The New York Housing Compact: Part I

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Concerns around housing prices and availability have drawn widespread political attention in the wake of the COVID-19 pandemic. In New York City, after rents initially dipped during the pandemic due to renters leaving urban centers for largely suburban markets, many renters have since returned, driving rents up by approximately 25% in Manhattan, 18% in Brooklyn and 20% in Northwest Queens since 2021. Roughly half of renters statewide are now “rent-burdened,” paying more than 30% of their income towards rent, and the Real Estate Board of New York (REBNY) calculated that New York City alone needs 560,000 new apartments over the next decade in order to keep up with population growth.

For homebuyers, the low interest rate environment resulting from COVID-19 stimulus led to substantial increases in home prices, with anecdotes of significantly above-market offers being made for new listings becoming the norm. The housing market has cooled in recent months, however, as rising interest rates have combined with economic uncertainty to cause many buyers to take a “wait and see” approach before purchasing a home. Sellers, meanwhile, have not yet seemed willing to lower home prices in order to allow for a rebalancing in the market.

New York Governor Kathy Hochul recently released the “New York Housing Compact” (the “Housing Compact”), which, together with the 2023 State budget proposal, offers policies that aim to combat housing shortages and affordability issues by implementing growth targets, focusing on transit-oriented development, modifying zoning laws and introducing tax subsidy programs. Key to the Housing Compact, and favorable for the commercial real estate industry, is the apparent focus on increasing the supply of housing of all types, not simply affordable housing, in an effort to lower housing costs across the market.

Growth Targets. The Housing Compact has a stated goal of creating 800,000 new housing units by setting a 3% “new homes” target for downstate municipalities and a 1% target for upstate communities in three-year cycles. If municipalities do not meet these growth targets, a “fast track” approval process would be available to private developers as a “builder’s remedy” in order to obtain approval for development projects through a new State Housing Approval Board, even if those projects would not otherwise comply with applicable local zoning requirements. Similar initiatives have been recently pioneered in California and are viewed as an effective means to increase housing supply.

Transit-Oriented Development. The Housing Compact's focus on transit-oriented development would also place the onus on municipalities, particularly those that benefit from close proximity to mass transit, to rezone areas within a half-mile of a MTA station (including Metro-North and Long Island Rail Road stations) in order to allow for at least 15 homes per acre (and 50 homes per acre in municipalities within 15 miles of NYC). The Housing Compact also proposes to allocate $250 million for infrastructure in order to assist communities in meeting the Housing Compact's stated growth targets, including schools and sewer projects to support new housing.

Changes to Zoning Law. The Housing Compact also seeks to "expand the universe" of office buildings available for conversion to residential uses by streamlining the process to convert buildings built before 1990, which could free up approximately 120 million square feet for residential use in New York City. The Housing Compact also proposes to lift the State's cap on residential floor area ratio in order to allow for denser housing and proposes to legalize basement apartments. Mayor Eric Adams' administration recommended similar changes to City zoning laws to allow for increased residential inventory, and Manhattan Borough President Mark Levine recently proposed the rezoning of a variety of manufacturing districts across the City, along with the upzoning of certain residential districts.

Tax Incentives. The Housing Compact includes a pledge to work with the New York State legislature to craft a successor to the 421-a tax abatement program. 421-a, which was originally passed in 1971 and expired in 2022, was the foundation for the popular 80% market rate/20% affordable residential construction model, pursuant to which developers would receive a partial real estate tax exemption during construction and for a period ranging from 10 to 25 years following completion of an eligible project. Governor Hochul has also proposed extending the completion deadline for projects currently relying on 421-a benefits from 2026 to 2030, which REBNY calculates could affect 33,000 housing units spread over 72 projects. In addition to a potential 421-a replacement, the Housing Compact includes added low-income housing tax credits (LIHTC) and other real property tax exemptions that may be attractive to private developers.

Governor Hochul's proposals offer a number of potential benefits to New Yorkers. Adding additional capacity for housing will lower rental and housing prices across New York, counteracting the price increases that have been characteristic of the post-pandemic era. Central business districts will see a boost in activity as a new generation of residents enters the market. For investors and developers of office properties, the prospect of conversion to residential or mixed uses may provide a path towards greater diversification of existing portfolios and may also provide a safeguard against office market downturns or even boost office profitability with greater emphasis on housing in urban centers.

Despite its optimistic posture, the Housing Compact will need to overcome several significant obstacles in order to reach its full potential. In light of today's market conditions surrounding commercial developments, the Housing Compact attempts to address some of these forces with targeted approaches.

Public Support for Rezoning. Public opposition to housing projects may derail any attempt by a given municipality to increase density. While New Yorkers may want increased housing options, they are often averse to "dense" apartment-style housing developments due to concerns about increased traffic, disruptive construction activity, burdens on local schools and fear of a resulting decrease in property values. As such, some municipalities might elect to see how neighboring towns approach the Housing Compact before adding additional housing. Still, elected representatives have pioneered some notable recent initiatives in zoning laws, particularly in New York City—the SoHo rezoning in 2021, which allows for additional residential development and affordable homes, as well as Queens-based rezoning efforts in Flushing, where a 29-acre special waterfront district has become a residential development hotbed since 2020, and in Willets Point, where 2,500 fully-affordable housing units are planned to be built in connection with a soccer stadium development project. It remains to be seen whether elected officials in suburban and rural municipalities will have similar success in their rezoning efforts.

Constitutional Restrictions. If municipalities fail to embrace the goals of the Housing Compact, then the plan's growth targets and "fast track" mechanism are designed to override existing zoning regulations and local opposition to denser development. New Yorkers, however, through their elected officials, enjoy the ability to make choices about how to shape their communities, and they argue that commercial development in New York needs to be undertaken in compliance with existing zoning laws. The Housing Compact would enable state law to preempt local laws, and as such, is sure to meet constitutional challenges if implemented as proposed. Additionally, it is unclear how the Housing Compact's proposal to expand office-to-residential conversions will comport with land use regulations, particularly the ULURP process in New York City.

Economic Success. The Housing Compact is dependent on private development. In New York City and its immediate suburbs, the cost of acquiring developable land has increased significantly, and therefore, recent residential projects have often consisted of larger luxury units in lieu of more modest housing so that developers and investors can realize higher per-square-foot prices, leading to fewer additional housing units overall.

Additionally, rising interest rates for construction financing and an increase in costs for building materials due to inflation and recent supply chain disruptions have further constrained the economic feasibility of private development. In terms of office conversions, developers are faced with significant expenses in adding utilities for kitchens, plumbing for bathrooms, HVAC, building amenities and other modifications that are necessary to bring office buildings into compliance with residential building codes. Of course, the Housing Compact's proposed tax incentive initiatives could provide some meaningful relief in light of these economic factors in order to attract private developers. For projects not able to access the private debt markets, Fannie Mae or Freddie Mac lending may prove critical to the success of the Housing Compact's initiatives.

The implementation of the Housing Compact is far from a certainty and will face a variety of challenges. Certain proposals will require legislative approval, and private developers and investors will need to be incentivized to enter the market even after municipalities reform existing zoning laws. Whether those reforms are effectuated through local support or state-mandated requirements remains to be seen.

While the success of the Housing Compact will not be known for some time, these initiatives represent a significant milestone for the New York commercial real estate community and, if successful, may offer a roadmap to tempering affordability pressures in other states. We remain hopeful that the Housing Compact will spur additional conversations about which proposals are best suited for New Yorkers.

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Please do not hesitate to contact us with any questions.

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