

It Hurts to Pencil Out Multifamily Development in New York City These Days

'Our policymakers are the reason rents are so unaffordable in NYC. They need to wake up and get educated.'

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It's not just the challenges developers face with high interest rates and financing. The entire formula for making multi-family housing pencil out in New York City remains in flux, during a precarious moment of widespread affordability challenges.

"You had this run-up in rates and inflation, and the abatement went away at the same time, that was a big shot across the bow," said David Schwartz, principal and co-founder of Slate Property Group. "A lot of developers got stopped in their tracks."

For developers, the combination of a losing critical incentive support and a tax abatement as they cobble together a capital stack has been debilitating. The mid-2022 expiration of 421a, a popular tax abatement incentive for new housing that was used for 70 percent of the city's multifamily housing built over the last decade, along with the uncertainty around 485x, a replacement that state lawmakers passed this year that still requires city rulemaking to fully take effect, has been complicated by Mayor Eric Adams's push for City Of Yes. That citywide upzoning and regulatory reform effort to encourage more building has been years in the making.

“I think, right now, a lot of developers are just trying to figure out how to make sense of this,” said James Nelson, principal of Avison Young’s tri-state investment sales group.

In 2022, the city permitted 35,640 multifamily units, according to an Avison Young analysis. After 421a, which offered up to 25 years of property tax abatements, expired that year, the entire sales and development cycle faltered. Land sales dropped 75 percent, said Nelson. Permitting dropped to 12,492 units last year, and 6,842 thus far in 2024.

During the last full year of 421a, 1.6 million buildable square feet of land for rental development sold. Two years later, without the incentive, just 38,000 square feet traded hands. It’s a disaster for increasing affordability, and leaves Mayor Adams’s optimistic goals for housing production — 500,000 units over the next decade, which requires a record-setting rate of production every year — looking outlandish.

“Policymakers say that tax abatements are just a giveaway to developers — that housing will get built without them,” said Bob Knakal, a longtime investment sales broker and founder of BK Real Estate Advisors. “They are simply ignorant about the realities of the market. Incentives are everything, notwithstanding high rates. Our policymakers are the reason rents are so unaffordable in NYC. They need to wake up and get educated.”

Making projects pencil out in this environment requires financial heft, a more complicated capital stack, and success in navigating a new landscape for dealmaking. Since the city likely won’t even start rulemaking for 485x — which offers a 40-year tax exemption in return for making 20 percent of a building permanently affordable — until the end of 2025, this impasse may impact multiple quarters of potential construction. When it costs more to borrow money, and the same amount of money won’t go as far due to rising prices, having a well-defined, well-crafted series of incentives can unstick a jammed development market.

The financial math is increasingly requiring additional partners and funding sources. Glenn Grimaldi, CEO of Naftali Credit Partners, said many developers have been turning toward a combination of senior lending and private credit to fill out the capital stack for development financing. Paul Patafio at Hudson Realty Capital said his firm just finished a \$50 million preferred equity loan for a project in Long Island City, Queens, and has been seeing lots of activity with multifamily developers seeking to plug financial holes.

“The market is shaking itself up because people ignored fundamentals for a while,” Grimaldi said. “And, right now, I think this is a market for experts.”

One of the biggest challenges remains the requirements of 485x. Buildings with at least 150 units have significant wage requirements under the new incentive, and call for a deeper level of affordability, at 60 percent of area median income (AMI). In this combined incentive environment, the best possible outcome for the current morass is that since large projects will struggle to pencil

out, upzoning will make it possible to do a lot more midsize (under-150 unit) projects to make up the difference. In fact, Avison Young listed a project at 4 West 43rd Street that it's marketing as a combination of rental and condo, to tap into the benefits for a smaller multifamily development, using condo sales to help pencil out.

Without 421a, Schwartz at Slate Property Group said his firm wasn't really looking at new rental deals. Now, he's actively pursuing projects, because there's currently a path, however fraught and challenging, to make deals financially feasible. He said that while the abatements have changed, he's still seeing deals similar to what would have happened under 421a. "It's not having a drastic effect on these kinds of deals."

"We're starting to see excitement," Schwartz added. "We're seeing a lot of deals come in, good deals."

At 80 percent AMI, which comes out to \$52 a square foot for rent, it wouldn't be as big a stretch for developers to do affordable housing, said Nelson, when some neighborhoods had \$60 or \$65 a foot market rent. But at 60 percent AMI, rent falls to somewhere in the \$40s per square foot, a much bigger gap to fill. Nelson expects a lot of interest in a 149-unit apartment across the city, especially farther out in Queens and Brooklyn, where the abatement would likely be more meaningful and helpful.

"For developers, it's just math," said Nelson. "My borrowing costs are higher, my labor costs are higher, and they're solving for the land value. It's got to be compelling enough for landowners to acquiesce and sell. If you've owned a parking lot for 20 to 30 years, you may say, 'I'll sit on it until the next administration, maybe the benefits will be better.' "

Often, that math means condos, especially in Manhattan. Nelson pointed to a string of recent sales — Douglaston's \$114 million acquisition of 175 East 82nd and an adjacent property, or Legion's pickup of an empty development site at 540 West 21st Street in West Chelsea for \$87 million — all being turned into condos. He does see the City of Yes rezoning for conversions, specifically alterations to office-to-residential incentives to apply to buildings before 1991 instead of the current 1968 cutoff, potentially opening up 30 million to 40 million square feet of new conversion opportunities.

Views on 485x remain mixed. While some have celebrated a return to some kind of normalcy, or at least a set of rules to reorient their development, Knakal remains bearish. The rule, which divides the city into zones, will mostly produce housing outside of Zones A and B, which cover Manhattan below 96th Street and portions of Brooklyn and Queens.

"I speak to many developers every day and have not spoken to a single one who believes you can build rental housing in Zone A, pay the wages that are required, and have the development make economic sense," he said.

The lower AMI requirement means that the ability to collect rent to pay for other rising expenses — insurance recently shot up 27 percent annually, for instance — has been complicated or compromised. If rent doesn't cover the operating costs of the unit and operations of the building, a developer may simply not build.

City of Yes, by upzoning and adding density bonuses, could help, but its passage isn't final, community approval could take years yet, and it's been marked by a contentious approvals process. The City Planning Commission's hearing about the proposed change in early July lasted 15 hours, the longest such event on record, with the crowd evenly divided on the zoning changes. When the City Council takes up final recommendations later this year, it'll still reserve the right to make changes.

Avison Young's Nelson argues that density bonuses in areas like Jamaica, Queens, opens up more opportunities to develop near transportation hubs. Improving the situation remains a wait-and-see situation.

"This is sweeping reform," said Nelson. "Developers and their advisers will adapt very quickly. We're only a couple months into this. By the end of the year, you're going to see developers making major moves."