Historic Tax Credit Coalition

April 15, 2013

The Honorable Kenny Marchant
U.S. House of Representatives
Washington, DC 20515

The Honorable Jim McDermott
U.S. House of Representatives
Washington, DC 20515

RE: Historic Tax Credit

Dear Chairman Marchant and Vice Chairman McDermott,

This comment letter represents the views of the Historic Tax Credit Coalition (HTCC), a non-profit organization dedicated to developing a consensus on ways to maintain and modernize the federal Historic Tax Credit (HTC). Our members are tax credit investors, syndicators, tax attorneys, accountants, preservation consultants and real estate developers who are using the HTC as a financing tool to promote economic development through the rehabilitation of historic properties. The HTCC's activities include research on the economic impact of the HTC, the development of legislative and regulatory proposals to promote the simplification and greater use of the HTC, and efforts to foster greater communication between the National Park Service, the Internal Revenue Service and the HTC industry.

The HTCC strongly believes in the importance of retaining the historic tax credit in the tax code as part of comprehensive tax reform. The HTC has been a successful driver of economic development in communities across the country – generating jobs, federal, state and local taxes, increasing family incomes and spurring district-wide community revitalization. These HTC-financed projects have a proven track record including a high project success rate that far exceeds the real estate industry average, and a very low tax credit recapture rate. The credit qualifies as a Public Welfare Investment under OCC regulations and is exempt from the Dodd Frank Bill's Volcker Rule.

Retention of this federal incentive is also important because there is much more rehabilitation to be done. While the HTC has made enormous strides rehabilitating anchor properties that lead to the revitalization of entire commercial submarkets, tens of thousands of vacant and under-utilized historic buildings, rich in architectural heritage, remain that will continue to exert blighting influences on the surrounding community if these credits are no longer available. These rehabs are simply not economically feasible without the HTC.

We have attached a number of documents to this letter, including an economic impact study of the HTC completed by Rutgers University for the National Park Service, a study of the recapture

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rate of the HTC done by Novogradac and Company for the National Trust for Historic Preservation, an overview of how the HTC works and a letter signed by organizations that support our view that the HTC should be retained in the tax code. Also included are a complete history of the federal historic tax credit, a diagram of a typical historic tax credit transaction and case studies of the American Brewery Building in Baltimore, MD and the Boilermaker Building in Washington, DC. The HTCC's entire submission can be found at: https://www.dropbox.com/sh/ubia13b170lw1hd/kKgP4I76A_.

HTC Basics

The current program has its origins in the Tax Reform Act of 1978 which created a 10% investment tax credit for the rehabilitation of buildings older than 20 years. Its purpose, according to Congressional reports, and still relevant today, was to counter the flow of capital away from existing buildings due to demographic changes in center cities and the development of decaying areas.

The federal Historic Tax Credit as we know it today was enacted in 1981 as a bi-partisan effort of the Ronald Reagan Administration and a Democratically-controlled Congress to stimulate the American economy struggling to emerge from a deep recession. It was seen as a way to even the playing field for private investments in new construction and existing buildings within a broader package of incentives to promote economic growth. The initial legislation put a 25% credit in place for certified historic rehab, a 20% credit for non-residential buildings at least 40 years old and a 15% credit for non-residential buildings at least 30 years old.

The 1981 law was retained and modified as part of the 1986 Tax Reform Act to 20% and 10% credits respectively. The report of the Ways and Means Committee stated the reasons for its continuing support of the historic tax credit:

"The Congress concluded that the incentives granted to rehabilitations in 1981 remain justified. Such incentives are needed because the social and aesthetic values of rehabilitating and preserving older structures are not necessarily taken into account in investors' profit projections. A tax incentive is needed because market forces might otherwise channel investments away from such projects because of the extra costs of undertaking rehabilitations of older or historic buildings."

HTC eligible properties under today's law must be income producing and depreciable. Owner-occupied properties are not eligible. The program is jointly administered by the National Park Service (from application to placement in service) and the Internal Revenue Service (for tax compliance) and is codified under Section 47 of the IRC.

Today's 20% HTC is 100% earned by the investor when the building is placed in service. The law requires that the investor be an owner for a 5-year holding period. This tax credit equity is used by the developer to close the financing gap created by the higher cost of historic rehabilitation, the lower rents typically commanded by historic buildings in marginal commercial districts and the resulting lower loan amounts provided by banks to historic properties compared to new construction.

National Park Service statistics show that 77% of all certified tax credit projects are located in Qualified Low-Income Census Tracts with incomes at or below 80% of median. Fifty percent of all transactions support the development of either market rate or low-income housing.

Any transfer of ownership (such as a mortgage foreclosure) within the 5-year compliance period triggers tax credit recapture. However, the recapture risk burns off 20% per year over 5 years. In even rarer instances, the credit may be recaptured if the building's architectural character is altered within this holding period or if the building is deemed totally lost as a result of a natural disaster.

A qualified building is one that is on or can be nominated at the time of application to the National Register of Historic Places. A building can also qualify as a contributing structure within a National Register historic district. Rehabilitation standards must be met, as outlined in the Secretary of the Interior's Standards for the Rehabilitation of Historic Buildings ("Standards").

The rehab must be "substantial," –$5,000 or 100% of the adjusted basis, whichever is greater. The developer must submit a 3-part application to the National Park Service with Part 1 making the case for the property's eligibility to the National Register, Part 2 outlining how the rehab will meet the Standards, and Part 3 demonstrating after completion how the property has met the Standards. Part 3 is the final certification that the credits can be taken by the investor.

Most often the substantial rehab test is based on 100% of the adjusted basis--the cost of acquisition, less the value of the land, plus the cost of any improvements already made, less any depreciation taken. This very high threshold for minimum rehab makes it difficult to use the HTC more than once on a given building. Buildings that meet the current "sub-rehab test" are often functionally obsolete, under-utilized or vacant. The initial rehab costs are usually much higher on a square foot basis than subsequent renovation and upgrades years later. It takes many years of depreciation and a high second rehabilitation budget before the substantial rehab test can be met again.

The federal HTC has been so successful in encouraging catalytic historic rehab, 32 states have enacted complementary state historic tax credit statutes that allow investors to use the same cost basis to offset state income, franchise and premiums taxes. Applications for both credits are handled efficiently by the State Historic Preservation Offices which generally operate with regulations that are in sync with federal HTC requirements. State HTC proceeds are helpful in closing financing gaps, but not a replacement for the federal HTC incentive.

Economic Impact of the HTC

Rutgers University's Center for Urban Policy Research has been publishing reports on the economic impact of the federal HTC for the last four years. Its latest report *The Economic Impacts of the Federal Historic Tax Credit-2012* shows that the HTC has leveraged more than $106 billion in private investments over its 32-year history, more than 5 times the $20.5 billion in credits allocated by the National Park Service. A total of 38,700 buildings have been put back into commerce. These and related statistics below are generated by the *Preservation Economic*

Impact Model (PEIM), developed for the National Park Service by Rutgers University in 2004 to measure the economic benefits of historic rehabilitation. PEIM measures the impact of historic rehab on national and state economies from the beginning to the end of construction. The model's outcomes are therefore understated because PEIM's estimates do not include the economic ripple effect of building operations, nor does it measure the impact of tourism or the value of any additional rehab activity that may occur around an initial project as confidence in the historic area's future increases.

HTC-assisted rehabilitations have been remarkably consistent in their ability to promote private economic investments in surrounding buildings, leading to the creation of historic districts that become destinations, driving tourism and bringing people back downtown to enjoy new entertainment, recreation, residential and office facilities. Because of the additional cost of historic rehab, and the lower rents these "Class B" buildings can command, initial historic rehabs in a commercial area generally cannot be fully financed without the federal historic tax credit and other incentives. However, once the first HTC-assisted projects have been completed, property values rise, and investor confidence in a historic area has been established, there is often less need for federal, state and local financing incentives for the second generation of transactions. The HTC is a pump primer that works.

The Rutgers economic impact report estimates that the federal historic tax credit has created more than 2.3 million full-time equivalent construction and permanent jobs. Historic rehab generates high-skilled, good-paying jobs that include specialty trades such as plastering, paint restoration, historic floor and roof restoration, fine woodworking and refinishing, historic window repair and wallpapering.

Historic rehabilitation generates more jobs than new construction. Research by economist Donavan Ripkema in *Dollars and Sense of Historic Preservation* found that in the typical new construction project, 50 percent of the costs are generated by materials and 50 percent are attributable to labor. He found that historic rehabilitation projects are more labor intensive with 60-70 percent of the costs generated by labor and 30-40 percent by the purchase of materials. Rutgers research for the National Park Service indicates that local and home state economies capture an exceptionally high 75% of the economic benefits of historic rehab because labor and materials are more often purchased locally than with the typical new construction project.

There are few older towns and cities in the United States that have not discovered the economic potential of historic rehabilitation. Those that have maximized the adaptive reuse of their historic structures--cities like San Antonio, Richmond, New Orleans, Seattle, Cleveland, Philadelphia, St. Louis, and Baltimore--have experienced remarkable economic rebirth over the past 30 years.

The HTC is a Model Credit

The HTC has also proven itself to be an efficient use of federal dollars. The cumulative cost of the credit has been $20.5 billion over the life of the program. However, according to the study done by Rutgers for the National Park Service, the federal HTC has generated nearly $26 billion in direct federal tax revenue primarily from income taxes on wages paid to workers at construction sites, materials manufacturers and in the retail and service sectors as historic rehab expenditures ripple through the economy.

The HTCC believes that any economic incentive program that more than pays for itself should remain a part of the federal tax code. In addition, because the credit is paid in full only upon the building's placement in service, most of the HTC-related revenue generated for the Treasury is received before the credit is paid out to the investor– exactly the way a tax credit meant to spur economic activity should be structured.

The HTC's relative efficiency is also demonstrated by its exceedingly low recapture rate. The attached recapture study, referenced above, indicates that the cumulative recapture rate of the HTC over the 2001-2011 measuring period was just .73% reflecting a better than 99% project success rate.

Efficiency is also reflected in the high transfer pricing of the federal HTC. Corporate investors typically pay between $.95 and $.99 per tax credit dollar for the LLC or LP ownership interests that allow them to claim the credits. Other investor tax benefits include any taxable losses generated by depreciation. Investors also earn an upside from operating cash flow.

Case Studies

The attached HTC case studies—the American Brewery Building in Baltimore, MD and the Boilermaker Building at the Navy Yards in Washington, DC demonstrate the broad applicability, catalytic impact and critical financing role of the federal HTC.

American Brewery is an example of how iconic historic properties--in this case a former beer brewery—can be adapted to the needs of an economically distressed East Baltimore community with a 51% poverty rate and an unemployment rate 4 times the national average. Humanin, a 25-year-old provider of work force development services to physically and mentally challenged individuals, now uses American Brewery as its headquarters from which it serves over 4,000 clients annually.

The Boilermaker Building is a key property in a larger redevelopment of the Washington Navy Yards into a mixed-use community that is bringing new housing, retail and office space and construction and permanent jobs to one of Washington, DC's most difficult neighborhoods. The building once served as the manufacturing facility for naval ship boilers. The Boilermaker Building is being leased to restaurants and service retailers that will help make the Navy Yards a 24-hour waterfront neighborhood. Neither of these case study projects could have been completed without the use of the federal HTC and other federal and local financing incentives.

Keep the HTC

Again, we want to urge you in the strongest possible terms to keep this essential credit in place. We certainly understand the rationale behind fundamental tax reform, and we support the broad policy goal of lowering both the corporate and individual rate while broadening the base of taxpayers. But we believe that the HTCC has demonstrated through this summary letter and the attached materials that HTC-assisted historic property rehabilitation is not just a cultural good that underpins the preservation of America's architectural heritage. It is also a remarkably strong and targeted economic activity that is deeply woven into the revitalization strategies of thousands of cities and towns across the country.

We want to emphasize in closing that historic rehabilitation would not happen without the HTC. Even if developers get a lower tax rate through tax reform, they will not undertake the less profitable option of historic rehabilitation without this incentive. Absent the HTC, which fills the financing gap, there will be a halt to the rehabilitation of historic commercial properties in the United States.

Thank you for giving us the opportunity to make the case for the HTC on behalf of the entire industry. We also want to thank you for the time committee staff has taken to discuss the credit in the context of tax reform efforts. We look forward to working with you to help bring the tax reform process to a successful conclusion.

Sincerely,

John Leith-Tetrault
Chairman, Historic Tax Credit Coalition

cc: Chairman Dave Camp
cc: Ranking Member Sander Levin

Attachments:
Economic Impact Study
Recapture Study
Basics of the Credit
Letter from Interested Parties
Historic of the federal Historic Tax Credit
HTC Transaction Diagram
HTC Case Studies