Columbia Business School
The Hub

The Future of NYC Real Estate
A Think Bigger Innovations Workshop
December 8, 2023
Workshop White Paper, March 7, 2024
Chris Byrns and Stijn Van Nieuwerburgh

The Problem

New York City's real estate market is at a transition point. Coming out of the COVID-19 pandemic, the city's real estate market has seen significant shifts, including increased urban-to-suburban migration (Gupta et al. 2022), residential rent and housing affordability issues, and reduced value and usage of urban office space due to the adoption of remote and hybrid work (Gupta, Mittal, and Van Nieuwerburgh 2023) and higher interest rates. These changes present significant challenges to New York City's fiscal standing, as the city's taxable values of office buildings is poised to see significant declines, with office building vacancy rates having risen to 22.7% by the end of 2023 (Cushman and Wakefield) and office cash flows having declined by 17.8 percentage points in NYC between the end of 2019 and the end of 2022 (Gupta, Mittal, and Van Nieuwerburgh). Furthermore, the real estate sector is a major target for emissions-reduction policies, as buildings account for 29 percent of all U.S. greenhouse gas emissions (Leung 2018). NYC has begun increasing penalties for buildings without emissions-reductions improvements. In 2019, NYC passed Local Law 97 which imposes fines on owners of building that exceed emissions limits. Older office buildings are most affected by all of these challenges, facing weak demand for space, falling contributions to the tax base, and high capital needs to achieve compliance with emissions-reduction policies.

The conversion of underperforming office buildings into new uses that have stronger demand fundamentals, such as apartment buildings, could address many aspects of these key challenges. First, with NYC facing ongoing housing affordability issues, the creation of new housing could go toward addressing city-wide and neighborhood-specific housing affordability. Second, converted office buildings could achieve higher taxable values relative to the status quo, increasing tax revenues available for other municipal services. Third, office conversions would reduce the excess supply of office and help stabilize the market. Finally, conversions could offer opportunities to retrofit existing building systems and infrastructure to reduce greenhouse gas emissions going forward. Despite their appeal, such conversions face a myriad of obstacles (Gupta, Martinez, and Van Nieuwerburgh 2023).

The Policy Background

The workshop's discussions took place against the backdrop of active policymaking at all levels of government. The Federal Government came out with a multi-agency housing supply plan that prominently featured office-to-residential conversion on October 27, 2023. New York State Government representatives are debating new housing policies as we write this, including discussions around a replacement for the defunct 421-a housing development program and narrower office-to-residential plans. New York City Government is actively pursuing its own three-pronged plan to fight the office vacancy crisis. The first pillar is the NYEDC's Manhattan Commercial Revitalization plan which has already begun to subsidize up to 10 million square feet of transformative upgrades of office buildings form class B to class A+. The second pillar is the City of Yes for Economic Opportunity, which consists of a series of zoning reforms that would facilitate adaptive reuse of office into alternative use, outside of residential use. This includes use for life science, industrial, tough tech, maker spaces, home-based businesses, retail, etc. The third pillar is the City of Yes for Housing Opportunity which is a zoning reform proposal that would bring more housing to every neighborhood, notably by giving a density bonus for affordable housing, allowing for as-of-right office-to-residential conversions for office built before 1990, reducing parking requirements, allowing for accessory dwelling units, etc. Additionally, the Midtown South Mixed-Use Plan would rezone a part of the city with many underperforming office assets to allow for residential use. The City Council approved the City of Yes for Carbon Neutrality in December 2023, a set of zoning changes to facilitate the green transition of the built environment. Finally, NYC's Office Conversion's Accelerator team is up and running to help navigate office owners through the conversion process, following the recommendation of a January 2023 office reuse task force study. The overarching vision is one of neighborhood revitalization, allowing building owners to choose from among a range of options for their property the new use that makes most sense and investing in the public spaces that surround them.

The Proposed Solutions

The most frequently cited idea throughout the workshop was the need for a new property tax abatement policy to support the conversion of outdated office buildings into housing. Many participants discussed reviving a program like the expired 421-g program (Citizen's Budget Commission, December 2022 421-g report), however the workshop generally agreed that a new program would need to include some type of affordability component, unlike the expired 421-g program. Many participants acknowledged the likely political challenges such a program would face were it not to include any affordability requirement. Participants differed on the level of affordability and the size of the incentive to support any affordable requirement but agreed that some type of property tax incentive program would likely be among the best strategies to stimulate the conversion of office buildings into apartments. Workshop participants cited the difficulty of constructing rental housing in New York City in general without any property tax incentives, separate from the specific challenges associated with the conversion of office buildings into apartment buildings. Participants from the financial and real estate sectors noted that due to the greater risks and uncertainties of the conversion construction process, such projects would likely often require higher returns to compensate for the level of risk being assumed relative to new ground-up development projects.

A second innovative idea that participants broadly agreed upon would be the creation of a lender credit program to encourage banks to lend toward office building conversions. The workshop cited the Community Reinvestment Act ("CRA") and its system of credits that could serve as a model. Workshop participants from the financial and banking sectors noted that lenders often have limited appetite for lending on office conversion projects due to the lack of a track record, and the added complexities and risks. Particularly in the current real estate market, where capital is scarce and lenders have greater choice in selecting attractive projects, many banks are reluctant to lend on conversion projects when there are ample new development projects in need of capital. Were the state or federal government to create a credit program or be able to utilize the CRA credit program for office to residential conversions, lenders would have a new incentive to write loans on these projects that could balance out some of the financial considerations. As we discuss in detail below, the new 2023 CRA does just that!

Workshop participants also discussed the greater need for government incentives to reward good behavior and penalize bad behavior, so that office buildings were pushed more swiftly toward conclusive outcomes, either by remaining as a healthy office building or by starting the conversion process. Participants cited the tendency of some struggling office buildings to continue operating, albeit with middling economic performance and little benefit to their surrounding neighborhoods. Indeed, some office buildings with rising vacancy rates might still be able to continue operating for years with just enough occupancy to discourage repurposing the real estate. In these situations, high physical vacancy within these buildings contributes to limited foot traffic and retail activity in the surrounding areas, and the inability to see these buildings converted may result in the lost opportunity of greater property tax revenue through a conversion. Municipal governments should push struggling office buildings toward a swifter resolution through a combination of incentives and penalties.

Fourth, participants discussed unlocking the opportunity presented with available, and potentially cheap, space within cities to encourage greater cultural activity. Representatives from the arts and cultural sectors discussed how in years past, the creative industries were often the first to use and repurpose under-utilized spaces. In some office buildings within New York City, creative uses may be limited by existing zoning and building codes. However, local governments could create programs that increase flexibility, even if only temporarily. Creative uses could benefit neighborhoods by providing a new amenity, increased foot traffic, and greater property tax values through increased residential demand.

The last discussion point that workshop participants broadly agreed upon was a desire to empower municipal officials to creatively explore and implement new solutions. Some workshop participants cited the bureaucratic challenges facing NYC government, including onerous regulations and reduced staffing at key agencies. As of October 2022, the Department of Buildings and Department of City Planning had staffing vacancy rates of 22.7% and 20.7%, respectively (New York City Comptroller). Workshop participants from the real estate sectors cited ongoing delays with approval processes and discussed ways to empower mid-level officials by granting them greater leeway with regards to approvals. Municipal agencies are a critical partner in any office conversion, and participants hoped that the agencies could be given the resources and authority needed for them to be agents of change.

After the workshop concluded, the event organizers at the Hub and Columbia Business School continued exploring some of the most promising ideas identified by the participants. Specifically, the ideas around a new property-tax abatement, CRA lender credits, and new government policies to encourage conversions were explored in more depth, as discussed below.

While no single proposal will solve all of the challenges facing New York City, when taken together and implemented alongside the government policies already in the works, some of the steps explored by the workshop could go far in addressing the key concerns of resizing the market for office space, stabilizing the municipal tax base, expanding the affordable housing supply, and reducing greenhouse gas emissions in aging buildings. This working group hopes to continue exploring and discussing solutions going forward, and to examine potential solutions in greater detail.

Further Exploration of the Proposed Solution

1) **Property Tax Program to Stimulate Office-to-Residential Conversions**

Regarding a property tax program to incentivize office to residential conversions, like the former 421-g program, any future property tax abatement would likely require an affordable housing requirement to be politically feasible. The 421-g program, which expired in 2006, utilized both a property tax exemption of the value created through conversion and a property tax abatement of the pre-existing tax liability. The exemption was structured such that converted buildings which received the benefit were exempted from increases in assessed values for eight years, followed by a four-year phase out of the exemption. Additionally, properties received a 14-year property tax abatement, with property taxes fixed at the amount of tax due in the first year for 10 years, followed by a four-year phase out. Rental units in buildings which received 421-g were rent stabilized throughout the duration of benefits but were removed from rent stabilization upon the expiration of those benefits.

A revived property tax abatement could present developers with flexibility around the affordability requirement, in which the receipt of the exemption is tied to the provision of one level of affordable housing, while receipt of the abatement is tied to a separate affordability provision. Furthermore, there could be separate, set formulas for the exemption and abatement, instead of simply a single required affordability threshold, that would dictate the size of the benefit based on the share of affordable units. A tax incentive program that allows for a sliding scale of affordability and tax incentive support could potentially be utilized by more developers than a single affordability threshold due to its flexibility. Additionally, affordability could also be based on a project blended average across different area median income ("AMI") bands instead of a single AMI threshold for all units. However, like 421-a and 421-g, the new program would likely need either the ability to remove the affordability units from rent stabilization upon the expiration of benefits, or a renewal of some type of exemption. A permanent affordability component, without any further tax benefit, would likely make a development under such a program economically unfeasible without other additional subsidies. Like the 421-g program, the new program would need to exempt office-to-residential conversions from the Multiple Dwelling Law constraint of a maximum FAR of 12 for residential buildings. That exemptions should apply to all office buildings constructed before 1990.

In addition to property tax incentives, New York State could partner with New York City to create other non-cash incentives to further assist in the construction of affordable housing, such as a zoning bonus or transferrable FAR. This new square footage could be transferred throughout a special zoning district centered around a central business district ("CBD"). This flexibility for air rights is similar to the 2017 Greater East Midtown rezoning in which air rights are able to be transferred throughout the entire zoning district, not just to adjacent lots. The 2005 West Chelsea rezoning could also serve as a roadmap for some of these affordable housing goals, as it sought to combine the main state affordable housing property-tax incentive program (421-a), which it expanded to include rehabilitation of existing buildings within the district, together with the city's Inclusionary Housing Program's density bonus. The West Chelsea rezoning also created the High Line Transfer Corridor ("HLTC") where developers could acquire air rights from the HLTC, which in turn used the proceeds to fund the repositioning of the High Line as a park. New York City could create a similar pool of capital through the creative use of air rights to help subsidize conversions and neighborhood improvement capital projects. First, New York City could establish an "office to residential conversion fund" that could raise money by allowing developers of projects within the special zoning district to buy additional FAR from a pool of available FAR. The revenue from these purchases could then be available to subsidize conversion projects. Furthermore, additional subsidy could be created through a special as-of-right office to residential conversion FAR bonus, in which the developer who undertook a conversion project was awarded free FAR based on the square footage of the project. This FAR bonus could either be used on the respective conversion project, if it was structurally feasible to add to the building, or it could be sold and transferred throughout the special zoning district to separate new construction projects, so that the developer of the conversion project could utilize the capital. In this way, the need and demand for new office or residential construction could indirectly subsidize the conversion of older, outdated office buildings.

2) The New CRA Stimulates Conversions

Workshop participants were supportive of the idea of creating a new system of lender credits or expanding the Community Reinvestment Act and its system of credits to incorporate the conversion of office buildings into affordable housing. While changing the CRA as it is written would likely be challenging, as it is jointly regulated by the Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency, recent changes to the CRA already allow for some CRA credits to be awarded for office to residential projects if certain programs in support of conversions are implemented at the state level.

The Community Reinvestment Act of 1977 was drafted with the goal of implementing a strategy for meeting the community development and housing needs primarily of low- and moderate- income persons and neighborhoods. The most recent revision process to the CRA recently concluded after more than 30 years. The Final Rule as passed on October 24, 2023, will phase-in beginning January 1, 2026, through January 1, 2027, and expands the program in a few key areas that could be directly applicable to office to residential conversions in New York City.

First, the CRA now provides for an impact and responsiveness review factor that "considers whether loans, investments, or services directly facilitate the acquisition, construction, development, preservation, or improvement of affordable housing in High Opportunity Areas." These areas include all areas designated by the Department of Housing and Urban Development as a "Difficult Development Area" ("DDA"). Nearly all of New York City's CBD census tracts are listed as DDAs, allowing conversion projects within these census tracts to count toward the CRA's impact and responsiveness review of Community Development Financing Tests.

Additionally, the recent changes to the CRA now allow for the partial eligibility of credits on affordable housing projects that include less than a majority of affordable housing units. Under the revised rule, affordable housing projects with less than a majority of affordable units may be eligible for partial credits in proportion to the number of units that are affordable, as dictated by the local or state jurisdiction, so long as the project utilizes some form of government support including property tax incentive programs. Under these revised rules, were New York State to implement a new property tax abatement program in support of office to residential conversions with an affordability component, all projects would qualify for at least a partial CRA credit tied to the proportion of affordable housing units within the project.

Furthermore, additional programs could be instituted to potentially expand the CRA credit allocation from a partial one, dictated by the share of units made affordable, to a full allocation regardless of the share of affordable units. The revised CRA rule allows for a full allocation if the affordable housing project includes a certified Community Development Financial Institution ("CDFI") as a participant in the project. These institutions are often involved in the financing and creation of affordable housing, and there are some innovative CDFI's that could serve as a model for a potential institution created with the specific aim of stimulating office conversions into mixed-income housing projects. The Community Development Trust ("CDT"), a CDFI and REIT located within New York City, is an innovative organization that exists to support the creation of affordable housing across the nation. A new, privately operated, mission driven organization could be created with a similar aim of stimulating the creation of affordable housing for low- and moderate- income households through the conversion of office buildings. Assuming such an organization could qualify for certification as a CDFI, it could even be structured as a REIT like CDT to open itself up for CRA investors such as banks and other financial institutions. With such an organization able to partner with developers on conversion projects, it could serve as a source of cost-effective gap financing to help bridge any outstanding capital needs on conversion projects and allow for office to residential conversion projects to qualify for full, instead of partial, CRA credits under the revised rules. This potential organization's mission could also require borrowers, i.e. developers, converting office buildings into affordable housing to implement greenhouse gas emissions reduction improvements, thereby tying receipt of full CRA credits to green building systems.

3) Sticks and Carrots To Resolve Zombie Office Buildings Faster

Beyond potential changes involving a revived property tax incentive program, New York City could explore new ways to encourage conversion of outdated office buildings to residential uses and discourage continued operations of office buildings with high vacancies. One potential strategy to discourage owners from continuing ongoing operations of office buildings with high vacancies could be in the form of a "vacancy tax" on the square footage which is unleased in a particular building. However, many property owners might seek to circumvent such a tax through master leases with special purpose entities, and data on vacancies would likely have to be self-reported by property owners.

A potentially more effective approach would be for New York City to establish a special improvement district encompassing each central business district for the purpose of "special ad valorem" levies. These special taxation districts could impose an additional property tax on all commercial buildings over a certain square footage, and these new taxes could have a set expiration date of five or ten years to position the taxes as a temporary measure to encourage conversions and discourage continued operations of under-performing office buildings. The proceeds from these property taxes could go toward a dedicated bond issuance to capitalize a pool of government subsidy which could be made available to conversion projects.

While both well-performing office buildings and under-performing office buildings would be taxed under this proposal, the goal would be to increase the potential hardship for under-performing office buildings while enticing the landlords of the same buildings to convert to alternative use. The ad valorem tax could be structured to such an amount that well-performing buildings would be able to manage the additional burden, and it could be presented to the broader public as a contribution of the real estate industry to the overall well-being of the central business districts. Ongoing under performance of some office buildings weakens the collective vitality and economic well-being of any business district.

Workshop Overview

Following the success of its recent summit, the Think Bigger Innovation and Technology Hub at Columbia Business School has begun organizing a series of "innovation workshops." These sessions are tailored to encourage in-depth discussions and develop practical solutions for specific emerging issues. By convening a diverse group of experts from business, academia, and various industries, the workshops aim to bridge theoretical insights with real-world application, fostering innovative thinking and actionable outcomes in a range of fields. The initiative represents a concerted effort to leverage collaborative expertise in addressing some of the challenges of our time.

On Friday, December 8th, 2023, The Hub, the new think tank of Columbia Business School (“CBS”), and the Paul Milstein Center for Real Estate at CBS, hosted “The Future of NYC Real Estate: A Think Bigger Innovations Workshop” to discuss these challenges and explore potential solutions. The workshop was hosted by Sheena Iyengar, the S. T. Lee Professor of Business and Academic Director of the Think Bigger Innovation and Technology Hub at CBS and Stijn Van Nieuwerburgh, the Earle W. Kazis and Benjamin Schore Professor of Real Estate and Professor of Finance at CBS. The workshop invited representatives from varying backgrounds including government, urban planning, real estate, finance, architecture, the arts and other fields to engage in an open discussion around the future of real estate in New York City. The participants included the following individuals:

- Kai-Uwe Bergmann, BIG
- Chris Byrns, CBS Student, Milstein Center
- Joey Chilelli, Managing Director, Vanbarton Group
- Hally Chu, Housing Committee Director, NYS Senator Brian Kavanagh’s Office
- Ken Davenport, Broadway Producer
- Burke Davis, Managing Director, JPM Chase
- Jacob Dinetz, Director of Real Estate and New Business Development, Union Square Hospitality Group
- Carolyn Grossman Meagher, Director of Economic Development and Regional Planning, NYC Department of City Planning
- Ingrid Gould Ellen, Professor of Urban Policy and Planning, NYU
- Arpit Gupta, Associate Professor of Finance, NYU Stern School of Business
- Judy Herbstman, Vice President for Real Estate, Settlement Housing Fund, Inc.
- Sheena Iyengar, Host; Professor of Business in the Management Division, CBS
- BJ Jones, Executive Director of “New” New York
- Brian Kavanagh, NY State Senator
- Phil Kirschner, Senior Expert and Associate Partner, McKinsey
- Shawn Lese, Chief Investment Officer and Head of Funds Management, Nuveen
- Andrew Lim, Director, New York Research, Jones Lang LaSalle Inc. (JLL)
- Candy Martinez, Finance PhD Candidate, Columbia Business School
- Chris Mayer, Professor of Real Estate & Co-Director Milstein Center, CBS
- Stephan Meier, Professor of Business & Chair of the Management Division, CBS

- Grace Rauh, Executive Director, 5BORO
- Andrew Rein, President, Citizen Budget Commission
- Mellisa Roman Burch, Chief Operating Officer, NYCEDC
- Hilary Sample, Professor of Housing Design, Columbia GSAPP
- David Sherman, CBS, Co-Director Milstein Center
- Hilary Spann, EVP, New York Region, BXP
- Brian Steinwurtzel, Co-CEO and Principal of GFP Real Estate; CBS alumnus
- Stijn Van Nieuwerburgh, Host; Professor of Real Estate & Professor of Finance, CBS
- Mac Wilcox, President of Hanover Community Bank

The participants spent the morning discussing the problem and exploring potential solutions. Participants were broken up into four smaller groups for open discussion that explored the following topics:

- Creative space use and future cities: Turning Midtown and Downtown into More Vibrant Neighborhoods
- Resolving Commercial Real Estate Distress: Financing Solutions
- Stimulating Office Conversions
- Affordable Housing

Each smaller group worked to arrive at around four or five ideas to present back to the broader workshop. After a representative from each of the four small groups presented their ideas to the broader group, all individuals within the entire workshop selected three ideas they thought to be particularly innovative, forward thinking, or effective. The votes from all individuals were tallied, and the top five ideas were then expanded upon by the broader workshop group.