Opportunity Zones Knock Where They're Needed Least.

Places like Chapel Hill are poor areas on paper because they're filled with jobless college kids.

If you stroll down Franklin Street, the main drag here in this wealthy college town, you aren't likely to think you've landed in a disadvantaged place. Just a few blocks from the main campus of the University of North Carolina, groups of happy-looking young people crowd the sidewalks and patronize businesses including Starbucks, Chipotle, Cold Stone Creamery, several national bank branches, a bike shop, a craft-beer brewery and a wine bar.

But like many commercial areas adjacent to major colleges, this section of Chapel Hill is primed to attract millions of additional dollars in new investment thanks to changes that were part of the 2017 tax law. Investors around the country are racing to take advantage of one of the hottest tax-planning strategies in wealth management: sticking money into "opportunity zones."

The program allows investors to reduce and defer paying capital-gains taxes until 2026 by investing in high-poverty communities. But because of the way the federal government wrote the rules, some census tracts—including Chapel Hill's—appear on paper to be high-poverty areas but are actually populated by college students with no income. As a result, a tax benefit intended to help poor areas is channeling money to places that are already relatively well-off.

It's true that Chapel Hill's opportunity zone has a poverty rate of 47%, three times the state average. But the zone's median age is 22, 99.8% of residents have high-school diplomas and 49% say they've moved in the past year. The tract has a lot of apartments and rental units—including nearly a dozen fraternity and sorority houses—but the median value of owner-occupied housing is $500,000, or triple the state average.

Money is already pouring in. In April a Charlotte-based real-estate firm spent $23.5 million to buy a 119,000-square-foot Franklin Street office building with a ground-level CVS pharmacy and adjacent parking lot. "It is a bit of a head-scratcher why it is an opportunity zone," the company's vice president admitted to the Raleigh News & Observer, which noted: "Most people aren't likely to think of Franklin Street as a disadvantaged area." The company plans a $12 million renovation to refresh the offices and to convert them to a technology hub. It might include a co-working space.

Many of the country's 8,700 opportunity zones are in legitimately distressed communities in need of revitalization. Still, as investors have begun announcing deals taking advantage of the tax breaks, some of the projects in opportunity zones appear to fall short of the goal of spurring new investment that lifts up struggling areas.

Developers broke ground in Kentucky last year on a $50 million, 10-story apartment building near the University of Louisville that offers "a unique, unobstructed view of race track Churchill Downs," according to the trade publication of the National Apartment Association. The developer said: "We planned to build at University of Louisville, anyway, and this financing certainly made that decision even easier."

In Florida, a Fort Lauderdale developer broke ground this spring on a $40 million apartment building located in an opportunity zone. Monthly rents are expected to go for as much as $1,900. "A lot of these people who are going to live there have a high income," the developer confessed to a local business publication. The complex will feature amenities including a dog park, a fitness center with a yoga and cycling studio, a full-time concierge and a fourth-floor pool with cabanas.

A Pittsburgh-based real-estate investment firm announced in May that it purchased and plans to upgrade a student-housing community across a pedestrian bridge from the University of Louisiana at Lafayette. The complex already "features a 24-hour fitness center, swimming pool with LED lighting, cybercafe with free printing and a host of other amenities," the company said in a news release.

A study last year by the Brookings Institution identified 33 college towns with opportunity zones in which more than 85% of residents are college students. The top three were the University of Southern California, Indiana University of Pennsylvania and Illinois State University—each of which has nearby opportunity zones composed of 99% college students.

"There were some obvious flaws in the way this was designed," Brookings economist Adam Looney says. "You can build anything for any purpose and get the tax break." He says he has heard of opportunity-zone projects that include building self-storage facilities and solar-power generation, both of which—like renovating luxury student housing—have tenuous connections to community revitalization.

In Chapel Hill, the town's economic development officer, Dwight Bassett, says the opportunity zone is leading other investors to sniff around the college town—a development he welcomes. Asked if he'd describe the area as impoverished, he says, "No, I wouldn't." He adds, however, that a North Carolina Commerce Department official told him last year that the town had two census tracts eligible to become opportunity zones. The official asked Mr. Bassett to recommend one. "We looked where we could get the most economic benefit out of it," he says, "and that's the one we nominated."

The Wall Street Journal

By Tony Mecia

Sept. 13, 2019 6:10 pm ET

Mr. Mecia is editor of the Charlotte Ledger, a business publication in Charlotte, N.C.