

Opportunity Zones

State of the Marketplace

By Kenan Fikri, John Lettieri, and Daniel Newman

Background Information

Passed into law in December 2017, Opportunity Zones (OZs) quickly emerged as one of the most innovative elements of the Tax Cuts and Jobs Act (TCJA). OZs represent a deliberately flexible—and experimental—new approach to community and economic development designed to increase access to capital for a wide array of uses in eligible low-income communities. Prior federal efforts to boost low-income communities have largely followed the same playbook of offering tax incentives (often in the form of tax credits) for specific purposes. OZs represent a valuable chance to gain insights into the viability of a more wide-reaching, flexible, and open-ended approach to address a longstanding policy challenge.

During the recovery from the Great Recession, no segment of American society did better than investors. Stock markets soared, and by the end of 2017, households and corporations were sitting on \$6.1 trillion in unrealized capital gains in stocks and funds alone (the

figure is now much higher).¹ Meanwhile, the number of high and concentrated poverty census tracts rose sharply—the country contained 4,700 high poverty metropolitan census tracts in 2000, yet by 2018, it contained 6,400.² Born out of these intensifying economic and social inequities, OZs were intended to unlock some of the financial gains of the recovery for investment into the country’s chronically struggling areas.

For the first two years after OZs passed into law, the public discourse brimmed with hype and speculation about what might transpire once this unusually open-ended, flexible new development finance tool hit the market. Since final regulations were promulgated in December 2019, the OZ conversation has steadily moved beyond hypotheticals and into the realm of the observable. As the contours of a new marketplace come into focus, it is becoming clear that many of the loftiest hopes—that a tweak of the tax code could fundamentally

1. Economic Innovation Group analysis of Federal Reserve Survey of Consumer Finances and Financial Accounts of the United States data.

2. August Benzow and Kenan Fikri, “[Neighborhood Poverty Project](#),” Economic Innovation Group, 2020.

transform the economics of investing in low-income communities overnight—and greatest fears—that an OZ-fueled tidal wave of resident-displacing gentrification would crash across the designated communities—proved foreseeably off the mark.

Instead, a disaggregated market is actively in the process of figuring out where this powerful new tool of development finance fits in the broader toolkit. Mystery is dissolving away into practiced familiarity as more deals get done, best practices get established, and innovative use cases get replicated. At the same time, much remains to be done to educate investors, local leaders, and other potential market players on the incentive and how it functions. Broadly, the early 2020s are shaping up to be a “proof of concept” phase for the policy. The early results are promising but

also suggest that further tweaks to the policy will be necessary for it to fulfill its promise.

Taking stock three years since passage

A wide range of investments are currently taking advantage of OZ financing across the country. From clean energy to rural broadband and brownfield remediation, OZ capital is proving to be among the most flexible development finance tools the federal government has created. From rural Alabama to the steel towns of Pennsylvania, OZ capital is flowing to places long overlooked by traditional investors. And in communities all across the country, the wide applicability of OZs has catalyzed new conversations about what is possible and how to get there, forging new institutions, networks, and relationships that will pay off for years to come.



At the same time, implementation of the policy has not been seamless. The early years of the market have been more tilted toward real estate (residential rental in particular) than expected, in part due to how the Department of the Treasury interpreted the statute and which regulations it prioritized. In addition, the statute's crafters assumed that governors would apply qualitative filters in selecting their OZs that would weed out "bad apple" census tracts that were technically eligible due to statistical quirks but bore little resemblance to genuine low-income communities. Instead, governors adopted wildly varying

approaches to nominating their OZs with equally varying degrees of transparency. The resulting map is broadly very well-targeted towards need but does include a number of tracts that never should have been considered for OZs. These outlier tracts have generated the lion's share of negative attention to the fledgling policy, obscuring an otherwise sound designation process.

One critical handicap was placed on OZs right at birth. Because the TCJA was passed via budget reconciliation, the U.S. Senate's parliamentary rules forced the removal of the robust OZ investment reporting and data collection provision before final passage. In the years since, continued legislative gridlock has prevented reporting requirements from being restored, despite bipartisan consensus. Without such requirements, policymakers and outside observers will find it difficult to properly evaluate the policy's results over time, and many of the benefits of a relatively open-ended experiment in tax policy—namely, a better understanding of where and under what circumstances this kind of incentive can have a positive impact—will be wasted.

Nevertheless, the early results from this young new marketplace for investing in struggling American communities vouch for the model. In difficult-to-invest areas, the flexible stake of patient equity capital that OZs unlock can be decisive. Investor behavior is changing as people with capital look at the country's map in a new light, even if investing through OZ vehicles remains a relatively niche activity. Incremental refinements to the basic OZ structure that simplify investing and bolster both the integrity and transparency of the marketplace would set the policy on a strong course for the duration of this investment window, through 2026.



Novel design aspects of the Opportunity Zones incentives

OZs are designed to rekindle economic activity in low-income communities by rewarding investors who deploy patient equity capital into activities—businesses, projects, structures—that restore value and bolster the long-term economic capacity of communities that traditionally have been neglected and overlooked by investors. The policy is noteworthy for several key design features:

- its specific focus on equity capital,
- its approach to changing investor behavior, and
- its embrace of flexibility.

Equity

OZs are distinct from past place-based policies in that they harness an abundant but vastly underutilized resource in traditional community development—private sector equity capital. Equity is fundamentally different from other types of capital. Debt (e.g., loans) gives an investor a fixed claim to future earnings. Equity, by contrast, gives investors an ownership stake in the future. Equity investors only get a return if the entity into

which they invest grows or appreciates. They are often more tolerant of risk, since they stand to gain more if the investment succeeds. That makes the equity investor a committed partner to success. The OZ equity model is especially patient, generally committing an investor for at least a decade. Equity is especially valuable for young companies or high-impact development projects that require flexible and creative capital stacks to pencil out.

Behavior

Presently, many investors avoid wading into low-income communities because they do not expect them to be a secure store of value, let alone provide a return. Those decisions become self-fulfilling as, deprived of traditional capital and relegated to the sidelines of financial markets, communities flounder. The OZ tax incentives are designed to turn that thinking on its head and prompt investors to reconsider the areas of the map they have written off and actually do the work of identifying sound investment opportunities that are going unfunded.

OZs rest on the notion that competitive long-term returns actually can be found in what are today weak market areas. The idea posits that today's distressed communities have just as much latent potential as thriving areas. If markets start to work with and for these communities rather than against them, intrinsic value can be unlocked and catalytic bets on a better future will pan out. This behavioral aspect differs from other federal programs significantly. The difference between "The federal government will pay you to invest here" and "The federal government will reward you extra if you make a good investment here" is subtle but important. It shifts the narrative from community liabilities to community assets, and uses investor expectations as the mechanism that unlocks new sources of capital.

Flexibility

OZs are designed to be flexible and stimulate investment in a decentralized, market-directed way. Flexibility is important because it allows for a greater variety of use cases to receive investments of different sizes across a greater range of local areas relative to the most widely used development programs today. With so many different ways OZ capital can be deployed, it can in theory find a productive home in every eligible community—rural or urban, industrial or residential, old or new. Flexibility also allows it to be paired with other federal, state, or local incentives around environmental remediation, historic preservation, or affordable housing provision.

Traditional community development is oriented around products: a tax credit for financing affordable housing, for instance, or another fund for lending to women- and minority-owned small businesses. By contrast, the OZ model seeks to establish parameters within which a market can operate

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independently. The policy lays out broad rules and allows any entity operating within them to take advantage of the statutory tax benefits. As long as *qualifying* capital is being invested through *qualified* intermediaries into *qualifying* activities in *qualified* census tracts, investors can proceed with minimal engagement with the federal government.

The policy's flexibility has the potential to bring new and innovative participants to the world of economic and community development. It also allows investors to experiment and innovate in ways that are not possible under traditional programs. Flexibility is especially important for investments into operating businesses and for the recipient entrepreneurs themselves. From restoring a historic hotel in Selma, Alabama, to bringing a robotics startup from Silicon Valley to Baltimore, the unprecedentedly wide applicability of OZs to different investment scenarios and local contexts is already making itself felt on the ground.

Mapping OZs

There are 7,826 individual OZ census tracts designated across the 50 states and DC, and by most measures of socioeconomic well-being, they are among the highest-need communities in the United States.³ State governors were responsible for designating OZs. Each adopted different processes for selecting from the universe of eligible tracts with different goals in mind: Some states prioritized rural areas, while others tried to spread OZs evenly across their state.⁴ Some aligned zones with local strategic plans, and others set maps with startup ecosystems in mind. Many took care to align their OZs behind the considerable investments the states were already making to revitalize communities.

The end product was a map of OZs relatively well-targeted to needy places, demonstrating an average life expectancy three years shorter than the national figure, an average poverty rate of 26 percent in the latest 2019 data, and a median family income less than two-thirds the national level, on average. Ultimately, half of the country's persistent concentrated poverty census tracts were selected as OZs. Designated census tracts were on average more distressed but generally no more likely to be declining or rebounding on a range of economic conditions than other eligible low-income communities that were not selected.

Opportunity Zones demographics

	Poverty Rate	Median Family Income	Minority Share	Adults without a high school diploma	Adults with a bachelor's degree or higher	Prime age adults (25-54) not working	Housing vacancy rate	Life expectancy
Opportunity Zones (OZ)	26.4%	\$49,000	56.9%	20.5%	18.6%	30.0%	12.8%	75.2
Non-OZ low-income tracts	22.0%	\$55,400	53.4%	18.9%	20.6%	26.6%	11.0%	76.3
All low-income tracts	23.2%	\$53,900	54.4%	19.4%	20.1%	27.5%	11.5%	76.0
National	13.4%	\$77,300	39.3%	12.0%	32.1%	21.5%	8.2%	78.6

Source: EIG analysis of 2015-2019 American Community Survey estimates

3. Note that this section omits the nearly 900 OZ census tracts in Puerto Rico and other U.S. territories due to limited data availability. Including them would make OZs look worse off as a group, given the generally high poverty rates and lower levels of economic well-being that prevail in the territories.

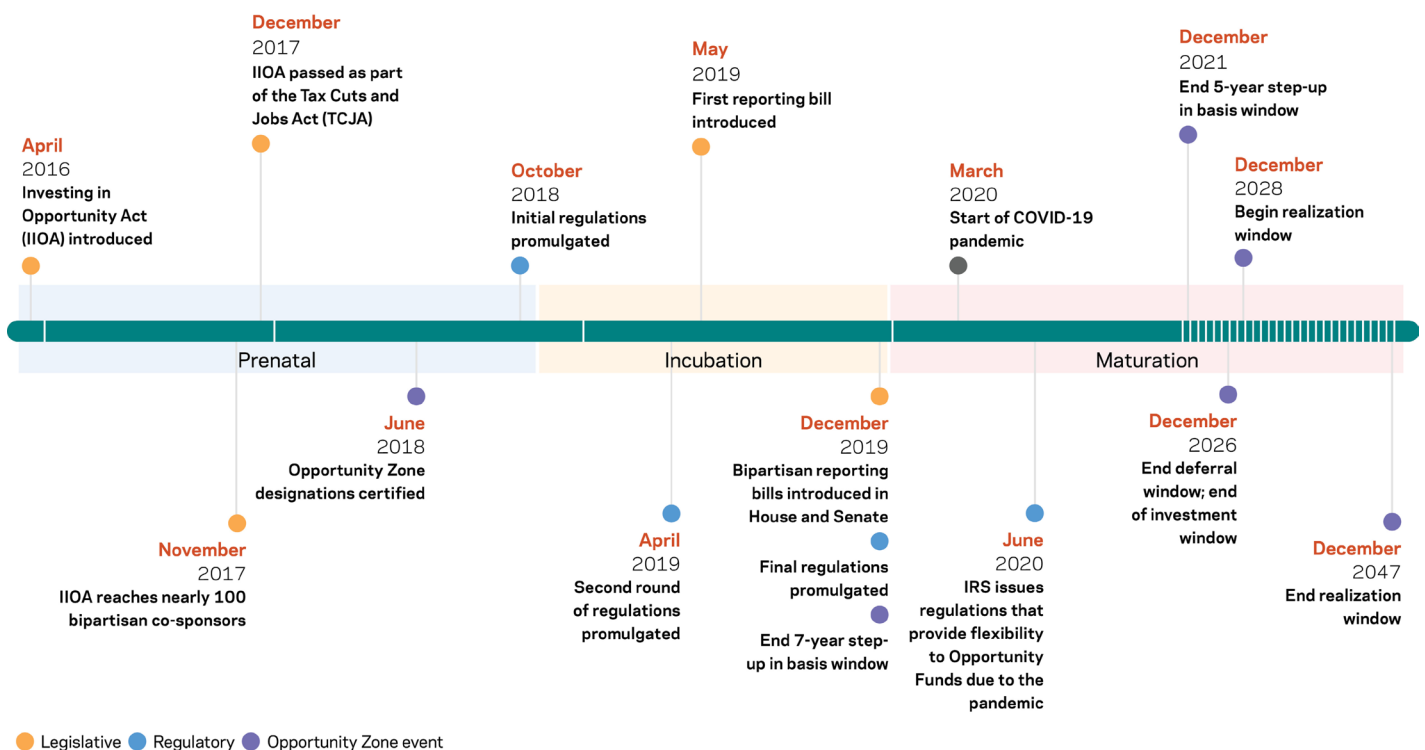
4. For more on the zone selection process, see Economic Innovation Group, [“The Map Comes Into Focus,”](#) 2018.

State of the Market

OZ's journey from raw concept to provision of the tax code has been demarcated by important legislative, regulatory, and structural milestones (see graphic below). While the market only started incubating in late 2018, when a limited round of initial regulations were promulgated, it has experienced steady growth over the months since. Activity truly

started to take off in early 2020, as regulatory clarity and developing market norms combined to unlock more capital and encourage broader participation from an increasingly diverse group of stakeholders. The pandemic side-swiped the market during a critical time in its maturation, but most segments seem to have recovered along with capital markets generally.

Opportunity Zones legislative, regulatory, and structural timeline



Market activity started accelerating in early 2020

The true scale of participation in OZs will remain a mystery until the Internal Revenue Service releases summary statistics from Opportunity Fund tax filings.⁵ Ultimately, concerns over taxpayer privacy will likely limit the amount of detailed transaction or investor-level data available, and data lags (tax data are generally not available until a full 18 months after a tax year ends) will add another wrinkle to the evaluation process.

In the meantime, the most authoritative estimate of the market's size comes from the White House Council of Economic Advisers (CEA). Their recent report extrapolated data from Securities and Exchange Commission and Treasury Department filings through the end of 2019 to estimate that \$75 billion in private capital had been raised at that point, equal to about 21 percent of total annual investment directed to OZs.⁶ While nearly impossible to ascertain the counterfactual (how much

investment would have been made into OZs absent the incentive), CEA estimated that approximately 70 percent of the total—or \$52 billion—likely represented new investment that would not have otherwise been directed to OZ census tracts. In addition, they estimate that equity investments into operating businesses were 29 percent larger in OZs relative to the set of census tracts that were eligible but not selected for inclusion in the OZ incentive.

A more concrete but limited look at the market comes from the professional services firm Novogradac & Company. Their regular and voluntary survey of Opportunity Fund managers generally seeking to raise capital (which represents only a fraction of all Opportunity Funds and investors) shows rapid acceleration in the size of the OZ market over the course of 2020. The volume of investment dollars on their radar more than tripled between December 2019 and December 2020. In total, their survey captured \$15.1 billion at the end of December.⁷

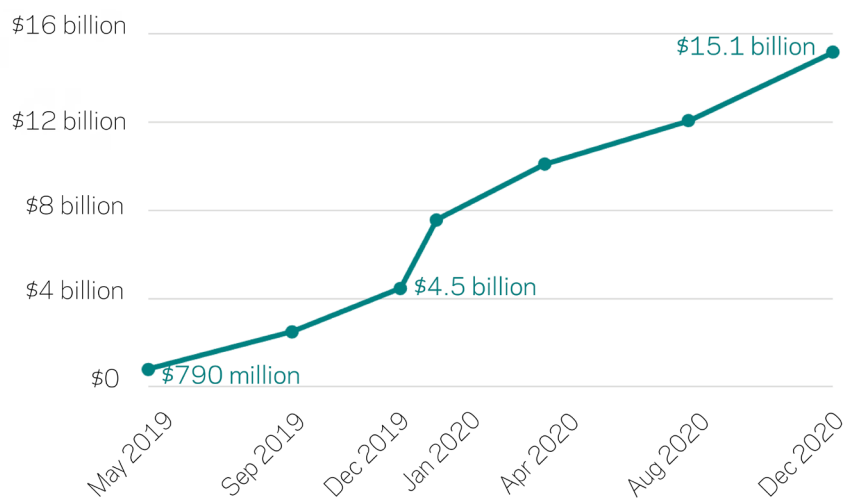


5. U.S. Government Accountability Office, GAO-21-30 “[Opportunity Zones Improved Oversight Needed to Evaluate Tax Expenditure Performance](#),” 2020.

6. White House Council of Economic Advisers, “[The Impact of Opportunity Zones: An Initial Assessment](#),” 2020.

7. Michael Novogradac, “[Opportunity Funds Investment Report: \\$15 Billion in Equity by End of 2020](#),” 2021.

OZ equity reported raised on Novogradac's survey of select Opportunity Fund managers



Source: Novogradac

Nevertheless, all methodologies struggle to estimate what many observers believe to be the largest segment of the market: closely-held Opportunity Funds not raising any outside capital and often investing into single projects. Putting it all together, there is widespread agreement that OZs have so far moved tens of billions of dollars. The available evidence suggests the market is large and growing rapidly as investors respond to the incentives and action-forcing deadlines baked into the statute.

The diverse scope of investment activity is coming into focus

The available evidence also suggests that the growing market is diversifying. Novogradac's fund survey remains dominated by real estate, with residential real estate the top investment category, but CEA and other private providers such as NES Financial find investments into OZ businesses growing to represent a sizable share of the market.⁸ In general, the

flexibility of the tool has led to a plethora of experimentation in geographically and economically diverse parts of the country.

There currently is no comprehensive public directory of OZ investments, but EIG's Opportunity Zones Activity Map gathers many of the most noteworthy investments catalyzed through the policy to date.⁹ The map is intended to memorialize high-impact activities and illustrate how the incentive's flexible design has translated into a wide range of use cases nationwide.

The growing collection of around 210 investments, assembled from publicly available information, currently chronicles investments across 41 states plus DC. While the activities are not necessarily representative of the incipient market in its entirety—there are plenty of more run-of-the-mill investments into residential, commercial, or industrial real estate—the curated list showcases the breadth of what is possible through the OZ incentive.

8. NES Financial | JTC, "OZ Data Insights, Fall 2020," 2020.

9. The map can be accessed at <https://eig.org/oz-activity-map>. In addition to investments, it includes notable Opportunity Funds and various policies and initiatives that have arisen around from OZs.

EIG Opportunity Zones Activity Map



[CLICK HERE TO VIEW THE INTERACTIVE MAP](#)

Source: EIG Opportunity Zones activity map data as of February 10, 2021

Real estate investments comprise the largest segment of projects on the tracker thus far. An overwhelming majority of them are breaking ground on vacant parcels, repurposing parking lots to higher uses, refurbishing empty and abandoned structures, and restoring economic activity to corners of communities that have laid dormant for years. The structure of the incentives push investors to seek out such uses, and the timing constraints in the regulations dramatically favor this sort of infill development that reactivates inert and unused areas, rather than purposes that replace or displace existing activity or businesses. Roughly one-quarter of the investments on the map have been made into rural areas, suggesting that rural parts of the country may at least be holding their own in winning quality OZ investments. Rural areas seem to be much more competitive at attracting investments into operating businesses, as well: Roughly half of all investments into OZ startups and growth companies on the map are in rural areas.

Other notable market niches observable on EIG's map that seem to be gaining traction include:

- **Affordable housing:** Investments into low-income, affordable, and workforce rental housing.
- **Brownfield redevelopments:** Investments into the clean up and reuse of historically contaminated and abandoned lands or structures.
- **Clean technologies:** Investments into solar, biofuels, electric vehicle infrastructure, and water technologies.
- **Healthcare:** Investments into care facilities, medical offices, and physical and mental health technology companies.
- **Historic preservation:** Investments that continue the economic and community life of historical buildings, remaining true to their heritage.

Local capacity and leadership are key differentiators between leaders and laggards

Local capacity to understand and deploy OZs varies immensely across the country. A handful of standout locales currently lead the nation in leaning into OZs and cultivating diversified and impact-oriented OZ ecosystems with the support of different institutional models. Most of the proving grounds have benefited from engaged public, private, and civic leadership that recognized the potential in the OZ model and determined early on that they would not let the opportunity pass them by. They responded to changes in the economics of investing in their communities triggered by

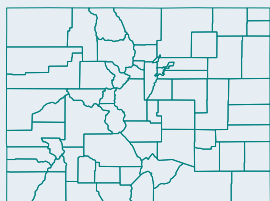
the enactment of OZs—and they stand in stark contrast to many other localities that have approached OZs more passively and with less assumed responsibility to adapt to changing facts on the ground, steer the market, and shape outcomes. These leading communities have aligned projects and funds with local needs and opportunities, a critical success factor in the market’s early years.

Highlighted below, two states (Alabama and Colorado) and one locality (Erie, Pennsylvania) demonstrate the power that state and local governments have to nurture local OZ markets and elicit investment in their communities, while Indiana exhibits a more decentralized approach.



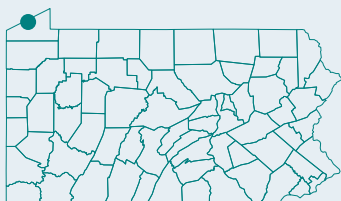
Alabama

OZ activity in the state demonstrates two things: First, that OZs can deliver for sidelined communities and for parts of the country that other federal programs typically bypass, and second, that the policy rewards local initiative—which at the end of the day is what creates a vibrant new investment ecosystem out of an otherwise obscure new provision of the tax code. OZs were a powerful catalyst for local initiative in Alabama, where the policy triggered the creation of a wholly new independent non-profit organization, Opportunity Alabama (OPAL), centered around OZs. OPAL’s work has yielded multiple OZ investments and the development of a \$1 billion pipeline of opportunities in rural and urban communities targeting blight removal; brownfield redevelopment; historic preservation; affordable, senior, and market-rate housing; industrial facilities; commercial storefronts; retail spaces; and startup businesses. The organization spearheaded a major overhaul of the state’s economic development policies with the Alabama Incentives Modernization Act and has adeptly pivoted to fill gaps in the small business safety net painfully exposed by the pandemic.



Colorado

Right out of the gate, Colorado’s gubernatorial leadership team decided to prioritize OZ investing into startup businesses and rural areas, respectively. Several investment successes have been ratcheted up especially in small communities along the economically struggling Western Slope (which have garnered at least nine known investments and counting), and the state has launched a series of initiatives to prepare underserved entrepreneurs for OZ investment. The state’s Office of Economic Development and International Trade (OEDIT) has partnered with a local business accelerator to launch the state’s OZ Capital Accelerator Program. Over the course of one year, the OEDIT and the Colorado Center for Innovation for Community Capital (CC4ICC) have provided technical assistance to 12 local businesses (a majority of them women and minority-owned) to support their capital raising effort, help develop business plans and materials, and make connections to OZ investors in the state. The national attention garnered simply by being a leader pays dividends itself; it helped a new space industry firm attract investment from a national OZ fund dedicated to investing in rural startups.



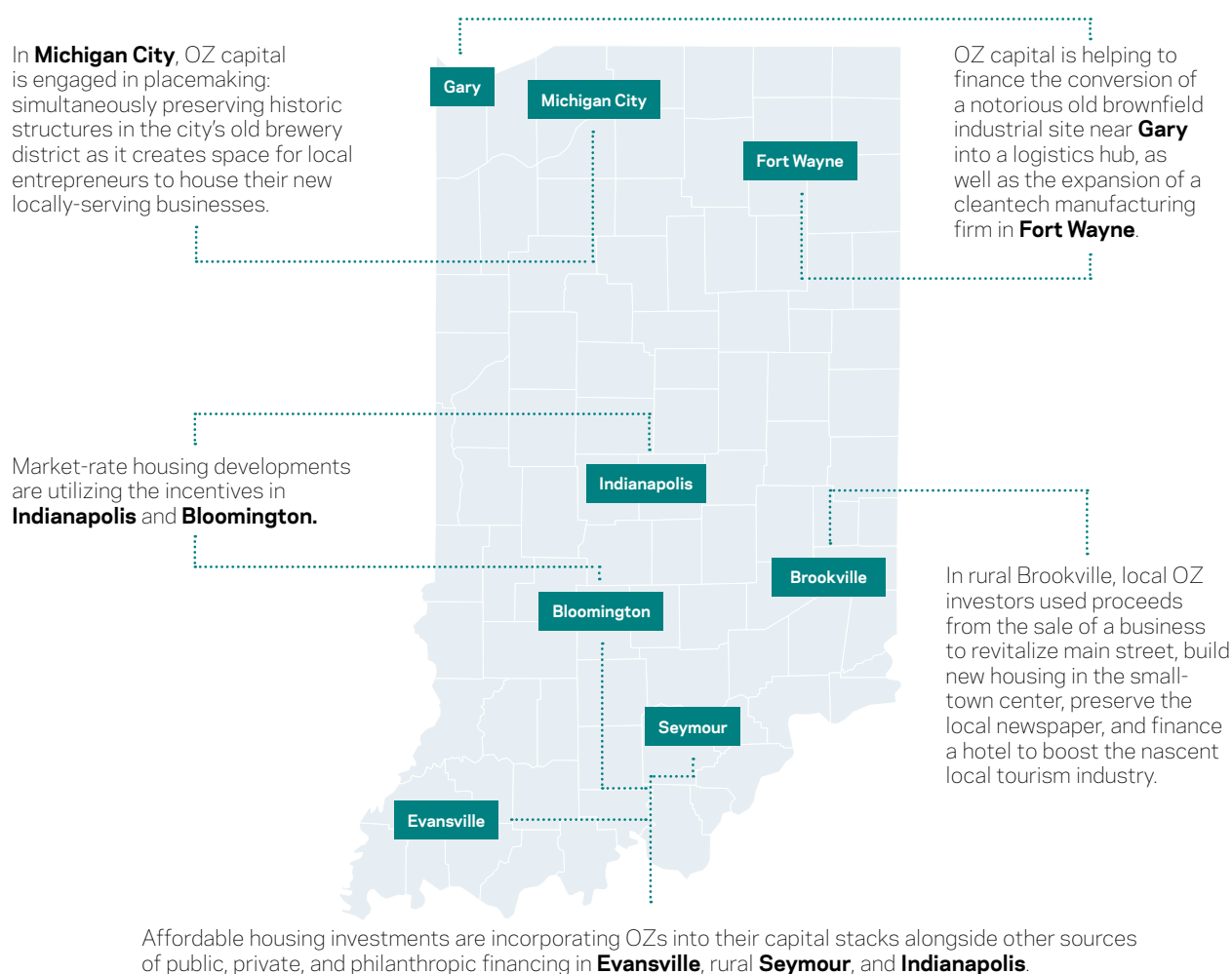
Erie, PA

The Erie Downtown Development Corporation (EDDC), formed just prior to the creation of OZs, quickly recognized the transformative potential of the new financing tool and used it to challenge all prevailing assumptions about Erie’s future. The group’s big coup came when it convinced Erie Insurance Co., a Fortune 500 firm, to capitalize a \$50m proprietary Opportunity Fund to invest locally. As of writing the fund had invested in a cybersecurity startup and in a major partnership to revitalize several properties in the city’s downtown core alongside another impact investing firm, EDDC, and the local community foundation. Erie, PA’s OZ activities and downtown redevelopment initiatives demonstrate how fiendishly complex it is to make big, meaningful investments into struggling but desperately needy markets throughout the country—and how important it is to have a high capacity local partner dedicated to fitting all the pieces together.

Indiana

Indiana is unique among early OZ proving grounds in that it has elicited such a range of OZ investment without the sort of deeply institutionalized efforts that help explain the successes of many other leading OZ ecosystems.¹⁰ Many of the state's early wins have sprung up organically, while others have been racked up among the loosely connected affiliates of the Opportunity Investment Consortium of Indiana, an effort spun out of the state's existing networks of community development organizations to learn about OZs and share strategies. The state showcases the diversity of activity taking root across the country and why the impacts of the incentive may differ in character and magnitude so much from one community to the next.

Select OZ investments in Indiana



Source: Economic Innovation Group, "Delivering Opportunity: A Diagnostic and Strategic Playbook to Maximize Indiana's Opportunity Zones," 2020

10. For a thorough assessment of the OZ landscape in Indiana and a set of strategies to fully realize the potential of OZs widely applicable to all states, see Economic Innovation Group, "Delivering Opportunity: A Diagnostic and Strategic Playbook to Maximize Indiana's Opportunity Zones," 2020.

Considerations for defining and measuring success

OZs were designed to be adaptive to the needs and opportunities of particular communities, rather than prescriptive or proscriptive with respect to how the capital can be utilized. However, this diversity will pose a challenge to researchers and other policy evaluators: investments into housing may have positive population and fiscal impacts but not be visible in local employment numbers. Similarly, investments into businesses may have little impact on housing prices. Such heterogeneity in inputs and outcomes will have to be taken into account. Qualitative assessments of local backdrops will be essential in determining what worked.

Any researcher or policy analyst attempting to evaluate OZs must currently navigate formidable roadblocks and blind spots. The greatest impediments come from the lack of a codified, public-facing data collection and reporting regime that provides timely information on the quantity, type, and magnitude of OZ investments into particular census tracts. Until that comes forward, any evaluation of OZs can only hint at results, at best.

As analysts and researchers are forced to get creative, they should keep several considerations in mind:

- **Sequence of events:** OZs may have been enacted at the end of 2017, but zones were not designated until mid-2018, little money was raised until 2019, and capital really only started to be deployed at scale in 2020. There can also be a 180-day lag between when an Opportunity Fund raises money and when it must deploy it, a timeline that regulators have extended due

OZs were designed to be adaptive to the needs and opportunities of particular communities.

to the pandemic. These stages of market development must be incorporated into study design.

- **False positives:** What little data is available suggests that relatively few OZs have actually received any investment through the incentive thus far. Depending on the exact nature of their inquiry, researchers may need to exercise caution in treating OZ communities as a single class.
- **Heterogeneity in observations:** OZs vary significantly in terms of location, zoning and land use, and urbanity versus rurality. These factors mediate the type of investment they are likely to attract and the nature of the economic impact that may result.
- **Heterogeneity in treatment:** Evaluating a program such as LIHTC, which delivers a specific product (affordable housing), is relatively straightforward. OZ capital, by contrast, is financing everything from theaters to startup incubators, charter school spaces to brownfield remediation, affordable housing to luxury housing, and agricultural processing facilities to hotels. It has even started to finance rural broadband. Each use case can be expected to have different impacts on different aspects of the local economy.

- **Geographic scale:** Relatedly, the radius of expected impacts will differ for investments of different types. The economic impact of a housing investment or small commercial space may be limited to its census tract, while the economic impact of a distribution center, manufacturing facility, or startup company may be much more diffused.
- **Time horizons:** Measures of activity can plausibly be tracked in real time, but meaningful economic impact will take years to take root. The connection between an equity investment here and improved economic opportunity there is often indirect and delayed. OZs are designed to combat the systemic under-provision of important types of capital to struggling parts of the country and through that, kick off a positive cycle. That makes OZs distinct from traditional programs aimed at financing specific services for near-term delivery. In the end, a holistic evaluation of OZs should ask both what was financed where and whether neighborhood conditions improved and economic systems function better as a result. OZs' indirect effects are expected to be the most meaningful, and any analysis of them cannot credibly begin for years.
- **Local institutional and policy context:** High-capacity local intermediary organizations and dedicated personnel are fostering active, impact-oriented OZ investment ecosystems in certain parts of the country. Incorporating such qualitative

variables will be key to answering some of the most policy-relevant questions, such as which local institutional environments produced the greatest impact.

In addition, state and local policies can influence where investments occur and what they finance. Ohio, for instance, has added state-level capital gains incentives that appear to have helped make the state a top-five OZ market on available private data.¹¹

- **Ambiguities in effects and interpretations:** Given the underlying heterogeneity of OZs, researchers must exercise caution in normatively defining success. Measures such as job growth or poverty reduction are generally sound everywhere, but changes in rents or home prices must be interpreted with local context. For example, a “luxury” apartment building may raise average rents modestly in a depressed market yearning to attract new residents to downtown, while it could slightly lower average rents in a pricier market where it adds to abundant supply in the asset class.

Interpretations can be similarly complex. A recent study found a distinct jump in prices for vacant land in OZs, and this matches with observations discussed above that the structure of the incentive encourages investors to seek out such properties.¹² This finding could narrowly be read as evidence that OZ designation provided some lucky landowners with a windfall benefit. Yet from a community

11. Based on Novogradac's Opportunity Fund Survey, which provides only a partial view on the national investment landscape. Ohio's numbers may be biased upwards because it elicits more transparency than other states by offering additional state incentives requiring disclosure for certain OZ investments.

12. Alan Sage, Mike Langen, and Alex Van de Minne, “[Where is the Opportunity in Opportunity Zones? Early Indicators of the OZ Program's Impact on Commercial Property Prices](#).” Working paper presented at the American Economic Association, December 2020.

perspective, an economically active parcel of land creating jobs, paying taxes, and providing amenities is likely preferable to an empty and economically inert gap in the streetscape. In any dynamic sense, taking the economic potential of the plot from latent to real will have multiple other more meaningful local impacts than the immediate, temporary effect on land prices. These dynamic considerations must be part of any complete assessment of the policy.

OZs were intentionally designed to be long-term interventions. It will require patience to determine the true local impact of, and public return on, these investments. In the short-term, seeing clear uptake of the incentive and diversification of fund-types and asset classes are key to determining whether the experiment is running as planned. Over a longer time horizon, there will need to be clear evidence of economic benefits to designated communities. Indeed, OZs were borne out of frustration with the slow rate of economic progress in many

low-income communities. Congress believed the scale and longevity of the problem warranted a radical new approach. In evaluating OZs, researchers must help policymakers understand what circumstances delivered the greatest impact so they can keep improving federal economic and community development efforts. The OZ experiment will, of course, be a success if it meaningfully boosts economic growth and opportunity in target communities. But it will also be a success if the relatively wide-open model of OZs, which was intended to encourage broad and innovative use cases, provides a plethora of data and observations that inform future policy iteration and ingenuity in tackling the underlying challenge of supporting economic revitalization in underserved areas.

The ultimate verdict on OZs is years away. In the meantime, there are few concrete actions policymakers can make that would go a long way in eliminating some of the shortfalls in the policy's original passage and ensuring it lives up to its promise.



Selma, AL

Living up to its promise

While the balance of activity in the young life of OZs shows real promise, more can be done on the administrative and legislative fronts to help the policy reach its full potential. Shortcomings in how the OZ statute was written in the rush of tax reform, combined with the slow-moving regulatory process, have made their mark on the young market. It took more than 500 pages of regulations for the Treasury Department to interpret the original 8-pages of statutory text. Dates certain in the statute that make the incentives perishable and extremely time-sensitive ran up against the slow gears of regulatory promulgation. The Treasury Department, for its part, prioritized issuing guidance needed to invest in real estate early but generally refrained from issuing subregulatory guidance and waited until the very end to provide answers to several of the critical questions that would make investing into operating businesses possible, with the effect of heavily tilting the early market in favor of the former.

In addition, one of the key advantages of OZs was intended to be its simplicity and widespread availability. Most federal community development tools are complex, niche activities backed by only limited appropriations from Congress, and demand

for them far exceeds supply. It is costly and time consuming to compete for and receive NMTC allocations, for example, limiting the program's usefulness to individual businesses and developments. OZs sought to encourage investing in distressed communities without such limitations, high associated costs, and complexity. That simplicity and accessibility was lost in translation from idea to fully-regulated tax policy, however. As it stands in 2021, complexity remains one of the biggest barriers to increasing participation in the OZ marketplace, growing equity investments into new and existing operating businesses, and allowing for creative funding structures to evolve to meet community needs.

There are a number of discrete refinements Congress could enact to make the policy more effective and counteract these initial shortcomings. By filling in the missing pieces from OZs' hurried passage in TCJA and providing clear instructions to regulators, Congress has the power to further accelerate the maturation of the OZ marketplace, shape it towards greater impact, and increase its ability to be a driving force behind a more equitable and inclusive pandemic recovery. Specifically, the following enhancements would bolster OZs as a policy:

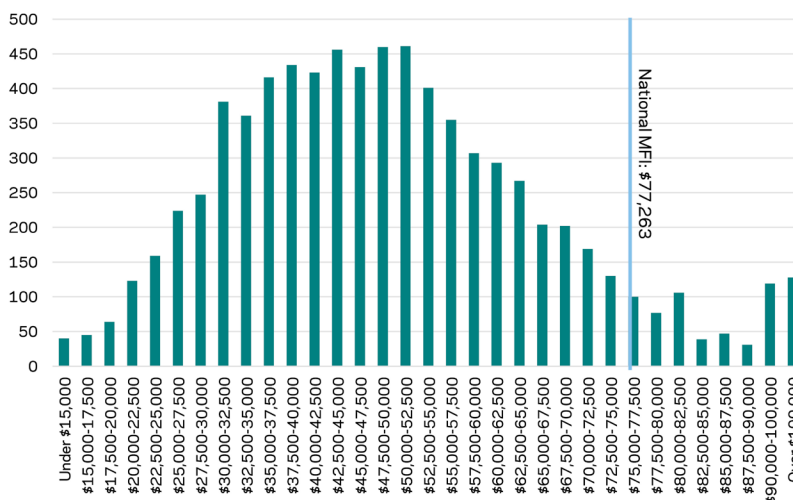
Reporting requirements and the IMPACT Act

The bipartisan *Improving and Reinstating the Monitoring, Prevention, Accountability, Certification, and Transparency Provisions of Opportunity Zones (IMPACT) Act* would establish a comprehensive data collection and reporting regime to track investments and evaluate the OZ policy, while striking the best balance between the need for granular measurement data and the imperative to protect confidential taxpayer, investor, and business information. The establishment of a robust reporting regime is the improvement that has the most bipartisan support in Congress, from local elected officials, think tanks, and other industry and community stakeholders. Restoring the transparency that was the original intent of the bill's sponsors and was always envisioned as critical to the implementation of the policy would go the longest way to dispel lingering misgivings and create the space for more impact investors, philanthropies, and other such actors to engage. There is a considerable appetite for passing reporting requirements into law as soon as possible.

Early sunset of undeserving tracts

Governors selected tracts that on the whole demonstrated far more socioeconomic need across nearly every available measure than the eligible tracts they bypassed. However, a small percentage of designated tracts – while technically qualifying according to Treasury's definition of a Low-Income Community (LIC) or the rule allowing some adjacent tracts for designation – are in fact high income and do not align with the underlying intent of the law. Congress could enact an early sunset of the OZ designation for higher-income tracts that do not meet the spirit of or congressional intent for the incentive. Even though such tracts do not appear to be winning disproportionate investor interest, their continued designation as OZs risks undermining the integrity of the broader policy, distorting the flow of capital away from higher-need areas, and opening up the provision for potential misuse. The sunseting of these tracts would need to be balanced with appropriate transition rules for existing investments, to avoid undermining investor confidence and certainty in the incentive.

Number of Opportunity Zone census tracts falling into each MFI band, 2019



Source: EIG analysis of 2015-2019 American Community Survey estimates

Allowing for direct investment into aggregator or feeder funds

Under current rules, OZ investors must make their investments directly into an Opportunity Fund, and those funds must invest directly in Qualified Opportunity Zone Property. This prevents aggregator or feeder funds from being established that would expand the pool of investors and enable individual investors to create more diversified portfolios of OZ investments. Allowing for aggregation would also permit financial institutions to pool funds that could then be invested into smaller, more specialized Opportunity Funds. Such reforms could go a long way towards allowing more traditional, venture capital or mutual fund style products to be made available to a broader swathe of the population and truly create an asset class of place-based investing vehicles. Without the ability to aggregate, most Opportunity Funds remain quite specialized and closely held.

Providing a capital fund to support technical assistance

Many states and communities need additional support to successfully develop and implement local OZ strategies that will benefit their residents and, in particular, attract impactful levels of investment to local businesses. In cities such as Baltimore, philanthropies have stepped into this space and demonstrated the need for more such capacity-building at scale by showing just how valuable such activities can be. Since OZs were enacted, community leaders have clearly expressed the need for technical assistance, pre-development and risk mitigating capital, and dedicated personnel to coordinate OZ strategies, interface with local stakeholders, and conduct outreach to investors and project sponsors. The examples of Alabama, Colorado, and Erie, PA, show that local capacity is an essential complement

to the OZ incentive. Modest investments into local capacity-building could pay huge dividends in private OZ investment and community impact.

To solve the problem Congress should consider creating a federal fund, housed within the Department of the Treasury or the CDFI Fund, that would distribute money to states that would then determine how best to allocate the funding to support OZ activities in their communities. The funds could be used to support local capacity building, hiring of personnel dedicated to coordinating OZ activities, and technical assistance, as well as providing pre-development or other forms of risk-mitigating capital to projects that support the creation of affordable housing, new and expanding businesses, and other community services.

Modification of regulations to facilitate affordable housing development

Many OZs could benefit from the development of quality affordable rental housing. However, the substantial improvement threshold required for existing property under current regulations is quite high for affordable housing projects that intend to rehabilitate existing property. This threshold is even more challenging for affordable housing deals in expensive urban areas, which is often where such housing is most acutely needed. Throughout the regulatory process, affordable housing developers have requested additional flexibility that would allow them to rehabilitate or convert existing property to affordable housing projects at a threshold that would ensure the housing is kept truly affordable. Possible solutions include making certain projects eligible for the original use test instead of requiring them to meet the substantial improvement threshold, as long as the OZ projects remain affordable at certain agreed-upon levels for a specific timeframe.

Conclusion

Opportunity Zones represent one of the boldest policy experiments in decades to allow for more communities to participate in and benefit from the country's economic progress. In the three short years since passage, OZs have succeeded in disrupting established patterns, changing conversations, and delivering capital for a wide variety of uses in a wide range of places. Fundamentals of the model are being proven.

Yet it is still a work in progress. Opacity and complexity have both inhibited market development. Now is the time for innovation to beget iteration. As the OZ market reaches critical stages of maturation in early 2021, a new administration and new congress have a window to enact needed reforms to maximize OZs' contribution to an equitable recovery from the pandemic recession.

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