Stephen L. Ross

Commentary

1. Introduction

Andrew F. Haughwout and Bess Rabin examine trends in New York City's economy and real estate markets prior to and following the 9/11 terrorist attacks. They analyze trends both in New York City employment and in an index of coincident economic indicators (CEI) specific to the city. On the real estate side, the authors focus on trends in the Office of Federal Housing Enterprise Oversight's index of metropolitan house prices, the New York City Housing and Vacancy Survey, and the national real estate index (NREI) of class A office space in Manhattan.

Haughwout and Rabin do not identify any persistent, negative effects of 9/11 on New York City's economy or real estate markets. Employment in the city had already entered a steep decline prior to 9/11 because of the continuing national recession, and that decline continued at a comparable pace in the months that followed. The CEI exhibits a very steady decline immediately before and after the attacks, and the rate of decline slows dramatically during the year following 9/11. Both the index of metropolitan house prices and the Housing and Vacancy Survey suggest that residential values rose following 9/11, and the NREI office rent data are fairly flat relative to the national average during the periods before and after the attacks. The one exception to this pattern of stability is a dramatic increase in the NREI of office building prices in Midtown Manhattan and an associated decline in the index for Downtown.

Haughwout and Rabin argue that the general stability of the city's economy and the surge in Midtown values are attributable in part to the actions of public officials in the wake of 9/11. Specifically, New York City officials made strong, repeated announcements that Downtown Manhattan would be a mixed-use community while simultaneously accelerating commercial development in and near Midtown. In this way, the administration removed uncertainty and facilitated the private sector response to the dislocations arising from 9/11, which in turn increased economic stability and raised the long-run value of commercial space in Midtown. In contrast, the authors cite earlier work by Haughwout et al. (2004) on a fiscal shock to New York City, which found that small increases in tax rates led to large, permanent declines in the city's tax base.

2. Housing Markets, Government Action, and Price Changes

The value of urban land rises in large part because of some form of agglomeration economies. If these agglomeration economies are driven by the efficiencies arising from a large, diverse labor market, the destruction of commercial office space during the 9/11 terrorist attacks might have been expected to increase property values because it created a shortage of physical capital while leaving the human capital stock in the

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New York metropolitan area broadly intact. However, if agglomeration economies arise primarily because of economic spillovers, the destruction of commercial office space should have lowered the value of economic spillovers, leading to lower property values in Downtown and potentially affecting the entire New York City economy (see Rosenthal and Strange [2005] for evidence of economic spillovers in the city).

Haughwout and Rabin suggest that the negative effects of lost economic spillovers were mitigated by government action. In the wake of any dislocation, firms face uncertainty as to where private sector activity will locate, and property values are likely to suffer based on this uncertainty. The authors suggest that New York City officials solved this coordination problem through the signals sent in public announcements and actions. As a result, firms could base location and investment decisions on accurate expectations concerning the spatial pattern of economic activity within the city. According to this logic, these government actions stabilized the city's economy in general and led to dramatic increases in the value of Midtown office buildings based on the expectation of increased economic efficiencies as the Midtown commercial district continues to grow.

The explanation provided by Haughwout and Rabin seems reasonable, but I would like to offer an alternative explanation that appears equally consistent with the data. While the commercial office space destroyed in the 9/11 attacks represented 30 percent of the stock of Downtown class A space, this loss represents a substantially smaller portion of the class A stock in New York City and an even smaller portion of space across the entire New York consolidated metropolitan statistical area (CMSA). Therefore, the effect of 9/11 is that the shock was relatively small when compared with the economic size of the entire CMSA. The lost commercial office space may have been replaced by marginal adjustments across the larger economy with higher end activities moving to Midtown and lower end activities moving to space outside Manhattan, which in turn pushed other activities to office space in the broader CMSA. Given that a large fraction of workers commute into Manhattan, such adjustments might only have had a relatively small effect on the overall labor market.

In this context, the key question is how quickly the real estate market can adjust to such a large spatial shock to the relative location of office space supply. Clapp and Ross (2004) examine the adjustment of the market for owner-occupied housing in Connecticut in response to economic and demographic changes. While they find that the relative demographic composition of towns is affected by such shocks, they find no evidence of systematic changes in relative town prices over a two-year time frame. They conclude that sufficient mobility exists within the owner-occupied housing markets such that the increased demand in a few towns arising from migration is spread across the entire metropolitan housing market. In a related analysis, Clapp et al. (2005) examine both the short-run effect (yearly changes) of town demographic changes on prices and the long-run effect (four-year change). They obtain very similar results in the two analyses, suggesting that prices adjust quite rapidly across housing submarkets. One might expect the market for commercial office space to adjust relatively quickly when compared with the market for owner-occupied housing.

Only Haughwout and Rabin's finding of declining Downtown and rapidly increasing Midtown office building values cannot be explained by a simple view that the real estate market is characterized by the actions of efficient and flexible actors. These results, however, must be put into context. The office building price indexes exhibit a high degree of variability, with a spike in Midtown prices occurring during the fourth quarter of 1997 that was just as sharp and large as the spike following the 9/11 attacks. The Midtown and Downtown series also appear to be negatively correlated for most of the 1990s—not just the period following 9/11. Finally, office prices in both Downtown and Midtown began moving off their extremes by the second quarter following 9/11, and while they have not returned to their previous levels, the indexes appear to have returned to levels that are consistent with the trends established after 1995.

3. Conclusion

Haughwout and Rabin provide a very detailed picture of New York City's economy and real estate markets leading up to and following the 9/11 terrorist attacks. Their view that 9/11 had a relatively minor effect on the city's economy is quite convincing. However, the underlying reason behind this benign effect is unknown. The authors suggest that government action allowed private commercial activity to coordinate in Midtown Manhattan, which mitigated the negative effects of the dislocations caused by 9/11.

In this commentary, I offer a different view—that the shock was actually quite small relative to the total stock of commercial office space in the region, and that over a short amount of time marginal adjustments by individual firms absorbed the large shock to class A space in Downtown Manhattan with only relatively minor effects on prices. Unlike Haughwout and Rabin, I view their post–9/11 findings as consistent with earlier work suggesting a large impact from a fiscal shock. In their study, the focus was on a large supply response, which was probably necessary to keep the after-tax price of commercial and residential property relatively unchanged following the shock.

References

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