

**THE STATE OF HISTORIC TAX CREDITS** 🏠

# The Role of Historic Tax Credits in Recovery: Lessons Learned Over Three Decades

**ALBERT REX, MACROSTIE HISTORIC ADVISORS**

COVID-19 is bringing to bear what has been eluded for over a decade: the shrinking of our economy, the beginning of a recession.

The question of the length or impact of this interruption is unknown. If you are like others working from home, you may have attended one of the many webinars over the last few months that has left financial leaders and real estate developers scratching their heads and using words like “unprecedented” with far too much frequency for your comfort.

The recession that has been predicted for a number of years is now upon us and there will be a variety of measures taken at the state and federal level to rescue the economy from collapse. To be sure, this situation is unprecedented, but looking back at prior downturns and other disruptions to the real estate economy in particular (think Hurricane Katrina), historic tax credits (HTCs) can play a significant role in generating economic activity.

The federal HTC incentive has generally been in its current form since 1986, when it was rolled back from a 25 percent credit to a 20 percent credit. State HTC programs have been around since the mid-1990s. There is a lot of economic data out there about these types of programs. There have also been a number of economic waves during those three decades, providing insights into how these credits can play a role in recovery, especially with some enhancements.

**Help in Times of Turmoil**

One example to look at relative to a response to a crisis is the Gulf Opportunity Zone (GO Zone) Act of 2005 that came out less than four months after Hurricane Katrina ravaged the Gulf Coast. That physical damage is clearly different from what the world is experiencing now. Most estimates of

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Katrina's impact described damage at north of \$100 billion, but the need to jump-start the economy is much the same as today's situation. The GO Zone legislation contained a number of stimuli, including activity bonds, bonus depreciation, an increase in the low-income housing tax credit (LIHTC) cap for each of the affected states, and an increase in the federal HTC from 20 percent to 26 percent in those areas.

When the GO Zone legislation passed, Louisiana had a 25 percent state HTC in place, meaning the gross credit available for an HTC project in the state was 51 percent with the temporary increase in the federal credit. If you look at the available data in *The Historic Tax Credit: Building the Future In Louisiana* (PlaceEconomics, 2017), you will see a spike in 2006-2007 in the level of HTC investment, a decline in 2008 and then a larger spike in 2009. In 2011, the year the GO Zone legislation expired, there was another decline. HTC use climbed from 2011 to 2016, but not back to 2009 levels. The combination of the state HTC and the 6 percent federal increase had a positive impact on development after a natural disaster and the mortgage crisis of 2008. The report also found that 42 cents of every historic tax credit dollar invested by the state is recouped before construction and generates \$8.76 in additional economic activity.

### **Sustained Positive Economic Impacts**

Since 2008, the Edward J. Bloustein School of Planning and Public Policy at Rutgers University, in conjunction with the National Park Service (NPS), has put out an annual report on the economic impact of the federal HTC. Statistics on the program are available back to the program's inception. The reports provide a good year-to-year review and an analysis of the HTC's impact in terms of jobs, investment and taxes. The 2018 report notes that "a \$1 million investment in historic rehabilitation yields markedly better effects on employment, income, GDP, and state and local taxes than an equal investment in new construction

or many other economic activities (e.g., manufacturing or services)." This certainly supports the idea that an increase in HTC investment can have a greater impact on the economy than other types of economic development.

Looking at the national HTC statistics for the years following the 2008 mortgage crisis, there is a slight dip in usage of the program in total number of projects and total dollars of investment, but then within a two-year period the usage starts to rise above pre-2008 levels. This rebound is much quicker than what was seen in the general economy. This may be due to the nature of the HTC as an equity source for the development, which reduces the overall economic risk from an underwriting perspective for banks, which were particularly skittish after 2008.

Not only do HTC projects appear to be more tolerant of economic swings, they provide other important stimulus besides putting dollars into the economy. Jobs are one of the areas where HTC projects outpace other economic development tools. The jobs are not just in construction, but manufacturing for supplies such as windows and retail trade and services. As studies looked at job creation across the country from the federal HTC, it is obvious that states with the greatest growth is in states with state HTC programs. With the potential of a threefold increase in unemployment rates back to 2009 level of 10 percent, job creation will be important to any economic stimulus.

### **Help for Housing**

While HTCs can play a role in financing all kinds of development, they are especially powerful in promoting housing developments. This is particularly true for affordable housing. Since 1996, anywhere from a third to half of all housing units created or rehabilitated in HTC developments each year have been low- or moderate-income. The outcome of affordable housing

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development and the health of the LIHTC could play a major role in the health of the HTC program.

In fact, the dip in 2008 and the quick rebound may be related to the increased use of HTC funds in LIHTC properties. Not only did banks start taking a more cautious approach in providing debt following the mortgage crisis, but the value of LIHTCs went down dramatically. This left a gap for developments that may have been nearly closed before the crash happened. HTCs became the gap filler. Additionally, some investors in the LIHTC space pivoted to investing in HTCs as LIHTC yields dropped, further stabilizing and increasing HTC use at that time.

The power of states to govern the special needs of their constituents has been central to the response to COVID-19. Federal response, like the one after Hurricane Katrina, will be important. But states also have the power to stimulate economic development with their own HTC programs and 36 currently do. Enhancements to these programs, similar to the GO Zone legislation, could help stimulate investment. At the very least, making sure programs that sunset sooner, such as Louisiana's, are extended is important

to providing some assurance to the market in this unstable time. Even further, some states that have been contemplating state HTC programs—such as Florida, New Jersey, and Tennessee—should consider this a good time to create a program that stimulates the economy in advance of any impact to tax collections. This may be especially true in a densely populated state like New Jersey, where there is a lot of good urban stock for the HTC and may be disproportionately impacted by the pandemic.

There is already discussion at the federal level of enhancements to the HTC program, including an increase in the credit from 20 percent to 30 percent for a period of time, a reduction in the basis test and eliminating the basis adjustment. We will see if these are included in a future COVID-19 stimulus bill in Congress and if some states will choose to follow suit.

One thing that is clear looking back: HTCs can be a tool for speeding economic recovery and creating more economic certainty in uncertain times. ❖

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

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