

# Fundamentals of Opportunity Zone Investing

Toolkit



Opportunity Zones  
CHARTER SCHOOL PROGRAMS



## Module 2:

# Fundamentals of Opportunity Zone Investing Toolkit

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## Glossary of Impact Investment Terms

### Basis

A basis, or tax basis, is the value of an asset that is used for determining the gain or loss when the asset is sold.

### Basis Step Up

When calculating tax burden for assets that have appreciated, investors are not always taxed on the full differential between the asset's purchase price and sales price. With a basis step up, the taxable value of an appreciated asset is reduced, resulting in lower capital gain taxes.

### Below-Market-Rate Investment

A below-market-rate investment is one made with an agreed-upon rate of return that is less than the current market rate of return. Some impact investors accept a below-market rate of return to fulfill strategic objectives beyond financial returns.

### Capital Gain or Capital Loss

A capital gain occurs when there is a rise in the sales price of an asset (such as owning part of a business or real estate) compared to the purchase price. A capital loss occurs when there is a fall in the sales price. Capital gains or losses are not realized until the asset is sold.

### Capital Stack

The capital stack is the organization of all capital in a real estate transaction. It also provides the structure for the order of rights to receive income and profits from the property.

### Community Development Financial Institutions

Community development financial institutions (CDFIs) are lenders and investors such as community development banks, credit unions, or loan or venture capital funds. They have as their primary mission the provision of credit and financial services to underserved markets and economically disadvantaged populations. CDFIs are certified as such by the U.S. Department of the Treasury's Community Development Financial Institutions Fund.

## Debt

Debt is an amount owed for funds borrowed. Generally, debt is evidenced by a promissory note that states the repayment and interest provisions.

### Debt Service Coverage Ratio

Debt service coverage ratio is a measurement of the cash flow available to pay current debt obligations. It is calculated as net operating income divided by debt payments due within 1 year.

## Equity

Equity is cash invested in exchange for ownership interests. Equity investments can take the form of an owner's share in a business or property. Return on equity is the financial gain that an investor receives from their ownership interests, which may include a share in the business's profits (ongoing) or appreciation (upon sale).

### Impact Investments

Impact investments, also called mission-driven investments, refer to investments that have the intention of generating social or environmental benefits in addition to financial returns. Impact investments target a range of financial returns from below-market to market rate. They are distinct from socially responsible investing, which screens out certain industries or firms.

### Loan to Value

A loan-to-value (LTV) ratio is calculated by dividing the loan amount by the value of an asset (e.g., the appraised value of a property) and is expressed as a percentage. Loans with high LTV ratios may be considered to have greater risk and require higher interest rates. For example, a \$15 million loan on a project valued at \$20 million would have a 75 percent LTV ratio.

### Mission-Related Investment

A mission-related investment is an impact investment made by a private foundation that does not count towards that philanthropy's annual required spending of 5 percent of the value of their net investment asset in the form of grants, foundation expenses, assets purchased, and program-related investment. This means it is an investment designed to result in positive social or environmental benefits while generating some degree of financial return.

### Net Operating Income

Net operating income is the total amount a business takes in during a period (gross operating income) minus the day-to-day costs associated with running the business (operating expenses). Operating expenses do not include debt-related expenses, such as loan repayments and interest.

### New Markets Tax Credit Program

The New Markets Tax Credit program is a federal program to spur private investment in distressed communities for community development and economic growth. Individual and corporate investors can receive a tax credit against their federal income tax in exchange for making equity investments in specialized financial intermediaries called Community Development Entities (CDE). A CDE is typically a nonprofit loan fund, community development organization, or private financial institution<sup>1</sup>. The program is managed by the U.S. Department of the Treasury's Community Development Financial Institutions Fund.

<sup>1</sup> <https://nmtccoalition.org/how-it-works/>

## Place-Based Impact Investment

Place-based impact investment refers to the local or geographically selected deployment of impact capital. This occurs when investments are made with the intent to yield both financial and social or environmental returns, often with the goal of addressing the needs of marginalized communities.

## Program-Related Investment

A program-related investment is an impact investment made by a private foundation that counts towards that philanthropy's payout requirement. That is, to maintain tax-exempt status, private foundations in the U.S. are required to spend at least 5 percent of their assets each year for charitable purposes. To get this tax treatment, the financial return cannot be a significant purpose for the investment.

## Qualified Opportunity Fund

A Qualified Opportunity Fund (QOF) is an investment vehicle that files either a partnership or corporate federal income tax return and is organized for the purpose of investing in Qualified Opportunity Zone Property.

## Qualified Opportunity Zone

A Qualified Opportunity Zone, often referred to simply as an Opportunity Zone (OZ), is a census tract where new investments, under certain conditions, are eligible for OZ tax benefits. The set of census tracts eligible to become OZs is defined in the Tax Cuts and Jobs Act of 2017 that created the incentive. Eligibility is based on factors such as neighborhood income and poverty levels. In most cases, governors in U.S. states and territories and the mayor of the District of Columbia could nominate 25 percent of eligible tracts as OZs. The U.S. Department of the Treasury then reviewed and designated OZs.

## Qualified Opportunity Zone Property

Qualified Opportunity Zone Property is a QOF's qualifying ownership interest in an OZ business or certain tangible property of the QOF that is used in a business in the OZ.

## Tax Deferral

Tax deferral is when taxpayers can delay paying taxes to some point in the future. Provisions in the U.S. tax code allow taxpayers to defer paying certain taxes until a later tax year under certain circumstances.

# Case Study: MetroHealth Ohio Workforce Units

## Introduction

This case study describes an actual Opportunity Zone (OZ) deal in the public health field. It provides an example of how such a deal can be structured and how OZ financing can be part of a mission-driven project designed for positive community impact. For charter school-OZ case studies, see the Module 3 Toolkit.

## Background

MetroHealth Ohio is a public health system in Cleveland, Ohio. As part of its larger neighborhood transformation initiative, MetroHealth has identified the link between health and housing as the entry point for addressing the social determinants of health in the community.



Three housing projects are planned. The first project is MetroHealth Gateway, an affordable housing project with up to 72 units and a community college access center on the first floor, expected to break ground in October 2020. The second project, MetroHealth South, the focus of this case study, will be a mixed-use workforce housing development combining up to 110 apartments offered at quasi-market-rate rent, with street-level, class A commercial space. The target population for this project is current MetroHealth medical residents. The third project is another workforce housing project still in the early planning stage.

## Opportunity Zone Investment in MetroHealth South

After the passage of the Tax Cuts and Jobs Act, MetroHealth worked with local stakeholders to ensure the census tract where the MetroHealth South project was located was designated as an OZ. To take advantage of the designation, MetroHealth South will be structured with an OZ financing component. The project will also draw on other potential subsidies from the local housing authority, state housing finance agency, and the City of Cleveland.

Structuring an OZ deal requires balancing many stakeholders and moving parts. In addition, MetroHealth South's target rents must balance the project's financial feasibility with affordability for future residents. To achieve this balance, rents need to be comparable to similar developments in the neighborhood but lower than in other areas in Cleveland.

The project did not attract attention from market-rate Qualified Opportunity Funds. As a result, MetroHealth aligned the project return with expectations of more mission-driven investors. As of this writing, MetroHealth is finalizing the project financing with PNC Bank, which is providing both OZ equity investment and debt financing.

Having PNC Bank as both the OZ investor and debt underwriter allowed the project to get favorable terms for the OZ component, as PNC was willing to accept a lower return compared to most market-rate-return OZ investors. OZ equity represents 27 percent of the capital costs for the project, with another 3 percent of financing from other equity sources. This capital stack helped the project lower the debt-to-equity ratio and the debt service cost, making the target rents financially feasible.

## Key Project Finance Components for MetroHealth South

Table 1 summarizes the financial components of the MetroHealth South project.

Table 1. Characteristics of MetroHealth South Financing

Characteristic	Description
Total units	100-110 units, 80% 1 bedrooms, 20% 2 bedrooms
Estimated commercial space	70,000 square feet
Target rent	\$1.50 per square foot for 1 bedroom and \$1.75 per square foot for 2 bedrooms
Total development costs	\$25-\$27 million
Target internal rate of return	20% levered post-tax internal rate of return
Capital stack structure	70% debt 27% OZ equity 3% equity from other sources
Target construction start date	2021

# National Resources for Opportunity Zone Information

Use these web-based resources to learn more about Opportunity Zone (OZ) locations, regulations, and data, as well as information on Qualified Opportunity Funds (QOFs) across the country.

## Advancing Education and Child Development in Opportunity Zones

<https://eig.org/oz-education>

This report examines the needs of children in Opportunity Zones and how the bipartisan community investment tool can be leveraged to support schools, childcare centers, and businesses focused on improving life outcomes for children. The report includes strategies for community leaders interested in catalyzing local strategies and investments, and is accompanied by a guide for engaging key stakeholders.

## City Builder by Citi

<https://www.citivelocity.com/citybuilder/eppublic/cb/>

City Builder by Citi provides data-driven insights into OZs. It includes information on characteristics of individual OZs across the country; local needs through data on affordable housing, grocery store access, clean water access, and resident employment; and QOFs actively seeking capital along with insights into the QOFs' investment and geographical focuses.

## EIG Opportunity Zones Portal

<https://eig.org/oz-activity-map>

The portal features four maps created by EIG that track and highlight all activities in OZs, investment to OZs, funds that have been created to steward investments in OZs, and initiatives at the state and local level that adapt OZs to local priorities.

## Investing in Qualified Opportunity Funds - Final Regulations

<https://www.irs.gov/pub/irs-drop/td-9889.pdf>

This document provides the full text of the final OZ regulations released by the Internal Revenue Service (IRS).

## Map of Opportunity Zones

<https://opportunityzones.hud.gov/resources/map>

This map from the Department of Housing and Urban Development allows users to view the location of all OZs and provides links to each state's OZ information page.

## Mastercard Center for Inclusive Growth Inclusive Growth Score

<https://inclusivegrowthscore.com/>

This interactive tool allows users to search and compare the Inclusive Growth Score for all census tracts, including 8,764 OZs, in order to understand the economies and the impact of economies on its residents in each census tract.

## Novogradac Opportunity Fund List

<https://www.novoco.com/resource-centers/opportunity-zone-resource-center/opportunity-funds-listing>

The Opportunity Fund List from Novogradac provides periodically updated information on numbers of QOFs and the amount of equity raised by those QOFs.

## **Opportunity 360 Opportunity Zone Explorer**

<https://www.enterprisecommunity.org/opportunity360/opportunity-zone-eligibility-tool>

The explorer maps all OZs in the country to help users identify locations of OZs; availability of other federal program and designations; and information on housing stability, economic security, and education, health, and mobility outcomes for OZ census tracts compared to national trends.

## **Opportunity Zone Fund Directory**

<https://www.ncsha.org/resource/opportunity-zone-fund-directory/>

The OZ fund directory is compiled by the National Council of State Housing Agencies to track publicly announced multi-project QOFs. Users can filter fund names by fund size, geographic focus of the funds, and investment focus.

## **Opportunity Zone Community Impact Assessment Tool**

<https://www.urban.org/oztool>

This tool assesses the potential social impact of a local development project under six impact areas: accessible and high-quality jobs; community wealth building; affordable and accessible housing; environment and open spaces; health, social services, and cultural amenities; and transportation and connectivity. The tool can be used to inform project stakeholders and determine how the project might positively affect and align with community needs.

## **Opportunity Zones Frequently Asked Questions**

<https://www.irs.gov/credits-deductions/opportunity-zones-frequently-asked-questions>

The frequently asked questions were prepared in response to inquiries that have been posed to the IRS. The questions are intended to provide a basic understanding and awareness of OZs.

## **Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic**

<https://www.irs.gov/pub/irs-drop/n-20-39.pdf>

This release from the IRS addresses relief for QOFs and investors during COVID-19.

## **StatsAmerica USA Opportunity Zones Map**

<http://www.statsamerica.org/opportunity/map.aspx>

This interactive map includes information on population, unemployment, and income in OZs.



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U.S. Department of Education  
Office of Elementary and Secondary Education

