

## Harmon's Law

A Supreme Court win could lead to an avalanche of lawsuits, plummeting rents, increased condominium conversions and, ultimately, real estate equity in New York. Or, more simply, new legislation.

In last week's column, I mentioned that, within the next couple of months, the Supreme Court will decide whether to hear the Harmon case, which involves the constitutionality of New York's rent-regulation system. Afterward, I received an unusually high number of emails from readers asking about the potential impacts on the market should this occur.



**Robert Knakal**

The Harmons live in a small, six-unit, walk-up brownstone in Manhattan, which has three rent-regulated apartments with tenants paying just 41 percent of current market levels. One of the Harmons' tenants pays less than \$1,000

a month for her apartment and owns a home in the Hamptons. Not incidentally, the Harmons are bringing this case to challenge the constitutionality of having their property "taken" from them without compensation.

I mentioned at the end of last week's column that, should the case be heard and the Harmons prevail, it could lead to the orderly elimination of rent regulation. This would likely be through a controlled negotiation producing a vacancy decontrol policy via means testing. I also stated that, should this occur, it would restore equity in a completely inequitable system.

Let me explain how this might play out. To the extent the Harmons prevail, the impact on the market would clearly be significant. The ruling itself would directly apply only to the Harmons' property. However, a win would undoubtedly create an avalanche of lawsuits brought by multifamily property owners to receive the same benefits.

A favorable ruling for the Harmons would likely allow them to not renew tenant leases in their brownstone. They could then take possession of their own property (what a concept) for use by their family, or they could simply rent units at fair market levels.

But what would the impact be on the rest of the multifamily market?

One very unlikely scenario would be that, due to the massive litigation that would surely follow, rent regulation would be eliminated market-wide, and, at the expiration of leases, property owners would not be compelled to renew. In the short term, this would initially have a negative impact on the value of the average multifamily property in New York City, as average rents would actually decrease.

Studies completed by the Wharton School and MIT suggest that the elimination of

price controls will cause the average rent to drop because there will be more mobility among tenants given a tremendous increase in supply to the marketplace. In fact, free-market rents are so high today because supply is constrained. There are 3.3 million dwelling units in New York City today, but someone looking for an apartment to rent has only 2.3 million choices because the 1 million rent-regulated units rarely become available, regardless of whether or not the apartment is the appropriate size for the tenants.

This new supply would force average rents down, thus reducing the value of the average building in the short-term.

In the long-term, values would rise because the ability to convert rental buildings to condominiums would be greatly enhanced. Conversion of the existing stock of buildings to condo would almost be forced based on the city's real estate tax policy, which is creating an environment in which, eventually, operating expenses will be so high that owners will not be able to hold onto properties. The only solution, in the long-term, would be conversion to allow for a passing along of the costs to the occupants of the units. As stated, this scenario of market-wide deregulation overnight is highly unlikely.

The more likely scenario is that the massive amount of litigation prompted by a Harmon victory would lead to a pre-emptive legislative change. A favorable Supreme Court decision for the Harmons would provide political cover for legislators to step up and reform rent regulation in a pragmatic manner.

Preservation of truly affordable housing would likely be a component of this reformation. However, more equitable policies such as means testing (which is only fair for public subsidies) and vacancy decontrol (which does not impact any present tenants) would lead to an orderly elimination of rent regulation over several decades. Another component of this common-sense approach would be the elimination of succession rights, which would eliminate the possibility that an apartment could remain regulated in perpetuity.

A Harmon victory would have profound implication for our market. It will be interesting to see if the land's highest court hears the case and, if so, how it will rule.

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