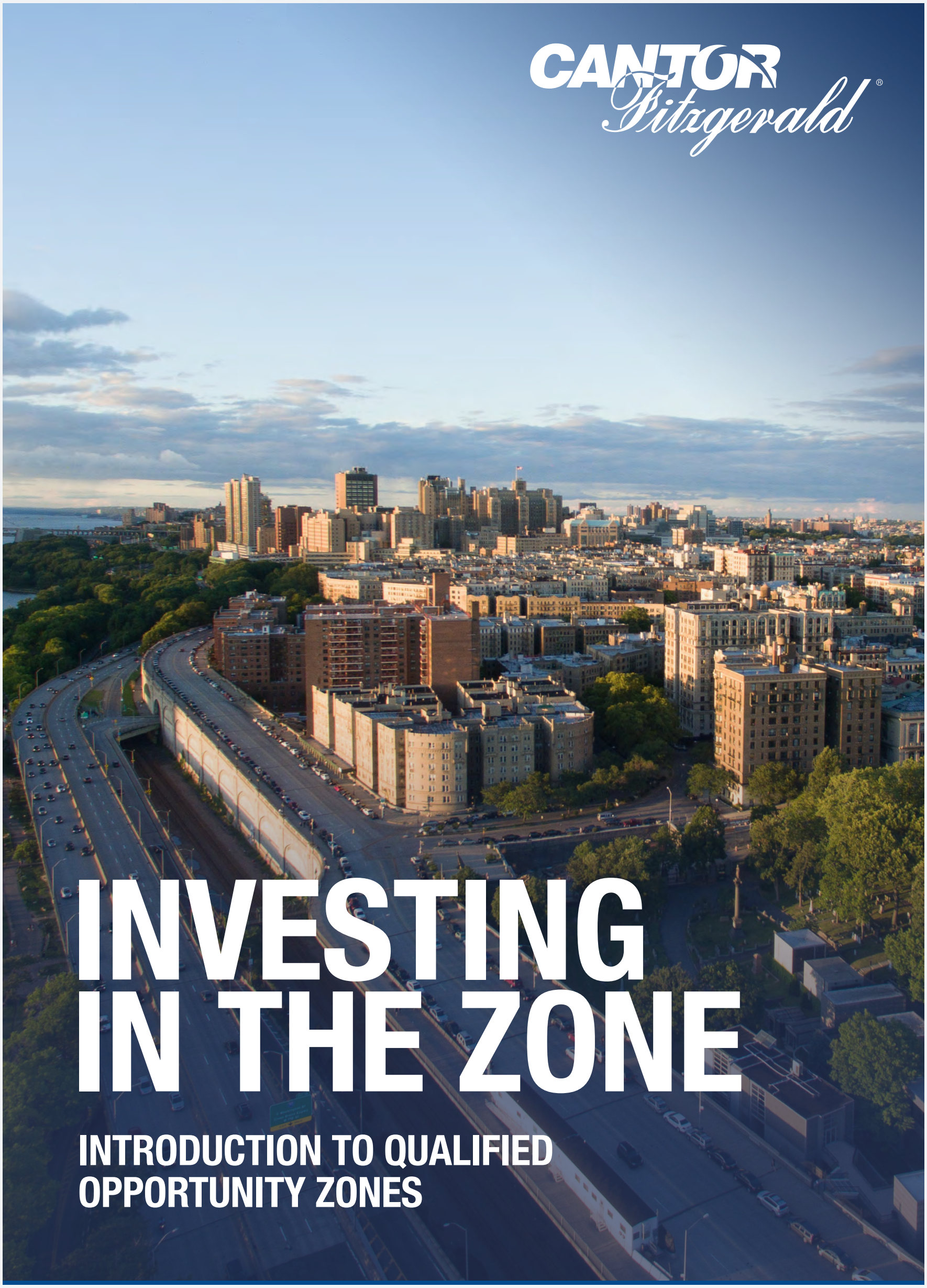

CANTOR Fitzgerald®

INVESTING IN THE ZONE

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

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What is the Qualified Opportunity Zone Program?

The Qualified Opportunity Zone Program ("QOZ Program"), which established Qualified Opportunity Zones ("QOZs"), was created by the federal government in 2017 as part of the Tax Cuts and Jobs Act.

This program is intended to encourage investment in lower-income communities across the U.S., principally by providing certain tax incentives in return for committing long-term capital to these communities through investment vehicles called Qualified Opportunity Funds ("QOFs").

What are Qualified Opportunity Zones (QOZs)?

A QOZ is a designated census tract in the United States that has been selected by a state governor and certified by the U.S. Department of Treasury for inclusion in the QOZ Program.

Each state governor was allowed to nominate up to 25 percent of the state's qualifying census tracts for inclusion in the QOZ Program.

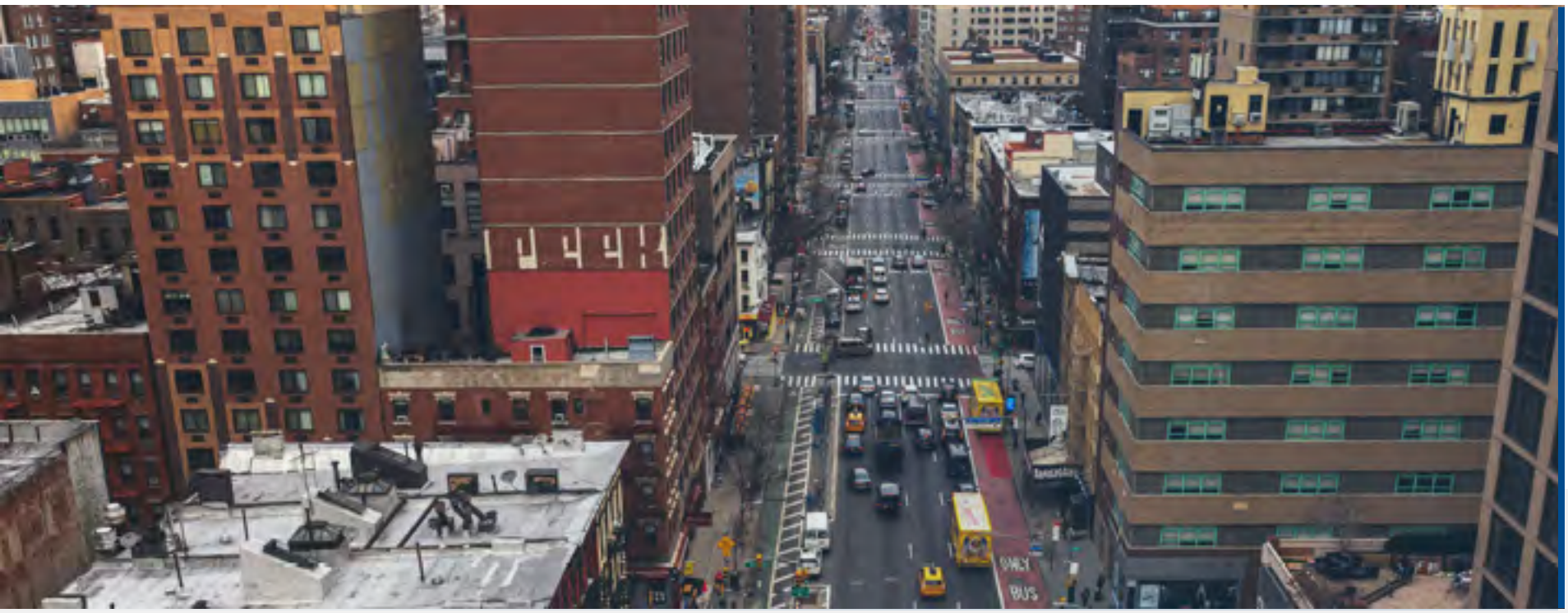
In order to qualify for inclusion, a census tract must pass one of the following low-income community ("LIC") tests based on the most recent census information from 2010:

- Have a poverty rate of at least 20%
- If the LIC is in a metropolitan area, have a median household income not exceeding 80% of the metropolitan median household income (or the statewide median household income, whichever is greater)
- If the LIC is not located in a metropolitan area, have a median household income not exceeding 80% of the statewide median household income

In total, there are over 8,700 QOZs spread across all 50 states, D.C., and several U.S. territories.

What are QOFs?

A QOF is an investment vehicle organized as either a partnership or corporation that holds at least 90% of its assets in QOZ property. QOFs can make investments in a wide variety of real estate and new or existing businesses, including commercial real estate, housing, infrastructure, and start-up businesses. QOFs can hold single or multiple assets. QOZ property includes interests held by the QOF in a Qualified Opportunity Zone Business ("QOZB").



What is a QOZB?

A QOZB is a business in which at least 70% of tangible assets qualify as QOZ business property owned or located in a QOZ. At least 50% of the gross income earned by the business must be from the active conduct of the business in the QOZ and generally may not be a "Sin Business." No more than 5% of the assets of the QOZB can be non-qualified financial property.

Potential Tax Benefits of Investing in a QOF

Potential tax benefits associated with the QOZ Program fall into two main categories:

DEFERRAL

If a taxpayer invests the capital gain from the sale of any property into a QOF within 180 days of recognizing the gain, taxes on such proceeds may be deferred until the earlier of December 31, 2026[1] or the disposition of the QOF interest.

ELIMINATION

Investors who hold their investment for at least ten years receive a step-up in basis which means they pay no tax on the appreciation of their QOF Investment upon disposition of such QOF Investment, regardless of the size of the potential profit.[2] In addition, the step-up in basis eliminates any depreciation recapture tax that would otherwise be owed upon sale.

All investments involve risk, and the realization of the benefits is dependent on proper structuring and the structure and performance of the future investments selected. Not all investments will provide all of these benefits.

[1] A 10% step-up in basis was available for investments made prior to December 31, 2021 and an additional 5% step-up in basis was available for investments made prior to December 31, 2019.

[2] Assumes that the investor is a resident of a state that conforms with the federal Opportunity Zone provisions.

Understanding Eligibility

WHAT IS AN "ELIGIBLE" GAIN?

A capital gain is eligible for deferral if it is from the sale or exchange of property with an unrelated party (not more than 20 percent common ownership) and the gain is treated as a capital gain (short-term or long term) for federal income tax purposes, including gains from:

- Stocks, bonds, options, hedge funds
- Primary and secondary residences
- Businesses, machinery, commercial buildings
- Land, livestock, art, wine, automobiles

WHAT IS AN "ELIGIBLE" TAXPAYER?

QOZ regulations provide that taxpayers eligible to elect gain deferral include:

- Individuals
- C Corporations (including regulated investment companies (RICs) and real estate investment trusts (REITs)
- Partnerships, and
- Certain other pass-through entities

The first day of the 180-day period to reinvest gains into a QOF generally is the date on which the gain would be recognized for federal income tax purposes.

Important Deadlines

Generally, to receive the QOF Program tax benefits, eligible capital gains must be reinvested in a QOF within 180 days from the sale of an asset. However, the QOZ Program final regulations provide additional flexibility for K-1 partnership gains resulting in additional planning options for financial advisors. For example, assuming a calendar-year partnership, K-1 partnership gains realized on or after January 1, 2021, have until September 11, 2022 to complete an investment in a QOF that is eligible for QOZ Program tax benefits due to the three options allowed for calculating their 180 day window:

1. 180 days starting with the date the asset is sold by the partnership;
2. 180 days beginning on the last day of the partnership's taxable year (December 31st for a calendar-year partnership); or
3. 180 days starting on the date the partnership's tax return is due, without any extension (March 15th for a calendar-year partnership).

Comparing QOFs & 1031 Exchanges

QOFs and 1031 exchanges both offer the potential for significant tax incentives and can be used in conjunction with one another. However, the two investment vehicles have many differences, and therefore, may be appropriate for different investors.

Under the 2017 Tax Cuts and Jobs Act, real estate is the only asset class that retained its 1031 exchange privilege. Capital gains from assets such as stocks, bonds, art, wine, livestock, classic automobiles, and other collectibles no longer receive the tax benefits of a 1031 exchange. Only real estate held for business or investment purposes can utilize the 1031 exchange while a capital gain from real estate or most other assets can be invested in a QOF.

SIDE-BY-SIDE COMPARISON

1031 EXCHANGE	CATEGORY	QUALIFIED OPPORTUNITY FUND
Real estate held for investment purposes.	ELIGIBLE ASSETS*	Any investment including stocks, bonds, real estate, collectables, partnership interests, etc.
Principal and capital gains of the real estate sale.	ROLLOVER PARAMETERS	Capital gains only (principal not required).
Real property without location restrictions.	ELIGIBLE INVESTMENTS	Generally includes commercial real estate, housing, infrastructure, and businesses within an OZ.
Must identify a replacement property within 45 days and close within 180 days.	REPLACEMENT PROPERTY	No identification requirement. The gain must be invested in a QOF within 180 days.
May be deferred indefinitely with a step-up in basis upon death.	CAPITAL GAINS TAX	The original gain may be deferred, but such gain must be included in income on December 31, 2026. Any new gain may be eliminated as well as any depreciation recapture tax that would otherwise be owed upon sale.
Maximize after-tax return through income and appreciation.	INVESTMENT GOALS	Maximize after-tax return through income and appreciation.

*Gains recognized from the disposition of the following assets are eligible to receive the respective tax benefits of the 1031 exchanges and investments in QOFs.

When it comes to investing in real estate, QOFs do offer certain potential benefits compared to 1031 exchanges. Unlike a 1031 exchange where an individual must invest all proceeds from the sale of the property to defer all taxes, an individual only has to invest the gain (including any unrecaptured depreciation treated as a capital gain) in the QOF allowing the individual to pull their basis out. Completing a QOF investment tends to be much simpler than a 1031 exchange as there is no 45-day identification period, no tracing requirement, and no Qualified Intermediary involved in the transaction.

Understanding when a QOF, a 1031 exchange, and/or a Delaware Statutory Trust ("DST") is appropriate for an individual selling an investment requires a holistic understanding of the individual's personal finances. When it involves the sale of a property, there is, even more, to consider including the basis in the property, amount of depreciation, any debt, and the sale price, among other things. Sometimes, multiple tax strategies may be used. For example, imagine an investor is selling a business along with the physical building where the business operates. A 1031 exchange could be employed to defer tax on the real estate portion of the sale while an investment in a QOF could defer and reduce certain capital gains tax from the sale of the actual business.

Given the complexity when evaluating these types of situations, investors should seek professional tax, legal, and financial advice in order to determine the best scenario for using one or combining these powerful tax-advantaged wealth creation tools.

QOZ vs. Non-QOZ Return Comparison

Below is a chart that shows the difference in returns on two hypothetical investments with the same internal rate of return (IRR):

POTENTIAL TAX ADVANTAGES OF INVESTING IN A QUALIFIED OPPORTUNITY FUND

SCENARIO: HYPOTHETICAL AFTER-TAX VALUE[1,2,3]

1 Million

INVESTMENT OVER 10-YEAR HOLD

(assuming hypothetical 10% compounded rate of return on both investments)

Investors may pay as little as $0 in capital gains on the next decade of investment returns.

	NON-QUALIFIED OPPORTUNITY FUND	QUALIFIED OPPORTUNITY FUND
ORIGINAL CAPITAL GAIN from sale of prior investment	$1,000,000	$1,000,000
TAX RATE	30%	30%
− **TAX ON ORIGINAL CAPITAL GAIN**	($300,000)	Deferred
= **INVESTABLE AMOUNT** *after tax*	$700,000	$1,000,000
× **COMPOUNDED HYPOTHETICAL ANNUAL RETURN**	10%	10%
= **APPRECIATION** *over 10 years*	$1,115,620	$1,593,742
− **TAX ON APPRECIATION** *after 10 years*	($334,686)	Eliminated
− **LONG TERM CAPITAL GAINS TAXES PAID[3] IN 2027** *on original capital gain*	$0	($300,000) *30% of $1,000,000*
= **FINAL VALUE**	**$1,480,934**	**$2,293,742**

[1] This illustration assumes the investor is subject to the top marginal U.S. federal income tax rate of 20% on long-term capital gains for individuals, the net investment income tax of 3.8% and a state tax of 6.2% for a total tax liability of 30%. No brokerage or investment advisory fees are accounted for with respect to the non-QOF example above.

[2] This assumes that the QOF investor is a resident of a state that conforms with the QOZ Program.

[3] Assumes that the investor has no capital losses to reduce such capital gain and refers to the inclusion of the original, invested capital gains in such investor's taxable income on December 31, 2026.

About Cantor Fitzgerald

Cantor Fitzgerald[1], with over 12,000 employees, is a leading global financial services firm at the forefront of financial and technological innovation and has been a proven and resilient leader for over 75 years. Cantor Fitzgerald is a preeminent investment bank serving more than 5,000 institutional clients around the world, recognized for its strengths in fixed income and equity capital markets, investment banking, prime brokerage, and commercial real estate. Cantor Fitzgerald is one of the 24 primary dealers authorized to transact business with the Federal Reserve Bank of New York.

Through a powerful alignment of vertically integrated affiliates, Cantor Fitzgerald's real estate platform offers broad access to critical market data and research, enhanced ability for diligence and underwriting, and superior deal flow enabling the ability to deliver institutional-quality real estate investments to investors. Since 2019, our family of real estate businesses completed more than $200 billion in real estate-related transactions with expertise across investing, leasing, managing, and financing. Our real estate investment platform includes core real estate funds, 1031 exchange solutions including DSTs and 721s, and qualified opportunity zone funds.

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An investment in real estate carries certain risks including but not limited to a lack of liquidity and potential loss of principal.

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RISK FACTORS

Investors in QOFs will need to hold their investments for certain time periods in order to receive the full QOZ Program tax benefits. A failure to do so may result in the potential tax benefits to the investor being reduced or eliminated.

If a fund fails to meet any of the qualification requirements to be considered a QOF, the anticipated QOZ Program tax benefits may be reduced or eliminated. Furthermore, a fund may fail to qualify as a QOF for non-tax reasons beyond its control, such as financing issues, zoning issues, disputes with co-investors, etc.

Distributions to investors in a QOF may result in a taxable gain to such investors.

The tax treatment of distributions to holders of interests in a QOF are uncertain, including whether distributions impact the aforementioned QOZ Program tax benefits.

A QOF must make investments in Qualified Opportunity Zones, which carries the inherent risk associated with investing in economically depressed areas.

Any additional legislation or administrative guidance may reduce or eliminate the expected potential QOZ tax benefits or increase the burden of compliance with the QOZ Program.

Investors in a QOF may not be able to take advantage of the QOZ Program's tax benefits if they do not properly make a deferral election on IRS Form 8949.

QOF may encounter significant opposition from local communities, political groups, or unions, which may damage their goodwill and reputation and adversely affect operations.

An investment in a QOF is speculative, illiquid, and involves a high degree of risk. This is no guarantee that investors will receive any return.

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