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## THE HIDDEN COSTS OF THE WORLD'S GHOST APARTMENTS

By David Cay Johnson



Take an evening stroll on either side of New York's Central Park and you will notice how few lights are on in the newer apartment buildings. That's because no one lives there.

Across the globe, empty luxury apartments darken many of the most desirable cities—Miami; San Francisco; Vancouver, British Columbia; Honolulu; Hong Kong; Shanghai; Singapore; Dubai; Paris; Melbourne, Australia; and London. The reason: The world's richest people are buying these grand residences not to live in but to store their wealth. In Paris, for instance, one apartment in four sits empty most of the time.

Some of these wealthy owners are looking for status, others a good investment. And for rich people in unstable countries, or those whose incomes depend on dubious businesses, holding real estate in foreign countries functions as private insurance.

Either way, the growing demand for luxury housing illustrates some of the adverse effects of the concentration of wealth at a time when worldwide wages are mostly stagnant. Because these palatial apartments and homes are rarely occupied, they impose a host of hidden costs on locals, including higher rents, longer commutes and fewer retail shopping choices. In some cities, notably New York, locals subsidize absentee owners.

The displacement of locals by the global superrich has prompted political leaders in San Francisco, Shanghai, Vancouver and New York, among other cities, to consider ways to ease the distorting effects of a relatively few wealthy people on the economies of their cities. In Singapore and Hong Kong, officials tried to slow the spread of absentee-owned luxury housing by limiting mortgages.

### **Welfare for the Wealthy**

These days, people who enjoy rivers of cash flowing into their accounts are having a hard time finding profitable investments in enterprises that make things or sell services. Holding money in banks is unattractive because the planet is awash in so much cash, interest rates are at historic lows. Instead of paying interest, some large cash deposits now incur bank charges.

This economic environment makes luxury apartments an attractive option to warehouse wealth. So long as other rich people are buying, owners enjoy the prospect of selling their units someday for a big profit. Many of these absentee owners buy their units through companies they control, transforming what would be personal after-tax operating costs into tax-deductible expenses. The prospect of higher prices encourages developers to buy and demolish existing buildings, often with the aid of government's power of eminent domain, which allows them to force existing owners out, paying them off at a discount.

What's also propelling this trend is the growing number of superwealthy people. There are far more billionaires than the 1,826 on the latest *Forbes* global list. *Forbes* primarily counts liquid wealth, mostly concentrated ownership of publicly traded companies that must be disclosed. Thus *Forbes* misses many more private and diversified fortunes. And for every billionaire, there are many more millionaires to whom the cost of a luxury apartment is little more than pocket change. Billionaires typically own 10 residences each, according to *Knight Frank*, a global real estate consulting firm. That means, statistically, that each of those residences sits empty 47 weeks per year unless friends or business associates use the space.

Some of this demand to own—but not live in—fancy apartments is vanity. But owning, not living in, a luxury apartment is especially attractive when the locals subsidize the costs. This welfare for the rich is done through subtle mechanisms few know about or understand.

**In New York state, the average property tax on single-family homes and townhouses is 2 percent of their assessed value, and in some counties, rates exceed 4 percent. But New York City's property tax on new apartments is a trifle.**

Yankees slugger Alex Rodriguez owns a \$6 million Upper West Side apartment with a picture-window view of the Hudson River. The owner of a \$6 million house would pay \$120,000 a year, but A-Rod's property tax is just \$1,200 a year, a rate of just two-hundredths of 1 percent annually.

In all, 150,000 New York City apartments qualify for a property tax break known as the 421-a program, which produces these low rates. Fully taxed, those apartments would pay an additional \$1.1 billion annually, the New York City Independent Budget Office calculated.

To encourage owners to occupy their units or sell, New York state legislation has been drafted to impose a progressive tax on vacant luxury apartments worth \$5 million or more. The proposed levy would start at one-half of 1 percent and rise to 4 percent on values above \$20 million.



Joggers pass the largely vacant Cape Royale condominium in Sentosa Cove on Singapore's Sentosa island, August 19, 2014. Sentosa Cove is a man-made island resort where foreigners can buy land. Dozens of houses - complete with their own private yacht berths and multiple swimming pools - sit empty while few lights are on in the apartment blocks overlooking the marina. EDGAR SU/REUTERS

## **A Safety Deposit Box in the Sky**

Some buyers use luxury housing to hide criminal proceeds, often acquiring their real estate through shell companies set up in jurisdictions from Wyoming to Panama to the Cayman Islands, which make it easy to conceal ownership.

Government officials and relatives who have grown rich from their political power are also active buyers of housing they seldom if ever use. President Xi Jinping of China has made cracking down on corruption his primary theme with the arrests of many party officials, especially from opposing factions. But when his niece Zhang Yannan was in her mid-20s, she acquired a \$7 million Hong Kong apartment and a waterfront home in an area of \$30 million villas, both of which appear to be vacant, Bloomberg Business News revealed three years ago.

While I was on a reporting trip to Singapore, tax lawyers told me about rich foreign clients who buy luxury apartments in that city-state to make sure they will retain some wealth should political change or social unrest force them to flee their home countries.

One lawyer spoke over lunch about two clients with similar wealth who owned multiple Singapore apartments. One was an Indian whose business is in Pakistan, the other a Pakistani whose business is in India. The businessman in Pakistan kept 40 percent of his wealth in Singapore, the businessman in India 20 percent, illustrating their assessments of the risks they faced.

Two years ago, Sotheby's International Realty reported that people living outside Canada—primarily in China, Iran and the U.S.—had purchased 40 percent of Vancouver luxury housing.

David Eby, a British Columbia provincial legislator, said he represents “a very empowered group of wealthy individuals who feel totally helpless” to stop absentee purchasers in Vancouver's priciest single-family neighborhood, where houses routinely sell for several million dollars. He said they object to teardowns to build what they consider oversized and tasteless mansions, as well as the loss of business to keep the area's village-like commercial corridor vibrant. Many want a heavy tax levied on empty residences to discourage absentee owners.

“I am challenged,” Eby said. “How do I even talk about this issue without instigating racism against a large number of Mandarin-speaking people who come here?”

### **‘This Is Really Hurting Our Business’**

Business owners far from the urban core can feel the effects of the superrich buying apartments they never visit. When large swaths of dense urban housing are empty, it means less of the foot traffic that urbanist Jane Jacobs showed in her 1961

book, *The Life and Death of Great American Cities*, is crucial to both economic vitality and safety.

Jane Kim, a San Francisco supervisor, said that in her downtown district “a lot of units are sold to international and out-of-town owners, so it is great in terms of property-tax revenues and paying into a general fund by people who do not make much use of municipal services. But it also means we are not filling the needs of people who want to live in the city, because they cannot compete” for housing due to high prices for both owned and rented apartments, “even though they make good money.”

In New York, in central Brooklyn, Maria Lanauze has laid off all but family employees of her Wyckoff 99 Cent and Hardware store. The reason is lack of foot traffic. The largest residential building nearby was emptied of residents who were paying \$1,200 to \$1,500 a month for their apartments. The building is being renovated for clients who can pay twice as much, but thanks to the 421-a property tax break, the landlord will contribute little to financing municipal services. “They kicked out all the Hispanic people and are waiting for people who are forced out of Manhattan,” Lanauze said, “but so far they haven’t come, and this is really hurting our business.”

Reduced density causes multiple problems for neighborhoods, according to Mason Gaffney, a 91-year-old, newly retired University of California, Riverside, economist whose specialty is real estate taxation. “When we tear down an existing building with many smaller, lower-cost units to replace it with huge luxury [units], we do damage to retailing because there are fewer people in the neighborhood” to buy goods and services, he said.

Gaffney said larger luxury apartments also mean more workers waste time, energy and money commuting to jobs they previously could walk to, which in turn makes it more difficult for businesses to hire from an easily accessible pool of diverse people with talents.

One way to reduce the problem, Gaffney says, would be to tax only land values, not buildings, as a means to encourage the highest and best development of land, especially in urban cores. But restrictions on mortgages, higher property taxes on empty apartments and halting the use of eminent domain to forcibly acquire center-city land for new luxury housing are unlikely to stop this trend, because all that cash flowing to the top has to go somewhere.