New York, Just Like I Pictured It

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MR. MICHAEL CEMBALEST: Good morning, everybody. This is Michael Cembalest with the October 2023 Eye on the Market podcast. This one's called New York: Just like I Pictured It. A couple months ago, a client of the firm, which is one of the largest apartment owners in the United States, asked me if I would prepare a forensic study of New York City, specifically, to present at their board meeting at the end of September for purposes of a discussion about the rationale for continued long-term capital investments in the city.

And I agreed to do it, under the condition that I would be able to share it with our clients after I was finished with the project because I knew it would be a lot of work. And they said yes, and so here we are. There's a four-page Eye on the Market Word doc HTML that you can read, and then there's an attached deck that's got over 100 slides. I'm just going to walk through some of the main points here, but you should look to those two other resources if you want to see what we did.

And here's the summary. New York City has a lot of advantages related to its outright size. It dwarfs every other city, including Los Angeles and Chicago, just in terms of its overall economic output, size of its labor force, its purchasing power. New York City has a lot of business sector diversification, which is surprising, 'cause a lot of people think it's just about finance and it's not. Within the financial sector, New York City still has global financial sector dominance versus other competitive cities.

And then in terms of the post-COVID recovery, a lot of measures have now reached pre-pandemic levels, like the labor force, people going out to dinner, airport utilization. The residential and industrial sectors within commercial real estate are in pretty good shape in terms of low vacancy rates.

And the thing that would surprise you is that New York City crimes statistics, at least the way they're reported by the FBI and by the city itself, compare favorably to a lot of other cities, and sometimes that comes as a surprise. But mass transit utilization is still only around three-quarters of 2019 levels, and that's pretty much unsustainable given all the capital operating costs, even at 100% utilization rates.

New York City office vacancy rates are the highest as they've been since the early '90s. There's a lot of leased but underutilized space. Around 35% of New York City workdays are still done from home, according to the work that Nick Bloom at Stanford does, where he compares different cities. And as we explain in the deck, office-to-residential conversions are in principle possible, but once you filter through all of the regulatory and economic costs, there unlikely to make that much of a dent.

The city has some very daunting operating deficits in front of it and will have to enact some very deep budget cuts or tax likes, while at the same time trying to figure out how to reinvest in aging infrastructure, in public housing. New York City is still a really difficult place to do business, and the zoning restrictions in particular are burdensome at a time when flexibility is paramount.

And the city's tax rates are very high, the municipal debt burdens are high, home affordability is low, and that may explain when New York City has had one of the highest net outmigration rates of all the cities we looked at, and why New York State actually ranked next-to-last, other than Alaska, over the last decade regarding outmigration of both the number of taxpayers and their adjusted gross income.

As things stand now, the asylum situation threatens to substantially impair the city's financial situation; I think the mayor has been clear about that as well. And to top it all off, the electricity prices are very high. New York State has among the lowest wind and solar capacity factors, which is a measure of raw material, solar and wind power. And then on top of that, the city is increasingly exposed to national gas prices with the closure of Indian Point.

So now, somebody might say a lot of cities face these problems. And that's true, which is why we compared New York to 21 other large cities according to four main categories. An urban recovery Score, which looks at urban mobility and are people going back to restaurants and supermarkets and retail stores. Within that category, we also look at mass transit utilization and real estate vacancies. And on that basis, New York City actually ranks above median compared to the, within this 22-city group. And there's a color-coded heat map, summarizes some of this, and green is good and red is bad as you might expect. And here New York ranks slightly above median.

The problem is the city is dragged down by a very slow economic recovery since 2019. When you look at the labor force and payrolls and housing permits, personal income spending and outmigration here, the city ranks way below median. The city also ranks way below median on things like housing affordability, zoning, unemployment, ease of doing business, tax rates, electricity prices. And then lastly, the fourth category looks at fiscal health, which is tax revenues, government debt, liquidity and unfunded pensions, and retiree healthcare, and here the city ranks below median as well.

So when we put all those four categories together, New York is in a difficult spot ahead of only Chicago, Detroit, and unsurprisingly, San Francisco. The stories that we read when we started this project about the doom loop in San Francisco have been confirmed by the data that we actually came across as we were pulling this all together. So I'm not going to go into too much detail; we're just going to show you a few pictures and then talk about some of the policy options that we were thinking about.

We have a chart in here that shows this is the urban recovery. Apple did some tracking on this, so did Google, but there's a University of Toronto study which uses mobile phones to track visits to retail stores, markets, restaurants, museums. Again, New York ranks at the high end here, a 30% gap versus 2019, still significant, but New York ranks better than a lot of other cities.

Here we also have a table on mass transit recovery. And here as I mentioned, the city is around 75% of pre-COVID levels. But again, these a very capital and operating-intensive systems to run, and that's a very expensive problem for New York that's going to have to be resolved.

But here we have a chart that that shows in a lot of different ways what the city's facing. We have a chart that shows the utilization rates of the Long Island Railroad, the subway, Metro North, and the bus systems, ranging anywhere from 60 to 70%, 75% maybe. But New York City office building utilization is still at around 50% pre-pandemic levels. And that gap is essentially telling you all about people that are circulating and going places. They're just not going to their white-collar office jobs, and this is the work-from-home issue.

The vacancy rates in the city, when you include pending vacancies, have hit about 18%. That's as high as we've seen certainly since the early '90s. What's kind of remarkable is that the city ranks ninth-best compared to other cities. So this underutilized office space issue is a national phenomenon. And were 11 or 12 cities in the peer group that had vacancy rates, office vacancy rates even higher than New York.

The issue is that New York has the highest work-from-home percentage, and at least as of July of this year, was showing little signs of changing. We'll see in the next few months whether that that shifts. But a lot of the people who study this don't think it will, which raises a lot of complicated questions about how cities can change and repurpose underutilized office space instead of letting it become vacant, affecting tax revenues, resulting in areas that are underpopulated. You end up with a lot of squatters and all of the things that you might imagine would take place.

We have a few slides in the in the main deck on crime reported by the city from the FBI, which allows us to compare it to other cities. And New York kind of ranked in the middle in terms of violent crime and much better than a lot of cities in terms of property crime. Recently there's been a surge in auto larceny.

But I thought this was interesting, 'cause it was very timely. This is a table from the census. They do a household pulse survey. And each week they do surveys and they ask what percentage of people are feeling pressure to move from where they live because they're in an unsafe neighborhood. And here again New York ranked kind of in the middle and was outflanked by Seattle, San Francisco, Phoenix, surprisingly, and LA and Philadelphia and Chicago. So again, another data point that complements the notion that sometimes the crime situation in New York City, at least from a statistical perspective, doesn’t look as bad as you might think.

But where New York definitely has an issue is in the outmigration of its population. And this is hard data to get, because the IRS reports migration of taxpayers, but only with a three-year lag and only at the state level. So we went to our colleagues in Chase Data Science and we asked them can you try to figure this out based on change-of-address forms with respect to their credit card bills, and they did. They then matched it up with some historical data from the census and was remarkably close, like out to the second or third decimal.

When I complimented the Chase Data Science people on how well their approach went, their response was well, we knew it was going to be really good and they were very confident in their data, ‘cause we do bank somewhere like two-thirds or more of the country’s households, so they felt confident that it was going to match and it did. And here you can see the net migration data from New York was among the highest in the country over the last few years.

And that’s complemented by this. As I mentioned, this is the IRS data, which looks at migration statistics, both in terms of number of filers and adjusted gross income. We have a table in here that shows the five states with the most inflows and the five states with the most outflows, and New York ranks 49 out of 50, only head of Alaska, on both measures. So there’s something going on in New York that is resulting in people leaving, and that’s a bad fact.

As I mentioned, one of the benefits of the city is the sheer size of the place, which attracts a lot of people and employers. And this is the way that we’ve decided to show it. We created an index that combines economic output in dollars, labor force in terms of number of people, and personal income in dollars. New York on this basis is almost twice as large as Los Angeles, almost three times bigger than Chicago, and almost four times bigger than Dallas. So there’s a size advantage to New York City that draws people here.

But New York also has among the lowest home-affordability metrics in the country, and that's bad too, because that's one of the things that was going on in San Francisco before the city imploded. And what's notable is that it's not just the number of people that affects housing affordability. We looked at the Wharton, Wharton at the University of Pennsylvania has a residential land, the land-use index. And they score each city based on its restricted sub-zoning. And we have a chart in here that shows that there's a pretty decent correlation between how severe your zoning restrictions are and the affordability of housing in that city. And so that's something that has to be, we'll talk more about later.

This is the tax data. You have to look at tax rates for households as a function of their income. We picked $75,000 a year because it's reasonably close to median income for a lot of these big cities. And here you can see that New York is close to the top in terms of the combination of income, property sales, and auto-tax rates. So that's part of the issue that's pressuring the city.

And then the city is facing a pretty big fiscal cliff. And the way this kind of stuff works with cities is they can't run large deficits generally the way the federal government does. So whenever you see projections of deficits, those deficits have to be closed by some combination of tax increases or spending cuts. And what's interesting about New York is on the left, you get a projection of the deficits from the mayor, essentially the Office of Management and Budget of the mayor's office. But separately there's an independent New York City controller that is projecting budget deficits that are twice as large as the mayor's office, and the single largest component of that difference is the asylum costs that the city is expected to incur in the next few years.

The other analysis that we do, for those of you that have been fans and readers of the Eye on the Market, is we look at the cost of not just government debt but also paying off unfunded pension and retiree healthcare plans. I won't go through all the details here, other than to say that New York is not at the top, right. I mean, Chicago will continue to set world records of insolvency as it comes to these kind of things. But New York is definitely on the high side related on this measure too. So that's an additional pressure point.

Energy prices, they're high. Here you can see that New York has one of the highest electricity costs per kilowatt hour in the country and I'm not surprised. The chart on the right is interesting in the following regard. A few years ago, Indian Point was shut down, and I understand why people wanted to shut down Indian Point. There's a natural gas line that runs underneath Indian Point. So combining a gas line with a nuclear power plant's not a great idea.

At the time, NYSERDA, which is the New York Energy Agency, said don't worry about it, wind and solar is going to make up the gap. That turned out to be about 95% false. As you can see in the chart, most of the gap is made up by natural gas and imports of electricity from neighboring states that produce it with natural gas. So while this might have been an important decision to make, I think the energy gurus in the city, at least so far, have misunderstood what the dynamics were going to be in terms of electricity generation.

I'm not going to spend too much time on the office conversion issue. There are pathways by which they can happen, but they tend to require, they're very expensive to do. They only make economic sense when they can be purchased at 60 to 70% discounts from the prior owners. And then basically, the only way you can make money is to charge rental income in the 90th percentile of rents. And so while some of those projects may take place, I can't imagine how that's going to end up impacting the kind of stock of affordable housing, or even upper-middle-class housing in the city.

So what should the city do about it? I don't know; I'm not a public policy expert. But I consulted people who are. And there's no magic bullets, just a few ideas on the margin to increase efficiency and productivity. New York ranks last or close to last in every single zoning regulation index that you can possibly find. And according to the Department of Transportation, who did a study on this kind of thing, when you relaxed owning restrictions in big cities, you can really increase output and wages, because you can decrease commuting times for a lot of people that are forced to live so far from the city that it decreases what their job options are.

And just to kind of tick through some of the things about New York, in parts of the city, you can't build apartment buildings in parking lots or where one-story retail used to exist. New apartments often have to, and new retail often require off-street parking, which can be prohibitively expensive, and which is strange in a city that's trying to encourage mass transit. Some areas have limited development, special-district status that have been in place since the '70s. Some places have never been zoned for apartment buildings at all.

And some streets preclude development of new housing, even though they're adjacent to public transit. So there's an enormous amount of work that can be done here, and a lot of people are focused on this. I know the mayor's office is focused on it as well. But one of the reasons that you rank last in some of these indices is when a city - - really hard to change those things.

The city should encourage more public-private partnerships to develop apprenticeship programs, particularly for those people without four-year degrees. J.P. Morgan is active - - the New York CEO Jobs Council. More companies should get involved. Second-chance legislation is important. You would be amazed at how many adult males have some kind of criminal records, serious or not, and which can severely impair their ability to get a job and obtain housing and raise a family. And so second-chance legislation is something that helps increase employment and reduce recidivism.

The city should probably reduce the licensing requirements that make it difficult in terms of impairing interstate mobility. Occupations that require licensing in New York City include barbers, court reporters, nail cosmetologists, horse trainers and jockeys, notary public. You get the point.

And then the last one that I thought was notable was it may be time for the city and a lot of cities to rethink the tax-exempt status of hospitals, universities, museums, and religious institutions in terms of being tax-exempt owners of New York City real estate. A lot of universities in the country have technology-transfer offices to privatize and profit from federally-sponsored research. They collect millions of royalties, and all of that's tax-exempt.

Entities like the Trinity Church has a real estate portfolio reportedly worth $6 billion. Columbia University is the city's largest land owner, and its property tax savings are 50% larger than those given to Yankee Stadium. And the city, and it gets worse every time Columbia expands 'cause it's taking over property that used to be on the tax rolls. All in, there's around 12,000 New York City properties that were worth at least $40 billion ten years ago and that were exempt from property taxes, even though the entities that owned that real estate earned $134 billion in revenues that year, and that's something that should probably change.

So the last comment I would make is New York is a very difficult place to do business and is being outflanked by cities with a different approach. And we have a chart in here that shows as the ease of doing business score goes up, so has the economic and demographic growth of that city since 2019, so something for the city and its officials to think about. And then we close with a discussion about Detroit. For everybody that is inclined to think that raising taxes is the answer, it's a difficult one when you're in a downward spiral. And we have a chart in here that shows that Detroit continued to raise tax rates, but as entities fled the city, their actual collection of tax revenues fell.

So anyway, that's just a quick podcast synopsis of the research that we did. If you want to take a closer look, all the information is available in the Eye on the Market that was released today. Good to see everybody, and we'll be back to you before Thanksgiving with an update on the markets.

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