PRELIMINARY – COMMENTS WELCOME

Opportunity Zones:
An Analysis of the Policy's Implications for Investors, Policymakers, and Constituents

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Abstract

The Opportunity Zone tax incentive was established as part of the Tax Cuts and Jobs Act of 2017. This incentive provides investors with favorable capital gains tax treatment on existing appreciated investments if the proceeds are converted into new investments in selected low-income neighborhoods throughout the U.S. We summarize key provisions of the law and provide demographic and descriptive statistics on the 8,762 selected Opportunity Zones. We also outline considerations for investors when deploying capital in the designated Zones, and we present sample calculations to quantify the tax benefits and discuss associated investment features, such as the intrinsic option value of the deferral as well as the "tax carry" and related leverage effects. In addition, we use publicly-available data on projects funded by the New Markets Tax Credit to inform expectations of responses to this new tax incentive. Finally, we outline potential concerns for the success of the policy and make recommendations for required reporting by taxpayers, Opportunity Funds, and state and local governments. Such reporting would permit analysis of the extent to which the policy achieves its primary goal of improving economic conditions in low-income communities.

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1. Introduction

Opportunity Zones ("Zones") were established in the Tax Cuts and Jobs Act of 2017 as an innovative way to encourage economic development and job creation in low-income communities across the U.S. Specifically, this incentive provides investors with the deferral and reduction of capital gains taxes on existing appreciated investments if proceeds are converted into new investments in designated areas, with further capital gains tax reductions if the Zone investments are held for ten years. While the general public remains largely unaware of the incentive, Kevin Hassett, the current Chair of the White House's Council of Economic Advisors and one of the original architects of the incentive, stated that Opportunity Zones "could turn out to be one of the most noteworthy provisions in the law ten years from now."[1]

The Opportunity Zone incentive is a bold idea: a broad tax incentive to unlock wealth and deploy it across America by stimulating free-market investment in low-income areas. In the first part of this paper, we summarize key components of the incentive, including descriptive statistics of the selected Opportunity Zones (Section 2), the types of eligible investments (Section 3), and the mechanics of the tax benefits (Section 4). We then analyze possible outcomes of the incentive by comparing it to data on prior "place-based" incentives (Section 5) and discuss important issues for the implementation and success of the policy (Section 6). Finally, Section 7 includes recommendations for reporting by participating taxpayers, investment funds, and localities to enable future analyses of the effectiveness of the incentive in improving local economic conditions.

[1] https://www.taxnotes.com/tax-notes-today/tax-reform/hassett-touts-bonuses-early-signal-tax-cuts-working/2018/ 02/05/26vk2

2. Overview of designated Opportunity Zones and the nomination process

2.1 Overview of the incentive

Opportunity Zones are designated low-income communities and include rural, suburban, and urban areas in each of the fifty states, as well as five U.S. territories and the District of Columbia. The governor of each state selected up to 25 percent of eligible census tracts as Opportunity Zones, which were subsequently approved by the U.S. Department of the Treasury.[2] In total, there are 8,762 Opportunity Zones.[3]

A census tract was eligible for the Opportunity Zone designation if either the median income in the tract was no greater than 80 percent of the area's median family income, or if the tract had a poverty rate in excess of 20 percent.[4] The selected Opportunity Zones therefore reflect the income disparity across the US. For instance, 80 percent of the median income for the four highest-income states in the country is higher than the national median income of $69,946.[5] As a specific example, 80 percent of New Jersey's median income is $72,606, four percent higher than the national median and 62 percent more than the comparable amount for New Mexico ($44,720).[6] These data suggest that the needs of these low-income areas – as well as the local investment opportunities – will vary greatly across states and zones.

2.2 Descriptive statistics on the selected Zones

Exhibit 1 summarizes key statistics of the confirmed Opportunity Zones and provides demographic details by state. Data are obtained from the U.S. Treasury CDFI Fund's website, as well as from the U.S. Census Bureau's American FactFinder. The most populous states report the most Zones, including California (879), Florida (427), Illinois (327), New York (514), Ohio (320), Pennsylvania (300), and Texas (628). Puerto Rico also has a large number of Zones (861).[7] The median income of the Zones is $39,968, ranging from $32,453 in Georgia to $58,072 in New Hampshire. The average poverty rate across the Zones is 30.4 percent, as compared to a national average poverty rate of 15.4 percent. The states with the highest poverty rates in the Zones (equal to or above 31.0 percent)

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[2] Counties are subdivided into census tracts, which can be thought of generally as neighborhoods with average population of 2,500-8,000 people. See https://www.census.gov/geo/reference/gtc/gtc_ct.html.

[3] https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx.

[4] Tract eligibility was overseen by the U.S. Treasury CDFI Fund. States were also able to select census tracts that did not meet the criteria but were contiguous with other qualifying zones, subject to certain limitations (discussed further below).

[5] This median income is calculated using census tract-level data and differs slightly from the state-level median income of $67,871 from the Census website (https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_16 _5YR_B19113 &prodType=table).

[6] Ibid.

[7] While states were limited to selecting 25 percent of the low-income tracts as Opportunity Zones, all 861 low-income tracts in Puerto Rico qualify (IRC §1400Z-1(b)(3) as added by the Bipartisan Budget Act of 2018)

include California, Georgia, Illinois, Kentucky, Louisiana, and Pennsylvania. The designated Zones include over 14.0 percent of the state population in Vermont, Mississippi, and Wyoming.

A comparison of two specific Opportunity Zones illustrates the variation in the types of communities that stand to benefit from the incentive. The first, Census Tract 55031021100, is one of Wisconsin's 120 Opportunity Zones.[8] This zone includes the town of Superior, with a median income of $41,030.[9] Superior is a transportation hub along the Great Lakes for trade in ore and timber; its prominence has declined in recent years as the U.S. economy has shifted to technology and services industries. By comparison, Census Tract 06081612100 is one of California's 879 Opportunity Zones.[10] With median income of $53,000 and a location only three miles from Stanford University in the heart of Silicon Valley, this zone could benefit from the sustained success of the nearby venture capital and technology industries. Investment outcomes will be a function of the extent to which communities such as Superior promote and attract investment capital, as well as investors' preferences for each tract's local opportunities.

2.3 Nomination process

The law resulted in three interesting features of the designation process. Governors were delegated to select the Zones and had wide latitude in how this was accomplished. Consequently, there was considerable variation in how Zones in each state were selected for federal approval. In Congressional testimony on May 17, 2018, John Lettieri (President and Co-founder of the Economic Innovation Group, the organization that first advocated for this policy) highlighted the variation in methods that states used, ranging from proportional distribution of Zones among eligible counties to use of data analytics to identify locations particularly poised for economic growth.[11] A review of each state's Opportunity Zone website (hyperlinked in Exhibit 1) provides additional details on these selection methods. For example, California's Department of Finance originally used an entirely data-driven process that did not incorporate certain tract-specific factors, such as student populations that reduce a tract's median income. This process resulted in the designation of tracts with college campuses, including Stanford University and San Diego State University, and was critiqued for generating an "incomplete, and occasionally misleading, evaluation of realities on the ground."[12] California's state government

[8] https://www.wheda.com/Opportunity-Zones/
[9] https://factfinder.census.gov/faces/nav/jsf/pages/community_facts.xhtml#
[10] http://dof.ca.gov/Forecasting/Demographics/opportunity_zones/
[11] https://www.jec.senate.gov/public/_cache/files/a5c8907c-d1a9-47c4-99ad-6c9fc1d7727c/john-lettieri-testimony.pdf
[12] https://eig.org/wp-content/uploads/2018/03/EIG-Comment-Letter-re-CA-Opportunity-Zones.pdf

responded to the criticisms by issuing revised recommendations that reflected the public response. Colorado reports that it "took public input and collaborated with regional economic development partners who brought extensive human intelligence to the table" in selecting its 126 zones.[13] Many states, such as Massachusetts, posted applications so that residents could nominate particular areas for consideration.[14]

Second, the law permitted governors to select contiguous tracts – tracts that neighbor Opportunity Zones but that did not otherwise meet the income thresholds – to qualify. This provision allowed governors to designate large geographic areas without having to carve out specific non-qualifying neighborhoods. The law limits the designation of these zones to 5 percent of a state's overall designations, and any tract exceeding 125 percent of the median income of the neighboring zone is ineligible.[15] Exhibit 1 shows that a total of 198 contiguous zones were selected, representing 2.3 percent of all zones, or less than half of the permissible limit.[16] Furthermore, twelve states (and the District of Columbia) did not designate any contiguous zones. Thus, while some selected zones may not meet the low-income definition as required by the statute, there are relatively few of these contiguous zones that are able to receive tax-advantaged investment dollars under this program. However, if investors perceive these higher-income areas to present better investment opportunities, the contiguous zones may receive a disproportionate amount of investment funds.

Third, all governors were allowed to select a minimum of 25 tracts, permitting smaller population states to designate a higher percentage of eligible tracts than otherwise allowed under the statute. Eight low-population states explicitly benefit from this provision, selecting a total of 71 additional Zones to reach the minimum number of 25 tracts within their respective jurisdictions.[17]

[13] https://choosecolorado.com/oz/

[14] https://www.mass.gov/doc/opportunity-zone-workbook-32118

[15] IRC §1400Z-1(e)

[16] Minnesota, for instance, selected only one of its 128 Opportunity Zones to be a contiguous tract. Specifically, Census Tract 27123036000 is located near downtown St. Paul, adjacent to and across the river from two other Zones. By adding this contiguous tract, the city of St. Paul identified a long stretch along both sides of the Mississippi River to qualify for the incentive.

[17] States that benefited from this include Alaska (11 extra Zones), Delaware (5), Montana (2), North Dakota (12), Rhode Island (5), South Dakota (7), Vermont (13), and Wyoming (16).

3. Eligible investments and considerations for investors

3.1 Eligible investments

The Opportunity Zone incentive is place-based, meaning that it intends to enhance the economic performance of specific geographic areas. To encourage capital flows to the designated Zones, the law imposes few restrictions on qualifying investment type or purpose, allowing investment across a variety of asset classes. Taxpayers establish Opportunity Funds, which are corporate or partnership investment vehicles, to invest in the designated tracts. A key requirement of these Funds is that 90 percent of the fund's assets are qualifying businesses or properties located in the designated areas.[18] Exhibit 2 provides examples of potential assets and illustrates the breadth of this incentive across a number of different investment classes.

3.2 Considerations for investors

Local officials and policy makers generally prefer investments that exhibit direct benefits to the broadest group of constituents over the longest term. However, the law does not require that the selected investments demonstrate any expected social benefits to qualify for the tax incentive. Consequently, the extent to which local projects align with policy initiatives will reflect investors' preferences for both financial returns and social impact. Some investors will select projects with the greatest expected financial returns. Other investors may prefer projects that generate financial returns but also provide measurable benefits to local communities. Two characteristics of projects to consider include the following:

Extent of the effects on the local population: Many investments could have indirect effects on the local population via local employment opportunities or increased wages, whereas other projects will generate more direct effects on the community (such as building additional affordable housing units). Investors may also weigh whether these direct effects are targeted at particular population groups (such as children that would benefit from after-school programs in certain community centers) or whether the investments affect the larger Zone population (such as the funding of infrastructure-related projects).

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[18] IRC §1400Z-2(d)(1). Qualified Opportunity Funds are established as either partnerships or corporations. Qualifying opportunity zone property in which the Funds can invest includes stock, partnership interests, or property as defined in the Tax Cuts and Jobs Act of 2017. There remain many open technical questions, including issues related fund structure, qualifying investment assets, and requirements for substantial improvement of property for which additional guidance from Treasury is needed. The IRS has begun to publish some guidance in the form of responses to Frequently Asked Questions (https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions).

Time horizon for the investment benefits: Given that investors need to hold the project for ten years to realize the incentive's full tax benefits, qualifying projects will likely have a longer-term horizon.[19] However, investors may have differing preferences regarding the period over which the investment generates benefits for the community. For example, the construction of new facilities in a Zone could result in additional employment (assuming local residents are hired), but the types of facilities built could generate very different employment outcomes: a data center to house a corporate investor's servers could result in very few spillover effects on the community, whereas the construction of a new water treatment facility would increase employment opportunities and also affect local residents for many years, even after the ten year expiration of the Opportunity Zone policy.

Because financial performance and social impact are not mutually exclusive traits, the most effective investments from a policy perspective will be those that both maximize investor returns and have long-lasting effects on the existing residents. Identifying these optimal projects will require engagement from local officials and groups with awareness of these potential opportunities, as well as investment advisors with the ability to accurately estimate expected returns.

[19] The statute includes one exception which states that property initially held within a zone would continue to qualify for reduced capital gains, even if re-located to another jurisdiction by that same business (IRC §1400Z-2(d)(3)(B)). The property ceases to qualify for treatment at the earlier of i) when the property is sold, or ii) five years after it is moved out of the zone. Additional regulatory guidance is needed to clarify this provision. See also discussion in Mount, S. 2018. *New Program Allows Deferral and Possible Forgiveness of Capital Gains Invested in Low-Income Community Businesses.* Tax Management Real Estate Journal 34(2).

4. Opportunity Zone investment tax benefits

4.1 Summary and example of tax benefits

To participate in the Opportunity Zone incentive, taxpayers first sell existing investments, such as appreciated stock or real estate, and contribute the cash proceeds up to the full amount of realized capital gains from such investments into Opportunity Funds.

For example, assume an individual made an original investment of $350.00 in a technology company several years ago that is worth $450.00 today, resulting in $100.00 of long-term capital gains. If an investor sold this investment at the end of 2018, he/she would incur taxes of $20.00 and retain after-tax cash proceeds of $430.00.[20] Alternatively, the investor could defer the $20.00 capital gains tax liability by investing $100.00 into Opportunity Zones within 180 days of the sale. The taxes on the original capital gains would be due at the earlier of the sale of the Opportunity Zone investment or the end of 2026. This example calculation is included in Exhibit 3.

Investors receive the following immediate and future tax incentives:

(i) a *current deferral* on the capital gains tax that would otherwise be due upon the sale of appreciated investment assets. The deferral reduces the net present value of the investor's capital gains tax liability;

(ii) a *future reduction* of 15 percent (10 percent) of the capital gains tax liability if the investment is held by the taxpayer for at least seven (five) years;[21] and

(iii) a *future exclusion* of all capital gains earned on the appreciation of the Opportunity Zones investment if it is held for at least ten years.[22]

Continuing the previous example, suppose the $100.00 Opportunity Zone investment is sold for $215.89 ten years later, resulting in capital gains on the Opportunity Zone investment of $115.89.[23] Because the investment was held for more than seven years, the tax due on the original capital gain of $20.00 will have been reduced by 15 percent to $17.00. For comparison, this $17.00 tax liability for the 2026 tax year is approximately

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[20] The tax is calculated as $100 of gains, multiplied by the current long-term capital gains rate (20 percent). The example ignores any effects of the net investment income tax rate (3.8 percent).

[21] The mechanism to allow for a reduction in capital gains tax is an increase in the tax basis of the Opportunity Zone investment by 10 percent if the investment in the qualified opportunity zone fund is held by the taxpayer for at least 5 years, and by an additional 5 percent if held for at least 7 years (for a total exclusion of 15 percent of the original gain from taxation). Clarification is needed as to whether gains reclassified as ordinary income under §1245 and §1250 recapture will qualify for deferral.

[22] Opportunity Zone designations end by December 2028, and thus additional clarification is necessary to ensure that taxpayers who invest after 2018 would continue to receive the exclusion if they hold property for the full ten-year period (Wallwork, A and Schakel, L. 2018. Primer on Qualified Opportunity Zones. *Tax Notes*, May 14.)

[23] Assumes an 8 percent annual return on the investment.

$9.18 at the end of 2018 in net present value terms, equivalent to 45.9 percent of the taxes otherwise due.[24] Thus, the combination of the tax deferral and the 10-15 percent reduction in the amount of the liability reduce the net present value of the tax liability by over half.

Furthermore, because the Opportunity Zone investment was held for ten years, the additional $115.89 in gains would be tax free, for an additional cash tax savings of $23.18.

The total cash tax savings from the Opportunity Zone investment would be $26.18, equal to the sum of the $3.00 tax savings from the basis step-up ($20.00-$17.00) and $23.18 from the permanent gain exclusion. The effective tax rate on the total appreciation of $215.89 (of which $100 is attributable to the original investment, and $115.89 is attributable to the appreciation of the Opportunity Zone investment) is 7.9 percent, less than half of the statutory capital gains tax rate.

4.2 Related tax considerations

Furthermore, there are other tax considerations that make the incentive even more attractive to investors:

Intrinsic option value: In addition to the tax savings outlined above, the multi-year tax deferral option embedded in the Opportunity Zone incentive has intrinsic option value in that it allows a taxpayer to manage his/her tax liability across a number of years. For example, suppose a couple sold their house to move into a smaller one in anticipation of retirement. The retirees could convert the capital gains into an Opportunity Fund and realize taxes upon retirement, in a period where they will likely have lower income and thus be subject to a lower tax rate.

Additional capital for Zone investment and the tax carry: The tax deferral benefit increases the upfront principal for the Opportunity Zone investment. Continuing the example above and assuming that this gain represents the only capital gains to invest, the individual can invest $100 in the Opportunity Zone rather than the $80 otherwise available after paying capital gains taxes today. If held for less than five years, this additional $20 is effectively a zero interest rate "loan" from the government that is repaid when the investment is sold. If the investment is held for five or more years, then the "loan" is repaid as a 2026 tax liability, but at a lower amount ($17in the example above assuming a seven year holding period), implying even a "negative" interest rate. Furthermore, the gains on these “tax carry dollars” face a zero rate of tax if the Opportunity Zone investment is held for ten years.

[24] Assumes an 8 percent discount rate.

Leverage effects: The tax deferral effects can be further multiplied using leverage to finance the investment project. Continuing the example above, assume an individual would otherwise invest $80 after-tax in a real estate project financed using 25 percent equity and 75 percent debt, for a total purchase price of $320. With the Opportunity Zone incentive, the investor now can contribute $100 of equity to invest in even larger projects with a purchase price of $400. This incentive could have additional effects on the amount and contractual terms of debt financing agreements, as well as price effects on property and investments in the Zone areas.

4.3 Additional tax considerations for investors

The law has a number of important nuances relevant for investors. First, the law states that only the amount equivalent to the capital gains are eligible for preferential tax treatment – that is, the $100 in the example above. There are at least two implications of this requirement. The first is that only taxpayers with capital assets – and unrealized gains on those assets – can participate in this incentive. The second relates to the amount that investors will contribute. Specifically, if an individual contributes the entire proceeds from a previous investment (such as the $450 received from selling the appreciated stock) into an Opportunity Zone Fund, the component not attributable to the capital gain will be subject to regular tax treatment (the $350 in the above example). All appreciation on this component will be subject to tax upon the sale of the investment.[25] Therefore, investors will be required to separately track the two components to ensure the appropriate tax treatment. Alternatively, investors may choose to only invest the amount equivalent to the capital gains ($100) in the Zones.

Further, recall that the original capital gains liability from an investor's pre-existing investment can be reduced by 15 percent if the investor holds the Zone investment for at least seven years, and that the original capital gains taxes will be payable as part of the investor's 2026 tax liability. This timeframe means that eligible capital must be invested by the end of 2019 to qualify for the full 15 percent discount, such that investors need to react quickly to identify investment projects and establish Opportunity Zone funds. As an additional matter, the 2026 tax liability ($17.00 from the example in Exhibit 3) will need to be paid with other sources of cash, given that the Opportunity Zone investment must be retained until 2028 to qualify for the ten year capital gains exclusion. More guidance from the Treasury Department will be necessary to clarify these and many other questions related to the implementation and ongoing tax treatment of the incentive.

[25] IRC §1400Z-2(e)(1)

5. Possible outcomes based on comparison to prior place-based tax incentives

5.1 Comparison to New Markets Tax Credit

Policies for place-based tax incentives and development programs have been used since the 1970s to encourage the deployment of capital in low-income areas. Examples of these programs include Empowerment Zones and Enterprise Cities, both of which were first introduced as part of the Omnibus Reconciliation Act of 1993. Many academic studies have tested the effects of Empowerment Zones, but the research has produced mixed results - in part due to the difficulty in measuring outcomes because of the variety of incentives concurrently provided to the designated jurisdictions.

The Opportunity Zone incentive closely resembles the New Markets Tax Credit (NMTC) program, which was created as part of the Community Renewal Act of 2000. This program provides capital to fund a wide class of investments in low-income census tracts. Academic research finds some positive responses to the NMTC. For example, using tax return data, Gurley-Calvez et al. (2009) find that the invested funds appear to be incremental or "new" investment capital invested, consistent with the policy goal of encouraging individual investors to consider a new asset class.[26] Furthermore, Freedman (2012) finds that areas that receive New Market Tax Credit funds exhibit a modest decrease in poverty and unemployment rates and small positive effects on total employment and the quality of jobs.[27] Harger and Ross (2016) also find increases in employment in recipient areas, but the effects are concentrated within manufacturing and retail industries.[28] While these documented effects are generally positive, Freedman (2012) states that existing residents may not be the recipients of these improved economic conditions; rather, the recipient neighborhoods are changing – consistent with communities gentrifying and the possible crowding out of local residents.

There are several similarities between the NMTC program and the Opportunity Zone tax incentive. Both reflect the fundamental goal of deploying private capital in low-income neighborhoods to improve local economies. To do so, both policies provide preferential tax treatment for local investments that is predicated on holding the investment for a certain period of time: the NMTC program provides tax credits for investment held for 7

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[26] Gurley-Calvez, T., Gilbert, T., Harper, K., Marples, D., and Daly, K. 2009. Do Tax Incentives Affect Investment? An Analysis of the New Markets Tax Credit. *Public Finance Review* 37(4), 371-398. While the findings for individual investment are consistent with the intended policy goals, the paper also finds that there is no change in corporate investment dollars, suggesting that companies are not investing additional amounts but rather switching between different investment classes.

[27] Freedman, M. 2012. Teaching new markets old tricks: The effects of subsidized investment on low-income neighborhoods. *Journal of Public Economics* 96, 1000-1014.

[28] Harger, K. and Ross, A. 2016. Do Capital Tax Incentives Attract New Businesses? Evidence Across Industries from the New Markets Tax Credit. *Journal of Regional Science*, 56(5), 733-753.

years, whereas the OZ incentive provides capital gains tax reductions over 5-, 7-, and 10-year horizons. The two policies also both provide funding at the census tract level.

There are at least two notable differences between these two programs. Qualification for NMTCs requires investors to submit a written proposal to the government, which must be approved before the investment can be awarded funds through a certified Community Development Entity. In contrast, Opportunity Funds will be able to self-certify, removing a large administrative step in qualification.[29] Second, funding for the NMTC is capped, whereas participation in the OZ program is not. Due to the limited available funds for NMTC, only 16.1 percent of applications from 2003 to 2017 received funding.[30] This low percentage demonstrates the excess demand for these types of investments and suggests that there could be a much larger response to the new, more expansive incentive. Furthermore, prior research, as well as analyses of publicly-available NMTC data from the CDFI website, show that there has been a growing number of approved projects since 2010, confirming investors' continued interest in these grants. Exhibit 4, Panel A provides the number of approved projects by year for the period 2001 through 2015. [31]

Further analyses of the publicly-available NMTC data provide insight into potential outcomes from the Opportunity Zone incentive. First, Panel B of Exhibit 4 shows that the majority of NMTC funds (82.7 percent) were allocated to metropolitan areas. Despite this seemingly high percentage within metropolitan census tracts, it reflects a 2004 amendment to the NMTC statute, which required that a proportionate share of NMTC funds be allocated to non-metropolitan areas. Thus, we may observe even higher amounts of Opportunity Zone investments in cities given the lack of an administrative approval process to impose similar restrictions.

Second, analysis of the stated purpose of NMTC funds provides insight into the types of projects likely to be funded in Opportunity Zones. Exhibit 4, Panel C shows that approximately 36.3 percent of the NMTC funds were used for "Business Financing" or "Microenterprise" – presumably providing capital for local businesses. Approximately 63.7 percent of the NMTC projects relate to real estate or construction projects, including rehabilitation of existing properties as well as new construction of commercial properties. This allocation of funds implies that a significant portion of Opportunity Zone capital

[29] https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions, response to "How does a taxpayer become certified as a Qualified Opportunity Fund?"

[30] New Markets Tax Credit Coalition. 2018. *New Markets Tax Credit Progress Report*. Accessed at http://nmtccoalition.org/progress-report.

[31] The data used for these analyses was obtained at https://www.cdfifund.gov/Documents/Forms/DataReleases.aspx.

may be invested in the construction and real estate sector.[32] In a recent report, the New Markets Tax Credit Coalition states that the specific projects financed in 2017 with the NMTC related to manufacturing (18.5 percent); mixed use properties (17.7 percent); healthcare (13.3 percent); schools (11.8 percent); child and youth services (7.0 percent); and community services (5.9 percent) - with the remaining 25.8 percent allocated among thirteen other categories ranging from groceries to hotels. However, because the approval process for the NMTC prioritizes certain types of projects focused on the local population, this allocation may not necessarily be representative of Zone projects.[33]

Third, one criticism of the NMTC is that the recipient communities were not geographically dispersed. While 39 percent of U.S. Census tracts qualified for NMTC, approximately 50 percent of the selected projects (by count and by dollars awarded) were concentrated in ten states, as seen in Exhibit 4, Panel D. In contrast, the ten states with the fewest number of NMTC projects collectively accounted for only 2.5 percent of projects. Whether this similar distribution will occur with Opportunity Zones will be a function of investors' preferences and the ability of local governments and community organizations to attract capital into their respective jurisdictions.

Finally, the NMTC program suggests the extent to which disproportionate amounts of investment could be made in contiguous zones, which are zones that do not qualify as low-income under the statute (as discussed previously). While some contiguous zones were eligible for the NMTC, a recent report found "no evidence that [investment was] concentrated in eligible tracts adjacent to affluent areas" and instead that projects were "concentrated in highly distressed census tracts surrounded by other distressed areas."[34] However, these results – and other characteristics of the NMTC program – may not generalize to Opportunity Zone funds due to the lack of an up-front government Opportunity Fund certification process. While this feature enables more taxpayers to claim the incentive, it also means that there is very little to no oversight to ensure that the types and locations of the projects are consistent with the goal of improving local economic conditions. Instead, the distribution of investment capital will be driven largely by market forces.

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[32] It is important to note that we are unable to perform analyses of the underlying purposes of these projects with the publicly-available data, and thus we cannot comment on the ultimate use of these new facilities.

[33] For example, the NMTC selection process prioritizes proposals that demonstrate certain characteristics, such as (i) significant impact to the local community (job creation, services for low-income families, and "innovative activities"); (ii) applicants with prior experience making loans and equity investments in under-served communities; and (iii) location in one of ten states with historically low amounts of NMTC investment. (New Markets Tax Credit Coalition. 2018. *New Markets Tax Credit Progress Report*. Accessed at http://nmtccoalition.org/progress-report.)

[34] Ibid.

5.2 Comparison with §1031 exchanges

In addition to similarities with previous place-based incentives, the tax incentives for Opportunity Zones resemble "like-kind exchanges" under IRC §1031 ("Sec. 1031" or "1031 Exchanges"), in that both permit deferral of capital gains tax. However, there is an important distinction between these two provisions.

Specifically, 1031 Exchange treatment limits reinvestment of the proceeds from a sale to new investment in a similar asset class, most commonly real estate. In contrast, the capital gains deferral under the Opportunity Zone incentive applies to any realized capital gain that is invested in any qualifying investments within a designated Opportunity Zone. For instance, gains from an investment in a mutual fund could be converted into a new real estate investment in an Opportunity Zone, whereas comparable treatment under §1031 would require the initial funds to come from an existing real estate investment. The Opportunity Zone incentive is structurally less rigid than predecessor policies to accommodate a wider range of investment opportunities. Therefore, the total amount of capital participating in the Opportunity Zone incentive could be significantly larger than existing incentives.

6. Political uncertainty and policy concerns

6.1 Legislative support for the incentive

A primary concern is that Congress will repeal the Opportunity Zone incentive. However, legislative history and broad bi-partisan political support suggest that the risk of full repeal may be low.

The original idea was conceptualized in a 2015 white paper by the Economic Innovation Group (EIG), a bipartisan Washington organization funded by leading entrepreneurs, investors, and policy makers. The idea was included in legislation called the Investing in Opportunity Act that was introduced to Congress in 2017 by Senators Cory Booker (D) and Tim Scott (R), as well as Congressmen Pat Tiberi (R) and Ron Kind (D).[35] The proposal had over one hundred Democrat and Republican congressional co-sponsors when it was included in the Tax Cuts and Jobs Act of 2017, suggesting broad bipartisan support.[36] Given the 50-state nature of the bill and the high degree of latitude states were given in designating their zones, elected officials in both parties have expressed strong support for the policy to date. For example, Chairman of the Joint Economic Committee Rep. Erik Paulsen (R) stated that "Opportunity Zones hold the promise of flexible, innovative solutions." Similarly, Senator Martin Heinrich (D) also stated that Opportunity Zones "can help lift living standards in neighborhoods across the country."

6.2 Other policy and implementation concerns

There are at least four additional concerns with the incentive that could jeopardize its long-term success.

The first relates to which populations will most benefit from this incentive. While the goal is to improve local economic conditions in low-income neighborhoods, returns on investments may accrue in large part to investors. This can first be evaluated by assessing the group of eligible investors, relative to ineligible investors. To participate, a taxpayer must have existing unrealized capital gains to roll into an Opportunity Zone fund. Thus, the tax incentives will be claimed by the relatively small proportion of Americans with appreciated assets.[37]

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[35] https://www.congress.gov/bill/115th-congress/senate-bill/293

[36] http://eig.org/opportunityzones/history

[37] In 2010, families in the top 5 percent income band (with incomes in excess of $200,000 per year) “held 63 percent of the gross worth of nonresidential assets” and "47 percent of the total value of all capital assets." https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51831-capitalgains.pdf

Furthermore, because Opportunity Zone investments are not required to demonstrate specific benefits to the existing local population, investors may select projects based solely on their financial return, with little local social impact. While this could result in an improvement of local economic conditions, it could raise prices such that existing residents would be forced to relocate.[38] For example, in response to the Opportunity Zones proposed by California's Governor, the California Reinvestment Coalition stated that "this program, as currently structured, will contribute to displacement of low-income residents and residents of color in the selected census tracts." The extent to which the existing residents reap benefits from investments in the designated tracts is an open question.

The second concern relates to investors. For the program to succeed, investors will need to identify attractive investment opportunities, establish qualifying funds to invest in those opportunities, and hold the investments for a specified duration. The market for Opportunity Zone investments is nascent, with several private sector enterprises currently forming funds. Incentives to invest could diminish if viable opportunities are not identified relatively quickly, given that the current policy is only in place for a ten-year period and that the value of the tax deferral declines as investors delay. Investors and investment advisors may be unable to act quickly if they are waiting for additional regulatory guidance on critical issues related to implementation of the law. However, there appears to be growing interest in the investor community, suggesting a lack of investor capital may not be a constraint on the effectiveness of this program.

The third concern relates to local governments seeking capital in their home jurisdictions. Given the large number of tracts and the diversity of investment opportunities, some good projects may exist but remain unfunded unless local governments actively pursue and attract investors to their particular selected Zones. Furthermore, while the capital gains tax benefits are not predicated on a required certification or approval from the federal, state, or local jurisdiction, mayors and county officials can affect the types of projects selected because local approvals are often needed for large development proposals and permits. These officials can also induce investment by providing additional local tax incentives. An effective strategy for attracting capital will therefore require local officials to be educated about the incentive and also to be strategic with respect to attracting projects that can generate returns for both investors and local residents.

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[38] Looney, A. 2018. Will Opportunity Zones help distressed residents or be a tax cut for gentrification? Accessed at https://www.brookings.edu/blog/up-front/2018/02/26/will-opportunity-zones-help-distressed-residents-or-be-a-tax-cut-for-gentrification/.

Finally, the incentive may present issues for policy-makers and taxpayers. Depending on the level of investor participation, the policy could be quite costly to the federal government. Although investor participation in the incentive is uncapped, the Joint Committee on Taxation's revenue estimates suggested that the incentive will cost taxpayers in total $1.6 billion over its life.[39] This amount seems low relative to the over $60.0 billion of authorized credit authority that has been allocated to the New Markets Tax Credit program, which is capped in both size and scope.[40] To the extent that there is a large and enthusiastic response to this incentive by investors, the costs of the foregone tax revenue due to reduced capital gains could be much higher than the estimated $1.6 billion. Alternatively, if the incentive induces investors to trigger capital gains that would not have otherwise been realized in the first place, then the revenue generated in 2026 and 2027 could be greater than the amounts reflected in the estimate. Whether the government will be willing to extend the policy beyond its existing ten year window will likely be heavily influenced by the actual cost of the program.

[39] https://www.jct.gov/publications.html?func=startdown&id=5053. This estimate from the Joint Committee on Taxation shows a government expenditure of $12.4 billion for years 2018 through 2025, offset by revenue of $8.1 and $2.7 billion for 2026 and 2027, respectively (when the original capital gains deferral period ends), for an overall cost of $1.6 billion.

[40] Includes $15.0 billion for the period 2001-2007, with extensions authorizing $5.0 billion in 2008 and 2009, as well as $3.5 billion in years 2010 through 2019.

7. How reporting can inform analysis of the policy

Identifying the appropriate metrics to measure the effectiveness of the policy is critical to the ultimate success of the incentive. Given that "success" can be defined differently depending on the relevant group, parties need to be particularly careful to ensure accurate and timely monitoring and reporting for Opportunity Zone projects.

There are a number of relevant outcomes that should be measured when evaluating the effectiveness of the policy. One outcome is the extent of taxpayers' participation, including the number, type, and characteristics of investors claiming the incentive. Other important outcomes are the effects on local economic conditions, such as employment rates, business establishments, capital spending, housing and rental prices, and tax revenues (to name a few). Further, understanding the type of investments made in the Zones, as well as the characteristics of Opportunity Zones that have attracted the most (least) amount of capital, is important in understanding how the effectiveness of the policy varies across the country. Evaluation of these outcomes requires comprehensive and timely data from participating investors, established Opportunity Zone Funds, and recipient communities. Recommendations for the types of reporting necessary to facilitate these analyses include the following:

Fund reporting via self-certification: While the self-certification process is expected to impose minimal time and cost to taxpayers so as to maximize participation, data gathered from this process will be critical for evaluation of the anticipated investment effects. The IRS has stated as of this writing that taxpayers will attach a self-certification form to their tax return to report the Opportunity Funds in which they are participating. Details on the funds' intended location, type, and amount of investment, as well as the number of Fund investors, should be included on the form to provide data for analysis in the early years of the policy.

Taxpayer reporting of capital gain deferral: Taxpayers will report the amount of deferred gain attributable to the sale of existing appreciated property on their tax returns. In addition to identifying the amount of such gains that will be deferred due to the Opportunity Zone incentive, information on the source of gains (existing home sales, appreciated stock, etc.), as well as the relative proportion of gains allocated to Opportunity Zone investments, enables assessment of the types of taxpayers claiming the incentive. This information can be used to study a number of policy questions, as well as to refine future governmental revenue projections. Matching these data to the self-certification process can also be used to measure the extent to which taxpayers select multiple Funds and whether these Funds invest in the taxpayer's local area.

Annual reporting by Opportunity Zone Funds: Opportunity Zone funds, as corporations or partnerships, will file annual tax returns. In addition to the requisite information included on the income tax returns, reporting of Opportunity Funds' actual investments – by broad asset classes and by state –permits further analyses of the types of Fund investments, as well as the geographic dispersion of the capital across the U.S.

State and local reporting: Local data on economic conditions will be necessary to evaluate the broader effects of Opportunity Zone investment. These data should be collected as quickly as possible (to capture conditions preceding Opportunity Zone investment), as well as in an ongoing manner in future periods. Examples of these types of data include housing and rental prices, occupancy rates, number of business establishments, number of employees, number and type of new jobs created, amount of capital spending, and the amount of local tax revenue (to name a few). Many of these data may already be collected by different federal, state, or local government agencies. Thus, if municipalities can implement a system to routinely collect these data, local officials can perform a timely analysis of the policy, which in turn can be used to attract better and more effective projects to the jurisdiction. However, these data collection efforts should not be confined to the selected designated tracts; some data should also be obtained at the state level so that economic conditions across all census tracts (not just selected Opportunity Zones) can be measured and compared.

8. Conclusion

Early interest in the Opportunity Zone incentive suggests that a large portion of the touted $6.1 trillions of individual and corporate capital gains could be unlocked through this policy.[41] We are optimistic about the policy's potential effects, but we also acknowledge that there will be challenges in implementation and potential unintended consequences. Furthermore, the differing motivations amongst stakeholder groups suggest that no uniform policy solution will address all of the possible issues. Nonetheless, this incentive represents the chance to mobilize large amounts of wealth to benefit low-income areas across America. We look forward to future research on investors' responses to this incentive and how effective it is in spurring economic growth in low-income communities.

[41] https://www.jec.senate.gov/public/_cache/files/a5c8907c-d1a9-47c4-99ad-6c9fc1d7727c/john-lettieri-testimony.pdf

Exhibit 1
Descriptive Statistics on Designated Opportunity Zones

This exhibit provides descriptive statistics on demographic information for the 8,762 selected Opportunity Zones. The chart first presents average amounts for all Opportunity Zones in the United States. Because Census data for Guam, American Samoa, the Northern Mariana Islands, and the U.S. Virgin Islands is not prepared on the same basis as that for the fifty U.S. states, we then separately present only the total number of tracts and contiguous tracts in the following line and designate the missing fields with a * sign. Below this, we present descriptive statistics by each state. State names are hyperlinked to the corresponding state Opportunity Zone website. Data on the number of Zones and contiguous Zones is calculated from the full list of designated Zones found on the U.S. Treasury CDFI Fund website. Data on the median income, poverty rate, and populations for Zones and states is from the U.S. Census Bureau's American FactFinder website (variables S1701, B19113, and B01003). For the Zone median income, poverty rate, and population, and percent of state population, Census tract-level data were used. For the state median income and poverty rate, state level data were used.

Jurisdiction	# of Zones	# of Contiguous Zones	Median Income of Zones	Median Income of States	Avg. Zone Poverty Rate	State Poverty Rate	Total Zone Population	% of State Population
United States	7,826	169	$45,877	$69,946	28.7%	15.1%	31,389,750	9.9%
United States & Territories	8,762	198	*	*	*	*	*	*
By state (includes link to state website, where available):								
Alabama	158	5	$40,061	$56,828	30.5%	18.4%	610,372	12.6%
Alaska	25	0	$58,045	$87,365	17.1%	10.1%	86,699	11.8%
Arizona	168	8	$39,145	$61,001	30.8%	17.7%	686,222	10.2%
Arkansas	85	2	$39,224	$53,123	29.8%	18.8%	367,761	12.4%
California	879	8	$38,734	$72,952	32.5%	15.8%	4,150,434	10.7%
Colorado	126	7	$49,728	$77,130	21.7%	12.2%	491,481	9.2%
Connecticut	72	1	$42,661	$91,274	25.9%	10.4%	268,953	7.5%
Delaware	25	1	$47,777	$73,831	24.5%	12.0%	91,953	9.8%
District of Columbia	25	0	$43,174	$89,023	29.7%	17.9%	88,663	13.5%
Florida	427	0	$36,159	$59,139	30.7%	16.1%	1,906,489	9.6%

Georgia	260	0	$32,453	$61,328	38.1%	17.8%	1,030,713	10.2%
Hawaii	25	2	$55,859	$83,451	19.6%	10.8%	105,840	7.5%
Idaho	28	2	$47,589	$59,652	22.2%	15.2%	123,830	7.6%
Illinois	327	0	$35,873	$73,714	33.3%	14.0%	1,168,120	9.1%
Indiana	156	3	$41,052	$62,748	28.3%	15.0%	536,148	8.1%
Iowa	62	1	$46,646	$69,419	22.3%	12.3%	209,238	6.7%
Kansas	74	4	$46,738	$68,231	24.8%	13.3%	239,305	8.3%
Kentucky	144	5	$39,519	$56,522	31.0%	18.8%	558,875	12.7%
Louisiana	150	5	$38,480	$58,068	32.3%	19.7%	546,479	11.8%
Maine	32	2	$49,360	$64,294	20.7%	13.5%	112,740	8.5%
Maryland	149	4	$54,772	$92,049	20.2%	9.9%	598,784	10.0%
Massachusetts	138	1	$49,524	$90,180	22.9%	11.4%	547,360	8.1%
Michigan	288	5	$39,223	$63,958	29.1%	16.3%	891,501	9.0%
Minnesota	128	1	$50,099	$79,595	24.2%	10.8%	490,740	9.0%
Mississippi	100	5	$40,478	$50,592	29.3%	22.3%	440,922	14.8%
Missouri	161	8	$39,533	$62,285	27.7%	15.3%	580,936	9.6%
Montana	25	0	$47,369	$63,214	25.7%	14.9%	93,403	9.1%
Nebraska	44	1	$42,327	$69,207	25.0%	12.4%	143,227	7.6%
Nevada	61	1	$36,021	$62,528	30.2%	14.9%	224,392	7.9%
New Hampshire	27	0	$58,072	$83,709	16.8%	8.5%	123,703	9.3%
New Jersey	169	0	$45,502	$90,757	24.7%	10.9%	734,364	8.2%
New Mexico	63	4	$44,212	$55,900	27.5%	20.9%	258,340	12.4%
New York	514	17	$43,996	$74,036	29.9%	15.5%	2,092,572	10.6%
North Carolina	252	11	$41,499	$59,667	27.3%	16.8%	1,125,539	11.3%

North Dakota	25	0	$55,766	$77,277	23.9%	11.2%	81,913	11.1%
Ohio	320	3	$36,760	$64,433	30.9%	15.4%	956,488	8.3%
Oklahoma	117	3	$40,463	$59,742	27.3%	16.5%	382,295	9.9%
Oregon	86	5	$52,109	$65,479	24.1%	15.7%	402,233	10.1%
Pennsylvania	300	11	$38,846	$69,960	31.3%	13.3%	966,776	7.6%
Rhode Island	25	0	$47,980	$75,655	25.3%	13.8%	111,651	10.6%
South Carolina	135	7	$41,236	$58,158	28.1%	17.2%	541,967	11.2%
South Dakota	25	2	$49,051	$66,825	26.5%	14.0%	105,075	12.3%
Tennessee	176	6	$38,999	$57,747	29.3%	17.2%	701,926	10.7%
Texas	628	0	$42,480	$64,585	27.7%	16.7%	2,886,306	10.7%
Utah	46	0	$46,536	$71,058	22.3%	11.7%	205,652	7.0%
Vermont	25	2	$54,393	$71,465	21.4%	11.6%	91,245	14.6%
Virginia	212	5	$50,029	$80,068	20.7%	11.4%	897,082	10.8%
Washington	139	7	$50,697	$76,507	22.7%	12.7%	586,419	8.3%
West Virginia	55	3	$47,548	$54,409	24.9%	17.7%	202,833	11.0%
Wisconsin	120	0	$42,652	$69,925	28.2%	12.7%	437,375	7.6%
Wyoming	25	1	$57,399	$73,654	20.5%	11.6%	106,416	18.3%

Exhibit 2
Potential Investment Asset Classes

This exhibit shows some of the different types of asset classes that may be eligible for investment within an Opportunity Zone, pending additional guidance from the U.S. Treasury. These classes include investments in traditional businesses, real estate investments, impact investments, and alternative assets. Opportunity Funds are required to invest 90 percent of the fund's assets in qualifying businesses or property located in the designated area.

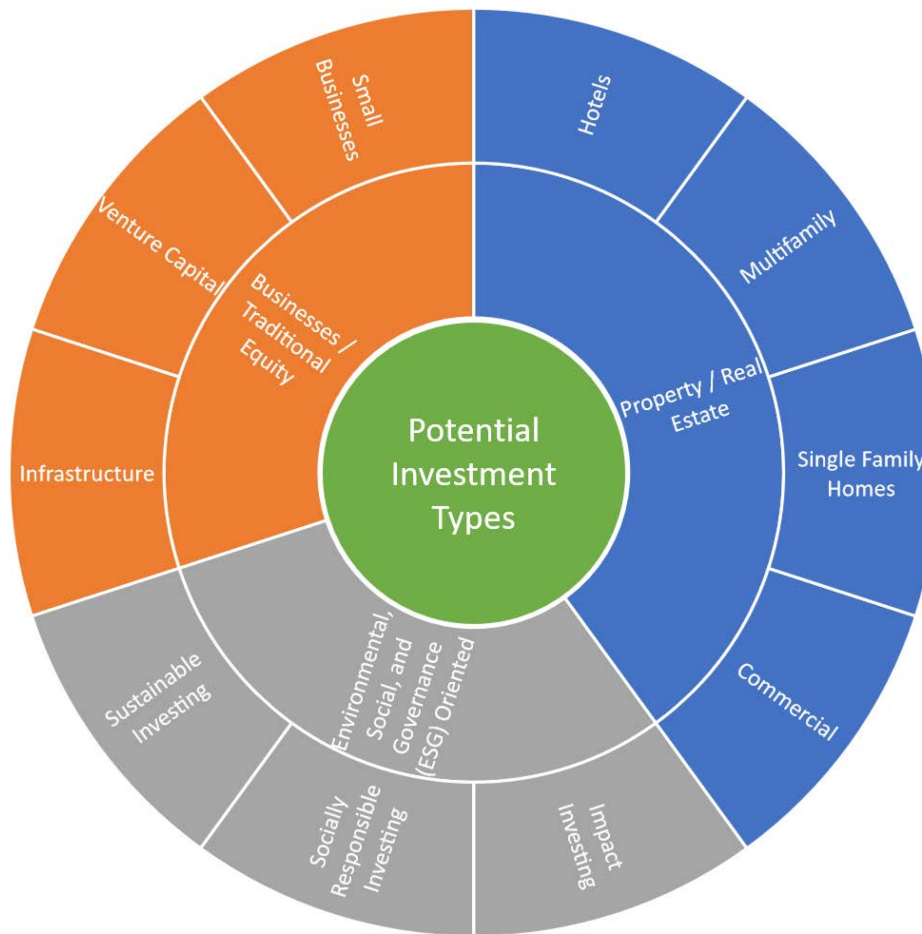

Exhibit 3
Example of Tax Savings

This exhibit provides an example of the i) capital gains tax deferral on the sale of existing appreciated property; ii) the capital gains tax reduction if the Opportunity Zones investment is held for seven years; and iii) the capital gains exclusion on appreciation of the Opportunity Zones investment is held for ten years. Calculations are based on several key assumptions listed at the bottom of the table and should not be relied upon for investment advice.

2018 Tax Deferral from Sale of Existing Appreciated Property	
Proceeds from sale of existing investment	$ 450.00
Less: Tax Basis	350.00
Total Capital Gain	**100.00**
Assumed LTCG Tax Rate[a]	20.0%
Deferral: 2018 Tax Liability	**$ 20.00**

2026 Reduction in Capital Gains Tax from Original Sale of Appreciated Property	
Capital Gains Tax Due	$ 20.00
Reduction Attributable to Basis Increase[b]	15%
Reduction: 2026 Tax Liability	**$ 17.00**
2018 Present Value of Tax Liability[c]	**$ 9.18**

2028 Exclusion of Capital Gains Tax from Sale of Opportunity Zone Investment	
OZ Investment Final Value[d]	$ 215.89
Amount contributed to OZ Investment	100.00
Capital Gains from Investment	**115.89**
Assumed LTCG Tax Rate	20.0%
Exclusion: 2028 Tax Liability	**$ 23.18**

Total Cash Tax Savings	
2026 Savings Attributable to 15% Basis Step-up[e]	3.00
2028 Savings Attributable to Gain Exclusion[f]	23.18
Total Cash Tax Savings	**$ 26.18**

Effective Tax on Original Investment	
Total Appreciation on Original Investment of $350.00[g]	215.89
Cash Taxes	17.00
Effective Tax Rate	**7.9%**

Notes

[a] Ignores any effect of the net investment tax.
[b] Assumes that the investment is held for the required seven years.
[c] Present value assuming 8.0% discount rate.
[d] Calculated based on an 8.0% annual return on investment.
[e] Equivalent to the difference in the $20 of tax due in 2018 to the $17 due in 2026 (without discounting).
[f] Assumes investment was held for ten years.
[g] Includes $100 of appreciation on original investment sold in 2018, as well as $115.89 appreciation on Opportunity Zone Investment.

Exhibit 4
Analyses of New Markets Tax Credit Data

This exhibit provides descriptive statistics on the New Markets Tax Credit for the period 2001 to 2015 using publicly-available data from the CDFI Fund's website. Panel A presents the number of approved projects by origination year. Panel B reports the proportion of projects in a metropolitan area, as classified by CDFI. Panel C provides statistics on the stated purpose of the NMTC project, and Panel D provides statistics on the proportions of projects by states with the most and least NMTC funding.

Panel A: Number of NMTC originated projects by year

Origination Year	*Number of Projects*	*Cumulative Number*
2001	2	2
2002	3	5
2003	15	20
2004	291	311
2005	598	909
2006	742	1,651
2007	1,021	2,672
2008	959	3,631
2009	888	4,519
2010	1,047	5,566
2011	1,307	6,873
2012	1,245	8,118
2013	1,174	9,292
2014	1,085	10,377
2015	1,143	11,520
Total	11,520	

Panel B: Proportion of projects in a metropolitan area

Location of project	*Number of Projects*	*% of Projects*
Metropolitan Area	9,521	82.7%
Non-Metropolitan Area	1,999	17.3%
Total	11,520	100.0%

Panel C: Stated purpose of investment

Purpose of Project	*Number of Projects*	*% of Projects*
Business Financing	4,159	36.1%
Microenterprise	24	0.2%
Real Estate		
Commercial Construction	3,755	32.6%
Commercial Rehabilitation	3,174	27.6%
Residential Construction	174	1.5%
Residential Rehabilitation	47	0.4%
Other	187	1.6%
Total	11,520	100.0%

Panel D: Distribution of NMTC across states

States	*% of Total Projects*	*% of Total $ Benefit*
Ten States with the Most NMTC Projects		
California	8.7%	8.7%
Ohio	7.2%	5.2%
Massachusetts	5.8%	4.5%
Missouri	5.6%	4.4%
Louisiana	5.5%	6.1%
New York	5.3%	7.3%
Wisconsin	4.3%	4.0%
Pennsylvania	4.0%	3.6%
Illinois	3.9%	3.3%
Total	**50.3%**	**47.1%**
Ten States with the Fewest NMTC Projects		
Vermont	0.4%	0.5%
Nevada	0.4%	0.2%
Idaho	0.4%	0.2%
South Dakota	0.3%	0.3%
Delaware	0.2%	0.3%
Hawaii	0.2%	0.3%
Kansas	0.2%	0.2%
North Dakota	0.2%	0.2%
West Virginia	0.2%	0.2%
Wyoming	0.1%	0.0%
Total	**2.5%**	**2.4%**