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## Real Estate Tax Credits and other Financial Incentives for Investing in Historic Property in the United States

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# Real estate tax credits and other financial incentives for investing in historic property in the United States

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## Abstract

This paper examines the legislative and administrative background for designating historic property for protection in the United States (US) and their rehabilitation against a whole series of financial inducements and mechanisms.

The preservation of heritage buildings in the US forms an integral part of the property market. Market forces and government regulations in the form of preservation law, standards for rehabilitation and the revenue code dictate the success or failure of renovating historic buildings. At all levels of governments (federal, state and local) there has been a growing reluctance in recent years to increase regulatory burdens and fiscal constraints on private citizens.

A number of incentives including tax credits, abatements and freezes, direct grant aid, debt financing support, revolving funds, revenue raising bond schemes and various other programmes are examined. The economic benefits associated with such incentives have been scrutinised from the evidence of a number of studies.

A review of the different incentives and benefits is followed by comparisons and conclusions concerning protection issues, financial incentives and the question of economics associated with practice in the United Kingdom, Republic of Ireland and elsewhere in Europe, contrasting the merits of adopting US approaches.

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## Introduction

The preservation of heritage buildings in the United States (US) forms an integral part of the property market. Market forces and government regulations, in the form of preservation law, revenue code, tax on property, building codes, planning regulations and banking laws dictate the success or failure of renovating historic buildings. At all levels of governments (federal, state and local) there has been a growing reluctance in recent years to increase regulatory burdens and fiscal constraints on private citizens. Moreover, a number of government incentives have been crafted, within a legal and administrative framework, to attract property developers and investors to historic preservation projects.

In the absence of a strong regulatory policy, the market place ultimately decides which buildings should and should not be rehabilitated. Rehabilitation is a key word, a process guided by federal standards (National Park Service, 1990) through ‘recommended’ and ‘not recommended’ actions that spell the emphasis of approach for historic built resources in the US, as distinct from the strictures of conservation regulation evidenced in Europe. To some extent this has been fuelled by a number of studies into the economics of ‘historic preservation’, which have recognised the wider values associated particularly with the urban heritage (social, functional, economic, resource etc). These have provided clear evidence of the benefits of financial support for *certified historic structures* and for buildings within *registered historic districts* in number of states (McNulty, 1989; Gale, 1991; Rypkema, 1994; Rypkema, 2000; Rykempa, 2000a; Rypkema and Wiehagen, 2000).

An extensive study by Hawkins *et al* (1997) was commissioned due to the dearth of information in this field. This lack of information had been seen as a disadvantage when competing for public funds and other support. This evidence has been used for justifying public funding (mainly through tax credit schemes), identifying in particular the gains that can be made from rehabilitation rather than new construction, in terms of economic development, and as a lever to encouraging private investment. Moreover, the National Park Service, the federal authority responsible for built heritage issues, has supported work to develop a Preservation Economic Impact Model. This has been tested in New Jersey in relation to a wide range of data to consider the relationship between the provision of tax incentives (in terms of lost revenue) to the additional revenue created by investment in the built heritage (via other economic activity) (Listokin and Lahr, 1997; Listokin and Lahr, 2002). The need for such studies in Europe has been recognised but there is little to compare to the research that has been conducted in the USA (see for example ICOMOS, 1993; Allison *et al*, 1996; Behr, 2000; English Heritage *et al*, 2000).

The legal and financial mechanisms that govern the protection of the built heritage in the US operate at three levels: federal, state and local level. The federal government, the 50 state governments and hundreds of municipal governments each operate their own system for encouraging the preservation of historic buildings. This paper examines the legislative and administrative background for designating historic property for protection and supporting their rehabilitation against a whole series of inducements and mechanisms for encouraging investment in this direction.

## The legal and administrative regime for historical buildings and districts

### REGISTRATION AND DESIGNATION OF HISTORIC PLACES

The National Historic Preservation Act 1966 (NHPA) (as amended) established the National Register of Historic Places, which is maintained by the National Park Service (NPS), a service of the US Department of the Interior. It comprises properties that have been nominated and accepted as having “*historic, architectural, archaeological, engineering or cultural significance*” at the national, state or local level. This includes individually listed landmark buildings known as “certified historic structures” that are depreciable buildings according to criteria found in the Code of Federal Regulations, Title 36, Part 60. It also covers buildings within “registered historic districts” that contribute to the relative significance of the district according to relevant standards for this purpose (Auer, 1996). A building will not qualify for inclusion in the register if the overall integrity of the building has been irretrievably lost due to alteration or neglect. Generally, a property must be at least 50 years old to gain entry to the register.

Two federal programmes, namely the Historic American Buildings Survey (HABS) and the Historic American Engineering Record (HAER), provide documentation assistance to the National Historic Landmark Programme, administered by the National Park Service, in recognising nationally significant buildings, sites, objects and districts that possess exceptional heritage (Wood, Ditchfield and Weaver, 2000).

There are approximately 75,000 listings on the National Register, including individual historic structures and historic districts incorporating groups of properties. In total it includes approximately 900,000 properties, buildings, structures and objects (circa 6,500 of the listings are for historic districts

mainly covering residential or main street commercial properties but the National Park Service is now also looking at rural districts such as farming areas. The National Register is considered to be about 20% complete (Denhez and Dennis, 1997).

The National Register does not have a grading system and therefore there is no system of prioritisation. Moreover, unlike the statutory system of listing buildings in the United Kingdom, inclusion in this register affords no special protection or regulation to restrict a property owner apart from inclusion in the federal ‘*section 106 process*’ (requiring the “consideration” of actions upon historic property – see below). Only land use designation in the form of local planning and zoning powers may prevent demolition, alteration and incompatible new construction and the degree of protection provided by certification whether in the national, state or a local register differs from locality to locality (Denhez and Dennis, 1997). In this respect the system is more like the concept of “protected structures” now operating in Ireland, although this may be differentiated as planning objectives *must* be defined in development plan policies for such structures (MacRory and Kirwan, 2001). However, registration does bring the possible eligibility for assistance from various federal, state and local subsidies and tax breaks.

The system of registration in the US is further weakened by the fact that nomination for inclusion in National Register generally requires the consent of property owners (Denhez, 1997). If the majority of owners in a historic district object to certification the property or district will not be listed. However, they may be determined as being ‘eligible for certification’ if they meet the criteria for selection. Such ‘eligible’ properties receive the same consideration for federal or federally assisted projects as those actually certified in the National Register (Wood, Ditchfield and Weaver, 2000).

A state or local historic district may also qualify as a *registered historic district* if the district, and its enabling statute, are certified by the Secretary of the Interior. In some states it is possible for a single property to be listed on a state register or designated or included within the boundary of a local historic district as well as the National Register. The criteria used to designate property at federal level are often adopted verbatim in local ordinances. Furthermore, owners of buildings that are not yet listed individually in the National Register or located in districts that are not yet *registered historic districts* may use the certification process to request a *preliminary determination of significance* from the National Park Service. A favourable determination allows the owner to proceed with a rehabilitation project pending the final decision (i.e. they are not legally binding until the building or historic district is actually included in the National Register) (Auer, 1996).

#### THE US CONSTITUTION AND PROPERTY RIGHTS

The US Constitution requires that no person shall be deprived of “Life, Liberty or Property” without appropriate procedural protections. In the context of preservation law, the ability to restrict the rights of property owners has been tested in the courts in relation to such issues as the legality of the regulation of individual landmarks; level of procedural protections required in designating historic districts and in controlling demolitions and alterations; the extent to which landmark or historic district restrictions can limit owners rights to develop property without interference; and concerning the remedies available to owners who claim that the economic impact of historic preservation legislation is unreasonable (Duerksen, 1983). In general terms the federal government does not have the ability to regulate what happens on private property through the National Historic Preservation Act 1966. Only a local historic preservation ordinance can regulate private property (Denhez and Dennis, 1997).

The 14<sup>th</sup> amendment to the Constitution guarantees every citizen the right to ‘due process’. State and local governments must meet the ‘due process’ requirements in the drafting and administration of historic preservation ordinances in order to ensure the fair treatment of property owners. State and local governments must provide notice to property owners of pending historic property or district designation. In addition, state and local governments may be required to provide public hearings, impartial and informed decisions based on objective criteria, adequate standards of approving or denying specific development proposals and written findings explaining local preservation commission decisions. For example, state law in Michigan requires that written notice of designation must be sent to property owners in order to ensure that the local government meets ‘due process’ requirements.

Furthermore, the 5<sup>th</sup> amendment to the Constitution prevents private property being ‘taken for use without just compensation’. The purpose of this clause is to ensure that individuals do not take public burdens that should be borne by the public as a whole. The ‘taking’ issue is often raised when states are considering the introduction of historic preservation regulations. Landowners may argue that historic property designation constitutes an unconstitutional ‘taking’ of private property in violation of the 5<sup>th</sup> amendment or similar provisions in state constitutions. Federal and state courts have generally rejected this argument on the basis that preservation regulations rarely prohibit property owners from making a ‘reasonable economic use’ of their land. Thus, as Beaumont (1996) indicates, speculative hopes for maximum profits should not be confused with the legal right to a reasonable economic use of property. By example, in the 1996 decision of *Pittsburgh Historic Review Commission v. Wine Work* (No 24 WD app. docket, May 21st 1996) the Pennsylvania State Supreme Court ruled that the City of Pittsburgh’s denial of permission to demolish a dilapidated historic house requiring

substantial renovation did not result in an unlawful ‘taking’. The court found that the owners had failed to establish that they could not recoup the investment in the property by selling it (in the dilapidated condition) or that they had been ‘deprived of any profitable use’ of the property.

### FEDERAL PROTECTION AND REGULATION

The NHPA 1966 (as amended) encompasses the basic federal law governing the preservation of historic resources. In addition to establishing the legal and administrative context for identification and designation of *national historic landmarks* via the National Register, it provides a national programme of financial and technical assistance to co-ordinate and support public and private efforts to evaluate and protect historic resources. This is achieved through the Advisory Council on Historic Preservation (ACHP), the Historic Preservation Fund and other specific assistance. In the words of the Act, the federal government’s role is to “*foster conditions under which modern society...and historic resources can exist in productive harmony*” (Blumenthal, Bevitt and Jandl, 1993).

Despite the constitutional position preventing the federal government from regulating what happens on private property, the ACHP acts as an independent policy adviser and has an important role in *considering* the impact of actions by federal agencies on historic properties via section 106 of the NHPA. The regulations ‘Protection of Historic Properties’ (36 C.F.R. part 800) provide specific criteria for determining whether an action will have an effect on the integrity of an historic property or district. If an action would alter the characteristics that make a property eligible for the National Register, it is held to have an effect. The regulations emphasise the need for consultation among the relevant federal agencies, the State Historic Preservation Office (SHPO), local governments, property owners and other interested parties to identify possible ways to protect the properties in

question. A Memorandum of Agreement (MOA) is drawn up and signed if agreement is reached, satisfying the requirement of section 106 that the ACHP be “*given a reasonable opportunity to comment*” (King, 1990). However, as this is just an advisory process the ACHP does not have the authority to require federal agencies to abandon projects that will affect historic properties. *The section 106 process* can only delay a project with federal involvement pending consideration of possible alternatives. A federal permit is not required if a private property owner wants to demolish a ‘certified historic structure’ and redevelop the site.

A number of additional laws direct specific federal agencies to consider historic preservation in conjunction with their goal mandated programmes, for example: the National Park Service Organic Act (1916, Amd.1980) directs the Secretary of the Interior to submit an annual report to Congress identifying *national historic landmarks* at risk of deterioration beyond repair; the Mining in the National Parks Act of 1976 requires consultation with the ACHP to protect landmarks threatened with destruction by surface mining activities; the Department of Transportation Act 1966, as amended, prohibits the Department of Transportation from using any historic sites (public or private) for federal or federally assisted highway purposes, unless there is no feasible alternative; the National Environmental Policy Act 1969 requires federal agencies to prepare an Environment Impact Statement if it is determined that federal actions may affect the human environment (including the effect on properties listed or eligible for listing on the National Register) (Blumenthal, Bevitt and Jandl, 1993). There are also a number of federal housing and community development laws that direct specific federal agencies to consider historic preservation.



**STATE ENABLING LEGISLATION AND LOCAL PRESERVATION ORDINANCES**

The 1992 amendments to the NHPA also provided greater decision-making authority to state and local governments (Executive order 11593/1971). It is at these levels of government that there is a greater likelihood that restrictions on the actions on private property owners can be applied. To combat the problem that the *section 106 process* can only delay a project and not prevent demolition and redevelopment, a number of states have now mimicked the federal system by maintaining a state register and implementing a *state 106 process* and some states will require a review of state financed or approved development projects (Figure 1). These procedures vary greatly in form and intent from locality to locality. In a typical situation a state agency will be put under a legal obligation to evaluate the likely impact of state projects on historic properties, to consult with the SHPO before undertaking any state funded project and to explore ways to mitigate any harmful effect on historic structures (Wood, Ditchfield and Weaver, 2000). As with the federal *section 106 process* the state agency

must consider the recommendations but not necessarily except them. Currently circa 40 states have enacted state ‘106 laws’ (Beaumont, 1996).

More significantly the US courts have validated the use of state enabling laws that provide power to local governments to enact local historic district and preservation ordinances (the first such ordinance was created in 1931 as an added provision to a zoning ordinance in Charleston, South Carolina to prevent the looting of historic building interiors). The most prominent judicial ruling in this context is the 1978 decision by the US Supreme Court in *Penn Central Transportation Company v. City of New York* (438 US 104 - 1978). Penn Central attacked the New York City landmarks ordinance as unconstitutional because it prevented the company from building a fifty-five storey office tower on top of the historic grand central terminal in Manhattan. The New York City Landmarks Preservation Commission determined that the tower would overwhelm the terminal building. The Supreme Court ruled that the local ordinance, and by inference comparative ordinances elsewhere, were



Figure 1: Baltimore to Ohio Railroad Warehouse, Camden Yards, Baltimore Orioles' Ball Park. Maryland 'state 106 law' was used to help preserve the historic building and retain the historic neighbourhood as part of a new development project.

constitutional. Since this ruling, there is no longer any doubt that a state's police powers may be legitimately used for aesthetic regulation, including historic district and landmark legislation.

Virtually every state in the USA has now developed enabling legislation to authorise its local governments to protect historic landmarks and districts. Such legislation is only effective if it is implemented by a local ordinance. More than 2300 municipalities have enacted local preservation ordinances. A typical preservation ordinance creates a local commission (or an architectural review board) to regulate proposed changes. A national non-profit charitable organisation, namely the National Alliance of Preservation Commissions (NAPC), supports many of the local preservation commissions. The level of autonomy of the various preservation commissions depends on the wording of the state enabling legislation (Wood, Ditchfield and Weaver, 2000). In general terms, changes to historic private property that are considered to be harmful, such as the inappropriate alterations, demolition of a landmark or the construction of high-rise structures adjacent to small-scale historic neighbourhood buildings, may be denied or delayed to allow time for the exploration of better alternatives (Beaumont, 1996). Thus, while at the federal level and state level, governments cannot require people to carry out works to historic properties, at the local level a commission may vote to consider whether any works to historic properties should be allowed. A number of states such as Wisconsin and Pennsylvania provide model ordinances to local governments to help them draft historic laws.

A good example of how the local system of regulation works can be indicated in relation to New York. The New York City Landmarks Preservation

Commission was established in 1965 and in 1966 New York became the first US city to have a city-wide ordinance covering both historic districts and individual landmark structures. Under New York City's law, the commission may designate both the exterior and interior of properties. Interior designation will only be given on areas of buildings that, according to their use, are already publicly accessible (and therefore a residential dwelling cannot be designated as a protected interior landmark). Since 1965 the commission has designated more than 933 individual landmarks, 66 historic districts containing more than 20,000 properties, 9 scenic landmarks and 94 interior landmarks (New York has a stock of circa 850,000 buildings) (Steel, 1997).

Development or restoration works on or adjacent to a designated landmark in New York requires certification from the commission prior to commencement. There are three types of control in this respect. First, a *certificate of no effect* will be issued when the proposed work will not affect the protected architectural features and the work requires a Department of Buildings permit. Secondly, a *certificate of appropriateness* must be issued when the proposed work would affect the protected architectural features and the work requires a Department of Buildings permit. Lastly, a *permit for minor works* must be issued when the proposed work would affect protected architectural features but the work does not require a Department of Buildings permit, for example, window and door replacement or masonry cleaning. Only the *certificate of appropriateness* requires a public hearing. The New York commission can deny applications for demolition of designated buildings, however, unlike the commissions in many other cities, it does not have jurisdiction to refuse a permit on grounds of inappropriate proposed use or to adopt rules on the height and size of new development in historic districts (Denhez and Dennis, 1997).

All applications are assessed on a case-by-case basis and the permit procedure of the commission puts the responsibility for assembling information on the applicant. The Department of Buildings is not allowed to approve any permits concerning a designated building until the commission has approved the work. Compliance with permits is monitored by site visits. Review of minor work is also considered very important, for example, window replacement and re-pointing of mortar. The historic property owner may only successfully challenge the commission on decisions made within its jurisdiction on the grounds of hardship: owner consent and economic hardship provisions in local preservation ordinances are usually required to include a safety valve to deal with hardship cases, although such provisions are rarely utilised by the public.

State enabling laws can also address special issues, such as ‘demolition by neglect’. The Maryland statute provides a definition of ‘demolition by neglect’ as “*any wilful neglect in maintenance and repair of a structure, not including any appurtenances and environmental settings, that is not the result of financial inability to maintain and repair the structure and that threatens to result in any substantial deterioration of the exterior features of the structure*”. Michigan’s statute allows the local preservation commission to require property owners to repair all conditions contributing to ‘demolition by neglect’ within a reasonable period. If the owner does not do so the commission may enter the property and make necessary repairs. The cost of the work is charged to the owner and may be levied by the local unit as special assessments against the property (*City of Ypsilanti v. Presbyterian Church of Ypsilanti*, decision by Circuit Court for County of Washtenaw, file number 94-2253-C2).

#### **STANDARDS FOR REHABILITATION AND BUILDING REGULATION CODES**

In order to qualify for federal funding assistance (though tax incentives and grant aid) the

rehabilitation of a *certified historic structure* must be approved by the NPS as being consistent with the historic character of the property and the district in which it is located. While the NPS will accept that some alteration to an historic building may be necessary to facilitate modern use requirements they require strict adherence to the Secretary of the Interior’s Standards for Rehabilitation (National Park Service, 1990; Delvac, Escherich and Hartman, 1997), although economic and technical feasibility of rehabilitation projects is taken into consideration (Auer, 1996). The standards, which were revised by Grimmer and Kay (1992) and supplemented by detailed guidelines (Weeks and Grimmer, 1995), provide a cost-effective design approach for the rehabilitation of historic buildings and apply to both the interior and exterior of historic buildings of all periods, styles, types, materials and sizes. The standards also refer to the site and environment of historic buildings, related landscape features and adjacent new construction.

The standards do not require any specific work to be undertaken. Although a particular feature of an historic building may be in need of repair, remedial work is not required unless the scope of planned works specifically affect or include treatment of that feature. For example, if modern windows have been inserted in a heritage building it will not be a requirement of the rehabilitation funding that these windows should be replaced. However if they are to be replaced as part of the rehabilitation, they must be replaced with something compatible to the original structure. The standards are very general and the guidelines are open to interpretation.

Building Codes are modified regularly in the US and within a few years of construction most buildings become ‘non-complying structures’. Although some code changes are retrospectively applied, in most cases existing conditions are allowed to remain when no work on the building is planned. However, regulatory conflicts often arise

when a proposed historic rehabilitation project must comply with both the building code and preservation guidelines. The building codes provide exact specifications for building construction or performance and can require the removal of original materials while the Secretary of Interior's Standards for Rehabilitation and Guidelines for Rehabilitating Historic Buildings uses non-technical language to outline a philosophy for the appropriate treatment of historic resources based on the retention of features and materials. Furthermore, while some building codes include fire related provisions, many fire codes are adopted and administered separately. Thus the situation is aggravated by the fact that there are multiple regulatory agencies involved with overlapping or different jurisdictions (Kaplan, 1996).

Since the 1970s municipalities have adopted a number of approaches to resolve conflicts in relation to the separate building codes that apply to existing buildings. The simplest of these contain single statements giving the code officials responsibility of determining what conditions are unsafe. This relies heavily on the skills and sensitivity of the official. Most states have now adopted one of the model clauses for the rehabilitation of historic buildings and related administrative appeal processes produced by professional organisations. These provide some flexibility for compliance in relation to historic buildings provided that the rehabilitation proposals are no more hazardous (based on life safety, fire safety and sanitation conditions) than the existing building:

BOCA (Building Officials and Code Administrators), National Building Code, 1996 (Section 3406.0 Special Historic Buildings and Districts)

ICBO (International Conference of Building Officials), Uniform Building Code, 1994 ed. (Chapter 34, Section 3403.5 Historic Buildings)

Uniform Code for Building Conservation (UCBC), 1994 (Chapter 6 Historic Buildings)

SBCCI (Southern Building Code Congress International), Standard Building Code, 1994, ed.; (Section 3401.5 Special Historic Buildings)

Many states including Wisconsin, Connecticut, Hawaii, Indiana, New York, North Carolina, New Jersey, Georgia and Pennsylvania include specific provisions for historic structures in their state specific building codes. Few states have progressed as far as the state of California, which in 1979 adopted the Californian States Historical Building Code (SHBC). The performance-based code was written by a consortium of state agencies involved with building construction regulations. Since 1985, adoption of the SHBC is compulsory. The purpose of the code is to:

*“provide alternative building regulations and building standards for the rehabilitation, preservation, restoration (including reconstruction), or relocation of historic structures designated as historic building” and “to facilitate the restoration or change of occupancy so as to preserve their original or restored architectural elements and features, to encourage energy conservation and a cost-effective approach to preservation, and to provide for the safety of the building occupants”*

(Kaplan, 1996)

Another related issue that has arisen in the US is the need to consider whether historic structures can be retrofitted to survive earthquakes. Many retrofit practices have damaged the architectural features, but there are various approaches that have been used to save historic buildings both from the devastation caused by earthquakes and from the damage inflicted on irreplaceable historic resources by insensitive retrofit practices. Seismic upgrading work is usually permanent and not reversible and there is likely to be some impact on the historic qualities of buildings. However, structures upgraded to withstand earthquakes survive better than those that have not been upgraded. In addition well-maintained buildings have fared better than those in poor condition during and after an earthquake (Look, Wong and Augustus, 1997).

## ADMINISTRATION AND FINANCE

The National Historic Preservation Programme, established by the National Historic Preservation Act 1966, is jointly administered at federal level by the US Department of the Interior and the Department of Treasury. Funds are appropriated annually by the US Congress and distributed through the Historic Preservation Fund (HPF).

The National Park Service (NPS) acts on behalf of the Secretary of the Interior, in partnership with State Historic Preservation Office (SHPO) in each state. The NPS and SHPO administer the Historic Preservation Fund by reviewing applications for conformance to the Secretary of the Interiors Standards for Evaluating Significance within Registered Historic Districts and Standards & Guidelines for Rehabilitation (Auer, 1996). The NPS also disseminates information to the public through technical preservation briefs, publications, guidance on preserving historic and using the historic preservation tax incentives, which are now the main source of financial assistance to owners of historic property.

The Department of Treasury through the Internal Revenue Service (IRS) is responsible for all procedures, legal determinations and regulations governing the tax consequences of the historic preservation provisions of the Internal Revenue Code (IRC) including policing the system. Since 1976 the IRC has contained various forms of incentive to stimulate investment in income producing historic buildings.

Federal funding initiatives may include the provision of:

Direct grant aid and subsidised loans for historic rehabilitation projects

Federal easement donation allowances against federal income, estate (inheritance) and gift taxes

Historic rehabilitation and low income housing tax credits to project sponsors

Mortgage assurance to financial institutions to lend money to conservation projects

Financial assistance for SHPO administration and heritage programmes

At the state level the NHPA establishes the responsibilities of SHPO, appointed by the Governor of each state, to administer the National Historic Preservation Programme at the state level and support state and local historic preservation interests and priorities. Apart from identification of properties for inclusion in the National Register other responsibilities include the development of a state wide preservation plan, technical assistance and advise to federal, state and local agencies (Parker, 1987).

The degree of financial support for preservation activities at state level varies greatly from state to state and municipality to municipality. State and local funding initiatives may include the provision of:

Direct grant aid for rehabilitation projects

State income tax credits for historic rehabilitation and low income housing projects

State income and property tax deductions for easement donations

Property tax exemptions, abatements and assessment freezes for certified historic structures

Transfer development rights

Historic preservation revolving funds programmes

State historic bond programmes

State sales tax exemptions for historic buildings

Another tool used in some states (California, San Diego City, Miami, Texas and Dallas) is the 'tax increment financing district'. The increase in property taxes that occurs due to restoration and new development is deposited in a special fund and reserved for the enhancement of a particular historic district. This financial tool allows taxpayers to redistribute tax dollars without a vote to the general populace (Denhez and Dennis, 1997).

In recent years, resource cutbacks in federal programmes have increased the need for states to



support and co-operate with local preservation initiatives. State enabling legislation is the principal means by which many state governments protect their historic resources by delegating their powers of regulation, acquisition and taxation to local governments in counties, cities, towns and villages. Some local governments may draft their own city charter upon being granted home rule status by state statute or by state constitution. State enabling legislation or home rule charter determines the level of autonomy of a locality.

The greatest challenge for any historic building project is to source sufficient funding to cover project costs while maintaining reasonable developers profit and market rental levels. Conventional debt financing is often inadequate to cover the entire costs of a rehabilitation project. Many historic resources are located in older inner-city neighbourhoods that suffer from poverty and low levels of investment. Access to capital, including credit from banks, savings and loan associations and other financial institutions is essential to local efforts to conserve these neighbourhoods. Acquisition and rehabilitation loans are necessary to maintain and improve the neighbourhood building stock. Without credit and financial services, experience in the US has shown that investment is replaced by speculation, deterioration of buildings, reduced business activity and desertion of the area by residents (Blake and Lowe, 1992).

In order to discourage the demolition and neglect of historic buildings ‘gap’ financing must be identified to pay for the additional costs of rehabilitation projects in terms of materials and design treatments. Potential sources of financial assistance for preservation activities in the US include federal, state and local funding programmes, private foundations, corporations and individuals. The fundamental building blocks of investment in historic buildings are debt financing, equity through tax credits and subsidies.

Against the legislative and administrative background to historic preservation in the US, this paper will now explore the various possibilities to finance rehabilitation work and investment in historic property.

## Federal Debt Financing Provisions

Many older neighbourhoods are at a disadvantage in attracting credit because lenders consider the areas too risky. In the 1970s, community organisations and advocacy groups began to document the discriminatory ‘redlining’ practices of lending institutions of denying credit to creditworthy applicants in older inner-city and minority neighbourhoods. Redlining practices have contributed to the physical and economic demise of many historic low and moderate-income neighbourhoods. As a result, Congress passed the following acts:

**Home Mortgage Disclosure Act (HMDA) (1975)** requiring lenders to disclose where they are making home mortgage loans. The Act requires that lenders prepare an annual disclosure statement which reports, by census tract, where they make mortgage and home improvement loans.

**Community Reinvestment Act (CRA) (1977)** requiring that lenders serve the credit needs of the entire community, including low and moderate-income neighbourhoods. The Act is designed to assess the lenders efforts to meet local credit needs and to encourage innovative partnerships with community groups and local governments. It does not impose strict lending requirements requiring lenders to make high-risk loans that jeopardise their financial solvency (Blake and Lowe, 1992).

In 1988 preservation advocates and community groups took action against redlining practices in Pittsburgh, Pennsylvania. The city wide non-profit historic preservation group Pittsburgh History and Landmarks Foundation created a coalition with 17 local non-profit community groups to form the Pittsburgh Community Reinvestment Group (PCRG). Through research and active problem solving and by utilising the provisions contained in the Community Reinvestment Act and the Home Mortgage Disclosure Act, the coalition has shown that ‘green-lining’ or reinvestment in historic districts by financial institutions is good business.

As a result, the coalition has made impressive gains towards eliminating redlining practices in Pittsburgh's low and moderate-income neighbourhoods. During its first year in operation, the organisation successfully negotiated a five-year \$109 million neighbourhood lending agreement with Pittsburgh's Union National Bank. The agreement included a \$500,000 loan to Pittsburgh's History and Landmark Foundation's revolving loan fund for inner-city historic preservation projects. In conjunction with this loan, the historic preservation group received a \$205,000 grant from the McCune Foundation to pay interest on the bank loan, establish a loan loss reserve and cover predevelopment costs such as legal and architectural fees (Blake and Lowe, 1992).

Another form of assistance is through the Affordable Housing Programme (AHB) of the Federal Home Loan Bank established by the Financial Institutions Reform, Recovery, and Enforcement Act 1989 which provides subsidised loans or direct subsidies to member financial institutions engaged in low and moderate-income housing projects. The programme assists the acquisition and rehabilitation of existing buildings and projects to revitalise neighbourhoods and is therefore a natural funding opportunity for projects that combine affordable housing and historic preservation (Delvac, Escherich and Hartman, 1997).

## Equity through tax credits

### FEDERAL REHABILITATION INCOME TAX CREDITS

The first federal tax incentive scheme for historic preservation was created in 1976 and amended in 1981. The current rehabilitation tax credit system, established by the Tax Reform Act of 1986, comprises of two credits (IRC section 47 (c) (2)(B) & (C), IRC S. 47 (c) (3), Treas. Reg. S. 1.48-12 (d)) (Boyle *et al*, 1994):

A 20% tax credit for the certified rehabilitation of certified historic structures (excluding owner-occupier residential)

A 10% tax credit for the rehabilitation of non-historic, non-residential buildings built before 1936

The two credits are mutually exclusive. A tax credit lowers the amount of tax owed. Thus, a dollar of tax credit reduces the amount of tax owed by one dollar. By comparison, an income tax deduction lowers the amount of income subject to taxation. Eligibility for either rehabilitation tax credit is dependent upon meeting certain criteria laid down in the Internal Revenue Code (IRC).

To be eligible for the 20% tax credit the building must be a *certified historic structure* when it is returned to use (Figure 2). That is, it must be either listed individually in the National Register of Historic Places *or* it can also be located in a *registered historic district* and be certified as contributing to the historic significance of the district. Buildings designated at state or local level will also be considered as *certified historic structures* if the designation is certified as conforming to the National Register criteria.

Projects undertaken for the 10% tax credit must meet special physical requirements concerning the retention of external walls and the internal structural framework, as follows:

A minimum of 50% of the building's walls existing at the time the rehabilitation began must remain in place as external walls at the works conclusion, and;

A minimum of 75% of the building's existing external walls must remain in place as either external or internal walls, and;

A minimum of 75% the building's internal structural framework must remain in place

(Auer, 1996).

The rehabilitation must involve a *depreciable building* (i.e. used for trade or business and held for the production of income) in office, commercial, industrial or agricultural use or for rental housing (Figures 3 and 4). It may not serve as an owner's private residence. A small number of states and municipalities have provided local tax credits to support the rehabilitation of owner-occupied residential property. But there has been strong

opposition on the part of many private owners to being included within a local historic district, particularly in regions where no home ownership financial incentives exist. This situation has led to preservation advocate groups supporting public demands for the introduction of historic home ownership assistance. The Historic Home Ownership Assistance Bill (H.R. 1172) was introduced into the US Congress in May 1995 and by June 2000 had received 211 sponsors (leaving only 7 short for the Bill to go forward). It is therefore possible that further assistance will be made available to owner-occupiers in the future, but with the recent change in the US administration this remains uncertain. The Bill proposed to provide a 20% federal income tax credit to individuals that rehabilitate historic homes or who are the first purchasers of rehabilitated historic homes for use as a principal residence (Shaw, 1995; National Trust for Historic Preservation web-site).

For relevant *depreciable buildings* qualifying rehabilitation expenditure must be chargeable to a capital account, rather than expensed. Soft costs such as architectural, engineering fees, consultancy, developers and surveyors fees and insurance premiums are allowed as part of the qualified rehabilitation basis. The term ‘developers fees’ has never been quantified or qualified and remains a major area of abuse, for example, including developer’s profit in the purchase price, disguising syndication fees and non-arms length transactions. New building construction (car parks or landscaping) and acquisition costs are excluded from qualifying expenditure (IRC section 47 (c)(2)(B)(ii), Treas. Reg. section 1.48-12 (c)(7)(ii), Treas. Reg. section 1.48-12 (d)(9)).

The rehabilitation must also be ‘substantial’, i.e., during a 24-month period selected by the taxpayer the ‘qualified rehabilitation expenditures’ must exceed the greater of \$5,000 or the *adjusted basis* of the building and its structural components. The



Figure 2: The New Amsterdam Theatre, Time Square, 42nd Street, New York designed by Herts and Tallant in 1903 and listed on the National Register of Historic Places. By the Early 1980s the building was vacant and in a state of disrepair. In 1997 the Disney Development Corporation completed the rehabilitation of the theatre, which involved cleaning and repairing exterior details and restoring the Art Nouveau interior finishes. The total rehabilitation costs eligible for federal credit amounted to \$37,100,000 allowing a 20% tax credit of \$7,420,000.

*adjusted basis* includes the purchase price, minus the cost of land, plus improvements already made, minus depreciation already taken. Qualified expenditures incurred outside of the measuring period may be included once the substantial test is met. The fact that the taxpayer may choose the measuring period allows flexibility in maximising the rehabilitation credit. A 60-month measuring period applies for phased developments (IRC section 47(c)(1), Treas. Reg. section 1.48-12 (b)(1)&(2)).





Figure 3: Rehabilitation of the Train Terminal Headhouse and Filbert Street Arcade, Philadelphia, completed 1885-1891 for the Reading Railway Company, is located on Market Street in Philadelphia. The building is certified in the National Register of Historic Places. Originally in office use, the building has been rehabilitated to provide retail, convention centre and hotel accommodation. Exterior work involved replacement of the roof, the re-pointing of masonry and the addition of shop fronts. Interior work included the restoration of the 'millwork' metal ceilings and plasterwork, in addition to the hotel adaptations.

Project Financing

Rehabilitation costs eligible for federal credit	\$72,300,000
20% Federal Historic Rehabilitation Tax Credit	\$14,460,000

Source: Pennsylvania Bureau for Historic Preservation

This section of the law was not intended to limit the owners to a strict two-year period during which all work must be started and concluded. It was designed as a test to ensure that genuine rehabilitation rather than superficial cosmetic repair is performed on eligible buildings. There is no restriction on the number of rehabilitation projects that can be carried out. The only requirement is that the 'substantial rehabilitation' requirement is fulfilled each time.

The rehabilitation tax credit may be claimed in the taxable year that the rehabilitated property is placed back in use, referred to as 'placed in-service' (Figure 5) (IRC section 4 (b), Treas. Reg. section 1.48-12(f)(2), Treas. Reg. section 1.48-12(c)(6)). Expenditures may be transferred provided that no actual use (whether personal or business) is made of the building between the time the transferor incurred the rehabilitation expenditures and the date of acquisition by the new owner (Delvac, Escherich and Hartman, 1997).

The *depreciable basis* of the rehabilitated building must be reduced by the full amount of the tax credit claimed. Rehabilitated property is depreciated using the straight-line method, where the same amount of depreciation is calculated each year. For relevant residential property this is over a period of 27.5 years for and for non-residential property over 39 years (Auer, 1996) (IRC section 47 (c) (2) (B)(i), Treas. Reg. section 1.48-12 (c)(7)(i), Treas. Reg. section 1.48-12 (c)(8)(ii)).

There is no formal review process for the rehabilitation of non-historic buildings for the 10% tax credit, but the approval process for the 20% tax credit requires submission of a three-part Historic Preservation Certification application to the SHPO (Blumenthal, Bevitt and Jandl, 1993). The SHPO forwards the application with recommendations to the National Park Service for final certification. The

IRS requires that the Certification of Completed Work from the NPS, signifying conformance with the Secretary of the Interior’s Standards for Rehabilitation, must be submitted with the tax credit claim. This process is codified under 36 C.F.R. Part 67 of the Federal Regulations.

If a rehabilitated property is disposed of within five years of being *placed in-service* the tax credit will be recaptured on a scaled basis. The owners of properties disposed of within a year of being placed in service will be liable for 100% claw-back of the tax credit, reducing by 20% per annum over five years (IRC S. 50 (a), Treas. Reg. section 1.48-12 (f)(3)) (Hahn, 1989). In the case of the 20% tax credit, the NPS or the SHPO may inspect a rehabilitated property at any time during the five-year period to ensure that no unapproved alterations have been carried out since completion. The NPS may revoke certification and notify the IRS of any unapproved works (Auer, 1996).

**Example 1: Rehabilitation Tax Credit Calculation**

Real property purchased for	\$1,300,000
Amount allocated to the purchase of land	\$ 500,000
Amount allocated to the building	\$ 800,000
Eligible basis	\$ 800,001

Qualified rehabilitation expenditures must exceed \$800,001 within the measuring period. The rehabilitation credit is earned on the entire amount of the rehabilitation expenditures not just the portion in excess of the basis.

Cost of rehabilitation	\$1,000,000
20% tax credit	\$ 200,000

The remaining \$800,000 will be eligible for depreciation using the straight-line method.

In order to allow developers to acquire long term ground leases rather than freehold interests, tenants may also earn the rehabilitation credit on their qualifying expenditures if the lease term remaining

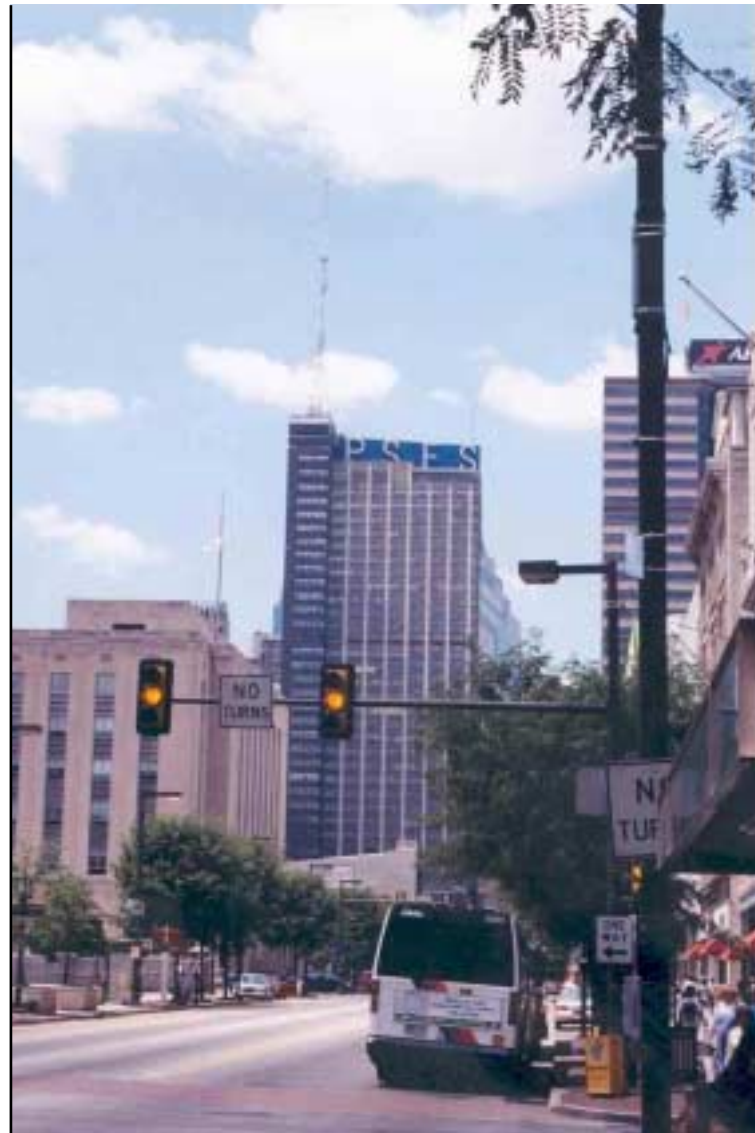


Figure 4: The PSFS (Philadelphia Saving Fund Society) Building, Philadelphia is the first international style building in the United States, dating from 1934, and is a National Historic Landmark. Work to convert the building to a 500-room hotel using the federal rehabilitation tax credit commenced in 1998.

at the end of the rehabilitation is equal to or greater than the depreciation period for the property. In this case, the lease term would have to be greater than 27.5 years for residential rental property and greater than 39 years for non-residential real property (Delvac, Escherich and Hartman, 1997).

In theory, there is no restriction on rehabilitating an historic building with the aid of rehabilitation tax credits, waiting five years and then demolishing the building. However, in practice however, this rarely occurs.

## STATE REHABILITATION INCOME TAX CREDITS

A number of state heritage programmes administer income tax credits that either supplement the federal historic rehabilitation tax credit (see below) or provide tax credits for historic properties that are certified as historic structures at the state or municipal level but are not entitled to the federal tax incentives.

Byrtus and McClelland (2000) identify twelve states that have created income tax credits for historic properties. The legislation is categorised as follows:

Income tax rehabilitation credits for residential or non-income producing historic properties. State legislation has been enacted in Connecticut, Colorado, Maryland, Michigan, Missouri, New Mexico, North Carolina, Ohio, Rhode Island, Utah, Virginia, West Virginia and Wisconsin

Income tax rehabilitation credits for commercial, rental or income-producing historic properties. State legislation has been enacted in Colorado, Indiana, Maine, Maryland, Michigan, Missouri, New Mexico, North Carolina, Ohio, Virginia, West Virginia and Wisconsin

Income tax credits for corporations that give a donation to aid the preservation of historic properties within enterprise zones. State legislation has been enacted in California and Florida

Income tax deductions for historic lands. State legislation has been enacted in California

By example North Carolina provides some of the most generous tax incentives for historic preservation in the US, following the recent enactment of a 20% rehabilitation tax credit for commercial property owners and a 30% rehabilitation tax credit for owner occupied historic dwellings. Homeowners must spend at least \$25,000 on their homes to qualify for the 30% rehabilitation tax credit. The 20% commercial tax credit can be added onto the federal tax credit of 20% thus providing a combined credit of 40%.

## Affordable housing through historic preservation

The federal government offers various programmes to assist the provision of affordable housing via the US Department Housing and Urban Development. For example, there is a rental assistance programme, which tenants can use to pay the landlord the

difference between fair market rent and the amount affordable to the tenant. The rehabilitation of existing buildings can also attract specific tax credits for developers and investors.

The Tax Reform Act of 1986 (IRC section 42) established the investment tax credit for acquisition, construction, or rehabilitation of low income housing for occupants who meet specific income requirements. An existing building does not need to be a *certified historic structure* to qualify for the low-income housing tax credit. However, where a *certified historic structure* is rehabilitated for use as low-income housing the federal historic rehabilitation tax credit and the low-income housing tax credit may be combined (Escherich, Farneth and Judd, 1997). This has greatly increasing available capital for historic rehabilitation projects and has encouraged many real estate investors into the housing market.

## THE LOW-INCOME HOUSING TAX CREDIT

This tax credit is available for a 10-year period. To fully attain the credit the low-income housing portion of a building must remain in compliance with the occupant's income limitations for 15 years. Two affordable housing tax credit percentages apply to buildings that qualify as 'substantially rehabilitated':

70% tax credit for rehabilitation expenditures that have not been federally subsidised, equating to a credit of circa 9% per annum for ten years

30% tax credit for rehabilitation expenditures that have been federally subsidised, equating to a credit of circa 4% per annum for ten years

The credits were fixed in the first year of the low-income credit (1987) at 9% p.a. and 4% p.a. respectively. The credit percentages are adjusted monthly by the US Department of Treasury. The credit represents the present value of the credit over a ten-year period, which equals 70% of the cost of





Figure 5: Rehabilitation of 10 Wood Street, Trenton, New Jersey, classified as a certified historic structure by the National Park Service in February 1993. The rehabilitation project carried out by the Wood Street Housing Partnership commenced in May 1994 with the assistance of the 20% federal historic rehabilitation tax credit. The building was placed in-service following completion in December 1994.

Project Financing	
<b>Total cost of rehabilitation</b>	<b>\$1,528,790</b>
<b>Rehabilitation costs eligible for federal tax credit</b>	<b>\$1,447,568</b>
<b>20% federal historic rehabilitation tax credit</b>	<b>\$289,514</b>
Source: Department of Environmental Protection, New Jersey	

**Example 2: Calculation of Low Income Tax Credit**

Eligible Basis / qualified rehabilitation expenditure	\$1,000,000
Annual credit percentage (70% tax credit equating to)	9% p.a. over 10 years
Annual credit amount	\$90,000
Total low-income credit (over 10 years)	\$900,000

the building to the developer subject to a 15-year compliance period. As interest rates change the present value computation changes. To be eligible for the low-income credit, the project must receive credit allocation from the appropriate state or local housing credit agency where the low-income housing project is located.

The low-income credit percentages are increased in qualified census tracts and difficult development areas designated by the US Department of Housing and Urban Development. The 70% and the 30% credits are increased to 91% and 39% by increasing the eligible basis by 130% (Delvac, Escherich and Hartman, 1997).

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**Example 3: Calculation of Increased Credit Percentages in Qualified Census Track**

Eligible basis / qualified rehabilitation expenditure in qualified census track (130%)  
 \$1,300,000  
 Annual credit percentage (70% tax credit equating to) 9% p.a. over 10 years  
 Annual credit amount  
 \$117,000  
 Total low-income credit (over 10 years)  
 \$1,170,000

Similarly, this could be calculated as follows:

Eligible Basis / qualified rehabilitation expenditure in qualified census track (100%)  
 \$1,000,000  
 Annual credit percentage (91% tax credit equating to) 11.7% p.a. over 10 years  
 Annual credit amount  
 \$117,000  
 Total low-income credit (over 10 years)  
 \$1,170,000

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A low-income credit project must set aside a minimum percentage of rent restricted units that meet certain criteria relating to cost per unit and income of occupants relative to area median incomes. The following income tests apply:

20:50 test - where at least 20% of the units must be rent restricted and occupied by tenants with incomes of a maximum of 50% of area median gross income, adjusted for family size

40:60 test - where at least 40% of the units must be rent restricted and occupied by tenants of a maximum of 60% of area median gross income, adjusted for family size (Delvac, Escherich and Hartman, 1997)

The eligible basis of the tax credit is the cost of the rehabilitation expenditures and the qualified basis is the low-income portion of the eligible basis.

A building is substantially rehabilitated if, during any 24-month period, the rehabilitation expenditures exceeds 10% of the *adjusted basis* (see above) as of the beginning of the measuring period. In addition, the minimum expenditure per low-income unit must be \$3000. Where a building is acquired from a Government agency, the taxpayer must only meet the \$3,000 requirement to qualify.

In certain circumstances, rehabilitation expenditures may include the acquisition costs of the existing building. To include the acquisition costs in the rehabilitated expenditure, at least ten years must have elapsed between the date the taxpayer acquired the building and the date the building (or substantial improvement to the building) was last placed in-service. Acquisition costs are not eligible if the building was previously placed in-service by the taxpayer.

If the low-income tax credit is used in association with the federal grants and subsidies the eligible basis must be reduced by the amount of any federal grants already received for the rehabilitation project. Federal subsidies such as tax-exempt interest bond financing or federal funded below market interest rate loans are not automatically excluded from the eligible basis to avoid federal funds from being at risk. However, the price is that the 30% credit rather than the 70% credit is allowed. The taxpayer may choose to exclude the amount of the subsidy from the eligible basis and still use the 70% credit. Acquisition costs for existing buildings can only qualify for the 30% credit regardless of federal subsidies received. By using federal subsidies for acquisition and not for rehabilitation, the total amount of tax credit can be maximised at 70% for rehabilitation expenditures.

While the tax credit is claimed over a 10-year period it is earned out over a 15-year recapture period. Failure to comply with the rent restriction requirements of the low-income credit 15-year



Figure 6: Rehabilitation of No. 210 Academy Street, Trenton, New Jersey (Academy Hanover Historic District): a timber frame and brick residence, constructed in circa 1900. The project involved the conversion of a single residence to two low-income residential units with the assistance of the both 20% federal historic rehabilitation tax credit and the low-income housing tax credit.

Project Financing	
Rehabilitation costs eligible for federal tax credit	\$253,700
20% Federal Historic Rehabilitation Tax Credit (HRTC)	\$50,740
Low Income Tax Credit (\$253,700 less \$50740)	\$202,960
LITC @ 9% per annum	\$18,266
For 10 years	\$182,660
20% Federal Historic Rehabilitation Tax Credit (HRTC)	\$50,740
Federal Low Income Tax Credit (LITC) over 10 years	\$182,660
<b>Total Credit:</b>	<b>\$233,400</b>

Source: Department of Environmental Protection, New Jersey

compliance period results in a recapture of a portion of the credit plus interest. If the tax credit is recaptured at any time during the first eleven years of the compliance period, one third of the credits already received must be returned. In year twelve, four-fifteenths of the credit will be recaptured. In year thirteen three-fifteenths of the credit will be recaptured and so on. By year 15, only one-fifteenth of the credits will be recaptured (Delvac, Escherich and Hartman, 1997).

## Combining tax credits and syndication

The possibility of combining the rehabilitation tax credit with a low-income housing project can result in an increased level of equity, which can be critical to the financial viability of rehabilitation projects (Escherich, Farneth and Judd, 1997). The additional equity can be generated through the formation of syndicates of investors willing to purchase the tax credits at a premium. For such projects the eligible basis for the low-income housing tax credit is reduced by the amount of the rehabilitation tax credit (Figure 6).

Developers can generate historic rehabilitation equity from investors through the syndication of tax credit sales. A typical approach is to form a limited partnership with the project sponsor as general partner. Investors make contributions to cover project costs in the form of limited partners purchasing interests in the partnership by making capital contributions. Each partner's share of the profits and losses for tax purposes is based on the partner's share in the partnership. In order to provide a return on investment to the investor-partners, the equity yield to the partnership is less than the amount of the credit itself. The sale of partnership interests are regulated by federal and state securities law which require disclosures and other safeguards to protect potential investors.

Many investors are willing to pay a premium to purchase the tax benefits from the historic rehabilitation tax credit and the low-income housing tax credit. This is demonstrated by market transactions, which indicate that for every dollar of low-income credit, investors will contribute approximately 50 to 55 cents, while for a dollar of rehabilitation credit investors will contribute 75 to 80 cents. The difference between the tax credit 'recapture' risks of the historic rehabilitation tax credit and the low-income housing tax credit account for greater equity yields from the historic rehabilitation tax credit. Investors are willing to pay more for the rehabilitation credit as it is earned entirely in the year in which the property is *placed in-service*. While the low-income credit provides more cumulative benefits, there is a 10-year claim back period and a 15-year recapture period for the low-income credit compared to the five-year recapture period for the rehabilitation credit (Delvac, Escherich and Hartman, 1997).

**Example 4: Syndication of the Low-Income Tax Credit**

Residential Rehabilitation

Eligible basis (cost of the rehabilitation expenditures)	\$1,000,000
Low-income portion (say)	75%
Qualified basis	\$750,000
Credit percentage	9%
Annual credit amount	\$67,500
Total low-income credit (over 10 years)	\$675,000
Equity yield for low-income credit through syndication (50 cents)	\$337,500

**Example 5: Combining the Federal Historic Rehabilitation & Federal Low-Income Tax Credit through Syndication**

Rehabilitation Credit

Cost of eligible rehabilitation expenditures	\$1,000,000
Tax credit	20%
Rehabilitation credit	\$200,000
Equity yield for rehabilitation credit through syndication (80 cents)	\$160,000

Low-Income Credit

Cost of eligible rehabilitation expenditures	\$1,000,000
Less rehabilitation credit (see above)	\$200,000
Eligible basis	\$800,000
Low-income portion (say)	75%
Qualified basis	\$600,000
Annual credit percentage	9%
Annual credit amount	\$54,000
Total low-income credit	\$540,000
Equity yield for low-income credit through syndication (50 cents)	\$270,000
<b>EQUITY FROM COMBINED CREDIT</b>	<b>\$430,000</b>

Non-profit organisations buy historic buildings and syndicate the restoration project by forming a limited partnership, where the non-profit agency holds a 1% interest in the property as a limited partner and the syndicate holds the other 99%. The non-profit organisation organises the building rehabilitation and the investment companies receives the 'passive activity' of the tax credit.



Ownership of the historic building reverts back to the non-profit organisation once the tax credits have been received by the passive syndicate members and the recapture period has elapsed.

The primary source of equity investment partners has been unrelated passive partners with federal tax liability that they are attempting to shelter. However, under the current federal law they are typically corporations rather than individuals due to 'passive activity' rules introduced by the reform of the tax credit system in 1986, which limit the ability to form a syndicate comprising a large number of individuals. Thus whilst it was once possible to collect a number of investors that could each shelter an investment of \$200,000 or more, this passive investment cannot now be used to offset tax liability from 'active' income sources such as salaries (except to a limited figure of around \$7,000). This rule does not apply to most regular corporations and real estate professionals that materially participate in the real property business and satisfy eligibility requirements regarding the proportion and amount of time spent in such businesses (Auer, 1996). Investment pools can be created by investment houses or by syndicates, to enable individual investors to participate in the tax credit programme but typical investors are now large corporations/publicly held stock "Fortune 500 or 1000" companies such as Proctor and Gamble, IMB, Ford, Walt Disney, utility companies and insurance companies.

#### **THE ROLE OF THE DEVELOPER: AN EXAMPLE**

Pennrose Properties Inc., a property development company operating in Pennsylvania, New Jersey, Maryland, Delaware and Washington DC has been providing high quality low-income housing for families, senior citizens and people with disabilities since 1970. The company maintain ownership of their residential affordable housing developments and provide an integrated system of management and support services to encourage self-sufficient

communities. Over the years Pennrose have established partnerships with community non-profit organisations, public funding agencies, private sector investors, local leaders and public housing authorities. Pennrose works in conjunction with community resources to tailor management programmes to meet the needs of their tenants. Once rehabilitation projects have been completed, Pennrose commit resources to maintain and manage properties for the long term

Over the ten-year period to 1998 Pennrose carried out very high-quality rehabilitation projects at a consistent level. The projects have had a very positive impact on surrounding residential neighbourhoods and have spurred additional development. The company has not sought to work exclusively on historic properties, but the rehabilitation tax credit and affordable housing tax credit provided a significant boost in generating private capital in the form of equity investment to rehabilitate structures. In effect, the developer sells the tax benefit by selling participation in the ownership of the property to which these tax credits are transferred. The entire credit can be taken by an investor in the tax year in which the property is *placed in-service*. Credits will usually be sold for 85% to 90% of their face value. While Pennrose may keep some equity in some developments, their primary motive for rehabilitation activity is in generating fees.

It may not be possible to make a project economically viable if a building is generally intact and restrictions on the efficient lay out and reuse are imposed due to important features that must be maintained. Pennrose Properties has not carried out projects unless it has been able to obtain an efficient utilisation of the interior space given the economics of the reuse. In some cases the city or local historic preservation groups have provided additional funding resources to retain important features thereby reducing the burden of efficiency on the



economics of the operation. Each case has to be negotiated with the NPS and the SHPO.

Although rental subsidy is a traditional methodology through which affordable housing has been produced in the US for many decades, Pennrose Properties Inc. rarely look for subsidised rents from the government. The company find it preferable to write down the cost of the development so that the debt that is placed on the property is as limited as possible. The level of rent is primarily based on the cost of operation. Rental subsidies are subject to alteration in the political process in terms of continuance. The developer is in a better position to have the capital cost written down in a way that creates economics that are supportable, even with lower income occupancy without long-term reliance upon federal, state or other operating subsidy.

As a matter of practice, Pennrose Properties Inc. partner with community-based organisations in virtually every project. Local community organisations become fully-fledged partners in the ownership and development of properties being rehabilitated for use as affordable housing. In return they do a variety of things for the partnership such as generating screening and helping to place tenants in the facility. Community support is also very helpful in providing access to local and regional funding sources that are important to the financial feasibility of the development. This issue would be considered in the selection process of properties.

Most affordable housing developments are located in areas that will remain affordable throughout the life of the structure, unless there is a major turnaround in the market conditions and economics of the region. Some may be converted at a later stage. The minimum period during which a property must be retained in lower income rental

use is 15 years and more typically 30 or more years by either statute or covenant, which is recorded with the land.

**CASE EXAMPLE: THE BRENTWOOD LOW INCOME HOUSING REHABILITATION PROJECT, PARKSIDE HISTORIC DISTRICT, PHILADELPHIA (PENROSE PROPERTIES INC./PARKSIDE HISTORIC PRESERVATION CORPORATION)**

The Parkside neighbourhood was originally constructive between 1818 and 1890 by beer baron Frederick Poth. The Parkside Historic Preservation Corporation, a neighbourhood based non-profit corporation, spearheaded the certification of the Parkside Historic District in the National Register of Historic Places to assist in rehabilitation action. Working in co-operation with Pennrose Properties Inc., the corporation has rehabilitated 12 historic buildings since 1983 to create 198 housing units for a total investment of \$18 million. Approximately 66% of the required capital for these projects was generated by combining the federal rehabilitation tax credit with the low-income housing tax credit.

The former derelict Brentwood building is one example of this co-ordinated rehabilitation action (Figures 7A and 7B) and resulted in the provision of forty-four residential units for use by low-income families and senior citizens. Apart from combining the two tax credits the building benefited from being located in a qualified census tract, increasing the eligible basis to 130% for the low-income housing tax credit). The project received the 'Preservation Achievement Award' from the Preservation Alliance for greater Philadelphia and the 'Building Excellence Award' from Commerce Bank. Pennrose Properties Inc. syndicated the tax credits to realise the equity to finance the rehabilitation project (see calculations shown below):



Figures 7A (prior to rehabilitation) and 7B (following rehabilitation): The Brentwood rehabilitation project at Parkside Avenue, Philadelphia. The project involved the rehabilitation of the near derelict Brentwood Building into forty-four residential units for use by low-income families and senior citizens with the assistance of the federal historic rehabilitation tax credit and low-income housing tax credit.

Development Costs	LITC Eligible Basis	LITC Non - Eligible Basis	Total
Construction	\$5,753,500		
Fees	\$381,207		
Tax Credit Fees	\$26,681		
SFE	\$30,000		
Environmental Audit	\$11,737		
Historic Consultant	\$25,000		
Organisational	\$0	\$5,000	
Miscellaneous	\$5,786		
Construction Financing	\$4,316		
Insurance	\$24,225		
Real Estate Taxes	\$3,498		
Title and Recording	\$9,942		
<i>Permanent Financing</i>	\$0	\$10,000	
Acquisition	\$0	\$192,122	
Reserve	\$0	\$45,700	
Developers Fee	\$690,000		
Syndication Fees	\$0	\$8,431	
TC Monitoring	\$8,600		
<b>TOTAL</b>	<b>\$6,974,492</b>	<b>\$261,253</b>	<b>\$7,235,745</b>

Source: Pennrose Properties Inc.

**Calculation of Low-Income Tax Credits**

Total eligible Basis	\$6,974,492
HRTC @20%	(\$1,400,000)
LITC Eligible Basis	(\$5,574,492)
Qualified Census Track @ 130%	(\$614,532)

Source: Pennrose Properties Inc.

**Comparison of Tax Credit Calculation Including and Excluding the Federal Historic Rehabilitation Tax Credit**

	<u>Including the HRTC</u>	<u>Excluding the HRTC</u>
Total Eligible Basis	\$6,974,942	\$6,974,942
Historic Rehabilitation Tax Credit (HRTC)	(\$1,400,000)	\$0
Low-Income Tax Credit (LITC) Basis	\$5,574,492	\$6,974,942
Qualified Census Track @130%	\$7,246,840	\$9,066,840
LITC @ 8.48%	\$614,532	\$768,868
Equity at 55% pay in rate	\$3,379,932	\$4,228,774
Tax Credit @ 85%	\$1,190,000	\$0
Total Equity Raise	\$4,569,932	\$4,228,774

Source: Pennrose Properties Inc.

Taking syndication calculations into consideration, the combination of the tax credits increased the equity raised for the project by \$341,158.

Pennrose Properties Inc. have been interested in ‘preservation easement donations’ in terms of their commitment to the long-term maintenance of their affordable housing properties, but for a variety of reasons have not utilised them. The recapture of tax credits by the IRS on completed developments already placed in service would preclude the donation of any easements. Furthermore, possible restrictions on the maintenance and use of the properties may create a level of resistance among investors. Nevertheless, easements are another financial mechanism in operation in the US and are worthy of consideration.

A further example identifies the relationship between the historic rehabilitation tax credit, the affordable housing tax credit and debt financing arrangements to serve the community:

**CASE EXAMPLE: SAINT JAMES II LOW-INCOME HOUSING REHABILITATION PROJECT, NORTH BROAD STREET HISTORIC DISTRICT, NEWARK, NEW JERSEY**

The Saint James II, formerly numbers 136 to 148 Broad Street, is located in the North Broad Street Historic District of Newark. The limestone row houses, dating from 1893, were rehabilitated by limited partnership in 1996 to provide 30 multi-family low-income rental residential units. Debt and equity financing was provided for the rehabilitation project as follows:

Equity Financing:

- 20% Federal Historic Rehabilitation Tax Credit
- Federal Low-Income Housing Tax Credit
- Syndication of tax credits to National Equity Fund Chicago, Illinois

Debt Financing:

- First Mortgage – Thrift Institutions Community Investment Corp.
- DCA Balanced Housing Programme Loan
- Federal HOME Fund Programme Loan
- United Thank Offering Loan
- FHBL Affordable Housing Programme Funds Loan

Due to federal involvement in the rehabilitation project via the debt financing through the federal level HOME fund loan programme, the *section 106 process* was instigated to assess any possible adverse affects of the proposed rehabilitation project on the row houses and adjoining structures located in the historic district.

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**Timeframe for rehabilitation project management and completion**

- 1994 (March) Section 106 Process: Initial SHPO ‘No Adverse Affect’ approval
- 1994 (May) Section 106 Process: Advisory Council on Historic Preservation (ACHP) approval
- 1994 (August) Historic Preservation Certification Application: Part 1 approval
- 1995 (October) Historic Preservation Certification Application: Part 2 SHPO approval
- 1995 (October) Low-Income Housing Tax Credit: allocation approval
- 1995 (November) Low-Income Housing Tax Credit: carry-over approval
- 1995 (December) Section 106 Process: Final SHPO approval
- 1996 (February) Historic Preservation Certification Application: Part 2 NPS approval
- 1996 (March) Start of construction / rehabilitation work
- 1996 (July) Historic Preservation Certification Application: National Register Listing
- 1996 (November) Building placed in service
- 1996 (December) Historic Preservation Certification Application: Part 3 submission
- 1997 (January) Low-Income Housing Tax Credit: request for tax credit
- 1997 (February) Qualified low-income occupancy

Source: St. James Community Development Organisation

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**Project Costs**

Acquisition	\$131,300
Relocation	\$100,000
New Construction	\$331,319
Rehabilitation	\$3,345,599
Total Development Cost	\$3,908,218

Source: St. James Community Development Organisation

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**Calculation of Low-Income Tax Credit**

Depreciable Basis (see note 1)	\$3,474,494
Less Building Acquisition	\$131,300
Less Historic Tax Credit	\$596,375
Less HOME Funds (see note 2)	\$340,700
Eligible Basis	\$2,406,119
Qualified Census Tract Adjustment	130%
Adjusted Basis	\$3,127,955
Multiplied by applicable fraction in low income use	100%
Qualified Basis	\$3,127,955
Annual Low-Income Tax Credit %	9%
Annual Tax Credit	\$281,516
Multiplied by 10 year claim period	\$2,815,160
Syndication of tax credit at 50 cents per dollar	\$1,407,580

Source: St. James Community Development Organisation

Note 1: Depreciable element of total development costs, as per project accounts.

Note 2: In calculating the rehabilitation tax credit, only \$340,700 of a total of \$500,000 in HOME Funds was deducted, as the balance of \$159,300 was expended on acquisition costs for which no tax credit is requested.

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**Calculation of 20% Federal Historic Rehabilitation Tax Credit**

Depreciable Basis	\$3,474,494
Less building cost	\$131,300
Less furniture and equipment	\$30,000
Sub-total	\$3,313,194
Reduction to reflect 10% new construction	\$2,981,875
20% Federal Rehabilitation Tax Credit	\$596,375
Syndication of tax credit at 80 cents per dollar	\$477,100

Source: St. James Community Development Organisation

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**Project Funding**

*Debt:*

Thrift Institutions Community Investment Corp.	\$587,052
FHLB Affordable Housing Programme Funds Loan	\$250,000
Federal HOME Fund Programme Loan	\$500,000
United Thank Offering Loan	\$30,000
DCA Balanced Housing Programme Loan	\$585,386

*Equity:*

Federal Low-Income Housing Tax Credit	\$1,407,580
Federal Historic Rehabilitation Tax Credit	\$477,100
Deferred Development Fee	\$71,000
General Partner	\$100
<b>TOTAL</b>	<b>\$3,908,218</b>

Source: St. James Community Development Organisation



## Preservation Easement Programme

A preservation easement is a legal agreement that ensures the long-term preservation of buildings by prohibiting demolition or inappropriate alterations. Easements may be referred to as ‘restrictive covenants’. Preservation easement donations may apply for a term of years or into perpetuity. The owner of any *certified historic structure* or a building contributing to the character of a *register historic district* (i.e., buildings or buildings in districts listed in the National Register), or a building protected by state or local ordinance as certified by the Secretary of the Interior, can voluntarily donate (by contract) a preservation easement to ‘qualified’ non-profit preservation organisation such as a community land trust or government entity at federal, state or local level, while maintaining private ownership (Byrtus and McClelland, 2000). The easement applies to the land and binds future property owners to its provisions (i.e., usually in perpetuity), in many cases providing stronger protection than from a local landmarks ordinance.

Preservation and conservation organisations may make use of three types of easement: scenic or open space easements, exterior or facade easements, and interior easements. For the purpose of the charitable contribution provisions only, a building does not need to be a *depreciable building* (i.e. income-producing) to qualify. It may be a structure other than a building and could be a portion of a building such as a façade or the land area on which an historic structure is located (Auer, 1996).

A preservation easement agreement is used to specify the critical historic features that must be maintained. Any alteration to architectural features identified in the agreement can only take place with the express permission of the easement holding body. In all other respects the property remains privately owned. Most easement programmes require that an easement donor contribute to an

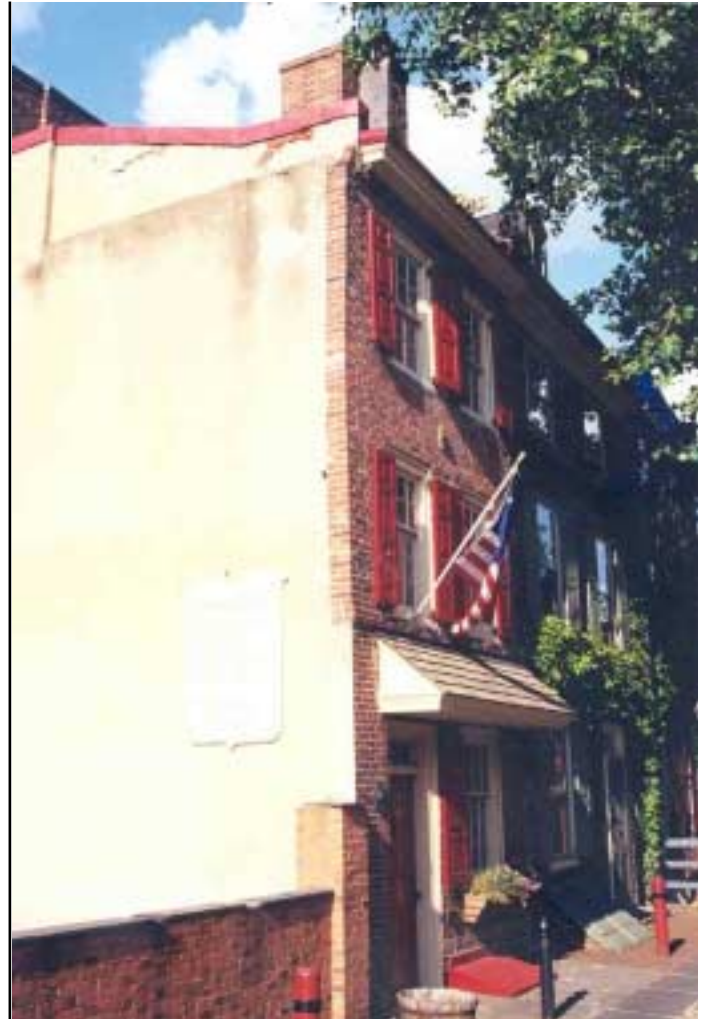


Figure 8: The row houses in Elfreth's Alley, Philadelphia, which date from the 1720's to the late eighteenth century. By the late 1930s, the properties were in a very poor state of repair. The Elfreth's Alley Association was subsequently formed to purchase the properties. When the market picked up the properties were sold and an endowment was created with the proceeds of the real estate sales. The endowment was then invested in mutual funds so that grants and low interest loans, usually in the region of \$5000 dollars, could be offered to the owners to rehabilitate the properties. No interest is charged if an owner repays a rehabilitation loan within one year. The Elfreth's Alley Association maintains an easement on the exterior of all the properties in the Alley. The Association funds an annual inspection of the properties by an architect to ensure that the buildings are well maintained. A list of any deficiencies found requiring immediate rectification is sent to the owners. The association is also a second party to the insurance contract ensuring that an up to date insurance policy is being paid by all property owners in the Alley.

administration fund or ‘easement endowment’ (Figure 8). The easement authorises the organisation to compel the owner by court action to make repairs or to restore the property to its original condition and may authorise the organisation to make repairs to correct the violation at the owner’s expense. Depending on the circumstances, an

organisation may seek monetary damages in compensation for irreversible actions.

Programmes in urban areas have had success in purchasing exterior easements at low-cost, often stipulating that the easement purchase funds are only used for the exterior restoration of the property. Historic Annapolis Foundation in Maryland has worked out a barter system, exchanging various services such as ground maintenance, historical research or architectural drawings in exchange for exterior easements.

Although easements have existed for a long time (originating from common law court decisions regarding real property and contracts), it was not until 1964 that the IRS recognised a charitable tax deduction for the value of the gift of an easement. This has been a major factor in encouraging conservation and preservation organisations to establish easement programmes. Congress organised the deduction of charitable easement donations from federal income, estate and gift tax liability in section 170 (h) of the Internal Revenue Code, for which the IRS issued regulations in 1986 (Section 1.170 A-14 of the Treasury Regulations). (Other miscellaneous expenses associated with a donation such as legal and accounting assistance, survey costs, recording and appraisal fees are not counted as being charitable expenses but nevertheless are tax deductible). All states have also passed some form of easement legislation (which usually authorises state agencies and qualified non-profit organisations to accept easements) or otherwise authorise easements. In this respect the law regarding easement donations varies from state to state (Watson and Nagel, 1995).

#### **FEDERAL, STATE AND LOCAL TAXATION CONSIDERATIONS**

An easement donor may make a charitable contribution deduction from federal income, estate and gift tax purposes for the *value* of a preservation

easement that is donated to a tax-exempt charitable organisation or public agency for defined ‘conservation purposes’ (known as a ‘qualified conservation contribution’). Easement agreements must be carefully prepared to conform to federal requirements. If an easement only complies with state and local real estate law, it may be valid and enforceable, but it may not qualify as a charitable conservation contribution deductible for federal tax purposes (Smith, 1997).

In the case of *federal income tax* derived from appraised real property, easements can be granted to historic property owners whose land is accessible to the public in exchange for a tax deduction. The deduction may not exceed 30% of the donor’s adjusted gross income in the year of the gift. Any excess may be deducted over five additional years or until the value of the donation has been used up, whichever ever comes first. Alternatively, the donor may donate up to 50% of adjusted gross income, as long as the donation deduction is limited to the appraised value of the property (Watson and Nagel, 1995).

An easement is likely to reduce the value of a property owner’s estate for *federal estate (inheritance) tax purposes*. If the easement is donated while the donor is alive, the value of the easement and any consequent appreciation allocated to the easement is removed from the property owner’s estate. If it is donated to the organisation by will, the value of the easement is allowable as a charitable contribution deduction for federal estate tax purposes. The estate tax benefit reduces the value of an estate to the point where the beneficiaries can pay the taxes due without having to sell the property. In addition, the *federal gift tax* or *capital gains tax* payable on property given or sold after it is placed under easement may be reduced because of property’s reduced value.

Income and estate taxes (inheritance taxes) at the state level often parallel the deductions available at the federal level. An easement may also affect an owner's local property taxes. The existence of an easement may cause an immediate decrease, in proportion to the easement's value, in a property's tax assessment. An easement's effect on local property taxes varies with from state to state and within different localities. The length of the agreement varies from five years in some states to 'perpetual' agreements in other states. Alaska, California, Florida, Georgia, Iowa, Kansas, Montana, Nebraska, Nevada, North Carolina, Ohio, Oregon, Tennessee, Virginia and Wisconsin have enacted legislation requiring tax assessors to give full recognition to the reduced marketability of property encumbered by easements (Watson and Nagel, 1995).

#### VALUATION OF EASEMENT DONATIONS

The value of the preservation easement is equal to the difference between the fair market value of the property *before* granting the easement (including any residual development value for more profitable reuse) and the fair market value of the property *after* the granting of the easement (taking redevelopment restrictions and any economic benefits to the value of the property from the donation of the easement into account) (IRS Ruling 73-339). Fair market value is defined as "*the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts*". The appraisal has to be at arms length, but the IRS regulations provide little help in constructing a valuation method and therefore these calculations depend heavily on the skill and subjective judgement of the valuer. The valuation can be complicated by the fact that easements are donated to an organisation with an endowment (to cover the administration costs including annual inspections by architects) and, if taken in perpetuity, it is difficult

to establish what future restoration costs will amount to. In Washington D.C. the decrease in value, as determined by the before and after appraisal method, is typically 5% to 20%. However, there has been evidence that an easement can result in a decreased property value of up to 50% when the historic building is located on a large parcel of land with development potential (Duerksen, 1983).

The possible charge of an unconstitutional 'taking' of a property right is negated by the fact that the donation of an easement is voluntary and future owners will purchase with full knowledge of the easement on the building. When an urban historic property is protected by a strong local landmarks ordinance, it is difficult to argue that the subsequent donation of an easement takes anything further from the owner's property rights that have not already been altered by designation as a *certified historic structure*. Any decrease in the value of the property relating from demolition or alteration restrictions should already have occurred at the time of the landmark designation. In this case it could be argued that the donation of an easement would not affect the value. In fact it has been found that in established historic districts the market may offer a premium value for older buildings with historic character suitable for renovation. The protection of the historic character of historic neighbourhoods due to strong landmark ordinances and easement donations may stimulate buyer interest and increase rather than decrease the market value of some historic buildings (Duerksen 1983).

#### EASEMENT DONATIONS AND THE FEDERAL HISTORIC REHABILITATION TAX CREDIT

The donation of a preservation easement is considered a sale for the purposes of recapture of the rehabilitation credit. To avoid a claw back of rehabilitation credit the taxpayer must grant the easement either after the 5-year recapture period is up or prior to the year in which the rehabilitation



credit is claimed. Developers that are eager to take advantage of the historic rehabilitation tax credits often neglect to consider the possibility of a preservation easement donation until renovation of the building has commenced. There are two serious consequences to this action:

Following renovation the reduction in value due to an easement donation is difficult to prove as the operating income of the building will increase and market value may now surpass the value of the redevelopment potential of the site.

The sale or gift of an easement within 5 years of receiving a rehabilitation tax credit will result in a recapture of the tax credit (IRS Ruling 89-90) (e.g. a façade easement will result in the recapture of a portion of the rehabilitation credit).

The difference in the tax treatment of easement donations by individuals and corporations affects their attractiveness as tax shelters. For example, the donation of an easement by a large publicly held corporation could reduce the book value of real assets and therefore the book value of the corporation's outstanding shares of stock. However, if a limited partnership donates the preservation easement on their historic building, each partner may take an annual charitable contribution deduction on their individual income tax return in proportion to the ownership interest in the building. In this case there is no recapture of tax credits in the sale of the real asset.

However, developers buying historic buildings in commercial use in busy city centre locations rarely consider the possibility of preservation easement tax shelters. In the past most attention has been given to easements on small residential buildings in neighbourhoods undergoing substantial renovation activity where it is difficult to show a reduction in value. Moreover, the IRS remains sceptical of use of easements for historic preservation purposes, for

example, some houses in historic district are subject to very tight regulations on alterations or additions, so donating an easement is somewhat of an academic exercise.

## State taxation incentives

### PROPERTY TAX EXEMPTIONS, ABATEMENTS AND ASSESSMENT FREEZES

The US system of levying a property tax poses a significant threat to many designated historic buildings. The real property tax system assesses the underlying value of the land as well as the value of the building. Thus where zoning permits another use the 'higher and best use' value attributed to the development potential of the site may be applied rather than the 'current use' value of the historic building (Hawkins *et al*, 1997). Without such zoning possibilities, the rehabilitation of an historic building is likely to raise the current use value of a building and therefore a higher property tax assessment will be incurred, however, in many municipalities the property tax burden as a percentage of market value is less for vacant land than it is for existing commercial or residential buildings. Thus, the inter-relationship between market demand, zoning and the property tax assessment system provides many historic landmark owners with an incentive to demolish their buildings in order to avoid a higher tax burden.

State property tax relief programmes designed to encourage the renovation of landmark buildings can provide an effective mechanism for returning landmark buildings to productive use. In the majority of states, the municipal government administers property tax incentives for historic properties. A small number of states have created property tax incentives targeted for the specific types of historic property such as historic industrial mills and historic motels and hotels. In some states property tax relief exists on paper only as enabling legislation and it is only effective if it is

implemented by local ordinance. Approval for state property tax credits may be dependant on the historic structure being certified in the state or municipal register of historic places.

Byrtus and McClelland (2000) have identified fourteen categories of legislation for property incentives operating in different states. These include:

Property tax relief for historic properties by reducing property tax assessment values

Property tax relief or credits for ‘qualified’ rehabilitation

Property tax exemptions or lower assessment levels for non-income producing historic properties (including residential properties) or historic properties that are owned or used by non-profit or government organisations

Property tax relief or preferential tax assessment for properties that neighbour a historic site if they are subject to special conditions and regulations due to their proximity to the historic site

Property tax assessment of historic properties at actual values rather than ‘highest’ or ‘best use’ value

Property tax relief for properties under easement agreements

Property tax relief or credits for rehabilitation improvements to historic properties under easement or restrictive covenant

Property tax subclass for historic properties

State property tax subclass for non-income producing historic properties

Property tax relief for rehabilitation to historic properties in community reinvestment areas or historic districts

Property tax credits for construction of architecturally compatible new structures in an historic district

Property tax relief for historic lands or for portions of land allocated to an historic site

Property tax relief for historic lands under easement

Property tax relief for historic lands owned by a qualified organisation

By example, a property tax abatement scheme was enacted by Washington State in 1985 through the ‘Special Valuation for Improvements to Historic Property’ programme to “*encourage maintenance, improvement and preservation of privately owned historic landmarks*”. The programme excludes the value of a building’s rehabilitation from its assessed

value for 10 years. Only properties listed in the National Register (or a local register) are eligible to qualify for the programme. Prior to this programme, the owners of *certified historic structures* were liable for an increase in property taxation relative to the increase in appraised property value following a major rehabilitation. The programme only exists in communities where the local government has chosen to provide it. Localities may extend the programme to residential and/or commercial property. While compliance with local rehabilitation standards for historic buildings is mandated, the programme does not require compliance with the Department of Interior Standards for Rehabilitation. As a result, compliance standards vary from municipality to municipality. The owner must maintain the building and obtain approval from the local preservation board prior to making any alterations. Interiors of architectural merit must be opened to the public once a year. Violation of the agreement will entail a recapture of back taxes with interest and a penalty of 12% of the repaid amount. Rehabilitation expenses must equal 25% of the property’s assessed value and the work must be completed within 24 months. The programme was made permanent following a study by the State Revenue Department in 1991, which concluded that:

Prior to rehabilitation, 82% of buildings were partially occupied, vacant or abandoned;

Over 70% of property owners believed that their rehabilitation projects inspired renovation in the neighbourhood;

The 122 projects participating in the programme at the time of the study would produce a net revenue gain of \$10 million for state and local governments through sales, business and occupation taxes in addition to increased property tax revenues from neighbourhood improvements (Beaumont, 1996).

## OTHER STATE TAX INCENTIVES

In some states, businesses and ‘qualified’ organisations are encouraged to own, use and rehabilitate historic properties through enabling legislation (Byrtus and McClelland, 2000).

For example:

**Franchise tax credits:** Financial institutions and public service companies in Maryland can claim state franchise tax credits for undertaking a rehabilitation of a certified historic property

**Business tax credits:** Businesses that have offices in historic industrial mills in Rhode Island can claim a credit for interest earned and paid on loans made for eligible business expenses or costs incurred in the rehabilitation of the mill and a business tax credit against the salaries paid to employees that work in the historic industrial mill

**Community contribution tax credits:** Corporations in Florida receive tax credits for donations to approved historic preservation projects

**Annual excise tax:** Public corporations in Washington are exempt from paying an annual excise tax for certified historic structures

**Sales tax exemption:** Non-profit organisations owning historic properties in Kentucky and Texas are exempt from collecting sales tax on admission fees and on materials used to rehabilitate or operate eligible property

**State income tax:** Qualified organisations in California can obtain deductions

## ENTERPRISE ZONES

Enterprise zones provide a financial boost to attract investment capital to projects in inner city areas characterised by negative market forces. By hiring local neighbourhood people for conservation projects and establishing viable businesses in the area, developers benefit from a further layer of financial incentives in addition to existing federal and state incentives. In essence, this underwrites the development by reducing the amount of debt that would have to be put into the project. When debt payments are reduced, lower rents will be required to cover debt payments. This is attractive to investors by virtue of their ability to save on tax obligations together with a virtually guaranteed market for the product that has been developed.

## Preservation Revolving Funds

Similar to the Architectural Heritage Fund, which supports revolving fund (and single) Building Preservation Trusts in the UK, there are many revolving funds in operation in the US (i.e., a pool of capital created and reserved for a specific activity

such as historic preservation, with the restriction that the monies are returned to the fund to be reused for similar activities). Revolving fund finance can be used to buy properties and resell them to sympathetic buyers with protective covenants or easements. Revolving funds can also lend money to enable sympathetic buyers to acquire and rehabilitate historic properties. When a property requires emergency stabilisation or when the magnitude of the rehabilitation task is a deterrent to buyers, funds may carry out necessary works prior to resale, acting as a developer of last resort. A revolving fund provides a pro-active tool for preservation organisations to save endangered properties, initiate the revitalisation of historic neighbourhoods and demonstrate the economic and social benefits of historic preservation to the community. Revolving funds also initiate and maintain partnerships with local government, neighbourhood organisations, developers and individuals (Moriarty and Lutzker, 1993).

A variety of public or private entities can operate a revolving fund in the US, but the majority of funds that buy and sell properties are managed by private, non-profit organisations. Non-profit preservation revolving funds rely on techniques such as rehabilitation agreements, covenants and easements to ensure the appropriate rehabilitation and long-term protection of the properties they assist. They are most effective when they target areas or properties that have been neglected by the private sector. Some funds are reactive waiting for potential properties to come to them, while some funds are proactive instigating area revitalisation projects.

## TAX AND CORPORATE STATUS

Revolving funds can be private foundations or publicly supported charities. To attract capital from donors, privately operated revolving funds in the US should be incorporated as a non-profit, tax-exempt organisation under Section 501(c)(3) of the Internal

Revenue Code. In 1986 the IRS Revenue Ruling 86-49 confirmed that operation of a preservation revolving fund could qualify as charitable activity (i.e., it satisfies the requirements for tax exempt organisation: this ruling resulted from several years of negotiation between the IRS and the Preservation North Carolina revolving fund after the IRS denied their application for tax-exempt status). Donations made to such organisations are deductible as charitable donations for federal income, gift and estate tax purposes and generally qualify for state charitable deductions. Corporate status is preferable to unincorporated associations or charitable trusts as corporations are deemed to be separate entities and the officers and members are generally protected from liability for corporate acts. In order to retain tax-exempt status a revolving fund must be organised and operated exclusively for exempt purposes and no part of its net earnings may add to the benefit of any private shareholders or individual.

The revenue ruling applies to revolving funds that are either part of a larger preservation organisation or are administered as a separate organisation. The key factor is the need to distinguish the fund from commercial real estate operations. If a revolving fund wants to sell properties in which it does not have an interest, a real estate licence is required. Revolving funds that purchase options, fee simple titles or other form of ownership interest will seek buyers as the owner not as the real estate broker (Moriarity and Lutzker, 1993).

#### **DONATIONS, PURCHASE AND RESALE**

Donors may wish to retain a life estate in a property allowing the possibility to remain there for the rest of their life. Alternatively a donation may be made subject to leaseback arrangement, enabling the donor to continue using the property for a specific time period. Properties sold to revolving funds at less than fair market value are termed bargain sales, where the vendor benefits from a charitable contribution deduction for the difference between

the bargain sale price and the market value of the property.

Certain states provide incentives to encourage corporations to donate properties to non-profit organisations. For example, Florida has a Community Contribution Tax Incentives Programme, which allows corporations donating properties to approved community development projects to receive a tax credit equal to 50% of their donation (Florida Statutes Section 220.183).

As an alternative to purchase and resale, a revolving fund organisation may take a long-term lease on a property in order to protect it. By leasing an endangered property from an unsympathetic owner, the revolving fund protects the property while a long-term solution is sought. A lease with an option to buy provides additional protection as the option can be exercised if the lease arrangement is not protecting the property adequately.

Revolving funds that do not rehabilitate properties prior to their resale may require the execution of a rehabilitation agreement in addition to an easement donation as a condition of sale. A rehabilitation agreement may define necessary rehabilitation works to be carried out by the new owner within a specified period of time. The required rehabilitation standard can be defined broadly by reference to the Secretary of Interior's Standards for the treatment of historic properties or they can refer specifically to architectural features that must be retained and techniques that must be used to ensure appropriate preservation practice. Remedies in the event of non-conformance must be included in the agreement and must be allowable under state law. Remedies may include:

The right of the revolving fund to repurchase the property if work is not completed according to the agreement

Provision for liquidated damages such as a cash payment agreed in advance

The right to sue for specific performance

The right of the fund to complete the rehabilitation and place a lien on the property for the expenditure incurred (Moriarity and Lutzker, 1993)

## FUNDING INITIATIVES

Revolving funds establish guidelines for project eligibility based on their overall mission and objectives. The fund managers must develop criteria to evaluate both the financial feasibility and preservation benefits of undertaking each potential project. Most funds set limits on the amount of funds that can be invested in a single project. A fund that does not take risks will not be able to effectively fill the gap left by the private sector. It is important for revolving funds to establish the level of risk they are willing to take.

The most common sources of start-up funds for revolving funds are grants from local foundations, corporations or state or local government agencies. As funds gradually become depleted, fund-raising is an ongoing activity of most revolving funds. Local lending institutions also provide funding in the form of a line of credit available to the revolving fund secured by the fund's assets or personal guarantees. By example, the Wisconsin Preservation Fund acquired two structures for rehabilitation in 1990, the former Milwaukee County Emergency Hospital and Schlitz malt house. The fund leased the structures to the Milwaukee public school system for a term of 20 Years. The acquisition and rehabilitation costs were financed by the sale of \$47 million in tax-exempt bonds through the Milwaukee Redevelopment Authority. This was made possible by the non-profit ownership of the buildings. The bonds will be repaid through the lease payments. The fund received fees for its role as project catalyst. At the end of the 20-year lease, the school system will have an option to purchase the buildings for \$4.25 million. If the school system does not exercise this option the fund will own the buildings free of debt and can use the assets to lever funds for other projects.

## PRESERVATION NORTH CAROLINA

North Carolina Preservation has a reputation as the most aggressive and innovative state-wide preservation revolving fund in the US, acting in its own right and supporting a network of local revolving funds. In 1973 the National Trust gave the North Carolina Society for the Preservation of Antiquities (now Preservation North Carolina) a \$600 Preservation Services Fund grant to investigate the possibility of establishing a revolving fund. In 1975, the organisation received \$35,000 from the Mary Babcock Reynolds Foundation to create a small revolving fund to acquire endangered historic structures, particularly in rural North Carolina.

In 80% of the cases, Preservation North Carolina secures an option to purchase property at a given price over a fixed time period. During this option period, usually ranging from three months to two years, Preservation North Carolina markets the property and secures a buyer who is willing to acquire the property subject to protective covenants. Alternatively, the revolving fund secures finance to directly purchase property, sometimes at a price less than market value. Occasionally properties are donated as a gift to Preservation North Carolina (Rypkema, 2000).

The most impressive component of Preservation North Carolina's revolving fund is the modest amount of money required to run the programme each year. Preservation North Carolina has worked out an innovative arrangement whereby the SHPO pays half the purchase price of properties listed on the National Register and the fund return 75% of these monies upon resale of the property, keeping the other 25% for use on new projects.

Over the last 20 years Preservation North Carolina has been involved in the acquisition and resale of 300 properties representing a pre-rehabilitation market value in excess of \$12.5 million. Furthermore, it has been estimated that an additional



\$60 million has been invested in the rehabilitation of these properties by subsequent owners. Local city and county governments and school districts receive between \$1 million and \$2 million every year from the property tax revenues generated by the buildings with which Preservation North Carolina has been involved. The impact of the revolving fund is increased by the fact that prospective purchasers seek to buy and rehabilitate property in close proximity to revolving fund properties (Rypkema, 2000).

## Transfer Development Rights

A *transfer of development rights* (TDR) system sets up a market for development rights that can be transferred from one property to another. A property owner may sell or transfer the right to develop land upon which an historic landmark is built to a parcel of land elsewhere in the town or city. By selling foregone development rights to a receiving site and by committing to maintain the landmark building the property owner receives funding to finance the preservation of the landmark building. TDR is particularly beneficial to churches and other non-profit property owners that are tax exempt and cannot take advantage of property tax abatements and other incentives.

The idea for TDR was created by Professor John Costonis in relation to the battle to save Adler and Sullivan's twelve storey Chicago Stock Exchange (1894-1972). Professor Costonis suggested that the air rights or unused zoning envelope above a *certified historic structure* could be sold to another developer that wanted to build higher than zoning would normally permit at another location, which would not pose a threat to adjacent *certified historic structures* (Costonis, 1974). The problem in Chicago was that application of TDR would rely on the idea of there being a market for air rights. In the early 1970s there was no zoning variance in downtown Chicago. Sears Tower, the 110-storey

Chicago office building of Sears Roebuck was built in 1974. The 440 metre (1,445 feet) high steel framed structure only required permission regarding building height (from the Federal Aviation Administration to ensure air safety). However, since 1974, the City of Chicago have reviewed every building proposal above 183 metres (600 feet) and thus prevented the development of a market for air rights.

Nevertheless, the concept of TDR was incorporated into zoning codes in New York. Furthermore, at least twenty-two states including California, Colorado, Maryland, New York and Washington and Delaware authorise the transfer of development rights (Beaumont, 1996). TDR also work in rural areas for example to preserve old farmsteads and the views from old battlefield sites.

In urban areas, TDR will only works where the economy is booming and there are intense development pressures in tightly defined development areas, such as central business districts in downtown Manhattan and San Francisco. The value of the air rights are agreed by negotiation, on a building per square foot basis. If the property market is depressed, TDR is worthless.

In New York City, TDR must be agreed through the New York Landmarks Preservation Commission and a preservation or maintenance plan must be drawn up for the maintenance of the landmark building. It is usually only possible to transfer the development right to adjacent or contiguous land sites in order to avoid scattering air rights all over the city. It is also only possible to transfer air rights over individually designated landmarks. There is a reluctance to transfer rights in historic districts to avoid high-density development. There are exceptions to this rule such as South Street Seaport in New York where there is an 'air rights bank' in the zoning plan. An example of a successful transfer development right is the Holy Apostles Church on 9<sup>th</sup> Avenue and 27<sup>th</sup> Street (Figure 9).



Figure 9: Holy Apostles Church, 9th Avenue and 27th Street, New York. The right to develop air space was transferred enabling the safeguarding of this church.

## Other federal funding initiatives

### HISTORIC PRESERVATION FUND

The US Department of the Interior through the NPS administers the Historic Preservation Fund (HPF) Grants in Aid Programme. This programme provides federal funding to states and territories for planning and preservation activities. The SHPO allocates these funds to projects according to annual state priorities.

The HPF was authorised in 1976 by amendments to the NHPA and is funded through revenues from Outer Continental Shelf oil and gas leases. The Act has allowed deposits of \$150 million annually to the fund, but historically only a fraction of this amount (one-quarter to one-half) has been appropriated and authorisation for the payments ceased at the end of the 1997 fiscal year. In recent years the lack of resources hindered the financing of work by the SHPOs particularly their ability to run grant aid programmes of assistance for historic buildings. However, in May 2000 President Clinton signed the HPF Reauthorization and Executive Order 13006 which again authorised the payment of \$150 million annually to 2005 (National Trust for Historic Preservation web-site). The fund is the primary source of federal revenue to fund SHPOs, public-private partnerships including technical advice and administration of federal programmes such as the historic rehabilitation tax credit and the ‘Save Americas Treasures’ grant-aid programme (National Park Service, 1998).

In establishing a partnership between federal, state and local governments the NHPA requires the SHPOs to award at least 10% of the annual HPF monies to Certified Local Governments in their state (every state has at least one Certified Local Government and nationwide the total exceeds 1000) to provide grant-aid for projects on historic buildings. To ensure state and local commitment to preservation projects all grants are 50-50 matching grants. Recipients may provide matching funds in the form of services in kind (include supplies, developing photographs, office rent and administrative costs), cash or volunteer hours. Projects tend to be short term and the amount of grants tends to be small. All CLG grants must result in a completed tangible result and must be carried out in accordance with the applicable Secretary of Interior’s Standards for Historic Rehabilitation (National Park Service, 1996). In addition to providing strong partnerships between local, state

and national preservation networks, the Certified Local Governments programme encourages integration with local land use planning personnel (Zellie and Kronick, 1995).

#### MISCELLANEOUS FEDERAL GRANTS AND SUBSIDIES

A variety of other miscellaneous finance sources have provided support for historic preservation work. By way of example, a number of federal grant and subsidy programmes are outlined below (this is not an exhaustive list):

*Federal Loan Guarantee Programme for Designated National Register Properties* (provided in 1980 via an amendment to the NHPA). The federal government can guarantee up to 90% of loans made by private lenders to finance 'any project for the preservation of property included on the national register'. The guarantee programme encourages lenders to make loans to developers considered credit risks

*Housing and Community Development Act 1974*. A rental assistance programme provides developers with income by subsidising low and moderate income household rents to full market rental value

*US Department of Housing and Urban Development*. Subsidisation for the provision of affordable housing through the acquisition and rehabilitation of existing buildings to revitalise neighbourhoods

*Affordable Housing Programme of the Federal Home Loan Bank (FHLB)*. Assisting housing finance lenders to develop affordable housing in the form of subsidised loans or direct subsidies

*Inter-Mobal Surface Transport Efficiency Act 1991*. Provision of funds for historic preservation projects

#### NON PROFIT ORGANISATIONS

Thousands of private non-profit organisations have set up at national and local levels in the US to aid the protection and rehabilitation of historic resources. By example, at the national level, the *National Trust for Historic Preservation* is a private non-profit organisation chartered by Congress in 1949 to administer financial assistance programmes, which are mainly directed to non-profit organisations, public agencies and community groups. It supports a variety of programmes:

*The Community Partners Programme* is an enabled initiative of the National Trust for Historic Preservation that creates partnerships between community development and historic preservation groups at the national, state and local levels to demonstrate the effectiveness of preservation based community development

*Inner-city Venture Funds* provide low-interest loans on flexible terms for projects that reuse designated historic properties for affordable housing, community facilities, retail and office space in low and mixed income neighbourhoods. Loan amounts are limited to \$200,000 for a revolving line of credit and \$150,000 for a project-based loan

*Heritage Property Investors (HPI)* is a fee for service component of the Trust's Community Partners Programme which provides developers of historic rehabilitation tax credit projects and historic low-income housing tax credit projects with financial structuring advice on project debt financing and access to corporate equity investors. HPI projects are eligible for short-term loans from the inner-city ventures fund including equity bridge loans

*Preservation Services Fund* provides matching grants ranging from \$500 to \$5000 to non-profit organisations, universities and public agencies to initiate preservation projects

*The National Preservation Loan Fund* provides below market rate loans of up to \$150,000 to non-profit organisations and public agencies to help preserve properties listed in or eligible for the National Register of Historic Places. Funds may be used to create or expand local and state-wide preservation revolving funds for site acquisition or rehabilitation work

*The Johanne Favrot Fund* offers grants ranging from \$2,500 to \$25,000 to non-profit organisations, government agencies, for profit business and individuals for projects that contribute to the preservation or the recapture of an authentic sense of place

*Save Americas Treasures* is a public-private initiative between the White House Millennium Council, National Trust for Historic Preservation and the Paul Getty Trust, an international cultural and philanthropic institution, to protect threatened historic and cultural treasures including the buildings, sites and districts. Matching grants of between \$10,000 to \$50,000 in support of the conservation, rehabilitation and ongoing care of preservation projects (Save Americas Treasures web-site)

*Main Street Programme* is run by the National Trust for Historic Preservation as a commercial revitalisation strategy working in 1300 communities across the US

The Main Street Programme has proved to be an effective tool for downtown revitalisation in the context of historic preservation. Originally developed for the central commercial districts of small towns, it was subsequently adopted for urban neighbourhood use with programmes operating in many major metropolitan areas such as Boston, San Diego and Chicago. Over the 18 year period to 2000, in excess of \$8.6 billion had been invested in Main Street districts around the country. There have



been 48,800 building renovations, 43,800 net new businesses and 161,600 net new jobs. For every one dollar used to operate a local Main Street Programme \$35 has been invested. The programme quickly proved to be effective in Boston as evidenced by the fact that in 1996, during the first year of citywide Main Street Programme, 11 Main Street districts generated a total of 85 new businesses, 539 new jobs and \$711,154 in private investment in physical improvements (Rypkema, 2000; Rypkema and Wiehagen, 2000).

## Other State funding initiatives

Most states have developed their own funding programmes to support historic preservation in addition to tax credits and incentives. Some examples can be given as follows:

### NEW JERSEY

In the state of New Jersey the *New Jersey Historic Trust* (NJHT) was established by statute in 1967 as a non-profit historic preservation organisation. The trust acts as a sister organisation to the SHPO and has administered grants and loans provided through the Green Acres, Cultural Centres and Historic Preservation Bond Act 1987 (PL 1987,C265) (refunded in 1992 and 1995) (New Jersey Historic Trust, 1998). The Act was approved by referendum and authorised the sale of \$100 million in state bonds to finance the following:

Development of cultural centres

Acquisition and development of lands for recreational and conservation purposes

Restoration, rehabilitation and improvement of New Jersey's historical resources

The Act provided up to \$22 million for a competitive grants programme and \$3 million for a revolving loan fund to assist 'bricks and mortar' capital preservation projects and authorises the NJHT to administer the following programmes:

The Historic Preservation Bond Programme Revolving Loan Fund. Loan amounts ranged from \$25,000 to \$450,000 with a repayment period of up to 20 years with interest rates below 4%. The Trust would lend up to 90% of the project costs for non-profit entities and up to 40% for local and county governments

The Historic Preservation Bond Fund provided grants from \$25,000 to \$1.25 million. All grant applicants had to meet stringent criteria established in the bond act and the programme regulations, relating to eligibility requirements, research, architectural and historical integrity, financial capability, public benefits and conform to the Standards and Guidelines (36 CFR part 1207)

An emergency grants and loan fund provided seed funding for critically needed work.

The Bond Act required 50:50 matching funds. Municipal and county government agencies and non-profit organisations have not been able to use state funds to match bond funds. The bond act stipulated that the sum of grants made to state owned properties must not exceed 50% of all grants authorised. 10% of each grant was withheld pending final audit of completed projects. Grant recipients also had to execute an easement agreement with the Trust. The easement period was determined by the amount of grant assistance provided by the Trust (ranging from 5 years for a grant of \$5,000 - \$25,000 to 20 years for a grant of over \$100,000).

Since the programme began, grant requests exceeded the funds available by approximately 300%. Over the decade to 1998 the trust awarded nearly \$55 million in matching grants to 182 projects (Renner and Dugan, 1998). This funding source was exhausted by 1997. Based on the popularity and success of the New Jersey Historic Preservation Bond Issue, it is likely that funds will be replenished through future historic preservation bond acts. However, for some buildings the constraints imposed by funding criteria have been found to be too great in some instances and have worked against the desire to preserve historic buildings. As a result some developers have targeted row houses that were in a very poor condition because they had more flexibility to rehabilitate these.

## NEW YORK

The *New York Landmarks Conservancy* (NYLC) established a fund in 1982 using proceeds from the redevelopment of the federal archives building in Greenwich Village. It provides property owners with technical assistance, loans and grants via an annual operational budget of circa \$1.2 million plus a programme budget of circa \$500,000 that provides:

Low interest loans for the restoration of landmark buildings. Loans generally cover exterior work or structural repairs and range from \$15,000 to \$100,000 with rates from 3% to market rates and terms of up to 10 years

Matching grants for the maintenance, repair and restoration of landmark religious structures

Grants for the creation of low and moderate-income housing in vacant, landmark quality buildings

The grants are available to fund both project planning and actual restoration work. The technical services centre also provides publications detailing practical guidance on the preservation of specific building types. The NYLC try to assist low and moderate-income properties such as one to four family row houses in historic districts in Brooklyn and Manhattan. The historic properties revolving loan fund, which makes secured loans to finance restoration, grew to almost \$7 million over 15 years (Mendelsohn, 1998). The NYLC will also joint venture with other lenders and fund the retention of aesthetic elements of buildings.

## PENNSYLVANIA

The *Pennsylvania Historical and Museum Commission* (PHMC) is the official history agency of the Commonwealth of Pennsylvania. The Commission was initiated in 1913 and consolidated with the State Museum and the State Archives in 1945. The Commission provides three grant programmes to aid non-profit museums, historical organisations and *certified local governments* throughout Pennsylvania:

The *Certified Local Government Grant Programme* which assists the identification, registration and protection of significant historic districts and properties in communities with Certified Local Governments. This programme is federally funded

The *History and Museum Grant Programme* which provides project and operating support and technical assistance to private institutions and state wide non-profit organisations. The grant programme was initiated by a special appropriation from the Pennsylvania General Assembly in 1985. In 1996 the Pennsylvania Historical and Museum Commission expanded the grant programme to include operating support funds to museums, increased technical assistance and a historic preservation grant category with an emphasis on collaborative grants

The *Keystone Historic Preservation Grant Programme* which provides 50-50 matching grants to non-profit organisations and local public agencies for preserving, rehabilitating and restoring eligible and certified heritage buildings, structures and sites that will be open to the public. Funding for the programme comes from the Commonwealth Key-Stone Recreation Park and Conservation Fund. This fund was established in 1993 by the Pennsylvania General Assembly using revenue from the voter-approved sale of bonds and from a portion of the state Realty Transfer Tax. The Commission also uses the fund to rehabilitate and maintain Commonwealth owned historic site and museums (Pennsylvania Historical and Museum Commission, 1998/99)

## A package of State funding tools: the Maryland example

The *Maryland Historical Trust*, a unit of the Department of Housing and Community Development, is the official SHPO for Maryland. The Trust administers federal and state historic preservation funding programmes in the state of Maryland. Enabling laws, updated in 1995, provide guidance to local governments on ordinance objectives and criteria for designating historic properties and districts (Maryland Historical Trust, 1996). These vary from jurisdiction to jurisdiction depending on the elected leadership. The Maryland statute requires counties and municipalities to adopt design guidelines for rehabilitation. The Secretary of Interiors' Standards for Rehabilitation provide a main point of reference in this regard (Beaumont, 1996).

## BALTIMORE DOLLAR HOUSES

One of the earliest examples of effective action to coordinate historic preservation activity in the state

of Maryland following the passing of the NHPA in 1966 can be evidenced in Baltimore. As a result of poorly planned highway construction projects, subsequently rejected, the city of Baltimore had been left with many blocks of late eighteenth century to early nineteenth century houses, which had been designated for demolition. The city of Baltimore offered the houses for sale for \$1 each to those who would rehabilitate them, with the assistance from the federal government in terms of loan guarantees, other public finance and design covenants. They are known as the ‘Dollar Houses’ and by 1998 the houses could fetch in the region of \$200,000 to \$300,000 each on the open market.

However, gentrification has not been regarded as significant issue as the city had over 50,000 vacant houses in downtown locations apart from a significant number of redundant historic industrial buildings, many of which have since been rehabilitated through other incentives. Moreover, the city has been aggressive in its policy on local designations since the benefits of reusing historic properties has been realised (Gale, 1991). Today there are 19 historic districts and approximately 22,000 designated historic buildings (18,000 federally designated, 7,000 locally designated with an overlap of 3,000), which now benefit from a plethora of financial support mechanisms.

#### **LOANS AND GRANT AID**

Direct state financial assistance is offered in Maryland to non-profit organisations, local jurisdictions, business entities and individuals for the acquisition, rehabilitation and restoration of the eligible historic buildings through the:

Historic preservation loan programme;

Historic preservation grant programme for capital and non-capital projects

The size of the fund varies from year to year and is determined annually by the Maryland General

Assembly – in recent years the grant fund has been in the region of \$1.2 million p.a. The state of Maryland (and other states such as New Jersey, New York and Pennsylvania) has authority to sell ‘bonds’ to the public in order to raise funds for multi-year programmes to finance state capital projects, including the funding of heritage grant programmes. These have been justified according to the better quality of life and the multiplying economic development that has been created. In fact economic studies to assess the benefits of historic preservation have been an essential part of the process of justifying raising money through bond financing, identifying the increased return from increased tax revenues whether by income taxes from jobs created or property taxes or sales taxes according to materials purchased. This evidence is effectively used to defend the programme.

#### **EASEMENT DONATIONS**

Owners of designated historic buildings may convey a perpetual historic preservation easement as a gift to the Maryland Historical Trust. The gift of an easement may have beneficial income, estate and property tax consequences for the donor. Beneficiaries of heritage grants also must convey a perpetual historic preservation easement on the property to the Maryland Historical Trust. The easement can apply to interiors, exteriors and entire parcels of land including archaeological resources. There is no law to stop people demolishing heritage buildings. However, by this mechanism the state can effectively preserve historic property. Maryland Historical Trust holds about 450 easements on a full range of resources including high-rise apartment buildings, plantation houses, log cabins, and bridges. The easement requires that beneficiaries must maintain, as well as preserve, historic structures. In an urban setting, where a property may already be within a locally designated historic district, the practical market effect of the imposition of the easement donation may be very slight.

## STATE REHABILITATION TAX CREDITS

Indirect state financial assistance is available through state rehabilitation tax credits and the easement gift programme (Pencek, 1994). The heritage preservation certification tax credit programme provides Maryland income tax credits equal to 25% (from January 1<sup>st</sup> 1999) of the qualified capital expenditure costs in the rehabilitation of a *certified historic structure* (10% in 1997, 15% in 1998). The credit is available for owner-occupied residential property as well as income producing property. If the amount of the tax credit exceeds the annual tax liability of the taxpayer, the excess credit may be carried forward for up to 10 years. Unusually, if a rehabilitated structure is sold, the amount of unused credit may be transferred to the new purchaser. In order to qualify, the rehabilitation must:

Be certified by the Maryland Historical Trust

Be substantial, with expenditure over a 24 month period either exceeding \$5000 for owner-occupied residential property or greater than the adjusted basis of the structure or \$5000 for income producing property

Conform with the Secretary of the Interior's Standards for Rehabilitation

## PROPERTY TAX CREDITS

State enabling legislation provides Maryland's local governments with the option, but not the requirement, to establish rehabilitation property tax credit programmes within the locally designated historic districts. Local property tax credits are offered on a limited basis, as many local governments are reluctant to initiate the enabling legislation due to concerns about reducing local tax revenues. There are two options available. The first option provides a property tax credit allowing property owners located within historic districts to deduct 10% of their rehabilitation expenditures from their property taxes. An alternative incentive, introduced in January 1996, freezes property tax at pre-rehabilitation level for a period of 10 years. The tax credit is for 100% of the tax assessment

increase if the property is certified at the Commission for Historic and Architectural Preservation.

Historic preservation interests in Baltimore City fought vigorously to combat reluctance from the leadership to allow property tax credits and freezes on the basis that the programme only deferred revenue increases and initiated rehabilitation activity in the long term. By 1998, more than a hundred properties had been rehabilitated using these tax incentives. The Commission for Historical and Architectural Preservation (CHAP), a Baltimore City agency, have recorded that more than half of these projects would not have been undertaken had the property tax credits not been available (CHAP, 1996).

## COMBINING LOCAL, STATE AND FEDERAL PROGRAMMES

There is a very directed strategy of co-operation between local administrations and the state of Maryland where local, state and federal historic rehabilitation tax incentives and credits can be combined on the same project. For example, in the city of Cumberland citizens can combine the federal tax credit, the property tax credit and the state tax credit programmes. In the case of income producing property, a developer can freeze property tax at pre-rehabilitation levels in addition to benefiting from the 20% federal tax credit and the 25% state tax credit. In effect, in addition to the property tax relief, the developer claims back 45 cents for every \$1 spent. Homeowners can only get the 25% state credit, as they are not entitled to federal tax credit. The tax incentives provide a very effective way to lever private investment into privately owned properties.

### EXAMPLE: REHABILITATION OF THE SIGNATURE BUILDING, NORTON TIN CAN AND PLATE COMPANY, BALTIMORE, MARYLAND

The 'Signature Building' (1924), a portion of the Norton Tin Can and Plate Company, was



rehabilitated by the Can Company LLC in 1997 for office, retail and restaurant use. The building is certified in the National Register of Historic Places (Figure 10). The rehabilitation project involved soil decontamination, building stabilisation, restoration of steel sash windows, roof reconstruction and salvage of some roof stacks and ventilators. The rehabilitation project obtained funding from combined sources as follows:

**20% Federal Historic Rehabilitation Tax Credit**

25% income tax credit or mortgage credit certificate from the Maryland State Rehabilitation Programme. A minimum expenditure of \$5,000 was required. Credits could be carried forward for ten years and transferred upon sale of the building

10-year property rehabilitation tax credit for the project from the Baltimore City Restoration and Rehabilitation Tax Programme. Under the programme the property tax assessment level of designated historic properties remained at pre-rehabilitation level for ten years. The minimum expenditure required was 25% of the market value of the property. The static tax assessment level remains constant upon the sale of the building to a new owner (Byrtus and McClelland, 2000)



Figure 10: Signature Building, Norton Tin Can and Plate Company, Baltimore, Maryland

The rehabilitation project was carried out in accordance with the rehabilitation standards set out by the Secretary of Interior in order to qualify for the federal, state and municipal programmes. In order to raise equity for the rehabilitation project, tax credits received by the federal, state and municipal levels of government were marketed by the Can Company LLC to the Bank of America, Struever Bros., Eccles and Rouse Company and the Fannie May American Community Fund.

**Project Financing**

Total cost of rehabilitation	\$24,000,000
Rehabilitation costs eligible for federal and state credit	\$18,000,000
20% Federal Historic Rehabilitation Tax Credit	\$3,600,000
5% State income tax credit	\$4,500,000
Total ten year municipal property tax credit	\$2,100,000

(The property tax assessment prior to rehabilitation was \$972,500, but was increased to \$16,000,000 following rehabilitation) Source: (Byrtus and McClelland, 2000)

**HERITAGE ENTERPRISE ZONES**

The *Maryland Heritage Preservation and Tourism Areas Programme*, signed into law in 1996, is administered by another state agency: the Maryland Heritage Areas Authority (1997). The programme encourages partnership between state agencies and communities to optimise heritage tourism experiences. In order to benefit from the programme, communities apply to the authority to become a *recognised heritage area*, which is, in effect, a heritage enterprise zone. On acceptance, the area becomes eligible for a matching grant to prepare a management plan setting out strategies, projects, programmes, actions and partnerships that will be involved in



achieving its goals. Since the inception of the programme, two registered areas per annum are made *certified heritage areas*, following management plan approval (Means, Pencek and Stewart, 1996; Maryland Historical Trust, 1996a; Pencek, 1997).

Certified heritage areas are eligible for financial benefits including:

Matching grants of up to 50% and loans to local jurisdictions for planning, design, property acquisition, development, preservation, restoration and marketing projects

Loans for income generating economic development projects. These are financed by revenue bonds sold by the MHAA

State income tax credits for the rehabilitation of certified heritage structures and the authority to provide local property tax credits

#### ASSISTANCE FROM OTHER STATE AGENCIES

State agencies in Maryland are directed to consider any possible adverse impact of their decisions on historic resources. By example the Department of Transport aggressively seeks ways to meet transportation needs while preserving not only historic sites and buildings but their context as well. Under the Intermodal Surface Transportation Efficiency (ISTE) Act (1991) and its successor the Transportation Equity Act for the 21st century (TEA-21), authorised by Congress in 1997, at least 10% of federal transportation funds must be used by the state for transportation enhancements, which can include historic building rehabilitation, acquisition of easements and direct acquisition of significant lands around civil war battlefields (Rypkema, 2000). Maryland receives \$7 million in each of five years for relevant enhancement projects.

### Review

Despite forming a federal union individual states within the US retain their legal sovereignty. The local government system is created by a grant of power from the state to the local level. This has resulted in a complex system of administration and

financial support in relation to ‘historic preservation’, split between federal, state and local levels.

#### PROTECTION AND ADMINISTRATION

Federal designation of historic structures and districts under the National Historic Preservation Act 1966 as amended, does not provide regulatory controls to restrict the actions of the private property owners. Federal legislation allows for legal demolition and inappropriate alteration to *eligible* or *certified historic structures* based on their financial situation. Protection at the federal level is limited to the impact of actions by federal agencies on historic resources. In this respect, the federal *section 106 process* is purely a procedural protection as it only requires federal agencies to consider the effects of their actions on property certified in the National Register. The Advisory Council on Historic Preservation can only delay a project with federal involvement pending consideration of possible alternatives. It does not have the authority to require federal agencies to abandon projects that will affect historic structures. Thus the NHPA does not place any restrictions on private owners, states or local governments acting without federal involvement.

To combat this problem a number of states have mirrored the federal system by maintaining a state register and implementing a *state 106 process* modelled on the federal *section 106 process*. State 106 procedures vary greatly in form and intent from locality to locality. As with the *federal 106 process*, state agencies must consider the recommendations but not necessarily except them thus weakening the positive attributes of the process. However, state governments can in effect protect their historic resources by delegating their powers of regulation, acquisition and financing (including taxation) to local governments in counties, cities, towns and villages through enabling legislation. State enabling



Figure 11: Façadism in Philadelphia

laws provide power to local governments to enact local historic districts and preservation ordinances, usually regulated by preservation commissions. These are able to protect historic resources from demolition, neglect or inappropriate alterations to private property and have been validated by the American court system, most notably in the Supreme Court judicial ruling of *Penn Central Transportation Company v. City of New York* in 1978.

The level of autonomy of the various preservation commissions depends on the wording of the state enabling legislation. In most states, enabling legislation for heritage policies and funding programmes is only effective if it is implemented by local ordinance. For example, the property tax relief schemes in Virginia and Maryland can only be implemented by enactment of a county ordinance.

State powers can vary from time to time and from jurisdiction to jurisdiction depending on the elected leadership. In areas not protected by *registered historic district* status or under the jurisdiction of a local preservation commission, the problem of inappropriate alterations to historic structures is problematic throughout the USA. In the absence of regulatory controls, escalating development in periods of economic growth poses a threat to historic resources (Figure 11).

The positive side to the federal and state enabled legal provisions for historic preservation is that they provide opportunities for assistance from various federal, state and local subsidies and tax breaks. Apart from the important federal tax credits, many states and local governments have enacted laws that provide tax credits and incentives and grant aid to owners of historic structures. Furthermore, the requirement that the State Historic Preservation Offices award 10% of the annual Historic Preservation Fund monies to Certified Local Governments in their state has helped to establish partnerships between federal, state and local governments. Moreover, in recent years, resource cutbacks in federal programmes have increased the need for states to support and co-operate with local preservation initiatives.

Strong, well-organised, volunteer driven local action has been the key to successful preservation efforts in the US. The National Trust for Historic Preservation together with other national and state-wide organisations, such as the Maryland Historical Trust and the New York Landmarks Conservancy, provide invaluable preservation advice, public awareness and funding raising activities, revolving fund, preservation easement and financial aid programmes to the owners of heritage structures. Many successful community preservation programmes have developed through the lessons learned from early preservation struggles, as evidenced by the perseverance of Preservation North Carolina.

## THE FEDERAL TAX CREDIT SYSTEM

While progress in building up the list of properties in the National Register of Historic Places has been slow, with the register being estimated to be about 20% complete (at 1997), action in support of historic preservation in the US has been driven by the potential for viability and economic gain. Moreover, the federal historic rehabilitation tax credit programme has provided an incentive for private owners of historic structures to apply for their buildings to be included in the register. In this respect the system of tax credits to assist rehabilitation work has been significant. Based on the 1997 fiscal year report of the National Park Service, approximately 27,000 projects have been completed since the rehabilitation tax credits inception in 1976 and more than \$18 billion investment has been yielded by the programme (National Parks Service, 1998a). Each rehabilitation project approved has provided an average of 45 new jobs, principally to local residents (National Park Service web-site).

However, it should be noted that the level of historic rehabilitation activity taking place throughout the US has declined dramatically following the tax reforms of 1986, which reduced the rehabilitation tax credit from 25% to 20%. The tax reform also imposed 'passive activity' rules, which effectively reduced the use of historic rehabilitation tax credits as a tax shelter by syndicates of individual investors in historic real estate. This seriously damaged the confidence and momentum of the conservation industry particularly in the late 1980s to mid early 1990s. Prior to the Tax Reform Act of 1986 money was chasing buildings through syndication. While the market in historic rehabilitation has now built up again (but not to the pre 1986 level), the only investors now capable of taking full advantage of the tax credit are eligible corporations and companies that are publicly licensed but privately owned. Seeking to reverse this decline several members of Congress have proposed legislation

(unsuccessfully to date) to amend federal tax law by liberalising the 'passive activity' restrictions on rehabilitation tax credits. It is likely that any legislation restoring investors' ability to utilise these credits would result in a sharp increase in rehabilitation projects.

Notwithstanding the problems of the 'passive activity' restrictions, the provision of the historic rehabilitation tax credit programme has demonstrated federal government commitment to heritage preservation. The case studies relating to the rehabilitation of the New Amsterdam Theatre in New York, the Train Terminal Headhouse Building in Philadelphia, 10 Wood Street and 210 Academy Street in Trenton New Jersey provide evidence that the historic rehabilitation tax credits play a crucial role in attracting private capital to historic preservation. Rehabilitation projects can also make a major contribution to the revitalisation of neighbourhoods and communities as evidenced by the work of Pennrose Properties in the Philadelphia region.

The fact that the federal historic rehabilitation tax credit and the low income housing tax credit may be combined has greatly increased available capital for historic rehabilitation projects. This increased level of equity can be critical to the financial viability of historic rehabilitation projects. There may still be possibilities for additional equity to be generated through the formation of syndicates of investors willing to purchase the tax credits at a premium. The case study cash flows on St. James II Low-Income Housing Rehabilitation Project in Newark and the Brentwood Low-Income Housing Rehabilitation Project in Philadelphia provide evidence of the benefits to the developer of syndicating the combined federal historic rehabilitation and low-income tax credits.

There remain some limitations in the tax credit system. The theory behind the historic rehabilitation

tax credit is that the private marketplace is called upon which will in theory be more efficient than the government. Each potential rehabilitation project is thoroughly vetted in the market place and the market decides which buildings are rehabilitated. The National Park Service makes decisions about rehabilitation standards and design, while at the same time the forces of capitalism in the form of a private investor or developer assesses market place criteria to determine whether there is effective demand for the space being provided in the market place. As most of these projects have mortgaged loans on them, lending institutions also make a judgement about the economic viability of rehabilitation projects. The downside is that there are many casualties in the process and many buildings do not get rehabilitated regardless of their architectural merit. In effect, an important heritage building located in an economically depressed area will not be rehabilitated.

Furthermore, the federal tax credit is not available for historic owner-occupied residential structures, meaning that a considerable number of historic buildings in this sector cannot obtain any financial assistance - again revealing the weakness of relying on the market-led approach to preservation activity. Ongoing attempts to introduce the Historic Home Ownership Assistance Bill have proved unsuccessful to date despite tremendous advocacy support.

### **STATE AND LOCAL INCENTIVES**

One positive consequence of the 1986 reform has been an increased level of co-operation between local government and historic preservation groups (Rypkema, Spatz and Kavlin, 1990). This co-operation has translated into some new local financial incentives and into a greater involvement of preservation advocates in community planning.

At the state level, legislatures have adopted new historic preservation incentives (including the provision of tax credits for historic home owners by some states). These state and local incentives include state income tax credits for commercial and residential property (e.g. Maryland), state property tax credits (e.g. Washington State and Maryland), state sales tax rebate programmes (e.g. New York), revolving funds (e.g. North Carolina) and preservation bond programmes (e.g. New Jersey and Pennsylvania). The latter is also tax efficient as state or local governments which issue their own debt in the form of bonds are exempt from paying federal tax on the interest received – therefore making them competitive in terms of rates of return from company issued bonds.

The US property tax system assesses the value of underlying land as well as the value of the improvements on a piece of property. The inter-relationship between market demand, zoning, rehabilitation possibilities to the property tax assessment system provides many historic landmark owners with an incentive to demolish their buildings in order to avoid the higher tax burden associated with preserving landmark properties. On the other hand, the introduction of property tax exemptions, abatement and freezes at pre development property value for a period of years, has been a successful tool in making rehabilitation projects economically viable.

However, many local governments have been reluctant to initiate the enabling legislation due to concerns about reducing local tax revenues. As a result local property tax incentives have only been available on a limited geographic basis. This is despite the fact that several economic studies have indicated the potential of historic preservation in terms of job creation and increased property tax revenues (see below), which has led some more enlightened state and local governments to develop voter-approved bond programmes to provide

funding for heritage grant, revolving loan funds and other assistance programmes for historic preservation work.

Effective tax and funding strategies to date seem to stem from the strength of the partnerships that have been formed in some states between the various levels of government. There is no doubt that the ability to combine federal, state and local financial aid is extremely beneficial to heritage property owners and for districts (such as the heritage enterprise zones operated in Maryland). But the existence and quality of financial aid programmes for heritage rehabilitation projects, education and public awareness at state and local level varies greatly from locality to locality. Harmonisation of tax policy at the federal, state and local level would promote a more equitable heritage protection mechanism, but with the sovereignty of individual states remaining paramount this will not happen.

#### **EASEMENTS, ENDOWMENTS AND TDR**

Preservation easement programmes ensure a measure of protection for historic structures without burdening non-profit heritage organisations with the costs and responsibilities of full ownership. In some cases they can provide a stronger protection for historic buildings than a local landmarks ordinance. In some states the beneficiaries of state or local government financial aid for heritage rehabilitation projects must convey a perpetual historic preservation easement on a designated easement holding organisation, many of which have been set up by governmental bodies (e.g. Maryland Historical Trust) - another example of official responsibility for historic preservation. They can be used for different purposes: to protect and safeguard exterior and/or interior features of buildings and to discourage land assembly to prevent construction of incompatible new development. They can be used to manipulate action and protection: small rehabilitation grants may require the donation of an

easement for a limited time period. A property can remain in private hands and continue to provide property tax revenues.

The donation of easements has tax benefits such as the reduction of the value of an estate for estate, gift and capital gains tax purposes and a reduction in a property's tax assessment. For the developer, the donation of easements on older commercial buildings in active business districts may yield substantial tax benefits when the easement is donated prior to rehabilitation. In turn, an easement presents an attractive opportunity for a receiving organisation to obtain significant leverage in the rehabilitation that follows the donation of easements on buildings owned by developers. However, the donation of a preservation easement following a historic rehabilitation project will result in a claw-back of the federal tax credit (via Revenue Ruling 89-90).

Easements provide another useful tool to assist historic preservation in the US and provide considerable scope to ensure continued maintenance of historic properties via an easement endowment. But it is a limited opportunity, which developers recognise and the Inland Revenue Service do not encourage. Similarly the transfer of development rights presents an even more limited opportunity of preserving a building with the benefit of a preservation or maintenance plan: in urban areas its only relevant where the economy is booming and there are intense development pressures in tightly defined development areas, such as central business districts in downtown Manhattan (New York) and San Francisco.



**ECONOMICS OF HISTORIC PRESERVATION**

A number of research studies funded by non-profit organisations, such as the National Trust, Maryland Historical Trust and the New Jersey Historical Trust, have demonstrated the positive economic and fiscal benefits of construction activities generated by historic rehabilitation projects such as economic stimulation through job creation, stimulated purchases and increased tax revenues. The logic behind such studies is not primarily directed at providing proof – represented by numbers of jobs, money saved, revenue created – but to establish a basis upon which, if necessary, specific reasoning can be made to convince public officials, bankers, property owners and others that preservation/rehabilitation activity makes economic sense (Rypkema, 1994). Having said this, mathematical conclusions on the magnitude of the economic impact of such activity are important in convincing those potentially involved in creating these benefits.

Such studies are used as evidence in support of financial programmes for the historic resource. By example, the Maryland Historic Trust (MHT) study entitled ‘The economic and fiscal impacts of rehabilitation projects assisted with Maryland Historical Trust historic preservation grants and loans’ (Government Finance Group Incorporated and Legg Mason Realty Group Incorporated, 1996) demonstrated that MHT projects had stimulated the state economy by creating jobs, stimulating purchases and increasing tax revenues. Based on the effects of the rehabilitation spending on projects

alone, the report estimated that the state was able to recapture circa 61 cents for every \$1 spent over a one to two-year project life.

A further study ‘The economic and fiscal impacts of local historic districts - six case studies’ (Maryland Association of Historic District Commissions, 1998) considered six local historic districts including Annapolis, Berlin, Chestertown, Frederick, Laurel and Baltimore (Mount Vernon). The report demonstrated that the impact of historic districts on the state and local economies was significant, with particular reference to the following data:

The six historic districts had drawn over 3.4 million visitors per annum purely for heritage reasons. It was estimated that the heritage visitors spent over \$54.25 million per annum, created circa 800 jobs and paid over \$14 million in wages

Direct construction investment by the private sector in the six historic districts had exceeded \$24 million and created over 430 local jobs annually

Sustained public and private investment in the historic districts had paid dividends on the value of individual properties - over the long term (18-22 years) properties in the six historic districts had on average appreciated 28.9% faster than outside the historic districts but within the same jurisdiction

Properties in the six historic districts had paid \$16.25 million in local property taxes in 1997

Over \$40.3 million in wages and 1,600 jobs throughout Maryland had been supported annually by the efforts of construction and tourism spending alone in the six case study districts

Furthermore, Rypkema, in a recent study (2000a), has looked at the overall effects of historic rehabilitation in Maryland over a twenty-year period:

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**Economic Benefits of Historic Rehabilitation Activity in Maryland: 1978 – 1998**

Total private investment in rehabilitation projects	\$501,545,102
Number of historic buildings rehabilitated	1058
Number of construction jobs created	8,197
Number of jobs created elsewhere in the economy	7752
Total impact on the Maryland economy	\$1,023,753,826

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In the hope of building stronger public support for historic preservation the New Jersey Historic Trust commissioned a study from the Rutgers Centre for Urban Policy Research titled ‘Economic Impacts of Historic Preservation’ (Listokin and Lahr, 1997). The study incorporates an analysis of issues related to the economic impact of historic preservation, including rehabilitation of historic properties, heritage tourism and heritage property valuation. The study utilised the input-output model of analysis to document both the multiplier effects of preservation related activity, such as job creation, income generation enhanced urban environments and increased tax revenues.

According to the study, each year New Jersey preservation projects had invested circa half a billion dollars into the economy, including \$123 million in improving historic buildings, \$432 million in heritage tourism spending and \$25 million in spending by historic sites and organisations. In addition to creating more jobs, every \$1 million spent on non-residential historic rehabilitation had generated \$79,000 more in income, \$13,000 more in taxes and \$111,000 more in wealth than the same money spent on new construction.

Extending the study to a national level it was found that while rehabilitation work accounted for 20% of all construction work through the US, in New Jersey the added impetus in supporting this type of activity had raised the level to 40%. Moreover, historic rehabilitation was found to be a potent economic

pump-primer, state-wide and nationally, and greater in its effect to that of new construction (New Jersey Historic Trust, 1998):

Looking at the federal historic rehabilitation tax credit, Rypkema and Wiehagen (2000), in examining its application in Philadelphia, found that it had resulted in private sector investment of circa \$1.5 billion in the rehabilitation of 874 historic properties over two decades. Over the same period, circa 10,000 low and moderate-income housing units had been created. As historic preservation is labour-intensive industry, the increase in rehabilitation projects has resulted in increased employment and economic activity:

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**Historic Preservation Activity in Philadelphia 1978 to 1998**

Projects utilising federal historic rehabilitation tax credits	874
Investment	\$1,568,135,923
Direct jobs created	25,090
Indirect jobs created	30,735

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**For \$1 million spent**

	Jobs	Income	GDP	Taxes
Non Residential Historic Rehabilitation	38.3	\$1,302,000	\$1,711,000	\$202,000
Non Residential New Construction	36.1	\$1,223,000	\$1,600,000	\$189,000

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## Comparisons and conclusions

This paper does not purport to discuss the merits of conservation philosophy in the US. Its core basis has been to address two issues: a) the issue of financial support for historic rehabilitation and to examine the plethora of mechanisms available in the US, as well as b) the related issue of the economics of supporting the built heritage. In concluding this paper the aim is to reflect on these two issues by comparison to UK, Ireland and wider Europe in general terms.

### THE US, UK AND IRELAND

There is now a movement towards using US styled tax incentives in the UK, as announced in the Chancellor's Autumn Statement (17 November 2001). These include new community investment tax credits (to match every £100 million of private investment in deprived areas by £25 million of public money with the aim of encouraging economic renewal), the consideration of tax relief for donations to urban regeneration companies and the creation of business improvement districts. Although these ideas are yet to be worked out there is scope to consider the US approach to tax credits and incentives for work on historic buildings particularly in deprived areas (for example via heritage-based enterprise zones). The Heritage Economic Regeneration Scheme (HERS) (via English Heritage) and the Townscape Heritage Initiative (THI) (via the Heritage Lottery Fund) both address the need to deal with deprived areas in the UK, but are principally grant-based schemes. However, there has been some movement towards tax incentives for existing buildings including VAT relief and 100% capital allowances on the cost of residential conversion of redundant space over shops for letting. These have built on the concept of various LOTS schemes (living over the shop) adopted in previous conservation-led urban regeneration projects.

Furthermore, the link between the historic rehabilitation tax credit and affordable housing tax credit merits consideration as the issues of neighbourhood renewal and social housing provision are being developed. The US Department of the Interior has stressed the community benefits that result from rehabilitating historic structures for affordable housing uses in terms of culture and identity... *'the sense of where we are, as a people, and as a community have come from, our ties with our past and products of work that those before us have accomplished'*. Apart from this the provisions have often worked as catalyst for revitalization of adjacent properties and therefore neighbourhood renewal (Escherich, Farneth and Judd, 1997). The UK Green Paper proposals to reform the planning system has reflected on ways to deliver affordable housing, but there is opposition to the consideration of further obligations on developers. Specific and directed tax credits may be a way to draw developers and investors into this market, as has been the case in the US, particularly if it addresses the goal of regenerating the historic environment of deprived areas as HERS and THI aim to do.

There is an argument for providing specific tax incentives for the conservation and rehabilitation of the built heritage in addition to more general renewal tax provisions. Moreover, there is the danger that without such specific attention to the existing historic resource that there will be renewal at the expense of the built heritage. By example, the tax incentives provided in designated urban renewal areas in Ireland had some disastrous effects for historic buildings. In the 1990s the Temple Bar Designated Area in Dublin provided 50% capital allowances for new buildings, which encouraged the demolition of historic buildings, and façadism-retention schemes arose from the provision of 100% capital allowances for 'refurbishment' (Pickard, 1998). Legislation on the protection of historic structures has been strengthened in Ireland since 1999 with the provision of a system of 'protected

structures' (similar to listed buildings in the UK). However, there is still the danger in both countries that many historic buildings will be compromised in the interests of wider renewal policies.

On the other hand, the UK system of protecting buildings is often regarded as being too restrictive and too wide scale. With nearly 500,000 listed buildings the UK by far exceeds any other European country in terms of individually protected historic built assets (by comparison France has approximately 40,000 'historic monuments'). Although there is greater flexibility to make changes to the 94% of buildings that are listed as being grade II, there is little in the way of positive direction on reuse – only conservation principles and guidelines. The US *Standards for Rehabilitation and Guidelines for Rehabilitating Historic* could be argued to be a more positive approach to the encouragement of long-term preservation of historic buildings linked by positive incentives and policies (e.g. linking the issue of rehabilitation with affordable housing and community revitalization).

#### OTHER EUROPEAN COUNTRIES

Many European Union member states countries such as Belgium, Denmark, France, Germany and the Netherlands have a policy similar to the US of combining grant aid, tax incentives and other provisions to support historic structures (principally income/corporation tax relief) (Pickard, 2002; Pickard and Pickerill, 2002).

In each of the administrative regions of Belgium specific orders define levels of grant aid available for protected buildings of the architectural heritage and can cover both maintenance and restoration works (and in the Walloon Region for the conversion to a new economic use). The level of grant aid varies between the three regions (Brussels-Capital up to 40%, Flemish Region 40 – 90% and Walloon Region 60% to 95% depending on the type of property and the type of works). By example, a

25% subsidy can be obtained for preliminary studies and subsequent maintenance or restoration works can benefit from a 40% grant in the Brussels-Capital Region. Furthermore, for the remaining 60% (the owners share of the cost of works) an owner-occupier (leased property does not qualify) is able to set these costs against income tax subject to a ceiling of 25,000 Euros at one time (available in all three regions). If the works are phased the relief can be spread over a number of years. Income tax relief can also be given to taxpayers that participate in heritage projects with the sponsorship costs being considered as advertising costs and fiscally deductible as business expenses. Owners of listed property in the Brussels Capital Region, which is not leased or otherwise commercially exploited, are also able to benefit from an exemption on the annual tax levied on all real estate property in Belgium (Goblet *et al*, 2001).

In Denmark every owner of a listed building has an equal right to benefit from the grant system although grant-aided work is limited to preservation works (not improvement or rehabilitation works) as agreed in an approved scheme of works. The level of grant aid is normally in the range of 20% to 50%, for large or complex projects grant assistance up to 60% can be given and, exceptionally, the total cost of works can be covered. For approved schemes of works it is also possible to apply to a number of foundations for financial assistance usually to top up a state provided grant. Large organisations such as the Velux Window Company can benefit from tax relief by setting aside some of their income in a charitable foundation to support good causes such as the heritage. Owners of listed buildings are also exempt from paying property or land taxes if a preservation declaration has been registered on a property (Lunn and Lund, 2001).

A further tax relief provision is given for listed houses (buildings originally built as houses but including those now converted to another use)

through a special tax relief system negotiated by the *Byggnings Frednings Foreningen* (an association of owners of historic houses). Owners of listed houses have been given an annual tax allowance, the ‘annual decay scheme’, a sum calculated on the basis of notional repairs that would have to be carried out relating to each part of a building according to a specific formula. This annual amount is determined for each property and provides a sum against which receipted bills on maintenance work can be deducted. When the full allowance is not used in any year it is possible to transfer the remainder to the next fiscal year, therefore allowing the possibility to save an amount for when more substantial work may need to be carried out (BYFO, 1996).

In France, all of the 40,000 historic monuments are eligible to receive both grant aid and tax relief. Grant aid, limited to approved conservation works, is provided for any ‘classified monuments’ (between 30 – 50%) and also for properties included on the ‘supplementary inventory of historic monuments’ (usually in the range of 15 – 20% and exceptionally up to 40% (Longuet and Vincent, 2001). Owners of historic monuments are also entitled to claim a special tax credit of 20% each year for five years for amounts paid as a contribution to the non-subsidised element of the cost of works. In addition, a 14% deduction from any income derived from opening a building to the public can be claimed (Beauvais, 1999). Tax policy also benefits private enterprises that wish to support work on protected buildings by allowing firms to deduct any unconditional paid sponsorship from their taxable profit. Municipal authorities and state agencies can also provide assistance for other historic properties in protected or other older areas including for rehabilitation work.

The sixteen federal states (*länder*) in Germany all have different but similar laws on heritage protection and associated issues. Funding for cultural monuments has been provided from a

variety of sources: special or other programmes (federal and *land* or combined), which have centred mainly on the eastern *länder* since reunification, as well as tax relief measures. By example, each *land* has a budget for grant assistance towards conservative repair works. At the federal level a limited number of buildings of special national value have benefited from a higher level of funding and other special programmes include “*dach und fach*”, which has provided emergency assistance in the eastern *länder* mainly concerning external fabric matters (roofs, facades, timber framing etc). A further special programme for the east, *städtbaulicher Denkmalschutz*, similar to *sanierung* programmes operated in the west before reunification, has concentrated on global issues in historic towns (urban renewal retaining as much of the old as possible) (Kirschbaum, 1999).

Under federal law tax relief is given for the rehabilitation of unoccupied cultural monuments to encourage rehabilitation rather than new building. The relief applies to the combined works of preservation and improvement for an existing use or to enable a new use such as the conversion of a listed house into flats or to convert a factory to an entirely new use. All material and labour costs for conservation and modernisation can be set against income tax at rate of 10% for a period of ten years for an approved scheme of works (Brüggemann and Schwarzkopf, 2001). In certain circumstances the purchase costs of buying a cultural monument for use (to achieve a taxable income) can also be deducted at a lower rate (Bruis and Schleusser, 1998).

Both public and private foundations (such as the Messerschmidt Foundation) also play a significant role in providing finance in Germany. The *Deutsche Stiftung Denkmalshutz* (DSD) national foundation for architectural heritage protection was established in 1985 as a private trust with a starting capital of 500,000 DM donated by 23 companies to support the preservation and restoration of important



cultural monuments. The foundation has a large capital fund and raises some of its funds from private individuals who benefit from a provision allowing 10% tax relief on donations to cultural institutions. It supports requests for assistance from monument owners and provides assistance where there are social problems and a need for community support including a number of smaller specific building foundations (such as for churches or castles). The aim being to encourage regular and long-term maintenance and to avoid the need for major restoration works (Pickard and Pickerill, 2002). Some foundations support limited holding companies (*GmbH*) to work on a non-profit basis on buildings in need of action and new uses (Flitner, 1997).

In The Netherlands grant awards of between 20 – 70% can be provided for restoration/repair work and also for maintenance work (with increasing attention being focussed on the latter) (Richel-Bottina, 2001). The level of grant aid depends on the type of building and whether the owner is liable to taxation as non-taxpayers are usually offered a higher level of grant aid. The normal level of grant is 20% for taxpayers and 50% for non-taxpayers. Total funding can be gained through tax relief and/or grant assistance plus a subsidised loan. The *Nationaal Restauratiefonds* (National Restoration Fund) has a special role in co-ordinating finance on behalf of the state authorities. It organises the most appropriate form of funding according to the circumstances including the opportunity of a low-interest loan to top up any grant aid (or an element covered by tax relief). Funding will often be achieved through 20% grant aid, 30% tax relief and the remaining 50% through a loan usually at 5% less than normal bank rates (and recently as low as at 1%) over a period of thirty years (van der Baar, 1998).

Limited holding companies also work on a non-profit basis in The Netherlands and there are about

40 organisations operating in this way. By example, Stadtherstel Amstel was set up in 1956, working mainly in Amsterdam and its vicinity with the aim of restoring and rehabilitating historic buildings under threat (Eggenkamp and Luigies, 1997). Shareholders, including banks and pension funds, are paid a low return of about 5% but their incentive to invest is that their return is not taxable so long as the upgraded value of a building does not exceed the cost of works (Pickard and Pickerill, 2000a).

Some European countries have also developed specific rehabilitation policies and agencies in historic areas (Pickard, 2002a; Pickard and Pickerill, 2002a). Two examples are identified in relation to France and Denmark:

In France the emphasis is on protecting a limited number of exceptional ‘historic monuments’ but there is also support for other historic buildings in other ways. Moreover, there is now a greater move towards rehabilitation in older areas rather than supporting expensive restoration work to buildings located in the ninety-two *secteurs sauvegardés* (conservations areas), which has often resulted in gentrification. Since 1983 urban, architectural (and since 1993 landscape) zones (ZPPAUPs) have been utilised as a mechanism for urban rehabilitation. Under recent measures introduced in 1999 and 2000 new financial support tools (grant aid and tax incentives) were introduced in these zones. This includes the designation of a ‘perimeter for real estate restoration’, a planning procedure which aims to encourage the complete rehabilitation of buildings. It is a tool for urban regeneration, which can be part of a larger strategy of revitalising whole neighbourhoods, by means of its legally binding mechanisms. The initiative for such programmes often comes from local authorities, from a public development body or from a semi-public development corporation specially entrusted with the operation by contract. It might also come from a social housing organisation, or from a group of

owners who possess a complete building and who are associated in an urban real estate company. Rehabilitation work carried out by owners who undertake to lease buildings as dwellings for a minimum period of six years can then take advantage of special tax deductions. These deductions can be included in property taxes and can be taken into account in the interested party's overall revenues (Férel, 2001).

Furthermore, the rehabilitation of old parts of towns is further supported through *Opérations programmées pour l'amélioration de l'habitat* (OPAH) (Planned Housing Improvement Operations). Since 1977, over 3,000 OPAHS have been implemented, resulting in the rehabilitation of over 600,000 dwellings (mostly in old quarters and historic centres). The main body for grant provision is the *Agence nationale pour l'amélioration de l'habitat* (ANAH) (National Housing Improvement Agency) whose role is to subsidise work (improvement, rehabilitation and the restoration of architectural details) undertaken by private landlords. In a ZPPAUP these operations can be used as a coherent and operational part of a programme for repairing and upgrading housing and the normal upper limit on grants for architectural restoration work can be removed (Longuet and Vincent, 2001). Similarly, the State can give grants to owners of social housing to help them accommodate the extra expenses incurred by respecting the architectural qualities of buildings in improvement or rehabilitation work.

Since 1997 'buildings worthy of preservation' (as distinct from 'listed buildings') have been given a form of protection and assistance in Denmark. Instead of using specific area-based protection mechanisms, the policy for such buildings is managed via urban local plan and specific local preservation plan policies, and urban renewal schemes, and through the 'survey of architectural values in the environment' (SAVE) (National Forest

and Nature Agency, 1995). If a municipality has carried out a survey under the SAVE system (or has developed its own system), special urban renewal funding becomes available for the most significant 'buildings worthy of preservation'. Furthermore, as part of a policy of resolving social problems in areas, special schemes to support housing rehabilitation (with a higher grant being given for 'buildings worthy of preservation') have been established in times of high unemployment.

There are two main differences in public support measures in Western Europe. First, while the UK protects (by listing) a very large number of historic buildings, other countries formally protect a lower percentage of their historic buildings but use other mechanisms and financial assistance for rehabilitation including the restoration of architectural details. This latter approach is less restrictive and is arguably more likely to attract investors into the market for 'historic rehabilitation', as is the case in the US. Secondly, in the UK, and now in Ireland, there is an emphasis mainly on grant aid whilst other European countries allow tax relief as well (on the portion of non-subsidised costs). However, one argument against tax relief measures is that they only benefit taxpayers and higher rate taxpayers in particular. Yet this can be resolved, for example, by the different levels of grant aid applied in The Netherlands allowing non-taxpayers to receive a higher level of grant assistance.

Furthermore, the tax credit system in the US is arguably more generous than tax relief as it lowers the amount of tax owed (so that \$1 of tax credit reduces the amount of tax owed by \$1, whereas an income tax deduction lowers the amount of income subject to taxation). The adoption of a tax credit assistance system may be a better way to persuade greater numbers of developers and investors to consider the potential of rehabilitation. Tax incentives for corporations or syndicated groups of investors would help to create a market for

sustainable reuse of existing built resources and remove the risk that is often associated with this type of activity. The provision of standards for rehabilitation would help to provide greater clarity and flexibility for the officials that have to deal with applications to alter listed buildings and would help those that may wish to invest in such activity.

### THE ECONOMICS OF CONSERVATION

The justification for this type of approach may lie in empirical studies to assess the economic and social impact of public investment in the built heritage. However, on this second issue there has been little in the way of major studies carried out in Europe (Pickard, 2002b).

In the UK the 1995 study 'The Value of Conservation' (Allison *et al*, 1995) concentrated on the possible use of economic pricing systems and a review of literature. Nevertheless the study was important in that it recognised that the conservation of buildings and areas could have dynamic effects in terms of improvement or maintenance of buildings, but that market forces could not be relied upon to produce results that are socially and economically desirable in the long term. The study advocated a review of case studies. This has subsequently been undertaken in relation to the £36 million invested by English Heritage in 357 Conservation Area Partnership Schemes (CAPS) that were established between 1994 and 1999. A sample of 31 CAPS was chosen (nearly 10% of the total number of schemes). The resultant study demonstrated that £10,000 invested by English Heritage levered £48,000 funding from the private sector and other public sources and together this delivered on average 177 square meters of improved commercial floor space plus one new job, one safeguarded job and improved home (English Heritage *et al*, 2002). Apart from the CAPS study, the Heritage Lottery Fund is supporting a similar study in relation to its THI programme, the interim results should be published in 2002.

A more extensive study was carried out in Germany in relation to the federal *städtbaulicher Denkmalschutz* funding program (monument preservation in the context of town planning) between 1991 and 1997, operated in the new states in the eastern part of the now reunified country (Behr, 2000). A total of DM 3.27 billion in public funding was made available through the program and by 1997 approximately 4750 buildings had been conserved and/or rehabilitated in 123 historic towns, 7000 residential, commercial, public and church buildings had been renovated, and 835 roads and open spaces had been repaired/restored. Overall the ratio of public funding to private investment was 1:9 (in some towns 1:12). The study confirmed the labour-intensive nature of conservation/rehabilitation work compared to new construction (creating twice as many jobs) as well promotion of small and medium-sized enterprises (job creation potential and economic development) and other benefits (e.g. creation of pleasant environment for living and to attract business and industry). All these aspects have helped to strengthen the attractiveness of urban centres.

The US evidence is more comprehensive and extensive (this paper has not attempted to review the wide number of published studies that are available on this issue). It is clear that economic studies play an important role in justifying the variety of programmes that have been offered at federal, state and local levels. The evidence of a constant need for justification in a society where operations tend to be more market-led than elsewhere in the developed world provides powerful support for the notion of public financial incentives. This need for justification is as much the essential factor in the formula as is the regulatory aspect of 'historic preservation'. There is, therefore, a strong argument in following this approach by undertaking in depth studies on 'conservation economics'.

## Summary of main funding provisions for historic preservation in the United States

### NATIONAL LEVEL – FUNDING INITIATIVES MAY INCLUDE THE PROVISION OF:

Direct grant aid and subsidised loans for historic rehabilitation projects;

Federal easement donation allowances against federal income, estate (inheritance) and gift taxes;

Rehabilitation tax credit (for incoming producing property at 20% for certified historic structures and 10% otherwise);

Affordable housing tax credit (70% or 9% p.a. for 10 years for rehabilitation expenditure that has not been federally subsidised or at the reduced rate 30% or 4% p.a. when expenditure has been subsidised, with a higher credit level available in qualified census tract difficult development areas);

Mortgage assurance to financial institutions to lend money to conservation projects (e.g. neighbourhood lending agreement to ensure reinvestment in historic districts in Pittsburg);

Rental assistance to tenants to enable them to pay the landlord the difference between the fair market rent and the amount affordable to the tenant. This provides the developer with a greater ability to service debt than in a rent restricted project;

Financial assistance for State Historic Preservation Office administration and heritage programmes (e.g. via the Historic Preservation Fund);

National Trust for Historic Preservation (assistance to non-profit and community organisations and various programmes e.g. National Preservation Loan Fund and Main Street Programme for revitalization of historic downtown areas).

### STATE AND LOCAL LEVELS – FUNDING INITIATIVES MAY INCLUDE THE PROVISION OF:

Direct grant aid for rehabilitation projects (e.g. New Jersey competitive grants programme);

State income tax credits for historic rehabilitation and low income housing projects (including income and non-income producing properties in some states);

State income and property tax deductions for easement donations;

Property tax exemptions, abatements and assessment freezes for certified historic structures (e.g. maintenance of property assessments at pre-rehabilitation value for 10 years in the state of Washington);

Transfer development rights (with funding agreements to support retained historic structures – but limited to locations experiencing intense development pressures in tightly defined areas such as New York City and San Francisco);

Historic preservation revolving funds programmes (e.g. tax relief for private foundations such as Preservation North Carolina that undertake the charitable activity of rehabilitating historic structures);

State historic bond programmes (e.g. revenue raising funding programmes approved in Maryland, New Jersey, New York and Philadelphia);

State sales tax exemptions for historic buildings and other business, franchise and community tax incentives;

Enterprise zone/ heritage area initiatives (e.g. in California, Florida and Maryland).

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