



TRI-STATE Opp Zone, P3 & Angel Investing FORUM

Date: Tuesday, June 4, 2019

Location: Ashland, Kentucky

Presenters: Stephen Lukinovich, MCM
Chris Coffman, FBT
Mike Shull, FBT

Agenda

- Highlight General Opportunity Zone Rules
- Highlight October, 2018 - 1st Round Proposed Regulations
- April 17, 2019 - 2nd Round Proposal Regulations
- Public-Private Partnerships
- Questions
- Closing Remarks / Adjourn



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Opp Zone, P3
& Angel Investing
FORUM

Opportunity Zones

What is a Qualified Opportunity Zone (QO Zone)?

- Enacted as part of sweeping federal tax legislation commonly referred to as the Tax Cuts and Jobs Act of 2017.
- Internal Revenue Code (IRC) Section 1400Z-2 provides significant tax incentives for taxpayers to reinvest unrealized capital gains in certain property and businesses located or operating in low-income census tracts that Treasury has designated as qualified opportunity zones (“QO Zone”).

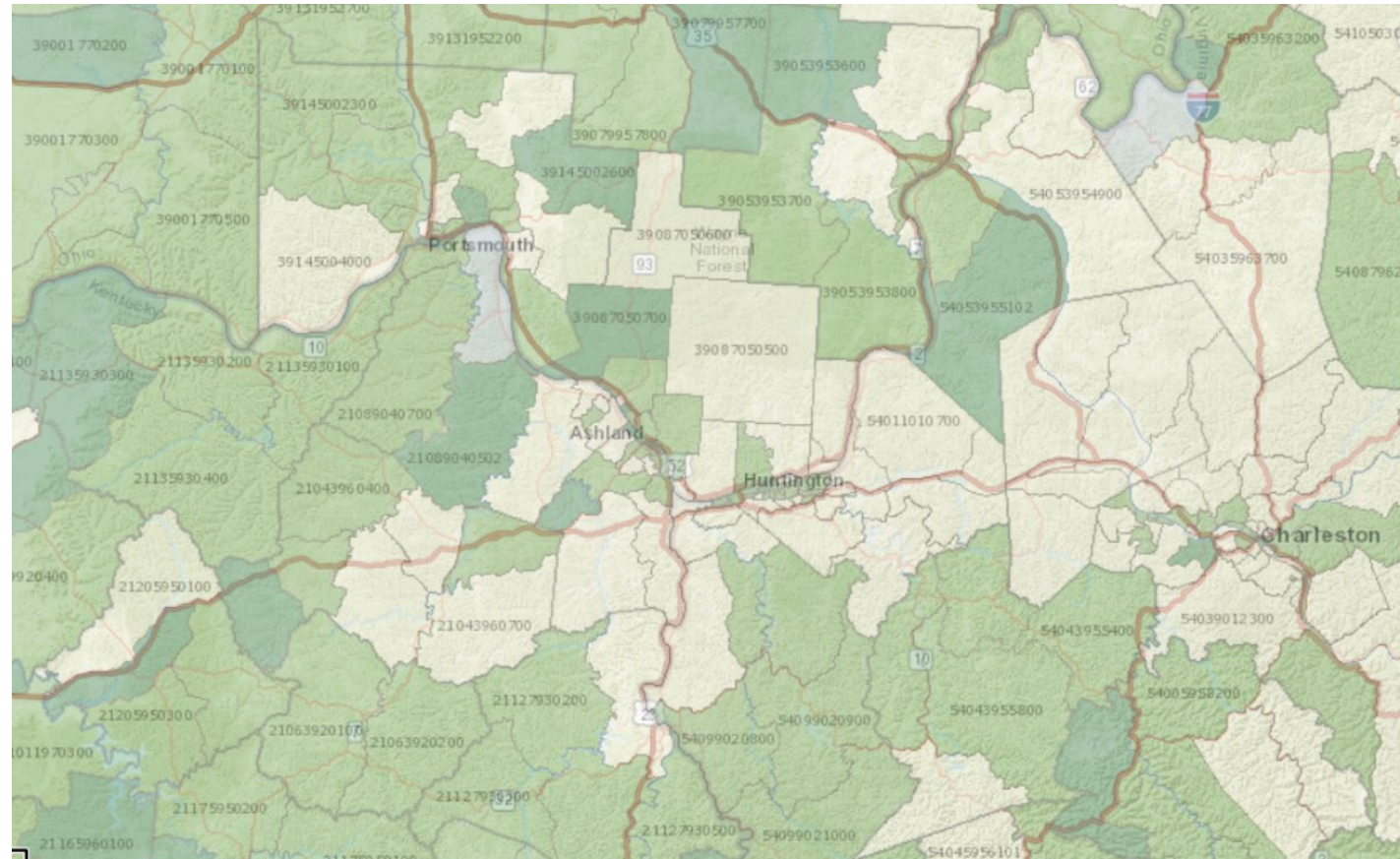
What is a Qualified Opportunity Zone (QO Zone)?

- Census tract determined to be a low-income community.
- Low-income census tract has individual poverty rate of at least 20% and median family income no greater than 80% of the area median.
- Governors of each State nominated eligible low-income census tracts and contiguous tracts. In each state, only 25% of qualified low-income census tracts could be designated as Opportunity Zones. Only 5% of the designated Opportunity Zones could qualify as contiguous tracts.
- The Department of the Treasury then designated the census tracts nominated by each state as QO Zones.
- QO Zones retain designation for ten years – proposed regulations provide that “permanent exclusion” election can be made until 12/31/2047

Opportunity Zones – Interactive Map

- An interactive map that permits the user to zoom in on specific addresses, census tracts, and opportunity zones across the country can be found at the following link:
 - https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml
- An interactive map and general opportunity zone updates and information can be found at the following link:
 - www.midwestoppzone.com

Opportunity Zones – Interactive Map



QO Zones – What are the Incentives?

- Investment incentives a taxpayer can elect to take advantage of with respect to their Opportunity Zone investment:
 1. Up to 7 year temporary deferral of capital gain invested in an Opportunity Zone Fund, through 12/31/2026, taxed 85%
 2. Permanent exclusion of gain on appreciation – 10 year hold

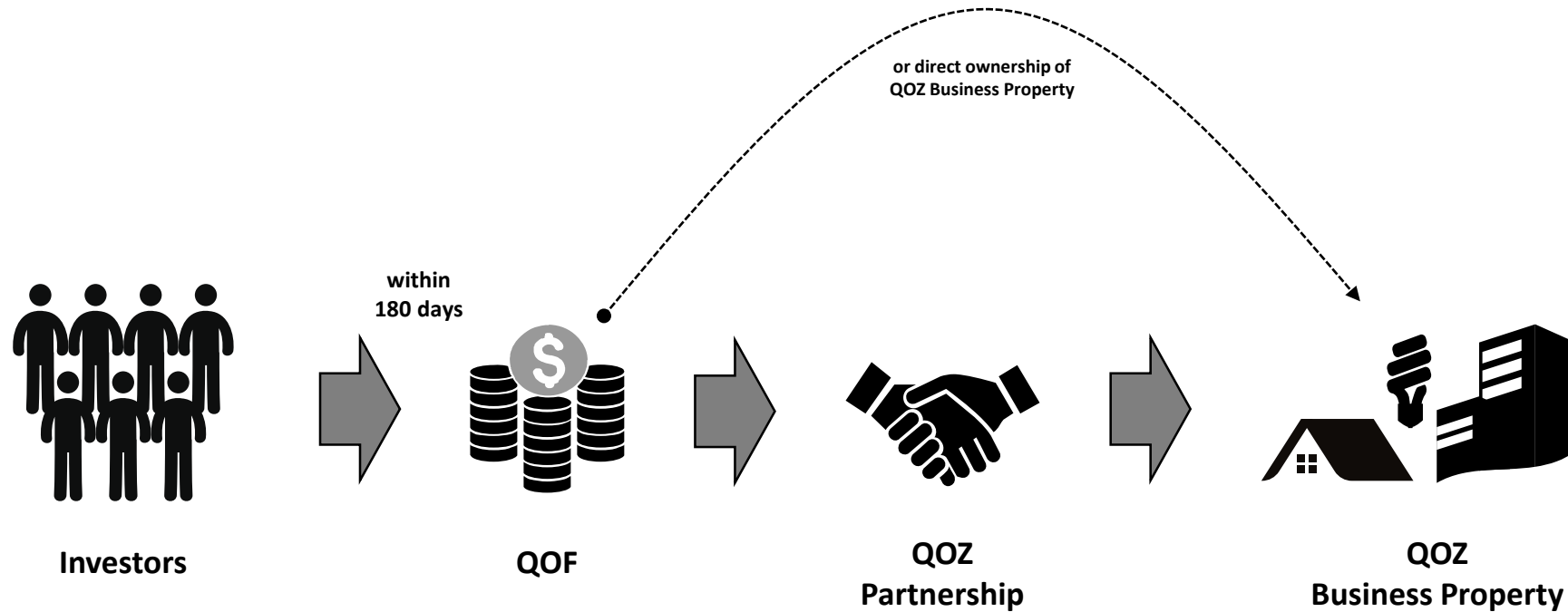
QO Zones Incentive – Temporary Deferral

- Gain deferral is temporary because the taxpayer must recognize the income in the tax year the investment is sold or the tax year that includes December 31, 2026, whichever is earlier.
- Treasury released guidance in the form of an FAQ indicating that a taxpayer can make an election to defer gain when it files a federal income tax return in the year gain would have been realized:
 - Taxpayers will use Form 8949 - elect to defer gain
 - Fund uses Form 8996 – self certify Fund: 90% test – six month rule

QOZ Business Property – Related Party Restriction

- To qualify as QOZ Business Property, the QO Fund or QOZ Business can only acquire the property from an **unrelated party**.
 - Unrelated party = less than 20% common ownership
- Property that a QO Fund or QOZ Business purchases in a transaction involving certain prohibited relationships such as individuals from the same family, entities related through common ownership or control, or entities from the same controlled group, may **NOT** be considered QOZ Business Property.

Basic Model for Rental Real Estate



Rental Real Estate

- New construction, or
- Substantial improvement of adjusted basis of building excluding land

October, 2018 - 1st Round Proposed Regulations

- **Existing Real Estate**
 - Real Estate Acquisition - Improve Building > 100%
 - Do not need to improve land
 - Rev. Rul. 2018-29
- **70% - 30% Test**
 - 70% of tangible property owned or leased by the operating business must be qualified opportunity zone business property.
- **50% Revenue Test**
 - Trade or Business – “Active Conduct” – 50% of gross income derived from within an Opportunity Zone

October, 2018 - 1st Round Proposed Regulations

- **Eligible Gains**
 - Long-term or short-term capital gains, including Section 1231 gains – does NOT include Section 1245 or Section 1250 ordinary recapture gains
- **Capital Gains Inside** Partnership, Trust or S-Corporation - “pass-through entity”
 1. Roll-over gain - 180 days, Entity level, or
 2. Partner/Shareholder/Beneficiary level – roll-over gain 180 days: date of gain or 12/31

April 17, 2019 - 2nd Round of Proposed Regulations

- 50% Gross Income Test

1. To be a QOZB, corporation or partnership must derive at least 50% of its total gross income from the active conduct of a trade or business within a QOZ.

2. 3 Safe Harbors and a facts and circumstances test for evaluating compliance.

- (a) 50% of the services performed (based on hours) for such business by its employees and contractors are performed within the QOZ;

Example: startup business develops software applications for global sale at campus located in an OZ.

- (b) 50% of the services performed (based on amounts paid)

Example: startup business uses non-OZ service center. More employee hours at service center, but 50% of total compensation is for services performed on the OZ campus.

- (c) Conjunctive test – Tangible property located in and management or operation functions of QOZB performed in QOZ are necessary to generate 50% of gross income.

Example: landscaper's headquarters and equipment storage in QOZ.

April 17, 2019 - 2nd Round of Proposed Regulations

- What if property held by an Opp Fund is sold, triggering capital gains – is the rollover gain tax free?
 - No - the gain on property held by the Opp Fund must be taxed – no authority
 - However, can hold cash for 12 months and rollover into eligible property – “reasonable period of time to reinvest” – extension for delay based on government inaction
 - 12 month period protects against blowing 90% test.
 - Appears to be limited to QOF’s sale of qualifying property and reinvestment – what about sale of assets by QOZB?

April 17, 2019 - 2nd Round of Proposed Regulations

- Statute imposes **“original use”** requirement for both real property and tangible personal property – tangible property acquired by purchase must have its “original use” in a QOZ commencing with a QOF or QOZB, or be substantially improved, in order to qualify for tax benefits.

Issues

- Can tangible property be used property, or must it be new property? Does property previously placed in service in the OZ for one use, but now placed in service for a different use, qualify?
- May property used in the OZ be placed in service in the same OZ by an acquiring, unrelated purchaser?

Answer

- “Original use” of tangible property acquired by purchase by any person begins on the date when that person or a prior person first places the property in service in the qualified OZ for purposes of depreciation or amortization (or first uses the property in the OZ in a manner that would allow depreciation or amortization if that person were the property’s owner) – issuance of CO?

April 17, 2019 - 2nd Round of Proposed Regulations

- Tangible property located in an OZ that is depreciated or amortized by a taxpayer other than the QOF or QOZB would not satisfy the original use requirement. – Conversely, tangible property (other than land) located in the OZ that has not yet been depreciated or amortized by a taxpayer other than the QOF or QOZB would satisfy the original use requirement.
- **Used tangible property** will satisfy the original use requirement with respect to a OZ so long as the property has not previously been used within that OZ in a manner that would have allowed it to be depreciated or amortized by any taxpayer.

April 17, 2019 - 2nd Round of Proposed Regulations

- “Substantially All”
 - Prior regulations (October 29, 2018) – at least 70% of the tangible property owned or leased by a trade or business is QOZB property. 70% threshold was limited to this specific “substantially all” test.
- Other sections also use phrase “substantially all”
- During substantially all of the QOF’s holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.
- During substantially all of the QOF’s holding period for QOZ stock or QOZ partnership interests, such corporation or partnership qualified as a QOZB.
- New regulations provide that: (1) substantially all requirement regarding “use” is satisfied if at least 70% of the use of such tangible property is in a QOZ; (2) substantially all requirement regarding the “holding period” is defined as 90%.

April 17, 2019 - 2nd Round of Proposed Regulations

- Profits Interest Partners – Opportunity Zone Fund

- Can an investor receive a profits interest in an Opportunity Zone Fund in exchange for services?
 - Profits interest partner ineligible for Opportunity Zone incentive/benefit
- What about a low basis Opportunity Zone investor?
 - Small capital/equity interest in Opportunity Zone partnership

April 17, 2019 - 2nd Round of Proposed Regulations

- Property Owners/Landlord - No Triple Net Leases. Not considered a trade or business – some active management role required. – trade or business defined within the meaning of IRC section 162.
 - Ownership and operation (including leasing) of real property used in a trade or business is treated as the active conduct of a trade or business for OZ purposes – not intended to apply to the meaning of “active conduct of a trade or business” in other IRC Sections.
- 5 year Test – Vacant/Unused Property – Considered original use – great news!
 - Although no substantial improvement is required, vacant property must be used in a trade or business (as defined within the meaning of IRC Section 162) of a QOF or QOZB.
 - Must make new capital investment in the property or increase the economic activity or output of the property – not solely for investment

April 17, 2019 - 2nd Round of Proposed Regulations

Unimproved Land

- Rev. Rul. 2018-29 - Can unimproved land be considered QOZB property? Land can be treated as QOZB property **ONLY** if it is used in a trade or business (as defined within the meaning of IRC Section 162) of a QOF or QOZB.
- Holding of land for investment does not give rise to a trade or business and such land could not be QOZB property.
- QOF or QOZB should make new capital investment in the land or increase the economic activity or output of the land. –
 - Example: QOF's acquisition of land currently used entirely by a business for the production of an agricultural crop – no new investment or increased economic output = no tax incentive.
- If a significant purpose for acquiring unimproved land was to achieve an inappropriate tax result – general anti-abuse rule treats the acquisition of the unimproved land as an acquisition of non-qualifying property. – prevent abusive transactions such as “land banking.”

April 17, 2019 - 2nd Round of Proposed Regulations

Lease Items

- **Uncertainty Under Previous Guidance**
 - 70/30 test required threshold amount of QOZB property either owned or leased.
 - Statute defined QOZB property as “purchased”.
 - **ISSUE** – Could leased tangible property be treated as QOZB property?
- **Leased Tangible Property Can Qualify**
 - Lease entered into after 12/31/2017
 - Substantially all of the use of the leased property must be in the QOZ.
 - Market-Rate Lease – arms length terms consistent with market (IRC § 482).
 - No “original use” requirement = No requirement to substantially improve

April 17, 2019 - 2nd Round of Proposed Regulations

Lease Items

- **Related Party Rent is appropriate**

- Must be Market Rate Lease – terms arms-length, consistent with market
- No prepayment for a period of use exceeding 12 months
- Personal property - acquire qualified property > lease value within 30 months
- General anti-abuse provision – intent to avoid “substantial improvement”

- **Value Lease Arrangements**

Value of lease eligible for purposes of meeting the 90% and 70%/30% tests – “present value” = sum of the present values of the payments to be made under the lease.

- **Improvements to Leased Property**

Satisfy the original use requirement and are considered purchased property

April 17, 2019 - 2nd Round of Proposed Regulations

Accelerating Investor Deferred Capital Gain

- **General Rule**

Deferred gain recognized on the earlier of disposition of qualifying investment or 12/31/26

- **Transfer by Gift of a Partner's Ownership Interest**

However, transfer by gift to grantor trust and taxpayer is the deemed owner – no inclusion event

- **Distributions in Excess of Partner's/Shareholder's Basis**

For a Partnership - includes eligible debt Basis: QNR and Recourse Debt

- **Dissolution of the Opportunity Zone Fund**

- **Claim of Worthlessness by an Opp Zone Investor**

- Transfer by reason of Death – From deceased Estate – no inclusion event
- Contribute membership interest to another partnership, unless upper tier

April 17, 2019 - 2nd Round of Proposed Regulations

QOF Investments held at least 10 years

- **General Rule**

- Where the taxpayer sells or exchanges a qualifying investment held for at least 10 years, the taxpayer can make an election to adjust the basis to FMV.
- Fosters sale of QOF assets rather than equity interest in QOF.

- **Special Election Rules for QOF Partnerships**

- Basis of the partnership interest is adjusted to an amount equal to the FMV of the interest including debt.
- Immediately prior to the sale the basis of the QOF partnership assets are also adjusted.
- Regulations do not address whether a QOZB is entitled to make the same election.

April 17, 2019 - 2nd Round of Proposed Regulations

QOF Investments held at least 10 years

- If a taxpayer holds a qualifying investment for at least 10 years, and the QOF partnership or QOF S corporation disposes of QOZ property after the 10 year period:
 - The taxpayer may make an election to exclude from gross income some or all of the capital gain arising the disposition reported on the QOF's K-1 and attributable to the qualifying investment.
 - Again, the regulations do not address whether a QOZB is entitled to make the same election.

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Partnership Distributions

- **General Rule**
 - Actual or deemed distribution of property is an inclusion event to the extent the distributed property has a FMV in excess of the partner's basis.
- **Reduction in Investment – Disguised Sale**
 - A transfer to a partnership will not be treated as an eligible investment to the extent the partnership makes a distribution to the partner and the transfer to the partnership and the distribution would be recharacterized as a disguised sale.
- Distributions that a QOF partnership makes to its partners that are made more than 2 years after the investors' contribution and that do not exceed the investors' basis will likely not be an inclusion event.

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Eligible Investments in Opportunity Zone Fund

- **Section 1231 Gains – 180 day rollover period begins last day of taxable year**
Not a good answer if looking to make roll-over sooner – could slow investment for some taxpayers even where the taxpayers do not anticipate any 1231 losses.
- **Need to watch Section 1231 ordinary Gains, including 5 year look back**
- **Regulations are Proposed – Depart from this position?**
Can you bifurcate Section 1231 Gains – Ordinary (ineligible for incentive – taxable) and Capital Gains (eligible for Opportunity Zone incentive)

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Eligible Investments in Opportunity Zone Fund

- **Contributed Property counts!**

Not just cash!

Only Adjusted Basis of Property counts

Contributed property will not be a good asset in the Fund

- **Property can transfer to a Opp Fund – fully taxable transaction – gain ineligible for Opportunity Zone incentive**

Gain from sale of property to QOF in exchange for equity interest in QOF is not eligible for deferral.

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- **Qualified Opp Zone investor can sell ownership interest to another Qualified Opp Zone investor**
- **For purposes of Original Use – when taxpayer depreciates property**

Only Adjusted Basis of Property counts

Contributed property will not be a good asset in the Fund

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Miscellaneous

- Real Property Straddling a QO Zone – may be considered in the QOZ if the cost of the real property inside the QOZ is greater than the cost of the real property outside the QOZ.
- Inventory in Transit - Proposed regulations clarify that inventory (including raw materials) of a trade or business does not fail to be “used” in an OZ solely because the inventory is in transit from a vendor to a facility of the trade or business that is in an OZ, or from a facility of the trade or business in an OZ to customers located outside the OZ. Inventory in transit at testing period does not count against the QOF or QOZB regarding substantially all (90%) of the “use” was in an OZ.
- No Aggregation for Substantial Improvement Purposes - The determination of whether the substantial improvement requirement is satisfied for purchased tangible property is made on an asset-by-asset basis. No aggregate approach for substantial improvement of property grouped by the same location.

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Miscellaneous

- Use of Intangibles – For purposes of determining whether a substantial portion of intangible property of a QOZ Business is used in the active conduct of trade or business, the term “substantial portion” means at least 40 percent.
- Working Capital Safe Harbor – 2 changes to “safe harbor” – (1) written designation for planned use of working capital now includes development of trade or business, and (2) exceeding 31-month period does not violate the safe harbor if the delay is attributable to waiting for government action – application for such action completed during 31-month period.
- Relief for Newly Contributed Assets – QOF allowed to apply 90% test without taking into account any investments received in the preceding 6 months.

Public-Private Partnerships



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No True Consensus Definition of a P3

- Federal Highway Act:
 - “A contractual relationship between the public sector and a private sector company designed to deliver a project or service that traditionally is carried out by the public sector.”
- Canadian Council for Public Private Partnerships
 - “A cooperative venture between the public and private sectors, built on the expertise of each partner, which best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards.”

Categories of P3s:

- **Economic Development:** Partnerships designed to spur economic activity (including tourism), or to make an otherwise private project feasible.
- **Infrastructure:** Partnerships to turn the operation of public asset (and the maintenance and risk involved) over to a private entity.
- **Infrastructure:** Partnerships to provide a piece of traditionally public infrastructure via private means.

P3: Economic Development -- KFC Yum! Center

Public:

State/Metro: Tax Increment Financing
Louisville Metro: Annual Payment

Quasi-Public:

ULAA Annual Lease Payment
PARC Garage

Private:

AEG Management + Guarantee
Naming Rights + Sponsorships
Concessions Agreements



P3: Economic Development -- Louisville Omni

Public:

State/Metro: Tax Increment Financing

Louisville Metro: Provided Land

Quasi-Public:

PARC Garage

Private:

Omni Hotels (\$150M)



P3: Infrastructure – Public to Private Delivery

Project Details

Developer: For campus student housing, the University of Kentucky contracted with the Education Realty Trust (EdR, NYSE: EDR, Memphis, TN).

Project Size: Dormitories: 6,000 + 3,000 beds

Wage Rates: All phases thus far have called for state prevailing wage rates.

Rent/Payment: Directly to EdR, with some proceeds being shared with UK.



P3: Infrastructure – Public to Private Delivery

The Indiana Toll Road

In operation since **1956**

157 miles long

PPP Vehicle: Lease-Develop-Operate (some modifications)

Developer/PPP Entity: Statewide Mobility Partners LLC

Owner Entities: INDOT, Indiana Finance Authority, Indiana Toll Road Oversight Board

Term: 75-year lease

Payment by Developer: \$3.8 billion

Maintenance Savings: \$100 million



P3: Infrastructure - Private Delivery, Operation

Louisville-Southern Indiana Bridges Project



P3: Infrastructure – Private Delivery, Operation

Frankfort Office Buildings: 300 Bldg, Capital Plaza

300 Building (Sower Blvd): Let in 2014/2015

Capital Plaza (Downtown): Let in 2017, under construction

PPP Vehicle: Long Term Lease-Develop-Maintain

Bid/Proposal Terms:

Term of Years

Annual Rent

Square Footage



Kentucky's Great Leap in P3 Legislation

States with Transportation PPP Enabling Legislation as of Jan. 24, 2013
(Updated from page 15 of the 2010 NCSL PPP Toolkit)



Kentucky's P3 Legislation

- KRS 45A.077 State Agencies
- KRS 65.028 Local Governments
- 200 KAR 5:355 Enabling Regulations
(both state and local)

Kentucky's P3 Statute: Proposal Requirements

- KRS 65.028(7) A request for proposal for a local government project utilizing a public-private partnership shall include at a minimum:
 - (a) The parameters of the proposed public-private partnership agreement;
 - (b) The duties and responsibilities to be performed by the private partner or partners;
 - (c) The methods of oversight to be employed by the local government;
 - (d) The duties and responsibilities that are to be performed by the local government and any other partners to the contract;
 - (e) The evaluation factors and the relative weight of each to be used in the scoring of awards; and
 - (f) Other information required by a local government to evaluate the proposals submitted by respondents and the overall proposed public-private partnership.

Kentucky's P3 Statute: Unsolicited Proposals

Step 1:

An unsolicited proposal is submitted to the local government. It must be marked “Unsolicited Proposal”. Any information contained within the proposal which contains trade secrets, financial records or other information that would be withheld under KRS 61.878 (Kentucky's Open Records Law) must be indicated as such, with a second copy of the unsolicited proposal submitted with such information redacted.

The submitting party must also submit a copy to the Finance and Administration Cabinet and to the Department for Local Government.

Kentucky's P3 Statute: Unsolicited Proposals

Step 2:

Within **90 days** (i.e., 1 day or up to 90 days), the local government elects whether to consider further action on the proposal.

Step 3:

The local government provides public notice of the proposal. This notice shall state that competing proposals be submitted within a period of **at least 30 but not more than 90 days** (this discretion is with the local government).

Kentucky's P3 Statute: Unsolicited Proposals

Step 4:

The local government determines it is in its best interest to implement some or all of the concepts contained in the unsolicited proposal(s).

Step 5:

The local government begins “an open, competitive procurement process pursuant to KRS 65.028”.

Step 6:

The local government issues an RFP fulfilling the specificity requirements found in KRS 65.028(7)(a)-(f).

Kentucky's P3 Statute: Unsolicited Proposals

Step 7:

The local government transmits a copy of the RFP to the Department for Local Government. A minimum window of **seven days** must be provided in the RFP for responses, however a much longer period is typical practice.

Step 8:

The local government makes a contract award using competitive negotiation on the basis of best value, and to be executed by the legislative body of the local government. This may include multiple stages where technical portions of the proposals are scored to determine they are sufficient to be regarded as responsive to the RFP.

Kentucky's P3 Statute: Unsolicited Proposals

Prohibitions

200 KAR 5:355, Section 3(5):

5. A valid unsolicited proposal shall:

- Be independently originated and developed by the person or persons, business or businesses, or other entities submitting the proposal;
- Be prepared without government supervision, endorsement, direction or direct government involvement; and
- Include sufficient detail to permit a determination that government support would be worthwhile and that the proposal could benefit the using agency or local government's constituency.



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Questions?

Presenters



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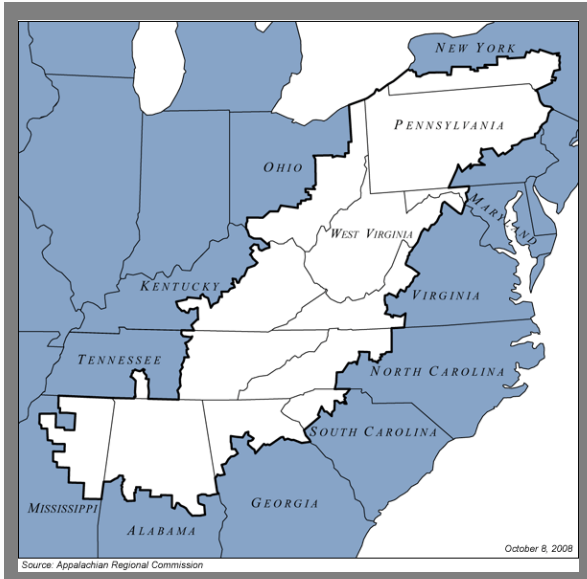
Appalachian Investors Alliance

Educational foundation dedicated to organizing capital to create economically resilient communities!



What is the problem?

Appalachia is last in almost every category.



- Fewer new businesses are starting
- More concentrated than ever before
- 20 counties accounted for *half* of all new businesses.
- *All of them were in large metro areas.*

What do we do?

Create economically resilient communities

- **Bridge the educational gap in the region**
- **Professionally support small venture funds**
- **Facilitate deploying capital in the region**
- **Stimulate economic development**
- **Cultivate advanced technology sectors**
- **Build a *self-reinforcing* system of wealth creation through *impact* investing**



How do we do it?

Apply our knowledge to enhance the regional economy



- **Financial, intellectual, and social capital to startups**
- **Insight and tailored service to investors**
- **Navigate the unique challenges of startups in the region**
- **Promote sustainable economies in our communities**

Why now?

Rise of the Heartland

- **People work where they want to live!**
- **Tech and talent are here**
- **Capital is missing**
- **Not a level playing field**
- **Syndication built into the fabric of the network**
- **Smart capital is the accelerant**



Why is this the right solution?

Scale.



- **Silicon Valley model does not work here**
- **Syndicate of groups and funds**
- **Support investors as *catalysts* for change**
- **Rising tide.....**
- **Wisdom, support, and buying power of many!**

What do we deliver?

Comprehensive package to help you become sophisticated angel investors



Infrastructure

Knowledge, expertise, diligence, fund management, and syndicated dealflow



Regional Network

Access to a network of business professionals with knowledge, expertise, capital, and angel investing experience



Best Management Practices

Professional perspective on industry, markets, term, competition, valuation, regs, etc.



Capacity Building

Tools and educational programs for building angel investing capacity in your community

Networks, tools, and technology of the professionals with hands-on community-based action

What does this mean to the region?

Comprehensive package create successful, sophisticated angel investors

- **Build here! Invest here! Stay here!**
- **Support for transformative entrepreneurs**
- **Create local/regional enterprise**
- **Efficient use of resources – investors and entrepreneurs**
- **Catapult for great companies!**



What is our track record?

Appalachian Regional Commission POWER Grants 2016 and 2018

- **42 communities served**
- **28 businesses improved**
- **200+ businesses coached**
- **20 company investments**
- **63 Jobs created**
- **\$5M, \$60M, two exits pending**





Questions?

Thank you for your time!

Contact US:

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Opportunity Zones

Bringing resources into the heartland



What is the OZone Program?

Appalachia is last in almost every category.

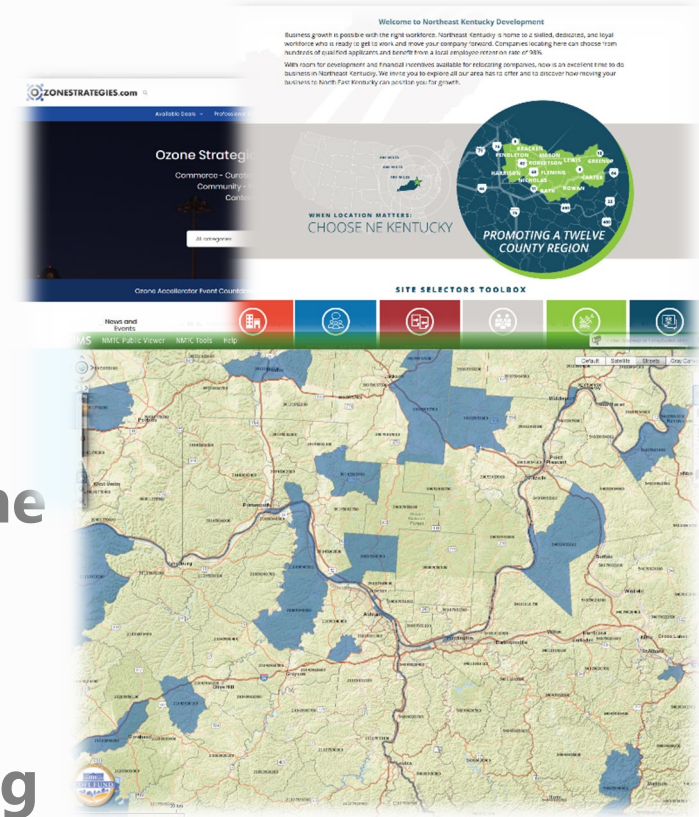


- **Investor friendly program**
- **Massive tax deferment and avoidance strategy**
- **\$1T in capital on sidelines**
- **Pull costal cash into the heartland!**
- **Impact will be your backyard**

Why is this important?

Big promises to the heartland

- Washington is pushing rural
- Massive tax incentive program
- Move capital off the sidelines
- Designed to drive coastal \$ into the Heartland
- 10 year effect
- Marketplaces are already blooming



Why are their two tracks?

Real estate vs. Companies

- **Massive investment coming in real estate**
- **Who is going to take up all the real estate?**
- **Company track is critical**
- **Financial opportunity!**
- **Cultivate advanced technology sectors**
- **Build a *self-reinforcing* system of wealth creation through *impact* investing**



Why am I here?

The Heartland is quietly on the move!

- **Banking, VC, competitive landscape have all changed**
- **People work where they want to live!**
- **Tech and talent are ubiquitous**
- **Capital is not**
- **Citadel Cities**
- **IP fountains – fly-over parts of fly-over states**



What do you need to know?

Compliance!

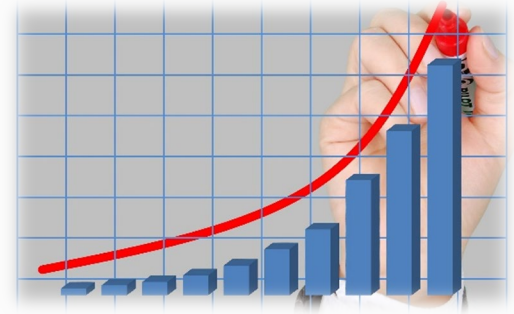


- **Fund is a C-Corp or partnership**
- **Equity, debt, or convertible debt**
- **New equity!**
- **Royalty style investments are not recommended**
- **All capital accounts start at \$0**

What is the catch? 50% Threshold

Businesses must be located in the OZone

- **50% of gross revenues in the zone**
- **50% of workforce in the OZone**
- **50% of compensation in the OZone**
- **50% of tangible property and management/operational functions in OZone**
- **Business friendly term driving employment, but does not prevent high growth businesses**



What about exits?

That is why we are in the business!



- Industry average is 2.7x in 3.4 years
- Fund can't distribute funds with preferential tax treatment for 10 years
- New guidance that returns must be reinvested with 12 months!
- Good for business!

What happens at 10 years?

Tax free!

- **Returns after 10 years are not taxable**
- **Currently 2047 is the expiration date**
- **That is expected to change**
- **Avoid mass liquidations at given points**
- **Lots of money to be made if you are smart ad patient!**



What questions remain?

Awaiting new guidance from Treasury and the IRS

- **Unclear if you must liquidate the entire fund or can liquidate the individual company / security**
- **Implications are profound**
- **Liquidating a portfolio.....arbitrage, terminate the weak, 10 year sell-off?**
- **Appears that funds will be able to liquidate individual assets, but the method is not settled yet.**



What does this all mean?

Look around you for growth opportunities!

- **OZone program is a boon for the Heartland**
- **Washington is pushing rural**
- ***Company* investments are critical**
- **Rules are 99% worked out**
- **Strongly in favor of business in your backyard**
- **The time to act is now in 2019!**





Questions?

Thank you for your time!

Contact US:

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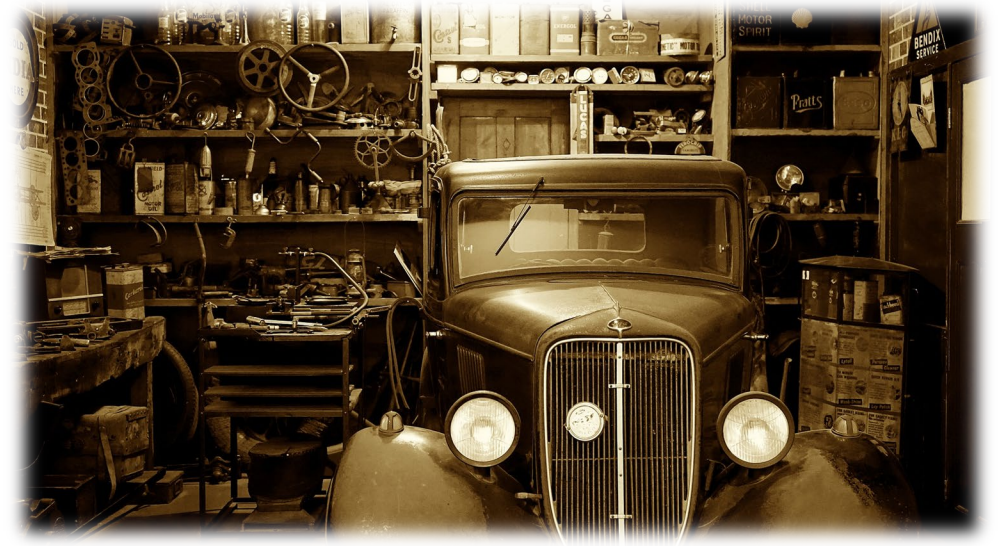
www.twitter.com/appalachianinv

www.facebook.com/appalchianinvestors

www.appalachianinvestors.com

Mind of the Investor Workshop

How to understand startup investing.



Who We Are

Experienced entrepreneurs and investors.

- **Syndicate of micro-venture funds**
- **We see 1000 – 1200 deals each year**
- **We invest in 1 – 2%; *time* and money!**
- **My story – both sides of the table!**
- ***Impact investing***



Why are we here?

Understand startup investing.

- **Entrepreneurs want to succeed**
- **Investors want to help**
- **OZones are coming!**
- **What is stopping them?**
- **How do you evaluate startups?**



FIRST BLUSH:

How Professional Angels do the Quick Look

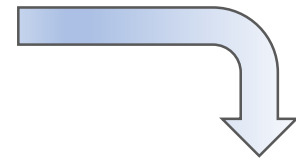
Entrepreneur:

Investors do not look for reasons to select you; they look for reasons to de-select.....

And, you are generally guilty until proven innocent.....

And, the deck is stacked against you!

But...but...but...but...but...but...but...but...but...but...but...

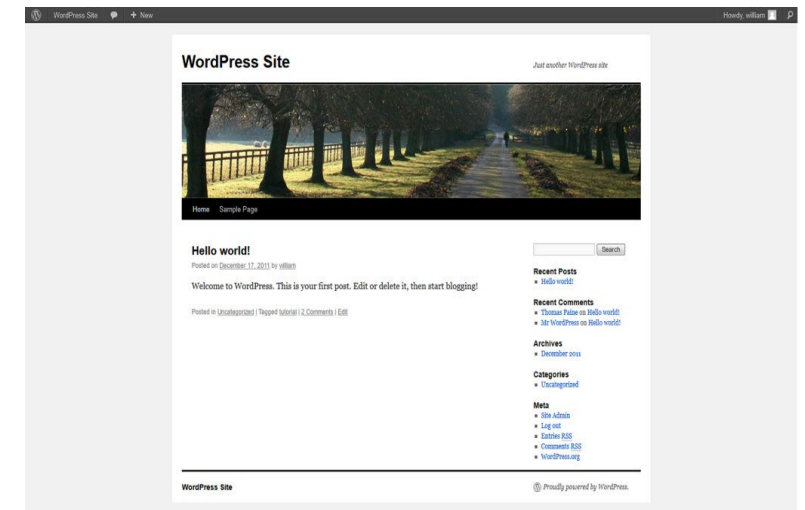


Investors see too many promising deals to dwell on marginal ones.

- 15 minute “quick look” for weeding out what *appear* to be flawed deals.
- 2 – 4 hours to determine if the venture is investable
- 20 – 40 hours of diligence to fully understand the status, liabilities, and potential of the company
- Spend you time on the deals that have real potential!
- Mentorship is the alternative.

Check out the company's website

- Is there one?
- Registered domain name or just a Facebook page?
- 404 error? Broken links?
- Tombstone page or content-rich?
- Professional-looking or done by an obvious amateur?
- Product mock-up or actual product shown?
- Physical address in the “Contact” information?



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Check out founders' social media profiles

9

- Stupid is as stupid does on social media. Q: “Would you give a stupid person your money?”
- Resume padding is obvious, esp. on LinkedIn.
- Beware of “serial entrepreneurs”, “thought leaders,” and anyone calling themselves a “strategist.”
- Are the entrepreneurs working full or part-time (or no time) in the business?

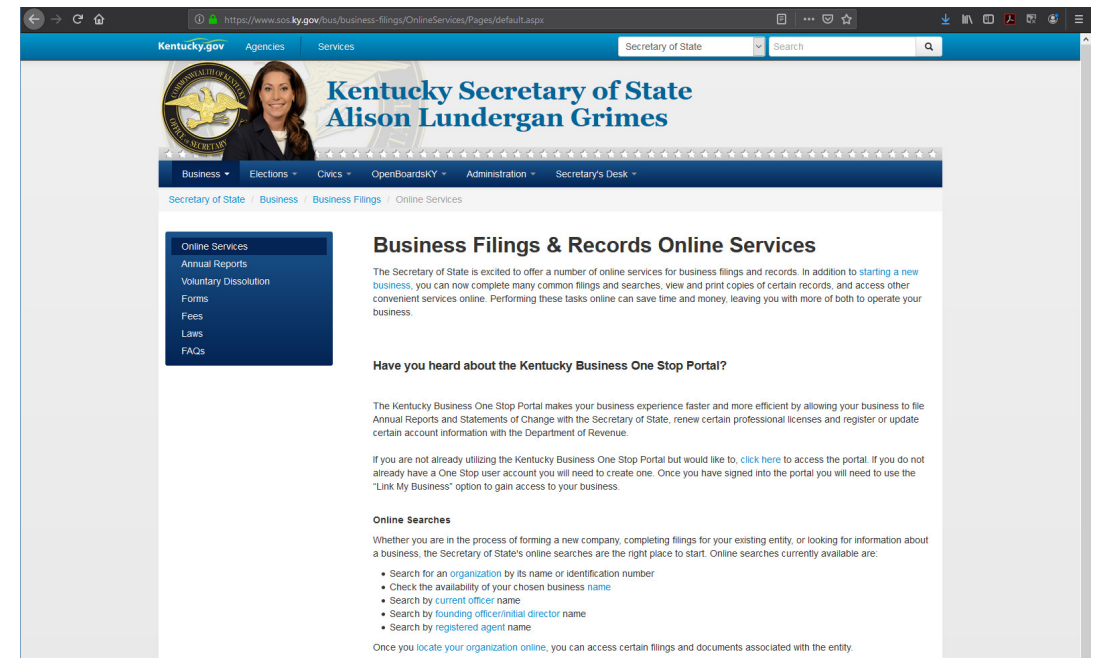


Do you understand their business/website?

- Is there a plain, easily understood description of what product or service the company provides?
- Why should anyone care?
- Who would care enough to trade \$\$\$ for what the company is selling?
- Is there a Call To Action (CTA)?
- Is there information for prospects on how to buy or become a customer (more than just “Contact Us”)?

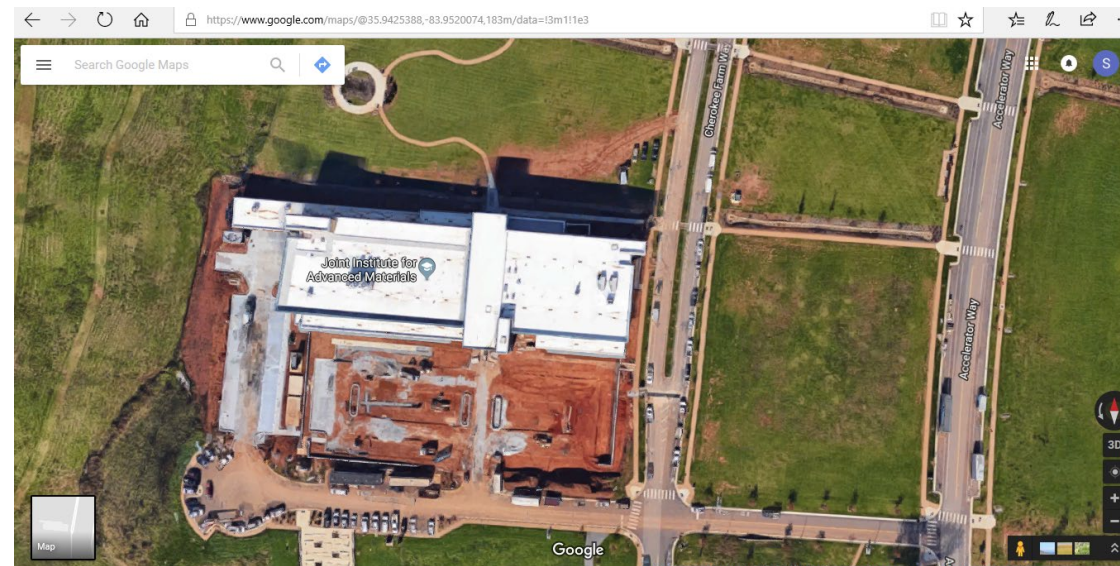
Check registrations with the Secretary of State

- Is the company actively registered?
- What is the business structure?
- How long as the company been in existence?
- Have annual reports been filed on time?
- What are the street addresses of the company office and officers?



Check business addresses with online GIS tools

- Does the company street address match a business location?
- Is the company operating from a residence? Is that appropriate for the type and stage of the business?



Check online for press about companies and founders

- Genuine positive press stands out. (It's easy to spot "puff-pieces" and company PR posing as "news.")
- Investors also check industry news and search for information about your competition.



Check into the company's fundraising efforts

- Has company tried to raise crowdfunding? On Kickstarter? Indiegogo? Fundable.com? What was the result? (Strong negative if the campaign didn't meet goal.)
- Is the company trying to raise money on iSelect? Gust? AngelList? How long has the deal been posted?
- Is there information on the company's financing available on Pitchbook? CrunchBase? Whoisraisingmoney.com?
- Beware of companies that repeatedly raise new rounds of capital without growing value for investors (Seed I, Seed II, Series A, Series A1, Series A2, Series A3, Series B...).

Check court records and background records online

- Most states provide civil case records and family law cases online. Some states put criminal records online.
- Basic background checks can be done for low cost or free.

The collage displays four different online services for checking court records and background information:

- Kentucky Court of Justice CourtNet 2.0:** A search interface for court records with filters for Party Category (Primary), Case Category (All), Party Type, County (Statewide), and search criteria like Last Name, Business, First Name, Birth Date, and Drivers License #.
- Intelius:** A background check service with a search form titled "Find Out with a Confidential Background Check". It includes fields for First Name, M.I., Last Name (required), Current/Previous Address, and City and/or State, along with a "Search" button. It also lists "More ways to get info you need" such as Criminal Records Search, People Search, and Reverse Phone Lookup.
- LexisNexis:** A professional research platform with a "RISK SOLUTIONS" banner and a "VISIT SITE" button. It mentions services like data analytics, fraud detection, and identity solutions.
- RELX Group:** A company logo and branding at the bottom right of the LexisNexis interface.

Check patents and applications online

- Published patents and applications are necessary for due diligence. A published application is public information.
- Investors gather information on the value of intellectual property and potential competition based on patent citations.



Search Patents

Google Search

I'm Feeling Lucky

The image displays two overlapping screenshots of patent search websites. The background screenshot is the USPTO (United States Patent and Trademark Office) website, showing the 'Search for patents' page. It includes a navigation bar with 'Patents', 'Trademarks', 'IP Policy', and 'Learning and Resources'. The main content area is titled 'Search for patents' and provides information on how to conduct a preliminary U.S. patent search, including a link to a 'Seven Step Strategy' and a 'detailed handout'. It also lists resources for searching patents, such as the 'USPTO Patent Full-Text and Image Database (PatFT)', 'USPTO Patent Application Full-Text and Image Database (AppFT)', 'Global Dossier', 'Patent Application Information Retrieval (PAIR)', 'Public Search Facility', 'Patent and Trademark Resource Centers (PTRCs)', and 'Patent Official Gazette'. The foreground screenshot is the Justia Patents website, showing a search bar and a list of patents by US Classification, including 's, and spittoons (Class 4)', 'class 7)', 'ng: fluid treatment and chemical modification of textiles and fibers (Class 8)', 'ing (Class 12)', 'g, and general cleaning (Class 15)', 'lware (e.g., bushing, carpet fastener, caster, door closer, panel hanger, attachable or adjunct handle, i balance, etc.) (Class 16)', and 'aration (Class 19)'.

Take-aways:

- Investors are looking to de-select.
- Perform a “quick screen” *before* spending time on formal due diligence.
- Decide to proceed, mentor, or reject quickly.
- It takes an experienced investor only about 30 minutes to complete these steps.
- Smart entrepreneurs know this and address it before they approach you.
- Technology and talent are ubiquitous.
- You are looking for transformative entrepreneurs.



LOVE AT FIRST SIGHT

It happens everyday

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Heuristics – Your Ante to Play

How to evaluate a company for funding



Five Deadly Sins in the First 15 minutes

How are we spending the day?



- **Hyperbole and misdirection**
- **Sloppy proforma**
- **Uninspiring pitch/deck**
- **Not doing their homework**
- **Lack of transparency/arrogance**

This is fundamentally a sales job!

The Filter

10% of all angel deals in the market get funding

- **Quick Screen is done**
- **Now we spend 2 – 4 hours researching**
- **Overwhelming at first!**
- **Becomes second hand quickly**
- **Fast No's or Yes's; No slow maybe's**



Does this make me say "WOW?"

Know and lead with your WOW

- Is there something here that gets me excited?
- Entrepreneur sell himself, his team, his company?
- Fluff sells...combined with substance = winner!
- Form and function!
- WOW not WHOA!



Is the product/service/business model NOVEL?

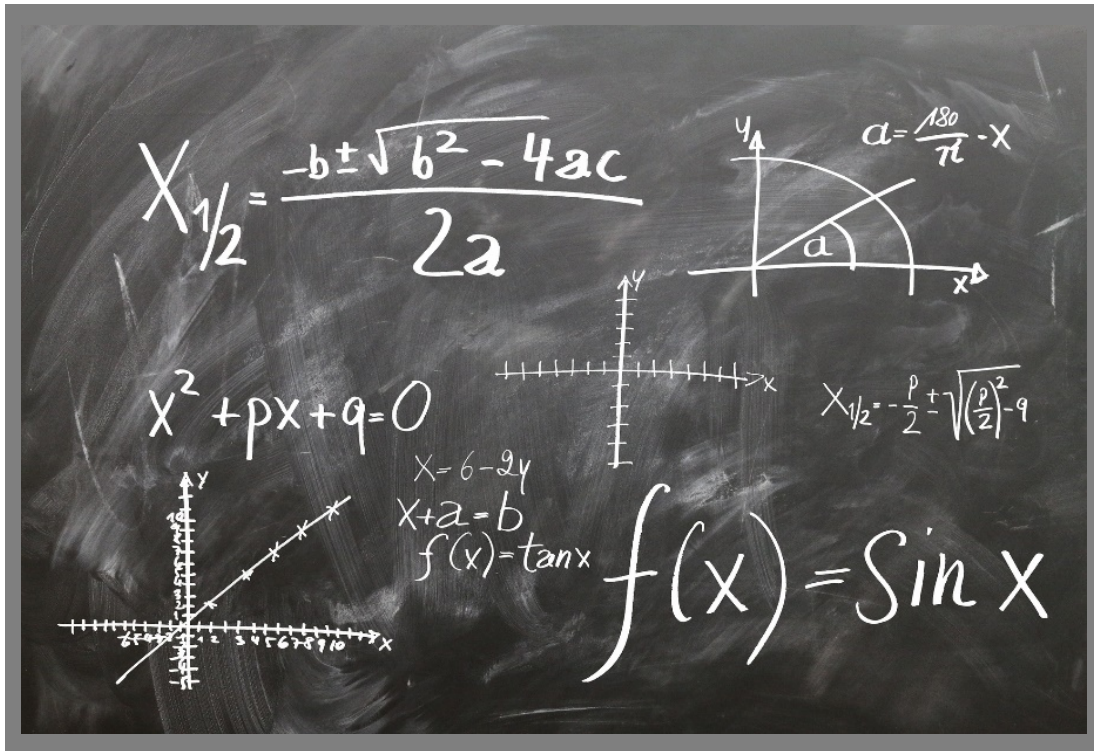
Novelty shows imagination

- **Have we seen 3 of these already?**
- **Does it solve a real problem?**
- **Imagination?**
- **Intelligence?**
- **Creativity?**
- **Driven to disrupt?**



Does it violate any laws of man or nature?

Sales job!



- Don't sell me a time or perpetual motion machine!
- The laws of physics have not changed in a long time!
- Don't sell me an educational or workflow nightmare!
- People don't change unless acted upon by an external force either!

Traction. Traction. **Traction!**

Scale.



- **Do a lot with a little!**
- **Good stewards of resources**
- **Understand marketing and sales**
- **Understand their clients**
- **Willing to make the hard calls**

The #1 question from investors = the easiest answer to justify a “no.”

Projections

Where we catch the cheaters

- **Are their financial projections rational?**
- **How is the sales mode constructed?**
- **Robust financial model?**
- **Detailed model?**
- **Does the model account for growth?**
- **Great pitches can still fail**
- **Sound business models win**



Timing

Timing is the hardest to control

- **Timing is out of your hands**
- **One of the biggest problems in product/market fit**
- **Too early = day dream**
- **Too late = nightmare**
- **Incumbents in the market?**
- **State of the market?**



Team!

Create resilient communities

- **Can this team win?**
- **Startup is a patient on the table!**
- **Can the team cure its problems before it expires?**
- **Experience counts**
- **Diversity of skills counts**
- **Winners keep winning**



Margins

Room for error!

- **Product margins = room for error**
- **Large margins = make mistakes and survive**
- **Small margins = you have no room for error**
- **30% gross margin is the floor**
- **> 70% margins give us great comfort**
- **> 90% margins are WOW!**



Market Size and Growth Rate

Size matters

- **Looking for \$1B+ markets**
- **Markets where 10x is a realistic option**
- **Looking for fragmented or unconsolidated markets**
- **Capturing 1% of any given market.....**
- **Double digit CAGR is the sweet spot**
- **Geometric growth is hard**



Barriers to Entry/IP

Anything to protect your market position?

- Do they have a way of slowing down fast-followers?
- Can they protect their market position?
- Do they have novelty that makes them an acquisition target?
- Trade secrets?
- Subterfuge?
- Patents/Trademarks/Copyrights?



Terms of the Offering

Never be clever with offering terms

- **Are they using industry standard terms?**
- **Are they trying to be clever with the terms?**
- **Are the terms investor friendly?**
- **Have they taken capital before and how?**
- **Are their prior investors reinvesting?**
- **Do they understand the implied contract?**



Size of your round and valuation

Size still matters

- **Are they raising the appropriate sized round for the BP?**
- **Is the valuation reasonable?**
- **Are they using the right investment vehicle?**
- **Assume multiple rounds of investment**
- **Will this valuation get us to a 5 - 10x at exit?**



Mergers/acquisition activity in the market?

Is this an active marketplace?

- Are companies being acquired in the industry?
- Is the industry consolidating?
- What are the exit multiples on revenue?
- Can they be acquired in this industry?
- Can they IPO instead?



Intangibles

Alternative reasons to invest

- Are there other aspects that make them valuable?
- Do they have good will, knowledge, a brand?
- Community/social impact?
- Intangibles won't replace a solid BP
- Can encourage you to invest/mentor



Show Us

Investors Want to See Your Business Plan

Why “Due Diligence?”

- Implies a level of commitment for investor and the entrepreneur.
- Investor decides when “due diligence” starts!
- Expect to give a “yes or no” within a reasonable amount of time.
- Don’t drag out “Due Diligence,” leaving the entrepreneur hoping and guessing.
- An investor that’s not actively asking for supporting info after reviewing the business plan isn’t really interested.

DD is to Validate the Biz Plan

- Not classified information.
- Investors don't sign Confidentiality or Non-Disclosure Agreements.
- Investors see too many similar deals.
- Genuine investors aren't interested in stealing your idea.
- Patents and published patent applications aren't secrets.
- Investors need to know in detail how the **business plan** or model will make them money.
- If an entrepreneur can't give you that information with evidence, they aren't prepared for Due Diligence.
- Mentor or move on.

“But I Don’t Have a Business Plan!”

- Don’t cool entrepreneurs/investors say you don’t need one?
- Didn’t THAT GUY → say he doesn’t make formal business plans? And that he wrote “plans on the back of beer mats and envelopes”?
- Yes; but you’re not THAT GUY →
- ALSO, he insists on receiving an executive summary with a “crystal clear concept” of the business proposition, including detailed knowledge of suppliers, demand, markets, distribution—in other words, *a business plan!*



Concise...

- As in: You can convey on a postage stamp your business idea (how you plan to make a profit).



- Which should convince the investor to turn next to your...

Financials

- Pro forma financial projections must support and be supported by the business (money-making) proposition.
- Hint: You can't "fill in" this part of the plan with a generic spreadsheet model you downloaded from the Internet.



=



- The thing is: investors *assume* your pro forma will be wrong!

Questions to ask

- Do the projections make sense?
- Do they capture the cost of scaling the business accurately?
- Do they accurately reflect the market opportunity?
- Does the team have a proven track record in marketing and sales?
- Time invested in answering these questions is very likely the difference between a good investment and a bad one.

How to analyze financials

- Common PE ratios are meaningless in most startups
- Five year proformas are use to determine:
 - If the entrepreneur can plan a business
 - If the entrepreneur has/can run a business
 - What the potential for the business is in the entrepreneur's mind
- Proforma vs. business plan – lock step!
- Expense side should be easy if you have run a business before
- Revenue side is the key!

What to look for

- Find market studies that support or refute projections
- Find comparable companies and use as a benchmark
- Make sure the math works!
- Three ways to build projections:
 - Wing it – plug in numbers that the entrepreneur aspirationally believes
 - Sale cycle based – build an estimate of the sales and marketing infrastructure and revenue growth based on knowledge of a sale cycle
 - Pipeline based – build the sales and marketing infrastructure and revenue growth based on solid client knowledge and experience.

About Your Pro Forma...

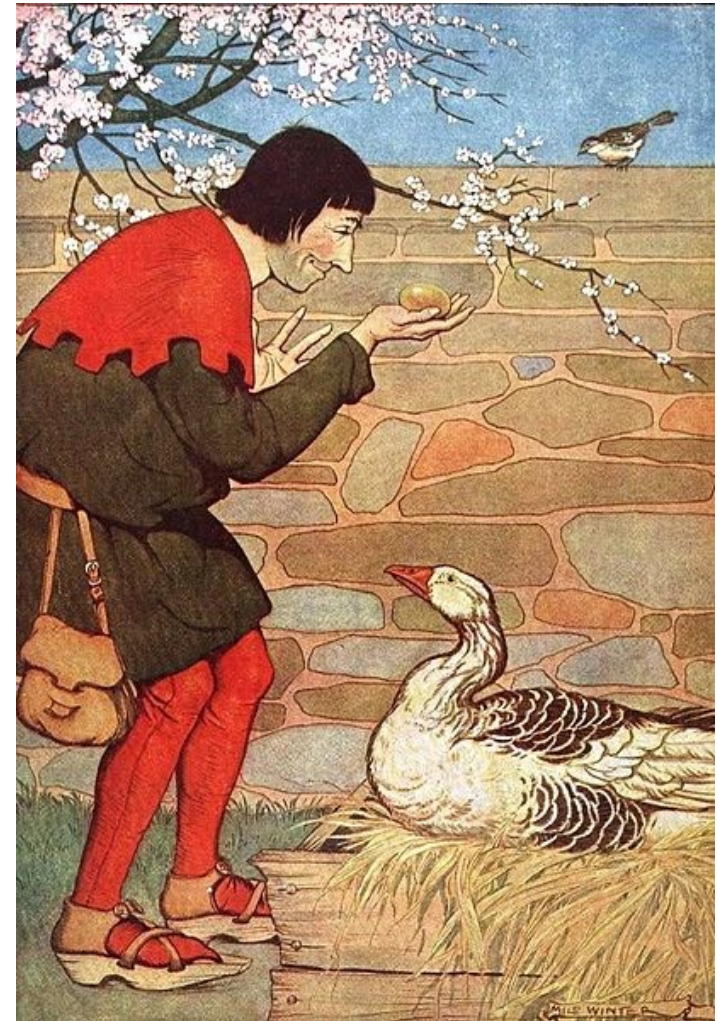
- “It will take twice as long and cost twice as much as you say it will.”
- “The difference between a venture capitalist and a vulture capitalist is how well or poorly you execute your business model.”
- Projecting into the future is hard; offering a real budget is essential.
- If you can’t accurately explain your fiscal year spending plan, and hold yourself and your company to that budget, you have no cause to be raising capital.

**THAT MOMENT WHEN YOU
REALIZE YOU GOT SOME
'SPLAININ TO DO:**



Remember:

- Nothing happens by good intent or wishful thinking.
- It happens by dedicated, disciplined action.
- Profit doesn't come by magic. Business plans shouldn't be fairy tales.
- Hold entrepreneurs to a high standard.
- Your community will benefit.



Risk

2 in 10 pay for everything with profit

- **Risk is the elephant in the room**
- **Despite Shark Tank, this is not a household activity!**
- **Think baseball! .300 and you are a hall-of-famer!**
- **Failure is part of the deal; no one can choose the winners**
- **Investment math**
- **2.7x in 3.4 years industry average returns!**





- **It takes time to build an ecosystem**
- **Knoxville – 5 \$50 - \$100M exits in 18 months**
- **Seeds were sown in 2007 and 2008**
- **Investors are the catalyst for change!**
- **ALA track record**
- **2 years, \$5M, \$60M, two exits pending**
- **The model works!**

To the Investors

Commit

- **Engage in this process**
- **Identify the entrepreneurs that can transform your community**
- **Invest first time, then money in them**
- **Help them to create value**
- **Celebrate the victories**
- **Create the community you want!**



To the Entrepreneurs

Carpe diem

- **People invest in people in markets they like and understand.**
- **Research your investors as they will you**
- **Understand what it takes to capture investment capital**
- **Do your homework!**
- **This is what it takes to be successful**
- **Trust that your community will respond!**



Questions?



Image credit: Beth Scupham