Strategic Selection of Opportunity Zones 2.0: A Governor's Guide to Best Practices

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Categories:

Matters of Interest
One Big Beautiful Bill Act

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Governors across America face the most significant Opportunity Zone (OZ) redesignation since the program's inception. The stakes are high. With the One Big Beautiful Bill Act signed in July 2025, the federal OZ program is now permanent. New designations begin July 1, 2026, and take effect Jan. 1, 2027.

The numbers tell the story: approximately $100 billion of OZ investment was used in the first round. The decisions governors make in 2026 will shape economic development patterns in their states for the next decade. This isn't just another economic development program—it's one of the most powerful tools available to state governments.

How 2018 Selections Were Made

The 2018 designation process was compressed following Congress' passage of the Tax Cuts and Jobs Act in December 2017. Governors faced a March 21, 2018, deadline. Despite this, most states approached it thoughtfully. California revised one-fifth of its nominations after public feedback. Pennsylvania received recommendations for 61% of eligible tracts. North Carolina designated at least one OZ in each of its 100 counties.

- **What governors prioritized:** The average OZ had a 31% poverty rate (above the 20% threshold) and income of 59% of area median. Fully 69% of residents lived in "severely distressed" tracts. Governors used the contiguous tract provision sparingly (2.6% of tracts). Less than 4% of zones showed gentrification indicators.
- **What actually happened:** By 2022, 75% of investment went to urban areas despite 45% of zones being rural. About 75% went to real estate (mostly residential). While 66% of zones received investment, one-third received nothing. Ohio data

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showed funded neighborhoods already had stronger fundamentals than unfunded areas.

The OZ 2.0 Timeline

The One Big Beautiful Bill Act (OBBBA), signed July 4, 2025, made the OZ program permanent with decennial redesignations beginning July 1, 2026.

Key changes:

- Median family income must be below 70% (down from 80%)
- Poverty rate of at least 20% with income below 125% of area median
- Contiguous tract exception eliminated
- Enhanced rural benefits: 30% basis step-up (vs. 10%) and 50% substantial improvement threshold (vs. 100%)

Critical dates:

- **December 2025**: Updated census data is typically released at year end.
- **Spring 2026**: Treasury releases eligible tract list, an early projection of which is available now with Novogradac or the Economic Innovation Group.
- **July 1-Sept. 28, 2026**: 90-day nomination window.
- **Jan. 1, 2027**: New zones take effect.

Best Practices for Selection

Before diving into specific criteria, analyze your current OZ performance—but with an important caveat. OZ 1.0 results don't reflect the program's flexibility for diverse real estate and business projects that need capital. The first iteration saw an estimated 75% of investment concentrated in real estate, with much of that in residential projects. This pattern doesn't represent the program's full potential to support diverse project types, including commercial, industrial, operating businesses, and mixed-use developments.

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- **Analyze past performance:** Identify which tracts attracted significant investment and why—e.g., proximity to downtown, anchor institutions, transit access, or existing market interest. Understand which zones attracted nothing and the reasons. Review total OZ investment, number of zones receiving investment, project types, job creation, and geographic distribution.
- **Compare to national benchmarks:** Per the national average, 66% of zones received investment through 2022. Among the high performers were Vermont (60%), Mississippi (64%), and South Dakota (68%). Investment was concentrated 75% in urban areas and more than 75% in real estate.
- **Don't repeat mistakes:** Avoid re-selecting remote rural areas with zero investment, political favor zones, gentrifying areas, or scattered random selections. Consider re-selecting 40-50% of current high-performing eligible zones, while dedicating 50-60% to fresh areas that could attract the broader range of investment types the program was designed to support.
- **Special consideration—natural disasters:** Areas that experienced recent natural disasters (hurricanes, wildfires, tornadoes, flooding, etc.) deserve priority. These areas had functioning economies pre-disaster and need capital. Disaster recovery is politically popular and bipartisan. Check FEMA disaster declarations—census tracts must still meet income or poverty thresholds.

A. Consider Areas at 60% or Below of Area Median Income

The area median income (AMI) for OZ 2.0 has dropped from 80% to 70% for eligible census tracts. Where possible focus on severely distressed census tracts with median family income at 60% or below AMI. This is the sweet spot—balancing genuine distress with realistic investment potential.

The CDFI Fund defines "severely distressed" as areas below 60% AMI. Designated OZs in 2018 averaged 59% AMI. Communities

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receiving investment averaged the 87th percentile for poverty.

The problem with going too low: Areas significantly below 60% AMI face compounding challenges—limited private sector presence, insufficient infrastructure, population decline, weak institutional capacity. While desperate for investment, they may lack absorptive capacity to benefit from a tax incentive alone.

How to apply this:

- **Prioritize**: 50-60% AMI with positive indicators (anchor institutions, recent investments, infrastructure)
- **Consider carefully**: 40-50% AMI with realistic investment paths
- **Include selectively**: Below 40% AMI only with unique assets (waterfront, transit, major anchor)
- **Avoid**: Above 65% AMI unless exceptional circumstances

B. Decide Your Rural-Urban Split

The optimal balance varies dramatically by state. There's no magic formula. The right split depends on your state's unique geography, economic structure, population distribution, and natural assets.

- **Size and number of major cities:** States with large metropolitan areas should weigh selections toward urban zones where investment capital naturally flows. New York, California, and Texas with multiple major metros, might allocate 60-70% to urban areas. West Virginia or Kentucky, which are without major metropolitan centers, should distribute more evenly—perhaps 50-50 or even 55% rural.
- **Natural assets and economic structure:** Colorado with Rocky Mountain tourism might allocate 40-45% rural, targeting gateway communities and mountain resort areas. Tennessee with the Smokies could justify 45% rural. California's diverse geography—coastline, agriculture, wine country—supports 35-40% rural. Ohio and Indiana with agricultural economies and manufacturing heritage might allocate 40-45% rural, focusing on regional manufacturing centers, ag-processing facilities, and secondary cities along

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interstate corridors. States with Great Lakes access or along the Ohio River corridor have natural advantages for manufacturing, shipping, and logistics operations—these water transportation assets should factor into rural-urban splits and specific tract selections. West Virginia's resource-based economy could warrant 55-60% rural, targeting coal-transitioning communities, natural gas infrastructure areas, and Appalachian tourism development.

Recommended Frameworks

Large Diverse States (California, Texas, New York)

- 60-70% urban/suburban | 30-40% rural
- Focus rural on secondary cities, natural assets, border communities (TX), agricultural regions (CA)

Mid-Size Metro with Assets (Colorado, Tennessee)

- 50-55% urban | 45-50% rural
- Target gateway communities, tourism corridors, mountain/recreation areas

Industrial Belt States (Ohio, Indiana, Kentucky)

- 50-55% urban | 45-50% rural
- Focus on manufacturing centers, interstate corridors, regional hubs, agricultural processing

Small Metro/Rural States (West Virginia)

- 40-45% urban | 55-60% rural
- Target resource-transitioning communities, tourism gateways, regional economic centers

The political reality: Whatever split you choose, ensure every region has representation and selections create logical clusters connected by transportation corridors. A state concentrating 80% in its largest city will face rural backlash. Over-allocating to remote rural areas with no investment potential produces failure rates that undermine the program's usefulness.

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C. Select Rural Areas with Transportation Access

Rural areas were 45% of 2018 designations but received only 25% of investment. Enhanced rural benefits aim to correct this, but financial incentives alone won't overcome barriers.

Prioritize rural tracts with:

- **Major highways**: Interstate exits within 10 miles
- **Navigable water**: Working rivers with barge traffic, ports
- **Rail and air**: Freight rail, passenger rail, regional airports
- **Major ports**: Deep water, inland, intermodal facilities

Target: Focus on regional economic centers, such as county seats, towns with hospitals/colleges, historic downtowns, and utility infrastructure.

Avoid: Deprioritize remote areas (90+ minutes from towns over 20,000) with no paved access, declining infrastructure, no anchors, and depopulation.

Strategy: Concentrate on rural selections in 2-3 regions for critical mass rather than scattering them across every rural county.

D. Follow the Smart Money

Has a credible investor, developer, or fund manager expressed genuine interest in a particular census tract? This matters. Screen for legitimate need and investor credibility rather than political connections.

The OZ program is market-driven. A tract with no conceivable investment interest is wasted, no matter how needy. Demonstrated investor interest is the strongest predictor of actual investment.

Balance your selections:

- **50-60%**: Tracts with demonstrated investment interest
- **30-40%**: Higher-need tracts (below 55% AMI) with strong fundamentals but no specific interest yet
- **10%**: Strategic gambles—very high-need or disaster zones

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Maintain integrity: Create transparent scoring where investment interest is one factor (20-30% weight), not the sole criterion. Publish draft selections for public comment.

The bottom line: The decisions governors make in 2026 will direct tens of billions in private investment over the next decade.

Key Takeaways

- Analyze past performance but recognize OZ 1.0 results underrepresent the program's flexibility for diverse real estate and business projects.
- Focus on census tracts at 60% AMI or below—genuinely distressed but with potential.
- Strategic rural-urban split will depend on your state's metro size, natural assets, and economic structure.
- Rural areas need transportation infrastructure—highways, ports, rail, or airports.
- Follow smart money—known investment interest predicts investment, but screen carefully.
- Publish your nominations when submitted to the Treasury Department—don't wait for certification. The Treasury is simply going to verify eligibility and as in 2018 is not expected to make substantial changes to state recommendations. Early disclosure allows capital providers to plan, and develop pipelines before Jan. 1, 2027.

Start early and publish immediately upon Treasury submission: Don't wait until June 2026. Be transparent—publish methodologies and draft selections, and give investors maximum lead time.

Think long term: These OZ designations last a full decade. Support selected zones—provide technical assistance and market to investors.

Governors who approach the 2026 selection process strategically can catalyze billions in investment that transforms struggling communities.

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The choice is clear. The data is available. The time is sufficient. Get it right.

For more information or assistance with the OZ 2.0 application process, please contact the author or any attorney in Frost Brown Todd's Public Finance practice group.

This guide synthesizes analysis of the One Big Beautiful Bill Act of 2025, research on first-round Opportunity Zone outcomes from Economic Innovation Group, Urban Institute, Brookings Institution, and academic studies, along with best practices in place-based economic development policy

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