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Exploring ‘State-Only’ Historic Tax Credit Strategies



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Located in the heart of Madison, Wisconsin, Grace Episcopal Church takes great pride in its 165-year-old building and the three-story stone tower that faces the Wisconsin State Capitol across the street. The church was designed by a prominent local architect, James Douglas, and is the oldest church building in Madison.

But all of that aging stone and slate comes at a cost and, in recent years, the relatively small congregation confronted urgent repair needs that topped \$1.4 million. Parishioners donated as much as they could and pursued external grants to fill the gap, but with each fundraising delay, potential costs increased. Fortunately, the church soon stumbled on an unconventional financing tool for a religious property: state-only historic tax credits (HTCs).

Understanding the Federal-State Distinction

The federal HTC has long served as the primary incentive for rehabilitating certified historic structures, offering a 20% credit toward the rehabilitation of eligible historic properties. In many states, an additional state HTC can be paired with the federal HTC as a complementary incentive. Since its inception in 1976, the federal HTC has helped fill the financing gap for preservation-focused redevelopment for tens of thousands of buildings across every state. Yet, the federal HTC has deliberate and significant restrictions, as it is not available to for structures that are deemed to be “tax-exempt use property.” As a result properties owned by nonprofit organizations (including schools, colleges and universities), governmental entities, religious institutions and others that are not tax paying entities cannot generate federal credits without

forming new and often complex legal structures. For small organizations like Grace Episcopal, these arrangements are simply not feasible.

Recognizing this eligibility gap, several state legislatures have made state HTCs available to nonprofit organizations, allowing them to be combined with the federal credit or used on their own. To date, about a half dozen states have structured their state HTCs in this way. Such “state-only credits” can be a transformative financing opportunity for nonprofit property owners, providing a more accessible alternative for mission-driven entities that maintain historic facilities but lack taxable income.

The State-Only Credit Process

In addition to expanding the eligibility criteria for state HTCs, these state-only credit programs streamline the administrative process, as they require only one level of review. The state historic preservation office (SHPO) must still approve the project, but without an additional review/approval by the National Park Service, applicants can often shorten review timelines, eliminate the dual-agency coordination required for federal HTCs and get projects started sooner. In some states, applicants may be able to reduce their documentation requirements, while others may require added documentation. Applicants must still meet

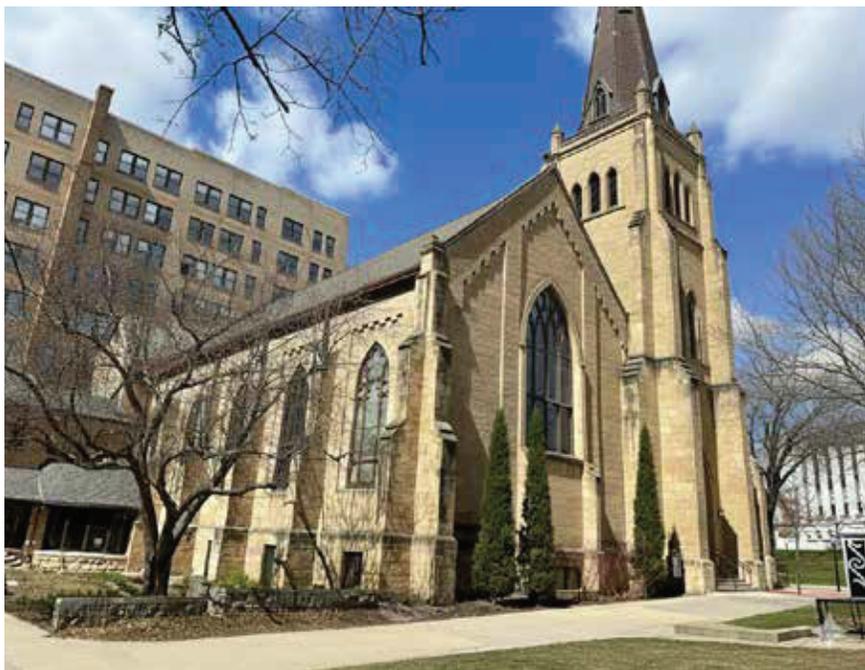


Image: Courtesy of Heritage Consulting Group
The Grace Episcopal Church in Madison, Wisconsin, used state-only historic tax credits to help fund significant repairs to its masonry, windows and roof.

certain guidelines; for consistency and best practices, state programs typically require adherence to the Secretary of the Interior's Standards for Rehabilitation, even if the development is not pursuing federal credits. Nevertheless, for smaller projects—especially those with modest rehabilitation budgets—this state-only approach is usually more efficient and cost-effective and preserves more institutional control over the project.

Case Study: State-Only Credits in Wisconsin

Madison's Grace Episcopal Church was fortunate to be in one of these states that makes its state HTCs available to nonprofit organizations, as long as they have a plan to transfer the credits. Wisconsin's state HTC has been in place for decades and is one of the most effective state programs in the nation. The credit applies to certified historic buildings and owners of eligible buildings may receive a state income tax credit for 20% of the qualified rehabilitation expenditures (QREs), up to \$3.5 million per parcel. With no annual program cap, applicants do not have

to worry about competing against other rehabilitation projects for a slice of the pie.

Given these cooperative conditions, Grace Episcopal Church turned to the state-only credits to help fund significant repairs to its masonry, windows and roof. Although the church originally had a slate roof, the historic roof had been replaced about 45 years ago with an inferior thin-slate roof that deteriorated and allowed for water infiltration.

Thus, the congregation wanted to

reintroduce an appropriate slate roof with a longer life span; the decorative cornice/fascia at the chancel and nave would be restored in place, and other roof features (such as the lead-coated copper gutter liner and ice guard aprons) would be replaced in-kind. Elsewhere on the building, the rehabilitation scope included cleaning and repointing select areas of masonry, as well as exterior window trim repair.

The state-only credits freed the congregation from the burden of additional financing costs and helped it tackle the repairs to its historic building with the most appropriate materials and methods.

“We are a relatively small, downtown Madison congregation,” said the Rev. D. Jonathan Grieser, rector of Grace Episcopal Church. “Maintaining the historic, museum-like quality of our building is a challenge. But the credits allowed Grace not to borrow to finance the project and to use scarce funds for other building projects and for our mission and outreach work in the community.”

The church was already listed on the National Register of Historic Places, which cleared the way for it to apply to the Wisconsin Historical Society for the credits; applicants must be individually listed

on the National Register or included as a contributing resource within a listed historic district. Beyond that baseline of eligibility, applicants must secure Part 2 approval before beginning work, and QREs must exceed \$50,000 and adjusted basis (legislation is pending to eliminate the adjusted basis requirement).

In keeping with the streamlined advantages of state-only HTCs, Wisconsin applicants typically receive a review within 30 days. Grace Episcopal Church's application was approved, with no conditions, in a single week. Thanks to the HTC, the congregation could move quickly to replace its roof before any more water could damage the building.

Case Study: State-Only Credits in Kansas

Similar success stories have played out in the other states with state-only HTCs, including on the University of Kansas campus. Facing significant long-term maintenance needs across its mission-critical buildings, the nonprofit university's historic campus requires repairs that extend beyond the level of funding currently provided by the state. To fill that gap, former university architect Jim Modig seized on the idea to use state-only HTCs and the university sought designation for two historic districts on campus to maximize their eligible buildings.

"An extra \$1 million to \$2 million from HTC proceeds lets us do additional projects that we wouldn't be able to do otherwise," said Mark Reiske, the current university architect. By using the state-only HTCs, the university cannot only compound the funds allocated in the state budget, but also make the case to donors about the leverage effect that their contributions can have for the historic campus. "It provides a good pitch to donors," Reiske said. "With the recent enhancements



Image: Courtesy of Heritage Consulting Group

The Grace Episcopal Church in Madison, Wisconsin, was already listed on the National Register of Historic Places, which cleared the way for it to apply to the Wisconsin Historical Society for state historic tax credits.

to the Kansas credit, they get a 40% match to their donation. Proceeds pay forward. One project feeds other projects."

The state-only HTCs have been a boon for major rehabs and smaller projects alike at the University of Kansas, as HTC proceeds roll forward to finance successive projects. At Linley Hall, for example, the university has planned a \$30 million-\$35 million restoration that will include building envelope, roof, foundation and HVAC work, among other repairs. Compare that with a new building, which university experts estimate would cost \$100 million. The state-only HTCs are a boon to the balance sheets, more than justifying the complexities of SHPO review and transferring the credits.

With each building that undergoes a state HTC-supported rehab, the effects are multiplied across buildings, laborers and local economies in Kansas. "Tax credits create economic development in the community," Reiske said. "It's an interesting cycle."

Conclusion

Nonprofit organizations that are considering state-only HTCs should plan carefully, as each state's program

has distinct requirements related to eligibility, transferability, refundability, review and recapture provisions. Nevertheless, in many circumstances, these programs may unlock new financing potential for nonprofit, institutional and mission-driven property owners, providing a strategic and highly effective rehabilitation tool. By engaging early with the appropriate SHPO, nonprofits can confirm their eligibility, clarify program expectations and ensure that project documentation aligns with the credit approval process.

For many nonprofit organizations, careful stewardship of their historic building is one way that they carry out their public-oriented mission and having a safe and dry space makes their other public outreach possible.

This was true for Madison's Grace Episcopal Church, which—among other outreach programs—maintains a robust food pantry out of its historic building. “We could not delay the roof project,” Grieser said. “The state historic tax credits were a significant factor in our ability to fund the project [and helped us fulfill] our responsibility to uphold what generations before us did to preserve and sustain this beautiful historic structure.”

With broader eligibility criteria, more flexibility and simplified administrative requirements, state-only HTCs offer a new path forward for nonprofit organizations to sustain their missions and preserve their historic buildings. ❖

Cindy Hamilton is president of Heritage Consulting Group.

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