Opportunity Zones Go Rural

by Marie Sapirie



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Qualified rural opportunity funds, a major new addition to the Opportunity Zone program in the One Big Beautiful Bill Act, are attracting plenty of interest and creating new questions as they begin to be implemented.

The OBBBA changes were designed to make rural investments attractive. Investors in qualified rural opportunity funds get a 30 percent step-up in basis after five years, instead of the 10 percent accorded to investments in nonrural qualified opportunity funds. A qualified rural opportunity fund is a QOF that holds at least 90 percent of its assets in QOZ property. Substantially all of the property's use during substantially all of the fund's holding period for the property must be in a QOZ composed entirely of a rural area. Alternatively, the QOZ property can be QOZ stock or a QOZ partnership interest in a QOZ business in which substantially all of the tangible property owned or leased is QOZ business property, substantially all of the use of which is in a QOZ composed entirely of a rural area.

Defined by Population

A rural area has a population of 50,000 or less and isn't an urbanized area contiguous and adjacent to a city or town with a population greater than 50,000. The definition used in the OBBBA is drawn from the Consolidated Farm and Rural Development Act of 1961, which is codified at 7 U.S.C. section 1991(a)(13)(A). It is used by the Department of Agriculture in programs like the Rural Business Cooperative Service, which supports rural economic development. In Notice 2025-50, 2025-43 IRB 542, issued in September 2025, the IRS adopted a method for determining a rural area similar to that used by the USDA. It differs slightly because the OBBBA definition of a rural area in section 1400Z-2(b)(2)(C)(ii) does not include all of the statutory provisions in 7 U.S.C. section 1991(a)(13).

Rural funds benefit from another change in the OBBBA. Section 1400Z-2(d)(2)(D)(i)(III) provides that property is treated as substantially improved by the qualified rural opportunity fund if additions to basis exceed 50 percent of the adjusted basis, rather than the 100 percent standard required for regular QOFs. That lower standard opens up more possibilities for projects, said Andrew Gradman of the Law Office of Andrew L. Gradman APC. "In many buildings, that's the difference between upgrading major systems with tenants in place and emptying the building for a gut renovation," he said.

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The Opportunity Zone program was designed to direct economic development to distressed areas, and the addition of rural funds is meant to better target that development to areas in greater distress. But unlike other tax credit programs with related purposes, such as the new markets tax credit and the low-income housing tax credit, the Opportunity Zone tax benefits are not allocated and there is no prioritization of projects that may provide the greatest benefits to low-income households. The result is that the Opportunity Zone program will continue to function like a bowl of trail mix in which the peanuts — the most distressed areas that the provision was meant to serve — are never eaten, while the M&Ms get eaten first, Gradman noted. Accordingly, he said,

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one problem of the program's first iteration was that cherry-picking by taxpayers led to oversupply in the most popular tracts.

A June 2026 report from the Treasury Office of Tax Analysis similarly noted that while investment in Opportunity Zones grew rapidly through 2024, ultimately reaching over three-fourths of designated tracts, "investment has remained highly concentrated, disproportionately flowing into tracts with stronger pre-existing economic indicators and pre-existing growth trends." Gradman said that the OBBBA changes to tracts — including rural zones, lower income limits, and the removal of contiguous zones — take the M&Ms out of the trail mix, but still offer no incentive to eat more peanuts. He added that whether there will be a repeat of the crowding and oversupply phenomenon in rural zones is an open question.

But the common belief that there weren't enough good parcels in rural areas may begin to dissipate. The industry didn't have the same incentives to investigate rural zones in the original program that it does now, Gradman said. And even if there are fewer good zones because of the decrease in total zones, the change in the test for substantial improvement might increase the number of good parcels by opening the door for comparatively minor rehabilitation projects, he said.

Size Matters

The number of rural tracts that will be available is still unclear, because the designation process has concluded but Treasury's sign-off process has not. And not all states have publicly released the tracts their governors nominated. "Based on the lists out so far, it looks like there will be a little over 2,000 rural tracts," said Barrett Linburg of Savoy Cos. "How many of those will have really great investments isn't clear, but if you have billions of dollars that need to be invested and they're all looking for a location at the same time, that's when it gets challenging."

Funds raising money and then seeking out projects isn't the only fundraising pattern that developed in the Opportunity Zone program; single-asset deals, which begin with a specific project and direct fundraising to it, are also common. The single-asset approach is "probably a better fit for the rural areas," Linburg said.

The rural incentives could magnify the problem of too much supply being delivered too quickly into popular tracts. "In areas with less than 50,000 people, it only takes two development projects of 250 units to really skew the market from a supply and demand perspective," Linburg said. The 30 percent step-up for qualified rural opportunity funds is a boon for marketing Opportunity Zone investment opportunities, but if the marketing works so well that billions of dollars are raised for rural funds and that money is largely pointed at a small number of rural tracts, there could be big problems, he said.

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Rural tracts in the original program may provide some clues as to what to expect in the new version. A recent analysis from the Brookings Institution found that the rural tracts with more builds were those with lower poverty, that were closer to activity centers in metropolitan areas, and that were more racially diverse. The authors suggested that "these three variables alone could compose, and perhaps already have composed, an Opportunity Fund investment thesis." And the Treasury paper from June 2026 pointed out that rural tracts "comprise approximately 38 percent of OZs, but only account for just over 16 percent of QOZ property in 2024, an increase from the almost 13 percent share in 2020." The paper explained that rural tracts didn't receive as much investment per tract as nonrural tracts, but that that was because the average rural zone received only $7.3 million of QOZ property, in contrast to the average nonrural zone, which received $23.3 million. Treasury found that the same share of rural Opportunity Zones received investment as the overall share of zones that received investment (77 percent).

Rural zones may differentiate themselves from nonrural zones in ways that aren't statutory. Recent studies suggest that a little more than half of investment in structures by QOZ businesses or directly by QOFs is in residential rental property,

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but rural zones may see a broader array of project types. "The reindustrialization movement and manufacturing could create a virtuous cycle of more jobs and a greater need for more housing and retail," Linburg said. But building the manufacturing plant that starts the cycle isn't necessarily easy, even with incentives like Opportunity Zones, he added.

While the rural incentives are exciting to the industry and investors who are already acquainted with the Opportunity Zone program, the most important change under the OBBBA was permanence, Linburg said. Because of that change and the time it affords for educating potential investors and their financial advisers, "the amount of equity is going to get much larger," he said.

Five and Dive?

Rural funds may tend to promise to liquidate at year 5, because that is when taxpayers need cash to pay their deferred tax, and because taxpayers with passive deferred gains and passive QOF investments can use suspended depreciation to shelter the deferred gain, Gradman said. Taxpayers who have higher-rate gain to defer will find the 30 percent haircut for rural zones appealing. General partners in QOFs would also generally prefer a five-year hold to 10 years, Gradman said, adding that the convergence of these incentives means that Opportunity Zone investments may become particularly popular for specific types of taxpayers. But he noted that if the shorter holding period and 50 percent substantial improvement threshold become dominant in the program, it raises the question whether the antipoverty rationale is being served in the way it was originally conceived. ■

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