



WALLED-OFF ASTORIA: Approximately 1,000 rooms at the Waldorf-Astoria New York will be converted into condominiums by its new owner, Anbang Insurance Group.

SPENCER PLATT/GETTY IMAGES

# CONDON'T!

*Last year the City Council passed a law forbidding hotels from offering select units as condos: Was it a case of government meddling, or a necessary intervention?*

By Cathy Cunningham

It's been a little over a year since the Real Estate Board of New York filed its opposition in New York's Supreme Court to the City of New York's Local Law 50, which prohibits owners of large Manhattan hotels from converting rooms to residential condominium units. Despite REBNY's complaint being dismissed due to lack of standing to sue, the industry group isn't backing down and filed a notice of appeal on Sept. 26.

The moratorium is set to expire in eight months, but there is a strong suspicion that it will be extended.

On the heels of this, Commercial Observer took a closer look Local Law 50—its impetus, its potential short- and long-term implications on the New York City real estate market and whether the law will be extended. We spoke with the law's supporters and adversaries, many of whom were not legally allowed to speak with us, given the pending

legal action, and found to be a topic that invokes strongly worded viewpoints, from it being called an "outrageous law" to an "essential intervention."

## The Long Arm of the Law

Local Law 50 was passed by the City of New York in May 2015 and approved by Mayor Bill de Blasio a month later. The City Council found it "necessary and appropriate to place limited, short-term restrictions on

the conversion of larger hotels in Manhattan to other uses." "Larger" hotels are categorized in the bill as those with more than 150 keys and, as a result of their size, are prohibited from converting more than 20 percent of their rooms to condominiums for a period of two years, ending in June 2017. The bill states that the moratorium was necessary as large hotels in New York City are a "critical source of quality jobs" and that residential conversions pose "a significant risk

to the city's economy, its tourism, its market for quality jobs and the quality of life for city residents and visitors."

Many of REBNY's 17,000 members own interests in the approximately 175 hotels carved out by the law. The industry group attempted to have the law dismissed on the grounds that for one thing, the law—ironically—isn't legal because New York City Council and de Blasio didn't comply with requirements of the New York City Charter and State Environmental Quality Review Act in enacting it, and second, contrary to the legislative findings that the law is based on, "there is no shortage of hotel rooms and no threat of a shortage of hotel rooms in New York City," according to the summons filed by REBNY on Oct. 1, 2015.

The industry group cited a financial impact statement from the Council's Finance Division, which states that during the 11 years preceding the enactment there were only 14 conversions of hotels into condos in the city, eliminating a total of 3,600 hotel rooms. By contrast, during the same period, the number of hotel rooms in the city increased by 37 percent to 111,000.

Further, REBNY alleges that Local Law 50 was enacted for the benefit of the Hotel Trades Council and its members, whose interests are at stake if property owners diminish or discontinue properties'

participation in the hotel business.

#### A Limited Discussion

According to sources familiar with the law's enactment, the Hotels Trade Council did push hard for the bill to be passed, primarily for the purpose of protecting union jobs. (The HTC declined to comment.) But,

limited service. The hotel industry is hurting from numerous external circumstances out of our control—the weak euro and British pound, Airbnb. One thing that can be moderated is the oversupply of limited service hotels, which have cut rates. This bill stops full-service hotels from ceasing to be hotels and exacerbating the problem."

*'Local law 50 is an intrusion into the ability of hotel operators and commercial real estate developers to act in the best interests of their shareholders.'*

— Kurt Larkin

that's not the only reason.

"The law is based on the nature of the hotel industry itself and the recent proliferation of limited-service hotels," one hospitality industry source familiar with the lawsuit told CO. "Of the 200 hotels in the development pipeline, approximately 100 are

STR Senior Vice President Jan Freitag said, according to a June article in *Hotel Management*, that of the 15,000 hotel rooms under construction in New York at the time, 8,000 were upscale and upper-midscale and a full 50 percent of incoming New York City hotels are in the limited-service sector.

"Developers, banks and brands like limited service because they're easy to operate, easy to build and easy to finance," Freitag said. "The mold is understood by the banks, and the real estate is understood and easily communicated to both developers and banks."

Although the hotel landscape in New York City has been steadily changing for years, the conversion of three quarters of the Waldorf Astoria New York into condos by its new owner, Anbang Insurance Group, may have been the nail in the coffin that finally sparked the city's intervention. "I'd say it was the watershed moment," said the hospitality industry source. "At that point not only was the union worried about limited-service hotels; they had another huge threat to deal with."

But was the threat as big as it was claimed to be? "It's just so over the top. It's a solution addressing a non-problem, because there is no problem," grumbled one attorney.

"This law is only attacking hotels with more than 150 rooms," said Joshua Stein, the owner of his eponymous law firm and a columnist for CO. "Those are the ones that tend to be the most unionized, and it's the stratum of the market where the new supply has not been as great. The new supply tends to be these smaller, limited-supply hotels, so that is interesting. It's not like a lot of people are building new Waldorf Astorias."

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**LAYING DOWN THE LAW:** Mayor Bill de Blasio approved Local Law 50 in June 2015, one month after it was passed by the City of New York.

### Homes Versus Hotels

While hotels made economic sense for the city years ago, some of those CO spoke with were of the opinion that the hotel market is oversupplied right now, and residential conversion may actually be a good thing for New York City in helping to sop up some of the demand for housing. “Why not convert them?” opined one source. “It’s good for the housing shortage.” (As CO has already reported, some hotels are indeed being converted but to homeless shelters, not apartments.)

Stein agreed. “This is another dislocation and distortion of the market,” he said. “Transactions that make perfect business sense and would help mitigate our housing problem are banned because of some political forces at work in the City Council. It’s a shame that we do business this way, but the level of governmental meddling in the New York City real estate market is just astonishing, and it should come as no shock that our market doesn’t work very well.

“Without Local Law 50 there are presumably some big hotels that are ripe for a conversion to housing, and if those hotels went into the housing market, you’d have a small increase in the supply of housing

which would at least to some degree help drive down prices from what they otherwise would be,” Stein said. “We aren’t going to experience that little bump in supply so this excludes some competition from the housing market and helps keep prices high. Great for owners but not so good if we care about affordability.”

### Switch Hitting

Part of the resentment harbored by those opposing Local Law 50 comes down to the rights of a real estate owner and the law’s dictating what can or, perhaps more accurately, *can’t* be done with a property.

“REBNY’s lawsuit is an important legal challenge for New York City’s real estate industry,” said attorney Kurt Larkin, a partner in Hunton & Williams’ labor and employment practice. “Local Law 50 is an intrusion into the ability of hotel operators and commercial real estate developers to act in the best interests of their shareholders.”

John Banks, the president of REBNY, said in his Feb. 19 deposition that his organization did not know how many of the properties’ owners were considering converting hotel rooms to other uses or how many were considering a sale to a purchaser who

would pursue such a conversion. “Clearly, however, by eliminating—at least for the two-year moratorium period—the possibility of a conversion and thereby reducing the options available to ownership, Local Law 50 diminishes the value of these properties.”

“Real estate is a long-term asset, and over time, markets change,” Stein said. “One of the bundle of rights you have, as an owner of real estate, is the right to change the use of your real estate within the constraints of zoning. Suppose they rezoned all of these hotels to say they can’t be used as housing, saying, ‘You can only be hotels.’ By doing that, they are depriving the owners of the value they previously had, in terms of the potential ability to change that property’s use to something that may be more profitable.”

Another attorney shared the sentiment. “Firstly, [Local Law 50] is clearly a land-use issue. Secondly, it is a constraint on the market—when you own hotels or any real estate asset you have the expectation that—subject to zoning—you should be able to convert it to any use that is permitted. This was a market intervention.”

Opponents’ umbrage is due to the fact that the city’s zoning already restricts property

owners with regard to the use of their building, and Local Law 50 adds an additional layer of limitation—the decreasing value attached to the potential to change the property’s use to a nightclub, housing or whatever else the property owner fancies. “Real estate has more value to the extent that you have more flexibility of use, and so any hotel property whose selling price would increase because of the potential for conversion to housing will become less valuable,” the attorney said.

And it’s not just those directly covered by the law who are anxious about the inability to switch a property’s use. “We’re trying to sell a hotel that the buyer wants to convert to residential rentals—so they aren’t impacted by the moratorium—but they’re still extremely concerned about it,” one broker told CO. “They’re very worried about the union implications or, more specifically, what will the unions think about another hotel potentially not being another hotel anymore.”

Additionally, the broker said that there could be future claims ahead at some point. “You’re missing a subset of the market that could be bidding on your property. Hotel owners should be more involved, as they



**FRONT RUNNER:** The Plaza Hotel announced its conversion into condominiums in 2005, and was the first landmark hotel to make the switch.

could have a claim for loss of value when a property finally comes to market.”

#### **Before Sunset**

The initial complaint against the city was dismissed due to the fact that REBNY failed to show that even one of its hotel-owner members had actually suffered financial injury under Local Law 50. Specifically, REBNY would need to show some form of particularized injury that has happened to its members, as opposed to the general public welfare.

“Even if REBNY’s members included everyone who was subject to this ban—and it’s entirely possible that REBNY has 80 or 100 percent of the victims, even if they all got together as a whole through REBNY or in a class action, it would still be difficult,” the attorney said.

REBNY member Peter Haupsburg, the chairman and chief executive officer of Eastern Consolidated, supported the lawsuit in his deposition, filed on Feb. 19. Haupsburg cited an example to bolster REBNY’s case, in which he was being consulted by a foreign family that had owned a large [unnamed] Manhattan hotel for a number of years. The hotel was losing money, and Haupsburg

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*- Joshua Stein*

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believed that the property, in its condition at the time, was worth \$70 million. The family mulled two options for the hotel—one was to inject capital to upgrade its quality, and the other was to sell the property to new owners who had the skills and resources necessary to effectuate a conversion to residential use.

“I believed that the property could have been sold for a residential conversion for about \$110 [million] or \$120 million,” Haupsburg said in his deposition (Haupsburg did not talk to CO). “Had such a transaction been completed, Eastern

Consolidated would have earned a commission in excess of \$1 million.”

Haupsburg’s testimony goes on to state that once Local Law 50 was enacted, the hotel owners abandoned any pursuit of a sale, and Eastern Consolidated lost the opportunity to earn a substantial commission “as a direct result of Local Law 50.”

The City of New York responded in June this year stating that while Haupsburg’s exploration to best serve his client is varied and ongoing, the moratorium of Local Law 50 is only temporary. Or is it?

REBNY’s appeal will now need to be perfected, or placed on the court’s calendar, for a hearing at the appellate division, which could be several months away. The general consensus among those that CO spoke with is there is a strong chance that the bill will be extended past its sunset date of June 2017.

“Whether or not the city elects to extend the moratorium period, the law is affecting right now the ability of real estate companies to make important decisions about how to run their businesses,” Larkin said. “There are other ways for the city to protect hospitality jobs without overregulating the real estate markets. In any event, I think hotel companies would tell you there is no shortage of hotel rooms in New York City. The number of new hotels opening in the city, and corresponding number of new rooms, has outpaced the number of rooms lost to conversions in recent years.”

For now, however, eyes are watching the intervention with interest. “The question is, Will all of this meddling by the City Council kill the golden goose, and will New York revert to the bad old days of the 1970s? They’re trying really hard to kill it, with this law and on other fronts, but the golden goose just keeps laying golden eggs,” Stein said.