

Crafting the Historic Tax Credit Deal

Greenville, SC September 15, 2015

COHN  REZNICK

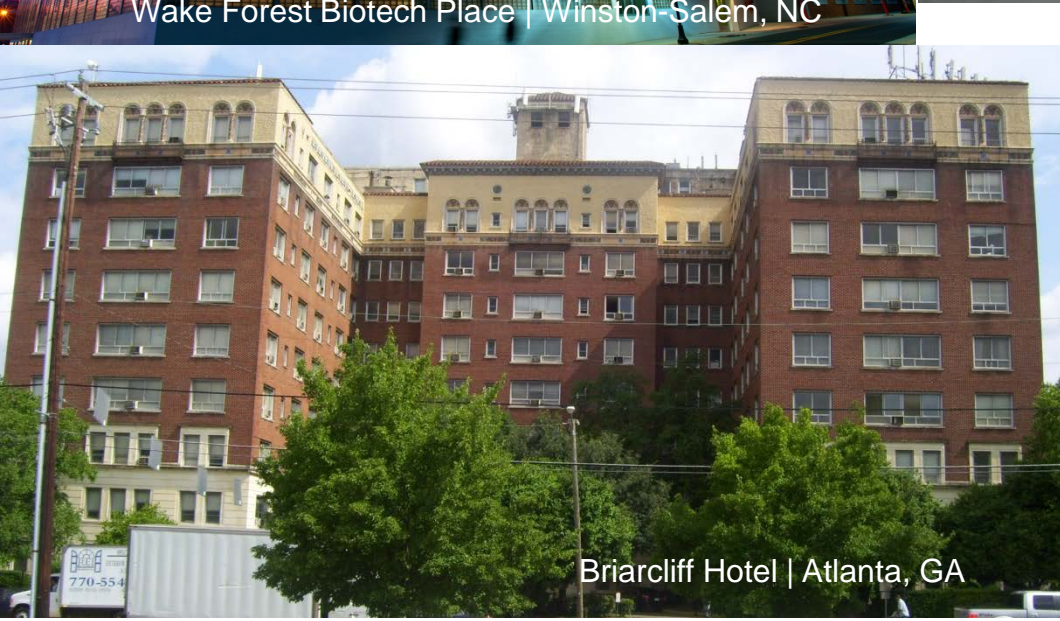
Federal Historic Tax Credit (Income-Producing Properties)

- 20% credit on federal income tax
- Credit Calculated on Hard and Soft Costs
- Credit Limited to Existing Building, Not Acquisition, New Construction or Site Work
- No Limitations on Corporate Investors

Qualifying Buildings

- National Register Properties – Individual or in District
- Generally at least 50 Years Old
- Architecturally or Historically Significant
- Designated Local Landmark Buildings or Buildings in Local Historic District Generally Do Not Qualify

Buildings built before 1966 meet the age requirement



Scope of Design Review

Exterior Renovations

- Material and Ornament Repair/Replacement
- Window Repair/Replacement
- New or Re-designed Entries
- New Additions – Attached, Adjacent, Rooftop
Site Work, Landscaping, New Site Construction

Scope of Design Review

Interior Renovations

- Repair/Removal of Ornamental Features
- Changes in Floor Plan/Circulation Features
- Corridors, Stairways Elevators, Auditoriums, Theater Spaces
- Mechanical systems

Federal Approval Process

- 3 Part Application Process
 - Part 1 – Historic Status
 - Part 2 – Design Approval
 - Part 3 – Project Completion
- State and National Park Service Review
 - 60-Day Minimum Review
- Secretary of Interior's *Standards for Rehabilitation*

2015 National Statistics

- 1,283 proposed project
\$6.63 billion in rehabilitation work approved
- 870 completed projects
\$4.47 billion in rehabilitation work certified
- 85,058 jobs created by completed projects
- 8,096 new low and moderate income housing units
23,569 new or renovated housing units overall

South Carolina Historic Tax Credit Programs

Historic Rehabilitation Tax Credit

Option 1: 25% credit (capped at \$1M/project); QREs < \$10M

Option 2: 10% credit (no cap); QREs > \$10M

Abandoned Building Tax Credit

25% credit (capped at \$500,000)

Building must have been abandoned for at least 5 years

Textile Communities Revitalization Tax Credit

25% credit (no cap)

For rehabilitation, renovation, and redevelopment of textile properties that have been abandoned for at least one year

South Carolina Historic Tax Credit Programs (CONT'D)

For both **Abandoned Building** and **Textile Communities Revitalization**:

- Must choose between these two programs, but either may be stacked with historic tax credit programs
- May be used against state income tax, corporate license fees, tax of insurance premiums, or real property taxes
- Notice of Intent to Rehabilitate required prior to start of project noting whether credit will apply to real property

South Carolina State Historic Tax Credits

South Carolina State Historic Tax Credit

Option 1

- 10% Credit
- Mirrors Federal Qualified Rehabilitation Expenses
- Mirrors Federal requirements
- 3 years

Option 2

- 25% Credit limited to \$1M per structure
- Optional election
- 3 years

South Carolina State Historic Tax Credits

South Carolina Textile Revitalization Credit (Mill Credit)

- 25% Credit
- Abandoned Textile Mill Site
- Can demolish Building
- Notice of Intent to Rehabilitate
- 5 years

Abandoned Building Credit

- Must be at least 50,000 square feet
- Owned by the government & abandoned for 5 previous years
- 25% credit limited to 500K per structure
- 5 years

IRS Rules

Investor

Federal historic tax credits are subject to passive activity loss rules and at-risk limitations

Investors tend to be widely-held C corporations

Non-Profit

“Disqualified Leases”

- A lease to a tax-exempt entity if tax-exempt bond financing was used
- If under the lease there is a purchase or sale option (or equivalent)
- If lease term exceeds 20 years
- If tax-exempt entity owned or used the property prior to the establishment of the lease

IRS Rules (CONT'D)

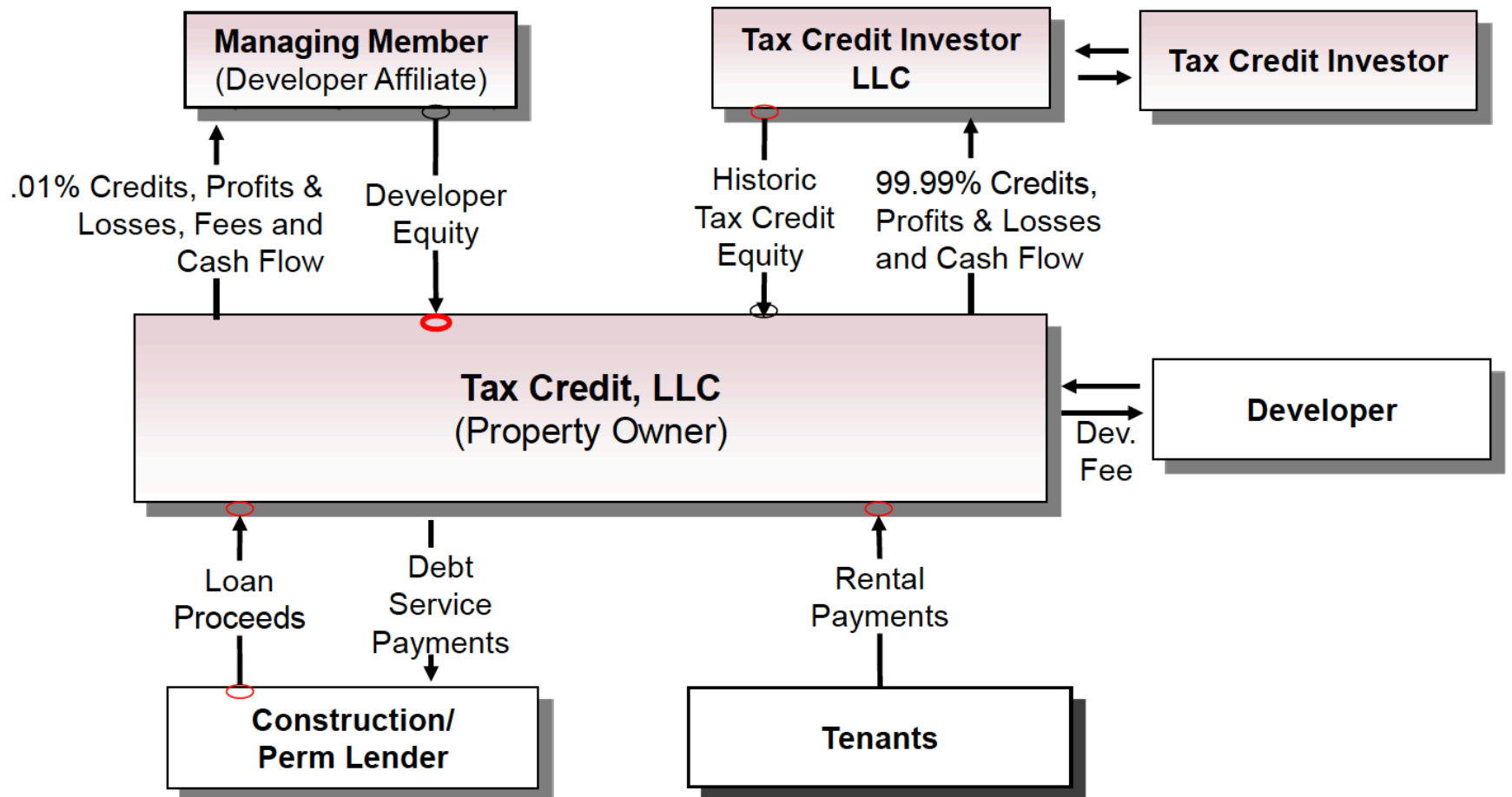
Long-Term Lease

Can itself rehabilitate the property and claim the federal HTC if the remaining term on the lease is greater than the depreciation recovery period

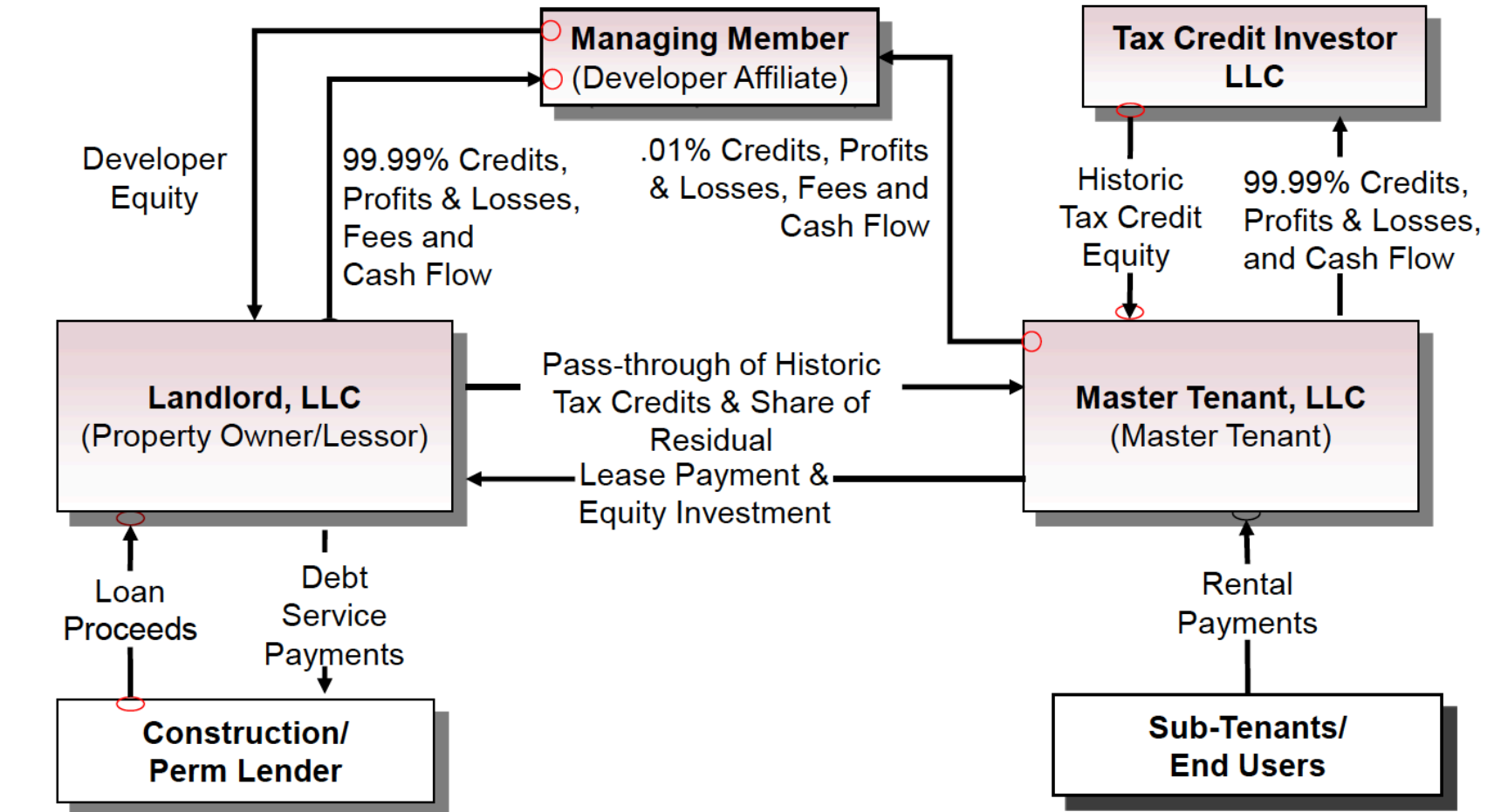
Owner can rehabilitate and make an election to “pass through” the federal HTC to a tenant as long as

- the property is Section 38 property of the landlord, and
- the lease is not a short-term lease (must be longer than 80% of the class life of property)

Single Tier Structure



Credit Pass-Through Structure (Master Lease)



Why Use Tax Credits?

Credits vs. Deductions A Credit Offsets Tax Liability Dollar for Dollar

	<u>Deduction</u>	<u>Credit</u>
Income	\$100	\$100
<u>Less: Deductions</u>	<u>(20)</u>	=
Taxable Income	80	100
Gross tax Due @ 35%	28	35
<u>Less: Credits</u>	=	<u>(20)</u>
Net Tax Due @ 35%	28	15

Qualified Rehabilitation Expenses

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;
- Construction period interest and taxes;
- Architect fees, engineering fees, constructions management costs;
- Reasonable developer fees.

Qualified Rehabilitation Expenses (CONT'D)

Does NOT Include costs related to:

- 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.

Sample Development Budget

	Total	Qualified Rehabilitation Expenditures	Depreciable Non-Eligible Basis	Funded Expense	Other
Acquisition Costs-Land	40,000	-	-	-	40,000
Acquisition Cost- Building	120,000	-	120,000	-	-
Construction Period Interest for Rehab	20,167	20,167	-	-	-
Permanent/Construction Loan Fee	6,000	1,000	-	5,000	-
Achitectural, Engineering	28,000	28,000	-	-	-
Construction Contract	300,000	300,000	-	-	-
Site Improvements	5,000	-	5,000	-	-
Contingency	35,000	35,000	-	-	-
Appliances	17,800	-	17,800	-	-
Historic Tax Credit Application Fee	2,500	2,500	-	-	-
Professional Fees	15,000	15,000	-	-	-
Marketing & Leasing Reserves	20,000	-	-	-	20,000
Insurance and RE Taxes During Construction	15,000	15,000	-	-	-
Development Fee	124,893	83,333	41,560	-	-
TOTAL APPLICATIONS:	749,360	500,000	184,360	5,000	60,000

Calculating the Credit & Equity

$$\frac{\text{QREs}}{\$500,000} \times \frac{\text{Credit Rate}}{20\%} = \frac{\text{Credits}}{\$100,000}$$

EQUITY:

$$\$1.15/\text{credit} \times \$100,000 = \$115,000$$

*Credit rate is sometimes 10%

Claiming the Credit

Triggered by Placement in Service

- CO or TCO is used

Options for claiming credit:

- 100% Year Placed In Service (most common)
- Carry back – one year
- Carry forward – 20 years

Claiming the Credit (CONT'D)

Credit is shared among owners base on the *profits* allocation

'Profits' include the owners' share of:

- Taxable income
- Operating cash flow

Allocations must remain the same during the recapture period

Recapture

Triggered by:

- Disposition of property
- Disposition of at least 1/3 partnership interest
- Noncompliance with SOI *Standards for Rehabilitation*
- Property becomes 'tax exempt use property'
- Total casualty loss

Amount of Recapture

- 100% of the credit in the first 12 months from Placed in Service
- Declines 20% every 12 months thereafter
- Possible recapture becomes zero after 60 months

Chatham Manufacturing Company

Winston-Salem, NC



Initial buildings constructed 1907 as Chatham Textile Mill
Complex expanded substantially ca. 1940 and 1956

Chatham Manufacturing Company

Winston-Salem, NC



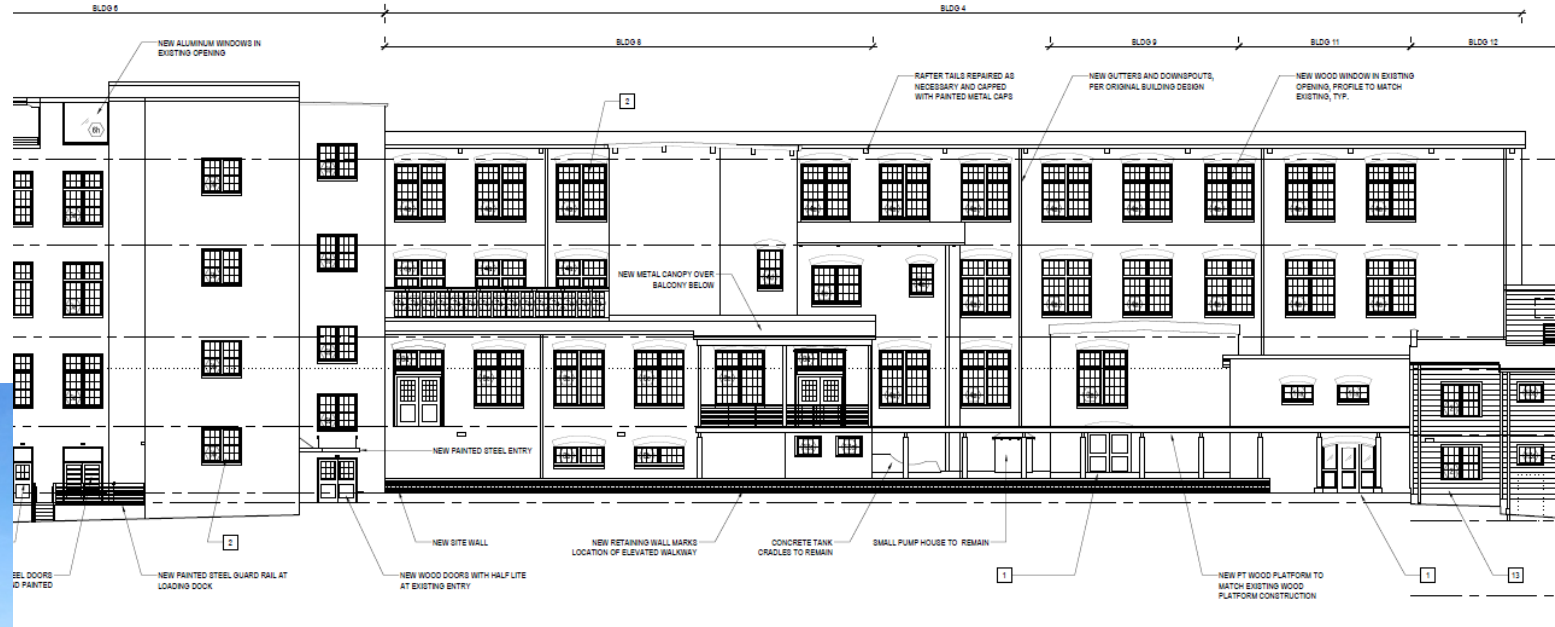
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Chatham Manufacturing Company

Winston-Salem, NC



50(d) Income – Hot Topic

Single Tier – no 50(d) reduction of basis

- Dollar for dollar on Credit

Lease Pass through

- Recognize income over the life of asset

50(d) Income continued

New IRS guidance released summer of 2016

- Income is not a partnership event
- Recognized over the shortest life of assets
- can accelerate when exit

Other Important HTC Topics to Explore

Functionally-related complexes

Investor Safe Harbor Guidance

Certified programs

Common design issues

- Windows
- Mechanical systems
- Paint removal and repainting services
- Industrial vs. finished

Much more...

CONTACT INFORMATION

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