

## PROPOSED HISTORIC RESTORATION TAX ABATEMENT PROGRAM

In accordance with T.C.A. § 67-5-218, Councilmember Syracuse and the Metro Historical Commission have initiated a project (BL2019-3) to incentivize long-term protection of historic properties by offering a property tax abatement. According to the T.C.A, the requirements and administration of the program will need to be approved by the Mero Historic Zoning Commission. This document provides information as to how the program will likely work.

### What is a Historic Tax Abatement?

A tax abatement is a freeze on taxes granted by a government to encourage specific activities such as local designation (historic preservation of local historic resources) and economic development. Tax abatements usually last for a defined period time or in rare cases indefinitely.

### Reasons for a Tax Abatement

- Encourages the local designation and therefore the long-term preservation of historic buildings and sites.
- Provides a financial incentive to rehabilitate existing property where zoning allows for a greater financial return to demolish and develop new.
- Designed to improve neighborhoods and increase the value of properties that might otherwise be demolished or remain vacant.
- Encourages rehab over replacement new construction, which has multiple benefits to the growth of a municipality. Rehab of existing buildings is more likely to add to the affordable/accessible housing pool and more likely to serve new and small businesses than new construction. Rehab is more environmentally sustainable than new construction as it retains embodied energy and keeps valuable building materials out of the landfill. In Metro Nashville, 23% of the waste we send to landfill is created from construction and demolition waste. When landfilled, this material can create greenhouse gases.
- Reduces the cost of living or the cost of doing business for a temporary period of time.
- Stimulates the economy by encouraging rehabilitation. Rehab keeps more money and jobs local than new construction. This same activity improves property and communities, which means higher property tax revenue for the city once abatements expires.
- Encourages continued development within established areas with existing infrastructure rather than encouraging sprawl.

**Benefit to the City**

The amount the city potentially forgoes in additional tax revenue is offset by the benefit the city receives from long-term protection of historic properties. Local historic designation is proven to have a positive economic value to Nashville. (Please see [The New Nashville: A Study of Impact of Historic Preservation](#) prepared by PlaceEconomics.) Once the improvements are made and the abatements expire, the properties then have higher appraisal values, allowing them to be taxed at a higher amount. Without the incentive, the property might be lost/demolished, or not be improved, and therefore it would not be bringing in a higher tax amount.

**Potential Economic Impact for Metro** *Provided by PlaceEconomics*

Donovan Rypkema provided an example assuming a project that is \$50,000, which is half the minimum amount proposed in this draft but useful in understanding the impact. If a \$50,000 historic residential rehabilitation project were to take place today, and if the amount spent on the project were fully reflected in the appraised value of the property, here would be the consequences from a property tax collection basis:

Increased Appraised Value	\$50,000
Assessment Ratio	25%
Increased Assessed Value (\$50,000 x 25%)	\$12,500
Tax Rate	\$3.155/\$100
Increased Taxes (\$12,500 x .03155)	\$394.00

If, however, the abatement was adopted, that enhanced value of the property would not be subject to taxation for ten years. Because property taxes are collected every year, and because a dollar received in the future is less valuable than a dollar received today, future streams of income need to be “discounted”, that is reduced to reflect what that future receipt is worth today – Present Value. For this calculation a “discount rate” is required. For this example, a discount rate of 6% was used, reflecting an amount slightly higher than the interest rate Metropolitan Nashville has to pay on municipal debt.

If the \$50,000 investment in a residential property were to be taxed immediately, over the next 25 years Metropolitan Nashville would receive an additional \$9,850 while if the abatement were in place the total receipts would be \$5,910. On a present value basis, however, the value of those receipts with no abatement would be \$5,037 while with the abatement a present value would be

\$2,137, reflecting a present value “cost” through foregone revenues of \$2,900 or about 5.8% of the project cost.

In the case of a commercial property if the \$50,000 investment were to be taxed immediately, over the next 25 years Metropolitan Nashville would receive an additional \$15,775 while if the abatement were in place the total receipts would be \$9,465. On a present value basis, however, the value of those receipts with no abatement would be \$8,066 while with the abatement a present value would be \$3,422, reflecting a present value “cost” of \$4,644 or about 9.3% of the project cost.

HOWEVER, the analysis above assumes that the investment would take place with or without the tax abatement. One purpose of the incentive is to encourage investment that otherwise is less likely to happen. If the example investment did not take place without the incentive, then the increased revenue to Metropolitan Nashville over the 25 years would be \$0. Therefore, every time the incentive was the catalyst for the investment, meaning it would not have taken place otherwise, the Metropolitan Government would have received a net present value benefit of \$2,137 for the residential project and \$3,442 for the commercial project.

When the incentive prevents demolition, the city gains in multiple ways that are not necessarily calculable in dollar amounts. For instance, valuable building materials are not sent to a landfill with a loss of embodied energy. Historic buildings that provide Nashville its unique identity will remain. Rehabilitation creates more jobs and keeps more money local than new construction and many other positive impacts. All of the purposes for which historic districts were initially created would be advanced and enhanced with the adoption of the program.

### Other Programs

Since this is a new program, a lot of guess work would need to be utilized to determine a direct impact; therefore, staff turned towards other programs to help define a potential economic impact. Although these programs have different qualifications, the general value of such a program is useful to note. California’s Mills Act is similar to a tax-abatement. It uses a market-based approach to preservation by encouraging designation in exchange for tax reductions. A [study](#) conducted by Andrew J. Narwold, professor of Economics with the University San Diego found that under the Mills Act, property taxes are lowered on the historically designated properties, costing local governments tax revenues but the overall taxable basis for the neighborhood increases by \$1.8 million for each historical building. Estimates show that local governments might expect a net tax revenue gain of \$14,000 per residential building per year.

Brandon Cole Spencer-Hartle in his [thesis](#) for University of Oregon reviewed Oregon’s similar program, which began in 1975 and is called a “Special Assessment of Historic Property Program.” In 2009, Spencer-Hartle found that the tax expenditure of the program amounted to just .1781 percent of the total property taxes collected in Oregon. (The expenditure for the local governments is not known because the change in assessed value is not tracked.) Because of the

increased improvement values to individual properties and the ripple effect of improvements to surrounding properties and neighborhoods, Spencer-Hartle quotes Earl Blumenauer as saying, “If we could go back and calculate the total increase in property tax revenue brought by the program, there would be no question that it was a success for the tax rolls.”

The program in Texas, is designed for each municipality to create their own program. Approximately 27 Texas cities have created a program. Dallas, TX started theirs in the late 1990s. Recently, in one year, they had 13 non-RS/R applications, which represented an investment of \$9,874,672 and 49 residential applications.

All of these programs have remained in place, potentially revised, but have remained for many years, which is evidence that these municipalities have found value in the programs. These programs also show us that we are not likely to be inundated with more projects that can be reasonably managed.

### **Potential Economic Impact for Property Owners**

A “real-world” local commercial example could be the rehabilitation of the Holston House at 118 7th Ave N. Historically, the building is known as the James Robertson Hotel. The architectural firm of Marr and Holman designed the 82,000 square foot building, which was constructed in 1929. Rehabilitation began in 2017 and the building now houses 191 guest rooms as part of the Unbound Collection by Hyatt and three food and beverage spaces. In 2017, the building and land was appraised at \$11,806,000 with an estimated tax bill of 155,102.51. In 2018, the building and land was valued at \$26,145,200 with an estimated tax bill of 343,485.18, an estimated increase of \$188,382.64.

If the owners had sought a Historic Landmark and the tax abatement program had been available for them to apply for, their taxes would have been frozen at the pre-abatement rate for a total of ten years, a savings of 1,883,836.40 over the ten-year period; and the income to the city would have remained steady. In addition, the local landmark would allow for the future protection of the property if the ownership or use changes. All of the work that was actually conducted on the exterior of the building would have met the design guidelines for a Historic Landmark so they would not have had to change their plans to take advantage of the credit. The owners also used the Federal Tax Credits for rehab, and they would have been able to pair that incentive and any other available incentives for rehab with the abatement. The requirements associated with the Tax Credits mirrors the design guidelines that would have been followed if the abatement had been used.

### **How Often will the Incentive be Used**

For budgeting purposes, it would be optimum to reliably predict how often this proposed incentive would be used. Unfortunately, there are too many variables for making such a forecast; however, there are some indicators that might establish a range of potential use.

PlaceEconomics, the author of Nashville's Economic Impact Study, provides the following information.

PlaceEconomics is currently conducting an analysis for the City of Baltimore on the use and impacts of a property tax credit program they have had for nearly 25 years. Baltimore averages approximately 140 projects a year; however, the investment that represents is more than seven times what is currently being invested annually in eligible properties in Nashville. With that comparison, Nashville could expect an average of 14 projects per year. That number could increase with applications for new historic overlays.

The number of projects could increase if property taxes increase. Currently, Nashville's tax rate is very low relative to other US cities, but an increase could expand interest in the program.

Although it is possible to estimate that we may receive approximately 14 projects per year there is no way to speculate on the value of the projects, which will drive the permit fee. Therefore, there is no reasonable way to forecast what the associated application fees may mean in revenue.

### **Potential Administrative Impact**

The program will likely increase the number of properties protected--a long-term benefit--without a dramatic increase in workload--a short-term consideration--if the program averages 14 projects a year.

There may be an increase in individual Historic Landmark designation, but the incentive is not likely to result in the designation of districts, which are far more time consuming to designate and steward than individual properties. It is the role of the applicant to provide the documentation to prove that a building is eligible for local designation; therefore, designation is not considered a significant time-drain for the MHZC staff or commission.

Many of the properties that are likely to use the incentive are already designated. There are approximately 10,500 properties under some type of historic overlay and therefore already qualify. The purpose of the incentive is not to incentivize rehab itself, as it is in some cities that are addressing blight, but rather to incentive long-term protection of Nashville's historic buildings. Therefore, the work that will use the incentive on the properties already designated is likely to require review anyway.

### **Comparison to Other Municipalities**

## Exhibit A

Tax abatements (also known as a tax freeze in some municipalities) are used by many cities across the country and are regarded as one of the most cost-effective incentive programs for discouraging demolition. In typical property tax assessment processes, when an improvement is made to a property the amount that the improvement has increased the value of the property is reflected in an increased value for tax purposes. A tax abatement defers reflecting the increased values of the property as a result of those improvements for a fixed amount of time. When improvements are immediately reflected in increased taxes, many cities find that there is a reluctance to improve properties. In today's market, that is not the case for Nashville; however, many property owners find it more financially beneficial to demolish historic properties for new buildings. The abatement would make it more feasible for a property owner to spend money on improving an existing building rather than sending it to the landfill to start over with a new building.

Many states offer some type of historic tax abatement program. They vary in years and qualifications, but most have a review process for the proposed work with the local historic commission. The following are examples of states that have enabling legislation for a tax abatement program: AL, CA, FL, GA, IL, IN, IA, KY, LA, ND, OR, SC, SD, TX, VA, WA. The programs are all very similar to Tennessee's enabling legislation in terms of the overall structure of the programs. For instance, Oregon and Florida's abatement programs, as well as others, last for 10 years. Most all use their existing design review board to review the proposals.

Philadelphia created their program in 2000. The purpose of their program was to incentivize improvements and expansions of the city's real estate, with the ultimate goal of growing the tax base. It is not for historic properties only, as many programs are and as Tennessee's program is written. The purpose of Nashville's program will be to provide for an economic incentive to keeping existing historic buildings rather than demolishing for presumably higher-valued development allowed by base zoning. Despite the different goals, a study done by Kevin Gillen, PhD., senior economic advisor at Houwzer, a Philly-based real estate agency, reveals information that could be useful to Nashville. From 2000 to 2008, the city granted abatements to 10,404 single-family properties. The study revealed that abated properties generally sold for prices that were higher than their original purchase price once their abatements expired, meaning that the city will benefit from the increased value of the property at the end of the abatement period. However, their general appreciation rate has lagged that of non-abated properties. (<https://thephiladelphiacitizen.org/the-abatement-debate/>) Gillen states that the "improvement/construction of these properties has contributed significantly to the city, with over \$100 million in direct tax revenue to date and approximately half of that in each year since their abatements have expired." (<https://thephiladelphiacitizen.org/the-value-of-the-abatement/>)

In addition, the study showed that the "value of the buyers/investors placed on the abatement is very large and very real: adding approximately 15-20 percent to a property's purchase price." For Nashville, this should mean that the abatement can serve to offset the loss of real or

perceived value in demolition and new construction. (<https://thephiladelphiacitizen.org/the-abatement-stakes/>)

Most of the states that do not offer a tax abatement program, and even most of the states that do offer an abatement program, offer a state tax credit for rehabilitation of historic properties. Tennessee is one of only 15 states that does not have a state historic tax credit.

### **Properties that Might be Beneficiaries of the Program**

- Storm and bomb damaged properties
- Properties in historic overlays requesting demolition based on the building needing significant rehabilitation to be usable
- Morris Memorial Building, Charlotte Avenue
- State Prison
- Polk Avenue Day Home for Working Women's Children, 1600 10<sup>th</sup> Ave N
- Marathon Motor Works, Clinton Avenue
- Federal Reserve Bank of Atlanta, 226 3<sup>rd</sup> Ave N
- 1716 Greenwood (former Hobson ME Church South)
- Masonic Home for the Aged, Inglewood
- 1700 Fatherland, former church
- Music Row's NRE buildings

## PROPOSED ADMINISTRATION OF THE PROGRAM

### Eligibility Requirements

#### Property & Owner Qualifications

- The building(s) must be contributing in a local historic overlay. (Application for the overlay may be submitted at the same time as the tax credit application.)
- The property must not be zoned R or RS.
- The property must be endangered which could be a situation where the existing zoning more than doubles the development potential beyond what the historic building can physically accommodate. For instance, a 4-story building that is zoned for 20 stories. It could be a physical threat such as damage caused from a disaster or years of neglect.
- The property owner must be up to date on tax payments for the property.

#### Project Qualifications

- The value of detached new construction on the lot does not qualify and should receive a building permit and preservation permit separate from the rehabilitation project, assuming that new construction on the site meets the design guidelines.
- The project should be a significant rehab and should not be maintenance alone, as maintenance generally does not increase value enough for the program to have value to the property owner.
- The value of the rehab work must be at least \$100,000.
- All proposed work must meet the applicable design guidelines and standards, even work planned for structures on the property that are not historic and new construction.
- The program can only be used once for any one property.

### Administration of the Program

MHZC staff will be responsible for administering the program, tracking applications and projects and communicating approved projects to the Office of the Trustee and the Property Assessor. The Assessor will make no changes to assessment; instead the Trustee will invoice the property owner based on the pre-improvement value, obtained from the Property Assessor's website at the time of the application.



## Program Timeline

1. Applications will be taken by the deadline of the regularly scheduled MHZC public hearing for July.
2. As a part of the application, MHZC staff will confirm with The Trustee that the owner is up to date on all tax bills.
3. Once approved, the applicant will conduct approved work and request inspections, as required.
4. The project must be completed and inspected by the application deadline for the MHZC's regularly scheduled public hearing in August. (This gives an applicant at least a year to complete a project.)
5. Commission will review the final project and determine whether or not to send the abatement to the Trustee's office at the regularly scheduled August public hearing.
6. If approved, Staff will send information regarding the approved project to the Office of the Trustee by their billing deadline of September 1.
7. Abatement period would begin on January 1<sup>st</sup> on the year after approval of a completed project and continue for 10 years.

## Application & Review Process

An application will include

- Application with the Planning Commission for local designation, if the property is not already in a historic overlay
- Preservation Permit application for the proposed project
- Building Permit application
- Abatement Application
- Affidavit of Historic Tax Abatement Agreement filed with the Davidson County Register of Deeds to ensure that future owners understand when the abatement expires and can plan for the increased tax rate
- Application fee

The MHZC will review all components of the application and ensure that proposed works meets the applicable standards and guidelines. Exterior alterations and the exterior of new construction shall be reviewed by the MHZC using the design guidelines for Historic Landmarks, The Secretary of Interior's Standards for the Treatment of Historic Properties, and the design guidelines applicable to the type of designation of the property. Where these documents may conflict, the more restrictive guidance shall be followed. Interior work will not be reviewed unless it affects the exterior or has the potential to jeopardize the structural health of the building or if the property has or is applying for a Historic Landmark-Interior designations. MHZC staff

will conduct inspections throughout the project and review the completed project to ensure work meets the Preservation Permit.

The abatement can be rescinded by the MHZC if the owner becomes delinquent with his or her property tax payments or is in violation of any permits. In the case of abatements being rescinded, the historic overlay will not be removed. The abatement can be rescinded if the building is demolished, work is done without a Preservation Permit or does not comply with the approved permit. The abatement can be rescinded if the property owner conducts work without applicable permits on any other property that they own in Metro Nashville. If the abatement is rescinded the owner would be responsible for paying back the difference between the abated value and the improved value. Pursuant to the provisions of § 2.68.030 of the Metropolitan Code of Laws, the MHZC's decisions may be appealed to the Chancery Court of Davidson County or the Circuit Court of Davidson County via a statutory writ of certiorari.

The MHZC should not approve more than 20 projects in any one application year.

An application fee will be recommended as part of the program. The current proposal recommends matching the "building valuation fee" currently used for building permits, matching the same calculation used by the Codes Department. The fee would be collected by the Codes Department at the time the Building Permit fee is collected and sent to the General Fund.