

## THE STATE OF HISTORIC TAX CREDITS ▼

# Evaluating the Use of Historic Tax Credits for Affordable Housing for Year 15



**ALBERT REX, MACROSTIE HISTORIC ADVISORS**

Can state historic tax credits (HTCs) play a role in exit strategies for Year 15?  
Depending on the future of the property, yes.

If state or federal HTCs were used in the original low-income housing tax credit (LIHTC) transaction, they are far beyond the required five-year compliance period for the federal HTC. Most states follow this timing as well, so there would be no impact from that perspective. Most state HTCs are likely less impactful in any event, as they do not typically require admitting the investor into the partnership, rather they are sold. Therefore, from an exit perspective the HTCs should have no impact on the project.

### **Redevelopment Considerations**

The importance of state HTCs—and federal HTCs—for that matter, may lie in the capital needs of the property. Since properties awarded LIHTC credits after 1989 have long-term use restrictions, an additional 15 years as a resyndication strategy may

be the right approach. If the capital needs are such that applying for new 9 percent or 4 percent LIHTCs make sense, then there is a good chance that the development can meet the basis test for using state or federal HTCs as a component of the capital stack of the new development, as LIHTC projects have similar tests. Like the LIHTC, HTCs can be used again on a property, even if they were used in the original rehab, as long as the new project passes the basis test.

Most state HTCs have a basis test that is less than the federal HTC 100 percent basis test. For example, Massachusetts only has a 25 percent basis test, Louisiana only requires that the rehabilitation exceed \$10,000 and Texas only requires it exceeds \$5,000. These lower basis tests may provide the opportunity for a state HTC to be used in a



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rehabilitation that is not a resyndication, but rather a less costly refresh of the property.

All HTC programs follow the Secretary of the Interior's Standards for Rehabilitation (Standards), but a typical misconception is that the Standards require the developer to return the building to its original appearance. This is not the case. For instance, if the building has later replacement windows, the reviewing agencies will not require the windows be replaced with new windows that look more historic if the window replacement is not in the scope of work. This means even a limited rehab, such as one only focused on system upgrades or updated kitchens and baths, can be good candidates for HTCs and that the scope won't expand due to their use.

### Generate Equity

Thinking about an exit strategy should start in advance of Year 15 and therefore provide opportunities to examine how HTCs could help the development. For the project sponsor, the HTCs could either support a decision to buy the asset and recapitalize it or could enhance the purchase price by bringing another source to the capital stack. In either case, the equity generated by the credits can have an impact on the bottom line for both buyer and seller.

### Understand Historic Significance

The biggest roadblock to bringing HTC equity into an exit strategy transaction is perception. The affordable housing development community routinely uses HTCs in housing production in the conversion of a mill or school building, but often overlooks the opportunity for existing affordable units. This may be due to a lack of understanding of how "historic" is determined or a general feeling that something that's been affordable for 15 years or more may not rise to the level of importance.

The federal HTC incentive requires that a building be a "certified historic structure" in order to use the program, which means it is listed in the National Register of Historic Places either individually or as a contributing element of a historic district. The historic designation is also a requirement to qualify for state credits, but in some case this requirement can be met by being on the state register or simply found eligible for listing on the National Register, both of which are lower thresholds.

National Register listing requires that a building be 50 years old or older, so buildings built in 1970 begin to qualify in 2020, and that they can be designated under one of four criteria:

- A. The property must be associated with events that have made a significant contribution to the broad patterns of our history.
- B. The property must be associated with the lives of persons significant in our past.
- C. The property must embody the distinctive characteristics of a type, period, or method of construction, represent the work of a master, possess high artistic values, or represent a significant and distinguishable entity whose components may lack individual distinction.
- D. The property must show, or may be likely to yield, information important to history or prehistory.

Criteria A and C above are the most common reasons a building or district are listed in the national or state register. These are fairly broad, leaving an opportunity for many different building types to be listed for many different reasons. There may be a perception that the national and state registers are a beauty contest; they are not. Buildings that may look commonplace or even ugly to some people, can still be listed on the register.

There are many examples of buildings being deemed "certified historic structures." For instance, a building may be significant based on the fact some form of

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federal financing was used to construct it. Another example could be a building that is listed because it was designed by a prolific local historic architect or it was built during the streetcar suburbs period, when a city neighborhood expanded. These two examples could be applied to buildings that house thousands of affordable units across the country. With the 50-year threshold, there is a good chance that buildings reaching Year 15 may not have been considered for HTC when they were originally converted to affordable housing.

### The Value of State HTCs

Once it has been determined that a project can meet both the basis test and found to be historic, then the question becomes, “Is pursuing these credits worth it?” With many state programs, the answer would seem to be yes; they tend to be more flexible and in some cases more valuable than federal HTCs. Many of the state HTC programs are certificated, meaning they can be sold to a taxpayer, unlike the federal credit that must be allocated to a partner in the partnership. That scenario, like the LIHTC, can require a lot of legal structuring and transaction costs.

In addition to having lower closing costs due to the ability to sell the credit, state HTCs often trade for a higher price as a sale than the syndicated federal HTC,

with some markets returning 90 cents for a dollar of state credit. Additionally, some state credit programs provide for a larger credit than delivered by the federal program, which is 20 percent of all hard and soft costs directly attributed to the rehab of the building. The Texas credit is a flat 25 percent and Connecticut gives a 5 percent bonus for affordable housing projects, making the credit up to 30 percent. Even if a state is equal to the federal program at 20 percent, a \$5 million project could generate net equity between \$900,000 and \$1,350,000.

As a sponsor starts considering its exit, analyzing if a building can qualify for state HTCs may help decide whether to undertake a rehab or enhance the sale price. If the sponsor chooses to keep the property, the additional equity from state HTCs may help them expand their scope or make the project work. If they choose to sell the property, knowing that state HTCs are available and communicating this to the marketplace, may increase the willingness on a part of a buyer to pay more, knowing there is potential equity to fund the rehab. In either case, it's worth considering as the property reaches Year 15 and may not just be old, but historic as well. ♦

Albert Rex is CEO and a partner at MacRostie Historic Advisors LLC.

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