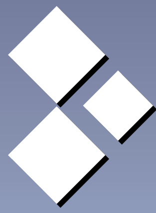

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HISTORIC TAX CREDIT TOOL BOX

Once-Dead Projects and Historic Tax Credits

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The reality of the real estate market is that it is cyclical. Real estate development has arced over the past decade from too hot to frozen and now back to warming. And as experienced a few years ago, the cycle down can be rapid–in some cases stopping a development in the middle of construction. Now that the market is warming again, developers are looking to complete these partially completed properties. This cycling presents both

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Photo: Courtesy of Heritage Consulting Group

The Oakland Lampworks in Oakland, Calif., is a 100,000-square-foot, four-story brick light bulb factory designed by the Austin Company and built in the 1910s.

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opportunities and challenges for the historic tax credit (HTC) program. The key thing to remember is that the program has demonstrated the flexibility to adapt and work for developers.

There are two fundamental scenarios where a project comes back to life. In the first, one developer has acquired the building, begins construction and for one reason or another, runs out of money. Not infrequently, the demolition work has been done, but perhaps construction financing was not secured. Either the developer or perhaps the bank ends up selling the building and maybe the development. A new developer picks up the pieces either through direct sale or foreclosure and comes in with a new plan–either to complete the development as intended but with better financing or perhaps adapting the property to a new market.

In these instances, the HTC program can be forgiving. So long as there is no association between buyer and seller, the new owner is not responsible for the impacts of the prior development. The critical point here is that new ownership must be entirely independent of the old. New ownership does not simply mean a new limited liability corporation or a new majority partner. Both the Internal Revenue Service (IRS) and the National Park Service (NPS) are both wary and cognizant of schemes that try to give the illusion of new ownership as device to secure tax credits when inappropriate demolition has been done.

But again, when the new ownership is truly new, the HTC program can be forgiving. In practical terms, regardless of the work of the prior developer in removing historic materials (e.g., windows, corridors, decorative trim), the new owner is not penalized nor required to restore these elements. The caveat, however, is that the building must still be certified as a historic building. If the property was already listed on the National Register, it remains a certified structure. A property may be removed from the National Register for lack of integrity, but it requires someone to actively pursue delisting. A more challenging scenario is where the building is a contributing structure to a historic district. The new buyer would still need to secure a Part 1 approval. The good news is that typically for district properties, the historic values are embedded in the exterior–so if the exterior is largely intact, then the chance of Part 1 approval is quite possible.

Photo: Courtesy of Heritage Consulting Group
The Oakland Lampworks, a former light bulb factory in Oakland, Calif., was converted into more than 90 loft-style apartments.

A very early example of this scenario was the Imperial Hotel in Portland. In 1985, the building was individually listed on the National Register. Shortly after, a developer sought to adapt this 1894 hotel building into offices. In the process, the interior was stripped and reduced to its concrete shell. As work was underway, the office market collapsed and the project died. Kimco Hotel Management (now Kimpton Hotel Group) acquired the building and transformed it into one of the first historic boutique hotels in the country, leveraging its investment with HTCs. In the redevelopment, the NPS continued to have design review of the project and new construction, but Kimco was not penalized for the earlier demolition.

More recently, Raintree Partners acquired the Wilson Building in San Francisco in similar circumstances. There the developer planned to adapt a seven-story office building on Market Street in San Francisco to condominiums. The development passed through local design review, demolition stripped the interior and a full height atrium inserted into the structure. When

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the condominium market collapsed, the development stopped. Raintree acquired the building with the vision of adapting it for market-rate housing, relying on HTCs in its pro forma. Shortly after acquiring, Raintree filed a Part 1, subsequently approved by the NPS, certifying the building as a contributor to the Market Street Theater and Loft National Register district. With that certification, the project was able to move forward without significant design challenges because there was little historic material left.

In the second scenario, the project stalled but never dies as a result of the tenacity of the developer. Typically, the development secures Part 2 approval but, because of market conditions, construction comes to a stop. Rather than sell the property, or perhaps there is no market, the developer holds the property, intent on outliving the real estate cycle.

A good example of this scenario is the Oakland Lampworks. Located in west Oakland, Calif., the building is a 100,000-square-foot, four-story brick light bulb factory designed by the Austin Company and built in the 1910s. In the early 2000s, the developer envisioned this to become 90-plus loft-style apartments. A Part 1 for a preliminary determination for individual listing was filed and approved, followed shortly by the Part 2 for the rehabilitation. And then the development market in the Bay Area disappeared. For all intents and purposes, the development died–until 2012. As the market returned, so too did the development. The applicant was allowed to pursue the development under the existing Part 2 application, but given the length of time, NPS required an updated set of photographs documenting the building's current condition. As the project moved forward, there were design modifications which were addressed through the amendment process. The project was finally completed the month before the start of 2015.

For properties where the developer perseveres, such as Oakland Lampworks, there are two key elements to keep in mind. The first is to anticipate that NPS will require updated documentation when the development restarts. This is standard procedure and allows the reviewers to appreciate the current condition. More importantly, even though the Part 2 cover sheet asks for an anticipated start/end date, and even though a development may begin, it is entirely up to the developer to choose its 60-month window for qualified rehabilitation expenditures.

In some situations, a development may collapse with the market, but the developer is able to create a new ownership structure to move the property forward. In these instances, new ownership may anticipate that any conditions of an existing Part 2 will carry forward, but that without design changes; no new conditions will be applied. Regardless, given the time elapsed; NPS typically will require a new Part 2 with documentation–not simply a change of ownership filing.

The upshot is that as the real estate market continues to rise, it is possible for developers to look at dormant developments and contemplate reviving them by using the 20 percent federal HTCs and associated state HTCs.

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 $3 billion in rehabilitation construction. He can be reached at 503-228-0272 or jmtess@heritage-consulting.com.

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