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Federal & State Historic Tax Credits

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a subsidiary of

NATIONAL TRUST FOR HISTORIC PRESERVATION®

- Tax Aspects Administered by the IRS.
- Preservation aspects jointly administered by NPS and State Historic Pres. Offices (SHPOs).
- Tax Credits = dollar for dollar reduction in tax liability (contrast with deduction).
- RTC is the most important (in dollar volume) federal preservation program.

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State Historic Preservation Tax Credit Programs

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Renee Kuhlman
Director of Special Projects
State and Local Policy


LOFTS
FOR RENT

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Q: One of the biggest differences?

A: Owner-Occupied Residential Properties

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Why are they needed?

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Help Where It's Needed the Most

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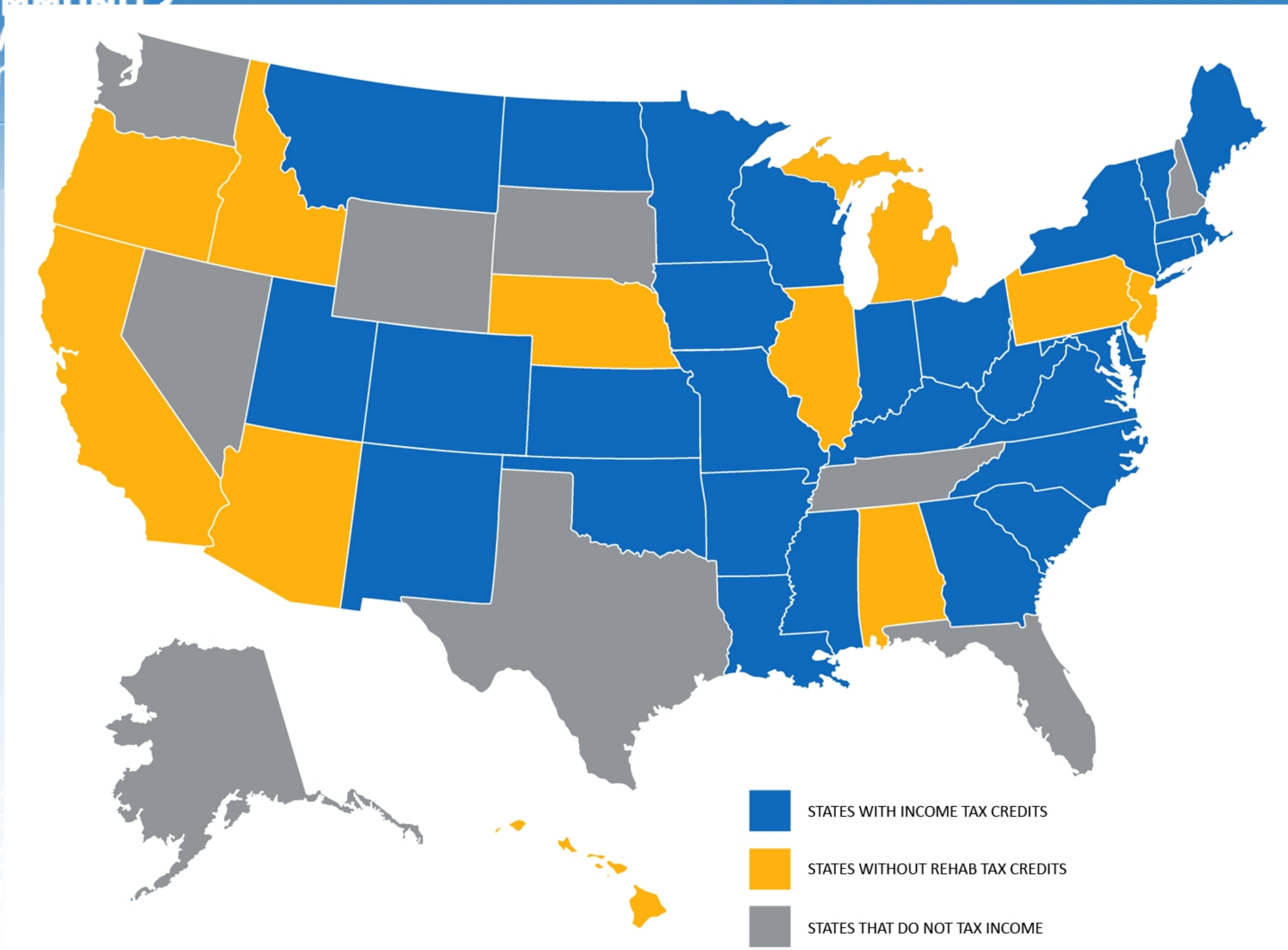
What's Our Role?

Thirty States Offer This Type of Incentive



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Some programs are "better" than others

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Capping

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Transferability

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Components of a Good Program

- No Cap (Aggregate or Per-Project)
- Available for homeowners
- Transferable
- **Reasonable % rates**
- **Multiple claimants**
- **Wide geographic**

What's Happening Now?

- Efforts to Gain a Program (PA, NB)
- Efforts to Im
- Efforts to Pr

Persuasive Arguments for the Credit

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Two Types of Rehabilitation Tax Credits

- Older (pre-1936), non-historic and non-residential buildings: 10 percent of qualified rehabilitated expenditures.

- Historic buildings: 20 percent of qualified rehabilitation expenditures.

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What Types of Buildings Qualify?
The IRS Rules: Depreciable Building Requirement

- Must be a "building". Building is defined as a structure or edifice enclosing a space within its wall and usually covered by a roof.
- Building must be depreciable. Depreciable buildings are generally those used for nonresidential (i.e. commercial) or residential rental purposes. (See Section 168(e))

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What Types of Buildings Qualify? The NPS Rules: Certified Historic Structure Requirement

Option #1

Building is listed in the National Register of Historic Places.

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What Types of Buildings Qualify? The NPS Rules: Certified Historic Structure Requirement

Option #2

Building is located in a registered historic district and certified by the Sec. of the Interior as being of historic significance to the district.

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What Types of Rehabilitations Qualify?
The IRS Rules:
Substantial Rehabilitation Requirement

The **QREs** incurred during any 24-month period** selected by the taxpayer and ending in the taxable year in which the building is **placed in service** must exceed the greater of:

- $5,000, or
- The **adjusted basis** of the building.

**A 60-month period may be used where written plans completed before the rehab begins show that the rehab is expected to take place in phases and is reasonably expected to take more than 24 months.

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What Types of Rehabilitations Qualify?
Definition of QREs

- “Qualified Rehabilitation Expenditures” (QREs) is the tax term given to those development costs on which rehabilitation tax credits can be claimed.
- QREs are any amounts chargeable to a capital account made in connection with the renovation, restoration or reconstruction of a qualified rehabilitated building (including its structural components), except as provided by law.

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What Types of Rehabilitations Qualify?
Definition of QREs

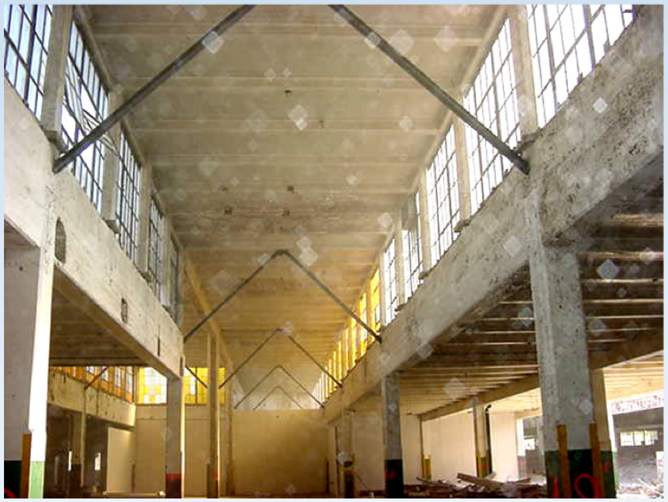
QREs include costs related to:

- walls, partitions, floors, ceilings;
- permanent coverings such as paneling or tiling;
- windows and doors;
- air conditioning or heating systems, plumbing and plumbing fixtures;
- chimneys, stairs, elevators, sprinkling systems, fire escapes;

Definition of QREs (cont'd)

QREs include costs related to:

- construction period interest and taxes;
- architect fees, engineering fees, construction management costs;
- reasonable developer fees



- Costs EXCLUDED from QREs:
  - Land and building acquisition;
  - Enlargements that expand total volume (cf. remodeling that increases FMR);
  - Personal property (furniture and appliances, cabinets and movable partitions, tacked carpeting);
  - New building construction;
  - Sitework (demolition, fencing, parking lots, sidewalks, landscaping)

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The 20% Rehabilitation Tax Credit
Calculating the Allowable Credit

- Credit equals 20% of all QREs incurred:
  - Prior to the start of the 24-month period selected (so long as they were incurred "in connection with" the rehab process that resulted in the substantial rehabilitation of the building);
  - During the 24-month period; and
  - After the last day of the 24-month period but before the last day of the tax year in which the measuring period ends.

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The 20% Rehabilitation Tax Credit
When is the Credit Allowed?

- Credit is generally allowed in the year in which the building is placed in service (provided substantial rehabilitation test has been met).
- "Placement in Service" means that the all or identifiable portions of the building is placed in a condition or state of readiness and availability for a specifically assigned function.
- Progress Expenditure Election available for properties with a "normal" construction period of 2 years or more

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The 20% Rehabilitation Tax Credit Recapture

- Credit previously allowed is recaptured if any portion of the project which includes QREs is disposed of prior to the fifth anniversary of placement in service.
- Amount subject to recapture decreases by 20% during each year of the five year period.

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The 20% Rehabilitation Tax Credit Recapture

- Disposition includes any sale, exchange, transfer, gift or casualty. Subsequent rehabs that do not comply with the Secretary's Standards can trigger recapture.

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The Tax Credit Market Place:

NPS Historic Tax Credit Statistics FY09 to FY10

	2009	2010	% change
Part 2s approved	1,044	951	-8.9%
Part 3s approved	806	883	+9.5%
Certified Rehabilitation Expenditures: (in millions)	$4,539.16	$3,438.06	-25%
Average cost of project:	$4.49 million	$3.59 million	-20%
Maximum amount of credit to be claimed: (in millions)	$939	$684	-27%
Average credit amount allocated per project (approx).	$899,938	$718,885	-20%

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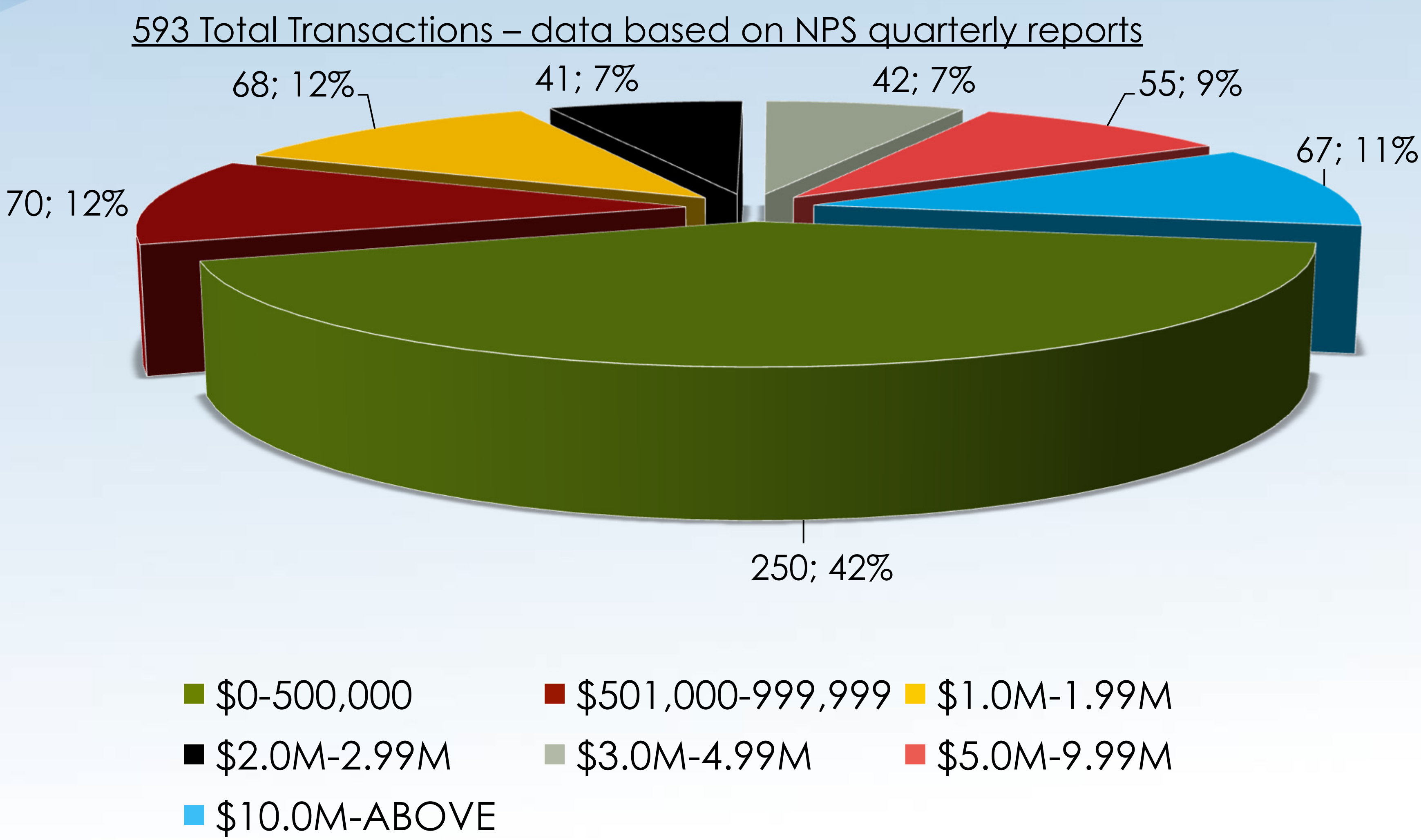
Total # of HTC Transactions by Deal Size in 2010



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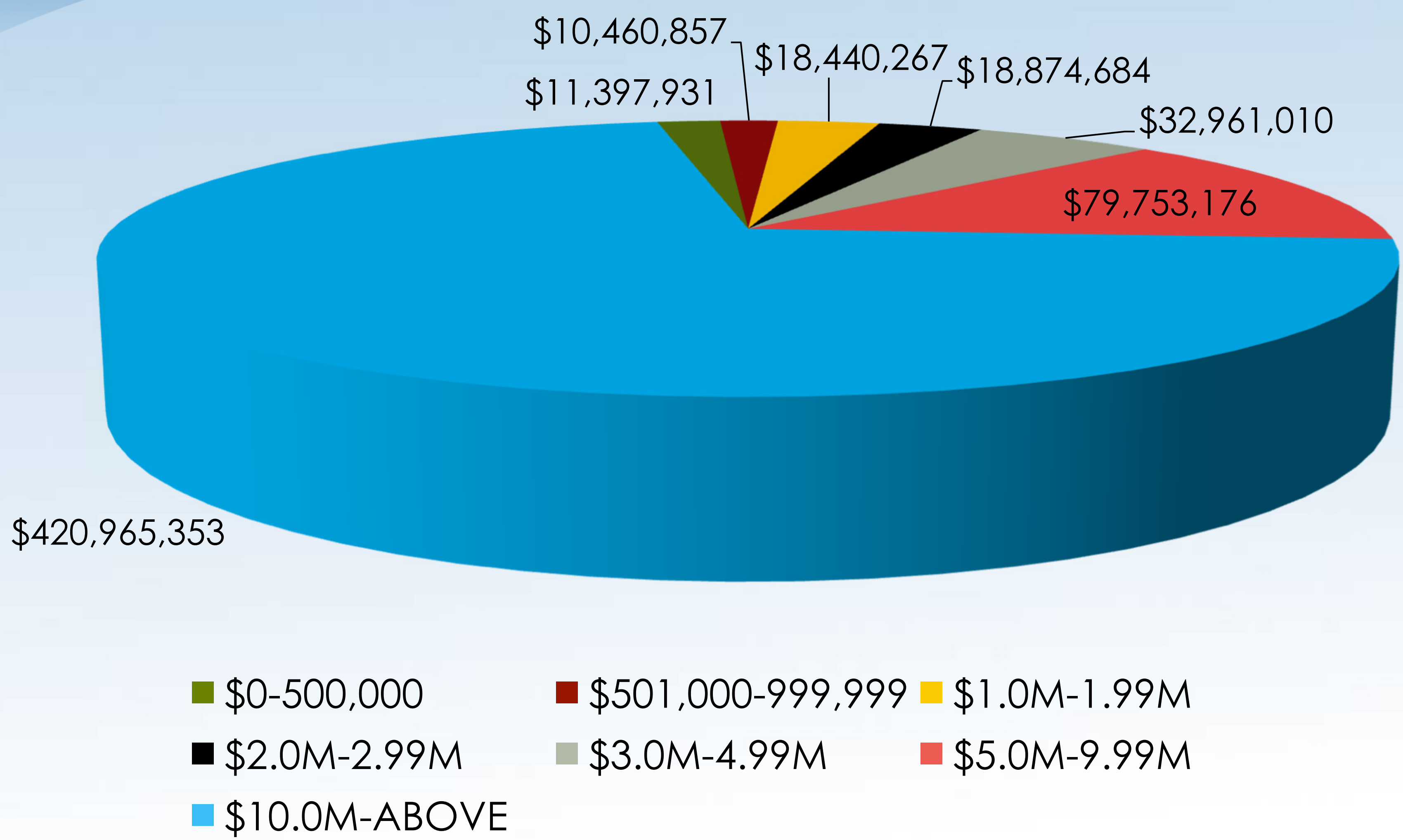
HTC Dollar Value by Deal Size in 2010



*Data based on NPS quarterly reports

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NTCIC: A brief history

Dalton Building Rock Hill, SC
First NTCIC Investment of
$1million

- Partnership with Bank of America led to organization of the Banc of America Historic Tax Credit Fund in 2000.
- NTCIC financed its first project, Dalton Building, in May 2001.
- NTCIC received its first New Markets Tax Credit allocation in October 2003.
- $423.5 million in gross equity/debt invested to date.
- $1.7 billion in total development costs to date.

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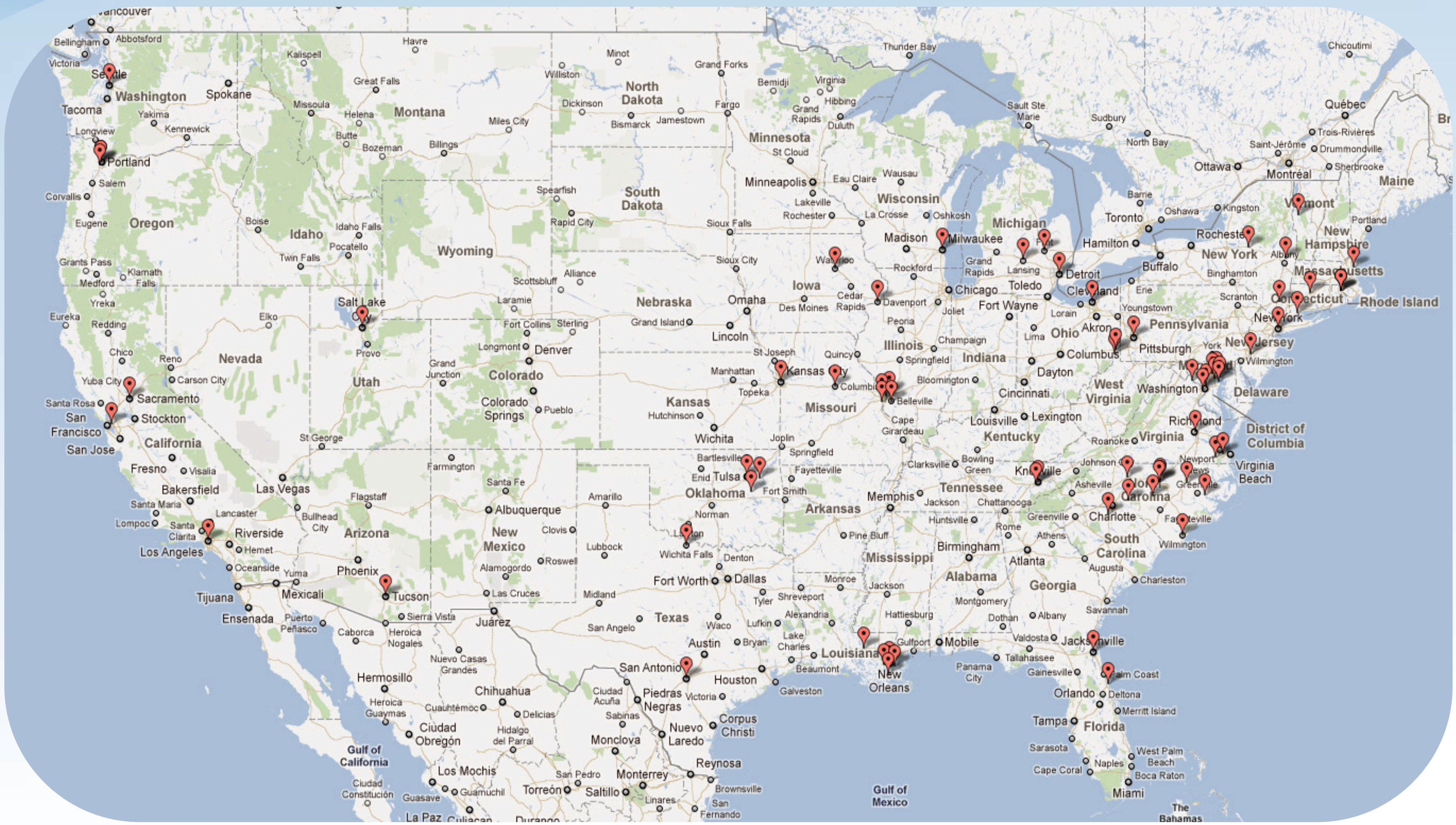
NTCIC Project Locations



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Total Investments by use

By Use	# of Projects	Net Investment
Cultural/Educational Facility	19	$97,648,917
Hotel	7	$63,535,343
Housing & Mixed-Use Commercial	23	$135,245,123
Office/Retail	19	$101,268,181
Non-profit Office	6	$25,827,071
Total	74	$423,524,634

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Harmony Mills
Cohoes, NY

Property Use: Residential (96 units)

Credits used: HTC

Net Investment: $2,696,588

Total Development Cost: $18,328,024

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American Brewery

Baltimore. MD

Property Use: Office headquarters for non-profit group Humanim

Credits used: HTC & NMTC

Net Investment: $5,337,101

Total Development Cost: $23,989,027

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Fox Oakland Theater

Oakland, CA

Property Use: Performing arts charter high school

Credits used: Federal Historic and New Markets Tax Credits

Net Investment: $15,687,989

Total Development Cost: $88,232,316

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Sample Transaction

Calculating the HTC Equity

Qualified Rehab Expenditures	$24,060,799
Credit Rate	20.00%
Total Calculated Credit	$4,812,160
Tax Credit Investor Allocation	99.99%
Total Credit to Investors	$4,811,679
Credit Price Per Each $1 of Credit	$0.98
Equity Contributions by Investors	$4,715,445

HTC Deal Structures—Step by Step

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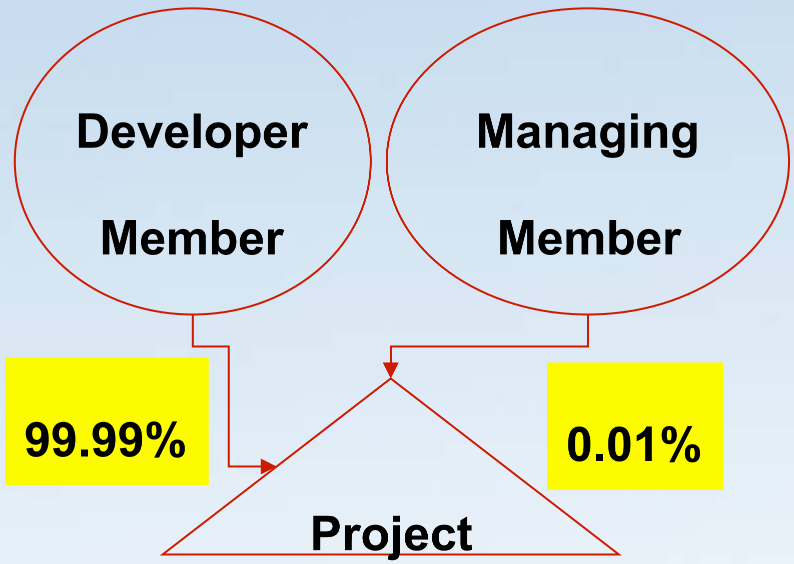
Historic Tax Credit Syndication
The Credit Pass-Through Structure

- Landlord LLC owns fee simple, undertakes rehab, enters into Dev. Agreement, and earns the Historic Tax Credit.
- Master Tenant, LLC leases the entire project from the Landlord LLC for a fixed annual rental payment.

Historic Tax Credit Syndication
The Credit Pass-Through Structure

- Master Tenant, LLC operates the property, subleases to end users and enters into the Property Management Contract.
- Landlord makes special tax election to pass the Historic Tax Credit through to the Master Tenant LLC.

Project Inception—A New Project



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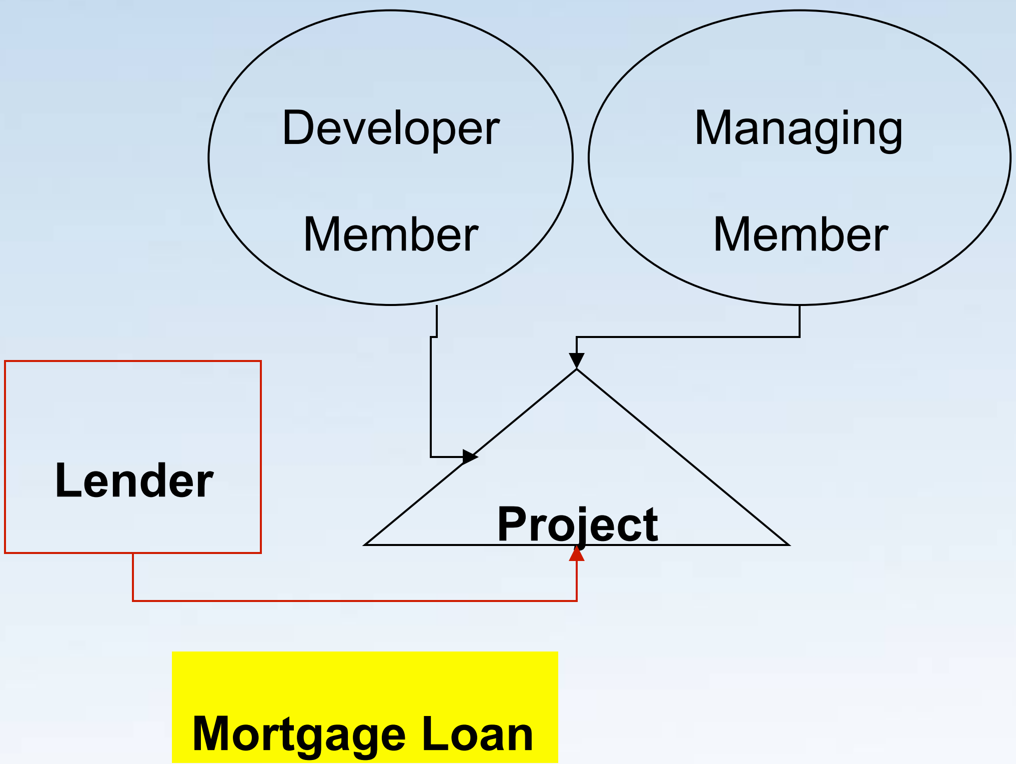
Adding Debt Capital



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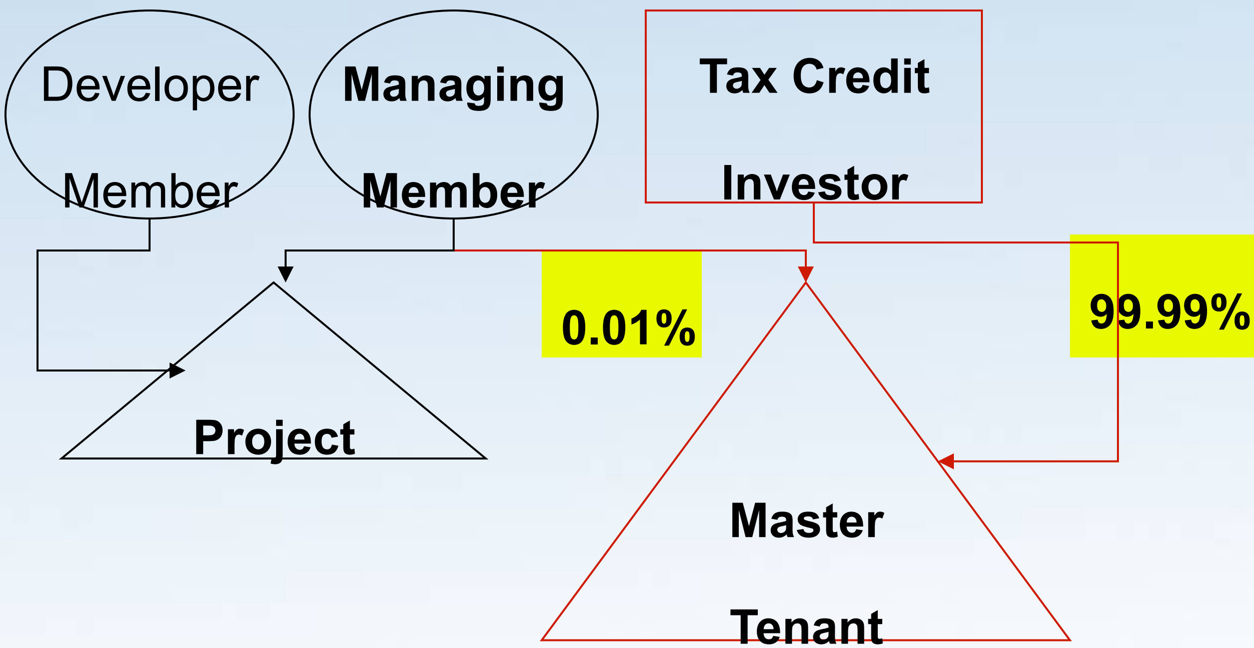
Closing—Step 1, Create Master Tenant



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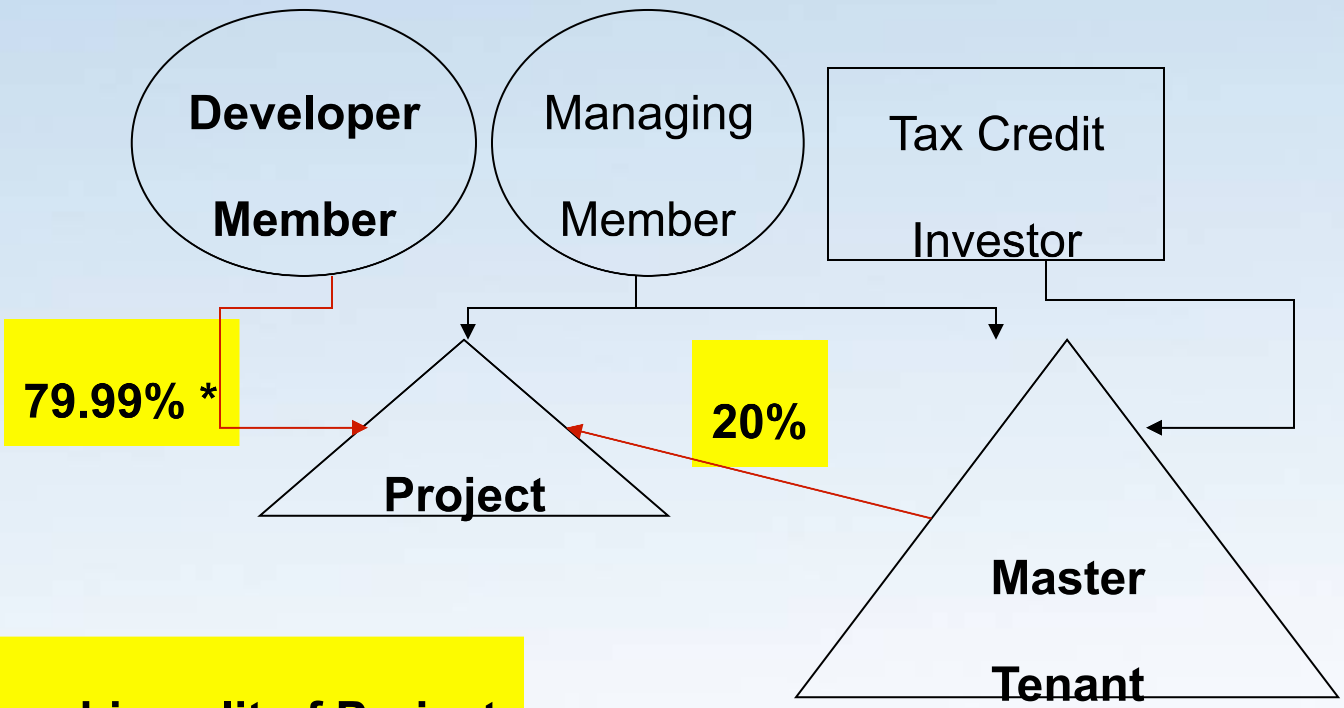
Closing—Step 2, MT Invests in Project



*** Ownership split of Project between Developer and Master Tenant may vary**

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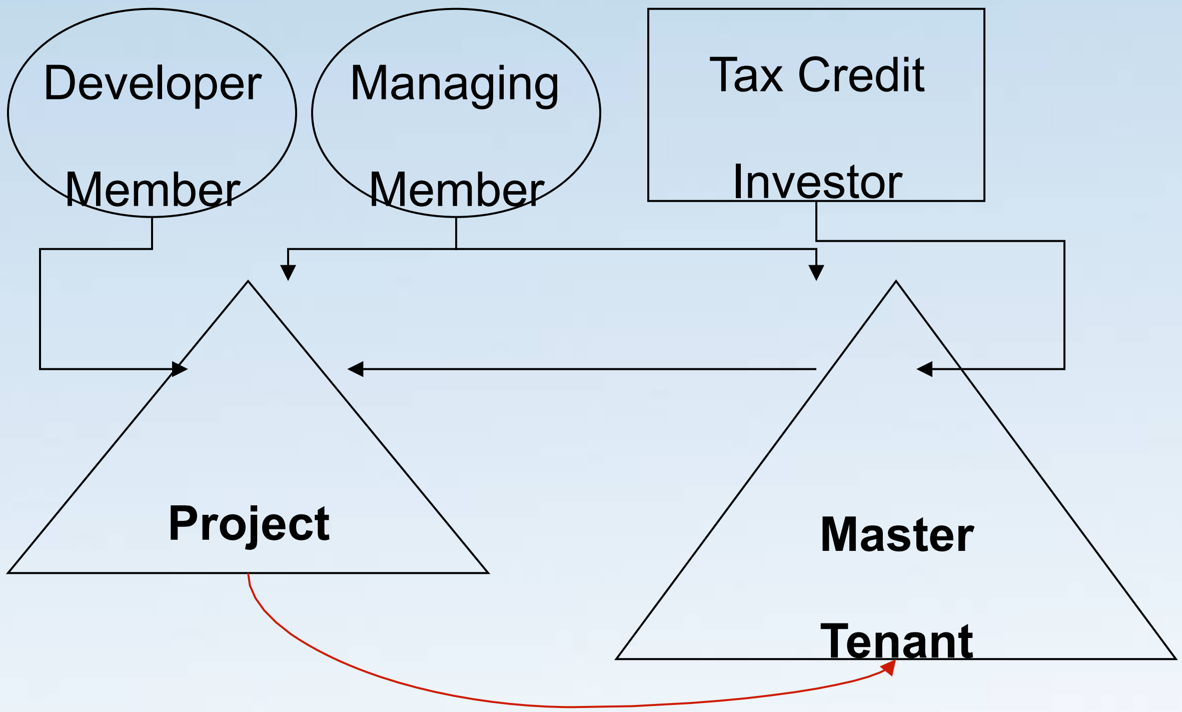
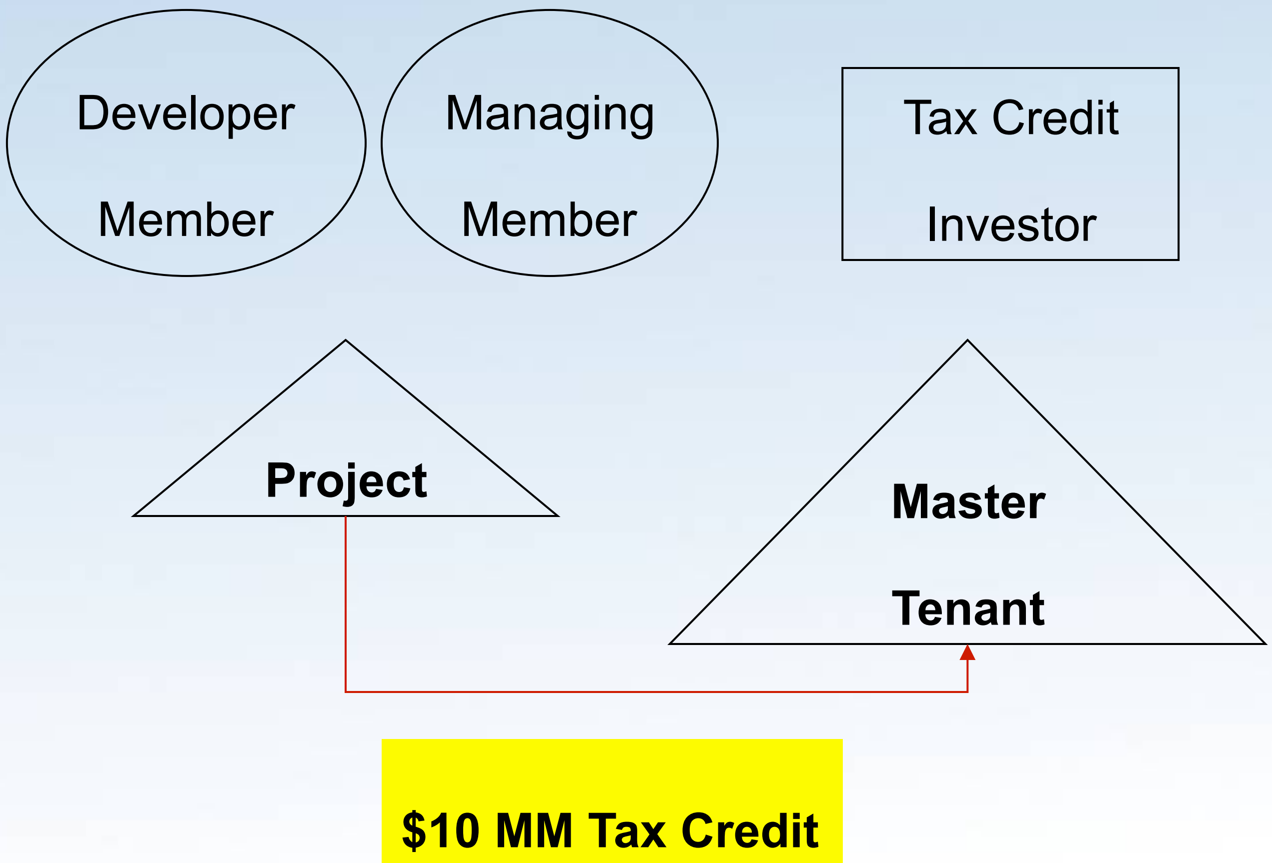
Before Placed in Service



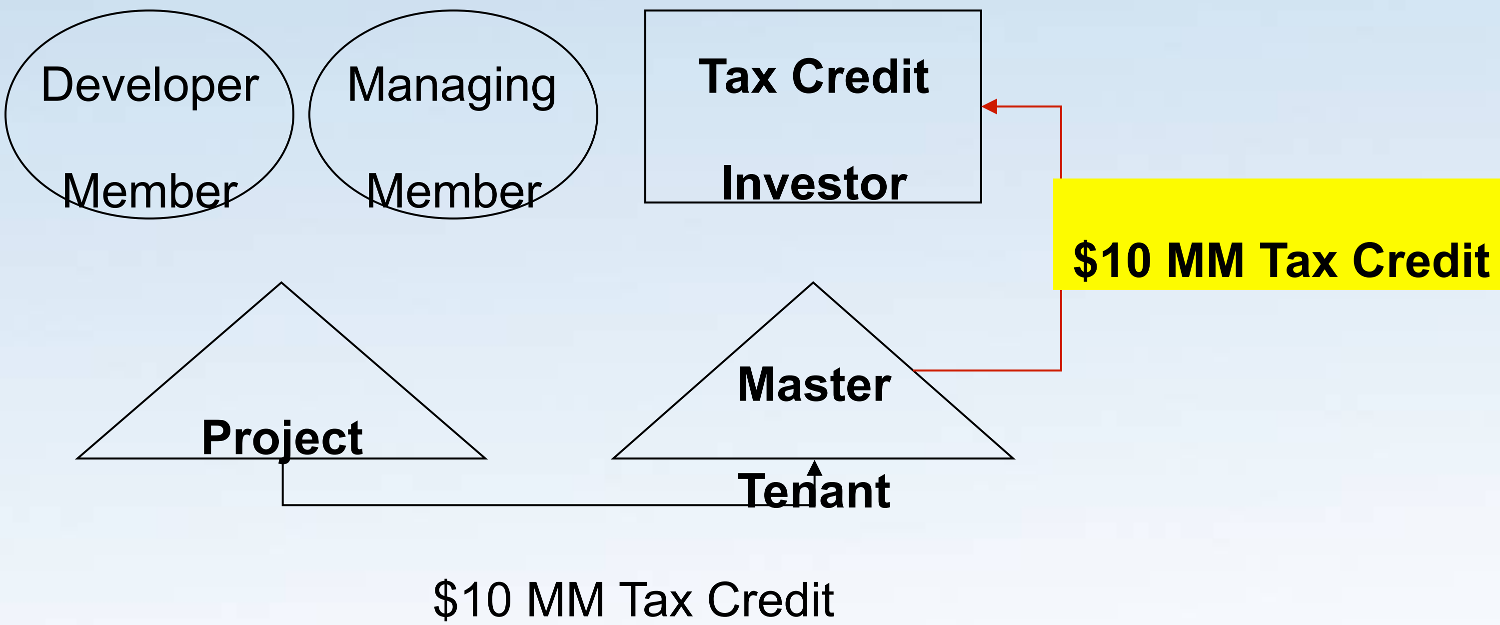
Long-term Lease of Building

(typically 32 years)

Placed in Service



Tax Credit Distribution



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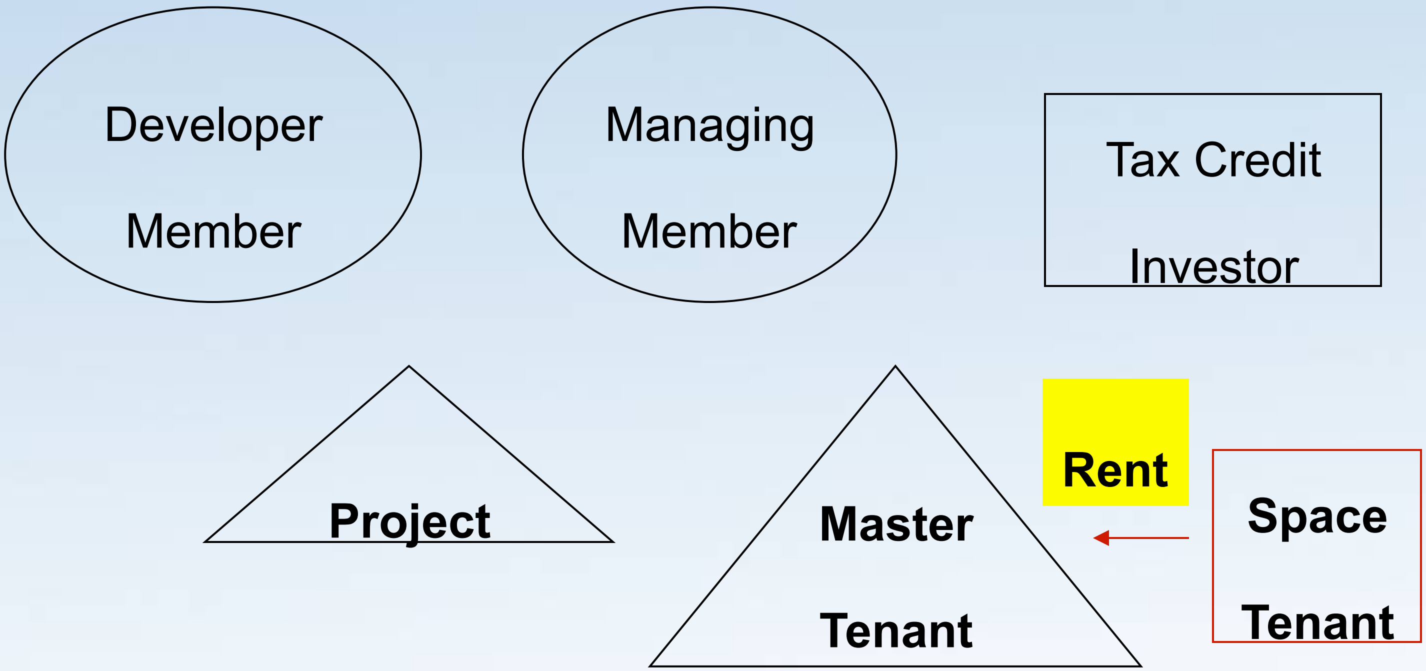
Operations—Step 1, MT Operates Building



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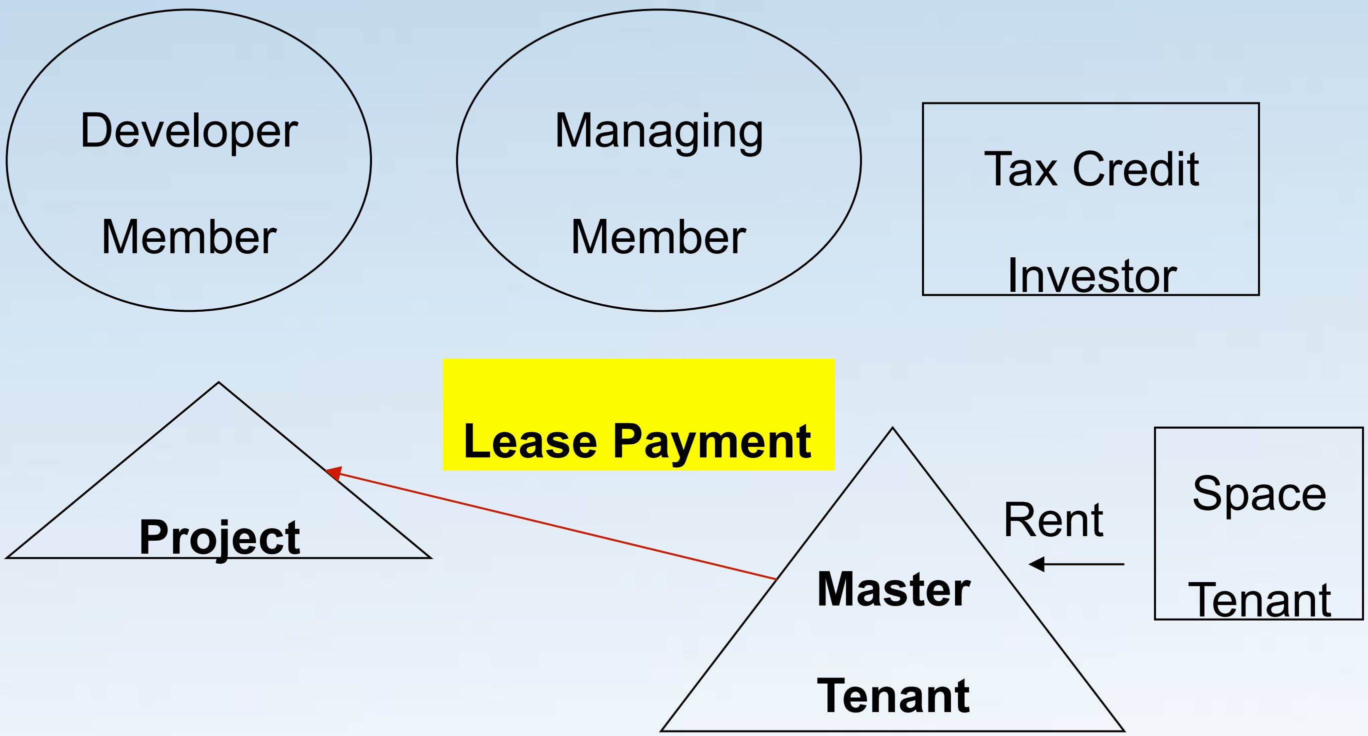
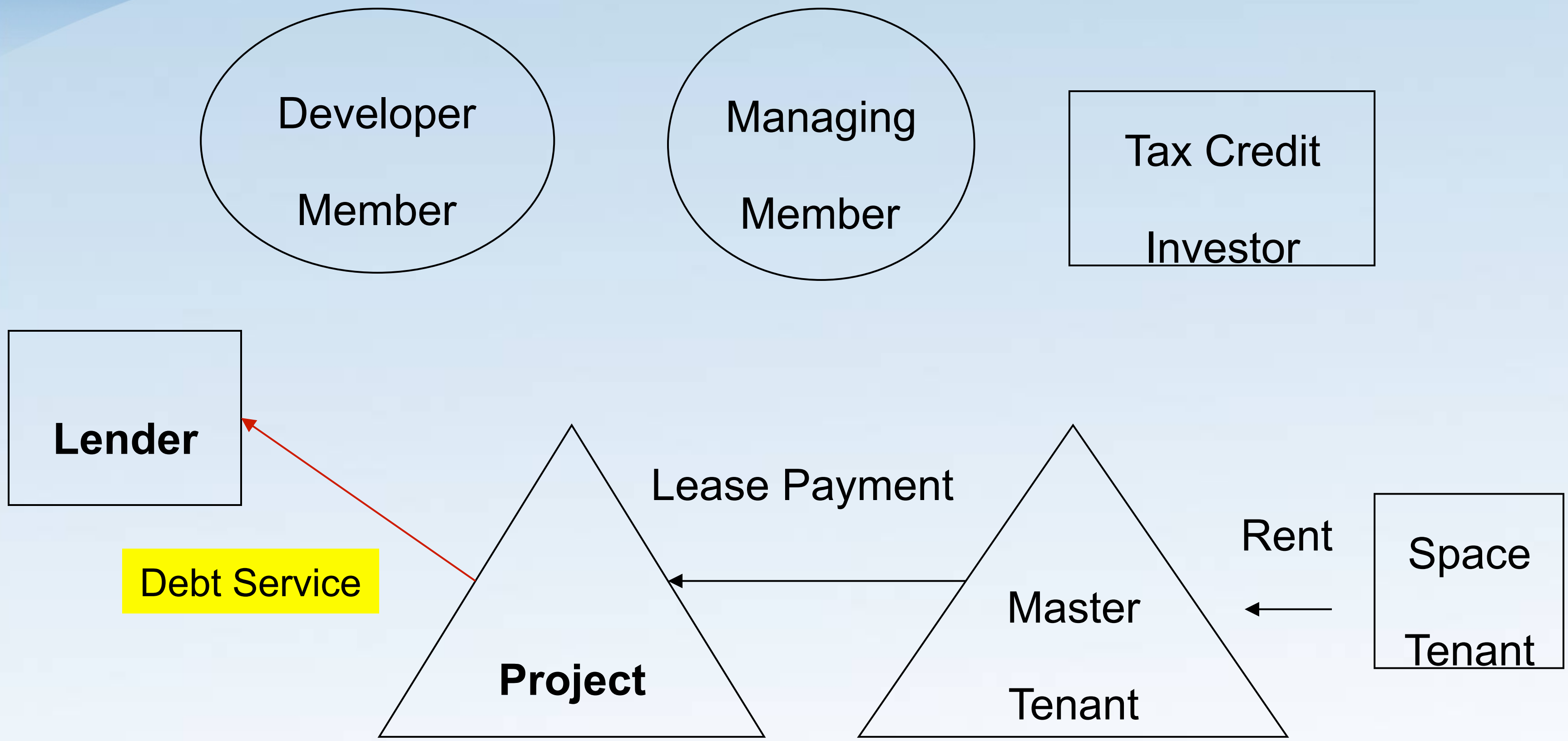
Operations—Step 2, MT Pays Lease



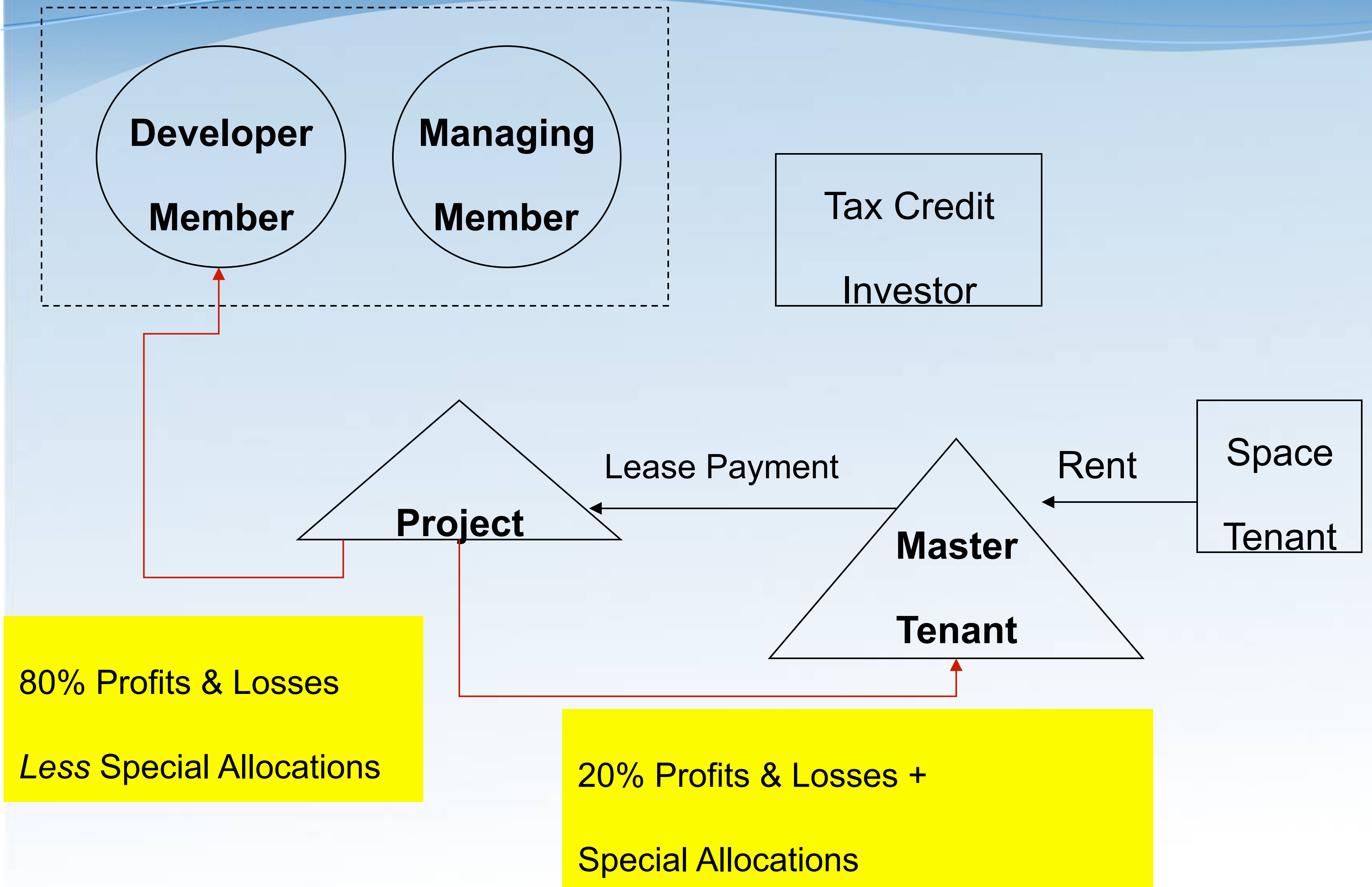
Note: Lease Payment generally

NOI less preferred return

Operations—Step 3, Debt Service



Operations—Step 4, Project Distribution



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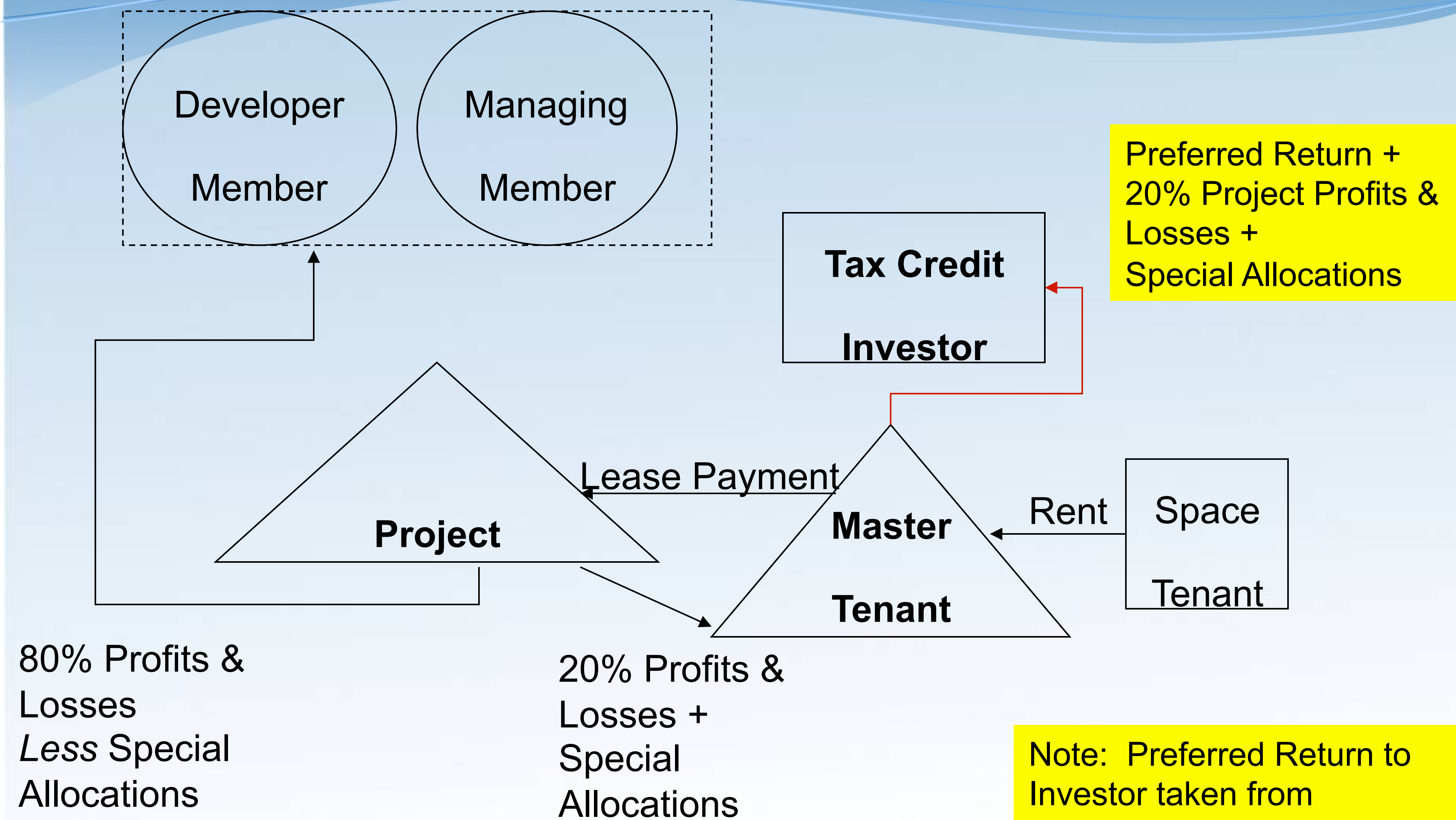
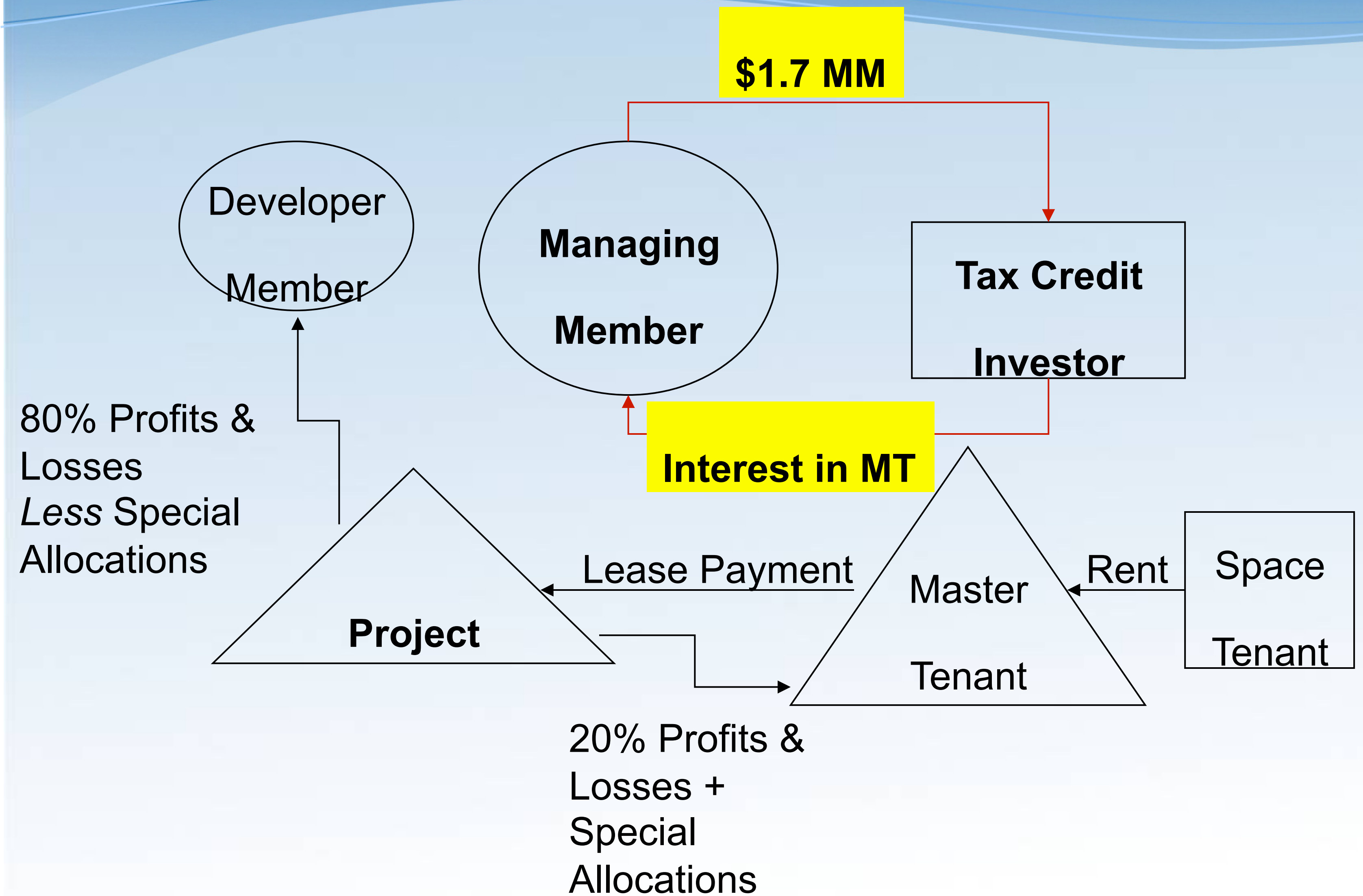
Operations—Step 5, MT Distribution



Note: Preferred Return to Investor taken from difference between Rent and Lease Payments

Exercise of Put—Sixth Year After Placed In Service Date



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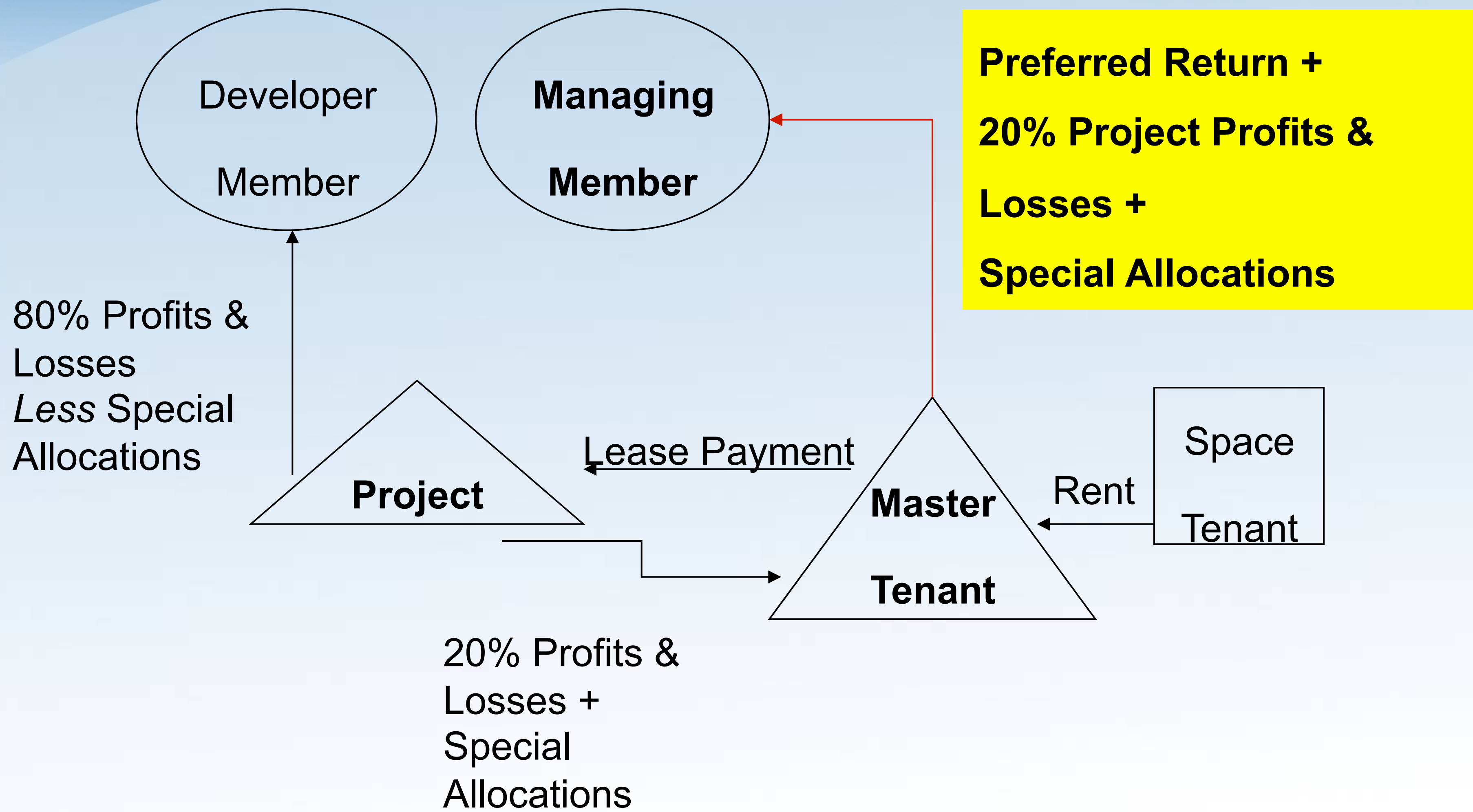
After Exercise of Put



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New Markets Tax Credit (NMTC) Basics

- Designed to encourage private investment in businesses and real estate projects in low-income communities.

- Administered by the Internal Revenue Service and the Community Development Financial Institutions (CDFI) Fund of the U.S. Treasury

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Snapshot of New Markets Tax Credits Activity

NMTC Round	Total Allocation
1	$127,000,000
4	$53,000,000
5	$60,000,000
6	$40,000,000
7	$35,000,000
8	$28,000,000
Total:	$343,000,000

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NMTC Basics

- Investors must be taxpaying entities.
- Credit equals 39 percent of investment amount, claimed over 7 years and starting on the date when the investment is received by the Community Development Entity (CDE):
    - 5% credit years 1-3; and
    - 6% credit in years 4-7
- $1 of investment yields a $.39 credit.
- For example, an investor that invests $1,000,000 in a CDE in 2007 will receive $50,000 in tax credits in 2007-2009 and $60,000 in 2010-2013, for a total of $390,000 in credits.

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NMTC Basics

- <u>Community Development Entity</u> (CDE): Receives an allocation and exchanges it for investor equity.

- <u>Qualified Active Low Income Community Business</u> (QALICB): Qualifying business or project that a CDE must invest in or lend to.

- <u>Low-Income Community</u> (LIC): Census tracts where QALICBs are located; must have greater than 20% poverty rate or less than 80% of median family income.

- <u>Qualified Equity Investments</u> (QEI): Investment into CDE that is used to calculate the tax credit amount.

- <u>Qualified Low Income Community Investment</u> (QLICI): QEI amount that goes through the CDE and into the QALICB in the form of a loan or investment.

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NMTC Basics

CDEs must use **Substantially All (85%)** of the proceeds from **Qualified Equity Investments (QEI)** to make **Qualified Low Income Community Investments (QLICI)** into **Qualified Active Low-Income Community Businesses (QALICB)** located in **Low-Income Communities (LIC)**.

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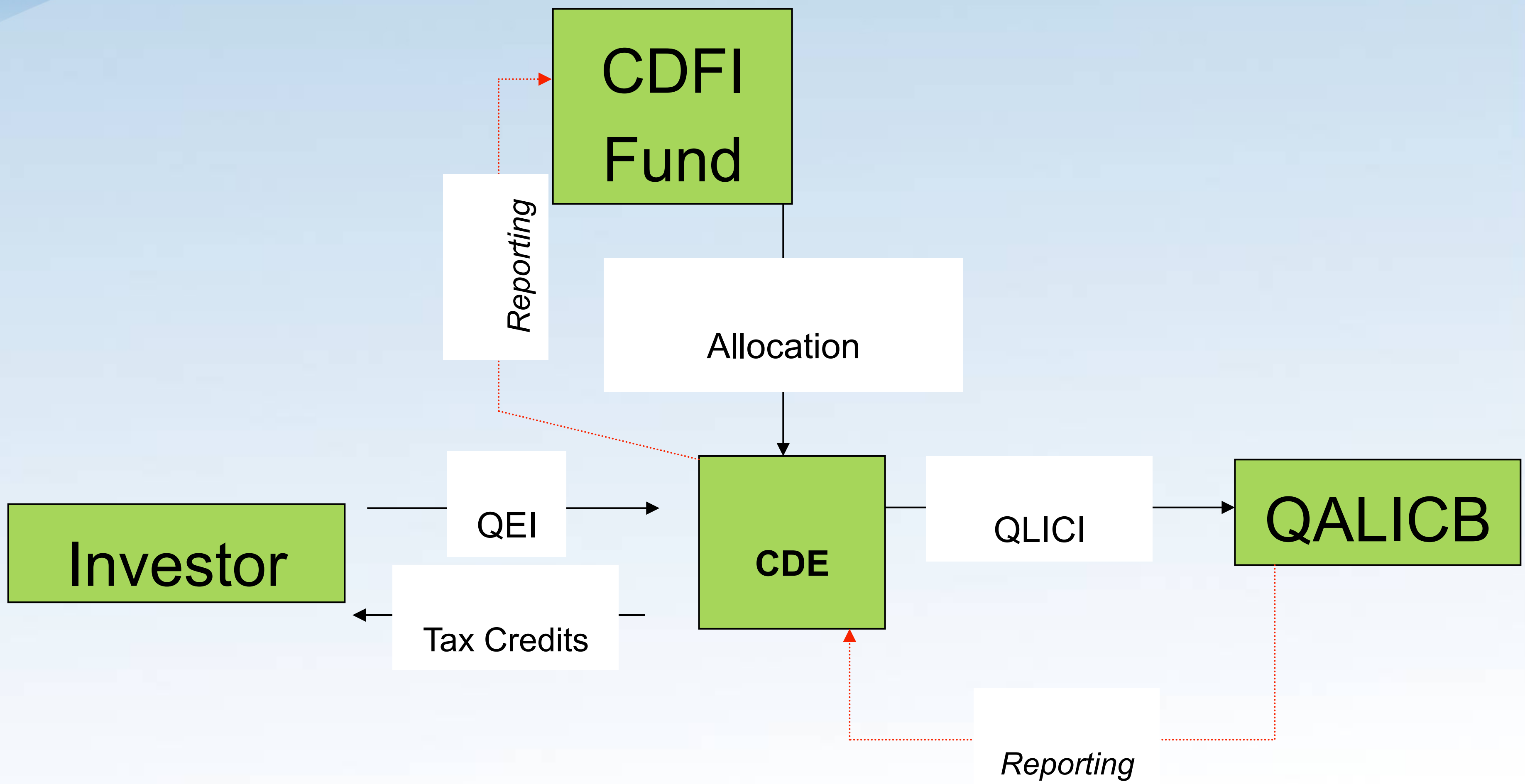
The NMTC Allocation and Investment Process



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Comparison of Tax Credits

	Federal HTC	NMTC
Value	20% of qualified expenditures of project	39% of equity from investor to NTCIC for the project
Timing	At time building becomes occupied	Over 7 years, from date equity is put into project
Prices	$.95 to $1.00	$.68 to $.79
Recapture	If ownership changes, such as a foreclosure on the loan or bankruptcy. If the developer fails to get National Park Service approval for rehab or loses it by altering character defining features.	If: 1) QEI does not meet "substantially all" requirement through failure to: a) invest 85%; b) meet QALICB requirements; or c) meet 1-year investment requirement; 2) CDE ceases to be a CDE; 3) CDE redeems investment

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Current Public Policy Issues: Tax Reform and the impact on social investment credits

- The impact of lowering corporate tax rates.
- The future of tax preferences including tax credits in a "simplified tax code."
- Is a grant more efficient than a credit?
- LIHTC vs. NMTC vs. HTC

Current Public Policy Issues: Recent Court Cases

- Virginia Tax Credit Fund v. Commissioner
- Boardwalk Hall v. Commissioner
- IRS arguments:
  - Is the partnership a true partnership?
    - Do the partners have real risk?
    - Do they have both upside and downside potential?
    - Do developer guaranties eliminate investor risk?
  - Is there economic substance?
    - Is there a pre-tax motive?
  - Is the transfer of credits in a partnership really a disguised sale of property subject to ordinary income tax?

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NTCIC Public Policy Priorities

1. Win Passage of CAPP Act:
2. Protect federal HTC from changes due to deficit reduction and tax reform.
3. Promote growth of HTC.
4. Strengthen federal HTC program within NPS.
5. Strengthen state HTC programs.

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