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Whose Opportunity?

UNDERSTANDING OPPORTUNITY ZONE INVESTMENTS

Opportunity zones are generating a lot of buzz in the investment community.
Under new tax laws, investors can get tax breaks for investing in real estate and private operating businesses in economically-disadvantaged areas which have been designated as opportunity zones. Opportunity zone funds are springing up to take advantage of these incentives, touting the tax benefits, the potential for outsized investment gains and the capacity to create positive social impact. Fund managers are pressuring investors to get in today, warning that the greatest tax advantages only apply to investments made before the end of 2019. But is it worth rushing into? We recommend investors slow down and take a closer look before investing in an opportunity zone. The greatest tax savings come from the appreciation of the underlying asset, and any investment should be made based on a thoughtful analysis of the project's financial viability. It is worth taking the time to thoroughly vet the long-term merit of the investment, not just the tax benefits. There are also some serious unknowns to consider; with opportunity zones still in their infancy, IRS guidelines are complex and evolving, making it ever more important for investors to do proper diligence.

In this paper, we will explain what opportunity zones are and explore their benefits and risks, as well as what questions to ask before investing. How much opportunity truly exists in opportunity zones?

What is an Opportunity Zone?

Opportunity zones were created by Congress in the 2017 Tax Cuts and Job Act to encourage private investment in low-income communities. Governors of all 50 states and U.S. territories were able to designate up to 25% of their low-income census tracts as opportunity zones. Currently, there are approximately 8,700 of these qualified opportunity zones across the U.S., which represent rural and urban communities with higher poverty rates, higher unemployment and lower family income. The opportunity zone designations are set for ten years.

To get the tax benefits, investors must invest through a Qualified Opportunity Fund ("QOF" or "Opportunity Fund"), which is created for the sole purpose of investing in an opportunity zone. The IRS stipulates that 90% of the QOF's assets have to be invested as equity, not debt, in a tangible opportunity zone property. QOFs are incentivized to make long-term investments, with the greatest tax benefits accruing after a 10-year holding period. Eligible investments include real estate, both commercial and residential, and small operating businesses, the type that would normally be the focus of private equity or venture funds. In reality, the requirements for operating businesses are complicated to navigate and the vast majority of opportunity zone offerings are currently in the real estate sector. As such, this paper will mainly focus on real estate QOFs, where we have seen the most activity and inquiry.