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policy brief

An Overview of Section 421-a Housing Subsidy Distribution

Section 421-a of the Real Property Tax Law was enacted in 1971 to encourage developers to build new multi-family housing in New York City by granting them substantial property tax savings. In Fiscal Year 2005, more than \$320 million in tax savings was provided to developers and purchasers of 421-a subsidized housing. Since 1998, the annual value of 421-a subsidies has increased by more than \$240 million. The 421-a program is now the third largest New York City real estate tax expenditure.¹

In Manhattan, generally between 14th and 96th Streets and within portions of the Williamsburg/Greenpoint waterfront, developers who receive 421-a benefits are required to help finance the construction of affordable housing offsite or to set aside a portion of their project for affordable housing. Elsewhere, there is no requirement to help finance affordable housing.

The Office of the Comptroller prepared the following overview of the distribution of 421-a subsidies in order to assist policy makers in determining how the program should be restructured.

Strong housing demand calls current 421-a program into question

When Section 421-a of the Real Property Tax Law was enacted in the early 1970's, New York City's population was shrinking, a severe fiscal crisis was looming, and a number of major employers had left the City or had announced their imminent departure. The residential real estate market was troubled and the construction of new private multi-family housing had virtually ceased outside of Manhattan and Staten Island.² In this environment, the broad consensus of public policy makers was that substantial subsidies to encourage new multi-family housing construction were largely justified.

The real estate market today is quite different. The number of new housing permits issued annually has grown steadily and dramatically, from permits for 4,446 units in 1994 to permits for 31,599 units in 2005.³ A Citywide surge in market rate housing construction has been accompanied by large increases in residential and commercial property values, a growing population and a City fiscal outlook transformed from the 1970's. With a recent population projection predicting 1.2 million more New Yorkers by 2025, demand for new housing is likely to remain strong.⁴

At the same time, however, New York faces a very serious housing affordability crisis. According to the 2005 New York City Housing

and Vacancy Survey, 28.8% of all renter households paid more than half their incomes on shelter and 22.6% of all renter households have incomes below the federal poverty level. The pressures facing moderate- and low-income families have been exacerbated by the loss of more than 12,000 units of affordable Mitchell-Lama housing since 2004. Further, the cost of purchasing market-rate housing has soared beyond the means of most New Yorkers. Therefore, while the justification for tax incentives to induce market rate construction may have dissipated in some parts of the City, the need for more affordable housing has grown more pressing.

421-a in brief

Section 421-a of the New York State Real Property Tax Law authorizes New York City to provide decreasing exemptions from real property taxes to new residential and mixed-use developments with three or more housing units. The project must be built on land that is vacant, underutilized or improved with a “nonconforming use.” Currently, the program provides 10-, 15-, 20- and 25-year tax exemptions:

- **10 years.** 10-year exemptions are offered in the Manhattan “exclusion zone,” encompassing the area between West Houston/14th Street and 96th Street. Developers in this area who apply for 10-year exemptions purchase negotiable certificates from developers of affordable housing. Either four or five certificates are provided for each unit of affordable housing, depending on the income eligibility requirements for the affordable housing. Ten-year exemptions also are available without any requirement to purchase affordable housing certificates in Manhattan south of the exclusion zone and between 96th and 110th Streets.
- **15 years.** 15-year exemptions, with no requirement to assist in the development of affordable housing, are available in Manhattan north of 110th Street and in all areas outside of Manhattan, except for certain sections of the Greenpoint/Williamsburg waterfront. Full exemption is provided for the first eleven years, followed by 80 percent exemption in the twelfth year, 60 percent exemption in the thirteenth year, 40 percent exemption in the fourteenth year, and 20 percent exemption in the final year.
- **20 years.** Developments in the Manhattan “exclusion zone” must set aside at least 20 percent of the units for households with incomes below 50% of the area median. These developments are also eligible for tax-free bond financing through either the New York City Housing Development Corporation or the New

York State Housing Finance Agency. Developments receive full exemption from property taxes for the first 12 years, 80 percent exemption for the following two years, 60 percent exemption for the subsequent two years, 40 percent exemption for the next two years, and finally two years of 20 percent exemption. Developments outside the exclusion zone are eligible for 20-year tax exemptions if they meet other criteria, such as significant government funding and/or financing. However, the mix and amount of affordable housing development varies.

- **25 years.** A development is eligible for the 25-year declining tax exemption if it meets a number of criteria, including setting aside 20% of the units for low-income households, if the development is located in a Neighborhood Preservation Area, an area eligible for Rehabilitation Mortgage Insurance Corporation (REMIC) insurance, and/or received substantial government assistance. There is a 100% tax exemption for the first 21 years and a 20% per year declining exemption for the remaining four years.

In addition, developers are entitled to up to three years of full exemption while the building is under construction.

Initial rents in rental buildings that are developed with 421-a assistance are established according to a statutory formula by the New York City Department of Housing Preservation and Development (HPD). Thereafter, units are subject to rent stabilization until the 421-a exemption expires.

Findings

1. Subsidies are heavily concentrated in Manhattan. In Fiscal Year 2005, Manhattan developments received 78% of all 421-a benefits but accounted for only 48% of the units that received 421-a benefits. Elsewhere, this pattern was reversed, with the percentage of units receiving 421-a benefits exceeded by the percentage of total 421-a exemption value taken. Among the factors behind Manhattan’s especially large subsidies compared to the number of units created are higher land values than elsewhere in the City, a large share of high-value condominium units -- which tend to have higher subsidies per unit -- receiving 421-a benefits than in the other boroughs, and a larger proportion of units developed for the high end of the market. The combination of these and other factors result in average assessment values that are significantly greater on a per-unit basis than the other boroughs.

Borough Distribution of Section 421-a Benefits and Units, 2005

Borough	Total 421-a exempt value	Percent of 421-a exemption	Percent of 421-a units
Manhattan	\$2,069,495,023	78%	48%
Bronx	\$82,706,729	3%	9%
Brooklyn	\$238,216,222	9%	21%
Queens	\$231,896,360	9%	19%
Staten Island	\$17,108,441	1%	3%

Neighborhoods with the largest 421-a concentrations as measured by exemption value are the Upper West Side (11%), Harlem (9.5%), Midtown/Clinton (9%), Fur-Flower District (7%), Lincoln Center (7%) and Sutton Place (7%).

2. Units with the largest subsidies are in Manhattan.

Developments with subsidies of more than \$10,000 per unit in 2005 accounted for 19 percent of units in the 421-a program but received more than 50 percent of 421-a benefits.⁵ These deeply subsidized units had a market value of \$4.2 billion.⁶ In 2005, 98% of these units were located in Manhattan.

Subsidies are not capped, and in 2005 property tax savings exceeded \$100,000 per unit in units at a number of Manhattan 421-a developments including 176 Perry Street, 351 East 51st Street and 845 United Nations Plaza (Trump World Tower), where per-unit savings ranged as high as \$160,000.

3. Outside of Manhattan, there are concentrations of buildings receiving 421-a benefits in growing neighborhoods. Concentrations of projects receiving 15-year exemptions can be found in communities outside of Manhattan with some of the fastest population growth rates in the City, such as Flushing, and in communities where the socio-economic demographic mix is becoming more affluent, such as in Greenpoint/Williamsburg.⁷

Number of 421-a Units and Value of Benefits in Selected Brooklyn Neighborhoods Receiving 15-Year Exemptions, 2005

Neighborhood	Residential Units	Market Value	Assessed Exempt Value	421-a Subsidy
Borough Park	754	\$184,109,815	\$10,962,509	\$1,505,279
Brooklyn Heights/Cobble Hill	379	\$47,871,766	\$17,215,955	\$2,132,079
Sheeps-head Bay/Brighton Beach	1,177	\$179,749,453	\$45,427,678	\$5,714,998
Williamsburg	914	\$98,019,571	\$33,970,586	\$4,216,839

In Brooklyn, developments receiving 15-year 421-a benefits are concentrated in Brighton Beach (25% of Brooklyn exemption value), Williamsburg (19%), Brooklyn Heights (10%), and Borough Park (7%). These neighborhoods have experienced increased housing demand and strong residential real estate markets.

In Queens, developments with 15-year 421-a benefits are most concentrated in Flushing (26% of Queens exemption value), Forest Hills (12%), Richmond Hill (9%) and Woodside (6%). From 1990 to 2004, the population of Queens increased 14%, and some communities with heavy concentrations of 421-a developments experienced even greater population increases.⁸

Number of 421-a Units and Value of Benefits in Selected Queens Neighborhoods Receiving 15-Year Exemptions, 2005

Neighborhood	Residential Units	Market Value	Assessed Exempt Value	421-a Subsidy
Flushing	1,103	\$165,329,822	\$31,531,395	\$3,895,623
Forest Hills	479	\$84,115,950	\$13,870,444	\$1,713,930
Richmond Hills*	41	\$26,471,000	\$10,980,043	\$1,266,134
Woodside	472	\$105,523,350	\$5,908,374	\$852,015
Rego Park	354	\$44,699,844	\$6,761,248	\$819,109

* Richmond Hill includes a development receiving 421-a benefits that provides housing for seniors for which RPAD does not list the number of housing units.

4. The 421-a program also subsidizes non-residential uses within a residential development, including commercial office and retail spaces, day care centers, medical offices, storage rooms, parking garages and even wine cellars. Commercial condominiums received \$19 million in subsidies through the 421-a program in 2005.

5. The 421-a 80/20 program has produced approximately 2,100 units of affordable housing at a subsidy cost of over \$1 billion. As noted above, developments receiving 20-year 421-a property tax exemptions are required set aside a portion of the development's units as affordable housing. Manhattan developments currently participating in the 421-a 80/20 program have created approximately 2,100 units of affordable housing. These developments received subsidies of \$103 million in 2005, or nearly \$50,000 per unit of affordable housing developed. During their remaining years in the 421-a program, these developments will receive more than \$1 billion in taxpayer assistance, non-discounted, or more than \$520,000 per unit of affordable housing created.⁹ This does not include subsidies received in prior years.

6. More than 7,675 housing units received subsidies through the 421-a negotiable certificate program in 2005.

As noted above, developments receiving 10-year exemptions must purchase certificates from affordable housing developers if the development is located within an exclusion zone. In 2005, developments receiving 10-year 421-a benefits in the exclusion zone received approximately \$119 million in tax exemptions. While no official estimate of the average price of these certificates is produced by the Department of Housing Preservation and Development, developers and housing advocates have reported that negotiable certificates typically fetch between \$10,500 and \$13,000.¹⁰ With an average of four 421-a negotiable certificates per affordable unit of housing, these developments helped finance approximately 1,918 units of affordable housing. The subsidy for each affordable unit of housing generated through the 421-a negotiable certificate program was likely between \$42,000 and \$52,000. The average tax expenditure per affordable unit of housing in 2005 financed through the 10-year negotiable certificate program was more than \$58,000.

7. In Manhattan south of the exclusion zone, 421-a subsidies totaled more than \$24 million in 2005.¹¹ In this area, high-value residential condominium units that received more than \$10,000 in tax benefits in 2005 accounted for 58% of the total benefits given to residential condominium units. For example, a development located at 124 Hudson Street received subsidies of more than \$26,000 per unit in 2005, including two units receiving more than \$72,000. The majority of the 421-a benefits given south of the Manhattan exclusion zone were to rental buildings. There was no requirement for developers and purchasers of 421-a assisted units in this area to help finance affordable housing.

Issues for further research

The scope of the research conducted for this *Policy Brief* was limited to examining how Section 421-a subsidies have been distributed geographically and by subsidy level. Even with this limited scope, however, the findings indicate that if it is to be retained, the 421-a program should be updated to reflect that the City's residential real estate market is much stronger than in the early 1970s, when 421-a was enacted, and that the non-Manhattan market, especially, is much healthier than in the 1980s, when an exclusion zone was added only in Manhattan. Further in-depth research could prove invaluable to policy makers, including:

Whether to extend the exclusion zone. Assuming that the 421-a program continues to delineate exclusion zones where developers are required to contribute to affordable housing, a

comprehensive study would be needed of neighborhoods where the exclusion zone could be extended without unduly deterring market rate housing construction. Clearly, given the dramatic recent run-up in real estate prices and the surge in high-end luxury housing construction in Manhattan south of East 14th Street and West Houston Streets, this is one area that should be considered for exclusion zone designation. In Manhattan north of 96th Street and elsewhere in the City, there are a number of communities where recent substantial increases in multi-family market rate housing investment and robust residential real estate markets call into question the necessity of continuing to provide 421-a subsidies with no requirement to contribute to affordable housing.

A study of potential exclusion zone expansion communities would need to look carefully at the local economics of market rate multi-family housing construction, with analysis of several building types and use mixes, taking into account the cost of developable property, hard and soft construction costs, building operating costs, rates of return, local real estate markets and other variables.

Such a study could also analyze the impact of eliminating 421-a subsidies in certain communities. The City could dedicate any resulting increased tax revenue directly to affordable housing.

How much affordable housing contribution to require in exclusion zones. The Comptroller's analysis of 421-a benefit distribution raises the question of whether exclusion zone programs have generated sufficient affordable housing considering the scale of the tax expenditure. As noted, projects currently participating in the 80/20 program have created approximately 2,100 units of affordable housing in return for more than \$1 billion in subsidy. If the required percentage of affordable housing had been greater, would more affordable units have been constructed, or might there have been fewer 421-a assisted projects and therefore fewer new affordable units? A study might show that in some potential new exclusion zone communities, a smaller affordable housing contribution than what is currently required in Manhattan would be warranted, while in some or all of the current Manhattan exclusion zone, the affordable housing contribution requirement could be increased with little or no adverse effect.

How to revise the negotiable certificates program. There is no government oversight of the negotiable certificates marketplace nor is there a minimum price for a certificate. The result is that developers effectively have a private license to trade City tax revenue unhindered and the value of the affordable housing contributions made in return for 10-year exemptions frequently is very small relative to the amount of subsidy received.

Alternative methods of determining which 421-a projects must contribute to affordable housing. A major drawback to using exclusion zones to determine which developments must contribute to affordable housing is that local residential real estate markets can change quickly. If a “hot” neighborhood quickly cools down, development might stall or cease because requiring an affordable housing contribution may make market rate development no longer economically viable. Yet it would be impractical and could hinder developers when planning new projects if exclusion zone boundaries were revised every year or two to reflect changes in local real estate demand.

An alternative approach would retain the 421-a framework but link affordable housing contributions to projects at any location in the City if certain project attributes meet specified benchmarks. For example, a developer wishing to receive 421-a benefits could be required to contribute to affordable housing if selling prices or rents exceed stipulated affordability criteria, established relative to neighborhood market values or household incomes.

The impact of 421-a tax subsidies on land costs. What is the impact of the 421-a program on the cost of developable property? Does the existence of as-of-right 421-a benefits serve to inflate the cost of land, thereby negating much of the incentive effect on developers?

Conclusion

Based on a review of the distribution of 421-a benefits by geography and benefit levels, this Policy Brief has raised a number of questions about the equity and effectiveness of the current structure of the program. The Comptroller’s Office is hopeful that the Mayor’s 421-a Task Force will take this analysis into consideration as it contemplates changes to the program.

Methodology

These findings were calculated using data supplied by the New York City Department of Finance (DOF) and the New York City Independent Budget Office (IBO). DOF supplied the Final Real Property Assessment Data (RPAD) for 2005/2006 on a CD Rom released generally to the public which provided the market value, assessed value, value of exemptions, the number of residential units, and geographic information, among other variables for all properties in New York City. A list of properties receiving 421-a benefits was generated by the IBO using data obtained from DOF but not generally released as a standard database to the public. These two data sets were combined to determine the characteristics of the properties receiving 421-a benefits.

A close review of the data found a small number of records where the number of residential units was misreported in DOF’s RPAD file. These records were corrected based on information available in other public information sources, such as certificates of occupancy.

Endnotes

¹ Calculations are based on New York City Department of Finance Office of Tax Policy, *Annual Reports on Tax Expenditures, Fiscal Years 1998 to 2005*.

² From a peak of 36,061 in 1972, the number of permits issued for housing units in New York City fell sharply to only 3,810 in 1975, 5,435 in 1976 and 7,639 in 1977. Source: U.S. Bureau of the Census.

³ United States Bureau of the Census, *New Construction Statistics, 1988 to 2005*.

⁴ Sam Roberts, “Coming Soon, 9 Million Stories in the Crowded City,” *New York Times*, February 19, 2006.

⁵ In contrast, 40% of units received \$3,000 or less in 2005.

⁶ Calculated using the market value reported in DOF’s RPAD Final Assessment File 2005/2006.

⁷ Calculated using US Census Bureau data found at Infoshare.org.

⁸ *Ibid.*

⁹ The total value of the remaining subsidy for developments currently receiving 421-a benefits under the 80/20 program was calculated by applying the declining tax exemption to each development to future assessed values, which was assumed to grow at 4% per year. The values are presented in current dollars.

¹⁰ The price range for 10-year 421-a negotiable certificates was consistently reported in interviews with housing developers and housing advocacy organizations to be \$10,500 to \$13,000.

¹¹ The data provided by RPAD does not indicate if a development was required to support the creation of affordable housing and/or if the development was located within an exclusion zone. To identify those developments within or outside of the exclusion zone, geographic information for each development was imported into ArchInfo, a geographic information software program. After being geo-coded, the boundaries of the exclusion zone were created to identify those developments within the exclusion zone.

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