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A Brave New World: COVID-19 Implications for Opportunity Zones

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With its tentacles outstretched, the widespread economic impact of COVID-19 is undeniable. In light of the global pandemic, questions have been raised about the long-term implications for real estate investment, particularly those taking place in opportunity zones (OZs).

Although the future is hard to predict, forecasts are being made. In the end, there will always be some potential risks that should be considered carefully, but we believe the cost of lost opportunity should also be carefully weighed.

As a partner at Urban Catalyst, an opportunity zone fund focused on ground-up development in the heart of Silicon Valley in downtown San Jose, and from my prior experience as a portfolio manager of a real estate trust with more than $100 million in assets, I've seen my share of the market ups and downs. What I've found is that the implications of COVID-19 notwithstanding, there will always be deals out there. The real test is, and has always been, knowing where to find the good ones and being brave enough to act on them.

For Urban Catalyst, the critical analysis is ascertaining the impact of the pandemic on our long-term real estate positions. Predicting the future is a difficult task, no matter how clear the crystal ball. The following is offered on the heels of that disclaimer.

While our perspective at Urban Catalyst may be unique to us, it may also prove a useful reference point to others during an otherwise dark and uncertain time.

At the time COVID-19 hit, we had acquired the land and started development for the handful of projects in our portfolio. Initially, it is worth noting that we had designed several contingency plans, at the inception of our business, to calculate the risks associated with potential economic downturns. When we

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FOUNTAIN ALLEY BUILDING


THE MARK


DELMAS SENIOR LIVING


THE ICON


KEYSTONE


MADERA @ GOOGLE VILLAGE


PASEO

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created our models, we could not have guessed that the genesis for the downturn would be a global pandemic, but predicting the source of the downturn was never as important as building the model to deploy in response.

More specifically, one of our models projected a recession to occur during the targeted 10-year life of our fund. The timing and effect of the model was surprising. Historically speaking, Silicon Valley land values, as opposed to the value of cash-flowing real estate assets, seem to remain relatively stable during periods of recession. In fact, this is exactly what the partners at Urban Catalyst noticed with their projects during the 2008 recession. Given this inherent resistance to recession, and since we had acquired our land at relatively low prices already, we were not too concerned about the financial risks associated with actually owning and holding the dirt.

Image: Courtesy of Urban Catalyst
Urban Catalyst's projects in the Silicon Valley are slated to break ground in the middle of 2021, with approximate rolling completion dates ranging from 2023 through 2026.

Rather, the surprise came when we looked at the cost of building the improvements. According to our model, if the recession were to hit before construction, something significant would happen. Looking at our team's prior projects in 2008, we noticed that construction costs dropped an average of 20 percent during the recession. Assuming $500 million in hard project costs in our current portfolio, the discount to our projects could potentially produce a whopping $100 million in cost savings. Even half of that figure could amount to an incredible $50 million in savings.

On top of that, Urban Catalyst's projects are slated to break ground in the middle of 2021, with approximate rolling completion dates ranging from 2023 through 2026. For us, this means that our projects are not slated for completion until several months or even years after the COVID vaccine is anticipated to have been introduced into the population.

Meanwhile, our development team has not slowed. In this regard, it is important to credit the city of San Jose for the fantastic job it has done during this time.

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Rather than shutter its offices, the city remained true to its Silicon Valley roots and embraced technology to keep its doors open. In fact, in our opinion, the effort San Jose has set forth has nothing short of impressive. In the words of Paul Ring, our head of development, the city of San Jose has “exceeded every expectation” and helped to keep us on track and on schedule. For that, we are very thankful.

It is important to be clear that we take no pleasure whatsoever in the fallout the world has been suffering since the outbreak of the global pandemic. The tragedies that individuals and families are experiencing are horrific and we obviously wish none of it had ever happened. Nevertheless, we must adapt to our changing environment. That’s exactly what we are doing. And for us, it turns out the timing looks pretty good.

While some other development companies here locally have closed their doors for now, we continue to charge ahead. For a multitude of reasons, we remain steadfast in our belief that the demand for our products will be as just strong after COVID as it was before. Thanks to our head start, we look forward to being among the first to deliver new products to the market in the years ahead.

Sean Raft is chief administrative officer and partner at Urban Catalyst, an opportunity zone fund based in Silicon Valley.

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Image: Courtesy of Urban Catalyst
Urban Catalyst is an opportunity zones fund focused on ground-up development in the heart of Silicon Valley in downtown San Jose, Calif.

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