Federal & State Historic Tax Credits
The 20% Rehabilitation Tax Credit Fundamentals

- Tax Aspects Administered by the IRS.
- Preservation aspects jointly administered by NPS and State Historic Pres. Offices (SHPOs).
- Tax Credits = dollar for dollar reduction in tax liability (contrast with deduction).
- RTC is the most important (in dollar volume) federal preservation program.
Q: One of the biggest differences?
A: Owner-Occupied Residential Properties
Why are they needed?
Help Where It's Needed the Most
What’s Our Role?

www.PreservationNation.org
Thirty States Offer This Type of Incentive
Some programs are “better” than others.
Capping
Transferability
Components of a Good Program

- No Cap (Aggregate or Per-Project)
- Available for homeowners
- Transferable
- Reasonable % rates
- Multiple claimants
- Wide geographic distribution
What’s Happening Now?

- Efforts to Gain a Program (PA, NB)
- Efforts to Improve, Expand a Program (IA, IN)
- Efforts to Protect a Program (MO, OK)
Persuasive Arguments for the Credit
Two Types of Rehabilitation Tax Credits

- Older (pre-1936), non-historic and non-residential buildings: 10 percent of qualified rehabilitated expenditures.
- Historic buildings: 20 percent of qualified rehabilitation expenditures.
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 Types of Buildings Qualify?
The NPS Rules: Certified Historic Structure Requirement

Option #1
Building is listed in the National Register of Historic Places.
What Types of Buildings Qualify?
The NPS Rules: Certified Historic Structure Requirement

Option #2
Building is located in a registered historic district and certified by the Sec. of the Interior as being of historic significance to the district.
The **QREs** incurred during any 24-month period** selected by the taxpayer and ending in the taxable year in which the building is **placed in service** must exceed the greater of:

- $5,000, or
- The **adjusted basis** of the building.

**A 60-month period may be used where written plans completed before the rehab begins show that the rehab is expected to take place in phases and is reasonably expected to take more than 24 months.
“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.
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;
QREs include costs related to:

- construction period interest and taxes;
- architect fees, engineering fees, construction management costs;
- reasonable developer fees
What Types of Rehabilitations Qualify?
Definition of QREs

• Costs EXCLUDED from QREs:
  • Land and building acquisition;
  • Enlargements that expand total volume (cf. remodeling that increases FMR);
  • Personal property (furniture and appliances, cabinets and movable partitions, tacked carpeting);
  • New building construction;
  • Sitework (demolition, fencing, parking lots, sidewalks, landscaping)
• Credit equals 20% of all QREs incurred:
  • Prior to the start of the 24-month period selected (so long as they were incurred “in connection with” the rehab process that resulted in the substantial rehabilitation of the building);
  • During the 24-month period; and
  • After the last day of the 24-month period but before the last day of the tax year in which the measuring period ends.
The 20% Rehabilitation Tax Credit
When is the Credit Allowed?

- Credit is generally allowed in the year in which the building is placed in service (provided substantial rehabilitation test has been met).
- “Placement in Service” means that the all or identifiable portions of the building is placed in a condition or state of readiness and availability for a specifically assigned function.
- Progress Expenditure Election available for properties with a “normal” construction period of 2 years or more.
The 20% Rehabilitation Tax Credit 
Recapture

- Credit previously allowed is recaptured if any portion of the project which includes QREs is disposed of prior to the fifth anniversary of placement in service.

- Amount subject to recapture decreases by 20% during each year of the five year period.
• Disposition includes any sale, exchange, transfer, gift or casualty. Subsequent rehabs that do not comply with the Secretary’s Standards can trigger recapture.
# The Tax Credit Market Place:
## NPS Historic Tax Credit Statistics FY09 to FY10

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part 2s approved</td>
<td>1,044</td>
<td>951</td>
<td>-8.9%</td>
</tr>
<tr>
<td>Part 3s approved</td>
<td>806</td>
<td>883</td>
<td>+9.5%</td>
</tr>
<tr>
<td>Certified Rehabilitation</td>
<td>$4,539.16</td>
<td>$3,438.06</td>
<td>-25%</td>
</tr>
<tr>
<td>Expenditures: (in millions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average cost of project:</td>
<td>$4.49 million</td>
<td>$3.59 million</td>
<td>-20%</td>
</tr>
<tr>
<td>Maximum amount of credit to be</td>
<td>$939</td>
<td>$684</td>
<td>-27%</td>
</tr>
<tr>
<td>claimed: (in millions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average credit amount allocated</td>
<td>$899,938</td>
<td>$718,885</td>
<td>-20%</td>
</tr>
<tr>
<td>per project (approx).</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Total # of HTC Transactions by Deal Size in 2010

593 Total Transactions – data based on NPS quarterly reports

- $0-500,000: 68; 12%
- $501,000-999,999: 41; 7%
- $1.0M-1.99M: 42; 7%
- $2.0M-2.99M: 55; 9%
- $3.0M-4.99M: 67; 11%
- $5.0M-9.99M: 70; 12%
- $10.0M-ABOVE: 250; 42%
- $10.0M-ABOVE: 593; 100%

National Trust Community Investment Corporation
HTC Dollar Value by Deal Size in 2010

- $0-500,000: $10,460,857
- $501,000-999,999: $11,397,931
- $1.0M-1.99M: $18,440,267
- $2.0M-2.99M: $18,874,684
- $3.0M-4.99M: $32,961,010
- $5.0M-9.99M: $79,753,176
- $10.0M-ABOVE: $420,965,353

*Data based on NPS quarterly reports*
NTCIC: A brief history

- Partnership with Bank of America led to organization of the Banc of America Historic Tax Credit Fund in 2000.


- NTCIC received its first New Markets Tax Credit allocation in October 2003.

- $423.5 million in gross equity/debt invested to date.

- $1.7 billion in total development costs to date.
## Total Investments by Use

<table>
<thead>
<tr>
<th>By Use</th>
<th># of Projects</th>
<th>Net Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cultural/Educational Facility</td>
<td>19</td>
<td>$97,648,917</td>
</tr>
<tr>
<td>Hotel</td>
<td>7</td>
<td>$63,535,343</td>
</tr>
<tr>
<td>Housing &amp; Mixed-Use Commercial</td>
<td>23</td>
<td>$135,245,123</td>
</tr>
<tr>
<td>Office/Retail</td>
<td>19</td>
<td>$101,268,181</td>
</tr>
<tr>
<td>Non-profit Office</td>
<td>6</td>
<td>$25,827,071</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>74</strong></td>
<td><strong>$423,524,634</strong></td>
</tr>
</tbody>
</table>
Property Use: Residential (96 units)
Credits used: HTC
Net Investment: $2,696,588
Total Development Cost: $18,328,024
American Brewery
Baltimore, MD

Property Use: Office headquarters for non-profit group Humanim

Credits used: HTC & NMTC

Net Investment: $5,337,101

Total Development Cost: $23,989,027
Property Use: Performing arts charter high school
Credits used: Federal Historic and New Markets Tax Credits
Net Investment: $15,687,989
Total Development Cost: $88,232,316
## Sample Transaction
**Calculating the HTC Equity**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified Rehab Expenditures</td>
<td>$24,060,799</td>
</tr>
<tr>
<td>Credit Rate</td>
<td>20.00%</td>
</tr>
<tr>
<td>Total Calculated Credit</td>
<td>$4,812,160</td>
</tr>
<tr>
<td>Tax Credit Investor Allocation</td>
<td>99.99%</td>
</tr>
<tr>
<td>Total Credit to Investors</td>
<td>$4,811,679</td>
</tr>
<tr>
<td>Credit Price Per Each $1 of Credit</td>
<td>$0.98</td>
</tr>
<tr>
<td>Equity Contributions by Investors</td>
<td>$4,715,445</td>
</tr>
</tbody>
</table>
HTC Lease Pass-Through

HTC Deal Structures—Step by Step
Historic Tax Credit Syndication
The Credit Pass-Through Structure

• Landlord LLC owns fee simple, undertakes rehab, enters into Dev. Agreement, and earns the Historic Tax Credit.

• Master Tenant, LLC leases the entire project from the Landlord LLC for a fixed annual rental payment.
• Master Tenant, LLC operates the property, subleases to end users and enters into the Property Management Contract.

• Landlord makes special tax election to pass the Historic Tax Credit through to the Master Tenant LLC.
Project Inception—A New Project

Developer Member

Managing Member

99.99%

0.01%

Project
Adding Debt Capital

- Developer Member
- Managing Member
- Project
- Lender
- Mortgage Loan
Closing—Step 1, Create Master Tenant

- Developer Member
- Managing Member
- Tax Credit Investor

Project

Master Tenant

0.01% to 99.99%
Closing—Step 2, MT Invests in Project

- **Developer** Member
- **Managing** Member
- **Tax Credit** Investor
- **Project**
- **Master Tenant**

* Ownership split of Project between Developer and Master Tenant may vary
Long-term Lease of Building
(typically 32 years)
Tax Credit Distribution

- **Developer**
  - Member
- **Managing**
  - Member
- **Tax Credit**
  - Investor
  - $10 MM Tax Credit
- **Project**
- **Master**
  - Tenant
  - $10 MM Tax Credit
Operations—Step 1, MT Operates Building

- Developer Member
- Managing Member
- Tax Credit Investor
- Project
- Master Tenant
- Rent
- Space Tenant
Operations—Step 2, MT Pays Lease

Note: Lease Payment generally NOI less preferred return
Operations—Step 3, Debt Service

- Developer
- Managing Member
- Tax Credit Investor
- Lender
- Debt Service
- Project
- Lease Payment
- Master Tenant
- Rent
- Space Tenant
Operations—Step 4, Project Distribution

- Developer Member
- Managing Member
- Tax Credit Investor
- Project
  - Lease Payment
- Master Tenant
  - Rent
- Space Tenant
- 80% Profits & Losses
  - Less Special Allocations
- 20% Profits & Losses +
  - Special Allocations
Operations—Step 5, MT Distribution

- **Developer Member**
- **Managing Member**

**Project**
- 80% Profits & Losses
- Less Special Allocations

**Master Tenant**
- 20% Profits & Losses + Special Allocations

**Tax Credit Investor**
- Preferred Return + 20% Project Profits & Losses + Special Allocations

**Lease Payment**

**Rent**

**Space Tenant**

Note: Preferred Return to Investor taken from difference between Rent and Lease Payments
Exercise of Put—Sixth Year After Placed In Service Date

- Developer Member
- Managing Member
- Tax Credit Investor

Project

- Lease Payment
- 80% Profits & Losses
- Less Special Allocations

Master Tenant

- Rent
- 20% Profits & Losses + Special Allocations

Space Tenant

Interest in MT

$1.7 MM
After Exercise of Put

Developer Member
80% Profits & Losses Less Special Allocations

Managing Member

Project

20% Profits & Losses + Special Allocations

Master Tenant

Preferred Return + 20% Project Profits & Losses + Special Allocations

Lease Payment

Rent

Space Tenant

Rent
New Markets Tax Credit (NMTC) Basics

- Designed to encourage private investment in businesses and real estate projects in low-income communities.

- Administered by the Internal Revenue Service and the Community Development Financial Institutions (CDFI) Fund of the U.S. Treasury.
## Snapshot of New Markets Tax Credits Activity

<table>
<thead>
<tr>
<th>NMTC Round</th>
<th>Total Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$127,000,000</td>
</tr>
<tr>
<td>4</td>
<td>$53,000,000</td>
</tr>
<tr>
<td>5</td>
<td>$60,000,000</td>
</tr>
<tr>
<td>6</td>
<td>$40,000,000</td>
</tr>
<tr>
<td>7</td>
<td>$35,000,000</td>
</tr>
<tr>
<td>8</td>
<td>$28,000,000</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>$343,000,000</strong></td>
</tr>
</tbody>
</table>
• Investors must be taxpaying entities.

• Credit equals 39 percent of investment amount, claimed over 7 years and starting on the date when the investment is received by the Community Development Entity (CDE):
  • 5% credit years 1-3; and
  • 6% credit in years 4-7

• $1 of investment yields a $.39 credit.

• For example, an investor that invests $1,000,000 in a CDE in 2007 will receive $50,000 in tax credits in 2007-2009 and $60,000 in 2010-2013, for a total of $390,000 in credits.
• **Community Development Entity (CDE):** Receives an allocation and exchanges it for investor equity.

• **Qualified Active Low Income Community Business (QALICB):** Qualifying business or project that a CDE must invest in or lend to.

• **Low-Income Community (LIC):** Census tracts where QALICBs are located; must have greater than 20% poverty rate or less than 80% of median family income.

• **Qualified Equity Investments (QEI):** Investment into CDE that is used to calculate the tax credit amount.

• **Qualified Low Income Community Investment (QLICI):** QEI amount that goes through the CDE and into the QALICB in the form of a loan or investment.
CDEs must use Substantially All (85%) of the proceeds from Qualified Equity Investments (QEI) to make Qualified Low Income Community Investments (QLICI) into Qualified Active Low-Income Community Businesses (QALICB) located in Low-Income Communities (LIC).
The NMTC Allocation and Investment Process

Investor → QEI → CDE

Tax Credits

CDE → QLICI → QALICB

Reporting

Allocation

CDFI Fund

Reporting
## Comparison of Tax Credits

<table>
<thead>
<tr>
<th></th>
<th><strong>Federal HTC</strong></th>
<th><strong>NMTC</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Value</strong></td>
<td>20% of qualified expenditures of project</td>
<td>39% of equity from investor to NTCIC for the project</td>
</tr>
<tr>
<td><strong>Timing</strong></td>
<td>At time building becomes occupied</td>
<td>Over 7 years, from date equity is put into project</td>
</tr>
<tr>
<td><strong>Prices</strong></td>
<td>$.95 to $1.00</td>
<td>$.68 to $.79</td>
</tr>
<tr>
<td><strong>Recapture</strong></td>
<td>If ownership changes, such as a foreclosure on the loan or bankruptcy. If the developer fails to get National Park Service approval for rehab or loses it by altering character defining features.</td>
<td>If: 1) QEI does not meet “substantially all” requirement through failure to: a) invest 85%; b) meet QALICB requirements; or c) meet 1-year investment requirement; 2) CDE ceases to be a CDE; 3) CDE redeems investment</td>
</tr>
</tbody>
</table>
Current Public Policy Issues: Tax Reform and the impact on social investment credits

• The impact of lowering corporate tax rates.
• The future of tax preferences including tax credits in a “simplified tax code.”
• Is a grant more efficient than a credit?
• LIHTC vs. NMTC vs. HTC
Current Public Policy Issues: Recent Court Cases

- Virginia Tax Credit Fund v. Commissioner
- Boardwalk Hall v. Commissioner
- IRS arguments:
  - Is the partnership a true partnership?
    - Do the partners have real risk?
    - Do they have both upside and downside potential?
    - Do developer guaranties eliminate investor risk?
  - Is there economic substance?
    - Is there a pre-tax motive?
  - Is the transfer of credits in a partnership really a disguised sale of property subject to ordinary income tax?
1. Win Passage of CAPP Act:

2. Protect federal HTC from changes due to deficit reduction and tax reform.

3. Promote growth of HTC.

4. Strengthen federal HTC program within NPS.

5. Strengthen state HTC programs.
Renee Kuhlman
National Trust for
Historic Preservation
Phone: 202-588-6234
renee_kuhlman@nthp.org
www.preservationnation.org
Andrew Farrell
NTCIC
202-588-6268
Andrew_Farrell@ntcicfunds.com