

What NYC's New Tax Abatement Program Means For Attorneys

By **Matthew Perlman**

Law360, New York (May 5, 2017, 1:19 PM EDT) -- The replacement for New York City's 421-A property tax exemption program, now called Affordable New York, was codified with the state budget passed last month, and developers and their attorneys are working to figure out what will be required to qualify under the new program and how the process will work.

The 421-A program was enacted in the 1970s to spur residential development in New York City by holding real estate taxes steady for certain periods during and after construction, providing relief from the heavier tax burden that would otherwise be felt due to a property's increased valuation. The program was later amended to require the inclusion of affordable housing in projects in certain geographic areas.

In 2015, changes were proposed for the program that included increased affordability requirements, as well as wage requirements for construction workers, but talks reached an impasse and the program expired early last year. Democratic New York Gov. Andrew Cuomo then left it up to a real estate industry group and a union coalition to hammer out a solution over the wages, which they finally did in November. The proposed changes and the terms of that agreement were adopted into law with the 2018 state budget that passed in April.

Enhancement Areas

Under Affordable New York, developers building larger projects in three enhancement zones will have to conform with construction wage requirements in addition to setting aside a percentage of the units for lower income families.

After a rush to get projects started ahead of 421-A's demise, attorneys told Law360 that they saw a period of reduced activity without the abatement in place because developers viewed it as an important component in financing residential developments. Now that the replacement has been finalized, they're starting to work out how to make use of the incentive while navigating the new requirements.

"Deals are suddenly starting to circulate," said Daniel M. Bernstein, of counsel with Rosenberg & Estis PC. "I have clients calling me with sites they're looking at and we're talking about the underwriting for new deals."

The new program applies to residential projects commenced between Jan. 1, 2016, and June 15, 2022, but projects that were started earlier can also qualify if they haven't received other benefits. Bernstein said he's fielding calls about some of those projects too.

“It has a pretty broad reach forward and backward, so developers of existing projects that aren't quite complete are also looking at this law and saying maybe I should opt into it,” he said.

Erica Buckley, special counsel with Stroock & Stroock & Lavan LLP and former chief of the Real Estate Finance Bureau for the New York State Attorney General's Office, said the new version of the abatement required a balancing of various competing issues. All rental projects qualifying for the incentive will now have to include between 25 percent and 30 percent affordable units, but developers have several options to choose from that mix different levels and percentages of affordability. The incentive lasts for three years during construction and 35 years following, with developers receiving a full abatement on the tax increases for the first 25 years after completion, and an exemption tied to the number of affordable units on the last 10 years.

If a project contains more than 300 units and is located within an enhancement area that includes certain parts of Manhattan, Brooklyn and Queens, developers will also have to meet wage requirements for construction. But the abatements on those buildings will be a full 100 percent for the entire length. Developers of larger projects in other parts of the city can also choose to opt-in to the enhanced program.

“It's like a mediation,” Buckley said. “Nobody's in love with it, but nobody's terribly miserable.”

Affordable New York also includes an option for condominium projects, a contentious issue for 421-A, which was criticized for its use on luxury for-sale developments. But the new program includes restrictions on qualifying condo projects, limiting them to 35 units, excluding projects in Manhattan and capping the assessed value of completed units at \$65,000 each for the abatement.

James P. Power, a partner with Kramer Levin Naftalis & Frankel LLP, said this per-unit threshold has people questioning the program's suitability for condo projects, and asking how developers can even know if they'll qualify for the exemption before the project is built.

“There's been some discussion about how it's questionable whether any project could qualify under the homeownership scheme, because there's also this threshold,” Power said. “There are questions about how that would be applied, and how a project would qualify for such a low assessment, particularly prospectively.”

Though, Buckley noted, it appears that projects that include a condo component within a larger development may also qualify.

Aside from changes to the benefits and requirements of the program, the new version will also mean changes to the process attorneys help guide their clients through to qualify for the incentive.

The biggest change is that under the old program, there was a two-step application process that included a preliminary qualification during construction and final approval after completion, while the new version requires only one application that's submitted post construction. Experts told Law360 this presents an issue because developers have in the past relied on the preliminary certificates of eligibility to show lenders and investors that the projects will receive the abatement once complete.

“It made sure that before you commenced construction, you pretty much knew you were going to get your benefits,” Buckley said. “The way it's structured now, you don't get that same level of certainty.”

The single application will make it easier for the city's Housing and Preservation Department to process applications. It may also help address enforcement issues that were experienced with 421-A. In November, city officials issued letters to dozens of building owners receiving the tax benefit, saying that their incentives would be retroactively revoked if they didn't comply with the requirements of the program.

But the new process may also cause developers to lean on their attorneys to issue legal opinions regarding a project's qualification for the abatement. They did this in the past for 421-A, Power said, but now those letters may carry an increased importance.

"With the change, in some ways it will make developers more reliant on their experts, their counsel," Power said. "Those types of letters will become more important, given the new structure and the new application process."

Buckley also acknowledged that attorneys sometimes issued these opinion letters under the old program, but said it's different when talking about a brand-new program that hasn't been tested yet. The old program also saw the tax benefit kick in during construction once the preliminary certificate was issued, while the new version will apply retroactively to the construction period after the project is complete.

"Attorney opinion letters don't come easily, and they're not inexpensive," Buckley said. "It's a huge undertaking to get an attorney to do something like that. For a program like this, it would be ideal if we could come up with something short of that."

Nick Kamillatos, a member of Rosenberg & Estis, said the new process will be taxing for developers too.

"You're going to invest a lot of money in acquiring property, constructing a building, making underwriting decisions, and then you make your application to get your statutory award of an exemption," Kamillatos said. "I don't think it's a problem, but it's an issue."

Kamillatos said they'll have to see how lenders react to the new process. He said they may want to perform more due diligence in order to better understand the risk being taken on, meaning they'll have to fully grasp the tax abatement requirements themselves. Or, he said, they could draw up two systems of underwriting, one with the benefits and one without.

"I'm not sure how it will play out, I'm not a lender, I'm a lawyer, but we will have to watch that," he said.

Buckley said she hopes HPD comes up with some kind of assurance for projects short of the old two-step application process, not a firm opinion but an advisory notice that might help assuage wary lenders.

"There's a difference between a preliminary certificate and giving benefits, versus giving some type of initial advisory ruling that it appears as though a project is eligible," Buckley said.

Bernstein said he's been working informally with HPD to help vet some of his clients' existing projects to see if they'll qualify for the program, even though the agency won't issue a formal opinion. Part of the problem, he said, is that HPD has yet to promulgate the rules that will put the program into effect.

Power said these rules are important, because they'll dictate how a political policy is actually put into place.

“As with any complicated regulatory scheme, there's a lot of gray area in the statute as adopted, and so there are a lot of questions about how it will be interpreted and implemented at the end of the day,” he said.

Details the rules will help clarify include requirements surrounding the placement of affordable units within a building, which were put in place in 2015 but need to be formalized for the new law, as well as some subtle changes in how the benefits will be calculated, Bernstein said.

They will also provide some clarity as to how the tax abatement program will work in conjunction with the city's Mandatory Inclusionary Housing program, which was enacted last year and requires developers to include affordable housing in projects that require zoning modifications or are located in certain areas. MIH was implemented after 421-A expired, and has been unsuccessful so far in part because it was designed with the abatement in mind, Kamillatos said.

The projects proposed under MIH have met resistance from local City Council members because developers had to make the buildings larger in order to be economical. But when coupled with the new tax abatement, they'll have a better opportunity to come up with a plan that works for everyone.

“Hopefully they're treated as amplifying each other so that Mandatory Inclusionary Housing becomes more viable from the developer's point of view, with the tax exemption, while providing the same level of affordability,” Kamillatos said

A spokesperson for HPD, Juliet Pierre-Antoine, confirmed that the agency does not currently plan to provide preliminary eligibility assurance for the Affordable New York program. She said they're currently working on drafting the new rules and that a “timeline should be available in the coming months.”

--Additional reporting by Braden Campbell.