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The Ups and Downs of State Historic Preservation Incentives

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Study after study has proved that the federal historic tax incentive program, through the rehabilitation and ultimate adaptive reuse of older and historic buildings, has been one of the most successful and cost effective programs in leveraging private investment, fostering public-private partnerships and creating jobs in both good and bad economies. The program has been so successful that many states, as my February article pointed out, have adopted their own incentive programs. Unfortunately, while many state historic tax credit programs have proved successful over the years, some have been altered to the point where their usefulness is questionable, and others have been eliminated. The following article will look at several states that have had successful historic tax credit programs that ultimately suffered these fates and some of the reasons why.

A Little Background

I began my career in historic preservation in the early 1970s while a history student at Lewis and Clark College in Portland, Ore., hoping to graduate and head to law school. Little did I realize that I was bound for a career in historic preservation and specifically historic preservation tax incentives. The federal tax code in the 1970s was biased against the preservation of historic buildings and favored new construction. As a result, the building stock in many commercial downtowns and older inner city residential neighborhoods was abandoned and neglected. When cities embraced urban renewal and tax increment financing as a redevelopment tool, they often looked to remove "blight" by demolishing older buildings and clearing the land for developers.

With the enactment of the Tax Reform Act of 1976 and the Revenue Act of 1978, incentives were put into place to promote the preservation of older and historic buildings. In my position at the Oregon SHPO office I witnessed the federal tax incentive program grow and become an effective tool in the rehabilitation of many income producing historic buildings. The state of Oregon at the time had no incentive for residential rehabilitation and with great foresight it enacted one of the first state historic preservation programs in the country. The program took the form of a state property tax freeze that provided a 15 percent tax freeze on the assessed value of a historic property. This law extended to income producing properties and could be used in tandem with the federal tax law. In addition, the tax freeze could be used for owner occupied residential properties. Thus, property owners would have financial incentive for rehabilitating homes or commercial buildings.

Oregon

Photo: Courtesy of Heritage Investment Corporation
The Bohnson Cottages in Portland, Ore. were rehabilitated under the state's historic preservation tax

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Since its enactment in 1975, Oregon's State Historic Preservation Tax Law has resulted in the rehabilitation of more than 2,345 properties throughout the state, making use of the program and an estimated investment in excess of $1 billion in rehabilitation expenditures.

While the law still exists, it is unfortunate that it is used very little and can in fact be a burden on property owners who, when they leave the program, face property values that are higher than if they had stayed off the program. Reasons for the laws' demise are many but they began with property tax limitation laws in the 1980s. Other reasons included the public's perception of a program they saw as elitist and a sense that the program allowed some to pay less than their fair share. Increased bureaucratic requirements, intended to offset the elitist perception, over-complicated what had been a very simple program. The program finally was cut back from 15 to 10 years.

Rhode Island

Photo: Courtesy of Heritage Investment Corporation
The Slater Mill in Pawtucket, R.I. was rehabilitated with state historic tax credits.

In Rhode Island, the state's lucrative Historic Preservation Investment Tax Credit was enacted in 2002 and assisted in the rehabilitation of more than 230 commercial income-producing buildings prior to 2008, at which time the program was curtailed due to its high cost and state budgetary issues. While active, the program provided a 30 percent credit based on qualified rehabilitation expenditures and was uncapped. Although projects were required to undergo design review, liberal program regulations allowed for significant utilization and the program's success led to its downfall. With the state government facing mounting budget deficits and the use of the state historic tax credit exploding, the program became a victim of the burgeoning economic crisis. In 2008, the Rhode Island General Assembly increased fees, reduced the amount of the credit and eliminated the credit for all projects begun after December 31, 2007.

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Since the state historic tax credit was cancelled, and with the onset of the current economic recession, the number of adaptive reuse projects undertaken in Rhode Island has fallen precipitously and unemployment in the construction trades has increased significantly. Recent efforts have been undertaken to reinstate a revised state historic tax credit program that proponents see as a tool in the revitalization of the real estate sector and its associated job growth. In June 2011, a bill was introduced in the state House of Representatives that proposed reinstating a revised state HTC. The bill would have created a 20 percent historic tax credit with an additional 5 percent added for projects with commercial and retail space. Projects that were eligible to receive in excess of $5 million in tax credits would have been limited to claiming $5 million in tax credits per year until the fourth year when the balance would become available. Although the bill was not passed, support remains strong among politicians, real estate professionals and preservation advocates. In February, two bills – S. 2313 and S. 2269 - were introduced in the state Senate that would create a state historic tax credit. Copies of the bills can be found online at www.historictaxcredits.com.

State of Michigan

Established in 1999, the Michigan Historic Preservation Tax Credit provided a 25 percent tax credit based on qualified rehabilitation expenditures. The tax credit was well utilized and successful, leveraging more than $1.4 billion in rehabilitation activity, with each $1 of state credit leveraging $10.56 in direct economic impact. Although extremely successful, the state tax credit program fell victim to budgetary issues in May 2011. It was then that the Michigan Business Tax was eliminated and replaced with the corporate income tax. Along with this change in corporate tax policy came sweeping changes in the state's historic tax credit program. The Michigan Historic Preservation Tax Credit program was eliminated in favor of the Michigan Community Revitalization Program.

The new program, administered by the Michigan Economic Development Corporation (MEDC), became active on October 1, 2011 and was funded with $100 million from the Michigan Strategic Fund (MSF). Unlike the previous program, which was similar to the federal historic tax credit, the new program provides incentives including loans, grants and other economic assistance to projects that "promote community revitalization." Funding from this program cannot exceed 25 percent of total eligible investment for a single project, $10 million for loan agreements or $1 million for grants. The new program regulations include a multi-step review process requiring local support, multiple program criteria, MEDC analysis and support and final approval and execution by MSF. Unlike the straightforward application process for the historic preservation tax credit, the Michigan Community Revitalization Program application process is competitive and more

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involved. As a result of the new regulations and program limitations, it is unlikely that investment in adaptive reuse projects in the state of Michigan will equal the amount that was seen when the historic preservation tax credit program was active.

Summary

To date, some 30 states have adopted historic tax credit programs. In most cases these tax credits take some form of the 20 percent federal income tax credit for historic rehabilitation contained in Section 47 of the Internal Revenue Code. We know that all state tax credit programs are not created equal despite proof of their ability to stimulate rehabilitation activity.

So what have we learned so far with respect to the factors that will determine the effectiveness and ability to maintain a successful program? Actually, many factors come into play when creating a successful state historic preservation incentive program. Programmatic and technical issues such as caps on credits, transferability of annual aggregate caps, statutory limits on the kind of project that can be funded, funding cycles, transferability of credits to third parties and ease of use are but some of the programmatic and technical issues that arise in successful state historic rehabilitation tax incentive programs.

I would argue, however, that given current economic conditions in which many states are seeing significant impacts on their budgets, that the political issues and lack of understanding of the value of the economic impact of the programs are some of the leading factors to state HTC programs' success or failure. As the economy turns around it will be important that we do not become complacent because a program seems to be working. The success of a program will often lead to its demise.

It is indeed ironic that in our current fiscal climate the move to start new or improve existing programs has slowed while all economic data shows that historic tax credits are highly effective at creating jobs and returning tax revenues to state treasuries.

John M. Tess is president and founder of Heritage Consulting Group, a national firm that assists property owners seeking local, state and federal historic tax incentives for the rehabilitation of historic properties. Since 1982 Heritage Consulting Group has represented historic projects totaling more than $1 billion in tax credits. He can be reached at 503-228-0272 or jmtess@heritage-consulting.com.

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