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Perspectives of the Real Estate Community on Historic Preservation

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The real estate industry has long harbored the view that any form of landmark designation represents a substitution of the police power for eminent domain. The former regulates property for health, safety, and general welfare without offering compensation to the owner, while the latter requires just compensation. Investors are understandably suspicious of a regulation, like landmark designation, that, in their view, constitutes an encumbrance against the property of such a nature that its value is diminished. Even those who favor the preservation of an architecturally or historically distinguished building are likely to fear the additional red tape of city, state, or federal regulation that designation brings—red tape that may add substantial costs in time and expense to rehabilitation projects. The industry, furthermore, is suspicious of any regulation that in effect removes the decision of whether to continue the existence of a building from those who are financially responsible for it.

It is for these reasons that many owners, especially of commercial and industrial properties, think that landmark designation should be confined to public buildings or to cultural, educational, and religious nonprofit buildings. Designation restricts present and future use of property; this restriction is a cloud on the title of a building at the time of resale. Landmark designation becomes, then, for private owners, a harsh regulatory action for which there is no adequate compensation. Furthermore, many in the industry think that this regulatory action is far less essential than the current regulatory tools, planning and zoning statutes, that the real estate industry concedes are essential for maintaining an orderly urban society. To reiterate, there is a conviction, held by many, that landmark designation for private buildings represents an unwise and undue reliance on the police power, and benefits the public at the expense of the owners.

The opposition to designation statutes tends to be less con-

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cerned with historic districts than with individually designated private properties. Historic district designation is less threatening to residential property owners, in part because it resembles zoning, in its area-wide application, and in part because it usually brings benefits to an area. For example, designation is perceived as a means of ending "redlining" by mortgage banks, of ending deterioration, and of promoting stabilization. Residents think that designation will induce new owners to invest in the area and will prevent neighbors from disfiguring their buildings, thus preserving or increasing property values. While designation provides no assurance of improvement in property values, bankers and investing homeowners may perceive a better environment for capital appreciation than in a non-designated area. It is hoped that designation will act as a powerful social and cultural force to thwart the manifold urban problems of crime, drugs, and residential deterioration. That force may or may not exist independently of designation.

Another reason for the real estate industry's lack of support for preservation is that we, as a group, have not tended to be culturally or historically minded. Furthermore, we in the industry have been victims of modern technology. Until recently, a rapid rate of functional obsolescence was assumed to be so pervasive that few buildings were believed to retain enough value after fifty years to justify paying for rehabilitation. Demolition became an ingrained, urban way of life; recycling was frequently rejected as unprofitable.

The prevailing attitude could not be blamed entirely on the real estate industry. For the last thirty years, the general public has placed great emphasis on modernity: a premium was eagerly paid for "newness." Terms such as "patina" and "urban texture" were not found in the real estate lexicon. There was insufficient appreciation of architectural eras and no widespread disposition to honor architectural achievements.

Recently, there has been ample evidence of a changing attitude on the part of industry groups about the principles and objectives of preservation. Some of the change has resulted from a recognition of economics rather than from an embracing of higher cultural standards. New construction is so prohibitively expensive that the investor or developer is forced to consider rehabilitation and modernization of older buildings as an alterna-

tive to building new structures. Last year a large percentage of all construction activity involved rehabilitation. That is encouraging. The provisions of the Tax Reform Act of 1976 that allow a five year write-off on rehabilitation of certified historic structures are also likely to inspire new investment in historic buildings.[1] There are other subtle forces contributing to the changing viewpoint.

Happily, one also detects a growing respect for the grandeur and quality of many of the older buildings. Rockefeller Center is perhaps the outstanding illustration. Even though it is now forty-five years old, it is at competitive parity with the best of the modern office towers. It projects an unusual character and quality far beyond its art deco architecture, and is a monumental illustration of how beautiful urban space can be. The rejuvenation of the Chrysler Building is a market phenomenon brought on not only by economic considerations but by a growing sentiment in the industry and on the part of major tenants in favor of buildings with architectural character. When Dancer, Fitzgerald & Sample leased 240,000 square feet of refurbished space in the Chrysler Building, their decision was influenced by the architectural character of the building as much as by the advantageous rents.

The designation of a landmark can have a substantial and positive effect on adjacent properties in the neighborhood. This is particularly evident when the design perpetuates an otherwise unobtainable pleasant contrast of old and new. The Cartier and Vanderbilt Buildings on Fifth Avenue, north of Olympic Towers, are a case in point. Fifth Avenue receives its character from, and is enhanced by, the variety of architectural types and styles reflective of the entire 20th century. The University Club on Fifth Avenue is part of the same beneficial effect. Quantification of this enhancement eludes one's grasp. One must, instead, feel the difference. For example, St. Bartholomew's Church makes a substantial contribution to the land value on Park Avenue. The Villard Houses and the rectory of St. Patrick's Church on Madison Avenue contribute a very special meaning to that portion of Madison Avenue. The Plaza Hotel has a similarly profound effect on Central Park South.

The recent Supreme Court decision upholding the application of the landmarks law in the *Penn Central* case was impor-

tant for many reasons.[2] The beneficial effect in an area which results from the designation of a low density landmark is frequently understated. The maintenance of light and air created by the low-rise building provides an important respite of open space that profoundly benefits all adjacent private plots. The maintenance of that respite is important: the Pan Am Building, the refurbished former Commodore Hotel, and whatever development occurs on that west side of Vanderbilt Avenue will all profit enormously from the preservation of this low-rise railroad terminal. To the extent that the rents of these valuable buildings are increased by the preservation of that marvelous open space, their real estate taxes will be increased and will offset the loss of the tax revenue from a structure over the terminal.

The value of open space can be seen by looking at an area that lacks it. One of the disadvantages of the financial and insurance districts downtown is the unrelieved canyon effect created by a lack of open space. With the exception of Trinity Church and its graveyard, there are few surprise vistas and precious little sense of openness in that area. The Fraunces Tavern buildings, with no particularly distinguished architecture, do provide some sense of scale and relief from the overpowering office towers.

The designation of some landmarks has little or no economic effect on their surroundings. The monumental older tower buildings, such as the Chrysler Building, the Empire State Building, and Rockefeller Center, contribute the same value with or without designation because changes in their exteriors are not contemplated nor is their demolition a threat, although there will be some interior changes to refurbish the functionality of space. Thus, when distinguished real estate is economically viable, designation is not as critical to assure the future existence of the building and probably should not be entertained, provided the architectural integrity will be unchanged. Designation, because of the effect on resale values, is an unnecessary complication in the building's existence.

On the other hand, designation as an historic landmark can provoke almost insoluble problems for the owner under existing legislation. Some older buildings may not feasibly be renovated on the interior because of faulty design, which perhaps cannot be corrected on an economic basis.[3] Typically, the older build-

ings are costly to maintain and are not energy efficient. Retrofitting of insulation or other energy conservation measures are not always possible. Designation is a burden where the market will not pay rental increases reflecting the cost of interior improvements. The prestige of a building's distinguished architecture cannot be considered sufficient compensation to the owner. Unfortunately, an uneven application of this burden frequently occurs despite the most inspired legislative concepts. It takes enormous effort and strong discipline to attempt to correct the inequities. Changes in the New York City legislation are essential in this respect.

We must protect communities against indiscriminate changes in exterior facades. That alone may justify historic designation.

The current Landmarks Law provides for property tax relief or approval of demolition or reconstruction when an owner can demonstrate an inability to make a reasonable return on this property.[4] "Reasonable return" is defined as a return of at least 6 percent of the assessed value of a parcel.[5] This provision is the greatest irritant to private property owners in their opposition to the Landmarks Law. A 6 percent return was inadequate even in 1965 when the law was passed and interest rates were 5-6 percent. Mortgage interest rates today are much higher. Six percent is a hopelessly obsolete rate of return. It makes the private property owner suspicious of government and of people who have the community interest at heart, and creates hostility and ill will. We should not be at odds; we should be together in our desire to keep the community a decent place.

Furthermore, there is no demonstrable relationship between the assessed value, on which the return is calculated and the market value. In good neighborhoods the assessed valuations may be only 50 percent of market value. This means that the owner is receiving a 3 percent return! That is confiscatory and is a taking without just compensation. In poor locations the assessment may be 150 percent or more of market value. If a property has not been sold for many years prior to the designation, there may be no factual basis for computing an appropriate rate of return.

The Commission has the right to grant partial or full tax exemption for a designated property if in so doing it would im-

prove the return to the reasonable standard cited. In the case of private buildings, it is sometimes debatable whether the building deserves tax exemption or whether such an exemption should be considered highly discriminatory. When continued operation of the landmark building is a hardship, and when there is no clearly definable successive higher use of a site, designation can be expensive, troublesome, and perplexing for the owner. If, on the other hand, a property is desirable for a new and higher use, it can more readily shed the landmark designation.

In view of our inflationary times and the high and rising cost of interest, it would appear equitable that owners be entitled to a rate of return at least equal to the mortgage interest rate, based on market value rather than on assessed value. The owner should also be entitled to a reasonable depreciation rate. How this 6 percent on assessed value mechanism has escaped invalidation by the courts is a mystery to me. In the name of fairness alone, the regulations must be liberalized to permit an owner to claim hardship when his return is less than a market return.

A cost-benefit approach, using both public and private monies for compensation, might force us to examine architectural and economic priorities. Why not establish hardship by noting differences in value before and after designation through an appraisal? This process would also tend to protect property owners against indiscriminate or nonessential designations that may diminish property value without compensation. More buildings might be lost, but we need to save only the best of the past, not to prevent new investment that may revitalize the City or result in great modern architecture.

Some critics have suggested different gradations of designations. Landmark buildings which are less accessible, are less distinguished, are designated for arcane reasons, or which do not benefit the total urban fabric to a significant extent should not carry the burden of the same regulations that apply to Carnegie Hall, the Plaza Hotel, the University Club, or St. Patrick's Cathedral, which contribute immeasurably to the urban scene. It may also be possible to distinguish by reference to the architectural caliber of each landmark; since some buildings appear to be designated for historic rather than architectural reasons, this might make the legislation less onerous.

Another change which would provide assurance to the private sector would be a provision in the zoning ordinance to transfer development rights (unexpended floor area) beyond adjacent locations to anywhere in the zoning district. Except for the South Street Seaport, the current New York City zoning ordinance only permits transfer of development rights to adjacent locations, properties immediately contiguous to the landmark, or to commonly held properties across the street or on diagonal corners.[6] If the ordinance were broadened to permit the sale of these development rights beyond adjacent locations to any place within a district, it would significantly enhance the value of unexpended floor area in a designated building. In this manner, no net addition to the permissible building bulk in the zoning district would be allowed.

This change would give the owner of underdeveloped property an opportunity to be partially compensated for damages arising out of the landmark designation. Owners of under-developed property can suffer the most from designation. It is desirable to ease their pain, anguish, and anger. Admittedly, the sale of development rights could provoke planning problems because of the enlarged bulk of the building receiving the development rights. Congestion might result from creating a larger building on another site. Thus, because many owners fear a rejection of the transfer of the development rights by planning authorities, they do not feel that this suggestion insures compensation, even though their market horizons are enlarged.

A preferred alternative is to create an urban development bank funded by federal UDAG grants.[7] Under this concept, if private property representing less than the full development of a site were designated a landmark, the owner could immediately transfer the development rights, at the appraised value, to the development bank and receive the cash value of the unused floor area. There would be no speculation as to whether the owner could obtain a buyer for the development rights or face the rejection of the transaction by municipal authorities. We, in the industry, think that HUD would make these UDAG grants available if the necessary local enabling legislation were passed and if the mechanism for the creation of the development bank were established. If and when needed, this reservoir of development rights could later be resold by the development bank to

owners within designated zoning districts. While there is no assurance that all acquired development rights could be resold, such a program would, nevertheless, provide the utmost flexibility in urban planning and development. It would also reduce substantially, if not wholly, the opposition of many private owners to landmark designation and would make more of us think that we are not being subjected to the police power rather than the power of eminent domain.

I believe deeply in public and private landmarks. A sense of history, a pleasant blending of old and new, and the patina of age and character add immeasurably to the quality of urban life. New communities, best exemplified by Houston, Texas, on a large scale, and by Reston, Virginia, on a small scale, indefinably lack the impact provided by a mix of buildings separated by a century or more of architectural, social, and cultural change. No thinking person seriously questions the desirability of a landmark designation if it can be effected with proper regard for our institution of private property rights.

In order to persuade owners of the obvious benefits of landmark preservation, a significant modification of the existing legislation is required. First, it is essential to increase what constitutes a reasonable rate of return for an owner to an amount that reflects current financial realities; this will still an owner's fear of being financially burdened for a protracted period of time. Second, the easier and more assured transfer of development rights must be permitted. The solution is to guarantee the sale of development rights at the appraised value to an urban development bank.

Landmark statutes in general need to be more sensitive to the economic effect of designation and to the burdens of designation on private owners, especially since landmark regulations are founded on the police power and that foundation is somewhat tenuous. After all, there were three dissenters in the United States Supreme Court in the *Penn Central* case, including Chief Justice Burger. In my judgment, the *Penn Central* case is unique and does not settle the issue of whether just compensation should be paid under certain circumstances. There appears to be some reasonable justification for the conviction held by most property owners that sole reliance on the police power represents a thinly-veiled effort to avoid just compensation; des-

ignation is a type of regulation that lacks the same relationship to protecting health, safety, and welfare possessed by other regulatory functions grounded in the police power.

Historic preservation requires that all of us—laymen, government officials, investors, and real estate professionals—work together. We need a greater sensitivity to each other's problems and concerns. By listening to each other and by working in concert to find solutions that distribute the burdens of historic preservation as fairly as the benefits, we can discover how best to save our unique architectural heritage.

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1. 26 U.S.C. § 191 (1976 & Supp. III 1979), *amended by* 26 U.S.C.A. § 198 (West Supp. 1980 & Pam. 1981).

2. Penn Cent. Transp. Co. v. New York City, 438 U.S. 104 (1978).

3. "Economic basis" may be defined in this context as recouping an equivalent or additional amount beyond the cost of the interior renovation from increased rents or lower operating expenses. When there is not an economic basis for renovation, the designation can be a special hardship on the owner.

4. New York, N.Y., Admin. Code Ann. ch. 8-A, § 207-8.0 (Williams 1976).

5. New York, N.Y., Admin. Code Ann. ch. 8-A, § 207-1.0v. The Commission may substitute other criteria, such as a bona fide sale of the property. The net return, after a 2 percent allowance for depreciation, does not include debt service, which may make up a considerable portion of a building's expenses.

6. New York, N.Y., Zoning Resolution § 74-712 (1980).

7. UDAG comes under The Community Development Block Grant Program, Title I of The Housing & Community Development Act of 1974, 42 U.S.C. §§ 5303-17 (1976); the UDAG portion was added under The Housing & Community Development Act of 1977, Pub. L. 95-128, 91 Stat. 1111 (1977) (codified at 42 U.S.C. § 5318 (Supp. III 1979). *See* 24 C.F.R. §§ 570.450-.466 (1981).