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May 18, 2016

The Honorable Brad Lander  
Council Member  
New York City Council  
250 Broadway, Suite 1751  
New York, NY 10007

Dear Council Member Lander,

At your request, the Independent Budget Office has reviewed the extended affordability benefit (EAB) provisions of the recent 421-a legislation. These remain available to qualified landlords, even as other provisions of the 421-a program lapsed with the failure to reach an agreement on prevailing wage requirements at 421-a projects. Under the new legislation, landlords of rental buildings that were developed under earlier versions of 421-a may qualify to opt into the EAB provisions. In exchange for either 10- or 15-additional years of 421-a tax benefits, they agree to a 10- or 15-year extension of the period units are subject to rent restrictions linked to affordability.

Our analysis, which is summarized in the attached memorandum by IBO's property tax economist Geoffrey Prophter, found 63 buildings that currently contain 3,797 apartments identified as affordable for families with incomes up to 80 percent of the area median income (AMI) that could potentially qualify for the extended benefits. Under the new law, owners of the buildings could also add 792 apartments (5 percent of the buildings' apartments) that would be affordable for families with incomes up to 130 percent of AMI, bringing the total number of affordable units potentially preserved and added to the affordable stock in exchange for the additional tax benefits to 4,589. However, because there are already agreements in place that would preserve affordability for some of these units, IBO estimates that preservation of 4,162 affordable apartments can be reasonably attributable to the EAB program.

If all eligible buildings choose to participate, IBO estimates that the net fiscal cost in present value terms over the course of the EAB period would be \$856 million. When comparing the tax expenditure to the number of affordable units preserved, it is important to keep in mind that the benefits of the EAB program depend not just on the number of affordable apartments preserved or created, but also on the number of years that these apartments remain affordable, a measure we label "apartment-years of affordability." If we assume that all affordable units in eligible buildings are preserved for either 10 or 15 years under the applicable EAB provisions, then 65,890 apartment-years of affordability would be

credited to the EAB program. However, as discussed in the attached memorandum, such a result is highly unlikely, given what we know about the regulatory agreements typically used for these buildings, which in many cases already require an affordability period longer than the original 421-a requirement. Therefore, IBO estimates that only 28,730 apartment-years of affordability, or 43 percent of that total, can be reasonably credited to the program. Because the property tax exemption granted under EAB is not affected by the presence of other regulatory agreements, however, the tax expenditure for the 28,730 apartment-years is \$30,000 per apartment per year.

IBO's cost estimates implicitly assume that from a public policy perspective an affordable apartment at 40 percent of AMI is just as desirable as an otherwise identical affordable apartment at 80 percent of AMI. If policymakers value apartments at different levels of affordability differently, the program's cost would need to be weighted based on the relative importance of various affordability levels.

If you have questions please feel free to contact me or Geoffrey Propher, the economist who did the study. He can be reached at (212) 341-7363 or [GeoffreyP@ibo.nyc.ny.us](mailto:GeoffreyP@ibo.nyc.ny.us).

Sincerely,

A handwritten signature in black ink, appearing to read "Ronnie Lowenstein". The signature is fluid and cursive, with a large initial "R" and "L".

Ronnie Lowenstein



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**To:** George Sweeting

**From:** Geoffrey Propheter

**Subject:** Housing and Cost Estimates for the 421-a Extended Affordability Benefits Program

### Introduction

At the request of Councilmember Lander, IBO conducted an analysis of the 421-a extended affordability benefits (EABs) program signed into law by Governor Cuomo on June 26, 2015. The state codified the EAB program as one piece of a broader 421-a package,<sup>1</sup> which included three principal elements:

- 1) The exclusion of 421-a benefits for condo and co-op buildings in Manhattan or for such buildings elsewhere containing more than 35 apartments;
- 2) The introduction of a menu of eligibility criteria and benefit levels that developers can choose from to replace the prior one-size-fits-all 421-a benefit and eligibility structure; and
- 3) The introduction of an opt-in provision allowing certain rental buildings currently receiving 20- and 25-year 421-a benefits the opportunity to receive EABs for an additional 15 years or 10 years, respectively.

Items (1) and (2) would have gone into effect had the Real Estate Board of New York and the Building and Construction Trade Council of Greater New York agreed to a memorandum of understanding regarding prevailing wages for trade workers on 421-a projects by January 15, 2016. An accord was not reached by the deadline, and thus the city is precluded from accepting new applications for 421-a benefits.

However, the creation of the EAB program was not tied to the prevailing wage agreement. As a result, that element of the enabling legislation went into effect retroactive to June 15, 2015, allowing owners of eligible rental buildings the option to apply for and receive EABs "as of right."

Councilmember Lander's request focused narrowly on the EAB provision of the 421-a legislation (item 3); for a discussion of the other two elements of the legislation, see our report published in June 2015, "[The Mayor's 412-a Proposal: Estimating Tax Revenue Forgone and Affordable Housing Gained.](#)"

### EABs and Eligibility Criteria

Owners of residential rental buildings eligible for EABs can have the building's assessed value for tax purposes reduced by 50 percent each year for the duration of the EAB period. In mixed-use developments, EABs only apply to the residential portion of the building and only if the residences are rental housing. For buildings currently receiving 20-year 421-a benefits, the EAB period is 15 years, while for those receiving 25-year 421-a benefits the period is 10 years.

EAB eligibility is determined by a variety of factors, the most crucial being:

- 1) Building construction must have commenced prior to July 1, 2008;
- 2) The building must be receiving 20-year or 25-year benefits under the 421-a program in effect prior to July 1, 2008;
- 3) No less than 20 percent of the apartments must be designated for families whose gross incomes average less than or equal to 80 percent of the New York City area median income (AMI), with no individual apartment being rented to a family whose gross income exceeds 100 percent of AMI;<sup>2</sup>
- 4) The building owner must designate at least an additional 5 percent of its apartments for families with gross income less than or equal to 130 percent of the area median income, which at present is \$127,270 for a family of four;
- 5) Designated affordable apartments must remain rent-stabilized for the duration of the EAB period;
- 6) Building service employees (such as guards, doormen, groundskeepers) working more than eight hours a week in a building with more than 30 apartments generally must be paid prevailing wage, which is defined and enforced by the New York City Comptroller.<sup>3</sup>

In addition, to receive the benefit an eligible rental building owner must file an application with the Department of Housing Preservation and Development (HPD) and pay a filing fee of \$3,000 for each apartment in the building; the filing fee may be reduced or waived at HPD's discretion. Moreover, building owners opting into the EAB program cannot opt out without HPD's consent and only if EABs are being replaced by tax benefits awarded under an eligible alternative HPD program requiring affordable housing.

### **EAB's Contribution to Affordable Housing and Rent Stabilization Inventories**

As HPD Commissioner Been noted in her testimony to the City Council in June 2015, the policy rationale for offering EABs is to incentivize property owners who currently contribute to the city's stock of rent-stabilized housing to continue doing so after their initial benefit period expires. Council Member Lander asked IBO to evaluate if the marginal increase in affordable housing due to the EAB program constitutes a "meaningful" impact. While IBO does not take a position on proposed changes in public policy, we collected and analyzed pertinent data to help the Council Member and other policymakers in their evaluations of the program's merits.

Market-rate and income-restricted rent-stabilized apartments in EAB eligible buildings are administered by rules in effect prior to July 1, 2008. The rules allow for apartments to be deregulated after the expiration of the benefit period under one of two criteria: either the apartment is vacated, or, a rider was attached to the initial lease and subsequent renewals indicating that the apartment will exit rent stabilization when the tax benefit expires and specifying the approximate expiration date of the tax benefit.<sup>4</sup> If the second criterion is met and assuming that the 421-a regulatory agreement is the only regulatory agreement requiring affordable apartments with stabilized rents in effect at the time,

apartments lose their affordability status and rent-stabilization protection once initial 421-a tax benefits expire and property owners elect not to opt into the EAB program.

By comparison, 421-a buildings administered by rules in effect on and after July 1, 2008, which are not eligible for EABs, are required to keep their affordable apartments rent stabilized for 35 years—15 years and 10 years after the 20-year and 25-year benefits will have expired, respectively. Moreover, once the benefit period lapses, the affordable apartments remain rent stabilized until the next vacancy or until the apartment reaches the legal rent threshold, which was set at \$2,700 in the same 421-a/EAB legislation. (This amount is to be adjusted each year based on the percentage increase in stabilized rents for one-year leases set by the Rent Guidelines Board; with a “rent freeze” in effect for this calendar year on stabilized apartments, the legal rent threshold for 2016 remains \$2,700.) Market-rate apartments, however, are not covered by EAB provisions, so these apartments will not be subject to stabilization rules once the initial 421-a benefits expire.

IBO identified 63 eligible buildings housing 3,797 affordable apartments eligible to opt into the EAB program.<sup>5</sup> Of these apartments, 16 percent are currently designated for families earning less than 40 percent of AMI, which for a family of four in 2016 is \$39,160. The balance is designated for households earning between 40 percent and 80 percent of AMI—between \$39,160 and \$78,300 for a family of four. Moreover, half of the apartments currently income-restricted are one-bedrooms with the other half split between studios and two- and three-bedrooms.

<b>The Vast Majority of Affordable Apartments in EAB-Eligible Buildings Are Currently Designated for Households Earning Between 40 Percent and 80 Percent of Area Median Income</b>	
<b>Affordability</b>	<b>Number of Affordable Apartments</b>
Under 40% of AMI	607
Between 40% and 80% of AMI	3,190
<b>Total</b>	<b>3,797</b>
Studios	982
1-Bedrooms	1,875
2-Bedrooms and Larger	940
<b>Total</b>	<b>3,797</b>
NOTE: A few buildings are allowed to set affordable rents at greater than 80 percent of area median income so long as the average of all affordable apartments is no greater than 80 percent of area median income. We treat these as “under 80 percent area median income” apartments.	
<i>New York City Independent Budget Office</i>	

Because 421-a tax benefits are awarded contemporaneously with other benefits such as federal low-income housing credits, tax-exempt financing, or the city’s 420-c program, some affordable apartments would remain affordable because of a superseding regulatory agreement independent of a building’s participation in the EAB program. It is not appropriate to attribute the preservation of affordable housing to the EAB program unless the EAB program’s regulatory period is longer and its income restrictions are more stringent than what any overlapping regulatory agreements require. Affordable apartments in buildings constructed through inclusionary zoning, for example, cannot be attributed to the EAB program because they are required to remain permanently affordable. Proper attribution is important from a policy evaluation standpoint, as the cost of the program will vary

according to how many affordable apartments it can be credited for saving. As the number of apartments preserved as affordable per year increases, the program’s cost per apartment per year decreases.

IBO does not have full data on other regulatory agreements eligible buildings could concurrently operate under during the EAB benefit period. Anecdotal evidence indicates that HPD prefers to negotiate 30-year regulatory agreements for the programs it oversees, suggesting that we should expect some regulatory agreements to overlap. It is also unlikely that there are any alternative regulatory agreements EAB-eligible buildings might be operating under that have *less* restrictive income requirements than those stipulated by the EAB program. Together these observations suggest the strong likelihood that some buildings (and by extension their affordable apartments) would have been designated for income-limited tenants even without EABs.

In contrast, the requirement under EAB that 5 percent of apartments be reserved for moderate-income housing at 130 percent of AMI can be reasonably attributed to the EAB program because few other regulatory agreements allow that level of affordability.

### EAB’s Tax Expenditure

The EAB program provides for a 50 percent reduction in taxable assessed value for the duration of the EAB period. IBO modeled the tax expenditure using the same technique in our June 2015 [report](#) on 421-a with the crucial difference that we now estimate costs using a more precise inventory of EAB-eligible buildings. Of the 63 buildings identified, 61 are in Manhattan and 2 are in Brooklyn. Assuming all eligible buildings opted in, IBO estimates the property tax expenditure for these buildings would total \$870.1 million in present value terms over the course of the EAB period.

The cost of the tax expenditure is partly offset by revenue from an EAB application fee of \$3,000 per apartment. IBO estimates that the application fee will generate \$13.8 million if all buildings opt in to the program. (The fee can be waived at HPD’s discretion, but we assume it is paid in full.) Taking the revenue from application fees into account, we estimate that the net cost of the EAB program—assuming that all eligible buildings opt in—is \$856.3 million in present value terms: the \$870.1 million property tax expenditure estimate less the application fees.<sup>6</sup>

<b>The EAB Program Will Cost the City \$856.3 Million Over the Program’s Lifetime, Assuming All Eligible Buildings Opt In</b>	
<b>Affordability</b>	<b>Number of Affordable Apartments</b>
40% AMI or Lower Preserved	607
40% to 80% AMI Preserved	3,190
Up to 130% AMI Created	792
<b>Total</b>	<b>4,589</b>
Gross EAB Tax Expenditure, <i>in millions</i>	\$870.1
Filing Fee Offset	\$13.8
Net EAB Tax Expenditure, <i>in millions</i>	\$856.3
NOTE: Dollars are expressed in present value terms.	
<i>New York City Independent Budget Office</i>	

While IBO cannot say with great certainty how many of the affordable apartments would not be preserved but for the EAB program, we can generate a range of program cost estimates based on the underlying assumption that all eligible buildings opt in. At one extreme, we assume the unlikely case that all units preserved as affordable are due to EAB, and at the other extreme we assume the unlikely case that only the additional affordable apartments created at 130 percent of AMI are attributable to the program. In the former instance we exclude affordable apartments created through inclusionary zoning, which requires permanent affordability, and thus preservation cannot be attributed to the EAB program. In addition, we generate a more plausible estimate of the number of affordable apartment likely to be preserved or created because of the program, an estimate informed through discussions with industry practitioners and information we obtained from some of the buildings' existing regulatory agreements.

Under the lowest-cost per unit scenario, in which all apartments preserved as affordable are solely attributable to participation in the EAB program, IBO estimates the city will spend \$187,000 per apartment, or \$13,000 per apartment per year, to maintain affordability. Under the highest per unit cost scenario, where the only affordable apartments attributable to the program are those at 130 percent of AMI targeting middle-income families, IBO estimates the city will spend \$1.1 million per apartment, or \$72,000 per apartment per year.

IBO's more realistic estimate between these two extremes is that all other buildings are currently operating under 30-year regulatory agreements, which implies that the EAB program can only be credited with preserving affordability during the final five years of the EAB period. Making these adjustments results in a more realistic estimate of 4,162 affordable apartments preserved or created due to the EAB program, including preserving affordability for existing affordable apartments for 5 additional years and creating apartments at 130 percent of AMI that remain affordable for 15 years.

The benefits of the EAB program depend not just on the number of affordable apartments preserved or created, but also on the number of years that these apartments remain affordable, a measure we label "apartment-years of affordability." Based on our more realistic assumptions, IBO estimates that the EAB program will preserve or create 28,730 affordable apartment-years, or 43 percent of the apartment-years created under the extreme assumption that all apartments preserved as affordable are solely attributable to the EAB program. The net fiscal cost of preserving or creating these apartments under our more realistic assumptions is \$30,000 per apartment per year.

<b>Under More Realistic Assumptions, Nearly 29,000 Affordable Apartment-Years Are Preserved or Created Through the Extended Affordability Benefit</b>			
	<b>All Affordable Apartments Preserved or Created Attributable to EAB</b>	<b>Only Apartments Created at 130 Percent of AMI Attributable to EAB</b>	<b>More Realistic Estimate of Affordable Apartments Preserved or Created Under EAB</b>
Number of Affordable Apartments	4,508	792	4,162
Number of Affordable Apartment Years	65,890	11,880	28,730
EAB Tax Expenditure per Affordable Apartment	\$190,000	\$1,081,000	\$206,000
EAB Tax Expenditure per Affordable Apartment per Year	\$13,000	\$72,000	\$30,000
NOTES: Dollars are expressed in present value terms. The estimates assume all eligible buildings opt into EAB program. <i>New York City Independent Budget Office</i>			

IBO's cost estimates implicitly assume that from a public policy perspective an affordable apartment at 40 percent of AMI is just as desirable as an otherwise identical affordable apartment at 80 percent of AMI. If policymakers value apartments at different levels of affordability differently, the program's cost would need to be weighted based on the relative importance of various affordability levels.

IBO's cost estimates do not reflect possible impacts of requiring EAB buildings to pay a prevailing wage to many of its employees. Though prevailing wages may affect city revenue through the income and sales taxes, we do not have sufficient data on existing wages to evaluate the marginal increase in personal income or marginal decrease in business income due to a prevailing wage requirement. Relative to citywide personal and business income, the revenue impact of paying prevailing wages to non-union workers in the EAB buildings would be negligible. From the perspective of some building employees, however, a requirement that they receive prevailing wages would have a considerable impact. For 2016, the city Comptroller has set prevailing wages for doormen and porters at \$33.44 an hour (\$23.06 for wages and \$10.38 for supplemental benefits), very close to the \$33.96 per hour rate (\$23.06 for wages and \$10.90 for supplemental benefits) for unionized doorman and porters. Since prevailing wage requirements closely follow union wage rates, the primary beneficiaries of the prevailing wage requirement would be nonunionized building service workers. IBO has no data on the extent of unionization among employees of the 63 EAB-eligible buildings.

### **EAB Program Implementation**

In early March, HPD released proposed rules for administering the EAB program and held a public hearing on the proposed rules on April 12<sup>th</sup>.

The proposed rules provide some clarification on a variety of questions regarding the EAB program's implementation, from application to rent requirements. With respect to applying for EABs, eligible property owners can only apply after a building is in compliance with EAB requirements but before December 31, 2016 (for buildings whose tax benefits expired in 2015) or 18 months after the expiration of the initial 421-a benefit period (for all other buildings), whichever is later.



Program compliance entails submitting the necessary application, application fee, and a regulatory agreement stating, among other things, that all affordable apartments will remain affordable and rent-stabilized for the duration of the EAB period, and further that any tenant holding a lease at the expiration of the EAB period will continue to receive rent stabilization protection until they vacate the apartment. Furthermore, applicants must submit evidence that during the initial 421-a benefit period all affordable apartments were rented to tenants under the required rent and income ceilings. Building owners must also demonstrate that all of the 130 percent AMI apartments are occupied by households awarded through the city's affordable housing lottery.

Notwithstanding any overlapping regulatory agreements also requiring affordable housing, the continued affordability of the existing 20 percent apartments rests on a building owner's ability to fill the additional 5 percent of affordable units with households from the lottery. At minimum, property owners need a 5 percent turnover rate in their market-rate apartments in order to have sufficient number of these apartments available for designation as affordable. Evidence suggests that the apartment turnover rate in the unregulated market exceeds multiples of 5 percent, and therefore IBO does not anticipate EAB-eligible property owners finding it difficult to redistribute the required number of apartments from market-rate to affordable for renters at 130 percent of AMI or less.<sup>7</sup>

As a final point of discussion, for the 20 percent of apartments at 80 percent of AMI or less, the proposed rules require that rent cannot exceed 30 percent of the AMI (less an allowed utility expense) in effect at the time the initial 421-a benefit period commenced, or legally permitted rent.<sup>8</sup> Since qualifying income is determined as of initial occupancy, by not resetting AMI to current levels, households whose real income growth has exceeded the area median during the initial 421-a exemption period will continue to benefit from subsidized housing through the EAB period. Of course, those households whose real income growth has not kept pace with the area median will also continue to benefit from subsidized rents.

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## Endnotes

<sup>1</sup>The state legislation was Chapter 20 of the laws of 2015 (Senate Bill 6012).

<sup>2</sup>AMI levels are determined by the U.S. Department of Housing and Urban Development and are re-estimated each spring. The New York City metropolitan area includes portions of New Jersey and Long Island.

<sup>3</sup>Rental buildings where 100 percent of the apartments are designated affordable *and* 50 percent or more of the apartments during the EAB period are designated for families earning up to 125 percent of AMI are not required to pay prevailing wages.

<sup>4</sup>Apartments vacated due to malicious action by the property manager, such as turning off water, do not become deregulated.

<sup>5</sup>In her June 2015 testimony, Commissioner Been noted that HPD also identified 63 eligible buildings housing 3,800 affordable apartments. However, IBO was unable to verify with HPD that the 63 buildings we identified are the same 63 buildings HPD identified. In addition, please note that the number of eligible buildings identified here is seven fewer than what IBO reported last June, a difference attributable to better information about the program's eligibility criteria.

<sup>6</sup>IBO's cost estimate does not take into account potential tax expenditure savings from eligible properties' postponement of J-51 tax benefits. The J-51 program provides an abatement and exemption for capital

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improvements for up to 34 years for buildings with affordable housing. Eligible buildings would not start receiving EABs until they are 20- or 25-years old, at which point buildings owners might apply for J-51 benefits to help finance rehabilitation. EABs are intended to subsidize discounted rents while J-51 is intended to encourage rehabilitation. Since 421-a and J-51 are mutually exclusive programs, agreeing to lower rents means postponing property improvements for the duration of the EAB period. If buildings opt into the EAB program the city saves on the J-51 benefits it may have otherwise had to provide during the EAB period. More precisely, the savings equals the present value of the J-51 benefits if they were taken at the end of the initial 421-a benefit period if a building did not opt in less the J-51 benefits if they are taken at the end of the EAB period if a building did opt in. It was not possible for IBO to generate an estimate of the J-51 tax expenditure offset without making unreasonable assumptions.

<sup>7</sup>We learned anecdotally from industry insiders that market-rate apartments tend to have tenant turnover rates in the double-digits, and some evidence bears this out. See, for example, Husock, Howard. (2013). "The Frozen City." *City Journal*, 23 (5).

<sup>8</sup>For the 5 percent of apartments at 130 percent of AMI, initial rent is based upon current AMI levels.