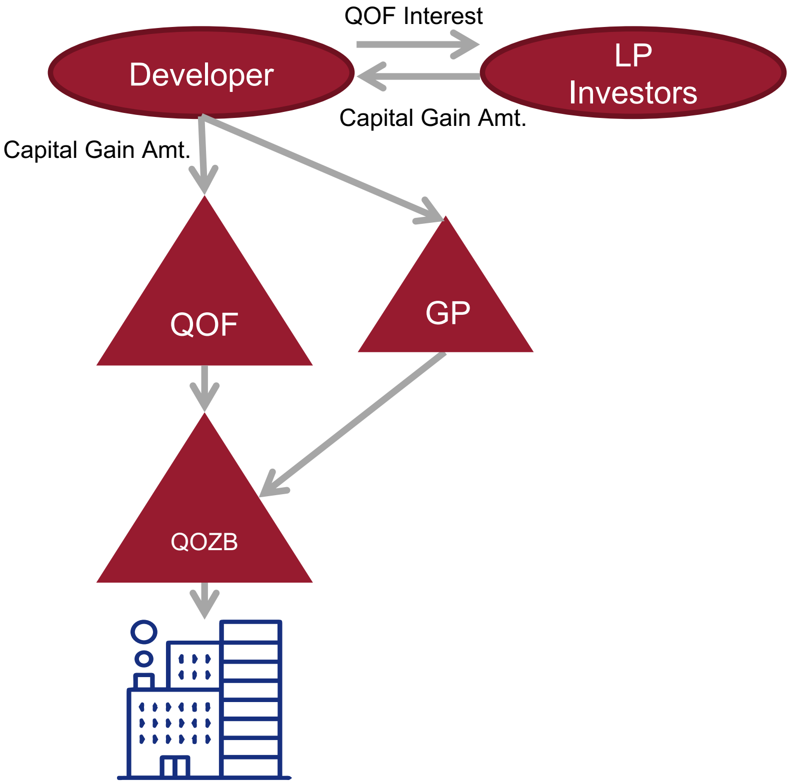
- Compliance with various tests is more challenging for an operating business than a real-estate development project.
- 70% tangible property test.
  - Original use vs. substantial improvement tests.
  - Application of substantial improvement test.
  - Property leasing rules.
- Gross income test – application of safe harbors.
- Sin business limitation.

Example 3a – Multi-Investor Fund



- The facts are similar to Example 1, except that Developer opens up the fund to investment from a range of other LP investors.
- What if some of LP investors are foreign?

Example 3b – Multi-Investor Fund via Secondary Sales

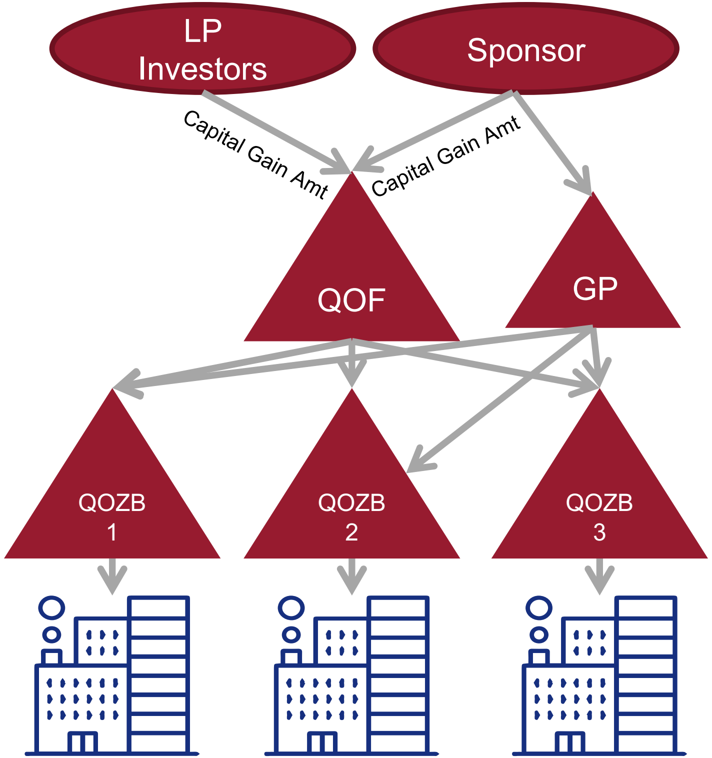


- The facts are similar to Example 3a, except that Developer forms QOF and sells QOF interests to LP investors as they recognize eligible gains.
- What if Developer's QOF interest is not an eligible interest?

Example 3 – Considerations

- Traditional funds vs. QOFs.
  - Additional pressure on investment timeline because timeline for raising capital from investors may not coincide with timeline for QOF to deploy capital.
    - Limitations on feeder funds/potential use of secondary sales (see Example 3b).
  - Investor time horizon.
  - Compliance costs.
  - Management compensation.
  - Planning interim distributions.
- Mixed-funds investments – contribution of eligible gains and non-eligible gains.
- Foreign investors – limitations on use of blockers.

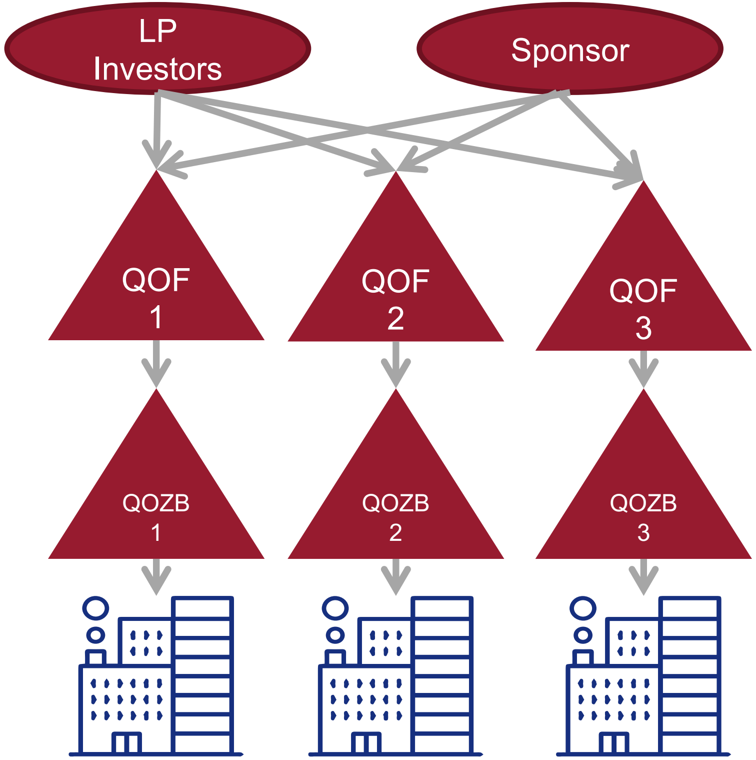
Example 4a – Multi-Asset Funds



- Sponsor establishes a QOF to invest in various businesses in various opportunity zones. These businesses could be real estate developments, operating businesses, or a combination of both.

- QOF will establish a separate QOZB partnership for each business in which it invests.

Example 4b – Multi-QOF Funds



- Sponsor plans to invest in various businesses in various opportunity zones. These businesses could be real estate developments, operating businesses, or a combination of both.

- Sponsor will establish separate QOFs (or a series partnership or LLC), and each QOF will establish a QOZB partnership, for each business in which it invests.

Example 4 – Considerations

- Exit Issues
    - Sale of QOF interest vs. sale of QOF assets vs. sale of QOZB assets.
    - Treatment of hot assets.
    - Exit before vs. after 10 years.