Pratt Center for Community Development

A Luxury Housing Subsidy New Yorkers Can't Afford

The legislature is poised to renew a massive tax break to New York's real estate industry that shortchanges affordable housing.

The access to affordable housing for hundreds of thousands of New Yorkers depends on what the state legislature does this June. An overhaul of state rent laws in 1997 allowed property owners to remove 30,572 apartments from rent regulation. Now Assembly Speaker Sheldon Silver has vowed to rebuild, and strengthen, New York State's weakened rent laws. But among other compromises to win the support of a hostile State Senate, Silver has signaled he is prepared to renew a major tax break for real estate development, known as 421-a. Senate leadership strongly supports the renewal of the tax abatement, which is prized by the Real Estate Board of New York.

Silver is playing a wildly expensive bargaining chip. The 421-a program cost New York City nearly $755 million last year in foregone taxes, or two-and-a-half times its cost just five years earlier. A number of factors have driven these escalating expenses. The real estate bubble pushed property values to record highs, and brought thousands of new luxury housing units to New York City. At the high end of the Manhattan market, newly built luxury properties continue to sell for six- and seven-figure prices. The tax break, which lasts between 10 and 25 years, is disproportionately valuable to wealthy households, since the abatement applies to tax assessments that are far higher for sprawling luxury properties than for more modest ones in working-class neighborhoods. As if that weren't enough, the Senate bill supported by REBNY would extend the benefit indefinitely for units that stay under rent regulation, and allows the break to be used for the first time to convert commercial and industrial real estate to residential use.

> **The 421-a program cost New York City nearly $755 million last year in foregone taxes.**

The 421-a program is forcing the vast majority of New York City households–the ones that do pay property taxes–to subsidize new, mostly luxury development. A disproportionate share of the city's property tax load now rests on occupants of older buildings, including co-ops and condos whose middle-class residents are now seeing assessments rise sharply. And it all comes at an unconscionably high cost. The taxes forgiven this year alone under 421-a would be enough to prevent all the teacher layoffs slated for this year, keep every firehouse open, prevent a planned $100 million cut to city libraries, and still leave $150 million in change.

> **Billions in tax breaks have produced just 5,700 units of affordable housing.**

To be sure, 421-a is not entirely a giveaway. It was created in 1971 to lure development back to a shrinking city, and remains an important tool for developers of new housing for the middle class in the boroughs outside Manhattan. Since 1985, developers in mid-Manhattan have been obligated to sponsor affordable housing, equivalent to 20 percent of the total units they are building, in order to receive an abatement. But because the tax abatement continues to be available automatically in most of the city, nearly 130,000 apartments currently receive 421-a benefits, while in its entire history the program has sponsored the creation of just 5,700 affordable housing units.

Four years ago, the City Council and state legislature both sought to strengthen affordable housing production under 421-a by expanding the "exclusion zone" – so-called because projects in this area do not qualify for the as-of-right benefit but must instead contribute affordable housing in order to receive a tax break. The zone now includes areas in

all five boroughs where developers must include affordable housing in tax-abated development projects, generally in neighborhoods where new market-rate housing is particularly expensive (see map). The administration also committed to placing $400 million into a new "421-a affordable housing fund" to be used for development in the city's highest-poverty areas; combining Battery Park City revenues and city capital funds, it replaces an inefficient system under which affordable housing developers sold certificates to market-rate developers who claimed the abatement. The City capped benefits, so that owners of ultra-luxury apartments would no longer claim breaks worth tens of thousands of dollars annually. Finally, the revised law determined that all projects receiving benefits in the exclusion zone would have to provide their affordable housing on site.

Annual 421-a Tax Abatements Qualified July '06 - June '08				
2006-2008	Developments	Residential Units	Annual Tax Abatement	15 Year Cycle
Received Abatement	123	2,219	$12.2 million	$158.7 million
Currently Vacant	148	5,642*	$30.9 million**	$413.8 million

Source: Department of Buildings Monthly Permits Reports July 2006 to June 2008, Individual New Building Permits from Building Information System (BIS) and Pratt Center for Community Development 2011.

*Number of residential units derived from individual new building permits filed with the NYC Department of Buildings.
**Value calculated using an average of $5,468 abatement granted to developed properties, multiplied by the total number of units in the planned developments.

"The changes have modernized the tax incentive to better target it towards the creation of housing for low- and middle-income families and will generate hundreds of millions of dollars for affordable housing," the Bloomberg administration announced in the 2009 update of its New Housing Marketplace Plan. "The reforms are designed to create the maximum amount of affordable housing for the city while also ensuring that construction of new housing will continue at a strong pace."

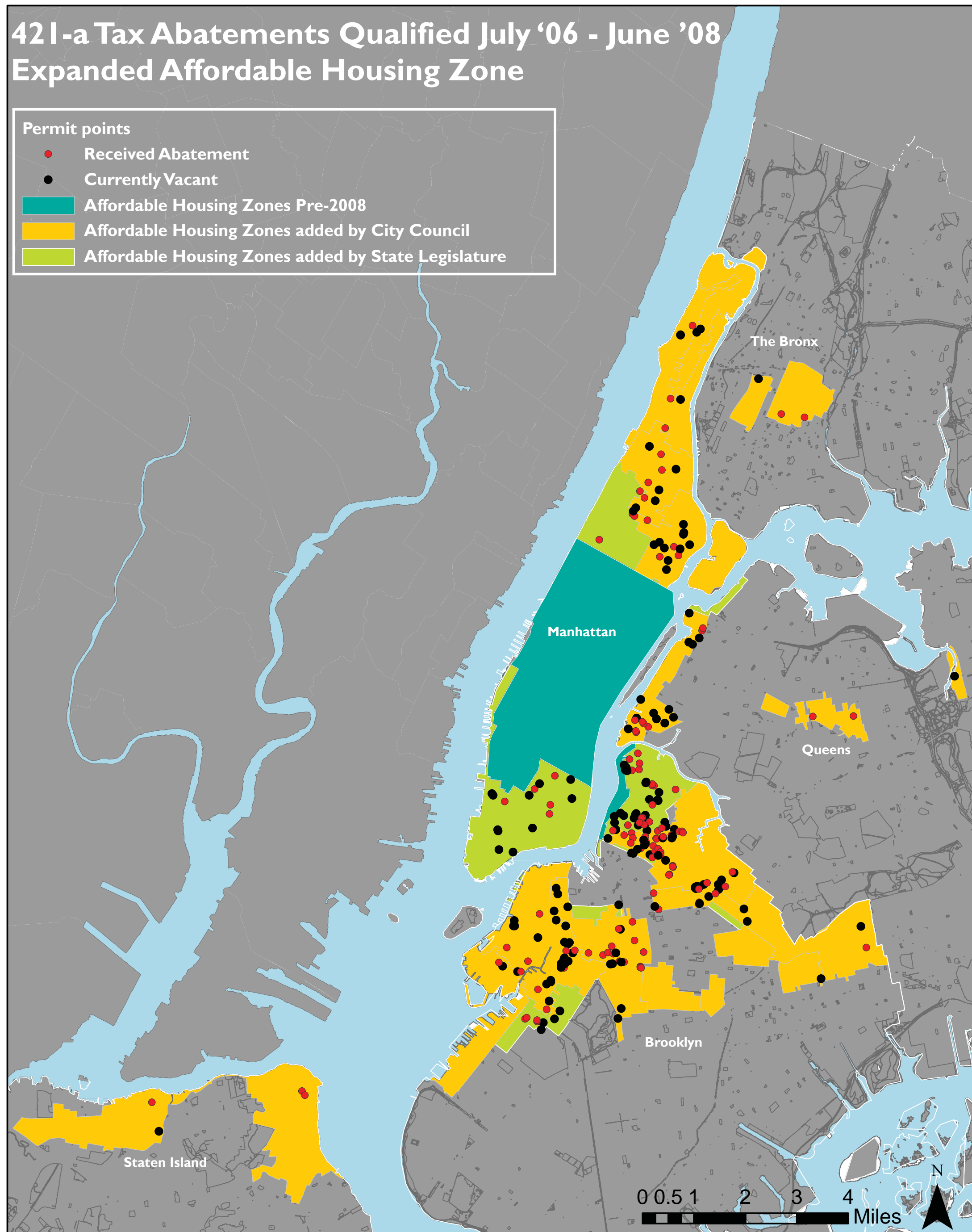
Four years later, the new affordable housing is nowhere to be seen. In renewing the abatement in 2007, the state legislature introduced a giant loophole for developers who sought to avoid the obligation to produce affordable housing: Projects in the expanded exclusion zone had until June 30, 2008, to begin construction under the old law, under which they were granted the 421-a benefit as of right. This has enabled developers to build thousands of market-rate housing units in the expanded exclusion areas, and reap the tax benefit, without including affordable housing. These projects were also granted an exemption from a cap the City had sought to impose in an effort to rein in subsidies for ultra-luxury housing; the cap would have limited the exemption to about $9,000 per unit annually.

A Pratt Center analysis has found that in the two years leading up to that 2008 deadline, developers initiated construction on 271 residential sites eligible for 421-a, totaling more than 7,900 permitted units, in the new exclusion zone areas. Of those, 123 sites are now built and occupied, totaling 2,271 units of housing. On average, these units are receiving an abatement that at current tax rates will be worth $82,000 each over the next 15 years. The total cost is $183 million in unpaid city taxes–without any obligation to produce affordable housing. (A small minority of projects opt for "extended benefits" of 20 to 25 years in exchange for setting aside some units as affordable; one such project is the 128-unit Urban Horizons mixed-income development in the Bronx.) Development projects initiated between January 2005 and June 2008 in the exclusion zone are now receiving $27.8 million in abatements a year, or $415 million over the 15-year life of the benefit (see table). Recorded sales prices for these units ranged from $509,000 for 900 square feet to $10.35 million for a 3,521-square-foot condo on West Broadway.

The remaining 148 sites are vacant, according to the Department of City Planning Pluto database 2010. Under the legislative measures introduced this year in Albany to renew 421-a, all will continue to remain eligible for 421-a benefits without an affordable housing obligation, under a new provision allowing for an "extended construction period" of three

years, in addition to the three years already allowed. Developers have established tax abatement eligibility for 5,642 units for these permitted sites, worth $31.9 million a year—again, with zero commitments for affordable housing production.

The total price tag for current and future abatements in the expanded exclusion area, nearly $60 million in foregone taxes annually at current rates, is still a fraction of the city's total $755 million loss for 421-a last year. But it's a painful reminder of the legislature's failure in 2007 to ensure a future for 421-a as an affordable housing program – a failure that now appears poised to continue, ironically sacrificed to the vital cause of renewing rent regulations.



Source: NYC DOITT 2004; NYC DCP 2005, 2006, Department of Buildings Monthly Permit Reports July 2006 to June 2008.

Recommendations

The 421-a tax abatement is an outdated artifact of an era in which New York City had to spark economic activity by any means necessary. Created as an essential jump-start to the city's stalled housing market and an important boon to the city's economy during a dire moment in its financial history, it has turned into a drain on the city's budget that gives disproportionately generous benefits to the wealthy and serves as an expensive incentive to build new structures.

We recognize the need for strategic investment in incentivizing housing market activity where such activity delivers needed benefits: affordable housing and new development in targeted areas, such as underdeveloped transit-rich zones, where there are strategic reasons to provide development incentives. The following recommendations outline improvements to the program that can strengthen the abatement's capacity to encourage needed housing development without needless giveaways of tax revenue.

Phase out the as-of-right abatement. Tax subsidies are not the way for New York City to lower the high cost of housing, and infact have had the perverse effect of inflating sales prices for luxury condominiums, since abatements are part of the sales pitch. The legislature should not renew the as-of-right abatement, which expired in December 2010. The time to act is now, at a time when few eligible residential construction projects are being initiated in New York City and the phase-out is unlikely to thwart otherwise viable development projects.

Target incentives strategically. The state and city should require inclusion of affordable housing as a condition of receiving long-term abatements regardless of geographic location. To the extent that special abatements are also available on a geographic basis, these should be designed to foster development in geographic areas targeted for growth under PlaNYC and other long-term plans and development projects.

Pay prevailing wages on non-affordable projects. If the legislature can't bring itself to reform 421-a this time around, it should at the very least make sure that the construction workers on projects receiving the abatement are paid a prevailing wage, in line with wages paid on other government-funded construction projects. The 421-a renewal bill introduced by Assembly Housing Committee Chair Vito Lopez includes a requirement for prevailing wages on construction projects with 80 or more units where half or fewer of the units are affordable.

We're not kidding ourselves: The legislature is likely to renew 421-a this year. The Real Estate Board of New York has fought fiercely to preserve the as-of-right abatement, and the very real need to renew and strengthen rent regulations is front and center for legislators who care about affordable housing. But now that we know the price of 421-a – a gift to real estate developers – it's time for New Yorkers to stand up and count the cost.

The evolution of another tax abatement, the Industrial and Commercial Incentive Program, or ICIP, shows that an expensive and poorly targeted tax abatement program can be redirected to more productive uses. In 1992, after the tax abatement heavily subsidized new office development in Manhattan that would have occurred anyway, the state legislature excluded office buildings south of 96th Street from the program. More recently--after a city study showed that it had paid out $2.8 billion in benefits for development that would have happened anyway (versus $571 million for projects that were made possible by the benefit)-- the City renamed ICIP the Industrial and Commercial Abatement Program, or ICAP, and scaled back benefits for retail developments, most sites in mid-Manhattan, and other projects that did not require a tax abatement in order to proceed.

New York City can't afford to continue subsidizing luxury real estate while cutting back on vital city services. We can at least start to reckon with the real price of the abatement for the millions of New Yorkers who do pay their property taxes, and ask what we're buying.