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How Many Empty Apartments Are Too Many?

As the number of vacant units in Manhattan rises, landlords are offering incentives to tenants

BY OLIVER HAYDOCK

This much we know: In Manhattan, there is a growing supply of empty apartments that, due to a combination of overpricing, bad timing and lack of demand, cannot find tenants willing to sign the dotted line. This is unfamiliar territory for landlords, who have conducted business in an environment that, for the past several years, has been defined by escalating rents; insatiable consumer demand driven by a robust local economy; and ever shrinking vacancy rates.

Yes, it's not as easy to find renters as it used to be, but brokers and other industry professionals are still confident that the Manhattan rental market will steady itself in the near future. "The fundamentals of the rental market are strong," Citi Habitats president Gary Malin said.

But what if, like John McCain—who uttered something very similar about our national economy the very day Lehman Brothers filed for bankruptcy—Mr. Malin is wrong?

Nearly every real estate brokerage has its own vacancy rates, whether internal or for public consumption, and a quick poll shows a range of vacancy rates from 1.46 percent of Manhattan apartments on the low side to 3.8 percent on the high side. According to yearly rates compiled by Citi Habitats, the Manhattan vacancy rate hit 2.62 percent in 2002, before bottoming out at 0.76 percent in 2006 and rising to 1.71 percent this October.

But Marc Lewis, president of Century 21 NY Metro and a 30-year industry veteran, puts the current vacancy rate closer to 5 percent. Considering that the local economy has imploded, and that everyone from politicians to art auctioneers are bracing for a major economic slump, it's not heretical to suggest that the worst is yet to come.

Is there anything that can stop the vacancy rate from pushing beyond 5 percent, as Mr. Lewis speculates, to something closer to 9 or 10 percent? Aside from a steep reduction in rents, which for landlords is as appealing as downing a shot of hemlock, the only great hope for property owners to move their product is a swift recovery in the local job market.

In other words, let's get used to these high vacancy rates.

Analysts take as an article of faith that the rental and sales markets are inextricably linked: The theory goes that if the sales market slows, the rental market will pick up. After all, people have to live somewhere, and if they are not buying, they must be renting. The financial crisis appears to have severed the relationship, as a slumping sales market has yet to manifest itself in the form of a more robust rental market.

And that's because the rental market's also closely linked to the city's economic health, particularly its employment picture. The city's unemployment rate, however, now stands at 5.7 percent, up from 5 percent last September and expected to rise into 2009. A slumping sales market—Manhattan apartment sales were down 24.1 percent annually in the third quarter, according to appraisal firm Miller Samuel—may not be enough this time to buoy rental landlords.

"Traditionally, that has been the case," Mr. Malin said, "but with the amount of layoffs taking place, there is a question mark about how much the vacancy rate will rise."

> **'The fundamentals of the rental market are strong.'**
> *—Gary Malin of Citi Habitats*

It's easy to forget that these are more than abstract numbers, but rather indicators with immense financial ramifications for landlords with slim balance sheets. At a 5 percent vacancy rate, a landlord with 1,000 units would have 50 unoccupied residences; now, if the vacancy rate jumped to 10 percent, the landlord would have another 50 vacant apartments. If the landlord's apartments averaged $2,500 in monthly rent, the owner would be losing an extra $125,000 a month in income, and $1.5 million annually.

If such economic twists impact enough landlords, the effects will reverberate not only throughout the apartment market, to tenants and to brokers, but will be felt in varied real estate branches like investment sales and commercial brokerage (who wants to buy apartment buildings that aren't garnering an appreciating return?).

The effects would also fell one of Manhattan real estate's more cherished conventional truths: that the borough has the nation's tightest apartment market. It does, for now, according to various reports.

While large-scale real estate rental shops, with portfolios in the thousands of units, like Rose Associates, Rockrose and the Related Companies, could weather such a deflationary storm, small-time outfits and heavily leveraged new developments might end up on the rocks.

"The little guy, with one or two little projects and little track record, is going to be in bad shape," said Daniel Baum, COO of the Real Estate Group New York. "He will find himself in a very, very precarious situation."

Brokers are emptying their bag of tricks to try to forestall any significant rent reductions. For the first time ever, Mr. Lewis of Century 21 NY Metro noticed property owners offering tenants incentive packages during the summer, traditionally a busy season of high tenant demand.

Other landlords are freezing rents, offering 18-month leases, and even warehousing some units to create some scarcity and a greater sense of urgency among prospective tenants. While their efforts have prevented large-scale price chops, tenants can already take advantage of falling rents in outlying neighborhoods like Upper Manhattan and even the ever-popular Upper East Side.

The hope is that landlords will be able to survive until next spring or summer, when the seasonal market will drive up business, but even that isn't a sure thing.

"Next year is where the big question is going to be," Mr. Baum said.

Two major investment houses, Bear Stearns and Lehman Brothers, no longer exist, and there are doubts that financial firms and other higher-paying industries will have an abundance of job openings to lure those transient young professionals fresh out of college or graduate school. Not even cheap rents can entice apartment hunters if there aren't any employment opportunities, especially in a city as expensive as New York.

"It's all going to depend on the hiring for next summer," Mr. Lewis said.

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