Stein's Law

On the Verge of the Next Boom

Here we are, looking back at the year 2012, well into the next boom in commercial real estate financing. It hasn't peaked yet, but it seems to be accelerating. And this time, the acceleration feels faster than the last time around. At least in New York City, we're largely back to where we were before the financial crisis—and we got there rather quickly.

Should we expect another financial crisis around the corner, sooner than we might expect, because maybe the cycles move more quickly now? If I knew the answer to that question, I wouldn't be practicing law.


Joshua Stein

Plenty of lenders large and small have piled back into the market, willing to back names they know, but mostly on a more conservative basis than in the years just before the 2008 financial crisis. The availability of money and the continued credibility of New York City have driven values ever skyward, at least for quality product. Virtually all the stalled condo development projects that terrified everyone in 2008 and 2009 have found new capital and a path to completion, though a slightly growing handful remains.

Yet another year of absurdly and historically low interest rates has helped drive down cap rates and drive up values, even in an environment where office rents have hardly been spiking. Speaking of office rents, we all know about the relatively low deal volume and lack of office tenant enthusiasm in 2012. What was particularly notable was how readily some large Downtown office users found temporary space in Midtown after Superstorm Sandy, suggesting that the market has more extra space than perhaps is recognized.

On the residential side, like 2006 all over again, we see lots of new development, focused in the high-end condo residential market, and, to a significant degree, high-end multifamily rentals as well. We see very little new low-end or medium-end anything. It's a high-end world, at least in Manhattan and, to a large degree, to the extent that development is occurring, in other boroughs.

Development is so difficult, and land is so expensive, and so many residential buyers (particularly foreign buyers) have so much money that perhaps high-end is the only end reasonably feasible for new development projects right now. One wonders whether it really needs to be that way.

Should the city government "do something" about this "problem"? Can the government figure out a way to encourage more varied types of development, at lower price points? What can the city do?

Major real estate development already has the benefit or the burden of multiple layers of municipal involvement, starting with the zoning ordinance, the building code and other codes, and continuing with layers of process, environmental review and community involvement (delay, cost, platforms for the NIMBYs) for any substantial project.

In addition, to be feasible and competitive, producing a profit for the developer, a project often needs to qualify for tax abatements and sometimes favorable subsidized or government-sponsored financing. Though these programs seek to spur development, once the marketplace for developable land expects them, any developer that doesn't get the benefit of them probably will have trouble competing. So qualification for those programs becomes a "gating item" for anyone who wants to put together a successful development project in any market where those programs are available. Net result: an even larger governmental role in the development process, and higher bids than otherwise for parking lots and other development sites.

If the municipal government wants to "do something" about the development process to encourage a broader range of new product, probably with a focus outside Manhattan, the usual instinct consists of enacting some new program to layer on top of all the existing programs to motivate developers to build whatever type of new construction we want to see. That approach, though familiar, would just further complicate a development process that already seems amply complicated and governmental.

It might make more sense to figure out how to uncomplicate that process, making it easier to build new projects, with greater flexibility, more quickly and in more areas of the city. This might involve revisiting the scope of all the legal and regulatory burdens on the development process, starting with zoning and some of our assumptions about how buildings should be built.

The city has started that process with rezoning in the boroughs, starting to streamline the permitting process, taking more of it online and asking questions about minimum apartment sizes. The process still has a long way to go, ideally in a way that sets simple and bright-line standards and expectations and minimizes the need for extended interaction with municipal authorities.

New York remains the place where everyone wants to be, even more the "center of the world" today than it was 20 or 30 years ago. People will keep coming here. Even with all the buildings that already exist, many quite old, we need more. One good resolution for New York City for 2012 might involve figuring out how to get more buildings more easily, and not just at the high end.

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