Mathletes: Here's why developers say they need 421a to make rentals happen

Builders share financial projections with *TRD* to illustrate why multifamily doesn't work without the controversial tax break

By Kathryn Brenzel

In January, 421a received a facelift in the form of a new name: "Affordable New York." The rebranding didn't quite shake the abatement's association with a program that critics say has cost the city $1 billion in tax revenue each year. Since lapsing in 2016, 421a has been the subject of fierce debate over whether the benefit — even as a vehicle for creating much-needed affordable housing — is stacked too heavily in the real estate industry's favor.

Developers dismiss that $1 billion number as meaningless, as many of the projects in question wouldn't have gotten built without the program, they say. Their argument boils down to this: Without 421a, rental construction in the city simply isn't financially feasible. The projects don't generate sufficient returns to be worth the trouble, because of what they described as exorbitantly high property taxes and land acquisition costs. In an effort to back up this narrative, three developers provided *The Real Deal* with rough financial breakdowns for multifamily development in Brooklyn and Queens under three scenarios: With the old 421a program, with the version now proposed by Gov. Andrew Cuomo and without the abatement entirely.

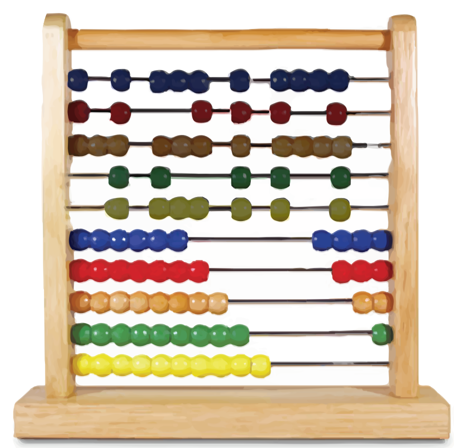
In the three analyses provided by developers, the initial cap rate — a basic measure of return based on expected revenue and expenditures — on rental projects without 421a doesn't exceed 4 percent. The dreariest cap rate sans abatement is 2.9 percent, for a 444-unit project in Astoria. At a 130-unit project in Ridgewood, Queens, developers projected a cap rate of 3.5 percent. The projected cap rate at a 135-unit project in Park Slope came to 3.6 percent without the abatement.

Even if the expired 421a program or the one proposed by Cuomo were in place, initial cap rates ranged from 3.6 to 5.3 percent, according to the developers' estimates. Without the abatement, multifamily projects simply don't pencil out, they said.

"If we're going to build, it's time and risk," said a developer who provided one of the three assessments. "We're going to want more than 4 percent."

Daniel Bernstein, an attorney with Rosenberg & Estis, said that "nobody builds affordable housing just for a zoning bonus. The economics don't work."

Without 421a, annual property taxes on the Park Slope project would come in at $1.6 million, the estimates show. The Astoria



project would pay $5.7 million in property taxes and the Ridgewood development $1.1 million.

The developers who provided these analyses requested anonymity as a condition of providing sensitive financial information on their rental projects.

For the city, the lack of 421a threatens to torpedo a vital part of the de Blasio administration's affordable housing agenda. City officials admit the effectiveness of the Mandatory Inclusionary Housing measure largely depends on the tax abatement being in place.

During a City Council subcommittee meeting in February 2016, Land Use Committee Chairman David Greenfield noted that MIH mentions 421a more than 400 times, indicating its dependence on the tax break.

Representatives for the city's Department of Housing Preservation and Development reviewed the three back-of-the-envelope calculations provided by developers. They said the analyses were comparable to the kind of studies they'd perform to determine project feasibility.

"Even though 421a is a benefit, it's not like it's this huge giveaway," one HPD official said. "We're really trying to balance a very fine line between affordability and feasibility."

Still, the city's Independent Budget Office estimated Cuomo's proposed program would cost the city $8.4 billion over the next 10 years in tax revenue. The IBO also released a report in January that estimated that the city effectively lost between $2.5 billion and $2.8 billion from 2005 to 2015, since condo owners saved more through the tax abatement than they paid in higher sales prices.

Holding out for bigger profits

Barika Williams, deputy director of the Association for Neighborhood & Housing Development, a housing advocacy group, said the breakdowns assumed that the purchase price would remain the same in all three scenarios. In reality, Williams said, the cost would likely fluctuate with the change in property taxes. (In a world with 421a, a seller can likely command a higher purchase price.)

The developers' breakdowns also show just the initial cost analysis for these projects in the three scenarios, so they don't reflect the full tax savings over the length of the abatement — which ranges from 25 years under the old program to 35 years under Cuomo's proposal. Williams said that developers aren't holding off on projects because they can't move forward — rather, they are waiting to see if they can maximize profit.

"It comes down to a matter of profits and how much extra profits they can get from 421a," she said. "Not whether the project is feasible and will or won't happen."

A March analysis by TRD showed that the city's Department of Buildings issued permits for 4,294 new residential units in the first two months of 2017, a dramatic increase from the fewer than 1,300 approved during the same time last year. Still, some of these projects likely qualified for 421a before it expired by receiving permits for basic foundation and other work before actually receiving a new building permit. It's unclear whether the doomsday-scenario halt on rental construction citywide would play out if 421a isn't eventually reinstated.

Cuomo further linked the abatement with affordable housing in January, when he rechristened it "Affordable New York." The proposal largely mirrors the legislation approved in June 2015 with a few key additions, including construction wage requirements for projects south of 96th Street in Manhattan and along the waterfronts in Brooklyn and Queens. These projects, as well as certain large developments that opt to pay the wages, are eligible for an extended 35-year abatement.

On Wednesday, Cuomo disputed

MIND THE CAP RATES

PARK SLOPE PROJECT	ESTIMATES
Purchase Price	$27.2 million
Buildable Square Feet	128,430
Net Residential (sf)	88,272
Net Retail (sf)	10,800
Hard Cost	$32.4 million
Soft Costs	$10.9 million
Land	$27.2 million

UNDER OLD 421a	ESTIMATES
Residential rent per sf	$47.8
Retail rent per sf	$60
Gross revenue	$4.9 million
Vacancy and losses	$243,370
Expenses	$1 million
Taxes	$26,680
Return	5.1 %

NO 421A	ESTIMATES
Residential rent per sf	$55
Retail rent per sf	$60
Gross revenue	$5.5 million
Vacancy and losses	$275,148
Expenses	$1 million
Taxes	$1.6 million
Return	3.6 %

PROPOSED 421a	ESTIMATES
Residential rent per sf	$46
Retail rent per sf	$60
Gross revenue	$4.7 million
Vacancy & loss	$235,426
Expenses	$1 million
Taxes	$26,680
Return	4.8 %

RIDGEWOOD PROJECT	ESTIMATES
Purchase Price	$24.8 million
Buildable (sf)	524,000
Net Residential (sf)	326,000
Net Retail (sf)	21,000
Hard Cost	$243.2 million
Soft Costs	$24.7 million
Land	$24.8 million
Total cost	$319.7 million

OLD 421a	ESTIMATES
Residential rent per sf	$50
Retail rent per sf	$40
Gross revenue	$4.5 million
Vacancy and losses	$227,200
Expenses	$1 million
Taxes	$50,000
Return	5.3 %

NO 421A	ESTIMATES
Residential rent per sf	$50
Retail rent per sf	$40
Gross revenue	$4.5 million
Vacancy and losses	$227,200
Expenses	$1 million
Taxes	$1.1 million
Return	3.5%

NO 421a	ESTIMATES
Proposed 421a	Estimates
Residential rent per sf	$46
Retail rent per sf	$40
Gross revenue	$4.2 million
Vacancy & loss	$209,200
Expenses	$1 million
Taxes	50000
Return	4.8 %

a news report from earlier this week that the legislature had a deal in place for 421a, telling reporters at a press conference that many concerns remained unsettled, particularly the program's link to rent-regulation laws.

"What we're down to is truly ideological issues," Cuomo said. "421a is an ideological, philosophical issue."

Tiny condos?

In the governor's proposal, only small condo projects in the outer boroughs with 35 units or fewer would be eligible for 421a. The measure also capped the average tax assessment value for the benefitting condo units at $65,000. The Republican-led state Senate proposed upping this threshold to 80 units and an average assessed value of $85,000. Alvin Schein, a founding partner at real estate law firm Seiden & Schein, said neither bill goes far enough in its inclusion of condo projects.

"The way it is drafted, it would only encourage construction of tiny apartments," he said. "It's impossible to come under $85,000 in a building that has family-sized units unless a miracle happens."

(It should be noted that the way the Senate's bill is technically worded, the $85,000 cap applies to each unit, which seems to be diction flub).

Schein noted the discussion surrounding 421a has swung from one extreme to another, due in large part to the spotlight on One57. (The IBO estimated in 2015 that 421a at the Extell Development ultra-luxury project cost the city $65.5 million over the course of 10 years.) What that line of argument misses, though, is that the luxury tower got the exemption through the 421a certificate program which expired several years ago, Schein said. That's not what is on the table now.

"We went from the discussion of millionaires and billionaires not getting a tax benefit to no one getting the tax benefit," Schein said. "They threw the baby out with the bathwater." TRD

ASTORIA PROJECT	ESTIMATES
Purchase Price	$24.8 million
Buildable (sf)	524,000
Net Residential	326,000
Net Retail	21,000
Hard Cost	$243.2 million
Soft Costs	$24.7 million
Land	$24.8 million
Finance	$27 million
Total cost	$319.7 million

OLD 421a	ESTIMATES
Residential rent per sf	$54
Retail rent per sf	$20
Gross revenue	$18 million
Vacancy and losses	$901,200
Expenses	$4.8 million
Taxes	$120,000
Return	3.8%

NO 421a	ESTIMATES
Residential rent per sf	$62.64
Retail rent per sf	$20
Gross revenue	$20.8 million
Vacancy and losses	$1 million
Expenses	$4.8 million
Taxes	$5.7 million
Return	2.9%

PROPOSED 421a	ESTIMATES
Proposed 421a	Estimates
Residential rent per sf	$52
Retail rent per sf	$20
Gross revenue	$17.4 million
Vacancy & loss	$868,600
Expenses	$4.8 million
Taxes	$120,000
Return	3.6 %