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When State Incentives Meet Budget Realities -The New York State Rehabilitation Tax Credit

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Recently, a number of developers have asked Heritage Consulting Group to find investors interested in purchasing New York state rehabilitation tax credits. After searching high and low, it is evident that the market has little to no appetite for the state's rehabilitation tax credits. With state historic tax credits so prevalent and useful, it was perplexing that there were no investors interested in purchasing these credits.

The New York rehabilitation tax credit provides a 20 percent tax credit based on qualified rehabilitation costs. It is capped at $5 million and is a companion program to the federal investment tax credit. Unlike the federal program, the state rehabilitation tax credit requires that a property be located in a census tract with a median income at or below the state family median income level, in a qualified census tract or in a state area of chronic economic distress. The New York rehabilitation tax credit is not available individually, and must be twinned with the federal program; subsequently there is no specific application required for the state credit.

As noted in previous articles, one of the primary drivers in the rehabilitation of historic buildings is the proliferation of state historic tax credit programs. When twinned with the 20 percent federal rehabilitation tax credit, state tax credits have become the lynchpin in meeting funding gaps and have enabled scores of successful projects. Although some programs are more successful than others, and each state has its own rules and benefits, there are few in the industry who would not agree that the state historic tax credits have been a grand success.

Unfortunately, the economic downturn of the past five years has done significant damage to state coffers and has caused state governments to re-evaluate their historic tax credit programs. Although the benefits of state historic tax credit programs appear to be crystal clear, and their costs a relative pittance in state budgets, the extended nature of the current economic crisis has made the state historic tax credit programs ripe for the ax.

New York's rehabilitation tax credit was enacted in 2007 but was considered to be of little value as it was capped at $100,000 per project and only 6 percent of qualified rehabilitation costs could be claimed. It soon became clear that the credit, although a step in the right direction, was not effective. In 2009, the state revised its historic tax credit program to better align it with more effective state historic tax credit programs. The revised state historic tax credit now would allow applicants to claim 20 percent of qualified rehabilitation expenditures with an increased cap of $5 million.

Although the state's revised historic rehabilitation tax credit program was an improvement, the credit was limited based on its cap, a limited geographical availability that was based on a medium family income and an inability to separate the federal and state historic tax credit for investors. Even with these limitations, the New York historic rehabilitation tax credit was viewed by developers and investors as a major boon for business, especially for small and medium sized projects.

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Following the enactment of the enhanced New York historic rehabilitation tax credit, the number of rehabilitation projects proposed and undertaken jumped significantly, especially in areas of upstate New York where the additional tax credits were essential. Projects that had failed in previous decades were now positioned for success.

Unfortunately, the enhanced program's early successes quickly became endangered due to state budget issues. As noted in previous articles, the elimination of state historic tax credits has been a popular target during recent years as state governments have battled growing deficits; those of New York were no exception. In order to close the state's short-term fiscal gap, the 2010 budget included a provision that deferred certain state tax credits temporarily; this temporary deferral included the historic rehabilitation tax credit. Under the 2010 budget, any rehabilitation tax credits in excess of $2 million that were earned between 2010 and 2013 are deferred until 2014. As imagined, this policy change has wreaked havoc on the New York rehabilitation tax credit.

Investors with projects under way face the prospect of covering much of the equity from the tax credits for up to four years. In addition, the enhanced historic rehabilitation tax credit is set to sunset in 2014, rendering the program nearly unusable. Program changes and retroactive deferment have left investors wary of New York's program and unwilling to invest in the state's historic rehabilitation tax credits.

In less than a year, the New York historic rehabilitation tax credit program transitioned from praise to pariah and is currently viewed as unusable. For projects in transitional markets, the loss of the state tax credit makes it significantly more difficult to fund projects as rents remain low and financing difficult. Where projects are viable, investors are unwilling to purchase the state's tax credits in fear of further legislative action.

Although the temporary deferral has had a significant impact on the use of New York historic rehabilitation tax credits, it is not all doom and gloom in the Empire State. Even with the significant adverse impacts of the deferral, the program has proved to be a significant economic development tool and developers, politicians and preservation advocates all have clamored for the program to be expanded. Just recently, the state Legislature passed a bill that would raise the maximum tax credit from its current level of $5 million to $12 million. This would increase significantly the size of projects that could garner the full 20 percent tax credit, and would assist in larger projects that have funding gaps that could not be remedied previously. While the increased tax credit would not repair the damage caused by the temporary deferral, an increase in the number of historic projects undertaken in New York could be expected.

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As the economy continues to make positive strides, it is important to understand that state budgetary issues remain and states' historic tax credit programs are often candidates for the red pen in budget negotiations. While historic tax credits have proved effective as economic development tools and are successful in creating jobs, increasing taxes and improving buildings and neighborhoods, short term budgetary demands often outweigh the longer term benefits garnered through the rehabilitation of historic buildings.

Thankfully, states appear to be taking a second look at historic tax credits as a way to stimulate local economies and the proposed increase in the cap in New York will increase the viability of the state's large projects. Although we're not out of the woods yet, and no one is satisfied with the current economy, optimism abounds that states like Pennsylvania and New Jersey, which continue to explore enacting state historic credits, will continue to realize the positive effects garnered from rehabilitation projects spurred by state historic tax credits. ❖

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