

Federal Historic Tax Credits Powerful Financial Tools for Owners of Historic Buildings

Walla Walla, January 23, 2020



Main Street, Walla Walla

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Stephen Day Architecture PLLC focuses on:

- Preservation architecture
- Historic property development
- Design analysis and research
- National Register nominations
- Tax Credits
National Park Service
Applications



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**The Penrose Walla Walla
(Historic YMCA/Oddfellows Hall)**

Tax Credit Overview:

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



Hastings Landing Hotel, Port Townsend, WA

Background:

Why Preserve Historic Buildings?

- Cultural preservation
- Impossible to replicate
- Economic advantages
- Preserving buildings is usually the most energy-efficient, sustainable choice
- Enormous amount of “embedded energy” in existing buildings



The Arctic Club Hotel, Seattle, WA

I. BACKGROUND

Tax Credits can be great tools to use in architectural preservation

Can produce needed cash equity early in these projects

Credits can also be used directly by
Owner/Developers of
Historic Properties

Can turn marginal projects
into feasible projects



Anhalt Apartment Building, Seattle

I. BACKGROUND

For Property Owners in National Register Historic Districts:

- The easiest way into the tax credit program
- No need to have your property listed individually
- No downside to being in a National Register historic district
- Local districts/landmarks can have more restrictive rules



Main Street, Walla Walla

I. BACKGROUND

Do you qualify for the Tax Credits?

1. Do you own a historic property located in a National Register Historic District?
2. (Or) Do you own a building listed on the National Register of Historic Places?
3. Are you going to be doing substantial work on the building?



Oregon and Washington Railroad & Navigation Company Building
(Pioneer Square-Skid Road National Historic District)

I. BACKGROUND

If you qualify for the
Federal Historic Tax Credits:

The Tax Credit = 20% of the
combined hard and soft costs
of your qualified building
project costs

The Tax Credit is a dollar-
for-dollar reduction in your
federal income taxes, for
qualified users.

Tax credits can be powerful.



Pine Street Market
(United Carriage and Baggage Transfer Company Building)
Skidmore/Old Town National Historic District, Portland, OR

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

EXAMPLE PROJECT: THE ARCTIC CLUB

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

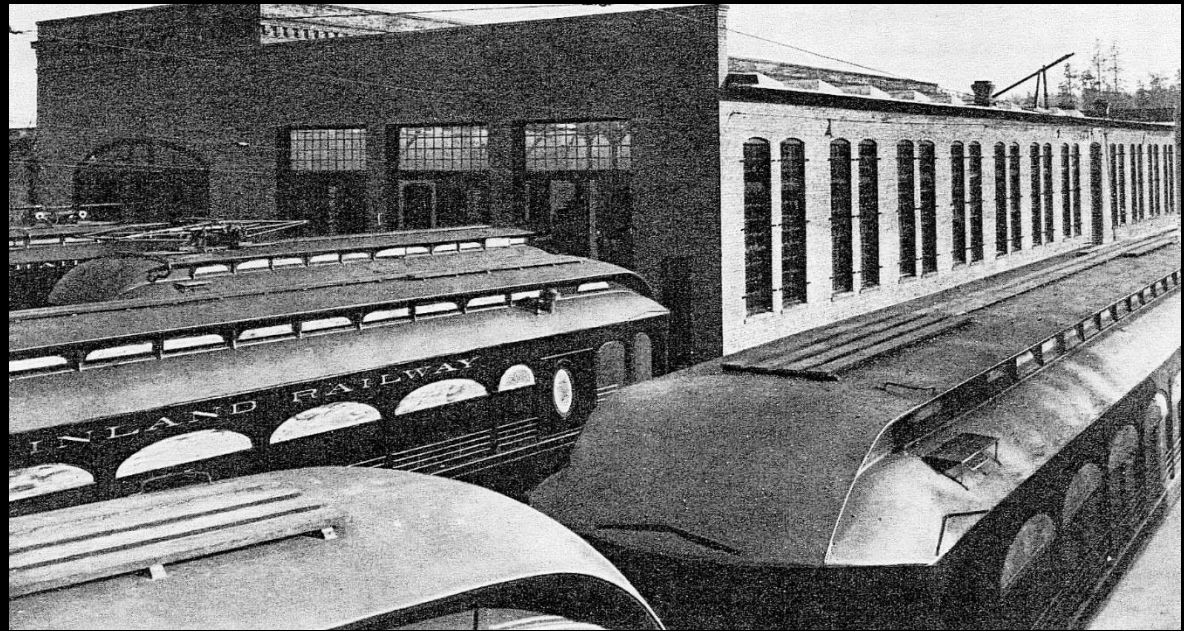


Property of Museum of History & Industry, Seattle

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

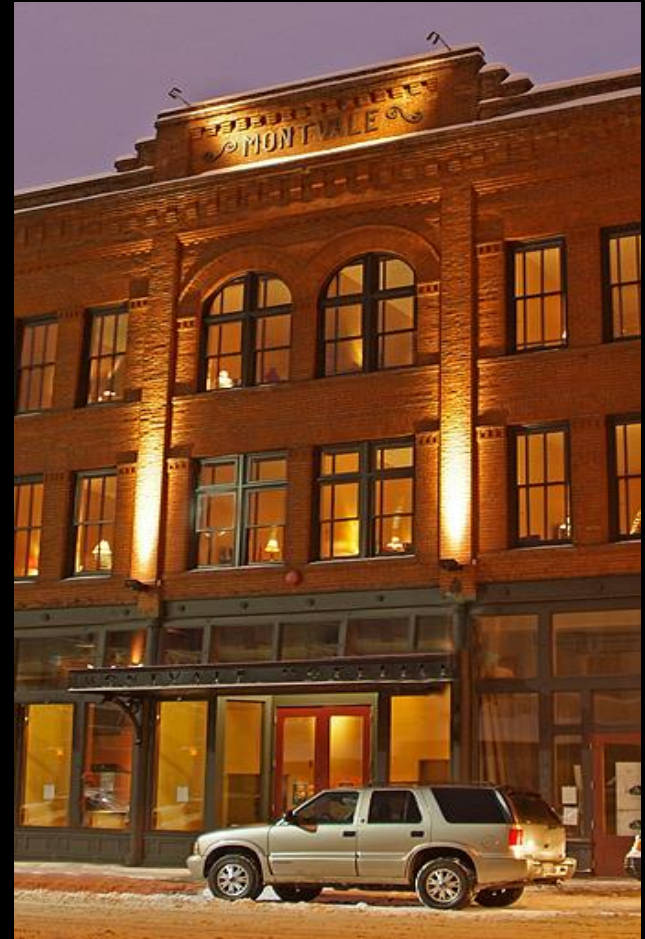
- Classic Anhalt apartment complex on Capitol Hill, Seattle
- Approximately \$11 million in qualified rehab expenses
- \$2.2 million in tax credits to investors in single entity structure



Anhalt Apartment Building, Seattle, WA

PROJECT: THE MONTVALE HOTEL

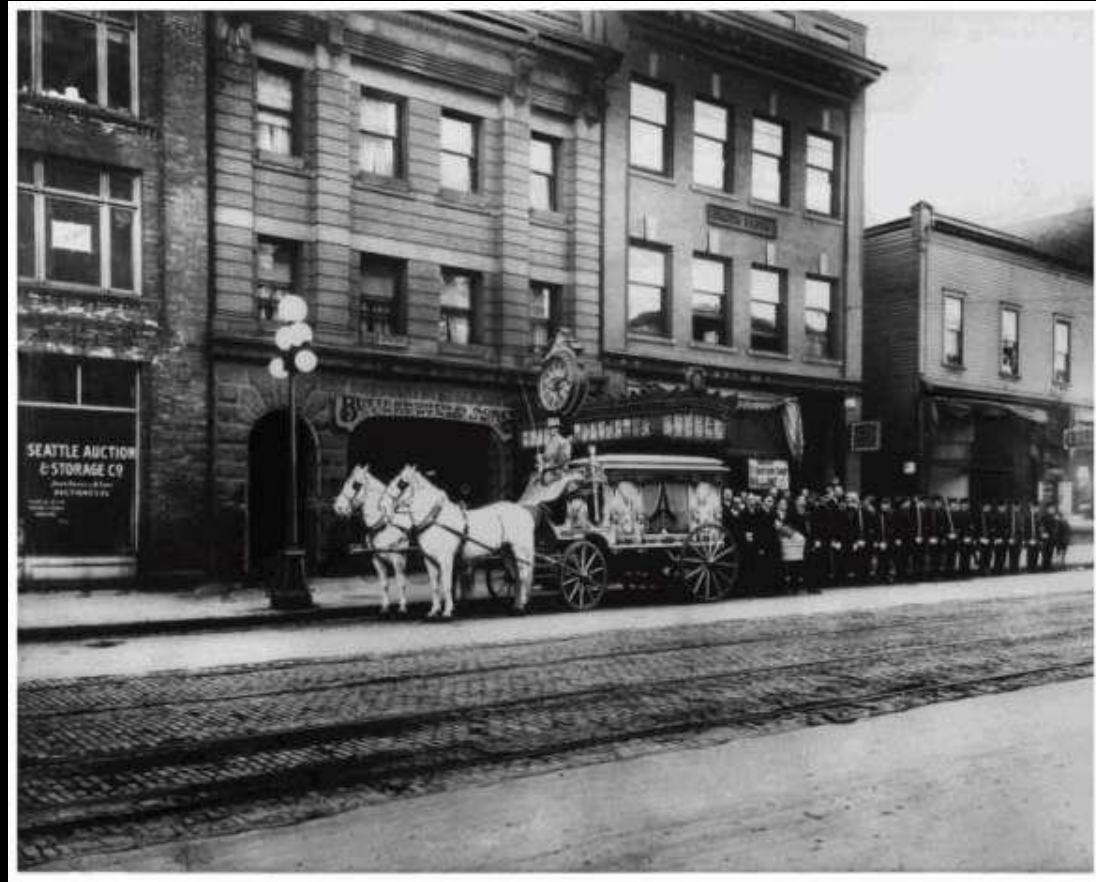
- Historic hotel development
- Approximately \$1.5 million in qualified rehab expenses
- \$300,000 in tax credits to investors in single entity structure



Montvale Hotel, Spokane

PROJECT: THE BUTTERWORTH BUILDING

- Original Butterworth's Undertakers/Mortuary Building
- Approximately \$6.2 million in qualified rehab expenses
- \$1,240,000 in tax credits to owners in single entity structure



The Butterworth Brothers Undertakers Building
Pike Place Public Market Historic District, Seattle, WA
(Now Kell's Irish)

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
- Located in downtown National Register historic district



The Five & Dime, Clarksdale, Mississippi
Clarksdale National Historic District

II. THE HISTORIC TAX CREDIT PROGRAM: BASICS

A. WHAT IS THE PROGRAM?

- A 20% credit for the rehab of “certified historic structures”



The Mount Baker Apartments/Retail Spaces, Bellingham, WA

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

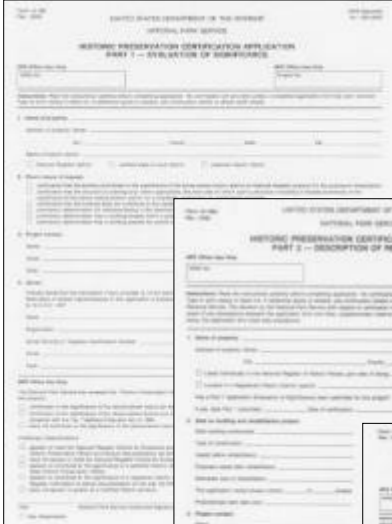
- Technical assistance (publications)
- Administers Tax Credit program
- **CERTIFIES** National Register listings and Rehabilitations for Tax Credit program



BECOMING A CERTIFIED PROJECT

Complete a 3-part application

Part 1 – Evaluation of Significance



This is the first page of the application, titled 'HISTORIC PRESERVATION CERTIFICATION APPLICATION PART 1 - EVALUATION OF SIGNIFICANCE'. It includes sections for project information, a detailed description of the project, and a section for the applicant's certification and signature.

Part 2 – Description of Rehabilitation



This is the second page of the application, titled 'HISTORIC PRESERVATION CERTIFICATION APPLICATION PART 2 - DESCRIPTION OF REHABILITATION'. It contains a detailed description of the proposed rehabilitation work, including a list of items to be restored or replaced, and a section for the applicant's certification and signature.

Part 3 – Request for Certification of Completed Work



This is the third page of the application, titled 'HISTORIC PRESERVATION CERTIFICATION APPLICATION REQUEST FOR CERTIFICATION OF COMPLETED WORK'. It includes a section for the applicant to request certification, provide a list of completed work items, and a section for the applicant's certification and signature.

FEDERAL INVESTMENT TAX CREDIT

NATIONWIDE

Since 1976 when the program began:

43,328 projects nationwide

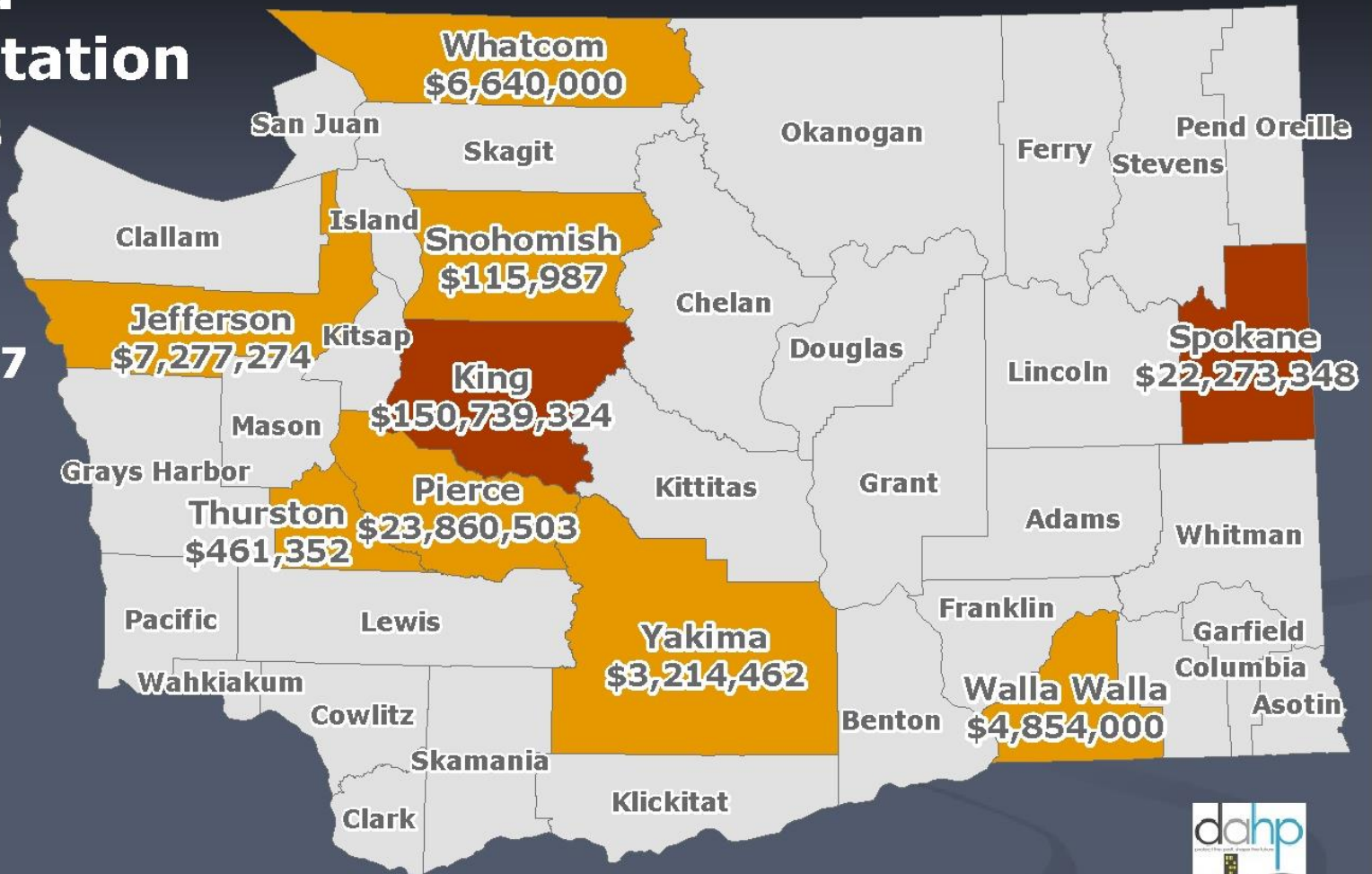
\$90 Billion Total Rehab Expend.

~1,100 projects / year

~\$5-6 billion / year

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

“QUALIFIED REHAB EXPENDITURES” (QRE’S):

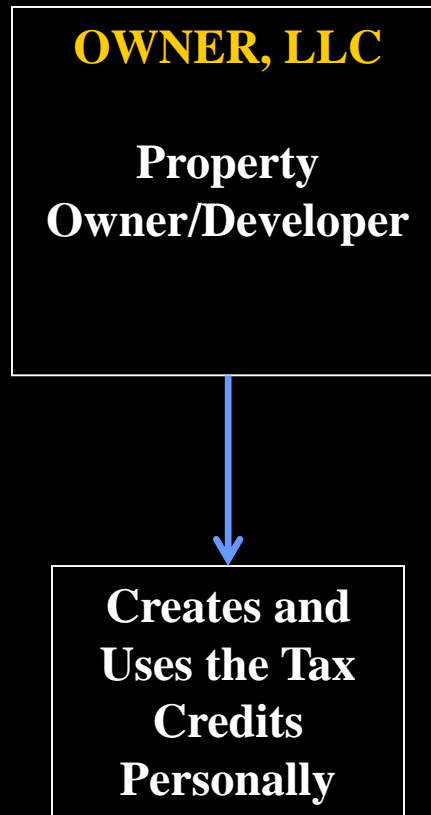
QRE’s can include most hard and soft costs of rehab project, including construction costs, consultant fees, developer fees, interest during construction

Historic tax credits
= QRE x 20%



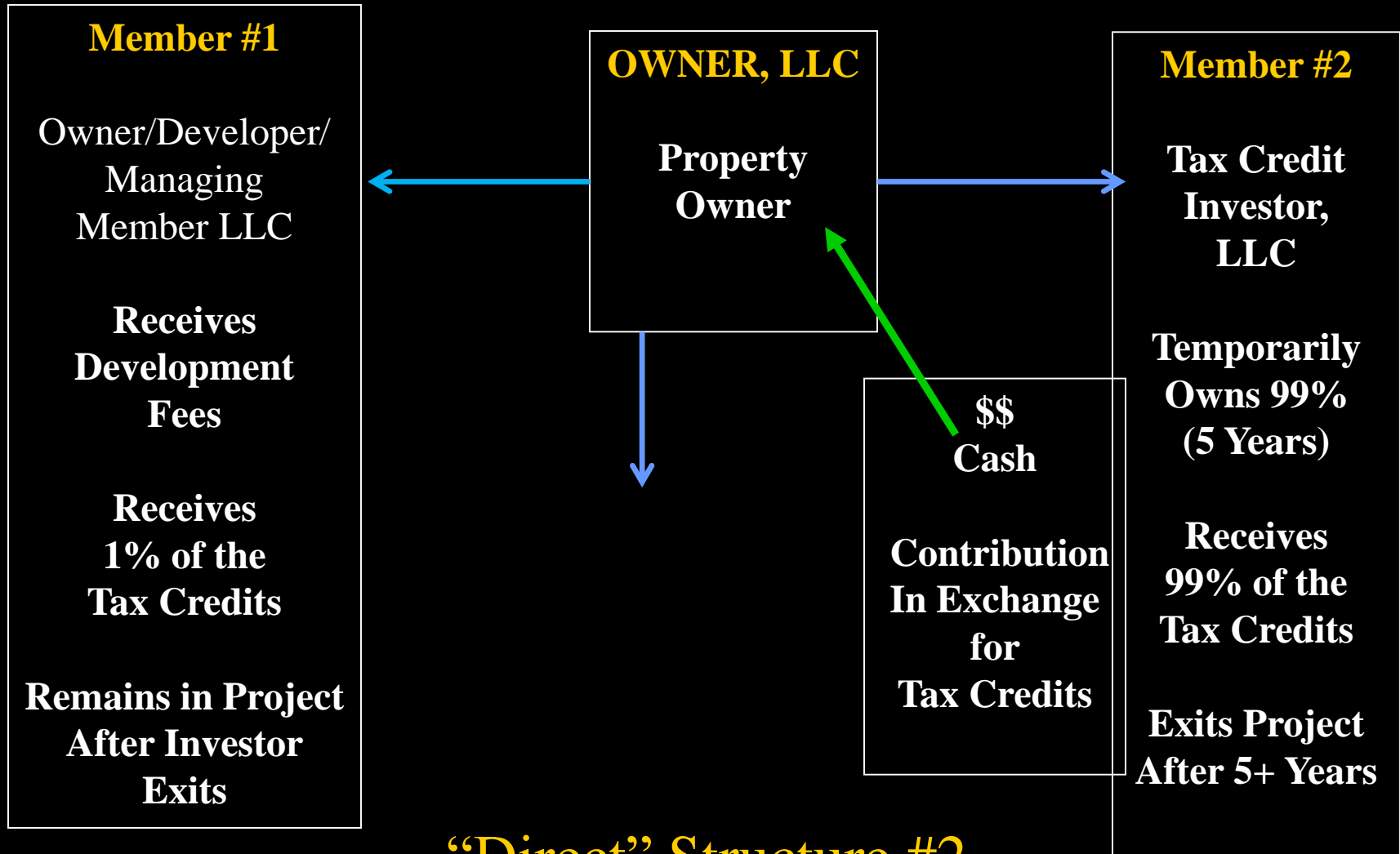
Pine Street Market, Portland OR

SIMPLEST STRUCTURE



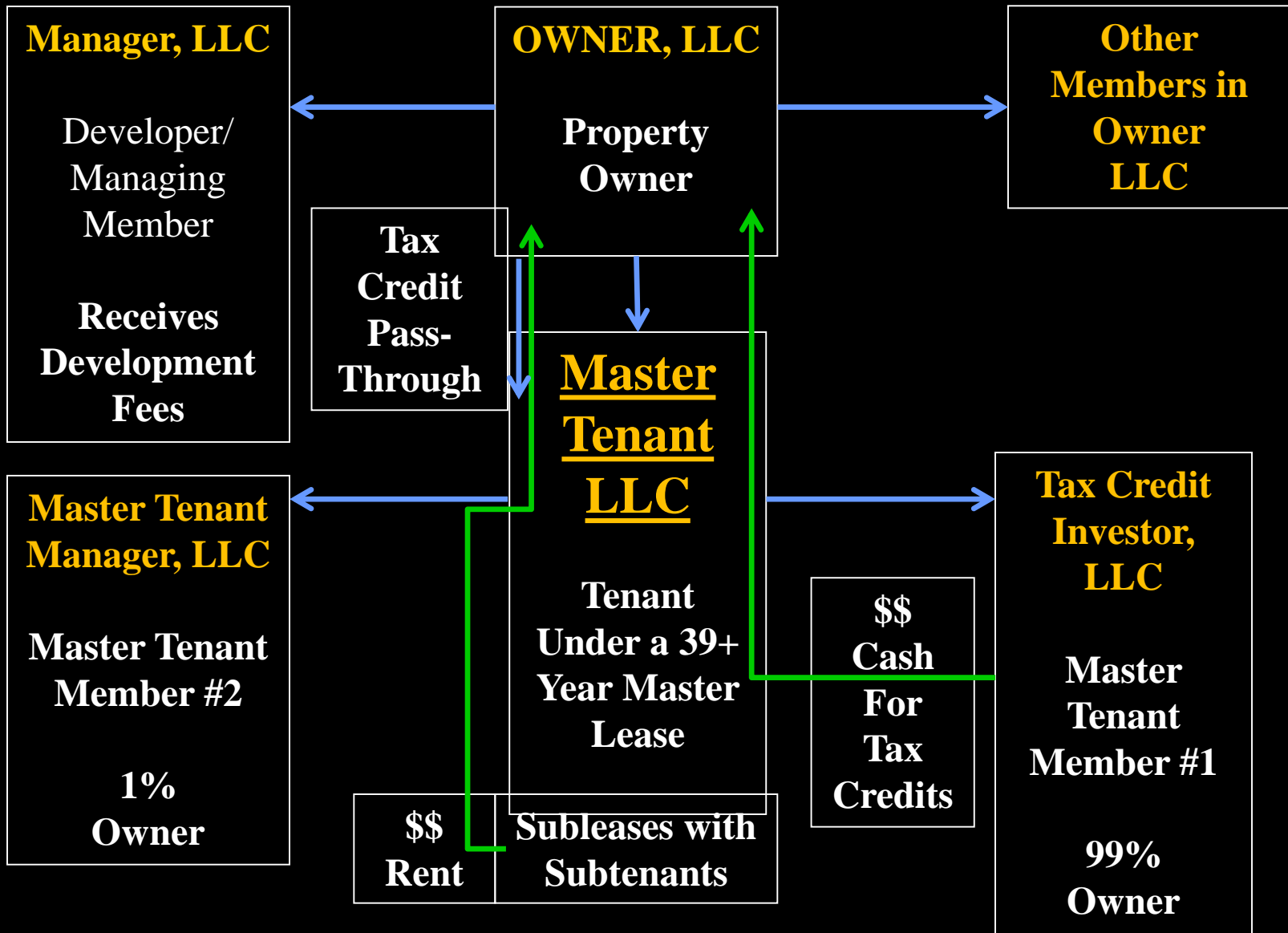
“Direct” Structure #1

“INSIDE INVESTOR” STRUCTURE



“Direct” Structure #2

“OUTSIDE INVESTOR” STRUCTURE



Master Lease Structure

“QUALIFIED REHAB EXPENDITURES” (QRE’S)

MUST BE “SUBSTANTIAL”

QRE’s total costs
(hard and soft
costs) must exceed:

Value of the
building before
rehab, minus
depreciation, **NOT**
including the value
of the land

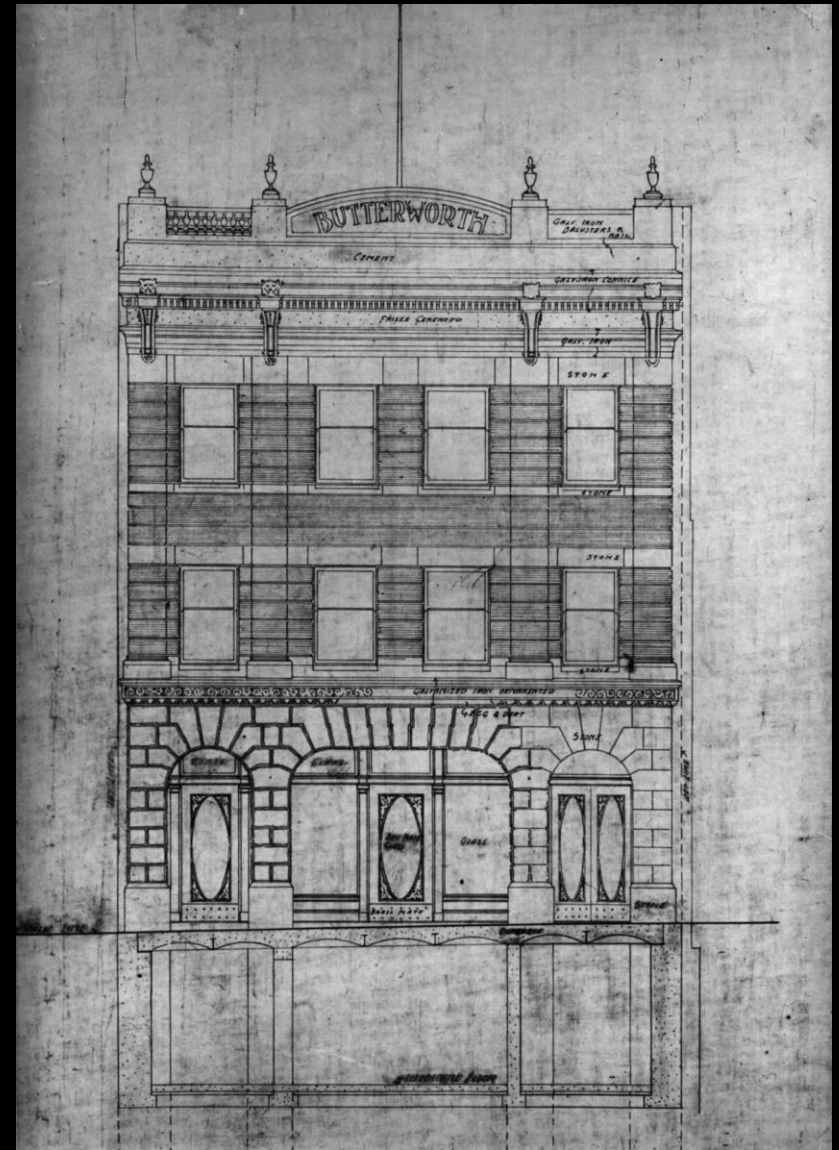


Colman Automotive Building, Seattle, WA

“Secretary of the Interior’s Standards for Rehabilitation”:

The Rule Book. Basically:

- Do not destroy historic features
- Repair rather than replace
- If must replace, replace in-kind
- Retain historic character of spaces and features
- Changes must be reversible and compatible with historic character



Butterworth & Sons Undertakers Building
Pike Place Public Market
National Historic District, Seattle

“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

**“QUALIFIED EXPENDITURES” for Tax Credit Purposes
DO NOT INCLUDE EXPENSES FOR BUILDING ADDITIONS:**



**The Penrose Walla Walla
(with and without building addition)**

BASICS

QUALIFYING BUILDING USES:

- Uses must be income producing or used in a business
- Rental housing yes, but condo housing rarely because typically too many owners and timing problems



Hale Building, Spokane, WA

SELLING, ALLOCATING OR TRANSFERRING CREDIT:

- Tax credits are not freely transferrable
- 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 the 5 year holding period



Hastings Landing Hotel, Port Townsend, WA

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 (Inn at Lynden), 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



Red Maple Apartments, Tacoma, WA

THE TAX CREDIT USER: INVESTOR

- 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
Clarksdale National Historic District

THE TAX CREDIT USER: OUTSIDE INVESTOR

- 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: OUTSIDE INVESTOR

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



Northern State Assembly Hall, Sedro Wooley, WA

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

V. HISTORIC TAX CREDIT CHECKLIST

1. Is the building on the National Register, or a contributing building in an National Register 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 depreciation, and 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?



You Can Make Great Tax Credit Projects Happen.

Questions?

Feel free to call me.

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Arctic Club Hotel, Seattle