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Valuation of Historic Properties

MARY E. MANN*

The importance of a fair approach to valuation and taxation of historical properties is becoming apparent, but the proper approach to that valuation has not yet emerged. As a preliminary matter, however, it is important to emphasize that valuation of historic properties has relevance in two areas: valuation incident to a taking or condemnation and valuation for purposes of taxation. There is a profound difference in the law with respect to valuation of properties for these two purposes, and it is rare that cases in one field are used in support of a valuation concept in the other.

When property is valued incident to a taking, the court is interested in a just value in order to compensate the owner for that taking. But when property is valued for purposes of taxation, the valuation will be the basis of the tax levy. In this instance, the law presumes that the assessor is correct; the burden is on the taxpayer to show that the assessment is incorrect.

I will discuss valuation problems which attend assessments of historic properties for taxation purposes. First, a jurisdiction must choose the tax policy it will apply to historic properties. Such a policy must incorporate an awareness that restrictions placed on historic properties may reduce the value of such property. Some states have recognized this and have attacked the problem by giving tax exemptions. Another approach would be to reflect that decrease in value in the assessment. There is a significant difference between giving a tax exemption and recognizing the effect of restrictions on valuation for taxation purposes.

I have been concerned with the erosion of the tax base, and thus I am fundamentally opposed to using tax exemptions to give incentives to accomplish projects that have a public function. I have had to address taxpayer groups, have almost been ridden out of town on a rail, and have seen the passions of the ordinary taxpayer rise with the increase in the tax burden. That
tax burden increases as the City's tax base erodes. The City of New York this year will raise $3 billion dollars from the local real property tax, from a tax base that is not growing. The tax base has been adjusted for so many purposes that the ordinary growth of 2 percent a year in the immediate post-World War II period simply is not going to occur in New York City.

My fundamental reason, however, for opposing a tax exemption mechanism is as follows: a tax exemption mechanism gives a benefit both to those financially harmed as a result of designation and to those unharmed. It is, after all, possible that the designation of a building as a landmark can increase its value. Tax exemptions, which apply equally to all designated property, benefit the owners of property which appreciates as well as property which depreciates.

There is, however, one type of exemption that perhaps could be justified. When the state or the landmark commission mandates that buildings be improved in order to preserve their historic character, a tax exemption mechanism is justifiable as an accommodation to an owner who will have to bear additional maintenance or improvement costs which perhaps he cannot afford. For example, in Puerto Rico, an exemption is granted for five or ten years, according to the degree of restoration required; 1 obviously, the concept behind this is to give the taxpayer a five or ten year period in which to recoup the cost of restoration through tax savings. The problem, however, with this kind of law is that the amount of the tax exemption is not related to the costs of the improvement. Texas recently enacted a statute which gives a tax exemption to properties designated as historical landmarks and, in addition, adopts a hardship concept. 2 This encourages preservation by giving tax relief to those historically significant sites in need of relief. 3 New Mexico's statute grants a total credit against property taxes for all costs incurred in restoration, with a ten-year carry-forward. 4 This statutory scheme improves on the Puerto Rican statute in that it does correlate the tax exemption to the costs of improvement.

Some historic preservation legislation relies on tax credits or abatements to relieve the economic burden on owners. It is important to distinguish between a tax exemption and a tax credit. When an exemption to the real property tax is given, the burden of paying the difference is shifted to the rest of the property on
the tax roll. For example, assume New York City is going to raise 3 billion dollars and is going to levy that against assessed values on the roll. If a large sector of property is exempted from that roll, the property remaining is going to bear a greater tax burden. But when a credit is given, the government will have calculated its tax rate with the assessed value of all the property as its base. The government simply does not collect a portion of the amount due. Giving a credit is not in keeping with the whole structure of the real property tax; it is much better to give relief by way of an exemption prior to the levy of taxes rather than afterward as an abatement, an omission, or a credit.

In 1977, New York City amended a statute known as J-51; as a result, New York City has a provision which grants a twelve year property tax exemption to the extent of any increase in value resulting from improvements to exterior walls made by an owner to comply with any law regulating historic properties which mandates such an improvement. The more important aspect, however, of J-51 relates to tax abatement: taxes levied on the historic property are abated each year for twelve years by an amount of 8 1/3 percent of the cost of improvements. This means that the owner of the historic property can recoup costs expended in making improvements.

The New York Landmark Law has a provision which authorizes the Landmark Commission to grant tax abatements or exemptions in hardship cases. When designated property is not capable of earning a reasonable return, this exemption acts to compensate the owner. Connecticut has a similar statute which authorizes localities to enact legislation granting tax abatement to property owners who can demonstrate that the tax load is threatening their ability to preserve the historic property.

The more interesting statutes, to my mind, are those which attack the valuation problem directly by mandating that valuation of historic properties for tax purposes shall be made at a current use value rather than at highest and best use value. There are at least three states which have statutes directing that the assessor take into consideration restrictions on property placed voluntarily. But I could find only one state, Virginia, which has a statute providing that the assessor, in setting value, can consider any restrictions on the property, whether imposed by government or assumed voluntarily. This statute has two pro-
visions regarding involuntary land use restrictions: the first states that notice to the tax assessor of the designation of a structure or site as a landmark is prima facie evidence that the value of such property is reduced because of the designation, and the second, that upon notice to the tax assessor of the establishment of an historic district and applicable restrictions, the assessor must take these restrictions into consideration and "place a lower valuation on same." The reason I emphasize this is that the Virginia legislature has apparently made the assumption that an existing assessment on a piece of property is an equitable one based upon its highest and best use. Clearly, an owner of designated property in Virginia has an advantage, as a result of the statute, when he is in court seeking a reduction in his assessment. On the other hand, where no statutory provision of this sort exists, fair valuation of historic properties is difficult.

In the absence of legislation, land is assessed at its "ad valorem value" which means, in almost all states, fair market value. The concept of economic highest and best use is an integral part of fair market value. There are several ways of arriving at fair market value. Mass appraisal techniques, including computer-assisted techniques, are coming out with astounding results in estimating the value of some properties. These techniques are particularly useful in areas where there is an intense sales market. It is impossible, however, where using sales of comparables for valuation, to incorporate the highest and best economic use of the property into the equation because buyers purchase property with a view toward the possible return. This is true even in the residential market; a person will not buy a property if he thinks he cannot resell within a reasonable time for an amount approximating his cost.

A second technique for valuation is capitalization of income. Where capitalization of income is the method used to value for taxation purposes, the economic highest and best use of the property is a factor. As an illustration, assume that property in a residential area borders upon areas which are becoming industrial and highly commercial. The purchaser of a residential property here could very easily have in mind an eventual commercial use; residential property sales at that border will reflect that consideration.

The question is how, in the absence of legislation, to include
voluntary and involuntary restrictions in an assessment. Normally, when assessing property, voluntary restrictions, other than easements, need not be taken into account by the assessor. For example, the assessor does not consider a mortgage, or an improvident lease, when valuing the property. In my opinion, in New York State, an assessor may not take private historic preservation agreements into account without a statute directing that action.

But land use restrictions for preservation purposes are often imposed by government. Whether the assessor must take this involuntary restriction into consideration is the question raised in the *Penn Central* case. The designation of Grand Central as a landmark restricted the use of the building. Grand Central applied to the Landmark Commission for permission to put a large building on the top of the terminal but was denied. The Commission merely said, "You cannot put that large building on top": it is widely recognized that some other permissible use or some other improvement might possibly be put on Grand Central which would be compatible with the historic designation. The problem, therefore, confronting the assessor is to determine what this particular restriction has done to the value of the building and how it should affect the assessment.

It is my view as a tax administrator that tax policy should be based upon the articulation and legislation of the effect on market value of use restrictions which are either imposed involuntarily by government or imposed voluntarily in the form of a preservation agreement by the owner. This is far from the operation of most assessment systems at present. Furthermore, the assessment on an historic property at the time a use restriction is put on it may be too low or too high. So no matter how good the theory, it is difficult to work with that assessment and properly reflect any type of use restrictions placed on the property.
Remarks

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3. Id.
6. Id.
7. See NEW YORK, N.Y., ADMIN. CODE ANN. ch. 8-A, § 207-8.0 (Williams 1976).
11. Id. § 10-139.
12. Id. § 10-140.

Historic Preservation and the Law: Appraisals of Realty for Taxation

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5. The American Standard Building located at 40 West 40th Street is an example of this.