

Novogradac Report on Tax Credits
Transcript: February 2, 2010

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(Intro music)

Hello! It's Tax Credit Tuesday and I'm Michael Novogradac.

Today is Tuesday, February 2nd, 2010. This week I will discuss the budget freeze that was included as part of President Obama's proposed federal budget for fiscal yearend 2011.

This proposal most certainly will have wide ranging implications for affordable housing, community development and renewable energy.

Then I will review recent analysis about the effectiveness of using state tax credits and other subsidies to spur economic growth.

This is a topic we've touched on often in recent months as certain tax credit programs have been subject to scrutiny and as state governments have faced significant budget deficits.

And finally I will describe how state agencies are using green building incentives in allocation plans for the low-income housing tax credit program.

A report released last month by Global Green USA rated each state on its use of green building incentives and for the first time since the company began its analysis in 2005, every QAP received points in at least three of the four green building categories used in the analysis. Global Green says this shows an increase in the degree of comprehensiveness with which green building is being addressed.

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But before we get to those topics, I have some breaking news.

On Friday, January 29th, Senators Jim Webb and Mark Warner of Virginia introduced the Rehabilitation of Historic Schools Act of 2010.

This bill would provide a new tax credit for communities to partner with private sector developers to rehabilitate the nation's older school buildings.

It is companion legislation to H.R. 4133, which was introduced by Congressmen Eric Cantor of Virginia and Artur Davis of Alabama in November. I first discussed that bill in the December 1st Tax Credit Tuesday podcast. If enacted, the change would allow the historic tax credit to rehabilitate public schools.

In a statement about the bill's introduction, Senator Warner noted that nearly one-third of our country's public school buildings were built a half century ago. He says his bill would allow state and local governments to leverage private capital in a time of limited public resources. In addition, Senator Warner says this change to the Internal Revenue Code would support public education, promote economic activity and create jobs.

Copies of both House and Senate bills are available online at www.novoco.com. Simply click on the Historic Tax Credit Resource Center button and then choose the Legislation link.

I also have some exciting updates to share from our new markets tax credit conference last week.

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On January 29th, the Government Accountability Office or GAO released a report that suggests that Congress should consider options to simplify the structure of the new markets tax credit.

The report, which is mandated by law, describes where and how community development entities or CDEs are using NMTCs. It also discusses how effective the Internal Revenue Service and the CDFI Fund have been in monitoring NMTC compliance.

In addition, GAO describes in the report how current economic conditions also may be reducing investors' appetite for tax credits and how CDEs, in general, are able to generate less qualified equity investment or QEIs. For example, the GAO reports that representatives from several CDEs indicated that before the housing market collapse and subsequent credit crisis in 2008, investors generally paid between 75 and 80 cents per dollar in tax credits. Under current economic conditions, the report says these representatives indicated that investors may only be willing to pay 65 to 70 cents per dollar in tax credits. According to the GAO, one CDE indicated that it had sold NMTCs to investors for as low as 51 cents per dollar and another CDE indicated that it had heard of NMTCs being sold for as low as 48 cents.

I will review this report in more detail in next week's podcast. In the meantime a copy can be downloaded from www.newmarketscredits.com.

I note that our conference had over 350 attendees -- a sign of the vitalness of the new markets tax credit program, and hopefully

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portends to a strong year for those trying to raise capital for the new markets tax credit program.

Now, let's get started with our first planned topic for this week's podcast and consider the potential impact of a proposed freeze on discretionary funding in the federal budget.

Yesterday, on February 1st, President Barack Obama released his proposed budget for fiscal year 2011. We are still reviewing the complete budget proposal and I will discuss the details at considerable length next week. This week I will address one specific aspect that's included in the proposal, which was previewed last week during the president's first State of the Union address: a proposed freeze on certain nondiscretionary funding.

Initial reports indicated that the freeze would affect \$447 billion in spending, or about 17 percent of the total federal budget. Areas that are included and subject to these limitations include the departments of Housing and Urban Development, Justice, Energy, Transportation, Agriculture, and Health and Human Services.

Not surprisingly, the affordable housing community has responded with concern. The National Association of Housing and Redevelopment Officials, or NAHRO, issued a statement in response to the State of the Union address and specifically addressed or commented the proposed three-year freeze on federal domestic discretionary spending. The group says that to the extent that it would affect funding for federal housing and community development programs, the freeze would be counterproductive to the ability of public housing agencies, redevelopment authorities, and community

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development agencies to spur job creation and stimulate local commerce by tackling housing and infrastructure needs. NAHRO also says a freeze would disproportionately affect the country's most vulnerable populations, including homeless veterans, seniors, and families who would not find decent, affordable and safe rental housing without assistance through the Section 8 Housing Choice Voucher program.

NAHRO is concerned that any freeze or reduction in spending below fiscal year 2010 funding levels would reverse the progress achieved in recent years to fund programs administered by local housing and redevelopment agencies, funding at levels proximate to actual need. For example, NAHRO says with public housing funding levels as low as 85 percent of actual need in recent years, the administration's commitment to funding public housing operations at 100 percent of need in fiscal year 2010 was most welcome and critically needed. The proposed freeze on domestic discretionary spending accounts, if ultimately applied to public housing operations, will very likely result in additional staff layoffs and further reductions in critical services to those in residence. They say such a spending freeze could dramatically impact the affordable housing community's ability to preserve our current stock.

Regarding other issues discussed in the State of the Union address, NAHRO says it agrees with the President's focus on job creation and they strongly support the passage of new jobs legislation this year. The group urged the Administration to carefully consider the role that housing and community development agencies can play in

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creating jobs, and to ensure the responsible dispersement of funding to those agencies in the fiscal year 2011 budget and in any future jobs legislation.

To review a complete list of recommendations proposed by NAHRO to create jobs and to stimulate local economies, please visit www.nahro.org.

Similar concerns about affordable housing were raised by the National Low Income Housing Coalition. In a statement issued in response to the State of the Union address, coalition president Sheila Crowley said that the Administration's agenda rightly focuses on jobs and education but urged the President to follow through on his commitment to capitalize the National Housing Trust Fund. The National Low Income Housing Coalition estimates that funding the National Housing Trust Fund with \$1 billion would support the immediate production of 10,000 rental homes. In addition to providing low-income housing units, the coalition says an investment at this level would create more than 15,000 new construction jobs and 3,800 new jobs in ongoing operations.

In addition to housing, a number of community development programs could face cuts under the proposed budget freeze as well.

In a blog entry on January 28th, Pat Lally, the congressional affairs director for the National Trust for Historic Preservation wrote, and I quote:

"... there is no single item in his speech more important than his proposal to freeze discretionary spending. Funding for the national

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historic preservation program, as measured by the Historic Preservation Fund, has been inadequate for years. This affects State and Tribal Historic Preservation Officers and their ability to conduct reviews critical for all sorts of historic preservation programs. Needed brick-and-mortar grant monies for local preservation projects through the Save America's Treasures program may also be reduced. In fact, we have joined with our national partners in historic preservation to mount a grassroots effort to get full and permanent federal funding for historic preservation, which receives (annually) less than half the amount Congress originally intended." end quote.

Lally goes on to say that a budget freeze would effectively undermine the Trust's ability to get more funds. In a worst-case scenario, he says a budget freeze may even translate into cuts for already scarce preservation resources.

In addition to the freeze, Lally also touched on a passage from the State of the Union address where President Obama discussed the need to provide incentives for energy-efficiency and clean energy. He reports that the National Trust has been lobbying for a new provision in the Community Restoration and Revitalization Act legislation that was developed with the Natural Resources Defense Council. The provision would amend the historic tax credit with a boost for building owners who reach substantial energy efficiency goals in the rehabilitation of an historic commercial property. The National Trust for Historic Preservation estimates that the energy provision would create – in addition to the number of jobs created by the tax credit as it currently exists – 58,000 more jobs over

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10 years. Lally says that more than 9,000 of those jobs would be created within the first two years of enactment.

The renewable energy community fared slightly better and expressed appreciation for the President's focus on clean energy. Still, industry groups urged more action following last week's speech.

The American Wind Energy Association released a statement on the President's State of the Union address applauding the President's emphasis on job creation. The group says that the Recovery Act saved 40,000 wind jobs and said it looks forward to working with the President to put in place additional policies including a national Renewable Electricity Standard, which will create thousands more jobs, including in manufacturing.

The Solar Energy Industries Association also released a statement in response to the State of the Union address. Their statement said the solar industry is eager to keep working with the Obama Administration and Congress to make sure the right policies are in place for the solar industry to continue to grow. The association reports that thanks to provisions in the Recovery Act, the solar energy industry grew by almost 40 percent in 2009 and created 18,000 jobs.

Then on Thursday, January 28th, Treasury Secretary Tim Geithner announced that the Administration's budget would expand the Advanced Energy Manufacturing Tax Credit by \$5 billion. This program provides a 30 percent tax credit for investments in manufacturing of components for wind power, solar and many other advanced energy technologies

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I will discuss this proposal along with the rest of the proposed federal budget for fiscal year 2011 in next week's podcast in more detail.

But I do note now for our listeners some tax highlights. The President's budget includes a one-year extension of the LIHTC Section 1602 credit exchange program. Unfortunately it does not include the 5-year LIHTC carryback, nor the LIHTC passive activity relief that are part of the consensus proposals. On the new markets tax credit front, the President's budget does include an extension of the new markets tax credit at the \$5 billion level, and includes a provision to allow the NMTC to offset the alternative minimum tax. More about the President's budget next week.

Next, let's shift from the federal budget matters to state budgets and how they are affecting the state tax credits and exemptions available for housing, development and energy.

The results of two recent studies suggest that offering tax breaks to individual companies or industries is a crude, expensive, and ultimately ineffective way for state governments to spur economic development.

One of the studies focused on Pennsylvania's efforts to encourage growth in the high-technology sector. The results of a study released on January 13th by Good Jobs First, suggested that Pennsylvania and six other states that are vying with one another to grow their high-tech economies would succeed best by focusing on their existing employers and shunning what it describes as an

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“economic war among the states” that includes a number of job creation and research and development tax credits.

The report says that as Ohio, New Jersey, New York, Maryland, North Carolina and West Virginia experience severe revenue crises, their resources would best be spent strengthening small, young and locally owned businesses, and improving the skills of workers to match industry needs rather than competing with each other for specific companies.

The study says that interstate movement of high-tech jobs is almost negligible, but that offshore job flight is a far more significant issue. The study recommends redress be sought through federal trade policy, rather than with state tax policy.

A separate study issued by the Tax Foundation examined film tax credits and production incentives offered by 44 states, the District of Columbia and Puerto Rico. The Tax Foundation reported on January 14th, that movie production incentives -- such as film tax credits, cash rebates, grants and select tax exemptions -- fail to spur economic growth or raise tax revenue. The report’s author says that while motion picture incentives are often touted as “job-creating” programs, they create mostly temporary positions with limited upward mobility.

Results of studies like these are adding fuel to the fire in some cases where state governments are considering eliminating state tax credits as a way to increase their revenues.

For example, Colorado Governor Bill Ritter recently proposed eliminating or suspending 13 tax credits and

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exemptions. He says the move would generate an estimated \$131.8 million for the 2010-11 budget year that begins in July. This budget year is facing at least a \$1.3 billion, that is a billion with a b, deficit.

The *Denver Post* reports that in a letter sent on January 2nd to the governor and legislative leaders, the Denver Metro Chamber of Commerce, joined by two other groups, said it was quote "gravely concerned" about Ritter's plan to nix three of the credits and exemptions that represent \$69.3 million in Ritter's balancing plan for 2010-11.

The paper says that other groups on the letter were Colorado Concern, a group of 100 leading business executives, and the National Federation of Independent Businesses of Colorado.

Governor Ritter has proposed removing for two years the sales-tax exemption for energy used in manufacturing. This change would generate an estimated \$48 million in the 2010-11 budget year. He also favors scaling back for three years a corporate enterprise-zone investment tax credit, which he says would generate \$4.5 million for 2010-11.

The Colorado Association of Commerce and Industry opposes the suggested cuts and says that the elimination or suspension of the various tax credits and other provisions will harm businesses across the state and hamper job growth and economic recovery.

In stark contrast however, some states continue to consider establishing or improving state tax credits for a number of activities, including affordable housing, historic preservation, renewable energy and community development.

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For example, on January 22nd, New Jersey Governor Chris Christie unveiled recommendations intended to guide almost every aspect of state government under the new administration. Governor Christie promised to cut government spending to close the state's budget gap. He also suggests tax credits to encourage investment and education.

In his team's report on economic development, Governor Christie promises the creation of a new 20 percent manufacturing investment tax credit. The report notes that both New York and Connecticut provide manufacturing tax credits. New York grants credits of as much as 10 percent of machinery and plant costs, and Connecticut allows up to 10 percent for manufacturing machinery. Neither state imposes a cap on its tax credit either. In New Jersey however, the manufacturing equipment tax credit is only 2 percent for the cost of new equipment. Smaller manufacturers with 50 or fewer employees and net income of less than \$5 million qualify for up to a 4 percent credit. Moreover, the tax credit is currently capped at \$1 million or \$2 million and applies only to equipment, not manufacturing plant investment.

In the report on community affairs, Governor Christie notes that the state's Neighborhood Revitalization Tax Credit program appears to be achieving its intended goal and has the potential for continued growth. The program generates as much as \$20 million in new investments to certain eligible communities and the report suggests the program's continued growth and expansion could enhance revitalization throughout the state.

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Governor Christie also suggested that New Jersey needs to continue its leadership in solar energy, including the manufacturing and installation of solar systems. To spur further development and job creation, the Christie Administration proposes that the state offer tax credits for companies that open solar manufacturing and/or support businesses in New Jersey.

We will continue to track these and similar proposals and keep you updated in the State Tax Credits section of the Novogradac Journal of Tax Credits, so stay tuned.

Our final topic for today is a summary of Global Green USA's latest rating the green building incentives included in each state's qualified allocation plan.

Qualified allocation plans or QAPs are established by state housing finance agencies and guide the annual distribution of federal low-income housing tax credits.

In its 5th annual QAP Green Building Rating Summary, Global Green presents a ranking and summary of green building trends in state QAPs every year.

Green building measures in QAP documents are evaluated across four categories –

- Smart Growth,
- Energy Efficiency,
- Resource Conservation, and
- Health Protection.

For 2009, the company reports that its 2009 analysis further confirms the trend of states incorporating a steadily increasing

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number of green building requirements in their QAPs, particularly in the area of energy efficiency. For the first time since Global Green began its analysis in 2005, every QAP received points in at least three of the four green building categories that used in the analysis. The report says this demonstrates an increase in the degree of comprehensiveness with which green building is being addressed.

Global Green reports that 34 states improved their scores this year, and the average score increased from 25 to 30. Connecticut and Georgia top the list again this year. In addition, even the lowest score in the rankings is 10 points higher than last year's lowest score.

This year, the report also provided an analysis and summary of the green building trends in QAP criteria over the past five years. In addition to verifying the anecdotal sense that there has been a steady increase in green requirements, Global Green says the results show a steady increase in each of their ranking categories and in the average total score.

A copy of the report is available online at www.taxcredithousing.com. We are also going to review the results in more detail in an upcoming issue of the Novogradac Journal of Tax Credits. The Journal features monthly news and analysis on low-income housing tax credits, as well as renewable energy tax credits, new markets tax credits, historic tax credits, HUD financing programs and more. To request a sample copy of the Journal, please call our Products Desk at (415) 356-7960. That's 415-356-7960.

Now, while we're on the topic of affordable housing, it's time for this week's Project Profile segment.

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Boston Capital announced last week that it had invested in the greening and rehabilitation of two affordable housing properties in West Virginia—Chelyan Village Apartments and Baker Heights Apartments. The developer for these improvements is Maryland-based TM Associates.

The Chelyan Village Apartments investment will include the rehabilitation of one two-story building that features 48 one-bedroom units for seniors. Renovations will include the addition of an elevator, new windows and siding, energy-efficient air conditioning units and new roofing. All units will receive new EnergyStar appliances. The proposed rehabilitation will total more than \$29,000 per unit in total construction costs.

Boston Capital's investment in the Baker Heights Apartments will include the rehabilitation of six two-story buildings that feature 32 one-bedroom and 24 two-bedroom units. Renovations include the installation of new roofs, windows, doors, vinyl siding and deck replacements. These units will also receive new EnergyStar appliances. The proposed rehabilitation will total more than \$22,000 per unit in total construction costs.

Jeff Goldstein, chief operating officer and director of real estate at Boston Capital, says energy-efficient improvements will contribute favorably to the desirability of the two properties.

Before we wrap up for the day, there are a few events on the Tax Credit Calendar that may be of interest to listeners.

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This week there's going to be congressional hearings related to the proposed federal budget, which I discussed earlier and will discuss in more detail in the next podcast.

Today, February 2nd, the Senate Finance Committee is scheduled to hear testimony on the President's fiscal year 2011 budget from Treasury Secretary Timothy Geithner.

Tomorrow, February 3rd, the House Ways and Means Committee is scheduled to hold two hearings. The first, at 10 a.m., is a hearing on the President's Fiscal Year 2011 Budget, also with Treasury Secretary Geithner. The hearing will focus on the tax proposals included in the budget, as well as an overview of the budget for the Treasury Department. A second hearing in the afternoon is scheduled for 2 p.m. tomorrow, and will feature OMB Director Peter Orszag as the sole, planned witness.

And then on Thursday, February 4th, OMB Director Peter Orszag will go the Senate and appear again, this time in front of the Senate Finance Committee.

I'd also like to remind listeners that replays of Novogradac's New Market Tax Credit Compliance Webinar are still available for viewing. The webinar was originally presented on January 12th by Nicolo Pinoli, a principal in our Portland, Oregon office. If you missed it, you can purchase a recording of the session, which covers all the latest information in NMTC compliance, online at www.novoco.com slash events.

Well, that brings me to the end of this week's report.

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Please join me again next week when I will review the proposed federal budget for fiscal year 2011 in greater detail. In that review I'll highlight the relevant changes and provisions for the affordable housing, community development and renewable energy industries.

I will also review the most recent GAO report on the new markets tax credit program, including the response that's part of the report from the CDFI Fund.

In the interim I also encourage listeners to follow me on Twitter.

This is Michael Novogradac and I'll be back next Tuesday.

Thanks for listening.

(outro music)

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