The Value of Historic Tax Credits: Case Studies and Recent Issues

South Carolina Historic Preservation Conference
April 16, 2013

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MHA
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Bringing strategy, equity, an
to historic building developm

General Overview

- 20% Federal Income Tax Credit
- For Income-Producing Property, Not Owner-Occupied Residential
- Credit Calculated on Hard and Soft Costs
- Credit Limited to Existing Building, Not Acquisition, New Construction or Site Work
- No Limitations on Corporate Investors

What is a Tax Credit?

Credits vs. Deductions
A Credit Offsets Tax Liability Dollar for Dollar

	Deduction	Credit
Income	$100	$100
Less: Deductions	(20)	-
Taxable Income	80	100
Gross tax Due @ 35%	28	35
Less: Credits	-	(20)
Net Tax Due @ 35%	28	15

Threshold Requirements

- “Substantial Rehabilitation”
  - Rehab Exceeds Greater of Adjusted Basis in Building or $5,000
- Work Certified by National Park Service
- Recommendation by State Historic Preservation Office (SHPO)
- 5-Year Credit Recapture Period

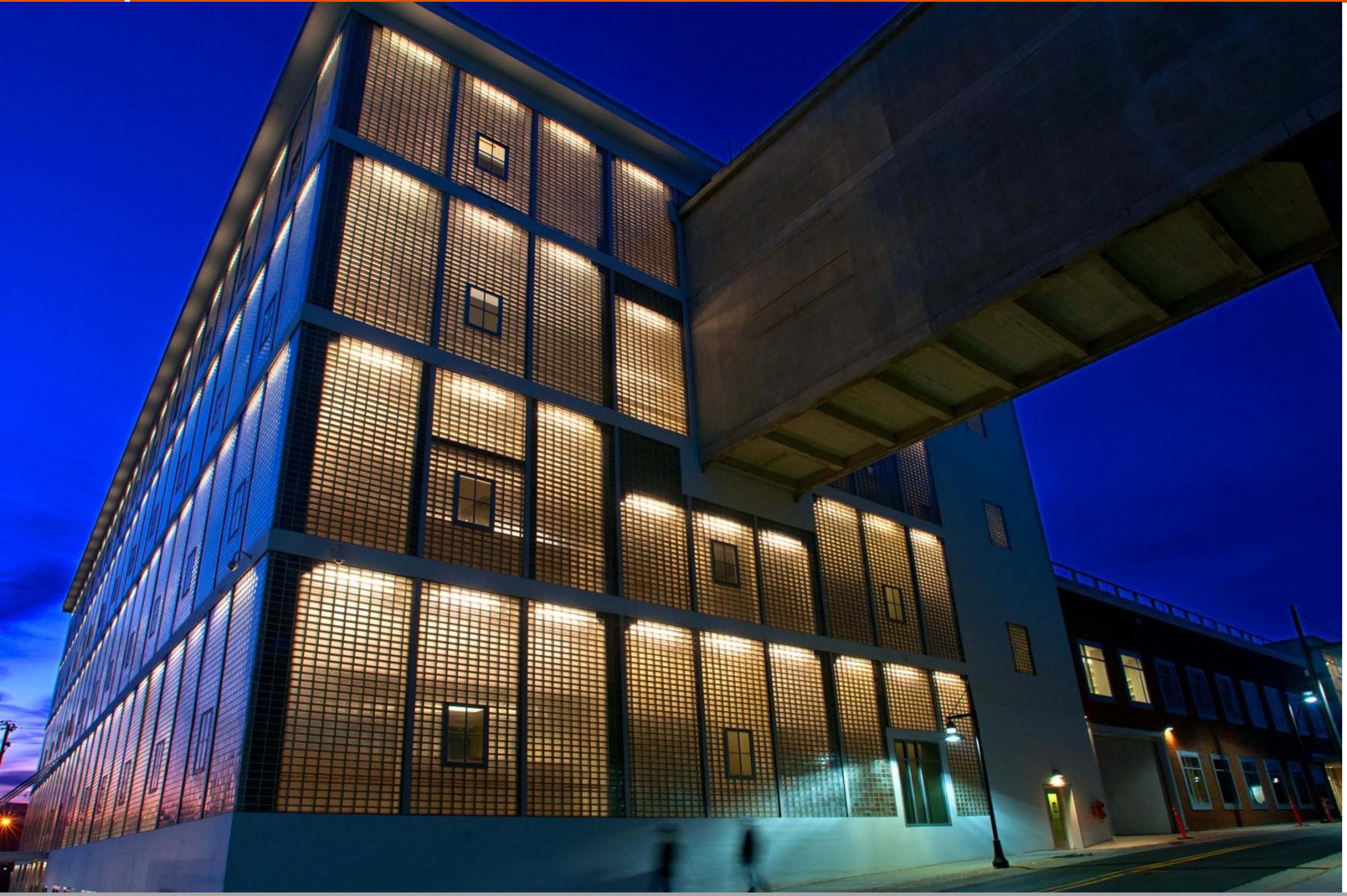
Typical Parties

- Developer/Owner
- State Historic Preservation Officer (SHPO)
- National Park Service
- Lender
- Tax Credit Investor (Federal & State if applicable)

Qualifying Buildings

- National Register Properties – Individual or in District
- Generally at least 50 Years Old
- Architecturally or Historically Significant
- Designated Local Landmark Buildings or Buildings in Local Historic District Generally Do Not Qualify

Recent Successes



RJ Reynolds, Winston-Salem - Mid-Century Factory Complex – Converted to Commercial Office and Laboratories

Recent Successes

Stevens Garage, New Orleans - Auto Dealership and Garage – Converted to Market-Rate Residential

Recent Successes

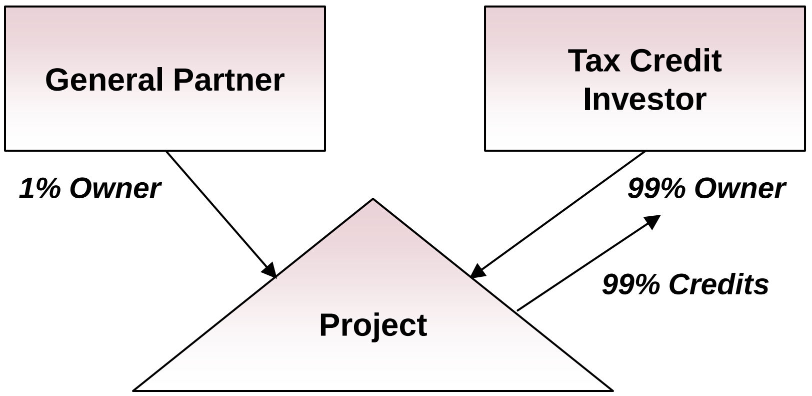
Colonial Village Alexandria, VA - Market-Rate Garden Apartment Complex – Converted to Affordable Housing

Recent Successes

Briarcliff Hotel, Atlanta – Hotel Converted to Housing – Continuing Affordable After Rehab

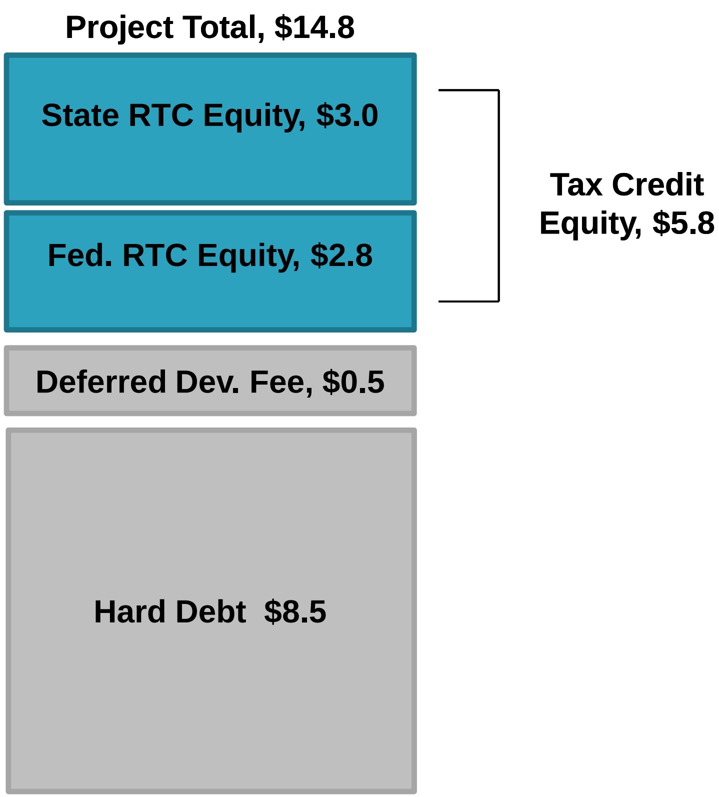
How Tax Credits Deliver Capital

Sample Structure



- Federal tax credits not sold, but passed to investors through partnerships
- Require structuring with partnerships and equity contributions
- Potential exit of tax credit investor after compliance period

Example 1: Combining State Tax Credits & Federal RTC Eliminates Sponsor Equity



- Renovation of historic Manufacturing Plant
- Federal RTCs, State RTCs, each with its own investor
- Multiple parties involved
- Market Rate Debt, combined with tax equity lowers Developer Equity to Developer Deferred Fee only
- Coordination of issues between investors is receiving significant focus by working groups

There are Two Types of Federal RTC: 10% & 20% Credit

	10% Credit	20% Credit
Qualification	Building older than 1936 and ***neither*** listed on National Register of Historic Places ***nor*** located in Historic District and contributing	Listed on National Register of Historic Places **or** located in Historic District and recognized as contributing to district
Permitted Use	Commercial, may not have residential rental	Commercial, may have residential rental
Requirements	Must exceed $5,000 of qualified rehab expenditure, or building basis, whichever is greater	Same

The 20% RTC Fundamentals

- Tax Aspects Administered by the IRS.
- Preservation aspects jointly administered by NPS and State Historic Pres. Offices (SHPOs).
- RTC is the most important (in dollar volume) federal preservation program.

The 20% RTC Statistics

- 1020 projects approved by NPS in FY 2012, reversing a three year decline*
- In FY 2012, roughly 47% of RTC projects were for multi-family housing, 21% for office space, 16% for commercial space*
- Of the 91% of projects receiving Part 3 approvals that used other incentives or publicly supported financing, 43% used state historic tax credits*

*Source: Annual Report for Fiscal Year 2012: Federal Tax Incentives for Rehabilitating Historic Buildings National Park Service

The 20% RTC (cont'd)

- More than $5.33 billion in private investment leveraged by up to $1.06 billion in tax credits*
  - Federal RTCs leverage approximately $5 of private investment for every $1 of tax credit
- Top states ranked by Part 2 approvals: OH (123), LA (104), VA (82), MD (62), MO (60), MA (52), IA (40), NC (39), PA (38), NY (36), and MI (34)*
- Top states ranked by Part 2 estimated rehabilitation costs: NY ($915MM), MA ($461MM), CA ($389MM), LA ($352MM), and IL ($322MM) *

*Source: Annual Report for Fiscal Year 2012: Federal Tax Incentives for Rehabilitating Historic Buildings National Park Service

Federal Approval Process

- 3 Part Application Process
  - Part 1 – Historic Status
  - Part 2 – Design Approval
  - Part 3 – Project Completion
- State and National Park Service Review
  - 60-Day Minimum Review
- Secretary of Interior's *Standards for Rehabilitation*

What Types of Buildings Qualify?

- The IRS Rules: Depreciable Building Requirement
  - Must be a “building”. Building is defined as a structure or edifice enclosing a space within its wall and usually covered by a roof.
  - Building must be depreciable. Depreciable buildings are generally those used for nonresidential (i.e. commercial) or residential rental purposes. (See Section 168(e))

What Kinds of Buildings Qualify?

- Almost Anything But a Personal Residence
  - Apartments
  - Hotels
  - Office Buildings
  - Warehouses
  - Distribution Facilities
  - Back-Office Support/Computer/Call Centers
  - Sports Facilities
  - Mixed Use of Any of the Above

Be Sure You Pass "The Test"

Substantial Rehabilitation Test

Standard Rehabilitation Test

- Look back from placed in service date to basis in building 24 months prior or beginning of project, whichever is later
- QREs must exceed prior basis or $5,000, whichever is greater
- Rolling 24-month window

Phased Rehabilitation Test

- Must be evidence that project will take longer than 24 months to complete prior to commencing rehab
- 60-month window
- Otherwise similar rules

What Types of Rehabilitations Qualify? Definition of QREs

- Qualified Rehabilitation Expenditures (QREs) is the tax term given to those development costs on which rehabilitation tax credits can be claimed.
- QREs are any amounts chargeable to a capital account made in connection with the renovation, restoration or reconstruction of a qualified rehabilitated building (including its structural components), except as provided by law.

What Types of Rehabilitations Qualify? Definition of QREs (cont'd)

- QREs include costs related to:
  - walls, partitions, floors, ceilings;
  - permanent coverings such as paneling or tiling;
  - windows and doors;
  - air conditioning or heating systems, plumbing and plumbing fixtures;
  - chimneys, stairs, elevators, sprinkling systems, fire escapes;
  - construction period interest and taxes;
  - architect fees, engineering fees, construction management costs;
  - reasonable developer fees

Scope of Design Review

Exterior Renovations

- Material and Ornament Repair/Replacement
- Window Repair/Replacement
- New or Re-designed Entries
- New Additions – Attached, Adjacent, Rooftop
- Site Work, Landscaping, New Site Construction

Scope of Design Review

Interior Renovations

- Repair/Removal of Ornamental Features
- Changes in Floor Plan/Circulation Features
- Corridors, Stairways Elevators, Auditoriums, Theater Spaces

What is Not a QRE?

- Land & Interest Carry on Land
- Building Acquisition & Interest Carry on Acquisition
- Acquisition-Related Costs
- Site Improvements & Landscaping
- Enlargements & Demolition
- Personal Property
- Tax Exempt Use Property

Sample Development Budget

	Total	Qualified Rehabilitation Expenditures	Depreciable Non-Eligible Basis	Funded Expense	Other
Acquisition Costs-Land	40,000	-	-	-	40,000
Acquisition Cost- Building	120,000	-	120,000	-	-
Construction Period Interest for Rehab	20,167	20,167	-		-
Permanent/Construction Loan Fee	6,000	1,000	-	5,000	-
Achitectural, Engineering	28,000	28,000	-	-	-
Construction Contract	300,000	300,000	-	-	-
Site Improvements	5,000	-	5,000	-	-
Contingency	35,000	35,000	-	-	-
Appliances	17,800	-	17,800	-	-
Historic Tax Credit Application Fee	2,500	2,500	-	-	-
Professional Fees	15,000	15,000	-	-	-
Marketing & Leasing Reserves	20,000	-	-	-	20,000
Insurance and RE Taxes During Construction	15,000	15,000	-	-	-
Development Fee	124,893	83,333	41,560	-	-
TOTAL APPLICATIONS:	749,360	500,000	184,360	5,000	60,000

Calculating the Credit

QREs	$ 500,000
Credit Rate	20%*
Credits	$ 100,000

- Calculate the equity amount: $1.15 per credit multiplied by $100,000 credits = $115,000

* Credit Rate is sometimes 10%.

What Triggers the Credit?

- Placement in Service
  - › CO or TCO is Evidence of Placement in Service
- When the building is ready for occupancy?
- **When Can the Credit Be Claimed?**
  - › Generally, the Year Placed In Service - 100% of the Credit Claimed
  - › Carry back One Year
  - › Carry forward 20 Years

Who Can Claim the Credit?

- Historic credits are shared among owners based on the ***profits*** allocation
- 'Profits' is considered to include the owner's share of:
  - › Taxable income
  - › Operating cash flow
- These allocations must remain the same during the recapture period

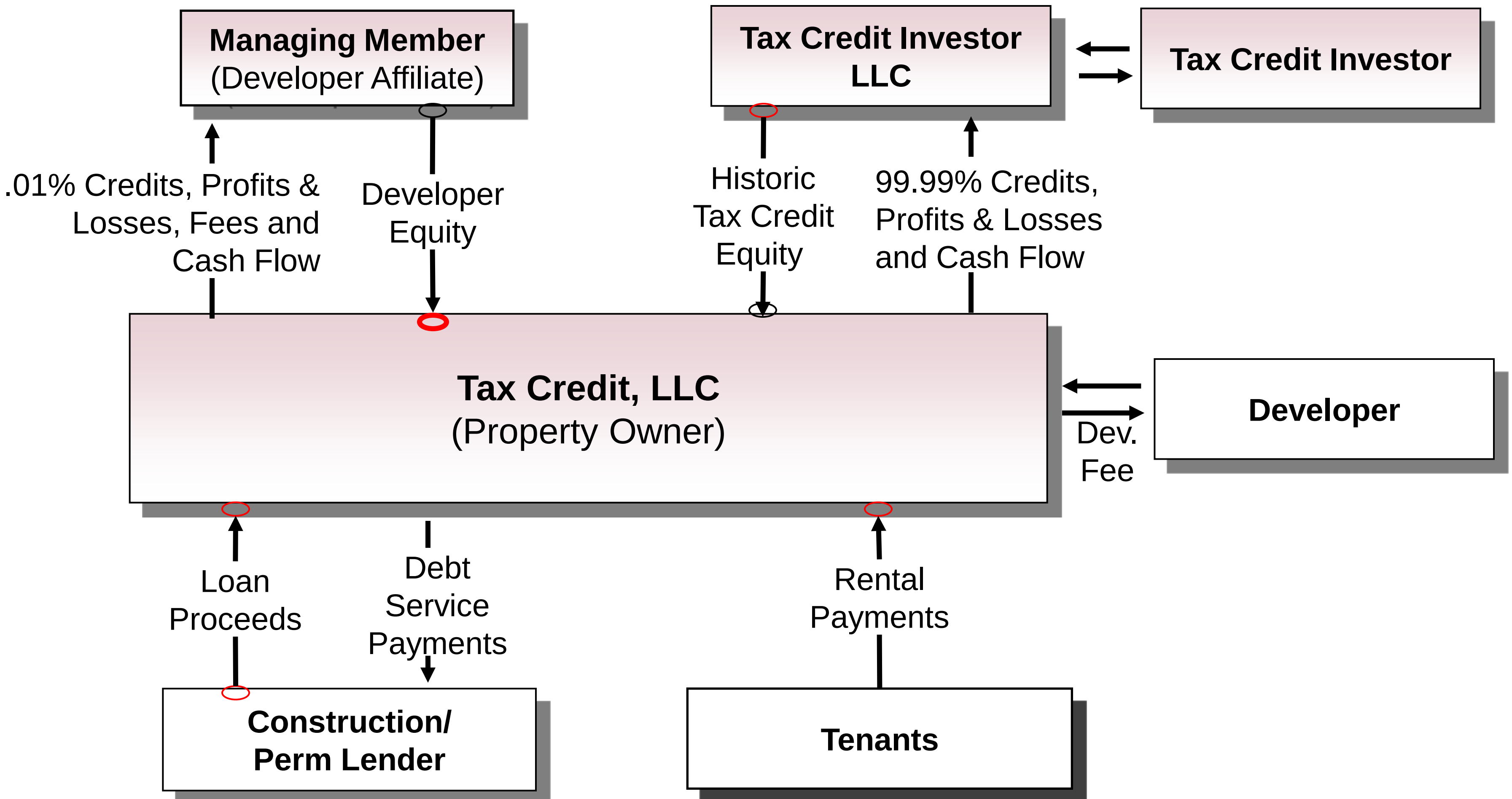
What is the Risk of Recapture?

- Triggering recapture
  - Disposition of the property
  - Disposition of at least 1/3 partnership interest
  - Noncompliance with Secretary's Standards
  - Property becomes 'tax exempt use property'
  - Total casualty loss
- Amount of recapture
  - 100% of the credit in the first 12 months from placed in service
  - Declines 20% every 12 months thereafter
  - Possible recapture becomes zero after 60 months

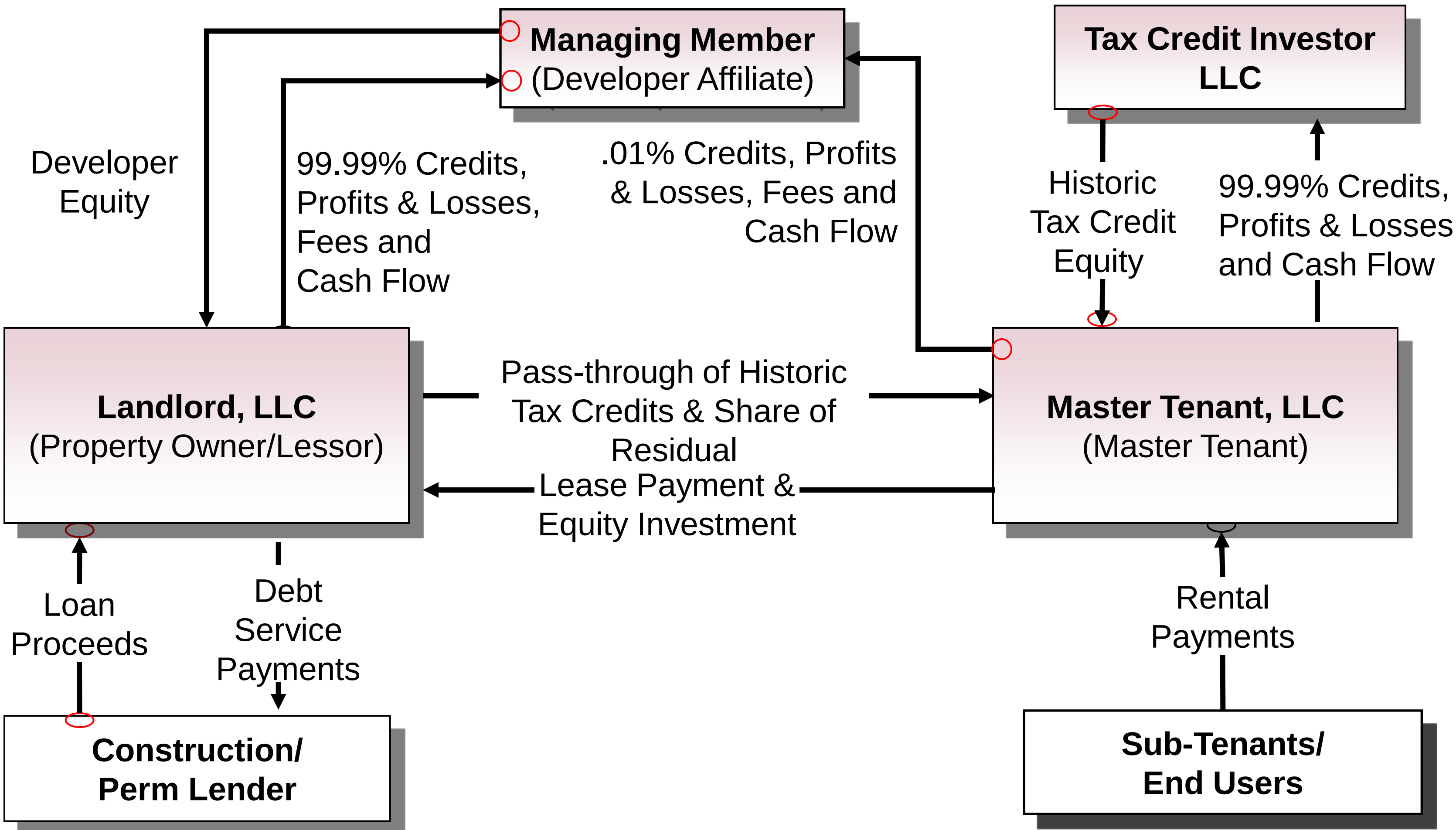
State Historic Credits

- Generally, equity to the developer is $0.60 – 0.80 per $1 of state credit when the state credit investor is a partner- maybe higher when the credit investor is not a partner.
- Limited universe of investors

Single Entity Structure



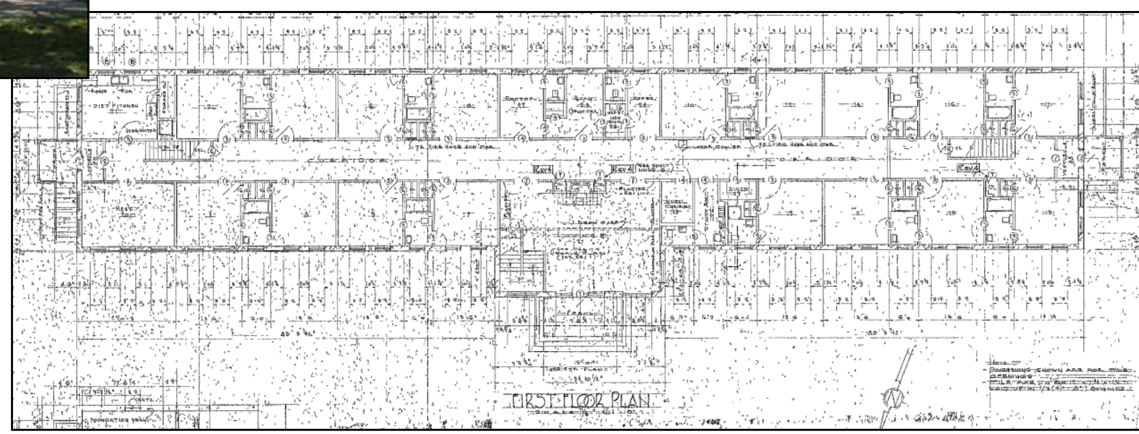
Master Lease/Credit Pass-Through Structure



Case Study 1

- Building NH55
  Charleston Naval
  Shipyard
- Sick Officer’s
  Quarters
- Built 1942

Building 55, Charleston Naval Shipyard



Building 55, Charleston Naval Shipyard

Case Study 2

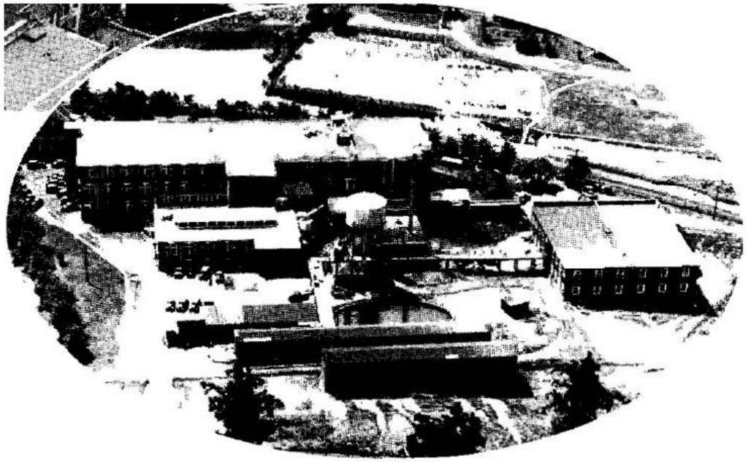
- Chatham Manufacturing, Winston-Salem, NC
- Initial buildings constructed 1907 as Chatham Textile Mill
- Complex expanded substantially ca. 1940 and 1956

Front Exterior

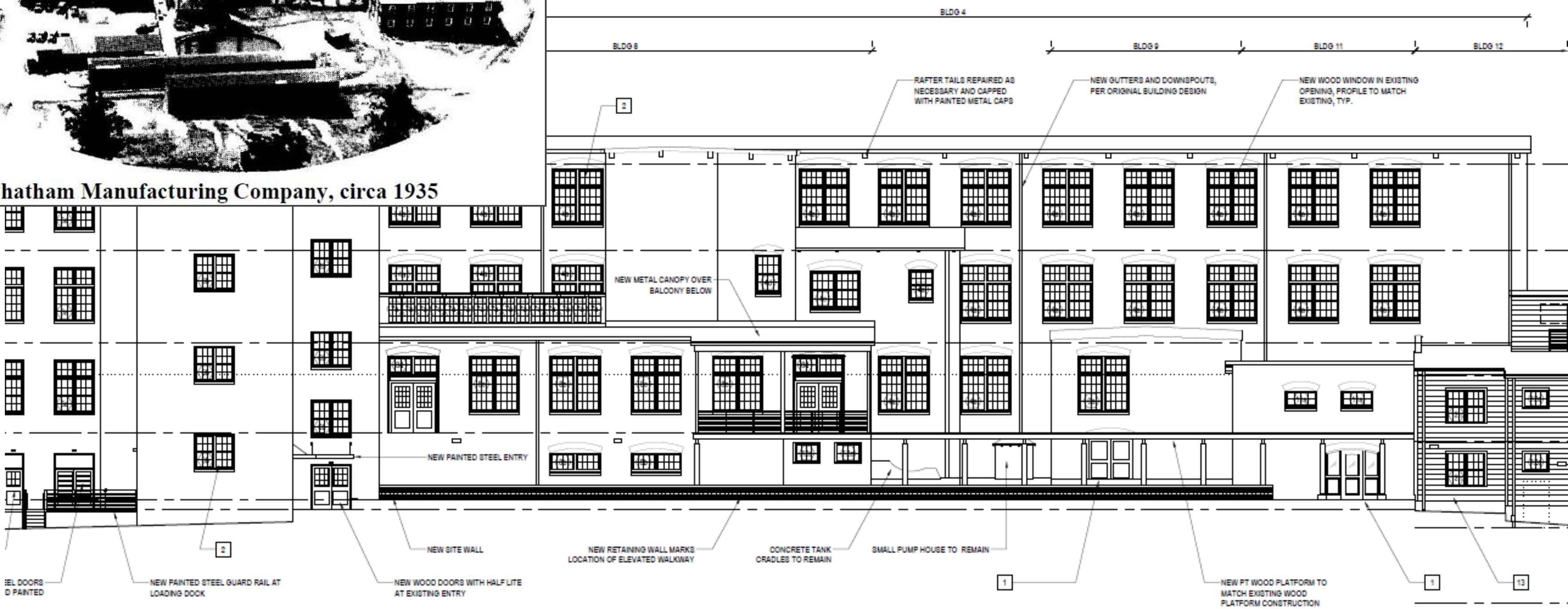
Back Exterior

Chatham Manufacturing, Winston-Salem

Chatham Manufacturing, Winston-Salem



Chatham Manufacturing Company, circa 1935



Current Deal Issues

- Court Cases
- Economic Substance
- State Credit Transactions
- Exit Transactions
- Nonprofit Participation
- Department of the Interior Review of RTC Program
- Guarantees

Thank you!

More Information?

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