

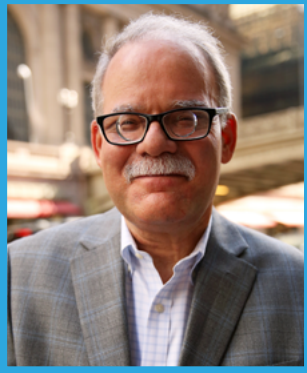
DE BLASIO'S MANDATORY INCLUSIONARY HOUSING PROGRAM: What Is Wrong, and How It Can Be Made Right

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Executive Summary

Inclusionary zoning provides an incentive, or a mandate, to real-estate developers to include lower-rent units in new housing. One signature proposal of New York City mayor Bill de Blasio has been a mandatory inclusionary housing program, known as MIH, enacted in 2016. MIH applies when an area is rezoned to permit more housing, or when a City Planning Commission special permit allows housing to be built. This report looks at how the program has fared.

MIH was explained to the public as a way to increase the total amount of permanently affordable housing. The cost of this housing, whose rentals are, by definition, below the market rate,¹ was supposed to be met by capturing some of the added economic value that rezoning creates for private developers and directing it toward the city's housing goals. In practice, this has rarely occurred. Only 2,065 MIH affordable dwelling units have been approved, in a city of 8.4 million residents.² Most of them receive heavy public subsidies.

The MIH program succeeded an earlier program—voluntary inclusionary housing (VIH)—that de Blasio's predecessor, Michael Bloomberg, greatly expanded. The VIH program has continued to operate where it applied at the end of Bloomberg's administration, and 8,476 permanently affordable VIH units have been approved during de Blasio's tenure.³ Unlike MIH units, many VIH units are located in the city's strongest housing-market areas, and, while they qualify for tax exemptions under state law, they do not receive additional public subsidies.

The failure of MIH to appreciably increase the stock of affordable housing is the result of the program's conditions and restrictions, which have limited its utility, without public subsidies, to relatively large new rental apartment buildings in the city's strongest housing markets. Yet the current city administration has focused rezoning in areas where all new housing requires public funding. This is partly attributable to well-funded and well-organized opposition to rezoning in more affluent areas, as well as the mayor's deference to city council members who oppose rezoning in their districts.

Ultimately, however, MIH reflects a fundamental failure to recognize that inclusionary zoning is always voluntary. No development occurs without the expectation of a threshold rate of return on investment. Developers need a large increase in density to justify applying for a zoning change, since 25% or 30% of any new development will be affordable housing and generate little profit. If property owners do not perceive that they are likely to succeed, they will keep the zoning that they have and decline to participate in the MIH program.

The city's current zoning rules do not allow enough housing to be built to alleviate its housing shortage, and the current design of the MIH program precludes the widespread rezoning necessary to mitigate this shortage.

To alleviate this shortage—to maximize affordable housing and market-rate housing—this report recommends that the city:

- ✓ Rezone the residual manufacturing zones in Manhattan, where housing markets are very strong but no new housing is permitted. These zones include Soho, Noho, and parts of Midtown South. Because these areas are small and largely covered by historic districts, the impact of such rezonings will be modest.

- ✓ Rezone larger manufacturing-zoned areas in strong housing-market areas in Brooklyn and Queens. These include parts of Gowanus, East Williamsburg, and Long Island City that no longer have an industrial character.

- ✓ Take advantage of the potential of the “middle market,” in central and southern Brooklyn, where spare capacity on certain parts of the legacy subway system provides substantial room to rezone for housing growth.

To make these rezonings effective for affordable housing, New York City needs to change MIH so that it will work for all types of housing, including conversions, small buildings, condominium buildings, and buildings that provide affordable housing off-site. Additionally, New York State should give the city authority to tailor tax-exemption programs to be consistent with affordable housing goals.

DE BLASIO'S MANDATORY INCLUSIONARY HOUSING PROGRAM: What Is Wrong, and How It Can Be Made Right

Introduction

Mandatory inclusionary housing (MIH), a signature proposal of Bill de Blasio's 2013 mayoral campaign, has largely failed to achieve its stated objective: requiring real-estate developers to provide a portion of all new housing in rezoned areas as permanently affordable to a diverse range of incomes. While 2,065 MIH units have been permitted or completed since the program's enactment in March 2016, most are deeply subsidized and concentrated in low-income areas.⁴ Only in rare cases has the program successfully led to permanently affordable housing backed by credible private financial commitments, supplementing public resources.

Meanwhile, the Bloomberg administration's voluntary inclusionary housing (VIH) program, which continued to operate during de Blasio's tenure, has resulted in permits for, or completion of, 8,476 permanently affordable housing units.⁵ These units are located in a more diverse range of neighborhoods and with more examples of developments that received the property-tax exemptions permitted by state law but otherwise with no public subsidies.

This paper reviews the history of inclusionary zoning in New York City and looks at the experience of the de Blasio administration's MIH program. It recommends changes to make MIH more widely applicable without deep public subsidies, as well as changes to zoning that would help alleviate the shortage of affordable and market-rate housing in New York City.

Inclusionary Zoning in Gotham: A Brief History

New York City has long used zoning as a tool to increase the supply of affordable housing (see sidebar **Building Housing in NYC: A Short Course**). The city's experience with inclusionary housing began in the 1970s, with the introduction of "floor area bonus" programs, in which developers in several neighborhoods were permitted to build more dwelling units that could be sold or rented at market rates in exchange for providing below-market rentals. These programs failed to produce any of the desired affordable housing, a result of unworkable requirements and unfavorable market conditions.

As the city's economy improved in the 1980s, several Manhattan community boards and elected officials became critics of some zoning provisions in R10 districts (which allow for the highest housing densities in the city). One provision allowed a floor area bonus for a privately owned public space, or "plaza"; another allowed for the bonus in exchange for a monetary contribution to a community improvement.

In response, in 1987 the City Planning Commission created a VIH program for R10 districts (which are mainly in Manhattan) that, with subsequent amendments, limited the floor area bonus to the provision of affordable

Building Housing in NYC: A Short Course

The New York City Zoning Resolution^a specifies where housing can be built in New York City, as well as characteristics such as unit densities (the number of dwelling units permitted in a building of a given size), height, and massing (the building's shape in three dimensions). The key measure of how large a building can be is the Floor Area Ratio (FAR), or the permissible square footage in the building. FAR is expressed as a multiple of the lot area, and it varies by the zoning district. For example, if a lot is 5,000 square feet (50 feet wide and 100 feet deep) and the district FAR is 3, the building can be a maximum of 15,000 square feet.

In New York City, small detached homes have a FAR of less than 1, while the city's largest apartment buildings in Manhattan, downtown Brooklyn, and Long Island City may have a FAR as high as 12. A "floor area bonus" is an increase in FAR, permitted in exchange for the provision of a benefit that ameliorates the effects of the additional density. Under former mayor Bloomberg's voluntary inclusionary housing (VIH) program, the density-ameliorating benefit is affordable housing.

The city's zoning is complicated and has many special rules. However, generally speaking, different residential zoning districts and their commercial district counterparts represent a FAR hierarchy. (There are 10 basic residence districts, R1–R10; R10 districts allow for the highest density.) The highest-density districts (with maximum residential floor area ratios between 7.5 and 12) are mostly closer to the city's core business districts.

Middle-density districts (with floor area ratios between 2 and 7.5) are generally mapped close to transit, radiating from the core, while low-density districts (with floor area ratios below 2) are mapped farther from transit. Manufacturing districts and certain commercial districts do not allow housing at all.

New York City's property-tax system divides properties into four tax classes that pay sharply different "effective tax rates"—based on typical taxes paid as a percentage of the building's market value. "Larger rental buildings ... along with utilities (Class 3), and commercial/industrial properties (Class 4), are taxed at far higher effective rates and therefore bear a disproportionate share of the overall tax burden."^b

To compensate for this higher tax burden and to ensure that unduly high taxes do not deter new housing construction, state law provides property-tax exemptions for new buildings under specific conditions. The exemption program in effect today is known as "Section 421-a" or the "Affordable New York Housing Program."^c

For most rental buildings, tax benefits (exemptions) last 35 years and require that affordable housing be provided in that period under one of three options. For large projects in specified areas, tax benefits are enhanced, but developers must pay specified wage levels to construction workers.

THE BASIC TAX BENEFIT OPTIONS ARE:

Option A

- 25% of the units must be affordable.
- At least 10% at up to 40% of the area median income (AMI)^d
- 10% may be at up to 60% of AMI
- Remainder at up to 130% of AMI

The developer may not receive public subsidies other than tax-exempt bond proceeds and 4% tax credits.

Option B

- 30% of the units must be affordable.
- At least 10% at up to 70% of AMI
- Remainder at up to 130% of AMI

Option C

- 30% of the units must be affordable at up to 130% of AMI.
- The developer may not receive any public subsidies.

The project cannot be located south of 96th Street in Manhattan or in any other area established by local law.

^a New York City, Department of City Planning, "Zoning Resolution," Nov. 14, 2019.

^b New York University, Furman Center for Real Estate & Urban Policy, "Distribution of the Burden of New York City's Property Tax."

^c New York Consolidated Laws, Real Property Tax Law—RPT § 421-a, Affordable New York Housing Program.

^d "AMI" is established by the U.S. Department of Housing and Urban Development. The 2019 AMI in the New York City Region for a family of three is \$96,100.

housing. The program was designed to exclude public funding: the value of the bonus had to support the cost of affordable housing. The limited geographic area and the absence of public subsidy resulted in a small stream of permanently affordable units that, unusually for the city's affordable housing, were located in New York's most affluent areas.

With an improving economy, new market-rate housing construction spread to other boroughs. In 2003, the City Planning Commission approved the rezoning of Park Slope in Brooklyn.⁶ The rezoning allowed increased densities along Fourth Avenue (a wide corridor with a subway and many potential development sites). During the rezoning process, the commission noted that elected officials (including Bill de Blasio, then a local city council member whose district included Park Slope) and a community group urged a floor area bonus program to be attached to the rezoning in exchange for affordable housing. However, the council—eager to pass the measure to ensure that protections for brownstone homes were provided in the rezoning—ultimately approved it without the bonus.

Spurred by this controversy, the Department of City Planning (DCP) and the Department of Housing Preservation and Development (HPD) accelerated their efforts to expand New York's inclusionary housing program. As adopted by the city council in 2005, 20% of residential floor area would now be reserved for permanent affordable housing in exchange for a 33% floor area bonus.⁷ The program applied to additional medium- and high-density zoning districts (districts characterized by apartment buildings), not only to the highest-density R10 districts.

In 2009, the City Planning Commission and the city council approved mainly technical amendments to make VIH more unified and coherent.⁸ This resulted in VIH in its current form. In 2013, toward the end of Bloomberg's administration, DCP reported on the progress of the expanded (post-2005) VIH program.⁹ Through July 2013, 2,888 affordable housing units had been constructed or approved—19% of the total number of units constructed, or permitted, in these neighborhoods. “This figure is very close to the 20 percent rate that is targeted by the program,” noted DCP, “and indicates that at a citywide level, the program has been successful in promoting affordable housing in conjunction with new development.”¹⁰

Whether this result—2,888 affordable units over eight years—was a success in ameliorating the city's affordable housing shortage emerged as a contentious issue in the 2013 mayoral campaign. Park Slope council member Brad Lander and the Association for Neigh-

borhood and Housing Development criticized VIH's output as unacceptably low and demanded a mandatory inclusionary program.¹¹ Bloomberg's rezoning of large areas to increase housing production, critics asserted, had created a windfall for real-estate developers, with only an inadequate zoning floor area bonus provision to promote the construction or preservation of affordable housing. Mandatory inclusionary zoning, they claimed, would ensure that much of the gains in real-estate value from future rezonings would be “captured” for a public purpose—alleviating the city's severe shortage of low-cost housing. The winning mayoral candidate, Bill de Blasio, pledged that enacting a mandatory inclusionary housing program would be a high priority of his administration.¹²

To enact a mandatory program, the city needed to provide an acceptable rationale in the context of its legal authority to enact zoning. In 2015, DCP announced a planning objective: “economic diversity.”¹³ To achieve this, the city would adopt a citywide zoning amendment to remove impediments to new housing construction and a program of neighborhood rezonings to increase densities. The city would also increase financial support for affordable housing. And there would be a mandatory inclusionary zoning policy.

In the same year, the (city-affiliated) New York City Housing Development Corporation (HDC) released a report that aimed to “evaluate what effects the application of an MIH program, if implemented in conjunction with land use actions to promote increased housing, would have on the financial feasibility of new residential development projects under a range of currently representative market conditions.”¹⁴ The report categorized the city's neighborhoods based on housing-market conditions (**Figure 1**): “very strong” (the most affluent areas of Manhattan); “strong” (parts of upper Manhattan and the Lower East Side, downtown and brownstone Brooklyn, Williamsburg, and Long Island City); “middle market” (broad areas of Brooklyn and Queens, as well as the Riverdale section of the Bronx); “moderate” and “weak” (lower-income areas, where most new housing receives some public subsidy).¹⁵

Long-term property-tax exemptions and revenues from permitting additional housing units, HDC noted, would make MIH developments feasible for developers only in very strong and strong neighborhoods. In moderate and weak neighborhoods, public subsidies would be needed to spur MIH developments.

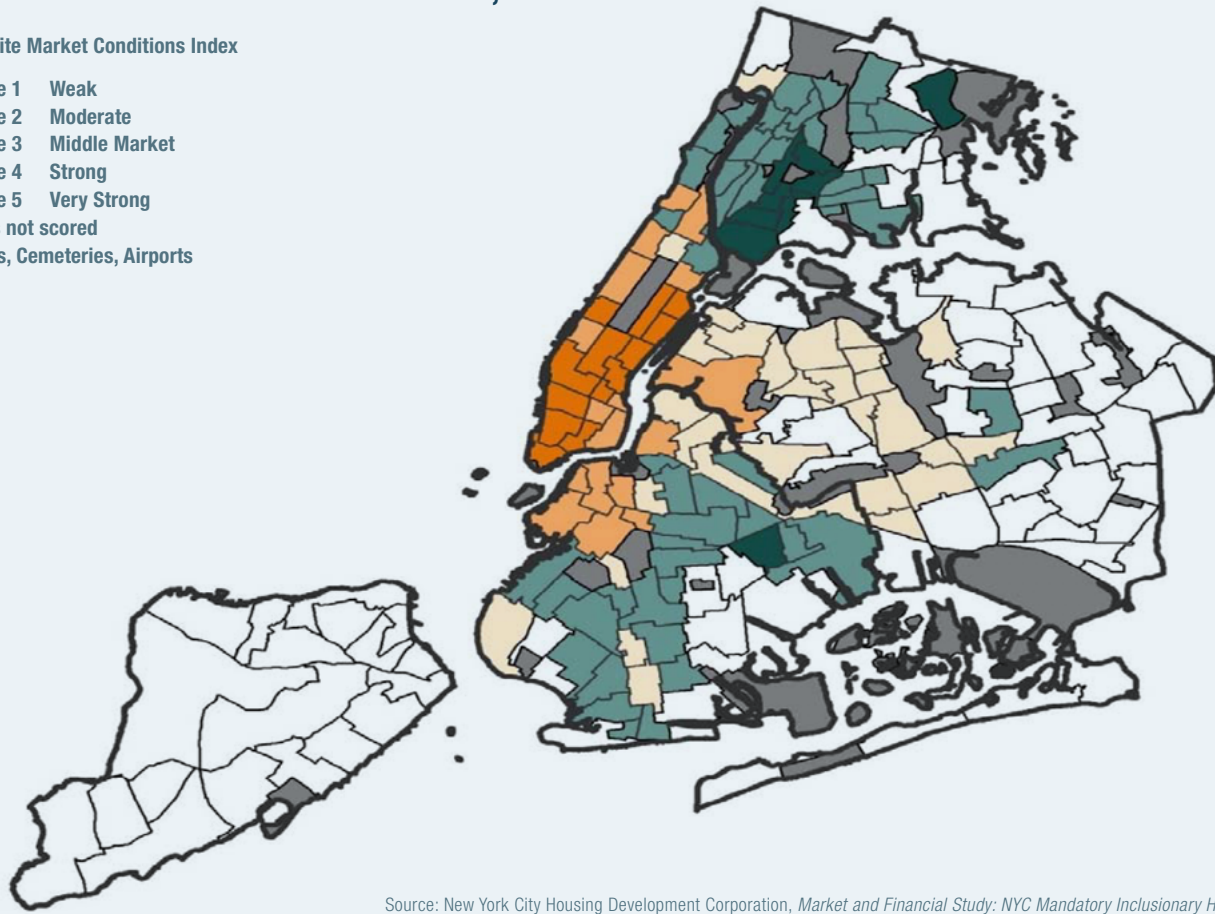
Not surprisingly, the report noted that returns to hypothetical MIH developments would fluctuate with location, with the fraction of units set aside, and with

FIGURE 1.

Neighborhood Market Conditions Index, 2015

Composite Market Conditions Index

- Score 1 Weak
- Score 2 Moderate
- Score 3 Middle Market
- Score 4 Strong
- Score 5 Very Strong
- NTAs not scored
- Parks, Cemeteries, Airports



Source: New York City Housing Development Corporation, *Market and Financial Study: NYC Mandatory Inclusionary Housing*, p.18.

an area's median income.¹⁶ In middle-market neighborhoods, zoning changes and tax exemptions would work only with affordable set-asides for households at higher AMIs.

The findings in HDC's 2015 report highlight an important fact: in the New York City context, MIH programs (indeed, all inclusionary housing programs) are very sensitive to real-estate tax policy. Taxes on rental housing are extremely high in the city.¹⁷ For decades, state legislation has permitted the city to offer exemptions on the added real-estate taxes resulting from new housing development. This was originally viewed as an incentive to build multifamily housing, but as the city's economy improved, it evolved into an incentive to build affordable housing. In 2015, as the city was developing its MIH program, the state legislature was working on a new version of its real-estate tax-exemption program ("Section 421-a"). The city had a vital interest in ensuring that MIH requirements and eligibility for tax benefits were coordinated because the former would not be achieved without the latter.

In September 2015, DCP released its MIH proposal for public review. Explanatory materials emphasized that the "proposed requirements would be the most rigorous of any major U.S. city."¹⁸

MIH would apply to all developments in rezoned areas of more than 10 housing units.¹⁹ Developments of 11–25 units could make a cash "payment in lieu" of providing affordable housing. Those of more than 25 units had three options. Option 1: provide 25% of units as permanently affordable at 60% of AMI; Option 2: provide 30% of units as permanently affordable at 80% of AMI. Option 1 was designed to be compatible with the requirements for utilizing federally tax-exempt bonds and tax credits for low-income housing. Option 2 was designed to be used with a property-tax exemption and permitted, but did not assume, additional subsidies.

There was also a third option, called the Workforce Option, available except in Manhattan Community Districts 1–8 ("very strong" neighborhoods): 30% of units had to be affordable at 120% of AMI; and no subsidies

could be used (except for as-of-right property-tax exemptions). It was called the Workforce Option because it was targeted to middle-income working households.

For all options, affordable units had to be newly constructed (these could be on-site, within the same community district, or within a half-mile of the development). A Board of Standards and Appeals special permit was available to reduce or waive these requirements when they proved economically infeasible.

To informed observers, it was clear from the outset that Options 1 and 2 would be economically feasible only in very strong and strong neighborhoods and only where tax exemptions were available. In other neighborhoods, Options 1 and 2 would work only with additional public subsidies, such as tax-exempt bond financing, low-income tax credits, or low-cost publicly owned land. In such cases, the public sector's financial commitments would be driving affordability, not MIH's zoning provisions.

There was another issue: Options 1 and 2 threatened to jeopardize the city's middle-market housing—apartments that were constructed at rents (or sales prices) that could yield a profit to the developer but could not provide an internal cross-subsidy to offset lower rents for affordable units. Option 3 (the Workforce Option) was designed to preserve the middle market by specifying that income levels in affordable units would be close to those in market-rate units.

MIH was thus designed on the edge of financial feasibility. Nonetheless, in March 2016, the city council further expanded MIH's affordability requirements, after critics asserted that they were too lenient for developers.²⁰ To Option 1, the council added a requirement for a minimum of 10% of housing to be affordable at 40% of AMI. The Workforce Option was also modified, to reduce the average income requirement from 120% of AMI to 115% of AMI; to require 5% of housing at 70% of AMI and at 90% of AMI; and to sunset 10 years after adoption in any MIH neighborhood. A new “deep affordability option” was adopted, too, requiring 20% of housing to be affordable at an average of 40% of AMI, with subsidies allowed only to support more affordable housing. The council required an additional 5% of affordable housing when affordable units were provided off-site.

These changes to MIH created additional roadblocks to the provision of affordable housing. Option 1 would even more surely be used mainly in combination with large public subsidies, as would the deep affordability option. The changes to the Workforce Option essentially negated its utility. Low, regulated rents in lower-in-

come affordable units require cross-subsidies from the higher rents collected from market-rate units. These cross-subsidies were not economically feasible in the targeted middle-market neighborhoods.

In 2015–16, the state revised its tax-exemption program.²¹ Currently, rental developments can receive a 35-year tax exemption with three options (see sidebar **Building Housing in NYC: A Short Course**). Tax benefit Option A is intended to be compatible with MIH Option 1; Option B is intended to be compatible with MIH Option 2; and Option C is intended to be compatible with the Workforce Option as originally proposed. Special rules apply to large rental developments in strong-market neighborhoods that receive extended benefits but are subject to “prevailing wage” requirements. Condominium projects are eligible for tax exemptions under very limited conditions.²²

In summary, MIH, as adopted, is economically feasible for new rental developments only in strong and very strong housing-market neighborhoods and when the city provides additional subsidies. MIH without subsidy is not economically feasible for nonrental developments, for conversions, for “payment-in-lieu” buildings of 11–25 units, and for developments with affordable units off-site. In all these cases, market-rate units are not eligible for tax exemptions. MIH can be applied in middle-market, moderate, or weak neighborhoods, but housing associated with such a designation must be entirely subsidized. Thus, the permanently affordable units that result cannot be attributed to MIH—because the city could have imposed affordability requirements in exchange for subsidies, independent of MIH.

MIH was implemented prospectively; property owners generally retained the development rights they possessed on January 1, 2014, when de Blasio took office, including the ability in certain zoning districts and designated areas to obtain a floor area bonus under Mayor Bloomberg's much-maligned VIH.

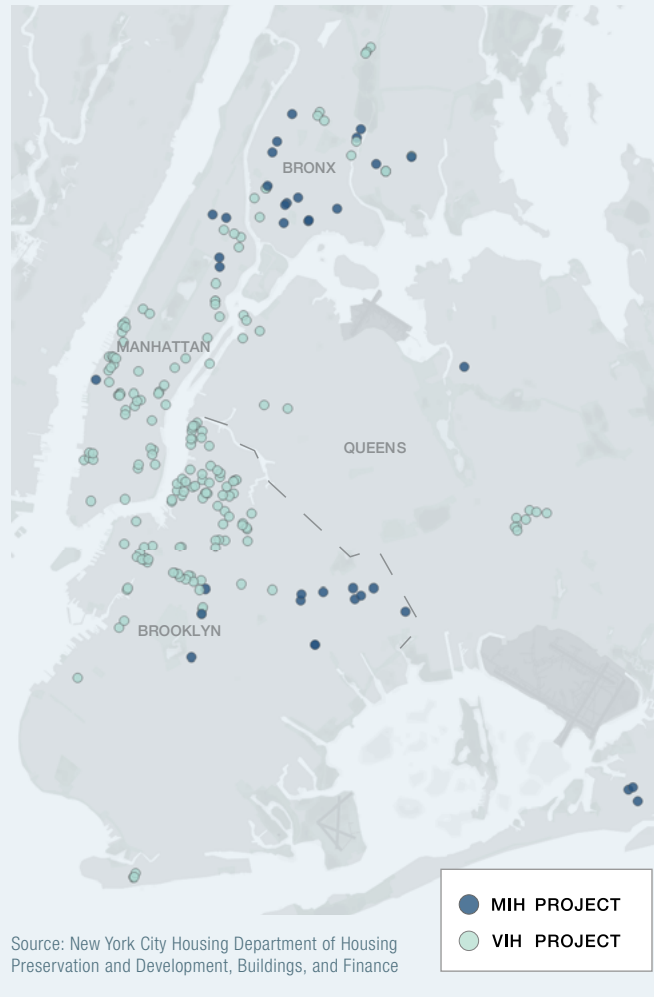
MIH Today

Data from HPD and the New York City Department of Finance indicate that, as of September 2019, 38 developments have committed to the provision of 2,065 MIH units (**Figure 2**). Since January 1, 2014, HPD has approved 181 projects, accounting for 8,476 VIH units.²³

According to the New York City Department of Buildings' online information system, two MIH buildings are completed: 869 East 147th Street, in the Mott Haven neighborhood of the Bronx (called MLK Plaza),

FIGURE 2.

MIH and VIH Developments as of September 2019



with 42 MIH units (167 units overall); and 133–45 41st Avenue, in Flushing, Queens, with 83 MIH units (232 units overall). Thirty-four MIH developments have building permits but have not been completed; two do not yet have building permits.

Of the 36 MIH sites completed or under construction, 30 are 100% affordable for a defined period, and all are heavily subsidized by city, state, and federal programs. (Most of these buildings use MIH Option 1, committing 25% of the units to be permanently affordable.) Many of these developments also have tax-exempt mortgage financing from HDC and use federal low-income housing-tax credits.

Some of these MIH developments have utilized city-owned land or land contributed by nonprofits. None would have been developed without public subsidies. Even the units that are not permanently affordable

remain rent-stabilized after the initial period of mandated affordability (at a specified income level). As these developments age, they will need substantial capital investments. It is unlikely that they will be able to generate revenue streams to enable capital investments to be financed from nonpublic sources.

MLK Plaza in Mott Haven is representative of an MIH building. According to the city's press release celebrating the ribbon cutting:

The total development cost for MLK Plaza is approximately \$63.71 million. HDC funding sources for this development include \$27.72 million in tax-exempt bonds and approximately \$10.86 million in corporate subsidy. HPD provided nearly \$12.53 million in subsidy plus an additional \$6.6 million under the OurSpace Initiative to fund the homeless units.

Additionally, Bronx Borough President Ruben Diaz, Jr. and former City Council Speaker Melissa Mark-Viverito each committed \$500,000, for a combined total of \$1 million.²⁴

To receive this assistance, the developer agreed to the following distribution of the 166 affordable units:

- 33 units at 30% of AMI, to be rented to the formerly homeless for a period of 30 years
- 8 units at 40% of AMI; 8 at 50% of AMI; 100 at 60% of AMI; and 17 at 90% of AMI
- All units to be affordable for at least 35 years; 8 to be permanently affordable at 40% of AMI; 21 at 60% of AMI; and 13 at 80% of AMI.²⁵

After the period of mandatory affordability, all units at MLK Plaza will continue to be rent-stabilized. Cooperative or condominium conversions are limited to cases of non-eviction (the tenant purchases the apartment or leaves voluntarily).

MLK Plaza is in Bronx Community District 1, which is combined with Bronx Community District 2 for statistical purposes. The combined community districts have 41.5% of their population living below the poverty level, the highest of any of New York City's community districts.²⁶ These demographics suggest that the promise of permanent affordability is not backed by an expected stream of high rents in the future.

The two MIH developments that did not have building permits as of September 2019 have filed similar regulatory agreements with the city that indicate

heavily subsidized, 100% affordable housing. These developments are at 2618 Fulton Street in East New York, Brooklyn; and at 20-02 Mott Avenue, in Far Rockaway, Queens.

Two MIH projects under construction include market-rate units. The Bedford-Union Armory redevelopment project in Brooklyn's Community District 9 has 164 such units (in addition to 250 subsidized units, of which 109 are permanently affordable). While Bedford-Union Armory uses city land, HDC funding, and tax credits, the promise of permanent affordability is at least supported by a private revenue stream and does not exclusively represent a public commitment. However, since the city had control of the land and could require permanent affordability as a condition of sale, MIH zoning per se did not lead to permanent affordability.

A second exception to the general rule of public subsidy is at 601 West 29th Street, in Manhattan, the only MIH development in one of Manhattan's affluent Community Districts 1-8 (601 West 29th Street is in District 4). The 931-unit development includes 234 MIH units. This is the only site that meets the conditions required for the success of an unsubsidized MIH development, as specified in the city's 2015 market study.²⁷ What accounts for this success?

Block 675, in which 601 West 29th Street is located, adjoins the Hudson Yards and West Chelsea rezoned areas. The block itself was not rezoned, however, and the original Hudson Yards plan called for its conversion into a public park. The city never followed through on that plan, while the rezonings created enormous real-estate value on surrounding blocks.

Changing the mapped zoning district to permit high-density residential development under MIH created substantial economic value that could support MIH's goals of socioeconomic integration and long-term affordability; 601 West 29th Street also acquired development rights from Hudson River Park (pursuant to state law and a special zoning provision). Given the high market rents expected at this location, the city's long-term tax exemption is particularly valuable.²⁸

The general ineffectiveness of MIH at inducing credible developer participation without subsidies—particularly in neighborhoods with strong housing markets—contrasts with the continued vitality of the much-maligned VIH. Unlike MIH sites, many VIH developments are in the city's most affluent community districts. For example, 3,715 approved units since the beginning of 2014 are in Manhattan Community Districts 1-8. MIH's goal of fostering socioeconomic diversity through zoning has been far better served by its VIH predecessor.

Why Has MIH Produced So Little?

Several factors account for the MIH program's problems, including:

A flawed program design. A fundamental goal of MIH was to increase the percentage of permanently affordable units above VIH's 20% and lower the target income threshold below 80% of AMI when public funding was used. However, no development subject to such requirements could achieve financial feasibility without tax exemptions. The city, working with the state legislature, did achieve most of its desired real-estate tax-exemption changes in 2015 and 2016, but the new tax program was effectively limited to new rental housing construction—conversions of nonresidential buildings to residential use were generally ineligible for tax exemptions, and none have been granted permits under MIH.²⁹

New construction developments between 11 and 25 units were also effectively precluded from MIH because buildings constructed pursuant to cash payments in lieu of providing affordable housing also did not qualify for tax exemptions. The de Blasio administration compounded the problem by adopting a prohibitively high payments-in-lieu schedule—as much as \$1,100 per square foot of required permanently affordable housing in Manhattan Community Districts 1-8. For example, zoning allows, by City Planning Commission special permit, construction of residential buildings in historic districts in Soho and NoHo in Manhattan. Under MIH, a building applying for such a special permit with 15,000 square feet of residential floor area would require a cash payment of \$4.125 million (25% of residential floor area, or 3,750 square feet, multiplied by \$1,100). Rather than making such a large cash payment to the city, property owners are likely to keep the lot in nonresidential use. Not surprisingly, no payments-in-lieu have been collected through this mechanism.

Similarly, the 2015-16 changes to state tax law made most condominiums ineligible for real-estate tax exemptions. This is a problem in enacting zoning changes in local markets, such as Flushing, Queens, where condominiums are the typical form of housing development.³⁰ No projects in which housing units would be individually owned condominiums have used MIH.

At the time MIH was adopted, the mayor and city council agreed to changes to the proposed Workforce Option, intended for middle-market areas. These are areas where market rents for new housing are high

enough to make development economically feasible with available tax exemptions, but not high enough so that market rents can “cross-subsidize” rents on units affordable to low-income households. The changes effectively required buildings developed under the Workforce Option to achieve an internal cross-subsidy of low-income rents in neighborhoods where market rents are not high enough to support it. This effectively invalidated the option. The Workforce Option has not been used.

Rezoning *have been concentrated in low-income communities where MIH means public funding.* For example, a rezoning for the Jerome Avenue Corridor (Bronx) was approved by the city council in March 2018.³¹ The three developments that have received building permits, at 1325 and 1769 Jerome Avenue and 1164 River Avenue, are all 100% low-income affordable housing, and two include supportive housing for the formerly homeless.

Moreover, in economically improving areas like East Harlem (Manhattan), rezonings choked off nascent private investment trends in mixed-income housing, leaving neighborhoods dependent on public funding. In 2018, for example, a new privately financed residential building was completed at 2183 Third Avenue. The 12-story, 58-unit building includes 12 affordable housing units, enabling it to qualify for a property-tax exemption under the program existing prior to 2015.³² The building at 2183 Third Avenue is grandfathered under a rezoning—approved by the city council in November 2017—of much of the avenue frontage in East Harlem.³³ The building couldn't get a permit today. This rezoning imposed MIH on the neighborhood, and it made new housing in the area dependent on public subsidies. The two MIH developments to receive permits in the rezoned area since November 2017 (at 1465 Park Avenue and at 1681 Madison Avenue) are 100% affordable and heavily subsidized.

The de Blasio administration has yet to undertake a large-scale rezoning of an area where, in theory, the underlying real-estate market might support MIH affordability requirements for new rental buildings without public subsidies. DCP has initiated the environmental review of an area-wide rezoning in the Gowanus area of Brooklyn, which might be the first such area.³⁴ The Bloomberg administration, on the other hand, implemented numerous rezonings in strong-market neighborhoods. These rezonings are now paying off, with numerous mixed-income developments created under VIH.

De Blasio's acceptance of city council members' “hard” vetoes on rezoning helps to explain the gap in rezonings

between his administration and Bloomberg's. To be sure, council members should have influence over rezonings in their districts, ensuring that local concerns are addressed. Yet hard vetoes encourage grandstanding and irresponsible demands, a tendency exacerbated by well-funded antidevelopment groups in affluent areas of the city. New York City mayors enjoy significant power to build coalitions that place limits on council members' ability to make unreasonable demands. The current mayor has not built such coalitions.

All inclusionary zoning is voluntary. The “mandatory” in MIH is really a misnomer. Building an apartment building is an investment, and it requires capital. No private, profit-motivated entity will make this investment unless there is a reasonable expectation of an acceptable rate of return.

The combination of MIH and the hard council-member veto has largely shut down private applications for zoning changes and special permits. During the Bloomberg years, private developers commonly applied for zoning-map changes to build housing, often in strong- or middle-market areas. In 2009, for instance, the City Planning Commission and the city council approved zoning applications by Toll Brooklyn L.P. for a development at 363–365 Bond Street, in the Gowanus area.³⁵ HPD approved VIH agreements for two developments at this location (for a total of 140 permanently affordable units); the developments have since been completed, with 700 total units.³⁶ The developments received tax exemptions but no public funding.

In short, as a result of MIH, the process of updating New York's obsolete zoning—as a partnership between private developers and the city—has largely ceased, except where public subsidies are available.

Recommendations

New York City has taken credit for creating or preserving 135,437 affordable units over the past five fiscal years (ending June 30, 2019).³⁷ The city has paid a steep price for what it has achieved. In FY 2019, HPD's capital budget expenditures were \$1.68 billion—more than 15% of the city's *entire* capital expenditures that year.³⁸ In addition, in FY 2019, the city exempted about \$1.5 billion in property taxes for new multifamily housing under Section 421-a.³⁹ Much of this expenditure offset capital costs incurred by real-estate developers in constructing affordable housing units. MIH's contribution to the affordable housing count in this period has been minimal.

Can MIH be made more effective?

It's important to keep in mind that, even in theory, the program works economically only in strong and very strong real-estate markets and only for new rental apartment buildings. The relevant markets are concentrated in Manhattan Community Districts 1–8 and the community districts along the East River in Brooklyn and Queens (Brooklyn 1, 2, and 6; and Queens 1 and 2). These community districts include most of the city's high-density zoning and experienced many of the Giuliani and Bloomberg administrations' most successful rezoning initiatives in terms of housing production, including Hudson Yards, West Chelsea, downtown Brooklyn, Greenpoint/Williamsburg, Long Island City, and Astoria.

The rezonings in these areas focused on obsolete industrial or commercial locations, where large amounts of new housing could be constructed without resulting in the demolition of many existing housing units. They were accompanied by commitments to communities and elected officials to make land-use regulations more restrictive in established communities.

Such communities were, in any event, widely protected from redevelopment by rent regulation and landmarking. Thus, new large-scale rezoning efforts in these areas to permit additional residential density run up against a number of practical obstacles. These include widespread mapping of historic districts and contextual zoning districts allowing little new development, as well as the cap in the state Multiple Dwelling Law limiting residential floor area ratios to 12.⁴⁰

Given the obstacles, local zoning changes and changes to state law have been, and will continue to be, fiercely contested by well-funded preservationist and antidevelopment groups. Nonetheless, the city should move to update its zoning map. Mayors will need to build coalitions with council members representing less affluent areas, overcoming local opposition in the name of distributing the burden of solving New York's overall housing shortage more fairly across the city.

To this end, zoning changes should focus on small residual manufacturing zones in Manhattan, including Soho and Noho and areas of Midtown South, where little or no industrial activity remains. Still, because of widespread landmarking, the potential of these areas for producing new housing, whether affordable or market-rate, is modest.

There are other reforms to undertake: remove the currently exorbitant requirements for conversions of nonresidential to residential space; encourage the

construction of new developments with 11–25 units on smaller lots; and allow feasible new condominium housing in rezoned areas. These reforms require some combination of the following: extending tax exemptions; reducing in-lieu payments while increasing the size of buildings for which such payments are permitted; and demanding fewer affordable units or raising the income limits on affordable units.

To encourage the building of new, large rental developments, New York needs to rezone manufacturing-zoned areas in the strong real-estate neighborhoods of Brooklyn and Queens (including parts of Gowanus, East Williamsburg, and Long Island City). If such rezonings allow a broader range of conversions, smaller buildings, and condominiums, a meaningful private contribution to affordable housing is possible.

The city's widespread middle-market neighborhoods offer still greater rezoning potential. These are the areas where the private market produces new apartment buildings but where the potential does not exist for market rents in rezoned areas to cross-subsidize affordable housing. The areas include many locations near subway and commuter rail stations that are largely developed with low-rise commercial or industrial buildings; they could be rezoned to permit apartment buildings.

Transit analyst Alon Levy notes the high potential of rezoning a large swath of central and southern Brooklyn where the city's legacy transit system offers substantial capacity to accommodate commuters residing in new housing.⁴¹ New York's current housing policies place rezonings in much of this area out of reach, because new housing would require even larger public subsidy commitments than exist at present—commitments that the city is unlikely to make. To make rezonings feasible, the city should restore its originally proposed MIH Workforce Option, which was designed to work without substantial cross-subsidy, in tandem with a practicable option for condominiums.

In neighborhoods with weaker housing markets, new housing will continue to need subsidies. However, neighborhood rezonings in the de Blasio administration have tended to permit high densities while squeezing all the land value that justifies private investment in high-rise buildings. Extremely ambitious housing production goals in areas where new housing is, by design, heavily subsidized and 100% affordable will be costly and perhaps unrealistic. Zoning low-land-value areas at a more moderate scale will result in less costly construction and allow the city's limited financial resources to be used more effectively.

Finally, the city and state need to address the disconnect between the control of zoning and the control of tax policy. The city's inclusionary housing goals are dependent on the state legislature's willingness to continue a tax exemption for new housing and to make it usable by developers who comply with the city's rules. Ideally, the legislature should give the city permanent authority to enact real-estate tax exemptions consistent with its affordable housing goals. The city has a strong incentive to make these tax exemptions deep enough to work, but not so generous as to unduly curtail tax revenues.

Conclusion

New York City has effectively placed itself in a box. The Zoning Resolution's district map doesn't allow the amount of housing the city needs. The city government is unwilling to rezone the limited number of areas where MIH might achieve its objective, thanks to community and city council member opposition. Private developers don't apply for zoning changes in stronger-market areas because MIH rules, interacting with community opposition and the council member veto, discourage them from believing that they can achieve an acceptable rate of return. The city has initiated zoning changes mainly in areas where dependence on public funding to make the projects viable limits the number of housing units that can be built. In some cases, the city has negated incipient private investment trends by imposing infeasible mandatory affordability requirements.

However, the box has low walls. The city can climb out of the box whenever it works up the courage to do so. The fundamental need is for more housing to be built—affordable and market-rate. Planners can identify appropriate locations where community impacts can be minimized. Such areas are well served by transit and characterized by low-rise commercial or industrial buildings where new housing represents a net gain to the stock.

Meanwhile, MIH rules can be modified—for example, by reducing the required percentage of permanently affordable units for new housing or raising the maximum income levels for affordable units—to the point where real-estate developers find that investment makes sense. The city can commit to upgrading transit and services, concurrently with new housing, affordable or market-rate.

The mayor will have to propose, and council members will have to endorse, changes that are sure to be vigorously opposed by the same constituencies that successfully advocated for MIH in 2013. Nevertheless, changes are necessary lest the housing shortage grows worse. The sooner the city makes these changes, the better off New Yorkers—those who live there now and those of all incomes who might want to live there in the future—will be.

Endnotes

- ¹ Benjamin Schneider, “CityLab University: Inclusionary Zoning,” CityLab, July 17, 2018.
- ² Author’s calculation based on data as of September 2019 provided by New York City’s Departments of Housing Preservation and Development (HPD), Buildings, and Finance.
- ³ Ibid.
- ⁴ Ibid.
- ⁵ Ibid.
- ⁶ City Planning Commission, “C 030194(A) ZMK,” Apr. 2, 2003.
- ⁷ NYC.gov, “DCP’s Greenpoint-Williamsburg Rezoning Adopted,” May 11, 2005.
- ⁸ City Planning Commission, “N 090316 ZRY,” June 17, 2009.
- ⁹ Department of City Planning (DCP), “Inclusionary Housing Designated Areas—Production, 2005–2013.”
- ¹⁰ Ibid.
- ¹¹ Stephen Jacob Smith, “Return of Rent Control: Brad Lander and Candidates Push for Mandatory Inclusionary Zoning,” *New York Observer*, Aug. 16, 2013.
- ¹² Michael Greenberg, “How Different Is de Blasio?” *New York Review of Books*, Sept. 23, 2013.
- ¹³ DCP, “New York City Mandatory Inclusionary Housing: Promoting Economically Diverse Neighborhoods,” September 2015.
- ¹⁴ New York City Housing Development Corporation, “Market and Financial Study: NYC Mandatory Inclusionary Housing,” September 2015.
- ¹⁵ Low-density areas with few apartment buildings were not included. This Manhattan Institute report uses the terminology from the above-mentioned study when describing real-estate markets in the city.
- ¹⁶ AMI is calculated by the U.S. Department of Housing and Urban Development and is used to determine eligibility for affordable housing programs. The 2019 AMI for the New York City region is \$96,100 for a three-person family. NYC.gov, “Area Media Income (AMI): Affordable Housing.”
- ¹⁷ Editorial board, “The Tax Is Too Damn High: Outsize Property Levies Saddle NYC Tenants,” *Daily News*, Oct. 23, 2018.
- ¹⁸ DCP, “Housing New York: Mandatory Inclusionary Housing,” September 2015.
- ¹⁹ Existing lots could not be subdivided to escape the requirement. The requirement was also applied to City Planning Commission special permits that created new housing where none were previously permitted.
- ²⁰ DCP, “Mandatory Inclusionary Housing: Update,” Mar. 22, 2016.
- ²¹ HPD, “421-a: Tax Incentives.”
- ²² No eligibility for condominium projects in Manhattan or for buildings larger than 35 units.
- ²³ Author’s calculation based on data provided by New York City Departments of HPD, Buildings, and Finance.
- ²⁴ HPD, “Radson Development, Bronx BP Diaz, NYC HPD & HDC Celebrate the Opening of MLK Plaza with a Ribbon Cutting,” Mar. 4, 2019.
- ²⁵ Office of the City Register, “Document ID: 2017040600699003,” Apr. 5, 2017.
- ²⁶ DCP, “Population: American Community Survey (ACS) Data Tables.”
- ²⁷ “Market and Financial Study: NYC Mandatory Inclusionary Housing,” New York City Housing Development Corporation (prepared by BAE Urban Economics, Inc. et al.), September 2015.
- ²⁸ Four small buildings in Brooklyn Community Districts 5 (East New York) and 16 (Ocean Hill/Brownsville) have filed MIH restrictive declarations with the City Register but do not have funding regulatory agreements with HPD or another government agency. The four properties have committed to a total of 35 permanently affordable units. Given that these buildings are in low-income communities with low prevailing market rents, there does not appear to be a readily plausible means of supporting these long-term commitments financially. The buildings may represent ongoing enforcement problems for HPD if the owners are unable to meet their obligations.
- ²⁹ In autumn 2019, a proposed zoning-map change triggering MIH was under public review for 90 Sands Street in Brooklyn, a deeply subsidized conversion of a former hotel to 507 units of supportive housing for formerly homeless adults and low- and moderate-income housing. Because this housing would be owned by a Housing Development Fund Corporation, it would qualify for a tax exemption.
- ³⁰ Josh Ye, “Flushing, New York Draws Mainland Buyers with Asian-Inspired Condo Projects,” *South China Morning Post*, Sept. 5, 2017.
- ³¹ DCP, “Jerome Avenue Neighborhood Plan,” Oct. 3, 2019.
- ³² Ameena Walker, “In East Harlem, 12 Rentals Asking from \$856/Month Hit the Lottery,” *Curbed New York*, May 30, 2018.
- ³³ DCP, “East Harlem Rezoning Proposal,” Nov. 30, 2017.
- ³⁴ DCP, “Gowanus Neighborhood Planning Study.”
- ³⁵ City Planning Commission, “C 090048 ZSK,” Feb. 17, 2009.
- ³⁶ Office of the City Register, “Document ID: 2014082800642001.”
- ³⁷ NYC.gov, “Housing New York.”
- ³⁸ The City of New York, “Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2019.”
- ³⁹ The City of New York, “Annual Report on Tax Expenditures: Fiscal Year 2019.”
- ⁴⁰ “Contextual zoning” refers to the mapping of zoning districts that restrict new construction to the size and massing of buildings that prevail in a neighborhood. The effect of such zoning is to limit new construction.
- ⁴¹ Alon Levy, “New York City Zoning and Subway Capacity,” *Pedestrian Observations*, Oct. 27, 2019.



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