The Big Three Cash In

Sam, Harry and Donald say goodbye to Brooklyn, Queens and the Bronx

By Jonathan Greenberg

THERE HAVE BEEN NO GROUND-breaking ceremonies to commemorate what will be one of the most significant developments in New York City housing. No headlines. No City Council proclamations. No fanfare. But for Manhattan's three wealthiest real estate men, a newfound ability to co-op rental housing in the bedroom boroughs will prove to be one of the greatest windfalls of their lives. "It will be a lot of goddamn money," says Sam LeFrak.

LeFrak owns 32,000 apartments in the city, nearly all of them in Queens and Brooklyn. Harry Helmsley has 25,000, 80% of them in the Bronx, Queens and Brooklyn. Donald Trump also has 25,000 apartments, most of them in Brooklyn, the rest in Queens and Staten Island.

In Queens, the three titans own roughly 10% of all rental properties. Now, LeFrak, Helmsley and Trump have decided that co-oping is the only solution to their outer borough landlord woes, and that process will redraw the New York City housing map. It will also make the three some $1.5 billion richer—much of that money to be poured into their Manhattan projects.

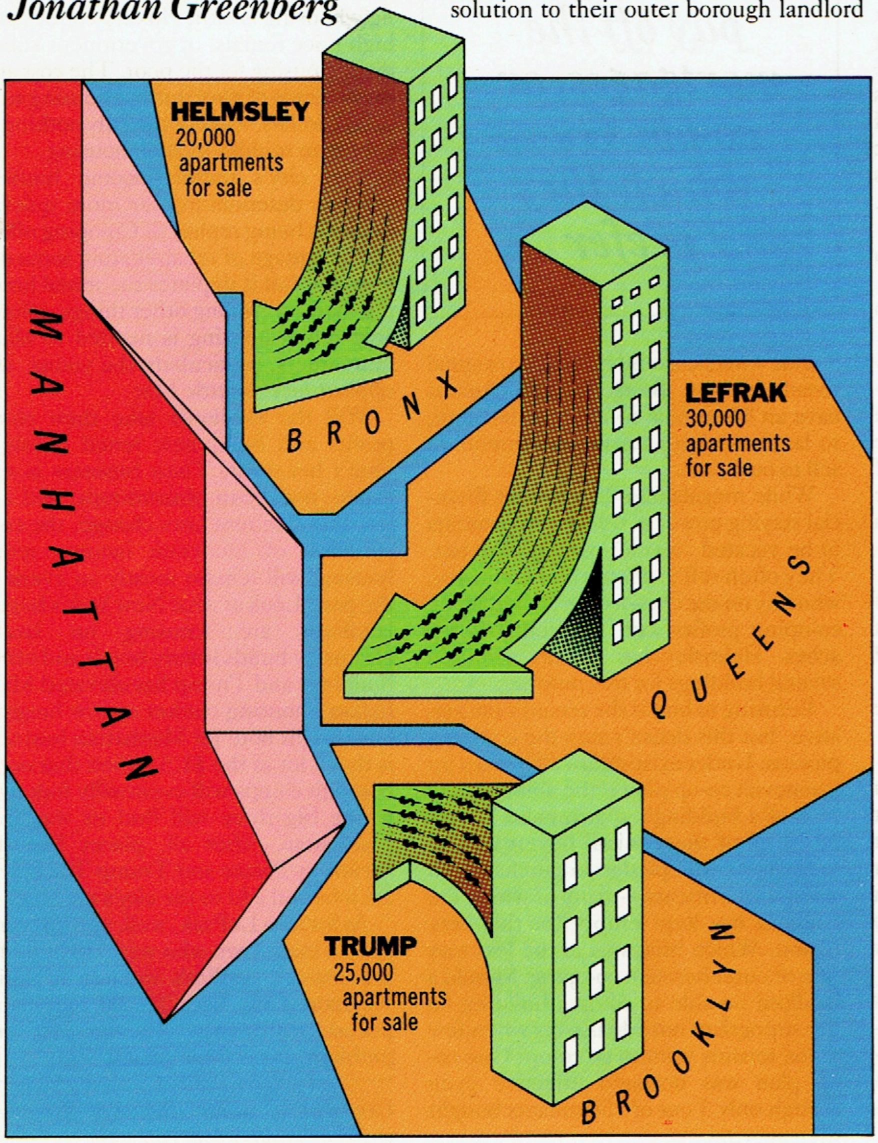

ILLUSTRATION BY NIGEL HOLMES

Call it a return to their roots. Outer borough apartments for middle income tenants provided the foundations of the fortunes of Trump and LeFrak, and Helmsley has owned in the boroughs since the early 1960s. Limited there by rent control and stabilization, the three empire builders plunged into Manhattan and built glamour buildings while their in-house managements did the scut work in the boroughs.

Numerous landlords have been testing the co-oping waters in the outer boroughs and found them agreeable. Tenants in Brooklyn and Queens with moderate incomes seem willing to shell out the capital to become co-op owners. Equally important is that if they don't have the money and the banks don't want to lend it, the larger landlords will help finance these purchases themselves. Best of all for landlords is that current laws allow them to co-op buildings even when only a small portion of the tenants chooses to buy in.

The time has come for the big three to cash in their oldest chips, although not all at one time. "You don't throw everything out there at once," says LeFrak, America's largest independent apartment owner. "If you bring it to the market when it's green, nobody wants it. If it's overripe, nobody wants it. You've got to bring it to the market when it's ripe."

The market is now ripe for LeFrak. He plans to offer conversions on at least 2,000 units a year, with insider prices of $25,000 to $50,000. He will "dribble out" sales over the years and shelter the income by building new rental housing, such as his Battery Park City in lower Manhattan. There's a lot of money to shelter. Even factoring in the cost of improving buildings to fulfill co-oping agreements, LeFrak will eventually come out with over $500 million from his outer borough properties—a pretty penny for a man whose objective has been to "build for the mass and not the class."

Not surprisingly, the megalandlords are quick to point out that tenants reap substantial rewards by co-oping. Rent-stabilized tenants can buy their apartments at an insider price of half the market value. Only 10% to 20% is needed as a downpayment, so tenants can increase their equity, and sometimes realize huge returns on their investments.

"I don't mind telling people they can buy these co-ops and make a lot of money, because I want to get rid of them," says billionaire Harry Helmsley, the wealthiest real estate man in America. LeFrak tells of receiving petitions from tenants begging him to co-op. The Trump Organization, which co-ops some 1,500 units a year, boasts about how easy it is to sell tenants their apartments. Helmsley tells of tenants who cashed in and made 1,000% returns.

The business of co-oping is not new to Helmsley, who also converts about 1,500 units a year. He was one of the first to co-op in the outer boroughs when he began selling off his 12,000 unit Parkchester development in the north Bronx a decade ago. It was not until last year, however, that he decided he could successfully co-op in Queens, and he recently disclosed that his long-range goal is to get out of rental housing entirely.

"There is no advantage to owning a multiple dwelling in New York," says Helmsley-Spear director Richard Weiss. His argument is that rent control and stabilization makes landlording unprofitable. In truth, many buildings being co-oped are profitable as rentals. This profitability, however, is often contingent upon the building's mortgage. Much of the city's housing was built with 4% to 6% mortgages after World War II. When it is time to refinance at the current rate of 15%, the increase usually sucks up the profit and sometimes more. Landlords have two options: pay off the mortgages, or co-op. Guess which they prefer.

For buyers, the economics are much more reasonable than Manhattan deals. Apartments in the outer boroughs often cost what Manhattanites pay per room. Take the hypothetical case of a Helmsley apartment in Queens. Say the rent-stabilized tenant pays $400 a month, no part of which is tax deductible. Now say the tenant buys for the insider price of $30,000—half the market value. The tenant pays $5,000 down and takes out a mortgage for $25,000. Helmsley will either arrange a low-rate government mortgage, or find a bank to sponsor the loan. If all else fails, Helmsley will finance it himself. With monthly maintenance of $300, interest payments of $200 and another $100 for amortization, it costs the tenant $600 per month to own the apartment he rented. But now the $200 interest expense is tax deductible, as is a portion of the maintenance fee. A tenant could come out owning a $60,000 asset for almost the same cost as renting. For Helmsley, it's cash and carry—cash made in the boroughs and carried back to Manhattan, where it goes into highly profitable luxury hotels.

State and city officials are all for this latest scheme. Indeed, the State Legislature has declared, "It is sound to encourage such conversions . . . which are an effective method of preserving, stabilizing and improving neighborhoods."

"When a person owns something it makes a helluva difference," says Governor Hendley, president of the LeFrak City Tenants Association. "If he sees little Johnny marking the walls in the hallway he's going to think, 'This is my hallway, it's not Sam LeFrak's hallway any more,' and he's gonna make sure Johnny doesn't do it again."

Of course not every insider buys. Where LeFrak has converted so far only 25% of the insiders bought. That is fine with LeFrak, Trump and Helmsley. If 25% of 2,000 units co-oped each year sell at an insider price of $30,000, that's an annual take of $15 million. As the other 1,500 units are vacated, landlords can sell them for at least $60,000. So, although they have to wait, when an apartment is sold to an outsider the landlord pockets double what he would have if the original tenant bought. Brooklyn and Queens have an 8% annual turnover in housing, so landlords have vacant apartments to sell to outsiders.

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While megalandlords have the financial staying power to wait for apartments to be vacated, smaller owners may not. They often sell to people like Helmsley, who buy on the cheap, convert and enjoy co-oping profits with few rental headaches. Helmsley has already acquired several buildings for this purpose.

Refusing to buy is the tenant's prerogative, but this doesn't stop the co-oping process. Under existing law all it takes for a nonevict co-op plan is the ability to sell 15% of a building's apartments. What's more, all of these initial buyers can be nontenants who pledge to purchase and occupy apartments—many of which the landlord has kept empty for this very reason. Which brings us to the less rosy side of outer borough co-oping. Should a landlord be able to co-op a building on the strength of outside buyers when few rental tenants want to go co-op? One co-op plan was declared effective even though only 3 out of 158 tenants bought their apartments.

New York State Attorney General Robert Abrams has introduced a co-op bill which has passed the State Assembly each of the last three years and could be brought before the Senate next year. It requires that 25% of a building's tenants agree to buy before a conversion can take place. For landlords, this will change little but selling strategy. They will work harder to talk the minimum percentage of tenants into co-oping.

They will meet some opposition, of course. John McKean, president of the Tudor City Tenant's Association, dismisses pride of ownership and contends that co-oping divides renters and owners, causing dissension in the community. "It's a monopoly profit and should be prevented," he adds. "The LeFraks, the Trumps and the Helmsleys are getting an enormous profit out of people just because of a shortage of places to live."

The problem with that argument is that despite a desperate need for new housing, rent control and stabilization have put a wet blanket over the industry's incentive to build rental housing. Most new housing is either luxury condos and high price rentals, or government-subsidized housing for the poor. The cost and inefficiency of government housing uses up tax dollars, leaving virtually nothing to subsidize middle-income housing.

The city's middle-income housing stock is deteriorating far more quickly than it is being replaced. Co-oping offers the advantage of rehabilitating some old housing, but it depletes the rental housing market. Among other things, affordable rental housing is needed to allow newcomers, particularly the young, the opportunity to settle here.

Will the landlords take their co-op profits and build new rental housing? Don't bet on it. Their business is real estate, not urban philanthropy, and unless they see rent laws change, the construction of moderate income rental housing will remain mostly an event of the past. Look at what New York's largest landlords are focusing on lately. Helmsley builds luxury hotels and office buildings and Trump has elevated Manhattan's housing market to new heights. One bright note for Manhattan business is that a lot of the $1.5 billion that outer borough co-ops will eventually fork over to the big three will find its way into Manhattan. After all, places like the Helmsley Palace and Trump Tower create jobs and add to the city's tax base.

As for Sam LeFrak, well, you just can't keep a man down who wants to build for the masses. LeFrak intends to build Newport City, with 12,000 reasonably priced apartments. There's just one problem. It's in New Jersey. M

Contributing editor Jonathan Greenberg writes frequently about real estate.