TAX CREDITS for Historic Rehabilitation

by John Leith-Tetrault and Kennedy Smith

Historic buildings shape New England's character and reflect communities' industrial, civic, ethnic, religious, and cultural heritage. Iconic buildings like Barre's union hall in Vermont, Boston's Old North Church, and Newport's waterfront mansions are integral to American history, along with thousands of New England's houses, barns, city halls, courthouses, storefronts, mills, churches, customs buildings, and theaters.

Historic buildings also provide opportunities to create high-quality affordable housing. But in spite of a shortage of affordable housing, the nation demolishes an average of almost 600 old and historic buildings every day, buildings that could continue to enrich our towns and cities for generations to come.[1]

The Economy and the Community

Rehabilitating historic buildings can be challenging and expensive, and sometimes communities with other priorities balk. Fortunately, there is help for meeting many goals simultaneously.

The federal government offers income tax credits equal to a percentage of eligible rehabilitation costs, reducing tax liability by one dollar for every dollar of tax credit earned.[2] From their 1976 launch through 2006, historic rehabilitation tax credits helped finance more than 31,000 rehabilitations, including hundreds of thousands of housing units. Additionally, almost 30 states have state programs that roughly parallel the federal program. (See "Preservation Tax Credit Programs in New England.")

Because the Tax Reform Act of 1986 placed restrictions on individuals, credits are often more valuable for corporations, and tax credit syndication is common. The market is well established, with tax credit pricing influenced by a project's size, perceived risk, competition for tax credits, project timing, and so on. Investors typically pay 95 to 99 cents per dollar of federal historic rehabilitation tax credit and 65 to 85 cents per dollar of state credit.[3]

Tax Credit Basics

Options at the federal level are a 20 percent income tax credit for historic buildings and a 10 percent credit for buildings built before 1936 but not historic.[4]

Claiming 10 percent is relatively straightforward: property owners determine that a building is not historic, then claim the credit on their federal income tax return. There are no rehabilitation standards or reviews. Claiming the 20 percent credit is somewhat more complicated.

To be eligible for the 20 percent federal historic rehabilitation tax credit, these criteria must be met:

- The building must be listed in the National Register of Historic Places, be a "contributing" building in a National Register-listed historic district, or be eligible for the listing.
- The project must be depreciable and income producing.
- Qualified rehabilitation expenses must equal or exceed the building's basis (original cost adjusted for factors such as depreciation) or $5,000, whichever is greater (in other words, a "substantial rehabilitation"). Qualified expenses include costs such as construction, architectural and engineering fees, construction-period interest, and developer fees. They do not include acquisition, landscaping, new construction, furnishings, and the like.
- Rehabilitation must meet the Secretary of the Interior's Standards for Rehabilitation.[5]
- Substantial rehabilitation must take place within a defined two-year period (five years under certain conditions).

To claim the credit, property owners must obtain plan approval from the state historic preservation office and National Park Service, plus final approval saying rehabilitation was done correctly.[6] The credit can be carried back one year or carried forward up to 20 years. It can be combined with other tax credits (low-income-housing, state historic, and New Markets).[7]

The program has some limitations:

- The building's depreciable basis must be reduced by the value of the tax credit.
- When coupled with low-income-housing tax credits, the reduced basis is used to calculate the housing credit.
- Historic rehabilitation tax credits cannot be transferred.
- A change of ownership within five years triggers credit recapture.
- There are some "disqualified lease" restrictions on the use of rehabilitated property by tax-exempt entities.

The National Trust for Historic Preservation, the National Conference of State Historic Preservation Officers, Preservation Action, and others are supporting legislation to correct those limitations.[8]

A New England Success

One example of the benefits of preservation tax credits is Providence's Dreyfus Hotel.

Built in 1890, the four-story building was a downtown landmark for years, with a bar and dining room considered among the city's finest intact commercial interiors. Johnson & Wales College purchased it in the 1970s and used it as a dormitory into

Tax Credit Programs in New England

Connecticut offers one tax credit program for historic homes and one for commercial and industrial buildings rehabilitated for residential and mixed-use activities.

The Historic Homes Rehabilitation Tax Credit program provides a credit of 30 percent of qualified rehabilitation expenses, up to $30,000 per unit, for up to four units. One of the units must be occupied by the property owner for a minimum of five years. Qualified rehabilitation expenses must total at least $25,000. Buildings must be listed in the National or State Register of Historic Places and must be located in a targeted area (generally one with family income levels below the state median). The program is capped at $3 million annually.

The program provides a 25 percent credit for rehabilitating historic commercial and industrial buildings for residential use (partial credits are available for mixed-use projects). As of January 1, 2008, the state offers an add-on credit of 5 percent for projects that include affordable housing. The cap is $15 million annually, with a per-project cap of $2.7 million. Credits may be used only by C corporations and can be transferred to other entities. Contact the Connecticut Historical Commission: (860) 566-3005, www.chc.state.ct.us.

Maine offers a 20 percent credit for income-producing properties that qualify for federal credits. Credits are capped at $100,000 annually per taxpayer. There is no statewide cap. The credit can be used by the building owner or lessee. As with the federal credits, qualified rehabilitation expenses must total the greater of $5,000 or the building's adjusted basis. Projects must comply with Department of Interior standards for rehabilitation. Contact the Maine Historic Preservation Commission: (207) 287-2132, www.maine.gov/mhpc.

Massachusetts offers a 20 percent historic rehabilitation tax credit. A building needs to be older than 50 years; it does not need to be listed in the National Register or contribute to a National Register-listed historic district. There is no minimum investment required and no per-project cap. The state program is capped at $50 million and is authorized through 2010. Projects must comply with Department of Interior standards. Contact the Massachusetts Historical Commission: (617) 727-8470, www.sec.state.ma.us/mhc/mhctax/taxidx.htm.

New Hampshire offers tax incentives for preserving historic agricultural buildings. Contact the New Hampshire Division of Historical Resources: (603) 271-6435, www.nh.gov/nhdhr/barntaxincentives.html.

Rhode Island's program was until spring 2008 one of the nation's most generous, with a tax credit equal to 30 percent of qualified rehabilitation expenses for income-producing historic properties. Unfortunately, budget issues forced the state to withdraw the offer for future projects. Projects already accepted will be completed.10 Contact the Rhode Island Historical Preservation and Heritage Commission: (401) 222-2678, www.preservation.ri.gov/credits.

Vermont provides a 10 percent add-on credit for projects located in designated downtowns and qualifying for the federal 20 percent tax credit. There is a cap of $50,000 per project and a statewide cap of $1.5 million. Vermont also offers credits for specific improvements. These include a 50 percent credit for improvements that help historic buildings comply with building codes; a 25 percent credit for façade improvements for pre-1983 commercial buildings ineligible for federal historic rehabilitation tax credits; and reallocation of state retail sales taxes paid for construction materials purchased for improvement projects in designated districts. Each credit has a per-project cap ($50,000 for elevators, $12,000 for lifts, $50,000 for sprinklers, $25,000 for other code compliance work, $25,000 for façade improvements). For sales tax reallocation, caps are based on population size. Contact the Vermont Division for Historic Preservation: (802) 828-3211, www.historicvermont.org/financial/credits.html.

the 1990s. It was vacant until 2005, when a Providence-based nonprofit arts organization, AS200, purchased it.[9] AS200 plans a redevelopment that will include 14 housing units. Eleven will be restricted to artists earning less than $25,000 annually; three will be market rate. There also will be 10 artist studios, a restaurant, and a small ground-floor retail space.

Although AS200 has had little experience in real estate development, the project has financial support from the City of Providence, the State of Rhode Island, the Federal Home Loan Bank of Boston (FHLB Boston), and the Providence Preservation Society Revolving Fund, among others, making the $7.4 million project attractive to tax credit investors. The National Trust Community Investment Corporation helped obtain a $3.4 million tax credit equity investment, combining the 20 percent federal historic rehabilitation tax credit—and the 30 percent state historic rehabilitation tax credit that Rhode Island had at the time—with federal New Markets tax credits. HUD's HOME Investment Partnerships Program, Rhode Island Housing, and Rhode Island Lead Abatement funds are helping with financing; equity comes from the restaurant owner; the Providence Economic Development Corporation is making an acquisition loan; and FHLB Boston's Affordable Housing Program is providing a first mortgage.

The Dreyfus Hotel is just one of a growing number of projects in New England and throughout the country in which historic rehabilitation tax credits have been pivotal in reusing historic buildings for affordable housing and community facilities-and connecting past and future.

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Endnotes

[1] Donovan Rypkema, "Economics, Sustainability, and Historic Preservation," speech for the National Trust for Historic Preservation, 2005, http://www.preservationnation.org/issues/transportation/additional-resources/rypkema-speech-sustainability-portland-10012005.pdf.

[2] The program is administered jointly by the National Park Service and the Internal Revenue Service. See *Tax Aspects of Historic Preservation*, www.nps.gov/history/hps/tps/tax/IRSQ_A.htm. The National Trust Community Investment Corporation offers an interactive online questionnaire that helps determine if a project is eligible for historic rehabilitation tax credits: www.ntcicfunds.com.

[3] Because state income taxes are a deduction from federal taxable income, state tax credits are priced lower to offset the lost federal deduction.

[4] "Historic" may imply not just historic significance, but also architectural or cultural.

[5] See http://www.nps.gov/history/hps/tps/tax/rehabstandards.htm.

[6] The building's owner or developer must file a form with the National Park Service. Part I certifies that the building is historic; Part II outlines rehabilitation plans; Part III certifies that the rehabilitation was completed correctly. See www.nps.gov/history/hps/tps/tax/hpcappl.htm.

[7] The New Markets Tax Credit Program permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated community development entities. See http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5.

[8] See http://www.preservationnation.org/issues/rehabilitation-tax-credits/community-restoration-and.html.

[9] AS200 stands for Artists Space at 200 Weybosset Street, where the organization was launched in 1985.

[10] See http://www.preservation.ri.gov/pdfs_zips_downloads/news_pdfs/08-04-07hpitc.pdf.