

CIM

Opportunity Zones 2.0: Incentivizing rural tax-advantaged investment

We recently spoke with **Robert Dupree**, principal and co-head of infrastructure & impact at **CIM Group**, about rural Opportunity Zones, a new Opportunity Zones category introduced in last year's "One Big Beautiful Bill Act" (OBBBA),¹ and how the incentives for rural investment may create opportunities in infrastructure. The following is an excerpt of that conversation.

The original Opportunity Zones (OZ) program is coming to an end this year. Did that program fulfill its promise?

More than \$40 billion of capital from more than 2,000 funds has gone into Opportunity Zones since the program's inception in 2017.² From that angle, I'd say it's been a success. Additionally, the OBBBA passed last year has made the Opportunity Zones program permanent, which I believe is a testament to the success of its initial iteration, dubbed OZ 1.0.

To date, a lot of capital has been allocated to the upper end of the low-income threshold, or to tracts adjacent to low-income areas. To further define the program's focus on low-income geographic areas, OZ 2.0 regulations incorporate notable changes.

How does the new OZ legislation define the zones differently?

The new program has lowered the income requirement to 70 percent of the area median income (AMI). It had previously been set at 80 percent. Additionally, adjacent census tracts will no longer be eligible starting in 2029. Both of those adjustments are intended to focus investment on true low-income areas and, as a result, will lower the overall number of OZs by approximately 20 percent.

OZ 2.0 legislation also provides a greater tax benefit for investors who contribute capital to an OZ fund focused on rural OZ investments. This change is expected to not only drive more investment to rural communities but also increase the types of projects in these zones.

What types of projects might suit rural Opportunity Zones?

To date, OZ dollars have primarily gone into traditional real estate development projects, particularly multifamily. And while Opportunity Zones are typically associated with real estate, they could include multiple types of real asset investments – real estate, infrastructure and even businesses.

When you think about a rural area – defined as having a population of fewer than 50,000 – it's unlikely that you would build a new class A apartment building, lease it up and generate enough revenue to justify the cost. For rural OZ tracts, we're likely to see a much greater focus on infrastructure assets. Rural locations are better suited for infrastructure assets that serve the needs of nearby communities but don't require a large population to be profitable. Such assets might include energy plants, landfills, water recycling facilities and water storage facilities, among others.

Would data centers align with the rural investment thesis?

Potentially, yes. As a firm, we have high conviction in continued momentum for data centers. However, an OZ investment

generally must be held for more than 10 years. Right now, if you build a data center in a rural area, you can likely fill it with tenants today. But technology is evolving rapidly, and we would need to be confident that there will be continued demand going into the next lease if that's seven-plus years out.

Where do you see the greatest opportunities in rural infrastructure?

One of the sectors that we are focused on is new energy generation. Energy demand has surged in recent years and is expected to continue to grow. Additionally, as old power plants throughout the U.S. are retired, energy generation decreases, creating a large demand/supply imbalance.

Energy generation can take many forms. At CIM, we've done a lot of work with solar. We like solar because it's quick to get up and running and comparatively inexpensive, though we will explore all forms of energy generation. These large plants can be located in rural locations and serve nearby households and businesses, as well as those hundreds of miles away, by connecting to the energy grid.

How do investment considerations differ between real estate and infrastructure?

The baseline economics are very similar, but where they tend to deviate is on the revenue side.

For many infrastructure assets, there is just one tenant. With many of our solar parks, for example, we sign power purchase agreements with a single entity that takes hundreds of megawatts of energy generation. These might be \$100-plus million, multi-year revenue contracts. Contrast that with an apartment building, where you're signing individual, typically year-long leases for every unit. However, that shorter lease duration allows you to increase rents commensurate with market changes on a more real-time basis.

On the industrial side, there might be situations where you have one tenant, but the term of the lease is usually shorter, seven to 10 years. With infrastructure, leases tend to be longer, 15-plus years, providing a longer period of contracted revenue.

What type of investor might consider a Qualified Opportunity Zone Fund (QOF)?

To start, investors should work with their tax and financial professionals to best assess their needs. Generally speaking, to invest in a QOF, investors must have sold an investment and generated a capital gain. Gains could be generated from the sale of real estate, equities or a business, for example. The investor may elect to take that gain – not the cost basis, just the gain – and put it into a QOF.

There are three primary benefits available to investors who put capital into a QOF starting in January 2027, when OZ 2.0 takes effect. First, they're eligible for a five-year deferral of taxes on the invested gain. Second, they can get a reduction in the taxes they have to pay after that five-year period. For a

traditional Opportunity Zone fund, investors are eligible for a 10 percent tax reduction. For rural Opportunity Zone funds, the tax reduction jumps to 30 percent, an expanded benefit created to incentivize investment in rural locations.

The third benefit is an exclusion of taxes on the fund's appreciation. If the investor holds their investment in the fund for at least 10 years, they can receive tax-free growth on that initial commitment, up to a maximum of 30 years. For example, if the investor originally put in \$1 million, and it grows to \$3 million after 10 years, they won't be paying tax on that \$2 million of growth.

At the end of the day, the biggest benefit depends on the fund manager's effectiveness. Are they making good investments? Are those investments performing as anticipated? The return will drive the fund's performance, which will then drive that tax-free growth benefit.

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Are there additional benefits for OZ investors?

QOFs can also optimize the benefit of depreciation. If the QOF is structured as a limited partnership, for example, it can pass through tax losses generated by accelerated depreciation deductions to investors who can then use those losses to offset passive income or gains from other investments.

In most asset types, the tax shield provided by depreciation deductions is a timing benefit. When an asset is sold, the basis for computing gain is reduced by the amount of the depreciation deductions taken previously, resulting in a larger taxable capital gain. In addition, depending on the nature of the asset, depreciation deductions can be subject to “recapture,” meaning a portion of the gain from selling the underlying asset is taxed as ordinary income instead of capital gain.

For investors in a QOF who hold their investment in a fund for at least 10 years, there is no recapture on the depreciation. So, they get an added tax benefit above and beyond the three main ones, and that can be magnified based on the type of assets in the fund. For example, solar projects allow for accelerated depreciation, where the full depreciation amount is passed through in the first year of operations rather than spread across the asset's useful life, which can range from 25 to 40 years.

With the OZ 2.0 legislation taking effect in January, what should investors be thinking about now?

When someone recognizes a gain from selling an investment, they have 180 days to put that gain into a QOF. If you are generating a gain in July 2026, for example, your 180-day window stretches into January 2027. If an investor recognizes a gain in the second half of this year, they can participate in Opportunity Zones 2.0 and access the benefits we've talked about.

If an investor is generating a gain through certain structures like a partnership or an S corporation, they have the flexibility to invest the gain in 2027 if it is recognized at any point this year.

For those who aren't yet eligible for 2.0 benefits, there's still an advantage to investing in an Opportunity Zone program today under the OZ 1.0 legislation. Investors can still get tax-free growth if they hold that investment for 10 years, which is a meaningful benefit. Again, investors should work with their tax and financial professionals to best assess their needs.

What factors are important to consider when evaluating QOFs?

It's key to understand the fund sponsor's capabilities and whether they have the resources and expertise to execute OZ projects and manage them effectively. Track record is important. The ability to manage a program with multiple stakeholders and multiple moving pieces is important.

To maximize the OZ tax benefits, investors must remain invested for at least 10 years, so it is also important to think about portfolio diversification – investing in a single project may present more risk over a 10-year period compared to investing across a diversified portfolio.

What is CIM's experience with OZs?

CIM has invested in real estate and infrastructure for more than 30 years. We were an early adopter of the QOF structure, and we've deployed billions of dollars of capital into OZ projects to date. We have large in-house development and property management teams, which give us direct connectivity to the assets. We believe that level of in-house capability is fundamental to success in OZs because the program revolves around building assets from the ground up or investing significant capital into redevelopment and then managing those assets through an extended hold period.

1 Congress.gov. “H.R. 1 – An act to provide for reconciliation pursuant to title II of H. Con. Res. 14,,” <https://www.congress.gov/bill/119th-congress/house-bill/1>.
2 Congress.gov. “Tax Cuts and Jobs Act of 2017,” <https://www.congress.gov/bill/115th-congress/house-bill/1/text/eh>.

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CORPORATE OVERVIEW

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