

The Law of Unintended Consequences

In the twentieth century, American sociologist Robert K. Merton was credited with popularizing the term “unintended consequences.” Unintended consequences can generally be grouped into three categories: unexpected benefits, unexpected drawbacks or perverse results. The latter is defined as an effect “contrary to what was originally intended” — i.e., when an intended solution makes a problem worse.

Today, the law of unintended consequences has commonly been used as an adage or colloquial warning that an intervention in a complex system tends to create unexpected and often undesirable outcomes.

New York’s rent-regulation system clearly qualifies as a complex system. The unintended consequences of the new rent-regulation laws will be numerous based upon the feedback and opinions being expressed by multifamily market participants.

The first unintended consequence is that fewer than expected “affordable” units will be created or preserved. The word affordable is in quotes because there is no measure of affordability in the program at all, as means testing is not part of the system. The rent regulation system is an inertia program, not an

affordable housing program. A significant change is that modifications made to the major capital improvement (MCI) and individual apartment improvement (IAI) programs have marginalized them to the point where they will be ineffective.



Robert Knakal.

For example, before the new laws were passed, if a regulated unit was vacated, it would be fully renovated and the rent would be brought up to market levels. The owner of the property would have taken advantage of the 20 percent vacancy bonus and would have passed along a fortieth of the amount of money spent on the renovation of the apartment in

the form of a rent increase. These renovation costs were usually in the \$60,000 to \$80,000 range and could have been significantly more if the apartment was a larger unit or was in a location that warranted significantly more investment. These improvements would have allowed the unit’s rent to be brought up to a market level.

Today, the vacancy bonus has been eliminated and the owner of the building only benefits from the first \$15,000 of apartment improvement, passing along a maximum of \$83 or \$89 per month (depending on the number of total apartments in the building) to the tenant.

Let’s assume that the regulated unit was renting for \$700 per month and the market value of the unit is \$3,500 if renovated. Under the old laws, the owner would have taken advantage of the vacancy bonus and done a complete renovation to the unit, bringing it into excellent condition. Today, most owners would not opt to renovate the unit and charge \$783 or \$789 per month. They would effectively be giving a life estate to the tenant. Who would ever move out of a completely renovated unit with such a low rent?

Most owners who find themselves in this position will likely opt to just nail the door shut and wait for better times (legislatively). If an owner absolutely needs money, they might give the unit a paint job but not much beyond that and find a new tenant to pay the marginally increased rent. As long as the unit is up to code and all appliances are working, the unit will be rented in what is likely poor, but legal, condition. This same approach would apply to regulated units that are vacated where the regulated rent was very close to the market rent.

The impact of that unit not likely being renovated has a cascading impact on many other people. The laborers who would have renovated the unit don’t get that job. In fact, hundreds of in-house laborers have lost their jobs already based upon this anticipated lack of work. The sellers of the supplies to the

contractor don’t make those sales, nor do the stores that sell appliances make those sales, and the manufacturers of the appliances don’t make their sales nor do the suppliers to the manufacturers, and so on.

Because getting the regulated unit back from the regulated tenant is no longer as beneficial as it once was, there is no incentive for an owner to go after a tenant that is illegally subletting their apartment, illegally using the regulated unit as a second residence or illegally listing the unit on Airbnb.

Another unintended consequence is that because rent increases will be muted, expenses will have to be watched closely and reduced. Flowers in lobbies and annual plantings will probably be a thing of the past. Repairing appliances and building systems, like heating plants and roofs, will be much more common than replacement with new ones. These changes in building operations will lead to a poorer quality of life for the residents of the building.

The reduction in supply based upon units being removed from the market will exert upward pressure on free market rents, making the city even less affordable for everyone. The list goes on and on.

The law of unintended consequences seems to be appropriately linked to our new housing laws.