The Future of the Garment Center

Report to CWE and WDI on recommendations to support apparel production in Midtown Manhattan

PRATT CENTER FOR COMMUNITY DEVELOPMENT

Fall 2017

Project Summary

In January 2017, the city announced plans to develop a new hub for the fashion industry in Sunset Park, Brooklyn. In March, the city announced plans to lift the special zoning restrictions in the Garment Center, the historic home of the industry and largest concentration of fashion design and production in the world, and to encourage apparel firms to relocate.

Manhattan Borough President Gail Brewer and other elected officials convened a task force which included the Pratt Center to develop strategies for strengthening the Garment Center while allowing Sunset Park to grow.

This report builds on the work of the task force and offers specific alternative strategies for preserving space in the Garment Center, identifies emerging technologies and assesses their workforce and training implications.

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Introduction

Garment Center History

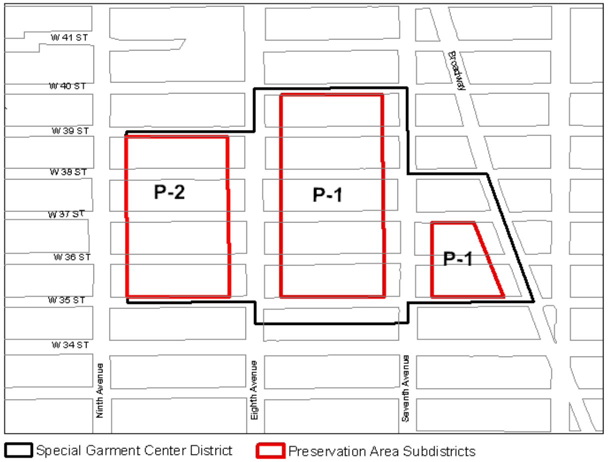
Special District formed in 1987

- Created to ensure access to apparel production capacity on mid-blocks for designers on the Avenues in the wake of pressure from the redevelopment of Times Square
- Established core Preservation Areas (P1 & P2) requiring equal set aside of production space when converting to other commercial uses*

Zoning in tact despite limited City support

- Office of Midtown Enforcement (OME) charged with upholding Special District provisions through regular inspections. OME later defunded and inspections terminated.
- Many buildings have illegally converted to office uses without penalty
- Hotels, which are legal, have proliferated
- City has unsuccessfully attempted to lift zoning restrictions in the past

Garment Center Special District



*Some exceptions apply

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Garment Center Today

Despite city inaction, an extraordinary ecosystem remains in the Garment Center

- Small, mid-sized and established designers
- Factories with expertise and specialization (over 400 Firms)
- Highly Skilled Workers (~5,000 employees)
- 1.4 million sq. ft. in production and logistics
- Wide range of suppliers
- Tremendous synergy from FIT & Parsons - train students who renew the industry

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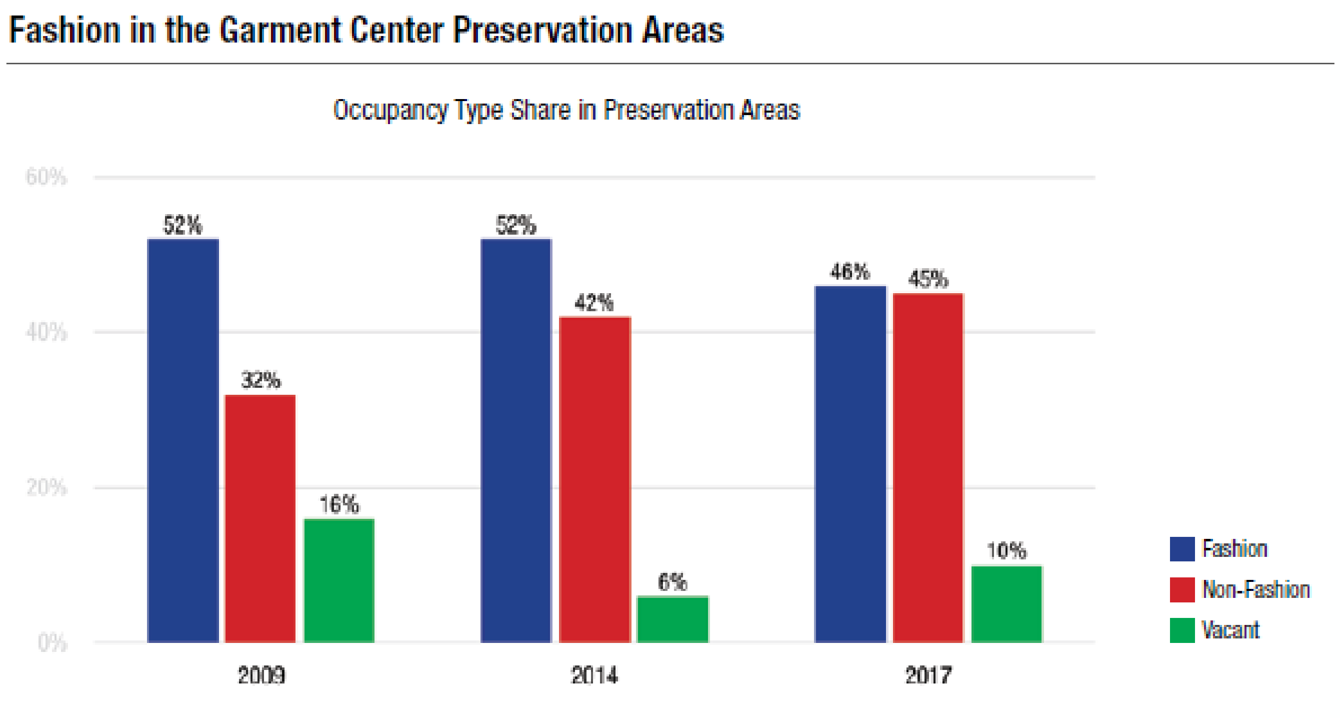
Garment Center Today

While other uses have increased, fashion dominates neighborhood character



Source: Garment District Alliance

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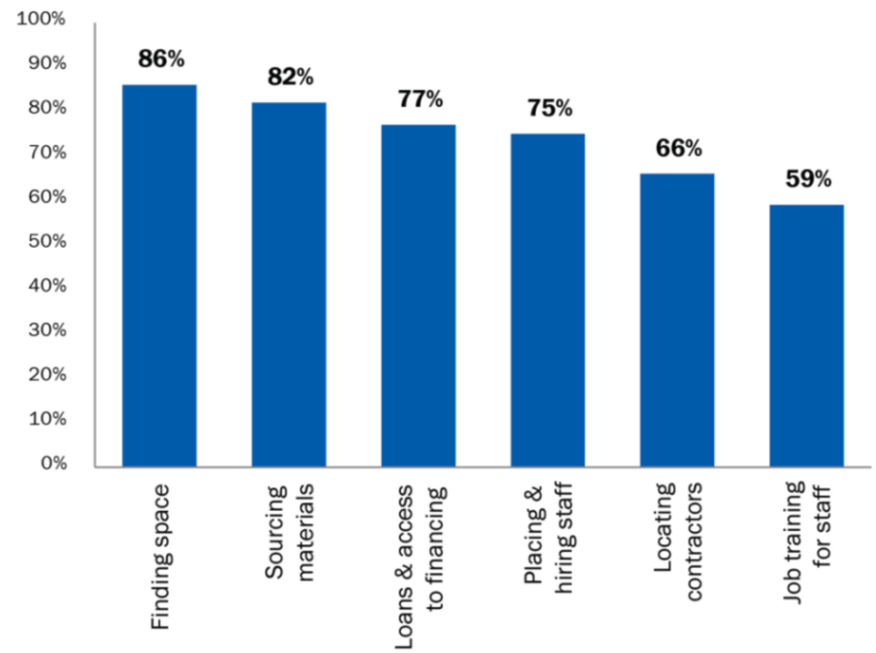
Garment Center Supports Citywide Fashion Industry

Garment Center cluster stimulates creativity and drives economic growth in and outside District

Designers, manufacturers, students, etc. located outside of Midtown rely on Garment Center firms and services*

- 61% visit Garment Center at least once/week
- 85% visit 2-5 businesses during each trip; 10% visit 6 or more
- 92% report that it is important to get to and from different businesses *within* the Garment Center quickly

The Garment Center is critical to helping students and entrepreneurs launch their businesses with an array of services and functions



Source: Future of Fashion, Pratt Center, 2014

*Survey conducted by Municipal Art Society, Summer 2017

City’s Initial Plan: Relocate Apparel Firms to Sunset Park and Free Garment Center for Class B Office Space

January 2017 City announced major investment in Made In NY campus (film, fashion & food) at Bush Terminal in Sunset Park

- Relocation and tenant fit out grants for apparel production firms
- Expansion of existing Fashion Manufacturing Initiative to support purchase of new machinery, technology and software
- Unspecified workforce training opportunities and other support services

March 2017 City announced plans to lift Garment Center zoning restrictions and to support office development

April-Nov 2017 Anticipated time to start and complete rezoning
As of 10/30/17 - start date postponed indefinitely

2020 Anticipated completion of Sunset Park renovation

City's Initial Plan: Key Concerns

No plan to retain critical functions in Midtown

- Despite its continued importance to the industry citywide and the presence of a critical ecosystem that includes design, production, suppliers and services, no strategies to retain production were included

- City projected some production would remain despite prevalence of short term leases and rent disparity between manufacturing and other uses
  - According to Garment Center Suppliers Association, the average rent for apparel manufacturers in the Garment Center is $30,95/sq. ft. compared to the market rate of $51/sq. ft. according to The Real Deal.

City underestimated benefit of clustering both design and production

- Current decentralization of industry created misleading narrative. City did not acknowledge that Garment Center is used by firms outside the district

- Assumed some designers would stay in Midtown but production could move to Sunset Park

- Division of design and production undermines efficiency and specialization

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City's Initial Plan: Key Concerns, continued

Backwards sequencing would unnecessarily place real estate pressure on Garment Center firms

- For those firms that could/wanted to move to Bush Terminal, the new space would not be available for another three years
- Many manufacturers live in NJ and might relocate companies to NJ
- Many Garment Center production firms are on month-to-month or other short term leases; lifting of zoning restrictions would have left little incentive for landlords to continue leasing to production firms when higher paying tenants would now be legal

City's Plan Evolved Slightly to Respond to Timing Concerns, but not Adequately

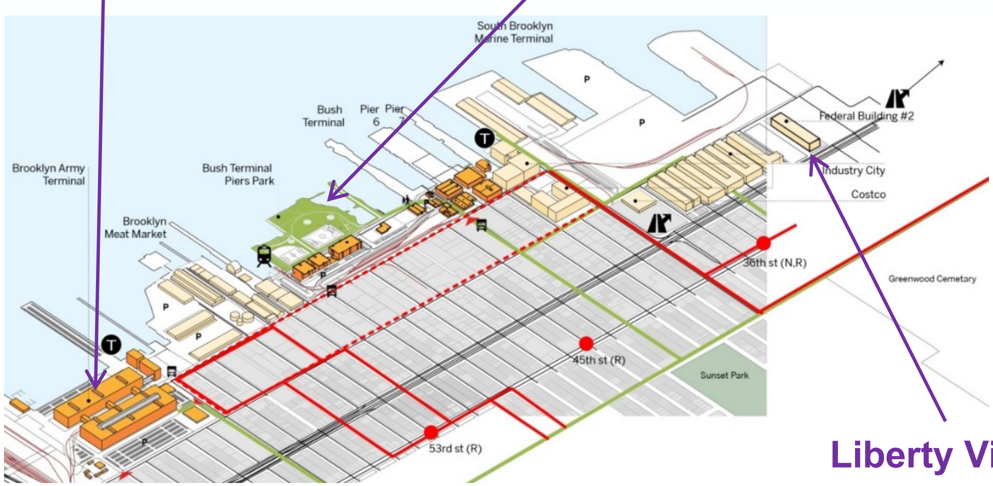
To address sequencing, City expanded its relocation offerings to include the Brooklyn Army Terminal and privately owned properties

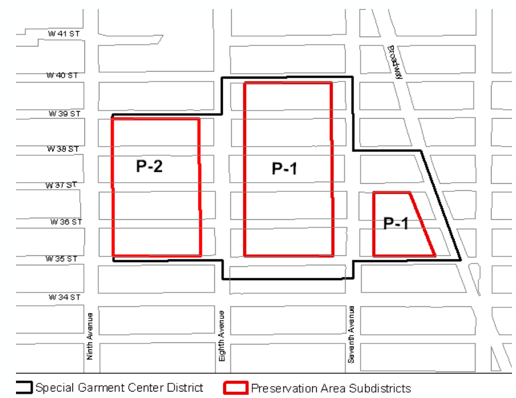
- Expansion of geography from 5 GC blocks to 1¼ miles makes replication of cluster benefits less likely
- Relocating firms to private property in gentrifying neighborhood reduces long-term security for production firms and deters investment
- Revised plan still did not include any provisions for maintaining production space in Midtown

BAT Fashion Center

Bush Terminal

Garment Center





Liberty View

1 ¼ miles

5 blocks

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Garment Center Steering Committee + Key Proposals

Formation of Garment Center Steering Committee (GCSC)

Established by Borough President Brewer, CM Corey Johnson and EDC to engage stakeholders to develop a strategy to maintain and strengthen the Garment Center

- Brought together range of industry stakeholders including elected officials, Pratt Center, BID, REBNY, Community Boards, Garment Center Suppliers' Association, Council of Fashion Designers of America, etc.

- Committee met every other week for three months

- Goal: Garner consensus on strategies to maintain and strengthen the Garment Center in Midtown; Sunset Park was considered outside the Committee's scope

Primary focus was on real estate issues but workforce and place making were touched upon to a lesser degree

- Pratt Center generated and refined many of the ideas discussed before the GCSC

- Worked collaboratively with other Committee members and other stakeholders

Pratt Center (and others) Advocated for Four* Main Components For A Successful Garment Center Plan

1. **Real estate:** Maintain an adequate amount of production space in Midtown to anchor ecosystem functions and the apparel industry citywide

2. **Management:** Promote real estate management structures that advance stability, affordability, enforceability, turnover and diversity

3. **Financing:** Develop a financial incentive package that incentivizes owners to secure production space long-term

4. **Timing:** Implement zoning restriction phase out only if and when an adequate amount of production space is secured for the long-term

*While workforce and place making are critical components of a plan for the Garment Center they were not a focus of the GCSA discussions. Additionally, the Steering Committee was strictly focused on the Garment Center and not Sunset Park.

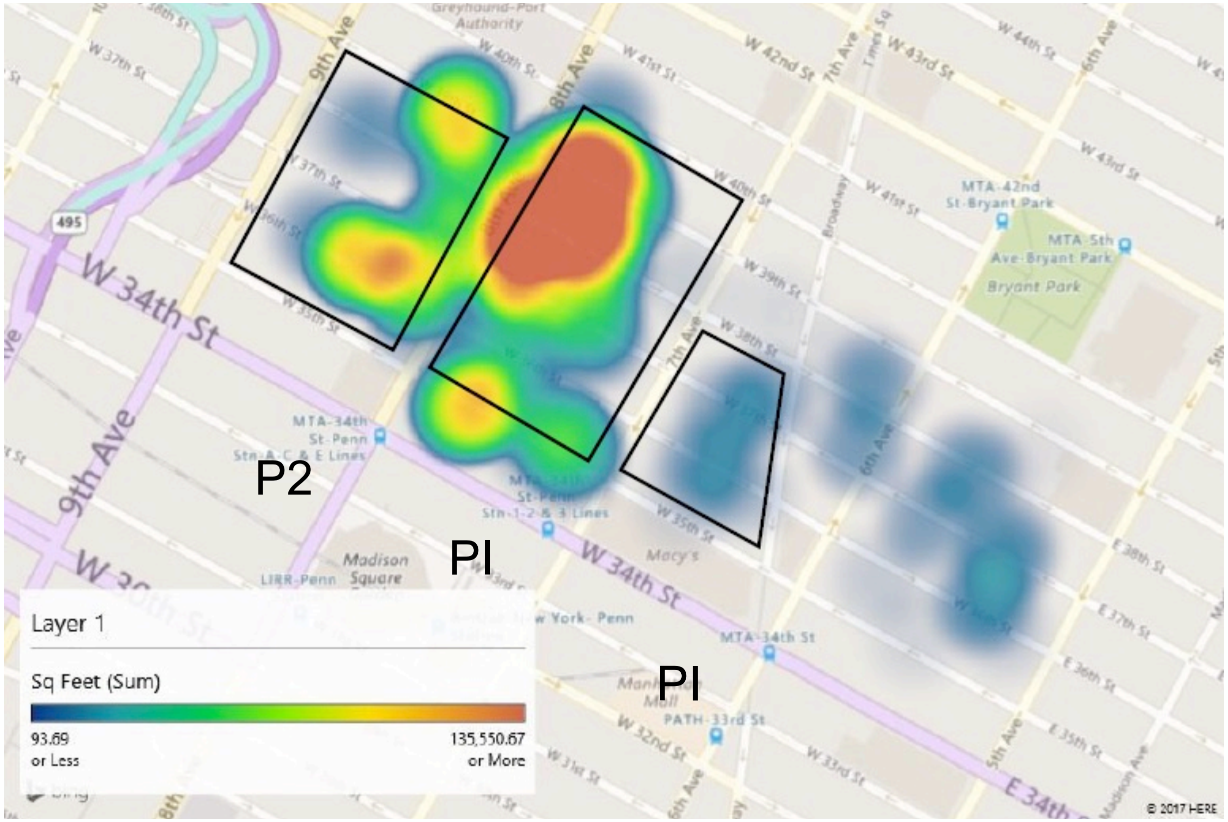
1. Real Estate 2. Management 3. Financing 4. Timing

Maintain an adequate amount of production space in Midtown to anchor ecosystem functions and the apparel industry citywide

Existing cluster has expanded beyond initial P1 and P2 areas of the Special District; long-term core could be comprised of firms operating from 23rd St. to 41st St., 5th Ave. to 9th Ave.

Existing Apparel Production in Garment Center

Source: Garment Center Suppliers Association, 2017



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1. Real Estate 2. Management 3. Financing 4. Timing

Guiding Principles:

A core amount of production space—a minimum of 500,000 sq. ft.*—should be preserved in the Garment Center to provide long-term support for the functioning of the entire eco-system.

Production space needs to be affordable and stable so companies can invest without fear of eviction or rapidly escalating rents

The managing entity needs to “curate” the tenants to assure a diverse mix of specialized goods and services remain available

The preservation mechanism needs to be enforceable to provide space for the industry overall as opposed to any individual company to accommodate turnover and the birth of new companies.

*A survey conducted in the Spring/Summer 2017 by the Garment Center Suppliers Association documented 1.4 million sq. ft. of active production space in Midtown.

Promote real estate management structures that advance stability, affordability, enforceability, turnover and diversity

City's plan relies on private ownership and financial incentives

- Easy to understand and implement but does not meet guiding principals
- Requires an ongoing (and potentially increasing) subsidy that City could withdraw
- Provides space for tenants currently in existence but does not secure long-term, affordable space for the industry overall

There are two potential models that can readily meet the guiding principals and needs of the Garment Center

- Non-profit owned and/or managed space (preferred model)
- Limited equity industrial co-ops or condos

Model 1: Non-profit ownership/management *(Preferred Model)*

Mission oriented organization dedicated to providing affordable, stable space owns and/or manages space

Ability to provide additional functions above space management including enforcement, business assistance, workforce training, etc.

NYC already has a non-profit, industrial development network (albeit small) in operation today that can be leveraged and provide insight for the Garment Center

Model 1: Non-profit ownership/management *(Preferred Model)*

Advantages

- Affordability—rents based on costs, not speculation
- Mission commitment creates lease stability
- Ability to curate for synergies and mix of services
- On-site/dedicated management and responsiveness
- Easy to enforce

Disadvantages

- Upfront subsidy
- City and BID/REBNY resistance
- Uncertainty that owners will be willing to participate within existing timeframe

NON-PROFIT EXAMPLE:

Greenpoint Manufacturing and Design Center

- An independent non-profit organization established in 1992 to provide affordable industrial space.
- 12 member board with expertise in real estate, law and finance.
- Financed through conventional debt, plus city, state and foundation grants.
- Own and manage 700,000 sq. ft.

Address	Square Feet	No. of Businesses
1155 Manhattan Avenue	366,000	76
72 McKibbin St.	72,000	19
810 Humbolt St.	95,000	12
7 St. Nicholas Ave.	22,000	4
1102 Atlantic Ave.	50,000	14
9415 100th St, Queens	85,000	In construction

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1. Real Estate **2. Management** 3. Financing 4. Timing

NON-PROFIT EXAMPLE:

Brooklyn Navy Yard Development Corporation

- A non-profit organization established in 1981 to revive an abandoned shipyard as a modern 300 acre, city-owned industrial park
  - 4 million sq. ft. of space
  - 330 businesses
  - 7,000 jobs
  - 2 million sq. ft. under development
- 28 member Board appointed by the Mayor representing community, real estate, finance and other sectors
- NYC contracts with BNYDC to manage operations
- Flexible lease terms
- Tenants curated for mission objectives
- Financed through conventional debt, EB5 plus city, state and federal grants and tax credits to close gaps

Model 2: Limited equity industrial co-ops or condos

Subsidies to co-op/condo association to lower acquisition and/or operating costs for tenants

Tenants "buy" co-ops/condos and sell back to Association based on formula that allows for appreciation but not speculation

Limited examples in industrial sector

424 Broadway Garment Condo

Model 2: Limited equity industrial co-ops or condos

Advantages

- Affordability—rents based on cost, not speculation
- Long-term stability
- Leverages private investment to reduce acquisition costs

Disadvantages

- High transaction costs
- City and BID/REBNY resistance
- Uncertainty that owners will be willing to participate within existing timeframe
- Uncertain enforcement and curation

Develop a financial incentive package that incentivizes owners to secure production space long-term

To preserve affordable manufacturing space, an incentive package is required to overcome differential between affordable manufacturing rent and other uses that would be allowed under different zoning policy

NYC Industrial Development Agency (IDA) is a governmental agency with the ability to eliminate real estate and sales taxes for projects that meet stated city policy goals

- Board members are appointed by Mayor
- Administered by NYC Economic Development Corporation
- IDA contracts have claw back provisions to enforce city policy goals such as long lease terms, tenant use groups, etc.

The IDA combined with other incentives such as the Non-Profit Industrial Development Fund could close gap and provide necessary enforcement

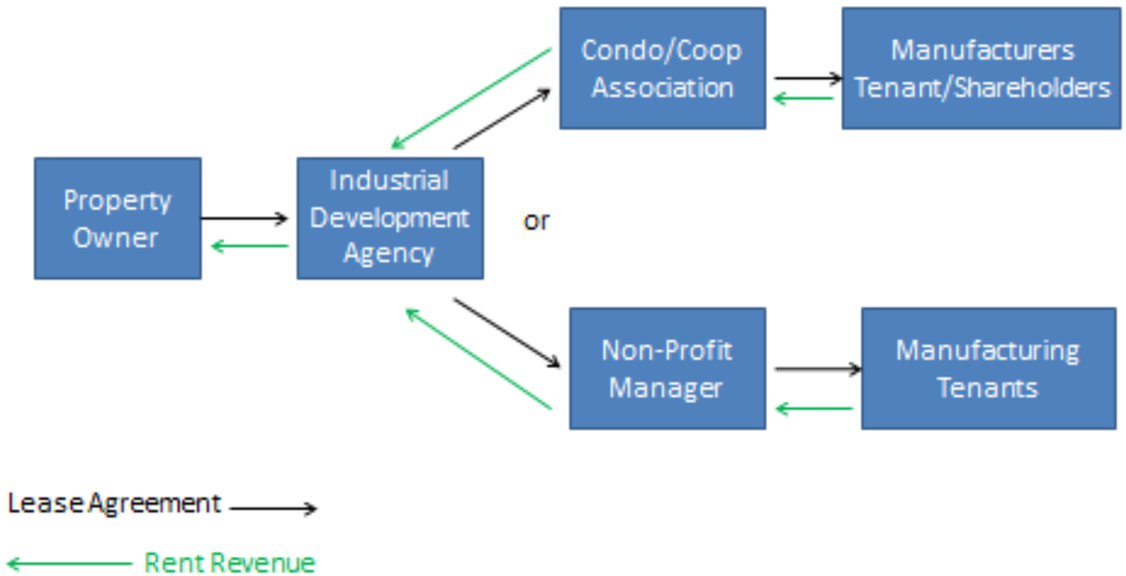
A Garment Center IDA program could incentive owners to commit to leasing to garment firms and applications to IDA for incentives would end once sufficient amount of space (i.e. 500,000 sq. ft.) had been secured

Key elements:

- IDA issues a Request for Expressions of Interest to identify properties
- Owner enters into a lease-lease back structure with IDA
- IDA subleases property to third-party operator (i.e. non-profit manager or co-op/condo association)
- Third party operator/manager subleases individual spaces for apparel production; rental revenue depends on price producers are willing and able to pay
- Owner receives guaranteed real property tax benefit for negotiated period of time and rent revenue stream for lease duration, which may not be less than 49 years
- At end of time period, building is unencumbered by the apparel production space allocation

*See Appendix for additional RFEI elements

Garment Center IDA Program



Program could also apply to building owners that want to sell their space rather than enter into long-term leases via the IDA; significant tax benefits might be available if the transaction qualifies as a "bargain sale"

The IDA alone would likely not be able to close funding gap sufficient to provide long-term, affordable rents; Financial package should be coupled with restructured Industrial Development Fund

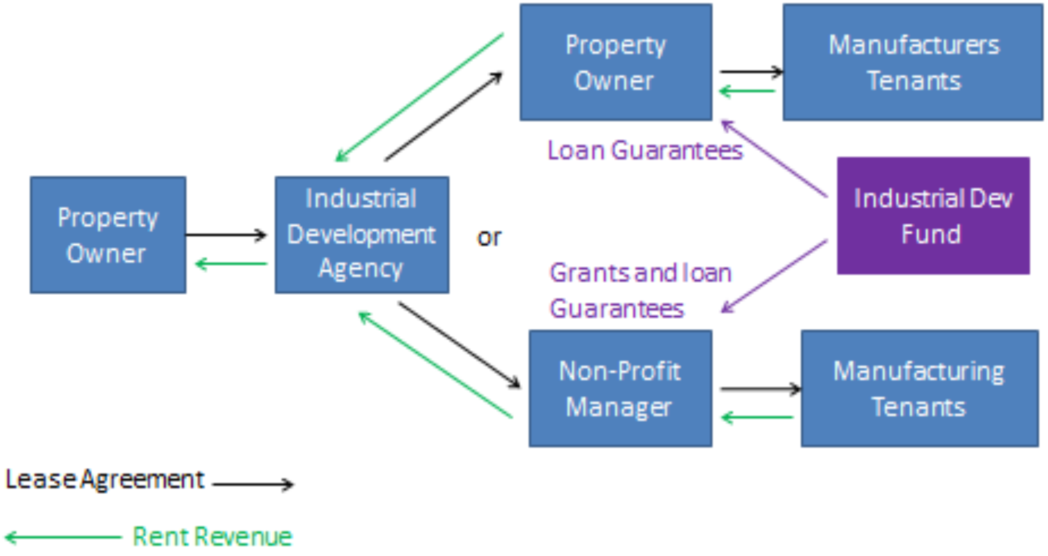
Industrial Development Fund

- Launched in 2016 and administered by NYCEDC
- Grants are available to non-profits and capped at $5 million (this cap would need to be increased for the Garment Center)
- One grant has been made to date to the Greenpoint Manufacturing & Design Center
- Originally, non-profits applied through an RFP that would need to be either re-opened or re-issued
- Approval delays undermines non-profits ability to purchase space in hot market where properties move quickly

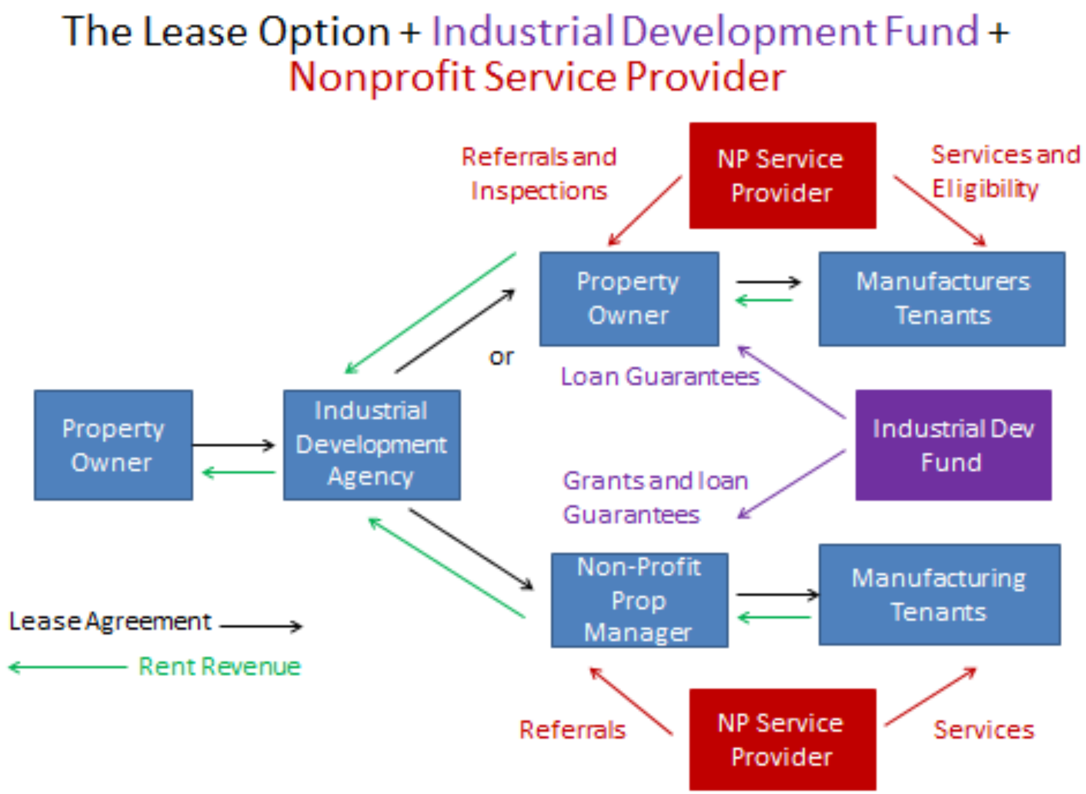
New Garment Center Industrial Development Fund could pre-approve a specific allocation to a specific non-profit (e.g.. GMDC) and include a loan guarantee to support the transaction

The IDA alone would likely not be able to close funding gap sufficient to provide long-term, affordable rents; Financial package should be coupled with restructured Industrial Development Fund

The Lease Option + Industrial Development Fund



The various financing options work well with a non-profit service provider that can help ensure space is used for production, holds owner accountable to program terms and assists in curating space



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1. Real Estate 2. Management 3. Financing **4. Timing**

Implement zoning restriction phase out only if and when an adequate amount of production space is secured for the long-term

The City's intention to certify zoning change proposal prior to implementing financial and management structure for the Garment Center undermines the success of any program from the start

- Property owners determining to opt in to program will be weighing against ability to rent to higher paying uses under new zoning paradigm leading to a widening of price gap
- If zoning change is widely understood to take place in the near future (e.g. two years), property owners may decide it is worth waiting for change and continuing to rent to apparel firms on a short term basis only

Conversely, establishing a program with deep incentives upfront and a phase out only once key milestones have been reached (e.g. 500,000 sq. ft. or 5 years) will encourage property owners to opt in early

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The GCSC ultimately recommended many of the proposals Pratt Center supported; certification was ultimately delayed

The GCSC issued a report and recommendations in August 2017

Recommendations included Pratt Center's proposals, namely:

- Creation of a Garment Center IDA
- A phase out of the zoning restrictions rather than a single date change; report noted lack of consensus on specific milestones but included options between 500,000 and 1 million sq. ft. and/or several years after initiation of program
- Support for a non-profit partner to facilitate implementation and/or ongoing operations

The GCSC report also included high-level recommendations tied to workforce development and place making

The City initially planned to certify zoning change in late August 2017; as of October the proposal has not been introduced for certification

Technology Changes + the Potential Impact on the Garment Workforce

Technology and Workforce Development

There are several technology changes that are expected to change design and production methods in the near future

NYC is not known for its innovation in fashion technology and as such must move to quickly adopt new technologies to remain as a global hub

The major trends fall into 3 categories:

1. Digitization/Customization
2. Automation
3. Smart fabric introduction

Digitization/Customization

Digital patternmaking enables a faster, more accurate patternmaking process; widely viewed as a necessary innovation yet many NYC designers and factories have been slow to introduce this technology.

Most digital patternmaking is done through CAD-based software to create a 2D file; new 3D programs simulate fit, stretch, sheen and pattern layout

- Uses a digital avatar to provide a 360 degree view of garment on human body; 3D scanners are also used to input data points into CAD file
- Results in a more accurate pattern and reduces sample making timeline

Overall industry trend to offer more customized garments, which requires (or is at least facilitated by) digital patternmaking

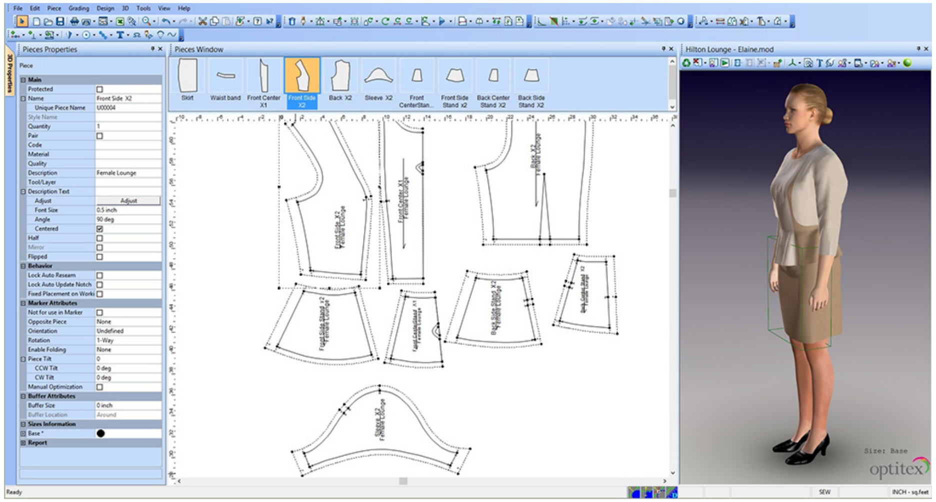
- Demand to introduce new styles more frequently then traditional 4/year requires faster turnaround
- Starting to see demand for individual garments where end user inputs measurements and orders customized clothing
- Customized sizing and design changes can be easily done in a digital file

Digitization/Customization, continued

While digital (especially 3D) patternmaking is not prevalent in NYC yet, designers and factories are expected to increase use in near future

Workforce Implications

- Need for Computer-Aided Design (CAD) experts
- Traditional patternmaking skills still required but individual will either also need CAD skills or will have to work with a CAD expert to translate pattern
- Reduces, but does not eliminate need for fit models
- Digital patternmaking facilitates greater use of automated spreading, cutting and sewing machines



Automation

Automation (or semi-automation) has existed in garment industry for a long time, but the use is expected to increase, especially with introduction of digital patternmaking

Automated Spreading Machines

- Traditionally, spreading fabric was an all manual job followed by manual (or later semi automatic) cutting; very labor intensive
- Automated machines roll out fabric and ensure tension and alignment
- Easily used with automatic cutting machines

Automated Cutting Machines

- Have been used in NYC factories without complementary digital patternmaking but not to full potential
- Results in less fabric waste, greater Quality Control and faster turn around times

Automation, continued

Automated Sewing Machines

- Rise of “sewbots” causing concern but seen as inevitable by many; opinions vary about the time it will take till technology is more prevalent (ranging from few years to decades)
- Current limitations with complicated seam patterns, matching exact sew points for patterned fabrics, etc.
- Likely hybrid approach in near future with garments constructed partially through automation and partially through more traditional sewing machines before full automation takes place

Workforce Implications

- Automated spreading and cutting will reduce workforce need for spreaders and cutters; enables more time for sewing
- Automated sewing will reduce need for sewing machine operators but technology is still in transition especially for high-end and complicated garments (e.g. jackets)
- Need training programs to merge knowledge of sewing with more advanced machine operation in near term

Smart Fabrics

"Smart" fabrics that incorporate some type of function (e.g. antibacterial, wicking, heat retention, lighting, etc.) into the fabric are on the rise; greatest introduction has been in athletic/performance wear but in other segments as well

Many smart fabrics will lose their properties through standard sewing and must be glued through thermal bonding

Thermal Bonding

- Fabric runs through 2 cylinders for bonding process
- Welds fabrics together with a glue (usually polyurethane based)

Workforce Implications

- Retraining of standard sewing operators is necessary, but not computer-based
- Must know standard sewing process plus understand glue line and retention temperature settings

Additional Technologies

New technologies are entering the garment industry but their adoption or application in NYC is still limited

Wearables

- Most commonly applied in accessories; similar to smart fabrics, wearables integrate some type of accessory function into garment
- Google and Levi's recently teamed up to demo a smart jacket that integrates touch-sensitive fabric that connects to a smart phone
- Largely in product development phase but demand for wearables is expected to rise

Whole Garment Knitting

- Advanced knitting machine that produces a single knitted garment often without any seams; can also be programmed for automatic finishing and trimming
- Reduces need for sewers/knitters
- NYC has a very small knitting segment so local workforce impact is minimal

Industrial Sewing and Innovation Center (Detroit's ISAIC)

Vision for a multi-functional space in Detroit to foster education and growth in sewn trades spearheaded by industry stakeholders including Shinoa

1. **Training**
   - 190 hour pre-apprenticeship program (classroom + 3 week internship)
   - 2000 hour apprenticeship program; apprentices will work on-site and off-site at local factories
   - Curriculum will focus on traditional and future (e.g. programmable sewing machines) skills
   - First DOL certified apprentice program in industrial sewing
2. **Worker-owned factory**
   - Envisioned to be able to employ graduates of apprenticeship program
3. **Innovation Center**
   - Provides member access to state-of-the-art technology
4. **Masters in Residence**
   - Fosters knowledge share and ability to teach new techniques to local firms

Conclusion + Next Steps

Conclusion

The future of the garment industry in NYC is at a crossroads. City actions that undermine the Garment Center will have a ripple effect across the region. While the City develops more space in Brooklyn for garment production, it must also stabilize the Garment Center as the industry hub.

New technologies that enable the industry to produce more quickly and be more responsive to customer demands will have an impact on the workforce. New training programs are required to not only augment current workers' skillsets but entice and prepare the next generation.

Stable real estate and management of production space coupled with preparing the workforce for increasing innovation in design and production methods will support the growth of the garment industry in NYC.

Next Steps

Convening of potential partners: CWE, FIT, Workers Unite, GCSA, CFDA <u>to explore mechanisms for service delivery</u>:

- **New organization vs. coordination of services by partners; who does what? Who is accountable to whom?**
- **Funding mechanisms?**
- **Linked to vs independent of real estate entity?**
- **Public involvement?**

Support for real estate solutions:

- **Direct operational/funding support vs strategic/political support vs no engagement?**

Program development for training initiatives

- **Inventory and assess existing training programs**
- **Explore engagement with ISAIC**

Appendix

Appendix

The following draft documents were prepared by Pratt Center for Community Development during the Steering Committee process to help inform the discussion:

- Hypothetical Real Estate Options
- Outline for a Request for Expressions of Interest (RFEI)
- Loose Threads Memo

Hypothetical Real Estate Options
Prepared by Adam Friedman
July 13, 2017

The Task Force's process and everyone's willingness to engage in open and honest dialogue has pushed the discussion about how to resolve issues and create a new model for strengthening the fashion eco-system in the Garment Center further than any previous effort. We wanted to offer some thoughts at this critical juncture about the role of the IDA, the need for an intermediary, and how to manage risk associated with a model that lifts zoning protections in favor of ownership or long-term leasing.

There are three big unknowns moving forward: What will be the need for space in the future for production, and maybe even for the fashion industry? Some members of the Task Force believe the industry can grow and others think it will shrink. This uncertainty is the reason that the resolution will be risky - we may protect too little or too much space. If we seek to preserve too much space, there will be vacant protected space which undermines public policy objectives to accommodate growing sectors and insufficient rent revenue to cover costs, and the entire model might collapse. If too little, we will have lost the opportunity to create jobs and reaffirm the City's preeminence as the fashion capital of the world. Therefore, we must create a model that can accommodate or adapt to change.

Second, can commitments be enforced? While we need to build in flexibility to accommodate change and manage risk, the model must be able to withstand market pressures and be enforced. Enforcement is hard for a variety of reasons: The sheer scale of the model involving several hundred tenants each with their own lease and each an opportunity to divert from the prescribed use of space; The opportunity cost of compliance and incentive to opt out will grow over time as the City's and owners' plans take hold and the neighborhood evolves, becomes more office oriented and the gap between production rents and other rents grows. Enforcement is a political decision – the administration has to want to enforce the commitments. It is not enough that the commitment be enforceable, but actually enforced. While this administration might be committed to enforcement, what about the next mayor, and the next mayor and the one after that?

Third, will current owners want to participate in whatever model is proposed? There is a growing gap between the rent levels for office and production space so owners will be understandably hesitant to commit, and knowing that the city is going to lift the zoning is itself a disadvantage to encouraging participating. Not only must they want to participate, they must agree within a relatively short time – before the change is implemented to prevent displacement. Therefore we must create a mechanism that is a sufficient incentive to induce participation, particularly in a short period of time.

Hypothetical Models:

The following three models are about how space gets managed and preserved to advance the industry's needs. They are not specific to a particular level of subsidy. We have used the basic IDA financing model, which could be enhanced through other subsidies if needed. They are for comparison purposes so we can explore strengths and weaknesses in each model and try to correct them. In addition, these models do not require that an entire building be dedicated for production but could accommodate a framework that only includes parts of a building.

Model #1: IDA transaction plus non-profit assistance

In this model, the IDA does what it does now: negotiates deals with an owner by which it takes nominal title to the property and leases it back to the owner with conditions that it sublease the space in a certain way, such as for manufacturing and at “below market” rates in exchange for relief from property taxes. The owners continue to select and negotiate lease terms with the tenants. This process would be enhanced by a third party such as a local development corporation operating a space bank, providing space referrals and other economic development services.

While this model is fairly straight forward, the weaknesses are in its adaptability and enforceability:

1. While this administration might be committed to IDA enforcing these agreements, the next mayor may not, or the next or the next;
2. IDA’s power is essentially punitive. It can punish an owner who clearly goes over a line, such as renting to a law firm in this case, but it cannot compel and owner to capitalize on an emerging opportunity or make judgement calls that might benefit the industry. For example, a priority for the industry might be preserving highly specialized companies such as ones that do pleating or particularly difficult fabrics or beading or embroidery. But if an owner wants to rent to an apparel tenant who can pay more rent, the industry can lose an important asset or operation;
3. IDA’s punitive power is too blunt an instrument as the industry evolves. IDA does not typically set guidelines or standards for the owners based on updated market needs throughout its project lease terms, which by definition limit the discretion of the owners. For example, a hypothetical standard might be that 80% of the space be used for actual production. But as production evolves or as the business model evolves, such as greater integration of design and production, the standard might become inappropriate for some firms, but not all firms. If an owner has discretion, they’ll tend to rent to whichever user can pay the higher rent, which might mean 70% production, and then 50% and then 10%, regardless of what balance the industry as a whole needs. IDA does not typically oversee a close judgement call and second guess an owner; and
4. Finally, IDA could be overwhelmed by the sheer scale of this effort: Each lease requires a judgement call about whether the space is used for manufacturing and sufficiently below market, and this initiative could involve hundreds of leases, big and small. Determining what is below market will become increasingly problematic as the neighborhood evolves and there are fewer factories other than those in the program that the lease can be compared to. Essentially, there will be almost no such thing as a “market” for production space in midtown outside of the IDA leases as non-IDA buildings are converted.

The power and discretion to select the tenants is critical to both advancing mission and managing risk, two key issues. Tenant selection is how mission is advanced, whether that is a private owner trying to obtain the most rent, or a non-profit trying to preserve the eco-system. In the above model, that power is still essentially in the hands of the private owners.

The riskiness of this entire venture – the preservation of space for apparel production – can be reduced by giving discretion to the building operator/manager to rent to greater variety of tenants, essentially expanding their market. For example, if there is insufficient demand for apparel production space, they might rent some space to companies that are more a mix of design, sales and production. Or they might rent to other types of manufacturers or to small designers. Or they might rent to other tenants for which there is synergy with apparel production such as a school. Expanding the IDA standards to include these options for a private owner trying to maximize rent revenue will lead to less low rent production space but if given to a non-profit entity these options might be a used as a last resort to reduce risk.

<u>Model #2: IDA conveys benefits plus Apparel Coop</u>

In this model, IDA does what it does today and rents back to a coop or condo association controlled by tenant-manufacturers and whose mission is to preserve affordable space for apparel production. This model is somewhat similar to today's affordable housing coops in the Mitchel-Lama program in which middle and moderate income tenants buy shares in a coop which rents the apartments back to the tenant-shareholders. When the tenants move, they have to sell their shares back to the coop association, often at a price fixed by an index established at the beginning of the lease, and the association resells the shares to another qualified tenant at a below market price.

This model has some advantages and disadvantages but is clearly an improvement over the first model:

1. Participation is limited to manufacturing tenants who can afford to buy in. While this might work for the healthier firms, it might be a disadvantage for start-ups and smaller firms;
2. The sale of the shares provides some revenue that can be used as an upfront payment to the owner to induce participation;
3. The lease becomes a valuable real estate asset which manufacturers might be tempted to misuse by renting to prohibited users or permitted uses but at higher rents. The business of the tenant manufacturers may decline but they may try to capitalize on their lease by subletting. This issue has been partially addressed in the housing situation by very strict control over who enters buildings, (which in this instance be owners, employees and guests) by annual inspections and by annual submission of tax returns
4. In addition to tenant representatives on the coop board, several representatives of the community and elected officials might also be appointed to the board to protect the public investment and interests, foster supportive community relations and bring other expertise to the management of the entity. (Housing coops don't have outside members but both the Navy Yard and Greenpoint Manufacturing and Design Center have outside board representatives; and
5. When a space turns over, the tenant coop association selects the replacement tenant to further mission. This would allow some discretion to curate the tenancies and flexibility to adapt to changing conditions, but could also be problematic if the seller and the coop board disagree on market pricing, and/or economic goals for the sale.

Model #3 IDA conveys benefits and aggregates property for lease to a non-profit manager such as GMDC.

In this model, IDA leases to a non-profit organization that rents space to manufacturers for apparel production which is essentially how the Navy Yard and Greenpoint Manufacturing And Design Center operate today. They have leasing, maintenance and management staff and deep financial expertise either in-house or in their consultant network.

1. GMDC's and BNY's boards review leasing to ensure it meets mission. BNY's board must approve each lease and that discussion includes both terms but how the company advances mission including employment practices, growth expectations and other financial considerations. Even when BNY rents to a non-industrial, i.e. off-mission tenant, the end result must advance mission overall. For example, when BNY rented land for the construction of Wegman's supermarket, BNY negotiated that the developer also buildout an additional 120,000 sf for production space and rent it back to BNY;
2. GMDC and BNY receive capital funding from the city which can be used to improve the property and decrease borrowing costs. It could be agreed in advance that this requires the owner's approval, or even that the owner oversee or act as the construction manager;
3. This model can adapt to change in the industry including declines to such an extent that there is insufficient demand for protected space which might become vacant. This adaptability is because they can be given more discretion about tenants without risk that they will undermine the industry. If such dramatic decline occurred, as a last resort, some risk management options that might include:
   I. Renting to companies with a mix of design, sales and production
   II. Renting to other types of manufacturers;
   III. Renting to entities with synergy with the fashion industry such as fashion schools, suppliers, etc; and
   IV. Terminating the lease by mutual consent if alternative demand is strong such as for office space unrelated to apparel and the owners want it back.

Outline for a Request for Expressions of Interest (RFEI)
Prepared by Adam Friedman
July 24, 2017

Summary:

This Request for Expressions of Interest (RFEI) seeks to identify property owners in Manhattan's Garment Center who would be interested in participating in a program that provides financial incentives to lease or sell their property for use by apparel manufacturers.

Background:

The City of New York is seeking to preserve space for apparel production in Manhattan's Garment Center. New York's fashion industry is a critical economic driver for the city's economy, generating close to 200,000 jobs. The fashion industry is comprised of a complex eco-system which includes designers, manufacturers, textile and other suppliers, showrooms and highly specialized services. While there has been some decentralization of the industry, it is anchored by an extraordinary concentration of these services in relative geographic proximity to each other in and around the Garment Center.

For approximately 3 decades, this concentration has been encouraged by zoning that required some preservation of space for production. Some production capacity is essential to the eco-system but production tenants can afford to pay lower rents then the other components of the eco-system and as such, it requires some protection. The city is now contemplating a change in zoning to eliminate these protections. The production component of the industry no longer requires as much space as was historically the case, and other economic sectors have grown and can use the space currently restricted for production.

The city has developed an alternative program to replace the zoning and to encourage the preservation of space for apparel production through a combination of tax and other financial incentives and management provisions designed to ensure maximum benefit for the fashion industry, reduction of risk for property owners, and ease of enforcement.

The city is seeking to identify property owners interested in participating in this program through this RFEI. When a sufficient amount of space has been enrolled in this program such that it will remain available for apparel production, the City will begin the rezoning process and eliminate the requirements to preserve space for production.

The program is still in development. The city may be able to work with prospective participants to fine-tune the program elements to accommodate their situation. Prospective participants are encouraged to respond with their proposals about how they could meet the objectives described above using the program, which is described below. Prospective participants should also indicate what, if any, additional incentives would be necessary to meet the objectives.

Program Elements

There are two ways a building owner can participate in this program; one is a sale and the other is a long-term lease to an entity that would continue to operate the building for apparel production.

1) Lease Options:

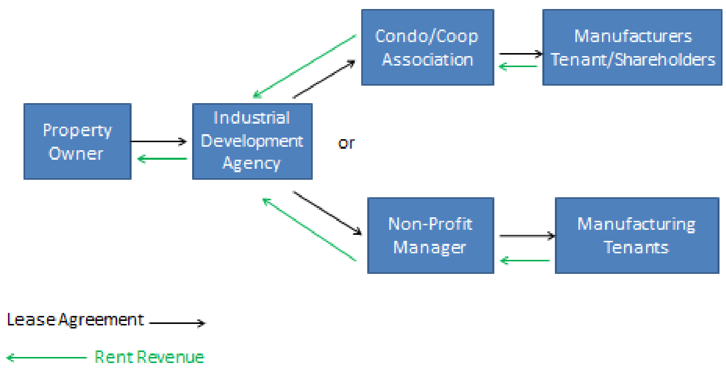
In this option, an owner would enter into a lease-lease back structure for the property with the city's Industrial Development Agency (IDA) which would sublease the property to a third party operator. The third party operator would sublease individual spaces for apparel production. In this lease option, the owner receives a guaranteed real property tax benefit for a period of years (to be negotiated with IDA) and a rent revenue stream for the duration of the lease which may not be less than 49 years. At the end of the lease-lease back, the property is no longer encumbered by the production commitment.

The third party operator could be either a non-profit organization dedicated to strengthening the apparel industry or another mission driven entity including a condominium or coop association whose members would be apparel tenant-manufacturers and other specialized production service providers. As part of this condo/coop option, another entity including the original owner of the property, could be hired to manage the building on behalf of the association controlled by the tenant-shareholders as is typically the case in residential coops.

In both lease situations, the rental revenue received by the operator would depend on what producers are willing and able to pay.

The use of IDA as a benefit provider in between the owner and the nonprofit manager or coop/condo association is that IDA can lower the operating costs by eliminating real estate taxes on the property for the duration of the program. It can also eliminate sales taxes on building materials and the mortgage recording fees. Finally, the city is willing to consider other forms of incentives, such as grant funding, in association with the IDA structure, but the city <u>is seeking to secure the greatest amount of production square footage at the lowest cost to the city in the form of tax benefits and capital appropriations</u>.

The Lease Option



Sales Option

An owner may sell his/her property to a qualified buyer which would include a nonprofit manager or condo/coop association. Because the property will be used for affordable apparel manufacturing space, it is anticipated that rent revenue would not be sufficient to cover acquisition and operating costs. In this instance, the city might seek to close the gap in a variety of ways including use of the IDA to lower operating and borrowing costs, the Industrial Development Fund, or a capital appropriation.

In addition, significant tax benefits for the seller might be available if the transaction qualifies as a "bargain sale" and the transaction in effect creates a tax deduction for the seller.

Other Program Elements:

1. Geographic Boundaries:

The city will consider proposals for properties in an area bounded by 27th Street on the south side, 6th Avenue on the east side, 40th Street on the north side and 10th Avenue on the West side.

2. Lease Terms:

The length of the proposed lease to IDA shall not be less than 49 years, though the owner may propose a longer lease term. The minimum amount of space in a building that may be considered for participation is 20,000 square feet.

Responses

Building owners are encouraged to respond to this RFEI with the following:

1. Location of building

2. Square footage proposed for the program, location of that square footage in the building (i.e. ground floor, floors 6-7, entire building, etc.), description of the square footage's suitability for apparel production, and description of existing uses in the square footage
3. Preferred participation option outlined above. Respondents may propose alternatives to what is described in this RFEI.
4. Price and lease terms for participation, including timing of start of participation
5. Anticipated rent terms to individual apparel production tenants, if anticipated building owner will rent directly to individual tenants.

Evaluation Criteria

Responses will be evaluated on a building's eligibility and ability to achieve the city's overarching goals, namely:

- Amount of space proposed
- Favorable benefit terms (both real property tax discounts and payment-in-lieu of tax (PILOT) structures, as well as potentially grant amounts), including cost and duration of participation
- Location of building and square footage in the building and suitability for apparel production

TO: The Steering Committee

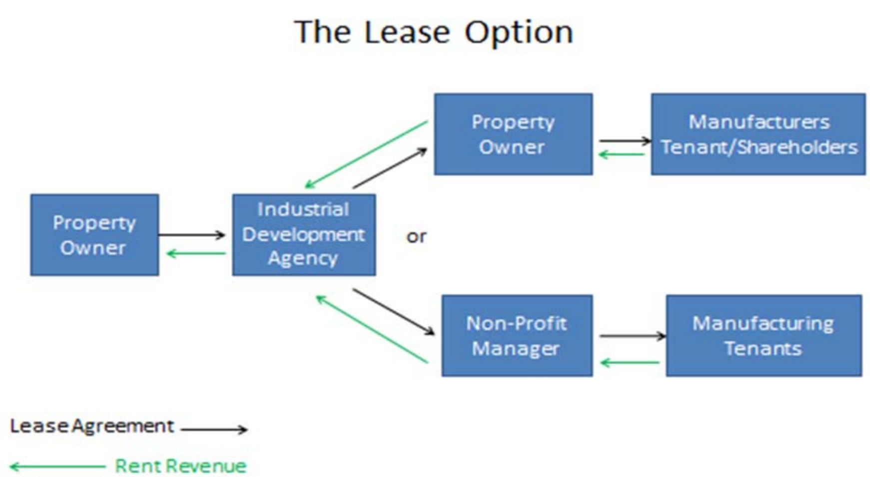
FR: Adam Friedman

RE: Loose Threads

DATE: August 9th 2017

There are a couple of important loose threads that need to be clarified, resolved and snipped, and to be reflected in new discussions, program development and the final recommendations. The following recommendations are in addition to those already under discussion:

As presently conceived, IDA benefits form the foundation of the strategy to secure long term leases for existing manufacturing tenants. Using the IDA can lead to situations where the owner continues to manage his property and leases directly to the manufacturing tenants, or where a nonprofit manages the building and leases to the manufacturing tenants:



However, there is some doubt that IDA benefits can close the gap and sufficiently motivate owners to participate in the program to preserve space for apparel production. It is this doubt about the adequacy of the benefits and the willingness of owners to sell or lease their space that has precipitated the discussion about the need for a "reevaluation" at some future date if the goals of this committee and the trigger for the lifting of the zoning restrictions are not achieved. Rather than discuss reevaluation, we should focus on the adequacy of the benefits to achieve the goals of the program. The deepest possible benefits should be provided immediately to encourage owners to enroll as soon as possible.

1. <u>Financing</u>

A. <u>The City's Existing Industrial Development Fund Would Have To Be Restructured And Re-Opened</u>

The IDF was cited as one source of funding to close the gap and help non-profits acquire space. The IDF provides partial gap-financing assistance in the form of grants to nonprofits, low-interest subordinate loans, and guarantees on senior private loans, all important services that could help advance this process. The IDF was launched in March 2016 and has made only one grant which was to GMDC. IDF grants are not available to for-profits. However, it may be that they can guarantee loans which is also of value.

There are several problems with using the IDF for the Garment Center initiative: First, it was designed for much smaller projects and grants are capped at $5m, though the City has indicated there is some flexibility. This would nevertheless be totally inadequate to close the gap on a single project; Second, originally, non-profits applied in response to an RFP, but EDC has not issued an RFP in many months and it is unclear if that they could now accept applications under an old RFP with older guidelines; Third, there is a long delay between submission of an application and a decision by EDC to award funding. This delay undermines the IDF's utility in a hot market because the building could be sold; And fourth, the uncertainty of the process inhibits not-for-profits from looking to buy space. Because not-for-profits must submit an application after other funding has been lined up and extensive negotiations and due diligence have been completed, and despite the absence of a commitment from the owner not to sell to someone else in the face of numerous other purchase offerings, it would be extremely risky and discouraging for not-for-profits to undertake this preliminary work without a commitment that there is funding available at the end of the process and within a reasonable time.

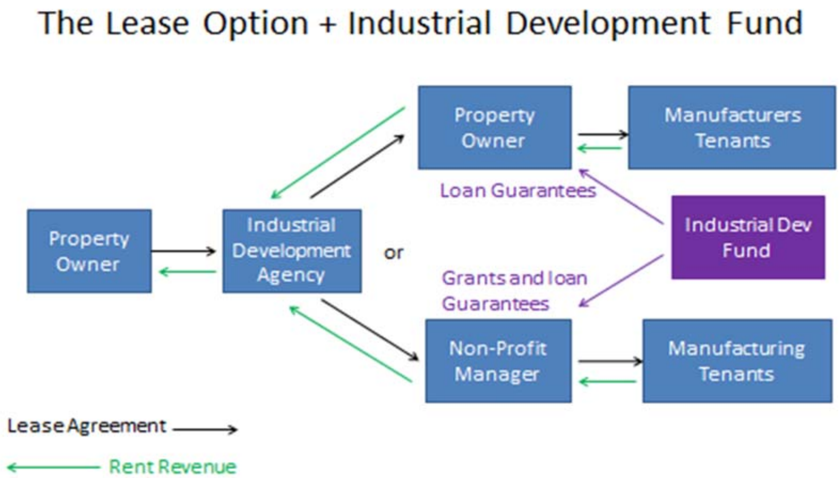
It was asserted at the last meeting that it was up to GMDC or another non-profit to put together a project and apply to the IDF. While a Garment Center project is on mission for GMDC, that doesn't mean it would good decision by GMDC to undertake this speculative work without risk reduction. GMDC has lots on its plate and has other projects that advance mission. In some way, we and EDC need GMDC more than GMDC needs this project.

If EDC wants GMDC or another not-for-profit to help it advance a specific city objective such as preserving space in the GC, it should get out front and help reduce the above risks.

Recommendations:

Create a Garment Center Industrial Development Fund, perhaps a subsidiary of the IDF, that pre-approves a specific allocation to a specific not-for-profit (i.e. GMDC) to assure them that the funding is available if it meets IDFs criteria for an award: the property has to be within the geographic bounds of the Garment Center and it will be used for apparel manufacturing. It can be used to purchase a building, make capital improvements to the building, purchase an option on a building, be an evaporating loan that amortizes over the length of the lease, etc.

The GCIDF should include a loan guarantee component.



B. <u>Existing Funding Commitments</u>

What else might be available? Now that the Steering Committee has gone through additional outreach and analysis, is the money previously committed to supporting the fashion sector consistent with the priorities set by the Steering Committee? How can funding be reallocated to reflect the new priorities and retention program established by the Steering Committee?

i. The City has committed $136 million for Bush Terminal. How is that being spent? How much of that is to renovate space for the fashion industry and for what specific urposes? How much of that is for infrastructure that could have been funded by DEP, DOT or other agencies?
ii. The Alliance is contributing $25 million over ten years toward relocation expenses including disruption costs. What projections have been done of anticipated relocation and disruption expenses? Has this been approved by the Alliance Board and necessary government entities? It has been repeatedly asserted that the Law Department has approved this use of funds. If so, can that <u>letter be circulated to the Steering Committee</u>?

C. <u>IDA, Enforcement, Subleasing, Future Companies And The Continued Rejuvenation Of The Fashion Industry:</u>

In the IDA model, current manufacturing tenants are protected through below market renewable leases. How does this allow for turnover and the birth and growth of new businesses which are essential to the wellbeing of the eco-system?

The reason this is a problem is the IDA strategy protects specific businesses currently in place. The business of a tenant with a below market renewable lease can shrink or fail, but the lease is an asset which he can use to generate rent and exploit the differential between affordability and market, undermining the original policy. This has been a very common problem in some affordable housing programs such as Mitchel-Lama in which tenants try to sublet their space and the managing agents implement draconian measures to control the building such as rigid oversight over who can enter a building, who can have a key, who can move furniture (i.e. equipment) in and out, etc. which has resulted in what some tenants have described as a “hostile” living environment. Given that the IDA’s relationship is with the owner and not the tenant manufacturer, IDA may not be able to enforce infringing subleases.

Recommendations:

> The need for space for emerging companies is one of the most important rationales for a non-profit developer/manager of space. This can be done either through ownership or long term rental by a non-profit.
>
> For other properties, entrance cards for people regularly entering the building verifying that they work for a prime tenant may be necessary. There will also need to be regular inspections/audits of who is working and occupying space.

D. The Role Of A Not-for-Profit Intermediary

There still seems to be some confusion about the role of a nonprofit. There are at least three roles a non-profit can play to facilitate implementation of this plan and strengthen the industry:

1. Service provider – This is the most typical role now played by dozens of organizations across the city generally with funding from Small Business Services to help companies access city and other programs to improve and finance technology, recruit and train workers, develop marketing initiatives, etc.;
2. Gatekeeper – If the city adopts and IDA/long-term strategy, there is going to be a need to ensure that the space is actually used for production as required, to maintain a list of manufacturers eligible for the space and make referrals when space becomes available; and
3. Owner/manager of space – GMDC and the Brooklyn Navy Yard own or manage more than 5 million sf of space scattered across Brooklyn and Queens. They recruit and screen tenants, they collect the rents, they borrow money from banks and receive grants from public agencies, they build and repair buildings and do all the functions landlords do. But they offer stable, affordable rents by basing their rent revenue on what they need to cover their operating costs (including debt service) as opposed to whatever the market will bear including competition with office space, and they make tenant selection decisions based on not only financial but policy considerations such as living wages and job density.

These three roles do not need to be played by one entity but could be fulfilled by two or three. GMDC has been clear that it is not a service provider. It manages properties and brings in another nonprofit to provide services. A building owned by a nonprofit does not need a Gatekeeper since it selects tenants based on mission, but the other buildings would need both a Service provider and a Gatekeeper.

Recommendation:

EDC and the Alliance should organize meetings with the most receptive property owners to meet Brian Coleman from GMDC to explore interest in selling or long-term leasing.

The program should include third party validation or certification of tenants as eligible for manufacturing space.

The Lease Option + Industrial Development Fund + Nonprofit Service Provider