



## FEATURED ARTICLE

**A**n understated section of the January 2018 Tax Cuts and Jobs Act can either mean the greatest land rush since unassigned Oklahoma lands were open to settlement in 1889 or the next great Tenant-In-Common fiasco, which deflated spectacularly during the Great Recession. Take your pick!

We're talking here about opportunity zones, which were established to encourage long-term investment in low income areas through tax relief. The idea is that investors could take profits from any capital asset—not just other real estate—invest in economically disadvantaged areas and delay paying capital gains. However, unlike in the old


tenancy in common investments (TICs) program or the now popular Delaware Statutory Trust Investments (DSTs), it is a requirement to first put these capital gains in an investment vehicle generically called opportunity funds.

As for the physical opportunity zone, it must have an individual poverty rate of at least 20 percent and median family income of no more than 80 percent of median income for the surrounding area. Governors of all 50 states and U.S. territories recommended sites with the U.S. Treasury Department, certifying 8,700 opportunity zones. This means there is plenty of land to work with.

As a result, it is difficult to find a commercial real estate developer who is not planning to enter the opportunity zone fray, becoming a boon to brokers across the country, who are working with newly formed opportunity funds and looking for potential targets.

"We are involved with two opportunity zone deals and in the middle of negotiating for a third," reports Scott Hensley, SIOR, president of Piedmont Properties of the Carolinas Inc., Charlotte, N.C. "In regard to one of our deals, 55,000 square feet of adaptive re-use for a brewery, office, and other uses, that would have happened anyway because the market was there. Having





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## What's Behind the Curtain of Opportunity Zones?

By Steve Bergsman | Sponsored By SIOR Foundation

the property fall into an opportunity zone in Charlotte was an added bonus for the developer.”

The other project was a 165,000 square foot industrial warehouse, and Piedmont’s newest opportunity zone deal will be another warehouse.

Danny Zelonker, SIOR, broker-partner at Real Miami Commercial Real Estate LLC in Miami, is currently working with two opportunity funds, one of which involves large commercial real estate enterprises. Zelonker is simply helping that opportunity fund find properties, but he will invest in the other.

### Opposing Views

**V**eteran commercial real estate brokers have seen many next-great-things come and go, so two opposing views of opportunity funds have begun to form. First, there is the prevailing school of thought that touts the opportunity zone concept as being both socially and economically beneficial, therefore so important it should not be ignored.

Opportunity zones were created to bring jobs to blighted neighborhoods, avers Zelonker.

Across town, Stephen Rigl, SIOR, a senior director of Binswanger-Gateway

Partnership in Miami, observes, “There’s a lot of interest from investors who are putting funds together, and we are sourcing properties from various clients. Opportunity zones are going to have quite an impact on commercial real estate in the designated areas.”

These opportunity funds, Rigl adds, will probably have to be national in outlook as “there are pockets all over the country that can work for investors. Multifamily, office, and industrial properties work especially well because there is a 30-month build-out (or renovation) requirement from the time of purchase to the completion of the investment.”



## "THE REASON THERE IS SUCH A FERVOR TO GET THINGS ORGANIZED NOW IS BECAUSE OPPORTUNITY ZONE PROPERTIES WILL BE IN HIGH DEMAND."

Hensley says he has seen reports predicting \$100 billion of private capital will be raised for opportunity zone investments.

"The reason there is such a fervor to get things organized now is because opportunity zone properties will be in high demand," says Rigl. "As soon as the IRS clarifies the parameters of the investments, investors will act quickly."

Then there is the antithetical notion that this new opportunity zone concept is poorly conceived and ill-timed, especially as the Internal Revenue Service and Treasury Department still have not created the operational metrics of how these investments would actually function in a complex real estate world.

"The Jobs Act created these opportunity zones, but the bill essentially said, 'we'll come back and give you definitive guidelines in the future,' which started to happen early in 2019," says Hensley. "Even though everyone knew what opportunity zones were, no one had a

clear understanding of what the rules were going to be. A lot of equity was raised—although sponsors didn't know until recently exactly what they could do."

### There is Still Plenty of Confusion

"Some very smart money is trying to figure out opportunity zone investments," notes John Culbertson, SIOR, a managing partner with Cardinal Partners in Charlotte, N.C. "It's like the Oklahoma land rush all over again—the pioneers are lining up at the border and it is going to get messy before the dust settles."

There are questions as to what is the real benefit of an opportunity zone and when does an investor actually reap that benefit?

"It is unclear to me all of the instances when a rehab counts as an investment and all of the ways that debt is treated," Culbertson continues.

Also, investors are asking questions about what type of uses are allowed. For example, in regard to retail, "sin" businesses are excluded. That includes liquor stores, massage parlors, hot-tub facilities, suntan outlets, casinos, golf courses, and country clubs. What if you are a landlord and build a shopping center in an opportunity zone? The investor plans to get a deferral, then a few years down the road, an agent leases 1,000 square feet to a liquor store. What happens to the tax benefits and who is policing this?

Culbertson throws up a few unanswered questions:

- How do tax credits from opportunity zones work with other incentives that may be offered by a local jurisdiction?
- Different states might have existing, non-conforming legislation on opportunity zones. What happens if there is a conflict in terms?
- After 10 years (any increase in value of investment is tax-free after 10 years), does the investor have to sell all to get the benefit or can the investor just sell a portion?
- If you refinance and get a loan at 100 percent of value, does that count as being sold?



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- You buy land with existing building and make substantial improvements. Does the tax credit apply to what was originally bought or does it include the improvements?

Despite these unanswered questions, Culbertson, too, has clients interested in opportunity zones. Mostly they are looking for industrial sites in the Carolinas.

Just as opportunity zone mania kicks in, the current, benevolent real estate cycle could be coming to a close. Already, says Zelonker, the landscape is changing and pricing is increasing, just as the wider commercial real estate market might be stalling. In addition, Zelonker cautions, “a lot of money has been raised, but it’s hard to find something to invest in.”

Hensley would agree. “My concern is there is going to be more money raised in funds than there are viable deals,” he says. “It could become a problem

because you have a lot of private equity firms, individuals, [and] partnerships, raising a lot of money and promising a level of return.”

That begs the question: will investors be so focused on tax deferrals that they overlook exactly where their money is going? As Hensley notes, “A deferral only goes so far. What happens when you get to 2026 and realize you put money into an opportunity zone and the investment either failed miserably or produced a meager return?”

Erin Stackley, Commercial Legislative Policy Representative at the National Association of REALTORS®, answers these questions and poses further points about Opportunity Zones in this issue’s Legislative Update, found on page 34. ▾



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# In Poland, Everywhere Is an Opportunity Zone

By John Palmer, director and head of industrial investment for Savills in Warsaw

Poland—with a population of 40 million—is the largest economy in Central and Eastern Europe and the country is booming with a GDP of 5.6 percent. Since 2014, Poland has attracted over €100 billion in European Union real estate funds. In addition, the total value of investments made by companies operating in its “special economic zones” (SEZs) reached €27 billion last year.

Two of the reasons why there had been so much corporate activity are investment flexibility and the tax-incentives behind the SEZs, including:

- Tax exemption of income earned on business activities. The maximum is 40 percent or 50 percent. Tax exemptions granted to small enterprises increase by 20 percent,

and to medium-sized companies by 10 percent.

- No real property tax.
- Possibility to either buy or rent in SEZs
- SEZ administrative, legal and organizational support

The SEZs were so successful, in 2018 the country passed legislation to make the whole country a virtual economic zone. The first SEZ appeared in 1995 and the scope needed to be expanded as the older industrial zones were getting filled up.

A major corporation can pick the region it wants and make it into an economic zone if the area has attributes (high unemployment or need to diversify local

economy) that the government feels should warrant incentives or an aid package.

However, the depth of the incentives changes depending on demographic factors. For example, a project in Warsaw—the country’s largest city with lowest unemployment and highest disposable income—would only get a maximum tax exemption level of 30 percent.

Many large international companies have taken advantage of the SEZs such as General Motors, Volkswagen, Michelin, Electrolux and Kellogg. Now that the whole country is effectively an SEZ, Mercedes Benz is building a factory in Southern Poland, near the German Czech border. ▾