

THE URBAN PROSPECT

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City Unveils New In Rem Program

This past spring the Giuliani Administration acknowledged publicly what many housing observers had already concluded — that the city had stopped “vesting” properties that are delinquent on their taxes. That acknowledgment committed the Administration to revamping the city’s approach to property tax enforcement and, in effect, toward housing that is in danger of abandonment. Following months of internal debate, on October 31 the Administration unveiled its strategy for redirecting the city’s tax enforcement and housing abandonment policies.

Through the reinstatement of tax lien sales the Administration proposes to rely on private-sector mechanisms to enforce tax collections. In what represents a significant achievement for housing and community development advocates within the Administration, however, most housing will be diverted from the sales process into a more comprehensive program for addressing its financial problems. Many observers feared that all low-income housing would be subject to tax lien sales, in effect reinstating the “revolving door” building auctions that were ceased in 1977.

Nevertheless, major elements of the new approach remain to be fleshed out and, as always, the program’s success will depend on the willingness of the Administration and City Council to fund it adequately. Furthermore, there remains the traditional institutional tension between the city’s finance and housing agencies which has frustrated the development of a rational policy toward economically distressed housing for the past 30 years.

Tax Lien Sales Not So Novel

Although the Administration’s proposal to enforce tax collections through tax lien sales has received the most press attention, it is actually the least novel aspect of the plan. Many cities already use the method, including Bridgeport, Denver and Chicago, as do a number of suburban New York counties. In fact, New York City utilized the lien sale approach for much of this century, finally phasing it out during the 1960s.

Tax lien sales are usually conducted in one of two ways. When a property is in tax arrears, a lien for the amount due is placed on the property and sold at auction to the highest bidder. In one method, the winning bidder pays the city a percentage of the face value of the lien, and is then entitled to collect up to the full amount owed, with a fixed interest rate,

from the property owner. If the owner does not pay or otherwise reach a settlement within a specified time period, the lienholder is entitled to initiate foreclosure proceedings as with a mortgage foreclosure. Some jurisdictions use a variation on this process, holding the face value fixed while taking bids on the interest rate. The Giuliani Administration has not specified the precise method of sales it contemplates, but appears to favor bundling the liens and selling them *en masse* through an RFP or similar process. Legislation it has submitted to the Council would limit participation to “responsible” bidders to be determined according to criteria established by the Department of Finance. It evidently intends to sell liens primarily on commercial and high-end residential properties.

With a related bill, the Administration also seeks to create more flexibility in its in rem foreclosure actions. A proposed amendment to the city’s Administrative Code would explicitly permit the Department of Finance to use tax class as well as geographic sections, or to use a particular tax class within a borough or section, as a basis for in rem foreclosure actions.

The program has obvious budgetary implications as the city’s tax delinquency rate is approaching five percent, the highest since the mid-1970s. Real property tax delinquencies now total over \$400 million; the Administration is anticipating \$78 million in tax lien proceeds during the coming year. The Administration also hopes that, with a new enforcement mechanism in place, tax delinquencies will decline and fewer properties will reach the foreclosure or lien sale stage. To encourage redemptions, the Administration’s legislative package would revamp the city’s laws governing installment payments on tax arrears, instituting a complex system of incentives to promote more rapid payment.

Good Owners, Bad Owners

Tax lien sales are not problematic when the properties involved have an underlying value sufficient to motivate owners to pay off the liens, or to provide a liquidation value to the lienholder if foreclosure becomes necessary. Economically distressed housing, however, may have little investment value and so the Administration proposes to divert it from the tax lien sales program.

Which residential properties are diverted from the tax lien sales program will be determined jointly by the Department of Finance and HPD. An investment bank has analyzed a sample of properties in the foreclosure pipeline on behalf of

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PLANNING WATCH

Lower Manhattan Plan Moves Forward

With the approval of tax incentives in the state legislature and zoning reforms in the City Council, the first elements of a Giuliani Administration plan for revitalizing downtown Manhattan have been put in place.

Released in 1994, the Administration's *Plan for the Revitalization of Lower Manhattan* calls for a combination of transportation improvements, zoning amendments and other incentives to encourage investment and create a 24-hour community south of City Hall. For decades that area has suffered from an aging commercial building stock ill-equipped to compete in a modern real estate market, as well as high vacancy rates and an almost complete lack of activity after business hours. The area's secondary office space market, facing a vacancy rate topping 20 percent, has been particularly hard hit.

Retaining Old Uses...

Forming the centerpiece of the plan is a package of tax breaks and other benefits approved by Governor Pataki in late October. These incentives will be available to buildings located in a "revitalization area" that includes most of Manhattan below Murray Street, excluding Battery Park City. They will offer savings to eligible commercial tenants through real property tax abatements, reductions in the city's commercial rent tax and rebates on charges for electricity. Other measures encourage the conversion of obsolete commercial buildings to residential or mixed uses through real property tax abatements and exemptions.

Real property and commercial rent tax benefits will be available for newly leased space and renewals in non-residential and mixed-use buildings built before 1975. For leases executed between April 1995 and March 1998, the legislation provides for a 50 percent abatement of property tax liability for the leased commercial space (not exceeding \$2.50 per square foot). To be eligible, the owner must make a minimum investment in the space of between \$10 and \$35 per square foot and new tenants must come from either Manhattan south of 96th Street or outside of New York City. Lease terms must be at least 10 years for large tenants (over 50 employees) or five years for small tenants. Tenants eligible for the new property tax abatement may also receive a commercial rent tax exemption equal to 100 percent of the initial year's liability, effectively reducing their first-year commercial rent tax bill to zero. In both programs, full benefits are granted for the first three years and phased out over years four and five. All benefits must be passed on to the tenant through reduced rents.

The legislation offers energy incentives in the form of a rebate to the building owner's energy bill which is then allocated among commercial tenants. To be eligible, an owner must either construct a new building or make improvements worth at least 20 percent of the assessed value

of the property. The owner must also have applied for benefits under the Industrial and Commercial Incentive Program, received financing from the New York City Industrial Development Agency or state Urban Development Corporation, or received tax exemption for construction work on mixed-use property under Article 4 of the Real Property Tax Law. Participants in the program receive a 12-year rebate equal to 30 percent of eligible charges for the first eight years and phased out over the following four. Landmarked buildings may receive an extra year of benefits.

The city estimates these benefits would lower average operating costs for downtown commercial tenants by \$5.00 per square foot, decreasing the cost advantage of relocating from downtown to New Jersey from 23 percent to five percent. Some of those gains could be offset, however, by legislation making its way through Trenton that would provide new benefits to companies that create jobs in New Jersey. Historically, companies leaving lower Manhattan have accounted for 75 percent of new tenants in Jersey City.

... And Attracting New Ones

According to the Department of City Planning, more than 1,860 of the 8,800 housing units in lower Manhattan were created through the conversion of non-residential buildings. They estimate that another 3,000 units could be created in existing older buildings. Many of the existing converted units were made possible by the benefits of the J-51 tax exemption and abatement program, which attracted larger developers to the residential conversion market beginning in 1976. In 1983, however, revisions to the J-51 program effectively halted its application to lower Manhattan. Since then, no major conversions have taken place.

To generate new interest in downtown conversions, the legislation adds a new section 421-g to the state Real Property Tax Law. This measure offers owners who convert their properties between July 1995 and June 2002 a 12-year property tax exemption and 14-year tax abatement. The exemption removes any increase in assessed value resulting from the conversion from consideration when determining property tax liability. For mixed-use buildings, the legislation offers a 12-year tax exemption for buildings in which at least 25 percent of the property is dedicated for commercial, community facility or accessory uses. To be eligible for mixed-use benefits, the building owner must invest at least 20 percent of the property's assessed value on improvements and apply for a building permit prior to July 31, 1999; the program is not applicable for new

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construction. For both programs, buildings designated as landmarks may receive an additional year of benefits. In one of the more contentious issues raised by the plan, dwelling units created under either program will be subject to rent stabilization.

These incentives complement zoning amendments approved by the City Council last September to encourage residential conversion of buildings constructed prior to the 1961 zoning revision. Many of those structures exceed the floor area permitted by current zoning. In R10 equivalent zones south of Murray Street, the new amendments reduce the minimum average unit size required in the overbuilt portion of a building — previously set at 1,800 square feet — to the same 900 square feet mandated for the as-of-right portion of the building. Other provisions raise the floor area limit for home-based businesses from 25 to 49 percent and eliminate a 500-square-foot cap on such uses, explicitly allow up to three non-residential employees, and remove restrictions on the types of activities permitted. The amendments also allow residential conversions to provide accessory, off-street parking for 20 percent of converted units, up to 200 spaces — the same number permitted for new construction.

Zoning Amendments a First Step

The zoning reforms approved in September are just the first step in a sweeping planning effort being conducted for the area south of City Hall. The Department of City Planning is currently exploring the possibility of establishing a new Special Lower Manhattan District, which would replace the four special districts that now govern various portions of downtown. Among the features being considered for the new district are simplified height and setback controls tailored to the unusual street geometry of the financial district, a wider range of permitted entertainment uses and, to promote historic preservation, increased opportunities for the transfer of development rights.

Comments from community groups have raised additional issues to be addressed. Residents of traditionally commercial downtown Manhattan have long considered the area's schools and open spaces insufficient to meet existing demand. Facing the potential addition of thousands of new housing units, Manhattan Community Board One has stressed a need to expand these facilities. Other groups have suggested extending conversion opportunities to buildings built after 1961 and creating a new zoning use group to facilitate combined live/work environments, while some have raised concerns over the preservation impacts of providing off-street parking in converted historic buildings.

Along with the efforts of the Department of City Planning, the Landmark Preservation Commission is in the process of designating 20 downtown buildings as individual landmarks, as well as a Stone Street Historic District. These sites would add to the two historic districts and 30 individual landmarks already designated below City Hall. In addition, the state's Empire Development Corporation has undertaken a study of the potential economic benefits of extending commuter rail links to lower Manhattan in an effort to make such a project part of the Metropolitan Transportation Authority's long-range capital agenda. ■

In Rem

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the city, and concluded that once tax arrears reach 30 percent of assessed value, there would be little investor interest in purchasing the tax lien. HPD also studied the characteristics of buildings taken in rem in the past and found that, when tax delinquency reaches the same 30 percent of assessed value threshold, there is relatively little chance that it will be redeemed by its owners. Combined with other indicators the city collects, including information on code violations, emergency repair orders and the like, officials believe that it is possible to predict fairly accurately which buildings would be destined for city ownership.

The Administration's plan anticipates keeping distressed housing in the hands of its current owner if that ownership is deemed responsible or, if necessary, to transfer it to other for-profit or not-for-profit ownership. That decision, too, will apparently be made administratively by HPD. When the agency determines that the property has been managed irresponsibly, in rem action will be allowed to proceed. The city's legislative package contains a provision that would require the court, when making a foreclosure judgement against a Class One or Class Two property, to authorize the Finance Commissioner to execute a deed either to the city or to a third party designated by the Commissioner of HPD. Those third parties would be chosen from a prequalified pool of for-profit and not-for-profit housing managers.

Allowing the Commissioner of Finance to transfer the title of a foreclosed property directly to a new owner has important advantages. Once the city takes title, several procedural impediments to rapid disposition are triggered, such as the Uniform Land Use Review Process (ULURP), which applies to all city dispositions of real property. Furthermore, the city becomes subject to a variety of political pressures, as in rem disposition policy over the past 20 years demonstrates. Executing a deed directly to a new owner short-circuits those obstacles. The judgement of foreclosure will erase all tax liens and other liabilities of the building, as is the case when the city itself takes title to a delinquent property. Ironically, more difficulties will arise when the city attempts to keep troubled buildings in the hands of their existing owners. Without a judgement of foreclosure, tax arrears, mortgages and other financial obligations are not so easily erased, so more complicated "workout" packages may be necessary.

A major concern expressed by housing experts regards HPD's capacity to make complicated, case-by-case judgements on a substantial number of buildings, especially given the three-year backlog of properties in the foreclosure pipeline. HPD officials respond that many of those judgements are already being made through the In Rem Foreclosure Release Board. They also point to a huge 1992 foreclosure proceeding in Brooklyn, which initially involved some 8,000 properties. It has since been whittled down to approximately 350 residential buildings through persistent efforts to encourage redemptions

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and through active intervention by a Small Property Owners Advocacy Unit HPD has established, which provides technical assistance and help in negotiating the city bureaucracy.

Another concern involves the terms under which the buildings are offered to new management. For-profit firms will, of course, only participate if the terms are competitive with other opportunities in the real estate market, and HPD has substantial experience in calibrating programs to match competitive alternatives. Some in the housing community are concerned, however, that not-for-profit organizations, increasingly hard-pressed for funds as other government programs are scaled back, will be enticed into more difficult building reclamation projects than they can handle.

An Ounce of Prevention

The most ambitious element of the Administration's plan is its emphasis on stabilizing troubled buildings and preventing them from falling into serious tax arrears in the first place. While this is a strategy long urged by housing professionals (see CHPC's 1992 report, *Preserving New York's Low-Income Housing Stock*), there is widespread skepticism that in the current budgetary climate the necessary funding will be available, or that the Administration will be more successful than its predecessors in making politically difficult reforms in the rent regulatory system and housing courts.

In its effort to stabilize ailing buildings where there is no evidence of owner malfeasance, HPD is emphasizing an "early-warning" defense. The agency believes that many buildings ultimately caught up in the in rem process begin their slide with relatively small regulatory, legal or maintenance problems that can be corrected if caught early enough. An RFP to recruit community groups to serve as its "eyes and ears" at the block level has already been issued. The agency is also working with a privately-funded group comprised of the Wharton Real Estate Center, the Center for Mental Health Policy and Services Research of the University of Pennsylvania, and the Center for Real Estate and Urban Affairs at NYU School of Law. That group is attempting to formulate a model to more accurately predict which properties are likely to go in rem and to develop specifications for an integrated data base for use by the city, community groups and the general public. The agency is also establishing a Building Evaluation Unit, the director of which has already been hired, to coordinate information received from Neighborhood Preservation Offices, neighborhood consultant groups and other sources.

While early identification of buildings slipping into trouble will be useful, the ability of the city to deliver effective assistance and relief is critical. Most housing professionals believe that any meaningful low-income housing stabilization

program must be based on HPD's Participation Loan (PLP) and Article 8-A loan programs.

The PLP program provides low-interest loans to private owners (1 percent city loans blended with private funds) for moderate and substantial rehabilitations and building refinancing, while the 8-A program provides generally smaller loans for systems repair and replacement. These programs are critical not only because they facilitate building improvements and operating cost efficiencies, but also because they provide for rent restructuring and access to J-51 tax benefits. Annual funding for PLP and 8-A are baselined at about \$20 million and \$8 million, respectively, but housing professionals believe that budgets triple those levels will be required to reduce significantly tax foreclosures and building abandonment. The Administration's plan acknowledges the need for greater funding of those programs, but does not offer a specific budgetary commitment.

Swimming Upstream

As welcome as many of these initiatives might be, the fundamental problem of low-income housing is, by definition, the meagre income of its tenants. On that front things are likely to get much worse before they get better.

The city has apparently ruled out any new subsidy plan for low-income tenants, while the federal government is eliminating entirely its funding for new Section 8 rent certificates and vouchers. Elimination of "incremental" Section 8 subsidies is particularly troubling because rehabilitation work through the PLP program is often predicated on providing them to residents who could not otherwise pay higher rents.

Moreover, pending cutbacks in welfare, Medicaid and the Earned Income Tax Credit are likely to remove hundreds of millions of dollars of income support from the city's poorest neighborhoods. Those cutbacks will limit rent increases for housing operators and probably cause an increase in collection losses.

With the income prospects of low-income housing so bleak, attention is increasingly focussed on tax relief. There is a growing consensus that unrealistic property tax assessments are a major contributor to tax delinquency and housing deterioration in low-income neighborhoods, a view known to be shared by a number of high-level officials of the Giuliani Administration. In the current budgetary climate, however, the historical resistance of the finance and budget agencies to tamper with the tax base is, if anything, heightened.

Although there are some indications that the Department of Finance has become more willing to recognize the problem, its preference seems to be toward facilitating tax appeals by individual small property owners. In contrast, many housing experts believe that there are more systemic flaws in the tax assessment process that require a major reevaluation of the way the city assesses low-income properties. They are increasingly frustrated with tax policies that produce delinquencies in a third or more of the buildings in several communities, and then require elaborate programs to rescue the housing. ■