OPPORTUNITY ZONES:
NAVIGATING A PATH TO INVESTMENT

DECEMBER 2018

Newmark Knight Frank

***OPPORTUNITY ZONES** are likely to serve as a powerful vehicle to defer capital gains, receive tax breaks and ultimately increase after-tax IRR. While aspects of the program remain to be sorted out by the Treasury Department, investor appetite is gaining momentum.*

TABLE OF CONTENTS

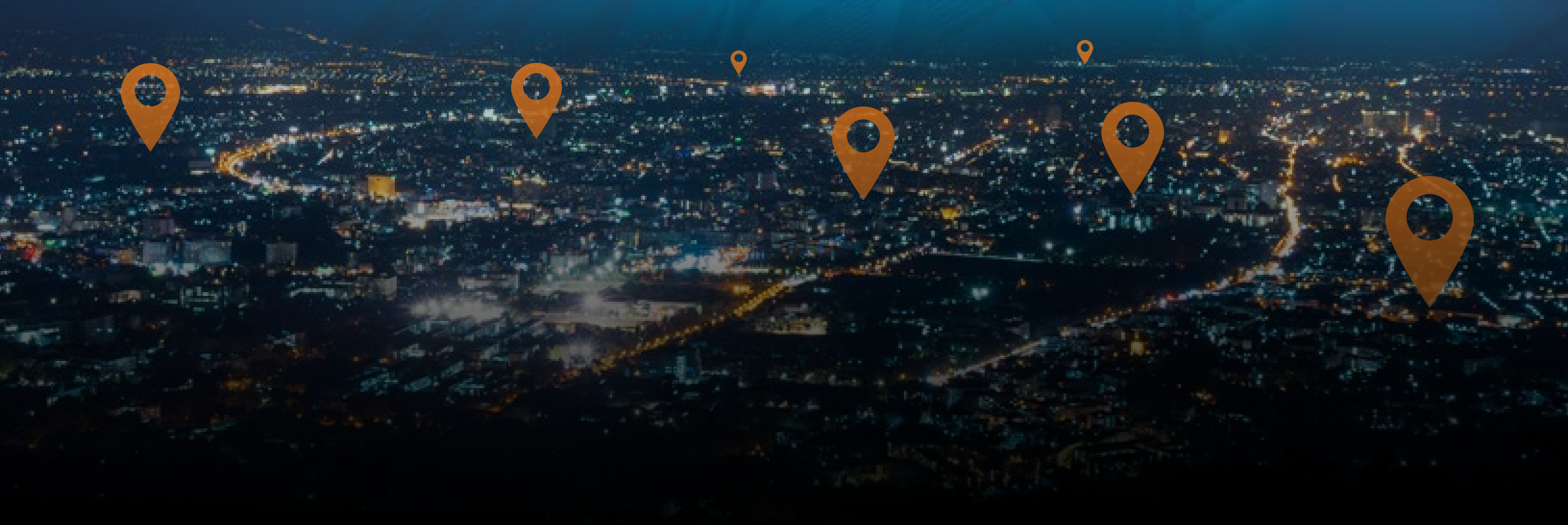
INTRODUCTION

Current institutional investors and developers who have raised opportunistic and value-add funds will have a significant advantage—both their experience with ground-up developments, and possible experience in the neighborhoods that have now qualified as Opportunity Zones, make them natural first movers. Large owner-users and long-term holders of commercial real estate also stand to benefit from the tax plan, primarily because the maximum benefit occurs at the 10-year hold mark and their longer investment horizon lessens the impact of changes in Opportunity Zone law or even local events that might negatively impact short-term investment yield.

The advantages are not constrained to the real estate community—any individual or corporation, from a local businessperson to a high net worth individual, with a recent or upcoming capital gain also can benefit by rolling their gains into an Opportunity Fund or Opportunity Fund Business (via equity interest). By qualifying as an Opportunity Zone Business, local businesses such as retail shops or distribution facilities within Opportunity Zones can raise capital by receiving direct investment from Opportunity Funds or by issuing equity interest to various classes of investor.

Prevailing market forces have redirected investments to many of the areas that now qualify as Opportunity Zones—some of the largest and most active foreign and domestic institutional groups are coincidentally the largest current investors in Opportunity Zones, such as Blackstone, Brookfield and Greystar. As the cycle has progressed, investors have grappled with lower returns across all asset classes, from equities in the S&P 500, which have averaged just above 12% annual return over the past three years, to commercial real estate yields, which have compressed in major markets to approximately 4.5% for office properties in markets like San Francisco and Manhattan.

Institutional groups have chased yield into developing submarkets in close proximity to major metros, and also into thriving non-gateway markets. Value-add and opportunistic fund strategies have grown in importance as the supply of core and core-plus product in these developing markets is inherently low. Therefore, for groups already developing product in Opportunity Zones, the legislation will reinforce their existing investment strategy and will almost certainly boost demand, without imposing costs related to strategy development and the identification of product. The lower return environment has also made debt and tax-deferral strategies more important to funds seeking to meet return benchmarks and deliver satisfactory performance to their investors, which could increase adoption of the Opportunity Zone program.



LEGISLATION **TIMELINE**

2017

DECEMBER 2017
Program is released as part of the Tax Cuts and Jobs Act

2018

MARCH 21, 2018
Governors' deadline to nominate up to 25% of the qualified census tracts in their state as Opportunity Zones

OCTOBER 19, 2018
The Treasury Department released guidance on the initially proposed regulations, including clarification of the 70-30 rule and requirements for the improvement period

2019

JANUARY 10, 2019
Public hearing will be held to discuss proposed regulations and provide further clarification and guidelines

DECEMBER 31, 2019
Deadline to maximize the deferral benefit on invested capital gains, assuming the investment is held for 7 years (see page 6 for further information)

2026

DECEMBER 31, 2026
The date when Opportunity Zone investors must pay the deferred capital gains tax on their invested capital gains

2028

DECEMBER 31, 2028
The Opportunity Zone designation for qualified census tracts expires on this date

OPPORTUNITY FUND **REQUIREMENTS**

- Must be organized as a corporation or partnership for the purpose of investing in Qualified Opportunity Zone property
- LLCs can organize as a Qualified Opportunity Fund as long as they choose to be treated as a partnership or corporation
- Individuals and corporations can self-certify through the IRS by filling out Form 8996 with their federal income tax return
- Opportunity Funds are the required investment vehicle to invest in Opportunity Zones
- Investors have 180 days to invest a capital gain into a Qualified Opportunity Fund that invests in Opportunity Zones
- Opportunity Fund investing does not require the use of a qualified intermediary
- Qualified Opportunity Zone Property is property that is:
  - Stock
  - Partnership Interests
  - Business Property
- Hold at least 63% of their assets in Qualified Opportunity Zone property (applying the 70-30 rule to the original 90-10 requirement)
- Lending activity on an Opportunity Zone project does not qualify as an OZ investment
- Opportunity Fund investments in real estate are subject to a substantial improvement or original use requirement
- There are carveouts for non-qualified businesses, i.e., casinos, golf courses, racetracks, etc., and for financial companies that invest and lend as their core business

REAL ESTATE **REQUIREMENTS**

For real estate property to qualify as Opportunity Zone property, the real estate property needs to have been acquired after December 31, 2017, and meet one of the two requirements below:

SUBSTANTIAL IMPROVEMENT

- A property is substantially improved when capital improvements in the 31-month period following the acquisition exceed the purchase price of the property, land value excluded
- Qualifying Example: Property is purchased for $1.0 million with land value of $200,000. Within 31 months, the OZ investor must improve and invest at least $800,000 to qualify as substantially improving the property

ORIGINAL USE

- This requirement has not been fully clarified by the Treasury Department, and therefore caution is advised for developers attempting to meet it
- The Opportunity Fund must prove that it is the first to use a property, during the property's existence
- If interpreted similarly to "empowerment zones," this rule would also apply to real property that has been vacant for more than one year, that is put to a commercial use by an Opportunity Fund
- In the case of unimproved or vacant land, it has been interpreted that the original use provision commences with the development/improvement of the land into a property type (industrial, retail, etc.).

OPPORTUNITY FUND BUSINESS **& EQUITY INTEREST**

OPPORTUNITY ZONE BUSINESS

- Substantially all (70%) of tangible assets of the Opportunity Zone Business must be owned or leased in an O Zone and at least 50% of the gross income earned by the business must be from the active conduct of the business in the Opportunity Zone
- If the business is newly formed, it doesn't need to hold Opportunity Zone investments at the time of purchase, as long as it is established and organized as an Opportunity Zone Business
- With the exception of various leisure businesses (such as golf courses and gambling facilities), most businesses would qualify and can range from industrial distribution facilities to retail shops
- It is unclear whether the Treasury Department will allow technology firms, or other businesses that can conduct business globally from a location in an Opportunity Zone, to qualify
- Opportunity Funds may hold interest in an Opportunity Zone Business directly or through a subsidiary partnership or corporation

OPPORTUNITY ZONE EQUITY INTEREST

- Equity issued by any domestic corporation that is a Qualified Opportunity Zone Business
- Capital gains reinvested in Opportunity Zone equity are subject to the same tax benefits as direct investments into Opportunity Zone Property
- The issuing corporation (O Zone Business) may not redeem a "significant" amount of its own stock one year before or after it issues its Opportunity Zone equity
- The issuing corporation (O Zone Business) may not redeem any equity from an Opportunity Fund, or related party, two years before or after it issues Opportunity Zone equity to that Opportunity Fund

TAX BENEFITS BY INVESTMENT **TERM LENGTH**

<5 *YEARS*

Deferred payment of **invested** capital gains until the date the Opportunity Fund investment is sold or exchanged.

5 *YEARS*

Deferred payment of **invested** capital gains and liability is reduced by 10%.

7 *YEARS*

Deferred payment of **invested** capital gains and liability is reduced by 15%.

10 *YEARS*

In addition to deferred payment and 15% reduction in liability of **invested** capital gains, **accrued** capital gains generated from the Opportunity fund investment are 100% tax exempt.

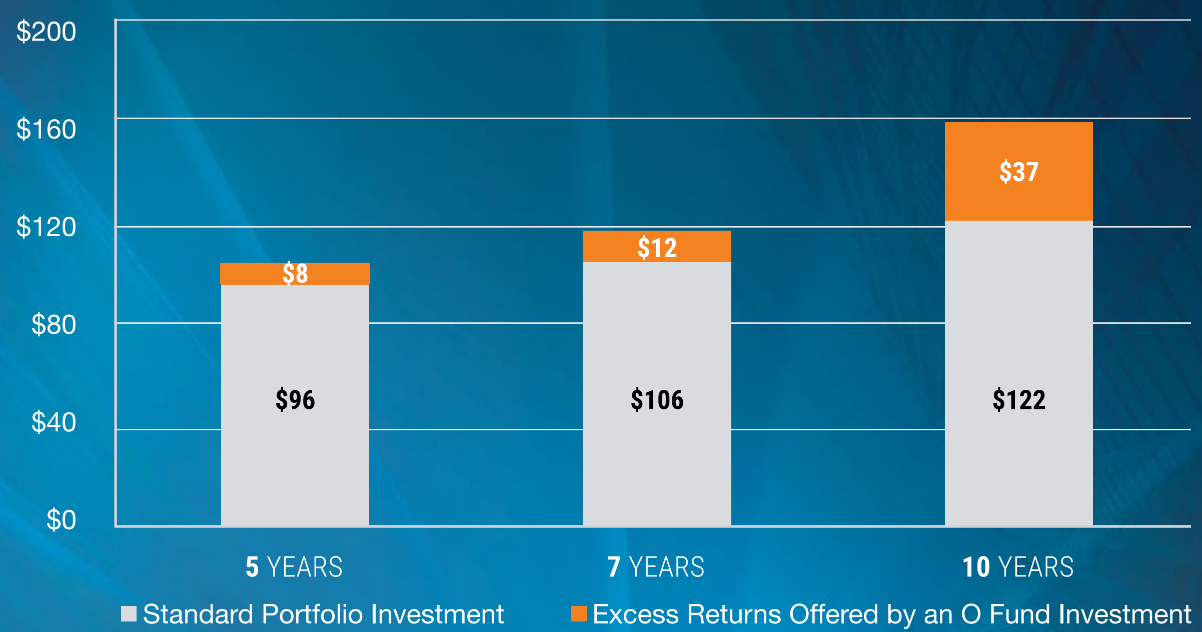
5 to10+ YEARS SIMPLIFIED
INVESTMENT EXAMPLE

SCENARIO: *A CAPITAL GAIN OF $100 REALIZED AND REINVESTED IN 2018*

	NON-OPPORTUNITY ZONE PROPERTY			OPPORTUNITY ZONE PROPERTY			
HOLDING PERIOD	TAX LIABILITY	FUNDS AVAILABLE POST-TAX	POST-TAX ANNUAL RATE OF RETURN	TAX LIABILITY	FUNDS AVAILABLE POST-TAX	POST-TAX ANNUAL RATE OF RETURN	POST-TAX ANNUAL RATE OF RETURN DIFFERENCE
5 Years	$30	$96	-1.12%	$29	$104	0.86%	1.97%
7 Years	$33	$106	0.99%	$32	$118	2.41%	1.42%
10 Years	$38	$122	2.58%	$20	$159	4.74%	2.16%

*Assumes long-term federal capital gains tax rate of 23.8%, no state income tax, and annual appreciation of 6% for both the O Fund and alternative investment.

AFTER-TAX VALUE OF INVESTMENT
SCENARIO: *A CAPITAL GAIN OF $100 REALIZED AND REINVESTED IN 2018*



Source: NKF Research

ADVANTAGES	CHALLENGES	UNCERTAINTIES
Unlike 1031 exchanges, capital gains from any investment (whether it be the sale of a business, or of stock) can be rolled into Opportunity Zones, within 180 days of sale. This opens up real estate investment to individuals and groups far beyond traditional real estate investors.	The inherent difficulty and risk involved with investing in impoverished and low-income neighborhoods; some areas might not be able to recover or appreciate as predictably as more established areas.	If the tax plan is not extended past December 31, 2026, investors could begin paying taxes on the accrued capital gains from the O Zone investment after this date, regardless of hold time. This is referred to as the "phantom" income date and is an inherent tax risk.
Opportunity Zones favor unrenovated class B/C product and raw land/development sites in emerging areas, which might already be targets by opportunistic funds, and even certain value-add focused funds.	Local regulations and permitting varies on a neighborhood basis. Some neighborhoods might be more accommodating to development than others.	Whether the "improvement" period can be extended past the 31-month requirement, due to delays caused by permitting, natural disasters, financing, labor shortages, and all other delays outside of the fund's control.
The stated goal of Opportunity Zones is to improve and encourage development of qualified communities; if successful, value can be created throughout the community and have a compounding effect on the original investment.	Securing financing, especially for construction loans, could potentially prove difficult, and will be highly dependent on the experience of the Opportunity Fund and their development plan.	Construction and rehabilitation may take much longer than 31 months and may occur in several build phases; Opportunity Funds might need a longer runway to fully develop their O Zone site. However, it is unclear whether the IRS will be accommodating of this reality.
A business currently can lower its tax basis by using depreciation, and still receive benefits of Opportunity Zones.	Finding investors, particularly less sophisticated retail investors, could be a challenge; most of the industry has not caught up with the legislation, and the legislation continues to evolve.	Whether the IRS will continue to allow the depreciation of assets within an Opportunity Zone, which lowers your overall tax basis, in combination with complete accrued capital gains deferral after a 10-year hold period.

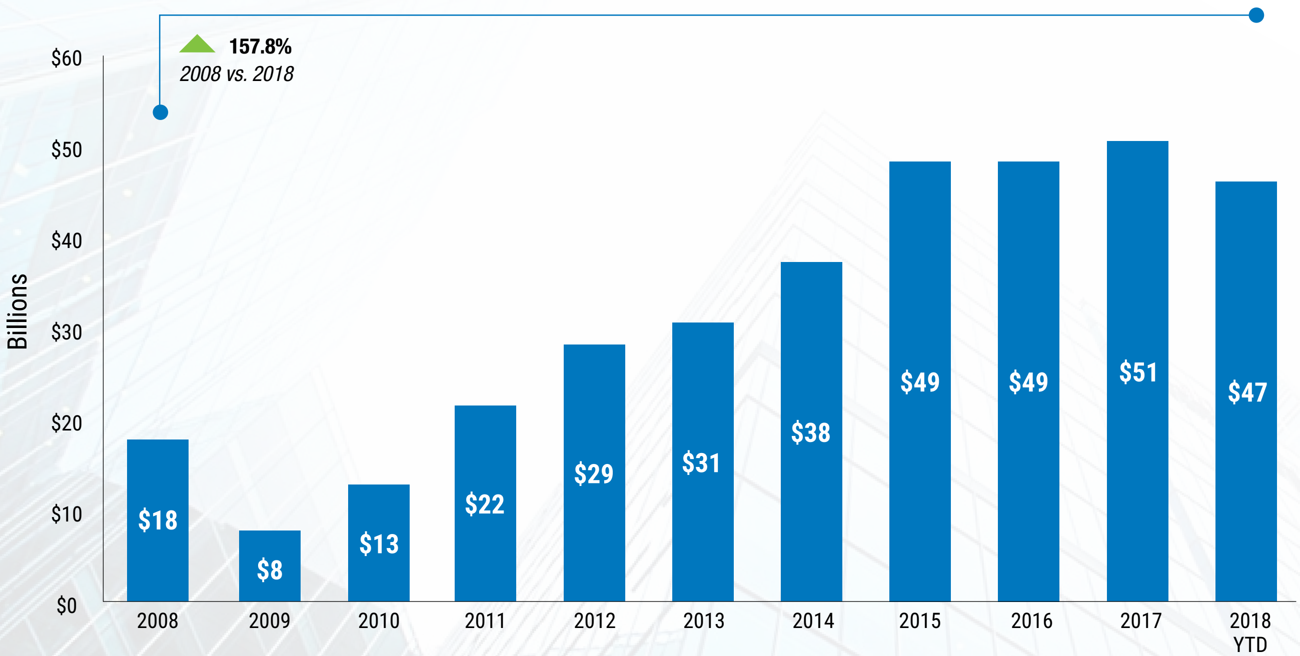
	1031 EXCHANGE	OPPORTUNITY ZONE BUSINESS PROPERTY
Like-Kind Property	Required	Not Required
Property Type	Real, tangible property only	Can be real or personal property as well as unimproved land, so long as a plan exists to improve the property in an O Zone
Finding the Replacement Property	Replacement property must be identified in 45 days, with limits on numbers of properties	180 days; deferred capital gains do not need to be managed by a qualified intermediary before they are deployed
Amount Invested	Both principal and capital gains from the sale	The capital gains from any qualified investment or business sale
Partnership Interests, Stock, or Personal Property	Not allowed	Allowed
Recognition of Deferred Gain	Upon sale of replacement property unless further deferred in another like-kind exchange	December 31, 2026, or sale of property, whichever occurs first
Income Tax Basis Step Up for Holding Property Five or Seven Years	None	10% if five years before December 31, 2026, 15% if seven years before December 31, 2026
Sale to Related Parties	Two-year holding period required	Retention of less than 20% interest stake required. If over 20% is retained after sale, owner is considered a related party and the deal does not qualify
Improvement or Use Requirement	None	Substantial improvement of the property; if property is owned by an O Zone Business, use is limited to the O Zone where the property is located
Future of Program	Program nearly limited to $1 million per taxpayer per year in an early 2016 tax bill that did not pass	Program is guaranteed until December 31, 2026. The Opportunity Zone designation for census tracts is valid until December 31, 2028

HISTORICAL INVESTMENT **IN OPPORTUNITY ZONES**

(Inclusive of activity in areas prior to designation)

- Demand for product has steadily risen in Opportunity Zones, even before the legislation was enacted; the past three years have attracted nearly $150 billion dollars in investment volume nationwide.
- As yields have compressed in coastal gateway markets, particularly as the current cycle progresses, investors have chased yield into smaller non-gateway markets. This trend has benefitted Opportunity Zones, which are predominantly located in non-gateway metros.
- While the largest markets; such as NYC and Los Angeles, continue to attract the most investment volume, the majority of investment occurs in other non-gateway cities, which have accounted for $34.7 billion dollars, or 67%, of investment volume in the past 12 months.

UNITED STATES TOTAL SALES VOLUME | ANNUAL TOTALS



Source: NKF Research, Real Capital Analytics

TOP BUYERS

24 Months Opportunity Zones

1. Blackstone
   $3.8 billion
2. Brookfield
   $1.8 billion
3. Wind Creek Hospitality
   $1.3 billion
4. Fireside Investments
   $1.2 billion
5. Gaming & Leisure Properties
   $930 million
6. Greystar
   $771 million
7. Morgan Properties
   $659 million
8. TH Real Estate
   $608 million
9. DivcoWest
   $505 million
10. GIC
    $504 million

Source: Real Capital Analytics

SELECT OPPORTUNITY ZONE FUND TARGETS

$1,000M+

Skybridge Capital
(EJF Capital will act as subadvisor)
$3 billion

$500M–$999M

RXR Realty
$500 million

Fundrise
$500 million

EJF Capital
$500 million

Youngwoo & Associates and EquitMultiple
$500 million

Caliber
$500 million

Bridge Investment Group
$500 million

$100M–$499M

PNC Financial Services Group Inc
$468 million

Enterprise Community Partners
$250 million

Normandy
$250 million

Rubenstein
$200 million

Virtua Partners
$200 million

Heritage Equity Partners
$100 million

<$100M

Viceroy Equities
$75 million

Source: NKF Research, Bloomberg, WSJ

UNITED STATES
OPPORTUNITY ZONE MAP

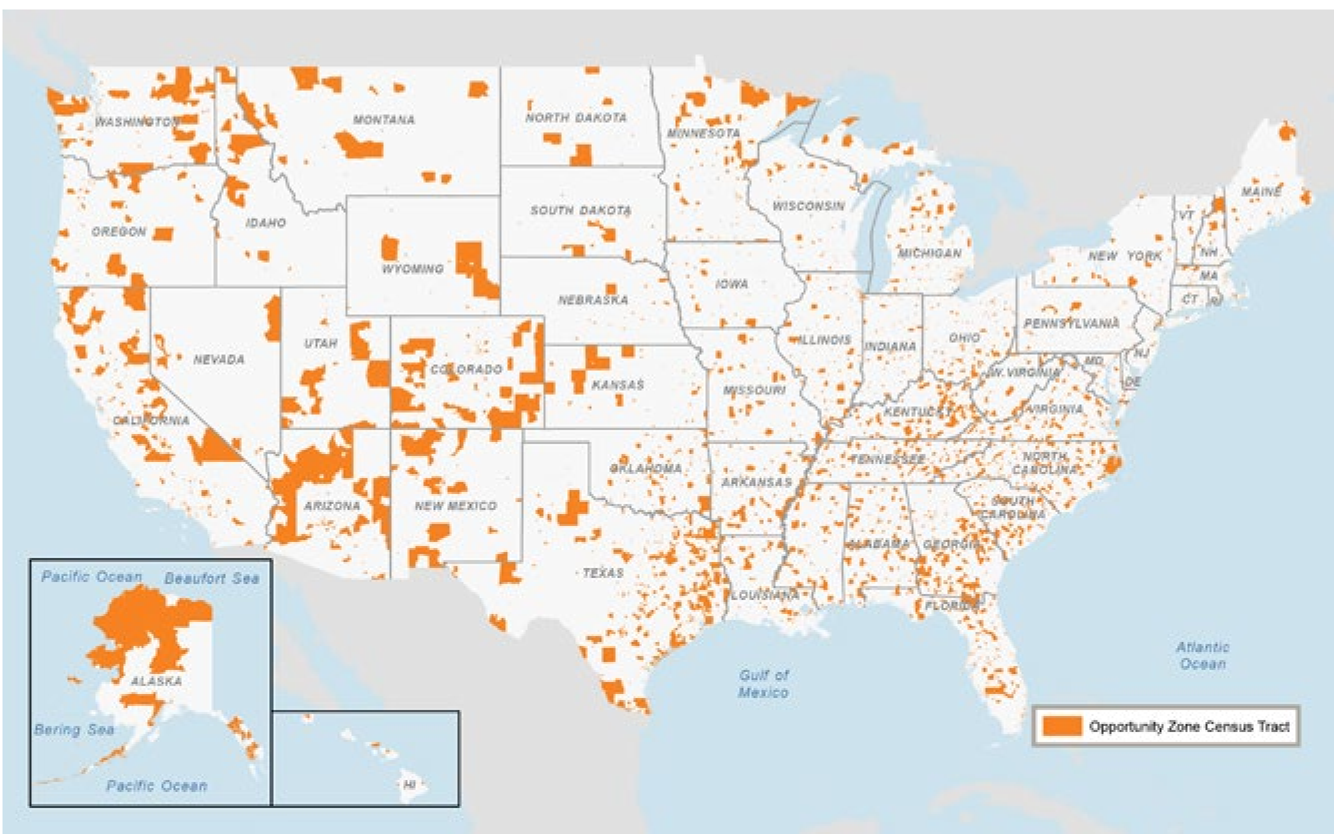
Despite the low-income community requirements for Opportunity Zones, many well-known emerging markets have made the list, from census tracts in Bushwick and Bed-Stuy, Brooklyn to the South End in Boston. As these neighborhoods have already begun to attract the attention of institutional funds and are transitioning into vibrant live-work-play neighborhoods, the location risk for prospective investors is substantially less compared with investments in less well-known areas, further away from urban cores.

$6 Trillion
Estimated unrealized capital gains from both American households and corporations

1 Million
Properties across all property types nationwide are thought to be located within Opportunity Zones

$52,694
Average household income in Opportunity Zones

18.2% of Total Land Area
in the U.S. that is represented by Opportunity Zones; comprises 5.4% of major metro land area



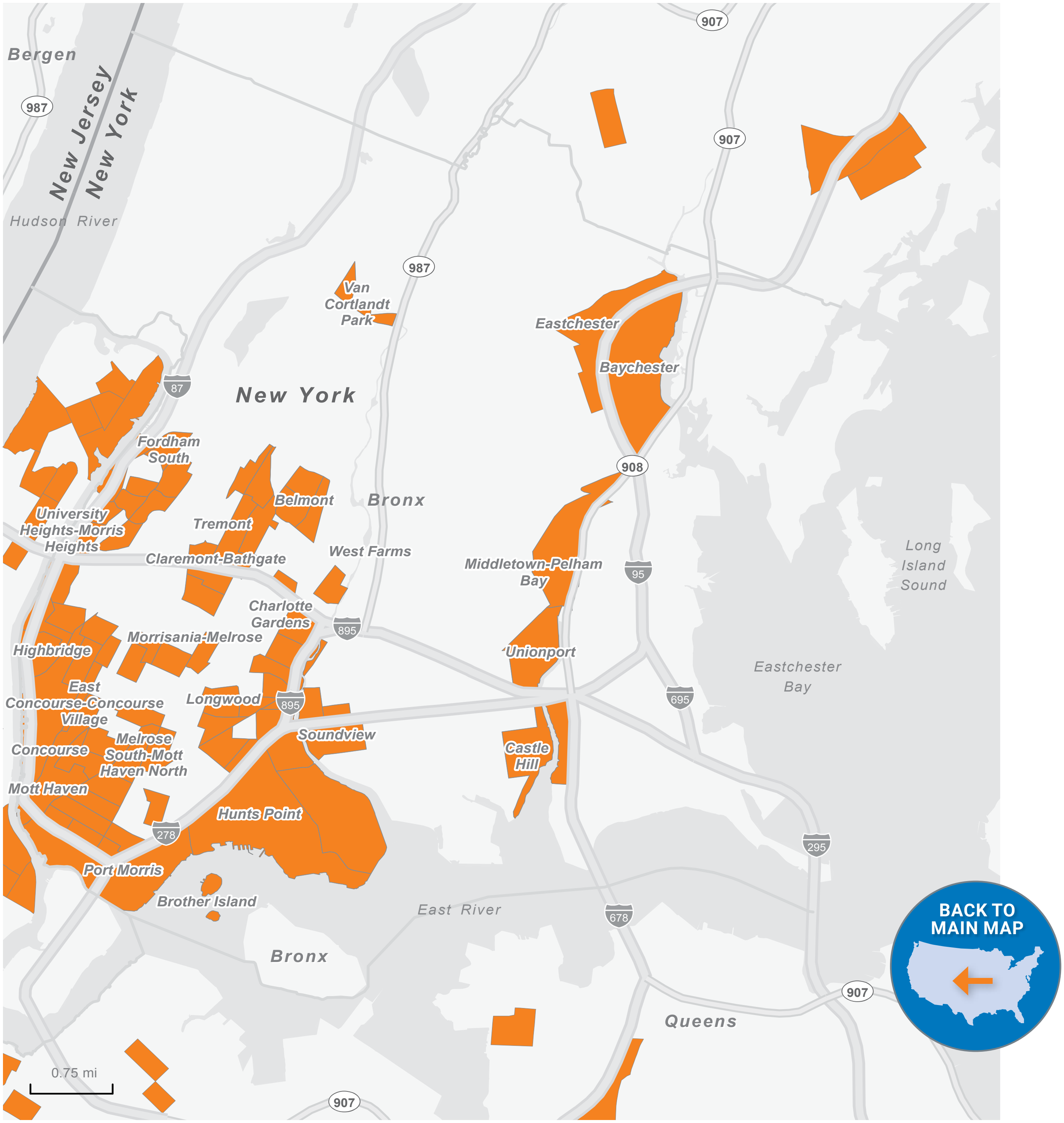
This map was produced using reliable private and government sources. This information is provided without representation or warranty.

Source: ESRI

SELECT UNITED STATES CITIES
OPPORTUNITY ZONE MAPS

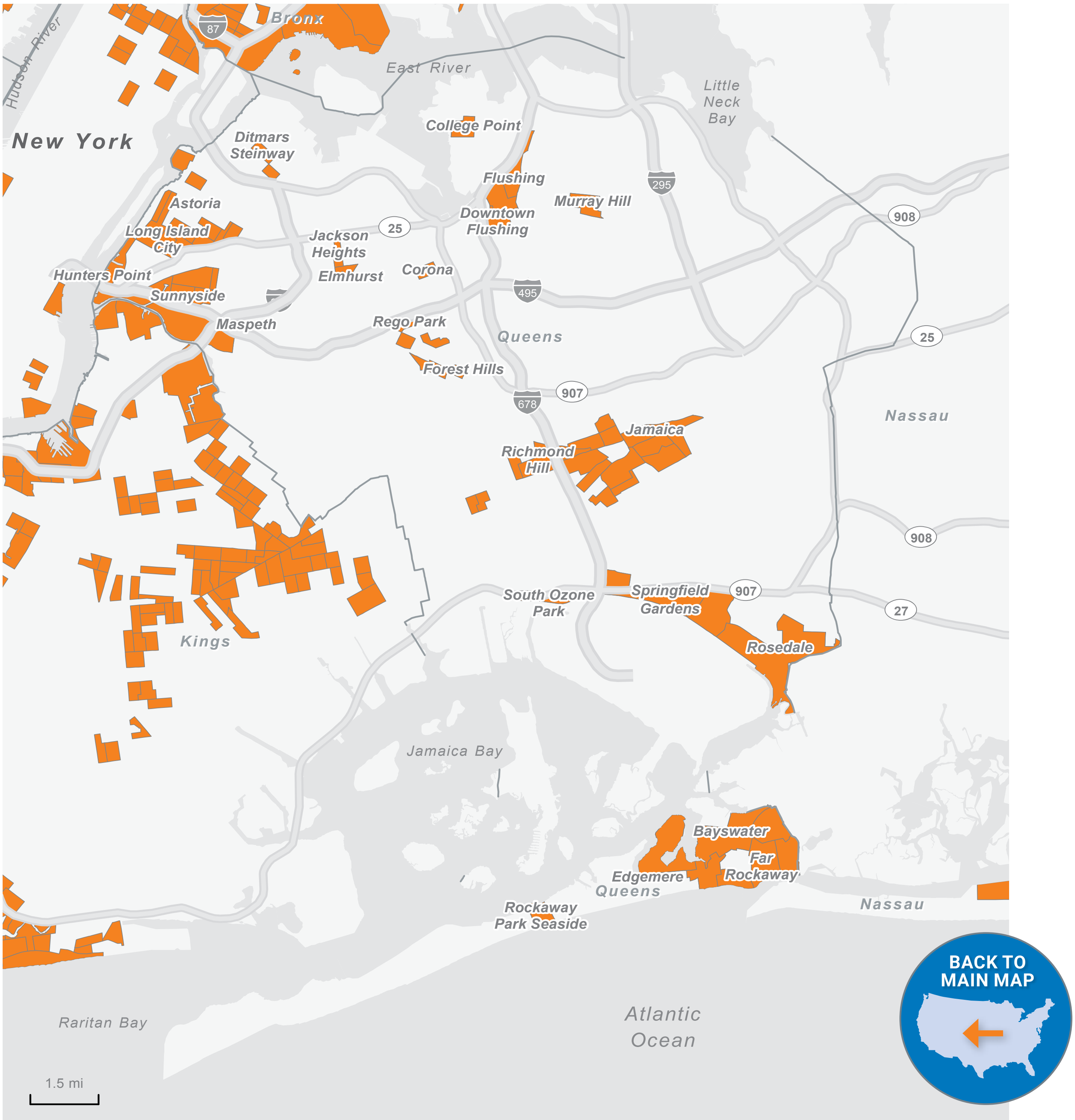
NEW YORK CITY: **BRONX**

OPPORTUNITY ZONE MAP



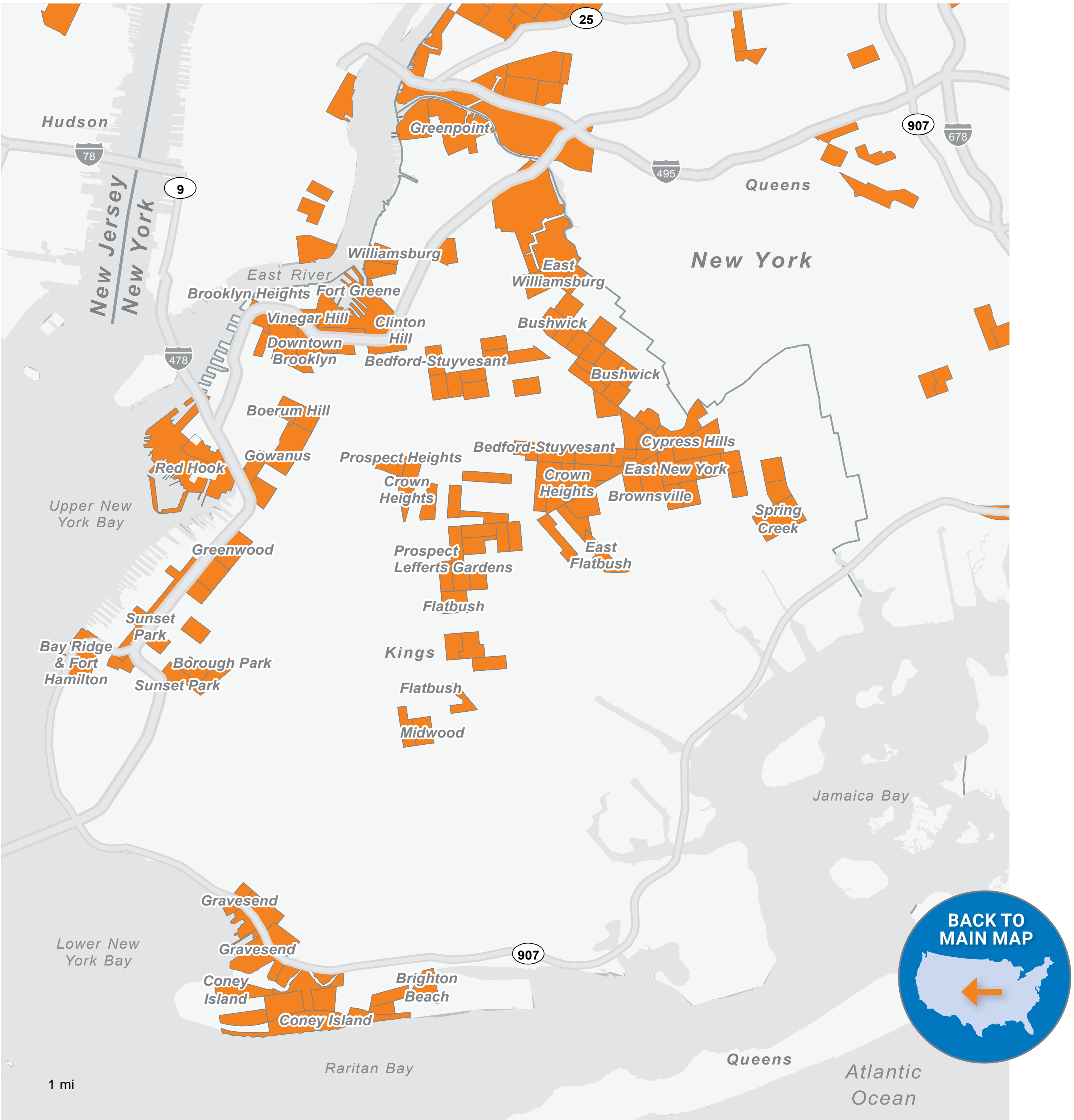
NEW YORK CITY: **QUEENS**

OPPORTUNITY ZONE MAP



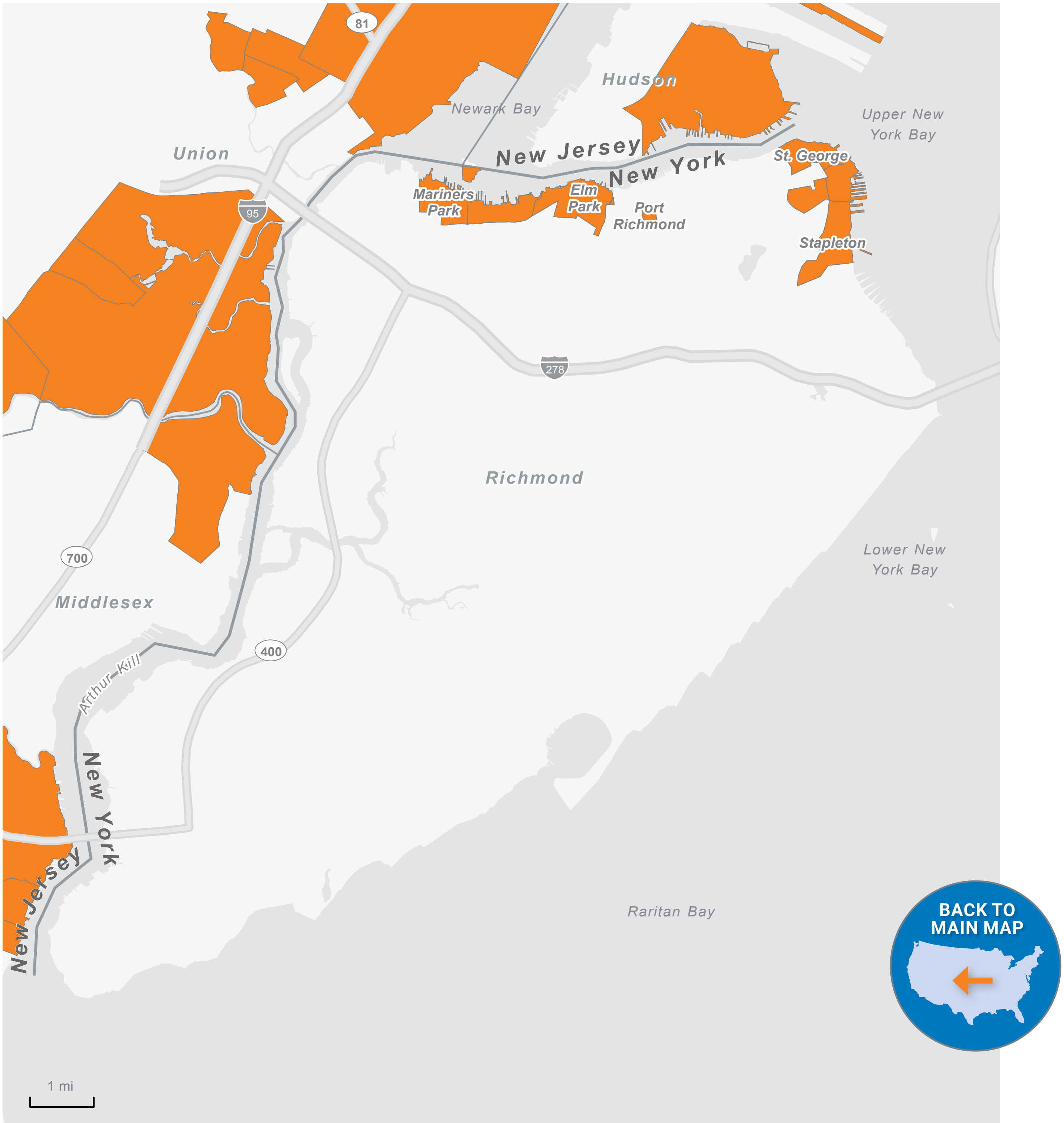
NEW YORK CITY: **BROOKLYN**

OPPORTUNITY ZONE MAP

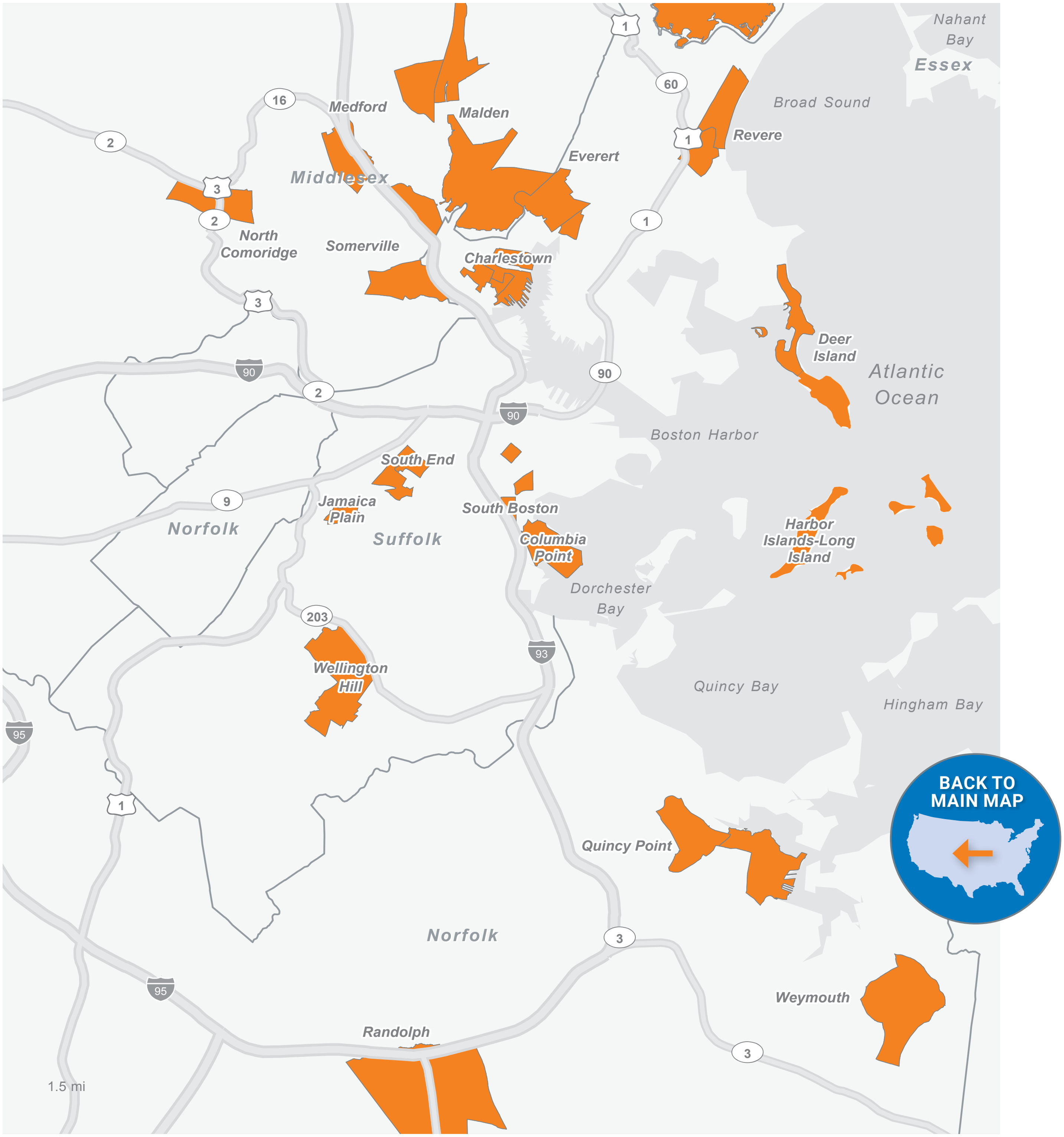


NEW YORK CITY: **STATEN ISLAND**

OPPORTUNITY ZONE MAP

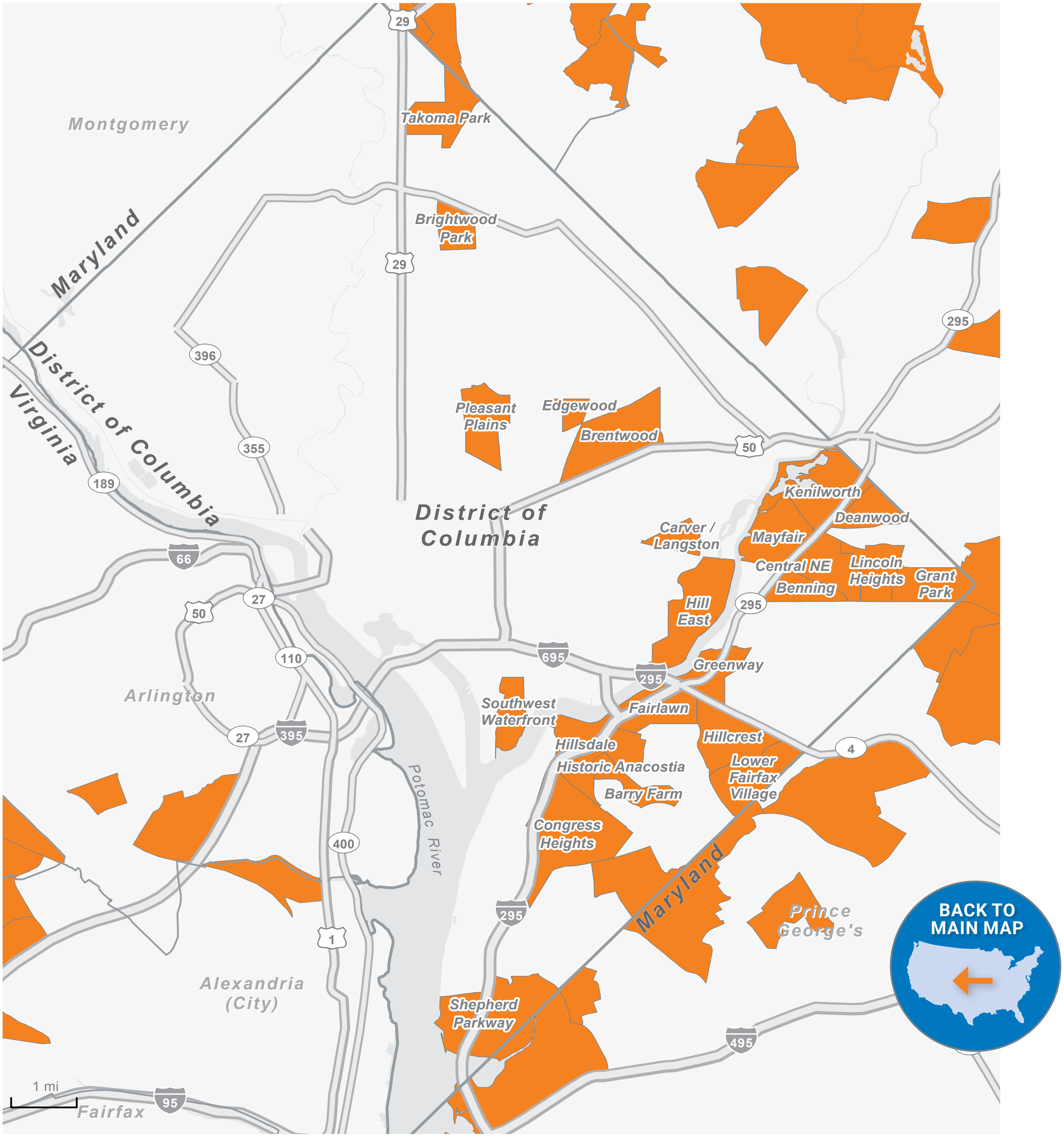


BOSTON
OPPORTUNITY ZONE MAP



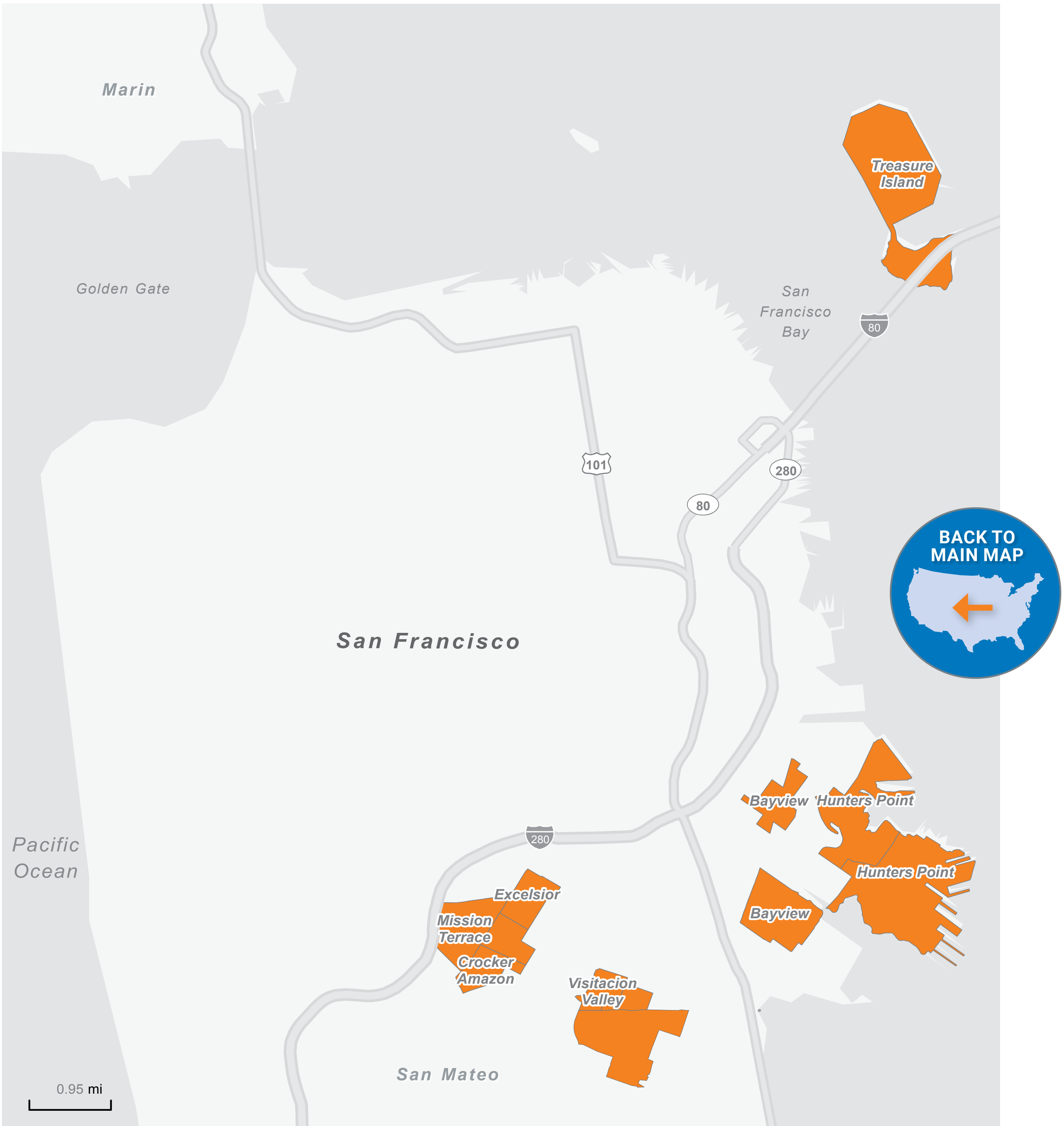
DISTRICT OF COLUMBIA

OPPORTUNITY ZONE MAP



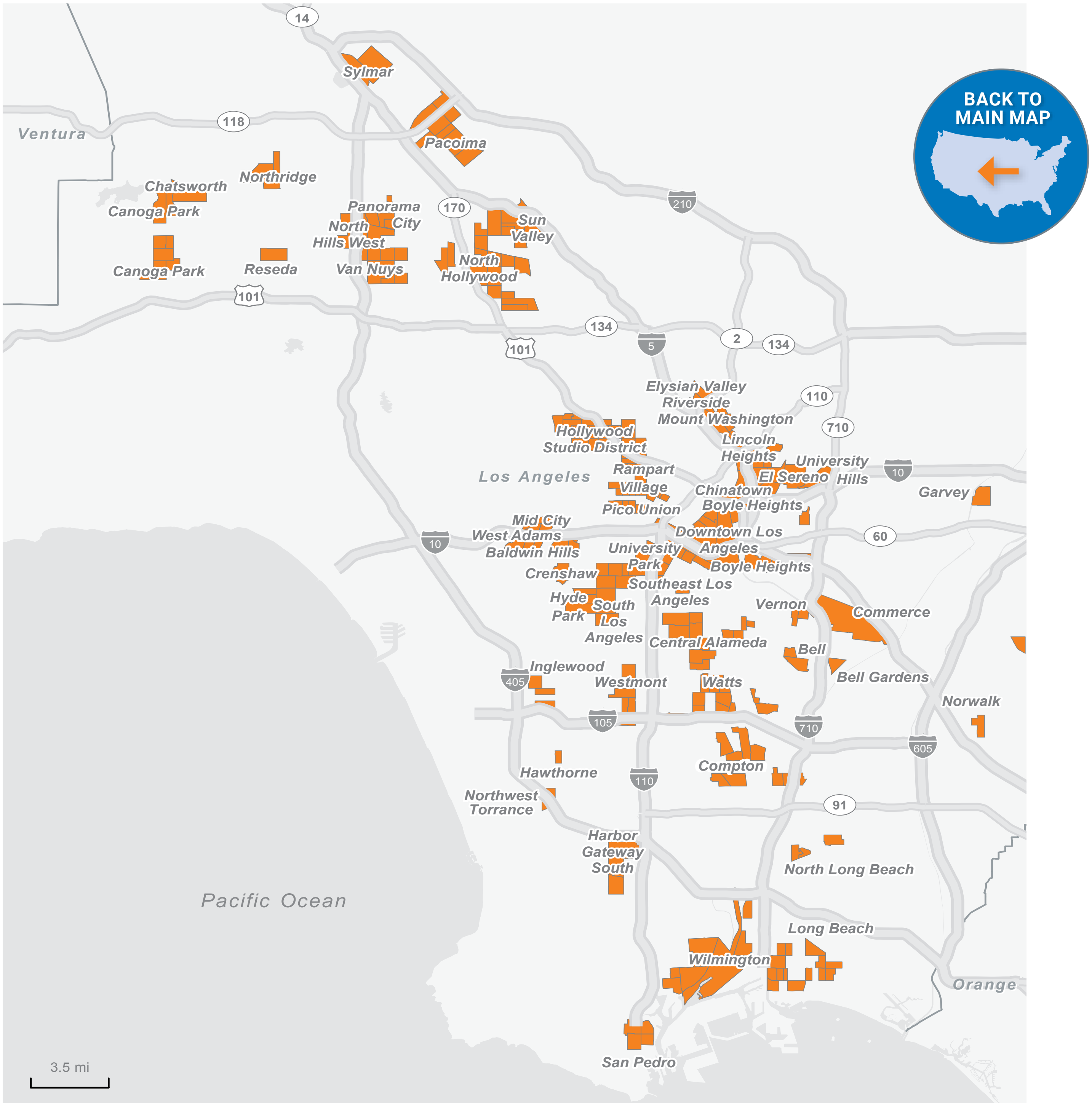
SAN FRANCISCO

OPPORTUNITY ZONE MAP



LOS ANGELES

OPPORTUNITY ZONE MAP



NEW YORK CITY HEADQUARTERS
125 Park Avenue
New York, NY 10017
212.372.2000

Jonathan Mazur
Senior Managing Director, National Research
212.372.2154
jmazur@ngkf.com

Alexander (Sandy) Paul
Senior Managing Director, National Research
202.312.5783
apual@ngkf.com

Mike Wolfson
Associate Director, Capital Markets Research
212.372.2453
mwolfson@ngkf.com

Daniel Littman
Capital Markets Research Analyst
212.372.2488
daniel.littman@ngkf.com

Rich Lachowsky
Research Analyst
801.578.5532
rlachowsky@ngacres.com

Newmark Knight Frank

NORTH AMERICA
Canada
United States

LATIN AMERICA
Argentina
Brazil
Chile
Colombia
Costa Rica
Mexico
Peru
Puerto Rico

EUROPE
Austria
Belgium
Czech Republic
France
Germany
Ireland
Italy
Netherlands
Poland
Portugal
Romania
Russia
Spain
Switzerland
United Kingdom

ASIA-PACIFIC
Australia
Cambodia
China
India
Indonesia
Japan
Malaysia
New Zealand
Philippines
Singapore
South Korea
Taiwan
Thailand

AFRICA
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

MIDDLE EAST
Saudi Arabia United
Arab Emirates

Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents.

Newmark Knight Frank Research Reports are also available at www.ngkf.com/research