

421A DEVELOPER'S TAX BREAK

expiring June 2015

Fix it or End it.

The 421a Developer's Tax Break is well understood to be an inefficient giveaway for the real estate industry. The 421a is a real estate tax exemption that was originally put in place in 1971 to encourage new residential construction in the City at a time when the city economy and real estate market were stagnant.

While this may have been a legitimate concern in the 1970s, the City's housing market today is a far cry from what it was 40 years ago. The primary challenge we face today is not whether the market will, on its own, incentivize development; it will. Instead, we are faced with the dilemma of how to prevent the market from only building housing that fails to meet the needs of low-, moderate-, and middle-income people and the neighborhoods in which they live.

Thousands of affordable, rent regulated apartments are being lost each year through loopholes in the rent laws, leading to displacement of residents and gentrification of low- and mixed-income neighborhoods. If we continue to lose our existing affordable housing even as we create more, through tools like 421a, our city's affordability crisis will only deepen. We must prioritize New Yorkers' needs over the narrow interests of real estate developers and protect our rent regulated housing stock. Today's challenge is to ensure that the future of our neighborhoods is vibrant, inclusive, and equitable.

While the 421a Developer's Tax Break has been modified throughout the years, these changes have proven inadequate. The current version of 421a forfeits billions of dollars in public money for minimal public benefit in return.

In Fiscal Year 2013 alone, 421a cost \$1.1 billion in forgone tax revenue that would otherwise be available for public services like schools, infrastructure, hospitals –and affordable housing.

In exchange for this immense price tag, the city received relatively few affordable apartments, at rents too high to be truly affordable to the majority of average neighborhood residents.

Currently the 421a Developer's Tax Break has two different sets of requirements.

In the vast majority of the city, developers are eligible for the 421a Developer's Tax Break without providing any public benefit in return.

This system grants a tax exemption on market-rate units with no requirement to build any affordable housing, and often subsidizes the construction of luxury units in affordable low- and middle-income neighborhoods.

January 2015

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Limited areas of the City are within the “421a Geographic Exclusion Area” (GEA): Manhattan, and small parts of Brooklyn, the Bronx, Queens and Staten Island. In these areas developers that choose to take the 421a Developer’s Tax Break must make 20% of their residential units affordable to residents earning 60% of the Area Median Income (AMI), currently calculated by the US Department of Housing and Urban Development (HUD) as \$51,540 for a family of four. However even these affordable units are priced substantially above the rent levels affordable to New York City’s actual median household income where [60% of New York City’s actual median income is just \\$31,339](#).

The 421a Developer’s Tax Break is doubly inefficient and expensive to the taxpayer because it is generally used in combination with other affordable housing incentive programs. In particular, it is often paired with the City’s voluntary Inclusionary Housing Program (IHP) which allows developers to build more units than the current zoning would allow in exchange for making some of those units affordable.

When using both the 421a and Inclusionary Housing programs, developers get to “double-dip” by counting the same 20% set aside of affordable units twice under each program, rather than layering on additional affordable apartments for each new subsidy source.

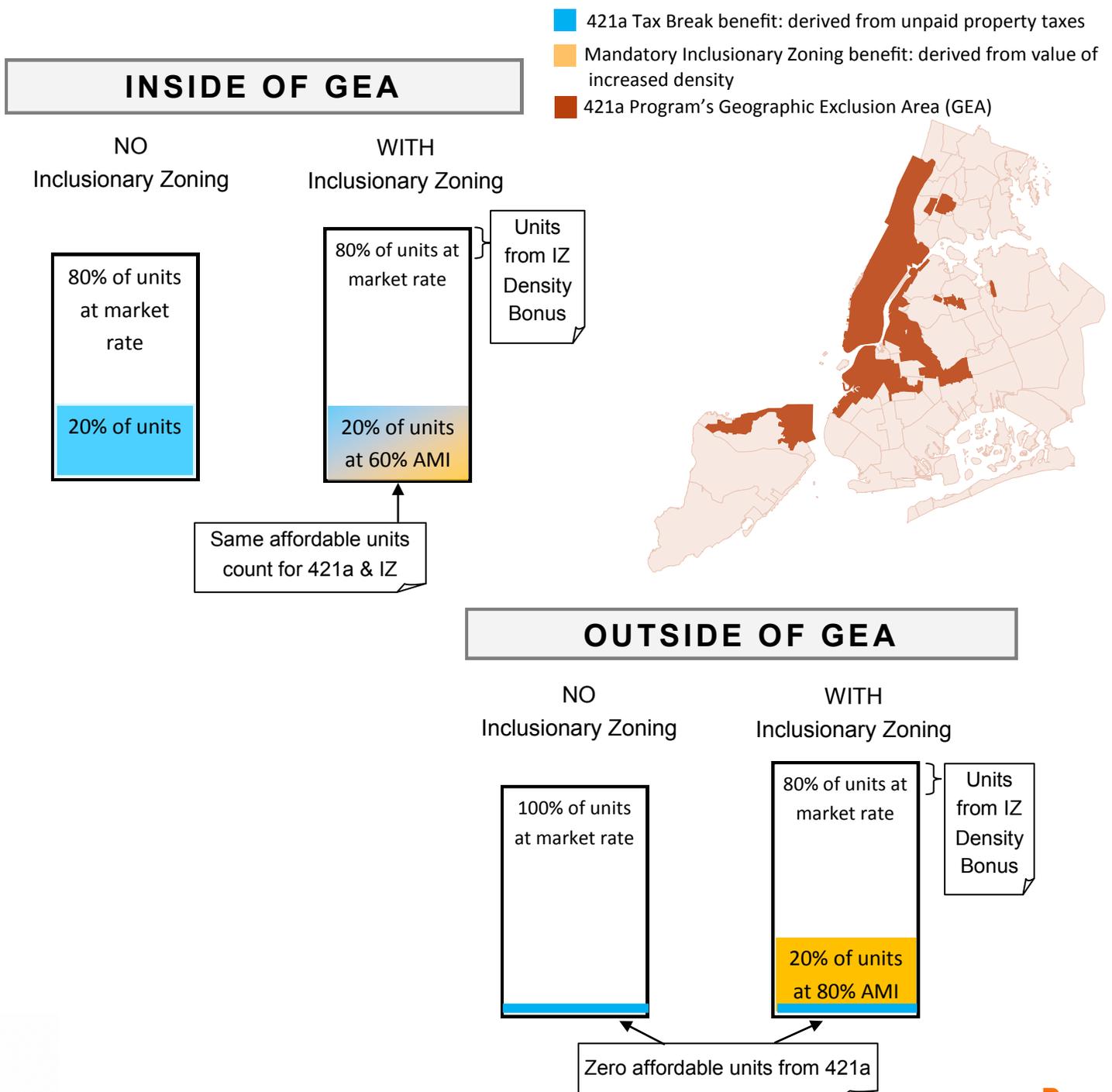
In some, developers are even “triple-dipping” by combining 421a, Inclusionary Housing, and subsidy money from the City’s Department of Housing Preservation and Development (HPD). This greatly diminishes the each housing program’s value to the public. The diagram on the next page illustrates why the current 421a Developer’s Tax Break doesn’t work and is both ineffective and inefficient for communities.

As it stands now, the 421a Developer’s Tax Break represents a windfall for developers, but a bad deal for New Yorkers. However, there is an upcoming opportunity to address these problems. 421a is scheduled to expire in June 2015, and must be renewed by the City Council and State government if the program is to continue.

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Current 2014 Situation:

WHY THE 421A DEVELOPER TAX BREAK DOESN'T WORK



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Serious consideration needs to be given to whether this overly generous property tax exemption that costs the city \$1.1 billion annually should be renewed at all. The current 421a Developer's Tax Break is tailor-made to encourage developers to build high-end luxury residential units. Since 421a tax exemptions are based on the tax value of new construction with an Assessed Value Cap, the tax exemption received by each residential development saves the most expensive properties the most money in unpaid taxes. Furthermore, since the value of the 421a tax exemption is set at the time of construction, the tax exemption becomes more valuable overtime as the property's assessed value increases. **It is deeply concerning that the City currently grants generous tax breaks to incentivize new market rate units that are increasingly priced for the top 15 percent of city earners.**

ANHD and housing groups across the City believe that the program should not be renewed, unless major changes are made so the tax break actually accomplishes a significant public purpose. We say:

.....▶ **Fix it or End it.**

If the 421a Developer's Tax Break is to continue in some form, we believe that City and State officials must go beyond making minor adjustments to the 421a GEA map or regulations, and instead substantially rethink how 421a can be made into an effective mechanism for creating affordable housing. This would change the 421a Developer's Tax Break from a program that primarily incentivizes the creation of luxury residential real estate development, into **a 421a program whose primary purpose is to incentive the creation affordable housing whenever luxury residential developments are built.** This shift is critical if we are to fix an outdated program based in the policy priorities of the 1970s real estate market and modernize it to meet New York City's booming 2010s real estate environment.

ANHD recommends that the City and the State make the following reforms to the 421a Developer's Tax Break in order to maximize the public benefit.

ANHD developed our 421a proposal by analyzing the current 421a Developer's Tax Break, citywide and local market-rate development trends, residential development proformas, multi-family residential development property taxes, market-rate and affordable housing construction costs, average rental prices, household demographics, and public NYC Department of Finance and HPD data.

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We first analyzed how much public benefit the current 421a Developer's Tax Break gives away. 421a cost \$1,062,900,000 in Fiscal Year 2013, as reported by the NYC Department of Finance. According to HPD, this \$1.1 billion grants tax exemptions to 153,121 residential units – both market-rate and affordable units. ANHD estimates that only 12,748 of those 153,000 are affordable units.

This indicates that only 8.6 percent of the 421a residential units that received a tax exemption in 2013 were affordable.

We created four fictional development projects in four different market scenarios – a “cool”, “medium,” “high,” and “very-high” neighborhood market. For each development prototype we estimated both how much in rents and how much in property taxes each building would pay if it were not receiving a 421a tax exemption. Market rents came from the latest Ellisman report. The property taxes were estimated based on the latest Department of Finance report.

We then estimated the degree to which different affordability scenarios would impact the cash flow of the building, and compared it to the tax burden of the building. We adjusted the percentage of affordable units set-aside, the level affordability, and the assessed value cap to test the financial feasibility of numerous different affordability requirement scenarios. This allowed us to determine the approximate level of affordability a building in each of the four market-typologies could support before it became more financially beneficial to pay property taxes. ANHD's 421a proposal ensures that developers are incentivized to use 421a, while maximizing the benefit to the public.

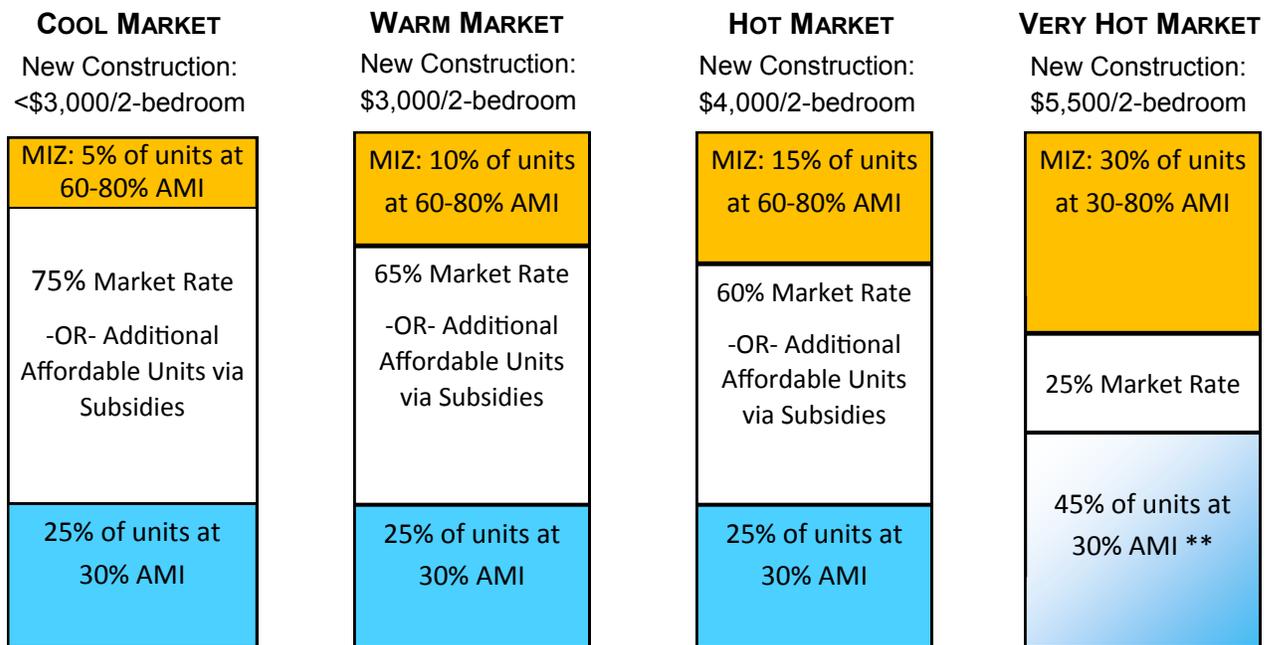
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PROPOSED:

421A TAX BREAK FOR AFFORDABLE NEIGHBORHOODS

- 421a Tax Break benefit: derived from unpaid property taxes
- Mandatory Inclusionary Zoning benefit: derived from value of increased density

CITYWIDE GEA — AFFORDABLE UNITS REQUIRED EVERYWHERE



**Designed to encourage developers to pay taxes rather than take 421a in hottest markets

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KEY REFORMS

BROADEN THE IMPACT BY REQUIRING A SET-ASIDE OF AFFORDABLE HOUSING EVERYWHERE IN THE CITY FROM THOSE DEVELOPERS THAT CHOOSE TO TAKE ADVANTAGE OF THE 421A TAX EXEMPTION.

The current Geographic Exclusion Area (GEA) is grossly misaligned with the actual reality of the City. One only needs to look at Central Brooklyn and Western Queens – substantial parts of which were left out of the current GEA – for examples of neighborhoods where previously ‘cool’ real-estate markets are now booming with new residential developments. Regrettably, in these areas we are currently giving away enormous 421a tax breaks for all-luxury developments and increasing area rental prices, with no affordable housing required.

The real estate industry advocates for tax breaks on the premise that it makes market-rate development more financially feasible. But rather than make these new residential developments financially feasible, these NYC tax-payer funded 421a tax exemptions are just increasing profits for real estate developers. Conventional market-rate housing development should benefit the public by paying property taxes to cover the additional infrastructure, police, schools, parks, health and other city services costs that need to be covered when there is new development. If a new development is exempted from paying taxes, it must be because it provides a substantial public benefit of the affordable housing needed by neighborhood residents. Under the current 421a Developer’s Tax Break, we get neither of these public benefits. Inside the GEA the affordable housing we get is priced at rents unaffordable to average local residents. Outside GEA, we simply get high-rent luxury housing that pays no taxes. **On-site affordable housing units should be required everywhere in the City in order to get a 421aTax Break.**

Under the current system, the affordable housing that is developed in neighborhoods outside the GEA with cooler real estate markets is affordable housing built with direct City subsidy that would not be affected by changes to the Geographic Exclusion Area one way or another. In fact, all the 421a Developer’s Tax Break does in these neighborhoods is make all-luxury development more competitive and therefore more likely to be built than City-sponsored affordable housing. The correct formula is simple: **if a market can support the type of high-rent luxury housing that usually gets built using the 421a Developer’s Tax Break, it can also support either its fair share of property taxes or affordable housing that serves community needs.**

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DEEPEN THE AFFORDABILITY LEVEL SO THE AFFORDABLE UNITS ARE PRICED FOR THE MORE THAN 1/3 OF NYC HOUSEHOLDS THAT EARN LESS THAN \$35,000 A YEAR.

The 421a Developer's Tax Break is uniquely suited to efficiently create housing at low-income levels, so revamping 421a presents a crucial opportunity to build units for lower-income New Yorkers who are left out of many existing affordable housing programs. Currently, where affordable apartments are created under 421a, they serve people with incomes at 60% of HUD Area Median Income (AMI), which is over the actual median NYC household income. This means that even the affordable units from the current 421a Developer's Tax Break are unaffordable to nearly half of the City's households. In order to be a more effective and impactful affordable housing program, affordable 421a units must have lower rents and be more deeply affordable for local residents.

The 421a development underwriting is capable of targeting deeply affordable levels because the difference in cost to the developer of bringing an affordable unit to a lower AMI level (for example, from 60% to 30%) is minimal once that unit has been taken out of market level and into an affordability requirement. The tradeoff for reaching down to a lower AMI level is very good – reducing AMI's from 60% to 30% only costs a few units in terms of balancing project costs. Our model therefore prioritizes the lower AMI level that actually meet residents' affordability needs over simply maximizing the number of units produced, while still ensuring that 421a will create substantial amounts of new affordable housing. By setting the affordability requirement at 30% of AMI, the affordable units created using 421a would [meet the affordability needs of the more than 1/3 of New York City households that make less than \\$35,000 annually.](#)

MAXIMIZE PUBLIC BENEFIT BY PROHIBITING DOUBLE-DIPPING OF AFFORDABLE UNITS WHEN USED IN CONJUNCTION WITH OTHER AFFORDABLE HOUSING SUBSIDIES.

The 421a Developer's Tax Break is often paired with other affordable housing subsidies, particularly the voluntary Inclusionary Housing Program. Developers use 421a plus the added value from a density bonus under the Inclusionary Housing Program to count the same 20 percent set-aside of affordable housing units for both programs, leaving the City, tax payers, and the community with half the public benefits. Furthermore, 421a is also paired with direct subsidy sources such as Low income Housing Tax Credits, bonds, etc, which leads to similar double- and even triple-dipping. The 421a Developer's Tax Break must be revamped to prevent this double-dipping so that more subsidy means more affordable apartments.

In addition, because 421a and Inclusionary Housing are likely to be used together in many buildings, and because Inclusionary Housing is currently underwritten to target the moderate-income level, our proposed lower AMI requirement for the 421a will help ensure that New York's affordable housing programs serve a wider range of need, and will encourage the creation of more truly mixed-income developments.

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PRESERVE 421A'S PUBLIC IMPACT BY REQUIRING THAT ALL AFFORDABLE UNITS BE PERMANENTLY AFFORDABLE.

The affordable units created through the 421a Developer's Tax Break should be made permanently affordable. The city has made laudable progress towards incorporating the principle of permanent affordability into its current affordable housing programs, having learned important lessons from the crisis of expiring affordability in housing built under earlier models. In order to ensure that any future 421a program creates stable and sustainable affordable communities, the affordable units must be permanently affordable. The design of the 421a Developer's Tax Break presents particular complications for structuring permanent affordability, but innovative solutions, such as a continuing tax break limited to only the affordable units, can and should be put in place.

PROMOTE MIXED-INCOME COMMUNITIES BY REQUIRING ALL 421 AFFORDABLE UNITS BE ON-SITE, BUILT WITHIN THE SAME BUILDING SYSTEMS, AND INTEGRATED.

The goal of fixing the 421a Developer's Tax Break is to leverage the City's strong housing market to incorporate low-income housing into all of the city's neighborhoods, and to encourage the creation and retention of mixed income communities. Off-site options and other flexible mechanisms undermine that purpose, and create the potential for abuse. 421a currently also allows for the unfair and unequal treatment of affordable tenants through limiting access to building amenities, creating 'poor-doors,' and physically differentiating between affordable units and market-rate units. No developer is forced to take advantage of the 421a Developer's Tax Break. Developers who do not want to include affordable units in their developments should simply opt-out and be required pay their taxes. We cannot afford to grant tax breaks to development projects that further reinforce a tale of two cities.

ENSURE COMPLIANCE BY CREATING A PER-UNIT FEE TO FUND TRACKING OF UNITS, AND ENFORCEMENT OF REGULATIONS AND TENANTS' RIGHTS IN 421A AFFORDABLE UNITS.

ANHD has found that the 421a Developer's Tax Break is currently lacking in basic mechanisms to keep track of affordable units created under 421a, and there is insufficient accountability to ensure that landlords are abiding by their obligations to tenants in affordable 421a apartments. Initial reviews of developments currently receiving a 421a tax exemption have found cases where tenants were provided incorrect leases that did not accurately reflect the units' affordability regulations. We recommend creating a per-unit compliance fee, similar to the one currently required as part of the LIHTC tax credit compliance process. This fee could then be used to offset the costs for HPD to track units created, and enforce the rights of tenants in affordable 421a Program apartments.

With 421a set to expire in June 2015, the City and the State have an opportunity to transform the 421a Developer's Tax Break to ensure that new development projects create affordable housing benefits for local communities. The City can and should create deeply affordable housing in all five boroughs, and create and preserve thriving mixed-income communities throughout the city.