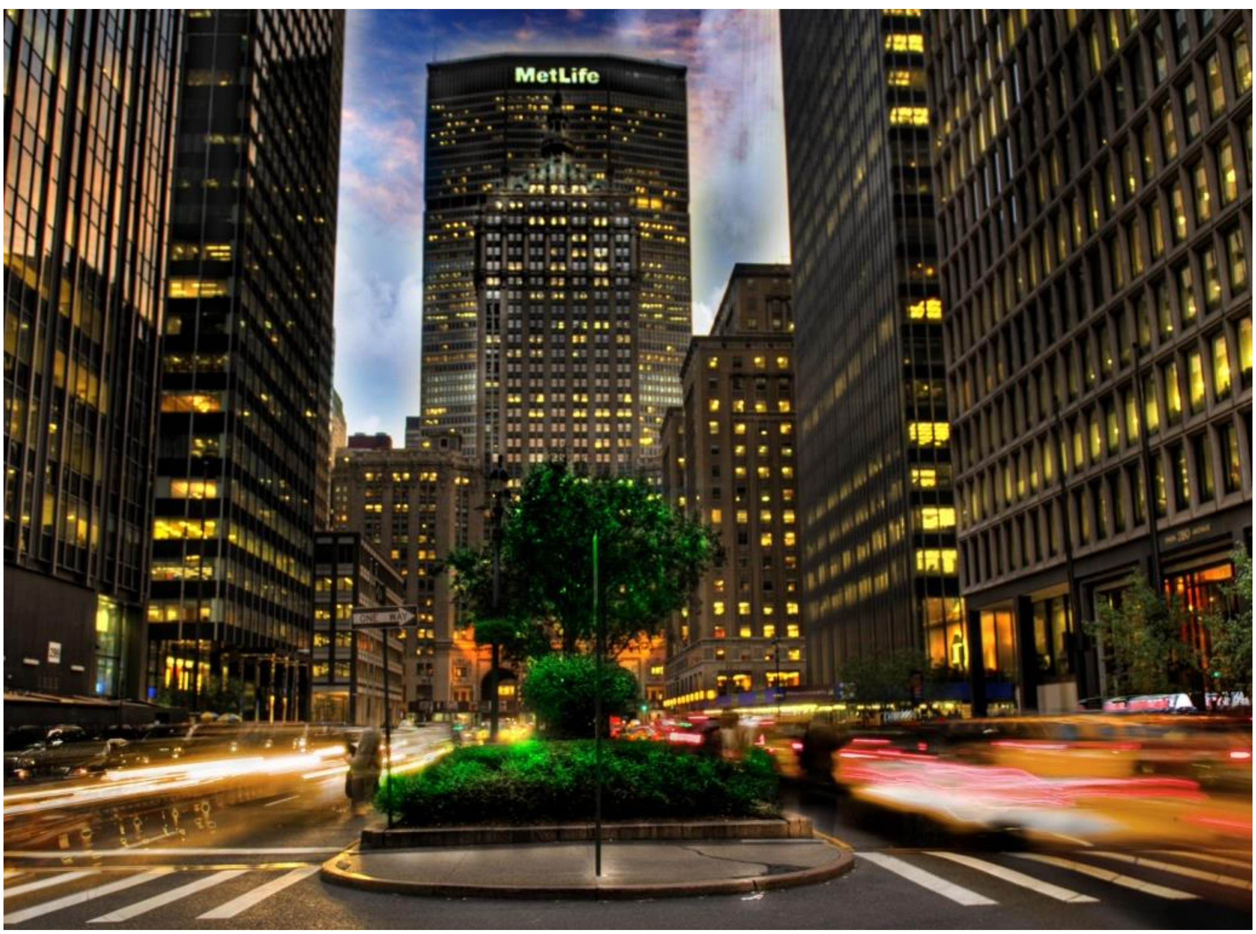
THE REAL ESTATE BOARD OF NEW YORK

PARK AVENUE DEVELOPMENT ANALYSIS



INTRODUCTION

The Greater East Midtown Rezoning, certified on January 3, 2017, contains a provision that establishes a minimum contribution amount ("the floor price") to the district improvement fund from the sale of landmark air rights and the payment for overbuilt development rights.

We think that the stated floor price of $393/sqft greatly overstates the value for TDRs exclusively for office use in 2017. The concept of a floor price and the valuation of TDRs would seriously impede transactions and jeopardizes the goals of the rezoning. Both the floor provision and the market price will be especially burdensome to the type of office buildings (large floor plate buildings with avenue frontage) that this rezoning hopes to encourage.

As a result of the economic realities facing new office development in a fully built commercial area, we have advocated for the elimination of the floor price and a realistic valuation of landmark air rights for commercial development. While we support the goal of creating new Class A commercial office space on the avenues as well as generating contributions for public realm improvements, it is important to note that as-of-right development of midblock sites and of enlargements of existing sites would accomplish many of the goals of this rezoning, at a lower development cost and at a more rapid pace. These types of projects would offer more affordable development opportunities than large, new construction on the avenues—in part because of lower land and opportunity costs. New development in East Midtown—on the avenue or the midblock, new ground up construction or an enlargement—would revitalize East Midtown and would generate the funds needed for the public realm improvements. We think new development, and the public realm improvements that they would bring, can be accomplished more realistically and quickly with the modifications we have proposed.

This memo illustrates and highlights the financial challenges of new development on a typical Park Avenue site and expands on the points raised in our Borough Board testimony.

EXISTING BUILDING ANALYSIS

In our analysis, we assume an existing building overbuilt at a 17 FAR and on a 30,000 square foot lot for a total of 510,000 square feet of zoning floor area (zoning floor area is what is purchased and is seen as the land cost).

As built, with the mechanical space and below grade space (neither of which counts as zoning floor area) the building's gross square footage is 566,000 square feet. A building's gross square footage is what must be built and is the basis for the construction cost.

Revenue from the rentable space in the building must cover the cost to build and maintain the leased space. Leased space includes: the mechanical and below grade space (not zoning floor area) as well as common areas, such as lobbies, hallways and other building amenities (zoning floor area). In our existing building, the rentable square footage is 600,000 square feet. Building revenue and rent per square foot is reported on this rentable square foot number. (See Table 1)

Table 1
Existing Building Square Foot Analysis

Zoning SF	Built SF	Rentable SF
510,000	566,000	600,000

NEW BUILDING ANALYSIS

In our analysis, we assume the new building is built to a 25 FAR on a 30,000 square foot lot for a total of 750,000 square feet of zoning floor area. The land cost will include the cost to acquire the existing building, purchase the overbuilt development rights with a contribution to the fund, the acquisition of development rights from a landmark, and demolition costs.

Land Cost

We estimate the cost of the existing Park Avenue building, described above, at $750 million dollars. In this example, 60,000 square feet (2 FAR) is what is now overbuilt based on the current base FAR. New development would require a contribution of $4.8 million for this portion of the new development. This amount is based on the City's method for valuing the overbuilt contribution which is 20 percent of the estimated market value landmark air rights of approximately $400 per square foot.

The remaining 240,000 square feet (8 FAR) is estimated at $400/sqft, or $96 million in total for this portion of the new development.

In addition, the demolition of the existing structure is estimated at $28 million.

The land cost of a new development would be $878.8 million. (See Table 2)

Table 2
Land Cost Analysis

FAR	17(2 FAR Overbuilt)	25
Lot Area	30,000	30,000
Total Zoning Square Feet	510,000	750,000
	Existing Building	New Building
Initial Land	$750,000,000	$750,000,000
Overbuilt Contribution	N/A	$4,800,000
Air Rights Purchase	N/A	$96,000,000
Demolition	$28,000,000	$28,000,000
Total Land Cost		$878,800,000

Construction and other Related Costs

With mechanical, below grade space, and common areas, the new building will contain 818,000 gross (built) square feet. This gross square footage is what must be built and is the basis for a project's construction costs.

Revenue from the rentable space in the building must cover the cost to build and maintain the mechanical and below grade space (not zoning floor area) as well as common areas, such as lobbies, hallways and other building amenities (zoning floor area). The customary leasing practice is to report rent per square foot based on the actual space occupied and a percentage, commonly termed a loss factor, to reflect the cost of building and maintaining common areas and mechanical and other built space not counted in zoning floor area. In our new building example, the rentable square footage is 890,000. Building revenue and rent per square foot is reported on this rentable square foot number.

Carrying Cost on Land

One critical component in the redevelopment of sites in a mature commercial district like East Midtown with an average vacancy rate is the cost of foregone revenue from the existing occupied building and expenses like property taxes. We estimate the carrying cost from the acquisition of the existing building to the completion of the new building at $217 million.

Hard and Soft Costs/Financing

The new building analysis assumes hard construction costs of $573 million; soft costs are $120 million. Financing of hard and soft costs is $165 million.

Tenant Improvement Allowances and Leasing Commissions

The final component in the development of the new building is the landlord's contribution for the tenant to build out their space—the tenant improvement allowance, or TI. This is a negotiated number, but an unavoidable one. The landlord is always making some level of contribution to the completion of the tenant's space as part of the lease agreement. Likewise, there is always, especially in a new building, leasing commission costs. These costs are based on the total dollar value of the lease.

In our illustration, the TI cost is $76 million; leasing commissions total $53 million.

Construction and other related costs total $1,204 million.

This brings the total project cost—land and construction—to $2,082.8 million, or $2,546 per gross square foot, or $2,340 per rentable square foot. (See Table 3)

Table 3
Total Project Cost

	Cost (in millions)	Cost Per Gross SF (818,000)	Cost Per Rentable SF (890,000)
Land Carry	$217	$265	$244
Hard Cost	$573	$700	$644
Soft Cost	$120	$147	$135
Financing	$165	$202	$185
TI	$76	$93	$85
Commission	$53	$65	$60
Total Construction/Related Cost	$1,204	$1,472	$1,353
Land Cost	$878.8	$1,074	$987
Total Project Cost	$2,082.8	$2,546	$2,340

RETURN AND RENTAL ANALYSIS

The target return for a new project is assumed to be a minimum of 6%. This annual return on total project costs of $2,082.8 million would be $124.9 million annual or $140 per rentable square foot, before taxes and operating expenses. Operating expenses are estimated at $15 per rentable square foot and taxes $49 per rentable square foot which is 25% of gross rent.

The average rent for the entire building required to achieve the target return is **$204 per rentable square foot**, not including an assumed average vacancy of 5%. (See Table 4)

Table 4
Return and Rental Analysis

	Return Analysis	Per Rentable SF
Total Development Cost	$2,082,800,000	
Target Return (6%)	$124,968,000	$140
Building Operating Expenses$13,350,000	$15	
Real Property Taxes	$43,610,000	$49
Average Rent PSF		$204

A recent review of average asking rents for Greater East Midtown between 42nd and 57th Streets for Madison, Park, Lexington and Third Avenue buildings show rents in a range of $67 to $93 per rentable square foot—significantly below the minimum rent required to make a new development economically feasible. (See Table 5)

Table 5
Average Avenue Asking Rents

Avenue Location	Average Asking Rent
Madison	$92
Park	$93
Lexington	$74
Third	$67

Analysis of average asking rents for midblock buildings show even lower average asking rents. However, the lower rents in these locations would result in a lower upfront land cost for someone interested in developing a new building in the midblock, as well as along Third Avenue. (See Table 6)

Table 6
Average Midblock Asking Rents

Midblock Location	Average Asking Rent
5th Madison	$88
Madison – Park	$68
Lexington – Third	$60
Third – Second	$56

However, midblock boutique buildings that provide more modern office space and revitalize the area command higher rents, on average $120/sqft. Though still below the average in our illustration, this rent over time would make new midblock development more likely, especially with lower existing building costs and realistic air rights costs for new commercial development.

CONCLUSION

Avenue development, especially along Park Avenue, is economically unfeasible under current market conditions. Existing landowners whose basis in the property is low because they acquired the property decades earlier could be lured into pursuing new development. However, the current floor price will set unreasonable financial expectations for air rights owners and the minimum contribution into the improvement fund will stall sales when these prices are not achieved.