J-51
To Be Continued?

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This is part of a series of CHPC briefings examining current issues of importance to the NYC housing and community development industries.

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The New York State law that authorizes the J-51 tax incentive program expired on December 31, 2011. This ended the authority of New York City's Department of Housing Preservation and Development (HPD) to issue new benefits, and it has thus taken no J-51 applications since then.

In the past renewal of J-51 has been virtually automatic. However the current attempt at renewal has been delayed due to questions relating to the cost of the program, outdated benefit schedules, concerns about processing inefficiency and rent stabilization issues.

As of last week HPD has put forward a proposal to address the renewal and its related problems.

The City's proposal makes substantial changes in the program, which are among the most sweeping in years. It proposes to:

- reduce the cost of the program by removing condominium and cooperative housing from eligibility;
- improve the benefit schedule by increasing the benefit allowance for many items;
- and improve processing efficiency by eliminating benefit items that are not system-wide and by mandating electronic applications.

In this *Inside Edge* we will discuss how HPD's proposed solutions address these problems and what alternatives there might be.

Cost of the Program

As the City continues to struggle with less than expected revenue growth due to the tepid recovery from the Great Recession of 2008, it looks to paring back its tax incentive programs, which represent major tax expenditures. J-51 alone costs the City about $257 million a year in foregone tax revenue. Although this is much less than the 421-a program (which costs about $912 million per year) it's a substantial sum which represents about 1.5% of New York City's annual real estate tax collection of $17 billion.

The City's first cost reduction proposal is to remove J-51 eligibility from coops and condos that are not otherwise subsidized by a City rehabilitation loan program.

As the chart, on page 2 shows, private condos and coops utilized about 23% ($571 million) of the total J-51 benefits provided, in 2000 - 2009. Condos and coops subsidized by affordable housing programs, which would continue to be eligible under the City proposal, utilized only 3% ($76 million) of the total amount of benefits. For rental units the lion's share (45%, $1.1 billion) went to rental buildings that received government subsidy, while the non-subsidized rental sector used 29% ($708 million).

On the downside this proposal leaves out coops and condos that are still in need of some assistance but could refinance themselves without a subsidized loan. There are at least three classes of such buildings. The first comprises rental buildings converted in non-eviction plans in the 1980's and 1990's. Many buildings housing people

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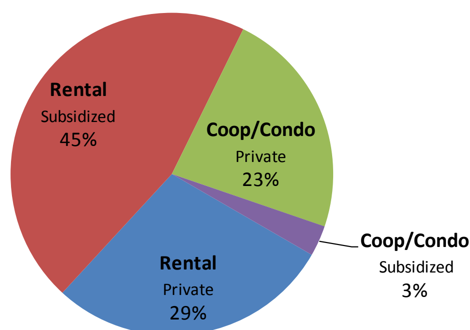

Source: HPD

of moderate income were converted during this period to coops and condos. Second is the low income coops created by the City's Tenant Interim Lease Program as part of its disposition of the foreclosed in rem housing stock. Many of these have seen their City imposed income restrictions expire, but they still house moderate income families. Third, is the many moderate income condos that have been built to accommodate immigrant communities throughout the City.

All such buildings eventually need rehabilitation. Not all of them can be refinanced with government funds. Many of them can afford to borrow at market rates, but the revenues of the building will limit the amount they can borrow. Such buildings will be able to do more rehabilitation if they receive a J-51 benefit.

The problem is to direct the benefit to such buildings and away from buildings where the J-51 benefit is merely unneeded subsidy.

The City could simply cap eligibility of buildings to those whose assessed value fell below a defined standard. This is a concept which J-51 currently utilizes on a limited basis. It could be applied to condos and coops, thus allowing more moderate income coops to finance rehab work without the need to seek a government subsidized loan.

Outdated Cost Reimbursement Schedules

A J-51 beneficiary who has done qualifying rehabilitation work receives two forms of benefit: an exemption of the value of the new work being added to the buildings assessed value, and an abatement of existing taxes.

The value of the benefits is calculated based on the value of the work done by the owner. To document this the owner submits receipts showing the actual cost of the work done. However HPD caps the amount allowed for each item of work according to a schedule known as the Certified Reasonable Cost (CRC) amount. The CRC schedule has not been updated since 1993 and currently has maximum costs that are well below actual costs.

As part of its proposal HPD says that it will update the CRC schedules to reflect current actual costs. However HPD is offsetting this, in part, by paring down the items which are eligible for J-51 benefits. Thus HPD is proposing to refocus J-51 on system wide renovations, such as roofs, HVAC, windows, plumbing, and electric and eliminate benefits for so-called "amenity renovations" such as kitchen and bathroom renovations. We are concerned that this part of the proposal may discourage owners from adding energy efficient upgrades to their buildings that may contribute to "greening" our older housing.

One side effect of increasing the CRCs is a reduction in rent increases from rent stabilization pass-throughs of Major Capital Improvements (MCI). J-51 requires that 50% of any benefits received under J-51 must be used to offset rent increases tenants receive from rent stabilization's MCI program. Thus increasing the J-51 benefit, and aligning it more closely with the items that are MCI eligible will result in a greater credit to tenants.

Improving Processing

One of the major complaints of owners is the length of time that it takes to process a J-51 application. Several changes to the program are proposed that the City says will help processing.

1. By removing condos and coops from the program, there will be fewer applications to process. A similar benefit is achieved by reducing the number of items that are J-51 eligible, thus reducing the amount of review needed.
2. The proposal includes mandatory electronic filing. This will presumably reduce the number of applications that have to be returned as incomplete.
3. The proposal adds a penalty, equal to 10% of the cost of processing items of work that are

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not actually complete when HPD conducts its inspection, a problem that frequently delays processing.

4. It would require that there be a certification of costs by a Certified Public Accountant. Presumably this will allow HPD to accept the CPA certified costs without further examination in many cases, though we are concerned that there be monitoring and an effective enforcement mechanism for the CPA's doing such certifications.

Fixing *Roberts v Tishman*

In 2009 in *Roberts v Tishman*, the New York State Court of Appeals ruled that recipients of J-51 could not use the "luxury decontrol" provisions of the rent stabilization law. Since there had been widespread belief from 1996 through 2009 that such buildings could decontrol units, there has been massive confusion as to what to do with the approximately 44,000 housing units that had been decontrolled prior to the Court's ruling. Questions such as what rent should such units be rolled back to, what is the effect of the four year statute of limitations in rent stabilization and a host of other problems have been the subject of litigation and proposed legislation.

There was reason to hope that new J-51 legislation might also address the *Roberts* problem by legislating a solution and cutting short the still endless litigation on the unresolved questions raised by *Roberts*.

However the City's proposal does not include a *Roberts* fix. Likely that is due to the strong support that the tenant advocacy community has expressed for keeping the re-regulated units under rent stabilization. As expressed by tenant advocates, this prevents "loss" of affordable housing units.

That support however is misguided since the *Roberts* decision does nothing to make apartments available to families of low and moderate income. No rent stabilized tenant, whose family income is less than $175,000, was affected by the *Roberts* decision.

Roberts only benefits two groups of tenants; (1) those who willingly rented market rate units that were improperly deregulated and (2) those seeking to rent vacant apartments that were or would have been improperly deregulated.

Neither of these groups though consists of the households who need the support of public policy to afford their apartments. The first group consists of households who voluntarily paid the market rate rent, because they determined that it was *affordable to them*. Thus these households are getting a windfall of rents that are being reset to an amount that is *less than* what they thought was affordable.

The second group, as a practical matter, does not exist. The *Roberts* decision only has a meaningful effect in neighborhoods where the market rent is substantially higher than the rent stabilized rent. Such neighborhoods are mostly in Manhattan in areas where higher income people live. (See, *Rent Regulation: Beyond the Rhetoric*, Citizens Budget Commission, June 2010). And such areas attract potential tenants of higher income. Thus, for example, a vacant rent regulated unit in most Manhattan neighborhoods south of 110th Street will attract multiple applicants. The owner will always choose to rent to the applicant with the best financial resources, no matter what the rent on the apartment. Low rent units will likely wind up being rented to high income tenants who could easily pay a market rent.

Thus since *Roberts* does not help low and moderate income tenants, there should be no objection to simple legislation that would end the uncertainty that it has produced in the residential housing market.

The outlines of such a solution are clear:

1. Owners should be permitted to return their J-51 benefits in exchange for access to luxury decontrol.
2. Tenants in such buildings would continue to pay their current rent.
3. Rents should be rolled back to 2005 for owners who choose not to return their J-51 benefits.
4. Money paid back by owners should be dedicated to housing purposes.

Getting it Passed

The City proposal is a major step forward for J-51. Though we have expressed some concerns in this article, it deserves to be passed, promptly, by the Legislature and Council.

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There are some serious obstacles to getting it passed. The City proposal comes late in the legislative year. With only about a week left in the legislative session there may simply not be enough time to get it passed.

Another complication is that a parallel effort to get additional changes in the rent stabilization law may become linked to the J-51 renewal. In 2011 substantial changes were made to rent stabilization focusing on restricting access to luxury decontrol. The requirements for high rent/vacancy decontrol were tightened, requiring that rents on a vacant apartment reached $2,500 per month rather than the prior $2,000 per month. To slow the rate of increase the amount that could be added to individual apartment increases was reduced from 1/40th of the cost of improvements to 1/60th for buildings with 35 or more apartments. For high rent/high income decontrol the income level was increased from $175,000 annual income to $200,000.

However there were a number of changes in the tenant advocates 2011 reform package that were never considered. Chief among them was requiring that the Mayor's appointees to the Rent Guidelines Board be approved by the NY City Council. There has been discussion that there will be an attempt to link passage of this requirement to J-51 renewal.

We think that there should be no such linkage. J-51 has been an important tool to preserving and upgrading affordable housing in New York City for more than 60 years. It should be reauthorized without delay.

J-51 is a program designed to provide tax reductions to owners to encourage rehabilitation of multifamily housing. It was created in the 1950s when New York City still had a substantial inventory of Old Law tenements which did not have central heating, central hot water, or, in some cases, indoor plumbing. When the City required the installation of these improvements, many owners objected that they could not pay for the costs of the improvements from their existing rent rolls, which were limited by the rent control system. J-51 helped fill that financing gap.

The program has been successful — from inception through 1977, over 675,000 units of housing were renovated using J-51 tax incentives.

The program remains useful and important today. As of the end of 2011 there were 583,776 units of housing benefiting from a J-51 tax reduction. J-51 remains the primary incentive to doing moderate rehabilitation – the kind of rehabilitation that keeps low and moderate income families in their affordable homes. Also, as we pointed out in our publication of last year *The Future of Real Estate Tax Exemptions for Affordable Housing in New York City* J-51 also serves the purpose of reducing the overtaxation of multifamily buildings in New York City.

J-51 deserves to be renewed, promptly.

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