Tax Incentives and Smart Growth –
Creative Connections of “Tried & True Development Tools

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What This Discussion Will Cover…

• Federal tax incentives and their role in leveraging smart growth transactions… what various types are in place?

• Tax incentive opportunities still available from the stimulus… ARRA tools that can connect to smart growth efforts

• Types of state tax incentives that can be linked to smart growth developments… with a focus on site reuse/brownfields incentives

• Examples…along the way
Federal tax incentives that can be linked to smart growth transactions – all at little or no cost to the project.

- Rehabilitation tax credits
- Low income housing tax credits
- New markets tax credits
- Energy efficient construction tax credits
- Brownfield cleanup expensing
Financial Advantages of Using Tax Incentives in Smart Growth Projects

- Increase project’s internal rate of return
- Ease borrower’s cash flow by freeing up cash ordinarily needed for tax payments
- Some credits can be sold for cash, or syndicated to attract additional capital investment
- Not subject to competitive public grant process
### Social/Community Advantages of Using Tax Incentives in Smart Growth Projects

- Credits attract different players to the redevelopment table.
- Offset additional pre-development or site preparation costs of site reuse/in-fill projects.
- Encourage private investment in sync with local plans that promote smart growth.
Rehabilitation Tax Credits

- Taken the year renovated building is put into service
- 20% credit for work done on historic structures, with rehab work certified by state
- 10% credit for work on “non-historic” structures built before 1936; no certification required

In 2008 – 1,231 projects, $1.12 billion in credits
- leveraged $5.64 billion in private investment
- led to nearly 68,000 jobs
- resulted in 17,051 housing units – 5,200 affordable
Rehabilitation Tax Credits – caveats and “fine print”

- Rehabilitation costs must be “substantial” – i.e., exceed minimum of $5,000 or the building’s adjusted basis

- Property must be “income-producing” – multi-family rental housing can claim the 20% credit, but not the 10% credit

- Rehab work must conform to state historic preservation standards – which can deter integration of “green” technologies

- Credit is recaptured on a sliding scale (20% annually) if owner disposes of the building within five years of completing renovation
**Renaissance Grand Hotel – St. Louis, MO**

- Developer led public-private partnership that renovated two defunct historic landmark hotels, in addition to 23-story new construction, for significant downtown infill/reuse
- Project included the old Statler Hotel, built in 1917 -- the 1st air-conditioned hotel in the country
- Kimberly-Clark Corp provided tax equity for several million dollars in historic rehabilitation tax credits
- **Credit as leverage** – Financing package included tax exempt bonds, brownfield cleanup tax expensing, empowerment zone tax incentives
Old Northampton Fire Station -- Northampton, MA

- Old Northampton Fire Station, built in 1872, shut down in 1999
- 13,000 sq. ft. building redeveloped into downtown office space, café, small scale retail
- Adjoining property, used by the fire department for maintenance activities, being redeveloped into a residential and studio space
- Total project costs -- $1.6 million
- Cash flow impacts of rehab tax credits a key part of the economic viability of this project
**Thames Street Landing – Bristol, RI**

- $8.3 million mixed-use redevelopment, including housing, hotel, and offices at a vacant downtown site
- 200-year history – buildings included original Bank of Bristol (1797), Taylor Store (1798) and DeWolf Warehouse (1818); industrial uses started in 1861
- Developed in phases; banks unwilling to provide follow-on financing until 1st phase generated a positive cash flow
- **Rehab tax credits key to generating positive cash flow, attracting additional private capital**
- Today, project is cornerstone for historic revitalization of Bristol waterfront
Berkey and Gay Building  -- Grand Rapids, MI

• Former downtown furniture maker, abandoned in 1960s
• $41 million cleanup/ conversion to mixed use
  – 242 apartments/condos
  – 100,000 sq ft commercial (restaurant, retail, offices)
  – 450 space parking ramp
• Rehabilitation tax credits key to attracting individual equity contributions
• 900 permanent jobs created
Low-Income Housing Tax Credits

- Can encourage capital investment in affordable housing on vacant properties, brownfields, other targeted sites
- Can be used to target investment to certain areas, such as infill or walkable locations, and also to discourage sprawl
  - States get annual population-based allocation for distribution to communities and non-profits – approx. $1.75 per capita
- Investors can get 9% annual credit for 10 years for qualified new construction/rehabilitation costs (i.e. 90% of total) for projects not financed with federal subsidy
  - Federal subsidy limits credit to 4%
- Credits can be used for new construction, rehabilitation, or acquisition and rehabilitation
Low-Income Housing Tax Credits – fine print and caveats

- New wrinkles…
  - Loss of tax incentive value on secondary market – from about 95 cents/$ to about 65 cents/$ now – impacts syndication value
  - “Green” priority for credit allocations within states

- Credits support a wide range of housing types/situations
  - Urban, suburban, rural projects
  - Housing for families, special needs tenants, SRO, elderly

$3.85 billion in credits issued in fiscal year 2008, supporting 1/3 of all new construction that year
Albina Corner – Portland, OR

- 3/4 acre Albina Corner is adjacent to a bus line and near a major light rail station.
- Area is gateway to several inner-city neighborhoods, where small scale contaminants have deterred reuse.
- Site redeveloped into a mixed-use area that includes 48 units of low-income housing built over 12,000 square feet of commercial space; includes a child care center and a second floor courtyard and play lot.
- LIHTCs one of 14 funding sources.
Brian J. Honan Apartments – Boston, MA

- Allston-Brighton CDC saw an opportunity to develop former Legal Seafoods fish processing plant into affordable housing
- **Low-income housing tax credits** key parts of financing incentive package needed to attract capital, convince funders that the project would work
- **Result** – affordable units in a sustainable development: green energy, pedestrian access to groceries, shops, transit
Mifflin Mills – Lebanon, PA

- PA’s first affordable “rent-to-own” townhouse community
- Former vacant, blighted city block near downtown
- Energy efficient construction, designed to blend into existing residential neighborhood
- 20 units, completed Nov. 2009
- $1.5 million in low-income housing tax credits key part of financing package needed to attract investors to rent-to-own project structure
New Markets Tax Credits

- Gives investors federal tax credits (39% over 7 years) for equity investments in designated Community Development Entities (CDEs), for use in low-income communities
  - CDEs use their allocations to make loans or investments in “qualified businesses” and development activities –
    - Community facilities such as health or child care
    - Charter schools
    - For-profit and non-profit businesses
    - Homeownership projects

$5 billion allocated in October 2009
$24.5 billion awarded to 463 CDEs since 2001
New Markets Tax Credits – fine print and caveats

- Challenging CDE designation, application process requires significant capacity, technical expertise
  - *Time consuming and complex*
- Costly – legal, other fees
- Matchmaking a good CBO strategy – find a CDE with an allocation!
  - *Recipients must allocate credits within 5 years*
- Historically, 50% + of all allocations have supported for-profit and non-profit business development
  - *Significant capital investment in central city areas*
New Markets Tax Credits -- highlights of 2009 funding round

- $5 billion awarded to 99 allocatees in 30 states
  - Allocatees anticipate making investments in 49 states
- Planned investments include:
  - $2.1 billion (41.4%) to finance and/or support business loans
  - $2.85 billion (57%) to finance real estate projects
- All investments at preferential rates/terms
New Markets Tax Credits: Bethel Center – Chicago, IL

- Bethel New Life, a faith-based CDC, used $1.5 million in NMTCs from LISC/Chicago to develop 23,000 sq.ft. Bethel Center on brownfield site
- Center has employment, day care services; 6 storefront businesses
- LEED gold certified
- *Credit as leverage:* NMTCs attracted private capital from Bank One and State Farm insurance
ENERGY POLICY ACT OF 2005 TAX CREDITS

- Commercial building deduction of up to $1.80 per sq. ft. for buildings that achieve a 50% energy savings target
  - Up to 60 cents per sq. ft. for buildings meeting at least a $16^{2/3}$% target
- 30% credit business solar energy tax credit, from 1/1/06 thru 12/31/07
  - 10% starting 1/1/08
Brownfield Cleanup Expensing Tax Incentive

- Deduction pegged to cleanup costs, which allows new owners to recover cleanup costs in the year incurred; only incentive targeted to private site owners

- Can include:
  - Site assessment, cleanup, monitoring costs
  - Costs related to install/monitor institutional controls
  - State VCP fees and associated costs
  - Removal of demolition debris

- No long term authorization in place; most recently extended until 12/31/09 (retroactive to 1/1/08)
  - Petroleum sites made eligible in 2007 extension
Brownfield Cleanup Expensing Tax Incentive – caveats and fine print

- “Stealth incentive” – used at less than 2 dozen projects annually
- Never been used in 23 states --
  - Alabama, Alaska, Arizona, Arkansas, Colorado, Hawaii, Idaho, Iowa, Kansas, Maine, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Oklahoma, South Carolina, South Dakota, Utah, West Virginia, Wyoming
Brownfield Cleanup Expensing Tax Incentive – caveats and fine print

- Little understanding of what it is, what it does, how it works
  - *On the part of Treasury (no regs/guidance), developers, transaction support professionals, state agencies who certify*

- Process not well articulated at state level

- Authorized in “fits and starts”
  - *Makes long-term, larger projects hard to plan*

- Subject to recapture on transfer
  - *Vague Treasury interpretation deters use*
Alliance Environmental/Goodwill Fire Department – West Chester, PA

- 8.5 acre former pharmaceutical property and dump site in economically distressed area
- Cleaned and redeveloped by Alliance Environmental
- Now, location of Good Will Business Park: 100,000 sq. ft. of retail, public service facilities including fire department and district court
- Incentive provided Alliance with nearly $800,000 in tax relief
Genzyme Building – Cambridge, MA

- Century-old former Cambridge Gas & Light MGP site, vacant 20 years, major soil contamination
- $25 million in remediation costs expensed from 1999 to 2004 – estimated $2 million in cash flow savings from brownfield incentive
- **Result** -- new $1.3 million sq. ft. office/retail/residential transit-oriented development: 700 new jobs; $6 million annual property tax revenues
- 12-story Genzyme Building is LEED platinum
American Recovery and Reinvestment Act

• What opportunities still exist from the stimulus?
• How can they finance growth efforts?
Principles behind $787 billion ARRA

• Preserve and create jobs and businesses, and promote economic recovery
• Combination of tax cuts, direct investments in infrastructure, environment, energy, science, and education to spur technological advances and jump start the economy
• Pursue links to Administration’s “green” goals
• Stabilize state and local budgets, to maintain essential services
• Priority to short term, quick start projects
• Not intended to change program structures or policies
Goal, Role of Stimulus, in a Nutshell…

What’s left that can still help communities promote smart growth activities?
**Smart Growth opportunities still exist from the stimulus**

**Recovery Zone Economic Development Bonding Authority**

- $10 billion for taxable bond issuances by 12/31/10
- proceeds must be used in locally designated “recovery zones” – areas of high unemployment, home foreclosures, and general distress
- proceeds can finance depreciable business property; reconstruction/renovation criteria included
- available in cities, counties of 100,000+
- subsidy/benefit –
  * 45% to issuer to offset interest, or
  * federal tax credit to holder = to 45%
Smart Growth opportunities still exist from the stimulus

**Recovery Zone Facility Bonding Authority**
- $15 billion for tax exempt issuances by 12/31/10
- proceeds must be used in locally designated “recovery zones” – areas of high unemployment, home foreclosures, and general distress
- supports business/economic development activity in distressed areas
  * reconstruction/renovation criteria specified
  * small business/retail components
Smart Growth opportunities still exist

**Energy efficiency tax incentives**

- **30%** of costs of on-site solar, fuel cell, small wind renewable systems, thru 12/31/16
  - *ARRA allows grant in lieu of credit in 2009, 2010*
- **10%** for geothermal, microturbines, thru 12/31/16
  - *ARRA allows grant in lieu of credit in 2009, 2010*
- **10%** credit for CHP installation, thru 12/31/16, in year it becomes operational
- energy efficient construction deductions, thru 12/31/13
  - *$1.80 sq. ft.* for buildings saving **50%** of energy costs; 60 cents for 20% savings
Opportunities still exist from the stimulus

**Industrial development bonds**

Expands eligible activities, for issuances thru 12/31/10 --

- To include “manufacturing-related facilities”
  * allows financing facility functionally related to manufacturing – warehousing, office space, distribution
- For capital needs of businesses that produce intangible property – “patents, copyrights, designs, formats, or similar items”
  * could benefit software, biotech, pharmaceutical, entertainment firms
- Exempts IDB benefits from AMT
Numerous state tax credits, abatements, and incentives exist that could be “fit” to smart growth needs.
How Have State Tax Incentive Programs Been Used to Support Smart Growth Redevelopment Activities?

- Site redevelopment/revitalization planning
- Infill site/vacant property acquisition
- Environmental site assessment
- Removal or remediation of contamination
- Site clearance, demolition, and debris removal
- Rehabilitation of buildings
- Construction of infrastructure, related improvements that enhance contaminated property value
Offered by 22 states, including –

- deferral of increased property taxes — Connecticut and Texas
- tax incentives for affordable housing -- Florida
- remediation tax credits – Illinois and Colorado
- cancellation of back taxes — Wisconsin and Massachusetts
- sales tax rebates to offset cleanup costs – New Jersey
- advantageous tax treatment of brownfield property improvements – North Carolina
- tax incentive “menu” -- Missouri
State Tax Incentive Innovations – Emerging Initiatives (Since 2007)

- Expanded tax incentives, loan guarantees for affordable housing on brownfield sites (FL)
- Brownfield TIF guarantees (PA)
- Environmental remediation TIF (WI)
- Remediation tax credits in new “Rivers Edge Redevelopment Zones” (IL)
- Advantageous taxation of brownfield property improvements (NC)
Tax policies to attract private capital

• Wisconsin allows new owners, working thru VCP, to have back taxes waived, expedite transfer of tax delinquent properties, to level the playing field and attract new investors

• Gas station to coffee shop -- Milwaukee
Assignable, transferable, marketable tax credits to encourage infill and site reuse

- Massachusetts’ Brownfield Credit for Rehabilitation of Contaminated Property; up to 50% credit against cost of environmental response and removal; can be combined with other state brownfield programs
- **Wire fabricator to printing/graphics plant -- Dorchester**
Revamping traditional development entities to focus on reuse

- Michigan has created a special category of development authority
- Cities, towns and counties can establish “brownfield redevelopment authorities”
- Exercise traditional development authority powers: expedited title clearance, TIF and bond financing; eligible applicants for other federal programs
Missouri’s Incentive “Diner” – Going a la carte for the full cleanup “meal”

- Missouri Brownfield Redevelopment Program
  - Offers range of loans, loan guarantees, for properties abandoned or underused for at least 3 years
  - Menu of jobs, investment, and property tax credits, up to entire amount of cleanup

- Abandoned rail roundhouse complex to office park and small business incubator
For further information..........

For additional examples and information....

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