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Opportunities Exist to Improve Opportunity Zones in Michigan

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Introduced as part of the Tax Cuts and Jobs Act of 2017, the Opportunity Zone (OZ) program is a federal incentive designed to encourage private investment in low-income communities by providing a tax break to wealthy investors.

The OZ program is an example of a place-based policy, meaning the incentive seeks to reduce socioeconomic disparities across geographies. The U.S. has a long history of using place-based policies to address inequities in access to opportunities, such as through Empowerment Zones (1995) and the New Markets Tax Credit Program (2000). Both programs were designed to improve the economic well-being of designated low-income communities–Empowerment Zones by providing tax breaks for hiring workers from the communities and the New Markets Tax Credit by drawing private investment to the communities.

Despite their popularity, the relationship between economic development incentives and good investments is not clear cut. A growing body of research demonstrates how economic development incentives fail to bring new jobs or business development to low-income communities. A 2018 Upjohn Institute study found firms that received tax incentives failed to create more jobs than those without incentives—in fact, employment growth was 3.7% slower in firms with incentives.[1] In its research on Michigan's incentive programs, the Mackinac Center finds the cost per job often exceeds the average annual wage of the job itself.[2]

Like other place-based policies, the OZ program aims to benefit residents in target communities. Over 890,000 Michiganders live in the 288 OZs across the state, located in nearly every county. While the program has the potential to benefit residents with low incomes living in these communities, loose rules and lack of oversight could accelerate gentrification in some neighborhoods or subsidize investments that bring little or no benefit despite the huge price tag.

These concerns are especially germane to Black and Brown communities, which have historically experienced underinvestment but are still in many ways excluded from decisions about OZ investments. The OZ legislation promises capital investments and new jobs for OZ communities, but the only guaranteed benefits will go to the wealthy, often White, investors whose taxes will be reduced by huge amounts.

Over 890,000 Michiganders live in OZs, representing 9.0% of the population.

The cost of the program is substantial. At the federal level alone, the Joint Committee on Taxation estimates revenue losses from OZ tax credits of $1.6 billion within the first ten years.[3] Only four states have estimated their anticipated revenue losses from the program, with estimates as high as $15.9 million annually in future years.[4] Although Michigan has not estimated the revenue impact, the state will certainly face additional losses due to its conformity with the federal definition of "personal income," meaning wealthy Michigan investors taking advantage of OZs, whether in or outside of Michigan, will receive a break on their state taxes as well.

Fortunately, Michigan legislators can take action to protect state revenue and improve transparency about how OZ investments are impacting communities in our state. **Michigan should decouple from the federal Opportunity Zone provisions,** as a growing number of other states have done, to ensure the state is not subsidizing lucrative investments, including those made in other states. Additionally, **the state should require reporting from taxpayers making use of the program** so communities can easily identify the type and size of investments being made in their neighborhoods.

The Communities

The U.S. Department of the Treasury used 2011-2015 data from the American Community Survey to select eligible census tracts. A census tract had to meet one of the following criteria to be considered a “low-income community”:

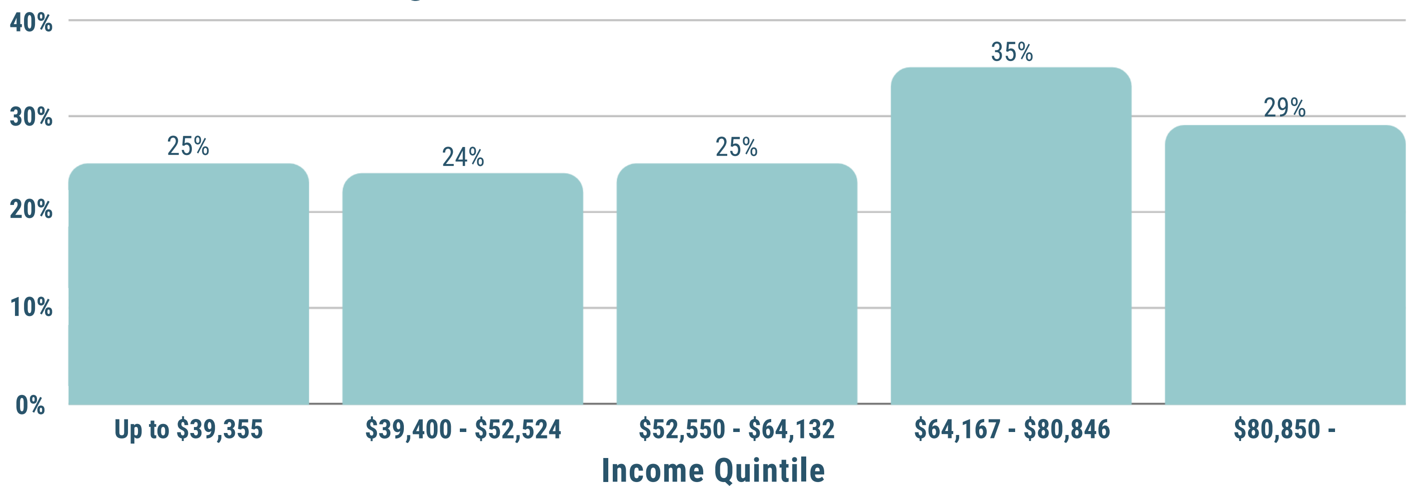
a) A poverty rate above 20%;
b) A median family income less than 80% of the area median (for urban tracts); or
c) A median family income less than 80% of the state median (for rural tracts).

Of Michigan’s 2,813 census tracts, 1,152 tracts (41%) met the definition of low-income communities and were therefore eligible for consideration to become an OZ. Once these eligible tracts were established, the list was presented to Gov. Rick Snyder to choose the final set of Opportunity Zones.

Because the definition of a “low-income community” was broad and not explicitly focused on poverty, governors had wide latitude to make nominations. The law allowed governors to select up to 25% of eligible census tracts as OZs; up to 5% of the selected tracts were not required to be low-income communities as long as they bordered a low-income OZ.

Of those the governor selected, most OZs (70%) were both high poverty and low income based on data available at the time. Some OZs (28%) are either low income or high poverty, while six (2.1%) are neither. Five of these, called “contiguous tracts,” are neither high poverty nor low income but were eligible because they directly border an eligible low-income OZ. One tract earned OZ status due to error or intentional mislabeling, a mistake which is further discussed below. Five of the six high-income, low-poverty tracts are in Wayne County.

Although fewer census tracts in higher income quintiles were eligible to become an OZ, a greater share of these tracts were selected.



Source: MLPP analysis of OZs based on ACS (2011-2015) data.

Although the governor did not select the eligible tracts with the highest levels of poverty, Michigan’s Opportunity Zones do exhibit greater need on average compared to eligible but unselected tracts. OZ tracts have smaller and younger populations; a smaller share of White residents as well as a larger share of Black residents; a greater share of disabled residents and a lower share of residents with a high school diploma.

Importantly, median family incomes as well as median home values are lower in selected tracts while poverty rates are higher. Poverty rates across all Michigan census tracts averaged only 19% in the 2015 data, but were 32% in designated OZ tracts. Nevertheless, the state did not select the absolute poorest tracts for inclusion in the program. Of the 100 poorest census tracts in Michigan, only 29% were selected as Opportunity Zones.

Key characteristics of Michigan census tracts, 2015

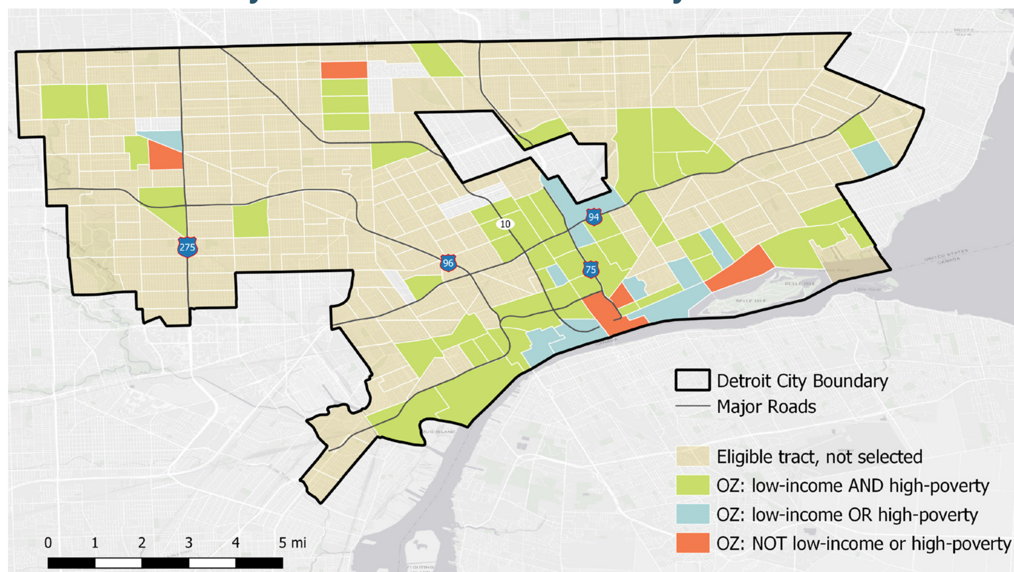
Characteristics	OZ Tracts	Eligible, Not Chosen	Significance*	All Tracks
Average population	3,090	3,325	X	3,519
Median age	36.9	38.6	✓	40.2
Share rural	14%	15%	X	11%
Share White	54%	63%	✓	75%
Share Black	34%	27%	✓	18%
Share Hispanic	7%	5%	X	5%
Share Asian	2%	2%	X	2%
Share American Indian	1%	1%	X	1%
Share foreign-born	6%	5%	X	6%
Share disabled	19%	17%	✓	15%
Share with a high school diploma	83%	85%	✓	89%
Share with a bachelor's degree	18%	18%	X	25%
Median family income	$39,482.52	$46,163.77	✓	$61,804.71
Poverty rate	32%	26%	✓	19%
Median home value	$72,813.87	$86,100.58	✓	$123,557.90
Number of tracts	288	1,240		2,813

Source: MLPP analysis of ACS (2011-2015) data.
* Indicates whether OZ tracts are statistically different (at the 1% level) from eligible but unselected tracts.

Governors across the country were given wide latitude in their selections, leading to accusations of political favoritism in some states. While Michigan saw relatively few instances of overt private influence over the zone selection, a ProPublica investigation found special interests lobbied for the inclusion of several zones in Detroit's central business district.[5]

At least one of these tracts was ineligible based on poverty rates, median income, and population, but it was re-classified as a "low-income community" and did indeed become an Opportunity Zone. Follow-up research into this discrepancy showed at least one contiguous tract was made eligible only because it bordered on this reclassified tract, indicating that two OZs in downtown Detroit should not exist based on the stated program rules.[6]

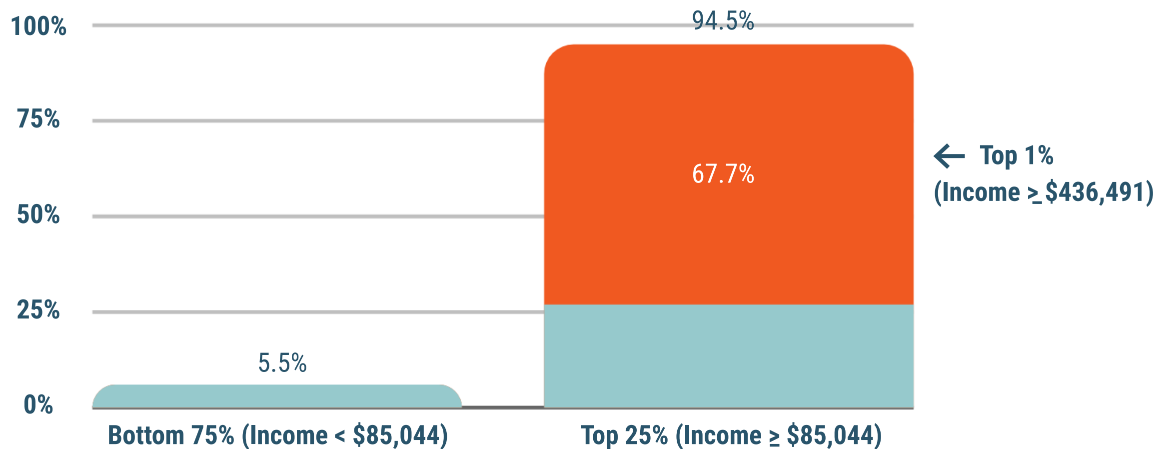
Almost all of Detroit's census tracts were eligible to become Opportunity Zones, but only about 1/3 were ultimately selected.



The Investors

Not everyone can take advantage of the Opportunity Zone tax incentives. The tax credit is only available to individuals with capital gains, which come from the sale of an asset such as property, a business, or an existing investment. In Michigan, two-thirds of capital gains income is concentrated among the top 1% of income earners, those earning over $436,500.

Capital gains are concentrated among Michigan's highest-income taxpayers.



Source: SOI Tax Statistics, Internal Revenue Service (2019).

In other words, the Opportunity Zones program is a tax credit for only the wealthiest Michigan residents. Early evidence shows the average household income for Opportunity Zone investors in 2019 was over $4.8 million.[7] And for those who do have the right kind of income to participate, the tax savings are substantial.

Individuals or corporations with capital gains can invest this income in a Qualified OZ Fund, of which 90% must be invested in an OZ business or property. While investors will eventually pay taxes on the capital gains from the initial sale, they will never be required to pay taxes on the sale of the OZ investment so long as it is held for ten years.

The Opportunity Zone program offers three types of tax incentives for investors:

Temporary tax deferral.

Investors who place existing assets with capital gains in a Qualified OZ Fund will not owe taxes on the gains from the original investment until 2026.

Permanent tax exclusion.

In addition to the deferral, investors will not pay taxes on capital gains from the OZ investment so long as the investment is held for at least ten years.

Tax reduction.

Finally, capital gains left in Qualified OZ Funds for at least five years will benefit from a base increase of 10% to 15%, effectively reducing taxes owed on the original investment.

Because there is no limit to the number of investors who can participate, nor is there a limit on the amount they are allowed to invest, the potential revenue losses are substantial.

Early Evidence

Early evidence on Opportunity Zones reveals the program has limited impacts for zone residents. To date, researchers have shown that OZs have had no or negligible effects on a number of outcomes, including home prices,[8] job vacancies, wages,[9] employment rates, and poverty.[10] Urban OZs appear to have had some positive effects on employment growth relative to unselected census tracts, driven largely by the creation of new establishments, but this trend did not hold up for rural zones.[11]

The program's limited impacts may be explained in part by the high concentration of investments in OZs with relatively higher incomes, home values, educational attainment, and gentrification. Data from paper tax returns is not yet available, but electronic filings from tax years 2019 and 2020 reveal not all OZs are benefiting from the program.

Opportunity Zones in the Detroit metro area have received a relatively large amount of investment through the program at nearly $5,000 per resident, but approximately 40% of designated zones in the city did not receive any investment. Across the country, the majority (63%) of OZ tracts received no investments in the first two years.[12]

While Michigan generally succeeded in selecting Opportunity Zones from communities with the greatest need, this evidence suggests being a designated OZ does not guarantee interest from investors. These results demonstrate what early critics of the program warned: investors will choose the most attractive sites for development over those with the greatest need.[13] Because investors have the choice to fund projects in relatively high-income, low-poverty OZs, there is no incentive to instead invest in the areas with the highest need.

> **"So many other OZs are more attractive to investors that money may never flow to these poorer zones even with the lure of the tax break."**
>
> David Wessel's *Only the Rich Can Play*

Problems with Opportunity Zones

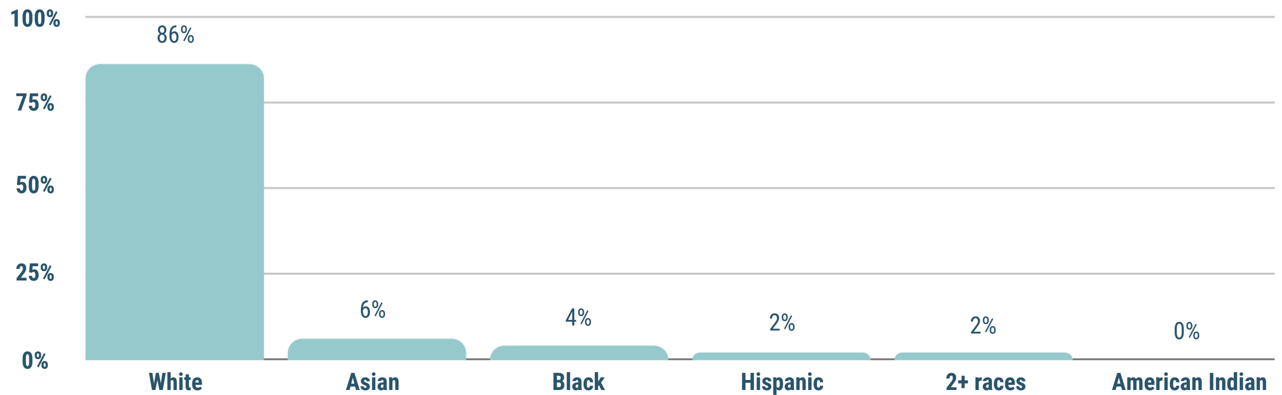
1

The program may exacerbate racial inequities.

Poverty exists and persists in Black and Brown communities in part due to the inequitable policies and institutions—including segregation, redlining and predatory lending—that maintain racial wealth and income disparities. The OZ program attempts to address racial inequities by attracting wealthy outside investors rather than investing in the people and businesses already living there.

Although we know little about the investors taking advantage of the program, we do know Opportunity Zones primarily benefit the richest Americans, who are disproportionately White. Opportunity Zones funds are often only open to "accredited investors," which requires the individual or corporation to have a minimum income of at least $200,000 in the past two years and a net worth over $1 million (excluding the primary residence). Few Americans have this level of wealth, and in 2020, less than 5% of households in Michigan with incomes over $200,000 were Black.[14]

White families make up the vast majority of Michigan households earning over $200,000.



Source: MLPP analysis of OZs based on ACS (2011-2015) data.

In addition to the direct ways in which Black and Brown Michiganders are not able to take advantage of the program as investors, the state revenue losses will divert resources away from schools and public services that benefit communities of color. State and federal tax dollars intended to fund child care, job training programs, and other essential services that promote opportunity will instead go to very wealthy, predominately White investors.

Rather than working to convince wealthy investors of the value of bringing capital to low-income communities of color, Michigan needs policies that invest directly in these communities and their local businesses.

2 There is a mismatch between investor wants and community needs.

Within Opportunity Zone communities, investors have little incentive to invest in businesses or projects that reflect the interests of residents. Opportunity Zone funds can be invested in real estate developments as well as directly into new or existing businesses, but research so far suggests the majority of OZ funding is typically directed towards commercial real estate investments. Smart Growth America found the design of the program prevents it from attracting investments to minority-owned small businesses or legacy businesses owned by community members.[15]

> **"Federal policy that is supposed to be enhancing opportunities for at-risk communities is in fact drawing potential investment away and concentrating it in an already well-resourced community."**
>
> Jean Hardy's *Rural Transformation in the 21st century*

From the investor perspective, real estate generally offers larger, more predictable projects with a higher rate of return. From a small business perspective, owners often prefer debt over equity financing and can find the rules and regulations around the new tax incentive difficult to understand. The mismatch between OZ investor and OZ business interests reduces the potential impact of the program.

This mismatch is perhaps most obvious in rural communities, where investment opportunities rarely have the high rate of return or fast growth investors seek. Research suggests Opportunity Zones are "incompatible" with rural development, both because of the program's failure to consider the needs of rural communities and its focus on growth rather than long-term sustainability.[16] It comes as no surprise that the Michigan Opportunity Zones Office, coordinated by the Michigan State Housing Development Authority and the Michigan Economic Development Corporation, has no examples of rural investments on its website, and it remains unclear if any rural zones in Michigan have managed to attract OZ investment.

3 States are subsidizing investments that would have occurred anyway.

A longstanding criticism of economic development incentives focuses on the very small role of tax breaks in firm location and investment decisions. A review of 30 studies found at least 75% of firms benefiting from economic development tax breaks would have made similar investment or location decisions even without the incentive.[17]

The structure of the program assures many of the resulting investments would have been made even without the tax breaks. While no data exists to show what share of projects had already begun before the new tax credit was passed, David Wessel, senior fellow at the Brookings Institution, found numerous anecdotal examples nationwide of developers investing OZ funds in buildings that were already complete or nearing completion.[18]

Because the size of the OZ tax break increases with the return on investment, investors are incentivized to seek out projects that are the least risky and would already attract investors even without the OZ designation. There is no added benefit to the investor of selecting an affordable housing project with a large social impact over a luxury housing development in a rapidly growing neighborhood. In fact, the return to the investor will almost certainly be greater in the latter case.

Some tracts likely to attract investors without the Opportunity Zone designation include areas around colleges and universities. These areas qualify as low income because large concentrations of students skew the income data, but they are often attractive to developers who can take advantage of a guaranteed market of reliable renters. In Michigan, 21 colleges and universities overlap with an Opportunity Zone, including Wayne State, Northern Michigan and Eastern Michigan.

Other tracts likely to attract investors even without the OZ designation include those in stadium districts. All three major sports venues in Detroit—Comerica Park, Little Caesar's Arena and Ford Field—are in designated Opportunity Zones. Similarly, stadium districts in Lansing and Midland fall within OZ tracts. While tracts like these represent just a small share of OZs, investors will prefer to invest in zones like these compared to those with low levels of existing development. Nothing about the OZ legislation prohibits it.

In Detroit, Comerica Park, Little Caesar's Arena, and Ford Field are all in designated Opportunity Zones.

In Lansing's stadium district, investors took advantage of OZ tax breaks while developing a mixed-use building with an upscale grocery store, above-market rental units and a hotel.[19] A two-bedroom apartment here begins at $1,915 (as of May 2022).[20] Based on HUD guidelines, this unit would only be "affordable" for someone earning $76,600 annually, which is far above the median family income of less than $50,000 in its census tract. Nothing about this development is against the rules of the program. While the stated intent of the Opportunity Zones legislation may have been to encourage growth and investment in low-income communities, developers are not obligated to make this a priority.

4 Many Opportunity Zones were already experiencing high levels of socioeconomic change.

When a traditionally low-income neighborhood is gentrifying, it attracts more wealth and investment at the expense of existing residents, who often find themselves priced out. Critics of place-based economic development policies have long worried how tax incentives could serve to displace the exact communities they seek to help, and Opportunity Zones will have these same negative impacts if they drive investments to tracts already experiencing socioeconomic change.

When OZ legislation passed in December 2017, eligibility for the program was based on the already outdated 2011-2015 American Community Survey (ACS) data. Because Michigan was still recovering from the Great Recession, many eligible census tracts were undergoing high levels of socioeconomic change during this time. Despite having the largest reduction in the unemployment rate of any state from 2010 to 2011, Michigan's unemployment rate was still significantly higher than the U.S. average.[21]

A national Urban Institute study reviewed the number of OZ census tracts between 2000 and 2016 to assess whether the program is encouraging investments in communities already experiencing high levels of socioeconomic change. Compared to eligible but unselected tracts, OZ tracts in Michigan were 3.5 times more likely to have experienced high levels of socioeconomic change during this time period.[22]

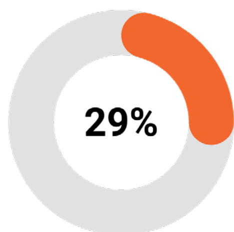
As a result, many of the tracts that met the income and poverty criteria when zones were selected are no longer considered economically distressed. Only 56% of Opportunity Zones in Michigan were considered both high poverty and low income in 2019 compared to 70% when the zones were initially selected. The number of OZs considered "high poverty" shrunk by over 18 percentage points by 2019 when the first investments began flowing into communities.

Changes in tract characteristics, 2015-2019

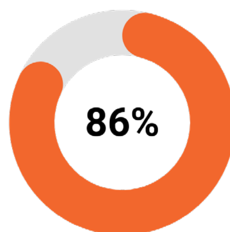
OZ Type	2015	2019	Percentage Point Change
High-poverty, low-income tracts	70.1%	56.3%	↓ 13.8
High-poverty, high-income tracts	11.1%	6.6%	↓ 4.5
Low-poverty, low-income tracts	16.7%	6.6%	↑ 14.6
Low-poverty, high-income tracts	2.1%**	6.6%	↑ 3.8

Source: MLPP analysis of OZs using ACS data.
**The incorrectly labeled census tract in Detroit is included here because it is in fact low poverty and high income.

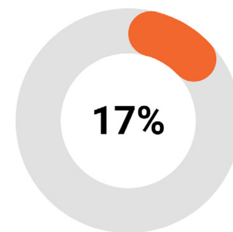
Because the designated OZ tracts are fixed, the state cannot update eligible tracts to better target truly disadvantaged communities. Investors will continue to receive outsized benefits for investments in these 288 Opportunity Zones through 2028, even as the number of high-poverty tracts shrinks.



Of the 100 poorest census tracts, only 29% were selected as Opportunity Zones.



Approximately 86% of Opportunity Zones are in urban tracts while only 14% are in rural tracts.



Only 17% of Michiganders reported capital gains in 2019, and most of these gains accrued to the top earners.

Policy Recommendations

Because Opportunity Zones are part of a federal program, the state is limited in its ability to change or improve its administration. Nevertheless, Michigan can take action on the two policy recommendations made below.

Decouple from federal OZ provisions.

The Opportunity Zone provisions lower the "gross income" of individual or corporate taxpayers. Because most states use the federal definition of adjusted gross income to determine how much is owed in state income taxes, these tax breaks at the federal level will automatically flow through to the state and contribute to revenue losses here in Michigan.[23]

As in most states, Michigan's overall state and local tax system is already regressive, meaning households with lower incomes pay a higher share of their incomes in taxes. The loss of income tax revenue from high-income households and businesses investing in Opportunity Zones will shrink the tax base, forcing the state to rely more heavily on regressive consumption taxes that hit low-income households the hardest.

Even more concerning, because a Michigan investor can place money in out-of-state OZs, the State of Michigan will be giving a tax break to individuals and corporations for their investments in other states. Some states, including North Carolina and New York, have already decoupled from some or all of the OZ provisions. Unless Michiganders want to pay for economic development projects in California, the state should take quick action to decouple from the program.

Introduce state reporting requirements.

The state should adopt annual reporting requirements to increase transparency and accountability, identify best practices, and reduce the risk of fraud. Because the federal government has not established any reporting requirements, it is up to states to set the metrics and evaluate the program.

The state should keep a public record of projects that can be disaggregated by census tract, OZ fund, dollar amount of investment and date of investment. Data should also be collected on the number of rental units before and after the investment is complete, the number of affordable units, the number of units sold, sales at affordable prices, the number of residents displaced, and the number of jobs created.

Having state-level data will allow researchers to identify misuses of the program, costs to the state and impacts on communities. At the same time, data will open the door for state agencies, community groups, and other stakeholders to improve coordination with investors and ensure funds are going to priority communities and projects.

Over 97% of counties received at least one OZ, including 100% of counties with eligible tracts. The two counties without any Opportunity Zones, Benzie and Leelanau, did not qualify due to low poverty rates and relatively high median family incomes.

End Notes

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