Lenders grapple with new NYC affordable housing regs

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It’s been four months the **New York State Assembly** passed the Affordable New York Housing Program, a tax abatement program that aims to encourage developers to build affordable housing in New York City, but commercial real estate lenders are still figuring out how to underwrite projects. “People are saying, ‘Before we go cowboy with it, let’s get our arms around it [and try to understand it],’” said **Paul McCormick**, senior v.p. of investment sales and capital services at **Ariel Property Advisors**. “To my knowledge, no one has closed a deal with it yet.”

The program replaces the popular 421-a tax abatement, which expired earlier this year. Unlike the old program, where developers secured a preliminary certificate of eligibility before beginning construction, developers are unable to apply for the tax exemption until after a project is completed. The timeline on receiving those benefits after the construction process is completed also hasn’t been defined yet, according to several lawyers familiar with the process.

This is creating uncertainty for developers, who could miss procedural steps that ultimately would disqualify them from receiving the tax abatement once construction is completed, as well as for lenders. "There isn't the clarity you had under the old program, where it was well established what was needed to get benefits," said **Sharon Skolnik**, partner at **Stempel Bennett Claman & Hochberg**. **Alvin Schein**, partner at **Seiden & Schein**, agreed, saying, "The deletion of preliminary certificates of eligibility will cause a regression of the comfort level for lenders."

The change could also cause financial stress for developers during the construction process. "From an economic point of view, there's going to be a need for the developer to carry any increased taxes throughout the entire process," Schein said. "They will get a construction exemption retroactively when the application has been approved, after being completed in full, but it is going to add some burden."

The **NYC Department of Housing Preservation and Development**, which oversees the administration of the program, hasn't given enough guidance on the process, several players told *REFI*. "HPD is still in the process of promulgating the rules [and disclosing] the actual steps that people need to take to be in compliance," Skolnik added. "There's a greater uncertainty as to what's required [and who is] eligible."

Juliet Pierre-Antoine, a spokeswoman for HPD, confirmed that the application process is no longer bifurcated and, as a consequence, only one certificate of eligibility will be issued to developers. "HPD is charged with checking eligibility criteria before we issue a certificate of eligibility," she added, noting that a summary of the new program's requirements, along with application materials, are available at http://www1.nyc.gov/site/hpd/developers/tax-incentives-421a-main.page.

This has meant that the lending process has been confusing for all parties. "If you can't know with absolute certainty that you'll qualify for the program until you build the project and undergo review by some government agency, then this creates delay and uncertainty, which are the enemies of real estate investing and particularly real estate lending," said **Joshua Stein**, a New York-based real estate lawyer. "There are things you're going to do to build your [project] in a certain way to have the characteristics the program wants. If you have any risk of not qualifying, then you could be stuck with a building that might not make any economic sense."

David Blatt, CEO of **CapStack Partners**, an investment bank, equated the new process to the implementation of risk retention among conduit lenders earlier this year. "Lenders were crying that this was the end of securitized lending on commercial real estate," he said. "But all of a sudden, you have a shuffling of players and then it's back to business." Lenders typically like to work within existing guidelines, he added, and are experiencing an acclimation period while they figure out how the underwriting process will work with regard to Affordable New York.

The confusion could present an opportunity for non-bank lenders, especially if banks continue to trim construction lending. "I do think that balance-sheet lenders will go through the process, [especially if it's] promoted by a relationship borrower that is initiating [participation in the product] for a relationship of theirs," said Blatt. Debt funds, in comparison, have an abundance of capital that they're willing to deploy to the construction lending area and could see a change in requirements as an opportunity to become more involved in the space.

Requirements in the Affordable New York program stipulate that developers pay a "fair wage" to their construction workers, which totals an average of $60 per hour in wages, benefits, and payroll taxes for projects below 96th Street and $45 per hour at projects within a mile of the East River waterfront. Developers that build multifamily rental projects consisting of 300 or more units can also get a full property tax exemption for 35 years if they set aside 35% of units for low- and moderate-income tenants.

The prevailing wage provision has been one of the most difficult aspects of the statute to document, according to Skolnik. "You have to provide documentation and prove [that you've paid a certain wage to the construction workers], but no one is sure what documentation will be required," she added. "Lenders don't really know what's going to be required of their borrowers and whether or not their borrowers will be able to comply."

So far, the construction of affordable housing projects has not slowed considerably, since many projects that are currently being worked on were started under the original 421-a guidelines. "We haven't seen [much of a] holdup for projects going into the ground," said **Steven Hochberg**, partner at SBCH. "Projects under the old statute, as well as the projects that clients are acquiring now, will get some tax exemptions."

Four months, Hochberg added, is a comparatively short time frame to evaluate the long-term effect the new program will have on new construction, and other market pros agreed. Schein added that while none of the developers he represents who are planning to use the Affordable New York Housing Program have gotten to the financing stage just yet, some had received term sheets. "I don't see lenders pulling of the market [due to] a fear of not knowing more about [the program]," said Schein. "They will just have to become accustomed to the coldness of the water."