SteelBridge Insights

SPECIAL EDITION: Opportunity Zone Fund Quick Facts

SteelBridge

Overview

We recently released an in-depth exploration of what makes a Qualified Opportunity Zone (QOZ), Qualified Opportunity Fund (QOF), and a QOZ Business. Here, the SteelBridge team provides some key facts and figures as a quick reference guide. Additionally, we have received extensive feedback regarding how a QOF would look in an earlier-stage fund such as emerging managers and venture capitalists. Here, we provide an overview of that structure and answer some additional questions.

Key Facts & Figures

- 70% of a QOF's assets must be invested in a QOZ
- 70% of a QOZ Business's operations must be in a QOZ
- 50% of a QOZ Business's income must come from QOZ activity
- 5% is the limit for a QOZ Business's "Nonqualified Property" (e.g. cash or stocks)
- 31 months from investment, a QOZ Business must have put invested capital to work
- 6 months from realizing capital gains, investors must have invested in a QOF
- 5 /7/10 years are the milestones for investors to remain in the fund to receive a step-up in basis for tax forgiveness

Treatment of Debt

Debt is viewed through two lenses: Inbound (the QOZ Business is a debtor) and Outbound (the QOZ Business is a creditor/lender).

Inbound Debt

- The QOZ Business can hold an unlimited amount of this debt *provided it doesn't violate the 5% Working Capital Test*. To avoid any such issues, we suggest writing a "working capital plan" for any inbound debt instruments.

Outbound Debt

- There are two restrictions on outbound debt to avoid violating the 5% Nonqualified Property Test.
  - Debt instruments with terms of 18 months or less (viewed as liquid)
  - Debts effectively considered Accounts Receivable in the QOZ Business's accounting

Treatment of Revenue

The treatment of QOZ Business revenue remains an open item. If a QOZ Business, for example, completes a sizable sale, how will this influx of capital be treated when meeting the 5% working capital test? This scenario is especially troubling for startups or early stage companies, where one new client can markedly change forecasts.

We are therefore hoping to see capital generated or obtained by active trade or business conducted by the QOZ Business in the QOZ be exempt from 5% reasonable working capital test.

Additionally, for purposes of developing a plan, we hope to see that a startup or early-stage company's fundraising documents, including but not limited to pro forma financials, cap tables, and revenue projections, be considered a 31-month working capital plan.

What's Next?

There are still many questions in this highly-specific part of a burgeoning field. For instance, what happens if an early-stage company receives a subsequent round of investment? How quickly must the capital be deployed, and for what purposes can it be used?

These questions have arisen mostly from VC firms intending to fund companies in QOZs that are not as heavily focused on PPE, such as software and service firms. When the regulations were still in the commentary period, we raised them directly to the Treasury Department as well as congressional offices who were intimately involved in drafting the original legislation.

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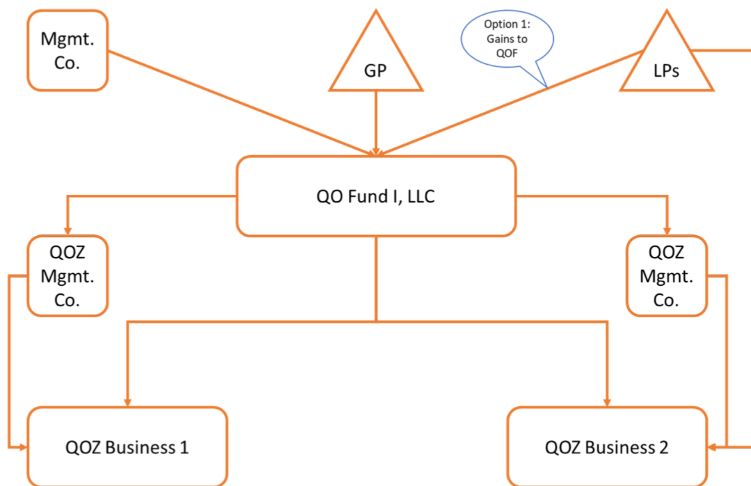
The Early Stage Conundrum

Among the many outstanding questions concerning QOFs, one consistently arising is how early-stage investors will be treated. In other words, how will venture capital groups and "bootstrapped" startups be able to enjoy the benefits of opportunity zones? After conducting several analyses and speaking with legal minds specializing in OZs, our team has developed the sample structure shown here.



Under this structure, investors are presented with two options:

1. Invest realized gain dollars through the QOF
   i. Subject to all QOF/QOZ Business requirements

2. Invest non-gain dollars directly in the QOZ Business
   i. Subject to the QOZ Business meeting its 5% working capital and 31-month deployment requirements

Fundraising and Capital Flow

As capital is injected into a QOZ Business through the structure above, the question arose around deploying that capital without disqualifying the QOZ Business. It is our recommendation, as shown below, that each subsequent round a startup takes carry with it a new 31-month plan to put that capital to work. Since these rounds frequently overlap (e.g. Series A capital is not fully utilized when a Series B investment is made), regulators would have the ability to view investment rounds individually while preventing a QOZ Business from exceeding its 5% working capital thresholds