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Credits & Incentives talk with Deloitte

The future of the 421-a property tax exemption in New York City

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CREDITS & INCENTIVES TALK WITH DELOITTE

The Future of the 421-a Property Tax Exemption in New York City

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Federal, state, and local jurisdictions use credits and incentives to encourage certain types of behavior that can range from hiring and new job creation to going green, and everything in between. Over time, however, credits and incentives need to be reviewed to ascertain whether they are still needed and are still accomplishing the goals for which they were established. One such incentive that has been the subject of significant debate in 2015 is New York's 421-a property tax exemption (the "421-a exemption"), which creates full or partial exemptions or tax abatements for new or substantially rehabilitated multiple unit dwellings.¹

The 421-a exemption was originally scheduled to expire in June 2015. However, with the enactment of Assembly Bill 8323 ("AB 8323") on June 26, 2015, the exemption was extended as specified for construction commenced on or before December 31, 2015.² Also, AB 8323 provides for the further extension of the 421-a exemption program until June 15, 2019, as substantially amended in AB 8323, if representatives of labor and real estate interest groups enter into a memorandum of understanding addressing wage protections for construction workers with respect to buildings of over 15 units that benefit

from the exemption.³ As this column goes to press, a memorandum of understanding has not yet been executed.⁴

This article provides an overview of the 421-a exemption program, including its general operation historically, and summarizes those aspects of the program-as amended in AB 8323-that would be applicable through June 15, 2019, pending execution of the memorandum of understanding mentioned above.⁵

Historical overview

In the 1970s, New York created the 421-a exemption to spur housing development at a time when new construction in New York City had slowed substantially and the city as a whole was struggling. As time passed and conditions improved, the program was adjusted in the 1980s to encourage the growth of affordable housing units.

As a result of this adjustment, a zone of exclusion (known as the Geographic Exclusion Area or "GEA") was created under the program whereby developments in prime Manhattan locations, i.e., generally south of 96th Street and north of 14th Street, were required to include at least 20% affordable housing in order to be eligible for the 421-a exemption.⁶ Originally, developers could also build affordable housing units elsewhere in the city to obtain affordable housing certificates, enabling the construction of market rate units in Manhattan without including affordable housing.

In the 2000s, the GEA was expanded to include the entirety of Manhattan, as well as certain portions of the remaining four boroughs with strong market values, thus permitting developers to obtain the benefits of 421-a in a greater number of locations.

Application of the 421-a exemption prior to AB 8323

As noted previously, AB 8323 adopted amendments to the 421-a exemption that will take effect only upon the execution of a memorandum of understanding addressing construction worker wage protection.⁷ Accordingly, this section summarizes the 421-a exemption program as in effect absent the pending amendments.

Under the program, qualified "multiple dwellings" are exempt-for up to three years during the construction period-from all increases in property taxes, other than special assessments for local improvements, that

result from improvements to the land. After completion of construction, a building could be exempt from a portion of the increased tax for anywhere from 10 to 25 years, depending on the location.

For purposes of the 421-a exemption program, the city is split into three zones: Manhattan generally between 14th and 96th Streets; all Manhattan below 110th Street, excluding the first zone; and Manhattan above 110th Street and all other boroughs.⁸ However, regardless of location, to be eligible for the exemption, construction must have begun before June 23, 2015.⁹

The program functions by providing a three-year exemption period for construction, then a 10-year, 15-year, 20-year, or 25-year exemption, depending on the type of project and its location.¹⁰ The longer exemption periods generally apply in Manhattan north of 110th Street, in the other boroughs, or to projects that include 20% affordable housing units.¹¹

AB 8323

With the 421-a exemption set to expire on June 23, 2015, New York State enacted AB 8323, extending the 421-a program for an initial period of six months.¹² AB 8323 also extended the law until June 15, 2019, with substantial amendments, conditioned upon labor and real estate interest groups, on or before January 15, 2016, entering into a memorandum of understanding addressing wage protections for construction workers on buildings exceeding 15 units that benefit from the exemption.¹³ Essentially, AB 8323 provides a temporary lifeline while certain aspects of the law revolving around wages for workers are reformed over the next few months.¹⁴

The AB 8323 extension and pending revisions to the 421-a exemption stem largely from a plan put forward by New York City Mayor de Blasio, which was nearly adopted in full. The hallmark of this plan, as included in the AB 8323 amendments that are pending, subject to execution of the memorandum of understanding, is a mandate that all properties receiving 421-a benefits include 25% to 30% affordable housing in the future.¹⁵ In addition, exemption periods would be extended, with the maximum period of exemption increasing from 25 to 35 years.¹⁶

Luxury condos in Manhattan would no longer be eligible for the program, though benefits would still be available for certain developments in the outer boroughs on a smaller scale.¹⁷ Finally, developers would be presented three options regarding the level and mix of affordable units to include in a given rental project.¹⁸ It appears that the only aspect of Mayor de Blasio's plan that was not included in AB 8323 was a so-called "mansion tax," the proceeds of which would have gone to fund additional affordable housing projects. Had it

been adopted, a 1% tax would have been imposed on all home sales over \$1.75 million, and a 1.5% tax would have been imposed on all sales over \$5 million.¹⁹

Whether the pending law changes that are subject to execution of a memorandum of understanding actually become effective is dependent upon resolution of the issue of wages for organized labor used in the construction of 421-a buildings of over 15 units.²⁰ The issue centers on Mayor de Blasio's plan to set a prevailing wage for all service jobs in 421-a buildings. While the Mayor's plan notably excluded construction workers, Governor Andrew Cuomo, among others, responded by pushing for the inclusion of construction workers if a prevailing wage is to be set.

The Mayor's office views the extension of a prevailing wage to construction workers, who already earn much higher wages than their service industry counterparts (such as doormen and janitors), as an event that would jeopardize the construction of some 17,000 of the 24,000 projected units of affordable housing that are anticipated to be built as a result of the current plan.²¹

Whatever the result of the labor debates, one thing remains clear: whether one is for it or against it, the status of the 421-a exemption will remain a significant factor in the creation of housing in New York City. Developers are already sidelining more affordable rental projects in favor of higher-price condos due to the uncertainty surrounding the exemption,²² and expiration of the 421-a exemption, in the event the contemplated memorandum of understanding is not executed, could potentially lead to significant changes in the development of housing in the city.

Conclusion

While the goals of increased housing stock, both market rate and affordable, are not very controversial and have generally been met—at least in part—by the 421-a exemption, this incentive has nonetheless been thrust into the New York media light. How 421-a helps developers and New York City achieve these goals has prompted recent criticism showing that while credits and incentives are meant to benefit communities and governments, there is not always agreement on the best way to achieve those results.

For example, some critics contend that given the strength of the New York real estate market, developers would build new projects in the city even if the 421-a exemption were not available.²³ Developers, however, would presumably maintain that due to the high costs associated with building in the city, the exemption is essential to future construction. Even Mayor Bill de Blasio has acknowledged the fundamental importance of the continued existence of the 421-a program.²⁴

Although critics may conceivably be unhappy with the duration of the exemption periods, they can now be content that the pending amendments contained in AB 8323 would mandate the inclusion of affordable housing in any building that is to receive 421-a benefits.

While the memorandum of understanding has yet to be executed, if the issue of construction worker wages is resolved, the future of the amended 421-a program as a boost to the New York residential real estate market and overall economy is potentially bright. Between now and the end of 2015, New York will surely continue to hear more about the status of this important tax incentive program.

¹ N.Y. Real Prop. Tax Law § 421-a.

² Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015) Sec. 63-a, amending N.Y. Real. Prop. Tax Law § 421-a.2(a)(iv)(A), and Sec. 63-b, amending N.Y. Real. Prop. Tax Law § 421-a.2(c)(ii). A copy of the new law is available at http://assembly.state.ny.us/leg/?default_fld=&bn=A08323&term=2015&Summary=Y&Actions=Y&Text=Y.

³ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c, adding new subdivisions 16 and 16-a to N.Y. Real. Prop. Tax Law § 421-a.

⁴ The reader should independently verify the current status of the law and any related memorandum of understanding as it could have changed since this column went to press.

⁵ Section 63-c of AB 8323 also adds new subdivision 17 to N.Y. Real. Prop. Tax Law § 421-a, which is not addressed in this article. Subdivision 17 creates specified Section 421-a exemption "extended benefit[s]" for "an extended affordability property" that "operate[s] as rental housing." See new subdivision 17(B) and (C). Subdivision 17 also requires that "building service employees" of an applicant for the program must "receive the applicable prevailing wage for the entire extended affordability period." See new subdivision 17(G)(II).

⁶ Kim Velsey, *A Taxing Matter: Looking Back on the History of 421-a*, Observer, June 28, 2015, <http://observer.com/2015/05/a-taxing-matter-looking-back-on-the-history-of-421-a/>.

⁷ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivisions 16 and 16-a to N.Y. Real. Prop. Tax Law § 421-a.

⁸ Map of New York City 421-a Geographic Exclusion Areas (GEA), http://www1.nyc.gov/assets/hpd/downloads/pdf/GEA_Map.pdf.

⁹ Note that this June 23, 2015, deadline has been extended to December 31, 2015, pursuant to Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015) Sec. 63-a, amending N.Y. Real. Prop. Tax Law § 421-a.2(a)(iv)(A), and Sec. 63-b, amending N.Y. Real. Prop. Tax Law § 421-a.2(c)(ii). The June 23, 2015, deadline had been extended from June 15, 2015, in legislation enacted on June 18, 2015. Laws 2015, ch. 19.

¹⁰ Tax Incentives, 421-a, NYC Housing Preservation & Development, <http://www1.nyc.gov/site/hpd/developers/tax-incentives-421a.page>.

¹¹ *Id.*

¹² Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015) Sec. 63-a, amending N.Y. Real. Prop. Tax Law § 421-a.2(a)(iv)(A), and Sec. 63-b, amending N.Y. Real. Prop. Tax Law § 421-a.2(c)(ii).

¹³ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivisions 16 and 16-a to N.Y. Real. Prop. Tax Law § 421-a.

¹⁴ Will Bredderman, *Despite Cuomo's Claims, de Blasio Hails "Real Progress" on 421a*, Observer, June 29, 2015, <http://observer.com/2015/06/despite-cuomos-claims-de-blasio-hails-real-progress-on-421a/>.

¹⁵ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivision 16(A)(II)-(IV) to N.Y. Real. Prop. Tax Law § 421-a.

¹⁶ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivision 16(B) to N.Y. Real. Prop. Tax Law § 421-a.

¹⁷ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivision 16(A)(XXIV) to N.Y. Real. Prop. Tax Law § 421-a.

¹⁸ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivision 16(A)(II)-(IV) to N.Y. Real. Prop. Tax Law § 421-a.

¹⁹ Ryan Hutchins, *Accord reached on 421-a program, rent law renewal*, Capital, June 25, 2015, <http://www.capitalnewyork.com/article/albany/2015/06/8571033/accord-reached-421-program-rent-law-renewal>.

²⁰ Laws 2015, ch. 20 (AB 8323; Jun. 26, 2015), Section 63-c adding new subdivision 16-a to N.Y. Real. Prop. Tax Law § 421-a.

²¹ Ryan Hutchins, *Accord reached on 421-a program, rent law renewal*, Capital, June 25, 2015, <http://www.capitalnewyork.com/article/albany/2015/06/8571033/accord-reached-421-program-rent-law-renewal>.

²² See Vilensky and Dawsey. See also Ryan Hutchins, *421-a deal brings more anxiety for real estate developers*, Capital, June 30, 2015, <http://www.capitalnewyork.com/article/albany/2015/06/8571214/421-deal-brings-more-anxiety-real-estate-developers>.

²³ Will Bredderman, *Cuomo, Legislative Leaders Announce Extensions and Reforms of Rent Laws, 421a*, Observer, June 23rd, 2015, <http://observer.com/2015/06/cuomo-legislative-leaders-announce-extensions-and-reforms-of-rent-laws-421a/>.

²⁴ Mike Vilensky and Josh Dawsey, *New York City Developers Are Wary Over Fate of 421-a Tax Break*, Wall Street Journal, June 3rd, 2015, <http://www.wsj.com/articles/new-york-city-developers-are-wary-over-fate-of-421-a-tax-break-1433380234>.