

COVER PAGE FOR MASTER'S PROJECT

BRIDGING THE GAP
Methods to Improving Financial Feasibility in Historic Rehabilitation Project

By

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Methods to Improving Financial Feasibility in Historic
Rehabilitation Projects

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Foreword

The impetus for this project came via an odd, but not entirely uncommon, path. In my personal experience, reading, and interviews, the overwhelming point, tirelessly made by all, is that every development deal exists on as a unique case. The context of the area in which the development project is located, timing of the deal, political will of the locality, resources available to the developer, and various other internal and external forces all contribute to a large degree of uncertainty when it comes to historic rehabilitation projects. Accordingly, the need for flexibility and adaptability is crucial to achieving success in such a specialized industry. By nature, completing a rehabilitation project requires a certain amount of ingenuity and creative strategizing to achieve true financial feasibility.

Obviously, there are a number of contingencies in historic rehabilitation projects that give cause for concern to many developers. The potential for unforeseen problems such as environmental hazards, structural issues, and others is a large reason why many never enter this market. Necessarily, the risk of complications and the restrictions imposed by historic preservation initiatives and laws can give rise to inflated costs. While this is not always the case, the gap in financing created by these costs can be a deterrent to giving ample consideration to potentially worthy rehabilitation projects. Were the rehabilitation game an easy one to play, our cities and towns would have a remarkably different look today.

The ability to find innovative methods to close this gap is what truly requires ingenuity on the part of the developer. Historic tax credits represent the most obvious means to achieving this and they will be reviewed below in both a brief literature review and more explicitly in the body of the text. They are not, by any stretch, the only path to solvency and carry requirements that may not be amenable to the development situation at hand. It is because of this that the project started.

The Beginning of the Project

Initially, the scope of this work centered on the completion of a project in a small city in North Carolina. Working with Preservation North Carolina, a leading statewide non-profit, the goal was the successful conversion of a 1920 apartment building in the downtown into 18 residential units. Making use of their 501(c)3 status, Preservation North Carolina had been able to acquire the building from the city at a reduced rate several years earlier. Unfortunately, due to past market conditions and other perceived barriers, no significant progress was made despite several proposals. Vacant for some years, the city desired a change on the property and included it in the Downtown Master Plan as ideally suited for rehabilitation. Accordingly, Preservation North Carolina and the city began talks of how to get the project off the ground.

In a meeting with city officials, an experienced developer, and representatives of Preservation North Carolina, the initial proposal was to pursue the most common and obvious track: conversion into residential using the federal and state historic preservation tax credits. The requirements of these programs, which will be discussed later, mandate that the property remain an income-producing property for five years. In terms of residential properties, this translates to a minimum mandatory period of rental residential.

Unfortunately for the initial plans, this proposal was not amenable to the city officials. The city manager expressed a strong desire for owner-occupied housing in the downtown area, which did not fit the income-producing requirement of tax credits. The need for a replacement gap-reducing mechanism became the topic of discussion.

On the city's suggestion, the group researched and considered changing the scope of the project to qualify for a grant through Housing and Urban Development's Neighborhood Stabilization Program. The first round of the Neighborhood Stabilization Program consisted of \$3.92 billion for the redevelopment of abandoned and foreclosed homes. Overall, there were 309 total grantees, with each state receiving a minimum of \$19.6 million to obligate to projects based on a determination of need. North Carolina obligated 20 grants to eleven local governments, six non-profits, and three statewide organizations for a total of \$48.85 million. The city was one of the local governments to receive funding for their proposal to purchase and rehabilitate fourteen foreclosed properties. Intending to provide homeownership opportunities to participants in the Individual Development Account and through a lease-purchase program, the city focused its investment in identified areas of need not absorbed by the investor market. The city received a total of \$2.1 million out of the \$5 million requested, of which more than \$1.3 million went toward the rehabilitation of a building in a similar area to the project under consideration (North Carolina Department of Commerce, 2009).

As part of the American Recovery and Reinvestment Act of 2009, the Neighborhood Stabilization Program began accepting applications for a second round of funding. The Notice of Funding Availability emphasized the intent of the program to assist in the residential projects in low and moderate-income areas. The goals of the program were, in part, to reconnect neighborhoods in a way that would leverage other resources, arrest decline, and ensure longest-lasting affordability. Funding applicants were rated based on 1) capacity to execute projects; 2) leveraging potential; 3) concentration of investment to achieve neighborhood (Housing and Urban Development, 2009). Based on the professional reputations of the individuals involved in the partnership and the receipt of prior funding for a concentrated area, the city felt the apartment project would be an ideal use for a portion of the grant.¹ Applying for \$10.3 million to redevelop 140 homes, the city included the building on the condition that the project change to owner-occupied condo units. The grant administered by the city would function mainly as a developer fee, allowing the units to be sold nearly at cost, which would achieve the income requirements of the grant.

Unfortunately, time passed with payments due all the while, and the city was denied in the grant process. Without the support of historic tax credits or the Neighborhood Stabilization Project grant, the team returned to the ideation phase. Of course, as the funding dried up, so did the original direction of this project. As a long-term way of assisting and informing the process, the scope shifted to become this manual. What follows is a selection of available funding mechanisms, each of which will be presented and briefly explained. These methods vary from low-cost lending options to grants to innovative partnerships and incentives.

¹ As a requirement of the Neighborhood Stabilization Program, the minimum grant available was for \$5 million. In addition, the recipient projects must return a minimum of 100 homes to use. Necessarily, the 18-unit apartment building only constituted a portion of the application.

The State of Historic Preservation and Tax Credits

Since the implementation of the first federal Historic Preservation tax credits in 1976, adaptive reuse and historic preservation efforts have played an increasingly important role in downtown revitalization. According to Listokin, Listokin, and Lahr (Listokin, Listokin, & Lahr, 1998), rehabilitation has grown continually as a percentage of the overall construction industry. Residential rehabilitation projects also underwent similar growth as a proportion of the industry. The reasons for such growth go beyond the simple aesthetics of rehabilitation, as the functional principle at work in most of these efforts is preservation as an economic development tool.

The infusion of capital in the form of historic rehabilitation can provide a “catalyst” effect by generating skilled and unskilled employment, tourism business, retail activity, and additional rehabilitation investment in surrounding areas. Furthermore, investment in historic rehabilitation in one area can spur lenders to become more interested in financing additional projects, leading to a cycle that can result in improved property values and better availability of credit (Rypkema, *The Economics of Historic Preservation: A Community Leader's Guide*, 1994). As evidence of this growth rate and catalytic effect, Holton (2008) detailed the economic benefits of historic rehabilitation to North Carolina. From 1998 to 2007, North Carolina experienced an 80% growth rate in completed projects, resulting in \$1.4 billion in statewide economic output, the direct creation of 8,630 new jobs, and the indirect creation of many more.

While the benefits of historic rehabilitation and reuse are substantial, it is vital not to overlook the potentially negative outcomes. Perhaps most common are the concerns of citizens wary of external controls associated with historic districts and landmarks. Over-regulation is certainly a very real concern; however, the more significant effect that can occur is the displacement of residents as a result of rising property values and competition for real estate (Listokin, Listokin, & Lahr, 1998). This gap in affordability can be a major deterrent to investors and characterizes the largest barrier to successful historic rehabilitation.

The Issue of Affordability

In a U.S. Housing and Urban Development analysis of the barriers to rehabilitation, Listokin and Listokin identified the affordability gap as the difference between the available financing and the cost of rehabilitation (Listokin & Listokin, *Barriers to the Rehabilitation of Affordable Housing, Volume I: Findings and Analysis*, 2001). Reviewing 82.2 million housing units, they determined that roughly one third of all units had rehabilitations that they considered “unaffordable”. For those of moderate income, 29.7% of all needed rehabilitations were unaffordable, 51.2% for low income, and 85.6% for those of very low income. When considering that 31% of those below the poverty line live in older or historic homes, it is obvious how complicated the situation is. Financing for “pioneer” projects in a struggling area can be difficult to come by and unforeseen problems with acquisition, analysis, approval, and construction are always a concern (Rypkema, 2002). At first glance, this can be an imposing set of obstacles; yet, the potential benefits are undeniable.

As home ownership in the central city and by young families has declined, affordable workforce housing has become an increasingly important issue. Following patterns of development, housing for low to moderate incomes migrated to the fringe. It is in this move that the value of the older and historic homes becomes evident. Rypkema's study produced a number of telling statistics that convey the true advantages of older neighborhoods. While less than 25% of new homes were within five miles of work, more than 40% of older homes were. Similarly, the rates of new and old homes proximity to public transportation were approximately 25% to 60%, respectively. Older homes are also closer to shopping and elementary schools, which are theoretically valuable commodities. Understanding the possibilities present in rehabilitating older neighborhoods, revitalization is a matter of overcoming the affordability gap of completing the project.

Bridging the Gap of Affordability

The federal income tax credits, which generate a 20% credit for Qualifying Rehabilitation Expenses, have done a great deal to close the gap in affordability. According to Rypkema (2002), properties in need of rehabilitation were overwhelmingly "moderate", which he notes has a cost of rehabilitation equivalent to the most efficient new construction in a federal program. By complying with the Secretary of the Interior's Standards for Rehabilitation, developers of income-producing properties can achieve savings that make an otherwise impossible project feasible.

In 2001 in West York Borough, PA, developers used tax credits to convert the 1905 Shelly School building into 17 affordable housing units (Mark, 2005). With total rehabilitation costs of \$1,883,860, of which \$1,515,809 were qualifying rehabilitation expenses, the development team was able to sell the credits at a rate of \$0.87 for a total savings of \$265,000. This helped the project to move forward, as the building would have continued to sit idle without the incentive. The project leased up completely two weeks after opening and maintains a waiting list.

Similar to West York, a 1912 public library in Sioux City, IA sat abandoned for nearly ten years. Owned by the city, it had been the subject of several unsuccessful proposals before a development team moved forward in 1996. The team worked with the State Historic Preservation Office throughout to ensure they followed the Standards for Rehabilitation. This required them to reduce the plans from 28 to 20 affordable housing units; however, the high demand for workforce housing and the \$263,107 in tax credit savings were enough to account for the change. Additionally, the developer noted the quality and appeal of the units as an attractor. It was leased out within a month and maintains a low turnover rate in a market with 29% in comparable units (Sullivan, 1999).

Rehab Chicago completed a number of projects by supplementing tax credits with a variety of grants and subsidies. Due to the demand for subsidization, the process for these methods is competitive, and often results in complex scoring methods to determine assistance (Listokin & Listokin, 2001). Despite the clear successes in this area, it is not enough to overcome all obstacles. While the federal tax credits enable the development of affordable housing, it is only of the income-producing variety. Homeowners, those that live in the older, historic homes in Rypkema's analysis, do not benefit from the credits (Rypkema, 2002). He suggests that states follow the example of the few that had

started and extend a tax credit incentive for rehabilitation of non-income-producing properties. This echoes the one of the final recommendations of the Litoskin analysis (Listokin, Listokin, & Lahr, 1998). North Carolina instituted such an incentive in 1998 and has experienced substantial benefit from it.

Historic Rehabilitation Tax Credits in North Carolina

To aid in the rehabilitation of historic homes in North Carolina, the legislature enacted a 30% state income tax credit payable over five years (Preservation North Carolina, 2009). Combined with the federal tax credit for income-producing properties, historic rehabilitation has been a positive force for economic development in the state. Since 1998, every county in the state has had at least one tax credit project completed. For every \$1 million invested in qualifying rehabilitation expenses, the state derives \$1.74 million in economic output, 17 jobs, and \$530,000 in employee compensation. Further, for every \$3.6 million in foregone tax revenue to the credits, the state gained \$160 million in new economic activity (Holton, 2008).

Moving Forward

This guide will not go into the specific mechanics of federal historic tax credits, as they are already familiar to many developers and officials. Instead, Appendix A contains an analysis of the treatment of historic materials and alterations in the tax credit application process. Closely examining four of the ten Standards for Rehabilitation used by the Department of the Interior, the Appendix section explores the flexibility of the standards and examines methods for justifying alterations and treatments that do not fit the letter of the law. In this way, it is possible to consider elements of rehabilitative design that may have been overlooked in preliminary considerations.

Overall, federal and state tax credits have provided substantial improvements to project feasibility since their enactment. They are not, however, the only option. Creative funding solutions are essential when attempting to solve cost and feasibility issues in a project. A novel combination of funding, like the combined tax credits at Shelly or the various subsidies in Rehab Chicago, can decide the future of a project, especially when it is for low to moderate income consumers. The large gap in affordability is often especially prevalent in these cases and innovative financing can facilitate affordability without sacrificing quality. Consequently, the success of these projects can have the “catalyst” effect that results in the large-scale improvement of the overall housing stock. This serves to establish the need for creative solutions and involves use of currently available subsidies, innovative local programs and incentives, and the structuring of partnerships that help achieve these goals.

A Note on Relationships

Throughout the course of the original project and the subsequent compilation of this guide, one axiom became abundantly clear: relationships matter. Reading case studies, interviewing developers and city officials, and dealing directly with the process of rehabilitation projects, every source continued to emphasize the importance of relationships to successful projects. Of course, I use the term relationships rather broadly, as there are several types of relationships to which I refer. Considering the overall process of redevelopment projects, the developer must maintain relationships with the city manager and other officials, lending institutions, equity investors, non-profit organizations, tax credit syndicators, the National Park Service, State Historic Preservation Organizations, local historic district commissions, tenants, etc. The list goes on ad nauseam.

Furthermore, it is not just the number and quality of relationships that developers must manage, but the complex networking of all of them as a whole. In other words, the creativity of developers in rehabilitation projects is crucial to the overall success. Putting together innovative and dynamic partnerships combines the interests of the town or city as a whole, the developer and investors, community organizations, and other stakeholders. This can not only work to achieve common goals of all, but also to facilitate solutions to issues of feasibility. Oftentimes, the involvement of non-profit organizations or proactive efforts by cities and towns can provide access to sources and solutions not available to developers themselves.

The Importance of the City Manager

The foreword to this guide provided a brief description of how this project came to be, essentially highlighting the importance of the city manager in the rehabilitation process. In that case, the city manager had previously prioritized the presence of owner-occupied housing in the downtown area. This eliminated the possibility of using historic tax credits, but opened up the possibility of the administration of Neighborhood Stabilization Project funds. As stated, the city did not receive the grant for which it applied, but this illustrates the ability of the city manager to provide access to a different source than originally considered by the development team. This is not, however, the only example and the proactive efforts by city and town managers in many areas exemplify some of the positive effects of well-built relationships with the rehabilitation industry.

The city manager of a mid-sized town in South Carolina expounded greatly on the topic, illuminating several examples and points important to successful projects. As a former planner in a town with a premier reputation for preservation projects, he went to a great deal of effort to stress the consequence of establishing a good working relationship with the city staff. Too often, development teams approached projects and city staff without taking the time to develop an understanding of the regulatory context of the city or the development process. Dedicating sufficient time to understanding the ordinances and codes at work allows for a more fluid and effective relationship with review staff. As the success of rehabilitation projects often rests in the hands of these individuals, it is crucial to relate to them in a way that engenders strong mutual trust.

A proactive city manager and staff can also be a valuable resource in forming partnerships and achieving goals that may directly benefit rehabilitation projects. One city manager elaborated on the effectiveness of consultant the city has worked with over the past fifteen years. The consultant, who has significant experience in the preservation and rehabilitation industry, meets annually with the city in a goal setting workshop. As part of this effort, the consultant helps the city prioritize its goals and develop internal and external mechanisms to achieve these. In working closely with city staff, developers can help envision ways to improve the feasibility of projects in the area, if those projects conform to the goals of the city. In this way, the city manager can also act as the intermediary between the varying interests. As the party through which all measures must pass, a motivated city manager or director can be the most effective organizer of partnerships. Through relationships with non-profits, developers, and other stakeholders, the city manager can represent these interests in the pursuit of partnerships that benefit all involved. This particular manager referred to a partnership on one preservation project that involved five different entities, including the city, community foundations, a local historic foundation, the Main Street program, and developers. By actively pursuing a partnership to achieve one of the city's set goals, they were able to leverage several different sources to successfully preserve an area landmark.

In interviews with experienced developers, they identified other aspects of the relationship with city staff that can play an important role in improving the likelihood of a successful project. Much in the same way that developers can improve relationships with city officials by devoting time to understanding the legal context in which they are working, city managers can show the same level of attention. In some cities, developers noted the effectiveness of inspectors particularly attuned to the requirements of historic rehabilitation projects. By understanding these requirements and possessing training in downtown revitalization, the inspectors and development teams could work together to minimize complications and delays. Similarly, changes in building code for historic structures can also facilitate success. By providing alternatives to the standard requirements, city staff can reduce costly expenditures necessary to meet code. Even minimal cost reductions can be significant in determining the feasibility of projects. This can play out in situations where the city or developers can leverage existing resources to benefit both parties. One developer worked closely with city officials to obtain an easement to put in an external staircase on a city-owned parking garage. This provided desirable access to the city's garage, which was an obvious benefit to the public, but also improved the access to the rehabilitation property. This served to greatly ameliorate the leasing potential of the building and allowed the developer to achieve lease-up more easily.

City managers and staff are also vital in one of the most obvious areas of local assistance to development projects: grant administration. Community Development Block Grants are one of the most common sources of funding for rehabilitation projects and are usually granted directly to local governments. Once obtained by the city, the city can loan or grant funds under any terms. Additionally, they can make conditional requests of developers. The consequence of relationships in these terms is obvious, as a positive working relationship can provide a great deal of assistance to projects in which the city has a vested interest.

State Historic Preservation Organizations and the National Park Service

Applying mainly to historic tax credit projects, relationships with the State Historic Preservation Organization and the National Park Service are crucial to successful completion. As stated, Appendix A contains a detailed analysis of working with these organizations to address the Department of the Interior's Standards for Rehabilitation. Maintaining healthy relationships with the agencies that review qualified rehabilitation is essential to obtaining the certification necessary to receive tax credits. As a briefer example of this principle at work, one developer described a small-scale project in a little town. This project consisted of a two-story building in which the developer planned two first-floor commercial units and seven second-story residential units. The second-story units were absolutely essential to the feasibility of the project; however, they required major alterations to the building. These renovations, which included popping the roof and lowering the floor, were impermissible at face value when considering the Standards for Rehabilitation. Fortunately for the project, the developer had an excellent long-term relationship with the State Historic Preservation Organization and was able to justify these alterations by stating that the project would not be completed otherwise. As the town and developer wanted this project completed to benefit the downtown, the agencies approved the alterations and the project was successfully finished.

Relationships with Financial Institutions

Maintaining positive relationships with lending institutions is a vital part of successfully finding and completing rehabilitation projects. There is a wide swath of different lending opportunities in rehabilitation projects and the variety of options available can create advantages or uncertainty. Establishing functional and trusting relationships with lenders allows developers to pursue deals with more confidence, as well as expand the opportunities available.

While there are varying opinions in the development community on how to classify tax credit syndication, I am including syndicators as part of the financial institution class. Some developers assert that they never consider tax credit syndications as a source, but merely as part of the total return. This is not the consensus view and many developers assume syndication of tax credits in their initial financial analyses. For example, on a project of roughly \$4-5 million, one developer worked with the same lender to acquire a tax credit bridge loan of \$1.025 million. By working with the same lender over an extended period of time, the developer formed a solid relationship with the lender, who also functioned as the syndicator. Due to the confidence instilled by working with each other previously, the lender was able to trust the developer to successfully execute the certified rehabilitation. Bridge loans of this kind are only safe if syndication is completed, which exemplifies the trust placed in the developer by the syndicator.

In smaller towns, project costs can often exceed the lending capacities of local lenders. Situations like these are another opportunity when positive relationships with lenders can be a significant advantage. In a project that won a 2008 award for innovative financing, one developer worked with ten different lenders to complete a roughly \$13.5 million project. That same developer also described another project during the interview

that epitomizes the effect of developing positive relationships with lenders, which is reproduced below. It also illustrates the benefits accrued from the involvement of city officials, positive relationships with subcontractors, and a penchant for finding creative solutions in negotiations with the federal government.

Positive Relationships – A Case Study

As part of the project, which involved the rehabilitation of a 27,000 square foot building in a major North Carolina city, the developer made use of federal and state historic tax credits, local façade grants, and local landmark tax deferrals to help defray costs. Beginning in 2006, the developer had a choice between a number of lending options and chose to work with a lender with whom they had past experience, despite receiving better terms from competitors. With the tensions occurring in the national lending market and real estate industry, the lender became concerned with the project length and gave notice that they reserved the right not to extend the construction loan for the project. In 2007, the developer went to competing lenders to refinance the construction loans and, consequently, began construction in 2008.

Unfortunately, the bank failed in January of 2009 and the Federal Deposit Insurance Commission (FDIC) took over as the receiver. At this point, construction was roughly 85% complete, but the FDIC does not continue to disperse construction loans and there was still over \$700,000 to be drawn. Without continued drawing off of the construction loan, work could not continue, subcontractors could not be paid, and the project was effectively in a holding pattern. As the FDIC owned 57% of the loan, they were the controlling party and were responsible for sell the loan. This presented a substantial opportunity to negotiate the sale of the loan at a discount; however, it also necessitated extensive cooperation with a lender that could acquire the loan.

Through a twist of fate, the developer happened to meet a representative of a smaller bank that held the 43% silent partner's share of the loan. Following a great deal of discussion and mutual assurances, the developer and lender came to the conclusion that the project could continue successfully if the bank became the controlling partner. As it is part of the FDIC's responsibility to work with lenders to resolve these complications, the developer and lender engendered good relations with the FDIC throughout the process. Relying on their reputation in the city, the developer also procured a letter of endorsement from the city's mayor, which served to justify any bids to acquire the loan at a discount. Seeing the advantage in possessing the controlling interest, the lender actually ended up buying the loan dollar for dollar. This put the developer at risk, as the lender could technically foreclose on the project; yet, the trust developed through this project and the issue of the construction loan was resolved.

While that addressed the construction loan, the project's bridge loan still posed a problem. Cost overruns from delays in the construction and financing process had set the project back greatly and it teetered on the edge. Acquisition of the bridge loan would have to occur at a significant discount to cover the cost of the overruns. As the bridge loan was made based on the assumption of the completion of certified rehabilitation, the developer and lender used this to justify the argument for a discount. Essentially, the loan was worth nothing without satisfaction of benchmarks in the tax credit process, which included a 75% lease-up and three consecutive months with a debt-coverage ratio

of 1.2. Following a rejected first bid and subsequent appraisal, the lender and developer renegotiated with the FDIC to acquire the bridge loan at a large discount.

Working out a leasing deal with a known tenant for space on the ground floor allowed the developer to meet the first hurdle in receiving the tax credit payments. Debt service, however, was still preventing the satisfaction of the debt-coverage criteria. Again taking advantage of the positive relationship, the lender agreed to convert the loans into interest-only for the first year to raise the debt-coverage ratio to an acceptable level.

While this all was occurring, the developer was not able to pay subcontractors. Fortunately, and again stressing the importance of relationships, the developer was able to assure the subcontractors payment would come and convince them to work without it for the meantime. Of course, if the bank failed and the project died, nobody would receive compensation; yet, the developer found other ways to take care of the subcontractors. In the end, only two out of twenty subcontractors placed liens on the property from February to August of 2009. Eventually, the project was completed and the developer experienced total savings of almost \$2 million through negotiations. It is worth noting that the developer cited an example in a nearby county where developers hired attorneys to negotiate with the FDIC. They failed to achieve any discount, strengthening the argument for the importance of personal relationships.

Local Programs and Incentives

The above note on relationships mentions several different programs and incentives available in local contexts. This section explores these options and their possible effects on the rehabilitation process, as well as providing some limited examples of these methods. Of course, as the above section emphasizes, there are a multitude of ways to explore partnerships at the local level. Many of the programs and policies cited here are officially recognized as part of local governments; yet, there are many others that can be negotiated on an individual basis, depending on the benefits to the various stakeholders. The point is to be creative in the approach to finding these funding solutions and not only make use of what is already there, but to explore what has been done elsewhere to encourage investment and improve feasibility. For this section, I classified measures into the following groups: tax relief, available funds, development process relief, and cost saving measures.

Tax Relief

There are several ways that projects can take advantage of tax relief at a local level. The benefits of tax relief should be apparent in almost any project. In income-generating projects, lowering the taxable basis or tax payments of a developer can be a vast improvement to cash flows and overall feasibility. In all projects, lowered or eliminated tax requirements increase the likelihood of successful rehabilitation projects.

Payment In Lieu of Taxes (PILOT)

Payment in Lieu of Taxes is a program that can exist at several different levels. At some levels, the federal government reimburses local governments for tax payments that have been foregone as part of PILOT. This usually occurs in cases of federally-owned lands. The same types of reimbursements occur at state levels for a variety of state-determined purposes. In terms of historic rehabilitation at a local level, local governments can, as a legislative act, determine that rehabilitation projects are eligible for inclusion in local PILOT programs. This can significantly reduce the property tax burden on developers and allow them to avoid costly tax payments.

Obviously, as this imposes additional costs on the local taxpayer, PILOT programs can be inherently subject to political risk. Knoxville, TN has successfully implemented PILOT as one of the programs in its suite of incentives benefitting economic development in targeted areas of the city (City of Knoxville, 2010). Developers can apply for the PILOT program and other incentives with an application to the Department of Economic Development for review. In Knoxville, this program can contribute to land and building acquisition costs, site work, and other related expenses.

Special Tax Valuation

Special tax valuation relies, like historic tax credits, on the completion of qualified rehabilitation expenses; however, in the case of valuation, it directly affects the

assessed value of taxable property. The State of Washington, which implemented this program in 1985, allows local review boards to review the submitted costs and determine the qualifying expenses. These can include “improvements made to the building within its original perimeter, architectural and engineering fees, permit and development fees, loan interest, state sales tax, and other expenses incurred during the rehabilitation period,” but do not include acquisition or enlargement costs (Department of Neighborhoods, 2010).

Once the local review board determines the qualifying expenses, the Department of Assessment deducts these expenses annually from the assessed value of the property for ten years. This allows developers to make substantially lower tax payments during the ten year period, which can provide enough time for cash flows and net operating income to catch up and surpass the debt service and tax requirements.

Property Tax Reduction

One of the significant hurdles in rehabilitation can be the escalating property taxes that accompany the overall increase in value. In order to encourage investment, many localities incentive rehabilitation projects with property tax reductions. The state of California instituted the Mills Act in 1976, allowing localities to enter into contracts with developers and negotiate alternative tax rates. Essentially, the property tax assessment is frozen at the initial level for a determined period of time, with a minimum of ten years. Similar to the special tax valuation program in Washington, this allows improved returns for that period of time and increases feasibility. Studies indicate that programs like this can achieve tax savings of as much as 60 percent (Torio).

Property Tax Deferral

The deferral of property taxes is another way to lessen the financial burden in projects and can be related to several different types of programs. As a premier example of property tax deferral programs, Raleigh, NC uses state enabling legislation to grant a 50 percent deferral of property taxes on designated local landmarks. The taxes are deferred indefinitely, except in cases where the historical significance of the property is lost. Recognition as a landmark and application for deferral necessarily convey review of any changes to the Historic District Commission (Raleigh Historic Districts Commission, 2010).

Tax Increment Financing

Tax increment financing (TIF) has become an increasingly popular tool to help finance rehabilitation projects. A large number of TIF projects were originally district or area-wide in targeted areas of cities; however, some localities have adopted more specific versions of the program. The Knoxville Community Development Corporation (KCDC) is authorized to issue tax-increment debt with no strong limits on discretion. This funding can be used for the purposes of acquisition, site preparation, necessary public improvements, and other costs approved by KCDC. The KCDC makes decisions on an individual basis, which allows individual developers to apply for isolated projects and those of varying size (City of Knoxville).

Available Funds

Special Local Taxes

During an interview with a developer experienced in several southeastern states, he elaborated on a \$1 million project in a small South Carolina town. While the project took advantage of a number of different incentives to help improve the feasibility, one of the most influential was the town's dedication of revenues from a restaurant tax. This also presents an instance where positive relationships between the developer and the city or town can result in pro active assistance on the public side. Small additions, like a penny tax, to existing rates, or the creation of insubstantial new taxes and fees, can often provide a valuable input into small projects. These measures work best in areas where projects can generate a significant amount of local interest, as there is a need to justify the additional burden on the citizenry.

Similar to the restaurant tax, other localities have developed dedicated local taxes for programs. King County, Washington allocated over \$5 million over the past ten years for heritage and preservation projects. According to the publications, "virtually every preservation group and facility in the county has probably benefited from this program" (City of Olympia).

Local Matching Grants

Local matching grants are one of the most common methods of receiving local subsidies in rehabilitation projects. They can take many forms and are often connected with larger organizations like the national Main Street program. One of the most prevalent types of local matching grants is a façade improvement grant, which is available in countless towns and cities across the country. Not only do the benefits of these programs improve the finances of the rehabilitation project, they directly improve the aesthetics of the streetscape. This direct benefit to the city is one reason why matching grants are such popular programs.

Minneapolis is one of many cities with a façade improvement matching grant and only represents one example. Projects in qualifying areas are eligible for matching rebates for façade improvements of between \$5,000-7,500 depending on the area of the city (Parrell). As many similar programs in smaller towns are connected to organizations like Main Street, the Minneapolis program is affiliated with the Great Streets initiative.

Special Condition Funding

Conditions existing in localities can oftentimes result in special financing opportunities for development projects. These conditions can involve any number of geographical, geological, cultural, or other situations that may include issues like floodplains, seismic activity, or culturally-endangered areas. A look at San Francisco's initiatives exemplifies two of these programs.

In order to help developers and residents address code issues that have been issues at times in the city, San Francisco developed the Code Enforcement Rehabilitation Fund (CERF). This fund prioritizes projects that address health and safety issues in the city and provides hardship loans of up to \$15,000 to remediate identified code violations.

Given the geologic history of the city, San Francisco also unveiled measures to combat the seismic issues in 1992. To provide relief, the Unreinforced Masonry Building (UMB) loans provided \$350 million to bring both affordable housing and other historic buildings up to code (Planning Department, 2003).

Case Study in Local Incentives: Oakland County, Michigan

Main Street Oakland County (MSOC) is an officially recognized Main Street organization in Michigan. In an effort to spur rehabilitation projects, the staff created a suite of incentive programs available to developers. With the support of the Economic Development Corporation of Oakland County and the Oakland County Business Finance Corporation, there are options ranging from assistance finding low-interest loans to tax credits to direct grants. Included within the suite are façade improvement grants, sign grants, awning grants, a paint program, retail rent subsidy grants, a revolving loan fund of working capital, design assistance, and the aforementioned assistance locating lending opportunities.

Development Process Relief

Reduced Plan Review / Streamlined Permitting Process

The delays associated with the entitlement process of development projects are notorious in some localities, often proving a deterrent to engaging in potential deals. To incentivize rehabilitation projects, many towns and cities use reduced plan review requirements or streamline the permitting process. This effectively allows a shorter holding period prior to the beginning of construction. Obviously, the potential benefits of beginning work quickly are significant, as it greatly lessens the entitlement risk of projects. Knowing they are operating in an atmosphere that prioritizes rehabilitation projects for the purpose of downtown redevelopment, economic development, or other purposes allows developers to operate with more confidence with regard to the timing of the project. This can assuage any doubts of investors or lenders, which can happen, as previously mentioned, as a result of delays.

Zoning and Land Use Code Relief

Much in the same way that streamlining the permitting process can improve the level of developer confidence, localities have taken other steps to provide the same cooperation and partnership. Flexibility and relief in the application of local zoning and land use ordinances can incentivize rehabilitation in much the same way. Seattle, Washington provides detailed descriptions of the relief for variances in zoning and land use.

Recognizing the value of flexibility in ordinance application, Seattle allows exceptions to encourage adaptive re-use of historic buildings. Not only can the Director of the Department of Planning and Development permit otherwise forbidden uses in landmarks, it is also possible to waive or modify standards for open space, setbacks, width and depth limits for screening, parking requirements, and landscaping (Department of Neighborhoods, 2010).

Building Code Flexibility

The concerns that surround zoning and land use ordinances can often have the same effect with regard to building code. Rehabilitation projects necessarily involve conditions that differ greatly from those in new development, making the application of standard building code problematic. For this reason, several states and localities adopted a separate code for historic structures. Providing flexibility in the application of building code allows developers to address issues that would be otherwise impossible under standard code (e.g. stairway width). Similar to the ability to modify zoning, the Director of Planning and Development in Seattle can request alternative requirements that still address health and safety in historic rehabilitation projects (Department of Neighborhoods, 2010).

Technical and Design Assistance

Often associated with the Main Street program or other similar initiatives, the provision of technical and design assistance to developers can be a significant advantage in establishing a trusting relationship. With the continually expanding design requirements in many localities, ensuring that owners and developers are aware of the specifics and how to address them greatly improves the approval process. With an existing relationship and understanding prior to the actual approval and entitlement, there is often a higher degree of comfort and confidence, which is of obvious benefit to all involved parties.

Cost-Saving Measures

City Master Lease

One of the biggest difficulties in completing rehabilitation projects in small towns is the perceived lack of market demand for space. Without solid assurances that they can find tenants to occupy the space, developers have little incentive to complete this variety

of projects. In the same South Carolina \$1 million project mentioned previously, the city involved itself in an innovative and incredibly helpful way. Agreeing to Master Lease the commercial spaces, the developer could account for the leasing of space without the typical concern about vacancies. This assurance allowed the project to move forward, satisfying the goals of the town and the intent of the developer.

Utility Fees and Other Costs

In the same project, the city also engaged another technique that provided a great degree of confidence to the developer. Consulting with the city on the finances of the project, the developer expressed reservation about approaching the project because of the uncertainty regarding costs. To address this skepticism on the developer's part, the city agreed to an in-kind assurance that the water, sewer, power, and taxes would not exceed the values specified in the pro forma model.

While guaranteeing a rate cap is one way of addressing this type of cost, other localities approach the issue differently. Many cities create specially-targeted districts in which connection fees for utilities are often waived to incentivize development. Gastonia, North Carolina waives water and sewer connection fees as part of their Housing Rehabilitation Program (City of Gastonia, 2005). As utility connection fees can total hundreds to thousands of dollars per unit, this type of service can be a boon to rehabilitation projects.

Property Donation

To facilitate rehabilitation projects occurring in areas targeted by localities, many localities and non-profit organizations will engage in property donation exchanges to lower the total development cost of projects. This can involve the donation of property already owned by a non-profit or local government, but can also involve the use of subsidy programs. If a city or non-profit receives money through Community Development Block Grants or from state or local housing trusts, these funds can be put toward the purchase, and subsequent donation, of a targeted historic property. The benefits of this type of involvement are readily apparent, as removing the cost of acquisition from the total development cost can achieve a substantial cost savings for the developer.

Permit Fee Waivers

Along with the streamlined permitting process that they offer, the city of Olympia, Washington couples the waiver of permitting fees for historic rehabilitation projects. Noting the savings to owners and developers, the city publication states that these methods “are well accepted as an enticement to encourage desirable projects” (City of Olympia).

Infrastructure Improvements

One method of encouraging and improving rehabilitation efforts that is not entirely project-specific is the provision of infrastructure improvements by localities. These can come in the form of streetscape improvements like street trees, parking changes, signage, public seating, and others that increase the marketability of properties in the area. Gastonia, North Carolina used a combination of federal and local funds to engage in a substantial streetscape improvement project along one of the primary target areas for rehabilitation (Palenick, 2009). Increasing the attractiveness and marketability of a general area can vastly improve leasing potential and project values, adding notable benefits for potential developers in the area.

Federal Sources

The following are a collection of sources of debt and equity available through a number of federal programs, administered by a variety of organizations and departments. The application process for many of these can be extremely competitive, as evidenced by the failure to win the Neighborhood Stabilization Project grant. These subsidies represent only a portion of those available, but serve to represent a number of the objectives and goals that historic rehabilitation projects can address.

Historic Preservation Easements

Amount Available: Difference between appraised market value and value after conveyance of easement

Awarding Organization: National Park Service; Internal Revenue Service

Website: <http://www.nps.gov/history/hps/tps/tax/easement.htm>

Description

For properties on the National Register or those contributing to National Register districts, donation of an easement to a governmental unit or charitable organization that is dedicated to historic preservation and has the resources to enforce easement restrictions. The donation functions as a charitable deduction on taxes and the value is determined by measuring the difference between the assessed fair market value and the value after preservation restrictions are enacted. For values over \$10,000, the IRS requires a \$500 filing fee.

Restrictions, beyond those that actually guide preservation and rehabilitation, include a requirement for public access to the property. This can take the form of visual

access from a public street or allowing the public to tour the property two days a year. Preservation easements are appurtenant and can also yield state and local tax benefits to developers.

Save America's Treasures

Amount Available: \$125,000-700,000

Awarding Organization: National Park Service

Website: <http://www.nps.gov/history/hps/treasures/index.htm>

Description

The National Park Service describes the Save America's Treasures grant as one of the largest and most successful programs nationwide. Available to federal agencies funded by the Department of the Interior or partnered with non-profit organizations, the non-profits themselves, units of state and local government, recognized Indian tribes, and active religious organizations that meet the criteria. Funds are available for preservation or conservation of properties that are National Landmarks or on the National Register, as well as those contributing to those districts.

National Transportation Enhancement Activities

Amount Available: 10% of State Transportation Program budget; \$800 million

Awarding Organization: Federal Highway Administration

Website: <http://www.fhwa.dot.gov/environment/te/index.htm>

Description

The Federal Highway Administration awards funds that benefit surface transportation and qualify in one of the twelve categories. Each state can receive up to 10 percent of their operating transportation budget. With regard to rehabilitation projects, the acquisition of historic easements and sites, historic preservation, and rehabilitation of historic transportation buildings are the three categories that are applicable. Different components of projects can qualify for these grants and the more qualifying components, the more funding the project is likely to receive.

Applications must be made to the state transportation enhancement director and are awarded based on qualifying elements. As an example, the 1996 rehabilitation of the Ben Schroeder Saddletree Factory in Madison, Indiana received \$932,000 in transportation enhancement funds for a \$1,166,000 project (Federal Highway Administration, 2008).

Community Development Block Grant (CDBG) – Entitlement Communities

Amount Available: Varies; determined through a statutory dual formula

Awarding Organization: Housing and Urban Development

Website:

<http://www.hud.gov/offices/cpd/communitydevelopment/programs/entitlement/index.cfm#more>

Description

CDBG funds are one of the most popular ways for localities to engage in incentivizing rehabilitation projects. From 2006 to the present, the entitlement community wing of the CDBG program allocated at least \$2.5 million each year. The application for funds must come in the form of a Consolidate Plan from one of the following eligible recipients: principal cities of Metropolitan Statistical Areas, metropolitan cities with populations of at least 50,000, and qualified urban counties with populations of at least 200,000. These localities can then allocate funds in a number of different ways that affect historic rehabilitation projects. Some of these include acquisition of real property, relocation and demolition, rehabilitation of structures, and the provision of funds to for-profit businesses to carry out economic development purposes. Applications are prioritized by attention to low and moderate-income communities, which often coincides well with historic property.

Community Development Block Grant (CDBG) – Non-entitlement Communities

Amount Available: Varies; determined through a statutory dual formula

Awarding Organization: Housing and Urban Development

Website:

<http://www.hud.gov/offices/cpd/communitydevelopment/programs/stateadmin/index.cfm#funds>

Description

The CDBG program for non-entitlement communities grew out of the recognition that states were in the best position to assess needs in non-major cities. Desiring to address the non-entitlement communities, this program applies to cities with less than 50,000 people and counties with less than 200,000 people. Accordingly, in 1981 HUD replaced the Small Cities program, allocating funds to 49 states and Puerto Rico on an annual basis. States must ensure that 70 percent of the allocated funds benefit low or moderate-income communities within three years. Beside these details, the permitted uses of the program are the same as those in the entitlement community version. Since 2006, HUD has allocated roughly \$1.1 million annually.

Public Works and Economic Development Program

Amount Available: Variable; 2008 awards totaled \$146,430,000

Awarding Organization: Economic Development Administration

Website: <http://www.eda.gov/AboutEDA/Programs.xml>

Description

The Public Works program is part of the larger Economic Development Administration, which endeavors to create sustainable economic opportunities in economically-distressed urban and rural areas. Specifically, the Public Works component allocates funds to support the construction or rehabilitation of facilities and public infrastructure in underserved areas. These funds may be used for the acquisition and development of land and improvements, construction, design, and engineering in projects that will create long-term private jobs and leverage private capital investment. Economic Development Administration funding is available to political subdivisions of states, special units of local government, and regional consortiums of political subdivisions. It is important to remember that, while the entirety of a project may not qualify for this program, components of rehabilitation projects certainly qualify.

Rural Housing and Economic Development (RHED)

Amount Available: Up to \$300,000

Awarding Organization: Housing and Urban Development

Website:

<http://www.hud.gov/offices/cpd/economicdevelopment/programs/rhed/index.cfm>

Description

RHED's intent is to foster innovative economic development and housing opportunities in rural areas, which consist of places with populations less than 2,500, counties with urban populations less than 20,000, and any place with a population of less than 20,000 that is not in a Metropolitan Statistical Area. The eligible applicants for this program include state community and economic development agencies, state housing finance agencies, recognized Indian tribes, community development corporations (CDCs), and rural non-profits. These funds are fairly flexible and can support plan preparation, architectural drawings, material purchasing, construction costs, and provision of infrastructure. They can also support revolving loans, Community Development Financial Institutions (CDFIs), and other forms of financial assistance. This presents an excellent opportunity to work with local governments in smaller towns and rural areas.

National Trust Loan Fund – Transformative Grant

Amount Available: Last grants totaled \$663,000

Awarding Organization: National Trust Loan Fund; John S. and James L. Knight Foundation

Website: <http://www.preservationnation.org/resources/find-funding/loans/national-trust-loan-fund/ntlf-knight-affordable-housing-fund-1.html>

Description

By partnering with the John S. and James L. Knight Foundation, the National Trust Loan Fund awards small grants to rehabilitation projects that will benefit the community, but are struggling to meet feasibility requirements. The funds were allocated to nine projects representing almost \$193 million in development costs. Requirements were scant, allowing the projects to use the funds for everything ranging from predevelopment costs to the installation of photoelectric power cells.

New Markets Tax Credits (NMTC)

Amount Available: 39% of Qualified Equity Investments in Community Development Entities; claimable over seven years

Awarding Organization: Community Development Financial Institutions Fund

Website: http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5

Description

Noted as one of the most effective programs for leveraging investment in distressed communities, the current federal administration is lobbying to expand and extend the NMTC program to \$5 billion annually. To qualify, investments must be made in Community Development Entities, which are dedicated to providing service and capital to low-income communities. The credits are taken over a seven year period, with the investor receiving five percent of the investment for the first three years and six percent for the final four. NMTC can often be paired with historic tax credits to generate additional equity. In an effort to expand the program, new changes are being considered, including allowing the credits to offset the Alternative Minimum Tax. This would open NMTC up to another class of taxpayers, potentially increasing future investment.

National Trust Community Investment Corporation (NTCIC)

Amount Available: Variable

Awarding Organization: NTCIC

Website: <http://www.ntcicfunds.com/about/>

Description

While this guide does not cover the use of historic tax credits explicitly, one important point made consistently by developers was the project scale necessary to syndicate tax credits. Most developers insisted that projects should be of at least a \$3-4 million magnitude to be worthy of syndication. The NTCIC, which is affiliated with the

National Trust, acts as a Community Development Entity and makes equity investments in projects that qualify for historic and New Markets tax credits. The value in the NTCIC is the willingness to contribute equity for tax credit projects as small as \$1 million. These investments are roughly one-third non-profit and two-thirds for-profit projects and can be an excellent consideration for smaller tax credit projects.

Section 108 Loan Guarantee Program

Amount Available: Five times the last CDBG amount received by the entity

Awarding Organization: Housing and Urban Development

Website:

<http://www.hud.gov/offices/cpd/communitydevelopment/programs/108/index.cfm>

Description

The Section 108 Loan Guarantee is one of the most fundamental funding elements in rehabilitation efforts. Essentially, the program enables localities to turn CDBG funds into low-risk guaranteed loans that are substantial enough to fund large rehabilitation and redevelopment projects. Regarding the details of the loan, the maximum repayment period is 20 years with interest rates based on LIBOR plus 20 basis points.

Brownfield Economic Development Initiative (BEDI)

Amount Available: \$17.5 million in 2010, maximum cap per award TBD

Awarding Organization: Housing and Urban Development

Website:

<http://www.hud.gov/offices/cpd/economicdevelopment/programs/bedi/index.cfm>

Description

BEDI's intent is to catalyze development in low and moderate-income industrial areas that are subject to real or potential environmental contamination. BEDI funds serve to stimulate or continue redevelopment on brownfield sites and can be used for land writedowns, site remediation, over-collateralization of Section 108 loans, enhancement of the security of Section 108 loans, and provision of below-market-rate financing to developers. Application for BEDI funds requires must be accompanied by request for Section 108 loans and the two must be used in conjunction. Furthermore, the maximum BEDI grant is a 1:1 ratio to the Section 108 guarantee.

Low-Income Housing Tax Credits (LIHTC)

Amount Available: Variable depending on the percentage of units priced at or below the Area Median Income

Awarding Organization: Housing and Urban Development

Website: <http://www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/basics/>

Description

LIHTC are one of the most useful methods of strengthening feasibility in rehabilitation projects. The credits are based on a complex system of multipliers involving the percentage of housing available to persons making less than the Area Median Income. For projects not financed with tax-exempt bonds, the minimum credit is nine percent of the qualified basis, which is the total cost of acquisition and rehabilitation of improvements. Each state is limited to credits totaling \$1.75 per resident and states can put restrictions on the amount available to individual developers.

In interviews with developers, they expressed a minimum project size of roughly 60-72 units in order to syndicate the credits. Based on this, it is important for developers to carefully consider their selection of LIHTC projects. In considering smaller projects, one solution is to assemble multiple sites into a scattered-site project.

HOME Investment Partnerships Program - Grant

Amount Available: Determined at state/local level by formula

Awarding Organization: Housing and Urban Development; State/Local governments

Website: <http://www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/basics/>

Description

The HOME program is the largest federal block grant available to benefit low-income housing, granting roughly \$2 billion annually to states and localities. One of the most significant notes about the HOME program is its flexibility in allocation. HUD can establish Investment Trust Funds that localities can draw off of to make grants, issue loans and guarantees, or provide other forms of financial assistance. The range of eligible activities is extremely broad, as long as mandatory minimum percentages of low-income residents are served.

One developer detailed the loan his projected received as part of the HOME program. With a loan amount of roughly \$250,000, the locality guaranteed an extremely low one percent interest rate over the 30-year amortization period.

National Trust Loan Fund (NTLF)

Amount Available: Up to \$350,000

Awarding Organization: National Trust for Historic Preservation

Website: <http://www.preservationnation.org/resources/find-funding/loans/national-trust-loan-fund/>

Description

The NTLF is a certified Community Development Financial Institution and specializes in permanent, predevelopment, acquisition, bridge, and rehabilitation loans for a variety of public and private entities. Borrowers eligible for loans under the NTLF include local governments, rehabilitation organizations, private developers, and organizations and entities involved in Main Street communities.

Eligible uses include upper-floor/mixed-use housing, commercial development, residential rehabilitation, affordable housing, façade improvements, and traditional preservation. The loan specifications are terms up to five years amortizing over 30 years, fixed-rate financing with local discounts available, a two percent origination fee, and a mandatory debt-coverage ratio of 1.10.

Small Business Administration (SBA) 504 Loan

Amount Available: Up to \$4 million

Awarding Organization: Small Business Administration

Website:

<http://www.sba.gov/financialassistance/borrowers/guaranteed/CDC504lp/index.html>

Description

The 504 loan is a long-term financing mechanism to help small businesses expand, improve, or modernize their facilities. The SBA works with Community Development Corporations and private lenders to facilitate this assistance to small businesses. Under the 504 program, businesses cannot have a net worth in excess of \$7.5 million and cannot exceed \$2.5 million in annual after-tax income. Additionally, speculative and rental real-estate businesses are not eligible.

Proceeds from 504 loans can fund the purchase of land and improvements, utilities, parking, landscaping, and the renovation of existing buildings. Interest rates relate to increments above the market rate for five and ten-year U.S. Treasury issues and are available in ten and twenty-year maturities. These loans also carry a three percent fee.

Final Thoughts

These methods only represent a small slice of the pie that is available to the creative developer. There is certainly no formulaic approach to bridging the equity gap in rehabilitation projects and every project necessitates a different solution. The keys to successful development then, lie in the ability of the development team to consider sources and uses of funds that may not be obvious at first glance.

Often, we think of projects at an entity level, failing to account for the numerous working parts that make up the whole. These parts are frequently what qualify a project for many of the varying options available from federal state and local governments. While the building itself may not be a candidate for different grants and loans, the infrastructure improvements associated with the site can be. Similarly, while not all of a project may fit into the guidelines of other subsidies, portions of the scope of work may and should not be overlooked.

This guide does not address a number of significant issues, first and foremost, opportunities at the state level. Some of the options contained in this guide do necessitate negotiations with state organizations for the administration of funding; however, the degree to which state programs and incentives vary made it too complex to consider them as part of this assemblage. As mentioned previously, the use of historic tax credits is probably the most significant source in rehabilitation projects. While I have attempted to address small aspects of historic tax credits, there is already a wealth of published information available to inform any interested party.

What remains as the final lesson in my journey through the murky waters of rehabilitation projects is that success inevitably depends on the willingness of the developer to think outside the standard solutions. Building on the foundation of solid relationships with the lending community, local government officials, and relevant reviewing bodies, employing this brand of creative thinking results in the best opportunities for achieving well-executed rehabilitation.

Appendix A: A “Give-and-Take” Process: Historic Materials and the Standards for Rehabilitation at Durham, NC’s American Tobacco Campus.

This paper, originally written in March 2009, was redrafted and edited for inclusion within this guide. It is intended to exemplify the flexibility of the Department of the Interior’s Standards for Rehabilitation in the federal historic tax credit process.

We are all familiar with the oft-quoted adage about missing the forest for its trees. In terms of historic preservation, however, it is vital to acknowledge the importance of these ‘trees’ to the overall ‘forest’. Specifically, if we view the historic site or building as the forest, it is entirely appropriate to envision the historic materials composing the site as the proverbial trees. In the course of preservation and redevelopment, the treatment of historic materials is a crucial piece of the puzzle. Defining the character of historic districts, the North Carolina General Statutes state that districts are significant “in terms of their history, prehistory, setting, *materials*², feeling, and association” (§ 160A-400.3, 1989). Furthermore, in regulating the change and use of historic structures, the Statutes specifically establish the “kind and texture of the building material”³ as a regulated feature (§ 160A-400.9, 1989).

Recognizing the value of historical heritage, the enabling legislation in the Statutes explicitly notes that “conservation and preservation...stabilize and increase property values in their areas and strengthen the overall economy of the State” (§ 160A-400.1, 1989). The stated purpose of this section is to safeguard the heritage and, more importantly, to “promote the use and conservation...for the education, pleasure, and enrichment of the residents.” This promotion of use is vital to the argument I will make and is important to remember throughout the following sections. Accordingly, the state of North Carolina participates in and supplements the tax credit incentives regulated by the United States Department of the Interior. To take advantage of these financial incentives, however, developers are required to comply with a relatively strict set of qualifications: most importantly, the Standards for Rehabilitation as established by the Secretary of the Interior. Comprised of ten individual rules, these Standards serve to guide all qualifying historic rehabilitation projects.

For the purpose of understanding the role of historic materials in the rehabilitation process, I selected the four Standards most pertinent to the issue:

- The historic character of a property shall be retained and preserved. The removal of *historic materials* or *alteration of features* and spaces that characterize a property shall be avoided.
- Distinctive features, *finishes*, and *construction techniques* or examples of craftsmanship that characterize a historic property shall be preserved.
- Deteriorated historic features shall be repaired rather than replaced. Where the *severity of deterioration* requires replacement of a distinctive feature, the new feature shall *match*

² Italicizing of quoted text is an editing choice of the author and does not represent special significance within the cited source. Rather, it serves to emphasize vital elements of the source text.

³ This section also acknowledges the “type and style of all windows, doors, light fixtures, signs, and other appurtenant fixtures”. For the purposes of this report, I have included these features as part of the historic materials classification, as all standards and issues relevant to materials apply.

the old in design, color, texture, and other visual qualities and, *where possible, materials*. Replacement of missing features shall be substantiated by documentary, physical, or pictorial *evidence*.

- New additions, exterior alterations, or related new construction shall not destroy *historic materials* that characterize the property. The new work shall be *differentiated* from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment (Historic Preservation Certifications, 1990).

Within these Standards are several items of importance. Obviously, the retention and protection of materials is readily apparent in the first two rules selected. In the case study, I will show how these Standards are applied in practice to the satisfaction of the National Park Service. Of greater interest to the focus of this report, however, are the Standards concerned with repair, replacement, and alterations. These Standards include the notions of material matching, documentary evidence, feasibility, and material differentiation.

Reading into the Standards, phrases such as “severity of deterioration”, “where possible”, and “differentiated from the old” suggest that the Standards are not as standard as the name implies. Rather, out of the desire to encourage the use of historic properties, these Standards provide a degree of interpretation and flexibility in the rehabilitation process. In fact, § 67.7 (b) explicitly states that the Standards “are to be applied...in a reasonable manner, taking into consideration economic and technical feasibility” (36 C.F.R. § 67, 1990). Expanding on this an architect of a Durham, NC project, described the approval of rehabilitation plans for the Historic Preservation Certification as a “give-and-take process” (Subject#1, 2009). In the subsequent sections, I intend to show, through a review of publications by Technical Preservation Services and a case study of this redevelopment project, that the approval of historic material treatments is as much subject to a high degree of justification and negotiation as it is to the stated Standards for Rehabilitation.

Historic Materials and the Standards for Rehabilitation

In 1977, Technical Preservation Services, a branch of the National Park Service, published the *Guidelines for Rehabilitating Historic Buildings*. The stated purpose of this document was to assist “property owners, developers, and Federal managers...during the project planning stage by providing general design and technical recommendations” (Weeks, 1992). The guidelines provide techniques and approaches that are “Recommended” as well as examples of those “Not Recommended”, but make specific mention that they are not intended to “give case-specific advice”. While the guidelines are useful in understanding valued methods, their most pertinent function is the constructed hierarchy of preservation processes. Specifically, the guidelines separate rehabilitation methods into six categories in hierarchical order: Identify, Retain, and Preserve; Protect and Maintain; Repair; Replace; Design for Missing Features; and Alterations/Additions to Historic Buildings.

Identification, Retention, and Preservation

The Identification, Retention, and Preservation step is self-explanatory and abides almost verbatim by the specifications of the Standards for Rehabilitation. This step is most congruent with the first two excerpted Standards, as it purely seeks to prevent the change or removal of historic materials. Most often, the Identification step is already completed by the time redevelopment proposals occur, as historic properties eligible for tax credits will already have some record of significance. Officials from the State Historic Preservation Office and the National Park Service will often make preliminary site visits to verify the significance. In fact, the majority of material analysis is done in the early stages. In the consideration of a project, the architect will often put together an assessment team composed of contractors, specialists, and preservation professionals to analyze the site and determine the significant features and most appropriate treatment. Following this step are the closely related Protection and Maintenance processes, which share a similar adherence to the Standards.

Protection and Maintenance

The Guidelines clearly denote the Protection and Maintenance step as the preferred option. Crucial to the understanding of this step is the notion of the “Least Degree of Intervention”. Included in this are inspection and testing of materials to determine the gentlest possible method of cleaning, providing proper drainage, removing rust and limited paint, and halting future deterioration through methods like protective coatings (Weeks, 1992). This step also best relates to the first two excerpted Standards, as the methods above are the actual techniques used to preserve the material character and “distinctive features, finishes, and construction techniques” (36 C.F.R. § 67 , 1990). As with the first step, there is little here that is objectionable or negotiable. It deals exclusively with existing features and materials that do not require substantial work. The remaining delineated steps in the guidelines are where the roles of interpretation and negotiation become essential.

Repair and Replacement

Repair and Replacement follow in the prioritized list and, while treated separately in the Guidelines, can be logically analyzed together, as they represent the beginning of the interpretive process. These steps also make use of the Least Degree of Intervention concept by recommending methods such as “patching, piecing-in, splicing, consolidating,” or otherwise reinforcing deteriorated materials (Weeks, 1992). This allows for the retention of as much historic material as possible, while ensuring that it is brought up to an acceptable condition. Repair and Replacement also make use of “Limited Replacement in Kind” when features are “extensively deteriorated or missing parts.” This method, however, is only acceptable when there are existing prototypes, recalling the important issue of evidence. By relying on prototypes or other forms of evidence, it is possible to recreate these missing parts in a way that still complies with the Standard of preserving distinctive features.

Repair and Replacement, however, also recall the issue of feasibility in the treatment of materials. While the Guidelines specify the preference for in-kind replacement, they note that “substitute material is acceptable if the form and design as

well as the substitute material itself convey the visual appearance of the remaining parts.” As with a missing part of a feature, the replacement of an entire feature with in-kind material is the clear preference when the “essential form and detailing are still evident.” The third excerpted Standard mandates the matching of replacement features mentioned previously, with specific attention to color, texture, and materials. This is vital in the repair and replacement of features, as incorrect matching of colors and textures can dramatically alter the appearance. Countless examples of improper mortar color exist and exemplify the effects that poor replacement can have. Substitutes are also acceptable when in-kind replacement is not technically or economically feasible (Weeks, 1992). Bringing feasibility in as a consideration opens these steps up to the aforementioned interpretive processes. As site and feature conditions vary, along with the financial and technical wherewithal of the owner, the flexibility of repair and replacement options increases. While the Guidelines discourage the removal and replacement of original materials that could be repaired, in accordance with the Standards, well-justified arguments can often lead to changes in the original material.

Design for Missing Features

With the absence of an entire feature, it no longer plays a significant role in the historic character. In this step, the designer and owner have an expanded array of options. The stated preference of the Standards and Guidelines is the recovery of the feature itself; yet, this is often impossible, necessitating other options. With accurate documentary evidence, the Guidelines also permit reproduction of the element, provided the owner desires to “reestablish the feature as part of the building’s historical appearance.” The final alternative is a “new design that is compatible with the remaining character-defining features” and takes into account the size, scale, and material (Weeks, 1992). This option raises difficulties concerning the Standards, as it mandates consideration of the historic materials, but simultaneously requires that the “new work...be differentiated from the old” (36 C.F.R. § 67 , 1990).

The issue of differentiation is a contentious one, as there is no quantifiable way to determine what constitutes adequate differentiation. A fine line divides accounting for the historic character of colors, textures, and materials and replicating historic design, which the Standards expressly discourage. There is a great deal of interpretation and subjectivity when considering newly designed features, as the approval of the project depends on the subjective judgments of the State Historic Preservation Office and the National Park Service. The subjectivity of this process is what leads to negotiation on the acceptability of proposed designs, as varying interpretations of differentiation require vast differences in design - an issue fully exposed in the final step of the Guidelines.

Additions and Alterations

If designing for missing features raises the question of differentiation of materials and design, alterations and additions to historic buildings bring it to a head. The National Park Service and the Technical Preservation Services division recognized the difficulties implicit in this issue to such a degree that they undertook the publication of a series of bulletins on material concerns in specific Addition and Alteration situations. If the

evaluation of repair, replacement, and missing features was open to interpretation, the consideration of additions and alterations is an argument of justification in and of itself. Of most relevance in the Standards is the issue of differentiation, but the often substantial changes required by rehabilitation and reuse make this issue a negotiation by necessity. With respect to historic materials, not only are there concerns about matching, not replicating, the original use, but there are also explicit instructions to prevent “character-defining features [from being] radically changed, obscured, damaged, or destroyed” (Weeks, 1992).

Specifically, redeveloping historic properties for new uses often requires de-facto changes to the building: most commonly in the form of new entrances and fenestration. Essential to this consideration is the issue of feasibility, though not in the context it occupied in the previous steps. In additions and alterations, it is the feasibility of use that is at issue, and this is the crux of the negotiation process. With the stated goals of reusing historic properties for present and future benefit, the designer and owner have a large degree of leeway to justify their proposals. It is for this reason that Technical Preservation Services went to such lengths to qualify what is appropriate. A building that requires a new entrance must now follow these bulletins. For example, new entrances should not reorient the building, be able to “be confused with the historic entrance, [or] change the character of the building.” Additionally, the new entrance should be a “compatible, contemporary design that does not draw attention” (Grimmer, Adding New Entrances to Historic Buildings, 2001). Further, “new entrances should be simple in design; they should not appear historic; [and] they should blend in with the façade” (Staveteig, New Entries on Mill Buildings, 2004). Contained within these requirements are marked concerns for original materials through limiting new openings, preventing the disruption of original materials, and ensuring that the original entrance remains distinct. However explicit the bulletins, the waters remain somewhat murky on this issue, as there is uncertainty about the difference between blending with the façade and differentiation.

Similarly, fenestration bulletins present explicit concerns for the historic materials of buildings, especially given the frequent requirement of cutting into historic walls to create new fenestration. Here, attention to materials comes in the form of a “wall’s sense of solidity,” as the character of buildings “is defined – at least in part – by their blank walls” (Grimmer, Adding New Openings on Secondary Elevations, 2001). Furthermore, the number of new windows should be minimal and fundamentally different from existing historic windows to maintain “the historic massiveness” of original walls (Staveteig, New Openings in Secondary Elevations or Introducing New Windows in Blank Walls, 2000). If functional, non-historic, windows already exist, additional specifications allow for the retention of the windows or their replacement “based on existing fabric, on historic documentary or pictorial evidence...[or] the historic character of the building” (Kelly, 2001). This bulletin explicitly cites the Standard requiring visual and material matching, emphasizing the importance of materials in fenestration alterations. Like the issue of blending with entrances, the possibility of design to match historic character raises conflict over the difference between historic replication and differentiation, though Grimmer’s bulletin specifies that “windows themselves should generally be distinguishable from the historic windows by the use of a simpler, or a slightly different light configuration (Grimmer, Adding New Openings on Secondary Elevations, 2001).

The degree to which Technical Preservation Services addresses issues of alteration and addition is evidence of its flexibility. By providing illustrated examples throughout the bulletins, they make a concerted effort to qualify the options available; however, the variability in the examples lends strength to the prospect of negotiation. While citing the applicable Standards in each bulletin, they also provide avenues of argument, as a well-reasoned justification of a design can easily satisfy the openings left by the interpretable language. If the owners and designers can show that their proposals satisfy the intentions of the specific Standards, but require exceptions due to feasibility or differentiation, there is a window of opportunity for approval. Likewise, the ambiguous and subjective requirements for matching, blending, and documentary evidence allow flexibility if the owner and designer can provide sufficient reasoning for the change.

Case Study: American Tobacco Campus – Durham, NC

The recent redevelopment of the American Tobacco Company Manufacturing Plant in Durham, NC stands as an ideal example of the flexibility and subjectivity involved in historic project approval. Abandoned after production stopped in August of 1987, the approximately 15-acre property sat unused until the construction of the Durham Bulls stadium adjacent to the site. Proximity to Durham's business district, the Durham Expressway, and the new stadium made the site prime real estate. Consequently, several proposals for adaptive reuse were considered in the 1990s until Capitol Broadcasting Company finally purchased the site and proceeded with its rehabilitation, getting it added to the National Register of Historic Places in 2000 (Brown, 2000). With an estimated cost of rehabilitation of more than \$80 million (_____, 2000), the project stood to be the largest of its kind in Durham and came to epitomize the revitalization of the city's downtown (Brown, 2000).

With such a high projected cost of redevelopment, the use of historic tax credits - and therefore the compliance with the Standards for Rehabilitation - was essential to the continuation of work. One need only point to the estimated time of completion, which Part 2 of the Historic Preservation Certification Application lists as December 2001, to see that the developers were counting on the tax credits to repay the project's investors (_____, 2000). Accordingly, the principal designer and consultant on the project paid careful attention to the assessment of historically significant materials and methods; however, the importance to the city of Durham, the substantial size of the project, and the fact that such a large site would continue to be an unused eyesore in a prime location provided the grounds for the justification of several design decisions that would otherwise probably fail to receive approval. As demonstrated below, the project paid close attention to the Standards in the relatively straightforward Protection, Repair, and Replacement steps. Yet, it also took into account the significant exceptions to the Guidelines permitted by the National Park Service and State Historic Preservation Office that allowed the project to move forward with designs for missing and new features.

Protection and Maintenance

The Power Plant Smokestack, a prominent and widely-recognizable feature of the site, was in fair to good condition upon beginning the project; however, to be consistent

with the goals of protection and maintenance, the architect submitted plans to the National Park Service to retain, repair, and “permanently stabilize this visual, focal ‘lightning rod’ as the central orientation point. Lightning had indeed cracked and damaged the structure, and masonry repairs were undertaken to match the color, style, and texture of the existing feature in a way that renewed its prominence on the site.

Similarly, the Lucky Strike Water Tower was structurally sound, but had a severely weathered finish. In order to retain this “center stage element”, contractors “freshened” the logo and finish in accordance with the Standard that mandates the preservation and protection of characteristic finishes (_____, 2000).

Exemplifying the careful protection methods discussed in the Guidelines, the treatment of the Crowe Building Entrance, constructed in 1954, involved a light cleaning of the precast concrete surround “with soap, water, and a soft brush” (_____, 2000). While labor intensive, this attention to detail satisfied the Standards while earning the trust of the National Park Service, which proved instrumental in later proposals (_____, 2000).

Repair and Replacement

The Strickland Loading Dock, a non-historic addition to the contributing section of the building, is a prime example of how the design team satisfied the Standards’ methods concerning repair. The original brick window openings had been modified to create a loading dock door, so the architect set about lowering the concrete sill to its original height. They then proceeded to repair the masonry below the window sill, taking special precautions in the submitted proposal to specify that the brick and mortar would match the adjacent original materials (_____, 2000).

Another excellent example of repair, as well as protection and maintenance, was the proposal for the treatment of the Old Bull Building, constructed in 1874. A large building constructed with slow-burn brick and mortar, the Old Bull Building was covered with steel framework and fiberglass panels sometime in the 1950s (Brown, 2000). The submitted proposal specified that the building would first be weatherized during Phase One, and then would undergo removal of the elevation cladding and subsequent repair of the underlying walls. Furthermore, existing salvageable windows would be repaired and missing windows would be replaced in-kind (_____, 2000).

To provide an ideal instance of repair, we need look no further than the windows of the Strickland building. Initial evaluation found that “almost all of the original windows are gone and the openings infilled with brick and smaller metal doors.” Following the stipulations regarding the use of existing prototypes and evidence, the plans referenced the few remaining windows and had all window openings reestablished and replaced with similar windows (_____, 2000).

Design for Missing Features

Following what appears to be a theme in the abandoned industrial complex, windows posed a frequent dilemma for the redevelopment proposal. As stated previously, there is a large degree of ambiguity regarding the line between falsely historic and historic material character. The third-floor façade of the Reed building serves as a

perfect example of one solution that made excellent use of prototypical and documentary evidence and ideally suited the historic character of the building. The building's arched window openings remained, but had been bricked in and covered in metal louvers. With no remaining windows in place, the designers referenced documentary evidence and the windows of the nearby Lucky Strike building and had "new painted metal, hopper-style windows" installed to keep with the flexible Standards and Guidelines on missing features (_____, 2000).

To represent the other side of designing for missing features, the Strickland building's North Bay proposal contained the design of new painted metal doors to replace the missing features. Without the original exit doors and no reference, the architects were free to design new features to replace them, creating a three-bay portico entrance different than the original five bays (_____, 2000). In contrast, the Reed building entrance also lacked doors in its three original arched openings. After the removal of the non-contributing concrete dock, evidence was used to reestablish the doorways "at their original size and shape," though new concrete steps were added to facilitate visitor entry (_____, 2000).

Additions and Alterations

As mentioned previously, it is primarily the additions and alterations to a project that are most threatening to project's historic tax credit eligibility. Fittingly, it is also the additions and alterations that prompt the most negotiation on the part of the designer and owner. According to an architect, the large-scale nature of the American Tobacco project allowed the architects substantial license in their negotiations with the State Historic Preservation Office and the National Park Service (Subject#1, 2009). While the prior proposals discussed were not particularly contentious, several of the addition and alteration proposals drew the ire of preservation officials. In order to gain the approval of these organizations, there were several important factors.

First and foremost is the consideration of feasibility. In Bays 3-10 of the Washington West Elevation, the windows were entirely bricked in and the quality of the materials in the wall was assessed as being "fair". The proposal was to convert and reuse this area as parking, which was an initially unattractive prospect; yet, the experience of the firm and its superb use of documentary evidence helped gain approval for this use. By citing frequent historic use of the Carr Street elevation as a loading dock for delivery needs, the firm established historical consistency with its proposed use. Additionally, by highlighting the lack of "visual intrusion" on the site and the necessity of parking facilities to the new uses, the architect made a strong case for the approval of this plan (_____, 2000).

Also of note in the clever proposals of the experienced firm was the prospect of competition as a basis for altering the buildings. Playing on the perceived benefit of the completed project to the city of Durham, and referencing the regional competition between Durham and the rest of the Triangle area, the architect proposed the construction of penthouse executive offices atop the Strickland building. Citing a "determined requirement for executive areas with views of the Ballpark," the designers used these tools to find the approval for a lucrative feature of the new site (_____, 2000).

Perhaps the most significant approval of a proposal in stark contrast with the Standards for Rehabilitation came in the form of new windows on the formerly windowless Crowe building. With “horizontal belts of limestone at water table and cornice level” on an otherwise “unornamented, brick façade” the large, imposing building had no other features besides the “slightly-projecting central bay” (Brown, 2000). Taking care to note that the wall “focuses on the dominant, projecting center third,” the architect proposed to leave the center bay “intact as the dominant feature” (_____, 2000). Making the argument that the Crowe building represented 65,000 square feet of potential space that would otherwise go unused without fenestration, the designers submitted plans to add new windows to “shadow” the center bay. In order to minimize the effect on the historic materials and the character of the windowless wall, the firm cut long, tall openings and set windows flush with the brick to maintain wall consistency. The long openings retained the large expanses of blank wall that defined the building, the colors chosen for the glass and framing were picked to match the adjacent brickwork, and the work left the middle section untouched. While the National Park Service eventually agreed and approved the proposal due to the necessity of using this building, they apparently did so without enthusiasm, even issuing a statement that proposals were reviewed on a “case-by-case basis” and this approval was, by no means, “precedent setting”.

Conclusion

While it is clear that the majority of original material treatment is done directly in compliance with the Standards for Rehabilitation, the publications of the National Park Service and the case of American Tobacco lend strength to the idea that negotiation is possible. While the size and prominence of the American Tobacco project potentially gave it more weight than the average undertaking in adaptive reuse, the lesson learned is no less valid. In fact, the admission by the National Park Service that the applications are reviewed on a case-by-case basis perhaps even further propagates the notion of flexibility. Furthermore, changes in organization staff can have a substantial effect on approvals. With differentiation, matching, feasibility concerns, and blending carrying such weight in certification decisions, the varying views and opinions of preservation professionals are inherently subjective and cannot provide the consistency implied by the Standards for Rehabilitation. While the Standards do express clear goals and the Guidelines provide substantial assistance in the planning of projects, the flexible nature surrounding historic materials continues to allow for the justification of material changes for the benefit of the whole. In other words, the ‘forest’ of the building can often rationalize the changing of the material ‘trees’ as much as the trees affect the approval of the forest.

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