Opportunity Zone Designation

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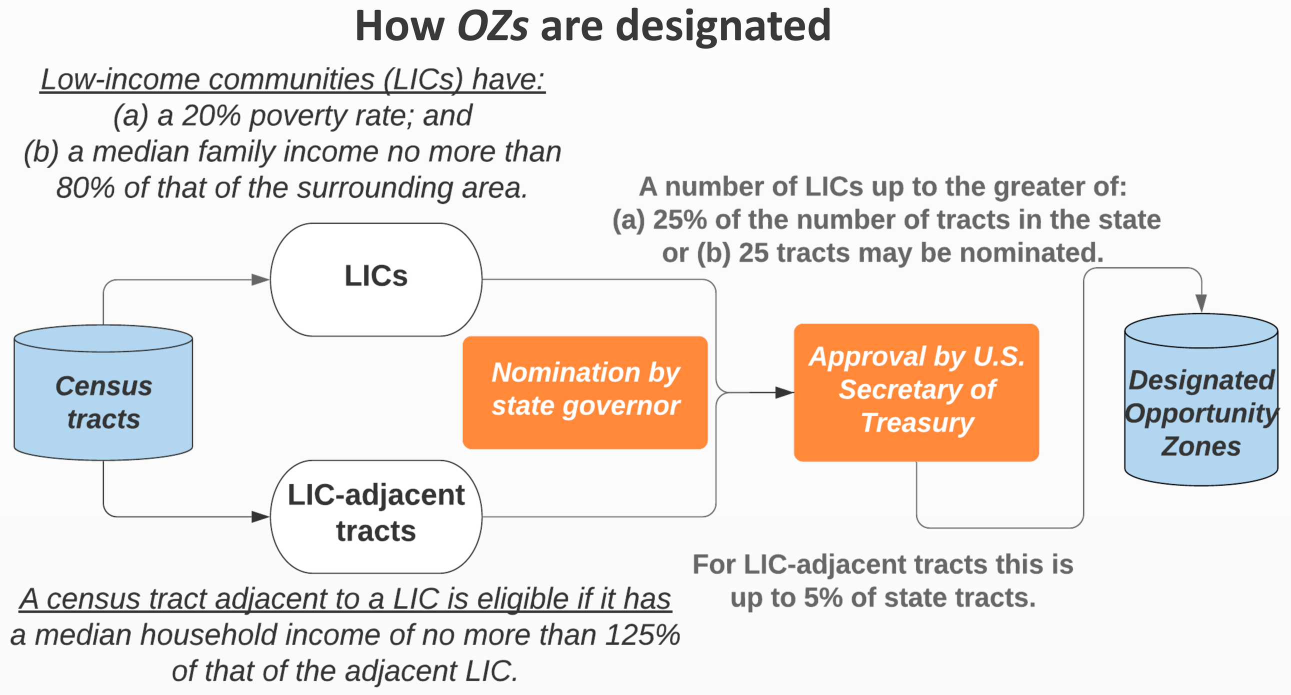
Background

2017 federal tax cuts created the *Opportunity Zone* (*OZ*) program to promote development in disinvested communities. Qualified investments in these designated census tracts may defer or waive capital gains taxes.

The program has been criticized as a giveaway to wealthy developers who would already had planned projects and parties with connections to state governors in charge of the designation process. Furthermore, research shows that place-based incentives are ineffective in general and problematic at worst.[1]

I wanted to use topic modeling and clustering to *(a)* see whether the areas chosen for tax benefits were significantly different from other eligible areas, and *(b)* identify tracts that appear to be misdesignated.

How *OZs* are designated



Data Collection

I collected data for all ~73,000 census tracts using the U.S. Census Bureau API.

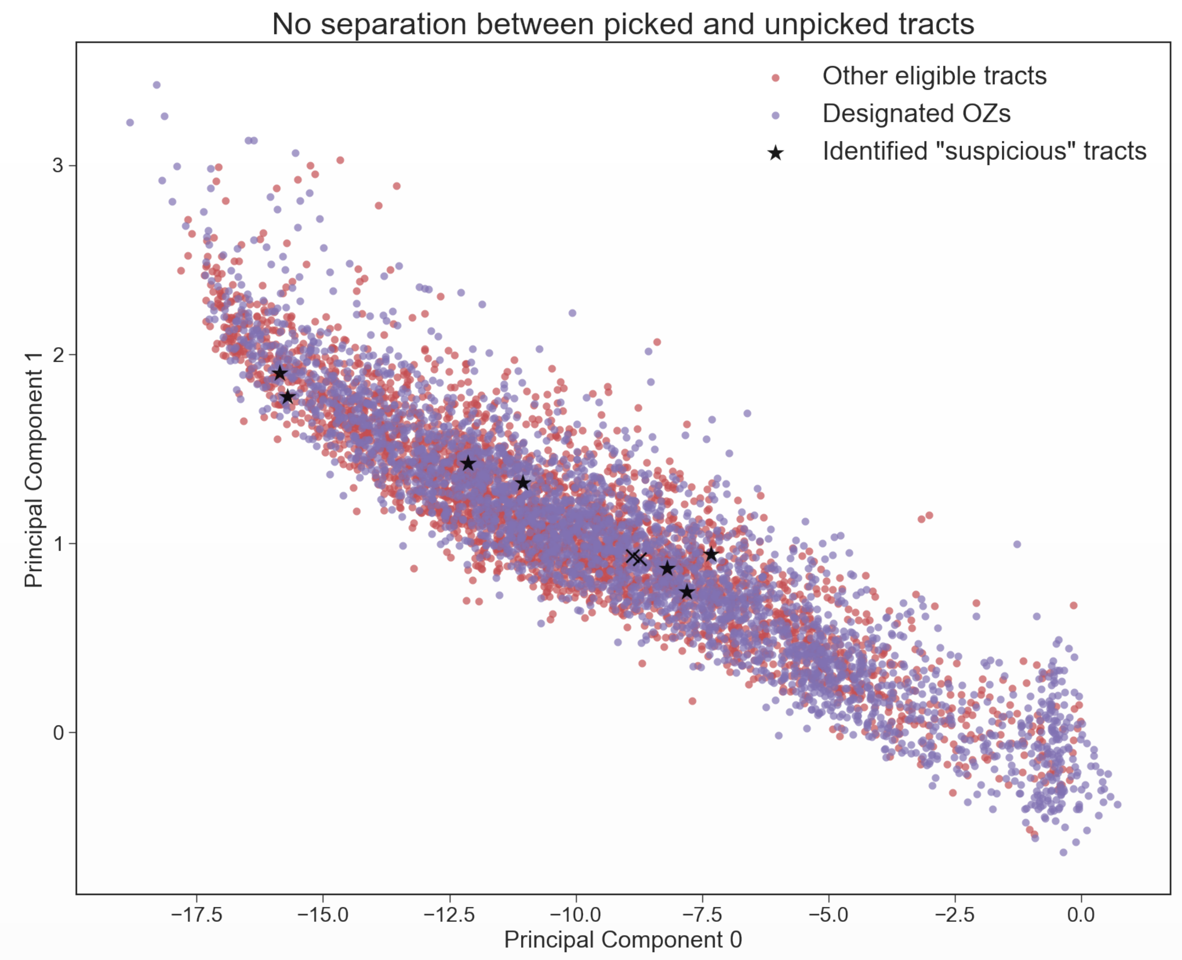
Of these tracts:

- **~40,000 (57%) were eligible** for tax benefits
- **7,710 (11%) were designated** as *OZs*

My feature choice was driven by the assumption that misdesignated tracts will be gentrifying, vacant, or have large student populations.

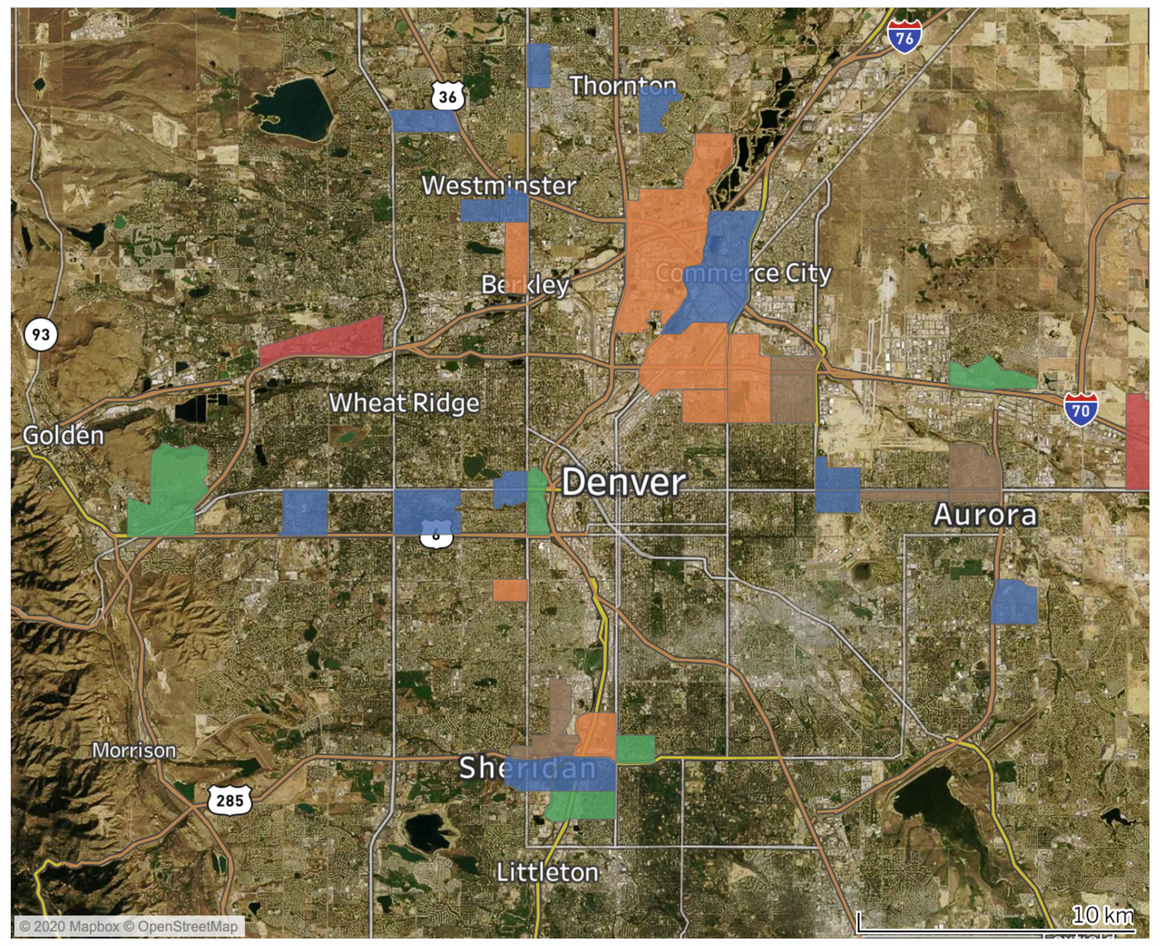
Method

i. Test for differences between *OZs* and other eligible areas



There is no apparent separation between the groups, and the largest significant difference is the proportion of black residents (+5.0% in *OZs*). Tracts with reported corruption[2] do not appear to be outliers.

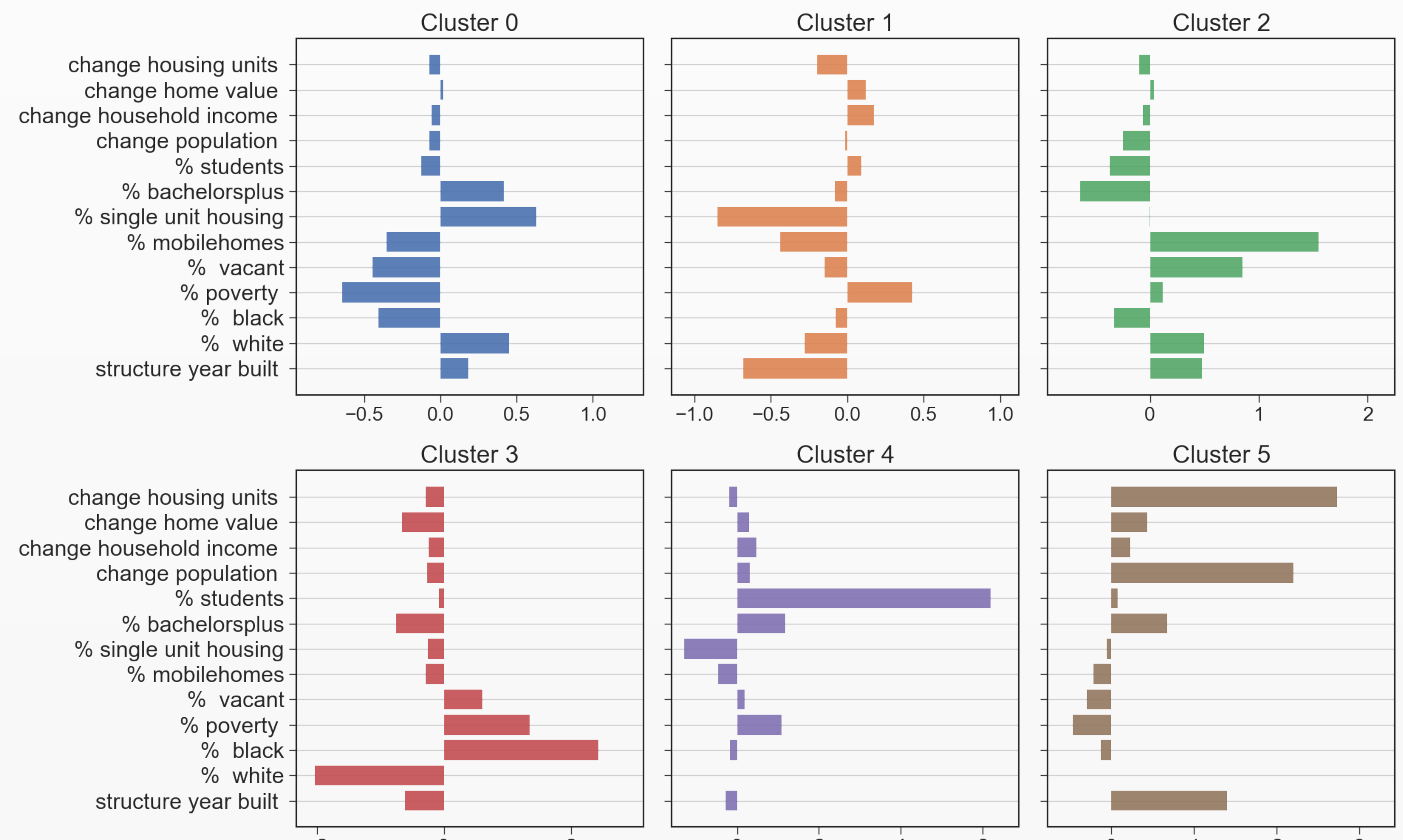
iii. Compare results against known tracts

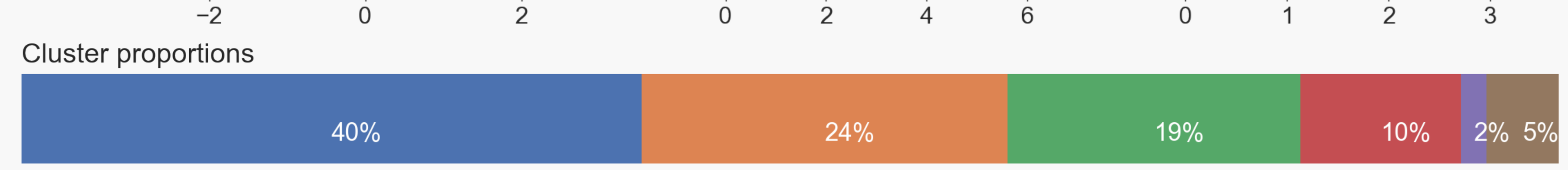


Denver's *OZs* colored by cluster. Although most of the designations seem justifiable, many of these areas were already developing. Note that specific tracts will not exactly reflect the cluster averages show below.

ii. Identify archetypes of selected *OZs* using KMeans clustering

These plots show the mean feature values for each cluster relative to all *OZs*.





There some very clear archetypes in the selected *OZs:*

0. Suburban
1. Urban early gentrification
2. More rural with population loss
3. High poverty and black population
4. Student area
5. Recently developed

Conclusions

The criteria for review of *OZ* designation should take into account both cluster membership and other demographics.

Clusters 4 and 5 are small and odd enough that they should be reviewed. Although students are poor, they are not the target of the *OZ* program. Cluster 5 has developed rapidly and may have been misdesignated based on 2011–15 estimates.

Clusters 2 and 3 appear to be appropriate targets for the program, although gentrification could threaten their residents.

Clusters 0 and 1 are the majority types and less interpretable. All the "suspicious" tracts I found in reporting on corruption in the designation process were part of these groups. For these we can use other statistical criteria such as relative poverty and educational attainment.

Locals are the best judges of the economic health of their neighborhoods. A local legislative approval process could be established to ensure governors are acting for the community interest.

Federal lawmakers have introduced two bills to require data collection and reporting on *OZs* (H.R. 5042 and S. 1344). But without revising the designation requirements, the success of misdesignated areas was guaranteed. Congress should take this issue seriously if they pretend to be budget-conscious.

References

1. – Eastman, Scott and Nicole Kaeding, "Opportunity Zones: What We Know and What We Don't," *The Tax Foundation,* Jan. 7, 2019.
   – Looney, Adam, "The early results of states' Opportunity Zones are promising…," *Brookings Institute,* Apr. 18, 2018.
2. – Drucker, Jesse and Eric Lipton, "How a Trump Tax Break to Help Poor Communities Became a Windfall for the Rich," *New York Times*, Aug. 31, 2019.
   – Elliot, Justin et al., "A Trump Tax Break To Help The Poor Went To a Rich GOP Donor's Superyacht Marina," *ProPublica.org*, Nov. 14, 2019.
   – "Bringing investment to poor places," *The Economist,* Nov. 17, 2018.

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