

AN ALERT FROM THE BDO REAL ESTATE & CONSTRUCTION PRACTICE

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SEIZE THE OPPORTUNITY (ZONE), BUT KEEP YOUR HEAD ON STRAIGHT

BDO's Stuart Eisenberg and Marla Miller demystify the new vehicle and recommend ways in which REITs can take advantage of their scale when investing in qualified properties.

The IRS defines an opportunity zone as an "economically distressed community where new investments may be eligible for preferential tax treatment." The Treasury has certified nearly 9,000 of these districts across all U.S. states and its territories, including the entire island of Puerto Rico. An opportunity zone designation has the potential to trigger a rush of investment activity and is intended to help revitalize neglected areas.

A qualified opportunity zone fund is an investment vehicle that must invest at least 90 percent of its assets in businesses that operate in a [qualified opportunity zone](#), either by acquiring stock or a partnership interest. The fund can also make direct investments in properties and real estate located within a qualified opportunity zone. REITs and other operators are forming opportunity zone funds to access the capital expected to be generated by this program to acquire and develop properties.

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WHAT ARE THE CORE INCENTIVES FOR INVESTORS?

Taxpayers can defer taxes by reinvesting capital gains from an asset sale into a qualified opportunity fund. The capital gains will be tax-free until the fund is divested or the end of 2026, whichever occurs first. The investment in the fund will have a zero-tax basis. If the investment is held for five years, there is a 10 percent step-up in basis and a 15 percent step-up if held for seven years. If the investment is held in the opportunity fund for at least 10 years, those capital gains would be permanently exempt from taxes.

WHAT DO INVESTORS NEED TO BE WARY OF?

While opportunity zones offer enticing benefits, tax savings should not be the only factor influencing the decision to invest or break ground on a new development. A bad deal is still a bad deal, and not all qualified investments are worth pursuing. As investors scope out opportunity zones, they should assess the potential investment with the same level of due diligence they would use for any other deal. Questions to consider include: Are the area's property values and income levels likely to grow? Does the developer or business have an established track record?

Investments in opportunity zones also have associated risks, just like any other investment. Larger qualified opportunity zone funds and ones established by experienced real estate owners and developers like REITs will have an advantage in this arena.

MORE ANSWERS TO COME

Investors should look out for additional IRS guidance on opportunity zones in the new year. One of the remaining questions relates to "churning" investments, or the time period investors have to reinvest capital gains in a qualified opportunity zone after recognizing the gains from the sale of another qualified opportunity zone asset. The proposed regulation suggests this will be a 180-day period, but confirmation is still pending and could influence investors' next steps.

To maximize the potential benefits, taxpayers must invest in a qualified opportunity fund before Dec. 31, 2019. While investors shouldn't blindly rush into opportunity zones, the clock is ticking to take full advantage of the tax savings.