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“Extra Credit” Rehabs

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Brownfields Redevelopment Tax Incentives for Preservation Projects

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Rehabilitation projects, especially those that involve rehabilitating and repurposing older industrial buildings, often run into contamination issues. Over the years, chemicals from former mills and factories soaked into the ground and leaks from underground storage tanks contaminated the surrounding soil. Cleanup costs for these industrial sites can be daunting. And understanding how to negotiate brownfields-related landmines, especially related to liability and regulatory issues, can be challenging. However, there are opportunities to enhance the project's financing by using brownfields-related incentives. By combining these incentives with federal and state historic credits, developers have been able to bring new life to older industrial projects and the surrounding community.

This article explores corporate and income tax incentives for brownfields redevelopment and discusses how these incentives can be layered with rehabilitation projects to provide multiple public benefits.

The term "Brownfields" is defined by the U.S. Environmental Protection Agency as "real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant."

BROWNFIELDS-PRESERVATION SYNERGIES

Former mills and industrial lofts are often excellent candidates for projects that combine brownfields elements with preservation. Many of these buildings are outmoded relative to their original use; however, they are often attractive for new residential or commercial uses because of engaging architectural elements and locations adjacent to residential or commercial corridors, often near rivers or canals. The Environmental Protection Agency (EPA) paid particular attention to the tie-ins between brownfields and mill projects in preparing a 2006 report, Revitalizing America's Mills. The report found that 351 former mills had benefited from EPA site assessment or cleanup funds. Some other indications of the brownfields-preservation overlap:

Brewer's Hill in southeast Baltimore is one of at least six Baltimore brownfield projects that also benefited from historic tax credits. Brewer's Hill is a $120 million mixed-use project, featuring 2 million square feet of green/energy-efficient commercial space.

PHOTO: BREWER'S HILL, LLC

- **Baltimore:** A review of the Baltimore Development Corporation's brownfields "site pipeline, 1997 – 2005" revealed that 9 out of 23 completed or under construction brownfield projects were also preservation projects, and at least 6 of those 9 projects benefited from the federal and state historic tax credits.[1] It might be noted that the Maryland historic tax credit was the single most important urban redevelopment incentive (for both brownfield and non-brownfield sites) in Maryland up until 2002, when the state began to institute a series of restrictive project ceilings and an overall program cap.
- **Missouri:** Missouri tracked the funding sources for 50 brownfield projects from 2000 to 2009. Researchers found that 9 of the 50 projects used state and federal historic tax credits, totaling $86 million in tax credit subsidies and comprising 30 percent of all public dollars going into the brownfields inventory.[2]

The limited evidence is that between one-fourth and one-third of brownfields projects are also rehabilitation projects, and that around 20 percent of brownfield projects are being assisted by state and federal historic tax credits. I have yet to find information as to the reverse, i.e., the number of preservation projects that are also getting brownfields assistance, but one might speculate that the same proportions hold: At least 20 percent of historic tax credit projects are also getting brownfields incentives.

Brownfields incentives that might come into play in these industrial conversion projects include grants and loans, property tax abatement, tax increment financing, and tax credits. This article will explore opportunities for preservation projects to take advantage of brownfields tax credit incentives. In general, developers view tax incentives as the most advantageous of these various incentives, because they are usually designed to be fairly predictable and automatic, involving less delay, uncertainty, and bureaucracy than grants and loans.

Preservation planners' reference point on tax incentives is the federal historic tax credit, which many states supplement with their own parallel programs. These state historic tax credit programs differ from each other on many critical details (transferability, state-wide caps, per project caps, etc.), but there is usually considerable commonality with the federal tax credit in relation to eligible projects, eligible expenditures, and procedures to get the certification. Unfortunately, there is not a parallel federal brownfields cleanup tax credit program, and, with nothing to mirror, the states that have adopted brownfields tax credits have done so with creative state-crafted solutions, i.e. with very little commonality.

FEDERAL BROWNFIELDS TAX INCENTIVE PROGRAM

First, while there is not a federal brownfields cleanup tax credit, there is (or "was") a deduction for brownfields cleanup expenditures. The federal section 198 Brownfields Tax Incentive Program allows the deduction of remediation costs (including petroleum, but not including asbestos and lead paint in buildings). The deduction is allowed in the year the costs are incurred, essentially treating cleanup as a repair to the land, rather than a capital expenditure that must be expensed over a period of years. The program is still on the books; however it was not renewed by Congress in 2013. There is a movement underway, spearheaded by the National Brownfields Coalition, to have it reinstated.

The following section looks at 13 state brownfields tax incentives, grouped into four rather different models. One or two particular states will serve as examples for each of the four models. The detail for all of the 13 states is contained in the "State Brownfields Corporate and Income Tax Credit Table," linked here.

Merchandise Mart in St Louis, Mo., made use of the federal brownfields tax incentive, as well as state and federal historic tax credits, and Missouri's brownfield remediation tax credit program. The rehabilitation of this building into 213 mixed-income apartments has spurred redevelopment of St. Louis' Washington Avenue Lofts District.

PHOTO: HRI PROPERTIES

STATE CLEANUP *AND* REDEVELOPMENT TAX INCENTIVES

New York, Connecticut, Missouri, and Iowa have each adopted a broad approach to brownfields tax incentives: not just cleanup, but also certain redevelopment costs are eligible for the tax credit. In comparison to cleanup-only tax credits, these broader redevelopment credits are potentially more lucrative to the developer, as well as more costly to the taxpayer, and three of the four states have an involved application process that includes needs testing, ranking relative to state criteria, and/or economic benefit analysis. The tradeoff seems to be that these broader incentives are potentially of greater help in closing project gaps (relative to cleanup-only credits); however, fiscal concerns have caused these states to structure the programs to be less automatic than the narrower cleanup tax incentives.

New York—New York Brownfields Cleanup Program (BCP) is the most lucrative of these cleanup/redevelopment tax credits. BCP is a combined regulatory program and tax credit program; eligibility for the tax incentive is dependent on being accepted into the regulatory program. The BCP credit is divided into two parts: site preparation and redevelopment. Site preparation credits are 22 to 50 percent of cleanup, and site preparation costs depend on the extent of the cleanup and the type of reuse. Higher percentages are for unrestricted use cleanups and residential reuse. The redevelopment credit can be 12 to 22 percent of total redevelopment costs up to $35 million or three times site prep costs, whichever is less. The add-ons to the basic 12 percent credit are:

- If the qualified site is remediated to Track 1 (a cleanup level that allows for the site to be used for any purpose without restriction) an additional 2 percent is allowed.
- If at least 50 percent of the qualified site is located in an Environmental Zone (distressed area designation) an additional 8 percent is allowed.

BCP is hard to characterize on the spectrum of needs-tested versus automatic credits: It was originally authorized as an automatic credit, but, after a particularly controversial high value project got a lucrative incentive connected to very modest cleanup costs, the State Department of Environmental Conservation instituted what amounted to an administrative needs test. Several projects that were turned down in this fashion challenged the decisions in court and most of the decisions went against the state.

The BCP credit is structured as a fully refundable credit, not a transferable credit.[3]

Missouri—The Missouri Brownfield Remediation Tax Credit Program is up to 100 percent of environmental site assessment, remediation, and demolition expenditures. The site must have been abandoned for 3 years and the project must create 10 new or 25 retained jobs. To be eligible to receive these benefits, the city or county must provide at least 50 percent real property tax abatement for 10 to 25 years. The Remediation Tax Credits are used to offset corporate and personal income tax, corporation franchise tax, and/or the financial institution tax. The tax credit is fully transferable, and there is no statewide cap.

As referenced, above, there is an application process and the state reviews applications in relation to both project need and economic and fiscal impacts on the state. The needs test and impact analysis are used to determine whether the project will be eligible for the full amount (100 percent) of remediation and demolition expenses.

The Connecticut and Iowa redevelopment tax credit programs are described in the chart, linked here.

Robertson-on-the River in Taunton, Mass., benefited from the Massachusetts Brownfields Tax Credit Program and state and federal historic tax credits. This $8.8 million investment (including $346,000 in remediation) produced 68 affordable housing units and 18,000 square feet of commercial space, all in an economically distressed area.

PHOTO: EVANS PAULL

STATE CLEANUP-ONLY TAX CREDITS

Massachusetts, Florida, Illinois, Indiana, South Carolina, and Kentucky have more narrow credits based on a percentage of site assessment and cleanup costs. In contrast to the redevelopment incentives above, most of these cleanup incentives are structured to be nearly automatic: If a developer has an eligible site and eligible expenses, he or she gets the credit.

Massachusetts—The Massachusetts Brownfields Tax Credit (BTC) program provides for a tax credit of 25 to 50 percent of site assessment and cleanup costs, the higher percentage linked to cleanup to an unrestricted-use cleanup standard. Eligible sites must be in the commonwealth's designated economically-distressed areas. The BTC credit is automatic and transferable, and there is no per project ceiling or overall program cap. Redevelopment Economics' recent report on the economic and fiscal impacts of the program found that more than 7,000 jobs were leveraged in BTC-assisted projects, and that $37 in total capital investments were stimulated for each $1 of BTC outlays.

Similar States—The Florida, Indiana, Illinois, South Carolina, and Kentucky programs are all somewhat similar to Massachusetts, although each of those states limits the credit by either per project ceilings or an overall program cap. The most expansive of these is the Florida incentive because the 50 percent cleanup tax credit can be linked to a series of bonuses, including a job creation tax credit of $2,500 per employee. These additional programs are summarized in the table (see this link).

BROWNFIELDS TAX REBATE PROGRAMS

Mississippi and New Jersey have tax credit programs such that recovery of remediation costs is linked to state revenues generated by the project. This approach is the polar opposite of providing any upfront project equity or other upfront financing assistance (the usual barrier to brownfields investments), because the reimbursement does not occur until the project has produced revenues that exceed cleanup costs. On the other hand, these kinds of reimbursement credits are fiscally-defensible and do serve to lower the risk that the tab for cleanup might sink the project.

Mississippi—In April 2013 an expansion of Mississippi's Brownfields Tax Credit was signed into law. SB 2147 allows the capture of state sales, income, and franchise taxes in the amount of 2 ½ times eligible site-assessment and cleanup costs. The bill vastly expands eligibility for a similar program that expired in 2009 and was limited to the former chemical plant in Vicksburg, Miss., where the "property [had] been abandoned from the bankruptcy estate." The new definition additionally includes all sites that are subject to a "Brownfield Agreement under Section 49-35-11." Brownfield agreements are Mississippi's standard voluntary cleanup agreements. The new legislation also eliminates the program's sunset clause.

Sites must be in a designated "Redevelopment Project Area" that is approved by the local government. For sites both inside and outside of Redevelopment Project Areas, Mississippi already grants a more limited state income tax credit for up to $150,000 or 25 percent of cleanup costs, whichever is less. For more information, download this program description.

New Jersey's Site Reimbursement Fund program is similar but the reimbursement is lower, at 75 percent of eligible cleanup costs. The New Jersey program, which is summarized in the attached table, is still on the books but no new projects have been certified for the credit in two years. The state is emphasizing a similarly structured, but broader economic development tax incentive, the Economic Redevelopment and Growth (ERG) Program.

JOB CREATION TAX CREDITS FOR BROWNFIELDS PROJECTS

At least two states, Delaware and Florida, have adopted a job creation tax credit linked to a brownfields designation. In the case of Delaware, the Qualified Investment in Targeted Areas tax credit program generally assists job creation and investment in designated economically distressed areas, but there is a bump up in the amount of the credit for brownfield sites (see chart). In the case of Florida, sites that have a brownfields site rehabilitation agreement or abut a site with a brownfields site rehabilitation agreement may be eligible for the Brownfield Redevelopment Job Bonus, a tax refund of up to $2,500 for each new job created.

Neighborhood Service Organization's rehab of the Bell Building in Detroit provided 155 apartments for low-income and homeless persons. NSO also provides a full complement of social services geared to the homeless population at this location.

PHOTO: FUSCO, SHAFFER & PAPPAS, INC.; CHRISTOPHER LARK, INC.

LAYERING BROWNFIELDS AND HISTORIC TAX CREDITS

Brownfields tax credits are generally complementary to historic tax credits because they are funding entirely different aspects of the same project. For the majority of the states cited here, i.e., those where the brownfields tax credit is funding only site assessment and cleanup, the eligible expenditures are external to the building, thus easily distinguishable from the eligible expenditures for the historic tax credit. I have not been able to review each state statute, but the usual case would be that in-building asbestos and lead paint cleanup would not be eligible for the brownfields credits, unless demolition of the building is required as part of the remediation; this, again, keeps a clear distinction between the two credits.

For the four states that credit redevelopment expenditures over and above environmental remediation, the layering of brownfields and historic tax credits is complicated, but the experience has been that it still works. Several projects in Michigan have taken advantage of both the historic tax credits and the Michigan Single Business (brownfields) Tax Credit. This incentive, which was a 12 percent redevelopment credit, no longer exists, but it provided critical funding to at least two notable Michigan projects that also got the benefit of historic tax credits:

- The Neighborhood Service Organization's Bell Building in downtown Detroit was structured to include three different tax credits: state and federal historic tax credits, Michigan Single Business (brownfields) Tax Credit, and Low-Income Housing Tax Credit. The resulting $30.3 million in project equity funded more than 60 percent of the total $50 million total project cost.[4]
- The former Knapp Department Store Building in downtown Lansing involved successfully layering five subsidy sources, including both state and federal historic tax credits and the Michigan Single Business (brownfields) Tax Credit. The $36 million redevelopment project included $20 million in tax credits and other subsidies, and will create 22 residential units, a runway fashion and design incubator, and a ground floor restaurant.[5]

CONCLUSION

Projects that combine brownfields redevelopment and historic preservation are serving multiple public benefit objectives: protecting public health; bolstering neighborhood or downtown revitalization; preserving the nation's architectural heritage; and generating a constellation of smart growth benefits, including reduced vehicle miles traveled, lowered run-off, and reduced need for public infrastructure investments (relative to alternative growth patterns). However, it is rare that so much public good comes from purely private investment. Developers of projects that can combine brownfields and historic elements can and should look to public sector incentives to close gaps. Because tax credits are generally the most automatic and reliable of these incentives, projects that combine historic and brownfields tax credits should be (and are starting to be) a well-worn path. **FJ**

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TAKEAWAY

Click here for "State Brownfields Corporate and Income Tax Credit Programs" chart.

1 Baltimore Development Corporation, Site Pipeline, Sept. 2005 (personal files).

2 Spreadsheet via personal communication with the Missouri Department of Natural Resources; the study is summarized here: http://www.dnr.mo.gov/env/hwp/bvcp/hwpvcp-brownfields.htm; and in the Sept, 2007 newsletter of the Federal Reserve: http://www.stls.frb.org/publications/br/2007/a/images/BR_Sp_07.pdf

3 "Transferability" refers to whether the applicant can transfer (sell) the benefits of the tax credit to an entity that has greater tax liability. New York's "fully refundable" credit means that a taxpayer whose BCP credit exceeds his/her tax liability is eligible for a refund of that amount from the state.

4 Housing On-Line, "From Yellow Pages to Housing," Tax Credit Investor, June 2011.

5 Sources for the Knapp Building: *Lansing State Journal*; and *Lansing On-Line News*.