“Extra Credit” Rehabs
Introduction.................................................. 3

New Markets Tax Credits: The Other Federal Tax Incentive for Preservation
ANNA KLOSTERMAN ........................................... 4

A Tale of Two Tax Credits—HTC and LIHTC
CAITLIN GEARY JONES ........................................ 12

Brownfields Redevelopment Tax Incentives for Preservation Projects
EVANS PAULL ................................................. 19

Refundable State Tax Credits for Historic Rehabilitation
HARRY K. SCHWARTZ AND RENEE KUHLMAN ............... 29

Addressing Preservation Problems through Targeted Rehab Tax Credits
ELIZABETH BYRD WOOD ..................................... 40

COVER: The Paramount Theater in Cedar Rapids, Iowa, was damaged during heavy flooding in 2008. A special tax credit allocation set aside for disaster recovery helped finance its rehabilitation.

PHOTO: MAIN STREET STUDIO
Introduction

“The old elementary school? That’s been rehabbed into condominiums. You know, a tax credit project.”

The words “tax credit project” trip off preservationists’ tongues like a hot knife through butter. While these preservationists are usually referring to the federal historic tax credit, a number of other tax credits often go into financing the rehabilitation of historic buildings, including low-income, brownfields, and new markets, to name just a few. When these “other” credits are combined with the historic tax credits, the financial projections that perhaps were in the red, suddenly begin to move into the black. And a historic rehab is born.

In the spring 2013 issue of Forum, we brought you “The Rehab Tax Credit: Turbo-Charged!” which took an in-depth look at the federal historic tax credit. This issue looks at some of the other credits available—maybe not created specifically for historic buildings, but credits that nonetheless can benefit historic rehabilitation projects, especially when combined with federal and state historic credits.

We are calling this issue “Extra Credit” Rehabs. Yes, we wanted a zippy title, but the combination of all these various tax credits really does result in A+ rehabilitation projects. From mills transformed into loft apartments, to newly reopened theaters, to vacant storefronts now housing downtown businesses, developers and preservationists have found creative ways to give historic buildings a new lease on life thanks to these critical financing mechanisms.

The contributors to this journal along with the people and organizations profiled qualify as A+ preservationists. They understand how to make “extra credit” projects work and happily for us, they are willing to share their experiences and expertise in the following articles. FJ
New Markets Tax Credits: The Other Federal Tax Incentive for Preservation

ANNA KLOSTERMAN

The New Markets Tax Credit (NMTC) is known by preservationists as a financial tool that aids in historic rehabilitation projects, often used in combination with the federal historic tax credit (HTC). What the NMTC program was originally designed to do and the background of how it became such an important vehicle for rehabilitation financing, however, is less well-known. This article will give a brief overview of the NMTC program and tell the story of how it came to be a critical component in making many rehab projects financially feasible.

BACKGROUND OF THE NMTC

In December 2000, the Community Renewal Tax Relief Act was passed by Congress with bipartisan support, creating the New Markets Tax Credit program to encourage investment in low-income communities. The Community Development Financial Institutions (CDFI) Fund, a branch of the Department of the Treasury, administers the program and determines the rules for qualification. Specifically, the program was designed to increase flow of private sector capital to businesses and real estate projects in underserved areas by way of a tax incentive for community development lenders and capital markets. The program’s target communities have historically had poor access to the kind of capital that facilitates projects that enhance the quality of life for residents, allow businesses to offer good jobs at living wages, and create vibrant neighborhoods. These areas are defined as census tracts where the individual poverty rate is at least 20 percent, or where median family income does not exceed 80 percent of the area median income (AMI).

THE NMTC PROCESS

The process begins with community development entities (CDEs)—the investment vehicle for the credit—which must be certified by
the CDFI Fund in order to apply for an allocation award. The National Trust Community Investment Corporation (NTCIC) is a CDE. There have been 10 allocation rounds since 2003, and applications for the 11th round were due in September 2013. The NMTC application process quickly became and remains competitive—between 2003 and 2012, allocation demand has been nearly seven times greater than the total allocation amount awarded. (See chart of “Distribution of NMTC allocation rounds” in Takeaway at the end of the article.) The CDFI Fund selects CDEs that promise to deliver the maximum subsidy to people and areas of deepest economic need, and applicants often commit to invest in areas that have significantly higher poverty rates and lower median family incomes than those minimally required under the program.

The application process is not for tax credits directly, but rather “allocation authority”—the authority to raise a certain amount of capital, called qualified equity investments (QEIs) from investors. Once a CDE receives an allocation award, it can secure investors to make QEIs in exchange for the credit. CDEs often include commitment letters from investors in their application materials to show that the allocation amount they are requesting can be utilized. Per program regulations, investors must be taxpaying entities and are typically banks and financial institutions, insurance companies, or other corporate entities. (See “Sources of QEI Investment Dollars” in Takeaway at the end of the article.)

The credit equals 39 percent of the QEI amount and is claimed over a seven-year period at 5 percent in each of the first three years, and 6 percent in the final four years. This allows investors to provide more capital in the form of a QEI, and lend on better terms to projects located in target communities and the businesses that occupy them, which are called qualified active low-income community businesses (QALICBs).

TWINNING THE NMTC AND HTC
In 1990 the National Trust for Historic Preservation created the Community Partners Program to employ preservation as an economic tool to revitalize historic properties in central business districts and urban neighborhoods. Through the program, a Historic
Tax Credit Fund with a bank was established to invest in projects that qualified for federal and state historic tax credits. At the time that the New Markets program was announced, John Leith-Tetrault was director of Community Partners. With his background in community development, real estate, tax credits, and preservation, he had the vision to use NMTCs to stimulate investment in historic properties, particularly by using it alongside the HTC.

The NMTC program was a natural match for the HTC for several reasons, including how well the NMTC program’s objectives

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**KEY TERMS**

**Community Development Entity (CDE):** A domestic corporation or partnership that is the intermediary between investors and project; 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 percent poverty rate or less than 80 percent of median family income (lesser of area or statewide median).

**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.

Example: A CDE uses Qualified Equity Investments (QEI) to make Qualified Low Income Community Investments (QLICI) into Qualified Active Low-Income Community Businesses (QALICB) that are located in Low-Income Communities (LIC).
dovetailed with those of Community Partners—providing necessary gap financing for projects that are difficult to finance conventionally, stimulating development in blighted areas, and supporting businesses that benefit low-income populations. Additionally, many historic properties were located in older, disinvested commercial areas. This holds true today, as 77 percent of federal HTC deals that occurred between fiscal years 2002 and 2012 are located in qualified low-income census tracts (See HTC in LIC pie chart in Takeaway at the end of the article.)

**NTCIC**

John Leith-Tetrault established the National Trust Community Investment Corporation (NTCIC) in 2000, applied for and in March 2003 received a first round New Markets allocation of $127 million. NTCIC was the first to introduce the product of twinned NMTC and HTC syndication, and it was so successful that the entire $127 million allocation was essentially committed within 90 days of the allocation announcement.

As a wholly-owned for-profit subsidiary of NTHP, one of NTCIC’s guiding principles is the rehabilitation of historic properties that have a high level of social and economic impact. Converting vacant buildings into affordable housing, community and arts facilities, and retail and office space means creating jobs, putting distinctive properties back on the tax rolls, and protecting a community’s unique sense of place.

By the end of 2003, NTCIC had closed 12 transactions deploying $76 million of its $127 million allocation. These projects generated more than 6,000 jobs in their communities, and in each case it was the NMTC equity that Leith-Tetrault said made the project financially feasible.

**EARLY HTC/NMTC PROJECTS**

*Dia Center for the Arts, Beacon, N.Y.–2003:* The first twinned HTC/NMTC project rehabilitated a 292,200-square-foot industrial structure formerly used as a Nabisco packaging plant into a modern art museum for the Dia Art Foundation. The property was built in 1929 as the Nabisco Box Printing Factory and served as the company’s label and carton printing and manufacturing plant for the north-eastern U.S. The property is situated on 26 acres along the banks of
the Hudson River in Beacon, N.Y.—a former mill town 60 miles north of New York City. The scenic ride along the Hudson River on the Metro-North train out of Grand Central Terminal takes less than an hour and a half.

The plant closed when operations ended in 1991 and remained vacant until rehabilitation began. Financing included $5.3 million in federal HTCs and $6 million in NMTC allocation from NTCIC. The effects of the rehabilitation on the surrounding region have been significant. The Williams College Center for Creative Community Development estimates that the total economic impact of the rehabilitation is more than $1 million annually, and the total impact in terms of local employment is an estimated 168 jobs. In addition to creating jobs, boosting state and local tax revenues, and increasing property values, it transformed the Beacon area into a vibrant arts community. The museum attracts an estimated 65,000 visitors from outside Dutchess County each year (many of them from New York City), bringing money into the local economy that most likely would have otherwise been spent in their own area.

American Tobacco Historic District, Durham, N.C.—2004: Dating back to 1847, the American Tobacco Campus once housed the sprawling manufacturing facilities of the Durham-based American Tobacco Company and was the area’s primary employer. When operations were abandoned in 1987, many residents were left
The rehabilitation of the Nabisco factory into a museum has brought new jobs, increased state and local taxes, and increased property values in the Beacon area.

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jobless, and the one-million-square-foot complex remained vacant for 17 years. Redevelopment occurred in phases—phase I rehabbed five of the historic properties into 500,000 square feet of Class A office space, along with restaurants and a large public space. Phase II continued the rehabilitation of the remaining historic buildings into residential units. Financing included $10.5 million in federal HTCs and $20 million in NMTC allocation, both from NTCIC.

The revitalization of American Tobacco is seen as a turning point in downtown Durham, and its catalytic impact spawned additional redevelopment projects in the area. Citing the Durham County Tax Assessor, a 2010 case study conducted by the nonprofit Self-Help reports that from 2002-2004 (the two years prior to the phase I) to 2005-2007 (the two years immediately following completion of phase I) downtown property sales increased by 62 percent, average sales price increased 115 percent, and the total dollar volume of sales increased by 248 percent. In addition to these good indications of downtown growth, phases I and II generated a combined total of 5,668 jobs.

THE FUTURE OF NMTCs

Unlike other tax credit programs, the New Markets Tax Credit is a non-permanent program, and its future relies on Congress’s ability to approve its legislation every two years. Such an accomplishment has become unpredictable for any issue, and because predictability...
is essential for investing anywhere, the uncertainty surrounding the program breeds hesitancy in the marketplace—the concern being if it is not reauthorized on a timely basis, investors could pull back from or leave the industry.

The program has received four separate annual or bi-annual extensions since the original authorization expired in 2007. The most recent legislative activity was H.R. 8, the American Taxpayer Relief Act of 2012, which was passed on January 1, 2013 and retroactively renewed the program for two years after it expired on December 31, 2011 along with several other tax-extenders. That two-year extension ended on December 31, 2013.

Tax reform could go either way for the program. On one side, reform is a legislative vehicle that presents the opportunity of making the credit a permanent part of the tax code. On the other side, the formula to reduce tax rates will eliminate or reduce tax expenditures, meaning all tax credits could be on the chopping block. The NMTC has succeeded in its purpose to encourage private sector investment to economically distressed communities by creating jobs and business opportunities. Unless the program is
extended, these underserved communities will lose a critical source of capital. With a fragile economic recovery still underway, now is not the time to cut it off. FJ

ANNA KLOSTERMAN is marketing and communications manager at NTCIC.

**TAKEAWAY**

Click here to see “Distribution of NMTC Allocation Rounds” chart.

**TAKEAWAY**

Click here to see “Sources of QEI Investment Dollars” chart.

**TAKEAWAY**

Click here to see “HTC in Low-income Census Tracts” chart.

**ADDITIONAL RESOURCES AND INFORMATION**

The New Markets Tax Credit Coalition (NMTCC) is a national membership organization that advocates on behalf of the NMTC program. Its Advocacy Toolkit provides information on pending legislation and ways you can help, including sign-on letters and materials such as impact reports, case studies, talking points, and fact sheets. Its In-District Advocacy Toolkit shows you how to take action in your hometown, including tips on one of the most powerful ways to build awareness—getting Members of Congress to visit a NMTC-financed project in your area.

Novogradac’s NMTC resource center has a great mapping tool that you can use to find qualifying census tracts. This tool features data from the 2006-2010 American Community Survey (ACS), which became the new standard of eligibility on July 1, 2013.

You can also view information on QLICIs by state and congressional district through 2010.
A Tale of Two Tax Credits—HTC and LIHTC

BY CAITLIN GEARY JONES

In 1910 President William Howard Taft attended and spoke at a dedication event for the then-brand new YMCA building in San Francisco’s Tenderloin neighborhood. At its opening, the facility, which for many years was known as the Central YMCA, later renamed the Shih Yu Lang Central YMCA, housed 103 hotel rooms, a theater, a grand meeting area, offices, a three-floor workout facility, and a swimming pool in the basement.

Over the years as the building aged, ongoing maintenance became a persistent problem, and the structure was in need of capital improvements including seismic upgrades, which the nonprofit YMCA of San Francisco could not afford to make. In the mid-2000s the decision was made to sell the building to Tenderloin Neighborhood Development Corporation (TNDC), which recently converted the structure into a new community asset.

Nearly a century after it was built, the YMCA building located in San Francisco’s Tenderloin neighborhood now houses studio apartments for formerly homeless individuals.

PHOTO (RIGHT): LORI LINKER
In late 2012, nearly a century after it was first placed in service, the transformation of the former YMCA building was completed, consisting of 172 new studio apartments occupied by formerly chronically homeless individuals as well as on-site support staff, a fully operational health clinic and wellness center, and separate commercial space. The $90 million redevelopment, now known as Kelly Cullen Community (KCC), used multiple funding sources to bring the building back to life. Sources included equity generated by federal low-income housing and historic rehabilitation tax credits (syndicated by PNC Bank), federal American Recovery and Reinvestment Act (ARRA) stimulus funds, loans from the city and county of San Francisco, money from the State of California’s Mental Health Services Act, a construction loan from Citi Community Capital, a pre-construction loan from US Bank, Federal Home Loan Bank Affordable Housing Program dollars, funds from the San Francisco Local Operating Subsidy Reserve (rental assistance), and more.

Historic adaptive-use projects like Kelly Cullen Community, where a developer creates an entirely new use for an aging property, is a common development strategy in the historic preservation world. Similarly, leveraging federal historic tax credits (HTC) in conjunction with the low-income housing tax credit (LIHTC) is a common funding strategy that can make otherwise infeasible transactions viable. In the case of KCC, the equity generated from the historic credit along with the dozen or so other funding sources, made the project possible for TNDC. “For various reasons including market and transaction complexity, absent the $13 million equity generated from the historic tax credits, Kelly Cullen probably would not have been feasible,” said Don Falk, president and CEO of TNDC. “The proceeds from the equity were so substantial that it was worth it to really figure out a way to make the housing credit and historic credit work together.”

LOW-INCOME HOUSING TAX CREDITS—A FUNDING ANCHOR
The low-income housing tax credit is an annual credit used to finance the development of low-income housing, affordable to tenants earning at or below 60 percent of area median income (AMI). It was designed to generate equity that would cover
approximately 70 percent of eligible development costs (30 percent if tax-exempt bonds are used). Credits are allocated in annual increments of 9 percent of eligible development costs per year (4 percent for projects financed with tax-exempt bonds) over a 10-year period. Building acquisition costs are also eligible for 4 percent acquisition credits. The remaining development costs are typically financed with a combination of conventional and soft debt.

Each year the Internal Revenue Service (IRS) issues a specific amount of housing credits based on a predetermined formula to each state. State housing finance agencies (HFAs) simultaneously develop qualified allocation plans (QAPs) to formulate policy goals that guide the agency in the administration and distribution of the credits. The Housing and Economic Recovery Act of 2008 (HERA) overhauled many aspects of the affordable housing finance system including for the first time, requiring state housing finance agencies to incentivize historic preservation in their QAPs. The most common incentives include awarding extra points and/or setting aside a certain percentage of credits for historic rehab projects. Developers are tasked with formulating a financing and development plan that meets the goals of the housing finance agencies, and operating the property as affordable for at least a 15-year, and sometimes as long as a 99-year, compliance period. Allocations are limited and almost always oversubscribed, so competition among developers for awards of LIHTCs is extremely competitive.
LIHTC AND HTC—GOOD FIT OR CONFLICT?

Despite the technical differences between LIHTC and HTC, they are often used in conjunction to achieve mutual policy goals—to revive vacant, functionally obsolete and/or aging historic properties and provide much-needed affordable housing for low-income individuals and families, especially in areas that are in desperate need of revitalization. There are, however, challenges or “red flags” that developers should be careful of when combining or “twinning” these credits.

TNDC and Kelly Cullen Community is a great example of the mutual goals that can be achieved by combining the two programs and navigating the challenges associated with managing the varying and oftentimes conflicting regulations of each credit. For instance, TNDC tries to incorporate energy efficiency and “green” building standards and design into the majority of the projects it develops and owns. In fact, in order to be competitive within the QAP and to qualify for housing credits in the state of California, it is almost a necessity that there are energy upgrades or “green” measures included in an applicant’s scope of work. Therefore, the organization first looked into replacing the building’s aging windows to improve the airflow and lower energy costs at Kelly Cullen Community. However the proposed windows did not meet the Secretary of the Interior’s Standards. So the organization rebuilt the original windows, an alternative solution that preserved the historic nature of the building.

Similarly, projects that receive a LIHTC allocation must be in compliance with the Americans with Disabilities Act (ADA) requirements, which can often require creative solutions when restoring historic elements of a building. During the development of Kelly Cullen Community, TNDC received varying opinions from the historic architect, NPS, and the city and county of San Francisco building department about the exact method to use to widen the doors within the building. The ultimate result was a lot of back and forth between the various stakeholders in order to determine the best way to balance the ADA compliance needs with preserving the building’s historic footprint.

There are also various costs associated with a rehabilitation project that may or may not be used to calculate the value of either the housing credit or historic credit, which affects the amount of
equity that can be raised for the overall development. For instance, while the historic credit is calculated based on the amount of qualified rehabilitation expenditures (QREs), which generally consist of improvements to the building structure and interior, the LIHTC is calculated based on eligible basis, which is essentially the cost of acquisition minus the cost of land, plus rehabilitation or new construction costs, personal property, and site improvements. LIHTC-eligible basis is also reduced by the amount of historic tax credit equity QREs to prevent developers from “double-dipping.”

In the case of Kelly Cullen, because the calculation of QRE cannot include the value of any newly created building footprint, the TNDC team was not able to include the few thousand square feet of new floor area that was added to the upper floors of the building in the QRE. Since the rehab of these upper floors was excluded from the QRE it did not generate historic credits, but did generate relatively more LIHTC eligible basis since there was no reduction of the LIHTC basis on those floors. Likewise, items such as the costs associated with the commercial use space were included in QRE calculation but not in the calculation of LIHTC eligible basis. It goes without saying that in any combined LIHTC and HTC deal that an experienced accountant and tax attorney are key elements to a successful project.
Another dichotomy to be mindful of when twinning LIHTC and HTC is that while the historic credit is recognized all at once after NPS approves the final Part III Application and the property is placed in service, the LIHTC is taken over a 10-year period. This means there is more up-front risk for the investor in a twinned deal than a purely historic tax credit transaction. To mitigate this risk most developers of twinned transactions seek a single investor for both credits.

In the case of Kelly Cullen Community, PNC Bank syndicated the historic tax credits, however, the size, scale, and complexity of the project, combined with its focus on chronically homeless individuals, scared off potential housing credit investors. So TNDC was fortunate to be able to trade in its allocation of tax credits for an American Recovery and Reinvestment Act loan, which was a common strategy used by developers back in 2009 when the equity market was in flux.

**CONCLUSION—PRESERVING A COMMUNITY ASSET**

“Ultimately, the strict requirements and higher level of scrutiny in using both credits was worth it,” says Don Falk. “The Shih Yu Lang YMCA building, for generations, was a community asset shared by so many different people of varying cultures, nationalities, and...
socio-economic status. From the moment we began the development process, I had people approaching me saying ‘this is where I learned to swim’ or ‘my grandfather was a member in the early 1940s. It became very clear early on that it was integral to the neighborhood and our partners that the building’s historical significance be maintained while also preserving its public purpose.”

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VIDEO
Click here to see the 2013 Richard H. Driehaus Honor Award video from the National Preservation Conference featuring the Kelly Cullen Community.
Brownfields Redevelopment
Tax Incentives for Preservation Projects

EVANS PAULL

Rehabilitation projects, especially those that involve rehabilitating and repurposing older industrial buildings, often run into contamination issues. Over the years, chemicals from former mills and factories soaked into the ground and leaks from underground storage tanks contaminated the surrounding soil. Cleanup costs for these industrial sites can be daunting. And understanding how to negotiate brownfields-related landmines, especially related to liability and regulatory issues, can be challenging. However, there are opportunities to enhance the project’s financing by using brownfields-related incentives. By combining these incentives with federal and state historic credits, developers have been able to bring new life to older industrial projects and the surrounding community.

This article explores corporate and income tax incentives for brownfields redevelopment and discusses how these incentives can be layered with rehabilitation projects to provide multiple public benefits.

BROWNFIELDS-PRESERVATION SYNERGIES

Former mills and industrial lofts are often excellent candidates for projects that combine brownfields elements with preservation. Many of these buildings are outmoded relative to their original use; however, they are often attractive for new residential or commercial uses because of engaging architectural elements and locations adjacent to residential or commercial corridors, often near rivers or canals. The Environmental Protection Agency (EPA) paid particular attention to the tie-ins between brownfields and mill projects in preparing a 2006 report, Revitalizing America’s Mills. The report

The term “Brownfields” is defined by the U.S. Environmental Protection Agency as “real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.”
found that 351 former mills had benefited from EPA site assessment or cleanup funds. Some other indications of the brownfields-preservation overlap:

- **Baltimore:** A review of the Baltimore Development Corporation’s brownfields “site pipeline, 1997 – 2005” revealed that 9 out of 23 completed or under construction brownfield projects were also preservation projects, and at least 6 of those 9 projects benefited from the federal and state historic tax credits. It might be noted that the Maryland historic tax credit was the single most important urban redevelopment incentive (for both brownfield and non-brownfield sites) in Maryland up until 2002, when the state began to institute a series of restrictive project ceilings and an overall program cap.

- **Missouri:** Missouri tracked the funding sources for 50 brownfield projects from 2000 to 2009. Researchers found that 9 of the 50 projects used state and federal historic tax credits, totaling $86 million in tax credit subsidies and comprising 30 percent of all public dollars going into the brownfields inventory.

  The limited evidence is that between one-fourth and one-third of brownfields projects are also rehabilitation projects, and that around 20 percent of brownfield projects are being assisted by state and federal historic tax credits. I have yet to find information as to the reverse, i.e., the number of preservation projects that are also getting brownfields assistance, but one might speculate that the same proportions hold: At least 20 percent of historic tax credit projects are also getting brownfields incentives.

  Brownfields incentives that might come into play in these industrial conversion projects include grants and loans, property tax...
abatement, tax increment financing, and tax credits. This article will explore opportunities for preservation projects to take advantage of brownfields tax credit incentives. In general, developers view tax incentives as the most advantageous of these various incentives, because they are usually designed to be fairly predictable and automatic, involving less delay, uncertainty, and bureaucracy than grants and loans.

Preservation planners’ reference point on tax incentives is the federal historic tax credit, which many states supplement with their own parallel programs. These state historic tax credit programs differ from each other on many critical details (transferability, statewide caps, per project caps, etc.), but there is usually considerable commonality with the federal tax credit in relation to eligible projects, eligible expenditures, and procedures to get the certification. Unfortunately, there is not a parallel federal brownfields cleanup tax credit program, and, with nothing to mirror, the states that have adopted brownfields tax credits have done so with creative state-crafted solutions, i.e. with very little commonality.

**FEDERAL BROWNFIELDS TAX INCENTIVE PROGRAM**

First, while there is not a federal brownfields cleanup tax credit, there is (or “was”) a deduction for brownfields cleanup expenditures. The federal section 198 Brownfields Tax Incentive Program allows the deduction of remediation costs (including petroleum, but not including asbestos and lead paint in buildings). The deduction is allowed in the year the costs are incurred, essentially treating cleanup as a repair to the land, rather than a capital expenditure that must be expensed over a period of years. The program is still on the books; however it was not renewed by Congress in 2013. There is a movement underway, spearheaded by the National Brownfields Coalition, to have it reinstated.

The following section looks at 13 state brownfields tax incentives, grouped into four rather different models. One or two particular states will serve as examples for each of the four models. The detail for all of the 13 states is contained in the “State Brownfields Corporate and Income Tax Credit Table,” linked here.
STATE CLEANUP AND REDEVELOPMENT TAX INCENTIVES

New York, Connecticut, Missouri, and Iowa have each adopted a broad approach to brownfields tax incentives: not just cleanup, but also certain redevelopment costs are eligible for the tax credit. In comparison to cleanup-only tax credits, these broader redevelopment credits are potentially more lucrative to the developer, as well as more costly to the taxpayer, and three of the four states have an involved application process that includes needs testing, ranking relative to state criteria, and/or economic benefit analysis. The tradeoff seems to be that these broader incentives are potentially of greater help in closing project gaps (relative to cleanup-only credits); however, fiscal concerns have caused these states to structure the programs to be less automatic than the narrower cleanup tax incentives.

New York—New York Brownfields Cleanup Program (BCP) is the most lucrative of these cleanup/redevelopment tax credits. BCP is a combined regulatory program and tax credit program; eligibility for the tax incentive is dependent on being accepted into the regulatory program. The BCP credit is divided into two parts: site preparation and redevelopment. Site preparation credits are 22 to 50 percent of cleanup, and site preparation costs depend on the extent of the cleanup and the type of reuse. Higher percentages are for unrestricted use cleanups and residential reuse. The redevelopment credit can be 12 to 22 percent of total redevelopment...
costs up to $35 million or three times site prep costs, whichever is less. The add-ons to the basic 12 percent credit are:

- If the qualified site is remediated to Track 1 (a cleanup level that allows for the site to be used for any purpose without restriction) an additional 2 percent is allowed.
- If at least 50 percent of the qualified site is located in an Environmental Zone (distressed area designation) an additional 8 percent is allowed.

BCP is hard to characterize on the spectrum of needs-tested versus automatic credits: It was originally authorized as an automatic credit, but, after a particularly controversial high value project got a lucrative incentive connected to very modest cleanup costs, the State Department of Environmental Conservation instituted what amounted to an administrative needs test. Several projects that were turned down in this fashion challenged the decisions in court and most of the decisions went against the state.

The BCP credit is structured as a fully refundable credit, not a transferable credit.3

Missouri—The Missouri Brownfield Remediation Tax Credit Program is up to 100 percent of environmental site assessment, remediation, and demolition expenditures. The site must have been abandoned for 3 years and the project must create 10 new or 25 retained jobs. To be eligible to receive these benefits, the city or county must provide at least 50 percent real property tax abatement for 10 to 25 years. The Remediation Tax Credits are used to offset corporate and personal income tax, corporation franchise tax, and/or the financial institution tax. The tax credit is fully transferable, and there is no statewide cap.

As referenced, above, there is an application process and the state reviews applications in relation to both project need and economic and fiscal impacts on the state. The needs test and impact analysis are used to determine whether the project will be eligible for the full amount (100 percent) of remediation and demolition expenses.

The Connecticut and Iowa redevelopment tax credit programs are described in the chart, linked here.
STATE CLEANUP-ONLY TAX CREDITS

Massachusetts, Florida, Illinois, Indiana, South Carolina, and Kentucky have more narrow credits based on a percentage of site assessment and cleanup costs. In contrast to the redevelopment incentives above, most of these cleanup incentives are structured to be nearly automatic: If a developer has an eligible site and eligible expenses, he or she gets the credit.

Massachusetts—The Massachusetts Brownfields Tax Credit (BTC) program provides for a tax credit of 25 to 50 percent of site assessment and cleanup costs, the higher percentage linked to cleanup to an unrestricted-use cleanup standard. Eligible sites must be in the commonwealth’s designated economically-distressed areas. The BTC credit is automatic and transferable, and there is no per project ceiling or overall program cap. Redevelopment Economics’ recent report on the economic and fiscal impacts of the program found that more than 7,000 jobs were leveraged in BTC-assisted projects, and that $37 in total capital investments were stimulated for each $1 of BTC outlays.

Similar States—The Florida, Indiana, Illinois, South Carolina, and Kentucky programs are all somewhat similar to Massachusetts, although each of those states limits the credit by either per project ceilings or an overall program cap. The most expansive of these is the Florida incentive because the 50 percent cleanup tax credit can be linked to a series of bonuses, including a job creation tax credit of $2,500 per employee. These additional programs are summarized in the table (see this link).
BROWNFIELDS TAX REBATE PROGRAMS

Mississippi and New Jersey have tax credit programs such that recovery of remediation costs is linked to state revenues generated by the project. This approach is the polar opposite of providing any upfront project equity or other upfront financing assistance (the usual barrier to brownfields investments), because the reimbursement does not occur until the project has produced revenues that exceed cleanup costs. On the other hand, these kinds of reimbursement credits are fiscally-defensible and do serve to lower the risk that the tab for cleanup might sink the project.

Mississippi—In April 2013 an expansion of Mississippi’s Brownfields Tax Credit was signed into law. SB 2147 allows the capture of state sales, income, and franchise taxes in the amount of 2 1/2 times eligible site-assessment and cleanup costs. The bill vastly expands eligibility for a similar program that expired in 2009 and was limited to the former chemical plant in Vicksburg, Miss., where the “property [had] been abandoned from the bankruptcy estate.” The new definition additionally includes all sites that are subject to a “Brownfield Agreement under Section 49-35-11.” Brownfield agreements are Mississippi’s standard voluntary cleanup agreements. The new legislation also eliminates the program’s sunset clause.

Sites must be in a designated “Redevelopment Project Area” that is approved by the local government. For sites both inside and outside of Redevelopment Project Areas, Mississippi already grants a more limited state income tax credit for up to $150,000 or 25 percent of cleanup costs, whichever is less. For more information, download this program description.

New Jersey’s Site Reimbursement Fund program is similar but the reimbursement is lower, at 75 percent of eligible cleanup costs. The New Jersey program, which is summarized in the attached table, is still on the books but no new projects have been certified for the credit in two years. The state is emphasizing a similarly structured, but broader economic development tax incentive, the Economic Redevelopment and Growth (ERG) Program.
JOB CREATION TAX CREDITS FOR BROWNFIELDS PROJECTS
At least two states, Delaware and Florida, have adopted a job creation tax credit linked to a brownfields designation. In the case of Delaware, the Qualified Investment in Targeted Areas tax credit program generally assists job creation and investment in designated economically distressed areas, but there is a bump up in the amount of the credit for brownfield sites (see chart). In the case of Florida, sites that have a brownfields site rehabilitation agreement or abut a site with a brownfields site rehabilitation agreement may be eligible for the Brownfield Redevelopment Job Bonus, a tax refund of up to $2,500 for each new job created.

LAYERING BROWNFIELDS AND HISTORIC TAX CREDITS
Brownfields tax credits are generally complementary to historic tax credits because they are funding entirely different aspects of the same project. For the majority of the states cited here, i.e., those where the brownfields tax credit is funding only site assessment and cleanup, the eligible expenditures are external to the building, thus easily distinguishable from the eligible expenditures for the historic tax credit. I have not been able to review each state statute, but the usual case would be that in-building asbestos and lead paint cleanup would not be eligible for the brownfields...
credits, unless demolition of the building is required as part of the remediation; this, again, keeps a clear distinction between the two credits.

For the four states that credit redevelopment expenditures over and above environmental remediation, the layering of brownfields and historic tax credits is complicated, but the experience has been that it still works. Several projects in Michigan have taken advantage of both the historic tax credits and the Michigan Single Business (brownfields) Tax Credit. This incentive, which was a 12 percent redevelopment credit, no longer exists, but it provided critical funding to at least two notable Michigan projects that also got the benefit of historic tax credits:

- The Neighborhood Service Organization’s Bell Building in downtown Detroit was structured to include three different tax credits: state and federal historic tax credits, Michigan Single Business (brownfields) Tax Credit, and Low-Income Housing Tax Credit. The resulting $30.3 million in project equity funded more than 60 percent of the total $50 million total project cost.4

- The former Knapp Department Store Building in downtown Lansing involved successfully layering five subsidy sources, including both state and federal historic tax credits and the Michigan Single Business (brownfields) Tax Credit. The $36 million redevelopment project included $20 million in tax credits and other subsidies, and will create 22 residential units, a runway fashion and design incubator, and a ground floor restaurant.5

**CONCLUSION**

Projects that combine brownfields redevelopment and historic preservation are serving multiple public benefit objectives: protecting public health; bolstering neighborhood or downtown revitalization; preserving the nation’s architectural heritage; and generating a constellation of smart growth benefits, including reduced vehicle miles traveled, lowered run-off, and reduced need for public infrastructure investments (relative to alternative growth patterns). However, it is rare that so much public good comes from purely private investment. Developers of projects that can combine brownfields and historic elements can and should look to public sector
incentives to close gaps. Because tax credits are generally the most automatic and reliable of these incentives, projects that combine historic and brownfields tax credits should be (and are starting to be) a well-worn path. FJ

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TAKEAWAY
Click here for “State Brownfields Corporate and Income Tax Credit Programs” chart.

1 Baltimore Development Corporation, Site Pipeline, Sept. 2005 (personal files).
3 “Transferability” refers to whether the applicant can transfer (sell) the benefits of the tax credit to an entity that has greater tax liability. New York’s “fully refundable” credit means that a taxpayer whose BCP credit exceeds his/her tax liability is eligible for a refund of that amount from the state.
4 Housing On-Line, “From Yellow Pages to Housing,” Tax Credit Investor, June 2011.
5 Sources for the Knapp Building: Lansing State Journal; and Lansing On-Line News.
Refundable State Tax Credits for Historic Rehabilitation

BY HARRY K. SCHWARTZ AND RENEE KUHLMAN

In 2005, the authors produced a public policy report for the National Trust for Historic Preservation on state tax credits for historic preservation. At that time roughly half the states in the country had laws creating historic tax credits. Many were relatively new. That report attempted to address the question, why do some state credits work better than others? The report also provided guidance to states adopting tax credit laws for the first time and to those attempting to improve existing statutes that were producing mixed or minimal results.

At this writing, 34 states have historic tax credit programs in place. This article will focus on the nine of them that have provisions in their laws that, in varying degrees, make such credits refundable. The nine states include Iowa, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, New York, and Ohio. Refundability exists where the holder of a tax credit has the option of claiming a refund from the state in the amount by which the credit exceeds that holder’s tax liability to the state.

A state tax credit typically has value only to the extent that the credit holder has sufficient liability for state taxes that the credit can be used to offset. Although state tax rates vary, they are far lower than federal income tax rates. As a consequence, an apparently valuable state tax credit may wind up in the hands of a party unable to use it.

Refundability directly addresses this problem by making the state tax liability of the credit holder irrelevant. The amount by which the credit exceeds the holder’s state tax liability is returned to the holder in the form of a refund check from the state treasurer.

THE FEDERAL PENALTY

Unlike the federal tax credit, which is not taxed by the federal government, state tax credits in almost all cases are subject to federal income tax at ordinary income rates. The problem is not unique to refunds. It applies as well to the transfer of state historic
tax credit certificates, where such transfer is permitted, and to credits passed through to partners and other pass-through entities that are recipients of the credits. Although strategies have been devised to avoid the penalty, they are complex and are economically feasible only for large projects with sophisticated investors.

**WHY ARE SOME STATE REFUNDABILITY PROVISIONS MORE PROMISING THAN OTHERS?**

This article addresses the question, why do some refundability provisions appear more likely to work than others? In answering this question, based on our examination of the statutes of the nine states with refundability provisions, and to the extent possible, their experience with refundable credits, we have attempted to identify those factors that impact negatively and positively on the effectiveness of those provisions. The following two factors appear to be the most important:

- The existence of significant statutory limitations on the dollar amount of credits that may be issued annually in the aggregate, and/or for any single project.
- Limitations on the amount refundable and restrictions on the manner in which the refund may be claimed.

Not included in this short list is the rate of the credit. The rate is calculated as a percentage of the amount expended on the appropriate rehabilitation of a historic property. Each of the nine states examined provides a base credit in the range of 20 to 25 percent. Minnesota sets its rate at 100 percent of the federal credit, which is 20 percent, and requires that the federal credit be awarded. In the event that the federal credit is not used, Minnesota will award a state grant equal to 90 percent of the amount that a federal credit would have provided.

Maine also fixes its somewhat more generous credit by referencing the federal credit, but setting the percentage at 25 percent, and providing the credit not only to taxpayers who use the federal credit but also to those who do not, provided that the latter incur appropriate expenditures in the $50,000 to $250,000 range.

Other states provide bonuses for types of projects favored by the legislature. Kentucky provides a rate of 20 percent for
commercial project credits and 30 percent for owner-occupied residences. Louisiana has a base rate of 25 percent for owner-occupied residences, which increases to 50 percent if the property is “vacant and blighted.” Maine increases its credit to 30 percent for affordable housing. Maryland lifts its 20 percent credit to 25 percent for a “high performance building.”

Although the bonuses may achieve legislative objectives by directing investment incentives to specified purposes, there is no evidence in the nine states surveyed that the rate of the credit materially affects the use of refundability.

A CAVEAT
The amount of credits awarded may be determined with a high degree of certainty because records of such awards are maintained by the state historic preservation office and are open to the public. The amount and number of credits claimed as refunds fall within the province of the state revenue department. These records are typically not available to the public. Hence judgments about the effectiveness of a state’s refund program must be based on a combination of estimates by state officials and an evaluation of the statutory structure of the refund program.

STATUTORY CAPS ON THE DOLLAR AMOUNT OF CREDITS THAT MAY BE ISSUED AND CLAIMED AS REFUNDS
It should be obvious that the existence of a statutorily mandated limit on the dollar amount of credits that may be issued annually on an aggregate basis, or with regard to individual projects, can undercut not just a refundability option, but the effectiveness of a state’s program as a whole. In this regard, of the nine states examined, Minnesota distinguishes itself as a model, having neither an aggregate annual cap nor a per project cap.

The programs in Maine and New York also lack aggregate annual caps, and both set limits of $5 million per commercial project. New York has a project cap of $50,000 on credits to a project involving an owner-occupied residence.

Both Mississippi and Ohio have annual aggregate caps of $60 million, but Ohio imposes a $5 million per project cap, only $3 million
of which is refundable in one year, while Mississippi has no per project cap. Iowa law establishes an annual aggregate cap of $45 million, with no per project cap. However, Iowa does require that the amount of credits awarded each year be allocated by specific percentages reflecting priorities established by the legislature.

The Ohio data are particularly revealing about the usefulness of refundability, notwithstanding the existence of the caps. According to state estimates, over the past three years, out of 49 projects certified, 32 project sponsors have elected to claim the refund. A substantial number of the projects claiming the refund involved projects under $1 million in credits. But 11 of the projects had total costs of $10 million or more. In some cases, projects of substantial size, ranging above $50 million in total costs, also made use of the refundable historic credit. What the Ohio experience demonstrates is that a per project cap of $5 million with refundability up to $3 million per year can provide an effective incentive both for large projects, involving total costs of $50 million or more, and for small, Main Street-type projects as well. This conclusion is reinforced by the amount of demand the program has attracted. In the last semiannual funding round, the state received 35 applications requesting $62.5 million in tax credits out of an available $33.9 million, roughly a 2 to 1 ratio of demand to supply.

At the other end of the scale, Kentucky imposes a $5 million aggregate annual cap on the amount of credits that may be issued and per project caps of $400,000 for commercial rehabilitations and $60,000 for rehabilitating an owner-occupied residence. Further complicating matters is a provision in the Kentucky law that specifies that if approved applications exceed in the aggregate the state-imposed dollar limit, then all of the approved credits shall be reduced proportionately, so as to limit the total amount of credits allowed to the $5 million aggregate cap. The effect of this provision, which we believe to be unique, introduces a measure of uncertainty for all program applicants, since individually they cannot know whether they will be granted the credit awarded in full or some lesser amount.

Maryland, a pioneer in the use of refundable historic tax credits, now requires an annual appropriation by the legislature to establish the aggregate amount of credits available in each fiscal year. As a consequence, developers proposing to rehabilitate a historic
property in Maryland can have no degree of certainty as to what level of funding the legislature will provide in any given year. Clearly this mechanism casts a cloud over the Maryland credit.

The Maryland statute sets a $3 million cap on the amount of credits that may be awarded to a commercial credit. Homeownership credits are capped at $50,000 per project but are not subject to annual appropriation. All credits are fully refundable.

Louisiana presents an interesting and, we believe, unique approach. Credits for commercial projects are transferable but are not refundable under Louisiana law. Holders of credits for owner-occupied residences and owner-occupied, mixed-use structures are entitled to claim a refund. The aggregate amount annually provided to this program is $10 million. However, the $25,000 limit per project is at the low end of the scale. Kentucky caps homeowner credits at $60,000 and Maryland at $50,000. Refundability is a particularly useful tool for homeowners, who typically lack the means to transfer a credit and have insufficient state tax liability to use the credit as an offset. But the project cap must be at a meaningful level to provide an effective incentive.

STATUTORY LIMITS AND RESTRICTIONS ON REFUNDABLE CREDITS

The ingenuity of legislatures in devising restrictions that undermine the usefulness of refundability is boundless. While some are relatively benign, others seem clearly devised to limit the exposure of the state treasury to refund claims.

Iowa and Minnesota appear to be exempt from this indictment. Although Iowa’s $45 million aggregate cap must be allocated among projects that fall within general categories specified in the statute, taking the refund is, in effect, mandatory. The recipient of the credit, or a transferee, may claim an undiscounted refund in a lump sum upon filing a tax return. The refund equals 100 percent of the amount of the credit minus any taxes offset by the credit (which may be zero).

As noted earlier, Minnesota also provides a refund in a lump sum equal to 100 percent of the amount of the credit minus any taxes offset by the credit. However, this refund is available only for
projects that qualify for the federal credit. Other projects may receive a grant from the state equal to 90 percent of the credit. Credits and grants may be assigned to another taxpayer, or to a pass-through entity. In the latter case, the entity may distribute the credit or grant ratably or as the partners or members may determine.

Three states fall into a second category: Maine, Louisiana, and Mississippi. Rather than providing the refund in a lump sum, they require that it be taken in equal annual installments. Maine pays the refund over a four-year period, Louisiana over a five-year period, and Mississippi in two annual installments. However, the Mississippi refund is discounted to 75 percent of the amount of the credit, and only credits in excess of $250,000 are eligible. By contrast, the credits in Maine and Louisiana are fully refundable at a rate equal to 100 percent of the credit. Although Maine requires use of the federal credit as a condition to claiming the state credit, it also provides a Small Project Rehabilitation Credit for projects with rehabilitation expenditures between $50,000 and $250,000 which does not require that the federal credit be claimed. This credit, like the credit for larger projects, carries a 25 percent rate and is fully refundable in four equal annual installments.

It is not clear to what extent the deferral of payment of a portion of the refund presents a deterrent to developers. North Carolina, which has had a successful program, and which does not provide a refundable credit, spreads out the award of its credit over five years. Yet a dollar today is obviously worth more than that same dollar five years from now. Unquestionably the Mississippi credit is at a disadvantage even though the refund is payable over a shorter period because the discount acts as a penalty for electing the refund. The other option, which exists in virtually all the states with tax credit laws, is the ability to carry forward the full unused amount of the credit into succeeding years as an offset against future tax liabilities. Notwithstanding the limitations noted above, Mississippi’s program in assisting homeowners with projects not eligible to qualify for the refund is impressive. Despite the restrictions, more than 80 homeowners have made use of the program since inception. Without the restrictions the number would doubtless be much higher.
Ohio law requires the state to conduct a cost-benefit analysis for each historic building seeking a tax credit. The state must determine whether rehabilitation of the building and awarding of the credit will result in a net revenue gain in state and local taxes once the building is used. The Ohio model takes into account tax revenues generated after the building is placed in service.

A recent cost-benefit analysis involving real costs on The Market Block Building in Warren, Ohio, demonstrated that the state investment of $630,800 in historic tax credits resulted in 100 percent of the state’s investment being returned in new tax revenues by the 4th year of operations. Some 34 percent of the state’s investment was recovered before the tax credit was awarded. By year 10 the building will have generated additional state and local tax revenues of $494,000 in excess of the amount of the credit, or a return on investment of 80 percent, and by year 15 the building will have generated $839,000 in new tax revenues, representing a return on investment of 130 percent.

This year Heritage Ohio presented its Best Commercial Rehabilitation Award to The Chesler Group for its exquisite renovation of The Market Block Building. The renovation involved joining three 1868 stores along the Courthouse Square into new office and meeting space for The Raymond John Wean Foundation.

With a renovation cost of just over $3 million, developer Michael Chesler found it hard and expensive to find a syndicator to monetize the needed state historic tax credits. Instead he used the refundability provision of the state’s historic tax credit program. According to Chesler, the refund provided equity to fuel the feasibility of the project. Without the state historic tax credits, the complex restoration would not have been possible. The refund feature of the Ohio State program is like an “equity coupon” and allows owners and developers the comfort to pursue historic projects without the need for a third-party investor.

**TAKEAWAY**

Click here for “Return on Investment” chart for The Market Block Building.
Although Ohio does not apply a percentage discount to its credit when used to obtain a refund, it does limit the amount of the credit that may be claimed in one year as a refund to $3 million. However, as noted above, the Ohio credit appears to be performing at a high level, so it is hard to view this provision as a significant obstacle.

Regrettably, there is a third tier of states in which, for a variety of reasons, tax refunds (not to mention tax credits) are either hard to use or may not be operating effectively as incentives for projects that would not otherwise proceed. Some features of the Kentucky tax credit law are exemplary and could serve as models for other states. Income from transfers of historic tax credits are expressly exempted from state tax. Tax-exempt entities are eligible to claim the credit. The first purchaser of a historic home rehabilitated by the seller is entitled to claim the same tax credit as the seller if the seller had retained the home as his or her principal residence. The rate of credit for owner-occupied residences is at the high end of the scale, at 30 percent, and the per project cap on credits for owner-occupied residential property is a generous $60,000.

As noted earlier, the problem arises because of the way the Kentucky statute treats situations in which the demand for credits exceeds the annual aggregate cap of $5 million. The law requires that in such circumstances the credit sought for each eligible credit shall be reduced ratably by an unknowable amount to cause the total amount of credits to be reduced to $5 million. Hence, no applicant for a credit can know in advance whether the credit will be awarded in full, or will be reduced to a lower amount that may make the proposed project infeasible as a result of conditions outside the applicant’s control.

Nevertheless, the results from Kentucky’s program are impressive. The state reports that 425 projects have been reviewed, representing more than $340 million in private investment. However, because of the state’s unique method for assuring compliance with the aggregate cap of $5 million in refundable credits, recipients of the credit have in fact received on average only 45 percent of the amount sought. Under these circumstances it is hard to escape the conclusion that marginal projects that truly needed the full state
credit would not benefit from the program, while projects that were not relying on the state credit to go forward would do so.

Clearly other state programs may also provide credits to applicants who do not meet the so-called “but for” test. “But for” is shorthand for a situation in which a project is not financially feasible without the full state credit, and but for the state credit, would not proceed. The Kentucky data appear to establish that a statutory provision that requires ratable reductions in credits to comply with an aggregate annual cap tends to reward projects that can do without the full credit, and discourages projects that do need the full credit.

Unfortunately, in Maryland, over the years the state’s legislature has carved back the program because of statewide budget concerns. The program now depends on an annual appropriation from the state legislature for commercial projects. In practical terms, preservation advocates must engage in a lobbying campaign every year to secure funding for the tax credit in the next fiscal year. Although the program remains lodged in the tax code and is fully refundable, it operates very much like an annual grant program. In addition, applicants must engage in a competitive process using criteria established by the legislature.

The results in recent years reflect the shrinkage of the Maryland program. In fiscal years 2010 to 2012, the amounts of total commercial credits awarded have been approximately $4 million, $11 million, and $7 million. The annual appropriations process also means that the program is open to legislative tinkering every year. Consequently key components, including refundability, are under constant legislative threat.

New York has chosen to direct the benefits of its program to less affluent areas. To be eligible for a commercial credit, the project must be located in a census tract containing a population whose family income does not exceed median family income. Commercial credits placed in service in and after 2015 are fully refundable. New York commercial credits must be used in conjunction with the federal credit.

The New York credit for homeownership contains a similar geographic limitation. In addition the statute adds an income test
for homeowners, denying refundability, but not eligibility, to taxpayers whose adjusted gross income in the taxable year exceeds $60,000. Such taxpayers may carry forward the unused balance of the credit to succeeding years.

The New York law contains a number of constructive features that may be of interest to other states. For instance, tenant-shareholders in cooperatives are expressly covered. Another provision grants the first purchaser of a rehabilitated historic home the right to claim the credit for eligible expenditures made by the seller.

**SOME CONCLUSIONS**

Where are refundability provisions likely to do the most good? What features should such provisions have (or lack) to be effective as an incentive to projects that would otherwise be infeasible? Based on our examination of the statutes of the nine states surveyed, and to the extent possible, on the available data, we believe some conclusions can be drawn.

**Homeowners:** First and foremost, we believe homeowners would reap the greatest benefits from refundable state tax credits. Homeowners are barred from using the federal tax credit. They tend to have relatively low state income tax liability. Notwithstanding the federal penalty noted above, the ability to receive cash from the state treasury can provide an attractive inducement to rehabilitate a historic home. But to work, the statute must provide certainty, a guarantee that funds expended will be reimbursed at the level anticipated, and that such level will be adequate to make the project financially feasible for the applicant.

What constitutes an adequate level to make a tax credit work will vary from state to state, but a rate of 20 to 25 percent of eligible expenditures, with a project cap of $40,000 to $60,000 could be enough. Further, we would propose that credits for homeowners not be limited by any annual aggregate cap that may be imposed on commercial projects. We believe that the budget implications of such an exemption, given the small size of the projects involved, would not be great enough to warrant their subjection to an aggregate annual cap.
Maryland is a good example of what can be accomplished with a refundable tax credit for homeowners. Although the state has had a troubled history with its commercial tax credit, its homeownership credit has been enormously successful. Since its inception, more than 3,800 homeowner applications have been approved triggering more than $350 million in rehabilitation expenditures. The credit is fully refundable in the year earned and is not subject to legislative appropriation or any aggregate annual cap. It provides up to $50,000 in credits to an owner of a historic home who incurs appropriate rehabilitation expenses of at least $5,000, based on a rate of 20 percent.

**Smaller Commercial Projects:** We also see benefits of refundable credits for smaller commercial projects of the Main Street type and somewhat larger. Some of these projects would be of sufficient size to justify the expense of claiming the federal credit; others would not. The Ohio data, noted above, suggest that a program with a $5 million project cap, but with only $3 million refundable in a year, can generate a high level of activity with commercial projects using the refund. The Ohio projects range from some claiming less than $100,000 in credits to others at the $5 million level. Other projects for which Ohio credits were claimed show total costs as high as $75 million. While some of these larger projects would probably not pass the “but for” test, Ohio does require a rigorous cost-benefit analysis from applicants to determine whether rehabilitation of the building will result in a net revenue gain in state and local taxes once the building is used. FJ

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**TAKEAWAY**

Click here to download chart of states with tax credits.
Addressing Preservation Problems through Targeted Rehab Tax Credits

ELIZABETH BYRD WOOD

In North Carolina, former tobacco mills were empty and crumbling.
In Baltimore, rows of vacant rowhouses provided a backdrop for TV crime shows.
In Maine, large brick textile plants along the state’s rivers sat vacant.
In the Gulf Coast following Hurricane Katrina, entire neighborhoods were flattened.

None of the above situations presents a pretty picture. But preservationists in those states are finding ways to combat such depressing scenarios. By taking a well-known preservation tool—a state or local historic tax credit—and working with lawmakers to tinker with it a bit, they have helped to turn abandoned mills into one-of-a-kind loft apartments and have brought storm-damaged buildings back to their former glory.

Some of these credits are targeted to a specific building type, such as historic mill buildings. In other cases, these credits can work for a range of building types, not just historic rehabs. But owners and developers of historic buildings can still take advantage of them and, in most cases, combine these credits with federal or state rehabilitation credits to make seemingly impossible projects financially viable. In many cases they have been enacted to address a specific problem, such as a lack of quality affordable housing or high vacancy rates in small towns. This article looks at several of these state and local tax credits and how they are being used to encourage the rehabilitation of historic buildings.

THE SOUTH CAROLINA ABANDONED BUILDINGS ACT
South Carolina recently enacted a 25 percent tax credit for the rehabilitation of vacant buildings for commercial use. Signed into
law in June 2013, the South Carolina Abandoned Buildings Act is intended to help towns and cities address the problem of large numbers of vacant buildings. While this law applies to any vacant building, preservationists see this as an effective tool to encourage the revitalization of historic manufacturing buildings and downtown properties.

Mike Bedenbaugh, executive director of the Palmetto Trust, South Carolina’s statewide preservation organization, explains that the state already had a textile mill credit, which preservationists used as a jumping off point to advocate for a broader credit that would benefit other kinds of vacant and abandoned buildings. To get the bill passed, preservation advocates took a realistic view of the political landscape and decided that the best strategy was not to confine the credit to just historic buildings. Bedenbaugh says, “Confining the credit to historic buildings would have generated a lot of pushback. Instead the strategy was to focus on any abandoned building, but all historic buildings are eligible.”

Projects do not have to meet the Secretary of the Interior’s Standards to qualify for the vacant properties credit; however, preservationists see this as an opportunity to encourage developers to combine the credit with the 10 percent state and 20 percent federal historic preservation tax credit, which would require projects to be certified as historic rehabs. The Palmetto Trust has a team ready to guide developers through the certification process.

A key factor is getting the legislation passed was a study that demonstrated the fiscal impact of the credit. After the bill failed to pass the first year it was introduced, the Palmetto Trust commissioned a study with the Strom Thurmond Institute’s Regional Dynamics & Economic Modeling Laboratory that confirmed that the credit will create more wealth in the state. The study found that
for every dollar spent on the tax credit will generate an additional $19 to $21 in South Carolina’s economic output. And for every $500,000 of tax credits earned by developers, it will create between 100 to 150 new jobs.

Bedenbaugh says, “The study showed what we knew intuitively, that this thing will create more wealth than it will take out of treasury.”

These compelling numbers really struck home with legislators, and on the third try, the law passed with unanimous support from both sides.

Bedenbaugh explains that they didn’t get everything they asked for. The credit has a $500,000 per project cap, which means only projects costing up to $2 million can fully benefit from the 25 percent credit. He says their goal with the credit is now “to show its worth, what it does, and get the cap lifted.”

THE BALTIMORE CITY TAX CREDIT FOR HISTORIC REHABILITATIONS AND RESTORATIONS

Maryland’s state enabling legislation allows localities to adopt local tax credits that can be applied against local property taxes. These credits are available for the rehabilitation of homes as well as income-producing, designated historic buildings. A number of cities within the state have adopted local tax credits for rehabilitating certified historic buildings within their city limits. According to the Maryland Historical Trust website, these credits are provided either as an offset of property taxes owed by a percentage of the rehabilitation expenditure (up to 10 percent), or an amount equal to the increase in property taxes resulting from the rehabilitation improvements for a period of up to ten years.

In Baltimore City, for example, the Baltimore City Tax Credit for Historic Rehabilitations and Restorations encourages owners of historic properties to complete a substantial rehabilitation—meaning property owners must invest at least 25 percent of their home’s assessed value in order to qualify for the credit. Projects must adhere to Baltimore City’s historic preservation guidelines.

Kathleen Kotarba, division chief for historical and architectural preservation in Baltimore City explains that the legislation, which
was signed into law in 1995, was introduced after a very thorough study (including a report completed by Joe Cronyn/Lipmann Frizell consultants) that showed the benefits of such legislation. She emphasizes that the credit is quite generous, and says, “The credit is available to homeowners and owners of income-producing property, applies to both exterior and interior work, is offered in both National Register and local Baltimore City historic districts, and may be layered with state and federal credits where applicable.”

Stacy Montgomery, a city planner with the Commission on Historic and Architectural Preservation (CHAP) and administrator for the program said that CHAP views the credit as playing a role in the rightsizing debate. She says, “it is an alternative to demolition.”

The Baltimore credit sunsets in February 2014, and Montgomery notes that CHAP needs to make the case for its effectiveness. She says that many on the city council understand its role in contributing to the health of the city neighborhoods they represent, and they are usually receptive to renewing the credit.

Kotarba says the program is working exactly as intended, and has, in fact, exceeded expectations. To date, the more than 3,000 rehabilitation projects undertaken have leveraged approximately $606 million in investment citywide since 1997. Another 1,000 projects are underway that are projected to yield another $600 million in investment. The investment to date is leveraging more than $4 billion worth of additional economic activity. She says, “Needless to say, we are quite happy about the success of the program.”

STATE MILL REHABILITATION TAX CREDITS (NORTH CAROLINA)
Developers in North Carolina can take advantage of tax credits if they rehabilitate one of the state’s historic textile, tobacco, or furniture plants. The “mills bill” was enacted in 2006 to enhance the economic feasibility of reusing the state’s former industrial sites.

In an article that appeared in the 2011 Forum Journal, Myrick Howard, president of Preservation North Carolina (PNC), explained that preservationists relied on the federal and state credit for years, but in the 1990s, after shifts in global economy affected the state’s industries and mills, even these credits were not enough to encourage
investment in such large industrial structures, especially those in small towns. He writes:

When I was growing up, we were taught that North Carolina’s economy depended on tobacco, textiles, and furniture. Over the period of one decade, all three of those industries were leaving the state in droves. When I grew up, my hometown of Durham was internationally known for the manufacture of cigarettes; by the end of the 20th century, Durham had no tobacco industry. But it had plenty of vacant industrial buildings.

To get the bill passed, Howard explains, preservationists focused on job creation. And, as their neighboring state to the south discovered, what really captured the attention of lawmakers was sound research that demonstrated the economic benefits of a credit. In this case, the legislature’s fiscal research, which was based on a study conducted by PNC, concluded that the bill “would be a catalyst to promote $259.4 million in historic rehabilitation spending in its first five years at a total cost of $39.9 million to the state.”

The credit is available for the rehabilitation of income- and non-income-producing historic mill properties and, depending on the county where the property is located, a project can receive up to a 40 percent credit for a certified rehabilitation. When combined with the federal credit, it can add up to a 60 percent tax credit for the certified rehabilitation of an income-producing structure. As of October of this year, $431 million has been invested in completed projects with another $628 million in the pipeline.
Howard says, “This specialized incentive has really transformed many communities in North Carolina, successfully turning deteriorating problem properties into beautiful community assets. The mill projects themselves have in turn stimulated the renovation of surrounding blocks, often including affordable workforce housing. It’s had more impact than any of us ever dreamed.”

**THE AFFORDABLE HOUSING REHABILITATION CREDIT INCREASE (MAINE)**

Maine has a 25 percent state rehab tax credit, which bumps up to 30 percent for affordable housing projects. In 2008 Maine passed the Historic Preservation Tax Credit that included an increase of 5 percent if the rehabilitation project results in the creation of a certain amount of affordable housing.

Greg Paxton, executive director of Maine Preservation, says the affordable housing option has provided a big boost to the Maine economy. According to an [*article in Mainebiz*](#), a weekly business news journal, the credit has been a boon to local governments, which have seen new properties added to the tax rolls, jobs created, and a catalytic effect on new construction.

To date 15 affordable housing projects using this option have been completed or are under construction. These 15 have invested $116 million in construction costs in Maine, a state with only 1.3 million residents, and some 507 units of affordable housing have been created.

Originally set to expire in 2013, the historic credit was renewed in 2011 through 2023. Paxton notes that when the credit first passed, Maine’s legislature was controlled by the Democrats with a Democratic governor in office. The opposite was true when the credit was renewed in 2011, with a Republican legislature and governor. Clearly lawmakers on both sides understood that the availability of these credits make it possible to convert former mills, schools, and manufacturing buildings into safe, affordable homes for Maine residents.
DISASTER RELIEF
Tax credits have also been used to help building owners recover from natural disasters. Congress provide additional relief to taxpayers affected Hurricane Katrina in the Gulf Opportunity Zone Act of 2005 (GO Zone Act), which allowed tax credits to assist with the redevelopment and new development in storm-damaged areas. Historic rehabilitation projects could take advantage of the credits along with new construction.

Under the GO Zone Act, the amount of rehabilitation tax credits increased from 20 to 26 percent for historic buildings, and from 10 to 13 percent for buildings placed in service before 1936, for any certified structure or qualified rehabilitated building located in the GO Zone, provided that the qualified rehabilitation expenditures on such buildings or structures were incurred on or after Aug. 28, 2005, and before Jan. 1, 2009.

David Preziosi, who was the director of Mississippi Heritage Trust at that time, says that many historic projects that were struggling to make the numbers work before Katrina were able to finally get underway thanks to these expanded credits.

Preziosi notes that the state historic tax credits also passed in Mississippi after Katrina. He says, “We had been working on state tax credits for awhile before then, but the storm helped get it passed with a bunch of lobbying and tying the credit to jobs creation post-Katrina.”

In Iowa, as part of the state’s historic tax credit program, there is a special tax credit set-aside for buildings affected by disasters. The state historic preservation office

The King Edward Hotel in Jackson, Miss., was able to take advantage of a number of tax credits, including the increased value of the federal historic tax credit within the GO Zone after Hurricane Katrina. This mixed-use revitalization project opened in December 2009.
reserves 20 percent of the tax credit allocation for any tax credit year in a disaster recovery fund for projects located in an area declared a disaster area by the governor of Iowa or by the president of the United States.

Following Superstorm Sandy last year, preservationists advocated for an increase in the current federal historic tax credit from 20 percent to 26 percent for properties affected by the storm that were listed in or eligible for listing in the National Register. While some federal funding for historic preservation projects was made available, an increased federal tax credit was not.

**TAX REFORM AND THE FEDERAL CREDIT**

At this writing Congress is conducting a comprehensive review of the Internal Revenue Code. The federal historic rehabilitation tax credit is critical to the effectiveness of virtually every state tax credit program. Without the federal 20 percent tax credit, state tax credits alone would be insufficient to provide an adequate incentive for the preservation of historic buildings. There are of course exceptions: state credits that assist homeowners and developers of small commercial rehabilitation projects that do not claim the federal credit. But the bottom line is that for state tax credits to continue as useful tools for historic preservation, the federal credit must survive intact.

Visit [SaveHistoricTaxCredit.org](http://SaveHistoricTaxCredit.org) for more information.
CONCLUSION
A dilapidated rowhouse, an abandoned storefront, a rundown vacant industrial building are all a drag on their surroundings. Nearby property values go down, vandalism is a problem, and soon the dreaded “d” word (demolition) is heard. And the buildings that help tell the story of a community’s heritage are soon gone. But specialized credits—often combined with other state and federal incentives—have meant new life for many buildings, thanks to the tireless advocacy and the creative and visionary efforts of preservationists to develop another financing tool to make the rehabilitation of these buildings possible. FJ

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TAKEAWAY
Click here for “Local Historic Preservation Tax Incentives” chart.