



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

March 20, 2020

Steven Banks
Commissioner
New York City Department of Social Services
150 Greenwich Street, 40th floor
New York, NY 10007

Re: Financing of the Conversion of 17 Former Cluster Site Buildings

Dear Commissioner Banks:

I write to share my office's analysis of the flawed processes the City employed in financing the bulk purchase of 17 buildings in Brooklyn and the Bronx (the "Properties") in April 2019 to support their conversion from cluster site shelters to permanent affordable housing, primarily for the tenants already in place. The City financed the entire \$173.5 million purchase price, which was well above the Properties' appraised value, with little apparent regard for its own appraisals or little thought to the cost of remediating some 400 building code violations present at the time of purchase. I understand that the City recently financed a second purchase of an additional 14 buildings for the same purpose.¹ In light of the City's intention to continue to pursue such conversions, I want to alert you to certain missteps we identified in the processes the City employed and provide you with recommendations that could help prevent future overpayments.

I fully support the City's efforts to phase out the cluster program and increase the supply of affordable housing. However, given the acute need for low income housing and the limited funds available for it, the City must ensure that any further conversions of cluster shelters are completed at a reasonable cost to maximize the City's ability to address its critical housing needs.

In financing any future conversion it is imperative that the City rely on only sound, impartial appraisals; avoid actions that diminish its bargaining power; and fully account for all related costs, including necessary repairs and improvement. Unfortunately, our analysis shows significant problems in each of those areas.

Background

Although a group of non-profit housing providers paid \$173.5 million to purchase the Properties

¹ On February 20, 2020, *The Real Deal* reported that, according to property records, the second phase of the cluster conversion had been completed. Article available at: <https://therealdeal.com/2020/02/20/city-will-convert-14-apartment-buildings-into-housing-for-homeless/>.

for use as permanent affordable housing, the City was a *de facto* purchaser, having both fully financed the acquisition and fully participated in negotiating the purchase price. The City’s interest in acquiring the Properties for use as permanent affordable housing and its efforts to achieve that objective—including its invocation of its eminent domain power—in effect drove the process to a foreseeable conclusion: the Properties were acquired for the desired public purpose but at a significantly inflated price without any accounting for the additional public cost that will be required to make them habitable for their intended use.

In analyzing the transaction, we carefully reviewed all of the information the Department of Social Services (DSS) provided, including your letter dated April 15, 2019, which generally explained how the purchase price was determined. For ease of reference, the key events and appraisals are listed below.

- In 2016, starting in August, the sellers’ representatives proffered the Properties to the City for use as shelters. The City rejected those proposals and indicated to the sellers’ representatives that it wanted the Properties to be used for permanent housing.
- By letter dated November 4, 2016, DSS notified the attorney for sellers of the City’s intent to use its power of eminent domain to acquire the Properties.
- During eminent domain negotiations, the City and the sellers each obtained appraisals that varied widely with respect to methods, assumptions, and estimates of the Properties’ fair market value.
 - The City’s Department of Housing Preservation and Development (“HPD”) conducted two internal appraisals which valued the Properties at:
 - \$49.67 million using HPD’s standard method for assessing residential properties subject to rent-stabilization rules; and
 - \$115.41 million using HPD’s standard method for assessing market rate properties based on vacant rent stabilization units.²
 - The City hired Metropolitan Valuation Services, Inc. (“MVS”), which valued the Properties at:
 - \$148.7 million using the highest and best use method;
 - \$143.1 million using the highest and best use method and considering income the properties would generate from City payments if the Properties were used as shelters under a City-funded Master Lease; and
 - \$117.1 million using the Properties’ value if they remained subject to rent stabilization rules with vacant rent stabilized units but without considering the income they could generate under a City-subsidized Master Lease scenario.
 - The sellers hired BBG, Inc. (“BBG”), which provided a restricted appraisal—intended only for the sellers—using the “Market Value As Is” method to value the Properties at:
 - \$191 million using Forecasted Market Rents (Income approach);

² HPD also conducted an internal analysis that valued the Properties at \$114.7 million under a DSS contract, was intended only for internal discussions, was not performed by a professional appraiser, did not follow a professional appraiser’s methodology, and was never finalized.

- \$200 million using Forecasted CityFHEPS Rents (Income approach); and
 - \$194 million using Forecasted CityFHEPS Rents (Sales approach).³
- HPD lent a total of \$173.5 million to two entities to enable them to purchase the Properties on April 4, 2019:
 - \$53,787,380 to JOE NYC Cluster LLC;
 - \$119,712,620 to the Neighborhood Renewal Housing Development Fund (Neighborhood Restore).
- On April 4, 2019, the sale closed on the Properties for \$173.5 million.

The City’s Stated Rationale for Financing the Properties’ Purchase at an Inflated Price Is Premised on Questionable Assumptions and Data

The City financed 100 percent of the Properties’ \$173.5 million purchase price without obtaining reasonable assurance that its loan did not exceed the Properties’ value. By any valid, standard measure, the price was well above the Properties’ value.

The City’s rationale for how it determined that it would spend \$173.5 million in public funds to finance this transaction is articulated in your letter of April 15, 2019, which cites three factors: (1) the sellers’ restricted appraisal from BBG valuing the property at \$200 million; (2) the risk that were the City to proceed with eminent domain, it might be ordered to pay an amount higher than the values its own appraisals placed on the Properties; and (3) the costs of delay associated with the eminent domain process, including \$5.8 million in annual rent the City would have continued to pay for the 17 cluster sites during the minimum 3 to 4 years that process might take to complete.

All three factors rest on the assumption that it was necessary or in the City’s overriding interest to have the City’s nonprofit partners acquire *these particular 17 buildings*, using eminent domain if necessary. Insofar as the City expressed that assumption, or let it be known, during its negotiations with the sellers, it undercut its own bargaining position and exposed itself to the risk of being deliberately overcharged.

In this connection, our review identified six weaknesses in the City’s processes that led to its overpaying for the Properties.

1. Impact of Initial Declaration of a Prospective Taking Through Eminent Domain

Policy concerns may have motivated the City’s decision to acquire the Properties through nonprofit partners, but by informing the sellers that it was prepared to use the power of eminent domain, the City foreseeably exposed itself to the risk of being deliberately overcharged—as your April 15, 2019 letter acknowledges: “There is significant experience with governments being required to make higher payments through eminent domain than the government’s

³ CITYFEPS is an acronym for two rental assistance programs, the City Family Eviction Prevention Supplement and City Family Exit Plan Supplement programs, under which the City provides vouchers to landlords and which preceded the October 2018 establishment of the City Fighting Homelessness & Eviction Prevention Supplement (CityFHEPS) program, which consolidated the CITYFEPS and other rental assistance programs into a single program. BBG based their appraisal using CITYFEPS and MVS used CityFHEPS. Both CITYFEPS and CityFHEPS will be referred to as CityFHEPS in this letter.

appraised value.” That experience was no doubt understood by the sellers as well as by the City.

In addition, the City understood that litigating a taking through eminent domain would inevitably add at least 3-4 years to the acquisition process, and in this case would have added an additional \$5.8 million in annual rent payments to the City’s costs.

However, it appears that the City summarily invoked eminent domain, and later reinforced its invocation with a public announcement, rather than examining the possibility of an *in rem* foreclosure or a simple negotiated purchase in which clearing the Properties’ unresolved violations and arrears would have been the sellers’ obligation. Resorting instead to the threat of eminent domain required that the Properties be appraised based on their “highest and best use” and foreclosed the consideration of other appraisal methods that would have resulted in a lower price.

2. Inappropriate Use of a Restricted Appraisal

Even though the City commissioned multiple full appraisals of the Properties by both a private entity and HPD, it inappropriately relied on a restricted appraisal the Properties’ sellers commissioned to arrive at the final purchase price. By definition, a restricted appraisal is not intended for use by anyone other than the client for whom it is commissioned. BBG itself noted in its restricted report that the appraisal was “intended for use only by [the sellers], its successors, assigns, and affiliates . . . use by others [was] not intended.”

The industry standards set forth in the Uniform Standards of Professional Appraisal Practice delineate when appraisal reports or restricted appraisal reports may be employed, explaining that:

When the intended users include parties other than the client, an Appraisal Report must be provided. When the intended users do not include parties other than the client, a Restricted Appraisal Report may be provided.

The essential difference between these two options is in the content and level of information provided. The appropriate reporting option and the level of information necessary in the report are dependent on the intended use and the intended users.⁴

Restricted appraisal reports are specifically described as “for client use only.”⁵

The City provided no rationale to support its departure from the industry standard limiting the use of restricted appraisals. The City described BBG’s appraisal as a draft report and conceded that it “was not structured to contain the level of supporting data that was in the MVS appraisal.” However, despite that view, the City ultimately cited the BBG report as a factor it considered in determining the sale price of the Properties: the restricted appraisal report by BBG assumed a value of \$191 million to \$200 million, which was significantly higher than both MVS’ maximum

⁴ Uniform Standards of Professional Appraisal Practice, Rule 8-2, 2018-2019 (comment to Standard Rule 8-2).

⁵ Uniform Standards of Professional Appraisal Practice, Standard Rule 8-2, 2018-2019 (comment to Standard Rule 8-2(b)(i)).

value of \$143 million and HPD's value of \$115 million. In the absence of any compelling justification for doing so, the City should not have relied on BBG's restricted appraisal, either explicitly or implicitly, as a basis for establishing the ultimate purchase price.

3. Insufficient Consideration of Lower Valuations and Inappropriate Consideration of Non-Comparable Buildings

The City's misplaced reliance on BBG's restricted report (which, among other things, lacked detailed supporting documentation) is all-the-more concerning in light of the much lower values at which the Properties were appraised by HPD and MVS. In particular, the extremely wide variation in the Properties' values, as estimated respectively by the sellers' appraiser, BBG, and by both HPD and MVS applying both market rate and rent-stabilization assumptions, should have caused the City to question—and apply professional skepticism to—BBG's base assumptions. Nothing in your letter or the other information provided by the City indicates that was done. Apart from the question of whether reliance on a restricted appraisal, such as BBG's, is ever justified, the City should have recognized that BBG's assumptions generated an unusually high value compared with the other appraisals it had and should have given more weight to those other appraisals than the final purchase price indicates it did.

HPD's original appraisal, which stated a \$50 million value for the Properties, contained a key assumption that the Properties' apartments would be rent-stabilized and that they would not become vacant. Six months later, HPD performed a second appraisal, stating a value of \$115 million, this time assuming that the apartments would be vacant and eligible to have their rents increased through vacancy decontrol, major capital improvements, and individual apartment improvements. The disparity between the two HPD valuations resulted from the two different—and rational—assumptions, which the City should have carefully considered, not only in connection with those two appraisals but also in its comparison of each of them with the other appraisals that placed higher values on the Properties.

The MVS appraisal, for example, stated a similar value to that arrived at in the second HPD appraisal of around \$117 million. Both of these appraisals relied on similar assumptions and utilized similar methodologies with the minor difference of the number of units considered.⁶

In contrast, BBG's initial restricted appraisal valued the Properties at a much higher \$191 million under the now-questionable assumption that the Properties rent-stabilized units would be eligible for rent increases through decontrol, thereby adding \$4.5 million per building (or \$110,000 per unit) to their overall value. BBG's still-higher valuation of \$200 million assumed not only that the rent-stabilized units would be eligible for decontrol, but that the Properties would generate additional income under the City-subsidized CityFHEPS program, a questionable assumption then and now as discussed in further detail below. Moreover, BBG's restricted appraisal was based not on an analysis of directly comparable buildings in the neighborhoods where the Properties were located, but on a borough-wide analysis, which would inevitably and inappropriately include buildings of varying value that were not remotely comparable to the 17

⁶ The small deviation across the Properties' 17 buildings results in a difference of approximately \$176,000 per building (around \$4,000 per unit). One driver of these differences was that HPD assumed that there were 701 units in the buildings, while MVS assumed that there were 726 units.

buildings that make up the Properties.

The City also maintains that the Properties' purchase price, broken down by dwelling unit, was consistent with the current median price for a rent stabilized unit. However, the City based that conclusion on a borough-wide analysis, which, like BBG's analysis, produced a value that is not representative of the actual value of the units or buildings in specific neighborhoods. As noted above, the median value of a building or unit in a given borough includes many buildings that are not, in fact, comparable due to wide variances in neighborhood values. Additionally, as discussed further below, it appears that the financing price failed to appropriately account for the cost of necessary capital improvements.

4. Failure to Identify and Account for the Full Cost of Rehabilitation

The City did not properly account for the actual conditions of the Properties when determining their value and arriving at a financing amount. MVS's appraisal expressly identified the limitations on its considerations in the "extraordinary assumptions" section of the report, noting that MVS did not gain access to individual units or otherwise examine the interiors of the Properties in connection with its appraisal. Rather, in the appraisal it provided the City, MVS "assumed" that the conditions of these buildings were "similar to the conditions of the influencing rental housing market" and that the Properties had "no structural deficiencies."

Since MVS did not examine the interiors of the Properties, no evidence was provided that either the City or MVS determined whether the buildings were in a state of good repair. While your April 15, 2019, letter notes that the purchase price included a \$1.75 million reduction "for taking the buildings with some violations," the documentation provided to my office does not establish how the City arrived at that number or which of the approximately 400 violations existing as of the fall of 2018 it covered. Moreover, as your March 28, 2019 letter acknowledged, the City "also plan[s] to provide capital funding for rehabilitation costs" and that HPD and the owners and management of the buildings will determine the scope of such rehabilitation.⁷

Given the well-known history of violations in City shelters and buildings used as cluster site housing,⁸ the City's decision to establish the amount it would provide to finance the purchase of the Properties while blind to the magnitude of the costs of the rehabilitation and capital improvements that would eventually be needed strayed far from the best-practice standard the City should be applying to expenditures of this scale. Without this information, the ultimate price taxpayers are paying to finance this conversion is not, and cannot, be known. At a minimum, the

⁷ The regulatory agreements between the City and the two purchasers provided for \$342,691 and \$547,301, respectively, as Building Loans "for certain costs of improvement."

⁸ See, e.g., NYC Comptroller Report, "An Investigation into the Provision of Child Care Services in New York City Homeless Shelters," October 26, 2016, available at: <https://comptroller.nyc.gov/reports/an-investigation-into-the-provision-of-child-care-services-in-new-york-city-homeless-shelters/>; NYC Department of Investigation Report, "New York City Department of Investigation: Probe of Department of Homeless Services' Shelters for Families with Children Finds Serious Deficiencies," March 2015, available at: <https://www1.nyc.gov/assets/doi/reports/pdf/2015/2015-03-12-Pr08dhs.pdf> (Findings that despite the cluster sites being the worst maintained and the most poorly monitored, and had risks such as obstructed passageways, locked exits, defective window guards, and evidence of roaches, rats, and mice for which violations were issued, landlords earned full rent for the apartments, with DHS paying two to three times market rate for housing families in the locations). The sellers also have a history of incurring violations on their properties.

City should have attempted to determine all relevant conditions of the Properties to ensure that the City was aware of the full cost to remediate any unsafe or unsanitary conditions, to replace or repair non-operational building systems, and to perform any other necessary renovations. In addition, although the City represented that it planned to provide capital funding for rehabilitation costs, nothing in the correspondence and materials provided to my office indicates that the City considered the costs associated with the potential temporary relocation of tenants during rehabilitation or remediation.

5. Questionable Assumption of Continuation of CityFHEPS Rents

In arriving at the ultimate purchase/financing price of \$173.5 million, the City deemed the Properties' participation in the City's Master Lease Cluster contract for between 512 and 515 units as their "highest and best use," even though the City's goal was to remove the units from that program through the conversion to permanent housing and, indeed, to eliminate the program altogether. The "highest and best use" appraisals performed by both MVS and BBG used rent figures based on the City Fighting Homelessness & Eviction Prevention Supplement (CityFHEPS) program to determine the Properties' value under a City-funded Master Lease Cluster contract.

MVS determined that the value of the Properties assuming their continued use under the CityFHEPS program was approximately \$143 million—\$26 million higher than MVS's alternative appraisal scenario of \$117 million as the Properties' market value. It appears that in arriving at the higher value, MVS assumed that the City would pay significantly higher rents than the market would otherwise produce. In effect, the City artificially increased the Properties' appraised value by adding a City-funded premium—the value of its own rent supplements—to the Properties' projected income based on the rents they could otherwise command.

However, the use of CityFHEPS rents for appraisal purposes was questionable. Preliminarily, there was no evidence that the City would have continued the Master Lease Cluster program at the Properties in the event it did not ultimately reach an agreement to finance their conversion. Indeed, to the contrary, your April 15th letter expressly states that the City is "phasing out the Giuliani-era cluster program." In addition, it is unclear why this Master Lease Cluster program would be considered the "highest and best use," as the program apparently provides rents far above market value and the City could choose to redirect the subsidies to different buildings. Finally, in the documents provided to the Comptroller's Office, the City did not provide any analysis, legal or programmatic, to justify the use of CityFHEPS rents. It appears that by assuming CityFHEPS would prospectively determine the Properties' value, MVS failed to independently perform a true "highest and best use" analysis and its resulting valuation was therefore questionable at best.⁹

Finally, given that the new rent-regulation laws now limit rents in the Properties' units to their previous rent-stabilized rates, the City should revisit its analyses of the Properties' highest and best use that relied on assumptions, such as the applicability and amounts of CityFHEPS-

⁹ BBG's value of \$200 million also assumed CITYFHEP rents but used a count of 512 units rather than MVS' count of 515 units. The difference in valuation is also attributable to higher rents and how much work the Properties required. An analysis of the Properties conducted by HPD that did not meet the standards of an appraisal used CityFHEPS rents in arriving at a value of \$114.7 million.

supported rents that existed under previous market conditions.¹⁰

6. Lack of Analysis

One—if not the most important—reason cited by the City for converting the Properties from cluster sites to affordable housing was to provide permanent housing as quickly as possible to over 1,000 individuals, apparently including those being sheltered in the Properties. The City also cited its intent to avoid subjecting residents in the remaining rent stabilized units to the risk of displacement if a purchaser other than the City or its nonprofit partners invested in major capital renovations and was able to raise their rents.¹¹ Those concerns are abated as a result of the recent enactment of tenant-protection laws. Going forward, the Tenant Protection Act of 2019, Part J, provides that residents in the types of cluster units located in the Properties and in similar buildings, are considered tenants and that rent increases in the relevant units are restricted to the “legal regulated rent paid for housing accommodations by the prior tenant, subject only to adjustment adopted by the applicable rent guidelines board.”

I agree that concern for the existing tenants’ wellbeing must be paramount in the design and implementation of any City housing program. That concern is neither, however, superior to nor inconsistent with our fiduciary responsibility to fully consider the fiscal impacts of the City’s actions. To the contrary, it is essential that the City fully evaluate such fiscal impacts in order to ensure that limited government funds are available to assist all who are in need.

While the articulated concerns related to keeping the tenants in place might have prompted the City to pay more for the Properties than they are valued on the open market, there is no publicly available record to show that the City fully considered the fiscal impacts of its decision to finance the purchase of the Properties at the price that ultimately was paid. For example, had the City identified alternate properties for conversion to affordable housing, it would have been able to perform an appropriate cost-benefit analysis that compared the cost of relocating the tenants with the cost of continuing their occupancy before finalizing the transactions involved in such conversions. Intangible benefits for tenants and service providers, such as continuation of residence, can be assigned a dollar value for incorporation into such a model. For accurate results, however, *all* costs—including those for correction of violations, renovations, and relocations (temporary and/or permanent)—must be included in this type of analysis.

Because the City appears to have avoided, intentionally or not, this type of appropriately deliberative analysis, it remains unclear whether conversion of these Properties was the best

¹⁰ The City’s assumption that potential vacancies would materially alter the Properties’ rental value appears to no longer be valid going forward. The Tenant Protection Act of 2019 now ensures that residents of Clusters and other similar buildings are considered tenants, and restricts rent increases to the “legal regulated rent paid for housing accommodations by the prior tenant, subject only to adjustment adopted by the applicable rent guideline board.” Accordingly, although there was at least a possibility that the Properties’ units would have become vacant at the time of HPD’s June 2017 appraisal, that possibility no longer applies to similar properties that the City may consider converting.

¹¹ For example, your letter of March 28, 2019 stated that the failure of the purchase to go through “would have put tremendous displacement pressure on the 261 non-cluster tenants in the buildings;” and your letter of April 15, 2019 stated that the transaction saved the City “\$5.8 million in annual rent payments for these 17 cluster sites as the eminent domain process moved forward prior to the transfer of the properties from the owner.”

option for the City and how, if at all, the desire to keep the existing tenants in place factored into the purchase price of the Properties. What is clear, however, is that the City overpaid for the Properties as a result of the missteps outlined above and that it has neither acknowledged nor expressed any intention to address the weaknesses this transaction exposed. Consequently, the City remains at risk of repeating the same mistakes, putting public funds at risk of waste and abuse, and further eroding public confidence in the soundness of its fiscal decision-making.

Recommendations

As a result of my review, I recommend that in future transactions and negotiations the City:

1. Favor negotiation with owners of properties the City identifies as potential sites for affordable housing over the use or threatened use of eminent domain, which triggers a standard of appraisal that drives the cost of City-financed acquisitions above their normal market rates.
2. Identify and use appropriate comparable properties, for example by using data that reflects values in the relevant neighborhoods rather than a borough-wide analysis, to ensure that its market price analyses are based on correct, relevant data.
3. Use appraisal reports consistently with industry standards, avoiding reliance on restricted appraisals of any other parties.
4. When two or more appraisals for the same property produce values that are significantly different, either: 1) offer to use a separate independent appraiser, hired by both parties, to assess the property's fair value; or 2) utilize HPD's current guidelines as a framework to obtain two independent "as-is" appraisals, and use the lower of two independent "as-is" appraisals to establish the purchase price the City is willing to finance.¹²
5. Determine all foreseeable rehabilitation costs so that the City can take account of the true costs of a prospective acquisition in negotiating the purchase price it is willing to finance.
6. Memorialize and retain documentation of all reductions in the value or price of any City-financed acquisition of property due to violations or inadequate capital conditions to support the terms of any financing the City agrees to provide and the price of any property it sells.
7. Revisit the questionable determination that a discretionary program where the City pays or subsidizes rents above market rate can properly affect a property's value as its "highest and best use," particularly where the City can, in its discretion, end such a program at any time. If the City accepts its own discretionary rent-subsidy programs as determinative of a property's fair market value, it should base such subsidies on the

¹² HPD's current guidelines are available at: <https://www1.nyc.gov/assets/hpd/downloads/pdfs/services/as-is-appraisal-guidelines.pdf>.

market rents in the area where the property is located rather than on the maximum CityFHEPS rents.

8. Explore and consider alternate sites through a market or cost-benefit analysis in its assessment of conversion of existing cluster sites, and memorialize all actions and policy considerations that are considered in determining the selection of properties and the expenditure of public funds for affordable housing.

I urge you to consider this analysis and these recommendations as the City continues to help vulnerable residents transition from cluster sites to permanent housing. If you wish to discuss the concerns raised in this letter, please contact Brian Cook, Assistant Comptroller, at 212-669-7658 or bcook@comptroller.nyc.gov.

Sincerely,



Scott M. Stringer
New York City Comptroller

Enc.: Exhibit A: March 25, 2019 letter from Scott M. Stringer, Comptroller, to Dean Fuleihan, First Deputy Mayor
Exhibit B: March 28, 2019 letter from Steven Banks, Commissioner, to Scott M. Stringer
Exhibit C: April 1, 2019 letter from Scott M. Stringer to Steven Banks
Exhibit D: April 15, 2019 letter from Steven Banks to Scott M. Stringer

Cc: Mayor Bill de Blasio
Louise Carroll, Commissioner, HPD
Baaba Halm, Executive Deputy Commissioner, HPD
Martha Calhoun, General Counsel, DSS
Margaret Garnett, Commissioner, DOI



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

March 25, 2019

Dean Fuleihan
First Deputy Mayor
City Hall
New York, 10007

Re: Conversion of Cluster Sites into Affordable Housing

Dear First Deputy Mayor Fuleihan:

I am writing to express concern regarding recent reports that the City is about to purchase or finance the purchase of 17 buildings in Brooklyn and the Bronx to convert cluster site homeless shelters into affordable housing. Last week, the *Daily News* reported that the City would pay \$173 million for these buildings, although an earlier analysis of available records placed the cost between \$40 million and \$60 million.^[1]

Given the continuing need for affordable housing in New York City, I fully support your efforts to find creative ways to increase the supply and eliminate expensive and poorly-maintained cluster site shelters. In fact, the phasing out of the cluster site program is something I've long called for. However, as the City's chief financial officer, it is my responsibility to point out that the City cannot afford to take these actions at the expense of transparency and fiscal responsibility. I therefore respectfully request that you provide my office with the following information no later than April 5, 2019:

1. Please explain why the City is paying \$173 million for the sites, if that is correct, and please provide all appraisals undertaken for or received by the City in regard to these properties. Published reports in the *Daily News* and other outlets indicate an extraordinarily wide range of valuations that have been made for these buildings—from \$40 million to \$143 million—and suggest that discussions about the City's acquiring them have been ongoing for some time.
2. The *Daily News* article further notes that these properties have unrectified and outstanding building violations. Please provide any analysis performed to indicate the projected cost to complete the repairs, including but not limited to, any engineering reports and whether that cost will be paid by the City. How does the cost of repairs factor into the purchase price?

^[1] <https://www.nydailynews.com/news/politics/ny-metro-cluster-173-031419-story.html>

3. Please indicate the process the City will use to purchase these buildings, including which City agencies will be involved, who will purchase and own the buildings, any public approvals needed, and the sources of the funding.
4. What regulatory restrictions will be placed on the property after approvals are granted, including any income restrictions?
5. Given that the City reportedly has been paying the owners of these buildings for the cluster site apartments used as homeless shelters, please provide any cost-benefit analysis that the City has obtained comparing the City's costs in providing those apartments as shelter with the costs of turning them into permanent subsidized housing. Please include:
 - The number of apartments and sizes (by square feet and number of bedrooms) if those figures are not already included in the cost-benefit analysis and appraisals;
 - The net reduction in the number of cluster site shelter units that the City will accomplish through this purchase; and
 - The total cost to operate the current cluster site portfolio including the cost for repairs that have been completed to date.

I know that you and I share a commitment to maintaining a City that provides opportunity to all of our residents and that begins with providing every New Yorker with a reasonable opportunity to find permanent affordable housing. Thank you for your prompt attention to this issue, and I look forward to hearing from you soon.

Sincerely,



Scott M. Stringer
New York City Comptroller



**Department of
Social Services**

Human Resources
Administration

Department of
Homeless Services

Steven Banks
Commissioner

150 Greenwich Street
New York, NY 10007

929 221 7315

Exhibit B

W-1
Rev. 12/16

March 28, 2019

Hon. Scott M. Stringer
Comptroller
City of New York
1 Centre Street, 5th Floor
New York, New York 10007

Dear Comptroller Stringer:

I write in response to your letter dated March 25, 2019 to First Deputy Mayor Dean Fuleihan regarding the impending transaction to convert 17 cluster sites to permanent affordable housing owned and operated by trusted not-for-profit housing organizations to provide affordable permanent housing to 1,200 homeless children and adults in addition to 261 permanent tenant households in these properties. I am glad that we agree that the Giuliani-era cluster program, started nearly two decades ago, must be phased out and I appreciate your support for creative ways to produce more affordable housing for New Yorkers experiencing homelessness right now.

In January 2016, the City was paying for over 3,600 cluster apartments to shelter families with children experiencing homelessness. Today, we are using just over 1,800. This transaction will convert 468 cluster units, or 25% of the remaining cluster units, to permanent housing, thereby providing stable, affordable, permanent housing for 1,200 New Yorkers experiencing homelessness, including over 800 children. These families are excited to have this opportunity and over the past several months have been preparing for their chance at permanency. Furthermore, this transaction will bring 261 other units in these properties with permanent tenants into a long-term regulatory agreement, ensuring that they will continue to serve as housing resources for low-income New Yorkers.

Below please find answers to your specific questions in your letter.

As you know, the Mayor and I have indicated on several occasions that the City is prepared to use the tool of eminent domain to convert cluster sites to permanent affordable housing to alleviate homelessness. In this transaction the City is paying what we would likely have paid if we went through what could be at least three years to acquire the property through eminent domain, and several more years before a court would determine the value of the properties. Through this transaction, 1,200 children and adults are getting

permanent housing now rather than being in limbo while the City seeks to acquire the properties through eminent domain.

To determine what we should pay to provide permanent housing for these 1,200 homeless children and adults, the City has been guided by the standard used in an eminent domain court proceeding. Specifically:

- Under a basic principle of condemnation law, a court will determine the value of property based on its likely highest and best use, not necessarily its actual use.
- To evaluate the potential cost of the properties if they were to be acquired through eminent domain, the City's Law Department retained an independent reputable appraiser. The low values cited in the press did not use the eminent domain legal standard.
- The independent appraiser valued the properties at \$143.1 million.
- The purchase price took into account that if the properties were to be condemned, a court could order the City to pay a higher value as well as attorney and expert fees. In addition, the City would have to pay interest on any award, which would be substantial.

The City's policy is to not release appraisals. Appraisals contain information regarding the internal deliberations about how property is valued. Disclosure of appraisals would interfere with the City's future negotiations for property acquisitions.

What we are paying is also consistent with the current median price for a rent stabilized apartment. The median price for a rent stabilized unit in the Bronx is \$220,000 and in Brooklyn is \$280,000. We have 13 sites in the Bronx and 4 in Brooklyn and we are paying \$237,000 per unit. As your letter notes, we also plan to provide capital funding for rehabilitation costs. After this acquisition, these buildings will be treated like standard affordable housing preservation deals. When ownership changes hands, the Department of Housing Preservation and Development will work with the local, high quality, not-for-profit housing organizations who are taking over ownership and management of these buildings to determine the rehabilitation scope and develop a plan for financing.

Furthermore, in evaluating the rehabilitation costs in addition to the per unit purchase price, it is not comparable to juxtapose the purchase price plus the ultimate rehabilitation costs with the median purchase price. In comparable

sales that produce the median unit costs of \$220,000/\$280,000 a purchaser is taking the unit subject to rent stabilized tenants in place who have rent increase and tenure protections. In this transaction, absent the purchase, if we simply exited the cluster units, the property owner would be selling 17 properties with 468 vacant rent stabilized units – which the purchaser potentially could have effectively taken out of rent regulation by investing in major capital renovations. That would have put tremendous displacement pressure on the 261 non-cluster tenants in the buildings. This transaction is protecting those tenants as well and ensuring all 729 units within this portfolio remain rent stabilized for decades to come.

One of the reasons we have prioritized ending the cluster program is because the City had less control over building conditions within the cluster portfolio of sites than at our traditional shelters. Cluster buildings across the full portfolio carried substantial violations, including these properties. In the Fall of 2018, these properties carried over 400 HPD, Environmental Control Board, and Department of Buildings violations. In order to prepare these properties to become affordable housing, the seller's maintenance crews, overseen and supplemented by Department of Homeless Services maintenance crews, have been working to improve the condition of the homeless units. As part of this work, the seller has been forced to remedy a large portion of these violations. The remaining violations will be cleared by the new not-for-profit owners, either immediately or during the rehabilitation work. Further, as a condition of this transaction the seller must settle all fines associated with these properties with the Department of Finance.

To finance the purchase of these properties by high quality not-for-profits, the City is making loans to two not-for-profits using HPD's loan authority: Neighborhood Restore and JOE. While HPD is the lender in this transaction, in addition to HPD, the complete details of the project have been reviewed by the City Law Department, the Office of Management and Budget, the Department of Social Services, and the City's Housing Development Corporation.

The properties will be managed by seven local not-for-profits: Banana Kelly, Fordham Bedford, Fifth Avenue Committee, MHANY, Samaritan Village, HELP and Settlement Housing. At the time of construction closing — expected to be within the next 12-18 months — long-term ownership will also be transferred to these not-for-profits.

Given that one private entity is selling properties to other private entities, this transaction is not subject to ULURP or any other public process through the City Planning Department.

The properties in this portfolio will be heavily regulated. This transaction includes a 60-year regulatory agreement covering 100% of the 729 units. Through re-rentals, 50% of the units will be long-term homeless set asides and 50% will be long-term affordable units subsidized to 60% AMI (\$56,000 for a family of three). After 60 years, half the units will be permanently affordable. The homeless set aside units will be filled upon re-rental using the current HPD/DSS process and the affordable units will be leased through Housing Connect – HPD’s online Lottery System.

Finally, with respect to your questions about the cost of using these units as shelter:

- Over the past five fiscal years the Department of Social Services has paid just under \$50 million in rent to the current owners of these properties for use as cluster shelter through this Giuliani-era program.
- The below chart compares the cost of shelter for a homeless family with the cost of permanent housing for a single year and shows a cost benefit for permanent housing as compared to shelter costs. The City share of family shelter is shown with the State and federal funding contributions and what it would be with the impending 10% TANF cost shift to the City that is proposed to be included in the State budget.

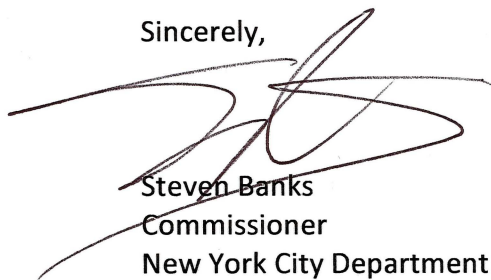
	Total	City	State	Fed
Annual cost of FWC shelter unit @ current funding	\$70,117	\$25,242	\$4,908	\$39,966
Annual cost of FWC shelter unit w/ 10% TANF shift to City	\$70,117	\$29,449	\$4,908	\$35,759
Annual cost of a cluster converted to a housing unit	\$22,534	\$22,534	\$0	\$0
purchase price of unit (60-year deal)	\$3,950	\$3,950	\$0	\$0
social services	\$3,500	\$3,500	\$0	\$0
CFHEPS rent for 1 year (assumes \$300 client contribution)	\$15,084	\$15,084	\$0	\$0

- Reliable square footage for each unit is not available at this time. However, apartment bedroom counts for the 468 units currently in the homeless set aside portion of this portfolio are approximately:
 - 2 studios
 - 309 one-bedroom units
 - 107 two-bedroom units
 - 50 three-bedroom units

- DHS currently funds just over 1,800 cluster units, a 50% reduction from the height of the 19-year program. This conversion of units to permanent housing will reduce the current cluster portfolio by 25%.
- As you know, DHS has been shrinking the cluster portfolio. In Fiscal Year 17, DHS' total costs across the portfolio were \$65,185,322.64 and in Fiscal Year 18 they were \$57,855,373.47.

We are happy to brief you further on this transaction at your convenience. As always, please do not hesitate to reach out with any questions or concerns. Thank you for your focus on our clients and your support for providing affordable permanent housing to homeless children and adults.

Sincerely,

A handwritten signature in black ink, appearing to read 'S. Banks', is written over the typed name and title.

Steven Banks
Commissioner
New York City Department of Social Services



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

April 1, 2019

Steven Banks
Commissioner
New York City Department of Social Services
150 Greenwich Street, 40th Floor
New York, NY 10007

Dear Commissioner Banks:

Thank you for your March 28, 2019 response to my inquiry regarding the purchase of 17 buildings to be converted from cluster site shelters to affordable housing. I appreciate the progress that Department of Social Services (DSS) is making on closing cluster sites, a model that my office has long viewed as problematic. As we all agree, the City should not allow any of its residents, homeless or otherwise, to live in unsafe conditions. That said, your letter raises more questions than it answers as to how the purchase price for these particular properties was determined.

In your letter, you state that “the purchase price took into account that if the properties were condemned a court could order the City to pay a higher value as well as attorney and expert fees.” However, this statement does not actually explain how the City determined that it would spend \$174 million instead of \$143.1 million, which was the independent appraiser’s evaluation. The City should not have a policy of spending significantly more than the estimated value of the property simply because it is fearful that someone “could” make them pay more. Did the City lose faith in the independent appraisal or base the valuation on some other metric?

While you do indicate that you are paying approximately \$237,000 per unit, which you state is near the median price for a rent stabilized unit in the Bronx and Brooklyn, this is an imprecise and unreliable metric for valuation purposes. Appraisals, when done correctly, analyze comparable properties to determine their value. However, median value across a borough forgoes those *direct* comparables and includes many buildings that are not in fact comparable. To put it simply, a rent stabilized building purchased in Bay Ridge, Crown Heights, Park Slope and Brownsville will each likely have different comparables and purchase prices per unit despite sitting in the same borough. It is for this reason that appraisals are typically used, *not* median purchase price.

Further you state that “in evaluating the rehabilitation costs in addition to the per unit purchase price, it is not comparable to juxtapose the purchase price plus the ultimate rehabilitation costs with the median purchase price,” claiming that absent the purchase, 468 units would be vacant and likely de-regulated. However, it appears that your underlying assumption here is faulty. Across the City, whether purchasing market rate units or rent stabilized units, developers consider the cost of rehabilitation to determine the capital improvements needed and the amount of financing necessary to achieve their financial goals for a building. The capital improvements needed, maintenance costs, and potential rental income are used to determine the purchase price by calculating the potential net



operating income. By only looking at potential rents, one is ignoring the other side of the equation necessary to determine if the purchase price was calculated correctly.

Moreover, without knowing the potential rehabilitation cost, the ultimate cost to the City for these projects cannot be known. While your letter indicates that these buildings had 400 violations issued by the Department of Housing Preservation and Development, the Environmental Control Board, and the Department of Buildings and that "the seller has been forced to remedy a large portion of these violations," it does not indicate how many violations presently exist, how much it will cost to repair and remove them, or if additional subsidies will be needed to repair these violations. The letter only indicates that the purchasers, two not-for-profits, will be responsible for rehabilitating the remaining violations. Any way it is analyzed, the cost of rehabilitation should be a factor in the City's calculations and decision making and should be transparently disclosed.

Your letter clearly acknowledges that it will be less expensive in the long run to run these buildings as affordable housing than cluster-site shelters and therefore, *at some point in time*, it will be in the City's financial interest to have purchased these properties. However, exactly when the City will end up saving money greatly depends on the amount of money the City ends up spending to rehabilitate these buildings.

It is therefore still an open question as to whether or not the City is spending its money wisely. Providing greater detail about the facts and analysis employed by the City to support its decisions will hopefully assuage that concern. I therefore ask again that you provide greater clarity on these matters and provide the appraisals I requested in my previous letter. I remind you that my office has the power to subpoena these documents if necessary.

I also want to take this opportunity to reiterate my previous calls that our City's homelessness and housing policies be merged. The City needs to provide a greater number of units to formerly homeless families, increase the subsidies to build extremely low and low-income housing units, and raise revenues through creative means such as a reform to the real property transfer tax and the mortgage recording tax. Converting cluster sites shelters into affordable housing could be an important part of the equation, but must take place as part of a larger plan to tackle homeless through the development of affordable housing.

As always, please feel free to contact me directly if you'd like to discuss any part of this inquiry.

Sincerely,



Scott M. Stringer
New York City Comptroller

**Department of
Social Services**Human Resources
AdministrationDepartment of
Homeless Services**Steven Banks**
Commissioner**150 Greenwich Street**
New York, NY 10007**929 221 7315**

April 15, 2019

Hon. Scott M. Stringer
Comptroller
City of New York
1 Centre Street, 5th Floor
New York, New York 10007

Dear Comptroller Stringer:

I am writing to provide an update and additional information regarding the transaction to convert 17 cluster sites to permanent affordable housing. I am pleased to inform you that the closing on these properties occurred on April 4, 2019. These properties are now owned and operated by trusted not-for-profit housing organizations and provide affordable permanent housing to nearly 1,200 homeless children and adults in addition to 261 permanent tenant households in these buildings — benefiting approximately 2,000 low-income New Yorkers overall. With this one project we were able to convert 468 cluster units, or 25% of the remaining cluster units, to permanent housing, marking a significant step in phasing out the Giuliani-era cluster program, started nearly two decades ago. From a high point of more than 3,600 cluster units, we have now reduced the number down to approximately 1,350 as we continue to implement our plan to end this failed approach to homelessness.

I am also writing to advise you that today, under separate cover, the Department of Social Services is providing your office with several appraisals and one analysis regarding the subject properties. The City generally maintains the confidentiality of such documents because of the potential impact release can have on future negotiations and eminent domain litigation. Notwithstanding this potential impact on future transactions and litigation, including future cluster conversions, we are providing these documents to give a full picture of this transformational initiative that is part of ending once and for all a 19-year policy failure for the benefit of 2,000 New Yorkers in need of high-quality affordable housing.

Below I provide an explanation of the appraisals and how the City reached the purchase price. As you know, this important project involved the acquisition for \$173.5 million of 17 cluster site properties (comprising 21 buildings), with 13 in the Bronx and 4 in Brooklyn. Cumulatively, the buildings have 729 units

consisting of 4 studio, 450 1-bedroom, 169 2-bedroom, and 106 3-bedroom apartments.

As we announced previously, this project proceeded under the threat of eminent domain. To determine the potential amount that the City would have to have paid if we had proceeded with eminent domain, the New York City Law Department retained Metropolitan Valuation Services (MVS) on February 5, 2018 to conduct an appraisal of the properties. MVS is one of the appraisers that the Law Department uses for valuation litigation purposes and was selected for this project due to their extensive experience evaluating multi-family homes and rent stabilized buildings in the Bronx and Brooklyn. The Law Department has retained this appraiser eight times since 2014.

In order to determine the highest and best use of the property as required by eminent domain standards, MVS determined the value of the properties under two scenarios, rent stabilization and the DSS Master Lease program, and reviewed comparable sales. Through the DSS Master Lease program, experienced not-for-profits can net lease buildings to use as permanent housing for clients who need light-touch social services, not supportive housing, and the clients who participate are permanent housing tenants. The program began in 2015 as part of the veterans rehousing effort and expanded to include non-veterans and families with children. The not-for-profit makes rent payments to the landlords based primarily on City voucher rent levels at the time of contracting and paid through tenant-based vouchers. There are currently 11 Master Lease contracts that have been registered by your office, involving 14 sites, more than 600 units and over a thousand children and adults, with an average annual program cost of \$14.8M.

MVS provided an initial appraisal amount for the highest and best use in March 2018 of an aggregate value of \$148.7 million based on participation in the DSS Master Lease Program as the highest and best use, and then in November 2018 MVS amended the appraised values to reflect an inadvertent error in the expenses to be reimbursed under the Master Lease scenario, thus reducing the appraised value of the 17 properties to \$143.1 million. The rent stabilized value, which was performed to determine which use was the highest and best use, indicated a value of \$117.1 million if the properties were operated within the rent stabilized market and without participating in the DSS Master Lease Program.

Formal narrative reports memorializing the appraisals provided in March and November 2018 were ordered upon the final decision to proceed with the acquisition. The reports provide extensive valuation analysis with detailed descriptions not only of the projected income and expenses under the Master

Lease Program but also several comparable sales in the relevant boroughs and market research.

DSS is providing the Comptroller's Office with final appraisal reports from Metropolitan Valuation Services (MVS) for each of the 17 properties, a cover letter summarizing the totals for the individual appraisal reports, and the submitted valuations from March and November 2018. Altogether, these reports total more than 1,900 pages. These reports clearly demonstrate that the City's negotiations were guided by an independent appraiser based on market driven data.

DSS is also providing your office with a draft appraisal report provided to the City by the owners of the properties. The owners retained BBG Inc., a third-party appraiser, to value the properties utilizing an income approach as well as a review of comparable sales. BBG is on the New York City Acquisition Fund list of approved appraisers (i.e., BBG is a firm that works regularly on affordable housing projects with the City). On January 15, 2018, BBG issued a restricted appraisal report that valued the collection of 17 properties at \$191 million or \$200 million depending on the scenario. The report was a restricted appraisal report that, because of its intended use, was not structured to contain the level of supporting data that was in the MVS appraisal.

DSS is also providing your office with two internal appraisals and one internal analysis performed by the New York City Department of Housing Preservation & Development (HPD). HPD relied on an income analysis and did not review comparable sales. The first appraisal is from June 2017 and valued the properties collectively at \$49.67 million. This appraisal did not value the properties based on their highest and best use as participating in the DSS Master Lease program, as a court would do, but instead valued the properties based solely on a scenario in which 100% of the units were generating rent stabilized rents.

HPD then did a second appraisal dated January 9, 2018 that valued the properties at \$115.41 million. As with the first appraisal, this appraisal again did not value the properties based on their highest and best use as participating in the DSS Master Lease program but instead valued the properties on the assumption that the units would generate market rate rents. The \$115.41 million value is similar to the rent stabilization value identified by MVS but, as indicated, still did not value the properties according to the highest and best use standard that would be applied by a court.

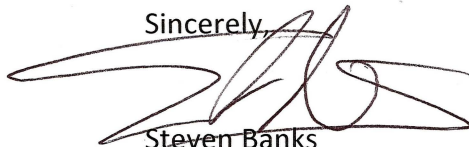
Finally, my office is providing you with an internal analysis that HPD performed in December 2017 that valued the properties at \$114.17 million. The analysis

sought to determine the value of the properties under a DSS contract. While we are providing it to you in the interest of full disclosure, I note that this analysis was intended solely for internal discussion purposes and ultimately was never finalized. It was not performed by a professional appraiser and does not follow the methodology of a professional appraiser, as is made clear by comparing this analysis to the final appraisal reports from MVS. The analysis also did not include the anticipated income and expenses for the DSS Master Lease Program and that were used by MVS.

The City began negotiations with the owners with this information and the understanding that the MVS appraised values gave the City the best indication of the value in eminent domain. Agreement was reached at a purchase price of \$173.5 million including a \$1.75 million reduction for taking the buildings with some violations. Negotiations are a two-way street, of course, and the owners began the negotiations with their appraised value of \$200 million. The City was guided in its negotiations by the fact that condemnation would take substantially longer (at least 3-4 years) and would come with substantially increased costs. There is significant experience with governments being required to make higher payments through eminent domain than the government's appraised value. It is also important to note that the City would have had to continue to pay \$5.8 million in annual rent payments for these 17 cluster sites as the eminent domain process moved forward prior to the transfer of the properties from the owner.

I greatly value our mutual commitment to addressing homelessness that has built up in our city for many years, including a 115% increase in the Department of Homelessness shelter census from 1994 to 2014 as rents jumped by nearly 19% and income increased by less than 5% and the City lost some 150,000 rent-regulated apartments. This transaction to convert cluster sites back to affordable permanent housing for homeless families and other conversions that will follow are an essential part of putting in place more effective policies to address homelessness. I look forward to working with you on our important work going forward. Please do not hesitate to reach out with any questions or concerns. I appreciate your focus on our clients and your support for providing affordable permanent housing to homeless children and adults.

Sincerely,



Steven Banks

Commissioner

New York City Department of Social Services