



Talking Heads

Merrill Hoopengardner

President, National Trust Community Investment Corporation

The battle to save historic credits *By Darryl Hicks*

Preservationists were jubilant when they learned that the Federal Historic Tax Credit (HTC) would be saved from the chopping block in the final version of the tax reform bill negotiated by Congress and signed into law by President Trump in December.

But that victory came at a cost.

The 20 percent HTC was turned into a five-year credit. Following the implementation of a transition rule on all new projects, investors must claim the tax credit over five years instead of all at once when the property is placed in service. The lesser used ten percent tax credit used by commercial developers to rehabilitate non-historic buildings placed in service before 1936 was repealed.

As the dust settles and tax professionals figure out what the legislative language means for developers and investors, one person who's keeping a watchful eye on the marketplace is Merrill Hoopengardner, president of the National Trust Community Investment Corporation (NTCIC), a subsidiary of the National Trust for Historic Preservation that ranks among the nation's largest syndicators of HTCs. Hoopengardner is also the chair of the Historic Tax Credit Coalition.

In January 2016, Hoopengardner succeeded NTCIC's founder and first president John Leith-Tetrault after spending 19 years working in community development finance in a variety of roles, most recently as a principal with Advantage Capital Partners and before that as an attorney with Nixon Peabody.

Tax Credit Advisor sat down with Hoopengardner to discuss some of the behind-the-scenes activities that went into saving the HTC and what the future looks like for that business.

Tax Credit Advisor: *Walk us through the days leading up to passage of the tax bill. When did you know the 20 percent credit was saved? What was your initial reaction when you learned about the changes that were made? Can you share some reactions from colleagues?*

Merrill Hoopengardner: We didn't know it was going to be saved until the very end. The process moved very



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quickly. The House Ways and Means Committee released its bill, which repealed both the ten and 20 percent credits, on November 2 and the full House passed it with very few modifications on November 9. That same day, the Senate Finance Committee released the Senate's first proposal

for tax reform, which retained the HTC but only at a ten percent level. We worked closely with our colleagues in the preservation and tax credit industries and Senate supporters during the final weeks to try and improve upon the initial Senate bill language. We know that Senator Bill Cassidy (R-LA) introduced an amendment to the tax bill (which was the last one incorporated by the Committee), which raised the credit percentage back to 20 percent. So we had advocates in Congress working through to the very end of the process, playing offense where they could, and then defense so that once the Senate bill had a significantly more favorable treatment of the HTC no other changes could be made to undercut that provision as the House and Senate bills were being reconciled. Changes were being made even to the last iteration of the tax bill being negotiated on the Senate floor. We knew changes could still be made in the Conference Committee, but until a final agreement was reached between House and Senate negotiators and published, we didn't know whether the Historic Tax Credit would be saved.

TCA: *So we have Senator Cassidy to thank for saving the Historic Tax Credit, but why did he change the structure of the credit?*

Hoopengardner: We have many members of Congress

Talking Heads, continued on page 12

Talking Heads, continued from page 10

who were involved in many different capacities to thank for saving the credit and yes, we are grateful that Senator Cassidy advocated on the credit's behalf and played a visible role in advocating for its retention. As to why the structure of the credit was changed, trade-offs were being made in the tax bill on many different provisions. It became clear that changes to the HTC would be necessary to provide some scoring relief. A five-year credit scores less than a single-year credit. This was a trade-off. We could keep the credit but it would come with some modifications.

(Editor's Note: Scoring is the colloquial term for the cost estimates produced for tax bills by the non-partisan Joint Committee on Taxation (JCT) in Washington. This process makes a determination as to how much every tax will raise and how much revenue will be foregone by tax credits, deductions and other tax preferences. A "score" is calculated over Congress's traditional ten-year budget window. Every tax bill that becomes law comes with a score from the JCT for each provision and then a total.)

TCA: And that was something you could live with?

Hoopengardner: We always want the best possible outcome. Our long-term strategy was—and is—to ensure a permanent HTC. It's the foundation for much of the historic redevelopment that gets done across the country in big cities and small towns alike. It's the federal government's most significant investment in historic preservation. We wanted to ensure that would continue for future generations, until tax reform comes again. Is it a perfect solution? No, we would have preferred to keep the HTC as it was. Is it a livable solution? Absolutely. There will be changes to the business that are being worked through now, but it's still a viable credit and we are grateful to the members of Congress who advocated to keep it permanent.

TCA: How will the tax bill impact projects that are already under development?

Hoopengardner: You will see a mix of outcomes. The tax bill includes transition language for the non-historic ten percent credit and for the 20 percent credit that effectively "grandfathers" many projects already under development. The tax community is still working through the details on how best to implement these provisions. There hasn't been any guidance yet from the IRS on some of the law's technical provisions. People are working through what can be known based on the legislation and legislative history. There's a time period that will depend on the

project and how it meets the terms of the transition rule. There are projects still under development that won't be completed until 2020 that still qualify under pre-tax reform, single-year credit rules. And then there are projects still coming together, or for other reasons don't meet the transition rules, that will have to contend with a five-year credit. But people are still assessing the financial impacts, both from a credit appetite perspective and a financial modeling perspective.

TCA: How will the structural changes to the Historic Tax Credit, coupled with the reduction in the corporate rate, impact investor appetite and pricing?

Hoopengardner: Reducing the corporate tax rate is generally a positive thing for the HTC, unlike the Low Income Housing Tax Credit. That's how the credits work, with the taxable nature of the HTC. So that's fortunately a counter balance to the net present value issue taking a single-year credit and turning it into a five-year credit. There are also other trends in the broader financial market that are exerting downward pressure on tax credits of all types, such as rising interest rates. We do expect a pricing decrease and depending on the investor, size of the transaction, asset class, and any number of variables, it could vary widely. We've heard some people say the value could drop by double digits, which mathematically seems entirely possible. There will likely be a decrease across the board but then a range, with some projects being impacted less.

TCA: What types of projects will be impacted the least?

Hoopengardner: Projects that have stronger economics. The HTC is an investment credit. When taxpayers invest in the credit they are making an investment, not just for the credits but for cash and other tax and non-tax items. Projects that have a higher cash flow could see better pricing, because more of the investor's return is coming from other elements of the transaction. So, you will see a variation in pricing based on factors related to specifics of each deal. The HTCs anchor the transaction, but there are other characteristics of the deal that provide a better return for the investor based on other attributes.

TCA: Do you foresee the investor base changing from corporations to more CRA-driven financial institutions?

Hoopengardner: Investors who are not financial institutions have come in and out of the market for many reasons.

Talking Heads, continued on page 14

Talking Heads, continued from page 12

At the moment, the HTC investor base has a strong concentration of financial institutions. Within those financial institutions, we see a mix of people who are looking for CRA-eligible investments and innate tax credit investments. I see opportunities for all corporate taxpayers and their appetite will depend on their tax liability. Investors were very focused on whether the credit would survive. All of their treasury departments spent a significant amount of time in December and January figuring out what their tax appetite would be with the new lower corporate tax rate being implemented so quickly. CRA will always be a positive, but not all historic investments are eligible. We've worked with bank regulators to be more flexible with their interpretations of what qualifies under CRA because we think more historic deals should be treated as CRA-eligible. For example, market-rate multifamily, coupled with historic, won't automatically qualify unless there are other economic development features in the transaction. That's a long way of saying the investor base will remain a mix.

TCA: What advice would you give to developers who are contemplating using the HTC under the prior law?

Hoopengardner: Contact your tax advisor. That will frame your ability to determine if your project will be eligible under the transition rule which will then allow you to estimate what your likely pricing will be and whether your sources and uses will balance out based on that estimation. Confirm whether you qualify for state HTCs. There may be forthcoming changes to state credits because of how they once married up with the federal credit, or because state credits change more frequently. Qualifying for state HTCs could mitigate some of the downward pricing on the federal historic side if your project doesn't qualify under the old rules. We also frequently see a synergy of combining HTCs with New Markets Tax Credits, Low Income Housing Tax Credits or other economic development programs. As people finalize development plans, the end use of a project will dictate what other sources of financing might be available. To the extent that pricing may have changed on the historic side, there may still be an opportunity to become more community development focused. If you are looking for New Markets Tax Credits or contemplating an affordable housing component, then this may be a good time if you are still in the early planning stages to reset on all of the potential sources and balance your capital stack.

TCA: Your organization is well-known for twinning Historic Tax Credits with New Markets Tax Credits. Now that the historic credit is a five-year credit will you need to structure these projects differently?

Hoopengardner: New Markets has always been a seven-year credit, but with investors putting in their money upfront on the projects. Our initial expectation, and this is part of what drives pricing downward on the historic side, is that investors will still fund under the same conditions that they bore under the old rules. Money will still be invested during construction only now HTC investors will receive their credits later. That's how the New Markets Tax Credit has generally worked. I think the credits structurally will still align very well, the five-year period for historic and the seven-year credit period for new markets often dovetail well if all of the financing comes in during the construction period, which gives you 12 to 24 months before the building is placed in service and then five more years until exit. To the extent historic pricing declines or NMTC pricing has gone down, which is also a possibility given investors' reduced tax liability, projects will have a funding gap that needs to be filled. These are two relatively shallow subsidies and you still need a significant amount of other capital to make these projects work.

TCA: Are cities and states at all worried that changes to the HTC will impede their efforts to preserve local landmarks? What assistance might they provide to developers to make up for potential funding gaps?

Hoopengardner: States must carefully evaluate the impact of the changes to the federal credit on their own programs. Some state tax credits piggy-backed off the federal program. If they don't want their single-year credits to turn into five-year credits, states will need to adapt. The Preservation League of New York, for example, is already working with state lawmakers to keep that state's credit a single-year credit. Local organizations are considering ways to increase the value of their state's credits, such as increasing the caps on the amount of state tax credits that can be allocated on a single project or statewide on an annual basis. **TCA**

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