National Trust *for* Historic Preservation
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Senate Finance Committee
Community Development and Infrastructure Working Group
Supplemental Comments of the National Trust *for* Historic Preservation
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Federal Historic Tax Credit: Program Mechanics, Legislative History, and Economic Impact.

Program Mechanics

The Federal Rehabilitation Historic Tax Credit (HTC) is a market-based, economic redevelopment tool targeting older and historic buildings. Its success is due in part to its flexible nature in targeting areas of development and adaptively-reusing multiple types of historic buildings that offer the greatest return on investment while also serving as a catalyst for economic development.

Owners of historic properties may qualify for an income tax reduction by rehabilitating historic properties according to standards established by the Secretary of the Interior. There are two separate and independent HTC incentives available for rehabilitating historic structures. A 20 percent rehabilitation credit is available for buildings either listed individually in the National Register of Historic Places or that serve as a contributing structure in a registered historic district. For older buildings not listed in the National Register or located in a Registered Historic District, a 10 percent rehabilitation tax credit may be available. To receive the 10 percent credit, a building must have been placed in service before 1936 and meet certain internal and external wall retention requirements.

Before the HTC may be claimed, however, the proposed rehabilitation work must be certified as conforming to the Secretary of the Interior's Standards for Rehabilitation. See IRS § 47 (c)(2)(B) & (C); Treas. Reg. § 1.48-12(d). This certification and review process is administered by the National Park Service (NPS), in conjunction with the relevant State Historic Preservation Officer (SHPO). In general, in order to be certified, the rehabilitation must be consistent with the historic character of the structure or the applicable historic district. The defining historic features and character of the structure must be maintained and not compromised by the rehabilitation work.

Significantly, federal HTC expenditures occur only after private funding has been invested and the rehabilitation project is completed. The HTC may only be claimed after a historic property is substantially rehabilitated and placed in service. In order to be considered substantially rehabilitated, the taxpayer has 24 months to demonstrate that rehabilitation expenditures exceed the adjusted basis of the building or $5,000 whichever is greater. The rehabilitation credit is generally allowed in the taxable year the rehabilitated property is placed in service provided that the building has met the substantial rehabilitation test.

HTC Partnership Structure

A specialized market within the commercial real estate industry has evolved since the HTC was established. While the majority of users of the HTC are individual owners of certified historic properties, most large-scale historic rehabilitation projects require the creation of a pass through entity (limited liability corporation or limited partnership) that includes a corporate investor.

Creating a pass through entity for large-scale historic rehabilitation projects allows an owner-developer to bring a corporate tax credit investor into the development entity as a limited partner or investor member. Tax credits are allocated to the investor in accordance with their ownership interests. Those interests are purchased through an equity contribution to the operating entity. This arrangement permits the developer to receive capital at a critical point in project development. The partnership structure allows the tax credit investor to receive an economically valuable reduction in tax liability and an opportunity to participate in the economic development of the project.

Program Attributes

The HTC program offers investors a stable investment in what would otherwise be difficult to develop projects. In nearly all cases, the cost of rehabilitating older and historic structures is more expensive than new construction. Historic rehabilitation projects take longer, require additional specialized labor, and involve more complicated financing arrangements than new construction.

Without an incentive for commercial owners of historic structures to rehabilitate their buildings, historic reinvestment would rarely occur in difficult to develop areas that need it most -- the historic cores of cities and towns. More than 84 percent of HTC projects, for example, are in Low and Median Income (LMI) census tracts with incomes at or below eighty percent of median. Other benefits of the federal HTC and rehabilitation include generating local, high-paying jobs, enhanced property values, and increased revenues for State and local governments through increased property, business and income taxes. In addition, National Park Service statistical analysis documents that fifty percent of HTC projects support development of either market rate or low-income housing.

Studies also conclude that historic tax credit projects are stable investments with little risk of recapture. According to a 2012 survey commissioned by the National Trust, Novogradac and Company LLP concluded that based on the dollar value of credits, less than three-quarters of one percent of tax credits were subject to recapture – a remarkable record of success that held even during challenging economic times. A principal reason for this exceptional investment safety is that private businesses conceive, plan and implement the project – including securing financing and placing the project in service – before the federal credit is issued.

Origins of National Policy

The national policy for incentivizing the preservation of our nation's historic resources has enjoyed longstanding bipartisan support. Beginning in 1965, a task force appointed by President Lyndon B. Johnson suggested tax deductions for preservation activities that beautified older areas of towns. Later, in 1972, after realizing federal tax policy was working at cross purposes with historic preservation, President Richard Nixon included incentives for the rehabilitation of certified historic structures in a tax reform proposal he submitted to Congress.

It was not until the nation's bicentennial, however, when the Congress and President Gerald Ford first enacted incentives for enhanced amortization and depreciation rates for specified rehabilitation costs through the Tax Reform Act of 1976. During consideration of that legislation, the Joint Committee on Taxation of the United States Congress stated:

> *Congress believes that the rehabilitation and preservation of historic structures and neighborhoods is an important national goal.*

Legislative History

The history of federal rehabilitation tax credits reflects almost 40 years of consistent federal tax policy that began with the 1976 Tax Reform Act. The history of the federal Historic Tax Credit (HTC) demonstrates Congress' clear intent and recognition of the need to strike a balance between capital investment in new construction and the rehabilitation of historic structures. Accelerating economic decline of the nation's inner urban cores in the 1970's drove federal tax policy toward developing an incentive that would level the playing field between new construction and rehabilitating older historic central business districts.

Subsequent changes in federal tax policy followed in 1978, 1981, 1982 and 1986 and reflected an effort by Congress to ensure the incentive level was appropriate to the need. The Tax Reform Act of 1986 restructured the historic tax credit to be the permanent part of the code it is now.

HTC Legislative Timeline

- **Tax Reform Act of 1976** – Allowed 60-month accelerated depreciation for historic structures.
- **Revenue Act of 1978** – established a 10% credit for buildings older than 20 years along with a special depreciation schedule.
- **Economic Recovery Tax Act (ERTA)** – In 1981, Reagan Administration dramatically increased the incentive to 25% for historic rehab, 20% for buildings over 40 years old, 15% for buildings between 30-40 year old.
- **1982 Tax and Economic Recovery Act (TEFRA)** – added 50% basis reduction for the 25% historic credit.
- **1986 Tax Reform Act** – Congress examined the original purpose of the rehabilitation tax credit and decided to lower the credit amounts to the current 20% historic and 10% older building credits permanent in the code because the need to incentivize historic rehabilitation remained vitally important.

The HTC passed an important test when it survived the 1986 Tax Reform Act with only minor modifications at a time when many other credits were eliminated. Significantly, the Senate Finance Committee's report accompanying the 1986 Act reiterated the congressional intent of the bill's legislative predecessors and stated:

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

<u>The Historic Tax Credit Has a Substantial and Widespread Economic Impact</u>

Rutgers University's Center for Urban Policy Research annually produces a report on the economic impact of the Federal Historic Tax Credit that has become the definitive source for both quantitative and qualitative information about the economic impact of the HTC. This well respected report, initially commissioned by the National Trust for Historic Preservation and the Historic Tax Credit Coalition, is now commissioned by the National Park Service. This year's report, titled *The Economic Impacts of the Federal Historic Tax Credit – 2014*, is expected to be published this summer.

In terms of national economic impact, Rutgers University's Center for Urban Policy Research has shown that the HTC has worked as Congress intended. Over the life of the program, the HTC has generated:

- Nearly 2.5 million jobs, including 77,000 jobs in 2014;
- $117 billion in total economic activity;
- The rehabilitation of more than 40,000 historic buildings; and
- Over $28.6 billion in federal tax receipts from an investment of $24 billion in credits – on a dynamic basis, this credit more than pays for itself.

The Historic Tax Credit Has a Proven Record of Success

As Congress contemplates major reforms to the tax code, it is important to consider the following community and economic development benefits of the HTC:

- Job Creation. The HTC creates more jobs than new construction. The labor to materials cost ratio for rehab is 60 – 40%. For new construction, it is just the opposite at 40% labor and 60% materials. Historic rehab also compares favorably in its jobs generating track record to other stimulus strategies such as highway construction and other infrastructure improvements.

- Neighborhood Stabilization. The HTC stabilizes neighborhoods and generates positive economic development. Many older and historic properties have been vacant for years and have a blighting influence on local commercial districts. The HTC provides the economic spark that can spur a renaissance for many neighborhoods and downtowns.

- Return on Investment. The private sector spends at least $4.00 for every $1.00 the federal government spends on historic rehabilitation. The current market for HTC is about $.95 on the credit dollar. At a discount of only $.05 on the dollar, it costs less than administering a typical federal grant program.

- Low and Median Income Benefits. Over the last 12 years, 84% of all HTC projects have been in Low and Median Income (LMI) census tracts and most projects are located in designated economic development districts.

- Preserves Market Dynamics. The HTC incentivizes private developers and the market to drive development, rather than the federal government.

- Small Business Incubator. The average sized project in 2014 was only $4.8 million. One-half of HTC projects are awarded less than $1 million in credits. At this small scale, most developers would qualify as small businesses by SBA standards. Buildings at this scale are often in smaller Main Street communities that often incubate upstart and small businesses.

- Catalytic Impacts. Historic tax credit projects generate an increase in the issuance of building permits, business licenses, and property values that often outpace these metrics in the larger surrounding community.

Conclusion

The basis for such an enduring national policy is clear. Historic buildings are tangible links to our past. They are the places that express the distinctive and unique heritage of our cities, towns and rural communities. The HTC promotes the rehabilitation of historic structures of every period, size, style and type. Scaling back or eliminating the HTC would be a sharp reversal of decades of a successfully implemented national policy endorsed on a bipartisan basis by successive Presidents and Congresses.