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Introduction

This issue is about the reconfiguration of New York City, a physical transformation that has been fueled by a mixture of population growth, increased affluence, and an unusually strong housing market. What is happening here is mirrored to varying degrees in successful cities elsewhere in this nation and across the globe.

Here, nine experts praise and critique city government's efforts to guide this transformation, to meet and balance growing demands for market housing, affordable housing, open space, industrial space, and historic preservation. Even as the housing market softens, these policies will have long-term effects and will continue to be debated.

In recent years it has been easy to forget Jonathan Miller's reminder that twenty years ago Manhattan's housing market relied on government tax policy to stimulate demand. Julia Vitullo-Martin applauds the results of public and institutional investment in the Bronx, but she notes that destructive government policies helped depress the borough in the first place.

Much of our attention is drawn to the city's extensive rezoning of former industrial areas on the Brooklyn waterfront and the west side of Manhattan. Frank Braconi questions whether these initiatives are sufficient to meet the needs of our growing population, while Kimberly Miller and Mark Alexander address what will be required to make the rezonings a success. Peter Beck shows us that limited public resources, directed to these areas for affordable housing, could perhaps be more effectively spent, while Lisa Kersavage shows us how rezoning need not have cost us valuable historic resources. Pamela Hannigan praises the city policy that is creating new industrial business zones in order to preserve and stimulate the valuable manufacturing resources that remain.

And then there is Governors Island. Is there a greater possibility for adding a jewel in our crown than the history and open spaces that this island offers and represents? Our third issue is dedicated to the possibilities of Governors Island.

Lawrence Sicular
February 8, 2006

The Gentrification of Manhattan

Long Term Trends in the Housing Market

by Jonathan J. Miller

AFTER Wall Street, real estate is the most heavily watched sector of the economy. Its role in changing the fabric of neighborhoods, reducing blight and decay, and enhancing the city's tax revenue stream, has been all important in determining the character of Manhattan. Over the past 25 years, real estate development has thrived in Manhattan. Housing demand has increased since the city was on brink of bankruptcy in the 1970s, and there is now a shortage of supply. Rising prices have pushed development into the other boroughs, especially Brooklyn and Queens. Along the way, there have been changes in the nature of new development, which are affecting where and how New Yorkers live.

THE 1980s: CONVERSIONS, NEW CONSTRUCTION, & TAX ABATEMENTS

In the early 1980s, demand for new, open-market housing was rising, but little inventory had been added to the housing stock since the 1960s.

Developers responded by converting existing rental buildings to cooperatives and, to a lesser degree, to condominiums. At its height, more than 16,000 units per year were converted in this manner. Landlords in a non-evict plan were required to convince at least 15 percent of the existing tenants to purchase as "insiders." The sponsors discounted prices in order to encourage a high enough percentage of tenants to vote in favor of the conversion. As a result, many tenants stayed, the apartment mix of these buildings remained stable, and the relatively affordable prices attracted outside buyers with similar or only somewhat higher incomes. Sponsors maximized their investment by upgrading retail tenancies as they expired, but the general level of residential support services was not significantly affected in many neighborhoods.

From 1985 to 1990, our firm, Miller Samuel Inc., tracked 119,319 units added to the condominium and cooperative housing stock in Manhattan. Of this total, 72 percent were within co-op conversions. The totals include tenant-occupied units that had the potential to convert to individually owned units.

Pressed by housing activists, the city also encouraged developers to build new housing through a variety of initiatives. One of these initiatives was the 50/50 program where a large quantity of city-owned property, that had been taken *in rem,* the legal definition for a court-supervised sale, was sold to private developers in return for their agreement to develop an equal amount of subsidized housing for low-to-middle income families. Other programs interspersed affordable housing units within new developments, in 80/20 percent market-to-affordable ratios, in return for tax credits.

Middle- and upper-income housing development was stimulated by 421a and J-51 tax abatement programs that encouraged development by granting tax abatements over ten to twenty years. The 421a abatement program allowed developers to pass along tax savings to condominium purchasers. Initially, real estate taxes were discounted 80 percent with 20 percent increases every two years until the abatement expired. Similarly the J-51 program encouraged capital improvements in existing buildings and was used primarily in older loft buildings undergoing conversion from manufacturing to residential use.

The mixture of new, open-market housing and subsidized housing proved to be an incendiary mix in some neighborhoods and was one of the factors that led to the Tompkins Square Park riots in 1988. This followed a decade of gentrification in surrounding lower-income neighborhoods. The image of a stripped and burned out school bus in front of a new "gut rehab" luxury cooperative or condominium development, with the words "Die Yuppie Scum" spray-painted on the front door, typified the entry of new housing stock into certain lower-income markets.

TAX CHANGES & A RECESSION END THE BOOM

While a large number of new condominium units entered the market, changes in the tax laws stalled many new developments. These tax-law changes included a revision of the Federal Tax code in 1986 that effectively eliminated write-off of passive losses against rental income, drying up most of the demand for investor units. Until then, developments had been more configured with studio and one-bedroom units to meet the demand of purchasers who rented them, often at a loss. As a result of these tax law changes, new developments were reconfigured mid-construction due to the loss of the investor sector. In 1986, the 421a tax abatements expired below 96th Street in Manhattan, resulting in an over-supply of condominium developments. Developers had to have the foundations installed on the site by the fall of 1985 to qualify for the abatement. Many were digging holes in the ground to make the deadline without definitive plans for the project.

The 1987 stock market crash was followed by recession, and the market was oversupplied until the mid-1990s. As mortgage rates rose, and the recession gained momentum, the surge in development evaporated and a trickle of new product entered the market through the middle of the 1990s.

THE LATE 1990s & THE 2000s, LUXURY CONDOMINIUM DEVELOPMENT DOMINATES

The new condominium units of the 1980s offered largely the same mix of unit sizes as the cooperative conversions of the day. As a result the disparity in demographics was not that pronounced. However, nearly ten years after the development boom ended, the dotcom boom of the late 1990s fueled a new type of development.

The pace of conversion from rental to either condominium or cooperative was about 10 percent the rate seen in the 1980s, largely because sponsors had already converted most economically feasible buildings. Rehabilitation and conversion of manufacturing and commercial properties, especially class C office space, has largely dominated the limited conversion activity.

Nearly all new development contained much higher levels of luxury amenities, and nearly all were in the form of condominiums. Prices increased more rapidly from 1998 to 2000 than any earlier three-year period, and the units that were developed were larger and contained a higher quality of finishes than had ever been attempted. The average size of a condominium unit that sold in early 1998 was 1,262 square feet. By 2000, the average square footage of condominium units had swelled to 1,666 square feet, a 32 percent increase. Since the average price per square foot is generally higher for larger units, the average sales prices were the highest ever recorded.

THE FOCUS ON LARGER APARTMENTS & LESSER LOCATIONS CONTINUES

In the Manhattan housing market, unlike most residential markets, there is a premium placed on larger contiguous space. As a result, developers continued to develop larger units than in the 1980s.

While the overall size of a Manhattan apartment increased a nominal 2.2 percent, or 28 square feet, from 1989 to 2005, the change within each size category tells a different story (see fig. 1).

The "sweet spot" for new units, as developers like to call it, has been found in the larger sized units. The average size of three-bedroom and four-bedroom apartments has grown 11.4 percent and

Fig.1

Manhattan Cooperatives and Condominiums

Avg. Square Feet	Studio	1 Bedroom	2 Bedroom	3 Bedroom	4+ Bedroom	All
1989	548	756	1,366	2,376	3,879	1,260
2005	486	758	1,441	2,647	4,157	1,288
% Change	-11.2%	0.2%	5.5%	11.4%	7.2%	2.2%

Fig.2

Manhattan Cooperatives and Condominiums

Price Per Square Foot	Studio	1 Bedroom	2 Bedroom	3 Bedroom	4+ Bedroom	All
1989	$273	$298	$352	$466	$538	$332
2005	$790	$840	$1,027	$1,339	$1,925	$955
$ Increase	$517	$542	$675	$873	$1,387	$623

Source: Miller Samuel, Inc.

7.2 percent respectively since 1989. Even the average size of a two-bedroom unit increased over this period by 5.5 percent.

However, the entry-level units did not follow the same pattern of square-footage growth. One-bedroom units are essentially unchanged in average square footage and studios contracted 11.2 percent in size. The developer's incentive to emphasize larger units is clearly found in fig. 2.

The difference in nominal dollar amounts is the compelling rationale for the change in the development incentive of new housing stock. On a per-square-foot basis, the change in the price was proportional to unit size. In other words, the net change for studio units was the lowest at $517 per square foot while the net change for four-bedroom units was the largest at $1,387 per square foot. Since this data includes both new developments and resale data, the growth in price for new housing was even more pronounced than this data suggests. Most new development has been in the form of condominiums because of their higher value. This premium was estimated at 15.5 percent in our joint research project with New York University in 2003, *The Condominium v. Cooperative Puzzle: An Empirical Analysis of Housing in New York City.*

The rush for new condominium development has been accelerating since 2001, making the availability of sites for assemblage more limited and expensive each year. One of the primary catalysts for the housing boom in Brooklyn, Queens, and potentially Long Island City, has been the high cost of land in Manhattan.

High land prices have forced developers to do two things. Firstly, to create larger units to extract more profit out of their sites. The problem with this approach is that there has been a shift in demand to mid-sized units and greater weakness at the upper end of the market, due to a larger supply of listing inventory. Secondly, to build upscale properties in neighborhoods that have not seen this type of housing before, where sites are available and where land

Pricing Survey Fig.3

Price Per Square Foot Change Since 1989	All	Area
Washington Heights	330.8%	Uptown
Hamilton & Morningside Heights	300.7%	Uptown
Soho & Tribeca	272.7%	Downtown
Greenwich Village	253.2%	Downtown
Chelsea	252.5%	Downtown
Inwood	242.8%	Uptown
Financial District	234.0%	Downtown
Lincoln Center	231.7%	West Side
Upper West Side	229.3%	West Side
East Village & Lower East Side	227.0%	Downtown
Union Square, Gramercy, Kips Bay, & Murray Hill	211.1%	Downtown
Riverside Drive & West End Corridor	197.9%	West Side
MANHATTAN	**187.6%**	
Midtown West & Clinton	180.7%	West Side
Harlem & East Harlem	179.3%	Uptown
Lenox Hill	169.3%	East Side
Midtown East & Turtle Bay	158.4%	East Side
Carnegie Hill	157.1%	East Side
Yorkville	156.7%	East Side
Upper East Side	156.5%	East Side
East End Avenue	151.7%	East Side
Battery Park City	119.7%	Downtown
Sutton & Beekman	110.1%	East Side

Source: Miller Samuel Inc.

costs are less than in more established locations. This places further pressures on developers to make the projects viable. The spread in price per square foot between new developments in these emerging markets and those in established markets has decreased in recent years.

GENTRIFICATION OF THE LOFT MARKET

The downtown loft market is a primary example of gentrification of housing stock. In the mid-1990s, the economy broke free of the recession and the surplus of housing that dated from seven-to-ten years prior was quickly being absorbed. Commercial and manufacturing areas downtown were underutilized and targeted for development. New loft units added to the residential housing stock eventually competed with established residential neighborhoods such as the Upper East Side and Upper West Side. The size and amenities of these new units grew over the years making the price points higher than most artists, who comprised the earlier occupancy base, could afford. Purchasers tended to be affluent professionals who worked in financial services. Along with these new residents came upscale restaurants, food, and clothing stores, pricing existing retailers out of the market. Gallery owners, who were there long before loft neighborhoods like Soho and Tribeca became upscale residential neighborhoods, were also priced out. Many of the galleries moved north to Chelsea, and these same tenants are being priced out again as retail rents increase there.

Dollar Change in Price Per Square Foot Fig.4

Market Area Change Since 1989	All	Area
Lincoln Center	$804	East Side
Soho & Tribeca	$747	Downtown
Chelsea	$735	Downtown
Upper West Side	$734	West Side
Greenwich Village	$717	Downtown
Carnegie Hill	$713	East Side
Lenox Hill	$684	East Side
MANHATTAN	**$623**	
Upper East Side	$599	East Side
Midtown East & Turtle Bay	$596	East Side
Midtown West & Clinton	$591	West Side
East Village & Lower East Side	$563	Downtown
Riverside Drive & West End Corridor	$556	West Side
East End Avenue	$524	East Side
Union Square, Gramercy, Kips Bay, & Murray Hill	$511	Downtown
Financial District	$473	Downtown
Battery Park City	$422	Downtown
Sutton & Beekman	$410	East Side
Yorkville	$393	East Side
Washington Heights	$374	Uptown
Hamilton & Morningside Heights	$364	Uptown
Harlem & East Harlem	$298	Uptown
Inwood	$250	Uptown

Source: Miller Samuel Inc.

PRICING SURVEY BY MARKET AREA

We have reviewed the average price per square foot of a number of market areas in 1989, as compared to 2005 (fig. 3). This analysis was based on a series of published market surveys completed by our firm for Prudential Douglas Elliman. The 2005 numbers were based on the first three quarters of the year.

The neighborhoods and market areas were selected from our market reports as locations that have distinct and similar housing characteristics and, more importantly, where there is adequate data available to derive some sort of conclusion. Some of these markets overlap. For example, the Upper East Side includes Yorkville, Carnegie Hill, and Lenox Hill. These markets have specific identities and as we have the capacity to analyze them, so they were included.

There is a distinct pattern in the appreciation rates of the various areas in the rankings. The overall Manhattan market saw a 187.6 percent increase in the nominal average price per square foot from 1989 to 2005 and would be considered a rough midpoint to determine whether a particular market areas exceeded or fell behind the overall average.

The Downtown markets saw major gains largely due to the expansion and development of the loft market, which changed the character of the area and attracted more upscale retail goods and services. One of the exceptions was Battery Park City, developed on landfill in the early 1980s. Its housing stock characteristics have not changed significantly since 1989 with the exception of a few new developments that are targeting more affluent buyers with larger units.

The Uptown area (including Washington Heights, Inwood, Harlem, East Harlem, Hamilton Heights, Fort George, and Morningside Heights) also saw significant price gains as buyers moved northward on the island in search of more affordable housing.

The Upper West Side saw some large increases but the gains were specifically related to new developments in the Columbus Circle area and Trump's Riverside South development. The East Side neighborhoods are the most established in Manhattan and have far less "upside" than the other market areas.

With few exceptions, newly developed market areas saw the greatest appreciation rates while previously established residential locations with less potential "upside" and saw the lower growth rates. However, one of the missing components of an analysis based on percentages is the impact to the potential buyer in terms of price. When analyzed by the change in price per square foot, the results change considerably (see fig. 4).

In this scenario, we see Manhattan prices have appreciated an average of $623 per square foot, which is in the top third of the market instead of in the approximate middle. This indicates that dollar growth leans in favor of the most expensive markets, with the highest dollar gains in more established neighborhoods such as the Upper West Side and Lenox Hill and in markets with a new or existing stock of larger units, including the loft markets in the downtown areas like Chelsea, Soho, and Tribeca.

THE HOMOGENIZATION OF PRICING

One of the more significant differences in terms of prices from 1989 to 2005 has been the homogenization of pricing between market areas. For a macro perspective, we divided Manhattan into the four distinct market areas: Eastside, Westside, Downtown, and Uptown (fig. 5).

Excluding Uptown, the dollar spread between the low and high price areas in 1989 was $100 in nominal terms while in 2005 the difference was actually less at $65. The development of new units has had the effect of reducing the pricing differential between market areas. Development opportunities in the Downtown and West Side market areas have essentially reached parity with the East Side.

Price Per Square Foot Summary

Fig.5

Quadrant	**1989**	**3Q 2005**	**Spread**
Uptown	$116	$472	$356
Downtown	$280	$956	$676
West Side	$320	$1,021	$701
East Side	$380	$1,018	$638
High-Low Spread (excluding Uptown)	$100	$65	

Source: Miller Samuel Inc.

OVERVIEW

After 25 years of residential development, Manhattan now has limited room for the large-scale expansion of owner-occupied housing that has resulted in higher housing costs and a higher cost service economy. The availability of buildings to convert to residential owner-occupied housing has become more limited. The development of new housing stock to meet the needs of low-to-middle-income wage earners has also been limited as gentrification has emerged as one of the driving forces of the new housing economics in Manhattan since the early 1980s.

The irony here is that the original grittiness and texture that makes living in Manhattan so unique, and serves as a powerful attraction to buyers, may ultimately be priced off the island.