Opportunity Zone Investment Structure Alternatives

By **Peter DiCorpo**

Opportunity Zone investment is expected to be among the hottest commercial real estate strategies in 2019. However, most investors are unsure which structure best suits their investment objectives.

Real estate investment managers are focused on offering optionality to those investors desiring access to Opportunity Zone investments. Many are forming Qualified Opportunity Funds (QOFs), which are commingled funds set up to invest in numerous Opportunity Zone properties. Other managers are focusing on single asset offerings of Opportunity Zone investments.

Both structures provide identical tax treatment. However, while QOFs offer diversification, they may also present capital deployment challenges and uncertainty around geographic concentration. A single asset offering, with its associated transparency of capital deployment timing and greater clarity about investment exit timing, may be more appealing to some investors.

A brief recap

Created by the Tax Cuts and Jobs Act of 2017, Opportunity Zone legislation was enacted to spur economic development and job creation in distressed areas across the United States. Subject to certain timing and other restrictions, the Act allows investors to defer capital gains that would otherwise be payable in connection with the sale of an appreciated asset by investing those gains in an Opportunity Zone.

In addition, some or all of the future gain that would be recognized on the sale of an Opportunity Zone investment may be permanently excluded from taxation, depending on the hold period of the underlying investment.

Qualified opportunity funds: potential pitfalls

Participating in a QOF may seem simpler than one-off transactions. An investor places the gain from an appreciated asset sale into a fund and the fund manager then identifies multiple projects in Opportunity Zones and proceeds. However, this simplicity can be deceptive. Funds may have difficulty deploying capital efficiently, which can reduce or eliminate the intended tax advantages.

By design, Opportunity Zones are located in secondary and tertiary markets that are new to many commercial real estate investment companies. Managers may find limited deal flow in these markets, especially if the market is unfamiliar.

Transactions are also smaller—in the $30 million to $50 million range—so it is difficult to concentrate investment capital into a few large deals.

Further, the legislation requires that extensive investment be made in a property post-acquisition, which means that most Opportunity Zone projects will focus on ground-up development or properties that require substantial repositioning.

An investor's ability to receive tax benefits depends on compliance with strict timing requirements. Every investor has a distinct 180-day deadline by which the gains from an appreciated asset sale must be invested in an Opportunity Zone fund. Additionally, the fund has its own 180-day timeframe within which it must deploy capital.

One-off investments: control and certainty

One-off transactions are another avenue for participating in Opportunity Zones. They give investors more flexibility and certainty.

A real estate investment manager identifies opportunities in designated zones and then secures capital to finance each project. Investors can select from a number of qualified deals and closing dates with confidence that the funds will be deployed before the fund's 180-day deadline. Investors can also choose to invest with real estate investment managers possessing experience developing or repositioning properties in the manner anticipated for Opportunity Zone investments.

This includes firms with expertise in ground-up development in the $30 million to $50 million range, as well as those with experience in smaller markets across the United States. Investors might also look for companies that typically hold these assets long-term and have expertise managing them.

Savvy investors should carefully weigh one-off transactions and QOFs before choosing the Opportunity Zone investment structure that is best aligned with their objectives. ■

Peter DiCorpo is the COO of Waypoint Residential, LLC, a vertically integrated real estate investment firm specializing in acquisition and development of conventional multifamily, student and senior housing properties throughout the United States.

Learn more at **www.waypointresidential.com**.

WAYPOINT RESIDENTIAL