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## Affordable housing: poised for de Blasio boost



Developers say mayor will spur development in affordable sector, not hinder market-rate

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It's been a long time since affordable housing development was seen as the ugly duckling of the real estate world in New York City. In fact, its status rose under former Mayor Michael Bloomberg's ambitious plan to develop and preserve 165,000 affordable units.

Now the sector is poised to get another boost as the city's new mayor, Bill de Blasio, starts implementing his agenda, which hinges on producing 200,000 affordable units.

In this month's Q&A, The Real Deal talked to affordable housing developers and others to gauge what they think of de Blasio's real estate-related appointees, how his proposals for affordable housing will play out and about the general state of the affordable housing development market.

The builders said the biggest challenges right now for the affordable development community in New York are the escalating cost of land and a lack of funding.

They are also advocating for changes to the federal income requirements that New Yorkers would need to meet in order to live in affordable and middle-income developments.

Most interviewed said the fear that some industry players have expressed about de Blasio's agenda tamping down overall market-rate development is unfounded.

"The interest rates increasing will put the crimp on market-rate housing and the mayor's initiative will just be one [thing] many can point to," said Heidi Burkhart, president of affordable housing brokerage Dane PCG. "If the interest rates do not rise, I would be shocked if the real estate market appetite was crimped."

For more on the returns affordable housing developers are seeing these days, where they expect future housing to be built and what other changes they expect from de Blasio, we turn to our panel of experts.

### **Jonathan Rose: founder, Jonathan Rose Companies**

#### **Mayor de Blasio has pledged to create or preserve 200,000 affordable housing units in NYC and said he'd invest \$125 million annually from the city's pension funds to do so. What do you think of his goal and financing mechanism?**

All affordable housing costs more to develop than its occupants can pay for, so it needs a subsidy. We very much support the use of city pension funds to help provide the equity for affordable housing preservation. Those are investments that will earn a good return for the city's employees and help preserve housing. In fact, I would recommend the pension funds invest \$500 million per year in preservation. The pension funds could also invest another \$500 million a year for mixed-income housing.

#### **What issues do you think are holding back affordable housing development in NYC?**

There are two big issues: the lack of inexpensive land in the right locations and the lack of sufficient grant funds to close the financing gap.

#### **In which areas of the city are you expecting to see the most affordable housing development during the coming years?**

Affordable housing and affordable transportation are really linked, so it would be great if the city encouraged affordability along the new subway stops on Second Avenue by providing an FAR bonus for those projects that build extra affordable housing. And, of course, it would be great for the city to create a similar density bonus in Brooklyn, Queens, the Bronx and Staten Island. The issue is that communities often resist higher density and height. So the mayor has to lead.



*Jonathan Rose (left) and Adam Weinstein*

## **What are typical projected financial returns for an affordable housing development in NYC in today's market?**

Returns on the development of new affordable housing have dropped significantly over the last few years. Essentially the returns come from the development fees, which city agencies have reduced and delayed to the point that they barely cover a developer's cost. Returns from purchasing and preserving affordable units, or developing new mixed-income housing, can generate 3 to 6 percent cash on cash returns and 8 to 12 percent [internal rates of return.]

## **How do those returns compare to typical market-rate residential development projects in NYC?**

They are equal to the returns on market-rate rental developments in the early years. But over the long run, market-rate developments will appreciate much more. The returns for condo projects are significantly higher, but bear higher risk. Developers have reportedly tapped the 80-20 program to build over 6,000 units of subsidized housing in high-end towers in the last decade. But critics say the tax-exempt bonds that are being granted to developers could be used more efficiently. The program is very effective, and brings affordable housing to prosperous neighborhoods. I'm sure that the real estate tax formula in the abatement can use more nuance... Also, perhaps the formula should be different for condos versus rentals, perhaps with condo developments, above a certain sales price, the tax abatement is tied to a contribution to a Housing Trust Fund.

### **Adam Weinstein: president/CEO, Phipps Houses**

## **What issues do you think are holding back affordable housing development in NYC?**

Land pricing is always the enemy of affordable housing and construction costs. The city is sitting on a ton of inexpensive municipally controlled property adjoining Housing Authority buildings. The way the city went about trying to tap that resource in the last administration wasn't as well conceived as it could have been.

## **Do you think there will be more opportunity for developers who are currently doing market-rate housing to do affordable housing under de Blasio?**

I don't see market-rate developers shifting markedly, because in affordable housing the big revenue source is, was, and shall always be construction and real estate services – not the real estate. It's an impaired asset by definition and the market-rate game is really a cash-flow game, which is a very different mindset.

## **In which areas of the city are you expecting to see the most affordable housing development during the coming years?**

Where land is cheap. That would include the South Bronx, Southeast Queens, parts of central Brooklyn and mixed-income developments in some neighborhoods in Harlem... I could see the de Blasio administration continuing a trend of rezoning. Not so much a shift from manufacturing to residential, but more to mixed zone, which would be potential locations for affordable housing. But rezonings take a long time.

## **What are the most challenging aspects to developing affordable housing in today's market?**

I used to joke that I went into this world to develop affordable housing, but that what I really do is harmonize conflicting governmental programs. [But] it's always about financing. By definition, affordable housing can't sustain itself based on the income of the property. The most critical element of that financing is a low-cost governmental mortgage that fills the gap.

## **Controversy erupted last year when Extell created a separate entrance for lower-income residents who were occupying "affordable" units at one of its projects. Do you think developers should be required to provide the same amenities to all types of residents in the same buildings?**

I think providing amenities and providing a different entrance are very different things. The building segments have been used in other developments without controversy. Our client Silverstein Properties did the exact same zoning arrangement for Silver Towers. They were clear that they would offer the same amenities to [all the] residents and there was almost no controversy. If you offer an amenities package that is rich and desired, whether you walk in this door or that door makes less of a difference.

## **Some in the development community have expressed concern about de Blasio's wish to replace Bloomberg's voluntary inclusionary zoning policy with a mandatory policy that would require developers who benefit from rezonings to set aside a percentage of their units as affordable. What are your thoughts?**

I think this is to a large extent a tempest in a teapot. I do think it's fair of the government when entitling the owner of a property to greater benefit to ask the owner for something in return. There are lots of ways to effectuate that program. Taking a look at how you abate real estate taxes would be an effective way of coming up with a return that benefits the general populace. Production of inclusionary housing is another one.

## **On a similar note, do you think the new mayor will truly crimp the appetite for building market-rate housing in pursuit of affordable housing as some have suggested? Or do you think that concern is overblown?**

Overblown. I don't think the mayor is looking to crimp the appetite in the building market. I think he is simply looking for more ways to produce affordable housing.

## **What are typical projected financial returns for an affordable housing development in NYC in today's market?**

I think we are at a point where there is a flood of capital chasing equity returns of 3 to 4 percent. Over the long term, affordable housing is never going to be the great financial return that market rate is.

**Don Capoccia: managing principal, BFC Partners**

## **What's the state of the market for affordable housing development?**

At the end of last year, [the city] did a number of closings to try and finish up the 165,000-unit commitment of the Bloomberg administration. That activity will continue into this year. There was also a shift in resources to preservation projects, which my company got involved in. So between the preservation and the new production, I see us staying busy for at least the next couple of years.

## **What policy changes, if any, on the city, state or federal level would you like to see in connection with affordable housing development?**

On the federal level, the Federal Reserve should keep lending rates low. The better rates we have, the less capital subsidy we need. Also, there's been a proposal pending in Washington for at least a couple of years for income averaging. The strict 60 percent of [area median income], certainly in New York, doesn't address demand effectively. So the idea would be to average up to 80 percent and down to 40 or 50 percent, and you find a way within a single project to average out to 60 percent and address different income needs. We have been requesting that for some time.

## **Do you think there will be more opportunity for developers who are currently doing market-rate housing to do affordable housing under de Blasio?**

Listening to the mayor talk about his agenda, it's my understanding that he wants to see every project provide some level of affordable housing. Everybody across the spectrum in our industry is going to have an opportunity to work with the administration to produce affordable housing. It will be an interesting exercise.

## **What do you think of de Blasio's selection of Alicia Glen as his deputy mayor for housing and economic development, and Kyle Kimball as head of EDC?**

The appointment of Alicia Glen is going to be very helpful. She has an incredible depth of experience in affordable housing projects, and more importantly, in her years at Goldman she has come to really understand and perfect the art of deploying resources in a way that not only produces housing, but also [stimulates] economic development. She understands the nexus of all of this. The same with Kyle. We worked with him at EDC, and he designated us to do Seward Park, which will have 1,000 units, 50 percent of them affordable.

## **What are your thoughts about de Blasio's wish to replace Bloomberg's voluntary inclusionary zoning policy with a mandatory policy?**

If there is going to be a program that's mandatory, the model has to include an expansion of the technical infrastructure at the [Department of Housing Preservation & Development.] Right now it is very effective, one of the best housing production outfits in the country, but like every other city, there are constrained resources. If the mayor is going to do this, he's going to have to expand his technical housing production people at HPD and the city's [Housing Development Corporation.] I'm guessing that is not going to be a big issue, given his agenda.

## **What are typical projected financial returns for an affordable housing development in NYC in today's market?**

It's not a cash-on-cash return, so it's really hard to answer that question. The returns on affordable housing have been consistent over the last 10 to 15 years. We hold these properties in our portfolio. It is not significant returns compared to market-rate projects. But it's a consistent return and definitely worth the investment. The institutional investors are there every time we need them.

**Heidi Burkhart: president, Dane PCG**

## **What's the state of the market for affordable housing development?**

My firm has historically concentrated on preservation and rehabilitation of existing stock. In this arena, we have seen a huge increase of interest from 10 years ago. At that time, it seemed that everyone was making money in conventional real estate, so affordable housing was rather seen as the "ugly duckling." Affordable housing deals are known as "hairy deals" because there's a lot of minutia to go through. But in 2008, the conventional market took a turn. Affordable housing, however, remained stable. Since then, there have been several new funds in the space.

## **Do you think there will be more opportunity for developers who are currently doing market-rate housing to do affordable housing under de Blasio?**

Opportunity has always existed. Recently, though, more awareness of the opportunity has been made. I do see in the next years a rise in parties looking to city, state, and federal agencies for options in constructing developments other than market-rate housing. Interest rates will rise and when they do, I guarantee many more will look to shift to affordable housing.

**Controversy erupted last year when Extell created a separate entrance for lower-income residents at a project on the Upper West Side. Do you think developers should be required to offer the same amenities for all types of tenants?**

Knowing Extell's reputation in the industry, I'm just happy they chose to develop affordable housing at all. Gary Barnett has some of the most beautiful locations locked down. Many times, he does not necessarily need to include affordable housing, but opts to do so to receive more benefits to build. I see him rather like a Steve Jobs of New York City real estate. Many will critique him on his business style or decisions but Barnett has aggressively sought out some of the more complicated deals and has been a trailblazer for developments. As I may not agree with a separate entrance, Barnett is a master at what he does.

**What are your thoughts about de Blasio's wish to replace Bloomberg's voluntary inclusionary zoning policy with a mandatory policy?**

The size of the development in question would be a big concern of mine. A smaller development looking to meet the mandatory requirement may prove to be tough for the underwriting numbers. I appreciate what de Blasio is suggesting with the mandatory requirement, but prefer the freedom of choice that inclusionary brings.

**On a similar note, do you think the new mayor will truly crimp the appetite for building market-rate housing in pursuit of affordable housing, as some have suggested?**

I think the interest rates increasing will put the crimp on market-rate housing, and the mayor's initiative will just be one many can point to. If the interest rates do not rise, I would be shocked if the real estate market appetite was cramped.

**Martin Dunn: president, Dunn Development Corp.**

**What's the state of the market for affordable housing development?**

The demand and need for affordable housing in New York City is unprecedented. We got as many as 20,000 applications for a single project recently. The levels of production of affordable housing under the Bloomberg administration have been relatively consistent in past years. But it's not keeping pace with need.

**What policy changes, if any, on the city, state or federal level would you like to see in connection with affordable housing development for NYC?**

At the city level, I would like to see policy changes to encourage production of affordable housing within primarily market-rate deals without using limited public subsidies. The limited subsidies available should be targeted to economically distressed neighborhoods. At the state level, more housing resources need to be directed to New York City, where the need is greatest. At the federal level, the cuts to the Section 8 and HOME programs need to be restored and the tax-credit program needs to be amended to allow for serving families at a wider range of incomes – both higher and lower.

**Do you think there will be more opportunity for developers who are currently doing market-rate housing to do affordable housing under de Blasio?**

As long as the higher-end market is booming, with opportunities for much greater profits, I don't think you'll see crossover. Historically it's been the opposite, affordable housing developers moving into market-rate housing, where significantly more money can be made.

**What are your thoughts about de Blasio's wish to replace Bloomberg's voluntary inclusionary zoning policy with a mandatory policy?**

I feel strongly that in new rezonings that significantly increase land values, affordable housing should be mandatory and should be paid for from the increased land value – without using public subsidies. I advocated for mandatory inclusionary housing in front of the City Council in 2003 related to the plans for rezoning Greenpoint and Williamsburg. I think the Bloomberg administration missed a significant opportunity there. Property owners reaped huge windfalls, and then government had to pay for all of the affordable housing that was developed. While my firm has benefited from this, it was not good public policy.