Critical Land Use and Housing Issues for New York State in 2024

№ 5

Principles to Guide an Improved Tax Exemption to Secure New Rental Housing: Fostering Affordability and Equitable Development in New York City

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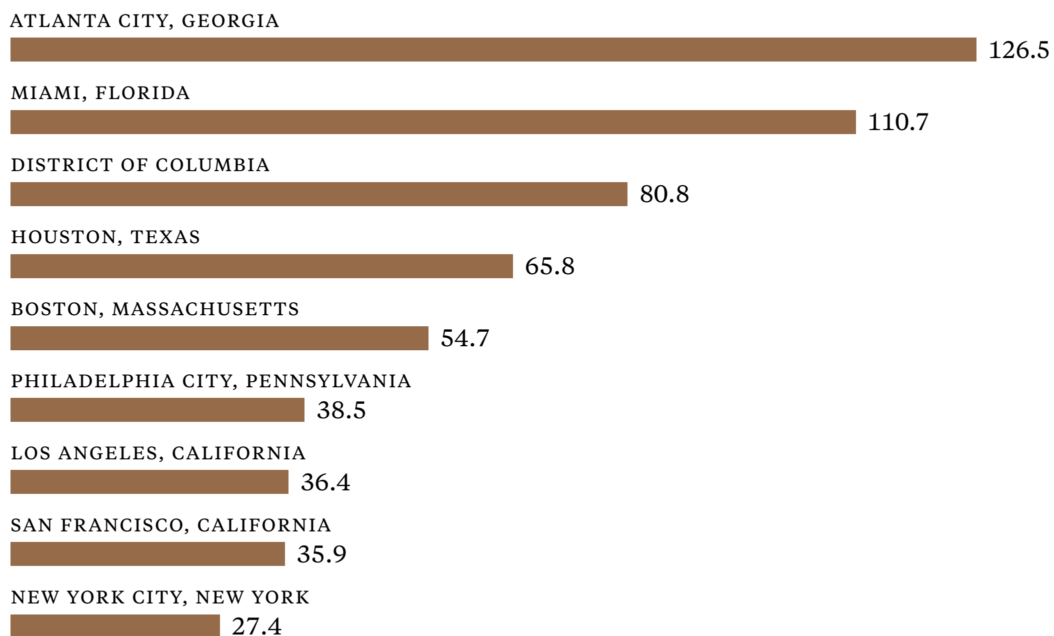
Introduction

Since its inception in 1971, various forms of the 421-a property tax exemption have played a critical role in incentivizing housing development in New York City. However, the program's lapse on June 30, 2022 has created uncertainty over the future of multifamily rental housing development. While buildings that began construction before this have a path to completion, the overall outlook for new housing development is unclear. Many observers find the expiration of the program to be especially problematic given New York City's worsening housing emergency: the 2023 Housing and Vacancy Survey shows that the vacancy rate (the share of apartments vacant and available for rent) is just 1.4 percent, the lowest rate since 1968.[1] The scarce availability of apartments for rent results in part because NYC had one of the lowest new construction per capita rates of any major city in the US over the last decade, as Figure 1 shows.

Figure 1: Housing Unit Permitting Rate (per 1,000 Residents), in Selected Cities (2014-2023)



Sources: U.S. Census Bureau Building Permits Survey 2014-2023. American Community Survey 2014. NYU Furman Center. Bureau Building Permits for 2023 data is preliminary (year-to-date).

1. New York City Department of Housing Preservation & Development. (2024, February 8). *New York City's Vacancy Rate Reaches Historic Low of 1.4 Percent, Demanding Urgent Action & New Affordable Housing*. NYC.gov. https://www.nyc.gov/site/hpd/news/007-24/new-york-city-s-vacancy-rate-reaches-historic-low-1-4-percent-demanding-urgent-action-new#/0

This brief explores how the exemption has affected both the production of multifamily rental apartments and the availability and location of affordable housing in recent years. It then articulates five central principles that can guide discussions about whether the exemption should be renewed and if so, how it should be restructured.

Of course, a fundamental requirement is that the exemption actually be necessary to secure housing production. Accordingly, the brief analyzes whether and under what circumstances the exemption is needed to make housing production financially viable. The brief then explains how a new version of the exemption needs to take into account the tradeoff between serving more, but higher income renters, or fewer, but lower income households, and shows some of the tradeoffs involved in that choice. It also explores the challenges of coordinating the exemption with other land use and housing policies to account for other benefits developers may layer onto the tax exemption, addresses the need for a fairer distribution of new construction across all the city's neighborhoods, and discusses the imperative of making all the city's neighborhoods more diverse and inclusive of lower-income renters. Finally, the brief addresses the problem of how to structure an efficient exemption when the city has not one, but multiple, rental markets.

The Role 421-a Has Played in Multifamily Development

New York State law has allowed New York City to grant a property tax exemption to encourage developers to build housing since 1971. Referred to as "421-a" because of its corresponding section of state law, the exemption encourages new housing construction by reducing or eliminating property taxes on the added value attributed to the new development.[2] In more recent iterations of the incentive, developments that used the exemption were required to provide some income-restricted housing in return, first in parts of Manhattan, then in

2. The 421-a program offers a tax exemption, not a tax abatement. Under the program, property owners are required to pay taxes based on the pre-development value of the site. Consequently, while buildings are "exempt" from property taxes on the incremental value resulting from development, they still fulfill tax obligations that derive from the original site value. This arrangement results in what is colloquially described as the 421-a "mini-tax."

some areas of other boroughs, and ultimately, everywhere in the city. Those affordability requirements make the incentive a significant tool, not only for spurring more housing production, but also for securing mixed-income housing across the city's neighborhoods.

The state law authorizing the exemption has been periodically renewed and modified; its most recent iteration, "Affordable New York," became available to builders in April of 2017 (retroactive to January 2016).[3] That version provided multifamily rental developers of six or more units[4] with a 35-year tax exemption from the increased value that came with new development. In most cases, after year 25, the exemption for the remaining 10 years will decline to match the proportion of the affordable housing units in the building.[5] Affordable New York incorporated several changes over prior versions of 421-a: it required all projects to include income-restricted housing; gave developers the choice of providing up to 30 percent of the units as affordable housing for moderate- and middle-income households (outside of Manhattan), or lower shares of the units if they were restricted to lower-income households; and limited the use of the program for condominiums and other forms of homeownership.

A significant portion of New York City's newly built housing has relied upon a 421-a exemption. Between 2010 and 2020, 123,500 new units were built using various forms of 421-a. Of those units, about 20 percent were income-restricted targeted to low-, moderate-, and middle-income households. Those income-restricted units accounted for about 40 percent of all income-restricted homes built during the decade.[6]

3. In this brief we use 421-a as a noun to describe the programmatic allowances of this law: SECTION 421-A, Affordable New York Housing Program, Real Property Tax (RPT) CHAPTER 50-A, ARTICLE 4, TITLE 2; we use "Affordable New York" (ANY) to refer to the 421-a (16) program.

4. The program also included a small-scale provision for condominiums.

5. For example, if a property had 30 percent affordable units, it would receive a 30 percent exemption between years 26 and 35.

6. Efforts in recent years to provide affordability to households with very low or extremely low incomes employed programs offering deeper government subsidies, which also allowed those projects to take advantage of the 420c or Article XI property tax exemption programs. Without 421-a, projects providing income-restricted housing can only qualify for a tax exemption if two-thirds of their units are reserved for households with annual incomes less than 165 percent of the area median income.

Five Principles for Reforming the 421-a Program

The need for, and design of, the 421-a program has always been controversial. Both the Governor and members of both houses of the state legislature believe that there is a need for an exemption, but none have publicly grappled with how the exemption should be modified to respond to recent changes in market conditions, the city's needs, and the imperatives of fair housing.[7] Our analysis of those recent changes suggests that the Governor and Legislature need to focus on crafting a property tax exemption for 2024 that will:

1) Efficiently spur robust new construction of rental apartments to address the city's housing shortage;

2) Ensure that the exemption secures as much affordable housing targeted to the households in the city least able to afford stable, high quality housing as is financially feasible, without also inflating land values;

3) Be thoughtfully coordinated with other subsidy programs, zoning initiatives, and the City's commitment to get housing built in every neighborhood;

4) Meet the City's obligations under the Fair Housing Act to have more affordable housing in thriving, diverse neighborhoods; and

5) Flexibly address the city's very different neighborhood rental markets, yet be simple to administer and enforce to ensure that developers and owners who take advantage of the exemption live up to their obligations.

We explore each principle in turn.

7. Governor Hochul's proposals within the Executive Budget for Fiscal Year 2024/2025 suggest leaving the determination of affordability levels and the allocation of income-restricted apartments under the purview of the City's Department of Housing Preservation and Development. This move aims to replace the 421-a tax exemption program with a new framework that still incentivizes the construction of affordable housing, as outlined in detail here: Gottlieb, B.J. (2024). Hochul Proposes 421-a Replacement Program and Completion Deadline Extension in 2024/2025 NYS Budget. Herrick. https://www.herrick.com/publications/hochul-proposes-421-a-replacement-program-and-completion-deadline-extension-in-2024-2025-nys-budget/. While neither the New York State Senate nor the Assembly have put forward specific proposals for a tax exemption to succeed the 421-a program, the Senate said that "The Senate is open to further discussing the creation of a tax exemption for new multi-family construction in New York City that includes deeper affordability requirements, strong transparency and compliance provisions, and living wages for construction and building service workers, as part of a comprehensive housing package that includes the core principles of Good Cause Eviction. The Senate is also open to further discussing an extension of the 421-a tax exemption completion deadline for projects already vested in the program as part of a comprehensive housing package that includes tenant protections": New York State Senate. (2024). Bill No. R01952. New York State Assembly. https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=R01952&term=2023&Summary=Y&Text=Y

Principle One:
A new exemption must efficiently spur robust new construction of rental apartments to address the city's housing shortage.

New York City provides unique challenges for constructing rental housing. The limited land available enables landowners to charge higher prices for the sites on which buildings must be built. Further, the challenges posed by density limits across the city, the relatively higher cost of labor in the city, and the extensive regulation imposed upon new buildings drive construction costs up. In addition, the property tax regime set by state and city law makes property taxes on rental buildings among the highest in the United States.[8] Given those challenges and risks, investors are likely to put their money into rental projects only if those projects offer investment returns that are on par with other building types (condominiums, for example), or construction in other cities or of other types of buildings and uses.

A challenge facing policymakers is determining whether a property tax exemption is needed to render mixed-income, multifamily rental housing a viable investment. Our analysis, detailed in the Appendix, indicates that an exemption is necessary to make project financing feasible across the city's varied markets given the current economic environment. Without it, the costs associated with land acquisition and construction and operating costs, exacerbated by high property taxes, would significantly hinder new rental development.[9]

In some markets, given high property taxes, developers will not even be able to raise enough funding to cover the cost of construction, let alone generate enough to pay for a site. To make rental housing a competitive option, then, city and state policymakers have several choices: they can sit back and hope that landowners will drop their prices considerably (although land prices cannot fall below zero), they can undertake regulatory and other reforms to lower the cost of constructing and operating new rental buildings,[10] or they

8. Lincoln Institute of Land Policy (2023, August). *50-State Property Tax Comparison Study For Taxes Paid in 2022*. https://go.lincolninst.edu/50-state-property-tax-comparison-for-2022.pdf

9. Even if the market would otherwise produce sufficient rental housing to meet demand, an exemption might still be efficient if the benefits of the rental housing secured with the exemption, especially any affordable housing, outweighed the costs of the exemption, and could not be obtained at lower cost through any other means of securing the benefits.

10. Comptroller Brad Lander has suggested that reforms of the property tax system could obviate, or reduce, the need for a 421-a exemption. Property tax reform has been hard to secure given the difficult politics of reducing the advantages the current system gives to existing homeowners. The New York Court of Appeals' decision to allow a challenge to New York City's tax policies to go forward may spur some changes, but the litigation likely will take years: Tax Equity Now NY LLC v. City of New York, et al., No. 1 (2024, March 19). State of New York Court of Appeals. https://www.nycourts.gov/ctapps/Decisions/2024/Mar24/1opn24-Decision.pdf. More fundamentally, while some of the burden the property tax system imposes on rental buildings is driven by the inequities highlighted in the litigation, and in recent proposals for reforms,none of the reform proposals would lower the property tax enough on rental buildings in all of the city's rental markets to make an exemption program unnecessary: NYC Advisory Committee on Property Tax Reform. (2020). *The Road to Reform: A Blueprint for Modernizing and Simplifying New York City's Property Tax System*. https://www.nyc.gov/assets/propertytaxreform/downloads/pdf/final-report.pdf

can offer a tax exemption to offset the effect the city's property taxes have on the cost of operating buildings and thereby make it possible to raise enough funding to make development economically viable.

The first option—waiting on landowners to adjust their expectations and accept a dramatically lower price for land because 421-a no longer exists—is unrealistic, especially given the urgent need that more housing be built today. Our modeling shows that site acquisition costs would have to decline substantially for multifamily rental development to be financially viable (and in some markets land acquisition costs would have to go to zero or even go negative) as we explain below. But such a drastic decline is highly unlikely in the short run and doubtful even in the long run. With no 421-a in place, site prices may be less affected in the short run, as developers of other viable uses might be able to outbid rental developers where condominium development is feasible.[11] Further, even if competition for sites weakens, site owners are unlikely to lower their prices for some time, preferring instead to see if legislative changes will happen, or if the market provides an unanticipated opportunity. How long it would take for owners to come to terms with a new reality would depend on the degree to which the site is generating income, particularly if that income is sufficient to cover current property taxes and any other costs of maintaining a site. As a result, any significant decline in the value owners expect from the sale of their sites will be slow at best, making it unlikely that developers will be able to acquire new sites at drastically lower prices with the goal of developing rental housing.

Regulatory reform is similarly unlikely to solve the problem in the near future. While every mayor in recent decades has promised to cut regulatory red tape,[12] the time it takes to get the necessary land use and building permits in New York City continues to be significant.[13] The City adds new processes regularly[14] as well as imposing new regulations to address critical issues such as climate change and flooding risks that are costly to implement.

11. Even with the downturn in the office market and new office development, there are other potential uses competing for land in New York City: condominium buildings and other homeownership options, warehouses to meet the demand for online retail, buildings that support the life sciences industry, and space for infrastructure improvements ranging from new transit options and resiliency measures to traditional needs like parks and other green space.

12. Morris, C. Z. (2012, June 25). New City Plan Will Cut Out Red Tape for Business Startups. Patch. https://patch.com/new-york/bayside/new-city-plan-will-cut-out-red-tape-for-business-star59217c449d; Jorgensen, J. (2015, February 3). Bill de Blasio Pitches His Affordable Housing Plan in State of the City Address. https://observer.com/2015/02/bill-de-blasio-pitches-his-affordable-housing-plan-in-state-of-the-city-address/; Ngo, E. (2022, December 8); Mayor Adams' 'Get Stuff Built' housing plan seeks to reduce red tape. Spectrum News New York 1. https://ny1.com/nyc/all-boroughs/politics/2022/12/08/mayor-adams---get-stuff-built--housing-plan-seeks-to-reduce-red-tape

13. The Mayor's Management Report states that in FY 2022, only 48% of zoning actions with CEQR were certified/referred within 15 months, compared to 54% and 38% in FY 2021 and 2020, respectively. The MMR also reports that the average amount of time to secure a building permit from application to DOB to approval has increased from 8.3 days in FY2020 to 18.12 in FY2023: https://dmmr.nyc.gov/compare-indicators?ids=23217,23215

14. The state legislature and city council have added new layers to the land use review process, for example. The New York State Senate. (2021-2022). Senate Bill S8830. https://www.nysenate.gov/legislation/bills/2021/S8830; Office of New York City Council Speaker Adrienne Adams. (2023, May). *Fair Housing Framework*. https://council.nyc.gov/wp-content/uploads/2023/05/Fair-Housing-Framework.pdf

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Additionally, process constraints such as environmental impact reviews imposed by state and federal governments have also been stubbornly resistant to change.[15]

To understand what would be needed to make the development of rental housing competitive with other investments that pose similar risks, we ran a simplified real estate pro forma, based on assumptions that reflect existing construction and operating costs, as well as the costs of raising funding. To gain an understanding of the scale of the decrease in the amount that mixed-income, multifamily rental developers can bid for sites, we compare the amount of funding that a developer could reasonably expect to raise if the project were subject to the full property tax, but with no affordability requirement (the current state of affairs now that Affordable New York has expired) versus the funding that the developer could raise if the project could use Affordable New York. We use a stripped-down version of a standard tool used in real estate to determine a project's financial viability—a return on cost (ROC) pro forma. That tool allows us to estimate how the unavailability of the Affordable New York tax exemption would affect the amount a developer of market-rate, multifamily rental housing would be able to pay to acquire sites. We refer to the estimated amount available for a developer over and above the cost of construction as the Supportable Acquisition Cost (SAC).[16] Our modeling shows that, using a reasonable estimate of development costs in high-rent areas, the absence of 421-a would require that land values decline by more than 30 percent in order for a developer to bid for a site. For mid-rent markets, the reduction is even larger, rendering the amount that the developer could pay for the land near zero. In lower rent neighborhoods, the model shows that the amount the developer could pay for the site goes negative—a developer would not only need to be able acquire the land at zero cost but would also require an additional subsidy for the development for the project to be financially viable.

It is unlikely, at least in the short run, that landowners would be willing to accept bids for sites that are down by 30 percent from what the sites commanded when Affordable New York was in effect. As we explore more fully below, landowners likely could be forced to

15. Efforts to reduce constraints in state law, e.g. reducing the projects eligible for SEQR review, have not made progress. The New York State Senate. (2022). Senate Bill S9607. https://legislation.nysenate.gov/pdf/bills/2021/S9607; The New York State Senate. (2023). Senate Bill S925A. https://legislation.nysenate.gov/pdf/bills/2023/S925A

16. We used the ROC pro forma to compare the amount of capital a developer can reasonably raise to acquire a site and build a project. Developers can tap two types of sources: debt (i.e., a loan) and equity that investors (including the developing entity) would be willing to invest if the return on their investment is sufficiently high relative to the risk the project entails. The amount of capital that can be raised depends on the expected net operating income (NOI), which derives from subtracting a building's operating costs from its annual income. A shorthand way to translate how much capital can be raised by an anticipated amount of NOI is called the return on capital (ROC). ROC reflects how much funding a developer is likely to be able to raise from a given dollar of projected NOI. ROC can vary over time with the general interest rate environment, the returns available to investors from alternative investments, and risks such as the outlook for the rental market once the building will be leasing.

accept some reduction in value to sell their sites, but even a 30 percent reduction may cause them to withhold land from the market. They certainly would not be giving the land away for free, which is what the model shows would be required in mid-rent neighborhoods (values go negative in lower rent neighborhoods, requiring additional subsidies for development to be feasible there). We do not know how long it would take for landowners to adjust their expectations to the level that would be required to support rental development, but we assume that they would be willing to wait out at least one real estate cycle, which could last many years.[17]

Our modeling of the financial viability of rental projects suggests that they will not happen without a tax exemption unless the prices of land fall significantly, or other forms of subsidy are provided to support development. A new tax exemption is necessary to spur sufficient new construction of rental apartments to meet demand.

That said, even a redesigned exemption is not going to completely resolve the amount of new housing that has to be built to meet the city's needs. First, reductions in taxes can only do so much to close a gap in the revenue needed to make a project more feasible. Even eliminating all property taxes is usually not enough to generate housing that can be rented at rates the city's lowest-income households can afford. Public subsidies in addition to tax exemptions may still be necessary to make housing affordable for all the city's households. Second, even a tax exemption cannot make development possible if zoning stands in the way. Exemptions work when there is both a market to support the costs of building and operating a building and land use regulations impose no significant barriers to development. Third, using an exemption to both spur new construction and secure some share of the units as income-restricted affordable housing requires a delicate balance—if requirements for affordable housing are too onerous, development will not happen at all. But if those requirements are too weak, the government is wasting money by over-subsidizing development projects. The balancing act needed is particularly challenging because, as we discuss further below, the city has a number of different rental markets, each of which require a different balance.

17. Owners of land might still find a market with developers who plan to build condominiums. It is reasonable to assume that condominiums would continue to be developed even in the absence of 421-a because taxes can be capitalized into the sales price and condominium units are undertaxed relative to rentals. Indeed, Affordable New York, the most recent version of 421-a, did not give exemptions to condominiums, unlike prior versions, because it was assumed that condominiums would still move forward given strong demand for homeownership housing. However, 2022 data show that even condominiums may not be able to attract investment without a tax exemption: very few completed residential projects were condominiums. In 2022, only 637 out of 24,521 (or 2.5 percent) completed units were classified as condominiums. It may be that uncertainty over interest rates, combined with the demographic changes in the city attributable to the Covid pandemic and other disruptions, explain that data, but it also may be that the city's high property taxes are making it difficult to finance even the construction of new condominiums.

Principle Two:
A new exemption should secure as much affordable housing targeted to the households in the city least able to afford stable, high quality housing as is financially feasible, without also inflating land values.

The affordability requirements in the most recent 421-a version resulted in a significant number of units serving moderate- and middle-income households rather than the lower-income households most vulnerable to housing instability. In part, that reflected an attempt to offer options that would allow developers in different markets to choose the option that made projects viable given rents in different neighborhoods. But that attempt allowed many developers to offer affordable units at rents out of reach for lower-income households, even where the market would have supported deeper affordability. Those are the risks of trying to have a program without requirements specific to different rental market conditions, a subject we return to below.

Additionally, in recent years, Area Median Income (AMI), which is determined by the U.S. Department of Housing and Urban Development (HUD), has increased significantly. Changes in AMI that have exceeded actual income growth make a broader segment of renter households eligible for affordable housing units, rather than reserving those units for the city's lower-income residents. As Table 1 depicts, there was a 32.3 percent rise in AMIs over the latest four-year span, corresponding to a compounded annual growth rate of 7.2 percent. This is a sharp increase from the 2011 to 2015 period when AMIs expanded at a compounded annual rate of just 1.3 percent.

Table 1: Change in AMIs and Median Household Income of Renter Households in New York City (Over Four Year Periods Between 2007 and 2023)

Year	*100% AMI (Family of Three)*	*4-Year Growth Rate in AMI (%)*	*Annual Compounded Growth Rate of AMI (%)*	*Annual Compounded Growth Rate in Median Renter Household Income (%)*
2007	$63,800	N/A	N/A	N/A
2011	$73,700	15.5%	3.67%	-1.95%
2015	$77,700	5.4%	1.33%	2.07%
2019	$96,100	23.7%	5.46%	4.35%
2023	$127,100	32.3%	7.24%	Not available

Sources: American Community Survey, HUD Income Limits (2007, 2011, 2015, 2019, 2023), NYU Furman Center.

Table 2 shows that the share of renter households with an annual income below 60 percent AMI has increased from 51 percent in 2016 to an estimated 56 percent in 2023. If a new exemption used the AMIs in the most recent 421-a version, more than 80 percent of all the city's renters would be eligible to apply for the affordable units. Because about 54 percent of the city's renters are rent burdened and likely are struggling to pay their housing costs, such broad eligibility for subsidized housing may be good social policy. But that would likely come at a cost with: much of the affordable housing going to people less needy than the city's lower-income families.

Table 2: Share of New York City Renter Households Below AMI Thresholds

Year	*Share Below 60 AMI*	*Share Below 80 AMI*	*Share Below 100 AMI*	*Share Below 130 AMI*
2016	51.0%	61.1%	69.2%	78.6%
2022	55.2%	66.4%	75.0%	82.8%
2023	55.6%	67.2%	75.7%	83.3%

Sources: IPUMS (2016 and 2022), HUD Income Limits (2016, 2022 and 2023), the U.S. Bureau of Labor Statistics, Consumer Price Index, NYU Furman Center.

Notes: The 2023 data points are estimated using the 2022 Public Use Mircro Sample. We assumed that the household income grows at the rate of inflation.

Table 3 highlights the difficulties households at different AMI levels face in securing affordable, high quality housing in neighborhoods that provide better educational opportunities. As anticipated, the lower a household's income, the more likely they are to be paying too much of their income for housing. What is surprising, however, is how dramatic the differences between the income bands are: the share of renter households with annual incomes between 50 and 60 percent of AMI who are rent burdened, for example, is more than 2.6 times the share of rent burdened households with incomes between 90 and 100 percent of AMI. In addition, the lower the income band, the smaller the share of households who are able to live in neighborhoods in which the share of fourth graders in local public schools performing at grade level in math and English Language Arts is above the median for the city as a whole.

Table 3: New York City Renter Household Characteristics by Income (All Renter Households, Including NYCHA and Subsidized)

AMI	*Area Median Income Range for Renter Households of 3*	*Share of Renter Households that are Rent Burdened*	*Share of Renter Households in Areas Where Student Proficiency Rates are Above The City's Median*
0-30% AMI	$0–$38,129	85.00%	35.70%
30-40% AMI	$38,130–$50,839	74.20%	37.50%
40-50% AMI	$50,840–$63,549	64.80%	38.30%
50-60% AMI	$63,550–$76,259	53.30%	40.80%
60-70% AMI	$76,260–$88,969	42.10%	46.00%
70-80% AMI	$88,970–$101,679	28.60%	43.10%
80-90% AMI	$101,680–$114,389	26.30%	46.70%
90-100% AMI	$114,390–$127,099	19.80%	49.50%
Above 100% AMI	>= $127,100	7.70%	66.20%

Sources: IPUMS (2022), HUD Income Limits (2023), New York City Department of Education, NYU Furman Center.

Note: We looked at renter households that live in Sub-Borough Areas (SBAs) where the share of fourth-grade students performing at or above grade level in both English Language Arts and Math is above the median percentage across all SBAs.

Table 4 shows how challenging it is for families with the lowest incomes to find housing. For the more than 846,000 households with annual incomes that are 50 percent or less than AMI, for example, less than 722,000 homes are available for rents affordable to those households.

Table 4: Affordability of Private Rental Units vs. Non-Public Housing Renter Households by AMI Level

Household Income Level	*Cumulative Number of Private Rental Units Affordable to Households (< 30% of Household Income)*	*Cumulative Share of Private Rental Units Affordable to Households (< 30% of Household Income)*	*Cumulative Number of Non-Public Housing Renter Households*	*Cumulative Share of Non-Public Housing Renter Households*
Up to 30% AMI	185,099	11.00%	576,723	34.30%
Up to 40% AMI	412,702	24.50%	720,972	42.90%
Up to 50% AMI	721,871	42.90%	846,206	50.30%
Up to 60% AMI	1,049,716	62.40%	984,030	58.50%
Up to 80% AMI	1,396,504	83.10%	1,184,710	70.50%
Up to 100% AMI	1,532,577	91.10%	1,316,965	78.30%
Up to 120% AMI	1,599,459	95.10%	1,412,518	84.00%

Sources: New York City Housing Vacancy Survey (2021), The U.S. Bureau of Labor Statistics, Consumer Price Index, NYU Furman Center.
Notes: When we estimated the affordability of a unit, we made the assumption that a studio could be for two people max (i.e. using 2-person household AMI to do the calculation), and an one-bedroom could be for three people max, etc.

Previous versions of 421-a have allowed developers to rent the affordable units to households with moderate or middle incomes. While about 9,000 income-restricted units produced between 2010 and 2020 with 421-a alone were targeted to lower-income families, more than 5,400 of the units produced with the 421-a tax exemption alone were targeted to households with earnings between 81 and 165 percent of AMI.[18]

Requiring developers to include affordable housing to households with lower incomes involves a tradeoff, as explained further below. To preserve the financial viability of the project, the number of affordable homes required generally must be decreased to make up for the added cost of providing those homes to lower income households. Policymakers therefore will have to choose between providing more income-restricted homes and providing those homes to the households who need them the most.

18. NYU Furman Center. (2022, May). *The Geography of New Housing Development*. NYU Furman Center. https://furmancenter.org/stateofthecity/view/the-geography-of-new-housing

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Tables 3 and 4 leave no doubt that the households with the lowest incomes face considerably more housing challenges than moderate- and middle-income households. Combined with the City's obligations under the Fair Housing Act, those challenges suggest that a new tax exemption should prioritize serving households with lower incomes than those previously targeted, as long as that leaves the development of market-rate multifamily buildings financially viable citywide.

Principle Three: The new exemption should be thoughtfully coordinated with other subsidy programs, zoning initiatives, and the City's commitment to get housing built in every neighborhood.

An increasing number of elected officials, housing policy experts, and community members have called for a fairer distribution of new housing across the city's neighborhoods. In 2023, Governor Hochul introduced a "Housing Compact" that would require every community district in New York City to allow growth at a rate equal to three percent of the current housing stock over a three year period.[19] Mayor Adams has proposed land use changes to secure "a little more housing in every neighborhood" that are now under discussion across New York City.[20] More recently, the City Council adopted a "fair housing framework" that requires the City's housing and land use agencies to "establish targeted housing production goals for each Community District to ensure each New York City neighborhood plays an equitable role in addressing the city's housing crisis, while accounting for unique community needs."[21]

Those goals will not be easy to achieve because the rate of development is quite low in many areas of the city. The Furman Center reported last spring that New York City's lowest-density community districts take up 44.7 percent of the total land across the five boroughs but contain just 28.4 percent of the city's population, and during the last decade, saw new housing developed at half the rate of the city overall.[22] More broadly, Table 5 shows each community district's share of the city's population and the share of the city's new

19. NYU Furman Center. (2023, May). New York City's Low-Density Neighborhoods. NYU Furman Center. https://furmancenter.org/stateofthecity/view/new-york-citys-low-density-neighborhoods

20. Office of the Mayor of New York City. (2023, September 21). *Mayor Adams Launches Historic Effort to Build "A Little More Housing in Every Neighborhood."* NYC.gov. https://www.nyc.gov/office-of-the-mayor/news/692-23/mayor-adams-launches-historic-effort-build-a-little-more-housing-every-neighborhood-

21. New York City Council. (2023, November 15). *New York City Council Votes to Pass Fair Housing Framework Bill to Establish Housing Targets for Each Local Community District in Response to City's Housing Crisis.* https://council.nyc.gov/press/2023/11/15/2503/; Hitchcock, B., Flores, S., & Miller, E., (2024, February 13). *Tackling New York City's Housing Crisis is a 'Shared Responsibility'*. NYU Furman Center. https://furmancenter.org/thestoop/entry/tackling-new-york-citys-housing-crisis-is-a-shared-responsibility

22. NYU Furman Center. (2023, May). *New York City's Low-Density Neighborhoods*. NYU Furman Center. https://furmancenter.org/stateofthecity/view/new-york-citys-low-density-neighborhoods

construction built in that district between 2010 and the second quarter of 2023. To take just one comparison, Manhattan Community District 105 (Midtown, Flatiron, and Union Square) started 2010 with just 0.6 percent of the city's population but hosted 5.4 percent of the city's new housing built since then. In contrast, Manhattan Community District 112 (Washington Heights/Inwood) had 2.8 percent of the city's population (three times that of CD 105) but only contributed 0.3 percent of the city's new housing (less than 1/18 the amount built in CD 105).

Table 5: Share of Citywide Residential Units Completed by Community Districts (2010–2023 Q2), Top Ten

See interactive map and full table

Rank	*CD*	*CD Name*	*Share of Citywide Residential Units Completed*	*Cumulative Completion Share*	*Share of Citywide Population in 2010*
1	104	Chelsea-Hell's Kitchen	8.6%	8.6%	1.3%
2	301	Williamsburg-Greenpoint	7.1%	15.7%	2.1%
3	302	Downtown Brooklyn-Fort Greene	6.4%	22.1%	1.2%
4	402	Long Island City-Sunnyside-Woodside	5.8%	27.9%	1.4%
5	105	Midtown-Flatiron-Union Square	5.4%	33.4%	0.6%
6	401	Astoria-Queensbridge	4.6%	37.9%	2.3%
7	201	Melrose-Mott Haven-Port Morris	3.0%	40.9%	1.1%
8	303	Bedford-Stuyvesant	2.9%	43.8%	1.9%
9	101	Financial District-Tribeca	2.9%	46.6%	0.7%
10	203	Morrisania-Crotona Park East	2.4%	49.1%	1.0%

Sources: U.S. Census Bureau Decennial Census (2010), NYC Department of City Planning, Housing Database 23Q2, NYU Furman Center.

NYU Furman Center

Share of Citywide Residential Units Completed by Community Districts (2010–2023 Q2), Bottom Ten

Rank	*CD*	*CD Name*	*Share of Citywide Residential Units Completed*	*Cumulative Completion Share*	*Share of Citywide Population in 2010*
50	311	Bensonhurst-Bath Beach	0.4%	97.7%	2.2%
51	411	Auburndale-Bayside-Douglaston	0.3%	98.0%	1.4%
52	210	Co-op City-Throgs Neck	0.3%	98.3%	1.5%
53	112	Washington Heights-Inwood	0.3%	98.6%	2.3%
54	409	Kew Gardens-Richmond Hill-Woodhaven	0.3%	98.9%	1.8%
55	211	Pelham Parkway-Morris Park	0.3%	99.2%	1.4%
56	413	Queens Village-Bellerose-Rosedale	0.2%	99.5%	2.3%
57	318	Canarsie-Flatlands	0.2%	99.7%	2.4%
58	410	South Ozone Park-Howard Beach	0.2%	99.8%	1.5%
59	310	Bay Ridge-Dyker Heights	0.2%	100.0%	1.5%

Sources: U.S. Census Bureau Decennial Census (2010), NYC Department of City Planning, Housing Database 23Q2, NYU Furman Center.

Further, Table 5 reveals that just ten of the city's 59 community districts accounted for almost 50 percent of the city's new housing built over the past 13.5 years. At the same time, 26 districts each hosted less than one percent of all new housing built since 2010 (and Bay Ridge/Dyker Heights, Canarsie/Flatlands, South Ozone Park/Ocean Beach, Queens Village/Bellerose/Rosedale each contributed less than 0.25 percent). Those 26 districts contributed less than 15 percent of the city's new housing, despite containing almost 43 percent of the city's population in 2010. Indeed, the share of the city's new housing built in 39 of the city's community districts was less than their share of the city's entire population.

To achieve a fairer distribution of housing construction, the new version of a tax exemption will have to tailor its benefits and requirements carefully to ensure that housing development is financially viable in every neighborhood across the city. As discussed below, that likely will require distinctions between the major different markets in the city.

In order to achieve a more equitable distribution of growth across the city, and to ensure that developers are being asked to provide affordability when they receive benefits in addition to the tax exemption, a new exemption will have to work with the City's existing and proposed housing and land use policies. The City now requires developers to provide a share of income restricted apartments under its Mandatory Inclusionary Housing (MIH) program when either public or privately sponsored rezonings result in significant new capacity to use the site or existing building for residential purposes. MIH was crafted to work in concert with the most recent version of 421-a by requiring somewhat deeper affordability (targeted to lower AMIs), as well as permanent affordability, in exchange for the additional zoning capacity made possible through the rezoning. A replacement version of 421-a would need to again be carefully coordinated with MIH to ensure that developers are providing affordable housing commensurate with both zoning benefits and the benefits of a tax exemption, while preserving the financial viability of new housing across the city's different neighborhoods.

Similarly, the City has proposed to grant additional floor area ratio (FAR) to buildings in medium and high density zoning districts that use the additional capacity to provide affordable and supportive units. That proposal—the Universal Affordability Preference (UAP) provisions of the City of Yes for Housing Opportunity zoning text amendment—is currently under review by community boards and borough presidents. The City also has proposed to "greatly expand opportunities for new 'missing middle' housing—that is, small apartment buildings that are relatively inexpensive to build" in low density zoning districts.[23] Neither proposal, however, defines AMI requirements for buildings that take advantage of those provisions, other than saying UAP will require affordability for households with annual incomes of less than 80 percent AMI (and those requirements may be subject to change during the City's land use review processes).[24]

The state legislature and Governor will need to consider those issues as they craft a new tax exemption because the goal should be to require that the share of affordable housing and depth of affordability targeted be appropriate given that developers will receive both

23. New York City Planning's Zoning Application Portal. Project Number: 2023Y0427. https://zap.planning.nyc.gov/projects/2023Y0427; VHB. (rev. 2023, September 29). City of Yes for Housing Opportunity: Draft Scope of Work in Preparation of a Draft Environmental Impact Statement. NYC City Planning. https://zap-api-production.herokuapp.com/document/artifact/sites/nycdcppfs/dcp_artifacts/2023Y0427_Draft%20Scope%20Of%20Work_1_627E990F2456EE11BE6E001DD804E34E/24DCP033Y_Draft_Scope_Of_Work_09262023_rev_09292023.pdf

24. New York City Department of City Planning. (2024, January 30). "City of Yes for Housing Opportunity: Info Session." https://www.nyc.gov/assets/planning/download/pdf/plans-studies/city-of-yes/housing-opportunity/city-of-yes-housing-presentation-013024.pdf

additional zoning capacity and the benefits of a tax exemption.[25] Unless all the benefits the development receives are considered together in setting the affordability requirements, the programs risk over-subsidizing the development, which would result in greater profit margins, albeit at different degrees, to the entities involved in a development. But the requirements also would need to be finely tuned to ensure that the City could achieve its goal of spurring more housing production in all the city's neighborhoods.

Coordinating all the different policies and programs that may be involved in a development using the new tax exemption will be especially challenging because some of the policies at stake have not yet been finalized. Affordability requirements should err on the side of caution,[26] lest the tax exemption be insufficient to spur development across the city, but must also use taxpayers' money efficiently to serve the city's lower income residents.

Principle Four: The new exemption should help the City meet its obligations under the Fair Housing Act to secure more affordable housing in thriving, diverse neighborhoods.

Affordable New York reflected changes over the prior programs to address criticism that prior versions resulted in most affordable housing being constructed in the city's lowest-income neighborhoods, which often have the highest share of Black and Hispanic residents. Since those revisions were made, which required affordable housing to be included in every building using the exemption,[27] the City adopted *Where We Live*[28]—its strategy for meeting obligations under the Fair Housing Act imposed on state and local governments to

25. One further aspect of the nuanced coordination required between the tax exemption and other state and city policies has to do with the various housing vouchers funded by the city, state, and federal governments. Tenants who qualify for those vouchers should be able to use them in the affordable housing required by a new tax exemption. But the calculation of how much affordable housing, at what level of affordability, can be required of developments with a tax exemption must take into account how the additional subsidies provided to the developer through vouchers affect the economics of the development.

26. Whichever law is adopted later will bear the burden of adjusting to the other program's design, especially when it comes to income restrictions. For example, if 421-a is enacted first, then the income levels required in UAP will both depend on, and need to act in addition or in complement to, 421-a's requirements. Ignoring one or the other risks potentially over subsidizing developments, or clustering too many units at a particular AMI band.

27. Raetz, H., & Murphy, M. (2022, February). The Role of 421-a during a Decade of Market Rate and Affordable Housing Development. NYU Furman Center. https://furmancenter.org/files/publications/The_Role_of_421-a_Final.pdf

28. Office of the Mayor of New York City (2020). Where We Live NYC: Fair Housing Together. NYC.gov. https://www.nyc.gov/assets/hpd/downloads/pdfs/wwl-plan.pdf

"affirmatively further fair housing."[29] Any new exemption must take into account that obligation and the City's commitments to achieve greater equity in the siting of affordable housing.

The most recent version of the tax exemption did indeed help make the siting of affordable housing more equitable. Of the income-restricted housing units built with 421-a over the decade between 2010 and 2020, those provided with 421-a but no other government subsidies were more likely to be in higher-median-income, lower-poverty neighborhoods than were the income-restricted homes using 421-a that also received other subsidies.[30] As noted earlier, "the 421-a tax exemption appears to have been an important tool for creating affordable housing in the city's wealthier SBAs [sub-borough areas] during this period."[31]

The Governor and legislature should take into account the relative value of providing income-restricted housing for households at different AMIs in higher opportunity neighborhoods. Earlier research shows that of the units targeted to low-income households built between 2014 and 2020 with a tax exemption, "apartments with two or more bedrooms were, on average, located in tracts with lower median incomes, lower median gross rent, and slightly higher poverty rates than their smaller counterparts."[32] Because much research has shown a link between access to neighborhood resources and children's outcomes,[33] a new tax exemption may want to require a minimum share of larger income-restricted apartments, rather than tying the size of the income-restricted apartments to the size of the market rate apartments.

29. The Fair Housing Act of 1968, Pub. L. 90–284, title VIII, §801, Apr. 11, 1968, 82 Stat. 81, codified at 42 U.S.C 3601, requires the Department of Housing and Urban Development (HUD) and state and local governments HUD funds to "affirmatively further" the policies of the Act. 42 U.S.C. 3608(e)(5)). HUD has interpreted that language to mean that the Fair Housing Act "not only prohibits discrimination, but also ... [requires] the agency and its program participants ... [to] proactively take meaningful actions to overcome patterns of segregation, promote fair housing choice, eliminate disparities in housing-related opportunities, and foster inclusive communities that are free from discrimination." Notice of Proposed Rule, Affirmatively Furthering Fair Housing, 88 FR 8516 (Feb. 9, 2023). The final rule is expected to be published in the next few months.

30. NYU Furman Center. (2022, May). *The Geography of New Housing Development*. NYU Furman Center. https://furmancenter.org/stateofthecity/view/the-geography-of-new-housing

31. Id.

32. Id.

33. Chetty, Raj, et al. (2016). The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Project. *American Economic Review 106*(4); Ellen, I. G., & Glied, S. (2015). Housing, Neighborhoods, and Children's Health. *The Future of Children*, *25*(1), 135–153. http://www.jstor.org/stable/43267766

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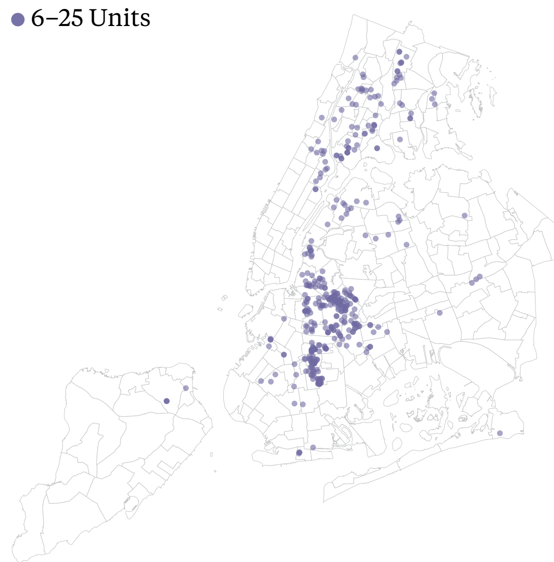
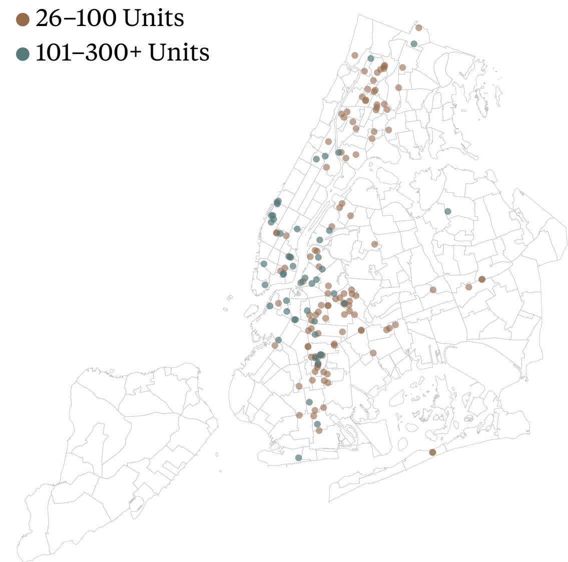
Figure 2: 6 to 25 Unit Properties Built Using the "Affordable New York" Version of 421-a



Sources: Department of City Planning MapPLUTO (2023), Department of Finance (2023), NYU Furman Center.

Figure 3: 26 to 100 Unit Properties and Properties With 101 or More Units Built Using the "Affordable New York" Version of 421-a



Sources: Department of City Planning MapPLUTO (2023), Department of Finance (2023), NYU Furman Center.

Principle Five: The new exemption should flexibly address the city's very different neighborhood markets, yet be simple to administer and enforce to ensure that developers and owners who take advantage of the exemption live up to their obligations.

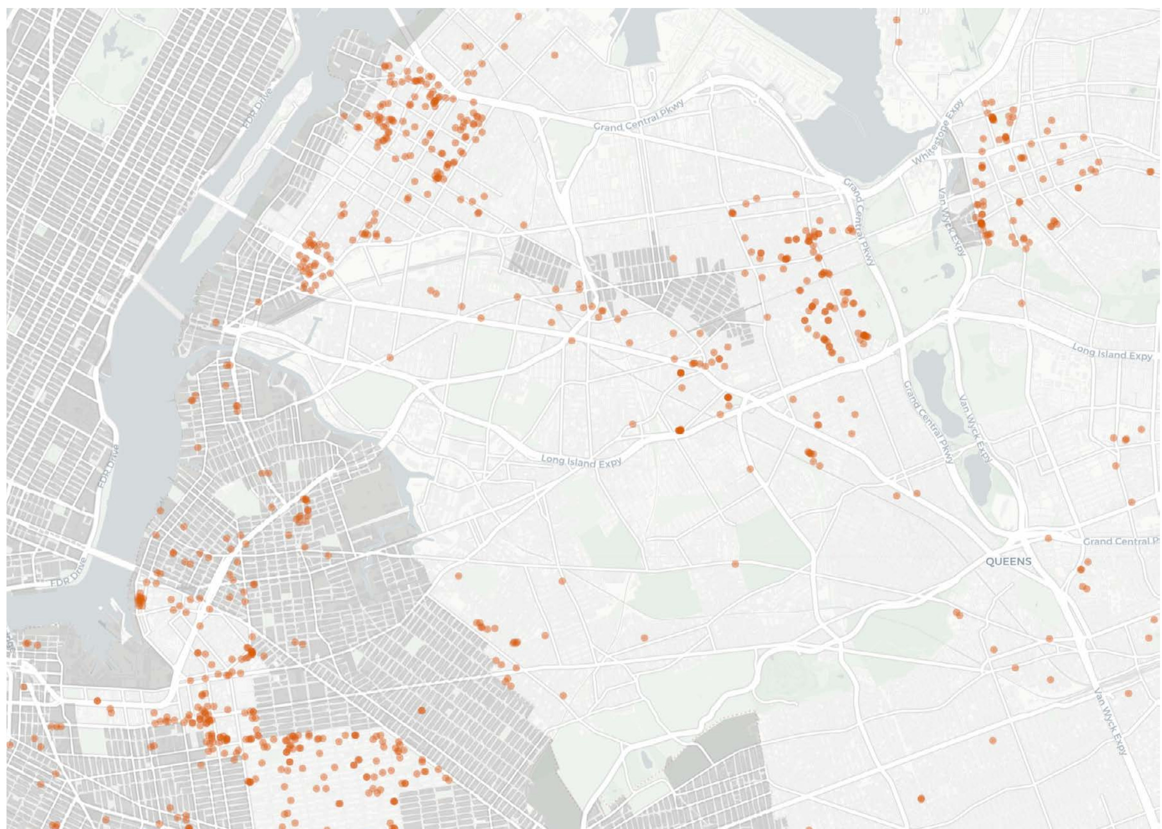
Any 421-a tax exemption program must operate within New York City's complex real estate context, which is challenging due to the diversity of neighborhood rental markets. This complexity stems from variations in factors such as rent levels, local amenities, and zoning regulations that dictate the types of buildings permissible across different areas.

Historically, policymakers have attempted to navigate these differences by introducing mechanisms like affordability requirements, benefit terms, and wage standards that varied by the size of the development or by geography. These measures were designed to reflect the economic and demographic diversity within the city, but they have also made the program's implementation and enforcement more complex.

The 421-a program has been used to build a range of building sizes—from smaller developments in mid-market neighborhoods to larger ones in high-rent neighborhoods like Manhattan and Downtown Brooklyn. However, the relationship between a building's size and the market rents at its location is not always direct, complicating the program's efforts to tailor its approach to the diverse market conditions (See Figures 2 and 3).

Geographic distinctions, such as the Geographic Exclusion Area (GEA) used in the version of 421-a preceding Affordable New York, aimed to address disparities by requiring affordable housing in certain areas while exempting others. This approach, while intended to reflect local market conditions, highlights the challenges of accurately defining and applying geographic criteria in a city where real estate dynamics can vary significantly even within short distances and across real estate cycles.[34]

Figure 4: Map Detail of 15-year 421-a Locations and the 2008 Geographic Exclusion Area



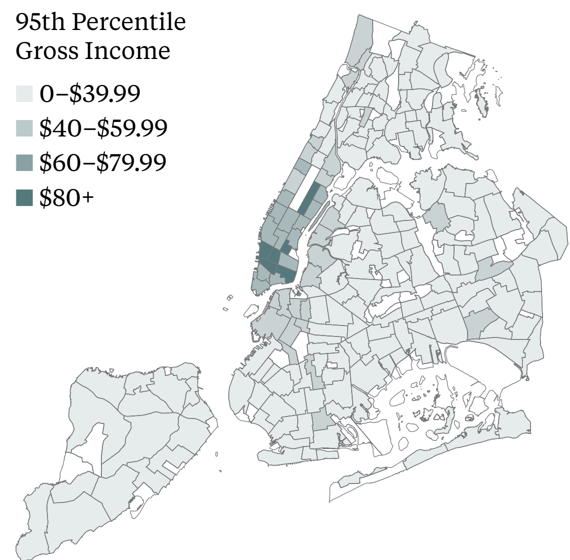
Sources: Department of City Planning MapPLUTO, Department of Finance, NYU Furman Center.

The gray area is the Geographic Exclusion Area (GEA) in northwest Brooklyn and parts of Queens that was included in the version of 421-a prior to Affordable New York. The orange dots represent developments that received a 15-year tax benefit but did not have to supply any on-site affordable housing. The map highlights the imprecise nature of a GEA approach by showing how much development occurred right on the edges of the GEA (i.e. Long Island City, Williamsburg, Astoria, Corona, and Downtown Flushing)

34. As an example, the 2008 GEA was created right around the time of the financial crisis, which put a dent on development financing and the market as a whole, rendering the GEA to be less meaningful.

Nevertheless, setting appropriate affordable housing requirements requires, at a minimum, attention to neighborhood rent levels. Because of the wide range of rents across the city, a uniform standard is unlikely to result in an exemption that is both fair and responsive to varying economic conditions that would make the requirement too onerous to allow development in some neighborhoods and too generous to developers and landowners in others. For example, Figure 5 highlights the huge variation in estimated rent per square foot across the city's different markets. Here, we show the 95th percentile of rent level per square foot, which is derived from income and expense data reported by owners to the New York City Department of Finance. This effectively identifies the upper limits of market rents, providing a sense of where the economic and geographic landscape intersect to give an idea of the areas that can sustain higher obligations, without hindering development, versus the areas where stringent requirements would risk hampering the housing construction.

Figure 5: 95th Percentile of Residential Rental Income per Square Foot, at the Neighborhood Level (Neighborhood Tabulation Area)



Sources: Department of City Planning MapPLUTO (2023), Department of Finance (2023), NYU Furman Center.

Policymakers have struggled over the years to adapt the 421-a program to the nuances of New York City's real estate market because of the challenges posed by diverse building types, evolving markets, and significant variations in the rents within and between neighborhoods. Understanding and addressing these challenges with an appropriate design that is adaptable and flexible is crucial for the program's ability to contribute to the city's housing goals.

To reflect such different markets across the city, policymakers should adopt a data-driven approach that ties neighborhood tiers to data about rent levels in each area. Geography is a necessary factor for differentiating affordability requirements, and geographic submarkets can be defined by existing boundaries that are commonly used in housing and community development, such as community districts or neighborhood tabulation areas (NTAs). A data-driven approach provides the best chance of balancing the dual challenges of encouraging affordability in high-rent areas, and mitigating the burden of property taxes in markets with lower rents.

Designing a Tax Exemption to Fulfill Those Principles: Lessons from our Modeling

As discussed above, and as Table 1 in the Appendix shows, if no tax exemption is adopted to replace the expired Affordable New York program, we estimate that a developer of a prototypical high-rise building in the highest rent areas would have at least 30 percent less to offer for sites on which to build a 100 percent market rate building. We conclude, therefore, that some tax exemption should be offered to the developers of rental housing. That does not mean, however, that the exemption should just be extended in its most recent form. As the principles outlined above suggest, changes are needed to make the tax exemption more efficient, more likely to serve the New Yorkers struggling the most to secure stable, affordable housing in neighborhoods with good services and amenities, and more in harmony with the state's and city's other programs and goals.

Considerations for Evaluating Economic Impacts and Market Adjustments

How much room there is to make the program more consistent with the principles articulated above depends on several factors. First, Affordable New York may have been too generous to developers in exchange for the level of affordability required. As noted above, many more units for households with moderate- and middle-incomes resulted from Affordable New York than from prior versions of the exemption and from estimates of the level of exemption required in the negotiations leading to Affordable New York. So, it may be possible to change the level of affordability required, in the highest and mid-rent markets, by asking developers to supply more affordability in exchange for the tax benefit.

Second, it may be possible to require that land prices reasonably adjust downward over time and force landowners to adjust expectations around a newly enacted 421-a program. By explicitly acknowledging the benefits landowners receive from the exemption, and asking them to share in the cost of providing affordable housing, policymakers may be able to dampen the expectation that land prices will continue on the trajectory that earlier versions of the tax exemption helped to make possible. As we explained above, in some markets, builders would be able to build 100 percent market rate development if land costs declined by 30 percent (which we labeled as an unrealistic expectation, especially given the immediate need for housing). Under a newly enacted 421-a program, however, landowners would have to choose between selling to a developer at a price that has adjusted to new valuation norms, exploring an alternative development option, or waiting out a long cycle with an unclear future and risking a prolonged period of stagnation. Finally, by tailoring the requirements more carefully to the city's different markets, it may be possible to make the exemption more efficient.

Each of these three factors is uncertain, and the savings they represent may be eaten up by other increases in costs or risks. Labor costs and the costs of complying with new regulations such as those intended to reduce greenhouse gas emissions produced by residential buildings will result in pressure to use any savings achieved by lower land prices or a more efficient exemption for goals other than affordability.

The model described in the appendix shows, however, that in the highest rent markets, it may be possible to achieve a bit deeper affordability than Affordable New York required, with the same share of units income restricted. In mid-market areas, though, policymakers will need to consider tradeoffs between achieving deeper affordability, which would require lowering the share of units that could be income-restricted or providing a higher share of income-restricted units at a higher AMI level for all the reasons we have articulated above.

Tailoring and Optimizing Affordability Requirements

In order to understand what an aggressive, but reasonable, assumed decline in land values would yield in terms of affordability, while keeping other development assumptions constant, we modeled what could be achieved if the amount landowners insist upon could be forced downwards by 20 percent across different submarkets in the city. We choose 20 percent as a significant but conceivably achievable adjustment, emphasizing the role that land value recalibration plays in this discussion.

Next, to understand how 421-a could be tailored to market conditions, with the goal of maximizing the amount of affordability that a property tax exemption could generate, we use our model to estimate what affordability could be supported in the highest rent and mid-rent neighborhoods. Using the assumptions described in more detail in the Appendix and reasonable rental income that could be expected in these submarkets, we show levels of affordability that likely could be achieved in each market. Because the level of affordability depends on both the depth of AMIs targeted, the share of units that must be income-restricted, the length of the tax exemption, and characteristics of the market, the affordability requirements we suggest are just one of a number of options.

Given shifts in AMI and our modeling of adjusted land values, for sites in the highest rent markets, we project that projects could remain financially viable if the affordability required were made more aggressive than the Affordable New York requirement (Option A) that 25 percent of the units be income-restricted along these terms: 10 percent of the units at 40 percent of AMI, 10 percent to households at 60 percent AMI, and 5 percent to households at 130 percent of AMI (a total average AMI of 64 percent). The modeling indicates that the 130 percent AMI tier could be eliminated, but the share of units that would be income-restricted could remain at 25 percent, with AMIs even reaching a lowered average threshold of 50 percent AMI.

In lower rent areas, in which smaller buildings are more the norm to be built, unless development is more deeply subsidized, the model suggests that it could be very challenging to impose affordability requirements on small owners and retain the economic viability of development, even with adjusted land costs. A smaller share, for example, 10 percent at 60 percent AMI, could work with a full 35 year benefit. An alternative is to allow units to be set at market rents, but then require some or all of those units to be rent-stabilized, allowing the rent in all the units to be initially set at market levels but with rent increases that fall under the jurisdiction of the local Rent Guidelines Board. That alternative could work with a much shorter tax exemption period than 35 years.

In the mid-rent markets, Affordable New York allowed developers to income restrict 30 percent of the units at 130 percent of AMI in recognition of the fact that 130 percent of AMI would be at, or slightly above, the local market rent, but income-restricting those units would make them rent stabilized. Our model suggests that a different approach could be to prioritize reaching rents that serve lower income households, but such an approach would require lowering the share of units that are income restricted to just 10 percent of the units,

at an average household income in the 50 to 60 percent AMI range (to keep in line with the Affordable New York framework, an additional portion could be income-restricted at a higher AMI, to secure rent stabilization benefits for those units).[35]

While we have been focused on how to feasibly reach lower-income households through the 421-a program, given market and regulatory constraints, policymakers could also serve households with slightly higher incomes in mid-markets. This approach, which was viewed by observers of Affordable New York as a controversial one, would still be consistent with fair housing goals if this strategy was adopted only in mid-markets. Our model suggests that a higher share of affordable units, for example, 20 percent at an average income of 90 percent of AMI, could be secured through the program in mid-markets. It is important to note that 90 percent of AMI would include rent levels at or below HUD's Fair Market Rent (FMR), which could open up a crucial source of housing for tenants with federal Housing Choice Vouchers or vouchers provided by New York State or City. In contrast, 130 percent AMI or other middle-income options would largely preclude voucher holders from being able to access such housing. Because many mid-rent areas are in neighborhoods in which a higher share of more deeply subsidized affordable housing was built over the past decades, trading off deeper affordability for a smaller share of units could also be most consistent with the City's goals of getting more housing built in every neighborhood, and its fair housing goals of securing a wider distribution of rent levels in new housing in high-rent areas.

35. Our model assumes that the non-income restricted units are not subject to rent stabilization. The Housing Stability and Tenant Protection Act (HSTPA) of 2019 impacts a future 421-a in several ways. HSTPA limits rent increases in rent stabilized units permanently and also locks in preferential rents until a tenant moves out. Because these weren't always the rules in 421-a (and different versions of 421-a had different rules around rent stabilization), careful attention should be given to any rent stabilization requirements. Putting all units, whether income-restricted or not, into rent stabilization, for example, might change an investor's or developer's perspective on the attractiveness of building under the 421-a program.

Conclusion

In conclusion, the expiration of the 421-a tax exemption program presents both a challenge and an opportunity for New York City. As the city grapples with a dire housing shortage, the need for a robust strategy to encourage housing development is undeniable. The 421-a program, despite its controversies, has historically been a crucial mechanism for stimulating the production of multifamily rental apartments, including a significant number of income-restricted units. The expiration of the program, however, brings to the fore the urgent necessity to re-evaluate and reform the exemption's structure to better meet today's housing needs and policy goals.

The five principles outlined for reforming the 421-a program emphasize the need for a tax exemption that not only encourages the development of new rental apartments but also ensures that these developments contribute significantly to the city's affordable housing stock. Moreover, any new exemption must be crafted to work in harmony with the City's broader housing, zoning, and social equity objectives, providing a fairer distribution of housing development across neighborhoods and promoting more diverse neighborhoods and wider choices among neighborhoods for the city's lowest-income residents.

Our analysis, supported by a simplified real estate pro forma model, illustrates the critical role of a tax exemption in making multifamily rental development financially viable in New York City's challenging real estate environment. The findings highlight the nuanced dynamics of different housing markets within the city and underscore the importance of a redesigned tax exemption that can flexibly address these variations while remaining straightforward to administer.

APPENDIX

Our Model: A Simplified Return-on-Cost Real Estate Pro Forma

A real estate pro forma is a financial model used to assess the viability of a proposed real estate project. It aims to determine whether a project can secure sufficient funding to cover all associated costs, from initial planning and site acquisition through to construction completion and leasing. The analysis comprises two main components:

1. Evaluating whether the funding that can be secured matches or exceeds the total project costs, including planning, acquisition, construction, and leasing efforts.
2. Calculating the net operating income (NOI) of the property once operational, which represents the revenue remaining after all operating expenses have been paid.

The utility of a pro forma lies in its ability to connect these components, translating NOI into an estimated amount of capital that can be raised. This estimate considers a Return on Cost (ROC), reflecting the anticipated cost of capital derived from both debt and equity investments. The ROC provides insight into the financial return investors might expect, accounting for the risks associated with real estate development.

In our analysis, we used a simplified ROC pro forma model, incorporating a calculation for what we refer to as Supportable Acquisition Cost (SAC)—the amount that a developer would be able to raise, minus the costs of constructing the building and getting it up and running. This calculation is based on assumptions about market rents, construction and operating costs, expected ROC, and a methodology for estimating full property taxes. Our dialogue with developers across various market scenarios and building types—high-rise buildings in high-rent areas, mid-rise in mid-rent areas, and low-rise in lower rent areas—helped inform our assumptions regarding construction and operating expenses, as well as the ROC required in today's market.

Our model is not sensitive to financing costs, loss factors, or pre-development property taxes not exempt under 421-a because it does not include nor rely upon assumptions about those factors. It also does not account for potential fluctuations in rents and costs over time. It does reflect the finite duration of the property tax exemption and its varying benefit schedule.

Using this model, we compared the SAC for mixed-income multifamily housing developments, with and without the benefits of the Affordable New York tax exemption and its affordability requirements. This comparison allowed us to explore the possible affordability levels achievable with a 20 percent reduction in the amount a developer can offer for a site, providing insights into how a revised 421-a program could apply across New York City's diverse rental housing markets.

Table 6 presents supportable acquisition costs our model suggests would result from different scenarios. The first two lines give the SAC for our three prototypes with no tax exemption. Paying full taxes and with no affordability requirements, the model indicates SACs of $191, $6, and $-18 respectively for our three prototypes of high-rise/high-rent, mid-rise/mid-rent, and low-rise/low-rent, which are 31 percent, 98 percent, and 112 percent below the supportable acquisition costs possible with the benefit of Affordable New York, respectively. The next line shows the SACs if land costs could be decreased by 20 percent (or the equivalent dollar amount in savings could be derived from other development costs or reduced profits relative to the Affordable New York returns). The model then allowed us to test whether deeper levels of affordability could be achieved while still resulting in SACs of 80 percent the level achieved by Affordable New York. The model shows that among the affordability requirements that could work are: for the high-rise, high-rent prototype, an affordable share of units of 25 percent affordable to households with income at an average of 50 percent of AMI; for both the mid-rise, mid-rent and low-rise, low-rent prototypes, a share of 10 percent at 60 percent of AMI appears financially feasible (or alternatively, 20 percent at 90 percent AMI).

Table 6: Modeling of Supportable Acquisition Costs Under Various Assumptions for Each of the Three Prototypes

	High Rise		*Mid Rise*		*Low Rise*
Without Affordable New York (ANY)	$191		$6		$(18)
ANY Opt A (25%@66% of AMI), 35 year exemption	$278		NA		NA
ANY Opt C (30%@130% of AMI), 35 year exemption	NA		$256		$156
Decrease in SAC without ANY	-31%		-98%		-112%
80% of Adjusted SAC, 35 yr TE with ANY	$222		$205		$125
25%@50% of AMI, 35 yr TE	$245	10%@60% of AMI, 35 yr TE	$196	10%@60% of AMI, 35 yr TE	$130

Assumptions used for Our Three Prototypes

Table 7 lays out the assumptions we used in our model. The rents, construction cost, and operating expenses are our best assessments of current costs based on what we heard from a range of developers. In two cases—the ROC and property taxes –we deliberately chose values that were at the low-end of the range for assessing financial viability. For example, we relied on a 5.5 percent ROC, a value at the low-end of the range we heard from developers. Many observers thought that ROC must now be higher (6 to 7 percent) given market risks and higher interest rates. A higher ROC would reduce the SACs more than our model does but not significantly alter the relative feasibility of different affordability requirements with a new 421-a. For full property taxes, we relied on a rule of thumb based on a percent of gross revenue. We set the percentage at 25 percent, which is at the low end of what the industry uses. That conservative number results in a lower relative difference between the supportable acquisition cost available under Affordable New York and what's available if no tax exemption is available, but its level is not critical to the calculation of the affordability levels that could be achieved if acquisition costs could be 80 percent of what the model estimates those costs were under Affordable New York.[36] We also modeled a 35 year full

36. As a test of that percentage, we also computed the property tax using the methodology laid out by DOF for capitalizing NOI to come up with a market value, multiplied it by 0.45 (the assessment ratio) and then again by the tax rate. In all cases the result of this set of calculations exceeded 25 percent of gross revenue.

tax exemption rather than a step down structure starting in a certain year. For income-restricted rents according to the Area Median Income (AMI), we used HUD's 2023 AMI for a family of three for the New York metro area.

For our three prototypes, we modeled Affordable New York's Option A for the high-rent prototype (requiring 25 percent of the units at an average of 66 percent of AMI) and used Option C for the other two prototypes (30 percent of the units affordable to the lower of 130 percent of AMI or local market rent.)

After deriving SACs using the ROC pro forma, we further adjusted downward the ones benefiting from Affordable New York to reflect the time limitation of the property tax exemption—35 years—by computing the present value of a full tax exemption for a full 35 years using the ROC of 5.5 percent as the discount rate.

Table 7: Assumptions for a Return-on-Cost Pro Forma to Estimate the Maximum Amount a Developer of Multifamily Rental Housing can Pay for Site Acquisition under both Affordable New York (ANY) and Full Taxes with No Affordable Requirement, for 3 Market Prototypes

Return on Costs (ROC)	5.50%
Full Property Taxes (PT) as a % of Gross Revenue	25.00%
2023 AMI (100%), Family of Three	$127,100.00

No Vacancy Allowance, Loss Factor, or Mini Tax

Construction Type and Rental Market (3 prototypes)	*High Rent High Rise (Manhattan)*	*Mid Rent Mid Rise in the Outer Boroughs*	*Low Rent Low Rise In the Outer Boroughs*
% of Units Affordable Under ANY	25%	30%	30%
% of AMI for Affordable Units	(Option A) 66%	Lower of 130% or Market	Lower of 130% or Market
Square Feet (SF)	800	750	750
Total Development Cost/SF w/o Acquisition Cost	$850.00	$650.00	$450.00
Market Rent/SF	$95.00	$65.00	$45.00
Market Rent/Dwelling Unit/Month	$6,333.00	$4,063.00	$2,813.00
AMI% equiv. to market rent	199%	128%	89%
Average Rent/SF	$79.11	$65.00	$45.00
Annual Operating Costs (OC)/ Dwelling Unit (no PT)	$11,200.00	$9,500.00	$7,500.00
OC/SF	$14.00	$12.67	$10.00
Net Operating Income (NOI)/SF	$65.11	$52.33	$35.00

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Correction: A prior version of this report appeared on our website that included errors in estimating 421-a unit counts. Those errors are corrected in this version (updated 4/12/2024).