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Did States Maximize Their Opportunity Zone Selections?

Analysis of the Opportunity Zone Designations

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May 2018 (Revised July 2018)

The Tax Cuts and Jobs Act included a new federal incentive—Opportunity Zones—to spur investment in low-income and undercapitalized communities. This incentive could become the nation's largest economic development "program," but its potential for positive impact depends first on the decisions of America's governors. April 20, 2018, was the final deadline for governors (and the mayor of the District of Columbia) to select which among the roughly 56 percent of eligible census tracts should be classified as Opportunity Zones.

Of the eligible tracts, governors were able to designate 25 percent (or at least 25 tracts in states with fewer than 100 qualified tracts) as Opportunity Zones. The incentive provides the following three tax benefits for equity investing in Opportunity Zones:

- **Permanent exclusion of taxable income on new gains.** For investments held for at least 10 years, investors pay no taxes on capital gains produced through their investment in Opportunity Funds (the investment vehicle that makes investments in Opportunity Zones).

- **Basis step-up of capital gains invested.** For capital gains placed in Opportunity Funds for at least five years, investors' basis on the original investment is increased 10 percent. If invested for at least seven years, investors' basis on the original investment is increased 15 percent.

- **Temporary deferral of capital gains.** Investors can place existing assets with accumulated capital gains into Opportunity Funds. Those capital gains are not taxed until the end of 2026 or when the asset is disposed of.

Apart from the exclusion of a few "sin" businesses, the activities and projects Opportunity Funds can finance are broad. Funds can finance commercial and industrial real estate, housing, infrastructure, and current or start-up businesses. For real estate projects to qualify for Opportunity Fund financing, the investment must result in the properties being "substantially improved."

The Selected Zones

The statute defined local areas (census tracts) as eligible for selection as Opportunity Zones if they are "low-income communities" under the high-poverty or low-median-income definitions established for the New Markets Tax Credit program.[1] Census tracts that are contiguous to low-income communities are eligible for selection if their median family income does not exceed 125 percent of the adjacent qualifying low-income community tract. Contiguous tracts cannot represent more than 5 percent of tracts selected.

A total of 42,176 census tracts were eligible to be designated as Opportunity Zones (table 1). A total of 8,762 were designated, and of these, 8,532 were low-income communities and 230 were contiguous communities. Contiguous tracts represented 2.6 percent of all designated tracts, lower than the 5 percent allowed.

TABLE 1

Opportunity Zone Designations

Census-tract classification	Designated	Eligible nondesignated	All eligible
Low-income communities			
N	8,532	23,332	31,864
Share of group	97.19%	69.83%	75.51%
Contiguous communities			
N	230	10,082	10,312
Share of group	2.62%	30.17%	24.45%
Total (N)	**8,762**	**33,414**	**42,176**

Source: Community Development Financial Institution Fund.
Note: Includes all 50 states, the District of Columbia, American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands.

Assessing the Selected Opportunity Zones

Given the range of investments and projects eligible to receive benefits in Opportunity Zones, governors had to weigh which communities would maximize the return on public investment. Their selections were doubly important because the statute includes no provision to change which communities are classified as Opportunity Zones over time as local conditions change.

Many criteria could be used to assess how successfully governors targeted their selections. We offer two for consideration: need and benefit. With respect to need, though a case could likely be made for each of the eligible census tracts, the return on investment for public subsidy is expected to be

higher among communities struggling to access capital. With respect to benefit, low- and moderate-income residents will need to be able to afford to remain their communities as the areas upgrade—not be displaced—if they are to benefit from the gains Opportunity Zones bring.

To guide selection and subsequently assess the need and benefit Opportunity Zones are poised to provide to neighborhoods that were ultimately selected, we prepared a dataset for all eligible tracts, ranking them in terms of the investment flows they have recently received and the social and economic changes they have experienced.[2] We scored investment flows to tracts based on commercial lending, multifamily lending, single-family lending, and small business lending. We ranked tracks within states, as this aligned with the choice set available to governors.

We also created an indicator for whether tracts have experienced high levels of socioeconomic change. The logic is that in communities already experiencing high levels of socioeconomic change, further investment places low- and moderate-income residents at risk of displacement, and therefore Opportunity Zones in these areas may be less likely to result in benefits for residents in need. We defined this measure as changes taking place between 2000 and 2016 in shares of residents with a bachelor's degree or higher, and median family income; share of non-Hispanic white residents; and average housing cost burden. The appendix includes a detailed description of the investment score and socioeconomic change measures.

The investment and social change measures we created are national in scope. Though instructive, we recognize that no measure can fully summarize the complexity of local conditions. Local knowledge is necessary to fully consider the criteria of need and benefit for specific census tracts.

Opportunity Zone Investment Scores

The actual Opportunity Zone designations indicate only minimal targeting of the program toward disadvantaged communities with lesser access to capital relative to all eligible tracts. The distribution of tracts governors designated is similar to the distribution of all tracts that were not designated.

We ranked each eligible census tract in its investment received on a 1-to-10 scale, with 10 being the highest score. Figure 1 displays the distribution of designated and eligible nondesignated tracts by investment score. Just under a third of Opportunity Zones are located in tracts that have the lowest levels of investment as defined by our measure (scoring a 1, 2, or 3).[3] However, 28 percent are located in tracts attracting the highest levels of investment (scores 8, 9, and 10). For comparison, roughly 30 percent of nondesignated tracts scored a 1, 2, or 3 and another 30 percent scored 8, 9, or 10.

FIGURE 1
Investment Score Distribution of Opportunity Zones
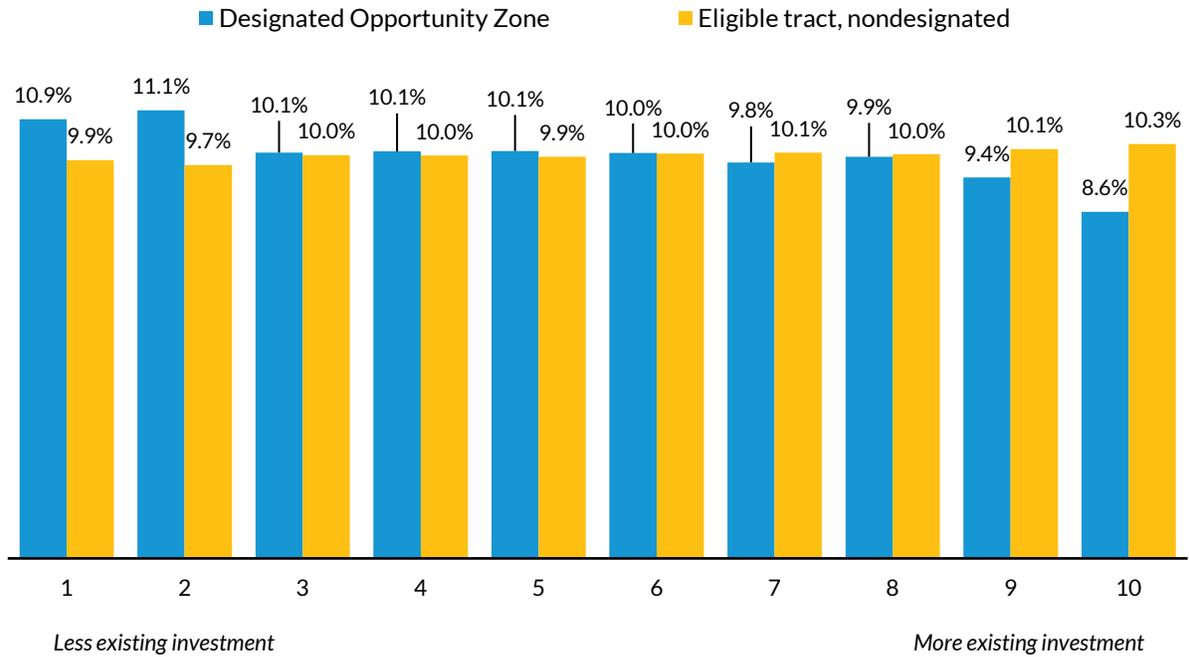
Source: Urban Institute analysis of 2011–15 CoreLogic, 2015 Longitudinal Employer-Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics, 2011–15 US Census Bureau American Community Survey, 2000 Decennial Census, 2011–15 Home Mortgage Disclosure Act, and 2011–15 Community Reinvestment Act data.
Note: This figure excludes US territories.

Though investment scores for the US states and DC overall look similar for designated and nondesignated tracts, there is more variation looking separately by state. States selecting areas with the lowest levels of preexisting investment are Montana (4.1), DC (4.4), Alaska (4.6), and Georgia (4.7). Conversely, the average investment score for designated tracts was 6.4 in Hawaii, 6.6 in Vermont and Nebraska, and 6.8 in West Virginia (figure 2).

FIGURE 2

Average Investment Score, by State

▲ Eligible tract, nondesignated   ● Designated Opportunity Zone
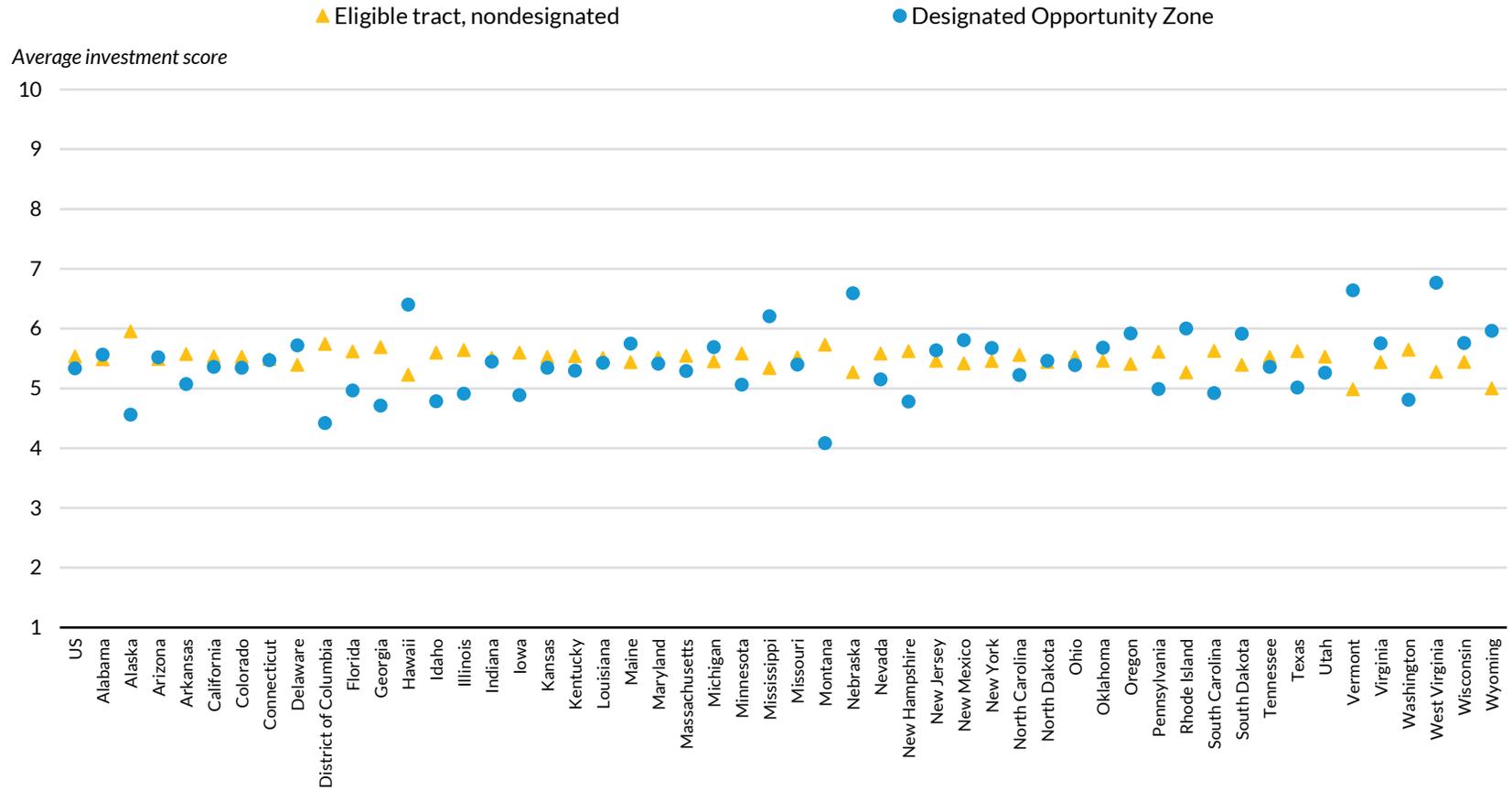
Average investment score

Sources: CDFI Fund, Urban Institute analysis of 2011–15 CoreLogic, 2015 Longitudinal Employer Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics, 2011–15 US Census Bureau American Community Survey, 2000 US Census Decennial Census, 2011–15 Home Mortgage Disclosure Act, and 2011–15 Community Reinvestment Act data.

Note: This figure excludes US territories.

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Opportunity Zone Socioeconomic Change

According to our definition, 3.7 percent of US tracts experienced sizable socioeconomic change from 2000 to 2016. Tracts experiencing socioeconomic change were actually more represented among designated tracts (3.2 percent) than among eligible nondesignated tracts (2.4 percent).

These trends vary considerably across the US (table 2). Some states have no or few tracts that have experienced sizable socioeconomic change, such as New Hampshire, South Dakota, and West Virginia among either the designated or nondesignated communities.

Conversely, these changes are more prevalent in others, notably New York, where 13 percent of Opportunity Zones have already experienced high levels of socioeconomic change. Delaware, Connecticut, and Maryland are next highest at 8, 7, and 6 percent.

Washington, DC, a city that has state-like authorities, has a much higher share of tracts that have undergone such changes, at 32 percent. However, a better comparison may be other cities such as New York City at 21 percent, Oakland at 37 percent, and Seattle at 40 percent.

Table 2 shows the share of designated and eligible nondesignated tracts that experienced socioeconomic change for each state and DC.

TABLE 2
Share of Tracts Experiencing Socioeconomic Change by State

State	Designated (%)	Eligible, nondesignated (%)	State	Designated (%)	Eligible, nondesignated (%)
Alabama	1.3	0.1	Montana	0.0	0.7
Alaska	4.0	0.0	Nebraska	4.5	0.0
Arizona	1.8	1.3	Nevada	0.0	0.0
Arkansas	1.2	0.2	New Hampshire	0.0	0.0
California	3.9	2.7	New Jersey	4.7	2.7
Colorado	3.2	4.0	New Mexico	0.0	0.0
Connecticut	6.9	1.1	New York	13.0	7.1
Delaware	8.0	0.0	North Carolina	1.6	2.2
District of Columbia	32.0	49.5	North Dakota	4.0	0.0
Florida	1.4	1.8	Ohio	5.3	0.6
Georgia	2.7	2.6	Oklahoma	3.4	0.4
Hawaii	4.0	1.9	Oregon	1.2	2.8
Idaho	0.0	0.6	Pennsylvania	5.0	2.8
Illinois	1.5	4.5	Rhode Island	4.0	2.8
Indiana	3.8	0.8	South Carolina	2.2	3.1
Iowa	0.0	0.6	South Dakota	0.0	0.0
Kansas	0.0	0.0	Tennessee	4.0	1.4
Kentucky	0.0	0.5	Texas	1.8	2.1
Louisiana	2.0	3.3	Utah	4.3	1.7
Maine	0.0	0.5	Vermont	0.0	0.0
Maryland	6.0	5.2	Virginia	4.2	2.9
Massachusetts	3.6	4.5	Washington	3.6	1.1
Michigan	2.1	0.6	West Virginia	0.0	0.0
Minnesota	2.3	0.5	Wisconsin	0.8	1.3
Mississippi	2.0	0.2	Wyoming	0.0	3.2
Missouri	1.9	1.5	US	3.2	2.4

Source: Community Development Financial Institution Fund and Urban Institute analysis of 2012–16 US Census Bureau American Community Survey.

Note: This table excludes US territories.

A Closer Look at Tract Conditions

In addition to our composite investment and socioeconomic measures, other attributes about tracts are useful in understanding Opportunity Zone selections. Table 3 summarizes economic, housing, demographic, and education factors for designated and eligible nondesignated tracts. We provide distributions of selected communities for each of the 50 states and Washington, DC, separately online.[4]

Tract Characteristics by Opportunity Zone Designation Status

Characteristics	Designated	Eligible, nondesignated	All tracts
Economic (average or average %)			
Median household income	$33,345	$44,446	$58,810
Poverty rate	31.75%	21.12%	16.61%
Unemployment rate	13.14%	9.26%	8.12%
Housing (average or average %)			
Median home value	$145,187	$170,919	$232,818
Median rent/month	$768	$885	$1,023
Homeownership	44.62%	56.65%	62.99%
Severe rent burden	26.46%	24.32%	22.31%
Vacancy rate	15.83%	13.67%	11.97%
Demographic (average %)			
White alone	39.57%	55.37%	61.72%
Black alone	24.04%	17.25%	13.29%
Hispanic	29.93%	20.01%	17.04%
Asian Americans and Pacific Islanders alone	2.92%	4.04%	4.80%
Younger than 18	23.60%	22.78%	22.41%
Older than 64	13.61%	14.53%	15.22%
Education (average %)			
Age 25+ with high school degree or less	54.81%	49.59%	42.03%
Age 25+ with bachelor's degree or higher	17.61%	21.06%	29.00%
Geography (%)			
In a metropolitan area	78.15%	78.63%	83.44%
In a micropolitan area	11.40%	11.19%	9.19%
Non–core-based statistical area	10.46%	10.18%	7.37%

Source: Community Development Financial Institution Fund and Urban Institute analysis of 2012–16 US Census Bureau American Community Survey.

Notes: This table includes all 50 states, the District of Columbia, and Puerto Rico. It does not include American Samoa, Guam, the Northern Mariana Islands, or the Virgin Islands because of data limitations. All differences between "designated" and "eligible, nondesignated" are significant at the 1 percent level except for geographic characteristics. Census tracts in non–core-based statistical areas are not in metropolitan or micropolitan areas.

A look at all states and DC combined shows that governors did some targeting during the selection process. Designated tracks do have lower incomes, higher poverty rates, and higher unemployment rates than eligible nondesignated tracts (and the US overall average, which is as expected given eligibility criteria). Housing conditions trend in similar ways, with lower home values, rents, and homeownership rates. The designated tracts are also notably less white and more Hispanic and black than eligible nondesignated tracts. Age compositions are comparable. Education levels are somewhat lower among designated tracts than eligible nondesignated tracts.

Rural and urban areas face different challenges with respect to accessing capital, yet communities in both of these environments can be challenged in that regard. In terms of this program, there appears to be no targeting on the basis of urbanization. There is no difference in the share of designated and eligible nondesignated tracts that are located in metropolitan areas, in micropolitan areas, or in non–core-based statistical areas.

Looking Ahead

Opportunity Zones were created to spur capital flow to target neighborhoods. Though understanding tract designations is important, designations alone do not indicate where new capital will flow as a result of this incentive. Going forward, there is a clear need for the federal government to track the capital flows spurred by this new tax incentive to properly monitor and assess the program. In addition, other indicators in the selected communities—for example, a bolstered tax base, increased local earnings, or limited displacement—will eventually provide evidence on whether and how this incentive was able to drive meaningful, positive change in neighborhoods that need it.

Appendix. Methodology

Investment Score

We developed a score of investment flows to tracts based on four components: commercial lending, multifamily lending, single-family lending, and small business lending.

Opportunity Zones will spur equity investments into tracts, but information about existing equity flows is not available at small areas of geography across the dimensions of interest. As such, we present debt flows as one means toward understanding local capital access, but note the important distinction between debt and equity flows. Further, we have not incorporated other types of capital flows that matter to tracts—notably local, state, federal, and philanthropic funding. Though the investment score provides information about capital access for low-income communities and contiguous tracts, local knowledge will help contextualize, clarify, and even correct the understanding conveyed via this score.

Commercial lending. To develop this measurement, we used 2011–15 CoreLogic data of loans to commercial, industrial, agricultural, and exempt properties geocoded to 2010 census tracts, excluding single loans that totaled $100 million or more. We summed the total investment over the five-year period at the census-tract level and created an annual average. We divided that average investment amount by the number of workers employed in the tract to create an investment-employee ratio. We obtained employment data from the Longitudinal Employer-Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics at the census-block level and then aggregated them to the census-tract level. We calculated this measure only for census tracts with 200 or more employees.

Multifamily lending. We developed a measure of multifamily lending using 2011–15 CoreLogic data of loans to multifamily properties (five or more units) coded to 2010 census tracts. We excluded single loans that totaled $100 million or more. We summed the total investment over the five-year period at the census-tract level and created an annual average. We divided that average investment amount by the number of multifamily units in the tract to create an investment–multifamily-unit ratio. We obtained the tract data for multifamily units from the 2011–15 American Community Survey. This measure was calculated only for census tracts with 200 or more multifamily units.

Single-family lending. We compiled a single-family lending measure for 2011–15 using tract-level Home Mortgage Disclosure Act records. We considered only home purchase loans. We took the average amount and total number of home purchase loans per tract to arrive at estimated average total loans over the five-year period. We divided the average annual amount by the total number of single-family units in each tract to arrive at an average annual level of Home Mortgage Disclosure Act single-family lending per single-family unit. This measure was calculated only for census tracts with 200 or more units of single-family housing as obtained from the 2011–15 American Community Survey.

Small business lending. We compiled a small business measure at the tract level for the years 2011 through 2015. We obtained lender-level Community Reinvestment Act loan amounts for small

businesses from the annual aggregate Community Reinvestment Act data files for 2011–15, available through the Federal Financial Institutions Examination Council. We excluded likely credit card loans by dropping records if the average size of their loans made under $100,000 was less than $10,000. Collapsing five years of data by tract, we arrived at a total sum, which we used to obtain the average annual amount of Community Reinvestment Act lending. We then divided this amount by the number of small business employees in each tract. We considered any private-sector employee working at a firm with up to 19 employees as an employee of a small business. We obtained these data from the Longitudinal Employer-Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics at the census-block level and then aggregated them to the census tract.

We created z-scores for each component measure (commercial, multifamily, single-family, and small business) unless the tract did not meet the cutoff criteria. We averaged the z-scores to create a composite investment score. If a tract did not meet the eligibility threshold for a given category, it was averaged based on the other categories. Then, looking at only low-income communities and contiguous tracts, we ranked tract z-scores relative to other low-income communities and contiguous tract scores within the same state or territory. We then created a decile ranking of the composite z-scores for all eligible low-income community and contiguous tracts, meaning that each has a ranking from 1 (low) to 10 (high).

Socioeconomic Change Flag

Eligible tracts that have gentrified may need federal investment support less than tracts that have not. Gentrification is challenging to measure at a national level and ideally would incorporate local data.[5]

To help inform the decision of which tracts will maximize the return on public investment, we created a flag for tracts that have experienced high levels of socioeconomic change. But local knowledge will be needed to validate, verify, and modify the information presented.

Tracts received a socioeconomic change flag if they were more than 1 standard deviation above the mean of all national census tracts on the composite socioeconomic change index we developed. This index was composed of four indicators measuring the change in their respective values between 2000 and 2016. We obtained all 2012–16 data from the 2012–16 American Community Survey, and we obtained all 2000 data from the 2000 Decennial Census. We obtained all US Census data through the online portal NHGIS (IPUMS NHGIS, University of Minnesota, www.nhgis.org).

We included the following four measures in these calculations:

- Percentage-point change in the share of residents with a bachelor's degree or higher

- Dollar change in median family income

- Percentage-point change in the share of non-Hispanic white residents (which, for example, can help to explain difference in assets, not just incomes)

- Change in average housing burden

» We created the housing burden measure by calculating z-scores for two housing measures and averaging them: (1) change in the tract's median home value divided by change in the metropolitan statistical area's median household income, and (2) change in the tract's median gross rent divided by change in the metropolitan statistical area's median household income. For rural areas outside metropolitan or micropolitan statistical areas, we used the county median household income instead. Any tracts with fewer than 100 units of rental-occupied housing were scored by the home value measure alone, and any tracts with fewer than 100 units of owner-occupied housing were scored by the rent measure alone.

To receive a score in the first three demographic indicators (educational attainment, median family income, and race or ethnicity), tracts had to have at least 100 residents. We created z-scores for each of these three factors and then averaged them with the housing burden z-score. We calculated this score for all US tracts. Any tract 1 standard deviation or more above the mean is flagged as a "1," having experienced sizable socioeconomic change across these dimensions.

Notes

[1] As put forth in section 45D(e), several criteria dictate whether a census tract is a low-income community, including if the tract has any of the following: a poverty rate of 20 percent or higher; for tracts in metropolitan areas, a median family income that is 80 percent or lower of the statewide or metropolitan area median family income, whichever is higher; or for tracts not in metropolitan areas, a median family income that is 80 percent or lower of the statewide median family income. The median family income limits are 85 percent for tracts in a "high-migration rural county" that has experienced 10 percent out-migration over two decades.

[2] Brett Theodos, Carl Hedman, Brady Meixell, and Eric Hangen, "Opportunity Zones: Maximizing Return on Public Investment," Urban Institute, accessed May 11, 2018, https://www.urban.org/policy-centers/metropolitan-housing-and-communities-policy-center/projects/opportunity-zones-maximizing-return-public-investment.

[3] These findings are for the 50 states and Washington, DC. Because of data limitations, we were not able to calculate investment scores for tracts in the US territories.

[4] Tables of the state-level tract characteristics by Opportunity Zone designation status can be accessed through https://www.urban.org/sites/default/files/urban_statesozs_update.xlsx.

[5] See, for example, a review of local measures: Chris Bousquet, "Where Is Gentrification Happening in Your City? Using Mapping to Understand Gentrification and Prevent Displacement," Data-Smart Solutions, June 5, 2017, https://datasmart.ash.harvard.edu/news/article/where-is-gentrification-happening-in-your-city-1055.

Errata

This brief was updated on July 12, 2018. The shares of people age 25+ with a bachelor's degree or higher in table 3 (page 8), along with the share of low-income communities designated as Opportunity Zones in table 1 (page 2), have been changed to correct a previous coding error. In addition, the original brief mentioned that the US Treasury had not approved Opportunity Zones for Florida, Nevada, Pennsylvania, and Utah. The Treasury has since approved these states' Opportunity Zones, so that mention has been deleted. The designated tracts in Florida, Nevada, Pennsylvania, and Utah mapped so closely to the proposed tracts that no data in the brief were affected.

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