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October 12, 2012

Via Hand Delivery

Hon. Robert B. Tierney
Chair
Landmarks Preservation Commission
Municipal Building
One Centre Street, 9th Floor North
New York, NY 10007

Re: City & Suburban Homes Co, First Avenue Estate
429 East 64 and 430 East 65 Streets ("Property")
Application for a Certificate of Appropriateness on
Grounds of Insufficient Return

Dear Chairman Tierney:

This letter transmits three sets of a supplement to the application of Stahl York Avenue Co., LLC for a certificate of appropriateness of grounds of insufficient return pursuant to Section 25-309 of the New York City Administrative Code. Each set consists of a report from Cushman & Wakefield addressing whether the Property is capable of earning a reasonable return, supporting materials from Gleeds that addresses construction costs and Gregg Wolpert that addresses primarily rent levels and vacancies at the Property, in neighboring buildings on its block and elsewhere in the neighborhood, and a letter from us summarizing this material.

Responses to the specific questions raised by members of the Landmarks Preservation Commission and the public will be submitted to you within 10 days. We are not able to submit our responses today because some of the information necessary to prepare responses was delivered only late this week.

Please let me know how many additional sets of the supplemental material you would like us to submit.

We are available to meet with you and your staff in order to answer any questions about the material submitted with this letter.

Very truly yours,

Paul D. Selver

cc: Mark Silberman, LPC General Counsel
Richard Czaja
Gregg Wolpert
Mark Isserles, Esq.
Al Fredericks, Esq.

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October 12, 2012

Mark A. Silberman, Esq.
Counsel
Landmarks Preservation Commission
1 Centre Street
New York, New York 10007

Re: City and Suburban Homes Co., First Ave. Estate
429 East 64th St. / 430 East 65th St., Manhattan
Block 1459, Lot 22

Dear Mark:

This submission supplements our previous submissions in support of the pending application for permission to demolish the two referenced buildings (the "Subject Buildings") on the grounds of economic hardship pursuant to Administrative Code §25-309. It addresses several issues raised by members of the Commission during the January 24, 2012 public hearing in this matter. It also demonstrates that the argument that the Subject Buildings are capable of earning a reasonable return set forth in the January 24, 2012 memorandum of HR&A Advisors, Inc. (the "HR&A Report") is based upon a set of invalid assumptions and a faulty analysis. We show herein that, in fact, there is simply no feasible scenario under which the Subject Buildings could have generated a return on assessed value of at least 6 percent during the applicable 2009 test year, which is the test of economic hardship established under the Landmarks Law.

In addition to this letter, our current submission includes a (i) a letter from Gregg S. Wolpert of the Stahl Organization dated October 11, 2012 (the "2012 Wolpert Letter"), (ii) a report by Gleeds New York entitled New Elevator Scheme – Revision 2 and dated August 27, 2012 (the "Gleeds New Elevator Report"), (iii) a report by Gleeds New York entitled Market Rehab Scheme – Revision 2 and dated August 27, 2012 (the "Gleeds Market Rehab Report") and (iv) a Comparative Economic Feasibility Study by Cushman and Wakefield dated October 12, 2012 (the "2012 Cushman Report").

Our Previous Submissions

Our previous submissions included a 2010 income and expense schedule (Form TC201) for the Subject Buildings that was filed with the New York City Tax Commission, which shows that, in the 2009 test year, these buildings were operated at a loss in that the expenses incurred in operating the buildings significantly exceeded the income that they generated. As we have explained, a significant number of apartments in the Subject Buildings were vacant during 2009, which is a reflection of the applicant's longstanding plans to eventually demolish these buildings and redevelop the site. In order to determine whether the Subject Buildings are capable of earning a six percent return on assessed value "under reasonably efficient and prudent management," as provided under the Landmarks Law, in our prior submissions, Cushman and Wakefield ("Cushman") analyzed three hypothetical scenarios involving full occupancy of these buildings during the 2009 test year. In its 2009 report, Cushman analyzed two scenarios – one involving building-wide capital improvements and renovations to the 97 apartments that were vacant at the end of 2009 and the other involving only vacant apartment renovations. In its 2010 report, Cushman analyzed a third scenario in which the Subject Buildings' vacant apartments were re-rented after receiving only minimal repairs and improvements necessary to render them habitable. All of the work contemplated under each of these scenarios could have been performed with the buildings' existing tenants in occupancy. Cushman's analyses showed that, under each of these scenarios, the Subject Buildings would not have earned a six percent return on assessed value. Among the three scenarios that were analyzed, the scenario in the 2009 report involving both building-wide and apartment improvements would have generated the highest return, i.e., 1.19 percent on assessed value, which is still far short of the 6 percent return which the Landmarks Law defines as reasonable.

Analysis of a Total Renovation Scenario

During the public hearing on this application and in the Commission's subsequent questions, we were asked to analyze one or more additional scenarios involving a total renovation of the Subject Buildings that would result in the installation of elevators and/or the creation of new, larger apartments. In order to reach all areas of the Subject Buildings, a total of eight elevators would have to be installed and extensive work would have to be performed at each building entrance to render the elevators accessible to the handicapped. In addition, complicated structural reinforcement would have to be undertaken because the present floors are supported by wood joists.

The 2012 Wolpert Letter explains that such a total renovation of the Subject Buildings would be extremely difficult, if not impossible, to perform. A total renovation could occur only if the Subject Buildings were vacated on a temporary basis, and, because neither the rent stabilization and rent control laws provide for the involuntary relocation of tenants to facilitate a renovation (even a major one), vacating them would have required agreements with all of the then-existing tenants.[1]

[1] The same problem would preclude as a practical matter a major renovation that did not include the installation of elevators but reconfigured and enlarged the apartments only.

Even if all of the construction and tenant relocation issues could be resolved, a total renovation of the Subject Buildings would be extremely costly. The Gleeds New Elevator Report analyzes such a total renovation and estimates its cost in 2009 dollars. According to Gleeds, this renovation would involve significant site work, including courtyard concrete, exterior lighting and drainage, along with extensive core and shell work, including installation of eight new elevators with elevator pits and bulkheads, new windows, new electrical service and metered water service, new gas risers, new ventilation systems and new sprinklers. The renovation would result in the creation of 10 new and larger studio and one and two bedroom apartments on each floor, for a total of 120 apartments, in contrast to the 190 apartments now found in the Subject Buildings. These apartments would have new bathrooms and bathroom fixtures, new kitchens with necessary appliances, new wood and ceramic floors, new electrical panels and distribution, new lighting and new interior walls and finish carpentry. The Gleeds New Elevator Report estimates that such a total renovation of the Subject Buildings would have required between 12 and 14 months to perform and, in 2009, would have involved hard costs of $25,411,803.

The 2012 Cushman Report explains that a total renovation of the Subject Buildings would not be financial feasible. Cushman points out that, in addition to the hard costs analyzed by Gleeds, such a project would involve substantial soft costs for items such as architectural and engineering services, insurance and real estate taxes. In addition, it would almost certainly require tenant buyouts and relocations, the timing and costs of which cannot be determined with any degree of certainty. Gleeds has estimated that, once the Subject Buildings were vacated, the renovations would take between 12 and 14 months, during which time the buildings would generate no revenue. Additional revenue would have to be forgone during a rent-up period after completion of the work

Cushman estimates that, in comparison to the revenues that it had previously projected for a scenario involving building-wide capital improvements and renovations to vacant apartments, such a total renovation would increase achievable rents by about $6 per square foot and would produce additional annual net operating income of about $230,000. It concludes that, given these projected levels of cost and income, a total renovation of the Subject Buildings could not be privately financed and would instead require a 100 percent equity contribution by the owner. Under these circumstances, no rational and prudent investor would ever undertake such a renovation because, in addition to the time and energy required to be invested in the project, it would require decades to recoup the equity costs required for this total renovation scheme.

Re-analysis of the Scenario Involving Building-wide and Vacant Apartment Improvements

Among the four building improvement scenarios that Cushman has now analyzed, the scenario involving building-wide and vacant apartment improvements which Cushman analyzed in its 2009 report (the "Base Building / Vacant Apartment Scenario") continues to be the most economically viable. We therefore asked Cushman to re-analyze this scenario and, in so doing, (i) utilize a more accurate estimate of the cost of the renovation work, (ii) consider additional comparable properties and (iii), in calculating the rate of return, adhere more closely to the methodology used by the Commission in the KISKA matter.

The Base Building / Vacant Apartment Scenario would involve many of the building-wide capital improvements that would be performed in the above-discussed total renovation scenario, including new windows, new electrical service, and metered water service, new gas risers, new ventilation systems and new sprinklers. However, it would not involve the installation of elevators. Furthermore, the apartments in the Subject Buildings would remain intact and the vacant apartments would receive a moderate renovation designed to make them more attractive to prospective tenants. This work would include repair or replacement of ceilings and partitions, as needed, new bathrooms in most apartments and new kitchens in all units, sanding and sealing of existing wood floors, new lighting, new electrical panels and distribution and new interior doors. In its 2009 report, for the Base Building / Vacant Apartment Scenario, Cushman relied on a Gleeds estimate of the cost of the building-wide improvements, but made its own rough estimate of the cost of the apartment renovations based on general industry rules of thumb. Using this methodology, Cushman estimated the total cost of both the building-wide and apartment work to be $15,180,225. The accompanying Gleeds Market Rehab Report contains a thorough analysis of the work involved in the Base Building / Vacant Apartment Scenario, which is based on an in-depth inspection of the Subject Buildings and their vacant apartments by an experienced development consultant. Gleeds estimated the total cost of the building-wide and apartment work involved in this scenario, in 2009 dollars, to be $17,379,464, exclusive of soft costs.

In addition to being based on an actual inspection of the Subject Buildings, Gleeds' estimate took into account some of the special conditions associated with these buildings that would complicate and increase the cost of renovations, such as the lack of elevators, the multiple narrow stairways that would have to be used to transport equipment and materials as high as six stories and the limited staging areas. For these reasons, this estimate is far more reliable than any that could be derived from the standard cost-calculation manuals that various public agencies sometimes use to estimate construction costs. Cushman relied on this more accurate cost estimate in its re-analysis of the Base Building / Vacant Apartment Scenario.

In its 2009 report, Cushman reviewed the recent rents of a number of vacant apartments in the other buildings in the City and Suburban Homes Co. First Avenue Estate (the "Other Buildings") and found that the rents for these apartments, which have somewhat better layouts than the apartments in the Subject Buildings and are closer to the retail stores along First Avenue and the Lexington Avenue subway, averaged about $43 per square foot. Cushman also reviewed recent rents in apartments within four other apartment buildings in proximity to the Subject Buildings, which were served by elevators and had room dimensions, layouts and amenities superior to those found in the Subject Buildings. The per square foot rents for these apartments averaged approximately $40 for a studio, $46 for a one-bedroom and $51 for a two-bedroom. Based on these comparable rents, Cushman estimated that, under the Base Building / Vacant Apartment Scenario, vacant apartments in the Subject Buildings could be leased for an average market rent of $40 per square foot. Since the apartments in the Subject Buildings have an average size of 371 square feet, $40 per square foot represents an average monthly rent of about $1,235.

In its 2012 report, Cushman provides an adjustment grid which shows the specific rent adjustments that it made to the apartments in the four elevator buildings that it reviewed in its 2009 report to account for their superior size, layout and amenities in comparison to the apartments in the Subject Buildings. The 2012 Cushman Report also reviews 2009 apartment rentals in three groups of additional buildings. First, it analyzes 2009 actual lease transactions for 14 apartments in walk-up, non-doorman buildings located on the Upper East Side between East 60th and East 84th Streets. The average rents per square foot for these apartments were $45.76 for studio units, $33.14 for one-bedroom apartments and $36.57 for two-bedroom units, which is consistent with Cushman's projected rent of $40 per square foot for vacant apartments in the Subject Buildings under the Base Building / Vacant Apartment Scenario.

Cushman next analyzes 2009 leases for an additional 9 apartments in elevator, non-doorman buildings located between East 63rd and East 79th Streets. The average rent per square foot for these apartments was about $42. Cushman explains that the annual yearend report prepared by CitiHabitats found that, in 2009, elevator, non-doorman buildings generated rents that, on average, were approximately 15 percent higher than rents in walk-up buildings such as the Subject Buildings. Cushman therefore made a 15 percent downward adjustment in the rents of these nine comparable buildings. This resulted in an average rent of about $36 per square foot, which provides further support for Cushman's $40 per square foot estimate for the Subject Buildings.

Finally, the 2012 Cushman Report reviews 2009 lease transactions for 115 elevator, doorman buildings located between East 60th and East 82nd Streets. The average per square foot rents for these apartments was $48.74 for a studio unit, $46.54 for a one-bedroom and $47.75 for a two-bedroom. The above-mentioned Citihabitats report also found that, in 2009, buildings with both elevators and doormen commanded a rent premium of about 25 percent over walk-up buildings. Cushman therefore made a downward adjustment of 25 percent in these average rents to account for the walk-up, non-doorman condition of the Subject Buildings. This adjustment produced average rents of $38.99 for a studio apartment, $37.23 for a one-bedroom and $38.20 for a two-bedroom. On the basis of its review of these three categories of 2009 lease transactions in a number of Upper East Side buildings, Cushman reaffirmed its conclusion that, in 2009, following building-wide and in-unit renovations, the vacant apartments in the Subject Buildings could have achieved market rents of about $40 per square foot.

The 2012 Wolpert Letter lends significant support for the conclusion that Cushman's estimate of 2009 market rents for vacant apartments under the Base Building / Vacant Apartment Scenario almost certainly represents the maximum rents that could have actually been achieved under this scenario. Wolpert explains that almost all of the vacant apartments in the Subject Buildings are subject to Rent Stabilization, under which the allowable "legal rent" for a vacant apartment is governed by its rent history and by the prescribed rent increases for vacancy and for the cost of apartment improvements. Wolpert found that, following the contemplated renovations, the 2009 legal rent for some of the vacant apartments in the Subject Buildings would have exceeded Cushman's estimated average market rent of $1,235 per month, while the legal rent for other vacant apartments would have been less than this market rent. The 2012 Wolpert Letter states that, if the lesser of the post-renovation legal rent and the projected average market rent of $1,235 is applied to each of the 97 apartments in the Subject Buildings that were vacant at the end of 2009, the average monthly rent that could actually have been achieved for these vacant apartments would have been $1,213.

Wolpert also points out that the many vacant apartments in the Other Buildings that are available to rent would provide direct competition for any available vacant apartments in the Subject Buildings. He notes that in March 2011 there were 191 vacant apartments available for rent in the Other Buildings and, taking into account the allowable vacancy increases, these apartments had an average legal rent of $951. Between 2009 and 2011 the apartments in the Other Buildings that were actually rented achieved average rents of between $1,233 and $1,248. The availability of comparable apartments in the Other Buildings at moderate rents makes it highly unlikely that renovated apartments in the Subject Buildings could have achieved rents in excess of the $40 per square projected by Cushman.

The 2012 Cushman Report also reaffirms Cushman's assumption of a 10 percent vacancy and collection loss under the Base Building / Vacant Apartment Scenario. The report explains that, although City-wide apartment vacancy rates have historically been below 5 percent, a higher vacancy should be assumed for the Subject Buildings because they are six-story walk-up buildings with small, awkwardly laid out apartments. In this regard, the 2012 Wolpert Letter explains that the small walk-up apartments in the Subject Buildings tend to attract single persons and young people, including students at nearby teaching hospitals, who are naturally more transient than families and older persons. Wolpert notes that the Other Buildings, where there is an active leasing program, have had vacancy rates in excess of 20 percent for some years. Based on these factors, the 2012 Cushman Report concludes that, under the Base Building

/ Vacant Apartment Scenario, a vacancy rate of between 5 and 7.5 percent should be projected. Cushman also projects a collection loss of between 2.5 and 5 percent, which is based in part on the fact that tenants in rent-stabilized buildings such as the Subject Buildings are not easily evicted when they fall in arrears on their rent. Cushman therefore reasonably estimated an overall vacancy and collection loss of 10 percent.

The 2012 Cushman Report proceeds to re-calculate the rate of return under the Base Building / Vacant Apartment Scenario in a manner that is consistent with the rate of return methodology used by the Commission in the KISKA matter, which Cushman did not do in its 2009 report. Cushman therefore derives assessed value by adding the Subject Buildings' 2009 assessed value and 45 percent of the estimated cost of the base building and apartment work on those structures. Although the Department of Finance frequently calculates real estate taxes on the basis of a property's effective gross income, we submit that the "cost approach" that the Commission employed in KISKA and Cushman uses in its 2012 report is the fairest and most appropriate approach to use in determining assessed value where a hardship application involves analysis of building renovations because, unlike the "income approach," the cost approach takes into account at least some, although not all, of the costs of the renovation work and, accordingly, is more likely to show whether the contemplated renovation would allow the applicant to earn a reasonable return on its investment.

In its 2012 report, Cushman goes on to calculate the real estate tax expense by applying the applicable 2009 tax rate to this assessed value. In addition, Cushman's estimated depreciation expense equals the sum of the $17,005 depreciation expense shown on the 2009 federal income tax return for the Subject Buildings and 2 percent of the estimated hard costs of the work performed under this scenario. Using this methodology, which is fully consistent with KISKA, the 2012 Cushman Report concludes that in 2009, under the Base Building / Vacant Apartment Scenario, the Subject Buildings would have earned an annual return of 1.158 percent on assessed value, which is slightly lower than the rate of return that Cushman calculated for the same scenario in its 2009 report (1.19 percent) and still significantly below the reasonable return of 6 percent established under the Landmarks Law.

The HR&A Report

The HR&A Report states that HR&A reviewed recent listed rents for nine walk-up apartment buildings in the vicinity of the Subject Buildings and the City and Suburban Homes Co. East 79th Street complex. On the basis of these listed rents, HR&A concluded that in 2009, following repairs and improvements necessary to render the Subject Buildings' vacant apartments code-compliant and habitable, these apartments could have rented for about $49 per square foot, or an average monthly rent of $1,508. HR&A assumed a 5 percent vacancy rate for these units. It adopted Cushman's estimate of annual expenses under this scenario and it employed the KISKA methodology in calculating rate of return. It proceeded to determine that in 2009 the Subject Buildings could have earned approximately 13 percent on assessed value, thereby exceeding the 6 percent return standard established under the Landmarks Law.

The 2012 Cushman Report and the 2012 Wolpert Letter explain that the assumptions and conclusions set forth in the HR&A are faulty in a number of respects, including the following:

- HR&A did not provide information on the size of the apartments it surveyed and did not show the listed rents for these units on a per square foot basis. Independent surveys indicate that on the Upper East Side studio apartments average about 530 square feet and one-bedrooms average about 786 square feet. Information obtained on eight of the nine buildings surveyed by HR&A show that the average size of apartments in these buildings is about 593 square feet. In contrast, the average size of the apartments in the Subject Buildings is 371 square feet. Therefore, the listed rents collected by HR&A certainly do not reflect the rents that could be achieved in the Subject Buildings.

- The HR&A report assumes that the vacant apartments in the Subject Buildings would receive only minimal repairs needed to render them habitable and code-compliant. The comparable apartments surveyed by HR&A are improved to a far higher standard. The 12.5 percent discount applied by HR&A to account for this discrepancy is clearly insufficient.

- The HR&A report concerns listed rents rather than actual rents resulting from completed lease transactions. An independent survey showed that in 2009, actual New York City rents averaged more than 7 percent less than listed rents. Furthermore, listed rents typically do not reflect any rent concessions that a landlord is willing to give. In 2009, over 50 percent of residential leases included landlord concessions, most typically one or two months of free rent. One month of free rent would reduce an apartment's actual first-year rent by more than 8 percent.

- The HR&A Report does not take into account the maximum legal rents on the vacant rent-stabilized apartments in the Subject Buildings. Under Rent Stabilization, a number of these vacant apartments could not have achieved HR&A's project market rent, particularly where only minimal repairs would be made to these units, which is reflected in the cost assumptions contained in the HR&A Report.

- Most of the buildings surveyed by HR&A are 5-story walk-up buildings, while the Subject Buildings are 6-story walk-ups. Information in Gregg Wolpert's letter about occupancy levels on the sixth floor of the other buildings on the block demonstrates that the top floor of a 6-story walk-up is extremely difficult to rent, which would tend to reduce the average achievable rent in the Subject Buildings.

- HR&A assumed a 5 percent vacancy rate in the Subject Buildings. This assumption ignores the historically higher vacancy rate in the City and Suburban Homes First Avenue Estate and does not take into account the more transient population that has typically leased the small walk-up apartments in this complex. In addition, in its estimate of building income, HR&A failed to include any collection loss, which is clearly not reasonable.

For all the foregoing reasons, the HR&A Report does not present a credible argument that the Subject Buildings are capable of producing a reasonable return as defined by the Landmarks Law.

Conclusion

Under the Landmarks Law, a hardship application must be granted if the applicant demonstrates that the relevant property does not have the capacity, "under reasonably efficient and prudent management," of earning a net annual return of 6 percent on the property's assessed value. We have shown that, in the 2009 test year, the Subject Buildings actually operated at a loss. In our previous submissions, we examined three hypothetical scenarios involving repairs and improvements to, and full occupancy of, these buildings, which run the gamut from a minimal repair scenario, involving only the work needed to render the buildings' vacant apartments habitable, to a scenario involving both building-wide capital improvements and renovations to vacant apartments, each of which could be accomplished with existing tenants remaining in place. The costs and income associated with each of these scenarios have been analyzed by highly qualified experts. The rate of return produced by each of these scenarios has been calculated using the same methodology that the Commission has previously employed in determining a hardship application under the Landmarks Law. We have shown that, in the 2009 test year, none of these scenarios would have produced a return of 6 percent on assessed value.

In our current submission, at the Commission's request, we have analyzed a fourth scenario involving a total renovation of the Subject Buildings, including the installation of elevators and the creation of new and larger apartments. We have shown that this total renovation scenario is not remotely feasible because it would require the consensual relocation of all the existing rent-regulated tenants in the Subject Buildings and because its enormous cost in relation to future projected income would make it impossible to finance. In short, we have conclusively demonstrated that, under efficient and prudent management, the Subject Buildings are not capable of earning a reasonable return as defined under the Landmarks Law. Our hardship application should therefore be granted.

Very truly yours,

Paul D. Selver