Using Unexpected Tax Incentives for Historic Preservation

1/30/2020

TODAY'S AGENDA

- Overview of Traditional Incentives
- Overview of the New Markets Tax Credit Program
- Overview of Opportunity Zones
- Case Study
- Keys to Success/Summary
- Q&A

WHAT ARE “TRADITIONAL” INCENTIVES?

TYPES OF INCENTIVES

- Non-Tax
  - Cash Grants
  - Forgivable/Low-interest loans
  - Real Property grants or cost reductions
  - Infrastructure grants or assistance
  - Property Assessed Clean Energy (PACE) Financing
  - Permit, development, and impact fee waivers
  - Job training grants or assistance
  - Utility rate reductions
- Tax Based
  - Sales and use tax exemptions / refunds
  - Property tax abatements / rebates
  - Mortgage recording tax exemptions
  - Payroll tax rebates / credits
  - Income / Franchise tax credits / exemptions
  - Gross receipts tax credits

TRADITIONAL INCENTIVES: INTENT

- Encourage:
  - Overall private investment
  - Investment in targeted areas
  - Creation or retention of jobs

- Increase Tax Base:
  - “Expanding the tax base” isn’t a fancy way of saying “increasing taxes.”

- To fill the “gap” between a viable and non-viable project
  - Project financing shortfalls

WHO PROVIDES THE INCENTIVES?

- City / Townships
- County / Parish
- State / Territory
- Federal
- Special Districts
- Economic Development Authorities
- Community Development Financial Institutions / Entities (CDFIs) / (CDEs)

DIFFERENCE BETWEEN FEDERAL AND LOCAL INCENTIVES

- Federal
  - Incentivize to promote National Interests
    - Energy efficiency & sustainability
    - Social Use of Government Assets
    - SME business growth
- Local
  - Job Creation
  - Incentivize to Promote Specific Industries
  - Incentive Geographically Targeted Areas:
    - Historic Districts
    - Opportunity Zones
    - Tax Increment Financing Districts

COMPLIANCE

Essential to realize the full value

- Majority (~50-65%) of incentives are never fully realized because of:
  - Overlooking / Misunderstanding Statute
  - Lack of implementation and /or
  - Failure to monitor future compliance requirements

COMPLIANCE CONT.

- Risks
  - Projected job creation numbers are not met
  - Wage criteria is not met
  - Projected capital expenditures are not met
  - Exit Strategy
- Approach the community immediately upon notice of potential shortfalls in agreement requirements
- Payback could be triggered years after the credit or incentive is received
  - Each clawback is individually tailored and may have different triggers
  - Review agreements carefully to determine full extent of potential clawbacks

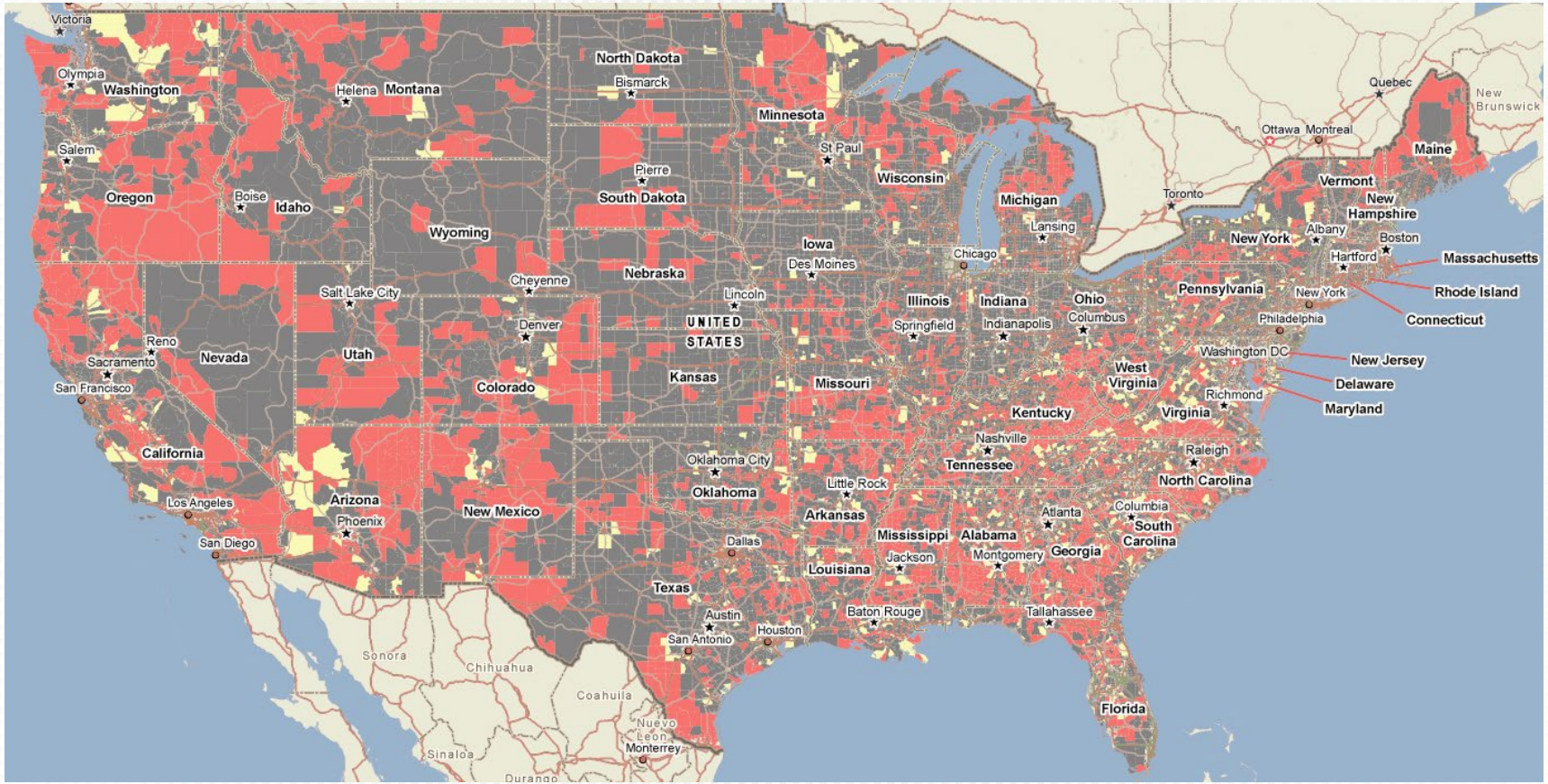
ULTIMATE BENEFIT

The Bottom Line

- Improved Return on Investment
- Enhanced Cash Flow
- Decreased Effective Tax Rate
- Increased Earning Per Share

WHAT IS NEW MARKETS TAX CREDIT (“NMTC”) FINANCING?

NEW MARKET TAX CREDITS



NMTC FINANCING

- NMTC financing is obtained through Community Development Entities ("CDE's")
- 1%-2% interest only loan (gap financing) with forgivable loan aspects after seven (7) years of compliance
- Offers upfront cash at the time of closing that can be used for:
  - New development
  - Expansions
  - Everyday capital expenditures
  - Operating expenses
- Provides an estimated 15%-20% pre-tax reduction in project costs
- The NMTC program was recently approved for a one-year, $5 billion extension as part of the Fiscal Year 2020 appropriations bill, H.R. 1865

HOW TO QUALIFY FOR NMTC FINANCING?

- Project must be located in a qualified census tract
  - All 50 States and US Territories qualify
  - Severely distressed census tract
  - Distressed census tract with secondary qualifier (e.g. metro, food desert, etc.)
- Project should meet the following conditions:
  - Creating new jobs or retaining existing jobs at the project location, or
  - Creating essential services for the residents of the qualified census tract
  - Cannot be a prohibited NMTC use (i.e. liquor store, golf course, massage parlor)
- Demonstrable “but for” argument for NMTC financing
- Other considerations
  - Underserved areas
  - State NMTC programs

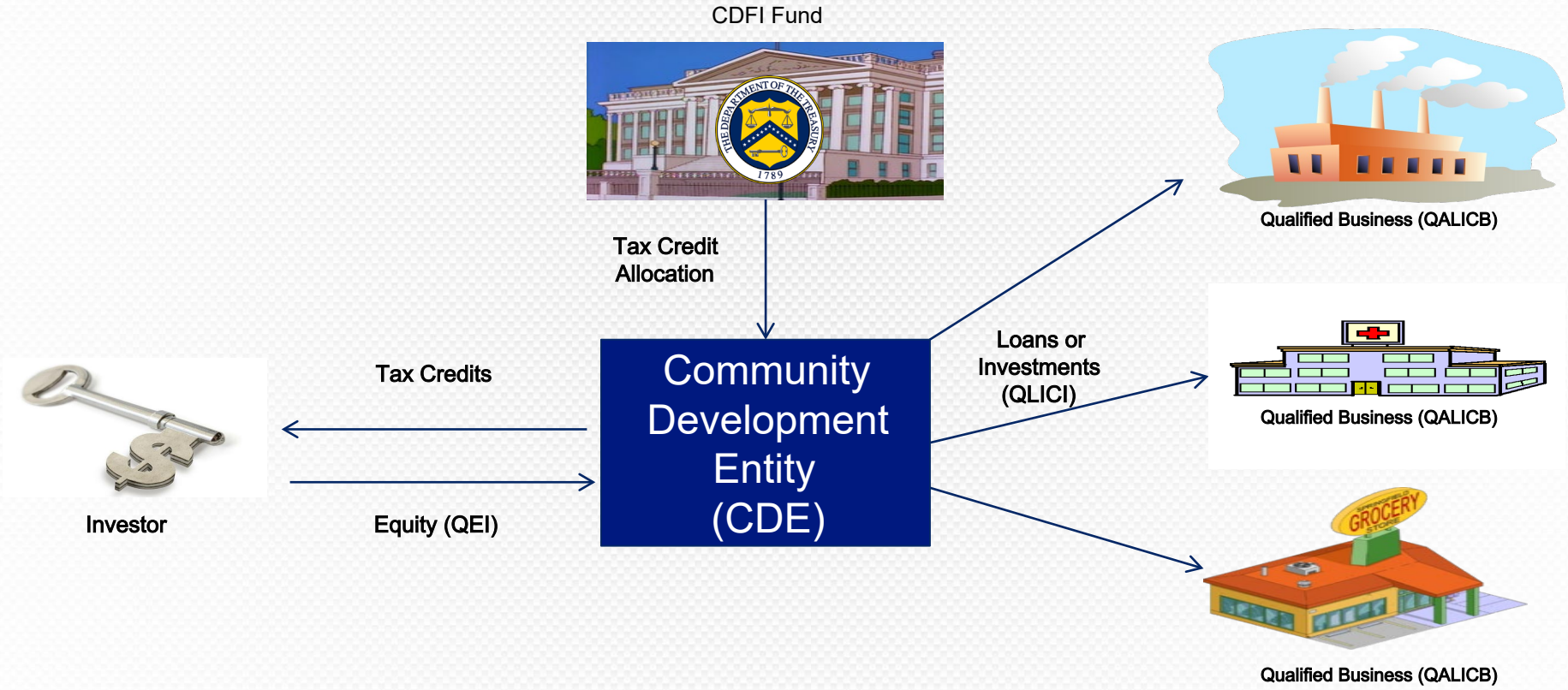
HOW TO QUALIFY FOR NMTC FINANCING CONT.

- Other Consideration
  - Targeted State / Territory / Areas – Florida, Georgia, Idaho, Kansas, Nevada, Tennessee, Texas, Virginia, West Virginia, Wyoming, Puerto Rico
  - Island Areas of the United States – America Samoa, Guam, Northern Mariana Islands, and US Virgin Islands
  - Federal Indian Reservations, Off-Reservation Trust Lands, Hawaiian Home Lands, and Alaska Native Village Statistical Areas

TYPES OF PROJECT

- By Industry
  - Grocery / healthy foods related
  - Healthcare
  - Manufacturing
  - Retail
  - Educational facilities
  - Community facilities
  - Mixed-use
    - Affordable housing requirement
- By Community Benefit
  - Job creation
  - Job retention
  - New / increased services
  - Increased revenue to low-income community
  - Energy efficient / Environmentally friendly

NMTC financing is obtained through Community Development Entities ("CDEs")



ANALYSIS OF THE NMTC BENEFITS: $12M INVESTM

Total Project Investment:		$12,000,000
NMTC Generated:		$ 4,680,000
NMTC Equity ($.85 discount rate) :		$ 3,978,000
Less Fees*:		
CDE Project Fees (5%)	($ 600,000)	
Legal Fees	($ 150,000)	
Financial Projections	($ 30,000)	
Upfront Fees	($ 780,000)	
Company Investment at closing	**$8,802,000**	
Closing Day– NMTC Benefit		**$3,198,000****
7 Years Worth of B Loan Interest Payments :	($ 560,000)	
Put Option:	($1,000)	
Final NMTC Benefit (pre-tax)		**$2,637,000**

RYAN NMTC SERVICES

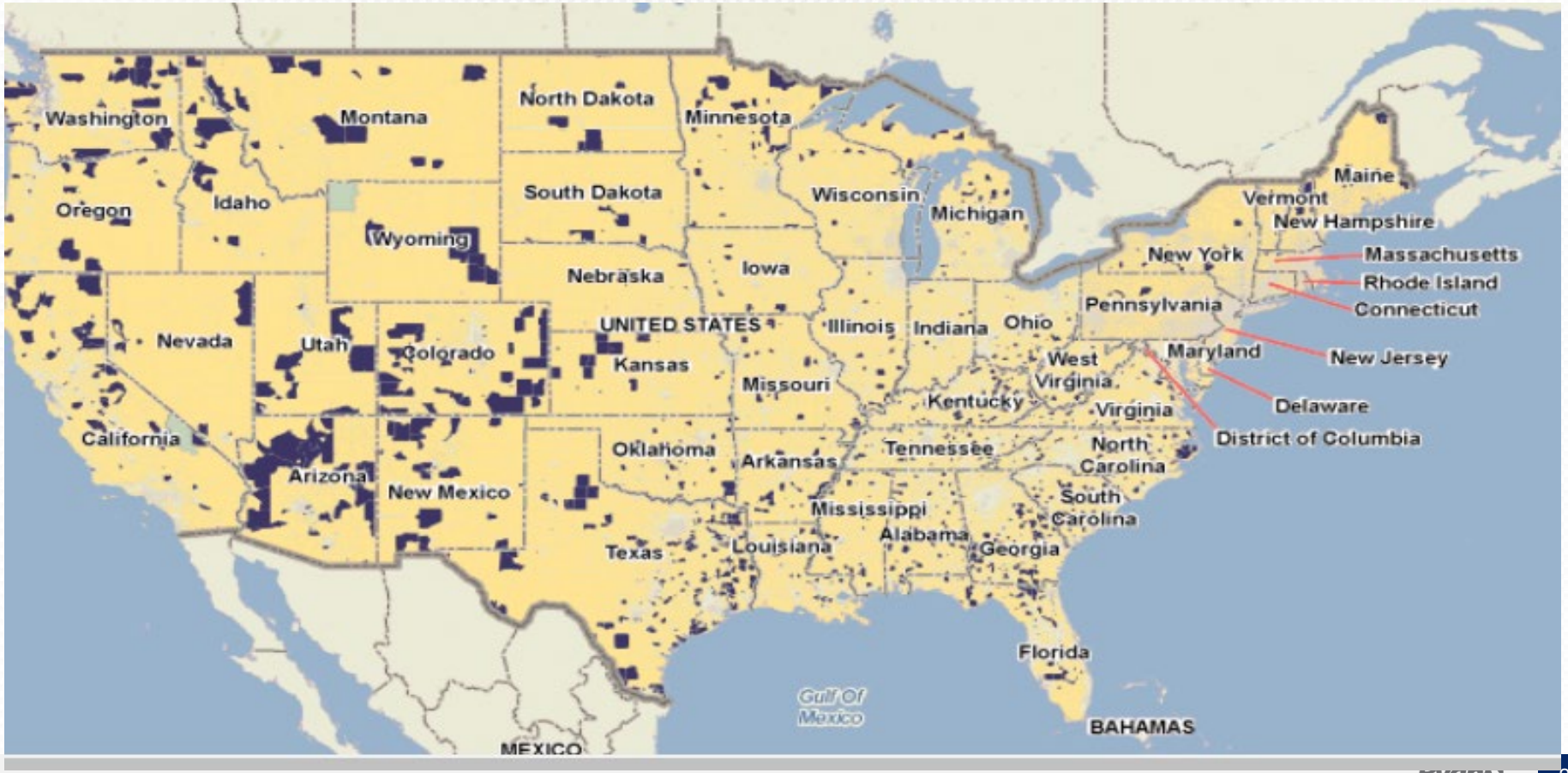
- Sourcing Allocation
  - Qualify all of your locations and potential projects for both federal and state NMTC programs
  - Find the best CDE partners with available allocation
- Negotiating Terms
  - Negotiate with investors and CDE's to maximize the NMTC benefit
  - Advise on the most appropriate NMTC structure for the transaction
- Closing Process
  - Minimize your time spent gathering and submitting the substantial amount of due diligence materials
  - Coordinate and lead the process for the fastest, easiest closing

RYAN NMTC SERVICES CONTINUED

- Post Closing Compliance
  - Assist/Advise on documentation and reporting requirements
  - Provide for an easy unwind of the NMTC transaction at the end of the seven (7) year holding period
- Additional Services
  - Assist with site selection and securing additional incentives (if available)

WHAT IS AN OPPORTUNITY ZONE?

OPPORTUNITY ZONES



QUALIFIED OPPORTUNITY ZONE PROGRAM

- Established in 2017 as a part of the Tax Cuts and Jobs Act of 2017
- Program is designed as a bipartisan solution to expand the geography of economic growth
- Designed to spur long-term private sector investments in low-income communities across the US
- Unlike NMTC, it is not a loan product. Specifically designed to channel more equity capital into overlooked markets

PLAYERS IN THE QUALIFIED OPPORTUNITY ZO PROGRAM

- Attorneys
  - NMTC
  - Tax
  - Real Estate
  - M&A
- Investors
  - Individuals
  - Corporations
  - Partnerships
  - Family Offices
- Industries
  - Retail
  - Hospitality
  - Healthcare
- Consultants
  - Accounting
  - Tax
  - Investment
- Department of Treasury
  - IRS
  - CDFI Fund
- Project
  - Developers
  - Business Expanding Locations

ELIGIBLE TAXPAYER

- Taxpayers that are eligible to defer gain under the OZ incentive program are those that recognize “capital gain” for federal income tax purposes.
- Individuals, C Corporations (including REITs and RICs), partnerships, common trust funds, and certain other types of entities should qualify.

QUALIFIED OPPORTUNITY ZONE FUND BENEFIT

- Taxpayers receive capital gains tax deferral (and more) for making timely investments in Qualified Opportunity Funds (QOFs), which invest in Qualified Opportunity Zone Property (QOZP)
- Taxpayers can self-certify as QOFs by filing Form 8996
- Tax Incentive Benefits
  - Gain Deferral
  - Partial Forgiveness
  - Forgiveness of Additional Gains

GAIN DEFERRAL

- Capital Gain Tax deferral ends upon the earlier of:
  - December 31, 2026

    OR
  - An earlier sale of the QOZP
- Depreciation recapture may be eligible for deferral; more IRS guidance is needed

PARTIAL FORGIVENESS AND FULL FORGIVEN OF ADDITIONAL GAIN

- Partial Forgiveness / Tax Reduction
  - Basis in QOF is initially deemed to be zero
  - If the investment in the fund is held for 5 years, there is a step up in basis in the QOF of 10% and up to 90% of the gain is taxed on December 31, 2026
  - If the investment in the fund is held for 7 years, there is an increase in the basis by 5 and up to 85% of the gain is taxed on December 31, 2026
- Forgiveness
  - If the investment in the fund is held for 10 years, there is step up in basis equal to the Fair Market Value of the investment
  - Forgiveness of gain on the appreciation of the investment
  - Requires an election

SAMPLE INVESTMENT

Jan 2, 2018
Taxpayer enters into a sale that generates $1M of capital gain

June 30, 2018
(Within 180 days), Taxpayer Contributes entire $1M of capital gain to the QOF

- Taxpayer is deemed to have a $0 basis in its QOF investment
- QOF Invests the $1MM in Qualified Opportunity Zone Property

2018 2019 2020 2021 2022 2023

June 30, 2023
(after 5 years, Taxpayer's basis in investment in QOF increases from $0 to $100k

June 30, 2025
(After 7 years), Taxpayer's basis in investment in QOF increases from $100k to $150k

Dec 31, 2026
$850k of the 1MM of deferred capital gains are taxed and the basis in QOF investment increases to $1MM

June 30, 2028
(After 10 years), Taxpayer sells its investment for $2.0MM. Basis in the investment is deemed to be FMV. The effect is no tax on appreciation in investment.

2023 2024 2025 2026 2027 2028

OPPORTUNITY ZONE TESTS

- 180 days from gain generated, you must have fund set up and the gains invested in the fund
- 180 days from starting the fund, you must have 90% invested
- 90% test must be completed by end of tax year

WAYS TO INVEST

- Invest into “property-specific” QOFs (Qualified Opportunity Funds) where a specific target within an OZ has been determined;

- Invest in QOF-focused or “zone-specific” OZs, which are focused on a specific geographic region and OZ. This option provides investors with a great deal of visibility into potential targets;

- Invest in general QOFs with potential targets across the entire U.S., essentially acting as a “purely blind pool” with discretion left to fund managers and real estate developers.

GAIN ISSUES

- The OZ incentive program provides gain deferral for only *capital* gains (however, depreciation recapture may be eligible for deferral; more IRS guidance is needed)

- The gain to be deferred must be gain that would have been recognized (assuming that deferral under the OZ incentive program were not permitted) no later than December 31, 2026.

- In the case of a taxpayer who made an election to defer with respect to some but not all eligible gains, the term "eligible gain" includes the portion of the eligible gain as to which no election has been made.

GAIN ISSUES CONTINUED

- The gain to be deferred must not arise from a sale or exchange with certain related persons. Generally, the OZ incentive program adopts the related party rules found in Sections 267(b) and Section 707(b)(1) of the Internal Revenue Code (the "Code"), except that it substitutes "20 percent" in place of "50 percent" each place it occurs in Sections 267(b) or Section 707 (b)(1). For example, a partnership and a person owning, directly or indirectly, more than 20 percent of the capital interest, or the profits interest of such partnership, are considered to be related parties.

- Except as otherwise provided for in provisions of the OZ incentive program, the first day of the 180-day period by which an investment of capital gains must be made into a QOF is the date on which the gain would be recognized for federal income tax purposes

CASE STUDY USING VARIOUS INCENTIVES

CASE STUDY: A TEXAS HOTEL DEVELOPMEN

- Rehabilitated / Preserved a vacant historic hotel
- Catalyst for revitalizing the area
- Paired resources to get the job done
- Created 100+ jobs in the process
- Successful operating real estate

CASE STUDY: A TEXAS HOTEL DEVELOPMEI

- Analysis of Local Incentives Process
  - Worked with local Economic Development Corporation
  - Sourced a grant based on increased sales / use tax collection
  - Worked with City to reduce future Property Taxes
    - Decreased operating expenditures, increased NOI

CASE STUDY: A TEXAS HOTEL DEVELOPMEI

- Analysis of Local Incentive Benefits

Incentives	Terms	Estimated Savings
Property Tax Abatement	10 Year 100% Property Tax Abatement (RP and BPP)	$5,000,000
Local Grant	Forgivable Grant	$3,000,000

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CASE STUDY: A TEXAS HOTEL DEVELOPMEI

- Analysis of Total Benefits on $30MM Project

Incentives	Estimated Savings
Federal HTC Equity	$3,772,000
State HTC Equity	$5,290,000
FederalNMTC Benefit	$3,198,000
Property Tax Abatement	$5,000,000
LocalGrant	$3,000,000
TotalIncentives	**$20,260,000**

Incentives	Benefits
Up Front Cash	$15,260,000
Operating Costs Reduction	$5,000,000

KEYS TO SUCCESS

Must bring in partners early and keep them informed

- Real Estate / Development
- Government / Media Relations
- Treasury
- Tax
- HR
- Accounting / Finance
- Executives
- Store / Facility Managers (compliance)
- Purchasing

REALIZE THAT FREE MONEY ISN'T "FREE"

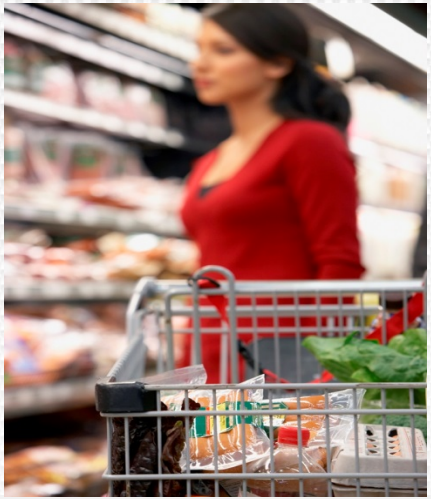
Compliance – Most incentives come with compliance items and promises you'll need to live up to.

The "But For" – When current sources of funding are needed to get the project across the finish line.

The Governments motivation? Jobs, catalytic investment, or increased services…

Jobs

Grocery



Housing

SUMMARY

- Understand that many types of State and Federal credits, incentives and financing programs are available depending on the project
- Find a good governmental partner
- Remember that incentives are the tail, not the dog

Incentives can increase your ROI dramatically, and be an invaluable part of a company's growth strategy.

Q & A

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