

## The Non-Historic Rehabilitation Tax Credit: An Important but Overlooked Incentive

By John M. Tess, President, Heritage Consulting Group

One of the lesser known rehabilitation tax credits is the 10 percent credit for non-historic buildings. The credit was created with the Tax Reform Act of 1986 at the same time as the 20 percent historic rehabilitation tax credit. Although the program has limited applicability, it is simple in concept and administration and thus can serve as a strong incentive to urban revitalization.

### The 10 Percent Rehabilitation Tax Credit

In many respects, the 10 percent non-historic and 20 percent historic tax credits (HTCs) are similar. Both are dollar for dollar federal tax credits, not deductions. In both instances, a project must meet the substantial rehabilitation test; the qualifying rehabilitation expenses must exceed the greater of \$5,000 or the adjusted basis of the building (exclusive of land value). Similarly, what is acceptable for qualifying rehabilitation expenses is the same for both the 10 percent and 20 percent credits.

The 20 percent and 10 percent incentives are distinguished in two specific ways: First, whereas in the 20 percent tax credit program, the National Park Service (NPS) has design review over the entire project, the 10 percent incentive has no design review requirements. There is no need to adhere to the Secretary of the Interior's Standards for Rehabilitation. Beyond the design freedom, there are a number of practical benefits: Whereas the 20 percent credit requires the submittal of a narrative supported by extensive photo-documentation and architectural plans, there are no submittals to NPS for the 10 percent credit. Design-build and value engineering solutions are free of any delays created by

required review. There are no hiccups in the construction process and timetable resulting from design review.

Second, while the 20 percent program must be applied to a complex in its entirety, the 10 percent credit does not need to be and may be limited to individual buildings within a complex. For example, a four-building 1920 to 1935 industrial complex under common ownership is treated as a single project for the 20 percent HTC; for the 10 percent credit, the developer may choose to use the credits in any combination and would not be penalized if the larger project included demolition of one or more of the structures.

To be eligible for the 10 percent incentive, a project must meet several critical thresholds. The first is that the building cannot be listed on the National Register of Historic Places, either individually or as a contributing building in a National Register district. In the situation where a building is located within a National Register historic district, the applicant must seek a determination of non-contributing status from the NPS to claim the credit. The owner accomplishes this by filing a Part 1 – Evaluation of Significance. Unlike the 20 percent tax credit, in this instance, the applicant checks the box in Section 2 (Nature of Request) seeking “certification that the building does not contribute to the significance of the above-named district.” And unlike the 20 percent determination process, the support materials are provided to demonstrate why the building is not historically or architecturally significant. The owner only needs to provide documentation to the NPS if a building is located in a National Register district. For pre-1936 buildings outside

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a historic district and not listed on the National Register, no documentation of non-historic status is required.

The definition of “non-historic” for the 10 percent credit is very specific. If there is no linkage to the National Register, then a property may be eligible for the 10 percent credit. This includes buildings that may have local or state historic designations, are located within a local- or state- designated historic district or a potential but not listed National Register district.

There are, however, other critical qualifiers for the 10 percent rehabilitation credit. First, the property must have been placed in service **before** 1936 and cannot have been physically moved. The 10 percent credit cannot be used for residential projects. The qualifier relates to the building’s planned use, not its historic one. Thus, a 1925 apartment building adapted for hotel use could qualify for the 10 percent credit, but a hotel being adapted for housing cannot.

Finally, the 10 percent credit has an internal and external wall retention requirement:

- ♦ at least 50 percent of the building’s walls existing at the time the rehabilitation began must remain in place as external walls at the work’s conclusion,
- ♦ at least 75 percent of the building’s existing external walls must remain in place as either external or internal walls, and
- ♦ at least 75 percent of the building’s internal structural framework must remain in place.

### Opportunities

For qualifying projects, the opportunity of the 10 percent tax credit can be significant. The benefits include being able to apply the 10 percent credit to one building within a unified complex and not needing to meet the Secretary of the Interior Standards. This freedom can be essential for select projects where owners wish to incorporate innovative design elements. Examples of elements that may conflict with the Standards include rooftop or adjacent additions, storefronts and interior spaces.

**Rooftop Additions:** The acceptable NPS parameters for a rooftop addition in a 20 percent rehabilitation are no rooftop additions on buildings three stories or less, a minimum of a one-bay set-back on primary elevations and a limit of one additional floor. In the case of a 10 percent project, none of these constraints exist: A rooftop addition may be placed on any structure, may be of any number of floors, and may be built not only to the parapet but conceptually extend beyond the parapet.

**Adjacent Additions:** According to the Standards, the acceptable parameters for the 20 percent credit are adjacency only at the

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side or rear, design similarity in scale and massing, and use of compatibility of materials. In the case of a 10 percent project, the addition could be of any design, massing and scale. For example, with the 20 percent credit, typically the height of the new side addition cannot be taller than the original resource; with the 10 percent credit, there is no limitation beyond local zoning laws.

**Storefronts:** With the Secretary's Standards, storefront treatments typically require a traditional configuration with a bulkhead, plate glass window and transom. Nano doors, oversized canopies and other devices intended to extend a restaurant or retail space into the sidewalk zone are generally not acceptable. Within the parameters of the 10 percent program, such limitations do not exist.

**Interior Spaces:** Many buildings constructed in the first two decades of the 20<sup>th</sup> century were specific single use structures. These range from theaters and churches to fraternal halls and auto showrooms. Dividing large interior spaces is difficult and often impossible to achieve under the 20 percent program. With the 10 percent credit, such subdivisions are not an issue.

Parallel situations exist in signage, new canopies, new window openings, interior finishes, and corridor retention. With the 20 percent tax credit, there is a necessary design review process that requires documentation and review time and often results in design revisions. In the most extreme circumstances, the 10 percent credit can be used as part of a design that uses the older architecture as a canvas for a new contemporary architectural statement. More typically, it is a path to support rehabilitation where the requirements of the building's new use conflict with its original design.

### Limitations

For all of its positives, the 10 percent tax credit program does have limitations. First and foremost, it is 10 percent less than the 20 percent credit. For a \$20 million project, it is the difference between \$2 and \$4 million. Parallel to that, many, if not most, rehabilitation projects rely not only on federal credits but also on state historic preservation incentives. These include property tax abatement and state income tax credits. The state program rules almost always mirror the 20 percent tax credit and are usually not available for buildings that only qualify for the 10 percent tax credit.

Monetization of the credits can also be difficult. In today's market, syndicating tax credits is challenging and with a limited pool of investors for smaller sized deals (i.e., projects involving tax credits of less than \$1 million). By contrast, the larger the tax credit, the larger the investor pool and the better the negotiating position for the developer.

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While the 10 percent credit is free of NPS design review, most metropolitan areas have some degree of design review for building projects. The design freedom found in the 10 percent program does not eliminate the need to comply with local regulations.

Finally, from an urban redevelopment perspective, the 10 percent credit is limited in its applicability. Increasingly, broad sections of our urban cores are being listed on the National Register. Today, there are over 1 million buildings listed on the National Register, either individually or in historic districts, and 30,000 more properties are added annually. The universe of buildings eligible for the 10 percent credit is further limited by the pre-1936 placed-in-service date and the exclusion of residential rental.

### **Conclusion**

For the right project, the 10 percent non-historic tax credit is an outstanding incentive. Freed of the need to adhere to the Secretary of the Interior Standards and of the need for federal design review, the 10 percent incentive can bring additional money into a project. It is

particularly useful for those projects where the design of the building does not lend itself neatly to adaptive reuse. The credit is not without its limitations, such as the inability to leverage it with state historic tax credits and the inability to use the credit for residential projects. For buildings that are not certified historic structures, however, it is worthwhile to weigh the relative benefits and costs of both the 10 percent and 20 percent options before beginning a renovation project. ❖



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