Historic Rehabilitation Tax Credits: Round Robin Introduction

Real Places Conference
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Texas Historical Commission
Historic Rehabilitation Tax Credits

Tax credits provide the most powerful financial incentives for historic preservation. They help finance historic preservation by offsetting income tax or business tax liability as a dollar-for-dollar reduction.
Federal Historic Preservation Tax Incentive Program

Allows for a credit on federal income tax liability of 20% of qualified expenses on an eligible rehabilitation project.

Administered by the NPS, IRS and SHPOs.

Since 1978, the credit has:

• Revitalized over 41,000 vacant and underutilized buildings
• Created 2.5 million jobs
• And spurred over $130 billion in private investment.
From 2002 – 2015:

• 126 rehabilitation projects completed and certified

• $1.1 billion in total rehabilitation costs

• $184 million in tax credits to individuals and businesses

• Supported over 16,000 jobs

• Generated over $236 million in local, state, and federal taxes
Texas Historic Preservation Tax Credit (THPTC)

Texas was the 36th state to create a state tax credit program. Administrative rules were passed by the THC in 2014 and the program went into effect on January 1, 2015.

The program parallels the federal process to allow applicants to pair credits, and is considered one of the strongest credits in the country.

Allows for a credit on the Texas Franchise Tax – or Texas Insurance Premium Tax – of 25% of qualified expenses on an eligible rehabilitation project.

Administered by the THC and the Texas Comptroller.
Impacts of THPTC

First 4 years of the THPTC:

- Increase in number of applications for federal credit
  - 427 Part A applications received
  - 328 Part B applications received, with $2.695 billion in estimated costs

- Increased geographic distribution of projects and increased variety in size of projects
  - Applications received for projects in 84 different cities
  - Project costs range from $5300 to $180 million

- 146 completed projects have been certified, with $1.2 billion in qualified expenditures
Tax Credit Programs

Federal Tax Credit Program

- Credit worth 20% of expenditures
- Offsets owner’s Federal Income Tax
- Available to business properties (retail, offices, apartments, hotels)

State Tax Credit Program

- Credit worth 25% of expenditures
- Offsets Texas Franchise tax and/or Texas Insurance Premium tax
- Credit may be sold for cash
- Available to business properties and non-profit properties
Historic Rehabilitation Tax Credits
Combining the state and federal credits:

The state tax credit may be used separately or in conjunction with the 20% federal tax credit for rehabilitation.

Combining the credits can make many projects possible that were never previously financially feasible.

Federal 20% + State 25% = Max Benefit 45%
Historic Rehabilitation Tax Credits

Combining both credits: Melrose Building, Houston

- Constructed 1952
- Vacant since 1980s
- First Modern-style office building in Houston
- Underwent conversion for use as a hotel, using both state and federal credit programs, certified in November 2017
Historic Rehabilitation Tax Credits

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Combining both credits: Harbert’s Garage, Columbus

- Constructed 1932
- Contributes to Columbus downtown historic district
- Rehabilitated for use as a tenant lease space, certified December 2018
How do the finances work?

- Credits are awarded to successfully completed projects (developer/owner must carry costs)
- Before credits are realized, financing is often carried out through bridge loans or capital from investors. Approval for the program at the beginning of the project can help secure financing or investors.
- **No cap for credits**, for any project or for the program
- The awarded credit amount is a straight percentage of eligible costs – it is “all or nothing.”
Qualified Rehabilitation Expenditures (QREs)

Qualified Costs (examples)
- Structural elements
- Surfaces & finishes
- Systems (plumbing, electrical, HVAC, elevator, sprinklers)
- Architect’s fees, etc.
- Interest & taxes

Non-Qualified Costs (examples)
- Site work (parking, etc.)
- Additions/new construction
  - Signage
- Appliances & furniture
  - Acquisition costs
- Payments from insurance or grants
How does approval work?

- Both programs are not competitive, but based on whether you qualify.
- Applications are reviewed on a continuous rolling basis throughout the year.
- The application process starts before work has begun, and requires an architectural review of your project to be approved.
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Before work starts:
- Contact THC to discuss project
- Plan project, photograph building
- Submit Parts 1 and 2 of application
- Receive determinations

After work ends:
- Assemble close-out documentation
- Submit Part 3 of application
- Receive final approval of project
- Receive tax credits
Basic program requirements:

1) Building must be a *certified historic structure*.

2) Project must be a *certified rehabilitation*.
   a. Eligible property type
   b. Meets cost threshold
   c. Work meets Secretary’s Standards for Rehabilitation
What is a Certified Historic Structure?

- **National Register**, individual listing
- **National Register**, district listing – contributing buildings only

State only
- **Recorded Texas Historic Landmark** (RTHL)
- **State Antiquities Landmark** (SAL)
Does my building have to be historically designated before my project begins?

_No_. The first step of the application process is to assess whether the building is designated _OR_ eligible for designation.

If the building is not yet designated but found _eligible_ for designation, the applicant must pursue designation while undertaking the rehabilitation. Historic designation must be made official in order to receive the tax credits.
What is an eligible property use?

Buildings that will have a **business or income-producing use** qualify for both state and federal credits. This includes rental residential.

**Non-profit** use facilities are also eligible for the state program.

**Owner-occupied residential properties and government-use properties** are not eligible for either program.
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Non-profit examples using the state credit only

St. David’s Episcopal Church, Austin
Structural stabilization
Phase 1 certified September 2018

Thistle Hill house museum, Fort Worth
Structural and ADA modifications
Certified August 2018
What is the cost threshold?

- The federal credit requires a “substantial rehabilitation” equal to the adjusted basis of the building or $5000, whichever is greater.

Adjusted basis = purchase price of property - value of land + improvements – depreciation

Substantial rehabilitation test must generally be met within 24 months.

- The state credit requires expenses of at least $5,000 (enables small projects or phased applications for one building).
What are typical eligible project types for federal AND state credits?

- Downtown commercial buildings
- Hotels
- Office buildings
- Apartment buildings
- Industrial adaptive re-use

Applying for federal credits typically requires a whole-building rehab project (regardless of size).
What are potential project types for the state credit ONLY?

- Individual floors or portions of a building
- Exterior-only or interior-only “facelifts”
- Roof replacements
- Window repair
- Systems upgrades (HVAC)

Applying for state credits requires only a $5000 investment (regardless of building size).
What is a rehabilitation?

Rehabilitation makes possible a compatible use for a property through repair, alterations, and additions, while preserving those portions or features which convey its historical, cultural, or architectural values.
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Architectural Review

• All projects are reviewed for conformance with the Secretary’s Standards for Rehabilitation, which are a “building-first” approach.

• Each project is judged as a whole.

• The current condition is the starting point.

• All buildings are different – the Standards are interpreted by THC and NPS to apply to each individual property.

• All work done on the exterior, interior, and site is subject to review.
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Remember that this is an **earned credit**: participation is an applicant’s choice. It is the applicant’s responsibility to ensure they can:

- Meet their architectural needs AND the Standards. Anticipate design compromises.
- Have a financially beneficial outcome.

**Coordinate with THC early and often!**
Do I need to hire an architect or other professionals?

- In most cases, yes. An architect is necessary for a large-scale project or one with major plan changes. Very simple projects can be successful without one, but an architect can guide your design to ensure success. They can also provide the necessary documentation of your completion date.

- A CPA will be necessary to provide your audited cost report.

- An architectural historian is important if you are looking to get a new historic designation.

- Some people hire a tax credit consultant for expert guidance and advice.
Afterwards:

There are no “lingering” review requirements after certification

National Register designation does not impose future reviews*

Apply again at any time, if all eligibility criteria are met

The federal tax credit program has a 5-year recapture period, which governs:
- Further alterations or demolition
- Sale or ownership transfer of building

*Unless required by local ordinance (very unusual)
How is the state credit sold?

- It is up to the recipient to coordinate with a buyer in a private sale.
- Interested buyers may include capital companies, banks, or local large companies that incur franchise tax.
- When the credit is sold, the buyer and seller record the transfer with the Texas Comptroller.
- Certified applicants are actively selling credits for $.80 to $.90 or even more.
Application Review Process

**Part 1/A**
- Submit Part 1 for Federal
- Submit Part A for State
- THC Review 30 days*
- National Park Service (NPS) Review: Additional 30 days
- Receive Part 1/A Approval: letter of preliminary eligibility or certification of historic building
- **STATE ONLY:** If not designated at Part A, resubmit Part A upon designation of building

**Part 2/B**
- Submit Part 2 for Federal
- Submit Part B for State
- THC Review 30 days*
- NPS Review Additional 30 days
- Any Part 2/B Amendments: Processing time varies
- Receive approval letters for Part 2/B and any amendments

**Complete Rehabilitation Project**

**Part 3/C**
- Submit Part 3 for Federal
- Submit Part C for State
- THC Review 30 days*
- NPS Review Additional 30 days
- Receive Federal tax credit certificate
- Receive State certificate of eligibility
- **Claim Federal tax credit on income tax return**
- **Claim State tax credit on business franchise tax return**

**STATE ONLY**
- Submit Certificate of Eligibility, application form, and audited cost certification to Texas Comptroller’s Office
- Texas Comptroller’s Office Processing Estimated 30 days
- Receive tax credit certificate

*State review periods listed here are estimates, intended for planning purposes.