NEW YORK CITY COMPTROLLER
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A Better Way Than 421-a:
The High-Rising Costs of New York City's Most Unaffordable Tax Exemption Program

BUREAU OF BUDGET & BUREAU OF POLICY

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Executive Summary

New York City's current property tax system is notoriously opaque, unfair, and regressive. For the past four decades, rather than dealing with its structural flaws, New York State has layered on a patchwork of exemptions and abatements to lower tax rates for various owners. The largest of those is the 421-a tax incentive program for new residential development, which will cost New York City $1.77 billion in foregone tax revenue this year, and which is set to expire on June 15, 2022.

Each time 421-a has expired, there have been calls for structural reform to the City's property tax system. Reformers push for a fairer, more transparent, and more predictable system that addresses underlying inequities, better supports the development of housing in New York City, and targets scarce City resources to genuinely affordable housing. Unfortunately instead, each time, 421-a has been renewed with a new round of changes, often increasing the system's complexity and perpetuating the status quo.

With 421-a scheduled to expire on June 15, 2022, just a few months after the release of the Final Report of the NYC Advisory Commission on Property Tax Reform,[1] this is an important moment to review the program critically. Rather than rush to renew with modest tweaks, this is an opportunity to achieve structural reform.

To assist with that critical review, the New York City Comptroller's office undertook an analysis of various aspects of Affordable New York (the program version of 421-a legislated in 2017), of the changes proposed by Governor Hochul, and of the nexus between 421-a and structural property tax reform.

Our findings show that:

421-a is expensive and inefficient. Most of the income-restricted units are unaffordable to the vast majority of New Yorkers, and especially to the residents of the neighborhoods where they are built.

- 421-a is both expensive and inefficient: Tax expenditures (the foregone property tax) reached $1.77 billion for roughly 64,000 exemptions in FY 2022.[2] In our sample covering 2017 to 2020, the average income-restricted unit in the developments choosing the lowest income range is estimated to cost $1.4 million in present value ($4.2 million over the 35-year life of their exemptions).

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[1] NYC Advisory Commission on Property Tax Reform (2021) *The Road to Reform: A Blueprint for Modernizing and Simplifying New York City's Property Tax System*, https://www1.nyc.gov/assets/propertytaxreform/downloads/pdf/final-report.pdf.

[2] NYC Department of Finance (2022) *Annual Report on Property Tax Expenditures, Fiscal Year 2022*, https://www1.nyc.gov/assets/finance/downloads/pdf/reports/reports-tax-expenditure/ter_2022_final.pdf

- The income-restricted units generated by 421-a are unaffordable to the vast majority of New Yorkers: More than 60% of the income-restricted units created by the 2017 program through 2020 were built for families earning 130% of the Area Median Income or well over $100,000 a year in 2021, making those units unaffordable to nearly 75% of New Yorkers.[3] For example, in 2021 a family of three would have to earn up to $139,620 and pay about $3,400 a month for a two-bedroom apartment.[4]

- The 2017 program primarily subsidizes relatively small developments in Northern Manhattan and the other boroughs where the rent of income-restricted units can be nearly undistinguishable from that of market-rate units.

The amendments proposed by Governor Hochul are modest and would change little about the program.

In this report, we compare the current 421-a program to 485-w ("Affordable Neighborhoods for New Yorkers"), the new version of the program proposed by Governor Hochul as part of the State FY 2023 Executive Budget. We find that:

- Affordable Neighborhoods for New Yorkers is essentially equivalent to the current program across metrics and geographical areas.

- Based on the experience of the 2017 program, most developments would likely choose 485-w's new Option B or Option C, indicating that the proposed tweaks to the program would again fail to create truly affordable housing, with monthly rent for a two-bedroom at over $2,300 or estimated monthly homeownership costs over $3,800.[5]

- While the new proposal provides authority to regulatory agencies to establish monitoring guidelines for homeownership projects, the poor track record of compliance with affordability requirements within rental developments and the serious challenges of enforcement of homeownership resales, call the long-term affordability of these units into question.

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[3] Association for Neighborhood & Housing Development (2019) https://anhd.org/blog/summertime-gladness-your-ami-cheat-sheet-here

[4] See NYC Housing Preservation and Development https://www1.nyc.gov/site/hpd/services-and-information/area-median-income.page.

[5] Homeownership costs are estimates by the Comptroller's Office.

The property tax preference for homeownership is a constraining factor for the development of multifamily rental housing, and it can be addressed with comprehensive tax reform.

- The Final Report of the NYC Advisory Commission on Property Tax Reform shows that large rental buildings are taxed at effective tax rates that are significantly higher than for other residential properties. The Commission estimates that the median effective tax rate on rental buildings with more than 10 units is 1.53%, roughly double that of condominium units. This difference in tax treatment results in a strong disincentive to rental housing development.[6]

- In the framework proposed by the Commission, the median effective tax rate for the residential class would be approximately 1% at the top of the value distribution,[7] after the introduction of tax relief programs for primary and low-income residents. To provide a broad, strong, fair incentive for new construction, the tax rate should be equalized across all types of new residential development.

- While further study in the context of comprehensive reform is needed, our simulations show that lowering the tax rate on new market rate rental developments by one third could be broadly comparable with the incentive currently given by 421-a.

This is a critical moment of opportunity to achieve property tax reform.

- The expiration of 421-a presents an opportunity to achieve long-elusive property tax reform. If we fail to take this opportunity, it will likely not come again for years.

- The Final Report of the New York City Advisory Commission on Property Tax Reform released in December 2021 provides a solid foundation for reform.

- Allowing a time-limited lapse of 421-a tax benefits while pursuing broader reform is not likely to impair housing production in the short term. Our analysis shows that when 421-a lapsed for a year in 2015, developers rushed to begin projects before the deadline, yielding roughly three times as many permitted units in that year as in the years prior and sustained completions thereafter.

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[6] NYC Advisory Commission on Property Tax Reform (2021) *The Road to Reform: A Blueprint for Modernizing and Simplifying New York City's Property Tax System*, Figure 1, page 22, https://www1.nyc.gov/assets/propertytaxreform/downloads/pdf/final-report.pdf.

[7] Ibid., Table 22, page 46.

Recommendations

State legislators should let 421-a expire on June 15, 2022. Instead of modest changes to 421-a, legislators should set a deadline of December 31, 2022 to achieve structural property tax reform.

Legislators should appoint a working group of State Senators and Assemblymembers to develop and introduce legislation—by December 31, 2022—to enact comprehensive property tax reform, in consultation with City leaders and other stakeholders. Reform should build from the principles and recommendations contained in the Final Report of the New York City Advisory Commission on Property Tax Reform: that New York City's "property tax system should be fair, simple, and transparent; similar properties should be taxed similarly; and owner relief programs should be expanded in the interests of affordability." Reform should include the following elements:

- Introduce a uniform sales-based valuation methodology and a single tax rate for 1-3 family homes, co-ops and condominiums, and small rental buildings. Assessed value growth caps should be replaced by tax relief programs that favor primary and low-income residents.

- Make the equalization of tax treatment of new residential construction a pillar of comprehensive reform to provide a broad, strong, fair incentive for new construction going forward. This would largely eliminate the need for 421-a as an incentive to development.

- Establish a new, targeted affordable housing tax incentive (potentially on the model of the City's Article XI exemption which is sized to account for the market conditions, costs and standards, and other subsidies) that would match the tax benefit granted to a building to the level needed to achieve the specific, genuine affordability the development will offer. That new incentive should also come along with strong labor standards to provide good jobs for New Yorkers.

Introduction

"Opaque. Arcane. Inequitable." That's how the final report of the NYC Advisory Commission on Property Tax Reform, released in December 2021, begins. "Since the current property tax system was enacted in 1981, it has been overly complex and difficult to understand," the report continues. "Despite significant changes in the landscape over the past 40 years…a cohesive strategy for changing the property tax system has been too elusive. A collection of exemptions and abatements enacted over the years…has attempted to remedy [these issues], but problems persist."[8]

Opaque, arcane, and inequitable are good words to describe the largest of those exemptions and abatements: the 421-a program.

Instead of more tweaks, the Commission recommended the implementation of structural reform guided by a few key principles: "[A]ny property tax system should be fair, simple, and transparent; similar properties should be taxed similarly; and owner relief programs should be expanded in the interests of affordability. The Commission's general approach was to strip the system of the features that lead to structural inequalities, reconstruct the system to align with these basic principles, and then layer on owner relief programs to help ensure low- and moderate-income owners have affordable tax bills and primary residents are not displaced from neighborhoods that they have called home."

The 421-a program is not fair, simple, or transparent – it was never designed to be. Instead, it is one of the layers that has been added on top of our opaque, inequitable system, in an effort to address some of its weaknesses. This approach has taken NYC's property tax system even further from its core goals.

This is not only an issue of fairness and affordability, but one of efficiency as well. One consequence of a property tax system that taxes rental development at a higher rate than homeownership, is that the 421-a program has two distinct and not necessarily aligned goals: incentivizing development and the creation of affordable housing. Furthermore, the periodic expiration of the program creates uncertainty and encourages rent-seeking.

With the current version of 421-a set to expire on June 15, 2022, policy makers face a stark choice: Will we continue to layer on more opaque, inequitable policies, rendering structural reform even more elusive? Or will we seize this opportunity to achieve a fair, simple, and transparent system, one that removes inequities among homeowners, eliminates disparities based on the ownership model of new construction, sets a predictable and level playing field for future development, and focuses our affordable housing resources on genuinely affordable housing?

That is the choice we face.

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[8] NYC Advisory Commission on Property Tax Reform (2021) The Road to Reform: A Blueprint for Modernizing and Simplifying New York City's Property Tax System, https://www1.nyc.gov/assets/propertytaxreform/downloads/pdf/final-report.pdf.

A Brief History of 421-a

New York's 421-a tax incentive program was created in the 1970s to spur housing development during a time of disinvestment, by exempting the value of new residential construction from taxation. The goal was neither to implement a "fair, simple, and transparent" property tax system, nor to develop affordable housing. It was to reduce the tax burden on residential development, in order to prompt more of it – with the specific goal of spurring new market-rate development in core Manhattan, the only place at the time where policy makers could even imagine it taking place.

The program, and the state of the City's property tax base, have changed substantially since then. Despite dramatic increases in land costs, market rate development takes place in neighborhoods across the city and rents continue to rise. Over the past 50 years, the "housing problem" has broadly shifted from one of abandonment to one of affordability.

Beginning in the 1980s, and then expanding in 2006 and 2017, the 421-a program has responded to those shifts by gradually requiring the inclusion of income-restricted units. In 1985, such requirements were imposed in the strongest markets in Manhattan (the so-called Geographic Exclusion Area) and could be satisfied with either on-site or off-site income-restricted units. Off-site units would be built by affordable housing developers using the proceeds from the sale of negotiable tax exemption certificates.[9] In 2006-2008, the negotiable certificates were abolished, Geographic Exclusion Areas were extended, and exemptions on market-rate units were capped.[10]

Changes made in 2017, branded as "Affordable New York" (ANY),[11] required income-restricted units within all rental developments qualifying for the program and increased their percentage relative to prior legislation. At the same time, tax exemptions schedules were lengthened to 35 years (as much as 20 years longer than in previous legislation, dramatically increasing the lifetime tax expenditures) and scaled down eligibility for homeownership developments.[12]

[9] Because a market for certificates failed to develop, this option was inefficient for both market-rate and affordable housing developers, as well as subject to manipulation. See NYC Housing Preservation and Development (2006) *Recommendations of the 421-a Task Force*, page 8, [NYC Government Publication | Recommendations of 421-a Task Force: Recommendations Report | ID: br86b455n | Government Publications Portal]

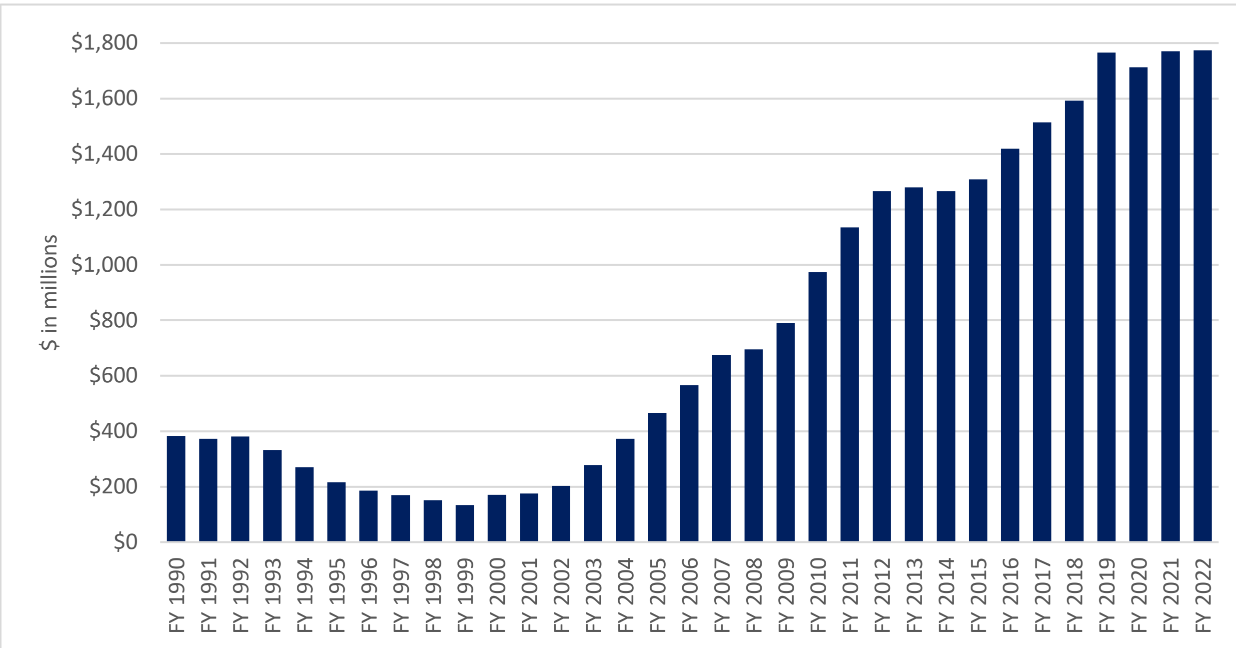
[10] Cohen, S.B. (2008) "Teaching an Old Policy New Tricks: the 421-a Tax Program and the Flaws of Trickle-Down Housing," *Journal of Law and Policy*, 757.

[11] The 2017 program is also referred to as 421-a (16) after the section of the Real Property Tax Law that contains it.

[12] Restrictions were introduced also in light of the experience of One57, a luxury condominium development that purchased negotiable certificates for $5.9 million and was awarded tax exemptions worth more than 10 times as much in present value, while financing the construction of just 66 affordable apartments in the Bronx. See NYC Independent Budget Office (2015) *Examining the 421-a Tax Exemption for One57*, https://ibo.nyc.ny.us/iboreports/from-tax-breaks-to-affordable-housing-examining-the-421-a-tax-exemption-for-one57-july-15-2015.pdf.

The NYC Department of Finance (DOF) estimates that the annual cost of 421-a tax expenditures (the foregone property tax) reached $1.77 billion for roughly 64,000 exemptions in FY 2022.[13] Because the exemptions are long-lived and rules have changed over time, in any given year tax expenditures include developments covered by different rules and schedules. For instance, in FY 2022, only 11.5 percent of tax expenditure is attributable to rental development built under the 2017 program. Chart 1 provides the history of tax expenditures, adjusted for inflation.

Chart 1: 421-a tax expenditures (inflation-adjusted)



FY 2022 tax expenditures are calculated on developments that have already qualified for the program and, as such, cannot be removed even if 421-a were to expire in June 2022. In fact, because exemption schedules stretch for more than three decades, 421-a expenditures will continue far into the future, whatever happens this year.

The sunset of 421-a in June 2022 has two offsetting implications on property tax revenues. First, the risk of expiration (or a more restrictive program) incentivizes developers to expedite projects in order to qualify for the tax exemptions before the June 15th deadline. This behavior was observed in 2015 in correspondence with the temporary expiration of the prior iteration of 421-a. Section "What Would Happen in the Short Term if 421-a Expired?" provides an analysis of the surge in development activity and subsequent completions. Second, property tax revenues from new construction will begin to accrue over time from developments that remain economically feasible.

[13] NYC DOF (2022) *Annual Report on Tax Expenditures, Fiscal Year 2022,* https://www1.nyc.gov/site/finance/taxes/annual-report-on-tax-expenditures.page

Affordable New York

The legislation creating Affordable New York passed in 2017 and it covers buildings that started construction between January 1, 2016 and June 15, 2022 and are completed by June 15, 2026. Projects commenced before January 1, 2016 that had not yet received tax benefits were also made eligible.[14] A summary of the rules for rental buildings is provided in Table 1 below.

Table 1: Affordable New York summary description[15]

Option	Income restrictions (% of residential units and AMI levels)	Exemption schedule	Geographies	Other subsidies	Building size (units)
A	25% of units: • 10% at 40% AMI • 10% at 60% AMI • 5% at 130% AMI	Years 1-25: 100% Years 26-35: 25%	No restrictions	• Tax-exempt bond proceeds • 4% tax credits	6+
B	30% of units: • 10% at 70% AMI • 20% at 130% AMI	Years 1-25: 100% Years 26-35: 30%	No restrictions	Allowed	6+
C	30% of units at 130% of AMI	Years 1-25: 100% Years 26-35: 30%	Outside of Manhattan South of 96th Street	None allowed	6+
E	25% of units: • 10% at 40% AMI • 10% at 60% AMI • 5% at 120% AMI	Years 1-35: 100%	• Manhattan south of 96th street • Brooklyn Community Boards 1 & 2 • Queens Community Boards 1 & 2	Same as A	300+
F	Same as B	Years 1-35: 100%	Same as E	Same as B	300+

[14] NYC Housing Preservation and Development, *Tax Credits and Incentives: 421-a*, https://www1.nyc.gov/site/hpd/services-and-information/tax-incentives-421-a.page.

[15] NYC Housing Preservation and Development, *Tax Credits and Incentives: 421-a*, https://www1.nyc.gov/site/hpd/services-and-information/tax-incentives-421-a.page, Nixon Peabody *The Developers Guide to "Affordable Housing NY Program" AKA the 421-a Tax Exemption* https://www.nixonpeabody.com/-/media/Files/Brochures/developers-guide-to-421-a-Affordable-Housing-NY-Program.ashx. Residential units are subject to rent stabilization, although high-rent decontrol is still in effect for non-income restricted units. Additionally, all projects with 30+ units are required to pay prevailing wages to building service workers unless 100% of the residential units are subject to income restrictions up to 125% of AMI. Options E through G are subject to minimum hourly wage requirements for construction workers. Tax benefits are available to projects subject to Mandatory Inclusionary Housing and opting in the Voluntary Inclusionary Housing program. Income restrictions need to meet inclusionary housing requirements.

Option	Income restrictions (% of residential units and AMI levels)	Exemption schedule	Geographies	Other subsidies	Building size (units)
G	Same as C	Years 1-35: 100%	• Brooklyn Community Boards 1 & 2 • Queens Community Boards 1 & 2	Same as C	300+

The 2017 program introduced many changes. First, *all* rental projects were required to have income-restricted units. However, for projects outside of Manhattan below 96th Street, a middle-income option (130% of AMI) was added which requires no low-income units. Second, the share of income-restricted units was increased from 20% to 25%-30%, with a variety of AMI levels, depending on the specific program option chosen. Third, exemption schedules were lengthened to 35 years, 10 to 20 years longer than the previous program. Fourth, eligibility for homeownership developments was restricted to buildings up to 35 units, outside of Manhattan, and with assessed value less than $65,000 per unit.

Data on the 2017 program are derived by triangulating various sources: the Department of Housing Preservation and Development (HPD) Housing New York,[16] NYC Housing Connect lotteries, NYC Department of Finance, and the Automated City Register Information System (ACRIS). While different methodologies for data cleaning and matching yield different results, our analysis broadly agrees with other sources.[17] Table 2 contains the summary of developments from 2017 to 2020.[18]

The analysis shows that Option C (requiring 30% of units be income-restricted at 130% of AMI) is the most widely used, with 374 out of 397 (94%) of the developments in the sample. As a result, as shown in Table 3, more than 60% of the affordable units created under the 2017 program were built for families earning well over $100,000 a year. For example, in 2021, in order to qualify for a two-bedroom apartment a family of three would have to earn $139,620 and be able to pay nearly $3,400 per month.[19] Moreover, these units comprise almost all of the income-restricted units outside of Manhattan, where in many cases they are set at prices that are indistinguishable from market-rate development in the neighborhood.

The primary impact of the 2017 changes was to shift the production of income-restricted units toward the 130% AMI level, at prices that are out-of-reach for the vast majority of City residents.

[16] NYC Housing Preservation and Development *Housing New York Units by Building* https://data.cityofnewyork.us/Housing-Development/Housing-New-York-Units-by-Building/hg8x-zxpr, *Housing New York Units by Project* https://data.cityofnewyork.us/Housing-Development/Housing-New-York-Units-by-Project/hq68-rnsi

[17] NYU Furman Center, *The Role of 421-a During a Decade of Market Rate and Affordable Housing Development*, https://furmancenter.org/research/publication/the-role-of-421-a-during-a-decade-of-market-rate-and-affordable-housing-development

[18] This report excludes the analysis of developments in the pipeline and expected to receive tax benefits.

[19] See NYC Housing Preservation and Development https://www1.nyc.gov/site/hpd/services-and-information/area-median-income.page

The developments built with option C have on average less than 30 units, similar in form to the small rental option envisioned by Governor Hochul's 2022 proposal, which is discussed in more detail in the next section of this report.

Table 2: 2017 program summary, 2017-2020

Option	Developments	Total Units	Income-restricted units			
			Number	Percentage	Present value of tax expenditure per unit ($000s)[20]	Lifetime tax expenditure per unit ($000s)
A/E	14	5,646	1,428	32%	$1,439	$4,207
C	374	8,145	2,605	58%	$386	$1,056
B/F	9	1,083	423	9%	$575	$1,547
Total	**397**	**14,874**	**4,456**		**$757**	**$2,113**

Table 3: 2017 program income-restricted units 2017-2020

AMI restriction	Number of units	Percentage
40%	575	13%
60%	625	14%
130%	2,834	64%
Other	422	9%

Because they are found in stronger markets, developments choosing options A and E have the highest cost, with the present value of tax expenditure per income-restricted unit averaging $1.4 million. Most of the income-restricted units at the lower end of AMI restrictions were developed within just six large projects. They account for approximately 1,150 income-restricted units and 4,600 total units. Based on property records available in ACRIS, marketing, and press sources, it appears that these projects planned to restrict 20% of their units but were able to qualify for the 2017 program (option E), typically lowering income restrictions on 10% of the units to 40% (from 60%) and adding 5% of income-restricted units up to 120% of AMI. In exchange, these projects gained between 14 and 23 years of full tax exemption.[21] We estimate the present value of the additional tax expenditures triggered by option E for these projects to be more than $650 million and the number of additional income-restricted units generated to be approximately 230.

The estimated present value of tax expenditures for the developments in our sample over the lifetime of their exemptions is approximately $3.3 billion.

[20] See footnote 24 for a brief explanation of methodology.

[21] Benefit schedules were lengthened to 35 years of full exemption from 12 years of full exemption followed by an 8-year phase-out in Manhattan and 21 years of full exemption followed by a 4-year phase-out in Brooklyn.

Affordable Neighborhoods for New Yorkers

The New York State FY 2023 Executive Budget included a proposal for replacing the 2017 program with "Affordable Neighborhoods for New Yorkers" (ANNY), which would be codified in section 485-w of the Real Property Tax Law.

The 2022 proposal retains the structure of the current option A for rental developments with 30 units or more, lowering the income restriction for 5% of the units from 130% of AMI to 80%. For rental developments with less than 30 units, the 2022 proposal envisions that 20% of the units are available for incomes up to 90% of AMI. Finally, the proposal includes a homeownership component that limits initial and subsequent resales for the first 40 years to buyers with incomes at 130% of AMI. In the case of rental buildings, tax exemptions are full for 25 years and equal to the share of income-restricted units for 10 additional years. Homeownership developments would receive 40 years of full tax exemption. Table 4 below summarizes the main provisions.

Table 4: Affordable Neighborhoods for New Yorkers summary description[22]

Option	Income restrictions (% of residential units and AMI levels)	Exemption schedule	Geographies	Building size (units)
A	25% of units: • 10% at 40% AMI • 10% at 60% AMI • 5% at 80% AMI	Years 1-25: 100% Years 26-35: 25%	No restrictions	30+
B	20% of units at 90% AMI	Years 1-25: 100% Years 26-35: 25%	No restrictions	6-29
C (Homeownership)	100% of units at 130% AMI	Years 1-40: 100%	No restrictions	6+

[22] New York State FY 2023 Executive Budget, Education, Labor and Family Assistance Article VII Legislation, Part II, https://www.budget.ny.gov/pubs/archive/fy23/ex/artvii/elfa-bill.pdf, https://www.budget.ny.gov/pubs/archive/fy23/ex/30day/elfa-artvii-amendments.pdf.

In Table 5, we compare current and proposed option A in two ways. First, we simulate the ratio of total foregone taxes to rent reduction in income-restricted units.[23] Second, we simulate the difference in the rate of return with and without tax benefits.[24] A higher ratio of foregone tax to rent reduction corresponds to a more generous tax program and a higher return differential. We separate "core areas" (Manhattan south of 96th street, Brooklyn Community Districts 1 and 2, and Queens Community Districts 1 and 2 – collectively the Enhanced Affordability Areas in the 2017 program or, equivalently, the Prime Development Areas in the 2022 proposal) from other markets. While the simulations are only a very high-level approximation of the range of market conditions and specific project characteristics, they show that, while the 2022 proposal is slightly less generous, they are close to the current program, both across metrics and geographical areas.

Table 5: Comparison of current and proposed option A

Option A	Core areas		Other areas	
	Foregone tax / rent reduction	Return w/ tax exemptions minus return without	Foregone tax / rent reduction	Return w/ tax exemptions minus return without
2017 program	0.9 to 1.1	-0.1% to +0.9%	1.1 to 1.4	+2.0% to +3.0%
2022 proposal	0.9 to 1.0	-0.4% to +0.5%	1.0 to 1.2	+1.5% to +2.4%

As noted earlier, the currently available option C has been by far the most common choice by developers outside of core areas. This option is replaced in the 2022 proposal by two alternatives: 1) rental developments under 30 units that restrict 20% of the units to 90% of AMI for 35 years, and 2) homeownership developments that restrict sale and resale price to 130% of AMI for 40 years. In Table 6 we start by comparing the current option C and the proposed option B. First, in both cases, tax expenditures per dollar of rent reduction and the contribution to rates of return

[23] In order to compute lifetime tax expenditures and the ratio of foregone tax to rent reduction, we assume that growth in Assessed Value (AV) before exemptions averages 3% annually over the 35-year period. The assumed growth in AV is comparable to historical growth rates in the Citywide rental rates for market and rent stabilized units. It is assumed that the tax rate for Class 2 remains constant over time. The discount rate used to compute net present value is 6%.

[24] Note that a positive return differential does not indicate that a project meets the hurdle rate of return required to undertake the project. To simplify the exercise, we look at unlevered IRRs with 7/year reversion, which abstract from financing. It should be noted that a zero or slightly negative return differential does not necessarily imply that projects will not use tax benefits. For one, the simulations cannot capture the specifics of many investments and we observe developments currently taking option A. Second, tax exemptions free up cash flow that can be used to lower equity. The 2022 proposal's option A would also impose rent stabilization on income-restricted units after the expiration of tax benefits, while under the current program income-restricted units could exit rent stabilization upon vacancy after 35 or 40 years, depending on the option. The simulations are restricted to a 35-year horizon and do not capture this change. To estimate its value, one would need an estimate of turnover rates before and after passage of the Housing Stability and Tenant Protection Act of 2019, which, to our knowledge, is not currently available.

are higher than in option A. It should be noted that, before the passage of the 2017 program, developments with 20% of income-restricted units at 60% of AMI would have been awarded exemptions of 20 to 25 years. In contrast, the 2022 proposal requires 20% of units at 90% of AMI and provides exemptions for 35 years.

Table 6: Comparison of current option C and proposed option B

Current option C and proposed option B	Core areas		Other areas	
	Foregone tax / rent reduction	Return w/ tax exemptions minus return without	Foregone tax / rent reduction	Return w/ tax exemptions minus return without
2017 program option C	1.0 to 1.5	+0.6% to +2.2%	1.9 to 3.7	+4.1% to +5.7%
2022 proposal option B	1.3 to 1.6	+1.5% to +2.4%	1.8 to 2.4	+3.7% to +4.6%

In addition to option B, the 2022 proposal significantly increases the amount of tax expenditures on homeownership programs and shares the same 130% of AMI target as the current option C. We estimate that the restriction on buyers' income corresponds to market values of $300,000 to $600,000, depending on unit size. This would translate to assessed values roughly between $30,000 and $60,000, therefore below the initial assessed value threshold to qualify for the homeownership in the 2017 program (option D).[25] However, the 2022 proposal is more than twice as generous by fully exempting taxes for 40 years and dropping geographical and size restrictions. In summary, the 2022 proposal would likely shift the production of units at 130% of AMI from rental to homeownership, while small rental buildings would target 90% of AMI and continue to represent the largest share of projects.

[25] The NYC Advisory Commission on Property Tax Reform report provides the median ratio of DOF-estimated market value to sales price (for condominium buildings, see Table 7, page 24). The assessed value is obtained by multiplying the sales price by the ratio in Table 7 (between 0.21 and 0.23) and then by the assessment ratio (0.45 for Class 2 properties).

Table 7: Comparison of current and proposed homeownership programs

Homeownership	Main provisions			
	Length	Value restrictions	Geography restrictions	Size restrictions
Current option D	Years 1-14: 100% Years 15-20: 25%	Assessed value below $65,000	Only outside of Manhattan	6-35 units
Proposed option C	Years 1-40: 100%	Sale and resale price restricted for 40 years to buyers with income up to 130% AMI	No restrictions	6+ units

Property tax reform

At the end of 2021, the NYC Advisory Commission on Property Tax Reform convened by Mayor de Blasio and Council Speaker Johnson put forward a framework for comprehensive reform that would redistribute the property tax burden more equitably, correct its regressivity, and simplify the system, while achieving revenue neutrality.[26]

The reform proposal envisions a new residential class of properties that aggregates 1-3 family homes, co-op and condominium buildings, and rental buildings with up to 10 units. The first component of reform is to value all properties in the class consistently, based on comparable market transactions (sales-based market value). Second, properties should be taxed at a common rate, applied to the sales-based market value. The Commission estimated that the revenue-neutral rate to achieve horizontal equity is 0.814% of the sales-based market value.[27] These changes would remove the regressivity embedded in the current system and would apply to existing properties as well as to new developments.[28]

The Commission also proposed to layer tax relief programs for primary residents (a so-called partial homestead exemption) and to institute a circuit-breaker mechanism that would limit the percentage of income paid in property tax by low-income owners. These programs would replace assessed value growth caps and the coop-condo tax abatement. Because the relief programs would apply only to primary residents and up to certain income or market value thresholds, the outcome is to achieve a degree of tax progressivity, with higher-value properties and higher-income owners facing a tax rate close to 1%.[29]

The Commission also estimated that, when market value is obtained from a sales-based methodology, the median tax rate on rental buildings with more than 10 units is 1.53%, roughly double the current median rate for condos.[30] To provide a first approximation of a potential framework for equalizing the tax rate on new rental and homeownership developments as part of comprehensive tax reform, we simulate lowering the tax rate on rental development by one third. Intuitively, this is the distance between the current median rate of 1.5% on large rental buildings and a 1.0% rate on the proposed residential class. While this exercise is illustrative and does not capture the full range of details and broader market implications of comprehensive tax reform, it nonetheless provides directional results, summarized in Table 8.

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[26] NYC Advisory Commission on Property Tax Reform (2021) *The Road to Reform: A Blueprint for Modernizing and Simplifying New York City's Property Tax System.* https://www1.nyc.gov/assets/propertytaxreform/downloads/pdf/final-report.pdf

[27] The Commission's proposal includes the repeal of the co-op/condo abatement but retains other exemptions and abatements (e.g., exemptions for senior and disabled homeowners, etc.), which would continue to lower the tax burden for specific purposes.

[28] See Table 16, page 40 of the Commission's report.

[29] See Tables 22 and 23 of the Commission's report.

[30] See Figure 1 of the Commission's report.

Table 8: Rate of return differential with lower tax rate on new market rate rental development

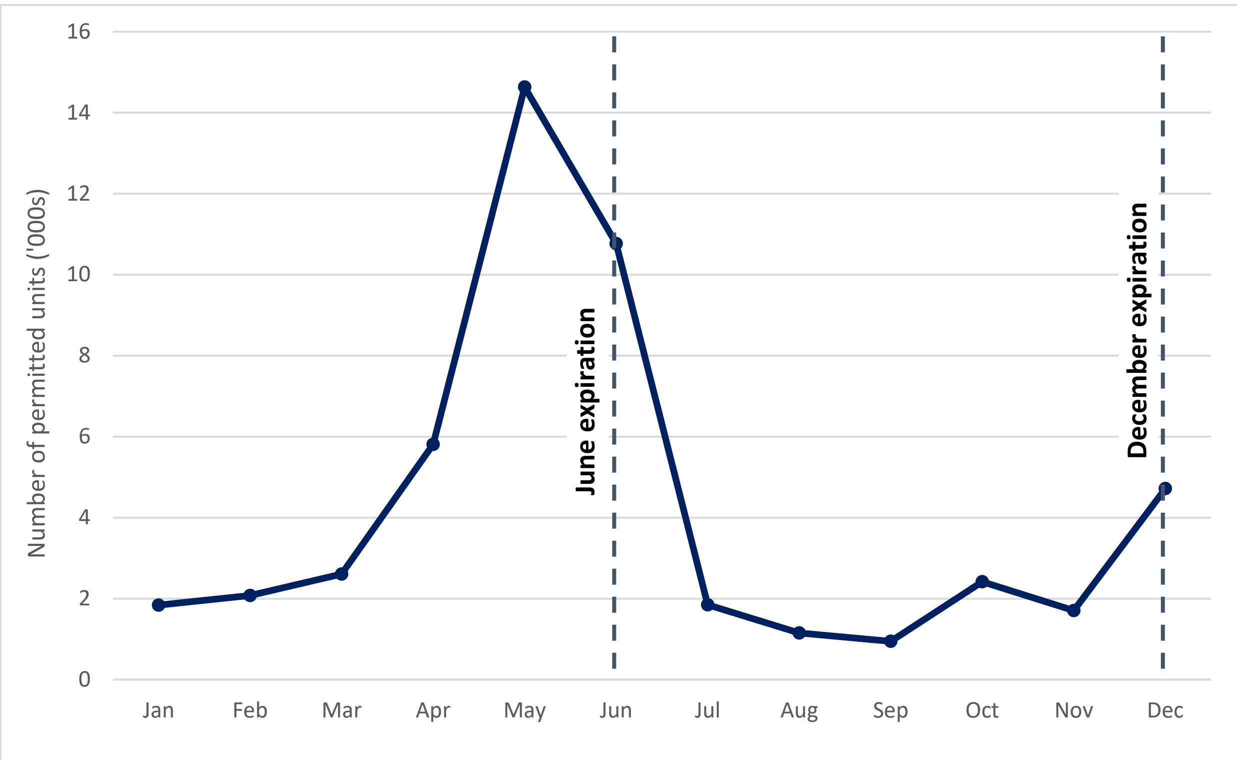
	Core areas	Other areas
Return differential with lower tax rate	+3.1% to +3.4%	+3.4% to +3.7%

In our simulations, lowering the tax rate on new market rate rental development by one third would increase rates of return by between +3.1% and +3.7%, which, depending on the market area, is roughly consistent or higher than the incentive associated with 421-a. Lower, uniformly and broadly applied tax rates could largely eliminate the need for 421-a as a development incentive. After tax reform, both new homeownership and rental buildings would generate tax revenues at comparable levels. The City could then separately address the need for income-restricted units with programs that work in conjunction with inclusionary housing and that link rent reductions to government intervention directly and efficiently.

What would happen in the short term if 421-a expired

Before 421-a expired in 2015, developers rushed to submit permits in order to qualify before the expiration deadline.[31] Monthly data shows that permits spiked in May and June of 2015 just before the program was set to initially expire. The expiration was then extended until December 31st, which resulted in another increase at the end of the year as shown in Chart 2 below.

Chart 2: Residential permits in 2015



Source: Comptroller's Office analysis of NYC Department of Buildings (DOB) data.

The Census Bureau data reported in Table 9 shows an increase of permitted housing units from 20,428 in 2014 to 56,183 in 2015. The spike was followed by 16,280 permits in 2016 before activity rebounded in 2017-2019. Completions remained elevated in the aftermath of the 2015 surge, showing that the large number of permitted units were delivered to the market.

[31] The program's sunset was initially set in June 2015 and was extended to December 2015.

Table 9: Permitted and completed units 2012-2019

Number of units	2012	2013	2014	2015	2016	2017	2018	2019
Permitted	10,334	17,995	20,428	56,183	16,280	22,101	20,910	26,547
Completed	10,714	13,636	14,332	15,120	23,770	26,311	28,572	26,599

Source: Census Bureau, HUD, Rent Guidelines Board *Housing NYC: Rents, Markets and Trends 2020,* Tables D.5 and F.4, https://rentguidelinesboard.cityofnewyork.us/wp-content/uploads/2021/01/Housing-NYC-2020.pdf.

NYC Department of Building data confirms that a large portion of the 2015 permitted units has been built and awarded a certificate of occupancy. Our analysis found more than 50,000 units permitted in 2015 have been built, with large increases in the number of units receiving 421-a exemptions.[32] The experience of 2015 shows that a time-limited lapse of tax benefits does not necessarily impair housing production in the short term.

Table 10: Number of completed units by year of building permit

Development type	Year of building permit				
	2013	2014	2015	2016	2017
421-a	5,551	7,925	17,843	2,196	2,227
Other exemption	1,426	1,597	2,707	2,784	4,534
No exemption found	15,306	15,101	29,964	15,071	8,896
Total	**22,283**	**24,623**	**50,514**	**20,051**	**15,657**

Source: Comptroller's Office analysis of building permits and certificates of occupancy (NYC DOB) and tax exemption data (NYC DOF).

[32] The data are not fully consistent with the Census Bureau, which indicates 16,280 units were permitted in 2016. The decline in 2017 is in part due to the length of time between the initial permit and receipt of a certificate of occupancy. There is a large number of units permitted in 2015 for which we could not match exemption data. This group includes both developments that are taxable and developments with information that could not be matched to DOF files (e.g., in the case of a change of tax identifier after construction).

Recommendations

This report contributes to the mounting evidence that 421-a is expensive and inefficient. This report also demonstrates that allowing a time-limited lapse of 421-a tax benefits is not likely to impair housing production in the short term.

With 421-a's expiration coming up soon on June 15, 2022, state legislators should seize this opportunity to finally achieve the structural reform needed to create a fair, more transparent, and more predictable property tax system that addresses underlying inequities, better supports the development of housing in New York City, and better targets scarce City resources to truly affordable housing.

State legislators should let 421-a expire on June 15, 2022. Instead of modest changes to 421-a, legislators should set a deadline of December 31, 2022 to achieve structural property tax reform.

The Final Report of the New York City Advisory Commission on Property Tax Reform released in December 2021 provides a solid foundation for reform. The legislature should appoint a working group of State Senators and Assemblymembers to develop and introduce legislation—by December 31, 2022—to enact comprehensive property tax reform in consultation with City leaders and other stakeholders. Comprehensive property tax reform should:

- Introduce a uniform sales-based valuation methodology and a single revenue-neutral tax rate for 1-3 family homes, co-ops and condominiums, and small rental buildings. Assessed value growth caps should be replaced by tax relief programs that favor primary and low-income residents.
- Make the equalization of tax treatment of new residential construction a pillar of comprehensive reform to provide a broad, strong, fair incentive for new construction going forward. This would largely eliminate the need for 421-a.
- Establish a new, targeted affordable housing tax incentive (potentially on the model of the City's Article XI exemption which is sized to account for the market conditions, costs and standards, and other subsidies) that would match the tax benefit granted to a building to the level needed to achieve the specific, genuine affordability the development will offer. That new incentive should also come along with strong labor standards to provide good jobs for New Yorkers.

Each time 421-a is set to expire, the City and State are presented with an opportunity to finally achieve long-elusive property tax reform. This spring, the City and State are faced with that same opportunity – this time just a few months after the release of the Final Report of the NYC Advisory Commission on Property Tax Reform[33] calling on New York's leaders to finally enact far-reaching reforms. If we fail to take this opportunity for reform, it will likely not come again for years. Now is the time to act.

[33] NYC Advisory Commission on Property Tax Reform (2021) The Road to Reform: A Blueprint for Modernizing and Simplifying New York City's Property Tax System, https://www1.nyc.gov/assets/propertytaxreform/downloads/pdf/final-report.pdf.

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