The Economics of Historic Preservation Tax Credits

Opportunities
HISTORIC TAX CREDIT WORKSHOP
Oneonta, NY
May, 29 2014

“NYS and Federal Historic Tax Credits”
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Omni Housing Development LLC
Credit to Steve Weiss, Esq. Cannon Heyman & Weiss PC

For the descriptions of the legal basis of the Federal and NYS Historic Preservation tax Credits
The Challenges of Preservation
Tax Credits Provide a Powerful Tool
I. The Basics of Federal Historic Rehab Tax Credits

a. 20% Historic Rehabilitation Tax Credit
   i. Internal Revenue Code Section 47 / NY Tax Law 606
   ii. Credit vs. Deduction
   iii. Calculated as a percentage of the eligible qualified rehabilitation expenses (QRE’s)
   iv. Can immediately claim 100% of the historic credits
      a. When building is placed in service
      b. Substantial Rehab must be met
      c. Per accountant cost certification
   v. Unused federal credit can be carried back one year and forward for 20 years
I. The Basics of Federal Historic Rehab Tax Credits

a. 20% Historic Rehabilitation Tax Credit

vi. Two other tests to qualify for historic rehabilitation tax credits:

1. “Income Producing”
   a. Must be income-producing property - office, retail, industrial, hotel and/or rental residential housing (i.e., a depreciable building).
   b. Owner-occupied residences are not depreciable, and do not qualify for federal rehabilitation tax credits.
   c. Residential rental use is considered to be income-producing.
I. The Basics of Federal Historic Rehab Tax Credits

a. 20% Historic Rehabilitation Tax Credit

vi. Two other tests to qualify for historic rehabilitation tax credits: (cont.)

2. Substantial Rehabilitation

a. Rehabilitation must be “substantial” to qualify for any tax credits.

b. A building is **substantially rehabilitated** if QRE’s during a 24-month period (or 60-month, if phased project is specified prior to the start of rehabilitation) selected by the taxpayer exceed the greater of

   i. $5,000 or
   
   ii. the adjusted basis of the building and its structural components.

c. Adjusted basis is defined as the purchase price, minus the cost of the land minus any depreciation already claimed plus previously incurred rehabilitation costs.
I. The Basics of Federal Historic Rehab Tax Credits

   a. 20% Historic Rehabilitation Tax Credit (cont.)

vii. Qualified Rehabilitation Expenditures (QRE’s)

1. The rehabilitation tax credit is 20% of the qualified rehabilitation expenditures incurred.
2. Rehabilitation expenditures must be “capital” in nature meaning “depreciable” as real property.
3. This includes almost all hard and soft construction costs.
I. The Basics of Federal Historic Rehab Tax Credits

a. 20% Historic Rehabilitation Tax Credit

vii. Qualified Rehabilitation Expenditures (QRE’s) (cont.)

4. Architect’s fees, engineering fees, legal fees, consulting fees, reasonable developer fees, construction management costs and construction period interest and taxes and any other fees paid that would normally be charged to a capital account are allowable as part of the qualified rehabilitation expenditures.

5. Building and land acquisition costs are not considered qualified rehabilitation expenses.

6. The cost of new construction beyond the “shell” of the existing building, such as expenditures attributable to landscaping, parking lots, site work and building enlargements, are not considered qualified rehabilitation expenses.

7. The costs of personal property and furnishings are typically not considered qualified rehabilitation expenses.
I. The Basics of Federal Historic Rehab Tax Credits

a. 20% Historic Rehabilitation Tax Credit (cont.)

viii. Recapture

Historic rehabilitation tax credits claimed may be subject to prorated recapture by the IRS if within five years of completion of the rehabilitation:

a. if a rehab property is disposed of or foreclosed
b. if a rehab property is destroyed by casualty
c. if ownership is transferred
d. if post-certification alterations do not meet the U.S. Department of the Interior Standards or
e. if the property loses its status as income-producing.
I. The Basics of Federal Historic Rehab Tax Credits

b. 10% Rehabilitation Tax Credit

i. Internal Revenue Code Section 47 also offers a 10% tax credit

ii. for rehabilitations of non-historic, non-residential income producing pre-1936 buildings

1. building must NOT be listed in the National Register
2. building must NOT be located in a Registered Historic District (or if so, has been determined to be a “non-contributing structure”)
3. Building was placed in service before 1936 and has not been moved since
4. Properties must be income-producing (i.e., a depreciable building)
5. Building is used for non residential rental purposes

iii. Must satisfy the substantial rehabilitation test
II. NYS Commercial Historic Tax Credit

a. Legislation sponsored by Assembly Member Sam Hoyt and State Senator David Valesky was signed by Governor Paterson into law on July 28, 2009.
b. Allowed state credit is 100% of federal credit value (equivalent to 20% of qualified rehabilitation costs) up to a maximum of $5,000,000 in credit with respect to a qualified historic structure.
c. Unused NYS credit may be carried forward indefinitely.
d. Rehabilitation must be located in a qualified census tract.
e. NYS Historic Tax Credit is not transferable within business partnerships (NO “Bifurcation”).
f. Scheduled to sunset December 31, 2019.
g. For buildings placed in service on or after January 1, 2015, the NYS Historic Tax Credit is refundable.
III. Syndication

a. Market remains strong for HTCs (Banks, CRA, immediate return)

b. Smaller rehabilitations may experience difficulty getting favorable pricing – private placements

c. Passive activity loss rules can limit use of credit—individuals are limited in the credit claimed

d. Negotiating Deal Points
   i. Pricing
   ii. Pay in schedule (20, 70, 10)
   iii. Guarantees
   iv. Adjusters (upward and downward)
   v. Cash flow distributions (preferred return)
   vi. Annual fees
III. Syndication

e. Boardwalk impact
   i. Investor not a partner
      - no upside, no downside, “buying credits”
   ii. Profit motive and attributes of ownership
   iii. Fix:
      - Equity in during construction (20%?)
      - Guaranty of operating deficits capped at 12 months of operating expenses
      - Tax credit guarantees capped at 80% of investor capital
      - Preferred return not guaranteed
      - No longer advancing last installment when put is exercised
      - Investor in deal longer – put exercisable at year 6

f. Housing Bill (July 30, 2008)
   i. Housing and Economic Recovery Act of 2008 (H.R. 3221)
   ii. Now, HTC and LIHTC offset AMT
   iii. In awarding LIHTC, States must now give points in their QAP for Historic Rehab properties
Case Study
III. Syndication

g. Equity Raise

Historic Tax Credit Basic Example of Equity Raise
3 Vacant Buildings in the Groesbeck Historic District—Albany’s Southend

Project Cost Assumptions

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>Assumption</th>
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<tbody>
<tr>
<td>Acquisition Cost</td>
<td>$70,000 ($15,000 allocated for land)</td>
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<tr>
<td>QREs</td>
<td>$1,050,000</td>
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<tr>
<td>non-QRE</td>
<td>$150,000</td>
</tr>
<tr>
<td>Total</td>
<td>$1,270,000</td>
</tr>
</tbody>
</table>

Tax Credits Generated (20% of 1,050,000) $210,000

Price Per Credit Assumptions

<table>
<thead>
<tr>
<th>Credit Type</th>
<th>Assumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Credit</td>
<td>$0.95</td>
</tr>
<tr>
<td>State Credit</td>
<td>$0.55</td>
</tr>
</tbody>
</table>

Equity Yield

Allowable Credit x Price Per Credit = Equity Raise

Federal Credit Yield: $210,000 x $0.95 = $199,500
State Credit Yield: $210,000 x $0.55 = $115,500
Total Equity Raise: $210,000 x 0.25 = $315,000 (25%)

With Refundable NYS Credit: $409,500 (32%)
Preservation Tax Credits ➔ Preservation
Preservation or Demolition
Case Study

Morton Ave
III. Syndication

h. Master Lease HTC Syndication Structure