
By

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A Master’s Project submitted to the faculty of the University of North Carolina at Chapel Hill in partial fulfillment of the requirements for the degree of Master of Regional Planning in the Department of City and Regional Planning.

Chapel Hill

2011

Approved by:

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ADVISOR        READER (optional)
Acknowledgments
I would like to extend my appreciation and gratitude to the group of people who helped make this project possible. I would like to thank my advisor, Dr. Meenu Tewari, for her guidance through this process and Dr. William Lester for helping me formulate my ideas and my research question. I am also indebted to the assistance of several other individuals who offered their experience in economic analysis, historic preservation, and small town development. Their willingness to help has not gone unnoticed and the significant information is greatly appreciated.

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Contents
I. Introduction .................................................................................................................................................. 4
II. Literature Review ......................................................................................................................................... 7
   III. Case Study: Analysis of Federal Historic Tax Credits ........................................................................ 14
   IV. Case Study: Analysis of Gates County ............................................................................................... 20
   V. Case Study: Cost Comparison; New Construction vs. Rehabilitation .............................................. 28
  VI. Conclusion ............................................................................................................................................... 36
Works Cited.................................................................................................................................................... 38
I. Introduction

Economic development embodies a twofold definition. On the one hand, it can be thought of as a process and on the other an outcome. It serves dual roles, both as a pathway to create and secure wealth and well being for its constituents while simultaneously providing concrete measures of desired outcomes such as the number of additional jobs created, income growth, and the overall increase in the local governments’ tax base. These outcomes not only facilitate the planning process, but also serve as tools to evaluate and measure the success of economic development interventions.

Private business development is one strategy that economic development planners use to grow a region’s wealth, tax and employment base. The traditional way of achieving this is by focusing on a region’s competitive advantage, building out its core strengths by industrial recruitment, or by filling gaps in a region’s economic base with diversification strategies. When assessing a community’s competitive advantage, the standard approach is to focus on the assets such as capital information, skill base, natural resources, and infrastructure. Less understood is a focus on a regions’ cultural and historical assets as a source of dynamic advantage. We know little about how these alternative approaches work in generating economic development and how they compare to the outcomes of the more traditional economic development planning process.

In this paper I will examine the economic benefits of historic preservation as a viable alternative to traditional methods of economic development, especially new construction on a Greenfield site. This paper will also provide a model or framework that
can be used by small towns or rural communities to weigh the pros and cons of historic preservation versus new construction. To do this, I will draw on the case of Gates County in North Carolina where officials are poised to launch a number of commercial and retail projects in the near future. I will also draw heavily upon a report published by Athens-Clarke County Unified Government and the Historic Preservation Division of the Georgia Department of Natural Resources (1999).

Many counties and localities that use traditional strategies of economic development deploy a variety of growth inducements such as financial incentives, human capital provisions, tax abatements, publicly financed infrastructure improvements, and publicly financed (shared cost) new commercial building on Greenfield sites. With the increasingly competitive nature of business attraction and economic development, smaller and rural communities are pressured to succeed in the states’ economy. While these aforementioned tools and strategies may be appropriate for some communities, especially large cities and metro areas, or localities with specific resources and endowments, for small and rural communities, these traditional methods can come at a disadvantage and have a negative impact. For example, there are high costs associated with new development projects, both to private and public investors. Other disadvantages can include increased traffic to the area, loss of the small town feel, and reduction of natural habitats.

Although many small and rural communities lack the tools and resources to compete with larger counties and cities to create economic development for their residents, there are alternative tools of economic development available to them. Based on the results of my analysis I will argue in this paper that historic preservation is a
feasible and potentially powerful tool for economic development for smaller and rural communities, but too often, it is viewed solely as an aesthetic tool and not as a vehicle for economic development. While there are pros and cons to the use of historic preservation as a strategy for economic development, growing evidence suggests that under certain conditions and in some places the benefits may far outweigh the cost (Rypkema, 2003).

In this paper, I will utilize a three-step analytical method. First, I will present a review of the relevant literature, which I will use to draw out the key pros and cons of a historic preservation based economic development strategy. I will argue that there are two “cons” or problems associated with historic preservation centered economic development that are identified as central bottlenecks to HPED. First, a concern about regulation – that is, the assumption that HPED involves compliance with a complicated set of regulatory mandates that add to project costs and limit flexibility in project design. And second, a concern with costs. Given the usually small scale of HPED projects, and hence the lack of scale economies, and the complexity of restoring and retrofitting existing buildings, there is an assumption that HPED projects can be costlier to implement on a per unit cost vs. return basis than traditional Greenfield development. From there, I will examine each of these assumed constraints through two case studies. The first case is an examination of federal tax credit programs for preservation projects and the potential barriers rural communities face due to increased regulations on using incentives for historic preservation. The second case is a hypothetical comparative cost analysis of a historic preservation project versus a new construction project in Gates County, North Carolina.
Finally, based on the findings from the two case studies and the literature review, I will draw conclusions about the prospects of HPED and suggest steps for future research. The primary purpose of this paper is to present a framework for comparing HPED and traditional Greenfield development models based on a set of criteria that can be used to complete a historic preservation cost analysis and make an informed decision about historic preservation versus new construction.

II. Literature Review

In recent years, a substantial amount of literature has emerged regarding historic preservation and its relationship to economic development (Rypekma, 2003; Listoken/Lahr, 2000; Mason 1998). In addition to the literature, there has been public debate about the economic costs and benefits of historic preservation (Mason, 1998). In response to this debate, economists, preservation activists and researchers have begun to provide qualitative and quantitative evidence of the benefits of historic preservation to a local economy. In today’s society, small and rural communities are trying to compete in the global economy. Successful economic development is often measured by quantifiable results. In determining the value of economic benefits, local municipalities often place sole importance on job creation and industry sector growth, however as discussed in the literature, historic preservation has additional positive impacts on a community such as enhancing the cultural identity, which are understudied but can lead to growth in the arts and heritage tourism industries and create beneficial economic spillovers..
The purpose of this literature review is to highlight four positive impacts of historic preservation as well as some potential shortcomings in an attempt to answer the larger question, “Does preservation pay?” I will review this literature not to simply restate known facts about the benefits of historic preservation, but to add to the debate of historic preservation as an ED strategy by comparing it a new construction projects as a practical tool for thinking about economic development alternatives for small and rural communities.

The first benefit of the use of historic preservation as a tool for economic development is the creation of jobs for local residents. A growing number of studies across the country have shown that historic preservation acts as a powerful economic engine, creating tens of thousands of jobs and generating significant increase in household income (Mason, 1998). Because of the labor intensive nature of building rehabilitation, historic preservation projects translate into a greater local economic impact in terms of jobs and income, in ways where the jobs and income stay in local hands (Rypkema, 1999). Leithe and Tigue (2000) argue, for example, that the effect of job creation goes beyond direct effects (e.g employment provided in the construction and related industries) to include many indirect benefits that should also be considered. For example, historic preservation not only benefits the state economy through direct construction jobs, but it also generates indirect impacts such as the demand for locally procured building products which spurs sales in related industries. While this is true of any construction project, the detailed and specialized work required in historic preservation projects, creates a particularly important niche for smaller, and often local businesses, drawing them more centrally into the construction market. Historic
preservation is thus an important economic development strategy for attracting and retaining small local businesses.

Not only do historic preservation projects involve the use of general contractors, but the detailed craftsmanship required for preservation projects also requires the use of specialists. As a result, this specialized field of construction results in even more job creation that can often provide a larger number of higher paying jobs in historic preservation projects relative to new construction. According to Donovan Rypkema, investment in new construction creates forty jobs per US $1 million compared with an investment in historic rehabilitation, which results in anywhere from forty-three jobs per US $1 million (Rypkema, 1997) to 49 new jobs per rehabilitation project (National Park Service, Heritage Preservation Services Division, 2006).

Rural communities have a long history of strong traditions including local entrepreneurship as well as ideals and specific attitudes about the community. For small towns and rural communities, historical meaning, symbolism and spiritual values, political functions, and aesthetic qualities, are very important. (Mason, 1998). While new construction can add value for the community, it can also negatively affect the fabric of tradition and culture in small and rural communities. Fendley & Christenson (1989) assert that economic development processes must rebuild an economy while sustaining the unique identity of the local community. They go on to coin the phase “rural reflation” and define it as a dual attempt at creating market value for a community product in a world economy while sustaining a community's unique identity.

Small and rural municipalities have a dual responsibility to the residents in the community both to maintain the small town culture while pursuing private investment for
economic development. Often negative externalities associated with new construction and developments such as traffic congestion as well as the reduction of natural habitats and prime farmland influence the reluctance of small and rural municipalities to pursue economic development opportunities. Unlike new construction projects, historic preservation allows modernization to meet the public safety, comfort and convenience needs of citizens without the impact of sprawl on the local built environment and the loss of local character (Rypkema, 1999). With the use of historic preservation, older buildings are rehabbed to current occupancy standards as with new construction, which prevents the unnecessary acquisition of undeveloped land and high cost of demolition of historic buildings.

Higher property values are another benefit for historic preservation. Not only does preservation increase property value, but preservation generates higher property tax revenues for local governments that further strengthen community services. For example, the presence of vacant historic buildings can reduce property values and weaken local commercial markets. The literature on the impacts of historic preservation notes the effects of preservation activity on property values (Leithe & Patricia, 2000). Recent studies from the State of Georgia illustrate that property value of locally historic designated projects increase by almost 11 percent between 1983-1996 (Leithe & Patricia, 2000). In a comparison of properties designated as historic vs. non-historic, studies have shown that non-designated properties grow at a slower rate than those with historic designation. For example, in Rome, GA a sample of properties designated as historic, increased in value by 10 percent more than non-designated properties over a 16-year period beginning in 1980 (Leithe & Patricia, 2000). Another example is found
in the study in Athens, GA where between the periods of 1976 to 1996, the average assessed value for historic properties grew by nearly 48 percent compared to non-designated neighborhoods that saw a growth of only 34 percent. While historic designation is not the sole factor in causing the increase in property values, these studies do provide evidence that historic designation is a significant factor in creating value for property owners (Leithe & Patricia, 2000).

Another way historic preservation can encourage economic development is through its direct correlation with tourism. Historic preservation strategies have been identified as a benefit for the tourism industry (Rypkema, 2008). For Gates County, heritage tourism has been a major industry focus. This major economic engine in North Carolina’s Northeast Region continues to grow as more and more visitors discover the natural, cultural, historic, and recreational resources. Studies from around the country are beginning to show that historic sites and buildings are among the one or two most important attractions to tourists and travelers (Rypkema, 2008, (Roddewig, 1988)).

It is clear from the literature that historic preservation has several benefits to community and economic development. Although there are many pros associated with historic preservation, a few cons and myths make the historic preservation process less appealing to small and rural communities. First, some argue that despite some savings in historic preservation projects, there are other associated costs that can be overbearing, particularly related to regulations. A 2006 article published by the Wall Street Journal, states that "strict regulation on construction and modification can make repairs costly and burdensome." In addition to the costs associated with regulatory
compliance, developers are concerned about how fast they will see a return on their investment, the lengthy timeframe of regulations can be a deterrent to private investors.

Most of the concerns and myths about historic preservation projects are associated with one of three aspects: (i) cost, (ii) time, and (iii) return on investment.

Consider the following table, which presents a summary of myths\(^1\) offered by Rypkema in his publication, *The Economics of Rehabilitation* (1999)

<table>
<thead>
<tr>
<th>ASSUMPTIONS ABOUT COST, TIME AND RETURN ON INVESTMENT</th>
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<tbody>
<tr>
<td><strong>Cost</strong></td>
</tr>
<tr>
<td>The cost of rehabilitation in the end is nearly always more than new construction</td>
</tr>
<tr>
<td>The cost of trying to retro fit an existing building to meet the standards of today’s tenants makes rehab too costly to pursue.</td>
</tr>
<tr>
<td>The cost of operating older buildings is much greater than energy efficient new buildings.</td>
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<tr>
<td>The financing available for rehab projects is not as attractive or plentiful as for new construction.</td>
</tr>
<tr>
<td>There is no way of knowing at the outset of a rehab project which building components are going to save money and which are going to cost more than new construction.</td>
</tr>
<tr>
<td>Net-to-gross ratio is significantly lower in old buildings making new</td>
</tr>
<tr>
<td><strong>Time</strong></td>
</tr>
<tr>
<td>It takes longer to complete the project trying to rehab an existing structure instead of starting from scratch.</td>
</tr>
<tr>
<td>The only way to rehab an old building is to do the whole thing over</td>
</tr>
<tr>
<td><strong>Return on Investment</strong></td>
</tr>
<tr>
<td>The vacancy rate for older buildings is much higher than for new buildings.</td>
</tr>
<tr>
<td>Most older buildings are in downtown location, and it is the suburbs where money is being made in commercial real estate investment.</td>
</tr>
</tbody>
</table>

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\(^1\) The term myths is used by the author to define the argument of rehabilitation vs. New construction
construction more cost effective.

| The rents that can be obtained from even quality rehabbed space are much less than in a new building. |

While Rypkema (2008) identifies each of these myths and provides research to dispel them or call them into question, my reorganization of them into three broad categories provides a nice framework for the two cases I will examine in the next two sections of this paper.

Given that most of the myths associated with historic preservation are centered around financial issues, I chose to delve more deeply into that area first. I will begin first by presenting a case study on the history of federal tax credits and how they can ultimately alleviate some of the financial pressures presented above. Second, I will present a cost comparison analysis of a hypothetical development project in Gates County, North Carolina. I use the indicators listed above in Table X to develop a Pro forma and framework for comparisons that will enlighten us about the specific costs associated with new construction projects versus a historic preservation project.
III. Case Study: Analysis of Federal Historic Tax Credits

Using Gates County as an illustration, I will provide a more concrete illustration of the economic value and impacts that rehabilitation projects can have on local communities. I do so by examining a particular mechanism that counties use for economic development, namely incentives. I focus in particular on the use of Federal tax credits that counties generally use as incentives for historic preservation oriented development. Below I will discuss the evolution of historic tax credits while aiming to demonstrate that tax credit incentives are one of the many benefits of historic preservation. A brief history of the Federal Historic Rehabilitation Tax Credit follows which illustrates the effect on financing historic resources over the last several decades. This section also examines the background and evolution of the federal historic tax credit in the United States, presents quantitative and qualitative information regarding economic benefits, and explores ways in which current incentives can benefit small and rural towns directly.

Before the 1976 Tax Act, tax codes generally favored new construction projects. The 1976 Tax Act introduced supportive measures for historic preservation for the first time relieving the depreciation cost of historic rehabilitation. This act counted preservation easements as charitable donations and provided for 60-month accelerated depreciation\(^2\). The Tax Reform Act of 1976 also allowed owners of historic, depreciable structures to reduce write-off schedules from 25-30 years down to five years, which in turn allows them to qualify for tax rebates earlier.

\(^2\) Depreciation is attractive to real estate investors because it reduces taxable income.
The first tax incentives to historic property owners were written into the Revenue Act of 1978. The 1978 Act offered a tax credit of 10% of rehabilitation costs on historic, commercial, and industrial buildings to the owners or developers. These incentives were followed in 1981 by a three-tiered (15%, 20%, and 25%) investment tax credit for historic structures and were put in place as a part of The Economic Recovery Tax Act (ERTA) (Asabere & Huffman, 1995). This new three-tiered system made historic preservation profitable by establishing a range of available tax values, and a large number of investors and developers diverted funds to renovation and rehabilitation. For example, the maximum any property could qualify for in 1978 was a 10% credit. Under the new law, a 30 year old property could qualify for a 15% reduction in associated construction costs; a 49 year old and up property could qualify for up to a 20% discount. Any property deemed historic by the Department of Interior qualified for the maximum credit of 25% (Asabere & Huffman, 1995). This was a major shift in the rehabilitation and preservation field. Prior to this act, historic preservation was not viewed as profitable when compared to big box development because the high costs of complying with regulations were viewed as being more costly than the subsequent benefits.

Unfortunately the increase in tax credit claims brought with it serious abuse of the program. It is estimated that almost 20% of projects claiming credit were not eligible, and up to 40% of owners who sold properties before the five year holding period did not pay back cancelled credits. These abuses led to an increase in restrictions and a scaling back of credits with the Tax Reform Act of 1986 (Tyler, 2000). In a 2004 study

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3 A five-year holding period was a requirement of this Act. This period required owners to maintain ownership of the property for at least five years after the completion of the preservation
by the Edward J. Bloustein School of Planning and Public Policy of Rutgers University, the authors used data from the Dept of interior to find that as a result of this abuse, historic rehab tax credit investment grew from $738 million in the fiscal year (FY) 1981 to $1.128 billion in FY 1982 to $2.165 billion in FY 1983 and a high of $2.416 billion of approved work by FY 1985.4

As a result of all of the abuse of financial incentives used to lure investment, the 1986 Tax Reform Act (TRA) was enacted which changed the rehabilitation tax credit provisions. This reform reduced the percentage awarded to buildings with a historic preservation and increased the age of the buildings the funds could be applied to. The reform also reduced the percent credit of historic income-producing properties (from the 1981 Act) from 25 percent to 20, meaning, a $1 million rehab project would qualify for $200,000 credit, instead of $250,000.

The federal historic tax credit application process is currently divided into a three-step process. First, the property must be evaluated for historical significance. Second, the rehabilitation work must be described and third, a certification of completed work must be submitted to the granting agency. These restricted application guidelines reduced the number of wealthy individuals seeking to invest in historic rehab projects. The 1986 Tax Reform Act changes caused investment to plummet. In 1985, we saw a high of 6,100 projects with an aggregate of $2.4 billion dollars. By 1993, that number had dropped to a staggering low of about 538 projects with an aggregate of only 468 million.

Investment has subsequently rebounded strongly. This recovery began towards the second half of the 90’s due to heavy interests from corporations looking for

4 Figures are set in nominal terms and are not adjusted for inflation
alternative investments vs. other tax credit programs. Proposed investments in FY 2006, 2007, and 2008, amounted to $4.1 billion, $4.3 billion, and $5.6 billion respectively, thus exceeding the peak annual dollar investment of the ERTA era (Figure 1.1). Data illustrates that the number of projects has never recovered from its 1985 peak performance (despite large gains), with annual project numbers over the past several years hovering between 1,000-1,200. However, through FY 2008, the historic tax credits have cumulatively amounted to about $57 billion dollars of investment distributed among 45,000 projects—proving that it is one of the most effective tools for promoting rehabilitation.

**Figure 1.1 Federal Historic Tax Credits, Fiscal Year 1978-2008**

Secondary data also illustrates the economic impact the federal tax credit has had on job creation, income, and gross domestic product by sector from 1978 through 2008 (see Figure 1.2 below). The planning department of Rutgers University developed this analysis using the input-output model, IMPLAN. This modeling technique
demonstrates the affects that investment in historical preservation projects can have on industry sectors.

Figure 1.2: Income, Jobs, GDP Created by Sector, Cumulative

Jobs Created by Sector from Federal Historic Tax Credit Investment
(1,815,208 jobs cumulative, FY 1978-2008)

Income Created by Sector from Federal Historic Tax Credit Investment
($71,714.7 million cumulative, FY 1978-2008)
In summary, construction and manufacturing sectors had the most direct impact in all three categories (jobs, income, and GDP). The use of tax credits also caused indirect benefits, particularly in the service industry. This data illustrates the multiplier effect historic tax credits have on other sectors of the economy through indirect and induced efforts. Although this data is helpful in understanding the impacts of historic preservation, without a comparison to the economic impacts of a new construction project with a historic preservation centered project the argument is still inconclusive. In the next section of this paper, we will consider a line-by-line comparison between a historic preservation project and a new construction project using our reference site of Gates County.
IV. Case Study: Analysis of Gates County

As illustrated in the case study the use of historic tax credits can provide comparable economic incentives, which fill gaps created by rehabilitation projects while still creating benefits for small and rural communities associated with successful economic development. But the larger question still remains: why do small and rural communities still neglect historic preservation in favor of other economic development tools.

Gates County is an example of a small town where developers are currently considering sitting a new commercial park on a Greenfield or undeveloped site. The goal of this Commercial Park and related projects is to stimulate the economy of Gates County by providing jobs, increasing the tax base and enhancing the quality of life for its residents.

As currently planned, this project will require the development of 155 acres of prime undeveloped land that has been re-zoned for mixed-use development. Forty-five acres of the property will be devoted to commercial use, while the remaining land will be used for light industrial and residential use. The County manager and County commissioners chose to invest in a new commercial development project that will

5 North Carolina is comprised of 100 counties, which are grouped into 7 economic partnerships. The North Carolina Department of Commerce ranks the counties annually on economic well-being and assigns each county a Tier designation. This ranking system is based on the overall level of economic activity in the state. This Tier system ranges from most distressed counties (Tier 1), followed by Tier 2 and least distressed as Tier 3. Roughly, 40% of the state’s counties are designated as Tier 1. Gates County NC is an example of a small, rural and Tier one county in North Carolina looking for viable tools and strategies that would benefit their economy. Gates County is located in the eastern region of North Carolina. The Eastern region of North Carolina has more than half of its counties designated as Tier 1.
enable the County not only to recruit and obtain the services of commercial establishments, but also the services of industrial and other higher paying employment opportunities. While this decision or solution may well serve the county’s needs, new construction will require large outlays of capital cost upfront and will involve heavy infrastructure expenses. This large capital cost requirement is a bottleneck in the ability of this small town to induce more e-commerce in the region so much so that the project is currently stagnant.

Despite the county managers and commissioners’ willingness to embark on a new construction project, Gates County has a strong presence of under-utilized historically registered buildings that could serve as a tool and material base for economic development. This section will unpack the debate of new construction versus the rehabilitation of historic buildings via a detailed cost comparison, complete with numbers associated with real estate economic projects. This Pro Forma will also highlight how historic buildings perform in comparison to new construction projects and dispel myths associated with costs of the historic preservation process. Moreover, it illustrates how the use of federal incentive programs can be an added bonus for developers to influence interests with investing in economic development projects.

Context

I first perform a social-demographic and economic analysis of Gates County to understand and illustrate the assets, strengths, and challenges of small and rural communities. The following analysis of Gates County, the surrounding region, and the state, explores socioeconomic trends and demographic characteristics to provide a context and foundation for future community and community development. This set of
information is sought out to examine the challenges facing the area, including current economic conditions and potential threats to future growth. The primary sources of data referenced include the Quarterly Census of Employment and Wages from the U.S. Bureau of Labor Statistics, Public Use Micro Data and the County Business Patterns from the U.S. Census, as well as the NC Employment Security Commission. Secondary resources reviewed for this part of our analysis are included in the bibliography.

**Population Growth:**

As private developers begin to investigate the potential to do business in Gates County, luring investors will be a challenge because of the population decline and consequently a shrinking market size and labor market. According to the data, the population growth rate showed a sharp decline towards the end of the last decade in comparison to the region and the state. These numbers (particularly from 2006-2008) suggest a stagnant population growth rate, perhaps caused by the lack of commercial and economic development.

**Figure: 2 Population growth rates of Gates County, region, and state**

Source: NC State Data Center, Office of State Budget and Management, 2009
Projections also illustrate that Gates County population growth is expected to decline. Both the state and the region are expected to continue losing population through 2025, albeit at a small and decreasing rate of decline (see Figure 3).

**Figure 3: Projected population growth rate of Gates County, region and state**

Source: NC State Data Center, Office of State Budget and Management, 2009

**Racial Composition:**

Gates County’s racial composition differs from that found in the rest of the state. African Americans are a large component of the population both locally and regionally (see Figure 4). In contrast, the Hispanic population in Gates County has a much smaller population in comparison to the region and state.
The median household income in Gates County in 2008, for example was $44,737 compared to $36,914 for the region and $46,574 for the state (see Figure 5). The higher numbers in income levels compared to the region can be explained partially by a higher concentration of retired residents in the region.
Another important income and poverty indicator is the unemployment level. In 2009, Gates County’s unemployment rate was 7.4%. The regional rate was 9% and the rate was 10% for the state (see Figure 6). While unemployment is lower in the county compared to the region and state, but that rate is steadily increasing.
**Educational Attainment:**

Education is the final component of basic socioeconomic analysis. The percentage of high school graduates among residents 25 years of age or older in Gates County is lower than the region and state, at just over 70%, compared to 72% and 78% for the region and state respectively (see Figure 8). Low performing numbers in this statistic present a challenge for private business recruitment. Human Capital is based on the knowledge and skill set a community has. The human capital in a county can become a key asset to community and economic development. Developers and private corporations look at the access of human capital when determining whether to relocate to a region or local area. The lack of a qualified workforce may result in fewer jobs and wealth creation for citizens.

**Figure 8: Percent of residents aged 25+ with high school diplomas in Gates County, region, and state**

Source U.S. Census Bureau, 2000
Socioeconomic Summary

Assets and Strengths:

In order to create and sustain economic development, Gates County must start with understanding their inventory of assets and strengths. Assets and strengths could become the building blocks to understanding what tools and strategies to best use for economic development. In an interview with the current Gates County manager, he states that people of Gates County are its primary assets. “The people are here and ready to work” (Toby Chappell, personal communication, 2011). On the surface, this statement can be seen as contradictory based on statistical data illustrating the low educational attainment in the county. However, according to Chappell, most residents of Gates County are equipped with skills of a vocational trade, such as construction, farming, and manufacturing. The county manager sees the qualified workforce of Gates County as the strength of the county. The county wants to leverage this strength as an incentive for private firms to locate to the area. He also states that the majority of this workforce is lost to surrounding counties and the state of Virginia because of citizens being lured away with the availability of higher wage jobs. According to statistics, 31% of Gates County’s working population is employed outside of the county.

Along with the presence of labor in the county as an asset, the availability of land can also become a tool Gates County can use as an incentive to recruit private firms to the county. Firms are constantly looking for advantages to increase profitability. As the economy continues to expand in more developed regions of North Carolina, land is
becoming a scarce resource. With the availability of cheap land, Gates County can use this asset as a competitive advantage. Although conditions seem ripe for economic development in Gates County (available land and labor), there are significant hurdles and challenges to these efforts.

Challenges to Economic Development:

The biggest hurdle for Gates County is the lack of infrastructure present in the area including highways, roads, and sewer lines. The county is currently in a state of trying to solve long-term problems with short-term fixes. Because of this, major economic development projects will take time due to the need for costly upfront investments to improve and expand the existing infrastructure and the region’s physical capital. With the exception of the county courthouse and the old county prison the majority of the county is on a septic tank system. This system will not sustain the type of development Gates County wants to attract.

Factors and limitations presented in this section serve as an illustration of how there are limited opportunities for economically led development in this region and this county. While there are challenges, the idea of historic preservation is a solution that builds on the assets of these small communities. The next section furthers this debate by looking into the cost comparison of a new construction project to a rehabilitation project in Gates County.

V. Case Study: Cost Comparison; New Construction vs. Rehabilitation

Using real estate terminology, the difference between the cost of a project and its value is called the gap. Thus the rationale for every historic preservation incentive—federal, state or local, is to close the gap. The provisions for the use of these incentives
are justified in that there is value in both economic and non-economic terms. The public receives benefits in the long run through historic preservation that may not be acquired by the developer in the short run. Because value has multitude meanings many of them cannot be quantifiable in dollars and cents. As stated earlier, cultural value, architectural value, heritage value, community values are all real values that can be legitimately restored by historic preservation (Rypkema, 2003)

Methodology:

Using a Pro Forma, I have created a detailed list of what private investors need in deciding whether to acquire and rehabilitate an existing structure or acquire property, demolish the existing building and erect a new one. The Pro Forma used was a recreation of a similar Pro Forma created by real estate and economic development consultant Donovan Rypkema. Rypkema is also the founder of Place Economics, a private sector firm with extensive experience in the measurement of the economic impacts of historic preservation. His work and the firm’s work have been credited for its contribution to historic preservation and economic development for over twenty-five years. This list will provide cost comparison of the following variables: acquisition of land, construction cost, and net-to gross ratio, operating expenses and income, cash flow, loan payments, potential rent and vacancy percentage, and the investor’s return. These criteria, along with others will be explained and presented in a table that will allow the preservation advocate to help the developer make his or her decision. The values used below are examples only (and are based on data gathered from the Gates County Tax office) and will vary widely from locale to locale and from time to time. The values presented in the table follow basic real estate principles and associated real estate
projections. While these values pertain specifically to Gates County, they are typical of most new development and rehabilitation projects in small and rural communities. This comparison also utilizes additional resources including estimated real estate information appraisal listings, general contractors, and cost estimators, market data from appraisers, operating history, standard data sources, commercial brokers, loan officers, and follows a typical amortization schedule. This comparison will allow decision makers for not only Gates County but other similar small and rural communities to determine the dollars and cents of rehabilitation. Within the table each line item will be discussed and highlighted to explain in detail what is considered for developers trying to decide whether to acquire and rehabilitate an existing building or construct a new one. Below I will present the cost comparison. Immediately following the comparison is a key that explains how the line items were obtained and provides a more detailed explanation of each category.
## Does Preservation Pay?

### Cost Comparison of a Rehabilitation Project vs New Construction

<table>
<thead>
<tr>
<th></th>
<th>Rehabilitation</th>
<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Building Size (sq.ft.)</td>
<td>100,000</td>
<td>100,000</td>
<td>1</td>
</tr>
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</table>

### Capital Cost

<table>
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<th></th>
<th>Rehabilitation</th>
<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>B Acquisition cost</td>
<td>$ 75,000.00</td>
<td>$ 325,000.00</td>
<td>2</td>
</tr>
<tr>
<td>C Demolition cost</td>
<td>$ -</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td>D Construction cost (sq.ft)</td>
<td>$ 96.00</td>
<td>$ 100.00</td>
<td>3</td>
</tr>
<tr>
<td>E Construction cost (total $)</td>
<td>$ 9,600,000.00</td>
<td>$ 10,000,000.00</td>
<td>D x A</td>
</tr>
<tr>
<td>F Total Capital Costs</td>
<td>$ 9,675,000.00</td>
<td>$ 10,325,000.00</td>
<td>B + C + E</td>
</tr>
</tbody>
</table>

### Operating Income

<table>
<thead>
<tr>
<th></th>
<th>Rehabilitation</th>
<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>G Rent (sq. ft.)</td>
<td>$ 15.00</td>
<td>$ 18.00</td>
<td>4</td>
</tr>
<tr>
<td>H Vacancy (%)</td>
<td>10%</td>
<td>8%</td>
<td>5</td>
</tr>
<tr>
<td>I Net-to-Gross Ratio</td>
<td>89%</td>
<td>92%</td>
<td>6</td>
</tr>
<tr>
<td>J Rentable Square Feet</td>
<td>89,000.00</td>
<td>92,000.00</td>
<td>A x I</td>
</tr>
<tr>
<td>K Rent (Total $)</td>
<td>$ 1,335,000.00</td>
<td>$ 1,656,000.00</td>
<td>G x J</td>
</tr>
<tr>
<td>L Vacancy (%)</td>
<td>$ 133,500.00</td>
<td>$ 132,480.00</td>
<td></td>
</tr>
<tr>
<td>M Total Operating Income</td>
<td>$ 1,201,500.00</td>
<td>$ 1,523,520.00</td>
<td></td>
</tr>
</tbody>
</table>

### Operating Expenses

<table>
<thead>
<tr>
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<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>N Operating Expense Ratio (%)</td>
<td>38%</td>
<td>35%</td>
<td>7</td>
</tr>
<tr>
<td>O Total Operating Expenses</td>
<td>$ 456,570.00</td>
<td>$ 533,232.00</td>
<td>M x N</td>
</tr>
<tr>
<td>P Net Operating Income</td>
<td>$ 744,930.00</td>
<td>$ 990,288.00</td>
<td>M-O</td>
</tr>
<tr>
<td>Q Unleverage Investment Return</td>
<td>7.7%</td>
<td>9.6%</td>
<td></td>
</tr>
</tbody>
</table>

### Financing

<table>
<thead>
<tr>
<th></th>
<th>Rehabilitation</th>
<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>R Capitalization Rate</td>
<td>10%</td>
<td>10%</td>
<td>8</td>
</tr>
<tr>
<td>S Value Based on Appraisal</td>
<td>$ 7,449,300.00</td>
<td>$ 9,902,880.00</td>
<td>P / R</td>
</tr>
<tr>
<td>T Loan-to-Value Ratio</td>
<td>65%</td>
<td>65%</td>
<td>9</td>
</tr>
<tr>
<td>U Available Loan</td>
<td>$ 4,842,045.00</td>
<td>$ 6,436,872.00</td>
<td>S x T</td>
</tr>
<tr>
<td>V Inversto Cash Required</td>
<td>$ 4,832,955.00</td>
<td>$ 3,888,128.00</td>
<td>F-U</td>
</tr>
<tr>
<td>W Loan Term (Years)</td>
<td>25</td>
<td>25</td>
<td>9</td>
</tr>
<tr>
<td>X Interest Rate (%)</td>
<td>10%</td>
<td>10%</td>
<td>9</td>
</tr>
<tr>
<td>Y Annual Payment on Loan</td>
<td>$ 484,204.00</td>
<td>$ 643,687.00</td>
<td>10</td>
</tr>
<tr>
<td>Z Cash Flow</td>
<td>$ 260,726.00</td>
<td>$ 346,601.00</td>
<td>P-Y</td>
</tr>
<tr>
<td>AA Investors Cash-on-Cash Return</td>
<td>5.4%</td>
<td>8.9%</td>
<td>Z / V</td>
</tr>
<tr>
<td>BB Gap Between Cost and Value</td>
<td>$ 2,225,700.00</td>
<td>$ 422,120.00</td>
<td>F-S</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
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<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>CC Gap Between Cost and Value</td>
<td>$ 2,225,700.00</td>
<td>$ 422,120.00</td>
<td></td>
</tr>
<tr>
<td>DD Tax Credit Available (%)</td>
<td>20%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>EE Eligible Expenditure</td>
<td>$ 9,600,000.00</td>
<td>$ -</td>
<td>From E</td>
</tr>
<tr>
<td>FF Tax Credit Available ($)</td>
<td>$ 1,920,000.00</td>
<td>$ -</td>
<td>DD x EE</td>
</tr>
<tr>
<td>GG Gap After Adjustment</td>
<td>$ 305,700.00</td>
<td>$ 422,120.00</td>
<td>CC - FF</td>
</tr>
<tr>
<td>HH Investor Cash Before Credit</td>
<td>$ 4,832,955.00</td>
<td>$ 3,888,128.00</td>
<td>From V</td>
</tr>
<tr>
<td>II Investor Cash After Credit</td>
<td>$ 2,912,955.00</td>
<td>$ 3,888,128.00</td>
<td>HH - FF</td>
</tr>
<tr>
<td>JJ Cash Flow</td>
<td>$ 260,726.00</td>
<td>$ 346,601.00</td>
<td>From Z</td>
</tr>
</tbody>
</table>

### After Credit Adjustment

<table>
<thead>
<tr>
<th></th>
<th>Rehabilitation</th>
<th>New Construction</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>KK Investor’s Cash-on-Cash Return</td>
<td>9.0%</td>
<td>8.9%</td>
<td>JJ / II</td>
</tr>
</tbody>
</table>
A: The existing historic site is approximately 5.2 acres owned by the Gates county school board. A local real-estate developer, who owns the property where the potential commerce park will be located, is selling the land at $65,000 per acre. To keep the comparison the same the proposed building will be the same size for the existing building and the new. Typically, a 100,000-sq.ft building could be constructed on this amount of acreage.

B: The acquisition cost ($325,000) and ($75,000) is based on the $65,000 per acre and the selling of the historic property through North Carolina Preservation.

C: Demolition costs are not incurred with either option.

D: Rehabilitation cost of construction is slightly lower ($96 per square foot versus $100) over new construction. This represents a five percent increase in cost to new construction projects. This also includes the added cost of utility and water for the new construction.

E: With the cost of construction being higher for new projects per sq. ft the total cost of rehabilitation ($9.6 million) is lower than ($10 million) for new construction.

F: Total capital cost will be higher for new construction ($10,325,000 versus $9,675,000) because it includes land acquisition costs in addition to the construction costs.

G: It is estimated that the new construction project will command higher rents ($18/square foot per year vs. $15/ square foot per year) than the rehabilitated older building.

H: Vacancy rate is expected to be greater in rehabilitation (10 percent) than in new construction (8 percent).
I: Because of the floor plan limitations of older buildings, more intensive use of the space is projected to be possible in newer buildings. This presents a higher net- gross ratio (92 percent versus 89 percent).

J: With a higher net-to-gross, new construction projects have more rentable square feet space (92,000 versus 89,000) than historic buildings.

K, L, M: With these factors, the higher rent, lower vacancy and additional rentable space, combine to provide newer building with more total operating income ($1.5 million versus $1.2 million).

N: Operating expenses are more favorable to new construction compared to rehabilitation (35% vs. 38%).

O: Because of the difference in total operating income, even with the expense ratio being higher for historic preservation, the total operating expense ratio is less than new construction.

P: This leaves the new building with greater net operating income ($990,288) than the rehabilitation ($744,930).

Q: The rate of return is higher for new construction. This is calculated by dividing the net operating income by the total capital costs that have been invested in the project. It is called unleveraged return because no financing has been considered at this point.

R: A capitalization rate is the relationship between how much revenue the property will generate and the value or how much the property is worth. A local appraiser in this case has established a rate of 10% based on current interest rates; remaining life of building; economic life of the building; investor demands; and others.
S: As a result of the net operating income being greater for new construction, the value of the new building ($9.9 million) is estimated to be greater than that of the rehabilitation project ($7.4 million).

T: The same loan-to-value ratio has been factored in for both alternatives (65 percent).

U: Banks can only lend against the value and not the cost.

V: Because of the nature of lending services, whatever is not secured through the bank must be provided by the borrower. The cash required in higher for rehab project ($4.8 million) than new construction ($3.8 million).

W, X: Because of its risk banks may give rehabilitation projects shorter loan terms (20 years) and a higher interest rate (11 percent) than new construction projects (25 years, 10 percent).

Y: The annual payment on the loan was based on an amortization schedule based on the numerical values.

Z: Most investors want to know what the cash flow is. Cash flow is the money left after net operating income has been reduced. In this comparison the rehab project had a cash flow of $212,306 and the new project $346,601.

AA: The cash on cash return is calculated by dividing the cash flow and the investor cash required. In this scenario, the investor would receive 5.4% for the rehabilitation project and 9% for new construction. This line item is very important in terms of understanding what a developer or community will get out of the project. These figures depict that new construction is more lucrative than preservation projects.

BB: As discussed early the gap between cost and value is not uncommon in historic preservation projects. Almost all the variables summarized in the table above work in
favor of a new construction project; however what follows in this analysis is the impact of historic tax credit on the investment return. This addition will help in making the case for economic value.

**CC:** We start the analysis of tax credits with the gap between cost and value. With most historic preservation projects, federal tax credits are used to close this gap.

**DD:** A 20% percent tax credit is used for the rehabilitation of historic structures.

**EE:** The tax credit is applied to the construction cost of the project ($9.6 million).

**GG:** The Gap between the cost and value has been reduced with the impact of the tax credit.

**HH:** The Investor cash is now brought forward from the calculation of investor cash required.

**JJ, KK:** The cash on cash return after credit adjustment improved. This makes a rehabilitation project more attractive to investors. With the adjustments provided by the incentives, the return is almost identical to that of a new construction project.

This analysis provides a quantitative illustration of how rehabilitation projects can be just as effective as new construction and that coupled with the other unquantifiable benefits discussed in this study such as the conservation of cultural identity and preservation of natural habitats makes historic preservation a tool for economic development. In the end, historic preservation projects provide an economically attractive alternative. While this analysis may not be the only tool for a final decision for economic development, it is a sufficient means of evaluation for a small and rural community to begin to make the economic argument.

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VI. Conclusion

“National associations of economic development professionals define economic development as the process of creating wealth through the mobilization of human, financial, capital, physical and natural resources to generate marketable goods and services” (Morgan, 2009). This multifaceted process, results in new private investment, job creation, increased wealth, and a higher standard of living for residents. But what drives economic development? Economic developers have traditionally concentrated mainly on attracting private business. The attraction, retention, and expansion of business create a ripple effect that results in the desired outcomes for communities. In turn, new jobs spawn income, sales, and property tax revenue growth for local and state governments. There are no quick fixes in economic development. Economic development is a long term process that may involve numerous organizational players, along with a range of tools and strategies.

Most communities have a department of economic development. If not a department, communities will have an individual- be it a city manager, commissioners, or even a planner that is concerned with job creation, business retention, business attraction, or industrial recruitment. Gates County, NC is no exception to the predicament that most small and rural communities are facing in NC in terms of community and economic development. And for effective development to take place economic development must be in line with the community’s character and respond to any social or cultural issues that may impact such development. I have highlighted measurements and plans 7. Operating history, standard data source 8. Commercial broker 9. Loan officer, standard data source 10. Amortization schedule.
traditional methods of economic development and the barriers for small and rural communities. I have also illustrated how the use of preservation or rehabilitation as an alternative to these traditional approaches to growth and development may be a viable resource for small and rural communities.

“Lower taxes to the minimum and another town will abate taxes altogether. Lend money at a low-interest rate and somewhere else will lend it interest free. Provide all public infrastructure and another community will throw in a building as well”. (Rypkema, 2008) Many communities are under the misconception that if you build it they will come. Often times these measures of business creation and industrial recruitment have negative impacts such as sprawl, depletion of cultural and natural assets, and public debt. To suggest that a community invest in a one shot or quick fix solution to economic development almost never solves the problem of sustainable economic development. This is not to suggest that these strategies and others are not important tools of economic development rather it is to contend that, “regardless of how fast, cheap, or easy one community can make development, a city right down the road can make it faster, cheaper, and easier” (Rypkema, 2008).

The information discussed in this paper provides the details of historic preservation benefits. Why are small and rural communities reluctant to look for alternatives to economic development? My intent in this study was to display the alternative tool of historic preservation in economic development. I identified the benefits of historic preservation through a review of the literature on historic preservation, and grounded this in the practice of HPED by examining the impact of federal historic tax credits, the single most commonly used mechanism to include historic preservation on the local
I then used the case of Gates County to develop the costs and benefits of traditional vs. Historic Preservation centered development focused on a particular project that the county is actively considering making investments. I conclude that while the information provided here can be improved by further research and analysis of the economic impacts of historic preservation, there is a clear comparative framework available to communities interested in pursuing historic preservation based development as an economic development strategy. This research serves therefore to illustrate to rural and small municipalities and decision makers the strength of historic preservation oriented development based on the use of assets present in their communities. With questions of how to create economic development in rural and small communities this information of the benefits of historic preservation and the potential negative impacts of using traditional tools of economic development can be a catalyst for how small and rural communities engage in the twofold process of economic development.

Works Cited


