

HISTORICAL PRESERVATION DISTRICTS AND LOCAL POLITICAL ORGANIZATIONS EFFECTS ON REAL PROPERTY VALUES

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Abstract

This article describes in detail the significance of having real estate or entire districts designated as historically significant. The economic, political and social effects of such a designation is examined. The function of a local historic preservation commission is addressed as well as the role of a local political group such as a city council. It is shown that such a local historic preservation commission augments the benefits of a historical designation by eliminating and/or informational asymmetries. A simple supply/demand economic model is developed indicating the valuation changes arising from the benefits of the historical designation. Changes in social valuation are also addressed. Hedonic regression models along with “difference in difference” regression models are explicated. Empirical results from these models are briefly surveyed.

Keywords: Hedonic Regression, Asymmetric Information, Preservation District

Introduction:

The main purposes of this paper is to establish the significant benefits of developing a dynamic and governmentally supported local historical preservation district commission and to explain the role that a governmental body plays in supporting this commission. The main role of the district commission is to ensure the historical preservation of the local district in question. This paper will also illustrate the various types of benefits that not only accrue to the historical preservation district itself, but also to the neighboring commercial and residential communities. Most of these benefits exist even in local preservation districts that do not have any local regulations regarding land use in place, but are much more prominent where local ordinances and regulations are utilized. A modest economic model will be developed to help demonstrate some of these direct and indirect benefits.

More formalized models including hedonic regression models will also be described. Past empirical outcomes from models using these approaches will be conveyed. The presence of such a local historical preservation district also contributes in a very positive manner to the expanding public emphasis on sustainability. The critical role played by the local preservation commission in supplying valuable information to the real estate market will also be explored. The role of mayors, city managers, council members, and other local politicians will be examined here as well.

I.:

ECONOMIC AND POLITICAL IMPORTANCE OF HISTORICAL DESIGNATION

The foremost reason for having an area within a municipality or town designated as being historically significant is to provide a means of protecting the area from physical and economic deterioration. The National Historic Preservation Act of 1966 gives the U.S. Secretary of the Interior the authority to designate a building or district as being historically significant. Upon receiving this designation the building or district is given official recognition by being placed on the National Register of Historic Places which is normally referred to as the National Register. Although this national honor offers selected protection for the sites listed in the register it does not guarantee the future conservation of such sites. Physical and economic deterioration of the buildings in question might still occur. This is where the local preservation commissions perform such a vital role. These commissions are truly the front line enforcers of maintaining and preserving the substance and economic value creating nature of the historic sites and neighborhoods. Local preservation districts have the largest influence when the following two conditions exist: clearly written and well publicized guidelines for all affected properties and vigorous educational outreach to the real estate community including brokers, bankers, architects and especially owners. Both of these conditions are predicated by the existence of a fully staffed local preservation historical committee which makes consistent and predictable decisions. The importance of a supportive local government cannot be emphasized enough. The cooperation of mayors and city councils are needed to ensure that the actions of the historical commissions are carried out.

IMPACT OF HISTORICAL DESIGNATION ON DEMAND

Although the foremost reason for historical designation relates to preventing the deterioration of buildings and thus maintaining their value a secondary effect can also be established. This relates to a positive spillover effect on commercial and especially residential properties within and

surrounding the historical district. A simple supply and demand model can be used to display the increase in property values. We will assume that the demand for properties is a negative function of price and a positive function of both household income and an active local historical preservation district commission. Graphically this means that when the desired quantity demand (horizontal axis) for properties is plotted against the property values (vertical axis) the demand curve will have a downward (negative) slope. Increases in household income would cause the demand curve to increase (shift to the right). In other words we are assuming that real properties are a normal good which seems like a reasonable assumption to make since normally higher income individuals own higher priced homes. The Preservation Economic Impact model developed at Rutgers University demonstrates that historical preservation results in a greater degree of job creation than new construction thus creating higher household income which in turn enhances the demand for properties. The presence of, and higher activity level of, the local preservation commission would also cause an increase in demand. Positive action by local mayors and city councils would be another reason why the demand would increase. Any increase in demand would cause property values to increase and at times the increases could be quite dramatic.

There are numerous reasons why a direct or positive relationship exists between the presence and activities of the historical commission and the demand for properties. Firstly, the commission plays an important role in seeing that land use ordinances are carried out. The preservation of such properties encourages potential buyers of property that the neighborhood will not be permitted to perish over time. This would also provide incentives for property owners surrounding the district to revitalize their properties. Secondly, the commission serves to reduce informational asymmetries that might exist in real estate markets. Asymmetric information exists when the buyers and sellers have different information sets. Generally a seller would possess a more immense quantity of information about a property than a potential buyer. Real estate brokers do offer warranties that sellers can attach to their properties which can reduce the information differences, but these add to the cost of the property and thus discourage sales. One significant implication of an information asymmetry is that demand is reduced and subsequently real estate values are reduced. Adverse selection might arise where too few of the higher quality properties normally associated within and around a historical district become sold. The historical preservation commission provides further important information about the nature, significance and quality of structures within the district and thereby reduces or eliminates informational asymmetries. This in turn stimulates demand and thus prices for the properties within and surrounding the historical district.

IMPACT OF HISTORICAL DESIGNATION ON SUPPLY

We will assume that the supply of properties for sale are a direct function of real estate prices and an indirect function of the following variables: tax benefits of property ownership, favorable neighborhood effects, stronger sense of community and land use ordinances. As with demand, real estate values are measured on the vertical axis and quantity of properties for sale on the horizontal axis. Since a positive relationship is assumed to exist between these two variables the supply curve would naturally have a positive slope. Increases in tax benefits, neighborhood effects, sense of community, and land use ordinances would all cause the supply to decrease which would be shown as a leftward shift in the supply curve. Any decrease in supply would cause property values to increase.

The vigorous presence and activities of a local historic preservation committee can lead to a national government designation such as a listing in the National Register of Historic Places. Such a designation comes with significant tax benefits such as a federal tax credit for the rehabilitation and maintenance of the designated properties. The recognized presence of these tax benefits would provide an incentive for current property owners to maintain and retain their real estate therefore decreasing the supply of properties for sale on the market. The tax benefits might not be known to the public at large. The local commission can once again play a vital role in disseminating this important information. Local government officials can also play a significant role in providing this information to the general public. A firmer sense of community or attachment to a community would further serve to reduce the supply of property for sale. If property owners have an emotional attachment to the area they of course will be reluctant to relocate their residence or business operation. Local land ordinances also have the advantageous effect of keeping properties from being offered for sale in the real estate market.

VALUATION DIFFERENCES

The historical designation along with an active local historic preservation commission and a supportive local government leads to the aforementioned changes in demand and supply. These changes in turn lead to an increase in property values within the district. (Appendix A shows how a decrease in supply from S_1 to S_2 along with an increase in demand from D_1 to D_2 results in higher property values.) Properties near the historic district also will see similar changes in supply and demand and thus similar changes in property values. Here we can employ what we will call the Las Vegas Effect. Before Las Vegas casinos proliferated in Nevada (especially on “the strip”) the area was essentially worthless desert. When the casino resorts began to open in the 1950’s the land that the casinos occupied eventually

increased exponentially in value. But as we now know, the value of land surrounding the Las Vegas Strip also increased exponentially in value. This is a type of neighborhood effect or positive externality. Increases in property values do indeed appear to be contagious at least with regards to contiguous properties.

The academic and professional literature abounds with examples of meticulous studies showing the positive effects that historical preservation districts have on the prices of real property within the district and surrounding the district. The vast majority of these types of studies utilize one of two established valuation models: difference in difference models or hedonic regression models. The difference in difference models are the easier of the two to utilize. This model involves computing a sample mean for the growth rates in property values within and surrounding an historical district and also a sample mean for the growth rate of property values clearly outside the district. A statistical test is then performed to see whether or not there is a meaningful differentiation in the growth rates. The chief problem with this type of study is that no particular variables are controlled for. The averages disguise the probable significance of the variety of differences that exist in the many properties themselves. These would include square footage differences, number of bedroom differences and the condition of the property. The hedonic regression model is thought to be superior to the difference in difference models. This type of model provides a means to estimate the implicit value of various structural characteristics of a property. It allows for a precise assessment of the extra value given to a property with historic designation while controlling for specific property and neighborhood characteristics. In this type of theoretical model we assume that utility is a function of a vector of attributes of the property and a composite attribute of all other goods. The problem that a household must solve is to maximize this utility subject to a budget constraint involving rental prices for houses and a unit price for the composite good and also subject to a linear transformation technology that relates attributes to the housing stock. Statistical hedonic models typically include the natural log of the property price as the dependent variable and structural and neighborhood characteristics as well historic preservation district status as the independent variables. (The semi-log form of the model is normally used, because then the coefficients on each explanatory variable can be interpreted as percentage changes in the property price given a one unit change in the independent variable.)

EMPIRICAL RESULTS SAMPLE

Both types of studies confirm statistically significant additional positive values associated with properties within and surrounding a district identified as historically significant. Examples of such studies include Ford

(1989), Leichenko, Coulson and Listokin (2001), Clark (1997), Coffin (1989), Linneman (1980), Rypkema (1994, 2002, 2005), and Listokin, Listokin and Lair (1998). Most of these studies see additional benefits to property values when known local land ordinances exist alongside a local preservation district. Market failures, due to informational asymmetries, resulting in lower property values might arise if these benefits are not publicly pronounced. The local historic preservation commission would play this important role along with a cooperative and active local governmental body.

SOCIAL VALUE AND SUSTAINABILITY

Positive externalities are also present when historical preservation districts exist. They undoubtedly add social value. Sustainability is presently receiving positive recognition in both private and public markets. Notable economist and historical preservationist Donovan Rypkema equates sustainable development with historic preservation. When given all the embodied energy found in older residential and commercial properties filled with bricks, metals, concrete and other materials, sustainability advocates point out the negative impact of destroying the current resources and creating a new building made of all new material. (Embodied energy is defined as all the resources expended during the construction of a building. These can include raw materials as well as the electric, gas energy and human capital that went into the construction of the components and the building itself.)

The novel expression emerging from the topic of sustainability states that “the greenest building is the one that is already built.” Rehabilitating historic buildings can be a sound sustainable strategy of promoting energy efficiency by significantly preserving the energy already represented in existing buildings (embodied energy), rather than waste additional energy building with a new structure with all new material. This new material itself would have to be produced which would utilize more energy as well. It is estimated that a new energy-efficient office building that includes as much as 40 percent recycled materials would take approximately 65 years to recover the energy lost in demolishing a comparable existing building.

The U.S. Environmental Protection Agency (EPA) has estimated that building construction debris constitutes around a third of all waste generated in this country, and has projected that over 27% of existing buildings in the United States will be replaced within the first three decades of the 21st century. Very few historic buildings are structurally unable to be saved. (The major reasons why buildings can't be saved are mainly due to non-repairable structural damage, dangerous materials (asbestos, lead paint) or location issues (earthquake, contaminated soil).) Many preservationists point out that the main issue with the new green building movement, which still

only accounts for less than one percent of all newly constructed buildings, is that preserving existing buildings may be the greenest approach.

Preserving an older building is often called the ultimate recycling project, yet preservationists commonly fight the perception that historic structures are terribly inefficient and require expensive and drastic corrective measures to retrofit for an energy saving return on investment.

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