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An Opportunity Zone Guide for Governors and a Case Study of South Carolina

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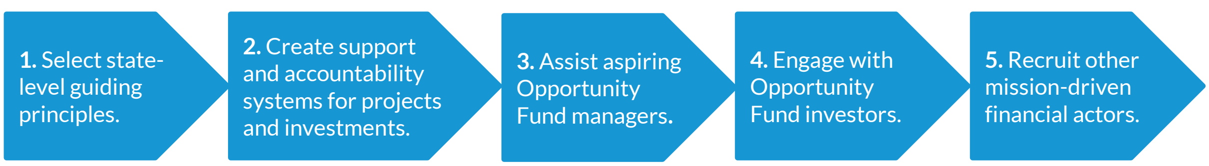
Opportunity Zones, a federal program created by the Tax Cuts and Jobs Act of 2017 to incentivize investment in American communities, are gaining momentum. Much of 2018 was spent selecting zones, writing draft rules, and educating people about this new community development tool. Now that the rules regulating Opportunity Zones are becoming clearer, investors, local officials, developers, and businesses are engaging with the incentive. Hundreds of Opportunity Funds have been created, and Opportunity Zone investment is beginning to flow.

Given the Opportunity Zone incentive is open-ended, governors can shape their states' policy environments to maximize the tool's benefits and minimize its potential harms. Over the next few years, developers and investors will show considerably more interest in placing their projects in Opportunity Zones versus other locations, a reality that governors must immediately acknowledge and react to. Indeed, governors are particularly obligated to do so given they selected their states' zones.[1]

This brief provides guidance on actions governors can take to respond to the Opportunity Zone incentive. After an overview of principles governors should strive for, we describe specific policies states could create or bolster to encourage or discourage certain actions among individual projects, Opportunity Fund managers, investors, and other mission-oriented actors. We also include a case study of South Carolina's Opportunity Zones to contextualize these issues.

FIGURE 1

Steps for Governors



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Introduction

Opportunity Zones work by incentivizing the investment of capital gains into 8,764 census tracts across all 50 states, Washington, DC, Puerto Rico, and four US territories. Qualified investments within these tracts benefit in one (or more) of three ways: (1) a temporary deferral of taxes on previously earned capital gains, (2) a discount of 10 or 15 percent on owed capital gains taxes, and (3) the permanent exclusion of taxable income on new gains representing returns on the Opportunity Zone investment. (For more details on the incentive's mechanics or the characteristics of Opportunity Zones, see Lester, Evans, and Tian 2018, Theodos and Meixell 2019a, and Theodos, Meixell, and Hedman 2018.)

Eligibility requirements are minimal compared with other federal community development tools. For example, there are no requirements (as with the Low-Income Housing Tax Credit) that new apartments be rented to low-income residents; no requirements (as with the Small Business Administration's 7(a) and 504 loan guarantee programs) that federally backed investment occur only when fully private-market financing is unavailable; and no requirements (as with the New Markets Tax Credit) that investors establish an oversight board of community development experts and representatives to review projects. Some "sin" businesses are, however, excluded outright.

Beyond simple restrictions, several conditions determine whether an investment qualifies. For example, businesses must have a sufficient amount of their income (or staffing, salaries, or tangible property) in an Opportunity Zone to qualify. Real estate investments must make "substantial improvements" to the property or be an "original use." Eligible capital must be provided as an equity investment, not debt (though debt could be part of a larger financing package), and investments must result from a taxpayer's recently realized capital gains.[2]

Opportunity Zone incentives will drive capital flows across the country, but how that capital flows and into what projects is still largely undetermined. More than 10 million people living in poverty and more than 1.8 million who are unemployed live in Opportunity Zones. Moreover, more than 21 million people of color live in designated zones. There is a stark contrast between the communities selected for investment and those who hold capital gains. For example, taxpayers with adjusted gross incomes above $1 million report 63 percent of taxable net capital gains, whereas those with incomes below $100,000 report just 6 percent of such gains.[3]

State-level policy could play a substantial role in attracting Opportunity Zone projects. Though the policy creation can be long and complex, governors have a relatively short time frame for changing state policies in response to the new federal incentive. Investors are seeking to move quickly because capital will need to have been invested for either seven or five years by 2026 to receive the 15 or 10 percent step-up in basis, and because the temporary deferral becomes less valuable as 2026 approaches. (However, investors can access the permanent exclusion for investments made through, at latest, June 2027 using 2026-recognized gains and then held for at least 10 years.) With this time frame in mind, states are beginning to innovate.[4]

We propose a five-step plan for governors to maximize the potential benefit of this new tool while minimizing unintended consequences. First, governors should follow state-level guiding principles when making decisions about Opportunity Zones. Second, they can create and encourage support and accountability systems for new investments. Third, they can engage the growing community of Opportunity Fund managers. Fourth, they can engage investors. Finally, governors are advised to recruit other mission-driven financial actors to participate at each level of the Opportunity Zone ecosystem.

Step 1: Select State-Level Guiding Principles

Before charting a course for their state to respond to Opportunity Zones, it is useful for state governments to identify guiding principles that state policies should conform to. Though there are many possible guiding principles—and reasons they may differ by state—we offer the following six as a starting point:

- **Incorporate community needs, goals, and voices.** It is notable how little community input is required to access federal resources under this new incentive. This reflects a broader trend whereby control over federal community development resources has moved away from the federal government and toward first state and local governments, and now private markets (von Hoffman 2012). As such, when governors are designing state policies and programs that will interact with the Opportunity Zone incentive, they should consider meaningful ways to encourage and require community input in decisions about using public-sector resources to develop their neighborhoods.[5] They should also uncover insights about which projects truly serve local needs (such insights can be drawn from community input and other data sources). The goal is to prioritize ways of using public resources that best facilitate or enhance private Opportunity Zone investments. For example, support for operating businesses may be more needed than subsidizing market-rate real estate (given weaker collateral and higher risks for operating businesses), and it may generate more follow-on economic activity, such as job growth.
- **Promote transparency, monitoring, learning, and evaluation.** We are still awaiting clarity on federal reporting requirements, but regardless of what the Internal Revenue Service requires, states should mandate full reporting on federal and state incentives for all Opportunity Fund investments where such requirements can be added. Nonburdensome reporting on the "who," "what," "when," "where," and "how much" of any Opportunity Zone investment is crucial for public consideration of the incentive's costs and benefits and for ensuring accountability for the billions of dollars in forgone federal revenue. (For more detail on metrics worth collecting, see Theodos and Meixell 2019b.) Governors must then actively assign responsibility for monitoring these programs and include robust requirements that the transaction-level data be made publicly available in a transaction-level manner in real time. States should devote sufficient resources to program monitoring, learning, and evaluation. They could also use this reporting proactively to incentivize certain types of projects, funds, and investors.

- **Think and act locally.** Governors designated a wide range of census tracts as Opportunity Zones across rural and urban communities (Theodos, Meixell, and Hedman 2018), as well as 248 zones in tribal areas.[6] There are Opportunity Zones in downtown Brooklyn and in downtown Berkeley (near the University of California), where the median home value is more than $1 million. However, there is also a zone in Youngstown, Ohio, in which more than half of households live below the poverty level and the median home is worth $14,000. Of course, not all zones include such extremes, but these differences illustrate that governors must carefully design state programs in light of local market conditions. Some zones will not be attractive to investors absent further subsidies, and others will be overly attractive. Governors will need to work with local leaders to consider and compensate for disparate conditions across zones in their jurisdiction. State action should allow for localized flexibility where necessary, rather than painting with too broad a brush. It is also important to recognize that state powers differ dramatically from local powers across the US, and that a state's authority relative to the authority of its delegates will be central in designing Opportunity Zone policy responses.[7]
- **Be cost-effective.** The federal government's decision to spend significant sums incentivizing investment in Opportunity Zones does not mean states have more resources to spend. For instance, states choosing to conform their state capital gains to the incentive must consider the opportunity costs of revenues lost from such a move. As such—and given competing demands for state funds—it is critical that governors consider the benefits of creating and modifying programs and policies against their costs to ensure they are worthwhile.
- **Do no harm.** Given the relative lack of guardrails around the Opportunity Zone incentive and the fact that the incentive is primarily inclined toward appreciating investment markets, governors must use the tools at their disposal to ensure they do not harm communities, especially those communities' low- and moderate-income residents. Harmful projects could include those that drive gentrification or contaminate air and water quality. Investments that repurpose naturally occurring or subsidized affordable housing as expensive rental or ownership units that price out current residents are perhaps the most harmful. In addition to direct real estate conversions, governors may want to prevent investment from accelerating too quickly in zones at risk of rapid change.
- **Acknowledge and align with the original incentive.** As with all policies, the Opportunity Zone incentive has specific requirements that states ought to consider when creating or modifying state-level programs and policies. Creating state policies to encourage certain types of projects that do not work within the structures and timelines dictated by the federal incentive would be ineffectual. This means considering big-picture elements and smaller details to ensure Opportunity Zone–eligible business and investments qualify under state efforts to be twinned with or leverage Opportunity Zone financing.

State executive branches have a role to play across the entire Opportunity Zone value chain by helping individual projects, fund managers, investors, other mission-oriented actors, and local communities engage thoughtfully with the incentive. Governors hold several key means of bending Opportunity Zone capital in ways that meet local needs and accomplish community goals.

Step 2: Create Support and Accountability Systems for Opportunity Zone Projects and Investments

State governments have a few basic levers they can pull to directly support or inhibit projects. They can offer additional "carrots" by creating new programs and incentives or expanding existing ones. They can remove "speed bumps" by aligning state-controlled tax incentives, reducing investment friction, and easing the investment process. States also have authority over local land use and building codes, and can use local preemption to encourage or discourage the production and deconcentration of affordable housing. States can also encourage accountability, whether that means promoting local priorities or ensuring the visibility of Opportunity Zone projects where they occur.

Governors should consider the following strategies for meeting these high-level goals:

- **Support community organizing, planning, and connecting.** States can directly support community planning and organizing processes, and can link communities with other stakeholders. Although such efforts may be broader in scope than Opportunity Zones, the incentive presents a new opportunity and a renewed urgency for such state support. States can most directly support local planning through grants, as New Jersey is doing with five $100,000 community grants.[8] Colorado provides smaller grants (most less than $10,000) to localities to support project-feasibility studies, requests for proposals, investment memoranda and marketing, or legal/accounting support on specific projects.[9] States can also support local Opportunity Zone commissions, as is being proposed in Florida.[10]
- **Align Opportunity Zone investments with other state programs and priorities.** States have many tax tools they can pair with the Opportunity Zone incentive. For instance, Illinois's place-based Solar for All program provides investment incentives for solar projects that benefit low-income communities. To further encourage clean energy investments in Illinois's low-income communities, the state could expand the geographies that qualify for the Solar for All program to include all the state's Opportunity Zones. In so doing, states can increase the share of Opportunity Zone capital that serves state goals by making investment opportunities more attractive. Additionally, states can discourage harmful competition among local governments over firms; there are some promising examples of such anticompetitive policies across the US (Randall et al. 2018). Of course, the primary consideration for many states is whether to conform state capital gains tax treatment to this federal incentive (box 1).
- **Review and refine regulatory and permitting processes.** Many states will want to review their existing processes and requirements for new businesses and construction in Opportunity Zones, with the aim of fast-tracking projects that promise substantial community benefits (this will not be the case for all Opportunity Zone investment). For instance, projects in California

falling under California Environmental Quality Act review could be fast-tracked if they meet state priorities. In many states, regulated utilities control grid interconnection queues for renewable energy projects. These utilities often delay such projects' development, viewing them as a threat to their existing businesses. States could pass legislation fast-tracking new renewable-energy assets in Opportunity Zones for interconnection. Of course, states also have a role alongside localities in discouraging Opportunity Zone projects that will undermine community vitality and interests. States should only provide subsidies and other supports to projects that conform with the guiding principles chosen in step 1, but they can go farther by also using regulatory and permitting processes.

- **Prepare projects and businesses for investment.** Some desirable Opportunity Zone investments can benefit from preinvestment support to enhance their likelihood of success. For instance, states can support programs for aspiring entrepreneurs from low-income backgrounds who want to start businesses (Theodos and González 2019). Many Opportunity Zones are in formerly redlined districts with legacies of racial discrimination.[11] States can use the Opportunity Zone incentive to begin undoing decades of disinvestment by focusing investment on leaders from these marginalized communities. For example, the District of Columbia's "OZ Community Corps" will provide pro bono legal advice to residents and existing businesses in its Opportunity Zones to help projects in those zones benefit people already living and working there.[12] States can also support predevelopment efforts for various real estate projects in Opportunity Zones, such as by rezoning eligible tracts to enable new development; this may often involve states supporting and working through local governments.

BOX 1

State-Level Capital Gains

Forty-one states and the District of Columbia currently levy a state individual income tax (and thus tax capital gains in some capacity). Of these, 18 and the District of Columbia automatically conform to the Internal Revenue Code, 16 states enacted legislation to comply with Opportunity Zone provisions, 3 partially conform (with specific uses/restrictions), and 4 do not currently match the Opportunity Zone incentive in their state tax code (2 of these, Hawaii and North Carolina, enacted nonconformity legislation in the aftermath of the Tax Cuts and Jobs Act).

States that tax capital gains but do not automatically conform with federal tax law must decide whether to match the federal incentive. States must decide whether the costs of conformity (deferred and reduced tax intake) outweigh the benefits of further incentivizing investment activity. This should be evaluated alongside the rest of a state's priorities and policies around Opportunity Zones. California provides an instructive example: Governor Newsom's first budget proposal recommended matching the federal incentive for investments made in clean energy and affordable housing, but not in other investment types.

Source: "State Tax Code Conformity – Personal Income," Novogradac, accessed September 3, 2019, https://www.novoco.com/resource-centers/opportunity-zone-resource-center/guidance/state-tax-code-conformity-personal-income.

- **Effectively use state-owned land.** States should review which of their assets are in Opportunity Zones. They can then employ various tools for using their land in conjunction with the Opportunity Zone incentive and can repurpose significant tracts of land for business purposes. For instance, Massachusetts state policy encourages local governments to convert brownfield sites (such as landfills) into "brightfields" by allowing solar developers to install panels.[13] Such projects turn contaminated land into a revenue-producing clean energy resource. States can also offer their land to developers to decrease the costs of projects that are high government priorities, such as low-income and workforce housing development. Because local governments also have significant land holdings, states ought to coordinate with and incentivize county, city, and town governments where possible to amplify local impact.

Step 3: Assist Aspiring Opportunity Fund Managers

Governors will find that the Opportunity Zone incentive is creating localized investment activity. In Minnesota, a local group has formed the Minnesota DREAM Fund, focused on investing exclusively in the state's Opportunity Zones. Although the asset management industry has recently become increasingly concentrated in financial hubs, the Opportunity Zone incentive's rules will likely encourage locally focused fund managers and localized capital investment. By encouraging fund managers to invest in projects that reflect state priorities, governors can influence these new pools of capital to be used for community benefit.

Governors should support the industry ecosystem by using capacity building to increase the pool of potential local fund managers. They should also let the private market determine winners and losers among prospective managers to help ensure incentivized projects will be owned by long-term managers. Such support can come in various forms that include the following:

- **Provide convening and "matchmaking" assistance to fund managers.** States can help bring various market participants—fund managers, investors, communities, and advisors—together to ensure Opportunity Funds operating in their communities are successful. By bringing more stakeholders (especially those in the community) to the table, states can make investments more likely to benefit communities. For example, many states (including Maryland, Virginia, and West Virginia) and Washington, DC, have begun maintaining central databases of aspiring fund managers and interested investors.[14] Alternatively, states can support other coordinators—like Opportunity Alabama, a nonprofit that acts as a market-maker for in-state investors and projects—springing up across the country to serve this function.
- **Aid fund managers through capacity building, sharing best practices, and investment.** Many local fund managers have limited investing experience, and states can act to mitigate the risks this poses for the investment ecosystem. For instance, states can provide "template" fund-formation documents for managers that could include private placement memoranda and shared subscription agreements. They could also actively support technical assistance provision. In this vein, the Kresge Foundation selected potential fund managers to provide

guidance on deal structuring and tax and legal advice provided by Calvert Impact Capital, Holland & Knight, and Plante Moran.[15] States could also support emerging fund managers who target areas of priority and benefit to the state and community (e.g., via concessionary coinvestment). Alabama's recently signed, impact-focused Opportunity Zone tax credit is an interesting example (Opportunity Alabama 2019).

- **Create objective tests for determining whether investors are "state aligned."** The lack of federal measurement and reporting requirements for this incentive, combined with its fairly flexible compliance architecture, creates room for a diversity of investment activity, not all of which will support state priorities. States can therefore create objective measures that their fund managers should meet, such as disclosure and reporting, prioritization of community needs, and investments in favored asset classes. Governors (or independent government-supported bodies) can then "certify" funds that meet these requirements. This can ensure funds are used in ways that consider state-level priorities and signal to impact and community-conscious investors that they are acting with the interests of communities in mind. (Alabama's impact-focused Opportunity Zone tax credit, which is creating metrics to assess investors' alignment with state priorities, is also notable in this regard.)
- **Align other state-level resources to support Opportunity Zone investments.** States can use other financial tools to support Opportunity Zone investments and amplify their effects. For instance, state pension funds can invest in the debt or other parts of the capital stack for Opportunity Zone projects that support state priorities. When Opportunity Zone investments align with community plans and goals, this tool could help harmonize broader state initiatives such as investments in workforce development, infrastructure, and entrepreneurial support.

Step 4: Engage with Opportunity Fund Investors

Individual or corporate investors with capital gains will only be able to place capital in deals that actually "come across their desk." It is therefore in states' interest to ensure the projects investors see advance state priorities. States can do this by providing "matchmaking" services to connect prospective investors with appropriate fund managers. They can also support convenings and cultivate (and help build) a local investor ecosystem. Moreover, although their mechanisms are different, community foundations are examples of how to engage high-net-worth people for collective action. By clearly signaling priorities through new policy and aligning regulations with the Opportunity Zone incentive, governors can support investors who want to work with managers who share state goals.

Step 5: Recruit Other Mission-Driven Financial Actors

Many states have rich ecosystems of nonprofit and other mission- and place-driven financial actors. Such actors have an interest in ensuring the Opportunity Zone incentive's policy goals are met. Many local philanthropies, foundations, and donor-advised funds want disinvested communities to succeed and are natural partners for states working to achieve positive outcomes.[16] Moreover, funding and support from pension funds and college endowments for activities that advance state priorities can relieve funding gaps that might otherwise befall state governments. The reciprocal is also true: Opportunity Zones can strengthen existing institutions, catalyze anchor supporters for new investment, and forge new connections across communities.

States can use several tools to achieve these outcomes. For example, they can partner with the community development financial institutions that work in their communities and provide them additional resources, such as funding for teams to do prescreening or predevelopment work for local fund managers. States have played key roles starting and growing community development financial institutions, and we have previously identified seven key ways that states can deepen and grow this work (Theodos et al. 2017).[17] States can also support and develop the philanthropic tools being used to recognize “good” managers.

Conclusion

The outcomes of the Opportunity Zone policy will be inextricably tied to localized investment activity occurring within individual Opportunity Zones. Most of that investment has yet to be made, meaning states can still influence the capital that Opportunity Zones will bring to their communities. However, the clock is ticking: the value of the incentive diminishes slightly every day, and the window for realizing the 15 percent step-up in basis will close soon. If done right, states can use the Opportunity Zone incentive to leverage small amounts of public investment and use state regulatory authority to unlock private capital for public good. If done wrong, states will spend scarce resources subsidizing investments that would have occurred anyway and provide little or no community benefit—or even undermine it. By orienting their Opportunity Zone–related support to marry current policy interests with attractive investment opportunities for taxpayers, states can ensure investments flow into their most vulnerable communities.

Case Study: The South Carolina Landscape

To ground these recommendations in the context of a state policy ecosystem, we took an in-depth look at Opportunity Zones in South Carolina. Although we reference these potential policy interventions with South Carolina in mind, they are broadly applicable to other states.

What Are South Carolina's Policies for Opportunity Zones?

South Carolina has enacted three policies to entice Opportunity Zone deals and is considering a fourth:

- **State capital gains tax.** Of 41 states with a state income tax, 33 have adopted rules providing state tax breaks for capital gains that mirror the federal incentive.[18] The South Carolina state tax code does not automatically align with the Internal Revenue Code, and it achieved conformity through legislative action.[19] No additional transaction-level reporting was required.
- **Low-income housing tax credit preference.** The South Carolina State Housing Finance and Development Authority has adopted a preferential point in its Qualified Allocation Plan for low-income housing tax credits for investments in Opportunity Zones (SC Housing 2018).
- **Local prospectus grants.** The South Carolina Department of Commerce has a grant program that helps localities create Opportunity Zone prospectuses and obtain outside consultation when selecting projects that could receive public assistance.
- **Income tax credit.** The South Carolina state legislature is considering legislation that would provide a 25 percent income tax credit to any company investing within an Opportunity Zone.[20]

It is also important to understand the tax incentives that may contribute to an Opportunity Zone project's capital stack and ultimately influence the kinds of investments states will see. South Carolina has two relevant tax credits: (1) the textiles communities revitalization tax credit provides developers 25 percent credit against rehabilitation expenses of abandoned textile mills,[21] and (2) the angel investor tax credit provides a 35 percent credit for investments in small businesses less than five years old.[22] These credits could make deals that may not have been viable in one state viable in South Carolina.

What More Could South Carolina Do with Opportunity Zones?

As this brief details, there are many incentives and disincentives governors could use to expand the Opportunity Zone incentive and shape investment to maximize community benefit and minimize adverse outcomes.

South Carolina's approach to Opportunity Zones has straddled the line on these issues, often opting for broad incentives that apply (much like the federal legislation) to any Opportunity Zone investment. The state could tailor its capital gains tax and the proposed income tax credit to incentivize investment that aligns with specific community goals. Moreover, the state's use of its low-income housing tax credit

Qualified Allocation Plan to incentivize low-income housing development within Opportunity Zones is noble in spirit but may fall short in practice. To the extent that Opportunity Zones are areas with shortages of affordable housing, this incentive is well targeted. However, the policy may further segregate distressed communities that already have substantial concentrations of subsidized stock.

Ultimately, South Carolina should consider additional action based on the priorities we describe in this brief: incorporating community voices, goals, and needs; promoting transparency, monitoring, learning, and evaluation; thinking and acting locally; being cost-effective; doing no harm; and aligning with the original incentive. Options for acting on these priorities include the following:

- **Designate a state coordinator.** Designating a point person to handle Opportunity Zone–related requests, establish priorities across state agencies, and convene local Opportunity Zone actors is a relatively easy first step a governor can take. For large states, it may make sense to designate a small number of regional or city-level coordinators.
- **Provide new funding.** If targeted toward specific types of projects or outcomes that benefit communities, useful policy levers could include new Opportunity Zone tax incentives, funds, predevelopment assistance, or funding for community development corporation capacity building. Governor Hogan has proposed a $3 million state grant program in Maryland to support workforce development training for businesses in Opportunity Zones, and the Maryland Department of Housing and Community Development is directing funding toward several Opportunity Zone priority areas, including $20 million for affordable-housing projects, $8 million in small business lending, and $3.5 million in its Strategic Demolition Fund for site predevelopment work.[23]
- **Connect beyond Opportunity Zone financing.** It will be important for South Carolina (and other states) to include philanthropy, higher education, and the workforce in Opportunity Zone funding, work, and conversations. Simply designing new tax incentives will be too narrow an approach. For Opportunity Zones to benefit residents, South Carolina will need to do the hard work of supporting intergenerational mobility, something Opportunity Zones cannot do in isolation.
- **Reduce financial risk.** Anything a state can do to lessen the risk of investments in beneficial projects can be a strong incentive. This could involve loan guarantees, loss reserves, or other forms of credit enhancement.
- **Expedite approvals and permitting for beneficial projects.** Existing state regulatory and permitting processes required in real estate or business dealings are key intervention points. Projects that benefit communities could be flagged and streamlined for approval. Projects that could be harmful could be treated with greater scrutiny at these stages.
- **Serve as or support an intermediary.** Intermediaries could vet deals for community benefit, particularly deals with new investors interested in entering the Opportunity Zone space. A state could perform this role or outsource it to a philanthropic consortium, community development financial institution, or community development corporation.

- **Align other state programs with Opportunity Zone goals.** States should not pursue Opportunity Zone strategies in a silo. Ideally, new state incentives will piggyback off and pull together existing and new state programs. For example, South Carolina could restart its community development tax credit incentive and align it with Opportunity Zone priorities. Moreover, South Carolina will likely see fewer clean energy Opportunity Zone deals than comparable states owing to its lack of property-assessed clean energy financing programs. Thirty-six states have enabling legislation on the books, and 20 states have active property-assessed clean energy programs.[24] Funds looking to pursue clean energy projects within Opportunity Zones will likely concentrate a greater amount of activity in these states. Maryland and the District of Columbia are two examples of jurisdictions providing a collected list of potential complimentary tax credits, funds, and programs that could be paired with Opportunity Zone investments.[25]
- **Understand and reference local contexts.** Statewide strategies toward Opportunity Zones should consider regional and localized variations across zones. A census tract without significant capital flow necessitates a much different approach than one at substantial risk of gentrification. We therefore recommend governors conduct thorough market analyses of their states' zones as part of the policy formation process.

What Do South Carolina's Opportunity Zones Look Like?

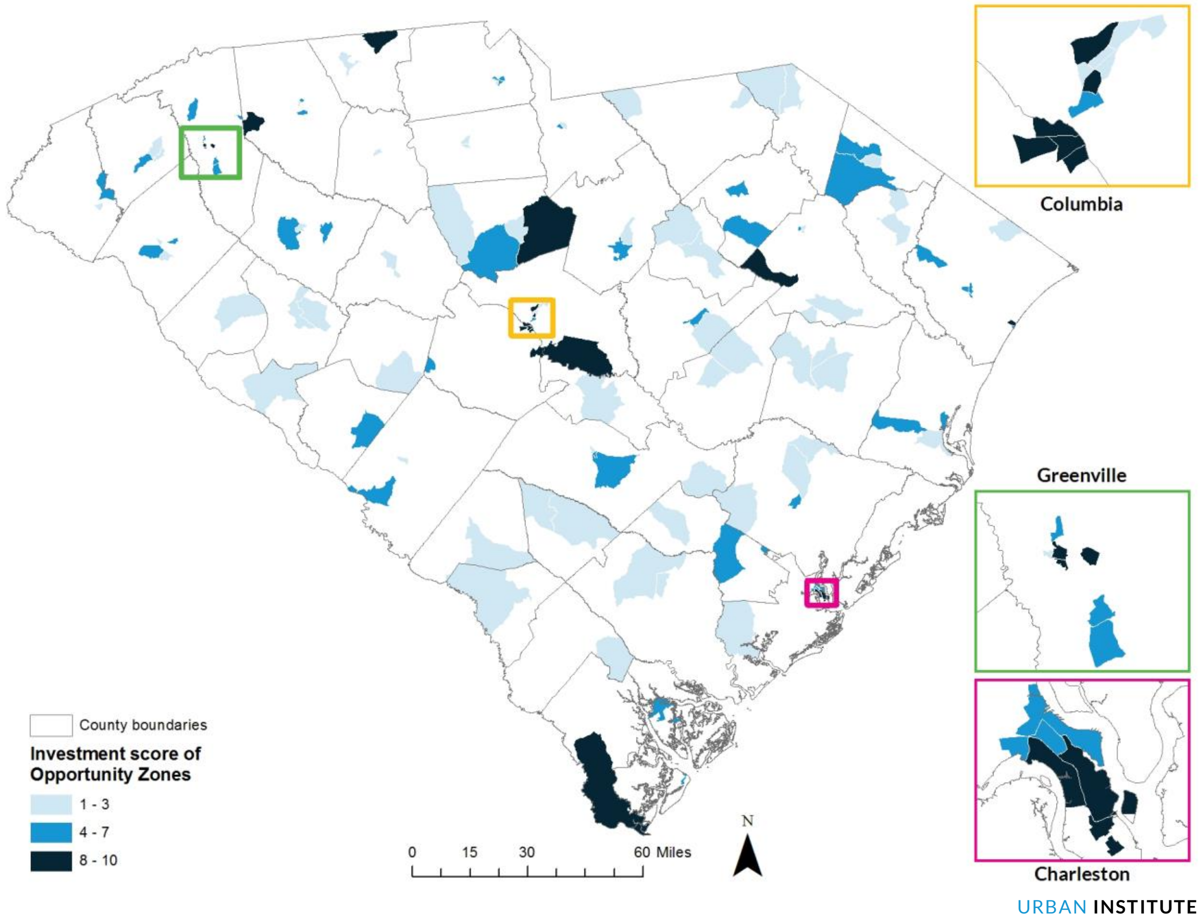
Of South Carolina's 1,103 census tracts, 67 percent were eligible for Opportunity Zone designations. Of these, 135 tracts across the state's 46 counties were chosen (figure 2).

What are the attributes and conditions of South Carolina's Opportunity Zones? To determine how well the zones are targeted toward certain factors, we examine this question along three lines of analysis: investment flows, residents' economic conditions and demographic makeups, and whether a tract has experienced rapid socioeconomic change indicating a risk of gentrification (table 1).

To better understand how well South Carolina's Opportunity Zones can access capital, we scored each eligible tract on a scale of 1 (lowest) to 10 (highest) based on its past ability to attract investment in commercial projects, small business lending, multifamily housing, and single-family homes.[26] Notably, 38 percent of Opportunity Zone tracts scored a 3 or lower on this scale. Similarly, the state picked fewer tracts that had already seen significant amounts of investment: only 19 percent of zones ranked 8 or higher (figure 3).

FIGURE 2

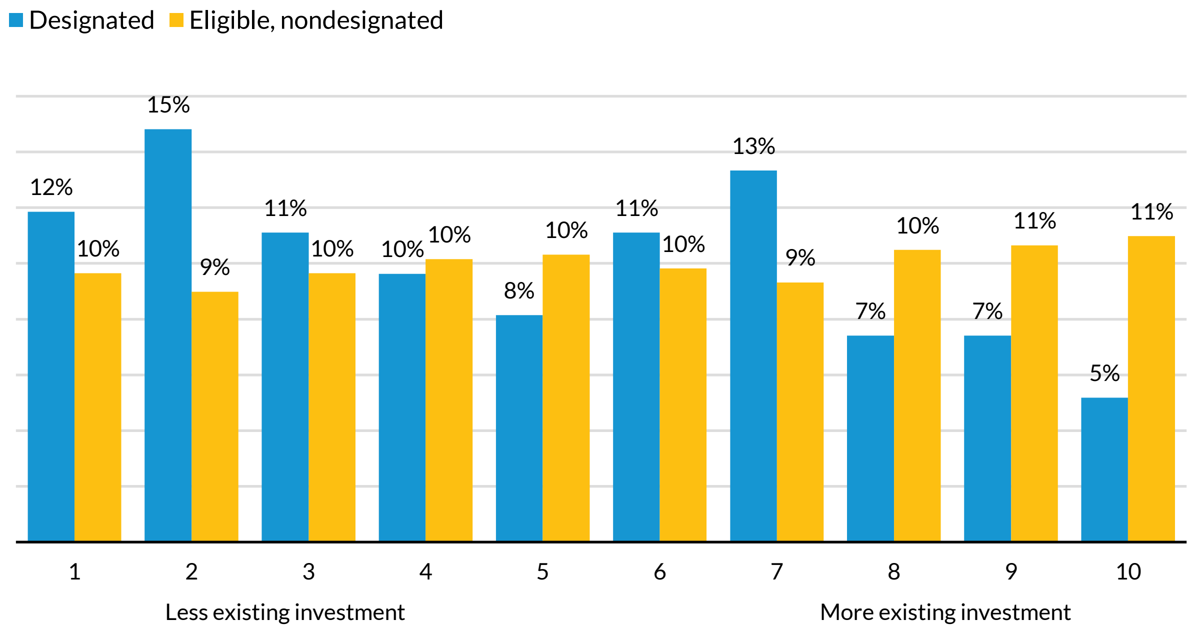
South Carolina's Opportunity Zones by Investment Score



Source: Urban Institute analysis of 2011–17 CoreLogic data, 2015 Longitudinal Employer Household Dynamics Origin Destination Employment Statistics Workplace Area Characteristics, 2011–17 American Community Survey data, 2000 Decennial Census data, 2011–17 Home Mortgage Disclosure Act data, and 2011–17 Community Reinvestment Act data.

FIGURE 3

Investment Score Distribution of Opportunity Zones in South Carolina



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Source: Urban Institute analysis of 2011–17 CoreLogic data, 2015 Longitudinal Employer Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics, 2011–17 American Community Survey data, 2000 Decennial Census data, 2011–17 Home Mortgage Disclosure Act data, and 2011–17 Community Reinvestment Act data.

TABLE 1

South Carolina Census Tract Characteristics by Opportunity Zone Designation Status

	Designated	Eligible, nondesignated
Descriptives (N)		
Eligible for Opportunity Zones	135	606
Low-income community	128	410
Contiguous	7	196
Economic conditions		
Median household income**	$32,062	$40,574
Poverty rate**	29.6%	21.8%
Unemployment rate**	13.0%	9.9%
Housing		
Median home value**	$98,204	$125,525
Median rent/month**	$679	$760
Homeownership**	55.9%	65.0%
Severe rent burden**	25.7%	22.0%
Vacancy rate	16.1%	15.8%
Demographic		
White alone**	42.1%	59.3%
Black alone**	50.5%	31.9%
Hispanic	4.7%	5.4%
Asian American and Pacific Islander alone**	0.6%	1.1%
Younger than 18	22.8%	21.8%
Older than 64	15.4%	15.7%
Education (average %)		
High school degree or less (age 25+)**	56.7%	50.3%
Bachelor's degree or higher (age 25+)**	15.3%	20.3%
Socioeconomic change flag (%)[a]	2.2%	3.1%
Average investment score[b]	4.1	4.3

Source: Urban Institute analysis of 2011–17 CoreLogic data, 2015 Longitudinal Employer Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics, 2011–15 American Community Survey data, 2000 Decennial Census data, 2011–15 Home Mortgage Disclosure Act data, and 2011–15 Community Reinvestment Act data.

Note: Measures for economic conditions, housing, demographics, and education levels represent averages across all designated or eligible nondesignated tracts.

[a] This measure reflects changes between 2000 and 2016 in shares of residents with a bachelor's degree or higher and median family income, share of non-Hispanic white residents, and average housing cost burden.

[b] Average investment score created averaging flows for tracts based on commercial lending, multifamily lending, single-family lending, and small business lending, with tract averages ranked among all census tracts nationally.

* Differences between designated census tracts and eligible, nondesignated census tracts are significant at the 5 percent level.

** Differences between designated census tracts and eligible, nondesignated census tracts are significant at the 1 percent level.

Notes

[1] For more on Opportunity Zone eligibility, see Theodos, Meixell, and Hedman (2018).

[2] Per the statute, 50 percent of a business's gross income must come from its "active conduct" for it to be eligible for investment. The second round of proposed IRS regulations stipulated that a business could also qualify as an Opportunity Zone project if 50 percent of its employee and/or contractor hours were in a zone or zones, 50 percent of employee and/or contractor compensation was in a zone or zones, or tangible property in the zone(s) accounted for more than 50 percent of total property. In addition, at least 40 percent of intangible property used in a trade or business's active conduct must be in the zone(s). The IRS has provided further guidance on the "substantial improvement" clause, which requires an Opportunity Zone business to spend at least as much on improvements to a property as it paid to acquire it, and will apply only to the buildings acquired and not the underlying land. Any structure that has been vacant for five years or longer is considered an "original use," and does not require substantial improvements. Substantial improvements are also not required for unimproved land, nor for leased property, which is treated as business property. These proposed regulations also provide Opportunity Funds 31 months to invest the capital gains, though there can be multiple and overlapping 31-month periods for different investments, and each period can extend beyond 31 months if there are delays owing, for example, to permits pending with a local agency. The permanent exclusion of new gains lasts up to 2048 if the investment is held.

[3] Authors' calculation based on IRS Statistics of Income from Tax Year 2016, Table 1.4.

[4] "State Opportunity Zones Legislation," Novogradac, accessed September 3, 2019, https://www.novoco.com/resource-centers/opportunity-zones-resource-center/state-opportunity-zones-legislation.

[5] One tool we have developed is the Opportunity Zone Community Impact Scorecard, which will be made available on the Urban Institute's website.

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[26] Opportunity Zones will spur equity investments into tracts, but information about existing equity flows is not available for small geographic areas across the dimensions of interest. We therefore present debt flows as one way to understand local capital access but note the distinction between debt and equity flows.

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Errata

A previous version of this brief mistakenly referred to "Dillon's Rule" as "Dillion's Rule."

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