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Public Actions to Accommodate Changes in Property Values

JOHN C. NELSON*

The title assigned to me is descriptive because, it assumes, first, that there is a decrease in value if property is designated as an historic site or landmark, and, second, that there is a societal obligation to make restitution to the owner of property that has been so designated.

Are these assumptions valid? What is the effect of designation as an historic property? Is there an adverse effect on property placed on the National Register as an historic site under the federal act or on property designated as a landmark under a local statute?

As to federal designation, when the statute was passed, its primary thrust was to insure that federal agencies did not demolish historic sites in connection with federal projects.¹ This law was beneficial to the private property owner because, if he preserved historic property, he received a plaque. From the owner's viewpoint there was no adverse impact: he could destroy the property or do whatever he wanted with impunity.

The historic preservation provisions of the Tax Reform Act of 1976 had a dual effect.² An owner who rehabilitates a landmark with approval is entitled to a fast write-off,³ which is obviously beneficial. An owner who demolishes an historic structure, on the other hand, is not entitled to the business deduction for the cost of demolition and cannot take accelerated depreciation on a new structure built on that site.⁴ This latter provision has a detrimental effect. The owner of an historic property has to look at a federal designation in terms of the Tax Act. There is great uncertainty under any tax statute until there have been rulings or decisions by way of litigated cases. From the point of view of the property owner under the federal act, if he wants to rehabilitate the property, he is in a favored position. The law is beneficial. If, however, he does not know what he wants to do with the property, there is an adverse effect. The historic preser-

vation tax provisions of the Act expire in 1981. I would be surprised if they were not renewed, at least as to the adverse effect.⁵

There is also a detrimental effect by virtue of local designation under the New York City Landmark Law because the thrust of that local law is to prevent any change in the property.⁶ Why is this detrimental? Anyone would say, *prima facie*, that if I can change my property with impunity, I am better off than having to negotiate as to whether I can change it. I do not know how to measure that restriction in terms of value, but it does have an adverse effect. John White mentioned that throughout the City owners have always said that they didn't want to be landmarked; the fact is that few private buildings have been landmarked. Accordingly, the attorneys who practice in real estate have not really had to focus on what the impact of landmark designation is on a private building.

One reason for the passage of the local law relates to the process of assembling a large number of properties in New York City, as was done with the buildings built in the seventies on Sixth Avenue properties. As the assemblage becomes public knowledge, the buyer will not be paying the fair market value of the property. He will be paying an inflated value that can range as high as five or ten times the market value. The last owner bought out may receive twenty times the value of the property. An owner whose building has been designated as a landmark will not be in a position to take advantage of that kind of situation. But the value that the owner is being deprived of is not economically sound except where there is a large scale assemblage. Accordingly, although this is a demonstrable money loss, it is purely speculative and one which I, for one, would not grieve.

Buying a brownstone in an historic district may involve a beneficial effect. In buying into that neighborhood, the owner knows that there will not be all sorts of destruction and change in the neighborhood without some sort of regulatory approval. On the other hand, buying a brownstone designated as an individual landmark, with stores occupying the first few floors, may involve a detrimental effect. Nothing changes at the time it is designated, but over a period of time tenants normally like to change signs and windows. The owner must negotiate with the Commission as to how to effect changes. Again, I cannot measure the value of that burden. Again, the designation *per se* has

not resulted in a loss. But if a future purchaser cannot be sure he will get the kind of rents he had assumed, that will be translated into some kind of monetary value, which means the seller may have to lose some money on the sale. Another detrimental effect is the fact that under the law the owner must keep the property in repair, subject to fine or imprisonment or both.⁷ This provision also deters some people from considering the acquisition of that property. Having fewer purchasers has an indirect effect on value.

In summary, then, the assumption in the title of this talk — that there is an adverse effect on an owner from designation — is probably accurate. When and how it is measured is the difficult problem.

As to the second basic assumption in the title, that society has an obligation to reimburse the owner or to give some relief, it seems clear that there is no legal obligation. I believe, however, there is a moral obligation because the burdens of designation fall on only a few owners. That will undoubtedly change in the future. If a sufficient number of properties are designated as landmarks and sufficient sophistication has been developed as to properties which potentially might be landmarked, property can be bought and sold with some reasonable expectation as to whether it will be considered a landmark.

As of today, however, my recurring nightmare involves representing a developer who, assembling a site, acquires thirty properties and pays inflated prices for the last two or three. Three or four months later, he finds that a property he has acquired has been designated a landmark. This means that, in the worst of worlds, he may not be able to proceed with the project at all and, in the best of worlds, he may proceed with the project but he has paid a highly inflated price for property that he cannot use for his expected purpose since the landmarked portion cannot be demolished. Even though I may have difficulty persuading a number of people that society has a moral obligation to compensate the purchaser in this situation for the loss he sustains, I am personally troubled by the issue. I can see that he gambled by laying out more than the fair market value of the property, but he did it in a game where he understood the rules. Developers know that they may not acquire all the properties needed for a project. They know there are great risks in assem-

bling property for large buildings, but normally they have lines of credit, working relationships with banks and insurance companies where they know they will get the financing. They have tested the market. They have some idea whether tenants will be available. They know the risks, and they take the risks within the rules. Even a change in zoning is normally predictable. But how is a developer supposed to anticipate landmark designation of a particular parcel? I do not know what the guidelines are, and I do not know how I can warn my client of this risk. Morality entails fairness, and the scenario smacks of unfairness. Accordingly, I believe there might be, in limited circumstances, a moral obligation for society to offer compensation for designating property as a landmark.

Is there any practical reason why society should be thinking of compensation? The *Penn Central* case did not get to the issue of damages.⁸ The eternal conflict between the rights of society and the rights of property owners will continue. Society is belatedly exercising its rights to foster preservation, but private property has a protected status under the common law. The courts will continue to recognize the rights of society to preservation. But in an era where many more properties will be designated as landmarks and more litigation will ensue, we should assist the courts by compensating owners so that the courts can continue skirting the issue of whether or not compensation must be paid. Accordingly, I believe we have moral and practical reasons to recognize that landmark designation does have an adverse effect and that relief should be afforded the owner of a landmark.

Some possible public actions available to grant relief to the owner are transfer of development rights, tax abatement, condemnation of an easement, grants-in-aid, low interest loans, and changes in zoning, building, or other codes. Under present New York law, I do not believe any are presently of assistance in giving relief to the owner of property designated as a landmark. The transfer of development or air rights offers the best possibility, but it is not effective today: as a result of the amendment of the zoning ordinance in August of 1977,⁹ development rights can be transferred only to adjacent parcels. The only special relief afforded to landmark parcels is that the definition of where you can transfer is a little broader; you can jump across the street and go catty-corner. For all practical purposes, however,

the owner must be lucky enough to find someone who wants to build and is willing to use his air rights.

The Planning Commission should be thinking about transferring within a larger, but finite, area. In the Seaport Museum district, an arrangement was worked out with the interested parties. There are five or six receiving lots. 1,400,000 square feet of development rights are available to be transferred from landmark properties. Negotiations are going on for the transfer of some of these rights to the designated receiving lots. That is, an owner of a landmark parcel should have the right to transfer unused development rights within a radius of perhaps twenty-five hundred feet to compensate for the fact that he can no longer use that development potential.

Other methods of compensating the owner have been suggested. First, as for tax abatement, there are too many uncertainties as to whether there is a loss to an owner and how to measure that loss. Further, even if this could be determined, the City cannot afford to pay anything today. Second, loans, or grants-in-aid, really do not go to the question of compensation for the designation. They will help with rehabilitating a landmark property, but the owner is not being compensated for any loss. Third, change in zoning, building or other codes might be considered but it would have to be on an ad hoc basis, which leads to the possibility of abuse. Fourth, condemnation of the facade of a structure, by taking an easement in gross, creates more problems than it solves: I do not know how to value the property which would be taken in such a condemnation, and I do not know who would do the repairs. If it is believed the owner should be paid something, I would not fuss with a condemnation. I would simply pay him the money.

Finally, in considering the problem of financial assistance to owners, there are fiscal constraints in New York City. There are also constitutional constraints in New York State: money or credit of the state or any subdivision cannot be given in aid of a private undertaking.¹⁰ The fiscal and constitutional constraints buttress the argument for the transfer of development rights. Indeed, the creation of a larger building elsewhere would lead to increased tax revenues for New York City which otherwise would not be derived from the landmark site. In summary, the transfer of development rights might be a very useful tool, but I

would not consider the other methods of compensation that seriously.

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1. National Historic Preservation Act of 1966, 16 U.S.C. §§ 470-470t (1976 & Supp. III 1979), *amended by* 16 U.S.C.A. §§ 470-470w-6 (West Pam. 1981).

2. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976) (codified in scattered sections of 26 U.S.C.).

3. I.R.C. §§ 167(o), 191 (1980).

4. I.R.C. §§ 167(n), 280B (1980).

5. I.R.C. §§ 167(n), 167(o), 191, 280B (1980).

6. NEW YORK, N.Y., ADMIN. CODE ANN. §§ 205-1.0 - 207-21.0 (Williams 1976 & Supp. 1981).

7. *Id.* § 207-10.0.

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

9. New York, N.Y., Zoning Resolutions, 74-79 to 74-793. *See id.* art. I., ch. 2, § 12-10 (defining Zoning Lot).

10. N.Y. CONST. art. 7, § 8.