



SAVING HISTORIC PLACES

MODULE  
**04**

Preservation Toolkit

# Funding Sources & Incentives

Historic rehabilitation projects are typically funded from multiple sources. In financial speak, we call this the “capital stack”—the combination of all the funding pieces that go into the purchase and improvement of a particular property. The most common sources in the historic rehab capital stack are outlined on the following pages.

# Funding sources for Historic Rehabilitation in Oregon

Available to

<i>Funding Source / Incentive</i>	<i>Income-Producing Commercial / Mixed Use</i>	<i>Nonprofit / Public Projects</i>	<i>Owner-Occupied Residential</i>
<b>Owner/Investor Equity</b>	Yes	Yes	Yes
<b>Bank Loans</b>	Yes, if borrower and project meet lender's requirements.	Yes, if borrower and project meet lender's requirements.	Yes, if borrower and project meet lender's requirements.
<b>Urban Renewal Funds</b>	Yes, if located in an Urban Renewal Area	Yes, if located in an Urban Renewal Area	Unlikely
<b>20% Federal Historic Tax Credit</b>	Yes, if meets eligibility requirements	Nonprofits can use if working with a tax credit investor. Publically-owned projects cannot utilize	No
<b>10% Tax Credit for non-designated buildings built before 1936</b>	Yes for non-residential uses	Nonprofits can use if working with a tax credit investor.	No
<b>Other Tax Credits - LIHTC or NMTC</b>	Yes	Nonprofit - yes; publically-owned - no	No
<b>Special Assessment</b>	Yes	No	Yes
<b>Grants</b>	Unlikely	Yes	Unlikely

See more detailed information regarding these funding sources and incentives in the following pages.

## Owner/Investor Equity

The majority of historic rehabilitation projects involve some cash funding that comes from an owner and/or an investor. In a project that has a simple capital stack, such as owner's equity and a bank loan, the equity might comprise 35% of the funding and the loan would comprise 65%. Most lenders want the owner to have "skin in the game"—that is, a financial motive to make the building profitable and successful for the long-term.

## Bank Loans

The world of lending is highly complex with all types of lenders specializing in different debt sources. For purposes of this Toolkit, we are going to focus on the construction/permanent loan combination that is typically used to fund the rehabilitation of Main Street-scaled properties.



A construction loan is a short-term loan that is used to finance the construction of the project. Payments are typically interest-only.

The duration of the loan is based on the length of construction plus the amount of time anticipated to lease up the building until it is financially stabilized. When the property is leased and tenants are paying rent, the construction loan is paid off by a permanent loan. The permanent loan has an amortized payment just like a typical home mortgage. It is typical for permanent loans to have payments amortized over 25 years, but require a balloon payment in the 10th year, necessitating a refinance of the property at that time.

It is important to note that commercial lenders do not finance 100% of the cost of a project. They leave themselves a healthy cushion in the event that the project fails and they are forced to foreclose. A loan is typically sized based on a percentage of the appraised value at project completion and the amount of income the project is anticipated to generate after the operating expenses are paid.

Lenders typically perform extensive due diligence to ensure they are lending to an individual or partnership that is credit-worthy and financially solvent, as well as to ensure that the project itself is financially viable. Lenders often have a number of prerequisites to funding a loan including pre-leasing for commercial/retail spaces, market studies demonstrating sufficient demand for uses such as hotel and housing, an experienced development team, the remediation of environmental contaminants, and others.

## Urban Renewal Funds

Urban renewal is a state-authorized tool to invest property tax revenues in projects that ultimately result in higher property values in a designated urban renewal area. Typically, cities or counties designate an urban renewal agency with the authority to raise and leverage money to help revitalize neighborhoods. Urban renewal funds available to a historic rehabilitation project can come in the form of storefront improvement grants, low-interest loans, and financial assistance to determine the feasibility of a development project. To take advantage of these funds, the building must be located within an urban renewal area and meet other criteria set forth by the local urban renewal agency.

## 20% Federal Historic Tax Credits (HTCs)

The federal HTC program provides a 20% tax credit on the substantial rehabilitation of income-producing historic buildings which have been listed in the National Register of Historic Places. A tax credit is a dollar-for-dollar credit on your federal income tax liability. This is different from a deduction, which reduces your taxable income. If you spent \$500,000 to rehabilitate a historic building, you could get \$100,000 of that back as a credit.

Large rehabilitation projects can work with an investor who becomes a partner in the project and provides equity in exchange for the credits. This means that the tax credits are turned into cash that can help fund the project. Most investors are looking for projects with approximately \$10 million in eligible costs, though there are some investment entities that will participate in smaller projects. Typically, 25% of the equity is paid when the investment transaction closes, 55% when



Federal Tax Credits were utilized for this conversion of an old Portland fire station into office space

the completed project has obtained certificate of occupancy, and the final 20% when the final project certification is obtained from the National Park Service. Note that this means that not all of the tax credit equity would be available as a funding source, as the majority would be disbursed after the project is complete.

Investors typically require an annual preferred return of at least 2% on their equity investment and 5-7% when they exit the ownership structure after the five-year tax credit recapture period has expired. Additionally, investors have closing prerequisites similar to lending institutions.

**For smaller projects** where it is not feasible to partner with an equity investor, HTCs can be claimed by the property owner the year in which the project is completed and placed in service. Credits can be carried back one year and forward 20 years. There is a five-year tax credit recapture period during which the ownership of the property cannot change without resulting in repayment of the credits.

The tax credit requires that a project adhere to the **Secretary of Interior Standards for Rehabilitation** and go through design review of exterior and interior alterations by both the State Historic Preservation Office and the National Park Service, in addition to any local building department or planning review. The design review process is intended to ensure that alterations do not negatively affect the building's historic character-defining features. The application review takes 60-90 days and requires architectural plans, photographs, and a written description of the scope of work. The application cost varies based on the cost of the project.

More information can be found at: [www.nps.gov/tps/tax-incentives.htm](http://www.nps.gov/tps/tax-incentives.htm)

## 10% Federal Tax Credits for Non-Designated/Non-Contributing Buildings Built before 1936

A 10% tax credit is available for the rehabilitation of older buildings placed in service before 1936 that are not individually listed in or eligible for the National Register, and are not contributing to a National Register historic district. The building must be rehabilitated for non-residential use. In order to qualify for the tax credit, the rehabilitation must meet three criteria: at least 50% of the existing external walls must remain in place as external walls; at least 75% of the existing external walls must remain in place as either external or internal walls; and at least 75% of the internal structural framework must remain in place. There is no formal review process for rehabilitations of these non-designated historic buildings.

## Other Tax Credit Funding Sources

In addition to the Historic Tax Credit, there are two other tax credit programs that can and have been used on historic rehabilitation projects. Typically, these have been substantial multi-million

dollar projects. Both programs require a tax credit investor who provides equity in exchange for the credits.

**Low-Income Housing Tax Credits** are a substantial financing source for income-restricted multi-family housing projects. Investors buy these tax credits in qualified properties that have received a state allocation. In exchange, the owner agrees to rent a specific number of units to qualified tenants at specified below-market rents. Because of their complexity, the use of these credits requires a development team highly experienced in low-income housing development projects.



Baker City Apartment

Like the Low-Income Housing Tax Credits, the **New Markets Tax Credit (NMTC)** is a federal tax credit designed to encourage investment in low-income communities and it is also allocated annually on a competitive basis. A project must be located in a qualified low-income census tract and demonstrate a direct benefit to the low-income community. This usually entails a project providing higher-wage jobs and/or needed services such as a grocery store, clinic, daycare center, or other community-focused use. At least 20% of a project’s gross income must come from commercial uses. The benefit of NMTC to real estate development projects come in the form of tax credit equity or an interest rate reduction on a loan.

## Grants

Grants are typically a small portion of the funding needed to rehabilitate a historic building. In Oregon, the State Historic Preservation Office currently offers **Preserving Oregon** matching grants up to \$20,000 for National Register-listed properties. Resources in public and nonprofit ownership are given preference over those in private ownership. There are other charitable foundations that fund historic preservation including The Kinsman Foundation, Oregon Community Foundation, Oregon Cultural Trust, and the National Trust for Historic Preservation. It should be noted that grants to fund a private residence or privately owned commercial property are very unlikely. Depending on the proposed use, be it health care, entertainment, economic development or programs that support children or low-income residents, other grants may be available to support non-profit rehabilitation projects as well.



Rivoli Theater, Pendleton

## Oregon's Special Assessment of Historic Property Program

While not a direct source of funding, Special Assessment provides a property tax break, whereby a historic property's assessed value is reduced and frozen for an initial 10-year term. By applying prior to the commencement of a significant capital investment, the benefit is maximized by locking in the property's pre-rehabilitation value. There is a modest application fee equal to 1/10 of 1% of the assessed value. A State Historic Preservation Office (SHPO)-approved preservation plan is required and 10% of the real market value of the property must be invested within the first five years.

At the end of the 10-year period, the property is reassessed using the county-wide changed property ratio for that property type. Depending on the amount invested during the 10 years and market conditions at the time of reassessment, owners should be aware that there can be a dramatic increase in their assessed value that is difficult to predict at the time of application.

More information can be found at:

[www.oregon.gov/OPRD/HCD/SHPO/Pages/tax\\_assessment.aspx](http://www.oregon.gov/OPRD/HCD/SHPO/Pages/tax_assessment.aspx)

## Loans for Residential Properties

For single-family residential properties in good condition with modern systems and structural integrity, a traditional home mortgage or equity loan is the most likely funding source. Of course, to secure any loan, the borrower's credit history and ability to repay the loan is paramount. While requirements vary from lender to lender, generally speaking, banks will not provide permanent financing (such as a typical 30-year mortgage) for aged properties with significant code deficiencies, safety and structural issues, missing or greatly out-of-date building systems, excessive deferred maintenance, or other issues they deem a barrier to resale upon foreclosure. Additionally, building insurers can be reticent to provide affordable coverage (or any coverage at all) for aged buildings that have not been modernized and insurance is typically required by any lender, creating yet another obstacle in the financing game.



Beeks House, Washington County

For dilapidated historic houses with little inherent monetary value, it may be a significant uphill battle to secure any upfront financing through traditional loans. These properties may require a cash buyer who can use their own funds to stabilize the property and increase its value before seeking traditional financing. There is a program through HUD's Section 203(k) program that insures mortgages covering the purchase (or refinance) and rehabilitation of a home in need of repair and/or modernization. Section 203(k) potentially saves borrowers time and money, while also protecting the lender by allowing them to have the loan insured by the government even before the condition of the property is improved. Funds allocated toward the rehabilitation are placed in an escrow account and released as work is completed. The 203(k) program holds the most promise for financing the rehab of dilapidated historic single-family properties, yet is still a complex funding source that is not perfect for every building and every borrower.



## == If Historic Places Matter to You, Join Restore Oregon! ==



Since 1977 Restore Oregon has worked to preserve, reuse, and pass forward the historic homes and buildings, bridges and barns, churches and Main Streets that make Oregon, Oregon.

As a nonprofit, our ability to advocate, deliver programs, and produce materials like the Preservation Toolkit depends on the support of people like you. We invite you to stand up for the historic places that matter to you and become a member by visiting us at [restoreoregon.org/join](https://restoreoregon.org/join).

Thank you!



1130 SW Morrison Street, Suite 318  
Portland, OR 97205  
503 243-1923 | [info@restoreoregon.org](mailto:info@restoreoregon.org)  
[restoreoregon.org](https://restoreoregon.org)

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