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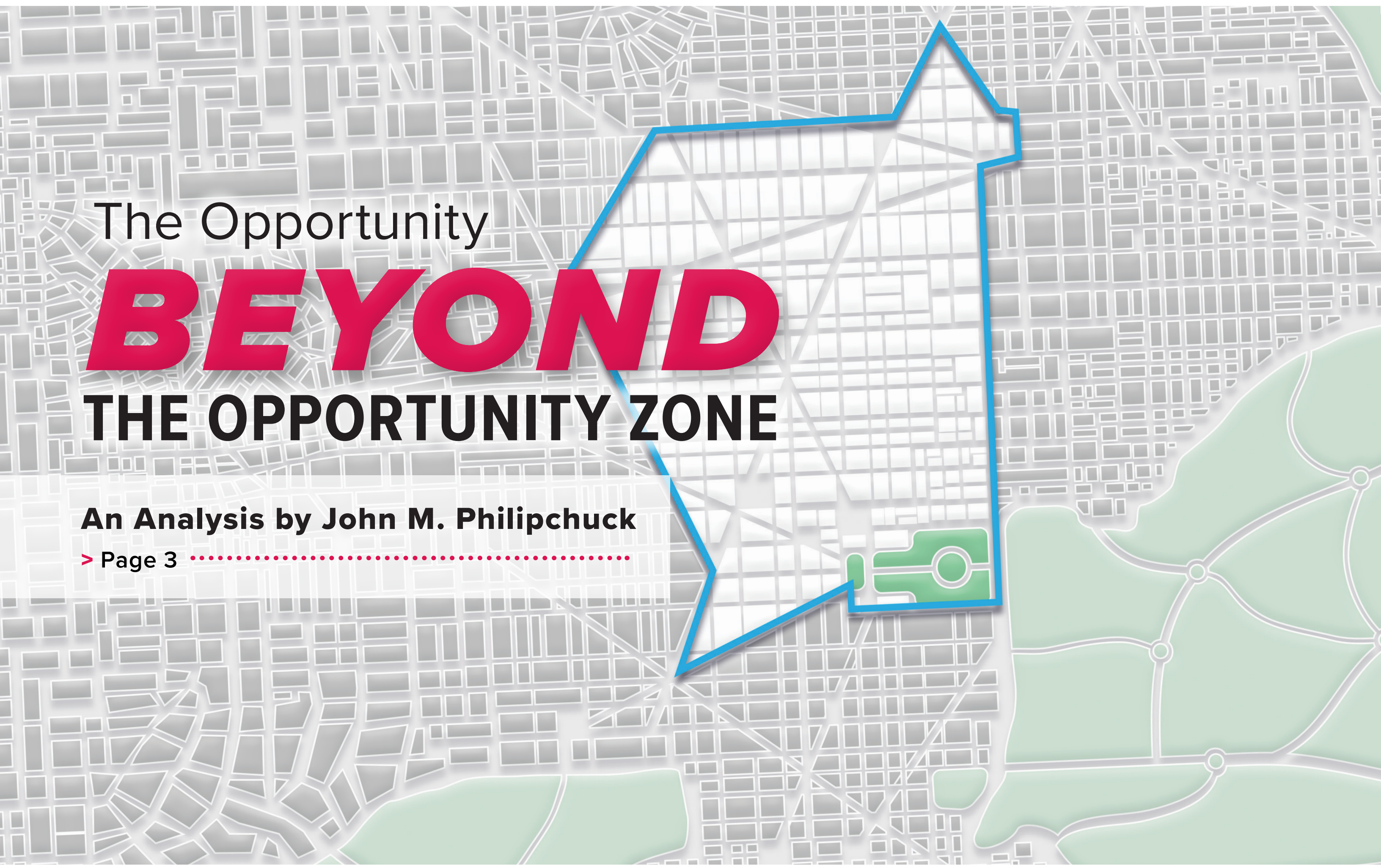

The Opportunity BEYOND THE OPPORTUNITY ZONE

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As We Look Ahead

BY JULIE L. MELANDER, CRE®
2019 CHAIR | THE COUNSELORS OF REAL ESTATE

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Happy New Year and Welcome to 2019! The year has just begun. This year, will we see a continuation of the Bull Market, a mild Economic Recession, or something in between?

The uncertainty and pace of change in our world and in our business are increasing exponentially. The year 2010 doesn't seem that long ago. Yet, think about it: the iPad, the iPhone 4 and 3D Digital Photography made their debut that year. It has been a little over 11 years since the iPhone was introduced, and now 77% of all adult Americans own a smartphone. The advent of this revolutionary new communication tool represents the fastest integration of new technology ever recorded: a Game Changer for virtually everything we do. Yet with this unprecedented ease and efficiency, comes disruption as long established, increasingly outmoded patterns of business disappear.

DIVERSITY AND THE CRE VALUE PROPOSITION

Change is definitely upon us, not only affecting our professional lives but the tenor and composition of our beloved organization. We now have over 50 real estate specialties represented within The Counselors of Real Estate. The average age of our membership is dropping. Our Global reach encompasses 19 countries and our organizational profile reflects the rising stature of women in our industry and in our world. We, as recognized property and thought leaders, must maintain our professional and organizational edge by continuing to embrace diversity, in its many forms, securing our role and relevance going forward.

Perhaps most of all, we must remain obsessed with the Counselors' "Value Proposition" which can vary with each member. Some are drawn to our unique industry outreach initiatives: The Consulting Corps, the CRE Foundation, and now the newly-launched "Giving Back/ Disaster Relief" initiative. Others particularly value the CRE credential which they find validates their expertise, enhancing their business and business development opportunities.

To enhance external branding, we have redesigned *The Counselor* and adopted an ambitious Strategic Plan for our award-winning Journal, *Real Estate Issues (REI)*. *REI* includes a new, easy to access digital format, more frequent circulation of articles, and a rapidly growing readership from outside the Counselor organization (**why not take a moment to send a complementary issue of REI to a colleague by contacting Managing Editor, Alyssa Bray at: abray@CRE.org**).

CRE BUSINESS COLLABORATION

A particular passion for me in my role as 2019 Chair is shining a spotlight on **"Business Collaboration with other CREs"**. We all need to make a living and what more natural, stimulating and lucrative way to do so than to align with fellow Counselors of Real Estate on assignments requiring multi-disciplinary expertise. I have appointed a special **"CREs Working Together"** Task Force to showcase examples of professional collaboration already in place and expand opportunities for more. Please reach out to me at CounselorsChair@gmail.com if you have interest in participating, have a story to tell, or an idea you believe could enhance this effort.

(*CONTINUE ON **PAGE 7***)

OPPORTUNITY ZONES

The Opportunity Beyond the Opportunity Zone

BY JOHN M. PHILIPCHUCK
FOUNDER & MANAGING PARTNER | IMPACTUS, LLC

ORIGINS OF THE "OZ"

With inadequate public and philanthropic resources available to address social and economic challenges in underserved communities throughout the United States, tapping into private capital has always been a viable solution. Enter Opportunity Zones.

The Opportunity Zone ("OZ") program is a new community investment tool established by Congress through the Tax Cuts and Jobs Act of 2017, signed into law on December 22, 2017. The OZ program was designed to incentivize long-term equity investments into low income and economically distressed areas. While the program is active today, legislative details are still being ironed out with input from private industry advocates.

The concept of Opportunity Zones was first presented publicly in 2015 in a white paper written by economists Jared Bernstein, the former Chief Economist under Vice President Joe Biden, and Kevin Hassett, the current Chairman of the Council of Economic Advisers under President Trump. Economic Innovation Group, a bipartisan public policy organization founded by Sean Parker of tech giants Napster and Facebook, and Steve Glickman, a former Senior Economic Advisor under President Barack Obama, originally conceived the OZ program.

OZ'S REACH

The OZ program is the largest community investment tool in the U.S. in decades and is expected to create an entirely new asset class and investment marketplace. Recent estimates suggest U.S. investors hold $6.1 trillion of unrealized capital gains, a massive capital base with strong incentive to support OZ investments, including real estate.[1]

There are more than 8,700 OZs designated by census tract. They are scattered throughout the U.S. and its territories, with roughly 75% of OZs located in urban areas and 25% in rural communities. An estimated 35 million homes and over 1.5 million businesses are covered under the legislation.[2]

THE ALL-POWERFUL OZ

Taxpayers who recognize a gain from the sale of another investment or asset can defer paying taxes on those gains through 2026 if a portion of or all of the gains are reinvested into a Qualified Opportunity Zone ("QOZ") property or business through a Qualified Opportunity Fund ("QOF"). Taxpayers are further incentivized to hold their QOZ investments for five or more years, which reduces the tax liability through a step-up in basis.[3]

In addition to the aforementioned tax benefits, investors who roll eligible capital gains into a QOF and hold their investment at least 10 years will pay **no new capital gains tax on appreciation of the QOZ investment, eliminating the capital gains tax altogether.**

QOFs must be comprised of equity investments only and hold at least 90% of assets in QOZs. Investments can be made into any asset type including, but not limited, to real estate, newly issued company stock, business property, infrastructure, and start-ups.

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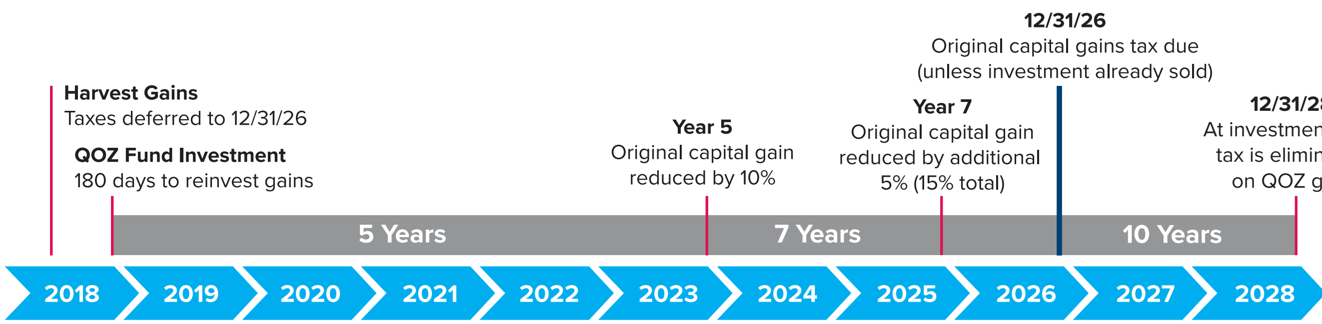
Opportunity Zone Investment Timeline



1. Economic Innovation Group
2. Walker & Dunlop, Opportunity Zones & Funds – An Investor's Guide, August 2018
3. IRS.gov, https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions

Real estate is subject to a "substantial improvement" requirement and is considered substantially improved if the QOF doubles the original basis in the property within a 30-month period post acquisition. As a result, new development and major rehabilitation projects are the most likely targets of QOFs.[4]

Three Primary Tax Benefits

1. Tax Deferral	2. Tax Reduction	3. Tax Elimination
• Pay no tax until 2026	• 10% less tax owed after 5 year hold • Extra 5% after year 7	• No new capital gain tax if OZ investment held for 10 years

MASSIVE AFTER-TAX BENEFITS

Opportunity Zone investments present an attractive opportunity for investors sitting on unrealized gains. Upon the sale of an asset, OZ investors have 180 days to roll over their capital gain into a QOF. Once the investor completes the rollover, their capital gain is eligible for incentivized tax treatment. OZ investors are incented to put capital to work early in the program, given that the incremental after-tax return diminishes over time.

In order to benefit from the five and seven year tax discounts (tax payment deadline is December 2026), taxpayers must reinvest their gains by December 31, 2019.

OZ VS. 1031

Similar to OZs, Section 1031 of the IRS tax code allows investors to defer paying capital gains taxes on the sale of real estate as long as the proceeds from the sale are reinvested into "like-kind" property within 180 days.[5] **Unlike 1031, OZ eligible gains are not limited to the sale of real estate and can be long-term or short-term gains.** Investors can invest gains from the sale of stocks, bonds, a business or even artwork.

Another advantage of an OZ investment over a 1031 is that capital gains for 10-year holders are reduced over time, and new gains are eliminated, not just deferred.[6] The illustration to the right shows the benefit of both deferring and reducing the capital gain tax. The first column is a typical investment where a 23.8% tax rate on a $1.0 million invested capital gain results in a $238,000 tax payment in year 0. The second column shows a QOZ investment in which the capital gain is deferred until 2026. The 15% reduction in tax rate in year 7 results in a tax of only $202,300 in year 7 and the opportunity to significantly increase long-term profits by investing more in year 0.

WHAT'S BEHIND THE CURTAIN?

Critics of the OZ program have asserted the negative implications of massive capital infusion into the most disadvantaged neighborhoods. Gentrification and displacement comes to mind, followed by misuses of investor capital. For any tax incentive program of this size and scale to be thought of as successful, QOFs ought to embrace a Triple Bottom Line approach, focusing on Social, Environmental and Financial impact in OZs.

THE REAL OPPORTUNITY BEYOND THE OPPORTUNITY ZONE

As we delve further into this new program, let us "begin with the OZ community in mind" and be both social and financial fiduciaries of this capital. QOFs should be encouraged to (i) engage OZ community leaders and understand their needs, (ii) embrace sensible regulation and reporting requirements to ensure the program achieves desired outcomes, and (iii) prudently invest capital that lifts all people and places, while providing adequate returns to investors. With this framework in mind, our real estate leaders will launch catalytic projects that revitalize communities in greatest need of our contributions. •

Impact on After-Tax Returns

	Typical Investment	QOZ Investment	
Invested Capital Gain	1,000,000	1,000,000	
Less: Capital Gain Tax (23.8%)	(238,000)	-	
After-Tax Investment	762,000	1,000,000	
Year 10 Value (assumes 7.5% appreciation)	1,570,506	2,061,032	
Less: Year 10 Capital Gains Tax (23.8%)	(192,424)	-	
Year 10 After-Tax Value	1,378,082	2,061,032	
Less: Capital Gain on invested Gain Due 12/31/26	-	(202,300)	
Total Year 10 After-Tax Value	**1,378,082**	**1,858,732**	**QOZ Impact**
Total Net Gain	***378,082***	***858,732***	***2.27x***

4. Novogradac, https://www.novoco.com/notes-from-novogradac/new-opportunity-zones-could-be-used-finance-rental-housing
5. IRS.gov, https://www.irs.gov/newsroom/like-kind-exchanges-under-irc-code-section-1031
6. Walker & Dunlop, Opportunity Zones & Funds – An Investor's Guide, August 2018

CONSTRUCTION COSTS

Counting Construction Costs: Commercial Real Estate Implications of a Trade War & Skilled Labor Shortage

BY WILL MCINTOSH, PH.D., CRE®
GLOBAL HEAD RESEARCH | USAA REAL ESTATE

and

JOHN KIRK, CAIA, CCIM
DIRECTOR, RESEARCH | USAA REAL ESTATE

The Turner Building Cost Index – which measures costs of non-residential building construction in the United States – is up nearly 6% year-over-year as of third quarter 2018, on pace for the highest annual increase in a decade. Strong construction activity has certainly played a role in driving up costs, but the shortage in skilled labor and escalating trade tensions appear to have exacerbated the situation. This article will highlight some of the implications for the commercial real estate markets given the current construction cost outlook.

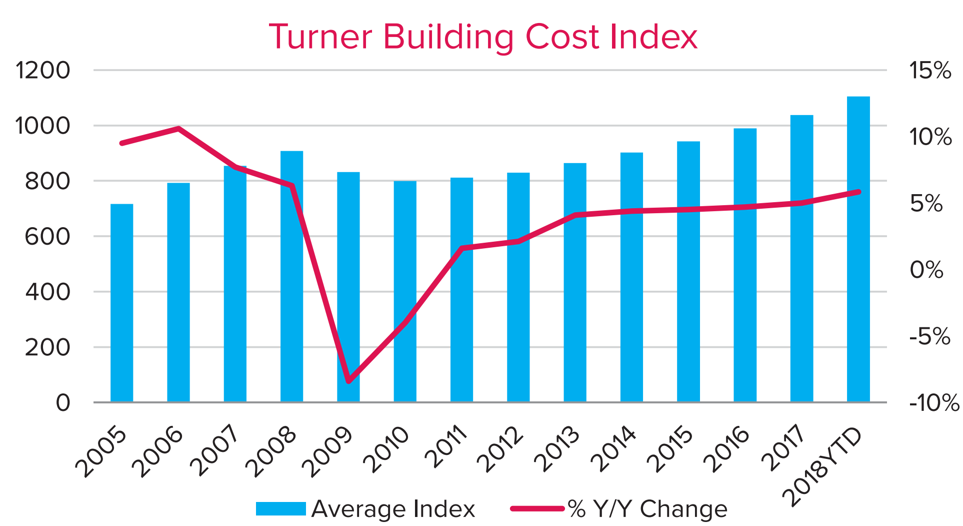
LOOKING FOR LABOR

The U.S. construction labor pool lost nearly a third of its workers in the aftermath of the Global Financial Crisis (GFC), spurring higher project development costs. According to the Bureau of Labor Statistics, the number of construction workers has yet to return to its pre-recession peak, and tight labor conditions are likely to persist given supply pipelines are near record levels, or cycle highs, across all major property types. Nearly 60% of contractors reported a skilled labor shortage in the U.S. Chamber of Commerce's most recent commercial construction survey as of third quarter 2018. The robust employment market seems to have compounded the labor shortage, as the unemployment rate fell to 3.7% in the second half of 2018, the lowest in nearly 50 years. The dearth of skilled workers may be the employment market's most significant challenge today, as tightening labor conditions could ultimately limit economic growth, and thus real estate supply, in the years ahead.

TEMPERING TRADE WAR EXPECTATIONS

No one can say with certainty what a full-on trade conflict would mean for the global economy in general or commercial real estate, but even this early, the implications are troubling. Already investors have concerns regarding the cost of raw material imports like aluminum and steel, which have been subjected to 10% and 25% tariffs, respectively. Anecdotal evidence suggests some markets saw an instant and substantial increase in the price of aluminum, upwards of 10–20%. Market participants also observed a similar rise in steel (around 10%). In an environment where asset and land prices are already near record highs, some development projects are no longer feasible given the increased material costs, thus creating a headwind for supply growth should this situation persist or worsen. On the other hand, constraints on supply would generally have positive implications for rents and the values of existing assets.

Ultimately, investors have limited power to affect change regarding both previously described factors. Therefore, such unwieldy issues are likely to continue to influence investment conditions. While it is difficult to quantify how commercial real estate markets will respond, early signs suggest supply growth could moderate in the near term, as investors reassess which projects are viable given the accelerating of construction costs. •



Source: Turner Building Cost Index as of Q3-2018. Base year: 1967, index 100

Task Force Expands Opportunities to Give Back

BY SCOTT MULDAVIN, CRE®
PRESIDENT | THE MULDAVIN COMPANY, INC.

The Counselors of Real Estate ("CRE") "Giving Back" task force was formed in early 2018 at my request with the strong support of CRE leadership including 2018 Chair Joe Nahas, current Chair Julie Melander, and CEO/President Mary Fleishmann and staff. The purpose of the task force is to enhance Counselor opportunities to "Give back" to the industry and enhance the role of "Giving Back" in our culture and brand. Joining me in leading the task force in 2018 included Lewis Stirling, Constantine Korologos, and Leslee Lewis.

The efforts of the "Giving Back" task force build on the Counselors' "Giving Back" culture established through existing initiatives including the CRE Foundation, CRE Consulting Corps, and the leadership and participation by individual Counselors in scores of nonprofit boards, charities, and collaborations tackling a myriad of industry challenges. The "Giving Back" culture is also particularly well reinforced by our two highest awards, the Landauer/Robert White and James Felt Creative Counseling awards, which honor Counselors for industry excellence and selfless acts of charity and honor.

The genesis of the idea to expand the Counselors' "Giving Back" opportunities grew out of my experience forming the Green Building Finance Consortium, a nonprofit with the mission of enabling private sector investors to evaluate sustainable property investment from a financial perspective. Over 10 years, I collaborated with scores of Counselors to raise funds, fill my board of directors, assist in my research, and help in many other ways. The Counselor Foundation also funded an international meeting of young sustainability leaders from Mexico, Canada, and the U.S.—many of whom have gone on to make great leadership contributions in their countries.

The Giving Back task force will focus on fostering and supporting similar collaborative efforts by Counselors addressing other industry issues including homelessness, affordability, gentrification, and community revitalization.

In addition to the work of the "Giving Back" task force in 2019, the CRE Foundation and CRE Consulting Corps have been very active, identifying new opportunities to engage Counselors and serve our communities. The "Giving Back" task force, Disaster Response Group, CRE Foundation and CRE Consulting Corps will all be working closely together to leverage and enhance our respective efforts.

DISASTER RESPONSE GROUP

The Counselors of Real Estate and its members have a culture of caring and support for members and their communities when they are confronted with personal tragedy or disasters. As a result of our more substantive responses in recent years and the increasing number and magnitude of natural disasters, the "Giving Back" task force formed the Disaster Response Group to enhance the Counselors' preparation and response resources and coordinate future disaster efforts.

Some of our past experiences include: Counselor coordination of a large group of volunteers after 9/11 to address leasing, insurance and related real estate questions for New Yorkers. When Katrina struck in 2005, the organization reached out to assist local members and continued for a number of years to provide various levels of support (Consulting Corps, etc.). In 2017, when Harvey struck Houston, there was an immediate response to reach out to members and a 2-day effort to compile and distribute a list of "Lessons Learned" from other Counselors who had experienced similar disasters.

The Disaster Response Group has drafted and adopted a "CRE Disaster Response Guide" and a "DRG Structure and Process" document to give us the structure we need to proceed. The Disaster Response Guide deals with decision-making responsibility, defines levels of disaster response, provides guidelines for disaster response priorities, and outlines disaster response implementation roles and responsibilities. The "Structure and Process" document simply defines the five key CRE Groups involved, discusses leadership succession and appointment of DRG members, and lays out responsibilities for approval/distribution of content.

A key goal of the CRE Disaster Response Group is to enhance the quality and speed of the Counselors' response to disasters affecting its members and their communities. To do this, we will be codifying some of the lessons learned by Counselors and others from prior disasters and conducting research to generate the most helpful articles, reports, and links to support disaster preparedness and response.

In addition, we will be soliciting Counselor participation as "volunteers" to assist in future disasters across a number of specialty areas including leasing, insurance, finance, and asset management.

*(CONTINUE ON **PAGE 7**)*

CRE GIVING BACK (CONTINUED FROM PAGE 6)

We will distribute our content through an enhanced "Counselor Disaster Response Insights" document that will be customized and sent to all Counselors in affected areas, with encouragement to send the document to clients, friends, and others in the community as appropriate.

Content will also be presented on the Counselors' Disaster Response section of the website. Our goal is not to replicate what others are doing but focus on real estate specific topics. We will address immediate health and safety concerns as well. The current list of Disaster Response topics includes:

1. General Disaster Preparedness/Response
2. Resilience Planning
3. Accessing Assistance
4. Housing and Social Services
5. Schools
6. Transportation and Logistics
7. Compliance with Laws, Codes and Ordinances
8. Leasing: Tenant Rep and General
9. Asset and Property Management
10. Technology and Communications
11. Legal and Insurance
12. Construction/Development/Rehabilitation
13. Financing: Commercial and Home
14. Valuation
15. Municipal/Regional Infrastructure

With the formation of the Counselors' Disaster Response Group, the related Disaster Response Volunteer Corps, and infrastructure being put in place to foster and support individual Counselor philanthropic collaboration, 2019 looks to be an exciting year of growth for Counselors giving back to their communities.

If you want more information or to get involved, please contact me (smuldavin@muldavin.com) or the new Disaster Response Group Chair, Constantine Korologos (tinokorologos@gmail.com). •

CHAIR'S CORNER (CONTINUED FROM PAGE 2)

THE CRE NETWORK: BUILD IT... OWN IT.

A related new initiative, the **"CRE Marketplace"**, is a purpose-driven Forum enabling CREs to seek partners, capital, land, or even buyers for their businesses through a secure and reliable CRE platform. **The Marketplace** was conceived as a sister program to our exceptionally popular **"Requests For Expertise."** If you get a chance, I encourage you to revisit the follow up reports on this outreach (**"Here's What Happened"**) to remind yourself of this extraordinary benefit of membership and the broad scope of expertise available within the CRE network.

Then….why not take things a step further: Have lunch with someone in the marketplace who is doing something interesting and tell them about The Counselors of Real Estate. Talk to them about their business and tell them about yours. Most importantly, introduce them to The Counselor organization and invite them to investigate membership. The future of The Counselors of Real Estate is in Our Hands: Yours and Mine. With committed, collective effort, that future will be brighter than ever.

Julie

Julie L. Melander, CRE®
2019 CRE Board Chair •

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Devised and implemented a strategy to privatize the funding, development and management of housing on **U.S. military bases**.

Resolved the contentious dispute between the developer of the **World Trade Center** and its insurers after the 9/11 attacks in 2001.

Developed training facilities for the **Philadelphia 76ers**.

Formulated a strategy to foster economic growth and employment in the **Republic of Serbia** through redevelopment and reuse of approximately 450 well-located surplus military properties.

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