

## A Luxury Housing Subsidy New Yorkers Can't Afford

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

The tax abatement on new multifamily residential real estate development known as 421-a cost New York City nearly \$755 million last year in foregone taxes, or two-and-a-half times the level of property taxes forgiven under the program just five years earlier. The abatement, prized by the Real Estate Board of New York, expired last December. Now, the state legislature is poised to revive the tax break in exchange for the renewal of rent regulation, which expires June 15. As Albany trades 421-a renewal for the rent laws that protect the access to affordable housing of more than 1 million tenants in New York City alone, it is critical to understand the actual value of the tax abatement to developers and the ways in which the program as currently constructed gives out its benefits indiscriminately, in most cases without leveraging anything in exchange.

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The escalating cost of the 421-a program is driven by a number of factors. 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 based on property values that are far higher for sprawling luxury properties than for more modest ones in working-class neighborhoods. The latest version of the bill seeks to extend the abatement indefinitely for units that stay under rent regulation. What's more, a proposed expansion of 421-a would for the first time extend benefits to the conversion of commercial and industrial properties to residential use, effectively subsidizing the displacement of small businesses in mixed-use neighborhoods.

As currently designed, 421-a 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 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.

**The 421-a program has 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 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 the super-heated mid-Manhattan real estate market have been obligated to sponsor affordable

housing, equivalent to 20 percent of the total units they are building, in order to receive an abatement. However, in its entire history this program has sponsored the creation of just 5,700 affordable housing units. The tax abatement continues to be available automatically in most of the city, including areas where market demand is such that incentives may be unnecessary to attract development. Nearly 130,000 units currently receive 421-a benefits. Most

developers have no obligations around job quality in exchange for the benefit, in contrast with the mandate under federal housing subsidies to pay construction workers prevailing wages.

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.

“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.”

### 421-a Tax Abatements in Expanded “Exclusion Zone” July 2006 - June 2008

Permitted 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 Permit 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 New York City Department of Buildings.

\*\* Value calculated using an average of \$5,468 abatement granted to developed properties, multiplied by total number of units in planned developments.

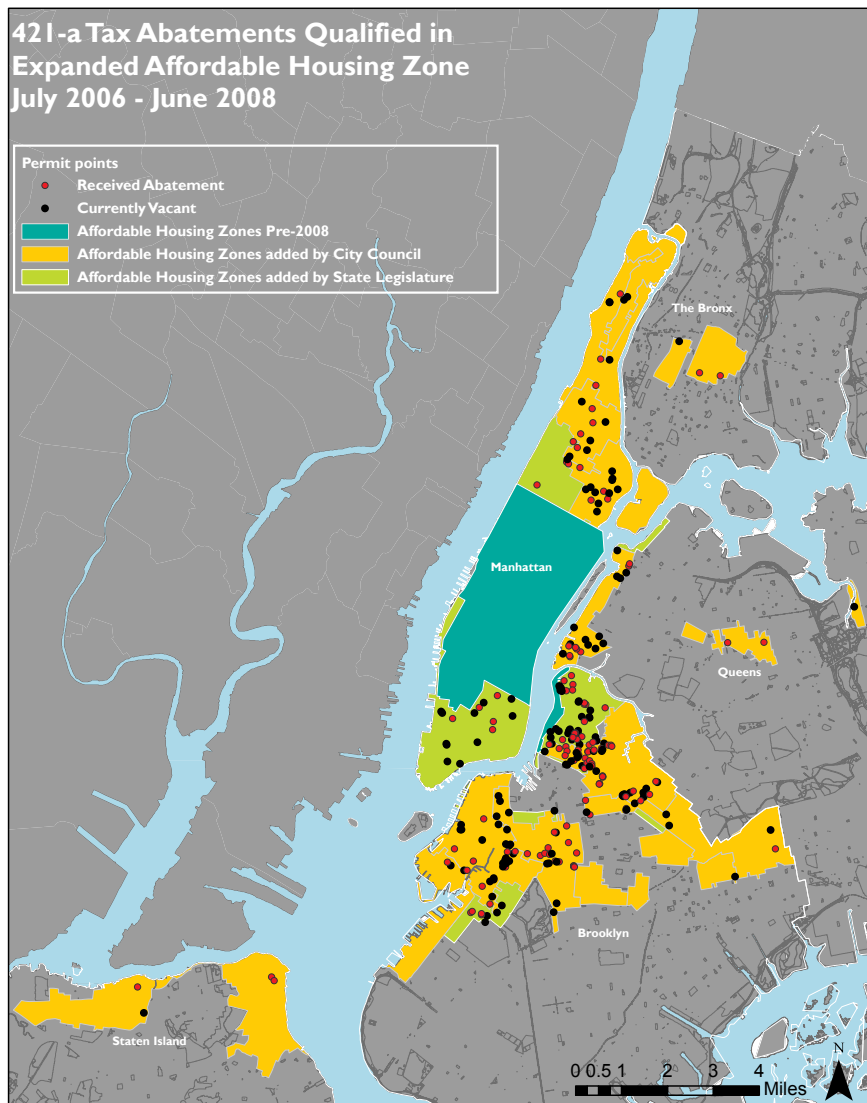
Unfortunately, projects built at the end of the boom were not covered by the expansion of the exclusion zone, and produced little or no affordable housing. In renewing the abatement in 2007, the state legislature determined that projects in the expanded exclusion zone had until June 30, 2008, to begin 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 7,800 permitted units, in the new exclusion zone areas. Of those, 123 sites are now built and occupied, totaling 2,219 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 \$158.7 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 \$30.9 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 reminder that the legislature must do more to ensure a future for 421-a as an affordable housing program.



This map shows the areas of New York City where the 421-a tax abatement is only available to developers who include or finance some affordable housing. In 2007, the City Council (green areas) and state legislature (yellow areas) sought to significantly expand the area where the affordable housing requirement applies. However, a loophole has allowed projects in these zones to proceed without affordable housing. Red dots show projects that have been completed and are currently receiving a 421-a abatement; black dots represent sites for future development that are exempt from the affordable housing obligation. Added together, the red and black dots represent \$60 million a year in abatements.

Source: NYC DOITT 2004, NYC DCP Pluto 2011, Department of Buildings Monthly Permit Reports July 2006 to June 2008.

## Recommendations

The 421-a tax abatement is an artifact of an era in which New York City sought 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 in fact 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.

**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 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 Assembly version of the 421-a renewal bill includes a requirement for prevailing wages on construction projects with 80 or more units where half or fewer of the units are affordable.

Realistically, 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 renewing 421-a—an expensive gift to real estate developers—needs to be counted as a very large bargaining chip, as well as an opportunity to better target its benefits.

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.