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THE STATE OF HISTORIC TAX CREDITS 🏠

The Economics of State and Federal Historic Tax Credits: A Conversation with Donovan Rypkema of PlaceEconomics



ALBERT REX, MACROSTIE HISTORIC ADVISORS

Federal historic tax credits (HTCs) are a well-documented source of financing for all types of real estate.

The program grew out of National Historic Preservation Act of 1966, which was the first real federal law focused on the retention of America's historic fabric. HTCs have been around in some form or another since 1976. State programs naturally followed the success of the federal program and have been a catalyst for further investment in historic rehabilitation within those states, including increased use of the federal incentive.

Donovan Rypkema of PlaceEconomics, a Washington, D.C.-based real estate and economic-development consulting firm, has become synonymous with historic preservation economics. Rypkema's 40-year career began when he was a user of the first

iteration of the HTC program in 1976 on his own project in Rapid City, S.D. From there, he went on to earn a master's degree in historic preservation from Columbia University and since then has worked in 49 states across the U.S., focused on the nexus of historic preservation and economics. He has authored numerous studies that analyze the economic impact of state HTC programs, and in so doing, has seen how those programs affect the use of the federal program.

I recently sat down with Rypkema to talk about those impacts.

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Q: When was the first time you looked at state HTC incentives in your work related to historic preservation?

A: We did our first statewide study in the early 1990s in Virginia. What has evolved over time are two things: the availability of accessible big data and the use of GIS which can help translate numbers into a geographic visual. Our basic approach to analysis is to ask, “what is true about historic districts that is both different than and positive as compared to cities as a whole?”

Q: You brought up Virginia and its state historic tax credit program. Before the 1990s, we only had the federal credit and it really came into shape after Ronald Reagan’s tax bill of 1986. What was the impact of the new state credit in Virginia?

A: Almost overnight, not to overstate it. I had been hired by David Brown, who was later at the National Trust, to do a statewide economic study. In part, they used that economic evidence to go to the Legislature and persuade them that they should have a parallel credit at the state level. It just had a huge impact there, but really most states that have added a state credit it has dramatically affected the magnitude of the activity [at the federal level].

Q: Being the first state historic tax credit program, what lessons or corrections came out of Virginia that other states used as they created their own state HTC programs?

A: One key thing is that they didn’t try to correct, but really expanded upon the ease of transferability of the credit. As you know, with the federal credit you have to spend money to set up an entity and pass it through to them. It is cumbersome. You can’t really sell the federal credit. But at the state level in Missouri, Delaware,

Texas and other places, you get a certificate and you sell it and that ease of transferability has made state credits more effective and also broader as it allows little projects to take place.

Q: When the federal government scores the impact of a program, there is often doubt whether it is revenue-neutral or positive. Does that doubt exist at the state level?

A: Scoring can be very narrowly defined at the state level, but in most of our research, we have found before the state credit is authorized to be released, the state recovers 40 to 50 percent of its money because of the taxes generated in the process. The developer has to spend the money, buy the materials, pay the labor. They are spending money. It does not mean the state comes out whole in Year 1. They don’t. It is going to take six, seven or eight years and then beyond that it is net positive. It also matters what is counted. We, PlaceEconomics, take a more conservative approach to this calculation of the return to the state. We only count the revenues being generated from the construction activity until the work is done.

Q: Does local tax revenue come into play relative to your calculations?

A: It does. We did a study a couple of years ago in Louisiana: there had already been two very good studies measuring the stuff we usually measure. The lieutenant governor, a big proponent of the tax credit, said to us, “I go to the legislature about extending the tax credit—they ask me two things: One, what is the human story? Two, we know the building is positively affected. We want to know what happened around it.” We used the data from the studies that had already been done to report on jobs, etc. But we then looked locally at metrics around those projects—what happened in local property tax generation, but also increase in building

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permits, new businesses license and the catalytic impact.

Q: So in your work you really look at all levels—local, state and federal—and have found that they have to work together to make a successful project.

A: They really do. I would suggest that one of the arguments is that the level of government that has the least flexibility in raising tax revenue is the local government. They are constrained by state-enabling legislation and can't have deficits. One of the real arguments from a public policy perspective is that outside the federal Treasury, which Listokin (David Listokin, Rutgers University) shows gets back more money than they put out, the next biggest beneficiary is local governments. They are generating money (through enhanced values therefore property taxes) that goes toward fixing potholes and paying cops and teachers at the local level.

Q: What other local programs have you seen that are tied to rehabilitation? For instance, Cook County, where Chicago is, has a property tax freeze for local landmarks that are rehabilitated.

A: Yes, a whole range of them. The property tax thing is most common. We even had one in South Dakota 35 years ago. The programs vary: sometimes it is an assessment freeze, sometimes it's a tax freeze, sometimes it's a tax credit. Both Annapolis and Baltimore have a property tax credit against tax liability.

Some states have a waiver of sales tax on materials that go into historic buildings. There are other grant moneys and low interest loans. We work with a lot of the incentive programs and there is a long list. Rarely is just the federal tax credit enough. It really does take

a layering of these including incentives—federal, state and local.

Q: Can you speak more about the impact of local or state programs on the use of the federal credit?

A: We have a model that we update every year. There are 17 states and jurisdictions that have never had a state tax credit and they are everywhere: big states, small states, Midwest, East. So they are really representative of the country. Our thesis is that the ups and downs of federal HTC activity is driven by factors in the market—high rates, low rates, recession, growth—is really going to be reflected by the up and down curve of what is happening in those 17 states. So that is our baseline. When we then look at a given state, we look at their pattern, parallel or not, to that baseline before and after they have a state HTC. The consistent pattern (sometimes there is a little warp) is that prior to the tax credit, their curve will largely be up and down like the 17 other states. Then they get the tax credit and in a year or two, the lines dramatically shift. In general terms on an order of magnitude basis we think there is a 40 to 60 percent increase in the use of the federal tax credit when there is an effective state tax credit.

Q: Is there a last thing you want to mention based on your experience over your career or in the current environment?

A: Dollars are going to be limited coming out of this [COVID-19] virus, so how can one government dollar do more than one thing? The affordable housing crisis is huge. We want to have historic preservation. We want to have affordable housing. How do we merge those things? There ought to be much more priority given to those projects that are combining [the low-income housing tax credit] and historic credits or local programs that advance both measures at once. I think to be fiscally

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responsible, we cannot just to cut down expenditures to nothing and raise taxes to everything. We have these programs; how can they do more than they are doing now? We have to be creative about things and layering

things and having multiple outcomes as opposed to just getting a historic building restored. ❖

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Albert Rex is a partner at MacRostie Historic Advisors and serves as CEO

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