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Critical Issues: Using a Revolving Fund for Downtown Preservation

Preservation Leadership Forum

A revolving fund can be a powerful financing mechanism for the preservation of individually significant downtown structures or for stimulating private investment in a downtown historic district.

What is a revolving fund? A revolving fund is a pool of monies used by a nonprofit organization or a governmental agency to buy and sell or to lend to others to buy historic properties in order to preserve them. The properties may be rehabilitated with revolving fund monies. Proceeds from sales or loan repayments and from donations replenish the revolving fund pool.

REVOLVING FUND TECHNIQUES

The goals of the preservation community and the financial resources at its disposal will determine which of the several revolving fund techniques to use. When working to save historic properties, a revolving fund may acquire properties outright and resell them under protective covenants. It can vary that procedure by obtaining a lease or an option on the property. The revolving fund may have to move a property to save it. Once the revolving fund owns a property, it has the choice of rehabilitating the property, stabilizing it against the weather, or doing no work on the property. These variations are discussed here in more detail.

PURCHASING IN FEE SIMPLE

Buying a historic property outright (or, as it is called technically, "in fee simple" or "in fee") is the best way to preserve it. Ownership gives the revolving fund control of the property, eliminating any threat from an unsympathetic owner. Where a property is widely known and prized in the city, a fund-raising campaign for its purchase and preservation can generate substantial contributions.

However, there are disadvantages to outright purchase by a revolving fund. Once the property is in the revolving fund`s ownership, the fund is responsible for any taxes, insurance and maintenance of the property. An outright purchase ties up the revolving fund`s capital, thereby reducing operating flexibility. While holding the property, the revolving fund may have to forego other preservation opportunities for lack of capital. Many revolving funds have seen their activity grind to a halt because of one "white elephant" which takes years to sell. Once a property is purchased, there is no backing out or renegotiating its purchase price. A purchase poses a risk to the revolving fund. If the property`s purchase price was too high or if the property is hard to sell, the fund may have to take a financial loss to dispose of it.

ACQUIRING AN OPTION

When the revolving fund is working with cooperative owner, obtaining an option may be preferable to purchasing the property in fee simple. An option gives the revolving fund an exclusive right to purchase the property during a specified period of time at an established price. During the option period, the revolving fund can purchase the property at any time after giving the owner appropriate notice. In addition, the owner cannot sell the property to anyone else during that period. The consideration given for the option is typically applied to the purchase price.

The option gives the revolving fund an opportunity to seek a sympathetic purchaser for the property prior to the fund`s acquisition of it. Indeed, if the revolving fund can find a buyer during the option period, it can purchase the property literally minutes before selling it. The check from the ultimate purchaser can be used to cover the revolving fund`s purchase, if the transaction is carefully structured.

Options tie up less of the revolving fund`s resources. Even if the revolving fund pays as much as 10 percent of the purchase price for an option, it will be able to spread its resources wider and work with more properties than if it bought the property outright. During the option period, the revolving fund is not responsible for property taxes, insurance, utilities or other carrying costs, unless otherwise agreed. By obtaining an option rather than purchasing the property in fee, the revolving fund can renegotiate the price with the owner if the fund finds that its option price is too high. It can also walk away from the property if it finds that it can`t sell it.

An option gives the revolving fund time to raise funds in advance to purchase the property. It is much easier for a charity to raise money to pay for something it is going to buy than to raise money for something it has already bought. There are, however, problems with options. An owner who is eager to sell may not be willing to consider granting an option.

If the owner is not considered to be trustworthy by the revolving fund, then outright purchase may be the preferable alternative. During the option period, the property remains under the owner`s control. The owner may try to alter the property, damaging its architectural integrity, or he may refuse to sell under the option. The revolving fund would then have to go to court to enforce its option rights. Although the revolving fund would likely prevail and force a sale, the legal headaches and risk of harm to the property in the interim must be considered.

When a revolving fund regularly uses options, it is important that the staff and the board retain a sense of urgency about finding a buyer during the option period. If the fund does not actively seek buyers for the property during the option period, it will lose credibility with the owner and the community, and it may have to exercise its option in order to continue working with the property.

The fund should obtain liability insurance on any optioned property in order to protect itself in case a potential purchaser is injured on the premises.

USING CONTRACTS TO PURCHASE

The revolving fund may use a contract to purchase in circumstances where an owner will not grant an option but the revolving fund needs to buy time before it purchases the property. A contract to purchase obligates the fund to purchase the property, but provides some time prior to closing the transaction.

During that time the revolving fund can search for a buyer. If the revolving fund succeeds, it can sell the property on the same day it purchases it. If the revolving fund does not succeed in finding a buyer, it must purchase the property anyway or forfeit its earnest money deposit. The deposit should be deemed liquidated damages in the contract to avoid a lawsuit as a result of the fund`s default under the contract. Otherwise, the seller might take legal action to force the purchase by the revolving fund.

RELOCATING HISTORIC STRUCTURES

Relocating historic buildings is a preservation alternative of last resort. It should not be done for the convenience of the owner, but only when there are no feasible alternatives to relocation.

Relocation may cause a building to lose its listing in the National Register of Historic Places unless detailed certifications are completed. And yet, if a revolving fund`s goal is to save imminently endangered properties, the fund inevitably must consider moving structures.

Relocating a historic structure requires a significant commitment of time and funds. Usually, the fund must purchase a lot, move the structure, and place it on a new foundation, each of which requires up-front money. The fund then owns the property outright, and the previously mentioned disadvantages of purchase in fee simple will be fully applicable.

Additionally, moving a structure is phenomenally time-consuming. Many details must be attended to. Permits and special insurance must be obtained. Utility lines and other obstructions such as parking meters . must be moved. The height and weight of the structure must be considered when choosing a path. For example, the Historic Preservation Foundation of North Carolina had to repave a portion of a parking lot which sank under the weight of a house being moved.

In spite of the many problems inherent in relocating a historic structure, a move may be worth the trouble. Moving a building to save it from destruction is a bold preservation step. The relocation of a significant landmark can provide tremendous publicity for the revolving fund and give it widespread recognition and credibility. It can provide a boost for fundraising efforts and membership development.

When the revolving fund is relocating a structure, it should maximize publicity, while at the same time emphasizing that moving structures is not good preservation policy. The move should be viewed as a preservation event and an educational opportunity.

The revolving fund should not pay the owner of the structure for it, unless it is absolutely necessary to save the structure. The owner typically will profit more by donating the structure to the revolving fund and taking a charitable deduction for the gift than he will by selling the structure for relocation. Generally, the only markets for such a sale are preservation groups and salvagers. In fact, if the owner is a tax-paying entity dependent on good public relations, the revolving fund should ask the owner to contribute at least the estimated cost of demolition toward the move. The revolving fund does the owner a service by taking a public relations burden off his shoulders or by relieving him of the expenses of demolition.

If the costs involved in relocation are less than the fair market value of the structure on its new site then the revolving fund may make some money upon selling the structure. To reduce its costs, the revolving fund should solicit donations to assist with the move. These donations may include cash, a new site or services such as the removal of trees or utility lines in the path of the move.

On occasion, the revolving fund may find a buyer for the structure before the move. In that case the buyer can arrange for the move. The revolving fund should have the structure deeded to it and then obtain a preservation easement on the new site prior to transferring ownership to the purchaser. Retaining control over the structure until the easement is obtained will protect the revolving fund in case the buyer changes his mind about the project before it is completed.

Although a technique of last resort, moving a building to a new location may fill a vacant lot in a historic district or eliminate an obtrusion.

THE REVOLVING FUND AS LESSEE

Occasionally the revolving fund may be faced with an owner who will neither sell the property nor fix it up. Perhaps the owner has sentimental attachments to the structure, or is elderly and wishes to leave decisions about property disposal to his children. In such instances the revolving fund may seek to enter into a lease with the owner in order to preserve the structure until its ownership changes.

Additionally, a revolving fund may obtain a long-term lease on a governmental building. If the property has been unused, the government may lease the building at a minimal rate on the condition that the revolving fund rehabilitate and maintain it. In the long run, the government gets its building back in better condition without expending tax dollars.

A lease is not a permanent preservation solution. It simply buys time until a more complete solution can be found, and it can give the preservation organization control over what happens to the structure during the lease period.

If the preservation organization does not have a need for the leased space, it can sublet the space to other users or it can assign the lease to a sympathetic party. If a lease or sublease exceeds the rehabilitation period plus the depreciation period, a lessee can take an investment tax credit for his rehabilitation expenditures on the structure. Such an arrangement may be very appealing to a developer since he would have low front-end costs and would be able to apply the tax credit to most of his investment in the property.

THE REVOLVING FUND AS LESSOR

The revolving fund may lease buildings which it owns outright to third parties rather than sell them.

This arrangement may be desirable if a building is of such great significance that the organization seeks to retain ownership to guarantee preservation, or if the previous owner has donated the building and wishes the organization to retain ownership of it. If the local real estate market is weak yet shows signs of improvement in the future, the revolving fund may be used to lease the building until the market recovers and it can realize a better price.

Generally, a revolving fund will prefer to sell a property to a third party rather than lease it. A sale will provide the funds to do other projects. If, however, the revolving fund has sufficient resources to operate otherwise, a lease can provide income to the fund. At the same time, the building will be put into use and will be protected.

REHABILITATING REVOLVING FUND PROPERTIES

If the revolving fund has acquired a property in fee, then the decision must be made whether to do any rehabilitation work on the property prior to resale. Rehabilitating a property owned by the revolving fund will be tempting. Frequently the property is in poor condition and looks pathetic. The first inclination is to give it a fresh coat of paint. But rehabilitation must be approached with caution.

Rehabilitation by the revolving fund adds considerably to its financial and time commitment to the property. Staff must develop specifications and obtain multiple bids; it must oversee the work. The revolving fund`s capital is available for fewer properties if rehabilitation is done by the revolving fund.

In addition to the added expense to the revolving fund, other reasons not to rehabilitate properties owned by the fund exist. The revolving fund may find it more difficult to recoup its costs in a property if rehabilitation is done. The potential buyer may have ways to do rehabilitation at less expense. For example, the buyer may do the work himself. Perhaps the buyer has special needs which will require him to redo some of the work done by the revolving fund. Rehabilitation may ward off buyers by making the property too expensive for the buyer who would have done the work himself over a period of time. Similarly, rehabilitation for one use might jeopardize a sale to a potential buyer who had another use in mind.

Rehabilitation by the revolving fund also complicates a sale if the purchaser wishes to take advantage of the rehabilitation tax credit. The tax credit applies only to rehabilitation work, not to acquisition costs. The lowest possible purchase price is desirable in order to maximize the rehabilitation tax credit. Even though ways exist for the buyer to take the credit on work done by the fund, the process is more complicated than if the buyer did all of the rehabilitation.

Rehabilitation cannot be done on properties under option or under a sales contract to the revolving fund.

Of course, there may be times when at least partial rehabilitation of a property is desirable prior to resale. If the property has been damaged by the elements or by vandals, the revolving fund must secure or stabilize the property. Bad public relations can result from a preservation organization`s allowing a historic property which it owns to deteriorate.

Cosmetic rehabilitation may be desirable if a sense of preservation momentum must be maintained. For example, if the fund purchased a downtown commercial structure and had no immediate prospects for resale, it might clean up the front of the building in order to enhance revitalization efforts. Poor public relations would result indeed if a preservation group has the worst eyesore downtown.

In some cases, the fund may need to clean up a property or its grounds, or to remove safety hazards in order to show it to potential purchasers. Sometimes the property will look so bad that some rehabilitation work will be needed to make it sellable.

When a property is especially important to the community or when it is in deplorable condition, the revolving fund may develop a fund-raising effort to provide funds for rehabilitation. Donors should be fully apprised that the fund is planning to sell the property and that their donations will be used only to get the property in good enough condition to sell it. At times the revolving fund will not be able to recoup the funds which it has raised and invested in the property. But if those funds have made an unmarketable property sellable, then they have done their job.

In summary, a revolving fund can purchase historic properties and resell them with protective covenants, acquire properties by gift and sell them after rehabilitation or lend money to other preservation groups or individuals for property purchase or rehabilitation. Flexibility is one of the attributes of this important preservation financing tool. In considering what kind of revolving fund to establish, an organization or public entity must examine what it wishes to accomplish in setting up a revolving fund and what resources may already be available.

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