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THE OP-ED PAGE

How Government Could Muck Up the Recovery

Industry must watch actions in D.C., Albany and downtown

EXECUTIVE SUMMARY

- There are signs of recovery in the New York real estate market.
- But there are still signs of struggle, including higher vacancies and a dearth in financing.
- Government actions on FIRPTA, 421a and wages could hinder or help nascent recovery.

New York City's real estate market has shown signs of recovery from the global economic crisis that rocked our city and industry at the end of 2008. However, our return to the prosperity of a few years ago faces serious challenges, as the failed bombing in Times Square and the Dow's nearly 1,000-point plunge last week should remind us.

Government actions in our control, from tax policy to business regulations, could propel or derail our recovery. It

is essential that our industry continues to be vigilant—in Washington, in Albany and in City Hall—on legislative matters to promote a business climate that encourages new investment and economic activity.

New York City's unemployment rate declined in March to 10 percent from 10.2 percent, and job losses appear to have abated. Further, our job losses (169,000, according to New York City's Office of Management and Budget) were significantly lower than the 250,000 projected last year, resulting in a less significant impact on our local economy.

According to the New York City Independent Budget Office (IBO), these fewer job losses are partly the result of structural changes in the composition of our local employment. Health and education comprise a larger share of our city's employment and appear comparatively recession-proof.



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Also, the Federal Reserve's financial-stabilization package has lessened the recession's impact on New York.

Modest job growth is returning to our city. Employment figures for March indicate a growth of 28,000 jobs (not seasonally adjusted), the second month in a row of growth. The positive change in employment will slowly trickle through our local economy. An important indicator of an improving office market has been the steady decline of available sublet space. This has helped stabilize the vacancy rate (13.5 percent) and the average asking rent (\$50.41) in Manhattan. We have begun to see some owners increase asking rents for high-end space. However, we will need sustained employment growth for more significant office leasing and rent increases to occur. New York's office market remains the strongest in the nation, according to the mayor's executive budget documents released last week.

As tourists continue to flock to our city, hotel occupancy levels remain high, and leisure and hospitality employment continue to rise. These visitors and an improving economy have contributed to the improvement we are seeing in the retail market. In March, national retail sales were up 7.6 percent over last year and up 1.6 percent month on month. New York City retail employment in March was up 1.4 percent year on year. Similarly, April's consumer confidence index was at its highest since September 2008. As a result, REBNY's Spring Retail Report notes that average asking rents have started to increase in most of the retail corridors we surveyed. Likewise, homes sales in New York City in the first quarter of 2010 are up 52 percent over the past year, signaling that economic activity is returning.

Our economy and the real estate market are still fragile. Many parts of our economy are still suffering from the devastating impacts of the national recession. We are not expected to return to the employment levels of 2008 for another three years. The budget deficits at the national, state and local level and the prospect of higher taxes are casting a cloud over our recovery.

Office rents are down 25 percent from the peak, and vacancy rates are nearly twice as high today from the peak of the market, in 2008. Large office-building sales have been virtually nonexistent for the most part since 2008, and financing has been largely unavailable for these transactions, which have in the past generated significant transaction tax revenue. In 2009, New York City transaction (transfer and mortgage recording) tax revenue was \$1.25 billion, down \$2 billion (62 percent) from 2007.

To avoid losing the momentum we are generating, we need to make sure that government proposals to address budget deficits do not depress our nascent recovery. REBNY has been engaged in a wide range of legislative matters to sustain economic growth.

In Washington, we have called for amendments to the Foreign Investment in Real Property Tax Act (FIRPTA), which imposes a gains tax on non-U.S. buyers of real estate. Eliminating the gains tax on such transactions would provide more liquidity in the market. The proposal to tax the profits distributed to the entity that arranges funding and manages a real estate project, usually the general partner, at the ordinary income tax rate, not at the capital-gains rate, would impose higher taxes on this crucial real-estate-related activity. This proposed change in the "carried interest tax" would weaken our recovery.

In Albany, as part of the budget negotiations, the governor has proposed legislation that would defer 50 percent of certain tax credits that would be used or refunded over the next three years. This deferral would apply to almost all tax credits, including brownfields, rehabilitation of historic properties, green buildings and low-income housing. This deferral is effectively a tax increase and could jeopardize the development of numerous projects whose funding has been contingent on the receipt of the credits. We also need Albany to extend the 421a partial tax exemption program for new residential construction. We are recommending modest amendments to provide a catalyst for developments stalled since 2008; to induce the conversion of obsolete office buildings to residential use; and to offer building owners a reduction in taxes for keeping low-income units in 80/20 projects permanently affordable.

At City Hall, the City Council introduced a bill that would mandate the payment of a prevailing wage to building workers if a developer receives any tax benefit from the city. This bill would seriously undermine the value of the tax exemption that is critical to new development and major renovation projects.

As the real estate market slowly improves, it will continue to need the help of government to lower taxes, remove restrictions for investment and provide the needed stimulus for the economic activity that does so much to fund the services that are crucial to our city's future.

Steven Spinola is the president of the Real Estate Board of New York.