March 26, 2013

Susan M. Cosper, Chairman
Emerging Issues Task Force
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Ms. Cosper:

I am writing on behalf of the Historic Tax Credit Coalition (HTCC) in response to our understanding that FASB’s Emerging Issues Task Force has instructed staff to prepare a change in rules that would allow for the effective yield accounting method to be used by investors in non-guaranteed Low-Income Housing (LIHTC) transactions. I applaud the Task Force for the position it has taken with respect to EITF 94-1 and its interest in extending effective yield accounting to include Low-Income Housing Tax Credits that meet the four stated criteria. This is an encouraging step forward.

While listening to the audio tape of the March 14 meeting, I noted with interest the discussion among board members on whether it made sense to pursue a more comprehensive approach at the outset to avoid creating different accounting treatments for similar congressionally mandated tax credits. On behalf of the HTCC, I hope to argue successfully in this letter for the comprehensive approach.

The Historic Tax Credit Coalition (HTCC) is a group of historic tax credit industry representatives who have come together to help develop a consensus on ways to modernize the federal Historic Tax Credit (HTC). Its members are tax credit syndicators, corporate investors, tax attorneys, accountants, preservation consultants and real estate developers who are involved in the business of using the HTC as a financing tool to help facilitate the rehabilitation of historic properties. The HTCC’s activities include research on the economic impact of the HTC, the development of legislative and regulatory proposals to promote the simplification and greater use of the HTC, and efforts to foster greater communication between the National Park Service, the Internal Revenue Service and the HTC industry. Our website can be found at www.historiccredit.com.

Background
The federal historic tax credit is a 20% credit taken on the qualified rehabilitation expenditures incurred to renovate a certified historic structure. The HTC actually pre-dates the Low-Income Housing Tax Credit. It was enacted by the Reagan administration as part of its economic stimulus package in 1981 to level the playing field between investment in new construction and existing buildings. Based on research commissioned by the National Park Service and conducted by Rutgers University’s Center for Urban Policy Research, 38,700 historic buildings have been
rehabilitated under this successful program generating $106 billion in total development activity. Nearly 2.4 million jobs have been generated. $20.5 billion in credits have been allocated by the National Park Service over the life of this program, and it has more than paid for itself by returning $25.9 billion to the US Treasury in the form of federal tax receipts. See pages 5-6 for more details.

The HTC is also well-known for its ability to attract private investments beyond the first building financed. Individual buildings lead to the creation of historic districts and the revitalization of entire commercial neighborhoods. The 11-year economic impact on just one city, Richmond, VA, is illustrated by a geocoded map on pages 7-8 which shows that between 2001 and 2012, 503 HTC-financed projects were completed, generating nearly $1.4 billion in total rehabilitation activity and creating over 21,400 direct, indirect/induced jobs through the date of construction completion. The economic impacts statistics are derived from Rutgers’ Preservation Economic Impact Model, developed for the National Park Service to measure the positive community benefits of the HTC.

In a separate study done for the National Trust for Historic Preservation, Novogradac and Company found that the recapture rate of the federal HTC is extremely low. Over a 10-year measuring period (2001-2011) a survey of investors representing over 50% of the HTC market showed that the recapture rate was only 0.73% on a cumulative basis. An executive summary of this study is included as pages 9-11. These data, in addition to the economic statistics cited above, are indicative of a credit that is a safe and sound investment, well-established in the market place and achieving the social benefits intended by Congress.

Comments on the March 14, 2013 EITF Meeting
The accounting treatment of the federal HTC, as stated in the attached article written for the Novogradac Journal of Tax Credits in November 2010 on pages 12-14, has been a concern of the Historic Tax Credit Coalition for some time. The HTCC was part of the drafting process for the white paper submitted by the Financial Services Roundtable and is responsible for the included references to the federal HTC. We did not send a letter of support because we were in favor of a white paper that more broadly represented the needs of all congressionally mandated tax credits, including the LIHTC, HTC, alternative energy and New Markets Tax Credits.

All of the above mentioned federal credits are governed by the same statutes and regulations of partnership law. They share legal structures that are similar. And the true financial impacts of these different credits on their investors are all distorted by the equity method of accounting.

In fact, the HTC in particular is more seriously impacted by the “above the line” asset impairment write-down that is currently required. A significant portion of the credit investment (typically greater than 50%) must be recognized as an impairment when the investment is made, unlike the LIHTC, which can spread this P&L impact out over its 10-year credit vesting period. This accounting treatment is often noted by prospective investors as a reason not to invest in the HTC. As one Wall Street company real estate investment officer put it, “I earn bonuses by generating profits, not losses.” Other corporate tax credit investors have told us that they rank the HTC lower in their overall investment platform priorities due to the more severe book treatment of the HTC compared to the credits that vest over time.
Request
The Historic Tax Credit Coalition respectfully requests that the Emerging Issues Task Force review the impact of its accounting rules for all congressionally mandated credits equally and at the same time. While this may seem like a tall order, the structures and investor motives in each case are more alike than they are different. Speaking for the HTC, we know that all Historic Tax Credit transactions easily meet the four criteria discussed in the March 14 meeting.

1. **It is probable that the tax credits allocable to the investor will be available.** As stated above, HTCs are available to the investor when the property is placed in service. The credits are certified in a Part 3 approval from the National Park Service. The Part 3 application consists of before and after photographs to verify that the historic design standards (“Secretary of the Interior’s Standards for the Rehabilitation of Historic Properties”) outlined in the Part 2 application have been followed. The National Park Service reports that its rejection rate for Part 3 applications is less than 1%. In the rare instances of a Part 3 denial, the developer always has a grace period to remedy any Part 3 shortcomings and reapply.

Similarly, construction completion risk in HTC transactions is minimal. Managing members (developers) of LLCs formed to complete HTC-financed transactions provide completion guarantees. The construction contingency line item in a historic rehabilitation development budget is typically 8-12%, much higher than new construction because of the potential for unforeseen conditions. Failure of HTC projects to complete construction and deliver credits is virtually unheard of in the industry.

2. **The investor retains no operational influence over the investment, and substantially all of the projected benefits are from tax credits and other tax benefits.** Similar to LIHTC transactions, the HTC investor is always an investor member with no management rights and no control over the day-to-day decisions of the LLC. Substantially all of the HTC transaction benefits are derived from the value of the credits and other tax benefits of the project. However, the HTC is an investment tax credit that is subject to an economic substance test. Traditionally, the investor does receive a small (1-3%) priority return or cash flow split on its investment. However, these cash flow benefits are insignificant compared to the transaction’s tax benefits and do not drive investor appetite for the HTC. Pages 15-16 include diagrams of the two widely used legal structures for the HTC.

3. **The investor’s projected yield based solely on the cash flows from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment) is positive.** The investor return on HTC transactions is positive based solely on the cash flows from tax credits and other tax benefits. In addition to the small cash return discussed above, after the 5-year compliance and holding period, investors typically have a voluntary right to exercise a “put” option to exit the transaction. Put pricing in today’s market can
be as little as 5% of the original investment amount. Without cash generated by
the put or the priority return, the investor’s projected yield is still positive.
Neither the put payment nor the priority return is a primary factor in determining
overall investor interest in the HTC.

4. The investor limited partner in the affordable housing project for both legal
and tax purposes, and the investor’s liability, are limited to its capital
investment. Industry practice for the HTC is the same as the LIHTC. The
developer has the responsibility to complete construction and operate the
property. Cost overruns and operating deficits are covered by the general partner
or managing member.

In conclusion, I believe that EITF’s narrow focus on just one credit, the LIHTC, rather than on
the similar needs of other federal credits has the near-term potential to reduce investor demand
for other credits such as the HTC. While it is hard to predict the future, effective yield
accounting treatment for tax credit investments may very quickly become a minimum
requirement for corporate tax credit investors. Those credit industries that can’t provide it could
be at a material disadvantage in the market place. This would certainly be an unintended
consequence of an otherwise positive step by the EITF. I urge you to consider the HTCC’s
request for a more comprehensive approach. Based on the above analysis I believe that the HTC
meets the definition of an analogous situation that should be considered as part of your follow up
to the March 14 decision.

If you wish, we would be pleased to meet with you to discuss more fully the content of this letter
and its attachments at any time that is convenient for you. Thank you for your consideration of
this request.

Sincerely,

John Leith-Tetrault
Chairman
Historic Tax Credit Coalition
What do high-paying jobs, billions in private investment, and historic buildings have in common?

Together, they are revitalizing communities all across America.

Historic rehabilitation creates thousands of local, high-paying, high-skilled jobs every year. According to research conducted by Rutgers University’s Center for Urban Policy Research, the federal Historic Tax Credit (HTC) created 57,783 new jobs in FY 2012. Over 2.35 million jobs have been created over the life of the program.

The Historic Tax Credit leverages private investment five times the cost of the program. For every $1.00 in HTCs, $5.00 in private investment is leveraged. Taken over the life of the program, the HTC is responsible for $106 billion in new investment in our urban and rural communities.

Historic preservation stimulates the local economy. Over three-quarters of the economic benefits generated by rehabilitation remains in the local communities and states where the projects are located. This reflects the fact the labor and materials for historic rehabilitations tend to be hired or purchased locally.

Rehabilitation of historic buildings “primes the economic pump.” $1 million invested in historic rehabilitation produces markedly better economic impact in terms of jobs, wages, and federal-state-and-local taxes than a similar investment in new construction, highways, manufacturing, agriculture, and telecommunication.¹

continued >
Historic Tax Credits drive investment to low-income neighborhoods. Since 2002, more than 75% of all HTC projects have been located in neighborhoods with family incomes at or below 80% of the area median. This new investment can start a cycle of economic revitalization, encourage additional investments, raise property values and create a safer and more secure environment.

This is a government program that more than pays for itself. The cumulative $20.5 billion cost of the HTC program is more than offset by the $25.9 billion in federal taxes these projects have generated.

Historic rehabilitation is green. Recycling old buildings reduces landfill waste and saves energy by reusing existing materials rather than manufacturing new building components such as doors, windows, roofing and framing. Reusing existing buildings almost always offers environmental savings over demolition and new construction – even if that new construction is energy-efficient.

The Historic Tax Credit investment is a sound investment. Over the last ten years, less than 1 percent of all historic tax credit projects have failed to meet IRS compliance requirements for the five-year period following the project’s completion. That equates to a project success rate of over 99 percent, despite the economic recession conditions beginning in 2008.

THE HISTORIC TAX CREDIT CAN DO MORE: The Creating American Prosperity through Preservation (CAPP) Act will ensure the survival of the program and make the Historic Tax Credit an even more powerful economic engine. The legislative changes will modernize the Historic Tax Credit, generate more new jobs and investment on Main Street, and incentivize energy efficiency in older commercial buildings. To learn more and help save the federal HTC, please visit www.preservationnation.org/issues/rehabilitation-tax-credits/

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1 Kansas case study, Center for Urban Policy Research, Rutgers University, 2010
2 Compilation of National Park Service HTC Quarterly Reports from 2002-2008
3 National Trust for Historic Preservation, “The Greenest Building: Quantifying the Environmental Value of Building Reuse”
4 Novogradac & Company, “Historic Rehabilitation Tax Credit Recapture Survey”

FOR MORE INFORMATION PLEASE CONTACT:
Tom Cassidy | 202.588.6078 | tom_cassidy@nthp.org

National Trust for Historic Preservation
1785 Massachusetts Avenue NW Washington, DC 20036
www.PreservationNation.org
FEDERAL HISTORIC TAX CREDIT PROJECTS IN VIRGINIA
Richmond
This map depicts 503 Federal Historic Tax Credit projects that received Part 3 certifications from the National Park Service between the years 2001–2012.

Legend
- Historic Tax Credit Project
- Road

For more information, contact Tom Cassidy, Vice President of Government Relations and Policy at 202.588.6078 or email tcassidy@savingplaces.org

Information provided by the Historic Tax Credit Coalition and the National Trust for Historic Preservation
Economic Impacts of HTC Investment
2001 through 2012
Richmond

Total Number of Projects: 503
Total Development Expenditures: $1,382,068,397
Total Number of Jobs: 21,450
Construction Jobs: 9,411
Permanent Jobs: 12,039
Household Income generated: $769,110,800
Federal HTC amount: $229,423,354
Historic Rehabilitation Tax Credit Recapture Survey

COMMISSIONED BY
THE NATIONAL TRUST FOR HISTORIC PRESERVATION
THE NATIONAL TRUST FOR HISTORIC PRESERVATION AND NOVOGRADAC & COMPANY LLP WISH TO ACKNOWLEDGE THE CONTRIBUTIONS AND ASSISTANCE OF JEROME BREED OF BRYAN CAVE INTERNATIONAL CONSULTING LLC; WILLIAM MACHEN OF HOLLAND & KNIGHT LLP; AND FORREST MILDERS OF NIXON PEABODY LLP IN THE PREPARATION OF THIS REPORT.

On the Cover: The White Stag Block, Portland, Oregon. The 133,000-square-foot facility, built between 1892 and 1907, merges three buildings retaining the historic features that facilitated the use of historic rehabilitation tax credits and new markets tax credits.
EXECUTIVE SUMMARY

The National Trust for Historic Preservation commissioned this study to determine the frequency and amount of recapture that investors have experienced with the federal historic rehabilitation tax credit (HRTC). The study was conducted using an on-line survey of a group of HRTC investors that have made significant investments. Survey respondents consist of large institutional investors, including national banks and Fortune 500 companies that make direct and indirect investments in HRTC transactions.

Collectively, the survey’s respondents have invested in more than 50 percent of the HRTCs claimed during the past 10 years and their responses demonstrate that they have experienced very low rates of recapture during the past 10 years. Respondents indicate that of the total HRTCs claimed, they have experienced a recapture rate of less than three-quarters of one percent over the past 10 years. This successful track record can be attributed to several factors: large dollar investments from third parties; careful screening of properties before development by third-party investors; economies of scale and uniform practices; construction and lease-up risk borne by investors and developers; and regulatory guidance and enforcement by the Internal Revenue Service.

CASA de Maryland
8151 15th Avenue, Langley Park, MD

Property and Project Details
Originally named Langley Park, the three-story Georgian Revival McCormick-Goodhart Mansion was constructed in 1924 as a private residence, the grand centerpiece of a 565-acre estate. Following the death of its owners, the mansion became a seminary, a Montessori school and finally a child-care center before sitting vacant for years. CASA, the largest Latino and immigrant service organization in Maryland, acquired the building for $1 in 2001 with the vision to expand beyond its primarily Latino-focused outreach to meet the needs of the area’s increasingly diverse immigrant community. With the purchase of the building, CASA began a certified historic rehab to convert the mansion into a multicultural center. Since its opening in June 2010, the center has been providing a variety of services including financial and computer literacy education, a justice center for pursuing immigrant legal and civil rights, job placement and a cafeteria for food service industry training.

The scope of renovation included restoration of the exterior and most of the existing historic interior that used $963,384 in federal historic tax credits as well as new markets tax credits, Maryland state historic tax credits and federal energy tax credits. The project obtained LEED Gold status for green design elements.
Any tax credit syndicator interested in economic survival during the great recession has been working overtime to identify new investors. Speaking from personal experience, nothing is more frustrating than trying to convince a company CFO to try something new when revenue is down and cash is tight. Arranging the first phone conversation isn’t so hard. But getting past that first phone call to a face-to-face meeting without the help of a powerful door opener can be a daunting task. I have found that having 20 of these conversations going at once is essential because 19 of 20 conversations will go nowhere. Getting to a “no” can often take months. Getting to a “yes” can take a year or more.

New Investor Tax Credit Appetite

So what’s behind this investor reticence, aside from the normal human tendency to duck and cover when the economic future is so hard to read? Discussions with potential new investors that are not derailed by a prospective investor’s concerns about lack of taxable income or its inability to use the capital losses generated by the write-off of 90 to 95 percent of its capital account upon exit often focus on the historic tax credit’s negative impact on the company’s profit and loss statement (P&L).

Most investors must currently account for their tax credit investments using the equity method, which requires that the investor’s activities in tax credit partnerships be shown in its operating results. The equity method of accounting leads to the so-called “above the line” and “below the line” dual impacts of tax credit transactions. Losses from operations (including paper losses from depreciation) and the write-off of the investor’s capital account in anticipation of exercising the put option all have the above the line effect of reducing pre-tax profits. The below the line impact is, of course, the credit’s reduction of tax liability.

In the case of the historic tax credit, the recognition of the capital account write-off typically occurs the year the property is placed in service when the entire 20 percent credit is taken. The immediate impact on the P&L for low-income housing tax credits (LIHTCs) and new markets tax credits (NMTCs) is not as severe because those credits vest over 10 and seven years respectively and the capital account write-off can be taken on the P&L over the compliance period. So while the early vesting of the historic tax credit (HTC) simplifies tax planning in uncertain times, publicly traded companies that are typically judged by Wall Street on pre-tax earnings are very wary of the HTC’s especially harsh negative impacts on their P&L. The retreat from the HTC market by key financial institutions over the past two years can be largely traced to its early vesting characteristic and P&L impacts.

The Potential of Expanding Effective-Yield Accounting

Investors in guarantied-yield LIHTC funds can currently take advantage of Accounting Standards Codification 323-740, formerly issued as FASB EITF 94-1 - “Accounting for Tax Benefits Resulting from Investments in Affordable Housing Projects” - to achieve more favorable P&L treatment of operating and capital losses associated with affordable housing tax credit investments. This FASB rule provides LIHTC guarantied-yield fund investors with a method of avoiding the volatility in earnings from tax credit investments. It allows investors with an expected positive yield to recognize the benefit of the tax credits and the costs of the investment.
continued from page 1

together in income taxes so that the effect on the investor’s financial statements is equal to the constant effective yield to the investor over the holding period.

“The key benefit of effective-yield accounting treatment is that the deductions and losses generated by federal income tax credit investments are recorded below the line as part of a company’s income tax expense,” explains Michael Novogradac, CPA, managing partner in Novogradac & Company’s San Francisco office. “The effective-yield accounting treatment appropriately nets income and expenses in the same place on a company’s income statement.”

Importance to the Historic Tax Credit Industry

It should not surprise the readers of History on the Hill that the impact of equity method accounting rules has a greater impact on investor appetite for the HTC than the LIHTC and NMTC. We know from the discussion of economic substance in May’s edition that the burden of showing a pre-tax investor motive falls most heavily on the HTC. The June edition reported that the HTC has the most to gain from a change in the IRS definition of CDE control (as it relates to the new NMTC related party test) because twinned HTC/NMTC investments typically provide more than 50 percent of a transaction’s equity.

The HTC industry has been at the table on the latter two issues. It needs to step up to table on potential expansion of effective-yield accounting as well. How easy will this be? Novogradac made the following assessment: “We are optimistic that this below the line treatment of deductions and losses can be expanded to a broader array of tax credit investments and investment structures. But, such an expansion will not be easy, and will not be quick.”

John Leith-Tetrault has 32 years of experience in community development financing, banking, community organizing, historic preservation, training and organizational development. He has held senior management positions with Neighborworks, Enterprise Community Partners, Bank of America and the National Trust for Historic Preservation. Mr. Leith-Tetrault is the founding president of the National Trust Community Investment Corporation and serves as the Chairman of the Historic Tax Credit Coalition. He can be reached at (202) 588-6064 or jleith@ntcicfunds.com.
Novogradac Journal of Tax Credits

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This article first appeared in the November 2010 issue of the Novogradac Journal of Tax Credits.

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Single-Entity Structure for Historic Tax Credit Investment

HISTORIC DUPONT CIRCLE PROJECT
Single Entity Structure for Historic Tax Credit Investment

Corporate Investor -> NTCIC Investor Fund I

Developer (Managing Member) -> Ownership LLC
99.99% Investor Member - NTCIC Investor Fund I
00.01% Managing Member

FHTC Equity

99.99% of FHTC Credits, Profits, Losses, and Cash Flow

Loan

Rent Payments

Tenants

Interest Payments

1st Mortgage (1st Mortgage Lender)

EITF-13B Comment Letter No. 1
Sample Master Tenant Structure for Historic Tax Credit Transaction

Lenders

Loan

Debt Service Payments

Lessor LLC
90.00% Member - Managing Member
10.00% Member - Master Tenant, LLC

Managing Member

Master Tenant, LLC
99.99% Member - NTCIC Federal HTC Investor
00.01% Member - Managing Member

NTCIC Federal HTC Investor

Federal HTC Investor

Federal HTC Equity

Pass-Through of Federal HTCs

Master Lease

Rent Payments

Commercial & Residential Tenants