Summary

Fixing Rhode Island's Historic Tax Credit program

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The functionality of the Rhode Island Historic Tax Credit program has broken down at this critical juncture when the creation of housing, and particularly affordable housing, is critical. Historic Tax Credits have been a key contributor to housing creation: since 2013 when data is available, historic tax credit projects have provided 20% of Rhode Island's new housing units including 20% of the affordable units. The following actions are needed for this previously successful program to continue to provide important benefits in the creation of housing while enhancing neighborhoods and turning blighted properties into neighborhood assets.

Possible solutions:

1. **Create predictable funding for state historic tax credits**
   - Appropriate funding to replenish the program and make predictable annual allocations so the queue is not stalled. As of the November 2023 revenue estimating report, 57 projects are in queue, requesting $91 Million in tax credits to catalyze almost $500 Million in rehab investments.
2. **Create parity for residential projects**
   - Increase the percentage of the credit for housing projects from 20% to 25%, matching the current credit offered for commercial projects.
3. **Make prevailing wage requirements useable**
   - Apply the prevailing wage requirement to the amount of the state credit, not the total construction project costs.
   - Increase the per project cap of credits from $5 Million to $8 Million.
   - Exempt projects that include at least 20% affordable or workforce housing units, or are sponsored by nonprofit organizations, from the prevailing wage provision.
4. **Fix administrative obstacles that hamper the program**
   - Lower the fee from 3% of Qualified Rehabilitation Expenditures to 0.5%.
   - Increase time frames for construction starts and give the Division of Taxation discretion to grant extensions.
   - Extend the sunset to every five years.
   - Give the Division of Taxation the authority to provide details about the status of the queue and to manage the queue more efficiently.

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Long track record of benefits

Rhode Island's State Historic Tax Credit Program is a proven economic and community development engine. Over the last 22 years more than 300 historic buildings have been rehabilitated, using $442.8 million of state historic tax credits to catalyze more than $2.2 billion dollars in investments throughout Rhode Island in 24 cities and towns.

Despite the HTC program's outstanding track record and the near universal consensus of the benefits to communities from repurposing historic buildings and turning blighted areas into revitalized neighborhood assets, Rhode Island has structured its historic tax credit program almost as an obstacle course. Recent changes to the law threaten to make the program entirely unworkable, at least for construction projects over $10 Million.

The breakdown in use of Rhode Island's Historic Tax Credit could not come at a worse time as it limits the creation of housing at the height of the housing crisis. Since 2013 when data is available, projects using Historic Tax Credits have generated 20% of all housing in RI including producing 20% of all affordable housing in RI. The program is too important a contributor to helping Rhode Island's housing crisis to allow it to fall into disuse at this critical juncture.

Rhode Island rehabilitation development projects don't exist in a geographic or economic vacuum. Developers are leaving Rhode Island to work in other states where historic tax credit programs are not plagued by Rhode Island's unique set of obstacles and risk.

Obstacles to accessing the RI Historic Tax Credit

- **Large Fee:** Rhode Island requires an up-front, large, nonrefundable fee of 3% of Qualified Rehabilitation Expenditures. This fee makes participation in the program risky. For large projects, the fee can rise to $750,000.

- **Opaque Queue:** The way the "queue" of projects is managed is not transparent which makes it difficult for projects to plan and meet deadlines. A project has no way to determine where they stand in the queue and when they might be offered credits. A project can be in queue for years with no information on how close they are to receiving an allocation. Then, once they are notified that credits are available, projects have only 90 days to act.

- Further, the queue is inflexible, stalling the advancement of projects. Even if a project were willing to reduce its credit to match immediately available funds, there is no permission for such a negotiation and the queue continues to back-up. That could be the current situation where almost $1 Million is on hold as the next project in line is seeking some amount more than is currently available.

- **Unrealistic Timeframes:** The requirement to commence construction within 12 months of receiving approval by the RIHPHC is often impractical given the complexity of financing, and supply chain and workforce scarcity issues. The project launch, project progress, and completion schedule requirements of the program are inflexible, even in the face of understandable delays due to changing market conditions and interest rates.

- **Sunsets annually:** The program sunsets each year unless the General Assembly acts, adding uncertainty and risk to participation in the program. The sunset seems unnecessary as the funds in the trust fund are already limited and control the future of the program. Also, as a 22-year program that has generated more than $2.2 billion in investment in the state, the program has earned the right to no longer be on such short "probation".

- **Disadvantages housing creation:** Despite Rhode Island's housing supply and affordability crises, the program currently disadvantages housing projects. While a commercial project is awarded 25%, a housing project is limited to a 20% credit.

- **Unique Prevailing Wage requirement:** Based on reports from a wide variety of developers, the prevailing wage requirement that started in 2023 for construction projects over $10M increases costs anywhere from 25 – 40%.
    - Those increased costs more than negate the value of the credit, swelling costs to a point where the subsidy is a negative benefit.
    - Large rehabilitation projects can't be done without the state historic tax credit, but under the current program, large projects also can't get done with the historic tax credit.
    - One purpose of HTC is to put rehabilitation on parity with new construction, directing development away from "greenfields" and targeting blighted properties. The prevailing wage requirement adds costs to historic rehabilitation projects, so they are no longer on par with new construction.
    - The increased per unit cost can make a historic rehabilitation project ineligible for affordable housing funding.
    - While increasing costs, there is no relief in the $5 million project cap to accommodate increased costs associated with the prevailing wage requirement.

- Many independent contractors, a backbone of RI small businesses, are closed out of working on larger projects.
- Prevailing wage applies to the entire construction project, not just the value of the credit, despite the state credit being only one component of a project's financing. The increased costs exceed the value of the credit, making projects infeasible.
- Prevailing wage shops are not always available for certain trades and in certain regions, so the requirement for 100% prevailing wage cannot be met.

- **Funding for historic tax credits is almost exhausted, and replenishment is not predictable:** The program is all but out of funding and there is no predictable allocation to ensure continued availability of credits. At the 2023 November Revenue Estimating Conference, 57 projects were then in queue seeking more than $91 Million in credits that would leverage almost one half billion in rehabilitation investments. The $920,000 in unused credits remaining in the trust fund is not enough to fund the next project in line and projects have stacked up in queue with none moving forward. Twenty-five new applications were filed between May 2023 and November 2023.

Rhode Island is disadvantaged in the regional historic tax credit market

No other state has anything approaching Rhode Island's fee structure. Nearby, neither Maine nor Massachusetts imposes any fee, and while Connecticut is allowed to charge a fee of $1,000, it is usually waived and not collected.

No other state threatens to sunset their program each year. Most programs don't sunset. Those states that do have a sunset have a three-to-five-year period.

No other state disadvantages housing by providing a lower percentage than to commercial project. To the contrary, several states (including Maine and Connecticut) provide a bonus for housing projects.

Only one other state in the country, New Jersey, has a prevailing wage requirement tied to a historic tax credit project, and that New Jersey program provides a 40 - 45% credit (versus Rhode Island's 20 – 25% credit).

Other states operate with more transparency about when projects can expect to learn about funding decisions.

Other states appropriate funds annually to their programs.

Given the obstacles to the use of Rhode Island's tax credit, many developers have indicated they are no longer able to work in Rhode Island as project financing cannot be "penciled out" and have walked away from historic properties in desperate need of rehabilitation. For instance, planning for projects in Woonsocket and West Warwick has ceased and projects in Newport and Providence are searching for ways to go forward.

Possible solutions:

Create predictable funding for state historic tax credits

- Appropriate funding to replenish the program and make predictable annual allocations so the queue is not stalled. As of the November 2023 revenue estimating report, 57 projects are in queue, requesting $91 Million in tax credits to catalyze almost $500 Million in rehab investments.

Create parity for residential projects

- Increase the percentage of the credit for housing projects from 20% to 25%, matching the current credit offered for commercial projects.

Make prevailing wage requirements useable

- Apply the prevailing wage requirement to the amount of the state credit, not the total construction project costs.
- Increase the per project cap of credits available from $5 Million to $8 Million.
- Exempt projects that include at least 50% affordable housing or workforce housing units from the prevailing wage provision.
- Exempt projects that are sponsored by nonprofit organizations from the prevailing wage provision.

Fix administrative obstacles that hamper the program

- Lower the fee from 3% of Qualified Rehabilitation Expenditures to 0.5%.
- Increase time frames for construction starts to 24 months and allow the Division of Taxation to grant 6 – 12 months extensions if the causes of delay are for good reasons, often beyond the developer's control.
    - **Support H7920 that would extend the program to June 30, 2029**
- Either eliminate the sunset (acknowledging the program is controlled by the amount of funding in the trust fund) or extend the sunset to every five years.
- Give the Division of Taxation the authority to provide details about the status of the queue, requiring them to maintain an up-to-date list of projects in queue with assigned project number, amount of credit, and address of project.
- Give the Division of Taxation the authority to manage the queue more efficiently by offering projects next-in-line the option of accepting a reduced credit that matches available funding instead of waiting for the trust fund to replenish.

Illustration of the impact of recommended changes to the program on a $40 Million residential project, such as a mill-reuse.

$40M Residential Rehab Project	Credit	Fee	Increase costs due to Prevailing Wage (estimated 35%)	Net value of Credit	Difference to the 2013 program
Current program – 100% PW	$5 Million	$600,000	$14 Million	-9,600,000	-$14Million
PW applies to the $5M Credit	$5 Million	$600,000	$1,750,000	$2,650,000	-1,750,000
PW applies to a higher $8M cap	$8 Million	$600,000	$2,800,000	$4,600,000	200,000