New York City Independent Budget Office

Focus On:
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The Mayor's 421-a Proposal: Estimating Tax Revenue Forgone and Affordable Housing Gained

The 421-a property tax exemption is the city's most controversial tax incentive program with vocal advocates for and against its continuation. The program reduces the assessed value of residential property subject to the property tax for a number of years, with the benefit duration depending on a building's eligibility. Under current law, at least 20 percent of a building's apartments must be set aside as affordable to receive the tax benefit if the building is located within certain areas of the city. The program is set to expire on June 15 unless the Legislature acts. While some have called for simply extending the current program and others have called for its complete elimination, the de Blasio Administration has proposed to extend the program but with significant changes.

Mayor de Blasio has proposed a three-part reform in an effort to focus more of the future benefits on the preservation or construction of affordable housing. The first proposal calls for eliminating 421-a eligibility for new coop and condo projects. The second aims to encourage additional production of affordable housing by lengthening the exemption period for new rental projects in exchange for a higher concentration of on-site apartments designated for low-, moderate-, and middle-income families. The third aims to preserve affordable housing in existing 421-a buildings with 20 percent on-site affordable apartments by offering a 50 percent exemption for an additional 15 years in exchange for increasing the number of apartments set aside as affordable.

IBO estimates that if the Mayor's proposed changes were enacted:

- new 421-a tax expenditures would be $2.7 billion greater than if the program is simply extended in its current form,
- the changes would result in the creation or preservation of 13,241 additional affordable units over 10 years; and
- that the average cost to the city—measured in tax expenditure terms—to create or preserve one additional affordable unit for one additional year would be $20,899 less than if the current law were extended.

These estimates are very similar to the projections for the parts of the reform plan presented by the de Blasio Administration earlier this week at a City Council hearing.

IBO analyzed the property tax cost and affordable housing implications for each of the proposals in the Mayor's reform package and then calculated the cost and housing implications for the package as a whole. For the first two proposals our analysis considers how the Mayor's reform package would have changed property tax expenditures and housing in new 421-a buildings added to the tax roll in 2015. We then generalize our findings to new hypothetical sets of buildings added to the tax roll each year for the next 10 years to generate a sense of the cost and housing implications of the Mayor's proposed reforms relative to current 421-a policy. In doing so, we follow the de Blasio Administration's lead in reporting cost and housing implications over a 10-year horizon. Our analysis of the third proposal starts with the set of buildings on the 2015 roll that would have been eligible under the Mayor's proposal.

Because the city is still in the midst of a transition period stemming from the last major 421-a reform in 2008, it was necessary to estimate what the property tax expenditures and affordable housing situation would look like under current 421-a law once the transition period has concluded in order to create a baseline scenario to compare the Mayor's proposals against. Therefore, IBO's estimates are comparable to how things would look at a point in the near future when very few new 421-a buildings constructed under pre-2008 eligibility rules are being added to the tax roll.

By necessity, IBO's estimates depend on underlying assumptions about how developers would react to the proposed policy changes in the coming years. We present our estimates as preliminary given the uncertainty in predicting how the city's real estate market will change in the short- and long-run. When choosing among a range of plausible assumptions we followed an analytically conservative approach so as to reduce the risk that our projections will underestimate future costs (here in the form of tax expenditures) or overestimate future benefits (the number of affordable units created).

Proposal 1: Eliminate 421-a for Coops and Condos

The de Blasio Administration has proposed eliminating 421-a benefits for new coops and condos. The tax expenditure for the 145 condo and coop buildings first receiving 421-a benefits in 2015 is $27.5 million, and over the buildings' exemption lifetimes we expect the cumulative tax expenditure to be $267.2 million in present value terms. Over the next 10 years, IBO calculates that excluding condos and coops from the 421-a program could reduce the city's property tax expenditure by $2.0 billion. But this estimate ignores factors that will likely reduce the city's actual savings. Instead, IBO estimates that the present value of the net savings would be $987.2 million over the next 10 years. There are four reasons why actual savings will be less than the simple tax expenditure calculation indicates.

First, over the next few years, some new coops and condos will be eligible to start receiving 421-a benefits even if the Mayor's proposal is implemented. Due to the lengthy policy transition period following the 2008 reforms, many buildings that have been grandfathered into the program under old rules continue to be added to the tax roll. Because the city is committed to the future costs and savings of grandfathered projects, any changes in tax expenditures due to these buildings are independent of the Mayor's proposed reform. We therefore exclude them from our analysis, which results in a reduced tax expenditure savings estimate of $1.3 billion.

Second, condos serving as primary residences that otherwise would receive 421-a would instead become eligible for the city's existing coop-condo abatement, which under current law is not available to apartments in buildings receiving 421-a. IBO estimates that over the next 10 years, the city would spend the present value equivalent of $228.0 million more on the coop-condo abatement for these buildings. With this adjustment, IBO further reduces the estimated tax expenditure savings to $1.1 billion.

Third, some condos and coops receiving 421-a also contain affordable housing. Since 2008, 25.3 percent of the on-site affordable housing created under 421-a has been located in condos and coops. If eliminating 421-a for condos and coops eliminates the affordable housing these buildings would have contained, then it is a loss to the city's affordable housing stock. If that loss were to be offset by an equal increase in affordable housing in new rental buildings, then the net gain to the city in terms of units is zero as the Mayor's proposal will have simply induced a substitution from one type of housing location to another rather than a net gain in affordable housing stock. To reflect this possibility, we assume 20 percent of the 421-a tax expenditure is attributable to 20 percent of the on-site affordable housing in relevant buildings. We then adjusted this figure downward by 25.3 percent to account for substituted affordable housing. Since this is money that would be directed towards affordable housing in rentals rather than in condos, avoiding this portion of the 421-a tax expenditure that would be expected if the current eligibility rules were extended is not a net revenue gain to the city. Over 10 years the estimated substituted spending is modest, $22.7 million.

Fourth, some condo development that would have occurred if current rules were extended will presumably not take place in the absence of the exemption. To the extent this is true, the avoided tax expenditure overestimates the amount of revenue the city will actually receive if coops and condos are no longer eligible to receive 421-a. It is impossible to know how much additional condo development that would have occurred under current program rules would not occur if the Mayor's proposal is enacted. Nonetheless, we expect the policy change to discourage some development, and we would be remiss to not adjust for it. IBO assumed the developments most likely to not proceed are those at the lower end of the price spectrum. Based on the share of newly constructed 421-a condos selling for less than $500,000 since 2008, we could expect that 10.2 percent of all currently planned condos will not be developed. Therefore, we further reduce our tax expenditure estimate by this percentage, leaving a net "savings" to the city of $987.2 million over the next 10 years once the policy transition period has concluded.

Proposal 2: Provide New Rental Buildings More Benefit Years in Exchange for 5 Percent to 10 Percent More Affordable Housing

Mayor de Blasio's second proposal is to amend current 421-a law with provisions allowing a longer benefit period in exchange for creating more affordable housing units. Specifically, the proposal would increase the benefit period to 35 years for all new 421-a projects and increase the minimum percentage of on-site affordable housing units from 20 percent under current law to either 25 percent or 30 percent of the units, depending on the mix of income levels the developer chooses to offer. Current policy requires all affordable apartments in 421-a buildings with on-site affordable housing to be set aside for low-income families—those earning no more than 60 percent of the area's median income (AMI). The Mayor's proposal would increase income eligibility for some units up to 130 percent of AMI with exact income levels depending on program requirements.[1] Moreover, for the first 25 years of the benefit period, the exemption is 100 percent of the assessed value added to the land due to construction while during the final 10 years the exemption equals the percentage of on-site affordable housing. Under the Mayor's proposal it would no longer be possible to receive 421-a benefits without providing on-site affordable housing.

In order to generate cost and housing estimates, IBO makes the simplifying assumption that all new rental buildings that otherwise would be eligible for 20-year or 25-year benefits under current policy set aside 30 percent of its apartments as affordable. In addition, we assume that the Mayor's more generous exemption period would incentivize rental buildings that currently are not required to provide on-site affordable housing to do so.

IBO estimates that over the next 10 years this piece of the Mayor's proposal would cost $2.2 billion more, in present value terms than if current 421-a rules were extended. However, because the proposal requires more affordable housing, the city would have gained an additional 9,197 apartments designated for moderate- and middle-income families. Because current 421-a policy already requires low-income housing, any additional units would be for these higher-income families. Thus, while the total program cost increases, the amount of foregone property tax revenue per affordable apartment created falls from $577,300 under current policy to $383,800 under the Mayor's proposal.

Over the Next 10 Years, More 421-a Benefits for More Affordable Housing Would Cost More Overall But Less per Affordable Apartment Compared to Current 421-a Policy

	Current 421-a	Proposed 421-a	Change
Tax Expenditure (in millions)	$3.823	$6.071	$2.248
Affordable Apartments	6,622	15,819	9,197
Tax Expenditure per Affordable Apartment	$577,300	$383,800	$(193,500)
Affordable Apartment Years	146,170	553,654	407,484
Tax Expenditure per Affordable Apartment per Year	$38,500	$31,400	$(7,100)

NOTE: Figures may not add due to rounding.

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An alternative way to consider the change in cost is in terms of apartment years, which is the number of years an apartment is affordable. For example, two apartments affordable for 20 years equals 40 apartment years. Because not every apartment remains affordable for the same amount of time under current law, comparisons between the Mayor's proposal and current law on a per apartment basis are not the most comprehensive method of assessing the cost differences. Using apartment years addresses this issue because it accounts for differences in the length of time an apartment is affordable. If current rules were extended, IBO estimates the city will forgo $38,500 in property tax revenue per affordable apartment per year while under the Mayor's plan the cost falls to $31,400, a reduction of $7,100 in the annual per apartment cost.

Proposal 3: Provide Existing 421-a Rental Buildings More Benefit Years in Exchange for Setting Aside 5 Percent More of the Apartments as Affordable

The Mayor's third proposal aims to preserve existing affordable housing created under 421-a, but the extended benefits are only available to buildings that began receiving 421-a before 2008. The plan offers an extension of current 421-a tax breaks for 15 years for buildings currently receiving 20-year benefits and for 10 years for those currently receiving 25-year benefits. In exchange for a 50 percent reduction in tax liability during the extension period, the Mayor's plan requires that landlords increase the number of affordable units by 5 percent, where "affordable" is based on a family of four earning up to 130 percent of the area's median income. In addition, the proposal requires currently designated affordable apartments to remain affordable for the duration of the extended benefits period.

To estimate the cost of this proposal, IBO adopted the simplifying assumption that all eligible buildings would opt-in. Based on an analysis of the 2015 property tax roll, we found 70 buildings currently receiving 421-a that would be eligible for the Mayor's preservation proposal—69 of which are in Manhattan.

The Mayor's third proposal would be more expensive both in terms of total cost and cost per apartment compared with current 421-a policy. The city is committed to forgo $3.3 billion in property tax revenue in present value terms for these 70 buildings. Granting 10 to 15 more years of a 50 percent exemption would increase the cumulative cost of 421-a by about $1.5 billion. In exchange, the city would add or preserve 4,625 apartments to its affordable housing stock—3,700 currently affordable apartments that would remain so for up to 15 additional years and the balance of those units that would be shifted from market to affordable. On a per apartment basis, under current law the city will "spend" $905,000 over the exemption lifetime in forgone tax revenue for each affordable apartment. Under the Mayor's proposal the average cost would be $1.041 million.

However, this proposal's cost cannot be meaningfully evaluated on a per apartment basis. Because different apartment buildings are at different points in their 421-a exemption life, there will be differences between buildings in terms of when the city will incur additional tax expenditure, which affects the value of the tax expenditures in present value terms. A building currently receiving 20-year benefits in the first year of its exemption life will begin to receive the extended benefits 19 years from now whereas the same building in the final year of its exemption life will begin to receive it next year. This makes evaluations on a per apartment basis a misleading method of evaluating average program costs.

Thinking of the proposal's cost in terms of affordable apartments per year corrects for these issues. Under current law, IBO expects the city will spend $45,200 annually per affordable apartment for the eligible rental buildings. The Mayor's proposal increases the average annual cost to $54,742.

Overall Reform Cost

IBO estimates that the Mayor's 421-a reform package would cost the city $2.7 billion more in forgone revenue over the next 10 years compared with extending current policy. While excluding condos and coops from 421-a saves the city nearly $1 billion over this period, the savings is more than offset by the Mayor's other two proposals which increase spending in order to add or preserve more units in the city's affordable housing stock. In addition, the Mayor's plan is expected to add or preserve about 13,200 more apartments for middle- and moderate-income families, and the average cost in terms of property tax expenditures to subsidize these apartments is $20,899 less per apartment per year compared with current 421-a policy.

Our estimates, though based on reasonable assumptions today, should nonetheless be viewed with caution. Because the program confers a substantial tax benefit, if enacted the Mayor's reforms would change the incentives to build residential housing in both the short-run and long-run. As the market responds to a different incentive structure, one would expect the assumptions underlying our estimates to also change over time, thereby changing the cost and

Extending Benefits for Existing 80/20 Buildings Would Cost More Overall and More per Apartment Year Compared With Current 421-a Policy

	Current 421-a	Proposed 421-a	Change
Tax Expenditure (in millions)	$3.348	$4.813	$1.466
Affordable Apartments	3,700	4,625	4,625*
Tax Expenditure per Affordable Apartment	$905,000	$1,041,000	$136,000
Affordable Apartment Years	74,088	87,938	13,850
Annual Tax Expenditure per Affordable Apartment	$45,200	$54,742	$9,552

NOTES: *This figure includes the 3,700 affordable apartments to be preserved in addition to the 925 newly created ones.
Values may not add due to rounding.

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Over the Next 10 Years, the Mayor's Proposals are Expected to Cost More Overall But Less per Apartment Year

	Additional (Savings)/ Cost (in millions)	Change in Affordable Apartments	(Savings)/ Cost per Affordable Apartment per Year
Proposal 1: Net savings From Eliminating Condo/Coop Eligibility	$(987.2)	(580)	$(48,700)
Proposal 2: 35-Year Benefits for New Rental Buildings	$2,248	9,197	$(7,100)
Proposal 3: Extend Benefits for Existing Rental Buildings	$1,466	4,625	$9,552
Total	**$2.736**	**13,241**	**$(20,899)**

New York City Independent Budget Office housing projections. It is difficult to predict how attractive or unattractive a new policy will be compared with the status quo, particularly in a program as complex as 421-a. Consider that only four years after the state created the now defunct 421-a certificate program in 1985, the program's popularity had caught city officials off guard.[2] For better or worse, over the next two decades the certificate program played a much larger-than-expected role in the city's residential development landscape.

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Endnotes

[1]The Mayor's proposal offers developers of rental housing three paths to receiving 421-a benefits with each path requiring a different combination of income-restricted affordable housing. Developers that set aside at least 20 percent of the units for low-income families (based on a three-person family making $46,620 a year or less today) need only set aside another 5 percent for middle-income families to be eligible. Otherwise, developers can choose to either set aside 30 percent of the apartments for middle-income families ($101,010 a year), or set aside 10 percent of units for moderate-income families ($54,380 a year) and 20 percent for middle-income families.
[2]Peterson. Ivey. "Linking 421-a to Low-Income Housing," *The New York Times*, December 17, 1989.

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