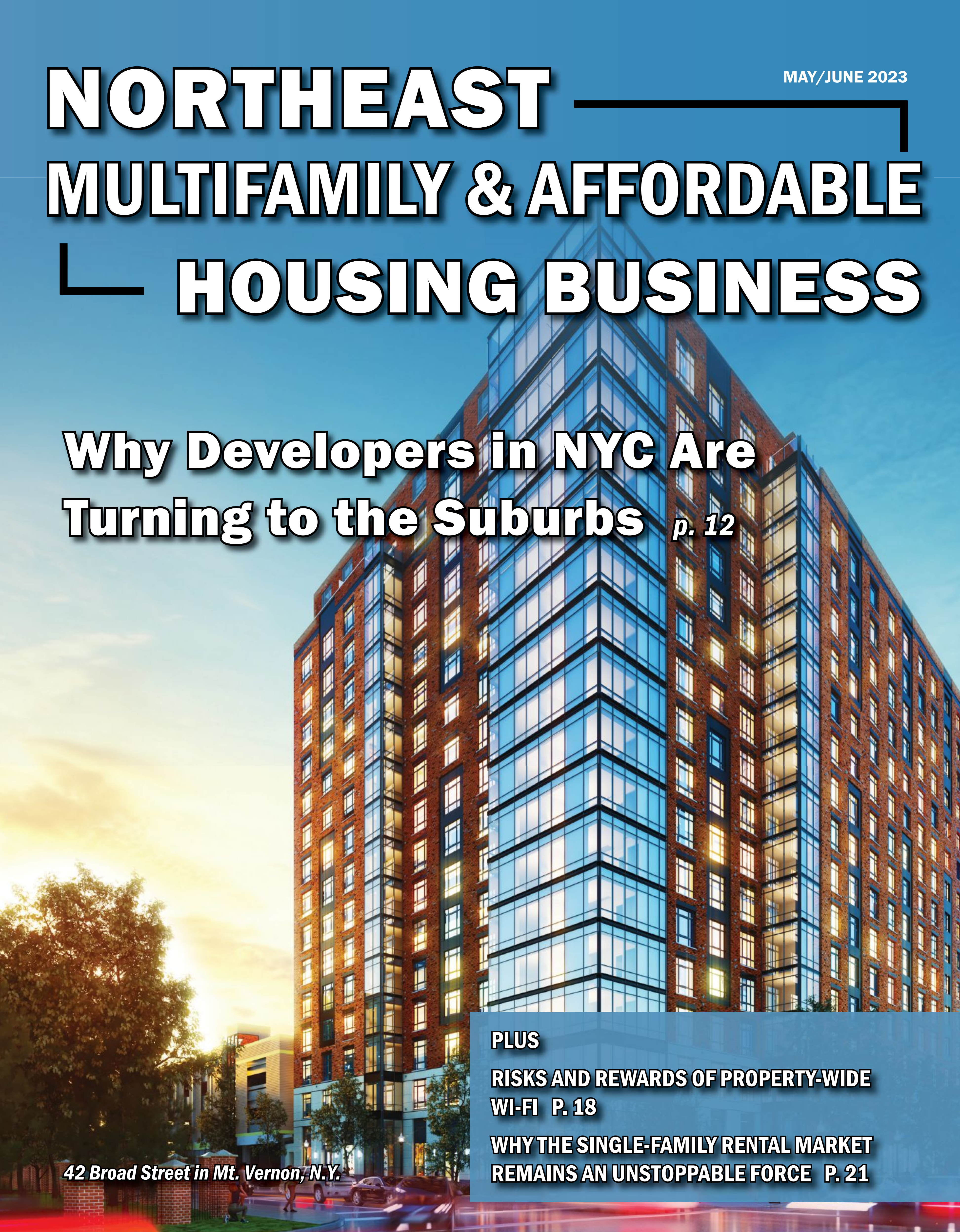
NORTHEAST MULTIFAMILY & AFFORDABLE HOUSING BUSINESS

MAY/JUNE 2023

Why Developers in NYC Are Turning to the Suburbs *p. 12*



42 Broad Street in Mt. Vernon, N.Y.

PLUS

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PUBLISHER'S LETTER

NYC Apartment Market Experiences Highs, Lows

Scott France
President and Publisher

There's good news and bad news coming out of the New York City apartment market. Let's start with the good news — strong rent growth and healthy investor demand.

"I find it interesting that rents in NYC haven't cooled at all while rents everywhere else are softening," says Lev Mavashev, founder and principal of Brooklyn, New York-based Alpha Realty. The median rent in Manhattan rose 12.8 percent to $4,175 in March on an annual basis, according to the Elliman Report. "This once again shows NYC is proving to be resilient. This data will definitely pique investors' interest, both domestic and foreign, in acquiring NYC multifamily assets," says Mavashev.

The bad news is the fallout from the recent expiration of the 421-a program, which granted apartment developers a partial exemption from property taxes if they agreed to include income-restricted units (affordable housing) in their projects.

"There is still development going on in NYC, but I am also seeing a massive shift in sentiment," says Mavashev. "I think that unless there is a new tax abatement program, we will see development activity come to a halt. Almost no new developments are being planned now, and we are already seeing it play out in the investment sales market. The sale of development sites without 421-a tax abatements are practically non-existent, especially in the boroughs outside of Manhattan. Developers are not even making bids on those sites." For more on the NYC apartment market, turn to page 12.

Also in this issue, an increasing number of communities are capitalizing off the need for internet access by providing Wi-Fi connectivity across the property. Turn to page 18 to read about the pros and cons of property-wide Wi-Fi connectivity.

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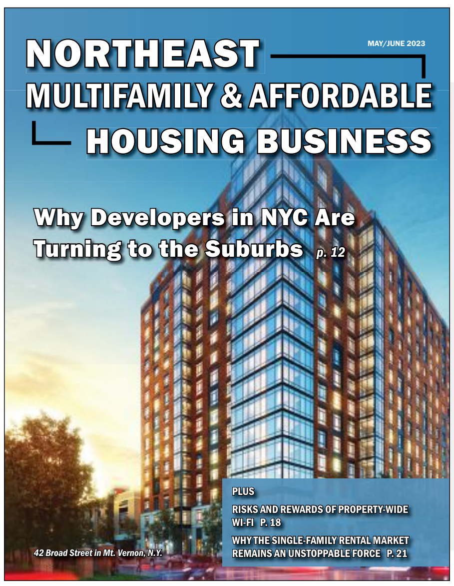

ON THE COVER

Why Developers in NYC Are Turning to the Suburbs

The expiration of a crucial property tax exemption program has forced developers to seek greener pastures — and willing zoning officials — in surrounding communities

Bendix Anderson

Pictured: 42 Broad Street in Mt. Vernon, N.Y. Photo courtesy of Alexander Development Group.

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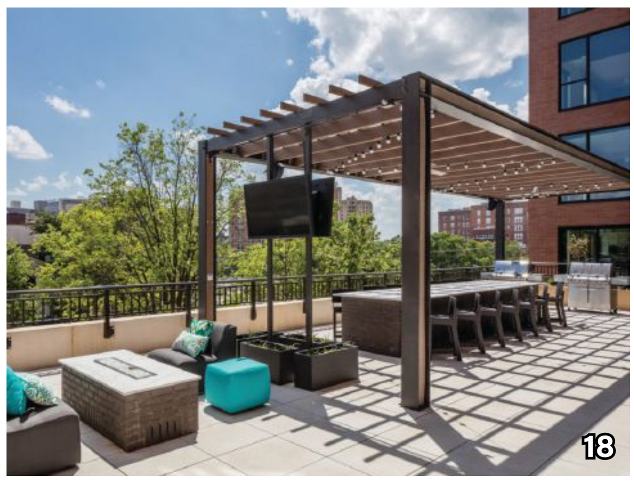

Why Developers in NYC Are Turning to the Suburbs

The expiration of a crucial property tax exemption program has forced developers to seek greener pastures — and willing zoning officials — in surrounding communities

Bendix Anderson

In the New York metropolitan area, more apartments are under construction, more renters are looking for apartments and renters are paying higher rents than almost any other apartment market in the U.S.

But the cost to build a new apartment or renovate an old one is also higher, development sites are more expensive and regulations like rent stabilization are tougher than almost anywhere else.

And New York City has some of the highest property taxes in the U.S.

In June 2022, the Affordable Housing NY Program — also known as the 421-a tax exemption program — expired. The exemption had protected many developers from New York City's punishing property taxes. Since then, the number of developers taking out new building permits and buying new development sites within the city limits has collapsed.

But developers are still planning new apartment projects in the towns around New York City. Property taxes are also high in the suburbs, but many developers have successfully negotiated exemptions.

Many suburban "villages" resist new development, but apartment developers have found local zoning officials in a handful of suburban municipalities willing to talk.

Roadblocks to Building in NYC

It has finally become impossible for many apartment developers to make new plans within New York City.

"When you look at the economics, the numbers don't work out," says Shimon Shkury, president and founder of Ariel Property Advisors, a commercial real estate services and advisory company located in New York City.

The sunsetting of the 421-a program was a game-changer because the program had granted apartment projects a partial exemption from the city's brutal property taxes in exchange for restricting the rents of at least 30 percent of their units.

"Property taxes in New York City are a third of your gross income," says Shkury. Even developers who already have a site struggle to fit that kind of cost into their development budgets.

Developer Blue Onyx plans to mix apartments that are affordable to low-income renters with market-rate apartments at its 24+Half project in Patterson, N.J.

Created in 1971, the 421-a tax exemption program had been renewed and reorganized several times over the years. This time, it's not clear when — if ever — the program will be renewed. Skeptics, including some progressive lawmakers, viewed the program as a billion-dollar giveaway for developers. Others wanted apartment developers to commit to create more affordable housing to earn the abatement.

The expiration of the 421-a program is just the latest challenge for apartment developers in New York City. Developers have also had to contend with rising interest rates that have strained development budgets across the U.S.

Many New York developers who once paid all-in interest rates that floated around 3 percent for construction loans now have to pay rates that have risen above 8 percent. That's due to the Federal Reserve's decision to aggressively combat high inflation by raising its benchmark fed funds from near zero in March 2022 to a range of 5 percent to 5.25 percent today.

Meanwhile, the cost of building an apartment has dropped as supply chains untangle. The Producer Price Index (PPI) for inputs to multifamily construction contracted 7.7 percent year-over-year in May, according to the Associated General Contractors of America.

But the recent moderation in the price of materials followed a lengthy uptick in construction costs. For example, the PPI for inputs to multifamily construction increased 15.5 percent in 2021.

Today, subcontractors of all types have to fight for business by offering more competitive pricing. "We are seeing more aggressive pricing from the subcontractors on down," says Bryan Murray of March Construction, based in Wayne, N.J.

The cost to build in New York City is higher than any other U.S. city, except for San Francisco, according to an annual survey conducted by Turner & Townsend, a global real estate consultancy and data firm with offices in New York City.

The expiration of the 421-a program seems to have pushed many stressed developers past the breaking point.

"Many developers are just sitting on the sidelines for now, waiting for a new tax abatement program," says Lev Mavashev, founder and principal of Alpha Realty, a real estate brokerage firm based in Brooklyn, New York.

Fewer Developers Get Building Permits

Developers applied to receive building permits for 5,475 apartments in New York City in the first quarter of 2023. That's down 31 percent from the fourth quarter of 2022, and down 73 percent from the same period last year. It's also 13 percent lower than the average since the first quarter of 2008, according to an analysis conducted by the Real Estate Board of New York.

Just a year ago, New York City planners were swamped with building permit applications. Developers received building permits for 49,964 apartments in 2022, as they rushed to get their projects approved before the tax abatement program expired. That's nearly twice as many building permits as developers received in 2019, which seemed busy at the time.

Developers now have 44,000 market-rate apartments under construction in the New York metro area, according to RealPage. That's even more than the previous peak of 35,500 units in 2016.

More than one-third of metro New York's construction is occurring in Brooklyn with an especially high concentration in the borough's downtown. Other hot spots include Brooklyn's Williamsburg neighborhood and Long Island City in Queens.

Many of those apartments are likely to open this year (16,020 new units) or in 2024 (30,426 units), according to RealPage. But the number of new apartments opening is likely to shrink in 2025 (16,752 units), provided state lawmakers don't quickly change course and renew the tax break.

Other economists believe developers will finish their projects underway more quickly, despite the delays that have become common for many projects in New York.

"We forecast 2023 to be a historic high for multifamily completions," says Christopher Rosin, associate economist at Moody's Analytics. Many developers rushed to get building permits in time to qualify for the 421-a tax abatement, and many of those projects are now under construction. Lower energy and material costs also helped some developers make progress on projects delayed by the pandemic.

New renters are likely to fill these new apartments almost as quickly as they open. The percentage of apartments that are vacant in the metro area will barely rise to 2.2 percent this year, just under the trailing decade average of 2.3 percent, according to Marcus & Millichap.

Demand for apartments in New York City is quite strong. The number of occupied apartments increased more in the New York City-White Plains, New York metropolitan statistical area in 2022 than any other market in the U.S., according to RealPage. The demand for apartments was strong enough to absorb 11,710 units.

The next strongest apartment market in the U.S. for absorption was Newark-Jersey City, New Jersey, which added 6,782 to the number of occupied apartments in 2022.

Suburban developers believe a shortage of housing in New York City is pricing renters out of the city and driving them to apartment communities in the suburbs.

Because the tax abatement has not been renewed, the housing shortage is expected to get worse as developers remain on the sidelines.

"The effect of that is to supercharge well-located real estate sites in the inner-ring suburbs. We are looking throughout Westchester County and Northern New Jersey for deals," says Mark Alexander, principal of New York City-based Alexander Development Group.

Suburban Developers Wait Years for Permits

In the suburbs of New York City, developers are still fighting to obtain permits to build new apartments.

Alexander has been working since 2020 to get approval to build 300 apartments in the Mt. Vernon East neighborhood of Mt. Vernon, New York, a city in southern Westchester County that borders on New York City. During the pandemic, a new mayor paused consideration of all new apartment projects to create a comprehensive plan for development.

Alexander also took more than a decade to develop 249 new apartments on the site of an old, concrete, parking garage a block away from a commuter rail station at 42 Broad St. in Mt. Vernon's Fleetwood neighborhood.

"We chased after this property from 2012 to 2013," says Alexander. By the end of 2013, Alexander had the site under contract. It took a year to get the initial approvals to build, but Alexander had to fight off two court challenges trying to stop the development before construction could finally start in 2018.

It took more than a decade to finish the 249 new apartments at 42 Broad St. in the Fleetwood neighborhood of Mt. Vernon, N.Y. The developer fought off two court challenges trying to stop the development.

The coronavirus pandemic and flooding caused by Hurricane Ida in 2021 also delayed construction. As of press time, new residents were scheduled to finally be able to move into the new, 16-story tower at the end of June.

The highly desirable building is one of the largest ever to be pre-certified for the tough "passive house" energy efficiency standards set by Phius, a sustainability organization based in Chicago. Alexander anticipates the property will earn top rents for the Westchester market.

Obtaining a building permit in the towns around New York City is often a multi-year process — especially in expensive suburbs with good school districts that sometimes resist higher-density development.

In the Village of Tarrytown, N.Y., right next to the famous, little town of Sleepy Hollow, developer Amtrust RE has already spent a year in "informal meetings" with local officials to get approval to turn an aging, mostly vacant office building into about 220 new apartments on a 7.5-acre site overlooking the Hudson River.

It may be another year before developer Amtrust RE completes negotiations with local officials to get approval to turn an aging, mostly vacant office building in Tarrytown, N.Y., into about 220 new apartments.

WILLIAMSBURG HOUSES SHOWS THE FUTURE OF PUBLIC HOUSING

NEW YORK CITY — The hip, desirable Williamsburg neighborhood in Brooklyn includes one of the city's oldest public housing projects.

Workers are now fixing up the 1,620 public housing apartments at the Williamsburg Houses, arranged on a 24-acre site a few blocks from the point where the fully gentrified neighborhood of Williamsburg turns into the quickly gentrifying neighborhood of Bushwick.

MDG Design + Construction is undertaking a $490 million renovation, with new kitchens and bathrooms, piping systems, floors and heating systems. The work in the apartments is already close to halfway complete — 600 households have already moved back into renovated, lead-free apartments, according to the New York City Housing Authority (NYCHA).

The new windows at the Williamsburg Houses in Brooklyn, N.Y., were custom-built to match the original windows at the historic landmark, originally completed in 1938.

The 20 buildings will also receive new roofs, ramps, and infrastructure for free Wi-Fi. The renovations are expected to wrap up in spring 2025.

Designed in the International Style, the Williamsburg Houses was designated a New York City Landmark in 2003 and added to the National Register of Historic Places in 2021. It is the second oldest public housing project in the city. First Lady Eleanor Roosevelt attended the ribbon-cutting ceremony in 1938. But over time, the interior walls became covered with layer after layer of poisonous lead paint.

"There was enough lead that we could not keep anyone in the units [during the renovation]," says MDG founder and CEO Michael Rooney. Each set of apartments must be totally empty before work can begin, and each household must agree to the temporary move.

To expedite the renovations, management partner Wavecrest Management is moving residents for 10 to 12 weeks to vacant apartments also located at the Williamsburg Houses. Earning the trust of residents is a big part of the job. Many worried for years they would someday be pushed out of their homes as the city grew more expensive around them.

The Williamsburg Houses is just one example of the huge challenges and opportunities facing NYCHA.

"We are unable to deliver on the mission [to safely house public housing residents] given the chronic underfunding for decades," says Heather Beck, a senior advisor at NYCHA's real estate department. New York's public housing was largely created through federal public housing programs.

Public housing authorities like NYCHA still depend on federal funding provided by Congress for the U.S. Department of Housing and Urban Development (HUD). But for decades, Congress has consistently provided billions of dollars a year less than HUD estimates housing authorities need to safely maintain the apartments, according to the Washington, D.C.-based Public Housing Authorities Directors Association.

In 2018, NYCHA announced a 10-year plan to recapitalize and rehabilitate 62,000 apartments — approximately one-third of its 177,000-unit portfolio — though its Permanent Affordability Commitment Together (PACT) program. PACT is the city's implementation of the federal Rental Assistance Demonstration program.

In June 2022, New York state added to the plan with its new Public Housing Preservation Trust, which will recapitalize another 25,000 public housing apartments.

Both PACT and the Public Housing Preservation Trust replace HUD public housing funding with more reliable, project-based funding from HUD Section 8 rental subsidies. Congress has never yet underfunded HUD's Section 8 program, perhaps because so many diverse stakeholders — from private development firms to the nation's largest banks — are involved in investments that rely on Section 8 funding.

Partners like NYCHA and MDG use this dependable funding to raise more money for renovations. Says Beck: "It allows us to bring debt onto the properties."

— Bendix Anderson

"We made our formal presentation recently to the mayor," says Jonathan Bennett, president of AmTrust based in New York City. "We are very much taking into account the fact that it is a village, and the requirements and the needs and sensitivities of a village."

The process is still far from over. "It could be another year," says Bennett.

Suburban Developers Need Abatements, Too

Property taxes are also brutally high in many municipalities surrounding New York City. That makes it difficult to develop new apartments.

"Without a long-term tax abatement, it is virtually impossible," says Levi Kelman, CEO and founder of Blue Onyx, which is currently developing 78 new apartments in East Orange, New Jersey.

The property tax law on the books in East Orange would claim roughly 5 percent a year of the total value of an apartment property, if it were enforced. That's not much different than the total "cash-on-cash" return from many investments. Blue Onyx negotiated to reduce the tax rate to a percentage of the income from its planned property, which creates a win-win scenario for the city and other key stakeholders, says Kelman.

Blue Onyx is working with local officials to transform several historic mill buildings into apartments at its 24+Half project in Patterson, N.J.

A property tax abatement made it possible for Blue Onyx to move forward with its plan to build 78 new apartments in East Orange, N.J.

"The city has worked very closely with us. This part of East Orange had not seen new development in 40 years," says Kelman. Blue Onyx bought the site from the city in 2017. It now plans to start construction this summer.

Developers of affordable housing are often even more reliant on local officials to provide soft financing in order to fill holes in project budgets.

Kelman is counting on the support of officials in Patterson, New Jersey, to help pay for Blue Onyx's plan to redevelop several buildings in Patterson's Great Falls Historic District. The mill buildings were originally built in the 1800s, when the Passaic River turned the wheels of American industry.

"The city believes this is one of the most important development sites it currently has," says Kelman. The first step is to win zoning approval. "We are finalizing our date for a special planning board session."

Soft financing from local and state sources and a tax abatement should also help Blue Onyx create 167 new affordable and market-rate apartments.

The proposed gap-financing measures include federal tax-exempt bond financing with federal 4 percent low-income housing tax credits, as well as state and federal historic tax credits. (The 4 percent tax credit, which amounts to roughly a 30 percent subsidy, is for the development of affordable rental housing financed by tax-exempt bonds.)

Interest Rates, Delays Drain Budgets

Even for projects in New York City that secured a property tax abatement before the program expired, development has become increasingly difficult as interest rates rise.

ANAX Real Estate Partners opened 80 new apartment units in 2022 at its building at 30 Kent St. in the Greenpoint neighborhood of Brooklyn in New York City. The property received the 421-a tax abatement, in exchange for restricted rents at 30 percent of its apartments.

Because ANAX partnered with the owner of the site, the developer's basis in the land was low enough — about 35 percent of the land value — to enable the development to work as a rental property. Demand from potential renters was also quite strong for the apartments with unrestricted rents. It took less than six weeks to achieve a full lease-up of the property.

All these advantages barely made up for higher interest rates and the delays caused by building during the pandemic.

"By the skin of our teeth we got through that deal," says Eric Brody, founder and principal of New York City-based ANAX. The developer was able to land permanent financing for the stabilized building without needing to write a check to contribute more equity. "It was not a cash-in refinance, which is sort of the best you can ask for today."

Condominiums are not any easier. As interest rates rise, fewer and fewer potential homebuyers are able to pay New York City's high prices, says Brody. In 2021, ANAX opened The Huxley, a new condominium building in the East Harlem neighborhood of Manhattan. This April, ANAX finally paid off its construction loan once the majority of its 71 condominiums had sold.

"The sales have slowed up, but the ticking time bomb — the debt — has been paid off," says Brody.

ANAX has created a "rescue capital" fund to provide preferred equity to other multifamily developments struggling with high interest rates.

"We hope to get $100 million to $150 million out the door in the next six to 12 months," says Brody. For example, ANAX has approached one developer who simply needs more equity to close the permanent financing for its completed project. ANAX is also negotiating with two other multifamily developments forced to stop construction before they were completed.

"They just don't have the cash to get to the end," says Brody. Restarting work at these properties can be very complicated. "If you have 50 subcontractors on a site — they all have rights. You have to navigate through that. It's not a tri-party agreement. It's whatever you call a 50-party agreement."

The wave of new projects that received permits and 421-a tax abatements just before the program expired in June 2022 may also have problems. To keep their abatements, they must be completed within four years. A full year later, many have not yet found financing to start construction.

"You will have people walking away from those deals," says Brody.

Buyers Hunt for Rent-Stabilized Bargains

Investors are also looking for opportunities to buy rent-stabilized apartment properties from other investors who overpaid.

In 2019, lawmakers made New York City's rent stabilization laws much tougher. Before the new rules, many investors bought rent-stabilized properties with plans to remove the restrictions of rent stabilization and quickly raise the rents.

A 421-a tax abatement helped ANAX Real Estate Partners make the numbers work for its development of 80 new apartments at 30 Kent St. in Brooklyn, N.Y., despite rising interest rates and delays caused by COVID.

Strong demand for rental apartments helped the market-rate apartments lease in less than six weeks at at 30 Kent St., in Brooklyn, N.Y.

After enactment of the new rules, removing rent restrictions has become almost impossible. Slightly more than 1 million apartments in New York City are rent-stabilized. That's nearly half (44 percent) of the rental housing stock in the city, according to the New York Housing Conference (NYHC).

"Some owners have overpaid for buildings and can't afford to maintain them," says Brendan Cheney, NYHC's director of policy and communications. Overleveraged owners that paid too much for their apartment buildings may soon be forced to sell.

A certain type of investor is ready to pounce and buy these troubled assets. These buyers often represent private capital such as individuals and family offices rather than institutions. "These investors are long-term believers in New York City real estate," says John Horowitz, first vice president and division manager with Marcus & Millichap.

AmTrust has been shopping for the last year to build up a portfolio of rent-stabilized apartment buildings in New York City. It plans to buy these buildings at low prices, with a cap rate of roughly 6 percent, so that the income from low, regulated rents is enough to cover the debt service and operating costs of the property and still earn a profit.

However, many current owners of these buildings paid much higher prices — at cap rates closer to 4 or even 3 percent — and have resisted selling for much less than they paid, according to real estate experts. Amtrust recently submitted a letter of intent to acquire a portfolio of rent-stabilized apartment properties in Upper Manhattan.

"It has not been easy," says AmTrust's Bennett. "There is a large gap between the buyer and seller. [The gap] is getting closer now." ●