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USE OF HISTORIC TAX CREDITS FOR SCHOOL CONSTRUCTION IN VIRGINIA:
COSTS, BENEFITS, ADMINISTRATIVE IMPLICATIONS,
AND PUBLIC POLICY ISSUES

A dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy at Virginia Commonwealth University.

by

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Acknowledgment

I dedicate this dissertation to my family. To my parents, Franca and Mario Venturini, who taught me the value of hard work, and have watched me embark on new projects from far away. To my children, who have taught me life's most important lessons, my son James, his wife, Aronne, and their children Eleanor and Mark; my son Michael, and my daughter, Claire. Above all, I want to dedicate this work to my husband, James, for believing that I could accomplish anything, and for maintaining his unwavering support of all that I do.

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Abstract

USE OF HISTORIC TAX CREDITS FOR SCHOOL CONSTRUCTION IN VIRGINIA: COSTS, BENEFITS, ADMINISTRATIVE IMPLICATIONS, AND PUBLIC POLICY ISSUES

By Paola Venturini Brooks, Ph.D.

A dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy at Virginia Commonwealth University.

Virginia Commonwealth University, 2011

Major Director: William C. Boshier, Jr.
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A number of studies show that school facilities in the United States are deteriorating and that a substantial outlay of financial capital is required to bring school facilities to good overall condition. The current economic environment, marked by slow growth, high unemployment, and low tax revenues has highlighted widespread issues with the financial condition and fiscal sustainability of local governments. While studies show that the success of the educational process is related to the condition of school facilities, providing a safe and effective educational environment for students and teachers is a great challenge for local governments.

Alternative sources of funding for the rehabilitation of old schools, which would reduce the need for long-term debt financing, are worth exploring. Federal and state historic

rehabilitation tax incentive programs have proven to be successful in bringing private capital, economic activity, and jobs to distressed areas around the country, while being largely fiscally self sustaining. Current legislation, however, does not make the federal tax credit program easily accessible to public schools, and a significant court decision has the potential to undermine the viability of the entire Virginia program.

This study examined the financial costs and benefits of historic tax credit financing for school construction in Virginia, investigated administrative issues related to the private-public nature of the program, and finally analyzed the relevant public policy issues. The study followed a case study methodology of two schools in Virginia which utilized historic tax credit financing, and four schools which utilized traditional financing for renovation. This study will expand the body of knowledge of modern education financing and enrich the existing literature by introducing a financing alternative that includes a private-public partnership. The study will also be of great value to policymakers, public administrators, the investor community, and the public at large as they evaluate financing alternatives for school construction.

CHAPTER 1. INTRODUCTION

Aging school buildings in America are deteriorating, particularly in urban and economically-disadvantaged neighborhoods. The average age of schools in America is 42 years, 46 in urban areas, and 44 in poor areas (National Center for Education Statistics [NCES], 1999). One-third of American schools require extensive repair or replacement of buildings to bring them to good overall condition, and schools in central cities and schools with a 50% or more minority population are more likely than other schools to have unsatisfactory environmental conditions such as lighting and physical safety. Additionally, a study by the U.S. General Accounting Office found inequalities of access to facilities that can support education into the 21st century (U.S. General Accounting Office [USGAO], 1995b & 1996a).

There is no recent comprehensive national study that can provide reliable numbers on the total cost of needed repairs or rehabilitation of American schools. A best estimate by the National Education Association (2000) of the cost of needed repairs is \$322 billion while earlier studies by the NCES (2000) and the USGAO (1995a) estimated the cost at \$127 and \$119 billion, respectively.

Lack of funds and deferrals of expenditures needed for maintenance and repairs are claimed as the reason for deteriorating school facilities (USGAO, 1995a). Given that the financial responsibility for funding school construction in the United States generally falls with the local governments, and given the current economic environment and the shortfall of local tax revenues, the deferral of construction expenditures is likely to continue. In fact, according to

the 35th Annual Official Education Construction Report published in the magazine, *American School and University* (Agron, 2009), the trend of expenditures for new construction and renovation of schools in the United States is decreasing significantly: expenditures were \$71.1 billion for the 3-year period 2006-2008 and are expected to be \$63.4 billion for the 3-year period 2009-2011.

In Virginia there are 1,815 schools with pupil enrollment of 1.2 million. The USGAO (1996b) reports that 81% of the schools in Virginia need repairs ranging from \$1,000 to \$26,000,00 to upgrade buildings to good overall condition. In 2009, local governments in Virginia spent \$1.1 billion for education capital projects, \$1.4 billion in 2008, and \$1.4 billion in 2007. These expenditures represent 29.2% of the local governments' total capital expenditures in 2009, 37.5% in 2008, and 39.4% in 2007 (Virginia Auditor of Public Accounts [VAPA], n.d.). Given the critical need for more capital improvements for education, the significance to the local budgets of such expenditures will inevitably increase.

Studies have found that facilities and the physical environment of schools have an impact on student achievement and behavior (Bishop, 2009), teacher job satisfaction and retention (Buckley, Schneider, & Shang, 2004; Cash, 1993; Hines, 1996; McGowen, 2007), and community development (Weiss, 2004). In order to improve the educational process, school divisions need to make the necessary capital investments to ensure a healthy, safe, comfortable environment, which incorporates open and flexible designs to enable effective teaching and learning. Optimizing the learning potential of students will positively impact the future workforce, the industrial and economic growth of the community, and the overall future well-being of our nation.

While studies provide evidence that public school facilities are aging (NCES,1999; National Education Association [NEA], 2000; USDOE, 1999; USGAO 1995a & 1996b) and that the poor conditions of schools have a negative impact on the education experience (Buckley et al. (2004); Cash, 1993, Hines, 1996; McGowen, 2007; Weiss, 2004), the challenge for the local governments is the financing of the rehabilitation construction costs. Traditional forms of financing for capital school projects include cash reserves, general obligation bonds, bonds of the state public school authority, and loans from the literary funds (Brimley & Garfield, 2002; Guthrie, Springer, Rolle, & Houck, 2007; Howell & Miller, 1997). When local governments use debt to finance the cost of construction, they commit to the repayment of principal and interest (the debt service charges) over a period of time, much like a household would repay a mortgage on the house. When governments become overcommitted (burdened) with debt service, their long term financial sustainability is put at risk, their future solvency becomes questionable, their accessibility to liquidity sources grow to be limited, and their bond rating could potentially be downgraded. A government becomes overburdened with debt when its current and future tax revenue base cannot support its debt service obligations. The long term financial sustainability of a local government, therefore, is a function of the sustainability of its tax revenue base and the relative amount of debt burden it carries.

One of the most pressing issues in public administration today is the continued financial sustainability of local and state governments. Concerns over low tax revenue streams, high debt loads, and stretched out repayment times, have prompted warnings within the investment community of a possible “widespread cascade in defaults” and a contagion of the municipal bond market (Bookstaber, 2010; Gelinas, 2010; Malanga, 2010). During the period 2000 to 2008, when tax revenues were outpacing inflation by 15%, U.S. state and local governments increased

their debt from \$1.4 trillion to \$2.2 trillion, and later added another \$15 billion over the following 2 years (Gelinas, 2010; Malanga, 2010). These financial management practices of continuing to grow the debt load and failing to reduce it in favorable economic times, have failed to provide a solid financial foundation for states and local governments, and a number of them are now experiencing serious financial stress, and their ability to support the ongoing and future needs of the community is in question.

In May of 2008, the city of Vallejo, California, filed for bankruptcy; and as recently as September, 2010 the state of Pennsylvania had to step in and provide \$4.4 million of funds and grants to the city of Harrisburg, which recently considered bankruptcy, to prevent it from defaulting on its debt obligations (Grzeskowiak, 2010). In 2009 the state of California, the world's eighth largest economy, had to issue \$400 million in IOUs to its citizens in place of paying out tax refunds (Jaffe, 2009). The financial community is showing concerns about governments being overextended financially, and has placed increased scrutiny on the financial condition and performance of municipal and state finances. Local governments need to consider creative financing alternatives that will help source greatly needed funding for school construction while minimizing the impact on their debt and their long term financial sustainability.

In Virginia, the major source of financing available to local governments is the municipal bond market. Local governments in Virginia can access the bond market directly through issuance of general obligation bonds or indirectly through the Virginia Public School Authority. As of June 30, 2009, local governments in Virginia had total debt of \$25 billion, including \$10 billion issued for the purpose of Education (VAPA, n.d.). As displayed in Figure 1, capital

expenditures for education have been increasing steadily over the past 10 years in Virginia.

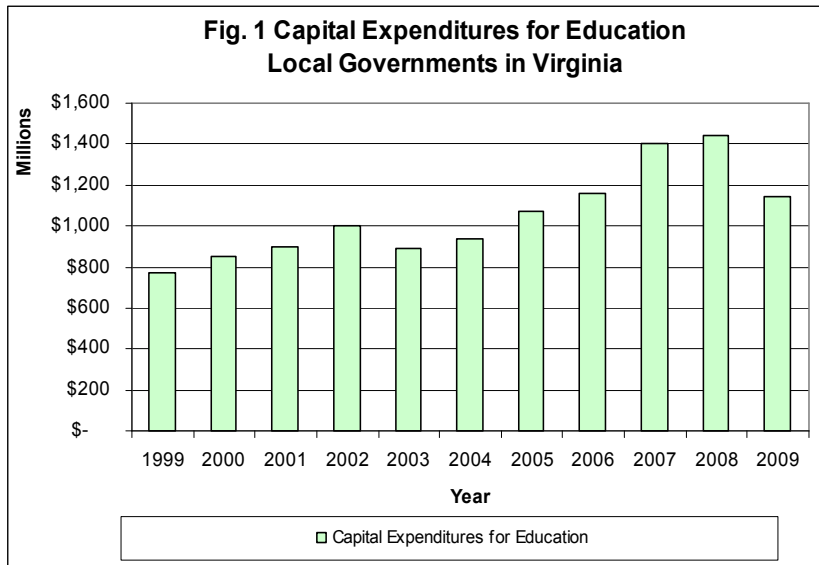


Figure 1. Capital expenditures for education.

Source. Constructed from data published by the Virginia Auditor of Public Accounts, *Comparative Reports*.

During the same period, as shown in Figure 2, the amount of debt issued for education by Virginia’s localities and the related interest costs have been growing consistently in order to fund capital projects. Debt issuance, therefore, appears to be the principal source of funding

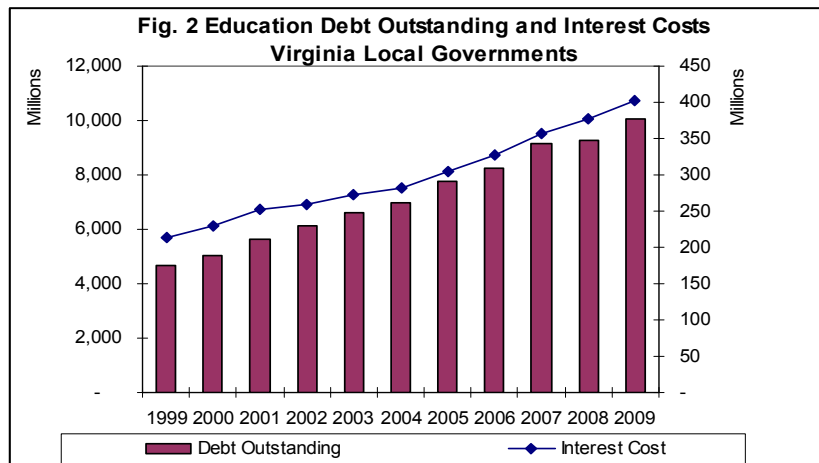


Figure 2. Education debt outstanding and interest costs.

Source. Constructed from data published by the Virginia Auditor of Public Accounts, *Comparative Reports*.

used for school capital projects in Virginia. In fact, in Virginia, over the 10-year period 2000 to 2010, debt outstanding for education doubled in size from \$5 billion to \$10 billion with the cost of interest in excess of \$3 billion over the same period (VAPA, n.d.). If local governments were to meet rehabilitation construction needs, and construction expenditures increased or continued at the current pace, the debt burden could become far too great for the local governments of Virginia to bear, and could impact their bond rating.

With 81% of the schools in Virginia needing upgrades or repairs to good overall conditions, local governments and the commonwealth should cautiously consider alternative sources of funding that would alleviate the need for long term financial obligations. Current policies at the state and federal level should be explored and creatively utilized to generate funding for school rehabilitation from both public and private sources. For example, the rehabilitation of two schools in the Richmond and Petersburg, Virginia area were financed in part with an innovative funding structure that involved the syndication of federal and state rehabilitation tax credits, and therefore the infusion of private capital. Rehabilitation tax credits are tax incentives designed to encourage the investment in, and the preservation and rehabilitation of older buildings. Rehabilitation tax credits provide income tax reductions based on a percentage of allowed construction costs, can be carried forward for up to 20 years, and are transferable by the taxpayer to other individuals or entities. Through the syndication and sale of state and federal historic tax credits, private funds were sourced for the funding of the rehabilitation of the two schools in Virginia, hence, realizing immediate equity in the properties, generating economic activity in depressed inner city areas, maintaining historical architectural character, and building state of the arts school facilities for premier regional schools.

In order to qualify for the tax credit, certain conditions must be met, for example, with regards to the taxpayer status, the property type, the use of the property, the rehabilitation costs, and the type of rehabilitation undertaken. Given the exempt taxpayer status of school divisions and the local governments, the utilization of rehabilitation tax credits as a source of funding for school facilities presents a number of legal, operational, and public policy issues worth exploring. This study applied a case study research method to assess the costs and benefits of using historical tax credits in Virginia to partially fund school renovations, the implications for administrators, and the public policy issues. In the case study, the use of historical tax credits to renovate two schools in the Richmond area was examined, analyzed, and compared to more conventional methods of financing used by four other schools in the Richmond area to finance their renovations. The two schools whose renovation was partially funded with historic tax credits are the Maggie L Walker Governor's School for Government and International Studies and the Appomattox Regional Governor's School for the Arts and Technology. The four schools whose renovations were funded with conventional forms of financing are the Douglas S. Freeman High School and Highland Springs High School in Henrico County, and the Meadowbrook High School and Thomas Dale High School in Chesterfield County.

Current literature on education financing does not contemplate historic tax credits as a potential source of rehabilitation construction funding, hence this study will expand the body of knowledge and enrich the existing literature on education financing by introducing a structured alternative that includes private and public funds. This study will expand and deepen the knowledge of historic tax credits as an alternative source of funding for school construction, and will provide a comparison to traditional forms of financing with regards to financial costs and benefits. The study also aims to identify reasons why historic tax credits are not broadly utilized

by looking for potential issues with the funding process, barriers created by the regulatory and public policy environment, normative implications of giving up ownership for public property, and the broadness (level) of awareness and understanding of the tax credits. Given the scarce resources of local governments in Virginia and in the United States, the study's comprehensive analytical framework will be of great value to policymakers, administrators, the investor community, and the public at large as they evaluate financing alternatives for school facilities rehabilitation.

Following a review of theoretical, practitioner, government, industry, and statutory literature, the study utilized a case study methodology to address the research problem and answer the research questions outlined below.

Research Problem

The syndication of historic tax credits as an alternative source of funds for partially financing construction costs for public school facilities is not well utilized.

Research Questions

1. What are the financial costs and benefits of using historic tax credits for public schools financing?
2. What are the statutory requirements to qualify for the federal and Virginia historic tax credits?
3. How did the law apply in the Maggie L. Walker School for Government and International Studies in Richmond, VA and the Appomattox Regional Governor's School for the Arts and Technology in Petersburg, VA?
4. What are the administrative implications resulting from the use of historic tax credits financing for school construction in Virginia?

5. What are the public policy issues arising from the use of historic tax credits for school construction in Virginia?

CHAPTER 2. LITERATURE REVIEW

This chapter will provide the literature context for the study. The chapter will start with a review of government and industry studies of the condition of school facilities in the United States and the Commonwealth of Virginia. It will then review studies linking the condition of school facilities to learning and teaching performance, and community development.

The next section of the literature review helps establish the literature context for this study in the field of education finance, and more specifically modern education finance. This section first provides an overview of the historical evolution of education finance in literature, and then narrows its focus on the new paradigm of modern education finance.

Following the broader topic of education financing, the next section of the literature review covers funding sources for financing school construction in Virginia and discusses legal and operational parameters regarding debt obligations for local governments and the Commonwealth of Virginia. This section also addresses current issues in the municipal bond market spurring from the distressed financial environment of local and state governments. Next, this chapter reviews the applicable federal and state laws and regulations guiding historic tax credits.

Finally, drawing from the literature review, the chapter concludes that school facilities in the United States and Virginia are inadequate, that the learning and teaching processes are impacted, that resources for improvements are limited, and that alternative forms of financing

such as the syndication of historical tax credits are worth exploring. This conclusion lays the basis for this in depth study of the utilization of historic tax credits for school construction in Virginia.

The chapter ends with an overview of the J. Kingdon's multiple streams model as it is used in the study to help analyze and explain a significant public policy issue related to the use of historic tax credits for school renovations.

Condition of School Facilities in the United States

The most comprehensive study of the condition of school facilities in the United States was conducted in 1994 by the U.S. General Accounting Office (USGAO) at the request of the United States Congress. Based on its study, the USGAO published a series of reports:

1. Condition of America's Schools (GAO/HEHS-95-61 Condition of America's Schools, February 1995);
2. American Schools Not Designed or Equipped for 21st Century (GAO/EIEHS-95-95 21st Century Schools, April 1995);
3. American School Report Differing Conditions (GAO/HEHS-96-103 School Conditions Vary, June 1996);
4. Profile of School Condition by State (GAO/HEHS-96-148 School Facilities: State Profiles, June 1996).

The GAO study was conducted using surveys of a national sample of approximately 10,000 schools in over 5,000 school districts, and was enhanced by visits to 41 schools in 10 school districts. The surveys, which had a 78% response rate, asked questions about the physical condition of the school buildings, the school environmental conditions, expenditures incurred or projected to meet federal mandates for accessibility and removal of hazardous material, and

estimates of the total cost of needed repairs, renovations, and modernizations to put all buildings in good overall condition (USGAO, 1995a).

The results of the GAO comprehensive study provide a basis for assessing the physical condition of school facilities and the capital improvements needed. While two-thirds of the schools surveyed reported adequate facilities, one-third of the schools, which served 14 million or one-third of the total student body, reported needing extensive repairs or replacement of one or more buildings. Lack of funds and deferrals of expenditures needed for maintenance and repairs were claimed as the reason for the deterioration of the facilities. Based on the study's estimates, schools in the United States need about \$112 billion to repair or upgrade facilities to good overall condition, including \$11 billion for upgrades to comply with federal mandates for student accessibility and to remove hazardous materials (USGAO, 1995a).

The distribution of schools needing upgrading to good overall condition varies across various dimensions. With regards to variation among states, a substantial difference was reported between the lowest score of 62% of schools in Georgia and 97% of schools in Delaware needing repairs and upgrades of facilities to good overall condition. Variation across other dimensions was not as significant; however, a consistent theme emerged with regards to race, income levels, and schools located in central cities. Based on the study, 33.8% of the schools with more than 50.5% of minority population, 33.1% of the schools with 70% student population in the poverty class, and 31.3% of the schools located in central cities consistently reported school facilities needing upgrades and repairs to bring them to good overall condition (USGAO, 1996a).

The USGAO was also asked to evaluate the capacity of school facilities in America to prepare the future workforce and provide the appropriate physical and technological environment to support learning in the 21st century. The USGAO study found that 40% of the schools cannot meet the functional requirements of laboratory science or large-group instruction even moderately well, and more than half the schools have unsatisfactory space flexibility for effective teaching. The study also reports that “not all students have equal access to facilities that can support education into the 21st century.” In fact, schools in central cities and schools with a 50% or more minority population were more likely than other schools to have unsatisfactory environmental conditions such as lighting and physical security (USGAO, 1995b).

More recent studies have been conducted by the National Center for Education Statistics (NCES) in the Office of Education Research and Improvement of the U.S. Department of Education (NCES, 1999) and the National Education Association (NEA, 2000). These studies corroborate the results of the USGAO surveys and confirm the poor condition of school facilities in the United States. Based on their 1999 survey of 903 public schools in the United States, the NCES found that three-fourths of the schools required improvements to bring buildings to good overall condition at an estimated cost of \$127 billion; one-fourth of the schools had at least one building in less than adequate condition, and schools in central cities and schools with the highest concentration of poverty were more likely to report permanent additions to schools to be in less than adequate condition (NCES, 2000). Additionally, based on information sourced through its Fast Response Survey System (FRSS), the NCES has been able to estimate that in 1998 the average age of U.S. schools was 42 years; the average age of schools in urban areas was 46 years; and the average age of schools with 50% or more students with free lunch was 44 years (NCES, 1999).

The NEA (2000), using data collected from literature, research databases, surveys, and questionnaires, produced an estimate of the need for school modernization in the United States. In its report, *Modernizing Our Schools: What Will It Cost?*, the NEA (2000) states that the total funding needed for public school modernization is \$321.9 billion. Similar to the USGAO study, the NEA found that funding needs vary considerably across states, from \$50.7 billion in New York to \$333 million in Vermont.

Relevant to this study are also the historical trends of construction dollars spent on school facilities. Using data sourced by Market Data Retrieval from surveys of every school district in the United States, the *School Planning & Management* magazine publishes an Annual School Construction Report, which provides information about school construction activity in the United States. Data published by the *School Planning & Management* magazine for the years 1985 to 2009, and by the *American School & University* magazine for the 1983 and 1984 years, provide a view of construction trends in the United States during the 27-year period (P. Abramson, personal communication, October 25, 2010). The historical trend chart (see Figure 3) of dollars spent for school construction, unadjusted for inflation, shows expenditures growing from a low of \$4.7 billion in 1983 to highs of \$21.6 billion in 2002 and 2005, and declining to a low \$16.4 billion in 2009. The decline following the 2005 high, reflects the difficult economic and fiscal environment of the school districts. The historical trend also shows that the percentage of total construction costs attributable to new construction has grown over the 27-year period from 49% in 1995 to 73% in 2009. It appears that while total construction costs have increased four-folds

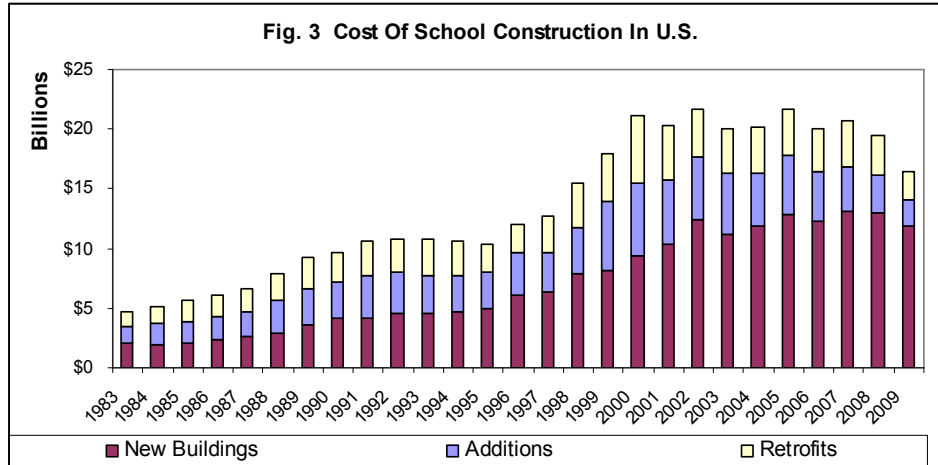


Figure 3. Cost of school construction in the United States.

Source: Constructed from data published by the *American School & University* magazine (Abramson, 1983, 1984) and the *School Planning & Management* magazine (Abramson, 1985-2010).

over the past 27 years, the increase has been mainly in new construction, while the dollars spent on additions and renovations have increased at a much slower pace and represent a much smaller percentage of total expenditures (P. Abramson, personal communication, October 25, 2010).

Percentage distribution of school construction costs in the U.S. are displayed in Figure 4.

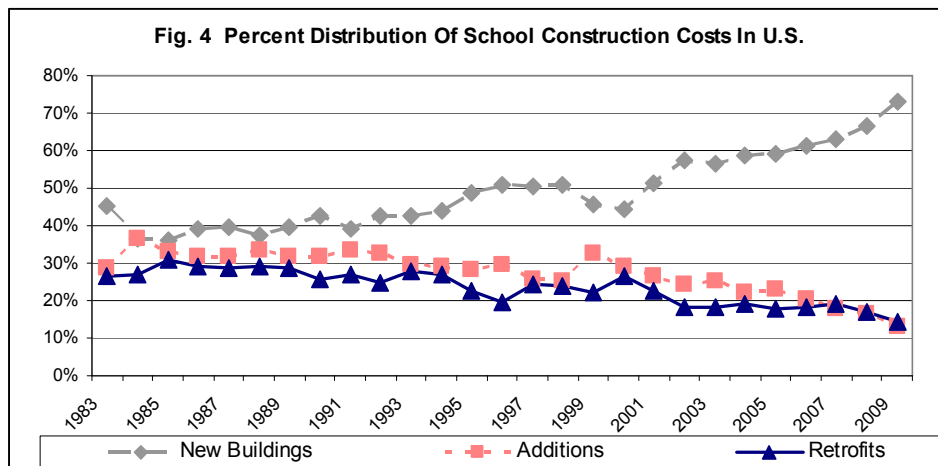


Figure 4. Percentage distribution of school construction costs in United States.

Source: Constructed from data published by the *American School & University* magazine (Abramson, 1983,1984) and the *School Planning & Management* magazine (Abramson, 1985-2010).

Condition of School Facilities in Virginia

Student enrollment in public schools in Virginia has been steadily growing over the past several years as can be observed in Figure 5, which was constructed from data of the Virginia Department of Education (VDOE, 2011a). Pupil enrollment for the school year 2009-2010 was 1,245,270, an increase in 7 years of 6% from 1,176,128 in 2002-2003, and in line with the 8% general population growth in Virginia during the same period. There are 1,881 public schools in Virginia (VDOE, 2011a).

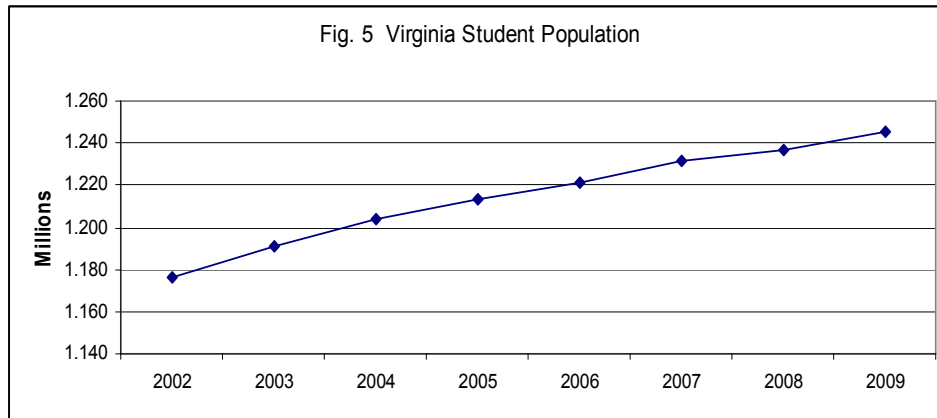


Figure 5. Virginia student population.

Source: Virginia Department of Education Data (2011).

The USGAO's (1996b) report, Profile of School Condition by State, summarizes the results of the comprehensive 1994 study for each state. The USGAO reports that 81% of the schools in Virginia need to upgrade or repair buildings to good overall condition, with a range of dollar amounts needed from \$1,000.00 to \$26,000.00. Based on the study, 27% of the schools in Virginia have at least one inadequate building of any type, 60% of the schools have at least one inadequate building feature (such as roof, floor, plumbing, etc.), and 58% have at least one unsatisfactory environmental factor (such as lighting, heating, ventilation, etc.).

Each year the Virginia Auditor of Public Accounts (VAPA) collects financial information regarding the operations of local governments in Virginia and publishes the Comparative Report of Local Government Revenues and Expenditures. The report is based on data submitted by the local governments, as required by state law, for all counties, cities, and towns with population greater than 3,500 and towns operating a separate school division. Based on the Comparative Reports of Local Government Revenues and Expenditures for the respective years, capital expenditures for education totaled \$1,144,808,222 for the July 1, 2008 to June 30, 2009 fiscal year; \$1,439,460,718 for the July 1, 2007 to June, 30, 2008 period; and \$1,405,332,026 for the July 1, 2006 to June 30, 2007 period (VAPA, n/d).

The literature supports this study's proposition that aging school buildings in America and Virginia are deteriorating; however, the extent of the financial need to bring them to good operating condition is not well documented, mainly because of lack of current, comprehensive, and authoritative data. The USGAO study provided valuable insight into the condition of school facilities in 1994, however, an update to the study is needed to obtain current reliable financial data for the researcher, practitioner, and industry communities.

Impact of Facilities on School Success

A number of studies have concluded that the quality of school facilities impacts the educational process. Cash (1993) found that student achievement is higher in better quality buildings, buildings with higher quality cosmetics, schools with better quality science facilities, buildings with air conditioning and other environmental factors. Cash (1993) also found that building condition and student behavior factors are related. Building on Cash's study, Hines (1996) found similar results in her study of urban high schools in Virginia, and reiterated the

strong relationship between building condition and student achievement. In another study of new schools in Virginia, Bishop (2009) concluded that design elements such as natural lighting, temperature control systems, and open spaces positively impact student behaviors and staff attitudes and behaviors.

Physical conditions such as poor air quality, temperature control, lighting, layout, room size, can impact the effectiveness of instruction, teachers' health, and ultimately teacher morale and job satisfaction. In the study "The Effect of School Facility Quality on Teacher Retention in Urban School Districts," Buckley et al. (2004), using data from survey of K-1 teachers in Washington, DC, concluded that facility quality is an important predictor of teacher retention decisions. Similarly, McGowen (2007), in a study of Texas public schools, concluded that teachers' retention rate is related to the condition of school facilities particularly when considering support spaces.

The quality of school facilities has also been found to have a significant impact on the economy and quality of life of the neighboring communities. In a review of the research of "Public Schools and Economic Development," Weiss (2004) concluded that evidence from research shows that (a) public schools have a profound effect on the nation's "human capital," and enable economic growth, increased productivity, higher wages, greater social opportunity, and therefore greater economic development; (b) at the state and local level, schools, by developing the future workforce, can make the local economies more attractive for business site selection; (c) there is strong evidence that quality of schools affect residential property values; (d) there is new evidence showing that quality, size, and shape of school facilities, together with the construction and renovation of the facilities, affect economic development; (e)

well-maintained facilities enhance academic performance, which in turn impacts economic development as described above.

It is also intuitively reasonable to propose that school buildings provide value beyond the classroom space, and can directly impact the vitality of the neighborhood. In most successful examples of integration of schools within communities, school facilities, in addition to serving as community emergency shelters, also provide space for community meetings, voting places, after school youth activities, sport events, neighborhood celebrations, church gatherings, night school, business meetings, concerts. When school facilities become community hubs, commercial activity increases, and economic growth follows. The literature suggests that poorly maintained and overcrowded facilities contribute to neighborhood decline, while new or well-maintained school facilities help revitalize a neighborhood (Weiss, 2004).

With the evidence advanced by the literature, it appears safe to conclude that school facilities in America and Virginia are deteriorating, and as a consequence the learning potential of students and the teaching potential of teachers are hindered. This situation has a direct and indirect impact on the economy and the social development of the population at the local and national levels. In the last decades quality of education has gained center stage in education public policy, as evidenced by significant legislative initiatives such as the No Child Left Behind (NCLB) of 2001 which requires schools to maintain quality educational scores or risk losing students to other better performing district schools (Guthrie et al., 2007). Educational reforms such as the NCLB have guided changes in education finance, which is now mostly concerned with linking educational results to financial inputs in an effort to improve efficiency (Guthrie et al., 2007). This research attempted to evaluate an innovative source of education financing for

the rehabilitation of old schools, and therefore contribute to the aspirations of the new goals of education public policy and the strive for efficiency of modern education finance.

Education Finance

The field of education finance has evolved over time, changed by state and federal legislative and court actions, actions by governors, and citizens. This section describes the evolution of education finance and the development of the modern education finance paradigm, and provides the background for placing this research in the context of the literature of education finance, specifically modern education finance.

Guthrie et al. (2007) describe in *Modern Education Finance and Policy* how early education finance evolved in three phases. The first phase, covering the period following the American Revolution and the drafting of the Declaration of Independence (1776) to post-Civil War Reconstruction era, was characterized with efforts on building a school system in the new nation, although bearing significant regional differences across the colonies. While the federal, state, and local governments were all involved in providing for education, the focus was to serve or modify the regional aspirations. The federal government only provided land grants for building schools, but not year-to-year subsidies. The states provided incentives to localities to establish schools, and started to raise additional taxes to support schools. Local governments had the principal responsibility for generating revenues for schools and experienced the most heated debates regarding taxation for the purpose of schooling. This period produced very little literature in education finance, (Johns, 1971 as cited in Guthrie et al., 2006, p. 48).

Phase two of early education finance covers the period from the end of the 19th and beginning of the 20th century. This period is characterized by efforts by the states to enforce free public education. During this period scholarly literature on education financing started to

emerge. Cubberley, considered the “father” of education finance, published extensively, initially focusing on expanding education opportunities by developing means for the states to use intergovernmental fiscal arrangements to reward local governments, and later by devising means for the states to distribute revenues to compensate for differences in property wealth. Following Cubberley, a number of scholars contributed to the development of education finance as a field of study. These scholars, in addition to their literary contribution, substantially influenced how states generated and distributed revenues to local districts to increase access to schooling (Guthrie et al., 2007).

Phase three of early education finance was a result of the social and policy environment of post-World War II Civil Rights movement, and as such the focus in education finance was on equitable generation and distribution of revenues. Two significant scholarly publications (Guthrie et al., 2007) addressed differences in property-related resources as injustices within the states. Each built arguments around the 14th Constitutional amendment equal protection clause, which identified disparity in resources as a possible adjudication item. Proposition One, put forth by Coons et al. (1970), states “the quality of a child’s schooling should not be a function of wealth, other than the wealth of the state as a whole.”

Guthrie et al. (2007) in *Modern Education Finance and Policy* explain that in recent decades a new public policy movement has emerged in education which has given education financing a central role in the development of education policies. The policy focus has shifted from an input-focused understanding of school finance to an outcome-based understanding of school finance. This shift has created a change in the target measures, orientation, and concerns of the classic education finance, and has formed a new paradigm where education financing is now a principal instrument for pursuing educational policy.

The new public policy movement in education finance that gave impetus to a new paradigm in education finance is the result of events in the education policy arena. The A Nation at Risk (1983), a report from the National Center on Excellence in Education, triggered calls for better performance of public schools in America by the public and policy makers, and waves of reforms in education policies that generally aimed at increasing school performance expectations and raising teachers' salaries. The 1989 summit of America's governors in Charlottesville, Virginia, started a second wave of reforms in education. The new reforms attempted to link various components of education, and addressed the system as a whole in rewarding or penalizing for the achievement of progress. The 2001 No Child Left Behind Act strengthened the focus on the educational process outcomes. The law ultimately permits parents of underperforming schools to claim public funds and place their children in other schools, including private schools (Guthrie et al., 2006).

While this research will not directly link educational outcomes to financial input, previous research has demonstrated that the quality of school facilities has a positive impact on the educational process. Financing the rehabilitation of old schools provides the means for improving school conditions and evaluating costs and benefits of historic tax credits financing and analyzing the barriers to their implementation adds to the literature of modern education financing. This research attempts to evaluate an innovative source of education financing for the rehabilitation of old schools, and therefore contributes to the aspirations of the new goals of education public policy and the strive for efficiency of modern education finance. Said differently, historic tax credits financing has the potential to improve the cost of rehabilitation construction, resulting in better education environment at an efficient cost, therefore achieving the mandates of the new educational policies.

Financing School Construction in Virginia

In Virginia, school divisions are political subdivisions of the Commonwealth; however, they do not have taxing authority and depend financially on the general-purpose local governments they are associated with. The title to all school property is vested in the school board, except by agreement between the school board and a city, in which case it can be vested in the city (Virginia Code 22.1-125, 2010). Cities and counties (the general-purpose local governments) where the school division resides are responsible for securing the funds for school construction and operations.

Construction of school facilities is subject to extensive design and engineering standards. In Virginia, plans require approval by the superintendent of the school division, and certification of compliance with the regulations of the Board of Education and the uniform statewide building code. The division superintendent's approval, architect's or engineer's statement, and a copy of the final plans and specifications must be submitted to the Virginia Superintendent of Public Instruction (Virginia Code 22.1-140, 2010) prior to contracting for construction. In the case of the rehabilitation of a school building that is designated as a historic building, then certification by the Department of Historical Preservation will be required.

In Virginia, local governments can use any one or a combination of the following funding sources to finance construction of school facilities (VADOE, 2008):

- Cash (General Fund);
- General obligation bonds;
- Virginia Public School Authority;
- Literacy fund;
- Syndication of historic tax credits.

The sections below provide descriptions and legal, regulatory, and financial implications and issues for each source of funding.

Cash (General Fund or Reserve Fund)

It is seldom the case, but local governments may build up sufficient cash to pay, at least in part, for capital projects such as school construction. During periods of economic growth accompanied by a strong housing market and low unemployment, local and state governments will have steady tax revenues and may accumulate cash in their General Fund. Alternatively, tax funds may strategically be set aside and placed in reserve for future building needs, in effect spreading construction costs over a period before the construction actually occurs (Brimley & Garfield, 2002).

Cash reserving is believed to be an important factor for achieving financial strength and long-term fiscal sustainability for governments. Craig Clifford (2005) outlines how long-term planning should include an assessment of the lifecycle costs of fixed assets, and policies for fully funding reserves to meet the needs for renovations and capital improvements. Cash reserving effectively implements fiscally conservative policies aimed at minimizing debt service obligations and, while not easy to implement, it can prove to be an effective funding strategy for capital projects. The town of Normal, Illinois, for example, aiming to achieve debt-free status, used a combination of revenue sources and pay-as-you-go financial policies, funding major improvement projects with cash and paying down all its outstanding debt. Normal became debt free while improving services and completing capital projects for its citizens (Cohen, 2000).

As outlined by Brimley and Garfield (2002) in *Financing Education in a Climate of Change*, the cash reserving process and, in general, the use of available cash for capital projects, presents some public policy and public administration issues. One significant objection to using

cash for school construction is the question of who pays and who uses the facilities. Some reason that the users of the school facilities should bear the cost of financing the construction, therefore taxes should be paid by the future users of the schools rather than by the past users. Other important objections include (a) the potential diversion of accumulated reserves due to changes in the administration of the school and the funds, (b) inflation and rising costs of construction may erode the value of the reserves, and (c) taxpayers may move and never use the school and new families may move in and never have paid for the cost of the facilities (Brimley & Garfield, 2002).

Cash reserving and pay-as-you-go policies also present challenges with implementation. Generally, small and average-sized districts have low tax base valuations relative to the high cost of school construction, or statutory provisions limit tax rates, consequently limiting the ability of districts to source sufficient revenues for construction. As Brimley and Garfield (2002) point out, many school districts have found pay-as-you-go policies impractical in recent years due to the high cost of school construction.

General Obligation Bonds

General obligation bonds are bond securities backed by the unlimited taxing power of the government that issues them, and are said to be secured by the full faith and credit of the government that issues them (Fabozzi, 2002). While they are subject to default risk, general obligation bonds are considered to be safe investments. Economic downturns, however, can impact the ability of local governments to raise tax revenues sufficient to support the debt service requirements and ultimately can cause the local government to default (Hyman, 2005).

General obligation bonds are a form of long-term financing particularly suitable for capital projects such as construction of school facilities. By financing the construction of school facilities with long-term debt, the cost is generally spread over a 30-year period in line with the useful life of the buildings, and is borne by those taxpayers who are actually benefitting from the school services. This pay-as-you-use finance concept ensures that citizens are taxed at the time of use as opposed to when the expenditures are actually incurred (Hyman, 2005).

Brimley and Garfield (2002), in *Financing Education in a Climate of Change*, provide a list of the benefits and the disadvantages of using bonds to fund school construction. The benefits listed are as follows: (a) tax levies remain relatively stable since the tax burden is spread over a longer period of time and the yearly burden is relatively small; (b) school districts can easily source large amounts of funds with bonds, while with pay-as-you-go strategies it is more difficult to source funds to meet construction needs; (c) facilities needed to operate a new program can be built when needed, instead of waiting when enough funds are available; (d) the population that gets the greatest use of the facilities would be the one to pay for them; and (e) inflation may actually cause building costs to increase more than the cost of the interest on the bonds. The disadvantages listed by Brimley and Garfield (2002) are: (a) when interest cost is added, the total cost of school construction is greater; (b) since costs are deferred, the school facilities often end up being larger and more elaborate than needed; and (c) payers of property taxes bear the entire cost of the school construction.

In Virginia, issuance of bonds by local governments is permitted by the Constitution of Virginia (VII, § 10). The Virginia Constitution limits the amount of debt city and towns can issue to 10% of the real estate assessed value, and requires counties to hold a citizen referendum to approve debt issuance. A referendum is not required if the debt (issued by the county) is for

the purpose of school construction and is sold to an agency of the Commonwealth, such as the Virginia Public School Authority. Being able to source needed financing without having to conduct a referendum is an operational benefit of utilizing the Virginia Public School Authority for financing school construction.

In Virginia debt issuance is also governed by the Code of Virginia (Public Finance Act §15.2-2600, 1991). The law authorizes local governments in Virginia to “acquire, construct, reconstruct, improve, extend, enlarge, equip, maintain, repair and operate any project which is located within or outside the locality” (Code of Virginia, Public Finance Act § 15.2-2600, 1991), to enter in debt agreements to finance or refinance such projects, and to source funds for servicing the debt via various means of taxation. The law also grants local governments the authority to perform other acts, such as purchase or exercise eminent domain to acquire property; receive federal or state grants for the completion of the project; and hire engineers, attorneys, accountants, and construction experts. For the purpose of this law a project is defined as any public improvement, property or undertaking for which the local government is authorized by law to appropriate money (Code of Virginia, Public Finance Act § 15.2-2600-2663, 1991).

The Public Financing Act of 1991 requires that specific procedures and steps be followed by local governments in the process of issuing bonds. The procedures include, for example, requirements for holding public hearings, incorporating certain provisions in bond ordinances, and holding referenda if required. With regards to bonds for school financing, the law specifically requires that school boards formally request by resolution for the county to take on the bond issuance (Code of Virginia, Public Finance Act, § 15.2-2600-2663, 1991).

General obligation bonds of local governments in Virginia issued for the purpose of school constructions can be (a) sold directly to investors in the municipal bond market, (b)

pooled with other localities and indirectly offered to the municipal bond market through the Virginia Public School Authority.

General obligation bonds issued by a local government and sold directly on the municipal bond market generally require a strong rating by one or more recognized rating agencies (i.e., Fitch, Standard and Poor, and Moody's) or, alternatively, insurance from a strongly-rated bond insurer (i.e., Ambac, MBIA). Rating agencies review quantitative and qualitative information about the local government and its financial condition, and issue independent ratings and opinions regarding the creditworthiness of its bonds. The analysis performed by the rating agencies includes the evaluation of economic drivers and performance, debt and other long-term liabilities, financial resources and obligations, and management policies and practices of the local government. The analysis attempts to identify actual and potential obligations, and measure them against current and forecasted financial resources available to the local government (Fabozzi, 2000; Hallacy, 2005; Porter et al., 2010).

Local governments have a financial interest in securing, managing, and maintaining strong bond ratings. Strongly rated bonds are more marketable and more readily accepted by investors, and generally achieve better pricing when sold to investors. A bond's rating is a measure of risk, specifically credit risk, and bonds with higher ratings are perceived as less risky, and therefore require a lower risk premium in their interest rate. A strong rating therefore allows local governments to obtain cheaper financing (Hallacy, 2005).

In addition to credit risk, investors and issuers of general obligation bonds are also concerned with "tax risk." Most bonds issued by state and local governments, also known as municipal bonds, are tax-exempt, which means their interest payments are exempt from federal, and sometimes state and local taxation. This feature makes them particularly attractive to

individual and corporate investors looking to shelter their income from taxes, such as property and casualty insurance companies (which hold 12% of all outstanding government bonds), mutual funds, and individuals (Gaffney & Berger, 2005; Seymour, 2010). Because of the tax-exempt feature, municipal bonds are normally issued at a lower interest rate relative to the coupon of corporate bonds and, in the case of bonds with AAA ratings, even relative to treasury bonds with the same maturity. As Fabozzi (2000) describes in *The Handbook of Financial Instruments*, the higher the tax rate the more attractive the tax-exempt feature and the smaller the yield differential between a municipal bond and a treasury bond. “Tax risk” refers to (a) the potential for taxes to decrease and reduce the yield favorability of the municipal bonds, and (b) the possibility that legislatures change the tax laws and eliminate the tax-exempt status of municipal bonds altogether (Fabozzi, 2000).

Local governments may adopt financial and debt management policies that, amongst other provisions, place limits on the amount of debt they can issue. These limits regulate the amount of debt burden the local governments can take on, and help manage and preserve favorable credit ratings. The County of Arlington, Virginia, for example, in 2008 adopted the following policies: (a) ratio of tax-supported debt service to general expenditures should not exceed 10%, (b) ratio of net tax-supported debt to market value of real property in the county should not exceed 4%, (c) ratio of tax-supported debt to resident per capita income should not exceed 6%, and (d) growth in debt service shall not exceed average 10-year historical revenue growth. These policies help determine how much debt the County of Arlington can prudently carry to ensure its creditworthiness; hence, its triple-A rating is maintained (County of Arlington, 2008).

Virginia Public School Authority

The Virginia Public School Authority (VPSA) has been in existence since 1962 when it was established by State law (Virginia Code, 1950 § 22-29.3; 1962, c. 194; 1980, c. 559; 1998, cc. 4, 900) as a public body corporate and agency of the commonwealth (Commonwealth of Virginia, Department of Treasury, 2010). The VPSA serves as a state bond bank for local governments in Virginia who may lack the expertise and economies of scale for issuing bonds for school construction.

The VPSA, through its Pooled Bond Program, purchases general obligation bonds issued by local governments and then issues VPSA bonds secured by the cash flows receivable on the local government obligations. Therefore local general obligation bonds issued for the purpose of financing school construction are effectively pooled by the VPSA and resold to investors with additional implicit and explicit guarantees and other credit enhancements under the name of the VPSA. The VPSA bonds are backed by the payments on the general obligation bonds and are further secured by the State Aid Intercept provision. State Aid Intercept would divert to VPSA state-appropriated funds payable to the local issuer in the event the local government defaults on the general obligation funds. Should the State Aid Intercept funds be insufficient to cover the debt service of the general obligation bonds, the Virginia General Assembly is authorized to appropriate sufficient funds from the State Budget to prevent default on the VPSA bonds. Given the collateralized nature of the VPSA bonds and given the fact that the bonds ultimately have, by statute, the backing of the state of Virginia, they carry a favorable rating of AA+, Aa1, and AA+ by Fitch, Moody, and Standard & Poor, respectively (Commonwealth of Virginia, Department of Treasury, n.d.).

State bond banks can achieve better borrowing costs than the individual local governments. This pricing advantage is due to better bond ratings and to lower issuance costs and economies of scale. State bond banks generally have better ratings than local governments due to the pooling of the risk and the additional credit enhancements described earlier, and therefore can borrow at lower costs. Additionally, benefits of economies of scale and lower issuance costs have been found to result in overall lower borrowing costs for state bond banks. Katzman (1980), in his study of state bond banks in Maine and Vermont, found that significant borrowing costs savings are realized when borrowing is done with state bond banks, and that the savings are associated with the pooling of risk and the spreading of the fixed transaction costs. Kidwell and Rogowski (1983), using regression analysis of net interest cost and a number of market and issuance variables, also found that interest costs savings are realized by participating in bond banks (specifically for issuers who sold their bonds by negotiations or who sold their bonds competitively and were rated A or below). In a more recent study, Robbins and Kim (2003) found that borrowing costs are lower for bond banks and that the savings are primarily due to lower costs of issuance.

The VPSA as mandated by the state legislature (Virginia Code 1950, Virginia Public School Authority, § 22.1-162-22.1-175, c. 11), also administers other financing programs such as (a) the Literary Fund Interest Rate Subsidy Program (currently suspended), which subsidizes the debt service of the general obligations bonds of local governments for projects on the Department of Education's first priority waiting list; (b) the School Equipment Financing Notes to provide grant funds for the purchase of computer technology and infrastructure for public schools; (c) the Stand Alone Bond Program, which issues Special Obligation School Financing Bonds that are secured only by the general obligation school bonds of the local government; (d)

the Qualified School Construction Bond Program authorized by the American Recovery and Reinvestment Act (ARRA) which provides federal subsidized financing for certain eligible public school capital purposes.

The role of the VPSA in school construction financing in Virginia is significant as it provides the local governments with easy access to investors, cost efficient execution, and cheaper financing. As of June 30, 2009, the VPSA had outstanding long-term debt of \$3.4 billion, or 11% of the \$34.1 billion of total debt of the Commonwealth of Virginia, and 34% of the \$10.1 billion of education debt outstanding at the local government level.

Virginia's Debt Capacity Model

The state of Virginia maintains the highest credit quality awarded by the three main rating agencies (AAA S&P, Aaa Moody's, AAA Fitch). The high ratings allow Virginia to more readily source funds in the capital markets and to do so at a cheaper interest rate relative to states and other public entities with lower ratings. The three rating agencies use similar evaluation methodologies and criteria, focusing on certain quantitative and qualitative factors, such as debt burden, economic conditions and diversity, fiscal performance and flexibility, and general administration of government (Porter et al, 2010). For Virginia, a critical factor for its high ratings is the proactive management of its debt burden.

In December 1990, the Secretary of Finance of Virginia issued the report, An Assessment of Debt Management in Virginia, which reviewed current debt management practices and made policy recommendations. One of the recommendations from the report was the utilization of a debt capacity model to strategically manage the debt burden. The debt capacity concept evolved into the Report to the Governor and the General Assembly submitted every year by the Debt Capacity Advisory Committee. The report provides a review of the outstanding tax-supported

debt and recommends the amount of debt that can be prudently issued in line with the capital needs, financial goals and financial policies of the Commonwealth of Virginia. The most critical debt management policy is that the maximum amount of debt service supported by tax revenues should remain below 5% of operating revenues (Darr, 1998). To date the debt capacity model has proven to be an effective tool for controlling the size of the debt burden, prioritizing capital projects, and favorably impress the rating agencies.

Debt capacity, as calculated in the debt capacity model over a forward-looking period of 10 years, is a function of the level of tax revenues and the debt service level. Debt service, in turn, is a function of the size of the debt and the interest rate on the debt itself. Understanding how changes to these factors impact the outcome of the debt capacity model is important for long range planning. Revenue sensitivity analysis helps explain how the economic environment and changes in tax revenues can impact the capacity model and hence the level of debt the Commonwealth can prudently hold. As of June 30, 2009, the incremental average debt capacity changes by \$5.3 million for each \$100 million change in revenues in each and every year. Another way to express the sensitivity is for each 1% change in tax revenues in each and every year, the average debt capacity changes by \$11.22 million. Interest rate sensitivity measures the change in debt capacity for each increase or decrease in one percentage point to the base rate. As of June 30, 2009, a one percentage point increase to the base rate would decrease debt capacity by \$332 million, and a 1 percentage point decrease would create debt capacity of \$416 million (Virginia Department of Finance, 2009).

As of June 30, 2009, based on the debt capacity model and the 5% of revenues threshold, debt capacity in Virginia was zero. This means that according to its own policy limitation, it is not financially prudent for Virginia to issue any additional debt in 2010, 2011, 2012 and 2013.

Projected capacity is restored in 2014 with debt allowed of \$425 (Virginia Department of Finance, 2009).

In addition to information about the tax-supported debt, the Debt Capacity Advisory Committee is required to report on moral obligation debt and other debt that carries a limited or contingent liability for the Commonwealth. Moral obligation debt is typically revenue bonds backed by the Commonwealth's pledge that it will pay bondholders in the event of default. In Virginia, moral obligation debt issuers are the Virginia Resources Authority and the Virginia Housing Development Authority. Both of these two authorities are typically not a source for school construction financing. The pledge is not legally binding, but carries with it an implied "moral" obligation, and therefore could potentially become a liability of the Commonwealth.

The Virginia Public School Authority, under the provisions of the Virginia Code, Virginia Public School Authority (§22.1-162-22.1-175), is authorized to issue bonds under a "sum sufficient appropriation" (SSA) provision, which will call on Virginia to appropriate funds sufficient to service the debt of the VPSA in the event of default of bonds in its pool. If any local government fails to make payment on its general obligation bonds and the application of the State Aid Intercept provision does not cure the default, then the VPSA bonds will be payable from sum sufficient appropriations first from available funds in the Literary Fund and then from the General Fund of the Commonwealth. The VPSA bonds are therefore contingent or limited liabilities of the Commonwealth. While the rating agencies' models normally exclude contingent debt liabilities from debt calculations, they are closely examined and monitored to assess their risk exposure.

The Virginia Public School Authority accounts for 11% of the total debt of the Commonwealth. If the VPSA debt of \$3.4 billion was to be included in the Virginia Debt

Capacity Model, and based on an average debt service projected over the 10-year model period of \$325 million (Virginia Department of Treasury, 2009), Virginia’s ability to issue any additional debt for any purpose would be further restricted by \$105 million (E. Whitley, personal communication, December 7, 2010) (see Table 1).

Table 1

Commonwealth of Virginia Debt as of June 30, 2009

	<u>\$ in millions</u>		
	Total debt	VPSA	
Tax supported debt	9,000		
Moral obligation and contingent liability debt	3,976	3,250	
Other debt not supported by taxes	18,452	161	
Totals	31,428	3,411	11%

Source: Constructed from data published by the Debt Capacity Advisory Committee (Commonwealth of Virginia, 2009).

The debt capacity model is a component of the overall Virginia’s Capital Outlay Decision Making Model which is rooted in long-range planning, and part of the strong financial management practices of the Commonwealth of Virginia. As described by Darr (1998), the components are of the Virginia’s capital outlay decision-making model are: (a) the Agency Master Plans, which provide current condition and future needs of physical plants for each agency; (b) the Six-year Capital Outlay Plan which provides a six-year projection of capital needs, their justification, and ranking with regards to priority order; (c) the Debt Capacity Model which provides a measure of debt affordability; and (d) the Agencies Strategic Plans which provide a six-year view of the agencies’ goals, objectives, and strategies for the achievement of

their mission. This comprehensive planning process ensures that capital expenditures are justified by the strategic mission and plan of the agencies, that they are evaluated in the context of a master plan and capital outlay plan, and that their impact on the Commonwealth's debt affordability is assessed (Darr, 1998). These strong financial practices are critical to the financial sustainability of Virginia and its AAA bond ratings.

The Municipal Bond Market – Current Issues

The ability of a municipal government to collect taxes and service its debt is a function of the strength and diversity of its economic tax base, the macroeconomic outlook, and the ability of its government to implement sound financial policies that can sustain it during periods of economic downturn. Governments with lower debt burden have greater financial flexibility and can generally perform better during periods of economic downturn.

Concerns over low tax revenue streams, high debt loads, and stretched out repayment times, have prompted warnings within the investment community of a possible “widespread cascade in defaults” and a contagion of the municipal bond market (Bookstaber, 2010; Gelinas, 2010; Malanga, 2010). During the period 2000 to 2008, when tax revenues were outpacing inflation by 15%, the state and local governments increased their debt from \$1.4 trillion to \$2.2 trillion, and later added another \$15 billion over the past two years (Gelinas, 2010; Malanga, 2010). Currently, however, the financial crisis together with poor contingency planning and widespread spending has pressured municipalities on the brink of foreclosure.

In May of 2008, the city of Vallejo, California, filed for bankruptcy and as recently as September, 2010 the state of Pennsylvania had to step in and provide \$4.4 million of funds and grants to the city of Harrisburg, which recently considered bankruptcy, to prevent it from defaulting on its debt obligations (Jaffe, 2009; Grzeskowiak, 2010; Varghese, 2010). The state

of California, the world's eighth largest economy, had to issue \$400 million in IOUs to its citizens in place of paying out tax refunds in 2009 (Jaffe, 2009). The financial community is showing concerns about governments being over-extended financially, and has placed increased scrutiny on the financial condition and performance of municipal and state finances.

While the Commonwealth of Virginia has been able to maintain its Triple-A ratings even during these difficult economic conditions, it is hard to assess how local governments in Virginia are impacted by the current economic environment and whether they will be able to sustain their debt obligations and their debt rating. In a July 15, 2009 review of "Virginia's Economic and Fiscal Climate," Virginia's Secretary of Finance, Richard Brown, expressed concern that local governments in Virginia are dealing with low-growth rates in revenues, increasing program costs, low real estate taxes in some cases insufficient to cover current budgets, higher costs, and cuts from state funds (Brown, 2009). If Virginia was to be called to step in for the VPSA contingent liability debt because of default by the local governments, it is reasonable to expect that rating agencies and investors would reevaluate their assessment of the VPSA programs and the ratings of the Commonwealth debt.

Literary Fund

The Literary Fund is funded with Commonwealth of Virginia revenues from criminal fines, fees, and forfeitures; unclaimed and escheated property; transfers from unclaimed lottery winnings; and repayments of prior Literary Fund loans. The Literary Fund, which was established in 1810, provides loans, when funds are available, for school facilities construction.

Mullins (2001), in his research of the history of the Virginia Literary Fund and its effectiveness in meeting the funding needs of schools in Virginia, found that during its 200 years

of existence the Literary Fund has been used for different purposes, initially to provide for the education of the poor, then to provide low interest loans to local governments for school facilities, and more recently to be used as a discretionary fund for other needs, such as balancing the State General Fund budget, providing revenues to colleges and libraries, and supplementing the Virginia Retirement System. Mullins found that the success of the Literary Fund as a funding source for free public schools in Virginia has been hampered by the diversion of its funds for other purposes (Mullins, 2001).

Loans made to local governments from the Literary Fund are low interest loans made for the purpose of building, changing, or enlarging school building. Some limitations include maximum size of \$7.5 million for a single project, \$20 million cap for locality, a repayment period of 5 to 20 years, and an interest rate based on the school division's composite index of local ability-to-pay (Dickey, 2007). Literary Fund loans outstanding to local governments for school construction were \$388.6 million as of June 30, 2009 (VAPA, n.d.).

Syndication of Historical Tax Credits

Rehabilitation tax credits are federal and state tax incentives designed to encourage the investment in, and the preservation and rehabilitation of older buildings. Rehabilitation tax credits provide income tax reductions based on a percentage of allowed construction costs, can be carried forward to future years, and can be transferred to other entities or individuals. When interest in the property is sold through syndication, the associated tax credit is conveyed and cash is generated for construction funding.

Both federal and state laws require specific provisions and articulate precise rules for obtaining tax credit eligibility, therefore it requires skilled and careful design, planning, legal, and financing execution.

Federal Historic Tax Credits

At the federal level, the tax credits have been used extensively across the United States and are credited with providing economic stimulus with regards to job growth and wealth production.

According to a study published in 2010 by Rutgers University in cooperation with The Historic Tax Credit Coalition, and The National Trust Community Investment Corporation, during the 30-year period 1978 to 2008, an inflation-adjusted total \$16.6 billion in federal tax credits were granted resulting in an estimated cumulative total of about \$85 billion of completed historic rehabilitation. The total economic impact to the United States include 1,815,208 jobs generating an additional \$197.6 billion in economic output, \$71.7 billion in income, \$97.6 billion in gross domestic product, and \$28.7 billion in taxes (\$21.0 billion federal taxes, \$3.9 billion state taxes, and \$3.8 billion local taxes). The cost-benefit analysis of this study highlights the multiplier effect of the construction efforts, which resulted in federal tax revenues of \$21 billion and a cost of \$16.6 billion in federal tax credits (Rutgers, 2010).

Federal rehabilitation tax credits are covered by Section 47 of Subpart E (Rules for Computing Investment Credit) of Part IV (Credits Against Tax) of the Internal Revenue Code (26 USC Sec. 47). Rehabilitation tax credits are direct dollar-for-dollar reductions of federal tax liabilities, and are used by taxpayers to offset, and therefore reduce, taxes owed to the federal government. The program plays an important role in the revitalization of downtown areas and

the restoration of historic buildings by providing property owners tax credits that help offset the cost of rehabilitation (Wiley & Wilson, n.d.).

Rehabilitation tax credits are tax incentives designed to attract private investments to revitalize older structures and older neighborhoods. Investors are allowed to reduce their income tax liability by subtracting a portion of the rehabilitation costs from taxes owed on their income tax return. Other tax credits that provide for investment incentives by the Internal Revenue Code (under USC Sec. 38) are the energy credit, the qualifying advanced coal project credit, and the qualifying gasification project credit.

The amount of the historical tax credit is a percentage of “qualified rehabilitation expenditures,” 20% for certified historical structures and 10% for structures placed in service prior to 1936 that are not certified historical structures. In order for the tax credit to be allowed, expenditures must meet the definition of qualified rehabilitation expenditures and the building must be a “qualified rehabilitated building.”

Qualified Rehabilitated Building

A building meets the definition of qualified rehabilitated building if (a) it has been substantially rehabilitated (i.e., if the qualified expenditures exceed the adjusted basis of the building, or \$5,000, whichever is greater); (b) if it was placed in service before the beginning of the rehabilitation; (c) for noncertified historical structures, 50% of the external walls are retained as external, 75% of external walls are retained as internal or external, 75% of internal walls are retained as internal; and (d) depreciation is allowable for the building (therefore it must be income producing or used in a business). In the case of certified historic structures, the Secretary of the Interior must certify that the rehabilitation of the historic structure is consistent with the historic character of the property or district where it is located (a certified rehabilitation). A

building is a certified historic structure if it is listed in the National Register or is located in a registered historic district and is certified as being of historic significance to the district.

Qualified Rehabilitation Expenditures

Qualified rehabilitation expenditures are defined as expenses that are (a) incurred for the rehabilitation of a qualified rehabilitated building, and (b) chargeable to a capital account for property that is depreciable. Expenses can be for residential, nonresidential, or real property with a life greater than 12.5 years, including any addition or improvement. Excluded are the cost of acquisition of the property, the cost of enlargement of an existing building, and expenditures for tax-exempt use property.

Users of the Property

A key restriction relevant to this research is listed under Internal Revenue Code Section 47(c)(2)(B)(v), in which the law states that rehabilitation expenses used for tax-exempt use property, such as schools, do not qualify for rehabilitation tax credit. Tax-exempt use property is defined in section 168(h) of the IRS as property leased to a tax-exempt entity (i.e., governmental unit), and includes property leased to tax-exempt entities. A property is treated as a tax-exempt property only if the portion of the property leased to the government unit is more than 35% of the rentable floor space of the building (see Department of Treasury regulation 1.168(j)-1T Q-6). Stated differently, if less than 35% of the rentable floor space is leased to a government entity, the property use qualifies for historical tax credit.

The brief, *Property Leased to a Tax-Exempt Entity*, prepared by M. Primoli (n.d.) of the Internal Revenue Service (IRS), gives an interpretation of the Disqualified Lease Rule. Section 168(h)(1)(B)(ii) of the Internal Revenue Code defines a “disqualified lease” as a lease to a tax exempt entity where:

(1) Part or all of the property was financed directly or indirectly by an obligation in which the interest is tax-exempt under Internal Revenue Code Section 103(a) and such entity (or related entity) participated in the financing, or (2) Under the lease there is a fixed or determinable purchase price or an option to buy, or (3) The lease term is in excess of 20 years, or (4) The lease occurs after a sale or lease of the property and the lessee used the property before the sale or lease. (Internal Revenue Code Section 168[h][1][B][ii])

In summary, a property with rentable space in excess of 35% leased to a government unit is a tax-exempt entity. A lease with a tax-exempt entity becomes a disqualified lease for the purpose of claiming the rehabilitation tax credit when the lease term is in excess of 20 years (unless renewable at market terms), or the lease includes a purchase option, or the lessee had use of the property prior to the lease, or the financing of the property was provided by a tax-exempt entity.

Transferring the Credits

Tax credits are attached to the property and they can be transferred only through transfer of an ownership interest in the property. Credits can be allocated differently amongst multiple owner partners, however the allocation must be consistent with the allocation of the interests in the partnership's profits. The syndication of tax credits offers public schools the opportunity to invite private investors to participate in the renovation of older public schools (Wiley-Wilson, n.d.). The syndication can yield proceeds in a range from \$.50 to \$.90 to the dollar.

Holding Period

Property must be held for a period of 5 years or hence the tax credit is recaptured (Wiley-Wilson, n.d.).

Pending U.S. Legislature

The following information pertains to U.S. Senate and U.S. House of Representatives proposed legislature to eliminate use restrictions that prevent U.S. public schools from fully utilizing federal historical tax credits for the purpose of renovating old school buildings.

S. 2970 Title: To exempt public school rehabilitation from the tax-exempt use exception to the rehabilitation credit. Introduced January 29, 2010 by Sens. Jim Webb and Mark Warner (“Amending,” n.d.)

H.R.4133 Title: To amend the Internal Revenue Code of 1986 to exempt public school rehabilitation from the tax-exempt use exception to the rehabilitation credit. Sponsor: Rep. Cantor, Eric [VA-7] (introduced 11/19/2009 Latest Major Action: 11/19/2009 Referred to House committee. Status: Referred to the House Committee on Ways and Means (“Amending,” n.d.).

Virginia Historic Tax Credits

The Virginia Historic Rehabilitation Tax Credit Program was started in 1997 and since, it has facilitated private investments in Virginia of approximately \$1.5 billion and the rehabilitation of more than 1,200 historical buildings. In 2007, the Center for Public Policy at Virginia Commonwealth University (VCU) conducted an economic analysis of the Virginia Historic Rehabilitation Tax Credit Program. In cooperation with the Virginia Department of Historic Resources, the administrator of the program, the VCU Center for Public Policy analyzed data from projects conducted during the first 10 years of the program and conducted surveys of individuals and businesses that completed rehabilitation projects. Based on results from its survey, the VCU Center for Public Policy determined that 67% of individuals and business reported that the historic tax credits incentives were very important in their decision to rehabilitate the property (Pratt & Kinsey, 2007).

Using IMPLANPro, the VCU Center for Public Policy modeled the impact of the renovation construction expenditures on the Virginia economy, it assessed its relationship and spillover impact to related industry sectors, employment, household income, and tax revenues. Based on the VCU study, and based on the results of the IMPLANPro economic impact model of 67% of the 10-year historical rehabilitation construction expenditures, the 10-year overall impact of the tax credit program to the economy during the period 1997-2006 was estimated at \$1.6 billion, the impact to in-state jobs of 10,769, \$444 billion in labor income, and \$46 million in state tax revenues (Pratt & Kinsey, 2007).

In addition to the direct economic impact of the tax credits, the program can be credited for sustainable development and smart growth strategies, such as urban revitalization and inner-city redevelopment, efficient reuse of existing assets, conservation of resources and reduced pressure on landfills, open space preservation, and reduced automobile dependence due to concentration of business and residential in typically downtown areas (Commonwealth of Virginia Department of Historical Resources [CVDHR], 2008).

Investments and revitalization of areas where the most socially marginalized population resides, such as inner-cities, also creates social benefits through improved housing stock, affordable housing, community preservation, economic activity, and economic integration. Other benefits include improved sense of community, expansion of historic education resources, and preservation of Virginia's identity (CVDHR, n.d.c). The Maggie L. Walker Governor's School in Richmond, Virginia, is featured by the National Trust of Historic Preservation on its website as a successful rehabilitation of a community-based school. The Maggie Walker school building serves as an anchor to the Jackson Ward neighborhood, and the school works with the community and community groups, sharing resources, and being active in the revitalization of

the community. Since the renovation of the school, the Jackson Ward neighborhood and surrounding area have seen an increase in residential construction and a rebirth of the entire area (National Trust for Historic Preservation, n.d.).

Virginia Historic Rehabilitation Tax Credits

In Virginia historical rehabilitation tax credits are established by § 58.1-339.2 of the Code of Virginia. The Code:

1. Entitles individuals, trusts or estates, or corporations incurring eligible expenses in the rehabilitation of a certified historic structure to a credit against their Virginia tax liability in an amount equal to 25% of the allowed expenses;
2. Allows taxpayers to carry forward to future taxable years amounts of tax credit greater than the current year tax liability;
3. Allows partners in a partnership to allocate the amount of tax credit as the partners mutually agree;
4. Charges the Commonwealth of Virginia Department of Historic Resources with the authority to process applications, determine the amount of eligible rehabilitation expenses, and issue certificates to taxpayers;
5. Charges the Director of the Department of Historical Resources with the responsibility to issue the required regulations for the implementation of the law.

This study will examine the regulations to determine specific requirements and how they were applied in the case of two schools that utilized historical tax credits in Virginia in their financing structure.

No studies could be located that address historic tax credits in the context of their cost and benefits from the user perspective, nor in the context of the public administration and public

policy issues involved in securing such funding for school construction. Studies on historic tax credit generally focus on the economic impact of the federal or state program, similar to the above-mentioned studies by Rutgers (2010) (for the federal tax credit program) and by Virginia Commonwealth University (for the Virginia tax credit program). Rehabilitation of older historic schools is not undertaken frequently, and rarely for public schools. For example, the National Trust for Historic Preservation provides a report of 19 case studies of successful rehabilitation of historic school buildings. Of the 19 case study schools, only 3 reported partial funding using historic tax credits, and of the 3, only 1, the Appomattox Regional Governor's School, is a public school ("Historic," 2002). This research, therefore, is important to the literature, as it provides an empirical foundation for the study of rehabilitation tax credits and their utilization to partially fund the renovation of historic school facilities.

This literary review validates the initial premise of this study that called for an in-depth study of financing alternatives such as historic tax credits for school construction. The literature shows that school buildings in America have significant deficiencies and need rehabilitation, and their current condition has a negative impact on the learning potential of children. The literature also shows that financing sources for school construction are scarce, and the current distressed economic environment has highlighted the need for a conservative use of debt at the local level. Given the lack of previous studies of historic tax credits as funding sources for school construction, and given the fact that two schools in the Richmond area successfully utilized historic tax credits to partially fund the rehabilitation of their historical buildings, this study's focus was on expanding the knowledge and understanding of historic tax credits in the context of their funding potential and their associated public policy and public administration implications. The study utilized a case study method which analyzed the funding of rehabilitation construction

with tax credits for two schools (the Maggie L. Walker School for Government and International Studies in Richmond and the Appomattox Regional Governor's School for the Arts and Technology in Petersburg) and compared it to the funding of four other schools (Douglas S. Freeman High School and Highland Springs High School in Henrico County, and the Meadowbrook High School and Thomas Dale High School in Chesterfield County) which utilized a traditional funding method. Public policy and public administration implications were also analyzed.

John Kingdon's Model

Policy solutions to public problems develop and evolve over time, however in order for them to ultimately become public policies, they must advance in the legislative agenda, and be acted upon in the legislative process. The Kingdon's model is a useful framework for analysis in this study, as it provides a method for explaining and understanding how public policy solutions related to historic tax credits may be ready to advance in the policy agenda, and how ultimately they may become public policies.

The Kingdon's model is an adaptation of the "garbage can model of organizational choice" (developed by Cohen, March, and Olsen in 1972) which described organizations as "organized anarchies" where preferences and choices are not clear and participation is fluid. According to the garbage can model problems are addressed and choices are made, but not necessarily in a rational manner.

J. Kingdon's revised garbage can model sees the federal government as an organized anarchy where three separate streams of problems, policies, and politics, run rather independently through the organization. When at least two of the three streams, representing the three major agenda setting processes in the federal government, come together, i.e. they are

coupled, they produce policy action. The model recognizes that the process of policy making is fluid, that the three streams may progress at different times, and that policy entrepreneurs operating within each stream look for windows of opportunities to connect the streams and transform policy proposals into public policies (Kingdon, 2003).

In the Kingdon's model, the problem stream is represented by new or existing problems which must be specifically identified and explicitly articulated in order to even be considered by policymakers and turned into policies (Kingdon, 2003). A number of strategies, such as indicators, focusing events, testimonies, crises, symbols, are used to bring focus and attention to specific problems and pressing needs. When a pressing need is identified, policymakers will look for alternatives in the policy stream to develop a solution, and a window of opportunity will open for policy making.

In a rational model, problems are analyzed and alternative policy solutions are developed. On the contrary, in the policy stream of the Kingdon's model, policy proposals, alternatives, and solutions float around in search of a problem to which to attach, or may look for political events that would result in policy adoption. It is in the coupling of the policy with a problem, when such policy can resolve a pressing problem, or a political event, such as a new administration, or a shift in the national mood, that a window of opportunity will open for policy action (Kingdon, 2003).

The political stream in the Kingdon's model refers narrowly to the electoral, partisan, and pressure group forces which describe the policy making environment in Washington, such as the concern of politicians with voter's reactions, their inclination to align within party lines and vilify the opposing party, and their strive to secure the support of key interest groups. Within this stream swings in the national mood and public opinion, changes in the balance of power of

organized political groups, and election results with turnover in the administration or legislative seats can provide windows of opportunities for focusing on new problems and promote new policies (Kingdon, 2003).

The current economic and political environment could potentially be a powerful force for policy action with regards to issues related to historic tax credits laws. This study identified a significant issue in the federal tax law and utilized the Kingdon's model in chapter four to explain how a window of opportunity might open for policy change.

CHAPTER 3. RESEARCH METHOD

This chapter discusses the research framework and detailed methodology for the study. After restating the business case, public policy foundation of the study, and research problem, the chapter formulates the research questions and research methodology upon which the inquiry was built. The chapter then follows with a review of the theory of knowledge (paradigm) and theoretical perspective of the research inquiry, and a review of the literature supporting the choice of the methodology. Finally, this chapter describes and discusses the data sources, measures, procedures, limitations and significance of the study.

Business Case

Evidence advanced by research suggests that in America the learning potential of students and the teaching potential of teachers is hindered by the deteriorating condition of school facilities. Substantial capital is needed to improve school facilities in Virginia, however in the current distressed economic environment resources are scarce, and debt should be used conservatively. An innovative financing structure that utilizes the syndication of historic tax credits, and reduces the use of debt financing, and which traditionally has been used exclusively by the private sector, has been used to partially fund the extensive renovation of two schools in the Richmond, Virginia area.

At the heart of the problem is the fact that historic tax credits, and tax credits in general, spawn from investments made by taxpayers, not public bodies. Exploring through research how this alternative financing method can and has been utilized to fund public schools, and

understanding its financial, public policy, and public administration implications, could result in an expansion of its utilization, improved school facilities, and substantial savings for struggling local governments in Virginia. Results from this research will be of great interest to public administrators, public policy makers, private investors, and the public at large.

Research Problem

The syndication of historic tax credits as an alternative source of funds for partially financing construction costs for public school facilities is not utilized extensively.

Research Questions

1. What are the financial costs and benefits of using historic tax credits for public schools financing?
2. What are the statutory requirements to qualify for the federal and Virginia Historic Tax Credits?
3. How did the law apply in the Maggie L. Walker School for Government and International Studies in Richmond, VA and the Appomattox Regional Governor's School for the Arts and Technology in Petersburg, VA?
4. What are the administrative implications resulting from the use of Historic Tax Credits financing for school construction in Virginia?
5. What are the public policy issues arising from the use of Historic Tax Credits for school construction in Virginia?

Research Methodology

This study utilized a case study method of research. Two case studies were utilized. The first involved obtaining information and reporting about the rehabilitation construction of the Maggie L. Walker School for Government and International Studies in Richmond, VA and the

Appomattox Regional Governor's School for the Arts and Technology in Petersburg, VA, and specifically the utilization of historical credits for partially funding the construction. Information was obtained by reviewing and analyzing documents, records, public notices, financial information, and interviewing key players involved in the renovation of the schools. The second case study reviewed the financing of the renovations of Douglas S. Freeman High School and Highland Springs High School in Henrico County, VA and the Meadowbrook High School and Thomas Dale High School in Chesterfield County, VA, and which provided a basis for comparison of traditional forms of financing with funding using historic tax credits. The six high schools included in the overall study reside in the same Richmond, VA Metropolitan Statistical Area (MSA), and completed their renovations in the past 11 years.

Virginia schools were selected for this study as representatives of the larger population of schools in the country that could potentially qualify for historical tax credits for renovation construction. All of the six schools met the age requirement for applying for historical tax credits, and their general proximity in the same MSA controlled for some potential regional factors that could have an impact on the study. In the 1996b USGAO report discussed in the literary review chapter of this research study, 20.8% of school facilities in Virginia were found to have at least one inadequate original building. When compared to other states, that percentage ranged from a minimum of 14.5% to a maximum of 49.3%, averaged 26.3%, and had a standard deviation of 7.5. Virginia appears to display characteristics that are typical of the majority of other states in the United States when measured in percentage of schools reporting at least one inadequate original school building. While the age requirement might have been met, whether a building qualifies for the program is determined by the Virginia Department of Historic

Resources and the National Park Service as administrators of the Virginia and federal program, respectively.

Additional comparative information regarding the schools selected for the study is outlined in Table 2.

List and Description of Schools

Case Study 1

1. The Maggie L. Walker School for Government and International Studies. The Maggie L. Walker High School in the downtown community of Jackson Ward in Richmond, VA opened in 1938 as a school for Black students during the segregation period. The building was designed in the art deco ornamental style by Carneal, Johnston, and Wright, and was named in honor of Maggie Lena Walker, a prominent African American business woman. In 1990 it closed and remained vacant for over 10 years; however, in 1998, in recognition of its importance in the history of Black education in America, the school was listed on the National Register.

Renovation of the school began in August 1999, and today the building maintains many of the original architectural elements and details while housing a technologically advanced school facility. The substantial financial investment of \$23 million in the Jackson Ward community was facilitated through business, industry, local, state, and federal funds and efforts.

Today the building houses the Maggie L. Walker School for Government and International Studies, a partnership of school divisions created in 1991 to improve education in government and international studies. School divisions include: Charles City, Chesterfield, Goochland, Hanover, Henrico, King and Queen, New Kent, Petersburg, Powhatan, Prince George, and Richmond.

Table 2

Comparative Data of Virginia Schools in Case Study Analysis

	Case Study 1		Case Study 2			
	(1)	(2)	(3)	(4)	(5)	(6)
	Maggie L. Walker for Government and International Studies	Appomattox Regional Governor's School for the Arts and Technology	Douglas S. Freeman High School	Highland Springs High School	Meadowbrook High School	Thomas Dale High School
Renovation construction start	1999	1996	2007	2006	1998	1999
Renovation construction end	2001	1999	2009	2008	2001	2002
Total cost of renovation	\$24,761,695	\$17,831,645	\$23,759,052	\$23,600,528	\$37,415,741	\$32,075,882
Location	City of Richmond	City of Petersburg	Henrico County	Henrico County	Chesterfield County	Chesterfield County
Pupil population 2009-2010	713	360	1,689	1,794	1,806	2,449

2. Appomattox Regional Governor's School for the Arts and Technology. The Petersburg High School, located at 512 W. Washington Street in downtown Petersburg, VA was renovated, and in 1999 started to house the Appomattox Regional Governor's School for the Arts and Technology. Like the Maggie L. Walker Governor's School, the Appomattox Governor's School serves multiple school divisions: the cities of Colonial Heights, Franklin, Hopewell, Petersburg, and Richmond; and the counties of Amelia, Charles City, Chesterfield, Dinwiddie, Powhatan, Prince George, Southampton, Surry, and Sussex (VDOE, 2011a).

Case Study 2

3. Douglas S. Freeman High School. The school is located in the far western part of the County of Henrico, approximately 10 miles west of Richmond, at 701 Three Chopt Road in Henrico, VA. The school was first opened in 1954 and had pupil enrollment of 1,689 for the 2009-2010 school year. The school underwent extensive restoration completed in 2009 at a total cost of \$20 million.

4. Highland Springs High School. The school is located in the eastern part of the County of Henrico, 15 miles east of Richmond, at 15 S. Oak Ave in Henrico, VA. The school had pupil enrollment of 1,794 for the 2009-2010 school year. The school underwent an extensive restoration completed in 2008 at a total cost of \$24 million.

5. Meadowbrook High School. The school is located in the County of Chesterfield, 10 miles south of Richmond, at 4901 Cogbill Road in Richmond, VA. The school had pupil enrollment of 1,806 for the 2009-2010 school year. The school underwent an extensive restoration completed in 2001 at a total cost of \$35 million.

6. Thomas Dale High School. The school is located in the southern part of the County of Chesterfield, 15 miles south of Richmond, at 3626 W. Hundred Road in Chester, Virginia.

The school had pupil enrollment of 2,449 for the 2009-2010 school year. The school underwent an extensive restoration completed in 2004 at a total cost of \$34 million.

Theory of Knowledge and Theoretical Perspective

Creswell (2003), drawing from Crotty's work (1998) on research design, outlines three critical elements of inquiry for designing a research proposal: (a) the knowledge claims made by the researcher, including the theoretical perspective; (b) strategies for inquiry; and (c) methods of data collection and analysis (Creswell, 2003, Crotty, 1998). Based on these elements of inquiry the researcher selects the appropriate quantitative, qualitative, or mixed method of research.

This study was concerned with the problem of school construction and the scarcity of financial resources to achieve healthy, safe, and modern school facilities in Virginia. The study was also concerned with an alternative source of funding for construction, specifically the syndication of historical tax credits, as a potential although partial solution to the shortage of funds. The starting point of view and theoretical perspective of the study was pragmatic in nature, in that it looked at a practical application and solution to the underlying problem.

Pragmatists are concerned with "what works" (Creswell, 2003) and use any and all methods of research and inquiry to better understand the problem (Rossman & Wilson, 1985) and its solution (Patton & Patton, 1990). This study began with a body of knowledge that the renovation of two schools in the Richmond, VA MSA were in part financed with historical tax credits, and that the renovation of four other schools in the same MSA were financed with traditional financing methods. This study looked to expand the understanding of the utilization of historic tax credits in school construction funding by studying the economic benefits and public policy and public administration implications. Studying the practical application of the historical tax credits laws could lead to a solution to the underlying problem of financing school

construction in Virginia. This study became even more relevant when costs and benefits associated with historic tax credit were compared to the funding of school rehabilitation utilizing traditional forms of financing. For this reason, two separate case studies were used, one that focused on the application of historic tax credits in two school renovations, and a second that focused on traditional financing for the renovation of four schools in the same MSA.

A qualitative method of research provided a suitable approach for this study. Qualitative research promotes understanding (Stake, 1995 & 2006), and is emergent, in that it emerges during the study, when more is learned about the problem. Qualitative research is not strictly prefigured, but rather unfolds during the study, when new questions and sources of information will be known and methods of inquiry can be refined (Creswell, 2003). The utilization of historical tax credits for funding construction is not new, but what is new and needed further research and understanding was the utilization of this funding strategy by schools, which traditionally occupy buildings owned by governmental entities.

A case, such as the use of historical tax credits by two Richmond areas schools, is something that is not sufficiently understood but is special enough to be studied (Stakes, 1995 & 2006). A case study is the in-depth study of the program, event, activity, process, or individual that represents the case (Creswell, 2003). A case study of the partial funding of the renovation of the two schools with historical tax credits would provide critical understanding to how the tax law can be and was applied and its various public policy implications. Additionally, the study provided useful information regarding the costs and benefits of using this funding vehicle. A second case study that focused on the financial costs and benefits of school renovation using a traditional form of financing provided the basis for comparison between the two methods of funding.

Research Question 1

What are the financial costs and benefits of using historic tax credits for public schools financing?

This research studied only the financial benefits. Other intangible and social benefits associated with rehabilitation of historical buildings were not addressed in this study but are discussed in the literature and findings section. This research study was emerging and built upon itself. In the course of the research it became clear that the cost of compliance with the federal and state laws can erode the financial benefits of the tax credits. The cost of compliance includes construction premium paid for meeting the Secretary of Interior Standards of Rehabilitation, and other soft costs for engaging consultants and other professionals to resolve the complex issues of the financing transaction. Other costs are associated with the syndication of the tax credits and are due to market, project risk, and other factors that drive the size of the tax credit discount.

Benefits were evaluated in the context of how the financing of the entire project was obtained and the amount of proceeds from the tax credits syndication. Local governments should experience an increase in tax revenues as the result of an increase of the real estate tax base (increased property values for properties near the schools). Increased tax assessed values for properties in the direct vicinity to the schools would be a good indicator of the impact of the renovation on real estate values. The geographic area considered for this part of the study was defined by the Assessor's offices of the local governments.

Other benefits considered by this study include the economic impact resulting from construction activities for the renovation of the schools. The Virginia Center for Urban Development at Virginia Commonwealth University used the "IMPLAN Pro" economic impact

modeling system to provide this study with estimates of the economic impact based on construction expenditures for the renovation project of the 6 schools in the case study.

Finally, this study evaluated financial benefits due to the reduced use (and cost) of traditional funding because historic tax credits financing was used. When funds are brought into the project from other sources (i.e. historic tax credits), the need to borrow by issuing debt is reduced. To evaluate this benefit, the study turned to the financing of the four schools in the second case study and reviewed how they were financed, the cost of the financing, and the impact of the borrowing on the financial metrics of the local governments or of Virginia as applicable.

Research Question 2

What are the statutory requirements to qualify for the federal and Virginia Historical Tax Credits?

The law discusses requirements and applicability of the tax credit for certain critical elements that broadly categorize rules and restrictions of the law. This research question requires an in-depth analysis of the federal and state laws and regulations and the development of an understanding of the specific legal requirements with regards to each critical element. The recording of the legal requirements will help put structure around the research process, and will facilitate the review of the application of the laws and regulations in the two schools in the first case study which utilized historical tax credits (i.e. how the Maggie L. Walker School for Government and International Studies and the Appomattox Regional Governor's School for the Arts and Technology qualified for the tax credits).

The critical elements are outlined below:

- Substantial rehabilitation;

- Qualified expenditures;
- Building uses;
- Building users;
- Claiming the credit;
- Transferring or allocating the credits; and
- How long the tax credit user must own the property.

Research Question 3

How did the law apply in the Maggie Walker and Appomattox Regional Governor's schools?

This research question entails reviewing and recording how the legal requirements for the federal and Virginia historical tax credits were applied in the two schools. Multiple evidentiary data sources were used, and, when obtainable, each requirement and its application were confirmed using the most reliable data source. Data sources are ranked below (1 highest, 4 lowest) based on their level of reliability.

1. Public governmental records.
2. Records of public hearings.
3. Private records.
4. Interviews.
5. Other published material (newspaper, magazine, internet articles, advertising).

Research Question 4

What are the administrative implications resulting from the use of Historic Tax Credits financing for school construction in Virginia?

The identification and recording of administrative implications was performed using information gathered through interviews with administrators and subject matter experts, published material, public records, and using the researcher's individual assessment. The list of potential implications was generated by reviewing the implementation data sourced by answering Research Question 3 and asking "what are the operational implications of . . .?" for each step of implementation. This maintained a structured and linked approach throughout the entire research study. Appendix A provides details about the expected number/source of interviews and the questions proposed to address Research Question 4.

Research Question 5

What are the public policy issues arising from the use of Historic Tax Credits for school construction in Virginia?

Public policy issues, the parties impacted, and the related arguments of contention were identified using a comprehensive analytical assessment that used various methods of inquiry: interviews with key stakeholders, review of court decisions, review of news articles from newspapers and other publications, review of bills introduced in the U.S. Congress, and using the researcher's individual assessment.

In order to maintain a structured and linked approach to the case study method, the list of public policy issues was generated from asking the basic research question: "What are the public policy issues of . . .?" for each of the requirements of the law as learned in answering Research

Question 2. Appendix B provides details about the expected sources for interviews and the questions proposed to address Research Question 5.

Conclusions and Recommendations

Drawing from the research and overall analysis of the two case studies, the final phase of the study will focus on answering the initial and emerging research questions with a summary narrative that will consolidate the learning achieved. The narrative also identifies needs and opportunities for further studies and policy action.

Limitations of Study

Qualitative research is interpretative, and involves complex reasoning that is multifaceted, iterative, and simultaneous (Creswell, 2003). While the data gathering and analysis followed a structured process to ensure completeness and objectivity of data, this study also involved interpreting legal, structural, operational, and financial information and analyzing it in light of the researcher's professional and academic background. For this reason, the study and interpretation of the data may lack some objectivity. The researcher, as outlined above, followed a research process structure designed to minimize this risk.

This study was based on a small number of observations: the six schools in the two case studies. Therefore the results of the study may not have a strong basis for generalizability. As historic tax financing for construction of schools is evolving, its specific application in Virginia will depend on the legal and political environment of the school division, and the desire of the community to support its public policy and administrative implications.

Significance of Study

This study expands and deepens the knowledge of historic tax credits as source of funding for school renovations, and provides a comparison of the cost and benefits to traditional forms of financing. This study also developed an understanding of the barriers (financial, administrative, political) of using historical tax credits for funding capital investments in public schools. This study and its comprehensive analytical framework will become a valuable tool to policymakers, public administrators, the investor community, and the public at large as they evaluate financing alternatives for school construction.

Summary of Data Sources

Table 3 summarizes data sources for findings and analysis.

Table 3

Data Sources for Findings and Analysis.

Research Question	Content Source	Interview Source
1. What are the financial costs and benefits of using historic tax credits for public schools financing?	Email correspondence Legal documents of private partnerships Financial Statements of local governments Documents archived with State Agency Databases of real estate assessments Reports from modeling of economic impact Industry publication	Agency administrator Representative for renovation project of case study school School administrators
2. What are the statutory requirements to qualify for the federal and Virginia historic tax credits?	Federal law and regulations State law and regulations White papers Federal and state agency instructional and educational material	Member of federal agency staff Member of state agency staff
3. How did the law apply in the Maggie L. Walker and the Appomattox Regional Governor's Schools?	Documents archived with State Agency Newspaper and internet articles	Attorney
4. What are the administrative implications resulting from the use of historic tax credits financing for school construction in Virginia?	Email correspondence Documents archived with State Agency Federal and state agency instructional and educational material Newspaper and internet articles	Member of state agency staff Representative for renovation project of case study school School administrators
5. What are the public policy issues arising from the use of historic tax credits for school construction in Virginia?	Proposed U.S. legislation Newspaper and internet articles Economic impact studies Documents from original and appellate case and related attached briefs Legal publications Newspaper and internet articles	State agency administrator Attorney

CHAPTER 4. FINDINGS AND ANALYSIS

Introduction

Chapter 4 provides the results of the study. The study follows an emergent case study methodology, which reports observations and findings from a number of sources including conversations with administrators and reviews of public and private records. It addresses each of the five research questions outlined in chapter 3 in sequence, starting with question 1 which reports costs and benefits of the historic tax credit and traditional financing for school renovations. Questions 2 and 3 build on each other; in question 2 the specific requirements of the federal and Virginia laws are classified, numbered and depicted in tables and flowcharts. In question 3, the tables, numbering, and flowcharts are used to track how the legal requirements applied in the Maggie Walker and Appomattox Regional governor's schools rehabilitation financing. Research Question 4 discusses the administrative issues identified in the study, and finally research question 5 analyzes relevant public policy issues.

Research Question 1

What are the financial costs and benefits of using Historic Tax Credits for public schools financing?

1. Financial costs associated with construction premium of historic renovations when the Secretary of Interior's Standard of Rehabilitation are followed as required by the historic tax credits laws. Construction costs are believed to be higher for historic renovation, however the estimate of the premium is not easily obtainable from builders, but as a guideline,

costs are about the same if the exterior is in good shape (personal communication with Leith-Teittrault, J, October, 2011). Another source suggests that a major rehabilitation project will cost between 12% less and 9% more than new construction (Preservation Nation, n.d).

2. Financial costs associated with larger soft costs required by the engagement of consultants and other professionals due to the complexity of the historic tax credits

financing. The cost of the rehabilitation of the two schools which used historic tax credits was greatly impacted by the soft cost of complying with the tax credit regulations (standards of rehabilitation, and the development of the partnership structure established to qualify for the tax credits). This study found that only 61.5% of the renovation costs of the Appomattox Governor’s School and 54.9% of the renovation costs of the Maggie Walker Governor’s School were spent for hard construction costs. Legal costs accounted for .5% of total project costs.

3. Financial costs associated with syndication discount and other syndication costs.

Below are the details related to the qualified costs and basis for the calculation of the federal and state tax credits, the amount of tax credits granted and the net proceeds received from the syndication after subtracting the discount and syndication costs.

Appomattox Regional Governor’s School

Allowable Costs (Basis for Tax Credits)		17,268,854.00
Amount of Tax Credits Federal	20.0%	3,453,770.80
Discount and Cost of Syndication	22.0%	(761,454.80)
Net Federal Tax Credits	78.0%	<u><u>2,692,316.00</u></u>

Amount of Tax Credit State	25.0%	4,317,213.50
Discount of State Tax Credits	31.1%	(1,344,242.50)
Net State Tax Credits	68.9%	<u><u>2,972,971.00</u></u>

4. Financial benefits due to the proceeds of the syndication and other contributions.

Rehabilitation of the two historic schools rallied financial support from area philanthropists and local fundraising. Contributions financed a substantial portion of the renovation costs: 55% for the Appomattox Regional Governor's School, and 33% for the Maggie L. Walker Governor's School.

Appomattox Regional Governor's School

Net proceeds from Federal tax credits	2,692,316.00
Net proceeds from state tax credits	2,972,971.00
Pledges of private contributions	9,412,379.79
Bank Loan	2,191,187.21
	<u>17,268,854.00</u>

Maggie Walker Governor's School

The Maggie Walker Governor's School was financed as follows: one third with proceeds from the syndication of state and federal tax credits, one third with private contributions, and one third with commitments from the localities utilizing the governor's school.

Net proceeds from Federal and state tax credits	8,253,898.33
Pledges of private contributions	8,253,898.33
Commitments from localities	8,253,898.33
	<u>24,761,695.00</u>

5. Financial benefits from increased real estate assessments. A potential benefit associated with the renovation of the schools is an increase in tax revenues resulting from higher real estate assessed values in the neighborhoods impacted by the school renovations. Higher real estate assessed values, when compared to the total percent change in the city or county, could be due to a perceived economic value in the renovations of the school facilities, or could be due to factors unrelated to the school renovations. This study does not aim to prove, disprove, or infer a

causal relationship between school renovations and property values, but only intends to report observations specific to the six schools in the two case studies.

The tax assessor's office for the cities of Richmond and Petersburg, and the two counties of Henrico and Chesterfield provided the information reported below. The areas of potential impact of the school renovations were defined by the tax assessor's offices of the two counties as real estate within the Freeman and the Highland Springs High School district areas. The City of Richmond defined the area of potential impact of the Maggie L. Walker Governor's School renovation as the Carver neighborhood west of Hermitage Road, cautioning that some of the value improvement could be generally related to the VCU expansion in the Richmond downtown area. The city of Petersburg defined the area of potential impact of the Appomattox Regional Governor's School as area 23-17 in the city of Petersburg mapping records, between West Washington Street and West Wythe Street.

The data in tables 4 and 5 represent the sum of residential and commercial real estate assessed values for the neighborhood area of impact of each school and for each year reported. The years reported cover periods of time prior to, during, and following the years of completion of the school renovations for the purpose of observing noticeable changes in real estate values. Renovations for the Highland Springs High Schools were completed in 2008, Freeman High School in 2010, Meadowbrook High School in 2002, Thomas Dale High School in 2001, Maggie L. Walker Governor's School in 2001, and the Appomattox Regional Governor's School in 2000.

The percentage change in real estate assessments when compared to the percent change for the entire local government may be an important observation and can be of significance in understanding the full impact of the school renovations in the two case studies. However the real

estate assessment offices contacted in the study cautioned that factors outside of the school renovations could impact changes in real estate values.

Table 4 reports both the values and yearly percentage changes in assessed values for the County of Henrico, the school district areas for Freeman High School and Highland Springs High School. The decline in values reflected in the table for the years 2009, 2010 and 2011 are in line with an expected decline due to the housing crisis. It is interesting to observe that the Highland Springs high school district area fared better than the county overall with regards to changes in real estate values during and after completion of the renovation (the 2-year renovation was completed in 2008). Similarly, the Freeman school district area fared better than the county overall, experiencing a lower decline of real estate values during the real estate crisis (the 2-year renovation was completed in 2010).

Table 5 reports both the values and yearly percentage changes in assessed values for the County of Chesterfield and the school district areas for Thomas Dale High School and Meadowbrook High School. It is interesting to observe that the areas in the Thomas Dale and Meadowbrook high schools typically experience a lower rate of real estate value appreciation when compared to the County of Chesterfield overall. With regards to changes in real estate values for the Thomas Dale High School, a noticeable increase in the rate of appreciation is observed in 2001, the year of completion of the 2-year renovation. Similarly, the Meadowbrook school district area experienced a rate of increase in real estate values greater than the one by the Thomas Dale high school district area (which typically has higher yearly rate of increase than Meadowbrook) in 2002, the year of completion of the 2-year renovation.

Table 4

Values and Percentage Changes in Assessed Residential and Commercial Real Estate - Henrico County, Virginia

<u>Total assessments (\$ millions)</u>			
	Henrico County	Highland Springs	Freeman
2005	25,171	1,730	4,865
2006	29,083	1,989	5,431
2007	35,520	2,294	5,968
2008	34,477	2,521	6,281
2009	34,733	2,691	6,259
2010	32,017	2,541	5,875
2011	31,702	2,533	5,808
<u>Total assessments (% change)</u>			
2006	15.54	14.99	11.62
2007	11.82	15.33	9.89
2008	6.02	9.89	5.25
2009	0.74	6.77	-0.34
2010	-7.82	-5.58	-6.14
2011	-0.98	-0.32	1.14

Source: County of Henrico, VA Tax Assessor's Office (Excel, September, 2011).

Table 5

*Values and Percentage Changes in Assessed
Residential and Commercial Real Estate - Chesterfield
County, Virginia*

<u>Total assessments (\$ millions)</u>			
	Chesterfield County	Thomas Dale	Meadowbrook
1998	13,290	1,282	984
1999	14,090	1,341	1,014
2000	15,026	1,401	1,044
2001	16,096	1,478	1,094
2002	17,435	1,542	1,143
2003	18,798	1,619	1,194
<u>Total assessments (% change)</u>			
1999	6.01	4.6	3.05
2000	6.65	4.47	2.97
2001	7.12	5.44	4.83
2002	8.32	4.37	4.48
2003	7.82	5.01	4.43

Source: County of Chesterfield, VA Tax Assessor's Office, Excel, September, 2001.

Data reported by the City of Richmond reflected incomplete data for the years 1998-2001 when the city did not do full reassessments and when the rehabilitation of the Maggie Walker Governor's School occurred. No data will be shown for the Carver neighborhood in the City of Richmond.

With regards to the impact on real estate values and the tax assessments, this study concludes that a potential relationship exists between school renovations and real estate property values, however based on the data and analysis available, the strength of that relationship is uncertain and hard to quantify, particularly in light of other micro and macro economic factor that may have impacted real estate values in the areas.

6. Financial benefits from the economic impact of engaging in renovation construction activity. The Virginia Center for Urban Development at Virginia Commonwealth University provided estimates of the economic impact of the renovation of the six schools in Virginia. These estimates were prepared using the "IMPLAN Pro" economic impact modeling system, a software used by economists to examine the economic impact of particular industries, project spending, or policy decisions (B. Kinsley, personal communication, October 28, 2011) (see Table 6).

This important analysis provides information regarding the impact to Virginia from the renovation of each school in 2011 inflation-adjusted dollars. For each school, the analysis provides the economic impact, the jobs impact, and the wages and benefits impact. The economic impact study shows substantial economic benefits resulting from the activity spurred by the renovation of the six schools.

Table 6

*Economic Impact of Renovation Construction at Selected Locations in Virginia**

School	School name	Start date	End date	Total cost of renovation (\$)	Total cost of renovation (in 2011 \$)	Impact to Virginia from renovation spending		
						Economic impact (2011 \$)	Employment/ jobs impact	Wages/benefits impact (2011 \$)
1	Maggie Walker	1999	2001	24,761,695	31,459,000	53,214,000	450	23,554,000
2	Appomattox Regional	1996	2000	17,831,645	23,299,000	39,412,000	333	17,445,000
3	Douglas Freeman	2007	2009	23,759,052	24,918,000	42,149,000	356	18,657,000
4	Highland Springs	2006	2008	23,600,528	24,664,000	41,719,000	352	18,466,000
5	Meadowbrook	1998	2001	37,415,741	47,536,000	80,408,000	680	35,591,000
6	Thomas Dale	1999	2002	32,075,882	40,117,000	67,860,000	574	30,037,000
Totals				159,444,543	191,993,000	324,762,000	2,745	143,750,000

*Source: Virginia Center for Urban Development @VCU and IMPLAN Pro (version 3, 2008 data). Renovation expenditures applied to IMPLAN Sector 39: Maintenance and Repair Construction of Nonresidential Structures.

7. Financial benefits from reduced or eliminated costs of traditional financing. The study of the costs and benefits of historic tax credits for school construction in Virginia is enhanced when compared with traditional financing for school renovations. The renovation of the four schools in the second case study used traditional forms of financing, and in the sections that follow the impact of the financing on the local governments and their financial policies is analyzed.

The second case study includes the renovation of four schools, two located in the County of Henrico, and two located in the County of Chesterfield, therefore a review of their financial condition and financial policies will be needed. The primary source of study of the current financial condition, the debt load, and the established financial policies of the counties are the respective 2010 Comprehensive Annual Financial Reports (Henrico, 2010; Chesterfield, 2010). The sections below provide the relevant information for the study for the counties of Henrico and Chesterfield.

Financial and Statistical Information Regarding the County of Henrico, Virginia

As of June 30, 2010, “Total Long-Term Debt” is \$730,725,871, \$420,720,000 of which represents the par amount of general obligation bonds outstanding (Henrico 2010 CAFR, Note 7 Long-term Obligations). The general obligation bonds had maturity dates ranging from 2016 to 2028, and interest rates ranging from 2.00% to 6.25%. For the 5-year period 2011-2015 the annual debt service requirements for the general obligation bonds ranged from \$41,047,112 in 2015 to \$47,981,155 in 2011 with an average of \$44,252,888 (Henrico 2010 CAFR, Note 7 Long-term Obligations). Total debt service for the 2010 fiscal year totaled \$55,280,550 (\$35,155,291 for principal and \$21,125,259 for interest).

Financial Policies and Guidelines of the County of Henrico, Virginia

The county has established certain financial guidelines to direct the financial management of the county and to ensure financial stability now and into the future. Specifically, the debt guidelines require the county to perform on a yearly basis a long-term affordability analysis to ensure it does not exceed its ability to service its debt (Henrico CAFR, MD&A Section). The debt guidelines include the following thresholds:

- Debt service as a percentage of general fund expenditures: 7.75%;
- Debt service as a percentage of assessed value: 1.49%;
- General obligation bonded debt per capita: \$1.650.

Additionally, the County is required to adopt water and sewer rates sufficient to generate revenues to ensure the availability of funds to pay for debt service of enterprise fund bonds, and provide for capital replacement (Henrico CAFR, MD&A Section).

Compliance with Financial Policies and Guidelines of the County of Henrico, Virginia

For the year ended June 30, 2010, the percentage of debt service to general fund expenditures (noncapital expenditures) is 7.08%, remaining below the 7.75% threshold and in compliance with the county's financial debt guidelines (Henrico 2010 CAFR, Long-term Debt MD&A pg. 25, statistical section page table IV). The calculation uses data from the County of Henrico Statement of Revenues, Expenditures and Changes in Fund Balances for the year ended June 30, 2010, specifically amounts under the heading of Debt Service (Retirement of principal, Interest, Other) for Total Governmental Funds. The sum of these amounts (\$55,280,550) is divided by the amount under the heading of Total Expenditures for Total Governmental Funds (\$780,768,369). The calculated percentage for the year ending June 30, 2010 is 7.08%, below the debt guideline threshold of 7.75%.

The statistical section of Henrico County's Comprehensive Annual Financial Report provides additional information regarding the county's debt capacity. This information provides a perspective of the affordability of the county's current levels of outstanding debt and the ability to issue additional debt in the future. Table IX of the Statistical Section of the June 30, 2010 CAFR provides ratios of outstanding debt by type. Based on total general obligation bonds outstanding of \$420,720,000 (par value) and an estimated county population of 313,989 (from Table XI of the statistical section), the per capita debt is \$1,340; and based on a total assessed value of taxable property of \$36,065,011,000, the ratio of debt service to assessed value is 0.15%. These two ratios fall below the debt guidelines threshold of \$1,650 and 1.49%, respectively.

Description of the Financing of the Freeman and Highland Springs Renovations

The cost of the renovation project of the Freeman High School was \$23,759,052, and was financed through issuance of general obligation bonds of the County of Henrico. The \$23,800,000 bond issuance was authorized in the 2000 voter referendum and was executed in 2005 as part of a larger bond offering of \$77,815,000. The bonds have an average coupon rate of 4.5% requiring total coupon payments of \$1.1 million a year. The cost of renovation of the Highland Springs High School was \$23,600,528 and was financed through issuance of general obligation bonds of the County of Henrico. The \$23,600,000 bond issuance was authorized in the 2000 voter referendum and was executed in 2006 as part of a larger bond offering of \$71,915,000. The bonds have an average coupon rate of 4.325% requiring coupon payments of \$1 million a year.

When analyzed in the context of the County of Henrico debt load and financial guidelines, the bond financing for the renovation of the Freeman High School represents 5.7% of

the total general obligation bonds of the County of Henrico and 1.9% of its total debt service for 2010. The bond financing for the renovation of the Highland Springs High School represents 5.6% of the total general obligation bonds of the County of Henrico and 1.8% of its total debt service for 2010. When the financing of the renovation of the two Henrico schools are combined, their bond financing represents 11.3% of the total general obligation bonds of the County of Henrico and 3.8% of its total debt service for 2010. With regards to the county's financial guidelines, the general obligations bonds in total contribute to .3% of the debt service to general fund expenditures ratio, .01% of the debt service to assessed values ratio, and \$151 to general obligation bonded debt per capita. The information related to the financing of the renovation of the two schools in the County of Henrico is summarized in the table in Appendix G.

Financial and Statistical Information Regarding the County of Chesterfield, Virginia

As of June 30, 2010, total outstanding debt is \$643,545,727, \$454,770,000 of which represents the par amount of general obligation bonds outstanding (Chesterfield 2010 CAFR, Table X). The General obligation bonds' maturity dates range from 2011 to 2030, and interest rates range from 2.75% to 6.30%. For the 5-year period 2011-2015, the annual debt service requirements for the general obligation bonds ranged from \$46,569,188 in 2015 to \$58,976,886 in 2011 with an average of \$52,460,728 (Chesterfield 2010 CAFR, Note 9 Long-term Obligations).

Financial Policies and Guidelines of the County of Chesterfield, Virginia

The county is required to obtain approval of a voting majority of its qualified voters prior to issuing general obligation bonded debt and Virginia Public School Authority (VPSA) bonds. The Chesterfield County Board of Supervisors established a debt policy that requires the county

to maintain at 10.0% and below the amount of debt service costs as a percentage of general government expenditures. Additionally, the County of Chesterfield limits debt to 3.5% of assessed value and practices a target ratio of 3%.

Compliance with Financial Policies and Guidelines of the County of Chesterfield, Virginia

For the year ended June 30, 2010 the percentage of debt service to general government expenditures is 9.1%, remaining below the 10.0% threshold and in compliance with the county's financial debt policy (Chesterfield 2010 CAFR, Long-term debt MD&A pg. 25). The calculation uses data from the County of Chesterfield Statement of Revenues, Expenditures and Changes in Fund Balances for the year ended June 30, 2010, specifically amounts under the heading of Debt Service (Retirement of principal, Interest, Other) for Total Governmental Funds. The sum of these amounts (\$68,002,861) is divided by the amount under the heading of Total Expenditures for Total Governmental Funds (\$743,892,952).

The ratio of debt to assessed value as of June 30, 2010 is 1.77%, below the target ratio of 3.5% and below the target of 3%. The ratio is calculated by dividing total debt of \$643,545,727 by the total assessment value of \$36,382,042,086.

The statistical section of Chesterfield County's Comprehensive Annual Financial Report provides additional information regarding the county's debt capacity. This information provides a perspective of the affordability of the county's current levels of outstanding debt and the ability to issue additional debt in the future. Table XI of the statistical section of the June 30, 2010 CAFR provides ratios of general obligation bonded debt outstanding. Based on total general obligation bonds outstanding of \$454,770,000 (par value) and an estimated county population of 316,000, the per capita debt is \$1,439, and based on a total assessed value of taxable property of \$36,382,042,086, the ratio of general obligation bonds to assessed value is 1.25%.

Description of the Financing of the Thomas Dale and Meadowbrook Renovations

The renovation of Thomas Dale High School required the issuance of \$28,162,284 in general obligation bonds by the County of Chesterfield, or 6.2% of the total current balance of the county's general obligation bonds. The county also used internal funds available or reserved. As the debt was issued over time and as part of multiple larger issues, an estimated coupon of 5% was used for the purpose of this analysis. The cost of the debt issued was \$1.4 million per year, or 2.1% of the total debt service of the county. As a result of the debt issued and its debt service cost, the financial guidelines of the county were impacted as follows:

- Debt service as a percentage of general fund expenditures (10% limit): 0.2%
- Debt as a percentage of assessed value (3.5% limit): 0.004%

The renovation of Meadowbrook High School required the issuance of \$28,869,395 in general obligation bonds by the County of Chesterfield, or 6.4% of the total current balance of the county's general obligation bonds. The County also used internal funds available. As the debt was issued over time and as part of multiple larger issues, an estimated coupon of 5% was used for the purpose of this analysis. The cost of the debt issued was \$1.4 million per year, or 2.1% of the total debt service of the county. As a result of the debt issued and its debt service cost, the financial guidelines of the county were impacted as follows:

- Debt service as a percentage of general fund expenditures (10% limit): 0.2%
- Debt as a percentage of assessed value (3.5% limit): 0.004%

Additional financial metrics of the impact of the debt issued in connection with the funding of the renovations of the Thomas Dale and Meadowbrook high schools can be found in Appendix H.

In conclusion, the financing for the four schools which used traditional financing for the renovation resulted in local government's general obligation bonds being issued, with related impact on the financial policies and long term debt position of the two counties. There was no impact to the VPSA, or the debt capacity model of the Commonwealth of Virginia.

Research Question 2

What are the statutory requirements to qualify for the Federal and Virginia Historic Tax Credits?

Tables and figures (flowcharts) have been prepared to address Research Question 2 to unfold the analytical process of by this study. Requirements of the laws were categorized and numbered in separate tables for the 20%, the 10% federal tax credit law, and the Virginia tax credit law. This research will later refer to the tables, figures, and numbering developed here when it will analyze how the law applied in the renovation of the two Governor's schools in Research Question 3.

One of the goals of this study is to provide an analytical tool for administrators that would facilitate understanding and simplify analysis of historic tax credit rules, and tables and flowcharts were developed for this purpose. Tables and flowcharts were reviewed and their accuracy validated by a representative of the Virginia Department of Historic Resources and a representative of the National Park Services.

Twenty Percent Federal Historic Tax Credit

The U.S. Code (Title 16, Subtitle A, Chapter 1, Subchapter A, Part IV, Subpart E, § 47) and Treasury Regulation Section 1.48-12 identify property and taxpayer conditions that must be met in order to qualify for the historic tax credit. The property and taxpayer conditions have various preconditions that make the law difficult to understand. In an effort to help understand

the intricacies of the law, this study summarizes and outlines the information in matrices and flowcharts, providing a visual and content summary of the federal law.

The language of the law states that “rehabilitation credit. . .is the sum of 10 percent of the qualified rehabilitation expenditures with respect to any qualified rehabilitated building. . .and 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure.” The major difference between the 10% and 20% rehabilitation credits is whether the building has certain historic characteristics. The 20% rehabilitation credit is for a building that is a certified historic structure and whose renovation meets the Secretary of the Interior Standards of Rehabilitation, and once the rehabilitation is completed, is deemed to be a certified rehabilitation. The requirements for the 10% rehabilitation credit are lower: the building and its renovation do not have to meet strict certification requirements, but must meet some age and design guidelines with regards to the retention of interior and exterior walls. Table 7 (for the 20% rehabilitation credit) and Table 8 (for the 10% rehabilitation credit) present the conditions and preconditions of the law in matrix form. Additionally, the sections below expand on the definitional requirements and preconditions of:

- certified historic structure,
- certified rehabilitation,
- qualified rehabilitation expenditures, and
- qualified rehabilitated building.

Definitions and exclusions are also analyzed and outlined for:

- tax-exempt entities, and
- tax-exempt use property.

Certified historic structure. Items 1.1 to 1.3 in Table 7 are the conditions and preconditions that must be met in order for the property to meet the requirement of certified historic structure. These include a requirement for the building to be listed in the National Register, or located in a registered historic district, and for the building to have historic significance to the district. The same information is presented in flowchart format in Appendix E. This flowchart can be used as a decision tree to evaluate whether a building can be determined a certified historic structure.

When the building qualifies as a certified historic structure, the rehabilitation may, if other conditions are met, qualify for a federal historic tax credit of 20% of the qualified rehabilitation expenditures. The 10% historic tax credit applies instead to qualified rehabilitated building, which does not require historic certification but has an age requirement of having been built prior to 1936.

Certified rehabilitation. Items 2.1 to 2.4 in Table 7 represent the preconditions that must be met in order for a property to be a certified rehabilitation (certification is granted by the National Park Service upon recommendation of the Virginia Department of Historic Resources). These preconditions include requirements that the rehabilitation be “substantial”, that the property be returned to use, that the material and design of the rehabilitation meet certain standards, and for the property to be subject to depreciation (it must be income producing and owned by a taxpayer). This last requirement is a stumbling block for schools in that traditionally schools are not income producing and are not owned by a taxpayer. Public schools are usually owned by local governments and their school boards, which are tax-exempt entities.

Qualified rehabilitation expenditures. Items 3.1 to 3.4 in Table 7 are the conditions and preconditions that must be met in order for the amounts spent for the rehabilitation to be

Table 7

Conditions Required for 20% Rehabilitation Tax Credit

1.0 Certified historic structure	<p>1.1 Listed in the National Register, or 1.2 Located in a registered historic district and</p>	<p>1.2.1 District listed in the National Register 1.2.2 District designated by state or local statute, and certified by the Secretary of the Interior as substantially meeting all the requirements for the listing of districts in the National Register.</p>
2.0 Certified rehabilitation	<p>1.3 and certified as being of historic significance to the district</p> <p>2.1 Substantial rehabilitation</p>	<p>1.3.1 Meets the Secretary of the Interior's Standards for Evaluating Significance Within Registered Historic Districts.</p> <p>2.1.1 expenses for rehabilitation exceed the adjusted basis of the building or \$5,000, whichever is greater. 2.1.2 occurred during a 24-month period ending within the taxable year (60-month period for phased rehabilitation). 2.1.3 rehabilitation includes reconstruction.</p>
2.2 Placement in service	2.3 Building rehabilitation construction design	<p>2.2.1 Property is placed in service (i.e., returned to use) - tax credit allowed in the taxable year the rehabilitated property is placed in service.</p>
2.4 Depreciation must be allowed for the building		<p>2.3.1 meeting the Secretary of Interior's Standards for Rehabilitation.</p> <p>2.4.1 Income producing property, property used for a business or trade, and owned by a taxpayer.</p>

Table 7 - continued

3.0 Qualified rehabilitation expenditures	<p>3.1 amount chargeable to capital account</p> <p>3.2 for depreciable property, which is nonresidential real property, residential rental property, real property with a class life greater than 12.5 years</p> <p>3.3 spent in connection with the rehabilitation of a certified rehabilitated building</p> <p>3.4 Excluded: (a) expenditures if straight-line depreciation is not used; (b) cost of acquisition; (c) expenditures for enlargement of an existing building; (d) expenditures for noncertified rehabilitation of a certified historic building; (e) expenditures for tax-exempt use property or portion of property.</p>
4.0 tax exempt use property	<p>4.1 nonresidential real property and residential rental property leased to a tax-exempt entity in a disqualified lease</p> <p>4.1.1 Disqualified lease is lease to a tax-exempt entity: (a) if 50% of the property is leased to a tax-exempt entity in a disqualified lease; (b) if the tax-exempt lessee entity participated in the financing of the rehabilitation; (c) if the lease included purchase or sale price to the tax-exempt lessee or to a related entity; (d) if the lease exceeds a 20-year term; (e) tax-exempt lessee or related entity owned and used--for a period greater than 3 months before the lease--the property prior to the lease occurring (i.e., sale leaseback; (f) for this purpose, nonresidential property includes residential property.</p>
5.0 Tax-exempt entity	<p>4.2 property (other than nonresidential real property) leased to a tax-exempt entity.</p> <p>5.1 Generally, U.S. government, states, and their political subdivisions, organizations exempt from paying taxes, foreign entities, Indian tribal government.</p>

Source: U.S. Code (Title 16, Subtitle A, Chapter 1, Subchapter A, Part IV, Subpart E, § 47) and Treasury Regulation Section 1.48-12

determined qualified rehabilitation expenditures. Some expenditures are subject to exclusions. One of these exclusions is particularly relevant to this study as it relates to expenditures for tax-exempt use properties or portion of properties. This analysis of the tax law requirements therefore requires the definition of two additional terms: tax-exempt use property, and tax-exempt entity (as defined by section 168 of the Internal Revenue Code). The definitions are added to the matrix and to the flowchart in Appendix F.

Mark Primoli of the IRS, in *Tax Aspects of the Historical Preservation Tax Incentives – Frequently Asked Questions*, writes that rehabilitation tax credit would be of no use to a tax-exempt entity, but that tax exempt entities sometimes form a limited partnership and maintain a minority ownership interest, enabling the limited partners to be entitled to the tax credits. The tax-exempt use exclusion, however, is another stumbling block for schools as it restricts the use of the property by tax-exempt entities.

Ten Percent Federal Historic Tax Credit

As outlined above, the rules for the 10% tax credit are not as restrictive with regards to the property and the rehabilitation work. The 10% credit does not require the building to be a certified historic building and does not require the rehabilitation work to be deemed a certified rehabilitation. Table 8 provides the 10% credit requirements in matrix form, and the applicable flowchart can be found in Appendix H. The definitions for qualified rehabilitation expenditures, tax-exempt use property, and tax-exempt entity remain the same for the 10% tax credit.

Qualified rehabilitated building. Items 6.1 to 6.4 in Table 8 represent the conditions and preconditions that must be met in order for a property to be a qualified rehabilitated building. These preconditions require the rehabilitation work to be extensive, that the property was first put in use by 1936, that a certain percentage of interior and exterior walls be preserved, and that

Table 8

Conditions Required for 10% Rehabilitation Tax Credits

<p>6.0 Qualified rehabilitated building</p>	<p>6.1 Substantial rehabilitation</p>	<p>6.1.1 expenses for rehabilitation exceed the adjusted basis of the building or \$5,000, whichever is greater. 6.1.2 occurred during a 24-month period ending within the taxable year (60-month period for phased rehabilitation). 6.1.3 rehabilitation includes reconstruction.</p>
<p>6.2 Placement in service</p>	<p>6.2.1 Prior to rehabilitation. 6.2.2 For noncertified historical structures must be placed in service prior to 1936.</p>	
<p>6.3 Building rehabilitation construction design</p>	<p>6.3.1 50% of external walls retained as external walls; 6.3.2 75% of external walls retained as internal or external walls; 6.3.3 75% of internal framework structure is retained;</p>	
<p>6.4 Depreciation must be allowed for the building</p>	<p>6.4.1 Income-producing non-residential property, property used for a business or trade, and owned by a taxpayer.</p>	
<p>3.0 Qualified rehabilitation expenditures</p>	<p>3.1 amount chargeable to capital account 3.2 for depreciable property, which is nonresidential real property, residential rental property, real property with a class life greater than 12.5 years 3.3 spent in connection with the rehabilitation of a certified rehabilitated building</p>	

3.4 Excluded: (a) expenditures if straight-line depreciation is not used; (b) cost of acquisition; c expenditures for enlargement of an existing building; (d) expenditures for noncertified rehabilitation of a certified historic building; (e) expenditures for tax-exempt use property or portion of property.

4.0 tax exempt use property

4.1 nonresidential real property and residential rental property leased to a tax-exempt entity in a disqualified lease

4.1.1 Disqualified lease is lease to a tax-exempt entity: (a) if 50% of the property is leased to a tax-exempt entity in a disqualified lease; (b) if the tax-exempt lessee entity participated in the financing of the rehabilitation; (c) if the lease included purchase or sale price to the tax-exempt lessee or to a related entity; (d) if the lease exceeds a 20-year term; (e) tax-exempt lessee or related entity owned and used--for a period greater than 3 months before the lease--the property prior to the lease occurring (i.e., sale leaseback; (f) for this purpose, nonresidential property includes residential property.

4.2 property (other than nonresidential real property) leased to a tax-exempt entity.

5.0 Tax-exempt entity

5.1 Generally: U.S. government, states, and their political subdivisions, organizations exempt from paying taxes, foreign entities, Indian tribal government.

Source: U.S. Code (Title 16, Subtitle A, Chapter 1, Subchapter A, Part IV, Subpart E, § 47) and Treasury Regulation Section 1.48-12

the property be subject to depreciation (it must be income producing and owned by a taxpayer). This last requirement is a stumbling block for schools in that traditionally schools are not income producing and are not owned by a taxpayer. Public schools are usually owned by local governments and their school boards, which are tax-exempt entities.

Virginia Historic Tax Credit

Based on a review of the Virginia Statute 58.1-339.2 and related Regulation 17 VAC 10-30 (Historic Rehabilitation Tax Credit) the conditions for the Virginia historical tax credit are for:

- Individual, trust, estate, partnership, corporation;
- Eligible expenses incurred;
- Certified historic structures.

The amount of the tax credit is 25% of the eligible expenses. In the case the credits are granted to a partnership, electing small business corporation, or limited liability company, they are allocated among partners or shareholders either in proportion to their ownership interest or as partners or shareholders mutually agree.

With regards to school construction, the code excludes expenses incurred by a non-taxpayer, including a local government or any agency of the commonwealth, and any expense financed, directly or indirectly (i.e., through guarantees, backstop arrangements, etc) by an obligation of the Commonwealth of Virginia. This represents another stumbling block to utilizing historic tax credits for financing school rehabilitations.

The Virginia historic tax credits qualifying conditions are outlined in Table 9 and further described in flowchart form in Appendix I.

Table 9

Review of Virginia Laws and Regulations to Outline and Record Specific Requirements

V1.0 Individual, trust, partnership, estate, or corporation

V1.1 Credits granted to a partnership, electing small business corporation or limited liability company shall be passed through to the partners or shareholders.

V1.2 Tax credit is allocated among partners or shareholders either in proportion to their ownership interest or as partners or shareholders mutually agree.

V2.0 Eligible rehabilitation expenses

V2.1 Amount chargeable to capital account

V2.2 Spent for the material rehabilitation

V.2.2.1 Consistent with Secretary of Interior's Standards for Rehabilitation.

V.2.2.2 > = 50% of assessed value of building, > = 25% for owner occupied building (75% used by owner as personal residence).

V2.3 For a certified historic structure

V2.4 Excluded: (a) cost of acquisition; (b) expenditures for enlargement of an existing building; © expenses not incurred by a taxpayer, including by a local government or any agency of the commonwealth; (d) any expense financed, directly or indirectly, by an obligation of the Commonwealth of Virginia.

V3.0 Certified historic structure

V3.1 Listed in the Virginia Landmarks Register

V3.2 Certified by the director of the Virginia Department of Historic Resources as contributing to the historic significance to the district.

V3.3 Or certified by the Director of the Virginia Department of Historic Resources as meeting the criteria for listing on the Virginia Landmarks Register.

Source: Virginia Statute 58.1-339.2 and related Regulation 17 VAC 10-30

Research Question 3

How did the law apply in the Maggie L. Walker School for Government and International Studies in Richmond, VA and the Appomattox Regional Governor's School for the Arts and Technology in Petersburg, VA?

Information necessary to address Research Question 3 was obtained through an in-depth review of the documents related to the application for the federal and state applications for historic tax credits of the two schools and augmented by discussions with staff members of the Virginia Department of Historic Resources. The application documents are archived at the Virginia Department of Historic Resources and are available to the public for review.

Information related to the partnership structure and the financing of the Appomattox Governor's School, also necessary to answer Research Question 3, were discussed during a meeting with B. Walker (personal communication, October 19, 2011), who was at the time of the Appomattox Governor's school rehabilitation the Managing Partner of the Appomattox Governor's School Limited Partnership. Information about the partnership structure and financing of the Maggie Walker was, instead, obtained through indirect sources and although not as complete, it was sufficient to answer the research question.

Since one of the main sources of information for answering Research Question 3 is the federal and state historic tax credit application material as filed with the Virginia Department of Historic Resources by the two schools, this study will first provide a description of the application processes for the federal and state tax credits.

Following the review of the tax credits application processes, the study will turn to the ownership structure developed for each school and will list the entities identified by this study. This will provide the basis for evaluating some of the exclusions in the federal and state historic

tax credit laws related to public ownership and public use of property. Finally, the study will use the numbering developed for Tables 7 and 8 (and corresponding flowcharts in appendices) to present findings about how the tax credit regulations (federal and state) applied in the historic rehabilitation of the two governor's schools. This will preserve the intended continuity of the study and its research framework.

Federal Tax Credit Application Process

The application for the federal tax credit is a 3-part process that ensures all relevant information is collected and to ultimately evaluate and award the tax credits prior to, during, and upon completion of the rehabilitations. The application process addresses the historical significance of the property, the accounting (tax) treatment of the expenses, whether the rehabilitation work follows the Secretary of the Interior's Standards of Rehabilitation, the ownership and use of the property, and finally the allowable cost basis for calculation of the tax credit. The application is processed through the State Historic Preservation Officer (in Virginia, the Virginia Department of Historic Resources) who works with the National Park Service to review and approve the applications.

Part 1. Evaluation of significance. The purpose of Part 1 is to request designation of the property as a certified historic Structure. The Part 1 form requires a description of the property with regards to its architectural style, the exterior construction material, the type of roof, its distinguishing features, and its relationship to other buildings in the district or neighborhood. Consideration is given to the appearance and condition of the property prior to rehabilitation, its relationship to the historic district, and the historic character of the building. The Secretary of Interior's Standards for Evaluating Significance within Registered Historic Districts are listed in the application material which is available on the National Park Service website (NPS, n/da).

Part 2. Description of rehabilitation. The second step of the application process describes the rehabilitation work to be undertaken on the building. The evaluation of the proposed rehabilitation will be done following the Secretary of the Interior’s Standards for Rehabilitation which consist of 10 basic principles developed to help preserve the distinctive character of a historic building while allowing for reasonable changes to meet new needs (NPS, n/db).

Part 3. Request for certification of completed work. This form is the last step of the application and is used to request approval of a completed rehabilitation work, and final approval of the basis for calculation of the tax credits. A final approval determines the rehabilitation a certified rehabilitation of a certified historic structure, and therefore eligible for the 20% federal tax credit.

Virginia Tax Credit Application Process

The Virginia Tax Credit application process follows the federal process closely, in fact when requesting both federal and state tax credits, Part 1 and Part 2 of the application can be submitted via copies of the federal forms (original signatures required). Part 3 of the application does require a Virginia Part 3 application form. Photos and other required documentation is explained in the “Instructions to Apply for State & Federal Rehabilitation Tax Credit” which can be found on the Virginia Department of Historic Resources website (Commonwealth of Virginia, Department of Historic Resources, n/da).

The study will turn next to the Appomattox Regional Governor’s school and analyze how the federal and state laws applied, and the school qualified for the historic tax credits. The same analysis will then be extended to the Maggie Walker Governor’s school.

The Appomattox Regional Governor's School for the Arts and Technology

Ownership structure. Following is a list and brief description of the entities established for the rehabilitation project of the Appomattox Regional Governor's School.

Appomattox Regional Governor's School LP. The limited partnership was established in 1998 for the sole purpose of acquiring, financing, owning, maintaining, improving, operating, leasing, and if needed, selling or disposing of the Appomattox Regional Governor's School in Petersburg, Virginia. The City of Petersburg conveyed the property of the school to the limited partnership.

Capitalization:

General partner capital (Appomattox Governor's School LLC) (0.01% interest)

Investment limited partner (First Union Development Corporation) (99.99% interest)

Federal tax credits times .85

State tax credits times .61

Virginia Enterprise Zone Credits times .61

Fees:

Co-developer fee paid to co-developers (Appomattox Developer LLC, Appomattox Governor's School Developer LLC, and First Union Development Corporation).

Incentive management fee paid to general partner (Appomattox Governor's School LLC)

Lease agreement:

Appomattox Governor's School LP as landlord, Appomattox Regional Governor's School as tenant

Appomattox Governor's School LLC. A limited liability company and general partner of the Appomattox Regional Governor's School LP

Capitalization:

Appomattox Education Foundation, Inc. (100%)

First Union Development Corporation. A corporation, lending bank, and the investor limited partner of Appomattox Regional Governor's School LP

Appomattox Developer LLC, Appomattox Governor's School Developer LLC.

Authorized member of Appomattox Governor's School LLC and First Union Development Corporation (co-developers).

Appomattox Education Foundation. With the Appomattox Governor's School LLC, Guarantor for the benefit of the investor limited partner.

Sole member of Appomattox Governor's School Developer LLC (authorized member of Appomattox Governor's School LLC).

Appomattox Regional Governor School. A political subdivision of the Commonwealth of Virginia.

Tenant in a Lease agreement with the Appomattox Governor's School LP as landlord.

Responsible for paying rent, property and other taxes, insurance and other expenses

Appomattox Governor's School Developer LLC. Authorized member of Appomattox Governor's School LLC.

How the federal rehabilitation tax credit regulations applied in the Appomattox Governor's School rehabilitation. The numbering developed in Tables 7 and 8 (and flowcharts in appendices) will be repeated in the following sections to present findings related of how the tax credit regulations (federal and state) applied.

1.0 Certified historic structure.

1.2 - The building must be located in a registered historic district and certified as being of historic significance to the district. Part 1 of the Historic Preservation Certification Application (Evaluation of Significance) indicates that the Appomattox Regional Governor's School property was the original Petersburg High School building, in the historical district of Folly Castle in Petersburg, Virginia, a National Register District. Certification as a certified historic structure for the purpose of rehabilitation was requested on the basis that the building contributes to the significance of the Folly Castle Historic District. A statement of significance describing the historical and architectural background of the building, as well as the relationship of the building to the historic neighborhood was included in Part 1 of the certification application.

The National Park Service determined that the property is a certified historic structure for the purpose of rehabilitation work on October 13, 1998. With reference to the matrix provided in this study (Table 8) the building met items 1.2.1 (located in a registered historic district listed in the National Register) and 1.3 (certified as being of historic significance to the district).

2.0 Certified rehabilitation.

2.1 - The building must undergo a substantial rehabilitation, i.e., expenses exceed the cost of the building and the rehabilitation occurred during a 24-month period ending within the taxable year (60-months for phased rehabilitation). The rehabilitation of the Appomattox Regional Governor School cost in excess of \$17 million, well above the value of the abandoned high school. The rehabilitation expenses occurred over a period of 2 years.

2.1 - The building was placed in service prior to the rehabilitation. The building was returned to use on January, 2000.

2.2 - Building rehabilitation construction design. With the recommendation of the Virginia Department of Historic Resources, the National Park Service found that the rehabilitation of the Appomattox School met the Secretary of The Interior's Standards for Rehabilitation and therefore designated it as a certified rehabilitation on November 26, 2000.

2.4 - Depreciation must be allowed for the building, therefore the property must be income producing property and owned by a taxpayer. To meet this requirement an ownership structure was designed to convey ownership of the building from the City of Petersburg to a limited partnership and to execute a lease agreement between the limited partnership and a "tenant." Property was transferred to the Appomattox Governor's School LP and then a 7-year (renewable) lease agreement was established between the Appomattox Governor's School LP as the landlord, and the Appomattox Regional Governor's School as the tenant. The lease reflected arm's-length (economic) transaction terms and was further assigned to First Union (predecessor of Wachovia/Wells Fargo) as security for a line of credit for the Appomattox Governor's School LP to cover costs during construction (B. Walker, personal communication, October 19, 2011).

3.0 Qualified expenditures.

3.1 - Qualified expenditures are amounts chargeable to capital accounts. The eligibility of the costs was verified by a certified public accountants firm, which performed an audit of the rehabilitation expenses. The independent auditor report includes a schedule of the project's total development costs and eligible basis for the calculation of the tax credits. Of the total state eligible expenses of \$17,268,854, only \$16,822,760 are attributable to rehabilitation of the historic structure, while \$446,094 are attributable to site work. Federal tax credits only apply to the historic structure, while state tax credits apply also to site work.

3.2 - Property must be depreciable, therefore income producing and owned by a taxpayer. To meet this requirement an ownership structure was designed to convey ownership of the building from the City of Petersburg to a limited partnership and to execute a lease agreement between the limited partnership and a tenant. Part 2 of the Historic Preservation Certification Application indicates that the owner of the building is the Appomattox Governor's School LP (Limited Partnership). A 7-year (renewable) lease agreement was established between the Appomattox Governor's School LP as the landlord, and the Appomattox Regional Governor's School as the tenant. The lease reflected arm's-length (economic) transaction terms and was further assigned to First Union (predecessor of Wachovia/Wells Fargo) as security for a line of credit for the limited partnership (B. Walker, personal communication, October 19, 2011).

3.3 - Expenditures must be spent in connection with the rehabilitation of a qualified rehabilitated building. The building was designated a certified rehabilitation on November 26, 2000 (see item 1.2).

4.0 Tax-exempt use property.

3.4 and 4.11 - Excluded are expenses for tax-exempt use property, i.e. property leased to a tax-exempt entity in a disqualified lease. The lease between the Appomattox Governor School LP and the Appomattox Regional Governor's School is not disqualified in that the financing of the property was not done with tax-exempt financing, the lease does not contain a purchase option, the lease does not exceed 20 years, and the lessee did not use the property before the sale or lease (Regional Board vs. Petersburg School Board, abandoned high school vs. regional school for the gifted). Prior use of the building was "abandoned high school," use of the building after rehabilitation is "high school for gifted children."

How the Virginia rehabilitation tax credits law applied. The section that follows makes reference to the numbering developed in Table 9 for the requirements of the Virginia historic tax credit law.

V1.0 Individual, trust, partnership, estate, or corporation.

V1.0 - Tax credits are granted to partnerships and shall be passed through to the partners. An ownership structure was designed to convey ownership of the building from the City of Petersburg to a limited partnership. Part 2 of the Historic Preservation Certification Application indicates that the owner of the building is the Appomattox Governor's School LP. Part 3 of the Commonwealth of Virginia Request for Certification of Completed Work shows that the state credits are to be transferred to Appomattox Governor's School SCP LP pursuant to the one time transfer regulation in the Virginia tax code (Section 15[D]).

V2.0 Eligible rehabilitation expenses.

V2.1 - Chargeable to a capital account. The eligibility of the costs was verified by a certified public accountants firm, which performed an audit of the rehabilitation expenses. The independent auditor report includes a schedule of the project's total development costs and eligible basis for the calculation of the tax credits. Of the total development costs of \$17,831,645, \$148,229 are noneligible, and \$414,562 are for personal property. The total eligible expenses and the state historic tax credit basis is \$17,268,854.

V2.2 - Consistent with the Secretary of Interior's Standards for Rehabilitation. With the recommendation of the Virginia Department of Historic Resources, the National Park Service found that the rehabilitation of the Appomattox School met the Secretary of the Interior's Standards for Rehabilitation and therefore designated it as a certified rehabilitation on November 26, 2000.

V2.2.2 - Expenses are greater than 50% of assessed value of the building. The rehabilitation of the Appomattox Regional Governor School cost in excess of \$17 million, well above the value of the abandoned high school.

V2.4 - Excluded are expenses incurred by a local government or agency of the commonwealth or financed, directly or indirectly, by an obligation of the commonwealth. Expenses were incurred by a nongovernment entity, the Appomattox Governor's School LP, and were financed as follows: \$2,692,316 syndication of federal tax credits; \$2,972,971 syndication of state tax credits; 9,412,379 pledges from school districts (moral obligations), which utilized local government funding sources; and \$2,753,979 fundraising contributions.

V2.3 - Eligible expenses are for a certified historic structure. The National Park Service determined that the property is a certified historic structure for the purpose of rehabilitation work on October 13, 1998, based on its determination that the property is located in a National Register district and that the property contributes to the significance of the district.

V3.0 Certified historic structure.

V3.2 - Certified as contributing to the historic significance of the district. The Virginia Department of Historic Resources designated the property a certified historic structure on June 6, 2000 based on the fact that the property is located in the Folly Castle Historic District, a district that is listed in the Virginia Landmarks Register, and that the property is a contributing historic property in the district.

The Maggie L. Walker Governor's School

Ownership structure. Following is a list of the entities identifies for the Maggie Walker Governor's School.

Maggie Walker Governor's School LP General partner: LLC

Maggie L. Walker Governor's School LLC. Sole gp of owner

Maggie L. Walker Governor's School SCP LP

Maggie L. Walker High School Renovation Foundation.

How the federal rehabilitation tax credit law applied.

1.0 Certified historic structure.

1.2 - The building must be located in a registered historic district and certified as being of historic significance to the district. The Maggie L. Walker Governor's School Building is listed in the National Register of Historic Places and therefore qualifies as a certified historic structure (meets condition in item 1.1 of Table 7)

2.0 Certified rehabilitation.

2.1 - The building must undergo a substantial rehabilitation, i.e., expenses exceed the cost of the building and the rehabilitation occurred during a 24-month period ending within the taxable year (60-months for phased rehabilitation). The rehabilitation of the Maggie L. Walker Governor School cost in excess of \$23 million, well above the value of the abandoned high school. The rehabilitation expenses occurred during the period August 1999 to August 2001, a period of 24 months.

2.1 - The building was placed in service prior to the rehabilitation. According to Part 3 of the application, the building was returned to use in August 2001.

2.2 - Building rehabilitation construction design. With the recommendation of the Virginia Department of Historic Resources, the National Park Service found that the rehabilitation of the Maggie L. Walker Governor School met the Secretary of the Interior's Standards for Rehabilitation and therefore designated it as a certified rehabilitation on February 6, 2002.

2.4 - Depreciation must be allowed for the building, therefore the property must be income producing property and owned by a taxpayer. To meet this requirement an ownership structure was designed to convey ownership of the building from the City of Richmond to a limited partnership and to execute a lease agreement between the limited partnership and a tenant. Part 2 of the Historic Preservation Certification Application indicates that the owner of the building is Maggie L. Walker Governor's School LP. The limited liability company is 99.99% owned by a subsidiary of Wachovia Bank, the Maggie L. Walker Governor's School Tenant, LLC (10K of Wachovia Bank; Ress, 2004) and was established for the purpose of qualifying for and syndicating the state and federal tax credits. Rent, taxes, and insurance are paid by the Regional Board for Maggie L. Walker (funded through the Maggie L. Walker Renovation Foundation) to Wachovia Bank, the indirect owner of the building, providing rental income to the ownership structure (Ress, 2004).

3.0 Qualified expenditures.

3.1 - Qualified expenditures are amounts chargeable to capital accounts. The eligibility of the costs was verified by a certified public accountants firm, which performed an audit of the rehabilitation expenses. The independent auditor report includes a schedule of the project's total development costs and eligible basis for the calculation of the tax credits. Of the total development costs of \$24,761,695, only \$22,384,202 is eligible for the federal tax credits.

3.2 - Property must be depreciable, therefore income producing and owned by a taxpayer. To meet this requirement an ownership structure was designed to convey ownership of the building from the City of Richmond to a limited partnership and to execute a lease agreement between the limited partnership (or related entity) and a tenant. Part 2 of the Historic Preservation Certification Application indicates that the owner of the building is Maggie L.

Walker Governor's School LP. The limited liability company is 99.99% owned by a subsidiary of Wachovia Bank, the Maggie L. Walker Governor's School Tenant, LLC (Ress, 2004; 10K of Wachovia Bank) and was established for the purpose of qualifying for and syndicating the state and federal tax credits. Rent, taxes, insurance is paid by the Regional Board for Maggie L. Walker (funded through the Maggie L. Walker Renovation Foundation) to Wachovia Bank, the indirect owner of the building, providing rental income to the ownership structure (Ress, 2004).

3.3 - Expenditures must be spent in connection with the rehabilitation of a qualified rehabilitated building. The building was designated a certified rehabilitation on February 6, 2002 (see item 2.2).

4.0 Tax-exempt use property

2.4 and 4.1.1 - Excluded are expenses for tax-exempt use property, i.e., property leased to a tax-exempt entity in a disqualified lease. The lease between the Maggie L. Walker Governor School LP and the regional board is not disqualified in that the financing of the property was not done with tax-exempt financing, the lease does not contain a purchase option, the lease does not exceed 20 years, and the lessee did not use the property before the sale or lease (Regional Board vs. Richmond School Board, abandoned high school vs. regional school for the gifted, lessee was in the Jefferson High School building) (Goldman, 2011). With regards to financing, the school was financed as follows: one-third with proceeds from the syndication of federal and state historic tax credits, one-third with contributions made to the Maggie L. Walker Renovation Foundation, and one-third with a loan from Wachovia Bank, which member localities of the regional board agreed to repay over time periods up to 20 years ("Minutes from Regional Board Meeting," June 18, 2009).

How the Virginia rehabilitation tax credit law applied.

V1.0 Ownership by individual, trust, partnership, estate, or corporation.

V.1.0 - Ownership by limited partnership. Part 2 of the Historic Preservation Certification Application indicates that the owner of the building is Maggie L. Walker Governor's School LP.

V2.0 Eligible rehabilitation expenses.

V2.1 - Chargeable to a capital account. The eligibility of the costs was verified by a Certified Public Accountants firm, which performed an audit of the rehabilitation expenses. The independent auditor report includes a schedule of the project's total development costs and eligible basis for the calculation of the tax credits. Of the total development costs of \$24,761,695, \$1,371,740 is for noneligible rehabilitation expenses. The total eligible expenses and the state historic tax credit basis is \$23,389,955 and the historic tax credit is 5,847,489 based on a tax credit rate of 25%.

V2.2 - Consistent with the Secretary of Interior's Standards for Rehabilitation. The Virginia Department of Historic Resources found that the rehabilitation of the Maggie L. Walker Governor's School met the Secretary of the Interior's Standards for Rehabilitation and therefore designated it as a certified rehabilitation on December 27, 2001.

V2.2.2 - Expenses are greater than 50% of assessed value of the building. The rehabilitation of the Maggie L. Walker Governor's School cost in excess of \$23 million, well above the value of the abandoned high school.

V2.3 - Eligible expenses are for a certified historic structure. The property is listed in the Virginia Landmarks Register (1998, June) and therefore it is certified historic structure.

V2.4 - Excluded are expenses incurred by a local government or agency of the commonwealth or financed directly or indirectly by an obligation of the commonwealth.

Expenses were incurred by a nongovernment entity, the Maggie L. Walker Governor's School LP and were financed as follows: one-third with proceeds from the syndication of federal and state historic tax credits, one-third with contributions made to the Maggie L. Walker Renovation Foundation, and one-third with a loan from Wachovia Bank, which member localities of the regional board committed to repay over time periods up to 20 years ("Minutes from Regional Board Meeting," June 18, 2009).

V3.0 Certified historic structure.

V3.1 The property is listed in the Virginia Landmark Register. The Virginia Department of Historic Resources designated the property a certified historic structure on June 6, 2000 based on the fact that the property is listed in the Virginia Landmarks Register (June, 1998).

Research Question 4

What are the administrative implications resulting from the use of historic tax credits financing for school construction in Virginia?

This study has found that administrative issues related to using historic tax credits for school renovations fall into two broad categories, those associated with renovating an historic building, and those derived from the complex public private partnership structure, which is established to comply with the tax credits regulations. Following is a description of the issues identified in this study.

Issues From the Rehabilitation of the Building.

Obtaining and maintaining the building as a certified historic structure. The first step in the application for tax credits is a request for approval that the building is a certified historic structure. Requesting and obtaining certification of the building is perceived to be difficult, and there is also a perception that certain responsibilities come with the certification (E.

Tune, personal communication, September 27, 2011). Upon review, however, the application process does not seem cumbersome, instead it seems simple and straightforward, and helpful instructions are provided on the Virginia Department of Historic Resources and the National Park Service websites. Part-1 Evaluation of Significance of the Historic Preservation Certification Application is a 2-page form that covers applicable questions and descriptions to help determine the historical significance of the property. In addition to this form, applicants are asked to provide photographs of the property and a map locating the property within the boundaries of the historic district, if applicable.

Although the certification is the first step in the application process for historic tax credits, the determination alone that the building is a certified historic structure does not involve assuming long-term responsibilities (E. Tune, personal communication, September 27, 2011).

Meeting historic rehabilitation design requirements. The Department of Interior's Standards of Rehabilitation impose certain restrictions that could impact the design of the school renovation. The standards are designed to achieve the long-term preservation of a property's historic significance, and therefore they seek to preserve historic materials and features. The standards provide restoration guidelines for the exterior and interior of historic buildings, landscape features, the building's site, and attached or adjacent construction, and do allow reasonable flexibility to meet modern need. In order to receive certification by the Virginia Department of Historic Resources, the restoration must be consistent with the historic character of the building and, if applicable, the district where it is located (CVDHR, n/db). School administrators therefore may be limited in what they can achieve with regards to space that meets the needs of modern school design.

Choosing competent and experienced architects and historic preservation consultants is very important to the success of the project (B. Walker, personal communication, October 19, 2011). If the professionals, particularly the historic preservation consultants, are engaged (brought in) immediately, know the process and know the historic fabric of the building, they will guide the renovation process, and the final review will be straightforward. Additionally, if the Virginia Department of Historic Resources is engaged early on, design solutions can be developed, and construction issues can be resolved before the historic rehabilitation is compromised (E. Tune, personal communication, September 27, 2011).

Parties involved. The number of parties involved in historic rehabilitations is much greater than in traditional renovation projects. In addition to architects, historic preservation consultants, and developers, other individuals are more directly involved with the financing of the project and the syndication of the tax credits. Because the bridge financing of the project is dependent on the expected proceeds from the syndication of the tax credits, and in turn the amount of the tax credits is strictly dependent on the building, the rehabilitation expenses, and the final outcome of the rehabilitation, close coordination with all parties is needed. Below is a summary description of the parties and their roles.

- Historic preservation consultants, architects, and developers are concerned with designing and executing a rehabilitation that will result in the building to be deemed a certified rehabilitation.
- Certified accountants are responsible for verifying each construction cost and determining whether it can be classified as a qualified rehabilitation expenditure. They work closely with the historic preservation consultants, architect, developers, and the

Virginia Department of Historic Resources on one hand, and the lender, syndicators, and the legal team on the other.

- Lenders who provide the bridge financing for the project, are concerned with the expected proceeds from the syndication of the tax credits because they provide equity for the project.
- Syndicators, usually chosen by the lenders, are responsible for the marketing and execution of the syndication, therefore they need to know very early on the size of the tax credits that can be offered to investors.
- Finally, the attorney designs the partnership structure and prepares all legal documents.

With many moving parts, and many parties involved in the project, coordination and communication flow is very important. Typically the process of certification runs more efficiently when there is one individual (typically the historic preservation consultant) who becomes the contact person for the project and takes on the role of coordinator (E. Tune, personal communication, September 27, 2011). Additionally, it was noted that the strong involvement of parents and/or community leaders can be of greatest importance, as they can be the force in setting in motion the rehabilitation and bringing it to completion (E. Tune, personal communication, September 27, 2011).

Erosion of the tax credits benefits. The motivation behind the development of the historic tax incentive programs is that the cost of renovation of historic buildings, if executed following prescribed guidelines of the U.S. Secretary of Interior, typically exceeds the value of the properties after renovation, making it difficult to find motivated developers to engage in rehabilitation projects. In Virginia, for example, the General Assembly in 1996 created its tax incentive program to make it economically feasible to rehabilitate older buildings and maintain

their historic value (“Amicus Brief,” 2010). On the other hand, an opposing view is that given the number of historic rehabilitations across the United States and Virginia, certainly the market seems to sustain the economic viability of the tax incentive programs and profits, therefore, must still remain after paying the construction premium for historic rehabilitations. The sense is that there is an economic incentive (i.e., it is profitable) for the market to support historic rehabilitations (B. Walker, personal communication, October 19, 2011) or else such market would fail.

The central question for property owners is therefore how much of the benefits of the tax credits are eroded by the additional cost of construction and other soft costs. Quantifying the cost of the rehabilitation standards and the net value of the tax credits is nevertheless difficult, and while this study provides concrete examples of the hard and soft costs for school rehabilitations, it cannot provide hard set guidelines for the construction premium associated with standards of rehabilitation compliance. This study, however, found that if the exterior of the building is in good shape (i.e., the windows do not need to be replaced), the costs are about the same for rehabilitations following standards and for those not following the standards; but if the exterior walls need extensive work, there is a cost differential (J. Leith-Tetrault, personal communication, October 26, 2011).

An important risk to consider when rehabilitating historic buildings is the uncovering of unforeseen structural, materials, or environmental problems during demolition, which could materially increase the cost of renovation. While “you never know what you find” brings uncertainty to the final cost of renovation, one positive aspect of the historic tax credits is the fact that they are not locked in at the start of the project, but rather they are awarded as a percentage of the actual qualifying costs (B. Walker, personal communication, October 19, 2011). As the

renovation costs increase, therefore, the amount of tax credits available as equity for the project will also increase and will partially offset the additional costs.

Issues From Using Historic Tax Credits Financing

Transfer of ownership.

Findings. Perhaps the most significant challenge to overcome is transferring the ownership of the school properties to private limited partnerships, a step necessary to enable the historic tax credit funding. The cities of Petersburg and Richmond conveyed ownership of the property to limited partnerships prior to starting the application process for tax credits. A lease agreement between the regional board (as tenant) and the limited partnership (as landlord) was put in place for both schools, which entitled them and the communities to fully utilize the property. Eventually, the ownership of the properties of both the Maggie L. Walker Governor’s School and the Appomattox Regional Governor’s School reverted back to public entities, the respective regional school boards. This occurred after the 5-year holding period required for the partnership structure to stay in place.

Analysis. Transfer of ownership to a private entity remains an important factor when considering historic tax credit funding for schools. From a community point of view, “giving up” ownership of a public building means giving up control, trusting the public administrators and the private parties involved, trusting that the school project will be completed, and most importantly, trusting that the community is giving up something for something better. The long-term impact on socioeconomic factors in the neighborhood will need to be considered.

Ultimately, the communities must rationalize the benefits in the context of the risks and rewards presented to them.

Design and execution of the transaction.

Findings. The development of the partnership structure and the complexities of the transaction require the services of highly skilled and experienced attorneys, certified public accountants, bankers, and syndicators. Attorneys, in particular, hold a central role in the design of the partnership structure and execution of the transaction. Multiple individuals have pointed to the attorney involved in both governor's schools as being the architect of the transactions and key to the successful execution. These individuals have stressed the importance of hiring an attorney that "knows what he/she is doing."

It is worth repeating here that effective communication and close cooperation amongst all parties involved in the project is crucial. Both the construction team (i.e., architects, developers, historic preservation consultants) and the financing team (i.e., accountants, bankers, syndicators, investors, attorneys) face interdependencies within the team, with each other, with the Virginia Department of Historic Resources, and the National Park Service. It is easy to understand why experienced individuals who are subject matter experts and who know roles and responsibilities would be critical to the success of the project.

One of the reasons for the historic tax credits financing not being used more extensively for schools is the complexity of the transaction, and the ability to make the current law work for the specific situation. Even after the completion of the renovation and the financing, it is hard for school administrators and others involved to describe the transaction wing to wing.

Analysis. The two governor's schools in this study provide a model for execution, but the private – public nature of the transaction make the accessibility of information less open and it requires the engagement of highly specialized professionals. If changes to the current rules of the law were to make the execution more accessible and easier for public schools, then a

standard process for execution could be developed, transaction costs could decline, and more schools could participate in the program.

Ongoing administration of partnership structure.

Findings. Following the syndication of the tax credits and the funding of the school renovation, certain responsibilities remain to ensure private investors' interests in the tax credits are protected. In order to avoid the recapture of the tax credits, the ownership structure developed to qualify for the historic tax credits must be kept in place for 5 years. This means, for example, that the various legal entities involved in the transaction must be managed and maintained, they must comply with their legal obligations, they must be funded, file their tax returns, budget for and pay for property taxes, insurance, rent. These responsibilities are not typically undertaken by public school administrators, and problems can surface if they are not planned for the long term.

In 2004, three years after the completion of the Maggie L. Walker renovation, the school received a property tax bill in excess of \$1 million from the city of Richmond. School property is typically tax-exempt property and is not subject to real estate property taxes; however, the Maggie Walker school was at the time owned by the limited partnership that executed its renovation. While those that designed the structure accounted for such liabilities, and planned for periodic payments to flow from the limited partnership to the renovation foundation and on to the school to pay for taxes and other expenses, the process failed and payments were neither received by the school, nor paid to the city of Richmond for the property taxes. The school administrators were taken by surprise, had to deal publicly with the issue, and eventually asked for a reduction for most of the tax bill (personal communication, D. Myers, July 14, 2011; Ress, 2004).

Analysis. The Maggie Walker example highlights some potential problems when private and public entities share responsibilities. While some of the ongoing responsibilities may legally rest with the managing partners of the limited partnership or the foundation, the school board clearly has a vested interest in the continued compliance with the law of all parts of the transaction. To prevent communication gaps and breaks in the processes, such as in the example of the Maggie Walker, school administrators should plan for and establish an ongoing administration (and accountability) of the structure as a whole for at least the minimum required period of 5 years.

Administering the ongoing responsibilities of the partnership structure can, however, be a challenge for public school administrators. This nontraditional form of ownership and financing is complex and relatively new for schools in Virginia; hence, public administrators may not have the skills and experience to easily understand the transaction “wing to wing.” During the development and execution phases of the construction and funding of the school renovation the administrators typically rely heavily on the legal and finance professionals hired to design and complete the transaction structure. To properly manage this public private partnership funding structure, school administrators may need to develop new financial and administrative competencies.

Research Question 5

What are the public policy issues?

Public Value

The federal and Virginia historic tax credits programs have been successful in preserving the historic architecture of the country and Virginia, the cultural identity, and overall preserving the history of this state and country. School buildings typically provide an architectural anchor

for the neighborhoods, and are social centers for students and communities, and are therefore of particular significance to the history of the country. The two schools in the case study have deeply rooted origins in the history of the cities of Petersburg and Richmond and their renovations have been acclaimed across the region and the country. Their rehabilitation inspired and mobilized students and alumni, neighborhood communities, business and government leaders, civic leaders and philanthropists, all rallying to ensure history is preserved and continues to be made in the school buildings.

The public value of the historic tax credits programs, however, transcends the rehabilitation of the buildings, and has been proven to provide extensive socioeconomic benefits to the neighborhood communities. Economic impact studies of the federal and the Virginia historic tax credit programs show an impressive positive contribution to economic growth and jobs. With many distressed school buildings being located in inner city run-down neighborhoods and rural areas, the program brings in capital, business, jobs, and generally, economic benefits where they are needed most. Additionally, given schools traditionally are social and community anchors, the social fabric of the neighborhood is favorably impacted.

Finally, given the current economic and fiscal environment, local governments and school districts are struggling to find needed financing for school construction. Historic tax credits and their syndication to private investors can provide greatly needed funding to poor school boards across the nation. With studies supporting the notion that the conditions of the school buildings impact the education process, the rehabilitation of distressed schools provide an investment in the long-term welfare of the communities and the nation. The public value of the historic tax credits programs for school rehabilitation therefore extends to providing the means for economic equalization.

The last research question of this study addresses public policy issues related to the use of historic tax credits for school rehabilitations in Virginia. In the sections that follow, two important policy issues are discussed. The first deals with a “prior use” limitation in the federal law, which prevents schools from accessing the historic tax credit program. The second relates to a very significant court ruling in the Fourth Circuit U.S. court of appeals regarding the federal taxability of the Virginia tax credits. Both federal and state issues preclude schools in Virginia to fully utilize historic tax credits for school rehabilitations.

Prior Use Limitation

Findings. It has become clear that limitations imposed by the current tax laws impact the costs, benefits, administrative issues, and ultimately the use of historic tax credits for school construction. For example, according to the federal tax code, a lease between a school and a limited partnership would be disqualified for the purpose of the historic tax credits if following the rehabilitation there isn't a “change in use” of the property, i.e., the public school continues to be employed as a public school following the rehabilitation. The two governor's schools in the case study qualified only because they changed their use from “abandoned high school(s)” to “regional governor's school(s) for the gifted” (Goldman, 2011).

Over the years, a number of bills have been introduced in the U. S. Congress to make historic tax credits more accessible to public schools. Most recently, on October 12, 2011, Senators Mark Warner and Jim Webb introduced the Rehabilitation of Historic Schools Act of 2011.” The bill (S. 1685) amends Section 47(c) (2) (B)(v) of the Internal Revenue Code and lifts the restriction on prior use for public schools. A similar bill was introduced by Representatives Cantor and Davis in 2010 (H.R. 4133). The School Modernization and Revitalization Tax Credit (SMART) initiative, also aiming at fixing the prior use limitation, has been advocated by

former Virginia Governor and Senator George Allen and Paul Goldman, former Chairman of the Democratic Party of Virginia Chairman. Making it easier for public schools to gain access to the benefits of the historic tax credits is a policy embraced by both Democrats and Republicans (Martin, 2009).

Analysis. John Kingdon explains the agenda setting policy-making process in the context of the garbage can model where problem streams, policy streams, and political streams are independently operating. A window of opportunity opens when these streams come together to formulate a policy that will be acted upon in the legislative process (Kingdon, 2003). Analyzing the policy issue in the context of the Kingdon model may be helpful to this study and may bring a greater perspective of this policy issues.

The stated goal of the Federal Historic Tax Credits program focuses on the preservation of historic buildings in the United States; however, the prior use limitation effectively excludes historic schools from benefitting from the program. To garner support for a change in the current law, the underlying policy “problem and scope” need to be broadened. The premise of this study is two-fold: one is the fact that schools in Virginia and the United States are deteriorating and the educational process (and with it the country’s future prosperity) is impacted as a result; and the other, the fact that local governments have limited financial resources to meet the demand for rehabilitating old school buildings. Statements by public officials, politicians, and the fact sheets accompanying proposed legislation reveal that the problem and scope has been broadened even further to include a reduced level of private capital investments in communities across the country, high unemployment, and declining fiscal strength of local governments. A policy change to lift the prior use limitation for schools is likely to achieve greater public and political support with such broader scope.

The current policy solution brought to the U.S. Senate by Senators Warner and Webb focuses specifically on lifting a prior use limitation, and would allow an existing school to continue operating as a school following an historic rehabilitation. Administratively, this policy would still require the formation of a partnership structure, transfer of ownership of the school building to a limited partnership, and a lease agreement for the continued use of the building as a school. In this scenario, the administrative issues identified earlier in this study still remain, specifically the transaction costs of a complex partnership structure, but ultimately the Warner and Webb Senate bill would be an effective policy solution for providing access to tax credits financing to schools.

Politically, the policy issue has gained momentum in recent months given the country's current environment marked by slow economic growth and high unemployment. A timely study by Rutgers University in cooperation with the National Trust Community Investment Corporation produced the First Annual Report on the Economic Impact of the Federal Historic Tax Credit in 2010 (followed by the Second Annual Report in 2011). The study reports that during the period of its existence (1978-2010), \$90.4 billion in expenditures for historic rehabilitations under Federal Historic Tax Credit generated 2.0 million jobs, income of \$76.3 billion, GDP of \$103.8 billion, and tax revenues of \$30.5 billion (\$22.3 billion federal, \$4.2 billion state, \$4.1 billion local). The Rutgers University study also shows that the cost of the federal program (\$17.5 billion in 2010 inflation adjusted dollars) is more than offset by the additional federal tax revenues (\$22.3 billion) generated by the rehabilitation activities, making the program self-sustaining (Rutgers University, 2010). With tremendous political focus on economic growth, job creation, and fiscal conservatism, a policy to expand the reach of the historic tax credit program to public schools at no net cost to taxpayers may prove to be an easy

sell to constituents and policymakers of both parties. The current environment may very well provide the window of opportunity described by Kingdon when problem, policy, and political streams couple and produce a policy that will be acted upon in the U.S. Congress.

Fourth Circuit U.S. Court of Appeals Decision

Findings. A significant public policy issue has surfaced recently following the March 29, 2011 Fourth Circuit United States Court of Appeals decision on the case of Virginia Historic Tax Credit Fund 2001 LLC; Virginia Historic Tax Credit Fund 2001 SCP, LLC; Tax Matter Partner v. Commissioner of Internal Revenue. The appellate court reversed a earlier ruling of the U.S. Tax Court (Virginia Historic Tax Credit Fund 2001 LLC et al. v. Commissioner of Internal Revenue, December 21, 2009) and found in favor of the Commissioner of Internal Revenue with regards to the classification of certain transactions involving the allocation of Virginia historic tax credits amongst partners as a “disguised sale,” and therefore subject to taxation under sec. 707 of the U.S. Tax Code. The taxation of these transactions greatly reduces the financial incentives of the Virginia Historic Rehabilitation Tax Credit Program and undermines its desired policy outcomes.

The Virginia rehabilitation tax credit law does not allow tax credits to be sold or transferred; however, it allows partnerships to allocate them to the partners as the partners mutually agree. In practice, partnership fund arrangements are established to effect the syndication of the state historical tax credits, sourcing private capital contributions by limited partners, and allocating a disproportionate share of state tax credits to them. The capital contributions of the limited partners effectively fill the gap between the costs of historical rehabilitations and the conventional financing available to the projects (Virginia Historic Tax

Credit Fund 2001 LP et al. v. Commissioner of Internal Revenue, December 29, 2009; Virginia Historic Tax Credit Fund 2001 LP et al. v. Commissioner of Internal Revenue, March 29, 2011). The primary tensions of the case stem from the way the partnership funds reported the investor's contribution to the funds (as nontaxable contribution to capital) in their federal tax filings. According to the Internal Revenue Service such contributions were instead disguised sales of income tax credits to the investors and therefore must be included in taxable income (of the partnership funds) for the purpose of federal income taxation according to sec. 707 of the Internal Revenue Code (IRC § 707; Virginia Historic Tax Credit Fund 2001 LP et al. v. Commissioner of Internal Revenue, March 29, 2011).

In the case, the Commissioner of Internal Revenue, as claimant, argued two claims alleging that partnership transactions are disguised sale. These two claims, outlined below, were initially rejected by the lower court (Virginia Historic Tax Credit Fund 2001 LLC et al. v. Commissioner of Internal Revenue, December 21, 2009):

1. In the case, investors were not bona fide partners in the partnership funds, but rather purchasers of tax credits;
2. In the case, transactions between the investors and the partnership funds were disguised sales under I.R.C. §707.

The Fourth District Appellate Court did not rule on the first claim regarding the bona fide partner status, but found on the second claim that the transactions were in fact disguised sales under I.R.C. § 707, reversing, therefore, the lower court, and concluding that the transactions were subject to federal taxation. The appellate court reached its decision first by finding that although Virginia's historic tax credits are not transferable and nonheritable, they are in fact property for federal tax purpose. Secondly, the appellate court found that in this case, with regards to the

transfers of the credits, certain determining factors were critical in its finding that the transactions between the investors and the partnership funds were in fact disguised sales under I.R.C. § 707: (a) the timing and amounts of the credits transactions were predetermined, (b) the investors had secured contractual rights to them, (c) their allocation was disproportionately large in relation to the interest of the investors in the partnership, and (d) the investors had no obligation to return money or other consideration to the partnership (Virginia Historic Tax Credit Fund 2001 LP et al. v. Commissioner of Internal Revenue, March 29, 2011).

While the Fourth Circuit Court expressly stated that whether the tax credits are considered property and whether a disguised sale has occurred depend on the specific facts of the specific case; the impact of the court's decision could be significant and far reaching, and could influence tax credits programs in Virginia and other states. The Fourth Circuit Court decision has already been cited in the case of George H. Tempel et ux. v. Commissioner, in finding that state conservation credits issued by the State of Colorado were property and therefore a taxpayer selling them realized taxable capital gains (Belkowitz et al., 2011).

The objections to the Fourth Circuit Court outlined below focus on the arguments of the case and on the impact that the ruling has had and will have on the Virginia program.

1. Rehabilitation costs are the impetus for the Virginia law. The intent and design of the Virginia tax credit law was to preserve historical structures for future generations. Kenneth T. Cuccinelli, II, Attorney General of Virginia, in his Amicus Brief filed on behalf of the Commonwealth of Virginia and in support of Virginia Historic Tax Credit Fund 2001, the defendant in the case, provides the historical and legislative background of the Virginia law ("Amicus Brief," 2010). As Cuccinelli outlines, Virginia's inventory of historically significant buildings (registered on the National Register of Historic Places) is in excess of 2,700. The cost

of renovations of historical buildings, if executed following prescribed guidelines of the U.S. Secretary of Interior, typically exceed the value of the properties after renovation, making it difficult to find motivated developers to engage in rehabilitation projects. The Virginia General Assembly in 1996 created a flexible tax incentive program to make it economically feasible to rehabilitate older buildings and maintain their historic value (“Amicus Brief,” 2010).

2. The Virginia law was designed to accommodate partnership structures. The Virginia law specifically excludes certain rights with regards to ownership of historic tax credits; they cannot be transferred nor inherited, therefore precluding their classification as property. While the Fourth Circuit Court explained at length its legal basis for determining the property classification of the tax credits, state and federal laws are in disagreement with regards to this issue. Additionally, the development of partnership structures designed to accommodate the transfer of the credits to prospective investors was contemplated in the development of the Virginia law. And, as K. Cuccinelli advocates in the Amicus brief, “Respect for the policy goals of state and federal governments counsels against adverse tax treatment of partnerships when that adverse treatment would thwart important public policy goals.” Cuccinelli goes on to explain that in the case, the marketing of the tax credits by the partnerships was appropriate, as attracting investments that would not otherwise be made in historical rehabilitations is the reason the state provides the tax incentives in the first place (“Amicus Brief,” 2010; Virginia Historic Tax Credit Fund 2001 LLC et al. v. Commissioner of Internal Revenue, December 21, 2009). The economic gain offered to investors should not be held against the partnerships. Further, Cuccinelli writes, “Principles of federalism and comity should foster a system in which the federal government, while protecting federal rights and federal interests, strives to not interfere with the legitimate activities of the states” (“Amicus Brief,” 2010). Cuccinelli also points out

that historic preservation, as established in the National Historic Preservation Act of 1966, (as amended in 16 U.S.C. sec 470-1, 2006), is not solely a Virginia policy objective but also a national objective. The federal law spells out a policy of cooperation with and assistance to the states and local governments in expanding historic preservation programs and activities (“Amicus Brief,” 2010; Virginia Historic Tax Credit Fund 2001 LLC et al. v. Commissioner of Internal Revenue, December 21, 2009).

3. The ruling greatly reduces the financial incentives provided by the tax credit law. Developers’ financial incentives for engaging in historic preservation projects are greatly reduced when 40.75% (35% for federal and 5.75% for state) of the capital contributed through partnership to a developer for the rehabilitation project is redirected to tax liabilities (K. Kilpatrick, personal communication, August 4, 2011; Virginia Department Historical Resources, 2011). Partnerships, for the purpose of taxation, are “pass-through” entities and each partner must pay taxes on his or her allocated share of the partnership income. (I.R.C. §§701, 702; Virginia Historic Tax Credit Fund 2001 LP et al. v. Commissioner of Internal Revenue, March 29, 2011). A partnership must report proceeds received from the sale of its assets as taxable income, while amounts received (i.e., contributed) from or distributed to partners are tax free. With the characterization of the partnerships’ historic tax credit transactions as disguised sales of partnership assets, rather than contributions to capital from its investor partners, the amounts become subject to income taxation, reducing therefore (net) cash availability for historic renovations. The court ruling effectively allows a large portion of the tax credit funds to become federal tax liabilities to the I.R.S., leaving less money on the ground. While the developers’ financial incentives for the rehabilitation of historically-significant buildings are reduced, there is no reduction of the risk associated with their construction projects, therefore developers may

have to reduce the quality and extent of their rehabilitation work in order to execute an economically viable rehabilitation project. This could result in rehabilitation of “fewer buildings and badly done because the incentive to be done correctly is not there” (K. Kilpatrick, personal communication, August 4, 2011).

4. The ruling impacts the ability to secure financing for rehabilitation projects. With the cost of a historic rehabilitation often exceeding the value of the building after the rehabilitation, conventional lenders are not in a position to provide financing for the entire project. When financing rehabilitation projects, lenders take into consideration the equity value provided by historical tax credits once the project is completed, and they provide financing accordingly. Under the ruling, a large chunk of the equity is reduced by tax liabilities, and lenders are therefore required to reduce the amount financed (“Amicus Brief,” 2010; Virginia Historic Tax Credit Fund 2001 LLC et al. v. Commissioner of Internal Revenue, December 21, 2009). This has a direct negative impact on the ability to secure financing for the projects (“Amicus Brief,” 2010; V.D.H.R. 2011) and increases the overall cost of borrowing.

5. The ruling undermines the Virginia Historic Tax Credit program. More broadly, the Fourth Circuit Court ruling could have a dramatic impact on the viability of the entire state historic tax credit program, and therefore objections to the ruling include arguments in favor of the initial development and continued support of the state tax credit program. The economic impact of the tax credit program in Virginia has been documented in the 2007 Virginia Commonwealth University (VCU) study (Pratt & Kinsley, 2007) and its 2010 update (Kinsley, 2011). During its first 13 years in existence the Virginia Historic Rehabilitation Tax Credit program awarded \$599.4 million of tax credits for 1,747 rehabilitation projects with rehabilitation expenditures of \$2,424.1 million. These values change to \$653.0 million of tax

credits and \$2,646.6 million in rehabilitation expenditures when calculated in 2009 dollar terms. Based on the model developed by VCU, the economic impact of the program on the region was a total of 12,887 of jobs, labor income of \$532 millions, economic value added of \$771 million, and \$55 million of state tax revenues. Additionally, the program supports the preservation of the state's historic buildings and identity, and the revitalization and repopulation of depressed urban neighborhoods, with the associated societal benefits on distressed communities. With its focus on renovation and restoration, the program promotes "green" alternatives in construction ("Amicus Brief," 2010).

The Fourth Circuit Court ruling does not provide guidance and in general is unclear about what transactions and partnership structures will be treated as nontaxable credit allocations or must be treated as a disguised sale. However, based on what transpired from the case, certain actions could mitigate the risk of unfavorable scrutiny by the I.R.S. For example, as outlined in Belkowitz et al. (2011), with regards to investors:

- They should be engaged early on in the project to demonstrate partner entrepreneurial risk and as a partnership investment to avoid characterization of sale of tax credits;
- They should be given a larger portion of ownership in the partnership (1% or greater) and an additional stake in the profits and loss of the partnership;
- They should hold partnership interest for a significant period of time. However, Rascoe, Garcia, and Marshall (2011) note that extending the time during which the investor remains in the partnership likely will not remedy the results reached by the Fourth District Court); and
- There should be features in the partnership structure that make investors take on construction and operational risk.

Analysis. Obviously those who developed, implemented, financed, applied, and advocated for the Virginia Historic Tax Credit program strongly oppose the position held by the Fourth District Court and the Commissioner of Internal Revenue. Interest groups are rallying public support for the program through published statements and briefs, media interviews and articles, and strongly advocate the economic, jobs, community, and cultural benefits of the program. The National Trust for Historic Preservation, a privately-funded nonprofit organization, in a statement issued in response to the Fourth Circuit Court ruling, expresses its concern regarding the reduced value of the state historic tax credits and the financial blow to current and future projects that "...transform communities, catalyze additional development and save vital pieces of our country's fabric" (Brown, as cited in National Trust for Historic Preservation, 2011). Other groups such as Preservation Virginia, the National Conference of State Historic Preservation Officers, and the Historic Richmond Foundation join the National Trust for Historic Preservation in expressing concern regarding the Fourth Circuit Court's decision and the chilling effect on rehabilitation projects (Preservation Virginia, 2011; "Virginia Officials," 2011); however, it is not yet clear how the individual groups will mobilize and if and how they will be able to remedy the outcome of the court ruling. In the meanwhile, Kathleen Kilpatrick, Executive Director of the Virginia Department of Historic Resources, has asked the Virginia Attorney General to do whatever he can to educate the Fourth District Court regarding the damaging impact of the court's decision on the program (CVDHR, n.d.d).

Major Interview Sources

Table 10 summarizes the major themes and major interview sources of the study.

Table 10

Major Themes and Major Interview Sources

Broad Topic	Major Interview Sources
4th Circuit Court ruling	Agency administrator
School financing costs	School administrators
Communication and coordination challenges	Members of agency staff
Ongoing administration of partnership structure	Representative for renovation project of case study school
Rehabilitation work and standards of rehabilitation	School administrators
Competency of parties involved	Agency administrator
Cost premium and cost overrun	Representative for renovation project of case study school
	Members of agency staff
	Representative for renovation project of case study school
	Representative for renovation project of case study school

CHAPTER 5. CONCLUSION AND RECOMMENDATIONS

This study addresses the problem of financing historic school rehabilitations in Virginia. It evaluates the syndication of historic tax credits as an alternative source of funds for partially financing construction costs, analyzes costs and benefits, and identifies administrative implications and public policy issues. The study utilizes a pragmatic case study approach using the case of two schools in the Richmond, Virginia area, which utilized historic tax credits, and a second case study of four schools in the same Metropolitan Statistical Area of Richmond that used traditional financing. This research adds to the field of modern education finance as it focuses on innovative financing with investment of private capital in a public private partnership.

Findings are that the historic rehabilitation programs provide tax incentive of up to 20% for the federal program and 25% for the Virginia tax credit program, for a combined tax incentive of up to 45% of the rehabilitation expenditures. After discounting and other syndication costs, the proceeds from the federal tax credits can range from \$.80 to \$.90 for each \$1, and proceeds from the Virginia tax credits can range \$.65 to \$.70 for each \$1. The research, however, found that costs associated with historic rehabilitations can partially erode the tax incentives. Construction costs for historic rehabilitations following the Secretary's of Interior Standards of Rehabilitations (National Park Service, n/d) are in many cases, especially when they require extensive work to the exterior of the building, more expensive than renovations without regards to the standards. The construction premium is generally hard to quantify or

estimate, but it is believed to be around 9% of the hard construction costs. The study also found that consulting, legal, and other professional costs associated with the structuring of the partnerships and compliance with the federal and state regulations, can erode the benefits further. These overhead costs can become relatively burdensome, particularly to smaller projects. More research is needed to design a method of analysis for schools to determine the optimal size of a project in order to carry the overhead costs and realize the financial benefits of the tax credits.

This study found that no general obligation bonds were issued in connection with the historic rehabilitation of the two Governor's Schools, and that historic rehabilitation of schools can mobilize parents and community leaders and generate charitable contributions to the project. The four schools in the second case study obtained traditional financing through the issuance of general obligation bonds, and the related interest cost would have impacted the financial policies and financial (strength) metrics of the local governments.

Historic tax credits programs enable infusion of private capital in the economy, provide stimulus for economic growth, and create jobs at no net cost to taxpayers. An economic impact analysis shows that the rehabilitation of the six schools in the case studies provided a significant contribution of capital, income, and jobs to the area. A national study of the federal tax credits shows that the program is largely self-sustaining, and provides economic benefits in excess of the cost of tax revenues. The economic impact of the Virginia historic rehabilitation tax credit program was estimated to be \$1.9 billion for the period 1997-2009, and is credited for generating 12,887 jobs during the same period. To fully understand the fiscal impact, however, additional research is needed to analyze how the costs and benefits of the programs unfold over time (i.e., the timing of when the tax revenues from the increased economic activity are generated and the timing of when the tax revenues are reduced because of the tax credits).

This study's analysis of the requirements of the law found that both federal and state laws require buildings to be certified as being of historic significance, owned by a taxpayer, and income producing. Conveying ownership to a limited partnership and renting the building to a tenant largely meets the requirements of the tax laws. However, a limitation in the federal law precludes historic rehabilitations of government buildings to continue the prior use of the property (i.e., there must be a change in use of the property following the rehabilitation). The two schools in the case study had a change in use from public schools to governor's schools for the gifted and were able to secure the tax credits. Additionally, the Virginia statute precludes the project from being directly or indirectly financed with debt of the Commonwealth of Virginia.

This study found that the limitations imposed by rehabilitation standards for historic buildings result in some administrative issues, such as obtaining and maintaining the building as a Certified Historic Structure, meeting the historic rehabilitation design requirements during the renovation, coordinating and collaborating with a larger number of parties involved in the project, and the potential erosion of the tax credits benefits. With many moving parts, and many parties involved in the project, coordination and communication flow, and the involvement early on of competent and experienced professionals are very important to the success of the project. Typically, the process of certification runs more efficiently when there is one individual (typically the historic preservation consultant) who becomes the contact person for the project and takes on the role of coordinator.

Additional administrative issues result from the complexity of the partnership and financing structure, and generally the nature of the private-public partnership in school rehabilitations. Transfer of ownership of the school property to a private entity remains an important factor when considering historic tax credit funding for schools, and ultimately the

communities must rationalize the benefits in the context of the risks and rewards presented to them, and be on board with the project. The development of the partnership structure and the complexities of the transaction require the services of highly skilled and experienced attorneys, CPAs, bankers, syndicators. In order to avoid the recapture of the tax credits, the ownership structure developed to qualify for the historic tax credits must be kept in place for 5 years. An ongoing administrative process must be planned for and put in place.

The study presents the following conclusions.

- I. This study concludes that providing tax incentives for private investments in the rehabilitation of historic school buildings appears to be a favorable policy at multiple levels. The federal and state programs can effectively preserve the historic capital of schools, provide an improved and more effective education environment, and positively impact the social welfare of mainly disadvantaged communities.
- II. It has become clear that limitations imposed by the current tax laws impact the costs, benefits, administrative issues, and ultimately the use of historic tax credits for school construction. Additionally, regulatory limitations of the federal tax credit program prevent schools from utilizing the building following the rehabilitation, and a recent court ruling on the (federal) taxability of the Virginia tax credits has put the entire Virginia historic tax credit in jeopardy. The current policies, and more so the federal policy, miss the opportunity to expand very successful, self-sustaining, historic rehabilitation incentive programs to historic school buildings.

- III. The tax credits programs are of greatest public value to poor communities with little access to traditional financing, such as inner city or rural communities. With private capital investing in the rehabilitation of historic schools, which are traditionally architectural and social anchors of communities, much needed economic stimulus could be brought into decaying neighborhoods.
- IV. The two governor's schools in this study provide a model for execution, but the private – public nature of the transaction makes the accessibility of information less open and it requires the engagement of highly specialized professionals. If changes to the current rules of the law were to make the execution more accessible and easier for public schools, then a standard process for execution could be developed, transaction costs could decline, and more schools could participate in the program.
- V. The introduction of new legislature to lift the change of use limitation in the federal law is accompanied by greater awareness of the socioeconomic benefits provided by the program, a feasible policy solution, and a favorable political environment. These elements, when analyzed in the context of J. Kingdon's model of policy making, provide a window of opportunity for policy action.
- VI. A court ruling has effectively determined the taxability of the Virginia historic tax credits, allowing a large portion of the tax credits to become federal tax liabilities, leaving less capital for rehabilitation construction, reducing the ability to source financing for the project, shrinking the financial incentives of the tax credits, and ultimately undermining the economic viability of the Virginia historic tax credit program.

VII. These programs also reduce the need for local governments to issue long-term debt, they enable infusions of private capital in the economy, provide a stimulus for economic growth and job creation, and they do so at no net cost to the taxpayers.

The Maggie L. Walker Governor's School in Richmond and the Appomattox Regional Governor's School, acclaimed across the region and the country for their excellent performance in education and the historic preservation of their buildings, serve as models for successful historic school rehabilitations. Policy solutions to increase the accessibility of the federal program to schools and to protect the continued effectiveness of the Virginia program have been introduced and based on this study have and deserve public and political consideration.

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[US/Historic_Tax_Credit.pdf](http://www.wileywilson.com/SynapseWeb45/images/cmi/en-US/Historic_Tax_Credit.pdf)

APPENDIX A

Expected Number/Source of Interviews and the Questions Proposed to Address

Research Question 4

Question 4: What are the administrative implications resulting from the use of Historical Tax Credits financing for school construction in Virginia?

Anticipated interview questions:

1. What are the administrative implications of using historical tax credit?
2. Specific items emerging from research (i.e. what was the impact of a school having taxable real estate property)

Anticipated list of interviewees:

1. Current or former Principal of Maggie L. Walker School for Government and International Studies
2. Current or former Principal of Appomattox Regional Governor's School for the Arts and Technology
3. School Administrators
4. Virginia Department of Historic Resources staff members
5. Individuals involved in the school rehabilitation projects

Preliminary list of public records to be reviewed:

1. Minutes of city councils meetings for cities of Richmond and Petersburg
2. News releases
3. Application forms for Historic Tax Credits (federal and state)

APPENDIX B

Expected Number/Source of Interviews and the Questions Proposed to Address

Research Question 5

Question 5: What are the public policy issues arising from the use of Historic Tax Credits for school construction in Virginia?

Anticipated interview questions:

1. What are the public policy issues of using historic tax credit?
2. What were the issues considered, discussed, or that should have been discussed during the renovation of school?
3. Specific items emerging from research:
 - a. What consideration was given to the implication of ownership vs. lease of school property?
 - b. What consideration was given to the implication of which entity owned the funds from the syndication of the historic tax credits? School district or local government?
 - c. Were the school construction plans expanded due to additional funds available from the historic tax credits?

Anticipated list of interviewees:

1. Current or former Principal of Maggie L. Walker School for Government and International Studies
2. Current or former Principal of Appomattox Regional Governor's School for the Arts and Technology

3. School administrators
4. Director of the Virginia Department of Historic Resources
5. Individuals involved in the rehabilitation projects

Preliminary list of public records to be reviewed:

1. Pending legislature.
2. Public hearings related to approval and implementation of historical tax credits.
3. Relevant court decisions.

APPENDIX C

School Renovation Financing – County of Henrico, Virginia

County of Henrico Relevant Financial Information (2010)

Total County of Henrico Debt Service	55,280,550
Total County of Henrico General Obligation Debt	420,720,000
Total County of Henrico General Fund Expenditures	780,768,369
Total Assessed Value	36,065,011,000
Total Population	313,989

County of Henrico Financial Guidelines:

Debt Service as a % of General Fund Exp: 7.75%;	2010 Compliance 7.08%
Debt Service as a % of Assessed Value: 1.49%;	0.15%
General Obligation Bonded Debt per Capita: \$1,650	1,340

School renovations - financial information:

	Douglas Freeman HS	Highland Springs HS	Freeman & Highland Springs
Renovation Construction Costs	23,759,052	23,600,528	47,359,580
County of Henrico 2000 Bond Referendum			
8/17/2005 20 years 3.25-5.00	23,800,000		23,800,000
11/15/2006 20 years 4.00-5.00		23,600,000	<u>23,600,000</u>
			47,400,000
Debt service (year) @ estimated coupon rate	1,076,950	1,020,733	2,097,683
% of Total County of Henrico Debt Service	1.9%	1.8%	3.8%
% of Total County of Henrico General Obligation Debt	5.7%	5.6%	11.3%
Debt Service as a % of General Fund Expenditures	0.1%	0.1%	0.3%
Debt Service as a % of Assessed Value	0.0%	0.0%	0.01%
General Obligation Bonded Debt per Capita	76	75	151

APPENDIX D

School Renovation Financing – County of Chesterfield, Virginia

County of Chesterfield Relevant Financial Information (2010)

Total County of Chesterfield Debt Service	68,002,861	68,002,861	68,002,861
Total County of Chesterfield General Obligation Debt	454,770,000	454,770,000	454,770,000
Total County of Chesterfield Debt	643,545,727	643,545,727	643,545,727
Total County of Chesterfield General Fund Expenditures	743,892,952	743,892,952	743,892,952
Total Assessed Value	36,382,042,086	36,382,042,086	36,382,042,086
Total Population	316,000	316,000	316,000

Debt Service as a % of Assessed Value	0.19%
General Obligation Bonded Debt per Capita	1,439

County of Chesterfield Financial Guidelines:

2010 Compliance

Debt Service as a % of General Fund Exp: 10%	9.14%
Debt as a % of Assessed Value: 3.5%;	1.77%

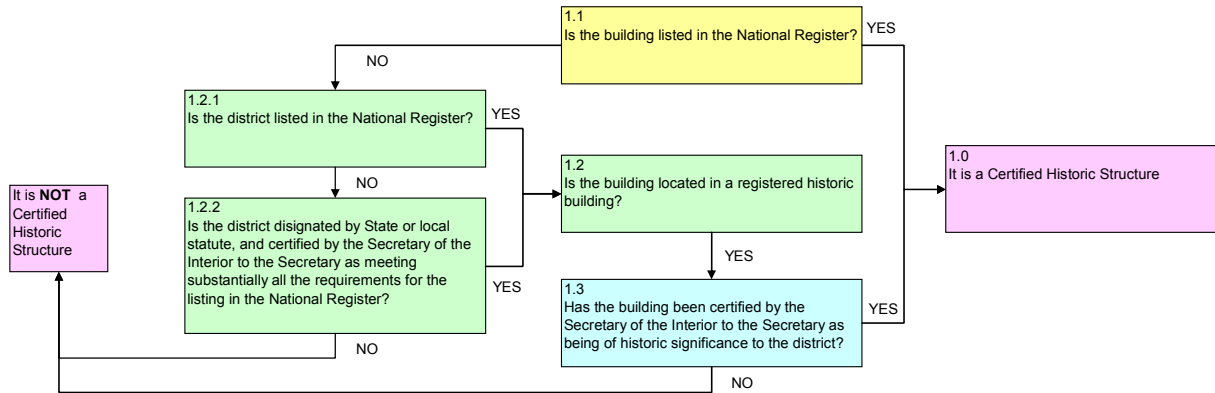
School renovations - financial information:

	Thomas Dale HS	Meadowbrook HS	Thomas Dale & Meadowbrook
Renovation Construction Costs	32,075,882	37,415,741	69,491,623
Internal funds available/reserved	3,913,599	8,546,346	12,459,945
County of Chesterfield 1996 Bond Referendum			
	28,162,284		28,162,284
		28,869,395	<u>28,869,395</u>
			57,031,679
Debt service (year) @ (est) 5% avg coupon rate	1,408,114	1,443,470	2,851,584
% of Total County of Chesterfield Debt Service	2.1%	2.1%	4.19%
% of Total County of Chesterfield General Obligation De	6.2%	6.3%	12.54%
Debt Service as a % of General Fund Expenditures	0.2%	0.2%	0.38%
Debt as a % of Assessed Value	0.1%	0.1%	0.16%
Debt Service as a % of Assessed Value	0.004%	0.004%	0.01%
General Obligation Bonded Debt per Capita	89	91	180

APPENDIX E

Decision Tree Of The Requirements For Certified Historic Structure

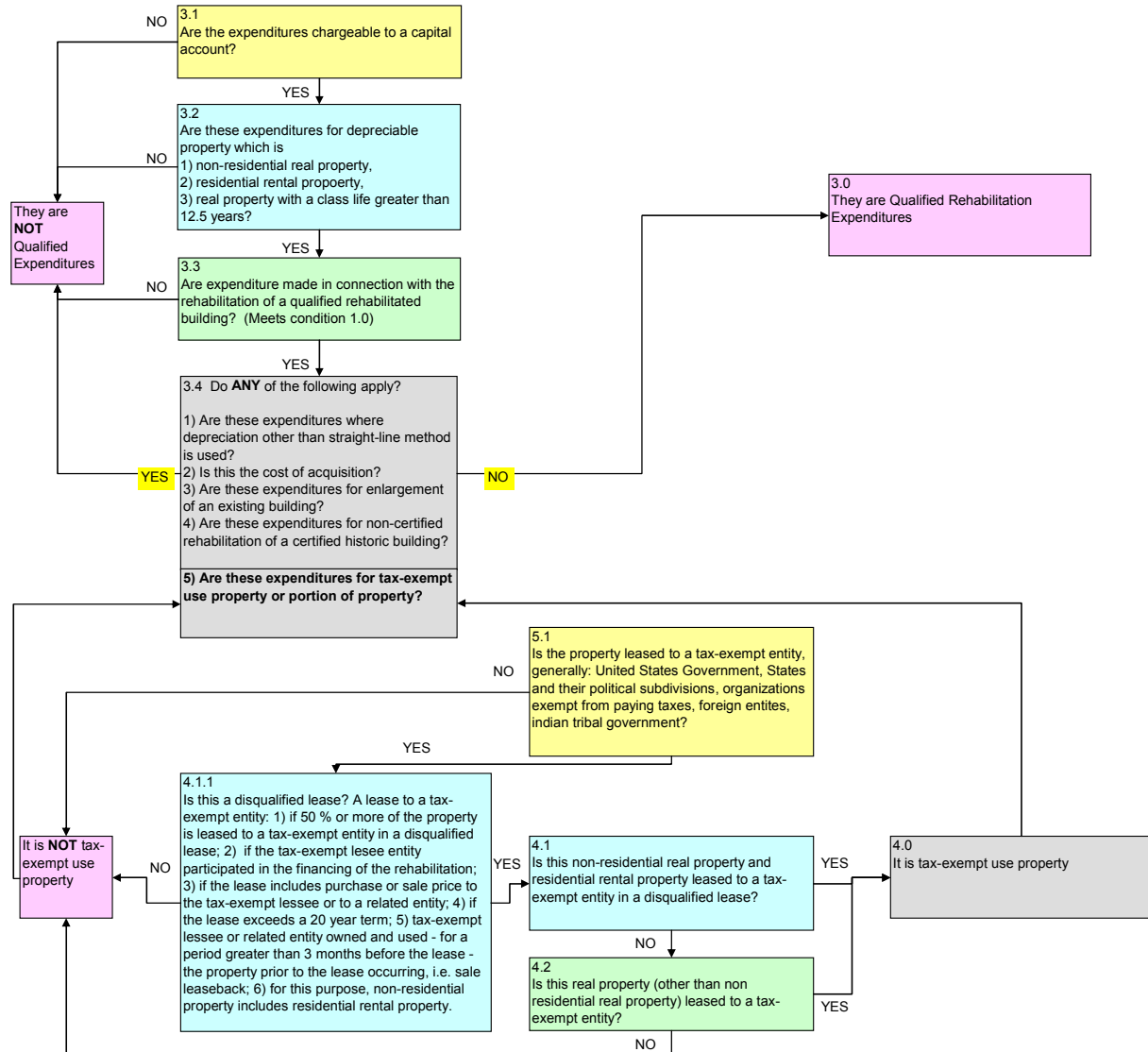
Certified Historic Structure



APPENDIX F

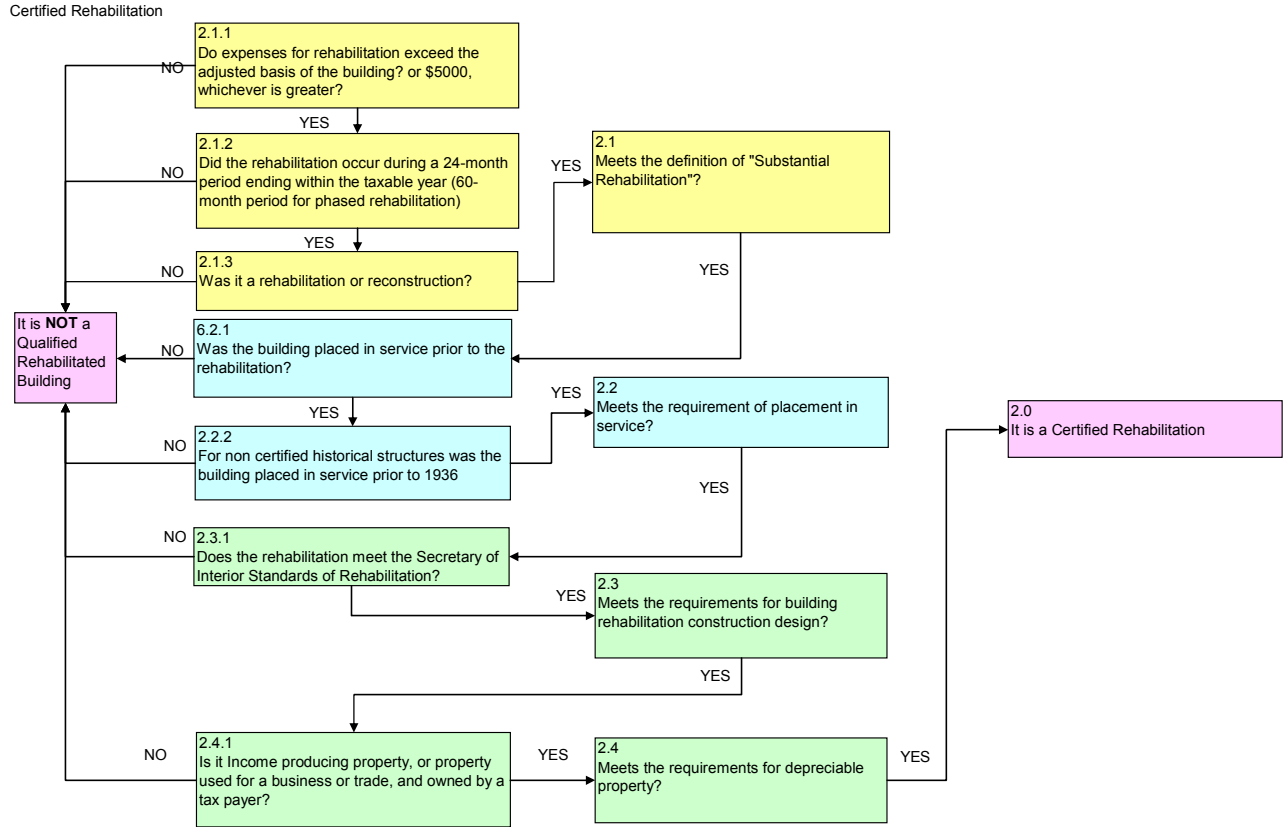
Decision Tree of the Requirements for Qualified Rehabilitation Expenditures

Qualified Rehabilitation Expenditures



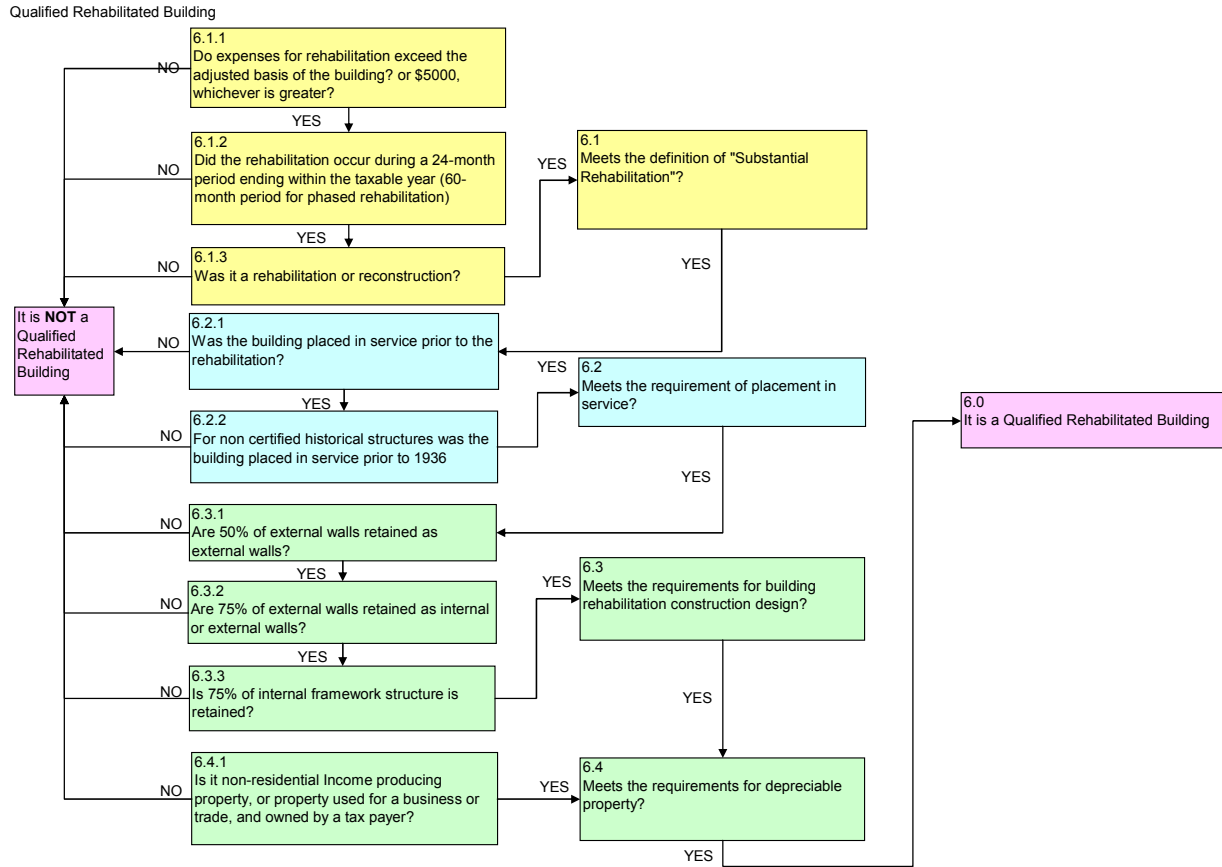
APPENDIX G

Decision Tree of the Requirements for Certified Rehabilitation



APPENDIX H

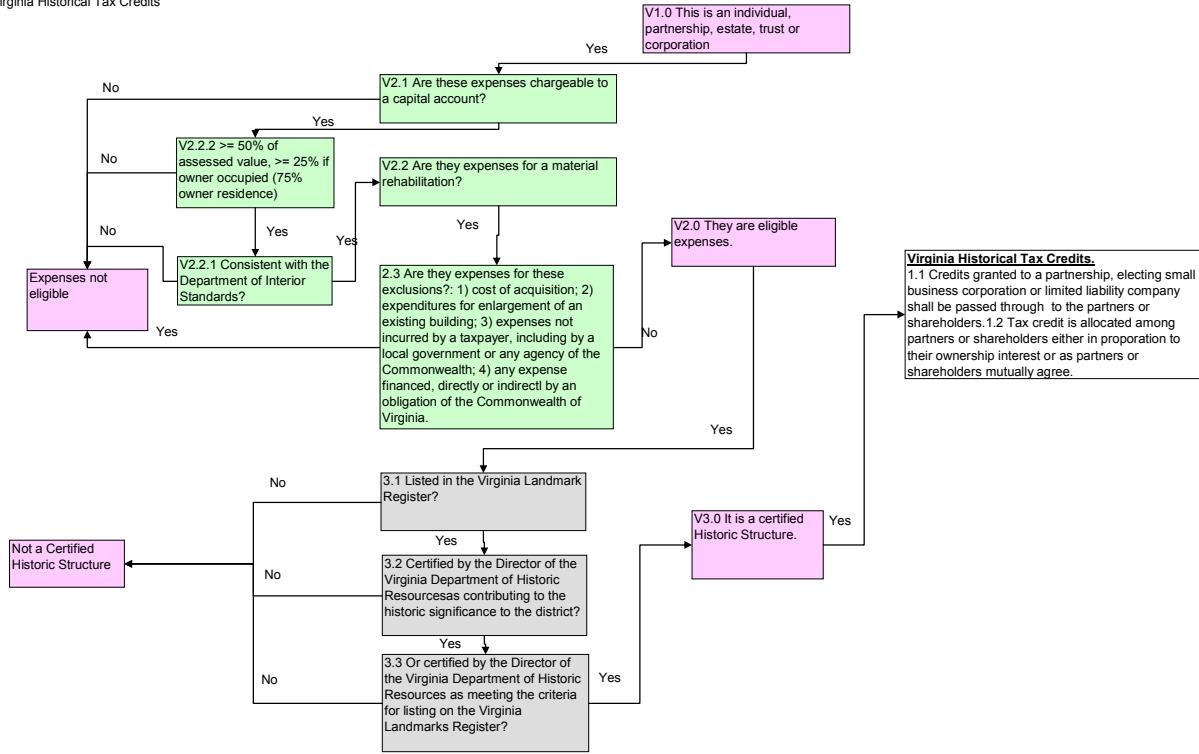
Decision Tree of the Requirements for Qualified Rehabilitated Building



APPENDIX I

Decision Tree of the Requirements for the Virginia Historic Tax Credits

Virginia Historical Tax Credits



VITA
PAOLA BROOKS

Paola Brooks has a PhD in Public Policy and Administration from Virginia Commonwealth University in Richmond, Virginia, a Master in Business Administration from the University of Richmond, in Richmond, Virginia, and a Bachelor of Business Administration in Accounting from Columbus State University in Columbus, Georgia. Paola Brooks has extensive professional experience in finance and administration in the corporate and public sectors. Paola Brooks also has broad teaching experience in finance and public policy and administration both at the undergraduate and graduate levels.

Her dissertation topic is: “Use of historic tax credits for school construction financing in Virginia: costs, benefits, administrative implications, and public policy issues” (2011). Paola Brooks’ research interests are in public and corporate finance, risk management, insurance, policy development, policy analysis. Specific areas of focus are financial management at the local, state, and federal levels, strength and sustainability in public financial management, public private partnerships; corporate finance, market liquidity, asset liability management; insurance and financial systems regulatory and political environment.

Paola Brooks resides in Glen Allen, Virginia.