North Sky
CAPITAL

Fourth Quarter 2019

Quote of the Quarter

"Life's most persistent and urgent question is: what are you doing for others?"

— Martin Luther King, Jr.

Market Commentary – Positive Potential for Opportunity Zones

Overview

- *Opportunity Zones can be used to create jobs and sustainable infrastructure in low income areas*
- *Spotlight on Wetland Mitigation Banking*

Impact Investing in Opportunity Zones

We have started a sustainable infrastructure investment strategy that will invest in Opportunity Zones ("OZs") across the USA. This effort is a continuation of our prior infrastructure investment strategy. Through this initiative we intend to (1) earn an attractive investment return, (2) move our country to a more sustainable energy and water future, and (3) boost economic development and job creation.

Investment return. All money (presumably long or short capital gains) is contributed upfront. For illustrative purposes, if investments deliver a net IRR of 8%, 10% or 12%, then the net multiple to an investor would be approximately 2.2x, 2.6x or 3.1x, respectively. The tax benefits would be IN ADDITION TO that net return (e.g., deferring capital gains taxes otherwise payable now and no federal capital gains tax on the gains achieved by IIF)[i].

More sustainable future. We have developed a robust pipeline of potential investments in clean energy, waste, water and other impactful projects in OZs around the country. Solar, energy storage, wastewater treatment, biogas, and recycling projects are obvious near-term opportunities for us. We expect to consummate IIF's first investment in the next 60 days.

Economic development. All the projects we are currently pursuing have the potential to create significant and quantifiable positive social impact in low income communities. As such, we believe this investment strategy embraces the reason the new OZ regulations were created, which was to incentivize and catalyze patient, long-term private investment in economically disadvantaged areas across the United States. Unfortunately, the program came under fire recently due to flaws in design and implementation, as well as potential abuse by certain public and private sector actors.[ii] Much of the negative sentiment stems from the handful of real estate OZ funds that sprang up to utilize the new OZ tax structure.[iii] Bulldozing low income housing and erecting fancy condos was not likely the primary intent of the OZ tax rules. Immediately alarm bells went off regarding the displacement of low-income residents from their communities, and perhaps rightfully so. The purpose of the OZ program was to spur economic growth within low income communities, as well as improve the overall living conditions of current residents. Our strategy is designed for this purpose.

As noted in our Q3 Market Commentary, we believe an approach that creates jobs and improves the lives of the people currently living in OZs is the proper path. We designed this investment strategy to target attractive financial returns while also producing positive environmental and social impacts – namely, better and cleaner infrastructure for our country and good-paying jobs where they are needed. Over the past 10 years our prior infrastructure funds created more than 2.5 GW of new clean energy generation capacity in the USA and more than 2 million hours of high-quality green jobs. We are excited to bring that experience to bear, creating positive impact within OZs and continuing to help solve some of our country's most critical infrastructure challenges.

If you would like to discuss this initiative with us in greater detail, please contact Andrew Harris.

Spotlight on Wetland Mitigation Banking

Mitigation banking is an example of a place-based investment thesis that could benefit from the OZ program, and we have seen potentially interesting OZ opportunities in this sector in recent months. We first invested in the mitigation banking sector in 2017 on behalf of one of our prior private equity funds and recently revisited the sector on behalf of our current private equity secondaries fund, Clean Growth V, which acquired an ownership interest in a large wetland mitigation banking portfolio this summer. Given the sector's relevance to both our private equity secondary and OZ strategies, we thought a spotlight on mitigation banking would be useful.

The origin of wetland mitigation banking is the Clean Water Act (1972). The objective of the Clean Water Act is to restore and maintain the chemical, physical and biological integrity of the Nation's waters. This law is the primary means for the federal government to regulate water pollution. Among other things, this law provides a means for real estate and other property developers to mitigate the damage or negative impact one of their projects may have on a waterway or wetland. Initially, developers attempted ineffectively to manage their wetlands impact onsite, resulting in a patchwork of unconnected, dysfunctional wetlands across the United States. The shortcomings of this approach led to the creation of mitigation banking, a process whereby a third party restores, enhances or preserves a wetland and then sells federal- and/or state-issued credits to developers within the same watershed. Wetland mitigation banks can range in size from a few hundred to a few thousand acres, allowing for large-scale hydrological and ecological restoration that creates a functional ecosystem.

The mitigation banking market accelerated in 1989 when President George H.W. Bush's administration implemented a "no net loss" policy for wetlands. In 1995, the U.S. Environmental Protection Agency ("EPA") released additional guidance that identified mitigation banking as the preferred method of compliance.

There are two basic types of mitigation banks in operation today: wetland/stream banks and conservation banks. Wetland/stream banks offer credits to offset ecological losses that occur in wetlands and streams under the Clean Water Act and these banks are regulated and approved by the US Army Corps of Engineers and the EPA. Conservation banks offer credits to offset losses of endangered species or their habitats under the Endangered Species Act and these banks are regulated by the U.S. Fish and Wildlife Service and National Marine Fisheries Service. While federal agencies take the lead role in approving and monitoring mitigation banks, state and local agencies also participate in the market and issue credits of their own.

Today, mitigation banking represents a $300 billion total market value[iv] with strong demand for credits from both public (e.g., Minnesota Department of Transportation) and private (e.g., Pulte Homes) developers. For those interested in learning more about mitigation banking, please see the EPA's overview.

Looking Forward to 2020

North Sky Capital will be celebrating its 20th anniversary in 2020. It has been our goal all along to be an innovator in the private markets. In partnership with our investors, we have notched several important firsts along the way: first cleantech fund of funds in North America, first impact secondaries fund worldwide and first sustainable infrastructure investment strategy focused on Opportunity Zones. We are also growing, with offices now in Minneapolis, Boston and NYC and hiring underway for 3-4 new positions. We are working hard to close out the year with several new investments. We also expect successful exits for individual companies and infrastructure projects across our various funds in the very short term. Early next year, we will launch a completely refreshed website and issue our firmwide 2020 Impact Report. We are operating at what feels like the top of our form and are eager to dive into the new year.

We could not have done this without the support and collaboration of our investors, senior advisors, the institutional consultant community, wealth managers, family office platforms, lawyers, accountants, service providers, friends, family and others who are our personal and professional lifeblood. We recognize your significant contributions and offer our gratitude and thanks to you all. We wish you a Happy Hanukkah, Merry Christmas and a happy, healthy and prosperous New Year.

Let's Keep Talking

We are eager to hear from you. Please contact us through the below hyperlinks if you have:

- an interest in impact investing and would like to learn more about how we can help you take the **first step**,
- capital gains that you are thinking about **reinvesting** in an Opportunity Zone,
- an existing impact investment that you would like to **sell**, or
- a sustainable infrastructure project in need of **financing**.

Upcoming Events

We are regular speakers and attendees at key industry events. We hope to see you at these upcoming events:

February 23-25	**Higher Education Climate Leadership Summit**, Atlanta, GA http://www.intentionalendowments.org/2020_higher_ed_climate_leadership_summit
February 25-27	**Confluence Philanthropy's 10th Annual Practitioners Gathering**, San Juan, PR https://www.confluencephilanthropy.org/10th-Annual-Practitioners-Gathering
March 3	**Impact Investing Presentation** by Scott Barrington and Andrew Dayton The Minneapolis Club, Minneapolis, MN (more details to come)
March 31-April 1	**Impact Capitalism Summit Denver**, Denver, CO https://impact-capitalism.com/

North Sky Capital Contacts

Scott Barrington
CEO & Managing Director
(612) 435-7170
sbarrington@northskycapital.com

Gretchen Postula
Head of Investor Relations
(612) 435-7177
gpostula@northskycapital.com

Andrew Harris
Principal
(646) 708-5769
aharris@northskycapital.com

---

[i] Investors should consult their own tax professional

[ii] New York Times: https://www.nytimes.com/2019/10/26/business/michael-milken-trump-opportunity-zones.html; https://www.nytimes.com/2019/11/06/business/opportunity-zones-congress-criticism.html; https://www.nytimes.com/2019/11/16/opinion/trump-tax-opportunity-zones.html

[iii] Novogradac: Opportunity Zones Resource Center, October 2019: https://www.novoco.com/notes-from-novogradac/residential-investments-top-novogradac-qof-listings

[iv] Eco-Asset Solutions and Innovations (EASI), August 2019: https://www.einnews.com/pr_news/493348365/u-s-mitigation-credit-market-value-tops-300-billion-in-2019