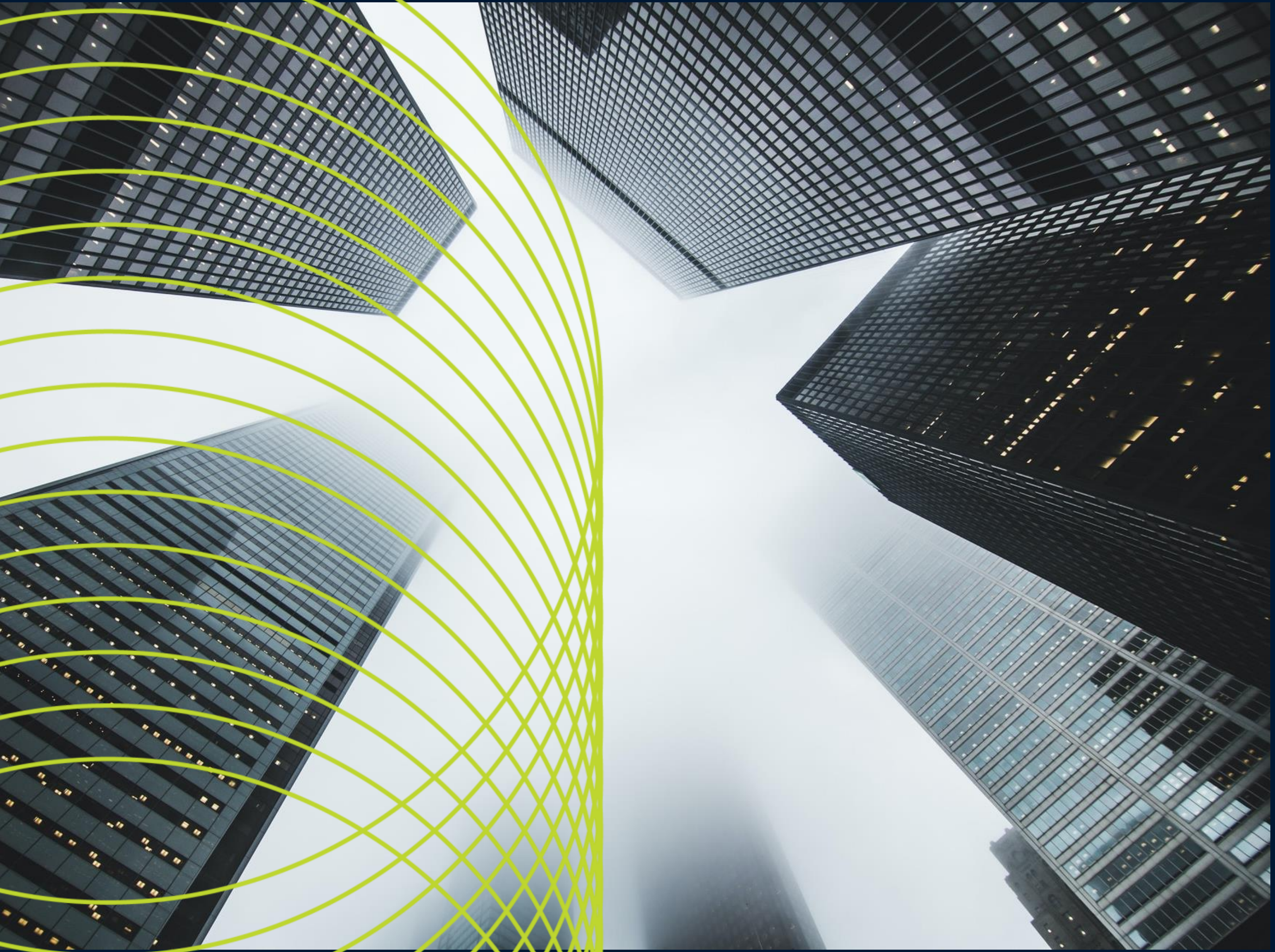

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THE HISTORIC TAX CREDIT- A CHAMPION FOR THE CONSERVATION OF AMERICA'S PAST

SECTION 47 OF THE INTERNAL REVENUE CODE

Historic Tax Credit Program Basics – Section 47 of the Internal Revenue Code

- The Historic Rehabilitation Tax Credit (“HTC”) Program is administered by the National Park Service (“NPS”), US Department of the Interior.
- The Federal HTC is a 20% credit of the qualifying expenses of a project’s rehabilitation earned in the year the rehabilitated building is placed in service.
- The HTC credit is claimed in equal ratable annual installments over the 5 year compliance period beginning in the year in which the rehabilitated building is placed in service.
- HTCs are a dollar-for-dollar tax credit, not a deduction.

In 2022, over 850 projects were certified completed totaling $6.56 billion** in private investment

Over 44% of projects had QREs less than $1 million and 17% had QREs less than $250,000.

The median QRE was $1.31 Million

The average QRE was $7.64 Million

**2021 totaled $7.16 billion

Sustainability

- The HTC is a great tool for environmental sustainability

- Less materials in landfills;
- Better for the environment than demolition;
- Historic buildings used energy efficient aspects when built

* Utilize a qualified preservation designer who understands the Secretary of the Interior’s Standards for Rehabilitation

Job Creator, Community Revitalizer

- In 2021, the HTC created over 135,000 jobs according to the NPS, while generating over $7.7 billion in GDP;

- This is an increase of 700 million in GDP and 13,000 jobs from 2020;

- It pays for itself;

- It is a community revitalizer (more jobs, more businesses, more tax revenue, and it leverages private investment 1 to 4) per the NPS.

THE HTC AND HOUSING

The program has created over 600,000 new housing units, of which more than 175,000 are affordable housing units.

In 2022 alone, the HTC created 9,036 new units of housing and rehabilitated 5,533.

Of those housing units, 6,789 were low to moderate income housing units.

APPLICATIONS BY THE NUMBERS- THE TOP 5 STATES OF 2022

1. Ohio (129)
2. Louisiana (122)
3. New York (118)
4. Virginia (101)
5. Missouri (101)

LOUISIANA BY THE NUMBERS- 122 PART 1s FILED

- 122 PT 1 filed → 109 PT1 approved
- 100 PT 2 filed → 95 PT2 approved
- 51 PT 3 filed → 47 PT3 approved

Financing Terms

- HTCs = Historic Tax Credits
- QRE = Qualified Rehabilitation Expenditures
- NPS = National Park Service
- SHPO = State Historic Preservation Office
- Federal HTCs = federal Rehabilitation Tax Credits
- State HTCs = state Historic Tax Credits*
  - Keep in mind that there may be differing requirements between the Federal and State HTC programs.
  - Allocable v. transferable credits
- Other types of and federal tax credits or other incentives are often available. Examples include grants, state rehabilitation credits and other Federal incentives such as New Markets Tax Credits.

HTC Program – Application and Certification Requirements – the 3 Part Application Process

- Part I- Certification of the Structure*
  - The structure must be a Certified Structure.
  - If the building is NOT already listed on the National Register, the applicant must provide information to the NPS including information on the building's history, significant, architectural integrity and photographs of the building's physical appearance.
  - Once a project has received Part I approval, the project may then apply for National Register status. **
  - The project can move forward while National Register status is pending, BUT approval must be received within 30 months following the completion of rehabilitation of the building.
- *This does not guaranty availability of the credit, it is merely a prerequisite to potentially qualifying for the Credit.
- ** Note that this is a lengthy process, often taking up to 9 months.

A Certified Historic Structure (Part I)

- It is listed on the National Register of Historic Places, or
  - Databases are available via the following link, but note that several states have not yet been digitized by the NPS and must be requested in paper form:
  - http://www.nps.gov/nr/research/
- It is located within a registered historical district **AND** contributes to the historical significance of the district.

THE 3 PART APPLICATION PROCESS - CONTINUED

- Part II- Approval of Plans and Specifications
  - The structure must be rehabilitated in accordance with plans and specifications approved by the NPS, which are submitted to the NPS by the State Historic Preservation Office (“SHPO”)*.
  - Note that the developer must restore the historically significant elements of the structure.
  - Many historic investors will not move forward unless an approved Part II is in hand.

- Part III- Certification of the Rehabilitation
  - Upon completion, the rehabilitation must be a “Certified Rehabilitation” as certified by the U.S. Department of the Interior/NPS.
  - Photographs following completion are submitted

- *SHPO is not concerned about the financial aspect of the project’s transaction, they are looking to the integrity of the building rehabilitation.
- **There is a fee for review of Part II and III

What Qualifies as a Certified Rehabilitation (Part III)?

- **Rehabilitation work must <u>preserve the historic character of the building,</u> so the NPS strongly suggests waiting to do work until your project has gone through their review process.**
- The building must be depreciable;
- The property must be placed in service;
- The rehabilitation must be substantial*;
- The building must be a certified historic structure when it is placed in service.

*NPS is looking for more than simply changing a few rooms in the building. In addition, Section 47 of the Code requires that the building must be “substantially rehabilitated”.

The Building Must be Depreciable

- It must be used in a trade or business or held for the production of income:
  - Offices;
  - Commercial;
  - Industrial;
  - Agricultural; or
  - Rental Housing
- Straight Line Depreciation. The QRE, along with the building shell, must be depreciated using a Straight Line Depreciation Cost Recovery Method.
  - 27.5 year (residential)
  - 39 year (commercial)

Placed Into Service and Credit Recapture

- The building must be returned to use; AND
- The owner must hold the building in a trade or business or for the production of income
- for five (5) full years after completing the rehabilitation or pay back the credit
- If the owner disposes of the building before the 5 year time period has run, the credit recapture is as follows:
  - Less than 1 year, 100% tax credit recapture;
  - Properties held 1-5 years, 20% recapture per year.
  - Section 1.47-3(g) provides an opportunity to avoid recapture as a result of foreclosure.

*Being placed into service does not necessarily refer to actual use, but rather that the building is ready for its intended use. A final certificate of occupancy is strong evidence of placement in service.

Substantial Rehabilitation

- During the 24-month period selected by the taxpayer, rehabilitation expenditures must exceed the greater of $5,000 or the taxpayer's adjusted basis in the building
- To calculate the adjusted basis:

  Purchase Price

  \- Cost of the land- the contract to acquire the building should allocate the aggregate cost between the building and associated land.

  \+ Improvements already made

  \- Depreciation already taken

  ____

  Total Adjusted Basis

Must spend 1 dollar more than the taxpayer's total adjusted basis

Examples of QREs

Generally, costs that are directly associated with the work undertaken on repair or improvement of a structural component of a historic building and are capitalized to the basis of building;

- Structural components of the building (per Treasury Regulation 1.48-1(e)(2));
- Plumbing/plumbing fixtures, heating/cooling systems, electrical wiring/fixtures, etc.;
- Architectural and Engineering fees;
- Site Survey fees;
- Construction period interest;
- Reasonable development fees;
- Legal expenses;
- Insurance Premiums;
- Other construction related costs.

Examples of Ineligible Costs

- Acquisition of the building;
- Demolition;
- Any new additions;
- Parking lots;
- Sidewalks;
- Landscaping;
- Personal Property;
- Fees to the extent not allocable to the development of the building.*

*Note that this list is only an example of ineligible costs, it is not an exhaustive list.

5 Year Compliance – Credit Recapture

- 5 Year Compliance Period commencing upon the building being placed into service (this is generally evidenced by the issuance of a certificate of occupancy (COO)).
- May not transfer all or any portion of the building during 5-year compliance period, whether intentionally or via foreclosure. Investors will require SNDA or foreclosure agreement depending on structure.
- Must maintain the property in accordance with approved plans and specs during compliance period = No Modifications Unless Pre-approved.
- Property must be continuously used in a trade or business or for the production of income during 5-year compliance period.
- Depending on the structure, there are limitations on the sale of a partnership interest in the entity which owns the building during the compliance period.
- Failure to comply will result in a recapture of the credit amounting to 20% of the credit taken for each year less than 5 full years, plus penalties and interest.
- Tax credit recapture burns off at 20%/full year of compliance (i.e., out of compliance within the 3rd Year = 60% credit recapture.

Tax Credit Investment – Market Overview

Investment Pricing. Depending on structure, investors contribute between $.70 and $.82 per credit to the entity which owns the rehabilitated building. If the building owner is a partnership, the credits are allocated among its member in accordance with their sharing of partnership profits.

Investor Returns. Investors require priority returns on capital contributions (typically 2.5% annually).

Investor Exit. An investor’s membership interest is subject to a put to an affiliate of the project sponsor but the put price cannot exceed the fair market value of the investor’s interest in the entity which owns the rehabilitated building (typically the lesser of FMV or 5% of total investment). No call options.

Cash Value. Typically, a tax credit investment nets an approximate cash value of 15% to 17% of Qualified Rehabilitation Expense (or 30% to 35%) using both state and federal historic tax credits.

Tax Credit Investment Structures

Federal Allocation. Federal tax credits are allocated among partners based on sharing of partnership profits; however, the owner may elect to pass-thru the credits to a long-term tenant (subject to compliance with applicable rules). If so transferred to a tenant, members of the tenant share the credits in accordance with partnership profits.

Single Tier. In a single tier structure, typically the federal investor is admitted as a 99% member and the owner affiliate is the 1% managing member.

2-Tier Lease. In the more generally common 2-tier lease structure, the completed project is leased to an entity owned 99.00% by the federal investor and the owner affiliate is the 1% managing member. Operations take place at the tenant level, and the income is used to pay operating expenses, management fees and rent, which is in turn used to service debt and pay developer fees.

Timing of Investment

Investor Partners contribute capital in accordance with an agreed upon schedule in the operating agreement. A typical example:

- Typical Structure:
  - 25% at financial closing.
  - 50% at certificate of occupancy
  - Balance at Part 3 Certification.*
- Revenue Procedure 2014-12

*These numbers are general benchmarks only

Interplay Between HTC and Debt Financing

- HTC as an equity enhancement to borrower from lending perspective.
- Limitations on the ability to foreclose during the recapture period – SNDA/Foreclosure Rights Agreement
- Section 49 Issues.

Interim Financing / Bridge Loans

- Developers typically take bridge loans against future equity contribution obligations to fill construction budget gaps.
- Lender must underwrite the borrower and the investor’s ability to fund its capital contributions obligations when due.
- Generally require financial strength behind personal guarantees of construction completion in accordance with Part 2 Approved Plans.
- Underwriting requirements increasing in this lending environment.
- Interest reserve accounts funded at closing to cover the term of the bridge loan.

Tax-Exempt Use Limitation

- Real Property leased to a tax-exempt entity (tax exempt organization, governmental entity or foreign person/entity) in a disqualified lease* is treated as tax-exempt use property.
- Any rehabilitation expenditures that are associated with tax-exempt use property are NOT eligible for HTCs (neither the 10% nor 20% credit).
- The 50% Threshold Test: Property is treated as tax-exempt use property only if the portion of such property leased to tax-exempt entities under disqualified leases is more than 50% of the property. If more than 50% of a building is leased to a tax-exempt entity, a taxpayer would be able to claim the rehabilitation tax credit on the expenditures incurred for the portion of the building not rented to a tax-exempt entity.

*See next slide for the definition of “Disqualified Lease”

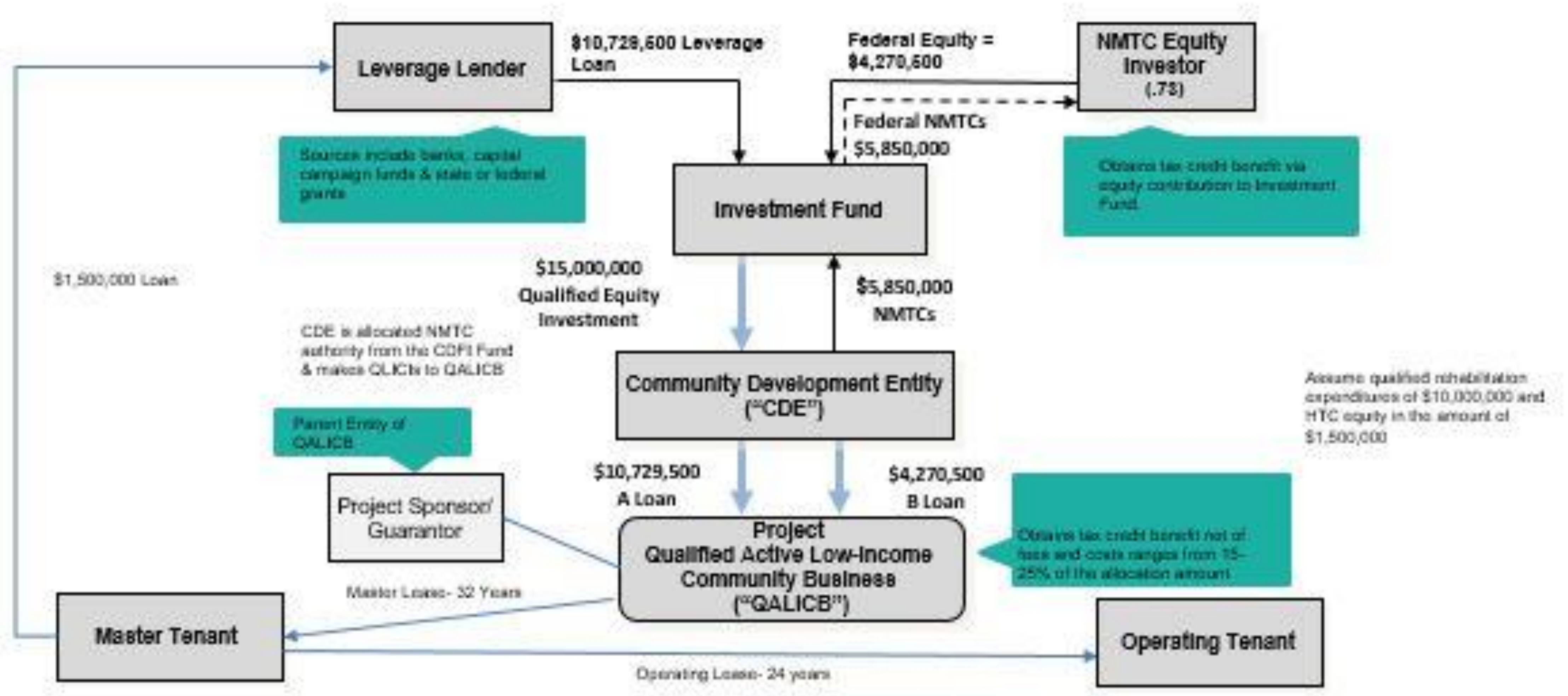
Disqualified Leases

- A disqualified lease is defined in Section 168(h)(1)(B)(ii) as a lease to a tax exempt entity where:
  - Part or all of the property was financed directly or indirectly by an obligation in which the interest is tax-exempt under Internal Revenue Code Section 103(a) and such entity (or related entity) participated in the financing, or
  - Under the lease there is a fixed or determinable purchase price or an option to buy, or
  - The lease term is in excess of 20 years;
  - The lease occurs after a sale or lease of the property and the lessee used the property before the sale or lease.
  - In a tow tier structure, the term of the operating lease is deemed to include the term of the master lease.
  - For this purpose, extensions of the lease term are included unless the rents paid during such term are fair market rentals.

Combining the HTC with other Tax Credit and Subsidy Programs

- State HTC Programs
- New Markets Tax Credits
- Low Income Housing Tax Credits
- HUD/USDA loans
- Grants
- Energy Tax Credits and CPACE Loans
- Opportunity Zone Investment
- PACE financing

Example $15,000,000 NMTC – Federal Historic Credit Hybrid Structure



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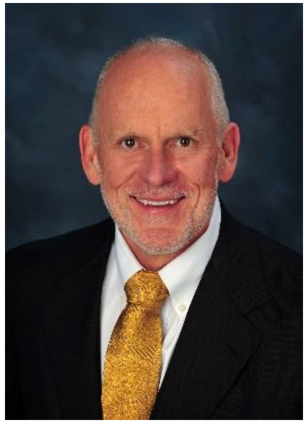

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Thank You