Reforming New York City's 421-a Property Tax Exemption Program:

Subsidize Affordable Homes, Not Luxury Development

Pratt Center for Community Development

HABITAT FOR HUMANITY NEW YORK CITY

Buildings Profiled in this Report

Habitat-NYC and the Pratt Center examined buildings with some of the largest tax exemptions throughout the city. This report profiles 10 buildings – 7 in Manhattan, 2 in Brooklyn, and 1 in Queens – that illustrate the failures of the 421-a program in its current form. The average estimated lifetime cost of the 421-a tax breaks for these 10 buildings is $94 million for just these 10 buildings, an average of $9.4 million per building, and $73,000 per unit. Yet not one includes a two-bedroom rental for less than $2,000, and prices for condo units go up to well over $2 million.

Executive Summary

This year, the City of New York will consider a much-needed overhaul of the 421-a property tax exemption program, which provides extensive tax breaks to residential developers. The 421-a program was created more than three decades ago, at a time of fiscal crisis and neighborhood abandonment, when New York was hungry for any new development.

In today's housing market, however, 421-a is subsidizing luxury housing in upscale neighborhoods, at a huge financial cost to the City. The program – which cost the City $320 million this year – is creating few of the affordable homes that average New Yorkers desperately need.

Habitat for Humanity-New York City and the Pratt Center for Community Development reviewed the program and found that:

* The 421-a program has subsidized over 100,000 housing units since the program's inception. However, according to a 2003 report by the Independent Budget Office, only about 8% of the units are affordable to low or moderate income families.
* The cost of the program to the City of New York has grown 150% in just 4 years, up from $130 million in lost tax revenue in 2002 to $320 million in 2006.
* The exemptions are especially lucrative for Manhattan developers, where housing stimulation is least needed. While Manhattan projects accounted for only 23% of all exemptions in 2005, Manhattan developers received over 78% of the value of these tax breaks.
* In some cases, developers contribute as little as 12 to 15 cents for affordable housing (in the Bronx) for every $1 of forgiven taxes on luxury buildings (in Manhattan).

As developers enjoy these growing tax breaks, the recently-released Housing and Vacancy Survey shows that New York City's housing crisis continued to deepen from 2002 to 2005:

* Average tenant incomes were down 5.6%, but average rents were up 8.7.%
* The number of New Yorkers paying more than half of their income in rent grew by 13%, to more than 570,000 households (more than one quarter of all tenants).
* More than 100,000 families are living in overcrowded conditions; and almost 8,000 families are living in homeless shelters.

The 421-a program represents a huge loss in tax dollars, with little public benefit. It is time to leverage these tax dollars to effectively foster the housing that New York City needs – affordable homes.

Pratt Center for Community Development and Habitat for Humanity thank the following for their work on this report:

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Background

Article 421-a of the New York State Real Property Tax Law was enacted in the 1970s, during the height of New York City's fiscal crisis, when the residential housing market plummeted. New York City and State officials opted to give property tax breaks to any newly constructed multi-unit housing development to encourage the construction of new buildings.

During the 1980s, as the housing market rebounded in Midtown Manhattan, it became apparent that unnecessary tax breaks were being offered to developers of some of the world's most valuable real estate. So City officials decided to take advantage of Manhattan's growing prosperity to generate affordable housing by designating an "exclusion zone," roughly between 14th and 96th Streets. In this zone, developers became eligible for 421-a *only* if they agree to build affordable units for low-income families. They can either make one-fifth of their units affordable (in a development known as an "80/20"), or they can buy their tax break by purchasing "negotiable certificates" that are used to create affordable housing elsewhere in the City.

In other neighborhood, developers still receive an "as-of-right" exemption for any development at all. In Lower Manhattan and between 96th and 110th Streets, market-rate buildings are eligible for a 10-year exemption. Above 110th Street and in all of the outer boroughs, they are eligible for a 15-year exemption (see chart on page 4).

Despite skyrocketing prices and the dramatic resurgence of housing markets over the past decade, in most of New York City -- including TriBeca, SoHo, Wall Street, Harlem, the Lower East Side, Brooklyn Heights, Park Slope, Long Island City and Astoria -- the 421-a program remains almost unchanged since its inception 30 years ago.

88 Leonard Street, TriBeCa
Under Construction
scheduled completion Summer 2006;
21 stories; 352 units
Photo Source: Curbed.com

Monthly rents:
Studios: $1,895 to $2,450;
1-bedroom: $2,450 to $3,750
2-bedroom: $4,250 to $5,000;
3-bedroom: $6,500 to $12,500

Assessed value without 421-a exemption: $7,020,000

Assessed value with 421-a exemption: $365,581
Property taxes without 421-a exemption: $803,770
Property taxes with 421-a exemption: $41,858

Tax savings for property owner in 2008: $761,912 (estimated)*
Lifetime cost for building: $16.8 million

How the 421- a Program Works

A 421-a exemption is available for new housing developments with three or more units, located on sites that were vacant or underutilized or that had a "nonconforming" zoning use. Under the program, owners are exempt from paying the increase in property taxes that results from the new construction. For example, if the vacant land was valued at $1 million and the new property is worth $10 million after construction, the property owner will not be taxed for the $9 million increase in value for the exemption period.

The program is available for condos, co-ops, or rentals. For condos and co-ops, there are no restrictions on sales price. For rental properties, the units must be registered under the rent-stabilization system. However, initial rents are set at market-value for the area. The program parameters are as follows: A

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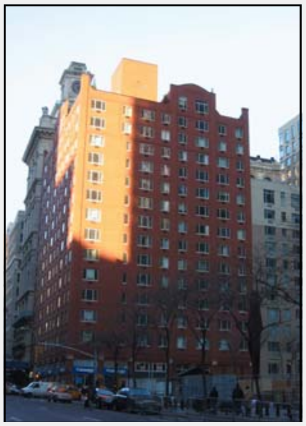
Manhattan, roughly 14 – 96th St	Rest of Manhattan below 110th	Outer Boroughs/Above 110th St
10 year exemption: Off-site affordable certificates	**10 year exemption: As-of-right for market-rate**	**15 year exemption: As-of-right for market-rate**
Developers purchase certificates from low-income housing developer creating affordable housing anywhere in the city. Certificates have generally sold for $12,000 - $15,000 each; each provides a 10-year exemption for a market-rate unit (as described in the adjacent box). Affordable developers receive 4 or 5 certificates for each affordable unit they build.	Buildings are eligible for a 10-year exemption from property taxes, with no affordability requirement. Two years of full exemption, then two years of 80% tax exemption, then two years of 60% tax exemption… and so on.	Buildings are eligible for a 15-year exemption from property taxes, with no affordability requirement. The first 11 years are fully-exempt, year 12 is 80% exempt, year 13 is 60% exempt …and so on. (NOTE: Not available on Greenpoint-Williamsburg waterfront).
20 year exemption: 20% affordable on-site	**20 year exemption: 5% affordable for middle-income**	**25 year exemption: 20% affordable or special area**
Developers who set aside 20% of their units, on-site, for low-income households (below 80% AMI) receive a 20-year exemption. Most of these are 80/20s, also subsidized with tax-exempt bonds and low-income housing tax credits. These projects are fully exempt for 12 years, then 2 years 80% exempt, 2 years 60% exempt, etc.	Buildings are also eligible for a 20-year exemption if they receive substantial government assistance. This gives a 20-year exemption to buildings receiving Liberty Bond financing, even though they are only required to make 5% of the units affordable to middle-income families.	Buildings are eligible for a 25-year exemption (21 years of full exemption, then 1 at 80%, 1 at 60%), if they: Set aside 20% of units for low-income households, or Receive substantial government assistance, or Are located in "Neighborhood Preservation Areas," which are spotted throughout all boroughs (e.g. Corona, Jackson Heights)

Rental: *336 Broadway in TriBeCa, a 15-story building with 155 rental units, was built in 2000. Before the new building was built, the site had an assessed value of about $3 million, leading to an annual tax bill of about $350,000. With the new building, the property was estimated to have increased in value by nearly $10 million -- so it the owner would have had to pay an additional $1.2 million in property taxes. But with 421-a, the owner still only had to pay $350,000. While the tax benefit decreases a bit each year, the owner will receive a partial exemption for 10 years, totaling about $9.2 million for a building where 2-bedrooms rent for more than $4,000 per month, and where there are no affordable units.*



336 Broadway, TriBeCa
Built in 2000; 15 stories; 155 resident units

Assessed value without 421-a exemption: $14,130,000

Assessed value with 421-a exemption: $6,246,000

Property taxes without 421-a exemption: $1,751,554

Property taxes with 421-a exemption: $774,254

Tax savings for property owner in 2006: $977,300
Lifetime Cost for building: $9,215,183

Condo: *At 85 Adams Street in Manhattan is currently being developed as the "Beacon Tower" condominiums. The lot had an assessed value of just $100,800 before construction began. As construction progresses on this 77-unit condominium, the property's estimated assessed value will rise to over $5.1 million in FY2008. Under 421-a, the owner will not be taxed for the $5.1 M increase in assessed value resulting from new construction. This translates into an estimated annual savings of over $550,000 (or over $9 million over the lifetime of the exemption). This benefit will be passed on to the buyers of the new luxury condo units. Because of the tax breaks – which last for 15 years – each buyer will be able to borrow more debt, and the developer is able to increase the sales price of each unit by tens of thousands of dollars. Prices for the units will range from $540,000 to $2.4 million.*

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Modest Options for Affordability

Thanks largely to the "exclusion zone" in Manhattan, where developers must develop or contribute to affordable housing to receive a 421-a tax break, a modest amount of affordable housing has been created through this program. The exclusion zone runs from 96th Street on the north, down to 14th Street on the East Side, and Houston Street on the West Side.

In this area, developers are not eligible to receive any 421-a property tax exemption as-of-right. If they include 20% affordable housing on-site, they are eligible for a 20-year tax exemption under 421-a (as well as additional tax-exempt bond financing and low-income housing tax credits, if they are constructing a rental project).

There is an off-site option as well. Developers who build 100% market-rate projects can purchase "negotiable certificates" from low-income housing developers in other parts of the City (most are built in the Bronx). For each affordable rental apartment constructed in the outer boroughs or outside the prime Manhattan areas, the builder gets five negotiable tax-abatement certificates. Each certificate entitles a market-rate developer to a 10-year partial tax exemption.

However, because there is little oversight of the certificate process and relatively few buyers and sellers, there is substantial concern that the certificates are undervalued. The Independent Budget Office has estimated that developers pay as little as 12 to 15 cents toward affordable housing for every $1 of tax break.

"Corona Towers"
38-19 108th Street, Corona
Built in 2003;
7 stories;
87 resident units

Condo prices:
1-bedrooms for $250,000
2-bedrooms for $350,000
3-bedrooms for $410,000

Assessed value without 421-a exemption: $3,897,000
Assessed value with 421-a exemption: $326,160

Property taxes without 421-a exemption: $446,167
Property taxes with 421-a exemption:$37,668

Tax savings for property owner in 2007 (est): $408,498
Lifetime cost of building: $14,514,803
Lifetime cost per unit:: $166,837

Even with these two affordability options, few affordable homes have been created. According to the IBO's 2003 report, only 8% (4,905) of the 60,000 units subsidized through the 10-, 15-, or 20-year 421-a programs between 1985 and 2002 were affordable to low- or moderate-income families (insufficient data is available on the 25-year exemption to determine affordability). And this was prior to a significant increase in 421-a projects awarded in the past four years, as the real estate market has boomed and affordability has diminished.

Developers outside of the exclusion zone have the option of extending the "as-of-right" benefit by 10 additional years (to 20 years in Manhattan below 110th Street, or 25 years elsewhere) if they include affordable housing on-site. However, few appear to have done so, and insufficient data is available to determine how many affordable units have been created in this way. In addition, some areas of the outer boroughs have been designated as "neighborhood preservation areas" where developers receive a 25-year exemption even for market-rate development.

Even when the program is used in the outer boroughs, it often benefits developers in neighborhoods where the market is hot, giving little in return to the communities. One example is a large cluster of buildings that have used the 421-a program in Corona and Jackson Heights in Queens. Because this area was declared a "neighborhood preservation area" in need of extra help, despite its strong housing market, developers are eligible for a 25-year tax exemption for building exclusively market-rate housing. As a result, taxpayers have subsidized dozens of market-rate development, to the tune of several million dollars, for buildings that are out of the reach of most neighborhood residents and would likely have been built anyway.

Recent Trends

Rising Costs to the City

The cost of the 421-a program to New York City, in lost tax revenues, has increased dramatically in recent years – almost tripling from $130 million in 2002 to $320 million in 2006. This reflects two trends:

* While the number of buildings receiving an exemption has re maimed relatively stable (20,975 exemptions were issued in 2001, compared to 19,119 in 2005), many more are large multi-family buildings . As a result, the number of exempt housing units increased by almost 50 percent over the past five years, rising from 32,449 to 48,078.

* As property values have skyrocketed, so has the value of the exemptions. The tax loss per unit almost doubled, from an average of $3,400 per unit in 2001 to $6,700 in 2005.

Disproportionate Benefits for Manhattan

The 421-a program increasingly benefits developers and owners in Manhattan, where the housing market is strongest and economic stimulation is least needed:

* Although Manhattan developers received just 23 percent of all 421-a exemptions in 2005, these exemptions accounted for 75 percent of the tax revenues lost under this program.

* Manhattan developers and owners received tax breaks worth $250.1 million in 2005, while those in the other four boroughs realized only $72.4 million in tax breaks;

* 421-a exemptions to Lower Manhattan buildings financed through Liberty Bonds can easily exceed $10 million in forgone taxes over the 20-year life of the abatement, although 95% of the units are market rate, and the remaining 5% are "affordable" to households earning over $100,000.

421-a Myth vs. Fact

Myth: New York City cannot change the 421-a program dramatically, because the City's housing market is too fragile to risk upheaval.
Fact: NYC's housing market is strong due primarily to dramatic population growth, which is projected to continue for several decades.

* The residential market added 52,000 between 2002 and 2005, the largest increase since 1991 as median monthly rents rose 5.4 percent.

* This housing boom is happening through the City. According to the Real Estate Board of New York, the average price of an apartment in Brooklyn climbed 35% in a single year, up to $478,000 in 2005 from 2004. Property values in Harlem have jumped more than 300% over the past decade.

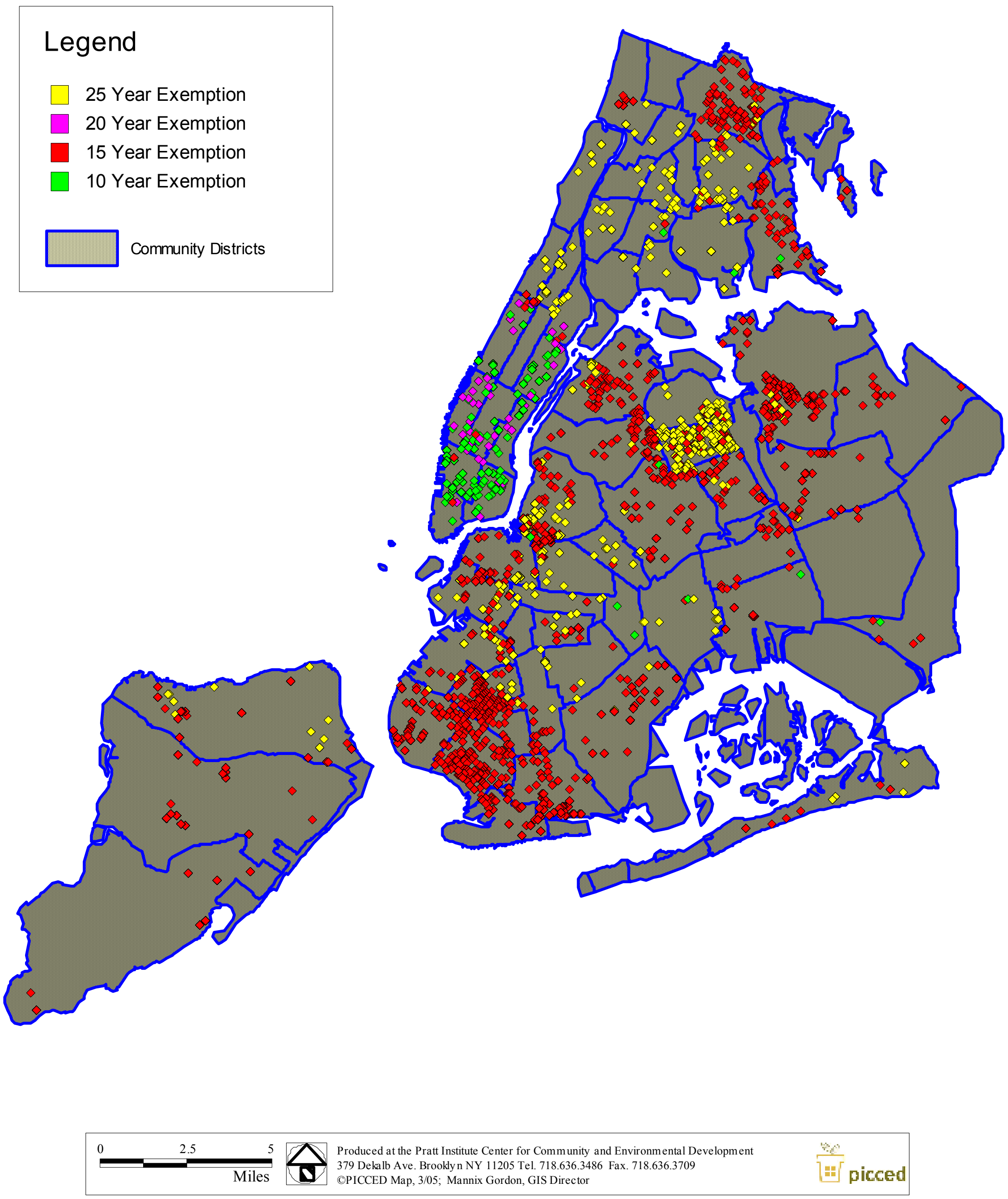
* The City's population grew by nearly 700,000 people (over 9%) from 1990 to 2000, to over 8 million people.

* New York City's population is projected to jump 16 percent over the next 25 years, reaching 9.5 million people by 2030. Both the Bronx and Brooklyn are projected to surpass their mid-20th century population peaks, and Queens and Staten Island will continue to grow beyond their already record size.

Myth: Without tax breaks, developers will stop building.
Fact: It is not necessary to provide a property tax exemption simply to encourage market-rate new construction in New York City.

Even from 1985 through 2002, before the recent boom, only 36% of new residential construction has taken place with 421-a, usually because developments were ineligible (e.g. if they were on land zoned for manufacturing and required a variance) or because developers chose not to use the program.

New York City
421a Units by Exemption Tenure

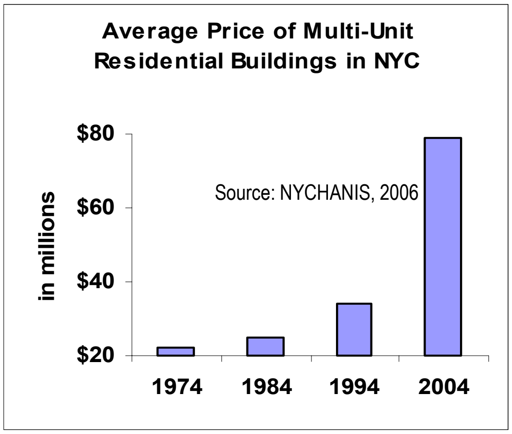


Source: New York City Independant Budget Office, FY 2004
NYC Dept. of Finance Tax Assessor Role FY 2004
NYC DCP Community Districts 2005

"Because our population is growing, demand has outstripped supply, and for many New Yorkers, incomes are not keeping pace with increasing rents. The problem before us is no longer abandonment but affordability." –

Mayor Michael Bloomberg, 2006

Trends in new housing starts indicate that housing production has little to do with the 421-a program. Housing starts plummeted in the 1970s and in the late 1980s and stayed low in the early 1990s. Production rose in the early 1980s, and again from 1995 through today. These changes bear no relationship to the 421-a program. Instead, they are due to broad changes in market dynamics, including population growth, gentrification and interest rates.



Myth: The 421-a program enables development in more difficult times and places.

Fact: The benefits of the 421-a program go primarily toward development in established neighborhoods and when the market is already strong.

In a recent analysis, *New York Observer* reporter Matthew Schuerman found that, of the 4,002 total buildings certified for 421-a exemptions by the Department of Housing Preservation and Development since 1987, over 80% (3,244) were approved after January 1999 (once the real-estate market had become quite healthy). A majority of the 421-a approvals (2,381) came in the past two years alone.

* Schuerman found that just a small portion were located in up-and-coming neighborhoods where development might need to be nourished. "Far from trailblazing," Schuerman concluded, "it looks as if the 421 program is merely gilding a well-traveled road."

Proposals for Reform

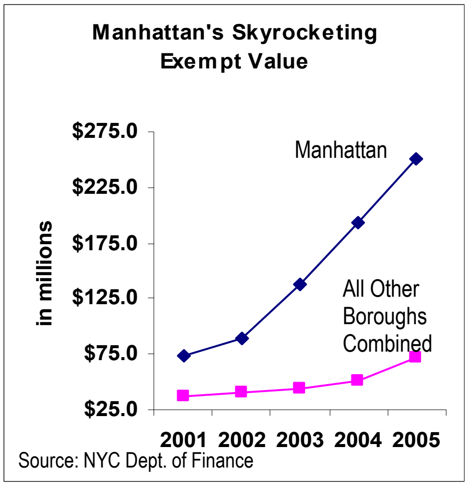
Over the next year, the City's 421-a task force will be examining a range of proposals for restructuring the 421-a program. Here are a few of the possibilities that are likely to be considered:

Abolish the 421-a tax exemption entirely, with resulting property tax revenues going into the City's general revenue fund, and/or to the New York City Affordable Housing Trust Fund to finance affordable housing.

* Reduce or cap the benefit that any individual building can receive, in order to level the playing field between Manhattan and the outer boroughs.

* Expand the "exclusion zone" to neighborhoods where subsidies are not necessary to stimulate housing production.

Other cities do not provide an as-of-right property tax exemption for new residential construction, and their housing markets have not suffered. Los Angeles provides a property tax exemption for new housing construction only if the development is fully affordable and owned by not-for-profits. Seattle requires that 20 to 30 percent of the units be affordable, and that affordable units and fixtures be substantially comparable to the market-rate ones.



* Require an affordable housing component as part of *every* newly developed residential project that receives 421-a benefits, anywhere in the City.

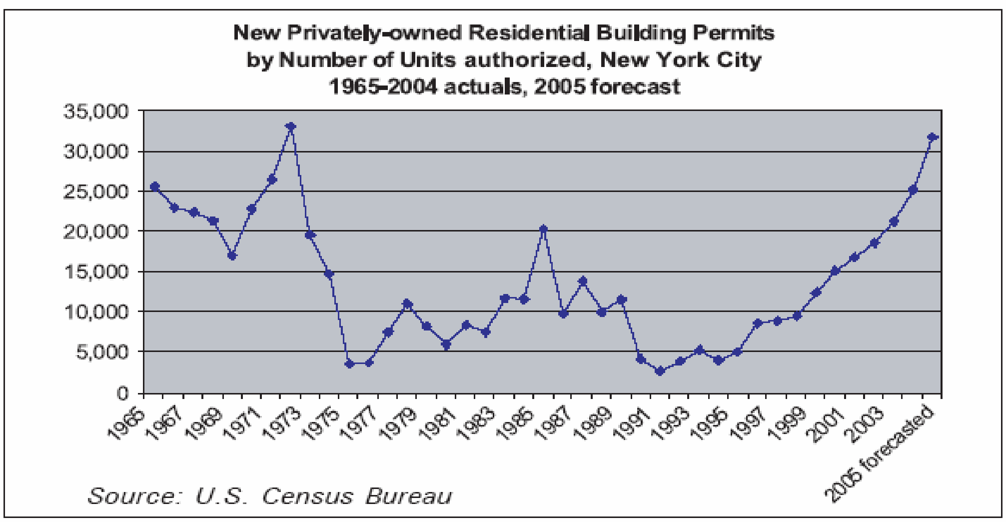
Part of the debate will focus on how developers meet the affordability component. Some proposals include:

* Create a sliding-scale of affordability, so that developers could choose to build a modest percentage of low-income units, or a higher percentage of moderate-income units.

* Require that *all* affordable units are included on-site and eliminate the "negotiable certificates" program.

* Allow off-site affordable housing, but improve oversight on the sale of certificates to increase their value, perhaps by having the City set a minimum price, and/or by tying the value of the certificates to the value of the tax exemption on the market-rate housing.

* Eliminate the certificate program and replace it with a requirement that developers make a "payment in lieu of taxes" (PILOT), which could be split between general revenues and the New York City Affordable Housing Trust Fund.



Conclusion

The 421-a program served a valuable purpose when it was designed in the 1970s as an antidote to abandonment. Times have changed dramatically, but 421-a has remained almost untouched.

In its present form, the 421-a program is a massive misuse of the tax dollars of New York City residents. It continues to subsidize luxury homes in expensive neighborhoods, with nearly 80% of the benefits going in Manhattan. It subsidizes buildings that would have been built anyway – at an annual cost to the City of $300 million and rising fast. And it creates very little affordable housing.

At the same time, New York City today faces a severe shortage of affordable homes, a crisis that tears apart vulnerable families, stresses communities, and discourages workers and businesses from locating in New York City.

Only with a strong set of reforms can the 421-a property tax exemption program to meet *today's* affordable housing needs.

182 Montague Street, Brooklyn Heights

Built in 2000;

34 stories; 192 units

Monthly Rents:

Studios start at $1,900, 1-bedrooms start at $2,100

2-bedrooms start at $3,850

Assessed value without 421-a exemption: $11,835,000

Assessed value with 421-a exemption: $1,056,300

Property taxes without 421-a exemption: $1,467,066

Property taxes with 421-a exemption: $130,938

Tax savings for property owner in 2006: $1,336,128

Lifetime cost for building: $16,742,855

Lifetime cost per unit: $87,202

SoHo Court 303 Elizabeth St., NoHo

Built in 1996, 12 stories, 195 residential units

Studios from $1,700/month,

1-bedrooms from $2,200/month,

2-bedrooms from $3,000/month

Assessed value without 421-a exemption: $16,425,000

Assessed value with 421-a exemption: $13,349,350

Property taxes without 421-a exemption: $2,036,043

Property taxes with 421-a exemption: $1,654,785

Tax savings for property owner in 2006: $381,258

Lifetime cost of building: $9,501,965

Lifetime cost per unit:: $48,728

147 Chambers

Built in 1997, 123 Residential Units

Income from units $3,441,495 in 2005

Tax savings for property owner in 2006: $459,148

Lifetime cost of building: $5,436,638

Lifetime cost per unit: $44,200

124 Hudson

Built in 2002, 26 units

3-bedroom for sale $3,345,000

Tax savings for property owner in 2006:

$710,044

Lifetime cost of building: $5,442,071

Lifetime cost per unit:: $209,310

“The Greenwich St. Project”

491 Greenwich Street

West Village/TriBeCa

Built in 2002, 14 stories, 22 condo units

Most recent sale $1.4 million, in 2004

Assessed value without 421-a exemption: $3,969,000

Assessed value with 421-a exemption: $441,540

Property taxes without 421-a exemption: $484,853

Property taxes with 421-a exemption: $53,938

Tax savings for property owner in 2005: $430,915

Lifetime cost of building: $2,819,449

“Beacon Tower” 85 Adams Street,

Downtown Brooklyn

Built in 2006; 23 stories; 77 resident units

1 and 2-bedroom for $540,000 to

$1,000,000.

Prices go up to $2.4 million.

Reforming New York City's 421-a Property Tax Exemption Program:
Subsidizing Affordable Homes, Not Luxury Developments

Habitat for Humanity-NYC and the Pratt Center for Community Development

Ten Examples of How 421-a Subsidizes Luxury Development in Expensive Neighborhoods

	Address	Borough	Units	Sample Prices		One-Year Tax Benefit*	Estimated Lifetime Benefit	
				Rent	Buy		Per Building	Per Unit
1	88 Leonard Street†	Manhattan	352	$12,500 for 3-bedroom		$761,913	$16,848,284	$47,864
2	199 Bowery	Manhattan	66		$975,000 for 2-bedroom	$493,671	$2,510,023	$38,031
3	336 Broadway	Manhattan	155	$2,150 for 2-bedroom		$977,300	$9,215,183	$59,453
4	147 Chambers Street	Manhattan	123	$2,400 average rent		$459,148	$5,436,638	$44,200
5	303 Elizabeth Street	Manhattan	195	$3,000 for 2-bedroom		$381,258	$9,501,895	$48,728
6	491 Greenwich Street	Manhattan	22		$1.2 for 2-bedroom	$454,754	$2,819,449	$128,157
7	124 Hudson Street	Manhattan	26		$3,345,000 for 3-bedroom	$710,044	$5,442,071	$209,310
8	85 Adams Street†	Brooklyn	77		$1,300,000 for 2-bedroom	$558,746	$9,325,980	$121,117
9	182 Montague Street	Brooklyn	192	$3,850 for 2-bedroom		$1,336,128	$18,160,066	$94,584
10	38-19 108th Street‡	Queens	87		$410,000 for 3-bedroom	$408,851	$15,101,037	$173,575
	Total for 10 Buildings		1295			$6,541,813	$94,360,626	
	Average per Building					$654,181	$9,436,063	$72,865

†85 Adams and 88 Leonard are in construction and estimated for FY2008.
‡38-19 108th Street is in construction and estimated for FY2007.
All other buildings are based on actual tax information from FY2006.

These buildings represent just 2% of the annual lost revenue to NYC through the 421-a program.