

UPGRADING PRIVATE PROPERTY AT PUBLIC EXPENSE

The Rising Cost of J-51

POLICY BRIEF

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The Community Service Society of New York (CSS) draws on a 168-year history of excellence in addressing the root causes of economic disparity through applied research, advocacy, litigation, and innovative service models that serve to strengthen and benefit all New Yorkers.

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Since 1955, New York State and New York City law have provided for tax benefits to certain property owners who rehabilitate buildings for residential use.

This tax break, known as “J-51” for its former location in the New York City Administrative Code, currently benefits more than a third of the dwelling units in the city in the type of building to which it is primarily targeted, those with ten or more units. It is one of the city’s most expensive housing programs, amounting to \$256.6 million in tax expenditures for 2011.

The policy justification for the J-51 program is that it encourages improvements in the city’s housing stock, but the very wide application of its benefits suggests that it is not well targeted to buildings that both need improvement and would not receive improvement without the program. The program’s high cost also raises the question whether better results could be achieved through a different policy design.

In addition, the program has grown very rapidly over the past ten years, and the pattern of tax expenditures has dramatically shifted as well. These changes don’t reflect any intentional change in policy, but instead demonstrate that the program is subject to a great deal of drift, as changes in the housing market bring about changes in J-51 expenditure that are unrelated to its policy purpose.

Design of the J-51 Program

The J-51 tax benefit consists of two parts. First, owners who make eligible improvements to existing buildings receive *exemptions*, which are reductions in the amount of assessed value subject to property tax. If improvements raised the assessed value of a building from \$10 million to \$11 million, the owner would continue to pay taxes based on the lower assessment for ten years, then phase in full taxes gradually over a four-year period. (In special circumstances, especially when buildings are receiving other forms of subsidy, exemptions can last 34 years. Also note that in New York City, the assessed value of a property is not simply the Department of Finance’s estimate of the property’s value, but the estimated value multiplied by an assessment ratio and then adjusted to smooth out changes in value. For apartment buildings, the assessment ratio is 45 percent.)

J-51 was developed and had its major revisions at times when real estate investment conditions in New York City were vastly different from those we see today. Times have changed, and the owners of rental housing in the city are in a far more advantaged position.

Second, eligible owners receive *abatements*, which are direct reductions in the amount of property tax owed. If the improvements cost \$1 million, the owner’s tax bill would in most cases be reduced by \$8,333 a year until the benefit totals \$900,000. The same improvement may result in both an exemption and an abatement, so an owner who makes an eligible improvement may get much of the cost of the improvement back in *reduced* taxes and then also delay paying *increased* taxes because of the increased value of the property. The eligibility rules are different for the two benefits, however, and some improvements don’t increase a building’s value and therefore don’t trigger exemptions.

Rental, coop, and condo buildings are all eligible for J-51, but the benefit primarily applies to apartment buildings, not private houses. Some of the major eligibility principles are as follows:

- The improvements normally must be Major Capital Improvements as defined by law.
- Buildings in Manhattan below Harlem can receive *exemptions* only if the building’s assessed value is very low after the improvements, if it contains 30 percent affordable units, or in other special circumstances. This applies to rentals, coops, and condos.
- Buildings in Upper Manhattan and in the Bronx, Brooklyn, Queens, and Staten Island can receive *exemptions* for any Major Capital Improvement. This applies to rentals, coops, and condos.
- Rental apartment buildings in any part of the city are eligible for *abatements* if their assessed value is below \$40,000 per apartment before the improvements. (Note that in New York City, assessed values are 45 percent of the city’s estimate of these buildings’ actual value, so the limit is higher than it appears.)
- Coops and condos in any part of the city are eligible for *abatements* when their assessed value is below \$40,000 per apartment before the improvements and other requirements are met.
- Coops and condos are *also* eligible for *abatements* for three years after they are converted from rentals. Note that this means abatements are more available for owner than rental buildings.
- More extensive improvements, called “moderate rehabilitations” receive extra benefits, including tax exemptions for 34 years, even in Manhattan below Harlem.
- Certain government-assisted buildings receive especially rich benefits, including the 34-year exemption period. This includes formerly city-owned buildings.
- There are also special eligibility rules for conversion of non-residential buildings, lofts, and single room occupancy hotels.

Note that the geographic limitation for exemptions and the value limitations for abatements tend to tilt the program toward more affordable buildings. The long exemption period for government-assisted buildings is another device that tends to direct benefits toward affordable buildings.

But in most cases, eligibility does not depend on actual affordability. This is sure to result in many high-end apartments receiving J-51 benefits of one kind or another. The absence of a value limit for coops and condos at the time of conversion is especially likely to make the benefit available to unaffordable apartments. Also note that the benefits are “as of right,” so they apply to every building that makes improvements, regardless of whether the improvement would have been made without the benefit.

The J-51 program also has several features that seek to direct benefits to tenants by linking benefits to rent regulation. Apartments in unregulated buildings become subject to rent stabilization when the buildings begin receiving J-51 benefits. They then remain regulated for the life of the benefit. After that, apartments remain regulated as long as the tenant in place remains, unless that tenant’s first lease included a notice of the expiration of rent protections. Another provision benefits tenants in apartments already subject to rent stabilization. Normally, these tenants would be subject to rent increases based on the expense of the improvements, but these increases are reduced by 50 percent of the value of the J-51 tax abatement, allowing landlord and tenant to share in the benefit. Unfortunately this provision is often not properly enforced, according to many tenant advocates.

Expense of the J-51 Program

In fiscal year 2011, New York City spent \$256.6 million in J-51 tax expenditures to support improvements to buildings with a total of 709,000 apartments. This is the second largest housing expenditure that the city makes from its own resources, after the 421a tax expenditure, which cost \$911.6 million in fiscal 2011. (421a is a tax benefit that applies to newly constructed housing.)

As Table 1 shows, the J-51 tax expenditure is larger than the amount the city is receiving for 2012 from the federal Department of Housing and Urban Development’s Community Development Block Grant, a major source of funding for the city’s housing activities. (The 2011 CDBG was somewhat larger.) Each year, J-51 also costs more than the entire annual expense budget for the city’s Department of Housing Preservation and Development, once the department’s distribution of federally-funded Section 8 vouchers is subtracted. J-51 costs more than twice the total 2012 budget for the HPD office responsible for enforcement of the housing maintenance code—and much of this money is derived from the CDBG.

The city’s New Housing Marketplace Plan is funded by a complex combination of sources, including federal ones. The most important component of the funding comes from HPD’s capital budget each year—\$127 million in city and \$63 million in federal money for 2012. (The city projects increases in both the city and federal amounts in subsequent

TABLE 1: SELECTED HOUSING EXPENDITURES IN NEW YORK CITY

City Funding		Federal Funding	
Program	Cost	Program	Cost
421a construction tax benefit	\$912 million	NYCHA Section 8 vouchers	\$1 billion
J-51 improvement tax benefit	\$257 million	NYCHA-operated housing	\$945 million
City share of HPD capital budget	\$127 million	Federal share of NYCHA capital budget	\$584 million
City share of NYCHA capital budget	\$93 million	HPD Section 8 vouchers	\$335 million
City share of HPD expense budget	\$66 million	CDBG share of HPD expense budget	\$131 million
		Federal share of HPD capital budget	\$63 million

years.) The Battery Park City Authority and the New York City Housing Development Corporation are also contributing smaller amounts to the plan.

The New York City Housing Authority’s annual operating budget general fund for 2011 is \$2 billion, but that it is almost entirely tenant rent and federal money. NYCHA has a capital budget of \$677 million for 2011, but only \$93 million is city money. In addition, the authority spends another \$1.1 billion on Section 8 vouchers each year, but that is entirely federally funded. (HPD’s voucher program costs another \$335 million in federal money.)

These comparisons demonstrate the outsize prominence of J-51 among the city’s housing activities, and they imply a high standard for the amount of social benefit such a large expenditure should provide.

Distribution of J-51 Benefits

Both owner-occupied and rental apartments are eligible for J-51 benefits in all parts of the city. Citywide, owner apartments receive 31 percent of the benefits and rentals 69 percent. Manhattan apartments receive 34 percent of the benefits, the Bronx receives 30 percent, and Brooklyn receives 27 percent. This pattern, which has been relatively stable for the past decade, is shown in more detail in Table 2. This geographic pattern appears to be influenced both by the eligibility rules described above and by property values. Exemptions are most valuable in Manhattan, where properties are assessed at the highest values.

TABLE 2: GEOGRAPHIC DISTRIBUTION OF J-51 TAX EXPENDITURES IN 2011

Borough	Expenditure	Estimated Coop and Condo Expenditure	Estimated Rental Expenditure
Manhattan	\$86,400,000	\$19,200,000	\$67,200,000
The Bronx	\$75,900,000	\$21,900,000	\$54,000,000
Brooklyn	\$68,100,000	\$27,800,000	\$40,300,000
Queens	\$24,300,000	\$10,700,000	\$13,600,000
Staten Island	\$1,900,000	-	\$1,900,000
Total	\$256,600,000	\$79,700,000	\$176,900,000

The J-51 program also affects Upper Manhattan and the portion of the borough below Harlem differently, as shown in Table 3. This can be seen in the number of apartments receiving benefits. Buildings in Manhattan below Harlem are often ineligible for exemptions based on geography and ineligible for abatements based on their assessed value—but coop and condo buildings can avoid the assessed value limit for three years after conversion. Thus it should not be surprising that far more coop and condo apartments than rentals receive the benefit in that part of the city.

History of the J-51 Program

The present form of the J-51 program results from a complicated history of enactment and amendments, with significant changes not just in the details of implementation, but in the program’s core purpose.

The city of New York created the program at the end of 1955, using powers granted by a state law enacted in 1946. As Mayor Robert Wagner signed the legislation, he said that the program’s purpose was “to encourage improvement of substandard dwellings and in that way aid in providing decent living quarters for those who are unfortunate enough to be obliged to live in substandard tenement houses built many years ago and lacking the ordinary decencies and comforts of modern dwellings.” During the program’s early years, the range of improvements eligible for tax benefits was gradually expanded, but eligibility restrictions based on buildings’ value tended to concentrate benefits on small buildings such as the coldwater tenements for which it was intended. By March of 1973, it had facilitated the improvement of 250,000 rent-controlled apartments.

TABLE 3: DISTRIBUTION OF APARTMENTS WITH J-51 BENEFITS IN MANHATTAN

Region	Rental Apartments	Coop or Condo Apartments	Total Apartments
Manhattan below Harlem	39,913	72,518	112,431
Upper Manhattan	45,153	13,084	58,237
Borough Total	85,066	85,602	170,668

During the 1970s, the J-51 program was reconfigured as a response to declining investment in New York City. When the law was renewed in 1975, it was amended to extend the number and kind of buildings to which the benefit could be applied, with an emphasis on encouraging the conversion of commercial buildings and lofts to residential use. This promptly led to an increase in the amount that owners of commercial buildings could get when selling their properties. Enhanced benefits for moderate rehabilitations were added with the next renewal of the law in 1979. After 1975, the number of apartments rehabilitated under the program dropped from about 75,000 per year to 41,000 in 1979, then rose again to 83,000 in 1983. The average size of the buildings benefitting from the program also increased.

During the same period, the city’s housing department also began encouraging landlords to use J-51 as part of its anti-abandonment efforts, and renewals of the law added special provisions for buildings receiving government subsidies. But concerns also arose that the program was unnecessarily subsidizing luxury housing and contributing to displacement, and the renewal of the program became a highly contentious issue. In 1983, the law was renewed with an amendment limiting J-51 tax exemptions to buildings assessed at \$38,000 per apartment after improvements. In 1987, that restriction was rolled back, so that it only covered Manhattan below 110th Street. Subsequent changes to the law have been relatively minor, but changes in the city’s housing market have led to significant changes in the program’s cost and impact.

Recent Evolution of the J-51 Program

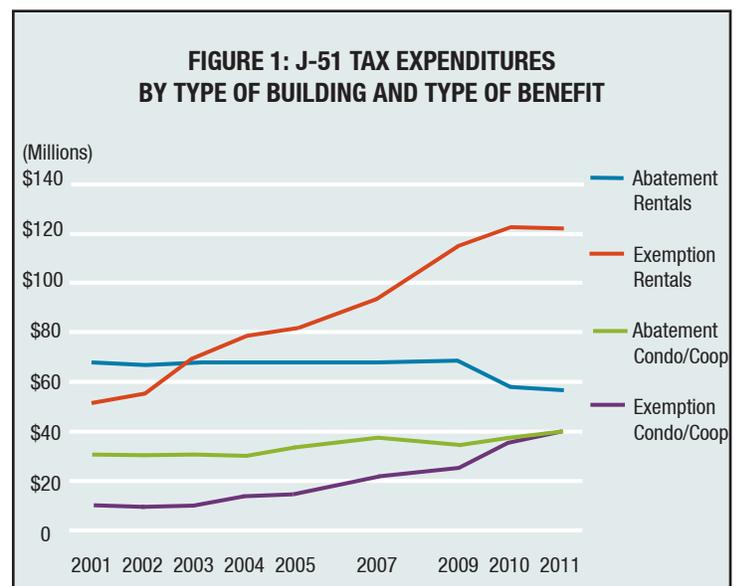
In 2011, the J-51 program cost the city of New York \$161.1 million for exemptions and \$95.6 million for abatements—but both the total expenditure and the proportions of exemptions versus abatements in the expenditure have changed dramatically since 2001. These changes appear not to be driven primarily by policy, but by the great changes in the housing market over the period.

The increase in total expenditures from 2001 to 2011 was 49 percent in unadjusted dollars, or 18 percent after inflation. Figure 1 shows these changes in non-inflation-adjusted dollars. During the same period, the share of the benefit

for abatements shrank and the share for exemptions rose dramatically. In 2001, J-51 expenditures consisted of 62 percent for abatements and 38 percent for exemptions. In 2011, they were just the opposite: 62 percent for exemptions and 38 percent for abatements.

The program’s abatement component shrank by 4 percent even before inflation, or 24 percent after. This was based on a decline in the amount of abatement per unit, coupled with a modest 7 percent rise in the number of units. Part of this change might be explained by the fact that improvement expenses eligible for abatement benefits are limited by a set schedule of reasonable costs, and this schedule has not been changed in many years, but there also seems to have been a shift toward less extensive improvements.

The exemption component, on the other hand, grew very rapidly—164 percent before inflation, 109 percent after. This was based on a modest 10 percent increase in the number of units coupled with a 139 percent increase in the cost of the exemption per unit (89 percent after inflation). These per-unit costs rose throughout the city, but part of the citywide increase can also be attributed to a shift of exemptions away from the Bronx, where per-unit exemption costs are lowest, and toward Brooklyn, Queens, and especially Manhattan, where costs are highest. Since apartments in Manhattan below Harlem are generally not eligible for exemptions, this probably reflects the decade’s surge in



investment in gentrifying Upper Manhattan. This geographic pattern is also very likely coupled with a shift of exemptions away from government-assisted buildings. Figure 2 shows the evolution of the borough's shares of the exempt apartments over time.

Conclusion and Recommendations

The J-51 tax expenditure program is an extraordinarily expensive program. The enormous growth in its cost over the past decade is not resulting in improvements to many more apartments. There has been an increase of only 7.4 percent in the sum of exempt and abated apartments from 2001 to 2011, and the declining value of abatements suggests that each apartment may be receiving a smaller amount of improvement. Expenses have ballooned by more than 100 percent, after inflation, over ten years for a roughly constant amount of benefit.

The program's affordability targeting is also only indirect, which undoubtedly results in a large share of its benefits going to unaffordable apartments. Its affordability targeting is also out of date, ignoring the trend toward high-end development in Upper Manhattan and many other areas of the city. The apparent shift in benefits toward exemptions in Upper Manhattan, which are not subject to an assessed value limit, probably involves benefits for apartments with very high rents and may even be subsidizing displacement. The large share of benefits going to coop and condo apart-

ments also casts doubt on the program's affordability targeting, although some of those apartments are in government-assisted affordable coops.

It cannot be doubted that some of the benefits of the J-51 program are going to respond to real needs for improved housing. Most of the government-assisted affordable buildings that have ever received exemptions are probably still receiving them, accounting for a substantial share of the exempt buildings. But the program was developed and had its major revisions at times when real estate investment conditions in New York City were vastly different from those we see today. Times have changed, and the owners of rental housing in the city are in a far more advantaged position than they were in the 1950s, 1970s, or even the 1980s. Over the 56 years of the program's existence, efforts to retarget it appear to have had only modest success in shifting the direction of benefits toward the greatest need. The result is the squandering of public funds at a time of great fiscal stress.

The J-51 program should be either drastically altered or eliminated entirely and replaced with a far more targeted incentive for improvements that benefit low-income tenants and that would not be undertaken without the incentive. If the program is continued, the following changes would significantly improve it:

- Eliminate all benefits for coops and condos except those being developed with government assistance.
- Improve the coordination of the J-51 benefit with the rent increases allowed in rent-stabilized buildings for major capital improvements by requiring landlords to seek a J-51 exemption before applying for these rent increases and document the outcome to the state agency that administers rent stabilization; and by reducing the rent increases by 100 percent of the value of the tax benefit instead of only 50 percent.
- Eliminate the exemption benefit, which is now exploding in cost, except for those buildings being developed with government assistance. This could be combined with an increase in the caps on abatement levels, which would tend to raise the benefit for lower-rent developments while lowering it for high-end ones.

