

Preservation Law Educational Materials . . .

ASSESSING ECONOMIC HARDSHIP CLAIMS UNDER HISTORIC PRESERVATION ORDINANCES

Historic preservation ordinances in effect around the country often include a process for administrative relief from preservation restrictions in situations of “economic hardship.” Under typical economic hardship procedures, an applicant may apply for a “certificate of economic hardship” after a preservation commission has denied his or her request to alter or demolish a historic property protected under a preservation ordinance. In support of an application for relief on economic hardship grounds, the applicant must submit evidence sufficient to enable the decisionmaking body to render a decision. The type of evidence required is generally spelled out in preservation ordinances or interpreting regulations. The burden of proof is on the applicant.

The exact meaning of the term “economic hardship” depends on how the standard is defined in the ordinance. Under many preservation ordinances economic hardship is defined as consistent with the legal standard for an unconstitutional regulatory taking, which requires a property owner to establish that he or she has been denied all reasonable beneficial use or return on the property as a result of the commission’s denial of a permit for alteration or demolition.

Requests for relief on economic hardship grounds are usually decided by historic preservation commissions, although some preservation ordinances allow the commission's decision to be appealed to the city council. In some jurisdictions, the commission may be assisted by a hearing officer. A few localities have established a special economic review panel, comprised of members representing both the development and preservation community.

Economic Impact

In acting upon an application for a certificate of economic hardship, a commission is required to determine whether the economic impact of a historic preservation law, as applied to the property owner, has risen to the level of economic hardship. Thus, the first and most critical step in understanding economic hardship is to understand how to evaluate economic impact.

Commissions should look at a variety of factors in evaluating the economic impact of a proposed action on a particular property. Consideration of expenditures alone will not provide a complete or accurate picture of economic impact, whether income-producing property or owner-occupied residential property. Revenue, vacancy rates, operating expenses, financing, tax incentives, and other issues are all relevant considerations. With respect to income-producing property, economic impact is generally measured by looking at the effect of a particular course of action on a property’s overall value or return. This approach allows a commission to focus on the “bottom line” of the transaction rather than on individual expenditures.

In addition to economic impact, the Supreme Court has said that “reasonable” or “beneficial use” of the property is also an important factor. Thus, in evaluating an economic hardship claim based

on the constitutional standard for a regulatory taking, commissions will need to consider an owner's ability to continue to carry out the traditional use of the property, or whether another viable use for the property remains. In *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978), the landmark decision upholding the use of preservation ordinances to regulate historic property, the Supreme Court found that a taking did not arise because the owner could continue to use its property as a railroad station.

The Supreme Court has also said that the applicant's "reasonable investment-backed expectations" should be taken into consideration. Although the meaning of this phrase has not been delineated with precision, it is clear that "reasonable" expectations do not include those that are contrary to law. Thus, an applicant's expectation of demolishing a historic property subject to a preservation ordinance at the time of purchase, or likely to be subject to a preservation ordinance, would not be "reasonable." Also pertinent is whether the owner's objectives were realistic given the condition of the property at the time of purchase, or whether the owner simply overpaid for the property. Under takings law, government is not required to compensate property owners for bad business decisions. Nor is the government required to guarantee a return on a speculative investment.

Commissions may also be able to take into account whether the alleged hardship is "self created." Clearly relevant is whether the value of the property declined or rehabilitation expenses increased because the owner allowed the building to deteriorate.

Application of the takings standard in the context of investment or income-producing property is usually fairly straightforward. The issue can be more complex, however, in situations involving hardship claims raised by homeowners. In the context of home-ownership, it is extremely difficult for an applicant to meet the standard for a regulatory taking, that is, to establish that he or she has been denied all reasonable use of the property. Even if a commission insists that houses be painted rather than covered with vinyl siding, and windows be repaired rather than replaced, the applicant can still live in the house. The fact that these repairs may be more costly is not enough. Even if extensive rehabilitation is required, the applicant must show that the house cannot be sold "as is," or that the fair market value of the property in its current condition plus rehabilitation expenditures will exceed the fair market value of the house upon rehabilitation. See *City of Pittsburgh v. Weinberg*, 676 A.2d 207 (Pa. 1996). It is also important to note that "investment-backed expectations" are different in the context of home ownership; owners often invest in home improvements or renovations without the expectation of recouping the full cost of the improvement in the form of increased property value.

In addressing hardship claims involving historic homes, commissions must be careful to be objective and consistent in their approach. Otherwise, a commission may undermine the integrity of its preservation program and raise due process concerns as well. Ideally, grant money, tax relief, and other programs should be made available to historic homeowners who need financial assistance.

Special standards for economic hardship may apply to nonprofit organizations. Because these entities serve charitable rather than commercial purposes, it is appropriate to focus on the beneficial use of their property, rather than rate of return, taking into account the particular circumstances of the owner (i.e., the obligation to serve a charitable purpose.) In such situations, hardship analysis generally entails looking at a distinct set of questions, such as: the organization's charitable purpose; whether the regulation interferes with the organization's ability to carry out its charitable purpose; the condition of the building and the need and cost for

repairs; and whether the organization can afford to pay for the repairs, if required? (Note, however, that while consideration of financial impact may be appropriate, a non-profit organization is not entitled to relief simply on the basis that it could raise or retain more money without the restriction.)

The Proceeding

Under a typical hardship process, the applicant will be required to submit specific evidence in support of his or her claim. Once a completed application has been filed, a hearing will be scheduled, at which time the applicant generally presents expert testimony in support of the economic hardship claim on issues such as the structural integrity of the historic building, estimated costs of rehabilitation, and the projected market value of the property after rehabilitation. Once the applicant has presented its case, parties in opposition or others may then present their own evidence. The commission may also bring in its own expert witnesses to testify. As noted above, the burden of proof rests on the property owner.

In hearing economic hardship matters, commissions must be prepared to make a legally defensible decision based on all the evidence presented. In the event of conflicting expert testimony, which is often the case in economic hardship proceedings, the commission must be prepared to weigh the evidence, making specific findings on the relative credibility or competency of expert witnesses.

In evaluating the evidence, the commission should ask itself five distinct questions:

- 1) **Is the evidence sufficient?** Does the commission have all the information it needs to understand the entire picture, or is something missing. The application is not complete unless all the required information has been submitted. If additional information is needed, ask for it.
- 2) **Is the evidence relevant?** Weed out any information that is not relevant to the issue of economic hardship in the case before you. Commissions may be given more information than they need or information on issues that are not germane to the issue, such as how much money the project could make if the historic property were demolished. The property owner is not entitled to the highest and best use of the property.
- 3) **Is the evidence competent?** Make an assessment as to whether the evidence establishes what it purports to show.
- 4) **Is the evidence credible?** Consider whether the evidence is believable. For example, ask whether the figures make sense. A commission will need to take into consideration the source of the evidence and its reliability. (If the evidence is based on expert testimony, the commission should determine whether the expert is biased or qualified on the issue being addressed. For example, it may matter whether a contractor testifying on rehabilitation expenditures actually has experience in doing historic rehabilitations.)
- 5) **Is the evidence consistent?** Look for inconsistencies in the testimony or the evidence submitted. Request that inconsistencies be explained. If there is contradictory evidence, the commission needs to determine which evidence is credible and why.

In many instances the applicant's own evidence will fail to establish economic hardship. However, in some situations, the question may be less clear. The participation of preservation organizations in economic hardship proceedings can be helpful in developing the record. Commissions should also be prepared to hire or obtain experts of their own. For example, if a

property owner submits evidence from a structural engineer that the property is structurally unsound, the commission may need to make an independent determination, through the use of a governmental engineer or other qualified expert, as to the accuracy of that information. It may be impossible to evaluate the credibility or competency of information submitted without expert advice.

The record as a whole becomes exceedingly important if the case goes to court. Under most standards of judicial review, a decision will be upheld if it is supported by substantial evidence. Thus, in conducting administrative proceedings, it is important that evidence provides a true and accurate story of the facts and circumstances and that the commission's decision is based directly on that evidence.

EVIDENTIARY CHECKLIST

The following checklist is a useful tool for local commissions and other regulatory agencies considering economic hardship claims:

1. **Current level of economic return**

- Amount paid for the property, date of purchase, party from whom purchased, and relationship between the owner of record, the applicant, and person from whom property was purchased;
- Annual gross and net income from the property for the previous three years; itemized operating and maintenance expenses for the previous three years, and depreciation deduction and annual cash flow before and after debt service, if any, during the same period;
- Remaining balance on the mortgage or other financing secured by the property and annual debt-service, if any, during the prior three years;
- Real estate taxes for the previous four years and assessed value of the property according to the two most recent assessed valuations;
- All appraisals obtained within the last two years by the owner or applicant in connection with the purchase, financing, or ownership of the property;
- Form of ownership or operation of the property, whether sole proprietorship, for-profit or not-for-profit corporation, limited partnership, joint venture, or other;
- Any state or federal income tax returns relating to the property for the last two years.

2. **Any listing of property for sale or rent, price asked, and offers received, if any, within the previous two years, including testimony and relevant documents regarding:**

- Any real estate broker or firm engaged to sell or lease the property;
- Reasonableness of price or rent sought by the applicant;
- Any advertisements placed for the sale or rent of the property.

3. **Feasibility of alternative uses for the property that could earn a reasonable economic return:**

- Report from a licensed engineer or architect with experience in rehabilitation as to the

structural soundness of any buildings on the property and their suitability for rehabilitation;

- Cost estimates for the proposed construction, alteration, demolition, or removal, and an estimate of any additional cost that would be incurred to comply with the requirements for a certificate of appropriateness;
- Estimated market value of the property: (a) in its current condition; (b) after completion of the proposed alteration or demolition; and (c) after renovation of the existing property for continued use;
- Expert testimony or opinion on the feasibility of rehabilitation or reuse of the existing structure by an architect, developer, real estate consultant, appraiser, and/or other real estate professional experienced in historic properties and rehabilitation.

4. **Any evidence of self-created hardship through deliberate neglect or inadequate maintenance of the property.**
5. **Knowledge of landmark designation or potential designation at time of acquisition.**
6. **Economic incentives and/or funding available to the applicant through federal, state, city, or private programs.**