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Twinning the HTC with the Low-Income Housing Tax Credit

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There was a time when constructing or renovating a building was generally a straightforward affair. Buy the land, find your equity, get your approval and build. While this outline remains, the simplicity of the good old days seems as dated as the typewriter. Today, even straightforward projects are complicated. Complex ownership entities, lengthy project review and multiple funding sources have become the norm, and connecting these pieces has become paramount to the success of a project. These complex arrangements have enabled many projects to be successful but require significant connecting and understanding amongst project team members.

One classic financing arrangement is twinning the federal historic rehabilitation tax credit (HTC) with the low-income housing tax credit (LIHTC). This relationship seems like an easy pairing; historic buildings can generally be adapted for housing and are often located in areas where the demand for affordable housing is strong. Unfortunately, that's where simple ends and complex begins. Although the programs may seem similar, in reality they are completely unrelated, with separate rules, requirements and administrative bodies. Making the two programs work together successfully requires time, patience and a strong project team that is flexible and able to meet both programs' demands.

Photo: Courtesy of Heritage Investment Corporation
Located in the Mt. Airy neighborhood of Philadelphia, the 1895 Nugent Home for Baptists was originally built as a retirement home for Baptist ministers.

To understand the complexities of combining the two programs, it is important to understand the basics of each program. The HTC provides a 20 percent "by-right" tax credit based on qualified rehabilitation expenditures. To be eligible for the HTC, a building must be a qualified historic structure that is either individually listed in the National Register of Historic Places or deemed a contributing resource to a National Register historic district or certified local historic district. Work proposed as part of an HTC project must undergo design review to ensure that it meets the Secretary of the Interior's Standards for Rehabilitation. The state historic preservation office administers the HTC on an advisory level and the National Park Service (NPS) completes final certifications at the federal level.

The Internal Revenue Service (IRS) uses U.S. Department of Housing and Urban Development standards to administer the federal LIHTC program. Unlike the HTC program,

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individual state agencies are responsible for allocating LIHTCs. The LIHTC program has two separate rates, 9 percent and 4 percent. The IRS allocates 9 percent LIHTCs annually to state housing finance agencies, which award the credits to qualified projects. Each state housing agency is required to allocate its 9 percent tax credits through a competitive process based on federal and state guidelines and criteria. The 4 percent tax credit is considered to be a by-right tax credit and is provided to properties that receive tax-exempt bond funding. Credits are claimed over a 10-year period.

While working with either tax credit program is enough to keep a project team occupied, twinning the credits may be enough to turn one's hair gray. The two programs have unique requirements that are rarely convergent. Success in twinning the credits is predicated on understanding each program and formulating one project that meets the requirements of both.

Timing, Cost and Design

The three most important items in twinning the two programs are timing, cost and design.

Timing is most critical with the LIHTC, where approvals can take years. Not only does it take a substantial time to learn if your project was awarded credits, but properties often have to be submitted multiple times before they are funded. These timing issues can be difficult on the entire project team and it's important that everyone understands the application process. Once the project has been awarded LIHTCs, the clock begins ticking and the project must be completed by the date indicated by the state housing agency, often in a period as short as 18 months. For the HTC, 60 day to 90 day review times are typical, and can severely hamper meeting the LIHTC deadlines if the project team is slow to make its historic submissions. Prior receipt of HTC approval is advantageous and can improve an LIHTC application in states that provide points for historic preservation.

Cost is a determining factor in awarding LIHTCs, and higher costs make project approval less likely. Although cost is a primary factor in the LIHTC criteria, it is not nearly as important for the HTC. Costly architectural treatments required to meet the Secretary of the Interior's Standards may be necessary to receive rehabilitation tax credit approvals, but architectural or historic merit holds no sway with regard to LIHTCs. In fact, the added costs of meeting the Secretary of the Interior's Standards may negatively affect a project's ability to secure LIHTC funding. Twinning these tax credits requires the developer to balance LIHTC cost requirements with architectural treatments required to meet the Secretary of the Interior's Standards.

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Photo: Courtesy of Heritage Investment Corporation
This photo of the interior stair of the Nugent Home for Baptists shows the results of a decade of abandonment and decay.

The final critical item in the twinning of the two programs is design. As with timing and cost, the key is to find a balance between the LIHTC design requirements and the Secretary of the Interior's Standards. While one program focuses on housing and tenant needs, the other is meant to protect the historic integrity of a building. Requirements with regard to lead paint, energy efficiency and unit layouts must be met to be eligible for a LIHTC allocation. These requirements often contradict with the Secretary of the Interior's Standards, which aim to preserve the building's historic character. It is a proverbial juggling act to design a project that meets the design criteria of both programs.

Of course, each of these three items affects the other two. Design requirements affect project cost and design changes affect the timing of approvals. The need to limit project costs will influence what historic elements can be retained and where value engineering is required to meet LIHTC cost criteria.

Twinning the Credits in Philadelphia

Recently, Heritage Investment Corporation has been involved in a twin deal that exemplifies the challenges of utilizing both programs in the funding package for one project. Located in the Mt. Airy neighborhood of Philadelphia, the 1895 Nugent Home for Baptists is a grand brick and stone structure originally constructed as a retirement home for Baptist ministers. The building is an architectural gem and holds a significant place in its working class neighborhood. Following a decade of abandonment and decay, Nolen Properties purchased the building with the intent to rehabilitate it into affordable housing. To make the project economics work, it was paramount that LIHTCs and HTCs be secured. Although the building was listed in the National Register and was previously utilized as a multifamily facility, twinning

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the tax credits was not a simple process.

According to Jim Nolen at Nolen Properties, patience, persistence and attention to detail were required to make the project work. Nolen said the LIHTC process required patience, with the first LIHTC application submitted in September 2009 and funding not received until the project's fourth application in October 2011. Nolen was also quick to mention that the design requirements of the Pennsylvania Housing Finance Agency (PHFA) were not easily integrated into the Secretary of the Interior's Standards.

Prior to design changes, the project was approved for HTCs but costs per residential unit topped $300,000, well in excess of the typical $180,000 per unit cost for LIHTC-funded developments in Philadelphia. The high per unit cost was largely due to renovating distinctive and original architectural features, such as in-kind replacement of the prominent clay tile roof and replicating missing cornice and porch features; Nolen had to retain or replicate these features to meet the rehabilitation tax credit requirements. Because the project's financial viability depended on the use of both tax credit programs, Nolen Properties was forced to redesign the project in order to lower per unit costs. The redesign balanced the requirements of the Secretary of the Interior's Standards with PHFA's requirement to lower per unit costs. The development team determined that a new addition at the rear of the property could increase the density and lower the project's per unit cost while maintaining the historic building's architectural integrity. PHFA and NPS found this solution acceptable and the project was awarded LIHTC and HTCs.

As illustrated above, it is possible to utilize both HTCs and LIHTCs to fund an affordable residential project, but flexibility and responsiveness of the project team is critical to meet the criteria of both programs.

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