Fordham Urban Law Journal Spring Symposium presents

A Taxing War on Poverty: Opportunity Zones and the Promise of Investment and Economic Development

February 26, 2021
10 a.m. - 2:45 p.m. EDT
Zoom Webinar

CLE COURSE MATERIALS
A Taxing War on Poverty: Opportunity Zones and the Promise of Investment and Economic Development

Panel 1 - Attracting Private Investment to Distressed Neighborhoods
Charlie Metzger, "We're Not in Kansas Anymore": Using State and Local Power to Fulfill the Potential of the Opportunity Zone Program, 47 Fordham Urb. L.J. 1121 (2020). Available at: https://ir.lawnet.fordham.edu/ulj/vol47/iss4/11
Federick, Rejane; Ortiz, Guillermo. Center for American Progress. Promise and Opportunity Deferred. (February 20, 2020)
Novogradac, Michael. Supporting Slides. (February 2021)

Panel 2 - A Comparative Lens: Analyzing Place-Based Initiatives
Layser, Michelle D.; Barbieri, Edward W.; Greenlee, Andrew J.; Kaye, Tracy A.; Saito, Blaine G. Mitigating Housing Instability During a Pandemic. Abstract. (May 12 2020)
Hemel, Daniel. A Place for Place in Federal Tax Law.
Layser, Michelle D.. Wisconsin Law Review. The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform.

Panel 3 - Systemic Racial Injustice: Gentrification Accelerated
Katz, Bruce; Nowak, Jeremy. Guiding Principles for Opportunity Zones.
Fulton, William. Opportunity Zones: Gentrification on Steroids?

Panel 4 - The Future of OZs: The Biden Administration and Beyond
Golding, Alexander; Metzger, Charlie. Opportunity Zones haven’t fully reached their potential but don’t write them off yet. (Sept. 16 2020)
Looney, Adam. Brookings. Will Opportunity Zones help distressed residents or be a tax cut for gentrification? (February 26, 2018)
Lowrey, Annie. IDEAS. Fixing America’s Forgotten Places. (July 24, 2018)
Alexander Golding, Founding CEO of Helped Hope

As the founding CEO of Helped Hope and the recipient of the Marvin L Kay Fellowship in Finance at George Washington University, Alexander has made it his mission to educate the world about responsible investing. Alexander was recognized for this work when the Denver Business Journal named him “Who’s Who in Impact Investing” in 2018.

Sought after nationally, Alexander has held seminars at major universities and the United Nations. In early 2017, he launched the Florida Impact Investing Initiative. Since then, owners or managers of over one hundred billion investor dollars ($100bn) attended his events and learned about impact opportunities. His impact investing network consists of approximately 6,500 members, approximately 300 of whom are investors. He sends due diligence notes on potential investments to a subset of this group.

Alexander is currently studying social impact, business administration, and artificial intelligence at George Washington University, where he is the recipient of the Marvin L Kay Fellowship in Finance. He received his Bachelor of Science in Finance from the Leonard N. Stern School of Business at New York University and taught “Topics in Social Entrepreneurship” at Florida Atlantic University in the fall of 2017. Alexander is a mentor at Lynn University’s Social Impact Lab. You can find his most recent publication at Fortune, where he wrote about using the Opportunity Zone legislation to provide more capital to communities of color.

Professor Anika Singh Lemar, Yale Law School

Anika Singh Lemar is a Clinical Professor at Yale Law School. She teaches the Community and Economic Development clinic (CED), which provides transactional legal services to organizations seeking to advance economic opportunity. CED’s clients include affordable housing developers, community development financial institutions, farms and farmer’s markets, fair housing advocates, and neighborhood associations. From 2007 to 2013, she represented for-profit, not-for-profit, and governmental clients engaged in a variety of real estate projects including building affordable housing, remediating and redeveloping brownfields, and revitalizing urban neighborhoods. From 2005 to 2007, she was a Skadden Fellow and Staff Attorney at the Community Development Project of the Urban Justice Center in New York. From 2004 to 2005, she served as a Law Clerk for the Honorable Janet C. Hall of the U.S. District Court for the District of Connecticut.

Professor Lemar received her B.A., *cum laude*, in Ethics, Politics, and Economics from Yale University and received her J.D., *cum laude*, from New York University School of Law where she was a Root-Tilden-Kern Scholar, a Dean’s Scholar, and a Robert McKay Scholar. While in law school, she received the Paul and Daisy Soros Fellowship for New Americans and helped to found Next City, a highly-regarded urban affairs publication.
**Professor Blaine G. Saito, Northeastern University School of Law**
Blaine G. Saito, an expert in the field of taxation, joined the Northeastern faculty as Assistant Professor of Law in 2020. His research focuses on the intersection of tax rules, economics, tax administration and social policy. His current research focuses on tax expenditures and their use in social policy and international tax issues. His work has been published in the *Virginia Tax Review*, *Harvard Journal on Legislation* and *Georgetown Journal of Law and Public Policy*.

Saito most recently served as a Climenko Fellow and Lecturer on Law at Harvard Law School. He graduated from Harvard College in 2004 with an AB in chemistry, and went on to earn a JD from Harvard Law School and an MPP from the Harvard Kennedy School.

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**Professor Brandon M. Weiss, American University Washington College of Law**
Brandon Weiss is an Associate Professor of Law at American University Washington College of Law. His research and teaching focus on property law and theory, as well as the relationship between housing, economic mobility, and government intervention, with a particular emphasis on federal subsidized housing policy.

Weiss serves on the Executive Committees of the Property Law Section, the Real Estate Transactions Section, and the Community Economic Development Section of the Association of American Law Schools (AALS). Prior to joining American University, he taught as an Associate Professor of Law at the University of Missouri at Kansas City (UMKC), where he served as a Senior Fellow at the L.P. Cookingham Institute of Urban Affairs. Previously, Weiss taught at UCLA School of Law as a Visiting Assistant Professor and affiliated faculty member at the Ziman Center for Real Estate. He also practiced law in Los Angeles as a Skadden Fellow and Equal Justice Works AmeriCorps Legal Fellow at Public Counsel Law Center, working on the preservation of subsidized housing, and at Bocarsly Emden Cowan Esmail & Arndt, a boutique transactional affordable housing firm.

Weiss earned his J.D. from Harvard Law School, where he was awarded the Dean’s Award for Community Leadership. He also holds a Master in Public Policy from the Harvard Kennedy School of Government, where he focused on urban policy and housing finance. Weiss received his Bachelor of Science in Symbolic Systems (Cognitive Science) from Stanford University.
Bruce Katz, Co-Founder, New Localism Advisors

Bruce Katz is the Co-Founder (with Jeremy Nowak) of New Localism Advisors. The mission of the firm is to help cities design, finance and deliver transformative initiatives that promote inclusive and sustainable growth.

Katz regularly advises global, national, state, regional and municipal leaders on public reforms and private innovations that advance the well-being of metropolitan areas and their countries.


Katz was the inaugural Centennial Scholar at the Brookings Institution from January 2016 to March 2018, where he focused on the challenges and opportunities of global urbanization. Prior to assuming this role, Bruce J. Katz was a vice president at the Brookings Institution and founding Director of the Brookings Metropolitan Policy Program.

Before joining Brookings, Katz served as chief of staff to U.S. Housing and Urban Development Secretary Henry Cisneros and was the senior counsel and then staff director for the U.S. Senate Subcommittee on Housing and Urban Affairs. After the 2008 presidential election, Bruce co-led the housing and urban transition team for the Obama administration and served as a senior advisor to new Secretary of Housing and Urban Development, Secretary Shaun Donovan, for the first 100 days of the Administration.

Katz is a visiting Professor at the London School of Economics. He gives dozens of lectures and presentations annually before public, corporate, civic and university audiences across the world. In 2006, he received the prestigious Heinz Award in Public Policy for his contributions to understanding the “function and values of cities and metropolitan areas and profoundly influencing their economic vitality, livability and sustainability.” Katz is a graduate of Brown University and Yale Law School.

Catherine Lyons, Director of Policy and Coalitions, Economic Innovation Group (EIG)

Catherine serves as EIG’s Director of Policy. Prior to joining EIG, she was Southern California Director for FWD.us, a bipartisan advocacy organization focused on immigration reform. She previously led the housing and community development policy work for the Bay Area Council in the San Francisco Bay Area. She served as an AmeriCorps member in New Orleans after graduating magna cum laude from the University of Southern California with a dual degree in print journalism and international relations. She recently received her Master of Public Policy from Georgetown University’s McCourt School of Public Policy, during which she interned at the DC Department of Small and Local Business Development and the U.S. Senate Committee on the Budget.
Charlie Metzger, Associate Editor, Fordham Urban Law Journal
Charlie is a 3L at Fordham Law and Associate Editor of the Journal. His Note, “‘We’re Not in Kansas Anymore’: Using State and Local Power to Fulfill the Potential of the Opportunity Zone Program,” was published by the Journal in the summer of 2020. Charlie spent his 1L year as a Law Clerk at the New York State Housing Finance Agency (HFA)--the bond issuer and tax credit authorizer for Affordable Housing in NYS--and the summer after his 2L year as a Summer Associate at Katten Muchin Rosenman LLP. At FLS, he is a Research Assistant to Professor Nestor Davidson, a member of the Stein Scholars Program, and works in the Community Economic Development (CED) Clinic. Before coming to law school, Charlie was a Union Organizer in Manhattan at UNITE-HERE!, AFL-CIO. He received an A.B. from the School of Public and International Affairs at Princeton in 2012.

Professor Christopher Tyson, Build Baton Rouge
Chris serves as the President and CEO and is responsible for directing day-to-day operations as well as developing and implementing the Authority’s short and long term strategy and plans. Also serves as a direct liaison to the Build Baton Rouge’s Board of Directors and communicates on behalf of the Authority to other key stakeholders, including the City of Baton Rouge/East Baton Rouge Parish Mayor-President.

He is a Baton Rouge native and holds a Bachelor of Architecture, with honors, from Howard University; a Masters of Public Policy from the Harvard Kennedy School; and a Juris Doctor degree from the Georgetown University Law Center. He is currently on leave from his position as the Newman Trowbridge Distinguished Professor of Law at the Paul M. Hebert Law Center at Louisiana State University. Chris has also practiced as a real estate and land use attorney, a management consultant, and a member of U.S. Senator Mary Landrieu’s Washington, DC legislative staff.

Professor Edward W. De Barbieri, Albany Law School
Professor Edward W. De Barbieri teaches courses in community economic development. His scholarship examines community-based and place-based economic development strategies, and ways that the public can engage in these strategies to lead to reforms in economic and social systems. His articles have appeared or are forthcoming in the Fordham Law Review, Florida State University Law Review, Yale Law & Policy Review, Cardozo Law Review, Fordham Urban Law Journal, and Journal of Affordable Housing & Community Development Law.
Prior to joining the Albany Law School faculty in 2016, Professor De Barbieri directed a community economic development clinic at Brooklyn Law School, and was an Adjunct Professor of Clinical Law at New York University School of Law. His background also includes work as a legal services attorney at the Community Development Project of the Urban Justice Center, beginning as an Equal Justice Works fellow. He spent his final year of law school conducting research in Ireland as a Fulbright fellow, and is a graduate of Yale Divinity School, where he concentrated in religious ethics.

Libin Zhang, Tax Partner, Fried Frank

Libin Zhang is a partner in the New York office of Fried, Frank, Shriver, Harris & Jacobson LLP. He works on a variety of corporate, real estate, and international tax matters, including a large number of qualified opportunity funds since late 2017. His mid-2018 research on qualified opportunity zones was cited by the U.S. Senate Committee on the Budget in “Tax Expenditures: Compendium of Background Materials on Individual Provisions” (Dec. 2018). He received his J.D. magna cum laude from Harvard Law School, his LL.M. in Taxation from New York University, and his J.D. and M.S. joint degree from the California Institute of Technology.

Michael Novogradac, CPA, Managing Partner, Novogradac

Michael Novogradac is the managing partner of Novogradac, which has been in business since 1989. He specializes in affordable housing, community development, historic preservation and renewable energy. Mr. Novogradac’s focus is in real estate taxation and accounting. He is the author of numerous real estate-related tax and accounting articles and books, including the Novogradac Opportunity Zones Handbook, the New Markets Tax Credit Handbook and the Low-Income Housing Tax Credit Handbook. A frequent speaker at tax incentive conferences and forums throughout the country, Mr. Novogradac is active in advocating for the inclusion of affordable housing, historic preservation, community development and renewable energy incentives in federal and state tax policy and broadcasts a weekly podcast, Tax Credit Tuesday. As a leading industry expert, he is frequently quoted in national media, such as The Wall Street Journal, The New York Times, Politico, Bloomberg, Forbes, CNBC News, NBC News, National Public Radio and Crain’s New York Business. In addition, he serves as advisor on industry and governmental affairs for the NMTC Working Group, LIHTC Working Group and the Opportunity Zones Working Group. Mr. Novogradac also serves on the executive committee of the Housing Advisory Group and the boards of directors of the Affordable Housing Tax Credit Coalition, the National Housing Conference, the NMTC Coalition and Historic Tax Credit Coalition. In 2016, Mr. Novogradac was inducted into the Affordable Housing Hall of Fame. He also received The Affordable Housing Visionary Award from The NHP Foundation in 2018, in recognition of his contributions to the affordable housing community and in 2020 was honored as one of the top 25 OZ Influencers through Opportunity Zone Magazine. Mr. Novogradac graduated from the University of California, Los Angeles,
with a bachelor’s degree in economics. He received an MBA from the University of California, Berkeley. He is licensed in California, Oregon, Maryland and Texas as a certified public accountant. You can follow Mr. Novogradac on twitter @novogradac and on his blog at www.novoco.com/blog or listen to his weekly podcast at www.novoco.com/podcast.

**Professor Michelle D. Layser, Illinois College of Law**

Professor Michelle Layser joined the Illinois Law School faculty in fall 2018, teaching partnership taxation, state and local taxation and property law. Before coming to Illinois, Professor Layser spent two years at the Georgetown University Law Center as a Law Research Fellow and Adjunct Professor of Law.

Professor Layser has broad research interests at the intersection of tax law and social policy. Major themes in her research include the use of tax expenditures to deliver public goods, often by encouraging partnerships between governments and private actors, and the effect of such tax expenditures on economic inequality. Her current research looks at how tax law is used to encourage private investment in housing and community development. Past works have looked at the unequal taxation of same-sex families, the potential role of non-profits in supporting news production, tax incentives for investment in clean energy technologies, and how tax law rewards residential segregation.

Professor Layser earned her LL.M. in Taxation from New York University. She received her JD from the University of Southern California Gould School of Law, where she graduated order of the coif. While in law school, she served on the board of the *Southern California Law Review*. She earned her BA with honors from the University of Pennsylvania.

Professor Layser has worked as a transactional associate at Latham & Watkins LLP (Los Angeles, Washington D.C.) and as a managing editor at Bloomberg BNA.

**Professor Nestor Davidson, Fordham Law School**

Nestor Davidson joined Fordham in 2011 and was named the Albert A. Walsh Professor of Real Estate, Land Use and Property Law in 2017. Professor Davidson is an expert in property, urban law, and affordable housing law and policy, and is the co-author of the casebook Property Law: Rules, Policies and Practices (7th ed. 2017). Professor Davidson founded and serves as the faculty director of the law school’s Urban Law Center and previously served as Associate Dean for Academic Affairs.

Professor Davidson practiced with the firm of Latham and Watkins, focusing on commercial real estate and affordable housing, and served as Special Counsel and Principal Deputy General Counsel at the U.S. Department of Housing and Urban Development.
Professor Davidson earned his AB from Harvard College and his JD from Columbia Law School. After law school, he clerked for Judge David S. Tatel of the United States Court of Appeals for the District of Columbia Circuit and Justice David H. Souter of the Supreme Court of the United States.

**Professor Paula Franzese, Seton Hall Law School**

Prof. Paula Franzese is the Peter W. Rodino Professor of Law at Seton Hall Law School. She received her B.A., *summa cum laude*, Phi Beta Kappa, from Barnard College, where she was awarded the Bryson Prize, Alpha Zeta Fellowship, Marion Churchill White Prize, Davidson-Foreman Foundation Award and Barnard Alumnae Fellowship, and her J.D. from Columbia University School of Law, where she was an International Fellow, Teaching Fellow and recipient of the Rosenman Prize for excellence in public law courses.

She is the author of several books and numerous publications on housing law reform, landlord-tenant law, exclusionary zoning, takings law, homeowners’ associations, the dilemma of privatization, and government ethics law reform. She served as Special Ethics Counsel to two governors, Chair of the State Ethics Commission and Vice-Chair of the Election Law Enforcement Commission. She is the recipient of the National Council on Government Ethics Laws’ highest honor, the COGEL Award, for her “significant, demonstrable and positive contributions over a long period of time to the fields of campaign finance, elections, ethics, freedom of information and lobbying reform.”

Nationally renowned for her excellence in teaching, a recent book, *What the Best Law Teachers Do* (Harvard University Press), profiles the pedagogical approach that renders her a “dazzlingly effective model of rigor, hard work, creativity and humility.” She is the unprecedented ten-time recipient of the Student Bar Association's Professor of the Year Award, and in 2019 the award was renamed in her honor the Paula A. Franzese Professor of the Year Award. She was named one of twenty inspiring women in education by sheknows media and recently presented on education as a human right at the United Nations.

She is a Fellow of the American College of Real Estate Lawyers and a Fellow of the American Bar Foundation. Her numerous accolades include the Sir Thomas More Medal of Honor, the YWCA Woman of Influence Award, the Women Lawyers Association Trailblazer Award, the State Bar Foundation’s Medal of Honor, and the Bishop Bernard J. McQuaid Medal, the University’s highest honor.

Prior to joining the academy Prof. Franzese was a litigator with Cahill Gordon & Reindel, where she also served as a member of the NYC Housing Court Reform Project.
Professor Rashmi Dyal-Chand, Northeastern University School of Law

Professor Dyal-Chand’s research and teaching focus on property law, poverty, economic development and consumer law. She is Associate Dean for Research and Interdisciplinary Education. Her recent projects have examined the role of property remedies in achieving more equal distribution. Her article, “Human Worth as Collateral,” won the 2006 Association of American Law Schools scholarly papers competition for new law teachers. Her work has appeared in journals including the Cardozo Law Review, Fordham Law Review and Stanford Journal of International Law. Professor Dyal-Chand is also an editor of the law school’s SSRN online publication, Human Rights and the Global Economy.

Prior to joining the law school faculty in 2002, Professor Dyal-Chand served as an associate general counsel of The Community Builders, Inc., a nonprofit affordable housing developer, where she provided legal representation on all aspects of complex real estate and housing development transactions. Following law school, she served as a law clerk to the Hon. Warren J. Ferguson of the US Court of Appeals for the Ninth Circuit, was a Public Interest Fellow at the law firm of Hall & Associates in Los Angeles and practiced in the business department of the Boston law firm of Foley Hoag, where she specialized in transactions involving intellectual property licensing and transfer.

Stephanie Copeland, Managing Partner, Four Points Funding, LLC

Stephanie Copeland is a pragmatic operational leader who has a demonstrated track record of shareholder value creation. She is expert in establishing high performing teams who can scale through disciplined accountability. Stephanie became the Managing Partner of Four Points Funding on January 1, 2019, previously, serving on Governor John Hickenlooper’s cabinet as the Executive Director for the Colorado Office of Economic Development and International Trade.

She joined the governor’s cabinet from The Zayo Group, where she served as President of the communications infrastructure services firm. She was part of the leadership team taking the company public, controlling the full P&L and operational responsibilities for Zayo’s network services. Prior to Zayo, Stephanie spent her career in the Telecommunications sector in both the US and Europe. In the early 1990s, she moved to St. Petersburg, Russia, to take a management position with Cable & Wireless. After returning to the U.S. in 1994 she joined the team that started MFS International, a company that built some of the first competitive fiber networks in Europe, and in 1998 joined the early team at Level 3 Communications and spent 3 years in London building out Level 3’s business in Europe.
Copeland holds a Bachelor of Arts from the University of Illinois in German and Commercial studies. She completed post graduate courses at the University of Paderborn in Paderborn, Germany.

Copeland is an advocate and supporter of women in business, serving as a mentor to support women across the communications industry. She was named Fierce Telecom’s top women to watch in 2015.

Steve Glickman, Founder and CEO, Develop LLC

Steve Glickman is the Founder and Chief Executive Officer of Develop LLC, the nation’s leading advisory firm dedicated to building and supporting Opportunity Zone Funds seeking to positively transform low-income communities across America, and he is one of the nation’s top Opportunity Zones experts who is a sought after speaker in communities around the country.

Steve is the Co-Founder and former CEO of the Economic Innovation Group (EIG), a bipartisan research and policy organization in Washington, D.C. focused on addressing economic inequality through the creation of a new marketplace for private equity investments in distressed communities.

Under Steve’s leadership, EIG was the architect of the $6 trillion Qualified Opportunity Zones program, the largest community investment incentive in U.S. history. EIG conceptualized the program and drafted the underlying legislation -- the “Investing in Opportunity Act” -- championed by Senators Tim Scott (R-SC) and Cory Booker (D-NJ), which received nearly 100 bipartisan congressional cosponsors before being passed into law in 2017.

Steve is also an Adjunct Professor at Georgetown University, where he teaches on economic diplomacy and international trade in the School of Foreign Service. He sits on Georgetown’s Board of Governors and the Board of The NewDEAL.

Steve previously served in the Obama Administration from 2008-2013 – as a senior economic advisor at the White House, where he managed trade and investment issues, manufacturing, and small business issues for the National Security Council and the National Economic Council. Steve also held the position of Deputy Associate Counsel at the White House, as well Chief of Staff for the U.S. and Foreign Commercial Service at the U.S. Department of Commerce.

Prior to his service in the Administration, Steve worked on Capitol Hill as Counsel to Chairman Henry Waxman on the U.S. House Committee on Oversight and Government Reform and as a legislative aide to then-Congressman Ed Markey. He began his legal career as a Federal criminal prosecutor for the U.S. Department of Justice in Washington, DC and as an Investigative Counsel at the Democratic National Committee.

Steve received his B.A. and M.A. from Georgetown University, J.D. from Columbia Law School, and LL.M. from the London School of Economics and Political Science.

Steve lives with his wife and two sons in Washington, DC.

Professor Tracy A. Kaye, Seton Hall Law School

Tracy A. Kaye is a Professor of Law and Eric Byrne Research Fellow at Seton Hall Law School. She specializes in U.S. federal income tax law and international, European Union, and comparative tax law. She has been a Fulbright Senior Research Scholar at the University of Luxembourg, PwC Visiting Professor at the Vienna University of Economics and Business, and Research Scholar at the Max Planck Institute for Intellectual Property, Competition, and Tax Law. Her research on tax incentives in the United States and the European Union was selected for the 3rd annual Comparative Law Work-in-Progress Workshop at the University of Michigan Law School. Professor Kaye is known internationally for her comparative work on tax avoidance, tax discrimination, and tax incentives.

Previously, she worked as a tax legislative advisor for a U.S. Senator, who was a member of the Senate Finance Committee. Her work on Capitol Hill contributed to the reform of the low-income housing tax credit and her research resulted in an article entitled Sheltering Social Policy in the Tax Code: The Low-Income Housing Credit. She has also explored the use of opportunity zones and low-income housing tax credits to mitigate housing instability. Prior to beginning her academic career at Seton Hall Law School, Kaye earned a B.S. in Accountancy, magna cum laude, at the University of Illinois; an M.S. in Taxation at DePaul University; and her J.D., cum laude, at the Georgetown University Law Center.
"We're Not in Kansas Anymore": Using State and Local Power to Fulfill the Potential of the Opportunity Zone Program

Charlie Metzger

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“WE’RE NOT IN KANSAS ANYMORE”: USING STATE AND LOCAL POWER TO FULFILL THE POTENTIAL OF THE OPPORTUNITY ZONE PROGRAM

Charlie Metzger*

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* J.D. Candidate, Fordham Law School, 2021. A.B. Princeton University, 2012. I owe many debts of gratitude to the people who helped make this piece a reality. Thanks first to Professor Nestor Davidson, who advised this Note, for the wisdom and guidance he has provided all throughout my law school career. Also to the labor and community organizers who taught me how power is distributed in urban politics, foremost among them Peter Ward, Jim Donovan, Julia Rybak, Bhav Tibrewal, and Frank McMillan, and to the many opportunity zone and economic development practitioners — in government, philanthropy, and industry — who agreed to be interviewed for this piece. Thanks especially to my former supervisors in the Legal Department of the New York State Housing Finance Agency who introduced me to Affordable Housing Law and to Alexander Golding and Adam Rice who were incredible sounding boards as the ideas in this work took shape. The staff of the Urban Law Journal did a remarkable job shepherding this Note to completion and my family did the same keeping me grounded along the way. And finally, to Kristen McCarthy, whose life’s work is the creation of opportunity for children in historically marginalized and under-resourced communities.
INTRODUCTION

In late August, 2019, the New York Times published an explosive long-form article addressing the effects of a little-known federal program designed to bring billions of dollars in investment to some of the poorest neighborhoods in America.\(^1\) The piece, titled “How a Trump Tax Break to Help Poor Communities Became a Windfall for the Rich,” laid out a harsh indictment of the Opportunity Zone (OZ) program, calling it a “once-in-a-generation bonanza for elite investors.”\(^2\)

The article’s authors, economics reporter Jesse Drucker and investigative reporter Eric Lipton, argued in exhaustive detail that a set of wealthy Americans — many of them with personal connections to President Trump, his family, or his administration — are exploiting the OZ program by taking advantage of its core tax benefits without expanding access to capital for underserved communities or investing in projects that will genuinely ameliorate poverty.\(^3\) “Instead,” the authors wrote,

> billions of [dollars of] untaxed investment profits are beginning to pour into high-end apartment buildings and hotels, storage facilities that employ only a handful of workers, and student housing in bustling college towns . . .”\(^4\)

As a consequence, the federal government is effectively “subsidizing luxury developments — often within walking distance of economically distressed communities —

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2. Id.
3. Id.
4. Id.
that were in the works before Mr. Trump was even elected president.\(^5\)

The story ignited a firestorm on Twitter — particularly from the OZ program’s defenders, who argued that the piece had cherry-picked damning evidence instead of reporting in a manner that was fair and even-handed.\(^6\) But perhaps the most innovative response was a Twitter thread written by Matt Wachter, Vice President of Finance & Development at the Erie Downtown Development Corporation (Erie DDC) in Erie, Pennsylvania, who offered a more local and nuanced critique of the Times article, tweeting that because of the OZ program:

Instead of a 25-year redevelopment plan, @ErieDDC now anticipates it can revitalize a series of largely vacant or abandoned buildings at the heart of Erie’s downtown in as little as five years while, in parallel, new investment is providing a shot-in-the-arm to Erie’s emerging ecosystem of IT and cyber security small businesses, many of whom are women or minority-owned . . . . No federal policy in memory has galvanized as much excitement in our community.\(^7\)

The responses cited above exemplify the current debate about the OZ program. Its proponents argue that it is a legitimate anti-poverty initiative, born from bipartisan consensus, with the potential to bring much-needed investment dollars to communities starved for access to capital and economic opportunity.\(^8\) They emphasize the duration of

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5. Id.

6. See, e.g., Steven Glickman (@StevenGGlickman), TWITTER (Sept. 1, 2019, 2:38 PM), https://twitter.com/StevenGGlickman/status/1168231608119439360 [https://perma.cc/B4RR-ZFJ6] (“I’m disappointed that the @nytimes chose to cherry pick a handful of anecdotes about the #OpportunityZones marketplace to support conclusions that don’t reflect the reality of this bipartisan program that has real impact around the country.”).


8. For instance, former Obama Administration official, OZ investor, and evangelist Steve Glickman has cited the involvement of Austan Goolsbee and Jared Bernstein, both alumni of the Obama White House. See, e.g., Glickman, supra note 6; see also John C. Fleming, Opportunity Zones Aren’t a Gimmick — They’re a Legitimate Investment Option, FORTUNE (Sept. 23, 2019), https://fortune.com/2019/09/23/opportunity-zones-investment-trump-taxes/ (“Those looking for socially conscious investing can rest assured that these Opportunity Zone investments will target development in areas of the country that need it most. Last
the program and cite a range of projects with social benefits which are already in the development pipeline. The program’s critics, which include the New York Times Editorial Board in an article published two months after the late August long-form piece cited earlier, argue the OZ program is little more than a sophisticated handout to rich investors. They contend that while the OZ program’s “stated purpose is to drive big money into investment deserts,” it is in reality, a “black comedy” allowing “a massive waste of public resources for the benefit of a wealthy few.” And caught somewhere in the middle are the state and local officials trying to make the program work.

The purpose of this Note is not to insert itself into the debate about the ethics or legitimacy of the OZ program. While there are good reasons to be skeptical of the program’s effectiveness as an anti-poverty mechanism — not least the set of high-profile OZ Fund managers, like the recently-pardoned “junk bond king” Michael Milken, who are not known for their concern for the poor — there are also early signs that the program is being leveraged to create social impact in some economically under-resourced areas.

year, the unemployment rate in Opportunity Zones was nearly 1.6 times higher than the average U.S. census tract. Similarly, the average poverty rate across Opportunity Zones exceeded 32%.

9. Ben Carson, Opportunity Zones: A New Dawn for Economic Opportunity, REAL CLEAR POLY (Apr. 26, 2019), https://www.realclearpolicy.com/articles/2019/04/26/opportunity_zones_a_new_dawn_for_economic_opportunity_111177.html [https://perma.cc/H668-AM6T] (“Last week, I visited Birmingham, Alabama’s ‘Campus of Hope,’ where thousands of residents in Birmingham public housing will soon get access to valuable resources to help put them on the path to financial self-sufficiency. I also traveled to Little Rock, Arkansas to tour the development of Cumberland Towers. Each of these sites is situated in an Opportunity Zone, which means today’s snapshot represents the ‘before’ pictures on a self-development path made possible by the combined power of private-sector investment and this Administration’s foresight in public policy.”).


11. Id.


Furthermore, as an empirical matter, the jury is largely still out on whether the program will live up to its stated purpose — which its creators have been quick to point out. Measuring its effectiveness is especially complex since the OZ program’s tax benefits are deferred over an extended time horizon. And suggestions that the program should be completely repealed are politically impractical — at least for the foreseeable future, the OZ program is a legislative fait accompli.

This Note is also not primarily focused on suggesting remedies to the structure of the OZ program at the federal level. Possible federal fixes have been spelled out in a high degree of detail across many forums, from the halls of Congress to the pages of this very Journal.

Instead, this Note looks at the implementation of the OZ program closer to the ground: in the states and localities where OZ Funds are investing capital and governments are engineering policy responses to attract and then channel that investment. This kind of analysis is warranted for a range of reasons — foremost among them is the fact that federal regulation surrounding the OZ program is distressingly skeletal. The enabling statutory language, included in the 2017 Tax

[https://perma.cc/QE7K-8RDR] (“The high-tech Innovation District planned for York City’s Northwest Triangle is expected to be three times larger than initially planned, thanks to the area being a federally designated opportunity zone.”).

14. See Glickman, supra note 6 (“This program is designed for patient investors, and the real value comes after 10 years, with only a very small incentive upfront. That means smart money will look for places that have a long runway for growth (i.e. South Side of Chicago, Atlanta, and Detroit.”).


Require annual, public information reporting from Opportunity Funds and annual statements to the IRS from fund investors. Eliminate loopholes that could allow ‘sin list’ investments like casinos and prohibit investments in stadiums and luxury apartments. Terminate zones that are not low-income or impoverished, while allowing states to replace zones that are terminated. Tighten existing rules to ensure that this generous incentive goes to productive, new investments that are actually in zones, and not to projects that were already underway or investors trying to park their money tax-free.

Id. See also Victoria Lee, Opportunity without Reach: The Problems with the Opportunity Zone Program and the Need for Clarification, Oversight, and Regulation, 47 FORDHAM URB. L.J. 117, 143 (2019).

16. Furthermore, many of the programs acknowledge that this kind of local leadership is essential to making the program work. See, e.g., John Lettieri & Steve Glickman, Local Leadership Is Key for Successful Opportunity Zones, THE HILL (Apr. 8, 2018), https://thehill.com/opinion/finance/382135-local-leadership-is-key-for-successful-oppo
Cut and Jobs Act (TCJA), is only six pages long.\textsuperscript{17} And while the Internal Revenue Service (IRS) recently issued its final rules governing OZs — laying out the regulatory framework which will govern the mechanics of the program — those regulations are not intended to direct capital with any geographic specificity within existing OZs or to place additional federal restrictions around where and how capital can be invested at a granular level.\textsuperscript{18} At least at this early stage, the purpose of the regulations seems to be to clarify the mechanics of OZ tax benefits.\textsuperscript{19}

This bare-bones regulation is particularly striking given the sheer size and scope of the OZ program. Early predictions are that OZs will drive “billions — even trillions — of dollars in long-term investment into historically impoverished urban and rural census tracts across the country”\textsuperscript{20} and will cost the federal government on the order of $1.6 billion in lost capital gains tax revenue from 2018–2027.\textsuperscript{21} And since “new regulations stipulate that the program’s

\textsuperscript{17} See infra Part I for a discussion about the creation of the OZ program. For the enabling legislation, see Tax Cuts and Jobs Act, H.R. 1, 115th Cong. § 13823 (2017).


\textsuperscript{19} Novogradac, Second Tranche, supra note 18.


\textsuperscript{21} SCOTT EASTMAN & NICOLE KAEDING, TAX FOUND., OPPORTUNITY ZONES: WHAT WE KNOW AND WHAT WE DON’T 1 (2019),
benefits [will] continue through 2047,” the true revenue impact on the federal government could be decades long.\(^\text{22}\)

However, despite thin regulation from the federal government of the OZ program, a diverse range of state and local governments across the country did not wait for the IRS to finalize its rules and have instead generated policy responses designed both to attract and channel investment and to also place additional guardrails on the OZ program.\(^\text{23}\) This is not surprising — economic development is hardly the province of the federal government alone. And — to paraphrase Justice Louis Brandeis writing almost a century ago — states have always served as “laboratories of democracy” within our system of federalism, designing policy approaches to meet a range of issues.\(^\text{24}\)


22. Id. It is worth noting that the OZ program is off to a slower than expected start. See, e.g., Ruth Simon & Peter Grant, Opportunity Zone Funds Are off to a Slow Start, Lagging behind Heady Expectations, WALL ST. J. (Oct. 22, 2019), https://www.wsj.com/articles/opportunity-zone-funds-are-off-to-a-slow-start-lagging-behind-heady-expectations-11571742002 [https://perma.cc/KN9C-5KPM].

[O]pportunity-zone funds have so far, on average, raised less than 15% of their goals, according to a new analysis by Novogradac & Co., a San Francisco accounting firm that advises fund managers and investors on tax incentives. The Novogradac data includes 103 funds set up to invest in opportunity zones. These funds, which include many of the industry’s largest, have raised a combined $3 billion of the roughly $22.7 billion they seek. Novogradac said it is aware of 285 of these types of funds, though not all have shared fundraising details.

Id. That said, “it isn’t surprising that the program is taking time to pick up steam, especially given that regulations aren’t yet final and these are new markets for many investors.” Id. As of January 2020, the most recent data from Novogradac shows 292 OZ Funds reporting more than $6.7 billion in equity raised, a significant increase over the prior month when 184 funds reported having raised $4.46 billion. Michael Novogradac, Opportunity Funds Listing Shows Strong Increase in Investment, NOVOGRADAC (Jan. 8, 2020), https://www.novoco.com/resource-centers/opportunity-zone-resource-center/opportunity-funds-listing [https://perma.cc/Q4DP-G6MY] [hereinafter Novogradac, Opportunity Funds Listing].


[M]any states and communities are fulfilling the role that Justice Brandeis envisioned when he called them ‘laboratories of democracy.’ Sometimes by direct ballot initiatives and sometimes by legislative action, states and
The purpose of this Note is to canvass these state and local policies to answer a compelling question: what can state and local governments do in response to a federal investment incentive program of this magnitude with so few guardrails?

Part I introduces the OZ program. It begins by tracing the history of the idea that became the first legislative attempt at enacting the OZ program into law, from its inception at a think tank called the Economic Innovation Group (EIG), to its inclusion in the TCJA, to its implementation by the IRS. It then explains the principal components of the program and summarizes the major critiques offered by observers.

Part II lays out one of the main challenges the OZ program faces: the danger of unconstrained investment. It delineates the difference between place-based and person-based economic development programs and stacks the OZ program up against some of its intellectual forerunners (like the Low-Income Housing Tax Credit (LIHTC) and the New Markets Tax Credit (NMTC)).

Part III analyzes the toolkit being developed and deployed by early adopters at the state and local level who are attempting to address the problem of unconstrained capital. Specifically, it looks at OZ programs in Louisville, KY; Cuyahoga County, OH; and Washington, D.C. It draws out the policy initiatives that are common across these different locations and also highlights their differences.

Finally, Part IV evaluates the policy choices made by these early adopters. It also suggests a range of other tools that state and (principally) local governments can use to attract capital, and then direct the flow of investment traffic.

I. THE ORIGINS AND MECHANICS OF THE OPPORTUNITY ZONE PROGRAM

A. Origins

The idea that eventually became the OZ initiative was first proposed in a 2015 whitepaper titled “Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas,” authored by two experts affiliated with the Economic Innovation Group (EIG), a

localities have been moving forward, toward a more inclusive democracy, and testing new ideas for financing campaigns, structuring voting systems, setting district boundaries, and expanding participation.

Id.
Washington, D.C.-based think tank. Notably, despite writing for EIG, the authors credentialed themselves in the report based on their affiliations with think tanks at opposite ends of the ideological spectrum: the Center on Budget and Policy Priorities and the American Enterprise Institute. The paper began with the premise that America's recovery from the financial crisis and the Great Recession had been robust but geographically uneven: “[W]hile certain areas of the country are doing remarkably well and nearing or exceeding their pre-recession economic states, the recovery has been profoundly uneven, with large swaths of the country facing chronic rates of long-term unemployment and historically low levels of new investment.” As an illustration, the report offered unemployment statistics from around the country — comparing in one instance, the


26. BERNSTEIN & HASSETT, supra note 25.

27. Id. at 2. In this debate, one point of agreement is that communities of color have a significantly harder time accessing capital than white communities. See, e.g., ROBERT FAIRLIE, ET AL., BLACK AND WHITE: ACCESS TO CAPITAL AMONG MINORITY-OWNED STARTUPS 2 (2016), https://siepr.stanford.edu/sites/default/files/publications/17-003.pdf [https://perma.cc/LF3B-BSED] (“Black-owned businesses are persistently smaller and face more difficulty in raising external capital. Large differences in credit worthiness are important for explaining the difference. Even controlling for credit worthiness, persistent differences in perceptions of treatment by banks are also important.”); see also Access to Capital Is Still a Challenge for Minority Business Enterprises, MINORITY BUS. DEV. AGENCY (Mar. 1, 2010, 2:13 PM), https://www.mbda.gov/news/blog/2010/07/access-capital-still-challenge-minority-business-enterprises [https://perma.cc/WG48-KTXX].
unemployment rates in Fresno and San Francisco, California (11% and 5%, respectively, as of December 2014, even though the cities are less than 200 miles apart). The report painted a grim picture of the human cost of unemployment: “distressed and traumatized workers who face plummeting incomes, stalling career progressions, and cracking self-confidence. In addition to these intuitive tragic effects of unemployment, research has also identified other negative side effects, the most distressing of which is an increase in mortality following job loss.”

The report next considered — and largely dismissed — a range of federal subsidies which have been attempted in order to spur development in distressed communities: “empowerment zones (EZ), renewal communities (RC), enterprise communities (EC), and the New Market Tax Credit (NMTC).” The authors argued that the empirical research analyzing these programs had shown their results to be mixed, at best.

Accordingly, EIG proposed a new mechanism — a “New Model for Attracting Private Investment.” Since the private sector had little incentive to invest in higher-risk neighborhoods and provide an injection of capital, the federal government ought to give them one. This policy solution would attempt to spur private investment in distressed neighborhoods by taking advantage of the staggering quantity of unrealized capital gains in the United States, which EIG estimated to be roughly $2.26 trillion at the time the report was written. The authors recommended a new kind of investment vehicle — a “structure analogous to that of a venture capital firm or

29. Id.
30. Id. at 5. While the report argued that the NMTC was the most successful program of the set it considered, it still contended that “the NMTC is not structured to induce the kind of larger-scale investment that can accelerate the revitalization of an entire community.” Id. at 10. Its criticism of all the programs it considered boiled down to complexity and underutilization, weak or misaligned incentives, the programs’ restrictive scope, interaction with other programs, and the absence of force multipliers. Id. at 11–15.
31. Id. at 6.
32. Id. at 16. The report made the assumption that “[f]or political and fiscal reasons, large-scale public sector investment is unlikely to happen anytime soon.” Id. Accordingly, this public sector investment would have to be “supplemented by private sector investment to support robust economic growth.” Id.
33. Id. “Private sector investors have little current incentive to invest in higher risk ventures in economically depressed communities, but the return on investment for doing so may increase if the existing friction could be deferred or eliminated.” Id.
34. Id.
mutual fund company,” which would operate in specific geographic areas, and deploy special tax benefits established for them, which “would apply so long as the investments stayed” in those areas.\textsuperscript{35}

Bernstein and Hassett argued this kind of policy would solve the shortcomings inherent in earlier economic development subsidies, like pooled assets, the elimination of first-mover problems, and lower risk to each individual investor.\textsuperscript{36} Their report closed by making a recommendation for how the program could work mechanically: “[U]nrealized capital gains might be rolled over into special funds constrained to invest in distressed communities, with the capital gains taxed only if the money is withdrawn from the qualified funds down the road.”\textsuperscript{37}

Bernstein and Hassett’s paper was the inspiration for the first legislative attempt at enacting the OZ program into law: the “Investing in Opportunity Act,” introduced jointly by Senators Cory Booker (D-NJ) and Tim Scott (R-SC), and Congressmen Ron Kind (D-WI) and Pat Tiberi (R-OH), first during the waning months of the Obama Administration, and then again in February of 2017 — just weeks after President Trump was sworn into office.\textsuperscript{38}

The bill’s bipartisan sponsors were enthusiastic, describing the program’s possible benefits in terms designed to appeal to constituencies on either side of the aisle. Senator Booker, a Democrat, emphasized the bill’s potential to expand access to capital:

\begin{quote}
[B]arriers stand between too many communities and access to the capital needed to generate economic growth and opportunity. In an era of capital moving overseas or going towards uses that don’t maximize opportunity for most Americans, our bipartisan legislation will help lower these barriers and jumpstart economic development and entrepreneurship.\textsuperscript{39}
\end{quote}

\begin{flushleft}
35. Id. at 17.
36. Id.
37. Id.
\end{flushleft}
Congressman Tiberi, a Republican, observed that the program would stimulate investment without requiring an outlay of government funds: “We’re not writing a check from the federal government. We’re getting private-sector dollars. It wouldn’t be up to some bureaucrat or congressman in Washington, D.C. It would be up to the people in the community who would tailor the investment to what they think would actually work.”

The OZ concept reappeared several months later as a last-minute addition to the TCJA, the “biggest overhaul of the US tax code in more than 30 years.” It was added at Senator Scott’s insistence; in interviews he connected the program to his upbringing in poverty in South Carolina. Incidentally, at the time the TCJA was being debated, Kevin Hassett, the co-author of the EIG whitepaper proposing the OZ idea, had been appointed by President Trump to serve as the Chair of the White House Council of Economic Advisers. Hassett spoke approvingly of the addition in the weeks leading up to the bill’s passage by Congress. However, the inclusion of OZs to the TCJA went largely unnoticed.

40. Id.
42. See Jim Tankersley, Tucked into the Tax Bill, a Plan to Help Distressed America, N.Y. TIMES (Jan. 29, 2018), https://www.nytimes.com/2018/01/29/business/tax-bill-economic-recovery-opportunity-zones.html [https://perma.cc/V5RC-5968] (“The zones were included in the tax law by Senator Tim Scott, a South Carolina Republican who was born into poverty in North Charleston, and based on a bill he co-sponsored in 2017 with several Democrats . . . . ‘I came out of one of these communities,’ [Scott said], ‘so I believe that there’s untapped potential in every state in the nation.’”).
43. Id. (“‘This is a little billion-and-a-half dollar part’ of the law, Kevin Hassett, the chairman of Mr. Trump’s Council of Economic Advisers, said in an interview. ‘But if it’s successful, we’ll look back 10 years from now and say this was one of the most important parts of the tax bill, and one we didn’t talk nearly enough about.’”). The Times also took note of Mr. Hassett’s connection to EIG and the research which proposed OZs to begin with:

   Mr. Hassett has a longtime interest in providing tax incentives for economic development in distressed areas. He said he first began discussing opportunity zones with Mr. Parker several years ago at a meeting in Mr. Parker’s Greenwich Village home. Before joining the Trump administration, Mr. Hassett wrote several white papers to help elevate the idea as part of an extensive, multiyear effort by the Economic Innovation Group to win support.

44. Id. Media Coverage of the TCJA focused much more on tax cuts for wealthy individuals and corporations, as well as changes to the standard deduction and the
while Senator Scott reported speaking with both President Trump and Hassett about the idea before the bill’s passage, “in the rush to pass the bill over the course of a few frenzied weeks, the idea was never debated on the floor of the House or Senate. It was never promoted by Republican leaders or the White House.”

President Trump signed the TCJA into law at the end of December 2017.

B. Mechanics

This Section gives an overview of how OZs work mechanically. While the tax law surrounding OZs is complicated, at the heart of the program is a basic bargain: investors agree to inject revenue from capital gains into certain low-income census tracts for a prescribed length of time in exchange for tax benefits from the IRS.

i. Opportunity Zone Selection

The first step of implementing the OZ program was assigned to America’s governors (as well as the chief executives of possessions and territories), who were allotted 90 days from the enactment of the TCJA to choose which low-income census tracts would be designated as OZs. For OZ selection purposes, the definition of “low-income census tract” comes from Section 45D(e) of the tax code, the NMTC. Governors were permitted to designate up to 25% of


45. Tankersley, supra note 42. Despite giving the OZ concept a more favorable treatment than it would go on to do in 2019, the New York Times did express early skepticism, noting that “risks remain, including whether investors will steer dollars toward areas that really need investment.” See id.


eligible census tracts as OZs. Most significantly, they were also permitted to select a number of non-low-income census tracts as OZs with some restrictions, including the restriction that higher-income OZs must be geographically contiguous to low-income tracts and have roughly the same median family income (not exceeding 125% of a neighboring low-income tract).\(^4\) The OZ program placed a cap on these higher-income OZs, so governors were able to designate only up to 5% of their OZs in this manner.\(^5\) After finishing their selection process, governors submitted their designations of both low-income and higher-income tracts to the Treasury Secretary for certification.\(^6\) Certification by the Department of the Treasury lasts a decade, irrespective of whether the underlying economics of a particular census tract change over time.\(^7\)

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\(^{4}\) Zachary Patton, Need Help Understanding the Opportunity Zones Eligibility?, ENTERPRISE (Feb. 9, 2018), https://www.enterprisecommunity.org/blog/understanding-opportunity-zones-eligibility [https://perma.cc/S7KN-CTBT] (“We have received questions on this regarding whether a tract has to meet the 125 percent threshold for all contiguous Low-Income Communities. Our understanding of the guidance provided by the IRS on February 8, 2018 is that it need only satisfy this requirement for at least one contiguous Low-Income Community.”).

\(^{5}\) Id.

\(^{6}\) Econ. Innovation Grp., \textit{supra} note 48, at 1 (governors with fewer than 100 low-income census tracts in their states could still designate up to 25 tracts).

\(^{7}\) Id.
ii. Commentary on the Opportunity Zone Selection Process

One common criticism of OZs focuses on this stage of the rollout process and takes issue with the ability of governors to choose relatively higher-income neighborhoods for inclusion. EIG, where OZs were born, wrote about this option in favorable terms, arguing that it provided governors with “real-world flexibility in assembling economically meaningful zones from individual census tracts.”53 Other observers expressed concern that it would funnel capital to already-gentrifying neighborhoods.54 Another line of criticism in this same vein focuses on how gubernatorial selection of OZs was prone to rent-seeking and lobbyist influence,55 or clerical error.56

53. Id. at 2.
55. See, e.g., Jeff Ernsthausen & Justin Elliott, How a Tax Break to Help the Poor Went to NBA Owner Dan Gilbert, PROPUBLICA (Oct. 24, 2019), https://www.propublica.org/article/how-a-tax-break-to-help-the-poor-went-to-nba-owner-dan-gilbert [https://perma.cc/F38A-PHYW] (Billionaire and Cavaliers owner Dan Gilbert “influenced the local [OZ] selection process, as well, other emails obtained by ProPublica show: Quicken’s top lobbyist was so enmeshed in the process, his name appears on an opportunity zone map made by the city economic development organization, recommending part of downtown be included in the tax break. No other non-city officials are named on the document”); see also, Justin Elliott, et al., A Trump Tax Break to Help the Poor Went to a Rich GOP Donor’s Superyacht Marina, PROPUBLICA (Nov. 14, 2019), https://www.propublica.org/article/superyacht-marina-west-palm-beach-opportunity-zone-trump-tax-break-to-help-the-poor-went-to-a-rich-gop-donor [https://perma.cc/38ZN-TAQU] (“The state of Florida, based on an analysis of unemployment and poverty rates, had not originally intended to pick the census tract containing the superyacht marina for the program. But those plans changed in response to [billionaire Wayne, Jr.] Huizenga’s lobbying, according to documents from the Florida Department of Economic Opportunity obtained by ProPublica.”); Jeff Ernsthausen & Justin Elliott, A Trump Tax Cut Meant to Help Poor Areas Could Pay off for Kevin Plank and Goldman Sachs Thanks to Misaligned Maps, BALTIMORE SUN (June 19, 2019), https://www.baltimoresun.com/business/real-estate/bs-bz-plank-opportunity-zone-20190612-story.html [https://perma.cc/2NS7-HLOK] (“But the census tract became eligible to be picked as an opportunity zone because of misaligned maps. Tiny differences between the maps used to delineate opportunity zones and empowerment zones — a Clinton administration incentive for economically distressed communities — showed an overlap between them at that sliver of a parking lot, which the U.S. Treasury Department decided made the tract eligible. Maryland Gov. Larry Hogan chose the area for the program after his aides met with lobbyists for the project.”).
56. Robert Orr, These Opportunity Zones Shouldn’t Exist — Scandal or Innocent Mistake?, NISKANEN CTR. (Nov. 4, 2019),
Empirically, more than 42,000 census tracts around the country were eligible for designation as OZs; from those, governors selected roughly 8700, of which 230 were higher-income, contiguous tracts. This represented 2.6% of all OZs chosen, well below the 5% cap imposed by the enabling legislation. An early analysis of the tracts selected for inclusion in the OZ program, performed by the Urban Institute, found that “the designated tracts have lower incomes, higher poverty rates, and higher unemployment rates than eligible nondesignated tracts.” At the same time, however, “[the] analysis shows minimal targeting of the program toward disinvested communities by a measure of investment flows developed by the researchers.”

### iii. Tax Benefits at the Core

The core of the OZ program is a set of two tax incentives offered to investors, which practitioners have christened the “Deferral Benefit” and the “Exclusion Benefit” in the legal literature. The Deferral Benefit allows an investor to sell an asset, realize a capital gain, invest that gain (the “underlying gain”) in a qualified OZ fund (OZFund), and defer payment of capital gains tax on the underlying gain until

https://www.niskanencenter.org/these-opportunity-zones-shouldnt-exist-scandal-or-innocent-mistake/ [https://perma.cc/K5LV-ERTY].

Apart from the improperly classified LIC tract in Detroit (tract ID 26163517200), misclassifications also appear to have occurred in Los Angeles, CA (06037206020) and Oklahoma City, OK (40109103200). Furthermore, these misclassifications were instrumental to the improper designation of two additional OZs through the Contiguous Tract Criteria (tracts 26163517000 & 06037206031 respectively). In total, five OZ tracts were misclassified. While two of these can retain their OZ status under a reclassification as contiguous tracts with legitimate LICs, the other three OZs are entirely improper — that is, they should not have qualified under the requirements stipulated by the TCJA.

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58. Id.


60. Id.

The Deferral Benefit also provides a basis step-up: if the investor leaves the funds in an OZFund for a minimum of five years, she is granted a 10% basis-step up. If she leaves the funds in an OZFund for a period of seven years, she is granted an additional 5% basis-step up. Put another way, if an investor takes full advantage of the Deferral Benefit, she will ultimately pay capital gains taxes on only 85% of the underlying gain.

The Exclusion Benefit exempts the investor from paying any capital gains tax at all on the investment in the OZFund entirely (the “new gain”) if she holds that investment for a minimum of ten years. Due to the total absolution of capital gains liability, commentators have observed that the Exclusion Benefit is potentially worth substantially more to investors over time than the Deferral Benefit.

**iv. Opportunity Zone Funds**

OZFunds are the vehicle by which investors participate in the OZ program and take advantage of the Deferral and Exclusion Benefits. The enabling language in the TCJA requires that OZFunds invest directly in “qualified opportunity zone property” (OZProperty), or
indirectly in “qualified opportunity zone businesses” (OZBusinesses). The definitions of these terms are analogous:

A qualified opportunity zone business . . . is defined as a trade or business in which substantially all of the tangible property owned or leased by the business is OZProperty, substituting the term ‘qualified opportunity zone business’ for the term ‘qualified opportunity fund’ each place it appears in the definition of OZProperty.

v. Proposed Rulemaking and Commentary

The TCJA tasked the IRS with promulgating rules governing the OZ program. The agency issued several rounds of proposed rules, and then a set of final rules in December 2019. One of the most crucial rules is the 90% Qualifying Assets Test, which governs the percentage of OZFund assets required to be invested in eligible assets. As written, the rule is much more lenient towards indirect OZFund investments, in other words, investments into OZBusinesses, than to the direct purchase of OZProperty: the rule obligates OZFunds to hold 90% of their assets in qualifying investments, but OZBusinesses are subject to a 70% tangible property test.

This disparity, some observers have argued, is cause for genuine concern since it may blunt the overall effectiveness of the initiative. It invites OZFund managers to hold 90% of the fund’s assets in either stock or other ownership interest in OZBusinesses, which in turn hold only 70% of their assets in qualifying property. At bottom, then, an

66. See id. This is defined as either “OZStock . . . OZInterests . . . or OZProperty.” Id. The accounting firm Novogradac drew up a chart explaining these possible investment structures. See Opportunity Zones: A New Tool for Community Development, supra note 63, at 3.


70. Berman & Weller, supra note 48, at 14. Practically speaking, this allows an OZFund to hold substantial percentages of its assets outside of OZs by using the intermediary of investing in OZBusinesses. See also Schrier, supra note 69, at 18 (explaining that an OZFund with $10 million in assets could hold only $6.3 million inside an OZ by “investing $9 million in a partnership and having the partnership
OZFund seeking to take full advantage of this proposed rule can hold only 63% of its assets in an OZ. 71

Observers have also criticized the IRS’s penalties for failure to meet these benchmarks. The law imposes a penalty on OZFunds that fail to meet the percentage thresholds described above. 72 However, as codified in the rules, while noncompliant funds are charged a fee for each month they fail to meet the required investment thresholds, and the proposed penalty diminishes the value of the Deferral Benefit with time, these funds do not lose the ability to take the Exclusion Benefit after the ten-year investment period. 73

In view of the weaknesses of both the enabling legislation and the IRS’s final rules, the abuse potential of the OZ program is clear: not only has the federal government failed to put in place meaningful guardrails to channel capital, but also it has constructed a regulatory regime which allows investors to claim the core benefit of the

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73. See Berman & Weller, supra note 48, at 16 (“The penalty is calculated based on the excess of 90% of the amount of assets in the OZFund over the aggregate amount of the ‘qualified opportunity zone property’ held by the OZFund, multiplied by the underpayment rate established under the IRC for such month. This penalty, in effect, chips away at the Deferral Benefit until December 31, 2026, but does nothing to mitigate or take away the Exclusion Benefit. By the standards of penalty provisions in the IRC, this one is particularly gentle, as the currently applicable interest rate under Section 6621(a)(2) is about 6.0% per annum.”). A final concern covered in the piece is the “working capital rule” included in the proposed rules:

With respect to the temporal aspect relating to an entity’s holding period for OZProperty, the issue is how the test will be applied when the entity does not have existing operations or assets when the OZFund invests, but intends to use OZFund capital to fund operations or acquire assets. The Proposed Regulations take much of the pressure off of this issue by providing a ‘working capital’ rule modeled after Section 1397C(e)(1), permitting an OZFund that is developing a new business or constructing or rehabilitating real estate (or the entity representing an issuer of OZStock or OZInterests) to deploy its capital over a 31-month period provided that it has: (a) a written plan to utilize capital to create OZProperty; (b) establishes a written schedule of how the capital will be deployed in pursuit of this end, (c) and adheres to the plan and schedule.

Id. at 14–15.
initiative while, at times, investing barely over half of the capital in their OZFunds in actual OZs by using an intermediary.

II. THE DANGER OF UNCONSTRAINED CAPITAL AND THE TENSION BETWEEN PLACE-BASED AND PERSON-BASED PROGRAMS

Essential to the debate over the efficacy of OZs is a distinction between economic development programs that target “distressed communities” and those that target “distressed people” — in other words, between what scholars term “place-based” programs (the former) and “person-based” programs (the latter). Both styles of the initiative have defenders and detractors. In recent years, place-based programs have been a particular lightning rod in the economic development literature. Advocates for place-based programs argue, variably, that “large, place-making developments can help revitalize low-income areas,” or that “the collection of neighborhoods making up an inner city are an ideal sub-region for a place-based approach.” Critics respond that place-based programs ignore the “corporate and political forces that create economic inequality and widespread poverty,” and that while “American workers today face declining job security and dwindling earnings as companies downsize, move overseas, and shift more jobs to part-time workers,” place-based programs “cannot address these major trends.”


76. Peter Dreier, Philanthropy’s Misguided Ideas for Fixing Ghetto Poverty: The Limits of Free Markets and Place-Based Initiatives, NONPROFIT Q. (Mar. 19, 2015), https://nonprofitquarterly.org/philanthropy-ideas-for-fixing-ghetto-poverty-the-limits-of-free-markets-and-place-based-initiatives/ [https://perma.cc/GRM7-LDYU] (“American workers today face declining job security and dwindling earnings as companies downsize, move overseas, and shift more jobs to part-time workers . . . . As indicated above, place-based policies cannot on their own address the major trends that have led to widening inequality, a decline in the overall standard of living for most Americans, and an increase in poverty.”). For an analysis of why the efficacy of place-based programs is challenging to measure, see AUSTIN NICHOLS, URBAN INST., EVALUATION OF COMMUNITY-WIDE INTERVENTIONS 1 (2013), https://www.urban.org/sites/default/files/publication/23766/412855-Evaluation-of-Community-Wide-Interventions.PDF [https://perma.cc/5YCA-98YR]. Professor Michelle Layser has been similarly pointed in her criticism of place-based programs:
As a place-based initiative, the OZ program finds itself squarely at the center of this debate. In relevant ways, it is similar to the place-based initiatives that preceded it at the federal and state levels, including national programs like Empowerment Zones (EZs) and the Renewal Communities (RC) project which succeeded it, as well as the Low-Income Housing Tax Credit (LIHTC), the New Markets Tax Credit (NMTC), and state Enterprise Zones. Like NMTCs, for example, OZs require investing in a pre-selected geographical area for a preset length of time. However, one crucial difference between the OZ initiative and its intellectual grandparents is the absence of a competitive process and the comparatively skeletal federal regulatory regime. The LIHTC and the NMTC are competitive grant programs: state housing finance agencies, or HFAs (for LIHTC), and the Department of the Treasury (for NMTC) evaluate applications and

“In sum, spatially oriented investment tax incentives are the dominant form of place-based investment tax incentives under current law. This is true despite a lack of empirical evidence to suggest that such tax laws help poor communities, even though their proponents claim that helping poor communities is an important goal.” Michelle Layser, The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path toward Community Oriented Reform, 2019 WIS. L. REV. 745, 771 (2019).

77. Community Partners, LOC. INITIATIVES SUPPORT CORP., https://www.lisc.org/opportunity-zones/community-partners-playbook/introduction/ [https://perma.cc/5VK3-DYZQ] (last visited Apr. 4, 2020) (“Opportunity Zones are certainly not the first tax incentives for investments in distressed communities. The Empowerment Zone (EZ) program, created in 1993, enabled businesses located in low-income communities selected by HUD and USDA to claim certain tax benefits. In competitions held in 1994 and 1998, HUD selected 30 different urban EZs, and the USDA selected 10 rural EZs. In 2000, Congress created the Renewal Communities (RCs) program to replace the Empowerment Zone program, and in 2001 HUD selected 40 RCs, 28 in urban areas and 12 in rural areas. While HUD and the USDA are no longer designating new EZs and RCs, businesses operating in those communities can continue to claim certain tax benefits.”).

78. Id. (“In 2000, in the same legislation that authorized the Renewal Communities program, Congress enacted the New Markets Tax Credit (NMTC) program. Under this program, investors can claim tax credits for investing in Treasury-certified Community Development Entities (CDEs), which in turn provide loans and investments to businesses and real estate projects in low-income communities. The investor may claim tax credits valued at 39% of the total investment in the CDE, phased in over a seven-year holding period. The total tax credit allocation authority is currently capped at $3.5 billion annually, meaning that CDEs must apply to the Treasury Department for the authority to issue tax credits to their investors.”). Place-based incentives have been launched by states as well. See, e.g., Urban Enterprise Program, NJ.GOV, https://www.nj.gov/njbusiness/financing/uez/ [https://perma.cc/M3R9-5ULW] (last visited Mar. 16, 2020). There is evidence that state-based programs are effective at sparking job creation. See, e.g., Stephen B. Billings, Do Enterprise Zones Work?: An Analysis at the Borders, 37 PUB. FIN. REV. 68 (2008).
decide which proposals to approve.\textsuperscript{79} The LIHTC application process is particularly exacting, involving multiple layers of safeguards with restrictions imposed by both the federal government and the states.\textsuperscript{80} State HFAs have the ability to set extended affordability requirements, establish that certain kinds of projects — like permanent supportive housing or housing for senior citizens — are state priorities, geographically restrict the grant of tax credits, and incentivize the use of companies owned by minorities or women.\textsuperscript{81} By contrast, OZs are far less regulated: “With the opportunity zones incentive, any eligible taxpayer — individuals or corporations — can make investments funded by realized gains in opportunity funds. There is no cap.”\textsuperscript{82}

Even a robust regulatory program undergirding a place-based incentive is no guarantee of unmitigated success. Since their inception, the LIHTC and the NMTC have both attracted their fair share of detractors. For instance, critics have argued that the LIHTC, though extremely expensive for the federal government, is ineffective at generating long-term affordability, or that the NMTC ends up benefitting residents of higher-income neighborhoods who commute

\textsuperscript{79} Opportunity Zones: A New Tool for Community Development, supra note 63, at 1–2.

\textsuperscript{80} See, e.g., Corianne Payton Scally, et al., Urban Inst., The Low-Income Housing Tax Credit: How It Works and Who It Serves 3 (2018), https://www.urban.org/sites/default/files/publication/98758/lithc_how_it_works_and_who_it_serves_final_2.pdf [https://perma.cc/2G4Q-PPTK] (“The 9 [LIHTC] percent credits are allocated to states annually by the IRS to distribute to eligible projects through a competitive process through state housing finance agencies. Award criteria are updated each year through a state’s Qualified Allocation Plan, which outlines the state’s priorities and scoring criteria.”).

\textsuperscript{81} Id. at 4 (“The 9 percent credits are highly competitive, with many more projects requesting credits than can be funded. Because developers have strong incentives to score the most points possible, the preferences spelled out in a state’s Qualified Allocation Plan have a powerful ability to shape the type and location of housing built.”). To take one example, the New York State HFA established the development of supportive housing and senior citizen housing as goals. See 2019 Mission Statement for the New York State Housing Finance Agency & Its Subsidiary the New York State Affordable Housing Corporation, N.Y. St., Homes & Community Renewal, https://hcr.ny.gov/system/files/documents/2019/04/2019-hfa-mission-statementdocx.pdf [https://perma.cc/85HN-VBKN]. New York State also has goals to promote equity through its Minority and Women Owned Business Enterprise (M/WBE) program. See, e.g., Minority and Women-Owned Business Enterprise Compliance, N.Y. St. Educ. Dep’t., http://www.archives.nysed.gov/grants/lgmif-mwbe-compliance [https://perma.cc/P5MD-YDRX] (last visited Apr. 4, 2020).

\textsuperscript{82} Opportunity Zones: A New Tool for Community Development, supra note 63, at 2.
to targeted areas. There is also a concern that place-based initiatives, even when tightly regulated, can either cause or accelerate gentrification and displacement.

These concerns are amplified for the OZ program. The differences between OZs and other place-based initiatives highlight a central challenge: the deployment of unconstrained capital with almost no federal guardrails directing it. This is perhaps the central roadblock to OZs achieving their stated aim of addressing poverty. There is, for instance, no requirement in the program that projects claiming OZ benefits create any jobs at all, let alone for poor workers. There is no obligation for OZ investors to build affordable housing that is accessible to longtime residents of neighborhoods designated as OZs. In fact, there are no federal safeguards at all to ensure that communities have any say over how and where capital is invested.

83. Urban Institute Evaluates the Low Income Housing Tax Credit, Nat’l Low Income Housing Coalition (July 23, 2018), https://nlihc.org/resource/urban-institute-evaluates-low-income-housing-tax-credit [https://perma.cc/6JVG-C4AY] (“Despite its popularity, LIHTC falls short in several critical areas. First, LIHTC investment does not permanently address affordability problems — properties are only required to be affordable for up to 30 years. The report cites an NLIHC estimate that more than 115,000 units could expire in the next five years. Additionally, LIHTC properties have struggled to meet the needs of extremely low-income renters (those earning below the federal poverty level or 30% of the area median income, whichever is greater) without additional federal rental assistance. The lengthy and complicated tax credit allocation process is also inefficient, and projects have few incentives to bring down costs.”); see also Matthew Freedman, Place-Based Programs and the Geographic Dispersion of Employment, 53 REGIONAL SCI. & URB. ECON. 1, 1 (2015) (“This paper examines the labor market impacts of investment subsidized by the U.S. federal government’s New Markets Tax Credit (NMTC) program, which provides tax incentives to promote business investment in low-income neighborhoods . . . . I find evidence that many of the new jobs created in areas that receive subsidized investment do not go to residents of targeted neighborhoods. The results suggest that the local economic benefits of place-based programs may be diluted when subsidized businesses have scope to hire from broader regional labor markets.”).

84. See, e.g., Nathaniel Baum-Snow & Justin Marion, The Effects of Low Income Housing Tax Credit Developments on Neighborhoods, 93 J. PUB. ECON. 654, 663 (2009) (acknowledging that isolating cause and effect here is challenging, but finding that “LIHTC developments significantly increase turnover of owner-occupied households within 1 km”).

85. See Daniel Hemel, A Place for Place in Federal Tax Law, 45 OHIO N.U. L. REV. 525, 533 (2019) (“An enterprise could, for example, acquire an existing factory in a high-poverty area, fire all the workers, replace them with robots, and still claim all the opportunity zone tax benefits for its investment.”).

86. Id. (“A developer could buy a building in an opportunity zone currently occupied by low-income tenants, tear it down, replace it with luxury rentals, and claim the opportunity zone tax benefits.”).

87. Contrast this with the fact that there is at least some political responsiveness baked into LIHTC. “Although they vary widely in characteristics such as their
Professor Michelle Layser has gone so far as to suggest that spurring gentrification is a feature of the OZ program, and not a bug: “[a]t the time when the [2017 TCJA] tax law was introduced, the Trump Administration’s primary focus was on creating a favorable, pro-growth business environment.” 88 The staff of EIG who first helped to dream up OZs would undoubtedly disagree with that characterization; regardless of its veracity, however, the most egregious excesses of the OZ program — especially those highlighted in the media — tend to be clear examples of this abuse liability.

III. EARLY ADOPTERS: STATE AND LOCAL RESPONSES TO THE OPPORTUNITY ZONE INITIATIVE

A. Overview

In the two years since OZs were first enacted into law, researchers, commentators, and practitioners have written widely about how the program can be improved by adding guardrails to direct funding to areas where it is most needed and where it will be least likely to generate gentrification and displacement. 90 One of the most

relationship to state government, most HFAs are independent entities that operate under the direction of a board of directors appointed by each state’s governor. They administer a wide range of affordable housing and community development programs.” About HFAs, NAT’L COUNCIL ST. HOUSING AGENCIES, https://www.ncsha.org/about-us/about-hfas/ [https://perma.cc/7R45-MQ8H] (last visited Apr. 4, 2020) (emphasis added).

88. Layser, supra note 76, at 788. She continues:

Given this political context, even some members of the development community were skeptical of the program’s objectives . . . . This critique of Opportunity Zones is understandable, given the law’s spatially oriented form. But the form itself was to be expected. Notwithstanding claims that the mission of Opportunity Zones is to help poor communities, the context and design of the new law reflect the same pro-gentrification origins that underlie the vast majority of place-based investment tax incentives.

Id. at 788–89.

89. See generally Drucker & Lipton, supra note 1.

90. See, e.g., Morgan Simon, What You Need to Know about Opportunity Zones, FORBES (Mar. 30, 2019), https://www.forbes.com/sites/morgansimon/2019/03/30/what-you-need-to-know-about-opportunity-zones/82a7627056ae2 [https://perma.cc/2KSY-T4PB] (drawing a distinction between “extractive” and “non-extractive” projects: “A non-extractive OZ project is one where the value created is shared. I’d like to see a good blend of broad-based ownership for employees and contractors, training and apprenticeships, and general acknowledgement of existing community efforts. A lot of people are doing these things, but they are on the margins. We need to ask . . . if a project generates $100M in profits, where does this money flow? How much of it is left in the community? I just wanted to call out that a $100M dollar investment with a little bit of philanthropy wrapped around it and some kind of job fair, that doesn’t really cut
comprehensive reports is the “Opportunity Zone Playbook” drafted by the Local Initiative Support Center (LISC), which proposes six concrete steps that community partners can take to direct streams of OZ funding:

Step 1: Hold a Stakeholder Meeting/Get the lay of the land, educate partners about Opportunity Zone policy and engage key players . . . . Step 2: Embarking on a Plan for Work in the Opportunity Zones/Assess the terrain, map and support community planning . . . . Step 3: Incentives and Guardrails in the Opportunity Zones/Tapping policies and public programs that can help bolster success — and minimize risks — for communities . . . . Step 4: Collaborating to Build Pipeline & Leverage Local Expertise/By forging a consortium or grant programs, or by modeling the financial feasibility of projects, community partners can begin to kindle Opportunity Zone projects . . . . Step 5: Ramp Up Your Investor Marketing/Creating a prospectus, marketing your zone and other strategies for connecting with investors . . . . Step 6: Develop Impact Metrics & Encourage Transparency/Rigorous evaluation and accessible reporting are keys to inclusive and equitable success in the Opportunity Zones.91

Another is the Governance Project’s “Toolkit for Maximizing the Impact of Opportunity Zones.”92 Across these varied approaches,
common themes have emerged: community participation, transparency, scale, and impact.\(^3\) Since the goal of this Note is not to suggest criteria by which to measure the success of OZs, I adopt these four goals as normatively desirable.

The purpose of this Part is to lay out and evaluate a broad spectrum of state and local government responses to the OZ initiative. The following Sections analyze the work of three early adopters: Louisville, Kentucky; Cuyahoga County, Ohio (whose county seat is the city of Cleveland); and Washington, D.C.

The selection of these three cities and their presentation order is intentional. They represent a wide range of possible policy responses to the OZ initiative, from informal to formal policymaking power. They are also politically, demographically, and geographically varied: Louisville and Cuyahoga County have Democratic chief executives,\(^4\)

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\(^3\) Commentators have also suggested applying criteria from outside the OZ literature to guide OZ investment. See, e.g., Nestor M. Davidson, A Better Approach to Urban Opportunity, 27 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 449, 456 (2019) (arguing that “Dyal-Chand argues convincingly for prioritizing the economic stability of workers through democratic participation, vocational training focused on long-term individual growth, and strong wages and benefits. She likewise argues for businesses to find niches that would allow for multiple bottom-line approaches, tools for connecting to broader markets and sources of finance, and collaborative structures to spread risk and leverage management expertise”). For a notable example of the ways in which community participation can ensure that investment achieves meaningful results for impacted communities, see Timothy Fields, Jr., A Dream Realized: Community Driven Revitalization in Spartanburg, EPA BLOG (Aug. 26, 2014), https://blog.epa.gov/2014/08/26/a-dream-realized-community-driven-revitalization-in-spartanburg/ [https://perma.cc/8NG9-JCQX].

while Republicans dominate the Kentucky and Ohio state legislatures. Because it is not a state and has limited home rule, Washington, D.C.’s political powers are constrained by the federal government.

## B. Coordination Problems

Perhaps the single greatest obstacle to using OZs for impact and returns (as opposed to returns alone) is a coordination problem: the community of investors with capital gains to deploy does not, in many instances, overlap with local stakeholders inside of OZs who have the most knowledge about which projects, if given access to capital, could create impact. Stephanie Copeland, CEO of the Governance Project, a leading think tank partnering with states and municipalities across the country to leverage OZs to create impact, phrased it this way: “Who knows best what communities really need? It’s the local stakeholders, who are often ill-equipped to attract capital because of

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95. See Kentucky General Assembly, BALLOTpedia, [https://ballotpedia.org/Kentucky_General_Assembly](https://perma.cc/7U8U-QKC4) (last visited Mar. 16, 2020); Ohio General Assembly, BALLOTpedia, [https://ballotpedia.org/Ohio_General_Assembly](https://perma.cc/WT9R-4URS) (last visited Mar. 16, 2020) (note that Ohio has a Republican “trifecta”: both houses of its legislature and its governor’s office is held by a Republican).

96. See DC Government Organization, OFF. CITY ADMIN., [https://oca.dc.gov/page/dc-government-organization](https://perma.cc/5QZJ-WEZP) (last visited Mar. 16, 2020) (“The current form of government was established by the District of Columbia Home Rule Act in 1973. Although local officials have the authority to pass laws and govern local affairs, the United States Congress maintains the power to overturn local laws. Furthermore, unlike any other jurisdiction in the country, residents of the District of Columbia are not represented by voting members of the United States Congress.”); see also Martin Austermuhle, Four Decades after Getting Home Rule, the Fight in D.C. Goes On, WAMU 88.5 (Nov. 15, 2013), [https://wamu.org/story/13/11/15/four_decades_on_dc_continues_fighting_for_home_rule](https://perma.cc/8MA8-26HA).

97. See, e.g., Opportunity Zones Reality Check, LOC. INITIATIVES SUPPORT CORP. (Oct. 10, 2019), [https://www.lisc.org/our-stories/story/opportunity-zones-reality-check](https://perma.cc/C3UD-QMXV) (“Participants noted that Opportunity Zone investments take time to structure and close, and require careful coordination with local stakeholders to ensure that community needs are met. Opportunity Zone funding might gravitate toward areas where development would have happened anyway, and one challenge would be how to direct funding to places where it would not have gone otherwise. Still, many investors may be looking to deploy capital by the end of this year in order to gain the full tax benefits of the program.” (emphasis added)).
structural disadvantages. A98 Another factor compounding this challenge is the reality that “capital tends to follow very hard paths” with “very specific ways of underwriting risk.” A99 This Note concludes with an analysis of tools adopted across these three cities; however, as a threshold matter, the many practitioners I interviewed for this Note all agreed that solving this basic coordination problem is crucial to making the OZ program work on the ground.

C. Case Studies

i. Louisville, KY

On a spectrum of government action directing OZ investment, where one end represents the exercise of informal government power (through networking and agenda-setting) and the other end represents the exercise of formal government power (through official actions of the chief executive or the legislature), Louisville firmly represents the “informal” end of the spectrum.

Louisville Mayor Greg Fischer was an early proponent of the OZ initiative: many of the first law journal articles analyzing the program specifically mentioned him as an early adopter. A100 In a late-2018 op-ed in the Louisville Courier Journal, Mayor Fischer himself wrote that:

As a former entrepreneur, I know that one of the biggest challenges that start-up businesses face is equitable access to capital . . . . We want responsible development and projects that benefit our citizens by providing investment without displacement . . . . If we use any local incentives, we will look for Opportunity Funds that would

98. Telephone Interview with Stephanie Copeland, CEO, Governance Project (Dec. 13, 2019).
99. Id.
100. See, e.g., Diane Lupke, Opportunity Zones: A Different Zone Opportunity, J. Tax’n 24, 44 (2019) (“In Louisville, Mayor Greg Fischer praised Opportunity Zones for attracting investment in a major business expansion . . . . One of the first Louisville investors to take advantage of the recently designated Opportunity Zone is the Marion [sic] Group through its spin-off and expansion of Blacksmith Iron Works, a fabrication and custom metal solutions business that recently moved into a 20,000 square-foot facility at 3100 Vermont Avenue in the Russell neighborhood.”); see also Kriston Capps, The Obscure Tax Program That Promises to Undo America’s Geographic Inequality, CITYLAB (Apr. 25, 2018), https://www.citylab.com/equity/2018/04/can-opportunity-zones-save-the-country/558266/ [https://perma.cc/C9GK-EJY3] (“In Louisville, for example, that might mean turning an under-used high school into a vocational training facility. That’s one idea for an investment opportunity in Louisville’s historically black, near-downtown neighborhood of Russell.”).
make a social impact by hiring and partnering with local residents who can also benefit from any income and wealth that is created.\textsuperscript{101}

Mayor Fischer’s desire to attract capital makes sense in the context of economic conditions in his city: several months before his op-ed ran in the \textit{Louisville Courier Journal}, the paper reported the results of a study from the Greater Louisville Project showing that one in five children in the city live in poverty, and that its poverty level cost the city $200 million each year in lost economic growth.\textsuperscript{102}

Around the same time that Louisville was looking to attract OZ investment, the nonprofit Accelerator for America (AFA) worked with local government expert Bruce Katz and his New Localism Advisors team to create “a replicable product — an Investment Prospectus — to enable cities, counties, and states to communicate their competitive advantages, trigger local partnerships, and identify sound projects that are ready for public, private, and civic capital.”\textsuperscript{103}

Louisville jumped at the chance to work with Katz and AFA: they enlisted Katz to work with economic development staff like Mary Ellen Wiederwohl, Chief of Louisville Forward (the city’s economic development arm) and Senior Policy Advisor Eric Burnette, and to draft a version of the prospectus that AFA envisioned.\textsuperscript{104}

The result was a document called the “Louisville Opportunity Zone Prospectus: A Platform for Action.”\textsuperscript{105} The prospectus is now on its second iteration: the original version was nearly 50 pages long and is essentially a sophisticated pitch deck aiming to connect investors to the city. The document’s executive summary lays out, in

\begin{itemize}
  \item \textsuperscript{103} Bruce Katz \& Ken Gross, \textit{Accelerator for America, Investment Prospectus Guide: A How-To For Opportunity Zones 1, 3} (2018), \url{https://static1.squarespace.com/static/5d9f9365f67b454b1ce2dc2f/t/5e38ae218a999b24d895fe2e/1580772908835/New+AFA+Prospectus+Guide.pdf [https://perma.cc/N23K-3E5L]}
  \item \textsuperscript{104} Telephone Interview with Eric Burnette, Senior Policy Advisor, Louisville Forward (Nov. 20, 2019).
  \item \textsuperscript{105} Accelerator for America, \textit{Louisville Opportunity Zone Prospectus: A Platform for Action} (2018) [hereinafter Louisville Opportunity Zone Prospectus], \url{https://louisvilleky.gov/sites/default/files/louisville_forward/louisville_prospectus_version_13_11.5.2018.pdf [https://perma.cc/F9YU-SHQ5]}
\end{itemize}
brief, Louisville’s argument for why investors should inject capital there: it is an expanding city, with a diverse and growing economy, whose OZs were chosen “intentionally” to “maximize the impact of Opportunity Zone investment.”

The pages that follow the summary give an overview of how the OZ program functions and explain Louisville’s assets in greater detail (with a focus on demographics and major industries). But the heart of the document is a neighborhood-by-neighborhood breakdown of Louisville’s opportunity zones — with specific projects detailed on subsequent slides. Each project slide explains the neighborhood’s assets, as well as tailor-made investment opportunities for investors to consider. These slides also include maps (termed “mental maps” by AFA), which show the various OZs, as well as “land use” and other assets.”

As an example, slide 29, titled “Central Business District Catalytic Investment: Louisville Gardens,” describes a “[c]ity-owned, historic 6,000-seat performance venue,” which is “[p]rimed for restoration as an arts and entertainment venue, convention facility, and mixed-use space, at an estimated cost of $65 million,” and is “[l]ocated in the heart of downtown” near “10 new downtown hotels since 2009.” Immediately underneath this information, a box titled “The Opportunity” gives investors the hard sell: “City seeking development partner to create a new mixed-use facility” and “City offering other incentives and land.”

Louisville Forward released version two of the prospectus in late November 2019. Like its predecessor, this new version begins with an overview of the city’s assets and makes a clear argument for investors to deploy capital there. However, unlike version one, version two of the pitch deck includes an entire category of possible projects called “Projects with a High Social Return” in a section called “Louisville Priorities.”

106. Id. at 2.
108. LOUISVILLE OPPORTUNITY ZONE PROSPECTUS, supra note 105, at 29.
109. Id.
111. Id. at 12–13.
“[c]ommunity spaces and surrounding commercial uses,” and “[f]ocus on tech.” It also pitches specific projects already in the development pipeline, which are looking to attract additional investment — like a company called “Weather Check,” a black-owned business located in an OZ and part of the Y-Combinator incubation program in 2019.

In addition to drafting and releasing this pitch book, Louisville Forward has used the city’s informal power to attract investment in other ways. It, for instance, established a relationship with OneWest, a nonprofit development company, which purchased a large plot of land in the city with plans to develop it. Additionally, the city partnered with the Louisville Urban League to help fund the construction of a large athletic facility called the “Track on Ali,” located in an OZ.

Finally, Louisville worked extensively with the Governance Project to develop a ready-made “plug-and-play” tool that will allow public officials to identify socially impactful OZ projects and then build out the kind of projections and deal documents which investors require when weighing the attractiveness of a potential investment. The tool, which is sponsored by the MasterCard Center for Inclusive Growth, is named GroundUp; Governance Project’s CEO Stephanie Copeland describes it as “Turbo Tax for Opportunity Zone deals”: “[I]t asks a set of questions about the deal, and then auto-generates many essential deal documents.” The value of this sort of tool is its bridging of the gap between two communities whose partnership is essential for using OZs for impact: investors and public officials. Since “a big part of community development is figuring out the financing structure, this tool will give public officials more of an active voice in conversations with the investment community, in terms that investors are familiar with.”

Louisville’s work to attract and funnel OZ investment has been constrained in two senses. The first is that Kentucky, under now-former Governor Matt Bevin, was largely unwilling to extend

112. Id. at 13.
113. Id. at 17.
114. Id. at 19.
115. Id. at 20.
116. See Telephone Interview with Stephanie Copeland, supra note 98.
117. Id.
118. Id.
additional funding to incentivize investment. While some states have proposed layering additional tax incentives on top of the OZ program, Kentucky has not yet adopted that approach. Additionally, as the consequence of a decision made by the Kentucky Retirement Systems Board, which manages the state’s public employee pension system, Louisville faces an increased pension obligation which amounts to “a looming budget hole over the next four years that will grow to roughly $65 million.” As a consequence, Louisville is unable to offer any additional economic incentives to OZ investors — which it might not have done even in an alternate fiscal reality in which its pension obligation had been lower.

ii. Cuyahoga County, Ohio and National Work by the Kresge Foundation

One of the most demanding policy regimes developed so far to govern capital flows in the OZ space was created by the philanthropic sector and not by government. In May 2019, the Detroit-based Kresge Foundation announced a $22 million investment, with substantial restrictions, into two OZFunds: Arctaris Impact (based in Boston, Massachusetts) and Community Capital Management (based in Ft. Lauderdale, Florida). These two funds were, according to the foundation, the first in the country to agree to “voluntary reporting,

119. See Telephone Interview with Eric Burnette, supra note 104. Although, concededly, it was one of the first 18 states to have its OZs certified. See Press Release, Team KY, Cabinet for Econ. Dev., Gov. Bevin: Kentucky Opportunity Zone Initiative Holds Promise of Economic Growth for Local Communities (Apr. 9, 2018), http://thinkkentucky.com/newsroom/NewsPage.aspx?x=04092018_Oportunity_Zones.html [https://perma.cc/WV6S-LV9T].


122. See Telephone Interview with Eric Burnette, supra note 104.

metrics and transparency measures.” Kresge and its staff chose to focus on OZ investing, particularly because of a perceived gap in regulation from government actors:

[W]hen public policy has a gap . . . there’s a moment for philanthropy to really do its job. That’s what we have tried to do with Opportunity Zones, and we hope others in the philanthropic community will find unique ways to do the same in Opportunity Zones and in other places.

Much of Kresge’s funding comes in the form of an investment structure called principal protection, or “catalytic first loss capital” (CFLC). Under this relationship, the Foundation will provide a kind of insurance to the investors in the OZFund, a guarantee that Kresge will bear the first losses — up to a certain threshold — if investments decline in value. The Global Impact Investing Network defines the concept this way: “CFLC aims to channel commercial capital towards the achievement of certain social and/or environmental outcomes . . . . [G]rants and guarantees provided expressly as CFLC are distinct because they always take the first loss . . . in the event of losses.”

124. Id.
126. See Kresge Foundation Press Release, supra note 123.

(1) Impact acceleration: By offering CFLC, Providers can typically attract greater amounts of capital towards a targeted impact than they could aggregate by utilizing their own funds alone, thus multiplying the scale of impact many-fold. (2) Resource optimization: By incenting commercial investors to explore a new market, providers can potentially demonstrate the market’s long-term commercial viability, encouraging investors to continue to invest without credit enhancement. This allows Providers to channel their scarce resources towards issues and areas where the market case is not yet proven.

(3) Better terms for Investees: By reducing the risk for Recipients, and by fostering greater competition in new financial markets, Providers can enable improved terms — such as lower cost of capital — for end Investees that are working on addressing important social and/or environmental problems.

Id. at 7.
Principal protection/CFLC is a form of credit enhancement — in the same family as letters of credit from a bank used on an LIHTC-funded affordable housing transaction or a Small Business Administration loan guarantee. It is often provided by philanthropic organizations or governments as a means of attracting capital from investors who would otherwise perceive deals as too risky due to “a lack of information or track record given the novelty of either the market or a particular type of investment opportunity.”

For OZFunds like Arctaris, CFLC is more valuable than other incentives because of the funds’ focus on investment in growth or mid-stage investing in businesses rather than investment in real estate. State-level economic incentives like tax increment financing (TIF) or local incentives like accelerated zoning approval are far less important to OZFunds whose investments are not real estate-based. In this instance, the Kresge Foundation has agreed that its contribution will insure a certain percentage of these two funds’ investments in OZs around the country.

In return for this commitment, the OZFunds have agreed to abide by a strict set of criteria — far beyond the requirements established in the OZ legislation — which are codified as covenants. The first metric Arctaris agreed to meet relates to scale: for every dollar of insurance provided by the Kresge Foundation, the fund has committed to raising $9 of additional capital. The logic underlying

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128. Id. at 3.
129. Id.
130. Interview with Jonathan Tower, CEO, Arctaris (Dec. 15, 2019. This was, after all, the original intent of the OZ program. See, e.g., Sophie Quinton, So Far, Real Estate Dominates a Tax Break Meant for Businesses, PEW CHARITABLE TR. (June 12, 2019), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2019/06/12/so-far-real-estate-dominates-a-tax-break-meant-for-businesses [https://perma.cc/NH9U-QN4W] (pointing out that “[t]he incentive ‘will unlock new private investment for communities where millions of Americans face the crisis of closing business, lack of access to capital and declining entrepreneurship,’ said a bipartisan congressional group — Sens. Tim Scott, a South Carolina Republican, and Cory Booker, a New Jersey Democrat, and Reps. Pat Tiberi, an Ohio Republican, and Ron Kind, a Wisconsin Democrat — in announcing the idea”).
131. See Telephone Interview with Stephanie Copeland, supra note 98.
132. Press Release, The Kresge Found., supra note 123 (“In the absence of a regulatory mandate, Arctaris and CCM have committed to making investments that reflect the stated social and community goals of the Opportunity Zones program and address unmet needs in under-resourced communities.”).
133. Interview with Jonathan Tower, supra note 130; see also Press Release, The Kresge Found., supra note 123 (“Leveraging the Kresge guarantee, Arctaris plans to
this requirement is that the foundation wants to ensure that its investment would be paired with significant capital from the fund to reach as broad a scale as possible.

The second is an impact requirement. Arctaris has committed to making investments that are beneficial for neighborhoods: prioritizing affordable housing, “pathways to prosperity for residents of low-income communities,” and “investments in operating businesses that create quality jobs” — and also to forming “community advisory boards similar to those in the New Markets Tax Credit Program.”

Third, Arctaris has committed to avoid net-negative investments, like those that create displacement, or non-productive investments, like self-storage facilities. Finally, Arctaris has agreed to a set of transparency requirements, most notably, measuring and then disclosing the number of jobs created in each census tract by its investments.

These principles are generally aligned with the U.S. Impact Investing Alliance framework referenced above. They also reflect the Kresge Foundation’s belief that since “the underlying legislation was passed without minimum transparency or reporting guidelines,” OZs present a “ripe opportunity for misuse.” Arctaris views this investment from Kresge as having the potential to turbocharge its work: to create an “exponential” impact by demonstrating to other foundations, municipalities, counties, and states that this kind of investment is worth making. It also views the restrictions as very stringent: Jonathan Tower, Arctaris’s CEO, explained that these covenants will not disincentivize investment (otherwise the fund would never have agreed to them in the first place), but they do demarcate the outer boundary of the kind of “strings attached” that the fund would have accepted in exchange for CFLC.

launch a principal-protected Opportunity Zone fund with more than $500 million in initial capitalization from U.S. commercial banks, institutional investors, and family offices. Supplementing Kresge’s catalytic support, Arctaris expects to secure additional guarantees and grants from other foundations and state government economic development agencies. The Fund will make growth equity investments in small- to medium-sized enterprises involved in manufacturing, renewable energy, and telecom, as well as real estate infrastructure.”

134. Interview with Jonathan Tower, supra note 130; see Press Release, The Kresge Found., supra note 123.
136. Interview with Jonathan Tower, supra note 130.
137. Press Release, The Kresge Found., supra note 123; see also Pollard, supra note 126.
138. Interview with Jonathan Tower, supra note 130.
One region which has followed the Kresge Foundation’s lead is Cuyahoga County, Ohio, home to the city of Cleveland. Even before the Kresge Foundation named Arctaris a winner of its national OZ competition, the greater Cleveland area had already sought to market itself as an attractive destination for OZ investment and to channel that investment toward socially beneficial purposes, such as “jobs, training, education, quality affordable housing, increased access to broadband, public transportation and healthy-living environments.” In March 2019, the City of Cleveland and Cuyahoga County, in partnership with a collection of non-governmental organizations (NGOs), established an initiative called “Opportunity CLE” as the region’s main vehicle for generating and funneling OZ investment toward the 64 OZs across the county.

The initiative acknowledged in early press coverage that the OZ program is at risk of being abused — of becoming a “National Gentrification Fund.” In response, Opportunity CLE has taken a number of steps to restrict capital flows — first in the form of informal policymaking and networking. For instance, Opportunity CLE built and released a pitch deck similar to that of Louisville and seeks to connect investors with entrepreneurs eager for access to capital. In partnership with the Urban Institute, the initiative is

140. Id.
141. Id.
142. Id.

The first step is marketing the region, members said. The investment prospectus released Thursday pitches Greater Cleveland as a place where investment dollars can stretch further than they would elsewhere. The prospectus includes sections on each of the 11 districts and provides information about their assets, infrastructure, population and projects under development there, as well as a pitch for why investors should consider putting their money there. The 11 districts are: Downtown Cleveland, W. 25th-MetroHealth Corridor, Health-Tech Corridor, Opportunity Corridor, Glenville-Rockefeller Park Innovation District, Euclid/Collinwood Industrial Corridor, Outer Belt Development District, Aerozone Innovation Hub, Cuyahoga County Airport District, Transportation Boulevard Development District and Caledonia Park District.

Id. The selection of the zones themselves was not without controversy: “East Cleveland, the poorest city in Ohio, received no opportunity zones. County officials had recommended the tract containing General Electric’s Nela Park campus, next door to Caledonia, but the state passed on it.” Nick Castele, Cuyahoga County Won Dozens of Opportunity Zones. Now What?, IDEASTREAM (Dec. 10, 2018),
also developing a “social impact scorecard,” not yet rolled out, whose purpose is to identify those projects which are “the most socially positive” and to help those projects attract funding.\textsuperscript{143}

Opportunity CLE received a boost in November of 2019 when the Ohio State Legislature passed, and Governor Mike DeWine signed, an additional state tax credit for OZs.\textsuperscript{144} The “Ohio OZ Tax Credit” provides a nonrefundable, transferable credit equal to “10\% of a taxpayer’s qualifying investment in an Ohio qualified opportunity zone fund.”\textsuperscript{145} Similar to the federal OZ program, this additional incentive has very few restrictions: the credit tops out at $1 million per fiscal biennium per individual taxpayer, and the credit is capped at $50 million statewide per biennium.\textsuperscript{146} Additionally, there is a geographic requirement: capital must be invested in “an Ohio QOF which is a qualified opportunity fund that holds 100 percent of its invested assets in qualified opportunity zone property situated in an Ohio opportunity zone.”\textsuperscript{147} However, the restrictions end there: the
tax credit imposes no additional geographic limitations and does not have community involvement, impact, or transparency requirements.

In the last year, both Cuyahoga County and the City of Cleveland — through the city’s Chamber of Commerce and its development arm — have authorized substantial expenditures to partner with OZFunds, with the twin goals of bringing capital to the region and placing restrictions on that capital’s use. In December 2019, the Cuyahoga County Council through the city’s Chamber of Commerce and its development arm — have authorized substantial expenditures to partner with OZFunds, with the twin goals of bringing capital to the region and placing restrictions on that capital’s use. In December 2019, the Cuyahoga County Council approved $1.5 million in funding for Arctaris in the form of an Economic Development Loan, as part of an investment vehicle which will be partially guaranteed by the Kresge Foundation’s award. In return for favorable loan terms — a ten-year loan at 2% interest — the county has imposed a set of restrictions on the fund which layer on top of the Kresge Foundation’s. According to the language of the resolution passed by the county, each proposed investment that Arctaris chooses is reviewable by the council “for social impact,” which is defined as “creat[ing] well-paying jobs accessible to community residents,” and “improve[ing] access to basic services.” The resolution obligates Arctaris to raise at least $8.5 million of investment on its own, for a total of $10 million in capital invested. Arctaris is also required to submit a report detailing “job creation and retention reporting” each quarter. Finally, there are clear impact expectations written into the resolution’s language: each project that receives an injection of

period for such stock or interest, the use of the corporation’s or partnership’s tangible personal property was in the designated zone.

Raquel M. Mazarin, Ohio Governor Mike DeWine Signs FY 2020–21 Budget Bill, 29 J. MULTISTATE TAX’N & INCENTIVES 27, 30 (2019).

148. CUYAHOGA COUNTY COUNCIL, http://council.cuyahogacounty.us/ [https://perma.cc/3R6F-VL6C] (last visited Apr. 4, 2020) (stating that “[t]he Cuyahoga County Council is the legislative body of Cuyahoga County government, made up of 11 elected representatives from across the County . . . . The Council makes policy decisions for the effective functioning of County government, and is a link between government agencies and citizens. It has legislative and taxing authority for the County, and is a co-equal branch of the County government with the executive branch. This form of government for Cuyahoga County was established in January 2011, replacing the three-member Board of County Commissioners, when the Charter form of government adopted by voters went into effect”).


151. Id.

152. Id.
capital from this new fund is expected to create “300 permanent jobs” within three years after its completion.\textsuperscript{153} While these expectations are not explained in the resolution itself, the resolution is likely designed to prevent the county’s investment from being used to finance projects which have only a short-term impact on job creation (generally in the form of construction jobs) and which are, as a result, considered socially undesirable.\textsuperscript{154}

In addition to wanting to attract capital generally, part of the county’s motivation for investing in Arctaris was the desire to revitalize its lagging manufacturing sector.\textsuperscript{155} Manufacturing was once the lifeblood of the region’s economy but declined precipitously during American deindustrialization in the second half of the twentieth century.\textsuperscript{156}

There are encouraging signs of a manufacturing recovery, however, and regional officials are hopeful that OZs can help catalyze it. Northeast Ohio is home to 1200 manufacturing companies — 300 of which are located in OZs.\textsuperscript{157} Ohio workers are employed in manufacturing at twice the national average and earn, on average, ...
$11,000 more than workers in other sectors.\textsuperscript{158} The manufacturing industry contributed $106 billion to the local economy in 2016, which was almost 20\% of the state’s entire economic output.\textsuperscript{159} However, structural problems threaten to stunt manufacturing revitalization: manufacturing firms are generally undercapitalized because they do not generate enough revenue to attract investment from banks and are often overly reliant on loans from the Small Business Administration.\textsuperscript{160} Demographics compound this problem: “Over the next five years . . . 70\% of those owners of small to midsize companies are looking to sell their business and are in need of buyers.”\textsuperscript{161} OZFunds could be a natural solution to this problem. On the investor side, they employ “patient capital,” which is by design a longer-term investment; on the investment side, manufacturing is similar to real estate in that it is less mobile.\textsuperscript{162} This potential is at the heart of Arctaris’s partnership with Cuyahoga County; in an interview with Cleveland.com, a principal from the firm explained that manufacturing would be the focus of Arctaris’s investment in the region.\textsuperscript{163} This kind of relationship is one of the most exciting policy innovations in the OZ space: Arctaris has replicated this kind of model across the country — local collaboration, first loss capital protection, and a strict set of guidelines about where and how capital can be invested.

\textit{iii. Washington, D.C.}

While Louisville represents an “informal policymaking/networking” approach to OZ investment and Cuyahoga County illustrates the power of the philanthropic sector to generate policy innovations in the OZ space, Washington, D.C. exemplifies how municipal governments can use already-existing tools to control OZ investment using a structured economic development process. The microeconomic climate in the District helps explain why — D.C. has gentrified at a dizzying pace, particularly over the course of the last decade. According to a 2019 report from the National

\textsuperscript{158} SHIELDS, supra note 156, at 1.
\textsuperscript{159} Id.
\textsuperscript{160} Palmer, supra note 157.
\textsuperscript{161} Id. (continuing that “[i]t is a baby boomer thing . . . . Obviously in Cleveland, you are dealing with a lot of third- and fourth-generation businesses, and the prospect that the family is going to step in to take over is unlikely” (internal quotations omitted)).
\textsuperscript{162} Id.
\textsuperscript{163} Astolfi, supra note 149.
Community Reinvestment Coalition using the most recent data available, 20,000 black D.C. residents were displaced between 2010 and 2013.\textsuperscript{164} Of the major American cities analyzed in the study, “Washington, D.C., was the most gentrified city by percentage of eligible neighborhoods that experienced gentrification.”\textsuperscript{165} Investors’ interest has not slowed since the TCJA was enacted. In the spring of 2019, the commercial real estate analytics company Yardi Matrix named the District the most attractive region for OZ investment on the East Coast.\textsuperscript{166}

As a result of this context, and the sheer scale of development, local officials were less concerned about attracting investment dollars and more concerned about unintentionally accelerating the pace of displacement: “there was more of a sense in D.C. that the city could steer the ship and be more selective in terms of what zones it designated and tailoring those investments through public resources including land or subsidies.”\textsuperscript{167}

This started with OZ selection: the process of choosing the District’s OZs, to begin with, was run through the Office of the Deputy Mayor for Planning and Economic Development (DMPED),


\textsuperscript{165} Quander, supra note 164.

\textsuperscript{166} Erika Morphy, DC Is the Most Attractive Opportunity Zone on the East Coast, GLOBEST.COM (Mar. 25, 2019), https://www.globest.com/2019/03/25/dc-is-the-most-attractive-opportunity-zone-on-the-east-coast/?slreturn=20200003153652 [https://perma.cc/F44T-KPED] (explaining that “[i]t used such indicators as GDP and population growth, number of eligible OZs, and poverty rates in each area, attributing points for each of these and calculating the total. The data for the indicators came from The US Census Bureau, the Bureau of Labor Statistics and the US Department of Treasury”). Perhaps not so surprisingly, the methodology underlying this ranking system completely ignored social impact. In actuality, it penalized OZs for having higher poverty rates: “[f]or the poverty rate indicator, between 0 and 15 points were awarded in inverse proportion, with a lower poverty rate leading to more points.” Diana Sabau, Study: Top Counties for Opportunity Zone Investment, COMMERCIALCAFE (Mar. 18, 2019), https://www.commercialcafe.com/blog/top-counties-opportunity-zone-investment/ [https://perma.cc/3X9B-A2KT].

which continues to house the District’s OZ work. Since D.C. is not a state, the TCJA gave Mayor Muriel Bowser the ability to submit OZs to the IRS in the same way as governors; DMPED was highly intentional about selecting zones with “demonstrated need” that had “investment opportunities that could be paired with complementary incentives to benefit residents.”

Ultimately, the IRS certified 25 zones total across the District, with the majority concentrated east of the Anacostia River in historically poorer Wards 7 and 8.

The District also received a major boost from the philanthropic sector: in September 2019, the Rockefeller Foundation announced that D.C. had been chosen to participate in its “Opportunity Zone Community Capacity Building Initiative,” which meant the Foundation would fund technical assistance through LISC to “build a pipeline of projects and small business investments that move beyond the early stages of planning and attract private investment in economically-distressed areas.” Mayor Bowser designated Sharon Carney, who was already working at DMPED, to coordinate Opportunity Zone efforts. Mayor Bowser’s stated aim for implementing the OZ program locally is to maximize benefits to current residents; Carney explained that the District has approached this in several ways: one, by providing support and resources for community-based stakeholders (including projects and businesses) to learn about OZ and connect with potential investment opportunities; and two, by helping investors align with community priorities and


discover resources that can help generate benefits for communities.\textsuperscript{171} In addition, the District works to align OZ investment with the structures that the city already has in place for managing development.\textsuperscript{172}

The first of these structures pre-dates the OZ program by four decades: D.C.’s Advisory Neighborhood Commission (ANC) system enacted in 1976. The ANC system is a feature of D.C.’s Home Rule Charter: locally elected commissioners serve two-year terms as the “official voice in advising District government . . . on things that affect their neighborhoods.”\textsuperscript{173} While not obligated to follow the recommendations of ANCs, agencies are required by law to assign them “great weight” and are statutorily barred from taking “any action that will significantly affect a neighborhood” without “giving the affected ANCs 30 days advance notice.”\textsuperscript{174} In effect, the ANC system can act as a check against socially undesirable or net-negative OZ investment and, at minimum, provides local stakeholders — who are the closest to the ground — a voice in the development process.

The second is zoning-related. In late 2019, the D.C. government completed an update of the city’s Comprehensive Plan, since, “in its current form, which was approved in 2006, the Comp Plan does not sufficiently address the District’s long-term needs around housing, equity, resilience, and public resources.”\textsuperscript{175} Carney noted the importance of such structures – including District plans and formalized community input mechanisms – in guiding OZ investments.\textsuperscript{176} In recent years, the District has been amending its Comprehensive Plan in consultation with tens of thousands of District residents through community engagement.\textsuperscript{177} The District’s Comprehensive Plan serves as the guide for long-term development and land use in the District and, as such, influences zoning and all

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\textsuperscript{171} Interview with Sharon Carney, Chief Opportunity Zone Officer, Office of the D.C. Deputy Mayor for Planning and Econ. Dev. (Nov. 14, 2019).

\textsuperscript{172} Id.


\textsuperscript{174} Id. (“[D]etailing that [t]his includes zoning, streets, recreation, education, social services, sanitation, planning, safety, budget, and health services.”).


\textsuperscript{176} Interview with Sharon Carney, supra note 171.

\textsuperscript{177} Id.
\end{flushleft}
projects, regardless of source of financing. As OZ investment continues to flow into the District, “the city is tracking and reviewing proposals for discretionary development and map amendments in Opportunity Zones to ensure that proposed projects align with existing plans and provide benefits to the surrounding community.”

Mayor Bowser has been clear that one of the highest priorities for her second term in office is the development of more affordable housing in the District; the city government is working to use the OZ program to achieve that goal. This past spring, Mayor Bowser announced a $24 million commitment to fund projects in D.C.’s OZs, which “support affordable housing, workforce development, and the growth of small businesses.” This coincided with an announcement earlier the same month, that the Mayor was proposing an additional tax on commercial property sales to increase the city’s affordable housing trust fund substantially; in May, the D.C. City Council enacted a modified version of that tax into law.

In addition to using tax revenue to incentivize affordable housing development in OZs, D.C. has another tool at its disposal: the large amount of publicly-owned land in the District, which the government can use as an incentive for investors. Essential to catalyzing any OZ deal is the concept of “de-risking” it for the OZF contributing the capital — which looks different depending on whether the investment is a piece of real estate to be developed or a

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178. Id.
179. Greene et al., supra note 168.
183. Greene et al., supra note 168. “The city is also contributing public land and financing in these areas, which can help ensure that new projects will provide job opportunities for local residents and businesses through DC’s first source hiring and small business contracting requirements.” Id. See also Cheryl Cort, Public Land Deals Give Hot Neighborhoods Affordable Housing, GREATER GREATER WASH. (June 4, 2012), https://ggwash.org/view/27915/public-land-deals-give-hot-neighborhoods-affordable-housing [https://perma.cc/SCP8-RHMQ].
business-seeking venture capital funding. While this tool is still in its early stages, the use of public land for OZ development holds tremendous promise: if the city already owns a piece of property and can contribute it to an OZ transaction, that both lowers the risk inherent in the deal (by removing the need to purchase the property in the first place) and gives the city enormous leverage in dictating what kind of project will be built.

Finally, the District has created a number of policy initiatives that fall into the “informal policymaking” category: it created a network of professionals (like lawyers and accountants) called the “OZ Community Corps” that has agreed to provide pro bono services to District residents, small businesses, and nonprofits seeking to start projects — or attract investment — in OZs. Also, in July 2019, it launched an “Opportunity Zone Marketplace,” a platform for investors to use to find OZ-eligible projects; projects on the marketplace site must meet one of the criteria established by the city for projects that are socially beneficial.

IV. ANALYSIS AND EVALUATION OF OPPORTUNITY ZONE PROGRAMS

The case studies discussed in Part III represent a range of different policy responses to the OZ Program across a spectrum, from informal government policy to formal policymaking. The ultimate yardstick for judging the utility of any of these methods will be their effect: do they attract OZ investment? And even more crucially, does that

184. See Telephone Interview with Stephanie Copeland, supra note 98.
185. For an analogous, though not OZ-related, project illustrating this principle, see Elena Knopp, As Bayfront Master Developer, Jersey City Can Call Shots, NJBIZ (July 9, 2018), https://njbiz.com/as-bayfront-master-developer-jersey-city-can-call-shots/ [https://perma.cc/4RK3-57DA].
188. Of course, one possible response not considered here is to ban OZ investment entirely, or to place a moratorium on their use, which Boulder, CO adopted and then reversed. See Sam Lounsberry, Boulder Council Lifts Opportunity Zone Development Moratorium, DAILY CAMERA (Oct. 16, 2019), https://www.dailycamera.com/2019/10/16/boulder-council-lifts-opportunity-zone-development-moratorium/ [https://perma.cc/KKQ6-B2AJ].
investment catalyze the kind of economic development that lifts low-income communities out of poverty, or does it simply act as a tax giveaway for the rich on the investor side while simultaneously accelerating gentrification and displacement on the community side?

It will be years before those questions are answered or are even answerable. However, since the OZ program is now two years old, the IRS regulations have been finalized, and OZFunds have raised and deployed several billions of dollars in capital, we can draw some preliminary conclusions about state and local action. Accordingly, this Part evaluates the policies articulated above and suggests a course of action for state and local governments, based on the findings in Part III and also on a set of tools traditionally in the local government toolkit.

A. Evaluation

In the spring of 2019, the trade publication *Institutional Investor* published an extremely well-sourced article titled, “Is Anyone Actually Investing in Opportunity Zone Funds?” Its answer, in short, was “not really,” or at least, “not to the extent the investment community thought they would.” One challenge the article highlights is the extended lock-up period: it quoted one fund manager who said that OZs are “a longer-term investment that takes more consideration before pulling the trigger.”

But perhaps a more fundamental challenge to using OZs for impact is the uphill battle of changing “operating norms”: since capital tends to follow pre-set channels, the default position of investors looking at OZs is to do what they have always done — find the safest possible investment, whether or not it is going to improve outcomes for poor neighborhoods and their residents; if no safe investments are readily apparent, investors will stay away. And so a crucial role that state and local governments can play in the OZ space is to help solve this coordination problem: to help bureaucrats and investors speak the

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191. See Telephone Interview with Stephanie Copeland, *supra* note 98.
same language, to identify worthwhile investments by engaging with communities, and to stop unproductive investments. Some OZFunds will seek out socially beneficial projects and invest in them on their own, motivated simply by a desire to create impact. But without strong participation from government, most funds likely will not.

Knowing what we know now — that the scale of OZ investment is significant, though far short of initial predictions — a central challenge has emerged: state and local actors need to walk a fine line between attracting investment on the one hand while simultaneously setting up guardrails to direct capital toward worthwhile projects and discourage investment in projects that are either net-negative or which will push out longtime residents (especially residents from historically marginalized communities). These goals are not diametrically opposed, but they are in tension with one another: advertise OZ-eligible investments too heavily (and layer on too much public money in incentives) and governments risk accelerating displacement and gentrification. However, if state and local actors create too many guardrails — in a way that is perceived as anti-investment — they will scare away investors altogether and lose out on the opportunity to inject capital into places that need it badly.

Overall, state and local governments should take three affirmative steps to attract and direct OZ funding for impact in order to walk the fine line described above. First, they should use informal policymaking power to identify and then advertise socially impactful projects. Next, they should craft a package of incentives or capital unique to their local context, though with extensive strings attached. Finally, they should reserve the power to ward off damaging investments. These three policy prescriptions are designed to help government officials — largely in the community economic development space — strike an appropriate balance.

The first step that state and local governments should take is to create marketing materials and pitchbooks similar to the one the City of Louisville built with help from Bruce Katz and Accelerator for America. That process ought to begin by actively engaging community stakeholders in a conversation about where investment would be most impactful. Cities like Washington, D.C. (or New York

192. See id.
193. As of summer 2020, when this Note went to press, the most recent data available from Novogradac showed that roughly $4.46 billion had been invested in OZFunds, far short of initial expectations. See Novogradac, Opportunity Funds Listing, supra note 22.
194. See supra Section III.C.
with its Community Board system) which already have a mechanism in place to “encourage and facilitate the participation of citizens within City government,” are at a natural advantage, though lacking such a system is by no means an insurmountable roadblock. Lining up projects for investors provides a starting point for a conversation about where investment can do the most good as well as generate the most return. Governments should also pay very close attention to the Governance Project’s “Plug-and-Play” tool when it is released, since it can go a long way toward making deals more attractive.

Another trend which has emerged from the constellation of state and local OZ early adopters is that many of the most successful regions, which are generating investment and placing meaningful restrictions on it, have adopted a “carrot and stick” approach, under which they offer capital or an additional incentive in exchange for restrictions. And so, the second step that state and local governments should take is to follow this lead.

In doing so, they should seek to craft a package of incentives that is reflective of the local economic context. For instance, there is a crucial distinction between the types of incentives that are appealing to funds that invest in real estate projects and funds that invest venture capital dollars at the seed or the growth stages — in other words, in operating businesses. Much of the OZ coverage in the national press, particularly the most controversial coverage, has focused on real estate projects. In reality, many of the OZ program’s creators, and its highest-profile advocates, now argue that operating businesses should be the real focus of investment moving forward since they can be more impactful and since the abuse potential may be lower.

For OZFunds investing in real estate, the package of tax incentives that many states have proposed — and some have enacted — might

196. See Telephone Interview with Stephanie Copeland, supra note 98.

Please remember that we’re all dealing with real estate, while the regulations were meant for businesses and jobs, jobs, jobs,” Friedman said. “If everyone [just] builds real estate, we’re going to have all kinds of stranded real estate in this country . . . . The corporations have to go to OZs, which they will because the advantages [for them] are unbelievable.

Id. (internal quotations omitted).
be impactful. One tool which could help incentivize targeted real estate development in OZs is for states and municipalities to help lower the cost basis of development: first, by providing access to cheap debt, and also by de-risking the development cycle. Washington, D.C.’s commitment to provide $24 million in funding for affordable housing in OZs is a great example of the former — more states and cities should follow its lead. To de-risk development, state and local governments should also offer expedited zoning approval for OZ investments that are determined to offer meaningful community benefits.

However, expedited zoning approval, or additional tax incentives, are unlikely to be effective for OZFunds investing in operating businesses. On those kinds of deals, operating businesses may present higher risks if they lack collateralized real estate assets. The most impactful step that state and local governments can take to attract and direct these investment dollars is likely to offer catalytic first-loss capital. Since venture capital as an asset class is risky, a priority for OZFund managers is to minimize or eliminate downside risk. States and municipalities who want to use OZs for impact can maximize their influence and also scale up investment dollars by providing this sort of protection for investors.

Whether they offer incentives in the form of tax benefits, accelerated zoning approval, or catalytic first-loss capital, state and local governments should attach significant restrictions — in the form of legally binding covenants — that require community engagement, transparency, scale, and impact. The Kresge Foundation’s work is a terrific model; the only logical criticism that can be leveled against it is that its scale is simply too small to keep pace with net-negative investment from OZFunds who are not concerned with social impact at all. The philanthropic sector — and state and local governments — should invest more dollars in the sort of first-loss capital that Kresge allocated and which localities like Cuyahoga County then turbocharged with additional capital. The good news is that many of

198. See, e.g., Novogradac, State, Local Governments, supra note 23.
199. See Telephone Interview with Stephanie Copeland, supra note 98.
200. See, e.g., Opportunity Zones 101, LOC. INITIATIVES SUPPORT CORP., https://www.lisc.org/our-resources/resource/opportunity-zones-101 [https://perma.cc/GSQ7-8Z7U] (last visited Apr. 4, 2020). “Finally, to the extent these are going to be large scale investments, local zoning and approval processes would probably be triggered, which hopefully will offer an opportunity for community engagement.” Id.
201. Interview with Jonathan Tower, supra note 130.
202. Id.
the brightest minds in the community economic development space have already done the hard work of clarifying what kinds of additional restrictions on OZ investment would be impactful, and that those restrictions are being implemented around the country. In other words, the investment and philanthropic communities have found an idea that works — catalytic first loss capital paired with robust restrictions; the next step is to expand that model before it is too late.

Finally, state and local governments should enact policies to blunt the impact of damaging OZ investment. Washington, D.C. is a terrific example of the ways localities that already have strong laws regulating development can enmesh OZs within that statutory framework. Regions without a similar framework to Washington, D.C.’s should enact one, and should aim to deploy the wide range of policy tools available to restrict or encourage development, up to and including enacting a short-term ban on the construction of self-storage facilities, or re-zone neighborhoods where developers have proposed multifamily condo construction. Even if the overall impact of OZs ends up being significantly smaller than expected, governments can and should use local regulatory power to push capital toward social impact.

CONCLUSION

When asked what he thought of the French Revolution, Chinese Premier Zhou Enlai is reported to have said that it was “too early to say.” The same can certainly be said of the OZ program and of the policy moves that governments have engineered to respond to it.

Some commentators have argued that state and local action to mold the OZ initiative is unwarranted. It does seem as though the program will be smaller in scope than originally envisioned. But still, the threat of unchecked capital is very real, especially in rapidly developing and gentrifying communities. And there is also a very real

203. See Community Partners, supra note 77; see also Toolkit for Maximizing the Impact of Opportunity Zones, supra note 92.
204. See supra Section III.C.iii.
possibility that, in the wake of the coronavirus pandemic and the recession that will almost certainly ensue, policymakers will consider enacting a variant of the OZ program as part of a package of long-term relief or might even simply expand the original program. Furthermore, there are reasons to believe that partnerships between government and OZFunds can create scale, impact, transparency, and community input. More state and local governments should follow suit. Or as Warren Buffett once observed, “Big opportunities come infrequently. When it’s raining gold, reach for a bucket, not a thimble.”


The Opportunity Zones (OZ) tax incentive has not lived up to its promises of poverty alleviation or economic development. Enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA), the incentive initially received little attention. Its designers touted it as a “new private sector investment vehicle” for attracting long-term investment into economically distressed areas. The incentive provides investors a tax deferral and other tax benefits if they roll over their capital gains—profit made from the sale of a property, stock, or bond—into a qualified opportunity fund which then invests that money into a designated region known as an Opportunity Zone. Supporters of the incentive believe that it will unleash a wave of capital into long-impoverished communities, stimulating revitalization via job creation and overall economic growth. Almost three years after the passage of the TCJA, however, critics note that it will, by and large, not produce equitable or sustainable economic development for distressed communities. They also point out that the incentive is finally being recognized for what it truly is: government-sanctioned gentrification driven by the capital gains of America’s wealthiest investors. As currently designed, the OZ incentive contains no transparency or reporting structures. Therefore, the public is finding it extremely difficult—if not impossible—to know who raised the capital that is going into OZ-designated areas and where it is being invested as well as who is benefitting from the investments.

Beyond the OZ incentive, the landscape of past national placemaking efforts begs a long-standing question: Why do federal attempts to tackle economic inequality often fall short of their ambitions? The answer is simple: Despite calls for more equitable economic development, the traditional U.S. placemaking field has largely not come to terms with why many distressed communities—particularly communities of color—became distressed in the first place. Moreover, far too many in the development field do not understand what equity looks like in practice. Addressing inequality in economically distressed communities is not simply about deploying more capital to these areas; the capital must also be responsive to the social ills that systemic oppression and disinvestment caused in the first place.
Placemaking is a multi-faceted participative process of planning, design and shared ownership that creates and transforms spaces, neighborhoods, villages, and cities.”
– Maria Adebowale-Schwarte, founding director of Living Space Project10

This issue brief explores the equity design flaws of the OZ incentive as well as the allure and elusiveness of equitable economic development. It calls for a transformation of the United States’ approach to placemaking, analyzing why self-determination and self-actualization is integral to community revitalization and how a people- and place-conscious ecosystem can achieve this.

What are distressed communities?

According to recent data, more than 50 million U.S. residents—nearly 1 in every 6—were struggling while living in distressed communities.11 With even more people living in neighborhoods that are at risk of becoming distressed, the economic development field is long overdue for reform that ensures equity is at the core of its objectives, activities, and outcomes. Distressed communities are often defined by higher-than-average population loss, poverty rates, and unemployment rates, as well as inadequate and eroding infrastructure that lacks vital healthy neighborhood features. These communities often have declining local economies due, in part, to loss of businesses and overall economic disinvestment.12 Distressed communities also tend to be overwhelmingly communities of color. Meanwhile, climate change is fueling more extreme weather events that hit economically disadvantaged areas and communities of color the hardest. These communities are often disproportionately exposed to the highest levels of toxic pollution and have the fewest resources to prepare for and recover from climate disasters.13
The persistent distress in these neighborhoods is largely born from a half-century of disinvestment and isolation created by discriminatory policies and practices that effectively cut off, steered away, and withheld public and private investment from these areas. These racialized policies and practices included exclusionary zoning, redlining, slum clearance, urban renewal, and racially restrictive covenants, among others. Policymakers should have designed OZs to rectify these shameful practices, which provide important lessons regarding past placemaking endeavors that created and exacerbated, rather than alleviated, concentrated poverty and inequality.

A place-based history lesson in equitable economic development

Although policymakers at the local, state, and federal levels have long given lip service to the idea of centering equity in economic development, they have often lacked the proper framework and commitment to actualize that approach. Equitable economic development promotes the belief that all communities have a right to live in a pollution-free, inclusive, and just economic environment that is free from persistent and systematic discrimination. This can be achieved through comprehensive and community-accountable public action and investment that intentionally dismantles structural barriers and sustainably expands opportunities for all communities—especially communities of color and residents of economically disadvantaged neighborhoods.

Important tenets of equitable economic development

- Advance an integrated people, place, and economy approach that centers equity and focuses on the needs of the most disadvantaged
- Account for the inequities that afflict distressed communities and their residents
- Embody a community-responsive development framework grounded in economic, racial, and environmental justice principles
- Prioritize community self-determination through meaningful local participation, leadership, ownership, and control
- Invest in and strengthen local ecosystems, community capacity, and assets via anchor institutions, public infrastructure, and initiatives
- Incorporate a robust reporting and evaluation framework that identifies, tracks, and measures community benefits and equity outcomes

Historically, national place-based initiatives depended upon federal spending and control to bring about the responsible development and revitalization of housing, infrastructure, and main streets in disinvested communities. However, over time, the role of federal, state, and local governments has diminished, resulting in less capacity to direct resources to where they are needed most. Since the 1980s, community development has followed a neoliberal approach, conforming to market rules and
limiting government involvement. As such, federal, state, and local governments have increasingly relied on tax cuts and tax credit policies to incentivize the private sector to carry out the national public good agenda—a responsibility that the private sector is, on the whole, ill-suited and disinclined to carry out.

The closest the federal government has come to some semblance of equitable place-based development were Presidents John F. Kennedy and Lyndon B. Johnson’s Community Action Program—part of the War on Poverty—and President Barack Obama’s suite of neighborhood revitalization initiatives, including Promise Neighborhoods, Choice Neighborhoods, and Promise Zones. Each of these efforts centered a community-led, interdisciplinary, integrated, and place-conscious approach instead of one that was top-down and outsider-driven. Like the place-based anti-poverty field, the Kennedy, Johnson, and Obama administrations acknowledged that while a lack of access to capital is a major contributor to the already massive and growing socioeconomic inequality in long-distressed communities, it is not the only factor.

Unfortunately, the OZ incentive is proving to be just the latest iteration of post-1960s federally backed placemaking, as it was not designed to confront the systemic inequities that created distress and concentrated poverty in disinvested communities. To change this, the United States must adopt a placemaking approach that follows and supports distressed communities’ self-determined visions and blueprints for economic, social, and environmental well-being.

Equitable economic development fundamentally necessitates both a people- and place-conscious framework that refuses to separate distressed places from the people who have long resided in them. This demands a fundamental change in how community development stakeholders value long-distressed communities and the residents who live there, as more often than not the relationship between communities and stakeholders has been plagued by predatory, paternalistic, and extractive behaviors.

Opportunity deferred: Examining the design flaws of the OZ incentive

Proponents of the OZ incentive continue to herald it as a poverty alleviation tool designed to funnel private capital into low-income census tracts that were nominated by governors in every U.S. state and territory as well as the mayor of Washington, D.C. Given that 19 million people who are economically insecure—defined as living at or below 200 percent of the federal poverty line—live in OZs, the incentive, if properly structured, could transform low-income communities across the nation. However, the incentive’s design largely ignores the needs of these low-income communities in favor of clearly defined tax benefits for wealthy investors chasing the highest rate of return.
First, the target demographic for the OZ incentive is quite exclusive. According to *The New York Times*, only 7 percent of Americans report taxable capital gains on their tax returns, and almost two-thirds of that income was reported by individuals with a total annual income of $1 million or more.27

Second, the OZ incentive drives investors to seek projects with high rates of return—such as high-end real estate—rather than projects that these areas critically need such as supermarkets, affordable housing, community health centers, clean energy, resiliency measures, and accessible transportation options.28 Third, the OZ incentive does not feature performance metrics to measure its success. It provides no guidance on how investments should create jobs and business opportunities for existing residents, protect existing residents from displacement, or reduce poverty or the racial wealth gap.29 It also does not provide guidance on building new community infrastructure that would allow for greater socioeconomic mobility. Failure to tie the OZ tax break to these types of performance measures will mean that its benefits for existing residents are not guaranteed. Finally, the structure of the OZ incentive was not designed to support the neighborhood revitalization activities of community development financial institutions (CDFIs) and other organizations that have a demonstrated history of investing in economically distressed communities.30

By design, the OZ tax incentive will mostly benefit wealthy investors. Rather than helping distressed communities, these investors are on a path to harm them, as investors are incentivized to support gentrification and the displacement of current residents. This is particularly alarming considering the devastating impacts of increasingly extreme weather events and the heavy concentration of pollution sources in economically disadvantaged areas. The OZ incentive was not designed to promote investments in projects that help reduce local pollution or build future-ready, resilient infrastructure and housing that can withstand more extreme heat, storms, floods, and other climate change effects.31 In short, OZs as they are currently designed will solidify already entrenched inequities rather than serve as a tool for community wealth-building.
Bamboozled, hoodwinked, and led astray: Seduced by the promise of OZs

Press coverage about the implementation of the OZ incentive has been polarized. President Donald Trump has supported the incentive, stating, “We’re providing massive tax incentives for private investment in these areas to create jobs and opportunities where they are needed the most.” However, The New York Times’ Editorial Board slammed OZs, writing, “Of all the ways President Trump’s 2017 tax cut has enriched the wealthy at the expense of the public interest, perhaps the most outrageous is the black comedy of ‘opportunity zones.’”

From a policy perspective, the stark contrast in opinions on OZs is telling. The lack of transparency and objective data collection around the OZ incentive has meant that one’s view of it is mostly driven by what information one has access to as well as that information’s source. Policymakers have largely been forced to evaluate the massive public subsidy of the OZ incentive through anecdotal evidence from around the country. This is unacceptable. Policymakers should have access to sound empirical data collected by the federal government, and those data should be shared publicly.

The U.S. Department of the Treasury recently made an effort to provide an avenue to track the effects of OZ investments. However, the incentive is on the same path as past federal efforts that relied on tax incentives to spur economic development within historically disadvantaged communities—and that failed to demonstrate proof of concept.

Equitable economic development requires more than access to capital

As Kelly Price crooned in the Notorious B.I.G.’s “Mo Money, Mo Problems,” “It’s like the more money we come across, the more problems we see.” Simply infusing capital into distressed communities does not address the systemic inequities that discriminatory policies and the actions of both public and private entities created. As a result, initiatives such as OZs often create or exacerbate problems for longtime residents of disinvested communities in the form of outsider land grabs that spur new or fuel existing gentrification and displacement. This is because these initiatives were not designed with the supports and access points that would have allowed communities to meaningfully take part in their own revitalization.

The type of money utilized in economic development is just as important as how it is deployed, as this determines who has the access and power to dictate what is developed. (see Figure 2) Again, to assume that capital is the be-all and end-all is to ignore the necessity of enabling distressed communities to determine their revitalization, build their capacity, and recognize and invest in their assets—a core, nonnegotiable tenet of equitable economic development. As Rep. Ayanna Pressley (D-MA) often says, “The people closest to the pain should be closest to the power.” The residents of disinvested communities are the foremost experts on their own
lives and surroundings and thus know best the solutions needed to sustainably better their neighborhoods. Yet, as history has demonstrated, access to the power, resources, and opportunities to effect local solutions and self-determined prosperity has almost always been discriminately withheld, sabotaged, or obliterated.

“...I don’t think we should ignore the historical conditions that led to disinvestment in these communities—particularly [the] concentration of poverty really driven by racism and discrimination in many of these places. And while voluntary frameworks are useful for those actors who want to do the right thing … we know capital doesn’t flow to these places not because these places aren’t worth investing [in], not because there aren’t good ideas or smart people or growing businesses. It’s because the market doesn’t value these places, and this incentive creates an opportunity. But without something further to nudge a market in the direction, I fear personally that what we’re going to do is reinforce those stereotypes that exist in the way that capital flows currently. And I don’t see any mechanism where we sit today to address any of that inequity, particularly racial inequity in a lot of these places.”

– Aaron Seybert, managing director of the Social Investment Practice at the Kresge Foundation, testifying before the House Subcommittee on Economic Growth, Tax, and Capital Access during a hearing titled, “Can Opportunity Zones Address Concerns in the Small Business Economy?”

Furthermore, the notion that any type of capital will suffice is not only a myopic approach to revitalization but also a particularly ill-informed and caustic one when applied to communities of color that have long been left behind. The ongoing devastation created by racist subprime lending and real estate practices of the U.S. housing industry proves that the type of capital—both financial and social—matters just as much as who has access to it. Consequently, this approach never confronts the long-standing policies and practices that made these communities of color distressed in the first place, nor does it address the racialized ideology around so-called risk that was created more than a century ago and still dominates the lending and investment industries. As the Kirwan Institute observed in its report, “Challenging Race as a Risk”:

*The ability to exercise agency over where one lives is a hallmark of freedom. And yet, this privilege has not been equally afforded to all. Race has been—and continues to be—a potent force in the distribution of opportunity in American society. Despite decades of civil rights successes and fair housing activism, who gets access to housing and credit, on what terms, and where, remains driven by race.*
Equitable economic development policies require a comprehensive and intersectional justice framework

“Persistent racial and economic inequalities—and the forces that cause them—embedded throughout our society have concentrated toxic polluters near and within communities of color, tribal communities, and low-income communities.”51 – The Equitable and Just National Climate Platform

Historically, communities of color have often been denied equitable access to the opportunities and resources needed to build and sustain thriving neighborhoods.52 The persistent racial and economic inequalities within the United States have created greater environmental and public health risks for low-income and tribal communities as well as communities of color, directly contributing to the climate crisis that currently grips the planet.53 Communities of color have had their neighborhoods stolen,54 segregated,55 degraded,56 preyed upon,57 displaced,58 polluted,59 and even destroyed.60 Given this history, equitable economic development policies must not only be rooted in racial and environmental justice but must also be developed and implemented by the individual communities they are meant to help.

As leading scholar of critical race theory Kimberlé Crenshaw has stated, “If we can’t see a problem, we can’t fix a problem.”61 Until policymakers acknowledge that placemaking has always been political and continues to be profoundly racialized—as a place is inextricably tied to its residents—the community development field is doomed to repeat the same lackluster and harmful approaches that neither revitalize communities nor alleviate inequity.62 The place-based investment challenge that has always been before the United States is whether such investment can sustainably bring about equitable economic development that prioritizes the needs and leadership of the communities most harmed and held back by inequitable policies and actions. There is also the long-standing question of whether the willpower, humility, and courage exist to actualize this development.

Equitable economic development promotes a thriving people- and place-conscious ecosystem

“Our vision is that all people and all communities have the right to breathe clean air, live free of dangerous levels of toxic pollution, access healthy food, and enjoy the benefits of a prosperous and vibrant clean economy.”63 – The Equitable and Just National Climate Platform

In nature, an ecosystem is a diverse self-producing system of living and nonliving things that dynamically interact in balance with one another and their physical environment.64 The primary function of an ecosystem is to form, nurture, and sustain healthy, diverse life forms.65 Similarly, when it comes to equitable community development,66 a thriving people- and place-conscious ecosystem is one in which
people and the social, economic, and environmental conditions and assets where they reside interact to produce the resources, opportunities, and access necessary for all community members to form healthy, thriving, and sustainable neighborhoods. Such neighborhoods are prepared for the extreme weather events caused by climate change.

Communities are actively shaped by their societal, economic, and environmental contexts; they are important parts of geographic regions and key pillars of the broader social ecosystem. A people- and place-conscious ecosystem reflects the fact that a place cannot be divorced from the people who reside there and ensures that longtime residents are not displaced once their area begins to receive the attention and resources it was long denied. This model also acknowledges and prioritizes a system that has often been overlooked and resource-constrained: the existing and locally rooted community development finance system, which has long delivered capital to distressed, low-income, and other under-resourced communities. Simply put, to create people- and place-conscious ecosystems, place-based approaches must invest in both redressing the harms of disinvestment and cultivating sustainable future-ready revitalization and shared prosperity. Placemakers can do so by utilizing the rich community assets and finance system already in place as well as reinforcing the statutes that bolster them such as the Community Reinvestment Act and New Markets Tax Credit Program.

“I see real community development as combining material development with the development of people. Real development, as I understand it, necessarily involves increasing a community’s capacity for taking control of its own development—building within the community critical thinking and planning abilities, as well as concrete skills, so that development projects and planning processes can be replicated by community members in the future.”

– Marie Kennedy, professor emerita in community planning at the University of Massachusetts Boston

Done correctly, this form of placemaking will maximize existing community assets, prioritize shared values, and cultivate a local economy that organically and sustainably supports thriving environments and healthier lives. In contrast, places of concentrated poverty, distress, and environmental injustice are not “natural” but rather the product of inequitable public and private policies and practices. In essence, distressed communities can be identified by a host of social, economic, and environmental indicators that together reflect the extent to which families are forced to look beyond their immediate communities to access essential infrastructure, resources, and opportunities, as well as private and public services needed to thrive. These can include quality schools, housing, health clinics, grocery stores, gainful employment with family-sustaining wages, and clean and climate-resilient infrastructure. For example, due to systemic discrimination and neglect, far too many Baltimore communities suffer from preventable deadly health issues linked to heat pollution due to a lack of green spaces and subpar neighborhood design.
Overcoming past policy harms will require the mobilization of U.S. assets to invest in the creation of equitable communities, especially in the face of devastating climate impacts that will disproportionally affect low-income communities and communities of color. These government assets include but are not limited to direct investment via grants, low-interest loans, technical assistance, governance, and oversight supports. As the historic Equitable and Just National Climate Platform—signed by more than 220 environmental justice and local and national environmental organizations—states, “Generations of economic and social injustice have put communities on the frontlines of climate change effects.”

Disrupting and reversing the trend of persistent, place-based poverty and distress requires a multilevel engagement of diverse stakeholders, investments, and approaches. It also requires a nuanced understanding of utilizing the right capital tool to address community-identified needs. As such, interventions must consistently be developed in partnership with communities and in accordance with their defined needs and priorities. Building this type of ecosystem will require a complete reimagining and reprioritizing of how federal, state, and local governments—as well as the community development landscape writ large—views, values, and interacts with disinvested communities.

**Essential equitable economic development actors**

Driven by a social mission to create change in the same way that for-profit organizations need to produce revenue, nonprofit actors such as community development corporations (CDCs) and other intermediaries, CDFIs, community land trusts, and foundations have and will continue to play key roles in the evolution of strategies for tackling persistent poverty and disinvestment in distressed neighborhoods. In 1997, Harold Mitchell—a resident of Spartanburg, South Carolina, who went on to serve in the state’s House of Representatives from 2005 to 2017—founded ReGenesis, a certified CDC focused on cleaning up contaminated and abandoned property in Spartanburg. Serving as a critical representative of neighborhood interests, ReGenesis worked with local government and environmental agencies to assess levels of contamination and develop a plan to address the environmental harms plaguing these communities. Starting in 2000, ReGenesis began to focus on equitable neighborhood revitalization work, driven by its ability to build and sustain new partnerships. By leveraging a $20,000 U.S. Environmental Protection Agency environmental justice small grant into more than $300 million in public and private funding, ReGenesis was able to launch an ambitious, community-driven approach to neighborhood reinvestment. Over the past 20 years, ReGenesis has brought job training programs, 500 affordable housing units, six health clinics, clean energy, and other critical community elements to Spartanburg.

Unlike the OZ incentive, CDFIs and other foundations have long recognized the importance of providing varied yet locally accessible forms of capital and technical capacity assistance as well as connecting diverse stakeholders to help sustain and
strengthen community-building initiatives. These entities often serve as the connective tissue between specific community needs and generalized local, state, and federal policies and programs. Locally rooted organizations involved in community development finance are leading meaningful innovation that utilizes and effectively deploys capital tools that serve multiple interests. That said, they are not a substitute for the role of federal, state, and local governments, which must recommit to and ramp up their appropriating, oversight, and cross-sector aligning functions in order for equitable and accountable community-building to be sustainably realized.81

While each stakeholder in the community development space has a critical role to play, at its core, the goal of a thriving people- and place-conscious ecosystem is self-determination. This includes control over local assets and development decisions as well as the resources, tools, and supports that come with it.82 Black, Native, and Latinx communities in particular have the least amount of power and resources when compared with white communities, who have historically had more resources and exercised greater control over the fates of their neighborhoods.

Equitable economic development requires that communities be free to set the conditions that allow their placemaking vision to be realized and sustained, especially when outside capital and the private sector are involved. What this mandates, in part, is a continual process of rectifying both past and present inequitable structures that govern the community-building space while at the same time constructing a new placemaking infrastructure and approach that acknowledges and defers to the agency and power that distressed and disinvested communities have possessed all along.
Conclusion

“Place defines who we are as individuals and as a society who we are or what we want, as much as our social networks and political beliefs. And the places we provide for people to live in are a measure of how much we respect human rights, fair economics and the environment.”83

– Maria Adebowale-Schwarte, founding director of Living Space Project

Reforming the United States’ placemaking investment framework is no easy feat, but it is long overdue and well worth the endeavor for the sake of equity. Achieving equitable, climate-ready economic development will require a complete rethinking of national and local frameworks. To start, U.S. placemakers must be intentional about redressing both current and past initiatives that continue to produce inequitable outcomes based on race, socioeconomic status, and geography. The persistence of people living in neglected places plagued with extreme, concentrated poverty and pollution is a political choice often dictated by a powerful few. This choice can and must be undone.84

OZs as currently designed fail as an equitable economic development tool and thus must be completely overhauled or fully repealed. This nation’s prosperity and strength are measured by the health and well-being of its people and environments. Moving forward, U.S. placemakers—from policy to practice—must embrace a framework for a people- and place-conscious ecosystem through which distressed communities can achieve the self-actualized health and well-being that they need and deserve.

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Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas
In recent months, there has been significant renewed attention from a broad spectrum of policymakers in addressing the impact of the uneven economic recovery through geographically focused economic policies designed to counteract poverty with special incentives to private investors.

Such polices in the United States date back to the 1970s and 1980s, when a number received rare bipartisan support and were enacted, with varying degrees of success. In the aftermath of the Great Recession, long-term unemployment, slow growth, and a lack of quality employment opportunities remain an acute problem, and are especially intense in many specific locales around the U.S. In this paper, we discuss tax preferences that have been used in the past to motivate investors to invest in disadvantaged regions of the United States, summarize the evidence exploring the effectiveness of these measures, and then discuss the shortcomings of previous policy designs. We finish with a sketch of a new type of structure that could be far more effective in stimulating economic growth and facilitating the creation of new jobs in areas of the country struggling the most.

I. The Uneven Economic Recovery and Problem Of Geographic Disparities

More than five years after the end of the Great Recession, the U.S. is on the path of slow but steady economic recovery. The unemployment rate fell to 5.5 percent in February 2015, but a significant number of potential workers have not re-entered the labor force since the end of the recession and wage growth remains tepid.¹ Last year, the economy finally added more jobs than were lost during the recession, but a closer look at the nature of those new jobs reveals that a large share of mid- to high-paying jobs were replaced by lower-wage positions. At the same time, the stock market has reached all-time highs, and foreclosure rates have come down.
However, while certain areas of the country are doing remarkably well and nearing or exceeding their pre-recession economic states, the recovery has been profoundly uneven, with large swaths of the country facing chronic rates of long-term unemployment and historically low levels of new investment. Nationally, we see historically low numbers of new business ventures being established. In addition to the unevenness of the recovery geographically, the unevenness within different income groups has been a growing concern for many policymakers.

While much of the popular policy conversation focuses on income disparities among individuals, geographic disparities are an equally important part of American life. As of December 2014, for example, the unemployment rate in Fresno, California was 11 percent, while the unemployment rate in San Francisco—less than 200 miles away—was five percent. Multiple other cities in California are currently experiencing elevated levels of unemployment: El Centro, California had an unemployment rate of 23.1 percent in December 2014, while Merced and Yuba City were at 12.6 and 12.2 percent, respectively. Modesto, California hit 10.5 percent.

Snapshot variations are common, but differences can last a number of years as well. Yuma, Arizona has had a consistently high unemployment rate—the last time it was below 20 percent was March 2009, and was at an incredibly high 25.6 percent in December 2014.

Extremely high unemployment in cities such as Fresno, Yuma, or Detroit leads to pockets of distressed and traumatized workers who face plummeting incomes, stalling career progressions, and cracking self-confidence. In addition to these intuitive tragic effects of unemployment, research has also identified other negative side effects, the most distressing of which is an increase in mortality following job loss. Studies have linked job losses to increases in death rates, suicide rates, and even serious illnesses such as cancer. Another recent study on neighborhood effects found that growing up in the poorest quartile of neighborhoods versus the top quartile leads to a lifetime earnings gap as significant as between a high school and a college graduate. More subtle effects have also been identified; some studies suggest that unemployment leads to a higher
likelihood of divorce and lower achievement outcomes for children of unemployed workers. Worst of all, the longer the unemployment spell, the less likely the possibility of reemployment—and by extension the opportunity to escape these terrible costs—becomes.

Not only have some regions been vastly more successful at generating jobs than others, but significant regional variation in the quality of employment growth exists as well. For example, an analysis by The Atlantic found that Las Vegas, Sacramento, Philadelphia, Buffalo, and Hartford were among those that lost the most high-wage jobs, while job growth since the recession in areas like St. Louis, Riverside, New Orleans, Rochester, New York, Tampa, Columbus, Orlando, and Birmingham was mostly tied to low-wage jobs. Many workers are underemployed, working part-time but looking for a full-time job, a problem that may be worse in distressed communities.

The social costs of living in a high-unemployment area are also compelling. New generations born into these areas have fewer opportunities due to a lack of public investment and jobs. Older generations have the strong social ties to families, friends, and culture that prevent them from moving away, so instead they remain in areas with stalled or declining fortunes. Distressed communities, in essence, face very high transition costs. All the while, better-off cities receive a federal subsidy from the tax exclusion of state and local taxes from federal taxation.

The difficulty with which unemployed workers relocate—often staying in place due to social factors even when geographical wage differentials exist—creates a vicious cycle of persistently high unemployment in the same places. Distressed communities can be thought of as caught in a bad equilibrium outcome, where some economic shift has left the city with declining private activity and a falling tax base. This leads to a drop off of public investment and infrastructure, making it even more difficult to attract private capital. In essence, capital liquidity constraints both drive and are driven by a lack of public infrastructure, resulting in an equilibrium characterized by decay.
The proliferation of severely distressed areas around the country has been a drag on the overall health of the U.S. economy and the pace of the economic recovery. Where GDP growth falters in one area, it has an impact on the U.S. as whole not only by acting as a drag on overall production but also because distressed areas are potential markets for consumption of goods produced elsewhere in the U.S. and their weakness has a spillover effect on other communities. High levels of unemployment in one area contribute to nationally high levels of unemployment, along with larger national expenditures on unemployment insurance and other welfare benefits to those who are out of work. The implications of distressed communities for the United States as a whole further establishes the case for new policy prescriptions to combat the weakness of distressed areas.

II. Addressing Geographic Economic Disparities

A federal subsidy for private activity can knock the community out of the bad equilibrium and help it back on its feet. In response to the view that circumstances have at times specifically disadvantaged some geographic areas, a number of programs have been introduced over the years that were designed to address geographic disparities and provide extra incentives for investors to focus their efforts where the need is perceived to be the greatest.

There are solid economic arguments for providing these subsidies. First, it is a strong empirical regularity that, while economic theory might predict that individuals should move away from a city or neighborhood in a downward economic spiral, many chose not to. Thus, the existing social safety net will provide benefits to such individuals, benefits that will be quite costly to governments at all levels. Given the high costs of these benefits, it seems possible that a prudent reform could be a net positive for the budget. Second, once a downward spiral has begun, an opportune objective of policymakers would be to create a new equilibrium where investors decide to return to a distressed area because they expect other
investors to return as well. Incentives that are attractive enough could plausibly upend the “Nash equilibrium” where investors choose not to invest because all of the other investors have made that choice as well.

Most of the primary federal measures introduced in the past to address these geographic disparities have expired as of the end of 2014. As many regions are still struggling with high unemployment, policymakers are now actively considering the reinstatement of legacy geographic-based policies and the design of new alternatives in the near future.

Four main types of federal programs for distressed communities with special tax incentives have existed in the U.S.: empowerment zones (EZ), renewal communities (RC), enterprise communities (EC), and the New Market Tax Credit (NMTC). The goals of these programs—first created in 1993 in the case of EZs and ECs, with the addition of RCs and the NMTC in 2000—have been to alleviate poverty, reduce unemployment, and boost economic activity in targeted areas. While the enterprise community and renewal community programs have expired, the tax provisions for empowerment zones and the NMTC were extended through the end of 2014 and are currently awaiting renewal by Congress—along with dozens of other temporary tax provisions.

**Empowerment Zones, Renewal Communities, and Enterprise Communities**

Designation of an area as an EZ, RC, or EC has generally followed after a nomination from the Secretary of Housing and Urban Development or the Secretary of Agriculture based on defined characteristics such as population size, poverty rate, unemployment rate, etc. Businesses in areas that became a part of the program qualified for a number of credits and tax benefits to incentivize location within the zone or hiring individuals who live and work within a zone. For instance, if a business sold a qualified EZ asset it held for more than a year, it could elect to postpone part or all of the gain from sale if it purchased other qualified EZ assets within 60 days. Another example is the EZ employment credit of up to $3,000 a year, which provided businesses with an incentive to hire individuals who live and work in an EZ. A business located in an
empowerment zone could also increase its deduction under section 179, which allows it to deduct all or part of the cost of qualifying property the year it is placed in service, by up to $35,000.

A summary of all the previously available provisions is included on the following page.\textsuperscript{16}

Unfortunately, research into the effects of these enterprise zone programs in the U.S. has found at best mixed results, with little consensus in the literature as to whether they are beneficial. Before instituting a national enterprise zone program in 1993, numerous state and local programs existed in the U.S. and were examined in an attempt to get an early idea of a national program’s potential effectiveness. In 1988, the U.S. Government Accountability Office (GAO) conducted an analysis of an enterprise zone program in Maryland that resembled proposed federal legislation in order to report to Congress on its effectiveness. Although the GAO found that employment did increase in enterprise zones, they also extensively interviewed businesses, which reported that the program was not a significant reason why they increased employment or located their establishments within an enterprise zone.\textsuperscript{13} It is an open question, of course, whether such survey evidence is meaningful.

Since that preliminary assessment, research into the effects of enterprise zone programs has found similarly mixed results, with some studies reporting positive effects on the local labor market in zones and others finding no discernible changes. Soon after the initial GAO report, Barry Rubin and Margaret Wilder (1989) analyzed state-level urban enterprise zones and found them to be a cost-effective tool to improve one area’s comparative advantage against another in an urban setting.\textsuperscript{17} Subsequent research by Leslie Papke (1994) found mixed effects of Indiana’s state program; while unemployment claims in zone-designated areas fell by 19 percent, the value of depreciable personal property within the zones also fell by 13 percent.\textsuperscript{15} Contradicting these findings, Marlon Boanet and William Bogart (1996) reported that in their analysis, New Jersey’s urban
# Federal Tax Benefits Specifically Available To Businesses Operating In EZs, ECs, and RCs

<table>
<thead>
<tr>
<th>TAX BENEFIT</th>
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<tr>
<td><strong>EZ Employment Credit</strong></td>
<td>EZs</td>
<td>Businesses can claim a 20-percent credit on the first $15,000 paid in wages to EZ residents who perform substantially all of their work in the EZ.</td>
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<td><strong>Increased Section 179 Deduction</strong></td>
<td>EZs and RCs</td>
<td>Qualified businesses can deduct $35,000 more than the maximum allowable deduction under certain qualifying property in the year the property was placed in service.</td>
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<tr>
<td><strong>Enterprise Zone Facility Bonds</strong></td>
<td>EZs and Round I ECs</td>
<td>State and local governments can issue tax-exempt bonds to provide loans to qualified businesses to finance certain property. A business cannot receive more than $3 million in bond proceeds for activities in any EZ or Round I EC or more than $20 million for activities in all EZs and Round I ECs nationwide. These bonds were also subject to state volume caps, which limit the amount of tax-exempt debt that state and local government entities can issue.</td>
</tr>
<tr>
<td><strong>EZ Facility Bonds</strong></td>
<td>EZs</td>
<td>State and local governments can issue tax-exempt bonds to provide loans to qualified businesses to finance certain property. State and local government entities can issue up to $60 million for each rural EZ, $130 million for each urban EZ with a population of less than 100,000, and $230 million for each urban EZ with a population greater than or equal to 100,000. These bonds were not subject to state volume caps.</td>
</tr>
<tr>
<td><strong>Non-recognition of Gains on the Sale of EZ Assets</strong></td>
<td>EZs</td>
<td>Taxpayers that incur capital gains on the sale of qualified assets can elect to postpone those gains from tax liability if they purchase a replacement asset within 60 days.</td>
</tr>
<tr>
<td><strong>Partial Exclusion of Gain on the Sale of EZ Stock</strong></td>
<td>EZs</td>
<td>Taxpayers that hold stock for more than 5 years in corporations with assets under $50 million incur a tax liability on only 40 percent of their capital gains, provided the company offering the stock was a qualified zone business.</td>
</tr>
<tr>
<td><strong>RC Employment Credit</strong></td>
<td>RCs</td>
<td>Businesses could claim a 15-percent credit on the first $10,000 paid in wages to RC residents who performed substantially all of their work in the RC.</td>
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<tr>
<td><strong>Commercial Revitalization Deduction</strong></td>
<td>RCs</td>
<td>Businesses that received an allocation from an agency authorized by the state for costs associated with new construction or renovation of non-residential commercial property could either deduct half of the qualifying expense for the year in which a building was placed in service or amortize all of the expenses over a 10-year period.</td>
</tr>
<tr>
<td><strong>Zero Percent Capital Gains Rate for RC Assets</strong></td>
<td>RCs</td>
<td>Investments in qualified RC businesses purchased after 2001 and before 2010 and held for more than 5 years were not subject to tax liability on capital gains.</td>
</tr>
</tbody>
</table>
program in the 1980s did not have a significant impact on unemployment or property value in designated zones. 17

Research into state enterprise zone programs in the first decade of this century also found little impact of the programs on local job markets. In an evaluation of multiple state enterprise zone programs, Daniele Bondino and John Engberg (2000) could find no significant impact on employment, with little difference between the effects of different types of programs or different amounts of money spent on them. 18 Similarly, Greenbaum and Engberg (2000) found no evidence that enterprise zone programs in the six states that they analyzed had an effect on unemployment; although they found an increase in new business activity within zones, existing businesses offset this by decreasing their own activity. 19 Analyses of California’s enterprise zones have found conflicting results. While O’Keefe (2004) concluded that enterprise zones experienced greater increases in employment than similar areas that were not given the enterprise zone designation, 20 Neumark and Kolko (2010) found no effect of the program on employment, even among lower wage workers. 21 Elvery (2009) reached similar conclusions in an analysis of California and Florida’s programs, reporting no evidence that they improved the probability of a worker residing within the zones finding employment. 22

Though the U.S. federal government enacted its first enterprise zone program in the form of Empowerment Zones and Enterprise Communities in 1993, GAO analyses in both 2006 23 and 2010 24 failed to reach a conclusion about the effectiveness of the two programs due to poor data collection by the agencies responsible for administering the programs. While some of the EZs and ECs did experience reductions in poverty and unemployment, it was not possible in their analysis to tie this to the program. However, a recent study by Ham, et al. (2011) that analyzed federal enterprise zones alongside state programs found that federal programs may actually have a greater impact on labor markets than state programs. 25 Although they found positive impacts for both levels of programs, they estimated a higher impact of federal programs on unemployment and poverty rates within localities. Similarly, a study by Matias Busso, Jesse Gregory, and Patrick Kline (2013) reviewing the first round of EZs found that an EZ
designation substantially increased employment in zone neighborhoods and generated wage increases for local workers without a corresponding increase in population or the cost of living.  

New Markets Tax Credit

Arguably the most successful of the federal legacy programs for stimulating investment in distressed areas is the New Markets Tax Credit (NMTC). The NMTC, which bears some resemblance to the general idea we propose below, provides individual and institutional investors with a 39 percent tax credit against their federal tax liability for the provision of loans, investments, and even financial counseling to distressed areas. The credit is incrementally claimed over a seven-year time period: five percent in each of the first three years and six percent for each of the following four years, making this a vehicle that tilts toward quite patient capital, since the investment must be held for seven years.

The NMTC investments are made through a Community Development Entity, a private entity that must qualify for the program based on the unemployment, poverty rates, and low-income levels of the census tract area that the CDE represents (75 percent of NMTC projects have been undertaken in communities with poverty rates above 30 percent). According to the Local Initiative Support Corporation (LISC), an intermediary for the program, since 2000, $31 billion has been invested in the program in small businesses, including small manufacturers, charter schools, health and child care centers, and shopping areas.  

Interesting, and germane to our idea discussed next, LISC notes that according to a GAO study, almost 90 percent of NMTC investors say that but for the credit, they would not have made the investment.

A 2013 Urban Institute evaluation of early-year NMTC projects came to a more nuanced conclusion, finding that 64 percent of the projects would not have happened at the same time and in the same location without the NMTC, but in only half of those cases did investors claim that the NMTC was the deciding factor in whether to make the investment at all. The same report also found that for every $53 of NMTC investment there
was an additional $47 of investment from other sources, including $23 of investment from public sources.

Although the NMTC is arguably a more streamlined program than the EC, RC, and EZ programs which involve many disparate components, its structure still is perhaps overcomplicated, with a 2010 GAO report concluding that it “could be simplified.” In addition, although it supports many different types of investments, more than half of investments through the NMTC are for the development or leasing of real estate as opposed to operating businesses that can, if they survive, have greater potential for expansion and job growth. Investors using the NMTC have favored real estate at least in part because of the structure of the program; a report from the Federal Reserve Bank of St. Louis pinpoints two reasons that the program tilts towards real estate: it raises fewer concerns about compliance with the program’s regulations and location requirements, and real estate investments have longer time horizons and can therefore use the tax credit throughout the seven year holding period without worrying about realizing a return on its capital within that period.

The financial structures used by NMTC claimants have become increasingly complex and guidance from the Department of the Treasury has failed to keep pace with changes in the program. Clear reporting by NMTC projects is necessary to track the success of the program in creating new businesses, but, because of inadequate reporting, GAO was unable to determine how much equity remained in the NMTC projects after the 7-year credit period and the number of NMTC projects that ultimately failed.

While effective in some areas, the NMTC is not structured to induce the kind of larger-scale investment that can accelerate the revitalization of an entire community. The 2013 Urban Institute report found roughly a third of the projects to be less than $500,000 in size and nearly 80 percent under $20 million. And, while it may have an effect on marginal sources of investment—investors who were on the fence about investing in an area
but who now would because of extra incentives—it may not be as effective at attracting new investment. A 2007 GAO report showed that the average expected return on investment for NMTC projects decreased from 8.2 percent in 2003 towards the start of the program to 6.8 percent in the years that followed. In 2014 the GAO described how NMTC projects typically take advantage of other public programs to subsidize new investments, underscoring the difficulty in pinpointing the impact of NMTC alone on investor behavior.

III. Weaknesses Of Past Approaches

Complexity and Underutilization
As we have shown, the evidence for the benefits of both federal and state enterprise zone programs has been largely inconclusive with even the most positive studies rarely showing little more than marginal gains in the areas covered by the programs. One reason why the evidence may be so mixed is the underutilization of the provisions available under the various programs. Existing tax structures are already complex, and adhering to the additional rules created by the enterprise zone programs is cumbersome. Enormous resources are required to organize an activity in a manner that benefits from the positive treatment, and managing a rollover, for example, within a 60 day window may seem impossible to many investors.

Utilization of all the programs’ provisions has not been tracked sufficiently as mentioned above, but the available data suggests that businesses have not been taking advantage of all the available provisions for a number of different reasons. While the Internal Revenue Service does collect data on the use of some of the program tax benefits, it does not do so for all of them, and none of the data can be linked to the individual communities that claimed the benefits. As a result, the majority of the available information comes from surveys conducted by the GAO. The surveys tried to assess the use of EZ and EC tax benefits, but suffered from low response rates and all of the usual shortcomings of surveys.
On the whole, the surveys do suggest that programs suffered from underutilization—businesses did not pursue certain benefits due to their overly complicated nature, lack of clear knowledge about them, or inability to qualify for all the requirements. For example, respondents to a GAO survey published in a December 1998 report were asked to explain their reasons for not claiming the EZ employment credit; of the 3,117 small urban businesses surveyed about 30 percent did not qualify for the credit because their employees lived outside of the zone, 40 percent did not know about the credits, for eight percent the credit was too complicated to use, and five percent did not have a federal tax liability.

Weak or Misaligned Incentives
The underutilization is also in part attributable to the weak incentives at the heart of previous programs, which poorly targeted the goals of increased employment and investment in distressed communities. Previous efforts can logically be divided into three categories: employment subsidies, asset purchase subsidies, and capital investment incentives. However, none of the specific approaches within these categories appear to be ideal for encouraging enterprises to relocate to distressed communities and hire workers in those areas. All three categories failed to provide a direct incentive either for investing in new companies and small businesses, or for larger investments in infrastructure and capital-intensive industries such as manufacturing, both of which are necessary to revitalize distressed areas.

Past programs have relied heavily on employment subsidies to encourage companies to hire residents of covered areas. Lifting employment is a key objective of programs that target vulnerable areas, but attracting capital for the large investments in plants and equipment that are required to revitalize a city is also necessary, and employment subsidies are a very indirect method to accomplish that. Even if one assumes that the objective of the credit is to expand hiring by existing employers, the subsidies that have been tried to date are fairly weak. First, the credits are generally small—for example a 20 percent tax credit on the first $15,000 of wages paid under an EZ amounts for $3,000—and may be too small to encourage an employer to hire a new employee from a distressed community given
training and other indirect labor costs. In addition, since the credits are usually not refundable, an employer does not receive a benefit unless the business is profitable, which is frequently not the case, particularly for startup companies. Because most of the credits from programs like the federal EZ and RC programs only apply to the first several thousand dollars of wages paid to employees, they may also distort the hiring decisions of companies located within the zones; instead of hiring one worker for $30,000, they may hire two workers for $15,000 in order to twice receive the enterprise zone credit of 20 percent on the first $15,000 in wages. Accordingly, the wage subsidies may provide perverse incentives to avoid advancing workers up a career ladder. Finally, to the extent that wages do increase, then workers may decide to move to different neighborhoods. In some designs, firms can lose access to subsidies through such eventualities that are often beyond direct control.

The second two commonly used policies, asset purchase subsidies and capital investment incentives, have been targeted at expanding investment opportunities, another important challenge facing revitalization efforts. Asset purchase subsidies suffer predominantly from restrictive definitions that were mentioned above—in order to qualify as an EZ business, the scope of the business’ operations must satisfy a number of different criteria. The qualified property clauses also create difficulties in the ease of application of these provisions. Examples of provisions that suffer from the problem of overly restrictive definitions include the enterprise zone tax-exempt facility bonds and the RC commercial revitalization deduction. Loosening some of these restrictions or adopting a new structure might prove to be significantly more effective.

Specific investment incentives have also been used with the goal of increasing investments within a distressed community. The partial exclusion of the gain on sale of an EZ asset is one example of this type of policy. The exclusion is 60 percent for an enterprise zone business, higher than the 50 percent that applies for ordinary qualified business outside the EZ. It is more tax efficient for a business to invest in flow-through entities than to utilize this provision, so it is rarely used.
The other provision in this category is the exemption for capital gains tax on qualifying RC business held for more than five years. This incentive has become mostly outdated with the introduction of the capital gains exclusion for small business stock held for more than five years by the Creating Small Business Jobs Act of 2010, which was enacted in September 2010. These two provisions are not identical since the current law only applies to small businesses, so the gain cannot exceed $10 million or 10 times the taxpayer’s aggregate basis in qualified stock of the corporation that is disposed of during the taxable year; however, it serves a similar purpose within the tax code. Targeted efforts to revitalize depressed areas should be specifically tailored to their needs and simple enough to use without large obstacles, rather than replicating efforts applied to the entire country.

Restrictive Scope
In addition, restrictions on the size of investment that can qualify discourages large well-capitalized investors from participating, a factor that makes the switch to the positive Nash equilibrium where investors return to the distressed area because they are comforted by the safety of numbers less likely. Such restrictions exacerbate the first-mover problem. A good candidate for a first-mover would be a large diversified investor that could spread the risks of such investments broadly, and perhaps invest in a critical mass of enterprise all at once. If only small investments qualify, then complex coordination is an essential element of success.

Where public infrastructure is poor, it can be especially difficult to entice enough first-movers to step in and invest to the point where infrastructure will improve and tempt other businesses in. While incentives such as the ones included in the EC, EZ and RC programs may be sufficient to keep investment going where it has already started, they may be too weak to convince businesses to make the first move.

Although the NMTC is structured differently from the EC, EZ and RC
programs, it too utilizes an organization framework that is not optimal for many investors. The approval process for the NMTC can be bureaucratic and compliance cumbersome, creating relatively little draw for interested investors. The NMTC also requires a seven-year commitment. While there’s an obvious and positive role for patient capital in this area, many investors will find that too restrictive, and ultimately much of the investment through the program over the last decade has been in real estate. While such investment is often helpful to depressed areas, it is not the type of job-generating activity that we hope to incentivize through the alternative vehicle we introduce below.

Interaction with Other Programs
The General Accounting Office found that NMTC projects commonly utilize other sources of public funding: 62 percent of projects initiated between 2010 and 2012 received funds from federal state, or local public sources. Current Treasury guidance limits the ability of projects to use the NMTC in combination with the Low-Income Housing Tax Credit, but there is not specific guidance on its use with other tax programs. According to the GAO, the most frequent tax programs paired with the NMTC were historic tax credits and tax exempt bonds for private nonprofit education facilities. These other programs will have separate qualification requirements, and if the viability of certain projects depends on the combined subsidy of these programs, an additional obstacle could arise from these other requirements.

Absence of Force Multipliers
In a broader sense as well, previous programs left many potential sources of investment untapped. There was no structure in place to encourage investors to exit existing investments, for example, and bring their realized gains into enterprise zones. There also was not a structured way to involve intermediary groups, such as banks, private equity, and venture funds, in investing in enterprise zones, although these groups


generally can bring large resources to projects and have the potential to invest in companies that may thrive within an area. The emphasis on individual businesses instead of larger structures and institutions may indeed be part of the reason for the tepid results of enterprise zone programs.

The checkered results of the studies evaluating previous attempts can be attributed to misaligned incentives and a weak set of policies, yet economic theory supports targeted assistance to depressed areas. Given that, and the significant geographic disparities that are evident in the data since the Great Recession, alternative designs may well be a preferable policy option to reinstating the questionable programs of the past. A simpler, targeted approach may be warranted to have a significant effect on employment and investment in the given area.

IV. New Model For Attracting Private Investment Is Needed

For political and fiscal reasons, large-scale public sector investment is unlikely to happen anytime soon, and must be supplemented by private sector investment to support robust economic growth. Private sector investors have little current incentive to invest in higher risk ventures in economically depressed communities, but the return on investment for doing so may increase if the existing friction could be deferred or eliminated.

The recovery has been particularly kind to investors in the stock market since the recession. Since early 2009, the Dow Jones has almost tripled, rising almost 12,000 points, and in 2013 alone, investors in the S&P 500 saw gains of over $4 trillion. An analysis by the Economic Innovation Group estimated that the amount of unrealized capital gains held by U.S. investors stood at roughly $2.26 trillion as of year-end 2014—a significant
increase in the five years since the recession. The explosion in unrealized capital gains and cash holdings presents an opportunity for policies that create new incentive for private investors to redeploy capital to regions in need of economic development.

It is beyond the scope of this effort to develop a detailed proposal, an effort that we leave to future research. However, in this section, we sketch a new approach to geographically targeted economic policy that could be far more effective than those tried in the past, and at the same time appeal to policymakers of every political persuasion. Our key observation is that existing and prior approaches have not harnessed the power of intermediaries such as private equity firms, banks, venture capitalists, mutual funds, and hedge funds. By focusing on often small individual businesses, policies have implicitly required an unrealistically large amount of coordination among potential investors, and hence, have failed.

Consider, as an alternative, a structure analogous to that of a venture capital firm or mutual fund company, but specialized in development investments in businesses in predetermined locales. These specialized investment vehicles, which could raise capital from a mix of individual and institutional investors, would operate in targeted locales, and special tax provisions that are established for them would apply so long as the investments stayed within qualified geographic areas. One key advantage is that they are structured so as to allow partners to pool their resources and invest in numerous projects at any given time in a highly nimble fashion.

This structure would be much more attractive than previous designs. In particular, firms would emerge that would specialize in pooling investments, but onerous conditions such as the 60-day requirement would be unnecessary as money could easily sit on the sidelines for longer periods as the funds seek profitable investment opportunities. This would help to counteract the first-mover problem described above, in which any one investor has no hope of shifting an area from an equilibrium of decay to an equilibrium in which public investment and private enterprise conspire to spur renewal. By pooling assets, the risk to any one investor
is limited. They would also have the capacity to move a high volume of investments into depressed communities at relatively low cost to the Federal Government.

A number of important options must be considered when devising the special tax provisions to be applied to investments in distressed regions. One key consideration policymakers might weigh heavily is an objective to make investments into economically depressed communities an easy and attractive option. There are a number of possible policies that could potentially have a major effect on such choices. For example, unrealized capital gains might be rolled over into special funds constrained to invest in distressed communities, with the capital gains taxed only if the money is withdrawn from the qualified funds down the road. A similar treatment could apply to direct investments in enterprises within the qualifying investment zones. Depending on how generous Congress would like the incentive to invest to be, the capital gains basis of the unrealized gain could be adjusted/“stepped up” in some manner as well. The generosity could be linked to the type of investment, with investments in infrastructure, for example, receiving more generous treatments. An alternative or complementary structure would be to treat funds that invest in distressed communities as 401k investments, allowing individuals to deduct investment into qualified investment vehicles in the year that they are made, accumulate gains tax-free, and then pay capital gains tax upon withdrawal of the funds. Alternatively, a Roth structure could be used under which individuals would invest post-tax income but accrue gains that would be tax-free when realized.

While the exact specification of target areas is outside of the scope of this paper and should receive further research, it is worth noting that, under a model as described above, the target investment zones could conceivably be scaled to the size of cities to maximize their potential impact. Partnership and collaboration between large funds and municipal governments could be valuable. Clearly, legislation to create these new investment structures would have to establish a process that identifies target areas in a transparent and orderly fashion, based on objective
economic criteria such as the area’s unemployment rate, foreclosure rate, labor force participation rate, or even its disaster zone status.

V. Conclusions

A confluence of factors motivates our proposed actions in this area. First, the geographically uneven nature of the current recovery, along with the heightened costs to families stuck in weak local economies with inadequate public and private investments, can usefully be viewed as both a crisis and an opportunity. Second, as we have noted, a very large stock of savings in the form of unrealized capital gains has built up in recent years. Third, policy measures to incentivize private investment in disadvantaged areas have largely been unsuccessful. The New Market Tax Credit is a notable exception, but here too, complexities may be restricting the scope of investments in ways that fail to tap potential growth and jobs.

Over the past two years, these factors have led to renewed interest and attention from policymakers in developing regional incentives programs to address the problem of distressed communities. For example, President Obama has discussed a “Promise Zone” program, while Rand Paul introduced the idea of “Freedom Zones,” both of which are aimed at increasing investment in economically weak areas. The NMTC has the support of a bipartisan, bicameral coalition of legislators calling for it to be made permanent. These proposals speak to the desire for geographic preference programs, and show a real and continued interest on the part of the policy community in addressing issues posed by distressed communities.

In this paper, we look at the debilitating aspects of the uneven economic recovery to the overall U.S. economy, and analyze the impact of past and existing geographically targeted policies designed to encourage economic development in distressed areas. We find that the success of such programs has been limited for several major reasons: a mismatch of
incentives and goals in many programs; weak and too narrowly targeted incentive structures that fail to foster sufficient investment to create a positive equilibrium were sufficient capital enters an area; bureaucratic requirements that are not offset by small rewards; and finally, a structure that does not tap all potentially available sources of investment funds. However, public incentives to attract private sector capital remain important, and so we have sketched a proposed new structure that could offer the potential to succeed where past approaches have failed. This approach will allow for better-targeted incentives to increase investment in distressed areas, along with a more streamlined process for making these investments.

In our view, policies promoting the establishment of investment funds specifically designed to allow all Americans to invest in the restoration of depressed areas could serve many positive goals. Most importantly, in a resource-constrained environment, such funds could provide the capital needed to reshape our most distressed communities by incentivizing those who have benefited from the American dream to invest in ways that seek to serve the common good. In addition, one could imagine that it would become a social norm that, for example, companies and/or individuals would invest a small fraction of their savings or profits in funds that invest in distressed communities. If these funds succeed in establishing a new equilibrium where investors flock to distressed areas because they are confident that other investors will as well, then the investments will also have the potential to be highly profitable, which would feed a virtuous cycle. In doing so, the program would partially address widening inequality and lack of economic mobility in targeted areas, but do so in a manner that relies on markets and new enterprise to help the poor. As such, policies in this area may well become vehicles for aligning the interests of a wide variety of political stakeholders, garnering the kind of broad bipartisan support that has become a rarity in the current political climate.
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Between 2007 and 2015, average hourly wages grew by 4.2 percent in real terms, or 0.5 percent per year.


See Sections 1391-1393 and Section 1400E for exact criteria and processes.

For a complete summary see IRS Publication 954 or *Community Development: Federal Revitalization Programs Are Being Implemented, but Data on the Use of Tax Benefits Are Limited.* (GAO-04-306) (Washington, DC: U.S. Government


14 Information on Empowerment Zone, Enterprise Community, and Renewal Community Programs: Briefing for Congressional Addressees. (GAO-10-464R)


4 See: http://lisc.org/docs/resources/policy/Policy_Brief_NMTC.pdf.


11 The 2014 GAO study also raised the possibility of NMTC projects earning above-market rates of return. An Urban Institute study identified a case where the NMTC appeared to earn a 24 percent annual rate of return, but the authors stated that the complexity of the structure made it difficult to captures all non-
NMTC funds that may have been invested, which would have lowered the return. The case study is: Martin D. Abravanel, et al., “New Markets Tax Credit (NMTC) Program Evaluation: Final Report,” Urban Institute, April 2013.


\(^{36}\) Ibid.

\(^{37}\) Section 1397C.

\(^{38}\) Section 1202.


\(^{40}\) 26 U.S.C section 45D(i)(1); Treasury Reg. section 1.45D-1(g)(3).
EIG brings together leading entrepreneurs, investors, economists, and policymakers from across the political spectrum to address America’s economic challenges.
Executive Summary

The Tax Cuts and Jobs Act of 2017 not only cut taxes for businesses and individuals broadly but also made targeted cuts to spur investment in economically distressed communities designated as Opportunity Zones (OZs). This report from the Council of Economic Advisers (CEA) compares the advantages of OZs with those of other Federal antipoverty programs and documents the characteristics of the nearly 8,800 low-income communities designated as OZs. It also quantifies the effect of OZs investment and finds that a large increase is already benefiting OZ residents while potentially having only a small effect on the Federal budget.

OZs chart a new course in Federal policy aimed at uplifting distressed communities. Antipoverty transfer programs subsidize the consumption of goods such as housing and healthcare but can lead to reduced economic activity by raising taxes and discouraging eligible, working-age participants from seeking jobs. Also, 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 cut taxes to increase economic activity by spurring private sector investment, job creation, and self-sufficiency. They also give greater scope for market forces to guide entrepreneurs and investors because they have no cap on participation and require no government approval.

The CEA finds that OZs, which are census tracts nominated by State governors and certified by the U.S. Department of the Treasury to be eligible for the investment tax cuts, are among the poorest communities in the United States. These communities have an average poverty rate more than double that of all other communities and are home to a higher share of African Americans, Hispanics, and high school dropouts. Even among all the communities eligible to be an OZ under Federal law, every State selected communities that, on average, had a median household income less than that of communities that were not selected.

The CEA also finds that the OZ tax cuts have spurred a large investment response. This report estimates that Qualified Opportunity Funds raised $75 billion in private capital by the end of 2019, most of which would not have entered OZs without the incentive. This new capital represents 21 percent of total annual investment in OZs and helps explain why the CEA also finds that private equity investment in OZ businesses grew 29 percent relative to the comparison group of businesses in eligible communities that were not selected as OZs.

The growth in investment has already made OZs more attractive to their residents, as reflected in what buyers are willing to pay for homes located in the OZs. The CEA estimates that Opportunity Zone designation alone has caused a 1.1 percent increase in housing values. Greater amenities and economic opportunity behind the housing value increase will be broadly
enjoyed, and for the nearly half of OZ residents who own their homes, the increase provides an estimated $11 billion in new wealth.

Regarding effects on the Federal budget, the CEA finds that each $1 raised by Qualified Opportunity Funds through 2019 has a direct forgone Federal revenue effect of 15 cents. By comparison, each $1 in investment spurred by the New Markets Tax Credit, an existing Federal program with similar goals, results in 18 cents of forgone revenue. Including indirect effects, the CEA estimates that the OZ incentive could be revenue neutral, with economic growth in low-income communities reducing transfer payments and offsetting forgone revenues from taxes on capital gains. Thus, the CEA projects that the capital already raised by Qualified Opportunity Funds could lift 1 million people out of poverty and into self-sufficiency, decreasing poverty in OZs by 11 percent.

The COVID-19 pandemic slowed investment everywhere in the second quarter of 2020, including in Opportunity Zones, but the initial evidence suggests that the OZ model has power to mobilize investors; engage State, local, and tribal stakeholders; and improve the outlook for low-income communities—all with limited prescription from the Federal Government. This report’s findings highlight the potential for the Opportunity Zone model to help spur the post-COVID-19 recovery in thousands of distressed communities across the United States.
Introduction

One of the main provisions of the Tax Cuts and Jobs Act, which was signed in December 2017, reduced U.S. corporate income tax rates to bring them in line with international levels. Lowering the corporate tax rate decreases the cost of capital, thereby stimulating investment and growth in gross domestic product and wages (CEA 2017). The Opportunity Zones (OZs) provision of the act mirrored this effort to lower capital taxes but with a focus on distressed communities. By reducing taxes on the capital gains invested in such communities, the provision lowers the cost of capital for businesses, which is expected to lead to new investment, jobs, and economic opportunity that has been lacking for decades. This CEA report compares the advantages of OZs relative to other Federal antipoverty programs, and it documents the characteristics of the nearly 8,800 low-income communities designated as OZs. The CEA also quantifies the effect of OZs on investment, finding a large increase that is already benefiting residents while potentially having only a small effect on the Federal budget.

To stimulate investment in OZs, the provision provides three potential tax benefits to investors that invest capital gains in Qualified Opportunity Funds, which are vehicles for investing in qualified OZ properties. The first benefit of investing in these funds is that the 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.1 Finally, and most important, 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.

Funds can make equity investments in partnerships or corporations that operate in OZs as determined by various tests, such as where they generate income or where their assets lie. A Qualified Opportunity Fund can also directly purchase tangible property for use in the fund’s trade or business, but the property must have its original use begin with the fund or the fund must substantially improve the property. For example, a Qualified Opportunity Fund could purchase and install new solar panels in an OZ, or it could buy an apartment building and substantially improve it.

Although the Federal tax incentive described here is at the core of OZs, all levels of government have worked to complement this incentive. At the Federal level, on December 12, 2018, President Trump signed Executive Order 13853, which established the White House Opportunity and Revitalization Council.2 The order gave the council the mission of leading

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1Because an investor must pay capital gains taxes on the original gain by 2026, the original option to pay taxes on only 85 percent of the original has expired and would not apply to investments made in 2020. This is because the investments could not be held for the original seven years before having to pay the tax.

2 The council’s various efforts are highlighted on the interagency website OpportunityZones.gov.
efforts across executive departments and agencies “to engage with State, local, and tribal
governments to find ways to better use public funds to revitalize urban and economically
distressed communities.” In its one-year report to the President, the council made 223
recommendations to this end and, as of this CEA report’s publication, has taken more than 270
related actions.

Complementary efforts have also occurred at the State and local levels. For example, the
Alabama Incentives Modernization Act provides additional State tax breaks for Qualified
Opportunity Funds, and the State of New Jersey has created an OZ website and data tool with
resources for local governments, investors, and businesses. The city of Erie, Pennsylvania,
along with local businesses and nonprofit leaders has created the Flagship Opportunity Zone
Development Company to encourage investment in the city’s OZs. And the city of Cleveland
has taken a similar approach by creating the Opportunity CLE initiative to promote local OZ
investments.

The CEA finds that OZs, which are census tracts selected by governors to be eligible for the
investment tax cuts, are among the poorest communities in the United States. These
communities have an average poverty rate that is more than double that of other communities
and are home to a higher share of African Americans, Hispanics, and high school dropouts.
Even among all the communities that were eligible to be an OZ under Federal law, every State
selected communities that, on average, had a lower median household income than did
eligible communities that were not selected.

The CEA also finds that the OZ tax cuts have spurred a large investment response. The report
estimates that Qualified Opportunity Funds raised $75 billion in private capital by the end of
2019, most of which would not have entered OZs without this incentive. This new capital
represents 21 percent of total annual investment in OZs and helps explain why the CEA also
finds that private equity investment in OZ businesses grew 29 percent relative to eligible
communities that were not selected as OZs and thus act as a control group.

This growth in investment has already made OZs more attractive to their residents as reflected
in the prices buyers are willing to pay for homes located in OZs. The CEA estimates that OZ
designation alone has caused a 1.1 percent increase in housing values. The greater amenities
and economic opportunity behind this housing value increase will be broadly enjoyed, and for
the nearly half of OZ residents who own their homes, the increase provides an estimated $11
billion in new wealth.

Regarding effects on the Federal budget, the CEA finds that each $1 raised by Qualified
Opportunity Funds through 2019 has had a direct forgone Federal revenue effect of 15 cents.
By comparison, each dollar in investment spurred by the New Markets Tax Credit, an existing
Federal program with similar goals, results in 18 cents in forgone revenue. Including indirect effects, the CEA estimates that the Opportunity Zone incentive could be revenue neutral, with economic growth in low-income communities reducing transfer payments and offsetting forgone revenues from taxes on capital gains. Also, the CEA projects that the capital already raised by Qualified Opportunity Funds could lift 1 million people out of poverty into self-sufficiency, decreasing poverty in OZs by 11 percent.

**Comparing Opportunity Zones with Other Antipoverty or Place-Based Programs**

Unlike antipoverty transfer programs—which raise taxes and reduce the incentive for program recipients to participate in productive economic activity—OZs lower taxes to stimulate economic activity in distressed areas. Relative to other place-based policies, the OZ incentives are more open-ended and less top-down in their design, which makes OZs more effective at attracting investment to communities most in need.

**Antipoverty Transfer Policies**

Antipoverty transfer programs provide cash grants or subsidies for the consumption of goods. Notable examples are housing vouchers, food stamps, cash assistance for needy families, and Medicaid. Although these programs support many Americans in need, they can also weaken the incentive for working-age adults to find employment. Because of eligibility requirements linked to income, taking a job or working more hours can cause a participant to become ineligible if his or her income exceeds a program’s threshold. Considerable evidence confirms that such programs typically discourage employment (e.g., Hoynes and Schanzenbach 2012; Jacob and Ludwig 2012; Bloom and Michalopoulos 2001).

Antipoverty transfer programs also raise taxes to fund these transfers. Even if the transfers and associated eligibility requirements did not discourage work, they would still come at a cost. Each $1 raised through taxes costs society more than $1 because of the positive marginal cost of public funds. This cost captures the effect of a tax in driving a wedge between the market value of what an extra hour of labor produces and the worker’s value of that hour (i.e., her opportunity cost). Given this tax wedge, each $1 in funds raised by taxes costs society an estimated 50 cents in forgone value (Dahlby 2008; CEA 2019).
The rules governing OZs do not create a disincentive to work because eligibility is based on community-wide measures of poverty and income rather than those of any particular individual. Nor does the OZ incentive have the same marginal cost of public funds associated with transfers funded by tax revenues. The incentive cuts taxes on capital supplied to low-income communities, which reduces the tax wedge associated with the supply and demand for capital. The forgone Federal revenue might be made up through higher taxes elsewhere, or it could be offset by declines in government transfers because of rising incomes in poor neighborhoods, which is considered in a later section.

OZs, nonetheless, are not a substitute for cash grants or subsidies. Not everyone can work, and most people living in poverty do not live in OZs. To the extent that transfer programs have appropriate work requirements for those who are able to work, OZs complement such programs by fostering job creation.

OZs also complement the Earned Income Tax Credit (EITC), which is an antipoverty tax incentive. The EITC targets low-income workers, especially those with children, and is phased out as a family’s income rises. Because the EITC is only provided to low-income families with earnings, it encourages people to enter the workforce. Empirical research confirms that the EITC increases workforce participation for single mothers, who benefit the most from the credit (Nichols and Rothstein 2015). In this sense, the EITC increases the supply of labor, while OZs stimulate demand for it.

**Federal Place-Based Policies: The New Markets Tax Credit Program**

The Federal program most comparable to Opportunity Zones is the New Markets Tax Credit (NMTC), though OZs offer improvements over the NMTC program. Both use tax incentives to encourage private investment in low-income communities, but the total tax benefit available through the NMTC program is capped, limiting how much investment it can spur. In most years since 2007, Congress has authorized the NMTC program to award tax credits to support about $3.5 billion in place-based investments. On average, these credits account for about half of total project costs, so the program supports roughly $7 billion in investment annually. As of 2016, nearly 3,400 census tracts have received NMTC program credits since the program’s inception in the early 2000s (Tax Policy Center 2020).

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3 NMTCs are a limited allotment of tax credits that reduce investors’ Federal tax obligations. Tax credits differ from tax deductions, which decrease the amount of income subject to being taxed.
In addition to being smaller in scale than the OZ initiative, the NMTC program has a top-down approach to distributing tax benefits. The U.S. Department of the Treasury administers the NMTC program through its Community Development Financial Institutions Fund (CDFI), which ultimately selects what applicants can receive tax credits. Community development entities must first apply to the CDFI to be qualified for the program. Those that are qualified then identify investment opportunities and submit applications to compete for a limited pool of credits. In 2018, development entities requested $14.8 billion in NMTC funds, but only $3.5 billion were available, and only about a third of all applicants received funding (Lowry and Marples 2019).

Even for approved applicants, the NMTC program places greater restrictions on investors. Funds must remain invested and compliant with program requirements for seven years or else forgo all their tax benefits (with interest and penalties). With OZs, funds can liquidate one investment and roll the proceeds into a new one without penalty, though standard taxes apply to any capital gains. OZs are also flexible in other ways; investors can contribute funds up to any size, and they can pool their funds with any number of other investors (Vardell 2019; Bernstein and Hassett 2015).

Many of the participants in the NMTC program are large financial intermediaries equipped to navigate the CDFI’s application process and manage compliance risk (Vardell 2019; Hula and Jordan 2018). To manage the risk, most NMTC transactions use a complex leverage model that combines debt and equity. According to Hula and Jordan (2018,23), the model requires “a team of accountants and attorneys” with relevant expertise to structure the investment. By contrast, any investor with eligible capital gains can invest in a Qualified Opportunity Fund. These funds, in turn, need only self-certify their investments on their tax returns and follow the broad guidelines provided by the Department of the Treasury’s regulations.4

Although the NMTC program is more prescriptive than OZs, it is more flexible than the economic development grants given by the CDFI Fund. Harger, Ross, and Stephens (2019) find that the tax credits—but not the grants—increased the number of new businesses in low-income communities. They attribute the difference in part to the greater flexibility of the tax credit relative to the grants. At the same time, the authors found that even the NMTC program may not have had much effect on local employment.

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**Other Federal Place-Based Development Programs**

Along with Opportunity Zones, in recent decades three other Federal programs have also relied on tax policy to spur economic development in specific places: empowerment zones (EZs), enterprise communities (ECs), and renewal communities (RCs). EZs and ECs date to 1993, while RCs were authorized in 2000. These programs extended a mix of tax benefits and grants to businesses in designated census tracts. These programs had a smaller geographic reach, with many States having little or no participation in them. A key tax benefit among these programs was an employment tax credit of up to $3,000 on the wages paid to people who lived and worked in the designated tract. Other tax benefits included increased limits for expensed deductions, tax-exempt bond financing, and exemptions from certain capital gains taxes (CRS 2011). The EC and RC programs have both ended, and only the tax benefits associated with the EZ program continue. Early research on the effects of the programs showed little evidence of success, but more recent studies have documented beneficial effects on unemployment, wages, and poverty (CRS 2011; Ham et al. 2011; Busso, Gregory, and Kline 2013).

The Federal Government also supports place-based economic development through grant programs, with the largest being the Community Development Block Grant program. The U.S. Department of Housing and Urban Development (HUD) administers the program and provides about $3 billion a year in block grants. The program’s structure makes rigorous evaluation difficult, and few systematic evaluations have been done, especially in recent years (Theodos, Stacy, and Ho 2017). HUD allocates funds using a formula based on population, poverty, housing conditions, and other factors. State and local government grantees have considerable discretion, within broad guidelines, on how to use the funding, such as that at least 70 percent of the funds must be used to benefit low- and moderate-income persons. The flexibility of the program is similar to OZs, but its design is very different in that it relies solely on public funding and does not seek to incentivize private investment.

The Economic Development Administration (EDA) of the U.S. Department of Commerce also administers grants for economic development. EDA’s 2019 appropriation was roughly $300 million, but the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) appropriated an additional $1.5 billion to administer grants to States and communities adversely affected by the COVID-19 pandemic. As with the HUD grants, few rigorous evaluations have been done of EDA’s grants (Markusen and Glasmeier 2008).
Characteristics of Opportunity Zones

The census tracts designated as OZs have some of the most entrenched poverty in the United States. These communities had an average median income just over half of the U.S. average in 2000 and they fell further behind over the subsequent 16 years.

The Opportunity Zone Selection Process

As prescribed by law, governors nominated which census tracts should be designated as Opportunity Zones by the U.S. Department of the Treasury. To be eligible for designation, a census tract must:

- Have a poverty rate of at least 20 percent; or
- Have a median income below 80 percent of that in the State or metropolitan area, or for rural census tracts, 80 percent of that in the entire State; or
- Be contiguous with a census tract meeting one of the above conditions and have a median income less than 125 percent of the qualifying contiguous census tract.

Governors could designate up to 25 percent of their qualifying census tracts, or up to 25 tracts for those States with fewer than 100 eligible tracts. Eligible, contiguous tracts were restricted to make up no more than 5 percent of designated OZs in any State.

Aside from these restrictions, States could determine how, and which, census tracts would be designated as OZs, thereby drawing on State and local expertise. With this Federal design, States took diverse approaches in nominating their OZs. Arizona, for example, tasked the Arizona Commerce Authority with meeting with city, county, and tribal governments to select tracts. Kansas took a different approach, with its Department of Commerce requesting “Letters of Interest” from communities seeking OZ designation, allowing communities to explain their need and their ability to attract investment.
All governors submitted tracts for consideration to the U.S. Department of the Treasury by the end of April 2018. The Treasury ultimately designated a total of 8,766 tracts as OZs, with nearly all designations occurring between April and June 2018. Almost all OZs (8,537 tracts) met one of the criteria for low-income communities; the remaining 229, or 2.6 percent of all designated census tracts, were eligible for selection based on contiguity with a low-income tract. Figure 1 highlights the OZ tracts (in green) and the eligible tracts that were not selected (in gray).

**Figure 1. The Geography of Opportunity Zones**

Sources: U.S. Department of the Treasury; U.S. Census Bureau.
The Economic State of Opportunity Zones

This subsection reports on the CEA’s overall findings that census tracts selected as Opportunity Zones are among the poorest communities in the United States. The CEA finds that they have an average poverty rate more than double that of all other census tracts and are home to a higher share of African Americans, Hispanics, and high school dropouts (figure 2).

Figure 2. Demographics of Opportunity Zones, 2012–16

Sources: 2016 American Community Survey (ACS), five-year estimates; U.S. Department of the Treasury; CEA calculations.

Note: This analysis excludes census tracts in Puerto Rico, American Samoa, the U.S. Virgin Islands, Guam, and the Northern Mariana Islands. The 2016 ACS is based on a five-year estimate from 2012 to 2016.
The economic woes of OZs are not new. In 2000, census tracts that later became OZs had an average median household income that was 57 percent of the average in other tracts, $39,305 compared with $68,726 as given in the 2000 Decennial Census. In real terms, median household income in the average OZ fell by 11 percent from 2000 to 2012–16, compared with a 6 percent drop in the average non-OZ census tract (figure 3).

Figure 3. Average Median Household Income by Census Tract Designation, 2000–2016

Household income index (2000 = 100)

Sources: 2000 Decennial Census; 2016 American Community Survey five-year estimates; U.S. Department of the Treasury; CEA calculations.
Note: This analysis excludes census tracts in Puerto Rico, American Samoa, the U.S. Virgin Islands, Guam, and the Northern Mariana Islands. The 2016 ACS is based on a five-year estimate from 2012 to 2016.

The poverty and income criteria for eligibility explain some of the lower income in selected census tracts; but even among eligible tracts, States consistently nominated low-income tracts. In each of the 50 States and in the District of Columbia, median household income in OZs was lower than in eligible-but-not-selected tracts and considerably lower than in ineligible tracts (figure 4).
Figure 4. Average Median Household Income by Tract Designation and State, 2012–16

OZ tracts Eligible tracts, but not selected Ineligible tracts

United States
- Georgia
- Ohio
- Nevada
- Alabama
- Kentucky
- Illinois
- Tennessee
- Louisiana
- Pennsylvania
- Florida
- Missouri
- Arkansas
- Mississippi
- South Carolina
- Michigan
- Indiana
- North Carolina
- Wisconsin
- Oklahoma
- Arizona
- Nebraska
- Montana
- West Virginia
- Rhode Island
- California
- Texas
- Kansas
- Iowa
- New Mexico
- Washington, D.C.
- Connecticut
- Idaho
- Maine
- New York
- South Dakota
- Minnesota
- Oregon
- North Dakota
- Massachusetts
- Washington
- New Jersey
- Delaware
- Vermont
- Colorado
- Utah
- Virginia
- Wyoming
- New Hampshire
- Maryland
- Hawaii
- Alaska

Median household income

Sources: 2012-2016 American Community Survey, five-year estimates; U.S. Department of the Treasury; CEA calculations. Note: This analysis excludes census tracts in Puerto Rico, American Samoa, the U.S. Virgin Islands, Guam, and the Northern Mariana Islands. The 2016 ACS is based on a five-year estimate from 2012 to 2016. Eligible but not selected tracts include those eligible based on low-income status or on contiguity with low-income tracts.
Figures 2 through 4 indicate that, as a whole, OZs encompass economically distressed areas. Although average values can mask diversity within the OZ group, only 3.2 percent of OZs experienced rapid socioeconomic change according to a metric developed by the Urban Institute (2018). This metric considers changes in income, demographics, educational attainment, and housing affordability.

The patterns shown in figure 5 suggest that States selected tracts that were both economically distressed and demonstrated a potential to attract fruitful investments. They selected tracts with varying levels of poverty, not focusing solely on those with the least poverty (among eligible tracts) nor on those with the highest poverty rates. The strategy has an economic rationale: States would benefit little from OZs if they selected tracts where a designation was unlikely to spur investment.

**Figure 5. Population by Poverty Rates and Census Tract Designation**

![Figure 5](image-url)

Sources: 2016 American Community Survey (ACS), five-year estimates; U.S. Department of the Treasury; CEA calculations.
Opportunity Zones’ Effect on Total Investment

The CEA estimates that by the end of 2019, Qualified Opportunity Funds had raised $75 billion in private capital. 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.

Capital Raised by Qualified Opportunity Funds

The $75 billion estimate for private capital raised is based on two different samples that track these funds over time. To extrapolate from sample values to population values, we rely on the total number of these funds in existence, as estimated by the Department of the Treasury based on tax filings (1,500 funds in 2018). Both samples and estimation approaches give a roughly similar estimate for the capital raised by these funds, with the average being $75 billion.

The first sample covers Qualified Opportunity Funds voluntarily reporting data to Novogradac, a national professional services organization that has tracked funds since May 2019. As of January 17, 2020, the sample had 513 of these funds, a small subset of all funds, which had collectively raised $7.6 billion in capital. Qualified Opportunity Funds voluntarily reporting data might not be representative of the general population of funds. However, comparisons with a non-voluntary sample, as discussed below, suggests that it is reasonably representative.

The second sample is based on data from the Securities and Exchange Commission (SEC). The SEC considers investment interests in Qualified Opportunity Funds as securities, which means that funds must register with the SEC unless they file for an exemption. Qualified Opportunity Funds seeking an exemption can file Form D within 15 days of the first sale of securities in an offering. In filing Form D, these funds provide information such as the amount sold in the offering, but they are not asked to identify themselves as funds. To create a sample of these funds from the Form D data, we select all funds with “Opportunity Zone” or similar words (e.g., “OZ Fund” or “QOZF”) in their name. This yields 197 Qualified Opportunity Funds that had filed Form D by the close of 2019, 153 of which had raised capital, totaling about $2.9 billion. If Qualified Opportunity Fund names are uncorrelated with other fund characteristics, our

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5 The count of Qualified Opportunity Funds in the population (1,500) is based on a Treasury Department estimate based on preliminary counts of filings of Form 8996. The Treasury may adjust this count as more information becomes available.

6 Although our analysis is for the close of 2019, more recent data from Novogradac show a 31 percent increase in capital raised from January to April 2020.
sample should be reasonably representative of the broader population of funds seeking an exemption from SEC registration.⁷

The Novogradac and SEC samples show similar growth in the number of Qualified Opportunity Funds and capital raised. From May 2019, when Novogradac began tracking these funds, until Novogradac’s January 17, 2020, report, the number of funds increased by 277 percent. The SEC data show a 271 percent increase in the number of these funds from 2018 to 2019, based on information on when each fund was incorporated. Additionally, the capital reported by Novogradac Qualified Opportunity Funds increased by 858 percent over the reporting period, while the capital raised by the SEC sample of funds increased by 1,523 percent from 2018 to 2019. See figure 6.

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⁷ Funds seeking to make public offerings of securities are generally not exempt from SEC registration and would not file a Form D. We expect such funds to be larger, on average, than those focused on private offerings.
The two samples of Qualified Opportunity Funds inform two different approaches for estimating the total capital raised by funds. The first approach, based on the self-reported Novogradac data, is to multiply the Novogradac total equity amount ($7.6 billion) by an expansion factor, defined as the number of Qualified Opportunity Funds in the population divided by the number of funds in the Novogradac database. This factor reflects how much of the fund population is captured by Novogradac’s database. The estimate of capital raised is then:

\[
Capital \text{ Raised (Novo.)} = Capital \text{ Raised}_{\text{Novo}} \times \frac{\text{Population count of Funds}}{\text{Novo. count of Funds}}
\]

\[
= 7.6 \text{ billion} \times \frac{1500 \text{ Funds}}{136 \text{ Funds}}
\]

\[
= 84 \text{ billion}
\]

The number of Qualified Opportunity Funds (1,500) in the population comes from the Department of the Treasury and corresponds to the end of 2018, and the number of funds in the Novogradac database (136) is from May 2019, the earliest reporting of the Novogradac data. This estimation approach assumes that Qualified Opportunity Funds reporting to Novogradac are similar in size to funds not reporting to Novogradac. It also assumes that our expansion factor accurately reflects Novogradac’s coverage of the Qualified Opportunity Fund population in January 2020.

The second estimation approach, which draws on the SEC sample, multiplies an estimate of the number of Qualified Opportunity Funds in existence at the close of 2019 by an estimate of the average amount of capital raised per fund, among those having raised capital. More specifically, it is:

\[
Capital \text{ Raised (SEC)} = "\text{Population count of Funds}"_{2018} \times "\text{Growth in Fund count}"_{2018-2019} \times "\text{Share of Funds with Capital}"_{2019} \times "\text{Capital per Fund}"_{2019}
\]

\[
= 1,500 \times 3.71 \times 0.60 \times 0.019
\]

\[
= 63 \text{ billion}
\]

The population count of Qualified Opportunity Funds is again from the Department of the Treasury, the growth in the fund count is based on the 2018 to 2019 growth in the number of funds incorporated (as reported in the SEC data); the share of funds with capital is as of January 2020 and comes from the Novogradac database; and capital per fund comes from the SEC data (0.019 billion per fund). For the share of Qualified Opportunity Funds with capital (0.60), we use the Novogradac data instead of the SEC data, which primarily cover funds that have already
raised capital since that is what triggers their filing of the SEC form that generates the data. As such, funds that have raised at least some capital are likely to be overrepresented in the SEC data. In summary, the key assumptions of the second approach are that the SEC data provide a reliable estimate of the growth in the number of Qualified Opportunity Funds in the population and, among those with capital, their average capital raised. In line with the Novogradac data, the approach also assumes that 60 percent of all funds raised some capital by the close of 2019.

The standard error of the average amount of capital raised per Qualified Opportunity Fund permits providing a confidence interval around the SEC-based estimate of the total capital raised. The resulting 90 percent confidence interval is $33 billion at the lower end and $93 billion at the higher end. It therefore includes the Novogradac-based estimate and the average of the two estimates, which is about $75 billion and is our preferred estimate. This is 21 percent of baseline annual investment in OZs, which is reported in the next subsection.

**Estimated Investment Growth Caused by the Opportunity Zone Incentive**

Not all the capital raised by Qualified Opportunity Funds is necessarily new to Opportunity Zones—some of it may have occurred without the incentive, and it is now occurring through a fund. In this subsection, the CEA draws from the academic literature to estimate how much new investment is likely given the lower tax rates caused by the OZ incentive. We estimate that the incentives have brought $52 billion in new investment in OZs through 2019, representing 70 percent of the $75 billion raised by Qualified Opportunity Funds.

To estimate new investment, we calculate the reduction in the cost of capital caused by the cuts to capital gains tax rates. We then link the cost of capital to investment elasticities from the academic literature. This modeling of the OZ incentive illustrates how the incentive is similar to the corporate tax rate cuts resulting from the Tax Cuts and Jobs Act. These cuts were also projected to increase investment through a decline in the user cost of capital (CEA 2017).

The investment estimates come from first calculating the pretax rate of return needed to attract investors to supply funds in OZs. To achieve the same post-tax return inside OZs as outside them, investors would be willing to accept a lower pretax return because of lower effective tax rates in OZs. The second step of the estimation then calculates the increased investment from OZ businesses that occurs as they have access to new funding at a lower capital cost. Figure 7 illustrates the concepts behind the calculation, showing how the

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8 The resulting confidence interval reflects uncertainty over the population value of capital per fund. It does not capture uncertainty over other parameters used in the calculation of total capital raised by funds in the population.
A reduction in taxes makes investors willing to accept a lower pretax rate of return and still invest in OZs.

Figure 7. Opportunity Zone Investment Supply-and-Demand Model

The numerical estimates rely on three parameters: baseline investment in OZ census tracts that predates the incentives, the post-tax rate of return that is required to attract funds, and the effective tax rate that prevails in OZs with the incentive. For the first parameter, we estimate baseline investment of $243 billion by apportioning national investment to counties based on gross domestic product, and then from counties to census tracts based on income and population. Second, using data that show a pretax 9.8 percent rate of return earned by investors outside OZs—which then face a capital gains tax rate of 21.3 percent—the required post-tax rate of return is 7.7 percent. We find that, to receive the same post-tax 7.7 percent rate of return in OZs—which feature only a 6.9 percent effective tax rate, as described below in the “Budgetary Effects of Opportunity Zones” subsection—investors only require a pretax rate of return equal to 8.3 percent (= 7.7/(1 – 0.069)) in 2019. Finally, we assume a -9.55 semi-elasticity of investment to the cost of capital, from Ohrn (2019). Over a one-and-a-half-year period, the increase to investment is then calculated as:

\[ 1.5 \text{ years} \times ($243 \text{ billion}) \times (8.3\% - 9.8\%) \times (-9.55) = $52.2 \text{ billion}. \]

The one-and-a-half-year period is used to reflect the time between the designation of Opportunity Zones (mid-2018) and the end of 2019.
The Industry Focus of Qualified Opportunity Funds

Recent data from the Securities and Exchange Commission allow us to describe the sectoral focus of a sample of Qualified Opportunity Funds, the same one described above. The SEC form completed by Qualified Opportunity Funds requires them to select one industry group. The selections, shown in figure 8, reveal the diverse focus of funds. Slightly less than half of them focus on real estate, with the majority targeting commercial real estate. Another 45 percent describe their industry as a “Pooled Investment Fund,” which suggests that they have investments across various industries. Finally, about 10 percent are in the “other” category, which includes funds that reported a focus on health care, technology, construction, and investing, and as well as those selecting the “other” option on the form.

Figure 8. Percentage of Qualified Opportunity Funds, by Industry

The industry focus indicated by the SEC data are consistent with the types of projects seeking to attract Qualified Opportunity Fund investment, as evidenced by data from the Opportunity Exchange, which is a private organization that helps entities showcase OZ businesses and properties to stakeholders locally and nationally. As of February 2020, The Opportunity Exchange hosted $45 billion in proposed projects across 24 States. About 30 percent of the projects on the Opportunity Exchange are businesses seeking equity investments, 26 percent are real estate projects with a development plan, and the rest are properties for sale without a development plan.

Form D does not provide definitions for the industry categories that filers can select.
Opportunity Zones’ Effects on Business Investment and Housing Values

The CEA finds that receiving an OZ designation led to a 29 percent relative increase in equity investment. Such communities have also benefited from larger house price appreciation, which creates $11 billion in additional housing wealth for homeowners and improved local amenities for renters.

Equity Investments in Opportunity Zone Businesses

Qualified Opportunity Funds can invest in Opportunity Zones by directly purchasing property or by making equity investments in operating businesses. In this subsection, we present data regarding private equity investment in businesses located in OZs compared with those located elsewhere. 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, compared with businesses in eligible-but-not-selected census tracts.

Many businesses pursuing equity investments must file the same SEC Form D that Qualified Opportunity Funds file. We use address information from this form, which gives the location of the principal place of business, to determine whether the business is located in an OZ census tract, an eligible-but-not-selected tract, or an ineligible tract. To capture nonfinancial operating businesses, we exclude entities that identified themselves as banks or investment funds.\(^\text{10}\) To better measure systematic investment trends, as opposed to variation in the behavior of a few large firms, we focus on filings that raised less than $50 million in any quarter, which captures more than 96 percent of filings.\(^\text{11}\) We then compile the total investment raised by businesses in each census tract type by quarter.

In figure 9, we present the four-quarter moving average of the total equity investment in each group of tracts, with values indexed to their value in the first quarter of 2018. The three groups had similar investment trends until the first half of 2018, when investment in OZ businesses

\(^{10}\) Specifically, we exclude all firms that identified their industry or their fund as “pooled investment fund,” “commercial banking,” “investment banking,” “other banking and financial services,” or “investing.”

\(^{11}\) Bauguess, Gullapalli, and Ivanov (2018) report that more than 96 percent of filings have an offering size of $50 million or less. An even larger percentage would actually raise less than $50 million.
spiked. All States nominated census tracts in March and April 2018, and the Department of the Treasury finalized its formal designation of OZs by the second quarter of 2018. Over the seven quarters 2018:Q2–2019:Q4, equity investment in OZs was 41 percent higher than it was in the prior seven quarters. By comparison, investment was only 13 percent higher in eligible-but-not-selected tracts. This suggests that OZ designation led to a 29 percent increase in equity investment relative to comparable tracts (41.4–12.6 percent).13

**Figure 9. Private Equity Investment by Tract Group, 2016–2019**

![Figure 9. Private Equity Investment by Tract Group, 2016–2019](chart)

*Source: SEC; U.S. Department of the Treasury; CEA calculations. Notes: TCJA=the Tax Cuts and Jobs Act*

**Opportunity Zone Designation and Housing Values**

Evidence from real estate markets suggests that the Opportunity Zones incentive is making many OZs more attractive for both residents and investors. This increase in housing value has led to an estimated $11 billion in additional wealth for the nearly half (47 percent) of OZ residents who own their housing.

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12 Not every businesses in an OZ is necessarily a Qualified Opportunity Zone Business as defined by statute and regulation.  
13 The location of a business in a particular OZ does not mean that the business’s activities must be concentrated in that particular OZ. A business can achieve the status of a Qualified Opportunity Zone Business if 50 percent of its gross income is derived from its business activities in any OZ. Thus, a business could have multiple income-earning centers spread across various OZs. Alternatively, the business can qualify if at least 50 of the services purchased and used by the business (measured by hours or dollars) occur in OZs or if at least 50 percent of its tangible property and management functions are in OZs.
Real Capital Analytics tracks commercial real estate properties and portfolios valued at $2.5 million or more. Its data show 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. Similarly, Sage, Langen, and Van de Minne (2019) use the same data and find 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.

Sage, Langen, and Van de Minne (2019) find a price increase only for particular property types and conclude that the OZ incentive is having limited economic spillovers in communities. Their data, however, only include commercial properties valued at $2.5 million or more. An analysis by Zillow, which was based on transactions of varying property types and values, suggests that the OZ incentive is having broader effects. After designation, the year-over-year change in the average sales price for properties in OZs rose to more than 25 percent while falling to below 10 percent in eligible-but-not-selected census tracts.

The Zillow analysis is limited in that it is based on changes in sales prices over time, without controlling for any changes in the composition of properties being sold. It is not based on price per square foot or, more ideally, on price changes for homes that are similar in many other dimensions. Chen, Glaeser, and Wessel (2019) provide a more rigorous assessment of effects on housing prices, though only through 2018. For a measure of housing prices, they use the Federal Housing Finance Agency (FHFA) repeat sales index for single-family homes. Their analysis centers on comparing OZs with eligible but not selected low-income tracts (thus excluding tracts whose eligibility was based solely on contiguity with low-income tracts). Across the two groups, they compare the growth in housing values in 2018 relative to that of prior years (2014–17). Their estimated effects are much smaller than those suggested by the Zillow analysis: their base model gives an estimate of 0.25 percent higher appreciation, with the estimates across models ranging from 0.09 to 0.74.

We replicate and extend the analysis done by Chen, Glaeser, and Wessel. First, we replicate the results from their base model and find a similar result (table 1, first and second columns). Then we reestimate the model with updated FHFA data released in May 2020. The update improves data from prior years and adds 2019 data.\footnote{The data are available at \url{www.fhfa.gov/DataTools/Downloads/Pages/House-Price-Index-Datasets.aspx}. See “Census Tracts (Development Index; Not Seasonally Adjusted).”} \footnote{We also normalize the housing price index to make 2013 the base year (= 100). The renormalization ensures that that changes in the index are approximate percentage changes, with a 1-point change in the index corresponding to a 1-percent increase in values. If index values are about 300, which is typical in the original index, a 1-point increase represents a 0.3-percent increase in values. The renormalized values are also much less skewed than the original index values.}
With the updated and expanded data, we estimate that OZ designation led to a higher annual appreciation of 0.53 percent. Over two years, this implies a roughly 1.1 percent \((= 1.0053^2 - 1)\) increase in values. This is a notable finding because it is based on OZ designation, not on whether a tract has actually received investment. Moreover, much of the investment raised by Qualified Opportunity Funds was probably not invested by the end of 2019. By comparison, Freedman (2012) looked at census tracts that had actually received investment through the New Markets Tax Credit and failed to find a statistically significant effect of investment on housing values over about five years, with the point estimate implying an annual effect of at most 0.5 percent.

**Table 1. The Effect of Opportunity Zone Designation on Home Value Appreciation**

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Chen et al. (2019)</th>
<th>CEA Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opportunity Zone effect on housing values (percent)</td>
<td>0.25</td>
<td>0.25</td>
</tr>
<tr>
<td>Standard error</td>
<td>0.22</td>
<td>0.22</td>
</tr>
<tr>
<td>Number of Opportunity Zones</td>
<td>2,674</td>
<td>2,674</td>
</tr>
<tr>
<td>Number of eligible zones that were not selected</td>
<td>10,198</td>
<td>10,198</td>
</tr>
</tbody>
</table>

Sources: Chen, Glaeser, and Wessel (2019); Census Bureau American Community Survey, 2012–16; FHFA; Department of the Treasury; CEA calculations.

Note: The estimated effect is based on comparing Opportunity Zones with eligible but not selected low-income tracts.

The extra 1.1 percent appreciation implies $11 billion in additional wealth for the nearly half (47 percent) of OZ residents who own their housing. Homeowners can access newly found equity without selling their homes through cash-out refinancing, which has been common in the last two years. This does not mean that rising values only benefit homeowners. 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. Brummet and Reed (2019) draw a similar conclusion from a thorough analysis of Census microdata, finding that less exposure to poverty and rising values tend to benefit original residents and led to better outcomes for their children. Using a different data source from Medicaid records, Dragan, Ellen, and Glied (2019) draw a similar conclusion about the effects of rising housing values and neighborhood improvement on residents and their children.
Within Opportunity Zones, the distribution of the benefits from improved amenities is unclear. In some instances, the benefits may go primarily to low-income households. For example, Gamper-Rabindran and Timmins (2013) find that 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 (Brummet and Reed 2019), and sometimes improved amenities increase housing values more than they increase rents (e.g., Granger 2012).

**Opportunity Zones’ Effects on Poverty and the Budget**

The CEA’s estimate of new investment suggests that Opportunity Zones may lift about 1 million people out of poverty, an 11 percent decrease in the baseline population in poverty in OZs. This decline in poverty, and with it a reduction in transfer payments, may be sufficient to make the OZ incentive nearly revenue neutral.

**Projected Effects of Opportunity Zones on Poverty**

Census-tract-level data on poverty for 2019 will not be available for several years. The CEA therefore projects the effects on poverty using a prior study linking investment to poverty. Freedman (2012) uses tract-level data to estimate the effects of investment subsidized by the New Markets Tax Credit on tract-level outcomes. His empirical approach exploits the program’s eligibility cutoffs to address the potential that subsidized investment went to tracts that would have performed better even without the subsidy. His most conservative estimate indicates that each $1 million in subsidized investment (in 2018 dollars) lifts 20 people out of poverty in the tract receiving it. Applying this finding to our estimate of new investment in Opportunity Zones ($52,000 million) suggests that 1 million people will be lifted out of poverty (= 52,000 x 20).

This effect is arguably applicable to OZ investment. The NMTC program has similar eligibility requirements for census tracts and rules to ensure that the subsidized investment happens in qualified tracts. The main difference is that community development entities must apply to and be selected by the Treasury Department, which only selects a portion of applicants. The
Treasury scores applications using several criteria, including the expected effect of the project on jobs and economic growth in the community. It is possible that applicant reporting and Treasury selections result in the investments having larger effects on poverty. Conversely, the long-term net effects of a particular project on low-income populations is arguably hard to discern with consistency. In any case, our poverty projections are arguably conservative; we use the smallest estimated effect from Freedman (2012), which is about half the main estimate reported, and apply it to new investment as opposed to all subsidized investment, which is the basis of Freedman’s estimate.

**Budgetary Effects of Opportunity Zones**

The CEA estimates that the Federal Government forgoes $0.15 for every $1 in capital gains invested in a Qualified Opportunity Fund before 2020, or about $11.2 billion for the $75 billion raised through the end of 2019. The forgone revenues stem from the deferment on the capital gains tax on the original gain, the reduction in taxes on the original gains when paid, and the lack of taxes on the gains earned while invested in the Qualified Opportunity Fund. In our calculation, we assume that taxpayers maximize their tax savings by waiting until 2026 to pay taxes on the original gains, the latest date allowed by law, and that they keep their money in the Qualified Opportunity Fund for at least 10 years.

Our calculations assume that capital gains would normally be taxed at a 21.3 percent rate, as opposed to an effective rate of 6.9 percent in 2019. This lower effective rate arises from the tax deferral and step-up in basis on funds that are invested in OZs to begin with, as well as the exclusion of capital gains taxes on the returns that accrue to those investments after they are held for at least 10 years. For funds invested in 2019, the present values of taxes paid on investments in an OZ are less than one-third what they would be if invested outside an OZ. These calculations are then repeated for each year to incorporate the dynamic nature of the OZ tax incentives, as discussed in a Congressional Research Service report (Lowry and Marples 2019).

When estimating overall revenue impacts, any static calculation that uses only the difference in rates while assuming a fixed tax base gives an inflated measure of tax revenue losses. Therefore, in our approach, we incorporate the response of investment—and hence the tax base—to the incentive. Specifically, we estimate how much of the observed $75 billion would have occurred anyway—whether in an OZ or elsewhere in the country—versus how much is new investment. Investment that would have occurred anyway and been taxed at a 21.3 percent rate but that is now taxed at a lower rate because of the incentive unambiguously lowers revenues. However, new investment creates offsetting revenue gains, even when taxed at the lower OZ rate.
We employ a similar elasticity-based approach as in the investment section in this report. The approach suggests that of the $75 billion in Qualified Opportunity Fund capital, $22.8 billion would have occurred anyway in OZs, even without the incentive. Of the $52.2 billion balance, another $24.9 billion is new to OZs but was shifted from elsewhere in the country, based on calculations using the elasticity-of-investment movement done by Koby and Wolf (2019). Thus, the incentive results in revenue losses from this $47.7 billion ($22.8 billion + $24.9 billion) but creates revenue gains from the entirely new $27.3 billion ($75 billion – $47.7 billion) in investment. On net, we estimate the present value of tax revenue losses on capital invested through 2019 to be $11.2 billion, which is 15 percent of the $75 billion in Qualified Opportunity Fund capital.

By comparison, the CEA estimates that for each $1 in investment associated with the New Markets Tax Credit, the Federal government forgoes $0.18, more than the amount for OZs. Based on estimates from the Joint Committee on Taxation, the lost tax revenue for each $1 in tax credit authority is $0.26.  However, credit authority typically represents only 69 percent of total private investment associated with projects (Abravanel et al. 2013). This implies about $0.18 in forgone revenue for each $1 in associated investment (=0.26 x 0.69).

The previous calculations only consider the effect of the Opportunity Zone incentive on capital gains tax revenues. However, the incentive will have an offsetting effect on the Federal budget by stimulating the economies of low-income areas that receive a large share of transfer payments from the Federal Government. Using county-level data on transfer payments and poverty rates, the CEA estimates that an additional person living in poverty in a county is associated with about $8,240 additional Federal transfer payments to the county, including transfers related to income maintenance, unemployment insurance, and medical assistance (mainly Medicaid). At this rate, economic growth that lifts 1 million people out of poverty for a little more than one year would save the Federal Government enough to offset the revenues forgone from the capital gains tax cuts (savings of $11.2 billion = 1 million person reduction in poverty x 1.36 years x $8,240 per person).

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16 In December 2019, the Joint Committee on Taxation estimated the dynamic revenue effects from a $5 billion allocation for the NMTC (see the relevant line at www.jct.gov/publications.html?func=startdown&id=5237).
17 This is based on footnote 7 in a paper by Abravanel et al. (2013), which reports that qualified equity investments represent 53 percent of total project costs, while public funds represent 23 percent of project cost. This implies that qualified equity investment represents 69 percent of private project cost (= 0.53 / (1 - 0.23)).
18 This estimate is based on Bureau of Economic Analysis county-level data on Federal Government transfers and county-level population and poverty data from the Census Bureau. The average transfer per person in poverty, defined as total transfers in the county divided by the county population in poverty, over a seven-year period was about $11,500. However, regressing county-level transfers per capita on the poverty rate suggests that, at the margin, an extra person living in poverty is associated with $8,240 in greater transfers to residents of the county.
19 Of course, this calculation should be viewed as illustrative because we lack an estimate of the causal impact of poverty reduction (via investment incentives) on total Federal spending.
Conclusion

Much remains to study regarding the effects of Opportunity Zones on real estate markets, entrepreneurship, poverty, and income. In coming years, researchers will have ample data to assess the effects of OZs on diverse community outcomes. As of the 2019 tax year, the Internal Revenue Service’s revised Form 8996 will collect detailed information on Qualified Opportunity Fund activity. This information will enable researchers to learn how much Qualified Opportunity Fund investment is occurring in particular census tracts and economic sectors. These data will permit the same rigorous empirical studies that have been done for the New Markets Tax Credit (Freedman 2012; Harger and Ross 2016).

The available evidence shows that Qualified Opportunity Funds are well positioned to invest in communities in 2020: they have raised considerable capital, and the final regulations from the Department of the Treasury, which were published in December 2019, have given further clarity on how the incentive and associated investments will function. However, numerous State-mandated restrictions and preventive behavior to slow the spread of the COVID-19 pandemic have prevented business as usual and have slowed investment everywhere, including in OZs.

It is also possible that a sizable amount of capital will enter Qualified Opportunity Funds in 2020. As noted above, the capital raised by these funds in the Novogradac sample grew by about 30 percent in the first four months of 2020. Late in the first quarter, the pandemic prompted a massive selloff that likely generated capital gains for many investors exiting what had been a long bull market. And the rapid rebound in stock values has created the potential for more gains.

Pre-COVID-19 evidence suggests that the OZ model can help spur economic recovery in thousands of distressed communities across the United States. It has the power to mobilize investors, engage State and local stakeholders, and improve the outlook for low-income communities—all with limited prescription from the Federal Government. In other words, the OZ provision of the Tax Cuts and Jobs Act of 2017 is working as intended.

In nominating communities as Opportunity Zones, States selected places in need that had the potential to attract investment. The provision’s incentives have helped mobilize the investment of $75 billion in private capital in Qualified Opportunity Funds, and some of this capital has already spurred growth in direct equity investments in businesses and real estate. Finally, OZ designation and the associated investment (both anticipated and realized) have made people more optimistic about these communities as places to live and to work in, with designation causing a 1.1 percent increase in housing values as of the close of 2019.
Such initial benefits underscore the potential of the Opportunity Zone model, which rests on private initiative; on engaged State, local, and tribal governments; and on limited Federal prescription—all to further prosperity and self-sufficiency in those areas that most lack it. This dynamic process will be important for helping the relatively poorer part of the population that has been most affected by the economic slowdown from the COVID-19 pandemic.
References


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www.whitehouse.gov/cea

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The Urban Law Journal
2021 Spring Symposium

A Taxing War on Poverty: Opportunity Zones and the Promise of Investment and Economic Development

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OPPORTUNITY ZONES
OPPORTUNITY ZONES

Brief History

2016
Opportunity Zone Legislation

2017
Opportunity Zone Legislation

2017
Tax Cuts and Jobs Act

2018-2019
Regulations released

OZs: Known to need some technical corrections

Final regs released Dec. 2019
Qualified Opportunity Zones

- Population census tract that is a low-income community (LIC)
  - Approximately 75,000 total census tracts in the U.S.
  - 37% of the census tracts in the United States are LICs
  - NMTC Definition: Based upon poverty rate (20%) or median family income (80%)
- Timely nominated by each Governor
- 25% of the LICs were eligible
  - Approximately 8,700 census tracts
  - 5% of the tracts to be nominated can be contiguous tracts (125% MFI limit)
- Impact of 2020 Census Boundary Changes????
Investor Benefits:
Defer capital gains & more

Qualified Opportunity Funds (QOFs)
for making timely investments in

Qualified Opportunity Zone Business Property and Businesses
which invest in
3 Tax Incentive Benefits

1. Capital Gain Deferral
   Defer to 12/31/2026

2. Partial forgiveness
   7/5 year hold
   15% - 12/31/2019
   10% - 12/31/2021

3. Forgiveness of additional gains
   Ten year hold – FMV basis step up on selling Fund interest
Investment made within 180 days (+ COVID-19 extensions)

Begins on the day on which gain would be recognized for Federal income tax purposes assuming no deferral

Extended for investors who faced a deadline of April 1 or later for their 180-day window to invest

1. July 15, 2020
2. Dec. 31, 2020
3. Mar. 31, 2021
Partial Forgiveness and Forgiveness of Additional Gains

INVESTMENT (Mar. 2018)

SALE

TODAY Feb 26, 2021

Basis increased by 10% of the deferred gain
Up to 90% taxed

HELD FOR 5 YEARS

Basis increased by 5% of the deferred gain
Up to 85% taxed

HELD FOR 7 YEARS

Basis increased by 5% of the deferred gain
Up to 85% taxed

HELD FOR 10 YEARS

Recognize Gain Dec. 31, 2026

Basis is equal to Fair Market Value
Forgiveness of gains on appreciation of investment
Requires an election

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028

Today  Feb 26, 2021

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Qualified Opportunity Zone Business (QOZB)
Qualifications

✓ Organized as a **corporation** or **partnership** for tax purposes, including **LLCs**.

✓ Satisfy a **70% tangible property asset test**
  - At least **70% of the tangible property** (e.g., real estate, machinery, furniture) must be:
    • Used in a trade or business
    • Acquired by purchase **after December 31, 2017**
    • Used in an OZ
    • Property for which the owner is the original user of the property in an OZ
      - or the property is substantially improved
    • Substantially improve = Spend more than 100% of adjusted basis over 30 mos.
QOZB Qualifications

✓ Satisfy a **50% active gross income test**
  – At least 50% of gross income of the QOZB is from the active conduct of a trade or business in the OZ.

✓ Satisfy an **intangible property test**
  – A substantial portion of the intangible property owned by the QOZB is used in the active conduct of the business in the OZ.

✓ Satisfy a **nonqualified financial property test**
  – Maintain less than 5% of assets as cash, stock and partnership interests, receivables not from ordinary customers, options, annuities, and other sources of cash in excess of the reasonable working capital needs of the business.
Ineligible Businesses

Can’t be a “Sin Business”

A private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.
Qualified Opportunity Zone Businesses

1. **New Businesses** *Forming* in an Opportunity Zones
   a) Rental Real Estate
   b) Operating Businesses

2. **Existing Businesses** *Expanding* in an Opportunity Zone
   a) Rental Real Estate – Renovations > Building Cost
   b) Operating Businesses – Additions > Existing Tangible Property

3. **Existing Businesses** *Moving* into an Opportunity Zone
   a) Operating Businesses
Opportunity Zones Investment Report

www.novoco.com/products

Overview

Funds Raised by QOFs Reporting Equity Amount.. $15.16 billion
QOFs that Report the Amount of Equity Raised .. 659
All QOFs Tracked ............... 927
Opportunity Zones Investment Report

www.novoco.com/products

QOF Equity Over Time

Dec. 2020
$15.2 billion

May 2019
$790.0 million

Investment Type Fund Focus

Highly active with 40 QOFs tracked by Novogradac that have reported an amount of equity raised. At least a partial focus on residential development, a trend that has held steady since reporting on the QOFs began in May 2019. There are few other areas for investment in the Novogradac reports—commercial, hospitality, opening businesses and renewable energy.

As has been true since Novogradac started tracking the activity, residential and commercial activity are the dominant investment trends among QOFs.

As of Dec. 30, 2020, 40 QOFs that report an amount of funds raised have a sole focus on residential properties, while another 41 include residential as one of multiple areas of focus. Those 350 QOFs account for $15.2 billion in equity investment, 16.3% of the overall investment total.
Opportunity Zones Investment Report

www.novoco.com/products

Residential, Commercial Still Top Investments

- Residential only $3.22 billion
  - One of multiple investment types $3.25 billion

- Commercial only $9.28 billion
  - One of multiple investment types $1.69 billion
  - One of multiple investment types $398.19 million
  - Operating Businesses only $256.65 million

- Hospitality only $299.99 million
  - One of multiple investment types $375.26 million
  - Renewable only $23.12 million

- Operating Businesses only $427.63 million
Final Regulations Expand on the Nature of a Qualified OZ Business and Qualified OZ Business Activity

KRISTIN DUKUPER, HOLLAND & KNIGHT LLP

Register provide objective standards for evaluating compliance with certain rules that will be of interest to real estate owners and developers.

The standards expressed support the OZ incentive’s policy goal of catalyzing investment in distressed communities. Other rules affecting real estate addressed in the final regulations provide less helpful guidance and still require a leap of faith for those seeking to comply.

This article will address the guardrails, or lack thereof, established in the final regulations regarding the nature of permitted businesses and the characteristics of leases to which a qualified OZ business is a party.

Rules for Excluded Businesses Eliminate Uncertainty for Certain Distressed Community Investments

The final regulations provided useful and sometimes surprising fine-tuning on when an activity that could be characterized as a "tax business" will not disqualify a qualified OZ business. A "tax business" is a business described in Internal Revenue Code (IRC) Sections 144(a) (HOE), which includes a golf course, country club, massage parlor, hot tub facility, movie theater, racetrack or other facility used for gambling or an office principal business of which is the sale of alcoholic beverages for consumption off premises (an excluded business).

But first, the final regulations closed a loophole by clarifying that not only is a qualified OZ business prohibited from directly operating an excluded business, but it is also prohibited from leasing to an excluded business when the excluded business represents more than a de minimis portion of the qualified OZ business’s leasing activity. For this purpose, de minimis means that no more than 5 percent of the qualified OZ business’s property is leased to an excluded business (on a net square footage basis for real estate), and no more than 5 percent of the gross income from such property is attributable to the excluded business (the de minimis test).

A similar rule provides that a qualified OZ business itself can operate as an excluded business as long it meets the de minimis test with respect to gross income. The final regulations offer an example of a hotel developed by a qualified OZ business with an on-site spa that offers massage services that meets the de minimis test with respect to gross income, the net square footage of the area devoted to the spa and the value of tangible property leased to the spa. Although not explicitly required by the final regulation, the example implies that such a program of the de minimis test must be met for wellness as well as leased property.

The de minimis test provides clear guidelines for situations that may otherwise concern, such as a grocery store that sells lottery tickets and liquor. As long as the de minimis test is met with respect to the lottery ticket and alcohol sales, there should be
The Urban Law Journal 2021 Spring Symposium

A Taxing War on Poverty: Opportunity Zones and the Promise of Investment and Economic Development

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MITIGATING HOUSING INSTABILITY DURING A PANDEMIC

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ABSTRACT

Housing instability threatens to impair the United States’ policy response to the COVID-19 pandemic by undermining public health strategies such as social distancing. Yet, mitigation of housing instability has not been the focus of early emergency legislation, including the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which has focused on providing cash support to individuals and businesses. Although many of these laws have the potential to reduce housing instability, this Article argues that they face barriers to effective implementation akin to those that hindered similar interventions during the Great Recession. These barriers—which include administrative hurdles, reliance on voluntary participation, resource constraints, and political pushback—may prevent these interventions from effectively mitigating housing instability. For this reason, additional rental assistance and mortgage payment assistance will be necessary to prevent the loss of housing that will ultimately exacerbate the public health crisis. We also recommend a new civil right to counsel in eviction cases and targeted place-based interventions to promote affordable housing development where it is needed most.

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INTRODUCTION

One evening in April 2020, as the COVID-19 pandemic swept through the United States and businesses closed their doors, Margarita Lopez received a knock on hers.\(^1\) When she opened it, a man handed her a note that read “Good Luck.”\(^2\) She was being evicted from her Staten Island apartment; New York’s emergency eviction freeze was set to expire on July 31\(^a\) leaving Margarita with little time or recourse.\(^3\) Reflecting on the experience, Lopez told a reporter: “Every time I walk out of this door, I’m scared for my life. I feel like I have no power . . . I feel stuck. If I end up homeless, a shelter is not an option because eventually I’ll get sick. It’s a lot of questions about what comes next.”\(^4\)

Lopez is not alone. Only one-third of tenants nationwide were able to pay April’s rent, and only slightly more than half expected to be able to pay their full rent in the following months.\(^5\) Homeowners also fell behind. Roughly 3.4\% of Americans were delinquent on their mortgage payments as of April, and by July 4.1 million homeowners were in forbearance.\(^6\) Yet, the federal policy response to the pandemic included remarkably few direct interventions to reduce housing instability and prevent homelessness.\(^7\) This

\(^2\) Id.
\(^3\) Id. Although the freeze would later be extended until August 20\(^b\), Margarita’s case did not meet the more narrow criteria to qualify for additional time.
\(^4\) Id.
\(^6\) Andrew Van Dam, Analysis / An indicator that presaged the housing crisis is flashing red again, WASHINGTON POST, https://www.washingtonpost.com/business/2020/07/14/new-mortgage-delinquencies-hit-record-high/ (last visited July 24, 2020).
\(^7\) This article focuses on housing instability as it affects the public health crisis. However, note that under international human rights law, the right to adequate housing is a crucial component of a right to an "adequate standard of living" as conveyed in the UN Declaration of Human Rights. "Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including . . . housing . . . and the right to security in the event of unemployment, sickness, ...or other lack of livelihood in circumstances beyond his control." Universal Declaration of Human Rights, GA Res 217A (III), UNGAOR, 3rd Sess, Supp No 25, UN Doc A/810 (1948) 71. The United States contributed to and endorsed the UN Declaration of Human Rights in 1948.
failure to prioritize the mitigation of housing instability during the initial stages of the pandemic places millions of Americans at risk of eviction or foreclosure, with great consequences for public health.\(^8\)

This Article analyzes the pathways by which unmitigated housing instability could impede the success of public health strategies during the pandemic and provides a historically grounded evaluation of the housing policy response. The phrase *housing instability* is used to capture the multiple and often overlapping dimensions of how the pandemic may directly or indirectly impact housing tenure and security. Although most of the dimensions of housing instability described were present prior to the pandemic, their potential impact becomes much greater given the economic, social, and public health shocks associated with COVID-19.\(^9\)

Social distancing, the primary public health tool for controlling a pandemic like COVID-19, is likely to increase housing instability. In turn, housing instability will prevent people from social distancing. Because social distancing requires people to remain home as much as possible, it has been accompanied by business closures and a rise in unemployment. If unemployed workers are unable to pay their mortgage or rent, homelessness will increase, making social distancing difficult. This will undermine the public health response.

\(^8\) Alicia Adamczyk, *Millions of Americans could face eviction in July—and it could “destabilize communities for years to come”*, CNBC (2020), https://www.cnbc.com/2020/07/01/nearly-7-million-households-could-face-eviction-without-assistance.html (last visited Jul. 24, 2020). In New Jersey alone, a Stout report prepared for the Coalition of Housing Advocates in NJ estimates that 450,000 renters (“approximately 40% of all renter households”) will be unable to pay their August rent. STOUT, *THE POTENTIAL IMPACT OF COVID-19 RELATED EVICTIONS IN NEW JERSEY* 7 (July 23, 2020). Furthermore, “New Jersey could experience 304,000 eviction filings in the coming four months” once the eviction moratoriums are lifted, “an estimated 600% increase from pre-COVID-19 levels.” Id. at 4.

\(^9\) Research shows that evictions lead to “homelessness, mental and physical health challenges, employment loss, challenges re-renting…. These impacts often trigger a social safety net response (e.g., use of homeless shelters, Medicaid spending..., payment of unemployment benefits…) that is extremely expensive for states and cities. Furthermore, these impacts are likely to be significantly worse when coupled with COVID-19. The virus’s community transmission could worsen its already detrimental effects, including contributing to an increase in … cases, particularly among vulnerable populations. If this were to happen, generational poverty in New Jersey, especially for Black and Brown renter household would undoubtedly be exacerbated.” STOUT, *supra* note 8, at 28.
For these reasons, this Article argues that it is essential for lawmakers to directly address housing instability. Yet, lawmakers have rarely taken the steps needed to effectively mitigate housing instability, even when its harms have been more salient. To understand why, this Article analyzes policies intended to mitigate housing instability during the last significant economic crisis, the Great Recession, when housing instability was at the forefront. Despite the prominent role housing instability played during the Great Recession, lawmakers failed to implement policies that reduced it effectively.

Our analysis of policy failures during the Great Recession reveals three lessons for the COVID-19 crisis. First, housing payment assistance is preferable to indirect forms of relief to homeowners and renters. Second, grants are preferable to tax expenditures. Third, place-based interventions are necessary to address ongoing housing instability in the months and years following a crisis. Drawing on this analysis, this Article provides a historically grounded critique of the initial policy response to the COVID-19 pandemic. This initial response to the pandemic has faced many of the same barriers to effective mitigation of housing instability, and as a result, further intervention is necessary.

This Article makes several important contributions to the literature. First, it contributes to the literature on COVID-19 by providing an account of the barriers to mitigating housing instability during periods of crisis and placing the pandemic in context with historic policy interventions. Second, this Article contributes to the urban and poverty law literatures by using the COVID-19 pandemic as a case study to reveal new insights about the relative effectiveness of housing laws during pandemic conditions. Third, this Article contributes to the tax law literature by describing the potential and the limitations of the tax expenditure approach to promote affordable housing during a pandemic.

The Article proceeds as follows. Part I analyzes data from the Eviction Lab to predict that housing instability, as reflected in eviction rates, is likely to rise as a consequence of the pandemic. It argues that policymakers are most likely to take steps to mitigate rising housing instability if the public health risks associated with housing instability are understood. Accordingly, it describes the pathways by which housing instability threatens to undermine the public health response during the COVID-19 pandemic.
Part II describes the major interventions taken during the Great Recession and identifies the barriers to their effective implementation. During the Great Recession, the policy response focused on foreclosure prevention, primarily through loan modification, and place-based interventions to increase the supply of permanent affordable housing. These programs generally failed to meet expectations due to resource constraints, the use of incentives rather than more direct controls, a focus on long-term place-based strategies at the expense of more immediate people-based strategies, slow government implementation, a reluctance among regulators to administer the programs, and low-participation by banks. Direct housing assistance, including a homelessness prevention and rapid rehousing program, played a much smaller role but was arguably more effective.

Drawing on the foregoing analysis, Part III examines the initial policy response of federal, state, and local governments during the COVID-19 pandemic, including the first significant emergency legislation, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). In addition to providing cash assistance to individuals and businesses, initial policies have included foreclosure moratoriums and eviction freezes that directly mitigate housing risk. However, these interventions have failed to eliminate the need for direct housing payment assistance and grant funded place-based interventions.

For these reasons, Part IV sets forth two significant priorities for lawmakers: direct relief to renters and homeowners to mitigate housing instability during the pandemic, and place-based interventions to mitigate housing instability and geographic inequality after the crisis. To this end, we recommend three significant policy interventions: rental assistance and mortgage payment assistance programs, a civil right to counsel in evictions to help ensure the efficacy of eviction freezes and foreclosure moratoriums, and targeted place-based interventions to promote affordable housing development. These recommended interventions, which are designed to mitigate housing instability, are not only essential to address the continuing threat from COVID-19, but also to prepare the U.S. for future pandemics.
I. HOUSING INSTABILITY DURING A PANDEMIC

A. Predicting the Impact of COVID-19 on Housing Instability

Social distancing strategies used to control the COVID-19 pandemic created a sudden and widespread wave of business closures, employee furloughs, and layoffs. Even before precautionary shut downs were instituted in parts of the US, the country officially entered a recession in February 2020. By the end of April 2020, the official U.S. unemployment rate had risen to 15%. This number was almost certainly an underestimate, as state employment agencies have struggled to process claims, and many unemployed workers had not yet filed.

Though many states have implemented eviction moratoriums to prevent unemployment from causing a wave of evictions, housing attorneys “say that they’ve seen a flood of [wrongful eviction] cases nationwide since the economic collapse precipitated by the spread of COVID-19.” Such housing instability is likely to increase as unemployment persists. It is important to note that eviction rates were high even before the pandemic and disproportionately affected communities of

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14 See infra App. A.
16 See, e.g., Franzese, McNeil & Pascale, supra note 5.
color. Just as COVID-19 has had a disproportionate effect on this population, communities of color will also suffer a comparable disparate impact with respect to housing instability akin to the 2007 housing crisis.

The nation’s long-term eviction crisis has garnered substantial public attention. Trends before, during, and after recessions can help predict how the economic turmoil caused by the COVID-19 pandemic may impact housing instability. To this end, Figure 1 analyzes data from Eviction Lab to show how eviction rates have changed in each state since 2000. Designated recession periods, including the 2008–2009 Great Recession, are shaded in pink.

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17 Zoe Greenburg & Tim Logan, A ‘Tsunami of Evictions’ Threatens to Strike Boston, The Boston Globe, June 28, 2020, https://www.bostonglobe.com/2020/06/28/metro/tsunami-evictions-threatens-strike-boston (researchers found that between 2014 and 2016, a disproportionate number of evictions happened in communities of color, and that the number of Black renters in an area is a better predictor of eviction filings than any other factor in Boston). Other groups also likely to be disproportionately affected by housing instability include LGBT people (generally more likely than non-LGBT people to face housing instability during non-crisis periods, making them especially vulnerable during the pandemic). See LGBT people are more likely than non-LGBT people to face housing instability, WILLIAMS INST., https://williamsinstitute.law.ucla.edu/press/lgbt-housing-press-release/, Apr. 2, 2020.

18 Elora Raymond, Kyungsoon Wang, and Dan Immergluck, Race and Uneven Recovery: Neighborhood Home Value Trajectories in Atlanta Before and After the Crisis, 31 Housing Studies 3, 324-339 (2016). See also STOUT, supra note 8, at 27.

We highlight two key observations. First, eviction rates among states reflect substantial variations due in part to state-level eviction laws. Though the causes of these variations are beyond the scope of this Article, it is worth noting that some states with consistently high eviction rates—such as Michigan and Louisiana—experienced steep spikes in eviction rates during the early stages of the Great Recession. Once the rates had spiked in these states, they remained high for several years before declining. This suggests that housing instability may persist long after a crisis event like the pandemic.

Second, in many states, the rate of eviction has continued to rise in the years leading up to the pandemic. One explanation is that, in many parts of the country, rental housing markets substantially restructured after the Great Recession to include new classes of institutionally-owned single-family rental properties. Research shows that eviction rates within these institutionally-owned single-family rental properties may be higher than for

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other rental properties. Large landlords are also likely to use evictions—and particularly serial filings—against the same tenant as a means to regulate their relationship with tenants facing other forms of economic instability. These changes to the housing market may make tenants more vulnerable during the pandemic than they were prior to the Great Recession.

A study on evictions in Boston found that market-rate eviction filings are nearly twice as common in two- and three-family “properties where the landlord does not live in the building as in properties where the landlord is an owner-occupant.” Furthermore, the study noted significant racial disparities in the neighborhoods most impacted by evictions with respect to market-rate housing. "Seventy percent of market-rate eviction filings occur in neighborhoods where a majority of residents are people of color," even though these communities contain less than half of the city’s market-rate rental housing. In fact, even after controlling for income, market-rate eviction filings are more prevalent in census tracts with a higher proportion of Black tenants, suggesting “that housing instability and evictions have a disproportionate impact on Boston’s Black residents.” This is partially due to a history of racial segregation in Boston combined with current-day high rental burdens and housing instability. This research indicates that communities of color are more likely to be directly affected once the moratorium on evictions is lifted.

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22 Id. These trends can be explained in part by different motives for institutional investors when compared to other rental property owners. Id.

23 Dan Immergluck et al., Evictions, Large Owners, and Serial Filings: Findings from Atlanta, 35 HOUS. STUD. 903, 920 (2020).

24 David Robinson & Justin Steil, Evictions in Boston The Disproportionate Effects of Forced Moves on Communities of Color 73 (2020). Fifty-five percent of “two- and three-family properties in Boston are owner-occupied”. Id. Owners of owner-occupied buildings “filed for an eviction in one in every 137 units each year between 2014 and 2016” whereas absentee landlords “filed for an eviction in one in every 105 units”. Id.

25 Id. at 36. The authors note “that historic patterns of housing discrimination and residential segregation that persist today and the related concentration of disadvantage in communities of color are reflected in the disproportionate distribution of eviction filings and severe housing instability.” Id. at 35.

26 Id. at 40.

27 Id. at 49.

28 Id. at 13-14 (“According to court data, 78 percent of eviction cases in Boston that were suspended due to COVID-19 were in communities of color.”).
Our own analysis of cross-sectional eviction data at the county level from 2016 shows that on average, eviction rates tend to increase as the proportion of nonwhite county population increases. We split all counties in the United States into quintiles based upon the proportion of nonwhite population—the eviction filing rate in those counties in the fifth quintile—which has the highest proportion of non-white residents was more than four times that in the lowest quintile. Likewise, the eviction rate in these counties was nearly double.

These data suggest that without effective mitigation of housing instability caused by COVID-19, eviction rates are likely to rise for a sustained period, and are likely to disproportionately impact racial minorities. This may be particularly true in states with consistently high eviction rates, and those where large landlords have broad discretion to evict. The next section argues that the willingness of lawmakers to take steps to mitigate housing instability during the pandemic may depend on whether housing instability is recognized as a public health threat.

B. Policy Response to Housing Instability Varies by Perceived Harm

As this section will explain, the rhetoric and policies during the Great Recession show that housing instability is taken most seriously by lawmakers when it is perceived as creating spillover effects that harm the broader public. Housing instability featured prominently as a cause of the Great Recession. A rapid expansion of the secondary mortgage industry during the early 2000s had been fueled by the introduction of risky subprime mortgages. These subprime mortgages led to a wave of defaults and foreclosures in 2006 and 2007 and ultimately triggered the collapse of the housing finance industry that precipitated the recession. The national

30 Data analysis on file with author.
31 Raphael Bostic & Ingrid Gould Ellen, Introduction: Special Issue on Housing Policy in the United States, 24 J. HOUS. ECON. 1, 1 (2014). Note that there has been “considerable debate as to the causes of the crises,” and contributing factors may have included changes in the housing credit industry and government regulation (including affordable housing mandates). Id.
33 Id. at 565.
unemployment rate peaked at 10.1% in October 2009, and the number of moderately cost burdened rental households “grew to 49%, with 26% of renters severely burdened.” From 2007 to 2010, family homelessness rose by 20%.

There is ample literature outlining the effects of housing instability on personal and community health. For example, a review of 35 unique studies on foreclosure found that home foreclosure adversely affects physical and mental health at the individual level as well as the community level. “[T]he stress of personally experiencing foreclosure was associated with worsened mental health and adverse health behaviors, which were in turn linked to poorer health status; at the community level, increasing degradation of the neighborhood environment had indirect, cross-level adverse effects on health and mental health.” Research on renters who have been evicted, noted increased levels of stress, depression, anxiety or insomnia as well as other negative impacts on these tenants’ and their children’s mental and physical health. For reasons such as these, some advocates described the foreclosure crisis as a “humanitarian crisis.”

However, the political rhetoric during the Great Recession overwhelmingly downplayed the social welfare aspects of housing instability. At every stage of the policy response, mitigation strategies were aimed toward minimizing economic harm and protecting markets. There was political “opposition to using federal resources to assist distressed

38 See, e.g., The Seattle Women’s Commission and the Housing Justice Project of the King County Bar Association, Losing Home: The Human Cost of Eviction in Seattle (September 2018), Center on Urban Poverty and Community Development, Case Western University, The Cleveland Eviction Study: Observations in Eviction Court and the Stories of People Facing Eviction (October 2019), and Babajide, Rilwan, et. al., Middlesex County Coalition on Housing and Homelessness, Effects of Eviction on Individuals and Communities in Middlesex County (May 12, 2016).
39 Foscarinis, supra note 36, at 519.
homeowners” and “[n]either the Obama administration nor the Bush administration made any sustained efforts to convince the public that helping distressed homeowners was the right or sensible thing to do.”  

Instead, policymakers emphasized goals such as “alleviating the ‘spillover effects’ of mortgage foreclosure (e.g., the decrease in property values of non-foreclosed homes when foreclosures happen nearby)” and the need to stabilize the credit market.

Accordingly, the initial interventions focused on mortgage reform and loan counseling to slow the rate of foreclosures but omitted housing payment assistance. As housing instability increased due to jobs losses, so did the need to assist struggling homeowners and tenants. Nevertheless, rental assistance and mortgage payment assistance remained an exceedingly small part of subsequent interventions. Again, policy justifications emphasized societal costs beyond harm to homeowners, including harms to “([1]) lenders holding mortgages on foreclosed properties, ([2]) homeowners living near foreclosed properties, and ([3]) local governments.”

Thus, lawmakers readily implemented policies to mitigate housing instability when it was perceived as a threat to industries or the broader public, but they were reluctant to provide direct assistance that might be perceived as mere welfare payments to benefit struggling homeowners and renters. This history highlights the importance of educating policymakers and the public about the public health threat presented by housing instability. It also reveals a political reality: individual harms to tenants and defaulting homeowners is not sufficiently compelling to lawmakers to ensure the rapid implementation of housing legislation. For this reason, the next section of this Article describes how housing instability may undermine efforts to contain the COVID-19 pandemic, ultimately contributing to its spread.

42 See infra Part II.A.
C. Housing Instability as a Public Health Risk During COVID-19

Housing instability threatens to undermine the public health response to the pandemic by increasing the number of households facing acute housing distress and homelessness, ultimately increasing the risk of transmission and exposure to COVID-19. As a result, the pandemic raises the stakes associated with longstanding housing issues such as homelessness, shortages of affordable housing, and the relationship between income insecurity and housing instability.

As housing instability increases, people are more likely to move into crowded spaces like shared residences, where the rate of transmission is higher. Even prior to the pandemic, millions of housing insecure people lived “doubled up” with family members or friends. When two or more families share a single-family residence, there is less physical space between occupants, making it difficult to practice social distancing in the home. People living in doubled up residences are less likely to be able to self-quarantine or isolate if they experience symptoms. This allows the virus to spread between members of the residence, causing even more infections.

The public health risk further increases if housing insecure families lose all access to housing and seek refuge in overcrowded and underfunded homeless shelters.\(^47\) Inside crowded shelters, people are unable to maintain the six-feet of social distance recommended by the CDC or practice basic hygiene.\(^48\) People in shelters sleep only feet apart and use communal bathrooms, creating the perfect conditions for a virus to spread rapidly throughout the shelter.\(^49\) At least one confirmed outbreak at a homeless shelter in San Francisco infected more than 70 residents and staff.\(^50\)

Other large cities such as New York and Chicago face similar challenges dealing with COVID-19 and their homeless populations. HUD estimates in 2019 showed that there were about 78,000 people without access to consistent housing in New York City, with at least 3,500 people without access to emergency or transitional housing.\(^51\) These homeless are typically taken to congregate housing where COVID-19 easily spreads due

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\(^49\) Id.


to close quarters and lack of supplies. By May 2, 2020, 60 such homeless persons had died, 75% of whom had been staying at shelters.52

If the challenges of preventing outbreaks in homeless shelters result in shelter closures, then many homeless people will be forced back on to the street.53 Already, some homeless persons have voluntarily left crowded shelters and set up camp in an effort to avoid catching COVID-19.54 As a result, people who may have been exposed to the virus in shelters may become prevalent in public spaces—contrary to public health recommendations for isolation or self-quarantine—increasing the risk of exposure to the broader public.55

Moreover, with many public facilities such as libraries and public restrooms closed due to social distancing efforts, the number of safe and sanitary restrooms available to homeless people has plummeted drastically.56 For example, when New York City closed many of its other public spaces, the subways became a refuge for those without housing. Demonstrating the public health hazard that ensued, more than 100 transit workers have died from COVID-1957 while 6,000 are sick or quarantined.58 New York City and State were forced to take unprecedented action. As of May 6, 2020, the MTA has closed the subways between 1 and 5 am, allowing for deep cleaning and disinfecting and eliminating the overnight shelter that some homeless had come to rely on.59


54 Levin, supra note 48.

55 Id.

56 Id.

57 Id.


Because failure to mitigate housing instability may undermine broader public health goals, we argue that early action to assist the growing number of housing insecure people is essential. To help shed light on what interventions may be most effective for mitigating housing instability, the next Part reviews the major interventions taken during the Great Recession and identifies barriers to their effective implementation. By learning from the past, lawmakers can increase the likelihood that new policies implemented during the pandemic will effectively mitigate housing instability.

II. LEARNING FROM HISTORY: POLICY FAILURES AND THE GREAT RECESSION

This Article has argued that unmitigated housing instability has the potential to undermine the public health response to COVID-19. For this reason, an effective policy response during the pandemic must include preventative policies that keep owners and renters in their homes, as well as a housing safety net that facilitates rapid rehousing of people who lose their homes to foreclosure or eviction. Because mitigation of housing instability was at the center of the policy response to the Great Recession, an analysis of interventions during that period can help inform current policymaking.

This Part will analyze key foreclosure prevention strategies and people and place-based interventions implemented during the Great Recession to mitigate housing instability. Through this analysis, this Part identifies barriers to the effective mitigation of housing instability, including the over-reliance on incentives, the prioritization of place-based interventions over people-based assistance, implementation challenges, and low participation. Based on this analysis, this section highlights three important lessons relevant to the COVID-19 response: (1) housing payment assistance may be more effective than indirect interventions, (2) grants may be more effective than tax expenditures during crisis periods, and (3) place-based investment in neighborhoods may be necessary.

As of May 3, 2020, NY Penn Station’s Amtrak and NJ Transit concourses will also be closed from 1 am until 5 am for intensive cleaning of the transit hub and trains.
A. Foreclosure Prevention During the Great Recession

During the Great Recession, both the Bush and Obama Administrations “relied on incentives and subsidies to lenders and servicers to modify loans.” However, as this section will explain, the success of these programs was hindered by slow program rollouts, their voluntary nature, low participation by banks, prohibitively restrictive eligibility requirements, and a reluctance among regulators to administer the programs to their fullest potential. Unless these barriers are addressed, similar loan modification programs are unlikely to effectively mitigate housing instability during the pandemic.

The first significant federal effort to slow foreclosures during the Great Recession was the Bush Administration’s FHASecure program, which encouraged lenders to modify adjustable-rate mortgages. That program was followed by two other Bush-era loan modification programs, the Hope Now Alliance, and the Hope For Homeowners program. All of these programs fell short of expectations.

FHASecure resulted in a mere 4,212 loan modifications (as compared to 80,000 predicted modifications). Hope Now Alliance was “responsible for only approximately 9% of loan modifications in the first six months of 2008” and 2% in the second half of the year. The Hope for Homeowners program also “failed to get any traction” and only 340 loans were modified under the program in 2010. This number was disappointing as 400,000 loan modifications were anticipated.

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62 Zalewski, supra note 60, at 335.
63 Immergluck, supra note 40, at 206.
65 Id.
66 Immergluck, supra note 40, at 206.
67 Id., at 204.
68 Arthur, supra note 41, at 601.
The Obama Administration’s loan modification programs also failed to reach their full potential. These initiatives included the Home Affordable Modification Program (HAMP)\(^69\) and the Hardest Hit Fund created under the Troubled Assets Relief Program (TARP).\(^70\) Under HAMP, eligible homeowners temporarily received a lower interest rate that would become permanent if they did not default.\(^71\) Although 3-4 million homeowners were expected to participate, only about 816,000 homeowners were granted loan modifications during the first two years of the program.\(^72\)

The Hardest Hit Fund earmarked $7.6 billion in federal grants to state housing finance agencies to develop local foreclosure prevention strategies.\(^73\) However, during the first year of the program, only 3% of funds were expended and 7% of projected total homeowners were assisted.\(^74\) Only $478 million of approved funds were spent in the first year and a half.\(^75\) These statistics reflected the low number of loan modifications made during the period. For example, during the first year only three homeowners were approved for debt reduction in Arizona despite the fact that almost half of the state’s homeowners held underwater mortgages.\(^76\)

At least two factors contributed to the failure of these loan modification programs to reach expectations. First, the federal government was reluctant to fully administer these programs. Under the Bush Administration, free-market ideologies resulted in the early programs being “half-hearted and underfinanced.”\(^77\) But the Obama-era foreclosure mitigation efforts suffered from a similar lack of will on the part of federal regulators and government sponsored enterprises (GSEs). According to one

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\(^{70}\) Zalewski, supra note 60, at 335–36.

\(^{71}\) Id. at 336.

\(^{72}\) Id. Frequently homeowners resorted to the courts in order to secure loan modifications under HAMP following lender intransigence. See Begum et al. v. J.P. Morgan Chase Bank, N.A. et al., No. 1:10-cv-02014 (E.D.N.Y. May 6, 2010). One of the authors of this Article was part of the legal team that filed this case.

\(^{73}\) Zalewski, supra note 60, at 336.

\(^{74}\) Blair D. Russell et al., Take-Up of Mortgage Assistance for Distressed Homeowners: The Role of Geographic Accessibility, 24 J. HOUS. ECON. 57, 58–59 (2014).

\(^{75}\) Zalewski, supra note 60, at 336.


\(^{77}\) Zalewski, supra note 60, at 338.
report on the Hardest Hit Fund, “the two largest mortgage guarantors, Fannie Mae and Freddie Mac, [would] not participate” in the program.\textsuperscript{78} The GSEs and then-director of the Federal Housing Financing Agency Edward J. Demarco had taken the position that reducing mortgage principal was “bad for business, and as a result bad for taxpayers.”\textsuperscript{79} This experience suggests that significant political challenges stand to limit the effectiveness of loan modification programs.

Second, all of these loan modification programs relied on voluntary participation by both lenders and homeowners. Lenders were reluctant to participate due to “the market structure of mortgages and securitization that may complicate renegotiations, lack of incentives and authority for servicers to modify loans, and overall servicer congestion and lack of capacity to process applications.”\textsuperscript{80} On the borrower-side, voluntary participation was affected by program awareness, eligibility criteria, and the extent to which homeowners persisted throughout the application processes.\textsuperscript{81} One researcher found that proximity to intake agencies affected take-up rates.\textsuperscript{82} Another noted that some homeowners may have been reluctant to participate due to the fact that the modifications would cost them “half of future appreciation and significant pride.”\textsuperscript{83}

Unless these barriers can be overcome, incentive-based programs like these may be ineffective to mitigate housing instability, particularly in cases of prolonged unemployment caused by an ongoing pandemic.\textsuperscript{84}

\textbf{B. Place-Based Interventions During and After the Great Recession}

Although the policy response during the Great Recession centered on foreclosure prevention, some efforts were made to increase the supply of affordable housing. Two significant place-based interventions included in the Housing and Economic Recovery Act of 2008 (HERA)\textsuperscript{85} were the

\begin{footnotesize}
\footnote{Dewan, supra note 76.}
\footnote{Id.}
\footnote{Russell, supra note 74, at 59.}
\footnote{Id.}
\footnote{Id. at 65, \(\text{(noting the “greater distances associated with lower percentages of complete applications.”)}\)}
\footnote{Arthur, supra note 41, at 599.}
\footnote{Dan Immergluck, \textit{The Foreclosure Crisis, Foreclosed Properties, and Federal Policy: Some Implications for Housing and Community Development Planning}, 75 J. AM. PLAN. ASS’N 406, 415 (2009) (“Borrowers suffering from long spells of unemployment are less likely to be helped by moderate reductions in mortgage payments.”)}
\end{footnotesize}
expansion of the low-income housing tax credit (LIHTC) program and provision of emergency funding for rehabilitation of abandoned and foreclosed homes (the Neighborhood Stabilization Program).

Subsequent legislation doubled down on the place-based approach. The fiscal stimulus package included in American Recovery and Reinvestment Act of 2009 (ARRA) included supplemental grant funding to bolster the LIHTC program and an appropriation to the Public Housing Capital Fund for rehabilitation of vacant rental units. Later, when certain low-income areas failed to recover from the recession, lawmakers introduced the Opportunity Zones tax incentive to further combat blight in distressed neighborhoods. This section analyzes the impact of these interventions and argues that place-based interventions were insufficient to mitigate the spike of housing instability in the short-term.

1. LIHTC Expansion and Supplemental Grants

HERA made several statutory changes to the LIHTC program, including: increasing the size of the program, expanding the 9% credit; 

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86 HERA §§ 3001-05. The LIHTC provides for a tax credit equal to the “applicable percentage” of the qualified basis of each qualified low-income building. I.R.C. § 42. The tax credit functions as a supply-side subsidy for affordable housing and is the largest federal subsidy for affordable housing production. Tracy A. Kaye, Sheltering Social Policy in the Tax Code: The Low-Income Housing Credit, 38 VILL. L. REV. 871, 878 (1993).
89 ARRA Title XII (Home Investment Partnerships Program).
90 ARRA Title XII (Public Housing Capital Fund).
93 HERA § 3002. The applicable percentage is the yield over a ten-year period. It is common to refer to “4% credits” (used for rehabilitation projects or tax credits
adding a discretionary “basis boost” to provide a larger tax credit for select projects;\textsuperscript{94} and the expansion of acquisition and rehabilitation credits.\textsuperscript{95} Despite these changes, investor appetite declined the following year.

A significant barrier to the effective mitigation of housing instability through tax expenditures is the fact that tax relief is not as attractive to investors during recessions as it is during periods of growth. In a growing economy, financial institutions readily invest in LIHTC projects in order to reduce their income tax burden.\textsuperscript{96} However, the recession “reduced the profitability of banks and other financial institutions that were large LIHTC investors.”\textsuperscript{97} With less tax liability to offset, these investors no longer needed nonrefundable tax credits, and demand for the newly expanded tax credits decreased.\textsuperscript{98}

To address this problem, ARRA authorized the Tax Credit Assistance Program (TCAP) to provide supplemental grants for LIHTC automatically awarded for projects financed with tax-exempt bonds) and “9% credits” (competitively allocated tax credits for new construction projects). Historically, the “9% credit” floated between 7.35% and 9.27%. Congressional Research Service, \textit{An Introduction to the Low-Income Housing Tax Credit} (Feb. 27, 2019). HERA established a 9% floor for the applicable rate for the competitive 9% tax credits. Without this change, the applicable rate would have been 7.94% in August 2008. GAO, supra note 92, at 9. Initially only applicable to projects placed in service prior to 2013, the change was made permanent in 2016. Consolidated Appropriation Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015), I.R.C. § 42(b)(2). HERA also expanded the number of projects eligible for the 9% credit by narrowing the definition of ineligible federally subsidized projects. HERA § 3002(b), I.R.C. § 42(i)(2)(A). Prior to the change, “if any part of a building’s eligible basis was federally subsidized, the building was ineligible for the 9 percent credit.” GAO, supra note 92, at 9.\textsuperscript{94} HERA provided for a discretionary basis boost whereby state housing authorities could treat individual projects “as if” they were in difficult development areas. HERA § 3003(a). This gives housing finance authorities “the ability to designate any building, regardless of location, as eligible for an enhanced credit of up to 130 percent of the building’s eligible basis” (rather than 100 percent). GAO, supra note 92, at 9. I.R.C. § 42(d)(5)(B)(v). Some states have used this flexibility to locate LIHTC projects in higher opportunity neighborhoods, while others did not do undertake such efforts. See Blaine G. Saito, \textit{Collaborative Governance and the Low-Income Housing Tax Credit}, 39 VA. TAX REV. 451, 487–88 and accompanying notes (2020).\textsuperscript{95} HERA relaxed the 10-year waiting period for rehabilitation of existing buildings. HERA § 3003(f), I.R.C. § 42(d)(6). Prior to the change, “the acquisition cost of an existing building would not be eligible for the credit unless there was a period of at least 10 years between the date” acquired and placed in service. GAO, supra note 92, at 9.\textsuperscript{96} Id.\textsuperscript{97} GAO, supra note 92, at 10.\textsuperscript{98} Id.
projects.\footnote{Congressional Budget Office, \textit{Federal Housing Assistance for Low-Income Households}, CBO (2015), http://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50782-lowincomehousing.pdf. Note that ARRA included a total of $17.2 billion for housing assistance programs. According to the CBO, “[m]ore than one-third of that amount went to projects that had received assistance from the Low-Income Housing Tax Credit (LIHTC), public housing improvements accounted for about one-quarter of that spending, as did the combination of community development programs and assistance to the homeless. The rest went to owners of project-based rental assistance (PBRA) properties.” \textit{Id.} at 8. \textit{See also} GAO, \textit{supra} note 92, at 11; ARRA, Title XII (Home Investment Partnerships Program).} A related program, the Tax Credit Exchange Program, allowed state housing finance agencies to exchange portions of their housing credit ceiling for cash grants to finance low-income housing.\footnote{GAO, \textit{supra} note 92, at 11.} Data limitations make it difficult to fully assess the impact of these interventions. Our analysis of LIHTC project allocations from 2008–2011 reflects 208 projects financed with the TCAP subsidy.\footnote{LIHTC Database Access, HUD USER, https://lihtc.huduser.gov/ (last visited May 7, 2020). Data analysis on file with author.} Over half of the TCAP allocations were made in 2009, when 131 projects (approximately 9\% of projects) were supplemented by the grants.\footnote{\textit{Id.}} This suggests that, at minimum, the program was implemented quickly.

Nevertheless, the Department of Housing and Urban Development (HUD) records suggest that the number of LIHTC subsidized projects placed in service declined sharply during the period from 2008–2010.\footnote{GAO, \textit{supra} note 92, at 22. Drawing on HUD data, the GAO reported that 1,225 projects were placed in service in 2007; 1,286 in 2008; 886 in 2009; and 594 in 2010. \textit{Id.}} Although the GAO found that the interventions “likely prevented even further decreases in LIHTC projects after 2008, particularly in rural areas,”\footnote{\textit{Id.} at 24.} the declines suggest that the interventions were insufficient to fully overcome the market forces that chill LIHTC investment during recession periods.

2. Rehabilitation Subsidies

a. Interventions During the Great Recession

In addition to increasing the need for affordable housing, the waves of foreclosures during the Great Recession increased the number of foreclosed properties in many metropolitan areas.\footnote{Immergluck, \textit{supra} note 84, at 409.} As a result, a major

\footnote{\textit{Id. at} 8. \textit{See also} GAO, \textit{supra} note 92, at 11; ARRA, Title XII (Home Investment Partnerships Program).}
policy question during and after the crisis was how to deal with vacant properties. While “[a]ddressing problems associated with neighborhood blight are typically the responsibility of local government agencies . . . the scale of the housing crisis exceeded the resources of many local governments.”

The primary federal intervention was the Neighborhood Stabilization Program (NSP) introduced by HERA. The program, implemented in the fall of 2008, provided $3.92 billion in emergency funding to state and local governments for rehabilitation of abandoned and foreclosed homes. Another $2 billion was subsequently appropriated under the ARRA and a final round of $1 billion in funding was included in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The purpose of the NSP was to “mitigate the impact of foreclosures on neighborhoods by reducing the stock of distressed properties, removing visual blight and sites of crime, and signaling to residents that the neighborhood was capable of improvement.” Local governments and nonprofits were tasked with using the funds for five approved activities: “rehabilitation or redevelopment of foreclosed and vacant properties, demolition of blighted structures, land banking, and stand-alone financing for purchase or development of affordable housing.” The majority of NSP funds were allocated to state and local government entities and local nonprofits, though “several national organizations, including Habitat for Humanity, also received funds.”

The outcomes of the NSP program were uncertain. Some early observers expressed optimism that the program would encourage investment in rental housing, noting that “[o]ne known outcome is that many NSP

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107 HERA § 2301.  
108 Immergluck, supra note 40, at 219.  
109 ARRA Title XII (Community Development Fund).  
110 Immergluck, supra note 40, at 210.  
112 Id. at 31.  
114 See generally Laura Schwarz, The Neighborhood Stabilization Program: Land Banking and Rental Housing as Opportunities for Innovation, 19 J. AFFORDABLE HOUS. & CMTY. DEV. L. 51 (2009).
awardees have purchased properties to ‘land bank’ them for future affordable housing development.” Other studies predicted that NSP investment would have a “multiplier effect” whereby private market investors choose to invest in areas that have received NSP subsidies. Still others noted the long-term benefits that might arise from the organizational and coalition capacities put in place. Meanwhile, one community and economic development attorney provided an anecdotal account of a nonprofit using NSP funds to combat blight in a low-income Miami neighborhood without social displacement.

On the other hand, an early report by researchers at Enterprise Community Partners noted that less than half of the funds were being used to develop affordable rental housing. Later studies reported mixed impact on neighborhoods, with some targeted census tracts exhibiting statistically significant reductions in distressed properties compared to non-targeted tracts, but others noting no significant differences. One researcher speculated that the lack of consistent results might be due to “the small scale of [NSP] activity in most targeted areas.” Others have pointed to administrative complexity and the short time frame as barriers to participation.

b. Post-Recession Intervention

Significantly, the spatially uneven recovery from the Great Recession—the effects of which are still visible in many low-income neighborhoods—was an important impetus for the enactment of the Qualified Opportunity Zones legislation. This tax incentive, created by

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115 Fraser & Oakley, supra note 113, at 38.
116 Id. (citing Carolina Reid, The Neighborhood Stabilization Program: Strategically Targeting Public Investments, 23 COMMUNITY INVESTMENTS 23 (2011)).
117 Fraser & Oakley, supra note 113, at 38.
120 Schuetz, Spader & Cortes, supra note 106, at 31.
121 Id. at 45.
122 Fraser & Oakley, supra note 113, at 39.
the Tax Cut Jobs Act (TCJA) of 2017,\textsuperscript{124} was not part of the emergency response to the Great Recession. However, its subsequent enactment constitutes an important post-recession legal development that merits discussion due to its prominent position among existing place-based incentives.

The Opportunity Zones tool is the latest place-based tax incentive to encourage investments in distressed neighborhoods.\textsuperscript{125} Specifically, the law provides for favorable tax treatment of capital gains that are reinvested into qualified opportunity funds (QOFs).\textsuperscript{126} A QOF is a corporation or partnership formed to invest in qualified opportunity zone property.\textsuperscript{127} Qualified opportunity zones were designated in each state by the Treasury Department after being nominated by the states’ respective governors.\textsuperscript{128} Each governor was allowed to nominate a number of census tracts within their state not exceeding 25% of the number of low-income communities\textsuperscript{129}

\textsuperscript{125} Many studies unfortunately show that place-based tax policies have not had a measurable impact on alleviating poverty. Michelle D. Layser, The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform, 2019 Wis. L. Rev. 745, 766 (2019).
\textsuperscript{126} See generally I.R.C. § 1400Z–2. Specifically, a taxpayer who realizes a gain from a sale of property and reinvests that gain in a QOF within a designated timeframe may defer recognition of the gain. I.R.C. § 1400Z–2(a)(1), (b)(1). See also, IRS Notice 2020-39, Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic (June 4, 2020). Furthermore, if a taxpayer holds the QOF investment for at least 10 years, the taxpayer may increase the basis to the fair market value at the date of sale. I.R.C. § 1400Z–2(c). If at least 5 years, the taxpayer increases the basis by an amount equaling 10% of the amount of gain deferred. I.R.C. § 1400Z–2(b)(2)(B)(iii). If at least 7 years, the taxpayer further increases the basis by an amount equaling 5% of the amount of gain deferred. I.R.C. § 1400Z–2(b)(2)(B)(iv). In effect, the taxpayer gets to both defer payment of taxes on the taxpayer’s initial capital gains and to eliminate the capital gains taxes on the QOF investment. I.R.C. § 1400Z–2(c).
\textsuperscript{127} I.R.C. § 1400Z–2(d)(1). Specifically, the fund must hold at least 90% of its assets in such property. Id. See IRS Notice 2020-39 for a temporary relaxation of this rule. IRS Notice 2020-39, Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic (June 4, 2020). Opportunity zone property can be QOZ stock, QOZ business property, or a QOZ partnership interest. I.R.C. § 1400Z–2(d)(2)(A).
\textsuperscript{128} I.R.C. § 1400Z–1(b)(2)(C).
\textsuperscript{129} Low-income communities are defined as such based-on poverty rates and median family income, as per I.R.C § 45D(e), the New Markets Tax Credit program. See THE PROMISE OF OPPORTUNITY ZONES, JOINT ECON. COMM. (Nov. 29, 2018), https://www.jec.senate.gov/public/index.cfm/republicans/2018/11/the-promise-of-opportunity-zones#_edn1.
within their state. A census tract that was not a low-income community could still qualify if the tract bordered a designated low-income opportunity zone and the median family income did not exceed 125% of that of the bordering, low-income community. There are currently 8,764 designated opportunity zones throughout the United States and its territories.

According to the FDIC, as of September 2019, there were at least 235 self-reported QOFs that collectively hold an estimated $62 billion to $72 billion. However, as the TCJA did not include any reporting requirements for QOFs, we are reliant on various organizations that are collecting data, and this information varies widely. Novogradac estimates that there are now $10 billion in funds raised by 406 QOFs reporting equity investments.

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130 I.R.C. § 1400Z–1(d). In New Jersey, tracts were chosen based on a formula using the Municipal Revitalization Index, which reflected economic indicators such as income, unemployment rate, and property values; access to transit; and the value of existing investments. Opportunity Zones, State of N.J. Dep’t of Cmty. Affairs, https://www.state.nj.us/dca/divisions/lps/opp_zones.html (last visited May 10, 2020). Guidance provided by the House Committee Report suggested considering tracts “that: (1) are currently the focus of . . . private economic development initiatives . . . (2) have demonstrated success in geographically targeted development programs . . . and (3) have recently experienced significant layoffs . . . .” H.R. Rep. No. 115-466, at 538–39 (2017) (Conf. Rep.).


in April 2020. The Opportunity Zones Database (OpportunityDB) reported 133 QOFs with an investment capacity of $43.2B. In March 2020, the National Council of State Housing Agencies (NCSHA) reported 210 QOFs with a total anticipated investment of $47.6B and notes that 63% of these funds target investment in affordable housing and community development.

However, concerns remain about who ultimately benefits from the program. Economist Paul Krugman has criticized the opportunity zone “tax break” as a way for Republicans to “bribe private investors” to spend on infrastructure rather than do so themselves. Other news articles reported that the law was driving billions of investment profits into projects such as high-end apartment buildings, hotels, student housing, and storage facilities. For Opportunity Zones to help distressed communities, there...
must be an affirmative effort for investments to reflect the needs of the residents within those communities.\textsuperscript{140}

Current barriers to using QOFs for affordable housing include the law’s emphasis on increasing property value to receive capital gains tax relief,\textsuperscript{141} a requirement that developers double the basis of rehabilitated property,\textsuperscript{142} the absence of any requirement that QOFs adopt a social mission,\textsuperscript{143} and barriers to engaging nonprofits in Opportunity Zone transactions.\textsuperscript{144} Despite these barriers, the NCSHA has featured three case studies on their website of OZ investments that are developing affordable homes for very-low- to moderate-income households and further community revitalization efforts.\textsuperscript{145}

The first example, the Tappan, is a mixed-use, mixed-income building in Cleveland with 95 apartments, including 59 apartments affordable to households earning between 80\% and 120\% of Area Median Income (AMI), and a ground-floor bakery.\textsuperscript{146} The Tappan is financed with a combination of OZ equity from local investors and debt and OZ equity from PNC Bank, as well as a loan and tax incentives from the City of Cleveland.

The second example is the Ox Fibre Apartments, a historic paintbrush factory in Frederick, Maryland that was repurposed into 83 affordable apartments for families earning between 40\% and 60\% of AMI

\textsuperscript{141} De Barbieri, \textit{supra} note 137, at 37.
\textsuperscript{142} Letter from Daryl J. Carter, Chairman and Chief Executive Officer of Avanath Capital Management, LLC, to Ms. Jennifer DeCaspers, Chief of Staff of the Internal Revenue Service, (June 6, 2019).
\textsuperscript{143} De Barbieri, \textit{supra} note 137, at 28 (explaining the self-certification process).
\textsuperscript{144} Layser, \textit{supra} note 140, at 59.
\textsuperscript{145} \textit{ECONOMIC INNOVATION GROUP (EIG)}, \textit{Opportunity Zone Investments Create Affordable Homes, Support Community Revitalization} (Nov. 20, 2019), https://eig.org/news/opportunity-zone-investments-create-affordable-homes-support-community-revitalization-2 (“These encouraging developments illustrate some of the ways Opportunity Zones are attracting investment in affordable housing and community revitalization.”).
(rents as much as $500 less than market). The financing includes 4% LIHTCs from the Maryland DHCD, federal historic credits, OZ equity, tax-exempt permanent financing from Freddie Mac, and additional debt from state and local sources.

The last example, Parramore Oaks, is an energy-efficient building in Orlando with 96 apartments affordable to families earning between 40% and 60% of AMI, including people with special needs or transitioning from homelessness, and 24 market-rate apartments. It was one of the first developments to combine the OZ tax incentive with 9% LIHTCs, allocated by the Florida Housing Finance Corporation.

Moreover, the White House Opportunity and Revitalization Council established by President Trump has featured affordable housing collaborations in some of its road shows. For example, HUD hosted an Opportunity Zones Convening in Trenton to provide information and resources for municipalities and local stakeholders to attract investments in their cities. New Jersey HMFA Executive Director Richman noted how LIHTCs “are fundamental to expanding affordable housing.” New Jersey revised its guidelines for awarding LIHTCs and now awards points for projects located within an opportunity zone. As the NCSHA case studies

149 Exec. Order No. 13853, 83 FR §65071, Establishing the White House Opportunity and Revitalization Council (2018). On December 12, 2018, President Trump established this Council to further the Administration’s plan to coordinate Federal resources to be used in opportunity zones.
150 HUD Regional Administrator Lynne Patton Convenes in Trenton to Maximize Investments in New Jersey Opportunity Zones, HUD (March 4, 2020), https://www.hud.gov/states/new_jersey/stories/2020-03-04. (Lynne Patton, HUD Regional Administrator for NY and NJ noting “[a]t HUD, we are passionate about this initiative, because we know that Opportunity Zones will elevate distressed neighborhoods by encouraging new business development and creating substantial job opportunities …”)
151 Id.
demonstrated that affordable housing projects need to leverage multiple incentives, the interaction between the LIHTC program and the opportunity zone tool should be carefully examined.

C. People-Based Interventions During the Great Recession

Housing payment assistance to mitigate housing instability was rare during the Great Recession. Few interventions were directed to homeowners themselves, let alone renters. However, two people-based interventions were notable. First, under ARRA, funds were appropriated to HUD for homelessness prevention and rapid rehousing, including short- and middle-term rental assistance for tenants. Second, the Dodd-Frank Act created the Emergency Homeowners’ Loan Program to provide mortgage payment relief to certain eligible homeowners. This section analyzes these interventions and argues that targeted programs to prevent homelessness were generally successful; however, general mortgage payment assistance programs faced many of the same barriers to effectiveness as other foreclosure prevention interventions.

1. Rental assistance

The ARRA created the Homelessness Prevention and Rapid Re-Housing (HPRR) program in 2009. Under the law, $1.5 billion were earmarked for “housing search assistance, temporary rental assistance, and funds to cover security deposits and other one-time or short-term costs associated with securing housing.” These funds were to be used for: financial assistance (short- and medium-term rental assistance, security and utility deposits, utility payments, moving cost assistance, motel and hotel vouchers); housing relocation and stabilization services (case management, outreach, housing search and placement, legal services, credit repair); data collection and evaluation; and administrative costs. The program ran for three years and was discontinued in September 2012.

153 ARRA, Title XII (Homelessness Prevention Fund).
155 ARRA, Title XII (Homelessness Prevention Fund).
156 Id.
158 Brendan O’Flaherty, Homelessness research: A guide for economists (and friends), 44 J. HOUS. ECON. 1, 3 (2019).
Compared to the other interventions discussed in this Part, the HPRR program was relatively successful. According to HUD, almost 700,000 people were served in the first year and nearly all “were subsequently able to obtain or maintain permanent housing.” Because few states had significant homelessness prevention programs in place prior to HPRR, some economists concluded that the federal subsidy probably did not substitute for states’ existing funds. Meanwhile, one researcher found “a significant decrease in the probability of being homeless in school districts that were more likely to have received [HPRR] funds” and having the program either “in the county, or closer to the school district where families live, on average reduces the number of homeless students by five to seven percent.”

These findings suggest that targeted interventions to prevent homelessness through housing payment assistance and supplemental programs may be more effective than indirect strategies (e.g., loan modification programs) to mitigate housing instability during a crisis.

2. Mortgage payment relief

The $1 billion Emergency Homeowners’ Loan Program (EHLP) was created under the Dodd-Frank Act. The EHLP provided “a zero interest, forgivable bridge loan to homeowners who have experienced a substantial loss of income (a reduction of at least 15%) due to unemployment or underemployment caused by adverse economic conditions or medical

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160 O’Flaherty, supra note 158, at 12.
condition.” When the program was introduced, a HUD report estimated that it would benefit as many as 34,474 homeowners.164

However, like other foreclosure mitigation programs, the EHLP failed to meet expectations. The program benefited fewer than 12,000 homeowners165 with only half of the allocated funds being spent.166 Reasons for the deficiency included program start delays and “borrowers having difficulty meeting the eligibility criteria to qualify for assistance.” 167 Although the program was created in July 2010, it was not launched until summer 2011.168 Thus, like the other foreclosure prevention initiatives, the EHLP was ultimately undermined by lackluster participation and a slow government rollout.

D. Lessons for COVID-19

As this Part has explained, many of the interventions used during the Great Recession took the form of incentive programs that encouraged voluntary participation among private market participants. However, participation in these programs was lower than expected due to a variety of factors. Barriers to successful implementation included: resource constraints; the use of incentives rather than more direct controls; a focus on long-term place-based strategies at the expense of more immediate people-based strategies; slow government implementation; a reluctance among regulators to administer the programs; and low-participation rates.

As a result, these programs generally failed to reach their full potential. This section draws on this analysis to highlight three lessons for mitigation of housing instability during the COVID-19 pandemic: housing payment assistance may be more effective than indirect interventions; grants may be more effective than tax expenditures for promoting affordable housing development during a pandemic; and there may be a continued need

163 U.S. DEPT. OF HOUS. & URBAN DEV., How Does EHLP Work?, https://archives.hud.gov/initiatives/ehlp/how.cfm (last visited Apr 30, 2020). Homeowner eligibility was limited to households that earned up to 120% of AMI. Hollar, supra note 43, at 185.
164 Hollar, supra note 43, at 186.
165 Immergluck, supra note 40, at 210.
167 Id.
168 Immergluck, supra note 40, at 210.
for place-based interventions to lift up neighborhoods that are disproportionately affected by the pandemic.

1. Housing Payment Assistance is Preferable to Indirect Interventions

Housing payment assistance may be more effective than indirect interventions for mitigating housing instability. Despite receiving a comparatively small funding allocation, the Homelessness Prevention and Rapid Re-Housing program—one of the few interventions to include housing payment assistance—was arguably more successful than other programs at mitigating housing instability. This suggests that a large-scale, fully funded homelessness prevention program that includes housing payment assistance may be beneficial to mitigate housing instability during the pandemic. However, onerous application processes and restrictive eligibility criteria would likely chill participation, preventing people from receiving the assistance they need.

2. Grants are Preferable to Tax Expenditures

Grants may be more effective than tax expenditures to support affordable housing development. Most of the changes to the LIHTC remain fully or partially in place under current law, raising the question of whether further expansion would be warranted during the COVID-19 pandemic. There are several reasons why statutory changes to the LIHTC may not be effective in the current crisis. First, evidence from the Great Recession suggests that statutory expansions to the LIHTC may be insufficient to promote affordable housing development during a recession period when financial institutions are less profitable. Direct grants like TCAP may be more effective than tax credits at sustaining affordable housing development during crisis periods.

Second, the current value of LIHTCs to investors is lower than it was prior to the Great Recession as tax credits are less valuable to investors with less tax liability. When the 2017 TCJA reduced the highest corporate tax rate from 35% (the rate applicable during the Great Recession) to 21%,

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169 ARRA, Title XII (Homelessness Prevention Fund).
170 See supra notes 92–94.
the value of the LIHTC also declined.171 For example, prior to tax reform, investors in Midwest and Southeast markets would pay $1.05 to $1.10 per dollar of tax credit, an amount that reflected a premium paid for points earned for compliance with the Community Reinvestment Act.172 In 2020, “the vast majority of deals get 90 cents to $1 per credit” in those same markets.173 As a result, roughly 10% of federal dollars spent on affordable housing under the LIHTC projects are captured by investors instead of being utilized by developers. Even if this leakage is deemed acceptable during non-recession periods, it suggests that LIHTC expansion would not be the most efficient use of emergency spending.

3. Place-Based Interventions are Necessary

A third lesson revealed by the uneven recovery after the Great Recession is that place-based interventions are necessary to prevent long-term housing instability following a crisis. In the context of the pandemic, place-based intervention may be especially important if vacancies arise as result of a prolonged pandemic. Both the harms associated with vacant and abandoned properties and the tendency for uneven distributions of such properties have been well documented.174

Figure 2 visualizes data from the HUD’s USPS vacancy dataset to explore state-level variations in vacancies. The chart shows that state-level vacancy rates tend to remain relatively constant over time, with substantial inter-state variation in overall vacancy rates. Vacancy rates rose in all states during the Great Recession and remained elevated for several years before noticeably dropping in 2015.

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172 Id.
173 Id.
174 Layser, supra note 140, at 23–25.
This may be explained in two ways. First, units in weak housing markets are likely to remain vacant for extended periods of time during economic crisis because landlords may prefer to keep units on the market and unrented rather than lowering their prices. This may be the most salient observation for our analysis. Second, units under construction but not yet occupied may remain vacant for long periods of time, and upon completion may take time to be absorbed into the housing market. In either case, prolonged elevated vacancy rates are indicative of housing distress.

States like Michigan that already have high vacancy rates may be particularly vulnerable to such spikes if foreclosures were to result from the pandemic. State-level statistics also mask significant variations across smaller geographic units. During the Great Recession, both the distribution of foreclosures and uneven recovery tended to disadvantage places with lower-incomes and more racial minorities.175 While vacancy rates may not

rise to the same degree during the pandemic, if steps are not taken to mitigate housing instability, similar patterns could emerge.

During the pandemic, vacancies may concentrate in low-income areas for several reasons. Higher population density in low-income areas may lead to a concentration of COVID-19 outbreaks that lead to unemployment and, ultimately, housing instability. Even in the absence of outbreaks, unemployment rates may be higher among residents of low-income neighborhoods if residents’ low-wage positions are not easily adapted to remote-work arrangements. Pre-existing housing insecurity in low-income neighborhoods may make residents particularly vulnerable to such economic shocks. For these reasons, a complete policy response to the current crises should include strategies to mitigate the long-term impact of the pandemic on low-income neighborhoods.

However, experience with NSP suggests that, at a minimum, such interventions may require higher funding levels than past programs if they are to have a significant impact. Ideally, such programs would not only target low-income areas that experience a high rate of vacancies, but would also prioritize areas where such vacancies present actual threats to neighborhoods (e.g., by increasing health risk or facilitating crime).\(^{176}\) Experience with Opportunity Zones also suggests that if place-based tax incentives are used, they should carefully target problem areas and define the activities eligible for subsidies.\(^{177}\) To ensure that the benefits of these interventions flow to neighborhood residents instead of investors, the law should also limit subsidized development to affordable housing and development that is likely to benefit community residents.\(^{178}\)

These lessons, derived from the history of Great Recession era interventions, can help inform current strategies to mitigate housing instability during pandemics like COVID-19. Yet, as the next part will show, the initial policy response has repeated many of the same mistakes that limited the effectiveness of interventions during the Great Recession. Namely, the early interventions have failed to include direct housing payment assistance to homeowners. Though early interventions have included efforts to freeze mortgage and rental payments, those interventions have suffered from lack of enforcement. Meanwhile, the indirect measures taken to mitigate housing instability during the early months of the COVID-19 pandemic...
19 crisis are insufficient to mitigate housing instability. The next Part evaluates these interventions and argues that more direct efforts to mitigate housing instability will be necessary.

III. HISTORY REPEATS ITSELF: THE COVID-19 PANDEMIC

As demonstrated in Part II, a variety of policy tools were implemented during the Great Recession to mitigate housing instability, but few realized their full potential. This Part argues that many of the initial interventions during the COVID-19 crisis face barriers to effectiveness similar to those seen during the Great Recession. These barriers—which include administrative hurdles, reliance on voluntary participation, resource constraints, and political pushback, among others—may prevent these interventions from effectively mitigating housing instability.

A. No Direct Housing Payment Assistance

1. In General

The analysis above demonstrated the importance of including direct forms of housing payment assistance to struggling homeowners and renters. Examples of direct assistance may include cash payments made directly to landlords or lenders, or it may include housing vouchers akin to the current Housing Choice Voucher program. The initial legislative response to the COVID-19 pandemic did not include direct housing payment assistance.

Instead, the initial response relied upon (1) temporary eviction freezes and foreclosure moratoriums, and (2) indirect interventions. As this section will demonstrate, the temporary eviction freezes and foreclosure moratoriums were insufficient to eliminate the need for direct housing payment assistance, and the indirect interventions have failed to fill that gap.

2. Temporary Eviction Freezes and Foreclosure Moratoriums

To mitigate housing instability during the pandemic, policymakers may choose to provide financial assistance in either of two ways: sending people money or temporarily halting their recurring necessary expenses.\(^{179}\) Though the early policy response has embraced both strategies, housing instability has been mitigated primarily through the latter approach. In fact,

the most direct early interventions to mitigate housing instability has taken
the form of foreclosure moratoriums and eviction freezes.\textsuperscript{180}

Federal law has been used to freeze evictions and stave off
foreclosures on federally financed properties. The CARES Act provides for
nationwide foreclosure moratoriums, forbearance rights, and eviction
freezes.\textsuperscript{181} Under the law, borrowers of federally backed mortgages may
request forbearance for up to 180 days, with an additional 180 day
forbearance period permitted.\textsuperscript{182} Meanwhile, servicers of federally backed
mortgages may not foreclose on defaulted loans until at least August 31,
2020.\textsuperscript{183}

The law also places a temporary moratorium on eviction filings
against tenants living in buildings financed with federally backed
mortgages.\textsuperscript{184} The Urban Institute estimates that “eviction moratoria
covering federally financed properties will apply to roughly 12.3 million
(28 percent) of the 43.8 million [U.S.] rental units.”\textsuperscript{185} State-level eviction

\textsuperscript{180} See Elmsford Apartment Assocs., et al. v. Cuomo, Governor of New York, No. 20-
EO 202.28 which, \textit{inter alia}, temporarily halts evictions of financially impacted tenants
during the COVID-19 pandemic.)

\textsuperscript{181} Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. 116-136,
§ 4022 (2020). Specifically, the law applies to any loan for a one to four-family home
insured by Federal Housing Administration, Department of Veterans Affairs, Department
of Agriculture, or purchased or securitized by Federal Home Loan Mortgage Corporation
or Federal National Mortgage Association. CARES Act § 4022(a)(2). The CARES Act
also mandates foreclosure forbearance for greater than four-family housing, allowing for
up to three 30-day forbearance periods for mortgage payments due. CARES Act §
4023(c).

\textsuperscript{182} CARES Act § 4022(b). The Stout analysis cites a Furman Center study that reports,
“About 20 percent of New York City renters live in 2-4 unit buildings. Across the
nation, 34 percent of renters live in single-family homes, with an additional 17 percent in
2-4 unit buildings. Rental arrears may pose particular problems for owners of smaller
buildings, placing those owners at risk of maintaining mortgage payments.” \textit{See also}
STOUT, supra note 8, at 34.

\textsuperscript{183} CARES Act § 4022(c)(2); Brenda Richardson, \textit{Government Agencies Extend
Foreclosure And Eviction Moratoriums}, FORBES,
https://www.forbes.com/sites/brendarichardson/2020/06/17/government-agencies-extend-

\textsuperscript{184} CARES Act § 4024(b).

\textsuperscript{185} Laurie Goodman, Karan Kaul & Michael Neal, \textit{The CARES Act Eviction Moratorium
Covers All Federally Financed Rentals—That’s One in Four US Rental Units}, URBAN
INSTITUTE (2020), https://www.urban.org/urban-wire/cares-act-eviction-moratorium-
covers-all-federally-financed-rentals-thats-one-four-us-rental-units (last visited July 19,
2020).
freezes have supplemented the federal law in order to cover additional tenant populations. As shown in Appendix A, at least 43 states have implemented eviction freezes in the first few months of the pandemic, and at least 31 states have imposed foreclosure moratoriums. However, these state-level interventions vary with respect to the populations covered, their duration, and the degree of protection.\(^{186}\)

When they apply, these foreclosure moratoriums and eviction freezes are mandatory direct regulation, which differs from the voluntary loan modification incentives used during the Great Recession. Compared to the voluntary programs of the previous crisis, these efforts have been relatively successful at preventing a wave of foreclosures and evictions even as unemployment levels have spiked to unprecedented levels.\(^{187}\) However, in addition to the limited coverage of the freezes, these interventions have been hindered by at least two factors: uncertainty about how past-due payments should be treated once the moratoriums and freezes are lifted, and an informal (and often illegal) practice of evicting tenants without initiating formal eviction procedures through the court system.

Although banks have complied with the mortgage foreclosure moratoriums, the law provided little guidance as to how the moratoriums should be structured, and the approaches taken by banks has varied. Early reports indicated that at least some banks intended to require borrowers to repay missed payments in a lump sum at the end of the forbearance period.\(^{188}\) Many borrowers worried that they would be unable—after months of unemployment—to repay the full forbearance amount at the end of the period. While the unemployment assistance and stimulus payments discussed in Part III.B. below may enable some borrowers to comply with such terms, others may be unable to do so if they experience delays or are ineligible for those relief payments.


\(^{187}\) See FISHER & FOX, supra note 61 (arguing that government programs to modify mortgages need to be more robust and include principal write-downs).

In response to these concerns, “the Federal Housing Finance Agency announced that servicers of mortgages backed by Freddie Mac and Fannie Mae should not require lump sum repayments once the forbearance period ends.” However, borrowers with privately held mortgages—about 30% of mortgage holders—are not protected by those rules, and many continue to face burdensome repayment requirements. Among homeowners with federally-guaranteed mortgages, “confusion has lingered, with homeowners whose mortgages are backed by the government still being told that they’d have to make lump-sum payments when they resumed their loans.”

Similarly, questions remain as to what will happen once eviction freezes and mortgage moratoriums are lifted. Most eviction freezes permit widespread eviction as soon as the freezes are lifted. Unless the social safety net is sufficient to ensure that such people will receive assistance that enables them to pay their housing payments when due, the current moratoriums and freezes may simply delay—rather than prevent—waves of foreclosures and evictions.

However, it is important to note that even during the covered period, the effectiveness of eviction freezes has been undercut by lack of enforcement. According to some reports, “landlords and even public-housing authorities in some states have continued to file for eviction without consequences.” In other cases, landlords are using illegal “self-help” evictions to evict tenants without using formal court procedures, such as by changing tenants’ locks or making threats. Low-income tenants may be particularly vulnerable to these tactics due to lack of attorney representation, lack of knowledge about their rights, and fear of legal repercussion.

Thus, these interventions fail to eliminate the need for direct housing payment assistance. The CARES Act included no such assistance. Instead, the law included several indirect efforts to mitigate housing instability

189 Id.
191 Id.
192 Lab, supra note 183.
193 Rebecca Burns, Landlords Illegally Evicting Tenants, Despite Federal Restrictions, AM. PROSPECT, Apr. 23, 2020, https://prospect.org/api/content/a9dd126e-84e1-11ea-8b47-1244d5f7c7e6/.
194 Semuels, supra note 15.
through monetary relief to individuals and employers. The next section argues that these interventions are insufficient to prevent housing instability.

3. Overreliance on Indirect Interventions

a. Monetary Relief for Individuals

i. Unemployment Assistance

Among the indirect forms of relief, the most promising early intervention to prevent housing insecure people from slipping into homelessness has been a major expansion of the unemployment insurance safety net. The CARES Act expands unemployment insurance along numerous dimensions. It expands: (1) the qualification criteria for covered workers; (2) the amount of time people are eligible to remain within the unemployment compensation system; (3) the amount of benefits people receive from unemployment compensation; and (4) the availability of short-time unemployment compensation, otherwise known as work-share programs. All of these interventions have significant potential to mitigate housing instability.

However, the effectiveness of these interventions may be limited by a number of factors. These include structural features of state unemployment programs, administrative challenges and implementation delays, and the voluntary nature of some of the interventions. As a result, the capacities and actions of state governments and private market participants may present barriers to effective administration of the federal unemployment assistance program.

The most significant expansion of unemployment insurance under the CARES Act is the Federal Pandemic Unemployment Compensation (FPUC) program, which provides an additional $600 per week to anyone receiving any form of unemployment insurance compensation until July 31, 2020. The potential reach of this benefit is bolstered by two other changes

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196 CARES Act § 2104(b). This extra $600 per week is disregarded for purposes of determining eligibility for Medicaid and the Children’s Health Insurance Program (CHIP). CARES Act § 2104(h). The CARES Act also supports short-time compensation programs known as work-share programs. This program allows employers to reduce employees’ hours to avoid lay-offs. I.R.C. § 3303(v); U.S. DEPT. LABOR, SHORT-TIME COMPENSATION (STC), https://oui.doleta.gov/unemploy/stc.asp (last visited May 5, 2020). In return, employees of a participating employer can collect unemployment benefits to
under the law—expanded eligibility criteria and extended coverage periods. However, for reasons to be explained in this section, implementation delays and the structure of states’ existing unemployment systems may nevertheless limit the program’s potential to mitigate housing instability.

At the outset, it is worth noting that the scope of unemployment assistance under the CARES Act is unprecedented. The $600 supplement to states’ existing unemployment insurance is sufficient to bring the national average replacement rate, the ratio of average unemployment benefits to averages wages in each state, close to 100%. For many low-wage workers, the extra $600 per week could yield more compensation than if they had remained employed.

The law also provides significant support to many workers who normally would not qualify for unemployment benefits. Specifically, self-employed individuals (e.g. gig workers), part-time employees, and those with limited employment history may be eligible to receive up to 39 weeks of benefits if they are unable to work as a result of COVID-19. The CARES Act also provides an extension of unemployment compensation for those who have exhausted their regular and extended unemployment benefits. This thirteen week extension includes the normal unemployment compensation and the additional $600 per week.

cover part of the lost income from the reduction in hours. Id. However, as of May 9, fewer than 1% of the 31 million Americans collecting unemployment were doing so under the short-time compensation program. Greg Iacurci, This is a lucrative — but little-used — unemployment benefit: “It’s a complete windfall”, CNBC (2020), https://www.cnbc.com/2020/06/02/work-sharing-programs-are-a-lucrative-but-little-used-unemployment-benefit.html (last visited Jul 19, 2020).


Id.

CARES Act §§ 2102(a)(3)(A)(ii)(I); (a)(3)(A)(ii)(II); (c)(1); (c)(2). CARES Act § 2102(a)(3)(A)(ii)(I) outlines 11 reasons that qualify one as unemployed as a result of this pandemic. Note that some categories of workers, such as undocumented immigrants and those who work in criminalized markets (e.g., sex work, illegal drug sales) are not covered by unemployment insurance. Though there may be strong public policy reasons to exclude such groups from coverage, the failure to assist these groups will leave them particularly vulnerable to housing instability.

CARES Act § 2107(a)(1)-(3).

CARES Act § 2107(a)(4).
If effective, these interventions stand to mitigate housing instability by providing unemployed workers the income support necessary to allow them to meet necessities, including rents and mortgages. However, some features of the program may prevent the law from realizing its full potential. Most significantly, all of these programs are funded by the federal government but left to the states to administer and deliver. This structure may result in regional variations in implementation that render the program more effective in some places than others. Such variation will likely stem from: (1) differences in states’ capacities to administer an unemployment insurance program of this scale, and (2) differences in states’ capacities or willingness to provide large unemployment insurance safety nets.

In many states, the unemployment insurance system has been overwhelmed by the sheer volume of applications for benefits. In some states, this problem has been compounded by an IT infrastructure of antiquated hardware that could not handle the sudden rush of claims. Meanwhile, states have been tasked with the implementation and administration of new unemployment benefits under the CARES Act and had to rapidly increase the number of government employees available. Even with the additional flexibility provided under the CARES Act, this has resulted in significant delays in implementation.

204 CARES Act § 2106 (allowing some level of staffing flexibility to state unemployment agencies).
As a result, many self-employed people, such as gig workers, have been unable to promptly receive unemployment benefits. Claiming unemployment benefits has required significant persistence on the part of unemployed workers to overcome the administrative hurdles. Lack of persistence may negatively impact take-up rates. If unable to receive their entitled benefits, some are likely to lose housing quickly, and especially when eviction freezes and foreclosure moratoriums expire.

Even if perfectly implemented, the law would likely mitigate housing insecurity in some states more effectively than others. The reason stems from differences in states’ capacities or willingness to provide large unemployment insurance safety nets. For example, state laws vary in the duration and level of generosity of their weekly unemployment benefits. Although the $600 supplement may help fill gaps, it applies uniformly and does not adjust for cost of living. As a result, the real economic value of the federal benefit will vary across geographies, making it particularly important that states’ baseline unemployment benefits provide a sufficient safety net. Furthermore, some states, like Florida, have placed onerous restrictions on unemployment and other social safety net programs, making it difficult for people to access them even in times of need. As a result, restrictions designed to prevent benefits from reaching the wrong people may cause significant harms to those who are entitled to benefits.

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206 Thomson-DeVeaux, supra note 203.

207 Id.; Koeze, supra note 197; Schwartz et al., supra note 202.


209 Weeds, supra note 202. Indeed, as of July, about three months after the passage of the CARES Act’s expanded unemployment benefits, many people entitled to these benefits still have not had their claims processed or received benefits. Eli Rosenberg, *Workers are*
In addition to these barriers to effective implementation, other problems loom. First, the limited duration of the federal supplement may remove an important intervention that helps those who are housing insecure. A failure to extend this program may harm people in those states with inadequate benefits exacerbating housing instability.\textsuperscript{210} This would lead to a public health crisis by potentially creating a surge of the homeless population that, in turn, leads to a new surge in COVID-19 cases and deaths.

Second, states’ fiscal health may present additional risks. While the new benefits are fully funded by the federal government, traditional regular benefits and extended benefits are still partially funded by the states. With a fall in revenues, states now have had to borrow from the federal government to meet these needs, which could lead to additional delays and future fiscal crises that exacerbate housing instability.\textsuperscript{211}

\textit{ii. Stimulus Payments}

In addition to ongoing unemployment assistance, the CARES Act also provided for a single cash payment to be delivered to all people—regardless of work status—except for nonresident alien individuals and individuals claimed as dependents on other people’s returns.\textsuperscript{212} Because the law does not contain any minimum income requirement, the payment is available to even the poorest individuals.\textsuperscript{213} For this reason, although the payment is primarily intended as an economic stimulus, it also serves as a limited social safety net for many recipients. This payment may be especially important in cases when unemployment assistance is delayed.

\begin{flushright}
\textit{pushed to the brink as they continue to wait for delayed unemployment payments, WASH. POST, July 13, 2020,}\n\textsuperscript{210}\https://www.washingtonpost.com/business/2020/07/13/unemployment-payment-delays/.
\textit{CARES Act § 2201(a) (to be codified at I.R.C. § 6428(d)).}
\textit{CARES Act § 2201(a) (to be codified at I.R.C. § 6428(d)). Note, however, that recipients must possess and remember a valid social security number in order to claim the payment. Id.}
\end{flushright}
Specifically, the payment was structured as a refundable tax credit to offset individuals’ 2020 tax liability—but the payment was to be paid in advance and adjusted, if necessary, when taxes are filed.\(^{214}\) Subject to phase-outs,\(^{215}\) the amount of the credit was up to $1,200 for an eligible individual, or $2,400 for eligible individuals filing a joint return.\(^{216}\) Eligible individuals with children will receive an additional $500 per child.\(^{217}\)

However, the delivery of stimulus payments has been more difficult than anticipated.\(^{218}\) Despite the effort to simplify the process by distributing payments to taxpayers via direct deposit,\(^{219}\) many people have received amounts that did not cover dependent children or had other glitches.\(^{220}\) Other barriers to the efficient rollout of stimulus payments have included technological issues, missing identification data, and the vulnerability to scammers.

\(^{214}\) CARES Act § 2201(a) (to be codified at I.R.C. § 6428(a), (b), (e), (f)).

\(^{215}\) However, the credit phases out for eligible individuals with an adjusted gross income (AGI) over $75,000. CARES Act § 2201(a) (to be codified at I.R.C. § 6428(c)(3)). For those eligible individuals who file a joint return, the phaseout starts above $150,000, while for head of households it starts above $112,500. CARES Act § 2201(a) (to be codified at I.R.C. § 6428(c)(1), (2)). The phaseout decreases the credit by 5% for each dollar above these defined thresholds. In other words, for each $100 above the phaseout amount, the credit decreases by $5. \(\text{Id.}\) Thus, for an eligible individual the credit disappears at an AGI of $99,000, at $198,000 for those who file a joint return, and $136,500 for a head of household filer.

\(^{216}\) CARES Act § 2201(a) (to be codified at I.R.C. § 6428(a)(1)).

\(^{217}\) CARES Act § 2201(a) (to be codified at I.R.C. § 6428(a)(2)).


First, technological issues have resulted in the rejection of direct deposits to many low-income taxpayers who used tax preparation services or software to claim their earned income tax credit. Many of these companies allow such taxpayers to pay for the preparation services from their refund. When claimants use these services, a bank account is created by the return preparer for direct deposit, and the money is transferred to the taxpayer after deducting fees. However, when the IRS attempted to deposit stimulus payments into those accounts, the banks rejected the payments. This resulted in confusion and delays for many of the lowest-income taxpayers, many of whom are housing insecure.

Second, missing identification data has delayed payments to a large portion of housing insecure people who have not filed taxes in recent years. People who are not on Social Security or Veterans Benefits must go to a website to enter either direct deposit information or their address. But this application system was only available online, and many poor who are housing insecure lack access to the internet—particularly when libraries and free tax clinics are closed due to shelter-in-place orders. This inability

222 Id.
223 Id.
224 Id.
225 Id.
228 Rubin, supra note 227.
to access the application website means that many low-income people may experience delays or never receive their payment.

Third, scams have emerged as a serious problem, particularly for those who have not recently filed taxes. As a result of data breaches, the dark web is full of personal information that criminals can use to claim non-filers’ stimulus payments If non-filers fail to claim their payments via the website described above, then an identity thief may claim their payment instead. For this reason, in addition to addressing the internet access issues, it will be essential to raise awareness about the availability of stimulus payments and the steps needed to claim them. Otherwise, take-up rates may be lower than anticipated.

In addition to these barriers to effective implementation, unintended transaction costs may also undermine the goals of the economic stimulus payments. About 6.5% of Americans do not have a bank account, and about 25% of all Americans are underbanked, meaning that although they have a bank account, “they use other financial services.” When receiving a check like the stimulus payment, many of these individuals turn to check cashers, who charge exorbitant fees. Other options like pre-loaded ATM cards or other Fin Tech payment delivery may be appealing for speed, but fees may reduce the amount of the money that reaches the recipient.

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230 Id.
231 Id.
233 Lieber & Rappeport, supra note 226.
Furthermore, the effectiveness of the economic stimulus payments for mitigating housing instability may be limited by features of the law itself. For example, the statute excludes several groups of people who may disproportionately experience housing instability, including nonresident aliens and those without work-authorized social security numbers, such as undocumented immigrants. These exclusions may lead to a spike in homelessness within these vulnerable populations. Although the law provides additional stimulus to households with children, it excludes adult dependents from this calculation. As a result, the parents of college students or caregivers of elderly dependents will not receive additional stimulus payments despite the extra costs associated with supporting them. To the extent that current economic conditions strain the finances of these families, the lack of additional stimulus support may lead to housing instability among these families.

Finally, because the statute provides for flat $1,200 payments throughout the country, the impact of the payment will vary based on cost-of-living. For example, a family living in a high housing cost area—including some of the major metropolitan areas that have become public health hot spots—may not see significant financial relief from these payments. Residents of lower cost-of-living areas, on the other hand, may benefit greatly from the payments. The lack of any adjustment to take into account variations in regional housing costs or other cost-of-living indicators could lead to a geographically uneven distribution of mitigation for housing instability.

Thus, although the stimulus payments have the potential to reach low-income populations that may be overlooked by the other interventions targeted specifically to workers, several challenges exist that may limit the impact of the program. As this section has explained, the full potential for the stimulus program to mitigate housing instability may be limited by implementation problems, transactions costs, and structural aspects of the

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236 Id.
238 Rubin, supra note 235.
239 Id.
law that disadvantage certain populations. As a result, some people may encounter delayed payments, reduced payments, or no payments at all—thereby limiting the extent to which the stimulus payments can help mitigate housing instability.\textsuperscript{240}

b. Monetary Relief for Employers

A second form of indirect mitigation of housing instability during the pandemic has taken the form of monetary relief for employers. The CARES Act greatly expanded the amount of funds available for employers to borrow in order to help them keep current staff employed and on payroll. As described below, the new Paycheck Protection Program provides for significant loans to be extended to small businesses. The law also expanded an existing lending program that authorizes the Small Business Administration (SBA) to make loans available to small business employers.\textsuperscript{241} While these programs have the potential to help struggling homeowners and renters indirectly (by assisting their employers), this section argues that their capacity to mitigate housing instability has been limited by their failure to support small businesses.

i. Paycheck Protection Program

The CARES Act created the Paycheck Protection Program (PPP), which authorized $670,335,000,000 in loans to employers.\textsuperscript{242} Eligible loan recipients include small businesses that employ 500 or fewer employees.\textsuperscript{243}

\textsuperscript{240} See Popper, supra note 229 (“‘I cried all day,’ said [Krystal] Phelps, who is about a month away from being unable to pay her mortgage and has cut out everything but the basics, canceling cable and eliminating snacks for the kids. ‘It is a little relief, and then you find out it isn’t happening.’”).

\textsuperscript{241} Small Business Act, Pub. L. 85-536, as amended, § 7(a).


\textsuperscript{243} CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(D). These include nonprofit organizations, veterans’ organizations, or Tribal business concerns. Id. The affiliation rules for businesses in the accommodation and food service industry can
as well as sole proprietors, independent contractors, and self-employed individuals.\footnote{CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(D)(iii).} Under the statute, these borrowers can receive a maximum loan amount that is the lesser of 2.5 times their average monthly payroll amount or $10 million.\footnote{CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(D)(i)–(ii). Independent contractors do not qualify as employees compensated by a business for the purpose of calculating loan forgiveness. 85 Fed. Reg. 20811, 20814 (Apr. 15, 2020) (Q&A 2.p.). An Interim Final Rule also excludes hedge funds, private equity firms, and firms in bankruptcy from the program. 85 Fed. Reg. 23450, 23451 (Apr. 28, 2020) (question 2.a., 4.). Firms that likely could have received capital elsewhere, like publicly traded companies, and thus did not meet the self-certification standard are also excluded but can return funds if they improperly received it by May 14, 2020. Id. at 23451–52 (Q&A 5), modified by 85 Fed. Reg. 30835, 30835–37 (May 21, 2020).} If an employer uses at least 60% of the loan proceeds for payroll costs and any additional proceeds to cover rent, utility payments, and interest on a mortgage, then the loan can be forgiven in full.\footnote{CARES Act § 1102(a)(1)(B), codified at 15 U.S.C. § 636(a)(36)(F). $30 million was set aside for distribution by community financial institutions and insured depository institutions and credit unions with consolidated assets of $10 million to $50 million. Paycheck Protection Program and Health Care Enhancement Act, Pub. L. 116-139, § 101(d), 134 Stat. 620, 621-22 (2020).} These amounts must be paid by the business in the covered period starting with the origination date of the loan and ending on the earlier of 24 weeks or December 31, 2020.\footnote{CARES Act § 1106(d)(8), as amended by Pub. L. 116-142, § 3(b)(2)(B).}

The PPP loans are distributed by banks and other lending institutions, with the SBA as a guarantor of 100% of the loan amounts.\footnote{CARES Act § 1106(a)(3), as amended by Pub. L. 116-142, § 3(b) (extending the covered period from 8 weeks to 24 weeks). The amount forgiven can be adjusted downward if there is a reduction in the number of employees or in the wages of employees, though there are exceptions, for example, if the business, as a result of public health measures cannot resume the same level of activity. CARES Act § 1106(d)(2), (d)(3), as amended by Pub. L. 116-142, § 3(b)(2)(B). Borrowers must certify that the funds are needed to meet ongoing operating costs as a result of current economic conditions. CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(G); 85 Fed. Reg. 20811, 20814 (Apr. 15, 2020) (Q&A t.). In order to qualify for forgiveness, 60% of the loan proceeds must go to payroll costs, while 40% can go to rent, mortgage interest, or utilities. CARES Act § 1106(d)(8), as amended by Pub. L. 116-142, § 3(b)(2)(B).} These institutions were to issue loans on a first-come first-served basis, prioritizing businesses “in underserved and rural markets, including

qualify each location as if it were a separate business concern, so long as there are 500 or fewer employees at each location. CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(D)(iii).

\footnote{CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(D)(i)–(ii). See CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(L) (stating interest must be below 4%); 85 Fed. Reg. 20811, 20813 (Apr. 15, 2020) (Q&A 2.i.) (setting interest rate at 1%).} Firms that likely could have received capital elsewhere, like publicly traded companies, and thus did not meet the self-certification standard are also excluded but can return funds if they improperly received it by May 14, 2020. Id. at 23451–52 (Q&A 5), modified by 85 Fed. Reg. 30835, 30835–37 (May 21, 2020).

\footnote{CARES Act § 1106(d)(8), as amended by Pub. L. 116-142, § 3(b)(2)(B).} In order to qualify for forgiveness, 60% of the loan proceeds must go to payroll costs, while 40% can go to rent, mortgage interest, or utilities. CARES Act § 1106(d)(8), as amended by Pub. L. 116-142, § 3(b)(2)(B).
veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals . . ., women, and businesses in operation for less than 2 years.  

Yet, a series of implementation problems have prevented PPP loans from meeting expectations, particularly in the case of very small businesses. First, delayed issuance of guidance led to mass confusion and long waits in the initial days of the program. Second, banks administered the PPP loans in ways that disadvantaged the smallest businesses. For example, large banks prioritized loans to existing customers with which they had strong relationships. Furthermore, some banks refused to give loans to

businesses that lacked existing loans or credit cards, disproportionately harming smaller businesses and benefiting larger ones.\textsuperscript{252}

Third, although Congress acted to replenish the PPP funding after it initially ran out, as of June 30, about $130 billion in aid remained unused.\textsuperscript{253} Some of the many reasons why there was leftover money stemmed from the fact that many small businesses were concerned as to whether they would have full forgiveness of the loan given the shifting rules of the program.\textsuperscript{254} Furthermore, the botched rollout may have reduced confidence in the program, ultimately chilling uptake during later stages of the program. Finally, many small businesses could not benefit from PPP given the

\textit{Banks Came to the Rescue.}, WALL ST. J., May 4, 2020, https://www.wsj.com/articles/small-businesses-were-at-a-breaking-point-small-banks-came-to-the-rescue-11588590013 (discussing how small banks were more effective at disbursing the funds). Moreover, less than 10\% of Community Development Financial Institutions—the community banks that more frequently lend more equitably, i.e., those that lend at greater rates to women- and minority-owned businesses—are participating in PPP. See Emily Flitter, \textit{Black-Owned Businesses Could Face Hurdles in Federal Aid Program}, N.Y. TIMES, Apr. 10, 2020, https://www.nytimes.com/2020/04/10/business/minority-business-coronavirus-loans.html.


\textsuperscript{254} See Flitter, supra note 253.
relatively short time-frame it covers in light of the potentially long duration of various public health restrictions as the virus ebbs and flows.\textsuperscript{255}

The failure of PPP loans to support many small businesses limits its effectiveness to mitigate housing instability.\textsuperscript{256} First, many women- and minority-owned businesses did not get loans,\textsuperscript{257} despite being specifically listed as intended recipients.\textsuperscript{258} In many cases, the owners of such businesses have invested significant personal capital into their businesses or employ members of their own families.\textsuperscript{259} As a result, they are at particularly high risk of experiencing housing instability.

Second, small businesses are major employers and major players in a community. Even with growing consolidation in the business sector, small businesses still employed 47\% of workers in 2017.\textsuperscript{260} If a small business

\begin{itemize}
  \item The number of active business owners decreased by 3.3 million (22\%) between February and April 2020. Black-owned businesses fell by 41\%, Latinx by 32\%, Asian by 26\%, and female by 25\%. Robert W. Fairlie, The Impact of COVID-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey 1, June 2020, http://www.nber.org/papers/w27309 (noting that the “concentrations of female, black, Latinx and Asian businesses in industries hit hard by the pandemic contributed to why losses were higher for these groups than the national average loss.”) Id. at 2.
  \item U.S. SMALL BUS. ADMIN., OFFICE INSPECTOR GEN., REPORT NO. 20-14, FLASH REPORT SMALL BUSINESS ADMINISTRATION’S IMPLEMENTATION OF THE PAYCHECK PROTECTION PROGRAM REQUIREMENTS (2020), at 4 [hereinafter SBA OIG]; Flitter, supra note 251; Danielle Kurtzleben, Minority Small Businesses Were Supposed To Get PPP Priority. They May Not Have, NPR (May 12, 2020), https://www.npr.org/2020/05/12/853934104/minority-owned-small-businesses-were-supposed-to-get-priority-they-may-not-have.
  \item See CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(P)(iv) (noting that loan distribution should prioritize businesses “in underserved and rural markets, including . . . small business concerns owned and controlled by socially and economically disadvantaged individuals . . . , women, and businesses in operation for less than 2 years”). The IG faulted the SBA and Treasury for failing to promulgate sufficient guidance for how to prioritize women- and minority-owned businesses or to collect data to aid in this effort. SBA OIG, supra note 257, at 4; CARES Act § 1102(a)(2), codified at 15 U.S.C. § 636(a)(36)(P)(iv).
  \item Heather Long, Small Business Used To Define America’s Economy. The Pandemic Could Change That Forever., WASH. POST, May 12, 2020,
\end{itemize}
shutters, not only do the employees of that business lose their jobs, but there are also larger ripple effects. Within communities, small businesses are often economic and social anchors, and their exit can devastate entire neighborhoods’ commercial viability. As a result, their failure can threaten the entire local economy, especially in small towns—ultimately creating a ripple effect that leads to increased housing instability.

ii. Emergency EIDL Grants

A second intervention to support employers is similarly unlikely to mitigate housing risk by propping up small businesses. Specifically, the CARES Act expanded the existing Economic Injury Disaster Loans (EIDLs) program. The emergency loans are typically available to eligible employers in declared disaster areas, which have suffered substantial economic injury and are unable to access capital through other sources. As in the case of PPP loans, eligible borrowers are limited to employers


262 See, e.g., Steinhauer & Wells, supra note 261 (noting that restaurants can often be major tourism generators and have other spillover effects into the local economy); Flitter, supra note 255 (noting that in light of growing resurgence in cases and shifting guidance, many small business owners are just giving up).

263 Small Business Act, supra note 241.

264 13 C.F.R. § 123.300 (describing eligibility requirements). The SBAs COVID-19 response follows reform efforts in recent years to improve the SBA Disaster Loan Program. See BRUCE LINDSEY, CONG. RESEARCH. SERV., R41309, THE SBA DISASTER LOAN PROGRAM: OVERVIEW AND POSSIBLE ISSUES FOR CONGRESS 3 (2015), https://nationalaglawcenter.org/wp-content/uploads/assets/crs/R41309.pdf. SBA Disaster Loans can be implemented through one of five ways, including presidential disaster declaration or SBA Administrator declaration. Id. at 4.
with up to 500 employees, and includes sole proprietorships, cooperatives, Employee Stock Ownership Plans, and tribal small businesses.\textsuperscript{265} Although under the statute, EIDL loan amounts are limited to $2 million,\textsuperscript{266} unconfirmed media reports indicate that these are reduced to $150,000 per applicant under the COVID-19 disaster.\textsuperscript{267}

The CARES Act also provided for an additional $10 billion in EIDL grants—advances on EIDLs or other loans that small businesses and nonprofit employers may receive in the future.\textsuperscript{268} Specifically, the CARES Act initially made EIDL grants of up to $10,000 available to small business and non-profit employers.\textsuperscript{269} The SBA reduced this grant from $10,000 per employer to $1,000 per employee up to 10 employees.\textsuperscript{270} The SBA closed the EIDL application process on April 15th—presumably because funds were exhausted and the SBA needed time to work through a backlog of applications—and reopened for new applications from U.S. agricultural businesses due to additional funds allocated by Congress.\textsuperscript{271}

It is unclear how the SBA Disaster Loan Program, and EIDLs in particular, will perform during the pandemic.\textsuperscript{272} However, the initial rollout suggests that the program’s capacity to mitigate housing instability will be limited by the same factors that hindered PPP loans. For example, as seen with up to 500 employees, and includes sole proprietorships, cooperatives, Employee Stock Ownership Plans, and tribal small businesses.\textsuperscript{265} Although under the statute, EIDL loan amounts are limited to $2 million,\textsuperscript{266} unconfirmed media reports indicate that these are reduced to $150,000 per applicant under the COVID-19 disaster.\textsuperscript{267}

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It is unclear how the SBA Disaster Loan Program, and EIDLs in particular, will perform during the pandemic.\textsuperscript{272} However, the initial rollout suggests that the program’s capacity to mitigate housing instability will be limited by the same factors that hindered PPP loans. For example, as seen

\textsuperscript{265} CARES Act § 1110(a). The interest rates for these EIDL loans are capped at 3.75\% for businesses and 2.75\% for nonprofits, and the loans have a maturity of up to 30 years. 13 C.F.R. § 123.302; see also Neil Hare, Loan Forgiveness Under The PPP And The SBA EIDL Programs: 10 Things Small Businesses Need to Know, FORBES, May 11, 2020, https://www.forbes.com/sites/allbusiness/2020/05/11/loan-forgiveness-ppp-sba-eidl-programs/#6f45c47f2e00.

\textsuperscript{266} LINDSEY, supra note 264, at 3.

\textsuperscript{267} See Hare, supra note 265.

\textsuperscript{268} CARES Act § 1110(e)(7). The CARES Act makes these EIDL grants that do not need to be repaid. CARES Act § 1110(e)(5).

\textsuperscript{269} CARES Act § 1110(e)(3). Note that under the program, the covered period is broader than the PPP—it includes January 31, 2020 through December 31, 2020. CARES Act § 1110(a).

\textsuperscript{270} See Hare, supra note 265.


\textsuperscript{272} From the available data, most SBA Disaster Loan Program loans tend to go towards rebuilding physical structures following natural disasters. It remains unlikely that a similar non-natural disaster of the size and scope of COVID-19 offers a precedent for the SBA to follow in extending capital and credit through the EIDL. Thus, as applied to low-income and housing insecure populations, the EIDL is best viewed through a lens similar to that of the PPP: a tool designed to allow employers to keep workers employed if possible.
in the case of PPP loans, application processing time may affect whether the program prevents business closures and layoffs.

Even before the pandemic, processing time was a significant issue with SBA Disaster Loans—including the EIDL.\textsuperscript{273} Though the SBA has not released data on wait times for EIDL grant processing,\textsuperscript{274} one data set indicates out of 18,920 EIDL grant applications, a median wait time to receive funds of 17 days.\textsuperscript{275} This wait time is significantly greater than the 36 hour aspirational goal enacted in recent Congressional reform. As of April 24, 2020, the SBA reported national EIDLs totaled 38,984 loans approved at a total dollar amount of $7,967,174,888.\textsuperscript{276}

Also like the PPP loans, early evidence suggests that the loans have not been disbursed evenhandedly. A May 8, 2020 SBA report indicated

\textsuperscript{273} See Lindsey, supra note 264, at 10. The SBA’s goal in FY 2009 was to process EIDLs within 18 days; though the SBA has reduced the standard processing time based upon application volume with the longest wait time at four-plus weeks for more than 500,000 applications per year. U.S. Small Bus. Admin., FY2016 Congressional Budget Justification and FY2014 Annual Performance Report, Oct. 23, 2015 at 87, https://www.sba.gov/sites/default/files/files/1-FY_2016_CBJ_FY_2014 APR_508.pdf [https://perma.cc/N8CU-ZAB7]. To improve disaster loan processing, Congress adopted measures to improve coordination between the SBA and FEMA. Small Business Disaster Response and Loan Improvement Acts of 2008, Pub. L. 110-120, 122 Stat. 923. These reforms also required the SBA to establish the Immediate Disaster Assistance Program. Pub. L. 110-1234, § 12084. Under this program, the SBA would provide interim “bridge loans” of up to $25,000 with 36 hours of receiving a loan application. See Lindsey, supra note 264, at 12. As of a 2014 GAO report, the SBA had yet to pilot this new lending program. U.S. Gov’t Accountability Office, GAO-14-760, Small Business Administration: Additional Steps Needed to Help Ensure More Timely Disaster Assistance (2014), http://www.gao.gov/assets/670/666213.pdf. The Immediate Disaster Assistance Program resembles the EIDL grants enacted under the CARES Act.

\textsuperscript{274} See Isaac Arnsdorf, Thousands of Small Business Owners Have Not Gotten Disaster Loans the Government Promised Them, ProPublica, https://www.propublica.org/article/thousands-of-small-business-owners-have-not-gotten-disaster-loans-the-government-promised-them (July 16, 2020) (noting that at a hearing on July 1, 2020, before the House Committee on Small Business, Associate Administrator James Rivera responded that while initially the average wait time for processing was 41 days, it had dropped to five days. But other data cited conflicts with Mr. Rivera’s statement).


that 3,009,934 EIDL grants\textsuperscript{277} were made totaling $9,883,210,000.\textsuperscript{278} While the grants were supposed to be issued on a first come, first served basis, some reports indicate that some applications were “jumping the line” and being funded sooner than other applications despite a later application date.\textsuperscript{279} As a result, there is some question as to whether the EIDL program may serve some businesses more effectively than others due to internal policies. Thus, EIDL grants are unlikely to mitigate housing instability for the same reasons that plague PPP loans.

\textbf{B. Use of Tax Expenditures}

1. In General

The analysis in Part II demonstrated that tax expenditures are often inferior to direct grants during a crisis period. Setting aside more general debates comparing tax expenditure and direct grant approaches, an important reason to prefer grants during economic downturns is that many forms of tax preferences decrease in value as taxpayers’ tax liability declines. As a result, the reduced size of the tax-based subsidy may render the tax preference ineffective as an incentive to engage in pro-social activities.

The initial response to the COVID-19 pandemic has included several notable tax preferences, two of which are discussed here: a refundable tax credit for employers, and expanded tax deductions for charitable donations. As this section will explain, only the latter of these tax expenditures may decrease in value as taxpayers’ income levels decline. However, neither tax expenditure is designed to promote any specific activity that would reduce housing instability.

\textsuperscript{277} The SBA terms them EIDL Advances.
2. Refundable Tax Credit for Employers

In addition to the relief to employers described in Part III.A.3, the CARES Act provides for a refundable tax credit for employers that are subject to closure due to COVID-19. All employers (including nonprofits) are eligible for this tax relief, regardless of size—with two exceptions: (1) state and local governments and entities they control, and (2) small businesses that borrow from the SBA, including through the PPP and EIDL. Eligible employers are allowed to claim a refundable credit against their employment taxes for up to 50% of qualified wages for each employee per quarter up to $10,000.

Significantly, this tax benefit is structured as a refundable credit. Unlike nonrefundable tax credits, which are limited by taxpayers’ tax liability, refundable tax credits can be claimed in full even if a business does not have current tax liability. In this sense, the tax credit is similar to a cash grant in that its value does not depend on a taxpayer’s tax liability.

As a result, the credit, paid in cash, can be a windfall for many businesses. However, this refundability feature does not increase the likelihood that this intervention will mitigate housing instability. This is because the tax credit is broadly available to all eligible employers and does not create an incentive for any particular behavior. Whether employers

280 CARES Act § 2301(a)-(b), (b)(3). The CARES Act also provides for payroll tax deferrals until December 31, 2021 for 50% of employment taxes owed before January 1, 2021, and the remaining employment taxes due by December 31, 2022. CARES Act § 2301(d)(3). This provision amounts to an interest-free loan of 6.2% of all wages paid for 2020 after approximately March 27. Lewis Horowitz & Eric Kodesch, IRS CARES Enough to Give PPP Loan Recipients an Interest-Free Loan From Continued Deferral of the Employer Portion of the Social Security Tax, JD SUPRA, Apr. 19, 2020, https://www.jdsupra.com/legalnews/irs-cares-enough-to-give-ppp-loan-68623/ [https://perma.cc/2GJF-HEZB]. For employers receiving PPP loans, the delay of employer payroll taxes is only for amounts payable before PPP loans are forgiven, if at all. Id.

281 CARES Act § 2301(c)(2)(C).


284 Unlike nonrefundable tax credits, which provide a dollar-for-dollar offset to taxes owed until the taxpayer’s tax liability is reduced to zero, refundable tax credits are not limited by a taxpayer’s tax liability. In other words, even a taxpayer that owes no taxes is entitled to the full credit amount delivered to the taxpayer as a cash “refund.”

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3613789
decide to use the cash from the credit to keep workers and those who are housing insecure employed—thereby helping to mitigate housing instability—remains to be seen.

3. Expanded Tax Deduction for Charitable Donations

The CARES Act also includes indirect support for nonprofits through an expanded tax deduction for donors.\textsuperscript{285} Specifically, the law provides a deduction of up to $300, if made in cash, for charitable contributions made by those who do not itemize their deductions.\textsuperscript{286} This provision is permanent and in effect for taxable years beginning after December 31, 2019.\textsuperscript{287} For taxpayers who itemize their deductions, the limitation on charitable contribution deductions is increased.\textsuperscript{288} The increase in the cap applies to contributions made in cash during the 2020 calendar year only.\textsuperscript{289} The stated purpose of these provision is to encourage taxpayers—including those who do not itemize—to donate “to churches and charitable organizations in 2020.”\textsuperscript{290}

However, unlike the refundable tax credit available to employers, the value of these charitable deductions may decrease as taxpayers’ income levels decline. This is because the value of a deduction is tied to a taxpayer’s marginal tax rate, which may fall if income decreases due to unemployment. As a result, the deduction may no longer provide a sufficient incentive to donate.

That said, even if the deduction provides sufficient incentive to donate, it is still unlikely to help mitigate housing instability. This is because

\textsuperscript{286} CARES Act § 2204(a) (codified at I.R.C. § 62(a)(22)), (b) (codified at I.R.C. § 62(f)(1), (2)(A), (2)(B)).
\textsuperscript{287} CARES Act § 2204(c).
\textsuperscript{288} CARES Act § 2205 (a), (c).
\textsuperscript{289} CARES Act § 2205(a)(3)(i). For individuals, the 50% AGI limitation in I.R.C. § 170(b)(1)(A) is increased to 100% of AGI. CARES Act § 2205(a)(2)(A)(i); I.R.C. § 170(b)(1). For corporations the limitation goes from the 10% taxable income limitation in I.R.C. § 170(b)(2)(A) to 25% of taxable income. CARES Act § 2205(a)(2)(B)(i); I.R.C. § 170(b)(2). For both individuals and corporations, any excess deductions over the limitation amount may be carried over to future years. CARES Act § 2205(a)(2)(A)(ii), (a)(2)(B)(ii). The law also increases the limits on contribution of food inventory from trades or businesses during 2020 from 15% of trade or business income to 25% of trade or business income. CARES Act § 2205(b).
\textsuperscript{290} See Section-by-Section analysis.
the deduction is not well-targeted to charities that will meet the needs of people who are low-income or housing insecure.291 In theory, increasing donations to nonprofits may help subsidize expansion of homeless shelters or emergency affordable housing. But the deduction is intentionally broad, and donors can just as easily choose to donate to well-resourced private universities, for example, instead of community health clinics or other service organizations that serve the poor or homeless.292 For this reason, it is unlikely that the deduction will effectively mitigate housing instability.

C. Omission of Place-Based Interventions

As discussed in Part II.D.3 above, there is likely to be a continued need for place-based investment in neighborhoods during and after a crisis period. However, the initial legislative response to the COVID-19 pandemic did not include any interventions to sustain affordable housing development or economic development in low-income communities. This omission may have significant long-term consequences for housing instability.

Thus, this Part has demonstrated that the initial interventions during the COVID-19 pandemic are unlikely to effectively mitigate housing instability. The next Part will provide an alternate vision of legislation that prioritizes the mitigation of housing instability.

IV. PRIORITIES FOR MITIGATING HOUSING INSTABILITY

A. Prioritizing Housing

A complete and successful policy response to COVID-19 must include mitigation of housing instability. This is a vital public health imperative. This Part draws on the forgoing analysis to identify two broad priorities for effective mitigation of housing instability. In doing so, this analysis not only provides a baseline for evaluating subsequent legislation during the COVID-19 pandemic, but it also serves as a set of recommendations for early policy responses to future crises.

291 Id.
The first priority is to include interventions that provide relief directly to individuals who are unable to pay their rents or mortgages. Such interventions are essential to mitigate housing instability during the crisis period. The second priority is to include place-based interventions that address ongoing affordable housing needs and mitigate geographic inequities exacerbated by the crisis. These interventions are necessary to mitigate housing instability in the months and years following the crisis. To this end, this section recommends direct people-based interventions and place-based interventions that are consistent with these principles.

B. Direct People-Based Interventions

People-based interventions that provide relief directly to individuals facing housing instability should be a top legislative priority during a pandemic. This section draws on the foregoing analysis to identify two types of relief that should be included. The first—direct housing payment assistance—is necessary even when indirect assistance (like unemployment insurance) or non-monetary direct interventions (like eviction freezes and foreclosure moratoriums) are available.

The second form of emergency relief is the implementation of effective and enforceable eviction freezes and foreclosure moratoriums. Advocates have devoted significant attention to the need to strengthen eviction freezes, in particular, to cover larger populations of tenants and provide greater protection. Such reforms could greatly increase the efficacy of such interventions to mitigate housing instability. However, problems with enforcement would remain. For this reason, this section recommends the creation of a civil right to counsel to help ensure that foreclosure moratoriums and eviction freezes are enforced. This section will elaborate upon both of these recommendations, beginning with housing payment assistance.

1. Housing Payment Assistance

This Article recommends both preventative policies that keep owners and renters in their homes and programs that provide a housing safety net to facilitate rapid rehousing of people who lose their homes due to foreclosure or eviction. Most importantly, the federal policy response must include housing-specific monetary assistance for renters or homeowners, such as rental vouchers and reinstatement of the Homelessness
Prevention and Rapid Re-Housing (HPRR) program that successfully ran from 2009-2012. HPRR could provide direct aid to struggling tenants and homeowners including financial assistance and housing relocation and stabilization services. Struggling homeowners should also be assisted by providing direct assistance with mortgage payments, property taxes, property insurance, utilities, and other housing related costs.

We recommend that lawmakers leverage existing tools, such as the Section 8 Housing Choice Voucher program, in order to take advantage of established administrative frameworks that can help minimize problems and delays during the program rollout. We believe that such targeted interventions to prevent homelessness through tenant and homeowner assistance will be more effective than place-based strategies or indirect assistance programs to mitigate housing instability during a crisis.

2. Civil Right to Counsel in Evictions Proceedings

Eviction freezes and foreclosure moratoriums will likely continue to play a significant role in mitigating housing instability, so it is essential that

293 AARP, Title XII – Homelessness Prevention Fund. Section 201 of the HEROES Act would authorize $100 billion for an Emergency Rental Assistance program to help households pay their rent and utility bills in order to remain housing secure during the pandemic. This program would utilize the framework of the HUD Emergency Solutions Grant (ESG) program, which currently administers homelessness assistance. A state selected administering agency would send the payment directly to the landlord, for both past-due and future rent. The Heroes Act, H.R. 6800 § 201, 116th Cong. (2020).


295 Sec. 202 of the HEROES Act would authorize $75 billion for a Homeowner Assistance Fund “to address the ongoing needs of homeowners struggling to afford their housing due directly or indirectly to the impacts of the COVID-19 pandemic by providing direct assistance with mortgage payments, property taxes, property insurance, utilities, and other housing related costs.” The Heroes Act, H.R. 6800 § 202, 116th Cong. (2020).

lawmakers take steps to ensure such laws are enforced. Because low-income tenants are particularly vulnerable to enforcement failures, this Article recommends a program to provide a civil right to counsel in eviction proceedings during these extreme circumstances. 297 Recall that while many states have implemented eviction moratoriums to prevent a wave of evictions, 298 housing advocates nevertheless report a flood of wrongful eviction cases nationwide. 299 Housing instability will likely increase as unemployment rates continue to rise and foreclosure moratoriums and eviction freezes expire. 300 This will lead to a surge of eviction cases. 301 Unfortunately, eviction leads directly and indirectly to housing instability and homelessness. 302

Low-income tenants are in the greatest jeopardy and can often be helped with modest resources. Most tenants in New York City threatened by eviction owe less than $600. 303 Studies show that a homeless individual can cost taxpayers over $35,000 in programs and services including increased costs to the public health care system and the cost of emergency housing. 304 Studies also show that right to counsel initiatives save huge amounts of resources by preventing the use of homeless services and

297 For an in-depth discussion of a civil litigation right to counsel, see John Pollock & Michael S. Greco, It’s Not Triage if the Patient Bleeds Out, 161 U. PA. L. REV. ONLINE (2012) (arguing for a civil right to counsel mirroring Gideon-style right to counsel in criminal matters).
298 See infra App. A.
299 See supra note 15.
300 See supra Part III.A.
301 Sec. 203 of the Heroes Act “extends and expands the eviction moratorium and foreclosure moratorium in the CARES Act to include all renters and homeowners, improves the forbearance provided under the CARES Act, and specifies the loan modifications” available to homeowners “to prevent any homeowner from facing a lump sum payment that they cannot afford.” The Heroes Act, H.R. 6800 § 203, 116th Cong. (2020).
programs simply by keeping people in their homes. A cost-benefit analysis in New York City showed that a right to counsel program would reduce evictions by 77% and save $320 million each year. Keeping people in their homes is also an important public health goal during this pandemic. A civil right to counsel in eviction proceedings program will help achieve this goal.

Landlords are almost always represented by attorneys in court while most tenants do not have representation. Many tenants have meritorious cases but are unable to prove such without assistance. In Chicago, having an attorney decreased tenants’ “odds of getting an eviction order by about 25%.” In an evaluation of a legal assistance program for low-income tenants in New York City’s Housing Court, the results demonstrated that having legal counsel produced large differences in outcomes for the low-income tenants. “For example, only 22% of represented tenants had final judgments against them, compared with 51% of tenants without legal representation.” Harvard researchers have also empirically shown that

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306 NLCHP, supra note 302.

307 This representation imbalance between tenants and landlords likely explains courts' historic “award[ing] of relatively little compensation for … violations” of the warranty of habitability. “We can only imagine how the law and court culture might look if both parties had enjoyed decades of equality of representation.” Kathryn A. Sabbeth, (Under) Enforcement of Poor Tenants' Rights, 27 GEO. J. ON POVERTY L. & POL’Y 97, 136 (2019).

308 Id. Professor Franzese has demonstrated that a tenant’s assertion of the defense of the implied warranty of habitability works but requires effective assistance of counsel as tenants are often unaware of their basic rights. Paula Franzese et al., The Implied Warranty of Habitability Lives: Making Real the Promise of Landlord Tenant Reform, 68 Rutgers L. Rev. 1, 3-6 (2017).


310 “Similarly large advantages for tenants with an attorney also were found in eviction orders and stipulations requiring the landlord to provide rent abatements or repairs.” Seron, Carroll, Martin Frankel, Gregg Van Ryzin & Jean Kovath, The Impact of Legal Counsel on Outcomes for Poor Tenants in New York City’s Housing Court: Results of a Randomized Experiment, LAW & SOC’Y REV. 419-434 (2001), https://www.rctoolkit.org/docs/7/Impact%20of%20Counsel%20on%20Tenants%20(Seron%20and%20NY%20study).pdf.
Massachusetts case outcomes are materially improved for tenants when they have access to full legal representation.311

Currently, New York City, San Francisco, and Newark, NJ have right to counsel programs for tenants in eviction.312 Various pilot programs313 have demonstrated that a targeted approach for serving low-income housing court litigants in danger of homelessness with legal, financial, and social service interventions can keep them from homelessness.314 In New York City, when Housing Court eviction cases were “resolved by OCJ’s legal services providers, 84% of households represented in court by lawyers were able to remain in their homes, not only saving thousands of tenancies, but also promoting the preservation of

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311 At least in part because “the inability of some self-represented litigants to understand and comply with court rules and procedures may make it impossible for their cases, however worthy, to be decided on the merits.” BOSTON BAR ASSOCIATION, Investing in Justice: A Roadmap to Cost-Effective Funding of Civil Legal Aid in Massachusetts, Oct. 2014, https://www.rtctoolkit.org/docs/7/Statewide%252520Task%252520%252520Expand%252520Civil%252520Legal%252520in%252520Massachusetts.pdf.


313 Since September 2007, a “Task Force on the Civil Right to Counsel (‘Task Force’) convened by the Boston Bar Association” has focused on how to establish a right to counsel for households at risk of losing their homes. It recommended pilot projects to explore mechanisms for providing counsel and the ramifications of creating a right to counsel including the costs as well as the cost savings to Massachusetts. “Funding was obtained for two pilot projects involving eviction cases.” BOSTON BAR ASSOCIATION, The Importance of Representations in Eviction Cases and Homelessness Prevention, Mar. 2012, https://www.rtctoolkit.org/docs/7/BBA%20Importance%20of%20Representation%20in%20Eviction%20Cases.pdf.

314 For example, in 2005, the United Way of NYC, in partnership with the NYC Civil Court and the NYC Department of Homeless Services, launched the Housing Help Program, a three-year pilot program to address the challenges facing families struggling to avoid eviction and homelessness. SEEDCO, Housing Help Program: Homelessness Prevention Pilot Final Report, June 2010, https://www.rtctoolkit.org/docs/7/NYC%20Housing%20Help%20Program%20report.pdf.
affordable housing and neighborhood stability.” 315 Many reports have concluded that the monetary benefits of representing eligible beneficiaries in eviction and foreclosure proceedings far outweigh the costs of providing these services. 316

Thus, in an effort to further stave off homelessness once the eviction and foreclosure forbearance measures have expired, we recommend a five year Right to Counsel Program of civil legal aid in eviction and foreclosure cases. The Right to Counsel Program would be funded through competitively granting awards to governmental entities to assist low-income tenants and homeowners to ensure that they actually obtain housing benefits to which they are entitled and to assist them in housing courts when faced with losing their apartments or homes. 317 The award recipients’ programs should focus on making full legal representation available to low-income tenants facing eviction in housing court and public housing authority termination of tenancy proceedings or low-income homeowners facing foreclosure. 318

B. Grant Funded Place-Based Interventions

The second priority is to include place-based interventions that mitigate housing instability in the months and years after the crisis period.


316 For example, the Analysis Group “estimates that the total annual cost to represent all eligible beneficiaries in Massachusetts is $28.48 million, while the annual savings from representing this population is $76.52 million.” Boston Bar Association, supra note 311.

317 Professor Sabbeth notes that the “[z]ealous use of counterclaims can increase a defendant’s leverage in negotiation and potentially improve a poor tenant’s bargaining power both inside and outside the courtroom. Counterclaims can also deter initiation of future litigation.” Kathryn A. Sabbeth, Housing Defense as the New Gideon, 41 Harv. Women’s L.J. 55, 113 (2018). The Heroes Act includes $50 million for the Legal Services Corporation to address legal needs arising from coronavirus. The Heroes Act, H.R. 6800 Title II, 116th Cong. (2020).

As explained in Part II.D above, the pandemic will likely create a need for additional interventions to increase the supply of affordable housing and to address problems associated with vacant properties. To ensure that the benefits of these interventions flow to neighborhood residents instead of investors, the law should prioritize affordable housing and development that is likely to benefit community residents.  

During the Great Recession, a significant barrier to advancing these objectives was the lack of resources. The LIHTC program struggled to provide adequate incentives during a recession period, and the NSP program received only modest funding. The TCAP and Tax Credit Exchange Program helped sustain LIHTC investment during that period, and lawmakers should consider reinstating those grant programs during subsequent crises like the COVID-19 pandemic.

It may also be possible to tap into the large pool of capital created by the Opportunity Zone legislation in order to increase the supply of affordable housing. However, for this place-based tool to help distressed communities, there must be an affirmative effort for investments to reflect the affordable housing needs of the residents within these designated opportunity zones. Place-based tax incentives work best if there are procedures for screening projects and approval is required by an administering agency with expertise in development of low-income communities. For this reason, we propose a program of competitively awarded grants to certified Community Development Financial Institutions (CDFIs) and qualified non-profit housing organizations that partner with QOFs to develop affordable housing. Certified CDFIs are community lenders that often provide funding for affordable housing developments.

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319 LAYSER, supra note 140, at 55–59.
320 Id.
321 Id. at 39–40.
322 Certification is given by the CDFI Fund for “specialized organizations that provide financial services in low-income communities.” U.S. Department of Treasury CDFI Fund, CDFI Certification, https://www.cdfifund.gov/Documents/CDFI_PROGRAM_FACT_SHEET_CERTIFICATION_updatedJAN2016.pdf (last visited July 24, 2020). In a report released in June 2020, the Urban Institute also recommends, inter alia, that “reforms should be made to support CDFIs, which have a long track record of making substantial investments in low-income communities.” Brett Theodos, Eric Hangen, Jorge González, and Brady Meixell, An Early Assessment of Opportunity Zones for Equitable Development Projects Nine
The U.S. Treasury Department’s Community Development Financial Institutions Fund (CDFI Fund) would allocate these grants through a competitive application process to certified CDFIs or qualified nonprofits with an affordable housing mission that are able to partner with a QOF on an affordable housing project. The goal of partnering a QOF with a certified CDFI or qualified nonprofit is to steer the approximately $10 billion of QOF equity into sorely needed affordable housing projects in opportunity zones in lieu of the hotel and luxury apartment projects that have tainted the OZ tool’s reputation. Direct grants to nonprofits are preferable to the non-targeted deductions included in the CARES Act. By providing grants directly to nonprofits that will perform targeted activities—such as the provision of affordable housing or creation of homeless shelters—the government can increase the likelihood that expenditures will support activities that are most necessary during the pandemic.

To implement this incentive, the IRS, CDFI Fund, and HUD would need to work together to coordinate the distribution and oversight of additional funds. All agencies need to have employees high enough on the chain communicate with each other and incentivize subordinates to coordinate. Furthermore, line employees in each agency need to work

*Observations on the Use of the Incentive to Date 35 (2020). The Urban Institute recommends redesigning the OZ incentive to “encourage equity investments in CDFIs who set up QOFs.” Id. at 37.*

323 “The CDFI Fund was created for the purpose of promoting economic revitalization and community development through investment in and assistance to Community Development Financial Institutions (CDFIs). The CDFI Fund was established by the Riegle Community Development and Regulatory Improvement Act of 1994, as a bipartisan initiative.” Department of Treasury CDFI Fund, About Us, https://www.cdfifund.gov/about/Pages/default.aspx (last visited July 24, 2020).


325 See supra Part III.C.4.

326 See Saito, supra note 94, at 496–97 (2020). Note that having an office in charge of interagency coordination in the IRS could aid in coordinating with HUD to manage LIHTC and that in the implementation of the ACA, a dedicated office seemingly aided in the implementation of key provisions.
together to analyze and manage the program and its outcomes. However, it should be noted that these agencies are already called upon to coordinate the administration of tax incentives for affordable housing and community development, such as the New Markets Tax Credit. By taking advantage of established cross-agency administrative structures, lawmakers can minimize the administrative burdens associated with the new grant.

CONCLUSION

In this Article, we have set forth two significant priorities: direct mitigation of housing instability during the pandemic, and place-based interventions to mitigate housing instability and geographic inequality in the months and years that follow. These housing security objectives have been underemphasized despite their importance to a full policy response to controlling the health crisis and managing the economic fallout of the pandemic. We recommend that legislators take steps to provide direct rental assistance for tenants and mortgage payment assistance for homeowners, a new civil right to counsel in evictions, and specific place-based interventions to promote affordable housing development. Interventions like these, which are designed to mitigate housing instability, are not only essential to address the continuing threat from COVID-19, but also to prepare the U.S. for future pandemics.

See id. at 494–95 (noting the importance of having joint teams of line level employees administer the program).
APPENDIX A

State-Level Interventions

<table>
<thead>
<tr>
<th>State</th>
<th>Mortgage Relief</th>
<th>Eviction Relief</th>
<th>Foreclosure Relief</th>
<th>Rent Relief</th>
<th>Assistance programs ($$)</th>
<th>Utility Disconnection Relief</th>
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Note that the form of these interventions vary across jurisdictions, with some offering stronger protections than others. Eviction Lab, COVID-19 Housing Policy Scorecard, EVICTION LAB, https://evictionlab.org/covid-policy-scorecard/ (last visited Jul 19, 2020). For a detailed list of state law resources describing these interventions, please see https://libguides.law.illinois.edu/ld.php?content_id=54944160.

Governor Doug Ducey instituted an agreement with banks to suspend evictions and foreclosures for 60 days.

Court order has suspended non-essential matters resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

Court order has limited in-person court proceedings likely resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

Court order has postponed civil court proceedings likely resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.
Executive Order suspending legal deadlines applicable to all legal proceedings. This would impact eviction and some foreclosure proceedings. There are no other state mandates regarding evictions and foreclosures.

Court order suspending in-person proceedings likely resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

Court ordered closure of all courts, suspension of trials, and extensions of deadlines likely resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

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⁶ Executive Order suspending legal deadlines applicable to all legal proceedings. This would impact eviction and some foreclosure proceedings. There are no other state mandates regarding evictions and foreclosures.

⁷ Court order suspending in-person proceedings likely resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

⁸ Court ordered closure of all courts, suspension of trials, and extensions of deadlines likely resulting in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.
Court order suspending in-person proceedings. Courts are prohibited from taking an action to effectuate an eviction, ejectment, or other displacement from a resident based on failure to pay rent or loan. This results in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

Court order suspending eviction trials, hearings, and other proceedings. This would impact judicial foreclosure proceedings and post-foreclosure evictions. Does no prohibit foreclosure sales.

Court order suspending non-emergency and non-essential court cases. This included new eviction cases and would also limit judicial foreclosure. There are no other state mandates regarding evictions and foreclosures.

Court order postponing all proceedings and court deadlines likely resulting in a de fact moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

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9 Court order suspending in-person proceedings. Courts are prohibited from taking an action to effectuate an eviction, ejectment, or other displacement from a resident based on failure to pay rent or loan. This results in a de facto moratorium on evictions, judicial foreclosures, and post-foreclosure evictions. This would not prohibit foreclosure sales. There are no other state mandates regarding evictions and foreclosures.

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A Place for Place in Federal Tax Law

Daniel Hemel*

Drive about 14 miles west from here on Ohio State Route 81 and just when you cross I-75, before entering downtown Lima, you will find that you have arrived in a different capital gains tax regime. The grass may not be greener on the other side of I-75, but the capital gains tax rules surely are. If you sell a capital asset at a gain and plow the proceeds into an investment here in Ada, you will owe capital gains tax today and potentially will owe more tax when you sell the Ada asset in the future. If you put the proceeds into an investment in downtown Lima instead, you can potentially defer capital gains tax until 2026, reduce your taxable income by 15 percent, and avoid any capital gains tax when you ultimately liquidate your Lima-based holdings.

Downtown Lima is home to a new opportunity zone created under the December 2017 tax law.1 And it is not the only nearby location where this strange new regime applies. Drive east for 35 miles on U.S. Route 30 and you will arrive at another one of these opportunity zones in Upper Sandusky. You can find another one 40 miles to the northeast, just past Findlay, and yet another east of there in Tiffin. All in all, 320 census tracts across Ohio—in 73 of the state’s 88 counties—are now federally designated opportunity zones where investments are potentially subject to much more complicated, but more generous, capital gains tax rules.2

The opportunity zone provision of the 2017 tax law is one of the most significant experiments with place-based taxation in federal tax history. It is not the first such effort: the now-expired empowerment zone program, established by Congress in 1993, was an earlier, narrower—and in many respects, better targeted—effort at spatial differentiation in federal taxation.3 Several other ongoing federal tax programs—including the Low Income Housing Tax Credit and the New Markets Tax Credit—also have strong spatial components.4 But while place-based taxation is not new, its expansion as part of the 2017 tax law provides an opportune moment to assess what role, if any, geographically differentiated rules ought to play in a tax system that otherwise follows a norm of formal equality with respect to individuals and firms in different domestic locations.

The 2017 tax law’s space odyssey is, I will argue, unlikely to be a successful mission in its own right. The new opportunity zones are virtually no one’s idea of

*Assistant Professor, University of Chicago Law School. These remarks were delivered at the Ohio Northern University Law Review 42nd Annual Law Review Symposium. For insightful comments, the author thanks Ethan Ames, Jennifer Bird-Pollan, Darien Shanske, Elaine Waterhouse-Wilson, and the editors of the Ohio Northern University Law Review.

4 I.R.C. §§ 42, 45D.
sound tax policy. The legislation is so poorly designed that one wonders whether the flaws might have been intentional: whether this was simply a cynical attempt to give tax breaks to rich donors and more work to well-connected lawyers, all under the guise of aid to distressed communities. I am not yet convinced that the cynical story is right, but not so sure it is wrong either. It is difficult to see how anyone who genuinely sought to lift up communities left behind by the recovery from the Great Recession would have written the law this way.

Yet the design flaws of the opportunity zone program do not (necessarily) augur the failure of all place-based federal tax policies. There are, I will argue, a number of ways in which spatial differentiation can plausibly improve the federal tax system, both on dimensions of efficiency and of equity. An optimistic scenario is that the December 2017 law’s foray into spatially differentiated taxation will draw our attention toward more productive uses of place in federal tax policy. But one must don rose-colored glasses in order to glimpse such a scenario, because the opportunity zone program before our eyes inspires little confidence.

My talk today will examine spatially differentiated federal taxation in three parts. The first part will provide a definition of place-based taxation and a description of previous spatially differentiated federal tax programs. The second part will consider the opportunity zone provisions of the December 2017 tax law, outlining their key features and highlighting their deepest flaws. The third part will sketch a number of more promising paths for place-based federal tax policy.

I.

I’ll start with a definition. A tax rule is spatially differentiated—or, to say the same thing in fewer syllables, place-based—if its application depends upon the geographic sites at which persons reside, properties are located, or activities occur. Spatial differentiation can—in theory—take a near-infinite number of forms. It might take the form of different exemption amounts or rate structures for taxpayers who reside in different locations. It might take the form of different credits or depreciation schedules for firms that purchase or deploy assets in different areas. Any tax rule can become a spatially differentiated tax rule simply by adjusting its application on the basis of location.

That’s what spatial differentiation is—here’s what it is not. Spatial differentiation is not the same as interjurisdictional variation. The top state income tax rate here in Ohio is 4.997%.5 Over the border in Indiana, the state income tax rate is a flat 3.23%.6 That’s interjurisdictional variation, not spatial differentiation. Interjurisdictional variation is foreordained in a federalist system that allows states—and subdivisions within a state—to exercise discretion over their tax rates and bases. Spatial differentiation, by contrast, is not inevitable. It is easy to

imagine a system that grants each state the freedom to structure its own tax regime but applies the same rules to all taxpayers at the national level.

Spatial differentiation is also not the same as spatial redistribution, though it will often have that effect. Spatial redistribution occurs when the tax system transfers resources from taxpayers in one location to taxpayers in another. Spatial redistribution is a byproduct of a tax system characterized by progressivity in a country characterized by spatial inequality. A graduated rate structure will result in redistribution from the richest states (Connecticut, Massachusetts, New York) to the poorest states (Mississippi, West Virginia, New Mexico). Specific provisions—like the new $10,000 cap on the state and local tax deduction, or “SALT”—will also have different impacts in different places. The 2017 tax law certainly leads to spatial redistribution—as have revenue statutes throughout U.S. history. That is not unusual. What is more unusual about the 2017 tax law is its explicit spatial differentiation.

Unusual, but not unprecedented. Prior to the Tax Cuts and Jobs Act, federal tax law did explicitly differentiate on the basis of geography in a number of different ways.

First, and least remarkably, federal tax law draws spatial distinctions that track international boundary lines. Section 871 imposes a tax on income earned by nonresident aliens inside the United States but not outside. A number of other provisions make similar inside-outside distinctions. Some amount of differentiation along international boundary lines is the necessary byproduct of a Westphalian system in which each nation-state exercises exclusive sovereignty over a limited territory. Indeed, perhaps the most remarkable aspect of the U.S. tax system’s spatial differentiation along international boundary lines is how little of it there is: the United States is unique in applying its tax laws to its own citizens wherever they are.

Second, within the territorial limits of the United States, federal tax law differentiates between the 50 states and the District of Columbia, on the one hand, and the unincorporated territories, on the other. Most residents of unincorporated territories such as Puerto Rico, the U.S. Virgin Islands, and Guam do not pay

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9 The Uniformity Clause of the federal Constitution provides that “all Duties, Imposts and Excises shall be uniform throughout the United States.” U.S. Const. art. I, § 8, cl. 1. In a somewhat confusing confluence of statements, the Supreme Court has said that the Uniformity Clause also applies to taxes, but that explicit geographic distinctions in federal tax law are nonetheless consistent with the clause as long as they do not reflect “an undue preference” for one state over others. See United States v. Ptasynski, 462 U.S. 74 80 n.9, 85-86 (1983).
10 I.R.C. § 871.
11 See, e.g., I.R.C. § 874 (special rules for deductions and credits for nonresident aliens); I.R.C. § 911 (partial exclusion of income earned by U.S. citizens and residents living abroad).
federal individual income tax on income from inside those territories. This exemption is sometimes explained as what the territories get for giving up votes in the Senate, the House of Representatives, and the Electoral College. As someone who was born in the District of Columbia and resided there immediately before moving to Chicago, I feel obliged to add that this justification for territorial exemption only aggravates D.C. residents, who also do not send a voting delegation to Congress. The fact that D.C. residents also pay more per capita in federal income tax than residents of any of the 50 states further fuels the outrage expressed on the District’s standard-issue license plates, which now read “End Taxation Without Representation.”

But our topic today is not taxation on the basis of representation—it is taxation on the basis of location. And prior to the December 2017 tax law, a number of federal tax provisions incorporated quite explicit spatial components.

One of those is the Low-Income Housing Tax Credit, or “LIHTC,” first enacted as part of the Tax Reform Act of 1986. The LIHTC program provides tax credits over a 10-year period to investors in residential real estate developments that house low-income tenants. In the normal course, the credits cover up to 70% of the costs of building and rehabilitating low-income units. That figure rises to 91% if the building is in a high-poverty census tract or in a zip code that has high construction, land, and utility costs relative to area median income.

A curious feature of the spatial differentiation embedded in the LIHTC program is that these two criteria—high poverty and high cost—seem to be at cross-purposes with each other. High-poverty areas tend to be the places where land is cheap; high-cost areas tend to be places where poverty is low. Since either high poverty or high cost can be a trigger for the souped-up credit, the net effect of these provisions is to incentivize LIHTC projects to locate either in the poorest parts of town or in the richest. Thus, developments in the Watts area of Los Angeles—where nearly 40% of the population lives below the poverty line—are eligible for the enhanced credit, but so too are developments in the famously wealthy Beverly Hills 90210 zip code.

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13 I.R.C. §§ 931, 933.
14 See, e.g., 164 Cong. Rec. H9399 (Sept. 28, 2018) (statement of Del. Norton) ("[T]he reason that most of the territories don’t come forward and ask for statehood is very clear. There is a quid pro quo for them. In exchange for not paying Federal taxes, they don’t have the votes in Congress.").
17 I.R.C. § 42(d)(5)(B).
18 See 2019 IRS Section 42(d)(5)(B); Qualified Census Tracts (2019), https://www.huduser.gov/portal/Datasets/qct/QCT2019M.PDF (listing census tracts 2420.00, 2422.00, 2423.00 2427.00, 2430.00, and 2431.00); I.R.C. § 42(d)(5)(B) Metropolitan Difficult Development Areas (2019), https://www.huduser.gov/portal/Datasets/qct/DDA2019M.PDF (listing 90210 area code).
Because building a low-income housing development in a high-cost area is much harder than siting it in a high-poverty neighborhood, the spatial differentiation within LIHTC primarily pushes developers toward already-impoveryed places. This aspect of LIHTC has generated quite a bit of criticism. The concern is that by encouraging developers to pack more low-income families into already low-income neighborhoods, LIHTC contributes to the concentration of poverty and exacerbates existing patterns of economic and racial segregation.

Defenders of LIHTC’s spatially differentiated incentives have a response to this critique. They point out that through much of the 20th century, federal policies such as mortgage “redlining” diverted investment away from low-income, largely minority communities. Defenders of LIHTC’s spatially differentiated incentives can argue that the preference since the late 1980s for development in high-poverty areas acts as a corrective to the decades of disinvestment that preceded the program. They can also point to evidence that links LIHTC-backed projects in high-poverty areas to higher property values and lower crime rates. More generally, they can argue that the primary problem plaguing high-poverty areas is not that they have too many poor people; it’s that they have too little capital. In this view, channeling capital investment toward high-poverty areas is precisely what federal policy ought to be doing.

The next major spatially differentiated tax legislation came in the first year of the Clinton administration, when Congress established the “empowerment zone” program as part of the 1993 omnibus budget bill. Roughly 100 high-poverty, high-unemployment communities were designated under the program as empowerment zones. Businesses in empowerment zones received a number of targeted tax incentives. Chief among them was a credit of up to $3000 for each worker they employed who lived inside the zone. The program cost the federal government approximately $2.5 billion over its first decade, a drop in the bucket compared to LIHTC, which carries a price tag over $9 billion per year.

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Several studies have scrutinized the empowerment zone program, which expired at the end of 2017. The available evidence suggests that the program did, as intended, generate additional jobs inside empowerment zones, but at a very high price: each new position came at a revenue cost to the federal government of over $100,000. Some of these jobs may simply have been shifted from locations outside the zones. And on top of that, the small boost to employment inside empowerment zones came with a sharp increase in rents. Much of the benefit of the program appears to have been captured by landlords in empowerment zones rather than by low-income resident themselves.

The enactment of the empowerment zone program was followed seven years later by the New Market Tax Credit. That program provides a tax credit for investments in high-poverty communities that are channeled through so-called “community development entities,” or CDEs. The tax credit is worth thirty-nine percent of the investment and is realized over the course of seven years. CDEs must incorporate community members in their governance process (for example, by allocating a certain share of their director or officer positions to community members), and they must compete with each other for new credit allocations from the Treasury Department, which exercises continuing oversight. The revenue cost of the program is now slightly over $1 billion per year, and the credit is set to expire at the end of 2019 unless Congress extends it, as it has several times in the past.

The most recent round of spatially differentiated tax provisions prior to the Tax Cuts and Jobs Act have targeted areas hit by natural disasters. The package passed after Hurricane Katrina in 2005 was the most generous: For taxpayers in Katrina-affected areas, it temporarily removed limitations on the casualty loss deduction, allowed for tax-free debt cancellation, and permitted penalty-free withdrawals from 401(k)s and IRAs. Congress passed a similar measure after Hurricanes Harvey, Irma, and Maria in 2017, just weeks before it turned to the Tax Cuts and Jobs Act.

II.

27 § 45D.
29 Id. at 2.
30 See Staff of the Joint Comm. on Taxation, supra note 12, at 27.
31 § 45D(f)(1)(G).
It was against this historical backdrop that Congress enacted the new opportunity zone program as part of the Tax Cuts and Jobs Act of December 2017.\textsuperscript{34} The opportunity zone provision effectively incorporates the worst elements of earlier spatially differentiated tax incentives while leaving out the redeeming qualities. Like the Low-Income Housing Tax Credit and the New Markets Tax Credit, it is extraordinarily and unnecessarily complicated—which almost as if it were intentionally designed to create more work for accountants and tax lawyers. But unlike those programs, there is little in the opportunity zone package that appears aimed at creating more affordable housing or jobs for low-income workers. Usually in tax policy, there is a tradeoff between complexity and targeting: a provision can be simple, but its simplicity comes at the expense of narrow targeting, or a provision can be precisely targeted but as a result it will need to be quite complex. The opportunity zone program scores an impressive two-for: it manages both to be complicated and poorly targeted at the same time.

The basics of the opportunity zone program are as follows: Each governor had until March 2018 to designate a quarter of the low-income census tracts in her state as opportunity zones.\textsuperscript{35} To qualify, a census tract had to have a poverty rate of at least 20% or a median family income less than 80% of the median income in its metropolitan area or state.\textsuperscript{36} A small number of census tracts that were not “low-income” by this definition but were next to low-income communities could also receive the opportunity zone designation.\textsuperscript{37} The IRS then approved each state’s designation between April and June of last year.\textsuperscript{38} Taxpayers can now invest in qualified opportunity funds, which are forming by the day, and which in turn invest in qualified opportunity zones. These investments are eligible for two different sets of benefits. The first is deferral and potential reduction of capital gains taxes at the time of investment. If I am a top-bracket taxpayer and I sell an asset with a $100 gain, I would normally pay a tax of $23.80 this year. If I put the $100 in an opportunity fund and keep it there until 2026, I can defer my capital gains tax bill until then, and instead of paying tax on $100, I will pay tax on $85.\textsuperscript{39} The second benefit comes when I sell my opportunity

\textsuperscript{34} The law’s official name is “An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018,” after the Senate parliamentarian—in a debatable interpretation of the upper chamber’s Byrd Rule—struck the more succinct “Tax Cuts and Jobs Act” moniker. See Ellen P. Aprill & Daniel J. Hemel, \textit{The Tax Legislative Process: A Byrd’s Eye View}, 81 L. & CONTEMP. PROBS. 99, 100, 125 (2018).
\textsuperscript{35} See § 1400Z-1; see also Treasury, IRS Announce First Round of Opportunity Zones Designations For 18 States, U.S. DEPT OF THE TREASURY (Apr. 9, 2018), https://home.treasury.gov/news/press-releases/sm0341 (noting that March 21, 2018 was the deadline for a governor to submit designations or request a 30-day extension).
\textsuperscript{36} See § 45D(e); see also § 1400Z-1(c).
\textsuperscript{37} See § 1400Z-1(e).
\textsuperscript{39} § 1400Z-2(a)-(b).
fund holdings. If I hold onto the investment for ten years, so until 2029, then I will owe no capital gains tax on my opportunity fund gains.\footnote{§ 1400Z-2(c).}

The statute requires that qualified opportunity funds invest ninety percent of their assets in qualified opportunity zone property.\footnote{§ 1400Z-2(d).} Qualified opportunity zone property includes stock in a corporation or an interest in a partnership if, according to the statute, “substantially all” of the corporation or partnership’s tangible property is inside the opportunity zone. The Treasury Department and the IRS have proposed regulations that would interpret “substantially all” in that context to mean “at least 70 percent”\footnote{Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18,652, 18,688 (May 1, 2018).}—which seems to be quite a stretch of the English language.\footnote{In the accounting context, “[s]ubstantially all’ is commonly considered to be approximately 90%.” The New Business Definition: Why It Matters, PRICEWATERHOUSECOOPERS: IN THE LOOP, Feb. 2018, at 2, https://www.pwc.com/us/en/cfodirect/assets/pdf/in-the-loop/fasb-new-definition-of-business.pdf.}

I would like to know how Treasury officials would feel if a young daughter or son of theirs claimed to have completed “substantially all” of the evening’s homework but had in fact left thirty percent undone. In any event, the net effect is that a taxpayer can benefit from the opportunity zone provision if she invests in a fund that invests ninety percent of its assets in businesses that hold seventy percent of their property in opportunity zones, which means that at the end of the day, only sixty-three percent of the investment needs to go into the areas that the statute was intended to lift up.

The fact that a taxpayer can claim one hundred percent of the benefits of the opportunity zone program when less than two-thirds of that taxpayer’s investment goes toward a low-income community is just one among a number of ways in which the provision is poorly targeted. First, unlike LIHTC, there is nothing in the opportunity zone program that appears aimed at expanding access to affordable housing. A developer could buy a building in an opportunity zone currently occupied by low-income tenants, tear it down, replace it with luxury rentals, and claim the opportunity zone tax benefits. Second, unlike the empowerment zone program’s work credit, there is nothing in the opportunity zone provision that ensures that investments receiving tax preferences will generate jobs—for low-income workers or for anyone else. An enterprise could, for example, acquire an existing factory in a high-poverty area, fire all the workers, replace them with robots, and still claim all the opportunity zone tax benefits for its investment. Third, unlike the New Markets Tax Credit, there is nothing in the opportunity zone statute that provides for community accountability or Treasury oversight.\footnote{A new working paper by Alan Sage, Mike Langen, and Alexander Van de Minne finds that opportunity zone designation led to a 14 percent increase in the price of “redevelopment properties” (i.e., apartments older than 60 years and other buildings older than 30 years) and a 21 percent increase in the price of vacant land. Alan Sage, Mike Langen, and Alexander Van de Minne, Where Is the Opportunity in Opportunity Zones? Early Indicators of the Opportunity Zone Program’s Impact on Commercial Property Prices 2, 18 (June 1, 2019) (unpublished Electronic copy available at: https://ssrn.com/abstract=3436899}
Perhaps the only saving grace of the opportunity zone program is that the tax benefits might turn out not to be so large. The Joint Committee on Taxation initially estimated a revenue cost of approximately $1.6 billion over the course of a decade\(^{45}\)—or slightly more than one-one thousandth of the total cost of the December 2017 tax law. Opportunity zones lose money for the federal government until 2025 and then lead to higher capital gains tax collections in 2026, when taxpayers who deferred gains when they made their initial opportunity zone investments will now owe Uncle Sam.

The revenue cost of opportunity zones could be even smaller if capital gains rates rise between now and 2026. Recall that when you roll capital gains into a qualified opportunity fund today, you defer your liability until 2026 and you pay tax only on eighty-five cents of every one dollar of realized gains. What you do not do is lock in current capital gains rates. So, if we find ourselves with a Democratic-majority Congress and a Democratic president who eliminate the preferential rate for long-term capital gains, opportunity zone investors may pay a much larger bill in 2026 than if they had paid tax on their gains today at current rates.

The second tax benefit of opportunity zones—the elimination of tax on all capital gains for investments held longer than a decade—also turns out to be somewhat less than advertised. Section 1202, the qualified small business stock provision, already allows taxpayers to erase tax on capital gains for small-business investments held longer than five years. “Small business” in section 1202 does not mean “small” by your and my standards: the business may have assets of up to $50 million at the time of the investment and still qualify.\(^{46}\) There are, to be sure, industry-specific limitations in section 1202 that are more onerous than the opportunity zone provisions. For example, section 1202 cannot be used for businesses that operate hotels and restaurants, while the opportunity zone benefits can be.\(^{47}\) But most of the income from operating a hotel or restaurant will be ordinary income, not capital gains, and will be taxed at normal rates regardless of whether the taxpayer channels her investment through a qualified opportunity fund.

Section 1202 aside, there is an easier way to eliminate tax on capital gains entirely without investing through a qualified opportunity fund—and that is to die. Stepped-up basis at death applies to all capital assets,\(^ {48}\) and it requires many fewer lawyer hours than an opportunity zone investment will. Moreover, if you sell an


\(^{46}\) I.R.C. § 1202(d).

\(^{47}\) § 1202(e)(3).

\(^{48}\) § 1014.
asset for a capital gain today, plow the gains into a qualified opportunity fund, and then die before 2026, your heirs lose the stepped-up basis benefit that they otherwise would have received if you had held onto the initial asset until the end of your life.49

I should acknowledge at this point that my views about the tax benefits of opportunity zones are somewhat contrarian: Listen to tax lawyers and accountants and you will hear that the opportunity zone provisions will allow taxpayers to achieve “tremendous savings”50 and “could potentially enable trillions of dollars in current and future capital gains to be deferred. . . .”51 And of course they say that: No tax practitioner ever wooed a client by advertising a modest tax-reduction opportunity that may end up costing more in legal fees than it achieves in actual savings. There are, however, at least two points on which the opportunity zone promoters and I can achieve consensus.

First, in terms of scope, the opportunity zones are indeed unique among the spatially differentiated tax provisions that Congress has enacted so far. There are approximately twelve times as many opportunity zone census tracts as there were empowerment zone census tracts: 8,762 versus 728.52 Unlike LIHTC, which is limited to a specific asset class (namely, residential real estate), the opportunity zone tax benefits potentially apply to any type of investment in tangible property. And whereas LIHTC and the New Markets credit are subject to binding dollar limitations, the benefits of the opportunity zone provisions are uncapped (though I would eat my hat if they turn out to be in the trillions, or even the tens of billions).

Second, in terms of the amount of attention that they have generated, the opportunity zone provisions are unique among spatially differentiated tax provisions as well. According to the LexisNexis database, the number of North American newspaper stories referencing opportunity zones in the first year after the Tax Cuts and Jobs Act was about 33 times the number of newspaper stories.

referencing empowerment zones in the first year after their creation in 1993—1,129 versus 34.53 LIHTC and the New Markets credit were barely a blip on the media’s radar when those programs were rolled out. Spatially differentiated taxation is arguably having its first real prime-time moment. Alas, given the opportunity zone program’s deep flaws, it is doubtful that the debut performance will dazzle.

III.

Whether we should lament this result depends on whether we think well-designed spatially differentiated tax provisions hold much promise. I think they plausibly do, though my conclusions are tentative and the programs I am envisioning would take a rather different form than earlier and existing place-based tax rules.

The case for spatial differentiation must be based on something more than a redistributive impulse. If we want to provide affordable housing to low-income families, we can do that by rewarding developers that house low-income families or by providing rental subsidies to the families themselves. There is no obvious reason to base the provision on place when we can target the subsidy with precision at the very people whom we want to aid. Likewise, if we want to encourage businesses to create jobs for low-income workers, we can provide tax credits for hiring low-income workers. There is no obvious reason to target the credits at all residents of low-income areas, who in some cases might not be low-income themselves, and there is likewise no obvious reason to limit the credits to residents of low-income areas, as some low-income families might live elsewhere. For spatially differentiated taxation to make sense, it must be the case that we learn something from the characteristics of places that we cannot just as easily learn by observing the characteristics of people.

One potential use of location in taxation that seems to satisfy this criterion is the idea of place as a tag. This idea is drawn from drafts of a forthcoming paper in the Journal of Political Economy by the Berkeley economist Danny Yagan.54 Yagan’s idea is as follows: in tax, we are always looking for “tags”—indicators of need or ability to pay other than income. The problem with calculating taxes on the basis of income is that income is itself responsive to taxes. When we redistribute from high-income individuals to low-income individuals, we discourage work and investment. Ideally, we would have some way of measuring your income-earning opportunities other than income itself—such as if the IRS could observe your IQ.

Yagan suggests that under certain circumstances, place can function as just such a tag. The Great Recession swept through some parts of the country like a category 5 hurricane and elsewhere was more like an economic tropical storm.


Individuals in some areas, like Phoenix, Arizona, fared much worse than those in other areas, like San Antonio, Texas. These differential effects persist more than a decade after the recession began. We might think of living in Phoenix at the time of the Great Recession in the same way we think of living in New Orleans at the time of Katrina: as a fact out of your control that has affected your ability to accumulate income. For much the same reason as we want to redistribute to individuals who lived in New Orleans in 2005, we might also want to redistribute to individuals who lived in Phoenix when the Great Recession hit shortly thereafter. This is a way of redistributing on the basis of need—or ability to pay—without distorting incentives to earn income in the future.

We could use mechanisms other than taxation to accomplish this type of redistribution, but the tax system has certain advantages. In most cases, the IRS already knows where you lived in 2008. It can adjust tax liabilities on that basis at little administrative cost. It can track down former Phoenix residents who now live somewhere else, and it can distinguish between current Phoenix residents who were there at the onset of Great Recession and current Phoenix residents who lived elsewhere at that time.

To be clear, the idea here is to use place as a backward-looking tag for redistribution, not to adjust taxes based on where you live now. The idea works best in the aftermath of a cataclysmic economic event; it works less well if the intervention is anticipated. Tagging on the basis of past place may therefore be only a one-time tool. If too often repeated, it may have the perverse effect of encouraging individuals to remain in the path of an economic storm rather than relocating to a place with greater employment opportunities.

Another potential use of place in taxation emerges from the literature on “moving to opportunity.” Moving to Opportunity was a randomized controlled trial conducted across five U.S. cities between 1994 and 1998 in which nearly 5000 families with children in public housing projects participated. Some participants received standard Section 8 Housing Choice vouchers that they could use anywhere that took Section 8. Others received “moving to opportunity” vouchers that they could only use if they relocated to a low-poverty area. The idea was that if concentrated poverty generates significant harms, then the families that received the “moving to opportunity” vouchers should fare better on measurable dimensions than the others.

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55 Id. at 2.
57 The argument for IRS administration of retrospective place-based payments accords with the idea that responsibility for spending programs should be allocated on the basis of institutional competencies. See generally David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955 (2004).
58 The design of the experiment and the results are summarized in Lisa Sabonmatsu et al., *Moving to Opportunity for Fair Housing Demonstration Program: Final Impacts Evaluation—Prepared for U.S. Department of Housing and Urban Development Office*.
The results were mixed. A decade later, adults in the families that “moved to opportunity” were no more likely to be employed than the control group, and they did not earn measurably higher wages. But rates of extreme obesity and diabetes were markedly lower among adults in the moving-to-opportunity families. Test scores for children in those families did not exhibit immediate improvement, but children whose families moved to low-poverty areas when they were younger than thirteen years old showed significantly improved long-term educational and economic outcomes. Harvard economists Raj Chetty, Nathaniel Hendren, and Lawrence Katz estimate that moving a child and her family out of a high-poverty housing project and into a low-poverty area when she is eight or younger will increase her lifetime earnings by somewhere around $300,000.59

These findings are amenable to a number of possible interpretations, and the scholarly debate over the implications of the Moving to Opportunity experiment is far too rich to summarize succinctly. One possible inference is that growing up in an environment of concentrated poverty produces tangible and long-lasting harms. If so, then a worthy social objective might be to encourage some higher-income households in high-income areas and some lower-income households in low-income areas to swap location, which would have the effect of deconcentrating poverty overall.

This normative claim is tentative because the existing evidence is incomplete. As researchers involved in the Moving to Opportunity experiment acknowledge, the experiment tells us only about the effects of moves on families initially living in high-rise public housing in high-poverty neighborhoods of Baltimore, Boston, Chicago, Los Angeles, and New York in the mid-1990s.60 And even among this population, the results tell us only about the effect of moves on families who participated in the experiment (i.e., who “were at least somewhat interested in moving and sufficiently organized to take note of the opportunity and complete an application”).61 The Moving to Opportunity results may be—but are not necessarily—generalizable to other populations (e.g., homeowners and renters of privately owned units) in other cities or suburban and rural areas in other time periods. Moreover, participants in the experiment had limited neighborhood-specific social capital. More than half of household heads reported at the outset that they had “no friends” in their initial neighborhood, and nearly two thirds had no family in the neighborhood either.62 Moving from a low-income neighborhood to a high-income neighborhood may be less beneficial if the movers leave behind networks of friends and family. And the Moving to Opportunity experiment tested only one half

61 Id. at 155.
62 Id. at 155-56.
of the household-swap equation: the movement of low-income households into higher-income neighborhoods. We do not know the effect of high-income households moving into low-income neighborhoods (either on themselves or on their new neighbors).  

With these considerable caveats in mind, spatially differentiated taxation suggests a potential way to facilitate the deconcentration of poverty and the emergence of more socioeconomically heterogeneous neighborhoods. We might imagine, for example, spatially differentiated income tax rate structures: steeply progressive rate structures in low-poverty areas and flatter rate structures in high-poverty areas. Households at the bottom of the income ladder would therefore have an incentive to move to high-income areas, where they would benefit from the additional progressivity, while households at the top of the income ladder would have an incentive to move to low-income areas, where they would benefit from flatter rates. Given the persistent correlation between income and race, spatially differentiated rate structures could also help to accomplish what a half-century of fair housing law has largely failed to bring about: it could encourage higher-income, disproportionately white families to relocate to areas that were historically communities of color, and enable members of minority groups to move into areas that have long been bastions of whiteness.

The idea of using federal tax policy to encourage economic integration—and with it, racial residential mixing—will almost certainly engender controversy. The movement of high-income households into low-income areas is sometimes characterized—and criticized—as “gentrification” (though note that the movement of high-income households into low-income areas will almost certainly need to occur if residential integration along racial and ethnic lines is to become a reality). Critics of spatially differentiated rate structures also might argue that politicians in Washington ought to get out of the business of choosing who lives, works, and

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63 A new working paper by Quentin Brummet and Davin Reed examines this other half, though results are inconclusive. Brummet and Reed find that that the entry of high-income households into low-income neighborhoods reduces exposure to neighborhood poverty for original residents (adults and children) and leads to higher home values for original residents who owned their homes. Quentin Brummet and Davin Reed, The Effect of Gentrification on the Well-Being and Opportunity of Original Resident Adults and Children 2, 18-20, 22-23 (Fed. Reserve Bank of Phila., Working Paper No. 19-30, July 2019), https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2019/wp19-30.pdf. The authors do not, however, find consistent effects on employment or income for original residents, nor do they find consistent effects on educational attainment for original resident children. See id. at 35 tbl.5, 37 tbl.7.

64 Note that zero is not a lower limit on the marginal or effective tax rate. Congress could set a negative tax rate for low-income residents of high-income neighborhoods so that these households can better afford the cost of the move and higher rents in their new environs.

65 Michelle Layser, for example, characterizes the idea of “integration . . . as a solution to urban poverty” as an implicitly “pro-gentrification” objective. See Michelle D. Layser, The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform, Wis. L. REV. (forthcoming 2019), https://ssrn.com/abstract=3347401 (manuscript at 48-49).

66 See Hemel, supra note 20.
invests where. To be sure, existing patterns of residence, employment, and investment are also not the outgrowth of an unbridled free market. They are products of policy choices—redlining, enforcement of racially restrictive covenants, mid-century urban renewal efforts, and so on. To refrain from place-based policymaking today is to allow the dead hand of past place-based policies to rule us in the present.

A third path for spatially differentiated federal taxation builds on the work of Princeton economists Adrien Bilal and Esteban Rossi-Hansberg, who observe that location can serve as an asset that facilitates resource transfers across time. One way to think of it is as follows: We can transfer wealth to our children by bequeathing financial assets to them; we can also transfer wealth to our children by raising them in amenity-rich places like Indian Hill outside Cincinnati, Pepper Pike to the east of Cleveland, and New Albany near Columbus. Raising children in these sorts of places endows them with human capital, social capital, and oftentimes political capital just as the transfer of financial assets endows them with economic capital.

The perpetuation of inequality across generations is, most would agree, one of the more vexing policy challenges that we as a nation face. The United States has for the most part given up on the idea of taxing intergenerational wealth transfers, though the federal estate and gift taxes remain nominally in effect. If we are ever to recommit ourselves to the idea of using the tax system to achieve a more level intergenerational playing field, we will have to grapple with the reality that wealth transfer occurs through locational assets as well as through financial assets. Should adults who were reared in Indian Hill or Pepper Pike or New Albany owe some sort of inheritance tax on their suburban upbringings? The idea may seem crazy at first, but a comprehensive tax on intergenerational wealth transfers might contemplate this notion.

These proposals are all quite preliminary and I look forward to ideas from other symposium participants. A robust regime of spatially differentiated taxation raises questions that today’s talk has only scratched upon. The promise of place-based taxation should not be judged solely on the basis of its past, and certainly not on the basis of the present opportunity zone mess. We may conclude upon reflection that the administrative and political challenges of spatially differentiated taxation render the game not worth the candle. My working hypothesis, though, is that there is indeed a place for place in federal tax law. The 2017 tax law may have been an inauspicious start to federal tax law’s space odyssey—or, more accurately, an ill-fated expedition following a number of earlier forays. But spatially differentiated

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federal taxation is not necessarily a doomed enterprise. If the opportunity zone experiment motivates more careful, creative thinking about the relationship between location and taxation, then something potentially positive will have emerged from the experience.
THE PRO-GENTRIFICATION ORIGINS OF PLACE-BASED INVESTMENT TAX INCENTIVES AND A PATH TOWARD COMMUNITY ORIENTED REFORM

MICHELLE D. LAYSER*

Place-based investment tax incentives, which encourage taxpayers to invest in poor areas, constitute a particularly controversial, yet undertheorized, category of tax laws. The central problem presented by current place-based investment tax incentives is a contradiction between rhetoric and reality. They are presented as laws that benefit low-income communities, yet the dominant types of place-based investment tax incentives are not designed for this purpose. Understanding the reasons for this disconnect is key to assessing the limits and potential of place-based investment tax incentives as anti-poverty tools. By tracing the development of place-based investment tax incentives to their pro-gentrification origins, this Article argues that what many anti-poverty advocates view as a flaw—the lack of safeguards for poor communities that allegedly opens the door to abuses—is, in fact, a feature of most current place-based investment tax incentives.

This Article makes several important contributions to the legal literature. First, it helps to establish spatial inequality as an area of inquiry for tax law research. Second, it advances our understanding of how place-based investment tax incentives relate to nontax anti-poverty policies. Third, it provides guidance for policymakers. This Article contends that if place-based investment tax incentives are used at all, then they should be used for anti-poverty goals. Place-based investment tax incentives have a unique advantage over nontax policies in that they continue to enjoy bipartisan support even as the political climate grows increasingly polarized. Thus, rather than abandon the tax-based approach, this Article argues that state and local governments should introduce pilot programs of community oriented investment tax incentives. Accordingly, this Article recommends that lawmakers incorporate participatory elements, such as

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community benefits agreements or use of mental mapping techniques, to
design tax incentives that are more likely to benefit residents of poor
communities. This would enable researchers to study their impact and
evaluate their potential as large-scale anti-poverty programs.

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INTRODUCTION

Place-based investment tax incentives, which encourage taxpayers to invest in poor areas, constitute a particularly controversial, yet undertheorized, category of tax laws. Recent debates over the new federal Opportunity Zones tax incentive, which was quietly included in the Tax Cuts and Jobs Act, are illustrative. Just months after proponents predicted that the new law would attract as much as $100 billion to poor areas, news outlets began to speculate whether the tax incentive had motivated the tech giant Amazon to select a “fast-gentrifying Queens neighborhood across the East River” in New York for its east coast headquarters.

1. Place-based investment tax incentives are defined as investment tax incentives used to encourage taxpayers to invest in poor areas. Michelle D. Layser, A Typology of Place-Based Investment Tax Incentives, 23 Wash. & Lee J. Civ. R. & Soc. Just. 403, 405 (forthcoming 2019) [hereinafter Layser, Typology]. The phrase “place-based investment” refers to government investment intended to produce positive externalities in areas of concentrated disadvantage. See Patrick Sharkey, Stuck in Place: Urban Neighborhoods and the End of Progress Toward Racial Equality 179 (2013) (noting that place-based investment can help reverse a long list of social and economic disadvantages in poor communities, including but not limited to: lower political influence, lower-quality public services and schools, a weak economic base, ineffective policing, gang activity and other crime, violence, teenage childbearing, high dropout rates, poor community health, joblessness, homelessness, and blight); Michelle D. Layser, How Federal Tax Law Rewards Segregation, 93 Ind. L.J. 915, 955–56 (2018) [hereinafter Layser, Segregation]. This approach contrasts with mobility approaches that attempt to decrease disadvantage by moving people away from areas with concentrated poverty. Id.

2. See I.R.C. §§ 1400Z-1 to -2 (2012 & Supp. V 2017). Under the new tax law, taxpayers who sell appreciated property can defer—or even permanently avoid—taxes they would otherwise owe on capital gains by reinvesting sale proceeds in so-called “Opportunity Funds.” See id. In turn, Opportunity Funds are required to make new equity investments in businesses located in designated Opportunity Zones. Id.


Anti-poverty advocates and watchdog groups were incensed. TalkPoverty.org tweeted to its followers, “Amazon (and Trump) are poised to get rich off a tax break that’s supposed to help poor communities.” When asked whether the law was really “supposed to help poor communities,” another anti-poverty advocate asserted that helping the poor “is the stated mission of the OZ program” but admitted that “it is not designed that way.” He added, “That is why we’ve been trying to sound the alarm and encourage those in power to put in guardrails and regulations to ensure benefits can accrue to residents of these communities.”

This Article argues that what anti-poverty advocates view as a flaw—the lack of safeguards for poor communities that allegedly opens the door to abuses—is, in fact, a feature of most current place-based investment tax incentives. The development of place-based investment tax incentives and their designs can be explained as a predictable outgrowth of the pro-gentrification business and political environment that produced them. Viewed through this lens, it becomes much easier to reconcile (but harder to justify) the continued use of place-based investment tax incentives despite the lack of empirical evidence that they benefit poor communities.

It also becomes easier to understand the experiences of poor communities whose neighborhoods have been designated for tax incentives—poor communities like Overtown, Miami. One of the oldest neighborhoods in the city, Overtown was once a relatively prosperous area known as Colored Town, but today it is known

9. Id.
instead as the city’s busiest opioid marketplace. City leaders have long sought to revitalize Overtown, designating the area for tax and regulatory relief. In 2015, a local redevelopment agency voted to give more than $100 million tax incentives to developers of a “high end shopping, luxury condominium, and hotel room[]” complexes in the neighborhood.

A couple years later, the Miami Herald began to report on the "rise of restaurants" in Overtown, which they said, “has helped breathe new life into the community.” An optimistic banner announced the neighborhood’s bright, up-and-coming future, proclaiming: “Experience Overtown. Eat, Live, Work, Play.” Still, neighborhood residents, religious leaders, and local housing rights and labor activists were not so sure. Pastor Rhonda Thomas, a longtime community resident, explained, “It’s not like I hate developers. Let’s just be fair and include the community that you’re coming into.” If the community had been included in the revitalization plans, then it was hard to tell just by looking around. The sidewalks were littered with crushed beer cans, and the highway overpass was crowded with homeless people living underneath.

Then, on a hot afternoon in June 2017, a ten-year-old boy left his community swimming pool, walked past the banners and a fancy new apartment building, and returned to his second-floor flat in this poverty-stricken neighborhood. When he arrived at home, he began to vomit, and by that evening he was dead—killed by an overdose of heroin and fentanyl. After it happened, one of his neighbors told a reporter, “If I

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14. Ducassi, supra note 11.


17. Ducassi, supra note 11.


19. Id.

20. Id.
had money, baby, I wouldn't be here." 21 About her own children, she said, "You really can't shield them from everything." 22

This Article contends that the failure of most place-based investment tax incentives to improve conditions for residents in neighborhoods with concentrated poverty—neighborhoods like Overtown—is a predictable consequence of laws that were never intended to do so. It argues that, although the political rhetoric around place-based investment tax incentives appeals to anti-poverty sentiments and helps maintain their bipartisan support, the actual laws are best understood as part of a pro-gentrification agenda. Viewed in this light, place-based investment tax incentives look less like failed policies, but they also are less justified. This Article argues that most current place-based investment tax incentives should be abandoned. Instead, lawmakers should introduce community oriented investment tax incentives that are specifically designed to benefit poor communities.

This Article makes several important contributions to the legal literature. First, it helps to establish spatial inequality as an area of inquiry for tax law research. To date, most tax and inequality research has focused on inequality at the individual or family levels, and comparatively little research has asked how tax law relates to spatial inequality. 23 This Article begins to fill that gap by analyzing the potential for tax laws to be used as tools to fight concentrated poverty. To this end, it provides a positive law theory to explain the current landscape of place-based investment tax incentives and their limitations as anti-poverty tools, and it demonstrates that place-based investment tax incentives may have greater potential to fight concentrated poverty than previously known.

21. Id.
22. Id.
23. But see Ellen P. Aprill, Caution: Enterprise Zones, 66 S. CAL. L. REV. 1341, 1343 (1993) (critiquing enterprise zone proposals and arguing that “[w]e should not be confident that a tax enterprise zone program will by itself revitalize our inner cities, or even that tax enterprise zones are the best way to start”); Louis Kaplow, Regional Cost-of-Living Adjustments in Tax/Transfer Schemes, 51 TAX L. REV. 175 (1996) (arguing that tax adjustments for cost-of-living are undesirable); Michael S. Knoll & Thomas D. Griffith, Taxing Sunny Days: Adjusting Taxes for Regional Living Costs and Amenities, 116 HARV. L. REV. 987, 989 (2003) (arguing that “the failure to adjust individuals' tax liabilities for different regional living costs misallocates capital and labor throughout the economy, discouraging investment and employment in high-cost regions and encouraging it in low-cost regions”); Layser, Typology, supra note 1 (providing a typology to help evaluate how place-based investment tax incentives impact poor communities); Layser, Segregation, supra note 1 (arguing that the mortgage interest deduction and low-income housing tax credit may interact to reinforce economic and racial residential segregation patterns); James M. Puckett, Location, Location, Location: Using Cost of Living to Achieve Tax Equity, 63 ALA. L. REV. 591 (2012) (questioning the assumption of taxpayer mobility and arguing that cost of living affects ability to pay).
Second, it advances our understanding of how place-based investment tax incentives relate to anti-poverty policies. Tax scholars have recently begun to describe place-based investment tax incentives as anti-poverty tax laws,24 but relatively little poverty law research has focused on the role of place-based investment tax incentives. A clear understanding of how these tax laws relate to nontax anti-poverty policy will be essential as tax and poverty law experts seek to evaluate and improve these incentives. This Article helps bridge the fields of tax law and poverty law by demonstrating the untapped potential of place-based investment tax incentives as anti-poverty tools. It also provides an explanation for why tax law has evolved to support place-based investment strategies even as nontax policies have shifted toward people-based strategies, such as the use of tenant vouchers.

Third, it provides normative and prescriptive guidance for policymakers. The Article contends that, if place-based investment tax incentives are used at all, then they should be used for anti-poverty goals. While nontax policies can and should be used in addition to tax-based approaches, place-based investment tax incentives have a unique advantage over nontax policies in that they continue to enjoy bipartisan support even as the political climate grows increasingly polarized. Thus, this Article argues that state and local governments should introduce pilot programs of community oriented investment tax incentives and provides a roadmap for designing tax incentives that are more likely to benefit residents of poor communities. This would enable researchers to study their impact and evaluate their potential as large-scale anti-poverty programs.

Part I of this Article explains why spatial inequality, including concentrated poverty, is an important area of inquiry for tax law research, and it introduces place-based investment tax incentives as the subject of study. Part II describes the current landscape of place-based investment tax incentives and demonstrates that neither theory nor evidence supports the optimistic rhetoric that drives the bipartisan popularity of these tax incentives. The central problem presented by current place-based investment tax incentives is this contradiction between rhetoric and reality; though they are presented as laws that benefit low-income communities, the dominant types of place-based investment tax incentives are not designed for this purpose. Understanding the reasons for this disconnect is key to assessing the limits and potential of place-based investment tax incentives as anti-poverty tools.

Part III confronts this problem by tracing the development of today's dominant types of place-based investment tax incentives to their

pro-gentrification origins in order to provide an explanatory theory about their development. Namely, it argues that the hidden objective of these types of laws is to support gentrification for the benefit of place entrepreneurs and other wealthy parties. Part IV argues that most current place-based investment tax incentives should be abandoned as bad policy. Even if gentrification is a legitimate policy goal, most current place-based investment tax incentives are less efficient or equitable than alternative types of incentives.

Accordingly, Part V argues that lawmakers should introduce alternative types of place-based investment tax incentives designed to improve neighborhood conditions in poor communities for the benefit of poor communities. After analyzing imperfect models of these types of incentives under current law, it presents a theoretically and empirically grounded roadmap for using participatory techniques to design community oriented investment tax incentives that are more likely to benefit poor communities. Until these community oriented investment tax incentives are tested, our understanding of the potential for place-based investment tax incentives to fight concentrated poverty will remain incomplete.

I. POVERTY, POLITICAL RHETORIC AND PLACE-BASED INVESTMENT TAX INCENTIVES

A. Concentrated Poverty as a Problem Faced by Policymakers

The tax literature includes at least two major lines of research that consider the relationship between taxation and inequality in the United States, both of which implicitly focus on inequality at the individual or family levels. The first line of research looks at the tax system itself and asks whether tax laws treat similarly situated tax units similarly (horizontal equity) and whether tax burdens are allocated based on tax units' ability to pay (vertical equity). In both cases, the unit of measurement is generally set at the individual or family level.

The second line of research looks at how tax law affects social and economic inequality more generally by considering the overall distribution of resources, or by looking at the distribution of resources across demographics like race or gender. Unlike traditional tax

26. See id.
27. See, e.g., Tahk, supra note 24, at 796 (analyzing the use of tax laws as anti-poverty tools); David Kamin, Reducing Poverty, Not Inequality: What Changes in the Tax System Can Achieve, 66 TAX L. REV. 593, 594 (2013) (exploring "the limits of the tax system when it comes to inequality and poverty"); Eric M. Zolt, Inequality in America: Challenges for Tax and Spending Policies, 66 TAX L.REV. 641, 643-44 (2013) (arguing that policy should focus on poverty reduction, not the reduction of
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fairness research, which has focused on the equitable distribution of tax burdens, this research considers how well the tax system promotes a fairer distribution of after-tax resources in society.28 A growing subset of this second strand of tax literature de-emphasizes overall distributional equity and instead emphasizes welfare measures like poverty rates, with a focus on how tax law affects the number of people (or families) experiencing poverty.29

These studies have rarely taken up questions about place and spatial inequities.30 But neither inequality nor poverty exist solely at the individual or family levels.31 Rather, “various forms of inequality are organized or clustered in social settings like neighborhoods, schools, and political districts, and these social settings represent crucial sites at which American inequality is generated, maintained, and reinforced.”32

Violence, unemployment, drug markets, gang activities, and health problems tend to cluster in space, so much so that one sociologist asserted that “[t]o truly understand inequity in America . . . it is necessary to move beyond a focus on income, occupation, and education, the traditional markers of socioeconomic status, and to consider the ways in which inequality is organized in space.”33 The clustering of people experiencing poverty within discrete neighborhood settings is often referred to simply as “concentrated poverty,” and it has been increasing over the past four decades.34 As such, it is essential to understand how the law, including tax law, relates to concentrated poverty and its consequences.35

Importantly, the concept (and problem) of concentrated poverty refers to more than a count of people in a location whose income is

inequality per se, and that the U.S. may need less progressive taxes in order to fund more progressive spending programs).

29. See Kamin, supra note 27, at 594; Zolt, supra note 27, at 643.
30. But see Tak, supra note 24.
31. See AMARTYA SEN, INEQUALITY REEXAMINED, 102–03 (1992); SHARKEY, supra note 1, at 14.
33. SHARKEY, supra note 1, at 15.
below the poverty line. In fact, the poverty rate itself may be misleading in geographic studies of welfare, as "areas may appear poor because they are disproportionately made up of groups who tend to be poor... which is a spatial reflection of a social effect rather than a direct spatial effect." Neighborhood poverty, on the other hand, "emerges when other benefits or penalties compound the advantages or disadvantages of particular groups by virtue of where they live."

Neighborhood poverty tends to permeate all aspects of such places. Poor neighborhoods in the United States are "fundamentally interwoven with racial segregation, with the resources available for children and families in the community, with the quality of local institutions like schools, with the degree of political influence held by community leaders and residents, with the availability of economic opportunities, and with the prevalence of violence." In metropolitan areas, the built environment also plays a role "in exacerbating or protecting against rising neighborhood poverty."

The neighborhood poverty rate is therefore a mere proxy that conveys "multiple dimensions of distress and negative effects." At certain thresholds, the poverty rate correlates with other indicators of disadvantage, and one researcher identified forty percent as the poverty rate threshold "at which neighborhoods are very likely to not have access to opportunities." In other words, negative outcomes are most likely to be observed in neighborhoods where forty percent or more residents have income below the poverty line.

Indeed, the negative effects of concentrated poverty have been thoroughly documented by social scientists. Researchers have shown that living in neighborhoods with a high concentration of individuals in

37. Id. at 188.
38. Id. at 189 (citing DAVID M. SMITH, HUMAN GEOGRAPHY: A WELFARE APPROACH 112 (1977)).
39. SHARKEY, supra note 1, at 28.
40. Pendall, supra note 34, at 34 (noting that "high-poverty neighborhoods are built literally on the bricks and mortar of the durable housing stock").
43. See, e.g., MATTHEW DESMOND, EVICTED: POVERTY AND PROFIT IN THE AMERICAN CITY (2016) (describing the legal, housing, and health challenges faced by poor families in Milwaukee); SHARKEY, supra note 1 (documenting the generational effects of concentrated poverty on black families); DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS (1993) (linking black poverty to residential segregation).
poverty—not just poverty alone—is a factor that contributes to a range of negative outcomes related to physical and mental health, crime, education and employment.\textsuperscript{44} Some effects of concentrated poverty, including reduced cognitive ability and earning capacity, appear to affect not only people who grow up in high-poverty neighborhoods, but also the next generation of children (whether or not they live in high-poverty neighborhoods).\textsuperscript{45}

Urban theorists have pointed to concentrated poverty (in addition to sprawl and segregation) as an empirical indicator of structural processes that act upon people and limit their opportunities for achievement.\textsuperscript{46} For example, areas with concentrated poverty are associated with higher crime rates,\textsuperscript{47} poorer housing conditions,\textsuperscript{48} fewer job options,\textsuperscript{49} and more health problems\textsuperscript{50} than seen in other, more affluent areas. These indicators reflect markets that operate in these areas—such as illicit drug markets, unequal housing markets and weak labor markets—and help shape residents' experiences of the world, the decisions they make and, ultimately, the opportunities they have before them.\textsuperscript{51}

Stated simply, when people live in neighborhoods with concentrated poverty, their chances of achieving substantial upward mobility—and escaping poverty, if applicable—are lower than the chances of people who live elsewhere.\textsuperscript{52} Of course, living in a neighborhood with concentrated poverty is not the sole challenge residents face—family background and family characteristics also play a

\textsuperscript{44.} \textsc{Sharkey, supra} note 1, at 14.
\textsuperscript{45.} \textit{Id.} at 119–24.
\textsuperscript{46.} \textsc{Gregory D. Squires & Charis E. Kubrin, Privileged Places: Race, Residence, and the Structure of Opportunity} (2006). \textit{See also} \textsc{Greenlee, supra} note 41, at 30.
\textsuperscript{47.} Tali Cassidy et al., \textit{A Systematic Review of the Effects of Poverty Deconcentration and Urban Upgrading on Youth Violence}, 26 \textsc{Health \\& Place} 78, 78 (2014) ("Violence levels vary greatly across neighbourhoods and concentrated poverty is correlated with high levels of violence.").
\textsuperscript{48.} \textit{See} \textsc{Pendall, supra} note 34, at 34.
\textsuperscript{49.} \textit{See} Matthew Freedman, \textit{Place-Based Programs and the Geographic Dispersion of Employment}, 53 \textsc{Regional Sci. Urb. Econ.} 1, 1 (2015).
\textsuperscript{50.} Megan Sandel et al., \textit{Neighborhood-Level Interventions to Improve Childhood Opportunity and Lift Children Out of Poverty}, 16 \textsc{Acad. Pediatrics} S128, S128 (2016).
\textsuperscript{51.} According to urban theorists, people experience these processes (including the effect of institutions like the tax law) as an "opportunity structure" that influences their decision making. George C. Galster & Sean P. Killen, \textit{The Geography of Metropolitan Opportunity: A Reconnaissance and Conceptual Framework}, 6 \textsc{Housing Pol'y Debate} 7, 9–11, 35–36 (1995).
\textsuperscript{52.} \textsc{Sharkey, supra} note 1, at 107.
role, as do other factors—but data suggests that it presents an independent, additional barrier to economic advancement. For example, neighborhood poverty during childhood is associated with less upward mobility as adults.

Moreover, the negative effects of concentrated poverty have been further linked to persistent racial income gaps, particularly between black and white Americans. Researchers have long noted that middle-income African Americans are more likely than whites (of any income level) to live in or near neighborhoods with high poverty rates, and doing so has made it difficult for many to maintain their economic position. The proportion of blacks who have made substantial economic advancements in the two generations since the Civil Rights Act has been “extremely low, particularly when compared with whites,” and there has been “an extraordinary amount of downward economic mobility among African American families that were doing fairly well a generation ago.” Living in (or in close proximity to)

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53. To be sure, the neighborhood environment is neither a complete explanation for the racial income gap nor the largest contributing factor. Id. Family background explained a nineteen percent racial income gap. Id. at 106.


55. Sharkey, supra note 1, at 114. As used here, economic mobility refers to intergenerational economic mobility, whereby children achieve, as adults, a higher or lower position on the income distribution than their parents. Id. For example, if a child’s parents had been in the twenty-fifth percentile of the overall income distribution, and that child reaches the twenty-sixth percentile as an adult, then that child has experienced upward economic mobility. Id.

56. Id. at 107. Note that so far, the research on neighborhood effects has focused most heavily on poor, urban black populations. One reason for the focus on urban blacks, as opposed to other racial demographics or poor people more generally, relates to data availability. Id. at 7.

57. In fact, only fifteen percent of white families with incomes below the poverty line live in neighborhoods with concentrated poverty, while seventeen percent of blacks who are not poor live in neighborhoods with concentrated poverty. Pendall, supra note 34, at 36. One researcher explained: “These neighborhoods tend to have more boarded up houses, more female-headed households, and fewer college graduates than middle class White neighborhoods.” Cecily R. Hardaway & Vonnie C. McLoyd, Escaping Poverty and Securing Middle Class Status: How Race and Socioeconomic Status Shape Mobility Prospects for African Americans During the Transition to Adulthood, 38 J. Youth Adolescence 242, 244 (2009).

58. See Hardaway & McLoyd, supra note 57, at 244.

59. Sharkey, supra note 1, at 4. Where white children from middle- and upper-income families have generally achieved “much higher income than their parents when they reach adulthood,” black children from similar families have achieved the opposite. Id. In other words, black families have been getting poorer while white
neighborhoods with concentrated poverty may be a partial cause of the racial income gap.\(^6\)

In sum, concentrated poverty presents a serious challenge to equality in America and, by disproportionately affecting minority populations, may also contribute to racial inequality. At the most basic level, these inequities are problems faced by lawmakers, who often point to place-based investment tax incentives as tools to help address issues like these.\(^6\) The next section briefly describes the political appeal of place-based investment tax incentives and the rhetoric that surrounds them.

\section*{B. Place-Based Investment Tax Incentives as a Popular Policy Response}

Unlike many nontax policies related to affordable housing and community development, place-based investment tax incentives have traditionally attracted significant bipartisan support.\(^6\) This bipartisan	

\begin{itemize}
\item families have been getting richer. See \textit{id}. As of 2010, blacks had family income that was "roughly [forty-seven] percent lower than whites." \textit{id}. at 105.
\item Id. at 96. Some of the racial income gap is attributable to family background (family income, parents' level of education, parents' occupation) and other family characteristics (parents' marital status, welfare receipts, type of housing). \textit{id}. at 105-06. But family background and other family characteristics do not explain the entire racial income gap or the reasons why black families are experiencing downward economic mobility at a greater rate than white families. \textit{id}. When the data is adjusted to compare black and white children who have the same family background and family characteristics—\textit{and} who grow up in the same type of neighborhoods—the racial income gap drops from forty-seven percent to seventeen percent. \textit{See id}. at 106 fig. 4.5. Adjusting for neighborhood type alone closes the gap by seven percent. \textit{See id}. Sharkey notes "if we were to compare two children, one black and one white, who were raised in the 1970s by families that look extremely similar in every observable way, the black child could expect to have about twenty-four percent lower annual income as an adult." \textit{Id}. This figure drops to seventeen percent, however, when the comparison accounts for neighborhood type. \textit{See id}. at 106 fig.4.5. Hispanic and American Indians are also far more likely than their white counterparts to live in areas of concentrated poverty. \textit{AleMayehu Bishaw, Changes in Areas With Concentrated Poverty: 2000 to 2010 at 14 tbl.2a (2014), https://www.census.gov/library/publications/2014/acs/acs-27.html [https://perma.cc/3CXJ-3WUN] (last visited Aug 10, 2017) (showing that in 2010, 50.4\% of blacks, 47.8\% of American Indians and Alaska Natives, and 44.1\% of Hispanics live in poverty areas, as compared to 16.6\% of white Americans). Note that the U.S. Census Bureau considers any area with a twenty percent poverty rate or higher to be a "poverty area." See \textit{id}. at 2 n.6.}
\item Though some question whether tax law should be used to address societal inequities, even some skeptics have observed that "there is no sense to the position that, while other laws might legitimately be used to achieve greater equality, the tax system must not be given over to such function." Blum & Kalven, \textit{supra} note 28, at 487.
\end{itemize}
support is bolstered by rhetoric that pitches the incentives as beneficial to a variety of communities, including the investment community, poor communities, and the taxpaying public.

Progressive groups tend to highlight the need to address concentrated poverty and inequality. For example, the left-leaning Center for American Progress has pointed to place-based investment tax incentives as part of the solution for addressing concentrated poverty, arguing that some federal incentives should be made permanent. Other advocacy organizations implicitly regard place-based investment tax incentives as anti-poverty tools, describing them as tax breaks “for low-income communities” and calling the goal of boosting development in poor areas “laudable,” as long as funds are directed to places that are really distressed.

Members of the development community view their own activities, which they frame in terms of benefits to poor communities, as dependent on the tax-based subsidies. For example, the Local Initiatives Support Corporation self-describes as “dedicated to helping community residents transform distressed neighborhoods into healthy and sustainable communities of choice and opportunity.” In testimony before the Congressional Joint Economic Committee, company representatives pointed to concentrated poverty as a growing problem and described two place-based investment tax incentives as “[t]wo of the most critical federal tools” that support their efforts.

Finally, conservative groups tend to support the tax incentives as pro-growth and likely to increase the tax base; however, they also tend to tout benefits to communities when presenting their case to the public. One conservative lawmaker described the new Opportunity Zones tax incentive as “an exciting tranche of common ground,” remarking that “people across the ideological spectrum can agree on this: leveraging modest federal investments to drive private capital into communities that have been sidelined as our national economy booms is a win-win


66. Id.

67. Id.
In voicing his own support for place-based investment tax incentives, he emphasized their capacity to bring "capital to places that have proven their ability to meet community goals and investor expectations for financial performance." Given this rhetoric and their popularity among such diverse groups, it is essential to understand the role—and potential role—of place-based investment tax incentives as a policy response to concentrated poverty. The next section will describe the current legal landscape of place-based investment tax incentives. It will show that despite the rhetoric that fuels their bipartisan support, the dominant type of place-based investment tax incentive is not designed to benefit poor communities.

II. DOMINANT TYPES OF PLACE-BASED INVESTMENT TAX INCENTIVES ARE NOT DESIGNED TO BENEFIT POOR COMMUNITIES

A. The Current Landscape of Place-Based Investment Tax Incentives

Though there are four basic types of place-based investment tax incentives, two of these types constitute the overwhelming majority of current place-based investment tax incentives. As this section will explain, neither of the most common types of place-based investment tax incentives is likely to benefit poor communities. Later parts of this Article will argue that the dominance of these types of place-based investment tax incentives, and the rarity of other types, is consistent with the theory that these tax laws are designed to support gentrification. But first, this section will describe the current landscape of place-based investment tax incentives and their impact.

The four types of place-based investment tax incentives can be described via a two-dimensional typology. The first dimension of the typology divides the tax laws according to whether they provide a tax break directly to taxpayers that conduct business in low-income communities or, alternatively, whether they provide tax benefits to third party investors who contribute capital to such businesses. In other words, if a business is entitled to a tax break because it expands its activities in a low-income community, then the tax law provides a direct tax subsidy to that business. On the other hand, if an investor is entitled to a tax break for contributing capital or extending a loan to

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68. Upton & Jones, supra note 62.
69. Id.
70. See Layser, Typology, supra note 1, at 456.
71. Id. at 412.
72. Id. at 429.
73. Id. at 415.
that same business, thereby enabling it to expand its activities in a low-income community, then the tax law provides an indirect tax subsidy to that business.\(^7\) All investment tax incentives can be divided into direct or indirect forms, regardless of whether they are intended to drive investments to a particular place.\(^5\)

Place-based investment tax incentives can be further divided along a second dimension of analysis that focuses on their spatial component. Accordingly, the second dimension of the typology divides the tax laws according to whether they incorporate features specifically designed to improve local residents' experiences of targeted areas. Thus, in addition to being categorized as direct or indirect tax subsidies, place-based investment tax incentives can also be categorized as community oriented (if they contain features to benefit local residents) or spatially oriented (if they do not). At minimum, a community oriented investment tax incentive must include some safeguard to prevent poor residents from being harmed, while spatially oriented investment tax incentives lack such safeguards.\(^6\)

Here, examples are helpful. Consider a tax law that enables Business X to claim a tax credit for locating in low-income Area X and hiring new workers, regardless of whether those workers are locals or commuters. Such an incentive may drive investment to that geographic area, thereby improving the economic environment within that space. But since nothing in the law encourages Business X to hire or otherwise engage with local residents, any benefit to the community would be incidental. For this reason, this tax law is best described as a spatially oriented investment tax incentive.

Similarly, a tax law that provides a tax break to rehabilitate buildings in low-income Area X, regardless of whether the rehabilitation project benefits local residents, would also constitute a spatially oriented investment tax incentive. For example, a tax law might encourage the transformation of a space used by poor residents into a space that will be used by wealthier people. Such law would improve the built environment in the area, but it would not necessarily

\(^7\) Id. at 416-17.

\(^5\) For example, wind energy production tax credits are structured as indirect tax subsidies; the tax credits create incentives for investors to contribute capital to entities that will produce renewable energy. In practice, those tax credits are typically claimed by third party investors who provide capital to energy projects, such as wind or solar projects. See Michelle D. Layser, Improving Tax Incentives for Wind Energy Production: The Case for a Refundable Production Tax Credit, 81 Mo. L. REV. 453, 473–82 (2016). The mechanism used to derive value from the wind energy production tax credit is similar to the monetization transactions described in Part II.B. of this Article. See also Thomas W. Giegerich, Monetization of Business Tax Credits, 12 FLA. TAX REV. 709, 725–27 (2012).

\(^6\) See Layser, Typology, supra note 1, at 432.
benefit local residents. Spatially oriented investment tax incentives like these effectively divorce the goal of improving a space from the goal of improving residents’ experience of such places.

On the other hand, consider a tax law that enables Business X to claim a tax credit only if it hires residents of low-income Area X. In this case, the tax law specifically incorporates a feature to help ensure that some benefits flow to the residents. Therefore, this tax law is best described as a community oriented investment tax incentive. Unlike spatially oriented investment tax incentives, community oriented investment tax incentives link the goal of improving a space to the goal of improving residents’ experiences in those places.

The two dimensions can be combined to identify four basic types of place-based investment tax incentives. First, spatially oriented direct tax incentives provide tax breaks directly to businesses that invest in low-income areas for the purpose of improving the economic or built environment. Second, spatially oriented indirect tax incentives provide tax breaks directly to third party investors who invest in entities that, in turn, invest in low-income areas for the purpose of improving the economic or built environment. Neither type of law includes features to ensure that local residents benefit from improvements to the space.

Third, community oriented direct tax incentives provide tax breaks directly to businesses that invest in low-income communities for the purpose of benefiting local residents through investment in human capital, community services, or other activities that directly benefit low-income people. Fourth, community oriented indirect tax incentives provide tax breaks to third party investors who invest in entities that, in turn, invest in low-income communities for these purposes. The table below summarizes these four types of place-based investment tax incentives.

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<th>Dimension #1: Form of Subsidy</th>
<th>Dimension #2: Approach to Targeting Place</th>
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<tbody>
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<td>Direct</td>
<td>Spatially oriented direct tax incentives</td>
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<td>Community oriented direct tax incentives</td>
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<td>Spatially oriented indirect tax incentives</td>
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77. Id. at 442.
78. Id. at 433, 443.
79. Id. at 446–47.
80. Id. at 433.
81. Id. at 453–54.
82. See id. at 456.
The current landscape of place-based investment tax incentives is dominated by spatially oriented investment tax incentives that, by definition, include no safeguards to protect poor communities. Both spatially oriented direct tax incentives and spatially oriented indirect tax incentives are common under current law, whereas community oriented investment tax incentives are comparatively rare.

For example, a common form of place-based investment tax incentives under state law are enterprise zone laws, which designate areas for regulatory and tax relief. Every state enterprise zone law incorporates spatially oriented direct tax incentives, while only a few states include any community oriented investment tax incentives among the mix of tax incentives. Though the exact form varies, every state makes at least some tax preferences available to business located within enterprise zone boundaries, regardless of whether the company hires, serves, or otherwise benefits local residents.

Meanwhile, all current federal place-based investment tax incentives are structured as spatially oriented indirect investment tax incentives. Federal place-based investment tax incentives include the New Markets Tax Credit (NMTC), the new Opportunity Zones tax incentive, and discrete place-based investment tax incentives included with the Low-Income Housing Tax Credit (LIHTC). All three of these laws provide tax benefits to investors who contribute capital to entities that, in turn, invest in low-income areas. And none of these tax laws include any features to ensure that poor communities will benefit from the tax-driven investments.

The next section provides a theoretical analysis of spatially oriented investment tax incentives and an overview of what is known

83. This conclusion is based on a review of federal place-based investment tax incentives, a detailed survey of state enterprise zone laws, and a high level survey of state place-based investment tax incentives other than enterprise zone laws. Data on file with author. See id. apps. A–C at 457–63.

84. See Layser, Typology, supra note 1, at 410, 457.

85. See Aprill, supra note 23, at 1343.

86. See Layser, Typology, supra note 1, apps. A–C at 457–63.

87. Id.

88. Note that on its face, the LIHTC is not a place-based investment tax incentive at all. To the contrary, the tax credit is available to investors regardless of where affordable housing projects are located. However, the law also provides for larger tax credits when projects are located in certain statutorily defined areas. These higher tax credits create incentives for developers to site projects in those areas and, in fact, a disproportionate number of LIHTC-financed projects are located in those areas. See id. at 422 n.83, 447 n.208.

89. The indirect form of the tax subsidies enables businesses to access large amounts of capital from investors, enabling them to engage in more expensive projects—such as new business startups, costly rehabilitation projects, or new construction projects—that their direct counterparts. See id. at 420–22, 449.
about their impact. It demonstrates that, despite their prevalence, neither theory nor empirical evidence support the use of spatially oriented tax incentives as tools to address concentrated poverty.

B. Theory and Impact of Spatially Oriented Investment Tax Incentives

Spatially oriented investment tax incentives dominate the current legal landscape of place-based investment tax incentives. However, as this section will demonstrate, theories about mobility predict that wealthy people are more likely to benefit from these types of tax incentives than the poor and, over time, these types of tax incentives are likely to cause gentrification. Moreover, empirical evidence is consistent with these predictions. Thus, this section raises a critical question about place-based investment tax incentives: why do spatially oriented investment tax incentives dominate the current legal landscape despite their predictable failure to benefit the poor?

The answer to this question is key to understanding the limitations and potential of place-based investment tax incentives as anti-poverty tools. To this end, this section will explain the theoretical and practical problems presented by current place-based investment tax incentives, looking first at how mobility effects impact all spatially oriented tax incentives.

1. TIEBOUT SORTING AND SPATIALLY ORIENTED INVESTMENT TAX INCENTIVES

Since spatially oriented investment tax incentives lack safeguards to protect local communities, theory predicts that if they work as intended—to improve neighborhoods through increased investments—then wealthy outsiders will capture at least some of the benefit of these improvements. This is because neighborhood improvements would be expected to "change[] the underlying incentive structure" that affects where people live and work and where businesses locate.  

90. Nestor M. Davidson, Reconciling People and Place in Housing and Community Development Policy, 16 GEO. J. ON POVERTY L. & POL'Y 1, 8 (2009).

91. Id.

92. Id.

This process is known as "Tiebout sorting," and it is the subject of a large volume of literature.  

Economist Charles Tiebout famously argued that local governments compete for mobile residents by
adjusting the mix of tax burdens and services available in different locations.\textsuperscript{93} Place-based investment tax incentives are an example of laws used by local governments to attract mobile capital and residents to poor areas. Though Tiebout sorting does not always take place to the extent that theory might predict,\textsuperscript{94} there is empirical evidence that place-based investments do result in wealthier outsiders migrating into the targeted areas following improvements.\textsuperscript{95} This suggests that, without specific safeguards to mitigate these effects, mobile outsiders are likely to displace poor residents by taking local jobs and homes.\textsuperscript{96}

Empirical studies of the impact of spatially oriented direct investment tax incentives have yielded mixed evidence as to whether the incentives cause Tiebout sorting. For example, numerous studies have tested the impact of enterprise zone laws, which feature spatially oriented direct tax incentives.\textsuperscript{97} Some studies have concluded that enterprise zone laws increase the number of jobs in a zone, but note that there is no reason to think the new jobs are filled by residents.\textsuperscript{98}

\begin{thebibliography}{99}
\bibitem{96} See Davidson, supra note 90, at 9.
\bibitem{97} Note that in addition to tax incentives, enterprise zone laws typically include regulatory relief such as fee waivers or zoning waivers. The mix of incentives makes it difficult to assess the impact of any one incentive, so one must take care not to overstate research findings on enterprise zones. Furthermore, since the package of incentives and designs of tax laws vary across programs, it is hard to know whether any single study is generalizable to the enterprise zone approach. See Layser, \textit{Typology}, supra note 1, at 444.
\bibitem{98} See, e.g., Jed Kolko & David Neumark, \textit{Do Some Enterprise Zones Create Jobs?}, 29 J. Pol'y Analysis & Mgmt. 5, 13, 24 (2010) ("In light of the fact that the average effect of enterprise zones is near zero, evidence of variation in the effects of enterprise zones could suggest that some enterprise zones increase employment, while others decrease it" but that "there is no reason to believe that enterprise zone employees are enterprise zone residents."). Other studies are skeptical that enterprise zone laws increase the number of jobs in the region, finding that most new enterprise zone jobs are offset by losses to jobs in nearby—and often similarly poor—areas. See e.g., Joel A. Elvery, \textit{The Impact of Enterprise Zones on Resident Employment: An Evaluation of the Enterprise Zone Programs of California and Florida}, 23 Econ. Dev. Q. 44, 57 (2009) (finding that "enterprise zones of California and Florida had, at best, no effect on employment and, at worst, a small negative effect in Florida" and that "zone residents were less likely to be employed than residents of observationally similar areas"); Daniele Bondonio & Robert T. Greenbaum, \textit{Do Local Tax Incentives Affect Economic Growth? What Mean Impacts Miss in The Analysis of Enterprise Zone Policies}, 37 Regional Sci. Urb. Econ. 121, 133 (2007) ("The results indicate that positive zone-induced increases in employment, sales, and capital
Interestingly, most studies have found no significant impact on neighborhood demographics.  

However, it is important to note that statistical data about demographics may not tell the whole story about Tiebout sorting, let alone gentrification. Gentrification has traditionally been characterized by displacement of residents, but little data exists to evaluate the rate of displacement of poor residents in communities targeted by spatially oriented direct tax incentives. Measuring the degree of displacement is an infamously difficult task that has presented a challenge to gentrification researchers since such research began in the 1970s. Some scholars have expressed skepticism that measuring displacement is empirically possible, while others have described the task as “measuring the invisible” and noted that “[b]y definition, displaced residents have disappeared from the very places where researchers or census-takers go to look for them.” High rates of turnover attributable to eviction may further complicate the task. Due in no small part to these empirical difficulties, many scholars have adopted definitions of gentrification that de-emphasize displacement and recognize other harms associated with neighborhood change that benefits wealthier populations instead of poor residents.
Meanwhile, there is strong evidence that property values increase in enterprise zones, and increased property values often lead to higher rents or property tax assessments—either of which may price out the poorest members of the community. New tenants and homeowners who move into those homes may still be poor, but they will presumably be better off than those who moved out (and more capable of paying the higher rents or taxes). As a result, the poverty rate may fail to capture displacement associated with gentrification.

In sum, there is little empirical evidence that spatially oriented direct tax incentives benefit poor communities, and there is at least some indication that they may actually harm those communities through displacement or other harms associated with gentrification. It is unclear to what extent spatially oriented direct tax incentives have resulted in displacement of residents; however, theory predicts that such laws would encourage wealthy outsiders to move into the area and displace residents.

One reason for these mixed empirical results may be that direct tax incentives are simply insufficiently sized to support large development projects or new construction. In fact, there is slightly more evidence that spatially oriented indirect tax incentives, which drive large amounts of capital to poor areas through subsidized financing, do contribute to gentrification. For example, to the extent that the NMTC has been linked to reduced poverty and increased employment rates, researchers predict that some of those changes are attributable to gentrification. This suggests that spatially oriented investment tax incentives do cause Tiebout sorting when the tax subsidies are sufficiently large.

But there is another reason why spatially oriented investment tax incentives are likely to cause Tiebout sorting: place entrepreneurs may actively pursue the types of investments that are most likely to attract wealthy outsiders. The phrase “place entrepreneurs” refers to investors and other market actors who seek to profit on places. As shown in Part III, all place-based investment tax incentives are influenced by place entrepreneurs, which have played a key role in the development of this category of tax laws. However, spatially oriented indirect tax incentives are particularly vulnerable to the influence of place entrepreneurs. The next section will explain why.

2. PLACE ENTREPRENEURS AS SIGNIFICANT STAKEHOLDERS

Place entrepreneurs are market participants, such as place-based investors, who seek to profit on location and evaluate places “based on assessments of locations as sites of financial reward.”\textsuperscript{109} This singular focus on profit is often at odds with the needs of poor communities.\textsuperscript{110} The conflict has been described as a “struggle between those who produce places for profit and those who consume it in their daily rounds.”\textsuperscript{111} The conflict between place entrepreneurs and poor communities is particularly relevant in the context of spatially oriented indirect tax incentives. To see why, one must have at least some basic understanding of how such indirect tax incentives work in practice.

The most straightforward model of spatially oriented indirect tax incentives is the one adopted by the new Opportunity Zones tax incentive. The new tax law allows taxpayers to defer taxes on capital gains realized during the tax year by investing their capital gains in so-called Opportunity Funds.\textsuperscript{112} In this way, the tax law works by encouraging investors to pool their capital in investment funds. By pooling together capital from numerous investors, Opportunity Funds are immediately capable of funding projects with significant capital needs.

But many spatially oriented indirect tax incentives, including the NMTC and the LIHTC, are earned over the course of several years, making it difficult for developers to access the full subsidy during the early years of projects, when the subsidies may be needed most.\textsuperscript{113} To solve this problem, a variety of industry actors work together to “monetize” future value from the tax breaks so that federal money can be used as start-up capital. In the most basic case, investors contribute money today for the right to claim the tax credits when they are earned in future years.\textsuperscript{114} The amount of money they contribute is based on the amount of tax credits they expect to be able to claim, plus an investment return.\textsuperscript{115}


\textsuperscript{110} Gieryn, \textit{supra} note 108, at 470.

\textsuperscript{111} \textit{Id.}


\textsuperscript{113} See I.R.C. §§ 45D, 42 (2018).

\textsuperscript{114} Giegerich, \textit{supra} note 75, at 749–52.

These monetization transactions are best understood through examples. In the case of the LIHTC, developers partner with so-called tax equity investors who contribute capital in exchange for the right to claim the tax credits as they are earned over the ten-year period. Similarly, NMTCs are claimed by investors who invest in Community Development Entities that have been awarded the tax credits, which will be earned over a seven-year period. In both cases, the capital investments are sized to equal the present value of the anticipated tax credits, plus an investment return. By monetizing the entire future value of the tax credits, project developers are able to access large amounts of tax-subsidized capital in order to help fund large projects, such as new construction or start-up businesses.

Thus, both investment funds and monetization transactions are effective at directing large amounts of private capital to projects. But the mechanism used to access the subsidy depends heavily on the involvement of third-party investors, fund managers, syndicators, attorneys, accountants and consultants. Those parties, who are essential to fund management and monetization transactions, capture value before it reaches poor communities. They also stand—along with community development entities, developers, and other industry actors—to derive significant value from the process of gentrification.

All of these parties, which ultimately profit on place-based investments, are place entrepreneurs. By relying heavily on place entrepreneurs for monetization or pooling of capital, spatially oriented indirect tax incentives implicitly define place along a “one-dimensional construct of capital logic based on the profit motive” and largely devoid of social meaning. In other words, they treat economic distress as “a process that occurs in economic space,” while communities, which are inherently social, fade into the background.

It is worth noting here that place entrepreneurs are not necessarily bad actors who consciously take advantage of the poor. In connection with this research, I spoke with high-level employees at several Community Development Entities and several consultants who represent clients in affordable housing and community development

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117. See Eickhoff and Carter, supra note 115, at 17.
118. McClure, supra note 115, at 366; Eickhoff and Carter, supra note 115, at 17 (describing the discounted “price” of NMTC credits to the investor).
120. Johnstone and Lionais, supra note 109, at 218–19.
121. Id. at 218. Note that Johnstone and Lionais distinguish between spaces and places, where “space is the location of profitable enterprise,” and “place is the location of social life.” Id. at 219.
The professionals who spoke to me seemed genuine in their belief that the deals facilitated through the NMTC and LIHTC have high social value and benefit low-income communities. Moreover, they expressed deep concern that, without such subsidies, many worthwhile projects would go unfunded.

Indeed, there may be good reasons to use tax incentives to encourage place entrepreneurs to invest in low-income communities. Some theorists have argued that today’s neighborhood poverty can often be traced to systematic disinvestment “aided and abetted by federal agencies, as well as the concentration of high-density housing projects within them, constructed by local authorities under federal programs.” Such lack of investment has been blamed for the deterioration of “educational facilities, employment opportunities, health care delivery, security of person and property, and so on.” Place-based investment tax incentives have the potential to reverse this trend.

However, the projects pursued by place entrepreneurs do not necessarily address these needs. A case in point, the NMTC has long been criticized for subsidizing projects that fail to benefit poor communities. A 2007 study of the descriptions of projects that were awarded NMTC benefits concluded that “approximately $2 billion of tax credit subsidy has been allocated to projects that appear to be designed primarily for those already with the very access to capital that the low-income residents lack.” For example, funded projects included “movie theatres, performing art centers for opera, symphony and ballet, hotels like the Marriott Inn with connected convention

122. Telephone Interview with David Godschalk, General Counsel, Telesis CDE Corporation (May 11, 2017) (interview on file with author) [hereinafter Godschalk Interview]; Telephone Interview with Peter Lawrence, Director of Public Policy and Government Relations, Novogradac & Co. LLP (May 11, 2017) (interview on file with author) [hereinafter Lawrence Interview]; E-mail from Paul Anderson, Director of Policy & Research, Rapoza Associates, to author (May 10, 2017); E-mail from Eric Klipfer, VP Manager of Alternative Products, RBC Community Development, LLC, to author (May 11, 2017).

123. Godschalk Interview, supra note 122; Lawrence Interview, supra note 122.

124. Godschalk Interview, supra note 122; Lawrence Interview, supra note 122.


126. Id. at 764.

127. Groves, supra note 100, at 231.

128. Id. at 225.
centers, museums, upscale commercial office, retail outlets, and even tourist centers.”

The Opportunity Zones tax incentive is likely to have a similar impact. The fund model described above is less reliant on place entrepreneurs than incentives that require monetization; however, in practice Opportunity Zones are likely to be combined with the NMTC. Since Opportunity Zones are effectively a subset of NMTC eligible census tracts, some industry experts expect that Opportunity funds will be used to attract equity financing to the same projects that receive subsidized debt capital through the NMTC program.

Therefore, despite adopting different incentive models, both the NMTC and Opportunity Zones tax incentives are likely to be similarly influenced by the interests of place entrepreneurs. Since neither law includes any requirement that businesses benefit local residents—such as through hiring, job training, or providing services—in order to qualify as a low-income community business or qualified opportunity zone business, there is no reason to think that Opportunity Zones tax incentives will be any more beneficial to low-income communities than the NMTC.

129. Id.
130. See Barlow George & John Sciarretti, Pairing NMTCs with Opportunity Zone Incentives, 9 Novogradac J. Tax Credits (April 5, 2018) https://www.novoco.com/periodicals/articles/pairing-nmtcs-opportunity-zone-incentives. As a practical matter, there is substantial overlap between NMTC eligible census tracts and designated Opportunity Zones. Under the statute, census tracts were eligible for designation as opportunity zones if they met the statutory definition of “low-income community,” which was defined by reference to the NMTC statute. I.R.C. §§ 1400Z-1(a), (c)(1) (2018). Under the NMTC statute, “low-income communities” generally refers to census tracts with a poverty rate of at least twenty percent, or which meet certain median family income thresholds. I.R.C. § 45D(e)(1) (2018). State governors were charged with designating [up to half] of eligible census tracts as opportunity zones. I.R.C. § 1400Z-1(b) (2018). In other words, the NMTC law defined certain census tracts as low-income communities, and a subset of those census tracts have since been designated as opportunity zones. Both laws provide tax breaks to investors who make equity investments in entities that, in turn, invest in the eligible zones. Where the NMTC has most often been used for debt financing of “low-income community businesses,” the Opportunity Zones tax incentives are expected to encourage equity financing of “qualified opportunity zone businesses.” I.R.C. § 45D (2018); see I.R.C. §§ 1400Z-1 to -2 (2018). Both “low-income community businesses” and “qualified opportunity zone businesses” are defined by tax law. Both definitions require the businesses to meet certain thresholds for owning tangible property located within zone boundaries and to generate income from business activities inside the zones. I.R.C. §§ 45D(d)(2), 1400Z-1(d)(3) (2018).

131. The LIHTC, on the other hand, promotes investment in affordable housing, which helps provide shelter to poor individuals. For this reason, one could argue that the LIHTC is a community-oriented incentive. However, the LIHTC also incorporates spatially-oriented indirect tax incentives within its incentive structure. Specifically, the LIHTC contains two place-based incentives: a bonus credit for projects located in “Qualified Census Tracts” (QCTs) and a bonus credit for projects located in
In sum, spatially oriented investment tax incentives are the
dominant form of place-based investment tax incentives under current
law. This is true despite a lack of empirical evidence to suggest that
such tax laws help poor communities, even though their proponents
claim that helping poor communities is an important goal. This lack of
evidence is consistent with theories that predict Tiebout sorting and the
impact of place entrepreneurs. And it is not an accident that spatially
oriented investment tax incentives have come to dominate the current
landscape of place-based investment tax incentives. The next section
will argue that the design and impact of these laws is consistent with the
pro-gentrification environment that produced them.

III. THE PRO-GENTRIFICATION ORIGINS OF PLACE-BASED INVESTMENT TAX INCENTIVES

The central problem presented by place-based investment tax
incentives is a contradiction between rhetoric and reality. On the one
hand, place-based investment tax incentives are presented by
lawmakers—and regarded by watchdog groups—as a possible solution
to problems faced by poor communities. On the other hand, the
spatially oriented investment tax incentives that dominate the current
legal landscape are limited, both in theory and practice, in their ability
to benefit poor communities.

“Difficult Development Areas” (DDAs). These incentives are specifically “intended to
provide additional incentives for the rehabilitation or replacement of substandard rental
housing in low-income areas.” Michael Hollar & Kurt Usowski, Low-Income Housing
Tax Credit Qualified Census Tracts, 9 CITYSCAPE: J. POL’Y DEV. & RES. 153, 154
(2007); see also DEP’T OF HOUSING & URB. DEV., STATUTORILY MANDATED
DESIGNATION OF DIFFICULT DEVELOPMENT AREAS AND QUALIFIED CENSUS TRACTS FOR
SECTION 42 OF THE INTERNAL REVENUE CODE OF 1986, at 3 (2002),
[https://perma.cc/8TDR-ZWNV] [hereinafter HUD NOTICE]. Both QCT and DDA tax
incentives may harm poor communities. Some studies have concluded that the
provisions may help draw more low-income residents into poor areas, thereby further
contributing to concentrated poverty. See Layser, Segregation, supra note 1, at 941–42,
973. Moreover, clustering affordable housing projects in very poor areas creates a
barrier to poor people’s ability to move to higher opportunity areas, potentially
undermining other anti-poverty strategies like Housing Choice tenant vouchers. Because
the law is designed without any effort to reduce these risks of harm to low-income
communities, the LIHTC cannot be described as a community-oriented incentives
despite its benefits. Furthermore, if the tax incentives promote the clustering of
affordable housing in specific, very high-poverty areas, then they may also help reduce
the number of projects located in other areas that are better candidates for
gentrification. In this way, the LIHTC may subtly support gentrification efforts
elsewhere in the city.
Moreover, a second contradiction compounds the first. Federal place-based investment tax incentives first appeared as common place-based strategies during a period when the broader trend in federal anti-poverty and affordable housing policies began to shift toward people-based strategies, such as rental vouchers used to aid poor tenants. Today, people-based initiatives continue to dominate nontax policies used to address concentrated poverty, while tax laws overwhelmingly adopt the place-based approach.

Thus, not only do place-based investment tax incentives fail to benefit poor communities, as their proponents claim, but the place-based initiatives supported by tax law also appear to deviate from broader trends of anti-poverty and affordable housing policy. This Part presents a theory to explain this current legal landscape and the apparent deviation between the tax-based approach and broader trends in housing and community development policies. Namely, this Part argues that both strands of policy can be traced to state efforts to support gentrification of poor areas.

It is worth noting that gentrification has rarely been a stated goal of any government policy, let alone place-based investment tax incentives. Most legal scholarship regards gentrification as an unintended, regrettable consequence of place-based policies, not the hidden motivator. Nevertheless, the rise of place-based investment tax incentives can be explained as a natural outgrowth of state policies in support of private industry efforts to profit through gentrification.

As this Part will show, powerful market forces and place entrepreneurs have helped shape the law in this area. As a result, the overwhelming majority of current place-based investment tax incentives are best understood as tax-based subsidies to enable private parties to

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132. As explained in Part III.B., place-based investment tax incentives first appeared on the state level in the 1980s, shortly after the nontax inner city “urban renewal” initiatives of the 1950s and 1960s fell out of favor. Urban renewal policies, which bulldozed neighborhoods and displaced whole communities, were widely regarded as failed policies. Davidson, supra note 87, at 2–3. Outside of the tax context, those early failures lead to a shift away from place-based policies and toward people-based initiatives, such as rental vouchers, to aid poor tenants. Peter Edelman, Our History with Concentrated Poverty, in INVESTING IN WHAT WORKS FOR AMERICA’S COMMUNITIES: ESSAYS ON PEOPLE, PLACE & PURPOSE (N.O. Andrews & D.J. Erickson eds., 2012). For example, Housing Choice Vouchers provide subsidies to low-income tenants that ostensibly provide low-income renters with greater housing choice. Id. Critics of mobility approaches emphasize risks and potential harms related to displacement of individuals from their home communities. Id.

133. See generally Groves, supra note 100 (approaching gentrification as a reflection of flaws within the New Markets Tax Credit program); Davidson, supra note 90, at 9 (characterizing the risk of displacement as a limitation of place-based strategies).
profit from gentrification.\textsuperscript{134} To elaborate on this theory, this section traces the development of place-based investment tax incentives over time in order to provide a positive law account for this category of tax laws. Specifically, this section posits that most place-based investment tax incentives have their origins in state-led gentrification policies.

A. From Urban Decline to Gentrification

1. URBAN DECLINE

Before one can appreciate the state’s role in promoting gentrification—and the link between gentrification policy and tax law—one must first understand how neighborhoods become candidates for gentrification in the first place. Before gentrification comes urban decline. And urban decline is inextricably linked to concentrated poverty.

The process of urban decline has been documented by social scientists as occurring in several phases, beginning with new construction of residential homes and an initial cycle of use.\textsuperscript{135} In his highly influential photo documentary \textit{How the Other Half Lives}, Jacob Riis described the origins of New York immigrant slums as “the decorous homes of the old Knickerbockers, the proud aristocracy of Manhattan in the early days.”\textsuperscript{136} Riis observed, “Nothing would probably have shocked their original owners more than the idea of their harboring a promiscuous crowd.”\textsuperscript{137} Riis went on to describe the transition of those houses, which were once inhabited by the wealthy, into poor immigrant tenements.\textsuperscript{138}

That transition process, which was neither unique to New York, nor time-bound to any one period, has been described as follows. For

\textsuperscript{134} Gentrification can be defined as “the production of space for progressively more affluent users.” Slater, supra note 100, at 744.

\textsuperscript{135} Neil Smith, \textit{Toward a Theory of Gentrification: A Back to the City Movement by Capital, not People}, 45 J. AM. PLAN. ASS'N 538, 543 (1979).


\textsuperscript{137} \textit{Id. at 7}.

\textsuperscript{138} See generally Riis, supra note 136 (discussing the transition of wealthy homes into immigrant tenements). But not all new construction is created for the wealthy. In many cases, new construction is driven by industry expansion and the need to house workers. In mid-nineteenth century Chicago, the “flood of canal workers and land speculators transformed Chicago from the town of ‘four and a half houses, a fort and a Potawatomi town’ . . . to the fastest-growing city in the world.” \textit{The Chicago River Tour with Geoffrey Baer: The History of the Chicago River}, WTTW CHICAGO, (https://interactive.wttw.com/chicago-river-tour/history-chicago-river) [https://perma.cc/RG5V-35J3].
as long as inhabitants of new homes have the motivation and capacity to make repairs and improvements, property holds its value. When repairs are not made, home values depreciate over time. When this happens, neighborhoods tend to convert into rental housing, kicking off a second phase of decline. In New York, the fancy Knickerbocker homes eventually "fell into the hands of real estate agents and boarding-house keepers" who converted the properties into rental properties.

Landlords, who derive value almost entirely from rent, have less incentive than owners to carry out repairs. Over time, under-maintenance in landlord-owned neighborhoods gives way to "more active disinvestment as capital depreciates further and the landlord's stake diminishes." At this stage, landlords often subdivide structures in order to rent spaces to more tenants. At the same time, landlords increasingly refuse to make repairs, paying only the necessary costs.

During this phase, in particular, "the poor [become] the opportunity of their wealthier neighbors," given their desperate need for housing and lack of negotiation power. By the late nineteenth century, the large rooms of the Knickerbocker homes had been "partitioned into several smaller ones, without regard to light or ventilation." And New York was not the only city experiencing urban decline; neighborhoods across America faced similar fates. By the 1950s in Chicago,

Almost all the buildings dated to the previous century. Many of them were cheap frame constructions slapped up after the Great Fire of 1871. . . . [N]early half of the 2,325 homes were without a bath or shower, many had no private toilet, and all but a few relied on coal stoves for heat . . . . Flimsy partitions carved up the apartments into multiple units . . . .

139. Smith, supra note 135, at 543–44.
140. Id. at 543.
141. Id. at 544. When neighborhoods did not naturally give way to rental properties, racist real estate practices hastened the process. Id. Real estate agents in the 1950s and 1960s actively sought out declining neighborhoods as targets for a practice called blockbusting. Id.
142. Riis, supra note 136, at 7.
143. Smith, supra note 135, at 544 (explaining that, unlike owner-occupiers who receive value as "both consumers and investors," landlords derive value almost entirely from rent and has less incentive to carry out repairs).
144. Id. at 544.
145. Id. at 545. See also BEN AUSTEN, HIGH-RISERS: CABRINI-GREEN AND THE FATE OF AMERICAN PUBLIC HOUSING 7 (2018).
146. AUSTEN, supra note 145, at 6; DESMOND, supra note 43, at 75–76.
147. Riis, supra note 136, at 7–8; DESMOND, supra note 43, at 75–76.
Despite the conditions, rents had jumped by [seventy] percent. Landlords overcharged for their firetraps.\textsuperscript{149}

Only when they can no longer collect enough rent to cover the costs of utilities and taxes, will landlords abandon their properties.\textsuperscript{150} In this final phase of decline, "buildings are abandoned not because they are unusable, but because they cannot be used profitably."\textsuperscript{151} At this point, the stage is set for an infamous type of market reversal: gentrification.

2. GENTRIFICATION AND URBAN RENEWAL

By the 1930s, cities throughout the country had begun to enter the late stages of urban decline. In such neighborhoods, "developers can purchase [property] cheaply, can pay the builders' costs and profit for rehabilitation, can pay interest on mortgage and construction loans, and can then sell the end product for a sale price that leaves a satisfactory return to the developer."\textsuperscript{152} But despite their profit potential, inner-city investments were risky, and private market investors were often unwilling to invest without state assistance to serve as insurance.\textsuperscript{153} For this reason, private real estate agencies began pressing for state assistance that would enable private entrepreneurs "to acquire and rebuild deteriorated sections of the city."\textsuperscript{154}

Gentrification can be initiated by any number of actors in the land and housing market, but empirical evidence suggests that the process is usually initiated by some form of collective social action, and the state "initiated most if not all of the early schemes."\textsuperscript{155} Around the country, pro-growth coalitions formed among mayors, business people and bankers, and by 1948, twenty-five states had adopted laws to enable urban redevelopment.\textsuperscript{156} In 1949, the federal government established its own urban redevelopment program to fund slum clearance,\textsuperscript{157} and five

\begin{itemize}
  \item \textsuperscript{149} Austen, \textit{supra} note 145, at 3.
  \item \textsuperscript{150} Smith, \textit{supra} note 135, at 545; Austen, \textit{supra} note 145, at 3, 6 (noting the high-rents charged for slum housing in 1950s Chicago).
  \item \textsuperscript{151} Smith, \textit{supra} note 135, at 545.
  \item \textsuperscript{152} Id.
  \item \textsuperscript{154} Alexander von Hoffman, \textit{The Lost History of Urban Renewal}, 1 in \textbf{THE AFFORDABLE HOUSING READER} 14, 15 (J. Rosie Tighe & Elizabeth J. Mueller eds., 2013).
  \item \textsuperscript{155} Smith, \textit{supra} note 135, at 545.
  \item \textsuperscript{156} Hoffman, \textit{supra} note 154, at 15–16.
  \item \textsuperscript{157} Id. at 17 (noting that the US Housing Act of 1949 was passed after much debate). The slum-clearance program effectively linked public housing to urban redevelopment by requiring that development sites be "'predominantly residential'
years later Congress enacted the Housing Act of 1954.\textsuperscript{158} Under the Act, cities were entitled to federal funds for nonresidential development that decreased housing problems, but only after the city established a local urban renewal authority.\textsuperscript{159}

The new local urban renewal authorities were often “manipulated by the powerful vested interests in the community resulting in urban renewal becoming a source of windfall profits for private developers and landowners.”\textsuperscript{160} Moreover, “almost every large city developed a corporate-based planning body concerned with urban development,”\textsuperscript{161} and those organizations “dominated the origins of local renewal policy making, financed central-business-district planning out of their private funds, and provided personnel for more public bodies charged with overseeing the local renewal programs.”\textsuperscript{162}

In this way, some scholars argue that the Housing Act of 1954 ushered in the first examples of systematic, state assisted gentrification in America.\textsuperscript{163} The federal government provided direct grants, and state governments aggressively assisted their corporate-led local urban renewal authorities in gentrification by “assembling properties at fair market value and returning them to developers at the lower assessed price.”\textsuperscript{164} In other words, governments bore the costs of the last stages of decline so that developers could reap profits.\textsuperscript{165}


\textsuperscript{159} Id.

\textsuperscript{160} Id.

\textsuperscript{161} Id. at 244.


\textsuperscript{163} See, e.g., Nager, \textit{supra} note 158, at 242.

\textsuperscript{164} Smith, \textit{supra} note 135, at 546. The Supreme Court aided in this approach, holding in \textit{Berman v. Parker} that taking property for the purpose of slum clearance was a public use, thereby arguably giving local governments “cart blanche to take private property and convey it to private entities as a public use under the guise of urban renewal.” \textit{Berman v. Parker}, 348 U.S. 26 (1954); Gerald S. Dickinson, \textit{Inclusionary Takings}, 62 Vill. L. Rev. 135, 145 (2017).

\textsuperscript{165} Smith, \textit{supra} note 135, at 546.
The impact of state-assisted gentrification was “highly class specific” and “[c]onditions generally worsened for the urban working class as a result of such intervention.”166 Though the precise meaning of gentrification has been debated by scholars, the term has been defined as “the production of space for progressively more affluent users.”167 In other words, gentrification connotes the transformation of a space for the benefit of more affluent users, with an emphasis on “a process of class transformation.”168 But gentrification also connotes racial transformation, so much so that the impact of gentrification on the poor was known at the time as “negro removal.”169

In the 1960s, urban housing conditions became a flash point in the civil rights movement. The Watts Riot, which took place in August of 1965, was the “largest and costliest urban rebellion of the Civil Rights era.”170 The riot was located in a “deeply impoverished African American neighborhood in South Central Los Angeles.”171 Social movements like these ultimately forced the creation of the Department of Housing and Urban Development (HUD).172 In the early years after the development of HUD, “[r]emoving public housing—long seen as anathema to gentrification—was . . . made practically impossible.”173

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166. Hackworth & Smith, supra note 153, at 466.
167. Slater, supra note 100, at 744 (quoting Jason Hackworth, Post-Recession Gentrification in New York City, 37 URB. AFF. REV. 815, 815 (2002)).
168. Id. at 744.
171. Id.
172. Hackworth & Smith, supra note 153, at 469. See Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (1968) (codified at 42 U.S.C. § 1441). That same year, Congress enacted the Fair Housing Act in order to prohibit, among other things, discrimination in the sale or rental of housing owned, operated, or directly or indirectly subsidized by the federal government. See Civil Rights Act of 1968, tit. VIII § 803, Pub. L. No. 90-284, 82 Stat. 73. The Fair Housing Act was an important step toward reducing discrimination in American housing, and in the 1970s the word “segregation” began to “disappear[] from the American vocabulary.” DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID 1, 4 (1993). Yet, sociologists Douglas Massey and Nancy Denton observed that segregation persisted after the Act, and “the only urban areas where significant desegregation occurred during the 1970s were those where the black population was so small that integration could take place without threatening white preferences for limited contact with blacks.” Douglas S. Massey & Nancy A. Denton, The Missing Link, in CITIES AND SOCIETY 233 (Nancy Kleniewski, ed., 2005).
173. Hackworth & Smith, supra note 153, at 469. “[T]he Housing and Urban Development Act of 1968, called for the development of [twenty-six] million new housing units over the 1969-78 decade,” of which six million were to serve low- or
The federal government terminated the direct urban renewal program entirely in 1974, replacing it with a block grant program that "left decisions of whether and how to pursue urban improvements to the discretion of local governments."\textsuperscript{174} Such programs marked a definitive move away from direct federal assistance in gentrification efforts toward public-private partnerships, and a shift of control from the federal government to state authorities. This shift was further advanced by the policies of President Ronald Reagan, who took office in 1981.

The Reagan Administration was overwhelmingly characterized by federalist and private market ideologies.\textsuperscript{175} Reagan worked to dismantle federal regulation.\textsuperscript{176} This assault on the regulatory state "took the form of funding reductions for welfare and affordable housing, but more subtly it also encouraged non-Keynesian modes of local governance."\textsuperscript{177}

In this political environment, the first place-based investment tax incentives were born: enterprise zones. As the next section will demonstrate, enterprise zone laws emerged as indirect pro-gentrification state law policies during a period when the federal government's willingness and capacity to provide direct financial assistance for gentrification was limited. The pro-gentrification origins of enterprise zone laws help explain the dominance of spatially oriented investment tax incentives that do not include any safeguards for poor communities.

\textbf{B. From Gentrification Policy to Tax Law}

The traditional narrative about the origin of enterprise zone laws goes like this: The enterprise zone concept originated in Great Britain, proposed by Professor Peter Hall during a speech in 1977,\textsuperscript{178} as a solution to "abandoned and unpopulated industrial areas." Hall imagined the zones as "freeports" where businesses and entrepreneurs moderate-income families. \textsc{Harrison G. Wehner, Jr., Sections 235 and 236: An Economic Evaluation of HUD's Principal Housing Subsidy Programs} 11 (1973).

\textsuperscript{174.} Hoffman, \textit{supra} note 154, at 26.
\textsuperscript{176.} Hackworth & Smith, \textit{supra} note 153, at 469.
\textsuperscript{177.} \textit{Id.} Keynesian governance is characterized by government intervention, whereas non-Keynesian governance is characterized by minimal government intervention. \textit{Id.}
\textsuperscript{179.} Aprill, \textit{supra} note 23, at 1354.
"would be exempted from taxes and government regulations, and would be provided with only minimal social service provisions." The "unbridled free enterprise" approach to economic development was attractive to British conservatives, and the proposals became a reality there in 1980. At that time, the Thatcher government designated eleven small areas as Enterprise Zones in distressed urban centers.

Meanwhile in the United States, economist Stuart Butler of the conservative Heritage Foundation began to introduce enterprise zones to Americans as a "radical new approach to inner city revitalization" beginning in 1979. Unlike the British version of enterprise zones, which were "not seen as tools to revive distressed neighborhoods," but rather to help create "metropolitan industrial parks," Butler's version of enterprise zones focused on tax and regulatory incentives to stimulate new jobs, especially in the small business sector, as a solution to urban poverty.

Republican Congressman Jack Kemp introduced the first enterprise zone bill to Congress in 1980, kicking off several years of debate. Reagan supported the proposal, stressing that tax incentives "do not require bureaucracy." The proposed law would have designated certain spatially-bound areas as eligible for a variety of economic and regulatory benefits, including tax credits and exemptions, intended to attract new investment to distressed areas. The proposal prompted immediate criticism from academic observers.

Prominent geographer Doreen Massey seized on a key critique of the proposed incentives, predicting that "the main impact of the zones will be spatially redistributive—that they will lead to a shifting around of jobs, but not to the creation of new ones." Even if new jobs were created within the boundaries of the zone, Massey argued, they would

180. Williams, supra note 178, at 45.
181. Id.
182. Id. at 46.
183. Id. at 47-48.
184. Id. at 49-50; Jeffrey M. Euston, Clinton’s Empowerment Zones: Hope for the Cities or a Failing Enterprise?, 3 KAN. J.L. & PUB. POL’Y 140, 141 (1993).
185. Euston, supra note 184, at 141.
186. Williams, supra note 178, at 52.
187. Id. at 54–55.
190. Williams, supra note 178, at 48 n.29.
not necessarily lead to a net increase in jobs in the region, since new companies in the zone may lead to closures or labor reductions at firms outside the zone. To the extent that new jobs might be created within the zones, others worried that "the zones could become havens for a revival of old-fashioned sweat-shops."

Kemp's bill and several other early proposals, including a high-profile bill introduced by President Ronald Reagan in 1982, never became legislation. Barriers to adoption on the federal level included a lack of empirical support for the strategy, opposition from some national businesses, and a suspicion that enterprise zones represented a "zero-sum game," in which governments entice business investments and jobs away from each other, with no net gain to the national economy.

Nevertheless, the idea took hold at the state and local level as early as 1981, and by the early 1990s, thirty-eight states and the District of Columbia had adopted their own enterprise zone legislation. According to this traditional narrative, the rapid growth of enterprise zone programs among the states was fueled by both ideological and practical dimensions. The bipartisan political attractiveness of enterprise zones likely stems from the fact that the "idea promises to achieve real improvements in purchasing power for individuals without providing direct government aid" and it "satisfies the political need to appear to be responding to problems for which there is no consensus on a solution and in a context where few resources exist."

Accurate or not, this traditional narrative fails to account for another important tension of the period: private industry continued to seek profit through gentrification, but existing federal legal frameworks constrained states' abilities to provide them with direct financial assistance despite the otherwise pro-business, pro-federalism political climate. Despite significant efforts to weaken HUD through funding cuts, during the 1980s the agency retained the power to enforce anti-

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192. Id. at 431.
193. Harrison, supra note 175, at 425; William W. Goldsmith, Enterprise Zones: If They Work, We're In Trouble, 6 INT. J. URB. REGIONAL RES. 435, 440 (1982) (explaining that zone-driven investment would depend "on a labour force with low skills, willing to work for low wages").
194. Willaims, supra note 178, at 160–61. See also Euston, supra note 184, at 140–42.
196. Id. at 432.
197. See id. at 432–33.
198. Id. at 434–35.
199. Hackworth & Smith, supra note 153, at 469.
gentrification laws that had been introduced in the early 1970s in response to the civil rights movement. 200

For example, under HUD oversight, cities were required to address affordable housing issues if a gentrification plan was unveiled in connection with any federal assistance. 201 Specifically, the federal government could not assist with any project without a "relocation assistance advisory program for displaced persons." 202 Similarly, no federal grants—including community development block grants—were available unless the state submitted a "housing assistance plan." 203 And, in 1988, Congress enacted the most restrictive rule of all: a requirement that, in the event that residents are displaced as a result of a state-assisted redevelopment plan, the relevant government agency must provide a one-for-one replacement of housing units lost through the plan. 204

These laws constrained states' abilities to provide the direct assistance for gentrification that were common in prior decades. 205 For example, in at least one documented case, a coalition of state and private actors abandoned a redevelopment plan because the cost of replacing destroyed units would be too high. 206 States that wished to continue supporting corporate gentrification efforts, without triggering housing assistance obligations or unit-replacement requirements, were forced to seek out indirect means of assistance. 207

A commonly chosen method was to assist and nudge private market gentrification efforts through favorable land-use laws. 208 Place entrepreneurs, such as developers, sought a favorable legal environment to enable them to profit on location and make their

200. Id. See supra notes 170–73 and accompanying text.
201. Id. at 469.
204. Housing and Community Development Act of 1987, § 509(a)(2), Pub. L. No. 100-242, 101 Stat. 1815, 1928 (1988) (codified at 42 U.S.C. § 5304(d)) (providing that "in the event of . . . displacement . . . governmental agencies or private developers shall provide within the same community comparable replacement dwellings for the same number of occupants as could have been housed in the occupied and vacant occupiable low and moderate income dwelling units demolished or converted to a use other than for housing for low and moderate income persons.").
205. See supra notes 163–65 and accompanying text.
207. Hackworth & Smith, supra note 153, at 469–70.
208. See Hackworth, supra note 206, at 451.
investment decisions based on the likelihood of financial returns. And the enterprise zone laws that emerged during this period were simply the tax-based equivalent to these land use laws. Like many urban land-use laws, enterprise zones provide favorable regulatory conditions for businesses. But they also provide an additional benefit in the form of tax-based subsidies to businesses located within zone boundaries.

Given the laws' pro-gentrification origin, one would expect enterprise zone laws to feature spatially-oriented investment tax incentives. If the primary objective of the tax laws was to assist developers in their efforts to profit in poor areas during a period when other sources of state assistance was limited, then there was no need to incorporate features to safeguard poor communities. Viewed in this light, the trends described in Part II begin to make sense, and the rhetoric that suggests that place-based investment tax incentives help poor communities begins to sound hollow.

The legislative history of enterprise zone laws offers further support for the theory that these laws were introduced to advance pro-gentrification business interests without regard to poor communities. A review of statements of legislative findings that were codified with the enterprise zone laws of twenty-one states revealed that only one state—New York—included a reference to poverty among the findings used to justify the tax laws. In contrast, the statements contained forty-four references to economic conditions, forty references to businesses, and twenty-one references to development.

In addition, when the language used in these statements was coded as business or spatially oriented versus people oriented, only

209. See id.
211. N.Y. GEN. MUN. LAW § 956 (statement of legislative findings and declaration). This analysis included the statements of legislative findings or purpose of enterprise zone laws in the following states: Alabama, California, Colorado, Connecticut, Washington, D.C., Georgia, Hawaii, Illinois, Louisiana, Maryland, Michigan, Montana, New Jersey, New Mexico, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, Texas.
212. Data on file with author.
213. Words coded as business oriented were: private, economic, business, industrial, development, stimulate, growth, expansion, sector, attract, expanding, commercial, activity, commerce, entities, capital, economy, facilities, firms, business-friendly, underdevelopment, and assistance (of businesses).
214. Words coded as spatially oriented were: areas, local, district, urban, abandoned, deterioration, blighted, rehabilitate, rural, adjacent, center, counties, dilapidated, geographic, geography, locate, property, structures, boundary, buildings, land, metropolitan, regions, and relocation.
215. Words coded as community oriented included: opportunities, job, assistance (of people), community, communities, employment, welfare, health,
about a quarter of all phrases were people oriented. It would be unwise to place too much weight on this high-level content analysis given the small sample size, which was limited to codified statements of legislative findings and did not include other sources of legislative history. Nevertheless, these observations provide some evidence that legislators were more concerned with business interests and economic conditions than with the welfare of poor residents—let alone poor residents who live in enterprise zones.

Moreover, the pro-gentrification origins of place-based investment tax incentives also help explain incentives included within the low-income housing tax credit (LIHTC). The LIHTC incorporates two place-based investment tax incentives in the form of additional tax credits for affordable housing projects located in a “qualified census tract” (QCT) or “difficult development area” (DDA).216 Both the QCT and DDA provisions were introduced in 1989, shortly after the one-for-one unit replacement rule was introduced.217 This suggests that one purpose of these provisions, which increase the size of tax subsidies available in designated low-income areas, may have been to make compliance with the one-for-one unit replacement rule—which would otherwise make gentrification particularly costly in these areas—more affordable. Thus, the spatially oriented indirect tax incentives included in the LIHTC can also be understood as arising from pro-gentrification sentiments.

In sum, place-based investment tax incentives were first introduced when federal law constrained the ability of state governments to initiate or directly subsidize gentrification. These state tax incentives “focused on prodding the private market rather than directly orchestrating gentrification” and “encouraged this relatively laissez-faire role” of government.218 With the exception of the QCT and DDA provisions included with the LIHTC, these early place-based investment tax incentives were overwhelmingly comprised of spatially oriented direct tax incentives.219 They provided tax breaks directly to businesses that located or expanded in enterprise zones, but they did not provide the deep subsidies needed to finance most new projects.220
That would change in the 1990s and 2000s. As the next section shows, deeper and more effective tax subsidies were enacted once legal constraints on government-assisted gentrification were relaxed. As the next section explains, these spatially oriented indirect tax incentives have allowed the state to encourage gentrification much more directly by subsidizing new construction.

C. The Resurgence of Federal Intervention in Gentrification and the Rise of Federal Place-Based Investment Tax Incentives

Spatially oriented indirect tax incentives, which are capable of providing significant tax subsidies to enable new construction and expensive startup businesses, emerged in the 1990s, when the Clinton Administration and Congress subtly removed the last remaining HUD-imposed restrictions on state-led gentrification. They did so via a series of important and related moves: the “reinvention” of HUD in the early 1990s, the introduction of the HOPE VI program in 1992, the repeal of the one-for-one unit replacement rule with respect to public housing demolitions in 1995, and the introduction of “voucherization” plans in 1996. With these legal changes, gentrification became “mutually constituted with a nascent regime under a devolved, privatized, and ‘reinvented’ policy framework.”

In the model observed that the non-tax features of enterprise zone laws would be the dominant incentives, because “tax breaks simply are not very helpful until a company has grown large (and successful) enough to have any profits to tax!” Harrison, supra note 175, at 425. If the goal is to promote new business start-ups, such critics observed, the incentives would need to include subsidies for start-up capital. Id.

221. Hackworth & Smith, supra note 153, at 469–70.


224. Emergency Supplemental Appropriations for Additional Disaster Assistance, for Anti-terrorism Initiatives, for Assistance in the Recovery from the Tragedy that Occurred at Oklahoma City, and Rescissions Act of 1995, Pub. L. No. 104–19, § 1002, 109 Stat. 194, 236 (July 27, 1995) (Rescissions Act of 1995) (“Notwithstanding any other provision of law, replacement housing units for public housing units demolished may be built on the original public housing site or in the same neighborhood if the number of such replacement units is significantly fewer than the number of units demolished.”).


226. Wyly & Hammel, supra note 223, at 763.
this pro-gentrification legal environment, the first federal place-based investment tax incentives were introduced.\textsuperscript{227}

The decade began with a pivotal transformation of HUD that proponents called a “reinvention.”\textsuperscript{228} The reinvention, which was compelled by “a near universal vilification of public housing,”\textsuperscript{229} included a significant consolidation of HUD programs, an end to new public housing construction, increased reliance on housing vouchers, and a renewed commitment to “building, preserving, and improving places.”\textsuperscript{230} A centerpiece of this new vision was the HOPE VI program, which featured the demolition of “unredeemable public housing projects,” which were to be replaced with mixed-income housing.\textsuperscript{231}

When introduced in 1992, the HOPE VI program provided for grants to renovate troubled developments, but by the time the program was fully funded in 1998,\textsuperscript{232} the focus of the program had become “the demolition of public housing rather than its renovation.”\textsuperscript{233} The one-for-one unit replacement requirement had been formally repealed by the Rescission Act of 1995, which authorized the demolition of public housing even “if the number of such replacement units is significantly fewer than the number of units demolished.”\textsuperscript{234}

In addition, Congress had formally authorized “voucherization,” whereby tenants affected by demolition could be offered rental vouchers in lieu of brick-and-mortar housing, further clearing the way for gentrification plans.\textsuperscript{235} This expansion of tenant vouchers is often described in the literature as part of a policy shift toward people-based initiatives for fighting poverty.\textsuperscript{236} Such people-based approaches are

\textsuperscript{227} A variation of the enterprise zone concept was finally passed at the federal level under the Clinton administration in 1993. Clinton’s enterprise zone laws were rebranded as Empowerment Zones and Enterprise Communities. Euston, \textit{supra} note 184, at 146.

\textsuperscript{228} Curhan, \textit{supra} note 222, at 239.

\textsuperscript{229} Wyly & Hammel, \textit{supra} note 223, at 723.


\textsuperscript{231} \textit{Id.} at 147.


\textsuperscript{233} Koeninger, \textit{supra} note 225, at 446.


\textsuperscript{236} See \textit{supra} note 222 and accompanying text.
typically cast as the opposite of the place-based approach adopted by place-based investment tax incentives.\textsuperscript{237}

In reality, the shift toward tenant vouchers merely reinforced a legal environment in which public housing could once again be demolished and replaced with properties that would benefit a higher-income demographic.\textsuperscript{238} As explained above, the inability to demolish public housing had placed a significant restriction on private parties’ ability to seek profits through gentrification.\textsuperscript{239} Not only did the policies of the 1990s remove this restriction, but they actively promoted gentrification by requiring developers to convert housing units previously occupied by the poor into spaces to be used by wealthier tenants.\textsuperscript{240} The place-based investment tax incentives introduced during this period must be understood in the context of this broader policy reversal that revived state-assisted gentrification while further retracting from direct financial assistance.\textsuperscript{241}

To be sure, the goal of these policies was not to harm poor communities, and not everyone who supported them was apathetic to their impact on the poor. Rather, many observers hoped that mixed-income communities would benefit the poor. Several prevailing theories supported economic integration—facilitated through mobility programs (e.g., housing vouchers), on the one hand, and mixed income housing on the other—as a solution to urban poverty.\textsuperscript{242}

Some theories relied on the assumption that higher-income residents would use their more powerful social positions in ways that would benefit their poor neighbors. For example, the social control theory argued that the presence of higher-income residents would “lead to higher levels of accountability to norms and rules” because higher-income residents were “more likely to take action to maintain social control in the community, benefiting residents of all income levels.”\textsuperscript{243} Another theory focused on political economy, predicting that higher-income residents would exert political and economic pressure that would result in “higher-quality goods and services available to a cross-section of residents in the community.”\textsuperscript{244}

\textsuperscript{237} Davidson, \textit{supra} note 90, at 1–2.  
\textsuperscript{238} Koeninger, \textit{supra} note 225, at 475. 
\textsuperscript{239} See \textit{supra} notes 201–07 and accompanying text. 
\textsuperscript{240} See \textit{supra} note 167 and accompanying text. 
\textsuperscript{243} \textit{Id.} at 214. 
\textsuperscript{244} \textit{Id.} at 215.
Other theories assumed that higher income residents would socialize with their poor neighbors for the benefit of the poor. For example, the social networks theory predicted that the presence of higher-income residents would “facilitate the re-establishment of effective social networks and social capital for low-income residents.” Similarly, the role model theory predicted that the presence of higher-income residents would “lead other families to adapt to more socially acceptable and constructive behavior,” helping to counter “the hotly debated notion of a ‘culture of poverty.’”

Though the empirical evidence for all these theories has since proven weak, they were influential throughout the 1990s. And by the early 2000s, some experts began defending income mixing approaches—which had already led to the displacement of many poor residents—by overtly defending gentrification itself as an anti-poverty strategy. Richard Florida published a popular book that presented gentrification, fueled by the so-called “creative class,” to the public as a pro-social solution to urban decline, and some legal scholars began to defend gentrification as providing economic, political, and social benefits to the poor. In short, the overwhelming trend in both policy and theory during this period was consistent with promoting gentrification, whether or not it was labeled as such.

This pro-gentrification legal environment cleared the way for federal place-based investment tax incentives. In 1993, one year after the HOPE VI program was introduced, Congress passed a federal version of enterprise zone laws known as Empowerment Zones and Enterprise Communities. Seven years later, in 2000, Congress introduced the New Markets Tax Credit (NMTC), which subsidizes the financing of projects located in poor neighborhoods. Shortly thereafter, in 2003, funding for the HOPE VI program peaked at $570 million. These federal tax laws and HOPE VI gained traction during

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245. *Id.* at 213.
246. *Id.* at 214.
248. *Slater,* *supra* note 100, at 740–43.
251. See *supra* note 223 and accompanying text.
a period when gentrification of neighborhoods was understood to be desirable.

Unlike the tax incentives associated with enterprise zones, the NMTC is an indirect tax subsidy that provides tax breaks to investors who provide capital to businesses in tax-favored zones.255 In this way, the NMTC can help subsidize the capital investments needed for large projects and new construction, hastening the progress of gentrification. In addition, the QCT and DDA provisions of the LIHTC were further amended in 2002 to include poverty criteria that expanded the number of tracts eligible for these spatially oriented indirect tax incentives.256

Thus, several indirect spatially oriented investment tax incentives were introduced or expanded at a time when support for gentrification policies was particularly high.257 Once again, it makes sense, given this context, that these laws lacked features to safeguard poor communities. The historical context of place-based investment tax incentives supports the theory that these tax laws exist to assist private parties in gentrification efforts—not the residents of poor communities.

In sum, this Part showed that place-based investment tax incentives were first introduced by states as a means to provide indirect support of gentrification during a period when their ability to provide direct assistance was limited by federal law. Federal laws restricting gentrification were subsequently relaxed, replaced by several federal laws that actively promoted gentrification—including new spatially oriented indirect tax incentives.

Even the newest example of spatially oriented indirect tax incentives—Opportunity Zones—is best understood as having pro-gentrification origins. At the time when the tax law was introduced, the Trump Administration’s primary focus was on creating a favorable, pro-growth business environment.258 Given this political context, even some members of the development community were skeptical of the program’s objectives. One Maryland-based architect was quoted by a trade news outlet saying,

255. I.R.C. § 45D (2012). The tax credit was designed to attract large, cash-rich investors—and, especially, financial institutions.
256. See generally HUD NOTICE, supra note 131.
257. See Hollar & Usowski, supra note 131, at 154 (describing the introduction of QCTs and DDAs in the 1980s).
[My] concern [is] that this strategy will result in gentrification on steroids . . . The guidelines and regulations thus far show little concern for the effects of new development on the existing blighted community. Focus should be on raising the quality of life for the existing population of the blighted area through new development and also through the improvement of consumer goods, and services where government falls short. Addressing social impact needs to be in the guidelines.\textsuperscript{259}

This critique of Opportunity Zones is understandable, given the law's spatially oriented form. But the form itself was to be expected. Notwithstanding claims that the mission of Opportunity Zones is to help poor communities,\textsuperscript{260} the context and design of the new law reflect the same pro-gentrification origins that underlie the vast majority of place-based investment tax incentives.

In conclusion, most current place-based investment tax incentives have pro-gentrification origins, suggesting that their failure to safeguard poor communities or benefit poor residents is not a flaw, but is rather a feature of these laws. This theory helps explain why spatially oriented investment tax incentives dominate the current landscape despite the lack of empirical evidence that they benefit poor communities. The next Part argues that spatially oriented investment tax incentives should be abandoned.

IV. SPATIALLY ORIENTED INVESTMENT TAX INCENTIVES ARE BAD POLICY

Parts II and III of this Article have argued that place-based investment tax incentives have developed in response to a pro-gentrification business and political environment. This section argues that most spatially oriented investment tax incentives should be abandoned. The analysis set forth here is fundamentally rooted in tax expenditure theory, which describes special provisions of the income tax system that are economically equivalent to direct expenditures.\textsuperscript{261}


\textsuperscript{261} See Surrey, supra note 210, at 715.
Under tax expenditure theory, the primary objective of tax incentives like place-based investment tax incentives is to advance non-tax policy.262 A traditional tax policy response to tax expenditures is to disfavor all tax expenditures on the basis that social and economic policies should not be advanced through tax law.263 But more recent scholarship has taken a more nuanced view, concluding that there is no reason why tax law should be off limits for advancing legitimate social and economic policy goals, assuming they are otherwise consistent with good policy.264

When evaluating whether a tax expenditure represents good policy, one may question whether the underlying non-tax policy goal should be advanced—whether through tax law, or through any other legal framework.265 Or, one can accept the underlying policy goal as legitimate but critique the tax law under broader tax policy principles.266 This section argues that spatially oriented investment tax incentives are problematic under both prongs of analysis. First, it argues that the underlying pro-gentrification policy objective is neither an appropriate nor necessary policy goal, regardless of the chosen legal tool. Second, it argues that even if gentrification was a legitimate policy goal, spatially oriented place-based investment tax incentives are inconsistent with the tax policy goals of efficiency, equity and simplicity.

A. Gentrification is Neither a Legitimate Nor Necessary Policy Goal

If the underlying pro-gentrification policy objective of spatially oriented investment tax incentives is illegitimate, then these types of tax laws should be abandoned. To this end, it is telling that pro-gentrification objectives have rarely been cited by those who support spatially oriented investment tax incentives, and few people defend the tax laws on the basis that gentrification itself is an important social goal.

262. Id. at 711.
263. See id. at 734.
264. See, e.g., David M. Schizer, Limiting Tax Expenditures, 68 TAX L. REV. 275 (2015) (proposing limits, but not repeals, of existing tax expenditures in order to maximize programmatic benefits while minimizing waste); Linda Sugin, Tax Expenditures, Reform, and Distributive Justice, 3 COLUM. J. TAX L. 1 (2011) (arguing that decisions about when to limit or repeal tax expenditures should take into effect their distributive impact).
265. See Surrey, supra note 210, at 713 (distinguishing the question of whether a tax instrument should be used from the question of whether the underlying non-tax policy objective should be advanced).
266. Id.
Perhaps due to the term’s decidedly negative connotations, proponents on both ends of the political spectrum have preferred alternate descriptions like renewal and revitalization.\textsuperscript{267} As discussed in Part I.B., politicians and industry lobbies that have supported place-based investment tax incentives stress that the laws increase investments in distressed areas, presenting that fact as if the benefit to poor communities is self-evident. Meanwhile, affordable housing and anti-poverty advocates support expansion of the tax programs,\textsuperscript{268} choosing to focus on the possibility that some poor people will benefit. They sound alarms when they perceive misuse of the tax incentives, but they generally regard harms associated with gentrification as an unintended consequence of the tax laws and otherwise take their pro-social mission at face value.\textsuperscript{269}

Academic observers have long decried the harms of gentrification. Despite rhetoric in favor of income mixing, the term gentrification "was coined with critical intent to describe the disturbing effects of the middle classes arriving in working-class neighbourhoods and was researched in that critical spirit for many years."\textsuperscript{270} The precise definition of gentrification has been debated, but most include some notion of forced displacement to the detriment of poor communities.\textsuperscript{271}

In addition, some recent research has demonstrated that gentrification is not only harmful to the communities that experience displacement, but also tends to increase inequality in other low-income neighborhoods.\textsuperscript{272} Specifically, “[a]s lower-income households move to neighbouring lower income households, we may observe an increase in income segregation at the aggregate level. At the local level, the corresponding segregation may be especially harmful to low-income households.”\textsuperscript{273} This new research suggests that the harms associated with gentrification may be even larger than previously thought.\textsuperscript{274}

HUD has also acknowledged the harms of gentrification, stating:

What we are hearing on the ground is a widespread need for policies and tools to help areas manage the change, to harness the potential up side of renewed attraction to and investments in low-income and urban neighborhoods while minimizing the

\textsuperscript{267} Slater, supra note 100, at 738; Upton & Jordan, supra note 62, at 1–2.
\textsuperscript{268} See supra Part I.B.
\textsuperscript{269} See, e.g., supra note 9 and accompanying text; see also supra Part I.B.
\textsuperscript{270} Slater, supra note 100, at 752.
\textsuperscript{271} See supra note 100 and accompanying text.
\textsuperscript{272} Christafore & Leguizamon, supra note 106, at 1481–82.
\textsuperscript{273} Id. at 1481.
\textsuperscript{274} Id. at 1480.
possible down sides, such as displacement, increased housing cost burdens, and the potential for long-term resegregation.\textsuperscript{275}

In sum, proponents rarely cite gentrification as their motivation, gentrification is known to be harmful, and HUD has acknowledged the need to protect communities facing gentrification as a result of reinvestment. Meanwhile, the dichotomy between “either unlivable disinvestment and decay or reinvestment and displacement is actually a \textit{false choice} for low-income communities.”\textsuperscript{276} As explained in Part V below, there are several ways to increase the likelihood that poor communities will benefit from place-based investment tax incentives.

For these reasons, this Article takes the position that gentrification is neither a legitimate nor necessary policy objective for place-based investment tax incentives. Since spatially oriented investment tax incentives are fundamentally motivated by pro-gentrification objectives, a case could be made for their abandonment on this basis alone. But even if gentrification were a legitimate policy goal, the next section argues that most place-based investment tax incentives should still be abandoned as bad tax policy.

\textbf{B. Spatially Oriented Investment Tax Incentives are Bad Tax Policy}

Tax policy has traditionally been analyzed along three axis: efficiency, equality and simplicity.\textsuperscript{277} Spatially oriented investment tax incentives offend all three principles. Thus, even if one were to reject this Article’s contention that spatially oriented investment tax incentives promote an illegitimate objective, these incentives should still be disfavored as inconsistent with tax policy goals.

\textbf{1. INEFFICIENCIES}

Spatially oriented investment tax incentives are inefficient to the extent that they encourage businesses to engage in tax-motivated behaviors that do not correct a market failure. It is important to note that all tax incentives are designed to change taxpayers’ behavior, but not all tax-motivated behavioral changes are inefficient.\textsuperscript{278} Tax incentives can be efficiency-enhancing if they counteract inefficiencies

\begin{itemize}
  \item \textsuperscript{275} Katherine M. O’Regan, Commentary: A Federal Perspective on Gentrification, 18 CITIESCAPE 151, 151 (2016).
  \item \textsuperscript{276} Slater, supra note 100, at 753.
  \item \textsuperscript{277} Layser, supra note 75, at 507.
\end{itemize}
due to market failure.\textsuperscript{279} Here, the primary market failure is the under-production of investments in poor communities that would produce positive externalities.\textsuperscript{280}

If systematic disinvestment in poor communities is a cause of concentrated poverty, then it stands to reason that reinvestment could provide a range of benefits associated with poverty reduction.\textsuperscript{281} For example, such benefits may include improved health outcomes, reduced violence, or improved schools. Because these benefits would extend to entire communities—and not merely to the investors—they constitute positive externalities. The potential social welfare gains of such investments are high, but companies' motivation to make the investments is likely to be lower than optimal since they will only capture a small portion of the benefit. Therefore, place-based investment tax incentives may be justified as efficiency enhancing if they increase the number of positive externality-producing investments.

However, when analyzing efficiency, one must weigh positive externalities against negative externalities.\textsuperscript{282} To the extent that place-based investment tax incentives produce the aforementioned benefits but also cause gentrification, the negative externalities associated with displacement and other gentrification-related harms may at least partially offset the benefits. Even without measuring the harms and the benefits, one can reason that a law that produces the same benefits with fewer harms will be the more efficient option. In this regard, the community oriented investment tax incentives proposed in Part V below provide a more efficient alternative.

Moreover, the tax laws are wasteful to the extent that they subsidize gentrifying investments that would take place absent the tax subsidies.\textsuperscript{283} Recent decades have seen a significant shift in capital from the suburban investment back to urban investments.\textsuperscript{284} According to some studies of large U.S. cities, "approximately [twenty percent] of low-income neighborhoods have experienced gentrification since 2000, compared with only [nine percent] between 1990 and 2000."\textsuperscript{285} While place-based investment tax incentives have undoubtedly subsidized some gentrifying investments, it seems likely that other, non-tax forces have contributed to the near doubling of the rate of gentrification. Even

\textsuperscript{279.} \textit{Id.}
\textsuperscript{280.} \textit{See id. at 44.}
\textsuperscript{281.} \textit{See supra note 125 and accompanying text.}
\textsuperscript{283.} \textit{See} Surrey, \textit{supra} note 210, at 719–20; Schizer, \textit{supra} note 264, at 297.
\textsuperscript{285.} \textit{Id.}
if gentrification is a legitimate policy goal, there is no strong justification for continuing to subsidize activity that appears to be happening anyway. To do so is simply bad tax policy.

2. INEQUITIES

Spatially oriented investment tax incentives are also inequitable, providing significant tax breaks to wealthy parties—undermining progressivity within the tax system—with little assurance that the tax expenditures also benefit the poor. Though this critique leads to a single conclusion, the analysis itself has two parts. The first focuses on progressivity within the tax system, and the second considers the broader distributive impact of the tax expenditures.

Nearly all place-based investment tax incentives, including those proposed in Part V, have the potential to undermine vertical equity within the tax system. Vertical equity is the principle that tax burdens should be commensurate to taxpayers' ability to pay. One way that the income tax system promotes vertical equity is through progressive tax rates. Progressive tax rates increase as the taxpayer's income increases, so that "a taxpayer with ten times the total income of another would pay something more than ten times as much tax." Place-based investment tax incentives reduce the effective tax rate of wealthy taxpayers, making the tax system less progressive than it would be without the tax preferences.

However, a distributive analysis of tax expenditures must also consider who ultimately benefits from the tax preference. There is some evidence that the incidence of spatially oriented indirect tax incentives at least partially falls on financial investors, syndicators, and other third parties. For example, one report found that monetization of the LIHTC may consume up to ten to twenty-seven percent of the equity invested in affordable housing projects.

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287. Id.
289. But see generally Blum & Kalven, supra note 28 (arguing that progressivity (beyond what results from a standard deduction or personal exemption) is not necessarily required for vertical equity).
290. Id. at 419.
292. Sugin, supra note 264, at 7.
293. The benefit of place-based investment tax incentives may fall on parties other than the taxpayer who claims the tax benefit. Id. at 19–21.
294. See Desai, supra note 116, at 192. Though it is unclear how much value is captured by NMTC investors, an accounting publication reported that investors paid
These studies provide further evidence that wealthy parties benefit from these tax laws, and not just through tax savings. Syndicators, accountants, lawyers, and others capture part of the value from spatially oriented indirect tax incentives through fees for services. Thus, not only do spatially oriented indirect tax incentives undermine progressivity in the tax system, but they also enable wealthy third-parties to capture value before it reaches poor communities.

Since direct tax incentives do not require monetization, fewer nontaxpayer third-parties are in a position to capture the benefits. The most likely candidates would be employees (if wages increase as a result of the tax laws) or property owners (if property values increase). At least one study of enterprise zone laws concluded that the laws have no effect on payroll per worker or the number of workers hired by enterprise zone establishments. This result indicated that the incidence of the tax benefits inured to the taxpayer claimants, which ultimately substituted capital for labor. Other studies suggest that commercial property owners and landlords capture a significant portion of the tax benefits. Thus, the benefit of spatially oriented direct tax incentives also appears to fall on parties who are likely to be wealthier than low-income residents.

Despite this, place-based investment tax incentives may still be desirable if the tax incentives increase the production of affordable housing and community development activities that benefit the poor, thereby helping to reduce spatial inequality. For example, even if developers, syndicators, and third-party consultants captured the bulk of the LIHTC, this may be an acceptable outcome if neighborhoods are improved for the benefit of low-income people. This is particularly true given the political and cultural biases against direct provision of public housing, which makes it less likely that other policies would fill a gap created if the tax incentives were eliminated.

Though there is some ambivalence in the literature about the extent to which many community development initiatives are tax-motivated, there is anecdotal evidence to suggest that the rate of investments would slow absent place-based investment tax incentives. For example, I spoke to several high-level employees of community development entities (CDEs) who predicted that no deals would take place if the between $0.68 and $0.74 per dollar of tax credits, suggesting that they capture at least some value from the tax subsidy. Eickhoff & Carter, supra note 115, at 17.

295. See supra Part II.B.
297. Id. at 243.
298. See Hanson, supra note 99, at 730. One early study of British enterprise zones estimated that landlords captured as much as sixty percent of tax benefit value in the form of increased rents. See Billings, supra note 99, at 87.
NMTC or LIHTC were repealed. In this vein, one contact speculated that banks, which overwhelmingly dominate the investor pool for such deals, would no longer contribute to CDEs.

Because banks are required under the Community Reinvestment Act (CRA) to invest in low-income communities, one may predict that they would continue to invest in CDEs without the subsidy; however, at least one in-house attorney at a CDE predicted that banks would seek out a more lending-based approach to meeting their CRA requirements. Unfortunately, debt coverage is a key limiting factor for CDEs, which need to attract equity capital in order to avoid becoming over-leveraged. The NMTC helps fill that gap by encouraging banks to make equity investments in CDEs—so if banks ceased to provide equity capital to CDEs absent a tax credit, then one would expect far less CDE-driven community development activity. Therefore, spatially oriented place-based investment tax incentives probably do help increase investments in poor areas.

However, even if spatially oriented investment tax incentives successfully increase the number or size of investments that take place, the benefit to the poor may nevertheless be limited if those investments spur gentrification. As explained in Part II.B., spatially oriented investment tax incentives are not designed to encourage investments that will benefit poor communities. Even the LIHTC may be less effective at benefiting poor tenants than one might expect; one study estimated that tenants capture less than half of the tax credits’ benefit in the form of rental savings, and such savings are highest in the early years.

In sum, spatially oriented investment tax incentives introduce inequities to the system by providing economic benefit to wealthy parties without corresponding benefits to poor communities. It is important to note, here, that all place-based investment tax incentives must deliver some potential value to wealthy parties. Without this, the tax law would not create an incentive. However, one should be skeptical of laws that seem to provide windfalls to companies or create

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299. See, e.g., Godschalk Interview, supra note 122; Lawrence Interview, supra note 122.


301. Godschalk Interview, supra note 122.

profit-opportunities for place entrepreneurs, while simultaneously failing to benefit—or, worse, actively harming—poor communities.

3. COMPLEXITY

A third tax policy criteria that can be used to evaluate place-based investment tax incentives is the goal of simplicity. Unlike efficiency and equity, this analysis needs less explanation. By now, it is probably clear to most readers that place-based investment tax incentives do not increase simplicity within the tax system. Rather, they introduce interpretive complexity through tax credits and deductions with complicated compliance rules. Some introduce practical complexity by necessitating monetization to extract value from tax credits. Most introduce administrative complexity by requiring coordination across federal, state and local agencies. In short, there is nothing simple about place-based investment tax incentives.

It is worth noting, however, that much of the complexity of the current tax code exists because laws are introduced to promote efficiency and equity. Though place-based investment tax incentives will never be simple, they may nevertheless be desirable if they are designed to advance efficiency and equity objectives. Unfortunately, this section has demonstrated that spatially oriented investment tax incentives are neither efficient nor equitable. As such, the complexity they add to the tax system provides one more reason to abandon this approach.

Given the harms of gentrification, it is time to rethink place-based investment tax incentives. The spatially oriented investment tax incentives that currently dominate the field are wasteful at best, and harmful at worst. Their designs are most consistent with objectives that few people set forth as legitimate, and they violate core tax policy principles of efficiency, equity and simplicity. For these reasons, spatially oriented investment tax incentives should be abandoned. The next Part argues that lawmakers should instead introduce community oriented alternatives that hold greater promise as anti-poverty tools.

304. Layser, supra note 75, at 507 (explaining that eliminating the need for tax equity monetization transactions would further the tax policy goal of simplicity).
V. REINVENTING PLACE-BASED INVESTMENT TAX INCENTIVES

A. Community Oriented Investment Tax Incentives as an Alternative to Pro-Gentrification Tax Incentives

This Article has argued that spatially-oriented investment tax incentives should be abandoned, but it would be a mistake to eliminate these tax laws without evaluating possible replacements. Systematic disinvestment continues to be a problem in many poor communities and, with reform, place-based investment tax incentives may still be a politically viable solution. This Part argues that lawmakers should begin to introduce community oriented investment tax incentives.

Community oriented investment tax incentives are rare under current law, and very little data exists to evaluate their impact. As a result, few, if any, empirical studies have specifically tested the impact of community-oriented investment tax incentives. One study of enterprise zone laws in Texas, which incorporate community oriented direct tax incentives, found that the laws increased resident employment in high-poverty areas by one to two percent per year; however, it would be premature to draw strong conclusions from an isolated study. More research is needed in this area.

Nevertheless, the theoretical case for community-oriented investment tax incentives is strong enough to justify further exploration into the use of place-based investment tax incentives to benefit poor communities. Community oriented investment tax incentives are superior to spatially-oriented incentives with respect to their non-tax policy justification, their tax-policy justification, and their predicted practical impact.

First, the design of community oriented investment tax incentives is more consistent with the rhetoric used by proponents of place-based investment tax incentives, who already tout the purported benefits to poor communities. For example, one senator predicted that the Opportunity Zones program could make life better for millions of Americans, saying "I look at it from a common-sense perspective and I ask myself, 'Is there a way for me to positively impact the lives of..."
Critics express concern that the laws may be abused, but abuse is not the problem; spatially oriented investment tax incentives simply are not designed to benefit poor communities. In contrast, community-oriented investment tax incentives are designed for this purpose. Specifically, the goal of community oriented investment tax incentives is to improve neighborhood conditions in poor communities for the benefit of poor communities. This goal is consistent with nontax policy goals already cited in connection with these tax laws.

Second, community oriented tax incentives represent better tax policy than current laws. They stand to be more efficient than spatially-oriented investment tax incentives. Investments that improve neighborhood conditions—from housing conditions to crime rates to school quality to health services—may help counter the deleterious effects of living in poor places.

In contrast, as explained below, community oriented investment tax incentives can be designed to narrowly target positive-externality producing investments, while also including features to reduce harms associated with gentrification. Therefore, community oriented investment tax incentives are likely to be more efficient than spatially oriented investment tax incentives, which are designed to promote gentrification and its associated negative externalities.

They also stand to be more equitable. Though wealthy parties would continue to derive value from community-oriented investment tax incentives, the laws would be designed specifically to benefit residents of poor areas. As a result, the potential welfare gains to poor communities associated with reduced spatial inequality may be sufficient to conclude that the distributive effect of these tax laws would be more efficient and equitable than current laws.


310. Id.

311. The incentives would still be claimed by wealthy taxpayers, thereby reducing progressivity in the tax system. Businesses that claim direct incentives probably will not pass the entire value along to employees, and wealthy third-parties will probably continue to capture some value.

312. This theory borrows some themes from interest convergence theory. One legal scholar articulated a theory of equitable economic development as follows: “Here, we could imagine that the corresponding interests of the regional interest holders are as follows: upper-class residents want to maintain their status quo; middle-class residents want to alleviate regional poverty by stemming the expansion of suburban poverty which was significantly implied the middle class; and low- and working-class residents want equitable development.” Patience A. Crowder, Interest Convergence as Transaction?, 75 U. Pitt. L. Rev. 693, 707 (2014).
Finally, community oriented tax incentives may more effectively balance problems associated with Tiebout sorting than current spatially oriented investment tax incentives. As one legal scholar explained, "any effort to create new economic and social conditions will inevitably change the individuals who live in the targeted communities, and those individuals will not have any entitlement to remain. That, however, is less a critique of place-based policymaking than a recognition of a certain shortsightedness in implementation."

In other words, it may not be possible—or even desirable—to prevent Tiebout sorting from taking place; however, lawmakers can recognize gentrification as a possible effect of place-based investment tax incentives and take steps to mitigate the harms. Community oriented investment tax incentives include features designed to do just that. In theory, then, community oriented investment tax incentives have a better chance of lifting up poor communities than current laws.

In sum, community oriented investment tax incentives are a theoretically promising alternative to the spatially oriented investment tax incentives that dominate current law. The rest of this Article will explain the possibilities and challenges presented by community-oriented investment tax incentives, beginning with an analysis of imperfect models that exist under current law.

**B. Models of Community Oriented Investment Tax Incentives Under Current Law**

An important question presented by place-based investment tax incentives is whether neighborhoods can be improved without spurring harmful gentrification. As discussed in Part II.B, many neighborhood improvements encourage Tiebout sorting, which can lead to displacement of residents. Since wealthier residents bring greater purchasing power, the place entrepreneurs who respond to place-based investment tax incentives are unlikely to resist trends toward gentrification. Absent safeguards for poor communities, gentrification seems all but inevitable, assuming the tax incentives are otherwise effective.

The spatially oriented investment tax incentives that are dominant under current law lack such safeguards by definition. That such tax laws fail to account for predictable harms to poor communities is not surprising. Rather, such design characteristics flow directly from the context and forces that gave rise to the laws. What is surprising is

313. Davidson, supra note 90, at 9.
314. See supra Part II.B.2.
315. See supra Part II.B.1.
316. See supra Part III.
that there are some—albeit rare—examples of place-based investment tax incentives that do include features to ensure that poor communities will benefit. These alternatives to the spatially oriented investment tax incentives described above are community oriented investment tax incentives, and they provide an imperfect model for how to reform the entire category of place-based investment tax incentives.

Community oriented investment tax incentives include safeguards for poor communities within their design. Like their spatially oriented counterparts, community oriented tax incentives can be designed in either direct or indirect forms. Their spatial component, however, is unique in that they target the people—the communities—that exist in a particular place. Where spatially oriented investment tax incentives treat places as separable from the people who live there, community oriented laws are designed to take residents into account.

As a practical matter, community oriented tax incentives are very uncommon in both direct and indirect forms. Some state enterprise zone laws include community oriented direct incentives, but such incentives are rarely the sole incentive available. The Indiana enterprise zone law restricts tax benefits to businesses that hire employees who live in enterprise zones.\footnote{\text{317}} However, it is much more common for state enterprise zone laws to include hiring local residents as one of several ways to earn a tax benefit.\footnote{\text{318}}

For example, Connecticut provides tax credits to enterprise zone businesses that expand businesses or create new jobs.\footnote{\text{319}} Expansion or renovation projects entitle businesses to a tax credit equal to twenty-five percent of their state corporate tax liability, but the tax credit doubles to fifty percent if at least thirty percent of new full-time jobs are filled by zone residents or are eligible for state job training benefits.\footnote{\text{320}} Similarly, new businesses in the zone are eligible for a one hundred percent credit if they satisfy several criteria, including hiring at least 375 employees, forty percent of whom are either zone residents or qualify for job training benefits under state law.\footnote{\text{321}}

Florida provides tax benefits to enterprise zone businesses that hire employees who live in the enterprise zone or participate in social welfare programs.\footnote{\text{322}} Texas law includes similar hiring incentives to enterprise zone businesses,\footnote{\text{323}} and it includes tax benefits for businesses

\begin{footnotes}
\item[317.] \textsc{ind. code} § 6-3-3-10 (2019).
\item[318.] \textit{See infra} notes 319–35 and accompanying text.
\item[319.] \textsc{conn. gen. stat.} § 12-217e (2019).
\item[320.] \textit{Id.}
\item[321.] \textit{Id.}
\item[322.] \textsc{fla. stat.} § 212.096 (2019).
\item[323.] Texas businesses located within enterprise zones are only eligible for benefits if twenty-five percent of their newly created positions are held by those same groups. \textsc{tex. govt code ann.} § 2303.402 (West 2019).
\end{footnotes}
located outside of enterprise zone boundaries that create new jobs as long as thirty-five percent are filled by enterprise zone residents, veterans, or economically disadvantaged persons. These laws include community oriented direct incentives to hire zone residents, but taxpayers may alternatively qualify for benefits by hiring qualifying non-zone residents. The alternate paths to earning the tax benefits dilute the community oriented tax incentives.

Imperfect models of community oriented indirect tax incentives also exist. The most common examples are state tax credits to individuals or corporations that contribute to entities that serve low-income communities; however, like the community oriented direct tax incentives described above, these tax incentives tend to be mixed with other types of tax incentives that may dilute their impact. One example of this variety of community oriented indirect tax incentive was introduced in Pennsylvania in 1976, and as of 2013 twelve states had enacted similar tax laws. These laws are commonly known as neighborhood assistance tax credits.

Under the Pennsylvania law, businesses can earn a tax credit by contributing to a private company that makes a “qualified investment to rehabilitate, expand or improve buildings or land located within portions of impoverished areas which have been designated as enterprise zones,” provided that the proposed project is approved by the state. Since the law does not include any additional requirements to ensure that enterprise zone residents benefit from the law, this incentive is a spatially oriented indirect tax incentive similar to the federal NMTC and LIHTC. And since it is tied to the state enterprise zone law, the law essentially functions as a backstop to the enterprise zone laws.

However, the law also creates community oriented indirect tax incentives. In addition to the activities described above, a business may be eligible for the tax credit if it contributes to certain neighborhood organizations. Donations to a neighborhood organization will earn the tax credit as long as the organization provides “neighborhood assistance, comprehensive service projects, affordable housing,”

324. Id.

325. Note that in some cases, these incentives are structured as tax credits to encourage charitable donations. In this sense, the incentives are not “investment” tax incentives; however, the goal of the incentives is to increase funding of entities that will invest in low-income communities.


327. Id.

328. 72 PA. STAT. AND CONS. STAT. ANN. § 8904-A(a) (West 2019).

329. Id.
domestic violence or veterans' housing assistance, job training or education for individuals, community services or crime prevention in an impoverished area." Impoverished areas, which do not need to be located in enterprise zones, are defined as any area “certified as such by the Department of Community and Economic Development” and approved by the governor. Certification is based on federal census data and “current indices of social and economic conditions.”

Another variation is the Delaware Neighborhood Assistance Tax Credit. Unlike the Pennsylvania law, the Delaware tax credit is available to individuals in addition to businesses, and it cannot be earned through contributions to private companies. Rather, the law provides for tax credits to businesses and individuals who donate to approved nonprofits. To be approved, nonprofits must document that they “provide neighborhood assistance in an impoverished area, or provide neighborhood assistance for low- and moderate-income families.” The Delaware tax code defines “impoverished area” as “any clearly-defined, economically-distressed urban or rural area . . . that is certified as such by the Delaware State Housing Authority.” Certification must be based on federal census data and “current indices of social and economic conditions.”

Neighborhood assistance, on the other hand, is defined to include “financial assistance, labor, material and technical advice to aid in the physical, economic and community improvement of any part or all of an impoverished area or to assist low and moderate income families through the provision of community services, crime prevention, economic development, education, housing, and job training.” Importantly, Delaware law does not limit neighborhood assistance to services rendered to residents of impoverished communities.

Rather, job training will qualify as long as it is rendered to low- or moderate-income persons, regardless of whether they live in an impoverished area. Rehabilitation or new construction of affordable housing will also qualify as long as it will aid low- or moderate-income persons, regardless of whether they reside in an impoverished area. To be sure, tax-based subsidies to organizations that render such services

330. Id.
331. Id. § 8902-A.
332. Id.
334. Id.
337. Id.
to the poor are socially valuable—but they are not place-based. As such, the Delaware law once again mixes the community oriented incentives with other types of incentives.

In sum, it is difficult to find examples of pure, community oriented investment tax incentives under current law. Though some examples of both direct and indirect community oriented investment tax incentives exist under state law, most incorporate other features—such as non-place-based components, or spatially oriented placed-based tax incentives—that may dilute the incentives. One consequence of this mixing of incentives is that it makes it difficult to isolate the impact of the community oriented tax incentives for the purpose of study.

Nevertheless, as explained above, the approach has theoretical advantages over spatially oriented investment tax incentives. For this reason, community oriented investment tax incentives should be viewed as promising until empirical data shows otherwise. Before empirical data can be gathered, however, pure examples of community oriented investment tax incentives must exist for testing. To this end, the next section explains how community oriented investment tax incentives might be designed and introduced via pilot programs that would provide more information about their impact.

C. Designing New Community Oriented Investment Tax Incentives

The primary goal of any community oriented investment tax incentive should be to improve neighborhood conditions in poor communities for the benefit of the people who live there. As such, it is helpful here to take a step back and consider the characteristics that have contributed to the failure of spatially oriented investment tax incentives to benefit residents of poor communities. First, as explained in Parts II and III, spatially oriented investment tax incentives are designed to advance the interests of businesses and place entrepreneurs, not local residents. In fact, pro-gentrification developers have strongly influenced the development of place-based investment tax incentives through their lobbying efforts and participation in pro-growth coalitions. Since the interests of communities and place entrepreneurs often conflict, it is understandable that spatially oriented investment tax incentives have not been designed to benefit residents of poor communities.

A second and related characteristic of spatially oriented investment tax incentives is that they are designed to create profit centers and enable gentrification, not to improve conditions for people who live in

339. See supra Part III.
340. See supra Part II.B.2.
high-poverty areas.\textsuperscript{341} Indeed, the goal of place entrepreneurs is to profit on place.\textsuperscript{342} One consequence of this focus on creating profit centers is that geographic boundaries take on elevated importance in the context of spatially oriented investment tax incentives. To earn the tax preference, businesses or property must be located within geographic boundaries. But businesses are not required to interact with area residents. In this way, the law treats space within the geographic boundary as distinct from the community that lives there. This disconnect makes it less likely that the tax incentive will benefit poor residents.

A third characteristic is that the objectives of spatially oriented investment tax incentives have often been opaque, or even ambiguous.\textsuperscript{343} Keeping the objectives vague has undoubtedly helped to maintain bipartisan support for the laws. Pro-business advocates can point to their growth potential, while anti-poverty advocates can embrace their potential to benefit poor communities. But the lack of a clear objective has also made it difficult to evaluate their success. While some laws require regular impact reports, many do not. Meanwhile, the research questions asked by social scientists may have little relationship to the purpose of the laws. For example, evidence that the laws fail to decrease poverty rates is most relevant if the laws are, in fact, designed to reduce poverty—and this Article has argued that they are not.\textsuperscript{344}

With these characteristics of spatially oriented investment tax incentives in mind, this section presents a road map for designing community oriented investment tax incentives that include more community oriented features. Rather than propose a specific prototype, this section argues that three principles should guide the design of every community oriented investment tax incentive: confer power to community stakeholders; link place to community; and incorporate a system for monitoring outcomes. This section will elaborate on each of these principles.

1. CONFER POWER TO COMMUNITY STAKEHOLDERS

Spatially oriented investment tax incentives aim to create business opportunities for place entrepreneurs that propose projects based on profit potential. Community members are systematically disempowered in this context. Any benefit to the community is incidental, and communities may even be harmed as a result of gentrification. In

\begin{itemize}
\item \textsuperscript{341.} See supra Part II.A.
\item \textsuperscript{342.} See supra Part II.B.2.
\item \textsuperscript{343.} See supra Part III.
\item \textsuperscript{344.} See supra Part II.
\end{itemize}
contrast, community oriented investment tax incentives must confer power to community members.

The purpose of community oriented investment tax incentives is to benefit community members, who represent additional stakeholders. Past experience with spatially oriented investment tax incentives provides powerful evidence that the interests of poor communities, private industry, and governments will not align absent deliberate efforts to empower community stakeholders. One way to empower community stakeholders is through citizen participation.

The importance of citizen participation in urban initiatives has been known since the early years of urban renewal. Citizen participation is “the active, voluntary involvement of individuals and groups to change problematic conditions in poor communities, and influence the policies and programs that affect the quality of their lives or the lives of other residents.” A key element of citizen participation is empowerment, and a related prerequisite is residents’ belief that they have the capacity to make a difference.

Unfortunately, efforts to engage community members has often failed to empower poor community stakeholders. Policymakers have actively “privilege[d] the knowledge and capacity of planners and architects to design spaces that serve the best interests of citizens.” Top-down approaches like these “inject the goal of establishing vibrant community into professional priorities but forego potential contributions from the beneficiaries of these designs.” When the narrative of a place is told by place entrepreneurs, and not by the community, they can “coopt and commodify established residents’ cultural symbols and practices,” ultimately contributing to their displacement.

345. See supra Part III.
349. Arnstein, supra note 346, at 216.
352. Id.
Effective citizen participation, however, is bottom-up, where citizens have “a voice in shaping the public spaces that they use.”\textsuperscript{354} For example, a study of how Chicago residents “pro-actively correct defects in existing spatial arrangements” observed that “residents have played crucial roles (sometimes with planners and other officials or professionals, sometimes without them) in recognizing problematic space, developing solutions, and eventually implementing reconfiguration.”\textsuperscript{355}

Through voluntary participation, the citizens helped alter their environment in at least two ways. First, they constructed environments that were even “more conducive to community building and social organizing.”\textsuperscript{356} Second, the citizen participants worked to “recognize and respond to defects in their circumstances” and sought to address “only those situations that are most urgent and problematic.”\textsuperscript{357} As such, “[t]his approach economizes the limited resources available in most urban neighborhoods by concentrating efforts on the most serious local concerns.”\textsuperscript{358}

Although the citizen participation observed in Chicago was initiated by community residents, this type of bottom-up citizen participation and its effects “can be deliberately harnessed and reinforced through the appropriate political institutions”\textsuperscript{359}—including through law. Here, the design of community oriented investment tax incentives should be driven by community participation, which would ideally inform both the law and administration of the tax incentive program.

In other words, the legal design should require what Professor Edward De Barbieri has coined “urban anticipatory governance.”\textsuperscript{360} Urban anticipatory governance is an “approach to land use planning [that] would engage residents before a finished proposal has taken shape—at a moment when their input can be used in designing a plan.”\textsuperscript{361} This approach can be used to inform two aspects of tax incentive design—substantive and procedural.\textsuperscript{362}

Substantively, the tax law may incorporate community participation by limiting taxpayer eligibility to those who can demonstrate that project transactions are subject to community benefits

\textsuperscript{354} Fung, \textit{supra} note 351, at 616.
\textsuperscript{355} \textit{Id.}
\textsuperscript{356} \textit{Id.}
\textsuperscript{357} \textit{Id.} at 617.
\textsuperscript{358} \textit{Id.}
\textsuperscript{359} \textit{Id.}
\textsuperscript{361} \textit{Id.}
\textsuperscript{362} \textit{See id.} at 87.
Community benefits agreements are “contracts between a coalition of community groups and a developer where the developer provides a slate of economic benefits in exchange for the coalition not opposing the development project.”364 One case study of projects with community benefits agreements concluded that they “can benefit communities when an inclusive and representative community coalition negotiates with a developer to reach a binding CBA without government as a party to the agreement” and help “share economic benefits and avoid displacement.”365

Even without a legal obligation, as many as half of NMTC projects may “involve formal or informal community benefits agreements (CBAs) between CDEs and businesses benefiting from the NMTC financing.”366 This suggests that the barriers to making this type of substantive change to the tax laws may not be unsurmountable.

Procedurally, the law may require developers to use participatory techniques during the planning stage in order to identify community needs, and to articulate how the proposed project will contribute to the pre-existing institutional ecology. Urban planners “have always been concerned with the built environment” and “the maps produced through their efforts, have been useful for the practices of planners but often have failed to resonate with and be put to use by community members themselves.”367 A promising method of soliciting community voices during this process would be through a method called “mental mapping.”368

Mental mapping has been described as “‘speaking landscapes’ of words, images, colors, and one’s personal experiences with geography as an attempt to diminish the power differential between researcher and the researched.”369 A related technique is “story mapping,” which emphasizes the role of storytelling in mental mapping in order to help residents “think beyond the boundaries of traditionally defined neighbourhoods and consider their shared everyday place meanings and

363. See id. at 89–91.
365. See id. at 1782.
369. Id. (citation omitted).
experiences that are often overlooked by both community members and community development practitioners." 370

Mental mapping allows participants to "express emotional, ideological, and physical interactions with geography" and it has been used to understand residents' "perceptions of city spaces and causes for social conditions" in their neighborhoods. 371 Though the value of mental mapping and participatory storytelling have long been known to researchers, the modern technique uses digital data and user-friendly mapping platforms to create and curate maps. 372 The goal is to combine modern mapping capabilities with a participatory process in order to understand places and engage residents in community development. 373

For example, mental mapping workshops have been used recently by journalists in Illinois to learn about issues affecting communities throughout the state. 374 The workshop not only yielded information about common perceptions of their region, but also points of contention. 375 In addition, a new study by a team of urban planning researchers has provided promising empirical support for the method. 376 The researchers used story mapping to understand the needs of an immigrant community facing the possibility of displacement due to a new metro rail line. 377 The technique yielded a variety of revealing insights about the community. 378

For example, "local laundromats . . . were popular among participants who lacked facilities within their apartments," serving as both functional and social spaces. 379 The researchers were confident that the story mapping process had been an empowering experience for residents, and that it had yielded "critical insights" for researchers and community organizations "into how residents see, experience and make

370. Lung-Amam & Dawkins, supra note 353, at 3. The authors note that scholars “have long recognized the value of stories within planning and community development processes.” Id.

371. Gutsche, supra note 368, at 488.


373. Id.


375. Id.

376. See generally Lung-Amam & Dawkins, supra note 353 (performing a case study of story mapping in Langley Park, Maryland and concluding that the method may help empower traditionally marginalized groups and encourage more complex narratives within community development planning).

377. Id. at 2.

378. Id. at 16.

379. Id.
meaning of their neighborhood." Though the researchers declined to predict whether mental mapping would have an impact on policymaking, this Article proposes that similar methods be used to inform lawmaking in the context of place-based investment tax incentives.

As a practical matter, mental mapping methods could be used by policymakers to gather information from community members in targeted areas. While citizen participation would ideally inform all aspects of the tax incentive design, there are at least two points when citizen participation would be especially important. First, in the case of limited tax subsidies like the NMTC or LIHTC, in which government agencies decide which projects should receive tax allocations, citizen participation can help program administrators identify which projects have the highest social value. Are the most urgent community problems related to hiring needs, the built environment, or something else? In some cases, it may be possible to administer the tax law to address specific problems faced by communities, a process that may help overcome deficiencies caused by broad statutory language.

For example, if the largest problem facing a community is resident unemployment, then community oriented direct tax incentives to hire area residents may be appropriate. Or, community members may identify specific types of businesses that could benefit their communities—such as affordable child care centers or chain grocery stores. Again, community oriented investment tax incentives could be administered to specifically target the types of firms that sell goods and services residents expect to benefit their community.

In fact, current law provides a partial model for this approach. Most current incentives are written broadly. Until recently, all federal indirect place-based investment tax incentives required taxpayers to

380. Id. at 17.
381. Lung-Amam & Dawkins, supra note 353, at 17.
382. See infra Part V.D. Mental mapping may also help inform so-called "neighborhood acupuncture" techniques, which are "community interventions that activate existing storytelling networks using light-touch and low-cost methods." Lung-Amam & Dawkins, supra note 353, at 5.
384. See Chanjin Chung & Samuel L. Myers, Do the Poor Pay More for Food? An Analysis of Grocery Store Availability and Food Price Disparities, 33 J. CONSUMER AFF. 276, 293 (1999) (finding that the cost of grocery store food is higher in poor neighborhoods because they have fewer chain grocery stores).
seek approval for tax-credit eligible projects. For example, CDEs must apply to the CDFI Fund for NMTC allocations based on proposed investments. Similarly, affordable housing developers must apply to local housing authorities for LIHTC allocations based on proposed housing projects. In these cases, agency representatives review project applications and determine which projects are eligible for the tax credits.

This allocation process serves a dual purpose of limiting the tax credits (only a fixed amount of tax credits are available for allocation each year) and ensuring some program oversight (since the CDFI Fund and local housing authorities are presumed to have substantive expertise). Community oriented investment tax incentives should adopt the same approach but incorporate citizen participation in the administration process. For example, the criteria for project eligibility and ranking should be developed in consultation with community representatives and informed by data gathered directly from community members.

Once the primary objective of the tax incentive and administrative criteria have been established, the next step is to design a place-based investment tax incentive that is consistent with these choices. The next section explains how these objectives should inform how the tax laws link place to community.

2. LINK PLACE TO COMMUNITY

Where spatially oriented investment tax incentives tend to approach poor places as separate from the communities that live there, community oriented investment tax incentives should seek to maintain the link between community and place. Spatially oriented investment tax incentives encourage firms to locate within a targeted area, but community oriented investment tax incentives should encourage firms to engage with the communities within a targeted area. The mechanism by which the law encourages firms to engage with the communities—or links place to community—should be informed by the specific objective to be advanced.

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385. The new Opportunity Zones program abandons the per-project approach, merely requiring that investments meet the statutory criteria that establish their location within an Opportunity Zone.
389. See Weisbach & Nussim, supra note 305, at 994 (presuming that agencies possess substantive expertise in their area).
By definition, all community oriented investment tax incentives must contain features that specifically benefit residents of a targeted area. But the specific objectives of the law should be tailored to the targeted community and informed by citizen participation, and they may reflect either of the following two broad goals. The first goal is to benefit individual members of the community, such as through incentives to hire. The second goal is to improve neighborhood conditions for the benefit of the community, such as through incentives to improve the built environment or to attract specific types of businesses.

The type of objective should inform how it links place to community. In some cases, for example, it may make sense to make tax preferences available to firms located outside the targeted area. This may be especially true in the context of incentives to benefit individual members of the community through labor investment. For example, recall that under the Texas enterprise zone laws, businesses throughout the area were eligible for tax breaks if they hired employees who resided in the zone.

At least one study concluded that zone resident employment rates increased even though firms were not required to locate in the zone to claim tax credits. The Texas law effectively links community members to place by requiring residence in the targeted place (in this case, an enterprise zone). In that regard, the law is spatially-targeted and place-based. At the same time, delinking the firm's location to the targeted place has several advantages.

First, it would eliminate locational distortions associated with firms relocating within zone boundaries, thereby avoiding harms to other parts of the municipality. Second, it would expand the pool of potential employers for zone residents by creating incentives for businesses throughout the region to hire them, rather than limiting opportunities to hyper-local businesses. This would increase the likelihood of unemployed residents matching with employers who can use their skills.

Third, it would also conform more closely to the realities of modern economies, in which employees often travel throughout the region for job opportunities. In the more traditional approach, in


391. See supra notes 323-22 and accompanying text.

392. See supra note 306 and accompanying text.

393. Aprill, supra note 23, at 1348.

which employers locate in the zone, the mobile job force is just as likely to spur gentrification as wealthier, higher-skilled outsiders travel into the zone seeking new job opportunities. This effect is reversed—and the risk of gentrification is less—when employers outside the zone employ zone residents.

Despite its potential advantages, this approach is the exact opposite of that taken by the spatially oriented indirect tax incentives that exist under current law. Both spatially oriented direct and indirect investment tax incentives typically require that firms are physically located within, and doing business in, the target area.\textsuperscript{395} The lack of any necessary nexus to local communities beyond mere physical proximity leaves to chance whether such investments will benefit the communities. In contrast, the Texas approach eliminates physical proximity but creates a strong link between place and community.

On the other hand, to the extent that the tax incentive aims to benefit the entire community, it may be necessary for a firm (or its project) to be located within the targeted area to link community and place effectively. This is especially true if residents' proximity to the business or project is predictive of whether they will benefit from the investment. To maintain this link, the tax law should place more emphasis on regulating the activities performed by local firms than on the mere location of those firms. For example, tax benefits may be limited to the types of investments that may be reasonably expected to benefit poor residents, such as low-cost childcare centers, community centers, or charter schools. Ideally, taxpayers would be required to

\textsuperscript{395} For example, as described in Part II.B.1 above, the NMTC is earned when a taxpayer makes a "qualified equity investment" in a CDE, which must use substantially all of the cash to make "qualified low-income community investments." I.R.C. §§ 45D(a)-(b). Contrary to the name, however, qualified low-income community investments need not benefit low income communities. Instead, qualifying investments include capital investments or loans made to businesses that are physically located within, and doing business in, the target area. I.R.C. § 45D(d)(1) (qualified low-income investment includes capital or equity investment in, or loan to, any qualified active low-income community business), I.R.C. § 45D(d)(2)(A) (defining active low-income community business as a business in which

"(i) at least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business within any low-income community, (ii) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within any low-income community, (iii) a substantial portion of the services performed for such entity by its employees are performed in any low-income community, (iv) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles . . . other than collectibles that are held primarily for sale to customers in the ordinary course of such business, and (v) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.").
certify that their activities directly benefit local residents and, as explained in the next section, should be subject to monitoring.

Thus, the mechanism by which the law targets place and community may vary depending on the specific objective of the incentive, but in every case there should be a conscious effort to link place to community. The next section addresses the question of how tax laws can be designed to advance the specific objectives needed to benefit a local community by effectively conferring power to community stakeholders.

3. INCORPORATE A SYSTEM FOR MONITORING OUTCOMES

Where the objective of spatially oriented investment tax incentives is vague, the goals of community oriented investment tax incentives should be clear and subject to monitoring. The success of community oriented investment tax incentives should be monitored and regularly evaluated based on their impact on community residents. Just as citizen participation can inform the objectives, citizen participation is also essential for monitoring outcomes. The metrics for evaluating the impact of the law should be clearly defined, and an assessment schedule should be set.

Most current place-based investment tax incentives do not require regular impact assessments, and most of what we know about their impact on communities is the result of studies that test factors like property values, employment rates, area poverty rate, or the amount of capital investments. These factors may or may not relate to intended outcomes. In the case of community oriented investment tax incentives, lawmakers should specify in advance which types of outcomes are relevant to evaluating the success of the law. Possible metrics need not be limited to those typically studied, but may be expanded to include factors like crime rates, health outcomes, or other factors identified through citizen participation. However, the metrics should be closely tied to the objective and responsive to real community need.

If, after a specified period, positive outcomes are not observed, then the tax law should be reevaluated, again with consultation with citizen participants. Since community oriented investment tax incentives introduce many of the same potential inefficiencies and complexities as their spatially oriented counterparts, their justification depends on their ability to impact communities positively. To the extent they fail to do so, they should be reformed or abandoned in favor of other policy tools.

In sum, a community oriented investment tax incentives should be designed with citizen participation, should link place to communities as needed to advance specific objectives, and should incorporate a mechanisms for monitoring outcomes. Though these principles should
guide the design of any community oriented investment tax incentives, the specifics may vary widely as different communities seek to address their unique circumstances. The next section considers the main challenges to implementation and proposes that cities and states consider pilot programs prior to adopting community oriented investment tax incentives as a widespread approach to combat concentrated poverty.

D. Challenges to Implementation

Like many policies, the primary barrier to shifting toward community oriented investment tax incentives is likely to be political. Spatially oriented investment tax incentives have historically enjoyed more bipartisan support than many social policies, largely because powerful industry lobbies derive significant benefits from the tax laws. Anti-poverty advocates, seeing few politically viable alternatives, have supported the programs while stepping into a watchdog role, hoping to curb abuses and increase the chances that poor communities will also benefit from the laws.

The profit potential for private industry is likely to be smaller under community oriented tax incentives than under current law, a fact that threatens to erode support for the laws. Anti-poverty advocates are likely to support the changes, but they represent a less politically powerful lobby than private industry. Meanwhile, the federal government recently doubled-down on the spatially oriented approach through its introduction of Opportunity Zones.

Nevertheless, community oriented investment tax incentives may be viable in politically progressive states and cities, which can and should consider introducing pilot programs to test the approach at the state and local level. If successful, the approach may well become politically viable at the federal level as the composition of leadership changes. Moreover, governments may experiment with community oriented investment tax incentives without immediately repealing current laws, which can be phased out at later dates once the impact of community oriented alternatives are better understood.

Finally, it is worth noting that while community oriented tax incentives represent better tax policy than their spatially oriented counterparts, one may still critique the approach as weaker than direct public spending. In a recent study of the rhetoric and realities of charitable giving, one scholar argued that the deduction for charitable

397. See supra Introduction.
giving reflects more private control than government assistance. One critique was that it represents a weak financial commitment from the government because "it contains no unconditional commitment to public support." Place-based investment tax incentives are subject to this same criticism. Though the incentives have proven capable of attracting investment, they are nevertheless dependent on the profit-driven decisions of private market actors. One consequence of this dependence is that investors often fail to make investments during periods when the need may be greatest. Tax incentives fundamentally depend upon taxpayers expecting to have tax liabilities, which may not be true during periods of recession. During the Great Recession, for example, financing for affordable housing projects came to a halt when would-be tax equity investors predicted that they would have insufficient tax liability to absorb the tax credits. Thus, though the tax-based approach has some political advantages over direct government grants, it falls far short of a commitment from the government to subsidize investments for the benefit of poor communities.

Nevertheless, in the politically-fraught context of affordable housing and community development, even an imperfect commitment from the government may be better than no commitment at all. In addition to demonstrating the pro-gentrification origins of current law, the history of place-based investment tax incentives reveals a reality in which policies that assist poor neighborhoods are most viable when they are perceived as limiting government involvement. Though the place-based investment tax incentives that exist under current law are deeply flawed, the broader tax-based approach may still hold promise.

400. Id. at 2615.
401. See, e.g., COHNREZNICK, supra note 300, at 6.
402. Id.
403. Layser, supra note 75, 480–81.
405. See supra Part III.
CONCLUSION

Concentrated poverty presents a serious challenge to equality in America. At the most basic level, spatial inequality is a problem faced by lawmakers, who often point to place-based investment tax incentives as tools to promote investment in poor areas. Place-based investment tax incentives have traditionally enjoyed significant bipartisan support, yet the empirical evidence is often disappointing to anti-poverty advocates. This Article has argued that what many anti-poverty advocates regard as a flaw of place-based investment tax incentives—a lack of safeguards to protect poor communities—is a feature of most current place-based investment tax incentives.

The development of place-based investment tax incentives and their designs can be explained as a predictable result of the pro-gentrification business and political environment that produced them. Viewed through this lens, it becomes much easier to reconcile (but harder to justify) the continued use of place-based investment tax incentives despite a lack of empirical evidence that they benefit poor communities. If place-based investment tax incentives are used at all, then they should be used for anti-poverty goals.

Anti-poverty goals may be advanced more effectively through community oriented investment tax incentives, which are rare under current law. Unlike most current incentives, community oriented investment tax incentives would confer power to community stakeholders, link place to community, and incorporate a system for monitoring outcomes. To this end, this Article has provided a roadmap for designing community oriented investment tax incentives that employs participatory mapping techniques to inform the tax incentive design and administration. State and local governments should introduce pilot programs of community oriented investment tax incentives that would enable researchers to study their impact and evaluate their potential as large-scale anti-poverty programs.
GUIDING PRINCIPLES for OPPORTUNITY ZONES

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EXECUTIVE SUMMARY

The Tax Cuts and Jobs Act of 2017 established an Opportunity Zones tax incentive, which provides a federal capital gains tax deferral and partial exemption for investments in designated Opportunity Zones. Governors in each state will select Opportunity Zones from an eligible group of low-income census tracts. Selections must be made by the third week of March 2018 (or third week of April 2018 if an extension is requested). Given the significant interest among many private investors, it is possible that Opportunity Funds will attract tens of billions of dollars in private capital, making this one of the largest economic development programs in U.S. history.

This policy brief puts forward four principles to guide the selection and development of Opportunity Zones. The principles are designed to enable the greatest job creation potential and the most significant advantages for lower income resident employment, both, inside and outside the eligible zones. Throughout the document we stress the use of data analytics, local knowledge, and the need to see these incentives as just one part of a broader economic development strategy.

1. **Principle One:** Identify areas that demonstrate both social need and market traction. Use a social needs index and job cluster data as the primary screen and then identify the deeper potential for equitable development by analyzing additional employment data along with transportation access data.

2. **Principle Two:** Link capital investments to human capital strategies to maximize impact for lower income residents. Focus on aligning skills upgrading with existing and future job growth both within and outside eligible investment areas.

*This policy brief was commissioned by The Governance Project, and prepared by New Localism Advisors, a firm co-founded by Bruce Katz and Jeremy Nowak. The Governance Project is a nonprofit organization supporting the work of a bipartisan group of high impact governors and mayors across a range social, economic and policy issues. Launching its first initiative in Spring 2018, TGP will offer state and local governments analytics, expertise and capital sources for policy initiatives. TGP will begin with a focus on economic opportunity strategies in distressed urban and rural communities and expand to initiatives in other policy areas including education, infrastructure, healthcare and more.*
3. **Principle Three:** View Opportunity Fund investment capital as integral to a comprehensive, multi-year investment strategy that leverages and partners with additional public, private, and independent sector debt and equity providers to build sustainable businesses, ensure a skilled workforce and strengthen community development both within eligible zones as well as in contiguous areas.

4. **Principle Four:** Ensure a high quality data system to collect information on investments and provide a feedback loop for ongoing measurement and improvement. We are less interested in expensive evaluation models than the ongoing disciplined use of data to inform ongoing operations and maintain long-term accountability.

**TAX CUTS AND JOBS ACT OF 2017**

The Tax Cuts and Jobs Act of 2017 established an Opportunity Zone tax incentive, which allows taxpayers to defer paying federal tax on capital gains from the sale of property if those gains are invested in Qualified Opportunity Funds that invest 90% of their assets in businesses located or property used in a designated low-income community. Investors receive modest reductions in their eventual tax bill if they maintain their Opportunity Fund investments for at least five and then seven years. Investors that hold capital in those funds for a full ten years also do not have to pay capital gains tax on the appreciation of their Opportunity Zone investments.

The census tract eligibility criteria for the Opportunity Zone incentive mirror the low-income tract criteria for the New Markets Tax Credit program. Unlike the New Markets Tax Credit program where there was universal eligibility for all low-income census tracts, the Opportunity Zones program directs the chief executive in every state and territory (including Washington D.C.) to choose up to 25% of their tracts to be eligible. In addition, five per cent of Opportunity Zone tracts may also be non-low-income as long as they are contiguous to a qualified, nominated tract and their median income does not exceed 125% of the contiguous qualified tract.

Making selections will generate demand for equitable distribution across urban, suburban, and rural communities. Those states that do the best job will also want to apply criteria and supporting data as the basis for selections. A strong selection *theory* holds potential for maximizing the number of investable projects and businesses, on the one hand, and access for low-income residents to those jobs, on the other.

**21ST CENTURY PLACE-BASED STRATEGIES**

Public policy analysts commonly distinguish between *place-based* and *people-based* approaches to poverty reduction. Place-based approaches invest or incent investments in specific communities based on assumptions regarding a deficit of capital, jobs, housing or infrastructure in those areas.
People-based investments flow directly to households (e.g. earned income tax credit) irrespective of where someone lives or works.

The history of place-based public policy in America is complex and includes early 20th century rural electrification, War on Poverty programs like the Appalachian Commission and Model Cities and a variety of business incentive and capital investment strategies including enterprise zones, empowerment zones and New Markets Tax Credits. In addition to federal efforts many place-based programs are sponsored by state and local governments. Philanthropy has also utilized place-based strategies in support of community development and poverty alleviation. Every city and county in America can point to geographic zones with specific incentives tied to its redevelopment from main streets to industrial corridors.

The history of place-based programs is uneven with respect to both community revitalization and poverty reduction outcomes. One limitation of many place-based programs is the failure to take into account the dynamism of demography, markets, and counter-incentives (school quality, regional economic trends) in society at large. Opportunity Zones will succeed if states take a dynamic, market-oriented perspective in selecting them that takes into account how integrated the zones are with surrounding communities and pays attention to issues of labor supply as well as capital demand.

Place-based programs in a 21st century economy must recognize four characteristics of economic reality.

1. **Employment Clustering:** Job growth is increasingly clustered in relatively small geographies around downtowns, medical and research institutions, and communities where there are strong entrepreneurial ecosystems. The advanced economy increasingly favors places where talent, research, quality amenities, and startup innovations co-locate. It is also important to look at emerging job clusters in more rural areas. The number of jobs differ but the co-location dynamics are the same.

2. **Training and Access:** The major driver of labor market attachment is workforce quality and job accessibility. While job requirements change rapidly due in large part to technology, there is a premium placed on adaptive technical and inter-personal skills. Communities with strong training programs linked to industry and quality transportation hold an advantage.

3. **New Forms of Capital Intermediation:** There is an abundance of global capital, but it is place agnostic and not always suitable for every stage of business growth or project development. Moreover, global capital flows focus on sectors and products more than places. Opportunity Funds create the potential for expanding the quality of intermediaries that have two essential qualities: local knowledge and capital markets credibility.
4. **Technological Disruption:** Advances in technology are radically altering how residents and institutions understand, navigate, experience and communicate within and across places. Opportunity Funds should take advantage of or experiment with technologies to boost resident engagement, strengthen employment linkages, accelerate product and process innovation and enhance quality place making. This may be particularly important for rural communities that lack large employment clusters but have strong workforce capacity.

Place-based programs must internalize these facts. In order for place-based programs to reach their fullest potential, however, places themselves need complementary strategies to address these economic realities and position their residents to access new employment opportunities in a changing economy. Tax incentives are not a magic solution to the basics related to job growth and labor quality. The Opportunity tax incentive is a tool and not a program. It must be reinforced by other economic development strategies to maximize its value, particularly for inclusive growth.

**AN INITIAL SCREEN: MARKET TRACTION AND SOCIAL NEED**

Our primary screen for the identification of preferred tracts is the co-existence of market traction and social need. By market traction we refer to places where there is significant but unrealized potential for job growth as evidenced by existing job clusters or relative proximity to job clusters, as well as transportation access for low-income residents to those jobs. By social need we refer to communities where income, labor market participation, poverty rates, and educational attainment demonstrate a limited capacity to attract investment absent a policy carrot and yet signify the potential to benefit inordinately from a resuscitation of market activity.

There are many ways to identify the intersection of market traction and social need. We began by mapping social need based on the interplay of variables listed below.

- % Population below poverty
- % Households with rent or mortgages greater than 30% of income
- % Population not in the labor force
- % of Population with less than a high school degree
- Gini index of concentrated income

We applied a factor analytic methodology to the variables in order to construct a weighted composite index of social need. We then mapped all eligible census tracts using the index. The map below shows the city of Philadelphia's eligible census tracts mapped with respect to levels of need. The rank is relative to all other eligible tracts in Pennsylvania. We differentiated among ten levels of need. The map shows 296 eligible tracts with varying levels of social need. The question then is how to best make choices among these eligible tracts.
To help make choices along our social need-market traction axis, we applied national employment data from the Longitudinal Employer-Household Dynamics database. The data is collected at the block level and can be aggregated up to census tracts. Moreover, it is updated annually and can be easily mapped.

The map below shows Philadelphia with the census tract differentiation based on social need scores and the jobs cluster data for areas that have at least 1,000 jobs clustered at the block level. The larger the circle, the greater the number of jobs.

The overlay of jobs and need is one initial screen to identify strong investment choices. In making selections there may be trade-offs between social need and market traction among eligible tracts. In census tracts where there are job rich clusters and a high level of social need, the selection process is relatively easy.

If there are no clear instances of high levels of job growth and high levels of social need, we favor trade-offs that emphasize job clusters within eligible tracts, even in instances where the social need is not the highest among all low-income eligible tracts. This strategic choice is driven by a primary emphasis on job growth and our understanding that job access and employment skills will do more to increase household income than the absolute proximity of jobs and social need.

While many rural communities do not have the same employment clusters as urbanized counties, the selection principle remains the same. Identify main streets and business parks where there are existing jobs and growth potential including communities contiguous to those places. Local knowledge is critical to identifying emerging business growth opportunities in rural areas.

It is important to note that this is a market-based program that does not guarantee investment in any selected census tract. Tracts with some pre-existing employment base, including newly emerging hubs, will often provide a stronger signal for new investment to follow suit. High social need tracts adjacent to job hubs may be candidates for increased investment from the job anchors to adjoining communities.

In many cities, the lag in data availability means that some census tracts may have experienced substantial market renewal even though they still qualify for Zone selection, raising the specter that the Opportunity Funds will be used to further gentrification and displacement of existing residents. To the greatest extent possible, governors and local officials should take account of current market conditions when designating Zones and avoid subsidizing investment that was already going to occur regardless of this new incentive.

It should be noted, however, that gentrification varies substantially across cities in terms of intensity, applicability and geography. The experiences of Boston and San Francisco should not be confused with the realities of Detroit and St. Louis. We believe that recent market renewal in the central business districts, midtowns, and university or medical districts of former industrial cities is a strong reason for selecting those areas if they are eligible. After decades of hollowing
out, these engines of American prosperity still need help building modern industries to power the next generation of growth and prosperity.

Governors and local officials should balance concerns around gentrification with the need to establish strong employment and fiscal bases in the cores of cities and urban counties, as well as rural communities.

A SECONDARY SCREEN: JOB CHARACTERISTICS AND TRANSPORTATION ACCESS

The capacity to invest in a census tract with a job rich ecosystem does not mean that the people in that tract will be able to access those jobs. Moreover, to fulfill their employment needs, firms hire from throughout a city, county, and region. In order to maximize the value of Opportunity Fund investments for low-income persons both within and outside the selected tracts there are two things that are necessary to demonstrate in addition to the primary data on social need and market traction:

1. that there is easy transportation access to those job centers from adjacent communities with high levels of social need

2. that there are a reasonable number of jobs in the selected communities with entry level employment capacity

While it is easy to measure distances between job clusters and low-income communities, that is not the same thing as transportation analysis. We can use transit shape files that can be downloaded for mapping but their quality is uneven. Local transportation data and conversations with employers and public officials can be helpful in measuring or approximating transportation costs and distance.

In terms of job suitability, the same database that we used for market traction analysis can be explored further to identify other employment characteristics: industry sector, employment codes, size of firm, income of jobs, and other variables. This allows us to get a relative sense of the availability of jobs for various skill levels that churn through incumbent firms and may emerge through new capital investments. In this context it is important to be aware of places where there is a high dependence on a single employer or a few employers that may be closing or have recently cut back operations. This could have negative or positive consequences for future investments.

Existing job data is far from a perfect approximation of future jobs given the changing nature of employment and technology. But coupled with direct local knowledge from civic and business leaders, it can add value to the selection process. For very low-skilled job access we might use data that shows jobs available to those with a high school degree or jobs available at a particular monthly income level.
This secondary screening – transportation and job categories - is a way to understand the potential for increasing the relevance of the eligible tracts for lower income residents. The answers will not be perfect but the inquiry can inform selections, particularly between tracts that have relatively similar social need and market traction profiles. With respect to transportation and transit, it goes without saying that national and global transportation hubs such as train stations and airports are critical assets around which employment clusters may grow. Where eligible, they may have a strong connection to low-income employees via public transit.

FINANCIAL AND HUMAN CAPITAL: THE INSTITUTIONAL NEXUS

The Opportunity Zones have the potential to unleash significant capital into distressed communities. But the effectiveness of the incentive will depend on three factors over and above smart zone selection: 1) local capital investment capacity; 2) the quality of skills upgrading or human capital programs; and 3) the sophistication of local institutions that play various matching and development functions.

Capital for various stages of business growth and development, along with a wide range of quality training programs are two critical factors to a quality enterprise ecosystem. Planning for the Opportunity Zones program ought to take an ecosystem perspective around these two issues.

The Opportunity Zone capital will naturally be constrained by regulatory prescriptions both with respect to term and timing. Until the final regulations are issued and subsequent IRS rulings made, we cannot determine the best and primary use of the capital. But we know that it can flow into new businesses, expanding businesses, commercial and residential development projects, brownfield refurbishment, some infrastructure assets, and more. We also know from experience that communities that thrive have competitive and collaborative capital sources.

The most important thing for local communities to do at this point is to have clarity around the effectiveness of various capital intermediaries from banks to venture capitalists to community investors and determine the potential role for Opportunity Funds in the mix. Moreover, it is important to identify ways for multiple intermediaries to work together on projects—be they nurturing startups, revitalizing Main Streets, or bringing innovation districts in all their complexity to life.

At the same time, a similar inventory of human capital strategies ought to be compiled with a focus on effectiveness from the perspective of employers. If the new capital is going to assist low-income residents then it must be deployed into job creation opportunities that are aligned with skills upgrading programs. Cities and states will be responsible for aligning those with their business and civic partners.
One final lesson from place-base revitalization efforts: institutions matter. Over the past twenty years, a variety of institutions – business improvement districts, local development corporations, business incubators and accelerators – have been created to drive quality place making, enhance entrepreneurship and innovation, maximize resident-to-jobs linkages (particularly with anchor institutions) and spur development that is mixed-use and has market rate and affordable elements. Communities and intermediaries should strive to capture and codify best-in-class institutional models that can be adapted and adopted across places.

The ultimate effectiveness of Opportunity Zones will rely on the capacity of communities to align a variety of capital sources and training initiatives and pursue institutional innovations within the context of capital deployment. Otherwise the value of the incentive in terms of deal generation and low-income labor market success will be diminished.
Opportunity Zones: Gentrification on Steroids?

William Fulton
A new federal program meant to spur investment in underserved areas could bring positive changes. Or it could hasten gentrification, particularly in Houston.

The Opportunity Zone program is probably the most important new federal program to address urban revitalization in decades. It’s a program that holds great potential to help Houston’s underserved neighborhoods – and also holds great risk in accelerating gentrification, especially inside the Loop.

The opportunity zone idea is basically an attempt to lure investors who are sitting on unrealized capital gains to invest in underserved, mostly urban neighborhoods. If you invest in these neighborhoods, you can defer capital or reduce gains, and if you wait long enough you don’t have to pay any capital gains at all. The idea is that, because investors are trying to avoid paying taxes on capital gains, there are a lot of investors sitting on the sidelines with capital to invest. Opportunity zones hold the potential to lure those investors into underserved areas. Already, many investment funds have been created to take advantage of opportunity zones.

To qualify, investors must meet certain criteria – still being worked out by the federal government – that include investing in businesses that do most of their business and generate most of their sales in opportunity zones. In Texas, the opportunity zones were
selected by Gov. Greg Abbott in consultation with local officials. The program is seen as extremely favorable to real estate investments in particular.

But unlike most other federal revitalization programs, opportunity zones come with no government funding sources and no government qualification criteria. Other tax credit programs – such as, for example, Low Income Housing Tax Credits – come with an upper limit on the amount of tax credits, meaning that states must allocate those tax credits to certain investments.

Opportunity zones hold no such restrictions. There’s no limit on the amount of investment – or the amount of capital gains deferred and forgiven. And there’s almost no way for a city to track opportunity zone investment. No government agency other than the Internal Revenue Service need be informed that an investment is made.

"Some are areas clearly in distress. Others, not so much," according to a 2018 Brookings Institution analysis of designated opportunity zones across the country. Loopholes allowed some states to direct investment to areas that didn't seem to need it. And, as the analysis notes, thanks to regulations released in October 2018, up to 30 percent of opportunity zone funds can be invested outside of the qualified zones.

There’s no question that – whatever hope they hold to improve underserved neighborhoods – opportunity zones also hold the risk of accelerating gentrification in Houston. Gentrification is typically defined as a situation where longtime residents of an underserved neighborhood are squeezed out by rising property values that result from new investment.

Recently, the Kinder Institute examined gentrification locally and concluded that virtually all of the neighborhoods on the east side of the Loop are likely to gentrify over the next few years.

If you overlay the opportunity zone map on top of those results, the risk of “gentrification on steroids” becomes obvious: Two-thirds of the neighborhoods susceptible to gentrification in the near future are located in opportunity zones. It’s entirely possible that opportunity zone investments – which should be a good thing – will accelerate the gentrification process that’s already underway, especially on the east side of the Loop.
So how can Houston make sure that opportunity zones help current residents of underserved neighborhoods rather than pushing them out?

Many cities are trying to steer opportunity zone investors toward specific types of investments, in a couple of different ways.

First, a lot of cities are marketing their opportunity zones but putting together what they’re calling a “prospectus” – essentially, a marketing package describing their opportunity zones and the types of investments that are available there. Oklahoma City even went so far as to group their opportunity zone neighborhoods into eight districts and give those districts names. In Houston, Councilmember Amanda Edwards is leading the charge to create a prospectus.

Second, cities are trying to sweeten the pot by encouraging opportunity zone investors to make investments that qualify for other city economic incentives – for example, tax-increment financing, which provide financing for infrastructure, and 380 agreements, which provide property tax abatements for certain types of investments. Unlike opportunity zones,
such incentives are within the control of the city (or subsidiary entities like Tax Increment Reinvestment Zones, or TIRZs). So only the city can increase the value of an opportunity zone investment by combining it with these other incentives. Nonprofit organizations such as community development corporations can combine opportunity zone investments with other tax credits such as the Low Income Housing Tax Credit.

Such incentives are especially important in a city like Houston which does not have conventional zoning. In most municipalities, the city could block or incentivize certain types of real estate investments through zoning – by prohibiting industrial development in an opportunity zone, for example, or increasing the density allowed for residential projects around a light-rail stop. Houston can’t do that, so using the economic incentives that are available will become more important.

The opportunity zone is a funny animal compared to the typical federal program – it’s driven mostly by private investors with few rules imposed by local government, and indeed cities won’t always know where these investments have been made. The risk of accelerating gentrification is real. If Houston and other cities use the other tools at their disposal to nudge opportunity zone investors into certain types of investments – say, affordable housing – the likelihood that these investments will benefit the people who currently live in underserved neighborhoods will increase.
NEW ORLEANS — President Trump has portrayed America's cities as wastelands, ravaged by crime and homelessness, infested by rats.

But the Trump administration's signature plan to lift them — a multibillion-dollar tax break that is supposed to help low-income areas — has fueled a wave of developments financed by and built for the wealthiest Americans.

Among the early beneficiaries of the tax incentive are billionaire financiers like Leon Cooperman and business magnates like Sidney Kohl — and Mr. Trump's family members and advisers.

Former Gov. Chris Christie of New Jersey; Richard LeFrak, a New York real estate titan who is close to the president; Anthony Scaramucci, a former White House aide who recently had a falling out with Mr. Trump; and the family of Jared Kushner, Mr. Trump's son-in-law and senior adviser, all are looking to profit from what is shaping up to be a once-in-a-generation bonanza for elite investors.

The stated goal of the tax benefit — tucked into the Republicans' 2017 tax-cut legislation — was to coax investors to pump cash into poor neighborhoods, known as opportunity zones, leading to new housing, businesses and jobs.

The initiative allows people to sell stocks or other investments and delay capital gains taxes for years — as long as they plow the proceeds into projects in federally certified opportunity zones. Any profits from those projects can avoid federal taxes altogether.

“Opportunity zones, hottest thing going, providing massive new incentives for investment and job creation in distressed communities,” Mr. Trump declared at a recent rally in Cincinnati.

Instead, billions of untaxed investment profits are beginning to pour into high-end apartment buildings and hotels, storage facilities that employ only a handful of workers, and student housing in bustling college towns, among other projects.

Many of the projects that will enjoy special tax status were underway long before the opportunity-zone provision was enacted. Financial institutions are boasting about the tax savings that await those who invest in real estate in affluent neighborhoods.
Mr. Scaramucci’s development in New Orleans offers a portrait of how the tax break works. His investment company, SkyBridge Capital, is using the so-called opportunity zone initiative to help build a hotel, outfitted with an opulent restaurant and a rooftop pool, in the city’s trendy Warehouse District.

The tax benefit also is helping finance the construction of a 46-story, glass-wrapped apartment tower — amenities include a yoga lawn and a pool surrounded by cabanas and daybeds — in a Houston neighborhood already brimming with new projects aimed at the wealthy.

And in Miami’s hot Design District, where commercial real estate prices have nearly tripled in the last decade, the tax break is set to be used for a ritzy new office tower with a landscaped roof terrace.

Some proponents of opportunity zones note that money is already flowing into downtrodden communities like Birmingham, Ala., and Erie, Pa. They argue that more funds will follow. And they note that because no data exists on where investments are being made, it is impossible to quantify the benefits going to the wealthy versus the poor.

“The early wave, that’s not what you judge,” said John Lettieri, president of the Economic Innovation Group, an organization that lobbied for the establishment of opportunity zones.

But leaders of groups that work in cities and rural areas to combat poverty say they are disappointed with how it is playing out so far.

“Capital is going to flow to the lowest-risk, highest-return environment,” said Aaron T. Seybert, the social investment officer at the Kresge Foundation, a community-development group in Troy, Mich., that supported the opportunity-zone effort.

“Perhaps 95 percent of this is doing no good for people we care about.”

A Tax Break Is Born
The opportunity-zone tax break was targeted at the trillions of dollars of capital gains held by rich Americans and their companies: profits from investments in the stock market, real estate and other businesses, even short-term trades by hedge funds. When investors sell those assets, they can incur tax bills of up to 41 percent.

Sean Parker, an early backer of Facebook, helped come up with the idea of pairing a capital-gains tax break with an incentive to invest in distressed neighborhoods. “When you are a founder of Facebook, and you own a lot of stock,” Mr. Parker said at a recent opportunity-zone conference, “you spend a lot of time thinking about capital gains.”

Starting in 2013, Mr. Parker bankrolled a Capitol Hill lobbying effort to pitch the idea to members of Congress. That effort was run through his Economic Innovation Group. In addition to Mr. Parker, the group’s backers included Dan Gilbert, the billionaire founder of Quicken Loans, and Ted Ullyot, the former general counsel of Facebook.

The plan won the support of Senators Cory Booker, Democrat of New Jersey, and Tim Scott, Republican of South Carolina. When Congress, at Mr. Trump’s urging, began discussing major changes to the federal tax code in 2017, Mr. Parker’s idea had a chance to become reality.

Mr. Scott, who sponsored a version of the opportunity-zone legislation that was later incorporated into the broader tax cut package, said it was “for American people stuck, sometimes trapped, in a place where it seems like the lights grow dimmer, and the future does, too.”

“Let’s turn those lights on and make the future bright,” he added.

Confined to six pages in the 185-page tax bill, the provision can significantly increase the profits investors reap on real estate and other transactions.

It allows investors to defer for up to seven years any capital gains taxes on the money they invest in opportunity zones. (That deferral is valuable because it allows people to invest a larger sum upfront, potentially generating more profits over time.) After 10 years, the investor can cash out — by selling the opportunity-zone real estate, for example — and not owe any taxes on the profits.

Over a decade, those dual incentives could increase an investor’s returns by 70 percent, according to an analysis by Novogradac, an accounting firm.

“We are very, very excited about the potential,” the president’s daughter Ivanka Trump said last year at an event celebrating Mr. Parker’s role in creating opportunity zones. “The whole White House obviously is behind the effort. The whole administration.”
The opportunity zones, focused on low-income census tracts, were drawn by officials in each state, as well as in Washington, D.C., and Puerto Rico. Last year, the Treasury Department approved roughly 8,800 such zones. (The White House and Treasury declined to make senior officials available to discuss the program.)

Nearly a third of the 31 million people who live in the zones are considered poor — almost double the national poverty rate. Yet there are plenty of affluent areas inside those poor census tracts. And, as investors would soon realize, some of the zones were not low income at all.

The Middle Man

The Harvard Club of New York City, in Midtown Manhattan, is the embodiment of America’s old-money elite. Crimson-jacketed waiters serve members who are watched over by oil portraits of elite alumni.

One recent morning, financial advisers representing several dozen of America’s richest dynasties — advisers to the Pritzker and Soros families were listed as attendees — crowded into a drab meeting room on the club’s third floor.

The advisers were there to see Daniel Kowalski, a top aide to Treasury Secretary Steven Mnuchin and the Trump administration’s point person for the opportunity-zone rules. Mr. Kowalski is barnstorming the country, bouncing from one conference to the next, explaining to real estate investors and developers how to take advantage of the new rules.

Mr. Kowalski was an aide to the Trump campaign, where he worked for the White House policy adviser Stephen Miller. Before that, he was an aide to Jeff Sessions when Mr. Sessions was on the Senate Budget Committee.

[The Trump associates benefiting from a tax break for poor communities.]
At the Harvard Club, he dived into an explanation of how opportunity zones work — and for whom they work. “The audience for opportunity zones is inherently fairly small because it’s limited to capital-gains income, which is why I wanted to come and talk to this group,” he told the room of advisers.

That audience is small indeed: Only 7 percent of Americans report taxable capital gains, and nearly two-thirds of that income was reported by people with a total annual income of $1 million or more, according to I.R.S. data.

Yet this is a vital constituency, since the success of the opportunity-zone program will hinge largely on how much money investors kick in. That is why the Trump administration — and Mr. Kowalski in particular — is promoting the tax break on Wall Street.

“I have served a little bit as a middle man between the business community and the I.R.S.,” he said at another conference a few weeks later.

More than 200 opportunity-zone funds have been established by banks like Goldman Sachs and major real estate companies, including CIM Group of Los Angeles, which has previously been a partner with the Trump and Kushner families on projects. Those funds have said their goal was to raise a total of nearly $57 billion.

The law does not require public disclosure of who are taking advantage of the initiative or how they are deploying their funds. Among those who have invested money or said they intend to are Mr. Kohl, a founder of the department store chain that bears his name; Steve Case, co-founder of AOL; Alexander Bhathal, part owner of the Sacramento Kings basketball team; and Richard Forman, the former owner of the Forman Mills chain of clothing stores, according to interviews and other public statements.

Many others are lesser-known business executives who recently sold small companies or real estate and are looking for ways to avoid large tax bills.

Paul DeMoret, for example, recently sold his auto-industry software company in Oregon. He said he was using some of those capital gains to help finance a Courtyard by Marriott in Winston-Salem, N.C., and an apartment building in Tempe, Ariz., among other projects in opportunity zones. He is making the investments through a private equity firm, Virtua Partners.

The tax break is largely benefiting the real estate industry — where Mr. Trump made his fortune and still has extensive business interests — and it is luring people with personal or professional connections to the president.

Mr. Christie, a onetime adviser to Mr. Trump, has raised money for opportunity-zone investments including an apartment building in Hackensack, N.J., and a self-storage center in Connecticut.
Cadre, an investment company co-founded by Mr. Kushner and his brother, Joshua, is raising hundreds of millions of dollars that it hopes to use on opportunity-zone projects. The company is eyeing neighborhoods in Savannah, Ga., Dallas, Los Angeles and Nashville that are expected to grow larger and wealthier in coming years. Jared Kushner has a stake in Cadre worth up to $50 million, according to his most recent financial disclosure.

Mr. LeFrak, a longtime confidant of Mr. Trump's and a major campaign donor, is building a luxury residential community in the middle of an opportunity zone in Miami. (It is unclear how much of the development's funding will end up being tax advantaged.)

Not far away in the Design District, Daniel Lebensohn is planning to build his high-end office tower. Mr. Lebensohn previously joined the Trump Organization to sell luxury condominiums at the Trump Hollywood complex north of Miami.

And Mr. Kushner's family company directly owns or is in the process of buying at least a dozen properties in New York, New Jersey and Florida that are in opportunity zones. They include a pair in Miami, where Kushner Companies plans to build a 393-apartment luxury high rise with sweeping views of Biscayne Bay, according to a company presentation for potential investors.

A representative for the Kushner family confirmed that it was considering opportunity-zone funding for some developments, but said it would probably not use the funding for the Miami projects.

‘The Best Thing I Have Ever Done’

Backers of the opportunity-zone program say luxury projects are the easiest to finance, which is why those have been happening first. Over the long run, they say, those deals will be eclipsed by ones that produce social benefits in low-income areas.

At least some struggling neighborhoods are already starting to receive investments.

In Birmingham, for example, a developer is using opportunity-zone funds to convert a building, vacant for decades, into 140 apartments primarily aimed at the local work force.

“We are seeing projects that are being announced here in Alabama that would not have happened otherwise,” said Alex Flachsbart, founder of Opportunity Alabama, which is trying to steer investors to economically struggling neighborhoods.

Similar projects are getting underway in Erie, Cleveland and Charlottesville, Va. Goldman Sachs is using some of its capital gains — profits on the company's own investments — in opportunity zones, including $364 million for mixed-income housing developments in Salt Lake City, Baltimore and other cities.

Mr. Case, the AOL co-founder, and Derrick Morgan, a former professional football player, are among those who have announced that they will invest in opportunity-zone projects that are designed to address clear social and economic problems.

As he announced his retirement from the Tennessee Titans in July, Mr. Morgan wrote on Instagram that his goal would be to “create more opportunities for those who are underserved and overlooked” in communities like Coatesville, Pa., where he went to high school.

Emanuel J. Friedman, a hedge fund manager, is using some of his capital gains and money he has raised from others to build 11 warehouses in rural Jasper County, S.C., near the Savannah seaport. The warehouses won't employ many people, but he said the jobs would offer higher wages than hotel housekeeping positions at the nearby Hilton Head resort, where many area residents now work.

“Of course it will make a difference,” Mr. Friedman said. “It is mind-boggling. It is the best thing I have ever done.”

A Spa for Pets
But even supporters of the initiative agree that the bulk of the opportunity-zone money is going to places that do not need the help, while many poorer communities are so far empty-handed.

Some opportunity zones that were classified as low income based on census data from several years ago have since gentrified. Others that remain poor over all have large numbers of wealthy households.

**Number of Opportunity Zones by Median Household Income**

More than 7 percent of opportunity zones had household incomes above the median census tract in 2017. Investors are focusing on projects in these neighborhoods.

<table>
<thead>
<tr>
<th>Median Income</th>
<th>Location</th>
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<tbody>
<tr>
<td>$54,408</td>
<td>U.S. tract</td>
</tr>
<tr>
<td>$77,692</td>
<td>Fishtown, Philadelphia</td>
</tr>
<tr>
<td>$91,397</td>
<td>Gowanus, Brooklyn</td>
</tr>
<tr>
<td>$98,508</td>
<td>Market Square, Houston</td>
</tr>
<tr>
<td>$137,147</td>
<td>Long Island City, Queens</td>
</tr>
</tbody>
</table>

And nearly 200 of the 8,800 federally designated opportunity zones are adjacent to poor areas but are not themselves considered low income.

Under the law, up to 5 percent of the zones did not need to be poor. The idea was to enable governors to draw opportunity zones in ways that would include projects or businesses just outside poor census tracts, potentially creating jobs for low-income people. In addition, states could designate whole sections of cities or rural areas that would be targeted for investment, including some higher-income census tracts.
In some cases, developers have lobbied state officials to include specific plots of land inside opportunity zones.

In Miami, for example, Mr. LeFrak — who donated nearly $500,000 to Mr. Trump’s campaign and inauguration and is personally close to the president — is working with a Florida partner on a 183-acre project that is set to include 12 residential towers and eight football fields’ worth of retail and commercial space.

In spring 2018, as they planned the so-called Sole Mia project, Mr. LeFrak’s executives encouraged city officials in North Miami to nominate the area around the site as an opportunity zone, according to Larry M. Spring, the city manager. They did so, and the Treasury Department made the designation official.

The Far West Side of Manhattan is part of an opportunity zone — even as high-end towers have been replacing run-down apartment buildings and more than 15 percent of households reported income of $200,000 or more in 2017, according to an analysis by Webster Pacific, a consulting firm. This is the new home of Pershing Square Capital Management, the prominent hedge fund run by the billionaire Bill Ackman.

Mr. Ackman is trying to find tenants for 80,000 square feet of unused office space in his fund's building, which has a Jaguar dealership on the ground floor. He said he was using its location inside an opportunity zone as a lure.

That is because investors can use their capital gains to invest not only in real estate but also in businesses inside opportunity zones. A company that sets up shop inside Mr. Ackman's building therefore would be eligible to accept tax-advantaged opportunity-zone money.

Financial institutions are not even trying to make it look as if their opportunity-zone investments were intended to benefit needy communities.

CBRE, one of the country’s largest real estate companies, is seeking opportunity-zone funding for an apartment building in Alexandria, Va., which CBRE is pitching to prospective investors as “one of the region’s most affluent locations.”

JPMorgan Chase is raising money to build housing targeting students in College Park, Md., near the University of Maryland. (Because many students do not have jobs, census data often wrongly suggests that college towns are poor neighborhoods.)

In marketing materials, JPMorgan noted that while College Park “qualifies as low income due to the student population, the area around it is affluent.” The bank added, “The tax benefits can be remarkable.”
The Swiss bank UBS is raising funds from its “ultra high net worth” clients — requiring in some cases that they have at least $50 million in investable assets — for developments in New York and Connecticut. The projects include a 23-story retail and office building in Downtown Brooklyn and an upscale apartment building in New Rochelle, N.Y., with a yoga studio and 24-hour valet parking. There is even a spa — for residents’ pets.

Other companies have set up subscription databases showing which zones have the highest incomes and fastest-growing populations to help investors steer their money to the most lucrative and least risky destinations.

“The current system is clearly driving capital to places that are known to be winners,” said Christopher A. Coes, vice president at Smart Growth America, a nonprofit group that encourages investments in American cities.

**Luxury Hotels, Abandoned Homes**

The Warehouse District of New Orleans is one of the city’s trendiest neighborhoods. Some of the area’s hottest restaurants — as well as a new one dishing out shrimp tempura tacos — are here. So are hipster barbershops. Boutique hotels spill well-heeled tourists onto the red brick sidewalks. High-end coffee shops are packed with young people buried in their MacBooks.

And it is getting hotter. The sounds of heavy-duty equipment heaving steel or pouring cement are audible across the neighborhood.

In other words, in a city grappling with acute poverty, this is not a neighborhood that especially needs a generous new tax break to lure luxury lodging. Yet state officials have established an opportunity zone here.

That decision benefited businesses already operating or planned for the district. One of those is a 225-room hotel, part of Richard Branson’s Virgin Hotels chain, whose plans were unveiled a year before Mr. Trump signed the tax law. Its location inside an opportunity zone meant investors could earn greater profits than they otherwise would have, by financing the project with tax-
Those investors include Mr. Scaramucci, who briefly served as White House communications director in 2017 and has claimed credit for helping to create the opportunity-zone plan. “We got to get into this business because this will be transformative to the United States,” he said recently.

Mr. Scaramucci’s investment firm, SkyBridge Capital, has raised more than $50 million in capital gains from outside investors, and most of it is being used to finance the hotel, according to Brett S. Messing, the company’s president. He said the hotel was likely to be the first of numerous opportunity-zone projects financed by SkyBridge.
Less than two miles away is the poorest opportunity zone in Louisiana — and one of the poorest nationwide. The zone includes the Hoffman Triangle neighborhood, where the average household earns less than $15,000 per year. Block after block, streets are lined with dilapidated, narrow homes, many of them boarded up. On a recent afternoon, one of them was serving as a work site for prostitutes.

City officials, including the head of economic development for New Orleans, said they were not aware of any opportunity-zone projects in this neighborhood.

Terrance Ross, a construction worker who has lived in the area for 20 years, is familiar with the building boom underway in the Warehouse District.

“Why is the federal government putting money where money is already accumulating?” he asked, lighting a cigarette and standing across the street from an abandoned house. “This neighborhood just needs some tender loving care.”

Similar scenes are playing out in opportunity zones across the United States: The federal government is subsidizing luxury developments — often within walking distance of economically distressed communities — that were in the works before Mr. Trump was even elected president.

In Houston, construction recently started on the Preston, with 373 “luxury for rent” apartments as well as a “skydeck” and a resort-style swimming pool. The development is being financed by the investors in Cresset, a multibillion-dollar asset management firm, including one of its founders, Avy Stein.

**Changing Incomes in Houston**

Early opportunity zone investment is coming to Market Square, already a site of high-end developments and major income growth.

<table>
<thead>
<tr>
<th>Median household income 2012-17</th>
<th>Decreased</th>
<th>Increased</th>
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<tbody>
<tr>
<td></td>
<td>0</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>10,000</td>
<td>$15,000</td>
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</table>

Market Square is home to three recent luxury developments.

Greater Fifth Ward

**Downtown Houston**

$36,564

Opportunity zones

south Central Houston

University of Houston

Houston Zoo

Rice University
And in downtown Portland, Ore., the developers of a 35-story tower with a hotel, condos and office space are hoping to raise up to $150 million in opportunity-zone money to pay for the project. Condos will go for as much as $7.5 million each. The hotel is a Ritz-Carlton.

**Partying at Red Square**

Club music blared from speakers as millionaires and billionaires — and the money managers, lawyers, accountants and other professionals looking to make money off all this wealth — milled around a pool and private cabanas at the Bellagio hotel in Las Vegas.

They were at an annual investment conference to talk about the next big thing. This year, that thing was opportunity zones, which were the focus of five panel discussions.

The Las Vegas event was hosted by Mr. Scaramucci. Among the attendees was Mark Cuban, the billionaire owner of the Dallas Mavericks basketball team. At one point he posed and smiled for a photo with Mr. Scaramucci and his wife.

“OZ are super hot right now,” Mr. Cuban said in an email after the event, adding that he had recently bought a property in an opportunity zone, but had not decided yet if he would use the tax break. “Every major investor I know has been pitched a property or fund within an OZ.”

The feeding frenzy is not confined to rich individuals. Lawyers, accountants, wealth managers and consultants are enjoying a gusher of new work — and raking in fees — helping clients structure deals with the maximum tax savings.
Real estate lawyers like Brad A. Molotsky are billing hundreds of extra hours as they field calls from eager investors. One day in June, Mr. Molotsky juggled clients who wanted to invest in $500 million worth of opportunity-zone projects.

“I am just one guy, and that was from just two meetings,” said Mr. Molotsky, who works in New Jersey for the law firm Duane Morris. He has completed more than 20 opportunity-zone deals, he said, and has dozens more in the pipeline.

The night after Mr. Scaramucci’s pool party, more festivities were underway on the other end of the Las Vegas Strip — part of a separate event also focused on opportunity zones. One party was at the Soviet-themed Red Square restaurant. Inside, an investor handed out postcards with photographs of buildings he wanted to buy in opportunity zones.

At another open-bar soiree, a man in a navy suit and a cowboy hat wandered the crowd, drink in hand. Attached to the top of his hat was a large sign. It beckoned: “Looking for OZ Funds.”
RESEARCH REPORT

An Early Assessment of Opportunity Zones for Equitable Development Projects

Nine Observations on the Use of the Incentive to Date

Brett Theodos
URBAN INSTITUTE
June 2020

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ABOUT THE URBAN INSTITUTE
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Acknowledgments

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The Urban Institute’s Collaboration with JPMorgan Chase

The Urban Institute is collaborating with JPMorgan Chase over five years to inform and assess JPMorgan Chase’s philanthropic investments in key initiatives. One of these is Partnerships for Raising Opportunity in Neighborhoods (PRO Neighborhoods), a $125 million, five-year initiative to provide communities with capital and tools to develop locally driven solutions to the challenges facing underinvested neighborhoods and the families who live there. In service of these goals, this report reviews and assesses how Opportunity Zones have been deployed across the United States in mission-oriented projects, now that more than two years have passed since the legislation went into effect.
Executive Summary

In the two years since Opportunity Zones (OZs) were signed into law, OZ investment had reached at least $10 billion—and likely more than that—before the COVID-19 crisis took hold. Despite being viewed primarily as an economic development tool in low-income communities—that is, positioning the local economy on a higher growth trajectory—many proponents have suggested that OZs also have a community development purpose of helping people in poverty to improve their local context and lead healthy, productive lives. We refer to development that blends economic development and community development goals, and that seeks to engage residents and local leaders in decisionmaking about development in their communities, as equitable development. This report examines how actors driven primarily by a community development mission have sought to use OZs to fulfill an equitable development mission.

Our research process included about 70 in-depth interviews with project sponsors; fund managers; investors; wealth managers; developers; philanthropies; and public and nonprofit agencies working with OZs, such as community development intermediaries, state OZ program offices, and city-level OZ coordinators. We asked interviewees to describe projects that were funded as well as those seeking funding, the terms of investment sought by project sponsors as well as investors, the nature of community engagement that they have observed, and other opportunities and challenges they perceive around using the incentive for equitable development. We found our sample of OZ projects through discussions with national and local OZ experts, the Opportunity Exchange listing of projects, the Economic Innovation Group’s Opportunity Zones Activity Map, scans of news articles, examples highlighted at a number of convenings around the country (including in Atlantic City, Chicago, Cleveland, Columbia, Greenville, Miami, Norfolk, Salt Lake City, Seattle, and Washington, DC), and through a snowball sample of additional informants we became aware of.

We find that OZs are helping spur the evolution of a new community development ecosystem, engaging both project developers and investors who have limited historical engagement in community development work. Despite this catalytic effect, however, we also see that many mission-oriented actors are struggling to access capital. Many project sponsors are struggling to access the class of investors—wealthy individuals and corporations with capital gains—for whom the OZ incentives are tailored. Additionally, many mission-oriented projects yield below-market returns that most OZ investors appear unwilling to accept. As OZ incentives are not structured to encourage resident or community engagement, mission-oriented projects struggle to compete for attention with higher-return projects—for which OZs provide much larger subsidies because of the design of the incentives.
A further challenge for mission-oriented projects is that the sponsors are seeking to support a community asset with a lifetime well beyond the 10-year time horizon of the OZ incentives. Given that an illiquid investment over a 10-year horizon is already challenging for OZ investors, the type of investment many mission actors need and the OZ market’s investment parameters are mismatched. Because of these challenges, we mostly saw mission-oriented projects succeed in using OZs when the capital stack also layered in significant other subsidy sources, or when a well-connected project sponsor was able to locate an investor willing to accept significantly below-market returns.

Although OZs were designed to spur job creation, the vast majority of OZ capital appears to be flowing into real estate, not into operating businesses, because of various program design constraints and the undesirability of selling equity from both the business owners’ and the investors’ perspective. Ultimately, most developers and investors view OZ incentives as providing a relatively small boost to overall returns. The OZ incentives have had mixed effects in terms of making projects work that would not otherwise happen. Some developers reported that the incentives did make a decisive difference in allowing a project to go forward, while others were clear that their project would have proceeded with or without OZ equity. Most observers appear to agree that a primary benefit of the program is that it elevates the visibility of neighborhoods and deals that investors might not have considered otherwise.

Taken together, these results raise a question for policymakers to reflect on the goals of OZs. To the extent that the OZ incentives were intended to foster equitable development outcomes—such as by creating quality jobs, affordable housing, community-oriented amenities like grocery stores, and improved quality of life for low-income people—our evidence suggests they need to be redesigned to more effectively allocate government dollars to help project sponsors achieve those outcomes. As they redesign OZ incentives, policymakers should use four broad principles to guide the process:

- **Better support investment in small businesses.** The most egregious failing of OZs to date is that very little OZ investment is going to small businesses, the exact group of investees that proponents had held out as standing the most to benefit. To correct this failing, one important solution is incentivizing investments in QOFs that could provide subordinated debt investment, or hybrid debt/equity products such as royalty debt, to small businesses. Beyond that, policymakers should consider granting greater flexibility around certain program rules, such as deployment rules, to mission-driven funds that specialize in small business investing.

- **Size the incentive based on the impact.** Rather than providing the largest incentives to the most profitable projects regardless of their social impact, the incentive should instead depend on project impacts. In turn, by targeting incentives toward investments with the greatest
impacts, these investments could be more deeply subsidized while more efficiently using total federal tax expenditures. To provide one example, OZ tax incentives could be based on the number of quality jobs created by the OZ investment. Other alternatives could include tweaking the incentives based on the equitable development characteristics present in a project, or limiting the incentives only to those types of projects where a positive social impact is deemed likely.

- **Broaden who can invest.** Because only a limited number of (mostly wealthy) taxpayers have capital gains, limiting OZ incentives to capital gains holders freezes out most stakeholders in low-income communities from investing in their own revitalization. A refundable tax credit, rather than a capital gains exclusion, could open up opportunities for these investors. Moreover, other actors such as foundation endowments and pension funds, have substantial resources, and most likely a greater proclivity to consider community investing than many capital gains holders, if an incentive can be structured to engage them.

- **Support mission-driven funds that are accountable to the community.** A redesigned OZ incentive should encourage equity investments in groups such as community development financial institutions (CDFIs), which have a long track record of making substantial investments in low-income communities, taking on higher risks than conventional investors, and working with the kind of investees who have been struggling to access OZ capital, such as small businesses and less sophisticated developers.

Protests in the wake of George Floyd’s killing underscore, among other things, the realities that opportunity is not spread evenly in our nation, especially by race. The COVID-19 health crisis, and the economic recession it is causing, add significantly to the list of challenges for practitioners looking to use the OZ incentive. Investment in operating small businesses are facing particular strain, but consequences will radiate to the financial sustainability of real estate, both commercial—which relies on rents from shuttered businesses—and housing—which relies on rents from residents who may have lost jobs or face a cutback in hours. At the same time, the crisis may provide an opportunity to rethink and redesign the OZ incentive so it can play a stronger role in helping hard-hit communities recover.
An Early Assessment of Opportunity Zones for Equitable Development Projects

Opportunity Zones (OZs) are gaining momentum, and now that the rules regulating them are clearer, investors, local officials, developers, and businesses have been engaging with the incentive. In the two years since the Tax Cut and Jobs Act of 2017 created the incentive and Treasury-designated Zones, hundreds of Qualified Opportunity Funds (QOFs) have been created, and OZ investment was beginning to flow until the COVID-19 crisis began. But has this capital been reaching projects that benefit low- and moderate-income households and communities? Although the program is still maturing, and the COVID-19 crisis now poses new challenges whose resolution is unknown, this report offers an early, qualitative assessment of how well OZs have channeled capital into projects aligned with equitable development goals.

The full extent of investment in Opportunity Zones over the past two years is unknown. With no federal requirement for detailed reporting of OZ investments, there is no public record to accurately sum the capital expended, no accounting of which communities have received OZ capital, and no comprehensive documentation of the types of projects funded. News stories, industry reports, and survey data pointed to a significant and growing uptake before the COVID-19 pandemic. Novogradac has tracked data on 621 QOFs, of which 406 have raised equity. Total investment in these documented funds reached $10.1 billion in April 2020, but this information is self-reported and incomplete.

The Internal Revenue Service (IRS) has deemed OZs primarily an economic development tool for low-income communities—that is, they position the local economy on a higher growth trajectory (Feldman et al. 2014). But many proponents have suggested that OZs can also drive community development—that is, help people in poverty improve their situation and lead healthy, productive lives (Andrews et al. 2012). By providing a path for community developers to tap into a new pool of investors, OZs could deliver a range of positive social outcomes, including equitable development.
We define equitable development as a form of neighborhood or community revitalization work that emphasizes outcomes both for people and place. It seeks to improve quality of life for original residents, not simply to transform a community by changing who lives there. It considers local and regional context along with disparities among residents. In this sense, equitable development could be considered the intersection or union of economic development and community development (von Hoffman 2019). In terms of process, it puts residents and local leaders in roles of informing and deciding on which investments should be made and how. There is a larger debate as to whether achieving impact requires deep project subsidies, or, for example, whether purely profit-seeking projects can advance equitable development objectives.\(^a\) We cannot resolve that debate here, but we offer that the answer likely depends on local context, though we anticipate that in most cases, deep, structural, and long-standing inequities across geographies and people groups cannot be resolved solely by investors seeking market-rate returns and accepting conventional risks.


Multiple stakeholders and observers have raised questions and criticisms about OZs that highlight the need to explore this topic. One set of concerns has to do with the selection of census tracts for OZ designation and whether investing in certain of these tracts could lead to gentrification and displacement. While on average, OZs show higher or equivalent levels of economic distress than other eligible communities that were not selected, a small number of Zones are fairly well off (Theodos 2019; Theodos, Meixell, and Hedman 2018). Precisely because the OZ incentive provides the largest rewards to projects with the largest expected returns,\(^7\) some stakeholders fear that developers have been focusing on the OZs that were already on the upswing, leaving more distressed areas behind.\(^8\) Other questions and criticisms have been surfaced by media reports of OZ incentives being used to fund luxury projects, as well as projects that were already likely to happen.\(^9\) Critics have also noted that incentives can be accessed without community input or any process of prioritization where local governments can ensure alignment with localized goals.\(^10\) These concerns have engendered a significant policy debate over the future of OZs, with multiple bills introduced to revise the incentive.

To understand OZs with respect to equitable development goals at this early stage and amid current challenges, we conducted close to 70 in-depth interviews with a range of stakeholders working on mission-oriented OZ projects across the country. We are not able to measure what proportion of OZ
capital is mission-driven, but rather sought to understand how OZs are playing out in that potentially small—but unknown—segment of the market. Considering the lack of reporting requirements and resulting lack of data on OZ investments, we are only able to assess the incentive based on this qualitative approach of semistructured interviews, which we believe are broadly representative of the mission-oriented OZ field. As noted, however, the Treasury has not released data we can use to describe the comprehensive distribution of OZ projects, and there are concerns that investors that do not align with equitable development goals may be less likely to make their investments publicly known.

For the interviews, we spoke with project sponsors; fund managers; investors; wealth managers; developers; philanthropies; and public and nonprofit agencies working with OZs, such as community development intermediaries, state OZ program offices, and city-level OZ coordinators. We asked interviewees to describe projects that were funded as well as those seeking funding, the terms of investment sought by project sponsors as well as investors, the nature of community engagement that they have observed, and other opportunities and challenges they perceive around using the incentive for equitable development. We found our sample of OZ projects through discussions with national and local OZ experts, the Opportunity Exchange listing of projects,11 the Economic Innovation Group’s Opportunity Zones Activity Map,12 scans of news articles, examples highlighted at a number of convenings around the country (including in Atlantic City, Chicago, Cleveland, Columbia, Greenville, Miami, Norfolk, Salt Lake City, Seattle, and Washington, DC), and through a snowball sample of additional informants we became aware of.

In this report, we summarize nine takeaways (box 2) on how mission-oriented actors are using OZs. We also include seven case studies (in boxes labeled “A Closer Look”) that illustrate how some practitioners are using OZ financing creatively to capitalize mission-oriented projects. Though our sample is certainly not comprehensive and we cannot be assured it is statistically representative given there is no known universe of projects to draw from, the themes we present recurred across multiple conversations, contexts, and actors, and we believe they reflect how OZs have been deployed to support projects oriented to equitable development.

BOX 2
Nine Takeaways on How Mission-Oriented Actors Are Using OZs

1. OZs Are Reaching Actors That Had Not Been Engaging with the Community Development Field
2. OZs Are Catalyzing an Ecosystem of Community Development Efforts
3. The OZ Structure Lacks Encouragement for Resident or Intermediary Engagement
4. Many Mission-Based Project Sponsors Are Struggling to Find OZ Investors

5. OZ Investors Demand Higher Returns Than Impact Projects Can Provide

6. OZs Were Designed to Spur Job Creation, but Most of Their Capital Is Flowing into Real Estate

7. Even for Real Estate, Exit Strategies at Year 10 Raise Challenges for Project Sponsors

8. To Drive Impact, OZs Often Need to Be Paired with Other Subsidy Sources

9. The Need for OZ Financing in OZ Projects Is Mixed

We find that OZs are helping spur the evolution of a new community development ecosystem, engaging both project developers and investors who have limited historical engagement in community development work. Despite this catalytic effect, however, we also see that many mission-oriented actors are struggling to access capital. Many project sponsors are struggling to access the class of investors—wealthy individuals and corporations with capital gains—for whom the OZ incentives are tailored. Additionally, many mission-oriented projects yield below-market returns that most OZ investors appear unwilling to accept. As OZ incentives are not structured to encourage resident or community engagement, mission-oriented projects struggle to compete for attention with higher-return projects—for which OZs provide much larger financial support in the form of greater tax expenditures.

A further challenge for mission-oriented projects is that the sponsors are seeking to support a community asset with a lifetime well beyond the 10-year time horizon of the OZ incentives. Given that an illiquid investment over a 10-year horizon is already challenging for OZ investors, the type of investment many mission actors need and the OZ market’s investment parameters are mismatched. Because of these challenges, we mostly saw mission-oriented projects succeed in using OZs when the capital stack also layered in significant other subsidy sources, or when a well-connected project sponsor was able to locate an investor willing to accept significantly below-market returns.

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the OZ equity. Most observers appear to agree that a primary benefit of the program is that it elevates the visibility of neighborhoods and deals that investors might not have considered otherwise.

Taken together, these results ask policymakers to reflect on the goals of OZs. To the extent that OZ incentives were intended to foster equitable development outcomes—such as by creating quality jobs, affordable housing, community-oriented amenities like grocery stores, and improved quality of life for low-income people—our evidence suggests they need to be redesigned so government dollars are allocated effectively and help project sponsors achieve those outcomes.

The COVID-19 health crisis, and the economic recession it is causing, add significantly to the list of challenges for practitioners looking to use the OZ incentive. Investment in operating small businesses will face particular strain, but consequences will radiate to the financial sustainability of real estate, both commercial—which relies on rents from shuttered businesses—and housing—which relies on rents from residents who may have lost jobs or face a cutback in hours. At the same time, the crisis may provide an opportunity to rethink and redesign the OZ incentive so it can play a stronger role in helping hard-hit communities recover.

Nine Observations on the OZ Program’s Deployment

1. OZs Are Reaching Actors That Had Not Been Engaging with the Community Development Field

The OZ tax incentive was designed to generate a broad marketplace of investments—free of the restrictions built into previous federal programs, such as the Low-Income Housing Tax Credit (LIHTC) and the New Markets Tax Credit (NMTC), that also sought to draw capital into disinvested communities. Almost any individual or corporation with capital gains can invest in a qualified opportunity fund, and there is no cap on the amount of OZs incentives that can be claimed. (See the appendix for an overview of how the program operates.) We don’t know how large the program will become; Treasury Secretary Steve Mnuchin estimated in 2018 that OZs could attract as much as $100 billion in private capital, though the investment climate has changed since then. Additionally, OZ incentives encourage equity investments over a relatively long-term investment horizon—generally 10 years. Since long-term equity financing can be difficult for developers and businesses to obtain, OZ incentives could unlock particularly valuable forms of capital.
The OZ legislation is trying to [change the] habit of investors who have historically relied on precedent to make business decision. It’s trying to steer their eyes towards new areas, new risk profiles, and new equations.—Fund manager

It is no surprise that the OZ incentive has attracted interest from actors across the country, including those engaged in equitable development. The flexibility of the program has resulted in a range of mission-oriented projects that are using—or at least seeking to use—the incentive. Some of the impact areas in which we see interest or activity include affordable housing, health care, food and agriculture, arts, small business development, renewable energy, and neighborhood revitalization. Notably, many (although certainly not all) of these projects are happening outside the auspices of a community development corporation (CDC) or community development finance institution (CDFI). It also appears that Black communities are particularly engaged with the program. We interviewed many Black entrepreneurs, with roots outside the community development industry, who have been seeking OZs funding. To be clear, not all these projects and sponsors have accessed funding, but their interest and activity are notable. Examples include

- real estate developers in Chicago, Seattle, and Washington, DC, building affordable housing and mixed-use projects;
- a group seeking to increase access to Small Business Administration (SBA) 504 financing for Black-owned businesses in North Carolina;
- a real estate developer raising OZ equity for mixed-use projects near historically black colleges and universities across the country;
- a family office manager channeling capital into a workforce development facility in the South Side of Chicago;
- a health care professional poised to become one of the first Black female real estate developers in Greenville, NC; and
- a marine biologist volunteering to help develop a food bank in South Carolina.

Our informants also raised the case of Our Opportunity, a QOF created by a half-dozen NBA players seeking to raise $300 million for OZs in Chicago and Cleveland, where many of them grew up. One interviewee believes that the interest in the Black community in this program has to do with "the
way that Black developers have been treated—the level of under-capitalization has been shameful and the financial products for them in the past were a poor fit." In this context, it is important to note that Senators Cory Booker (D-NJ) and Tim Scott (R-SC) introduced the Invest in Opportunity Act that birthed OZs.

We also interviewed people from other demographic groups with little background in the mainstream community development industry who are now using, or seeking to use, OZs for equitable development. These interviewees included a musician who is obtaining OZ financing to redevelop a theatre in Birmingham, Alabama; a NASA engineer who became a part-time solar entrepreneur after volunteering on a project to bring solar power to her children’s school; and a grassroots group seeking to develop tiny homes for the homeless. None of these groups are working with CDCs or CDFIs.

On the investor side, one project sponsor with experience developing workforce housing explained that before OZs, his firm had been "relegated to CRA lenders and social impact-related investors." “We [now] have a broad array of investors that are taking the time to understand these complicated capital stacks where before they probably wouldn't have.” These new investors who have been attracted to impact investments include family offices, high-net-worth individuals, and other people with capital gains. Individuals who had sold a Dunkin’ Donuts franchise used their capital gains to invest in an OZ where a Black developer completed an adaptive reuse development (Weiss and Katz, n.d.). The NASA engineer-turned-solar-developer is investing personal capital gains as the OZ equity. These stories are emblematic of the kinds of investors who have not previously invested in mainstream community development finance programs.

The community development system had become complacent—it was putting out widgets. So was conventional venture capital and private equity. [OZ] is bringing in new classes of investors—really different ideas are getting put on the table now. The people working on this are not the traditional community development people.—OZ consultant

Meanwhile, some traditional community development actors, including many CDFIs, have been less engaged with OZs than they were with other federal programs. As the Opportunity Finance Network, an association of CDFIs, reported, "relatively few CDFIs are moving forward with establishing their own opportunity funds” because of various challenges with the OZ program structure (Vasiloff 2019). Most
important, as other observers have noted, OZ incentives are for equity, but CDFIs tend to operate as lenders (Tansey and Swack 2019). Even for CDFIs willing to deploy equity, deployment rules create compliance risk for multi-investment funds that must be carefully managed. That said, a small set of CDFIs have developed or are seeking to develop equitable development-oriented QOFs. CDFIs like AltCap, CEI, Community Reinvestment Fund, Enterprise, Local Initiatives Support Corporation (LISC), and New Jersey Community Capital have formed—or are in the process of forming—their own QOFs with the goal of using OZs incentives to promote inclusive, equitable development. The vast majority of CDFIs, however, have not entered the OZ market directly (Vasiloff 2019).

2. OZs Are Catalyzing an Ecosystem of Community Development Efforts

OZs have also brought together coalitions that are impressive in the diversity of actors engaging in them. The incentive has engaged federal agencies, states, localities, investors, fund managers, developers, philanthropies, and community groups to an extent arguably unseen with other federal economic development initiatives.

The White House Opportunity and Revitalization Council has sought to align incentives and integrate OZs across other federal agency processes and programs. For instance, the Economic Development Administration includes OZs as an “investment priority,” and the Federal Housing Administration provides a series of incentives to encourage multifamily development within OZs. Several states, regions, and cities have set up nonprofit OZ intermediary organizations to match projects and investors. These organizations include Invest Acadiana, Opportunity Alabama, Opportunity Appalachia, and Opportunity Virginia. These organizations educate communities within their service area about OZs, build out inventories of social impact projects looking for OZ funding, help guide projects become investor ready, and curate potential investors serving a matchmaking role. For instance, Opportunity Alabama is tracking more than 300 potential OZ projects throughout the state at various stages of development and has so far helped close at least nine OZ deals. As one coordinator described: “Once OZ capital is connected to the project, we work with that project and its investors to bring the other sources of capital into the project to get it across the finish line. We look at all available sources we can bring to the table... banks, CDFIs, foundations, LIHTC, NMTC, state and local incentive, enterprise tax credits—and we help to make sure partners are aware of one another.”

A number of cities have designated OZ coordinators to build localized pipelines of mission-oriented projects, serve as matchmakers between potential investors and projects, and help convene potential sources of capital. In places like Baltimore and Kansas City, philanthropy initiatives are funding...
these positions. The Rockefeller Foundation’s grant for “community capacity building” helped cities hire a “chief Opportunity Zone officer” and community engagement specialists “to facilitate community involvement in the proposed Opportunity Zone projects and businesses.” In other cases, such as Norfolk, VA, and Washington, DC, designated city staff have taken up this work. A handful of cities, states, and intermediary organizations have launched integrated platforms (e.g., using partners such as the Opportunity Exchange) to allow for investor-project matchmaking.

States have also aligned or created new incentives around OZs and supported local community planning through grants (Theodos, Evans, and Meixell 2019). One of the most substantial efforts has been Alabama’s Incentives Modernization Act, which created a series of benefits for state-certified QOFs that meet specific impact investing standards. These funds receive the state capital gains tax benefits on OZ investments, can seek investment from 10 state pension funds (but these funds, as non-taxable entities, do not receive the OZ benefit), and are eligible for a $50 million tax credit pool to offset losses and guarantee returns on mission-oriented projects. Maryland offers enhancements to other state tax credit programs for qualified OZ businesses if they agree to provide the state with transaction-level reporting, and additional enhancement for projects that have a community benefits agreement or community residents on their governing/advisory board and provide a resolution/letter from their locality or county. Louisiana has expanded its Restoration Tax Abatement program (which previously applied only to specific designated districts) to all Opportunity Zones within the state. This program allows for an up to 10-year abatement of property taxes for renovations and improvements to commercial structures or owner-occupied residences. Other states, such as New Jersey through its OZ Challenge Program, have provided technical assistance grants for smaller cities to help prepare economic development strategies around OZs.

Nonprofit organizations have also promoted the use of OZs for positive social impacts in different ways. The Kresge Foundation is providing $22 million in guarantees to two impact-focused QOFs (Arctaris Impact and Community Capital Management) that have committed to detailed reporting, transparency, and community engagement. The Foundation has also supported an incubation program through Calvert Impact Capital for mission-based finance groups exploring becoming QOFs. Other organizations are bolstering city government efforts to use OZs in pursuit of social impact goals. The Rockefeller Foundation and Smart Growth America launched an Opportunity Zones Academy that provides five cities with technical assistance, connections to impact investors, and a peer learning network. The Mastercard Center for Inclusive Growth and Accelerator for America have partnered to help 50 city leaders build OZ investment prospectuses, track economic activity, consult, and generate a needs analysis. Groups such as Enterprise Community Partners, Governance Project, LISC, and
NeighborWorks America have developed technical assistance resources, led convenings, or funded nonprofit community development groups around OZ issues. Further, the growing OZ ecosystem has spurred countless local, state, regional, and national conferences and work sessions. Investors, fund managers, developers, accountants, and tax lawyers have convened frequently to discuss the details of the incentive and potential deals that could result: recent conferences and OZ working groups convened by the Economic Innovation Group and Novogradac are examples.

The vast range of engaged stakeholders and depth of these engagements is noteworthy. However, the ultimate investment results of these many-actor efforts are not yet clear. A fund manager cautioned against overhyping the value of these initiatives: “I don’t buy that this will have an enduring ecosystem effect. People check the box a lot, like naming people czars, but they don’t fundamentally change the way they work.” A CDFI practitioner agreed: “I think the marketplaces got hyped up too much… Certainly, convenings and networks are good because they help create important connections, but I’m skeptical about their impact, particularly because I think there is such a thing as too many networks, and we see that now with people not knowing where to go find deals.” This investor considered local government dedicated positions on OZs the most effective among the array of initiatives to foster OZ activity, mission-oriented or otherwise: “I can pick up the phone and ask the OZ coordinator directly about deals in her or his city,” he added.

Other interviewees were less certain that local OZ coordinators were facilitating investment. Many coordinating and facilitative structures have yet to demonstrate a consistent ability to connect projects to capital. One statewide investment coordinator we spoke with had been able to get only one project to closing so far out of 200 projects they were attempting to assist.
A CLOSER LOOK: Tribal Communities Come Together to Leverage OZs

*North Star Opportunity Zones, Northwest Washington*

Five communities in North Central Washington decided to pool resources to lift up their OZs. Chelan County, Colville Tribes, Douglas County, Ferry County, and Okanogan County created the NorthStar Opportunity Zones initiative to leverage the incentive in service of single- and multifamily housing, as well as economic development. Some projects they have already identified are an inpatient alcohol and drug treatment center, an industrial campus, a technology incubator, the renovation of a 1906 building that used to serve as a city jail, and a planned unit development campus.

The communities joined forces to solidify their standing before the scrutiny of potential investors, and to avoid having communities and tribes raising capital individually project by project. Given some challenges around sovereignty, partnerships, and dispute resolution that may affect these particular communities, North Star sought the support of the North Central Washington Economic Development District to create and launch the prospective multi-asset QOF as a blind pool fund that could support the many different project prospects of all the communities. The North Central Washington Economic Development District helped convene stakeholders for designing the QOF, while Washington State University Ferry County partners led the effort to recruit financial partners. The North Central Washington Economic Development District is also planning on using OZ equity to finance a business launch competition, focusing on growing small and mid-sized businesses in the region.

3. The OZ Structure Lacks Encouragement for Resident or Intermediary Engagement

Since the Model Cities program began in 1966, federal programs targeting resources to disinvested communities have incorporated measures intended to ensure that residents have a voice in how resources are employed in their community. The Empowerment Zones program, for example, which provided both grants and tax incentives for business expansion, required cities to prepare 10-year strategic revitalization plans in consultation with the community. The Community Development Block Grant program requires cities to prepare “consolidated plans” which “provides for, and encourages... participation by residents of low- and moderate-income neighborhoods.” LIHTC provides state
governments with the opportunity to develop allocation plans that prioritize certain types of projects over others, presumably based on input from citizens. The NMTC program requires that the Community Development Entities that receive allocations of these credits create advisory boards with members from the communities they serve or representative of the communities.

The OZ incentive is distinctive in that, as implemented by Treasury, it allows QOFs to self-certify, meaning they are not required to have a social-impact mission, nor to be governed or advised by community members. Despite involving a significant potential expenditure of taxpayer dollars, the OZ program provides no opportunity for citizen input about proposed projects, or even a role for a state or local government—or any other entity that might be accountable to low-income community residents—to prioritize the types of projects that should receive incentives once the state government has selected its Zones. Tellingly, some state and local OZ coordinators we interviewed noted that some development projects have gone forward without their office’s support.

Despite the lack of requirements in this regard, we did find creative instances of sponsors engaging with community members around OZs, although processes involving community planning were largely carried out before the OZ program was even announced.

- A hospital gave a $100,000 grant to local CDCs for facilitating a neighborhood master planning process, which is helping determine the community development program the hospital will implement with support from OZ investors.
- A CDC that uses grassroots community engagement and planning processes to inform its real estate development work is seeking OZ financing for a grocery store in a high-poverty neighborhood.
- A private developer described using a community planning process to determine the best mix of land uses and amenities.
- A project sponsor developing a high-tech vertical farm is working with the local school system to use the project as a STEAM (science, technology, engineering, arts, and math) learning opportunity for children.

Ultimately, based on our interviews, we heard that mission-driven OZ actors are using similar community engagement strategies that they might for other federal community and economic development programs like CDBG, LIHTCs, NMTCs, or programs run by the EDA or USDA. The difference between OZs and these other programs is that many OZ projects cannot easily be characterized as mission-oriented or in line with equitable development. The lack of community
engagement is a more significant issue as there are not intermediaries to guide or require OZ projects to align with community needs even if they do not engage community members—in fact, OZs do not even require sponsors to inform communities about their projects. At the same time, OZ proponents argue that requiring some form of community engagement would create a barrier to the flow of capital, rendering OZs ineffective.

A CLOSER LOOK: Empowering Zone Residents and Business Owners

We Grow KC, Kansas City, Missouri

The Kauffman Foundation, the Kansas City Chamber of Commerce, and the Urban Neighborhood Initiative came together to form We Grow KC, a group working with community residents to bring investment to Kansas City’s OZs in a way that facilitates community ownership and benefit.

Starting in late 2019, We Grow KC has held a series of deep community engagements with Zone residents, business owners, and aspiring entrepreneurs. These sessions provide residents with details on how OZs function and then strategize block by block to identify community gaps and needs. After identifying these needs, We Grow KC works with local businesses and project sponsors to identify projects that could leverage OZs, as well as other financing strategies, and matches projects and potential investors. We Grow KC has also brought the Opportunity Zone Impact Assessment Tool to community sessions to model and discuss the potential benefits and trade-offs of various projects. To address investor minimum capital thresholds, the group is bundling sets of smaller projects along the same street or street corner.

Additionally, Zone residents are unlikely to influence projects in their community by taking on a role as investors. Ninety-four percent of taxable capital gains in the country are in households with gross incomes above $100,000. Meanwhile, only 12 percent of OZ residents have household incomes above $100,000, making it highly unlikely that they invest in projects affecting their own communities. At the end of the day, people from outside Zones will largely be making investment decisions that affect Zone residents. The exception is projects sponsored by CDCs or other community-based nonprofits, which may have board-level accountability to the community as well as a charitable mission to meet. Depending on their state and city, residents can influence organizations to undertake
OZ projects that meet their interests through development entitlements and permitting. But neighborhood control, zoning processes, and approval rights vary widely across the US, for example as illustrated between Home Rule and Dillon’s Rule states.  

Community engagement could add a year or two to the project timeline, so that’s difficult, and when you layer in the OZ timeline, it becomes almost impossible. —CDFI practitioner

4. Many Mission-Based Project Sponsors Are Struggling to Find OZ Investors

As mentioned before, OZs were designed to reach different investors than what many other community development programs have attracted. Potential OZ investors include institutional investors, family offices, high-net-worth individuals, banks, and basically any individual or corporation with capital gains. As broad as this pool may be, most mission-oriented practitioners that we spoke with reported difficulty building relationships with potential investors. As one project sponsor reported: “It’s not an easy process—[the money] is not exactly flowing like water.” The reasons mission-oriented sponsors are experiencing these challenges are varied and include the following.

Lack of connections: For many project sponsors the difficulty finding investors stems from OZ equity being limited to capital gains; this reduces considerably the pool of investors to which sponsors can appeal for funds. According to Tax Policy Center estimates for 2018, fewer than 10 percent of taxpayers reported long-term capital gains. These taxpayers are overwhelmingly concentrated in the highest income brackets. Only 1.4 percent of taxpayers in the lowest income quintile, and 3.6 percent in the second-lowest income quintile, reported long-term capital gains. This limitation may be less decisive for developers of market-rate projects, as developers may have their own capital gains to invest or know others who do within their social and business networks. For project sponsors whose networks do not encompass taxpayers with capital gains, this limitation can be crippling.

Examples from our interviews include a developer trying to create permanent rental housing for people experiencing homelessness in a West Coast state. The developer shared that they were not getting any feedback from OZ investors, and added “the Opportunity Zones concept requires a particular type of investor, and we are not in the social or political networks to connect with those types of people. It’s been a disappointment.” Another project sponsor lamented: “I grew up on a rural farm—I didn’t meet a lot of venture capital types.” An interviewee from a social impact equity fund that had
considered—but is no longer pursuing—working with OZ investors felt that one barrier was a lack of connections within the right investment circles—even though this fund offers attractive returns. "We know foundations and banks more than we know high-net-worth individuals who happen to have had large capital gains in the last six months," they said. In a capital-raising success that is equally telling, one interviewee was able to raise $500,000 in capital from wealthy investors who sit on his board and through personal connections. The interviewee commented, “Are you ever going to be able to be a dude off the street and get some family office money? Probably not.”

Earlier, we noted that many Black project sponsors have sought to engage with OZs. While some of these sponsors have been successful, others have felt that patterns of discrimination have made it hard to connect with investors. A developer of color seeking what he described as “market rate” returns to build green workforce housing in the Midwest was unable to get a single meeting with a family office, despite years of experience running a US platform for an international investment group, and putting together what they described as an “institutional-grade due diligence package.” The developer felt that among the for-profit institutions, family offices, and high-net-worth-individuals who have capital gains, “their doors have not been open to women and minority developers. Doors are closed to us, and that’s been the case for other folks too.” While some Black developers report positive interactions with the program, the experience of exclusion is also consonant with research suggesting that funds led by high-performing Black men are the most harmed by racial bias from asset allocators, even when all other fund aspects are identical (Lyons-Padilla et al. 2018).

**Track record and experience:** As OZs have attracted new actors into the community development space, part of the struggle to connect with investors has to do with project sponsors’ track record and inexperience working with investors. An OZ fund manager commented, “The basic fluency with investment and numbers and business models, and the capacity of [these] developers to talk to people with investment capital is just not there... I see a big opportunity to bring investment fluency to developers in neighborhoods who are new and coming to the table for the first time.” A fund manager at a CDFI agreed: “Even if you know investors to pitch your project to, the difficulty does not come from the scale of the project so much as it comes from your capital readiness. How well are you capitalized and what is your track record for doing these projects? They need to be better prepared to present the pitch. This is where TA or philanthropic money could come helpful to make these smaller sponsors be capital ready.”

Project sponsors who have a track record, and enjoy high visibility and trust from local stakeholders, report more success. A health care system shared they had “banks pounding on their door” to invest in a mixed-use project including affordable housing near their hospital campus. In a
different example, a fund created to provide equity for real estate collateralized SBA 504 deals has raised $7.5 million in equity from a family office and expects to raise another $5 million from banks.

**Transaction costs:** Transaction costs—such as legal and accounting fees—have long presented hurdles to accessing capital through other community development programs, such as LIHTC and NMTC. Though the OZ program is indeed simpler than community development tax credits, it is not immune to transaction cost barriers. These costs can include elevated search costs—such as hiring a broker to find investors—in addition to legal and accounting costs to set up a QOF. “I spent a lot more on accountants and lawyers than I thought I would,” said one developer.

**Deal size:** Any investment that carries significant transaction costs needs to reach a certain scale before the transaction costs are worth it. Interviewees confirmed that sponsors usually need a relatively large deal to attract interest, at least from institutional OZ investors. A project sponsor emphasized the importance of project scale: “if you are not doing a large-scale project that is going to be able to generate strong market rate returns, your typical funds are not interested.”

**Return:** For many mission-oriented actors, their projects simply do not generate a return high enough to interest many investors. This dynamic is so important we devote the next of our nine observations to discussing it.

*Opportunity Zones investors are for-profit institutions, family offices, and high-net-worth individuals with capital gains. Their doors have not been open to women and minority developers for years, so who is getting access to this capital? —Real estate developer*
A CLOSER LOOK: Partnering with Wealth Advisors to Raise Capital

City Foundry, St. Louis, Missouri

Lawrence Group, an architecture and construction firm, is developing City Foundry STL Public Market, a large mixed-use development that will include a food hall, offices, grocery, entertainment, dining, theatre, and space for nonprofit groups. City Foundry is on a 100-year-old industrial brownfield site in the Midtown area of St. Louis. The project was born in 2015 when the property was acquired, and from 2016 to 2018 Lawrence Group worked on the environmental clean-up, early design, early leasing, and adding the property to the National Register of Historic Places to access the historic rehabilitation tax credit (HTC).

Lawrence Group struggled initially to form its capital stack; potential investors were interested in safer projects, such as multifamily housing or projects in the major coastal markets. Although Lawrence Group was able to secure the HTC and some debt pledges, the latter were conditional to higher levels of equity, something the sponsor was not in position to provide himself. In 2017, the stack had a gap of $39 million—17 percent of the $230 million total project costs. The sponsor approached CliftonLarsonAllen Wealth Advisors, an accounting firm with which it had a working relationship, to help raise capital through OZs. Already a leader in the OZs field, CliftonLarsonAllen helped Lawrence Group with the OZ financial modeling of the project (both from the tax and financial standpoints) and facilitated relationships with potential investors with sizable capital gains. Between January 24 and June 13, 2019, the single-project City Foundry QOF was able to raise $50 million ($11 million more than what was needed), mostly from investors outside St. Louis who were monetizing the sale of businesses. The additional OZ equity allowed the sponsor to lower the debt in the capital stack. Although this meant less ownership of the project for Lawrence Group, according to the firm, “it created a much safer project to handle the stresses of the current health crisis.”

The final capital stack was $50 million from OZ equity, $10 million from sponsor equity, $40 million from the HTC, and $130 million from loans, one of which was provided by St. Louis University, a neighbor of the development and anchor institution for the surrounding community. The projected internal rate of return after tax through the 10-year hold is 14 percent. The first City Foundry tenants had planned to move in on April 2020, but the COVID-19 crisis has put the process on hold for now.
The difficulties in raising capital that mission-driven actors have faced is particularly troubling given that many actors have made substantial investments in structures and institutions to facilitate OZ investment. It remains to be seen whether these challenges are temporary ones that will resolve as these facilitative structures gain traction. One optimistic interviewee felt that fund managers “will eventually get their sea legs. They are not there yet, but with time.” On the other hand, as mentioned above, one interviewee who was trying to raise OZ equity for a list of 200 high-social-impact projects had closed financing for only one project as of January 2020. A key question is whether this type of market-making infrastructure can reach maturity in time, given that, as several interviewees noted, the value of the OZ incentives is already decreasing as we approach 2026, and COVID-19 has caused significant market disruptions.

A CLOSER LOOK: Raising Local OZ Capital

Fredericksburg Food Coop, Fredericksburg, Virginia

A key challenges smaller community-oriented high social impact projects have faced is the inability to attract OZ capital at below-market returns. Fredericksburg Food Coop is attempting to overcome this hurdle by focusing on attracting smaller donors with strong interest in helping their local community.

The Fredericksburg Food Coop has raised slightly more than half ($1.7 million) of its total development cost from one-time membership fees of future consumers who now are part owners of the coop. Other businesses in this situation might turn to mainstream debt financing for the remaining $1.5 million, but start-up coops often have difficulty accessing this source because of their nontraditional business model. The Fredericksburg Food Coop has turned to OZs as a potential solution by creating a $1.5 million QOF. Start-up risks, the nontraditional model, and below-market returns made attracting interest from existing QOFs difficult. By creating its own fund, the coop is seeking to tap into a new market of investors with local interests. Though most QOFs have minimum buy-ins of $100,000 to $1 million, the coop’s fund has a minimum investor holding of $10,000.
5. OZ Investors Demand Higher Returns Than Impact Projects Can Provide

After the challenge of finding and connecting with potential investors, sponsors of mission-oriented projects are finding themselves with requests for market-rate (12–16 percent) or near-market-rate returns (8–12 percent). These internal rates of return (IRR)—even near-market—are in most cases unachievable for sponsors of mission-driven projects, creating frustration for sponsors about what they feel are unrealistic investor expectations. One Florida-based affordable housing developer relayed: “When we’ve talked to Opportunity Zone investors before about the transactions they want, the yields are something we can’t produce in affordable housing, and the amount of developer fee they want for us is too small. Their expectations are not realistic. You need to be an impact investor. A typical LIHTC investor gets maybe a 6 percent IRR. These folks were asking for double digits. There’s no way to squeeze that out of a LIHTC deal.” A health system related the same problem: “I hear at conferences from investors about their return expectations of 7 to 10 percent [pre-tax]. We can’t generate that kind of return.”

Many mission-driven practitioners we spoke to had projected IRRs between 3 and 7 percent. These practitioners are on a quest to find “real impact investors, not folks demanding double-digit returns.” As another put it, the projects need investors who are “driven by community benefits as well as return.” We found a few examples of such investors. One interviewee set up a small solar energy QOF with her own money. She was making 1 percent a year of total return (as detailed in the box A Closer Look: Increasing Benefits of Below-Market-Rate Social Impact Projects), but her real motivation for the project was tackling climate change. She also explained that investing in this QOF was a better alternative than simply donating money, which she cannot do with 10 percent of her wealth. “It’s so sustainable as a funding strategy,” she added.

Unfortunately, however, this approach to investment and returns is an exception among the cases we studied, and it appears that very few investors are willing to adopt it. One frustrated nonprofit affordable housing developer in a West Coast city exclaimed: “I question whether there really is an impact investing community. I’ve been on the circuit and it is clear to me that people want both high impact and market rate return. So then who pays for the impact? They expect us to go out and raise grant money to offset their returns, instead of them being willing to take less return.” Another community development nonprofit seeking support for two mixed-use projects in a high-poverty location reported talking with institutional investors wanting 10 percent returns before the value of the tax incentives. “That doesn’t do anything for us,” she related, “It just pushes the problem down the road.” That organization has since pitched several families who have made donations in the past about a below-market impact investment. Other community developers have resigned themselves to seeking
other funding for the projects. One community planner commented: “I don’t see [OZs] as being a real strong fit unless the social impact reporting requirement changes. The margins on businesses we are working on (like a drug treatment center) really require a mission driven investor.”

When we talk about workforce housing they are not interested. Investors either want high returns or donate their money for homeless housing. There’s not a connect between people’s motivation and their financial structure. —Real estate developer

Why do most investors demand double-digit pretax returns for OZ investments? Several factors are in play:

- **Incentive architecture:** The OZ benefit structure is a significant factor driving investor goals for return. The inherent economic incentive of OZs is to start with a low capital account and exit with the highest gain possible. OZs are designed to provide the largest subsidies to projects with the highest returns, rather than the highest social impact. This is because the largest component of the OZ incentive is that gains are tax-free: the larger the gain, the larger the financial support in the form of forgone tax. In other words, high-end apartment buildings and hotels can be expected to access larger incentives, as a percentage of project costs, than food banks, supermarkets in food deserts, or affordable housing projects. This fundamental design was reflected in our conversations with sponsors of mission-driven projects and their frustrations with the program.

- **Ten-year hold:** A critical factor driving investor return expectations is the need to compensate for the long holding period of OZ investments. For investments held for at least 10 years, investors pay no taxes on any capital gains produced through their investment in a QOF. However, during this 10-year holding period, investments are illiquid. Investors naturally respond to long, illiquid holding periods by boosting the returns they demand. As an OZ fund manager observed, “given that their investment will be illiquid for 10 years, almost every investor has a minimum return threshold of 10 percent net before the OZ benefit.” Another fund manager further explained, “A developer cycle is usually 3 to 5 years, so you are asking them for 5 to 7 more years.” Providing for an earlier exit would likely reduce demands for
return, but if anything, mission-oriented actors are seeking more capital that is patient for more than 10 years, not less, as we discuss in observation 7.

- **Shallow subsidy**: In the eyes of most interviewees we spoke with, OZ is a relatively shallow subsidy that is adding somewhere between 150 to 300 basis points to the return for most deals. Thus, for a typical project, the incentive is not enough to provide the return that investors seek. As one fund manager described, “you will hardly see the OZ incentive turning a project with a 5-to-8 percent return from a ‘no’ to a ‘yes,’ but it may happen with a project with a 10 percent return.” For that reason, mission-oriented projects generally have to layer other subsidies with OZ incentives, a theme we explore in more detail in observation 8.

A CLOSER LOOK: Opportunity Zones Can Finance Small Community Projects... with the Right Connections

*Mason Music Foundation & Woodlawn Theatre, Birmingham, Alabama*

When an old movie theatre in the Woodlawn neighborhood of Birmingham, Alabama, went up for sale, the owner of Mason Music realized it could be the perfect dual-location for his new business. He envisioned an offshoot of Mason Music as a performance venue and a nonprofit that provides scholarship-based music lessons for low-income students who could not otherwise afford them. He sought to leverage OZ investment to buy the property. Five investors, all Birmingham locals, provided roughly $150,000 in OZ financing, more than covering the $125,000 price of the building. The remaining $350,000–$400,000 in rehabilitation costs was financed through a traditional bank loan.

Investors will be paid an annual internal return of roughly 4 percent in addition to proceeds upon buyout of their shares in the theatre. Mason guaranteed the investors the chance to sell off their ownership of the property at year 10. If they choose to sell, he hopes to be able to buy out their share or find others willing to. In the worst-case circumstances, Mason would sell the building. With confidence in the appreciation of the real estate investment, and a guaranteed 10-year exit option, investors were willing to accept a lower annual return than they might have otherwise. Mason understands the ownership group of the building may change at year 10, but he intends to find a way to operate the music venue and nonprofit into the future.
This type of small and relatively unusual project would be difficult to finance through more conventional community development dollars like NMTCs. The investor-to-project matchmaking relied on the project sponsor’s connections (including members of the Mason Music Foundation’s board and parents of students at Mason Music). This makes the deal less transferable to other small locally focused social impact projects, particularly for long-disinvested neighborhoods with less social capital.

Mason reports that due to the COVID-19 crisis, “we have a temporary hold on the project until we know when large gatherings will be possible again.”

6. OZs Were Designed to Spur Job Creation, but Most of Their Capital Is Flowing into Real Estate

According to the IRS, “Opportunity Zones are an economic development tool—that is, they are designed to spur economic development and job creation in distressed communities.” However, the majority of OZ projects appear to be focused on real estate transactions, not direct investments in operating businesses. According to Novogradac’s data on 621 QOFs, only 4 percent are focused on investments into operating businesses. These statistics appear to also apply for mission-oriented OZ investments; very few sponsors we spoke with were working with operating businesses. One successful fund sought to provide minority-owned businesses in North Carolina access to SBA 504 financing. The equity will still be used to purchase real estate rather than investing directly in the businesses, although it will be owner-occupied space.

Both deployment rules and rigidity around investment time frames to access incentives appear to have hindered the use of OZs for equity investments in operating businesses. Investors have 180 days to invest in a QOF, and the QOF has to deploy the capital in a set time frame. The QOF can choose not to deploy all the capital at once, but it has to at least have a schedule of when to deploy. The QOF also must have 90 percent of its funds deployed at any one time. These rules create timing issues on both the front and back ends of a QOF when investing in a business, in stark contrast to venture capital. On the front end, investors with a capital gain are looking to deploy immediately, whereas a venture fund wants to obtain capital commitments and draw them only as they are needed. On the back end, OZ investors generally want to stay in a deal for 10 years, to maximize the tax benefit, and exit as soon as possible after that. A venture fund, however, exits an investment whenever the time is right to sell the business to a new investor. This makes it difficult to maintain the minimum capital deployment levels required by the IRS.
For start-up operating businesses, it may be easier to raise investment with a short time horizon. We spoke with a start-up company looking to manufacture affordable homes from shipping containers. The company found that it was unable to raise OZ equity for the first years of the project, largely because initial investors were unwilling to stay in what wealth advisors appear to see as a “risky, oddball investment” for 10 years. Instead, the company is raising $8 million in private equity that seeks an exit after 18 months, and it is planning to use OZ equity to buy out the initial private equity in a second round of capital raising.

Investors might be interested in a stable, long-standing business where equity can be invested, left for 10 years, and then taken out easily, but these are not the businesses that most need the investment promised by the OZ program. Even if an investor is willing to leave the money in an operating business for 10 years, structuring the equity exit requires great creativity. As one investment professional related: “How can we figure out a way where you get your equity back whether it’s through equity repurchase, whether it’s through us bringing in other partners to the deal. That’s not an easy thing to solve for. I think that’s part of why it’s been so hard to get operating businesses included in the Opportunity Zone framework.”

Nor is OZ equity an ideal fit for microbusinesses, which are disproportionately owned by people of color (McKay 2014). As Jennifer Vasiloff of the Opportunity Finance Network noted in her congressional testimony: “From the perspective a small business, it is daunting to give up significant ownership in a business to an unknown investor and substantially improving all of a business’ existing assets is unlikely to be a prudent expenditure. Some of these businesses would be better served by an affordable small business loan from a CDFI or other financial services institution” (Vasiloff 2019, 2). Moreover, few small businesses are able to generate the kind of growth that would provide attractive returns to equity investors. We add to these concerns that the 10-year exit investors seek could require sale of the business to a new owner. Investing in the real estate occupied by small businesses is helpful but hardly a complete solution to their financing needs—and again, the issue of what would happen to the real estate at the end of the 10-year timeline arises. The investor and the business owner may also need to come up with a way to split the tax benefits.

Ultimately, as the program figures itself out, I think you’ll see more movement towards operating business, but the safe bet right now is one that does have a real estate component. —QOF manager
A CLOSER LOOK: Increasing Benefits of Below-Market-Rate Social Impact Projects

*Norfolk Solar Qualified Opportunity Zone Fund, Norfolk, Virginia*

Clean energy projects are one area outside traditional real estate where OZ dollars have flowed. Norfolk Solar Qualified Opportunity Zone Fund finances the installation of solar panels on the roofs of businesses and nonprofits within OZs in the Hampton Roads region of Virginia. Panel installations are funded 30 percent through the federal Solar Investment Tax Credit, 30 percent through accelerated depreciation via the federal Modified Accelerated Cost Recovery System, and 40 percent from the electricity costs of panel recipients. The installer bills recipients at the same rate they were paying for electricity and increases that rate 2 percent annually (a lower annual increase than utilities) for seven years. At the end of the seventh year, the recipient buys the solar array at 3 percent of the cost of the initial unit. This structure allows the recipient of the panels to switch to solar at no short-term cost and achieve energy savings over the long run. Providing additional social impact, the business hires and trains OZ residents to conduct the installations.

By using OZs within this structure, the fund makes an extra 3 percent from the 15 or 10 percent step-up in basis. It passes these savings through to consumers by shortening the period over which they fully pay off the system to 7 years (absent OZ incentives the consumer would have to make payments over 8 years). Additionally, the investors receive the benefit of the tax deferral on their capital gains.

Because of the need to take depreciation (which cannot be done through a QOF), the fund has a mixed-stream structure. The fund provides 50 percent of the investment, and a separate investment fund LLC (non-OZ) provides the other 50 percent into a business set up for installing solar panels.

Presently the fund is relying solely on the capital of a high-net-worth individual (who owns the fund, the LLC, and the business involved) and her children. This investor is realizing a 1 percent annual return on her investment and benefiting from the tax deferral. This return could be increased to 2–3 percent annually on future ventures now that the initial legal and accounting fees associated with structure have been incurred. In a state that offers solar renewable energy credits, the investor estimates annual returns could be up to 3–5 percent.

Particularly in a state that does not offer solar renewable energy credits, such as Virginia, solar panel installation may not attract typical OZ investors considering the competitive marketplace. However, such a structure could be an attractive vehicle for investors looking to use their money to promote a social cause. In this case, OZs provided the investor with the tax deferral benefit and allowed for increased social benefits via the step-up in basis.
7. Even for Real Estate, Exit Strategies at Year 10 Raise Challenges for Project Sponsors

Given that their investments are illiquid, most OZ investors want to cash out at the earliest possible opportunity while maximizing the tax benefits—in other words, at year 10. While this investment time horizon is long from the investor perspective, most mission-driven practitioners are seeking to hold the asset for still longer. Thus, project sponsors must plan an exit strategy for their investors—in many cases, they report, at the expense of the social impact components of their projects.

Many project sponsors are planning to buy out the OZ investors at year 10. Some of our interviewees report having negotiated an option to buy at a set price where they pay the return of capital, plus a multiplier (e.g., one and a half the value of the original investment). Working in rapidly appreciating neighborhoods is an additional concern for sponsors who intend to buy out their OZ investors, and who may have to face increased costs. Further, according to some of our interviewees, the OZ designation began to accelerate the appreciation of land in some tracts. For example, one city official in the Midwest was worried about how the OZ designation has intensified the already high property tax burden in some areas of the city because land values have increased. This places a large financial obligation on the project sponsor. The sponsor is looking into several strategies to sustain the project, such as refinancing the project at year 10, selling a portion of the project (e.g., some real estate units), banking cash flows, or combining all these strategies. A university we spoke with hopes that it will be able to refinance the equity investments using the HUD 223(f) program.

Not everybody intends to maintain control over their asset, or sustain its affordability. Some interviewees acknowledged that they planned to sell the asset in its entirety at year 10. Though not ideal, some OZ practitioners believe that this strategy is preferable to no project at all. As one nonprofit housing developer put it, “Finding a long-term strategy that maintains affordability is very complicated, but we know that having the property affordable for 10 years is still better than having the property sit for an unknown number of years before we get the necessary funding to get this project [multifamily housing] rolling.” Similarly, a sponsor seeking to build a food bank in South Carolina was hoping OZ investors would provide equity for what amounted to a real estate speculation play, with a sale of the property in year 10 and all the investor return provided by real estate appreciation. This latter strategy depends on expectations of rapid neighborhood price appreciation to attract investment. One affordable housing developer working in the Midwest market shared his satisfaction with the way the OZ designation had increased the value of some of his properties located in Zones.
It’s going to involve state government in terms of thinking of public-private partnerships where they come in with some level of investment... or it could be how do you work with philanthropy that’s in that area to begin to engage in a way that helps de-risk for that investor base as well. —CDFI QOF manager

8. To Drive Impact, OZs Often Need to Be Paired with Other Subsidy Sources

Sponsors are struggling to find equity support for their social impact projects; even when they can raise OZ capital, they often need to pair it with other subsidies or program benefits. One interviewee put it succinctly: “The more socially impactful the project, the more the need for subsidy [beyond OZ incentives].” Several of our interviewees are using (or planning to use) OZ incentives in conjunction with programs like NMTC, LIHTC, CDBG, HTC, the Section 108 Loan Guarantee Program, the Solar Investment Tax Credit, the SBA 504 loan guarantee, the Modified Accelerated Cost Recovery System, HUD 221(d)(4) loans, and an array of state or local grants and city tax abatements. For them, OZ incentives are an “additional tool” to help fill out the capital stack, as one informant put it. However, combining OZ incentives with a number of other commonly used subsidies can present challenges.

For NMTC projects, our interviewees explained that most NMTC investors were separate from OZ investors in the capital stack, and that they were eager to understand how these two programs can be leveraged in the same investment (e.g., the same investor receiving the tax credits of the NMTC and the tax deferral and liability reduction of OZs for one transaction). One challenge to doing this, they report, is that most NMTC Community Development Entities want to make only debt investments, not equity investments. On the opposite side, practitioners report that the LIHTC and OZs can only be used together if they are leveraged by the same investor, to avoid timeline mismatches (the LIHTC compliance period is 15 years, and OZ investors maximize their benefits when pulling out immediately at year 10). One of the most challenging aspects of combining these programs is that the LIHTC and NMTC programs seek to fund projects that are not necessarily poised to generate significant nontax returns, while OZ incentives are most valuable when the project generates a substantial IRR.

For those working in the solar energy field, finding an investor that can leverage the OZ tax benefits together with the Solar Investment Tax Credit or Modified Accelerated Cost Recovery System has proven arduous. Since the OZ incentives can only be used by investors who have unrealized capital gains, and the Solar Investment Tax Credit and Modified Accelerated Cost Recovery System by those...
with passive incomes, the pool of potential investors that can twin these programs is very shallow. Overall, the need for additional subsidies to deliver impact complicates the landscape for equitable development at scale through OZs. “The only way to create really deep impact is by twinning incentives, but that doesn’t work with large developers. They can’t afford to learn the intricacies of NMTC or LIHTC. You need to make your tools very accessible and predictable,” one fund manager explained.

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You can only take advantage of the Investment Tax Credit and accelerated depreciation with passive income, whereas the OZ is only with capital gains... That’s a unicorn.
—OZ project sponsor

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**A CLOSER LOOK: Layering Community Development Programs**

*MetroHealth, Cleveland, Ohio*

MetroHealth, the public health system in Cleveland, Ohio, is focused on creating an impact beyond medical care. Part of its mission is to address social determinants of health in the community. MetroHealth has identified the link between health and housing as a primary inflection point. Situated in the Clark-Fulton neighborhood, MetroHealth decided to begin in its own backyard by developing three mixed-use buildings that combine housing with street-level commercial property. The first building would contain up to 72 units of affordable housing, the second building would be workforce units for health system interns and residents, and the final building would be workforce housing. These two workforce buildings will contain up to 190 units. Targeted commercial tenants include a grocery store, economic development center, police station, and community college access center. The site also intends to include day care services, financial literacy training, and first-time homebuyer education.

*Photo credit: RDL Architects*
MetroHealth envisioned and began work on this project before the introduction of OZs. However, OZs will play a necessary role in the capital stack—though they are seen as one tool of many that the health system has been assembling to bring this project to fruition.

The affordable housing building is structured without OZ financing as a LIHTC deal. MetroHealth has applied for a $1 million tax credit award from the Ohio Housing Finance Agency’s pilot $3 million incentive pool for LIHTC projects within the city of Cleveland. The city is also providing subordinate financing to support this development. The two workforce housing projects will use NMTCs and OZs financing as components of the capital stack, in addition to commercial debt financing. The combination of NMTC and OZs was cited as a major factor allowing the two workforce housing projects to pencil out from the developer’s perspective.

9. The Need for OZ Financing in OZ Projects Is Mixed

Interviewees gave mixed responses when we asked how critical a role OZs incentives played in the financing of their project. Only a few suggested their project could not have proceeded without OZ incentives:

- One developer reported, “We had exhausted state and county incentives. Had they had more money, we would’ve taken it from them because it’s cheaper. The project would’ve died but for the OZs investment.” This developer qualified their approach to using OZs incentives: “Are we putting anything under contract today, counting on OZs money if we don’t already know where it is coming from? No. Are we looking for OZs money on deals we already have under contract as an extra cushion? Yes... Never start a deal counting on OZs money. It is that last gap filler.”

- Another developer felt that “we probably could have done the deal at a market rate, but the affordable component, keeping rents at the workforce housing level—we couldn’t do that without the OZs incentives.”

- A QOF manager felt that “investors simply would not be there at all for our deal, without the OZs incentives”—but this fund manager had yet to raise financing when we spoke with them.

*Having OZs equity allowed us to create a much safer project to handle the stresses of this health crisis. We can withstand the time delay that coronavirus is causing for our tenants to move in and start operations. —QOF manager and real estate developer*
The largest group of interviewees we spoke with reported a role for OZ incentives that was somewhere in the middle ground—useful, but not critical, for financing their deal.

- A vertical farming operation that relocated to an OZ reported that “[Locating in] an OZ was a big factor for us—a key factor. But not as defining as having a pad-ready site.”

- A solar developer commented that the OZ program “adds a little sliver [of return]. It’s not this huge, wonderful thing.” Another solar developer agreed that “You could do this project without OZs incentives… but [they] help.”

- Several interviewees felt that the OZs incentives were mainly useful for raising the visibility of a deal with prospective investors. As one developer put it, “What [OZs] do is it shines a spotlight [on your deal]. It's a buzzword, a catchy thing these days. Opportunity Zones are a great fad.”

- Some sponsors felt that the importance of OZ incentives varied from investor to investor. “For three-fifths of investors [in our project], OZs is important, for two-fifths it is secondary, but for all of them it was helpful.”

Still, others confidently expressed that they would have completed the financing and implementation of their projects had the OZs program not existed. Most of these practitioners characterized the tax incentives provided by OZs as an “enhancer” for the terms of their deals that could translate into a modest increase in the IRR. These deals might still marginally benefit from OZs incentives—by having deals close faster, for example—but the incentive was clearly not necessary to make them happen.

- One developer said: “Every deal that I do with OZs, I can do without. I underwrite and create a strategy without OZs but I turn around and I say... you might get 15 percent here but now you’re going to get 17–18 percent. What I do is use OZs... as a tool to sweeten the terms of the deal.”

- In many of our interviews, practitioners reported that they had already committed to their projects before accessing OZs incentives—in some cases, even before the census tracts were designated as a Zone. As one reported: “We thought about this project not because of OZs, but because there was the need and demand for it. We’ve been assembling land for two and a half years...Without the OZs incentives we still would have figured out a way to do this, it just makes it easier to facilitate.”

- In three cases where we interviewed project sponsors, financing for the project had been finally structured before it became known that the project was in a Zone and eligible for incentives.
OZs were used in place of other equity capital that had been pledged. “We honestly predated the OZs program,” said one developer.

Even when improving returns for investors, most project sponsors report that OZs were not critical for filling a financing gap or increasing the social impact goals of their venture. Because of the program’s timeline, practitioners reported that it would be difficult to use the full extent of the incentive for a project that was not already on the drawing board. As a sponsor of a QOF noted, “Given just the development timeline that projects take, unless they were shovel ready or in the process of being developed, many won’t be able to take full advantage of OZs.”

The Opportunity Zones program is kind of like salt—it enhances a deal that is starting to make sense and helps it go forward. It doesn’t fundamentally change the structure of a meal, though. —Real estate developer

A CLOSER LOOK: Financing a Project Entirely with OZ Equity

Chatham Facility, Chicago, Illinois

The nonprofit Chicago Cook Workforce Partnership (CCWP) provides services and programs that enable youth and adults to develop skills and knowledge to meet the labor needs of Cook County’s employers. CCWP will open its new Chatham Workforce Training Center in the South Side of Chicago in 2020, where it will house part of its administrative operations and provide workforce development trainings and workshops. The new center is being built on a two-story 10,440-square-foot office building in the Chatham neighborhood. The project was initiated by IFF, a CDFI working primarily in the midwest, with a $250,000 grant support from a large bank.

Six months after commencing the development, and looking for a stable permanent owner for the property, IFF sold it to a local family office, which will rent the space in its entirety to CCWP. Initially, the family office explored the possibility of supporting the project by donating to IFF the necessary
capital for the build-out. However, the OZs legislation passed while the parties were negotiating, and they learned the site was located in a Zone. The family office created its own QOF in 2019, bought the property for roughly $2 million, and spent an additional $1 million to finish the construction. The $3 million total investment was made entirely with OZ equity from that one family office.

**Implications and Recommendations**

OZ proponents and government officials have described the goals of the incentive as being to spur economic development, promote business growth, create quality jobs,\(^{35}\) and in so doing to “help address the persistent poverty and uneven recovery that left too many American communities behind.”\(^ {36}\) According to the original concept paper proposing the incentive, OZs are intended to address a panoply of social ills related to living in areas with high unemployment and job loss, including increased illness and mortality, lower achievement outcomes for children, the breakup of families, and significant lifetime earnings disparities between those who grow up in poor versus wealthy neighborhoods (Bernstein and Hassett 2015).

Unfortunately, based on our interviews of people involved in OZ projects and attempted projects to date, the structure of the incentive appears to be least workable for the projects that could have the highest impacts around these issues. When mission-oriented OZ projects have been successful, it is typically only after substantial wrangling: searching for partners who will prioritize mission over profits, pairing OZ finance with other subsidy sources, and making concessions on issues like 10-year exits. As we have learned, the program can be used to finance projects that yield substantial community benefit, but it provides neither the depth of subsidy nor the use restrictions to incentivize the private market to prioritize such projects.

OZs disadvantage high-impact projects in four crucial ways.

1. Instead of rewarding impact investors who are willing to support projects with large social impacts, the capital gains exemption on OZ projects is structured to provide the largest financial benefits to the projects that provide the highest returns. Luxury housing in appreciating neighborhoods therefore may receive much larger public support than, say, affordable housing projects.

2. Because the incentive is limited to capital gains, the program does little to democratize community investing or ownership. Few people have sufficient capital gains to make OZ investments, thus creating a narrow pool of investors to which projects sponsors can appeal. In
particular, the OZ incentive design overlooks the possibility of supporting investments from low-income community stakeholders who do not have capital gains. This pool is much larger than many policymakers might imagine. For example, deposits by low- and moderate-income households in Community Development Credit Unions, which provide affordable debt to small businesses, homes, and families in low-income communities, total over $112 billion—more investment than may occur through OZs. The OZ incentive design also does not support or incentivize investment from other funds that may have a strong natural disposition to consider community investments, such as pension funds and foundation endowments.

3. The 10-year time horizon of most OZ equity investments is not long enough for long-term community ownership of such assets as affordable housing, health care centers, or schools, causing equitable development project sponsors to scramble to put together refinancing plans that may not work in a future interest rate or real estate market environment. Conversely, the 10-year time horizon is too long, too illiquid, and too fixed to make the incentive useable for non–real estate business investments.

4. The financing that the OZ incentives are designed to promote is poorly suited for most equitable development uses. By and large, OZs are effectively promoting market-rate private equity investment in real estate. But truly disinvested Zones with complex, long-standing challenges need investments in small businesses that will create quality jobs, as well as community resources such as affordable housing, schools, child care centers, and health care. Market-rate private equity for real estate is a poor vehicle to deliver these kinds of investments. It is unlikely, in our view, that OZ financing alone can unlock the small business growth or the development of community institutions and amenities that is needed to promote equitable growth.

Mission Actor Opportunity Zone Use Strategies

Despite multiple challenges they face, mission-oriented actors have developed coping strategies to be able to use OZ incentives, particularly through partnership with philanthropy and incentives offered by local and state governments. Across our interviews, we spoke with project sponsors that have pursued a series of strategies to compete for OZ financing despite being at a market disadvantage. Strategies to use OZs for projects that promote equitable development include the following:
• **Combining multiple subsidies**: Most of the successful high-impact projects have pursued OZs as one source of subsidy among many, pairing them with LIHTC, NMTC, local tax abatements, and other federal, state, or local government programs and incentives).

• **Partnering with anchor institutions**: Many sponsors have sought support from anchor institutions, such as hospitals, higher education institutions, faith-based organizations, or municipal or other local government enterprises. Even if they cannot invest in the project, these institutions may connect sponsors with the investment circles that can.

• **Developing a two-round financing structure**: Project sponsors hoping to control community assets for the long term are banking on raising other capital to buy out the OZ investor after year 10. Obviously, it remains to be seen whether they will be successful in doing so.

Philanthropies can also effectively further work to support high-impact OZ projects. Effective strategies include the following:

• **Pooling resources**: A national example is the Kresge Foundation and the Rockefeller Foundation’s partnership in resources, grants, and guarantees in support of investments that align with specific criteria. 38

• **Junior equity**: Where philanthropy attempts to lower investment risk via junior equity positions or other strategies, their efforts can be targeted toward high-impact projects.

• **Using equitable development frameworks in grantmaking**: For instance, philanthropic resources could be restricted to supporting projects that score highly on Urban’s Opportunity Zone Impact Assessment Tool39 and funds in compliance with the US Impact Investing Alliance and Beeck Center’s Opportunity Zones Reporting Framework.40 Particularly for high-impact projects looking to leverage funds from market-rate OZ investors, philanthropic dollars could enable a project’s return to be high enough to be marketable to Opportunity Funds. This might also mean supporting community catalysts for equitable investment, including the work of empowering, organizing, educating, and matchmaking.

States and local governments, while unable to fully tip the balance, have options at their disposal to put their weight on the scale for higher-impact OZ projects (see Theodos, Evans, and Meixell 2019). States and cities can consider encouraging or aiding mission-aligned projects in ways similar to the following:

• **State benefits for QOFs**: States can create added benefits for QOFs that meet specific impact investing standards.41 Funds might receive the state capital gains tax benefits, state tax credits,
or other incentives for these investments. In addition to supporting equitable development goals, states should require funds to track and report OZ investment activity.42

- **State marketplaces**: To lessen search costs and connect beneficial projects with willing investors, Washington, DC, and several states (including Maryland, New Jersey, Virginia, and West Virginia) have begun maintaining central databases of aspiring fund managers and interested investors. The Opportunity Exchange serves this role across several states.

- **OZ coordinators**: A handful of cities (including Atlanta, Baltimore, Cleveland, DC, Kansas City, and Norfolk) and states (including Alabama, Colorado, and Virginia) have OZ coordinators that serve as project-investor matchmakers.

- **Tax abatements and other incentives for equitable development projects**: Many localities have offered property tax abatements or other incentives to projects that provide social benefit for residents. These and other local incentives can be an important part of the capital stack, making high-impact projects financially viable.

### Broader Changes

Greater structural changes are necessary if the types of OZ projects that generate substantial social impact and community benefit for low- and moderate-income residents are to turn from the exceptions into the rule. These changes go well beyond the calls for better reporting—important as the matter is. (See Theodos [2019] for more on reporting needs.)

More comprehensive approaches to prioritize the highest impact projects could come through federal legislative or administrative action. We focus here on the fundamental changes needed for the program to fully support equitable development, but other, more incremental changes would also be valuable. Those changes include, for example, removing all contiguous tracts as well as low-income tracts that no longer qualify as such.43

More sweeping statutory changes could redesign OZ incentives so they much more effectively target limited government resources toward equitable development outcomes. The broad principles that should guide reshaping of the OZ incentives include the following.

- **Better support investments in small businesses**. The most egregious failing of OZs to date is that very little investment is going to small businesses, the exact group of investees that proponents had held out as standing the most to benefit. To correct this failing, one important solution is incentivizing investments in QOFs that could provide subordinated debt investment
(or hybrid debt/equity products such as royalty debt) to small businesses; pure equity is simply not an appropriate form of small business financing in many cases. Beyond that, policymakers should consider granting greater flexibility around certain program rules, such as deployment rules, to mission-driven funds that specialize in small business investing. Mission-driven practitioners need to be consulted as a part of this process. Further, OZs can be restricted to a more narrowly qualifying set of investments—for instance, real estate transactions only when the operating business is the owner-occupant

- **Size the incentive based on the impact.** Rather than providing the largest incentives to the most profitable projects, the incentive should instead depend on projected social impacts. In turn, by targeting incentives toward investments with the greatest impacts, these investments could be more deeply subsidized while more efficiently using total federal tax expenditures. To provide one example, OZ tax incentives could be based on the number of quality jobs created by the investment—thus aligning the incentive with a goal at the heart of the legislation’s original intent. Given that US businesses already regularly report employment and wages to both the state and federal governments, the data exist to make structuring such a system possible. Other alternatives could include tweaking the incentives based on the equitable development characteristics present in a project, such as limiting the incentives to projects where a positive social impact is deemed likely.

- **Broaden who can invest.** There is no particularly good reason to limit incentives for community investing to taxpayers who have prior capital gains. Doing so freezes out most stakeholders in low-income communities from investing in their own revitalization. A refundable tax credit, rather than a capital gains exclusion, could open up opportunities for these investors. Other actors such as foundation endowments and pension funds have substantial resources (and most likely a greater proclivity to consider community investing than many capital gains holders) if an incentive can be structured to engage them.

- **Support mission-driven funds that are accountable to the community.** The OZ program should be changed to require a rigorous certification process for QOFs rather than allowing funds to self-certify. This will help support mission actors rather than other OZ activity. Additionally, reforms should be made to support CDFIs, which have a long track record of making substantial investments in low-income communities. CDFIs are accustomed to taking on higher risks than conventional investors, as well as to working with the kind of investees who have been struggling to access OZ capital, such as small businesses and less sophisticated developers. CDFIs have successfully mitigated these risks by providing hands-on technical
assistance to their investees. A major constraint to growing the impact of CDFIs has been the lack of equity to capitalize them—an issue the industry is actively seeking to address. A redesigned OZ incentive could encourage equity investments in CDFIs who set up QOFs. In combination with opening up OZ incentives to new forms of investment, such as subordinated debt or debt-with-royalty products, this policy change would greatly expand the catalytic role that CDFIs are already playing in distressed communities, and help realize the promise of OZs for the many project sponsors who have struggled to access capital to date.

As we write this report, Wall Street’s extended bull run has ended, COVID-19 has the world at a standstill, and financing is volatile. People are beginning to emerge from their homes and the economy will recognize these gains. Predicting the future—always a difficult endeavor—feels all the more challenging now. However, in their present form, based on the field to date, it appears that OZs are neither on a trajectory to democratize access to capital nor will they, at scale, incentivize mission-oriented projects that align with community goals and priorities. An impressive mission-aligned OZ ecosystem is developing, and project sponsors are making impressive efforts to promote more equitable development. But this ecosystem and these efforts are insufficient in a marketplace incentivized to generate greater investor reward for more conventional projects. Philanthropic and local and state actors have options to partially reorient OZs to enhance community outcomes, but only the federal government can correct the structural barriers that discourage and prevent mission-aligned actors from using OZs to their full potential.

As we grapple with the twin public health and economic threats the current moment poses, and longstanding issues with police violence, the very place-based iniquities that compelled the creation of OZs, are at risk of widening further. COVID-19 has underscored troubling disparities in neighborhood access to vital services and amenities from health care facilities to grocery stores. Looking back to our last economic crisis, the Great Recession substantially exacerbated wealth disparities between White families and Black and Latinx families. Average family wealth fell across all groups between 2007 and 2010, but with vast differences by race and ethnicity: 40 percent among Latinx families, 31 percent among Black families, and only 11 percent among White families (McKernan and Ratfcliff 2013). We do not yet know how the COVID-19 recession will play out, but we should be prepared to see disparities.

As our attention turns to recovery, OZs likely have a role to play. That role, as our early findings indicate, could be solely to compel new economic activity in communities. But at this critical juncture, its role could be altered to create truly equitable development, building wealth for low- and moderate-income residents while meeting community needs. As federal policymakers consider extension and revisions to the OZ incentive in a post-COVID context, this potential should not be missed.
Appendix. Opportunity Zones Overview

Part of the Tax Cuts and Jobs Act of 2017, the Opportunity Zones incentive offers capital gains tax relief for investments in economically distressed areas.\(^{44}\) OZs aim to address a failure in capital markets, in which disinvested communities have lacked access to capital to fund investable projects (Theodos 2019). Individuals and corporations who have recently sold an asset for a capital gain can defer and reduce their taxes by investing the gains in Qualified Opportunity Funds, or QOFs. The QOFs must take those funds and provide equity investments to qualifying businesses and real estate projects in designated OZs. Across the country, 8,766 census tracts have been designated as Opportunity Zones.

The OZ incentive offers three distinct tax benefits for investors:

1. **Deferral of capital gains taxes:** Investors reinvesting capital gains into a QOF can defer taxes on those capital gains until December 31, 2026 (or the date of sale of the new qualifying investment, if the sale happens sooner).

2. **Reduction in the amount of the capital gains tax:** Investors can reduce the amount of capital gains tax by 10 percent if they hold the investment in the QOF for at least five years. At seven years, the capital gains tax reduction increases to 15 percent.

3. **Exemption from capital gains tax on capital gains generated by the QOF:** If investors keep their funds in the QOF for at least 10 years, then they pay no tax on any capital gains from the new investment. The value of this part of the incentive is much larger for investments that yield larger pretax returns. Observers believe that as a result, most investors will want to channel funds into investments that appreciate rapidly at the expense of those that do not (Tansey and Swack 2019).
Notes


3 Much has been made of whether to call OZs a “program” or an “incentive,” in ways that strike us as having more to do with ideology than the underlying meaning of those terms. In our view, much in the OZ statute and implementation is programmatic, and OZs are an incentive. As such, we use the terms interchangeably.


15 See, for example, “Navigating the Opportunity Zones,” a playbook put together by LISC to “lay out best practices for the range of Opportunity Zone actors” (accessed April 26, 2020, https://www.lisc.org/opportunity-zones/community-partners-playbook/).


19 Anne Kniggendorf, ”Creating a Model That Sets the Curve for Opportunity Zone Investment,” Ewing Marion Kauffman Foundation, August 1, 2019, https://www.kauffman.org/currents/creating-a-model-that-sets-the-curve-for-opportunity-zone-investment/.


28 Authors’ calculation based on IRS Statistics of Income from Tax Year 2016, Table 1.4.
Author calculations using 2014–18 US Census Bureau American Community Survey. Data accessed through the National Historic Geographic Information System’s online portal (IPUMS NHGIS, University of Minnesota), www.nhgis.org.

“Home Rule, as it sounds, gives local governments governing authority to make a wide range of legislative decisions that have not been addressed by the state. By contrast, the Dillon Rule creates a framework where local governments can only legislate what the state government has decreed” (Russell and Bostrom 2016, 1).


Novogradac, “Novogradac Opportunity Funds List Surpasses $10 Billion in Investment.”

The FHA 221(d)(4) loan, guaranteed by HUD is the multifamily industry’s highest-leverage, lowest-cost, non-recourse, fixed-rate loan available in the business. 221(d)(4) loans are fixed and fully amortizing for 40 years, not including the up-to-three-years, interest-only fixed-rate during construction. In summary, the loan is fixed for up to 43 years and fully amortizing for 40 (“HUD 221(d)(4) Non-Recourse, Ground-up Development and Substantial Rehabilitation Multifamily Financing,” HUD Loans, accessed April 26, 2020, https://www.hud.loans/fha-221d4).


The tool is available at https://www.urban.org/oztool.

The framework is available at https://ozframework.org/.


For more on what metrics should be collected see Brett Theodos and Brady Meixell, “Public Comment on U.S. Treasury’s Request for Information on Data Collection and Tracking for Qualified Opportunity Zones,” May 30, 2019.

Contiguous zones did not meet the low-income community threshold but were eligible because they bordered low-income communities. Zones that, with updates to the Census Bureau’s American Community Survey, no longer qualify as low-income communities could also lose their status.

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Opportunity Zones haven’t fully reached their potential, but don’t write them off yet

BY ALEXANDER GOLDFING AND CHARLIE METZGER
September 16, 2020 3:00 PM EDT
Just a few miles down the road from the apartment complex where Louisville police shot Breonna Taylor, a Black-owned business is transforming the way property owners file insurance claims for weather damage. WeatherCheck, cofounded by Y Combinator graduates Demetrius Gray and Jermaine Watkins, identifies weather-related property damage so that homeowners can file claims with their insurers. To date, the firm has 4 million rooftops in its customer base and it employs 11 people, double last year’s headcount. This success happened because of investments spurred by a federal program called the Opportunity Zone (OZ) initiative.

The OZ initiative made WeatherCheck’s growth possible. However, most minority-owned businesses aren’t as fortunate: A study conducted by PitchBook and All Raise found that just 1.9% of startups in Silicon Valley were founded by all-women teams, and a Harvard Business Review article by entrepreneur James Norman reports that less than 1% of all venture-funded teams are all Black.

A significant barrier for members of historically marginalized communities who seek to start or grow businesses is lack of access to capital. This prevents them from generating significant wealth and perpetuates systemic inequality. Investments into entrepreneurs in disenfranchised communities provide a crucial path for creating lasting positive change, and the Opportunity Zone legislation builds bridges for such investment.
The Commerce Department defines Opportunity Zones as low-income census tracts “where new investments, under certain conditions, may be eligible for preferential tax treatment.” Under the program, investors may defer, reduce, and potentially eliminate their capital gains tax if they invest their gains into such communities for a certain length of time. These benefits can make good investments even better. Analysis done by the Economic Innovation Group estimates this legislation can transform more than $6 trillion of unrealized capital gains into fresh funding nationwide.

The program’s detractors argue that the initiative is little more than a handout to wealthy elites. Though partially correct (many OZ projects are not designed to help marginalized communities), investors often simply don’t have experience structuring mission-driven investments that generate market-rate returns.

This is a coordination problem. It is solvable. Committed investors, engaged philanthropy, and smart state and local policy can create access to capital for marginalized communities that fosters genuine impact and fights poverty.

Many successful impact investors already follow this playbook. Two of the best examples are Arctaris Impact and Four Points Funding. Both firms extensively invest in Opportunity Zone businesses that hold to the original intent of the OZ legislation. More investors should follow their lead.

For 10 years, Arctaris has invested successfully in low-income neighborhoods, often in partnership with government and philanthropy. In many of these investments, the fund has agreed to stringent impact requirements in exchange for public funding and philanthropic dollars: exactly the kind of restrictions that critics of the OZ legislation argue are missing from the federal guidelines. This capital has helped to de-risk the fund’s investments, allowing it the flexibility to invest in firms that banks might turn away.

Such businesses, according to the Federal Reserve’s Small Business Credit Survey, tend to be minority-owned. An analysis of this data by the Federal Reserve banks of...
option was borrowing from hard-money lenders at exorbitant rates. With Arctaris’s funding, however, the company opened a Detroit office and eventually hired 52 full-time equivalent employees in that Opportunity Zone. Eventually, a larger minority-owned business bought them out, resulting in a win for the business, the fund, and the Detroit community.

Impact-focused OZ investment is not restricted to urban communities. Colorado-based Four Points Funding invests largely in projects in the state’s rural corridors, which are often left out of the national conversation about economic development and equity. Among these investments is a warehouse food hall in Craig, Colo. The building will be anchored by a coffee shop called Inclusion Coffee, whose mission includes providing job training and employment for young adults with disabilities. It will also house a coworking space and conference center.

Four Points is intentionally offering incentives that lower startup costs for local entrepreneurs. The use of OZ tax incentives augmented the project’s risk-return profile and will help bring more highly skilled staff and small businesses to a rural community: another win-win.

Experienced practitioners like Arctaris and Four Points prove that OZs can generate both impact and returns. Investors committing to the spirit of the legislation can provide capital to entrepreneurial leaders who need it badly. Those leaders, in turn, can uplift communities, right societal wrongs, build wealth for historically disenfranchised neighborhoods, and create quality jobs.

Though not without flaws, the OZ initiative still has extraordinary potential. We urge more investors to invest capital into high-impact projects where everyone succeeds as a result. Our communities need it.

*Alexander Golding is an MBA fellow at the George Washington University School of Business. Previously, he was the CEO of HelpedHope, the impact investing advisory*
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FROM MAZDA
Will Opportunity Zones help distressed residents or be a tax cut for gentrification?

Adam Looney  Monday, February 26, 2018

States are fast approaching a deadline set by the new tax law to designate low-income neighborhoods as “Opportunity Zones”—a designation that will unlock favorable capital gains treatment for investments in those areas. Supporters say this will help revitalize distressed communities, but there is a risk that instead of helping residents of poor neighborhoods, the tax break will end up displacing them or simply provide benefits to developers investing in already-gentrifying areas.

Unfortunately, the evidence on the benefits of existing place-based policies is inconclusive. To understand whether Opportunity Zones are effective—and worth extending when key benefits come up for renewal as soon as next year—states have only a short window to act to incorporate evaluation mechanisms into their selection process. States and the District of Columbia must select qualified neighborhoods for Treasury's approval by March 21. Only one in four low-income areas in any state can be designated as an Opportunity Zone, so states must reject more neighborhoods than they select. This is a perfect opportunity to build in a rigorous comparison of places that made the cut to those that did not, to see whether the program helps residents of low-income communities, which elements are effective, and whether it should be renewed.

For background, Opportunity Zones offer favorable capital gains treatment for taxpayers who invest in designated high poverty neighborhoods. Invest in real estate or businesses located in a qualified zone, hold it for ten years, and not only can you sell your investments free of capital gains tax, but you also get a tax break on untaxed capital
gains rolled into an Opportunity Zone investment. Individuals in a high-tax state and with short-term capital gains can avoid $7.50 in taxes for each $100 they invest, even before considering any return on their Zone investments. It’s very favorable treatment.

In high-poverty communities across the country, the persistent concentration of economic distress is a problem that dearly needs a solution. High poverty areas see a decline in the number of jobs and more businesses shuttering than opening. Children who grow up in them face long odds of climbing the economic ladder.

But our playbook of effective place-based policies is limited. In contrast to the new Opportunity Zones, the policy with the best proven record—Empowerment Zones—focused on people and local services not just capital investments. They encouraged hiring, subsidized upfront investment in capital and equipment, offered loan guarantees, regulatory waivers, a partial exclusion of capital gains, and large grants to local government authorities for local services and infrastructure. Researchers Matias Busso, Jesse Gregory, and Patrick Kline (2013) find that Empowerment Zones boosted local employment and wages. But the program was expensive and intensive, costing approximately $850 per resident. As a result, only 11 neighborhood zones were ever designated under the original design.

Beyond EZs, most other place-based policies haven’t been rigorously evaluated at all. For instance, while the New Markets Tax Credit program is widely lauded by investors and community organizations that help direct those investments, and has financed substantial numbers of projects, its design and implementation has thus far precluded a rigorous comparison of its net effect on investment or its benefit to local residents.

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In high-poverty communities across the country, the persistent concentration of economic distress is a problem that dearly needs a solution.
There is no evidence that the design of Opportunity Zones will be as effective as EZs or other redevelopment efforts, particularly when it comes to benefits to local residents. Moreover, the theoretical effect of the Zone tax subsidies on local residents is ambiguous. It’s a subsidy based on capital appreciation, not on employment or local services, and includes no provisions intended to retain local residents or promote inclusive housing.

In an optimistic scenario, the tax benefits might encourage purchasing and rehabilitating residential property or expanding local businesses. But the value of the tax subsidy is ultimately dependent on rising property values, rising rents, and higher business profitability. That means a state’s Opportunity Zones could also serve as a subsidy for displacing local residents in favor of higher-income professionals and the businesses that cater to them—a subsidy for gentrification. Indeed, the highest returns to investors, and thus the largest tax subsidies will flow to those investing in the fastest gentrifying areas. Most major metropolitan areas are already grappling with the right balance between promoting development and helping existing residents. Opportunity Zones favor one side of that balance. With few guardrails that might promote so-called “smart gentrification”—policies to retain local residents and preserve or expand low- and middle-income housing—it is uncertain whether poor residents will benefit or be kicked out.

More immediately, the design of Opportunity Zones might encourage pressure on states to maximize tax benefits to their citizens—including their developers—to select gentrifying neighborhoods rather than the most distressed neighborhoods. Already-gentrifying areas are guaranteed to have large capital gains. Selecting those areas would maximize the tax savings to investors who would otherwise face large tax bills down the road. In contrast, the benefit for investing in moribund or deeply impoverished areas where rents and property values are stagnant is speculative.

One can see this clearly in recent Treasury guidance that provides a list of qualified low-income areas, relying on maps of Census data dating back to 2011. That means states can designate once-poor neighborhoods that have already gentrified over the last several years. In Washington D.C., for instance, qualifying areas include the planned developments around DC United’s new stadium at Buzzard Point, where investors plan to invest hundreds of millions in and around the stadium, and the NoMa neighborhood.
where office buildings and pricey apartments are sprouting. By designating those areas as Opportunity Zones, the D.C. government can wipe out the tax bill that would otherwise apply on the sale of those developments. The same is true for gentrifying hotspots like the Shaw, LeDroit Park, Truxton Circle, Mount Pleasant, and Brookland neighborhoods. According to one estimate, half of DC’s low-income neighborhoods have already gentrified—and not just in D.C. but also in cities like Seattle, Portland, Minneapolis, and Atlanta.

In Atlanta, Vine City, just adjacent to the new Falcon’s Stadium, is eligible to be designated as an Opportunity Zone. Much of the available real estate there has already been snapped up by developers waiting for Atlanta’s wave of gentrification to sweep through. In San Francisco, SoMa qualifies even though it already has a Whole Foods, Trader Joe’s, and REI, as well as the new headquarters of AirBnB, Uber, and Pinterest. Let’s hope, for taxpayers’ sake, that their IPOs will not qualify as Opportunity Zone Property.

That’s why it’s imperative that states establish a transparent framework for selecting and evaluating the efficacy of their zones before they submit their selections to the Treasury. The fact that states can only select 25 percent of their low-income communities as Opportunity Zones provides a prime opportunity for evaluation. California must pick 878 tracts out of 3,500. If more than 878 are nominated, California could select winners by lottery or, by ranking them by a transparent priority—for instance, by municipality and by child poverty rate—and selecting the top 25 percent within each city. That would help us learn whether the lottery winners or last picked performed better than those not selected. Absent a transparent and rigorous selection methodology, it will be impossible to tell whether the program actually worked to use the evidence to drive policymaking when this provision comes up for renewal.

In the absence of evidence, unevaluated programs often become permanent and costly additions to the size of government whether they work or not. Opportunity Zones have already hailed a “policy triumph” by one optimistic observer, despite not yet having gone into effect, little evidence that they will be effective, and a price tag that might soar by billions if permanently extended. Let’s make sure we know whether “Opportunity Zones” work when it comes time to renew them.
Three Years of Opportunity Zones and Outlook for 2021

By Libin Zhang
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Opportunity zones have generated much enthusiasm and apparently $75 billion of investments since they first appeared over three years ago in the bill that became the Tax Cuts and Jobs Act. Libin Zhang of Fried Frank looks at some issues that affected opportunity funds and their investors in 2020, what the future may hold for the program under a Biden administration, and diversity and inclusion concerns that opportunity zone fund advisors have in mind in 2021 and over the next 10 or 30 years.

Many members of the opportunity zone community can remember where they were on Nov. 15, 2017, when the Senate Finance Committee added qualified opportunity zones to the bill that became Public Law 115-97 (the law formerly known as the Tax Cuts and Jobs Act of 2017 or TCJA).

Over the past three years, qualified opportunity funds have apparently raised $75 billion, which have poured into designated low-income communities and certain adjacent census tracts across the country.

While some opportunity funds involve real estate projects, other opportunity funds have focused on operating businesses such as alternative energy, life sciences and other tech startups, professional services, locally grown salads and more distant agricultural producers, and cannabis businesses from coast to Colorado to coast.

The opportunity zone community's end of 2020 is not as exciting as the end of last year, when many Christmas, Hanukkah, and Kwanzaa celebrations were interrupted by the release of 544 pages of final opportunity zone regulations (see Libin Zhang, Opportunity Zones: Final Regulations and Outlook for 2020, Daily Tax Report (Dec. 30, 2019), 61 Tax Management Memorandum 2 (Jan. 20, 2020), 36 Tax Management Real Estate Journal No. 2 (Feb. 19, 2020)). Nevertheless, the Covid-19 pandemic and the results of the 2020 presidential election may affect the future of opportunity zones and opportunity zone people of color (OZPOC) in 2021 and beyond.

Capital Gains and Time Travel Paradoxes

The opportunity zone federal tax benefits are:
1. Most types of capital gains can be deferred until the end of 2026 by investing in an opportunity fund, which can be as simple as a two-member limited liability company.

2. The deferred gains are reduced by 10% (or 15%) or more if the opportunity fund interest is held for five years (or seven years) before the gains are recognized. (The 15% reduction instead of 10% effectively became unavailable after the end of 2019, after which new investors lose out on that 1% economic benefit.)

3. After a gain-deferring taxpayer holds the opportunity fund interest for at least 10 years, the taxpayer generally does not recognize any taxable gain on exit through the end of 2047.

Although the tax statute technically requires capital gains to be invested in an opportunity fund within a 180 day period starting when the gain is recognized, the more flexible final regulations allow some gains to be invested as late as mid-September of the following calendar year. As relief from the Covid-19 pandemic, Notice 2020-39 further extended most 2020 investment deadlines to Dec. 31, 2020.

For example, an individual taxpayer has $1 million of long-term capital gains, $1 million of short-term capital gains, and $1 million of long-term capital losses allocated from hedge funds in 2019. Without an opportunity fund investment, she would recognize $1 million of short-term capital gains in 2019 subject to federal ordinary income tax rates of up to 40.8%.

The taxpayer can make a $1 million investment in an opportunity fund on Dec. 1, 2020 and elect to defer $1 million of 2019 long-term capital gains to potentially 2026. The $1 million of long-term capital losses offset the remaining $1 million of short-term capital gains to result in zero 2019 tax. The taxpayer effectively converts 2019 short-term capital gains into 2026 long-term capital gains.

A temporal distortion is introduced by the fact that the 2019 personal income tax return is still due on Oct. 15, 2020. One option is to first pay full 2019 tax on the capital gains and then file an amended 2019 return after Dec. 1 to claim a refund for the deferred $1 million of capital gains. Other options can involve less tax payment upfront.

The $1 million of 2019 long-term capital gains are generally deferred until the end of 2026, at which point up to 90% of the deferred long-term capital gains are subject to U.S. federal income tax at 2026 tax rates. Joseph Biden would like to increase the federal long-term capital gain tax rate from 23.8% to 43.4%. A tax increase might apply retroactively starting on Jan. 1, 2021. A historical analogy is when Bill Clinton signed the Revenue Reconciliation Act of 1993 into law on Aug. 10, 1993, which increased the highest ordinary income tax rate from 31% to 39.6% (plus an expanded 2.9% Medicare tax) as of Jan. 1, 1993.

Some commentators claim that it could still make economic sense to defer 2020 capital gains to 2026 even when future capital gains tax rates are nearly doubled. Investors should check the modeling assumptions and maybe compare it against a deferral of any capital gains realized in 2021. For taxpayers who have already invested in an opportunity fund over the past three years, they can structure ways to recognize the previously deferred gains in late 2020 while still preserving some or most of the taxpayer’s ability for a tax-free exit after 10 years.
The Senate can pass tax legislation with only 50 or 51 votes under reconciliation procedures. Higher taxes are less likely if the Democratic Party has only 48 or 49 Senate seats. If the Democrats do take control of the Senate after Georgia’s two Senate run-off elections on Jan. 5, 2021, taxpayers in early 2021 can recognize taxable gains back in 2020 and avoid 2020 gain deferrals by using certain retroactive tax elections.

The year 2026 occurs after the 2024 presidential election, which may result in a new presidential administration and lower tax rates. Alternatively, tax rates may increase further in anticipation of tens of billions of dollars of deferred gains recognized in 2026.

Diversity and Inclusion

During the third Trump-Biden presidential debate on Oct. 22, 2020, Trump noted that the opportunity zone program was “one of the most successful programs” and that “tremendous investment is being made. Biggest beneficiary: the Black and Hispanic communities and then historically Black colleges and universities.” But some commentators have observed that opportunity fund investments might not fully benefit the OZPOC community.

The Biden Plan to Build Back Better by Advancing Racial Equity Across the American Economy states that “Biden initially hoped that Opportunity Zones would be structured and administered by the Trump Administration in a way that advanced racial equity, small business creation, and homeownership in low-income urban, rural, and tribal communities. It is now clear that the Trump Administration has failed to deliver on that promise in too many places around America.”

The focus on diversity, inclusion, equity, and social impact may increase in the coming years. It is expected that few opportunity zone tax practitioners are opposed to diversity and inclusion efforts. Given that the opportunity zone program was a new creation that everyone has to learn from the beginning in 2017, and its important racial equity considerations, law and accounting firms have had an excellent opportunity for many of their diverse attorneys and tax specialists to build up the firms’ opportunity zone practices over the past three years.

Diversity and inclusion should be particularly important for opportunity funds and their advisers who are active in the country’s culturally diverse areas, such as Florida, California, Texas, and much of the rest of the southern U.S.
The scope of any opportunity zone reform is unclear, nor is it clear whether existing opportunity zone projects will be grandfathered. Biden may take some pages from the opportunity zone reform bills of Senator Ron Wyden (D-OR) or Representative Jim Clyburn (D-SC) and retroactively prevent opportunity funds from owning golf courses, country clubs, casinos, massage parlors, tanning salons, hot tub facilities, and liquor stores, which currently can be owned by opportunity funds with proper advice and structuring (see Treas. Reg. 1.1400Z2(d)-2(d)(4)(iv) Ex. 3 (golf course owned by an opportunity fund)). The bills would generally also add new tax reporting requirements and retroactively expand the above excluded businesses (or “sin businesses”) to discourage opportunity fund investments in parking garages, self-storage property, sports stadiums, tennis clubs, racquetball courts, skating rinks, health club facilities, airplanes, and any residential rental property that contains less than half low-income housing.

State-level reform efforts can provide precedent. Washington, D.C. enacted the well-known Fiscal Year 2021 Emergency Budget Support Act (D.C. Act 23-404) in August 2020. Opportunity zone benefits are allowed for D.C. tax purposes (including the 8.25% D.C. unincorporated business tax) only if the opportunity fund is specifically certified by D.C.’s mayor as meeting various conditions, including that it makes certain types of investments in solely D.C. opportunity zones. The law does not explicitly grandfather existing projects. The federal government and other states may be similarly inspired to channel opportunity zone dollars to favored causes.

Opportunity zones are census tracts designated by the state governor in 2018 after up to four months of study and deliberations by stakeholders. One question is what happens after the 2020 census, which can merge smaller census tracts, divide larger census tracts with growing populations, and adjust the boundaries of others. Although the general expectation is that opportunity zone boundaries are fixed for the next thirty years, the issue of census tract changes is mentioned in the Treasury and IRS 2020-2021 Priority Guidance Plan.

Opportunity Fund Qualifications

An opportunity fund’s lower-tier subsidiary must generally meet all the requirements to be a “qualified opportunity zone business” (QOZB). A QOZB must have at least 70% of its tangible assets generally consist of qualified tangible property that is located in an opportunity zone, is acquired by purchase from an unrelated party in 2018 or later, and meets various other requirements. Based on the fact that cash is an intangible asset, the regulations explicitly provide that cash is not qualifying tangible property for any purpose; a QOZB that owns only cash and contributed land (i.e., not acquired by purchase) or land acquired before 2018 would not numerically satisfy the 70% tangible property test when it applies to the QOZB.

Some opportunity funds have taken the position that the 70% tangible property test does not apply at all during a QOZB’s first few years, which means that potentially a QOZB can own exclusively nonqualifying property during that entire time. Given the paramount importance of maintaining opportunity fund status over 10 or more years in order to not jeopardize each investor’s tax-free exit, a well-reasoned legal analysis from reputable counsel may be appropriate for some uncertain tax issues.
Loss of QOZB status will have adverse consequences in many later years. Notice 2020-39 waives any penalties if an opportunity fund fails its tax requirements in 2020, but an opportunity fund may have problems in 2021 and later if a lower-tier subsidiary fails to be a QOZB in 2020. An opportunity fund can sometimes be better off revoking its opportunity fund status to avoid continuing monthly penalties, based on the decertification procedures issued by the IRS on Nov. 4, 2020.

A “working capital safe harbor” generally requires a QOZB to spend all of its cash over a period of 31 months. As relief from the Covid-19 pandemic, Notice 2020-39 generally provides that if a QOZB has cash covered by the working capital safe harbor as of 2020 year end, the business receives “not more than an additional 24 months” to expend the cash as long as all the other safe harbor requirements are met. The relief has some ambiguities, including that the 24 month extension might not be automatically available for everyone.

A QOZB has a 50% gross income test that can be met by generally having at least 50% of its employees and independent contractors work in opportunity zones, measured by either compensation or service hours. The Covid-19 pandemic has caused more people to work from homes that are not necessarily in opportunity zones. Opportunity funds can consider creative ways to encourage their highest paid or hardest working employees and independent contractors, including their tax advisors and legal counsel, to move to opportunity zones.

Conclusion

The opportunity zone program’s flexibility has attracted much attention over the past three years. When opportunity zone advisers are structuring opportunity zone investments, they cannot have only an understanding of the tax rules about opportunity zones, partnerships, passive activity losses, REITs, corporations, consolidated groups, LIHTC, other tax credits, FIRPTA, tax code Section 1202 small business stock, and state and local income taxes. Firms and practitioners should also be aware of diversity and inclusion concerns and other BIPOC and OZPOC issues that can affect opportunity funds for the next 10 or 30 years. When 2020 is compared to 2010, a society can change a lot in a decade.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

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Paula Franzese

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AN INFLECTION POINT FOR AFFORDABLE HOUSING: THE PROMISE OF INCLUSIONARY MIXED-USE REDEVELOPMENT

PAULA A. FRANZENE

I. INTRODUCTION

America’s suburbs have not caught up to the changes wrought by twenty-first century market shifts that have transformed the housing needs, preferences and workplaces of whole segments of the population. Built during the New Deal and post-World War II baby boom, suburbs quickly emerged as the lifeblood of white middle-class and upper middle-class America.\(^1\) Billed as a sanctuary from the office (which was located in a nearby suburban office park\(^2\) or city) where one worked until retirement, the single-family home in an exclusively residential zone became the primary source of housing for the upwardly mobile family.\(^3\) As laws and policies precluded people of color from participating in the promise of suburbanization,\(^4\) government poured billions of dollars into road construction and infrastructure development to support suburban growth. By 1970, bedroom communities had mushroomed in territorial size and the homogeneous populations they housed.\(^5\)

Today, the aims of inclusionary housing are converging with the new realities of both the workplace and consumer housing preferences. This century finds neither viable nor likely the

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\(^1\) Peter W. Rodino Professor of Law, Seton Hall University School of Law. The Author thanks the participants of the 16\(^{th}\) Kravotil Conference on Real Estate Law & Practice for their insights and Timothy J. Paulson for his excellent research assistance.

\(^2\) 1. LIZABETH COHEN, A CONSUMERS’ REPUBLIC: THE POLITICS OF MASS CONSUMPTION 202 (2002). See discussion infra Part I (discussing the systematic de facto and de jure racial segregation that excluded African Americans from the promises of suburban development).


\(^5\) 4. See infra Part I.

\(^5\) 5. COHEN, supra note 1.
prospect of having a life-long job at a blue-chip company and settling down in a nearby single-family home in an exclusively residential subdivision. Demographic trends reveal a growing population of millennials and their successors whose digital conversancy, lifestyles and work routines favor accessibility, flexibility, independence, mobility, environmental conservation and ease of access to work, housing, recreation, goods, services and transportation. Indeed, digital connectivity finds the new and emerging work force just as likely to be doing business at a WeWork facility or local Starbucks as in a traditional office building. Meanwhile, baby boomers are living longer, retiring later and seeking more compact housing in mixed-use centers with some of the same amenities as those favored by millennials. As those who are sixty or older downsize, they are relocating to denser parts of towns that bring a sense of urbanism to the suburbs. Sprawling suburban office parks and shopping malls, now underutilized or vacant, are fast becoming relics of the past.

Simultaneously, the demand for affordable housing remains acute, compounded by rising gentrification, mounting student and consumer debt, escalating housing costs and increasing costs of living. In cities, the last several decades’ cultural preference for urbanism has displaced or shut out low-income residents, as “wealthier buyers and sellers, seeking the same dense, walkable, transit-accessible neighborhoods that lower-income communities sought or were stuck in before then began competing with these communities for limited housing.” As race-based segregation gradually lessens, class-based segregation is growing. Economic housing segregation denies whole segments of the working poor and middle-class the opportunity to reap the benefits that neighborhood

6. See infra notes 86-89 and accompanying text.
7. WeWork is “an American company that provides shared workspaces for rent to service professionals ranging from individual entrepreneurs to large enterprises.” WEWORK, www.wework.com/ (last visited May 14, 2019); see, e.g., Larry Alton, Why More Millennials Are Flocking to Shared Office Spaces, FORBES (May 9, 2017, 3:55 A.M.), www.forbes.com/sites/larryalton/2017/05/09/why-more-millennials-are-flocking-to-shared-office-spaces/#43e0ddf769e8.
9. Joanne Kaufman, Their Ownership Days Are Over, N.Y. TIMES, May 5, 2019, at RE1. In 2017, close to a third of New York City’s rental population was comprised of renters who were sixty or older, a twenty percent jump from 2016. Id.
10. Alanna Schubach, Stop Blaming the Hipsters. Here’s How Gentrification Really Happens, BRICK UNDERGROUND (Feb. 15, 2018, 1:00 P.M.), www.brickunderground.com/rent/what-causes-gentrification-ny.
housing equity can achieve.\textsuperscript{12}

In prime suburban and city locations, the need for affordable inclusionary housing can be met in partnership with the wants of growing populations across all income levels for denser, walkable, mixed-use communities. It is happening in New Jersey, as bustling and inclusionary mixed-use sites in the State’s cities, towns and suburbs are sprouting up on prime properties that once housed shopping malls and suburban office parks. Those tracts are situated near transportation and supported by ample infrastructure already in place. Today they are being transformed into vibrant and efficient multi-use centers that mix residential, commercial and recreational uses with attractive housing opportunities available at both market rate and developer-subsidized rates for those of very low, low and moderate income.

With its decades-old Mount Laurel mandate stridently obliging economically exclusionary municipalities to satisfy their fair share of overall regional needs for low and moderate-income housing, New Jersey finds itself at the forefront of the sort of inclusionary land use reinvention achievable by mixed-use redevelopment.\textsuperscript{13} That redevelopment is providing an opportunity to remediate the wrongs of racial and economic housing segregation and make real the promises of inclusionary zoning. Converting properties that have outlived their utility, it is helping to achieve housing equity as it responds to market demands for more compact multi-use communities. Its emerging model can and should become a basis for national replication.

\section*{II. PART I: ECONOMIC EXCLUSION IN HOUSING}

The legacy of \textit{de facto} and \textit{de jure} race-based housing discrimination that denied African Americans the New Deal’s promise of home ownership continues to shape the harsh realities of housing exclusion today. Laws and policies in place for much of the twentieth century drew maps where “redlines” separated cities and towns into black and white zones.\textsuperscript{14} Franklin Delano Roosevelt’s Federal Housing Authority explicitly denied home-lending to African Americans while dissembling neighborhoods that were integrating organically, relegating displaced African Americans to government housing projects in low-income neighborhoods. It sanctioned the practice known as redlining, whereby housing brokers, agents and developers steered black prospective home buyers and renters into the least desirable zones redlined on Federal Housing Authority maps.\textsuperscript{15} Whites, by contrast, were

\begin{flushleft}
\textsuperscript{12} Id.
\textsuperscript{13} See discussion infra Part II.
\textsuperscript{15} Id. at 62–63.
\end{flushleft}
directed to home-buying opportunities in the prime parts of newly emerging suburbs, towns and cities. In 1968, a national commission charged with assessing the consequences of housing exclusion rendered the damning conclusion that government and social engineering had produced “two societies, one black, and one white – separate and unequal.”

In his acclaimed book, _The Color of Law_, Richard Rothstein details the litany of discriminatory federal and state laws and policies put into place throughout the twentieth century to build the nation’s segregated public housing projects. FDR’s Federal Housing Administration mandated racial separation in housing, denying mortgages to qualifying African Americans and precluding blacks from the promise of homeownership. Government programs such as the “Own-Your-Own-Home” campaign sought to promote homeownership, but only for white families.

Exclusionary zoning regulations were widely promulgated to further ensure that black families would be kept out of white neighborhoods. Economic zoning emerged in the twentieth century to circumvent the U.S. Supreme Court’s 1917 ruling in _Buchanan v. Warley_, which deemed race-based zoning unconstitutional. In that case, a Louisville, Kentucky zoning ordinance forbade “colored” persons from moving into majority-white areas. The Court invalidated the ordinance as a denial of property without due process, ruling that “colored persons are citizens of the United States and have the right to purchase property and enjoy and use the same without laws discriminating against them solely on account of color.” With explicitly race-based zoning thereby impermissible, local governments resorted to economic zoning to achieve many of the same exclusionary ends.

Economic zoning gained its legal foothold with the 1926 Supreme Court ruling in _Village of Euclid v. Ambler Realty_. In that case, the Court deemed it a valid exercise of state and local governments’ police powers for municipalities to enact zoning ordinances to ban apartment buildings and other “less desirable” uses from zones relegated exclusively for single- and two-family homes. The Court found unpersuasive the lower court’s determination that the zoning scheme was impermissible and, if condoned, would “classify the population and segregate them

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16. _Id._ at 63.
17. _NAT'L ADVISORY COMM'N ON CIVIL DISORDERS, REPORT OF THE NATIONAL ADVISORY COMMISSION ON CIVIL DISORDERS_ 1 (1968).
18. _ROTHSTEIN, supra_ note 14, at 60.
19. _Id._ at 62–64.
20. _See id._ at 60.
22. _Id._
23. _Id._ at 78–79.
25. _Id._ at 394–95.
according to their income or situation in life.” Instead, in *dicta* fraught with class bias, the Court likened the apartment building to “a mere parasite,” opportunistically built to take advantage of a residential district’s attractive character.  

Exclusionary zoning all but assured that America’s emerging suburbs would be closed to whole segments of the population. Economic exclusion achieves many of the same results as race-based exclusion because African Americans and Hispanics disproportionately live in poverty.  

First racially segregated by law and then, after passage in 1968 of the Fair Housing Act (hereinafter “the Act”), by *de facto* practices and economic barriers, those suburbs became the lifeblood of white middle-class and upper middle-class America. A haven from the office that was now a modest commute away thanks to the government’s massive investment in supporting infrastructure, the single-family home in exclusively residential, large-lot-size-only zones became the primary source of housing for the white upwardly mobile family. As whites were given a hand up with generous home mortgage opportunities, more and more blacks were forced to remain dependent on public housing built in inner cities.  

The Act aimed to remediate past wrongs by ending race-based housing exclusion. But it did not address economic discrimination in housing, nor did it prescribe where and how fair housing ought to be built. In the decades since the Act’s passage, economic segregation has grown, exacerbated by gentrification, rising housing costs and escalating costs of living. Economic gains have left behind the poor, wage workers and the “middle precariat.” The last forty years have yielded “the gilded age of inequality,” as “the rich have gotten fabulously richer, while the middle class has struggled and more workers have fallen into poverty.”  

The Economic Policy Institute report on the state of working America finds that African Americans suffer the highest rates of poverty (at more than 27 percent and double the national rate at 15 percent), followed closely by Hispanics (at 26 percent) and whites.

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26. Id. at 394.  
29. See Paula A. Franzese & Stephanie J. Beach, Promises Still to Keep: The Fair Housing Act Fifty Years Later, 40 CARDozo L. REV. 1207 (2019) (noting that the Fair Housing Act “aimed to undo the shameful legacy of *de jure* and *de facto* race-based housing discrimination”).  
(at 10 percent). Nearly half (46 percent) of black children under the age of six live in poverty, compared to 14.5 percent of white children. Entrenched systems of disadvantage find that “more than half of black adults raised at the bottom of the income scale remain stuck there as adults, compared to a third of whites.” What is more, in the last 20 years “there has been a 145 percent increase among non-Hispanic whites living in high-poverty neighborhoods.” An “incipient class apartheid” is expanding across the nation, contributing to tears in our social fabric and the erosion of civic life.

Exclusionary zoning denies millions of low-income persons the advantages of neighborhood housing equity. Where one lives determines how one lives, affecting one’s quality of life in countless ways. It ordains one’s range of employment and recreational opportunities and whether one has access to quality health care, good schools, safe water and healthy foods. The segregated poor suffer from higher rates of cancer, cardiac disease, depression and diabetes. Fewer than half of children born into poverty are ready for school at age five, and schools located in low-income neighborhoods are failing their students. By contrast, inclusionary economic zoning has been found to reduce the achievement gap in schools, raise property values, lower crime rates and decrease rates of welfare dependency.

Various state and local governments have advanced initiatives to promote economic inclusion in housing. Massachusetts’ Anti-Snob Zoning Act mandates that at least 10 percent of every city and town’s housing stock be affordable. Maryland’s land use law authorizes counties to promulgate inclusionary zoning ordinances,

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32. See The State Of Working America, supra note 277.
33. Id.
36. PUTNAM, supra note 11, at 39.
38. Kahlenberg, supra note 35, and accompanying text.
award density bonuses and create affordable housing units.\textsuperscript{43} New York City’s recently enacted Affordable Housing Plan requires that new residential developments set aside a percentage of units for those of low- and moderate-income.\textsuperscript{44} But no other state’s foray into the depths and peaks of inclusionary zoning approximates the fits and strides of the New Jersey experience. New Jersey’s 40-plus year and counting \textit{Mount Laurel}\textsuperscript{45} epic provides essential object lessons on what to do (and not do) to effectively advance the salutary aims of housing inclusion.

Today in New Jersey, mixed-use redevelopment of prime suburban properties that have outlived their utility is helping to achieve housing equity. This is its response to demands of growing populations across all income levels for denser and more compact multi-use communities. The sites for redevelopment capitalize on empty or soon defunct properties situated in prime areas with ready access to transportation and ample infrastructure already in place. Today they are being transformed into desirable and efficient multi-use centers that mix residential, commercial and passive uses as well as active recreational uses with housing available across all income levels.

### III. Part II: New Jersey’s Pioneering Social Experiment: \textit{Mount Laurel}

Mount Laurel is a place on the map in southern New Jersey, a sprawling township 22 square miles, or 14,000 acres large. In 1950, it had a population of less than 3,000. It was a primarily low- to moderate-income farming community. Situated close to a network of highways, by the 1960s it found itself the preferred situs for the suburban expansion that marked much of twentieth-century residential development. Within commuting distance to Philadelphia and other cities, Mount Laurel was considered a perfect spot for working baby boomers seeking to lay down roots. So ideal, that by 1970, its population had quadrupled.

To take advantage of the opportunities presented by that growth, in 1964, Mount Laurel changed its zoning laws to spur development of the then-American ideal of the big picket-fenced home in the suburbs.\textsuperscript{46} Commercial, industrial and agricultural uses were now permitted only on one-third of the Township’s acreage on the outskirts of the town. The other more desirable two-
thirds of land was zoned exclusively for single-family, detached homes built on large lots. The new zoning restrictions banned townhouses, apartment buildings and mobile homes. The result: intensive but low-density development affordable only to those of considerable means, with no opportunity for decent housing for the Township's own low- to moderate-income population.47 Those who worked in Mount Laurel, for the large part, could no longer afford to live there.

Residents whose families had lived and worked in Mount Laurel for generations found themselves displaced. Their appeals for inclusion were met with outright hostility. At a 1970 meeting held at an African American church in the town, then Mayor Bill Haines said in response to calls for affordable housing: "If you people can't afford to live in our town, then you'll just have to leave."48

With its 1975 groundbreaking ruling in Southern Burlington County NAACP v. Mount Laurel,49 the New Jersey Supreme Court issued a stern retort. Transforming what was brought as a race-based discrimination case into one of economic discrimination, the court ruled that the state constitutional guarantees of due process and equal protection require that Mount Laurel, and indeed every one of the State’s developing municipalities, satisfy their fair share of the present and prospective regional need for low- and moderate-income housing.50 Well ahead of other states’ efforts to promote economic inclusion in housing, the court understood that economic exclusion is racial exclusion. What is more, by casting the inclusionary mandate in terms of economic fair housing, its ruling could extend broadly to all working poor and moderate-income populations. Mindful of “the advanced view of zoning law as applied to housing laid down by this opinion,”51 the court left it to the coordinating branches of state and municipal government to vindicate the mandate without judicial supervision.52

While heralded as the case that could undo the economic segregation wrought by exclusionary zoning, little changed after the ruling was announced.53 Few units of affordable housing were built, while zoning laws that precluded economic diversity in housing remained in place. Not a single unit of low- and moderate-income housing was built in Mount Laurel itself.54

49. S. Burlington Cty. NAACP, 336 A.2d at 720.
50. Id. at 724–25.
51. Id.
52. Id. at 734.
54. Mount Laurel’s first inclusionary units were not built until the year 2000, with the opening of the Ethel Lawrence Homes. See Douglas Massey,
The vociferous and organized opposition to the Mount Laurel mandate invoked the “not in my backyard (NIMBY)” pathos to considerable ill effect. Suburban residents equated the prospect of affordable housing opportunities with gang activity, criminality and blight. Town Council meetings on the inclusion of affordable housing provoked comments like, “It will be a breeding ground for violent crime and drug abuse,” and protests of “reverse discrimination.” Affordable housing advocates suffered threats and violence. Ethel Lawrence, a low-income African American resident and leading advocate, had gunshots fired into her home and endured repeated vandalism.

Throughout the State, municipalities recoiled at the prospect of having to open their doors to low- and moderate-income residents. As is often the case, much of the resistance to economic integration was invoked under the banner of home rule, homeowner privilege and taxpayer rights. But antagonism toward affordable housing is a product more of prejudice, ignorance, fear and false characterizations about the poor and those of lesser means. Those fears are refuted by data and experience.

Poverty is not a pathology. Conclusions to the contrary misunderstand the complexities that conspire to all but assure entrenched systems of economic subjugation. This as widening chasms between the affluent and those just getting by (including the increasing “middle precariat”) continue to grow and upward mobility becomes more illusion than fact. Still, biases based on income and wealth die hard. At town council meetings across New Jersey and elsewhere, one finds residents and elected officials eager to trot out the standard tropes that affordable housing will bring increased crime, drugs, neglect and diminished property values. This compelling data shows that those fears yield to the facts of

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55. KIRP, supra note 48.
56. Id.
58. Lily Geismer & Matthew D. Lassiter, Turning Affluent Suburbs Blue Isn’t Worth the Cost, N.Y. TIMES, June 9, 2018, at SRT.
59. See MASSEY ET AL., supra note 41, and accompanying text.
60. See QUART, supra note 30, at 1224 (detailing the middle-class fall).
housing inclusion and its capacity to redound to the benefit of all residents.\textsuperscript{62}

In response to the defiance that followed its first ruling, in 1983 in \textit{Mount Laurel II}\textsuperscript{63} the New Jersey Supreme Court was determined to put some steel into its affordable housing mandate. There, in a stern rebuke, the court stated:

After all this time, ten years after the trial court's initial order invalidating its zoning ordinance, Mount Laurel remains afflicted with a blatantly exclusionary ordinance. Papered over with studies, rationalized by hired experts, the ordinance at its core is true to nothing but Mount Laurel's determination to exclude the poor. Mount Laurel is not alone; we believe that there is widespread non-compliance with the constitutional mandate of the original opinion in this case.\textsuperscript{64}

The court added, "We may not build houses but we do enforce the Constitution."\textsuperscript{65} To do that, the case introduced a series of bold policy prescriptions and remedies intended to compel meaningful local compliance with the directive to provide low- and moderate-income housing.\textsuperscript{66} Those included the "builder's remedy," a judicial remedy that gave incentives to builder-developers to challenge townships for failure to meet the fair share mandate. Successful suits awarded the builder the opportunity to build housing at higher densities than otherwise permitted, provided that a designated percentage of units built were subsidized by the builder and set aside for those of low- and moderate-income.

The builder's remedy litigation that quickly followed sparked a resolve to get the courts out of the business of land use planning. Hence, in 1985 the New Jersey legislature enacted the Fair Housing Act (FHA).\textsuperscript{67} That statute created the Council on Affordable Housing (COAH), an administrative agency to replace the courts in implementing the \textit{Mount Laurel} mandate. In \textit{Mount Laurel III},\textsuperscript{68} noting its preference for legislative and executive action to vindicate the intent of its rulings, the New Jersey Supreme Court sustained the FHA's constitutionality.\textsuperscript{69}

Vested with broad powers, COAH was responsible for determining municipalities' fair share obligation of the state and regional need for affordable housing and promulgating rules to

\begin{itemize}
\item \textsuperscript{62} See MASSEY ET AL., supra note 41 (detailing the benefits of affordable housing development in Mount Laurel Township). Mount Laurel raised its tax base, saw higher achievement for its school-age children, a significant decline in welfare dependency and preservation of property values. \textit{Id}.
\item \textsuperscript{63} S. Burlington Cty. NAACP, 456 A.2d at 410.
\item \textsuperscript{64} \textit{Id}.
\item \textsuperscript{65} \textit{Id}.
\item \textsuperscript{67} N.J. STAT. ANN. §§ 52:27D-301–29 (2019).
\item \textsuperscript{68} Hills Dev. Co. v. Bernards, 510 A.2d 621 (N.J. 1986).
\item \textsuperscript{69} \textit{Id} at 632.
\end{itemize}
assure local government compliance with the obligation. Still, the FHA gave COAH considerable discretion to approve townships' efforts to buy their way out of the Mount Laurel duty by transferring up to fifty percent of the given municipality’s affordable housing obligation to a designated receiving municipality to use to build affordable housing within their borders. 70 In considerable part, receiving municipalities were found in older urban areas within New Jersey.

Those so-called Regional Contribution Agreements or RCA’s, which could have helped the task of urban revitalization, largely failed due to improper management and oversight. What is more, the concept itself frustrated the primary aims of economic integration and the creation of affordable housing opportunities in municipalities otherwise closed to whole segments of the population. Other statutory mechanisms contained in the FHA promoted understatement of the true extent of qualifying municipalities’ fair share obligation by using as pretexts the statute’s allowance of downward reductions in fair share for reasons that included promotion of open spaces, recreational and agricultural areas and the preservation of historic areas. Once again, delay became a principal tactic to avoid the inclusionary housing imperative, and the suburbs’ doors remained closed to affordable housing.

COAH was obliged by the FHA to adopt regulations establishing a fair share formula for municipalities to calculate their respective affordable housing obligations. The enabling legislation included procedures for townships to petition COAH for “substantive certification,” which if granted would shield them for a designated period from future Mount Laurel challenges. COAH promulgated those so-called “Round One” regulations in 1986. Those provisions contained a fair share formula and included allowances for municipalities to rezone sites suitable for inclusionary housing for higher densities if those new developments set aside at least twenty percent of units for those of low- and moderate-income. Problematically, COAH was without a means to compel municipal compliance with fair share mandates. Moreover, it allowed RCAs to go forth without adequate oversight and, with its Round One regulations, added opportunities for townships to further reduce their assessed fair share on such grounds as “insufficient land.”

In 1994, COAH announced its Round Two regulations. Again, those made allowance for downward adjustment of fair share based on what was now called “realistic development potential” or “RDP.” COAH deemed the difference between allocated fair share and RDP “unmet need.” Now, unmet need would not be forgiven as it had been under the Round One scheme. Still, fulfillment of the assessed

unmet need was not mandatory, once again rendering those needs inadequately addressed.

Third Round regulations were promulgated in 2004. Some of those rules were subsequently invalidated by the courts as inadequate to assure vindication of fair share obligations. In 2008, COAH finally approved new Third Round rules which suffered from many of the same deficiencies and loopholes that rendered their earlier iteration invalid. Not surprisingly, in 2013 those new Third Round rules were invalidated by the New Jersey Supreme Court. Frustrated by the delays and inadequacies of the regulatory scheme, the court forcefully sought to spur “a new affordable housing approach.” Rules to govern the third round cannot wait further while time is lost during legislative deliberations on a new affordable housing approach. A remedy must be put in place to eliminate the limbo in which municipalities, New Jersey citizens, developers and affordable housing interest groups have lived for too long.

Once more, the court deferred to COAH to finally arrive at a regulatory scheme able to remediate past inadequacies and the harms imposed by delay. Meanwhile, New Jersey had elected a governor strenuously opposed to the very Mount Laurel mandate itself. Thereafter, the state Supreme Court, frustrated by COAH’s failure to adopt appropriate Round Three regulations, issued its ruling in Mount Laurel IV declaring the agency “moribund.” Decided in 2015, in Mount Laurel IV the court deemed COAH no longer equipped to process municipalities’ petitions for substantive certifications. The court determined that COAH’s functions would now be performed by fifteen designated trial court judges (one in each of the State’s vicinages) and left it to those judges to develop specific formulas to calculate third round affordable housing obligations, overall regional need and qualifying municipalities’ fair share responsibilities.

73. Id. at 917.
74. Id.
75. Colleen O’Dea, Christie’s No Friend to Housing for Poor and Middle-Income New Jerseyans, N.J. SPOTLIGHT (May 6, 2015), www.njspottlight.com/stories/15/05/05/christie-s-no-friend-to-housing-for-poor-and-middle-income-new-jerseyans/.
The judges who now oversee municipal compliance with the *Mount Laurel* mandate are assisted by a Special Master. The Special Master is a professional planner tasked with overseeing and monitoring municipal compliance and mediating settlements between the Fair Share Housing Center and municipalities alleged to be non-compliant with the inclusionary housing mandate. When settlement talks fail, the given challenge is heard by that vicinage’s judge tasked with presiding over *Mount Laurel* litigation.

In 2017, the court reaffirmed the state constitutional obligation imposed on economically exclusionary towns to add to stocks of low- and moderate-income housing within their borders and redress deficiencies in existing stocks, approving mandatory set-asides of 15 percent for residential rental development projects of five or more units and 20 percent set-asides for projects which include for sale units. In return for making those affordable housing subsidies, developers are awarded density bonuses that can assure “a reasonable profit” on their investment. What is or is not “a reasonable profit” is the subject of fierce debate during mediation and, when mediation fails, litigated in court. Municipalities seek to keep added density to a minimum to avoid the burdens on essential services. Developers in turn aim to drive up density awards to widen profit margins. Mindful of the burdens that additional density can impose, the New Jersey Supreme Court for now has left it to the state legislature to determine an effective response. Indeed, in its 2017 ruling the court noted once again, “We recognize, as we have before, that the Legislature is not foreclosed from considering alternative methods for calculating and assigning a municipal fair share of affordable housing, and to that end, we welcome legislative attention to this important social and economic constitutional matter.”

While townships, developers and affordable housing advocates continue to wrestle with fair share obligations, public interest advocacy groups and most notably the Fair Share Housing Center have used the *Mount Laurel* mandate and the courts’ willingness to zealously enforce it to some good effect. To date, approximately 65,000 units of low- and moderate-income housing have been built in New Jersey. Compelled to comply, towns like Mount Laurel that

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81. Id.


previously had shut their doors to low- and moderate-income housing are gradually realizing part of the inclusionary housing mandate.\textsuperscript{84}

Still, because of loose interpretations of the Mount Laurel regulations and developer shortcuts, affordable units built during the decades of COAH ineptitude and municipal resistance could be constructed in separate, less desirable parts of residential subdivisions. The regulations provide that inclusionary development should be consistent “with the mandate of the Fair Housing Act regarding unnecessary cost generating features.”\textsuperscript{85} That clause could be employed by developers to legitimize the use of cheaper construction materials, appliances, landscape design and interiors for the inclusionary units. As a result, the very aims of inclusion could be frustrated, with “us/them” lines drawn into the lesser quality and fringe locations of the affordable housing that was built.

With COAH’s dissolution, strict judicial oversight is once again putting some steel into Mount Laurel’s mandate. What is more, market forces and changing demographics are conspiring to make realization of the letter and spirit of that mandate a more hopeful prospect. The promise of economically integrated housing finds ready ground as part of the mixed-use reinvention of prime but now underutilized properties. Those tracts are mixing residential, commercial and recreational uses to create vibrant and inclusionary domains in desirable places previously closed to all but those of considerable means.

IV. PART III: THE RISE OF MIXED-USE REDEVELOPMENT AND THE PROMISE OF INCLUSION

Mixed-use redevelopment projects are providing opportunities for cities and towns to breathe new life into dormant properties in prime locations \textit{and} meet fair share requirements for inclusionary housing. Their success to date demonstrates that economic integration may well be achievable as cities and towns engage in the task of reinvention. That reinvention is responding to shifting demographic preferences as it advances the moral and legal imperative to provide economically integrated fair housing opportunity.

Today’s housing preferences favor environmentally sensitive, walkable places to live near work, shopping, recreational areas,

\textsuperscript{84} Id.; see also MASSEY ET AL., supra note 41 (explaining how, as result of inclusionary housing, Mount Laurel raised its tax base and saw higher achievement for its school-age children, a significant decline in welfare dependency and preservation of property values).

parks, restaurants, coffee shops and even sporting venues. Millennials, Gen X and downsizing baby boomers are the largest market drivers here, with millennials leading in home purchases. Concurrently, baby boomers are living longer, retiring later and looking for more compact housing in multi-use centers with the same sorts of features as those favored by younger groups. As those who are sixty or older downsize, they are relocating to denser parts of towns that bring a sense of urbanism to the suburbs.

This as the need for affordable housing continues to rise. New Jersey ranks among the most expensive places to own or rent. Last year, Crossroads New Jersey, a not-for-profit public interest advocacy group, reported that only twenty-nine affordable dwellings are available for every one hundred families making less than 30,000 dollars a year. New Jersey's rents have spiked to the sixth most expensive in the United States. Recent reports conclude that “[m]ore than 343,000 of New Jersey’s 1.1 million tenant households spend at least half of their pre-tax income on rent and utilities,” a percentage exceeded only by Florida. Economic exclusion persists throughout whole swaths of the State, rendering...
New Jersey still “one of the most segregated states in the country.”

As housing costs become increasingly prohibitive, demands for affordable housing are growing across all age groups and demographics. Saddled with significant student and consumer debt and hindered by wages that are not keeping up with rising costs of living, millennials find themselves priced out of housing markets. A recent National Association of Realtors study found that while vast numbers of millennials are reaching home-buying age, fewer can afford a starter-home than those of previous generations at a comparable age. Nationally, prices for starter homes are up by 57 percent as upwards of 45 million Americans reach first-time home-buying age in the next 10 years. At the same time, dwindling pensions and disappearing retirement benefits are contributing to a rise in senior poverty. Today, more than two million women over the age of 65 live at or below the poverty line. A recent study concluded that women, and particularly women of color, “are more likely to age into poverty than men.”

Rising housing costs, mounting debt service and escalating costs of living find many Americans just one paycheck or medical bill away from financial insecurity. “Us/them” lines drawn by income and wealth are blurring as “the other” – the economically insecure – become not “them” but “me.” The growing universality of the need for economically inclusionary places to live suggests that YIMBY – “yes, in my backyard” – may well replace the NIMBY protests that have marked much of inclusionary zoning’s fraught history.

Mixed-use redevelopment readily aligns with both the imperative that cities and towns provide economically integrated housing and with the desire of growing populations across all economic strata for denser, compact multi-use communities. That redevelopment is transforming desirable suburban and urban tracts that once housed single-use sites like massive office parks and shopping malls. Today, those are largely becoming relics of history. Whether vacant, underutilized or abandoned, in many aspects, they have outlived the conditions that prompted their very creation. Yet the properties on which they were built are prime real estate,

96. See Nadia Evangelou, Where is the Workforce Moving?, NATL Ass’N REALTORS (Aug. 6, 2018), economistsoutlook.blogs.realtor.org/2018/08/06/where-is-the-workforce-moving/.
97. Id.
99. Id.
surrounded by essential infrastructure and situated close to transportation hubs and major roadways. Initially zoned only for commercial uses, those properties are ripe for reinvention responsive to the changing demographics, lifestyle-related and work-related preferences of the contemporary marketplace and the need for affordable housing.

In New Jersey, mixed-use inclusionary redevelopment is reinventing those spaces to render them accessible places to work, play and live. Those emerging multi-use centers are melding residential, commercial and recreational uses in economically inclusive ways. Empty or underutilized single-use subdivisions, office parks and malls that sit in prime suburban and city locations today have the potential to become economically integrated centers. Fair share housing obligations are being met as low- and moderate-income housing is woven into the fabric of these emerging sites. As a result, Mount Laurel’s future is looking brighter. With effective planning and watchful courts, suburbs and towns once designed to exclude whole segments of the population may finally be opening their doors.

For example, located close to New York City, townships in Bergen County, New Jersey have long ranked as among the most economically exclusionary in the State, with vastly poorer towns “just a stone’s throw away.”  

Today, desirable places throughout the county are transforming into mixed-use town centers that meet affordable housing obligations. Within the county, Garden State Plaza (New Jersey’s largest mall) is transforming as part of its developer’s strategy to achieve “concentration, differentiation and innovation.”

The mall’s operator recently announced that “[a]partments, offices, public parks, additional shopping and dining, and a transit center are all part of a multi-year redevelopment plan that would make the 2.1 million square foot shopping center a ‘modern-day town center for Bergen County.’” The residential neighborhood within the development will feature “tree-lined streets and a promenade. A public park will be a centerpiece and lead to an open-air plaza and adjoining fields.” The development will include recreational centers, workplaces, restaurants, coffee

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102. *Id*.

103. *Id*. 
shops and retailers.

Originally built during suburban development’s heyday with its attendant investment in supporting infrastructure, the mall is already located at the intersection of major roads and highways. The new plans include the addition of a public transportation hub on site. The redevelopment falls within the property’s recent re-zoning which now renders it mixed-use. The re-zoning was implemented to facilitate attainment of Mount Laurel’s inclusionary housing mandate.\textsuperscript{104}

In Monmouth County, New Jersey, redevelopment aims to transform a now-vacant strip mall in a prime shorefront community into a mixed-use center that includes apartments, shops, parks and entertainment facilities.\textsuperscript{105} Similarly situated at the intersection of key roads, the redevelopment plans to include a half-dozen environmentally friendly low-rise residential buildings comprised of one- and two-bedroom condominium apartments. That construction design includes low- and moderate-income units.

North American Properties, a Cincinnati commercial real estate firm focused on mixed-use developments since 2010, has its sights set on renovating 418 acres of waterfront property in Sayreville located in Burlington County, New Jersey.\textsuperscript{106} The developer deems the project the “next-generation, mixed-used development, placing ‘heart share over market share’ in creating America’s next great hometown.”\textsuperscript{107} The project, called “Riverton,” is scheduled to create a 2.5 billion dollar community that mixes residential, retail, entertainment, office, hotel and recreational uses on more than two miles of waterfront, making it the largest mixed-use project in the State.\textsuperscript{108} Riverton will include market-rate, as well as low- and moderate-income single-family and multi-family housing,\textsuperscript{109} together with retail options across all price points.\textsuperscript{110}

In Holmdel, New Jersey, what was once Bell Labs’ sprawling (but then defunct) suburban office park has been transformed into a vibrant multi-use center.\textsuperscript{111} Now a bustling city-like center within

\textsuperscript{104} Id.
\textsuperscript{107} Id.
\textsuperscript{108} Id.
\textsuperscript{109} Susan Loyer, $2.5 Billion Waterfront Project will Create Town Within a Town in Sayreville, MY CENT. JERSEY (Mar. 16, 2018), www.mycentraljersey.com/story/news/local/development/2018/03/16/riverton-waterfront-project-sayreville/422849002/.
\textsuperscript{110} Id. (quoting North American Properties partner, David Weinert: “We’re going to have everything from off price, value, big box, theater, food hall, market, gym and electronics. We are going to cover all areas of merchandise”).
\textsuperscript{111} Chris Matthews, The Reincarnation of Bell Labs, FORTUNE (Feb. 2,
the suburb of Holmdel, the repurposed and renamed Bell Works is referred to on the tract’s website as a “metroburb.” The property was once the standard-bearer for the twentieth-century single-use suburban corporate office campus. Having outlived its purpose, when the site was purchased in 2013 it was vacant and in declining condition. Today the thriving two million-square-foot center boasts a public library, a range of corporate tenants, offices, more than 20 shops and restaurants and two markets. The development includes a nearby 280-unit apartment building that integrates Mount Laurel units throughout.

Scores of similar mixed-use redevelopment projects are changing New Jersey’s exclusionary housing landscape for the better. Thanks to the judiciary’s unyielding resolve to enforce the inclusionary housing mandate, changing market preferences for housing and lifestyle and the opportunities for reinvention presented by vast, once bustling spaces left behind by those market shifts, New Jersey is finally realizing the Mount Laurel mandate. Mixed-use inclusionary redevelopment is transforming vacant, abandoned and underutilized properties into vibrant, state-of-the-art centers. The redevelopment redounds to the benefit of the environment, developers, municipalities, local taxpayers and, most essentially, the State’s residents.

The projects underway are equipped with energy-efficient infrastructure, LED lighting and improved stormwater management systems. Many are designed in accordance with exacting LEED standards. Redevelopment is taking place on disturbed parcels already covered with buildings and impervious surfaces, thereby allowing for the preservation of more pristine and undeveloped areas of the State. Local taxpayers are poised to reap

2015), fortune.com/2015/02/02/bell-labs-real-estate-revival/ (outlining the changes of Bell Labs from a research laboratory to a new multipurpose center).

112. BELL WORKS, bell.works (last visited May 15, 2019).


116. Leadership in Energy and Environmental Design (“LEED”) is the most widely used green building rating system in the world. See What is LEED, U.S. GREEN BLDG. COUNCIL, www.usgbc.org/help/what-leed (last visited May 14, 2019) (explaining the requirements of LEED and its standards). Available for virtually all building project types, from new construction to interior fit-outs and operation and maintenance, LEED provides a framework that project teams can apply to create healthy, highly efficient, and cost-saving green buildings. Id. LEED certification is a globally recognized symbol of sustainability achievement. Id.
the benefits of an enhanced municipal tax base as previously vacant or underutilized sites are reassessed based on their revivification.

Affordable housing units are an integrated part of these emerging neighborhoods. Residents of very low-, low- and moderate-income are not merely living on the same floor or next door to market-rate residents. Irrespective of income level, all residents have access to the same community, with its nearby schools, places to work, shop, eat, play and, simply, interact. The benefits of housing equity are given the chance to accrue as mixed-use redevelopment becomes neighborhood-level integration. People prosper when given the opportunity to reap the advantages of quality education, desirable housing, safer neighborhoods and the advantages otherwise afforded only to those of greater means. So does civic life.

V. CONCLUSION

Innovative mixed-use redevelopment has emerged as a promising land-use model that is transforming vacant and underused single-use properties into thriving mixed-use residential and commercial communities. More significantly, mixed-use redevelopment offers an opportunity to remediate the wrongs of economic housing segregation and make real the promises of inclusionary zoning. Indeed, it provides a platform on which to reinvent the ways in which inclusionary housing can achieve neighborhood integration. Mitigating the exclusionary consequences of rising housing costs and neighborhood gentrification, it provides opportunities for the poor and those of modest-income to live, work and play in higher-income neighborhoods where NIMBY had long denied access. With its Mount Laurel mandate stridently in place, New Jersey is leading the mixed-use redevelopment movement to reimagine its small-town centers, cities and suburbs while advancing the long overdue attainment of housing equity.

Fair and inclusive housing opportunities are intrinsic to the cause of human dignity. Where we live deeply affects the determinants of how we live and the very quality of our lives. When exclusionary zoning bars entry to whole segments of the population because of income, social and economic costs are imposed on all. We share a collective destiny, but when denied proximity to each other because of how much or how little we have, we forget that what we do to the “other” we do to ourselves — that forgetfulness tears at the fabric of civic life and the very promise of democracy.

Without proximity to each other, we are without a basis to

117. See Rick Jacobus, In Defense of the 'Poor Door', SHELTERFORCE (Oct. 14, 2015), shelterforce.org/2015/10/14/in_defense_of_the_poor_door/ (stating housing equity is best achieved by integrating neighborhoods).
understand that no matter our differences we all want a better life for our children, dream the same dreams and hope to awaken from the same nightmares. It is indeed difficult to hate from up close. But from a distance, it is easy to submit to the delusion that the burdens we carry somehow relieve us of the responsibility to know the struggles endured by others. That veil of ignorance, in turn, denies us our innate capacity for empathy. It is then that we decide to live only for ourselves. Pernicious strands of narcissism have infected all spheres of engagement, contributing to divides of class, race and politics that taken to their extreme come with a once unimaginable price – the soul of our nation.

We can do better. Economic fair housing is achievable. As New Jersey’s *Mount Laurel* experience shows, courts can meaningfully advance the aims of inclusionary zoning no matter the logjams of the coordinating branches’ dysfunction and class-based biases that die hard. What is more, significant demographic shifts and changing suburban landscapes present ripe opportunities to vindicate those aims through mixed-use economically inclusive redevelopment. The redevelopments’ integrative designs seamlessly incorporate low- and moderate-income housing without separation or stigma.

Using the prime spaces that once were home to shopping malls and sprawling office parks, New Jersey has allowed re-design necessity to spark mixed-use redevelopment reinvention. Against the backdrop of firm judicial mandates to make low- and moderate-income housing a part of that reinvention, fair share obligations are being met in ways that redound to the benefit of all. In view of *Mount Laurel’s* fraught history of defiance and delay, the reinvention of inclusionary mandates that is now underway here is cause for considerable optimism. It is not merely possible to undo the harmful legacy of exclusionary zoning and economic segregation in housing. It is a moral and legal imperative.
IDEAS

Fixing America’s Forgotten Places

Opportunity Zones, created by Trump’s tax law, are meant to help the heartland thrive and make the country more equal—but can they pull it off?

JULY 24, 2018

Annie Lowrey
Staff writer at The Atlantic

FRESNO, Calif.—Census tract 06019000100 has a lot going for it. Locals cheer the melting-pot atmosphere, the arts scene, the nearby nature, and the affordable housing—affordable in national terms, which feels all the more amazing given that it is a quick drive both to the grandeur of Yosemite and to the tech hub of the Bay Area. Start your car up and grab a coffee here at
9 a.m., and you could be standing in downtown San Francisco or in front of Apple’s headquarters by noon.

For all that, though, this tract has its problems. There is the stifling summer heat, the poverty, and the pollution. Technology companies have not flooded into the area like they have in the Bay and in Reno, and the city faces underinvestment and blight. Roughly two-thirds of the families in 06019000100 live below the poverty line. The surrounding county is economically depressed too, with an unemployment rate above 8 percent, one of just a handful of places nationally where that is still true. Moreover, the income gap between households in Fresno County and Santa Clara County, where Apple is headquartered, has widened in the past 10 years.

[The Poverty Just Over the Hills From Silicon Valley]

Still, Fresno is a place that feels on the cusp, as if just a little more investment, a little more infrastructure, and a little more spit and elbow grease might help it thrive. It has what a real-estate broker might call “good bones,” with plenty of
lower-cost real estate and highway saturation. It has a steady supply of educated workers, by virtue of being home to Fresno State, among other schools. And it has a powerful industrial base, in terms of agriculture as well as in other industries. “If you are a company that is looking at having a West Coast presence, especially a distribution or an e-commerce center, there’s no better place than Fresno County right now,” said Lee Ann Eager, the president of the Fresno County Economic Development Corporation (motto: “Living the California dream”).

That little nudge might just be forthcoming. A provision slipped into the Trump administration’s sprawling tax bill aims to transform places like census tract 06019000100 by luring private dollars to them. In Opportunity Zones, as they are called, investors will receive huge tax breaks for building office parks, warehouses, housing, grocery stores, and the like, helping to ease poverty and end blight in distressed communities. Despite being not much more than a remainder in the
legislation, economists believe it
could end up becoming the biggest
place-based economic-development
policy the federal government has.

“The key factors that have led to our
uneven recovery are education,
infrastructure, and workforce
development. Can I address those
three pillars by putting a target, a
positive target, on distressed
communities? Can I address those
three issues and make a profit [as an investor] while also doing good?” said
Senator Tim Scott, the South
Carolina Republican who sponsored
the provision, sitting in his Capitol
Hill office—that’s census tract
11001008200. “The answer is yes.”

The answer to whether the
Opportunity Zone designation might help places like Fresno might indeed be yes: Mayors and economic-
development officials are enthusiastic about the initiative and scrambling to figure out how to capitalize on it, as are real-estate investors and developers. But economists argue that it looks unlikely to help revitalize the country’s most distressed communities—Flint and Detroit, the Mississippi Delta and Appalachia,
Toledo and Youngstown—and that it looks likely to supercharge investment in places that were already growing. That means the provision might intensify the very regional inequality it seeks to remedy.

This is the dilemma posed by pursuing public policy with private capital. Leveraging the efficiency of markets will undoubtedly help many places on the margin. But it might take far more creative investment to truly solve the country’s worst-off communities and fix its growing problem of place.

[The Economic Recovery’s Geographic Desparities]

Since the 1840s, America has become a more equal place—or, more to the point, places in America became more equal. The South caught up with the North. Electrification, the rise of the car and truck, the development of the highway system, the growth of manufacturing, and the federal government’s enforcement of antitrust statutes spread prosperity around the country. Aided by the Great Society and the New Deal, the middle class grew, everywhere from
Winnetka to Orlando to Humboldt.

As Phillip Longman noted in this magazine, the disparities in per-capita income across the different states shrank through the 1980s.

Then, something changed. The differences in per-capita and median income between states started growing again. Average incomes in big cities, in particular hubs such as San Francisco; Washington, D.C.; Chicago; Seattle; and New York, soared. Average incomes elsewhere stagnated. The recovery since the Great Recession has only aggravated these trends, with rural employment and earnings actually falling in the postrecession years in many places.

The average income in census tract 060081600115, in Atherton, California, is $250,001. The average income in census tract 060064680028, in Mendota, California, is 20 times smaller.

The problem of place seems particularly acute in the South and the Rust Belt, away from the vibrant, expensive coasts and the low-unemployment agricultural and oil-and-gas heartland. As the Harvard economists Edward Glaeser,
Lawrence Summers, and Benjamin Austin have noted, roughly half of men ages 25 to 54 in Flint, Michigan, are not working, versus just 5 percent in Alexandria, Virginia. “America’s social problems, including non-employment, disability, opioid-related deaths and rising mortality, are concentrated in America’s eastern heartland, states from Mississippi to Michigan, generally east of the Mississippi and not on the Atlantic coast,” they wrote. “The income and employment gaps between [the coasts, the heartland, and the eastern interior] are not converging, but instead seem to be hardening into semi-permanent examples of economic hysteresis.”

That growing regional inequality has had profound political effects, with trade-driven economic dislocations driving politically moderate representatives from office and leading to increasing polarization in a number of swing states, including Michigan, Ohio, and Pennsylvania. Economic anxiety might not have won Donald Trump the White House, but much of his strongest support came from more sclerotic rural and industrial areas. Thus,
With the tax bill in the works, Tim Scott saw an opportunity. The Economic Innovation Group (EIG), a Washington, D.C.-based think tank and advocacy organization, helped him revive a provision encouraging private investment in distressed communities. (It was based on a white paper written by Jared Bernstein, who was Vice President Joe Biden’s chief economist, and Kevin Hassett, now the chair of Trump’s Council of Economic Advisers.) States would nominate distressed places as Opportunity Zones, Treasury would certify them, and investors would create special funds to invest in them, receiving a rich variety of tax deferrals, deductions, and exclusions for doing so.

Senator Cory Booker—a New Jersey Democrat, a likely 2020 presidential candidate, and a longtime resident of
Newark, one of the most perpetually distressed communities in America—joined Scott in pushing for it. The law “will move capital off of the sidelines into places that haven’t been getting it, like the three in five distressed communities that have seen job losses between 2011 and 2015, while the country as a whole added 10.7 million jobs,” he told me. (Both Booker and Scott got their political start in municipal government, a fact which may help explain their shared interest.)

The provision was not a big one, not given the trillion-dollar sweep of the Trump tax legislation. The Joint Committee on Taxation has estimated that it would cost just $1.6 billion over the next 10 years (though the legislation is structured so that investors might realize most of their taxes outside the 10-year budget window). Still, the flexible structure of the new tax law and the accounting creativity of the country’s real-estate developers have led economists to anticipate that the provision might cost tens of billions of dollars in the near future.
Opportunity zones are meant to be Goldilocks-type places: not so distressed that no amount of government incentive would induce private money to them, not distressed but gentrifying and thus already seeing a flood of private money coming in. “It’s not the economically very-worst-off places,” said John Lettieri, the president of the Economic Innovation Group. “It’s obvious that in many cases those areas are not today capable of attracting private investment. Their needs are first-order needs.” He added: “You also don’t want to choose at the higher end in terms of opportunity, because you don’t want to choose places that are on the kind of inevitable upswing. They’re already experiencing rapid change. They don’t need this as an incentive tool.”

Across the country, states, mayors, and development officials have scrambled to identify those in-between places and figure out how to shepherd the private dollars that might get spent in them. Stephanie Copeland, the executive director of the Colorado Office of Economic Development and International
Trade, said the state built an index to identify places where private investment would be “highly catalytic.” She told me: “We looked at classic measures of distress, in terms of unemployment and poverty. We also looked at distance from the core of the state. Then we looked at assets that you had.” With that information, it chose to designate more rural areas, excluding more urban ones already on a clear upswing.

In Rust Belt communities, on the other hand, Opportunity Zones might help draw investment to neglected urban cores. “In Northeast Ohio, we’ve lost 7 percent of the region’s population since 1970. But we’ve greatly expanded our developed footprint—we’ve built more roads and more houses and more pipes and everything, with a shrinking population,” said Jason Segedy, who works on economic development in Akron, Ohio. “A lot of our issue is making the city more competitive with the suburbs and gradually getting at least more of a level playing field in terms of opportunities for new residents.”
Some localities were looking to create nonprofit or public-private partnerships and to use zoning and other local regulations to shape investment. In Fresno, for instance, a focus is on low-income housing. “The cost to build here in Fresno is 98 percent of the cost to build in San Francisco,” Preston Prince, the executive director of the Fresno Housing Authority, told me. “Yet our rents are our incomes and our rents are one-third of San Francisco’s. We don’t have the income, and we don’t have the philanthropic or government support at the local level to build. We just don’t have that same wealth.” He said he was cautiously optimistic about the response he had gotten from local developers about using the Opportunity Zone provision to finance new units.

But economists have proven more circumspect than developers and politicians. “We do have a lot of experience in the design of place-based policy and we have learned a fair amount over time about how these things work,” said Adam Looney, a former Treasury economist now at the Brookings Institution.
“There are several lessons from that that seemed to have been ignored or overlooked in the construction of this policy, things that make me concerned that the policy will not be effective.”

For one, economists argue that those very, very distressed communities are where the government gets the biggest bang for its buck—the ones where the need is greatest and the opportunity for change the biggest. “You’re the only one doing investment there, so you’re not crowding out activity that would have occurred anyway,” Looney said, pointing to evidence from the Low-Income Housing Tax Credit program. Moreover, investments in such places tend to have stronger spillovers, raising the status of whole neighborhoods and communities.

“When you build low-income housing in a really tough neighborhood, it improves the quality of the neighborhood, it helps you reduce crime, and it improves other people’s property values,” Looney went on. “It seems to have these other, positive benefits.”

Experts also anticipate that a kind of
perverse Goldilocks effect might take hold in Opportunity Zones, with all of the cash flowing into the too-hot places. There are Opportunity Zones in fast-gentrifying Northeast Washington, D.C. Or consider the inclusion of census tracts in Oakland, California, where rental-housing prices have increased more than 50 percent in just the past five years. “We aren’t concerned that it’s not going to help—we’re concerned it’s going to hurt,” said Paulina Gonzalez, the executive director of the California Reinvestment Coalition, which has publicly pushed back on the Opportunity Zone initiative as structured. “This is a result of a foreclosure crisis where you pushed people into rentals where we’re now adding an added layer of for-profit incentive.”

Another concern is that Opportunity Zones might simply shuffle investment around from place to place, rather than increasing the overall level of investment. Or that private-equity firms and property developers will use the Opportunity Zone designation for investments they would have made anyway. Or that real-estate investors will
manipulate the program into a giveaway and then lobby for its extension and expansion, even if there is evidence it does not work.

PRIVATE-EQUITY FIRMS and property developers:
Ultimately, those are the key architects of the provision, the ones that stand to reap the most direct benefits and are the most crucial determinants of its success. The initiative has Jack Kemp as a forefather, Scott told me, and businesses have been given huge latitude to determine where to put their money and what projects to invest in. “There is no up-front allocation or subsidy given to any investor,” Lettieri said. “They’re using their own capital at their own risk to invest in these distressed areas. And if they have additional gains, they will see the potentially substantial upside on the back end.”

The Opportunity Zone legislation has both expanded the federal government’s place-based policy and erased the federal government’s role in executing it. “This is another step down the continuum of greater private control over federal
economic-development resources,” said Brett Theodos, an expert on place-based policy at the Urban Institute.

During the Great Society, an initiative of Lyndon B. Johnson’s White House, the government directly financed a huge amount of construction across the country. Under President Gerald Ford, the government started to grant money to states to use on projects through the Community Development Block Grant initiative. Under Presidents Bill Clinton and George W. Bush, the private market started underwriting public-development deals through the New Markets Tax Credit program. “Fast forward to this,” Theodos said. “There are no intermediaries. There is no local decision making. There is no competitive application process. It’s the private markets deciding, in a very real sense, where the federal resources are being used.”

That is a feature and not a bug, in Scott’s telling. Distressed communities need more jobs, better jobs, and better-paying jobs, he said. They need more tax revenue to
finance better schools and better roads and better amenities. They need private industry, perhaps more than they need public investment, given that no community thrives on transfer payments alone. “Let’s say I have a $250,000 investment in the area [as a developer], as opposed to the government. I’ve got 10 years to get that money back out,” he said. “I think I’m going to handle that money better than the government. Most entrepreneurs can and will.”

But if private businesses and private jobs are an end, private investment might not be the best means. The lack of public control has raised the prospect that investors will finance projects with little spillover benefit. “What does a community need? You should think about that, and then match investment with that need,” Gonzalez told me. “That is not how this program is structured at all. It’s structured around incentivizing private equity to come in with investment, assuming that the investment is going to somehow benefit communities without any analysis around what the needs are.”

In truly distressed communities,
public investment might be necessary to induce private investment—to fix the deep-seated problems, diversify or change the industrial base, and address the market failure directly. “You can bulldoze your way through with subsidies or you can actually try to address the problems these communities have,” said Timothy J. Bartik of the W. E. Upjohn Institute for Employment Research. “You might be able to invest a dollar in reducing crime, and cut the cost of investing in the area by $2. Or you might make smart investments in anti-crime policies and the return is $5. And these investments are also public goods, not private goods.”

For some communities, those public goods might be hospitals and elementary schools. “I hate to say this because I don’t like the government intervening in this way,” said Copeland of the Colorado Office of Economic Development and International Trade. “But in really isolated communities [with declining populations], I’d love to see more intentional federal dollars spent around the two building blocks to retain people: health care and
education.” For others, it might mean spending on crime reduction. In others, on transitional jobs programs. In others, massive infrastructure investment. In others, regulatory reform to add housing units, as well as better transportation infrastructure and homelessness-prevention programs. In others, health programs to stem the tide of opioid abuse. “The scale of the challenge is so much bigger than the tools we’re bringing to the fight,” Lettieri told me.

In Fresno and countless other places, of course, the problem, or at least some of the problems, might be more on the margin. Prince, for example, said the designation probably would encourage the construction of more low-income housing. “If we’re going to address the systemic issues that we have had in neighborhoods here for long periods of time, we need every resource we can get,” he added. And Eager pointed to the initiative’s potential to encourage development around California’s long-in-the-works high-speed rail project.

But for Detroit and Flint and Newark and Appalachia, it might not be enough. Direct investment might
be necessary to help those worst-off communities and to make the country a more thriving and equal place, in terms of place.

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