Introduction to Opportunity Zones

This brief is part of a four-brief series created by the Charter School Opportunity Zones Initiative. To view the other briefs and additional resources, visit charterschoolcenter.ed.gov.

Opportunity Zones
CHARTER SCHOOL PROGRAMS

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

Introduction to Opportunity Zones

This brief provides an overview of the federal Opportunity Zones (OZ) incentive to help charter schools and charter management organizations understand how and why OZs were created, how OZs provide an incentive to investors, and cases when OZ financing could potentially benefit charter schools. For more details on the specific considerations of how OZs can be used for charter school financing, see the briefs on The Business of Charter Schools and Combining Opportunity Zones in Charter School Financing.

Opportunity Zone Overview

The OZ incentive, created by the Tax Cuts and Jobs Act of 2017, is a program meant to drive capital funds to support business growth and real estate development in low-income and undercapitalized communities. Governors nominated a subset of eligible census tracts and proposed their designations to the U.S. Department of the Treasury, which reviewed and approved the final designations.

There are of 8,766 OZs across all 50 states, Washington, DC, Puerto Rico, and 4 other U.S. territories[1]. The designation of all OZs will expire at the end of 2028.

The Opportunity Zone Incentive as a Financing Tool

OZs provide tax benefits to investors for qualifying projects located within designated census tracts. Corporate and individual taxpayers who have recently sold an asset for a capital gain can defer and reduce their capital gains tax burden by investing the gains in Qualified Opportunity Funds (QOFs), which then invest in a Qualified Opportunity Zone Business (QOZB). Apart from a few exceptions related to businesses such as liquor stores or racetracks, there are no limits to the types of businesses eligible for OZ investments.

For most charter schools, facilities construction and substantial improvement would be well-suited to attract OZ investments. In addition, for-profit charter schools or management organizations could also receive OZ funding for their operational activities.

Key features and requirements of a QOF are summarized in table 1 on the next page.

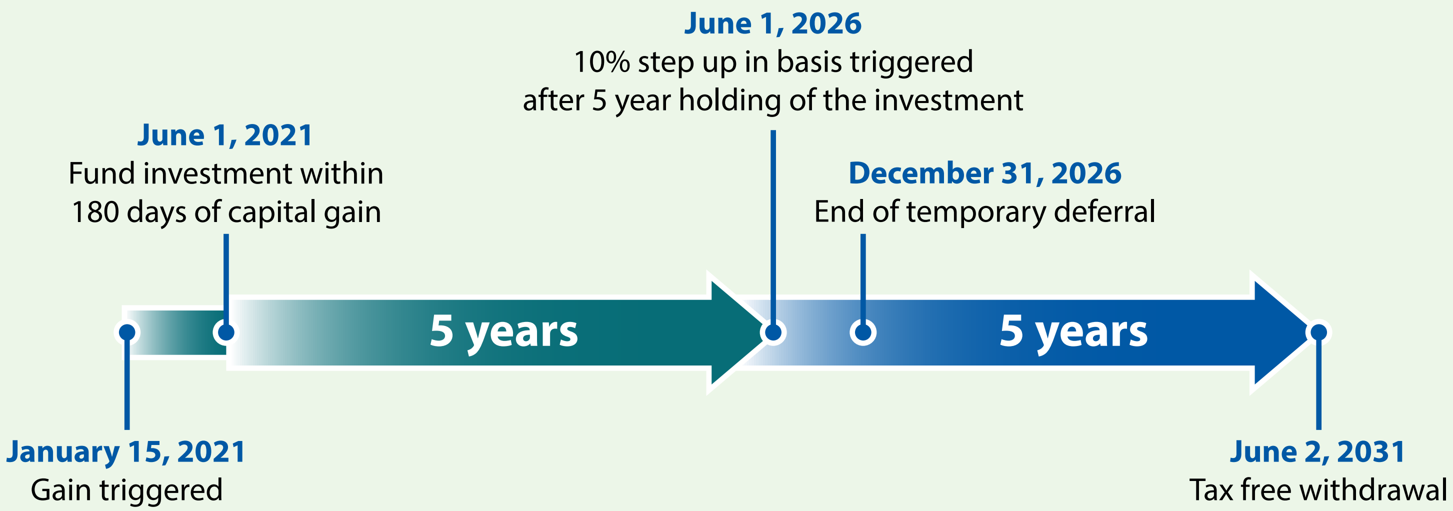
[1] *To locate Opportunity Zone census tracts, visit https://opportunityzones.hud.gov/resources/map.*

Table 1. Features and Requirements of Qualified Opportunity Funds

Feature	Requirements or Options
Types of investments	• Stock • Business property • Partnership interest
Types of investors	• Individuals • Corporations • Real estate investment trusts • Partnerships • S corporations[2] • Estates • Other domestic taxpayers
Benefits to investors	• Temporary deferral of previously earned capital gains. Investors can invest capital gains into QOFs. Unless extended by law, those capital gains are not taxed until the end of 2026 or when the asset is sold if the date of sale is earlier than 2026. • Basis step-up of capital gains invested. For capital gains placed in QOFs for at least 5 years, investors' basis on the original investment is increased 10 percent, meaning 10 percent of the deferred gains will be tax exempt. (There was originally the option for a 15 percent basis step-up if invested for at least 7 years, but that window has closed.) • Permanent exclusion of taxable income on new gains. For investments held for at least 10 years, investors pay no taxes on gains from sale of their interest in the QOF.
Benefits to charters	• Additional financial incentive for existing charter school investors. • Potential for access to a new pool of funding and investors who may not have previously invested in charter schools but may be attracted by the OZ opportunity. • Potential for lower cost financing and thereby better long-term financial performance.

[2] *S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes.*

OZ investors have 180 days to invest capital gains from an asset sale in a QOF, and the QOF has to deploy the working capital within 31 months for investments in QOZB (which can be extended under certain circumstances). QOFs qualify for the permanent exclusion of taxable income on new gains as long as investments are held for at least 10 years and are disposed of prior to January 1, 2048. Funds invested before December 31, 2021 can realize the 10 percent basis step-up for previously earned capital gains after they are held for at least 5 years. The timeline below illustrates an example of timing for an OZ investment that exits after 10 years.



Emerging Trends in Opportunity Zone Investment

The U.S. Department of Treasury has not released data on current and proposed OZ projects, but according to an inventory of 621 QOFs by accounting firm Novogradac, OZ investment has continued to grow and surpassed $10 billion by March 2020[3]. Of the 406 QOFs that reported raising equity, the average equity raised was $24.9 million. QOFs with a focus on residential and commercial real estate have raised the most equity. Investments for operating businesses (i.e., not real estate development projects) represent less than 4 percent of equity raised to date.

OZ projects can be paired with other subsidy sources. Based on preliminary findings from existing OZ deals, this may be needed for some projects to be financially feasible, since the OZ incentive on its own might not provide the depth of subsidy needed for the project to move forward.

[3] *Novogradac, M. (2020, April 29). "Novogradac Opportunity Funds List Surpasses $10 Billion in Investment." Novogradac. https://www.novoco.com/notes-from-novogradac/novogradac-opportunity-funds-list-surpasses-10-billion-investment*

Opportunity Zones

CHARTER SCHOOL PROGRAMS

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