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Upstairs in the Vieux Carré: An Analysis of Incentives and Tools to Catalyze Private Sector Rehabilitation

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Upstairs in the Vieux Carré: An Analysis of Incentives and Tools to Catalyze Private Sector Rehabilitation

Abstract
Millions of tourists flock to New Orleans’s famed French Quarter each year to enjoy its offering of unique culture and historic buildings. However, many of the low-rise historic buildings are in need of rehabilitation. These blighted structures threaten the vitality of the Vieux Carré Historic District. This thesis examines public sector incentives and tools to determine their ability to catalyze private sector rehabilitation of the French Quarter’s low-rise historic buildings. A list of extant incentives and tools were compiled and tested using two hypothetical projects, each representing a different type of common French Quarter building typology. The goals of this financial analysis were to determine which incentives provided the greatest monetary impact and whether or not the impact was sufficient to motivate the private sector to undertake the project. The analysis determined that state and federal historic tax credits were the most effective incentives, but that they were not adequate to spur a significant amount of rehabilitation activity on the French Quarter’s low-rise buildings. A sensitivity analysis was conducted on both federal and state historic tax credits to determine the appropriate tax credit rate. The analysis determined that combined tax credit rate of up to 90% of Qualified Rehabilitation Expenditures was necessary to achieve the necessary unleveraged yield for real estate developers to undertake these small-scale rehabilitation projects. Other recommendations included the adoption of tiered tax credit rates, reform of the Louisiana residential rehabilitation tax credit program, and the adoption of a rehabilitation sub-code under the parish’s building code ordinance.

Keywords
rehabilitation, incentives, new orleans, vieux carré, tax credits

Disciplines
Historic Preservation and Conservation

Comments
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UPSTAIRS IN THE VIEUX CARRÉ: AN ANALYSIS OF INCENTIVES AND TOOLS TO CATALYZE PRIVATE SECTOR REHABILITATION

Lawrence Jay Timon

A THESIS

in

Historic Preservation

Presented to the Faculties of the University of Pennsylvania in Partial Fulfillment of the Requirements of the Degree of

MASTER OF SCIENCE IN HISTORIC PRESERVATION

2012

____________________
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Lecturer in Historic Preservation

____________________
Program Chair
Randall F. Mason
Associate Professor
Dedication

Figure 0-1: Timons at Mardi Gras-Krewe of Bacchus, Lupin Float-Side Party

For Lawrence J. Timon III and F. Gaynell Timon, who ignited my passion for the City of New Orleans and Mardi Gras, educated me about business, shared their love, and instilled the values that continue to guide me to this very day.

For my brother, Philip C. Timon and his children who provided me with endless entertainment and unconditional love on my frequent trips to Chadds Ford.
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Donovan Rypkema       E. Ralph Lupin
Patricia Gay           Marcel Wisznia
Tim Lupin              Andrew Potts
Ted Featherstone

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<th>Description</th>
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<td>CBD</td>
<td>Central Business District</td>
</tr>
<tr>
<td>CBDHDLC</td>
<td>Central Business District Historic District Landmark Commission</td>
</tr>
<tr>
<td>CDE</td>
<td>Character Defining Element</td>
</tr>
<tr>
<td>CO</td>
<td>Certificate of Occupancy</td>
</tr>
<tr>
<td>GO Zone</td>
<td>Gulf Opportunity Zone Act</td>
</tr>
<tr>
<td>HTC</td>
<td>Federal Historic Tax Credit</td>
</tr>
<tr>
<td>LED</td>
<td>Louisiana Department of Economic Development</td>
</tr>
<tr>
<td>LIC</td>
<td>Low Income Community</td>
</tr>
<tr>
<td>LIP</td>
<td>Low Income Persons</td>
</tr>
<tr>
<td>LRRRTC</td>
<td>Louisiana State Residential Rehabilitation Tax Credit</td>
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<tr>
<td>LRTC</td>
<td>Louisiana State Commercial Rehabilitation Tax Credit</td>
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<tr>
<td>National Register</td>
<td>National Register of Historic Places</td>
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<td>NMTC</td>
<td>New Markets Tax Credit</td>
</tr>
<tr>
<td>NOI</td>
<td>Net Operating Income</td>
</tr>
<tr>
<td>NPS</td>
<td>National Park Service</td>
</tr>
<tr>
<td>OPA</td>
<td>Owner Participation Agreement</td>
</tr>
<tr>
<td>QRE</td>
<td>Qualified Rehabilitation Expenditures</td>
</tr>
<tr>
<td>PRC</td>
<td>Preservation Resource Center</td>
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<tr>
<td>RTA</td>
<td>Louisiana Restoration Tax Abatement</td>
</tr>
<tr>
<td>TIF</td>
<td>Tax Increment Financing</td>
</tr>
<tr>
<td>TOT</td>
<td>Transient Occupancy Tax</td>
</tr>
<tr>
<td>VCC</td>
<td>Vieux Carré Commission</td>
</tr>
</tbody>
</table>
Chapter 1 Introduction

Background:

Millions of tourists flock to New Orleans’s famed French Quarter each year to enjoy its offering of unique food, music, culture and historic buildings. However, many of the low-rise historic buildings are in a deteriorated state and in need of rehabilitation. These blighted structures threaten the vitality of the entire French Quarter historic district.

The effective rehabilitation of these buildings holds the promise of revitalizing the French Quarter’s renowned “tout ensemble”. Their reuse would increase the neighborhood residential base without compromising the neighborhood’s scale. Furthermore, it would expand and diversify the employment base beyond the extant ground floor retail, restaurant, and entertainment uses. In an effort to lend support to this effort, this thesis seeks to examine public sector incentives and tools for their ability to catalyze private sector rehabilitation of the French Quarter’s low-rise historic buildings.

Thesis Question:

The specific thesis question to be address in this thesis is:
What set of changes in public sector incentives and tools would catalyze significant new private sector rehabilitation of the French Quarter’s low-rise historic buildings?

**Research Methodology:**

The research methodology used to examine the thesis question includes:

1) Identifying current rehabilitation incentives and tools available in New Orleans;

2) Identifying existing challenges to rehabilitation of the French Quarter’s historic low-rise structures;

3) Analyzing existing incentives and tools to determine their efficacy in catalyzing rehabilitation in the French Quarter;

4) Conducting a sensitivity analysis on the incentives and tools to determine the most appropriate mix and level of incentives; and

5) Providing observations and recommendations.

Prior to conducting any formal analysis, the following steps were used to determine the appropriate analytical tools and prepare relevant data:

1) A literature review was conducted;

2) Interviews with key public sector officials and private sector practitioners were undertaken;

3) Fieldwork involving existing for-sale properties in New Orleans was conducted; and
4) A financial pro forma model was developed.

**Literature Review:**

As part of the research process, a review was conducted of scholarly literature, reports, and studies on topics related to the thesis question. The literature review aimed to:

1) Identify current incentives and tools available in New Orleans and Louisiana related to rehabilitation.

2) Review federal historic tax credits (“HTCs”) and incentives.

3) Review journal articles, theses, and other scholarly writings on incentives, policies and tools to catalyze rehabilitation.

**Interviews:**

A critical aspect to the success of any set of incentives and tools lies in their ability to address relevant market conditions or factors. Each building, neighborhood, and political unit (i.e. city, county, or state) faces a unique set of opportunities and challenges to successful rehabilitation of its historic buildings. To help identify these market conditions, a series of interviews was conducted with both private sector practitioners and public sector officials involved in historic preservation.

**Fieldwork:**

To further document local conditions, the author toured rehabilitation projects in both the French Quarter and Central Business District. These site visits
provided valuable background information used to identify both opportunities and challenges to rehabilitation of both low-rise and mid-rise historic buildings in the New Orleans.

**Financial and Sensitivity Analyses:**

A financial analysis will be conducted to determine the efficacy of the existing incentives and tools using two prototypical French Quarter rehabilitation projects based on common building typologies and extant building scale. Afterwards, a set of sensitivity analyses will be undertaken to determine the recommended mix and amount of incentives and tools necessary to create the desired private sector rehabilitation activity.

**Findings & Recommendations:**

The thesis concludes with the presentation of a set of findings and recommendations based on the results of the financial and sensitivity analyses and other information generated throughout the thesis research process.
Chapter 2 Literature Review

Public Sector Incentives

There are a significant number of public sector incentives available to catalyze private market-rate redevelopment or rehabilitation. The five purposes of incentive programs are to (Morris, 1992):

1) Provide a contract between the property owner and a public entity to maintain a historic property in exchange for public money;
2) Counter government forces or land use policies that inadvertently threaten historic resources;
3) Generate systematic rehabilitation of historic buildings;
4) Provide a level playing field for rehabilitation projects to compete with new construction; and
5) Compensate owners who may be significantly burdened by historic preservation laws.

The primary goal of these incentives is to positively impact (McMillan III, Mendenhall, & and Richardson, Summer 2007):

1) The total project costs,
2) Project revenue projections, or
3) Future value of the completed project to the point that the desired project is rendered feasible.
This goal can be accomplished through either incentive programs that are tied to:

1) A specific private rehabilitation project (i.e. tax credits); or

2) Public investments that create an overall environment that encourage private investment in rehabilitation (i.e. TIF program to address infrastructure issues).

An initial step in the research process was a review of scholarly literature, reports, and studies on topics related to:

1) Federal HTCs and incentives.

2) Current incentives and tools available in New Orleans and Louisiana related to rehabilitation and reuse of historic buildings.

**Federal Historic Rehabilitation Incentives**

**Federal Rehabilitation Tax Credit Program**

The HTC program has proven to be one of the most effective tools in the field of historic preservation and has been successfully utilized in a full spectrum of commercial and income-producing residential projects that meet the program requirements (Marburger, 2009). The program makes available HTCs equal to 20% of Qualified Rehabilitation Expenditures (“QREs”) on a certified rehabilitation of a
certified historic building (National Park Service, 2009).¹ These HTCs allow a qualified taxpayer to reduce its federal tax liability on a dollar for dollar basis.

In order to qualify for these HTCs, a rehabilitation project must meet the following criteria (National Park Service, 2009):

1) The building must be certified as “historic” as determined by one of the following three qualifications:
   a. An individual listing on the National Register of Historic Places (“National Register”);
   b. A contributing building within a National Register Historic District; or
   c. A contributing building within a state or local historic district.

A property owner can receive verification of the status of its building by submitting a Part I Certification application prior to the commencement of any rehabilitation activity.

2) The rehabilitation work must be certified as historic. Compliance with this criterion is based on the submission of a Part II application to the National Park Service (“NPS”) for review and certification that the planned rehabilitation meets the Secretary of the Interior’s

¹ There is also a 10% federal tax credit program for rehabilitation of “non‐historic” income‐producing buildings. However, this tax credit program will not be examined in this thesis since the subject matter is historic buildings within the Vieux Carré’ Historic District.
Standards for Rehabilitation. The NPS review also verifies that a building’s character defining elements (“CDEs”) are retained.

3) The rehabilitation work must pass the “substantial rehabilitation” test, which requires the QREs on the project exceed the greater of:
   a. $5,000; or
   b. The adjusted basis in the building.

4) The building must be depreciable under IRS requirements.

5) The property owner must obtain a Part III certification that all of the rehabilitation work is complete and in compliance within three years of the rehabilitated building being placed into service.

QREs may include the following expenditures (National Park Service, 2009):

1) Rehabilitation hard costs within the existing building including interior demolition and environmental remediation.

2) Construction related soft costs such as architectural design fees, building permit fees, third-party consultants and other soft costs related to the planned rehabilitation.

Certain potential construction costs do not qualify as QREs including (National Park Service, 2009):

1) Acquisition costs including permanent financing costs, title insurance and recording fees.

2) Land costs.
3) Hard and soft costs associated with new construction outside of the historic building, exterior demolition, site work, or furnishings.

The program also prohibits owner-occupied private residences from qualifying for HTCs (National Park Service, 2009). This provision has the unfortunate consequence of eliminating from the HTC program a large number of historically significant private buildings in the French Quarter that are owner-occupied single family residences.

**New Market Tax Credits**

The New Markets Tax Credit ("NMTC") program was established by the federal government through the Community Renewal Tax Relief Act of 2000 to encourage private capital investment in low income communities ("LICs" that are perceived to be high investment risks (Abravanel, Pindus, & and Theodos, September 2010). Under the NMTC program, tax credits are allocated through a competitive process to special purpose organizations that, in turn, use them to invest in projects intended to improve such communities (Abravanel, Pindus, & and Theodos, September 2010).

The use of NMTCs as a tool to rehabilitate historic structures in Louisiana grew significantly after Hurricane Katrina struck southern Louisiana in 2005. However, the NMTC projects in New Orleans were primarily dedicated to large rehabilitation projects located in the Central Business District (Houtman, 2010). The average transaction size for the nine NMTC projects associated with the Gulf
Opportunity Zone Act ("GO Zone") in New Orleans since Hurricane Katrina was $6,908,695 (Houtman, 2010). This large transaction size reflects the programs reputation for high transaction costs and the tendency to use it on larger scale projects.

No NMTC investments have taken place in the French Quarter (Houtman, 2010). This phenomenon can be explained by examining the demographics of the French Quarter. In 2009, the median household income was $43,677, while it was $36,468 for the City of New Orleans as a whole. As mentioned above, the NMTC program mandates that investments be focused either in LICs or to serve Low Income Persons ("LIPs") in higher income census tracts.

Clearly, the French Quarter does not qualify as a LIC given its high median household income. Furthermore, LIPs are not expected to be served by the prototypical French Quarter projects considered in this thesis since they are market rate deals. As a result, NMTCs are not expected to be available for these projects and will not be analyzed for their potential financial effect.

State of Louisiana Incentives

Louisiana State Commercial Rehabilitation Tax Credit Program

As a supplement to the federal rehabilitation tax credit, the State of Louisiana created the Louisiana State Commercial Rehabilitation Tax Credit ("LRTC") program, its own tax credit program for the rehabilitation of income-producing

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2 U.S. Census data
historic properties (Louisiana Department of Economic Development, 2012). The LRTC program provides a 25% state tax credit on QREs on a certified rehabilitation of a certified historic structures (Louisiana Department of Economic Development, 2012).

In order to be eligible for LRTCs the following criteria must be met (Louisiana Department of Economic Development, 2012):

1) The building must be a contributing element to a Downtown Development District (“DDD”) or a Cultural District.
2) The building must be used for an income-producing purpose.
3) QREs must exceed $10,000.
4) No taxpayer or entity affiliated with that taxpayer may receive more than $5 million in credits for rehabilitation work within a particular DDD.
5) Rehabilitation must meet the Secretary of the Interior’s Standards for Rehabilitation.

The application process for LRTCs follows the same basic three-part approach as the federal HTC program. Each of the three-part requires “certification” by the State of Louisiana’s Division of Historic Preservation as follows (Louisiana Department of Economic Development, 2012):

Part 1: Documents the building as a certified “contributing” historic structure that is eligible to receive the tax credit.
Part 2: Describes the proposed rehabilitation project.

Part 3: Documents that the rehabilitation work was completed according to Secretary of the Interior’s Standards for Rehabilitation.

**Louisiana State Residential Tax Credit Program**

In an effort to encourage rehabilitation of owner-occupied historic buildings, the State of Louisiana has also adopted the Louisiana State Residential Rehabilitation Tax Credit ("LRRTC") program (Louisiana Department of Economic Development, 2012). The LRRTC program provides either a 25% or 50% state tax credit on QREs on a certified rehabilitation of a qualified private residence (Louisiana Department of Economic Development, 2012).

Building eligibility for this LRRTC program is more liberal than other tax credit programs offered by the State of Louisiana. Buildings need only meet one of the following criteria in order to qualify for LRRTCs (Louisiana Department of Economic Development, 2012):

1) A contributing element to a:
   
   a. Cultural District.
   
   b. National Register District.
   
   c. Locally-designated historic district.
   
   d. Main Street District.
   
   e. DDD.
2) A residential building that is listed or is eligible for listing on the National Register.

3) A vacant and blighted building at least 50 years old.

LRRTCs equal to 50% of QREs are available if the building is determined to be vacant and blighted. A building qualifies as vacant and blighted if:

1) It has been unoccupied for six months, and

2) At least one of the following conditions exists relative to the building

(Louisiana Department of Economic Development, 2012):

a. Poses a danger to the community.

b. Not being properly maintained.

c. Becoming dilapidated.

d. Attracting illegal activity.

e. Is a fire hazard.

f. Is a factor in depreciating property values in the neighborhood due to its poorly maintained state.

However, there are three major drawbacks to the LRRTC program:

1. The LRRTCs are capped at $25,000 per building.

2. The amount of LRRTCs awarded state-wide is capped at $10 million in any calendar year.
3. LRRTCs are granted on a first-come, first-served basis and are not awarded until the project is completed.

The uncertainty surrounding the availability of the LRRTCs along with the relatively low cap of $25,000 per building severely impacts the efficacy of this incentive program. As a result, LRRTCs will not be considered in our financial analysis.

**Restoration Tax Abatement Program:**

The Louisiana Restoration Tax Abatement ("RTA") is a tax incentive program managed by the Louisiana Department of Economic Development ("LED") that permits local municipalities to grant five-year ad valorem tax abatements to encourage rehabilitation of both commercial and owner-occupied historic buildings that are (Louisiana Department of Economic Development, 2012):

1) Individually listed in the National Register;
2) Contributing elements of Register districts; and
3) In downtown or economic development districts.

The RTA program defers the increase in property tax assessment related to a certified rehabilitation and additions to the historic building. In addition, the RTA program has no minimum QRE threshold for commercial structures. Only owner-occupied residential rehabilitation projects have a minimum QRE requirement equal to at least 25% of the assessed valuation of the building. Property owners can also
apply for an additional five-year extension of the abatement so long as they remain in compliance with program requirements.

The program’s inclusion of owner-occupied properties as eligible for the tax abatement could be an important tool in promoting renovation of this property type since they are not eligible for HTCs.

**Tax Increment Financing**

Tax increment financing ("TIF") is a mechanism used by local governments to capture the future tax benefits of increased value or activity to pay the present cost of project improvements including infrastructure (Theriot, 2008). Louisiana first authorized the use of TIFs as an economic development tool in 1993 (Bowden, 2006).

In 2002, Louisiana’s legislature authorized the use of both sale & use tax and the transient occupancy tax revenues to fund economic development projects through TIF mechanisms (Theriot, 2008). Under the TIF legislation, municipalities are permitted to commit their portion of the “tax increment” to TIF projects without state approval (Theriot, 2008).

The tax increment represents the incremental increase in revenue generated by the TIF district above the base year. Figure 2-1 below provides a graphic representation of the tax increment. Base year income continues to be distributed as it was before the TIF. However, any new tax increment revenue collected above the base year amount is diverted to the TIF for the life of the TIF district. Upon
termination of the TIF, all on-going revenue is distributed pursuant to current tax allocation practices.

Figure 2-1: Tax Increment Financing Graph

After designating a TIF district, the municipality adopts an ordinance that designates the use of the tax increment generated by the TIF district. The municipality can either raise capital for improvements through the issuance of bonds or arrange a “pay as you go” agreement with the developer (Theriot, 2008). However, if they wish to use the full tax increment a cooperative agreement must be reached with the state after the LED reviews the proposed project (Theriot, 2008).
The Louisiana TIF program has been used successfully throughout the state to fund infrastructure projects and is eligible for use to pay for QREs. However, there are issues related to the TIF bond issuance such as minimum scale and bond marketability that affect the use of this tool for historic rehabilitation. These issues will be discussed further in the financial analysis below.

**Technical Assistance Programs:**

The Vieux Carré Commission (“VCC”) was established in 1936 to regulate the exterior of the buildings within the Vieux Carré Historic District (Louisiana State Legislature, 1936). Its authority to regulate encompasses the entire exterior envelope of the buildings including their roofs and interior courtyards (Friedmann, 1981).

In the 1980s, the VCC seemed to be more focused on a punitive approach to its duties. During this period, the VCC staff issued approximately 200 written violation notices and initiated up to 60 lawsuits each year (Friedmann, 1981). However, this approach has waned as funding for and staffing of the VCC has shrunk.

A common complaint is the lack of implementation of a sustained outreach program to educate residents, contractors, and business owners on VCC regulations (Dufour, 2010). As a result, these constituents are frustrated by exhaustive meeting schedules and frequent continuances as they attempt to maneuver through the VCC approval process (Dufour, 2010).
Council, the VCC confirmed that it hasn’t held any educational programs for French Quarter residents or property owners since before 2008, if at all (Vieux Carré Commission, 2011). This lack of public outreach is a particular disincentive to rehabilitation in the French Quarter since it is dominated by small properties with unsophisticated owners.

**Rehabilitation Sub-Code**

In 2011, the Louisiana legislature passed a resolution that permitted New Orleans’s Downtown Development District to undertake a pilot program to develop a rehabilitation sub-code to the existing state construction codes (New Orleans Downtown Development District, 2011). The proposed sub-code would be based on New Jersey’s innovative rehabilitation sub-code. In its first year (1998), the New Jersey rehabilitation sub-code led to a 60% rise in the rehabilitation spending in the state’s five biggest cities, rising from $179.1 million to $286.7 million (Shankar, 1999). This is an impressive result considering the previous year’s 1.6% growth (Shankar, 1999).

While the focus area for the initial New Orleans pilot program is the nearby Canal Street corridor, the potential application of new rehabilitation code to the French Quarter could be a very promising tool.
Chapter 3 Challenges to Private Sector Rehabilitation in the French Quarter

Identifying the existing challenges to private sector rehabilitation in the French Quarter is the next step in determining the best set of public sector incentives and tools to catalyze such activity. Through a series of interviews and research, some unique challenges facing the French Quarter were identified beyond those facing other historic districts within the City of New Orleans.

A useful exercise to help identify some of these unique challenges is to examine the proliferation of successful rehabilitation projects in the Central Business District Historic District with the relative stagnation within the Vieux Carré Historic District during the same period.

The Central Business District Historic District:

In 1978, the New Orleans City Council passed an ordinance establishing the Central Business District Historic District Landmarks Commission (“CBDHDLC”) to oversee the historic resources of the Central Business District (“CBD”) (The Council of the City of New Orleans, 1978). The CBDHDLC’s jurisdiction covers four separate local historic districts including the Canal Street Historic District that directly abuts the French Quarter (see Appendix A for a map of New Orleans’s Historic Districts).

For decades afterwards, few significant rehabilitation projects took place in the CBD as demand for office space dwindled from the consolidation and relocation of oil industry tenants. However, in the wake of Hurricane Katrina, the fortunes of
the CBD began to turn as significant new incentives were enacted on a federal and state level to incentivize investment throughout the parishes affected by the storm. While these incentives were intended to help facilitate a broad spectrum of projects by all levels of property owners, the necessary program safeguards and documentation required a level of sophistication beyond that of most laypersons. Predictably, these new incentives tended to be utilized by projects that: 1) had sophisticated owners, 2) were larger scale projects, and 3) were located in areas where regulatory hurdles could be overcome in a reasonable amount of time.

Figure 3-1 presents a list and map of recent rehabilitation/redevelopment projects that are planned, underway or have been completed in 2011-2012 within the four CBD Historic Districts. Developer Marcel Wisznia has completed two of the historic rehabilitations on the list that entailed converting former Class-B office buildings into 260 Class-A apartments. With the success of these projects, the Maritime and the Saratoga, Wisznia will break ground in 2012 on a third project within the CBD's Lafayette Historic District called Stephens Garage featuring 65 apartments and 20,000 s.f. of retail (Wisznia, 2011).

Wisznia attributes the feasibility of these two projects to the availability of: 1) the state and federal historic tax credits, and 2) HUD non-recourse housing financing for market-rate apartments (Wisznia, 2011). However, Wisznia also noted the considerable amount of staff time and third-party consulting costs associated with securing these incentives/tools (Wisznia, 2011).
Wisznia’s projects and his comments bring to light some of the challenges to rehabilitation in the French Quarter:

1) The completed Wisznia projects are relatively large in scale (10-14 stories in height and 100+ residential units) when compared to most properties within the boundaries of the French Quarter where few buildings exceed 50 feet in height. Larger scale projects can more easily support the third-party consulting costs required to comply with incentive program requirements and documentation.
2) The owners of the smaller-scale properties that populate the French Quarter are more likely to have difficulty utilizing some of the tools/incentives employed by Wisznia as they are currently administered. These owners typically lack the level of sophistication and/or resources necessary.

**Infrastructure Challenges**

**Parking & Streets:**

While no on-site parking is provided at either Wisznia project, there is no shortage of parking in the CBD as evidenced by its relative pricing. A non-reserve parking space in the CBD rents for $140 per month (Premium Parking, 2012). A similar parking space, offered by the same company, located in the French Quarter rents for $240 per month (Premium Parking, 2012). This shortage of available parking serves as a challenge that must be overcome in order to catalyze significant private rehabilitation in the French Quarter.

Another infrastructure challenge in the French Quarter is its narrow streets. They average just 22 feet in width curb to curb with 8 foot sidewalks on either side (Heard, 1997). Most modern streets are a minimum of 24 feet in width from curb to curb. These narrow streets further exacerbate the parking and vehicular traffic problems that plague the French Quarter.
Chapter 4 Base Case Scenarios

The next step is to establish two base case scenarios using prototypical French Quarter rehabilitation projects to test the validity the relative impact of the incentives and tools discussed in previous chapters. The two prototypical French Quarter projects were developed based on the following factors:

1) Common building typologies,
2) Typical lot size/configurations, and
3) The 50’ height limitation within the Vieux Carré Historic District.

The first prototypical project is a creole townhouse, a common building typology in the French Quarter. Figures 4-1 and 4-2 present a typical floor plan and elevation for this building typology, respectively. As the exhibits indicate, this building typology generally included both commercial and residential components. The lot size for these buildings range from 1,250 SF to 4,000 SF and the buildings themselves typically vary between 2,500 SF and 8,000 SF. For the purposes of this thesis, the “Creole Townhouse” project analysis will be based on a 4,750 SF building.

The second prototype will involve a more traditional commercial building typology constructed in the late 19th or early 20th century which is concentrated in the 200-300 blocks of Chartres, Decatur, and S. Peters Streets. These buildings are distinguished from the creole townhouse typology based on their lack of a carriageway or courtyard, and 100% coverage of the lot.
Figure 4-1: Prototypical Creole Townhouse Floor Plan

These factors result in buildings with substantially larger footprint that fill the entire property (footprints of 2,500 SF to 7,500 SF) and greater overall building area (total building area of 7,500 SF to 22,000 SF). With 100% coverage of the property, these commercial buildings are challenged to provide adequate natural light and to meet life safety codes for residential conversions. Figures 4-3 and 4-4 present the floor plan and elevation of 311 N. Peters Street which represents the prototype of commercial building considered in this thesis. For the purposed of this analysis, a building area of 14,000 SF will be assumed for the prototypical “VC Commercial” building.
Figure 4-3: Prototypical VC Commercial Building Floor Plan

Source: Talbot Realty
Rehabilitation Pro Forma Budgets

Existing Shell Building Costs:

Listing prices and building information was gathered from real estate listing sources on Creole Townhouses and VC Commercial buildings in the French Quarter.
that were both available for sale and in need of rehabilitation. Table 4-1 below presents these findings and calculates weighted average price per square foot ("PSF") for the two prototypical projects.3

Table 4-1: French Quarter Creole Townhomes and VC Commercial Buildings Listing Price Analysis

<table>
<thead>
<tr>
<th>Creole Townhomes</th>
<th>Building SF</th>
<th>Listing Price</th>
<th>PSF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>624 Burgundy St.</td>
<td>2,350</td>
<td>$444,500</td>
<td>$189.15</td>
</tr>
<tr>
<td>518 Conti</td>
<td>3,536</td>
<td>$725,000</td>
<td>$205.03</td>
</tr>
<tr>
<td>Total</td>
<td>5,886</td>
<td>$1,169,500</td>
<td></td>
</tr>
<tr>
<td><strong>Weighted Average</strong></td>
<td></td>
<td></td>
<td><strong>$198.69</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VC Warehouse</th>
<th>Building SF</th>
<th>Listing Price</th>
<th>PSF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>217-221 Chartres St.</td>
<td>22,741</td>
<td>$3,275,000</td>
<td>$144.01</td>
</tr>
<tr>
<td>223-225 Chartres St.</td>
<td>10,278</td>
<td>$1,475,000</td>
<td>$143.51</td>
</tr>
<tr>
<td>Total</td>
<td>33,019</td>
<td>4,750,000</td>
<td></td>
</tr>
<tr>
<td><strong>Weighted Average</strong></td>
<td></td>
<td></td>
<td><strong>$143.86</strong></td>
</tr>
</tbody>
</table>


For the purposes of this analysis, the weighted average cost per square foot of $198.69 and $143.86 will be applied as the acquisition cost for the existing shell of a Creole Townhouse or a VC Commercial building, respectively.

Rehabilitation Costs:

Estimated rehabilitation costs in this analysis are based on historical data provided by the Preservation Resource Center ("PRC") in New Orleans on its three most recent historic rehabilitation projects. The PRC has played an active role managing the rehabilitation of dozens of historic buildings throughout New Orleans.

---

3 Listing prices generally establish the upper limit of real estate prices. Actual sales prices may be lower.
since Hurricane Katrina. The average direct cost per square foot to complete its three most recent projects is approximately $84 based on the data provided. However, the PRC’s costs do not include overhead, market-rate borrowing costs, higher finish levels or adequate design costs (architectural/engineering) relative to what would be required in the French Quarter. Therefore, the project pro forma budgets for the two prototypical French Quarter projects will need to be adjusted to reflect these additional costs.

**Rent Assumptions:**

A blended rental rate of $24.00 PSF for the entire building was used in the Pro Forma Income Statement for both the Creole Townhouse and VC Commercial projects. This blended rental rate was derived from a review of retail, office, and residential rental rates for properties available for lease in the French Quarter in March 2012.⁴

**Project Pro Forma Development Budgets & Income Statements:**

Table 4-2 below presents the Pro Forma Development Budgets and Income Statements for both the Creole Townhouse and VC Commercial projects. The results for each prototypical project are discussed below.

---

⁴ Sources for the rental rate information included Loopnet, Trulia, and Talbot Realty, access March 18, 2012.
Table 4-2: Pro forma Development Budgets and Income Statements

<table>
<thead>
<tr>
<th>Base Case Pro Forma Development Budget</th>
<th>SF</th>
<th>Existing Shell Cost PSF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creole Townhouse</td>
<td>4,750</td>
<td>$198.69</td>
</tr>
<tr>
<td>VC Commercial Building</td>
<td>14,000</td>
<td>$143.86</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unit Cost</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building &amp; Land Acquisition</td>
<td>$943,786</td>
<td>$2,013,992</td>
</tr>
<tr>
<td>Rehabilitation Cost (Per PRC Data)*</td>
<td>$399,000</td>
<td>$1,176,000</td>
</tr>
<tr>
<td>Finish Upgrades to PRC Base Finishes*</td>
<td>$237,500</td>
<td>$420,000</td>
</tr>
<tr>
<td>Additional Design (Architect, Engineering)*</td>
<td>$23,750</td>
<td>$70,000</td>
</tr>
<tr>
<td>Legal*</td>
<td>$5,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Additional Legal &amp; Consultants for HTC*</td>
<td>$15,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>General Conditions*</td>
<td>$114,793</td>
<td>$202,320</td>
</tr>
<tr>
<td>Permits &amp; Fees*</td>
<td>$15,501</td>
<td>$37,366</td>
</tr>
<tr>
<td>Rehabilitation Cost (Per PRC Data)*</td>
<td>$9,438</td>
<td>$20,140</td>
</tr>
<tr>
<td>Additional Interest Carry &amp; Financing Fees*</td>
<td>$121,368</td>
<td>$273,162</td>
</tr>
<tr>
<td>Real Estate Taxes (Construction Period)*</td>
<td>$12,976</td>
<td>$38,335</td>
</tr>
<tr>
<td>Pre-Leasing &amp; Marketing</td>
<td>$5,938</td>
<td>$17,500</td>
</tr>
</tbody>
</table>

Total Development Costs

<table>
<thead>
<tr>
<th>PSF</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,904,049</td>
<td>$4,298,815</td>
<td></td>
</tr>
</tbody>
</table>

Development Costs Potentially Eligible for Historic Tax Credit

<table>
<thead>
<tr>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>$944,887</td>
<td>$2,247,183</td>
</tr>
</tbody>
</table>

(Note: * denotes potentially eligible as a Historic Tax Credit expenditure)

<table>
<thead>
<tr>
<th>Base Case Pro Forma Income Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creole Townhouse</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Average Rent PSF</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Scheduled Income</td>
</tr>
<tr>
<td>less Vacancy 5%</td>
</tr>
<tr>
<td>Effective Gross Income</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Unit Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax</td>
<td>$12,775</td>
</tr>
<tr>
<td>Insurance</td>
<td>$ 2.375</td>
</tr>
<tr>
<td>Property Management</td>
<td>$5,415</td>
</tr>
<tr>
<td>Utilities (Common Area Only)</td>
<td>$2,000</td>
</tr>
<tr>
<td>Repair &amp; Maintenance</td>
<td>$1,188</td>
</tr>
<tr>
<td>Reserves for Replacement</td>
<td>$5,415</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>$29,168</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Operating Income (NOI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$79,133</td>
</tr>
</tbody>
</table>

Unleveraged Yield (NOI/Total Development Cost)

<table>
<thead>
<tr>
<th>Creole Townhouse</th>
<th>4.2%</th>
</tr>
</thead>
</table>

Creole Townhouse:

Total development costs for the prototypical Creole Townhouse project, including acquisition of an extant building shell is $1,904,049 or $400.85 PSF before the benefit of any incentives or tools is recognized. The pro forma income statement reports a Net Operating Income (“NOI”) for the Creole Townhouse project of
$79,133. The unleveraged yield generated by the Creole Townhouse project before the application of any incentives is 4.2%.5

**VC Commercial:**

Total development costs for the prototypical VC Commercial project, including acquisition of an extant building shell is $4,298,815 or $307.06 PSF before the benefit of any incentives is recognized. The pro forma income statement reports a NOI for the VC Commercial project of $233,780. The unleveraged yield generated by the VC Commercial project before the application of any incentives is 5.4%.

**Real Estate Investor and Developer Rate of Return Expectations**

The expected unleveraged yield required by a real estate investor or a developer differs from project to project based on the relative risk assumed with each investment. In the case of a real estate investor, they typically buy lower-risk properties with stabilized cash flows that do not require substantial rehabilitation. For the purposes of this thesis, the expected unleveraged yield for this type of real estate investor purchasing one of the prototypical French Quarter projects is assumed to be 7.5% based on the projects’ scale and current market conditions.

A developer typically assumes a number of additional risks including: 1) construction costs overruns, 2) project absorption rate, 3) project entitlement delays, and 4) variance in market rent projections. As a result, a developer will not

---

5 The unleveraged yield is also referred to as the capitalization rate. It is calculated by dividing the Net Operating Income by the Total Development Cost of an investment. It is a common financial measure used to establish the value of an asset.
undertake a rehabilitation project unless they can receive a risk premium of at least 2% over the real estate investor’s expected unleveraged yield. This risk premium represents the developer’s expected profit upon sale of a completed project to a real estate investor. Therefore, we will assume that a developer will not undertake either of the prototypical French Quarter projects unless its expected unleveraged yield is at or above 9.5%.

**Developer Project Profit Calculation**

Table 4-3 below presents the hypothetical calculation of a developer’s profit on a rehabilitation project undertake with projected Total Development Costs of $1 million and stabilized NOI of $95,000 (a 9.5% “going in” unleveraged yield for the developer). The calculation further assumes the developer can sell the rehabilitated asset upon completion and stabilization to a real estate investor at a price that reflect an exit cap rate or unleveraged yield of 7.5% (Selling Price= $95,000/.075= $1,266,667).

**Table 4-3: Developer Project Profit Calculations**

<table>
<thead>
<tr>
<th>Developer Project Profit Calculations</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Development Costs</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Projected Net Operating Income (Projected NOI)</td>
<td>95000</td>
</tr>
<tr>
<td>Projected Unleveraged Yield</td>
<td>9.5%</td>
</tr>
<tr>
<td>Selling Price at Stabilization (NOI/Real Estate Investor Expected Unleveraged Yield)</td>
<td>7.5% $1,266,667</td>
</tr>
<tr>
<td>Less Total Development Cost</td>
<td>($1,000,000)</td>
</tr>
<tr>
<td><strong>Projected Developer Profit</strong></td>
<td>$266,667</td>
</tr>
<tr>
<td>Projected Developer Profit Margin (Profit/Total Development Costs)</td>
<td>26.7%</td>
</tr>
</tbody>
</table>
Using this set of assumptions, Table 4-3 above estimates a developer profit of $266,667 or 26.7% for undertaking the rehabilitation and lease up of the hypothetical project. This profit calculation does not take into consideration the additional compensation earned by the developer in development or leasing fees that are included in the total development costs.

**Findings & Observations of the Base Case Scenarios:**

A review of the Base Case Pro Forma Development Budget and Income Statement generates the following findings and observations:

1) Less expensive shell costs help the prototypical VC Commercial project generate a higher unleveraged yield than a Creole Townhouse project.

2) Both prototypical French Quarter projects are infeasible for a developer without the intervention of incentives or other tools given their base case unleveraged yield of 4.2% to 5.4%.

3) A typical real estate investor would also not invest in either project at this time given the remaining risk associated with the rehabilitation process and the current anemic unleveraged yields.
Chapter 5 Analysis of Existing Incentives & Tools

In this chapter, each of the existing incentives and tools identified in Chapter 2 will be tested to determine their relative impact on the unleveraged yields for the prototypical Creole Townhouse and VC Commercial projects. In some cases, several incentives and tools can be combined to help catalyze private rehabilitation. From this analysis, the set of incentives and tools with the greatest impact to the feasibility of these prototypical French Quarter projects will be determined.

Federal Historic Rehabilitation Tax Credits:

Table 5-1 below presents the estimated HTCs and Potential Equity Contribution that would be generated by each of the prototypical French Quarter projects.

<table>
<thead>
<tr>
<th>Federal Rehabilitation Tax Credits</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Development Costs</td>
<td>$1,904,049</td>
<td>$4,298,815</td>
</tr>
<tr>
<td>Development Costs Potentially Eligible for Historic Tax Credit</td>
<td>$944,887</td>
<td>$2,247,183</td>
</tr>
<tr>
<td>Potential Federal Historic Rehabilitation Tax Credits</td>
<td>20%</td>
<td>$188,977</td>
</tr>
<tr>
<td>Syndicated Credit Pricing per $1 of HTC</td>
<td>$0.85</td>
<td>$0.85</td>
</tr>
<tr>
<td><strong>Potential Equity Contribution from HTC Investor</strong></td>
<td><strong>$160,631</strong></td>
<td><strong>$382,021</strong></td>
</tr>
</tbody>
</table>

Potential HTCs of $188,977 and $449,437 are generated for the Creole Townhouse and VC Commercial projects, respectively. These HTCs are available to the owner once the property is “placed into service”, which would typically occur when a certificate of occupancy (“CO”) is issued. From that date, the owner has
three years to receive Part III certification of the QREs or face a “claw back” of the HTCs.

One additional hurdle that each potential HTC project must overcome is the “substantial rehabilitation test” whereby the QREs must exceed the greater of: a) $5,000, or b) the adjusted cost basis in the building (not including the land). In Table 5-1 above, the total acquisition costs, including land and building, of both projects is just below the amount spent on the rehabilitation depending on what portion of the acquisition price is attributable to the land.

Clearly, the substantial rehabilitation test could prove troublesome in a market where high shell building costs require even more extensive rehabilitation in order to qualify for the HTCs. Conversely, the “substantial rehabilitation” threshold can be easily surpassed for a building held for a period of years since the building's adjusted basis has been written down through depreciation.

In the Tax Reform Act of 1986, passive loss limitations were enacted that restrict most individuals from deducting more than $25,000 in losses from passive investments such as real estate. As a result, the majority of HTCs are now syndicated. This is a process by which an entity, such as a corporation, is brought in as a tax credit investor and allocated the HTCs in exchange for an equity contribution.

The price paid by a potential tax credit investor for each $1 of HTCs varies based on the quantity of credits being sold. HTC projects generating tax credits in
excess of $8 million have received payments above par ($1.02-$1.10 per $1.00 of HTC) and are actively sought out by large corporations such as Chevron.\textsuperscript{6} This premium is attributable to certain favorable GAAP accounting principles (Potts, 2012).

HTC projects that generate between $1 million and $3 million have a narrower appeal and generally generate offers slightly below par from mostly regional banks and corporations.\textsuperscript{7} The potential HTC investor pool in projects generating below $1 million is very weak according to information provided by CityScape Capital Group, LLC. The pricing for HTC credits drop off rapidly below the $1 million benchmark as the market becomes very inefficient with few buyers. Pricing between $.56 and $.90 per $1.00 of HTC was observed for project generating below $1 million in credits.\textsuperscript{8}

For purposes of this analysis, pricing of $.85 per $1.00 of HTCs was used for the Creole Townhouse and VC Commercial projects. As a result, the Potential Equity Contribution from a HTC Investor was $160,631 and $382,021 for the Creole Townhouse and VC Commercial projects, respectively.

**Louisiana State Commercial Rehabilitation Tax Credits**

Table 5-2 below presents the LRTCs and Potential Equity Contribution that would be generated by each prototypical French Quarter projects.

\textsuperscript{6} HTC pricing based on information provided by CityScape Capital Group, L.L.C.
\textsuperscript{7} Ibid
\textsuperscript{8} Ibid
Potential LRTCs of $236,222 and $561,796 are generated for the Creole Townhouse and VC Commercial projects, respectively. The rules governing the LRTCs are essentially the same as the HTCs. However, the pricing of the LRTCs by potential tax credit investors differs from HTCs.

There is a fundamental difference in the efficacy of state tax credits versus federal tax credits in reducing a tax credit investor’s overall tax liability. State tax credits are less valuable to tax credit investors based on the principle of the deductibility of state income taxes from a taxpayer’s federal income taxes.

A numeric example of the reduced efficacy of LRTCs is as follows:

1) A tax credit investor receives a $1.00 in LRTCs that results in a $1.00 reduction in the taxes paid to the state;

2) The tax credit investor’s state tax deduction from its federal taxes are thereby reduced by $1.00;

3) The tax credit investor’s taxable income on the federal level is thereby increased by $1.00; and

### Table 5-2: Louisiana State Rehabilitation Tax Credit Calculations

<table>
<thead>
<tr>
<th>Louisiana State Commercial Rehabilitation Tax Credits (LRTC)</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Development Costs</td>
<td>$1,904,049</td>
<td>$4,298,815</td>
</tr>
<tr>
<td>Development Costs Potentially Eligible for Historic Tax Credit</td>
<td>$944,887</td>
<td>$2,247,183</td>
</tr>
<tr>
<td>Potential Louisiana State Commercial Rehabilitation Tax Credit</td>
<td>25% $236,222</td>
<td>25% $561,796</td>
</tr>
<tr>
<td>Syndicated Credit Pricing per $1 of LRTC</td>
<td>$0.75</td>
<td>$0.75</td>
</tr>
<tr>
<td>Potential Equity Contribution from LRTC Investor</td>
<td>$177,166</td>
<td>$421,347</td>
</tr>
</tbody>
</table>
4) The tax credit investor must then pay federal income tax on that additional $1.00 of income.

If the tax credit investor is a corporation paying the maximum federal corporate tax rate of approximately 39%, the net effect is that a $1.00 in LRTCs is worth no more than $.61. The end result is a substantial discount in the pricing of state tax credits. Even large state-level HTCs are frequently discounted to $.70 per $1.00 of tax credit (Potts, 2012).

For purposes of this analysis, pricing of $.75 per $1.00 of LRTCs was used for the Creole Townhouse and VC Commercial projects. As a result, the Potential Equity from a LRTC Investor was $177,166 and $421,347 for the Creole Townhouse and VC Commercial projects, respectively.

**Louisiana State Residential Rehabilitation Tax Credits**

LRRTCs are not considered in this analysis based on the following: 1) the tax credits are applicable only to owner-occupied residential properties, and 2) the tax credits are capped at $25,000 per project which would have minimal effect on the economics of the prototypical Townhouse or VC Commercial projects considered in this thesis.
Restoration Tax Abatement Program

Table 5-3 below calculates the potential property tax savings available for the two prototypical French Quarter rehabilitation projects under the State of Louisiana's RTA program.

Table 5-3: Restoration Tax Abatement Calculations

<table>
<thead>
<tr>
<th>Restoration Tax Abatement Calculation</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Operating Income (after Rehabilitation)</td>
<td>$79,133</td>
<td>$233,780</td>
</tr>
<tr>
<td>Capitalization Rate</td>
<td>9.0%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Fair Market Value (Income Approach)</td>
<td>$879,250</td>
<td>$2,597,556</td>
</tr>
<tr>
<td>Assessed Value at 10% of Fair Market Value</td>
<td>$87,925</td>
<td>$259,756</td>
</tr>
<tr>
<td>Annual Property Tax at 2011 Orleans Parish East Bank Millage</td>
<td>0.14758</td>
<td>$12,976</td>
</tr>
<tr>
<td>Estimated Pre-Rehabilitation Annual Property Tax</td>
<td>0.4</td>
<td>$5,190</td>
</tr>
<tr>
<td>Annual Restoration Tax Abatement Program Savings</td>
<td>$7,786</td>
<td>$23,001</td>
</tr>
<tr>
<td>Total Restoration Tax Abatement Program Savings (Five-Years)</td>
<td>$38,928</td>
<td>$115,004</td>
</tr>
</tbody>
</table>

Under the RTA program, the Creole Townhouse and VC Commercial projects stand to save $38,928 and $115,004 over the five-year period, respectively.

Tax Increment Financing

The state enabling legislation for Louisiana's TIF program allows municipalities and the state to commit future sales tax and transient occupancy tax revenues within the TIF district boundaries to fund economic development projects. These economic development projects could include infrastructure, amenities, or even rehabilitation costs (Auditor, 2008).

The enabling legislation does not establish a minimum size for a TIF project and TIF bond issuance. However, high transaction costs related to the TIF process and the requirement that the TIF be approved by the passage of a municipal
ordinance have led municipalities to suggest a minimum project size of $5 million and a minimum TIF bond issuance of $1 million (Davin & Fitzgerald, 2011). TIF district boundaries can be limited to the project’s boundaries (project-specific) or encompass an entire wide-area district (district). In this analysis, a project-specific approach is utilized.

**Sales & Use Tax**

In New Orleans, retailers, restaurants and service providers collect a nine percent (9%) sales and use tax on all non-exempt purchases of services and goods.9 Table 5-4 below presents the allocation of the sales and use tax.

<table>
<thead>
<tr>
<th></th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>State of Louisiana</td>
<td>4.0%</td>
</tr>
<tr>
<td>Orleans Parish School Board</td>
<td>1.5%</td>
</tr>
<tr>
<td>Regional Transit Authority</td>
<td>1.0%</td>
</tr>
<tr>
<td>City of New Orleans</td>
<td>2.5%</td>
</tr>
<tr>
<td>Total Sales &amp; Use Tax</td>
<td>9.0%</td>
</tr>
</tbody>
</table>

Table 5-5 below estimates the City of New Orleans’s share of annual sales tax generated by the Creole Townhouse and VC Commercial projects and the maximum TIF bond that could be supported by the revenue generated. The calculations indicate that the Creole Townhouse project would generate an estimated $9,500 per year in sales & use tax which would support a maximum TIF bond amount of

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9 Per the Louisiana Association of Tax Administrators website, [www.laota.com](http://www.laota.com), accessed 3-26-12
The VC Commercial project would generate an estimated $28,000 per year in sales & use tax which would support a maximum TIF bond of $372,444.

**Table 5-5: Tax Increment Financing of Sales & Use Tax Calculations**

<table>
<thead>
<tr>
<th>Tax Increment Financing of Sales &amp; Use Tax</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Square Footage</td>
<td>4,750</td>
<td>14,000</td>
</tr>
<tr>
<td>Ground Floor Retail Space</td>
<td>950</td>
<td>2,800</td>
</tr>
<tr>
<td>Sales PSF</td>
<td>$400</td>
<td>$400</td>
</tr>
<tr>
<td>Total Retail Sales</td>
<td>$380,000</td>
<td>$1,120,000</td>
</tr>
<tr>
<td>Total Retail Sales Tax</td>
<td>9.0%</td>
<td></td>
</tr>
<tr>
<td>City of New Orleans Portion of Sales &amp; Use Tax</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Maximum Potential TIF Bond w/ Sales &amp; Use Tax Revenue</td>
<td>$126,365</td>
<td>$372,444</td>
</tr>
</tbody>
</table>

The issuance of TIF bonds based solely on sales & use tax is impractical given the relatively high transaction costs associated with such bonds.

**Transient Occupancy Tax**

The New Orleans Exhibit Hall Authority collects a total of seven percent (7%) in transient occupancy taxes (“TOT”) for hotel accommodations in Orleans Parish (Louisiana Dept. of Revenue, 2012). These funds are used to support the Superdome and the Ernest N Morial Convention Center (Louisiana Dept. of Revenue, 2012). The authority would have to authorize the diversion of its TOT revenue into a TIF bond to support the Creole Townhouse or the VC Commercial project. For a small scale project, securing this authorization may be difficult and costly.

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10 The maximum TIF bond amounts are based the issuance of a 30 year bond bearing 4% interest with a debt service coverage ratio of 1.30.
Table 5-6 below estimates the annual TOT revenue generated and the maximum potential TIF bond that it could support based on the same bond terms used above. The Creole Townhouse project would generate an estimate $24,313 in TOT revenue which would support a maximum TIF bond of $323,400. The VC Commercial project would generate an estimated $87,527 in TOT revenue which would support a maximum TIF bond of $1,164,241.

Table 5-6: Tax Increment Financing of Transient Occupancy Tax

<table>
<thead>
<tr>
<th>Tax Increment Financing of Transient Occupancy Tax</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rooms</td>
<td>10</td>
<td>36</td>
</tr>
<tr>
<td>Occupancy</td>
<td>69.8%</td>
<td>69.8%</td>
</tr>
<tr>
<td>Average Daily Rate (ADR)</td>
<td>$136.33</td>
<td>$136.33</td>
</tr>
<tr>
<td>Estimated Hotel Revenue</td>
<td>$347,328</td>
<td>$1,250,381</td>
</tr>
<tr>
<td>Estimated Total Transient Occupancy Tax</td>
<td>7% $24,313</td>
<td>$87,527</td>
</tr>
<tr>
<td>Total Maximum Potential TIF Bond w/ Transient Occupancy Tax</td>
<td>$323,400</td>
<td>$1,164,241</td>
</tr>
</tbody>
</table>

Table 5-7 below calculates the Maximum Potential TIF Bond if both revenue sources are combined. For the Creole Townhouse, the maximum potential TIF bond using both the sales & use tax and the transient occupancy tax revenues is $449,765. As discussed above, the transactional costs of issuing TIF bonds in an amount below $1 million is impractical. For the VC Commercial project, the maximum potential TIF bond using the combined revenue sources is $1,536,685.

Table 5-7: Maximum Potential TIF Bond with Combined Revenue Sources

<table>
<thead>
<tr>
<th>Maximum Potential TIF Bond with Combined Revenue Sources</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum Potential TIF Bond w/ Sales &amp; Use Tax Revenue</td>
<td>$126,365</td>
<td>$372,444</td>
</tr>
<tr>
<td>Total Maximum Potential TIF Bond w/ Transient Occupancy Tax</td>
<td>$323,400</td>
<td>$1,164,241</td>
</tr>
<tr>
<td>Total Maximum Potential TIF Bond (Combined)</td>
<td>$449,765</td>
<td>$1,536,685</td>
</tr>
</tbody>
</table>

This potential TIF bond amount does surpass the $1 million threshold discussed above. However, the following factors serve to diminish the practicality of
pursuing TIF bonds for the either of the prototypical French Quarter projects under consideration:

1) There would be significant credit risk for bond investors because the sole security for the TIF bonds is the payment of taxes by a single property owner.

2) Permission must be granted by each separate taxing authority in order for their portion of the sales & use tax or TOT revenue to be diverted to the TIF project.

3) The establishment of a TIF district would require the adoption of a city ordinance by the City Council. This public process can be length and contentious and does not lend itself to frequent use.

4) A prevailing wage requirement is typically required as a provision of the TIF documentation. This requirement could add 20%-30% to the rehabilitation costs of the TIF project. There are no such prevailing wage requirements attached to either the state or federal historic rehabilitation tax credits.

An alternative approach for projects with TIF revenues less than the minimum required for bonding would be for the municipality to negotiate an Owner Participation Agreement (“OPA”) with the property owner whereby the annual tax increment is paid from the municipality to the property owner. The property owner could then commit the annual OPA payments to a private lender to raise funds.
However, there are several inherent weaknesses with the OPA approach:

1) The potential amount raised through a private lender would be less than the maximum TIF bond amount because the private lending terms would be less favorable than those for municipally-issued bonds.

2) The property owner may still be required to undertake the rehabilitation using prevailing wage.

3) The public approval process for the OPA will be similar to that of a TIF.

Based on this information, the required allocation of owner resources and risks associated with pursuing and securing a project-specific TIF bond issuance or an OPA for either of the prototypical French Quarter projects make the TIF tool impractical to use.

**Technical Assistance**

Technical assistance related to historic rehabilitation projects in the French Quarter is available from such resources as the VCC and the PRC. However, quantifying the value associated with this assistance in reducing total development costs or increasing revenue for either of the prototypical French Quarter projects discussed is impractical. As a result, no tangible value will be assigned to this tool in this analysis.
New Market Tax Credit

As discussed in Chapter 2, NMTCs were not considered in the financial analysis portion of this thesis since:

1) The Vieux Carré Historic District does not qualify as a LIC under the program eligibility requirements, and

2) The market-rate prototypical rehabilitation projects considered are not intended to serve LIPs.

Findings on the Existing Incentives & Tools

Table 5-8 below presents a summary of the financial analysis conducted using existing incentives and tools available to facilitate the rehabilitation of the two prototypical French Quarter projects. In total, the existing incentives and tools would potentially generate $376,725 and $918,372 for the Creole Townhouse and VC Commercial projects, respectively. These results also illuminate the fact that the HTCs and LRTCs have the greatest potential of the tools and incentives examined for catalyzing significant private sector rehabilitation in the French Quarter.

Incentives and tools such as TIFs and NMTCs are clearly ineffective in stimulating significant private sector rehabilitation of the prototypical French Quarter projects considered.
Table 5-8: Summary of Financial Analysis of Existing Incentives & Tools

<table>
<thead>
<tr>
<th>Summary of Financial Analysis of Existing Incentives &amp; Tools</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential Equity Contribution from HTC Investor</td>
<td>$ 160,631</td>
<td>$ 382,021</td>
</tr>
<tr>
<td>Potential Equity Contribution from LRTC Investor</td>
<td>$ 177,166</td>
<td>$ 421,347</td>
</tr>
<tr>
<td>Total Restoration Tax Abatement Program Savings (Five-Years)</td>
<td>$ 38,928</td>
<td>$ 115,004</td>
</tr>
<tr>
<td>Tax Increment Financing</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>New Markets Tax Credits</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Potential Equity Contribution from Incentives &amp; Tools</td>
<td>$ 376,725</td>
<td>$ 918,372</td>
</tr>
</tbody>
</table>

Table 5-9 below calculates the unleveraged yield for the two prototypical French Quarter projects after the Total Development Costs are reduced by the Potential Equity Contribution derived from the existing incentives and tools. The unleveraged yield on the Creole Townhouse project increases from the base case of 4.2% to 5.2%. Similarly, the VC Commercial project increases from the base case unleveraged yield of 5.4% to 6.9%.

Table 5-9: Unleveraged Yield with Existing Incentives & Tools

<table>
<thead>
<tr>
<th>Unleveraged Yield</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Operating Income</td>
<td>$ 79,133</td>
<td>$ 233,780</td>
</tr>
<tr>
<td>Total Development Costs (before Tax Credit Equity)</td>
<td>$ 1,904,049</td>
<td>$ 4,298,815</td>
</tr>
<tr>
<td>Less Potential Equity Contribution from Incentives &amp; Tools</td>
<td>(376,725)</td>
<td>(918,372)</td>
</tr>
<tr>
<td>Total Development Costs (after Equity Contribution)</td>
<td>$ 1,527,324</td>
<td>$ 3,380,443</td>
</tr>
<tr>
<td>Adjusted Unleveraged Yield (NOI/Total Dev. Costs)</td>
<td>5.2%</td>
<td>6.9%</td>
</tr>
</tbody>
</table>

Clearly, the resulting unleveraged yields for both of prototypical French Quarter projects remain anemic given the project risk and investor expectations. Neither project reaches the developer’s required 9.5% unleveraged yield necessary for them to move forward. In the next chapter, ways to improve the unleveraged
yield of these projects to a level that will catalyze private sector rehabilitation is explored.
Chapter 6 Sensitivity Analysis

In the previous chapter, a financial analysis of the existing incentives and tools revealed that they are insufficient to catalyzed private sector rehabilitation of the smaller scale buildings that exist in the French Quarter. The analysis further revealed that the most effective incentive or tool was tax credits. Therefore, in this chapter, a sensitivity analysis is conducted using both HTCs and LRTCs to determine at what level will these tax credit generated adequate unleveraged yields to catalyze significant private sector rehabilitation of the low-rise historic buildings in the French Quarter.

Increasing LRTCs

The first approach to be considered is an increase in the LRTCs. This approach was selected based on two points: 1) tax credits were determined earlier in this thesis to be the most effective tool or incentive to increase the yield on the prototypical French Quarter projects; and 2) an increase in the LRTC incentive would be easier and faster to accomplish than a change in federal tax policies.

Table 6-1 below presents the expected unleveraged yields if the LRTCs were increased to either 50% or 70% of QREs for smaller-scale projects such as the prototypical French Quarter projects.

Scenario 1 represents the unleveraged yields as calculated in the previous chapter whereby the base case is adjusted for the application of existing incentives and current market conditions. From this starting point, Scenario 2 tests the impact
of an increase in the LRTC rate from 25% to 50% of QREs and no other changes. This results in increases in the unleveraged yields to 5.9% and 7.9% for the Creole Townhouse and VC Commercial projects, respectively.

Table 6-1: Unleveraged Yield-Sensitivity Analysis

<table>
<thead>
<tr>
<th>Unleveraged Yield-Sensitivity Analysis</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Case Yield without Tax Credit Incentives</td>
<td>4.2%</td>
<td>5.4%</td>
</tr>
<tr>
<td>Scenario 1: Yield with Existing Tax Credit Incentives</td>
<td>5.2%</td>
<td>6.9%</td>
</tr>
<tr>
<td><strong>Yield with Current Tax Credit Pricing</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scenario 2: Yield with 50% LRTCs</td>
<td>5.9%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Scenario 3: Yield with 70% LRTCs</td>
<td>6.5%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Scenario 4: Yield with 50% LRTCs &amp; 40% HTCs</td>
<td>6.7%</td>
<td>9.1%</td>
</tr>
</tbody>
</table>

Scenario 3 carries this test further by increasing the LRTC rate to 70% of QREs. At this level, the LRTCs and the existing 20% HTCs result in combined tax credits equal to 90% of the QREs for these smaller projects. The 70% LRTC rate moves the unleveraged yields to 6.5% and 8.9% for the Creole Townhouse and VC Commercial projects, respectively. Unfortunately, neither of these increased LRTCs scenarios reaches the 9.5% unleveraged yield required by a developer to undertake the projects. This situation is due the reduced syndication pricing associated with LRTCs.

**Increasing HTCs**

Scenario 4 in Table 6-1 above considers the combined effect of 50% LRTCs and 40% HTCs. This combination of tax credits increases the unleveraged yields to 6.7% and 9.1% for the Creole Townhouse and VC Commercial projects, respectively.
The slight improvement in the unleveraged yield achieved by Scenario 4 over the Scenario 3 results are due to the more efficient pricing of HTCs. However, the unleveraged yield still remains below the developer’s threshold of 9.5%.

**Improving the Pricing of HTCs & LRTCs**

The second dimension of tax credits that could be influenced on a local or state-level is the pricing of HTCs and LRTCs on smaller tax credit projects. One potential initiative to achieve improved pricing of smaller tax credit projects is the formation of a local or state-level for-profit corporation that specializes in syndicating tax credit projects below $1 million. Having this for-profit corporation based locally but with regional links offers several advantages including: 1) better knowledge of the market, and 2) reduced travel, due diligence and operating costs, while still offering access to sophisticated tax credit techniques.

This entity holds the potential to unleash the rehabilitation of hundreds of smaller scale buildings throughout New Orleans, not just in the French Quarter. The cumulative economic impact of such an increase in rehabilitation activity could easily equal the impact of the few larger marquee projects undertaken through the existing historic tax credit structure in Louisiana. Sponsors for such a for-profit corporation could include: 1) local or regional banks, 2) existing syndicators of larger tax credit projects, 3) state or local economic development agencies, and 4) existing large tax credit investors.
Scenario 5 in Table 6-2 below presents the resulting unleveraged yields for Scenario 1 assumptions (Existing Tax Credit Incentives) when the pricing of LRTCs increases from $.75 to $.85 per $1.00 of tax credit and HTCs pricing moves from $.85 to $.95 per $1.00 of tax credit. The increase in market efficiency represented through this higher tax credit pricing results in unleveraged yields of 5.3% and 7.1% for the Creole Townhouse and VC Commercial projects, respectively.

Table 6-2: Unleveraged Yield with Improved Tax Credit Pricing

<table>
<thead>
<tr>
<th>Unleveraged Yield With Improved Tax Credit Pricing</th>
<th>Creole Townhouse</th>
<th>VC Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario 5: Yield with Existing Tax Credit Incentives</td>
<td>5.3%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Scenario 6: Yield with 50% LRTCs</td>
<td>6.2%</td>
<td>8.3%</td>
</tr>
<tr>
<td>Scenario 7: Yield with 70% LRTCs</td>
<td>7.0%</td>
<td>9.7%</td>
</tr>
<tr>
<td>Scenario 8: Yield with 50% LRTCs &amp; 40% HTC</td>
<td>7.2%</td>
<td>9.8%</td>
</tr>
</tbody>
</table>

Scenario 6 in Table 6-2 indicates unleveraged yields of 6.2% and 8.3% for the Creole Townhouse and VC Commercial projects, respectively, if the LRTC rate is 50% and tax credits pricing is improved. Scenario 7 presents the unleveraged yield if the LRTC rate is increased to 70% and tax credit pricing is improved. At this elevated tax credit rate the unleveraged yield on the Creole Townhouse reaches 7.0%, while the VC Commercial climbs to 9.7%.

And finally, Scenario 8 provides the unleveraged yields using Scenario 4 assumptions (50% LRTCs and 40% HTCs) with the higher tax credit pricing. Under Scenario 8, the unleveraged yield for the Creole Townhouse is 7.2%, while the VC Commercial building generates a 9.8% return.
Findings from the Sensitivity Analysis

The sensitivity analysis conducted in this chapter generates a number of useful findings:

1) Some combination of increased LRTCs and HTCs totaling up to 90% of QREs may be necessary to achieve an unleveraged yield high enough to incentivize a developer to undertake a prototypical VC Commercial rehabilitation project.

2) A Creole Townhouse rehabilitation project may be infeasible even at the combined 90% tax credit level given the current level of acquisition costs.

3) Improved tax credit pricing can increase the unleveraged yield for the prototypical French Quarter projects considered from between .1% to .8%.
Chapter 7 Recommendations

The following recommendations are derived from the analysis contained in this thesis:

Adopt a Tiered Schedule of LRTC Rates

A tiered schedule of LRTC rates should be adopted by the State of Louisiana to overcome the financial challenges for smaller-scale historic rehabilitation projects such as the prototypical French Quarter projects discussed in this thesis.

Table 7-1 below presents a potential tiered schedule of LRTC rates.

Table 7-1: Potential Tiered LRTC Rate Schedule

<table>
<thead>
<tr>
<th>Potential Tiered LRTC Rate Schedule</th>
<th>Tax Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1: QREs up to $2 million</td>
<td>70%</td>
</tr>
<tr>
<td>Tier 2: QREs above $2 million and below $4 million</td>
<td>50%</td>
</tr>
<tr>
<td>Tier 3: QREs above $4 million</td>
<td>25%</td>
</tr>
</tbody>
</table>

Under this tiered rate schedule, a Tier 1 LRTC rate would apply to the first $2 million of QREs expended on every qualified historic rehabilitation project. Once a project exceeded $2 million in GREs, it would receive a Tier 2 incremental amount of LRTCs equal to 50% of QREs above $2 million but below the $4 million threshold. All QREs above the $4 million threshold would continue to receive LRTCs at the existing 25% rate represented as Tier 3 expenditures.

Table 7-2 below provides three numeric examples of the application of this tiered LRTC rate schedule. Project A represents a small-scale rehabilitation such as
the Creole Townhouse project discussed throughout this thesis. Project B represents a more moderate scale rehabilitation project along the lines of the VC Commercial project. And finally, Project C represents a larger-scale rehabilitation project such as the recent CBD office tower projects.

Table 7-2: Application of the Tiered LRTC Rate Schedule

<table>
<thead>
<tr>
<th></th>
<th>Project A</th>
<th>Project B</th>
<th>Project C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Project QREs</td>
<td>$800,000</td>
<td>$3,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Tier 1 LRTC Credits (70% up to $2M in QREs)</td>
<td>$560,000</td>
<td>$1,400,000</td>
<td>$1,400,000</td>
</tr>
<tr>
<td>Tier 2 LRTC Credits (50% of QREs $2M to $4M)</td>
<td>$500,000</td>
<td>$1,000,000</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Tier 3 LRTC Credits (25% of QREs over $4M)</td>
<td>$1,500,000</td>
<td>$1,900,000</td>
<td>$3,900,000</td>
</tr>
<tr>
<td>Total Project LRTCs</td>
<td>$560,000</td>
<td>$1,900,000</td>
<td>$3,900,000</td>
</tr>
<tr>
<td>% of QREs</td>
<td>70.0%</td>
<td>63.3%</td>
<td>39.0%</td>
</tr>
</tbody>
</table>

Using the Tiered LRTC Rate Schedule, the smaller-scale Project A receives LRTCs equal to 70% of its QREs, while the more lucrative Project C receives LRTCs equal to a more moderate 39% of its QRE. The mid-scale Project B falls in between the other two projects and receives LRTCs equal to 63.3% of its QREs.

Unleveraged yields of 6.5% and 8.9% would be achieved by the Creole Townhouse and VC Commercial projects, respectively, if these tiered LRTC rates were applied and HTCs rates were kept at the current 20% level. On these smaller projects, the unleveraged yield is only slightly affected by the tiered LRTC rate since only a small portion of the VC Commercial building’s QREs exceed the Tier 1 threshold of $2 million.
Adopt a Tiered Schedule of Federal HTC Rates

State and local officials should work in a coordinated manner with local, state and national preservation organizations to lobby the federal government to adopt a tiered schedule of HTC rates. Increasing the HTC rate from 20% to 40% on the first $2 million in QREs would serve as a considerable catalyst for smaller-scale rehabilitation projects nationwide.

Any increase in the HTC rate on a federal level could then reduce the LRTC rate necessary to achieve a combined tax credit level of 90% of QREs, which is desirable to improve the feasibility small-scale rehabilitation projects present in the French Quarter. Unleveraged yields of 6.7% and 9.1% would be achieved by the Creole Townhouse and VC Commercial projects, respectively, if the tiered HTC rates were applied and LRTCs rates were correspondingly adjusted so that a total of 90% of the QREs were subject to either federal or state tax credits. Here again, the unleveraged yields of the prototypical projects do not differ from the Table 6-1 results since only a small portion of the VC Commercial building’s QREs exceed the Tier 1 threshold.

Create a Local For-Profit Corporation to Improve Tax Credit Pricing

In Chapter 6, the concept of a local or regional for-profit corporation being created to help improve the pricing of smaller quantities of LRTCs and HTCs was introduced and discussed. As discussed above, this entity could help spark the rehabilitation of hundreds of smaller scale buildings throughout New Orleans, not
just in the French Quarter. The cumulative economic impact of such an increase in rehabilitation activity could match the impact of the larger marquee projects undertaken through the existing historic tax credit structure in Louisiana.

As determined in Chapter 6, this program could positively impact the unleveraged yield of small-scale rehabilitation projects by .1% to .8%.

Reform the Louisiana State Residential Tax Credit Program

The LRRTC program presently limits the state tax credit for rehabilitation of an owner-occupied historic building to $25,000. Eliminating or substantially increasing this tax credit cap would have a significant effect on rehabilitation activity throughout New Orleans. Furthermore, the adoption of a tiered tax credit rate schedule similar to the one recommended above for the LRTC program would help catalyze additional small-scale owner-occupied rehabilitation projects.

Adopt a Rehabilitation Sub-Code

New Jersey’s adoption of a rehabilitation sub-code had the immediate effect of spurring double-digit growth in rehabilitation projects (Shankar, 1999). While the focus area for the initial New Orleans pilot program with a rehabilitation sub-code is the nearby Canal Street corridor, the potential application of a new rehabilitation sub-code to the French Quarter could be a very promising tool.
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