CAN OPPORTUNITY ZONES LIVE UP TO THEIR PROMISE?

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Executive Summary

This paper attempts to take a comprehensive and objective look at the strengths and weaknesses of Opportunity Zones and the extent to which the program is living up to its stated purpose, namely, to aid in the revitalization of some of the nation's most distressed communities. The program is still in its initial phases, and the definitive data on the outcomes of the program to date are simply not available. However, based on what we know thus far, as well as the observations of a wide range of program observers and practitioners, we are more sanguine than discouraged about the program's potential for good.

Program History and Design. Opportunity Zones were initially proposed in 2015 in a bi-partisan bill sponsored by Senators Tim Scott and Corey Booker. However, the program did not become a reality until late 2017 when it was enacted as part of the Tax Cut and Jobs Act of 2017. The program is designed to direct some of the country's estimated $6 trillion in unrealized capital gains into investments in properties and businesses located in low-income communities. By deferring the taxes that would otherwise be due upon the sale of an appreciated asset—and by providing other forms of tax relief—the program attempts to draw private capital into communities that have long been subject to disinvestment.

One of the major hallmarks of the program is its free-market orientation. While there are broad restrictions on how the funds can be used—for example, investments in certain "sin" businesses are prohibited, as are the purchases of existing properties without substantial renovation—there are no requirements for project approvals at either the federal or local level, nor is there an upper limit on the amount of funds that can ultimately be deployed. Rather, investors simply channel their capital gains into "Qualified Opportunity Funds" (QOFs), which then must submit annual certifications to the IRS that their investments have met all applicable program requirements.

Eligibility for the Opportunity Zone program resembles that of its predecessor, the New Markets Tax Credit, which targets census tracts with a median household income that is less than 80 percent of the local (or statewide) median or with a poverty rate above 20 percent (otherwise known as LIC tracts). But unlike its predecessor, Opportunity Zones can also include census tracts that are contingent to a qualified LIC tract as long as the median income of that tract is less than 125 percent of the applicable median.

Given these basic eligibility requirements, the states—and not the federal government—could designate up to 25 percent of the qualifying tracts within their jurisdiction as Opportunity Zones (or a total of 25 tracts, which ever was greater). In making these designations, states were free to apply their own criteria and strategies to entice private capital into their communities, subject to the constraint that no more than more than 5 percent of their designated Opportunity Zones could be non-LIC contingent census tracts.

The White House has taken an inter-agency approach to oversee the program. Chaired by HUD Secretary Ben Carson, the White House Opportunity and Revitalization Council includes 17 federal agencies tasked with leveraging existing program resources to support OZ projects along five different streams: economic development; entrepreneurship; safe neighborhoods; education; and workforce development and measurement. The investment community also has created a new infrastructure designed to connect the emerging OZ investor class to the specific needs of the targeted communities.

A diverse set of private actors have emerged—from tax accountants to fund managers—many of which are new to the community development scene.

Communities, however, are experiencing a learning curve of sorts. Local governments working alongside nonprofits and small businesses often find themselves at a disadvantage, speaking a different language, lacking familiarity with equity-based programs, and having different objectives from the OZ investors. There is also the challenge of simply connecting high-wealth investors and funds with distressed communities. Time will tell whether communities can succeed in striking a balance between creating attractive investment opportunities and preserving a community's character and averting a rapid rise in property values.

Owing somewhat to its sluggish start and low levels of investment to date, the OZ program has come under increased scrutiny and criticism by a number of think tanks, community advocates and lawmakers. The concerns touch on all aspects of the program, including states' selection of eligible OZ tracts and claims of cronyism; the lack of requirements that investments contribute to economic growth, particularly jobs; fears of gentrification; and further institutionalization of patterns of discrimination, benefiting the wealthy at the expense of the poor.

What We Know Thus Far. The OZ program is still in its infancy and its potential impact will not be known for several years. Moreover, the reporting requirements that were part of the initial legislation were dropped as part of the reconciliation process. The IRS now requires QOFs to submit broad information on the amount and location of their investments as part of their annual certifications (IRS Forms 8996 and 8997). However, these data, which were not collected until the 2019 tax year, are not expected to become available until mid-2021. Even then, their usefulness may be limited due to privacy concerns that ultimately restrict the form in which the data are released.

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Right now, the only systematic data that exists on Opportunity Zones relates to the tracts that have been selected for the program, and some of the trends that are taking place within those tracts. We know virtually nothing about the extent to which OZ investments are spread across these designated Opportunity Zones, or heavily concentrated in certain areas. Nor do we know about the impact of OZ investments on the actual communities in which they are occurring. Indeed, while the CEA has pegged total investments at roughly $75 billion dollars, even this amount was derived through statistical estimation, as opposed to program data.

As a result, the program is largely operating in a data vacuum. While there is information on the characteristics of the nearly 9,000 census tracts that were selected for the program and some of the trends that are occurring in those areas, there is virtually no reliable program-wide data on how and where OZ funds are actually being employed. And while there are numerous examples of specific projects that are currently underway—some that are clearly "good," others that are more problematic—there is no real way to assess the extent to which such anecdotal evidence represents the exceptions, and not the rule. These data limitations make even an interim assessment of the program both challenging and inherently subjective.

Despite these important caveats, the outcomes observed thus far support several broad conclusions. First, taken as a whole, tracts that received an OZ designation tend to exhibit a greater level of distress than other potentially eligible low-income tracts, as least as measured by broad socioeconomic measures such as income, race, employment and educational attainment. While this pattern varies across the different states, the exceptions tend to be smaller states that had inherently fewer choices. In other words, the existing evidence does not suggest that the state selection process was systematically geared to choosing the "least needy" of the eligible tracts.

At the same time, states do not appear to have targeted Opportunity Zones to the most severely distressed communities within their states. For example, the distribution of investments in Opportunity Zones prior to their selection more or less mirrors the distribution across all eligible tracts, and house price appreciation rates appear to have been somewhat higher in tracts that received an OZ designation. While some have criticized these patterns as a failure of the program, others have argued that they more likely reflect the pragmatic view that the program will do little, if any good if it fails to attract the necessary private capital in the first place.

Despite the lack of detailed data on program outcomes, there have been many calls for reform in recent months.

As noted earlier, there is little, if any "hard" data on the level and types of investments made thus far. However, a number of private actors have attempted to fill this void by collecting data from the QOFs themselves. Based on these privately generated data bases—which may or may not be representative of all OZ investors—the great majority of OZ funds appear to be going to development of residential and commercial real estate, with only a small percent directed to investments in existing businesses. Again, while the lack of investment in existing businesses has been criticized by some observers, it is not at all clear whether the program really lends itself to such investments, nor is it obvious why they would necessarily produce a higher number of well-paying jobs.

Finally, even in the initial stages of the program, the OZ designation appears to have had an impact on the communities that have been selected. In particular, the evidence suggests that immediately following their selection, investments in businesses whose principle address was in an Opportunity Zone rose at a faster rate than investments in businesses located in other low-income tracts. Likewise, property values also appear to be on the rise in Opportunity Zones. While many would view these as positive developments—and while they may be reversed if the anticipated investments do not materialize—these trends raise the specter of displacement, particularly for existing residents who do not own their homes.

Recent Calls for Reform. Despite the lack of detailed data on program outcomes, there have been many calls for reform in recent months. While almost everyone who has looked at the program agrees that reporting requirements need to be strengthened, there is little, if any consensus on what else needs to be done. Some have called for a "reset" that would extend the applicable program timelines to make up for the delays in issuing the final regulations and the disruptions caused by the onset of the Covid-19 pandemic. Others have called for more fundamental changes to the program, including the creation of additional "guardrails" that would restrict how the funds can be used and changes to the tracts that have received an OZ designation. Still others have called for the complete termination of Opportunity Zones, arguing that the foregone taxes are better spent in the direct assistance of needy households.

Interestingly, both the Trump and Biden campaigns supported the continuation of Opportunity Zones, although neither side offered a detailed proposal on what, if anything, should be changed. In general, Republicans are hailing the program as an unmitigated success, particularly for minority communities, and want the program to be expanded. On the other hand, Democrats are calling for additional guardrails to ensure the program serves its intended beneficiaries and greater participation by CDFIs and the local community.

Recommendations. To the extent that there is any real consensus on what should be done with Opportunity Zones, it most likely relates to extending the program's existing timelines and instilling more rigorous and comprehensive reporting requirements. The lengthy and complex rule-making process, coupled with further delays caused by the onset of the pandemic, prevented many potential investors from receiving the full array of tax incentives provided under the program. As a result, proposals to extend the timeframe for investors to roll their gains into qualified funds make a lot of sense. Likewise, while there are tensions between the call for greater transparency and investors' natural desire to protect information they view as proprietary, nearly every program observer supports additional reporting requirements on the nature, location, and outcomes of OZ investments.

However, beyond these largely "technical" fixes, more substantive changes—for example, changing the state designations, adding additional guardrails to ensure that OZ investments have a greater social impact, or creating a new tax credit to broaden the program's reach—will undoubtedly take more strenuous effort, debate and time. Depending on what we eventually learn on how and where QOFs have invested their money, the prospects and nature of substantive reform measures will become much clearer. But whatever happens in the upcoming months, it appears likely that Opportunity Zones will have the next decade to prove their worth.

With these caveats in mind, we offer the following recommendations:

- First, the program should be "reset" to ensure that the momentum that was occurring prior to the onset of the pandemic continues after the economy recovers and we return to more normal market conditions. In particular, we recommend that the timeframes established under the original legislation be extended by at least two years.

- Second, reporting requirements should be strengthened to get a better understanding of how the program is being used. Depending on the form in which they are released, IRS data could ultimately provide useful information on the amount, type, and location of OZ investments. Nevertheless, data reporting requirements should be expanded to include more detailed information on the specific use and impact of OZ investments. In addition, to address the need for public accountability, any new legislation should mandate annual reports from the US Treasury (or another appropriate federal agency) on the program's size and impact.

- Third, given the inevitable specter of displacement, policymakers should consider ways to target a portion of housing assistance funds to Opportunity Zones that experience rapid increases in housing values. They should also explore ways to encourage homeownership in Opportunity Zones, including tax credits for first-time homeowners, as well as investments in companies that renovate homes and offer "rent to own" opportunities.

- Fourth, the new administration should continue the efforts of the White House Opportunity and Revitalization Council, which is currently scheduled to terminate on January 21, 2021. While Opportunity Zones cannot address the multitude of needs of distressed communities, if properly coordinated and leveraged with other federal and local resources, they could well play an important role in supporting a more organic, bottoms-up recovery.

- Finally, legislators should take steps to address the little-recognized loophole that currently enables QOFs to avoid the requirement that at least 90 percent of their funds be invested in Opportunity Zones by simply investing in qualified OZ businesses. While we recognize that many existing OZ businesses have activities that extend beyond the confines of the Opportunity Zone—and that investments in OZ businesses have been relatively limited to date—if exploited, this provision would greatly dilute the intended impact of the program, which is to rejuvenate distressed communities.

Additional changes to the program may well be justified once we have more information on how the funds have been used thus far. While by no means perfect, the Form 8996 data should shed considerable light on the extent to which further refinements are necessary, particularly with respect to the need for additional program guardrails. However, in making more fundamental changes, it is important to keep in mind that the program will do little, if any good if it fails to attract the necessary funds due to a lack of investor interest, or if by changing the "rules of the game," investors lose confidence that that they will ultimately receive the tax benefits they have been promised. These considerations would argue against imposing additional restrictions designed to limit the program to the most severely distressed tracts, or by removing certain tracts from their current designation as Opportunity Zones.

> While OZs may not be a perfect vehicle—or a panacea that can address the multitude of needs that residents of these community face—they are now in place and enjoy a striking level of interest and support.

Regardless of the changes that are ultimately made to the program, if the original intent of Opportunity Zones was to draw capital off the sidelines to revive distressed communities, the need seems greater than ever before. Given CBO's report that public debt has now climbed to 100 percent of GDP—and the fact that many states are now struggling with budgetary shortfalls due to the pandemic and the economic slowdown—not a lot of money will be available for government-financed place-based strategies. The political divisions within this country are profound. Opportunity Zones represent one of the few instances in recent years where a new initiative has generated considerable bi-partisan support. While certainly not a cure for all the ills affecting socially and economically distressed communities, it would be unfortunate if the current political divide results in the demise of a new and innovative approach before the program has a chance to get off the ground.

1.0 Introduction and Background

The Opportunity Zones program was created as part of the Tax Cuts and Jobs Act of 2017 Tax. By providing tax relief for investors who channel their capital gains into designated Opportunity Zones, the program attempts to leverage private resources in the service of broader social and economic goals. While hailed by some as is a new and innovative approach to meeting the needs of distressed communities, others are more skeptical, viewing it as essentially a handout to the rich. Although the program is still in its infancy, calls for reform range from adding reporting requirements to complete termination. The urgency of the debate has only been heightened by the onset of the Covid-19 pandemic and the ensuing spike in unemployment, which have had a disparate impact on the very communities the program was designed to serve.

With this in mind, this paper examines the initial implementation of the Opportunity Zone program and how it might be improved to better achieve the program's stated objectives. By examining what is known about the program to date and the early observations of program participants, the paper seeks to provide an objective look at both the strengths and weaknesses of Opportunity Zones and in doing so, to identify options for improving its impact on low-income communities and their residents.

The paper begins with a description of the origins of Opportunity Zones and the legislation that eventually led to its creation. It then describes key aspects of the program and how it relates to other federal community development programs. The next section reviews the implementation of the program thus far and how Opportunity Zones have attracted a new and diverse mix of investors, project developers, and intermediaries. We then discuss the major concerns that have been raised about the program, followed by what is known—and not known—about its impact to date. Finally, after reviewing where various constituencies stand on the future of Opportunity Zones, we offer some broad conclusions and recommendations.

The political divisions within this country are profound. Opportunity Zones represent one of the few instances in recent years where a new initiative generated considerable bi-partisan support. While certainly not a panacea for all the ills affecting socially and economically distressed communities, it would be unfortunate if the current political divide results in the demise of a new and innovative approach before the program has a chance to get off the ground. The program clearly needs to be improved to provide greater transparency and to mitigate the consequences of the Covid-19 pandemic on low income communities. However, in our view, "reset and reform" is by far and away the better policy option than a premature termination of Opportunity Zones.

1.1 History of Opportunity Zones

Opportunity zones represent the latest federal policy response to addressing the needs of the nation's economically distressed communities. Particularly since the Great Recession of 2007-09, policymakers have been evaluating past urban development strategies for insights into how to address the growing geographic inequality and seeming permanence of distressed communities. A list of such programs stretches back to the 1960s and includes many that are still operational today: economic development areas (1965), community development block grants (1974), enterprise zones (1993), and New Markets Tax credits (2000). As researchers have noted, these programs often did not live up to their billing due to lack of federal coordination, short time horizons, lack of local involvement, and weak coordination among financial intermediaries, nonprofits, and other partners.

1.2 Birth of a New Approach

In 2010, Raphael Bostic, then an Obama administration appointee at HUD and now president of the Federal Reserve Bank of Atlanta, stated that, “things are really different in Washington.” Federal agencies were being directed to break out of top-down, one-size fits all service delivery and to consider the importance of place; i.e., a greater recognition that communities differ by a host of socio-economic factors and thus will respond differently to federal anti-poverty initiatives. There was also greater focus on integrating federal activities through inter-agency efforts to find areas of overlap and coordination. The goal was to address community needs in a more wholistic way, drawing in more actors and touching more areas of need ranging from housing, to job creation, to small business, health, and transportation. Bostic called the greater focus on place “a path breaking and unprecedented approach” to public policy.[1]

Another turn has been toward market-based initiatives. Elwood Hopkins, managing director of Emerging Markets and a Presidential Fellow at Kresge foundation, has written extensively on the role of place-based initiatives, and has advised financial institutions, philanthropists and cities on effective community development strategies and investments. In a 2010 article, he described how the increased use of GIS systems were enabling researchers to develop neighborhood typologies based on various dimensions, such as housing, health, race, class, and even a local community’s “problem solving capacity.” In light of declining public subsidies, Hopkins noted that typologies have become necessarily market-oriented, focusing on a community’s ability to participate in the regional economy, to weather economic downturns, to attract capital, and to transition from one neighborhood type to another. According to Hopkins:

> “A neighborhood typology allows you to establish upfront the financial resources that will be required to create change. Some neighborhoods require massive public sector investments in infrastructure as a precondition to change. Others will require major private sector investment…Sizing the financial commitment is crucial, because it erases any illusion that a handful of nonprofits financed by limited grant dollars can accomplish the task.”[2]

Enter Opportunity Zones. The increased focus on place combined with an explicit market orientation provided the intellectual seedbed for an April 2015 paper by Jared Bernstein (The Center on Budget and Policy Priorities and a former economic advisor to Vice President Biden) and Kevin Haslett (American Enterprise Institute).[3] The paper was funded by the Economic Innovation Group (EIG), a think-tank started by Silicon Valley billionaire and early Facebook backer, Sean Parker.

The paper’s co-authors, who span the economic ideological spectrum, blame a history of disappointing community revitalization results on misaligned incentives, inadequate subsidies, untapped financial intermediaries, and complicated regulations. Casting a shrewd eye to political and fiscal realities that make “large-scale public sector investment…unlikely to happen anytime soon,” as well as to the “explosion in unrealized capital gains” presently sitting on the sidelines, the authors sketched out a new place-based program driven by market fundamentals and sweetened with not-insignificant tax-incentives. The market-style place-based program would be designed to draw capital into places where it is sorely needed, but where deals are hard to “pencil in.” In so doing, it would create a new “equilibrium” in distressed areas.

According to the authors, “Private sector investors have little current incentive to invest in higher risk ventures in economically depressed communities, but the return on investment for doing so may increase if the existing friction could be deferred or eliminated."[4] The authors also contended that this type of place-based program would deepen the investor base even as it garnered bi-partisan support.

Money helped bring about that support. In 2019, a hard-hitting critique in the *New York Times* unearthed who was bankrolling the initiative to steer unrealized capital gains—estimated to be over $2 trillion at the time—into distressed communities. In addition to Parker, other EIG backers included Dan Gilbert, the billionaire founder of Quicken Loans, and Ted Ullyot, the former general counsel of Facebook. In 2015 EIG spent $810,000 lobbying Congress for the program and close to $1 million in 2016.[5]

1.3 Tax Cuts and Jobs Act of 2017

In 2015, Sens. Tim Scott (R-SC) and Cory Booker (D-NJ) jointly introduced the "Investing in Opportunity Act," which featured the use of tax incentives to attract capital to "opportunity zones" as designated by individual states. A corollary House bill was sponsored by Ron Kind (D-WI) and Pat Tiberi (R-OH) who stated enthusiastically:

> "We're not writing a check from the federal government. We're getting private-sector dollars. It wouldn't be up to some bureaucrat or congressman in Washington, D.C. It would be up to the people in the community who would tailor the investment to what they think would actually work."[6]

The stand-alone bill was re-introduced in early 2017. At the continued urging of Sen. Scott a few months later—and by some accounts, at the last minute—the provisions were swept into broader tax overhaul, the Tax Cuts and Jobs Act of 2017. The House had no similar provision, and the six-page program received little or no debate before coming law. Whereas the original Senate bill contained provisions requiring program accountability and reporting, these were later dropped in the reconciliation process under the Byrd rule blocking "extraneous" provisions. The dearth of reporting requirements and lack of other program "guardrails" continues to draw concern about the program's ability to meet its vaunted goal of alleviating poverty in distressed communities.

2.0 What Makes Opportunity Zones Unique?

Since enactment of the TCJA in 2017, the OZ program has seen two rounds of Treasury/IRS rule-making that have further defined the program, including specifying the procedures for how states may nominate census tracts for OZ status, the type and duration of tax incentives available to investors, requirements for Qualifying Opportunity Zone Funds (QOF) and the Opportunity Zones Businesses (QOZB) they invest in, and details for investing taxpayers to self-certify the investments on a yearly basis.

As has been pointed out, compared to the potential scope and size of the program, not to mention the resulting federal cost in terms of foregone tax revenue, the regulatory structure is surprisingly lean, if not "depressingly skeletal."[7] Rather than give more direction to the use of funds, the second round of IRS regulations was prompted by investors' need for greater tax clarity and to resolve certain "gating issues" that had dampened initial investor enthusiasm.[8] More recent IRS guidance has sought to assuage the impact of the pandemic on investor timelines.

2.1 Key Elements of the Program's Design

Three key elements of the Opportunity Zone Program make it unique from other federal programs. The first relates to the tax incentives have been created under the program to attract private capital to distressed communities. The second relates to "Qualified Opportunity Funds," or QOFs, and the role that they play in investing that capital. The third relates to the states' ability to select low-income census tracts within their jurisdiction to receive the designation of an Opportunity Zone.

Tax incentives. The OZ program provides investors wishing to invest their capital gains in Opportunity Zones with two types of tax relief:

- *Deferral of past capital gains*. The first set of benefits is the ability to defer the federal tax that would otherwise result from the sale of an appreciated asset until as late as December 31, 2026, as long as the proceeds from that sale are reinvested in a QOF within 180 days. The deferral benefit also contains two basis step-ups:
  - If the investment is held for at least five years, the basis from the sale of the original asset is increased by 10 percent, also known as a 10 percent step-up in basis.
  - If the investment is held for at least seven years, the basis is increased by an additional five percent, for a total of 15 percent.
- *Exclusion of future gains*. In addition, any capital gain accruing from a QOF's investment in an Opportunity Zone is not subject to federal tax as long as that investment is held for at least 10 years.[9]

Thus, assuming that these various time frames are met, an investor taking full advantage of the tax benefits available from Opportunity Zones would pay: 1) a reduced federal tax on the capital gains from the sale of their original assets; and 2) no federal tax on any gains that accrue from their subsequent investments in an Opportunity Zone. In this sense, Opportunity Zones clearly require "patient investors."

Qualifying Opportunity Funds. As noted above, investors seeking to receive the tax advantages afforded by the program must go through a Qualified Opportunity Fund. A Qualified Opportunity Fund, which may be organized as a corporation or a partnership, is required to hold at least 90 percent of its assets in qualified opportunity zone property (excluding another QOF). However, QOFs do not need to get pre-approved by IRS. Instead, they self-certify that they meet applicable program requirements by simply filing an annual statement (Form 8996) with the IRS.

The Secretary of the Treasury is authorized to certify the 90 percent OZ property requirement and unless the fund establishes reasonable cause, assess monthly penalties for non-compliance. Qualified opportunity zone property includes: any qualified opportunity zone stock, any qualified opportunity zone partnership interest, and any qualified opportunity zone business property. Certain 'sin' businesses are excluded from receiving the tax benefits, and investors must make substantial new investments or improvements to acquired property. Beyond that, there are no requirements that the QOFs seek community involvement or create jobs; capital may freely flow to the projects offering the highest level of return.

Although enacted law used the term "substantially all" to refer to the various asset and holding period tests for QOFS, lawmakers left to the IRS the job of defining what the term actually means. Ostensibly to give preferential treatment to investments in qualified OZ businesses, which likely present greater risk than the purchase of real estate, the IRS defined "substantially all" as 70 percent of assets for QOF investments in OZ businesses. By contrast, QOFs investing directly in a qualified OZ property are held to a more onerous 90 percent test.

There are no requirements that the QOFs seek community involvement or create jobs; capital may freely flow to the projects offering the highest level of return.

The definitional differences opened a programmatic loophole, as some critics have pointed out: QOFs can get around the higher 90 percent asset test by investing in a QOZ business, which in turn invests in an OZ property. For example, a QOF that invests $10 million in an OZ via an OZ business intermediary only needs to hold $6.3 million inside the OZ ($10m x 90 percent x 70 percent), as opposed to $9 million if invested directly in the property, leaving the remainder to be invested in other assets. Another quirk is that even if a fund is penalized for failing to comply with the 90 percent and 70 percent asset tests it may still take full advantage of the exclusion provision if the investments are held for 10 years.

From the standpoint of drawing the maximum capital into distressed areas, these loopholes are problematic, as Charlie Metzger explains in an article in the Fordham Urban Law Journal:

> "In view of the weaknesses of both the enabling legislation and the IRS's final rules, the abuse potential of the OZ program is clear: not only has the federal government failed to put in place meaningful guardrails to channel capital, but also it has constructed a regulatory regime which allows investors to claim the core benefit of the initiative while, at times, investing barely over half of the capital in their OZ Funds in actual OZs by using an intermediary."[10]

State designation of OZ census tracts. Another unique feature of the OZ program is that states—not the federal government—are the ones to determine which of its low-income census tracts will receive the coveted OZ designation. A low-income census (LIC) tract is defined as having a poverty rate of 20 percent or greater or a median family income less than 80 percent of the local (or statewide) median. In addition, the program allows non-LIC tracts to be designated as QOZs under two conditions:

- The non-LIC tract is contiguous with an LIC that is designated as a QOZ (the contiguous LIC QOZ need not be in the same state).
- The median family income of the non-LIC tract does not exceed 125 percent of the median family income of that contiguous LIC QOZ.

Each state could designate up to 25 percent of its LICs as Opportunity Zones. States with less than 100 LICs (including the District of Columbia) could choose 25 tracts, while all tracts in Puerto Rico were designated as Opportunity Zones. Higher income tracts were capped at 5 percent of a state's designated OZ tracts.

For states to meet the deadline of March 21, 2018 to nominate LIC tracts for designation as QOZs "the maximum aggregate number of designations in a State" was based on the American Community Survey (ACS) five-year data set for 2011-2015 (even though a more recent data set was released in the fall of 2017).[11] Moreover, regulations allowed a "safe harbor" for situations where an eligible OZ tract is found to be ineligible using more recent census data. The Treasury secretary had 30 days from receipt of a state's nominated LICs to certify the OZ designation, which remain in effect until 2028.

Based on the 2011-15 data set, 41,000 census tracts were deemed eligible for designation as a QOZ. This included: 31,680 LIC tracts and 9,453 non-LIC tracts eligible for designation if a particular LIC contiguous to the non-LIC tract is designated as a QOZ. Beyond those parameters, states were given considerable latitude in designating which LICs or contiguous non-LICs to nominate as opportunity zones.

> Opportunity zones are but the latest iteration of the federal government's attempt to stimulate investment in distressed communities through grants or tax incentives.

According to Treasury data, a total of 8,764 tracts received the OZ designation: 8,532 tracts met program guidelines with respect to their median family income and their poverty rates, and the remaining 230 tracts are contingent to a low-income census tract. The 230 non-LIC tracts represent just 2.6 percent of all OZs chosen by the states, well below the 5 percent cap. Taken together, the 8,764 OZ tracts represent 12 percent of the US population or some 35 million people.

2.2 How OZ Compares to Other Placed-Based Incentives and Programs

To understand the unique role of Opportunity Zones and the potential benefits that may accrue to low-income communities, it is useful to view the program in the context of other comparable federal community development programs. For more than 50 years, policy makers have struggled with how best to address the needs of low-income families and the communities in which they live. Some programs, such as food stamps, housing vouchers, and income support, provide direct assistance to households in need. While these programs are a critical part of the social safety net, critics have long argued that for many able-bodied adults, they can discourage work and perpetuate a permanent underclass.

By contrast, so-called "place-based" or "community development" programs attempt to assist low-income families by revitalizing the neighborhoods in which they live, creating jobs and other opportunities so that residents can help themselves. These latter programs have taken different forms over the years, ranging from government grants that support the various needs of a community to tax incentives designed to stimulate private investment in the area. While these various approaches have met with some success, thus far, it seems safe to say that no one has discovered a “silver bullet” that satisfies the expectations of every potential stakeholder, including policymakers, community groups, taxpayers, and the residents themselves.[12]

Opportunity zones are but the latest iteration of the federal government’s attempt to stimulate investment in distressed communities through grants or tax incentives. Indeed, the TCJA’s inclusion of the OZ initiative came on the heels of the New Markets Tax Credit (NMTC), which is set to expire at the end of 2020 without a congressional extension. Under the program, individual and corporate taxpayers receive a tax credit for making cash investments in a qualified community development entity (CDE). The CDEs are required, in turn, to make investments in low-income communities (LICs), generally defined as having a poverty rate of 20 percent or greater or a median family income less than 80 percent of statewide median. The tax credit equals 39 percent of the investment claimed over a seven-year period: five percent in each of the first three years and six percent in each of the next four years.[13] The level of qualified equity investments was capped at $3.5 billion a year from 2010-2019. According to the Treasury department’s Office of Tax Analysis, the tax expenditure of the New Markets Tax Credit was $1.28 billion in 2020.[14]

There are several important differences between the two programs. While retaining NMTC’s focus on steering private investment to LICs, the OZ program gives individual states the power to designate the LICs that would receive the OZ designation, a designation that lasts until 2028. Rather than a tax credit, the program offers a deferral of taxation on capital gains invested in qualified funds and a tax reduction on the appreciation of qualified assets if held long enough. The OZ program encourages a longer investment horizon and is free of both the need to seek government approval of qualified investments and an aggregate limit. The tax expenditure for the OZ program is estimated to be $2.5 billion in 2020.[15] Although the deferral or exclusion of gains ends on December 31, 2026, the tax benefits can last through 2047.

Appendix A summarizes the key components of other federal community development programs that have been tried in the past. Compared to these other approaches, Opportunity Zones are clearly the least proscriptive, most market-oriented approach to community development that the federal government has tried thus far. While states are responsible for selecting Opportunity Zones among otherwise eligible census tracts, investors—and not a government agency—ultimately decide what and where to invest and there are no federal limits, or caps, on the amounts that can be invested.

Opportunity Zones are also unique in another important respect. As detailed in a recent Urban Institute report:

> “Since the Model Cities program began in 1966, federal programs targeting resources to disinvested communities have incorporated measures intended to ensure that residents have a voice in how resources are employed in their community… The OZ incentive is distinctive in that, as implemented by Treasury, it allows QOFs to self-certify, meaning they are not required to have a social-impact mission, nor to be governed or advised by community members.”[16]

Indeed, in his Congressional testimony, Brett Theodos, the lead author of the Urban Institute’s report, described the general evolution of placed-based programs this way:

> “We have gradually, and consistently, moved toward a model where the federal government exerts less and less control over our federal resources… Opportunity Zones mark the near-complete transition to privatized federal community and economic development policy.”[17]

While opinions differ on whether this evolution is good or bad, Opportunity Zones are arguably a new and innovative approach to addressing the needs of distressed communities.

From a real estate perspective, it is also important to recognize that the tax benefits available for Opportunity Zones resemble benefits currently available to real estate investors under S. 1031 of the Internal Revenue Code. A so-called 1031 transfer enables real estate investors to delay paying a capital gains tax on upon a property’s sale if they reinvest the proceeds in other real estate assets (including REITS) within 180 days. Taxes on the gain from the sale of the original property are due when the reinvested property is sold. If that property is held until the investor’s death, its basis is reset to its current market value, thereby avoiding any tax on the original capital gain.

In contrast, while the tax benefits associated with investments in Opportunity Zones are restricted to certain geographic areas, the tax relief applies to capital gains on *any* type of asset regardless of how the proceeds are reinvested (with certain restrictions). And while the investor must pay ultimately pay a tax on his original capital gains, the basis is increased by up to 15 percent, depending on how long the OZ investment is held, and any capital gains on the OZ investment are not subject to federal tax. The relative advantages and disadvantages of these two tax subsidies for real estate investors are complex and will ultimately depend on their individual circumstances. Nevertheless, it is not surprising that many OZ funds have invested in commercial and residential real estate.

3.0 Program Implementation

Despite the market orientation of the Opportunity Zone program—and the relatively limited role assigned to the federal government—the Administration had to take a number of steps to get the program underway, including the issuances of program regulations and reporting requirements as well as the creation of a special White House Task Force to oversee the program and leverage its use with other federal programs. The creation of Opportunity Zones has also led to the formation of a whole new "ecosystem" of OZ investors, developers and intermediaries whose sole purpose is to tap the resources currently locked into unrealized capital gains and to channel these funds into investments in Opportunity Zones. All of these efforts have been critical to getting the program off the ground.

3.1 Administration's Role

In December 2018, President Trump signed an executive order creating the White House Opportunity and Revitalization Council to oversee the program. Chaired by HUD Secretary Ben Carson and led by Executive Director Scott Turner, the Council includes 17 federal agencies and federal-state partnerships. Agencies are tasked with leveraging existing program resources to support OZ projects along five different streams: economic development; entrepreneurship; safe neighborhoods; education; and workforce development and measurement. According to the Council, the combination of "private capital and public investment will stimulate economic opportunity, encourage entrepreneurship, expand educational opportunities, develop and rehabilitate quality housing stock, promote workforce development, as well as promote safety and prevent crime in economically distressed communities."[18] The inter-agency approach mirrors earlier attempts by the Obama administration to dismantle federal silos and leverage existing infrastructure and assets.

The creation of Opportunity Zones has led to the formation of a whole new "ecosystem" of OZ investors, developers and intermediaries.

The White House council continues to actively build the administrative framework for promoting the cross-pollination of existing government initiatives with OZ zones. On the Council website are various reports that lay out program objectives, implementation plans, best practices and completed programs. A number of federal agencies have their own Opportunity Zone websites and maps showing interactions between OZ tracts and federal infrastructure such as airports and water treatment plants. In a further sign of federal integration, in August 2020, President Trump signed an executive order requiring the General Services Administration to give preference "in the process for meeting Federal space needs," to qualified Opportunity Zones, as well as "other distressed areas, and centralized community business areas (including other specific areas which may be recommended by local officials)."[19]

Notwithstanding the Administration's efforts to move the initiative forward, Opportunity Zones have been slow to get out of the starting gate. (See Appendix B for a detailed timeline.) Final regulations were only completed in December 2019. The delay reduced the opportunity for investors to receive the full tax benefits of the program, and it also led to criticism ranging from how the zones were chosen and the types of projects that have been funded. Before the pandemic hit in early 2020, Sen. Scott was preparing legislation to add stronger reporting requirements, which had been removed under procedural rules in 2017, and to make other adjustments to the program. Accommodating guidance was released in the spring and summer of 2020 giving investors more time to invest capital gains into QOFs.[20]

Despite the program's slow start, the Trump administration regularly touted the decentralized OZ program as a win-win for investors, entrepreneurs, and community leaders due to the program's flexibility and decentralization. OZ is "not a government program," states the White House Council. Rather, "it is a once-in-a-generation initiative to lift Americans out of poverty and bring economic and community revitalization to the areas that need it most."[21] In his February 2020 State of the Union Address, the President recognized a former homeless veteran who was housed, trained, and employed by Denver-based R Investments to work on Opportunity Zone projects in his own community.[22] In June, the President made two speeches in which he overstated the program's success, saying OZs had "added countless jobs and $100 billion of new investment."[23]

In late August, the White House released a report by the Council of Economic Advisors entitled "The Impact of Opportunity Zones, An Initial Assessment." The report, which is discussed in greater detail below, estimated that $75 billion in private capital had been invested in OZ tracts since 2019 with many positive effects, including a 29 percent increase in private equity investment in businesses that are located in Opportunity Zones (over a comparison non-OZ group) and a 1.1 percent rise in house prices.[24]

Citing the CEA findings, Sen. Scott and others who spoke during the Republic National Convention touted the OZ program as a how the Trump administration was serving the needs of minority citizens living in distressed communities. EPA administrator, Andrew Wheeler, said "his agency could help revitalize industrial areas through investments in water systems and economic development." He cited the impact of a tax break program launched in 2018 and meant to spur private investment in economically distressed areas, saying, "It's possible that Opportunity Zones are one of the biggest reasons Black unemployment in this country fell to its lowest recorded levels ever in 2019."[25]

Progressive Democrats remain both skeptical and cynical. In the words of editors at the *New York Times*, "Of all the ways President Trump's 2017 tax cut has enriched the wealthy at the expense of the public interest, perhaps the most outrageous is the black comedy of 'Opportunity Zones.'"[26]

3.2 Emergence of Other Actors and the Creation of a New infrastructure

In the Bernstein and Hassett paper, one of the critiques of prior place-based programs was the failure to draw in well-heeled "first movers" and a "supporting cast of intermediaries, including banks, private equity, and venture funds…[which] have the potential to invest in companies that may thrive within an area."[27] Perhaps an initial mark of success, OZs appear to have drawn a diverse set of players into the game. Early suggestions of massive investor interest—recall the $6 trillion-dollar pool of unrealized capital gains—were overblown due to rule-making delays, concerns about the expiration of certain provisions, and then the pandemic. Nevertheless, CEA's estimate of $75 billion in private equity investments into QOFs suggests the word "about the biggest tax incentive you've never heard of"[28] is getting out to the investor community.

Helping guide the gains into OZs is a cadre of supporting tax accountants, attorneys, fund managers, advisors, and accelerators. Firms such as Novogradac offer a suite of services, from fund structuring and modeling to tax analysis, OZ business due diligence, and reporting and compliance. OpportunityDb offers a database of funds, as well as maps, calculators, and other resources. Having given the program its intellectual start, EIG continues to promote OZs as a bipartisan solution and coordinates a "coalition of investors, philanthropy, financial institutions, non-profits, and service providers."[29] Other entities, ranging from private foundations to MBA programs offering courses and certifications in social-impact investing, focus on the program's core purpose to revitalize distressed communities. From these and other groups flow resources, blogs, magazines, podcasts, and webinars, all focused on raising awareness and expanding participation in the OZ program.

On the other end of the spectrum, the OZ communities themselves, participation appears to be less robust. Local governments working alongside nonprofits and small businesses often find themselves at a disadvantage, speaking a different language, lacking familiarity with equity-based programs, and having different objectives from the OZ investors. There is also the challenge of simply connecting high-wealth funds with distressed communities. In its June 2020 assessment, the Urban Institute interviewed over 70 actors in the OZ space and found that "many project sponsors are struggling to access the class of investors—wealthy individuals and corporations with capital gains—for whom the OZ incentives are tailored."[30]

To be sure, OZs present a learning curve for both investors and communities. Potential OZ investors may expect rates of return that exceed what so called "mission-driven" projects are likely to produce, at least in the short term. As a result, investors are likely to put money in localities where gentrification is already underway and walk away from higher-risk deals. Metzger calls changing investor operating norms an "uphill battle:"

> "Since capital tends to follow pre-set channels, the default position of investors looking at OZs is to do what they have always done—find the safest possible investment, whether or not it is going to improve outcomes for poor neighborhoods and their residents; if no safe investments are readily apparent, investors will stay away."[31]

Writing in *Fortune*, Metzger and Golding note that within local communities, there seems to be a general lack of "experience structuring mission-driven investments that generate market-rate returns." That said, they contend "it's a solvable coordination problem....Committed investors, engaged philanthropy, and smart state and local policy can create access to capital for marginalized communities that fosters genuine impact and fights poverty."[32]

CASE IN POINT

As we wait for broad data on OZ outcomes, anecdotal accounts of investments in designated communities are encouraging.

On September 23, 2020 the National Equity Fund, Inc. (NEF) and Fifth Third Bank announced a $25 million OZ deal to support development of nearly 300 rental homes for workforce housing and homeless veterans, as well as commercial space for entrepreneurs, with a focus on minority-owned businesses. The $25 million QOF supports developments in Cincinnati, Chicago and Kalamazoo.

"These are tremendous projects that will not only offer a good quality of life to residents but also make a positive contribution to their surrounding communities," said Matt Reilein, president and CEO of NEF. "What's more, these investments illustrate how OZ financing can expand the range of affordability within a community."

While many OZ critics bemoan the fact that investors are not more mission-minded, a sign they say that the program is geared solely to the rich, some communities seem to be adjusting expectations and structuring deals with a greater focus on profitability so as to attract investor funds. In July 2020, the US Conference of Mayors issued a resolution urging Congress to make needed reforms in the program, including, providing “mayors with local technical assistance and capacity building to help enable more communities to attract high impact investments and economic activity.”[33]

Some localities have started hiring the financial structuring expertise to help project sponsors make the business case for their proposals, which adds new transactions costs. They are also seeking innovative partnerships with nonprofits and other entities. Just recently, the Chicago-based National Equity Fund, Inc., a leading nonprofit investor in affordable housing, announced a major OZ deal with Fifth Third bank to expand workforce and rental housing in three cities (see box on page 18). According to Karen Przypyszny, a NEF managing director who leads the organization’s Opportunity Zones work,

A crucial role that state and local governments can play in the OZ space is to help bureaucrats and investors speak the same language, to identify worthwhile investments by engaging with communities, and to stop unproductive investments.

> “The Fifth Third fund proves that it can be done when all the partners prioritize impact. It’s not realistic to expect maximized returns that might be available with a conventional investment when what we are really trying to do is fill a gap that the mainstream market cannot address on its own.”[34]

A crucial role that state and local governments can play in the OZ space is to help bureaucrats and investors speak the same language, to identify worthwhile investments by engaging with communities, and to stop unproductive investments. Some OZ Funds will seek out socially beneficial projects and invest in them on their own, motivated simply by a desire to create impact. But without strong participation from government, most funds likely will not.[35]

Echoing that view is Ja’Ron Smith, Deputy Assistant to the President for the White House Office of American Innovation. “Opportunity zones have always been a tool given to local communities to help empower them—not a fix all for the problems,” Smith said. “It has to be leveraged and cultivated in a way that creates shared prosperity.”[36] Along with Sen. Scott, Smith has since criticized some state officials for their initial OZ designations, saying, “I think in a second bite of this apple, everyone will want to pay more attention and be more involved and be a lot more thoughtful with their Opportunity Zone strategy.”[37]

One such underutilized governmental asset is the community development financial institution (CDFI). In a March 2019 article entitled, “The Potential Role for CDFIs in Opportunity Zones,” authors Charles Tansey and Michael Swack provide a financial tutorial for CDFIs engaging in the OZ space.[38] Owing to their traditional focus on providing debt financing to communities, CDFIs have been somewhat out of the equity-oriented OZ mainstream. However, Tansey and Swack argue that the organizations have important contributions to make in terms of local knowledge, strategic partnerships, and the ability to provide long-term funding to other entities involved in the OZ property or business. The authors urge

CDFIs to engage early and assertively, seeking out long-term investors, such as insurance funds and banks that have unrealized gains as well as CRA obligations to fulfill.

The critical need for collaboration is echoed by Kimberly Johnson, professor of social and cultural analysis at NYU.

> "[To] the extent that [OZs] can work, they are places where there's a lot of close collaboration between investors, local governments, community groups, that really are focused on what works best for a particular community. Where it does not necessarily work is where something is built on the assumption that if we build it, people or businesses will come, and then that doesn't quite happen."[39]

A related issue is that the program's preferential treatment of unrealized capital gains necessarily targets high-wealth individuals with assets in the stock and real estate markets. According to the IRS, "only 7 percent of Americans report taxable capital gains, and nearly two-thirds of that income was reported by people with a total annual income of $1 million or more."[40] To blunt the problem of "unrestrained capital" flowing into a community, perhaps funding unwanted or unsustainable projects, UI and others suggest broadening the OZ investor base. For example, some have called for an OZ tax credit that would incent residents of OZ communities to invest in their own backyards.

4.0 Concerns Mount

Owing somewhat to its sluggish start and low levels of investment to date, the OZ program has come under increased scrutiny and criticism by think tanks, including Brookings (2018), The Urban Institute (2020), and community groups such as Americans for Financial Reform (2020). The concerns include:

- State selection of eligible OZ tracts and claims of cronyism
- OZ investments not required to contribute to "equitable economic development," particularly job creation
- Investor demands for higher returns will lead them to gentrifying areas where development is already underway
- Unrestrained capital will further institutionalize patterns of discrimination, benefiting the wealthy at the expense of the poor

In the words of Aaron Seybert, managing director of social investment practice at The Kresge Foundation, "The funds, as a tool alone, do not ensure a positive social impact." [41] As others have noted, OZ investments are not required to meet the United Nations' 17 Sustainable Development Goals, which some investors use as a framework for "impact investing."[42]

More broadly, the free-wheeling, self-certifying nature of the program adds suspicion that it will be misused. Noting the lack of investor interest in a designated OZ tract in rural Michigan a reporter described OZ having, "no pre-approval process, no community benefit requirement and no requirement to provide governance rights to community representatives.[43] This deeper concern raises questions of democratic engagement. With their funding shrouded by the opacity of the federal tax code, rather than straight up through the appropriations process, OZs suffer from a worrying lack of transparency. If $2.5 billion in public funds will flow to OZ investors this year to fulfill supposedly public purposes, where is the accountability?

It's a problem associated with the so-called "submerged state," which is the increasing tendency to move government programs out of the public eye—and out of the political winds that make sustaining those programs difficult, particularly when wealthy private actors are involved.[44] To Johnson, OZs are the perfect example of a "zombie policy," which she describes as:

> "politically attractive to both Democrats and Republicans. It also doesn't require a lot of upfront government money, which is key. So it's not that…a government official is pocketing money. It could be that…the business took the money. And then we find out five years later, oh, they didn't really do what they were supposed to do with it. So I think there's a lot of ways in which these programs are attractive to politicians because they kind of kick any potential problems of costs down the road."[45]

Therein lies the fundamental concern about Opportunity Zones: its market orientation. Were the tracts fairly chosen? Would these areas have been developed anyway without the tax benefits? Will the program lead to gentrification and displacement of community residents? Will it produce needed jobs and economic activity? Will it, as the American for Financial Reform Education Fund suggests in the title of its 2020 report, turn out to be "a corporate tax break masquerading as community development?" Or could OZs create a new equilibrium in distressed communities leading to an upward virtuous cycle where one investment begets more, as the original thought-leaders believed?

Sen. Scott continues to think so: “It doesn’t pick winners and losers or utilize a one-size-fits-all approach to economic development. It serves as one more tool in the toolbox to empower communities and investors to come together to identify and achieve projects and investments that will make a difference for their residents.”[46]

While definitive answers to these questions will not be known for many years, this report attempts to shed light on at least some of these concerns.

5.0 What We Currently Know and Do Not Know About the Program

Unfortunately, relatively little is currently known about how the OZ program is affecting the communities and residents it was designed to serve. Both supporters and critics of Opportunity Zones have presented anecdotal evidence to support their case either for or against the program. For example, a recent White House report points to numerous examples of seemingly worthy projects, ranging from the development of workforce housing to the conversion of brownfields to "vertical farms" to partnerships with Historically Black Colleges and Universities (HBCUs).[47] On the other hand, critics have cited examples of cronyism and inappropriate use of taxpayer dollars, including the development of luxury housing and high-end hotels in trendy neighborhoods that happen to be part of OZ-designated census tracts.[48] While the Treasury's Office of Inspector General (OIG) is investigating reports of potential abuse, it has yet to release the results. But even putting these claims aside, until one has comprehensive data on how and where the program has been used, it is simply impossible to make an accurate, objective assessment of the strengths and weaknesses of Opportunity Zones.

5.1 Lack of Mandatory Reporting Requirements Limits Current Understanding

How did we get to this point? To begin with, the program is very new and the mandated reporting requirements contained in the original legislation were dropped as part of the budget reconciliation process. Among other things, these reporting requirements would have eventually included annual reports that disclosed O-Zone investments at the national and state level; the number and value of Opportunity Funds; the percentage of O-Zones that received investments; and, most significantly, an assessment of the impact O-Zone investments had on job creation, poverty alleviation, and business creation.[49] While these reports were not required until the program had reached its five year milestone, the very absence of mandated reporting requirements is widely viewed as one of the program's major flaws.

Presumably, some of these data will eventually become available from the IRS Forms 8996 and 8997, which QOFs are required to submit an annual basis to certify that they meet program standards. The original version of Form 8896, which was in effect for the 2018 tax year, collected information on the total dollar value of OZ investments, but not their specific use or geographic focus.[50] However, the Treasury released an expanded revision of the form in October 2019, which will apply to the 2019 tax year. This new form will provide broad information on whether the funds were used to purchase a property or invest in a business and the location (i.e., census tract) of these investments. The form will also enable one to identify the broad types of businesses that have been supported through the program based on the business' Employer Identification Numbers (EIN).

At this point in time, however, it is unclear when these data will be released or the level of detail that will ultimately be provided to the public. According to the White House:

> "Returns for tax year 2019 need not be filed until the latter part of 2020, and processing returns and tabulating information will take additional time. Moreover, to protect taxpayer confidentiality, the data available to the public will be aggregated. This will limit the level of detail available to the public for tracts with few investments, which is more likely to occur in the first few years of the program."[51]

Questions regarding the potential usefulness of IRS data were echoed in a recent report by the Government Accounting Office (GAO), appropriately entitled ""Opportunity Zones: Improved Oversight Needed to Evaluate Tax Expenditure Performance." According to the GAO:

> "Some of the data from the relevant OZ forms is not captured in an easily accessible format, which makes it difficult to use for data analytics. It is unknown when or if these data will be converted into a more accessible format that could be used in an analysis of OZ performance. Treasury's ability to report on OZ outcomes using taxpayer data could also be constrained by taxpayer privacy safeguards… For example, Treasury officials noted that a low number of funds investing in a Zone might make it difficult to report data by Zone without potentially disclosing protected taxpayer information."[52]

Nevertheless, assuming that these data will eventually be released in a form that is useful to policy makers, they should provide broad information on OZ investment patterns and trends, including the extent to which OZ investments have been concentrated in higher income tracts that are adjacent to LIC tracts or LIC tracts that are already in the process of gentrification. At the same time, however, they will leave many important policy questions largely unanswered, for example, the number of jobs and affordable housing units that have been created by the program and its impact on existing residents and businesses.

Partially in response to the current data vacuum, a number of private actors have stepped up to the plate to encourage voluntary data collection efforts or to collect data on their own. For example, the Beeck Center for Social Impact and Innovation at Georgetown University, the Federal Reserve Bank of New York and the US Impact Investing Alliance have joined forces to develop a "common and flexible" reporting framework for OZ investors.[53] Among other things, they propose a draft reporting form that includes information on the size and location of the fund, the sectors in which it invests, its intended impact (e.g., education, employment, housing, etc.), its approach to community engagement, and a post-exit review of project's actual impact.

Other organizations have also attempted to fill the void. For example, Novogradac, an accounting firm that offers advice on Opportunity Zones, has tracked Qualified Opportunity Funds (QOFs) since May 2019. As of September 1, 2020, the Novogradac sample included 580 funds that had collectively raised $12.05 billion in equity and another 231 funds that did not report equity raised.[54] Likewise, a self-described tech entrepreneur named Jimmy Atkinson founded Opportunity Db, which maintains a data base with a list of specific OZ projects and QOFs that can be sorted by asset class (business, real estate), size, and minimum investment.[55] As of July 1, 2020, the site provided information on 247 different funds with a total investment capacity of $56 billion. While these two data bases represent only a fraction of the funds created thus far—and may not be representative—at a minimum, the very fact they exist at all underscores the need for these kinds of data.

5.2 Characteristic of Opportunity Zones and Program Targeting

One of the more controversial aspects of the program involves the extent to which OZ funds have been targeted to the communities most in need. There are three related, but separate, issues associated with the targeting of Opportunity Zones.

- The first relates to the design of the program itself and the types of census tracts that were eligible to become Opportunity Zones.

- The second relates to the extent to which governors used their designation authority to target the program to the neediest census tracts within their states, as opposed to other eligible LIC tracts that were already in the process of transition.
- The final, and in our view, the most important targeting issue relates to the decisions that are made by private investors, and the extent to which the majority of OZ funds are being funneled into areas with the least amount of needs. While census data can be used to address the first two questions, we know relatively little to date about how and where OZ funds are actually being deployed.

Program Targeting. In 2018, the Treasury released its list of low income (LIC) census tracts that were potentially eligible for the program.[56] Eligibility was based on the 2010-2015 Five Year Estimates from the American Community Survey (ACS), hereafter referred to as "2015 census data."[57] Forty-five percent of all US census tracts qualified based on their income or poverty rate, i.e., their median household income was less than 80 percent of the local (or statewide) median *or* their poverty rate was 20 percent or higher. Another 12 percent of all tracts qualified because they were adjacent to a LIC tract and had incomes below 125 percent of the income of the qualifying contiguous tract. Thus, in all, some 57 percent of US census tracts were potentially eligible for the program. Governors (and the mayor of the District of Columbia) had up until April 20, 2018 to designate up to 25 percent of these eligible tracts as Opportunity Zones (or in the case of states with fewer than 100 tracts, up to 25 tracts). While the governors were given broad authority to select these tracts, program regulations required that no more than 5 percent of Opportunity Zones could be contingent to LIC areas.

The relatively large number of geographic areas that were potentially eligible for the program—and the lack of federal guidance on the specific tracts that could be selected—has led many community activists to criticize the program from the start. For example, a report by the American for Financial Reform Education Fund (AFREF), which was prepared for a coalition of community groups, argued that the degree of targeting embedded in the program was insufficient, noting that:

> "the loose definition of "low-income areas," the older demographic data the program relied on, and the choices made in winnowing the list of eligible census tracts allowed many higher-income and already-gentrifying areas to qualify for the program."[58]

Many of their criticisms are based on the overall design of the program, as opposed to the outcomes observed thus far. For example, the report challenges the program's use of "80 percent of the local median" to define a low-income tract, arguing that this cut-off is too high. However, this definition is consistent with many other programs, including the New Markets Tax Credit. The report also questioned the use of the 2015 census data to generate the list of eligible tracts, noting that some 7 percent of LIC Opportunity Zones would not have qualified had 2017 data been used instead; while states could use newer data to add to this list, tracts that qualified under the earlier data were not removed.[59] However, given the time constraints that were faced by governors in making their designations, it is not at all clear what a better approach might have been. Finally, the report noted that even tracts with high poverty rates or low median incomes could have segments of their populations that are considerably better off. However, such a criticism can be levied against virtually *any* place-based program that is targeted to a specific geographic area, as opposed to specific individuals, and represents a fundamental policy divide that extends far beyond the efficacy of Opportunity Zones.

While one can disagree with the program's use of relative, as opposed to absolute household income, this approach is not unique to Opportunity Zones.

In a similar vein, AFREF calculated that, in 2017, 9 percent of OZ tracts had family incomes above 80 percent of the area median income and poverty rates below 20 percent.[60] Like many other programs, including low income housing assistance, eligibility for an OZ designation is based on the census tract's median income *relative* to the applicable MSA or statewide median. As a result, even high-income states with relatively low poverty levels will have tracts that qualify for the program. Thus, it is not at all surprising that OZ tracts in high cost cities such as New York and San Francisco have median incomes that are relatively high by national standards. Again, while one can disagree with the program's use of relative, as opposed to absolute household income, this approach is not unique to Opportunity Zones.

Finally, a 2018 Brookings report questioned the use of a census tract's poverty rate to determine eligibility, noting that many university towns with high concentrations of students scored surprisingly high on this measure.[61] More fundamentally, it questioned whether the program's use of poverty rates and median household incomes was the best way to measures a community's needs. Indeed, one of the recommendations of the report was to "define economic distress more accurately, to raise the threshold for what qualifies as distressed, and limit state governments' ability to pick non-poor areas."[62] The report also goes on to say that "Improvements in those areas would be especially valuable for programs like Opportunity Zones, which have few guardrails about how the federal subsidies are used."[63]

To a certain degree, the above criticisms come down to fundamental policy disagreements about how best to allocate scarce federal resources and how much power should be given to the states in making these allocations. Such disagreements are not unique to Opportunity Zones. In considering these issues, it is important to recognize that the program was not intended to be a panacea that would cure virtually every ill of distressed communities, nor was it designed to replace other more targeted income support programs. Instead, it was designed to encourage the deployment of some of the roughly $6 trillion in untapped capital gains to support investments in underserved communities. While policymakers may wish to reconsider the program's targeting requirements in the future, in our opinion, the issues raised thus far should not be viewed as fatal flaws.

State Targeting. Another targeting issue relates to the state selection process, and whether it was systematically biased towards eligible tracts with greater or lesser needs. Fortunately, while we do not know a lot about the operations of the program to date, we do know a fair amount about the socioeconomic characteristics of the areas selected to be Opportunity Zones and how they compare to other eligible low-income tracts and to the population as a whole.

Some of these data are presented in Exhibit 1, which was found on the EIG website and based on the most recent census data (i.e., 5-Years ACS estimates for 2014-2018.) On average, Opportunity Zones have a higher poverty rates, lower household incomes and a higher share of minority residents than other eligible LIC census tracts, as well as the population as a whole. They also have lower educational levels, higher unemployment rates, higher housing vacancy rates, and lower life expectancies. Moreover, while not shown in this chart, only 2.6 percent of Opportunity Zones were higher-income tracts that were contingent to an eligible LIC, roughly half of the 5 percent maximum imposed by program regulations.[64] Taken as a whole, these statistics suggest that states did not systematically target Opportunity Zones towards "easy" areas with no real need for additional assistance, as some have claimed. Indeed, based on the data in Table 2, Opportunity Zones appear encompass some of the more distressed communities in the country.

Exhibit 1: Socioeconomic Characteristics of Opportunity Zones Relative to Other Census Tracts[65]

	Poverty Rate	Median Family Income	Minority Share	Adults without a high school diploma	Adults with a bachelors degree or higher	Prime age population (25-54) not working	Housing vacancy rate	Life expectancy
Opportunity Zones	27.7%	$47,316	56.5%	21.1%	18.1%	31.1%	12.8%	75.1
Non-OZ low income census tracts	23.1%	$52,400	52.8%	19.3%	20.1%	27.5%	11.0%	76.2
All low-income census tracts	24.4%	$50,984	53.9%	19.8%	19.5%	28.4%	11.5%	75.9
United States	14.1%	$73,965	38.9%	12.4%	31.5%	22.2%	8.2%	78.6

Source: U.S. Census Bureau American Community Survey 2014-2018 5-Year Estimates. Census tract-level values are averages.

Other efforts to compare OZ tracts to other eligible LIC tracts found similar patterns but reached different conclusions about the appropriateness of program targeting. For example, using somewhat earlier data, the Urban Institute found that OZ tracts generally had lower incomes, higher poverty rates, a higher share of minority households, and lower educational levels that non-OZ LIC tracts.[66] Homeownership rates in OZ tracts (44.6 percent) were also considerably lower than in non-OZ LIC tracts (56.7 percent) and for all US tracts (63.0 percent). However, the Urban Institute also found that Opportunity Zones had a somewhat higher share of tracts that appeared to be in the process of gentrification (i.e., 3.2 percent for OZ versus 2.4 percent for other eligible tracts), and that existing investment patterns in Opportunity Zones largely mirrored those in other eligible tracts. Because of this latter finding, the study concludes that "Opportunity Zone designations indicate only minimal targeting of the program toward disadvantaged communities with lesser access to capital relative to all eligible tracts."[67]

Because the needs of states will inevitably differ, it does little, if any, good for states to target the program to areas where it is unlikely to succeed.

Although not the major focus of their analysis, another paper by a group of NYU and MIT scholars also compared the characteristics of census tracts that were selected for the program to otherwise eligible low-income tracts.[68] In general, they found that poverty rates in Opportunity Zones tended to be lower than those observed in other eligible tracts. However, once they controlled for other demographic factors, they concluded that "eligible tracts that qualified through the poverty route were 5 percent more likely to be selected as OZs than those that qualified through the income route." They also found that, compared to otherwise similar LIC tracts, rural areas were more likely to be selected, as were tracts with higher concentrations of Blacks and lower education levels. At the same time, their analysis suggests that LIC tracts with high concentrations of Hispanic or Asian households were less likely to be selected (controlling for other factors) as were tracts with lower year-over-year income growth.[69]

However, while these results are admittedly mixed—particularly with respect to investment patterns and recent income growth—it is not at all clear whether a program that relies on its ability to attract private capital should be heavily focused on areas with little, if any existing economic activity. Because the issue of how tracts were chosen continues to raise considerable concern, it is helpful to return to the 2017 conference report language, in which the intent of Congress is expressed:

> "Governors are required to provide particular consideration to areas that: (1) are currently the focus of mutually reinforcing state, local, or private economic development initiatives to attract investment and foster startup activity; (2) have demonstrated success in geographically targeted development programs such as promise zones, the new markets tax credit, empowerment zones, and renewal communities; and (3) have recently experienced significant layoffs due to business closures or relocations."[70]

Such guidance recognizes the fact that the needs and circumstances of states will inevitably differ, and that it does little, if any, good for states to target the program to areas where it is unlikely to succeed.

With these caveats in mind, it is useful to look at some of the variations that have occurred in the characteristics of the tracts that states selected as Opportunity Zones. For example, Table 2 examines the extent to which states have included higher income contingent tracts in their OZ designations, which is one measure of program targeting. The states in the chart have been sorted from low to high by their number of non-LIC tracts, expressed as a share of the total number of Opportunity Zones. Two broad conclusions can be drawn from these data. The first relates to the variation that was observed in the prevalence of contingent tracts in states' OZ designations. As shown in the chart, the OZ designations of some 13 states consisted entirely of LIC tracts. However, in 15 cases, the state's number of contingent tracts met the maximum set by program regulations.[71] The second relates to the relationship between the size of the state and the observed extent of program targeting. In particular, while there are some obvious exceptions, states with the highest share of contingent tracts tended to be relatively small and many were subject to the 25 OZ minimum.

A 2018 article by Wallwork and Schakel explained the observed variation this way:

> "Because no more than 5 percent of a state's QOZs may be non-LIC contiguous tracts, the District of Columbia, along with Guam and 12 states, cannot nominate more than two non-LIC contiguous tracts as QOZs. For more populous states,…however, it may be especially appealing to nominate non-LIC contiguous tracts in metropolitan areas that may be ripe for development…Local political pressures may confine QOZs in some states to areas genuinely in need of economic stimulus….On the other hand, QOZ nominations thus far submitted by populous states like New Jersey and California indicate that strategic and competitive needs may play an outsized role in the selection process."[72]

Table 2: Non-LIC Tracts as a Percent of All Opportunity Zones, by State

State	Designated Opportunity Zones				State	Designated Opportunity Zones			
	Total OZs (#)	LIC Tract (#)	Non-LIC Contiguous Tract			Total OZs (#)	LIC Tract (#)	Non-LIC Contiguous Tract	
			#	%Share				#	% Share
Alaska	25	25	0	0.0%	Maryland	149	145	4	2.7%
Florida	427	427	0	0.0%	Alabama	158	153	5	3.2%
Georgia	260	260	0	0.0%	New York	514	497	17	3.3%
Illinois	327	327	0	0.0%	Louisiana	150	145	5	3.3%
Montana	25	25	0	0.0%	Tennessee	176	170	6	3.4%
New Hamps.	27	27	0	0.0%	Kentucky	144	139	5	3.5%
New Jersey	169	169	0	0.0%	Pennsylvania	300	289	11	3.7%
N. Dakota	25	25	0	0.0%	Delaware	25	24	1	4.0%
Rhode Island	25	25	0	0.0%	Wyoming	25	24	1	4.0%
Texas	628	628	0	0.0%	North Carolina	252	241	11	4.4%
Utah	46	46	0	0.0%	Arizona	168	160	8	4.8%
DC	25	25	0	0.0%	Missouri	161	153	8	5.0%
Wisconsin	120	120	0	0.0%	Mississippi	100	95	5	5.0%
Massachusetts	138	137	1	0.7%	Washington	139	132	7	5.0%
Minnesota	128	127	1	0.8%	South Carolina	135	128	7	5.2%
California	879	871	8	0.9%	Kansas	74	70	4	5.4%
Ohio	320	317	3	0.9%	West Virginia	55	52	3	5.5%
Connecticut	72	71	1	1.4%	Colorado	126	119	7	5.6%
Iowa	62	61	1	1.6%	Oregon	86	81	5	5.8%
Nevada	61	60	1	1.6%	Maine	32	30	2	6.3%
Michigan	288	283	5	1.7%	New Mexico	63	59	4	6.3%
Indiana	156	153	3	1.9%	Idaho	28	26	2	7.1%
Nebraska	44	43	1	2.3%	Hawaii	25	23	2	8.0%
Arkansas	85	83	2	2.4%	South Dakota	25	23	2	8.0%
Virginia	212	207	5	2.4%	Vermont	25	23	2	8.0%
Oklahoma	117	114	3	2.6%					

Source: https://opportunitydb.com/location/

A number of other studies have looked at state variations in the targeting of Opportunity Zones. For example, the recent report by the Council of Economic Advisors (CEA) found that in each of the 50 States and in the District of Columbia, median household income in Opportunity Zones was lower than in other eligible-but-not-selected tracts.[73] However, the difference was relatively small in states such as Mississippi, New Mexico, West Virginia and Alaska. While the report did not present comparable state-specific data on poverty rates, it did examine the overall distribution of the US population by the census tract's poverty rate and OZ designation (i.e., selected, eligible-but-not-selected, and ineligible).[74] Such data suggests that states as a whole have selected tracts with varying levels of poverty, neither focusing solely on those with the least amount of poverty nor on those with the highest poverty rates. According to the CEA, "The strategy has an economic rationale: States would benefit little from OZs if they selected tracts where a designation was unlikely to spur investment."[75]

Other studies have examined other aspects of the state selection process. For example, the Brookings study cited earlier created an "index of economic distress" based on poverty rates (adjusted for the number of university-student residents), child poverty rates, educational attainment, home prices, and family income for each tract within each state.[76] It found that the majority of states selected tracts that scored higher on this index, meaning that on average, they selected tracts with greater needs compared to other eligible tracts within that state. The major exceptions again tended to be smaller states such as West Virginia, Mississippi, and Wyoming. However, the report also found that the majority of states selected census tracts with house price appreciation rates that were relatively high compared to otherwise eligible LIC areas within the state. In this case, the states that selected the highest shares of more rapidly appreciating tracts were Mississippi, Iowa, and Nevada. Such findings led the Brookings study to conclude that "States had too much flexibility and their incentives were not aligned with Congress's goals for the program."[77]

Finally, the Urban Institute study also examined the results of the OZ selection process in different states based on an index of recent investments (to measure need) and an index of socioeconomic change that was used to identify "gentrifying tracts" (to measure benefits).[78] The investment index measured a tract's level of investment compared to other census tracts *within the state* on a scale of one to ten, while "gentrifying tracts" were defined as tracts with an index of socioeconomic change that was more than one standard deviation above the *national mean*. According to their analysis, West Virginia, Vermont, Nebraska, and Hawaii selected areas with the highest levels of existing investments.[79] On the other hand, while they found that the share of OZ tracts that were in the process of gentrifying was very low in the majority of states, New York (13 percent), Delaware (8 percent), Connecticut (7 percent), and Maryland (6 percent) had the highest rates, both in absolute terms and relative to other eligible LIC tracts within those states.[80]

In interpreting these findings, it is important to keep several factors in mind:

- First, some of the results cited above are based on indices developed by the authors that rate the characteristics of a given census tract (i.e., level of distress, rate of house price appreciation, level of investment) relative to the characteristics of other census tracts *within the state*, as opposed to all US census tracts. As a result, according to these indices, the level of distress that is observed in an impoverished state will be different and more severe than the same level of distress that is observed in a more prosperous state. While this may be appropriate for examining the state selection process, it renders inter-state comparisons essentially meaningless.

The level of distress that is observed in an impoverished state will be different and more severe than the same level of distress observed in a more prosperous state.

- In addition, the degree of targeting that is captured by these indices and other metrics will be biased downward for smaller states, particularly those with fewer than 100 eligible census tracts. Since every state can select at least 25 Opportunity Zones, smaller states will inevitably have to include a higher number of tracts with relatively lower levels of distress if they want to meet this minimum.

- Finally, based on the analysis cited above, the degree of targeting observed across the different states appears to vary based on the criteria that is being used. In other words, there are few, if any consistent patterns of "good" or "bad" behavior, as least as defined by the Brookings or UI metrics. Again, this result is not surprising, given the flexibility of the program, as well as the different circumstances, priorities and strategies that undoubtedly characterize the different states.

Indeed, it is not at all clear that states *should* have selected the census tracts with the highest level of needs, which is the implicit assumption of many critics. Given the program's reliance on private capital, governors had to balance the needs of low income communities with the needs of potential investors, particularly in light of the severe state and local budget constraints that have been generated by the Covid-19 pandemic. Stated differently, there would be little, if any virtue for a state to simply select its neediest census tracts to be Opportunity Zones if those tracts ultimately fail to attract sufficient funds. Larger, more prosperous states may well be able to find "sweet spots" that are both severely distressed (however defined) but have a higher chance of attracting QOF. However, smaller, higher poverty states like Mississippi and West Virginia likely had fewer sweet spots to choose from.

Investor Targeting. In the end, whether or not the OZ program is targeting the communities most in need relates *less* to the census tracts that the states selected for the program, and *more* to the census tracts where OZ investors actually chose to invest. As noted in a 2019 Center for Budget and Policy Priorities Report:

> "Opportunity zone advocates note that, on average, designated opportunity zones have a higher poverty rate and lower household income than the national averages, but those averages mask an important fact: While most opportunity zones do face above-average levels of economic distress, many of the selected tracts are relatively affluent or have other structural advantages that made them ripe for investment even before the new tax break was created …While such areas may represent a small share of opportunity zones, the rules don't prohibit opportunity zone funds from investing exclusively in the most affluent zones. Thus, these "outlier" zones could attract a significant share of the opportunity zone investment and come to account for a disproportionate share of the lost federal revenue."[81]

The AFREF went a step further with this prediction:

> "Most of the money is likely to pour into Opportunity Zones in or near gentrifying neighborhoods that are already receiving ample investment, have an influx of prosperous residents, and will generate the highest profits."[82]

While data to test this hypothesis will ultimately be available from IRS Form 8996, at the time of this writing, there is no national data set that can be used to observe where the equity raised through the OZ programs is actually being deployed.

There is currently no national data set that can be used to observe where the equity raised through the OZ programs is actually being deployed.

5.3 Total Equity Raised to Date

According to Treasury estimates, some 1500 Qualified Opportunity Funds had been established by the end of 2018.[83] However, there is currently little, if any "hard" data on the number of QOFs that exist today or on the total amount of equity that has been raised thus far. The Council of Economic Advisors (CEA) used two approaches to estimate these numbers: the first relied on Novogradac data for a sample of 513 QOFs as of January 17, 2020; the second used SEC data on entities with names that appeared to be QOFs that were seeking exemptions from SEC registration requirements.[84] Based on these two data sets, the CEA estimates that the amount of equity raised by QOFs thus far is between $33 billion and $93 billion, with its "best estimate" pegged at roughly $75 billion. While these confidence intervals are fairly broad, until the Form 8996 data are released and analyzed, the CEA estimates will probably be the best we will have for some time.

The CEA report also attempted to estimate how much of the capital raised thus far could be directly attributed to the tax incentives created by the program. As noted by the CEA, "not all the capital raised by Qualified Opportunity Funds is necessarily new to Opportunity Zones—some of it may have occurred without the incentive, and it is now occurring through a fund."[85] To examine this issue, the CEA made a number of assumptions regarding: (1) the baseline levels of investment in OZ and non-OZ tracts prior to the program; (2) investors' required post-tax rates of return; (3) the program's impact on the investor's effective tax rate, and (4) the elasticity of investment with respect to the cost of capital. Based on these assumptions, the CEA estimated that OZ incentives have generated roughly $52 billion in new investment in Opportunity Zones, representing about 70 percent of the $75 billion raised thus far.[86]

Some observers have dismissed these estimates as "made up" numbers. In a sense, this is obviously the case, since the estimates were based on the academic literature, not on the direct observation of actual investments in the program to date. Indeed, based on interviews with some 70 OZ participants, the Urban Institute concluded that a significant share of the so-called "mission oriented" projects it examined would have been funded without the additional benefits of the OZ tax break. In particular, it found that:

> "The OZ incentives have had mixed effects in terms of making projects work that would not otherwise happen. Some developers reported that the incentives did make a decisive difference in allowing a project to go forward, while others were clear that their project would have proceeded with or without OZ equity. Most observers appear to agree that a primary benefit of the program is that it elevates the visibility of neighborhoods and deals that investors might not have considered otherwise."[87]

However, this finding may simply reflect the relatively short time frame that was available to receive the full benefits of the tax break. It may also reflect the fact that the types of "mission-oriented" projects examined by the Urban Institute need considerable subsidies to "pencil in." While the Urban Institute's findings may be indicative of the types of projects that are likely to be developed under OZ, they may not reflect the aggregate level of new investments being generated by the program.

5.4 Use of Funds

Not surprisingly, there is also little, if any aggregate program data on how OZ funds are actually being deployed, although, as noted earlier, there are numerous examples of the types of projects that are currently underway. Exhibit 3 presents the CEA's estimates of the overall share of OZ investments going to different types of projects based on SEC Form D data. Again, while the SEC data may not be representative of all QOFs—and while Form D does not provide definitions for the industry categories that filers can select—the data does provide a broad picture of where some of the larger funds are intending to invest.

As shown in the chart, 46 percent of the funds filing a SEC Form D reported that they intend to focus on some form of real estate; another 45 percent describe their industry as a "Pooled Investment Fund," which suggests that they have investments across various industries, including real estate; and about 10 percent are in the "other" category, which includes funds that reported a focus on health care, technology, construction, and investing, and as well as those selecting the "other" option on the form. Note that residential real estate accounted for only about 6 percent of reported uses of the funds, compared to 18 percent for commercial real estate.

Exhibit 3: Percent of Qualified Opportunity Funds, by Industry[88]

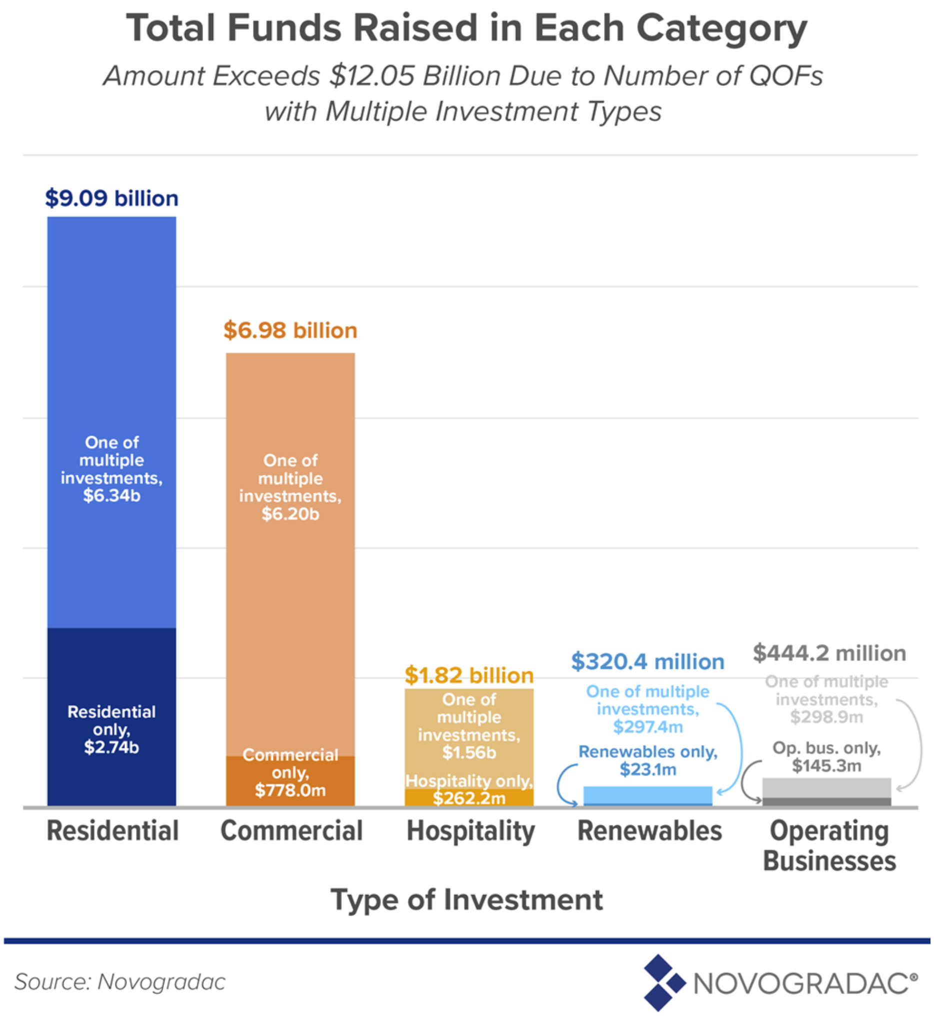
USE	Percent
REAL ESTATE	
• Residential	6%
• Commercial	18%
• Other Real Estate Investments (e.g., REITS, Finance)	22%
POOLED INVESTMENT FUND	45%
OTHER (e.g., health care, technology, construction, investing)	9%

Sources: Securities and Exchange Commission; CEA calculations.

The program's initial focus on commercial and residential real estate is supported by Novogradac data,[89] which covers 811 QOFs with some $12.05 billion in investor equity. Exhibit 4 below categorizes these funds according to their intended use. Note that the equity raised by funds that reported more than one intended use were assigned to more than one category, i.e., they were counted more than once. As a result, the totals appearing in the chart should be viewed as the *maximum* funding available for different types of projects, as opposed to the level of actual commitments.

Like the SEC data, the Novogradac data suggest that the majority of OZ funding is being directed to commercial and residential real estate (although the relative share of funds focused exclusively on residential, as opposed to commercial real estate is significantly higher than suggested by the SEC data). The Novogradac data also suggest than only a small share (less that 4 percent) of Opportunity Funds are being used to make equity investments in operating businesses, a pattern that concerns many community activists who would like to see the benefits of the program flow to existing members of the community, particularly small businesses that are currently struggling to survive.

Exhibit 4



According to the Urban Institute, there are many reasons that have made equity investments in existing businesses problematic, especially in the initial stages of the program.[90] Some relate to the structure of the program, for example, the time frames for committing and deploying the funds and the expectation that investors will sell their shares at the end of the 10-ten year holding period ("the equity exit"). Others relate to a preference on the part of smaller businesses for debt, as opposed to equity, due to a reluctance of many business owners to give a share of their company to unknown investors. While some expect the level of business investments to rise over time, others remain more skeptical. Indeed, the Urban Institute report called the concluded that "the most egregious failing of OZs to date is that very little OZ investment is going to small businesses."[91]

But from our perspective, it is not at all clear why the relatively small amount of OZ funds going into equity investments in existing businesses should necessarily be seen as a program failure. To begin with, as noted earlier, the potential "leakage" of business investments to areas outside of Opportunity Zones may mean that the presumed benefits of such investments to the community are relatively small.[92] In addition, from an employment perspective, the development of commercial properties—for example, the purchase of a property to develop a micro-brewery or a learning center—could presumably create more well-paying jobs than investing in businesses already operating in Opportunity Zones. Likewise, given the lack of decent and affordable housing in most of these areas, it is difficult to see why investment in residential housing is necessarily bad, particularly in light of the construction jobs that will inevitably flow from such investments.

The bottom line is that broad data on how the funds are being deployed tell one little about the specific nature of OZ investments or their impact on the broader community. Until such data are available, it is difficult to assess whether or not the patterns revealed in Tables 2 and 3 should be considered good or bad.

5.5 Geographic Focus

As note earlier, we currently know relatively little about where the equity raised to date is being deployed or the characteristics of the Opportunity Zones that are actually receiving OZ investments. However, some broad information is available on the Novogradac website. [93] Again, it is important to recognize that the Novogradac data is self-reported, and that the sample may not be representative of all QOFs. With these caveats in mind, some 23 percent of funds in the Novogradac sample reported that they had a national focus, 27 percent reported that they had a multi-city focus, while 29 percent reported that they were concentrating on a single city. Combined, single- and multiple-city QOFs have raised roughly half of the overall equity to date, with a roughly even split between the two.[94]

Exhibit 5 shows the 10 states with the highest reported shares of QOF investments based on the Novogradac sample. According to these data, California and New York account for about 25 percent of the equity raised thus far, followed by Ohio and Arizona. As shown by the last two columns in the chart, the findings for California and New York are not surprising, given their overall share of Opportunity Zones (which is roughly equivalent to their share of the total US population). However, the relative shares of QOF equity raised to date appear to be relatively high in Arizona, Maryland, and Ohio, and relatively low in Texas and Florida. At this point in time, it is difficult to know whether these figures are an aberration of the sample or whether they will hold up over time as the program matures.

Exhibit 5: Distribution of Equity Raised by State

	Total Reported Equity Raised	% of All Equity Raised (Equity Share)	% of Opportunity Zones (OZ Share)	Equity Share as % of OZ share
California	$1,191.4 M	15.90%	11.2%	142%
New York	$821.7 M	10.90%	6.6%	166%
Ohio	$601.2 M	8.00%	4.1%	196%
Arizona	$535.8 M	7.10%	2.1%	331%
Georgia	$357.9 M	4.80%	3.3%	144%
Texas	$343.3 M	4.60%	8.0%	57%
Maryland	$327.8 M	4.40%	1.9%	231%
Florida	$297.5 M	4.00%	5.5%	73%
North Carolina	$252.1 M	3.40%	3.2%	106%
Tennessee	$251.3 M	3.30%	2.2%	147%

Sources: Novogradac, Opportunitydb. See https://www.novoco.com/notes-from-novogradac/novogradac-opportunity-funds-list-surpasses-12-billion-investment https://opportunitydb.com/location/

5.6 Initial Impacts

It is clearly too soon to speculate about the impact of the program on the residents it was designed to serve, given that the final regulations were released less than a year ago and the program's initial momentum undoubtedly came to a pause with the onset of the Covid-19 pandemic. Moreover, as many program supporters have pointed out, in order to receive the full benefits of OZ tax incentives, the gains had to be invested in QOFs before the end of 2019. As a result, many projects that initially benefited from the program may have already been underway, making it difficult to evaluate the long-term impact of OZ incentives. With these caveats in mind, some preliminary analysis suggests that the mere designation of a tract as an Opportunity Zone may already be having an effect on business investments and property values in those areas.

Equity Investments in Businesses Located in Opportunity Zones. In addition to estimating the total investments that were being made by QOFs, the CEA report also attempted to estimate the program's impact on business investment in the areas that have been designated as Opportunity Zones. To do this, the CEA used SEC Form D data from 2016 to 2019 to compare investment trends for businesses whose principal location was in an Opportunity Zone to the trends observed for businesses located in other eligible and ineligible census tracts.[95] Note that the SEC data pertains to businesses that raised money through private offerings. While the CEA excluded larger offerings (above $25 million), these are clearly not the kind of "mom and pop" shops that many envision helping through the program.

From 2016 through the first half of 2018, investment trends were fairly similar in OZ and non-OZ areas. However, once they received their OZ designation, equity investments in businesses located in Opportunity Zones rose by 41 percent, compared to a 13 percent increase in other LIC tracts. This led the CEA to conclude that the OZ designation has led to an 29 percent increase in equity investments in Opportunity Zones.[96] In a footnote, the CEA cautions that the fact that a business is located in an Opportunity Zone does not mean that the bulk of its business occurs within that area.[97] Nevertheless, the CEA analysis suggests that the OZ designation *per se* may already be having a positive impact on businesses located in Opportunity Zones.

Employment. Despite the apparent increase in business investments, there is little, if any evidence that the OZ designation has led to a significant increase in the actual number of jobs. For example, a recent study by Atkins et. al. attempted to provide a preliminary assessment of the employment outcomes achieved thus far.[98] To do this, they matched zip codes with low-income OZs to a control group of similar zip codes that do not have any OZs, and compared changes in job postings and posted salaries across these two groups over time. They found that zip codes with OZs have fewer job postings but higher posted salaries, although the differences were relatively small. Based on these findings, the authors concluded that the "OZ designation has had little overall effect on economic outcomes so far" and recommend that "policymakers should consider ways to direct future investments to those areas most in need."[99]

Property Values. On the other hand, property values in designated OZ neighborhoods do appear to be rising at a faster rate than in other low-income census tracts. For example, using the FHFA House Price Appreciation Index, the CEA estimates that the value of single-family housing in OZ neighborhoods rose by about 1.1 percent more than they did in other low-income tracts over the last two years.[100] According to the CEA, this has created some $11 million in additional household wealth for the 47 percent of Opportunity Zone residents who own their homes. Such an outcome would be considered positive by most accounts, although rising property taxes might eventually cause some families to cash in their chips and move away.

Taken together, these studies suggest that the mere designation of a community as an opportunity Zone is having a positive effect on property values and business investment in these areas.

An unpublished study by Edward Pierzak found a similar trend for apartment buildings.[101] In particular, he found that between 2017 and 2019, the sales prices of apartment buildings in Opportunity Zones appreciated at a 8.5 percent higher rate than they did in other low income neighborhoods. However, unlike the outcomes for OZ homeowners, this result would likely hurt, not help many existing residents since rising property values are typically accompanied by higher rents. Indeed, Pierzak concludes that "Although it is too early to examine the long-term effects of the policy, the short-term effects suggest that the benefits of the favorable tax incentives have been effectively transferred to the property owners of the apartments at the time of the policy change."[102]

Finally, as noted in the CEA report, data from Real Capital Analytics, which tracks commercial real estate properties and portfolios valued at $2.5 million or more, suggest that year-over-year growth in development site acquisitions increased by more than 50 percent in Opportunity Zones after they received their OZ designation, far above the growth observed in the rest of the United States. Similarly, using the same set of data, Sage, Langen, and Van de Minne found that on average, an OZ designation led to a 14 percent increase in the price of redevelopment properties and a 20 percent increase in the price of vacant development sites in early 2019.[103] While Sage et. al. concluded that the price increase only occurred for particular property types, the CEA report references an analysis by Zillow that covers a broader range of property types and values (although it does not provide a specific cite). According to the CEA, Zillow that found that, after the OZ designation, the year-over-year change in the average sales price for properties in OZs rose to more than 25 percent while falling to below 10 percent in eligible-but-not-selected census tracts.

Taken together, these studies suggest that the mere designation of a community as an opportunity Zone is having a positive effect on property values and business investment in these areas. However, these effects are largely in anticipation of future economic development that may be generated by OZ investments and may disappear over time if such development does not materialize. In the end, it will most likely take many years to know the full effects of the program. As noted by Metzger:

> "…as an empirical matter, the jury is largely still out on whether the program will live up to its stated purpose — which its creators have been quick to point out. Measuring its effectiveness is especially complex since the OZ program's tax benefits are deferred over an extended time horizon…This program is designed for patient investors, and the real value comes after 10 years,

> with only a very small incentive upfront. That means smart money will look for places that have a long runway for growth."[104]

Unfortunately, it is far too early to tell if any of these trends will be sustained or if they will ultimately be reversed if the market determines that the initial hype surrounding the program was largely a pipe dream.

> Until aggregate data are available, OZ proponents will tend to view rising prices as a program feature, while detractors, including some think tanks and community advocates, see it as a bug. Time will tell.

Gentrification. Closely related to the issue of rising property values is the concern that OZ investments will so transform a neighborhood that residents will be priced out, or that the neighborhood will lose its cultural distinctiveness so that residents experience a loss of connectiveness and choose to leave. So-called cultural gentrification could occur when OZ investments seeking higher returns result in housing, retail, or other amenities that are designed to appeal to wealthier consumers, thereby changing the look and feel of the neighborhood.

Opportunity Zone-driven changes underway in Norfolk, Virginia are raising such alarms. With more OZ designations than any other city in the state, Norfolk's town council moved swiftly in 2018 to tear down 618 units of public housing in St. Paul's, a neighborhood whose residents are "mostly Black and mostly poor, a world apart from the downtown." After HUD Secretary Carson visited Norfolk earlier this year the town was awarded a $30 million grant to replace its aging public housing stock.

Using the HUD grant to leverage additional funds, including OZ investments, Norfolk expects to garner $150 million for the redevelopment of St. Paul's. But it will take years. Until new housing is completed, residents will receive housing vouchers to assist them in securing alternative housing. While city officials are confident in their plan "helping residents secure new homes and providing support services such as job training and assistance with financial planning," others remain skeptical, like council member Paul Riddick, whose district includes St. Paul's and is the lone holdout on Norfolk's eight-member city council. "Because of institutional and systemic racism," says Riddick, "the African-American community is going to be pushed out again. This is nothing but gentrification." Riddick fears that displacement will cause Norfolk's Black population to shrink from its current 40 percent to the mid-30 percent over the next 10 years.[105]

Concerns that OZs will further institutionalize patterns of systemic racism is at the heart of a blistering critique by the Center for American Progress (CAP). In its February 2020 report entitled, "Promise and Opportunity Deferred: Why the United States Has Failed to Achieve Equitable and Inclusive Communities," CAP claims the OZ program is simply "government-sanctioned" gentrification that fails to address a legacy of "discriminatory policies and practices," such as red-lining, exclusionary zoning, slum clearing and more. According to CAP, OZ is a failed approach because it "never confronts the long-standing policies and practices that made these communities of color distressed in the first place." Short of abolishing the program entirely, CAP stresses that community involvement is essential. As a place-making approach, the OZ program needs to support "distressed communities' self-determined visions and blueprints for economic, social, and environmental well-being."[106]

In a September 2020 report entitled, “Revitalizing America’s Neighborhoods: A Practitioner’s Perspective,” long-time housing advocate Paul Brophy makes a more nuanced assessment. Noting that “the specter of gentrification haunts our discourse on neighborhood improvement and impedes thoughtful analysis,” Brophy differentiates between situations where higher prices caused by gentrification are bad for a community and when they are actually good—and needed.

According to Brophy, gentrification is “bad” in hot markets like San Francisco, where escalating house prices have had “major negative effects…on San Francisco’s residents and collective personality.” The “modest-income renters and homeowners who cannot afford escalating property taxes…must find less expensive places to live, if they can, creating a serious public policy issue in these places.” However, gentrification can be a force for good in struggling communities that have seen a flight of investment and declining population. In such situations, an increase in a community’s valuation can reverse the downward cycle of price declines, which benefits existing homeowners, in particular. According to Brophy:

> “In many neighborhoods in weak-market cities, the appropriate intervention goal is to help housing prices rise so that homeowners can anticipate some level of appreciation and build some equity in their homes. Isn’t this what we collectively approve of in suburbs? Isn’t this the American Dream? Don’t city residents deserve the same opportunity? This is particularly true in African American neighborhoods. In Baltimore, for example, some middle-class African American neighborhoods have seen housing prices decline by 30 percent due to weak demand for these neighborhoods. This means that hardworking people of color are losing equity in their homes, making it far more difficult for them to pass wealth onto their children.”[107]

Until aggregate data are available, OZ proponents will tend to view rising prices as a program strength, while detractors, including some think tanks and community advocates, see it as a major weakness. Only time will tell.

5.7 Summary

The OZ program is still in its infancy and its potential impact will not be known for several years. Moreover, the lack of systematic data on how and where OZ funds are being used makes even an “interim” assessment of the program problematic. Nevertheless, despite these caveats, we believe that the data presented above supports several broad conclusions.

First, taken as a whole, tracts that received an OZ designation tend to exhibit a greater level of distress than other potentially eligible low-income tracts, as least as measured by broad socioeconomic measures such as income, race, employment, and educational attainment. While this pattern varies across the different states, the exceptions tend to be smaller states with inherently fewer choices. In other words, the existing evidence does not suggest that the state selection process was in any way geared to the least needy eligible tracts.

At the same time, states do not appear to have targeted their selection of Opportunity Zones to census tracts with the worst economic conditions. For example, the distribution of investments in Opportunity Zones prior to their selection more or less mirrors the distribution across all eligible tracts, and house price appreciation rates appear to have been somewhat higher. While some have criticized these patterns as a failure of the program, they most likely reflect a pragmatic view that the program will do little, if any good if it fails to attract the necessary private capital.

The great majority of these funds appear to be going to development of residential and commercial real estate, with only a small percent directed to investments in existing businesses.

While there is considerable uncertainty in the amount of funds that have been raised thus far, the CEA puts it at roughly $75 billion. The great majority of these funds appear to be going to development of residential and commercial real estate, with only a small percent directed to investments in existing businesses. Again, while the lack of investment in existing businesses has been criticized by some observers, it is not at all clear whether the program really lends itself to such investments, nor is obvious why they would necessarily produce a higher number of well-paying jobs.

Finally, even in the initial stages of the program, the OZ designation appears to have had an impact on the communities that have been selected. In particular, the evidence suggests that immediately following their selection, investments in businesses whose principle address was in an Opportunity Zone rose at a faster rate than investments in businesses located in other low-income tracts. Likewise, property values also appear to be on the rise in Opportunity Zones. While many would view these as positive developments—and while they may be reversed if the anticipated investments do not materialize—these trends raise the potential specter of displacement of existing residents, particularly renters.

The basic tension between economic growth and potential displacement is by no means unique to Opportunity Zones. However, in light of our finding that, generally speaking, the zones were appropriately targeted, we tend to agree with Brophy that “increased demand for these neighborhoods,” evidenced by rising property values, should generally be seen as a positive outcome.

6.0 Where Do We Go from Here?

In reviewing the growing body of literature about Opportunity Zones coming from think tanks, academics, and the investor community, we have noted a growing chorus of concern. Even though final regulations were only promulgated less than a year ago—and no aggregate data yet exists with which to evaluate whether the zones were properly targeted to need, even less if OZ investments are having their desired effect—many influential thinktanks and community groups are already calling for substantive changes, if not outright termination.

The reform debate is occurring as potential investors weigh whether to sell assets and deposit capital gains into QOFs; as project sponsors create "pitch decks" promoting their small business or real estate venture for consideration; and as states and localities help sponsors leverage other federal and state resources to help revitalize their OZ communities. Adding uncertainty to the mix, the economic shut-down due to Covid-19 precautions has greatly slowed the program's early momentum, and perhaps dampened investor interest in communities and businesses hard hit by the pandemic. Lastly, Opportunity Zones have become part of the election narrative; the politization of the program pits the wealthy against the poor, monied interests against public purposes, all with overtones of racial injustice. Clearly Opportunity Zones have not had an easy time getting up and running.

6.1 Recent Proposals

While almost everyone who has looked at this program agrees that reporting requirements need to be strengthened, there is little, if any consensus on what else needs to be done. Some have called for a "reset" that would extend the applicable program timelines. Others have called for more fundamental changes to the program, including adding restrictions on how the funds can be used. Still others have called for the complete termination of Opportunity Zones. This section describes some of these proposals, beginning with those that would simply support or enhance the existing program, followed by those that would either tighten certain requirements—or eliminate the program altogether.

Enhanced Reporting. As noted above, there is general agreement that existing program reporting requirements need to be expanded and improved. Two pending bills in the Senate have been designed to achieve this objective. While the bills are similar, they differ with respect to the degree of transparency regarding the specific QOFs that are participating in the program.

- **Comprehensive data and Treasury reports, with privacy protections**. The first bill, which was introduced by Sen. Scott as the IMPACT Act, would reinstate and strengthen the reporting requirements that were contained in the original legislation. (See Appendix C.) Under these new provisions, QOFs would be required to provide information on the size, nature, location, and impact of their investments (e.g., industrial classification, number of jobs created, number of new housing units, etc.) These new reporting requirements would also codify information already required of individual investors and add "measures that will continue to allow IRS to track both the deferral and recognition of gains, the trajectory of OZ investments over time, and compliance more broadly." Both the funds and individual investors could be penalized for failure to report accurate and timely information.

  The IMPACT Act also requires the Secretary of the Treasury to prepare annual reports that aggregate fund data for the purpose of ascertaining where funds are going, to which types of businesses and to what effect. At subsequent five-year intervals Treasury is required to submit a "comprehensive report on an exhaustive list of economic and demographic data points to provide a holistic view on the impact to each census tract over time," including comparisons between designated and non-designated census tracts. The bill explicitly requires the IRS to protect information gathered from individual taxpayer returns, including "competitive or proprietary information."

- **Comprehensive reports, including from GAO, and less privacy protections**. A bill introduced by Sen. Wyden (D-OR) in November 2019 contains similar reporting requirements as the IMPACT Act with the addition of a comprehensive GAO report to Congress due on the fifth and tenth anniversary of the bill. Wyden's bill also would provide more public transparency than Scott's. In particular, it would require the IRS to provide "a publicly available list of investment vehicles that are certified as qualified opportunity funds."

Program Reset. Given the delay in issuing regulations, the rigorous timelines embedded in the legislation, and the economic disruption triggered by the Covid-19 pandemic, numerous program advocates have also called for pushing out the program end date by two years or more. For example, by the time final rules were released in December 2019, the seven-year deferral benefit was essentially obsolete since the sunset for deferring taxable gains was set at 2026. To address this issue, Republicans introduced H.R. 6513 in April 2020, which would extend the deadline for investors to defer their capital gains taxes from 2026 to 2030.

Support and Expand the program. In addition to the above two technical "fixes," there have been a number of other suggestions for how the program might be expanded or enhanced. Some of these are listed below.

- **Use OZs for Pandemic relief**. In April 2020, H.R. 6529 received bipartisan support to treat small businesses hit by Covid-19 as "qualified opportunity zone businesses" eligible for opportunity fund financing.

- **Provide a tax credit to businesses in OZs making critical medical supplies**. In May 2020, Sen. Scott circulated a discussion draft of the Manufacturing Ability of Domestic Equipment (MADE) in America Act. The proposal provides a new tax credit for manufacturers of domestic drugs and PPE that operate in certain American Opportunity Zones. According to Sen. Scott, "By combining the promise of Opportunity Zones and the need to bring our supply chains back home, MADE in America is a two for one deal that will make our nation stronger for years to come."

- **Provide a tax credit to expand investor pool beyond high-wealth individuals**. Since the OZ program currently caters to wealthy investors with capital gains they want to shelter, some have argued that the program should be expanded to provide a tax credit to individuals who want to invest funds other than capital gains into their communities.

- **Allow formal participation by CDFIs**. In June 2020, Democrats proposed H.R. 7262 allowing opportunity funds to invest in community development financial institutions, which would then provide loans to businesses in underserved areas.

- **Provide technical support to localities**. Recognizing the challenge of equipping project sponsors to present viable projects to equity investors, in July 2020 the National Conference of Mayors issued a resolution calling for stronger reporting requirements, extended timeline, and the provision of technical assistance and capacity building to mayors. Sen. Booker has indicated he also supports increasing technical support to localities.

Tighten and target the program (guardrails). At the same time, many program critics have argued that the free-wheeling nature of Opportunity Zones is inconsistent with its stated public purpose and have called for greater controls over how and where the funds can be used.

- **Prohibit certain types of investments**: Under current law, fund managers enjoy wide latitude with regard to the types of qualifying businesses and properties that may receive preferential tax treatment. To address concerns that funds are flowing to luxury investments that do little for community revitalization and raise issues of cronyism, Sen. Wyden's bill would expand existing prohibitions to include investments in "certain luxury assets, including private planes, sports stadiums, self-storage facilities, and luxury rental properties."

- **Changes to State designations**: Many program critics also believe that states were given too much latitude in choosing the potentially eligible tracts that would receive the coveted OZ designation. Reform suggestions include changing the standards to force states to designate their most needy areas; using more recent data to update the designations, including adding or removing zones that no longer qualify; and tightening allowances for contiguous communities. For example, Sen. Wyden's bill would terminate designations of contiguous communities that are not low-income as Opportunity Zones. Sen. Booker has indicated he also supports changing state designations to eliminate higher-income Opportunity Zones in favor of lower-income zones.

Terminate the Program. Finally, an interesting set of bedfellows has indicated such dismay with the OZ program that termination is the only solution. Conservatives at the American Enterprise Institute view the program as fatally flawed because it seeks to direct private capital "away from its most productive ends; the fact that the program appears to have little impact to date is doubly troubling."[108] Progressives at the Center for American Progress and Americans for Financial Reform decry the program for its tilt toward the wealthy, abuse and cronyism, and the codification of institutional inequities and injustices. In November 2019, Rashida Tlaib (D-MI) introduced a bill to terminate the OZ program. In July 2020, she was joined by Rep. Alexandria Ocasio-Cortez (D-NY) in proposing an amendment to an appropriations bill that would bar the IRS from using funds to administer or enforce the OZ program. The amendment was defeated.

6.2 Presidential Platforms

In the end, the future of Opportunity Zones will most likely be determined by the recent Presidential election. While both the Trump and the Biden campaigns included Opportunity Zones in their policy platforms, they did so with different "spins" and policy objectives.

Citing the CEA's conclusion that OZs are on track to lift one million Americans out of poverty, President Trump heralded the program as a success story, particularly for persons of color. Starting at the August 24, 2020 Republic National Convention, coincidentally the same day the CEA released its report, Trump referred to the success of Opportunity Zones at just about every campaign event. In October, the President released a national campaign ad that featured the OZ success story mentioned at his State of the Union address in February. His Black Economic Empowerment "Platinum Plan" would "increase activity in Opportunity Zones including benefits for local hires."[109] At a recent industry conference, Deputy Assistant to the President Ja'Ron Smith indicated support for using new 2020 Census data to increase the share of eligible low-income tracts from 25 to 50 percent.[110] Reportedly Sen. Scott is making overtures to Democratic lawmakers to craft lame-duck legislation that would both expand the number of zones while tightening OZ eligibility and investor reporting requirements.

Echoing concerns about "equitable" development, President-Elect Biden's "Build Back Better" platform added some of the guardrails that many observers have called for to its proposed OZ reforms, which are positioned within a broader array of policies designed to expand racial equity. According to the Biden platform, the OZ program has failed to live up to its economic and community development promise; it has become a give-away to the rich with "too many instances investors favor high-return projects like luxury apartments over affordable housing and local entrepreneurs." Biden's reforms would seek to ensure that OZ investments make a positive social impact by:

- Incentivizing Opportunity Funds to partner with non-profit or community-oriented organizations, and jointly produce a community-benefit plan for each investment, with a focus on creating jobs for low-income residents and otherwise providing a direct financial impact to households within the Opportunity Zones.

- Directing that Opportunity Zone benefits be reviewed by the Department of Treasury to ensure these tax benefits are only being allowed where there are clear economic, social, and environmental benefits to a community, and not just high returns–like those from luxury apartments or luxury hotels–to investors.

- Introducing transparency by requiring recipients of the Opportunity Zone tax break to provide detailed reporting and public disclosure on their Opportunity Zone investments and the impact on local residents, including poverty status, housing affordability, and job creation.

Biden's OZ reforms are part of other proposals to increase economic justice, including expanded venture capital and low-interest business loans to minority business owners, strengthening CDFIs, MDIs and the CRA, expanding and making permanent the New Markets Tax Credit, and providing enhanced technical assistance and other resources promoting minority businesses.[111]

7.0 Conclusions and Recommendations

This paper attempts to take a comprehensive and objective look at the strengths and weaknesses of Opportunity Zones, and the extent to which the program is living up to its promise of revitalizing thousands of the nation's most distressed communities. Since the program is still in its initial phases, definitive answers are simply not available. However, based on the analyses that have been done to date, as well as the observations of a wide range of program observers and practitioners, we are more sanguine than discouraged about the program's potential for good.

Despite some claims to the contrary, state designations of Opportunity Zones, while not perfectly aligned with the most distressed communities, were not egregiously skewed toward areas already in the process of revival. Indeed, according to most measures, on average, Opportunity Zones had higher levels of distress that otherwise eligible low-income tracts. However, the degree of targeting varied across the different states and according to the particular metric that was used. These patterns most likely reflect the fact that states have varying needs and priorities, as well as a pragmatic view that the program will do little, if any good if it fails to attract the necessary private capital.

Initial reports also suggest that the program is having an impact in the form of increased investments in businesses located in Opportunity Zones and rising property values. Whether these observable trends are simply due to the OZ designation and therefore short-lived, or whether a long-term increase in neighborhood investments and valuation is underway, remains to be seen. In any event, we are hopeful that evidence of rising property values represents, in the words of Paul Brophy, the revival of stagnating or declining communities.

Notwithstanding a string of concerns that have been raised by some of the program's more ardent critics, there appears to be bipartisan support for continuing the program, albeit with reforms. While investment levels have yet to reach expectations, the program's lengthy and complex rule-making process, and further delays due to the pandemic, suggest that additional time is needed for the program incentives to come to fruition. Therefore, proposals to extend the time for investors to roll gains into qualified funds are clearly appropriate. And although nearly every observer supports additional reporting requirements, policymakers will need to strike a balance between the desire for greater transparency and investors' natural protection of proprietary information.

More substantive changes, like changing the state designations, adding guardrails to ensure investments achieve greater social impact, or expanding the number of zones and creating a new tax credit to broaden the program's reach will take more strenuous effort and time. Depending on what we will eventually learn on how and where QOFs have invested their money, the prospects and nature of substantive reform measures will become much clearer. Whatever happens, it appears likely that Opportunity Zones will have the next decade to prove their worth.

With these caveats in mind, we offer the following recommendations:

- First, the program should be "reset" to ensure that the momentum that was occurring prior to the onset of the pandemic continues after the economy recovers and we return to more normal market conditions. In particular, we recommend that the timeframes established under the original legislation be extended by at least two years.

- Second, reporting requirements should be strengthened to get a better understanding of how the program is being used. Depending on the form in which they are released, IRS data could ultimately provide useful information on the amount, type, and location of OZ investments. Nevertheless, data reporting requirements should be expanded to include more detailed information on both the use and the impact of these investments. In addition, to address the need for public accountability, any new legislation should mandate the US Treasury Department (or other appropriate government agency) to provide annual reports on the program's impact and costs.

- Third, given the inevitable specter of displacement, policymakers should consider ways to target a portion of housing assistance funds to Opportunity Zones that experience rapid increases in housing values. They should also explore ways to encourage homeownership in Opportunity Zones, including tax credits for first-time homeowners, as well as the creation of "rent to own" opportunities.

- Fourth, the new administration should continue the efforts of the White House Opportunity and Revitalization Council, which is currently set to terminate on January 21, 2021. Opportunity Zones cannot address the multitude of needs of distressed communities. However, if properly coordinated and leveraged with other federal and local resources, they could well play an important role in supporting a more organic, bottoms-up recovery.

- Finally, legislators should take steps to address the little-recognized loophole that currently enables QOFs to avoid the requirement that at least 90 percent of their funds be invested in Opportunity Zones by simply investing in qualified OZ businesses. While we recognize that many existing OZ businesses have activities that extend beyond the confines of the Opportunity Zone—and that investments in OZ businesses have been relatively limited to date--if exploited, this provision would greatly dilute the intended impact of the program, which is to rejuvenate distressed communities.

Additional changes to the program may well be justified once we have more information on how the funds have been used thus far. Right now, the only systematic data that exists about Opportunity Zones relates to tracts that have been selected for the program, and some of the trends that are taking place within those tracts. We know virtually nothing about the extent to which OZ investments are spread across these tracts or heavily concentrated in certain areas. Nor do we know about the impact of OZ investments on the actual communities in which they are occurring. Indeed, while the CEA has pegged total investments at roughly $75 billion dollars, even this amount was derived through statistical estimation.

In making more fundamental changes, it is important to keep in mind that the program will do little, if any, good if it fails to attract the necessary funds due to a lack of investor interest.

While by no means perfect, IRS data should shed considerable light on these issues, and in doing so, suggest the extent to which further refinements will be necessary to increase the efficacy of the program, particularly as they relate to the need for additional program guardrails. However, in making more fundamental changes, it is important to keep in mind that the program will do little, if any, good if it fails to attract the necessary funds due to a lack of investor interest, or if by changing the "rules of the game," investors lose confidence that that they will ultimately receive the tax benefits they have been promised. These considerations would argue against imposing additional restrictions designed to limit the program to the most severely distressed tracts or to remove certain tracts from their current designation as Opportunity Zones.

But regardless of the changes that are ultimately made to the program, if the original intent of Opportunity Zones was to draw capital off the sidelines to revive distressed communities, the need seems greater than ever before. The federal debt has now climbed to 100 percent of GDP, and many states are facing a fresh round of budgetary shortfalls caused by the pandemic and the resulting economic slowdown. As a result, not a lot of money will be available for government-financed place-based strategies. To the extent the stock market continues to perform, OZs remain the primary way to channel these “locked up” capital gains into the communities that need them the most. While Opportunity Zones may not be a perfect vehicle—or a panacea that can address the multitude of needs that residents of these community face—they enjoy a striking level of interest and support. With a few adjustments, Opportunity Zones could well play an important role in an organic, bottoms-up recovery in distressed communities.

Appendices

Appendix A: Selected Federal Community Development Programs

Program	Funding	Year	Description	Funding (2019)
Economic Development Agency (EDA) Grants	Grants	1965	Part of the Commerce Department, EDA provides grants and technical assistance to economically distressed communities to generate new employment or to retain jobs.	$300 M
Community Development Block Grants (CDBG)	Grants	1974	A HUD-administered program that provides annual grants on a formula basis to states, cities, and counties. While there are broad guidelines for the application of these funds, the grantee, and not the federal government, decides on how these monies are spent.	$3 B
Community Development Financial Institutions (CDFI) Fund	Grants	1994	Part of the US Treasury, the Fund provides capacity-building and technical support to local community-based financial institutions (CDFIs).	
Enterprise Zones, including: • Empowerment zones (EZs) • Enterprise communities (ECs) • Renewal communities (RCs)	Tax Credits and Other Tax Incentives	1993 (EZ,EC) 2000 (RC)	Collectively known as enterprise zones, these programs provide(d) several forms of tax relief for businesses operating in communities designated as distressed by either HUD or the US Department of Agriculture. Incentives include: tax credits for a portion of the wages paid to EZ residents, capital gains relief, tax exempt funding to finance certain properties, and an increase in the amount of a property's costs that can be expensed, as opposed to capitalized. [112] According to Wikipedia, there are currently 40 RCs and 30 EZs managed by HUD, and 10 USDA EZs and 20 USDA ECs. However, both the EC and RC programs have been discontinued.	NA
New Markets Tax Credit (NMTC)	Tax Credits	2000	The program, which is administered by the CDFI, allows investors to receive a tax credit against their federal income taxes in exchange for making equity investments in specialized financial intermediaries known as Community Development Entities (CDEs). The Treasury competitively allocates tax credit authority to CDEs, which then lend or invest in entities located in qualified low-income communities. While 43 percent of all census tracts qualify for the program, applicants have recently pledged to place at least 75 percent of their projects in "severely distressed" census tracts. Investors receive their allocated tax credits over a 7-year period, for a total of 39 percent of their investment. The program places relatively little restrictions on a project's type and purpose.[113]	$1.9 B

Appendix B: Timeline of Significant Events and Reports

2015:

- "Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas" by Jared Bernstein, Center on Budget and Policy Priorities and Kevin Haslett, AEI. Economic Innovation Group, April 2015.

2017

- Enactment Tax Cuts and Jobs Act of 2107

2018:

- States had until March 2018 to make the initial designations, and these were finalized by the IRS and Treasury Department fairly early in 2018.
- October 29, 2018. First notice of proposed rulemaking.
- December 12, 2018, President Trump signed Executive Order 13853 establishing the White House Opportunity and Revitalization Council.

2019

- February 14, 2019. Public hearing on first set proposed OZ regulations.
- April 2019. "Implementation Plan for the White House Opportunity and Revitalization Council."
- May 1, 2019. Second notice of proposed rulemaking.
- July 9, 2019. Public hearing on second round of proposed regulations.
- December 2019. White House Opportunity and Revitalization Council releases first year "Report to the President."
- December 19, 2019. Department of Treasury and IRS issue final regulations.

2020

- State of the Union Address, February 4, 2020. President Trump honors former homeless veteran helped by an OZ investor in Denver, Colorado.
- White House Opportunity and Revitalization Council releases "Opportunity Zones Best Practices Report to the President." May 2020.
- IRS Notice 2020-23, April 9, 2020, "Relief with Respect to Specified Time-Sensitive Actions." Provided a three-month extension of 180-day period investors may deposit deferred gains into QOFs.
- IRS Notice 2020-39, June 4, 2020, "Grants of relief for QOF Investors and QOFs." Amplifies Notice 2020-23 by extending the 180-day period to December 31, 2020. Also provides automatic relief to QOFs not meeting the 90 percent investment standard during said period.
- July 31, 2020. "Completed Action Items of the White House Council on Opportunity and Revitalization."
- August 24, 2020: "The Impact of Opportunity Zones," Council of Economic Advisors. Report compares OZ and non-OZ tracts and finds that the designated tracts are "among some of the nation's poorest communities," that the OZ program has attracted investments that would not have flowed to these communities otherwise, and that the OZ designation has caused house prices to rise by 1.1 percent, adding roughly 11 billion in "new wealth" to the one-half of OZ residents that are homeowners. The report concludes that the OZ program is on track to lift up to 1,000,000 people out of poverty.
- August 24, 2020. Executive Order on Targeting Opportunity Zones and Other Distressed Communities for Federal Site Locations. Requires the GSA to give preference "in the process for meeting Federal space needs," to qualified opportunity zones, as well as "other distressed areas, and centralized community business areas (including other specific areas which may be recommended by local officials).

Appendix C: IMPACT Act – Key Provisions

- **<u>Codifies requirements for Qualified Opportunity Funds</u>** to report information on the value of total assets held by the fund, the location and value of Opportunity Zone property held by the fund, whether the property is owned or leased, information on disposed investments during the tax year, information on the location and industry classification codes of businesses receiving equity investments as well as the value of those investments. The IMPACT Act also requires reporting on the number of persons employed through OZ investments, thereby providing data on job creation and firm growth without burdening small businesses and funds alike.

- **<u>Codifies requirements for investors</u>** to report critical information on Opportunity Zone investments including funds receiving investments, relevant dates on which investments and dispositions are made, descriptions of Opportunity Zone investments, and measures that will continue to allow IRS to track both the deferral and recognition of gains, the trajectory of OZ investments over time, and compliance more broadly.

- **<u>Adds penalties</u>** for both individuals and funds that fail to file the required returns or statements accurately and appropriately and also significantly enhances penalties for any individual who attempts to take advantage of the OZ incentive for fraudulent purposes.

- **<u>Requires that Treasury make public as soon as practicable and annually thereafter</u>** timely, comprehensive information tracking Qualified Opportunity Funds and their corresponding investments into zones.
    - Specifically, Treasury shall make public in the aggregate the total number of funds, the total assets of all funds, the distribution of Opportunity Zone investments across different industry classification codes, the percentage of all Opportunity Zones that have received investment through the incentive, the total amount of Opportunity Fund investments made in each census tract, the distribution of investments in real property and active businesses, data deciphering the sizes of businesses receiving OZ investment, and numbers of jobs created or sustained by those businesses in light of Opportunity Zone investments.

    - In five years and again five years thereafter, Treasury shall work with relevant agencies to provide a comprehensive report on an exhaustive list of economic and demographic data points to provide a holistic view on the impact to each census tract over time. This includes but is not limited to the unemployment rate of the zone, education levels of zone residents, the availability of affordable housing and percentage of income used for rent, impacts to median family income, the presence of specific industries and new business starts that create jobs, home equity impacts for residents, and more. The report will compare these data points with the time periods before these specific tracts were designated as Opportunity Zones and against other low-income communities that are similarly situated but were not selected for OZ designation.

- **<u>The IMPACT Act also ensures the protection of private taxpayer information</u>** currently safeguarded under federal law, thereby protecting competitive and proprietary information critical to the marketplace.

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business could have multiple income-earning centers spread across various OZs. Alternatively, the business can qualify if at least 50 of the services purchased and used by the business (measured by hours or dollars) occur in OZs or if at least 50 percent of its tangible property and management functions are in OZs." See CEA, op. cit.

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