

Using the 20% Historic Tax Credit for Affordable Housing

Teleprompter Script

Hello, I'm Nancy Boone, Federal Preservation Officer at HUD, in the Office of Environment and Energy. Welcome to this webcast on Using the Historic Tax Credit for Affordable Housing. We are broadcasting live today from HUD Headquarters in Washington, DC and will be taking questions at the end of the presentation. Over 700 people are participating in the webcast and we will answer as many questions as we can today, with the caveat that we cannot offer tax advice on individual situations. To submit your question, send an email to OEEwebcast@hud.gov at anytime during the webcast. We will also be posting extensive related material on HUD's website in the coming weeks, including links to the references mentioned today and an archived version of this webcast. The content presented in this webinar represents the views and experience of guest presenter Elizabeth Rosin and do not necessarily represent the official policy or position of HUD or the National Park Service.

Our presenter today is Elizabeth Rosin, Principal at Rosin Preservation. Elizabeth has a Masters Degree in Historic Preservation and has worked in the field for over 25 years. She is based in Kansas City, but works across the country, and that work has included consulting on over 100 successful Historic Tax Credit projects representing an investment of over \$1 billion in rehabilitated historic buildings.

For the Q&A session, we will also be joined by Brian Goeken, Chief of Technical Preservation Services at the National Park Service where he oversees the Historic Tax Credit program. HUD gratefully acknowledges the Park Service's assistance on this webcast. I also want to thank the National Trust for Historic Preservation who helped with some of our graphics.

We hope that you will be inspired by today's presentation to consider developing historic buildings in your community for affordable housing. And to tell us how the Historic Tax Credit may help those efforts, here's Elizabeth...

Thanks Nancy, let's get started.

The 20% federal Historic Tax Credit (HTC) is a financial incentive that encourages investment in historic buildings, many of which have outlived their original purpose.

It encourages private property owners to rehabilitate historic properties for an income-producing use, such as rental housing, office, retail, manufacturing and entertainment.

All of these properties have used the historic tax credit. It is an important tool for the redevelopment of historic Main Streets and can be a catalyst for neighborhood and downtown revitalization. It can also be an effective tool to create affordable housing...

including mixed-use affordable developments such as buildings that have commercial tenants on the first floor and apartments on the upper floors.

More and more, affordable developers across the country are using the HTC because it creates more opportunities for affordable housing by making it financially viable to rehabilitate properties in historic districts, adapt and re-use vacant schools, and bring new life to neighborhood eyesores. Rehabbing historic properties in higher-cost markets means designating affordable units in areas with better access to services and opportunities. In lower-cost markets, historic rehab preserves cultural and community

heritage, helping to create a sense of place and building momentum for equitable neighborhood development. Doing historic rehab can even increase equity for a LIHTC project! In all cases, the HTC helps to make affordable and historic developments economically viable.

Even PHAs are using the HTC. Through HUD's RAD program, Public Housing Authorities may partner with private investors interested in the HTC to rehabilitate historic public housing developments, such as the Iberville housing complex in New Orleans where it was used to upgrade historic public housing units to modern standards without losing the character of the historic place.

The HTC rewards owners for making an investment that extends the economic life of older buildings, and it becomes a source of project equity when syndicated to outside investors. The historic tax credit represents 20% of qualified expenses (I'll discuss those more in a moment). It directly reduces income taxes owed. Each dollar of tax credit offsets one dollar of taxes due, so a project with \$1 million of qualified rehabilitation expenses (or QRE) will generate \$200,000 of HTC which offsets \$200,000 of federal income taxes.

All of these buildings were rehabbed using both the historic tax credit and the low-income housing tax credit. The HTC is used in small towns and rural communities as well as urban centers. The properties that use the HTC represent the full spectrum of building functions, architectural styles, and periods of construction.

Investment in HTC projects can be catalytic for community revitalization. Many communities have a historic "white elephant" building that would qualify for the program. Vacant school buildings, for instance, are frequently converted to affordable housing. The 1918 high school in Baxter Springs, Kansas became 28 senior apartments using the HTC and LIHTC. The project restored several key historic building elements, including the monumental cornice and period appropriate windows.

While large, high-dollar rehab projects attract a lot of attention, buildings of all sizes can take advantage of the HTC. Over the past 5 years, roughly 50% of all HTC projects cost less than \$1 million. Roughly 25% of all HTC projects cost less than \$250,000.

Since the program started in 1976, HTCs have impacted communities throughout the country. The statistics for the program are impressive – the buildings preserved, investment made and jobs created. Most significantly for this conversation - 153,255 units of new and rehabbed low and moderate income housing using historic credits.

This map, produced by the National Trust for Historic Preservation, shows the distribution of HTC projects across the United States since 2002. You can see that HTC projects have been completed in every state in the country.

Is there a white elephant property in your community? Can you think of a historic property that you could develop? Keep that site in mind while we look at what is required to participate in the program.

Unlike LIHTC, historic tax credits (HTC) are available through a non-competitive, open application process. That means if you meet the program requirements, you get the tax credit. The project must involve an "income producing" "certified historic structure". The scope of work must meet the requirements of a "certified historic rehabilitation" and must make a "substantial investment" in the property, specifically in items that are considered "qualified rehabilitation expenditures" (QRE).

That's a lot of words to say if your project has \$5M QRE, you will receive HTC valued at \$1M. There is no cap on the amount of credits an individual project can claim nor on the amount of credits available for the program in any given fiscal year. Let's break down these terms.

The property has to be income producing for 5 years after the tax credit project is completed. In terms of housing, that means it must remain rental housing for this period.

The building must be listed in the National Register of Historic Places to qualify for the credit. We'll come back to this topic in more detail, but briefly – certified buildings can be listed either individually or as contributing to a historic district. Some buildings in a historic district can be non-contributing because of age or alterations. To find out if a building in a historic district is contributing, refer to the map in the National Register nomination. The nomination map for this historic district in Warrensburg, MO shows all of the contributing resources shaded white. These buildings, like those in the photo, are all eligible to use the HTC.

The rehab project must meet the Secretary of the Interior's Standards to be considered a Certified Historic Rehab. When you submit your application, the State Historic Preservation Office (SHPO) and the National Park Service (NPS) review photographs of the building, architectural plans, and a written scope of work to ensure that the project preserves the character-defining features of the historic building, site, and environment. In this example, significant masonry repairs were made and historically appropriate new windows and storefronts were installed, while on the interior the historically-significant features of the office corridor were incorporated into the affordable housing conversion.

Just like LIHTC, some expenses qualify for the credit, and some do not. QRE includes depreciable construction costs as well as allocated soft costs. This includes permanent treatments to the exterior and the interior of the building. A simple way to visualize this is to imagine turning the building upside down and shaking it. Anything that falls out is NOT QRE.

Because so many costs are considered QRE, it is easiest to describe those expenses that are non-qualified. These generally include : Acquisition, Enlargement of the building footprint or mass. This includes structures and equipment required for new circulation towers, if those elements are outside the historic building footprint. Even though they are not QRE additions may be allowed if they meet the design guidelines, we'll talk about this more in a minute; Site improvements, including hardscaping and landscaping; Personal property, such as furniture, appliances, and window treatments; Marketing and lease-up, including signage. All other costs related to your development should be QRE.

The IRS requires that you spend a minimum of \$5,000 or the "adjusted basis" of the building. The formula is somewhat complicated, but essentially is calculated to be the purchase price less the value of the land. In other words, you need to invest the value of the building in your rehab project. If you have previously made improvements to the building, those need to be added to the equation, and any earned depreciation can be subtracted.

Your project must meet the substantial investment test in a 24-month period. The applicant has some flexibility in defining that window, but if needed the project can be phased to extend the 24-month window to 60 months. The online guidance will include more information about phasing.

Lets talk a little more about the National Register and the Secretary's Standards.

The National Register of Historic Places is the nation's list of historic buildings, structures, sites and objects that merit preservation. The National Register was created by the National Historic Preservation Act of 1966, and is administered by the National Park Service with input from the state historic preservation offices (SHPOs). Typically, resources must be at least 50 years old to qualify for National Register designation, which now includes properties built through 1967. There are also exceptions for newer resources that can demonstrate exceptional significance. You can find out if a building is on the National Register by visiting the NR website or contacting your SHPO. Check out the link in the online guidance.

To list a building on the National Register it must demonstrate significance in one of four areas. Significance can be at the local, state or national level. The resource must also retain enough of its historic character-defining elements to communicate that significance. The listing process usually takes 6-9 months to complete and is separate from HTC review. Rehabilitation can begin before the building has NR status, but the building must be officially listed on the NR within 30 months after rehabilitation is complete. You can claim tax credits while the nomination is in progress, at your own risk.

The 4 buildings you see on the slide were built between 1840 and 1973. All are listed in the National Register and all were certified rehab projects that now provide affordable housing.

The Secretary's Standards for Rehabilitation preserve a building's historic character while allowing for modifications that allow it to be adapted for a new function and to remain economically viable. When Mt. Washington School was converted into affordable apartments for seniors, great care was taken to replace non-historic windows to match the design of those shown on historic plans and photos. The Standards do not require that missing historic features be put back, although developers often do restore important missing elements to enhance a building's character. The large open volume of two signature spaces inside the school, the auditorium and the library, was maintained and the historic trim was restored. Removal of non-historic elements, like the dropped ceiling in the library, helped to recapture the building's historic ambience. There are 10 standards, and a HTC project must meet all 10.

The 10 Standards for Rehabilitation can be summarized as: Retain and repair historic materials, features and spaces; Retain historic character, even if use changes; and Design alterations and additions so they are both compatible and reversible. Let's look at a few examples.

When the Bancroft School in Kansas City, MO was converted into affordable apartments, the project team worked hard to retain the building's character defining elements. They installed new windows to match the original windows, plaster walls and ceilings were repaired throughout the building, and the auditorium was preserved for community meetings. Distinctive elements in the corridors like trim, classroom doors and transoms were repaired. Transoms are the windows over the doorway. New walls were added within the large classrooms to create apartments, while trim elements like chalk board frames continue to communicate the building's original function. Harmful materials like lead paint and asbestos were removed without removing the historic materials. That's a great before and after, let's look at it one more time.

It's important to keep as much historic fabric as possible. You have to be able to justify removing any character-defining features. Windows, as you've probably gathered, are always a big concern. When the Murray Hill Elementary School in Chanute, KS was converted to affordable senior housing, the unique

window system could not be altered, but the project team successfully incorporated it into the new design.

Elm Terrace, formerly a Children's Hospital in Portland, ME was converted into 38 affordable units. The project included construction of a new addition that was discretely tucked behind the original building, and used compatible materials to match the original façade. On the left you see the addition set behind the historic building. On the right is the discreet connector that links the old and new buildings.

Because each building is unique in its architecture, history, current conditions, and context for redevelopment, reviewers consider the individual building history and circumstances to determine the appropriateness of a proposed rehab. What may be appropriate for one project may not be appropriate for another. Rehab of the Hollywood Bungalow Courts, in Los Angeles, provides housing for special-needs and low-income residents. The project preserved unique historic features, including an array of original built-in elements inside the apartments, as well as the open space, landscaping and scale of development that are as essential to the property's historic character as the buildings themselves. One community benefit of the HTC is that projects preserve the diversity of housing stock that creates community character.

The Standards give a developer a lot to think about. Fortunately, the NPS website features an array of technical guidance. NPS *Guidelines for Rehabilitation* provide general advice and dos and don'ts to help you meet the Secretary's Standards. Preservation briefs and technical case studies discuss how specific building elements and rehabilitation treatments may be reviewed. They can inspire solutions to a number of common rehabilitation issues, such as windows, large open rooms, abatement, and even sustainability. Yes, that's right, you can be historic, sustainable and affordable! What I really want you to take away from this slide is that there is no need to reinvent the wheel when completing a rehab project. It's all been done before. If you encounter an issue, it is likely someone else already encountered it and identified a solution. In addition to the on-line guidance from NPS, your SHPO staff are a great resource for finding appropriate solutions. Often they can visit the site to help understand the situation and explore options. Let's dig into the guidance on a couple of common topics.

I've mentioned windows several times already. As you may have guessed, windows are always the most complex and expensive item on any historic project. But, don't let this dissuade you from taking on a rehab. The NPS website provides detailed instructions on how to evaluate windows for repair or replacement. The original wood windows at the Chatham Apartments in Kansas City, MO were in extremely poor condition. When the property was converted into affordable senior housing, NPS approved new aluminum windows that matched the configuration, dimensions and profiles of the original wood windows. Repair can also be a good option, with costs for repair and energy upgrades often comparable to replacement. If you are going to replace windows, it is critical to have your shop drawings approved before moving forward. One developer installed windows without this approval, and had to replace all the windows again to claim their tax credits. Lesson-learned: always get your windows approved up-front.

Auditoriums, church sanctuaries and other large interior rooms raise questions about how they will be incorporated into a rehab project. These spaces are often critical to defining a building's historic character and function, and subdividing them will compromise the historic character. At Seven Oaks School, much of the auditorium was left as community meeting space, while a wall was added behind

the proscenium to incorporate the back stage area into an apartment unit. NPS offers online guidance that shows how other projects have successfully incorporated these spaces.

The abatement of lead or other hazardous materials is vital to protect residents but must be done with sensitivity to character-defining materials. NPS and HUD have detailed guidance on removing lead paint hazards in historic buildings.

A rehabilitated building is inherently very “green,” and HTC projects frequently achieve LEED status or recognition by other programs that encourage environmental sustainability. As interest in sustainability has increased, NPS has produced numerous publications on the topic as it relates to HTC projects. For instance, it is increasingly common to find solar arrays tucked out of sight on the roofs of historic buildings to help offset electric usage.

So we talked about the basic criteria and the specific requirements of the HTC. Let’s look at the Application process. To do this we are going to follow a single project through from start to finish. This case study will look at the Coliseum Apartments in Tulsa, Oklahoma.

There are three parts to the HTC Application. All three are reviewed first by SHPO and next by NPS. There are three entry-points to the application, depending on your building’s National Register status. If your property is not listed on the national register, you would start by preparing a draft nomination and filing this with your part 1 application. If your property is already contributing to a historic district, you file the part 1 to confirm that status. If your property is individually listed, you can go directly to part 2. The process for part 2 and part 3 is the same for all projects. In some variations of the scenario work can begin or credits can be claimed prior to NPS approvals, but always at the owner’s risk. Don’t worry about memorizing this chart, it will be available in our online guidance available after the webcast.

Let’s start with Part 1. This is the Coliseum Building. It was built in 1929 as workforce housing during the oil boom. It is not individually listed, but is in the Blue Dome Historic District, so we check the national register nomination to see if it is a contributing resource. Both the text of the nomination and the map indicate that the building is contributing. So we will prepare the part 1 application to document this.

The Part 1 application requests information about the building’s physical appearance, architectural integrity, history, and significance. For buildings that are not already listed on the NR, this information enables the reviewers to determine if it is NR eligible. For properties, like the Coliseum Apartments, that’s in a historic district, this information confirms that the building still has the qualities that made it contributing when the NR was designated. Part 1 approval for buildings that are not yet on the NR provides developers, investors and lenders with a level of comfort before the project moves forward. After the Part 1 is approved, these owners can start the National Register review process. As you saw on the flowchart, this is a separate process from the HTC review and takes 6-9 months to complete.

Photos documenting existing conditions are also critical to the Part 1 application. This photo map for the Coliseum Apartments shows the photo views for exterior and first floor images submitted with the application. There are similar photo keys for the 2nd floor and 3rd floor.

“Before” photographs show existing conditions on the exterior and interior as well as the configuration and relationship of spaces; the types and conditions of building materials; and the character-defining features and finishes that communicate the historic style, function and significance of the property. Significant elements at the Coliseum Apartments include the exterior brickwork and terra cotta

ornament, the shaped roofline on the street-facing facades, the windows, and the decorative treatment at the entrance...

...on the interior we see the arrangement of small apartments flanking a double-loaded corridor, and plaster walls and ceilings with minimal applied trim. Sometimes you need a little imagination to envision what these buildings can become.

Part 2 is the heart of the application. It includes a detailed description of the proposed rehab, including materials and techniques, and it presents architectural plans and pertinent construction specifications. Many investors and lenders require an approved Part 2 application before they will close on project financing. Plans submitted with the Part 2 don't have to be 100% complete but they must have enough information to show the reviewers how the historic features will be treated or altered and how new elements will be added. Additional detailed photos documenting existing conditions are submitted with the Part 2. If SHPO or NPS feels that an element of the scope does not meet the Standards, they will place a condition on the approval. As long as the completed rehab addresses the condition, the Part 3 application will be approved at the end of the project. The reviewers prefer to issue a "clean" approval with few, if any, conditions and will help applicants figure out how to revise the scope of work to meet the Standards. Construction can start before NPS approves the Part 2 application, but at increased risk. If at the end of construction any element of the scope does not meet the Standards, you cannot claim any of the credits.

Applicants can file an amendment to officially revise the scope of work to address conditions. Approval of the amendment assures the applicant that NPS will approve the revised approach when the Part 3 is submitted. An amendment can also be filed if new information becomes available or if the scope of work evolves during construction. This happens more often than not. For the Coliseum Apartments we submitted an amendment to get approval for replacement windows. The application described the purpose of the amendment and included comparative shop drawings for the windows.

When construction is complete, photo document the building to show the reviewers that the rehab was completed as approved. Each of these after images is keyed to a photo map just like the before photos. At the Coliseum Apartments, you can see the masonry has been repointed and cleaned, windows have been replaced, the historic configuration of spaces maintained and finishes restored.

The apartments are simple, as originally designed, but with modern kitchens and bathrooms.

When rehab is complete it is time to file the Part 3 application. Part 3 certifies that the completed rehabilitation meets the Secretary's Standards. The submittal includes the "after" photos, estimated QRE and total project costs, and ownership information (for assignment of credits). If a project is phased, you can file an amendment for NPS to review and certify that that phase of the rehab meets the Standards. The approved amendment can be used as evidence of pending approval and may allow the applicant to start claiming federal credits. The NPS charges a fee to review the Part 2 and Part 3 applications. The fee has a sliding scale based on project cost. The applicant pays half of the fee when NPS receives the Part 2 application and half when NPS receives the Part 3 application.

When your project is complete and approved, you are ready to claim the credit.

As we discussed earlier, you can use the credit to offset income tax liability dollar-for-dollar, beginning the year the building is placed in service. It can be carried back one year and forward up to 20 years.

Claiming the credit is very straightforward. The taxpayer submits IRS Form 3648 along with the NPS project number with your annual tax documents. If your project has not yet received Part 3 approval you must complete that step within 30 months after the placed in service date. The amount of the credit calculated on IRS Form 3648 is deducted from the bottom line of taxes owed. As I mentioned earlier, if a project has multiple phases, partial credit can be claimed when one or more phases are placed into service and the substantial investment test is met. The partial credit drawdown will be subject to recapture if the project does not ultimately receive Part 3 certification. Historic credits are also subject to recapture if building ownership changes or non-compliant alterations are made within 60 months after NPS approves the Part 3. Recapture is pro-rated based on the amount of time passed since the Part 3 approval.

The HTC can only be claimed by the owner of the property, but that ownership structure can take multiple forms. A fee simple property owner could be an individual, a partnership or a corporation. The only requirement for this program is that the owner be for-profit. A limited partnership can distribute the benefit to its members. In this scenario, an equity partner can invest in the project in exchange for rights to the credit. That investment then helps finance the rehab. Historic projects typically attract a net investment of \$.70/\$1 HTC that will be claimed. IRS Safe Harbor rules issued in 2015 require that the investor be a real partner with potential for both gains and losses in the deal. Under some circumstances a long-term lessee can claim the HTC. Because every situation is unique, always check with a tax advisor before starting a project to understand how the HTC will apply to your particular circumstances.

Many developers combine the HTC with other local, state and federal incentives.

State historic tax credits are currently available in 35 states, and nearly half of all federal historic projects are twinned with this incentive. Many state HTCs can be directly transferred (i.e. sold) to other businesses or individuals who want to offset their state tax obligation. If your project is in a state that has a state HTC, check with your real estate attorney or tax advisor to see if these are transferable and by what means. In just the last few weeks, while we were putting this presentation together, Alabama reinstated their state tax credit. That is great news!

This graphic shows the impact of a strong state historic credit. The states in dark green (Missouri and Virginia) have very user-friendly state tax credit programs and because of this they regularly submit a high volume of federal historic tax credit applications. The states in bright green also have strong state historic programs that encourage the use of the federal credit.

The two most common federal incentives used with the HTC are LIHTC (the Low Income Housing Tax Credit) and New Markets Tax Credits. Other federal, state and local Incentives that developers often combine with federal historic credits include HOME and CDBG funds, USDA rural loan programs, Brownfields grants, tax abatement, and tax increment financing. Be aware that a federal grant may affect the amount of historic credits a project receives. If your project is using additional sources of federal funds, be sure to consult with your tax advisor to understand how these funds may affect your project's overall financial picture. Investment in a historic tax credit project can also toward Community Reinvestment Act (CRA) requirements for banks.

As I noted earlier, HTC projects have rehabilitated over 150,000 units of affordable housing since 1977. Some of these projects, like Neighborhood Gardens in St. Louis, shown here, were originally developed

as affordable housing, while others adaptively reuse buildings constructed for other purposes. The historic and LIHTC programs differ in some fairly significant ways, like how the credits are calculated, which costs are QRE, and when the credits are awarded, but the program guidelines are generally compatible. The HTC will reduce the eligible basis for the LIHTC, although the LIHTC does not affect the amount of HTC a project earns. Affordable housing developers like to combine the two programs because it attracts additional equity to a project.

We have covered a lot of ground. As we wrap up this presentation, I would like to leave you with **Five Secrets for a Successful HTC Project**. Assemble a team of experienced, knowledgeable professionals to make your project run smoothly. These might include a preservation consultant who understands the application process, procedures, and Standards; an architect and structural and MEP engineers who are experienced with historic buildings; and a real estate attorney and tax accountant who are familiar with the tax rules related to the historic credit. Initiate contact with SHPO staff early in the development process and maintain regular communication. Allow ample time for the review process. This is one I can't emphasize enough. At minimum the review period for each part of your application is 60 days, although it isn't unusual for it to run 90 days, particularly at peak periods in the construction cycle. While these timeframes can sound daunting, they usually mesh well with the general development process if you anticipate them from the outset. You will sleep better knowing your Part 2 has been approved before you incur major expenditures and the hammers start swinging. It is very common for the rehab scope to evolve during construction. If plans change, don't assume that they will meet the Standards. Talk with SHPO and submit an amendment for review. Throughout the process, address issues proactively before they become problems. Engage SHPO in addressing these situations whether they occur before, during or after construction.

Thank you for being part of this webcast. All of us appreciate your interest in using historic tax credits to create affordable housing.

Before I turn things back to Nancy, please don't forget to email us your questions and visit the website for more information.

