Tax Expenditure Reform:

NYC’s 421-a Property Tax Expenditure Experience

NYC Office of Management and Budget

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Federation of Tax Administrators
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I. Introduction

I. Introduction

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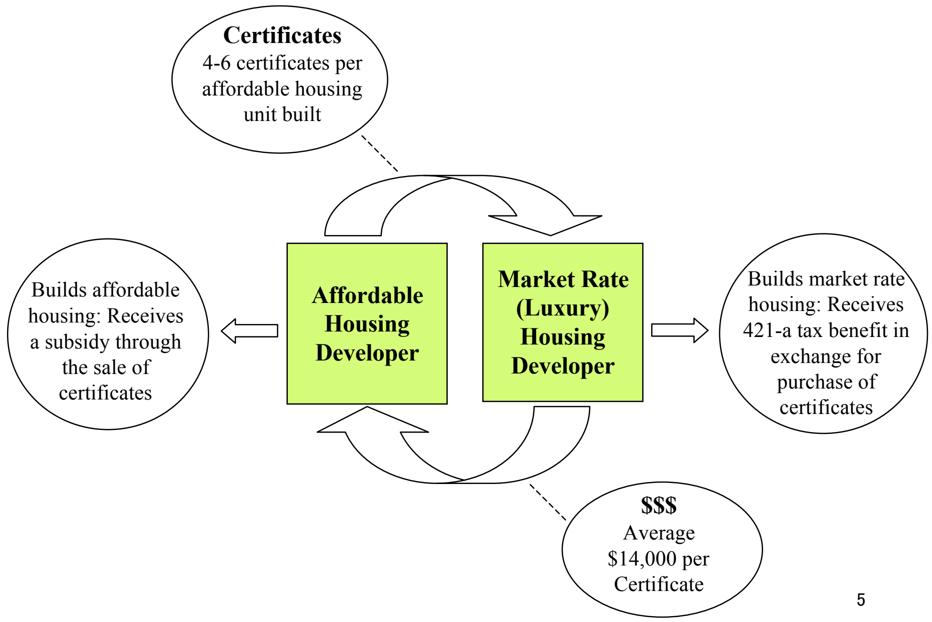
I. Introduction: 421-a Program Overview

- Created in 1971 as a property tax exemption to stimulate the development of multiple-unit residential housing. Initially provided a 10-year as-of-right benefit citywide.
- Mid-1980's changes made to:
  - Leverage the creation of affordable housing.
    - **Geographic Exclusion Area** established in Manhattan (high value market). **Certificate purchases** required to receive benefits. Certificates are purchased to finance off-site affordable housing units.
  - Further spur housing creation in lower value markets.
    - Extend as-of-right benefit to 15 years in outer boroughs and northern Manhattan.
    - Introduced extended benefits within NPP/REMIC areas.
- Early 90's further changes made to spur on-site affordable units through extended benefits, the 20- and 25-year programs, for 80/20 buildings.

I. Introduction: GEA and Benefit Type

Location	As-of-Right Benefit	With Certificates	80/20
Manhattan GEA	N/A	10yrs	20yrs
Manhattan Non-GEA South of 110th St.	10yrs	N/A	20yrs
Manhattan Non-GEA North of 110th St.	15yrs	N/A	25yrs
Outer Boroughs	15yrs	N/A	25yrs
Greenpoint Williamsburg GEA	N/A	15yrs	20yrs

I. Introduction: Certificate Program



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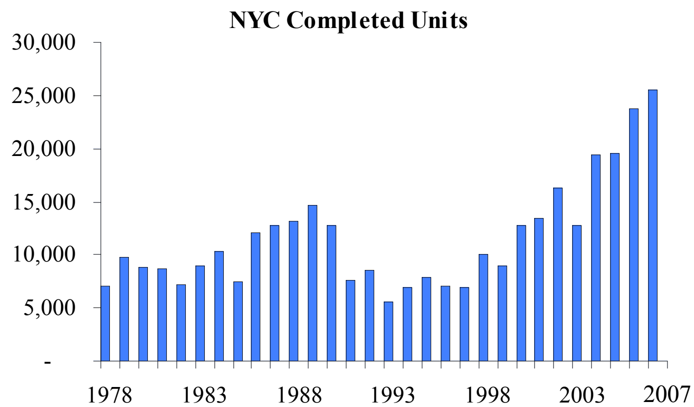
I. Introduction: Criticism of 421-a Program

1. **The economics of NYC housing has changed drastically since the 1970s.**



Source: NYC Rent Guidelines Board: "2008 Housing Supply Report", June 3rd, 2008

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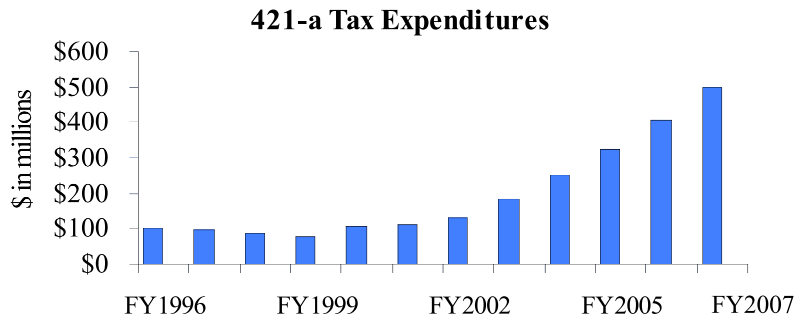
I. Introduction: Criticism of 421-a Program

2. Tax expenditures have ballooned, as the recent housing boom has accelerated.



Source: DOF Tax Expenditure Report Fiscal Year 2007

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I. Introduction: Criticism of 421-a Program

3. Outdated GEA Boundaries

- In today's strong housing market, critics argued, additional neighborhoods do not require as-of-right benefits to spur housing production. The GEA needs to be expanded.
- Even in non-GEA neighborhoods, high valued properties continue to receive disproportionately generous benefits. The structure of the tax exemption, based on DOF assessed values, results in higher valued properties getting higher dollar values of benefit.

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I. Introduction: Criticism of 421-a Program

4. Negotiable Certificate Program is Inefficient

- The certificate program does not efficiently capture for the City the value of benefit received by market-rate developers.

- The following table outlines the results of an analysis of 17 condo and 12 market-rate rental projects that purchased negotiable certificates and had begun to receive 421-a benefits between 2002 and 2006:

Average Benefit per certificate:	$70,878
Median Benefit per certificate:	$66,296
Average certificate price:	$11,440
Ratio of Price to Avg Benefit:	16%

Source: HPD

- Also, the higher the property values are, the greater the benefits received.

Sales Price	NPV of Tax Benefit
$600,000	$35,657
$800,000	$43,543
$1,200,000	$71,315
$1,800,000	$106,972
$2,500,000	$148,572

Source: HPD

I. Introduction: Criticism of 421-a Program

Example: 845 UN Plaza – a typical luxury condo

BBL	1-1340-1373	
Sale Date	6/28/2006	
Sale Price	$13,500,000	
Residential Square Footage	5,428	
Number of Certificates	5	(1 certificate per unit up to 1,200 sq ft)
Average Certificate Price	$14,000	(in 2006)
Total Cost of Purchasing Certificates	$70,000	(one time cost)
Total 421-a benefit received in FY2005-2009	$749,834	
Total 421-a benefit expected by FY2013	about $1,000,000	

I. Introduction: Criticism of 421-a Program

5. NPP / REMIC

- NPP/REMIC areas were considered to be significantly distressed in the 1980s, requiring extensive tax benefits to spur development. All developers receive maximum 421-a benefits without any affordable housing creation requirement.

- The economics of housing development in much of the NPP/REMIC neighborhoods has significantly improved. The justification for the maximum 421-a benefit with no affordable housing component in these areas is no longer present.

I. Introduction: Criticism of 421-a Program - NPP and REMIC

Source: HPD

I. Introduction: Charge of 421-a Task Force

- In October 2005, Mayor Bloomberg announced a $200 million expansion to his affordable housing program.
- In February 2006, Mayor Bloomberg announced the creation of the 421-a Task Force, made up of a diverse group of:
  - for-profit and non-profit developers
  - housing advocates
  - lenders
  - City Council representatives
  - staffed by HPD, DOF and OMB
- They met regularly over a 6 months period to analyze a variety of reform proposals.
- In October of 2006, the Task Force issued a final report.

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II. Task Force Policy Options

II. Task Force Policy Options: Summary

Reform Proposals Recommended by the Task Force:

- **Expand the Geographic Exclusion Area (GEA)**
  - Expand GEA to lower Manhattan and into northern Manhattan
  - Expand GEA to Brooklyn/Queens waterfront and into Brooklyn
- **Impose a Cap on the Building Exempt Assessed Value**
  - The Cap establishes a maximum per unit exempt building assessed value of $100,000, limiting the benefit received by high value buildings.
- **Eliminate the Negotiable Certificate Program**
  - Market rate developers in the GEA would no longer be eligible for the 10-year benefits through certificate purchases.
  - Create a Housing Trust Fund to spur affordable housing.
- **Eliminate Benefit for 3-5 Family Homes**
- **Eliminate Benefit for NPP and REMIC Areas**

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II. Task Force Policy Options: Expand the Geographic Exclusion Area

- DOF provided sales price data by neighborhood and building type to HPD.
- HPD calculated the Return on Cost for condo development by neighborhood and building type, using land acquisitions cost, hard construction costs and condo sales prices. This analysis was carried out for developments with and without the 421-a benefit.
- The Task Force recommended expanding GEA to neighborhoods where sales prices would support development without the as-of-right 421-a benefit.

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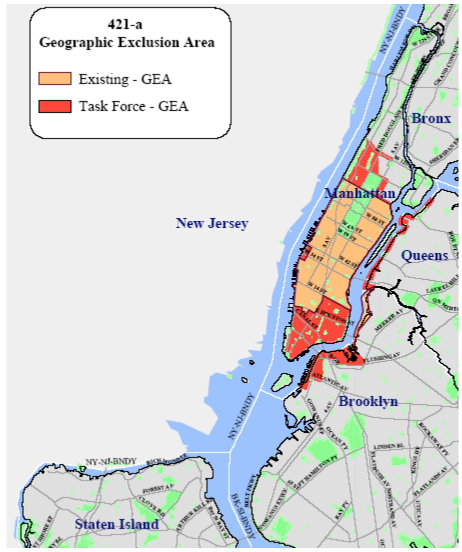
II. Task Force Policy Options: Expand the Geographic Exclusion Area

Expand the GEA to areas with high sales prices, rents and densities.

Expand GEA to:

- All of Lower Manhattan
- East Harlem: to 97th St. east of Park Ave. and to 111th St. west of Park Ave
- Central Harlem: to 111th Street east of St. Nicholas Ave; along St. Nicholas Ave to 126th Street; between 124th St. and 126th St. from St. Nicholas to 5th Ave.
- West Harlem: to 126th St. west of St. Nicholas Avenue
- Waterfront blocks from Astoria to Carroll Gardens
- Brooklyn Heights and DUMBO



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II. Task Force Policy Options: Impose a Cap on the Building Exempt Assessed Value

- Set a $100,000 cap on the Billable Exempt Assessed Value per unit for 421-a tax exemption.
- Buildings with at least 20% of the units dedicated to affordable units (80/20 buildings) would be exempt from the AV cap.
- Of the 28,552 newly constructed 421-a units from 2004 through 2006, this cap would have affected only 4,284 units or 15%. Of these affected units most, 4,144 or 97% were in the GEA, while 40% were condos and 60% were rentals.

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II. Task Force Policy Options: Eliminate the Negotiable Certificate Program

- Eliminate the 421-a negotiable certificate program and create a $300 million dedicated affordable housing fund.
- No tax benefit to developers inside the GEA without onsite affordable housing.
- The dedicated affordable housing fund will be:
  - Insulated from the appropriation process
  - Targeted to high-poverty districts citywide

Rationale

- Certificates are inefficient at spurring affordable housing development.
- Affordable housing fund will encourage a broader spectrum of participants and more diverse projects than certificate program.
- The affordable housing fund is not vulnerable to down cycles in the housing market.

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II. Task Force Policy Options: Eliminate Benefit for 3-5 Family Units

- 3-unit properties are assessed and taxed at a lower level than are multiple dwellings (Class 1 assessment and taxation).
- Consistent with the assumed expiration of the 421-b tax incentive.
- New properties with fewer than six units account for approximately 59% of new buildings, but only 12% of all new units receiving 421-a tax benefits.
- Increasing the minimum number of units will greatly ease the administrative burden of 421-a, since each application uses the same amount of staff resources.

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II. Task Force Policy Options: Eliminate Benefit for NPP and REMIC Areas

- Repeal eligibility for developments within Neighborhood Preservation Program (NPP) and Residential Mortgage Insurance Corporation (EMIC) areas to receive extended benefits without providing 20% affordable or using substantial government assistance.

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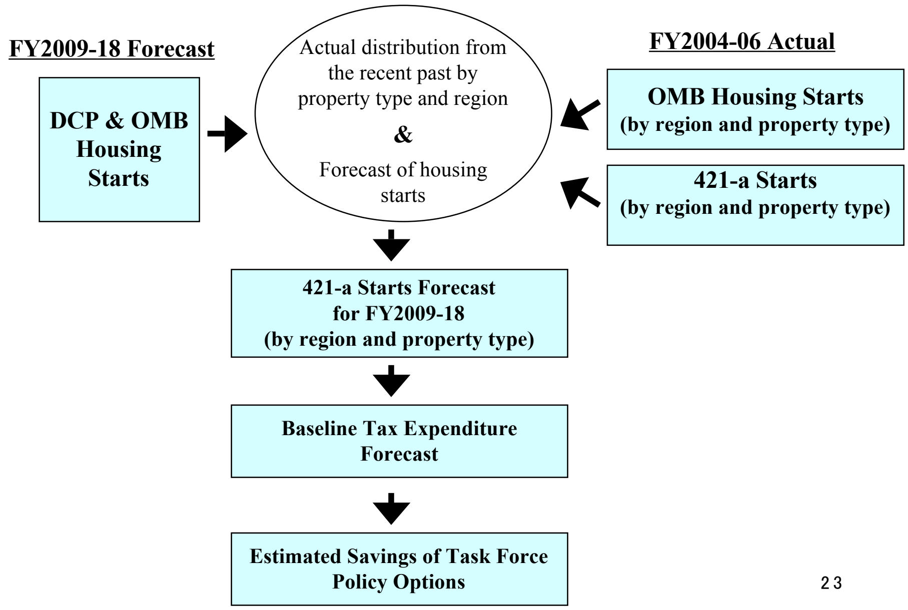
III. Tax Expenditure Savings

III. Tax Expenditure Savings: Methodology Summary



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III. Tax Expenditure Savings: Forecast of Housing Starts FY2009 – FY2018

- **History:** FY1971 – FY2000 completed units from NYC Rent Guideline Board's "Housing Supply Report", based on Certificates of Occupancy data.
- **DCP Forecast:** FY2001 – FY2010 Department of City Planning (DCP) provided a forecast of citywide housing starts in 5 year increments FY2005, FY2010.
- **Outyear Forecast:** FY2011 – FY2017 OMB estimated based upon Economy.com forecast of household formation used in the Hudson Yards demand study.

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III. Tax Expenditure Savings: Forecast of Housing Starts FY2009 – FY2018

DCP 2001-05, 2006-10. Economy.com 2011-2017.

	New York City				
	(A)	(B)	(C)	(D)	(E)
Calendar Year	Completed units	Average Households	Change in Households	Surplus Units	(A)/(C)
1971 - 1980	164,609	2,814	-49,774	214,383	-3.3
Annual Average	16,461		-4,977		
1981 - 1990	108,253	2,826	35,090	73,163	3.1
Annual Average	10,825		3,509		
1991 - 2000	82,489	2,935	210,990	-128,501	0.4
Annual Average	8,249		21,099		
2001 - 2010 (f)	154,125	3,094	105,783	48,342	1.5
Annual Average	15,413		10,578		
2001 - 2005	92,615	3,072	41,000	51,615	2.3
Annual Average	18,523		8,200		
2006 - 2010 (f)	61,510	3,117	64,783	-3,273	0.9
Annual Average	12,302		12,957		
2011 - 2017 (f)	30,926	3,184	58,900	-27,974	0.5
Annual Average	4,418		8,414		

III. Tax Expenditure Savings: OMB Housing Starts

- The problem with the DCP forecast is that despite detail by region, no building type detail was available. Created an OMB housing start with both.
- OMB Housing Start is based on DOF RPAD Recordbook File.

  - **New Units**: Parcels whose billable building assessed value field turns from missing or zero to positive in DOF Recordbook data.

  - **Conversions/Add-Ons**: Parcels whose unit number field increases by one or more for Class 1 properties; parcels whose unit number field increases by two or more for other properties. Only the increment in units are counted as starts.
- Compared OMB Housing Starts to DOB new units, DOF Final Roll new units and found reasonable match.

III. Tax Expenditure Savings: OMB Housing Starts

Housing Starts Data Comparison

Housing Supply Report /Rent Guideline Board		DCP Forecast		OMB Starts based on DOF Recordbook	
CY2000	12,794	CY2000	N/A	FY1999	N/A
CY2001	13,480	CY2001	18,523	FY2000	10,984
CY2002	16,228	CY2002	18,523	FY2001	16,786
CY2003	12,779	CY2003	18,523	FY2002	19,210
CY2004	19,366	CY2004	18,523	FY2003	19,180
CY2005	19,493	CY2005	18,523	FY2004	22,267
CY2006	23,768	CY2006	12,302	FY2005	24,113

- Housing Supply Report by RGB is based on certificates of occupancy, issued by Department of Buildings. Does not reflect all units. Data is not available by region and type of property.
- DCP forecast relies on the Housing Supply Report but adds additional data compiled by DCP and has region detail.
- OMB starts data from DOF file includes all parcels added on the final roll each year. May lag the Housing Supply Report.

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III. Tax Expenditure Savings: 421-a Starts

- We needed 421-a Starts by region, building type and 421-a program type.
- We turned to DOF RPAD Recordbook and crafted a definition of 421-a Starts by region and building type.
- We assume that future cohorts of 421-a Starts will follow the pattern of the most recent actual data on participation of 421-a Starts to OMB Housing Starts (FY 2004 – FY 2006).
- The future 10 years of 421-a Starts were derived by distributing the DCP Housing Starts forecast into the five regions and building types using the participation rate of 421-a Starts to OMB Housing Starts by region and by building type in FY 2004 through FY 2006.

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III. Tax Expenditure Savings: 421-a Starts

Distribution of DCP Starts by 421-a Participation Rate by Region and Building Type

	(A)	(B)	(C)	(D)	(E)	(F)	(G)
	2004-2006 421-a Starts		2004-2006 OMB Starts		421-a Participation Rate (A)/(C)	DCP FY09 Forecast Starts by Region and Building Type (F)=(D)*DCP	421-a Starts (E)*(F)
	Average	Share	Average	Share			
Manhattan Old GEA							
1-3 family	-	0.0%	4	0.0%	0.0%	2	-
Condos	743	7.8%	1,652	6.0%	45.0%	744	334
Rentals	3,045	32.0%	3,775	13.8%	80.7%	1,699	1,370
Total	3,788	39.8%	5,431	19.9%	69.7%		
Manhattan New GEA							
1-3 family	-	0.0%	89	0.3%	0.0%	40	-
Condos	259	2.7%	542	2.0%	47.8%	244	117
Rentals	944	9.9%	2,849	10.4%	33.1%	1,282	425
Total	1,203	12.6%	3,480	12.7%	34.6%		
Manhattan Non-GEA							
1-3 family	-	0.0%	20	0.1%	0.0%	9	-
Condos	106	1.1%	154	0.6%	68.8%	69	48
Rentals	133	1.4%	1,117	4.1%	11.9%	503	60
Total	239	2.5%	1,291	4.7%	18.5%		
Outer Borough New GEA							
1-3 family	-	0.0%	2	0.0%	0.0%	1	-
Condos	11	0.1%	52	0.2%	21.2%	23	5
Rentals	31	0.3%	83	0.3%	37.3%	37	14
Total	42	0.4%	137	0.5%	30.7%		
Outer Borough Non-GEA							
1-3 family	883	9.3%	8,141	29.8%	10.8%	3,664	397
Condos	1,446	15.2%	1,873	6.9%	77.2%	843	651
Rentals	1,916	20.1%	6,981	25.5%	27.4%	3,142	862
Total	4,245	44.6%	16,995	62.2%	25.0%		
Citywide Total							
1-3 family	883	9.3%	8,256	30.2%	10.7%		
Condos	2,565	27.0%	4,273	15.6%	60.0%		
Rentals	6,069	63.8%	14,805	54.2%	41.0%		
Total	9,517	100.0%	27,334	100.0%	34.8%	12,302	4,283

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III. Tax Expenditure Savings: Baseline Tax Expenditure

- Ten years of new cohorts of 421-a starts by region and building type were added starting in FY 2009.
- New 421-a starts were assigned an average building exempt AV (BEAV) based upon the 421-a starts (FY 2004 - FY 2006) average BEAV by region and building type. The average BEAV was grown by 3% per year.
- The Class 2 tax rate for FY 2007 with a 5% cap (.12891) from the July 2007 tax fixing resolution was used.
- NPV calculation completed for 12 years (FY 2009 through FY 2018) and 22 years (FY 2009 through FY 2028) back to FY 2007 dollars.
- NPV calculation made using a 6.5% discount rate.

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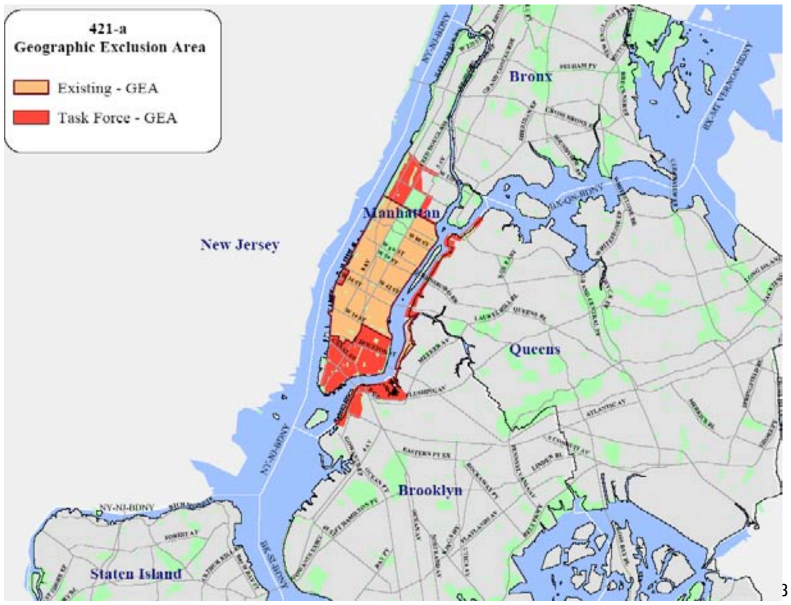
III. Tax Expenditure Savings: Estimated Savings of Task Force Policy Options

- Estimation of New GEA Tax Expenditure Estimates
  - The new GEA has no independent impact on tax expenditure savings because as-of-right benefit terms are not changed.
- AV Cap Imposed at $100,000
- Elimination of the Certificate Program
  - All market rate condos and rentals within the old and new GEAs are assumed to be dropped from the 421-a program.
- Elimination of 3-5 Unit Buildings
  - All 3-5 unit rental and condo buildings are assumed to be dropped from the 421-a program.
- Elimination of NPP/REMIC

III. Tax Expenditure Savings: Estimated Savings of Task Force Policy Options

- The present value of the 20-year tax expenditures savings on new 421-a developments over next 10 years is estimated to be about $500 million.
- $200 million of savings were already budgeted as additions to the capital plan announced as part of the Mayor's expansion of the New Housing Marketplace Plan October 2005.
- $300 million of the savings were budgeted to replace the certificate program with a dedicated fund for affordable housing.

III. Tax Expenditure Savings: Estimated Savings of Task Force Policy Options



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III. Tax Expenditure Savings: Estimated Savings of Task Force Policy Options

($ in millions)	Task Force Recommendations
New GEA	$1
AV Cap	$137
Elimination of Certificates	$288
Removal of 3-5 Family Homes	$49
New Housing Marketplace Expansion	($200)
Housing Trust Fund	($300)
Net Savings/(Cost) of Reform	**($25)**

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IV. Political Process

IV. Political Process: Overview

- **Task Force Recommendation**: In October of 2006, Task Force made recommendation to Mayor, the City Council.
- **City Council Legislation**: City Council amends local law and is signed by the Mayor on Dec. 28th, 2006 .
- **State Legislature**: State Legislature expands/amends local law as well as underlying authorizing legislation by June 30th, 2007.
- **30 Day Amendment**: 30 Day Amendment compromise crafted August 2007.
- **Final Bill**: Final 421-a legislation signed by the Governor February 19th, 2008.

IV. Political Process: Program Reform and Political Negotiations

($ in millions)	Task Force Recommendations	Council Proposal	
New GEA	$1	$1	
AV Cap	$137	$141	($65,000 AV Cap)
Elimination of Certificates	$288	$288	
Removal of 3-5 Family Homes	$49	$27	(Removal of 3 Family Homes)
New Housing Marketplace Expansion	($200)	($200)	
Housing Trust Fund	($300)	($400)	
Net Savings/(Cost) of Reform	**($25)**	**($143)**	

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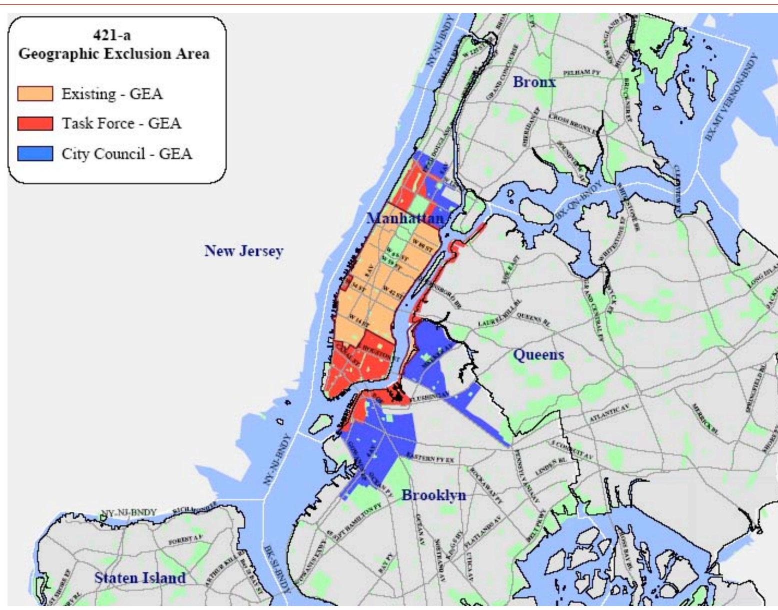
IV. Political Process: Program Reform and Political Negotiations



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IV. Political Process: Program Reform and Political Negotiations

The State legislature passed legislation (A.4408-a) more expansive than the Council 421-a reform local law.

- **Six Month Delay:** State legislature delays the effective date of the 421-a reform by six months from the local law.
- **Atlantic Yards Off-site**
  - A.4408-a changes the 421-a benefit for market rate condos in Atlantic Yards by first allowing condos built within GEA to get a 421-a benefit and secondly by extending the benefit period from 15 years to 25 years. This benefit is given to developers with no increased contribution to affordable housing.
  - 30 Day Amendment reduced the 421-a benefit to condo to 15 years.
- **Extension of Affordability Requirement**
  - A.4408-a extends the affordability requirement for participation in 421-a from 30 years to 40 years. The City's expectation is that any developer faced with this increased burden will seek to get it reimbursed through additional construction aid, most likely costing the City somewhere down the line.
  - 30 Day Amendment reduced the extended affordability requirement to 35 years.
- **Expansion of GEA**

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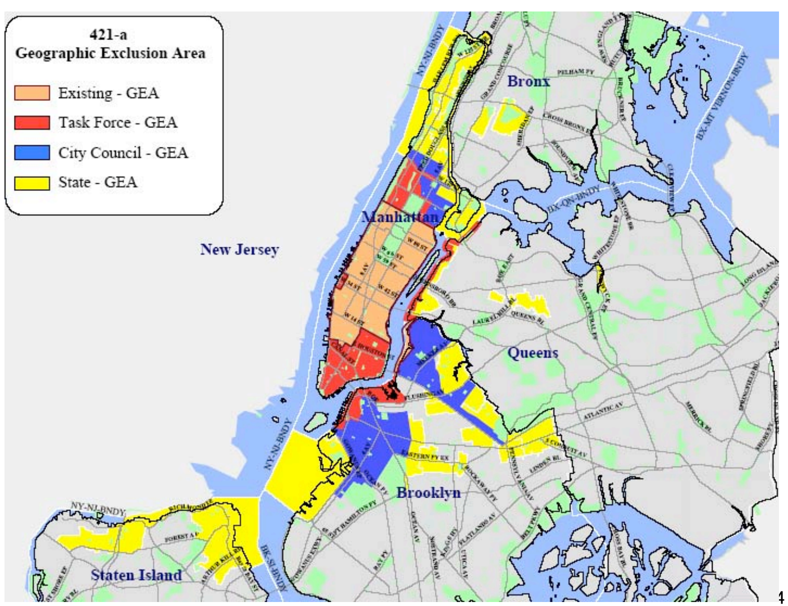
IV. Political Process: Program Reform and Political Negotiations



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V. Lessons Learned

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- The administration's goal was to fund increased affordable housing expenditures with savings generated reform 421-a reform. This goal was successfully accomplished.
- The problem was expenditures, after benefit expansions in Albany, significantly exceed savings.

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