CREW Network Industry Brief Vol. 1 | Issue 2 | August 2019

Opportunity Zones—Where Are We Now?

By Pauline Hale, CREW Network Industry Research Committee

It has been more than 18 months since the announcement of the United States' Tax Cuts and Jobs Act of 2017 and its buzzworthy Opportunity Zone (OZ) provision. Despite all the talk, actual investment has been sluggish due mostly to significant compliance and logistical questions around both the real estate and business investment options. The Internal Revenue Service (IRS) released the second tranche of guidance on its proposed regulations in April 2019, addressing many of the concerns, and OZ fund formation is now on the rise. Even still, the investment community is not treating the legislation as a silver bullet, warning that the deal still must pencil out, and the tax benefits are just icing on the cake.

Overview

There are more than 8,700 designated OZs in all 50 states, Washington D.C., and five U.S. territories, representing nearly 12% of the U.S. land mass and a population of 31 million. It must be noted that 2010 Census data was used by state governors in selecting these zones. As a result, some of these areas are already gentrified, including most of Downtown Portland, the core of Downtown Phoenix, parts of Brooklyn, New York, much of South Seattle, and West Oakland, California. These areas, and many others, benefitted from the "urban revival" of the 2010s and are no longer the underserved communities targeted by the legislation, having received the majority of the early investment interest.

Guidance Update

The IRS guidance issued in April clarified many of the questions potential investors had regarding the OZ real estate investment provisions, some of which had kept investors on the sidelines:

- Land (owned or leased) is not required to be "substantially improved," but land banking is not allowed
- The "substantial improvement" requirement is asset-by-asset (cannot be aggregated)
- Properties vacant at least five years do not have to satisfy the original use/substantial improvement provisions
- Leased assets, both personal and real, are generally treated as "original use" by the lessee and treated as "purchased property." No substantial improvement is required for either real or personal property.
- Properties straddling an OZ qualify, if contiguous and a majority is in the zone
- Contributed capital is excluded from the 90% asset test for six months after it is received from investors, as long as it is held in cash, cash equivalents, or short-term debt instruments
- A fund that invests at least 90% of its assets in qualified opportunity zone properties not lose its tax-advantaged status if it sells qualified property, stock or partnership interests in the fund so long as it reinvests the proceeds in another qualified property within 12 months

Increased Investment Activity

According to analysis by the National Council of State Housing Agencies (NCSHA), the amount of capital targeted for investment in designated OZs increased dramatically in June 2019. There were 163 funds expecting to raise nearly $43 billion, up from $29 billion in May, and nearly triple the amount anticipated at the start of 2019. The funds ranged in size from $1 million to $10 billion, with an average size of $264 million. One-third of the funds plan to invest nationwide, while the remaining two-thirds are targeting specific states or regions.[1]

Examples of Active Projects Underway

The first OZ project in Massachusetts is 21 East Street in North Attleboro, the redevelopment of the dilapidated L.G. Balfour Jewelry Building. The 4.3-acre transit-oriented development will feature 193 market-rate apartment units and 11,500 square feet of retail with a fitness center, parking, and transit shuttle service. Boston Realty Advisors worked on behalf of project sponsor Jones Street Investment Partners. Cambridge Savings Bank provided the five-year, $30.9 million construction loan.

A Marriott co-branded AC Hotel/Residence Inn hotel project broke ground on a former parking lot OZ site in downtown Oakland's (California) Uptown District. The 18-story, 286-room development located at 1431 Jefferson Street will be the second largest hotel in Oakland and is estimated to exceed $100 million in construction costs. Hawkins Way Capital controlled the site prior to the opportunity zone designation, but the zoning allowed more accessible financing with Goldman Sachs through a single asset opportunity fund.

What's Next?

With a clearer view on the regulatory environment, investment in OZs is finally taking hold. The regulations have been favorable to funds and investors, but there is caution from the investment community that the regulations may change. Therefore, it is imperative that the Qualified Opportunity Funds play by the law, not the regulations. From an investment standpoint, there is still strong opinion that the tax benefits only make a good deal great, so this will limit development in some of the neighborhoods most in need of investment dollars. Philanthropic and social impact organizations may be the key to achieving the more altruistic intent of the legislation. They have the local knowledge, political contacts, and access to foundations with the discretionary capital necessary to woo OZ investment in these communities.

Pauline Hale, MAI, MRICS, CCIM, is Senior Manager, Advisory, with Altus Analytics, Altus Group.

(1) July 19, 2019 edition, Opportunity Zone Fund Directory