

Opportunity Zones

Defer



Reduce



Eliminate

Quiz Question #3

- How many opportunity zones are there?
 - 693
 - 1,031
 - 3,460
 - 8,700

Opportunity Zones

- Part of Tax Cuts and Jobs Act
- Timeline
 - Investor sells asset generating capital gain
 - Invests gain (all or partial) in a Qualified Opportunity Fund
 - 10% step-up in basis if invested for five years
 - Additional 5% step-up if invested for seven years
 - Deferred gain becomes taxable December 31, 2026
- If QOF investment held for 10 years, no capital gain

I have a client selling investment real estate. Which option is most suitable – a 1031/DST or an opportunity zone fund?

1. What is the client's basis?

1031 Exchange/DST	Opportunity Zone Fund
Low basis	Significant basis

2. Does the client want to 1031 again?

1031 Exchange/DST	Opportunity Zone Fund
Investor can 1031 again	Taxes due 12/31/2026

3. Does the client need immediate cash flow?

1031 Exchange/DST	Opportunity Zone Fund
Immediate cash flow	Cash flow post development

4. How aggressive is the client's risk profile?

1031 Exchange/DST	Opportunity Zone Fund
Stabilized assets	Development Risk

5. Is the investor ok with a blind pool?

1031 Exchange/DST	Opportunity Zone Fund
Fully identified assets	May be a blind pool

6. What level of diversification is needed?

1031 Exchange/DST	Opportunity Zone Fund
Often single asset	May be multiple asset fund

7. What are the investor's return expectations?

1031 Exchange/DST	Opportunity Zone Fund
Modest IRRs	Potentially higher IRRs

8. What is comfort level of compliance risk?

1031 Exchange/DST	Opportunity Zone Fund
Well established	New, significant, developing

9. What is the client's time horizon?

1031 Exchange/DST	Opportunity Zone Fund
Potentially < 10 years	At least 10 years

Quiz Question #4

- An investor places funds at a QI, ID's replacement property, but decides to not purchase. When does he/she get the money back from the QI?
 - Immediately upon notification to QI
 - After a 30-day hold on the funds
 - 135 days after the end of the ID period
 - Never – QI buys new boat

10. Is the investors outside the 1031 safe harbor?

1031 Exchange/DST	Opportunity Zone Fund
Must use QI; 45-day ID	No QI; up to 180 days

11. Is the client in a pass-through entity where other investors just want cash?

1031 Exchange/DST	Opportunity Zone Fund
Drop & swap prior sale	Investors not tied together

12. Does a potential OZ client reside in a conforming state?

1031 Exchange/DST	Opportunity Zone Fund
Irrelevant	If no, fewer tax benefits

Quiz Question #5

- In development projects, what could possibly go wrong?
 - Nothing
 - Everything
 - Somewhere between nothing and everything

Development Risks

- Construction delays due to factors such as weather and contractor issues
- Cost overruns due to increases in prices and unforeseen events
- Lease up risk as the project could take longer to lease than expected
- Economic risk as a recession may lead to lower demand and lower rents

More Development Risks

- Disputes with the city or neighbors
- Underground surprises
- Financing risk including interest rate risk and the ability to refinance the construction loan
- Lack of operating history on which to base projections
- Cap rates may be higher in the future than the sponsor's projections

Opportunity Zone Fund Issues

- Many new sponsors
- Extremely complex fund compliance
- Few OZs are attractive for development
- Land prices increasing in OZs
- Weak developer due diligence

More Opportunity Zone Fund Issues

- **Project readiness**
 - Entitlements/permits
 - Construction financing
 - GMAX contract
- **Reasonable projections**
 - Construction costs
 - Rents, occupancy, expenses
 - Stress tested
 - Reserves
 - Exit cap rates

SCENARIO: HYPOTHETICAL AFTER-TAX VALUE

Traditional Stock Portfolio

Qualified Opportunity Fund

Assumptions:

- L-T capital gains rate of 23.8% (federal cap gains 20% + net investment income tax 3.8%)
- 7% compounding rate of return both investments

Results:

- Additional \$441,280 in after-tax appreciation

Source:

- Cantor Fitzgerald

	<i>Traditional Stock Portfolio</i>	<i>Qualified Opportunity Fund</i>
ORIGINAL CAPITAL GAIN <i>from sale of prior investment</i>	\$1,000,000	\$1,000,000
TAX ON ORIGINAL CAPITAL GAIN	\$238,000 <i>Capital gains tax</i>	\$0 <i>Capital gains tax deferred</i>
INVESTABLE AMOUNT after tax	\$762,000	\$1,000,000
APPRECIATION over 10 years	\$736,969	\$967,151
TAXES ON APPRECIATION after 10 years	\$175,398 <i>Capital gains tax</i>	\$0 <i>No taxes due</i>
LONG TERM CAPITAL GAINS TAXES PAID IN 2027 on original capital gain	\$0	\$202,300 <i>23.8% of \$850k, basis stepped up 15%</i>
TOTAL VALUE OF INVESTMENT net of all taxes paid	\$1,323,571	\$1,764,851