HISTORIC
TAX CREDIT
COALITION

April 15, 2015

The Honorable Dean A. Heller
324 Hart Senate Office Building
United States Senate
Washington, DC 20510

The Honorable Michael F. Bennet
458 Russell Senate Office Building
United States Senate
Washington, DC 20510

RE: Historic Tax Credit

Dear Senators Heller and Bennet,

The Historic Tax Credit Coalition (HTCC) is pleased to follow up its testimony of April 7, 2015 before the Community Development and Infrastructure Working Group with this comment letter. This letter is supported by over 600 organizations in all 50 states who share our view that the federal Historic Tax Credit should be retained in the tax code. (See separate correspondence for sign-on letter.)

The HTCC is a non-profit organization dedicated to developing a consensus on ways to maintain and modernize the federal Historic Tax Credit (HTC). We have 57 organizational members including leading historic tax credit developers, investors, syndicators, tax attorneys, accountants and preservation consultants who are using the HTC as a financing tool to rehabilitate historic properties. You can learn more about the Coalition at www.historiccredit.com. The HTCC's activities include research on the economic impact of the HTC, the development of legislative and regulatory proposals to promote the simplification and more efficient use of the HTC, and efforts to foster greater coordination between the National Park Service, the Internal Revenue Service and the HTC industry.

The HTCC has undertaken a number of policy initiatives to represent the interests of our members. The Coalition worked with Members of Congress last session, for example, to introduce an historic tax credit modernization bill, the Creating American Prosperity through Preservation (CAPP) Act (S. 1141 and H.R. 5655). It also worked closely with the IRS in 2013 on Revenue Procedure 2014-12 that creates a safe harbor for HTC transactions and addresses issues raised by the Historic Boardwalk Hall, LLC v. Commissioner decision. It has worked with the National Park Service to find ways to better fund the program and to provide more data transparency. The HTCC has worked with Rutgers University to develop and refine the Preservation Economic Impact Model (PEIM) that measures the economic impact of historic tax credit transactions. Using PEIM, the Coalition, Rutgers and the National Park Service publish an

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annual report on the economic impact of the HTC. The HTCC also sponsors an annual Congressional reception to honor outstanding achievements in historic rehabilitation.

We strongly believe in the importance of retaining the Historic Tax Credit in the tax code as part of comprehensive tax reform. The HTC has been a successful driver of economic development in communities across the country – generating jobs, creating federal, state and local tax revenue, increasing family and business incomes, and spurring district-wide community revitalization. HTC-financed projects have a long track record of successful investment, including a high project success rate that far exceeds the real estate industry average and a very low tax credit recapture rate. The credit qualifies as a Public Welfare Investment under Office of the Comptroller of the Currency (OCC) regulations and is exempt from the Volcker Rule established by the Dodd–Frank Wall Street Reform and Consumer Protection Act. In November 2014, the HTCC responded to a request for comments from the OCC, FDIC and the Federal Reserve and advocated for recognition of the HTC as an eligible investment under the Community Reinvestment Act (CRA). The attached proposal was favorably received by CRA advocates and bank regulators.

Retention of this federal incentive is also important given the significant amount of rehabilitation work that still could be completed. While the HTC has made enormous strides rehabilitating anchor properties that led to the revitalization of entire commercial submarkets, tens of thousands of vacant and under-utilized historic buildings – rich in architectural heritage – remain that will continue to exert blighting influences on the surrounding community. With conventional loans for historic property transactions averaging only 65% of total project cost, historic rehabilitation projects are simply not economically feasible without this incentive. The 20 percent HTC is an essential source of capital that helps fill the financing gap for these nationally-recognized rehabilitation projects.

HTC Basics

The current program has its origins in the Tax Reform Act of 1976 which created a 60-month accelerated depreciation schedule for certified historic rehabilitation. The Revenue Act of 1978 established a 10% investment tax credit for the rehabilitation of buildings older than 20 years with special depreciation features. The purpose of these incentives, according to the legislative history, and still relevant today, was to counter the flow of capital away from existing buildings due to demographic changes in center cities and the related spread of blight in central business districts and small town Main Street communities.

The federal Historic Tax Credit as we know it today was enacted in 1981 as a bi-partisan effort of the Ronald Reagan Administration and a Democratically-controlled Congress to stimulate the American economy struggling to emerge from a deep recession. It was seen as a way to even the playing field for private investments in new construction and existing buildings within a broader package of incentives to promote economic growth. The legislation put a 25% credit in place for certified historic rehab, a 20% credit for non-residential buildings at least 40 years old and a 15% credit for non-residential buildings at least 30 years old.

The 1981 law was retained and modified as part of the 1986 Tax Reform Act to 20% and 10% credits respectively. The report of the Ways and Means Committee stated the reasons for its continuing support of the historic tax credit:

"The Congress concluded that the incentives granted to rehabilitations in 1981 remain justified. Such incentives are needed because the social and aesthetic values of rehabilitating and preserving older structures are not necessarily taken into account in investors' profit projections. A tax incentive is needed because market forces might otherwise channel investments away from such projects because of the extra costs of undertaking rehabilitations of older or historic buildings."

HTC eligible properties under today's law must be income producing and depreciable. Owner-occupied properties are not eligible. The program is jointly administered by the National Park Service (from application to placement in service) and the Internal Revenue Service (for tax compliance) and is codified under Section 47 of the IRC.

Today's 20% HTC is 100% earned by the investor when the building is placed in service. The law requires that the investor be an owner for a 5-year holding period. This tax credit equity is used by the developer to close the financing gap created by the higher cost of historic rehabilitation, the lower rents typically commanded by historic buildings in marginal commercial districts and the resulting lower loan amounts provided by banks to historic properties compared to new construction. HTCC members report that construction costs for historic rehab are 25-30% higher than new construction.

National Park Service statistics show that 84% of all certified tax credit projects are located in Qualified Low-Income Census Tracts with incomes at or below 80% of median. Fifty percent of all transactions support the development of either market rate or low-income housing.

Any transfer of ownership (such as a mortgage foreclosure) within the 5-year compliance period triggers tax credit recapture. However, the recapture risk burns off 20% per year over 5 years. In rarer instances, the credit may be recaptured if the building's architectural character is altered within this holding period or if the building is deemed totally lost as a result of a natural disaster.

A qualified building is one that is on or can be nominated at the time of application to the National Register of Historic Places. A building can also qualify as a contributing structure within a National Register historic district. Rehabilitation standards must be met, as outlined in the Secretary of the Interior's Standards for the Rehabilitation of Historic Buildings ("Standards").

The rehab must be "substantial," –$5,000 or 100% of the adjusted basis, whichever is greater. The developer must submit a 3-part application to the National Park Service with Part 1 making the case for the property's eligibility to the National Register, Part 2 outlining how the rehab will meet the Standards, and Part 3 demonstrating how after completion the property has met the Standards. Part 3 is the final certification that the credits can be taken by the investor.

Most often the substantial rehab test is based on 100% of the adjusted basis – the cost of acquisition, less the value of the land, plus the cost of any improvements already made, less any depreciation taken. This very high threshold for minimum rehab makes it difficult to use the

HTC more than once on a given building. Buildings that meet the current "sub-rehab test" are often functionally obsolete, under-utilized or vacant. The initial rehab costs are usually much higher on a square foot basis than subsequent renovation and upgrades years later. It takes many years of depreciation and a high second rehabilitation budget before the substantial rehab test can be met again.

The federal HTC has been so successful in encouraging catalytic historic rehab, 34 states have enacted complementary state historic tax credit statutes that allow investors to use the same cost basis to offset state income, franchise and premiums taxes. Applications for both credits are handled efficiently by the State Historic Preservation Offices which generally operate with regulations that are in sync with federal HTC requirements. State HTC proceeds are helpful in closing the part of the project financing gap that cannot be covered by the federal HTC, but they are not a replacement for the federal HTC incentive.

Economic Impact of the HTC

As mentioned above, the National Park Service, Rutgers University's Center for Urban Policy Research and the Coalition have been publishing reports on the economic impact of the federal HTC for the last five years. Its latest preliminary report for 2014 shows that the HTC has leveraged more than $117 billion in private investments over the program's history, about 5 times the $24.1 billion in credits allocated by the National Park Service. Over the same period, the HTC has generated $28.6 billion in federal tax receipts, more than paying for the incentive on a dynamic basis. Over 40,000 buildings have been put back into commerce. These estimates are based on the outputs of the Preservation Economic Impact Model discussed above which measures the impact of historic rehab on national and state economies from the beginning to the end of construction. The model's outcomes are understated because PEIM's estimates do not include the economic ripple effect of building operations after placement in service, nor does it measure the impact of increased tourism or the value of any additional rehab activity that may occur around an initial project as confidence in the historic area's future increases.

Rutgers research for the National Park Service indicates that local and home state economies capture an exceptionally high 75% of the economic benefits of historic rehab because labor and materials are more often purchased locally than with the typical new construction project. HTC-assisted rehabilitations also have been remarkably consistent in their ability to promote private economic investments in surrounding buildings, leading to the creation of historic districts that become destinations, driving tourism and bringing people back downtown to enjoy new entertainment, recreation, residential and office facilities. A recent study completed for the National Trust for Historic Preservation by PlaceEconomics (see attached) has looked at economic activity before and after the completion of a historic tax credit project in a wide range of markets and different project sizes. The historic tax credit projects in each case generated a significant increase in the issuance of building permits and business licenses and increased district property values that outpaced the city as a whole.

We know that historic rehab generates high-skilled, good-paying jobs that include specialty trades such as plastering, paint restoration, historic floor and roof restoration, fine woodworking and refinishing, historic window repair and wallpapering. Historic rehabilitation generates more jobs than new construction. Research by economist Donavan Ripkema in *Dollars and Sense of*

Historic Preservation found that in the typical new construction project, 60 percent of the costs are generated by materials and 40 percent are attributable to labor. He found that historic rehabilitation projects are more labor intensive with 40 percent of the costs generated by materials and 60 percent by the purchase of labor.

The HTC is a Model Credit

The HTCC believes that any economic development program with a proven track record that more than pays for itself should remain a part of the federal tax code. In addition, because the credit is paid in full only upon the building's placement in service, most of the HTC-related revenue generated for the Treasury is received before the credit is earned by the investor– exactly the way a tax credit meant to spur economic activity should be structured.

The HTC's relative efficiency is also demonstrated by its exceedingly low recapture rate. The attached recapture study, referenced above, indicates that the cumulative recapture rate of the HTC over the 2001-2011 measuring period was just .73% reflecting a better than 99% project success rate. The study's measuring period includes the Great Recession years.

Efficiency is also reflected in the high transfer pricing of the federal HTC. Corporate investors today pay an average of $.95 per tax credit dollar for the LLC or Limited Partnership ownership interests that allow them to claim the credits. Other investor tax benefits include any taxable losses generated by depreciation. Investors also earn an upside from operating cash flow. And as mentioned above, in 34 states the federal HTC leverages state resources in the form of state historic tax credits.

Case Studies

The attached HTC case studies in Nevada, South Carolina, Florida, Washington, Indiana and Colorado demonstrate the broad applicability, catalytic impact and critical financing role of the federal HTC. These stories are from both large cities and small towns and reflect reuses of train stations, office buildings, large homes, schools and Main Street commercial buildings serving a wide variety of new tenants including multi-modal transit, hotels, market rate renters of loft housing and a nonprofit radio station.

Keep the HTC

Again, we want to urge you in the strongest possible terms to keep this essential credit in place. We certainly understand the rationale behind fundamental tax reform, and we support the broad policy goal of lowering both the corporate and individual rate while broadening the base of taxpayers. But we believe that the HTCC has demonstrated through this summary letter and the attached materials that HTC-assisted historic property rehabilitation is not just a cultural good that underpins the preservation of America's architectural heritage. It is also a remarkably strong and targeted economic activity that is deeply woven into the revitalization strategies of thousands of cities and towns across the country.

We want to emphasize in closing that historic rehabilitation would not happen without the HTC. Developers have told us that their real estate decisions are based on their rate of return, not their tax rate. As long as returns on new construction are higher, developers will generally produce new buildings rather than undertake the less profitable option of historic rehabilitation without this incentive. Absent the HTC, which fills the financing gap, there will be a halt to the rehabilitation of historic commercial properties in the United States.

Thank you for giving us the opportunity to make the case for the HTC on behalf of the entire industry. We also want to thank you for the time committee staff have provided us to discuss the credit in the context of tax reform efforts. We look forward to working with you to help bring the tax reform process to a successful conclusion.

Sincerely,

John Leith-Tetrault
Chairman, Historic Tax Credit Coalition

Attachments:
Economic Impact of the Federal Historic Tax Credit - 2013
HTC Recapture Study
HTC Case Studies
CRA Letter to Regulators
Catalytic Study

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