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Preserving history or restricting development? The heterogeneous effects of historic districts on local housing markets in New York City☆

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ABSTRACT

Since Brooklyn Heights was designated as New York City's first landmarked neighborhood in 1965, the Landmarks Preservation Commission has designated 120 historic neighborhoods in the city. This paper develops a theory in which landmarking has heterogeneous impacts across neighborhoods and exploits variation in the timing of historic district designations in New York City to identify the effects of preservation policies on residential property markets. We combine data on residential transactions during the 35-year period between 1974 and 2009 with data from the Landmarks Preservation Commission on the location of the city's historic districts and the timing of the designations. Consistent with theory, properties just outside the boundaries of districts increase in value after designation. Further, designation raises property values within historic districts, but only outside of Manhattan. As predicted, impacts are more positive in areas where the value of the option to build unrestricted is lower. Impacts also appear to be more positive in districts that are more aesthetically appealing.

1. Introduction

In 1965, the New York City Landmarks Preservation Commission was created to protect and preserve historic properties in New York City (Wood, 2008). That same year, the Commission designated Brooklyn Heights as the city's first landmarked neighborhood, and has since designated 120 historic neighborhoods in the city. These districts range from the Upper East Side Historic District, encompassing more than 50 blocks (or parts thereof) on the east side of Central Park, to the recently-designated Perry Avenue Historic District, an agglomeration of just nine single-family homes in the Bronx. Property owners in a designated district receive no special tax advantages, but must receive approval from the Landmarks Preservation Commission before making any major improvement or demolishing a property.

The preservation of historic neighborhoods has been controversial in New York City and elsewhere. Preservation advocates argue that the market-driven process of urban development will not adequately protect a city's architectural heritage, as individual owners will not internalize the full benefit to society of historic preservation (Mourato and Mazzanti, 2002). Proponents argue that historic districts not only preserve architectural history but also generate economic externalities by increasing tourism and nurturing the city's art and culture. To the extent that they create a common identity for neighborhood residents, the creation of unified historic neighborhoods could encourage the growth of community organizations and heighten social cohesion (Rose, 1981). Preservation proponents worry that the

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political process may be stacked against historic, aesthetic, or cultural considerations, especially in high-demand cities increasingly subject to pressure from property developers (Verrey and Henley, 1991).

Preservation critics, conversely, argue that preservationists are just another well-organized lobby of incumbents opposing change and development. While many critics recognize the value of preserving historic structures and neighborhoods, they contend that preservation policies unfairly restrict the rights of property owners. Property owners in historic districts are often subject to extensive regulatory hurdles that may discourage property owners from making improvements that would maximize the value of their property. In limiting development within historic districts, critics contend that these policies limit the supply of housing, driving the cost of housing beyond the reach of many residents and contributing to a larger crisis of affordability. Taken to the extreme, historic preservation could limit a city's ability to grow and adapt to the needs of an increasingly competitive global system of cities (Glaeser, 2010).

We focus on localized impacts on property values. As our theoretical model stresses, the impact of historic preservation is unlikely to be uniform across neighborhoods. The designation of a historic district has at least two offsetting effects on the value of properties within the district. On the one hand, designation restricts the changes property owners can make to their buildings and prohibits demolition and redevelopment. Owners value the option to redevelop, particularly for older structures like those found in historic districts, and especially when new construction can result in higher density (Clapp and Salavei, 2010; McMillen and O'Sullivan, 2013; Rosenthal and Ross, 2015). By removing this option, designation should lower land and property values, especially in high demand areas that are initially low density. On the other hand, designation may increase land and property values by preserving the historic beauty – or amenity level – of a neighborhood and minimizing the risk that new investment will undermine the distinctive character of the area.

The model predicts that preservation will not uniformly affect all neighborhoods. If buildings are initially built to the allowable zoning cap or demand for the location is low, then the impact of preservation on prices is likely to be positive. If demand for the location is high and heights are far below the allowable zoning cap, then the lost option value will be large and land values should increase less, or even fall. Thus, we would expect the effects of designation on property values to be more negative in higher value neighborhoods with a greater share of buildings built at heights well below the allowable limits. In addition, preservation should provide more benefit to owners if the neighboring historic homes that are preserved by the district rules are more attractive and historically meaningful. The model also predicts that properties immediately outside districts should increase in value after designation, as they are likely to receive many of the same benefits as properties within the district without being burdened by the same restrictions.

Our empirical work largely confirms our theoretical predictions. We find that construction activity falls in districts after designation, as expected given the rules accompanying designation. As for prices, we find that properties just outside the boundaries of districts increase in value after designation as they enjoy the benefits of preservation without the restrictions. Further, we find that designation raises property values within historic districts, but only in the lower-valued boroughs outside Manhattan. More generally, we find that designation only increases the value of properties in districts where the foregone option to redevelop is relatively low. Consistent with theory, we also find that the effects of preservation on prices are slightly larger in historic districts that score higher on one measure of aesthetic appeal.

2. Theoretical model: historic districts, building and land prices

What impact will a historic district designation have on welfare, construction, land prices and unit prices within a designated area? We explore these questions with an economic model, which will guide our subsequent empirical work. We consider a city with a continuum of neighborhoods, each containing exactly one unit of land that is subdivided into a continuum of parcels. Within a neighborhood, parcels are assumed to be homogeneous, at least before any redevelopment occurs, so that all buildings are of height $\tilde{h}_n$ and aesthetic value $\tilde{\alpha}_n$. Ex post building heights are denoted h_n and the ex post amenity level of the neighborhood is α_n, the average amenity value in the neighborhood weighted by land area.

The total welfare associated with living in one of these neighborhoods, relative to a reservation locale elsewhere, equals neighborhood specific non-amenity welfare, equal to B_n plus the neighborhood amenity value α_n plus the citywide amenity value of $\delta \int_{i=1}^{N} \alpha_i di$ or δA, the weighted average of the amenity value for the entire city. The non-aesthetic welfare is meant to include the economic returns from living in the city and commuting costs in each neighborhood.

We will focus on whether new building increases or decreases neighborhood amenity levels, and social welfare. Since people are homogenous, a Henry George theorem applies (Arnott and Stiglitz, 1979) and citywide property values provide a sensible welfare measure. Total amenities include the aesthetic value of a neighborhood, which presumably matters for both residents and non-residents.[1] The citywide amenity is meant to capture the passion that so many preservationists have for the history and beauty of neighborhoods other than their own. Naturally, rebuilding a neighborhood can change the amenity level through aesthetics and other channels, such as safety and light.

Neighborhoods are assumed to be small relative to the city, and buildings are assumed to be small relative to a neighborhood. We assume that builders do not internalize the impact that the amenity level of their building has on the welfare of others, but we briefly discuss, when appropriate, the impact of developer scale on developer behavior and the need for regulation.

We assume that willingness to pay does not rise with building amenities, only with neighborhood aesthetics, which ensures firms will provide the minimum possible amenity level given current technology and regulation. This assumption will not hold for many types of amenities, but the benefits of the aesthetic aspect of amenities will often be experienced outside of the building. People looking out from a building will see less of its exterior than people looking at the building from outside. These assumptions and the spatial equilibrium implies that if the price of housing in neighborhood n is denoted p_n, then $p_n = B_n + \alpha_n + \delta A$.

We let α_0 denote the legal or aesthetic minimum value of the amenity level, which will be chosen by all developers.[2] If a share, s_n, of the neighborhood's land area is re-developed, then $\alpha_n = s_n\alpha_0 + (1 - s_n)\,\tilde{\alpha}_n$, where $\tilde{\alpha}_n$ represents the historic amenity value of the area.

The cost of redeveloping a parcel is captured by a convex function $c(h)$, where h is the height of the new building. We also assume that $\bar{h}_n$ is the legal maximum of new building heights in the neighborhood. We can now define a redevelopment equilibrium:

[1] This model can be seen as an extension to the large literature on amenities in cities that focuses specifically on the welfare economics of rebuilding neighborhoods.

[2] The model could be easily changed so the homebuyers cared about the aesthetics of their building, as long as these tastes were homogeneous across individuals. In that case α_0 could be interpreted as the optimal aesthetic value of new building given buyers' preferences.