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March 2023

FPI Cost Analysis

The Cost of New Property Tax Breaks for Local Government

Estimating the Potential Impact of the Executive Budget's Proposed Property Tax Breaks on Localities

Key Findings

- The five tax incentives could cost local governments across the state as much as $2.84 billion per year if the state meets its housing goals:
    - 421-p's collective cost to localities other than New York City: up to $441 million per year
    - AHCC cost to New York City: up to $110 million per year
    - 421-a extension cost to New York City: up to $288 million per year
    - J-51 renewal cost to New York City: up to $301 million per year
    - Accessory Dwelling Units tax incentive collective cost to localities statewide: up to $1.7 billion per year
- Each tax incentive would be accompanied by new regulatory changes that would authorize residential construction not permitted under current law. These regulatory changes are likely sufficient to prompt new housing production regardless of available tax incentives

Tackling New York State's housing crisis is a central priority of the fiscal year 2024 executive budget. The budget proposes a suite of policy responses designed to create 800,000 new housing units, especially in the New York metropolitan area. Many of these measures, including required changes to local land use policy, are appropriately ambitious, given the urgency of the state's housing shortfall.

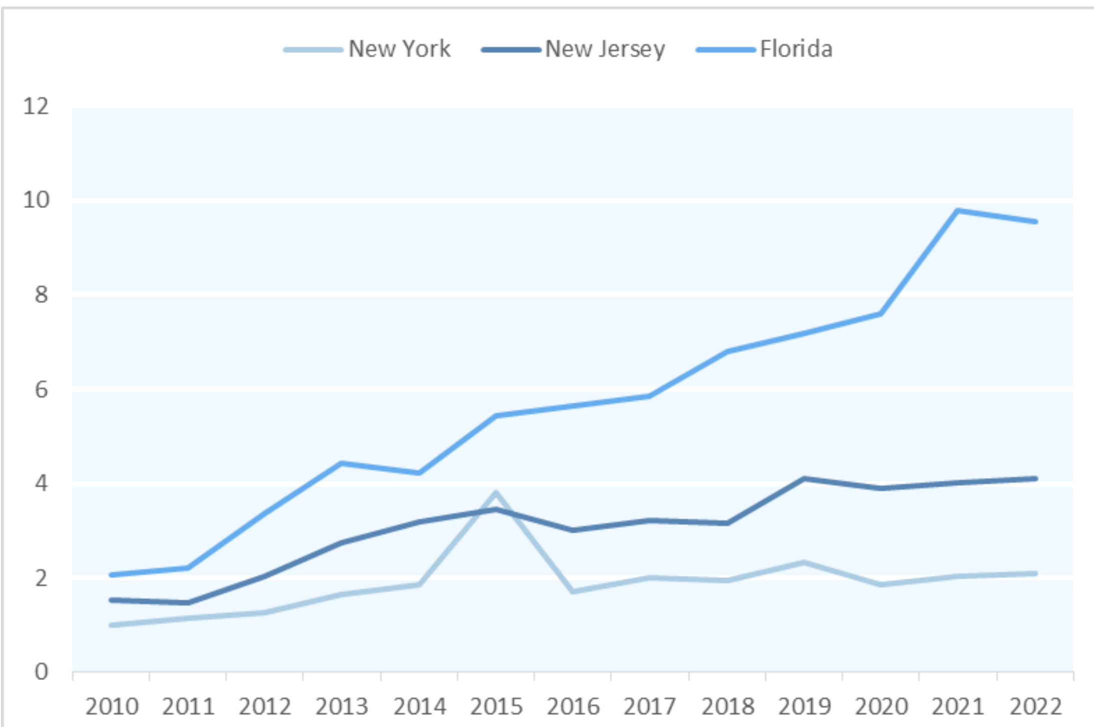
Other parts of the housing package, however, would authorize costly and unnecessary tax breaks. The main regulatory change needed to increase the supply of housing is simply permitting the construction of multi-family housing where it is not currently allowed. Layering new tax incentives on top of regulatory changes may afford a windfall to landlords and developers while doing little to spur housing development.

Instead, these tax incentives would deprive local governments of the revenue necessary to support newly-growing populations. The five proposals for new, renewed, or extended tax incentives could cost local governments across the state as much as $2.84 billion per year if the state meets its housing goals. While these incentives are intended to deliver income-restricted housing, tax benefits have proven an ineffective housing affordability policy. Further, they would place affordable housing financing at the local, rather than state, level, despite the state as a whole standing more to gain from increased housing supply than individual localities.

New York's housing supply and the executive budget

New York State faces an acute housing shortage. In 2022, New York permitted the fifth-lowest amount of new housing of any state, on a per person basis. New York's rate of new housing (2.0 units per thousand residents was just under half that of New Jersey (4.1) and one-fifth that of Florida (9.9) — the two most common destinations for New Yorkers moving to other states.[1]

Figure 1. Building permits per 1,000 residents for New York, New Jersey, and Florida, 2010-2022



New York's lack of new housing, and resultant high housing costs, have resulted in net migration out of the state across the income distribution. [Past FPI analysis] has shown that this outflow is driven primarily by high housing costs. For the most common moves out of the state, a median-income family's housing cost savings would be 15 times greater than any potential tax savings. While many residents who leave the state remain in the New York metropolitan area, and likely continue to hold New York jobs, the region's high housing costs make it difficult for families to remain in the state as they grow, causing significant population loss and threatening the state's economic dynamism.

Increasing New York's housing production is a central focus of the fiscal year 2024 executive budget. The budget includes a suite of legislative proposals, including state requirements for local land use policy that would aim to increase the supply of housing. Proposals especially target the New York metropolitan area, which faces a greater housing imbalance and higher prices than the rest of the state.[2] These proposals represent an ambitious response to an urgent challenge facing New York.

State vs. Localities: Who Benefits

The New York metropolitan area is the driver of state employment growth and one of U.S.'s costliest and most undersupplied housing markets. New housing in this area could carry benefits to both the state and local governments. New residents would stem the state's recent population loss and replenish the state's labor force, which remains below pre-Covid levels. A larger population would make the metropolitan area's economy more productive, increasing average productivity per worker.[3] For the state, which is funded primarily through its personal income tax, this would mean a stronger economic base and greater fiscal capacity to expand public services and make investments at the local level to support population growth.

For localities, which fund themselves primarily through property taxes, potential gains from population growth are less straightforward. While an increased housing stock and population would raise a locality's total property tax levy, its effect on per person property tax revenue is uncertain, and would be undermined by significant tax breaks. Rather than relying on local tax breaks, the state should directly fund housing security policies.

Tax Benefit Shortcomings

The executive budget's proposal to spur housing production that includes income-restricted units, however, relies on a flawed tool: local property tax benefits. The budget includes a series of proposals to authorize local governments to provide tax benefits for certain housing projects that include specified levels of income-restricted units. While the programs aim to increase the supply of income-restricted housing created alongside new market rate housing, they face four major shortcomings:

1. **By increasing property exemptions and abatements, local governments would be deprived of their primary source of revenue while facing the rising costs of a growing population.** This burden would especially fall on school districts and local government workers, whose level of service generally needs to scale with the population. Requiring expanded public services out of stagnant tax base could threaten service quality and public sector wages.

2. **Evidence from past tax breaks has found them to be inefficient tools to build affordable housing relative to other policies.** A 2022 report from the Community Service Society found that New York City's 421-a tax incentive cost the city $1.6 million per affordable unit. The city could have financed 11 times more affordable units if it had used direct subsidies rather than tax breaks for developers.[4]

3. The tax breaks are likely unnecessary. In the high demand, high cost New York metropolitan area, removing regulatory barriers to new housing will provide significant impetus for new construction without added financial incentives. **California recently passed two laws similar to the executive budget's two land use proposals, including affordability requirements for projects that override restrictive local land use regulations, without complementary tax incentives.** Massachusetts provides localities – not developers – with incentives when they rezone for residential density and require affordable housing construction.[5]

For New York to create tax incentives before housing can legally be built in the first place would likely provide developers a windfall on top of the boon brought by regulatory changes. Instead, any market interventions should be designed to judiciously correct any market failure observed in the wake of regulatory changes.

4. The tax breaks would place the burden of providing affordable housing on local governments. Because the state is in a stronger fiscal position to bear the cost of financing affordable housing, alternative policies should be pursued – such as direct rental assistance, as it was used during the Covid pandemic, or state-level vouchers for rent burdened households.[6]

Proposed property tax benefits

The executive budget proposes authorizing four local property tax breaks and extending a fifth. These programs would reach across the state: three programs are restricted to New York City; one is for localities other than New York City; and a fifth would apply statewide. Collectively, the proposals would have the potential to create local property tax breaks totaling billions of dollars per year. While localities would be authorized, not required, to adopt these breaks, this approach could cause local tax competition. **This competition could create a race to the bottom, in which localities, under pressure to meet their statutory housing production targets, adopt otherwise unnecessary tax breaks.**

421-p

Localities other than New York City would be authorized to administer a property tax exemption for newly-constructed multifamily buildings that include income-restricted units.[7] The program, 421-p (the proposal would become section 421-p of the New York State Real Property Tax Law), would provide a 19-year property tax benefits for new buildings setting aside 20 percent of units as income-restricted.

AHCC

A second proposal would authorize New York City to enact affordable housing from commercial conversions (AHCC) tax incentive benefits. Under the AHCC, commercial buildings that convert to residential and include 20 percent income-restricted units would qualify for a 25-year property tax exemption.[8]

421-an Extension

The executive budget does not propose a replacement to the 421-a program, which expired in 2022. 421-a authorized New York City to provide property tax benefits for new residential buildings that included income-restricted units. While the governor has expressed an intention to negotiate a replacement with the state legislature, the executive budget stops short of proposing a wholesale replacement. Rather, the budget proposes extending the deadline by which projects that began construction prior to the expiration of 421-a must complete construction by four years.[9] This would afford buildings that could qualify for 421-a benefits additional time to complete construction and still receive program benefits.

Despite not renewing 421-a itself, 421-p and AHCC would extend elements of the program both in the City and across the state. Figure 2 provides an overview of key provisions in each of these three property tax benefits.

Both 421-p and AHCC would be enacted alongside regulatory changes proposed in the executive budget with the same objectives. **Because these regulatory changes would authorize residential construction not permitted under current law, they would likely prompt new housing production regardless of available tax incentives.** 421-p incentives would be complemented by the executive budget's two major proposals to overhaul local land use across the state: the new homes targets and fast-track approval act and the transit-oriented development act of 2023.[10] If enacted, these proposals would permit substantially more housing in the New York metropolitan area. This housing would be able to be built as-of-right, without new tax benefits.

AHCC would be complemented by two additional proposed regulatory changes. The executive budget would expand New York City commercial buildings' ability to convert to residential uses. Any building occupied by commercial uses prior to 1991 would be allowed to make residential conversions as-of-right. Buildings would also be exempt from the city's floor area ratio (FAR) cap and joint living-work quarters regulations.[11] The budget would also allow the city to override the FAR cap itself, which limits the height of residential buildings in New York City.[12]

The executive budget does not include cost estimates for any of its local tax incentives proposals. To gauge the programs' potential costs to localities, FPI made estimates assuming localities meet the housing production goals proposed in the executive budget (the methodology for each estimate is described at the end of this brief). If regions of the state outside New York City meet their housing production targets and the rate of multifamily homebuilding outside the city increases modestly, 421-p's collective cost to localities could total $441 million annually after a decade. If New York City meets its goal of creating 20,000 units in commercial-to-residential conversions, AHCC could end up costing the city $110 million per year. Finally, a four-year extension of 421-a for buildings already under construction could cost the city $288 million per year.

Figure 2. Overview of 421-a and proposed 421-p and AHCC property tax benefits

	421-a	421-p	AHCC
Status	Expired in 2022; proposed four-year extension for existing projects under construction	Proposed by FY 2024 executive budget	Proposed by FY 2024 executive budget
Authorized localities	New York City	Localities other than New York City	New York City
Eligible buildings	New residential building with six or more units	New multifamily rental with 20 or more units	Primarily non-residential buildings that convert to primarily residential buildings with at least six units
Tax Exemption	35 year exemption: 100% exemption for 25 years; reduced to share of income-restricted units for remaining 10 years	Construction: up to 3 year full exemption Post-construction: 25 year exemption, phasing out 4 percent per year	Construction: up to 3 year full exemption Post-construction: 19-year 35% or 50% exemption for 15 years, followed by 4-year phase-out
Affordability requirements	Six options for rental buildings, requiring 25% or 30% income-restricted units. Two citywide options: ● 25% income restricted: 10% deeply affordable, 10% low income; 5% middle income ● 30% income restricted: 10% low income; 20% middle incomes Homeownership option for homes affordable at middle incomes	20% of units must be restricted to 80% AMI for first tenancy and 100% AMI after first vacancy for the duration of benefit period; right to renew at existing level of income-restriction	20% of newly created housing units must be income-restricted, including 5% deeply affordable (40% AMI). Weighted average for all income-restricted units must be no higher than 70% AMI
Geographic targeting	Larger rental buildings authorized in high-income parts of Manhattan, Brooklyn, Queens, with extended tax benefit and stabilization period. Additional option for rental buildings with higher income limits available outside core Manhattan	None	Core Manhattan (below 96th st) projects receive a 50% exemption. All other projects receive a 35% exemption

J-51 Renewal

The executive budget also includes a proposed renewal of the expired J-51 program. J-51 provides tax benefits for rehabilitation projects in New York City multifamily buildings. The program modifies the criteria for buildings eligible for the programs, lowers the total abatement value, and removes J-51's geographic targeting, among other changes (detailed in Figure X).[13] At its peak in 2020, J-51 cost the city $301 million.[14] The state expects the new program to carry the same cost to the city as the expired program.[15]

Figure 3. Comparison of expired J-51 program and proposed renewal

	Expired J-51	FY24 proposal
Eligible buildings	Longer benefit for: ● Buildings owned by limit-profit companies ● Homeownership buildings with average assessed values of no more than $40,000 per unit ● Projects receiving government assistance Shorter benefit for other buildings undertaking rehabilitation	● Rental: buildings with at least 50 percent regulated units, owned by limit-profit companies, or receive government assistance ● Homeownership: condo or coop buildings with average assessed values of no more than $45,000 per unit ● Regulated homeownership: buildings owned by mutual companies
Geographic targeting	Reduced abatement for projects north of Lower Manhattan and south of 110th street	No geographic component
Total tax abatement value	90 percent of construction costs	70 percent of construction costs
Annual maximum abatement	8 ⅓ percent of construction costs	8 ⅓ percent of construction costs, may not exceed annual taxes, or, for homeownership buildings, 50 percent of annual property taxes
Abatement benefit period	20 years	20 years
Exemption	34 year (30 year full abatement, 4-year phase-out) exemption of assessed value increase related to improvements; or 14 year (including 4-year phase-out) exemption for buildings not meeting affordability criteria or supported by government assistance.	Tax abatement only; no exemption
Rent regulation provisions	Rental units in participating buildings must remain regulated for duration of benefit period	Half of units in participating rental buildings must meet income restrictions set by City

Accessory Dwelling Units Abatement

Finally, the executive budget proposes a property tax abatement for newly-built accessory dwelling units (ADUs). ADUs are separate residential units attached or adjacent to existing housing, and can range from standalone units on a shared lot to converted basements or garages. The budget's proposed tax benefit would provide an exemption for buildings that create one or more ADUs. The proposal does not include any affordability requirements. Increased market value attributable to the new units would be exempt from property tax, up to $200,000 increased market value. Buildings would benefit from a 100 percent exemption on this value for five years, followed by a phase-out over the following five years.[16]

Like 421-p and AHCC, the ADU exemption would be accompanied by regulatory changes that would newly permit the creation of ADUs. The proposed new homes targets and fast-track approval act encourage localities to permit ADUs, by including ADU permitting as one of the law's preferred land use actions. Localities that do not meet the act's housing production targets could comply with the proposal by adopting two of its five preferred land use actions, avoiding the proposal's recourse mechanism, which allows building applications to override local land use restrictions.[17] Further, another proposed measure would authorize New York City to create a program to bring basement apartments into compliance as legal housing units.[18] These **proposed regulatory changes may render the proposed tax exemption unnecessary to the creation of new ADUs**.

The Regional Plan Association estimated the New York metropolitan area could create 307,500 ADUs if local land use permitted their construction. If the state reached this level of ADUs, the tax incentive's total cost to localities could total $1.7 billion per year.

A better approach to housing New York

Accelerating the production of housing in the New York metropolitan area is vital to the state's economic future. However, the success of this policy priority will largely depend on changes in local land use. Given the metropolitan area's high housing costs, regulatory changes that permit new housing will have a far greater effect than tax breaks. Rather than creating housing that would not be built but for these tax benefits, the proposals have the potential to provide developers and incumbent property owners with a windfall while straining the finances of local governments. Further, these tax incentives themselves have proven to be flawed tools for delivering affordable housing. Finally, the state as a whole stands to gain more from the economic and fiscal growth created by new housing than individual localities. A better approach would see the state directly fund effective housing security policy.

Methodology note

The executive budget did not include estimates of costs to localities for any of its proposed or amended local tax incentives. Further, the tax incentives would be accompanied by regulatory changes that would substantially affect existing patterns of local housing productions. For this reason, estimating potential program costs for local governments requires significant assumptions about housing production, program usage, and potential tax benefit for participants. For each proposal discussed in this brief, FPI developed assumptions based on available evidence to derive potential annual program costs.

- **421-p**

FPI based its estimate of the proposed 421-p program's potential cost to localities on a scenario in which localities meet the housing production targets established in the new homes targets and fast-track approval act for three three-year cycles. FPI estimated housing production pursuant to these targets at the county level, using 2020 housing unit counts from the U.S. Census Bureau.[19] Using data from another Census program, the building permits survey (BPS), FPI estimated the share of housing units built as part of multifamily buildings in New York State excluding New York City.[20] Because the executive budget land use proposals strongly encourage multifamily homebuilding, FPI assumed the current multifamily share of new out-of-city housing units would increase by one-quarter, from 43 percent to 54 percent. Using BPS data, FPI estimated the number of multifamily units that would be built (143,500), the number of buildings (4,137), and the average building value ($4.5 million). Next, FPI calculated an average property tax rate for new multifamily units, weighted by the amount of housing each county is expected to produce. Finally, FPI calculated the average tax liability and abatement value per building. Because FPI based its estimates on nine years of housing production, the average abatement level was set at 84 percent.

- **AHCC**

Ahead of the fiscal year 2024 executive budget, the City of New York released a plan to accelerate the commercial-to-residential conversions, and recommended policy changes at the state level, many of which are reflected in the executive budget. The city estimated its plan would produce 20,000 housing units.[21] To gauge the potential annual cost of these units, FPI estimated the average tax abatement cost per unit receiving the benefit. The city's Office of Management and Budget estimated that another tax benefit for commercial-to-residential conversions, 421-g, cost the city $130,000 per unit.[22] FPI adjusted this per unit cost to reflect annual, rather than lifetime, costs, and to reflect the proposed AHCC's less generous benefits relative to 421-g. To make this adjustment, FPI assumed that the 76 percent of conversion would occur in core Manhattan, a ratio in line with existing patterns.[23]

- **421-a extender**

The Real Estate Board of New York (REBNY) has estimated that 33,000 housing units risk missing out on 421-a benefits if the completion deadline for projects under construction is not extended.[24] Using the tax expenditure report, FPI estimated the average annual cost of 421-a benefits for units currently receiving program benefits.[25] The extender's recurring annual cost to New York City is the product of this average cost and the REBNY estimate of affected units.

- **J-51 renewal**

During the March 1, 2023 Joint Legislative Budget Hearing on housing, New York State Division of Housing and Community Renewal RuthAnne Visnauskas testified that the replacement to J-51 proposed in the fiscal year 2024 executive budget would be "revenue neutral" relative to the former program.[26] At its peak in 2020, J-51 cost the city $301.1 million.[27]

- **ADU abatement**

In its July 2020 report on ADU conversions, the Regional Plan Association (RPA) estimated that as many as 307,500 ADUs could be created out of the existing housing stock of Long Island, New York City, and the Hudson Valley.[28] This estimate may underestimate the state's full ADU potential, as RPA did not make estimates for Upstate New York. FPI estimated the potential cost to localities if this number of ADU conversions were made by calculating a statewide average property tax weighted by each county's total housing.[29] The weighted property tax removed school district tax levies imposed by Buffalo, Rochester, Syracuse, and Yonkers, as the proposed disallows these districts from providing ADU abatements. To measure the potential costs to localities, FPI calculated the potential annual cost of abatements for the RPA's ADU capacity estimated using this weighted property tax and the $200,000 proposed cap on added value subject to the abatement.

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