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Creating Affordable Housing Out of Thin Air:

The Economics of Mandatory Inclusionary Zoning in New York City

April 2, 2015 | NYU Furman Center

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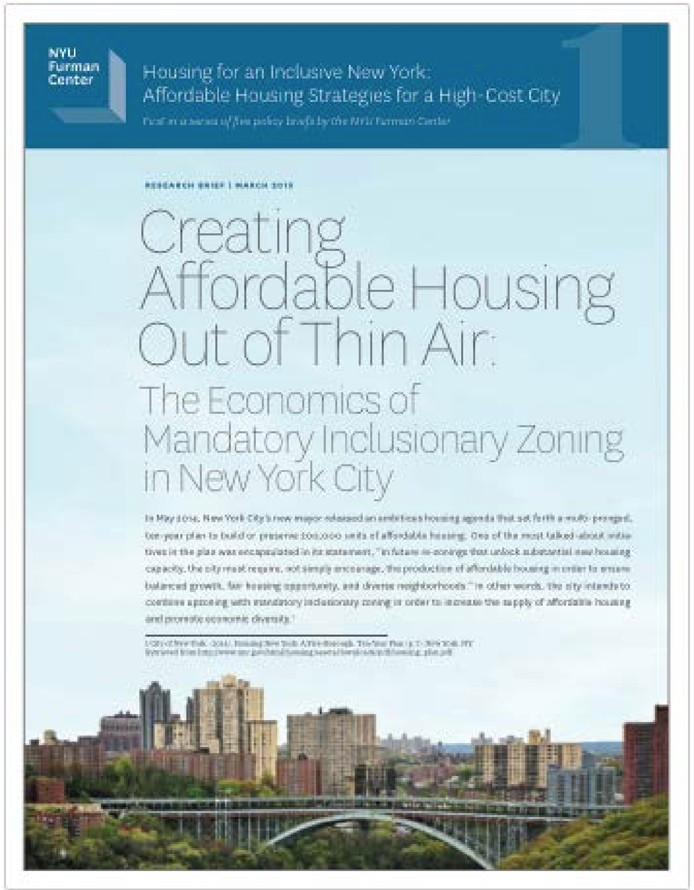
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Housing for an Inclusive New York: Affordable Housing Strategies for a High-Cost City

RESEARCH BRIEF | MARCH 2015

Creating Affordable Housing Out of Thin Air:

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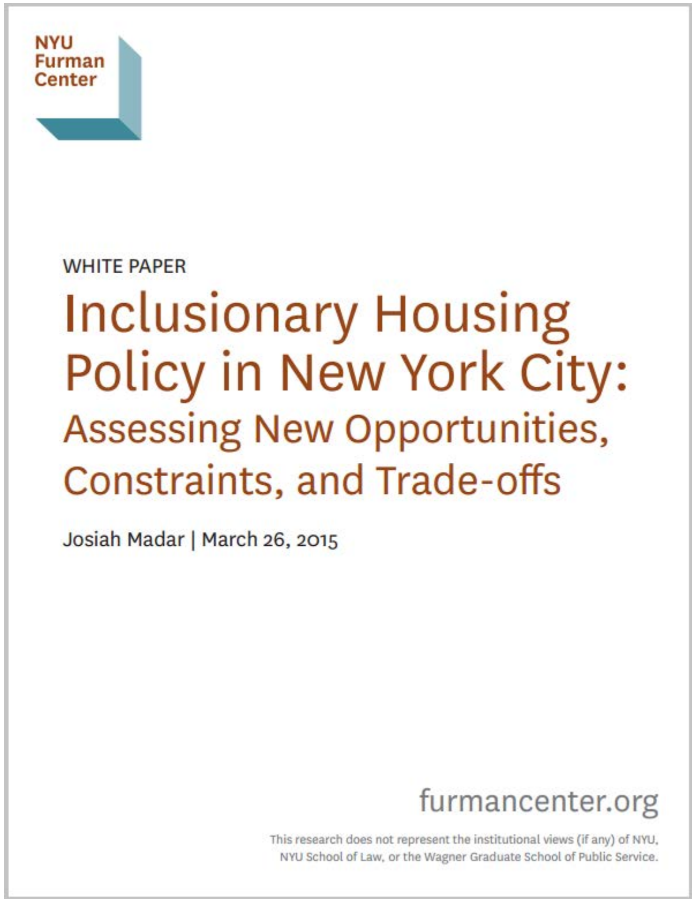
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WHITE PAPER

Inclusionary Housing Policy in New York City:

Assessing New Opportunities, Constraints, and Trade-offs

Josiah Madar | March 26, 2015

furmancenter.org

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TODAY'S PRESENTER

Josiah Madar

Research Affiliate
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AGENDA

- Goal of our analysis and preview of findings
- Background
- Methodology
- Findings
- Conclusions
- Q&A

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GOALS OF ANALYSIS

- In light of city's 2014 housing plan, analyze economic potential of added zoning density to generate affordable housing
- Economic analysis only; there are also legal constraints, which we do not address
- City also has significant planning concerns (e.g., infrastructure capacity)

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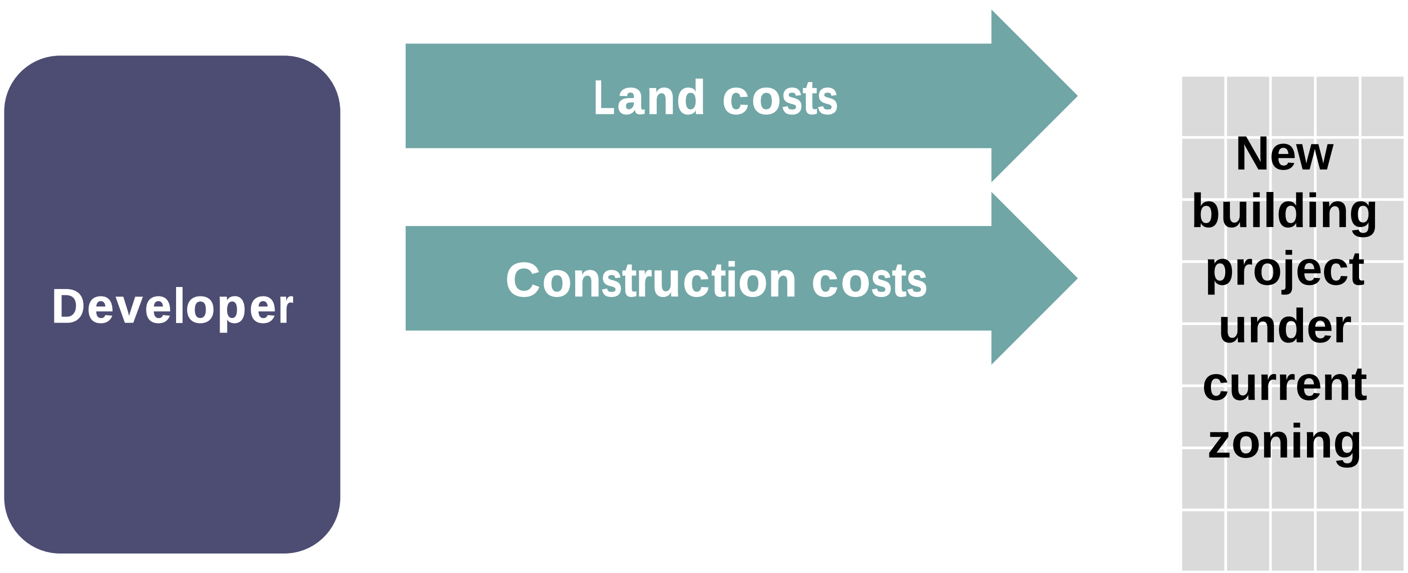
PREVIEW OF FINDINGS

1. In high-rent neighborhoods, additional zoning density is valuable enough to generate affordable units.
2. In lower rent neighborhoods, additional zoning density will not generate affordable units (without subsidy).
3. The economics of mandatory inclusionary zoning will change as rents, operating costs, and construction costs shift over time.
4. A program can use the cross subsidy generated by additional density in different ways.

BACKGROUND

- What is “mandatory inclusionary zoning”?
- How does it work?



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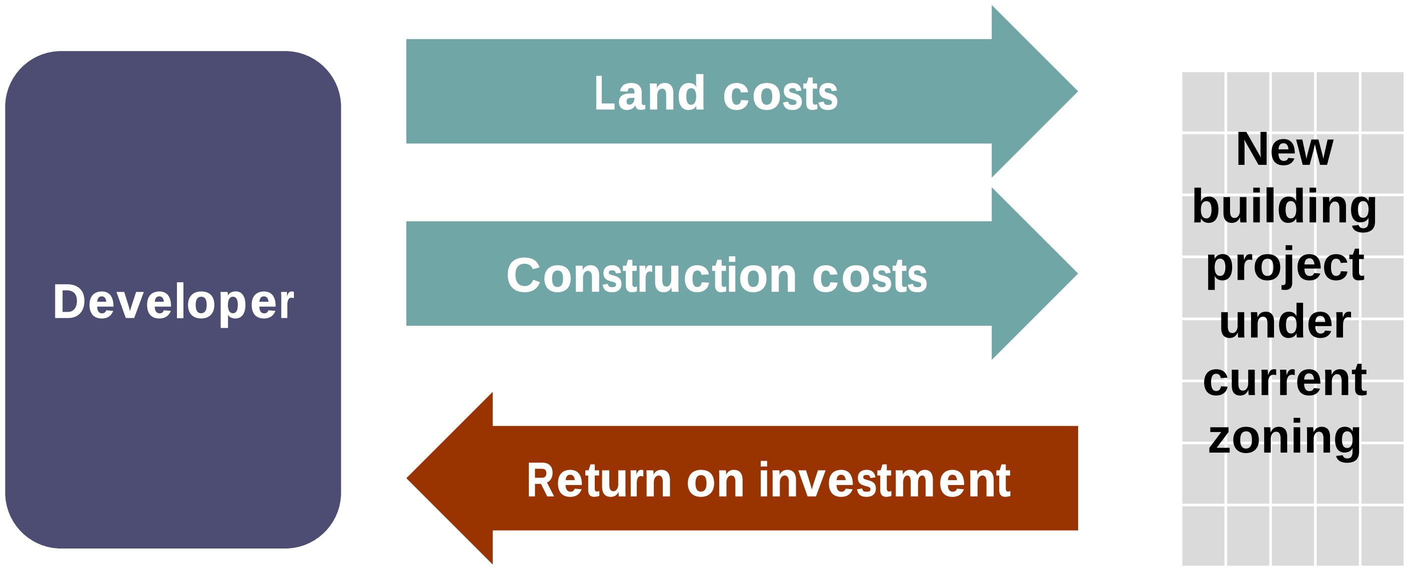

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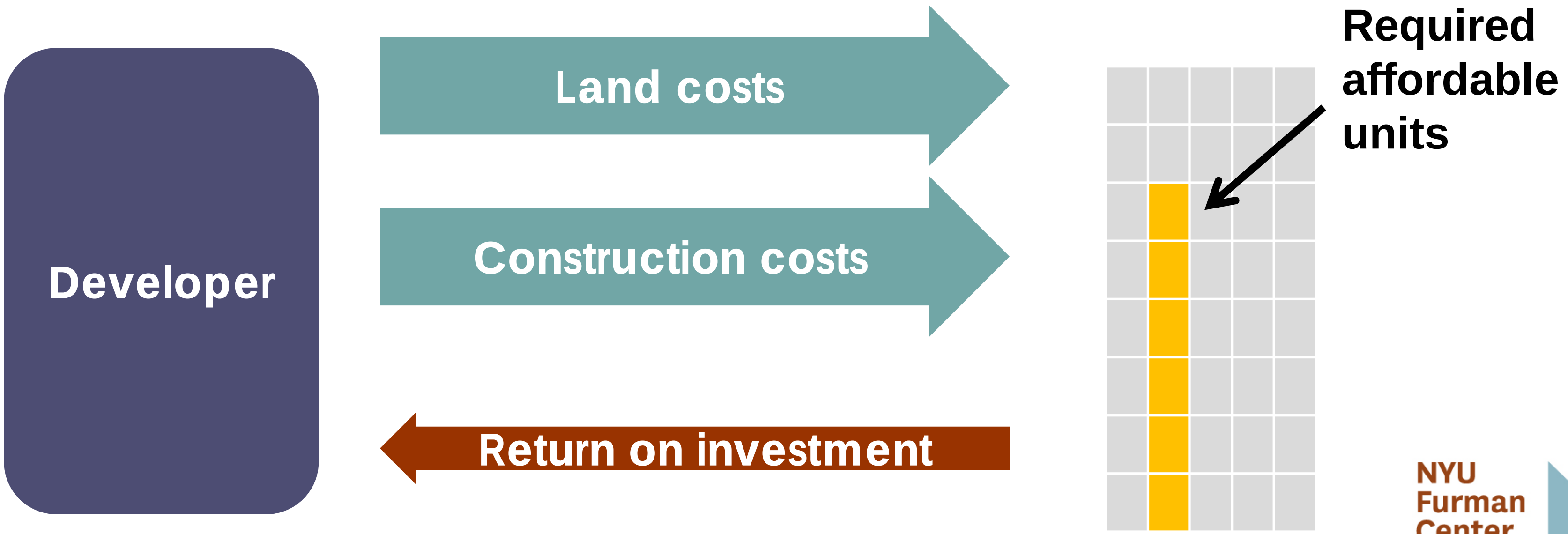

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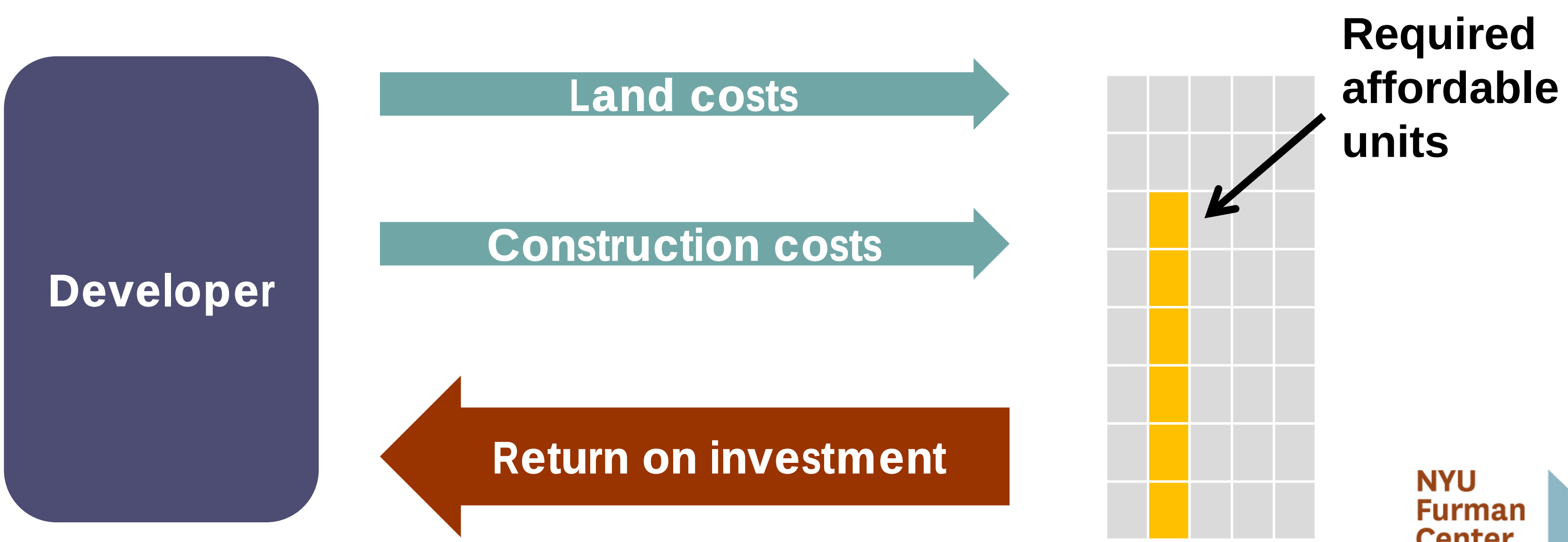

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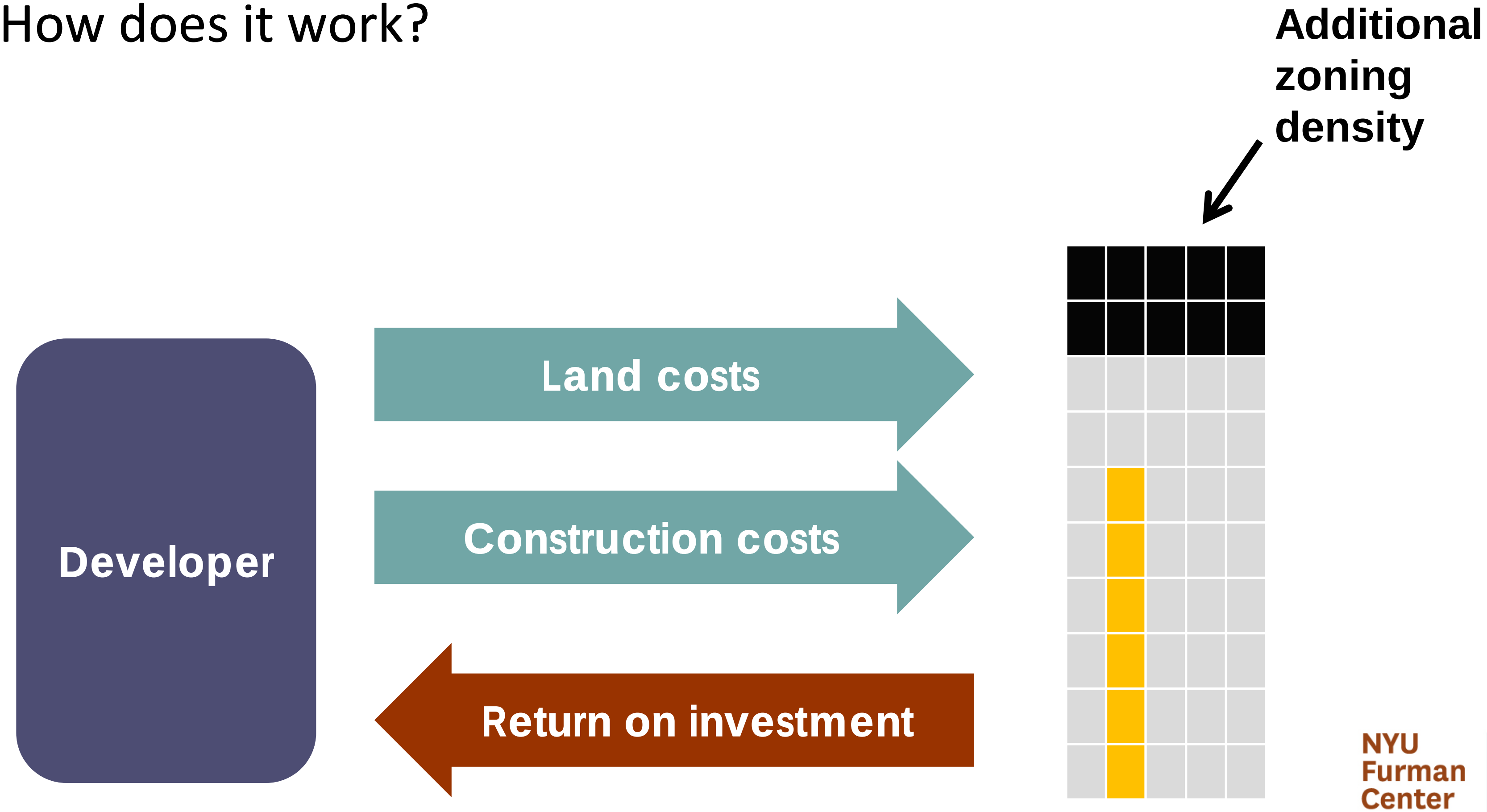

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Existing Policies

- City has already begun requiring affordable housing for some **discretionary** zoning changes
- City already has **voluntary** inclusionary zoning program that applies to some as-of-right projects: the “Inclusionary Housing Program”
- Also relevant: 421-a property tax exemption
  - 20% affordable required in “Geographic Exclusion Area” (GEA)
  - Effect on value of additional density (as we will see)

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METHODOLOGY

- Financial analysis of mid-rise and high-rise **rental** projects, varying by:
  - Market rent
  - Building type
  - Affordable share
  - Affordability level
  - Property tax exemption
- Similar analysis to what developers use; relies on assumptions about:
  - Construction costs
  - Operating costs
  - Market rents
  - Minimum financial returns required by developers
- NOTE: financial analysis results are approximations, not meant to be point estimates; conveys order of magnitude.

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METHODOLOGY

- For developer financial return, we use "stabilized net operating income yield" (NOI yield)

$$= \frac{\text{net operating income}}{\text{total development costs}} = \frac{\text{rental revenue} - \text{operating costs}}{\text{land costs} + \text{construction costs}}$$

- Requiring more affordable units reduces rental revenue and NOI yield
- Allowing more density can increase NOI yield if rents are high enough

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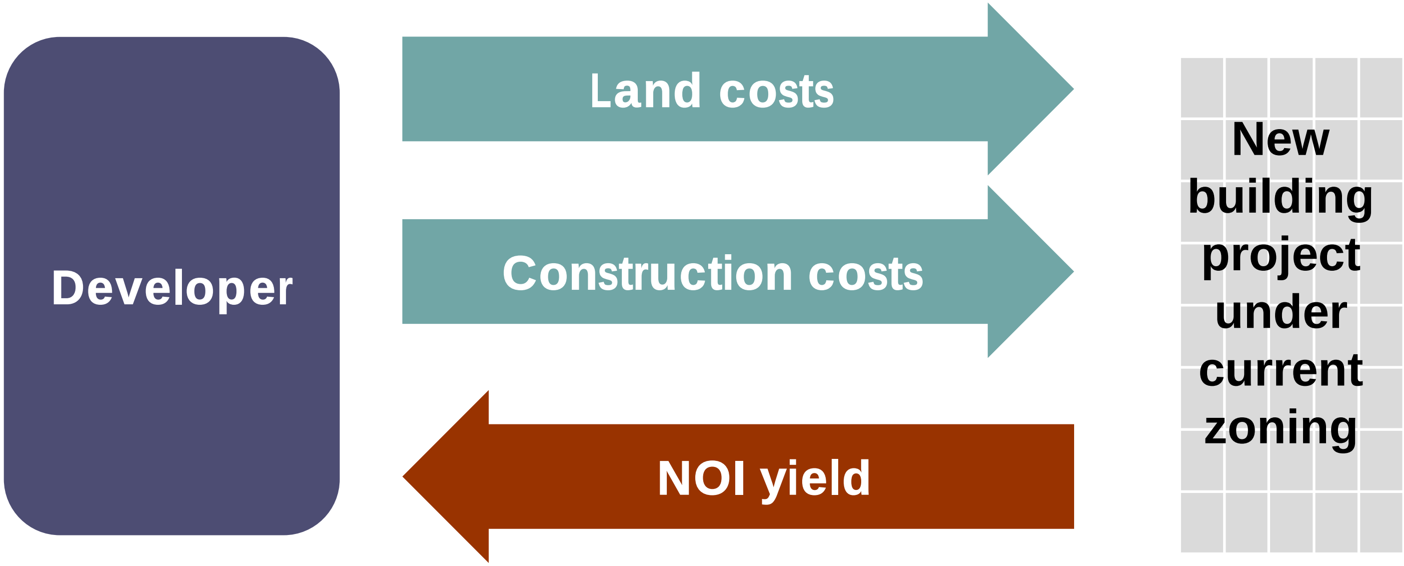
METHODOLOGY



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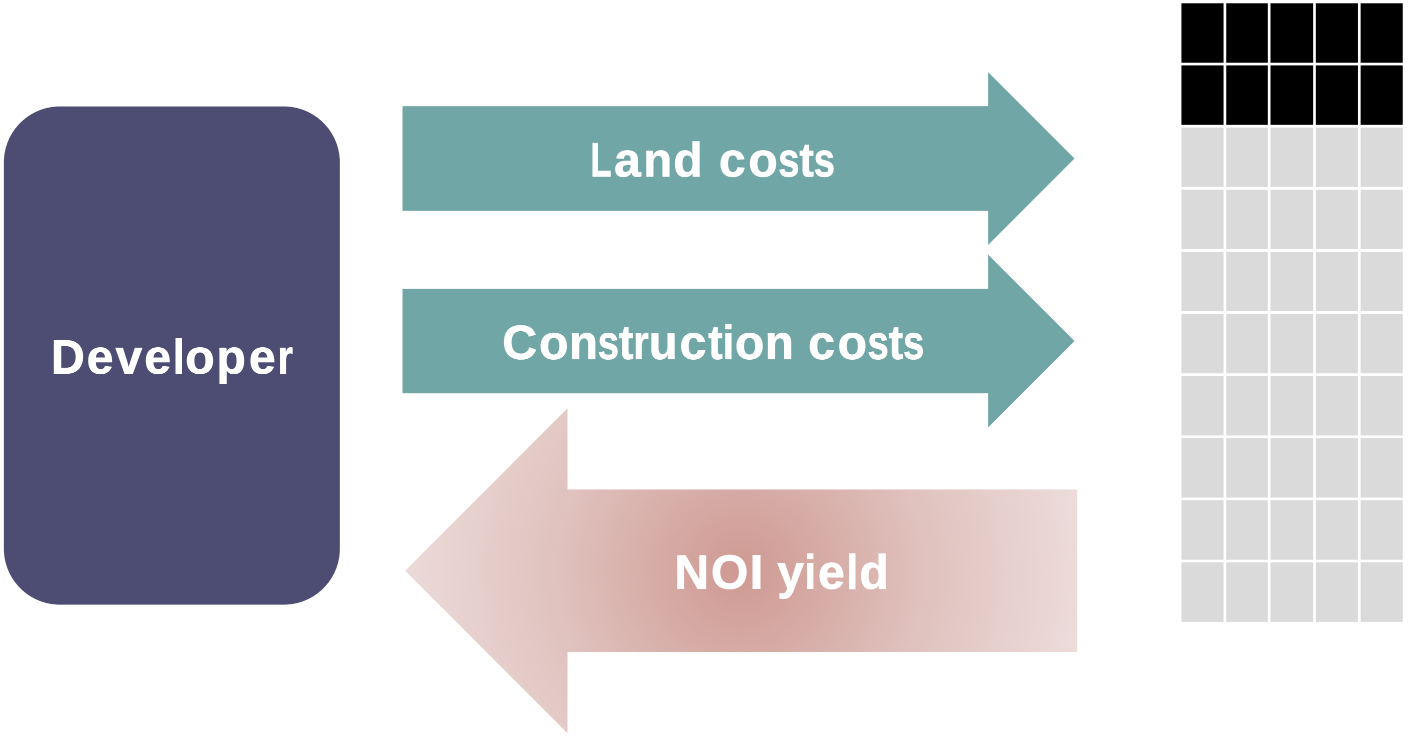

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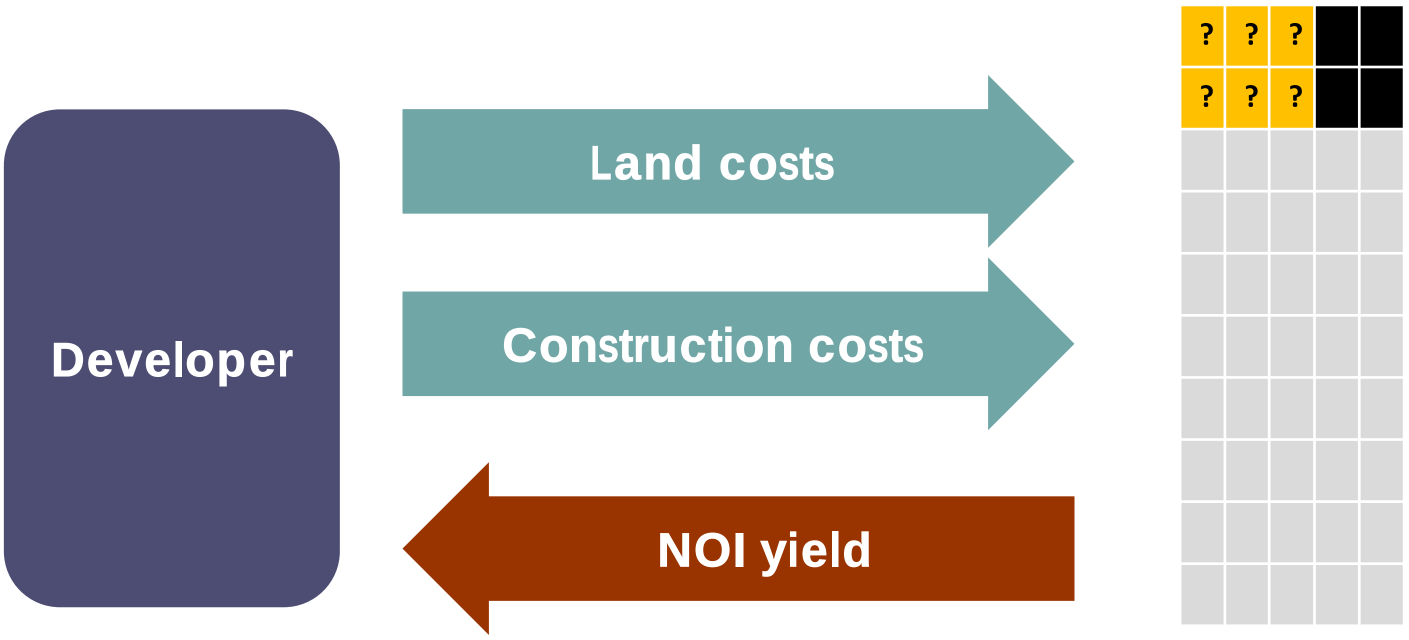
METHODOLOGY



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FINDINGS

1. In high-rent neighborhoods, additional zoning density is valuable enough to generate affordable units.

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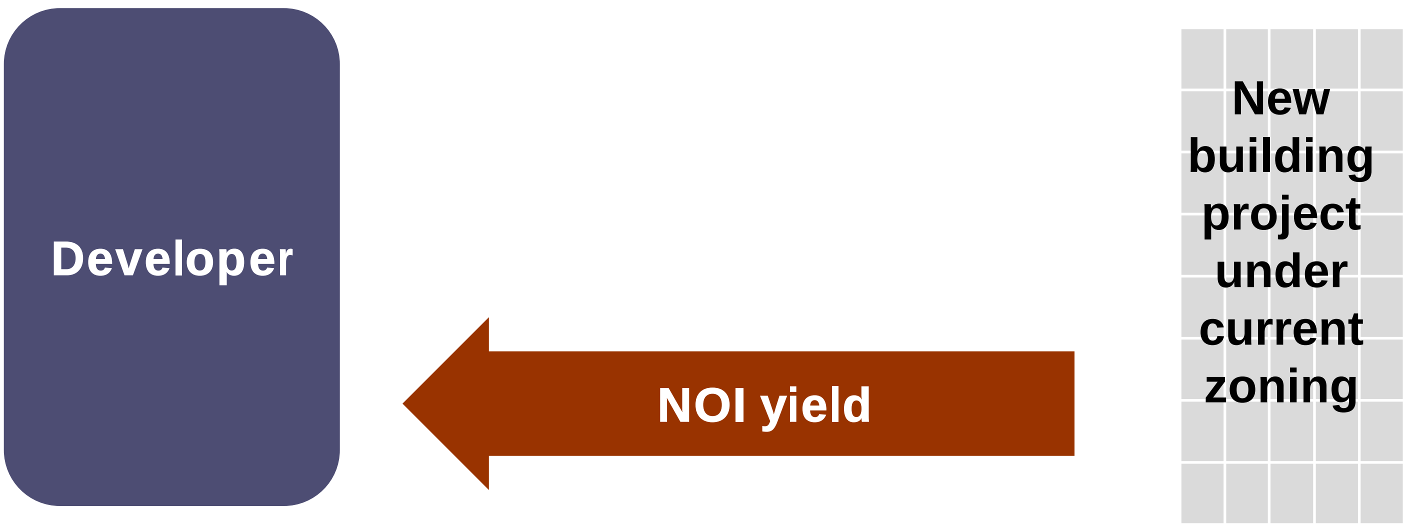
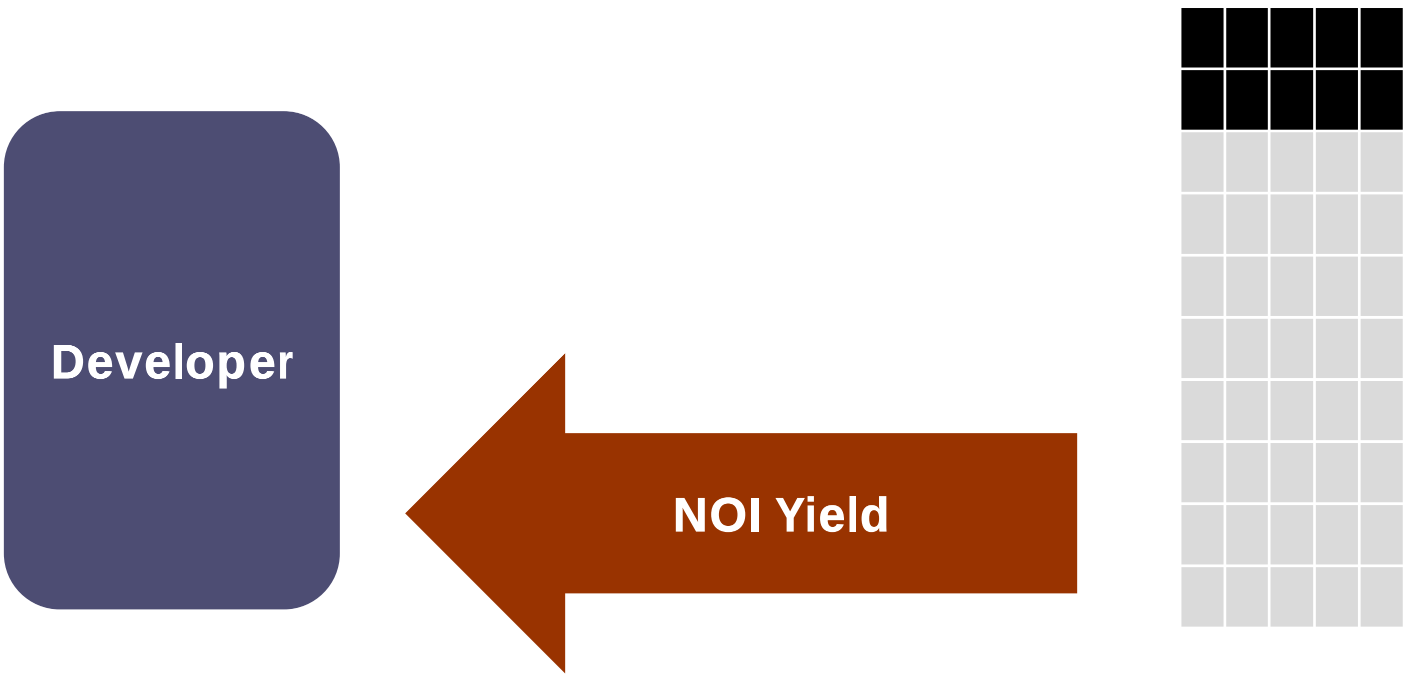
FINDINGS

In High-Rent Neighborhoods



In High-Rent Neighborhoods

- Where rents are high enough, additional market rate units will increase NOI yield: **Opportunity for cross-subsidy**



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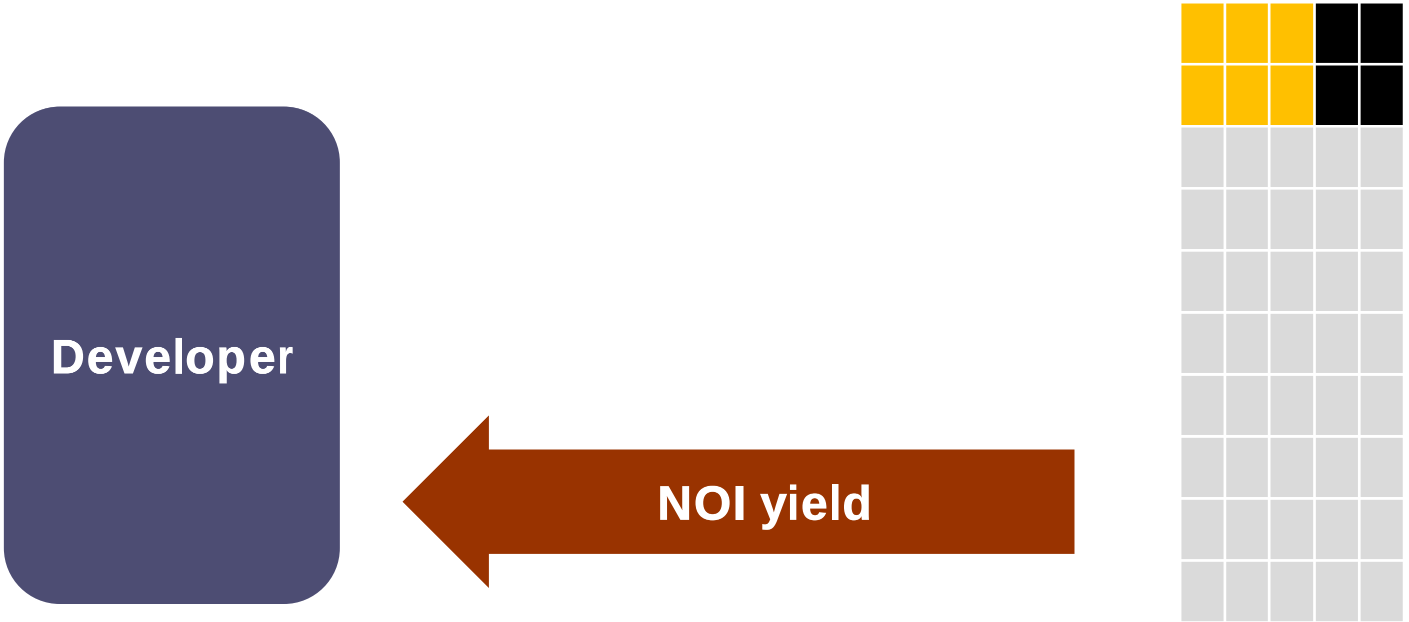

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In High-Rent Neighborhoods

Construction Type	Market Type	Annual Gross Rent	Example Neighborhood(s)
High-rise	Very Strong, inside the GEA	$80 per rentable sf (1BR: $4,800/mo)*	Manhattan Core
High-rise	Strong, inside the GEA	$60 per rentable sf (1BR: $3,500/mo)*	Downtown Brooklyn
Mid-rise	Strong, inside the GEA	$60 per rentable sf (1BR: $3,600/mo)*	Williamsburg Upland
Mid-rise	Moderate, inside the GEA	$44 per rentable sf (1BR: $2,600/mo)*	Astoria
Mid-rise	Moderate-low, inside the GEA	$37 per rentable sf (1BR: $2,200/mo)*	Bedford-Stuyvesant (inside the GEA)
Mid-rise	Moderate-low, outside the GEA	$37 per rentable sf (1BR: $2,200/mo)*	Bedford-Stuyvesant, Flushing, other relatively strong markets outside the GEA

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FINDINGS

In High-Rent Neighborhoods

- High rise in **very strong market**

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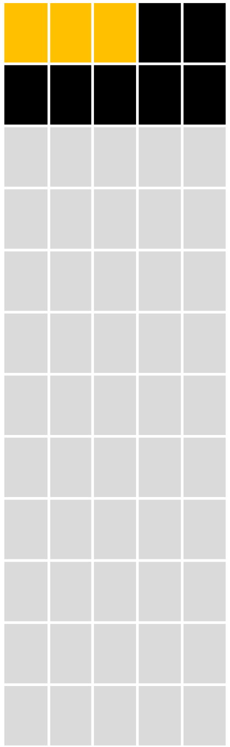
In High-Rent Neighborhoods

- High rise in **very strong market**
- If additional density pays **full property taxes**, we estimate that additional density can be **28% affordable** (at 60% AMI) without affecting the economics of the development.



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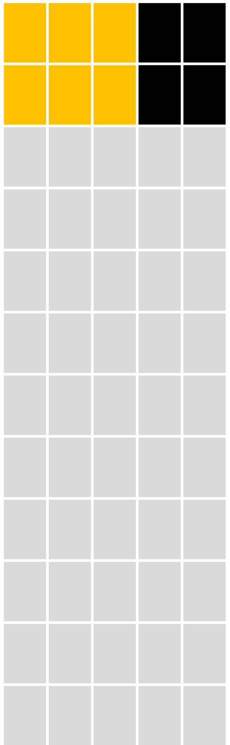
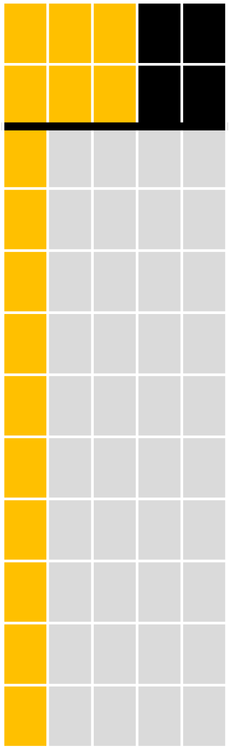


In High-Rent Neighborhoods

- High rise in **very strong market**
- If additional density pays **no property taxes**, we estimate that additional density can be **61% affordable** (at 60% AMI) without affecting the economics of the development.
- Inside the GEA, so 20% baseline affordability requirement applied even under old zoning



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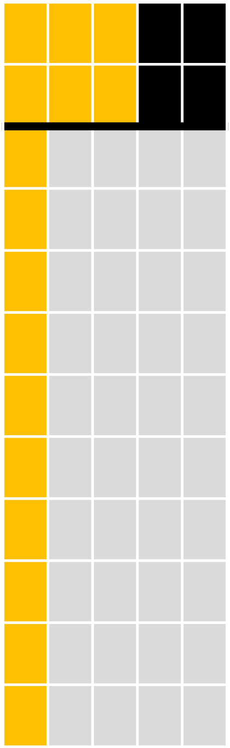
- Share of whole building that can be affordable depends also on extent of upzoning



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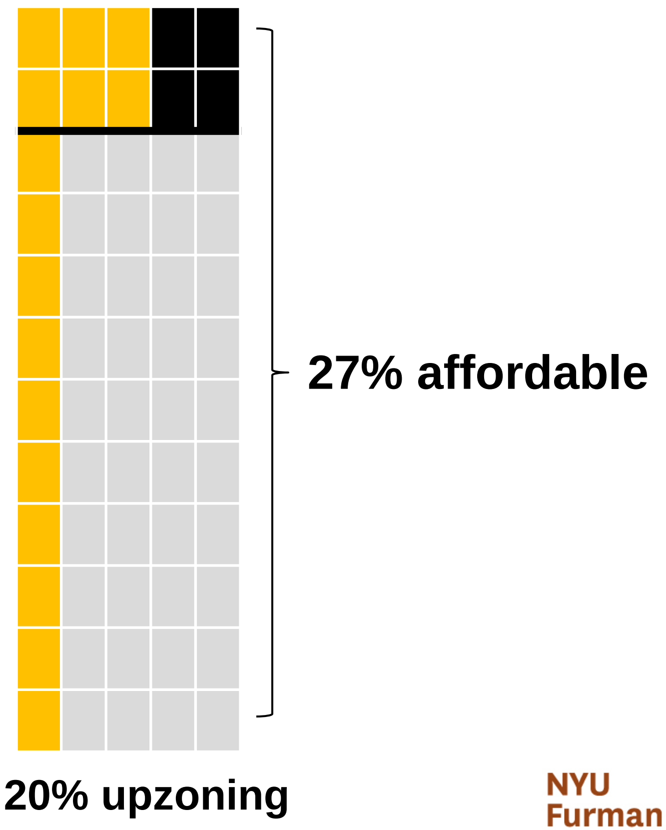

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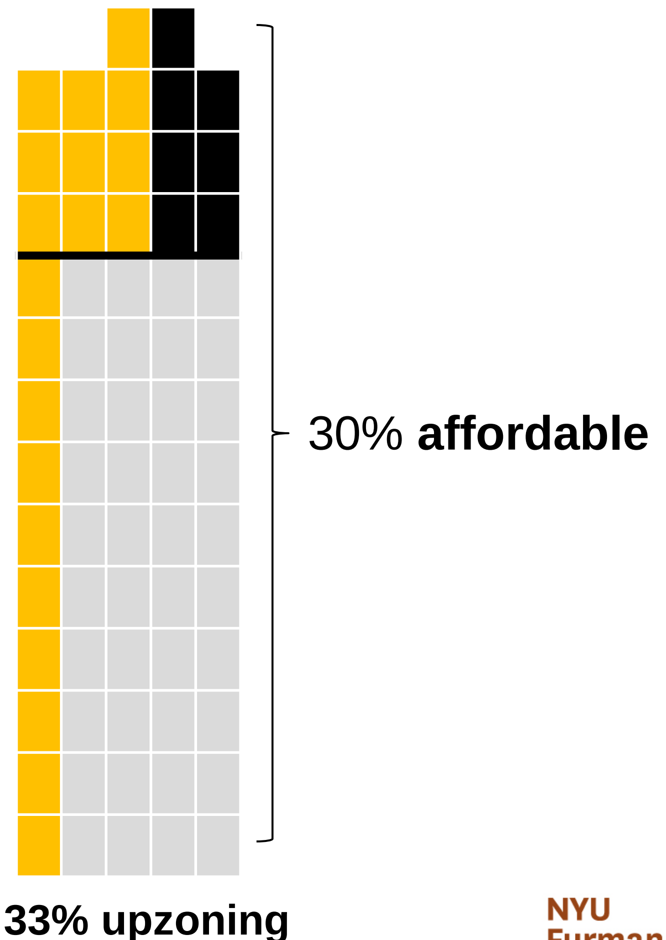

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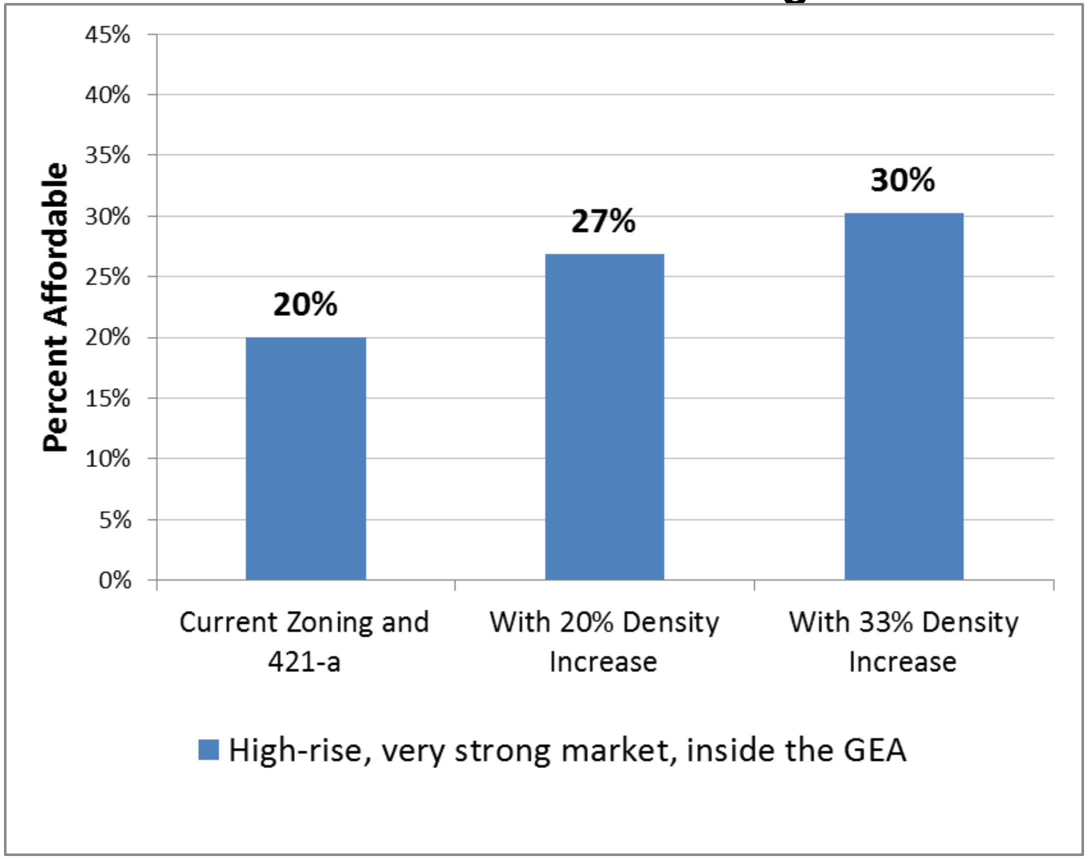
In High-Rent Neighborhoods

Affordable share* of entire building



*Affordable at 60% of AMI

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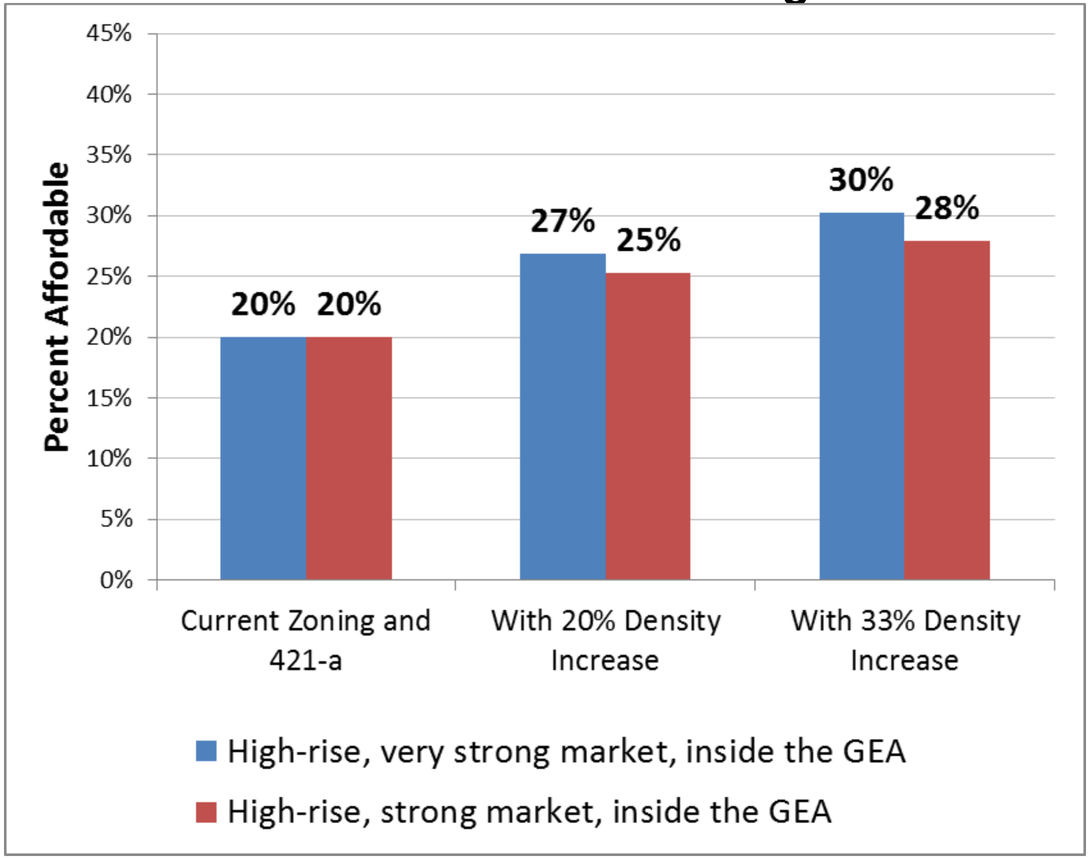
In High-Rent Neighborhoods

Affordable share* of entire building



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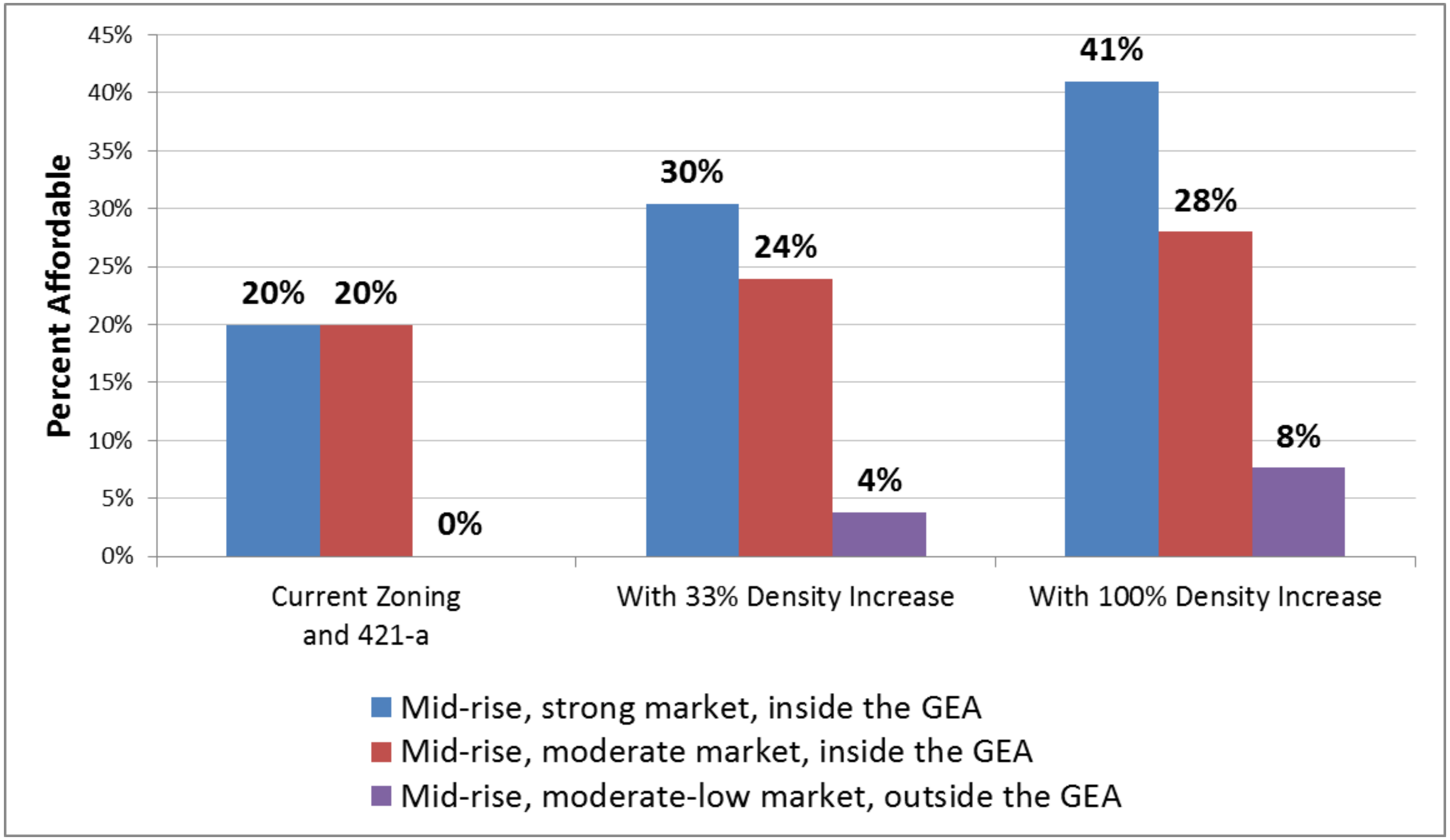

*Affordable at 60% of AMI

FINDINGS

1. In high-rent neighborhoods, additional zoning density is valuable enough to generate affordable units.
2. In lower-rent neighborhoods, additional zoning density will not generate affordable units (without subsidy).

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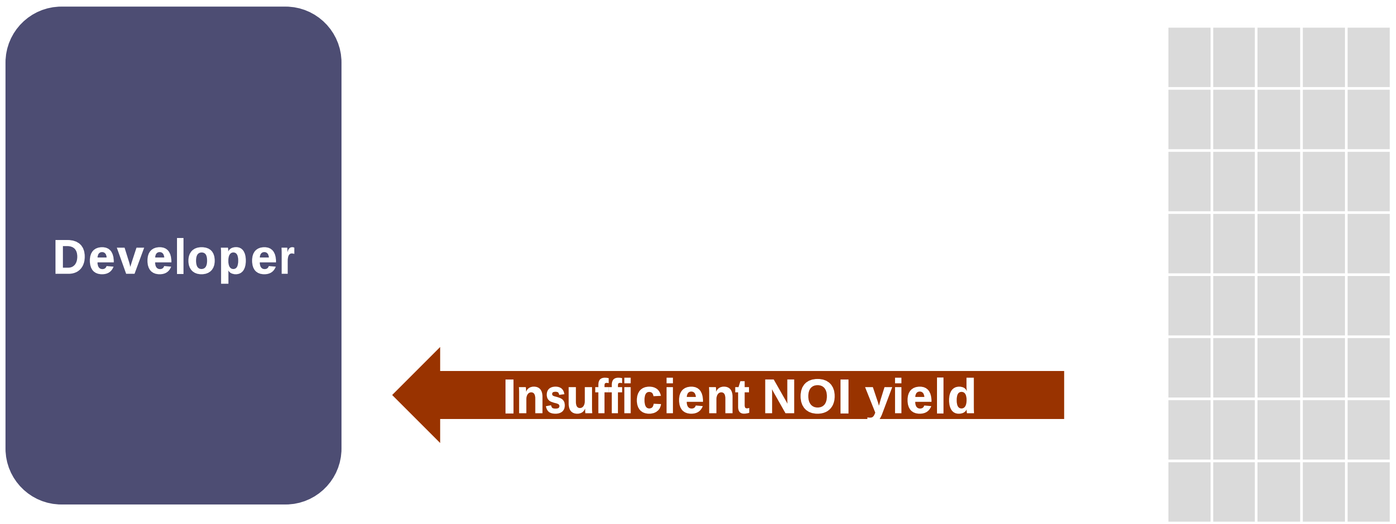
In Low-Rent Neighborhoods

- In some neighborhoods, 100% market rate may not generate an attractive return on construction costs (let alone land).



FINDINGS

In Low-Rent Neighborhoods

- In some neighborhoods, 100% market rate may not generate an attractive return on construction costs (let alone land).
- In these neighborhoods, no amount of additional density will make development viable.

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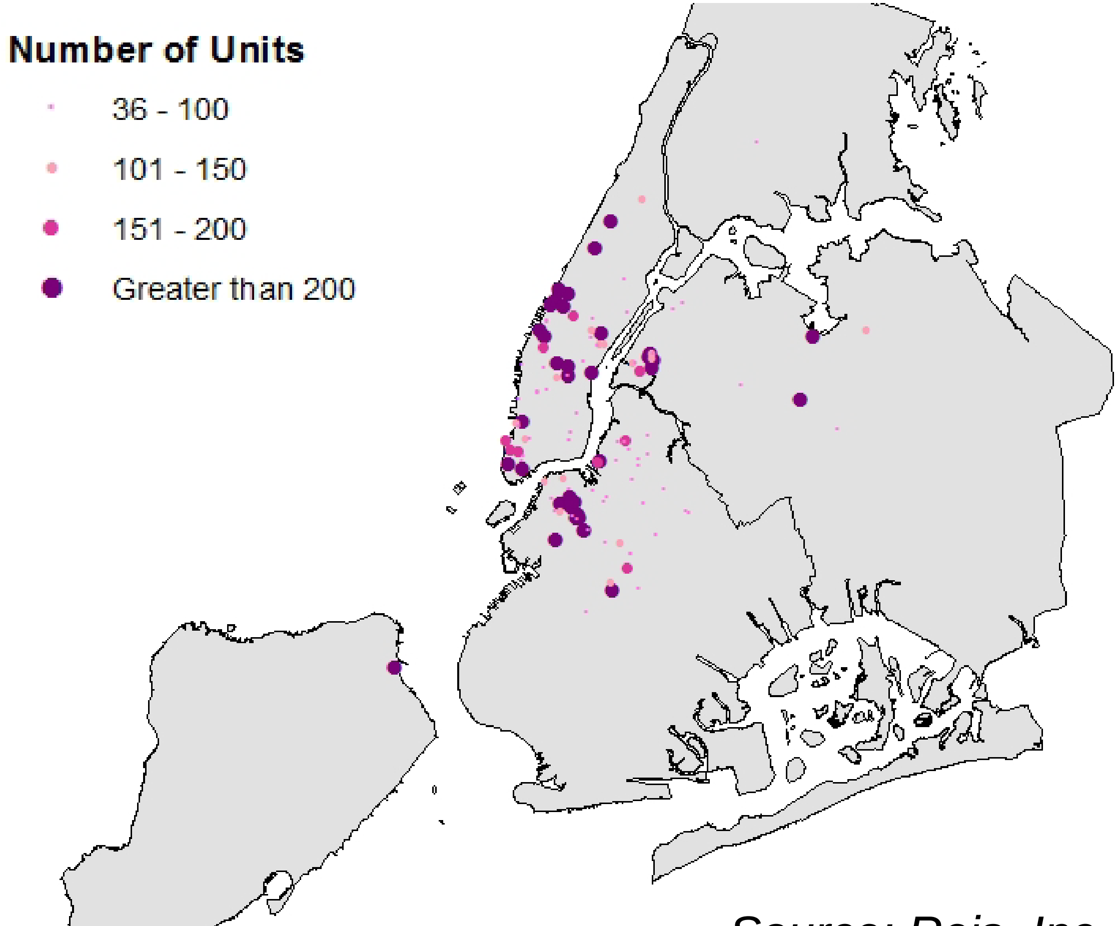
In Low-Rent Neighborhoods (cont.)

Location of market-rate multifamily projects currently under construction (as of January 2015)



Source: Reis, Inc.

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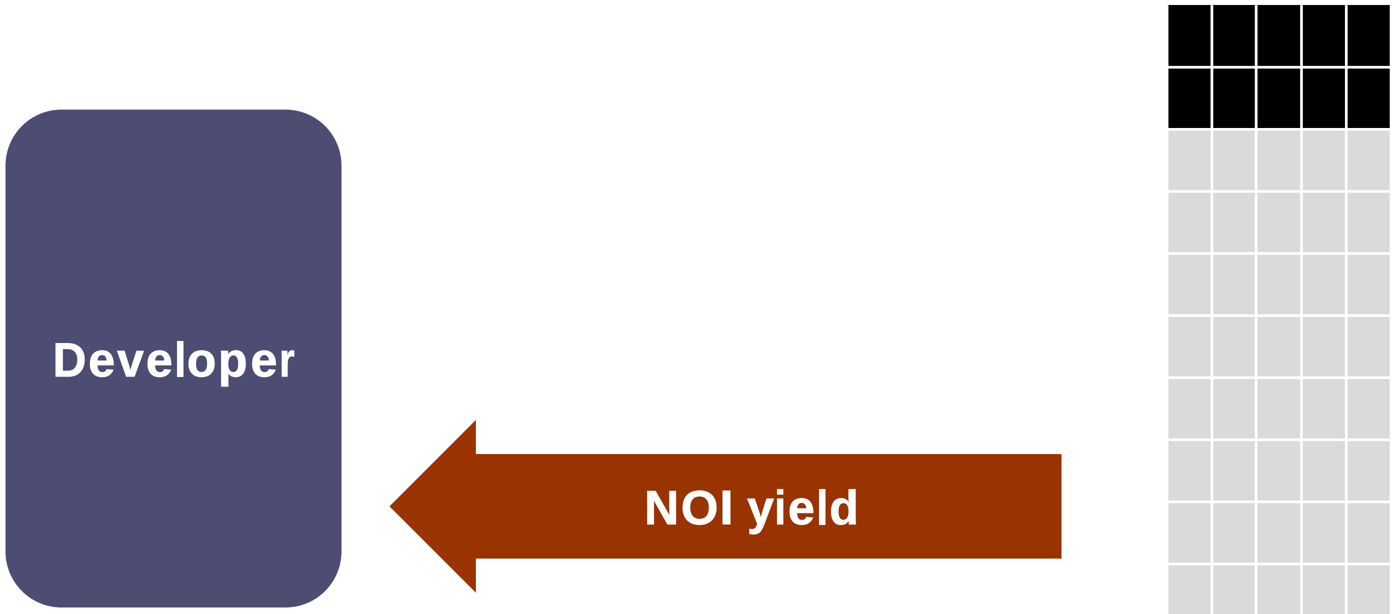
In-between Neighborhoods

- In some borderline neighborhoods, 100% market rate projects may be viable with upzoning.



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In-between Neighborhoods

- In some borderline neighborhoods, 100% market rate projects may be viable with upzoning.
- But adding a new requirement may make NOI too small; would stifle development even with current rents.

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In Low-Rent Neighborhoods

- Regardless of short/medium term effects, a requirement could ensure affordable housing long term.

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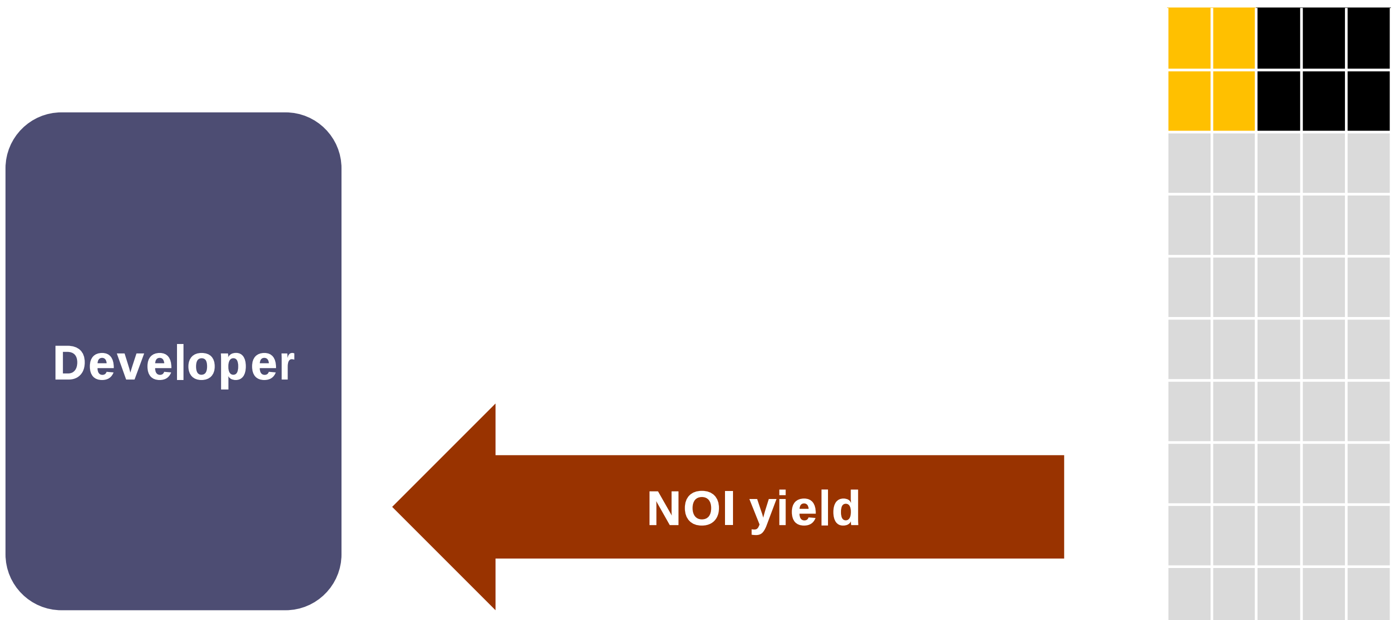
Economics of IZ Will Change Over Time

- What works today…



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Economics of IZ Will Change Over Time

- What works today…
- Might not work tomorrow if rents drop relative to construction and operating costs

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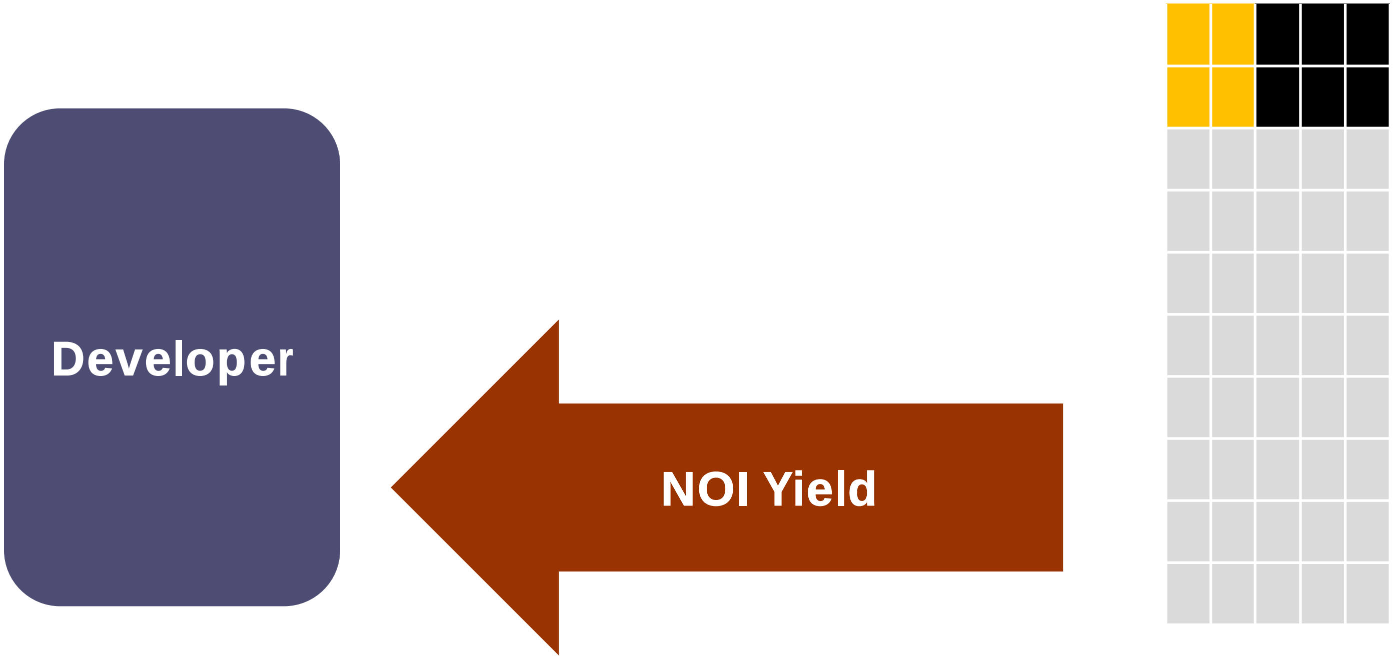
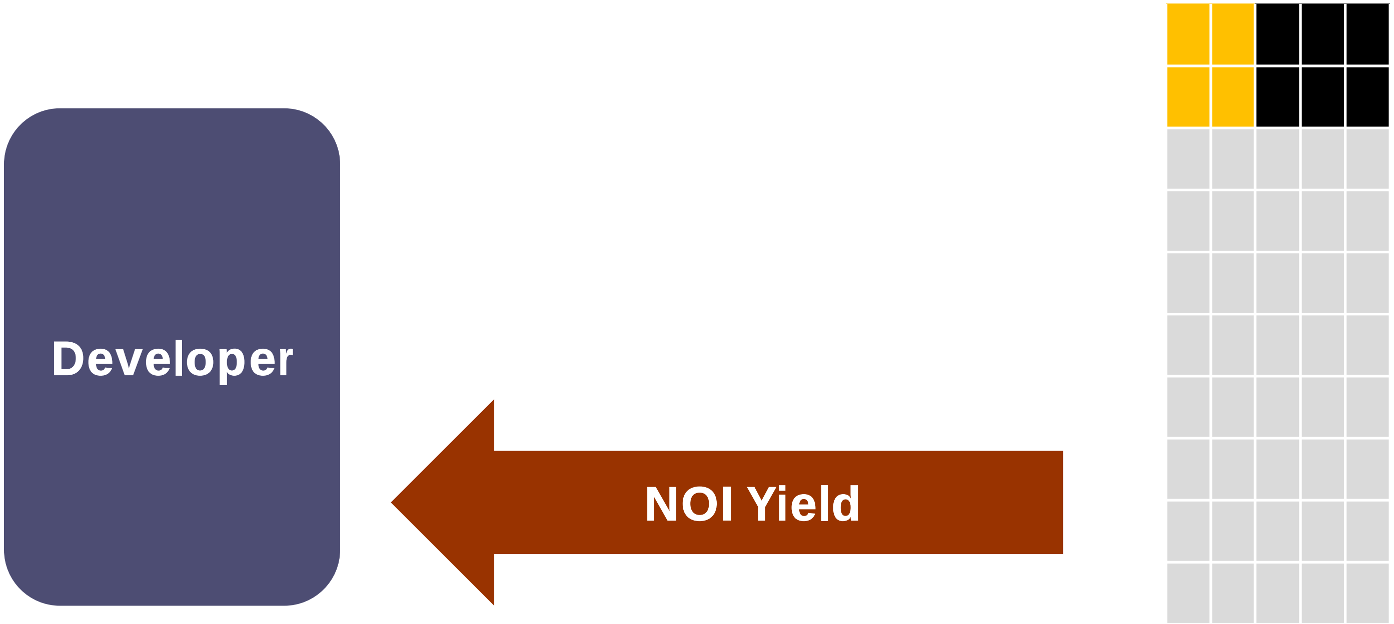
Economics of IZ Will Change Over Time

- What works today…
- May appear too generous if rents outpace costs



Economics of IZ Will Change Over Time

- What works today
- Tradeoff between certainty and flexibility



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Policy Design Decisions

- On-site versus off-site
  - On-site: ensures ongoing cross-subsidy; access to high opportunity neighborhoods.
  - But high opportunity cost:

Present value of foregone revenue from rent-restricting 1,000 rentable square feet of floor area at 60% of AMI

Very strong market	
With 20 year tax exemption	**$1,189,984**
Strong market	
With 25 year tax exemption	**$806,369**
Moderate market	
With 25 year tax exemption	**$428,149**
Moderate-low market, outside GEA	
With 15 year tax exemption	**$330,678**

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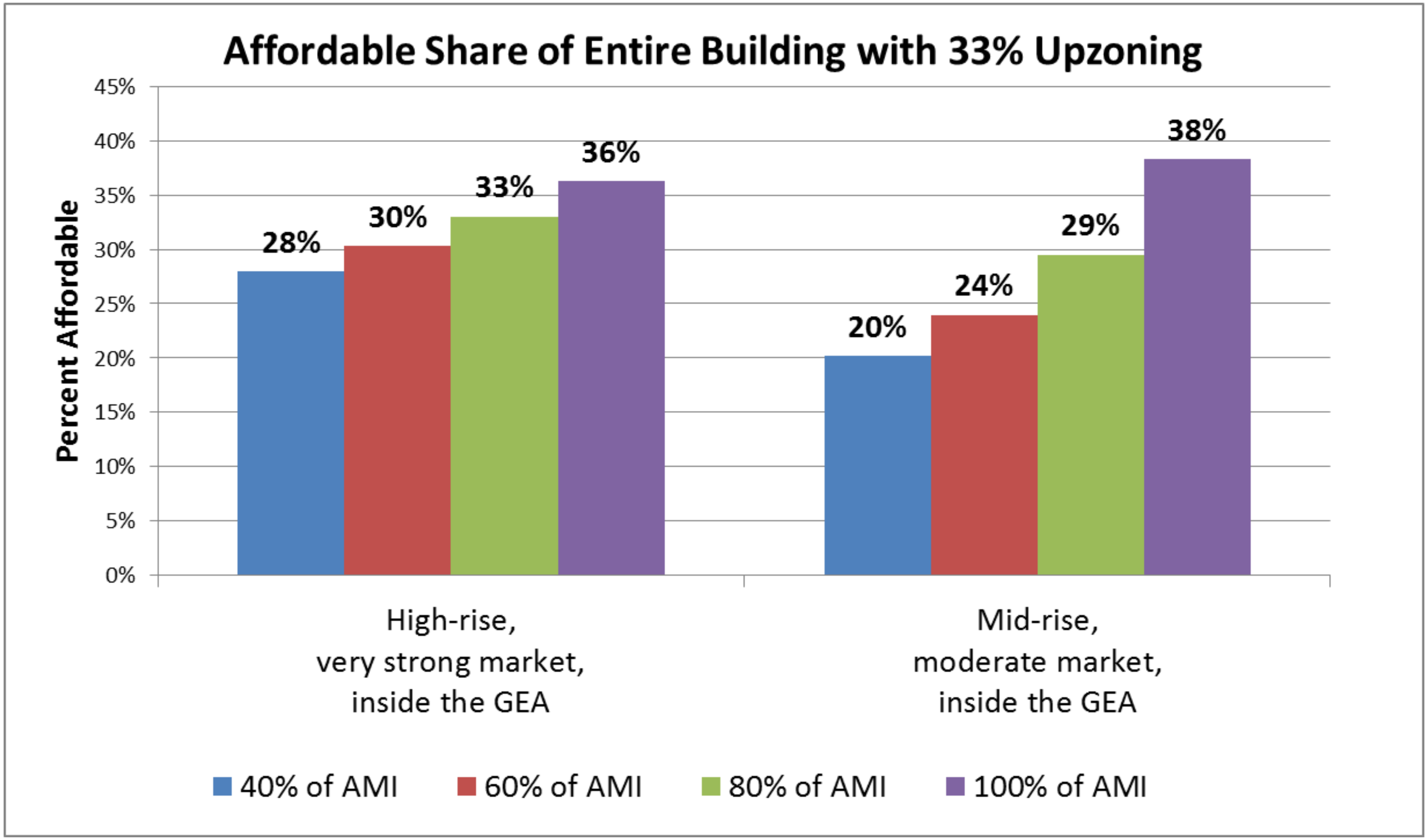
FINDINGS

Policy Design Decisions

- Level of affordability vs. percent affordable:



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Policy Design Decisions

- Permanent vs. long term affordability:
  - Probably does not affect development decisions
    - Present value of cash flow differences in distant future are small.
    - Impossible to forecast so far in the future
  - But other concerns: sustainability of off-site, 100% affordable vs. on-site mixed income

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CONCLUSIONS

1. In high-rent markets, additional density is valuable; city can require affordable units where it adds density.
    - The amount of affordable housing that can be required varies widely based market rents; likely construction type; extent of upzoning; level of affordability.
2. Property tax exemption makes additional density much more valuable.
3. In much of the city, the market is currently too weak for additional density to have any potential to spur mid-rise or high-rise development, let alone cross-subsidize affordable units.
4. The economics of mandatory inclusionary zoning will shift over time.
5. Policy options pose some significant tradeoffs.

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Q&A