

Federal Historic Tax Credits Update

RevitalizeWA! 2018 Annual Conference
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Water Street, Port Townsend c. 1920

Making the Most of Historic Tax Credits:
Tax Credit Essentials – Powerful Tools in
Preserving and Revitalizing Historic Architecture

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Arctic Club Hotel, Seattle

Stephen Day Architecture PLLC focuses on:

- Preservation architecture
- Historic properties re-development and partnership structuring
- Design analysis and research serving historic properties redevelopment
- National Register nominations
- National Park Service Parts 1, 2, 3

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Colman Automotive Building, Seattle

Tax Credit Segment:

- I. Background on the Credits
- II. Basic Rules for the Credits – Updated in 2018
- III. Using the Credits – For-Profit and Non-Profit Users
- IV. Tax Credit Project Checklist



Hastings Building, Port Townsend, WA

I. BACKGROUND

Tax Credits and tax credit laws can be great tools to use in architectural preservation

Can produce needed cash equity early in these projects

Credits can turn marginal projects into feasible projects



Anhalt Apartment Building, Seattle

*National Trust Conference
Planning Successful Tax Credit Rehabilitations*

I. BACKGROUND – Legal Foundation for the Credits

Historic Preservation is a “legitimate governmental role” (Penn Central v. New York City), upholding incentive programs in exchange for limits on demolition and alteration of landmarks...



Grand Central Station, New York

PROJECT: ARCTIC CLUB

- Arctic Club Hotel, Seattle
- Approximately \$29 million in qualified rehab expenses
- Approximately \$5.8 million in tax credits to investors

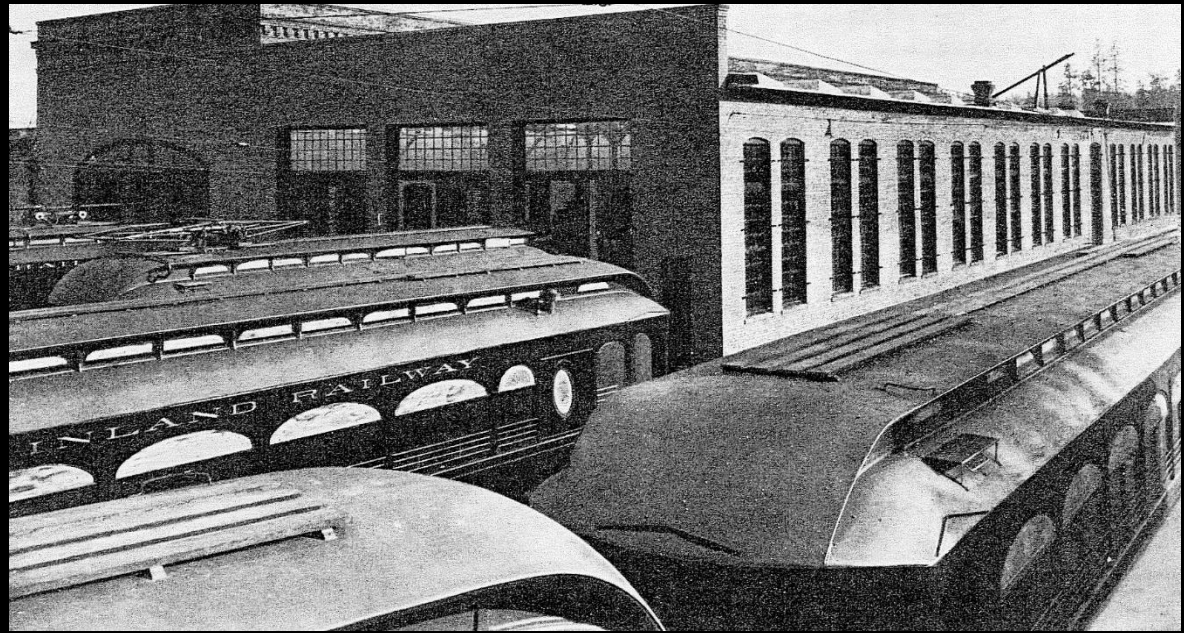


Property of Museum of History & Industry, Seattle

Arctic Club Hotel Seattle

PROJECT: SPOKANE & INLAND EMPIRE RAILROAD

- Former railroad fabrication facilities, converted to office and café uses
- Approximately \$14 million in qualified rehab expenses
- Approximately \$2.8 million in tax credits to investors



Spokane & Inland Empire RR, Spokane, 1911

PROJECT: HOLLEY MASON BUILDING

- Industrial lofts, long unused – converted to office lofts
- Approximately \$6.0 million in qualified rehab expenses
- \$1,200,000 in tax credits to investors in single entity structure



Holley Mason Building, Spokane

PROJECT: THE INN AT LYNDEN

- Main Street department store (closed for decades) – converted to boutique hotel and retail
- Approximately \$6.6 million in qualified rehab expenses
- \$1,300,000 in tax credits to investors in single entity structure



Waples Department Store, Lynden, WA
(The Inn at Lynden)

PROJECT: ANHALT APARTMENTS

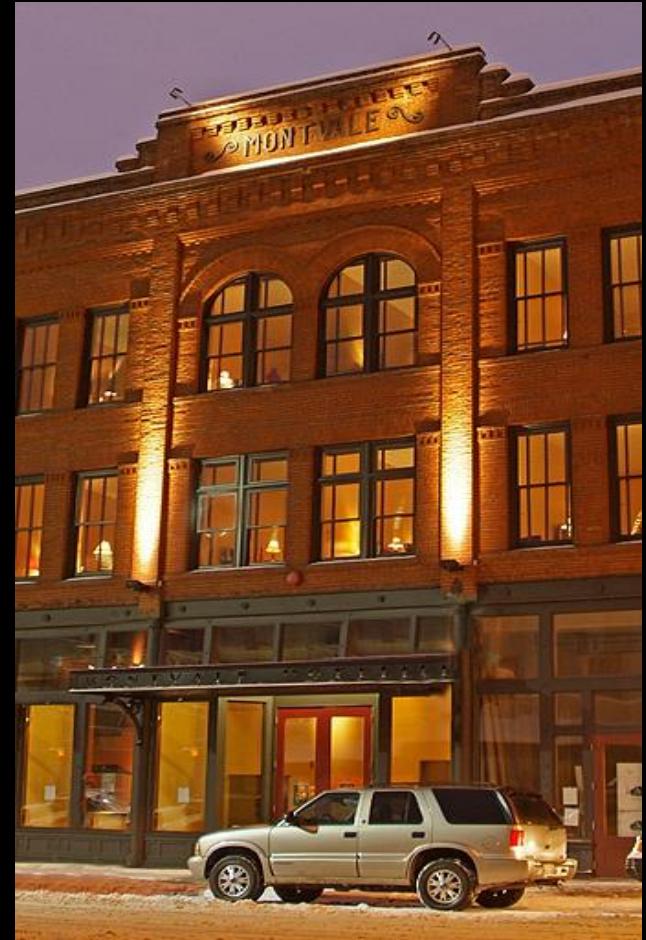
- Classic Anhalt apartment complex on Capitol Hill, Seattle
- Approximately \$11 million in qualified rehab expenses
- \$2.2 million in tax credits to investors in single entity structure



Anhalt Apartment Building, Seattle, WA

PROJECT: THE MONTVALE HOTEL

- Historic hotel development
- Approximately \$1.5 million in qualified rehab expenses
- \$300,000 in tax credits to investors in single entity structure



Montvale Hotel, Spokane

PROJECT: THE “FIVE & DIME”

- FW WOOLWORTH BUILDING converted to restaurant and small hotel
- Approximately \$1.3 million in qualified rehab expenses
- \$260,000 in tax credits to investors in single entity structure



The Five & Dime, Clarksdale, Mississippi

II. THE HISTORIC TAX CREDIT PROGRAM: BASICS

A. WHAT IS THE PROGRAM?

- A 20% credit for the rehab of “certified historic structures”
- No longer available:

10% credit for the rehab of “non-historic” (non-certified) and non-residential structures built before 1936



Harold Poll Building, Seattle

FEDERAL INVESTMENT TAX CREDITS

20% Federal Tax Credit on Qualified Rehabilitation Expenditures

Example: For \$1,000,000 in rehab expenditures a \$200,000 credit can be taken.

FEDERAL INVESTMENT TAX CREDIT

WHO DOES WHAT?

STATE HISTORIC PRESERVATION OFFICE

- Technical assistance (consultation)
- Initial contact with property owners
- Reviews Tax Credit Applications



NATIONAL PARK SERVICE

- Technical assistance (publications)
- Administers Tax Credit program
- **CERTIFIES** National Register listings and Rehabilitations for Tax Credit program



BECOMING A CERTIFIED PROJECT

Complete a 3-part application

Part 1 – Evaluation of Significance



UNITED STATES DEPARTMENT OF THE INTERIOR
NATIONAL PARK SERVICE
HISTORIC PRESERVATION CERTIFICATION APPLICATION
PART 1 – EVALUATION OF SIGNIFICANCE

This form is used to evaluate the significance of a historic property and to determine whether it is eligible for listing in the National Register of Historic Places. It includes sections for project information, evaluation criteria, and a summary of findings.

Part 2 – Description of Rehabilitation



UNITED STATES DEPARTMENT OF THE INTERIOR
NATIONAL PARK SERVICE
HISTORIC PRESERVATION CERTIFICATION APPLICATION
PART 2 – DESCRIPTION OF REHABILITATION

This form is used to describe the rehabilitation work performed on a historic property. It includes sections for project information, a detailed description of the work, and a list of materials and methods used.

Part 3 – Request for Certification of Completed Work



UNITED STATES DEPARTMENT OF THE INTERIOR
NATIONAL PARK SERVICE
HISTORIC PRESERVATION CERTIFICATION APPLICATION
REQUEST FOR CERTIFICATION OF COMPLETED WORK

This form is used to request certification of completed work on a historic property. It includes sections for project information, a summary of the work, and a request for certification.

FEDERAL INVESTMENT TAX CREDIT

NATIONWIDE

Since 1976 when the program began:

43,328 projects nationwide

\$90 Billion Total Rehab Expend.

~1,100 projects / year

~\$5-6 billion / year

FEDERAL INVESTMENT TAX CREDIT

STATS IN WASHINGTON STATE

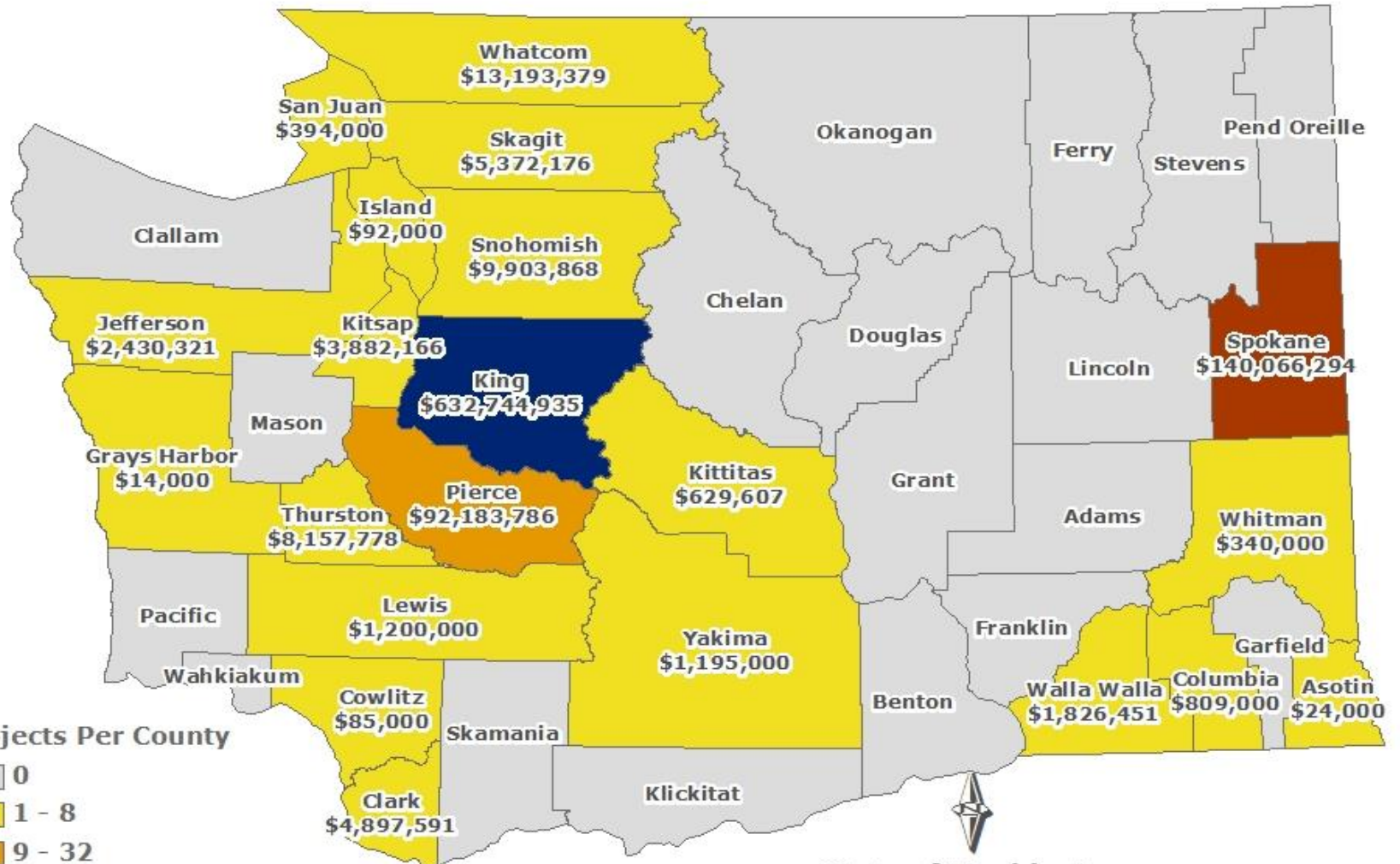
Since 1978 when the program began:

289 projects statewide
\$1.13 Billion Total Rehab Expend.

129 Seattle projects for
\$779 million Total QRE
~\$6.04 million / project

60 Spokane projects for
\$159 million Total QRE
~\$2.65 million / project

Certified Rehab Projects & Totals by County 1977 - 2013



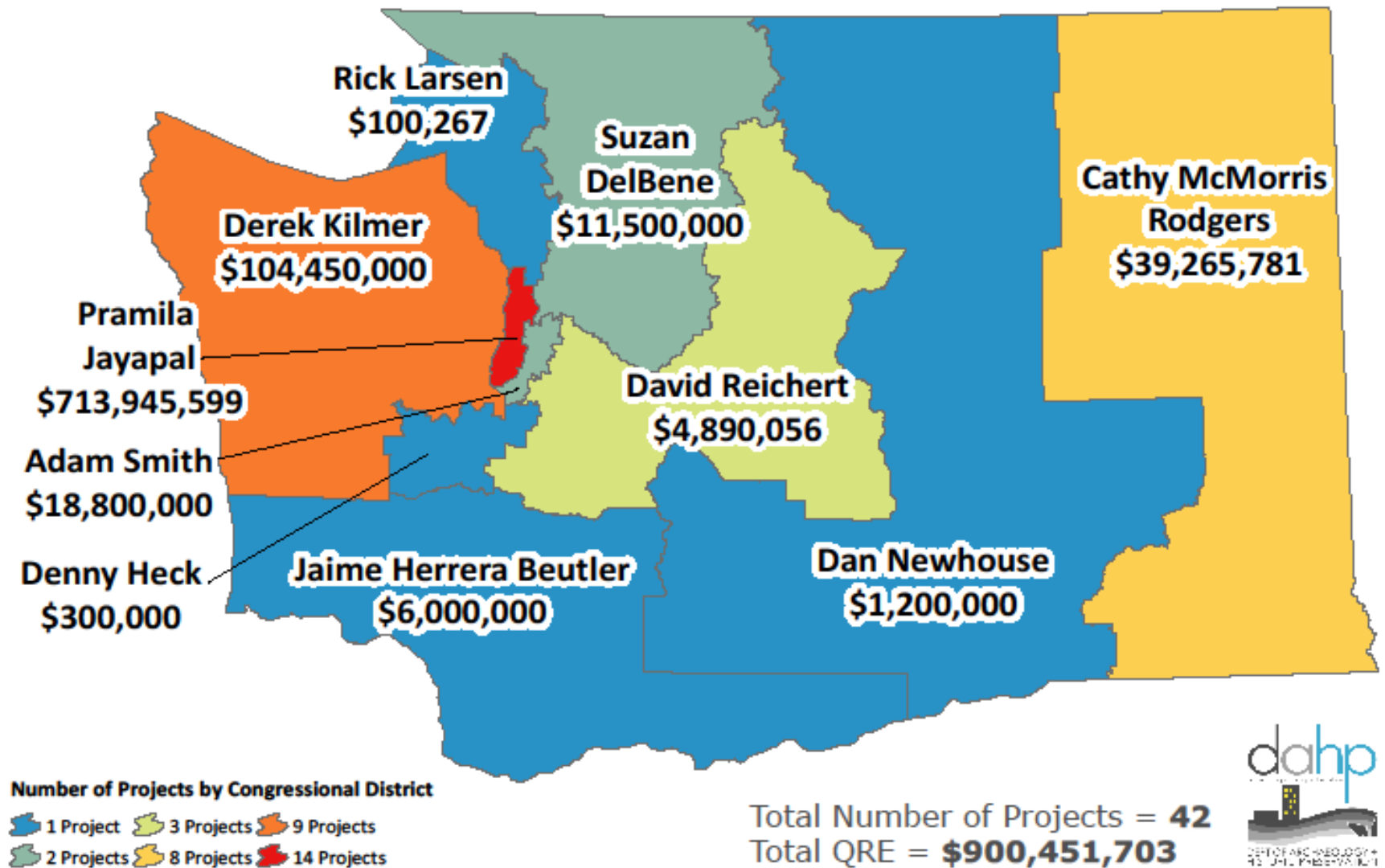
Projects Per County

- 0
- 1 - 8
- 9 - 32
- 33 - 55
- 56 - 123

State of Washington
Department of Archaeology and Historic Preservation

Map Created January 2014

HTC Pending Certification (as of 2017)



FEDERAL INVESTMENT TAX CREDIT

SOCIOECONOMIC IMPACTS

- **Jobs created** (2.4 million 1976-2012; ~60,000 in 2012)
- **Increased property values** – reuse vs. blight
- **Cumulative Economic Impact** = \$245.2 billion in output
 - GDP = \$121.2 billion – Government, Services, Finance/Ins./Real Estate, Retail, Wholesale, Transp/Utilities, Manufacturing, Construction, Mining, Agriculture
 - Personal income = \$89.1 billion
- **Cost of program vs. net gain in Federal tax receipts**
 - (\$20.5 billion in tax credits vs. NET GAIN \$25.9 billion in Federal tax receipts)
- **Environmental impact** – “the greenest building”
- **Social impact** – maintaining community character / sense of place

FEDERAL INVESTMENT TAX CREDIT

PROJECTS AT A DISADVANTAGE

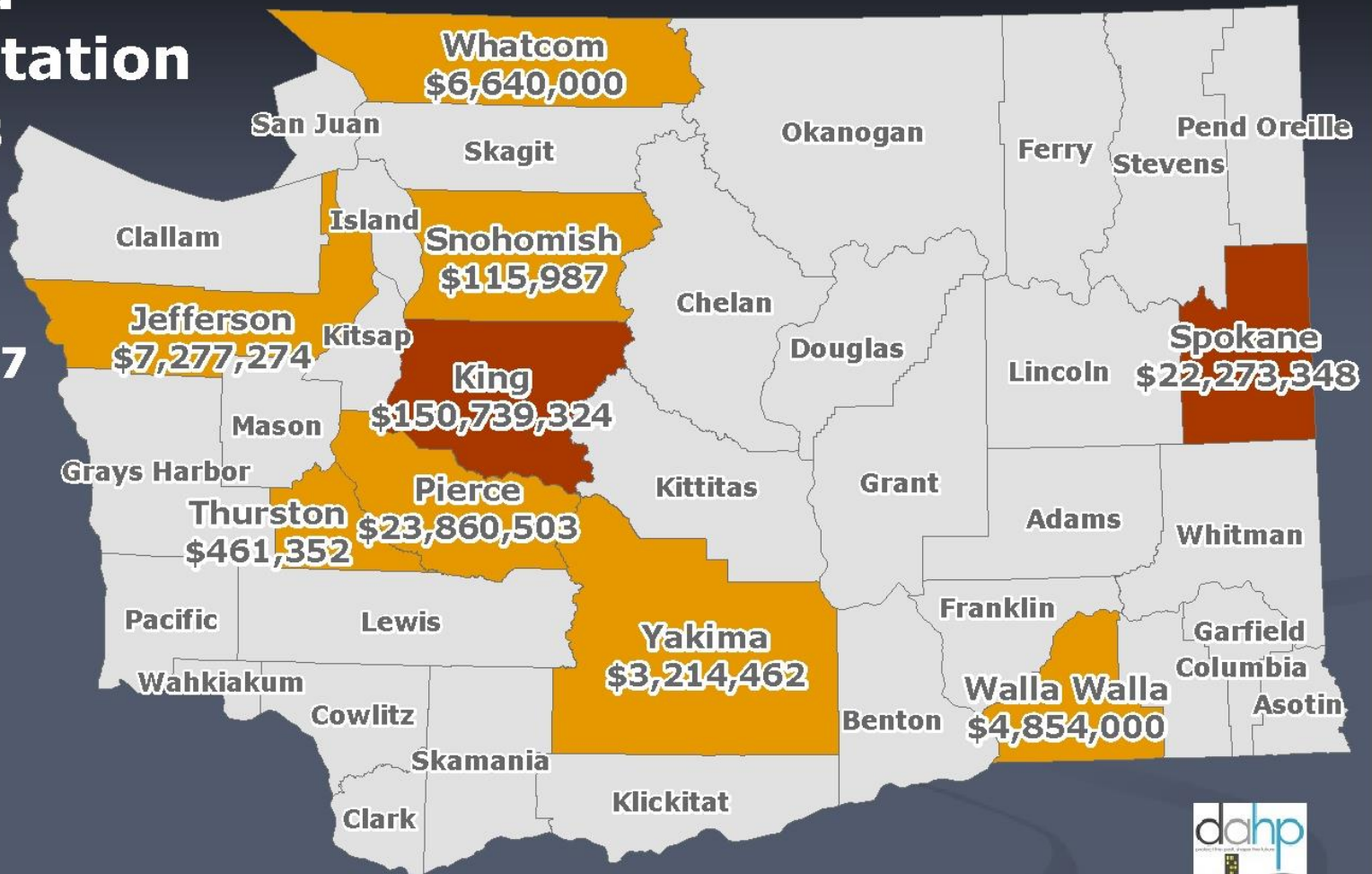
- **Smaller Projects**
- **In Communities with little or no knowledge of program**
- **In areas where technical expertise in preservation and craftsmanship is limited**
- **Those that do not meet Qualified Expenditure Requirements**

Addressing Program Shortfalls

- **Outreach:**
 - **CLGs reaching out to property owners and developers**
 - **Encourages development in smaller communities**
- **Education:**
 - **Planned workshops with focus on Eastern and Central Washington**
 - **Learn from other states**

Certified Rehabilitation Projects per County

2013 - 2017



Number of Projects

0 Projects

1 Project

8 Projects

9 Projects

Total Statewide Certified Rehabilitation Amount = \$219,436,250
 Total Number of Projects = 25



Map Created: 7/2017
 Map Authors: M. McLemore & N. Yann

FEDERAL INVESTMENT TAX CREDIT

FOUR BASIC REQUIREMENTS

1

The property must be individually listed on the **NATIONAL REGISTER** of Historic Places or be certified as a contributing property in a National Register listed Historic District

FEDERAL INVESTMENT TAX CREDIT

FOUR BASIC REQUIREMENTS

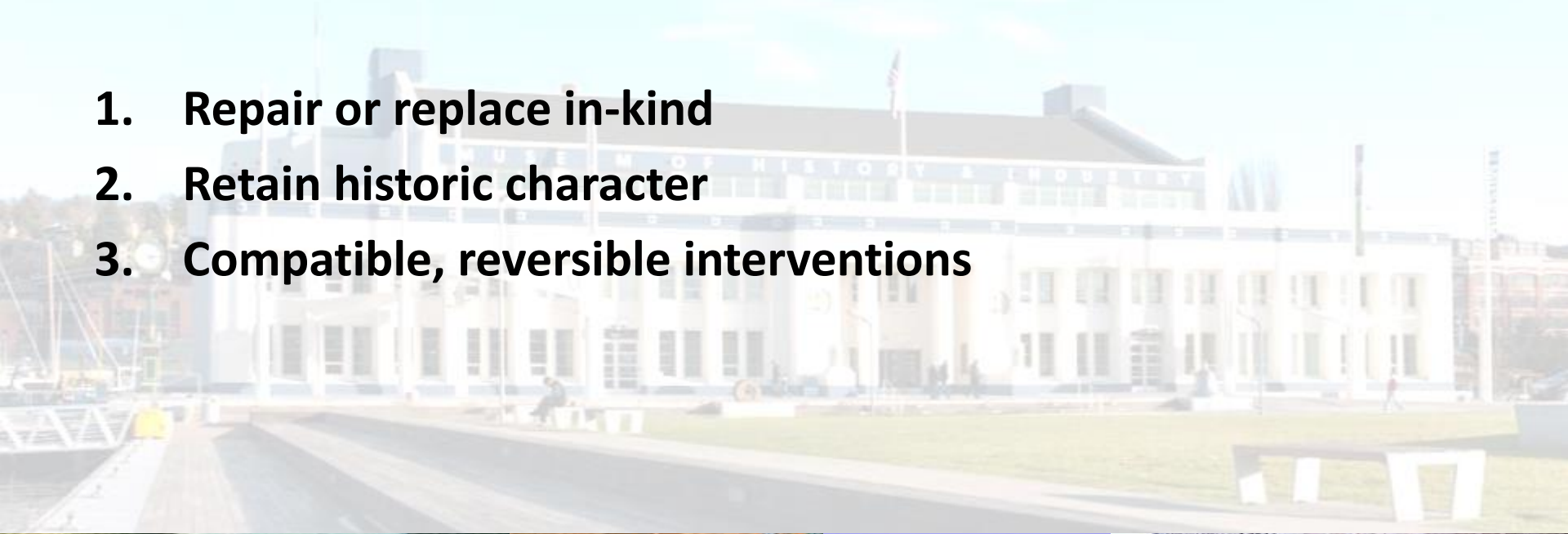
2

The proposed rehabilitation must meet the Secretary of the Interior's **STANDARDS** for the Treatment of Historic Properties.

SECRETARY OF THE INTERIOR'S STANDARDS

3 BASIC PRINCIPLES

1. Repair or replace in-kind
2. Retain historic character
3. Compatible, reversible interventions



FEDERAL INVESTMENT TAX CREDIT

FOUR BASIC REQUIREMENTS

3 The project must be **SUBSTANTIAL** – meaning the amount spent on the rehab must be at least \$5,000 and meet or exceed the IRS definition of the adjusted basis of the building.

Normally this means the value of the building itself, minus any depreciation and land value.

FEDERAL INVESTMENT TAX CREDIT

FOUR BASIC REQUIREMENTS

4

The property must be **INCOME PRODUCING**, including commercial, office, retail, and rental residential.

FEDERAL INVESTMENT TAX CREDIT

WHO QUALIFIES?

The applicant must be an **active participant** in the development of the project, usually the owner, but often a group of investors forming a limited partnership or corporation.

Cannot be a non-profit or government entity unless a private entity is established (limited partnership, LLC, etc.)

II. BASICS

HOW LARGE OF A TAX CREDIT IS AVAILABLE?

- **Federal Historic** tax credit = 20% of the “qualified rehabilitation expenses” (QRE’s)
- Example: \$5 million in QRE’s provides possibility of \$1 million in tax credits



Colman Automotive Building, Seattle

II. BASICS

HOW DO THESE PROJECTS GENERATE CASH?

- Rehab tax credits used by owners or long term lessees of certified historic structures
- Can be used by individuals in limited circumstances
- Taxable corporations are typical credit users



Wellman Building, Jamestown, NY

II. BASICS

WHAT CHANGED WITH THE PROGRAM IN 2017?

- 10% Rehab Credit eliminated
- 20% Credit must be spread out over 5 years (previously could be claimed over 20 years, or all at one time – this affects value of the credit)

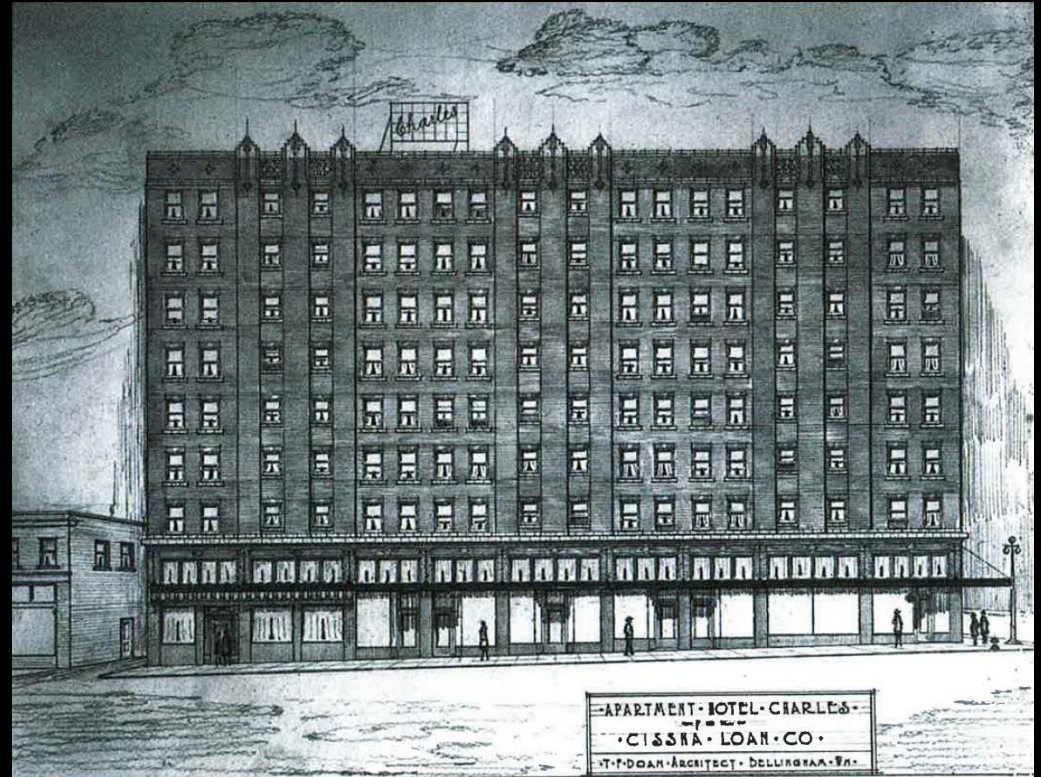


B.P.O.E (Elks Club) Building, Bellingham, WA
(this project will be subject to the new rules)

II. BASICS

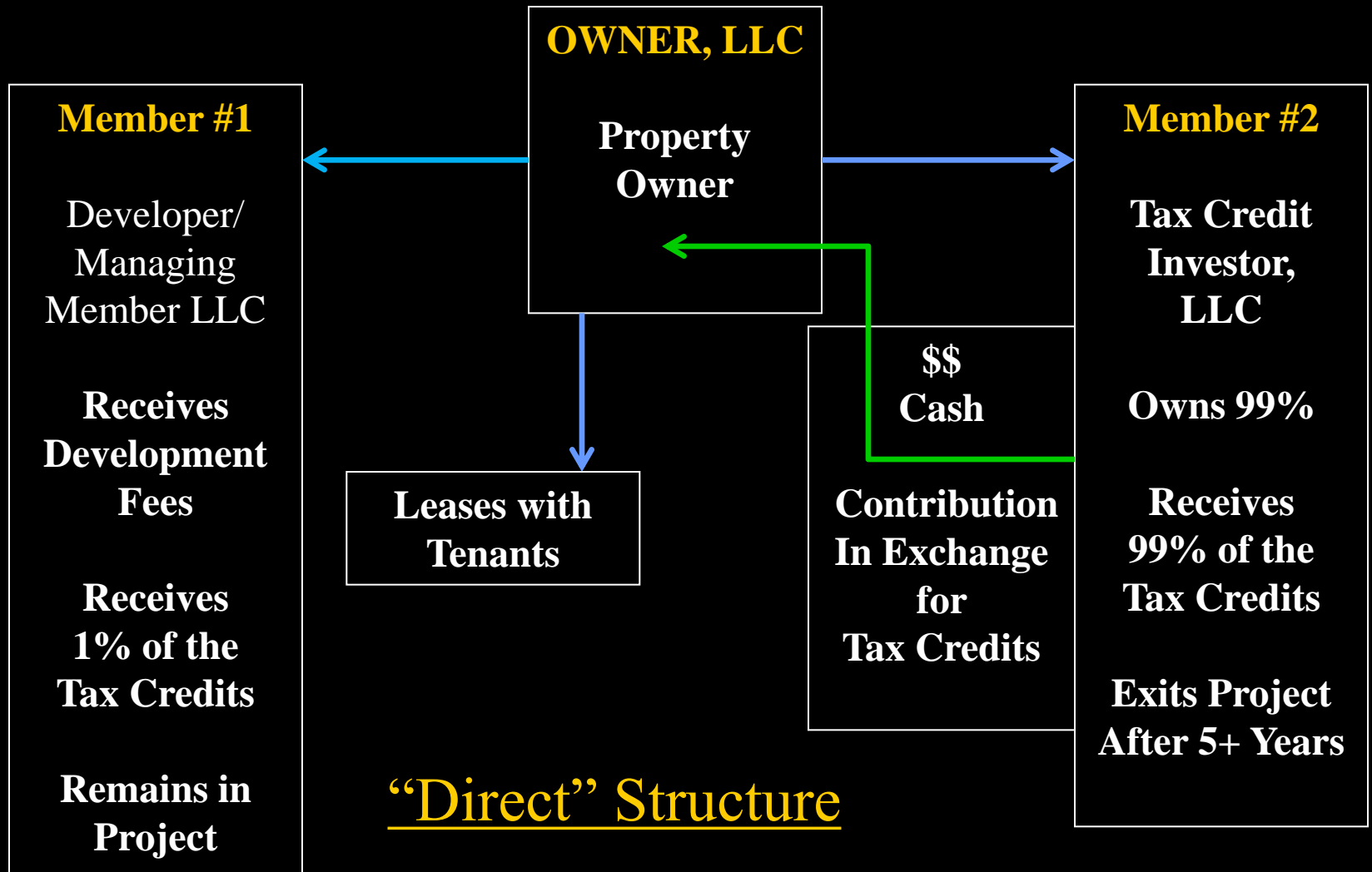
WHAT CHANGED WITH THE PROGRAM IN 2017?

- Existing projects can use the old rules only if:
- (a) in ownership of building by 1/1/18 and continuous through the rehab; and
- (b) rehab starts by mid-2018 and concludes QRE work by mid-2020 (except for phased projects, which can be spread over 60 months)

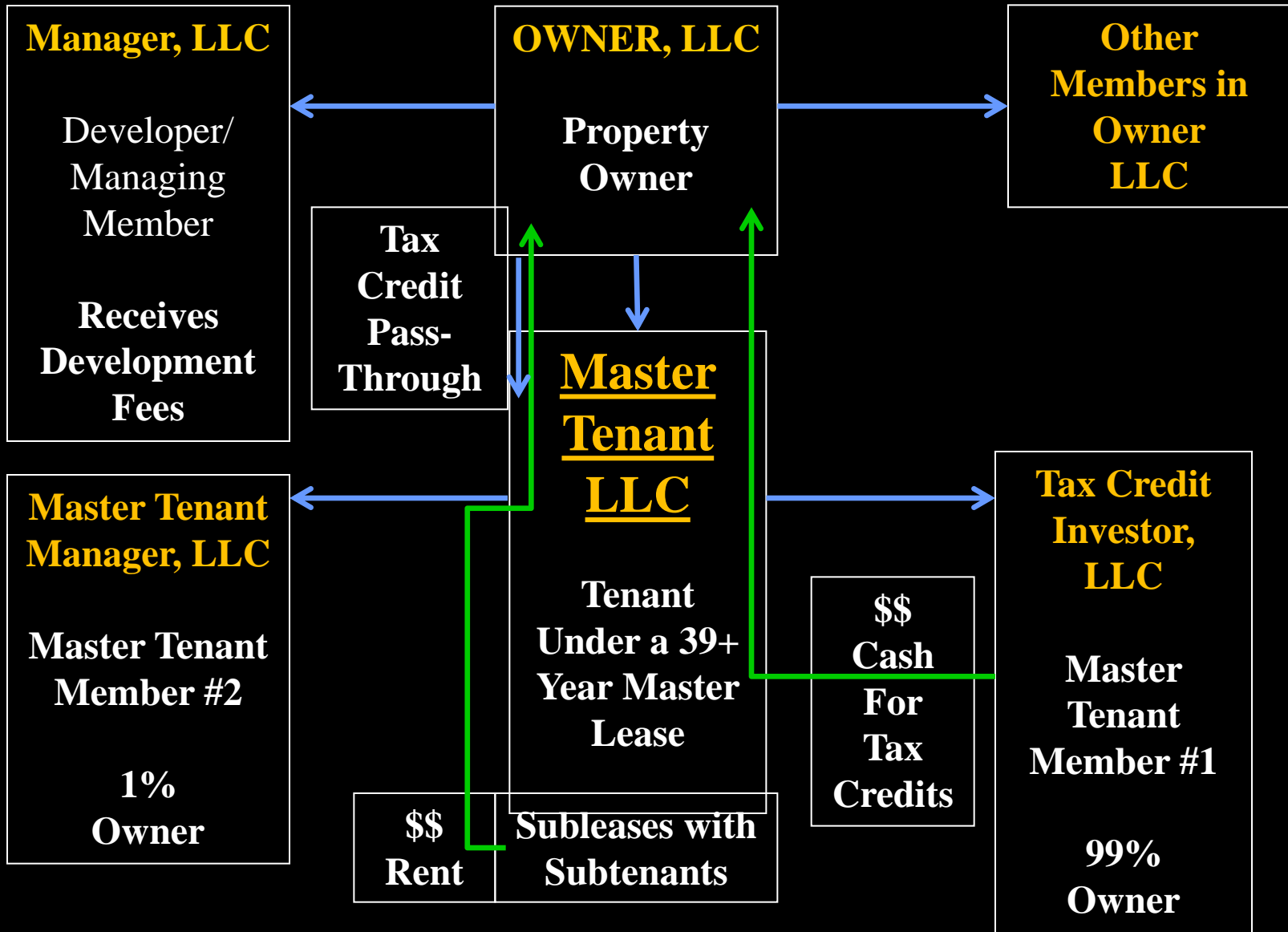


Apartment Hotel Cissna, Bellingham, WA
(this project will qualify under the old rules)

TYPICAL DEAL STRUCTURE #1



TYPICAL DEAL STRUCTURE #2



Master Lease Structure

“QUALIFIED REHAB EXPENDITURES” (QRE’S):

QRE’s can include certain hard and soft costs of rehab project, including construction costs, consultant fees, developer fees, interest during construction

Historic tax credits
= QRE x 20%



Pine Street Market, Portland OR

“QUALIFIED EXPENDITURES”

DO NOT INCLUDE:

Acquisition costs, additions to historic structures or new buildings, parking structures, parking lots, landscaping/site development costs



Arctic Club Hotel Penthouse, Seattle

BASICS

QUALIFYING BUILDING USES:

- **Not all building uses qualify**
- Uses must be income producing or used in a business
- Rental housing yes (for 20% credit only), but condo housing almost never



Hale Building, Spokane

BASICS

ALLOCATING OR TRANSFERRING CREDIT:

- Tax credits are not freely transferred
- Cannot be allocated without the underlying ownership interest or under a qualifying lease
- User must be an owner or master tenant – credits not “sold” to outside parties



United Carriage Building, Portland OR

BASICS

HOW LONG MUST TAX CREDIT USER BE IN PROJECT?

- Tax credit user must be owner or lessee for at least the minimum 5 year holding period
- Must be owner or lessee **before the rehab is placed in service** – cannot come in later



Holley Mason Building, Spokane

BASICS

- **TAX CREDIT RECAPTURE**

Can take place if tax credit user sells interest (or master lease is terminated) before end of 5 year holding period



Hastings Building, Port Townsend, WA, 1890

III. OPPORTUNITIES IN USING THE CREDITS

THE TAX CREDIT USER

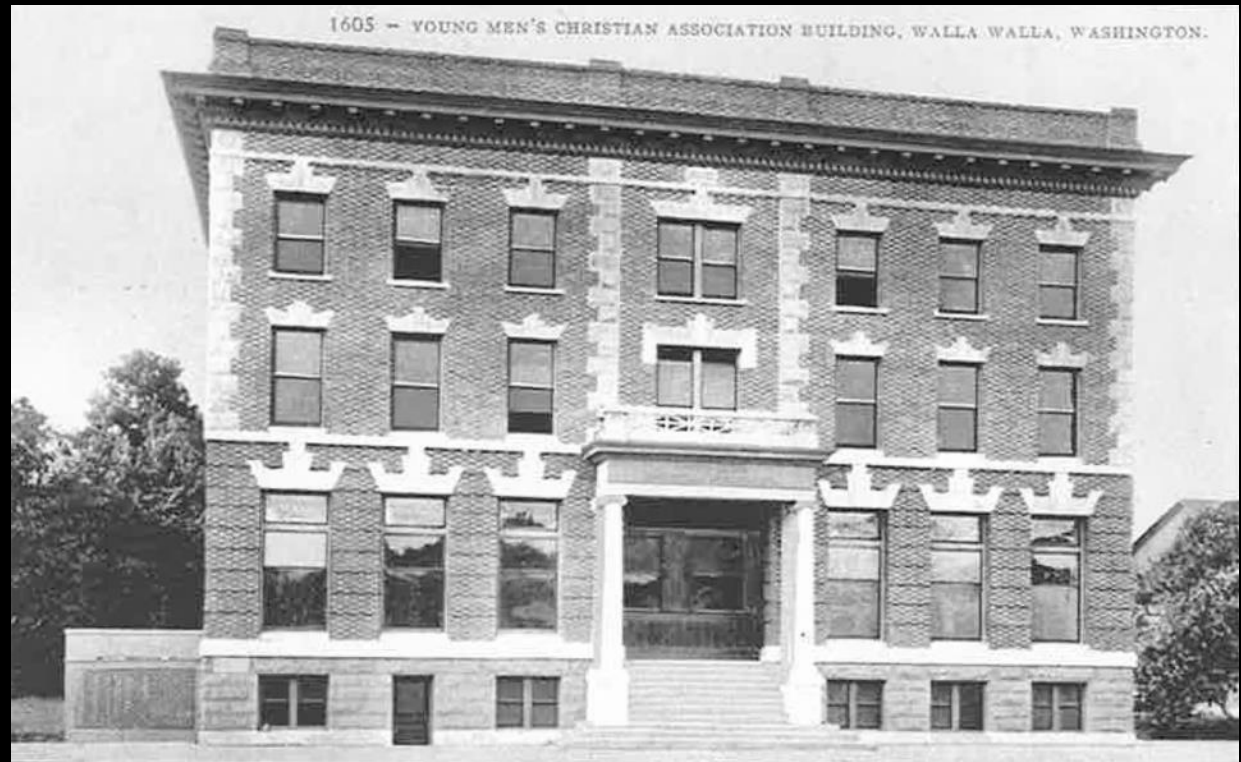
- Typically taxable corporations
- Often local lenders on smaller projects
- Can be individuals, if they are “real estate professionals”...more later



Lynden Department Store, Lynden, WA

THE TAX CREDIT USER

- T.C. Investor must have an ownership interest in project or be a master tenant under a permitted long-term lease



Historic YMCA, Walla Walla, WA

THE TAX CREDIT USER

- Tax credit investor typ.
- Pays anywhere between
- 65-85 cents per \$1 dollar
- of tax credit

- Tax credit “price” varies depending upon size, location, complexity and nature of the project



Northern State Hospital Farm, Sedro Wooley, WA

THE TAX CREDIT USER

- The tax credits must be allocated within the partnership in the same proportion as profits/losses are allocated
- If 99% of the credits are allocated to an investor, so must 99% of the profits/losses



The Stevens Building, Clarksdale, Mississippi

THE TAX CREDIT USER

- The minority owner is typically the developer and project manager – and the owner with day-to-day control
- The minority owner is paid fees that absorb the great majority of net cash flow



1600 East John Street, Seattle

THE TAX CREDIT USER

- After 5 year min. holding period, TC investor's interest is reduced to as low as 5%, often followed by a buy-out



Northern State Assembly Hall, Sedro Wooley, WA

THE TAX CREDIT USER:

SIGNIFICANT RECENT COURT DECISION

August 2012 Case (3rd Circuit):

“Historic Boardwalk Hall” Case

The Tax Credit Investor **MUST** have some level of financial risk and reward in the project –

Must be a “partner” in more than just name



Historic Boardwalk Hall, Atlantic City

THE TAX CREDIT USER

CHANGES IN THE TAX CODE WITH THE “STIMULUS ACT”

- Net effect is that more individuals can use the tax credits to reduce their personal income tax
- Increases the pool of potential tax credit investors



United Carriage Building, Portland OR

THE TAX CREDIT USER

- A “REAL ESTATE PROFESSIONAL” CAN BE A:
- Developer
- Broker
- Contractor
- Property Manager
- ...under certain circumstances (happy to discuss)...if you are a qualified real estate professional, you may qualify to personally use the tax credits. Otherwise you need to partner with a qualified investor.



Holley Mason Building, Spokane

OPPORTUNITIES IN USING THE CREDITS:

TAX EXEMPT ENTITIES AS OWNERS/DEVELOPERS

- TAX EXEMPT ENTITIES CANNOT USE THE CREDITS DIRECTLY
- So...tax exempt entity must either co-own the property with taxable entity or long term lease the property to a taxable entity



Northern State Hospital, Sedro Wooley, WA

TAX EXEMPT ENTITIES AS OWNERS/DEVELOPERS

- Tax exempt partner will typically own only a small portion of the entity –
- The tax credits must be allocated according to percentage of profit/loss interests



Northern State Hospital, Sedro Wooley, WA

TAX EXEMPT ENTITIES AND “DISQUALIFIED LEASES”

- “Disqualified leases” include leases to tax exempt entities that are:
- Longer than 20 years
- Contain extension options with predetermined price



Northern State Hospital, Sedro Wooley, WA

TAX EXEMPT ENTITIES AND “DISQUALIFIED LEASES”

- A project can still fully utilize the tax credits even if up to 50% of the space is leased under “disqualified leases”



Northern State Hospital, Sedro Wooley, WA

V. HISTORIC TAX CREDIT CHECKLIST

1. Is the building on the National Register or a contributing building in an NR listed historic district?
2. If not, does the building have the potential to be listed on National Register?
3. Are rehab costs in excess of adjusted basis (basically = value of building + improvements made since purchase, less land value)
4. Is the new plan compatible with re-use of significant historic elements?



V. BASIC HISTORIC TAX CREDIT CHECKLIST

5. Does the new plan require alterations (or users) that could jeopardize approvals?
6. Does the project schedule allow time for SHPO/NPS review and approvals?
7. Will tax credit investors be invested in the project by the time the renovated building is placed in service?
8. Experienced professionals on the team?



V. HISTORIC TAX CREDIT CHECKLIST

9. Is the lender involved early on in the project?
10. State tax credits available?
11. Property tax abatement available?



VI. THE HASTINGS BUILDING / HASTINGS LANDING

- 1890 Port Townsend
Victorian landmark, in
the Hastings family
ownership since its
original development by
Lucinda Hastings



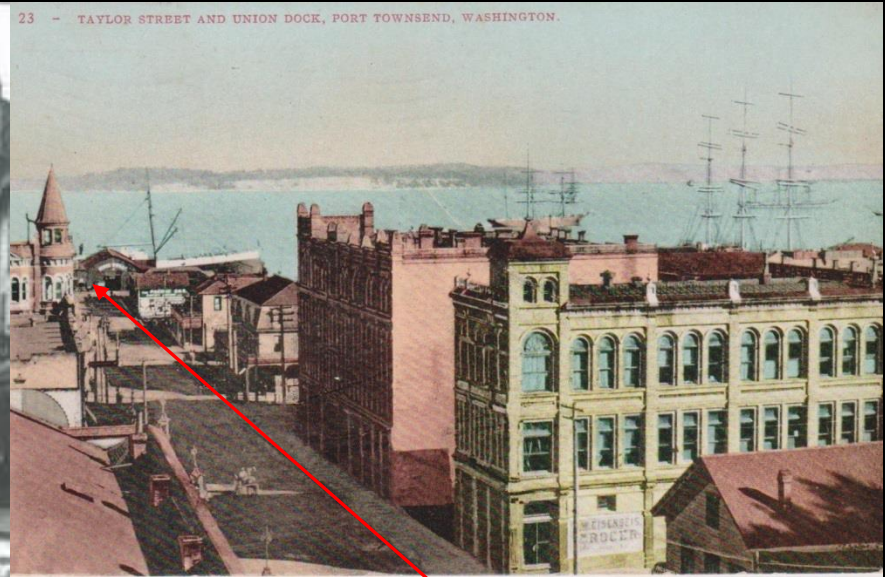
Hastings Building, Port Townsend, WA

VI. THE HASTINGS BUILDING / HASTINGS LANDING

- The Hastings Building was designed by Elmer H. Fisher, the architect who designed the Pioneer Building and many other Seattle structures built soon after the Great Fire of 1889



Water Street, Hastings Building, c. 1920



Taylor Street, Hastings Building, c. 1910

VI. THE HASTINGS BUILDING / HASTINGS LANDING

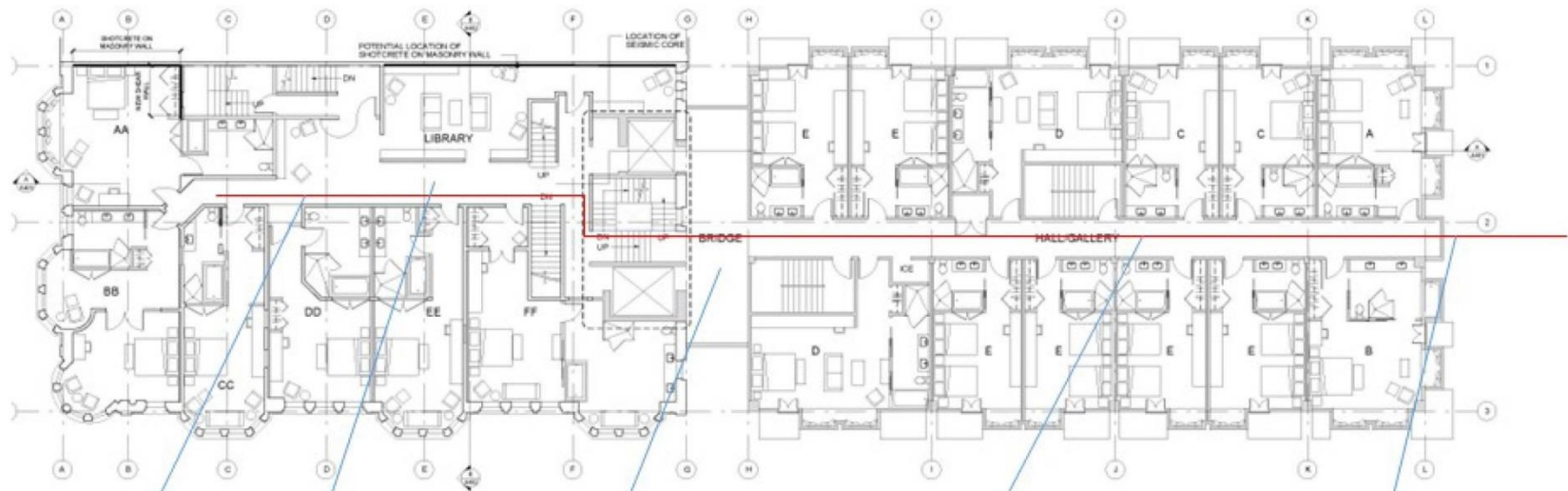
- Our firm is designing a complete rehabilitation of the Hastings Building, along with a major addition, converting the building to a boutique hotel, restaurant, and event spaces.



Interior Views, The Hastings Building, prior to rehabilitation

VI. THE HASTINGS BUILDING / HASTINGS LANDING

Historic Tax Credit Issues/Secretary of the Interior Standards: Must retain the historic atrium, circulation, historic character-defining elements (interior and exterior elements)



Sky-Atrium-Timeless

Historic architecture

Transition "Bridge" /stair /beach

Linear path connecting historic + modern

View to the Sea – timeless

"Buildings are Time Machines" (Hermann Czech)

VI. THE HASTINGS BUILDING / HASTINGS LANDING

Historic Tax Credit Issues/Secretary of the Interior Standards: New addition must be distinguished from the historic building, but be compatible in materials, forms, etc.



VI. THE HASTINGS BUILDING / HASTINGS LANDING

Historic Tax Credit Issues/Secretary of the Interior Standards: Must retain and restore where appropriate the historic character-defining elements (interior and exterior elements)



You Can Make Great Tax Credit Projects Happen.

Questions?

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Arctic Club Hotel, Seattle