ECONOMIC INNOVATION GROUP

Opportunity Zones: A New Economic Development Tool for Low-Income Communities

Guidance for Governors

February 2018

The Tax Cuts and Jobs Act of 2017 established a new economic development program called ***Opportunity Zones*** designed to encourage long-term private investments in low-income communities. This briefer is focused on the critical role governors will play in the implementation of the program.

Note: *Treasury has published procedures for nominating qualified opportunity zones and a mapping tool with eligible census tracts here: https://www.cdfifund.gov/pages/opportunity-zones.aspx.*

Background:

The program provides a federal tax incentive for reinvesting capital gains into "Opportunity Funds," which are specialized vehicles dedicated to investing in low-income areas called "Opportunity Zones." The zones themselves are to be comprised of Low-Income Community census tracts and designated by governors in every state and territory. The program has the potential to put significant amounts of private capital to work in distressed communities and serve as a catalyst for long-term, inclusive economic development.

Governors' role:

The most urgent aspect of implementation is in the hands of the chief executives of U.S. states, territories, and possessions (henceforth "governors"), all of whose jurisdictions are eligible for the program. Governors have **90 days** from enactment (**ending March 21, 2018**) to nominate low-income census tracts to be designated as Opportunity Zones. Nominations are to be submitted to the U.S. Treasury Secretary in writing. Treasury will send the specific instructions for doing so directly to governors. Governors may also request a 30-day extension (**ending April 20**) for submitting their nominations. After submission, the Treasury Secretary has 30 days to certify a state's Opportunity Zones.

Rules for Opportunity Zone designations:

Governors may nominate up to **25 percent of a state's Low-Income Community census tracts** for Opportunity Zone designation. For example, if a state has 500 low-income census tracts, 125 may be designated as Opportunity Zones. If the number of low-income tracts in a state is less than 100, then a total of 25 qualifying tracts may be designated. Designations, once made, remain in effect for 10 years. The 2011-2015 American Community Survey serves as the basis for determining eligibility.

Low-Income Community census tracts are generally defined in Section 45D(e) of the tax code as:

- *Tracts in which the poverty rate is at least 20 percent, or*
- *Tracts in which the median family income does not exceed 80 percent of the statewide median family income if located outside of a metropolitan area, or*
- *Tracts in which the median family income does not exceed 80 percent of the statewide median family income or the metropolitan area median family income, whichever is higher.*

Special Rule: In order to provide real-world flexibility in assembling economically meaningful zones from individual census tracts, governors are permitted to substitute a small percentage of non-low-income census tracts in their nominations, as long as the tracts are contiguous with other nominated low-income tracts and the median family income does not exceed 125 percent of the adjacent qualifying tract. Not more than **5 percent** of the total number of designated tracts in a state can qualify under this criterion.

Guidance for nominations:

Governors are given significant flexibility in making their Opportunity Zone designations. For example:

- The law sets a *ceiling* for the total number of tracts that may be nominated in each state, but governors may choose to nominate fewer in order to focus greater attention on targeted locales.
- States must conform to the Low-Income Community federal standard as a baseline for zone designations but are free to establish additional criteria to reflect local needs and priorities.
- Zones can be as small as a single census tract or a much larger grouping of contiguous tracts.

Congress included **non-binding guidance** for governors in earlier versions of the legislation as well as in the legislative history. Congress advised governors to give particular consideration to areas that:

1) Are currently the focus of mutually reinforcing state, local, or private economic development initiatives to attract investment and foster startup activity;
2) Have demonstrated success in geographically targeted development programs in the past, such as Promise Zones, New Market Tax Credits, Empowerment Zones, or Renewal Communities; and
3) Have recently experienced significant layoffs due to business closures or relocations.

Best-practice suggests governors may also wish to take the following factors into consideration:

- **Balancing need and opportunity.** This market-oriented incentive does not *guarantee* investment in designated areas. It is up to governors to determine where this tool will be most catalytic for their states, using such factors as an area's absorptive capacity for new capital, habitability for local entrepreneurs, and connection to markets, population centers, and anchor institutions that can play a critical role in facilitating growth in distressed locales.
- **Types of use cases.** This extremely flexible program is designed to attract a mix of investments: in the stocks of new and expanding businesses, in infrastructure, in real estate, in rental housing, and more. Which types of activities governors (and their local counterparts) wish to promote with the program may dictate which tracts they nominate in different communities. For example, some states will want to designate Opportunity Zones on the edge of university campuses in order to encourage spin-offs and technology transfer. Some may also want to use the tool to ensure the success of transit-oriented development projects in low-income urban neighborhoods. Others will see a powerful new tool for redeveloping brownfield sites in rural, urban, or suburban areas.

Next steps:

Every governor should **immediately establish a process for nominating Opportunity Zones** and actively solicit input from their mayors, county commissioners, and local economic development organizations to ensure that nominations align with local priorities. In addition, governors may find it useful to immediately **designate a point person or agency** to lead state efforts around the Opportunity Zones program and be responsible for zone designation, investor outreach, and support.

EIG is available as a resource for governors and their economic development teams looking to learn more about the program. For more information, visit eig.org/opportunityzones or contact John Lettieri at john@eig.org.