

Historic Preservation Tax Credits

The 20,000 Foot View

(Revised March 31, 2015)

(Note: There are several types of federal and state historic preservation tax credits. They are generally referred to as the “20%” and “10%” credits. This discussion only focuses on the 20% credit, which is the most common of the credits, and the one that all four of the Garver Feed Mill redevelopment proposals contemplate using as part of their respective sources of capital to fund the building renovation.)

Why is a discussion of the historic preservation tax credits relevant to restoration and redevelopment of the Garver Feed Mill? The City of Madison received four redevelopment proposals for the Garver Feed mill. All four development proposals assumed use of both the federal and Wisconsin historic preservation tax credits. These tax credits are estimated at a combined amount of just over \$5 million, and will support between 35% - 38% of the cost to redevelop the Garver building. Half of this value is the federal tax credit and half is the state tax credit. Without the availability of these tax credits, redevelopment of the Garver building is unlikely to be financially feasible.

Under typical redevelopment scenarios, if an initially selected proposal is determined at a later date to not be feasible, alternative plans can be solicited from developers. Such is the case with the current Judge Doyle Square development concept. However, a provision in the recently introduced 2015-2017 Wisconsin Biennial Budget would severely limit the state preservation tax credit. This could potentially make it unavailable to the Garver redevelopment.

To be able to access the state preservation under current law, the final development proposal selected by the City needs approval of the National Park Service by early December, 2015. Based on the following discussion of how the tax credits work, the City may not have the option to change development proposals after mid year 2015. Absent a change to the budget provisions limiting the state tax credit, this could be the last good chance the Garver Feed Mill redevelopment has for success using third party financing. Therefore, the development proposal selected has to be the best bet on financial feasibility and operational success. It is unlikely that alternate proposals can be assembled in sufficient time to meet the year end deadline.

What are historic tax credits? The federal government, and all but six state governments, provide assistance in the form of an income tax credit to owners of buildings who restore the structures to specific criteria. The federal criteria, for the most part, dictate the eligibility for the federal credit. Virtually all of the companion state tax credits follow the federal criteria. The criteria are referred to as “The Secretary’s Standards”. The “secretary” is the Secretary of the U.S. Department of the Interior.

Who administers the tax credits? The federal credit is administered by the National Park Service (“NPS”), which is part of the U.S. Department of the Interior. Each state has a State Historic Preservation Office, or SHPO. This SHPO is typically designated by each state governor. In Wisconsin, the SHPO is an employee of the State Historical Society.

Once the respective SHPO, the SHPO Office, and the NPS review and approve the restoration of an eligible building, if the building is listed, the federal tax credit is available to the taxpayer, and can be claimed on their federal income tax return, when the redevelopment of the subject property is completed as prescribed by the SHPO and NPS. Any individual, corporation, or other entity that pays federal income taxes is eligible for the federal tax credit. Similarly, the state tax credit is claimed by an entity having taxable income in that respective state. Generally, the federal and state entities claiming the respective tax credits do not need to be the same.

Administration of the state tax credits differs by state. However, if the building is deemed eligible for the federal preservation tax credit, generally it is also deemed eligible for the respective state tax credit. Typically, the reverse is also true; not eligible for the 20% federal credit means no state credit. In Wisconsin, the Wisconsin Economic Development Corporation (“WEDC”) issues a certificate indicating eligibility for the state credit. WEDC does this when the SHPO and NPS approve the restoration (see Part 2 of the NPS approvals described below).

What structures are eligible for the preservation tax credits? For the 20% tax credit, the building must meet the Certified Historic Structure definition, the rehabilitation must be substantial, and the building must be depreciable. The structure must also still retain sufficient exterior quality, or significant history and integrity, so that when it is restored, the building substantially resembles its original construction. The interior of the building can however change use. What was a manufacturing building originally could be renovated to office space, housing, public market, etc. But the exterior, including primary window and door openings, would generally appear the same as it did during the period of significance.

How do you obtain an allocation of the preservation tax credits? The federal credit is a three part process. These are referred to nationally as the Part 1, Part 2 and Part 3 applications.

The Part 1 application is submitted to the SHPO Office by the building owner or developer. Once approved by the SHPO Office, the Part 1 is sent to the NPS for final review and approval. The Part 1 determines that the structure is both eligible to be restored, and will have sufficient significance when restored. As an example, a building could have been the first railroad depot built in Wisconsin, in lets say 1886. It is clearly old enough and significant enough. But, based on its current condition, not enough of the building exterior remains intact, so any restoration would be primarily a “rebuild”, not a “restoration”. Thus, it would fail the Part 1 test.

For the Garver Feed Mill, no Part 1 has been submitted to the SHPO. While the building is significantly deteriorated, it is generally believed that at present it would meet the significance test of the Part 1. But until the ink dries on the approved Part 1, the 20% federal and state preservation tax credits are not guaranteed. If left in its current condition the building will continue to deteriorate. Should this be the case, at some point the deterioration results in the building being classified a “ruin”. In other words, no longer able to be restored. Once declared a ruin by the NPS, the 20% credits cannot be used.

After approval of Part 1, a Part 2 application is prepared. This is by far the most extensive and expensive part of the application process. A complete set of construction drawings dealing with the preservation and full redevelopment aspects will need to be prepared, generally to at least 75 % completeness. The Standards do not recognize the “design build” or “design on the fly” process, now a popular method of general construction. Preparation of the construction drawings could easily take at least 3 to 4 months months, and cost at least a hundred thousand dollars to prepare. In addition to the architectural drawings, third party reports on structural integrity, environmental issues, and building shell restoration will be needed, adding additional time and cost.

The SHPO and NPS, under current regulations, each get a minimum of 30 days for their approval process, once they have a complete set of drawings. Depending on questions, and any changes required to the plans, this review period could extend past the 30 day timeframe.

Approval of the Part 2 is a significant step along the way for the federal credit. For the state credit, once the Part 2 is approved by the SHPO, WEDC will need some time to prepare the certificate for the state credit. It would be wise to allow at least several weeks for this WEDC review and approval process to be completed.

Once the Part 2 is approved, then building renovation can begin. When the property is completely renovated, the owner submits a Part 3 application with the required “as renovated” photographs. Although not required, the owner can request that the SHPO Office or Architects inspect the work before the Part 3 application is submitted. Once the NPS Part 3 approval is obtained, the tax credits can be claimed on the current year tax return of the owner – investor(s), or for a multiple year renovation the credit can be claimed as the renovation progresses, assuming the building is listed.

How are the tax credits calculated? The federal tax credit is calculated at 20% of the eligible expenditures associated with the building restoration. This includes the building shell, windows, roof, all interior plumbing, HVAC, electrical, fire protection systems, etc. Also included is the interior remodeling cost (e.g., the cost to redevelop an old factory building into residential apartments). Exterior costs such as parking lots, landscaping, and any moveable equipment such as appliances, are not eligible for the tax credit.

Under current Wisconsin statutory provisions, there is no “competitive” requirement for the preservation tax credit. Additionally, there is no ceiling on either the federal or state credit amounts. Rather, the limitation on access to the tax credit is a function of historically eligible structures, of which there is a finite number. Thus, access to the preservation tax credit is self limiting.

However, a provision in the current Governor’s Biennial Budget would severely reduce the amount of credit available (cap it at \$10 million per year), would require statewide competition, and would also tie the allocation of the credit to a requirement to create jobs. However, City staff have been told that if WEDC issues a state tax credit certificate before 12/31/2015, the current state tax credits will be available for the Garver Feed Mill redevelopment (e.g., no competition and no limitation on amount).

Memo: restoration of the Garver Feed Mill is estimated to generate approximately \$6 million of federal and state historic preservation tax credits yielding roughly \$5 million of cash to be used in the redevelopment. Without the combined state and federal tax credits, redevelopment of the Garver Feed Mill is unlikely to happen.

Given the federal application process, and the potential implications of the State budget, where are the “speed bumps” that could cause issues with state preservation tax credits?

The federal and state tax credits are each worth about \$2.5 million. The federal credits are not impacted by state budget issues. Thus, one can assume the federal credits would be available if a Part 2 approval is obtained, and if the continued building deterioration does not transition the structure to “ruin” status.

The issues of primary concern relate to the state tax credit, also worth roughly \$2.5 million. If the state budget is enacted as proposed by the Governor, it is highly unlikely that the state credit would be available for the Garver redevelopment, IF the NPS Part 2 approval is not obtained by early December, 2015. If the NPS Part 2 approval is obtained by late 2015, then it is likely the state tax credit would be available.

The approved Part 2 is specific to the redevelopment plans. Each of the four redevelopment proposals for the Garver building will have a different Part 2 application. Therefore, if the development proposal initially selected is deemed unfeasible too late into 2015, an alternate proposal could not obtain the NPS and SHPO approved Part 2 by the end of 2015. Thus, the state credit would not be available. In other words, developer A cannot simply transfer their approved Part 2 to Developer B, since the development proposals differ, and the NPS Part 2 approval is based on detailed architectural plans specific to an individual proposal.

What does the timeline for historic tax credit approval look like at this point in time (assuming the language in the state budget remains unchanged)?

In order to obtain state preservation tax credits under current law, the following reverse time line can reasonably be assumed to be operational. While the developer can control many of the aspects of this timeline, they cannot make the SHPO and NPS do their work faster. Each get, and generally take, at least to 30 days as provided by current regulation.

- December 31, 2015 WEDC approves reservation of state preservation tax credits based on the approved NPS Part 2. This approval is governed by the current State budget process.

- November 30, 2015 NPS approves the Part 2 for the specific redevelopment proposal For the federal credit and the SHPO approves the Part 2 for the state credit

- October 30, 2015 Wisconsin SHPO and WEDC send their final recommendations for the Part 2 redevelopment plan to the NPS.

- September 30, 2015 Developer submits their final redevelopment plans and specifications to the Wisconsin SHPO for review and approval.

- June , 2015 Developer commissions preparation of Part 2 construction drawings, mechanical, electrical, plumbing plans, and interior specifications, along with NPS Part 2 documentation, final structural reports, environmental reports and land use approvals.

What implications on Garver Feed Mill Redevelopment can be drawn from the above timeline? The Garver selection committee recommended both a first and second redevelopment alternative. It is assumed that the first alternative development plan is proceeding. It is also assumed that City planning, zoning, building plan approval, and Parks Commission land acquisition is also proceeding, based on the first alternative development plan. At some point past June, 2015, if a decision to switch development alternatives is made, it will likely be too late for any of the other three redevelopment alternatives to be able to get an approved Part 2 by the end of 2015. Thus, redevelopment feasibility will most likely be impacted by loss of the state preservation tax credit.