

# THE URBAN PROSPECT

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## Reassessing Tax Incentives

Hoping to tie renovation of its troubled in rem buildings to renewed market interest in residential housing, the Giuliani administration is expected to release a proposal in the coming months to amend the 421a Program. Last year's 7,428 new dwelling units represent less than two-thirds of the housing created in 1971, when concern over lagging residential production motivated the state legislature to establish the 421a tax exemption program. Expected to facilitate the development of more than 150,000 units in its first three years, 421a has taken more than 25 years to foster 100,000 new apartments.

The 421a program has accounted for about a third of the 310,000 new multiple dwelling units built in New York City since its inception. Long criticized as a give-away to Manhattan developers, it is now widely acknowledged as essential to the development of new and affordable housing. This evolution is the result of amendments linking benefits to the provision of affordable housing, the availability of tax-exempt bond financing and tax credits, and the disappearance of capital budget funded housing programs.

Although details of the city's plan have not been made public the proposed amendment would shift the balance of incentives to encourage more Manhattan developers to satisfy their affordable housing requirements off-site. The amendment is expected to offer longer tax exemptions under the Negotiable Certificate Program and allow renovation of occupied city-owned buildings to fulfill the affordable housing requirement. With 25,000 city-owned apartments, few capital dollars, and limited disposition goals, the administration's proposal could funnel much needed resources into its distressed properties.

### Location, Location, Location

Section 421 of New York State's Real Property Tax Law was enacted to stimulate multi-family residential housing by offering 10-year partial tax exemptions on the added value of the property. In exchange for tax benefits, 421a projects submit to rent stabilization for the term of the exemption and are allowed additional annual increases of 2.2 percent to offset the gradual loss of tax benefits. To qualify, residential projects must be built on underutilized or predominantly vacant land, or land improved with a non-conforming use.

All projects are eligible for exemption during construction, which may not exceed a three-year period.

Amid considerable controversy the program has undergone manifold changes, the most important of which condition program eligibility for central Manhattan development on the creation of affordable units and provide longer incentives for housing development in Northern Manhattan and the other boroughs. In the early 1980's several luxury and "super-luxury" developments received 421a benefits, giving credence to claims that tax exemptions assisted projects that would have been built without such incentives. Those opulent developments had so tarnished the public's perception of the program that, in 1984, Mayor Edward I. Koch withheld benefits from Trump Tower and several other projects. Trump filed suit based on the law's poorly defined requirement that construction occur on underutilized land -- under which its Fifth Avenue property technically qualified -- and the Court of Appeals ordered the city to reinstate \$50 million in tax benefits.

Although the city lost its battle, the state legislature responded by mapping the Manhattan Exclusion Zone -- roughly defined as south of 96th street to 14th Street on the east side and to Houston Street on the west -- wherein projects can only receive benefits in exchange for providing affordable housing. The 1985 legislation also clarified the definition of underutilized land.

Partial tax exemption currently ranges from 10 to 25 years depending on the location of the building and various provisions for affordable or assisted housing. Projects in Manhattan south of 110th Street are eligible for a 20-year exemption (12 years full exemption, decreasing by 20 percent every two years thereafter) if they have substantial government assistance or allocate 20 percent of their units to low- and moderate-income residents.

New housing in Northern Manhattan and the outer boroughs are eligible for 15-year exemptions, which can be increased to 25 years if projects are government assisted, provide 20 percent affordable units on- or off-site, or are located in Neighborhood Preservation areas.

The affordable housing requirement can be satisfied off-site through participation in HPD's Negotiable Certificate Program. Under the program, builders of affordable housing

receive five certificates for each unit they produce, which can be sold to developers of market rate housing, qualifying them for tax benefits. However, in the Manhattan Exclusion Zone,

### New Multiple Dwelling Units and 421a Units 1971-1995

Year	New 421a	Total	Year	New 421a	Total
1971	0	19,464	1984	5,602	10,285
1972	7,060	22,667	1985	6,307	5,567
1973	12,046	20,936	1986	4,270	12,123
1974	2,993	20,339	1987	11,367	12,617
1975	2,531	21,394	1988	11,864	13,220
1976	1,592	23,917	1989	6,214	14,685
1977	2,661	10,223	1990	6211	11,901
1978	5,373	7,068	1991	3,848	7,639
1979	2,139	9,715	1992	2,470	7,900
1980	2,726	8,886	1993	1527	5,510
1981	3,277	8,734	1994	859	6,964
1982	3,036	7,249	1995	2,127	7,428
1983	2,029	9,021			

Source: *Housing Preservation and Development,  
Department of City Planning*

still the locus of new construction, Negotiable Certificates are worth only a 10-year tax exemption versus the 20-year exemption granted for providing affordable units on-site.

### Chasing the Market

Housing production in New York City has declined progressively since the 1960's, when more than 50,000 units were created each year. Section 421a was intended to return housing production to those levels, and, by that standard, the program has been an abysmal failure. Yet, despite the dearth of new construction -- even at the top of the market -- 421a continues to be criticized for assisting market rate housing.

Between 1971 and 1984, 1,887 buildings, offering 50,577 rental, cooperative and condominium units received 421a benefits. More than 90 percent of these buildings were located in the outer boroughs, although over half of the units were located in Manhattan. A 1978 study by CHPC and Rutgers University Center for Urban Policy Research found that rents in 421a apartments were among the highest in the city, and residents, unsurprisingly, were mostly young, upper-middle class professionals.

Nevertheless, by 1984 rent stabilized apartments in early 421a projects had fallen below market. With the first round of tax exemptions (and rent stabilization) on the brink of expiration, 421a tenants became cause celeb for advocates of rent regulation. The New York State legislature passed an amendment extending rent regulations for existing 421a tenants, allowing those units to be decontrolled upon vacancy, and adding the requirement that tenants be notified of their provisional stabilization status and alerted to the expiration date.

The majority of units receiving 421a exemptions remain in Manhattan, where 16,360 of the 28,122 units created in the last six years are located. There are currently 32,578 exemptions (representing 45,013 units) in effect. Nearly 45 percent of those are outside the Manhattan Exclusion Zone, 2,960 of which have allocated one-fifth of their units as affordable housing in exchange for 25 year exemptions.

### Park Avenue Affordable

In the twelve years that tax benefits have been tied to affordable housing, more than 5,000 low- and moderate-income senior citizens, female-headed households, and young working individuals and families have taken residence in Manhattan's newest, prime housing developments. Eligibility is based on 60 percent of median household income (\$29,400), although many buildings deep-skew their rentals or sales, offering some units at 40 percent of median. Because even 40 percent of median is considerably higher than public assistance income, most residents are working poor. Little is known specifically about these tenants and how they may have benefited socially from living in these communities. It is possible that, like tenants in Chicago's *Gautreaux* program, low-income families in 421a buildings experience educational and employment gains associated with living in a more affluent community.

Some observers contend that the program offers a housing windfall to a few low-income families at the expense of serving the larger pool of New Yorkers in need of affordable housing. Whatever the social arguments for or limitations of economic integration, the decision of where to locate the affordable housing component is primarily financial, given the structure of program incentives and the availability of tax-exempt financing, which reward providing affordable housing on-site.

Prohibitively high development costs and diminishing government support for housing in general make tax exemptions and tax-exempt financing among the few tools for constructing market rate and affordable housing. In fiscal year 1996, 421a tax expenditures totaled \$103 million, with a total exempt value of \$960 million. The number of exemptions and annual tax expenditures have been declining for

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## Planning Watch

# Zoning For Housing

Many housing analysts believe that the city's intricate zoning resolution is a primary reason for its low rate of new housing construction. In an effort to remove some of those regulatory barriers to new production, the Giuliani Administration has been developing a set of generic housing-related zoning amendments.

The Department of City Planning issued a study containing 35 proposed zoning amendments, under the title *Zoning To Facilitate Housing Production*, in July 1996. Since then Department officials have been meeting with various advocacy groups, including CHPC's Zoning Committee, developers and community organizations to refine the proposals. The slow progress of those discussions reflects the complexity of the city's zoning regulations as well as the frequent opposition pro-development regulatory reforms elicit. Final text is expected to be ready for public review by the end of the year.

### Cars and Kitchens

Several of the proposed reforms have long been advocated by developers of governmentally-assisted low-income housing. Not-for-profit developers of Section 202 elderly housing, in particular, have often been frustrated by parking requirements that have proven to be far in excess of what is required for that type of housing, and by the resulting necessity of gaining waivers to reduce it to appropriate levels. Currently, for example, section 25-25 of the zoning resolution requires that elderly housing built in R5 and R6 zones provide parking spaces for 22.5 and 31.5 percent of the dwelling units, respectively. Under the Department's proposal, the new requirements would be 25 percent for low-income elderly housing (80 percent of area median income) and 10 percent for very low-income elderly housing (50 percent of median) in both of those zones. Similar changes are proposed for governmentally-assisted low- and very low-income housing that is not specifically for the elderly.

CHPC's Zoning Committee has endorsed those proposals and, in fact, urged the Department to liberalize them further. The Committee suggested that the distinction between low-income and very-low income be eliminated, and that parking requirements for elderly and non-elderly assisted housing be set at the levels proposed for very-low income developments.

In order to further facilitate housing production for the elderly, the Department also proposes to eliminate the distinction between for-profit and not-for-profit residences and all references to existing programs and financing criteria. In certain districts the number of dwelling units permitted would be increased by up to 10 percent, and floor area formulas would be adjusted to encourage developers to provide more communal space in the buildings. Perhaps most importantly,

"rooming units" would be permitted in elderly residences in all zoning districts permitting multiple dwellings.

The rooming units contemplated would typically have private baths but not necessarily individual kitchens, and might be interspersed with more conventional apartments within a building. In such developments, the elderly can initially rent or purchase conventional apartments, and as they age and become less independent, move into more specialized dwelling units in which they receive nursing or housekeeping services. Such "assisted living" developments have become popular with the elderly elsewhere in the country, but cannot currently be built in New York City except in high-density residential zones.

The Department's proposal regarding elderly housing is similar to that made by CHPC's Zoning Committee in its recent study, *SRO Housing: Recommendations for Reform*. In that report, the committee urged the city to reclassify rooming units with private baths but without full kitchen facilities as Class A multiple dwellings, whether or not they are intended for the elderly. The committee observed that changes in food storage, preparation and service technology over the past several decades have made full kitchens unnecessary for all dwelling units, depending on the housing market being served. Assisted housing for the elderly is one such market. In fact, state regulations do not permit individual kitchens in adult home assisted living programs.

Another proposal involves off-site parking for residential buildings, which is not currently permitted as-of-right anywhere in the city. The Planning Department proposes that off-site parking be permitted in R3 and higher zones, providing that the accessory lot is no larger than 4,000 square feet and is within 600 feet of the building in R3 through R6 zones and within 1,000 feet in higher-density zones. While encouraging the proposal, CHPC's Zoning Committee noted that this type of change would ideally be mapped for particular low-density neighborhoods, to prevent a "missing teeth" effect in areas that have a distinct contextual character. In the meantime, the committee suggested that it be permitted by Planning Commission certification only in R6 and lower zones.

### Fast Track

Other proposed reforms include simplified density controls for multiple dwellings, greater flexibility of location for residential uses in mixed buildings, and relaxed rules for spacing homes on single zoning lots in low-density districts. Overall, CHPC's Zoning Committee endorsed all but two of the Department's proposals, while suggesting technical modifications to several of them.

When the text changes are ready, the Department intends to submit them as a package. Ironically, the one proposal that has been designated for a separate, early review is one of those the CHPC committee did not endorse. That proposal would create a new Board of Standard and Appeals special permit to allow extensions to one- and two-family homes. ■

# 421a

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more than five years, indicating that projects are transitioning out of the program faster than they are being added.

Tax exemptions are granted on the improvement of the property, and all 421a projects continue to pay taxes on prior assessed values. Housing experts claim that few, if any, recent rental buildings would have been built without tax benefits, and for those developments New York has forgone no real revenue. As exemptions decline and expire, 421a buildings increase New York City's property tax base. For example, New York City collects more than \$5 million in annual property taxes from the St. James Tower and Carnegie Hill

## Number of Units Issued 421a Certificates by Fiscal Year and Borough

FY	Manhattan	Brooklyn	Queens	Bronx	S.I.	Total
1990	2,475	944	2,237	307	333	6,296
1991	3,662	213	1,311	280	203	5,669
1992	2,349	541	907	217	221	4,235
1993	2,404	783	407	201	148	3,943
1994	2,070	297	126	81	0	2,574
1995	1,448	323	334	54	56	2,215
1996	1,952	548	180	424	86	3,190
Total	16,360	3,649	5,502	1,564	1,047	28,122

*Source: Housing Preservation and Development*

Tower, two former 421a buildings. The Ellington, which is in the phase-out years of its exemption, pays over \$800,000 in property taxes, just \$200,000 less than it would pay without 421a. Construction, jobs, and added sales taxes related to 421a projects, as well as the income taxes of 421a middle-income residents further add to the city's coffers.

For a new one-bedroom unit full exemption is worth approximately \$6,300 per year or \$525 per month (based on development costs of \$200/sq. ft. for a 700 sq. ft. unit). This can lower the initial rent by as much as 20 percent, making development possible in some areas where the market could not otherwise support the rents necessitated by new construction. Even with tax-exempt bond financing and tax credits, developers estimate that market rents for a one-bedroom apartment must be a minimum of \$1,600 per month (approximately \$28 per sq. ft.) to offset the cost of development and to cross-subsidize the affordable units. For example, a recent 80/20 project at 100 Jane Street is currently advertising one-bedroom apartments at \$2,550. River Tower, a former, and now unregulated, 421a building, is offering one-bedroom apartments for \$2,075.

Many recent 421a rentals received tax-exempt bond financing under the federal 80/20 program, which shares the

requirement that 20 percent of units be set-aside for low-income tenants. To date, over 8,500 units have been constructed under the 80/20 program in New York City; 6,432 of those units financed by the NYC Housing Development Corporation with loans for more than \$1 billion. The program, often referred to as the only game in town, is increasingly competitive as housing and other private activity projects jockey for limited bond financing. This competition is likely to reduce housing production in New York City under the 80/20 program, resulting in a corresponding decrease in the 421a program.

## Out of Site

Just over one thousand affordable units have been created off-site under the Negotiable Certificate Program, including 162 apartments in Manhattan, 171 in the Bronx, 582 in Brooklyn, and 128 in Staten Island. Spring Creek in East New York is the largest project developed under the Negotiable Certificate Program. The \$33 million, 582-unit project was financed through tax credits and negotiable certificates, allowing apartments to rent for about \$400 for a studio and \$750 for a three-bedroom unit.

In exchange for the 10-year tax abatement, the market for negotiable certificates is weak. In 1988, Spring Creek sold 183 of its certificates to Zeckendorf's Upper East Side Bel Aire project for \$18,000 each. Those certificates brought Spring Creek nearly \$3.3 million and were estimated to be worth approximately \$5 million in tax exemptions to Bel Aire. The going rate for certificates remains about \$10,000 to \$18,000. With five certificates granted to each affordable unit, the \$50,000 to \$90,000 doesn't necessarily cover the cost of building an affordable unit — let alone operating it at low rents without additional assistance. Virtually all negotiable certificate projects have also received tax credits.

Recent interest in the Negotiable Certificate Program has been negligible, with only 55 affordable units built in nearly five years. Current law allows for renovation of vacant city-owned buildings, however, only one city-owned property with 32 units has been rehabilitated. The administration's plan would extend eligibility to occupied city-owned buildings. Whether this would encourage wider participation in the Negotiable Certificate Program would depend on the length of exemption granted and the availability of other financing.

Given the paucity of new construction, there is clearly a need to increase the utilization of 421a and its Negotiable Certificate Program. If exemptions are increased to twenty years and potentially less expensive rehabs are offered in exchange, the city has an opportunity to increase the number and possibly even the ratio of affordable units. With housing losses outpacing new construction by three to one, amending 421a could maximize the city's return on its tax expenditures, while renovating and preserving the in rem stock. ■