Historic Tax Credits as a Development Tool

March 27, 2009
Columbia, South Carolina
The Players

- Developer/Owner
- State Historic Preservation Officer (SHPO)
- National Park Service
- Lender
- Investor / Credit Buyer (Federal & State if applicable)
What is a tax credit?

A *tax credit* is a dollar for dollar reduction to a taxpayer’s income tax liability.

A taxpayer claims a tax credit when it files its annual Federal income tax return.
## Credits vs. Deductions

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>$1000</td>
<td>$1000</td>
</tr>
<tr>
<td>Less: Deductions</td>
<td>-200</td>
<td>0</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>800</td>
<td>1000</td>
</tr>
<tr>
<td>Tax @ 20%</td>
<td>160</td>
<td>200</td>
</tr>
<tr>
<td>Less: Credits</td>
<td>0</td>
<td>-200</td>
</tr>
<tr>
<td>Net Tax Due</td>
<td>160</td>
<td>0</td>
</tr>
</tbody>
</table>
How is it used?

- Governments use tax credits as an incentive for certain types of investment, such as community development, housing and commercial real estate production
- Common types of tax credits used today:
  - Historic Rehabilitation Tax Credit
  - State Tax Credits
  - Affordable Housing (Low Income Housing) Tax Credit
  - Energy Investment Tax Credits
  - New Markets Tax Credits
Who Can Use Credits?

- C Corporations Can Use Losses and Credits Against Ordinary Income and Taxes
  - Generally cannot use credits against AMT
    - H.R. 3221 legislation “fixed” this issue
- Individuals Limited Under Passive Loss Rules to Approximately $8,750/Year
- Limitations on “Closely-Held” Corporations
Tax Credit Use in Real Estate Projects

- Tax Credits generate equity for a project as they are sold to investors seeking to use them on their tax returns.
- Market is almost exclusively corporations.
- Prices paid for Tax Credits fluctuate in the market.
- Limited Partnerships and Limited Liability Companies are the preferred vehicle to “flow” out the credits and other tax attributes.
Qualifying for the Historic Credit

Does the building qualify?

- **Certified Historic Structure - 20% Credit**
  Age Doesn’t Matter: must be either in a historic district or listed on the National Register

- **Non-Historic Structure - 10% Credit**
  Age Matters - Location Doesn’t Matter: must have been originally placed in service before 1936.
Calculating the Credit

Qualified Rehabilitation Expenditures (QRE’s) typically include costs for:

- Hard costs of rehab/construction
- Architect and engineering fees
- Developer fees
- Interior demolition
- Construction period interest
Calculating the Credit

What is NOT a QRE?

– Land and Interest Carry on Land
– Building Acquisition and Interest Carry on Acquisition
– Acquisition Related Costs
– Site Improvements and Landscaping
– Enlargements and Demolition
– Personal Property
– Tax Exempt Use Property
Calculating the Credit

When can QRE’s be Incurred to Qualify?

– Starting at the beginning of the rehab project
– Throughout the test period for determining Substantial Rehabilitation
– Through the end of the year in which the Substantial Rehab Test ends
Calculating the Credit

QREs $1,000,000

Credit Rate: 20%

Credits: $200,000

* Credit Rate is sometimes 10%.
The Chamberlin, Hampton, VA
The Chamberlin, Hampton, VA
The Chamberlin, Hampton, VA
Claiming the Credit

What triggers the credit?

– Placement in Service

- CO
- TCO
- U & O
Equity Calculation

$1,000,000 (HTC to Project)  
\times \quad 99.99\% \ (\text{typical investor allocation})  

$999,900 (HTC available to Investor)  
\times \quad $1.10 \ (\text{Price per $1 of HTC})  

$1,099,890 (Equity Raised)
Downside of Taking the Credit

- Potential for Reduced Depreciation
- Potential For Additional Rehab Costs
- Architectural Requirements May Not Meet Needs of the Market
- May Require Partners in Ownership
- Transaction Costs
- Risk of Recapture
Downside of Taking the Credit

The Risk of Recapture

– Triggering Recapture
  • Disposition of the Property
  • Disposition of at least 1/3 of Partnership Interest
  • Noncompliance

– Amount of Recapture
  • 100% in the first year after Placed in Service date
  • Declines 20% every 12 months thereafter
Other Tax Credit Issues

– Development Fee
  • Amount
  • Payment

– Tax Exempt Use Property
  • Check the tenants!!!

– Basis Adjustment and Impact on Depreciation
State Tax Credits

– The value of a state credit can be diminished by the federal tax system

– State credit laws vary in many respects from state to state

– There is a limited universe of buyers
South Carolina Historic Tax Credit

- Income Producing Property vs. Certified Historic Residential structure
- Qualification for the 20% Federal Rehabilitation Credit (Section 47) qualifies the project for 10% State Rehabilitation Credit
- Credit taken in equal installments over 5 years
- Allocation among partners
South Carolina Textile Credit

- Qualifications
  - Abandoned textile mill
  - Textile Mill Site - definition
  - Definition of facility includes ancillary uses
  - 80% of the mill has been non operational for at least 1 year immediately preceding Notice of Intent to Rehabilitate
South Carolina Textile Credit

- Process
  - Notice of Intent to Rehabilitate
  - Positive Vote of local governing body
  - Credit taken in equal, annual installments over five years
  - Carry forward un-used credit for five years
  - Allocation of Credit
Ware Shoals Inn, Ware Shoals SC
Ware Shoals Inn, Ware Shoals SC
Ware Shoals Inn, Ware Shoals SC
Ware Shoals Inn, Ware Shoals, SC

• Built in 1923 by Ware Shoals Manufacturing Co
• Public Gathering Place
• Community Center
• Textile operations have moved on
• Building survives
• Integral part of the History of Ware Shoals
• Currently being restored
• Business plan centers around Senior Living
Woodside Mill, Greenville, SC
Plain Vanilla – Structure Diagram

**Project / Building**

All Rehab work and Operations. Cash Flow, Profit and Loss, Credits. Follow ownership percentages. Reduction of Building basis and Investor Capital account will happen in this structure.

**LP (Investor)**

Owns 99.99%

**Profits/Losses, Cash Flow, Credits**

**GP**

Owns 0.01%
Lease Pass Through Structure Diagram

Landlord (Lessor)
- Building Owner
- Pays Taxes, Insurance, Replacement Reserves, Building Depreciation

General Partner
- Owns 90%

Tax Credit Investor
- (Large Corp.)
- Owns 99.99%

Master Tenant (Lessee/Tenant)
- Pays Tenant Operating Expenses, Property Management Fee, Lease, Asset Management Fee, Preferred Return

CREDIT TAKEN HERE
- Profits/Losses, Cash Flow

Operating Tenant(s)
- Short Term Sub Lease

GP
- Owns 0.01%

Profits/Losses, Cash Flow

Master Tenant
- Owns 10%

Long Term Lease
- Lease Payment

Dashed lines indicate flow of profits and losses.
Contact Information

- Jonathan Gross, CPA, Principal
  704-332-9100 / jonathan.gross@reznickgroup.com

- Marshall Phillips, MBA, Senior Manager
  704-332-9100 / marshall.phillips@reznickgroup.com