Could the early 1990s return?

November, 03, 2008

The turmoil on Wall Street bears an eerie resemblance to 1987's October stock market crash: a period of unprecedented prosperity and expansion suddenly halted by plummeting stock prices, complete with newspaper photos of panicked Wall Street traders, trouble with Iran and changes to the 421-a tax abatement program.

Despite assurances from the real estate industry that New York's housing market will be able to avoid the kind of slump that marked the city's serious recession in the late 1980s and early 1990s, the question remains: Could it happen again?

This time around, nobody knows how long or severe the all-but-inevitable recession will be. Right now, most market indicators show that the city housing market should fare better than it did during the dark days of the early 1990s.

Still, the status that the city has achieved as something of a real estate utopia — with safe streets, manicured parks and rapidly appreciating home values — shouldn't be taken for granted, experts warn.

They say that crime and homelessness are already on the rise (homicides are up 8.3 percent over the same period last year, and city homeless shelters are full) and will likely worsen as the city budget is depleted. Meanwhile, the aggressive expansion of development in outlying neighborhoods will probably come to a halt.

That means less building of new luxury housing in previously low-income areas of the city, such as Harlem, Bushwick and Long Island City. "You're not bringing new development into those areas," said Jonathan Miller, the president of the real estate appraisal firm Miller Samuel. "What you're likely to see is less movement in that direction — it will hold where it is."

How New York City weatheres the economic meltdown may depend more on the determination of Gothamites to protect the neighborhoods they've built up in recent years than on anything else.

"New York's traveled so far — it's not going back," said Richard Rosenfeld, a professor of criminology at John Jay College of Criminal Justice. "The city has gained back its neighborhoods. New Yorkers are going to fight before they give that up."

'Conversion mania'

On Monday, Oct. 19, 1987, the Dow dropped 508 points, or 22.6 percent, and the S&P 500 fell roughly 20 percent, ending a decade of unbridled development, speculation and co-op conversions in New York City.
"It was a huge development period," said Diane Ramirez, the president of Halstead Property, who has been a real estate broker since 1973. "Everybody in New York wanted to be an owner. Developers were building like crazy."

Much of the boom was due to apartment buildings being converted into co-ops, Miller said. "We had a tremendous surge in conversions in the 1980s."

Moreover, the city tweaked the 421-a tax incentive in 1985, changing the rules so that in much of Manhattan, developers would have to build a certain amount of affordable housing in order to qualify for the tax benefit.

Much like the changes to the program implemented this past summer, developers rushed to build before the new rules took effect. "The abatement expiration encouraged developers to get holes in the ground by 1985," Miller said.

The city's real estate and development landscape changed drastically in the late 1980s after the crash.

The stock market nosedive and ensuing recession, combined with changes in tax policy and double-digit interest rates, left the city with a tremendous glut of available apartments, especially one- and two-bedrooms, which had been popular with speculators.

"We had so much supply in the studio to two-bedroom range, we were choking on them," Ramirez recalled. "No one wanted to buy them. It was unbelievable oversupply."

In the mid-1980s, roughly 40,000 new co-op and condo plans were filed with the attorney general's office a year, said the chief economist for Terra Holdings, Gregory Heym, who called the period "conversion mania."

Between 1990 and 1991, the number of plans filed tumbled from 19,207 to 3,041. And by 1993, it hit an all-time low of 950.

In 2007, by comparison, there were 25,281 new plans filed — nowhere near the mid-1980s peak of roughly 40,000.

"We see a lot of construction now, but we have not over-converted over the past decade like we did in the 1980s," Heym said.

By 1989, New York City had roughly seven years worth of available inventory on the market, Miller said.

"The housing stock that came on the market in the late 1980s didn't get fully absorbed until the mid-'90s," he said.

Inventory is one area where today's New York real estate market is in much better shape than it was going into the recession of the late 1980s and early 1990s. Unlike the seven years of inventory stockpiled then, the city has only 7.9 months of supply, Miller said.

"That's part of the reason I'm optimistic about our current marketplace," Ramirez noted. "Our supply-and-demand numbers are quite good. From a historical perspective, we are in a much healthier place."

Other factors that have better prepared New York for the current downturn include lower mortgage rates, less real estate speculation and stronger employment figures.

Mortgage rates hovered near 11 percent in the late 1980s — almost double what they are now, making it
sharply more expensive for prospective buyers to make a purchase. Although some experts expect rates to rise — Miller said his "sense is that rates will trend higher over the coming year" — they're not expected to come anywhere near 1980s levels anytime in the near future.

Meanwhile, there are also fewer speculators in today's market than there were in the 1980s, Heym said.

"In 2007, before this thing started, the market was incredibly strong," he said. "It wasn't falsely propped up by investors. We're in a good position going in."

Heym also pointed to employment as a key factor that would help buffer the city. While the city is bracing for the loss of 40,000 financial sector jobs and tens of thousands of additional ones (11,000 employees have already gotten pink slips), the number of layoffs is not expected to touch what it was in the 1990s.

At that time, more than 350,000 people lost jobs, Heym said. "The big unknown for us right now is what the job losses are going to be," he said. "Most people are not expecting the job loss to be as much this go-round."

A different city

There's no denying that New York City's real estate market has been buoyed by vast changes in quality of life in the city over the past decade.

"We were a different city in the '80s," Ramirez said. "We're an international city now. Everybody wants to be here. We've got a lot more going for us."

A huge component of the improvement is the dramatic decline in crime the city experienced during the Giuliani administration and then during the Bloomberg years. The felony crime rate in New York City dropped by a stunning 71 percent between 1990 and 2006, according to the Furman Center for Real Estate and Urban Policy. Currently, the number of burglaries per 1,000 residents is less than one-fifth of what it was in 1990.

David Kennedy, director of the Center for Crime Prevention and Control and professor of anthropology at John Jay College of Criminal Justice, attributed the drop to changes in policing strategy that are unlikely to be reversed even if the city falls on hard economic times.

"It's a huge change that's occurred," Kennedy said. "Things could get a little bit worse and still be dramatically better than they were before."

Still, while New York is unlikely to fall back to 1980s levels of violence, "we can expect some increase in crime," Rosenfeld said.

Indeed, according to the NYPD's CompStat program, which tracks statistics weekly, the number of homicides for 2008 to date was 416 at the end of last month — 8.3 percent higher than last year's level of 384.

"There has not been a period in the city's history during which crime did not go up during economic downturns," Rosenfeld noted.

He said decreases in tax revenue could lead to cuts in the police force. "The NYPD has shown that it knows how to use scarce resources wisely," he said. "The question is, 'Will they have the resources to manage the increase in crime problems we're already beginning to see?'"
The city has roughly 36,265 police officers, down by about 4,000 from the peak in 2000. Recently, City Hall asked the NYPD to cut $94 million, or 2.5 percent of its operating budget, for the fiscal year ending next June.

In addition to crime, homelessness is on the rise because of the latest economic woes, according to Patrick Markee, senior policy analyst at the Coalition for the Homeless. The organization released figures late last month showing that 1,464 families entered city shelters in September, a 22 percent increase over the same month last year and the highest one-month gain since the city began keeping statistics 25 years ago.

"It's really bad, and the thing that's got us most alarmed is, it's probably going to get worse," Markee said.

With the credit crisis tied to crime, homelessness and quality of life, the economic realities for the city have already started shifting.

"The economy alone is ensuring that we're not going to see the rapid expansion of the past few years," Rosenfeld said. "If crime rates go up in addition, that can slow the expansion even more."

However, he said, now that new homeowners have moved into outlying neighborhoods, they're unlikely to abandon them. "Property owners as well as renters have real stakes in the stability of their neighborhoods," he said. "They aren't going to give that up easily."

By Candace Taylor