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CITIZENS SUMMARY

Findings in the audit of the Historic Preservation Tax Credit Program

Background

The Department of Economic Development (DED) Missouri Historic Preservation Tax Credit (HPTC) program was established in 1998 to provide an incentive for the redevelopment of commercial and residential historic structures statewide. In fiscal year 2013, the HPTC had approximately $79 million in redemptions, making it the state's third largest tax credit program. The HPTC provides state tax credits (which may be used to offset tax liability) equal to 25 percent of eligible costs and expenses of the rehabilitation of approved historic structures. The HPTC credit can be transferred, sold or assigned, but is not refundable. Missouri is one of at least 30 states that have established state tax credits for historic preservation. Eighteen of these 30 states have established an overall annual program limit, of which Missouri has the highest. As part of our audit, we interviewed DED and State Historic Preservation Office officials and staff and various external parties. We obtained information from the National Trust for Historic Preservation and contacted applicable state agency representatives from several other states. We also reviewed ten tax credit project files, reviewed historical trends, and visited several completed HPTC projects.

Program Cost

With redemptions of over $1.1 billion in the past decade, Missouri's historic preservation program is the largest in the nation. Missouri leads the nation in qualified rehabilitation expenses for historic preservation purposes and program redemptions have exceeded fiscal note estimates. The General Assembly imposed a $140 million annual program limit, which went into effect in 2010, but Missouri could reduce this limit to $75 million, as recommended by the Governor's Tax Credit Review Commission November 2010 report, and still have the largest state historic preservation program in the nation.

Program Efficiency and Effectiveness

While the goals of the program are laudable in some respects, the state's HPTC program is an inefficient use of state resources. Only 49 cents to 85 cents of every tax credit dollar issued actually goes toward rehabilitation costs. The remainder goes to investors, tax credit brokers or syndicators, and the federal and state government in the form of income taxes. HPTC applicants generally sell the credit to third parties and use the proceeds to reduce construction-related debt, but the sale of a HPTC certificate creates taxable income, resulting in additional income tax due by the seller. Our audit identified several options to improve the efficiency of the current HPTC program, including making the HPTC refundable to make the credit more attractive to investors and reduce the incentive to sell the certificates at a discount; requiring credits be assigned to a state agency, local political subdivision or other not-for-profit organization that would sell the credits in the market and grant the proceeds to the project; or eliminating the use of the state tax credits in favor of direct appropriations through a state agency to fund historical rehabilitation projects.

Too much time passes between project completion and the tax credit certificate issuance, which increases interest costs incurred by developers and reduces equity going toward construction.

The use of HPTC on owner-occupied residences may not be a needed, reasonable, or effective use of taxpayer dollars. The audit noted several instances where the credit was used for renovations to homes with high property values and high renovation costs. Because the tax credits represented a small percentage of total renovation costs, the credits may not have been a significant determining factor in the decision to redevelop the properties. The Governor's Tax Credit Review Commission December 2012 report recommended limiting the maximum tax credit allowed for owner-occupied residences to $50,000 and prohibiting the tax credit for owner-occupied residences if the home was purchased for more than $150,000.

The HPTC program is not subject to a sunset provision, and state law does not prohibit claiming the same project costs under two or more tax credit programs. This "stacking" of tax credits allows additional tax credits to be issued while no additional economic activity or state benefit is generated.

Program Administration

The DED could improve its oversight. State agency personnel do not conduct site visits, and the DED's cost certification work is inefficient and redundant. The DED does not monitor project approval time to ensure compliance with state law, and program activity projections appear to overstate the economic impact of the HPTC program. The DED's economic activity projections contain several flawed assumptions, and the DED does not verify or review the accuracy of the number of jobs reported on the preliminary application. The DED is not consistent with respect to the eligibility of certain costs, which often leads to disputes.

In the areas audited, the overall performance of this program was **Fair***

***The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

Excellent: The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.

Good: The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.

Fair: The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.

Poor: The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.