

New York State Assembly Votes to Put Thousands Out of Work

On February 2 of this year, the New York State Assembly passed a package of bills to modify and strengthen rent regulation to an even greater degree in the tenant's favor. The new legislation would repeal vacancy decontrol laws, increase penalties for tenant harassment and revoke a statute that restricts New York City from strengthening its rent regulation laws.

Legislators contend that these bills will help maintain the affordability of rent stabilized housing, but they will have the opposite effect on housing and will produce collateral damage. If these bills are passed in June by the Senate, two things are virtually guaranteed: First, the housing stock in New York City will deteriorate at a faster rate than that seen in the 1970s. Second, the tax base will be negatively impacted to a significant degree.

We must understand, first, that rent stabilized and rent controlled housing is misallocated, as financial need is not part of the equation. The rent laws provide maximum benefits to those who have been in place for a long time regardless of their financial status and need. This results in a system that makes people resistant to moving even when, in the normal course of family life, they would seek to downsize or upgrade the size of their apartments. This constrains the supply of available units, which puts upward pressure on the average rent that a New Yorker pays. This premise has been verified in studies completed at MIT and at the Wharton School.

Unfortunately, even if every economist in the world proved to the City Council and the New York State Assembly that the elimination of rent regulation would lower average rents in New York, it would be political suicide for any legislator to take a position against rent regulation. There are simply more tenant-voters than non-tenant-voters. It's for that reason that the Assembly passed that ridiculous package of bills in February.



This article, and all other Commentaries by Bob Knakal, can be found on *The Massey Knakal Reel* – a blog for breaking sales, listing and neighborhood real estate news – at www.masseyknakal.com/blog

Let's take a look at the probable consequences of this legislation.

Housing Stock Deterioration

In the 1970's, we saw a significant deterioration in the quality of our housing stock. Because of rising costs of ownership, which could not be mitigated because of rent regulation, many buildings were abandoned and burned, and entire neighborhoods suffered. The legislature, in response, created a system of rent regulation in which an owner was rewarded for making major capital improvements (MCI) in a property and for upgrading the quality of a unit via an individual apartment improvement (IAI). For an MCI, the owner could increase the legal monthly rent by 1/84th of that cost. For improvements to an individual apartment, 1/40th of the costs could be passed along.

COMMENTARY - BOB KNAKAL

That legislation motivated the private sector to invest in the city's housing stock. The Community Housing Improvement Program (CHIP) has estimated that on an annual basis these two incentives create approximately \$500 million of private investment. The Executive Director of CHIP, Patrick Siconolfi, said, "These two programs have been an enormous success, and the dollar value of investment in housing which they represent far exceeds state and city investment in affordable housing."

The current package of proposed bills, however, creates a disincentive for the private sector. Under the Assembly's Bill A01928, rent surcharges for costs of MCIs would be further regulated—and the bill would prohibit rent surcharges authorized for major capital improvements after the cost of the improvement has been recovered.

MCIs and IAIs are the primary incentives to upgrade building systems in the older rent regulated housing stock. Remember: 60% of New York's stabilized housing stock is at least 80 years old—and old buildings require more maintenance, not less. If the MCIs are recoverable over a longer period of time and made a temporary surcharge only, an owner will not be fully compensated for the cost of making an improvement.

As it is, the Department of Housing and Community Renewal (DHCR) does not allow recovery of the full actual cost attributable to an MCI. DCHR does not allow an owner to recover the cost of borrowing. Most MCIs are made with loans, since buildings, especially small and medium sized properties, seldom generate sufficient cash flow to pay for these improvements from reserves.

The proposed laws provide incentives for owners to do little more than patch and minimally repair building systems that are antiquated and obsolete rather than replacing them.

Negative Ripple Effect

All of the businesses that depend on these improvements

from the contractors to the suppliers to the manufacturers will be financially hurt by this legislation and thousands of jobs will be lost. Suppose that an owner, who has used a contracting firm for years to do major upgrades to her buildings, decides that without the incentives provided by the present system of rent regulation she can't make further improvements. She informs her contractor that there will be no work for them in fiscal 2009-10.

The contractor then has to lay off several employees as other owners follow suit. The contractor then contacts his suppliers, who provide windows, boilers, burners, plumbing, roofing material, intercoms, and electrical service—and informs them that purchases will be significantly reduced in the upcoming year. The suppliers then lay off several of their workers. The suppliers then contact the manufacturers from whom they buy these materials from and informs them that purchases will be reduced—forcing the manufacturer to layoff even more employees.

The result: fewer dollars pumped into the economy, thousands of jobs lost—and a deteriorating housing stock and worse living conditions for the average New Yorker.

Negative Impact on Our Tax Base

New York State and New York City depend on real estate taxes for a significant percentage of their operating budgets. We know that corporate tax collections will be significantly reduced this year as corporate earnings across all sectors drop. Should the slated bills passed by the Assembly pass in the Senate, real estate tax collections, too, will start to decrease.

Several of the bills will effectively put a cap on collectible rents and limit the upside potential in properties. For example, it's important that an owner be able to increase rents as tenants vacate an apartment or their needs for subsidized housing change. The city's Rent Guidelines Board determines the yearly allowable increases for regulated apartments—and has historically short-changed owners, both in relation to the guidelines and the vacancy

factor. State laws have attempted to make up this deficit by making the vacancy factor statutory. But one of the pending bills suggests reducing the vacancy factor from 20% to 10%.

Yet another bill calls for the elimination of preferential rents being for specified periods only. Any rent that is charged to a tenant, even if it is well below the legal registered rent, will be the new low basis of all rents moving forward for that tenant. In a declining rental market, some owners may leave units vacant rather than establishing a new lower rent threshold for the unit. This will lower income and taxes—and reduce the supply of available units.

While these rent bills are statewide, they negatively impact the tax base in New York City to a much greater degree than the rest of the state. This will result in Upstate residents subsidizing all of the regulated tenants in the City to an even greater degree than they already do.

We are in a recession, the effects of which are likely to be with us for years. Is now the time to put even more people out of work and reduce the taxes that are collected by the City?

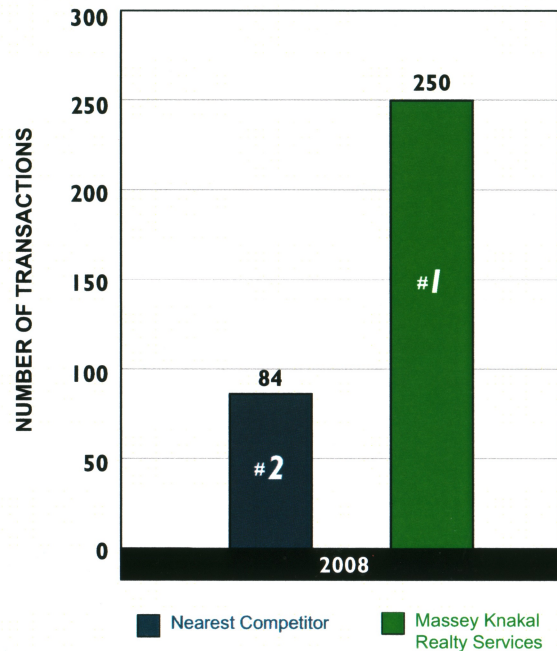
Protection for the Wealthy

Another pending bill calls for the elimination of luxury decontrol. Another calls for the reregulating of any units deregulated prior to January 1, 2007. The luxury decontrol provisions, enacted in 1993 and amended in 1997, provided for apartments to leave regulated status—upon vacancy—when the rent exceeded \$2,000 a month. For occupied units, if the rent was over \$2,000 per month, and the tenant’s income exceeded \$175,000 in each of the last two years, an apartment would become free market upon the filing of the appropriate paperwork by the owner.

Another pending bill calls for increasing the income threshold to \$240,000 and increasing the rent level eligible for deregulation \$2,700 per month! Is the assembly

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stating that those earning over \$175,000 are in need of welfare—which is what rent regulation is?

Broken Contracts

Another pending bill calls for all Mitchell-Lama properties built after 1974 to remain rent regulated forever. If this bill passes, I can’t imagine any developer would ever again want to build based on any program the Government provides, for fear that the rules will change



During Mr. Knakal's almost 25-year career, he has sold over 1,000 buildings having an aggregate market value of over \$5.8 billion. He was the top salesman, with partner Paul Massey, at Coldwell Banker Commercial (now CB Richard Ellis) in New York in 1986, 1987, and 1988 prior to forming Massey Knakal. In 1990, he was awarded Crain's New York Business "40 Under 40" awarded annually to 40 business people under forty years of age for outstanding achievement in the New York business community. In 2001, Mr. Knakal was named one of "The Top Dealmakers" by Real Estate New York Magazine. He has twice been the recipient of the Robert T. Lawrence Award in the Real Estate Board of New York's Most Ingenious Deal of the Year Contest. First in 2002, for the assemblage of the easterly blockfront of Second Avenue between 54th and 55th Streets. Then again in 2004 for the sale of the historic Gotham Book Mart at 41 West 47th Street.

Please give a call if you have questions about your property or the market in general.

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midway through the process.

Developers have long been reluctant to build in New York because they couldn't rely on the original contracts the Government provided in relation to removal from regulation once the benefits expired. Developers were frequently offered incentives to build affordable housing, only to find the laws changed when it comes time to have the properties removed from regulatory status. This bill is yet another example of that pattern. It will send a clear message to developers: "Do not build affordable housing in New York."

I believe that the city needs affordable housing and should have much more of it. New York should not be a place for only the wealthy, for it is the diversity of our city that gives it its character. It's unfortunate that our elected officials consider it the duty of the private sector to provide this affordable housing.

The public sector could provide affordable housing on its own initiative—or could create reliable incentives (which could not be easily changed by subsequent legislation) for the private sector to build. The key word here is "reliable." The elimination of the 421A program, which had resulted in the creation of tens of thousands of affordable units, will lead to an abyss in the bar chart showing the dramatic reduction of affordable units created over the next few years. Can't legislators look at the big picture?

With this set of bills, the Assembly is in effect taking private property for public use: reallocating private resources to supposedly benefit many at the expense of few. When the "few" and the "many" are translated into "voters," the Assembly's agenda becomes transparent. But they had better realize that the "few" is a lot larger than they think—because thousands of the "many" will be put out of work by this legislation.

There's still time to prevent passage of these bills in the State Senate. I urge you to contact your Senator to express your concerns.

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