Investments in Opportunity Zones Pick Up After Slow Start, Arrival of Pandemic

Federal Tax Incentive Program Sees Gains as New Challenges Loom

By Mark Heschmeyer

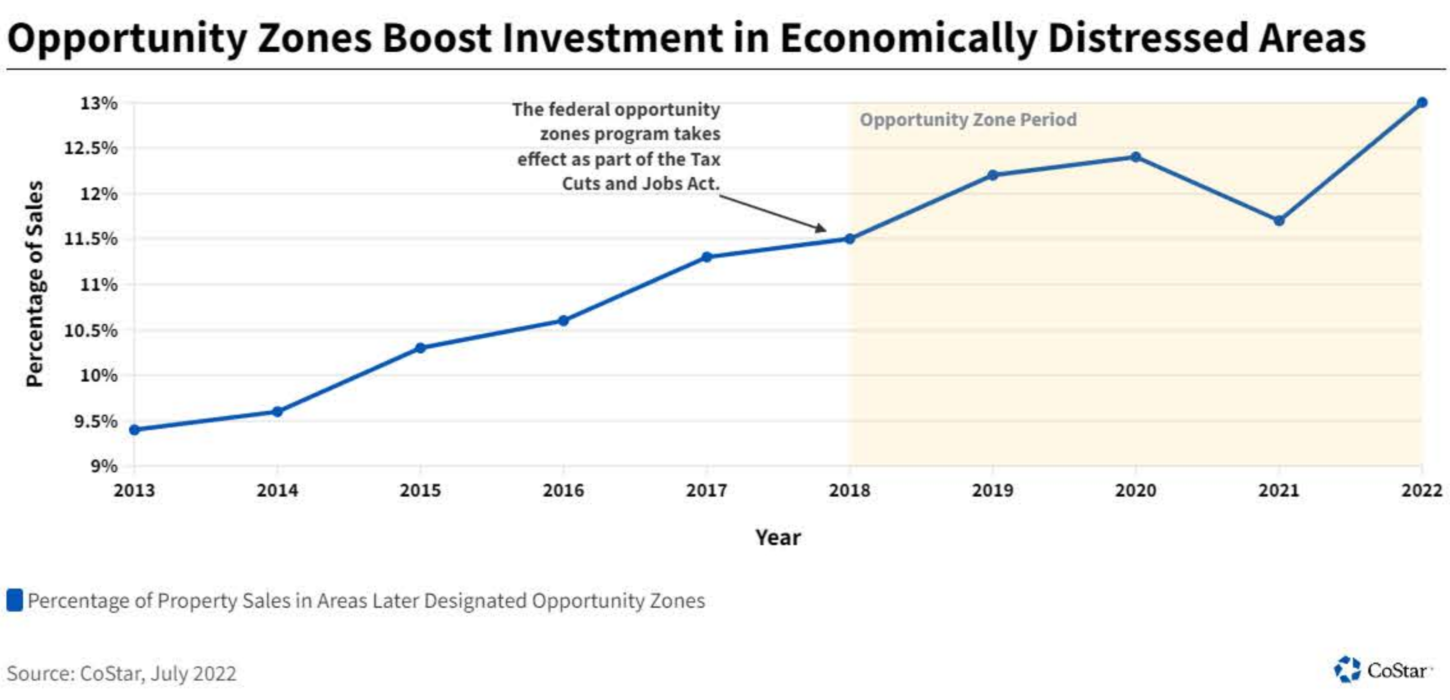
Investments in federal "opportunity zones" appear to be accelerating five years after the tax credit program was launched to target economically distressed areas across the country, according to new CoStar Group research.

The percentage of sales in areas designated for help reached 13% of properties nationally during the first half of this year, up from $11.5% in 2018 before the effort took effect.

Proponents are now watching to see whether the trend continues as investors face new challenges of record inflation, higher borrowing costs and a possible recession, and as Congress weighs an overhaul of the program to correct some inefficiencies and update zone designations.

The opportunity zones program kicked off at the start of 2018 in a time of economic prosperity as part of the Tax Cuts and Jobs Act approved by Congress months earlier. It allows for the reduction — or potential elimination — of taxes on investors' capital gains from any type of investment if those gains are put into a qualified fund to be invested in real estate or a business in one of 8,746 low-income areas federally designated as an opportunity zone.

The program "finally started to gain steam probably a year ago and then here we are with all these things happening at the same time with an inflationary market hyper-exacerbated by [the war in] Ukraine that threatens ... the supply chain," Michael Tillman, CEO and chief investment



officer of PTM Partners, told CoStar News in an interview.

Tillman, though, believes the program "has actually been tremendously successful in deploying capital. ... Some markets have seen more than others of course, but that is capitalism."

PTM has opportunity zone investment projects underway in multiple markets in Florida and greater Washington, D.C.

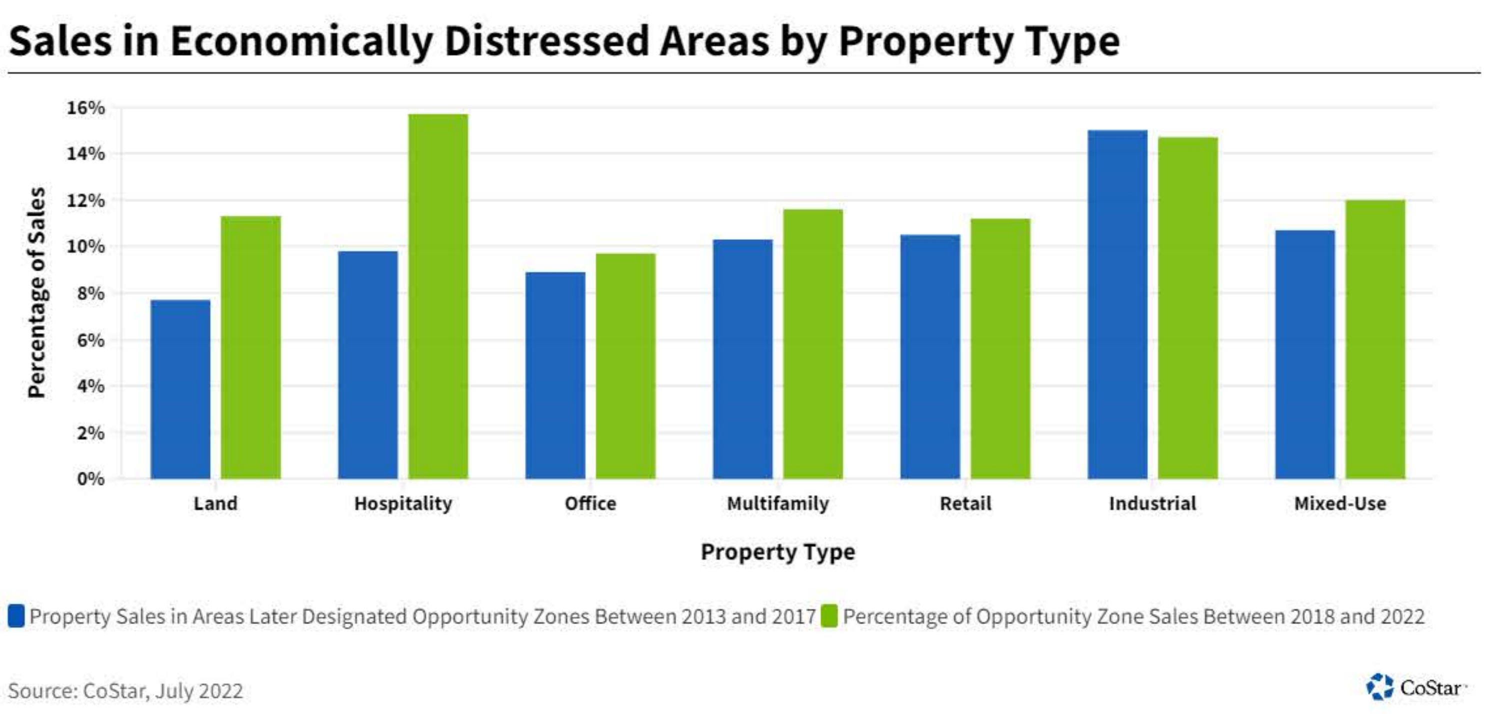
Investments Pick Up

The new investments coincided with an uptick in property purchases and new construction in some but not most of the zones across the country, CoStar sales data shows.
Many of the areas to receive investments had already been the target of transactions in the years preceding approval of the legislation, so it is not certain whether buyers were taking advantage of potential tax benefits by investing in opportunity zones, or whether they were just making ancillary investments stemming from new interest in the areas.

Funds established to invest in such zones offer another window into buying activity.

As of June 30, the 1,475 qualified opportunity zone funds tracked by professional services firm Novogradac reported $30.49 billion in equity raised. Of that amount, about $24.4 billion was at least partially focused on multifamily investments.

The total volume of multifamily property sales in opportunity zones increased by 64.5% from January 2018 with the enactment of the law through July 27, according to CoStar data. By comparison, the total volume of multifamily acquisitions across all U.S. markets was up only 44.7%.



In addition, CoStar data shows opportunity zone deals accounted for a higher percentage of total property sales since enactment of the program for all property types except industrial.

The focus on multifamily investing in opportunity zones comes as the need for affordable housing has grown sharply in the past few years, according to the National Council of State Housing Agencies. Many major markets are now experiencing historically low vacancy rates, and rents have spiked by double digits between 2021 and 2022.

There is currently a shortage of more than 7 million affordable rental homes for extremely low-income renters, with only 37 affordable and available units for every 100 extremely low-income renter households nationwide, according to the council.

Focus on Certain Markets

PTM's website greets visitors with these words: "Not all opportunity zones are created equal." It is a fitting description of the program in general. Many of the zones have yet to see any benefits. Research by groups including the think tank Urban Institute has shown the vast majority of sales and new construction are centered around prime neighborhoods in major metropolitan areas. It's one of the main criticisms of the program.
The federal program leaves the responsibility of identifying zones to state governors and the mayor of the District of Columbia. They all used their own criteria in making their choices.

The Urban Institute analyzed the census tracts designated by the states and D.C., scoring each against measures of the investment flows they were receiving and the socioeconomic changes they had already experienced. Those census tracts were compared with eligible tracts that were not selected for designation.

Governors in Montana, Alaska and Georgia, and the mayor of D.C., for example, picked areas with the lowest levels of preexisting investment, according to the Urban Institute. Conversely, governors in Hawaii, Vermont, Nebraska and West Virginia chose places with the highest levels of preexisting investment.

In another example, researchers from the University of Pennsylvania and Travelers Insurance used data from the Census Bureau and Urban Institute to study tracts in Portland, Oregon. They found that less distressed areas made up the majority of designated opportunity zone tracts in the city and were concentrated downtown compared to more deprived eastern areas.

When all the zones were finally selected across the country, investors and investment advisers began digging into which markets had the most upside. While analysis shows where most of the money has gone, the program opened up new areas for investors to explore.

"Some of my investors have invested in markets like Huntsville, Alabama, or Richmond, Virginia, in ground-up new construction," said Jill Homan, president of Javelin 19 Investments. "Those wouldn't have been one of our initial target markets. It was this threshold of it being an opportunity zone, which is what attracted us to even look at markets that otherwise we would not have been focused on."

Javelin 19 promotes opportunity zones as an investment adviser to individuals and qualified opportunity zone funds, and as a developer in opportunity zones.

Conflict Questions

Some members of Congress have expressed concern that politically connected individuals might have had an unfair or improper influence on the geographical designation of certain opportunity zones.
Among the examples, many referenced stories by the New York Times and Associated Press probing whether Jared Kushner, former President Donald Trump's son-in-law and senior adviser, wielded such influence at the time when the administration was promoting the legislation. A Kushner Cos. affiliate later spearheaded opportunity zone projects in Miami and New Jersey after the program became law.

Watchdog group Citizens for Responsibility & Ethics was vocal in calling Kushner and wife Ivanka Trump's involvement in opportunity zones a conflict of interest.

Under the law, executive branch employees are prohibited from participating "personally and substantially" in matters that have a direct and predictable effect on a financial interest of the employee or their spouse, according to CREW.

The group filed a complaint with the Department of Justice noting the potential for such a conflict since Ivanka Trump was employed as a senior adviser to the president.

Jared Kushner later sold his stake in the affiliate to avoid the appearance of a potential conflict of interest. The U.S. Office of Government Ethics cleared the sale in February 2020, saying it was a necessary divestiture to comply with federal conflict of interest statutes, according to the office's certificate of divestiture.

CoStar News reached out to Kushner Cos. and CREW for comment but did immediately hear back.

Last fall, Kushner Cos. brought in PTM as a joint venture partner in a major multifamily development in Miami's Edgewater neighborhood, an opportunity zone project at 2000 Biscayne Blvd, where Kushner Cos. has been planning a 1,300-unit development.

Edgewater has attracted luxury multifamily developers to its Biscayne Bay waterfront in recent years, with 2,000 new apartment units made available over the past year and 9,800 more underway, according to CoStar data. Yet, the median household income within a 2-mile radius of 2000 Biscayne is $59,090, according to the most recent census data.

Tillman of PTM said the development meets the criteria and goals of the opportunity zones program.

“For us, our focus is around utilization of the opportunity zones as a means to being able to deliver housing that addresses a lot of the affordability issues that we’re finding in the cities that we focus in on,” Tillman said. “All of our projects have workforce housing components, are built to be price competitive within the surrounding market, all while delivering Class A luxury multifamily.”

New Challenges

This year, opportunity zone investment has faced economic challenges with inflation at a 40-year high, triggering fears about a possible recession. In addition, stock market prices have fallen, which can reduce the amount of capital gains available to be allocated to opportunity zone funds. That could lead some investors to reconsider their options, according to Homan and Tillman.
“If portfolio valuations are down, then the investors’ allocation for alternative investments like opportunity zones could be overweighted,” Homan said. “Meaning if you make the pie smaller and you already had a certain amount designated for opportunity zones, you’re overweight in opportunity zones or you’re overweighted in alternative assets.”

Secondly, investors have to decide whether they want to sell their stocks now at the current lower prices and reinvest in opportunity zones that require a long-term year hold to receive the full tax benefits of the investment.

“I think, as with many things, the answers will be mixed,” Homan said. “I think for some investors, they’ll recognize that because this may be a once-in-a-lifetime tax incentive, they’ll seek out opportunity zone investments in durable markets and view the long-term hold so they can look through the downturn and come out the other end with a strong cash-flowing asset.”

In addition to economic challenges, there has been legislation introduced to update the law in both houses of Congress. The amendments would extend the tax incentives by two years through the end of 2028 to facilitate continued investment, implement reporting requirements by the funds on their investments, and sunset the opportunity zone designation for census tracts with a median family income at or above 130% of the national figure. The legislation would also allow qualified opportunity funds to be organized as so-called funds of funds to invest in other qualified funds, which would allow smaller projects to receive capital.

The amendments have bipartisan supporters, including the law’s original sponsor Republican Sen. Tim Scott of South Carolina. Supporters expect the legislation to pass in some form eventually, if not later this year after the midterm elections, then early next year.