

# Novogradac Journal of Tax Credits

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## HISTORY AND THE HILL



### Historic Tax Credit Recapture Study Supports Continued Exemption from Volcker Rule

By John Leith-Tetrault, National Trust Community Investment Corporation

With the February 13 deadline approaching for comments on the Volcker Rule, (Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act), *History and the Hill* has learned that the National Trust for Historic Preservation and Novogradac and Company LLP are preparing to release the first ever historic tax credit (HTC) recapture study. The timing couldn't be better and the findings on HTC investor recapture experience are very good news for the industry.

#### Background

The Volcker Rule, named after former Chairman of the Federal Reserve Paul Volcker is of interest to the HTC industry because it sets out limitations on equity investments by banks, including those made in real estate. HTC investments in certified historic properties, similar to low-income housing tax credit (LIHTC) investments, have always been made in the form of equity paid in, based on the achievement of performance benchmarks. Comments on these regulations were requested on October 11 by the Federal Reserve, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and the Securities and Exchange Commission.

During the debate on the Dodd-Frank Bill, the Historic Tax Credit Coalition, with the help of Rep. Allyson Schwartz, D-Pa., Earl Blumenauer, D-Ore., Brian Higgins, D-N.Y. and Russ Carnahan, D-Mo., was able to obtain an exclusion from the Volcker Rule by explicitly listing historic federal and state credit transactions in the definition of "public welfare investments" as outlined in 12 U.S.C. 24.

The study will not be finalized until just after the February publication of this column but preliminary results are promising. As of the time of this writing, only seven (a cumulative rate of about 1 percent) of the 650 surveyed transactions, have experienced recapture.

#### Study Results

The study will not be finalized until just after the February publication of this column but preliminary results are promising. As of the time of this writing, only seven (a cumulative rate of about 1 percent) of the 650 surveyed transactions, have experienced recapture. Survey respondents were limited to direct investors to avoid double counting syndicator transactions closed with direct investors. The study covers the 10 years from 2001-2010 and uses National Park Service data for Part 3 completed transactions during that timeframe.

#### Comparison to Other Real Estate Performance

The most comparable survey conducted in the tax credit industry has been the work done on the LIHTC by Fred Copeman, a principal at the Reznick Group. In its August 2011 report, "The Low-Income Housing Tax Credit at Year 25: A Current Look at Its Performance," the Reznick Group tracks the cumulative foreclosure rate of LIHTC transactions from

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1997 to 2010. With some caveats for possible under reporting, the study shows a foreclosure rate of 0.62 percent. It is unclear from the report whether these foreclosures occurred during or after the 10-year LIHTC vesting period and resulted in actual recapture. The 0.62 percent rate represents 98 foreclosures among 15,868 properties.

Equivalent cumulative foreclosure rate data for all commercial loan categories are difficult to find, but the Mortgage Bankers Association's (MBA) report Mortgage Delinquency Rates for Major Investor Groups for the 3<sup>rd</sup> quarter 2011 shows that the current delinquency rate for FDIC-insured banks and thrifts for commercial/multifamily loans 90 days delinquent or on non-accrual is 3.75 percent. The same MBA report indicates that the delinquencies for commercial loans held in commercial mortgage backed securities that range from 30 or more days late to real estate owned (REO) is currently 8.92 percent. These percentages reflect the high rates of the current recession and not a cumulative rate during a study period, as is the case with both the LIHTC and HTC studies.

### Industry Implications

The preliminary results of the HTC recapture study support earlier anecdotal evidence among industry investors and syndicators that the HTC, when viewed in comparison with commercial lending and investment transactions, generally, is a safe and sound investment. This finding may reflect the relatively short five-year compliance period, the low loan-to-cost ratios (typically 50 percent or less) of these projects and the high level of sophistication and experience of the developers that make use of the federal HTC. The ability of historic rehabilitation to increase surrounding property values and attract additional investment may also be factors.

Today's regulatory and political climate is threatening to all federal tax credit programs. The various federal regulators of banking and thrift institutions will decide this year which credits will continue to enjoy Volcker Rule exemption as public welfare investments. All three tax credits, the HTC, new markets tax credit and LIHTC, will need to present in tax reform hearings this year evidence to justify their continued existence. The HTC recapture study is timely for both purposes and a step in the right direction for the HTC industry. ❖

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