Mandatory Inclusionary Housing:

Financial Feasibility and the Current City Proposal.

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As part of New York City's proposal for Mandatory Inclusionary Housing (MIH), a comprehensive market and financial study was commissioned by the New York City Housing Development Corporation, which can be read in its entirety here. This study's purpose was to determine the effect of MIH on the financial feasibility of development. The study also published summaries of findings for rental and condominium development scenarios under MIH.

After the study was concluded, the City outlined its MIH proposal. It consists of three options for affordable housing that must be constructed in conjunction with any upzoning which results in the ability to build significantly larger developments.

- Option 1: 25% of units set aside for households making an average of 60% of AMI.

  60% AMI: $51,780 for a family of four, with 2-bedroom rents of $1,113.

- Option 2: 30% of units set aside for households making an average of 80% of AMI.

  80% AMI: $69,040 for a family of four, with 2-bedroom rents of $1,502.

- Option 3: 30% of units set aside for households making an average of 120% of AMI.

  120% AMI: $103,560 for a family of four, with 2-bedroom rents of $2,279.

This affordable units may be built either onsite or offsite, within half a mile of the market development or in the same community board. There is also an "offsite onsite" option, which allows a developer to build a separate affordable building on the same lot as the market building. Options 1 and 2 are also eligible for additional city subsidy.

These affordable housing options will be overlaid onto future upzonings either alone or in combination (option 3 must be overlaid in combination with at least one of the other options). In the case of multiple overlays, it will be the developer's choice which option to fulfill. Option 3 is disallowed in Manhattan below 96th street.

The technical and time-consuming aspects of a market and financial feasibility study such as the one commissioned by the City are the construction of the model and the researching of price assumptions. Determining the financial feasibility of additional scenarios, especially regarding the revised 421a rules, other affordability options, and additional density scenarios, can be done with simple adjustments to the model already constructed, and should not be difficult for the City.

STUDY OVERVIEW

The study examined whether added density, in conjunction with various requirements for affordable housing, and various government subsidies, would lead to development scenarios which were profitable and feasible in a variety of markets.

First, five market subsets in New York City were defined: Very Strong, Strong, Middle-Market, Moderate, and Weak. Then three separate "upzoning" scenarios for each of these markets were determined:

- A "low-rise" scenario where the allowable square footage was increased 130% from 2.00 to 4.60 and use changed from Manufacturing to Residential, resulting in a 7-story building.
- A "mid-rise" scenario, where the allowable square footage was increased 40% from 4.00 to 5.60, resulting in a 10-story building.
- A "high-rise" scenario, where the allowable square footage was increased 100% from 6.02 to 12.00, resulting in a 30-story building.

Finally, affordability scenarios were constructed. The three upzoning scenarios were examined to see how much affordable housing could be required as part of the upzonings, without affecting the financial feasibility of development, for three different AMI levels. These AMI levels were:

- 60% AMI: $51,780 for a family of four, with 2-bedroom rents of $1,113.
- 75% AMI: $64,725 for a family of four, with 2-bedroom rents of $1,404.
- 90% AMI: $77,670 for a family of four, with 2-bedroom rents of $1,696.

Scenarios were constructed for both on-site and offsite development; both condo and rental development; and for developments utilizing no subsidy, the 421a tax exemption, and both the 421a tax exemption and 4% Low-Income Housing Tax Credits. Specific scenarios which were determined to be impossible or unlikely due to either market or legal constraints were eliminated. This resulted in 1,210 separate scenarios where market feasibility was determined.

Overall, in weak and moderate markets, potential returns from developments were found to be well below what the study considered feasible both currently and across all MIH scenarios studied. As such, in these markets new housing can be expected to be developed through City- or State-sponsored affordable housing programs, utilizing government subsidy, instead of through the MIH program. In mid-markets, both current and potential returns were also found to be below the feasibility threshold across all scenarios, although they were higher than those of weak and moderate markets, and in some cases approached feasibility.

In strong and very strong markets, however, development was found to be economically feasible throughout a wide range of MIH scenarios. However, there are mismatches between what the study found to be feasible in these stronger markets that can support MIH development, and what the City has proposed for its MIH policy. ANHD has gone through the study in detail, summarized the main ways in which these mismatches occur, and also pointed out ways in which the scenarios studied were not sufficient or reflective of likely rezoning scenarios.

ANHD FINDINGS.

1) STRONG MARKET AREAS CAN SUPPORT SIGNIFICANTLY MORE AFFORDABILTY THAN THE CURRENTLY PROPOSED MIH OPTIONS.

- *City Proposal: 25%-30% affordable set-aside in all markets.*
- *Market and Feasibility Study: strong and very strong markets can support more or deeper affordability in almost all scenarios.*

The study found that in "very strong" markets, each of the three upzoning scenarios would be able to support a development that had a 50% set-aside of affordable housing at 60% AMI, without affecting financial feasibility. While not all development permutations (onsite or offsite, condo or rental) support this level of affordability, developers can be expected to choose the most profitable scenario they are legally allowed within any specific zoning and affordability framework.

In all cases, the most profitable scenario that would be allowed by right (Condominium development with offsite affordable housing), supports this level of affordability, and in "strong" markets, all scenarios but the "mid-rise" scenario, which provides only a relatively small density bump, could support up to a 40% set-aside of affordable housing at 60% AMI, and up to a 50% set-aside for the other AMI levels studied. Our analysis takes into account the fact that the 421a tax exemption has been eliminated for Condominium developments, and only the offsite affordable portion would be eligible for a tax exemption.

High-market areas are also where low-income households have the least possibility of obtaining affordable housing. Therefore, stronger options in these areas are not only financially feasible, but also serve to further the policy goals of economically diversifying neighborhoods and providing a wider variety of housing opportunities for a wider variety of income levels.

2) THE MIH OPTIONS PROPOSED ADD LITTLE-TO-NO AFFORDABILITY BEYOND THAT REQUIRED BY THE PROPOSED 421A LAW.

- *City Proposal: In most cases, MIH will be eligible for a full double-dip with the 421a tax exemption under its new rules.*
- *Market and Feasibility Study: analysis is based on former 421a rules, where MIH would have added more affordability.*

Most affordability scenarios for rental buildings proposed by the City under MIH will be eligible for an as-of-right 421a exemption under the new 421a rules without adding any affordable housing, with the remaining scenarios adding very little, although under MIH the affordable component will be made permanently affordable as opposed to 421a's 35-year affordability term.

Under two of the MIH options proposed—30% of units at an average of 80% of AMI, and 30% of the units at an average of 120% of AMI—buildings will be eligible for the 421a exemption without adding any additional affordable housing, based on the new "30% at or below 130% of AMI" option in the 421a text.

Under the remaining MIH option—25% at an average of 60% of AMI—the most likely scenario has developments lowering 5% of the units from 130% of AMI to 100% of AMI in order to qualify under another 421a option.

The market study scenarios were determined using the city's old 421a law, which required different amounts and types of affordable housing, and had a shorter exemption period. Under the old 421a scenario, the current MIH proposal would have added an additional 5%-10% set-aside of affordable housing.

In addition, the city has proposed a third option not studied in the analysis. This is an "onsite-offsite" option, in which the affordable component is built in a separate building on the same tax lot. Because land costs will be minimized and the value of the market-rate units maximized, this has the potential to be a more lucrative option for developers than either the "onsite" or "offsite" options, especially in stronger-market condominium developments. In rental buildings, there is the further incentive that the entire tax lot will be eligible for a 421a exemption, which is not the case with offsite affordable housing on a separate tax lot.

3) UNLESS OFFSITE OPTIONS ARE STRENGTHENED, MOST AFFORDABLE HOUSING CAN BE EXPECTED TO BE BUILT OFFSITE.

- *City Proposal: Same requirements for offsite and onsite affordable housing.*
- *Market and Feasibility Study: In most cases, offsite is more financially lucrative.*

Based on an analysis of the financial feasibility study, even with the elimination of the 421a benefit for high-end condominiums, under the proposed MIH options condominium developments are more likely to be built than rental developments in all cases in "very strong" and "strong" markets, which were the only markets in which condominium development was studied. In addition, in all condominium development scenarios, offsite affordability is more lucrative than onsite affordability. A chart comparing the Yield on Cost of condominium development with offsite affordable housing to rental development with onsite affordable housing in these scenarios follows (because the study looked at 75% of AMI but not 80% of AMI as a potential affordability option, we are using the 30% at 75% AMI as a stand-in for the 30% at 80% AMI option).

As such, virtually all development in the "very strong" and "strong" markets can be anticipated to be condominium development with the affordable housing offsite. Because of the "onsite-offsite" option proposed by the city and not studied by the market and financial analysis, this option will likely result in some scenarios in which offsite development on the same tax lot is the most profitable option.

Offsite affordability was generally also more lucrative for rental developments in mid-market neighborhoods, although the changes in the 421a law may have shifted that analysis (in moderate and low-market neighborhoods, market-rate development is unlikely, both with and without MIH, in all scenarios).

Onsite affordability is generally taken to have greater social value than offsite affordability, even when offsite is required in the same Community Board or within ½ mile, because of the likely placement of the affordable building in an area of less opportunity where land costs are lowest. For instance, in the recently proposed Brooklyn Heights Library development, the market-rate units are being built within a very short distance of several subway lines and zoned for P.S. 8, one of the city's most desirable public schools which received the highest "excellent" rating in four out of five categories on their latest quality review. The affordable component, while in the same Community Board, is two miles away, within walking distance only of one local subway line, and zoned for a public school which achieved solid, but not remarkable, scores on its latest quality review. Even when the offsite affordable development is sited on the same tax lot as the market development, there is still a lowered value because of the difference in the level of overall construction and amenities between market and affordable buildings.

Offsite affordable housing is generally only valued because of its ability in many cases to generate more units overall for the same cost, which the market study confirms. In order to utilize this advantage, and remedy the imbalance in feasibility between onsite and offsite affordability, the city could follow the example of most other jurisdictions which have an option for offsite affordable housing through an MIH program, and propose stronger requirements – lower AMI levels, more units, or both – for offsite affordable housing as part of MIH.

Yield/Return On Cost: Condominium w/ Offsite vs. Rental w/ Onsite

	25% at 60% AMI				
Market Scenario	Very Strong Mid-Rise	Very Strong High-Rise	Strong Low-Rise	Strong Mid-Rise	Strong High-Rise
Condo, no 421a, offsite	86.0%	127.6%	65.7%	46.7%	69.6%
(annualized)	14.6%	21.7%	11.2%	7.9%	11.8%
(less 2% risk premium)	***12.6%***	***19.7%***	***9.2%***	***5.9%***	***9.8%***
Rental w/421a & LIHTC, onsite	***7.2%***	***9.7%***	***7.1%***	***5.9%***	***7.3%***

	30% at 75% AMI				
	Very Strong Mid-Rise	Very Strong High-Rise	Strong Low-Rise	Strong Mid-Rise	Strong High-Rise
Condo, no 421a, offsite	79.9%	119.6%	60.7%	43.0%	65.1%
(annualized)	13.6%	20.4%	10.3%	7.3%	11.1%
(less 2% risk premium)	***11.6%***	***18.4%***	***8.3%***	***5.3%***	***9.1%***
Rental w/421a, onsite	***6.3%***	***8.3%***	***6.1%***	***5.1%***	***6.3%***

4) MORE OPTIONS ARE NEEDED IN THE MIH PROPOSAL, TO ACCOUNT FOR BOTH NEEDS AND LIKELY SCENARIOS NOT STUDIED.

Though over 1,000 scenarios were studied across a variety of developments and market types, this is still only a fraction of the individual development scenarios that will be possible during future upzonings. And left out of the study were both the AMI levels where the need for housing is the most acute, and scenarios involving larger density increases which will be likely going forward.

AMI levels under 60% AMI, where housing need is greatest, were not studied.

- *City Proposal: Averages of 60%, 80%, and 120% AMI levels proposed.*
- *Market and Feasibility Study: Studied only 60%-90% AMI levels.*

Only three different AMI levels were studied, none of which represent the income levels where the need for housing is the greatest: those of very- and extremely-low incomes (<30% - 50% AMI). As the intent of the MIH program is to produce economically diverse neighborhoods and expand housing opportunities for people of greater income ranges, the feasibility of providing housing for these lower AMI levels should be considered. The City has already proposed an additional option that was not studied as part of the analysis: a high-income option of 120% of AMI. Low AMI options need to be studied and considered as well.

Because of the large differential between the very high rents that stronger markets can command, and affordable rents at all AMI levels, in stronger markets providing a higher number of affordable units overall has a greater impact on financial returns than lowering AMI levels of the affordable housing component.

For instance, in all development scenarios in “strong” and “very strong” markets, the difference between providing affordable units at 90% of AMI and providing them at 60% of AMI affects a development’s yearly returns by between 0.2% and 0.8%, across all scenarios studied. Assuming a similar differential between providing units at 60% of AMI and at 30% of AMI, 30% AMI options still leave “very strong” markets able to support 50% affordability, and “strong” markets able to support 30%-40% in all cases except the “mid-rise” scenario.

Scenarios with density increases in excess of 130% were not studied.

- *City Proposal: up to 620% density increases already proposed, higher amounts likely.*
- *Market and Feasibility Study: studied only 40%-130% density increases.*

Only three different upzoning scenarios were studied, one of which (the mid-rise scenario) had a very modest density bump of only 40%, the other two with density bumps of 100%, and 130%. The 130% scenario includes a use change from Manufacturing to Residential, which adds to a project's financial feasibility due to the substantially higher rents and prices Residential developments can generally command.

However, in the East New York rezoning, DCP is proposing density increases of 188% along Fulton Avenue, and 260% to 620% along Atlantic Avenue, including use changes from Manufacturing to Residential/Commercial. Other recent rezonings have gone much further, such as the Downtown Brooklyn and Long Island City rezonings in the mid-2000s, which increased FARs by 300% - 1100% in strong markets, specifically from low-rise manufacturing districts with FARs of 1.00-2.43, to high-rise residential/commercial districts with FARs of 10.0–12.0.

With the administration's stated and demonstrated policy of maximizing residential density, scenarios with significantly more density increases than those studied can be anticipated. As such, additional options for these higher-density rezonings need to be studied and developed as well. Because of the additional density provided, it would follow that that more affordability could be required without affecting financial feasibility, especially in stronger markets.