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The Impact of Opportunity Zones: An Initial Assessment by the White House Council of Economic Advisers

Executive Summary

Opportunity Zones (OZ, OZs) were created in 2017 to allow investors to avoid federal capital gains tax by reinvesting their profits in funds that invest in high poverty or low income designated census tracts (or next door to a tract that meets those standards). "The Impact of Opportunity Zones: An Initial Assessment," authored by the White House Council of Economic Advisers (CEA), compares the advantages of OZs with those of other federal antipoverty programs and quantifies the effect of OZ investment. The report calculates that large increases in investments are benefiting OZ residents while having only a small effect on the federal budget. The report states that OZs were able to cut taxes to increase economic activity by spurring private sector investment, job creation, and self-sufficiency while also giving greater scope for market forces to guide entrepreneurs and investors. The CEA estimates the tax cuts increased investment in impoverished communities with Qualified Opportunity Funds, raising $75 billion in private capital during 2017-2019. The report concludes that OZ designations alone are responsible for a 1.1 percent increase in housing values, and when combined with greater amenities and economic opportunity, an estimated $11 billion in new wealth has been created for OZ homeowners and their surrounding communities.

- **Tax Benefits and Capital Gains**

A provision of the 2017 Tax Cuts and Jobs Act reduced U.S. corporate income tax rates and thereby decreased the cost of capital, stimulating investment and growth in gross domestic product and wages. By reducing taxes on the capital gains invested in low-income communities, the OZ provision lowered the cost of capital for businesses investing in these communities. These investments are expected to lead to more job creation locally, in turn spurring greater economic opportunities.

Under other existing place-based development programs, the federal government selects who receives grants or tax credits and narrowly prescribes their use. By comparison, OZs give greater scope for market forces to guide entrepreneurs and investors because they have no cap on participation and require no government approval.

For investors, OZs provide three potential tax benefits for investing capital gains in Qualified Opportunity Funds. The first benefit is that an investor can defer paying taxes on capital gains rolled into OZs until potentially as late as 2026. Second, when these taxes are paid, the investor may omit 10 percent (15 percent) of the original gain if the investment is held there for at least five (seven) years. Finally, any capital gains that accrue to investments in a Qualified Opportunity Fund are tax free if the investment is held for at least 10 years. The incentives cut taxes on capital supplied to low-income communities, reducing the tax wedge associated with the supply and demand for capital. The CEA Report found that tax cuts have spurred a large investment response, with Qualified Opportunity Funds raising $75 billion in private capital by the end of 2019. Although some of this capital may have occurred without the incentive, the CEA estimates that $52 billion—or 70 percent—of the $75 billion is new investment.

- **Increased Investment Spurs Economic Growth**

The Treasury Department estimates that 1,500 Qualified Opportunity Funds existed as of the end of 2018, based on preliminary counts of Form 8996 filings for that tax year. The CEA estimates that over 5,500 Qualified Opportunity Funds existed as of the end of 2019. Qualified Opportunity Funds can invest in OZs by directly purchasing property or by making equity investments in operating businesses. Investment data from the Securities and Exchange Commission show that OZ designation led to a 29 percent increase in equity investments in businesses whose principal place of business is in an OZ.

Private equity investment in OZ businesses grew by an estimated 29 percent relative to businesses in eligible communities that were not selected as OZs. Each dollar raised by Qualified Opportunity Funds through 2019 results in an estimated loss of 15 cents of federal revenue, compared to 18 cents of lost federal revenue for each dollar in investment through the New Markets Tax Credits program.

With the amount of capital raised through 2019, an estimated 1 million people could be lifted out of poverty and into self-sufficiency, decreasing poverty in OZs by 11 percent. This decline in poverty, and with it a reduction in transfer payments, may be sufficient to make the OZ incentive nearly revenue neutral.

- **Estimated Home Values Increased**

According to the CEA report, an OZ designation was responsible for an estimated 1.1 percent increase in housing values. Due to housing value increases and greater amenities and economic opportunity, an estimated $11 billion in new wealth has been created for OZ homeowners. The report indicates that year-over-year growth in development site acquisitions surged in OZs by more than 50 percent late in 2018 after the Department of the Treasury had designated the OZs, greatly exceeding growth in the rest of the United States. The data found that OZ designation led to a 14 percent increase in the price of redevelopment properties and a 20 percent increase in the price of vacant development sites as of early 2019.

The report concludes that homeowners are seeing immediate positive returns, with the ability to access newly found equity without selling their homes through cash-out refinancing. The report further states that these rising values do not only benefit homeowners, and that the causes of higher values—more local amenities and anticipated economic opportunities—will benefit many renters as well. The renovation of a blighted building, for example, benefits all who live nearby. Citing recent Census data surveys showing that less exposure to poverty and rising values tend to benefit original residents and lead to better outcomes for their children, the CEA draws similar conclusions about the effects of rising housing values and neighborhood improvement on residents and their children.

- **Building on Progress**

While the initial conclusions reported by the CEA are welcome news, there are still several issues that will need to be addressed before a truly clear outline of the success of OZs becomes visible. The structure of the tax incentives, as one example, may pose a barrier for more philanthropic investors. The current tax rewards structure depends on profits rather than job creation or wages, which presents a significant challenge for developers interested in helping low-income, minority neighborhoods prosper. The specific requirement that investors retain ownership of their investments for at least 10 years (in order to get the biggest tax benefit) means they will require high returns that most social-impact projects often can't meet. The fear is that given the geographic limits and need for a high return on investment, the incentives will simply subsidize luxury real estate that will ultimately drive out existing low-income renters.

The structure of the OZs policy of relying on equity financing, capital deployment, investment value, and holding-period requirements better suits it for real estate and startups rather than helping existing small businesses. The current OZ policy can accelerate gentrification in many areas instead of, as intended, providing housing and jobs for low-income communities. This is all the more troubling given that existing minority-owned businesses have closed at disproportionately higher rates during the Covid-19 pandemic.

The report also acknowledges that within OZs, the distribution of the benefits from improved amenities is still unclear. In some instances, the benefits may go primarily to low-income households. For example, cheaper homes benefit the most from the cleanup of hazardous waste sites because such homes tend to be closer to such sites. In the same vein, the renovation of an abandoned warehouse would mostly benefit the residents in the immediate vicinity, who may also be among the poorest in the neighborhood. Residents who rent their housing will generally benefit from improved amenities as long as the full value of the amenities enjoyed by residents is not passed on in the form of higher rents. Improved neighborhood conditions do not always result in rent increases for all renters, and sometimes improved amenities increase housing values more than they increase rents.

- **Legislative Actions**

Lawmakers from both parties support legislation to require the Department of Treasury to provide data on economic activity in OZs, but disagree over how much investor information should be disclosed or what the extension timelines should be. In the Senate, Senator Tim Scott (R-SC) introduced legislation that would provide a two-year extension of the deadline for investors to keep 15% of their original gains from being taxed, while Senator Ron Wyden (D-OR) has requested more detailed public disclosures of investor activity. Senator Cory Booker

(D-NJ), who sponsored the original opportunity zones bill with Senator Scott, has proposed adding more technical assistance to localities, eliminating higher-income zones, and adding lower-income replacements.

In the House, Republicans proposed (H.R. 6513) to extend the deadline for investors to defer their capital gains taxes, while a bipartisan bill (H.R. 6529) would make small businesses hit by Covid-19 eligible for opportunity fund financing. Democrats proposed legislation (H.R. 7262) to allow opportunity funds to invest in community development financial institutions.

Former Vice President Joe Biden’s Racial Economic Equity Plan, which he released in July, offers incentives to investors who partner with nonprofits or community organizations to produce a strategy focused on creating jobs for low-income residents. The plan would also require more data collection on opportunity zone investments and order a Treasury Department review to determine if the incentives are spurring projects with economic, social, and environmental benefits. President Donald Trump has also included expanding OZs in his 2020 campaign pledge but has made no new details available.

- **Conclusion**

Based on limited data available, OZs have been credited with increasing economic development and spurring greater community revitalization. Questions still remain if the supply of affordable housing will increase. NAHMA will continue to advocate that Congress protect the current supply of affordable housing and provide the necessary financial resources to do so. NAHMA members should continue to monitor OZ activities in their communities and encourage those efforts to be included in new construction or preservation of affordable housing.