MARKET NEWS

YOUR QUARTERLY CAPITAL MARKETS UPDATE FOR 2Q|2019

NORTHMARQ

OPPORTUNITY ZONES

CREATING VALUE WHILE REAPING TAX BENEFITS

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Download Research Rundown: Opportunity Zones at **http://bit.ly/2VpjDXY**

The explosion of information about Opportunity Zones has many people in CRE perplexed about how to make sense of "opportunities" for their market or their project. Each state determines which sites are designated as Opportunity Zones, so much work rests with local market real estate and tax experts.

The pure definition of an Opportunity Zone (OZ): Parcels or physical assets to be used as an economic development tool, with tax benefits intended to spur investment, economic development, and job creation in distressed communities.

At NorthMarq, we were interested in understanding how we, as capital markets advisors, can support our clients' business, and worked with Director of Research Pete O'Neil to create ***Research Rundown: Opportunity Zones.*** Read the complete report here to understand the tax benefits, history, and timeline of this part of the 2017 U.S. Tax Cuts and Jobs Act.

THE OZ DESIGNATION IMPACT ON CRE TRANSACTIONS

Because Opportunity Zones are intended to encourage investment, only the equity portion of the capital stack will have a tax benefit. For the debt on these projects, we think that financing will come from traditional lending sources, and some capital sources, particularly the Agencies, will likely create incentives or special programs for multifamily properties or projects located within an OZ.

A few considerations for potential investments:

- Investors considering an OZ fund or specific project should weigh the actual location/submarket along with the experience of the sponsor. Strong real estate fundamentals are still critical to making the project viable.
- The timelines required to meet OZ rules are tricky, given that many real estate projects have development schedules much longer than 180 days, which is the window to qualify for a tax deferral benefit. It is rare that a CRE development can come to fruition with municipal approvals and site plans within that compressed timeline – so the investor will have to provide the commitment without being able to fully underwrite the project.
- Because the program is still in its infancy, few CRE professionals have actually worked on an OZ project. At this point, "experts" have only completed a deal or two, so investors should fully research the team and its advisors.

Find Opportunity Zones in your state: http://bit.ly/2UUpDDH

POTENTIAL STRATEGIES

Based upon our research, some strategies seem like natural fit for the OZ program:

- *Vacant Land Development:* Even though this seems like a slam-dunk, investors will still need to consider demand, zoning restraints and completion of the development by 2025.
- *Industrial:* To satisfy demand for the last-mile movement of goods, industrial developers are beginning to consider developing smaller buildings closer to population centers. Parcels in lower-income areas could be a natural fit for these types of projects.
- *Data Center:* Data centers require high build-out costs, which achieves the investment threshold. Data centers also require a great deal of power and fiber connectivity, meaning sites must have this infrastructure in place for a project to be viable.

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- *Manufactured Housing Communities:* With the increasing demand for affordable housing, the land under these properties lends itself to both demand and the investment criteria.
- *Older Class B or C Multifamily:* High demand is already in place for B and C value-add communities, so this strategy may be less likely to achieve the investment targets.

TAX BENEFITS MAY BE REALIZED FROM OZ

Significant tax benefits can be achieved through an OZ investment by deferring or eliminating capital gains from other investments but specific rules drive timing. First, to qualify for a tax deferral benefit, the investor must place the amount of a realized capital gain into an OZ investment—or an OZ fund—within 180 days of realizing the gain. Second, these investments must have been held for at least five years by the end of 2026, meaning the investment must be made by the end of 2021 to achieve the tax benefit. Finally, the realized gain is not limited to a capital gain from real estate to benefit from the program. In this way, the OZ is different from the 1031-exchange.

However, the program specifics continue to evolve. The Internal Revenue Service and the Treasury Department continue to clarify the regulations surrounding OZs. There have been two releases of proposed regulations—one in October of last year and another in April of this year. There will be increased clarity as to how the program will work as regulations are released.

LEVERAGE LOCAL EXPERTISE

Across our platform, debt, equity and investment sales professionals are gaining more and more knowledge every week. We can help you evaluate the OZs in your market, guiding you through the complex, ever-changing rules to ensure the best fit for your real estate investment. To find the team in your market visit **NorthMarq.com/offices.**

IF AN INVESTOR
holds an investment in the Opportunity Fund for at least
10 YEARS
the investor would be eligible for an increase in its cost basis equal to the fair market value of the investment at the time of sale—effectively
ELIMINATING TAX
from the gain in the fund

INVESTORS CAN DEFER TAX ON PRIOR CAPITAL GAINS UNTIL NO LATER THAN DECEMBER 31, 2026, IF THE GAIN IS REINVESTED IN A QUALIFIED OPPORTUNITY FUND

DECEMBER 2017
The Tax Cuts and Jobs Act passes on December 22, 2017. As part of the tax package, the Opportunity Zone program is established.

MARCH 2018
First deadline for states to nominate low-income communities to be designated as Qualified Opportunity Zones

APRIL 2018
The Treasury Department and the IRS designate the first round of Opportunity Zones in 18 states/territories

JUNE 2018
Treasury and the IRS announce the designation of the final round of Opportunity Zones in all 50 states, the District of Columbia and five U.S. territories

DECEMBER 2019
Year-end 2019 is the deadline to maximize the tax deferral benefit for invested proceeds held less than 10 years