Note: The Office Adaptive Reuse report published (Dec 2022) on the website below represents the final findings of the task force. This PowerPoint is from a task force meeting leading up to that publication. It was for discussion purposes only and does not necessarily represent the views of the task force or the Department of City Planning. These slides have been modified minorly.
https://www.nyc.gov/site/planning/plans/office-reuse-task-force/office-reuse-task-force.page

OFFICE ADAPTIVE REUSE TASK FORCE MEETING 4

16 November 2022

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Today's objectives

Achieve a common understanding of the financial feasibility of office-to-residential conversions

Understand the opportunity, viability, and costs associated with affordable housing in conversions

Establish a path forward towards recommendations

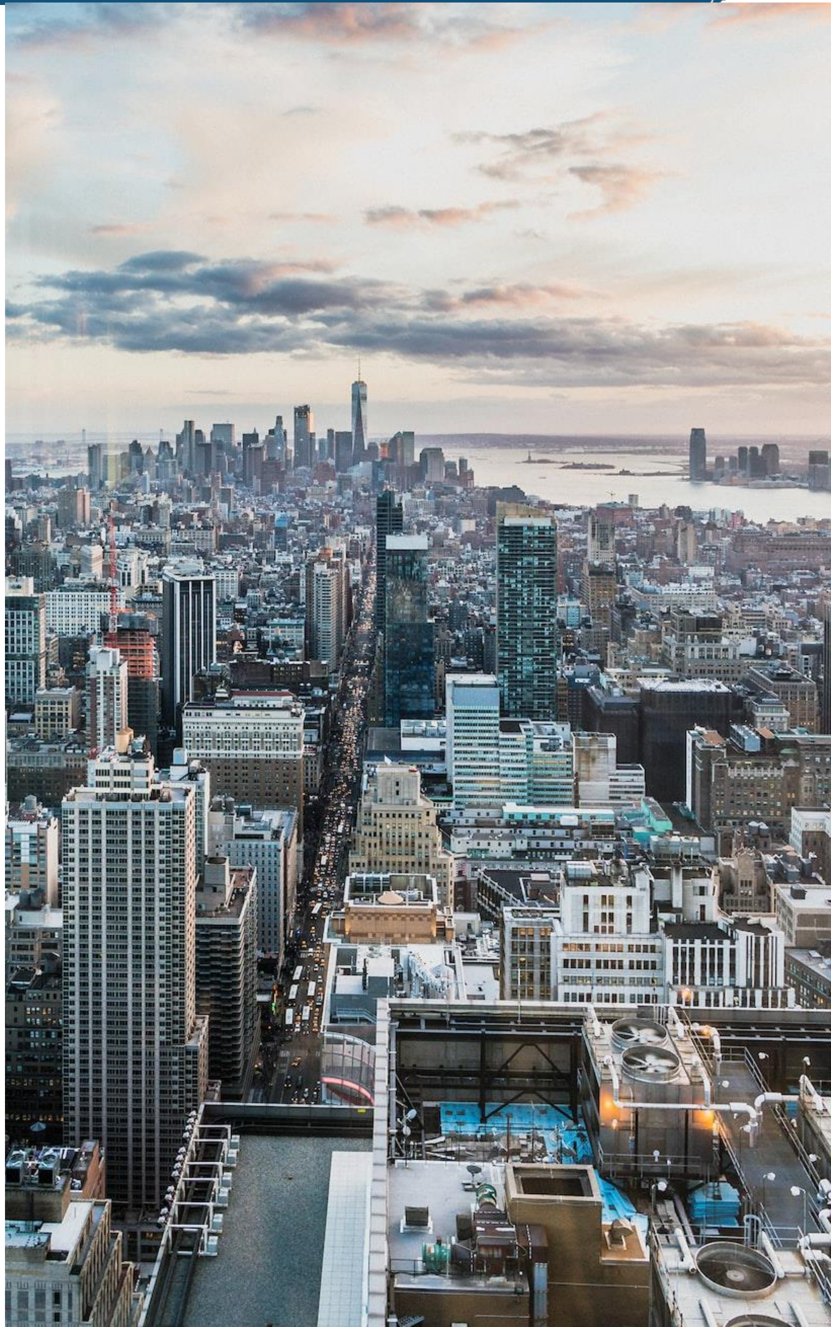
Agenda

Welcome, introductions, task force reminders (10 mins)

1. Financial feasibility of office conversions to market-rate residential (30 min)
2. Property tax impacts of conversions (10 min)
3. Mixed-income housing analysis (30 min)

Next steps and final session (10 min)

Task Force Overview



Scope

- Council-mandated task force to *"study options and make recommendations for converting vacant or commercially unviable office space to other potential uses" (Local Law 43 - 2022)*

Membership

- 12 members
- Supported by agency staff and consultant analysis

Duration

- Anticipated to end December 2022

Deliverable

- Public report outlining recommendations

Today's Focus

Sessions

1 (20 July)	• Kickoff and alignment on goals
2 (22 Sep)	• Types of office buildings at risk • Physical considerations in conversion
3 (19 Oct)	• Regulatory factors limiting reuse
4 (16 Nov)	• Financial feasibility of conversion • Property tax impacts • Mixed-income housing viability
5 (7 Dec)	• Recommendations

Legislative requirement (Local Law 43 – 2022):

"Under what circumstances commercially unviable office conversions to affordable housing units could be implemented, any costs or tradeoffs to the city associated with such conversions and proposals for how to fund or mitigate such costs"

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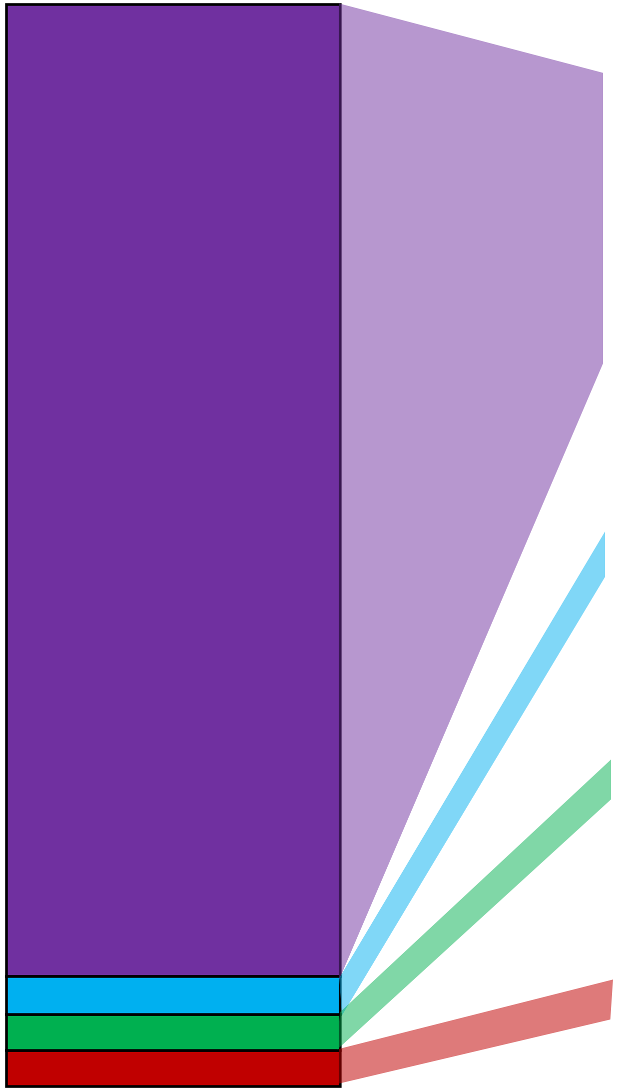
Financial feasibility of office conversions to market-rate residential

Conversion is a niche pathway for office building owners reviewing their options

NYC Office Stock



Options:

Remain office (with minimal investment)

Renovate to higher standard office

Reposition to education space, lab etc.

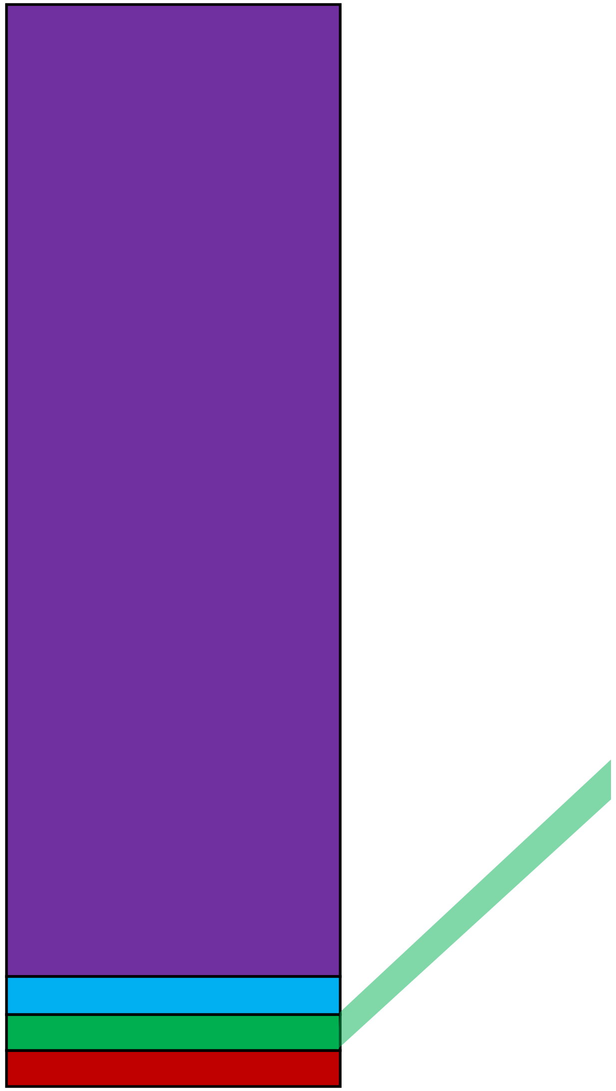
Reuse - convert to residential or hotel

Replace by demolition & rebuild as office or other use

Sell to someone who will pursue one of the options above

For conversion to work there needs to be alignment of many factors

NYC Office Stock



Reuse for residential

Important factors for office-to-residential to pencil

Suitable building characteristics
- Suitable physical characteristics
- Building age & location that gives access to permissive regulations
- Ability to vacate office tenants

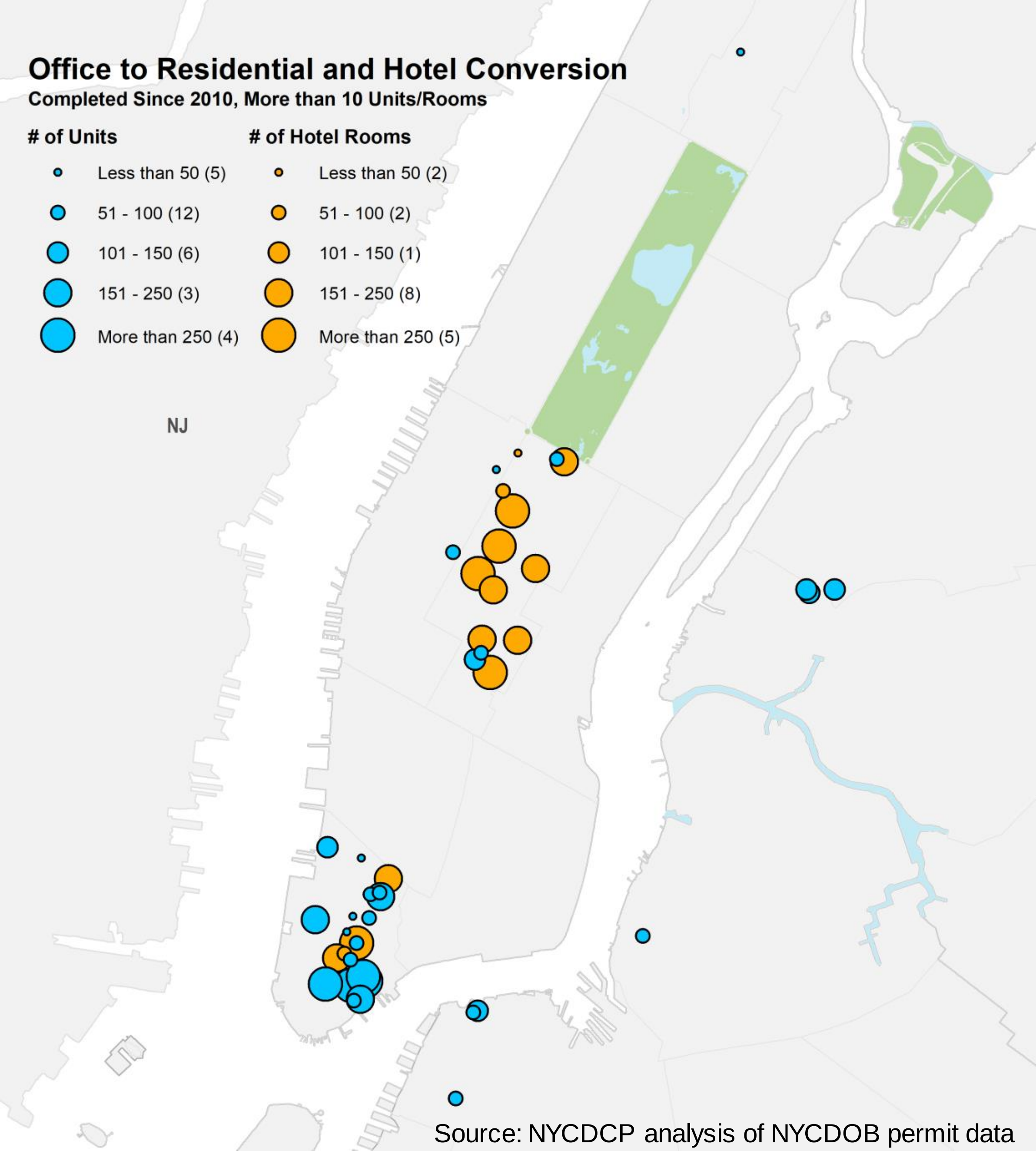
Conducive market conditions
- Tolerable financing costs
- Higher rent opportunities for residential

Owner interest and ability
- Debt position
- Interest and experience with conversion/residential
- Risk appetite

7M+ sqft of office converted to residential without government subsidy last decade

Office-to-residential conversion pencils out *for some* buildings (without government incentives)

- ≈ 7m sqft of office converted to ≈ 4,300 residential units between 2010 and 2020
- 1% to 3% of office buildings were converted to residential between 2010 and 2020 (in sqft terms)*
- Converting to a condo building is more popular than to a rental building historically



Note: On top of the ≈ 7M sqft of office-to-residential conversion, there was also ≈ 3M sqft of office-to-hotel between 2010 and 2020
*1% of all office sqft, 3% of office sqft eligible for ZR15-00 (the city's most permissive conversion regulations)

Source: NYCDCP analysis of NYCDOB permit data

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Strong conversion pipeline but too early to say if conversion investment is up

3,700+ residential unit pipeline from office conversions under construction or announced

- Interest in conversion is high but too early to tell if actual conversion investment has gone up
- 2022 announcements about conversion indicate conversion appetite despite financing headwinds

Under construction during 2022 (completion date may be well beyond 2022):

- 1 Wall Street (1931) - 566 condominium units
- 160 Water Street (1970) - 588 rental units
- 2 Washington Street (1970s) - 345 rental units ← Construction loan announced in 2022
- 685 Fifth Avenue (Mandarin Oriental Residences) (1926) - 69 condominium units

Announced in 2022:

1. 330 West 42nd Street (McGraw-Hill Building) (1931) - 225 rental units (partial conversion)
2. 90 John Street (1931) – 141 units (partial conversion*)
3. 55 Broad Street (1967) - 571 units
4. 25 Water Street (1969) – 1,200 rental units

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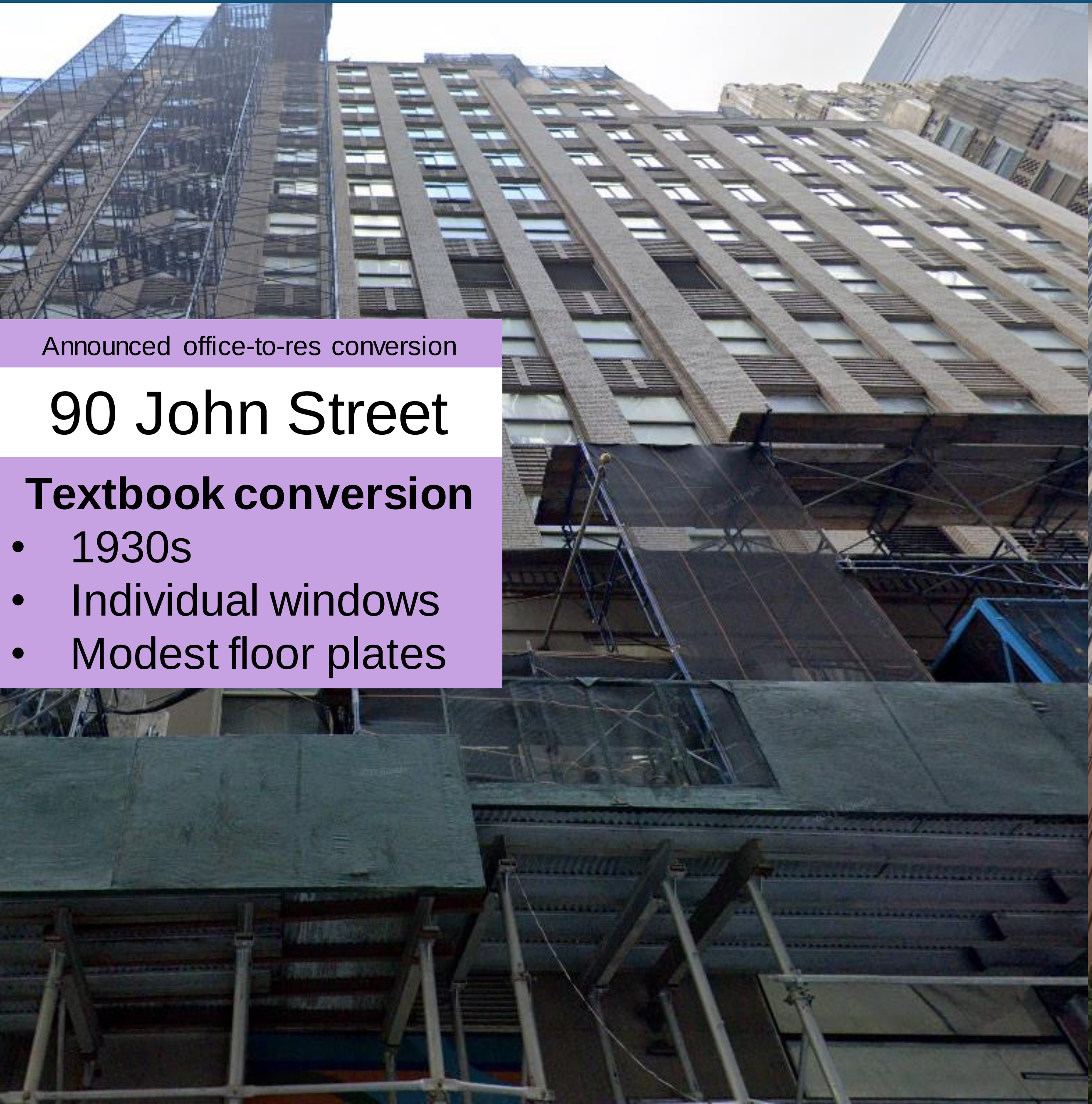
* Conversion of lower floors announced in 2022; upper floors converted in 1990s

2022 conversion announcements range from “textbook” to “notably” examples



Announced office-to-res conversion

90 John Street

Textbook conversion

- 1930s
- Individual windows
- Modest floor plates

Announced office-to-res conversion

25 Water Street

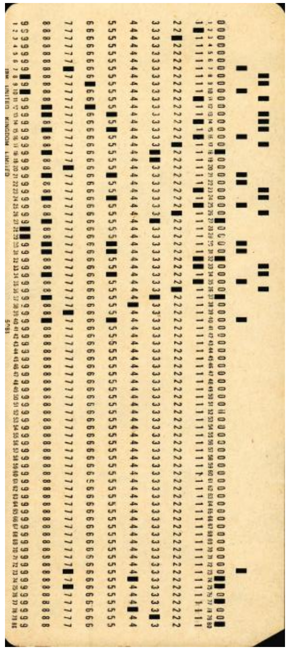
Notable conversion

- Large floorplate
- Unusual facade
- 1M sqft

Also known as 115 Broad Street & 4 New York Plaza

Fun fact

Original building design was inspired by the then-widely used punch card



Practitioners revealed high interest in conversion but skepticism about viability

Summary of 26 practitioner interviews

1. **Conversions “are far from easy money”**

2. **Conversion hurdles (architectural, financial, regulatory) are numerous. "Conversion rarely pencils out"**
   - Especially for larger boxier office buildings and buildings that require extensive façade work
   - Conversion to condos is more financially viable than conversion to rental

3. **Rentable sqft much lower in residential vs. office**
   - Conversions to residential with large floor plates can rent as low as 65% of gross square feet
   - Conversely, office buildings often can rent more sqft than is actually in the building*

4. **Challenges of emptying a building pre-conversion**
   - Challenging to align all lease termination dates of office tenants or move office tenants to other buildings
   - Although partial or sequential conversion has worked in some cases

5. **Market turbulence, uncertainty, and high financing costs limit the opportunity**
   - Many investors unwilling to sell or make big moves
   - High borrowing costs impacting the viability of new investments & acquisitions

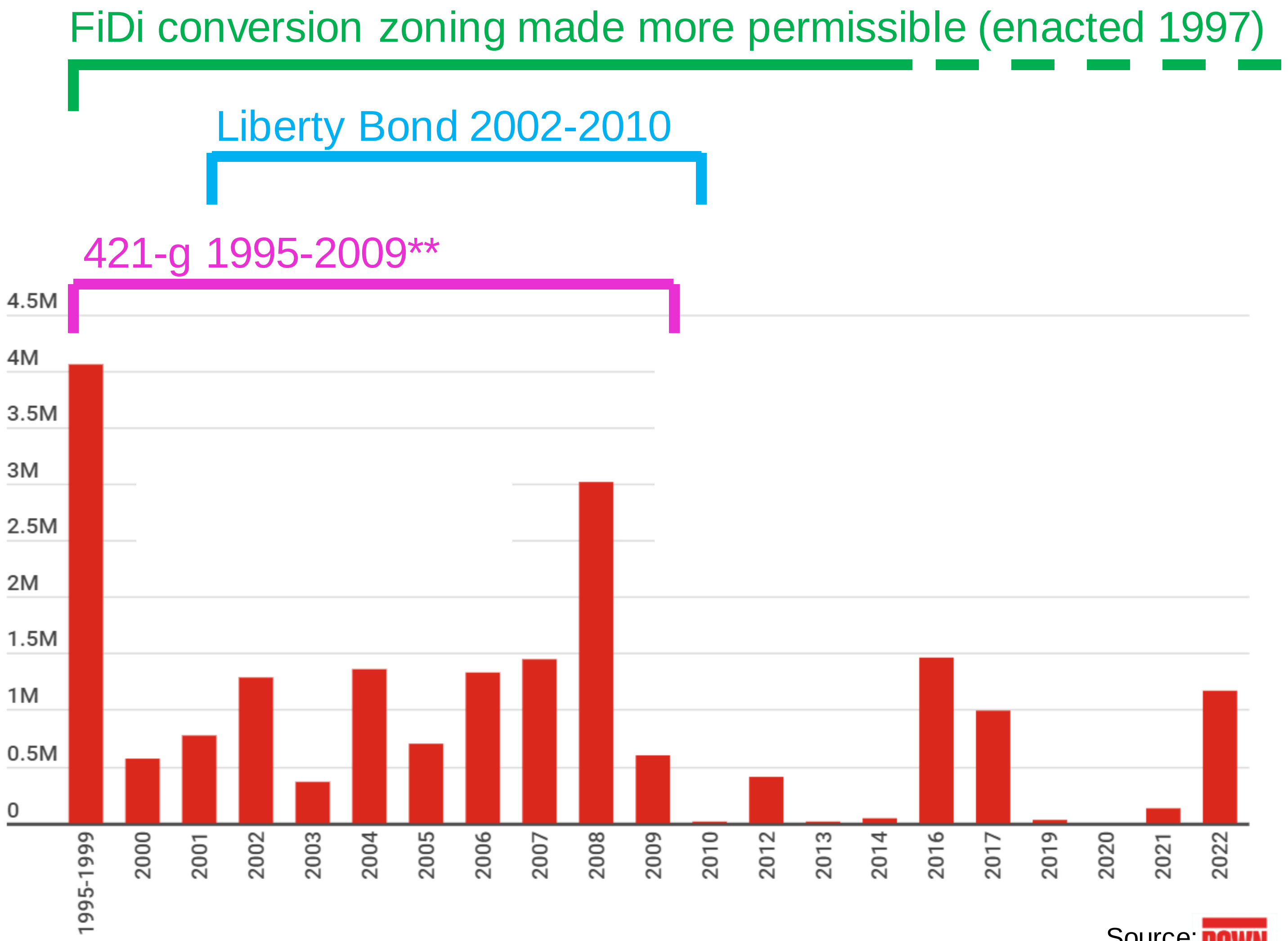
* Explainer

Historical addendum: Past incentives & zoning changes stimulated extra FiDi conversions

421-g conversion tax incentive was highly effective in stimulating additional FiDi conversion but was costly for the government, and no affordable (income-restricted) housing was created*

Liberty Bond program reduced the cost of borrowing for developers (via tax-exempt bonds). FiDi conversions were eligible. No affordability was required but a ≈3% fee was imposed to fund affordable housing.

Chart: FiDi office space converted to residential or hotel 1995 to 2022



Source: DOWNTOWN ALLIANCE

* 421-g program details are in the appendix. Did require units to be rent-stabilized

** 421-g stopped accepting applications in 2006, but the last building to enter the program opened in 2009

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Conclusion: Residential conversion is viable sometimes and may become more popular

Financial viability conclusions

- Office-to-residential conversion happens only occasionally because it requires many architectural, financial, and regulatory factors to align

- Conversion to market-rate residential (condo or rental) compares financially favorably to office use for millions of sqft of existing space, but for most office space, converting to residential is unlikely to "pencil out"

- Office-to-residential conversion happens today *without* government subsidy, but in the late 1990s/early 2000s, government financial incentives did induce increased levels of conversion

Future increases in conversion activity?

- **Shifting market forces**
  - An uncertain office market vs. a strong residential market is likely to induce more conversion
  - But economic headwinds (market turbulence, uncertainty, and high financing costs) might lower activity

- **Regulatory changes**
  - Easing of regularity impediments likely to spur more conversion (if implemented)

Property tax impacts
building level analysis

Property tax (for these buildings) is driven by the building's use & net income

DOF cap rates and tax rates differ by use. For example, large residential buildings likely to pay more tax than an office with the same net income*

		Change in property tax
Struggling office building	Conversion to successful multi-family residential building	↑ Increase
Middling office building	Conversion to successful multi-family residential building	↑ Increase (probably)
Successful office building	Conversion to successful multi-family residential building	↑ ↓ Case by case
Office building	Conversion to tax exemption non-profit use (e.g., educational)	↓ Decrease

* Taxing and valuing property based on its estimated future income is called the Income Capitalization Approach and is used to calculate property tax for office buildings (Class 4) and large multi-family residential buildings (Class 2) in NYC. Office-to-residential conversion tends to increase a building's property tax bill because: (1) Net operating income tends to rise, leading to higher Assessed Value (2) Cap rates are lower for residential than office, leading to higher Assessed Value, (3) Tax rates are higher for multifamily residential than office.

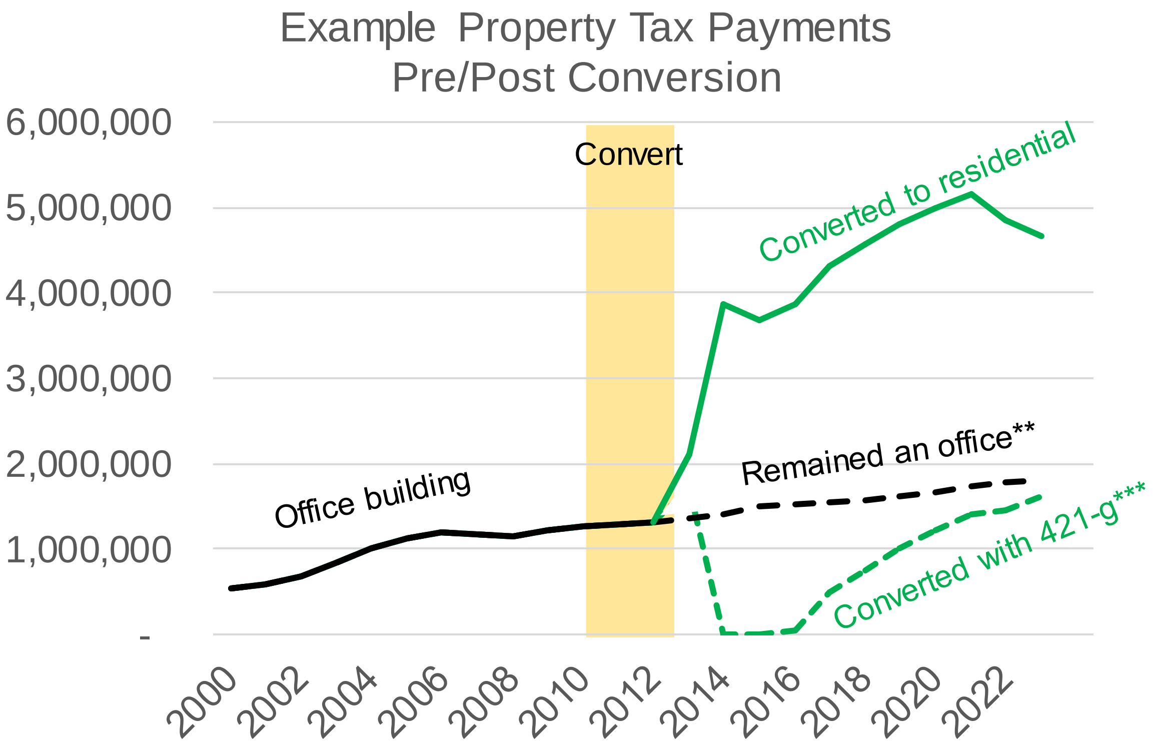
Actual office-to-res conversions tend to be a gain for city's property taxes*

Under current policy

- Past office-to-residential conversion have resulted in increases in a building's annual property tax contribution (compared to if they had remained an office).

Under past policy (421-g)

- Property tax significantly decreased for at least ten years when conversion utilized the 421-g incentive program which expired in 2006. Graphic shows the hypothetical impact if it had been used.



Source: OMB analysis

** assumes office remains at similar vacancy and net operating income levels in the future
***421-g expired in 2006. This is a hypothetical line of what property tax would look like under 421-g. After around 15 years, the dotted green line would join the solid green line as the tax incentive expired

Note: Property tax is only one tax source; other taxes may be impacted by conversion in positive and negative ways.
* Office-to-residential conversion increases a building's property tax bill because: (1) Net operating income tends to rise, leading to higher Assessed Value (2) Cap rates are lower for residential than office, leading to higher Assessed Value, (3) Tax rates are higher for multifamily residential than office. Many reasons for variability in exact percentage increase but mainly driven by the net operating income each building can achieve as a residence vs. an office

Mixed-income (affordable) housing

Current context: Limited opportunity for mixed-income housing in conversions

Residential conversions are permitted under current zoning in most instances

There have been no tax incentives (such as 421-a, which supported affordable units in new construction projects until it expired) to support conversion to mixed-income rentals

As a result, nearly all conversions have been to market-rate housing

Opportunity?
Opportunity for affordable housing in higher-cost neighborhoods with great access to jobs and services, where few affordable units exist

Reminder:
Any new tax incentive would require New York State law

Comparison of past and present tax incentives can inform future incentives

- Significant incentive
- Limited requirements
- Higher usage rate

↔

- Limited incentive
- Significant requirements
- Lower usage rate

	421-g	**421-a** (16) (Conversions generally ineligible)	**HONDA** (Housing our Neighbors with Dignity Act)
Available	1995-2006*	2016-2022 (expired)	2021-Present
Eligibility	Conversions (FiDi)	New construction of multiple dwellings. Conversions generally ineligible	Conversions
Incentive	**Significant** • 12-year post-construction tax exemption on increase in Assessed Value resulting from construction + 14-year post-construction tax abatement on pre-conversion Assessed Value** • 1-year construction-period exemption • Condo and rental both eligible	**Significant** • Rental projects: 35-year post-construction tax exemption from increase in Assessed Value *** • 3-year construction-period exemption • Shorter exemption term for homeownership projects	**Some** • Publicly subsidized financing • (Designed to be matched with other funding sources)
Requirements	**Minimal** • Initial rent is market-rate after which rent-stabilized for incentive period	**Significant** • 25% to 30%+ of units affordable in rental projects • Prevailing wage for building staff (for certain projects)	**Very Significant** • 100% units permanently affordable. Max AMI 80%. Average AMI 50%. 50% of units for unhoused. • Non-profit developer • Prevailing wage for building staff • If originally a hotel, consent from hotel staff union
Usage by eligible projects	Widely used	Widely used	Unused to date (Nov 2022)

* 421-g stopped accepting applications in 2006, but last building to enter the program opened in 2009
** Varies slightly depending on the circumstance
*** Some very large projects get enriched benefits.

NOTE: Other related tax incentives include **J-51**, especially the older versions of the program. Other financial incentives included the **New York Liberty Bond** program.

Next steps

Final session

Sessions

1 (20 July)	• Kickoff and alignment on goals
2 (22 Sep)	• Types of office buildings at risk • Physical considerations in conversion
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5 (7 Dec)	• Recommendations

Discuss task force recommendations

To be circulated beforehand:

- Recommendation options for discussion
- Draft copy of task force report (without a recommendations section)

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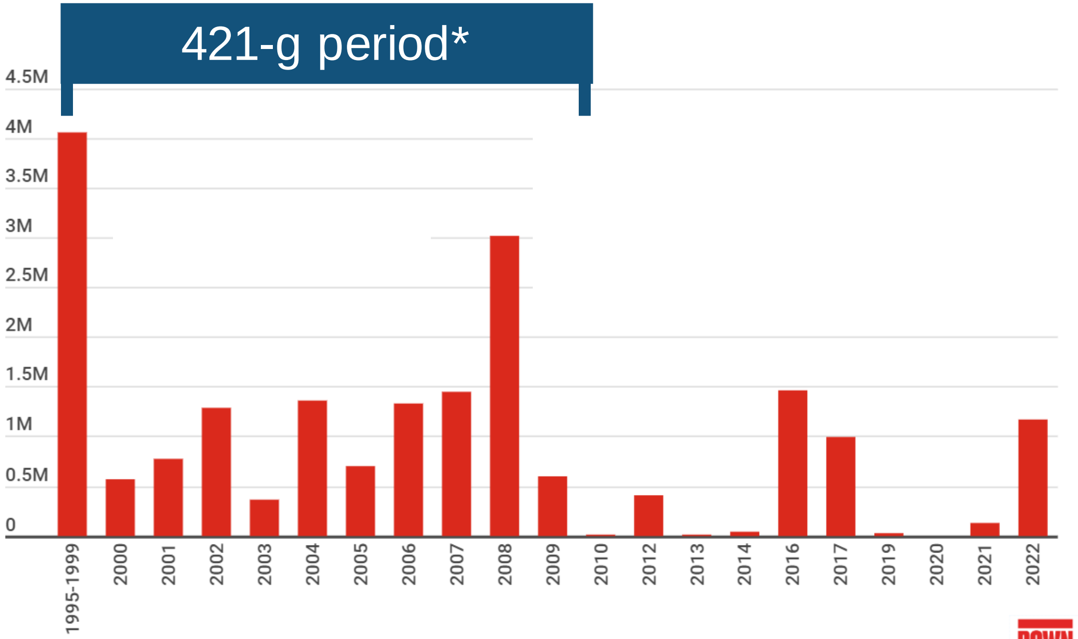
Appendix

421-g program details

421-g conversion tax incentive was highly effective in stimulating additional FiDi conversion but was extremely costly for the government, and no affordable housing was created

FiDi office space converted to residential 1995 to 2022



Source: DOWN TOWN ALLIANCE

* 421-g stopped accepting applications in 2006, but last building to enter the program opened in 2009

421-g Program Overview

Program:
- FiDi real estate tax exemption & abatement for office-to-residential conversions 1995 to 2006 (either rental or condo). No affordable housing required. Rent-stabilized rentals for 14 years. Condos were market rate.

Eligibility for program:
- FiDi commercial buildings wishing to convert to a multiple dwelling residential

Time frame:
- 1995 – 2006 (last building to enter the program opened in 2009)

Benefits to developer:
- 1-year construction-period exemption
- 12-year exemption from the increase in real estate taxes resulting from the work (Full exemption declines by 20% per year from Year 9)
- 14-year abatement of the real estate taxes paid on the property before conversion. (Full abatement declines by 20% per year from Year 11).
- The benefits above vary slightly depending on circumstance.

Benefits to city:
- ≈12K units from ≈90 office buildings (Source: OMB)
- Likely more housing created via conversion in FiDi than if no incentive

Cost to city:
- Government subsidy was typically $130k per dwelling unit created (in 2022 dollars) (Source: OMB estimate).