

GROUND RULES PODCAST TRANSCRIPT

EPISODE 6: INCLUSIONARY AIR RIGHTS AND NYC REAL ESTATE'S NEW RULES WITH BRYAN HURLEY

Editor's note: This version preserves the Q&A format and core substance of the conversation while lightly tightening for readability, correcting transcript artifacts, and maintaining the original conversational style.

INTRODUCTION

David Shamshovich

Hello everybody, and welcome to another episode of Ground Rules. Today we have Bryan Hurley of Cushman & Wakefield, a friend of ours and the firm who we've known for years. He's also a repeat guest.

Bryan does a lot of inclusionary air rights sales and is extremely knowledgeable about that area. We brought him back to talk about 421-a, the new tax exemption program, certificate sales, and the state of the real estate and development markets generally.

Camila Almeida

It was a good catch-up, especially because the last time we talked to him was before City of Yes and around the time 421-a was expiring. We had the before conversation, and now we have the after conversation. It was interesting to hear which predictions came true, what changed, and what he expects going forward.

David Shamshovich

Bryan has a useful perspective because, like us, he's constantly listening to developers, watching different projects and seeing where the market is moving. Having a broker who really understands what's happening in the market is incredibly valuable.

Without further ado, Bryan Hurley from Cushman & Wakefield.

Bryan, the last time you were here, half the rule book for New York real estate was about to be rewritten. 421-a had just died, good cause eviction was still a rumor, and nobody knew which way the market would break.

You sell investment properties across Manhattan's middle market, including mixed-use, multifamily and development sites, and you've carved out a specialty in inclusionary air rights, where our group works with you frequently. Welcome back.

Bryan Hurley

Thanks for having me again. A lot has changed. I was wrong in my prediction about good cause eviction and probably a couple of other predictions about what the legislature would do.

One thing I'm happy didn't happen was the elimination of the off-site inclusionary market. That was under discussion for a while. Some private developers and nonprofits pushed to make sure it remained part of the new City of Yes zoning rather than being removed altogether.

People sometimes look at the program as something that benefits private luxury condo developers. But it also helps subsidize affordable housing projects, which is important when the city and state are trying to create and preserve more affordable housing.

INCLUSIONARY HOUSING AND CITY OF YES

David Shamshovich

Let's explain that because even developers involved in these transactions don't always fully understand it. Many of these are preservation deals. Affordable units are rehabilitated, affordability requirements are imposed, and a development bonus is transferred elsewhere. How does that work?

Bryan Hurley

In 2017, the law changed so that 421-a developers could no longer receive a tax abatement and also generate off-site inclusionary rights.

Since then, much of the market has involved preservation projects. Nonprofit housing organizations have existing multifamily buildings that need substantial work. They enter into regulatory agreements with HPD and complete required renovations to improve the quality of the affordable housing.

Those organizations often don't have tens of millions of dollars available to renovate large multifamily buildings. One way to finance those projects is by selling off-site inclusionary rights to private developers in the community board who need them for condo developments.

For the private developer, those rights can provide additional bulk at a discount to land and potentially additional height. For the nonprofit, the proceeds help finance improvements to affordable housing.

David Shamshovich

That's why understanding the mechanics matters. You aren't simply brokering certificates. You understand how the process works.

Bryan Hurley

That's increasingly important in brokerage. Thirty years ago, access to information itself was valuable. Today, everybody has access to information. You have to distinguish yourself through expertise.

Whether it's multifamily and rent stabilization, tax abatements, low-income housing tax credits, or off-site inclusionary development under City of Yes, you need enough knowledge to advise clients rather than simply having their phone number and email address.

David Shamshovich

City of Yes went through several iterations. Certificate holders can continue selling certificates, but their use has been limited geographically. Why do you think the city ultimately preserved that option?

Bryan Hurley

I don't have much inside information, but I think there was greater recognition of how much affordable housing has been subsidized through these programs.

There have been large preservation projects, and the program also contributes to the creation of additional housing generally. It gives nonprofit affordable housing owners another way to finance the rehabilitation of aging housing stock.

Anything that can help finance those improvements has value.

David Shamshovich

There's also Mandatory Inclusionary Housing. Developers in places like SoHo/NoHo or Midtown South may be required to provide affordable housing to build residential, even where providing it on site can be difficult. What have you seen with off-site MIH?

Bryan Hurley

I've had a lot of outreach from developers looking at projects in the SoHo/NoHo rezoning because it's such a high-value condo market.

I haven't personally been involved in a completed off-site MIH deal. I've also seen interest around sites in Downtown Brooklyn, with developers trying to understand how to make the structure work, but I haven't seen anyone complete one yet.

David Shamshovich

We're working on an off-site one now, and once that precedent is set, I think there could be a lot more activity. There's a public-private partnership aspect to these programs. The private development helps support affordable housing, and the city also generates additional real estate tax revenue from the new development.

Bryan Hurley

Exactly. There are benefits on both sides, both affordable housing and additional market-rate housing.

485-X AND THE DEVELOPMENT MARKET**David Shamshovich**

Another major change is 485-x. We're now seeing developers gravitate toward 99-unit buildings because of the labor requirements above that threshold. What are you seeing?

Bryan Hurley

It's something that will have to be discussed going forward. The overwhelming trend in filings is toward buildings with 99 units or fewer.

Historically, economies of scale made larger development sites more desirable. Now that can work in reverse. A 300,000-square-foot development site may be less attractive because of the additional construction costs associated with building at that scale under 485-x.

Developers are looking at whether sites can be divided into multiple 99-unit buildings. But that's not possible everywhere because of lot configuration and zoning.

I've even seen developers look at sites where they could theoretically build more square footage and decide they would rather leave some of it unused because a smaller building fits the economics of 99 units better.

You don't want to lose housing that could otherwise be built.

David Shamshovich

That leads directly to land values. If a developer can't economically use all of the available zoning floor area, how are sellers adapting?

Bryan Hurley

I haven't seen significant seller capitulation yet because many larger sites that have traded since 485-x had already qualified for 421-a.

For sites that don't have that protection and can't be divided effectively, the economics change substantially.

A developer might pay a much higher price per zoning square foot for a site that can accommodate a smaller project than for a much larger site where wage requirements materially increase construction costs.

The problem is that many owners aren't ready to accept a 40 or 50 percent reduction from what they believed their land was worth five years ago unless they're forced to sell.

David Shamshovich

Eventually there has to be some adjustment. I don't see 485-x going away, although perhaps the data eventually leads to some amendment. In the meantime, the value of land is increasingly dependent on what can actually be developed economically.

Bryan Hurley

Developers are still looking for sites. People would like to build larger rental projects. But pricing has to reset.

A lot of owners have been waiting for interest rates to decline or legislation to change. At some point, they have to decide whether they're prepared to hold for another five or ten years or transact at what today's economics support.

THE MULTIFAMILY MARKET

David Shamshovich

Let's move to existing rent-stabilized housing. Operating costs continue increasing while owners have limited ability to raise rents. What are you seeing in the sales market?

Bryan Hurley

It's one of the hardest products to sell right now.

Operating expenses are climbing while rental income can't necessarily keep pace, so from an NOI perspective the asset can effectively depreciate.

Another major problem is documentation. The 2019 laws created significant exposure around rent-overcharge claims and rent histories.

Owners were previously told they only needed to retain certain records for a limited period. Decades later, they may be asked to substantiate work done in the 1980s, 1990s or early 2000s.

If a current owner acquired the property from somebody who acquired it from somebody else, those historical records may simply not exist anymore. Buyers and their landlord-tenant attorneys are looking carefully at that history because an inability to substantiate historical rent increases can dramatically affect value.

We're seeing minimum 8% cap rates even for fully rent-stabilized buildings in Manhattan.

David Shamshovich

What are some of the biggest things that derail those transactions?

Bryan Hurley

IAI documentation is a major one.

Before 2019, owners could deregulate apartments after the legal rent crossed certain thresholds. That sometimes involved substantial increases based on improvements to individual apartments.

A purchaser today may need documentation supporting renovations that occurred decades ago. If the current owner didn't own the building when that work happened, the records can be difficult or impossible to reconstruct.

The other major issue is building condition and required capital expenditures.

If a purchaser has to put \$2 million into a roof, boiler, stairwells or façade work, that spending doesn't necessarily generate additional rent. It's simply necessary to maintain the property.

That makes a fully rent-stabilized building in poor physical condition especially difficult to justify economically.

Buildings that have been well maintained are easier to sell because the buyer isn't immediately facing millions of dollars of capital work without a corresponding increase in income.

David Shamshovich

Given those economics, who can actually buy these properties?

Bryan Hurley

We're seeing family offices and generational New York City real estate owners who have very long investment horizons.

They may buy with cash or use relatively low leverage and hold the property for 20 years or longer. They're willing to operate it and see how the market and political environment evolve.

That's a different buyer from somebody who needs near-term rent growth to support significant debt.

David Shamshovich

We're also seeing the pressure on existing owners. Taxes, insurance and operating costs keep rising.

Bryan Hurley

Exactly. Taxes increase, insurance increases, fuel costs increase, while the rent may not increase. We'll have to see what happens as some of the larger portfolios continue working their way through the market and who emerges as the long-term buyer for that stock.

David Shamshovich

What about buildings with older 421-a abatements that are approaching expiration?

Bryan Hurley

There's significant appetite for those deals when they're priced correctly and the expiration is close enough.

If the abatement has more than ten years remaining, there's generally less interest. But when expiration is roughly six years away or less, there are buyers willing to acquire the property, manage through the expiration and potentially benefit afterward, depending on which version of the program governs the property.

Documentation remains critical. In today's New York multifamily market, paperwork can affect value by millions or even tens of millions of dollars depending on the size of the transaction.

That's why buyers conduct extensive diligence. As a broker, I'd rather know about deficiencies before marketing a property than discover them after a buyer is under contract and face a retrade.

Management companies are also increasingly important because they need to ensure that required riders and other documents are consistently maintained.

There can also be value-add potential in these properties. The buildings may be 15, 20 or 25 years old, so units can be dated even if the building itself doesn't require tremendous capital work. A buyer can modernize those units without necessarily taking on the kind of major infrastructure work associated with much older housing stock.

OFFICE-TO-RESIDENTIAL CONVERSIONS

David Shamshovich

Office-to-residential conversions have also become a major story. Class B offices were struggling after COVID, while now we're seeing significant leasing activity in better office space. What are you seeing?

Bryan Hurley

Our office leasing group at Cushman & Wakefield has had a strong period, particularly at the top end of the Class A market. We're seeing rents above \$300 per square foot in some cases, which hadn't been achieved before.

Class B and C properties are having more difficulty, which is helping drive conversion activity.

Downtown in particular has a significant amount of Class B and C office space being converted. As those residential units come online, they should also create demand for retail and other neighborhood services.

Over time, that can change the dynamics of the remaining office market as well. If you add thousands of higher-income renters downtown, you create additional retail demand and potentially make the neighborhood more appealing to office tenants.

David Shamshovich

So conversions are still very much happening?

Bryan Hurley

Yes. They've been one of the hottest asset classes over the last 18 months, and 467-m has been received much better than 485-x.

We're seeing strong demand for appropriately sized Class B and C buildings with adequate light and air.

Amenities are also becoming a major part of these conversion projects. Buildings are incorporating substantial amenity packages because they have areas, particularly podium spaces, that aren't ideal for residential units.

You're seeing everything from large gyms and pools to pickleball courts, golf simulators and other amenities. That's part of how these projects attract higher-income renters.

HOW THE BROKERAGE MARKET IS CHANGING**David Shamshovich**

How has your own business changed since we spoke a few years ago?

Bryan Hurley

The biggest difference is the asset-class mix.

Multifamily was a major part of our business coming out of COVID, when rents were rising rapidly. Then interest rates increased and the implications of the 2019 rent laws became clearer.

At the same time, the land market started coming back. Developers are buying land for luxury condos in neighborhoods such as the Upper East Side, Greenwich Village and SoHo, while rental developers are still seeking opportunities where the economics work.

Inclusionary remains a major part of my business regardless of the broader market.

I've also moved further into office properties because 467-m has created opportunities around conversion properties.

As brokers, we have to move with the market and educate ourselves about new programs so that we can advise clients about the opportunities, complications and issues we're seeing in actual transactions.

David Shamshovich

That's the value. You don't want to simply be the middleman. You want to understand what you're selling, what could move a transaction forward and what could create problems.

Bryan Hurley

Exactly. A lot of what I know comes from asking you questions about regulatory agreements and other issues so I can understand them well enough to explain them to clients.

David Shamshovich

And we tend to see the same group of people across these transactions. That's one of the interesting things about this part of the market. You work on something, and years later the rights or certificates can show up in another transaction involving people you've worked with before.

WHAT COMES NEXT FOR NEW YORK REAL ESTATE

David Shamshovich

What do you think people should be watching next?

Bryan Hurley

COPA is a big one.

It was one of the hottest topics last year and then faded somewhat, but issues that receive that much attention don't necessarily disappear.

A major concern is transaction timing. Real estate is already illiquid, and some potential versions of COPA could make multifamily transactions significantly slower.

Depending on the final structure, that could also affect 1031 exchanges, pricing and lending. If an asset becomes harder or slower to sell, lenders also have to consider that when underwriting because foreclosure and disposition could take longer.

David Shamshovich

And that affects reserves, rates and other aspects of financing. These policies don't exist in isolation.

Why do you think there's such a disconnect between efforts to protect housing and policies that can make owning, financing or developing housing more difficult?

Bryan Hurley

It's obviously complex, but a lot of it comes down to supply and demand.

Housing becomes less expensive when there's more of it. New York City has had a supply constraint for a very long time and hasn't been able to keep up with demand.

Politicians consistently campaign on building more housing. City of Yes was also intended to increase the city's ability to create additional units.

Ultimately, we need more housing across the spectrum: affordable, luxury and mixed-income.

David Shamshovich

The difficulty is that policies intended to address one problem can create other bottlenecks. Financing, development and ownership are all connected.

How much is uncertainty around the political and economic environment affecting the market?

Bryan Hurley

It's definitely affecting transaction volume.

People don't like making decisions without certainty. There are questions around legislation, rent freezes, interest rates, inflation and geopolitical events.

A seller isn't simply deciding whether to sell a property. They also have to decide what they'll do with the proceeds, whether through a 1031 exchange, another real estate investment or something else.

When conditions could be materially different between contract signing and closing, people hesitate.

That kind of volatility hurts transaction volume.

We're also constantly asked where interest rates are going. Nobody really knows. We've spent much of our recent history in an unusually low interest-rate environment, so there's no guarantee we return to that.

AI AND THE FUTURE OF THE BUSINESS

David Shamshovich

We've also seen artificial intelligence moving incredibly quickly. I'm a big proponent because it can improve work product and give you another perspective on something. Have you implemented it in your practice?

Bryan Hurley

We use it, but I think we're in an overload period. There are constantly new AI products for brokers, CRMs, dialing systems and workflow optimization.

Some of it is noise. When you actually use the products, they don't always help.

Real estate is also still a very person-to-person business, particularly in New York City with long-term family owners.

Where AI is very useful is underwriting, comps and other time-consuming work that historically required significant manual effort. If you can automate more of that, brokers have additional time for the things that create value: building relationships, understanding who's active in the market and executing transactions.

We're probably in a period similar to the early internet, where there are many products but nobody knows yet which ones will ultimately become indispensable.

David Shamshovich

That's what I've found too. Sometimes I'm spending more time figuring out how to eliminate busy work than actually eliminating it.

Bryan Hurley

There's an upfront investment in figuring out which tools work for you. Different brokers or lawyers may have different workflows.

But once you find the right tools, they can remove work that doesn't add much value and give you more time for what does.

AI is also useful for learning. For brokers, the ability to advise clients rather than simply sell properties is increasingly important. AI can help summarize lengthy legislation and make it easier to get up to speed on complicated issues, although you still need to verify the information.

David Shamshovich

That's where I find it especially useful. You can learn about something quickly, ask follow-up questions and use it to improve your own work. You still have to make sure it's right, but it can save tremendous time on things like organizing and wordsmithing.

Anything else you want to tell the Ground Rules audience?

Bryan Hurley

Reach out to David and Camila if you need them. I'm not just saying that because I'm on their podcast. Every client I've introduced to them who needed better advice has told me afterward how great they were to work with.

David Shamshovich

We feel the same way about Bryan. It's great working with somebody who understands these issues and doesn't need every part of the transaction explained from scratch.

Thanks for taking the time to join us.

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