

Multifamily Report



Market insiders worry that changes to the state's 421a program will curb residential development in northern Manhattan and the outer boroughs

A Legislative Obstacle

NEW YORK CITY'S MULTI-HOUSING MARKET REMAINS AS strong as can be, but it may take a government-sponsored nosedive in mid-2008, due to the State Assembly's revision of the Section 421a program. Changes to the program, which is administered by the city's Department of Housing Preservation and Development to promote apartment construction through tax exemptions in exchange for the construction of "affordable" housing, will limit that tax relief to projects where an affordable component is included in a mar-

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ket-rate building, rather than provided elsewhere. Nearly all those contacted by *Real Estate New York* agree that these changes will significantly slow development—particularly in northern Manhattan and the outer boroughs—and will have negative effects on developers, consumers and laborers alike.

Still, with demand for multifamily housing continuing to grow beyond

all expectations, it's hard to imagine that the market would be severely or permanently damaged by the 421a revisions, which take effect in July 2008. Michael Slattery, senior vice president of the Real Estate Board of New York, reports that the multifamily rental market remains strong in all five boroughs. The current supply is inadequate to the needs of a growing population, he says, especially since rental development has to some extent been forsaken in favor of condos. However, he notes, developments that include a percentage of affordable units could qualify for a floor area bonus in addition to the tax-exempt financing opportunities already in place. This could make rental development more attractive.

"The changes to Section 421a will have a dampening effect on housing production," he states. "The areas where those benefits are available as of right, without affordable housing requirements, will be greatly diminished. In the areas where as-of-right has not been eliminated, it has been capped. This will change the economics of projects, making them less profitable."

Christopher Halliburton, executive vice president of Warburg Realty, reports that developers are rushing to break ground on new projects, so they can qualify for 421a abatements without having to include affordable units in market-rate buildings. Meanwhile, he and his colleagues are educating themselves in how to market buildings that have a mixture of luxury and affordable units.

"On both sides," he admits, "there's the question of 'Who'll I be living with?'"

David Berger, senior managing director for GFI Realty Services' commercial sales division, insists that development of affordable housing will be drastically reduced if the changes to 421a are implemented.

"Development in Brooklyn has already come to a screeching halt in just the past 60 days," he says. "Because with land prices as they are, you can't make the numbers work if you have to build your affordable units on-site. All my development deals in Brooklyn are dying on the vine."

Jamie Heiberger-Jacobsen, a real estate attorney and president of Heiberger & Associates, agrees that Brooklyn and Queens will be

"But you don't see many new rentals," Scaglione says, "because current market conditions make for-sale developments more advisable. Certain REITs, like AvalonBay Communities, will build rentals with a view to long-term gain, but not many others will. On a new basis, you'll see more condo than co-op now, because condo's a simpler transaction. The concept of buying shares in a building is not familiar to people outside this city, and condo is a cleaner deal for the institutional investor."

Partly because most new rental projects contain affordable units, Scaglione says it's unlikely that Manhattan will become the preserve of the very rich and the very old, as many market-watchers have predicted.

"Besides," he adds, "there are lots of existing properties that get unspectacular but quality rents, and there always will be."

Rents are getting mighty high wherever you go in the city, says Christine Blackburn, vice president of the Barak/Blackburn Group of Prudential Douglas Elliman. She notes that in northern Brooklyn, much of the development will be luxury condos, in buildings housing three to eight units.



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CHRISTINE BLACKBURN
Barak/Blackburn Group

"We'll see thousands of luxury condo units coming into neighborhoods that housed abandoned factories and have been rezoned for residential," she says. "Those neighborhoods are blank canvases. As for rentals, you'll find that rents here are higher than in some parts of Manhattan, with one-bedrooms going for \$2,300, two-bedrooms for \$2,800 to \$3,000. You don't see these rental properties changing hands, because the owners know they're sitting

hardest hit by the 421a revisions.

"If you don't qualify for a tax deferral that you can pass along to your tenants," it'll be harder to develop low-income housing," she says. "Under the new rules, if you're building a luxury building, as much as 30% of it will have to be affordable housing. This changes the element; it puts people in those buildings who couldn't remotely afford to be there; it will decrease the amount of money the developers can make."

The rationale behind the revisions is "to increase affordable housing, and to limit, in the State Assembly's view, the benefits that developers could receive," says Heiberger-Jacobsen. "But it will be hard from a marketing standpoint to position luxury buildings as such if there's an affordable component, so people might not take the abatements, and this will make prices higher."

Mario Procida, partner in SDS/Procida, warns that the revised 421a will have major impact on purchasers, because they'll be paying full freight on the taxes, and that could make them reluctant to buy into a co-op situation.

"That will influence our decisions on the sell side, and on the cost side," he says. "It'll create an adverse situation for the labor unions, because I won't be able to pay my workers as much. It'll be interesting to see if we have any new starts" after the 421a changes kick in.

Demand for luxury rentals is exceptionally high, reports Robert A. Scaglione, managing director for residential marketing at Rose Associates. Renters will gladly pay \$3,000 for a studio, \$4,000 for a one-bedroom, and \$5,000 for two-bedroom apartments in prime-location buildings with a doorman and a health club, he says.

on gold mines."

We're not likely to see much new co-op development in Brooklyn, or elsewhere, according to Sheldon Gartenstein, senior vice president of NCB, which specializes in financing co-op projects. Condo deals are strictly real estate plays, he explains, while a co-op buyer has to pass muster not only with the lender, but also with the co-op board. Co-ops sometimes require a down payment of 25%, and some deals are all-cash.

"That's because if you default, as a shareholder, the other shareholders have to pick up your maintenance, so they'll not let you in if there's any likelihood of default," he says. "But we've never had a foreclosure on a co-op property. Co-op financing is straightforward and stable."

As for investment sales, Halliburton says the expiration of Mitchell-Lama restrictions on many apartment buildings in northern Manhattan has led to several bulk sales deals: mainly to investor-developers financed by banks, REITs and high-net-worth individuals.

"These are low-initial-return investments with great potential," he observes. "They require renovations, which enable the owner to pass on rent increases. Ten years from now, if you have a market-rate building on, say, East 112th Street—which is becoming a viable area for ownership—you can cash out."

Halliburton says that below 14th Street, "More rental units are coming in as a result of the Liberty Bonds that were issued post-9/11. You're also seeing a wall of high-rise rentals coming up in Chelsea, on sites that formerly housed open-air flea markets. On the whole it's a positive picture for developers and owners, but for the consumer it's a different picture. They're getting modern product, but it costs more." —RENY

Residential development, such as this luxury condominium SDS/Procida has planned for 189 Schermerhorn St. in Brooklyn, is going strong. However, industry experts are concerned that the revision of Section 421a could put the brakes on housing production.