

**THE STATE OF HISTORIC TAX CREDITS ▾**

California's New Historic Tax Credit Could Have Significant Effect

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California joined more than 35 states that have historic tax credits (HTCs) when Gov. Gavin Newsom signed S.B. 451 in October 2019. The program starts in 2021 and marks progress for a state that has never had its own HTC incentive.

Citing federal HTC statistics and the success of other state credit programs in the opening section of the law, a multiyear advocacy effort to see the bill passed finally came to fruition and one of the largest states in the union is poised for more potential historic rehabilitations as a result; at least, in theory.

The basics of the program for income-producing properties are as follows:

- it allows for a tax credit of 20 percent of qualified rehabilitation expenses (QREs) for most certified historic structures;
- it allows for a tax credit of 25 percent of QREs for certified historic structures that meet the following criteria:
 - ◊ located on surplus federal or state property or land;
 - ◊ includes affordable housing for lower-income households;
 - ◊ is located in a designated census tract;
 - ◊ is a part of a military base reuse authority; or
 - ◊ is a transit-oriented development that is a higher density, mixed-use development within a half mile of a transit station;
- an annual aggregate cap of \$50 million will be administered by the California Tax Credit Allocation Committee (CTCAC) and the state historic preservation office (SHPO) on a first-come first-served basis;
- the entire credit is taken in the first year the project is placed in service with a seven-year carryforward;
- the application requires a summary of expected economic benefits of the project (e.g., jobs created, expected increase in tax revenue, additional incentives);
- the current law is effective from Jan. 1, 2021, to Jan. 1, 2026.



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A residential credit was also created, but it is not pertinent to the topic of this article.

Stimulating Historic Rehabilitation

Until now, the only incentives for historic preservation in California have been the federal HTC and the Mills Act, a tax abatement program administered by local governments throughout the state. For the size of the state, there have been relatively low numbers of federal HTC applications for historic rehabilitation projects. Applications and approvals for federal HTC in California could see an increase as they did in Texas after 2016 when a new HTC program there began.

Texas Federal HTC Use

Image: Courtesy of MacRostie Historic Advisors LLC

The Hotel Fresno in Fresno, Calif., will incorporate affordable housing as part of its historic rehabilitation development.

Texas is a state of comparable size that was without a state HTC program until 2016.

Texas properties accounted for 44 Part 2 applications submitted and 26 Part 3 applications approved in 2018. The year before the Texas program went into effect, these numbers were 22 and three, respectively, resulting in a twofold growth in federal applications with the state program in place.

NPS FISCAL YEAR	PART 2 APPLICATIONS	PART 3 APPROVALS	ESTIMATED FEDERAL CREDIT INVESTMENT
2015*	22	3	\$31.5 million
2016	32	10	\$29.8 million
2017	49	13	\$32.5 million
2018	44	26	\$112 million
2019	41	26	\$51.9 million

The number of Part 2 applications filed in California in 2018 was 11 and Part 3 applications approved was three.

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California Federal HTC Use

Many other economic forces affect the number of projects that use the federal incentive, such as the ability for developments to meet the basis test, the perception or lack of knowledge about the HTC in a community and the availability of aged buildings. However, an observed increase in federal HTC applications in Texas and in other states support the reasonable expectation that California will similarly see an increase in federal HTC activity. This means the state benefits from federally provided funding, while reaping enhanced tax revenues. Another factor that may increase HTC investment in California is the fact that many buildings in the state are reaching the 50-year mark, one of the thresholds for the federal program.

NPS FISCAL YEAR	PART 2 APPLICATIONS	PART 3 APPROVALS	ESTIMATED FEDERAL CREDIT INVESTMENT
2015	7	9	\$41.7 million
2016	7	5	\$16 million
2017	15	8	\$15.4 million
2018	11	3	\$26.5 million
2019	6	9	\$41.2 million

One major handicap of stimulating substantial use may be the annual aggregate cap. Consider that for the years 2014-2018, the average QRE at Part 3 in California has been \$20 million. That means that the average development at the base 20 percent for the state HTC would receive \$4 million in credits. Under this average, the annual aggregate cap of \$50 million for the new program allows just 12 developments a year to receive a credit allocation. Since 2012, no more than 11 projects in a given year have received an approved Part 3 by the National Park Service in California.

If the goal is to stimulate the increased preservation and rehabilitation of historic properties and therefore, the

increased use of the incentive, this allocation may not be adequate to jump-start use. If the goal is to encourage the use of the 25 percent credit for critically needed transit-oriented development and affordable housing projects, it may be even less sufficient. At \$50 million, it may not be enough to see California rank among the top users of the federal incentive. However, it does not mean it will not create more appetite for them than in recent years. Several states have started with a smaller aggregate cap, only to increase it over time based on demand.

Stimulating Affordable Housing

Affordable housing is a crucial need in California and special programs are required to incentivize their development, especially in economies where land and constructions costs are as high as they can be in parts of the Golden State. The coalition of advocates for the legislation, led by the California Preservation Foundation (CPF) and American Institute of Architects, California, acknowledged that historic preservation could play a role in adding affordable housing in the state.

“As an organization, we feel a responsibility to help provide solutions to encourage creation of affordable housing,” said Cindy Heitzman, executive director of CPF. “We heard from the industry leaders that the historic tax credits will help create more housing and put the funds that would otherwise go toward construction, back into services for homeless populations.”

For these reasons, the 5 percent bump up was included in the California HTC bill.

In addition to the new HTC, CTCAC also administers a robust low-income housing credit (LIHTC) incentive. A recent bill (CA AB 101) created a \$500 million annual state aggregate for affordable housing in California, but only for new construction. Adaptive reuse may be considered new construction on a case-by-case basis

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and with early review from CTCAC. An existing \$70 million annual state aggregate LIHTC program does allow for use with older buildings, but has stipulations that disadvantage those that are over 15 years old.

It would be a shame to ignore the inherent opportunity of historic buildings in creating new affordable housing, especially in California. The availability of buildings on decommissioned military bases and other historically significant buildings that predate 1970 could provide unique opportunities for housing developers to design solutions that incorporate and celebrate California's history. Former barracks, hotels, or office buildings make great canvasses for new affordable housing options because of their existing floorplans. They are also often located in historically transit-oriented areas because of their proximity to business districts or, as is the case in former military bases, in communities that allow for an incredible number of amenities and special programming to be created.

Additionally, many housing authorities are seeing the opportunities of using HTCs for U.S. Department of Housing and Urban Development's Rental Assistance

Demonstration-financed properties around the country. Through this program, public housing rehabilitations can take advantage of HTCs through public-private partnerships and accelerate the rate of historic housing units that are updated to meet the demand for safe and affordable housing options.

Even though the objectives of the state HTC and LIHTC do not perfectly match it does not mean that the new HTC program cannot be used to help address the lack of affordable housing. Hopefully, it will encourage a wide range of historic preservation efforts that need the extra equity to come to life. The market acceptance of the credit and the yet-to-be-measured impact on economic development in the state will be the deciding factor on if the credit can be expanded in the future.

If state legislators are able to see the real benefit of historic rehabilitation after 2021, California could be a national leader in HTC development. ❖

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Katherine Ferguson is the director of marketing and business development for MacRostie Historic Advisors LLC. Learn more about their involvement in HTC projects around the country at www.macrostiehistoric.com.

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