

Preservation Easements: Economic Bonus for Appraisers and Property Owners

*The following article first appeared in **The Appraiser**, April 1982, an American Institute of Real Estate Appraisers publication who hold all copyright privileges on this article.*

Lenders, developers, planners and appraisers are taking a closer look at historic preservation easements, which have suddenly increased in popularity due to incentives created by the 1981 tax act. Preservation easements are now seen not only as a tool for historic preservation but also as a significant tax benefit for owners of historic buildings and a potential source of funding for historic rehabilitation.

The interest in preservation easements and other tax benefits for historic preservation resulted in a series of seminars held around the country recently by the National Trust for Historic Preservation, the National Park Service, and the National Conference of State Historic Preservation Officers. The session on easement donations held in Chicago emphasized the need for professional appraisers to value preservation easements, and featured Jared Shlaes, MAI, speaking on the appraisal process.

As explained during the seminar, a preservation easement is created when the owner of a designated landmark agrees not to make any alterations to the structure that would destroy its historic significance. By donating this right to an accredited organization such as a

The number of historic preservation easements donated since the law was passed has far exceeded the expectations of the federal government.

landmarks group or a city agency, the building owner is entitled to deduct the value of the forfeited property rights as a charitable donation. Because the market value of the property has decreased, the owner's property taxes and estate taxes are reduced as well.

The number of historic preservation easements donated since the law was passed has far exceeded the expectations of the federal government. The federal government planned that about \$5 million in tax revenue would be lost annually due to preservation easement writeoffs, but several single cases of multi-million dollar easement donations have recently been claimed: in Anchorage, two adjacent historic structures created the basis for a preservation easement of \$2.25 million; and a landmark apartment building in Chicago's Gold Coast neighborhood carried an easement donation of \$11 million. As more of these easements are claimed, they will be scrutinized and challenged by the Internal Revenue Service. It is also possible, said the seminar speakers, that building owners can be held liable for a percentage of any easements found to be overvalued.

Shlaes explained to the audience of attorneys, accountants, developers, and preservationists how preservation ease-

ments are valued by professional appraisers. The value of a preservation easement is based on the difference between the market value of the property before and after the easement is imposed. Shlaes told his audience: "You need a competent appraiser to look at the property through two pairs of spectacles—a 'before' pair and an 'after' pair."

To illustrate the appraisal process, Shlaes used the example of a small landmark office building in a downtown area where larger buildings were under construction. "In the normal course, the building would indeed be torn down and replaced by a big new building. But the owner wants to block that by donating a preservation easement to the landmarks preservation council, and does so. So now what does he have? He no longer has a building site—he has a box with some rooms in it that pay rent."

Shlaes then briefly described how each of the three approaches to value could be applied to the property for the "before" valuation and the problems that arise in applying the same approaches to the "after" valuation. The market data approach based on comparable sales indicated a value of \$50 per square foot for the 20,000 square foot building, resulting in a value

estimate of \$10 million.

But applying the market data approach to the "after" valuation isn't as easy. "There aren't that many sales—yet—of properties that carry preservation easements. The answer might be that there are not enough to have a valid market data approach. But let's say that we can find another historic building of about the same size in a location where there's no potential for tearing down and building-up again." Here, the property sold for \$40 per square foot, indicating an "after easement" value for the subject property of \$8 million, he described.

Using the cost approach, Shlaes estimated the before-easement value of the subject property at about \$10 million—\$2 million for the developable land and about \$8 million for the building, which has significant functional obsolescence because it has manual elevators, high ceilings, and a poor mechanical system that wastes energy. Valuing the property after the easement is imposed, Shlaes found that the value of the land had decreased about \$1 million due to

lack of development potential.

According to Shlaes, the third approach—the income approach—is the most appropriate method for valuing preservation easements. "This approach tends to be the most productive for the appraiser trying to value a preservation easement in the context of an office building, shopping center or other commercial property. These are the easements that are going to have the million dollar signs attached."

If in the initial analysis the value estimate was based on a net operating income of \$1,280,000, capitalized at 10%, the before-easement value estimate would be \$12,800,000. After the

easement is imposed, said Shlaes, "It will be harder to sell this property because the investors will be 'locked in' to this building. They won't be able to alter the facade; they won't be able to knock it down and build a bigger building. They may insist on a return more like 12%. So with the same income stream, instead of being worth about \$12.8 million, it will be worth about \$10 million.

Shlaes concluded, "You can see that there is a spread of about \$2 million between the value before and the value after. And it is that spread we are looking for, because that is the value of the easement."

Historic Preservation Course

"Introduction to Federal Projects and Historic Preservation Law," the highly popular "Section 106" training program developed by the Advisory Council on Historic Preservation, will be offered in San Francisco, Denver, Chicago, and Washington, D.C. during

1982. The course is jointly sponsored by the Council and the Office of Personnel Management, Management Sciences Training Institute.

Designed by the Council, the two-day course explains in clear, concise fashion
(see Historic, pg. 47)

TECHSTAFF INC.

A full service company serving the energy industry

Our services are:



- Consulting engineering
- Feasibility studies and route selection
- Design drafting • Survey and mapping
- Environmental services
- Permits and licenses
- Limited title and mineral abstracting
- Right-of-way and fee acquisition
- Pipelines • Electrical utilities • Railroads
- Inspections

TECHSTAFF INC.

816 Americana Bldg./Houston, Texas 77002/713-757-1721