

EXPOSURE DRAFT OF PROPOSED INTERNATIONAL VALUATION GUIDANCE NOTE

THE VALUATION OF HISTORIC PROPERTY (published March 2006)

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Exposure Draft of Proposed International Valuation Guidance Note 15

The Valuation of Historic Property

1.0 INTRODUCTION

- 1.1 Historic properties are assets that embody a cultural, historic, and architectural heritage.
- 1.2 Historic properties may have legal or statutory protection because of their cultural and economic importance. Many governments have enacted measures to safeguard historic properties and to protect designated conservation areas and historic districts.
- 1.3 Private organisations play a significant role in promoting historic preservation and education about historic properties. In some cases, historic properties also bring economic benefits through increased tourism in the communities where they are located.
- 1.4 The valuation of historic properties requires consideration of a variety of factors that are associated with the importance of these properties, including the legal and statutory protections that they enjoy; the various restraints upon their use, alteration and disposal; possible financial grants or rate/tax exemptions to the owners of such properties in some jurisdictions; and the recognition that some or all of their value may be reflected in an enhancement of the value of adjacent or nearby properties and not be measurable on site.
- 1.5 The costs to restore and maintain historic properties may be considerable and these costs, in turn, affect the value of the properties.
- 1.6 The assessment of the highest and best use of historic properties will depend on the specific restrictions that apply to them. In some situations, the use of historic properties is limited to restoration for owner-occupancy whilst in others, adaptation to some other use, including commercial use, is permissible.

2.0 SCOPE

- 2.1 Guidance Note 15 covers real property that has cultural and historic significance, specifically focusing upon historic buildings and sites. It does not address either natural heritage assets or heritage assets that are personal property, e.g., works of art. (Guidance Note 5 offers direction on the valuation of personal property.)

- 2.2 This Guidance Note applies to the valuation of historic properties in both public and private sectors. Historic properties owned either by public-sector or private-sector entities are distinguished by similar cultural characteristics, and share common problems in regard to restoration and/or adaptation. But the specific legal and statutory protections that apply to private and public historic properties and other restraints upon their use, alteration and disposal may differ.
- 2.3 Historic property is a broad term, comprising properties that have been extensively restored to an original condition, properties that have been partially restored (e.g., the building façade) and partially adapted to current standards (e.g., the interior space), and properties that have been modernized. This Guidance Note addresses properties having historic character to some degree or other.

3.0 DEFINITIONS

International Valuation Standards Definitions

- 3.1 *Conservation Area /Historic District.* An area or district of special architectural or historic interest, the character of which is desirable to preserve and which has been so designated by the local planning/zoning board. The authority to create such areas and districts usually derives from statute or legislation that enables municipalities or counties to establish conservation areas and historic districts under their general zoning powers.
- 3.2 *Current Reproduction Cost.* The current cost to construct an exact replica, using similar materials, methods, and workmanship.
- 3.3 *Exemptions from Protected Status.* Official permission granted by a local planning authority to demolish, alter, or expand a listed building. Various known as *Listed Building Consent, Historic Zoning Variance* or *Building Code Exemption.*
- 3.4 *Historic House Owner Associations.* Not-for-profit membership associations that promote the preservation of historic properties and provide their owner-members with advice on matters such as the management, repair, maintenance, taxation and insurance of historic properties.
- 3.5 *Historic Property.* Real property publicly recognised or officially designated by a government-chartered body as having cultural or historic importance because of its association with a local/regional historic event or period, with an architectural style, or with the nation's heritage. Four characteristics are commonly associated with historic properties: 1) their historic, architectural and/or cultural importance; 2) the statutory or legal protection they may enjoy; 3) restraints and limitations placed upon their use, alteration and disposal; and 4) the frequent obligation in some jurisdictions that they be accessible to the public. See also *Heritage Assets, Publicly Designated Historic Properties.*

- 3.6 *Listing of (Heritage) Buildings or Historic Properties Register.* A recording of officially designated historic properties. Not all historic properties are necessarily listed in registers. Many properties publicly recognised as having cultural and historic importance also qualify as historic properties.
- 3.7 *Preservation Incentives.* Incentives to the owners of historic properties, primarily fiscal in nature, to promote the restoration and maintenance of such properties. Examples may include exemptions on inheritance taxes for conservation properties gifted to heritage trusts, government subsidies, exemptions in municipal rates/taxes, investment tax credits to owners of historic properties and deductions taken on conservation easements donated to nonprofit organisations.
- 3.8 *Publicly Designated Historic Properties.* Those properties, the historic status of which is officially recognised by government-chartered bodies to identify historic properties and to promote historic preservation. Such bodies may be established by national/federal, state/provincial, or county/municipal governments. Local non-governmental historical societies may also designate historic properties and maintain *private historic property lists* or *registers* that confer many of the same benefits whilst remaining exempt from government restrictions. See also *Listing of (Heritage) Buildings or Historic Register*.
- 3.9 *Refurbishment or Rehabilitation.* The process of remodeling or adapting a building to a use other than that for which it was originally intended but for which there is current demand. Compare *Repair* or *Restoration*.
- 3.10 *Renovation.* Any process that either returns a property to its original condition (*restoration*) or modernizes the property and/or adapts it to a new use (*refurbishment*).
- 3.11 *Repair or Restoration.* The process of returning a property to a sound condition, generally to its original appearance and condition, after the property has incurred damage or deterioration. Compare *Refurbishment* or *Rehabilitation*.

International Public Sector Accounting Standards Definition

- 3.12 *Heritage Asset.* An asset having some cultural, environmental, or historical significance. Heritage assets may include historical buildings and monuments, archeological sites, conservation areas and nature reserves, and works of art. Heritage assets often display the following characteristics (although these characteristics are not necessarily limited to heritage assets):
- (a) Their economic benefit in cultural, educational and historic terms is unlikely to be fully reflected in a financial value based purely on market price;

- (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
- (c) They are often irreplaceable and their economic benefit may increase over time even if their physical condition deteriorates; and
- (d) It may be difficult to estimate their useful lives, which in some cases could be hundreds of years.

The above definition is consistent with the description of heritage and conservation assets in IPSAS 17.9 (n.b., IPSAS 17 does not currently contain a formal definition of heritage assets).

- 3.13 *Heritage Asset.* An asset with historic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture and this purpose is central to the objectives of the entity holding it. IPSAS Discussion Paper on Heritage Assets (January 2006).

The IPSAS Discussion Paper further explains “it follows that, for example, an historic building used by the entity itself would not meet the definition as it is held for purposes other than a contribution to knowledge and culture. And works of art held by a profit-oriented company would fall outside of the definition as the company’s primary objective is to make a profit other than a contribution to knowledge and culture. These assets should be accounted for under existing reporting requirements for tangible fixed assets”.

Definitions from the UNESCO Glossary of World Heritage Terms

- 3.14 *Cultural Heritage.* Three groups of assets are recognised:

1. Monuments: architectural works, works of monumental sculpture and painting, elements or structures of an archaeological nature, inscriptions, cave dwellings and combinations of features, which are of outstanding universal value from the point of view of history, art or science;
2. Groups of buildings: groups of separate or connected buildings which, because of their architecture, their homogeneity or their place in the landscape, are of outstanding universal value from the point of view of history, art or science; and
3. Sites: works of man or the combined works of nature and man, and areas including archaeological sites, which are of outstanding universal value from the historical, aesthetic, ethnological or anthropological point of view.

World Heritage Convention, Article I, UNESCO, 1972.

- 3.15 *Cultural Property*. Property inscribed in the *World Heritage List* after having met at least one of the *cultural heritage criteria* and the *test of authenticity*. (World Heritage Convention, Article II, UNESCO, 1972)

4.0 RELATIONSHIP TO ACCOUNTING STANDARDS

- 4.1 International Public Sector Accounting Standard 17 (Property, Plant and Equipment) does not require an entity to recognise heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognise heritage assets, it must apply the disclosure requirements of IPSAS 17 and may, but is not required to, apply the measurement requirements of IPSAS 17. (IPSAS 17, para. 7) The IPSAS Discussion Paper on Heritage Assets (January 2006) requires the valuation of heritage assets where this is practicable. However, where valuation is impracticable, an entity would be required to make relevant disclosures, including reasons why valuation is not practicable.
- 4.2 This Guidance Note considers historic structures as a category of heritage and conservation assets.

5.0 GUIDANCE

- 5.1 The valuation of historic properties involves special considerations dealing with the nature of older construction methods and materials, the current efficiency and performance of such properties in terms of modern equivalent assets, the appropriateness of methods used to repair/restore or refurbish/rehabilitate the properties, and the character and extent of legal and statutory protections the properties enjoy.**
- 5.2 The sales comparison, cost and income capitalization approaches may be employed in the valuation of historic properties. The selection of the approach or approaches to be used depends on the availability of data required to apply that or those approaches.**

5.2.1 In applying the sales comparison approach, the historic nature of the property may change the order of priority normally given to attributes of comparable properties. It is especially important that the Valuer find comparable properties with historic features similar to those of the subject. Criteria for the selection of comparable properties include similarity in location (i.e., in zoning, permissible use, legal protection, and concentration of historic properties), architectural style, property size, and the specific cultural or historic associations of the subject property. A variety of adjustments may have to be made to the comparable sales. These involve differences in location, costs of restoration or rehabilitation, or specific encumbrances. Adjustments are made in the following situations:

5.2.1.1 where the subject property is not located in a conservation area or historic district and if applicable, the search for comparables must be extended outside the area or district;

5.2.1.2 when costs must be incurred to restore or rehabilitate the subject property, but not the comparable sales; and

5.2.1.3 where the specific encumbrances upon the subject, e.g., restrictive covenants or preservation easements, differ from those upon the comparable properties.

5.2.2 Historic properties that are located in commercially zoned areas are often valued by means of the income capitalisation approach. The distinctive architecture and ambiance of historic properties account for their special drawing power under income-producing uses. When the highest and best use of an historic property is considered to be an adaptive use, the valuation will address the following:

5.2.2.1 All work proposed to adapt or rehabilitate the historic property must meet existing zoning requirements and covenant obligations.

5.2.2.2 Where listed building consents or a zoning variance and/or building code exemptions are required, the projected timeframe to obtain such authorisation must be taken into consideration.

5.2.2.3 The income capitalisation approach will consider the cost effectiveness of an income-producing historic property in terms of the rental and/or commercial income the property is able to generate. In particular, it will address the additional costs involved in maintaining the property, especially those costs incurred due to functional obsolescence.

5.2.3 The application of the cost approach has both limitations and advantages. It may be difficult, if not, impractical to estimate historic building costs. Thus, in applying the cost approach to properties for which restoration is the highest and best use, the Valuer estimates *current reproduction cost*, i.e., the current cost to construct an exact replica, using similar materials, methods, and workmanship. Where the highest and best use of an historic property is an adaptive use, e.g., the building facade and number of storeys cannot be altered but the interior space can be remodeled, the costs of rehabilitation will represent a mix of *current reproduction* and *replacement costs*. (See Guidance Note 8, The Cost Approach for Financial Reporting—[DRC].) The application of the cost approach to valuing historic properties may also provide especially useful information not obtainable from application of the other approaches.

5.2.3.1 The construction methods and materials used in old buildings may no longer be available, and reproduction of the craftsmanship that went into such buildings may not be possible. As a result, historic properties may not be reproducible. The relationship between the cost and market value of historic properties may be problematic. Where a market in historic properties exists, market value may well exceed any estimate of their building cost. Alternatively, even if the construction of the building can be duplicated at extreme cost, the value of the property in the absence of market support may be far less than the cost.

5.2.3.2 Depreciation estimates are complicated by the atypicality of an historic property, designation of which in many markets represents an enhancement of its value rather than a penalty. Furthermore, the useful life of an historic building generally exceeds its physical life (e.g., the useful life of an historic building in a state of ruin) and often may be impossible to estimate.

5.2.3.3 The land or site, upon which an historic property stands, is subject to constraints upon its use. In turn, such constraints affect land and overall property value.

5.2.3.4 Because the cost approach examines construction methods and materials, the application of the cost approach provides special insight into the value of the quality of more traditional building materials and craftsmanship as well as the premium the market places upon these features. In applying the cost approach, the Valuer may have to estimate the current cost to restore or rehabilitate depreciated building components.

5.2.3.5 The application of the cost approach to any property, whether historic or non-historic, requires separate value estimates for building and land or site components. The cost approach focuses on land or site value, building costs, and depreciation. These individual elements are often obscured in the application of the sales comparison or income capitalisation approaches.

5.2.3.6 Depending on specific market and/or property characteristics, the cost approach may, in some cases, yield a result, which does not qualify as market value. Care should be taken in defining the nature of the valuation so as not to mislead the reader of the report.

5.3 Legal measures to safeguard historic properties may limit or restrict the use, intensity of use, or alteration of an historic property. Examples include restrictive covenants that run with the land regardless of the owner; preservation easements that prohibit certain physical changes, usually based on the condition of the property at the time the easement was acquired or immediately after proposed restoration of the property; and conservation

easements that limit the future use of a property so as to protect open space, natural features, or wildlife habitat.

5.3.1 Restrictive covenants and preservation easements, whether existing or proposed, may have a major influence on the highest and best use of an historic property, and thereby have a significant effect on property value. Preservation easements can be donated, purchased, or obtained by compulsory acquisition/eminent domain.

5.4 The valuation conclusion shall be reported in accordance with IVS 3, Valuation Reporting.

6.0 EFFECTIVE DATE

6.1 This International Valuation Guidance Note became effective on xxx.