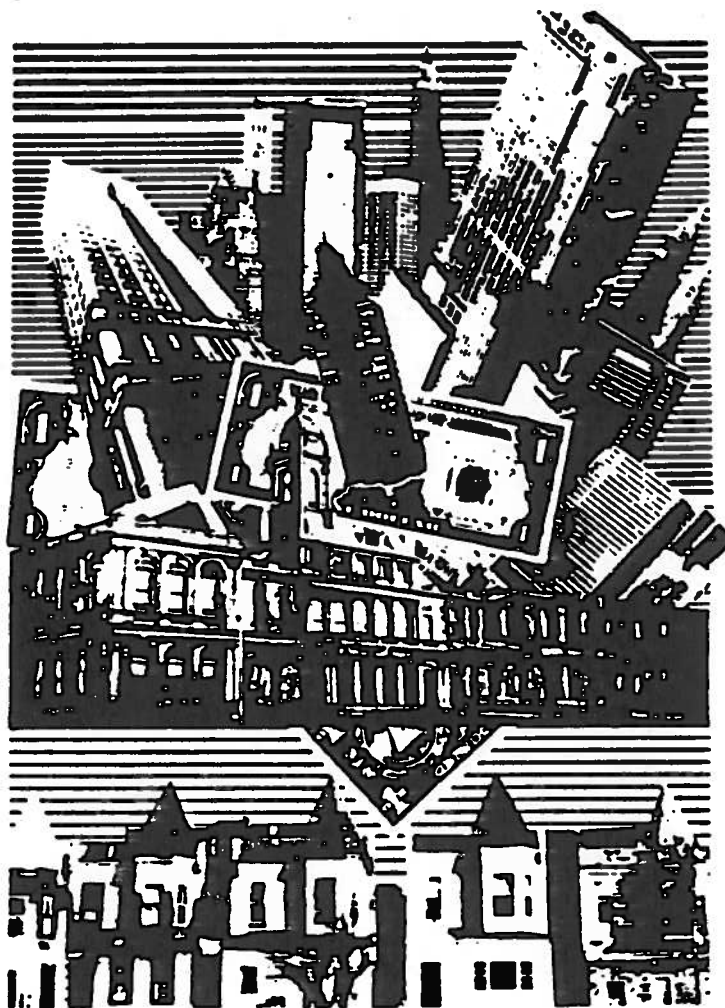


INCLUSIONARY ZONING and HOUSING TRUST FUND
A Proposal for Equitable Development in New York City

NEW YORK CITY'S HOUSING CRISIS:
PRIVATE DEVELOPMENT
AND PUBLIC NEED



**Sponsored by the Pratt Institute Center for
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INCLUSIONARY ZONING AND HOUSTING TRUST FUND

TABLE OF CONTENTS

	<u>Page</u>
Acknowledgments.....	1
Introduction.....	3
New York City's Housing Crisis.....	4
The Proposal.....	8
Inclusionary Zoning: Residential Development.....	14
Commercial Development: Impact on Housing.....	19
Housing Trust Fund: Revenue Sources.....	25
Balancing Housing Needs Neighborhood vs. Citywide....	28
Administering the Housing Trust Fund.....	32
 Attachments: Summary of Analysis of Residential Development	
 Summary of Analysis of Commercial Development	

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themselves or their organizations.

INTRODUCTION

This report will recommend a set of proposals that are both at the cutting edge of public policy regarding land use, development control and housing, and, at the same time, long overdue in The City of New York.

This irony is partially the result of the City's failure to retain control over its own development policy. New York was once the most progressive municipality in the nation in terms of its innovative use of zoning and land use regulations. This City pioneered the very concept of zoning beginning in 1916, and was still breaking new ground in the use of incentive zoning in the 1960s. But, more recently, especially since the mid-1970s, the City's development policy has been left almost entirely to the initiatives of the private market. Not surprisingly, this virtual abdication of its responsibility for development policy has, along with other unfortunate public and private actions, split the City more and more openly into opposing economic camps--the "haves" and the "have-nots." Manhattan condominiums sell for one million dollars per apartment, while in Brooklyn and the Bronx, twenty-family apartment buildings are abandoned by landlords who can't afford to maintain them on the meager rents their tenants can afford to pay. Stark contrasts such as these are symptomatic of the housing crisis this proposal is designed to address. Unfortunately, they are becoming ever more commonplace. There is still time to act, but that time is now.

NEW YORK CITY'S HOUSING CRISIS

Three factors have combined to make action on a more equitable development policy for the City particularly urgent now:

- . the continuing and worsening shortage in New York City's housing supply;
- . the radical change in Federal housing policy, i.e., withdrawal of support for housing production programs;
- . the intense but chaotic character of new market rate development in Manhattan.

1. New York City's housing supply has been shrinking both in absolute numbers and relative to its household population for many years. Consequently, the vacancy rate has been falling since the mid-1970s. When last measured over two years ago, it stood at 2.13%, but is almost certainly at 2% or lower today, especially for lower-priced apartments which are always more scarce. New York State law defines a vacancy rate of 5% or lower as an emergency. But this simple statistic can't begin to convey the actual impact on families--especially low-income families--trying to find decent housing in such a tight housing market. Quite often it is simply impossible. Over 310,00 housing units have been lost to abandonment and/or demolition since 1970, mostly from the lower cost end of the housing stock. It's no wonder then, that low-income families are forced to double-up in at least 17,000 public housing units and in untold numbers of privately-owned apartments. Over 87% of the Single Room Occupancy units in the City have likewise been demolished or more likely converted to upper-income housing. It's no wonder then,

that over 30,000 homeless individuals and families sleep in our streets and subways. The City now owns over 6,000 vacant buildings containing over 70,000 dwelling units abandoned by private owners only to face demolition by an already overwhelmed HPD. It's no wonder that groups of tenants are "squatting" in in rem buildings, often without the most basic services. Even without statistical analysis, the desperate lengths to which low-income people are forced to go to secure shelter in this City is compelling evidence of a very real housing shortage of crisis proportions.

2. Federal housing policy changes have had an immediate and drastic effect on New York City's ability to house lower-income households. For years, the City has depended upon the Federal government to fund all of its housing production programs of any size. Local resources, especially tax levy funds, were considered too scarce to make any appreciable impact on the City's housing supply problem. Federal Section 8 subsidies and Community Development Block Grants were the mainstay of the modest effort the City was able to mount against a tide of housing abandonment that had devastated many low-income neighborhoods. But this source is rapidly drying up. At its peak, HUD's Section 8 program could be counted for about 5,000 new dwelling units per year to house low-income families. This year there will be no such new units. Federal Community Block Grant funds continue to flow but at a reduced rate, down 15% in the last two years. At the same time, however, there is increasing competition for these shrinking CD funds as other Federal funding cut-backs have

been felt in other urban development programs not normally dependent on CD funds. The net result is an inadequate level of Federal aid to housing in a City grown dependent on Federal aid for its most severe housing needs. Not only is New York in the midst of a housing crisis, but it has been itself abandoned by the Federal government. While we must continue to fight for a dramatic reversal in current Federal housing policy (which will not come easily or soon), it is incumbent upon the City to do all it can to develop its own resources to confront our worsening housing shortage.

3. Intense and often ad hoc development in Manhattan continues to distort the balance (economic, political, and physical) among the five boroughs of the City. Competition for increasingly scarce development sites within proximity to midtown has led to unprecedented rent levels in new and substantially rehabilitated residential and commercial space in Manhattan. Residential rentals of over \$2,000 per unit per month are not uncommon, with coop and condominium sales prices similarly out of reach of the average New Yorker. New commercial space in prime locations commands rents of \$50+ per square foot per year. Market pressures in turn, have led the City to make dramatic changes in existing zoning designations, at least in some instances, to accommodate increased density for new development. This compliance of public policy, along with real estate tax giveaways, has resulted in large windfall profits to the owners and developers of Manhattan real estate, who have offered a mixed bag of largely superfluous "contributions" to the neighborhoods surrounding their projects,

but little if any consideration has been given to what public purpose this policy serves. In fact, this policy may have both direct and indirect negative impacts insofar as the overall development pattern of the City is concerned.

It is not the purpose of this report, however to criticize decisions that have already been made. Presumably, the City Planning Commission had valid reasons for granting these increases in development rights for various areas of Manhattan. Nevertheless, we do feel that City policy should be aimed toward redistributing at least some of this development pressure to the other boroughs where redevelopment is desperately needed. Ideally, City policy should foster equitable distribution of both the costs and benefits of development throughout the five boroughs. More realistically, however, development policy should at least avoid exacerbating an already intolerable housing crisis and provide a means of channeling redevelopment resources to those areas of the City currently underserved by the private market.

It is in this context that we propose a new approach to New York City's development policy, an inclusionary one that will begin to address the unconscionable gap that now exists, economically and geographically, between the "haves" and the "have-nots." While some inequities will undoubtedly continue to exist within the City regardless of the changes we now advocate, at least they will exist in spite of rather than because of our public policies.

THE PROPOSAL

As summarized below, our proposal for the adoption of an Inclusionary Zoning amendment and the creation of a Housing Trust Fund for New York City has several facets. But there are a few important features that our proposals do not include:

1. Zoning for Sale

We do not propose any increase in zoning density or development rights in Manhattan or anywhere else in the City as a means of generating revenue. Zoning policy should be made, in accordance with generally accepted planning principles, by the City Planning Commission acting in the public interest.

2. Stopping Development

It is in no one's interest to undermine the City's economic recovery, or stop its current real estate development boom. The City should, however, be looking for creative ways in which to harness the engine of economic recovery to benefit all New Yorkers.

3. Solving the Housing Crisis

Our most optimistic projections for the success of our proposals, even if realized, would still leave this City short of the necessary resources to meet all its housing needs. As potentially useful as our proposals seem to be, the City, State, and particularly the Federal governments must maintain and increase their level of support if we are ever to provide decent, affordable housing for all those in need in New York City.

4. Taxing Luxury Development

While there are many attractive arguments behind a tax approach to addressing the housing crisis (it is, potentially at

least, a simpler, more direct approach to generating revenue), we have reserved judgment on this alternative for several reasons. Our research into municipal development controls, implemented or proposed, throughout the country, found much stronger precedent for a zoning-based mechanism. Equally important, however, are our concerns about the political imponderables of seeking the necessary State enabling legislation for such a tax. This would not be required for a local zoning amendment which may be enacted by the City government within its current charter. Finally, zoning is inherently a more flexible mechanism and can be more easily adjusted to reflect legitimate geographic and development considerations.

Having stated what our recommendations do not include, we will briefly describe what they do. Most succinctly stated, our proposal involves three major elements which are independent but complementary.

1. Inclusionary Zoning

Inclusionary Zoning for residential development is based on the recognition that zoning, as a part of the police power, must be exercised to further the general welfare, and should be applied to expand housing opportunities for low- and moderate-income persons. Therefore, all new unsubsidized residential development of significant size (ten dwelling units or more), whether new construction or rehabilitation, as-of-right, or by special permit, should be required to provide for the development of affordable low- and moderate-income housing for an appropriate portion of its potential users.

This obligation could be met by subsidizing, on site, 10% of the total number of units developed, or alternatively, making a commensurate monetary contribution in the form of a capital grant of approximately \$6 per net rentable square foot or about \$6,000 for each unsubsidized unit developed.*

2. Commercial/Housing Linkage

The connection between new commercial development and increased demand for housing has been demonstrated in major cities throughout the country. In New York, especially over the last five years, housing production has lagged far behind the increased demand for housing created by the extraordinary influx of new office workers. Therefore, all new commercial development of significant size (100,000+ square feet), whether new construction or substantial rehabilitation, as-of-right or special permit, should be required to contribute toward the creation of a commensurate number of housing units to mitigate the impact on the City's already catastrophic housing vacancy rate. Required contributions are directly related to the impact on the housing market attributable to commercial development. Based on a

*These requirements would not be effective for projects participating in the various special zoning districts created (or subsequently created) by the City, which require a contribution designed to create or preserve affordable housing. Insofar as a special district is designated in order to preserve or foster the unique character of a particular geographic sub-area of the City, the City Planning Commission, in creating these districts, takes into account and balances both the local needs and citywide housing purposes to which these developer contributions might otherwise be put. As we have urged in the past, however, the City should review and update the magnitude of the contributions required of developers receiving FAR bonuses to more closely approximate the true value of these bonuses.

formula relating office development to housing demand, we project the need for one additional housing unit for every 1,000 square feet of new office space. Using the same \$6,000 per unit contribution as sited above under inclusionary zoning, this amounts to an equivalent \$6 contribution per net rentable square foot of commercial space.

Compliance with these requirements for both residential and commercial developments would be monitored as is compliance with other zoning regulations by the Department of Buildings. No further public review (unless otherwise required by the project for ULURP or Special Permit purposes) would be involved. No negotiation or exercise of discretion would be required by the City or the developer. As is presently the case, hardship appeals could be brought to the Board of Standards and Appeals for review and disposition.

3. Housing Trust Fund

The acceptance of contributions from developers in lieu of actually creating affordable housing entails a positive obligation on the part of the City to use those contributions exclusively for the development of that housing. It would not be appropriate to deposit these funds in the general treasury not to put them at the disposal of any City agency under a more general mandate. A properly designed Housing Trust Fund would be the most effective fiduciary conduit for such inclusionary contributions.

More importantly, however, a Housing Trust Fund could serve as the repository for a wide variety of housing and housing-

related revenues generated by, but, in most instances, not hitherto reinvested in the City's housing stock. The Housing Trust Fund would pool revenues from:

Inclusionary Zoning Contributions from
Residential Development
Housing Contributions from Commercial Development
The Real Property Transfer Tax
The State Capital Gains Tax
The Mortgage Recording Tax
UDAG and CDBG Loan Repayments
The Sale of City-Owned Property
Coop and Condominium Filing Fees
Interest Earned on Real Estate Escrow Accounts
Tax Increment Financing Districts
Hotel Occupancy Surcharge

and other sources yet to be identified, for the purpose of establishing a permanent funding source for the development of affordable housing. On an annual basis, we estimate that these funds might amount to some \$200 million, only one-quarter of which would be derived from the developer contributions discussed above.

By avoiding reliance upon direct Federal funding, the Housing Trust Fund could insulate a sizable portion of the City's financial support for lower-income housing from the political vagaries of changing Federal administrations. At the same time, the Trust Fund should be used to supplement rather than supplant governmental sources of support for housing such as CDBG, Capital

Budget funds or any future Federal housing subsidies made available to New York City. For example, the Fund could provide the leveraging needed to qualify for Federal rehab grants provided for in the Housing Authorization Bill recently enacted by Congress.

The Housing Trust Fund (HTF) would be accountable to an independent Commission appointed by the Board of Estimate. This Commission, acting within enabling guidelines established by the Board of Estimate, would monitor compliance with City policy for the expenditures of the Trust Fund and be responsible for the oversight of the Trust Fund on an ongoing basis. The HTF would not attempt to duplicate the functions of existing City agencies and would, except for a minimal administrative support staff, be dependent upon existing City agencies and their staffs to actually implement housing projects to be underwritten in whole or in part by HTF monies.

Further details on the entire proposal are contained in five specific sub-chapters dealing with:

Inclusionary Zoning: Residential Development
Commercial Development: Impact on Housing
Housing Trust Fund: Revenue Sources
Balancing Housing Needs: Neighborhood
vs. Citywide
Administering the Housing Trust Fund

INCLUSIONARY ZONING; RESIDENTIAL DEVELOPMENT

Inclusionary zoning is not a new concept. Ordinances providing for optional and mandatory set-asides of low- and moderate-income housing in new developments have been enacted throughout the United States. In 1979, the Center for Metropolitan Action (CMA) surveyed some of these programs in Housing Choice, a study commissioned by the Department of Housing and Urban Development. It was found then that many of these programs are successful in expanding the supply of housing, and since that time, the list has grown.

Inclusionary zoning is based on the recognition that zoning, as part of the police power, must be exercised to further the general welfare, and should be applied to expand housing opportunity for low- and moderate-income persons. Last year, the New Jersey Supreme Court, in Mount Laurel II, 92 NJ (1982) 158, ordered inclusionary zoning--including mandatory, affordable housing set-asides--as a chief remedy for exclusionary zoning in New Jersey municipalities. The opinion provides strong support for inclusionary zoning in New York and throughout the country. We quote from the opinion:

The constitutional power to zone, delegated to the municipalities subject to legislation, is but one portion of the police power and, as such, must be exercised for the general welfare. When the exercise of that power by a municipality affects something as fundamental as housing, the general welfare includes more than the welfare of that municipality and its citizens: it also includes the general welfare--in this case, the housing needs--of those residing outside of the municipality but within the region that contributes to the housing demand within the municipality. Municipal land use regulations that conflict with the general welfare thus defined abuse the police power and are unconstitutional. (Slip Opinion, pages 16-17)

In New York City, the housing emergency is acute. Cutbacks in Federal aid have virtually halted new subsidized housing development. The vacancy rate is dangerously low, and yet housing abandonment continues. At the same time, the market for luxury housing in Manhattan is booming. As the Jersey Court said, "the State controls the use of land, all of the land. In exercising that control it cannot favor rich over poor" (Slip Opinion, page 17). The time has come for New York City to expand its responsibilities to zone in the general welfare, equally for rich and poor.

Therefore, we are proposing a mandatory, across-the-board requirement that 10% of all new or substantially rehabilitated units be set aside for low- and moderate-income housing. That is, that 10% of the units in each new housing development shall have their maximum rents fixed at the Section 8 Existing Housing Fair Market Rent (currently \$420 for a two-bedroom apartment). The 10% inclusion requirement would be part of the underlying as-of-right zoning and would not be subject to negotiation. The percentage figure is preliminary, but our analysis indicates that it should still allow for a reasonable rate of return on investment. Developers may provide inclusionary units on-site, or off-site within the neighborhood. If a developer elects to make a monetary contribution in lieu of building units, that contribution will become part of the Housing Trust Fund, with at least 25% earmarked for use within the Community District of origin. By allowing actual construction of units, the set-aside

requirement encourages integrated housing patterns and helps to mitigate displacement impacts.

This requirement will apply to virtually all new unsubsidized housing developed anywhere within the City. However, the following types of development would be exempted:

- . Subsidized housing, e.g., Section 8, Participation Loan Program, Section 235, UDAG, etc.;
- . "80/20" developments (Tax Exempt Bond Financed Projects with 20% affordable DUs);
- . Non-profit housing developments for low- and moderate-income households or special needs populations;
- . Developments participating in Special District contribution requirements for the creation or preservation of affordable housing;
- . Any development below ten dwelling units.

Otherwise, all new market rate housing (including projects utilizing the Housing Quality amendment) would be subject to the inclusionary requirement. This includes projects utilizing tax abatements such as 421 for new construction or J-51 for rehabilitation.

The determination of an appropriate figure for a one-time contribution in lieu of on-site, subsidized DUs, is based on an analysis of individual case studies and prototypical building proformas under a set of conservative assumptions (see attached). Our method of analysis was designed to preserve the project's economic viability by maintaining investors' return on equity. This analysis indicates that a contribution equal to approximately \$6 per net rentable square foot is affordable for most

unsubsidized developments coming on the market this year. The use of a per net rentable square foot figure rather than a per DU figure should compensate for the inherent inefficiencies in developments undertaken in zoning districts other than R-10 (where we assume that the typical developer will choose to pursue the Housing Quality option, if available). This will also avoid any undue influence on a developer's choice of apartment size mix, allowing for optimum marketability. An escalation factor should be applied to this one-time required contribution for future projects (in order to keep pace with inflation, maintenance and operation costs for rental housing, etc.) on an annual basis. This factor should be equal to the allowable rent increase for Rent Stabilized units for the coming year as determined by the Rent Guidelines Board or its successor agency. Alternatively, a sliding scale or percentage contribution formula can be designed which would achieve the same net result but allow greater flexibility in implementation. (See attached financial analysis.)

In cases where developers may feel that an unusual hardship is being imposed on their particular development because of its peculiar site conditions or where other legitimate grounds for an exception may exist, application can be made for specific relief to the Board of Standards and Appeals whose determination in such matters is final. Otherwise, the administration of the inclusionary requirement will be within the province of the Department of Buildings which is the City agency responsible for enforcing the provisions of the zoning resolution.

Unless required in order to fulfill some other municipal law or regulation, projects subject to the inclusionary requirement will not be subject to any additional public review or approval.

Based on recent production rates in market rate housing and projection through 1985, we estimate that under the most conservative assumptions, at least 3,000 units of unsubsidized housing will be produced in each of the next several years. Based on our proposed rate of inclusionary contribution, this would result in total contributions to the Housing Trust Fund approaching \$18 million per year if these developers choose to make such a contribution in lieu of subsidizing 10% of their units on-site.

COMMERCIAL DEVELOPMENT: IMPACT ON HOUSING

The link between development of new office space and increased demand for housing within the same municipality has been well documented in a number of major cities (San Francisco, Santa Monica, Boston, Toronto, and London, to name a few).

While further research into housing and commercial development patterns and demographic trends has to be done specifically for the the New York City area, it is clear from already available data and from ubiquitous, anecdotal evidence (virtually every week in The New York Times "Real Estate Section"), that New York City continues to attract substantial numbers of new workers in the "FIRE" (Finance, Insurance, and Real Estate) and service sector of our economy, but is not providing housing for them nor even for the already existing population.

While new office jobs are created at the rate of 30,000 per year, our housing stock has in fact been shrinking relative to the number of households seeking shelter in the City (the vacancy rate dropped from 2.95% in 1978 to 2.13% in 1981). And, even in absolute terms, the number of net new housing units made available during that same three-year period (including rehabs, conversions, etc.) was 9,000 less than those lost during this same period to abandonment and demolition. This situation is, in fact, and is by New York State law, defined as a "housing emergency." And yet, we have neglected to take what seems to be one obvious, albeit partial, step toward its resolution. Clearly, office developers should be asked to bear part of this burden by carrying their fair share of the increased demand on the City's housing supply.

Therefore, we are proposing a straightforward requirement that every new large-scale commercial development provide for housing for that segment of the population most adversely affected by the increase in housing demand caused by the influx of new office workers. Based on our analysis (see below), the impact of new office employment could be offset by the production of one housing unit for every 1,000 square feet of office space developed. Commercial developers could at least begin to fulfill this requirement by making a commensurate monetary contribution to the HTF, similar to that required under the inclusionary zoning amendment. This would require a contribution of approximately \$6 per net rentable square foot of office or commercial space. This closely correlates with the \$6,000 per housing unit contribution required of residential developers, described earlier.

This requirement would be equally applied to all commercial development (with an exemption provided for the first 100,000 square feet of development) whether in newly constructed or substantially rehabilitated commercial buildings. Economic analysis of recently completed commercial projects shows that even under very conservative assumptions, contributions of the magnitude proposed above are easily supportable by the income generated by these projects. Investment in commercial development in New York, even after the imposition of this contribution requirement, will continue to be competitive with alternative capital investment opportunities (see attached).

It is important to note, that unlike our proposal for inclusionary zoning in regard to new or substantially rehabilitated residential development (which is based on the mandate that zoning promote the general welfare by providing housing for a range of income groups), our proposed zoning amendment, in regard to new or substantially rehabilitated commercial development, is based on a more traditional mitigation rationale. That is, office development has an identifiable impact on housing supply by increasing the number of households demanding housing within the City. New office space and new "FIRE" and Service sector employment means new households competing for already scarce housing units, especially in the moderate-cost segment of the New York City housing market.

The formula used to estimate this impact takes into account three variables:

1. The amount of office space associated with each new employee.

Based on recent data from the Real Estate Board, the Mayor's Office of Operations Management Report and Columbia University's Center for Human Resources, the argument could be made that a new employee is introduced into the City's labor market with every 100 square feet of new office space. But, in order to be conservative in our estimates and also to allow comparison with other major cities' office sectors, we will use the more generally accepted figure of one new employee for every 250 square feet of new office space.

2. The proportion of new office workers who would likely live in New York City if housing were available.

Based on U.S. Census data, and analysis of worker-residence data, it appears that at least 25% of new employees in New York City find housing in New York City, in spite of the extraordinarily tight housing market. In other major cities, where more extensive research on workers' locational preferences as well as actual residential patterns has been performed, 40% of the new office employees are identified as in the market for housing within the municipality. While New York's present housing market conditions make this figure an unlikely goal, neither can we be satisfied with the status quo where only 25%, or one out of every four workers, can manage to both live and work in this City. A compromise between these two figures, however, may be a more realistic goal. Therefore, we will use 33% as a working assumption for the proportion of new office workers needing housing within the City.

3. The number of employees per household.

While these first two indicators may show employee demand for housing, this must be tempered by an assessment of the demographic trends among office worker households. We can no longer assume that there is only one wage earner per household. U.S. Census data indicate, that on average, in New York City households, approximately 1.32 adults are employed full-time. If this average holds true for office workers, it would indicate that one housing unit is needed for approximately every 1.32 office workers. This is a higher proportion than in some other major cities, but then New York City does have an extraordinarily high number of single individuals living alone--912,345, or almost 33%

of the households--who obviously have only one wage-earner, at most. Given the lack of more specific data on the number of households containing office workers per se, we will assume that 1.32 workers per household is a fair approximation.

Using these three factors then, we can project the relationship between new office space and increased housing demand by the following formula:

One housing unit is needed for each "X" square feet of new office space, where "X" is:

$$\frac{1.32 \text{ workers/household} \times 250 \text{ SF of office space/worker}}{33\% \text{ of workers need housing in NYC}}$$

Thus, one dwelling is needed for every 1,000 square feet of new office space.

As mentioned earlier, the developer of new office space would be required to contribute \$6 per net rentable square foot of office space created (or an equivalent amount as determined by a sliding scale or percentage formula), to the Housing Trust Fund for the development of affordable housing units. This level of contribution amounts to approximately \$6,000 per required dwelling unit. This will, at a minimum, address the most pressing housing needs of the City's low- and moderate-income residents. However, developer contributions, if judiciously used in conjunction with other public and private resources via the Housing Trust Fund so as to leverage investment capital for housing, can have a potentially significant impact on the City's overall housing shortage (see Housing Trust Fund: Revenue Sources).

POTENTIAL ANNUAL REVENUE SOURCES FOR HTF

Title	Description	Comments	Projected Contribution
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Real Property Transfer Tax - A levy charged everytime a deed changes hands. In FY'84 73,000 deeds changed hands resulting in collections of \$146,148,468. The entire sum stays in NYC, with \$104 million going into the City's General Fund.

Most of these funds are presently earmarked. However, due to the enormity of the housing need and its relationship to real estate transaction that a setaside and/or surcharge totalling 10% be instituted to contribute to a HTF.

\$15 Million

State Stamp Tax - Similar to Real Property Transfer Tax but earmarked for the State. Small nominal amount remains in NYC for administration. FY'84 200,000 NYC deeds generated \$29,492,829 in State revenues.

Same as above - Create a State Stamp Tax Surcharge of \$15 plus 1/10 of 1% for amounts over \$35K - Surcharge would be targeted to HTF.

1.5 Million

Capital Gains Tax - A charge on the sale of property over \$1 million. 10% charged on the gain difference between the old and the new selling price. Approximately 25,000 transactions of this type occurred in FY'84, generating \$140,206,218. This revenue currently goes to the State General Fund and was recently abolished from going to the City's. \$158M collected statewide.

Its estimated that approx. \$150 million will be generated this year. As above, we propose that a surcharge and/or setaside equivalent to 10% be instituted and that that amount be contributed to a HTF

15 Million

Mortgage Recording Tax - A tax levied for recording a mortgage onto the title. 70,000 NYC recordings occurred in FY'84, producing \$152,976,944 in revenues collected, \$110M going to the State's General Fund. The balance is earmarked: 1% to the City for obligations over \$.5M, 1/4 of 1% goes to MTA and for mortgages of \$25K and above, 1/4 of 1% for the BONYMA Mortgage Insurance Program for rehabs. Statewide mortgage tax collections last FY amounted over \$225M.

This year we expect that BONYMA will receive approx. \$100 million. Of this they will retain about 9% leaving \$91 million. Of this, 65% or \$59 million - NYC's pro-rated share - should be invested in the Housing Trust Fund

59 Million

Building Dept. fees - A fee charged for building inspections. Various fees charged based on size, type, and kind, eg. \$35 for elevator inspection etc. FY'83 net fees \$13,950,000.

Using this pot of \$ at present is not feasible since an increase should go into increased inspections

Title Description Comments

IDAG repayments - Repayments of federal Urban Development Action Grants in FY'84 yielding \$257,000 in principal plus \$605,000 in interest, total \$862,000. Current repayments supply a revolving loan fund that is administered by the Financial Services Corporation and is used as retention, expansion, machinery or equipment monies for industrial and commercial companies.
 LP repayments - Repayments attributable to NYC's Participation Loan Program. \$2M for FY'84.
 Article 8A Loan Program repayments - Repayments attributable to NYC's housing systems repair loan program. FY'84 debt service \$6M.

This year's total of \$8.9 million seems exceedingly low. We estimate significant increases over the next few years. All repayments should be targeted to the Housing Trust Fund.

10 Million

Sale of Non-Residential City Owned Property - Proceeds from the sales and mortgages of In-Rem commercial properties. \$33M for FY'84.

In FY'84 a total \$39 million was received. We estimate that this level will continue for the next few years. The total, minus administrative expenses, should be targeted to the housing trust fund.

Sale of Residential City Owned Property - Proceeds from the sales and mortgages of In-Rem residential properties. \$6,452,345 in sales and \$689,665 in mortgages for FY'83.

30 Million

Coop and Condominium filing fees - Fees charged for incorporation of a Coop or Condominium, payable to the Attorney General's Office. \$3,923,785 collected for FY'84, includes \$300K in amendment fees. Schedule based on 1/10 of 1% of the offering price. Maximum fee cannot exceed \$10K. Fees go to State.

These fees should be completely restructured. Same fee schedule should prevail for all units selling below \$75K, the fee would be increased by 50% for units offered between \$75 - 100K, and by 100% for units offered above \$100K. The cap of \$10,000 per building should be removed.

8 Million

Cooperation filing fee - Fees imposed for the filing of corporations in NY State. \$13.6M collected statewide FY'84. Includes associated fees of issuance of certified stock and organizational filing. Payable to Dept. of State.

Fee structure should be revamped and increased with excess income estimate at \$2 million going to housing trust fund.

2 Million

Title	Description	Comments	Projected Contribution
Registration for Limited Partnership Syndications	- A fee charged for the registration of real estate syndications. Statewide FY-83 collections amounted to \$3,650,174, almost exclusively from NYC. Fees go to State. 1/10 of 1% of dollar offering. Minimum fee \$250, maximum cannot exceed \$10,000.	Real estate related limited partnerships are a lucrative area that have not been tapped to benefit NYC. We propose an intensive investigation of how this can be done. However, we propose that the fee structure be revamped to yield a total of \$9 - 10 million with the excess over \$4 million going to the HTF.	21 Million
Interest Earned on Real Estate Escrow Accounts	- Interest earned on state aided or assisted real estate endeavor.	This is being investigated by a Veatch Foundation Study. We estimate that \$10 million per year can be generated.	10 Million
Hotel Occupancy Surcharge	- A sliding scale surcharge averaging \$3.50 per room per night occupancy tax imposed on every hotel room in the City. Modeled after Leichter Senate bill: 3% under \$100/nite, 3.50 for \$100 to \$130/nite, 4% over \$100/nite.	There are over 100,000 hotel rooms in the City averaging over 80% occupancy over the 365 days of the year. In most instances the proposed tax per night would amount to less than a 3.5% surcharge to the cost of overnight lodging.	44 Million
Tax Increment Finance District	- A surcharge levied to those benefit by a particular service or local improvement in an area. Financing usually applied to re-development by a bond issue that will be serviced from the anticipated additional tax revenues following the redevelopment.	We estimate that about \$10 - 15 million per year can be generated by the increased real estate values attributed to public actions. These would be harnessed under our proposal by establishing a T.I.F.D. The income of which would yield about \$12.5 million per year to the H.T.F.	12.5 Million
Inclusionary Zoning Payment Commercial Development Exactions	- ----->	----->	50 Million
Mayor's/Governor's Housing Park City, Port Authority, etc.	Package-Includes MAC Funds, Battery	Total	\$ 278 * Million
			150 - 250 Million
			\$ 328 - 428 Million
		\$ Unleveraged	

We estimate, based on historical office development trends and current projections for new Manhattan office space over the next several years, that close to six million square feet of office space will come on the market in an average year (although this may vary a good deal for any given year). Allowing for the elimination of the first 100,000 square feet from each project, this would yield approximately \$32 million in contributions to the Housing Trust Fund.

HOUSING TRUST FUND: REVENUE SOURCES

Not since the latter part of the nineteenth century, when Jacob Riis publicized the desperate conditions in which many New Yorkers were forced to live, has public attention been as intensely focused on the City's housing needs. Today, every statistical indicator points to a growing crisis in housing, particularly for New York City's low- and moderate-income population.

Compounding this picture is the increased competition for our shrinking housing supply generated by the rapid growth of office space in Manhattan and by other city policies encouraging commercial and luxury housing development in certain areas of New York City.

We need a response to this housing crisis that encompasses the vision and political leadership necessary to move quickly and affirmatively to maintain, preserve, rehabilitate, and build new low- and moderate-income housing in New York City.

A Housing Trust Fund--properly developed--could be a critical component of that response. Therefore, we propose the establishment of a \$200 million dollar Housing Trust Fund that would be used in conjunction with existing public and private housing monies to preserve, rehabilitate, and build housing for New York's low- and moderate-income population.

The \$200 million dollar Trust Fund (the equivalent of only 1.5% of the City's annual operating budget) would be comprised of the broadest possible range of housing and housing-related revenue sources, including, but by no means limited to, the

developer contributions discussed under the Inclusionary Zoning mechanisms. The following itemized listing of potential Housing Trust Fund revenue sources illustrates the type and magnitude of income that could be generated on an annual basis for low- and moderate-income housing. It is by no means exhaustive and may be revised and/or expanded as broader public discussion is focused upon it.

The urgency of the housing crisis in New York dictates a solution on the order of magnitude we have proposed. A \$200 million dollar trust fund coupled with federal CDBG and other housing funds would total about \$400 million. This, if leveraged one to one, would generate another \$400 million yielding 20,000 to 25,000 units of additional housing per year, an absolute minimum for a city such as New York.

Obviously, not every one of these revenue sources is currently in place. Many of them are, but their revenue is not being targeted to the City's housing needs. In both cases, it will require a great deal of hard work and exercise of political will to directly confront the issue of whether this City and State are ready to take the first important step toward establishing a permanent resource for housing, one that will not be dependent upon the shifting winds of political change in Washington. We will probably never have sufficient resources to do without Federal housing aid in one form or another. But, our ability to house our own population should never again be left totally dependent upon Washington's largesse (or lack of it). New York has the potential resources, by virtue of its tremendous economic strength, which is more and more widely recognized every day, to do much more than just wait for a change in the national administration. It will take time and a great deal of cooperative effort between the public and private sectors, but this City can at least begin to regain control over its future development for the benefit of all New Yorkers.

BALANCING HOUSING NEEDS: NEIGHBORHOOD VS. CITYWIDE

As noted at the outset of this proposal, as effective as the Housing Trust Fund might ultimately be, it cannot be expected to meet all the housing needs in a city like New York. Therefore, some mechanism for targeting revenues generated via this Fund must be created. The pattern of neighborhood development suggests the creation of an allocation mechanism with two major focuses: "retention" of funds in areas where new development is taking place, and, therefore, where developer contributions are most likely to originate, and "distribution" of funds to areas where the need for development capital for affordable housing is greatest. In order to assure the most effective and equitable allocation possible, three major goals for distribution of Housing Trust Fund monies must be taken into account:

1. ~~Economic integration of neighborhoods, especially those~~ where new market rate development is taking place.
2. Mitigation of displacement (direct or indirect) caused by redevelopment.
3. Fair geographic distribution among the boroughs, especially where areas of greater need are currently under-served by private and/or public redevelopment efforts.

Therefore, we propose the following:

1. In order to further promote economic integration via the inclusionary zoning requirement, in each instance where a residential developer elects to make a contribution to the Housing Trust Fund (HTF) in lieu of subsidizing dwelling units within his

project, at least 25% of that contribution should be earmarked for the development of affordable housing within that Community District. These funds will remain in escrow with the HTF for at least two years, during which time a proposal for affordable housing development that meets the appropriate requirements of the HTF, and is located within that Community District, will be accepted. If no such proposal(s) come forward during that period of time, these funds will be allocated, along with all other HTF monies, as described in #3 below.

2. In order to mitigate the possible displacement effects of new development on lower-income households, we recommend that CD-eligible areas, Neighborhood Strategy Areas, and Neighborhood Preservation Program areas should retain up to the remaining 75% (in addition to the minimum 25% retention described above) of any developer contributions originating within such areas. Furthermore, in instances where redevelopment projects in non-lower-income areas have caused direct displacement, this same maximum retention formula should be applied. Again, for a period of at least two years, these funds will remain earmarked in an escrow account held by the Housing Trust Fund until such time as an appropriate, affordable housing proposal for a site within that Community District is developed. As in other development areas, however, if no such proposal is brought forth during this two-year period of time, these earmarked funds will revert to the general Housing Trust Fund, to be allocated as described below.

It should be noted here that a form of "retention" is also provided for in one other neighborhood type. That is, in areas

where Special Zoning Districts have been or will be created which mandate contributions to develop and/or preserve affordable housing, the requirement of the inclusionary zoning amendment will be superseded by the Special District regulations which, presumably, more accurately reflect and respond to the housing needs of that particular district in the context of citywide housing needs.

3. Equitable "distribution" of the general Housing Trust Fund monies (which should approach \$200 million annually when fully implemented) may ultimately be of greater importance than the "retention" provisions discussed above, which pertain only to residential project-generated inclusionary contributions amounting to approximately \$15 to \$20 million in any one year. Beyond simple interborough equity, the allocation of funds should take into account specific areas that require preservation and/or redevelopment, giving preference to generally recognized and designated areas of need such as CD-eligible areas, NSAs and NPP Areas. This should not be construed, however, to disallow favorable consideration, on a project-by-project basis, to proposals that benefit low- and moderate-income households, but are located in otherwise ineligible areas. As long as the direct benefit to low- and moderate-income families can be demonstrated, such projects should also be considered eligible along with the geographically targeted proposals referred to above.

In recommending the three-part allocation mechanism described above, we recognize that there are many valid arguments.

for alternative ways to allocate developer contributions, as well as the more general HTF revenues. Some individuals whose judgment we respect, felt that geographic targeting was not necessary either for retention or distribution purposes and might be needlessly divisive as long as HTF monies were monitored closely to assure that the direct beneficiaries were low- and moderate-income households. But after reviewing the goals stated at the beginning of this section, we remain convinced that those areas of the City that have the greatest need and exhibit the greatest amount of physical deterioration and decay require some extraordinary consideration in the framing of this proposal. Although this proposal may have (at least potentially) citywide impact on the shortage of affordable housing, we cannot ignore the demands of those neighborhoods where the poor (who need this housing most urgently) now live. We have been continually impressed over many years with the desire of residents of lower-income areas to hold on to and revitalize their neighborhoods against all adversities, from landlord-abandonment to gentrification and displacement. If the Housing Trust Fund can contribute in any substantive way to creating the permanent, affordable housing that this struggle for neighborhood survival requires, then that is where our priorities must be directed.

ADMINISTERING THE HOUSING TRUST FUND

Although some aspects of this proposal may be controversial, the administrative structure of the HTF, as innocuous as it may sound, will probably prove to be the most divisive, even among those who support the concepts behind Inclusionary Zoning and the Housing Trust Fund. Cynics may suggest that this is related to the fact that administration, in this case, means control over potentially large sums of money. But, money matters aside, there are substantive public policy questions that bear consideration in the creation of any new entity in the context of an existing housing bureaucracy in a city like New York.

Any administrative structure for the Housing Trust Fund in New York City should be capable of meeting the following objectives:

1. Simplicity. Any addition to the City's current procedural and administrative structure should be kept to an absolute minimum.
2. Accountability. The governing body should be accountable to the public, community boards, public officials, and the objectives of the Housing Trust Fund program. Accountability implies that there is access to the program, that the views of interested parties will be heard, and that the governing body can be removed for failure to perform. The administrative structure must also be such that the program is subject to outside audit and monitoring for performance.
3. Legality. The administrative structure must be such that an entity exists which has the authority to receive and

disburse funds from public as well as private sources; to enter into contracts; and to engage in such other activities as may be necessary to carry out the purposes of the program.

4. Independence. An administrative structure should be developed which assures that the operations of the Housing Trust Fund are, to the maximum extent possible, free from direct political control or influence.

5. Qualified. The staff should be qualified to carry out the purposes of the Housing Trust Fund. Such qualifications must include, at a minimum, the technical skills necessary to participate in the housing development industry and the skills required to work with the wide variety of interests involved with and concerned about housing in New York City.

6. Efficiency. The administrative structure should be free from excessive procedural requirements, and avoid adding regulatory layers to the development process. It should be flexible enough to permit response to the development alternatives necessary to achieve the purposes of the program, able to operate quickly and reliably, and free from excessive overhead costs.

Each of these objectives, however, can be achieved in a number of ways that, depending upon your view of the proper role of government, are more or less attractive. Not surprisingly, in our discussions with a wide variety of individuals active in public policy debates in New York City, we found no strong consensus on the "right" way to administer a Housing Trust Fund. In presenting our recommendations on this aspect of the proposal,

therefore, it seems best to simply summarize the results of our deliberations on this issue. This summary, however, includes a strong disclaimer to the effect that we recognize that a number of options exist in this area, and we have eliminated some perfectly legitimate ones for the sake of focusing the discussion on two alternatives which seem to meet the objectives stated above.

Option I - Minimum Structure

1. A Special Purpose Committee should be established by the Board of Estimate to provide oversight and program review for Housing Trust Fund expenditures.

The nine members of the Committee shall be comprised of one representative serving at the pleasure of each member of the Board of Estimate, plus the Commissioner of HPD serving ex officio. At least half the members should represent low- and moderate-income neighborhoods.

2. The Committee would have no staff per se, but Department of City Planning and Office of the Comptroller staff would jointly be responsible for carrying out the administrative tasks required by the Committee.

3. The Committee would be required to issue reports quarterly and to hold public hearings at least once a year concerning the amounts of HTF monies obligated and spent, adherence to HTF program objectives, and the performance of agencies and programs funded.

4. All programmatic functions, including project selection and implementation, should be carried out by HPD with contract

approval (as may be required by local law) of the Board of Estimate.

5. An annual income projection (or revenue budget) for the Housing Trust Fund should be developed by Comptroller's staff for review by the HTF Committee which will identify spending priorities for the coming year based on the City Planning Department staff assessment of low- and moderate-income housing needs (similar to the current HAP requirement). Subsequent reviews of HTF performance will use these documents as basic guidelines for evaluation.

Option II - Maximum Involvement

1. A quasi-public HTF Board should be appointed by the Mayor and the Board of Estimate to serve as the governing body for the Housing Trust Fund.

No more than ten Board members shall be appointed, one by each Board of Estimate member and two by the Mayor with the HPD Commissioner serving ex officio. Each shall be appointed for staggered terms of two years and may be reappointed. The Board shall contain a broad representation of housing interests, both public and private, and shall include no less than one-half of its membership as representatives from low- and moderate-income neighborhoods in New York City.

2. The Board shall retain the right to hire and fire the staff of the Housing Trust Fund.

The minimum size of the staff appropriate for carrying out the responsibilities of the Housing Trust Fund in an efficient and satisfactory manner shall be determined by the HTF Board with

the approval of the Board of Estimate, and shall be funded out of HTF monies.

3. Community Boards shall have an opportunity to participate in the operation of the Housing Trust Fund. All regulations shall be subject to public review and comment before approval by the Board of Estimate. Each Community Board in whose district developer contributions are generated will have an opportunity to review and recommend projects within their District to the HTF, consistent with the local "retention" mechanism described earlier.

4. Priority for the expenditure of HTF monies should be given to projects or programs emphasizing:

- . tenant ownership and management;
- . moderate to substantial rehabilitation rather than new construction;
- . permanent housing rather than temporary shelter;
- . non-profit and neighborhood-based housing developers;
- . capital grants or low interest revolving loans (the repayments of which will accrue to the HTF);
- . reduction of housing production and maintenance and operation costs as opposed to subsidization of individual tenants' rents.

In most cases, existing City, State or Federal housing programs will be utilized to help underwrite specific projects, but a small portion of HTF expenditures should be set aside for pilot projects which will effectively create affordable housing.

5. An annual revenue budget for the Housing Trust Fund shall be

developed by HTF staff based on projections of income from the various HTF income sources (to be provided by the Comptroller's office). An expenditure budget shall then be developed, identifying those programs through which the bulk of HTF monies are projected to be spent.

This expenditure schedule shall be developed by the HTF Board in consultation with the relevant governmental agencies. Each agency will be advised as to what level of funding they may expect from the HTF during that year.

Drawdown of HTF monies will only be made on a project-by-project basis after review by the HTF board at its monthly meeting, to assure compliance with the objectives of the HTF.

The Board shall be involved in project development decisions only in cases where pilot projects are brought directly to the HTF for funding as provided for in #4 above.

HTF staff shall prepare a monthly or quarterly review of agency expenditures of HTF monies to be presented to the HTF Board. The HTF Board will reserve the right to shift funds among programs and possibly among recipient agencies if necessary to achieve annual objectives for meeting low- and moderate-income housing needs.

There are undoubtedly many other more detailed questions of administration that will have to be addressed, if and when a Housing Trust Fund is established. Our intention here, however, is to offer alternative guidelines within which policy and specific administrative procedures can be developed to best achieve the overall goals of the Housing Trust Fund.

SUMMARY OF THE ANALYSIS OF RESIDENTIAL DEVELOPMENT

The estimated impact of the proposed residential inclusionary zoning requirement was calculated for eight different rental buildings (two prototype buildings: one in an R-10 zone and the other in an R-8 zone; and six actual buildings either constructed since 1981 or currently under construction). In the interests of brevity, only the results of the prototype analysis are reported here.*

The results of this analysis are presented in Table 1. The rates of return earned by each of the two prototype properties in the current as-of-right situation and after a Housing Trust Fund contribution are indicated. The assumptions employed in the analysis generally reflect current market norms. Wherever a judgment had to be made, a conservative choice was selected to minimize the risks of the developer. For example, a 5% vacancy rate was used in a housing market where only 2.13% of all occupiable units are empty.

* The results of the two sets of analysis are remarkably similar for the three actual R-10 properties and the prototype R-10 building. However, the rates of return in both the current as-of-right and Housing Trust Fund situations differed substantially for the prototype R-8 building versus the actual R-8 or R-9 buildings examined. These differences appear to be due to the significantly smaller size of the actual R-8/R-9 buildings and the greater design inefficiency of the real buildings. Additional analyses will be undertaken to determine whether the three R-8/R-9 properties examined are representative of properties in these zoning districts.

Very few standards are available to identify an acceptable return on real estate investments, since what is acceptable depends on the unique circumstances of every investor. Some investors--primarily pension funds--are interested solely in the pre-tax returns because they pay no taxes. Other investors, with substantial outside earnings, are primarily interested in the tax shelter benefits of real estate investment. Although it is hard to pin down precise benchmarks, it appears that pre-tax internal rates of return* of 12% to 15% are considered acceptable, if not good, returns in today's market.

It is even more difficult to specify acceptable after-tax returns because the widespread syndication of equity in properties has inflated property values and after-tax returns. This analysis assumes that syndication of the properties will not occur. The after-tax internal rates of return would be substantially higher if the properties were syndicated.

As indicated in Table 1, the R-10 building has a very desirable rate of return in both the pre-tax and after-tax situation, while the R-8 building has an acceptable rate of return in both situations. The greater efficiency of the design in the R-10 building accounts for the greater earnings on the investment.

* A measure of the return on equity which accounts for the effect of inflation on the costs and earnings of the property during the period when it is owned.

DRAFT 12/12/83

Requiring a contribution of \$6.00 per net rentable square foot obviously reduces the return earned by the developer, in this case, by approximately two percentage points in both R-10 and R-8 zones. After paying the contribution, the return for the R-10 building is still very good, while that for the R-8 property is just acceptable. Instead of accepting lower rates of return, developers may opt to retain the current as-of-right rate of return by raising rents. In the R-10 zone, rent increases of between 2.5% and 4.2% (\$55-\$90 on a unit renting for \$2,130/month in the current as-of-right situation) would be needed, while the required rent increase for the R-8 building might be even higher (1.6%-6.1%).* Rent increases of the magnitude estimated for the high end of the R-8 increase may be difficult to obtain.

This analysis suggests that the Housing Trust Fund contribution should not adversely affect development in R-10 zones--the effect on the internal rates of return does not significantly reduce development incentives and the rents required to avoid a reduction in the rate of return do not seem unattainable.

The impact of the contribution in the R-8 zone is more substantial, since the contribution of \$6.00 per net rentable square foot reduces the internal rate of return to a marginally acceptable level. Because a uniform contribution for all buildings, regardless of size, may adversely affect smaller-scale projects, development of a contribution system scaled to the size or cost of a building is being investigated.

* A range of rent increases is given because different methods employed to calculate the increases produce different results.

Description of Analysis of Residential Development

A. Data Sources

1. Land Costs - Real Estate Board of New York Report
2. Construction Costs (Hard and Soft) - Real Estate Board of New York Report
3. Assessed Value - Estimated at 45% of total development costs
4. Operating Costs - Real Estate Board of New York Report
5. Rental Income - Real Estate Board of New York Report

B. Assumptions

1. Vacancy Rate - 5% annually
2. Financing
 - Based on types of financing currently available, these assumptions were made:
 - term - 25 years
 - type - callable in 10th year (balloon loan)
 - interest rate - 13.5% (.1399 constant)
 - amount financed - 75% of total development cost; this is a conservative assumption since the permanent loan amount usually exceeds 75% of the total development cost.
3. Capital Improvement
 - None in first year of operation
 - 1% of development costs (hard and soft), excluding land assumed in Year 2
 - 5% annual increase assumed for Years 3 through 10
4. Depreciation - ACRS schedule used

(continued)

Description of Analysis of Residential Development, cont'd

C. Rates of Return Used

1. Return on Equity (R on E)

pre-tax - cash flow after paying all expenses except income tax divided by equity in project;

after tax - pre-tax cash flow plus tax benefits (or minus tax liability) divided by equity.

2. Internal Rate of Return

pre-tax - calculated at end of tenth year of operation;

- includes yearly cash flows plus property sale proceeds minus the remaining mortgage balance, transaction costs and New York State Capital Gains Tax.

after tax - calculated at end of tenth year of operation;

- includes yearly cash flows plus property sale proceeds minus the remaining mortgage balance, transaction costs, recapture of excess depreciation and New York State capital gains tax, and U.S. capital gains tax.

D. Housing Trust Fund Contribution

A developer of market rate housing would be required to set aside 10% of the units in a project as affordable housing, with their rents not exceeding the Section 8 Existing Fair Market Rents for units of comparable sizes. In lieu of this on-site provision, a developer would be required to contribute \$6.00 to the Housing Trust Fund for every net rentable square foot of market rate housing built. The first ten units (10,000 net rentable square feet) are excluded in calculation of the contribution.

The impact of this contribution is calculated employing a conservative methodology. The entire contribution is treated as an addition to the equity required for the project and to the project's depreciable basis. A smaller impact would result if contribution were added to the total project development cost for the purposes of determining the amount to be financed. In this situation, only 25% of the contribution would be added to the developer's equity.

Description of Analysis of Residential Development, cont'd

5. Investor Tax Bracket - 50% ordinary income
- 20% capital gain
6. Inflation
- rental income - 5% annual increase over initial year income;
- in addition, 421(a) regulations permit an annual rent increase not to exceed 2.2% over the initial monthly rental. This annual increase is based solely on the base rents and is not compounded annually, resulting in a constant increase each year.
- operating costs - 6% annual increase
- real estate taxes - differences between full assessed value and base assessed value phased-in according to 421(a) guidelines;
- 5% annual increase in assessed value, with increases phased in over 5 year period;
- current tax rate of 9.057% for multi-family buildings used.
7. Holding Period - property sold at end of tenth year;
- sale price determined by capitalizing 11th year net operating income using a 12% cap rate.
8. State of New York Capital Gains Tax - 10% of the difference between the project development costs and sale price estimated at the end of the holding period.

(continued)

Table 1: Effects of Developer Contributions on Prototype Residential Building Rates of Return

	<u>R-10 Building</u>	<u>R-8 Building</u>
AS OF RIGHT		
<u>Pre-tax</u>		
Return on Equity	10.76%	7.65%
Internal Rate of Return	18.63%	14.42%
<u>After-Tax</u>		
Return on Equity	23.98%	22.43%
Internal Rate of Return	20.14%	17.09%
 TRUST FUND CONTRIBUTION OF \$6.00/N.R.S.F.		
<u>Pre-Tax</u>		
Return on Equity	9.38%	6.78%
Internal Rate of Return	16.38%	12.64%
<u>After-Tax</u>		
Return on Equity	21.69%	20.55%
Internal Rate of Return	17.73%	15.10%
 Total Contribution to Housing Trust Fund	 \$1,164,000	 \$517,920
Number of units renovated at \$20,000 per unit	58.2	25.90
Number of units renovated at \$40,000 per unit	29.1	12.95
Rent Increase Needed to Maintain Same IRR		
- Dollars/Month	\$55-\$90*	\$32-\$130
- % Increase	2.58-4.28	1.68-6.18

* A range of rent increases is given because different methods employed to calculate the increases produce different results.

Table 2: Description of Prototype Residential Buildings

	<u>R-10 Building</u>	<u>R-8 Building</u>
Land Area	20,000 S.F.	20,000 S.F.
Floor Area Ratio	12 (assumes 2 F.A.R. bonus)	6.02
Gross Square Feet (GSF)	240,000	120,400
Net Rentable Square Feet (NRSF)	204,000	96,320
Rates NRSF/GSF	85%	80%
Total Development Cost	\$31,824,000	\$15,965,040
Amount Financed	\$23,868,000	\$11,973,780
NRSF per unit	1,000	1,000
Number of units	204	96
Monthly Rent/NRSF	\$2.13	\$2.13
Rent for a 2BDR unit	\$2,130	\$2,130

SUMMARY OF ANALYSIS OF COMMERCIAL DEVELOPMENT

In order to calculate the effect of the proposed developer contribution requirements on commercial projects, a total of ten buildings were analyzed. Eight of these were actually built and occupied or under construction during the last 2-4 years. The remaining two are prototypical buildings based on current market data obtained from a leading New York commercial brokerage firm. While the conclusions based on these analyses are similar for both real and hypothetical buildings (although rates of return vary significantly), we have presented the results only for the prototypical buildings in the attached tables. These buildings more accurately reflect current market conditions which, insofar as our proposal pertains only to new office space, is the context in which the impact of the contribution requirement can be most accurately judged.

The results of these analyses are presented in Table 1. Rates of return attainable under both the current as-of-right situation and under the Trust Fund contribution requirement are indicated for both a midtown and downtown office development. Pre-tax internal rates of return drop only slightly (by only two- or three-tenths of one percent) when a Housing Trust Fund contribution of \$6.00 for each net rentable square foot over 100,000 square feet assumed. Likewise, after-tax internal rates of return are affected only slightly by the contribution requirement (dropping by approximately one percent in both cases). Clearly, when dealing with internal rates of return of this magnitude (28% to 33%), the prospect of reducing these returns by only a

DRAFT 12/12/83

fraction of a percent or even a full percent should not significantly lessen the appeal of the investment to a developer. Furthermore, our analyses indicate that a developer wishing to maintain the maximum return projected under current as-of-right conditions could do so by simply increasing rents to commercial tenants \$.74 to \$1.08 per net rentable square foot. In today's office market these increases should be readily absorbed since current asking rents for new space are about \$45 per net rentable square foot in downtown and \$50 in midtown. In context then, the rent increases that would be needed to protect a developer's as-of-right rate of return would be only 1.56% to 2.40%.

While our hypothetical buildings are both fairly large commercial structures (1,000,000 gross square feet in midtown and 450,000 in downtown), our analyses of actual buildings with a variety of sizes indicate that rates of return for smaller buildings may be more adversely affected. Therefore, we have proposed to exempt the first 100,000 net rentable square feet of commercial development from the contribution requirement. Further analyses will be undertaken to determine whether a sliding scale or percentage based contribution formula might be necessary to achieve greater equality of treatment for different size developments.

These analyses conducted to date, however, suggest that the developer contribution we propose, \$6.00 per net rentable square foot of new office space (exempting the first 100,000 square feet developer), should not adversely affect office development in today's market.

Description of Analysis of Commercial Development

A. Data Sources

1. Land Costs - Leading New York City Brokerage Firm
2. Construction Costs (Hard and Soft) - Leading New York City Brokerage Firm
3. Assessed Value - Leading New York City Brokerage Firm
4. Operating Costs - Leading New York City Brokerage Firm
5. Rental Income - Leading New York City Brokerage Firm

B. Assumptions

1. Vacancy Rate - 5% annually
2. Financing - Based on types of financing currently available, these assumptions were made:
 - term - 25 years
 - type - callable in 10th year (balloon loan)
 - interest rate - 14.0%
 - amount financed - 75% of total development cost; this is a conservative assumption since the permanent loan amount usually exceeds 75% of the total development cost.
3. Depreciation - straight line, 15 year schedule
4. Investor Tax Bracket - 50% ordinary income
- 20% capital gain

Description of Analysis Commercial Development, cont'd

5. Inflation

- rental income - 5% annual increase over initial year income;
- operating costs - 6% annual increase
- real estate taxes - the assessed value was calculated at 45% of the total development costs;
- current tax rate of 9.323% for commercial buildings used.

6. Holding Period

- property sold at end of tenth year;
- sale price determined by capitalizing 11th year net operating income using a 12% cap rate.

7. State Capital Gains Tax

- 10% of the difference between the resale price and the project's total development costs.

C. Rates of Return Used

1. Return on Equity (R on E)

- pre-tax - cash flow after paying all expenses except income tax divided by equity in project;
- after tax - pre-tax cash flow plus tax benefits (or minus tax liability) divided by equity.

2. Internal Rate of Return

- pre-tax - calculated at end of tenth year of operation;
- includes yearly cash flows plus property sale proceeds minus the remaining mortgage balance, transaction costs and New York State Capital Gains Tax.

Description of Analysis of Commercial Development, con't

after tax

- calculated at end of tenth year of operation;
- includes yearly cash flows plus property sale proceeds minus the remaining mortgage balance, transaction costs, recapture of excess depreciation and New York State capital gains tax, and U.S. capital gains tax.

D. Housing Trust Fund Contribution

A developer would be required to contribute \$6.00 per net rentable square foot to the Housing Trust Fund. The first 100,000 net rentable square feet are exempted from calculation of the contribution.

The impact of the contribution was estimated employing slightly less conservative methodology than was used in the analysis of residential development. Twenty-five percent of the contribution was treated as an addition to the equity required for the project, while 75% of the contribution was assumed to be financed. The impact would be somewhat greater if the contribution were added entirely to the required equity as was done in the residential analysis.

Table 1: Effects of Developer Contributions on Prototype Commercial Building Rates of Return

	<u>Midtown Building</u>	<u>Downtown Building</u>
CURRENT AS OF RIGHT		
<u>Pre-tax</u>		
Return on Equity	14.57%	13.12%
Internal Rate of Return	33.19%	32.19%
<u>After-Tax</u>		
Return on Equity	15.87%	16.83%
Internal Rate of Return	28.88%	29.41%
TRUST FUND CONTRIBUTION OF \$6.00/N.R.S.F.		
<u>Pre-Tax</u>		
Return on Equity	13.21%	11.63%
Internal Rate of Return	31.98%	30.86%
<u>After-Tax</u>		
Return on Equity	14.97%	15.80%
Internal Rate of Return	27.92%	28.33%
Total Contribution to Housing Trust Fund	\$4,800,000	\$3,900,000
Number of units renovated at \$20,000 per unit	240	195
Number of units renovated at \$40,000 per unit	120	97.5
Rent Increase Needed to Maintain Same IRR		
- Dollars/Month	\$.78-\$1.08/WRSP*	\$.74-\$1.08/WRSP
- % Increase	1.56%-2.16%	1.64%-2.40%

* A range of rent increases is given because different methods employed to calculate the increases produce different results.

Table 2: Description of Prototype Commercial Development

	<u>Midtown Building</u>	<u>Downtown Building</u>
Lot Size		
Floor Area Ratio		
Gross Square Feet (GSF)	1,000,000	850,000
Net Rentable Square Feet (NRSF)	900,000	765,000
Total Development Cost	\$200,000,000	\$148,750,000
Amount Financed	\$150,000,000	\$111,562,500