OWNING AN OPPORTUNITY

Experts weigh in on Opportunity Zone Funds

BY BRANDI SMITH

At a groundbreaking in Arizona earlier this year, Nancy Wakefield says she got to see firsthand the manifestation of the benefits of the new Opportunity Zone provision. As tax senior director at RSM US, she's familiar with interpreting new tax law, but §§ 1400Z of the 2017 Tax Cuts and Jobs Act offered something new. It created the Qualified Opportunity Zone (QOZ) program.

"If this code section works the way it's supposed to, it should be a win-win for an investor and communities," Wakefield says. "The purpose is to channel private-sector dollars into distressed communities, where 31 million Americans live."

The groundbreaking ceremony she attended was in a QOZ in a small town that hadn't quite recovered from the Great Recession.

"The mayor told the crowd that this development was a game changer for the people of his city," remembers Wakefield. "This town likely never would have gotten that development, but for the fact that it was in an Opportunity Zone."

"... a once-in-a-lifetime opportunity ..."

After the passage of the Tax Cuts and Jobs Act, the governor of each state was able to recommend properties that should be named QOZs, the key being that those tracts should be in economically distressed areas. Roughly 8,700 zones were approved, including more than 600 in Texas. The program offers a tax incentive for private, long-term investment in those zones.

"I truly believe it's a once-in-a-lifetime opportunity because the benefits are really that good," says Craig Bernstein, principal and chief investment officer at OPZ Bernstein, a Washington, D.C.-based real estate private equity fund that specializes in qualified opportunity funds (QOF). "Given the tax-free appreciation, the deferral, the step-up and potential benefits that could be extended with no recapture on ordinary income, it's an exciting program."

As this article goes to print, the U.S. Treasury is set to release additional guidance about how to execute the code section. Even as the interpretation of §§ 1400Z evolves, QOZs are already generating a lot of buzz within the commercial real estate industry. REDNews gathered some of the experts in the field for a summit on Opportunity Zones & Real Estate Tax-Deferred Strategies in late March to learn more about the program's possibilities.

"... to get the maximum benefit ..."

The rules around what to invest in QOFs are pretty clear: you must use capital gain, be it short-term or long-term.

"That can come from the sale of your stock, the sale of real estate or the sale of art work," explains Wakefield. "It can come from the sale of anything as long as it's capital gain."

Once you have a sale date, you have 180 days to roll that gain into an opportunity zone fund. That fund can be organized as an LLC and treated as a partnership or it can elect to be taxed as a REIT.

When it comes to structuring the fund, Bernstein suggests single-asset funds are easier to operate.

"Most of the multi-asset funds out there are actually single-asset funds that have an overriding management agreement," he explains. "For example, 100 Main Street would be a fund, as would 101 Main Street and 102 Main Street. Those three single-asset funds could all be managed by a single Manager."

To qualify for tax benefits, the fund must invest 90 percent of its assets in a QOZ property.

Those benefits are three-fold. First, you can defer any taxable gain until the fund is sold or Dec. 31, 2026, whichever comes first. Second, you receive a 10 percent step-up in tax basis after five years and an additional 5 percent step-up once you hit the seven-year mark. Hold the fund for at least 10 years and the new capital gains taxes generated from the opportunity fund investment are slashed to zero.

The Preston
Courtesy: Hines

CORY OLDER

CRAIG BERNSTEIN

CHRIS RECTOR

NANCY WAKEFIELD

> "2019 will be a very big year for QOFs."(qualified opportunity funds)
> - Nancy Wakefield

"If you want to get the maximum benefit, you have to hold the fund for seven years, which means you would have to invest in a QOF in 2019," Wakefield says. "After that, you can still get the five-year hold and you can get the exclusion if you hold the investment for 10 years, but the seven-year opportunity is gone."

As a result, she predicts 2019 will be a very big year for QOFs.

"... there are risks ..."

It already has been a big year for Bernstein, who closed on his first QOZ purchase earlier this year. It's a program his firm is comfortable with, thanks to its familiarity with the New Market Tax Credit Program.

"The two programs are very similar in that they're government-based tax incentives that can be applied to real estate transactions," says Bernstein.

The Bernstein Companies, the parent company of OPZ Bernstein, has previously closed in excess of $1.5 billion worth of transactions (more than 80 of them in what are now labeled opportunity zones) under the New Market guidelines and is ready to help guide investors into QOFs now.

"A lot of people are starting up in this space with no historical real estate experience. What differentiates us is our historical track record, which is providing us with the necessary foundation for an institutional quality Opportunity Zone Fund offering," Bernstein says.

Investing in an Opportunity Zone Fund, like any other investment, has to make economic sense, Wakefield adds.

"There are risks to that investment, just like there would be if you went out and bought a piece of land, started a new business or invested in a real estate project," she says.

Urban East
Courtesy: River City Capital

Some view the program as a risk because it's a new code section with evolving regulation.

"There is uncertainty and some unanswered questions about how this is going to be applied," says Wakefield.

Due to the many nuances of the program, both she and Bernstein recommend that investors seek out guidance from qualified tax and legal professionals.

"Do not try this at home," Bernstein laughs.

"... we got really lucky ..."

That's advice Cory Older, president of River City Capital Partners, knows well. He stumbled into learning all about QOZs when a project his company was developing landed in one.

"We bought 6400 E. Riverside in Austin about two and a half years ago. Oracle was building a brand new campus there and we wanted to do a mixed-use project with a multi-family focus on the East Riverside corridor," he says.

As they were working to get permits for the project, their property got submitted and approved as a QOZ.

"We got really lucky," says Older.

The company is now getting ready to break ground on Urban East, which will deliver 375 apartments, 100,000 square feet of office and 20,000 square feet of retail/restaurant space to the Riverside neighborhood.

"This corridor is one of the fastest growing areas within Austin. Riverside is booming," Older says.

Qualifying as an opportunity zone flipped their funding effort on its head.

"Normally, as a developer, we're trying to raise money, but we are still getting equity calls," Older adds. "We were kind of forced to become experts in the code as fast as we could, though we're still relying on professionals as well."

One of the details he's learned, which he's excited to share, is that QOZ tenants can also benefit if they meet

< Continued from Page 9

certain requirements. The biggest factors are having 90 percent of tangible assets in the opportunity zone and generating 50 percent of revenue from that space.

He offers the example of a startup that chooses to office in an opportunity zone. As that company looks for capital, it can pitch all of the same benefits as a real estate developer, including deferral of current capital gain taxes and potentially tax-free capital gains should the company succeed and have a big exit.

"That will make raising capital so much easier. We're excited to see what that does, both for the startup world and for all the different businesses out there that are raising capital," Older adds.

Having dug deep to learn as much as he could about the benefits of QOZs, Older says River City Capital is now aggressively looking for land in those areas.

"I think as the rules become more transparent it'll be an exciting niche to watch," he says.

"...capital sources and opportunities..."

The program is one that Chris Rector, director of Hines' Houston office, is interested in, but not seeking out.

"We're always out looking for the best opportunities for our partners, whether they're in an opportunity zone or not," he says.

Hines recently announced plans to build The Preston at the corner of Preston and Milam Streets in downtown Houston. The 46-story tower will include 373 luxury residences, including 10 penthouses, a 10th-level zero-edge pool, pet spa, bike shop and 6,800 square feet of retail/restaurant space.

"Munoz + Albin is the design architect. They took inspiration from a ship's sail. That guided the design of the building, which is positioned diagonally," says Rector.

Like Urban East, The Preston's property was designated a QOZ after Hines acquired it.

"We have a great stake in this project being well done and well received by the market. We were going to make an investment in the location, but the timing was beneficial in terms of capital opportunities," Rector explains. "It opened up our capital sources and opportunities that wouldn't have been there otherwise."

He adds that virtually all of downtown Houston is designated an opportunity zone, based on the program's goal of spurring development in areas that are either economically challenged and/or of high economic importance for a community.

"... spreading the wealth ..."

"An important part of the story is that the purpose of this is to benefit distressed communities, where millions of Americans live. These investments can create jobs and benefit the people who live there," says Wakefield. "If you look at the map of where these opportunity zone tracts are, a lot of them are in low-income or low-density areas that a developer might otherwise pass up."

QOZs, she says, are an example of the good that capitalism can do: incentivizing investment in communities that recent economic growth has left behind, where there is real potential for revitalization.

"You're spreading the wealth and providing opportunity to parts of America that might not otherwise see it," Wakefield says.

"This program has the ability to not only deliver compelling risk-adjusted returns to our investors in a tax-efficient manner, but also positively impact thousands of lives across America," adds Bernstein.

That's precisely what Wakefield saw in action in that small Arizona town last month.

"I thought, 'This is why this country works,'" she remembers. "You have a capitalist system where people are motivated to succeed, with a tax provision that was passed to incentivize people to do something that is socially and economically good for America."