

Oversight Hearing—Residential Conversion of Commercial Buildings
Testimony of Mark A. Willis
Senior Policy Fellow, Furman Center for Real Estate and Urban Policy
New York University

Before
New York City Council
Committee on Land Use
Rafael Salamanca Jr., Chair
February 28, 2023

Thank you for inviting the NYU Furman Center to join this panel to testify on the economics of converting office/commercial buildings to residential and of including an affordability requirement.

There is no evidence that the City or State need to intervene in owner's choices of which buildings or how many buildings to convert. The City and State should remove the barriers to conversion that now exist in the zoning resolution, multiple dwelling law, and other regulations, but there is no evidence that subsidies or other interventions are necessary to spur conversion.

But the conversions pose a once in a generation opportunity to bring affordable housing to midtown, a neighborhood that has very little affordable housing and is one of the least diverse of the city's neighborhoods and has incredible public amenities and opportunities. Securing affordable housing in the conversions will require both the imposition of MIH and some subsidy for the lower rents in the affordable units.

My brief remarks today can only touch briefly on some key issues, but an expanded version of this testimony will lay out more detail about why conversions are appropriate, what some of the dangers of conversions are, and why intervention to spur conversions is not necessary at this point.

We learned from the experience downtown that conversions will not provide affordable housing unless required and incentivized to do so. It would be a terrible waste of what is really a generational opportunity to provide affordable housing in neighborhoods that now offer very little affordability to repeat those mistakes.

Under the City's MIH program, whenever zoning changes encourage the creation of new multifamily housing, MIH should be triggered to require affordability in the new, rehabbed, or converted buildings.

There is a danger that the state could authorize conversions in such a way as to avoid MIH, but that would undermine the City's carefully crafted MIH program and undercut the City's and City Council's role in critical land use decisions.

There is no question that affordable housing is needed, and indeed is critical to providing the lively mixed-use neighborhoods that conversions are meant to create. We have compiled data that show how little affordable housing is in the neighborhoods that would likely see conversions, but I trust that your travels through those neighborhoods gives you a good sense of just what a missed opportunity it would be if conversions result primarily in condos at the top of the residential and investment market.

To require and secure affordability without making conversions too expensive to go forward, the state will need to authorize, and the city will need to craft, some exemption from property taxes to make up the shortfall in rent in the affordable apartments. MIH was designed to work with a tax exemption, but 421-a has not been renewed. Some exemption will be necessary; otherwise, the affordability requirements of MIH would make the buildings unlikely to convert.

Why might some degree of conversions be beneficial to the city?

First, residential conversions could be an important way to help address New York City's housing shortage. Conversions could be cost-effective in bringing significant amounts of new housing to the marketplace, creating a more competitive marketplace that would benefit both renters and homebuyers.

Second, depending on the degree of demand for commercial space going forward, there is a risk that commercial space will be underused and may even become abandoned, imposing harm on surrounding neighborhoods. It is important that the city remain an attractive place for people to live, work, and/or raise a family, and office to residential conversions could help to achieve this.

Third, the underuse of office space could lead to a waste of the existing infrastructure in these commercial districts, not least of which is the extensive transportation system. Allowing these types of areas to go relatively underused and in turn forfeiting the full benefits of these investments.

Fourth, allowing buildings to languish would unnecessarily weaken New York City's tax base. These properties pay taxes according to their net operating income (NOI). If NOI significantly declines, so too will property tax revenue. Converting those buildings to a use that produces positive net operating income would be preferable.

What should the city do?

As the demand for office space changes over time, it seems quite likely that conditions will favor some degree of residential conversions. The shifts in demand for office space, coupled with the type of regulatory relief that has been discussed at the state and local level, such as changes to the Multiple Dwelling Law, Zoning Resolution, Housing and Maintenance Code, and Building code, would likely mean that going forward, conversions will take place without any government intervention, simply because it will make economic sense to do so.

Should office conversions include affordable housing?

Up to this point we have talked only about market-rate conversions, but policymakers should want to add an affordability component to the high-end housing that would otherwise be all that is created. There are numerous reasons.

From a fair housing perspective, for example, the opportunity to add affordable housing to Manhattan which is such a well-resourced neighborhoods would help fulfill the city's requirement to affirmatively further fair housing. The city recognized in its *Where We Live* analysis, additional affordable housing is needed in higher opportunity areas where few racial or ethnic minorities live. It cannot be ignored that the neighborhoods most likely to experience new housing from conversions are among the best resourced, but most least diverse neighborhoods in the city.

Should the state and city subsidize affordability?

Given a public interest in creating more affordable housing and consistent with relying on the market to govern conversions, it would make sense to provide a subsidy to cover the costs of the affordable apartments so as not to affect a developer's choice of use for the building. Such a subsidy would need to be sufficient to offset the effects of the loss of rental income on the building's gross revenue.

Lots more work needs to be done on how to provide a tax exemption for affordability that does not overly-subsidize the conversion's affordable units. We have done some work with a simplified version of the type of real estate pro forma that developers would use to estimate how much the conversion would allow them to pay to purchase the building. We considered an affordability requirement of 25 percent of the units having an average rent affordable to households at 60 percent of AMI. Our rough assessment is that an exemption of roughly half of the taxes would be sufficient, but again, more public discussion of exactly how to craft an appropriate subsidy tailored to different rental markets is needed.

Whether conversion works for a specific building depends not just on the market rent for residential but on the construction costs for the conversion and what the building is worth if it continues for commercial use.

Conclusion

In conclusion, ensuring policies that lead to mixed-income residential buildings from conversions should be a primary focus of elected officials. There is no evidence that, save for re-assessing code requirements that may be inhibiting conversion, that the government needs to intervene at this time except to include an affordable housing component with a property tax benefit to offset the decrease in income, thereby leaving owners to assess the potential advantages of a conversion.

Given the difficulty of predicting how different types of office buildings in different neighborhoods will fare over the next few years and over the longer run the city will want to closely monitor how many buildings are being converted, in what neighborhoods, and what

kinds of buildings to be able to make the most of the opportunity to maintain an alignment of the amount of office space with the potential to add both market rate and affordable residential units.

With that in mind, nimbleness should be a priority, which suggests that New York City should have as much flexibility as possible to adjust its taxing, zoning, and building code policies as more experience is gained and as the city's economy continues to evolve.

There are many aspects of conversions that require further thought. We appreciate the Committee's attention to these important issues, urge the committee to put affordability and fair housing at the center of the debates, and stand ready to provide whatever data and analysis could be helpful to the committee.

I would be happy to answer your questions.