Opportunity Zones as a Solution to California's Housing Crisis

Introduction

Governor Gavin Newsom pledged in his campaign platform to provide California with 3.5 million new homes by 2025. Though that number seems very hefty, the need for new and low-income housing in the State is absolutely essential, considering the rapid growth in population and homelessness in many localities. In what could be a potential stroke of luck for the governor, the Trump administration's 2017 tax reform provided a possible route to significantly cheaper real estate development in regions they deemed need it most. Through the newly formed 'Opportunity Zones' program, hundreds of regions in the state may be able to entice real estate development through significant breaks in capital gains tax related to future development.

Tax Incentives at Disposal

Opportunity zones present a number of positive opportunities for California but are especially interesting in their capacity to incentivize housing development in vulnerable communities. The potential benefits provided by designated zones include:

"1. Taxation on the original gain is deferred until the earlier of disposition of the QOF interest or December 31, 2026

2. Reduction of those deferred taxes by 10% if property is held for 5 years and by 15% if property is held for 7 years, or possibly further reduced under a fair market value calculation in 2026

3. No taxes due on any additional gain generated by the QOF upon sale or exchange of the investment if a QOF is held for 10 or more years (Citi)."

While these capital gains incentives are enticing, the scope of possible investment in the State is even more interesting. According to California's opportunity zone team, there are 879 designated tracts in the State, 57 counties with at least one tract, and approximately 3 million Californians living in opportunity zones (CA Opportunity Zones). I wanted to conduct several specific analyses to determine if the tracts could be further incentivized by other designated housing programs and if the designated tracts are actually in regions that need housing. Additionally, I wanted to determine whether the regions designated are actually conducive for likely development.

Analyses of Combined Opportunity Zone and LIHTC Regions

Since 1986, the main source of fiscal incentives in the development of affordable housing has stemmed from the 'Low Income Housing Tax Credit' (LIHTC). To date, 90% of all affordable housing built in the United States is a result of LIHTC incentives according to the New York Times (New York Times). Much like opportunity zones, LIHTC's have 'difficult development tracts' designated for varying levels of tax incentives. The difference being, LIHTC's provide long-term tax credits, that can be used on a wider scale than just capital gains tax. There are significant similarities in the codes, requirements, and capabilities of OZ's and LIHTC's, that in fact, open the door to investments that can combine both programs together in regions that are designated under both.

I believed that my analysis would show significant combinable capabilities given the similarities in each programs purpose; however, the intersection of the two programs designated tracts proved otherwise. Within California as a whole, only 489 of the 879 total opportunity zone tracts corroborated with LIHTC tracts (See Figure 1). Even more surprising was the scope and regions in which intersections occurred within Los Angeles county. Opportunity Zones as a whole are scattered throughout much of Los Angeles county, but when overlaid with LIHTC's, the only regions in LA that could strongly benefit were actually West Hollywood, Beverly Hills, Malibu, and Long Beach (See Figure 2). Though there are areas within some of these regions that could use housing development, there are two major issues with these results. Firstly, there are several regions in Los Angeles that are much more dire in terms of housing development then these localities. As well, the regions with the combinable incentives are not only predominantly upper class but have been historically reluctant to accept affordable housing development.

With the understanding that LIHTC's are heavily utilized for affordable housing across the country, it seemed suspicious that they would not be very correlated with opportunity zones. To better understand the potential effectiveness of opportunity zones and determine whether they were actually formulated for tracts in need of development or whether they were falsely advertised by the current Presidential Administration.

Analyses of Housing Need in Cal OZ's (Figures 3 and 4)

The first indicator used to test the potential effectiveness of opportunity zones in California was to measure their relationship with the Social Vulnerability Index's housing vulnerability levels (see figure 3). The housing index measures the need for greater housing in a general area. Regarding the State's housing vulnerability, many of the designated tracts in Northern California were not very socially vulnerable. Conversely, in regions with much higher population levels and needs for housing, such as the bay area and the majority of Southern California, opportunity zones were exclusively in medium to high levels of social vulnerability (most being high).

On the Los Angeles County level, opportunity zones seemed to predominantly address the communities with the highest housing vulnerability levels (see figure 4). The only opportunity zone regions that dipped below high housing vulnerability rates were actually in the combined LIHTC regions. Indicating that opportunity zones may actually be more helpful in addressing affordable housing needs.

Analyses of Housing Development Possibility in Cal OZ's (Figures 5 and 6)

While it is beneficial that opportunity zones were determined to address real cases of social vulnerability in the majority of designated tracts, it seemed pertinent to measure whether there has actually been recent development in these tracts before opportunity zones. To test the current state of housing for low-income people and their ability to stay economically sustainable in their living space, I intersected opportunity zones with their Housing Burden Percentile from the California EnviroScreen Scores. Regions with high housing burden scores indicated that much more middle to upper income housing was being constructed than low income, effectively raising living expenses and housing costs. The regions with higher burdens could use opportunity zones as a better incentive to produce affordable housing instead of embarking on luxury developments for investors. Meanwhile, those regions with low housing burden scores may either not need significant amounts of additional low-income housing or could be struggling to find any housing investors at all.

Overall, the EnviroScreen scores were fairly similar to the social vulnerability indicators on a regional basis. Northern California had a much lower housing burden than Southern California, most likely due to increased gentrification and population growth (See figure 5). The state itself proved to be slightly less consistent in its need for opportunity zone development using this indicator comparatively to social vulnerability. This trend was also the case at the Los Angeles County level, where there was a great variability in the housing burden scores than previously observed in the social vulnerability levels. Nonetheless, the County's opportunity zone tracts were still predominantly in the highest burden category, with all but 5 tracts in the Downtown, West Hollywood, Beverly Hills and south-central regions indicating a significant need for affordable housing development.

Conclusion

In terms of the limitations of my research and projections for potential opportunity zone outcomes, there are a couple significant issues. As of now, the opportunity zone legislation is still somewhat vague, which forces rough projections and estimated impact instead of known possibilities. This project would probably be easier to complete a year or two from now, when the legislation is more concisely defined. Moreover, since there are no large-scale housing developments completed in California as of yet, there were few indicators as to how receptive housing developers will ultimately be to the incentives.

I originally expected to find that opportunity zones would overlay the regions that needed additional housing, but I also expected to find a lack of potential real estate development zones because of a trending reluctance to produce affordable housing over luxury or middle-class homes. It seems, to a degree, that my hypothesis was correct on each of these factors. The opportunity zones almost overwhelmingly related to highly vulnerable populations related to housing, while most of these regions were also experiencing higher end development, which pushed out and increased prices on vulnerable populations.

Additionally, I initially believed that I could counterbalance this development reluctance with the potential to combine opportunity zone and low-income housing tax credit benefits together. Even though the two are intended to solve similar issues, my analysis indicated that this is not a possible solution in many of the most vulnerable communities but may be possible to implement in more affluent communities that hold both benefits, if they are willing to accept affordable housing development. The localities represented by both tax breaks were disappointingly not representative of a majority of the regions that need it most, especially in Los Angeles.

In regard to my comparison of the State with Los Angeles County, I anticipated that there would not be a huge difference in the low-income levels and social vulnerability rates because each tract had to pass minimum requirements. What I found on the other hand, was that Los Angeles County held tracts, for the most part, in communities that desperately need low-income housing, while much of the rest of the State's designated tracts are not nearly as socially vulnerable or burdened by increasing living expenses.

Related to the Governor's housing development plans, I believe there are legitimate possibilities for increased development rates by 2025. As mentioned earlier, LIHTC's account for 90% of affordable housing development, but since about half of the opportunity zones are not in designated LIHTC tracts, many regions may be able to finally incentive greater production. Additionally, the 489 census tracts that are combinable between opportunity zones and LIHTC's present significant housing and infrastructural development potential. The main consideration moving forward will be determining how some of the vague components of the opportunity zone tax code will be defined. Either way, the Governor should work closely with localities around the state to educate and promote opportunity zones as a means for resolving housing concerns.

Proof Reader: David Calkins

Figure 1

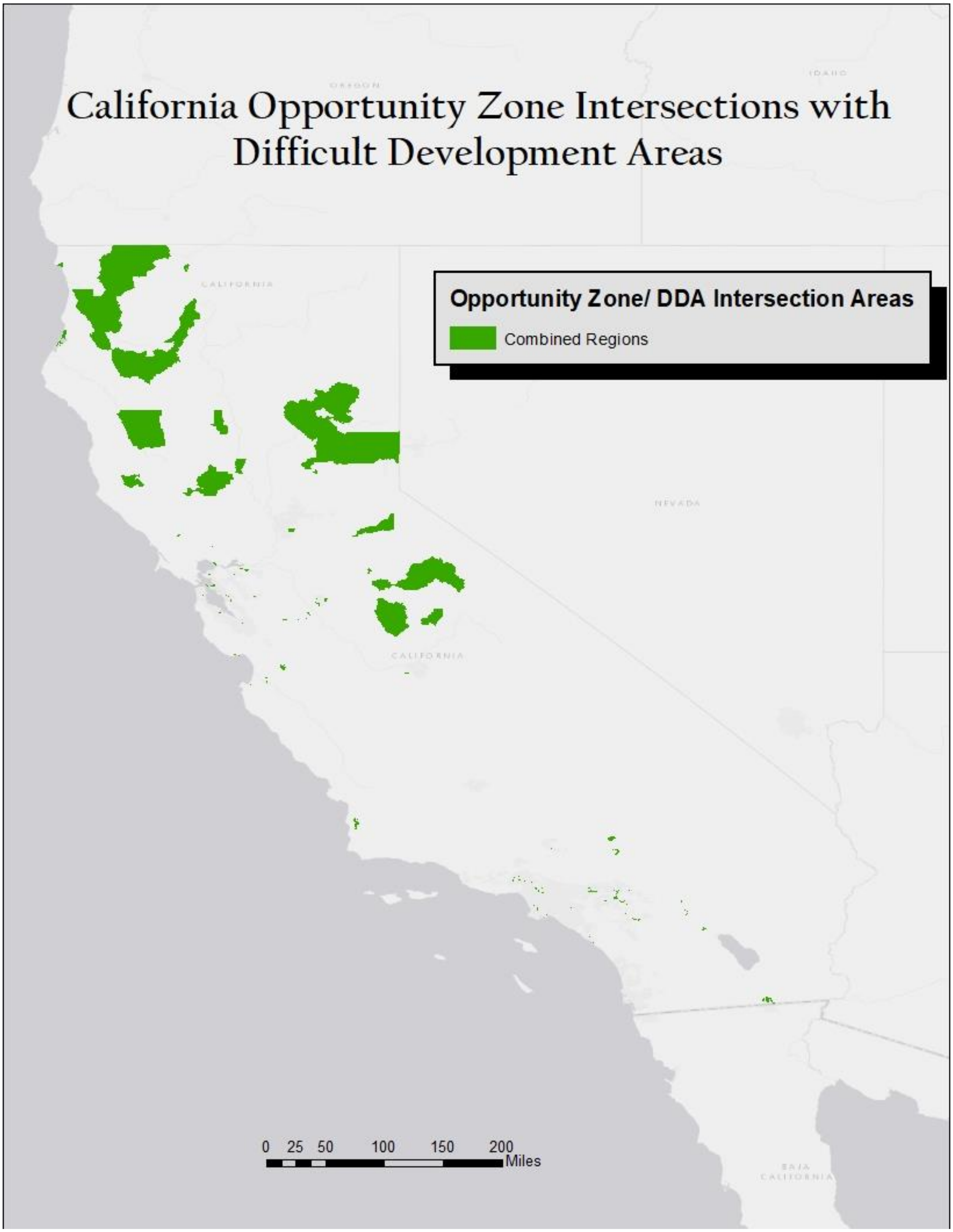

California Opportunity Zone Intersections with Difficult Development Areas
Opportunity Zone/ DDA Intersection Areas
Combined Regions
OREGON
IDAHO
CALIFORNIA
NEVADA
CALIFORNIA
BAJA CALIFORNIA
0 25 50 100 150 200
Miles

Figure 2

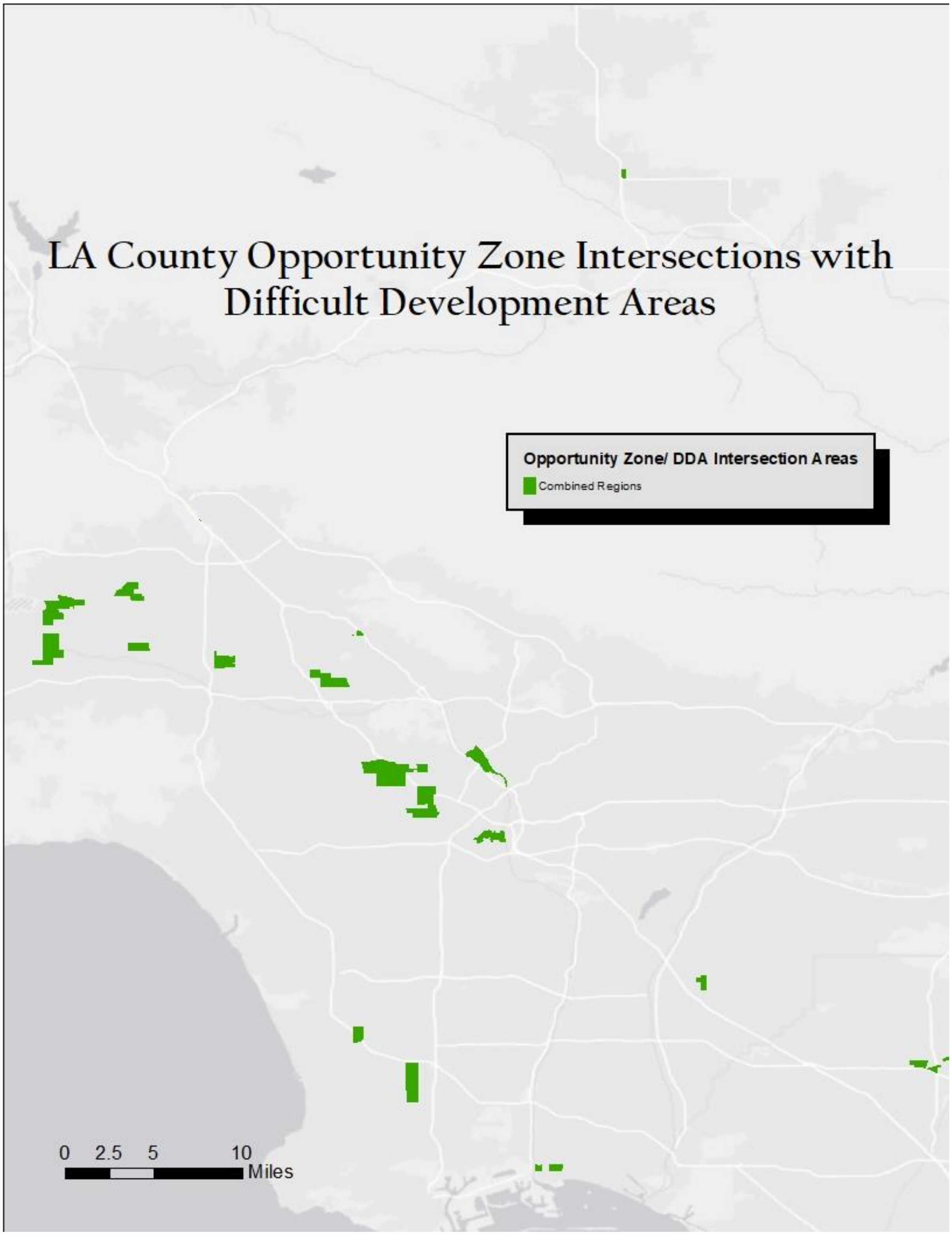

LA County Opportunity Zone Intersections with Difficult Development Areas
Opportunity Zone/ DDA Intersection Areas
Combined Regions
0 2.5 5 10
Miles

Figure 3

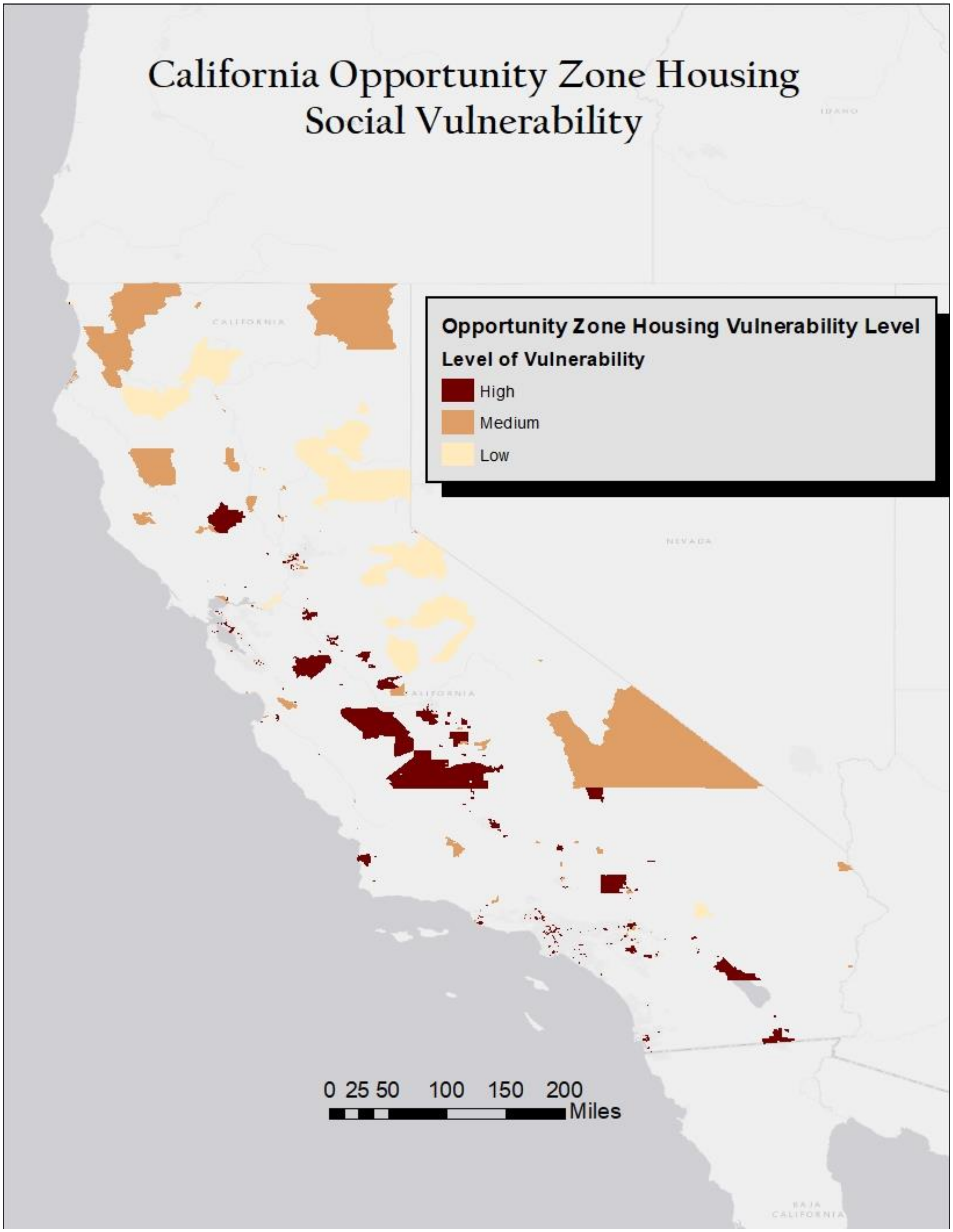
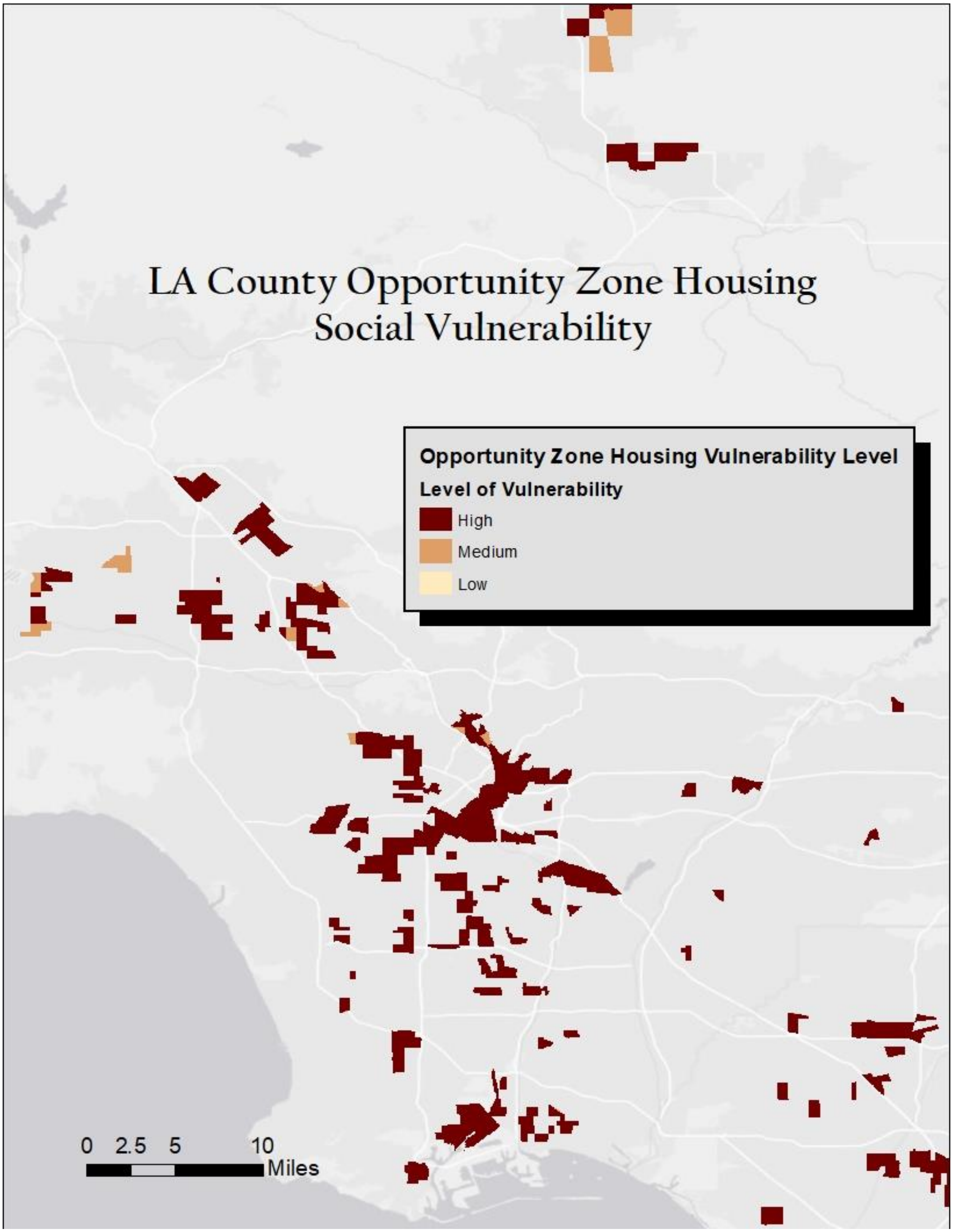

California Opportunity Zone Housing
Social Vulnerability
Opportunity Zone Housing Vulnerability Level
Level of Vulnerability
High
Medium
Low
0 25 50 100 150 200
Miles

Figure 4


LA County Opportunity Zone Housing Social Vulnerability
Opportunity Zone Housing Vulnerability Level
Level of Vulnerability
High
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0 2.5 5 10
Miles

Figure 5

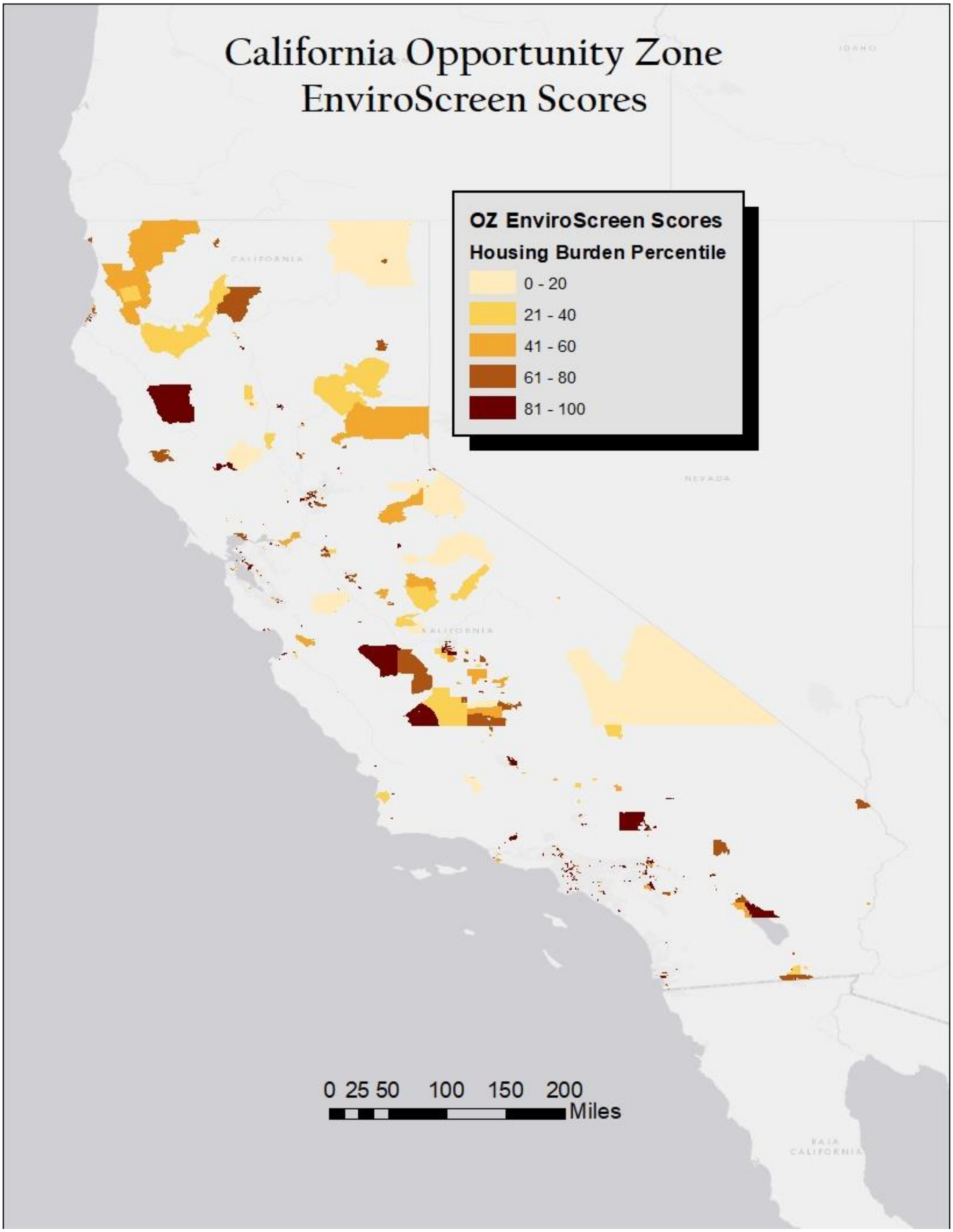
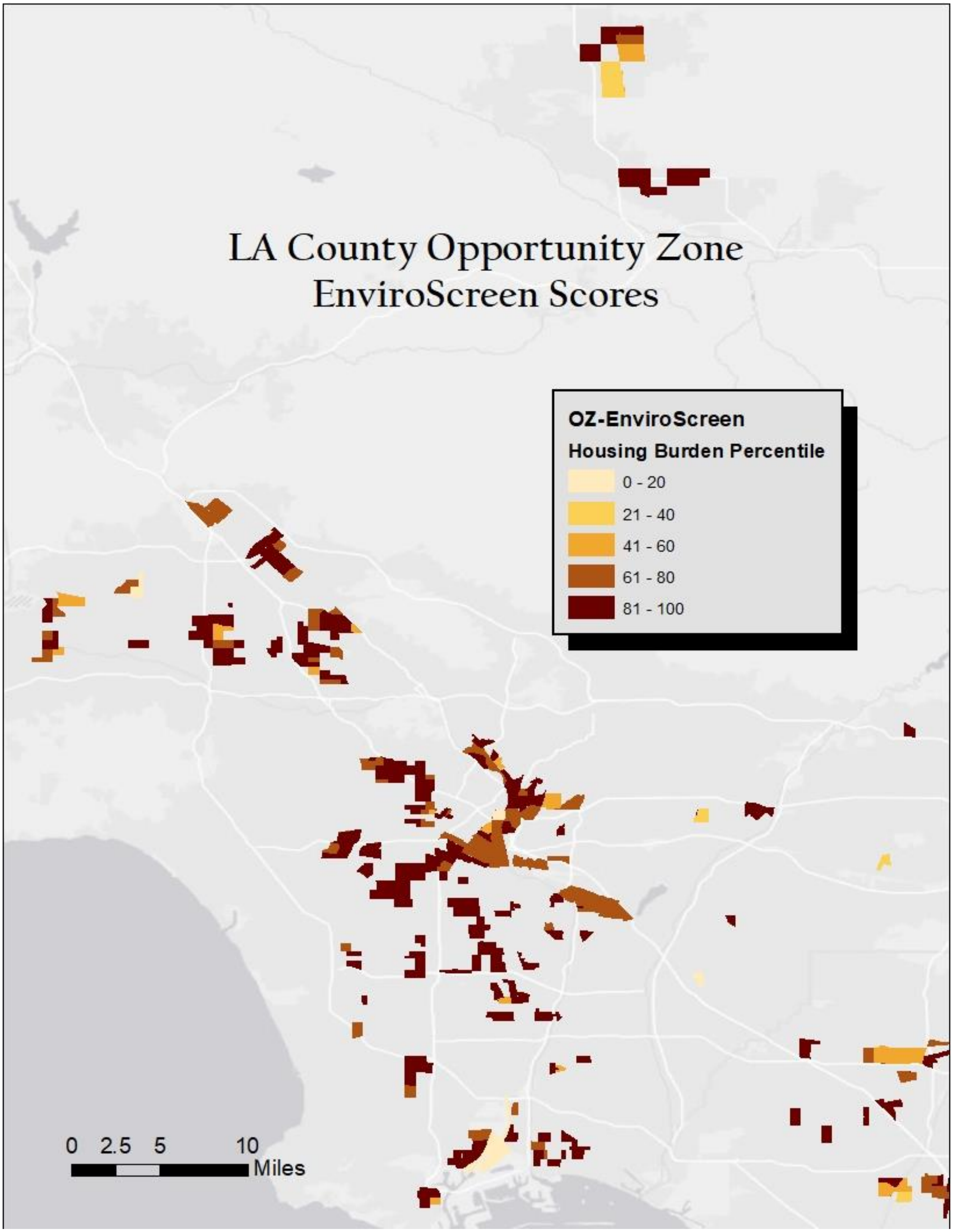

California Opportunity Zone
EnviroScreen Scores
OZ EnviroScreen Scores
Housing Burden Percentile
0 - 20
21 - 40
41 - 60
61 - 80
81 - 100
0 25 50 100 150 200
Miles
NEVADA
CALIFORNIA
IDAHO
BAJA CALIFORNIA

Figure 6


LA County Opportunity Zone
EnviroScreen Scores
OZ-EnviroScreen
Housing Burden Percentile
0 - 20
21 - 40
41 - 60
61 - 80
81 - 100
0 2.5 5 10
Miles

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