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The Positive Externalities of Historic District Designation

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Abstract

This paper argues that assigning historic district designation to a neighborhood or urban area increases the value of properties within the district and revitalizes the area economically because of the positive externalities associated with historic districts. It focuses almost exclusively on the economic and commercial reasons for why a historic property should be conserved and how policies to do so should be implemented.

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I. INTRODUCTION

This paper argues that assigning historic district designation to a neighborhood or urban area increases the value of properties within the district and revitalizes the area economically because of the positive externalities associated with historic districts. It focuses almost exclusively on the economic and commercial reasons for why a historic property should be conserved and how policies to do so should be implemented.

There are many reasons why historical buildings should be preserved. First, they have an aesthetic value. Historic buildings are often more interesting than the new, "industrial" buildings, housing and shopping centers (Tiesdell, 1996). In our constantly changing world, we need reminders of how things were and preserving historic buildings provides an anchor to the past, as well as an incentive to the future. This argument relates to the argument for architectural diversity. Historic buildings provide a contrast to more modern structures, which make them relatively more appealing. Arguments can also be made that historic buildings have functional diversity, resource value, value for continuity of cultural heritage, and economic and commercial value (Tiesdell, 1996).

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II. PREVIOUS LITERATURE

In a context where public funds cannot subsidize all the required and desired preservation, economic and commercial justifications for preservation and conservation must ultimately underpin all other reasons (Tiesdell, 1996). Rypkema (1992) argues that for any commodity to have economic value, it must possess the following four characteristics: "scarcity, purchasing power, desire, and utility." Historic buildings usually possess the first two characteristics, but they are generally lacking the last two. Furthermore, because of the obsolescence of a building, its utility will diminish greatly over time. For commercial desire to exist, there must be financial utility to investors. These two factors make it difficult to match the needs of the investors with the needs of the community for preservation.

According to Lichfield (1998), "the obsolescence of buildings and areas is expressed in a mismatch between the services offered by the building and the needs of the investors." The purpose of revitalization is to reconcile this mismatch. Revitalization involves both the renewal of the physical aspect of buildings, as well as a deeper economic revitalization, which is intended to be long lasting. Economic revitalization is required because, in the long term, the productive utilization of the property is what pays for the public cost of revitalization

(Tiesdell, 1996).

Although it is argued that historic buildings are part of the real estate market, and as such, they should be left alone so that the market adjusts the prices to the most profitable and efficient use of land, a free market economy ignores the social needs of the community. Historic buildings and areas have certain intangible value to society. Their loss or destruction results in a loss of welfare for society (Tiesdell 1996). This value relates back to the values associated with historic buildings and areas in the first part of this paper. The social value that historic buildings and areas possess is the positive externality effect.

In the land market, any intervention to adjust demand and supply will create new conditions for decision-making, which, in turn, will modify land values and land-use patterns. Public intervention into the private property market through conservation and preservation controls is therefore a way to make building owners more aware of the social value of their buildings (Tiesdell, 1996). Some argue that because of government intervention, homeowners and owners of historic buildings would not be able to obtain the maximum return for their property. However, it is argued that the positive externalities of the designation increase the overall return to the community; this overrides the loss of the private owner. Thus, in terms of historic urban quarters, there is further economic justification for land use and preservation controls: "to create and maintain a context that sustains and reinforces the composite value of the area" (Tiesdell, 1996).

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For economic revitalization to take place, the entire area needs to be considered. This is called area-based renewal. The strategies used to implement area-based renewal focus on unblocking supply-side constraints of land in order to promote economic revitalization. The rationale is that growth can be stimulated by improvements in the supply of land, labor, capital and entrepreneurship (Solesbury, 1990). Thus, when an area is assigned as a historic district, an attempt is being made to improve the area as a whole, not only a specific building site. By attempting to preserve the entire area, the loss in expected return on each building is minimized.

III. FORMAL MODEL

Having laid the groundwork for why an area should be preserved if it contains significant historic properties, this issue needs to be analyzed from a more formal economic viewpoint, specifically through the marginal benefit-marginal cost model. The hypothesis is that when an area is assigned as a historic district, the marginal benefit of owners within the district will increase because of the positive externalities associated with historic district designation. Marginal cost will also increase because of all the regulations and restrictions that the designation implies.

Historic property should be treated in this context as a merit good because of the positive external benefit it provides to society. Therefore, government subsidy is justified. The idea behind this is that by designating an area as a historic district, the government can help subsidize renovations made to the property either through subsidies or tax cuts. By doing so, the government is helping the owners maintain the external appearance of the property, which slows down the retirement of historic property, thus contributing to neighborhood renovation. So, there are two benefits related with historic districts. The owner benefits because the property is increasing in value. The area benefits because it will be economically revitalized by the designation.

The costs of historic district designation are that once a property is considered part of a historic district, the owner loses a great deal of control over the external appearance of the property, as well as its economic uses. As part of a historic district, a property's external appearance needs to meet certain standards and cannot be modified. In addition, the use of the property cannot be modified. As a result, owners of historic property experience a loss, since their property could possibly earn a higher economic return if used differently. However, marginal benefit is greater relative to marginal cost, which will increase demand for historic properties. This increase in demand will become evident by rising property values after the designation.

One can assume that the supply of historic property is highly inelastic, mainly because of its scarcity. Furthermore, the rise in property value also signifies that consumers will be paying a price higher than the actual physical cost of the property. The premium paid is the social need of the community, relating to the social and cultural value of the historic building.

The increase in property values in the area will benefit the area and lead to its economic revitalization if it is a commercial district. In conclusion, by examining the evidence, one should use an increase in property values as a measure to evaluate the effectiveness of historic district designation.

IV. EVIDENCE

Lockhard and Hinds find that districting has a significant positive effect on the restoration of residential properties of average quality (Nelson, 1991). However, once architectural quality is held constant, historic district designation did not lead to increased investment in two of the three groups sampled. Denniss (1991) concludes that the possible physical and economic benefits of historic district designation are abundantly clear, but there are nagging doubts about whether the act of designation should lead or follow reinvestment trends in older neighborhoods possessing historic attributes.

In their evaluation of the effect of historic district designation in New Orleans, Laska, Seaman, and McSeveney (1982) find that proximity of residences and neighborhood to such districts is a weak indicator for renovation. All these studies fail to associate district designation and property values in ways that control for other factors. They fail to control for the influences of neighborhood household income, proximity to the city center, property size and dimensions, or even "the date of transaction to account for changing value attributable solely to the passage of time" (Nelson, 1991).

Benson and Klein (1998) analyze the effect of historic district designation on residential property values in two Cleveland neighborhoods. They find that sales prices in the historic district fall short of initial expectations. They conclude that the local market perceived that the local neighborhoods were in economic decline and historic districting did little to alter this perception (Nelson, 1991). Ahern, Schaeffer and Milerick (1991) conducted a case study and examined the change in property values in the Chicago area. Ahern (1985) first found that with standard regression analysis, historic district preservation in the Chicago neighborhood studies, designation was only significant before the 1980's. Their empirical study in 1991 represents an example in which preservation activities have positive economic impacts. However, they concluded that if the policies associated with a historic district were too restrictive, the market value of the properties would decline.

Asabere and Huffman (1994) studied several neighborhoods in Philadelphia and found that residential property located in a federally certified district carried roughly a 26% price premium relative to property located outside of a federally certified district. Because investment tax credits, generally assumed to be the benefit associated with federal historic districting, are unavailable to owners who rehabilitate owner-occupied property, they attributed the premium to the positive externality effects that flow from the historic designation of a district or zone.

Ford (1989) found that if neighborhood and house characteristics are held constant, the effect on prices of a historic district designation is positive. Houses in areas with a historic district designation have higher transaction prices than they would if they were located in similar non-historic districts (Ford, 1989). Her hypothesis that homebuyers are willing to pay more for a house if they can be assured that the surrounding houses will remain unchanged over time is supported.

Nelson and Talley (1991) conducted a case study in Atlanta, Georgia. They were more concerned with the economic revitalization of the neighborhoods being studied. Their analysis indicated that historic district designation with the attendant investment benefits to property owners and public investment has a coincidental effect on commercial property values. They concluded that although historic district designation is a powerful urban planning tool, it should be used mainly as a supplement to other policies.

V. CONCLUSION

In conclusion, the evidence of whether historic districts create positive externalities and therefore, higher prices, is inconclusive. Some of the evidence suggests that there are no benefits to historic district designation and, in some cases, the restrictive policies of the designation actually lessen property values. Other evidence suggests that there is a premium to buildings located within a district, but the premium is not related to the social need to preserve the building. Instead it is related to the positive externality effect of living in a neighborhood where all other neighboring houses are required to maintain a certain standard. Theoretically, renovation should imply many economic benefits to an area, but evidence to support this is also inconclusive. Historic district designation may not be what leads to the economic revitalization of an area, but it can be a tool to speed up the renovation. Therefore, there are doubts of whether it should only be applied to neighborhoods that are already experiencing renovation.

The implications these results have for policymakers is that historic districts are not "a panacea for urban decline unless accompanied by a serious interest in dealing with many other issues" (Benson, 1988). It can be argued that historic district designation is a powerful tool only if it is designed to meet the individual and unique needs of the area in question. Long-range objectives and goals to make the designation more compatible with modern and contemporary urban standards should be developed and implemented. Also, the historical value of the building or area should be taken into consideration. Not every historic area can be preserved and only those that prove to have an economic utility should be.

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