The Opportunity Zones program is a new community development tool that is designed to spur investment in the country’s low-income urban and rural communities through private equity tax incentives. This article explores the program’s background and potential implementation barriers for Texas.

**Table of Contents**

- Page 2  
  Introduction
- Page 2  
  The Census Tract Selection Process
- Page 3  
  Opportunity Zone Demographics
- Page 6  
  Concerns and Red Flags
- Page 8  
  Avoiding Pitfalls: Potential Best Practices
- Page 10  
  Looking Forward

“The Opportunity Zones in Texas: Promise and Peril” is a publication of the Community Development team of the Federal Reserve Bank of Dallas. Learn more about our work, publications and events at [www.dallasfed.org/cd](http://www.dallasfed.org/cd).

**Author**

*Emily Ryder Perlmeter*
Community Development Advisor, Federal Reserve Bank of Dallas

**Contributor**

*Pamela Foster*
Communications Partner, Federal Reserve Bank of Dallas

*The views expressed in this article are the author’s and do not necessarily reflect official positions of the Federal Reserve Bank of Dallas or Federal Reserve System.*
Introduction

While the passage of the Tax Cuts and Jobs Act of 2017 garnered much media discussion and analysis, little was initially mentioned about a new community development tool tucked into the bill’s pages. Called the Opportunity Zones program, this tool is a private equity tax incentive program designed to spur investment in the country’s low-income urban and rural communities. Investors can receive a series of tax benefits through qualified Opportunity Funds (O-Funds), which are investment vehicles that deploy capital to designated Opportunity Zones (OZs). There is some tax benefit for investments held a minimum of five years, but investors get the most benefit from investments held at least 10 years, including a 15 percent step-up in basis and a permanent exclusion from taxable income of capital gains (for more detailed investment information, see this fact sheet from Economic Innovation Group). The goal is to incentivize investors to hold funds in these vehicles at least 10 years to give capital time to work in communities.

Since Opportunity Zones became law on Dec. 22, 2017, there have been many ongoing questions about this new incentivized program. Community groups, private investors and government agencies alike have been scrambling to understand the process of raising and expending these funds, as well as potential best practices. This brief article seeks to provide some background information and explain where Texas currently stands in the process.

The Census Tract Selection Process

To begin implementation of the program, each state was responsible for selecting census tracts to be designated as Opportunity Zones. On Feb. 8, 2018, the Internal Revenue Service (IRS) issued basic guidance on the selection process. Each state was required to select tracts, keeping in mind the following requirements:

- Eligible tracts must have an individual poverty rate of at least 20 percent or median family income of no more than 80 percent of area median income. This is the same eligibility requirement as for New Market Tax Credits (NMTC).
- Up to 5 percent of the designated Opportunity Zones may come from otherwise ineligible tracts. These tracts can qualify as an exemption as long as: 1) they are contiguous with an eligible tract, and 2) the median family income does not exceed 125 percent of the median family income of the contiguous tract.
- Up to 25 percent of all eligible tracts can be designated.

While some states requested 30-day extensions, Texas did submit its census tracts to the U.S. Treasury Department by the March 21, 2018, deadline. Texas Governor Greg Abbott’s office
selected 628 individual census tracts across Texas, which were approved by Treasury in April of this year. The 628 represent a little over 23 percent of the state’s eligible tracts. While some states took advantage of the contiguous 5 percent exemption, all of Texas’ submitted tracts meet the original low-income requirements. According to the Office of the Texas Governor, several factors were emphasized during the selection process: chronic unemployment, natural disasters within the past two years, and low population density. These were considered “significant economic disruptors” that could benefit from stimulus. The governor’s office also substituted some eligible tracts with “similar metrics recommended by local and state elected officials.”

Opportunity Zone Demographics

Map 1 shows the geographic distribution of tracts officially designated as Opportunity Zones in Texas. See the interactive map online and zoom in to view OZs in the more populous counties, where individual census tracts are small in area.

Map 1. Designated Opportunity Zones Spread Across Texas (interactive version)
Opportunity Zones in Texas: Promise and Peril

OZs are dispersed across the state and are overrepresented in rural areas: While 38 percent of census tracts across Texas are considered either partially or fully rural, 60 percent of OZs are in at least a partially rural tract. Rural tracts are also overrepresented in terms of population: 61 percent of the total OZ population lives in a partially or fully rural census tract, compared to 40 percent of the general Texas population. (For more discussion of rural OZs, see box, “Will Rural Communities Benefit? Lessons from the New Markets Tax Credit Program.”)

Will Rural Communities Benefit? Lessons from the New Markets Tax Credit Program

In rural communities, access to capital has traditionally been a barrier for economic development due to factors such as “brain drain,” lack of industry clusters and distance to markets. An Opportunity Zone (OZ) designation could provide a step in the right direction.

Experience with the New Markets Tax Credit (NMTC) program offers some insights. The NMTC program has had success rurally, generating $11.6 billion in project costs in rural communities across the country from 2003 to 2014. Analysis indicates that a quarter of NMTC projects occur rurally. Some examples of successful investments in rural Texas include mixed-use developments, science accelerators, schools, and healthcare centers.

However, attracting investors can be challenging when rural areas are competing with urban ones. OZs might have a harder time attracting capital rurally than NMTCs, in part because the NMTC program distributes tax credits through intermediaries called Community Development Entities (CDEs). CDEs must be certified by the Community Development Financial Institutions Fund (CDFI Fund), an agency of the Treasury Department, and some have standing partnerships with rural organizations. OZs offer no such certified intermediary with standing ties to rural areas, so private investors residing in urban locations may be more likely to look at metro areas, with which they are more familiar. Additionally, the CDFI Fund specifically targets 20 percent of its NMTC allocation to non-metropolitan counties. For OZs, no reserve is driven to any specific place.

Designation as an OZ does not guarantee that a tract will see even a dollar of capital, but there is potential incentive for investment. The NMTC program requires yearly Congressional approval and requires CDEs to participate in a competitive application process for tax credit allotment—while OZ capital gains exclusions are, for eligible investments, unlimited. Gentrification is also less of a concern for rural localities, unlike in
the urban core. For rural OZs, the challenge will be to highlight opportunities that will attract Opportunity Fund investment.

Notes


By county, the greatest number of OZs is found in Houston’s Harris County, the most populous in the state (Table 1). Hidalgo County in the Rio Grande Valley along the Texas–Mexico border also has a large concentration of OZs. At 23, the number of zones is higher than that of Travis or Dallas counties, both of which have larger populations. And Hidalgo’s neighboring Cameron County has an additional 16 zones, giving notable emphasis to the Rio Grande Valley.

Table 1. Texas Counties with Most Opportunity Zones

<table>
<thead>
<tr>
<th>County name</th>
<th>Number of OZs</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harris</td>
<td>105</td>
<td>16.7</td>
</tr>
<tr>
<td>Bexar</td>
<td>24</td>
<td>3.8</td>
</tr>
<tr>
<td>Hidalgo</td>
<td>23</td>
<td>3.7</td>
</tr>
<tr>
<td>Travis</td>
<td>21</td>
<td>3.3</td>
</tr>
<tr>
<td>Dallas</td>
<td>18</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Unsurprisingly, OZ tracts differ significantly on some important demographic measures from tracts that were ineligible to be designated—but in some cases, they also differ significantly from eligible tracts that were not selected. As seen in Table 2, all eligible tracts, whether selected as OZs or not, differ significantly from ineligible tracts on race, poverty, education and home price. In comparing the two groups of eligible tracts—low-income tracts selected as OZs and those that were not—similarities are found in median home value, percentage of residents without a high school diploma and increase in college graduates. For other measures, however, significant differences emerge between tracts that Texas selected as OZs and those that were passed over. On average, designated OZs have higher percentages of black and white residents but a lower share of Latinos than their unselected counterparts. The OZs also have higher poverty rates (28.1 versus 26.5 percent) and a lower share of residents with a bachelor’s degree or higher. And, while the OZ median home value of $89,932 is not considered statistically different from the eligible, non-selected median value of $102,343,4 the percent increase in home value since 2012 is significantly higher for OZs.
### Table 2. Texas Opportunity Zone Demographic Differences

<table>
<thead>
<tr>
<th></th>
<th>Not Eligible</th>
<th>Eligible, Not Selected</th>
<th>Opportunity Zone</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Race/Ethnicity (%)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>White</td>
<td>60.5</td>
<td>27.2</td>
<td>34.0</td>
</tr>
<tr>
<td>Black</td>
<td>8.0</td>
<td>14.8</td>
<td>18.9</td>
</tr>
<tr>
<td>Hispanic/Latino</td>
<td>24.1</td>
<td>54.2</td>
<td>44.6</td>
</tr>
<tr>
<td><strong>Poverty (%)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In poverty</td>
<td>8.6</td>
<td>26.5</td>
<td>28.1</td>
</tr>
<tr>
<td><strong>Education (%)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than high school</td>
<td>9.7</td>
<td>28.3</td>
<td>28.0</td>
</tr>
<tr>
<td>Bachelor’s or higher</td>
<td>37.4</td>
<td>16.4</td>
<td>13.4</td>
</tr>
<tr>
<td>Percentage point increase in college graduates 2012–2016</td>
<td>7.6</td>
<td>19.2</td>
<td>21.9</td>
</tr>
<tr>
<td><strong>Median Home Value</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Median home value 2016 ($)</td>
<td>211,141</td>
<td>102,343</td>
<td>89,932</td>
</tr>
<tr>
<td>Percent increase in home value 2012–2016 (%)</td>
<td>12.5</td>
<td>7.0</td>
<td>9.3</td>
</tr>
</tbody>
</table>

**SOURCES:** American Community Survey, U.S. Census Bureau; author’s calculations.  
[Gray shading] Indicates significant difference between OZ tract and eligible, not-selected tract.

### Concerns and Red Flags

Clearly, there is great need in these low-income communities. By directing investment into these tracts, Opportunity Zones have the potential to improve economic mobility and financial stability in the places that need it the most. Among the purported benefits of the OZ structure are incentives for longer-term investment periods (holding at least 10 years secures the most benefit), pooled capital from a potentially broad geographical reach (one need not live in an OZ to invest), and the capacity for investors who might otherwise not have the networks to deploy capital in low-income communities to participate by simply investing prior gains in a qualified fund.

However, there are multiple areas of concern voiced by some—including policy experts such as the Brookings Institution, as well as economic developers in local communities—regarding the implementation of the tool:

- **Guidance:** States were required to submit nominations for OZs while little was known about what projects would be eligible, what reporting requirements would exist, and how fund eligibility would be determined. This lack of information meant that states were
making tract recommendations with a large degree of uncertainty as to how they would be used. Treasury and the IRS have noted that additional legal guidance will be forthcoming in 2018.

- **Transparency and regulation:** Although the bill’s original language does explicitly require that at least 90 percent of fund assets must be deployed in OZs, there are few other criteria that O-Funds are currently required to meet. Guidance issued by the IRS in April 2018 includes the finding that a taxpayer can self-certify to become an O-Fund, with no approval needed from the IRS. (This self-certification is different from the certification approval process that Treasury’s Community Development Financial Institution Fund requires for community development entities accessing NMTCs, as noted in box, “Will Rural Communities Benefit? Lessons from the New Markets Tax Credit Program.”) While this is likely to reduce bureaucratic inefficiencies, the IRS decision has intensified concerns among some community leaders that there may be little accountability of funds and negligible tracking of their investments. Without such oversight, the worry is that funds could be allocated ineffectively, leaving communities with little to no benefit.

- **Gentrification and displacement:** Given that O-Funds will be market-driven equity investments, investors will likely be seeking “hot” or “up and coming” areas more likely to yield high returns, as these provide greater incentives for investors. Not only will they see greater appreciation of their assets, but they will also receive a greater tax exemption: If money is held at least 10 years in an O-Fund, investors receive a permanent exclusion from taxes on the gains in the event of a sale. Given these incentives, and because there are few requirements regarding what types of investments can be made (beyond exclusion of the traditional “sin” businesses), Opportunity Funds could potentially direct capital largely to projects in areas already on the verge of gentrifying—places where high returns are most likely. In that eventuality, investors would get a tax break while neighborhoods would simply continue on the path of gentrification, displacing some of the highest-need households from the area. Without incentives for inclusivity in place, this is a risk in these zones.

To understand how likely this gentrification scenario is for Texas, the Dallas Fed looked at census tracts selected as OZs on a few different measures that can be predictive of gentrification. Taking into account home price appreciation and educational attainment, the measure indicates likely gentrification if a tract meets the following requirements:

- Tract is considered low-income (individual poverty rate of at least 20 percent or median family income of no more than 80 percent of area median income).
- Home value increase from 2012 to 2016 is in the top 25 percent of all tracts in Texas.
Opportunity Zones in Texas: Promise and Peril

- Increase in population holding a bachelor’s degree or higher from 2012 to 2016 is in the top 25 percent of all tracts in Texas.

Using these criteria, 62 of Texas’ 628 OZ census tracts are flagged for gentrification. Harris County has the largest number, at 9 of its 105 OZs, while Bexar County has the highest percentage, with 21 percent of its OZs flagged (5 out of 24 tracts).

Finally, we wanted to see how this gentrification risk in OZs compares to that in the eligible tracts that were not selected. As Table 2 indicates, there is a significant difference between the two groups with regard to home value growth: OZs, on average, have experienced higher home price appreciation. But this is only part of the picture. Using our gentrification measure, we find that 9.7 percent of OZ tracts have a gentrification flag, compared to 8.5 of their unselected counterparts (Table 3). This difference is not statistically significant. This suggests that, at present, gentrification is not more of a risk for OZs than for eligible tracts that were not selected—though gentrification still remains a concern for nearly 10 percent of OZ census tracts.

Table 3. Nearly 1 in 10 Opportunity Zones Likely to Gentrify

<table>
<thead>
<tr>
<th></th>
<th>Eligible, Not Selected</th>
<th>Opportunity Zone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average educational attainment growth 2012–2016 (%)</td>
<td>19.2</td>
<td>21.9</td>
</tr>
<tr>
<td>Average home value appreciation 2012–2016 (%)</td>
<td>7.0</td>
<td>9.3</td>
</tr>
<tr>
<td>Gentrification flag rate (%)</td>
<td>8.5</td>
<td>9.7</td>
</tr>
<tr>
<td>Total number of tracts</td>
<td>2,046</td>
<td>628</td>
</tr>
</tbody>
</table>

Avoiding Pitfalls: Potential Best Practices

Recognizing that gentrification will likely be an issue in some Opportunity Zone communities, how might investors and community developers mitigate this risk while simultaneously maximizing economic benefit in these low-income communities? Community-based organizations and policymakers have put forth a few ideas:

- **Integrate investments thoughtfully within the broader economic environment**: O-Funds will not deploy capital in a vacuum. Each community will have different infrastructure, different priorities and policies, and different funding streams at play, which will have implications for how new equity investments are absorbed and used. Jeremy Nowak, co-founder of New Localism Advisors and the Reinvestment Fund, suggests that cities should think of O-Funds as “one of many tools in an economic
Development toolbox” and “embed this investment tool within broader community and economic development strategies.”

For instance, a city might want to engage its existing community colleges and align workforce development programs to ensure a strong regional talent pipeline for future business development. And if an OZ tract already has existing federal or state investments (such as NMTCs, Promise Zones, Empowerment Zones or Low Income Tax Credits) as well as philanthropic money, O-Funds could be layered on top of these resources to maximize impact. As the Beeck Center at Georgetown University notes, OZs “should be additive to existing efforts and not cannibalize existing or prospective community development investments.”

- **Focus on inclusivity:** “Make sure there are policies at the local level to really ensure equitable economic growth—though these policies will look different across markets,” says Olivia Barrow, policy analyst at Enterprise Community Partners. Certain policies may be in place in cities that can mitigate displacement. Inclusionary zoning, for instance, is a tool that either mandates or encourages development or preservation of affordable homes when new market-rate housing is built. Although cities in Texas cannot mandate inclusionary zoning, some cities, such as Austin, offer incentives to developers in the form of density bonuses or fee waivers to be inclusive of low- and moderate-income residents.

- **Encourage performance tracking at the local level:** While there are no federal reporting requirements for O-Funds, for states concerned about where equity is allocated and how to measure its efficacy, one tactic could be creating incentives for investment that are tied to performance measurement and reporting. According to Katie Kramer, vice president of the Council of Development Finance Agencies, if a community wants to offer incentives to direct capital to particular projects that align with its economic priorities, it has the opportunity to tie in reporting measures to hold these investments accountable. “If you’re going to layer on additional incentives to be able to attract [O-Fund investment],” Kramer says, “really think about how you can also encourage them to perform in a certain way.”

This list of strategies is by no means exhaustive and will likely grow as new guidance is issued by Treasury. Moreover, best practices will likely differ by locality, so advice should remain flexible, rather than be prescriptive.

As a final note, the Urban Institute released a dataset focused on helping communities understand current investment levels across tracts and developed an investment score based on current levels of commercial, multifamily, single family and small business lending in each tract. Using this dataset, the Dallas Fed created an interactive map of OZs by investment score, along with flags for gentrification risk as discussed above.
Looking Forward

While there are still open questions about how O-Funds will be created and by whom, some basic guidelines are in place: Any taxpaying person or entity can create a fund, but it must be organized as a corporation or a partnership and invest at least 90 percent of its assets in OZs. Funds can invest in multiple OZs at any given time, and there is no cap on the size of the funds or their investment levels. Similarly, there is no geographic requirement; funds located in one OZ may invest in another. And simply being designated an OZ does not guarantee investment; O-Funds have the say in where to make equity investments, suggesting that cities and states may want to incentivize prospective investors.

Opportunity Zones are estimated to go into full effect late this year or possibly early 2019. As state and city governments, community development professionals and investors await...
forthcoming guidance from Treasury, policy groups will continue to think through best practices to maximize impact and minimize displacement. OZs have potential to direct much-needed capital to historically underinvested neighborhoods and spur longer-term investments of at least a decade. They also have potential to open doors for a new wave of investors who might not otherwise have the networks or incentives to invest in low-income communities. But without reporting requirements, it could be difficult to discern the program’s efficacy or track how it might contribute to furthering gentrification and displacement in neighborhoods at risk. At the end of the day, Opportunity Zones are here to stay—at least for the next 10 years. It’s now up to cities, states and economic developers to cultivate best practices for inclusive and effective development.

Notes

2 Author’s calculations from Brookings Institution dataset available at https://www.brookings.edu/research/the-early-results-of-states-opportunity-zones-are-promising-but-theres-still-room-for-improvement/.
3 This calculation uses the Census Bureau definition of rural areas, which includes any area that is not urban or suburb. For more information see: https://www.census.gov/geo/reference/urban-rural.html.
4 We calculate statistical significance at an alpha level of 0.05, or a 95% confidence interval. When two values are not statistically different, this means that we cannot be certain that the difference is not just due to the sheer chance of sampling.
7 Gentrification is notoriously challenging to measure, and there is little consensus on the best way. Some studies have looked at education levels and home price growth, some have included race or ethnicity, and others have looked only at median family incomes. A recent Brookings Institution study across states looked at home price appreciation from 2012 to 2016 in the top quartile as a sign of gentrification: “The Early Results of States’ Opportunity Zones are Promising but There’s Still Room for Improvement,” by Adam Looney, Brookings Institution, April 18, 2018, https://www.brookings.edu/research/the-early-results-of-states-opportunity-zones-are-promising-but-theres-still-room-for-improvement/.
11 For example, see “Downtown Density Bonus Program,” Office of Planning and Zoning, City of Austin, https://austintexas.gov/downtown-density-bonus.
13 See methodology at https://www.urban.org/policy-centers/metropolitan-housing-and-communities-policy-center/projects/opportunity-zones-maximizing-return-public-investment. Note that the Urban Institute also created a gentrification flag, called “socioeconomic indicator,” which this map does not use, because it resulted in what we believed to be an undercount of gentrifying areas.