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Maximizing Historic Rehabilitation as an Economic Revitalization Tool

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As detailed in the National Park Service's (NPS's) 2011 Annual Report, the federal historic preservation tax incentive program is the nation's most effective program to promote historic preservation and community revitalization through historic rehabilitation. Since its inception in 1976, the tax credit program has generated $62 billion in the rehabilitation of income-producing historic preservation. In 2011, the program approved $4.02 billion in new rehabilitation work in 937 new projects. This work created 55,458 jobs. From the perspective of "boots on the ground," it is hard to imagine a real estate developer undertaking the renovation of a landmark property – buildings such as Denver's Union Station or Washington, D.C.'s Tariff Building – without such an inventive. The same can be said for smaller projects. The program has played an integral role in the preservation and rehabilitation of iconic buildings. It has played an integral role in maintaining the historic architectural fabric of our communities. The historic tax credit (HTC), particularly when coupled with other national programs, such as new markets tax credits (NMTCs) or low-income housing tax credits (LIHTC), and/or state historic incentives, provides enough of a financial and psychological benefit to make the vagaries of historic rehabilitation worthwhile.

This not to say a good program can't be made better.

It is estimated that there are approximately 5 million commercial buildings in the United States with an estimated 72 billion square feet of floor space. According to the U. S. Department of Commerce, every year 170,000 new commercial structures are built while 44,000 existing buildings are demolished. These are not all potential tax credit projects, but there is and continues to be an enormous demand for income-producing space. And considering the HTC statistics noted above in this broader context, the HTC renovations to date involve less than one tenth of 1 percent of the nation's building stock.

This is in part because the post-World War II growth pattern of sprawl continues. Historic and older buildings languish in cities' commercial districts, whether in Los Angles, Calif., Detroit, Mich. or Manchester, N.H. This pattern continues despite the continued migration from rural to urban areas and even despite successful "back to the city" efforts in nearly every major community. Philosophically, new continues to be preferred over old. This is borne out in every real estate market where Class A rents and occupancy rates far outpace historic, Class B and C. All too often, "back to the city" translates into new, larger and more energy efficient buildings, not rehabilitation of historic buildings. As architects and developers become more and more adept at creating "character-defining" spaces in new structures, the special opportunities of historic and older buildings recede.

The challenge facing the historic preservation community today is to take the success of the HTC and make it a bigger and bolder economic revitalization tool. Besides the direct rehabilitation impact, expanding the program increases the number of central city jobs, strengthens the urban tax base for schools and city services, and helps build the critical

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mass that can tip a town on the brink toward an upward cycle of investment and growth. As properties built in 1962 are reaching the 50-year mark, the HTC program will become relevant to modern-postwar construction, such as Mies van der Rohe's 52-story IBM Building. Is there value in the HTC connecting with the preservation and rehabilitation of our mid-century modern icons? For its part, the real estate industry is largely neutral; like most economic activity, it follows the money. Where more money is too be made, interest increases proportionately.

The opportunity presented by the HTC was recognized in 2005 when the NPS Advisory Board was asked to examine the program. The evaluation was far-reaching. It included the NPS and state historic preservation offices responsible for administering the program, as well as preservation advocates such as the National Trust for Historic Preservation, the Association for Preservation Technology International and Preservation Action, and beneficiaries of the program, including consultants and developers. The resulting report acknowledged that the HTC indeed generated economic development and revitalization. Those benefits continue to be reflected in the how the program is portrayed in the NPS' annual report.

The fact is that the rehabilitation of historic and older buildings can't and doesn't exist in a vacuum. Today, it is generally recognized that the LEED certification standards first largely undervalued retaining and reusing existing construction over new construction. This failing wasn't the result of bias on the part of those interested in energy efficiency, but was related more to preservation advocates being largely silent in the development of those initial standards. At the time, there was limited interest in a broader conversation, but for the HTC to expand, there needs to be a willingness to have that broader conversation.

One major driver for downtown historic rehabilitation during the past two decades has been the rise of boutique hotels. Yet, with few exceptions, for a boutique hotel to succeed, it must be associated with a major brand (e.g., Marriott, Hilton, Wyndham). Each brand has its own property standards, which relates to the

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target market level (star-rating) or brand-specific identity. It could be a requirement for amenities, or even a required breakdown of room types, also known as "keys" (e.g., king versus double-double). When a boutique hotel project involves HTCs, conflicts often arise between the brand requirements and the application of the Secretary of Interior's Standards. This conflict puts the developer between a rock and a hard place. The developer needs the HTC, but also needs the brand. The conflict increases the "brain-damage" quotient and development costs while also slowing the construction schedule. Historically, these issues are addressed on a case-by-case basis and sometimes by appeal. Often, the solutions result in a really good shoehorn, where the final designs are agreed to by all but may not be particularly elegant. Addressing the issue in this piecemeal fashion may limit the potential use of the HTC program. Perhaps a better approach would be to establish a dialogue with the brands and the larger marketplace.

A similar case can be found in office HTC applications. Although a building may continue be used for its historic uses (an office building as an office), the nature of office design has changed substantially over time. The high-rise office building dates to the early 20th century where the typical and most profitable arrangement consisted of interconnected spaces of 320 square feet arranged along a double-loaded corridor. Each unit ran along an exterior wall with operable windows for light and ventilation. In the 1930s, starting with the RCA Building, flexible office floors could be laid out to meet the needs of specific tenants. With the 1952 Lever House, Skidmore Owings and Merrill took this concept one step further with movable partitions – a design perfected by the end of the decade in Union Carbide Building. In part, these designs were possible with advances in HVAC and lighting design. Similarly, for most of the 20th century, office spaces were limited to a structural grid with spans of 15 feet, later extended to 25 feet at mid-century. By the second half of the century, structural design allowed column free spans of 42, 72 and even 100 feet. These technological changes followed market need. Early 20th century offices accommodated by and large hierarchical enterprises with a handful of spaces for executives and rows of desks for "worker bees." Design began to focus on value-oriented workplaces, be it a "cube farm" or "action office." Today's office market draws its cues from Silicon Valley campuses where the creative souls (not to be called employees) spend long hours in office settings with ample opportunities for meals and social interaction.

Throughout the country leading edge urban developers are attempting to blend the "back to the city" trend with a Silicon Valley-style workplace. They want to locate in older buildings in the downtown core, which offers the vibrancy of a historic setting while creating a 24/7 work space that allows them to compete for the creative best. But this new office application can and does run counter to traditional applications of the Secretary of the Interior

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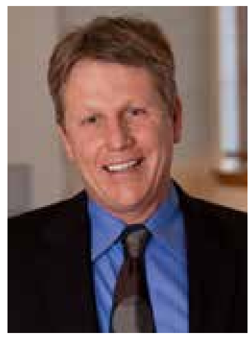
Standards. Corridor changes and interior finishes often become barriers to the HTC. As with hotels, the issue for the developer is not one of applying a personal design aesthetic but rather attempting to respond to marketplace requirements. The developer is again put between a rock and a hard place. As with hotel, the tax credit program addresses the question on a case-by-case basis. Again, as with a hotel, it would be beneficial to have a broader conversation. As discussed in the January issue of the Novogradac Journal of Tax Credits, similar conflicts exist in retail rehabilitations.

The conservative response would be to say that the HTC program is not all things to all developers, that Standard 1 directs that a use must be appropriate to the resource. But one could also argue that there is enormous demand for office, hotel and retail space in today's market. Without access to the HTC, many of those 44,000 buildings being demolished every year will be older and historic buildings that define our communities. For our historic commercial cores to thrive, we need to capture the market demand and to channel the HTC effectively. The HTC program offers a significant incentive and that the program today only captures a small portion of its potential. To move beyond, we need to acknowledge historic rehabilitation's place in today's real estate industry, reach out to the marketplace and begin a broader dialogue focused on economic revitalization of historic and older buildings.



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