

ISSUES IN VALUING

Heritage Conservation Properties



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“THIS ASSIGNMENT WAS TRULY AN ALL-ENCOMPASSING VALUATION CHALLENGE THAT REINFORCED THE FIRST PRINCIPLES OF VALUE.”

A client recently approached our company to determine the market value of a commercial building before and after it had been designated as a Provincial Historic Resource (Heritage Building) with the Calgary Civic Trust (Trust). Specifically, the purpose was to evaluate the property’s change in value based on the owner’s gift to the Trust of the property’s heritage interests and development rights. The intended use was for the Trust and property owner to determine if it was beneficial for the subject property to be added to the Historic Resources Inventory. After identifying the appraisal requirements, we determined that we would estimate the market value of the subject property with and without the Heritage Conservation Covenant attached.

The subject is known as the Gerlitz Residence and was recently designated as a Municipal Historic Resource. The improvements are situated on a 4,058 square foot rectangular-shaped site, improved with a 115-year-old, 1,035 square foot, two-storey, wood-framed building on a concrete block foundation. It is located along 10th Avenue SE and 12th Street SE, in the community of Inglewood, City of Calgary. The subject offers a central location near other mixed-use retail and office buildings. The site is zoned C-COR2 (Commercial Corridor 2), which allows a variety of commercial related uses subject to *Bylaw 27M2019*, which allows municipal control over changes to historically



significant assets. The interior is comprised of a main and upper floor office unit, as well as an unfinished full basement for storage. There is also a heated 726 square foot (+/-) garage.

From the 27M2019 Bylaw, the historic significance is defined as follows:

The 1904-05 residence possesses value as an early, two-storey example of the Edwardian Cottage-style in the community. Although a modest six-room size, the Gerlitz Residence has Edwardian features including its two-storey, side-gable form with wide, offset front veranda, bevelled-wood siding on the main storey, with wooden shingles on the upper storey of the front and rear façades. Inglewood's residential streetscapes are characterized by these early 20th Century working-class cottages constructed in the Edwardian Cottage, Foursquare, Edwardian Gable-Front, Craftsman or Queen Anne styles. 10th Avenue was one of the earliest residential streets to develop. It was 80% built-out by WWI, and almost fully built-out by 1924.

According to the *Historical Resources Act, Revised Statutes of Alberta 2000 Chapter H-9*, Historic Resource means any work of nature or of humans that is primarily of value for its paleontological, archaeological, prehistoric, historic, cultural, natural, scientific or esthetic interest, including, but not limited to, a paleontological, archaeological, prehistoric, historic or natural site, structure or object.

Some of the sites on the Historic Resources Inventory are protected against demolitions or inappropriate changes by also being designated as Municipal Historic Resources or Provincial Historic Resources under the *Alberta Historical Resources Act*. The regulations for Historic Resources indicate that, without prior approval from the Minister, they cannot be removed, destroyed, disturbed, altered, rehabilitated, repaired or otherwise permanently changed, other than for routine preservation or maintenance work. Also, renovations/maintenance to heritage buildings require municipal approval and are intended to utilize original material and installation techniques.

After reviewing all the information, as appraisers, we started anticipating the issues that would arise from such designations/restrictions, including economic life variables, remaining economic life, and/or physical life considerations. We also started contemplating the highest and best use analyses, considering that many heritage properties are protected from redevelopment. As such, highest and best use 'as vacant' was likely not a consideration in this assignment, as was the case for the costs of ownership-based restrictions to renovations, resulting in reproduction cost relative to replacement cost. All considered,

the fee simple interest and its associated full bundle of rights is very much restricted/limited when the rights are gifted. In this situation, there must be a benefit for the owner of the property. Typically, the Municipal Heritage Resources Inventory includes city-owned properties, properties whose owners have requested this legal protection, and properties whose owners have accepted it in exchange for receiving other benefits such as higher density allowances.

The scope of work involved discussions with the Trust to determine their opinions/experiences on the effects of heritage covenants with properties in the inventory. Our firm has also completed appraisals of other heritage properties in the past. Although the locations of those heritage properties were coveted and based on sales data, there seemed to be little consideration given to the limited development rights and the heritage interest.

From a valuation standpoint, our research indicated that some heritage experts believe that an appraisal could not reflect the normal supply-demand market mechanism for determining the value of a heritage-designated property. The demand for heritage preservation comes from legislation on the part of governments, presumably reflecting the desires of society, i.e., preservation of community, architecture and lifestyle. Also, the heritage designation can restrict alternative use of the property and it distorts the normal market decision-making process, especially in the absence of direct heritage comparables. More specific to our assignment were properties that were purchased as fee simple interest, with the full bundle of rights, and then sold with heritage protection and a limited bundle of rights. To further complicate the matter, the designation motives of owners are all different, i.e., increased density considerations, bylaw relaxations (parking, change of use), subsidies for renovations, and/or reduced property taxes. However, in some situations, we found that the cost of ownership could increase in the absence of subsidies or property tax benefits. As if qualitative and quantitative adjustments were not already difficult enough to prove, these variables complicate the appraisal challenge.

Further research indicated that those properties located in more coveted, high-traffic locations attract more favorable



subsidies and tax treatment, while properties in less desirable locations do not. The subject property was not located in a high traffic location. Through our due diligence, we determined that the subject property's commercial demand was low. It was also in fair to average condition, and, in the absence of subsidies, or the perceived risk in not being approved for one, the cost of ownership through increased operating/renovation costs would increase. The highest and best use analysis concluded that there was not a strong demand for increased development density, nor would the small site support any meaningful expansion strategies. Any renovation to the interior or exterior of the premises requires Trust approval, and original materials need to be used. The subject property was 115 years old, and there were signs of deferred maintenance, older windows, exterior doors, and general interior wear and tear. While the Trust cannot enforce renovations to a property, it is reasonable to assume that deferred maintenance must be cured within a reasonable timeframe or the property can begin to suffer from increased operating costs, or bad curb appeal and reduced value.

In conclusion, it was our opinion that, because the subject property would not likely benefit from subsidies and that favorable property tax was given to more coveted properties, combined with the deferred maintenance, there was a loss in value. We essentially estimated the amount of deferred maintenance associated with the property with and without heritage conservation, i.e., replacement cost versus reproduction cost. While there was some subjectivity involved in the interpretation of the magnitude of the increased repairs and maintenance schedule, our assertion was that there was an increased cost of ownership and property maintenance before and after the gift.

This case presented a unique appraisal challenge related to identifying and understanding the effects of property rights, highest and best use analysis, age/life analysis, costs of ownership, overtime, location considerations, and potentially offsetting government subsidies/property tax treatment of heritage properties. While we know there is a plethora of interpretations/opinions relative to this appraisal situation, we asserted ours. This assignment was truly an all-encompassing valuation challenge that reinforced the first principles of value. 🏠