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TECHNICAL MEMORANDUM

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Re: **Historic Designation and Preservation Tax Credit Options for For-Profit Organizations in Texas**

OVERVIEW

There are federal, state, and sometimes local historic preservation incentives to help property owners offset the costs of maintaining their historic buildings. These programs aid with maintenance, renovation, and unexpected disaster recovery such as flood or fire. The historic preservation incentive programs can be critical for ensuring that buildings remain safe, functional, and meet the owners' needs while putting money back in the organization's pocket afterwards.

The key points for the federal and state historic preservation tax credit programs are:

- Must have the correct historic designation for the program, which is the National Register of Historic Places (NRHP) for both the federal and state programs or the Recorded Texas Historic Landmark (RTHL) for the state only.
- Credits are a percentage of the Qualified Rehabilitation Expenses (QREs).
- All work included in the project must meet the Secretary of the Interior's Standards for Rehabilitation.
- Programs require three-part applications, two of which require non-refundable application fees based on the value of QREs in the project.
  - Part 1/A: Is it historic?
  - Part 2/B: What is the proposed scope of work? Includes application fee.
  - Part 3/C: Verification of work. Includes application fee.
- At least the Part 1/A must be submitted before the project is complete to qualify.
- Tax credits are issued after the Part 3/C applications are approved.

These points are discussed in detail below. Local historic preservation incentives depend on the municipality in which the property sits, and SWCA will happily assist any property owner to determine if a local preservation incentive exists and what the process is for participating in that local preservation incentive program.

HISTORIC DESIGNATION OPTIONS

To participate in both the federal and state historic preservation tax credit programs, buildings must be listed in the National Register of Historic Places (NRHP). If a property owner wants to participate in the state historic preservation tax credit program only, the property may also be listed as a Recorded Texas Historic Landmark (RTHL).

National Register of Historic Places

The National Register of Historic Places (NRHP) application process takes the longest of the designation types. SWCA estimates that the entire process lasts approximately 18 months from the first day of research until the building is officially listed in the NRHP. The NRHP is administered by the National Park Service (NPS) through the History Programs division at the Texas Historical Commission (THC). NRHP designations require the most research and level of detail of the historic designations, and therefore is the most comprehensive. An NRHP designation also allows a property owner to participate in both the state and federal tax credit programs.

Once designated, privately owned NRHP properties have no restrictions regarding future work on the property, up to and including demolition. Additionally, an NRHP-listed property may also receive involvement from the Advisory Council on Historic Preservation should a federally funded or permitted project affect the property in the future. For properties in Texas, that is generally highway construction; new pipelines, transmission lines, or cell phone towers; flood control; or disaster recovery projects.

Properties designated as National Historic Landmarks prior to 1964 are also considered to be listed in the NRHP for the purposes of the federal and state historic preservation tax credit programs.

Recorded Texas Historic Landmark

Any property owner may designate their building as a Recorded Texas Historic Landmark (RTHL), which garners a state historic marker for the property. The RTHL designation process occurs once annually, and the cycle for each year is announced on the THC's website. Applicants must go through their respective County Historic Commission. The RTHL process takes a minimum of 6 months from the first day of research until THC approves the designation; the process to approve the marker text and fabrication can take an additional 12 months or more. The program is competitive, and only 200 markers are awarded statewide every year to the state's 254 counties.

Once designated, RTHL property owners must comply with Texas Government Code, Chapter 442, Section 442.006(f), which requires the property owner to notify the THC at least 60 days in advance of any exterior changes to the building. Violation of the law may result in a civil penalty of at least $50 and as much as $1,000 for each day of the violation. An RTHL designation also qualifies a property only for the State Historic Preservation Tax Credit. The RTHL designation combines the negative effects of legal oversight with more limiting tax credit options.

Table 1. Comparison of Historic Designation Options

	State	Federal
Name	Recorded Texas Historic Landmark	National Register of Historic Places
Timeline	6+ months	12-18 months
Tax Credit Eligibility	State Only	Federal and State
Legal Oversight	Texas Government Code, Chapter 442, Section 442.006(f)	None

HISTORIC PRESERVATION TAX CREDITS

The federal and state historic preservation tax credit programs are very similar in many ways. When the state program began in 2015, THC deliberately modeled the program on the federal program to ensure that applicants could use both programs without difficulty. Although the two programs work together, there are still key differences in how each program handles the financial aspects. This memorandum will discuss first the aspects each program shares and then will discuss how the programs differ.

The value of the tax credits is based on a project’s Qualified Rehabilitation Expenses (QREs), and both programs have a three-part application that captures the same information: is property historic, what is the proposed scope of work, and did the project complete the scope of work as submitted?

Qualified Rehabilitation Expenses (QREs)

Not every cost associated with the rehabilitation work will be a QRE, though they are typically the larger portion of the project budget. The tax credit from both programs is based on the qualified expenses for the project, not the total project cost.

Table 2. Abridged List of Common Qualified and Unqualified Expenses

Qualified Rehabilitation Expenses	Unqualified Expenses
Plumbing and plumbing fixtures	Landscaping
Window repairs	Furniture
Professional fees (architects, consultants)	New additions/construction
HVAC equipment and installation	Window treatments
Roof repairs	Parking lots
Floor repairs	Appliances
Exterior and interior wall repairs	Cabinets
Electrical wiring and lighting	Fencing
Stairs	Repairs paid for by insurance
Life safety (sprinkler systems, fire escapes)	
Components related to operations and building maintenance	
Materials Testing (brick mortar, paint analysis, etc)	

A complete list of QREs is available through the Internal Revenue Service (IRS) and would be supplied by SWCA after contract finalization.

Application Process

Both tax credit programs require a three-step application process administered by the Division of Architecture at THC. At least one of the applications must be submitted prior to the end of construction, and the building must have received its historic designation before the end of construction to be able to earn the tax credit. Each application must be signed by an authorized person on behalf of the owner, and ownership information must match the information on file with the IRS and with the county property tax records.

The proposed work must meet the Secretary of the Interior's Standards for Rehabilitation to evaluate the proposed scope of work and assess its compatibility with the historic building, its materials, and its historic context. Preservation Briefs to address specific materials and building types are available online. However, the Preservation Briefs are general overviews so that they may be universally applicable. Differences in material usage, location on a building, building type, site, climate, and original appearance all impact the way a Preservation Brief should be interpreted. SWCA will work with owners, architects, engineers, and other project team members to ensure that the project scope will meet the Standards prior to application submittal.

After each application submittal, THC staff will review the application for 30 days. If the project also uses the federal program, THC staff will forward the application materials to the National Park Service (NPS) for additional review. Although NPS officially has 30 days for their review, in SWCA's experience, NPS review may take 45-60 days due to the program's workload.

Part 1/A – Evaluation of Significance

The Part 1/A application determines whether a building is eligible for the tax credit program. It is a separate and concurrent application process to the historic designation application. Buildings that already have the appropriate historic designation automatically qualify for the program. Buildings that do not already have their historic designation must have received it before the end of construction to receive the Certificate of Eligibility at the end of the program.

A Part 1/A application includes a written architectural description; written history of the building, associated persons, and the neighborhood; a map of the site and the surrounding area; historic photographs; and current photographs of both the interior and exterior. If the historic designation includes multiple buildings, SWCA will prepare architectural descriptions and photographs for each building as well as identification of which buildings Contribute to the property's history and which buildings are Non-Contributing. Only Contributing buildings may qualify for the tax credit programs.

Part 2/B – Description of Rehabilitation

The Part 2/B application is a complete written description of all the work planned for the building, both interior and exterior, and its site, and ideally it should be submitted before construction begins. In addition to the written description, the application includes a complete set of the Design Development drawings from the project architect, photos of the existing conditions, and any supplemental materials needed to support the written description. Supplemental materials may include, though are not limited to, engineering reports, product specification sheets, or historical paint analysis. The drawings from the project architect are essential to drafting the written description of work if the proposed scope includes any items beyond routine maintenance.

SWCA will also provide input during the Part 2/B preparation process to ensure that the proposed work will meet the Secretary's Standards. This may include, though certainly is not limited to, recommending glazing tints, changes to floor plans, or where HVAC venting should be placed to avoid important historic detailing.

The Part 2/B application does require a non-refundable application fee. The amount of the fee varies based on the estimated QREs for the project, and the fee itself typically qualifies as a QRE for the purposes of this program. For the state application, THC currently requires the fee be paid by check submitted with the application materials. For the federal application, NPS will notify the project owner when they receive the application materials from THC, and NPS will provide a link to pay the fee online at that time. Neither agency will start their review until they receive the application fee.

Once submitted, tax credit review staff will review the entire submittal. All work planned for the site is subject to their review, not only work planned for the historic building. This includes new construction, landscaping, or parking options. This is to ensure that the new work does not have a negative impact on the historic building. Staff do review the project holistically; good preservation in one area of the building may allow more current techniques to be used in other areas.

If a project is using both tax credit programs, SWCA will request the comments from THC while NPS conducts its review. The agency comments typically match, and this will allow the project to move forward while NPS finishes their review. It is not uncommon for agencies to provide conditional approval. Construction should wait until after the Part 2/B has been approved to be sure that no work will need to be redone following their comments. Projects that involve more repair and maintenance rather than wholesale renovation are easier for the agencies to review and approve.

Part 3/C – Request for Certification of Completed Work

The final application is submitted following the end of construction. The Part 3/C application is a set of photographs to show the finished work. The photographs are typically assembled as a direct comparison against the Part 2/B photographs to demonstrate precisely how the work has improved the building and helps retain its historic character. A Certificate of Occupancy, Architect's Letter of Substantial Completion, or final invoice must be included as well, depending on the level of complexity involved in the project.

The Part 3/C application also includes a site visit from the THC staff member responsible for reviewing the project. The Certificate of Eligibility will not be issued until after this site visit. Typically, during this site visit, the staff member will take their own photographs to publish on THC's website. Their site visits are also typically relatively short as they try to schedule multiple site visits in a single trip.

State of Texas Historic Preservation Tax Credits

The State of Texas tax credit provides 25% of an owner's QREs against their franchise or insurance tax, and there is no time frame in which the project must be completed.

After the tax credit process is complete, building owners submit the Certificate of Eligibility, an audited cost report, and a completed Form AP-235 to the State Comptroller's office. SWCA may assist with the Form AP-235, however, the bulk of this work should be performed by a Certified Public Accountant as part of the required audit.

The Comptroller's office will issue Form 05-901, Historic Structure Credit Certificate to the owner. This may be used to offset the owner's franchise tax or may be sold for cash. If an owner chooses to sell the Certificate for cash, owners may either sell the credit directly to a company that pays franchise tax or use a broker to facilitate the deal. If the owner chooses to use a broker, the cash value after the brokerage fee is typically \$0.87 - \$0.92 for every dollar in credit. On request, SWCA will provide contact information for known brokers that purchase and sell the Historic Structure Credit Certificates; however, each project will need to identify its own preferred buyer for the tax credits.

The value of the credit is based on Qualified Rehabilitation Expenses (QREs). An owner must spend at least $5,000 in QREs for their project to qualify for the tax credit program, however, SWCA recommends that an owner wait to have at least $100,000-$500,000 in QREs to make it cost effective once the administrative costs are considered.

Once the owner has the Certificate of Eligibility, THC no longer has purview over the building, and the owner may proceed with any work on the building without notifying or consulting the agency. This could include new windows, new additions, a new roof, or even demolition of the entire building.

Federal Historic Preservation Tax Credits

The Federal Historic Tax Credit program provides 20% of an owner's QREs against their federal income taxes. If the project includes only one building, the owner may only claim the credits against 24 months of project activities. If the project includes multiple buildings as part of a functionally related complex, then the owner may claim the credits against 60 months of project activities, and this type of project may be phased to claim credits in the interim. If a project takes longer than the allotted time, SWCA recommends that the client claim the most expensive 24- or 60-month period of project activities.

The minimum QRE value varies based on the project because the property must be a "substantial rehabilitation." Officially, NPS calculates this value as equal to or greater than the building's adjusted basis, and there is a formula for identifying this value. Practically, this value is typically the "improvement value" of a property as assessed by its respective county appraisal or assessor office. The "improvement value" is the total property value minus the land value.

After the project is complete, NPS will provide a Certificate of Completed Work, and that must be filed with the IRS and IRS Form 3468. Following changes to the tax code in 2017, owners may only claim 20% of their federal credit each year for five years after the building is placed in service. This works out to 4% of the project QREs claimed each year for five years.

NPS and the IRS also have a five-year callback period in which they may review any and all work on the building. This purview excludes any routine maintenance; however, it does include any new construction on site, new landscaping or parking in the project vicinity, or selling the building. If NPS does not approve the new work, then the owner may not claim the remainder of the credit proportional to when the work occurred during the five-year period.

Table 3. Comparison of the State and Federal Tax Credit Programs

	State	Federal
Historic Designation	Recorded Texas Historic Landmark or National Register of Historic Places	National Register of Historic Places
QREs	IRS-determined	IRS-determined
Applications	A/B/C	1/2/3
Application Fees	Required for Parts B and C	Required for Parts 2 and 3
Project Period	None	24 or 60 months
Staff Review	30 days	30-60 days
Credit Value	25% of QREs	20% of QREs
Tax Type	Franchise or Insurance Tax	Income Tax
Callback Period	None	Five years

SWCA's Houston office has been working on historic preservation tax credit projects in Houston and in Texas for more than 10 years. Our projects have won numerous Good Brick Awards from Preservation Houston, and notable completed projects include the Firestone in Amarillo, and St. Paul's United Methodist Church, and the W-K-M Company, Inc., both in Houston. Projects in progress include Holy Rosary Catholic Church, Rosenburg and St. Mark's United Methodist Church, Houston. We have written more than half a dozen NRHP nominations in the last two years, including St. Paul's United Methodist Church, St. Elizabeth's Hospital, and the Schlumberger Building, all in Houston.

If you have any additional questions, please do not hesitate to reach out to me. I can be reached at my direct line (346) 388-1424 or by email, hannah.curry@swca.com.

Sincerely,

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