Guest Editor’s Introduction

Daniel Marcin
Government National Mortgage Association

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Introduction

Opportunity Zones (OZs) are the latest federal place-based tax initiative, created by Congress with the Tax Cuts and Jobs Act of 2017.

The essence of OZs is that investors with capital gains can defer taxes on them by reinvesting those gains into business or property in designated low-income census tracts, with the possibility of paying zero federal income tax on any additional capital gains realized from the new investment.

It is too early to issue a fair and full evaluation of Opportunity Zones as a program. OZs have attracted cheerleaders and skeptics, but rulemaking by the Internal Revenue Service (IRS) took several years after the program was enacted, and the impact on investment is still a matter for speculation. Furthermore, the structure of the tax incentive requires holding periods of 5, 7, and 10 years for the investor to realize the most attractive benefits of participation. These interim implementation reports may nonetheless benefit all readers who have an interest in place-based interventions.

Abstract submissions for this symposium were sought on the *Cityscape* website and through announcements in various relevant professional organizations. Thirteen promising topics were selected. Ten sets of authors sent a full draft and at least one revision.

The Law

Opportunity Zones are the first, but probably not the last, major tax code provision to arise out of the enormous growth in the technology sector—in this case, out of Napster and Facebook.[1] The Economic Innovation Group, an organization founded by internet billionaire Sean Parker, put out a paper by Jared Bernstein and Kevin Hassett in 2015 that gave a broad outline of how Opportunity Zones might work (Bernstein and Hassett, 2015). U.S. Senators Cory Booker (D-NJ) and Tim Scott

[1] History of Opportunity Zones. https://eig.org/opportunityzones/history.

(R-SC)[2] became the main boosters of legislation to create Opportunity Zones. The Booker/Scott legislation did not become law on its own but was added into HR 1[3] of 2017, also known as the Tax Cuts and Jobs Act (TCJA), by Senate amendment[4] after not appearing in the original bill.

Opportunity Zones allow investors with capital gains to reinvest that money into Qualified Opportunity Funds (QOF), which then invest in OZs. Doing so has three main benefits.

1. The capital gains tax due on the original investment sale is deferred until the sale of the QOF investment or the end of 2026, whichever comes first.

2. If the investor holds the QOF investment for 5 years, the cost basis of the investment is increased by 10 percent. If held for 7 years, or 2 additional years, the cost basis increases by an additional 5 percent.

3. If the QOF investment is held for 10 years, then no tax is due on any gains on the OZ investment (IRS, 2021a).[5]

For additional discussion of the provisions of the law, see the author's article in an earlier issue of *Cityscape* (Marcin, 2020) and the article by Blake Christian and Hank Berkowitz in this symposium.

With the legislative process completed, the next steps were the regulatory process and the designation process, which happened simultaneously.

The OZ statute required the IRS to draw new lines, both geographic and legal. The law says that investments in Opportunity Zone businesses, partnerships, business property, or stock are eligible for the law's benefits, but the IRS needed to clarify what it means to be an Opportunity Zone business or property. Consider two (absurd) extremes: (a) Should having one employee or post office box in one Opportunity Zone be enough to qualify for OZ benefits? (b) Should having one customer or employee outside an Opportunity Zone be enough to disqualify one from receiving the OZ benefits? The IRS ruled that, to qualify as an Opportunity Zone business, that business must earn at least 50 percent of its gross income from activity inside an OZ. That amount can be computed by either hours of work, dollar amounts of paid-for services, or tangible property (IRS, 2021b). Opportunity Zone business property must be used "substantially all" of the time in an OZ. The IRS gives an example of a landscaping property that is kept overnight in an OZ and then used during the day, sometimes in OZs and sometimes not; to qualify, "substantially all" of that use (at least 70 percent of the time) must be in OZs (IRS, 2021c).

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[2] Opportunity Zones are frequently called "bipartisan" due to the cooperation of Democrat Cory Booker and Republican Tim Scott, but in the end, not a single Democrat voted for the Tax Cuts and Jobs Act in either the House (https://clerk.house.gov/Votes/2017699) or the Senate (https://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=115&session=1&vote=00323#position), so that description is debatable.

[3] "H.R.1 - An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." 115th Congress (2017–18), Public Law 115-97, December 22, 2017. https://www.congress.gov/bill/115th-congress/house-bill/1/text/pl. This is the final public law version of TCJA.

[4] "H.R.1 - An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." 115th Congress (2017-2018), Engrossed Amendment Senate No: 115-97, December 14, 2017. https://www.congress.gov/bill/115th-congress/house-bill/1/text/eas. This version, amended by the Senate, features OZs, whereas the version introduced into the Senate does not.

[5] As with all tax regulations, uncommon exceptions to these broad rules likely occur.

After some initial guidance from the IRS but before the completion of the rulemaking process, each state and territory's executive (usually the governor) was empowered to select OZs within the state. Any "low-income community"[6] qualified, generally a census tract with (a) a 20-percent poverty rate or higher, (b) a median family income of 80 percent or less than the metropolitan median family income, or (c) if not located in a metropolitan area, a median family income less than 80 percent of the state median family income. Executives could also select some tracts contiguous to low-income communities as long as the tract's median income was not more than 25 percent higher than the adjacent low-income community; as long as both the directly qualifying and the contiguous tract were selected; and as long as no more than 5 percent of all designations in that state were contiguous zones.[7] Executives could select 25 percent of all tracts that were eligible, with a minimum of 25 in a state. In total, 8,766 OZs were designated (Community Development Financial Institutions Fund, n.d.).

For future evaluators of this program, a few intergovernmental complications are worth noting. First, OZ benefits are for federal capital gains tax. Most states align their capital gains taxation rules with federal rules; however, some states have moved to decouple from the IRS rules and not provide OZ benefits on any state tax due. Second, the federal government has made several investments of its own in OZs, either with explicit spending or prioritization of grant dollars (White House Opportunity and Revitalization Council, 2020). Thus, any researcher looking to evaluate the effect of OZs will have to pay attention to any confounding factors, such as different treatment across states or different levels of federal spending or investment in OZs compared with the tracts not selected.

Other Place-Based Policies

This is not the first place-based policy for economic revitalization. Previous efforts include the federal Empowerment Zones and Enterprise Communities and various efforts at the state level and internationally. Most other programs were "programs" in a way that Opportunity Zones are not; they had a qualification, application, and selection process, and the selected areas received federal block grant money. By contrast, Opportunity Zones provide direct benefits only to the investors. No direct payment or tax cut is provided to anybody working in an OZ, running an existing business in an OZ, or who already owns property in an OZ, although in theory, all of those people reap indirect benefits from a lowering of the cost of capital (for more information on those other incentives, see Marcin, 2019).

Featured Articles

This symposium begins with an article by Blake Christian and Hank Berkowitz, who provide a summary of how OZs work, detail on some of the more complicated topics, and advice on how states and localities can improve their approach to maximize benefits for their citizens. The authors

[6] "26 U.S. Code § 45D—New Markets Tax Credit." Cornell Law School, Legal Information Institute. https://www.law.cornell.edu/uscode/text/26/45D.

[7] "26 USC 1400Z-1." From Title 26-Internal Revenue Code, Subtitle A-Income Taxes, Chapter 1-Normal Taxes and Surtaxes, Subchapter Z-Opportunity Zones. https://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title26-section1400Z-1&num=0&edition=prelim.

discuss esoteric provisions in simple language and draw clear comparisons between past law and current law and between prohibited investments and allowed investments. In particular, the reader can look to this article for a discussion and examples of how to pair the Low-Income Housing Tax Credit and other federal programs with OZs.

Next is a pair of articles on designations of OZs and missed opportunities or room for improvement in Baltimore and in Oregon, the first from Michael Snidal and Sandra Newman and the second from James Matonte, Robert Parker, and Benjamin Y. Clark. The authors of each article conducted dozens of interviews with a variety of OZ players, and each interviewee critiqued the actions of state or local government. These authors offer a series of constructive suggestions to elected officials and civil servants at all levels of government. Snidal and Newman advocate for the cancellation of OZ designation for several richer tracts; the expansion of OZ benefits to all investors, not just those with eligible capital gains; greater reporting requirements; and a greater role for Community Development Financial Institutions. Matonte, Parker, and Clark suggest that greater networking is needed between community advocates, investors, and governments, and that all players can contribute more to that effort. The authors note that these census tracts may suffer less from taxes on capital investment being too high than from the barriers to investment in people.

The next two articles cluster the OZs selected by the executives into groups based on common characteristics. The first is from Janet Li, Richard Duckworth, and Erich Yost of HUD and the second from Jamaal Green of the University of Pennsylvania and Wei Shi of Travelers Insurance. Only about 25 percent of eligible tracts could be selected, but what are some descriptive statistics on those tracts? Each paper uses principal components analysis to break down the set of OZs into just a few clusters. Li, Duckworth, and Yost categorize OZs into five broad categories: "rural, small-town, and tribal communities (35 percent of Opportunity Zones); underinvested majority-Black communities (26 percent); suburban majority-Hispanic families (19 percent); growing job hubs (13 percent); and metropolitan immigrant communities (6 percent)."[8] Green and Shi use employment data and the Census Neighborhood Deprivation Index to find nine groups of OZs, with two clusters appearing to be high-opportunity, high-employment, high-investment tracts, which were selected as OZs at higher rates than other clusters' tracts. This case study in Portland indicates that tracts with low need may have crowded more disinvested areas out of designation.

Some analysts treat OZs as simply a real estate investment tax cut. Yanling Mayer and Edward Pierzak examine the effect of OZ designation on single-family home prices by comparing the CoreLogic data between OZs and tracts that were eligible for OZ designation but not selected. With a difference-in-difference approach and a rich set of control variables thanks to the detailed CoreLogic data, the authors find that OZ tracts saw lower home price appreciation than did non-selected tracts before 2017. After 2017, however, OZ tracts had a 6.8-percent greater home price appreciation through 2020 over the eligible-but-not-selected tracts. Mayer and Pierzak also looked at the age of properties and hypothesize that older properties will more likely be investment properties; the authors' analysis confirms a larger premium for OZ designation for older properties.

An increasing focus of U.S. housing research is on *gentrification*. Haydar Kurban, Charlotte Otabor, Bethel Cole-Smith, and Gauri Shankar Gautam examine this trend in OZs in the District of

[8] Li, Duckworth, and Yost, this volume, page 75.

Columbia. The authors define gentrification as a greater-than-average change in the percentage of tract residents older than age 25 with a bachelor's degree. They compare business and residential vacancies against their gentrification measure and try to predict where investment will occur in OZs in D.C. With D.C. government data, the authors are able to analyze migration into and out of tracts across the city—in particular, they can identify the education level and income of the residents who are coming and going. Although D.C. as a whole is gentrifying at a positive rate, most OZs do not have a gentrification score higher than the city average.

Another increasing focus of social science is the relationship between the built environment and human health. Michelle Madeley, Alexis Rourk Reyes, and Rachel Bernstein describe efforts at the Environmental Protection Agency (EPA) to create communities with healthy economies, environments, and people through OZs. The authors led the creation of an OZ Mapper tool, which allows users to easily compare the EPA data against OZ designation and other publicly available data sources. For example, they show that 65 percent of OZs contain a floodplain, and 47 percent contain impaired water sources. The article tells a story of how EPA has used the OZ Mapper to customize its approach to investing in each community. Four examples show how OZs compare with brownfields, social vulnerability, walkability, flood risks, impaired waters, and food deserts. The authors have prepared additional resources that would help communities develop a prospectus, with the goal of maximizing the positive impact of investments in those areas.

Sara Harvey explores the possibility of pairing clean energy investments, in terms of both educating a new workforce and hardware installation, with OZs. The article examines existing anchor institutions and community solar installations and comes up with a series of recommendations for realizing the potential that OZs have for this industry.

Finally, practitioners may profit from Joseph Fraker's contribution, which looks at some recent local attempts to redraw census tract boundaries to expand the areas eligible for OZ investment. Although OZs were drawn based on census tracts as defined at the time of enactment of the TCJA in 2017, whether tract boundary changes would imply OZ boundary changes was not fully clear. After a period of confusion and attempts by interested parties to have their preferred areas drawn into existing OZs, regulators clarified that the boundaries of OZs would stay the same forever, even if the tract that they were based on changed its boundaries in 2020. Fraker reviews the history of the tract as a unit and presents details from a case study in Baltimore County, Maryland.

Future Research Needs

Researchers attempting national overviews of the OZ program in the near future will likely experience considerable frustration. Although IRS form 8996 requires much more granular information now than did the first draft—including the investment value by tract, specific business or property, and fund in each year—how much of that data the IRS will make available to researchers or the public is not clear at this point.

Because OZs do not have any formal stated goals or targets, many metrics will be employed by which to evaluate them. Backers of the program have called it an anti-poverty program or a racial equality program, and opponents have called it a gentrification program. Researchers will face the

typical challenges to determining program impact: designation is not random, states treat OZs differently, OZs are on different trend paths before designation, and federal and state governments are actively interfering in a clean evaluation by adding additional incentives or spending to some OZs. The country will owe a great debt to analysts who can overcome those challenges.

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Guest Editor

Daniel Marcin is a senior financial economist in the Economic Modeling and Analytics Division, Office of Enterprise Risk, Government National Mortgage Association (Ginnie Mae), a wholly owned corporation of the U.S. Department of Housing and Urban Development. From 2018 to 2020, he was an economist in the Public Finance and Regulatory Analysis Division, Office of Policy Development and Research at HUD, where he also served as the nonpolitical lead on the OZ Work Group. He can be reached by email at daniel.s.marcin@hud.gov or by phone at 202–402–2967.

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