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Worth the Cost? Evaluating the 421-a Property Tax Exemption

SUMMARY

Since its inception in 1971, the 421-a property tax exemption has helped finance the construction of 87,000 apartments in the city.

Under the 421-a program, owners are exempt over a certain period of time from paying the increase in property tax resulting from the construction of new multifamily housing. There are essentially four different programs under the 421-a rubric, with different exemption periods of 10, 15, 20, and 25 years based on the location of the project and affordability requirements. The Department of Finance estimates the program cost the city $130 million in foregone tax revenue in fiscal year 2002.

The program has two major goals—to stimulate the production of housing and to ensure that some portion of that housing is affordable to low- and moderate-income New Yorkers. IBO's analysis of the 421-a program sought to quantify how well those goals were being met and at what cost. Among the key findings:

- Since 1985, 192,000 apartments have been built in the city. Of these, roughly 69,000—or 36 percent—were constructed under the 421-a program.

- Under the 15- and 25-year exemptions, 17,500 and 8,300 apartments respectively have been built since 1985. The 10- and 20-year exemption programs have specific affordable housing requirements. Under the 10-year exemption, 33,000 market-rate units and 2,772 affordable units have been built since 1988. Under the 20-year exemption, 4,600 market-rate units and 2,133 affordable units have been built since 1992.

- Average rents in apartments built under the program vary widely, from $477 in the Bronx to $3,172 in Manhattan. This range results in part because the rent is initially set to correspond to the neighborhood market.

- On average, the estimated lifetime cost to the city for each apartment constructed under the 421-a program ranges from $22,559 for units with 10-year exemptions to $91,445 for those with 20-year exemptions.

In addition to this analysis, IBO also has examined some proposals for modifying the 421-a program.

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INTRODUCTION

New York City provides various property tax exemptions to encourage housing development. Most prominent among them is the 421-a exemption for new construction, first established in 1971. Many observers view the 421-a program as crucial to promoting development of both market-rate and affordable housing in the city. Without these tax exemptions, they argue, the high cost of construction would make development prohibitively expensive. In addition, the 421-a program helps finance construction of affordable housing, and many advocates view it as perhaps the single most important city tool for creating housing affordable to low- and moderate-income families. Others have argued that the tax exemption—which cost the city $130 million in foregone property tax revenues in fiscal year 2002, according to the Department of Finance—constitutes a give-away to developers of luxury housing in Manhattan's most expensive neighborhoods, with the city getting little in return, especially units affordable to lower income households.

The 421-a program has two broad goals: to stimulate the production of housing and to ensure that a portion of the new housing will be affordable to low- and moderate-income New Yorkers. Little is known about the program's success in meeting these goals, nor about the associated costs. To find out, IBO has sought answers to three questions: How much new housing has been built with 421-a? How affordable are 421-a units? And how much in property tax revenues does the city forego for each 421-a unit built?

It is not possible to know how many projects would have gone forward *without* a 421-a exemption. Although we may know anecdotally or on an individual project basis, the overall impact of 421-a in terms of getting housing built that would not have been otherwise is unknowable. For this reason, the annual tax expenditure as reported by the Department of Finance overstates the real "cost" of the program, since we should only count as a cost the tax exemption given to buildings that would have been built without it. For buildings that were built only because 421-a, at the margin, made them economically viable, then the city's cost is nothing.[1]

421-a: THE BASICS

The 421-a exemption program is available for new housing projects of three or more units, located on sites that were vacant, underutilized, or improved with a "nonconforming use," according to applicable zoning regulations, three years prior to the start of construction.[2]

Under the program, owners are exempt from paying the increase in property tax resulting from construction. For example, if a parcel valued at $1 million when vacant is worth $10 million after construction, the $9 million increase in value is not taxed during the exemption period. Each exemption phases out over time; the precise phase-out schedule depends on the exemption period, as discussed below.

For all rental properties built with a 421-a exemption, maximum allowable rents are initially set by the city's Department of Housing Preservation and Development (HPD) based on a statutory formula. In their first year of occupancy, rents for apartments not designated as affordable units correspond to market rates for the area. All apartments then remain under rent-stabilization rules for the duration of the exemption. As exemptions expire, rents may rise to market rates. For units built on or after July 1, 1984—in effect all the currently exempt 421-a apartments—landlords may increase rents to market rates after the exemption expires, when leases are up for renewal. Units designated as affordable remain rent stabilized for at least 20 years, and rents may only be increased to market rates upon vacancy.

Four programs in one. The current 421-a program is, in effect, four distinct programs, each with a different exemption period and program parameters. Two of the programs require construction or financing of a specified number of affordable housing units in return for the right to build subsidized market-rate apartments in central Manhattan (below 110th Street). The other two programs do not have an affordable housing requirement, but are limited to areas of the city outside of central Manhattan.

In both the 10- and 20-year programs, the city subsidizes market-rate units in central Manhattan in return for the creation of affordable units:

- **10-year exemptions.** The 421-a housing certificate program provides 10-year exemptions for properties in Manhattan in the so-called exclusion zone—roughly between 14th and 96th Streets. Developers purchase certificates that HPD grants to builders of affordable housing, generating equity capital for the affordable housing project. Depending on the income-eligibility requirements, affordable-housing developers receive four or five certificates per affordable unit.[3] Each certificate provides 10 years of property tax exemption for one market unit—two years of full exemption, followed by two years at 80 percent exempt, two years at 60 percent, etc.

Projects in Manhattan south of 110th Street but outside the exclusion zone—i.e. between 96th and 110th Streets; south of 14th Street; and in a small area in the West 30s—are eligible for 10-year exemptions without purchasing affordable housing certificates. In 2002, about 20 percent of the 10-year exempt units were located outside the exclusion zone, and therefore had no affordability requirements.

- 20-year exemptions. Developers who will set aside at least 20 percent of the units in a project in Manhattan below 110th Street for low- or moderate-income households receive a 20-year exemption under the 421-a Affordable Housing Program. These projects are fully exempt for 12 years, followed by two years at 80 percent exempt, two years at 60 percent, etc. Twenty-year exempt properties may also participate in either the city Housing Development Corporation or New York State Housing Finance Agency 80/20 programs. These 80/20 projects receive tax-free bond financing in addition to the property tax exemption. Buildings in the eligible area that receive substantial governmental assistance are also eligible for 20-year exemptions; for example, projects receiving Liberty Bond financing will be eligible for 421-a exemptions although they only are required to make 5 percent of units affordable.

In housing certificate units, average tenant income cannot exceed 80 percent of area median income, although in individual units in the same building, income may be up to 100 percent of median. If the building carries a mortgage—which is true in most cases—rents on designated affordable units cannot exceed $864 per month. In general, for the affordable units built in 80/20 projects, tenant incomes cannot exceed 80 percent of area median income, and rent is set at 30 percent of that ceiling. If a particular tenant has an income less than 50 percent of median, he/she may pay more than 30 percent of income in rent.

The 15- and 25-year exemptions are granted to construction projects outside core Manhattan:

- 15-year exemptions. Any project above 110th Street or in the other four boroughs is eligible for an as-of-right 15-year exemption. The first 11 years of a 15-year property are fully exempt, year 12 is 80 percent exempt, year 13 is 60 percent exempt, and so on.

- 25-year exemptions. A 25-year exemption is available outside of core Manhattan for projects in designated Neighborhood Preservation Areas or locations eligible for Rehabilitation Mortgage Insurance Corporation insurance. As an alternative to locating projects in eligible areas, the developer may set aside 20 percent of the units for low-income families, or receive substantial government assistance for the project (such as low-interest construction loans or grants that typically include their own affordability requirements). Twenty-five year units are fully exempt for 21 years, and phase out over the last four years. Affordable units built using housing certificates often receive separate 421-a exemptions under the 15- or 25-year programs.

421-a Exempt Units by Borough and Exemption Period, 2002

	10 Year	15 year	20 Year	25 year	Total
Bronx		1,583		2,129	3,712
Brooklyn		5,684		2,470	8,154
Manhattan	4,907	1,734	6,782	701	14,124
Queens		7,750		3,601	11,351
Staten Island		2,709		446	3,155
TOTAL	**4,907**	**19,460**	**6,782**	**9,347**	**40,496**

SOURCES: IBO, Department of Finance.
NOTES: Figures exclude a small number of properties where unit data are missing or other data irregularities exist. Figures include market rate and affordable units with exemptions.

Buildings built with 421-a exemptions may be either rental or ownership units—either condominiums or cooperatives. The 20-year units are virtually all rental properties. Ownership units predominate in the 10- and

421-a Units by Occupancy Status, 2002

	Rentals Units	Rentals Percent of All Units	Owner-Occupied Units	Owner-Occupied Percent of All Units
10 year	1,805	36.7%	3,108	63.3%
15 year	6,474	34.5%	12,267	65.5%
20 year	6,712	99.0%	70	1.0%
25 year	5,734	62.3%	3,472	37.7%
TOTAL	20,725	52.3%	18,917	47.7%

SOURCES: IBO, Department of Finance.
NOTE: Unit counts differ slighlty from previous tables because building status is missing for some.

15-year programs, and rental units are more numerous in the 25-year program.

BOOSTING CONSTRUCTION AND AFFORDABILITY?

In order to know how important the 421-a program is to new residential construction, we would have to know how much of the housing built with 421-a would have been built even without it. Unfortunately, the answer to this question is likely to remain elusive. Evidence of how much construction has occurred with and without 421-a, however, may be somewhat instructive, even if it falls short of a full answer to the question.

Number of apartments built. Since 1985, 192,000 apartments have been built in multifamily buildings in the city. Of these, roughly 69,000 or 36 percent were constructed under the 421-a program.[4] Although there is significant variation between the boroughs, even in Manhattan—where construction is generally most expensive—only 46 percent of units were built using the 421-a exemption.

The number of units built also varies according to the type of exemption. Since 1985, some 17,500 15-year units and 8,300 25-year units have been built. Since 1988, over 33,000 market-rate units have been built in Manhattan with a 10-year exemption, plus 2,772 off-site affordable units (the majority in Brooklyn and the Bronx) using housing certificates. A total of 4,600 market-rate units and 2,133 on-site affordable units have been built in central Manhattan through the 20-year 421-a program since its inception in 1992.[5]

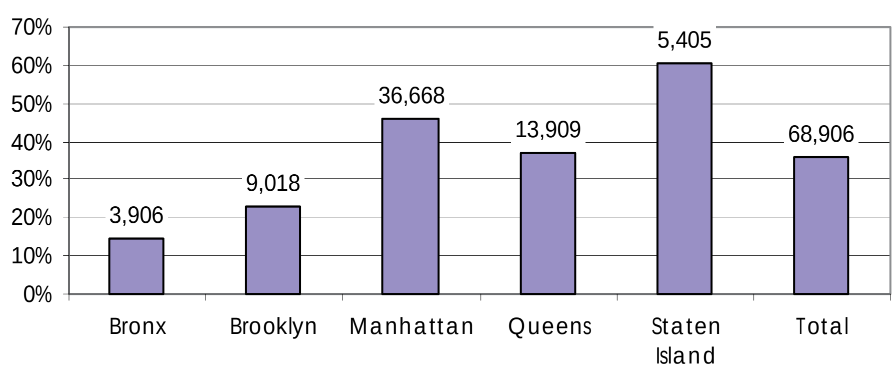
There are a variety of reasons why new construction might occur without 421-a exemptions. Some sites do not meet the eligibility criteria for the exemption.[6] However, we were not able to determine how many—if any—unassisted new housing construction projects were developed on 421-a eligible sites.

Another reason developers might pass up the tax break is to avoid a lengthy period of rent regulation. Some developers believe that rent regulations would limit their rental income by more than the value of the foregone property tax payments. This could be particularly true for buildings in Manhattan, where market rents might well exceed the allowable rent for the affordable units, even including the property tax exemption.

Additionally, the cost of housing certificates is proportionally higher for developers of buildings with small apartments than for those constructing larger ones. Anecdotal reports suggest that this may be a motivation to forego the exemption.[7]

421-a Exempt Buildings Account for Less than Half of All New Housing Construction

Percentage and number of new multifamily units built with 421-a exemptions,1985-2002



SOURCES: IBO, Department of Finance.
NOTE: Projects built without a 421-a benefit may have received other forms of construction subsidies.

In any event it is clear that, for whatever reasons, a substantial amount of new residential construction does occur in New York without the benefit of a 421-a exemption.[8]

Increasing affordability? In addition to stimulating housing construction generally, the 421-a program also seeks to ensure that some of the housing built is affordable to low-, moderate-, and middle-income New Yorkers. The housing certificate program generally requires the subsidy of at least one affordable unit for every four or five market-rate units built (depending on income eligibility criteria for the particular project). In most cases, one affordable unit is built for every four market-rate units in a 20-year exempt building. The 25-year exemption is specifically targeted to certain underserved neighborhoods, with an optional affordable component. The 15-year exemption is the only one without an explicit goal of serving low- to moderate-income households or neighborhoods.

Average base rents set by the housing department in recently constructed 421-a buildings generally reflect local market conditions. Examination of rents set by HPD in three recent years suggest that the 15- and 25-year 421-a programs, which support housing construction outside core Manhattan, are generally providing housing affordable to a range of low- to middle-income households. Rents for market-rate units built in core Manhattan under the 10- and 20-year exemption programs are higher, affordable only to high-earning households.

Estimated Average 421-a Rent for a One-Bedroom Apartment

	Mean Maximum Base Monthly Rent	Necessary Annual Income	Income as Percent of Area Median Income
Manhattan	$3,172	$126,864	225%
Brooklyn	2,077	83,096	147%
Queens	1,194	47,776	85%
Bronx	477	19,095	34%

SOURCES: IBO, The Department of Housing Preservation and Development.
NOTES: Based on rents set by HPD for 1999, 2000, and 2001, adjusted for allowable annual increases for rent-regulated apartments. Data for Staten Island too limited to use. "Necessary Annual Income" assumes the houshold is paying 30 percent of income in rent. Percentage of area median income is based on New York City 2002 median for a family of 3 ($56,500) as established by the federal Department of Housing and Urban Development.

We estimate that the average initial base rent for a one-bedroom, market-rate 421-a unit built from 1999 through 2001 in Manhattan, for example, was $3,172.[9] In comparison, the average rent for a market rate one-bedroom apartment in real-estate listings for Manhattan south of 96th Street was $3,163 at mid-year 2001. In Brooklyn, the average initial 421-a rent was $2,077—comparable to rents in some of the borough's more expensive neighborhoods, including Brooklyn Heights ($2,107) and Park Slope ($2,092). This suggests that many 421-a units in Brooklyn—all receiving either a 15-year or 25-year exemption—were getting quite high rents, comparable to Manhattan levels.

Although reliable market-rate rent data are not available for Queens and the Bronx, comparing 421-a rents to area median income shows that these units are generally affordable to moderate-income households in Queens. In the Bronx, 421-a housing—which typically receives 25-year exemptions—is affordable to low-income tenants; it is also important to note, however, that many of these projects also received other forms of government assistance, such as federal low-income housing tax credits, which require rents to be set at below market rates.

STIMULUS OR GIVE-AWAY?

It is often asserted that virtually all new residential building in the city uses 421-a exemptions, and that without it, residential construction in New York City would grind to a virtual halt. Our analysis shows that a significant share of new housing construction, particularly outside of core Manhattan, occurs without a 421-a exemption. Many affordable housing advocates also contend that 421-a is crucial to the production of affordable housing in the city. Others believe that the exemption is a give-away to developers of luxury housing, and that the city gets too little affordable housing in return for its money.

Resolution of these conflicting claims would require being able to show how much new housing would have been built in the absence of the 421-a exemption—a question that is unlikely ever to receive a definitive answer. What *is* possible is to estimate the value of the average tax subsidy provided by a 421-a exemption on a *per-unit* basis.

What an exemption costs. According to the Department of Finance, in fiscal year 2002 the total tax expenditure—that is, the total amount of property tax revenues *not* collected for the year because of the exemptions—was $130 million.[10]
Although buildings with 20-year exemptions comprise

Fiscal Year 2002 Tax Expenditure					
Exemption Period	**2002 Tax Expenditure (millions)**	**Percent of Total Tax Expenditure**	**Number of Exempt Units**	**Percent of Total Exempt Units**	**Average Cost per Unit**
10 years	$26.50	20.6%	5,095	12.8%	$5,192
20 years	$55.20	42.9%	6,745	17.0%	$8,182
15 years	$28.80	22.4%	18,596	46.8%	$1,546
25 years	$18.60	14.4%	9,316	23.4%	$1,995
Total	**$129.00**		**39,752**		**$3,245**

SOURCES: IBO, based on Department of Finance data.
NOTES: Excludes exemptions for which unit data was missing. The 10-year program cost includes only market-rate units. The 20-year program units include both market-rate and affordable units.

only 17 percent of all units with a 421-a exemption, 43 percent of the 2002 tax expenditure went to those buildings, with an average per unit tax break worth over $8,000. The 20-year exempt units consume such a large share of the cost because they are located in central Manhattan, where market values—and hence property taxes—are higher than in most of the rest of the city. The 10-year units, also based in central Manhattan, likewise have a higher annual cost-per-unit. Conversely, the 15- and 25-year exempt units, which are generally located in less expensive neighborhoods, comprise roughly 70 percent of the exempt apartments, but only 37 percent of the annual cost of the exemption.

A better measure of the per-unit cost of a 421-a exemption, however, is the foregone tax revenue over the full *lifetime* of the exemption. This cost can be viewed as two sides of a single coin: first, as the subsidy the city pays to encourage new construction, and second, as the value to the developer of the savings from not having to pay property taxes for the exemption period, which enters into the calculation of whether a building can be profitably built and marketed.

The picture that emerges from looking at lifetime costs is somewhat different than that based on looking at average costs in a single year. The reason is that the lifetime cost is a function not only of property values, but also of the length of the exemption. The average per-unit-cost of the as-of-right 15-year exemption is estimated to be about $19,400 (in current dollars). The estimated subsidy provided to 25-year projects is $31,300 per unit—higher than the 15-year cost largely because of the longer exemption period. For market-rate units built under the 10-year housing certificate program, our estimate of the per-unit subsidy averages $22,559. The estimated cost of the average per-unit subsidy provided to 20-year exempt projects is $91,455 per unit, including both market-rate and affordable units. Again, the higher figure is largely attributable to the longer exemption period, particularly the number of years the property is fully exempt—12 years under the 20-year exemption, as opposed to just two years for 10-year exempt properties.[11]

It is important to note that we are calculating the present value of the stream of tax expenditures from the city's perspective, using a discount rate of 6.0 percent based on the city's cost of funds. Viewed from the perspective of a developer with a higher discount rate and cost of borrowing, however, the present value of the stream of subsidies is considerably less. For example, using a discount rate of 8.5 percent would produce an average tax savings for 20-year rental projects of $76,218—or $15,200 less than shown in the table.

Estimated Lifetime 421-a Tax Expenditure
Constant 2003 dollars

		Average cost	**Units**
10-year	rentals	$23,214	13,161
	co-ops	15,493	1,150
	condos	22,543	30,142
	all (avg)	$22,559	44,453
20-year	rentals	$91,418	6,674
	condos	94,908	71
	all (avg)	$91,455	6,745
15-year	all	$19,385	18,319
25-year	all	31,271	9,486

SOURCES: IBO, based on Department of Finance data.
NOTE: See endnote 11 for explanation of methodology.

Some observers have suggested that it could be more efficient to directly subsidize the construction of housing—for example, by providing developers with up-front cash payments—rather than by granting tax exemptions over time. But it is often politically easier to provide tax breaks than direct subsidies. Moreover, cash payments would require review and allocation decisions by city government as opposed to the current as-of-right approach in which tax benefits are determined solely by the actions of market participants.

A cost-effective way to build housing? These may appear to be expensive subsidies, particularly for the 20-year units. Some would ask whether this price is excessive, or at least not the most cost-effective way to promote housing construction, and affordable housing in particular.

In fact, IBO's estimate of the cost of a 20-year exemption is likely *understated*. The cost we estimate implicitly assumes that the exemption is subsidizing both the market-rate and the affordable units equally, and the subsidy for an affordable unit is the same as that for a market-rate unit.

If one were to assume, however, that all of the market-rate housing could and would have been built in the absence of the tax exemption, then the entire cost of the subsidy could be ascribed to just the affordable units created—in essence, it is the price the city paid to get just the affordable units built. Reality obviously lies somewhere between these extremes: Some, but not all, of the market-rate units would have been built without the exemption. Thus, the estimated subsidy for an affordable unit built through the Affordable Housing Program is *at least* $91,000. A similar logic applies to the housing certificate program.

As we have noted, no definitive answer is possible to the question of how much housing would have been built without the exemptions. Our earlier examination of the initial market rents set by HPD for buildings in core Manhattan (and some parts of Brooklyn) suggests that they would generally be affordable only to middle- to upper income households. Selling prices for condos and coops are undoubtedly also in a comparable range.[12] Therefore, it seems conceivable that at least some of these units could have been built and operated or sold without the tax exemption—or at least with a less generous exemption than that conferred by the 20-year affordable housing program exemption.

On the other hand, buildings built with 421-a do eventually pay full property taxes, and at some point those property taxes offset the exemptions they originally received. IBO estimates that in most cases, market-rate projects built using housing certificates will have paid taxes equal to the value of their exemption within roughly 10 years of the exemption's complete expiration (including the partial taxes paid during the exemption period)—and frequently much more quickly than that. This also appears to be true of 15-year units. Most projects receiving 20-year exemption benefits were built on lots that had not been paying any property taxes, perhaps because of prior exemptions such as an urban renewal designation or city ownership. Thus, at least to the extent that these are properties that would not have been developed without 421-a, *any* property taxes eventually paid as a result of the development represent a gain for the city.

MODIFYING THE 421-a PROGRAM

Some affordable housing advocates have proposed expanding the 421-a program as a means of increasing affordable housing production. Two proposals, specific to the housing certificate program, have been suggested. The first would increase the length of the exemption period from 10 to 15 years. The second would give affordable housing developers six exemption certificates per low-income affordable unit, rather than five.

Extending the 10-year exemption. The first proposed change, to extend the length of the exemption period to 15 years, would increase the subsidy for the production of market-rate housing. Making the subsidy for market-rate units richer should tend to increase the demand for—and hence the price of—housing certificates. As the price of certificates rises, so would the amount of subsidies available for affordable housing. IBO estimates that lengthening the current 10-year exemption to 15 years would raise the per-unit subsidy to roughly $51,000 per unit, or about $30,000 more than currently. (We assume seven years of full exemption, followed by an eight-year phase out.)

Although housing certificates would become more valuable under the proposal, it is important to note that certificates currently sell for less than their value to developers—i.e., below what a competitive market price should be. Certificates currently fetch between $10,000 and $12,000 each, generating between $40,000 and $60,000 in equity for each affordable unit.[13] If IBO's estimate is correct, each certificate is worth up to twice its selling price to the developers who use them to build market-rate housing in Manhattan. It is not clear why the certificates do not sell for closer to their value to developers. If market-rate developers get a richer exemption without a corresponding increase in the amount generated for affordable housing, the city would merely be foregoing more tax revenues without gaining more affordable units.

Increasing the number of certificates. The second proposal, to increase the number of exemption certificates given for each affordable unit, would increase the supply of certificates. An increase in the supply of certificates would, all else equal, tend to drive down their price. While the impact on market-rate housing is clear—more certificates translate into more market-rate units—the impact on affordable housing is less certain, since more certificates may not increase the total amount of subsidy available for affordable housing development if the average price were to fall. This proposal would increase total tax expenditures on the certificate program without necessarily increasing the amount available to subsidize affordable housing construction. It would also decrease the ratio of affordable to market-rate housing.

Other proposals to modify the 421-a program include a "sliding scale" of on-site set-aside percentages and tenant eligibility limits as opposed to the current 80/20 requirement.[14] Allowing developers of projects in Manhattan to have a higher mix of income eligibilities in return for setting aside more apartments could extend the program's appeal, resulting in more participation in the program, and extending the benefits to a broader range of New Yorkers. Affordable housing advocates, however, might be concerned that a more flexible program could end up providing fewer housing opportunities for those at the lowest end of the income scale.

CONCLUSION

The 421-a property tax exemption, long considered one of the mainstays of new residential construction in New York City and an important tool for the creation of housing for low- and moderate-income families, has helped finance the construction of a total of 87,000 new dwelling units since its inception. Altogether, 421-a has helped finance over one-third of new multifamily construction citywide since 1985—and nearly half of new units in Manhattan.

Over 30,000 units have been built outside core Manhattan under the 15- and 25-year exemptions, many of them affordable to low- to middle-income households. The 421-a exemptions provided to these units are estimated to cost the city on average roughly $19,400 per unit for the 15-year exemptions, and about $31,300 for the 25-year exemption, which serves primarily distressed neighborhoods or low-income households. Average rents for these units are generally affordable to a mix of low- to middle-income households.

The 10- and 20-year programs, which in general require that 20 percent of the units built be affordable to low- and moderate-income households, have produced about 4,900 units of affordable housing, as well as the construction of roughly 54,000 market-rate housing apartments in Manhattan. The average per-unit subsidy under the 10-year housing certificate program is $22,600, while for the 20-year program it is $91,500.

All 421-a properties eventually pay full property taxes, and over time, at least to the extent that these projects would not have been developed without 421-a, the city recoups its investment. The question remains, however, to what extent the subsidies are necessary to stimulate housing production—particularly for market-rate housing in Manhattan largely affordable only to upper income households, at least some of which would have been economically viable without the tax exemption.

Two recent proposals to expand the 421-a program to promote more affordable housing development have focused on expanding the housing certificate program. The first proposal—to lengthen the exemption period to 15 years—would make the certificates more valuable to market-rate developers and thereby increase their sale price, generating additional funds for affordable housing development. The second proposal—to increase the number of certificates per affordable unit—would tend to push down the price of certificates without necessarily increasing the amount of funding for affordable housing.

Other options, including a "sliding scale" of affordable set-asides in return for a more flexible tenant income mix, may be worth further exploration if policymakers wish to consider changes to the program. Properly designed, such a reform might help lower the cost of a 20-year exemption without reducing new housing production.

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END NOTES

[1]It is always possible that a parcel that is eventually developed and receives a 421-a exemption would have been developed into some other use—perhaps with lower value however. It is not strictly correct therefore to say the city's cost is nothing; rather the correct comparison is between what would have happened without the 421-a and what happened with 421-a.

[2]The 421(b) program provides similar benefits to one- and two-unit buildings, but this analysis examines only the 421-a program.

[3]Developers may receive six certificates per affordable unit if the unit is targeted for a homeless person.

[4]This report is based on data from the city Department of Finance Real Property Assessment Database, also known as RPAD. We found a number of problems with the data in this file. For example, many properties were missing information on the number of units in the building, or the year the building was built. Properties were in some cases listed as having both 10- and 15-year 421-a exemptions, which is prohibited under the law establishing the exemptions. To the extent possible, we have tried to adjust for these problems, but the reader will notice some inconsistencies between figures from time to time.

[5]The number of affordable units built does not equal precisely 20 percent of the total units developed under either the 10- or 20-year exemptions. Market-rate projects are eligible for a 10-year exemption with no affordability requirement if they are built in Manhattan below 110th Street but outside the exclusion zone. In 2002, about 20 percent of the 10-year exempt units were located outside the exclusion zone, and therefore had no affordability requirements. Most projects receiving 20-year exemptions must make at least 20 percent of the units affordable, but there are several projects where more than 20 percent of units meet affordable rent standards, including some built exclusively as low-income or special needs housing. As a result, more than 20 percent of the total number of 20-year units meet affordability requirements.

[6]Legislation recently signed by the Mayor expanded the criteria for eligibility by raising the underutilization threshold (measured as actual built floor area versus what would be allowed under zoning regulations).

[7]See, for example, Oser, Alan, "Linking Low-Rent Housing to Manhattan's Market," *The New York Times*, April 26, 1998; Section 11, p. 7.

[8] For two similar parcels, the fact that one would be eligible for 421-a and the other would not should be reflected in the asking price for the land. In a developer's calculation of the profitability of a given project, the possibility of receiving 421-a tax benefits would warrant a higher purchase price for the site. It is also worth noting that much of the benefit of a 421-a exemption may actually end up in the hands of the seller of the land.

[9]HPD sets an initial maximum base monthly rent per room for new 421-a apartments based on a statutory formula. IBO's estimate is based on units for which HPD set the base rent in fiscal years 1999, 2000, and 2001. HPD could not provide IBO with records on the number of rooms per unit. State law defines the base room count as two-and-a-half rooms per dwelling, plus one room for each bedroom or other room separated by walls from the rest of the apartment. Kitchens, bathrooms, and hallways are not counted towards the room count. We have assumed that each unit has a total of 3.5 rooms—equivalent to a one-bedroom apartment—and estimated the rent accordingly. Rents set in 1999 or 2000 have been adjusted to reflect Rent Guidelines Board increases. All market rent data from Corcoran Rental Reports for mid-year 2001, <www.corcoran.com>.

[10]City of New York, Department of Finance, Annual Report on Tax Expenditures, Fiscal Year 2002.

[11]IBO's estimate of the average lifetime costs of 421-a exemptions combines actual historical values of exemptions as recorded in the finance department's Real Property Assessment Database with a projection of future values based on growth in real estate market values, expressed in constant 2003 dollars. The estimates were calculated using actual values for the expired portion of exemptions (through 2003), and a projection of growth in median assessed values for 2004 and beyond. We adjusted costs to 2003 values using the historical growth in assessed values for the expired portion of exemptions, and our projection of growth for the unexpired portion. The 10-year coop cost is calculated based entirely on actual costs of expired exemptions. Projects receiving a 20-year exemption include both market-rate and affordable units; projects under the housing certificate program include only the market-rate units-affordable units built using housing certificates are built offsite and usually receive 421-a benefits separately under either the 15- or 25-year programs.

[12]The tax exemption should be reflected in the price, so that the asking price would be higher to reflect the temporary tax exemption than it would be without the exemption.

[13]According to the Citizens Housing and Planning Council of New York: "A Proposal to Enhance Tax and Zoning Incentives for New Housing Production" (September 2002). HPD reports that certificate sales prices have fluctuated significantly over the last five years.

[14]Ibid.