Opportunity Zones Overview

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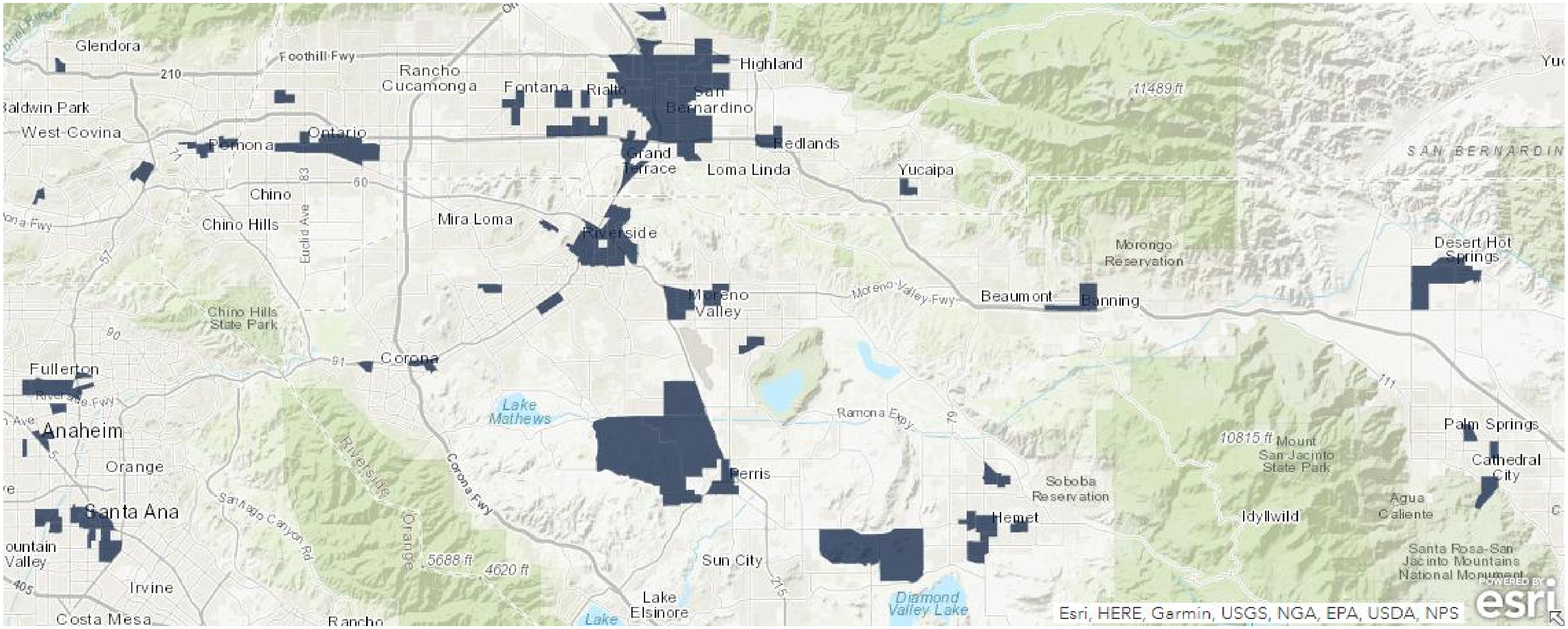
Opportunity Zone Program Timeline

- Created by the Tax Cuts and Jobs Act
- Intended to incentivize investment in economically distressed areas
- State governors were asked to select opportunity zones in their states, subject to certain limitations. These were determined by July 2017. There are roughly 8,700
- IRS released guidance on the basis of which investors could begin utilizing the program in October 2018
- IRS held a public hearing in on February 14th at which it received comments on how to implement the law from a variety of interest parties
- Second set of regulations released on April 18th
- **Most critical ambiguities in law have now been sufficiently clarified – expect accelerating activity**

State and Local Government Supporting Investment

Inland Empire Rich in Opportunity (Zones)



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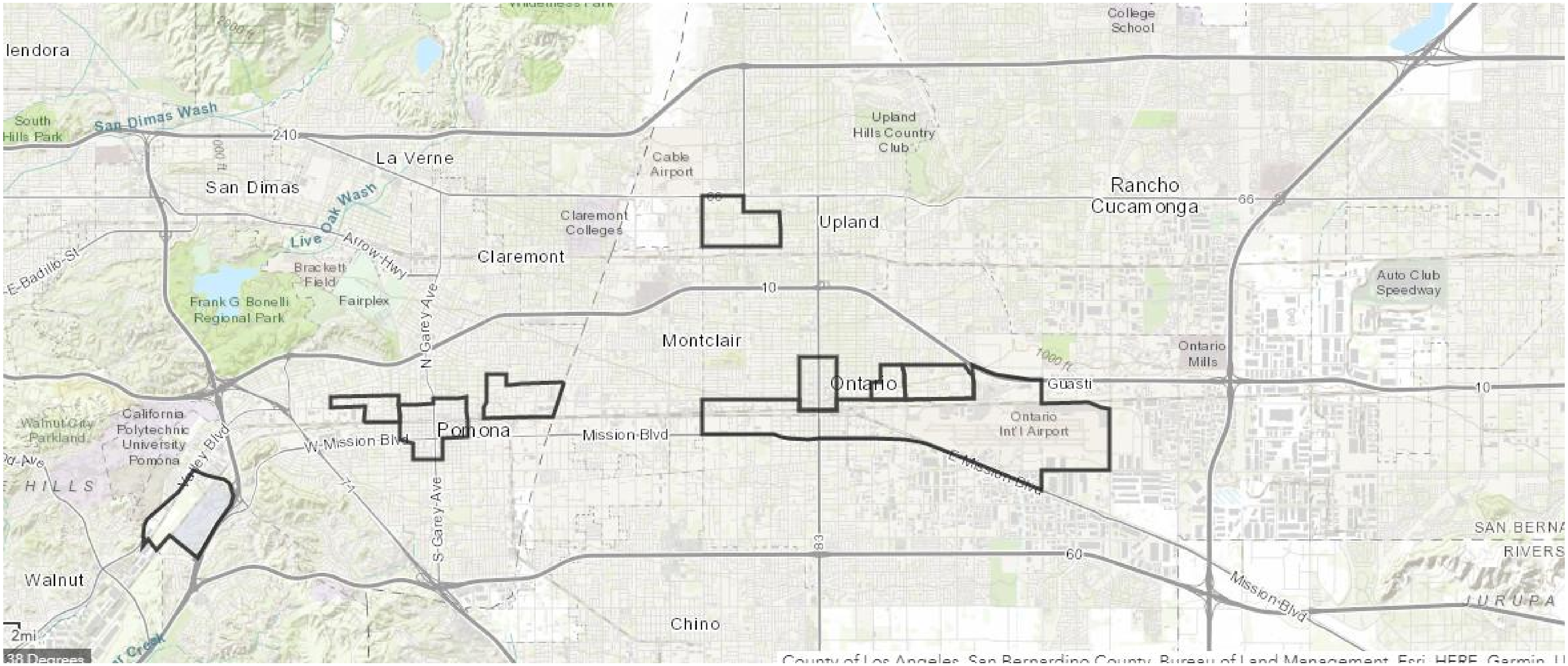
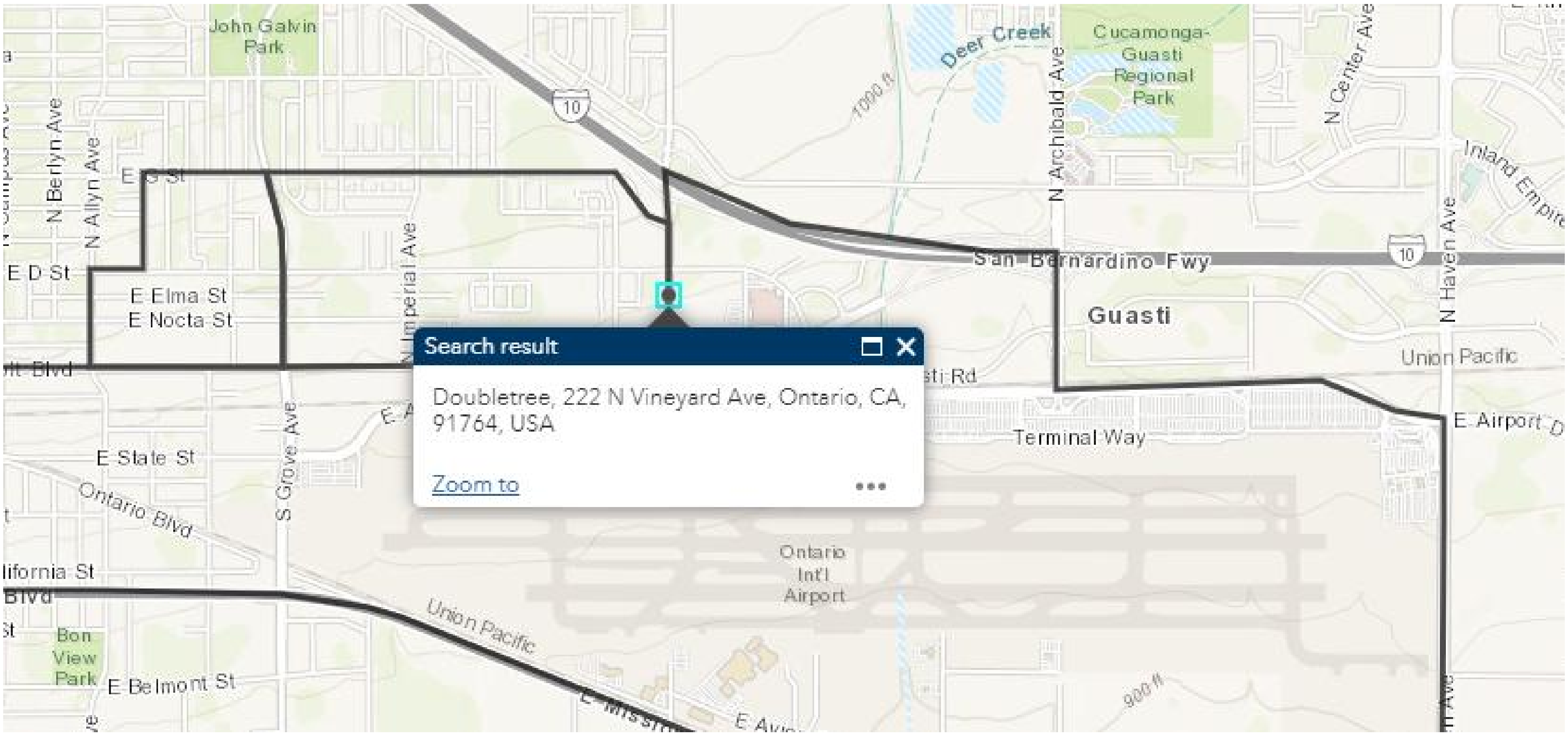


You Are in An Opportunity Zone Right Now!

CUSHMAN & WAKEFIELD



Program Funding

Program Funding

- Equity
  - Taxable investors sell appreciated assets and can invest any capital gain into the program
    - Can be any appreciated asset (real estate, stock, bonds, partnership interests, artwork etc)
  - Sale proceeds must be transferred to a qualified opportunity fund (QOF) within 180 days of sale
  - Carried interests specifically disqualified from tax benefits
  - Can provide additional equity capital but won't be eligible for tax benefits
  - New capital can be invested into the program until December 31, 2026
  - Can contribute assets, not just cash
- Debt
  - QOFs can use debt at the fund and asset/investment level
  - Cash-out refinancing permitted after 2 year

Tax Benefits

Three potential tax benefits

- Capital gain tax deferral on original investment until December 31, 2026
- Capital gain tax reduction on original investment (at 5- and 7- years)
- **No capital gain tax on opportunity zone fund investment if hold for at least 10 years**
  - Potential to accumulate tax-free gain until 2047

- Tax benefits are based on how long an investor remains invested in QOF, not how QOF has held underlying assets at time of liquidation

- Holding period hurdles create incentives for investors to move as fast as possible

QOF Requirements

- Tax-payer can self-certify as a QOF
- 90% of QOF assets need to be in eligible investments at all times
  - Tested every 6 months, assessed penalty if not in compliance
  - Penalty has not yet been defined
- Two classes of eligible investments, each with specific requirements
  - Opportunity zone property (including real estate)
  - Qualified opportunity zone businesses (QOZB)
- Currently being discussed whether to create additional reporting requirements on QOF investments

Opportunity Zone Business Property

Includes all tangible assets, most significantly real estate

For a real estate investment to qualify:

- A majority of the property must be located in an opportunity zone **AND**
- Be put to “original use” with the QOF investment, meaning be placed into service for the first time **OR**
- Be “substantially improved” by the investor within 30 months of acquisition → must double basis in structure (i.e. exclude land value) **OR**
- Have been vacant for at least 5 years

Therefore, most real estate investments will be either development/redevelopment or heavy rehabs

- Potential issue: above conditions on an asset by asset basis, creating reporting burden and could invalidate certain projects

Qualified Opportunity Zone Business (QOZB)

- Only equity investments eligible
- Business must have been formed after December 31, 2017
  - New businesses and potentially new subsidiaries of existing businesses
- 70% of tangible assets must be opportunity zone business property
  - Leased property located in OZ and improvements made to leased property count towards this test
    - Leased property does not need to be “original use” or “substantially improved”
- Must be an active trade or business
  - Excludes triple net leasing
- Must derive 50% of gross income from activity in one or more OZs – several ways to qualify
  - 50% of hour worked take place in OZ **OR**
  - 50% of labor cost incurred in OZ **OR**
  - Property and management/operations required to earn 50% of gross income located in OZ
- **Bottom line**
  - Wide range of businesses qualify
  - Advantages for funds to invest in real estate through QOZB (only 63% assets need to be in OZ)
  - Should be part of any startup or corporate location, relocation, expansion decision → **leasing market impact**

Investment & Reinvestment

- Capital raising
  - If a QOF raises additional capital, it has 6 months to place that capital into qualifying investments
- Investment dispositions and reinvestment
  - If a **QOF investor** sells his interest in a QOF, then he has 6 months to reinvest the proceeds into another QOF if he wants to maintain tax deferral benefits; however, the holding period resets
    - Creates secondary market in QOF interests
    - Same applies if investor received capital gain dividend
  - If a QOF sells an asset, then it has 12 months to reinvest the proceeds into another investment before the sale proceeds are counted towards the 90% asset test
    - Any interim gains generated by the asset sale would be taxable for the fund or investors who had been invested for less than 10 years
    - 12 month reinvestment period extended indefinitely if awaiting a government action
    - Facilitates creation of multi-asset QOFs
    - Most capital recycling will take place within long-lived QOFs
    - Benefits to organizing as partnership
    - The same benefits do **not** apply to asset sales by a QOZB (currently)
- Working Capital
  - Can hold cash for 31 months, provided there is a written plan for how it will be deployed, without violating 90% asset test
  - Safe harbor extended if waiting for a government decision

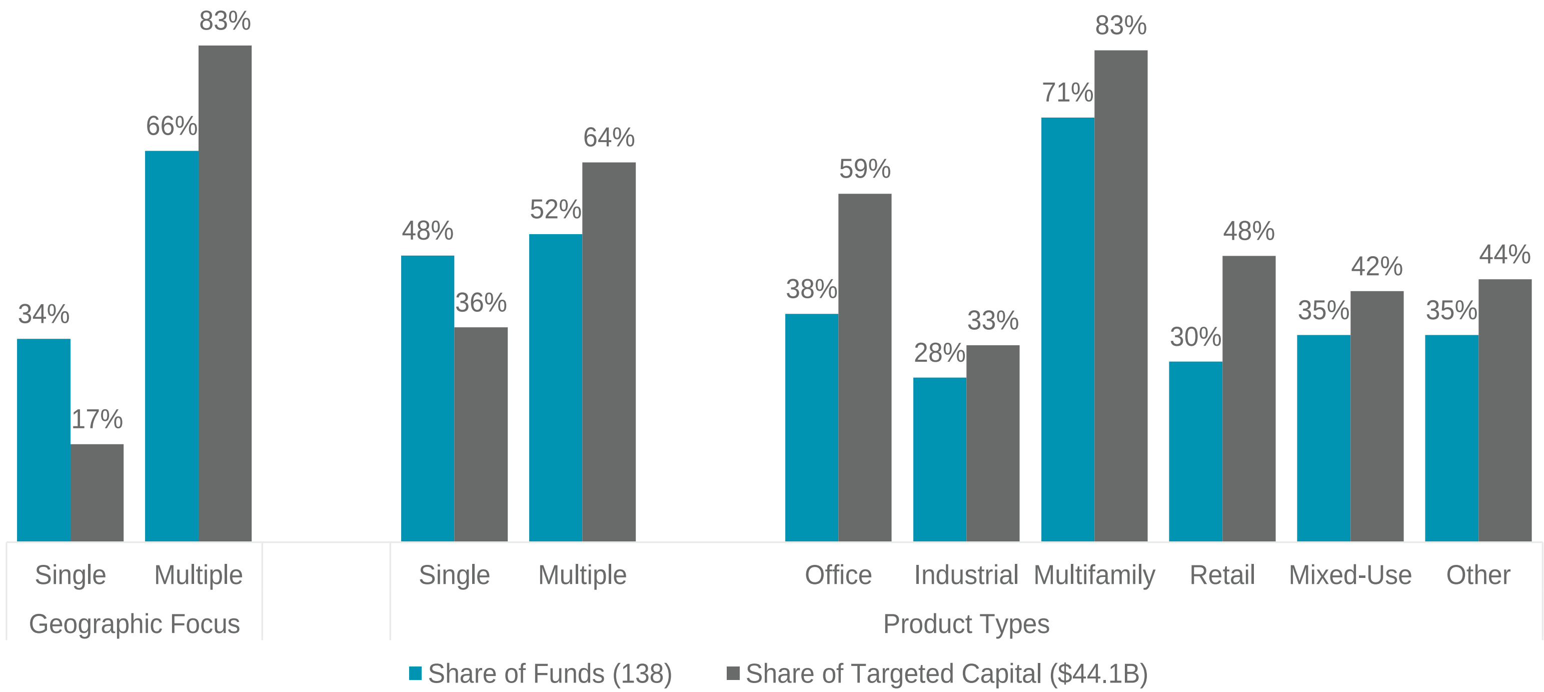
Who Stands to Benefit from Opportunity Zones

- Taxable investors with substantial unrealized capital gains
- Businesses with substantial capital gains that could restructure units as OZBs
- Lenders
- Property owners who could benefit from increased OZB leasing demand
- **Property appraisers and other real estate services providers**
- Developers
  - Whether as opportunity zone funds themselves or as JVs
- Owners of land or potential redevelopment sites in opportunity zones
  - Early indications that asking prices for OZ land have increased
- Fund managers
  - Estimated that $100B could be deployed under this program
  - Already tracking ~140 funds, over $40B in capital at opportunity zone funds, increasingly including many of the large players
    - E.g., CIM, Normandy, RXR, Brookfield

Characteristics of Funds

C&W Opportunity Zone Fund Database Distribution

Percent (%)



Source: Cushman & Wakefield Research

Takeaways for Appraisers

- More transactions means more appraisals
  - Valuing land for development
  - Valuing existing properties for rehab or redevelopment
  - Valuing properties intended to be contributed as QOF funding in a mixed investment
  - Revaluing properties that have gone up in value as a result of surrounding community investment

- The direct effect of the program is on tax attributes, which would not impact appraisal process

However,

- Investment could lead to economic changes in opportunity zones that would merit higher valuations, alter the comparable set for properties in OZs

- The emergence of a new bidder pool for eligible investment properties could improve liquidity and alter relevant cap rate benchmarks