Public Action Public Value

PRATT CENTER FOR COMMUNITY DEVELOPMENT

Investing in a just and equitable Gowanus neighborhood rezoning

Fall 2019

Acknowledgements

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REPORT AUTHORS
Sydney Céspedes
Laura Wolf-Powers
Elena Conte

REPORT CONTRIBUTORS
Michelle de la Uz
Jay Marcus
Sadra Shahab
Taylor McGinnis
Gabriel Fernandez

REPORT DESIGN
Ben Dodd
June Lee

Fifth Avenue Committee
Our Community. Our Future.

Fifth Avenue Committee, Inc. (FAC) is a 41-year-old nationally recognized community development corporation in South Brooklyn that advances economic and social justice by building vibrant, diverse communities where residents have genuine opportunities to achieve their goals, as well as the power to shape the community's future.

PRATT CENTER FOR COMMUNITY DEVELOPMENT

Founded in 1963, the Pratt Center for Community Development works for a more just, equitable, and sustainable city for all New Yorkers by empowering communities to plan for and realize their futures. As part of Pratt Institute, we leverage professional skills including participatory planning, community organizing, and public policy advocacy to support community-based organizations in their efforts to challenge systemic inequities and advance sustainable development.

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Introduction

The Gowanus neighborhood in Brooklyn, known for its unique mix of industrial, artistic and commercial activity, is poised for significant changes driven by public actions and planned neighborhood investment. The polluted Gowanus Canal, designated as a Superfund site[1] in 2010 by the Environmental Protection Agency (EPA), is in the process of being cleaned-up. The responsible parties, which include the City of New York and National Grid, are required to contribute to remediation costs currently estimated at $1.257 billion.[2]

Gowanus is also one of the dozen or so neighborhoods the City intends to rezone as part of Mayor de Blasio's plan to build or preserve an estimated 300,000 affordable housing units. The City's proposed rezoning, which involves millions of dollars in infrastructural investments in Gowanus, leaves out the approximately 4,250 people who live in the three local New York City Housing Authority (NYCHA) developments. Together, Gowanus Houses, Wyckoff Gardens, and Warren Street form the largest provider of affordable housing in the neighborhood and house 25% of renter households in Gowanus.[3] However, local public housing is in need of major investment to address the $237 million capital funding gap at the three developments. Deteriorating housing conditions threaten safety, health and quality of life for Gowanus residents living in NYCHA developments.

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By excluding Gowanus NYCHA developments from the rezoning boundary, the City prevents NYCHA from directly benefiting from the land use action and, therefore risks exacerbating the existing inequalities between residents of public housing and the community's wealthier and white neighbors.

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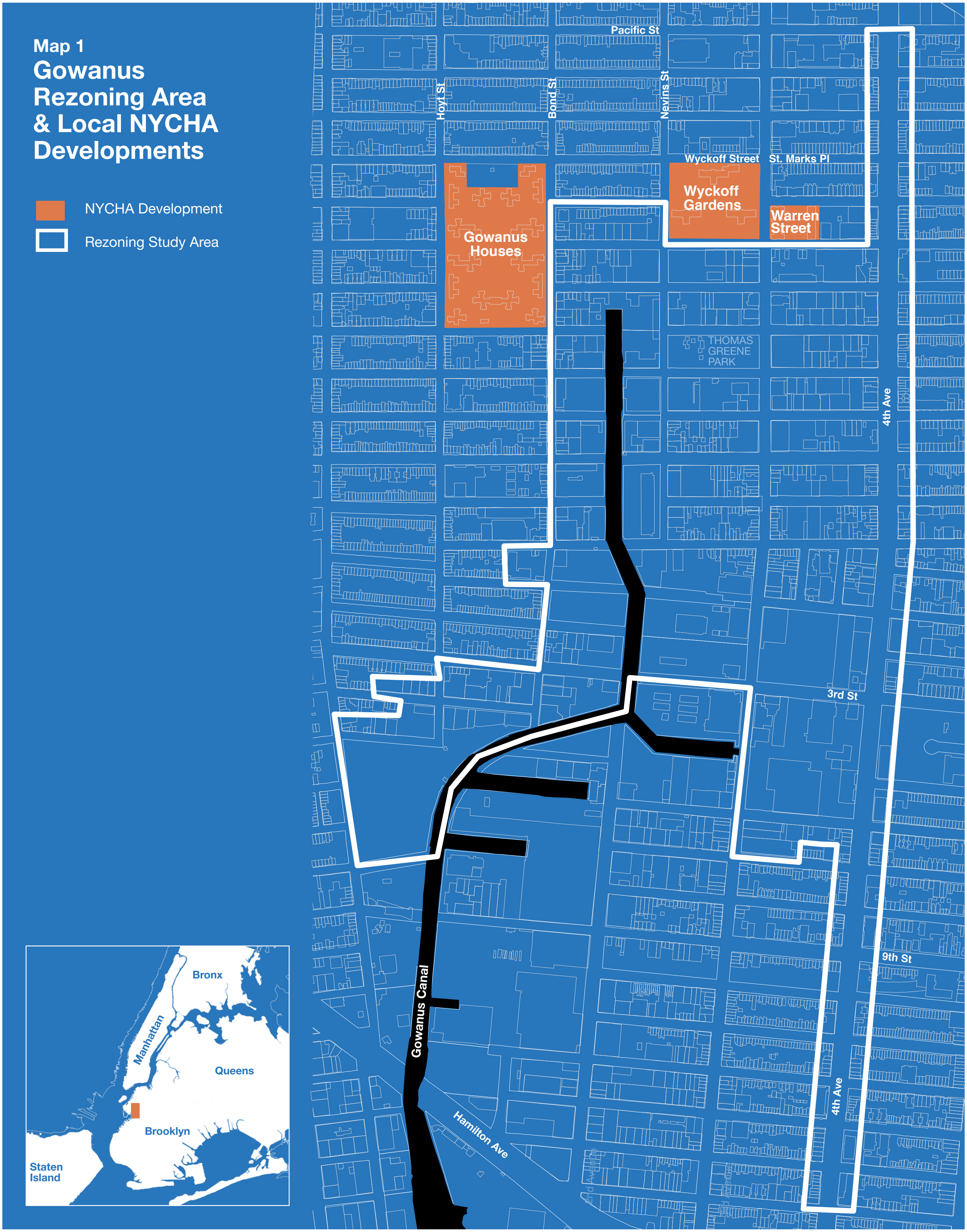
Despite this public housing crisis, the City has not meaningfully linked its Housing New York and NYCHA Next Generation strategies to preserve public housing as part of the Gowanus rezoning. By excluding Gowanus NYCHA developments from the rezoning boundary, the City prevents NYCHA from directly benefiting from the land use action and therefore risks exacerbating the existing inequalities between residents of public housing and the community's wealthier and white neighbors.

The City is missing an opportunity to address the public housing crisis that deserves its full attention, especially given NYCHA's extensive capital needs and the amount of property value being created through the City's land use actions. In New York, when regulatory actions such as zoning changes increase land values, landowners or speculative investors disproportionately reap the benefits. Property values increase, rewarding landowners, while soaring rents often displace longstanding businesses and existing residents.

Map 1
Gowanus Rezoning Area & Local NYCHA Developments



> **Justice requires that Gowanus public housing residents meaningfully benefit from improvements and investments coming into the neighborhood.**

In 2016 the City passed the mandatory inclusionary housing (MIH) program, that requires developers benefiting from an increase in allowable density and/or change in land use that allows for residential development, to set aside 20-30 percent of units as permanently affordable to families at specific income levels. The MIH program is an acknowledgment by the City that government actions, not only private investments, can significantly increase private land values. Even after inclusionary housing mandates are fulfilled in Gowanus, however, the developers can still make a profit and afford government action to recover additional publicly created value to finance repairs in public housing. These repairs are critical to the health and well-being of thousands of low-income households who are being left behind in New York's hyper-charged real estate market.

This report first details the results of a study by David Paul Rosen & Associates (DRA) that quantifies the economic value created for property owners by changes to land use designations and density allowances under the Department of City Planning's Gowanus Rezoning Proposal. The DRA study finds that after taking into account development costs in Gowanus and allowing both for compliance with MIH and for an expected rate-of-return of investment for property investors, an additional $108 million to $1.3 billion dollars of land value is generated in the Gowanus neighborhood rezoning.[4]

This report then recommends that the City recover and invest this additional value into the three local public housing developments to address the $237 million capital funding gap. Specifically, we recommend that the City study the feasibility of selling NYCHA's development rights to surrounding parcels within the Gowanus rezoning area, generating resources for a NYCHA Gowanus Improvement fund that would be required to be reinvested directly into Gowanus Houses, Wyckoff Gardens and Warren Street. This report also advocates a deeper Mandatory Inclusionary Housing option in Gowanus that would put new affordable housing created through private development within reach of current NYCHA residents.

Gowanus public housing residents are longtime community members who have been denied the right to safe and healthy housing. Justice requires that they meaningfully benefit from improvements and investments that are coming into the neighborhood. The City has a moral obligation to meaningfully link its strategies to preserve public housing to this rezoning and improve the quality of life for thousands of New Yorkers.

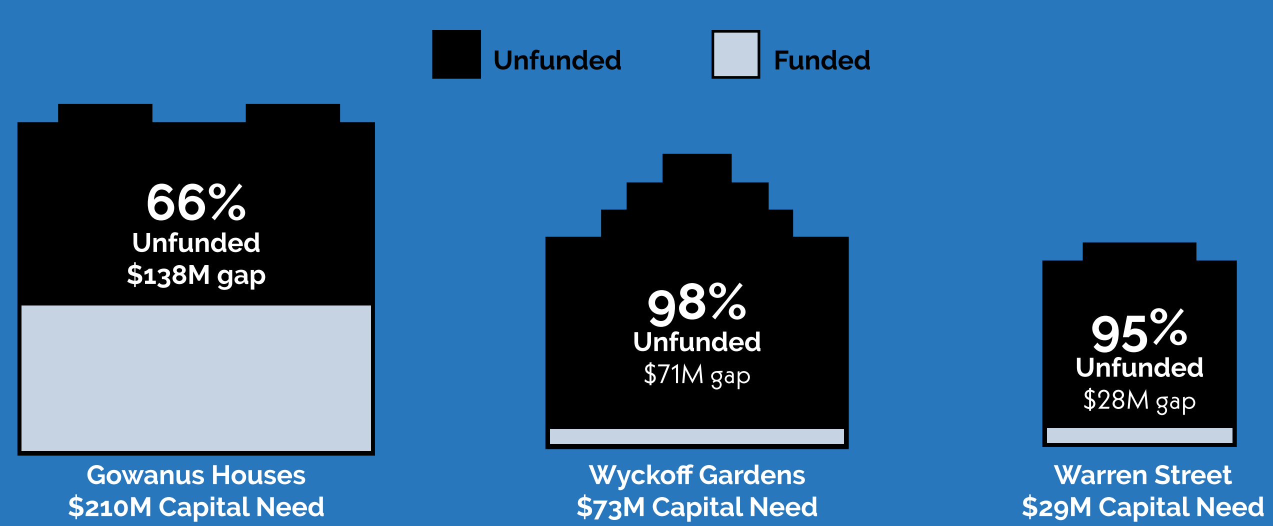
Public Housing: A Critical Asset

NYCHA in Crisis

For too long, New Yorkers who live in public housing have had to endure horrible, often dangerous conditions in their homes. In 2012, Superstorm Sandy attacked an already struggling system and devastated many NYCHA developments, including Gowanus Houses, and brought to light just how fragile and outdated the public housing infrastructure is. NYCHA residents go months without heat or gas, and reside in apartments plagued by rodents, roaches, mold, leaks, and chipping lead paint.[5] In Gowanus, residents also endure sewage backups into their apartments. In addition to being unpleasant, these conditions threaten community members' physical and mental health on a daily basis.[6] City and State officials have now recognized the urgency, with the Governor going as far as to declare a state of emergency for NYCHA.[7]

According to NYCHA's 2017 Physical Needs Assessment (PNA) $32 billion is needed to address capital repairs citywide. Approximately $25 billion or 78% of this need is unfunded based on NYCHA's projected federal capital funding and the cost to maintain its properties in good repair over the next five years.[8] The $2 billion promised by the Mayor

Figure 1
Capital funding need versus funding* at NYCHA developments in Gowanus



*These figures do not include Wyckoff Gardens 50/50 infill project and Warren Street RAD conversion. All figures are rounded up to the nearest one million.

over the next 10 years and the $250 million allocated by the Governor in 2019 is woefully insufficient to address NYCHA's citywide capital funding gap.[9, 10] If public housing conditions continue to deteriorate, the city risks losing 8% of its rental housing stock, further fueling the affordable and homelessness housing crisis and imperiling stability and economic survival for some of the city's most vulnerable households.[11] In Gowanus, the total capital funding need is approximately $312 million for the three local housing developments. Based on funding information provided by NYCHA, $237 million (or 76%) of the capital funding need remains unfunded in Gowanus.[12]

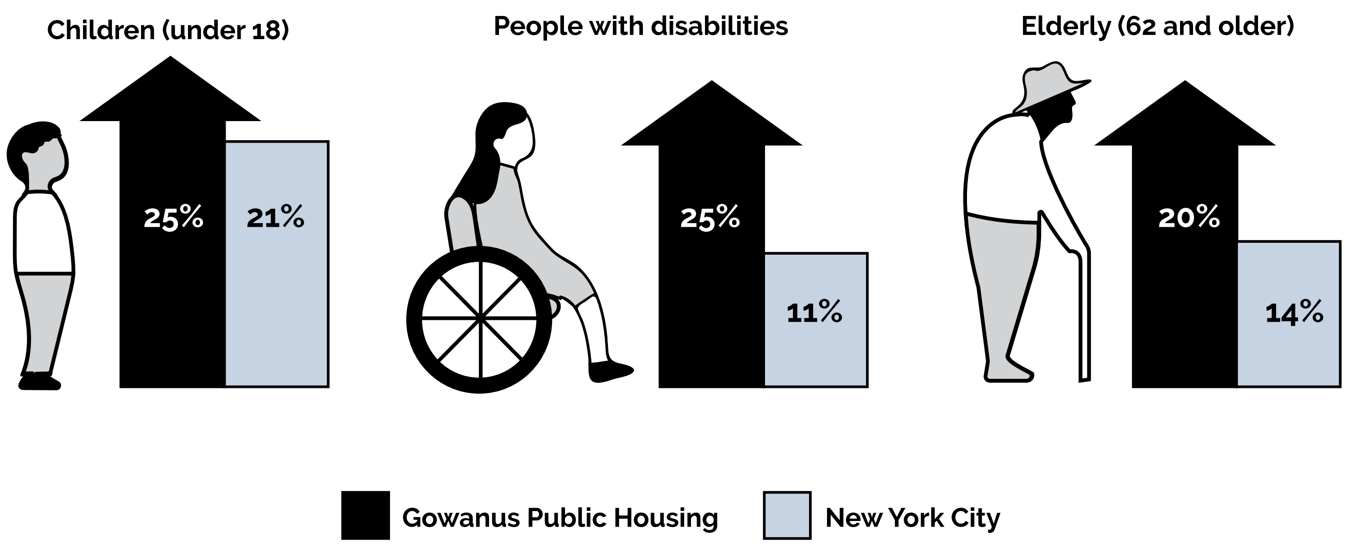
NYCHA's Impact

NYCHA's 178,000 apartments house 15% of New York's low-income population.[13] As the largest residential landlord in the country, NYCHA is home to over 400,000 residents or roughly one out of every 22 New Yorkers. NYCHA residents contribute to $5.9 billion in economic output in New York City.[14] Every New Yorker, not just those living in NYCHA, will be impacted should the government continue to do nothing about its public housing stock.[15] The importance of NYCHA to our social fabric and fair housing goals to desegregate our city neighborhoods cannot be understated. In many neighborhoods throughout the city, NYCHA is the only major housing source contributing to economic and racial diversity.[16] While gentrification has resulted in residential displacement due to rising market-rate rents as well as the deregulation of rent-stabilized housing by unscrupulous landlords, the protection of public housing has allowed residents to remain in their neighborhoods.

This is the case in Gowanus, where median income has sharply risen in the last fifteen years with the arrival of new, wealthier residents. The area has seen a higher rate of deregulation for rent-stabilized units than the city as a whole, 22% compared to 6%.[17] This has resulted in residential displacement that can be measured in part by the decline of Latinx residents from 35% to 25% of the population.[18] As low-income families have been displaced from much of the area's unregulated and rent-stabilized housing, the income gap between public housing residents and other Gowanus residents has increased dramatically. Residents in the larger Gowanus area enjoy much higher median incomes, ranging from

Figure 3

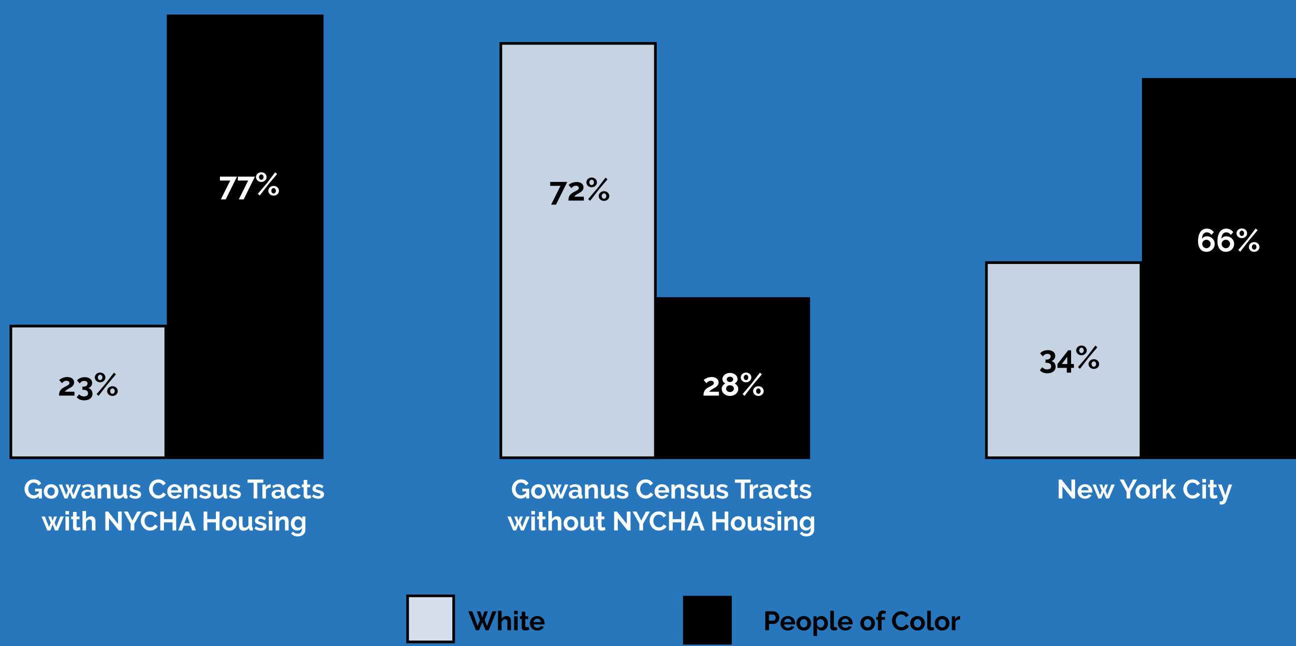
Public housing disproportionately houses populations vulnerable to the health impacts of deteriorating housing conditions.



Source: U.S. Dept. of Housing and Urban Development PD&R eGIS[19,20]; American Community Survey, 5-Year Estimate, 2017.

Figure 4

People of color in Gowanus are disproportionately affected by failures to address conditions in public housing



Source: American Community Survey, 5-Year Estimate, 2017.

$90,000 to $150,000 for census tracts neighboring public housing developments.[21] In contrast, the median incomes for residents of Warren Street, Wyckoff Gardens, and Gowanus Houses range from $15,500 to $18,000.[22,23]

This rezoning is one of many that seeks to address the affordable housing crisis and fulfill the Mayor's promise to build and preserve 300,000 units of affordable housing. And yet, the Mayor's plan actively leaves out public housing, the most affordable housing in the city. NYCHA plays a crucial role in supporting the City's fair housing goals to desegregate neighborhoods and provides an important source of affordable housing to low-income households that disproportionately experience rent-burden.[24] The City has an opportunity and a responsibility to recover the value that is created by this rezoning and to reinvest it into public housing and its residents.

> **"NYCHA plays a crucial role in supporting the City's fair housing goal of desegregating neighborhoods, and provides an important source of affordable housing to low-income households..."**

Study Overview

Calculating Increased Land Value

The Gowanus land value analysis performed by DRA estimates the post-rezoning increase in property values in the Gowanus rezoning area under the Department of City Planning's draft Gowanus Neighborhood Zoning Proposal.[25] DRA analysts followed a five-step-process to arrive at their estimate.

1. Analyzing Current Land Values

Pre-zoning land value for 2018 was estimated based on property characteristics and land sale transactions by major zoning category (residential, manufacturing, and commercial). Median or average prices from these transactions were calculated for the 798 parcels found in the rezoning study area, yielding low and high estimate for pre-zoning land value on a site per site square foot basis for the entire area.[26] Pratt Center then took the average of DRA's low and high estimate to arrive at the land value for 2018 for the 387 parcels considered most likely to be redeveloped. The estimated 2018 value of those 387 parcels is $2.59 billion.

2. Identifying Three Housing Prototypes

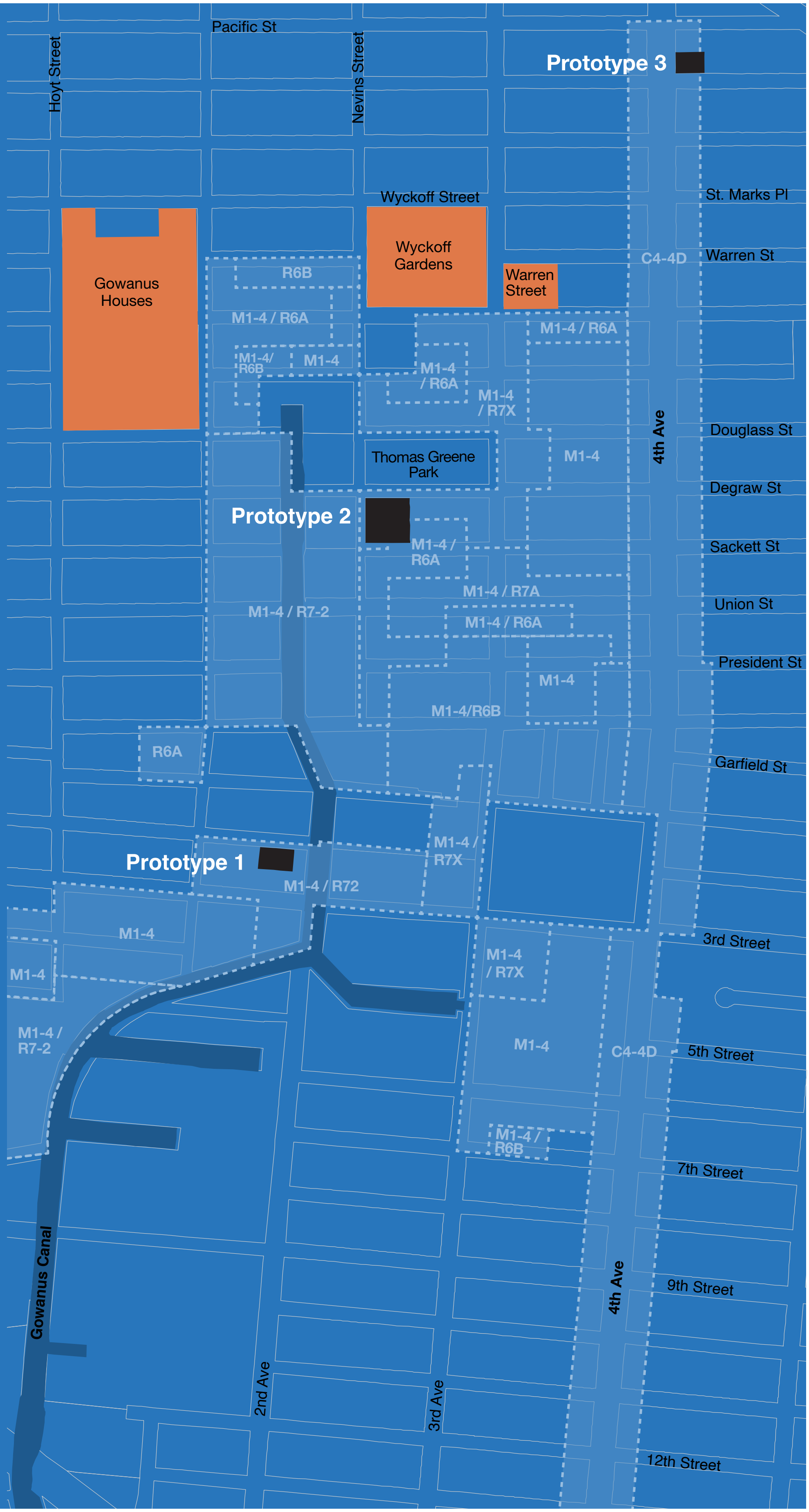
The Fifth Avenue Committee (FAC), a non-profit affordable housing developer based in Gowanus, then identified three prototype parcels in the rezoning area that are likely to be redeveloped under DCP's zoning proposal. The prototypes represent the type of development likely to occur under new zoning designations, which is expected to be primarily residential. FAC constructed the prototypes using market-based assumptions about development costs and operating revenues in New York City. They verified these assumptions with reference to their own current projects in construction and pre-development as well as third party unrelated sources and multiple discussions with local contractors, developers, brokers and consultants advising for-profit developers in Gowanus. Each prototype serves as a detailed example of the type of development that would likely occur on the site.

Map 2
Prototype Locations and Gowanus Rezoning Proposal

New zoning districts *(proposed)*

NYCHA development

Prototype Site



Prototype 1
155 3rd St

Zoning type	Industrial	Residential
Zoning designation	M2-1	M1-4/ R7-2
Floor Area Ratio (FAR)	2.0	4.4
Approximate stories (max)	2	17-22

Prototype 2
537 Sackett St

Zoning type	Industrial	Residential
Zoning designation	M2-1	M1-4/ R7X
Floor Area Ratio (FAR)	2.0	5.6
Approximate stories (max)	2	14

Prototype 3
35 Fourth Ave

Zoning type	Residential	Residential
Zoning designation	R8A / R6B /C2-4	R-9A / C4-4D
Floor Area Ratio (FAR)	7.2	7.7
Approximate stories (max)	3-14	17

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3. Applying Residual Land Value (RLV) Methodology to Housing Prototypes

DRA then estimated the post-rezoning residual land value for the three prototype sites. When a developer is thinking about acquiring a parcel, they consider two things: the total financial value of the building they will be able to build on the parcel (inclusive of a reasonable return on investment) and how much it is going to cost them (in construction costs, interest on debt etc.) to build. The difference between the two is the amount they will be willing to pay for the site, or the residual land value of the site.

In estimating the residual land value for the prototypes, DRA drew on DCP's proposed use, height and bulk reclassifications and on FAC's assumptions about the costs involved in developing the properties and the income that would be realized from the completed projects. The costs include MIH requirements assuming Option 1, parking requirements, water treatment and open space requirements, and environmental remediation costs[26] for the canal-front prototype. (For more information about cost and revenue assumptions see Appendix B and D).

4. Estimating Land Values after Rezoning

DRA then used the prototypes to estimate the residual land value across the area post-rezoning by:

- Identifying the 387 parcels[27] most likely to be redeveloped under DCP's draft zoning proposal;
- Multiplying the site area and buildable square foot figures for the three zoning designations by estimated residual land values for the zoning prototypes.

5. Calculating the Land Value Uplift

Finally, DRA subtracted the estimate of current land value from the estimate of future land value associated with likely redevelopment. **The analysis yielded an uplift estimate of $108 million to $1.3 billion dollars**.[28] This range constitutes the minimum and maximum residual land value in the rezoning area even after the developers and investors have taken out a return on their investment.[29] In other words, this value could be recovered and invested by the City into meeting the needs of public housing residents, *without making development unprofitable in the neighborhood.*

What is residual land value?

DRA used a method called residual land value (RLV) analysis to estimate post-rezoning land values. This method estimates the value of land by determining the value of what can be developed on that land under current market and regulatory conditions assuming "highest and best use," and then subtracting from it the cost of creating that value, inclusive of investor return, current costs of construction and environmental remediation, and requirements under DCP's zoning proposal. The "residual" is what the land is worth on its own.

1. Real Estate Revenue

– Operating Costs

= **Net Operating Income (NOI)**

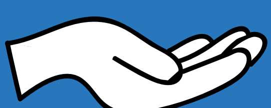
2. NOI / Market Cap Rate

= **Capitalized NOI**

3. Capitalized NOI

– Development Costs

= **Land Value**



1. Calculate the Net Operating Income (NOI)

NOI is the revenue generated by a property minus maintenance and management expenses. NOI is used to analyze the profitability of real estate investments that generate rental income. It is considered the best way to calculate the financial health of a property because it is least susceptible to manipulation.

2. Apply Market Capitalization Rate to the NOI

NOI is capitalized using a market capitalization rate, which is an indicator of the risk investors are willing to take with their capital under current market conditions. Capitalized NOI is an estimate of what the developed property is likely to be worth if it were placed on the market to be sold.

3. Apply Residual Land Value Method

The residual land value is the difference between what a potential development would be worth on the market today, such as a multi-family residential building, and the cost of creating that building.

To arrive at the residual land value, the costs of creating the development are subtracted from the capitalized NOI. Costs of development include construction costs and "soft costs," and incorporate a required rate of on investment (i.e., the rent that a developer pays investors for the use of their capital).

Case Example

Prototype 2: 537 Sackett St

The 537 Sackett Street property is a 40,000 square foot block-through parcel situated off of Nevins Street and next to Thomas Greene Park. Currently, 537 Sackett Street is zoned for manufacturing (M1-2) and is home to a two-story industrial building built in 1950. Formerly the location of a light fixture manufacturer, the site was most recently Adams Books Company, an independent bookseller that sells textbooks to schools.

According to the Department of City Planning's Gowanus Zoning Proposal, the parcel would be rezoned to a residential classification (M1-4 /R7X) with an option for increased density if non-residential uses are included. We assumed that under this zoning, a developer would choose to build out the lot as a 100% residential building at a floor area ratio (FAR) of 5.6.

Figure 5

537 Sackett Street

	Currently	Post-Rezoning
Zoning designation	M1-2	R7X/R6A
Zoning type	Manufacturing	Residential
Allowable use groups[31,32]	4-14	2
Max FAR	2.0	5.6
# of stories (max)	2-Story	14-Story
# of housing units (total)	None	222
# of MIH units	None	56
Estimated value per square foot	$708	$1,423
Estimated site value	$28.3 million	$56.9 million (RLV)
	Estimated Value Uplift	↑ $28.6 million

Example of a residential building that might be built under new rezoning.

DRA used data on sales transactions for similarly zoned parcels to estimate that the current value of the 537 Sackett Street property is approximately $708 per square foot, making the estimated total current value of the site approximately $28.3 million. If, post-rezoning, the owner of the site were to develop it to the specifications stated above, the result would be a 14-story building with 33 underground parking spaces and 222 apartments, 56 of which would be available to households earning 40% to 80% Area Median Income (AMI) under the City's MIH Option 1.

The capitalized residual land value of this property after the post-rezoning development occurs is estimated to be $1,423 per square foot.[30] The total residual land value at 537 Sackett Street is $1,423 x 40,000 square feet, or $56.9 million. The value of the site will increase by approximately $715 per square foot as a result of the rezoning. The implication is that the city could recover approximately $28.6 million after developers have collected their return-on-investment.

Opportunity Zone Tax Benefits

What are Opportunity Zones?

The Tax Cuts and Jobs Act, passed by Congress at the end of 2017, provides tax incentives for investing in designated Qualified Opportunity Zones. Opportunity Zones (OZs) are census tracts designated by state governors that must have poverty rates of at least 20 percent or a median family income of no more than 80 percent of the statewide or metropolitan area averages.

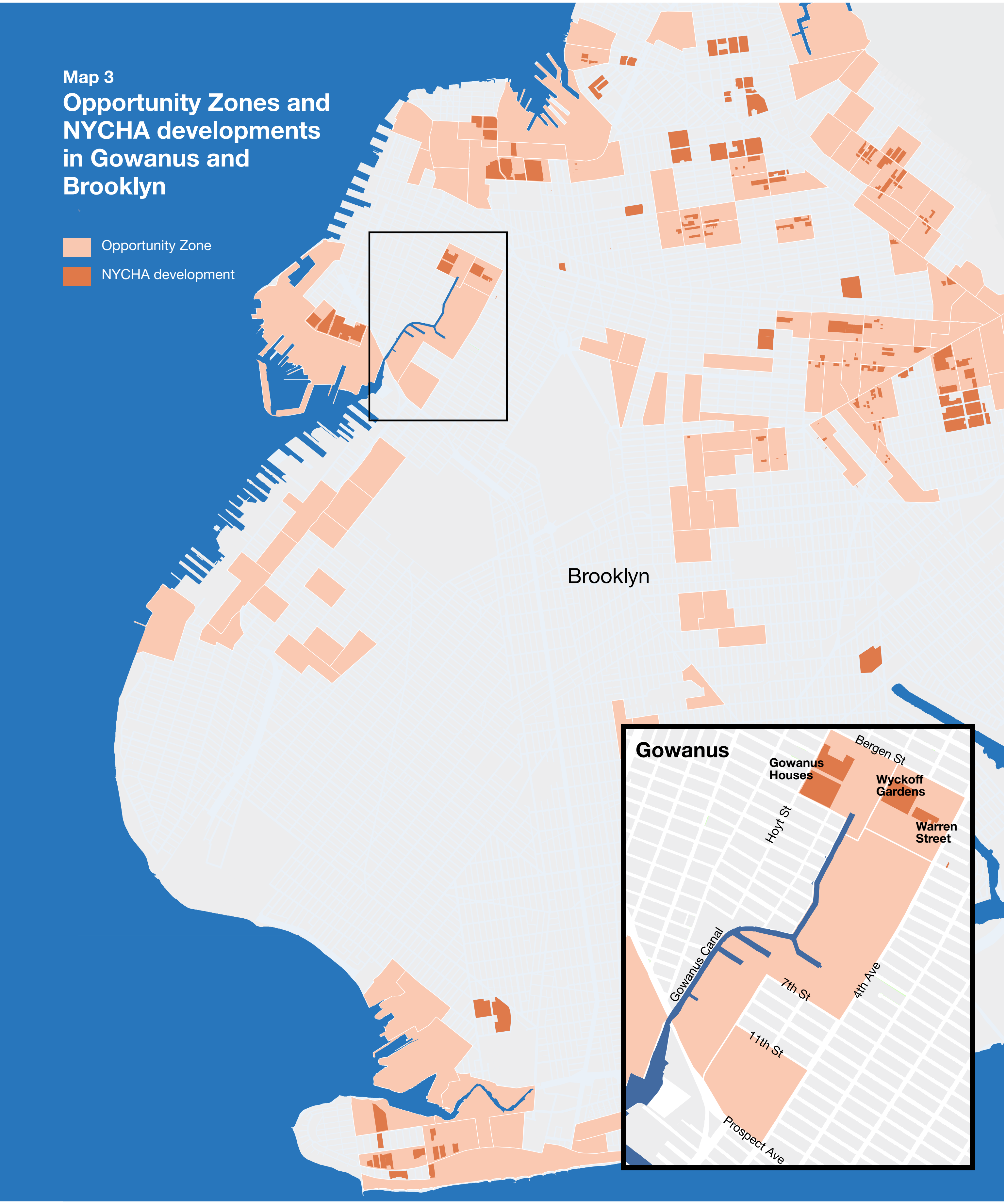
Investors seeking OZ benefits place capital into “Qualified Opportunity Funds” which hold at least 90% of their assets in Opportunity Zones. The OZ program requires than an investor make a “substantial improvement” in a property. Therefore, OZ real estate investments are either ground-up developments (undeveloped land or the complete tear-down of any existing structure) or projects requiring significant redevelopment. Additionally, New York State is a conforming state in the Federal OZ program, meaning that investment in a New York State OZ provides the same tax advantages to investors at the state level as those provided at the Federal level.

What does this mean for Gowanus?

The majority of the proposed Gowanus rezoning lies within a Qualified Opportunity Zone. The federal OZ designation has the potential to increase an investor’s after-tax returns and as a result increase what the investor is willing to pay for the OZ development site.

537 Sackett Street is located in Brooklyn’s Census Tract 119, a designated OZ. The site is zoned for industrial with a permitted FAR of 2. Based on its current industrial use, the income value of 537 Sackett Street is roughly $11 million. According to the Office of the City Register, however, the deed for 537 Sackett Street was purchased on January 3, 2018 for a much higher sum, $26.5 million. The $15 million difference between the purchase price and the property’s value suggests that the buyer is anticipating a higher and better use for the property due to the pending rezoning.[33] 537 Sackett Street's location in an OZ also increases the potential value of the site.

The return for an investor who places capital in a qualified opportunity fund that acquires the 537 Sackett Street site by the end of 2021 and sells it a decade later would receive different tax treatment from someone who invested in the property via a non-OZ fund.[34] Taking into account this OZ benefit, our analysis of a hypothetical ground-up development at 537 Sackett Street suggests that the value of the site increases by approximately $63 per square foot. This means that the current owner would likely sell the site to an OZ buyer today for a gain greater than $7 million, without having improved the site at all – showing that the OZ designation increases the potential value of the sites even more than the DRA analysis estimates.[35]


Map 3
Opportunity Zones and NYCHA developments in Gowanus and Brooklyn
Opportunity Zone
NYCHA development
Brooklyn
Gowanus
Gowanus Houses
Bergen St
Wyckoff Gardens
Warren Street
Hoyt St
Gowanus Canal
7th St
4th Ave
11th St
Prospect Ave

Recovering Value for NYCHA

From Value Capture to Public Value Recovery

Deteriorating apartment conditions are contributing to a quality of life and public health crisis in Gowanus. Currently, planned work is not adequate to meet the $312 million capital need, with $237 million remaining unfunded. While the City has proposed bringing additional funding to NYCHA through infill development at Wyckoff Gardens or by accessing the U.S. Housing and Urban Development (HUD) Rental Assistance Demonstration (RAD) program for Warren Street, many residents oppose one or both of these proposed strategies. Furthermore, there is no proposal to address the unfunded need at Gowanus Houses, which currently has the largest unfunded dollar amount ($138 million) of the three NYCHA developments.

An Equity Framework

Policy makers dedicated to equitable community development must consider the following questions when implementing a public value recovery mechanism:

1. From whom will the public sector be recovering economic value created as a result of public sector actions or infrastructure/public realm investments?
2. To whom will that economic value be likely to accrue after being recovered and distributed?
3. What is the relationship of the value recovery mechanism to the overall taxation and budget process?
4. Who bears the financial risks (if any) associated with depending on future revenues to fund current investment?
5. Who is involved in governing value recovery and allocation?

There is ample precedent for recovering property value increases triggered by public actions like rezonings. Land value capture refers broadly to a variety of mechanisms that "secure social benefits from increase in land value" due to land use change or investment in public infrastructure.[36] The Gowanus neighborhood presents the City with a promising opportunity to leverage a zoning action to support local community development that prioritizes existing need and advances equity. In the case of Gowanus, the greatest need lies in addressing urgent repairs at NYCHA's Gowanus Houses, Wyckoff Gardens, and Warren Street Houses.

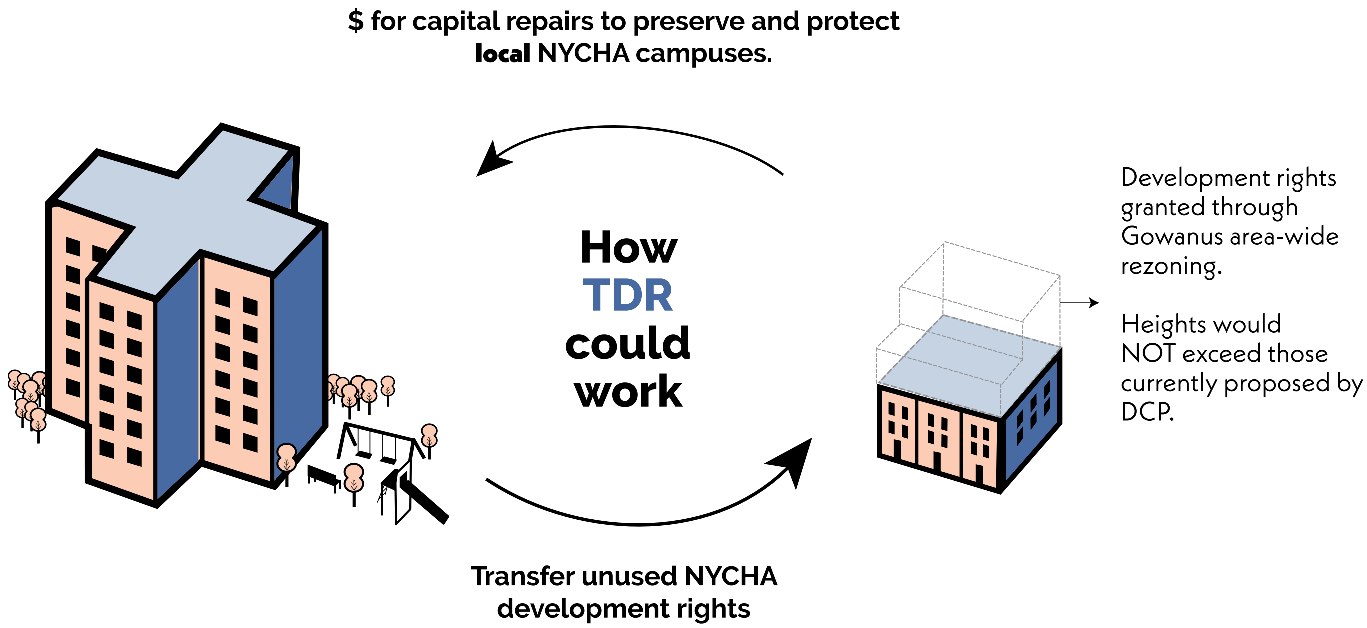
The question of how to recover a portion of the increase in land value conferred by the City's rezoning is a difficult one. Many available land value capture tools involve significant legal and political barriers, including the need for state legislative approval (See Appendix C). In addition, land value capture generally focuses exclusively on the mechanism for recovering value for the general public good but fails to address the question of how to equitably distribute value once recovered. This results in land value capture practices that contribute to urban inequality rather than alleviating it.

By centering equity, policymakers can shift the approach from value capture to public value recovery and ensure those most in need benefit from rezonings and other public investment.[37] Taking this into consideration and given the urgency of the impending rezoning in Gowanus, we identified two key mechanisms that would redistribute the value to NYCHA residents in the area:

1. the sale of NYCHA's development rights to surrounding parcels within the proposed Gowanus rezoning area and reinvest directly into the local public housing developments; and

2. a deeper Mandatory Inclusionary Housing option that would put new affordable housing within reach of current NYCHA residents.

Figure 3



Transfer of Development Rights

Transfer of Development Rights (TDR), also known as transfer of air rights, is a land use control mechanism that moves the right to build from one location to the other. TDR works by allowing an owner to sell their property's unused building rights to the owner of another property. This tool has been used to protect natural resources or other types of properties such as landmarked buildings and to incentivize development in certain areas.

In this case, TDR would protect NYCHA as an important public asset and improve living conditions for residents by moving the rights to build on NYCHA property to properties within DCP's proposed rezoning area. Instead of automatically being granted the right to build taller and bigger buildings, developers in Gowanus would purchase development rights transferred from the NYCHA properties adjacent to the currently proposed rezoning area. In the Gowanus area alone, the City Council estimates that $100 - $200 million could be generated by a TDR program that enables developers to purchase rights transferred from Gowanus Houses, Wyckoff Gardens, and Warren Street Houses.[38]

Our proposal to use TDR to support public housing in Gowanus is far from radical – in fact, it aligns with a strategy the City already plans to use to generate financing for NYCHA. In December 2018, Mayor de Blasio announced "NYCHA 2.0," the City's latest plan to bring needed funding to NYCHA campuses. This ten-year plan includes TDR, a strategy referred to as "Transfer to Preserve," as a method of bringing in additional funding for NYCHA repairs.

Despite this, and despite a strong local housing market that would make TDR especially feasible in the Gowanus area, the City has expressed no intention to make TDR part of this rezoning. The Gowanus Neighborhood Coalition for Justice (GNCJ), a coalition of community groups, advocates and NYCHA residents, has urged DCP to study the potential applicability of TDR as a means to recover value for local NYCHA repairs.[39] Additionally, City Councilmembers Brad Lander and Steve Levin, who represent the area to be rezoned, have endorsed TDR in their comments on City Planning's draft scope of work (DSOW) for the Gowanus Rezoning Proposal.[40]

There are a number of ways in which the City could facilitate TDR to reduce transaction costs, ensure NYCHA accountability and transparency, and even accelerate the time it will take to make repairs. First, a TDR bank could be established where one entity is buying and selling development rights to reduce the time and cost of these transactions. Second would be to require NYCHA to develop a capital investment plan that is shared with elected officials and NYCHA residents so that the order in which repairs will be addressed is clear. Transparency with respect to when and how sales and investment will happen is of utmost importance and crucial for the rights and dignity of residents. Finally, while TDR has the potential to recover and address most or all of the capital repair needs, it generates funds over a period of time. Given the urgent health and safety needs of residents, we recommend the government develop a process to lend money to NYCHA using bonds. NYCHA would have the ability to begin making repairs much sooner and would repay these loans as TDR sales become available.

It would be a great disservice to the longtime Gowanus residents if the City were to pass on this unique opportunity to bring funding to NYCHA developments as billions of dollars in public and private investment make its way to the neighborhood through this City sponsored rezoning.

A Deeper Mandatory Inclusionary Housing Policy

The City's Mandatory Inclusionary Housing (MIH) ordinance is a key initiative of Mayor de Blasio's housing plan and the impetus for the Gowanus neighborhood rezoning.[41] MIH requires developers to build permanently affordable housing alongside market-rate housing in certain areas where there has been a residential upzoning. The MIH ordinance has been key to creating a supply of permanently below-market units for New Yorkers at a range of incomes. Proponents of the Gowanus rezoning have said it will ensure that at least some affordable housing is built, since without a rezoning that maps MIH, developers will continue to build 100% market rate buildings. But MIH falls short when developers are permitted to build units whose rents, albeit below market, are not affordable to over half of the City's population and to a majority of the City's public housing population.

In Gowanus, 63% of Gowanus residents who live in the three local public housing developments have incomes below the lowest MIH affordability option available.[42] Permanently affordable housing generated in Gowanus under the City's current MIH policy will be out of reach for the vast majority of the remaining low-income population in this rapidly gentrifying area and especially public housing residents. In addition, developers cannot be required to choose Option 3, the "deepest affordability option" of the MIH program.

> **"MIH falls short when developers are permitted to build units whose rents are not affordable to over half of the City's population and to a majority of the City's public housing population."**

We are not advocating for a change to the MIH program, which would require a change in citywide legislation. However, the City should review its options with respect to how it can require more deeply affordable units in Gowanus given the increase in property value that is being produced by this neighborhood rezoning. Additionally, the City will need to analyze and consider the trade-offs between attaining deeper affordability for MIH units versus preserving revenue for the purchase of NYCHA air rights. The City has frequently said that the "Mandatory Inclusionary Housing represents the floor, not the ceiling, of affordability that would ultimately be achieved in new development."[43] The City has an opportunity in Gowanus to show its continued commitment to providing truly affordable housing to those most in need of this housing. Public housing residents deserve to benefit from the new housing opportunities afforded through the MIH program, the City's primary program for constructing new, permanently affordable housing. Pricing out public housing residents by offering unattainable new housing serves to further exclude residents from opportunities afforded through this rezoning.

Figure 6

City's proposed MIH Options would render vast majority of public housing households ineligible for new affordable housing based on income

63% of public housing households in Gowanus make below 30% AMI

83% of public housing households in Gowanus make below 50%AMI

		MIH Option 3		MIH Option 1	MIH Option 2		MIH Option 4
Area Median Income (AMI)	**30% AMI**	**40% AMI**	**50% AMI**	**60% AMI**	**80% AMI**	**100% AMI**	**110% AMI**
Family of 3	**$28,830**	**$38,440**	**$48,050**	**$57,660**	**$76,880**	**$96,100**	**$105,710**

Conclusion

Gowanus public housing residents are longtime community members who have been denied the right to safe and healthy housing. Justice requires that they meaningfully benefit from improvements and investments that are coming into the neighborhood. The rezoning alone will generate $108 million to $1.3 billion in additional land value for the Gowanus neighborhood.

The City must and can meaningfully link its strategies to preserve public housing with this rezoning by studying the feasibility of (1) the sale of NYCHA's development rights to surrounding parcels within the Gowanus rezoning and reinvest directly into the local public housing developments and (2) a deeper Mandatory Inclusionary Housing option in Gowanus that would put new affordable housing within reach of current NYCHA residents.

The state of emergency at NYCHA requires an urgent response to the crisis in order to address the poor quality of life and public health needs of public housing residents. All options that recognize the rights, dignity, and respect of public housing residents must be considered.

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27. DRA assumed sites that experienced a zoning change would be redeveloped.

28. This range is due to the fact that estimated property values resulting from rezoning are estimated under both the “low” cap rate of 4.5% and “high” cap rate of 5%.

29. A 12% rate-of-return is assumed for investors

30. The site value of $56.9 million assumes a 4.5% market capitalization rate. If a 5% cap rate is used, the land value is $1,062 per site square foot, and the total value of the property is $42.48 million. Approximately $14.4 million could be recovered by the public sector without making development unprofitable on the site assuming a 12% return on cost.

31. Use groups 4-14 consist of: Community facility; Hotels; Retail and services establishments serving local; Home maintenance and repair services serving local; Amusement establishments; Service Uses; Business and other services; Large retail establishments that serve a large area; Custom Manufacturing Activities; Large entertainment facilities that draw large numbers of people; Low coverage or open amusement uses; Facilities for boating; Waterfront recreation areas.

32. Use groups 1-3 consist of: all other types of residents (except for single family detached homes)

33. The property prices used for the DRA analysis reflect this “front running” in anticipation of a rezoning but do not reflect the potential value increase from the OZ program. OZ analytics were outside the scope of DRA’s analysis.

34. For the equity placed in the OZ fund, federal and state capital gains taxes would be deferred by 5 years, and only 90% of the original amount owed would be collected in Year 5. At the time of sale in 2031, the basis in the property would be stepped up to fair market value so that the gains would not be subject to federal or state capital gains tax.

35. Other factors related to the compliance requirements of the OZ program and the timing for the rezoning do come into play. For starters, the OZ program has a bias for “shovel-ready” projects. This is because capital raised for OZ projects has to have a plan for deployment to satisfy the OZ program’s 90% test. OZ funds must hold 90% of their assets in OZ property. An OZ fund can “safe harbor” its cash for 31 months provided it has a plan for implementing the cash during that 31-month period. An investor is not likely to pay an OZ premium for a site where the plan for development is predicated upon a rezoning being complete. One reason why prices in Gowanus have not moved related to OZ investments is because there are no “shovel-ready” projects there.

    A related factor limiting OZ investing in Gowanus has to do with how the timing uncertainty associated with the rezoning aligns with the fixed milestones associated with the OZ program. The OZ program is time-sensitive and designed to encourage investments before the end of 2019 and again before the end of 2021. Important tax benefits will not be available to OZ investors if they are not active at the end of 2021, and a consensus view is that OZ activity nationally will be reduced after 2021. The complexity, timing and risks associated with the conclusion of the rezoning makes it uncertain that investors will be able to take advantage of a tax reduction feature of the OZ program before the end of 2021. This is a second likely consideration holding back OZ investors in Gowanus.

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Appendix A

Prototype Assumptions

The table below summarizes the development assumptions for the three prototypes. It shows the estimated residual land value per buildable square foot and per square foot site area for each site based on the Gowanus rezoning proposal.

Summary of Residential Development Prototype Analysis Gowanus Area-Wide Rezoning Proposal

	Prototype 1 155 3rd Street	Prototype 2 537 Sackett Street	Prototype 3 35 4th Avenue
Location Description	Canal at 3rd Street	Nevins / Sackett Street	4th Ave. btw Dean & Pacific Street
Zoning	M1(4) / R7-2	M1(4) / R7X	R9A / C4-4D
Construction Type	Poured Concrete	Block and Plank	Poured Concrete
Number of Stories	17-22 stories	Max. 14 stories	Max. 17 stories
Permitted FAR	4.4	5.6	7.7
Density	190 dus / acre	222 dus / acre	431 dus / acre
Parking Type	Structured parking with building shell	Underground	Underground
Total Units	226	222	178
Average Unit Size	829 SF	717 SF	634 SF

Prototype Residual Land Value per SF (assumes MIH Options1)[1]

	Prototype 1 155 3rd Street	Prototype 2 537 Sackett Street	Prototype 3 35 4th Avenue
Per Building SF Low cap rate (4.5%) / High cap rate (5.%)	$193 / $126	$264 / $197	$239 / $168
Per SF Site Area Low cap rate (4.5%) / High cap rate (5.%)	$961 / $628	$1,423 / $1,062	$2,033 / $1,429
Environmental Redmediation[2] Low cap rate (4.5%) / High cap rate (5.%)	$889 / $556	Not applicable	Not applicable

1. Cap rate based on CBRE 2nd Half 2018 Cap Rate Survey data for multifamily infill projects in New York City, NY. Current range is 4.25 to 5.00. Assumes a minimum return on cost of 12%.
2. DRA estimated open space capital and maintenance costs under "low" and "high" cost scenarios. The "low" cost scenario reflects a minimally required amount of open space and level of improvements. The "high" cost scenario represents a higher, premium amount of open space and higher quality of improvements.

Appendix B

Gowanus Prototype Analysis- Cost & Revenue Assumptions

Below is an overview of prototype construction, operating and revenue costs. For more detail, please see David Paul Rosen & Associates (DRA) report.

		Prototype 1 155 3rd Street	Prototype 2 537 Sackett Street	Prototype 3 35 4th Avenue
Construction costs	**Building hard construction cost** low cost - per buildable square foot	**$350**	**$300**	**$350**
	Structured/ Underground Parking per square foot parking area	**$250**	**$250**	**$250**
	Soft Costs % of hard costs + construction costs	**30%**	**30%**	**30%**
	Public open space improvements low cost - per acre of open space	**$3M**	**N/A**	**N/A**
	Water treatment facility	**$70K**	**N/A**	**N/A**
Revenue & Operating Costs	**Average monthly rent per square foot**	**$5.33**	**$4.80**	**$5.33**
	Parking income $/space/month - assumes 100% utilization	**$450**	**$400**	**$500**
	Stabilized rental vacancy rate - Market	**5%**	**5%**	**5%**
	Stabilized rental vacancy rate - MIH ($/space/month - assumes 100% utilization)	**3%**	**3%**	**3%**
	Retail income ($/NSF/Year assuming triple net lease)	**$55.00**	**$55.00**	**$55.00**
	Retail vacancy rate	**5%**	**5%**	**5%**
	Miscellaneous income (annual per unit)	**$120**	**$120**	**$120**
	Rental operating cost (annual per unit)	**$7,498**	**$6,671**	**$6,552**
	Public open space maintenance	**$68,852**	**N/A**	**N/A**
	Water facility management per site acre per year	**$521,602**	**N/A**	**N/A**
Financing	**Market Capitalization Rate** (Low / High)	**4.5% / 5%**	**4.5% / 5%**	**4.5% / 5%**
	Minimum return on cost % of total development costs including land	**12%**	**12%**	**12%**

Appendix C

Summary of Public Value Recovery Mechanisms

Professor Laura Wolf-Powers, with input from partners at the Lincoln Institute of Land Policy, evaluated a variety of value recovery mechanisms from technical, legal and political perspectives to determine their potential to leverage publicly created value to address the severe capital needs of the three public housing developments, Gowanus Houses, Wyckoff Gardens and Warren Street houses, in immediate proximity to the Gowanus rezoning area. Tools were evaluated using an Equity Framework, timeliness of implementation, and whether implementation of the tool is legally feasible to recover value for the local public housing developments.

Value Recovery Tool	Description	Considerations *Legal & political*	Outcomes *Does it meet our goals?*
Special assessment	A charge imposed by a government on the owners of a selected group of properties to recover the cost (whole or in part) of a specific improvement or services that is presumed to be of general benefit to the public and of special benefit to the property owners	Enacted through city legislation Legality of the tool requires: - A **"nexus"** i.e., property owners are specific benefit from the use to which their contribution is put - **"Proportionality,"** the property owners paying the assessment should benefit from the expenditure in proportion to their outlay	**Legally infeasible** as tool would not meet nexus or proportionality condition if applied to Gowanus property owners to generate improvement on local NYCHA properties.
Charges for building rights or purchasable bonus	Developers pay the municipality a fee for additional development rights, which funds infrastructure or other public improvements.	A purchasable bonus for improvements to Gowanus Houses, Wyckoff Gardens and Warren Street Houses would need to flow through a municipal corporation or authority. NYCHA could be that authority.	The sale of bonuses would be unpredictable although this revenue stream could be used as collateral for borrowing in a carefully structured instrument. Without such an arrangement, NYCHA or any other authority/ corporation would probably have to wait until enough funds accumulated to begin capital repairs at the local public housing developments. **In Gowanus, additional density might invoke additional infrastructure challenges.**
Exactions	Developers pay the city to mitigate the cost of additional public services required by new development.	No state enabling legislation exists that specifically allows NYC to levy impact fees or exactions. Legality of tool requires identifying specific environmental or social impacts that exactions or fees would mitigate.	This strategy is subject to debate, with some experts who see insurmountable legal barriers while others cite lack of political will. If they construed the concept of mitigation broadly, officials or legislators could make a case for the stabilization of deeply affordable units at Gowanus Houses, Wyckoff Gardens and Warren Street Houses as a valid mitigation of the rezoning's impact. The tool might also require state enabling legislation. **Further investigation required.**
Impact or linkage fees	Developers pay the municipality a one-time charge designed to cover the costs associated with a development's impact on certain public services and infrastructure, and the city invests this revenue in public services and infrastructure. Again, the key concept is one of mitigation of impact.		

Payment in Lieu or Taxes (PILOT) negotiated with developers of condominium buildings	A PILOT is a payment made to a government to compensate for property tax revenue lost to tax exempt ownership or status. In several cases in New York State, officials have declared land to be tax-exempt and then used PILOTs to provide tax discounts to property owners.	PILOT payments in New York State have historically amounted to less than what would have been owed if the companies had been paying regular property taxes. If the mechanism were applied to condominiums however, it could be a vehicle to "right-size" taxes on these owners, whose taxes are not currently based on their properties' full value.	**Fails equity framework test.** The tool would have the effect of removing current revenue from the city's General Fund budget. Condominium owners should pay a higher share of the property tax, but this should occur through a straightforward reform process.
Transfer of Development Rights (TDR)	Landowners pay a fee to transfer the unused development rights from one owner to their own property, allowing them to build denser, taller building on their property. The fee generates revenue for the owner of the land "sending" the development rights.	The city could test out its NYCHA 2.0 "Transfer to Preserve" strategy in the Gowanus neighborhood rezoning Instead of automatically being granted the right to build taller and bigger buildings, developers in Gowanus would purchase development rights transferred from the local NYCHA properties adjacent to the currently proposed rezoning area.	Although many details of the City's NYCHA 2.0 plan have not yet been released, applying the concept in Gowanus could be an ideal way to address unmet needs in the local developments and demonstrate the potential of the strategy. **It is worth considering advocacy around this tool.**
Inclusionary Housing	The City requires developers to build a certain amount of low- or moderate-income housing in exchange for the right to construct market-rate residential or commercial properties. The City already has a Mandatory Inclusionary Housing (MIH) program that requires 20-30% of below market rate units in exchange for additional floor area ratio (FAR).	The City's MIH program does not provide capital funding for NYCHA developments in Gowanus. Additionally, 63% of Gowanus area public housing residents earn less than 30% of the AMI and would not be eligible to live in any MIH housing created through this rezoning. Finally, NYC's MIH program does not sufficiently recover the value generated by the City's actions (rezoning).	MIH falls short when developers are permitted to build units whose rents, albeit below market, are not affordable to over half of the City's population and for a majority of the City's public housing population, including Gowanus public housing residents. **The City should review its options with respect to how it can require more deeply affordable units** in Gowanus given the increase in property value that is being produced by this neighborhood rezoning.

Appendix D

Frequently Asked Questions

Analysis of Existing Property Values

1. How were existing property values estimated?

DRA's analyzed annual property sales by major zoning category (manufacturing, residential and commercial). The price per square foot and per dwelling unit by year and major zoning category for these sales are summarized in Table 8 of DRA's report. Except for recent condo sales in the Study Area for which there is no associated land area, DRA estimated existing property values on a per square foot of site area basis. The value of condominium units is estimated on a per dwelling unit basis.
Given the fairly wide range and fluctuation of property sales prices in the Proposed Zoning Area over time, particularly in Manufacturing zones, and the relatively small number of property sales each year, DRA estimated existing property values in the Study Area under "Low", "Middle" and "High" Scenarios to provide a range of estimated values rather than trying to pinpoint a particular estimated value.
Pratt Center calculated the average of DRA's low ($2,208,913,911) and high scenario ($2,964,154,594) for the 387 parcels to arrive at the 2018 land value estimate of $2,586,534,252.50 for the 387 parcels most likely to be redeveloped

2. Does DRA's analysis of 2018 property values take into account speculation?

DRA's 2018 estimates do not directly take into account into account potential speculation in land values since the proposed rezoning of the Gowanus neighborhood was first announced. It is difficult to separate increase in sale prices due to speculation from that associated with the regional growth in property values in the current economy.

Calculating Post-Rezoning Value

3. How were prototypes chosen?

Prototypes were chosen based on major zoning types and where development is anticipated based on the local knowledge of Fifth Avenue Committee and development partners.

4. Why did you only calculate the increase in value for 387 parcels in the zoning proposal?

We calculated the value uplift for just the 387 parcels because they represent parcels that experience a zoning change.

5. Where did the range come from?

DRA evaluated several scenarios based on different development assumptions. For the purposes of this report, Pratt Center used the "low cost" assumption for the remediation sites and "low cost" assumptions for the open space requirements. We then evaluated the post-rezoning value by applying the low cap rate (4.5%) and high cap rate (5%). The range of $100 million to $1.3 billion is a result of the different cap rates.

6. What assumptions went into the development costs and revenue streams?

DRA estimated "vertical" development costs of each prototype based on input from Fifth Avenue Committee and its development partners and included:

- Site improvements
- Building construction
- Parking construction requirements
- Soft costs or indirect costs
- Estimated impact fees
- Remediation costs for canal sites

DRA calculated net operating income (NOI) from each prototype based on:

- Estimated market rents
- Operating costs for the rental units
- Mandatory Inclusionary Housing requirements
- 421-A tax incentive

7. What assumptions are made about parking?

Parking requirements for the prototypes are based on the proposed new parking standards for Gowanus, which require parking spaces for 20% of market-rate units and no parking for affordable units. For the canal-front prototype, parking is assumed to be provided as structure parking within the building shell. For the other two prototypes, parking is assumed to be constructed underground.

8. What is included in soft or indirect costs?

Soft or indirect costs are estimated to equal 30% of hard costs based on DRA's experience with development nationwide and FAC input and are assumed to include:

- Architectural, engineering and design fees;
- Legal and closing costs;
- Taxes and insurance (during the construction period);
- Interest during construction (land and construction loans);
- Financing fees; and
- Marketing and leasing.

9. **What assumptions went into calculating the Mandatory Inclusionary Housing (MIH) requirement?**

DRA calculated used Option 1, which represents the most affordable units offered in New York City's MIH program. Option 1 requirements were calculated for developments with 25% of residential floor area affordable at a weighted average of 60% AMI, with at least 10% of units at 40% of AMI.

10. **How was the 421-a program included in DRA's assumptions?**

DRA assumed the prototypes 1 and 3 would qualify for the Tax Incentive 421-a program. The New 421-a Program is available to projects that commence construction between Jan. 1, 2016 and June 15, 2022 and are completed before June 15, 2026. The set-aside alternatives examined in this analysis are designed to meet both the MIH and 421-a Program requirements. DRA assumes that Alternatives 1, 2 and 4 qualify under Option A and Alternative 3 qualifies under Option F:

Option A:

- 25% of units affordable
  - 10% of units @ 40% AMI
  - 10% of units @ 60% AMI
  - 5% of units @ 130% AMI

- 25% of units affordable
  - The project cannot receive any government subsidies other than tax-exempt bond proceeds and 4% tax credits.

Option F:

- 30% of units affordable
  - 10% of units @ 70% AMI
  - 20% of units @ 130% AMI

11. **How did DRA calculate rents?**

Assumptions on apartment lease rate are based on a review of market data from Streeteasy.com, Elliman Market Reports, MNS Real Estate, and Rentcafe.com for the Gowanus neighborhood and selected comparable projects.

12. **Did DRA calculate vacancy rates for rental units?**

The net operating income calculations assume a 5% vacancy rate on market-rate units.

13. How did DRA arrive at capitalization rates?

Current cap rates were derived from CBRE's "Cap Rate Survey" for the second half of 2018 for multifamily infill properties in New York City and input from FAC's development partners.

Assumptions Specific to Prototype 1: Canal Site

14. What did you include with respect to remediation cost?

Estimated environmental remediation costs of $3.3 M to $4.1 M for a site similar to the canal-front prototype translates into estimated remediation costs of $15 to $18 per buildable square foot, and $73 to $90 per square foot site area. These per square foot remediation costs can be subtracted from the per square foot residual land values to derive the residual land values incorporating the cost of clean-up. For Prototype #1, the residual land value declines from $961 per square foot site area to $889 per square foot (under "low" cost, low cap rate scenario). Additionally, the analysis assumes added development-side costs for wastewater treatment and public open space improvements. All cost assumptions were based on information provided by partners with extensive experience in Brooklyn development. These remediation cost estimates incorporate the potential value of the Brownfield Tax Credit and represent estimated net costs to the developer.

15. **What did you include with respect to open space requirements?**

DRA worked with FAC and information provided by the Gowanus Canal Conservancy to estimate open space requirements and refine estimated capital and maintenance costs for environmental remediation, water quality management and open space. DRA estimated open space capital and maintenance costs under "low" and "high" cost scenarios. The "low" cost scenario reflects a minimally required amount of open space and level of improvements. The "high" cost scenario represents a higher, premium amount of open space and higher quality of improvements.

For the purposes of Pratt Center's report, we used the "low" cost scenario for the canal-front prototype.

Important Definitions

16. **What is the difference between property value, residual land value and the value uplift?**

Property value is the total value of the property.

Residual Land Value (RLV) is the net value that is left over after you calculate development costs, operating expenses and return-on-investment for property investors with respect to the best and highest use of the land.

Value Uplift is what you get when you subtract current residual land value and post-rezoning residual land value.

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