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The Big Opportunity for Investors in Opportunity Zones

Tax reform passed in December 2017 created a huge incentive for real estate investors in low-income areas that are designated as "opportunity zones." Investors in these areas may defer capital gains taxes and avoid paying taxes on gains if the investment is held for at least 10 years. The legislation has set off a flurry of activity among fund managers, developers and investors that are looking to take advantage of the new rule. While transaction activity has so far been muted as industry players try to understand the ground rules and raise capital in vehicles that will meet the needs of investors and withstand structural scrutiny, one thing is for certain: The opportunity is enormous.

- A study of Yardi Matrix's database found that within opportunity zones there are either in place or under construction 1.9 million multifamily units, 960 million square feet of office space and 180 million square feet of self-storage space.

- As a percentage of total space, properties in opportunity zones that are in place or under construction represent 13.1% of total multifamily units nationwide, 13.7% of total office space and 11.4% of total self-storage space.

- The development pipeline in those zones—projects that either have or are in the process of getting government approvals to build but have not broken ground—encompasses 450,000 multifamily units, 120 million square feet of office space and 12 million square feet of self-storage space.

Properties in Opportunity Zones: National Overview

	In-Place + UC	Planned + Prospective	Total
Mutlifamily OZ Units	1.9 Mil	455K	2.3 Mil
% of Total MF Units	13.1%	19.3%	14.0%
Office OZ Sq Ft	960.3 Mil	120.7 Mil	1,080.9 Mil
% of Total Office Sq Ft	13.7%	16.4%	13.9%
Self Storage OZ Sq Ft	180.4 Mil	12.1 Mil	192.4 Mil
% of Total SS Sq Ft	11.4%	12.3%	11.5%

Source: Yardi Matrix (as of March 2019)

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- Ground-up development is likely to be a major focus of opportunity fund capital, since the law requires investors to significantly increase the basis of assets purchased. For properties in place, that would mean buildings in need of wholesale improvements, which limits the pool of potential assets that would qualify.

- The potential for opportunity zone development is highest in the multifamily sector, where the number of planned and prospective units represents 24.2% of total stock. In office, planned and prospective projects represent 12.6% of total space in opportunity zones, while the percentage is only 6.7% in the self-storage segment.

- While it would seem intuitive that average rents of properties in opportunity zones—defined as areas with below-average income and higher-then-average unemployment—would be less than the market average, the data shows no clear pattern. Rents in opportunity zones are below the market average in many metros, but in some metros rents are more in opportunity zones or the difference is small.

Metro Focus

The heart of the program is an incentive to reinvest capital gains, which must be placed in a qualified "opportunity zone fund." Funds can be single-purpose vehicles or commingled. Shareholders who keep their investments for five years will pay no taxes on 10 percent of the investment's gains. After seven years, 15% of the gains will not be taxed. Shareholders who hold opportunity zone investments for 10 years can avoid paying taxes on all gains. Among the qualified investments are real estate, businesses and infrastructure.

The aim of opportunity fund legislation is to stimulate investment in distressed and low-income areas. Opportunity zone tracts have above-average unemployment rates and income significantly below the regional median. More than 8,700 areas in the U.S., encompassing roughly 10% of the U.S. population and 12% of the land, were designated by states and certified by the Treasury Department as opportunity zones. On average, income of residents in opportunity zone funds is about 60% of the area median income. The tracts are a mix of rural, urban and suburban.

When broken down by volume of commercial real estate opportunities, urban areas naturally had the most potential property investments. However, the amount of properties in opportunity zones is not strictly correlated with total metro size. Manhattan, for example, is by far the largest U.S. office market, but is among the lowest in terms of percentage of opportunity zone space because office buildings are generally located in areas with high-income residents.

An example of this disconnect on the multifamily side is the Richmond, Va., metro, which has 45,000 apartment units located in opportunity zones, the fifth most in the nation. Richmond has almost as many multifamily units in opportunity zones as Manhattan and Brooklyn, despite being a fraction of the overall size of those metros. The discrepancy has to do with the average income of residents and the way states composed the zones.

There are significant differences in metro results by property type:

Multifamily

- Metros with the most in place and under construction units include the Washington, D.C., metro (55,000), Phoenix (54,000) and Brooklyn (49,000). Combined, Brooklyn and Manhattan total 96,000 units and West Houston and East Houston account for 82,000.

- Brooklyn (32%), Portland (23%) and Cleveland (22%) have the highest proportion of in-place units in opportunity zones. High-income submarkets Fort Worth (1%), North Dallas (3%) and the San Francisco Peninsula (4%) have the lowest proportion.

- Miami (27,300), Los Angeles (25,400), Washington, D.C. (25,000) and Northern New Jersey (20,000) have the largest development pipelines in designated opportunity zones. Metros with the highest percentage of units in the pipeline in opportunity zones are Cleveland (70%), Detroit (57%), Brooklyn (41%) and East Los Angeles (40%).

- Metros in which apartment rents in opportunity zones lagged the metro average the most include urban Chicago ($869), the San Francisco Peninsula ($792) and West Palm Beach ($522). Metros in which apartment rents in opportunity zones were higher than the metro average include urban Philadelphia ($410), Brooklyn ($344), Bridgeport-New Haven, Conn. ($310) and East Los Angeles ($257).

Most In-Place & UC MF Units in OZs

Market	Units	% of Market Total
Washington DC	55,453	17.5%
Phoenix	54,467	17.2%
Brooklyn	49,080	32.5%
Manhattan	47,329	14.6%
Richmond–Tidewater	45,250	20.5%
Detroit	43,045	20.1%
West Houston	42,655	9.4%
Metro Los Angeles	40,299	20.8%
East Houston	39,017	20.1%
Portland	36,408	22.9%
Boston	35,816	14.9%
Cleveland–Akron	34,952	21.7%
San Fernando Valley	31,373	20.7%
Urban Atlanta	31,099	12.7%
Baltimore	30,726	13.7%
Inland Empire	30,034	19.4%
Northern New Jersey	29,791	12.9%
Northern Virginia	28,634	12.6%
Bridgeport–New Haven	27,853	20.7%
Indianapolis	27,765	15.9%

Source: Yardi Matrix (as of March 2019)

Least In-Place & UC MF Units in OZs

Market	Units	% of Market Total
Fort Worth	1,996	1.0%
San Francisco–Peninsula	5,005	4.0%
West Palm Beach	6,137	9.1%
Suburban Twin Cities	6,236	7.4%
Tacoma	6,876	10.1%
Bay Area–South Bay	7,133	5.3%
Jacksonville	8,898	8.6%
Suburban Atlanta	9,860	4.8%
Orange County	9,921	4.8%
North Dallas	10,117	2.8%

Source: Yardi Matrix (as of March 2019)

Multifamily: Highest Rent Spread Between OZs and the Metro Average

Market	Spread	% Spread	Avg. Rent Inside OZs	Avg. Rents Outside Ozs	2018 Rent Growth Inside OZs	2018 Rent Growth Out-side OZs
Urban Chicago	$869	86.9%	$1,000	$1,869	8.5%	4.2%
San Francisco–Peninsula	$792	34.2%	$2,315	$3,107	1.5%	5.3%
West Palm Beach	$522	44.6%	$1,171	$1,693	4.2%	3.5%
Ft Lauderdale	$387	30.4%	$1,274	$1,661	4.0%	3.6%
Urban Atlanta	$362	36.1%	$1,003	$1,365	8.0%	5.3%
Northern New Jersey	$360	22.7%	$1,587	$1,947	2.2%	2.4%
Metro Los Angeles	$358	16.2%	$2,205	$2,563	4.9%	5.3%
Manhattan	$354	9.2%	$3,868	$4,222	3.9%	3.9%
Orange County	$351	20.2%	$1,735	$2,086	4.5%	2.7%
Suburban Chicago	$349	39.6%	$881	$1,230	2.2%	2.7%
Northern Virginia	$294	18.9%	$1,553	$1,847	3.9%	2.4%
Seattle	$294	19.0%	$1,550	$1,844	2.2%	4.4%
Pittsburgh	$283	33.5%	$846	$1,129	1.3%	5.8%
San Fernando Valley	$269	15.6%	$1,724	$1,993	5.1%	5.0%
Orlando	$268	25.0%	$1,071	$1,339	5.8%	5.0%
San Diego	$265	15.7%	$1,687	$1,952	7.1%	5.3%
Las Vegas	$251	29.9%	$839	$1,090	8.1%	7.7%
Miami	$247	17.1%	$1,446	$1,693	6.6%	3.0%
Charlotte	$230	25.3%	$909	$1,139	3.2%	3.7%
Inland Empire	$221	16.8%	$1,317	$1,538	7.7%	5.3%

Source: Yardi Matrix (as of March 2019)

Multifamily: Lowest Rent Spread Between OZs and Metro Average

Market	Spread	% Spread	Avg. Rent Inside OZs	Avg. Rents Outside Ozs	2018 Rent Growth Inside OZs	2018 Rent Growth Out-side OZs
Urban Philadelphia	$(410)	-22.5%	$1,820	$1,410	4.7%	3.3%
Brooklyn	$(344)	-11.3%	$3,032	$2,688	-0.6%	4.0%
Bridgeport–New Haven	$(340)	-19.4%	$1,749	$1,409	1.9%	1.7%
Eastern Los Angeles	$(257)	-12.4%	$2,069	$1,812	2.8%	5.1%
Indianapolis	$(221)	-20.4%	$1,084	$863	1.7%	3.7%
Cleveland–Akron	$(150)	-14.4%	$1,040	$890	5.5%	2.9%
Central New Jersey	$(79)	-4.9%	$1,624	$1,545	1.1%	1.6%
Bay Area–South Bay	$(77)	-2.6%	$2,934	$2,857	3.4%	5.5%
Bay Area–East Bay	$(69)	-3.0%	$2,315	$2,246	3.1%	2.7%
Portland	$(60)	-4.2%	$1,438	$1,378	3.0%	3.7%

Source: Yardi Matrix (as of March 2019)

Most Planned/Prospective MF Units in OZs

Market	Units	% of Market Total
Miami	27,341	29.8%
Metro Los Angeles	25,426	35.4%
Washington DC	24,492	24.8%
Northern New Jersey	20,520	26.1%
Bay Area–East Bay	14,256	33.3%
Phoenix	12,023	30.2%
Brooklyn	11,925	40.7%
Boston	10,586	20.6%
Seattle	9,339	14.7%
Eastern Los Angeles	9,195	40.3%
Bridgeport–New Haven	8,553	32.6%
Tampa–St Pete	8,356	24.0%
Detroit	7,898	56.9%
Baltimore	7,835	26.7%
Cleveland–Akron	7,265	69.9%
Urban Atlanta	7,212	21.1%
Denver	7,100	12.5%
Nashville	6,949	23.8%
Richmond–Tidewater	6,843	30.6%
Portland	6,663	31.1%

Source: Yardi Matrix (as of March 2019)

Least Planned/Prospective MF Units in OZs

Market	Units	% of Market Total
Suburban Chicago	50	0.3%
Pittsburgh	406	4.6%
Fort Worth	602	3.3%
North Dallas	723	1.3%
Suburban Philadelphia	743	3.9%
Suburban Twin Cities	1,025	7.2%
West Palm Beach	1,151	4.5%
Inland Empire	1,298	8.5%
Tacoma	1,694	20.5%
East Houston	1,734	15.8%

Source: Yardi Matrix (as of March 2019)

Office

- Metros with the most office square feet in place or under construction in opportunity zones are Houston (61 million), Detroit (41 million), Portland (37 million) and Los Angeles (32 million). By percentage of stock, the metros with the most are Portland (51%), Cleveland (45%), Brooklyn (38%) and Detroit (35%).

- Metros with the most office space in the development pipeline in opportunity zones include Washington, D.C. (59 million square feet), the Bay Area (58 million), Dallas-Fort Worth (50 million) and Atlanta (41 million). Metros in which the development pipeline in opportunity zones represents the highest percentage of existing stock in those zones are Cleveland (67%), Columbus (60%) and Philadelphia (55%).

- Metros in which office asking rents in opportunity zones are the most below the metro average include San Francisco ($37.43), Manhattan ($23.61), Brooklyn ($11.86) and Austin ($11.45). Markets in which average office asking rents are higher in opportunity zones than the rest of the metro include Portland ($7.45), Houston ($6.55), Central New Jersey ($6.41) and Tampa ($5.52).

Most In-Place & UC Office Sq Ft in OZs

Market	Sq Ft	% of Market Total
Houston	61.0 Mil	23.2%
Detroit	41.3 Mil	35.3%
Portland	36.9 Mil	50.6%
Los Angeles	32.2 Mil	10.3%
Cleveland–Akron	28.9 Mil	44.6%
Phoenix	28.5 Mil	20.2%
Philadelphia	24.6 Mil	13.9%
Sacramento	22.3 Mil	29.2%
Bridgeport–New Haven	21.6 Mil	22.8%
Bay Area	21.5 Mil	8.5%
Washington DC	20.7 Mil	5.4%
New Jersey	19.3 Mil	10.3%
St Louis	18.8 Mil	30.9%
Baltimore	18.2 Mil	21.6%
Seattle	18.2 Mil	10.7%
Twin Cities	17.2 Mil	14.7%
Richmond–Tidewater	16.7 Mil	23.9%
Indianapolis	16.4 Mil	32.9%
Salt Lake City	16.0 Mil	30.4%
Brooklyn	14.1 Mil	37.8%

Source: Yardi Matrix (as of March 2019)

Most Planned/Prospective Office Sq Ft in OZs

Market	Units	% of Market Total
Washington DC	58.8 Mil	14.8%
Bay Area	58.4 Mil	11.8%
Dallas–Fort Worth	50.0 Mil	1.2%
Atlanta	42.0 Mil	10.0%
Boston	35.8 Mil	10.8%
Los Angeles	28.3 Mil	31.1%
San Francisco	28.3 Mil	6.1%
Chicago	27.8 Mil	1.9%
Houston	26.6 Mil	25.7%
Austin	23.9 Mil	6.2%
Manhattan	22.6 Mil	7.2%
Phoenix	21.1 Mil	16.6%
Seattle	18.5 Mil	7.5%
New Jersey	16.4 Mil	34.6%
Denver	14.9 Mil	19.9%
Philadelphia	14.5 Mil	55.3%
Charlotte	13.9 Mil	9.6%
Nashville	13.1 Mil	5.4%
Baltimore	12.1 Mil	36.2%
Miami	12.0 Mil	27.0%

Source: Yardi Matrix (as of March 2019)

Least In-Place & UC Office Sq Ft in Ozs

Market	Units	% of Market Total
West Palm Beach	0.7 Mil	1.8%
San Diego	1.0 Mil	0.9%
Pittsburgh	1.1 Mil	1.6%
Jacksonville	1.3 Mil	4.1%
Chicago	2.2 Mil	0.7%
Austin	2.2 Mil	2.7%
San Francisco	2.3 Mil	1.3%
Nashville	2.9 Mil	6.1%
Ft. Lauderdale	3.0 Mil	6.3%
Kansas City	3.4 Mil	6.0%

Source: Yardi Matrix (as of March 2019)

Least Planned/Prospective Office Sq Ft in Ozs

Market	Units	% of Market Total
West Palm Beach	-	0.0%
San Diego	-	0.0%
Twin Cities	0.2 Mil	3.6%
Las Vegas	0.3 Mil	9.4%
Indianapolis	0.3 Mil	12.2%
Kansas City	0.3 Mil	3.8%
Inland Empire	0.4 Mil	16.7%
Orlando	0.4 Mil	3.7%
Carolina Triangle	0.4 Mil	5.7%
Jacksonville	0.5 Mil	9.5%

Source: Yardi Matrix (as of March 2019)

Office: Highest Rent Spread Between OZs and Rest of the Metro

Market	Spread	% Spread	Avg. Listing Rate Inside Ozs	Avg. Listing Rate Outside Ozs
San Francisco	$34.73	145.2%	$23.92	$58.65
Manhattan	$23.61	49.2%	$47.95	$71.56
Brooklyn	$11.86	26.1%	$45.40	$57.26
Austin	$11.45	45.9%	$24.95	$36.40
West Palm Beach	$11.01	53.2%	$20.68	$31.69
Washington DC	$10.66	36.9%	$28.89	$39.55
Chicago	$10.20	54.8%	$18.62	$28.82
Orange County	$8.49	32.8%	$25.85	$34.34
Dallas–Fort Worth	$8.13	42.6%	$19.07	$27.20
Los Angeles	$7.93	26.4%	$30.06	$37.99
Ft Lauderdale	$7.81	36.1%	$21.66	$29.47
Seattle	$6.80	25.1%	$27.05	$33.85
Nashville	$6.12	27.4%	$22.31	$28.43
San Diego	$4.69	14.5%	$32.30	$36.99
Pittsburgh	$3.93	20.4%	$19.31	$23.24
Atlanta	$3.73	17.0%	$21.99	$25.72
Miami	$3.57	10.3%	$34.65	$38.22
St Louis	$3.15	17.0%	$18.56	$21.71
Denver	$3.15	13.0%	$24.26	$27.41
Orlando	$2.97	16.3%	$18.19	$21.16

Source: Yardi Matrix (as of March 2019)

Office: Lowest Rent Spread Between OZs and Rest of the Metro

Market	Spread	% Spread	Avg. Listing Rate Inside Ozs	Avg. Listing Rate Outside Ozs
Portland	$(7.45)	-23.2%	$32.18	$24.73
Houston	$(6.55)	-19.2%	$34.17	$27.62
New Jersey	$(6.41)	-16.8%	$38.17	$31.76
Tampa–St Pete	$(5.52)	-18.8%	$29.40	$23.88
Philadelphia	$(2.46)	-7.8%	$31.52	$29.06
Bay Area	$(2.10)	-4.6%	$45.77	$43.67
Detroit	$(1.37)	-5.9%	$23.09	$21.72
Cleveland–Akron	$(0.58)	-2.8%	$20.98	$20.40
Bridgeport–New Haven	$(0.53)	-1.8%	$29.21	$28.68
Las Vegas	$(0.30)	-1.1%	$26.71	$26.41

Source: Yardi Matrix (as of March 2019)

Self-Storage

- Metros with the most in-place and under construction self-storage space in opportunity zones include Richmond (6.2 million square feet), Phoenix (5.9 million), the Inland Empire (5.3 million) and Brooklyn (4.2 million). The most concentrated metros as a percentage of square feet include Brooklyn (54%), Richmond and Miami (22%) and Washington, D.C. (18%). The data measures 10x10-foot storage units.

- The most planned and prospective self-storage space in opportunity zones are in Portland (1.2 million square feet), Phoenix (734,000), Miami (642,000) and Central New Jersey (526,000).

- Metros with average self-storage rents in opportunity zones most below the metro average are Manhattan ($74), the San Francisco Peninsula ($62), the Bay Area ($30), Fort Worth ($26) and Northern Virginia ($23). The highest percentage spread is in San Francisco (39%), Fort Worth (38%), the suburban Twin Cities (26%), Manhattan (24%) and Atlanta (21%).

Most In-Place & UC Self Storage Sq Ft in OZs

Market	Sq Ft	% of Market Total
Richmond–Tidewater	6.2 Mil	22.3%
Phoenix	5.9 Mil	16.8%
Inland Empire	5.3 Mil	15.7%
Brooklyn	4.2 Mil	54.2%
San Fernando Valley	3.6 Mil	16.7%
Miami	3.5 Mil	22.3%
Detroit	3.3 Mil	17.4%
Bay Area–East Bay	3.3 Mil	15.4%
Sacramento	3.2 Mil	17.3%
Tampa–St Pete	3.1 Mil	11.2%
Northern New Jersey	3.0 Mil	17.4%
Boston	2.9 Mil	11.3%
Baltimore	2.8 Mil	17.6%
Denver	2.8 Mil	9.5%
Bridgeport–New Haven	2.8 Mil	17.5%
Orlando	2.7 Mil	11.2%
Portland	2.7 Mil	17.3%
Carolina Triangle	2.7 Mil	16.0%
Washington DC	2.6 Mil	17.9%
West Houston	2.4 Mil	5.5%

Source: Yardi Matrix (as of March 2019)

Least In-Place & UC Self Storage Sq Ft in OZs

Market	Sq Ft	% of Market Total
Suburban Twin Cities	162,374	1.4%
Fort Worth	263,280	1.1%
Central New Jersey	545,273	4.3%
San Francisco–Peninsula	598,572	4.3%
West Palm Beach	707,447	6.0%
Suburban Philadelphia	718,178	3.7%
Pittsburgh	756,141	6.4%
San Antonio	796,547	3.8%
Suburban Atlanta	843,438	3.0%
North Dallas	902,434	3.1%

Source: Yardi Matrix (as of March 2019)

Self Storage: Highest Rent Spread Between OZs and Rest of the Metro

Market	Spread	% Spread	Avg. 10X10 Rents Inside OZs	Avg. 10X10 Rents Outside OZs
Manhattan	$74	24.1%	$307	$381
San Francisco–Peninsula	$62	39.0%	$159	$221
Bay Area–South Bay	$30	19.9%	$151	$181
Fort Worth	$26	37.7%	$69	$95
Northern Virginia	$23	18.3%	$126	$149
Suburban Twin Cities	$22	25.6%	$86	$108
San Diego	$21	15.6%	$135	$156
Urban Atlanta	$20	20.6%	$97	$117
Ft Lauderdale	$19	15.0%	$127	$146
Suburban Philadelphia	$15	15.0%	$100	$115
Nashville	$15	15.8%	$95	$110
Inland Empire	$14	14.1%	$99	$113
Phoenix	$14	15.4%	$91	$105
West Palm Beach	$12	10.3%	$117	$129
Suburban Atlanta	$12	14.3%	$84	$96
Las Vegas	$12	13.3%	$90	$102
Pittsburgh	$11	10.4%	$106	$117
Central New Jersey	$11	8.7%	$127	$138
Orange County	$10	6.1%	$163	$173
Suburban Dallas	$10	11.5%	$87	$97

Source: Yardi Matrix (as of March 2019)

Self Storage: Lowest Rent Spread Between OZs and Rest of the Metro

Market	Spread	% Spread	Avg. 10X10 Rents Inside OZs	Avg. 10X10 Rents Outside OZs
Bridgeport–New Haven	$(48)	-29.3%	$164	$116
Eastern Los Angeles	$(22)	-12.2%	$180	$158
Washington DC	$(14)	-9.1%	$154	$140
Northern New Jersey	$(11)	-6.4%	$173	$162
Detroit	$(9)	-7.8%	$115	$106
St Louis	$(9)	-9.0%	$100	$91
Seattle	$(7)	-4.2%	$165	$158
Tampa–St Pete	$(5)	-4.3%	$116	$111
Cleveland–Akron	$(4)	-4.1%	$98	$94
Portland	$(3)	-2.1%	$145	$142

Source: Yardi Matrix (as of March 2019)

Most Planned/Prospective SS Sq Ft in OZs

Market	Units	% of Market Total
Portland	1,155,910	41.0%
Phoenix	734,608	25.4%
Miami	642,447	35.6%
Central New Jersey	525,725	34.3%
Sacramento	419,814	18.9%
Austin	348,327	36.2%
San Fernando Valley	340,609	20.7%
Washington DC	329,370	27.6%
Ft Lauderdale	319,000	16.2%
Detroit	297,589	22.8%
Orlando	287,491	9.5%
Eastern Los Angeles	267,797	27.6%
Bay Area–East Bay	256,529	25.2%
Seattle	241,149	9.8%
Manhattan	221,242	69.6%
Brooklyn	213,065	41.4%
Carolina Triangle	194,996	14.0%
Richmond–Tidewater	184,734	17.7%
Urban Twin Cities	181,350	27.5%
Urban Philadelphia	156,216	36.3%

Source: Yardi Matrix (as of March 2019)

Diversity Within Opportunity Zones

A common strategy of investors in distressed areas is to buy assets that are relatively inexpensive and add value by redeveloping the structure and bringing in tenants at higher rents. Key to this strategy is to find properties or submarkets that have below-market values and rents. However, just because a property is in an opportunity zone doesn't mean there is potential to raise rents. In most metros, the average rent in opportunity zones is less than the average rent of properties in the metro outside of opportunity zones, but by no means is there a clear pattern.

There are several reasons for the lack of clarity in the rent data, mostly owing to the way the zones were drawn. For one thing, the employment and income data used to identify eligible census tracts was from an average of the 2011-2015 American Community Survey. Some communities have experienced growth and/or gentrification in the intervening years and might not qualify if more recent numbers were used. About three-quarters of the jobs created since the Great Recession have been in the top 25 urban areas, and many rural communities have not recovered from losing a manufacturing plant or other major industry.

In some cases, the numbers are skewed by small sample sizes: There are few properties of one type or another in some low-income areas. Another factor is that the states were given a fair amount of leeway to set up the zones, and they employed different strategies. Some states focused more on urban areas, while in others the designated zones were spread throughout the state.

What's more, as small as they are, many census tracts designated as opportunity zones have a range of neighborhoods that defy simple characterizations such as high-income or low-income. One well-known example is Long Island City, a section of the borough of Queens in New York City. Long Island City has had its struggles as industries have left in past decades, but has rapidly gentrified in recent years and was selected by Amazon as the location of an East Coast headquarters before the company changed its mind.

Strategies for Investing

Opportunity zones have become an area of intense interest in the commercial real estate market. For one thing, the segment represents an entirely new area of outlays in a market that has for years had far more capital seeking assets than available investments. Opportunity zones also provide the potential to draw from a new base of largely untapped investors and the possibility of new markets that were thought to be too small or risky as investment strategies.

Another attraction is that opportunity zones give commercial real estate investors the potential for higher yields at the tail end of a nine-year bull market, when acquisition yields are at or near all-time lows. The spread between returns on stable assets in primary markets and value-add/secondary market properties has slowly tightened over the course of the cycle. Properties in opportunity zones could provide higher returns more in line with expectations of value-add investors.

However, the risks are significant, as well. Investing in low-income areas or those starved of business investment is inherently more volatile than core, stabilized markets. Performance of real estate in tertiary markets and low-income areas historically has been spotty.

Having favorable tax status is a good start, but it's no substitute for demand that produces income. There is money to be made injecting much-needed capital in markets that have been ignored, but to be successful funds need to be prepared to be in it for the long haul and have a holistic approach to development. Otherwise, investors could find themselves rehabilitating properties that are underused. The long-term benefit of the program—no taxes on gains—only works if the projects create value.

Investments should be carefully thought out and made in conjunction with local governments and businesses. Areas most likely to see growth in demand are those where there are public and private investments made in education, transportation and infrastructure to stimulate economic activity. To find the right zones to place capital, investors should have detailed submarket knowledge, relationships with local stakeholders and access to data such as Yardi Matrix that enables them to analyze the relative strengths of submarkets, neighborhoods and even individual buildings.

—**Paul Fiorilla,** *Director of Research*

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