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HISTORIC TAX CREDIT TOOL BOX

Ensuring Approvals on a Changing Development

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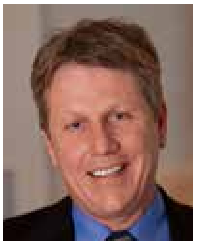

The reality of the real estate market is that it is cyclical. And as experienced in the past decade, the cycle down can be rapid–in some cases stopping a development before it begins. Now that the market is warming again, developers are looking to complete these partially completed developments. This cycling presents both opportunities and challenges for the historic tax credit (HTC) program. When a developer picks up a project, it is important to ensure that the necessary approvals are in place, especially when there are changes to the proposed scope of work.

There are two fundamental scenarios where a property comes back to life. In the first scenario, one developer has acquired the building, begins the development and runs out of money. Frequently, the demolition work has been done, but perhaps the market conditions have changed or the construction financing was not secured. Either the developer or perhaps the bank ultimately sells the building. A new developer picks up the pieces either through direct sale or foreclosure and comes in with a new plan–either to complete the development as intended or perhaps adapting the development to a new market. The new owner can often continue the old development (HTC application) or start a new development. If too much time has elapsed, or if a development is closed out by the National Park Service (NPS), the new owner may be required to begin a new development. Furthermore, the same development can change hands several times. When continuing an old project, it is vital for the new development team to ensure that all work proposed has been approved by the NPS. This involves a thorough review of all prior submissions and approvals and submission of amendments for any changes to the scope of work. Changes to the development including changes in use and scope of work must be submitted as amendments.

Case Study: The Euclid Building

One such property that faced these challenges was the adaptive reuse of the Euclid-71st Street Building in Cleveland. The building was listed in the National Register of Historic Places in 1996. Built as a speculative office and commercial building, the Euclid-71st Street Building was a key component of the Euclid Avenue commercial and cultural corridor in the early 20th century. Prominent Cleveland

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Image: Courtesy of Heritage Consulting Group
The Euclid Building in Cleveland required amendments to the proposed scope of work.

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architect George Grieble designed the building in a neo-classical revival style. The largest speculative office building in this section of the city, the building's terra cotta detailing, symmetrical proportions provided a significant architectural contribution to the character of Cleveland's famed Euclid Avenue.

By 2009, the building was vacant and an adaptive reuse plan using HTCs was initiated. The initial 2009 development proposed the adaptive reuse of the building as apartment units and was reviewed and approved by both the state historic preservation office (SHPO) and NPS. Unfortunately, following changes in the real estate market and the onset of the economic recession, the development stalled and eventually went quiet until 2011, when a new owner took on the rehabilitation development.

The revised development no longer proposed a residential use, but sought to capitalize on the building's location on the Euclid corridor. The development was also reprogrammed for leasable commercial space. At this time, the owner applied for the Ohio state HTC and successfully received an allocation. The Ohio state HTC program provides a tax credit up to 25 percent of qualified rehabilitation expenditures (QREs), which is capped at up to $5 million. The program is administered by the Ohio Development Services Agency in conjunction with the Ohio SHPO. The state HTC program is highly competitive, so receiving an allocation for the state tax credit was a huge boon to the development. But, once again, the development went quiet until 2013, when a new owner, Victory Midtown Landlord LLC, acquired the property.

While the development had its historic approvals, its reprogramming required that amendments be submitted to address the revisions to the proposed scope of work. While in some situations it may have been more straightforward to submit a new Part 2 application, the fact patterns surrounding this development made

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amending the existing Part 2 the most advantageous path forward. Seemingly, the simpler route would have been to submit a new Part 2 application, but this would have meant forfeiture of the state tax credits. Since the Ohio state HTCs are not as-of-right (as is the case with the federal HTC), the application process is extremely competitive and funding is not guaranteed. In order to ensure that the state allocation was maintained, the process of amending the Part 2 was undertaken.

As part of the amendment process, the development's ownership was revised, along with the proposed scope of work. To a certain degree, the work proposed for the office space was similar to that which was previously approved for the residential conversion, including retention of the historic lobby, installation of new finishes, exterior masonry repair and window replacement. The primary revisions to the scope addressed mechanicals and core and shell as the building was to be used as a multitenant building, with tenant improvements to be submitted at a later date. Basic circulation and public spaces, including elevator lobbies and restrooms were approved, but the remainder of the building was to remain vanilla box until tenants were secured.

Upon completion of the core and shell work, the development faced further struggles in locating commercial tenants. Although there were multiple potential tenants, it remained a challenge to secure tenants in an area of the city that had not yet garnered demand for Class A office space. With the core and shell complete, the building was beautiful on the exterior, but vacant on the interior. Facing the need to lease up the building, single-tenant occupancy became a possibility. In 2016, the hometown company Dealer Tire, which had outgrown its previous confines, agreed to lease the entire building as its new headquarters. This switch presented a new set of challenges in the approval process. To a certain extent, the design of the rehabilitation needed to accommodate for Dealer Tire's unique functional needs, whereas in a

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Image: Courtesy of Heritage Consulting
The Euclid Building in Cleveland went through multiple owners over seven years before being completed as a historic tax credit (HTC) development.

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multitenant office building, the office spaces would be more standard layouts with the tenants making minor decisions about the space, such as choice of finishes. This meant altering previously proposed layouts and accommodating for items like signage and finishes that were specific to Dealer Tire's brand. All aspects of the tenant fit-out were submitted as amendments and approved by SHPO and the NPS.

After nearly seven years, multiple owners, three separate programs and multiple HTC amendments, the development was completed. Victory Midtown Landlord LLC completed the $33 million historic rehabilitation in December 2016, using both state and federal tax credits. The Euclid Building is now the proud headquarters of Dealer Tire.

Conclusion

In some situations, a development may collapse with the market or a deal may fall through, but the developer is able to create a new ownership structure to move the development forward. In these instances, new ownership may anticipate that any conditions of an existing Part 2 will carry forward, but that without design changes, no new conditions will be applied. This process can be become further complicated when there are multiple changes in ownership, and following, multiple changes to the reuse program and scope of work over the course of the project. In those cases, it is necessary for the team to think strategically about the options to create a new development or continue the previous one. ❖

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