

REVITALIZATION OF INNER CITY HOUSING THROUGH PROPERTY TAX EXEMPTION AND ABATEMENT: NEW YORK CITY'S J-51 TO THE RESCUE*

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I. INTRODUCTION

A. *The Rental Housing Situation in New York City in 1975*

When the municipal bond market closed its door to New York City in the spring of 1975,¹ it shut out the city's program of providing mortgage loans to finance newly constructed and rehabilitated housing for low- and middle-income people. New York City could no longer act as a banker; the principal resource upon which the city had relied to solve its housing problems was gone.²

Despite the infusion of more than one billion dollars over twenty

* The opinions expressed in this Article are those of the author and do not necessarily represent those of New York City.

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1. S.E.C., STAFF REPORT ON TRANSACTIONS IN SECURITIES OF THE CITY OF NEW YORK 258 (1977).

2. NEW YORK CITY HOUSING AND DEVELOPMENT ADMINISTRATION, SUMMARY OF GOVERNMENT HOUSING ACTIVITIES IN NEW YORK CITY (1975).

Since the enactment of New York State's Limited Profit Housing Companies Law in 1955 [Article II of the New York Private Housing Finance Law] the City of New York has expended over one billion dollars in financing limited-profit housing projects. However, another billion dollars' worth of projects now on the

years for city-funded housing projects,³ New York City's housing picture in 1975 was grim. *Real Estate Weekly* published a study indicating that fifteen to twenty-five percent of the city's rental housing was in danger of actual collapse.⁴ Furthermore, the report⁵ revealed:

1. Thirty percent of the city's rent controlled⁶ and fifty percent of its rent stabilized⁷ buildings had operated in a negative cash flow position in 1974.

2. The market value of controlled and stabilized buildings had tumbled between 1973 and 1974 largely due to soaring fuel costs.

drawing boards also require financing. So vast a pipeline has strained the City's capital funds, upon which there are many other claims in addition to housing. *Id.* at 11. In addition to these "Mitchell-Lama" housing projects involving primarily new construction, the city makes loans to rehabilitate existing multiple dwellings under Articles VIII and VIII-A of the Private Housing Finance Law. As of June 30, 1971, the city had committed \$90,091,052 in mortgage loans for this purpose. Council of the City of New York, Committee on Charter and Governmental Operations, Report on the Municipal Loan Program—Blueprint for Failure 21 (1972).

3. *Id.*

4. *Real Estate Weekly*, May 15, 1975, at 1, col. 1.

5. *Id.* The study was prepared by the Real Estate Research Corporation for the Coalition to Save New York.

6. L. BLOOMBERG & H. LAMALE, *THE RENTAL HOUSING SITUATION IN NEW YORK CITY IN 1975* (1976), describe the various categories of rental units:

Controlled: These units are subject to the provisions of the Rent Control Law [Title YY of Chapter 51 of the Administrative Code of the City of New York] and Regulations which have jurisdiction over occupied private rental units in existence before February 1, 1947. All increases in rent are set and must be approved by the New York City Office of Rent Control. . . .

Change from 1970: Under the State Vacancy Decontrol Law, controlled units vacated on or after June 30, 1971 became decontrolled. The Emergency Tenant Protection Act, enacted by the State and adopted by the city, effective May 29, 1974, put all these vacancy decontrolled apartments in structures of six or more units under stabilization. . . .

Id. at 292.

7. *Id.* at 293. Bloomberg and Lamale describe stabilized buildings as: rental apartments . . . in structures of six or more units shown in the 1975 Housing and Vacancy Survey in two categories: (a) those in structures built [from] 1947 through 1973, consisting of nonsubsidized private rental units never subject to rent control and units in structures built on January 1974 or later and receiving tax abatement; (b) those in pre-1947 structures formerly under rent control and subsequently decontrolled.

* * *

Stabilized units are in buildings registered with the Rent Stabilization Association and levels of rent increases are determined by the Rent Guidelines Board. Individual disputes between landlords and tenants are adjudicated by the Conciliation and Appeals Board of the Rent Stabilization Association.

3. Normal mortgage financing had almost completely disappeared from the rental housing market.

4. The estimated 1974 abandonment rate was between 35,000 to 50,000 units or the equivalent of the net new housing built in New York City over the past five years.

The report attributed the rapid disintegration of rental housing to both the escalation of fuel costs and the city's weakening economy.⁸

It was imperative to halt the downward drift of the real estate market. But how? State and federal housing programs were in a state of transition and could offer little support. Federal housing subsidies had been cut off by the Nixon Administration in the 1973 housing freeze. The Section 8 rental subsidy housing program had yet to get fully underway.⁹ Furthermore, in early 1975 the New York State Urban Development Corporation, which had built a major share of governmentally assisted housing in the state, suffered a financial collapse.¹⁰

The city looked to the obvious. Any new housing program had to satisfy three criteria. First, the program needed to supply an immediate impetus to reverse the declining housing market. Second, any capital for reconstruction had to come from the private mortgage market because the city had lost its credit. Finally, the costs of any city housing program would have to be spread over many years.

B. *Tax Exemption and Abatement to Induce Housing Rehabilitation*

The city discovered how to abate its crisis out of its own housing experience. Since 1956, New York City had administered a tax ex-

8. Real Estate Weekly, May 15, 1975, at 1, col. 1.

9. The City Record, Official Journal of the City of New York (March 15, 1978) (The Council Stated Meeting of Feb. 23, 1978 at VI, quoting from the Mayor's Management Report),

The Section 8 program encourages private construction investment through federal rent subsidies which guarantee the rent roll for the developer/owner. Rent subsidies are usually combined with city tax abatement to increase incentive for the developer. Over the last three years cumulative funds for only 25,000 housing units have been allocated to the city by the U.S. Department of Housing and Urban Development (HUD). To date, only 1,831 units have begun construction through this program, due to unexpectedly lengthy and complex negotiations between developers and HUD, and problems in HUD processing. See 42 U.S.C. § 1437f (1976). See generally Whiteman, *Federal Housing Assistance for the Poor: Old and New Directions*, 9 URB. LAW. 1 (1977).

10. N.Y. Times, May 11, 1975, § 4 (Week in Review), at 8, col. 5.

emption and tax abatement program known as "J-51"¹¹ to stimulate the upgrading and rehabilitation of rent-controlled units in return for property tax relief. Originally, the "J-51" program induced owners to upgrade cold water flats by installing central heating and hot water service. Over the years, the program expanded to further induce the upgrading and preservation of existing residential multiple-dwellings through the removal of unsafe and unsanitary conditions and the replacement of inadequate plumbing facilities. Nonetheless, in 1975 J-51 was primarily a lure to encourage private investment in the existing rent-controlled housing stock which the politically sacrosanct rent control law deterred.¹²

J-51 induces an owner to improve a multiple dwelling by granting a twelve-year tax exemption from any increase in the assessed valuation of the structure resulting from these improvements. The law provides for tax abatements on both the structure and the land upon which it is built. These abatements may be up to ninety percent of the city's determination of reasonable cost of the improvements with a limit of 8 1/3 percent of such reasonable cost allowed to be abated in any one year for a period not to exceed twenty years. If in any one year the abatement is greater than the tax due, the owner's taxes will be reduced to zero.

Given its limited resources, New York City found that restructuring and expanding the existing J-51 program was economically and socially correct. Restructuring and expanding J-51 could not provide the sole incentive necessary to produce housing for the city's lowest income population. For complete success, the program required further subsidies from the federal or state governments. The J-51 program alone, however, could spur the city's growing emphasis on neighborhood preservation and rehabilitation.¹³

After World War II New York City placed little emphasis upon

11. N.Y., N.Y. LAW 118 (1955). The law derives its name from NEW YORK CITY, ADMINISTRATIVE CODE, ch. 51, § J-51-2.5.

12. N.Y. Times, Oct. 5, 1977, at D12, col. 3.

13. *Id.* at col. 5. Edgar A. Lampert, president of the Community Preservation Corporation, observed that "60 percent of the 2.2 million apartments in New York City are over 50 years old," which illustrates the importance of moderate rehabilitation and continued fiscal stability to the existing stock. He also noted that moderate rehabilitation costs an average of \$5,000 to \$10,000 per unit, compared with about \$50,000 for each unit of new housing. "This has got to drive any sane person to a preservation policy . . ." *Id.*

housing maintenance and rehabilitation.¹⁴ In the 1960's and the early 1970's the Mitchell-Lama middle-income construction program remained the city's major housing thrust.¹⁵ Although a municipal loan program existed which helped finance the rehabilitation of existing multiple dwellings, the program was plagued with scandals and never became a volume housing producer.¹⁶

By 1974, the soaring cost of new construction forced the city to focus on the need to strengthen the existing occupied housing stock. An atmosphere of preservation as opposed to the bulldoze-and-build syndrome of the post-war years began to take hold.¹⁷ New York City's efforts to make do with its existing housing stock often created better housing units than could be produced by the new construction of "luxury units." Rehabilitation was successful because the older buildings' construction reflected a period of greater concern with quality and livability.¹⁸ Reconstruction of closed factories and underutilized commercial buildings, when properly executed, provided irregular shapes and interesting forms which had been all but forgotten in the cookie-cutter units of the last two decades.¹⁹

14. *Id.* at col. 3.

15. *See* note 2 and accompanying text *supra*.

16. A New York City Council committee found that as of June 30, 1971 mortgage loans in the amount of \$90,091,052 had been committed to 231 projects consisting of 384 buildings containing 6,857 apartments. Council of the City of New York, Committee on Charter and Governmental Operations, Report on the Municipal Loan Program—Blueprint for Failure 21 (1972). Furthermore, the New York Times reported that scandal brought the municipal loan program to a halt in 1971; that the program was reviewed on a more modest scale in 1973; and that 30 projects have been started since 1973 at a cost of \$18 million. N.Y. Times, April 2, 1976, at 47, col. 1.

17. The N.Y. Times, Sept. 19, 1977, at 42, col. 2, quoted Robert C. Embry, Jr., an Assistant Secretary of HUD and Executive Director of President Carter's Urban Policy Group: "As opposed to 10 or 20 years ago we've got trends we can ride on," citing such developments as the energy crisis, which has put a premium on city living, on anti-growth sentiments among residents of the suburbs, and on a "whole new value system that values what is old and opposes newness and homogeneity."

18. *See* N.Y. Times, July 7, 1977, at C10, col. 1, which states:

[B]ut in the making of apartments, the old values really were better—there was more concern with both quantity and quality of space, with movement through space, with visual variety, with all of those aspects that contribute to the quality of the physical environment.

Economic considerations shrank space and reduced amenities until a point was reached a few years ago when it could fairly be said that most so-called "luxury" housing was inferior in many ways to subsidized housing for people of moderate means.

19. Stephen Jacobs, an architect reported to have built his practice around the conversion of factories and office buildings into residential units, stated that "people

Reexamining the J-51 program the city found that the J-51 exemption and abatement had encouraged two types of rehabilitation: first, upgrading and preservation of rental properties by installing major capital improvements; second, creation of new units by gutting and reconstructing. Major capital improvements generally include the upgrading or replacement of a building's systems or components. Examples include the installation of fireproof doors, the modernization of electrical and heating systems or the installation of new brass plumbing. Between 1968 and 1973 roughly eighty-five to ninety percent of the buildings in the program involved this type of rehabilitation.²⁰ During this period, however, major capital improvements accounted for approximately thirty percent of the total cost which the city certified as eligible for abatement.²¹ Roughly seventy percent of the remaining certified cost was attributable to major rehabilitation efforts. Approximately one-half of these rehabilitation efforts received government loans or mortgage insurance enabling rent reductions to an affordable level for lower-income tenants.²²

For the 1974 calendar year period 1,523 buildings providing 86,653 apartments received assistance at a certified cost of \$46,006,200.²³ While this housing activity was miniscule compared to the estimated need of 30,000 additional or new or significantly rehabilitated units a year,²⁴ such activity still represented 1,523 buildings which had been saved from the danger of abandonment. The cost which could be abated was roughly attributable to the following components:²⁵

Alterations to Permanent Residences and Conversions of Hotels and Buildings Classified as Single-Room Occupancies	\$18,598,200
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want something besides a plain white box, and are willing to pay for it—an open loft bedroom without enough space to stand up in will bring as much money as a regular enclosed bedroom.” N.Y. Times, Feb. 3, 1977, at 39, col. 3.

20. Eilbott & Kempey, *An Analysis of the J-51-2.5 Tax Abatement and Exemption Program for Stimulating Housing Rehabilitation in New York City* (unpublished report 1975).

21. The City of New York, Department of Housing Preservation and Development, *J-51 Tax Exemption-Tax Abatement Program, Report of Yearly Statistics, March 16, 1976 to March 15, 1977, Comparison of Annual J-51 Statistics*.

22. *Id.*

23. *Id.*

24. N.Y. Times, May 11, 1975, § 4 The Week in Review, at 8, col. 4.

25. The City of New York, Department of Housing Preservation and Development, *J-51 Tax Exemption-Tax Abatement Program, Report of Yearly Statistics, March 16, 1976 to March 15, 1977, Comparison of Annual J-51 Statistics*.

Municipal loans (gut rehabs in poorer neighborhoods)	\$ 8,749,900
FHA-assisted rehabilitation under Section 312	\$10,407,100
Major Capital Improvements	\$ 8,251,000

The cost certified to be abated over a twenty-year period expanded from \$320,000²⁶ in the year ending March 15, 1961, to \$46,006,200²⁷ in 1975. The total abatement of taxes in 1974 of all assisted buildings in the program was \$174,420,950,²⁸ an amount less than the \$207,255,644 of unpaid real estate taxes for the city's 1974-75 fiscal year.²⁹

C. *Advantages of a Housing Tax Exemption and Abatement Program*

One immediate advantage of a tax exemption and abatement housing program in 1975 was the ability to amortize the cost of tax revenue losses over a twenty-year period. If the city regained its economic strength this cost would be easier to bear in later years. Furthermore, tax losses might be offset in the long run by the benefits derived from a housing stock of greater value which might pay full taxes upon termination of the exemption and abatement.³⁰

Though the program's cost would be spread over a number of years, the construction activity induced by the program would pro-

26. The City Record, Official Journal of the City of New York, (June 16, 1978) (The Council Stated Meeting of May 23, 1978 at XII).

27. *Id.*

28. New York City Housing and Development Administration.

29. New York City Department of Finance. New York City's fiscal years begin July 1 of each year and terminate the following June 30.

30. See The Daily News, Oct. 11, 1975 at 18, cols. 1, 2 and 3, which state:

A plan to offer new tax incentives to property owners who improve their residential buildings was submitted by Mayor Beame to the City Council yesterday in an effort to draw private money into upgrading the city's older, moderately priced housing.

* * *

'This proposal will not only upgrade housing for our citizens,' Beame said, 'but it will also increase the long-term tax base of the city, increase jobs in the construction industry and stabilize neighborhoods that have a substantial number of older buildings.'

A spokesman explained that Beame and Housing and Development Administrator Roger Starr believed that the initial cost in tax revenue losses would be more than balanced in the long run by the added value of the city's housing stock. . . .

duce immediate income to the city through an increased business volume and an expansion of employment opportunities. Personal income tax collections would be increased because of the income earned by beneficiaries of the program, such as construction workers, contractors, subcontractors, vendors, and various professionals such as architects, lawyers and accountants. Upon completion of the rehabilitation, real estate brokers, renting agents and property managers would have the opportunity to enhance their income. Sales tax revenues should increase as materials are sold to rebuild the housing.³¹

A further reason why tax exemption and abatement became a major New York City housing program in 1975 stems from the short period of time needed to implement a program.³² Once the city had developed clear rules defining the eligible items of rehabilitation, pri-

31. The City Record, Official Journal of The City of New York (June 16, 1978) (The Council Stated Meeting of May 23, 1978 at XII). Appendix B at XII sets forth a schedule of estimated revenues generated from J-51 induced rehabilitation activity:

Tax Revenues Other Than Real Property Taxes Generated by Rehabilitation Activity	
New York State Stamp Tax on Deeds ¹	\$ 8,651
New York State Mortgage Recording Tax ²	182,250
New York City Real Property Transfer Tax ¹	78,638
New York City Mortgage Recording Tax ²	121,500
J-51 Application and Filing Fees	21,457
Buildings Department Fees	<u>49,852</u>
Total	\$462,348
Sales Taxes Generated by Construction ³	<u>413,000</u>
Total	\$875,348
Man Hours of Construction Generated ⁴	690,000
(660 Hours per unit)	

1. Based on actual sales for all properties transferred since January 1, 1972.
 2. Based on all mortgages issued since 1972 for 29 properties purchased by the owners who converted the properties. All the properties have not yet obtained permanent financing and additional mortgage recording taxes will be collected.
 3. Based on estimates that 35 per cent of the owners' claimed costs were spent on materials and 65 per cent for labor.
 4. Based on an average compensation rate of \$15 per hour.

32. See N.Y. Times, Oct. 17, 1976, § 8 Real Estate, at 1, col. 5, which states:
 An advantage of recycling is the comparative speed with which it can be accomplished. Work at 244 Madison Avenue will begin a few weeks from now, and occupancy is expected by late next spring or early summer. The nine-month construction period compares with two years or more if an apartment house of comparable size was started from scratch.

vate developers and contractors could immediately begin work.³³ Owners retained the discretion to decide which of their buildings would be reconstructed within the existing legal framework of J-51, the building code and the zoning laws. Unlike programs requiring constant governmental oversight, administration of J-51 would require little governmental involvement once the city established guidelines for participation.³⁴

As a result of these factors, the administrative costs of a tax abatement program are astonishingly low. Low costs comport particularly well with a tax cutting trend. In 1976, the New York City Housing and Development Administration estimated the total administrative cost of J-51 for one year to be \$170,000.³⁵ This sum was largely attributable to fees paid to rehabilitation specialists for examining whether the claimed costs of the work performed under the program were actual and reasonable.

The J-51 program could also enhance the city's overall well being. New units produced under the program would attract new residents and encourage the middle class to remain.³⁶ Furthermore, rehabilitation is considerably less expensive than construction of an equal number of residential units.³⁷

J-51 also could produce beneficial secondary impacts. Tax abatement and exemption can creatively supplement and strengthen existing federal programs. When the fiscal crisis halted municipal loan commitments for housing rehabilitation in the fall of 1975, for exam-

33. See N.Y. Times, Jan. 13, 1978, at B5, col. 2.

34. See *Id.*, col. 1; N.Y. Times, Feb. 17, 1978, at B5, col. 1 (slow progress in contrast to the J-51 program was made in implementing the city's participation loan program which involved complex negotiations among construction lenders, permanent lenders, city agencies and the property owner before the rehabilitation loans were made).

35. New York City Housing and Development Administration.

36. N.Y. Times, March 15, 1978, at D17, cols. 1, 2 and 3 stated that a study prepared by the Center for Urban Policy Research at Rutgers University concluded that over 30% of the occupants of buildings converted into residential quarters came from addresses outside the city. The study also found that almost 75% of the residents in all types of converted units had finished college and had a median household income of \$21,700, more than twice the city-wide median.

37. See note 13 and accompanying text *supra*. N.Y. Times, Sept. 16, 1977, at B11, col. 4. See also The City Record, Official Journal of The City of New York (June 16, 1978) (The Council Stated Meeting of May 23, 1978 at XI), which stated that a benefit of the J-51 program is the "creation of new units at less than \$60,000 per Mitchell-Lama unit, without incurring long-range bond debts, etc."

ple, participation loans³⁸ for this purpose were made by leveraging federal community development funds at one percent with market rate bank loans. In addition, the city used the federal funds to make mini-loans³⁹ at three percent interest to finance the upgrading and repair of major building systems of multiple dwellings. The additional tax relief provided by J-51 for these buildings enables rents to be lowered to a level which more community residents can afford.⁴⁰ It is preferable to subsidize more people in sound older buildings needing only moderate repair rather than to assist a few people in expensive, newly built subsidized housing, a policy enthusiastically endorsed by the United States Department of Housing and Urban Development⁴¹ (HUD).

Tax abatement and exemption also can be employed to further secure and attract investment for the renovation of buildings which are eligible to receive the benefits of federal mortgage insurance,⁴² Section 312 loans,⁴³ and Section 8 housing subsidies.⁴⁴ All of these programs, together with the Government National Mortgage Association's special assistance functions,⁴⁵ have been cited by HUD as components of an overall plan to nurture a more thriving urban environment, to lure middle-income families back to the cities, and to use federal funds as seed money to generate greater participation from other sectors of the economy.⁴⁶

From the outset, the policy of the Beame Administration⁴⁷ was not only to upgrade the existing housing stock but to increase the supply of moderately priced housing through J-51.⁴⁸ Obvious resources in-

38. N.Y. Times, April 2, 1976, at 47, col. 1; N.Y. Times, Oct. 5, 1977, at D12, col. 4; N.Y. Times, Feb. 17, 1978, at B5, col. 1.

39. N.Y. Times, Oct. 5, 1977, at D12, col. 4.

40. N.Y. Times, Jan. 13, 1978, at B5, col. 1.

41. N.Y. Times, Oct. 14, 1977, at B3, col. 1.

42. 12 U.S.C. § 1715(l)(d) (1976) (availability of mortgage insurance for rehabilitation projects).

43. 42 U.S.C. § 1452(b) (1976).

44. See 42 U.S.C. § 1437(f) (1976). See also N.Y. Times, Oct. 5, 1977, at D12, col. 6; N.Y. Times, Oct. 14, 1977, at B3, col. 1.

45. 12 U.S.C. § 1720. N.Y. Times, Oct. 5, 1977, at D12, col. 6; N.Y. Times, July 14, 1978, at A5, col. 1.

46. N.Y. Times, July 14, 1978, at A5, col. 1; N.Y. Times, Oct. 14, 1977, at B3, col. 1.

47. Abraham D. Beame was Mayor of New York City from Jan. 1, 1974 through Dec. 31, 1978.

48. The Daily News, Oct. 11, 1975, at 18, col. 4.

cluded factory loft buildings left free by the decline of manufacturing jobs in the city, vacant office buildings, run-down hotels,⁴⁹ and other obsolete commercial structures which could be recycled into attractive, spacious apartments.⁵⁰ All these properties were so economically distressed that redevelopment was impracticable without special incentives.⁵¹ When recycled, however, they could meet the purchaser demand for urban housing which broke away from traditional designs and looked instead to large central spaces, varying ceiling heights and irregularly shaped rooms.⁵²

By extending the stimulus of J-51 to the conversion of commercial nonresidential buildings⁵³ and eliminating the assessed valuation restriction⁵⁴ which had impeded the conversion of hotels into apartments, the city successfully used these available assets. Rehabilitation efforts in existing residential buildings increased as the city declared both rent stabilized and certain cooperatively owned buildings eligible for J-51 benefits.⁵⁵

49. Conversion of run-down hotels, particularly those composed of single occupancy rooms, was viewed as a means of eliminating their generally destructive impact on neighborhoods. *See* N.Y. Times, Dec. 2, 1977, at B7, col. 2 (conversion of West Side Towers, a single-room-occupancy hotel); N.Y. Times, July 21, 1976, at 37, col. 4 (conversion of McAlpin Hotel); N.Y. Times, March 21, 1975, at 60, col. 5 (conversion of Henry Hudson Hotel); N.Y. Times, Sept. 28, 1974, § 8 (Real Estate), at 1, col. 1 (conversion of Hotel Greenwich).

50. N.Y. Times, March 30, 1975, § 8 Real Estate at 1, col. 1; N.Y. Times, Feb. 3, 1977, at 35, col. 3; and N.Y. Times, June 29, 1975, § 8 Real Estate at 1, col. 6.

51. N.Y. Times, Jan. 4, 1978, at D16, col. 5 (tax arrearages indicated distress of real estate market).

52. N.Y. Times, Feb. 3, 1977, at 39, col. 2.

53. N.Y., N.Y. LAW 60 (1975).

54. Buildings with an assessed valuation of more than \$70 per square feet of lot area were not eligible for J-51 benefits prior to the enactment of Local Law No. 60 of 1975. Most hotels, office buildings and loft buildings carry substantially higher assessed valuations. *See* N.Y. Times, July 16, 1976, at B6, col. 3, and N.Y. Times, Aug. 8, 1978, at B4, col. 6, reporting that the Royal Manhattan Hotel had an assessment of \$6 million for fiscal year 1977-78, although it had been closed since 1974.

55. Prior to the enactment of Local Law No. 60 of 1975, buildings in the private sector were eligible for J-51 only if they were subject to rent control. Former Subdivision i (1) of § J-51-2.5 of the Administrative Code of the City of New York stated that the benefits of J-51-2.5 did not apply:

(1) except as provided in subdivision d, to any multiple dwelling which is not subject to the provisions of the emergency housing rent control law or to the city rent and rehabilitation law, or to the private housing finance law, provided that where the benefits herein provided are granted by the tax commission to any multiple dwelling which is decontrolled subsequent to the granting of such benefits, the tax commission shall withdraw such benefits, effective upon the com-

There is no doubt that revitalization of New York City's real estate market in 1975 required major inducements and incentives.⁵⁶ The Beame Administration's expanded J-51 program, more than any other factor, promoted rehabilitation efforts which eventually became both self-generating and contagious.⁵⁷ Gradually, self-confidence returned to the real estate market and the depressed prices of 1975 vanished.⁵⁸

II. LIMITATIONS UPON THE AMOUNT, DURATION AND AVAILABILITY OF TAX EXEMPTION AND ABATEMENT

In shaping a tax abatement program, municipalities must determine both the amount and the duration of the tax relief to be given as well as the overall limitations which should be imposed as a condition for receiving benefits. Tax abatement statutes, however, cannot be drafted to provide the minimum amount of inducement necessary to prompt every owner to upgrade or rehabilitate his property. Varied structures exist in diverse neighborhoods. In a neighborhood where deterioration is rampant, no amount of abatement will act as a catalyst for the infusion of private capital. In a transitional neighborhood, tax exemption and abatement by itself, or given in conjunction with a municipal loan, may act as a housing preservation tool and stem further decay. In fashionable urban enclaves, with low vacancy rates, tax abatement may not even be necessary to encourage build-

mencement of the first tax year following the tax year in which such multiple dwelling is decontrolled. . . .
Local Law No. 60 of 1975 amended § J-51-2.5(i)(1) to provide:

(1) except as provided in subdivision d, to any multiple dwelling which is not subject to the provisions of the emergency housing rent control law or to the city rent and rehabilitation law or to the city rent stabilization law or to the private housing finance law or to any federal law providing for supervision or regulation by the United States department of housing and urban development

56. See N.Y. Times, Oct. 17, 1976, § 8 (Real Estate), at 1, col. 1 ("J-51 . . . has provided stimulation for the construction industry at a time of extreme stagnation").

57. See N.Y. Times, Sept. 16, 1977, at B11, col. 3 ("A whole new housing stock is in the making."); N.Y. Times, Aug. 24, 1977, at D13, col. 1 (describing revitalization in Washington Heights near West 181st Street and St. Nicholas Avenue in Manhattan); N.Y. Times, Feb. 4, 1977, at A13, col. 3 (describing residential renovation and upgrading triggered by J-51 in Brooklyn). *But see* Slayton, *State and Local Incentives and Techniques for Urban Renewal*, L. CONTEMP. PROB. 793, 799-800 (1960) (criticizing tax exemption and abatement as a misuse of the taxing power).

58. N.Y. Times, July 29, 1977, at A17, col. 1 (sales prices of cooperative apartments "are up, on average, about 25 percent in a year . . . and in some cases as much as 50 percent. In retrospect, 1974 and 1975 look like 'rock bottom.'").

ing improvements.⁵⁹

A. *Assessed Valuation Limitation*

The J-51 statute in existence in 1975 attempted to prevent its applicability to high income areas by making ineligible all properties having a total assessed valuation prior to rehabilitation of seventy dollars or more for each square foot of lot area.⁶⁰ The chief effect of this restriction, however, was to prevent the conversion of floundering hotels into apartment buildings.⁶¹ Flourishing hotels are usually situated on land carrying high assessed valuations. If the hotel later declines in value, however, changes in the assessed valuation often lag behind.⁶²

In 1968, for example, the McAlpin Hotel on Herald Square in Manhattan sold for \$7.5 million but was repossessed after the new owners defaulted on mortgage payments.⁶³ Eight years later, after serving as one of the city's largest hotels for sixty-four years, the hotel sold for \$2.5 million, reflecting its high vacancy rate and decline.⁶⁴ The developer credited his decision to purchase and convert the McAlpin into middle-income housing to the Dec. 31, 1975 amendments to J-51 eliminating the assessed valuation restriction.⁶⁵

There are inherent disadvantages in basing the availability of a tax abatement upon the assessed valuation of a building. Tax assessment

59. See N.Y. Times, July 21, 1978, at A13, col. 1.

60. Former Subdivision i(3) of § J-51-2.5 of the Administrative Code of The City of New York stated that the benefits of J-51-2.5 did not apply:

(3) To any property the plans for which are filed with the municipal agency having jurisdiction thereof on or after July first, nineteen hundred sixty-eight, having a total assessed valuation prior to conversion, alteration or improvement of seventy dollars or more for each square foot of lot area. Administrative Code of the City of New York § J-51-2.5 i(3).

61. See note 54 and accompanying text *supra*. The retention of the assessed valuation restriction would have also blocked the post-1975 conversion of many commercial properties into apartment buildings. N.Y. Times, July 16, 1976, at B6, cols. 2-3. 3 Hanover Square in Manhattan stood vacant for three years with an assessed valuation of \$3.35 million; its planned residential conversion at \$7 million was sparked by its eligibility for J-51 benefits. *Id.*

62. See, e.g., N.Y. Times, July 28, 1976, at 51, col. 3 (Royal Manhattan Hotel's accumulated tax arrearages at a rate of \$1 million annually after it had closed and produced no revenue).

63. N.Y. Times, July 21, 1976, at 37, col. 7.

64. *Id.*

65. *Id.*

programs are subject to the vagaries of a municipality's tax assessment policies and to individual assessments which frequently do not accurately reflect neighborhood stability, economic return or investment potential. In deteriorating or transitional areas, such a limitation prevents the use of tax abatement to curtail blight until assessments catch up with depressed values. Furthermore, establishing the dollar amount of assessed valuation which can cause the desired renovation is difficult, if not impossible. If the dollar limit is set too low, there will be no stimulus for buildings which the program should address. If the dollar limit is too high, it will fail to bar unnecessary tax relief.

B. *Area Limitations*

The city considered and rejected the alternative of limiting tax abatement to specified neighborhoods. This approach was undesirable for several reasons. Choosing among competing neighborhoods generates intense political pressure and friction which frequently makes the selection of a neighborhood something less than rational. Once an area is revitalized and no longer requires assistance, it is politically difficult, if not impossible, to have the area undesignated. Refurbishing one or a few areas and excluding others would be discriminatory; the need for preservation help was city-wide. Even in more affluent neighborhoods, pockets of decay existed. Past experience revealed that denying one neighborhood the intensive care given to another neighborhood signaled a lack of governmental concern and accelerated the neglected area's decline.

Any municipality's decision to single out an area for special tax treatment must be based on public need.⁶⁶ A city has considerable freedom in selecting the objects of taxation and in granting exemptions. The exercise of this power, however, is subject to the requirements of the due process and equal protection clauses of the Fourteenth Amendment proscribing arbitrary or invidious exemp-

66. See *City of Columbus v. Muscogee Mfg. Co.*, 165 Ga. 259, 262, 140 S.E. 860, 861 (1927) ("The grant of an exemption from taxation rests upon the theory that such exemption will benefit the body of the people, and not upon any idea of lessening the burdens of the individual owners of the property."); *Akari House, Inc. v. Irizzary*, 81 Misc. 2d 543, 549, 366 N.Y.S.2d 955, 962-63 (Sup. Ct., N.Y. Cty 1975) (neighborhood rehabilitation serves a public purpose for which tax abatement may be granted). See also notes 68-69 and accompanying text *infra*.

tions from taxation.⁶⁷ To establish valid classification areas, the state enabling statute must set forth reasonable and rational legislative findings of fact⁶⁸ which indicate the need for and the public purpose to be served by the exemption.⁶⁹ These findings should be made by

67. *Ohio Oil Co. v. Conway*, 281 U.S. 146, 159-60 (1930), wherein the Court stated:

The States, in the exercise of their taxing power, . . . are subject to the requirements of the due process and the equal protection clauses of the Fourteenth Amendment

With all this freedom of action, there is a point beyond which the State can not go without violating the equal protection clause. The State may classify broadly the subjects of taxation, but in doing so it must proceed upon a rational basis. . . . The rule is generally stated to be that the classification 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike.'

68. In *Yonkers Community, Etc. v. Morris*, 37 N.Y.2d 478, 335 N.E.2d 327, 373 N.Y.S.2d 112 (1975), plaintiffs alleged that the proposed exercise of the condemnation power to effectuate an urban renewal plan in Yonkers would be unconstitutional because the land was not substandard and its taking would serve a private as opposed to a public purpose. The court upheld the taking, but it clearly indicated that there must be a factual basis to support a governmental agency's conclusion that the land was substandard. The court observed that "even where the law expressly defines the removal or prevention of 'blight' as a public purpose and leaves to the agencies wide discretion in deciding what constitutes blight, facts supporting such a determination should be spelled out." *Id.* at 484, 335 N.E.2d at 332, 373 N.Y.S.2d at 119. It would be equally necessary to factually substantiate the need for a grant of tax abatement to specified areas.

Article XIV, § 704-a(4), of the New York Private Housing Finance Law authorizes the New York City Rehabilitation Mortgage Insurance Corporation to designate areas within the city as special rehabilitation insurance areas based upon a finding by the Corporation that such areas contain a preponderance of housing accommodations susceptible to preservation and rehabilitation through the extension of private mortgage loans insured by the Corporation pursuant to § 704-a. N.Y. PRIV. HOUS. FIN. LAW § 704-a 4. (McKinney Cum. Supp. 1978-79).

69. In *City of New Orleans v. Dukes*, 427 U.S. 297 (1976), the Supreme Court upheld the constitutionality of a local ordinance prohibiting pushcart food sales in the old French Quarter by those vendors who had operated in the area for less than eight years

When local economic regulation is challenged solely as violating the Equal Protection Clause, this Court consistently defers to legislative determinations as to the desirability of particular statutory discriminations. . . . Unless a classification trammels fundamental personal rights or is drawn upon inherently suspect distinctions such as race, religion, or alienage, our decisions . . . require only that the classification challenged be rationally related to a legitimate state interest.

Id. at 303. See *Erie County Water Auth. v. County of Erie*, 47 App. Div. 2d 17, 20, 364 N.Y.S.2d 626, 628 (1975) ("Generally, . . . ownership by one specified by the Legislature as entitled to exemption, standing by itself, is not sufficient to qualify

the local legislative body or a municipal agency at the time of designation to establish that the need does in fact exist.⁷⁰

C. *Rent Restrictions*

In 1975, J-51 tax incentives were available only to those buildings subject to rent control.⁷¹ Six years earlier, New York City had insti-

property as tax exempt. The property must also be used for a purpose recognized by the Legislature as qualifying for tax exemption."'). *Eyers Woolen Co. v. Town of Gilsum*, 84 N.H. 1, 8, 146 A. 511, 515 (1929). *But see Hotel Dorset Co. v. Trust for Cultural Resources of the City of New York*, 46 N.Y.2d 358, 385 N.E.2d 1284 (1978) (New York Court of Appeals minimized the need for justifying tax treatment beneficial to only one geographical area at the time the appeal was heard).

In *Hotel Dorset Co.*, the court upheld a statute drafted in general terms to assist diverse cultural institutions in the state, but which, because of restrictive eligibility requirements, only benefited New York City's Museum of Modern Art. Rather than examining whether the statutory requirements were rationally related to the legislative objective, the court gave considerable weight to legislative findings expounding the necessity to preserve and foster cultural institutions. The majority opined that so long as there was no showing that other cultural institutions could not qualify for the same exemption in the future, the statute was not proscribed special legislation applicable only to a single enterprise.

70. In *Akari House, Inc. v. Rizzary*, 81 Misc. 2d 543, 366 N.Y.S.2d 955 (N.Y. City Sup. Ct. 1975), the court upheld the constitutionality of a statute providing that upon the expiration of any tax exemption granted to a redevelopment project pursuant to Article V of the New York Private Housing Finance Law, tax exemption would be further granted for a 10-year period on a declining scale until the property became fully taxable at the end of the 10-year period. The court found that redevelopment projects represented a rational classification for tax exemption. Although not discussed by the court, no public hearings were attendant to this further grant of tax exemption or to the original grant. Redevelopment company projects must be approved, however, by the local legislative body. *See* N.Y. PRIV. HOUS. FIN. LAW § 114 (McKinney 1976).

Chapter 414 of the Laws of New York of 1971 under attack in *Association of the Bar of City of N.Y. v. Lewisohn*, 34 N.Y.2d 143, 313 N.E.2d 30, 356 N.Y.S.2d 555 (1974), authorized the city to adopt a local law after a public hearing providing for the taxation of real property owned by an association which was not organized or conducted exclusively for religious or charitable purposes.

Public hearings are usually held with respect to the proposed designation of areas for slum clearance and urban renewal. *See* N.Y. GEN. MUN. LAWS § 505 (McKinney 1974).

71. Local Law No. 14 of 1959 denied J-51 benefits to multiple dwellings not subject to the city rent control law. In *Matter of Grossman v. Wagner*, 20 Misc. 2d 707 (N.Y. City Sup. Ct. 1959), the court held that this amendment to the then J-51 law was constitutional and binding upon the petitioner even though he had altered and improved his property prior to the amendment. Citing *Wisconsin & Michigan Ry. Co. v. Powers*, 191 U.S. 379 (1903), the court in *Grossman* stated that reliance upon a general statute of tax exemption did not create a contract to grant tax exemption. 20 Misc. 2d at 713-14.

tuted another rent regulation program known as rent stabilization.⁷² The rent stabilization program provided for the creation of a rent guidelines board, comprised of representatives of tenants, owners and the public, to promulgate annual guidelines for rent adjustments⁷³ based upon cost of living and real estate market data.⁷⁴ Since July 1, 1974, all rent controlled units become subject to rent stabilization as they are vacated.⁷⁵

As the city gradually phased out rent control and replaced it with rent stabilization, many owners were reluctant to subject their buildings to rent control's generally more restrictive provisions. By 1975, J-51's rent control requirement had virtually eliminated any inducement to reconstruct the entire interior of a building for residential use. Owners feared that rents would not be allowed to keep up with financing costs, maintenance and operation, and would not yield a reasonable rate of return over the extended period of the exemption and abatement.

The Beame Administration concluded that tax abated properties should be subject to some form of rent restriction for the substantial benefit given by J-51. It was decided, however, that rent stabilization, and not rent control, should regulate the rentals of units which, except for this J-51 requirement, would not be subject to regulation.⁷⁶ No other additional rent restrictions were placed upon J-51 assisted units and these units remain subject to the same form of rent regulation as other non-assisted buildings. A rent controlled unit in a building receiving J-51 benefits, for example, remains subject to rent control until, upon being vacated, the building goes into rent stabilization.

Unless the municipality has some extensive form of existing rent control, the imposition of rental regulations upon tax-abated units will necessitate the creation of a large administrative staff. Treating these units differently from non-tax-abated units by imposing rent controls will be particularly costly and burdensome upon their owners who will have to become familiar with another set of regulations. To obviate hiring a huge staff to establish first rents for each reno-

72. N.Y., N.Y. LAW 16 (1969).

73. NEW YORK CITY, ADMINISTRATIVE CODE § YY 51-5.0.

74. *Id.*

75. Emergency Tenant Protection Act of 1974, Chapter 576 of the Laws of New York of 1974.

76. Local Law No. 60 of 1975. N.Y., N.Y. LAW 60 (1975).

vated unit, New York City decided to let the market establish the first rental where there had been total reconstruction and thereafter to allow increases under rent stabilization.⁷⁷ To ensure future maintenance of benefitted properties a municipality should allow the fixing of first rents at a level sufficient to cover maintenance and operation costs and debt service. The level also should provide a rate of return comparable to other investments of similar risk.

D. *Profit Restriction*

Other limitations proposed as a *quid pro quo* for receiving tax abatement are restricting the profit an owner may realize after tax relief or making properties ineligible for abatement if the rate of return exceeds a percentage of the assessed value of the property.⁷⁸ Implementation of the former restriction requires perpetual regulation and investigation of tax-abated properties. These limitations could only be effectuated by extremely tedious work requiring the employment of a sizeable bureaucracy to police the profits. The opportunity for graft would be epidemic. Moreover, imposition of a profit restriction would kill all incentive for investment unless the rate of return was left sufficiently high to assure the owner of enough profit to provide compensation for his risk and work. To attempt to legislate such return or even to delegate it to an administrative body will invariably result in the curtailment of rehabilitation activity.

The real estate market constantly fluctuates. No collection of legislators or public administrators possesses the knowledge necessary to establish the minimum rate of return which will induce the desired renovation. In periods of rapid inflation, particularly in older cities such as New York, plagued with a transitional economy and high unemployment, it remains unlikely that any rehabilitation will be undertaken where profits are limited over a long period, without an additional sweetener.

E. *Dollar Limit of Abatable Cost Per Dwelling Unit*

To ensure no loss of tax revenues for luxurious alterations J-51 was amended in 1975 to control the maximum amount of rehabilitation work which each owner can abate per apartment.⁷⁹ Only the work

77. *Id.*

78. *See, e.g.*, S. 8346, A. 10992, New York State Legislature, 1978.

79. N.Y., N.Y. LAW 60, § 3 (1975), amending subdivision c of § J-51-2.5 of the Administrative Code of the City of New York, provided that:

necessary to create a habitable unit is abatable. If a higher standard is preferred, the owner assumes the extra cost over the livable level. J-51 empowered the city's housing agency, the Department of Housing Preservation and Development (HPD),⁸⁰ to establish the "habitable" level through the promulgation of regulations.

The J-51 statute confines abatement to ninety percent of the reasonable cost of the improvement, alteration, or conversion.⁸¹ The city has employed rehabilitation specialists for a number of years to examine the cost of the work allegedly completed by an applicant. If the actual costs are in excess of what the specialist deems to be the reasonable or average cost, only the reasonable cost is abated.⁸²

HPD's predecessor agency, in 1976 pursuant to the 1975 law, developed standards to establish the maximum dollar limit of abatement per apartment.⁸³ To determine this dollar limit for apartments, the cost to construct a basic studio apartment, including its major components, a kitchen and bathroom, was first determined.

After these basic costs were determined, HPD established adjust-

[I]n no event shall such abatement in the aggregate exceed ninety per centum of such reasonable cost thereof or in the aggregate exceed such dollar limit per existing class A dwelling unit or additional unit created by conversion to a class A multiple dwelling as may be established pursuant to rules and regulations promulgated by the department of development pursuant to subdivision m of this section. . . .

80. HPD was created in July 1977. N.Y., N.Y. LAW 29 (1977). Its predecessor was the Housing and Development Administration (HDA). The Department of Development within HDA administered the city's J-51 program. References in this Article to HPD are attributable to HDA if the events or activities occurred prior to July 5, 1977.

81. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(c) (1977).

82. In *Matter of Deull v. Housing and Dev. Administration*, 40 A.D.2d 803 (1972), HDA's determination of reasonable cost with respect to alterations and improvements for which abatement was sought, was remanded to HDA for reconsideration. The court found that HDA had apparently disregarded the actual cost and its reasonableness in relation to the work done, one factor which the court felt HDA should consider in determining reasonable cost. The fixing by HDA of an allowable cost based upon standard room and unit allowances without due consideration of whether or not the standard allowances were reasonably applicable to particular improvements was held to be an insufficient basis upon which the determination could be made. The J-51 statute at the time of the proceeding did not contain a dollar limit on the amount of abatement allowable per dwelling unit.

83. N.Y. MULT. DWELL. LAW § 4 (McKinney 1974); Rules & Regs. Governing Tax Exemption & Tax Abatement, New York City Record, Nov. 30, 1976, at 3758 (implementing N.Y. REAL PROP. TAX LAW § 489 (McKinney Supp. 1978-79); NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5 (1977).

ments for additional rooms in excess of the base cost. For a building, HPD set the dollar limit by aggregating the base cost and additional room adjustment of all of its dwelling units.⁸⁴

The dollar limit per dwelling unit may discourage a higher standard of construction work in areas or buildings where there is no market demand for higher or premium quality. The dollar limit may also benefit some buildings which would have been improved without tax abatement. Undoubtedly the dollar limit also encourages, however, many beneficial rehabilitation efforts which would never have materialized had limitations other than the reasonable cost of the basic improvement been employed.

F. *Limit on the Amount and Duration of Tax Abatement and Exemption*

J-51 sets the boundaries of tax relief by limiting the amount of tax abatement to ninety percent of the reasonable cost of the conversion, alterations or improvements and by allowing abatement for not more than twenty years.⁸⁵ Only 8 1/3 percent of this cost can be abated in any one year.⁸⁶ If the abatement is greater than the amount of real estate tax payable, none is paid. Tax exemption on account of these improvements expires after twelve years.⁸⁷

Other state statutes⁸⁸ establish a minimum tax or provide for a graduated decline of tax exemption and abatement over a fixed term. The minimum tax has the disadvantage of sometimes frustrating those projects most in need of tax relief. Some buildings, especially older multiple dwellings, will not find a lender if it is necessary to pay taxes at the outset when the building may be renting up and the risks are substantial. The declining exemption scale may ease the difficulty of going from full exemption to none. The administration of this formula, however, is somewhat more complicated, and it is unfavorable to those projects needing a large infusion of cash at the start through the early years after rehabilitation.

84. *Id.*

85. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(c).

86. *Id.*

87. *Id.* § J-51-2.5(b).

88. N.Y. REAL PROP. TAX LAW § 421 (McKinney Supp. 1978-79). *See* Teleon Realty Corp. v. City of New York, 88 Misc. 2d 767 (N.Y. City Sup. Ct. 1976) (court found that New York City had improperly calculated the minimum tax payable by plaintiff). *See also* 1974 N.Y. LAWS, ch. 941.

The reduced tax payments in the first twelve years on a J-51 building flowing from the combined effects of exemption and abatement provide a strong selling point to bankers and developers. By permitting greater amortization of debt in the early years of a loan term, the investment is made less risky. Any inequities in the city's tax assessments are nugatory because the taxes, if any, are greatly reduced.

The period of tax abatement should be consistent with standard banking practices. If only short-term loans are being made, it serves no purpose to have a considerably longer abatement period; estimated tax savings in the later years will not be taken into account. The longer loan period does assist major projects where much of the abatement is taken the period of tax exemption has expired.

The fear that a twenty-year abatement period will cause a building to go "cold turkey" at its tax abatement termination can be mitigated by more rapid amortization in the earlier years. If the municipality allows the owner to match and maintain rents with his expenses and if a large portion of the rehabilitation cost has been amortized, the project should be able to pay for itself upon the expiration of the abatement. Of course, if the assessed valuation of the property is substantially higher than its economic value or if the municipality has allowed the real estate tax rate to skyrocket, the loss of abatement will cause problems. Under these circumstances, however, the building's problems will not be attributable to the loss of abatement but to bankrupt municipal policies, and a declining scale of benefits will only exacerbate the building's woes.

III. ELIGIBILITY CRITERIA AND QUALITY SPECIFICATIONS

Only after a city has established the overall limitations and the amount and duration of exemption and abatement can the municipality examine other eligibility or project quality specifications which it might impose to achieve administrative efficiency or desired policy objectives.

A. *Eligible Buildings*

1. Class A Multiple Dwellings

The J-51 statute specifically defines eligible buildings. First, the statute classifies the types of buildings for which assistance can be granted. In New York City, for example, only residential multi-fam-

ily dwellings qualify.⁸⁹ These eligible, or "class A multiple dwellings," are apartment buildings in which each unit has a kitchen, a bathroom and separate egress to common areas.⁹⁰

J-51 allows abatement for only that part of the building devoted to actual, permanent residential occupancy. An owner demonstrates this occupancy by showing a signed, residential lease with a term of at least one year or actual occupancy by a person in uninterrupted residence in the building for at least one year.⁹¹

Buildings providing single-room occupancy (SROs) are ineligible for tax abatement because of a legislative determination that this type of residency should not be encouraged or assisted.⁹² SROs often have contributed to the deterioration of neighborhoods because of the unstable tenancy attracted to them. The *New York Times* described one SRO hotel on the West Side of Manhattan as "an incredible chamber of horrors"⁹³ and another hotel in Greenwich Village as a haven for derelicts and dope addicts.⁹⁴

Tax relief is not granted for work executed in any section of a building used for commercial purposes⁹⁵ or for any portion of a building which represents an increase in a building's gross cubic content from that in existence prior to the alterations or conversion.⁹⁶ Thus, the cost of a story added as part of the reconstruction is subject to full taxation. The J-51 program is limited solely to preserving what was in existence prior to the renovation. Unfortunately, this narrow scope occasionally impedes the conversion of SROs and non-

89. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(b).

90. N.Y. MULT. DWELL. LAW § 4 (McKinney 1974); Rules & Regs. Governing Tax Exemption & Tax Abatement §§ 1.2, 3 2(8), New York City Record, Sept. 29, 1977, at 2895-2899 (implementing N.Y. REAL PROP. TAX LAW § 489 (McKinney Supp. 1978-79) and NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5 (1977)) [hereinafter cited as Rules & Regs.]

91. RULES & REGS. § 3.2(7).

92. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(d)(2) (1977).

93. N.Y. Times, Dec. 2, 1977, at B7, col. 1 (West Side Towers on Broadway between 75th and 76th Streets in Manhattan).

94. N.Y. Times, Sept. 28, 1975, § 8 Real Estate, at 1, col. 2. The Hotel Greenwich was opened in 1897 as a "stately, 20 cent-a-night place of accommodation for the poor but respectable workingman." In the 1950's, the hotel's respectable inhabitants started moving out as drunkards and derelicts moved in. The Greenwich was transformed, with J-51 assistance, into a 190-unit apartment building. *Id.* at 12, col. 5.

95. RULES & REGS. § 3.4(1)(b); NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(d)(3)(e).

96. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(b).

residential buildings where economically feasible rehabilitation requires an increase in the size of the structure.

2. Cooperatives and Condominiums

In 1975, private apartment houses owned by the occupants as a cooperative or as condominium units first became eligible for J-51 benefits.⁹⁷ Tax relief is generally available only to newly created cooperatives and condominiums; that is, buildings where the work for which the abatement is given is completed within three years after the state's attorney general has accepted the prospectus to establish such a cooperative or condominium.⁹⁸ Furthermore, some existing cooperatives which are receiving or have received assistance from the city, New York State or HUD are also eligible for J-51 benefits.⁹⁹ The

97. N.Y., N.Y. LAW 60, § 5 (1975), amended the NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(d)(3) to provide that the benefits of § J-51-2.5 shall apply:

(3) to any building or structure otherwise eligible for any of the benefits of this section which after conversion, alteration or improvement: (i) is operated exclusively for the benefit of persons or families who are entitled to occupancy by reason of ownership of stock in the corporate owner, or (ii) is owned as a condominium situated in a building which is occupied as the residences or homes of three or more families living independently of each other provided, however, that the benefits of subdivision c of this section shall apply only to such buildings or structures (1) which are so converted, altered or improved with the aid of a loan provided by the [C]ity of New York or the United States [D]epartment of [H]ousing and [U]rban [D]evelopment or (2) to such privately financed buildings or structures which are converted, altered or improved within five years after filing of the initial prospectus to establish such cooperative or condominium entity with the attorney general.

98. N.Y., N.Y. LAW 48, § I (1976), amended § J-51-2.5(d)(3)(ii)(2) to define new or newly created condominiums or cooperatives as those which are "converted, altered or improved within three years after acceptance of the prospectus to establish such cooperative or condominium entity by the attorney general of the state of New York."

99. N.Y., N.Y. LAW 48 (1976). Section J-51-2.5(d)(3)(ii) of New York City's Administrative Code grants J-51 benefits to eligible cooperatives and condominium entities if they:

(1) are receiving or have received assistance from the city, state or the United States [D]epartment of [H]ousing and [U]rban [D]evelopment for rehabilitation, new construction or occupancy therein, provided such buildings or structures are not receiving tax exemption or tax abatement for new construction or rehabilitation as provided in paragraph 3 of subdivision i . . .

Section J-51-2.5(i)(3) of the Code provides that benefits of the Section shall not apply:

(3) to any property receiving tax exemption or abatement concurrently for rehabilitation or new construction under any provision of New York State or New York city law with the exception of any alteration or improvement to property receiving such tax exemption or abatement under the provisions of the pri-

legislature adopted this provision to help those buildings whose owner occupants have incomes which cannot support necessary major improvements without tax relief.

New York City has an exceptionally large rental housing stock. Incentives to induce conversion of either rental apartments in need of improvements or of an entire building into owner-occupied units were highly desired. Typically, owner-occupied buildings are better maintained, produce more taxes and are far less likely to be abandoned than rental properties.¹⁰⁰ Furthermore, the city recognized the need to attract and retain a taxpaying middle class, and perceived that the generally better quality of units which are renovated for sale to owner occupants might implement this objective.

3. Structures Converted to Residential Use

The 1975 legislative amendments expanded J-51 benefits for the first time to nonresidential structures converted to residential use.¹⁰¹ Retrospectively, the amendments constituted one of the most successful innovations of the program. Aside from the aesthetic pleasure of experiencing New York City's history through the revived facades and architectural details of the city's magnificent old buildings, the amendments triggered a host of conversions which both expanded the supply of decent, moderately priced housing and caused an economic resurgence in many parts of the city.¹⁰²

Just as the soft office market of the mid-1970's provided the impetus to convert a number of office buildings into residential use, the

vate housing finance law, provided, however, that the benefits of this section shall not apply to any alterations or improvements done in connection with the refinancing of a housing project pursuant to section 223f of the national housing act, as amended.

100. See N.Y. Times, July 31, 1978, at B10, col. 1 (approximately 500,000 apartments in New York City are under rent control and 800,000 apartments are covered by rent stabilization); N.Y. Times, April 3, 1978, at B3, col. 4 (president of a community group in Brooklyn's Clinton Hill area reported that "[e]very building that's falling down is a rental building. Every [one that] is well-maintained is a co-op.").

101. N.Y., N.Y. LAW 60 § 6 (1975) (deleting a provision of the NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(i)(2), which provided that the benefits of the section did not apply to any nonresidential building or structure unless in an area where a plan of redevelopment was being carried out).

102. N.Y. Times, Feb. 3, 1977, at 35, col. 2 and at 39, col. 2; N.Y. Times, March 15, 1978, at D17, col. 3; N.Y. Times, July 14, 1978, at A13, col. 1; N.Y. Times, July 19, 1978, at D1, col. 4. See also the following articles in the *New York Times* discussing the proposed conversion, with J-51 tax relief, of specific factories, office buildings and hotels.

sharp decline in manufacturing activity in the city prompted the conversion of loft buildings and factories.¹⁰³ The planned conversion of

Factories

1. Turtle Bay Towers at 310 E. 46th Street, Manhattan, a 1929 factory loft, N.Y. Times, July 7, 1977, at C10, col. 1.
2. The Ex-Lax Building, Atlantic Avenue, Brooklyn, originally a brewery prior to 1925, N.Y. Times, April 28, 1978, at B5, col. 1.
3. The Bakery, 325 E. 64th Street, Manhattan, the former Gnome Bakers Plant, N.Y. Times, July 21, 1978, at A13, col. 1.

Office Buildings and Other Commercial Structures

1. 31 Union Square West, Manhattan, a 16-story office building, N.Y. Times, Mar. 30, 1975, § 8 Real Estate, at 1, col. 1.
2. Three Hanover Square, Manhattan, a 24-story office building and 79 Pine Street, Manhattan, a 12-story commercial building, N.Y. Times, July 16, 1976, at B6, col. 2.
3. 244 Madison Avenue, a 61-year-old office building, on the southwest corner of 38th Street, Manhattan, N.Y. Times, Oct. 17, 1976, § 8 Real Estate, at 1, col. 1.
4. 111 Fourth Avenue, a 13-story office building erected for a mail-order suit company in 1922, on the southeast corner of 12th Street, Manhattan, N.Y. Times, Jan. 21, 1977, at A17, col. 3.
5. The Cast-Iron Building at 67 West 11th Street, Manhattan, N.Y. Times, Feb. 3, 1977, at 39, col. 3.
6. Federal Archives Building, an 1899 specimen of Romanesque Revival architecture, originally the United States Appraisers Warehouse, occupying the full block between Washington and Greenwich Streets and Christopher and Barrow Streets, Manhattan, N.Y. Times, July 15, 1977, at B5, col. 1.
7. 100 Hudson Street, Manhattan, N.Y. Times, Sept. 16, 1977, at B11, col. 3.
8. Financial District Office Buildings, Manhattan, N.Y. Times, July 14, 1978, at A13, col. 1.

Hotels

1. Henry Hudson Hotel, Manhattan, N.Y. Times, Mar. 21, 1975, at 60, col. 5.
2. Hotel Greenwich, Manhattan, N.Y. Times, Sept. 28, 1975, § 8 Real Estate, at 1, col. 1.
3. McAlpin Hotel, Manhattan, N.Y. Times, July 21, 1976, at 37, col. 4.
4. Royal Manhattan Hotel, Manhattan, N.Y. Times, July 28, 1976, at 51, col. 1, and N.Y. Times, Aug. 8, 1978, at B4, col. 1.
5. St. George Hotel, Broadway and 12th Street, Manhattan, N.Y. Times, Feb. 3, 1977, at 39, col. 5.

The provisions of J-51 encouraged commercial conversions throughout the city. See N.Y. Times, July 14, 1978, at A13, col. 1 (financial district of lower Manhattan); *id.*, Sept. 16, 1977, at B11, col. 3 (SoHo and NoHo) (south and north of Houston Street in Manhattan) and Tribeca (triangle below Canal Street in Manhattan); *id.*, Feb. 4, 1977, at A13, col. 3 (uptown Manhattan); *id.* at col. 4 (Brooklyn Heights, Cobble Hill and Carroll Gardens sections of Brooklyn); *id.*, April 28, 1978, at B5, col. 1 (Boerum Hill section of Brooklyn).

103. N.Y. Times, March 30, 1975, § 8 Real Estate, at 1, col. 1. A prominent example of a proposed factory conversion involved the former Ex-Lax industrial production facility in downtown Brooklyn. After manufacturing ceased at the Ex-Lax plant in 1975, the building remained vacant for three years until recycling became feasible

a sixty-one-year-old building on the corner of 38th Street and Madison Avenue is illustrative of J-51's impact upon underutilized and functionally obsolete office buildings.¹⁰⁴ Having fallen into foreclosure after standing largely vacant for several years, conversion was an attractive proposition for its new owners because the projected time for the total reconstruction of the interior was only nine months. Construction of a comparable new apartment house would take two or more years.¹⁰⁵ Second, as a distressed property, the office building was purchased at a cost which made rehabilitation practical.¹⁰⁶

The recycling of other commercial structures was seized upon because of their unique architectural features which made them particularly desirable for residential use. A turn of the century office building in Union Square, for example, which had ceased to be economically viable, was thought ideal for residential use: "[I]t's a magnificent building, built like a fortress . . . [T]he walls are 18 inches thick, and the ceilings are more than 11 feet high. It's less than a block from Fifth Avenue, on a park and with an almost unobstructed view to the south."¹⁰⁷

Commercial conversions present land use and development considerations which every municipality enacting similar incentives should address. J-51 benefits are available only for legal conversions in contrast to the proliferation of illegal loft conversions in lower Manhattan.¹⁰⁸ There must be compliance with the State Multiple Dwelling Law imposing health and safety requirements in multi-family buildings; the city's building code setting forth construction standards; and the zoning resolution controlling permissible land uses, applicable bulk standards such as height, setbacks and floor areas, and permitted residential density.¹⁰⁹

with the availability of J-51. The planned conversion of the factory into 57 cooperative apartments with 7,000 square feet of commercial space was labeled a "pioneering" undertaking in the Boerum Hill area. *Id.*, Apr. 28, 1978, at B5, col. 1.

104. N.Y. Times, Oct. 17, 1976, § 8 Real Estate, at 1, col. 1.

105. *Id.* at col. 5.

106. *Id.*

107. N.Y. Times, March 30, 1975, § 8 Real Estate, at 1, col. 4. *See also* N.Y. Times, Feb. 3, 1977, at 39, col. 3-4 (a building designed by John Kellum in 1868 typified the sort of buildings undergoing construction with its "elaborate facade detail, large windows and open and hence flexible floor areas within.").

108. N.Y. Times, Apr. 12, 1978, at D12, col. 1; N.Y. Times, Sept. 16, 1977, at B11, col. 3.

109. For a discussion of the laws applicable to the conversion of commercial

Since architects seldom design commercial structures with any thought of subsequent residential use, most conversions could not meet New York's Multiple Dwelling Law requirements. In response to the growing emphasis upon residential conversions, the legislature amended this law to provide more flexible standards for the customary apartment house requirements relating to light, air, egress and fire safety.¹¹⁰ Similarly, the city zoning resolution has been amended to permit planned conversion in a more individualized manner.¹¹¹

These land use policy questions cannot be ignored in implementing a tax incentive program to convert nonresidential structures into multi-family apartment buildings. Should residential uses be encouraged to intrude into manufacturing and commercially zoned districts? Should "bulk" requirements in commercial districts be modified to make residential conversion economically feasible? Will business be forced out by the conversions depriving a municipality of part of its economic base?

Housing officials believed that it was unclear whether J-51 prompted the decline of industrial properties and the dislocation of a few reported small businesses in lower Manhattan.¹¹² Of the estimated four thousand loft buildings south of 42nd Street, about one thousand as of April 1978 were reported to have been wholly or par-

structures into residential buildings, see Laber & Kretchmer, *New Legislative Acts Set Flexible Standards for Legal Conversions* N.Y. L.J. Nov. 16, 1977 at 25, col. 4.

110. *Id.* at 37, col. 2.

111. New York's Multiple Dwelling Law and J-51 apply with the same force to all buildings in the city. The zoning resolution, on the other hand, allows more individualized and more flexible planning by applying different controls depending on the building type and location. A lower Manhattan mixed use district was created, for example, to allow residential development in an area zoned for manufacturing purposes. A number of factors contributed to the decision.

First, no substantial new investment had occurred in industrial properties within the area in the last 20 years. The properties were underutilized and deficient in the quality of commercial space they could provide. At the same time, the failure to enforce land use and building laws had led to a drastic increase in illegal residential uses. Because of the increasing demand for loft living space, it was unlikely that the city could reverse the trend and enforce industrial use within the area's geographic boundaries. The city thought that residential use would encourage new development in an area containing attractive buildings amenable to conversion in proximity to open space. Furthermore, the action conformed with the commitment of public capital to establish high density residential zoning in the neighboring Washington Street Urban Renewal Area. N.Y., N.Y., ZONING RESOLUTION, art. 11, ch. 1 (1978).

112. N.Y. Times, July 19, 1978, at D1, col. 3; N.Y. Times, March 15, 1978, at D17, col. 4; N.Y. Times, Dec. 4, 1977, at 76, col. 4.

tially converted to residential use.¹¹³ Less than one hundred of these buildings constituted legal conversions eligible for tax abatement.¹¹⁴

In July 1978, the New York State legislature responded to the growing concern about illegal conversions and the dislocation of small businesses in areas ripe for conversion by enacting legislation providing penalties for the harassment of commercial tenants.¹¹⁵ In addition, the legislation mandated strict requirements to be complied with prior to the state attorney general's approval of an offering plan for the conversion of nonresidential property into a cooperative or condominium units.¹¹⁶

4. One- and Two-Family Houses

J-51 does not allow benefits for one- or two-family residences unless two criteria are satisfied: the residence must be located in an area where a plan of redevelopment or other concentrated program of governmental assistance is being carried out and the conversion or alteration must be in conformity with that plan.¹¹⁷ This is particularly sound policy in New York City where one- and two-family houses have enjoyed favored tax treatment through low assessed valuations.

Other municipalities, housing fewer people in multiple dwellings and containing distressed one- and two-family houses, will have to decide whether tax relief will rejuvenate them. Since one- and two-family houses are primarily owner occupied it is likely that they will be maintained as the owners' income permits. For impoverished owners, an outright subsidy would seem preferable to tax abatement because ongoing assistance is needed to maintain these homes.

B. *Elimination of Unhealthy or Dangerous Conditions in Existing Residential Buildings*

J-51 grants benefits for the rehabilitation of existing class A multiple dwellings only if the work eliminates "presently existing unhealthy or dangerous conditions" or replaces "inadequate and

113. N.Y. Times, Apr. 12, 1978, at D12, col. 3.

114. *Id.* at col. 4.

115. N.Y. Times, July 27, 1978, at 1, col. 2. 1978 N.Y. LAWS, ch. 508.

116. 1978 N.Y. LAWS, ch. 509.

117. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(i)(2).

obsolete sanitary facilities.”¹¹⁸ This clause limits the amount of abatement which can be granted to any owner who overhauls a building’s interior to create more units than in existence prior to the reconstruction. A building containing forty units, for example, which after gut rehabilitation consists of eighty units can receive J-51 tax advantages only for removing unhealthy and dangerous conditions in forty units. Thus, the regulations promulgated by HPD to implement J-51 base the dollar limit of abatable cost per dwelling unit on the number of dwelling units in existence prior to the rehabilitation.¹¹⁹ This restriction is not applicable to the reconstruction of a building which was not a class A multiple dwelling prior to conversion.

HPD’s interpretation assists the unwritten city policy of discouraging the break-up of larger apartments into smaller ones. The city imposes an analogous restraint upon structures which are converted to class A multiple dwellings. J-51 requires that the recycled building must provide bedrooms in a number which equals at least fifty percent of the apartments created or contains an average floor area of one thousand square feet if converted from nonresidential use.¹²⁰ Critics have charged that these limitations may interfere with market forces which dictate demand for studio apartments. Furthermore, the limitations increase the cost of rebuilding structures for occupancy by the elderly where a separate bedroom may not be needed or desired. The city has responded, however, that the restrictions represent the minimum level of size the city demands as consideration for its substantial subsidy.

Given this statutory framework focusing on “salvaging” a dwelling¹²¹ and the 1975 amendment creating a dollar limit per unit,¹²² the

118. *Id.* § J-51-2.5(b). Shortly after J-51’s enactment, case law indicates this limitation was strictly construed. In *Alwalt Realty Corp. v. Boyland*, 5 Misc. 2d 1061 (Sup. Ct., N.Y. Cty., 1957), for example, petitioner contested the city’s denial of tax relief for alterations executed at a claimed cost of \$93,000. The city alleged that the building was not standard and that there was no showing of a need to eliminate dangerous conditions. The court held that the proceeding was prematurely brought because petitioner’s administrative remedies had not been exhausted.

119. RULES & REGS., Rehabilitation Schedule.

120. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(d)(2).

121. In *Matter of Kreulen v. Boyland*, 8 Misc. 2d 895 (Kings City Sup. Ct. 1957), the court asserted that the purpose of the original J-51 legislation was to encourage owners “through tax allowances to alter and improve dwellings that can be salvaged” until new housing could be produced “in sufficient quantities to provide decent, safe and sanitary homes for lower income families.” *Id.* at 896.

In *Matter of Harby Realty Corp. v. Gilroy*, 17 Misc. 2d 76 (N.Y. City Sup. Ct.

city believed that benefits for work encompassing amenities such as air conditioning, kitchen cabinets, bath trim and accessories, removable appliances such as dishwashers or stoves, and paving for roof-top recreation, should not be allowed. The loss of tax relief for the cost of air conditioning and kitchen cabinets drew sharp retorts from the real estate industry because they comprise a sizeable part of the cost of any major rehabilitation effort.¹²³ HPD maintained, however, that these two items were not so much permanent improvements necessary to remove hazardous or unsanitary conditions as they were luxury items.

C. *Historic or Landmark Structures*

The necessity that the work eliminate unhealthy or dangerous conditions also limited the amount of abatement which could be granted for work done to the facade of a building of special architectural design and/or quality. Eligible exterior items included only waterproofing, painting, roofing and work involving the installation or repair of fire escapes, entrance doors and bucks and appropriate architectural fees.¹²⁴ This restraint proved troublesome for structures in designated historic or landmark districts and for historic or landmark buildings. The exterior of such a building must be re-

1958), the court upheld the denial of tax exemption and tax abatement benefits to a renovated building where the work commenced before March 1, 1955, the date the statutory benefits became available. The court found that "[t]he statute was not intended to give an unexpected windfall to the landlord who, previous to its enactment, filed plans for extensive alterations and conversions. Its sole purpose was to encourage salvaging premises for temporary decent housing. This petitioner was not so encouraging [encouraged] nor did it merely salvage the premises." *Id.* at 77.

In 1970, *Matter of Martell's Restaurant Corp. v. Housing and Dev. Administration*, 64 Misc. 2d 991 (N.Y. City Sup. Ct. 1970), the court upheld the right of the petitioner to receive J-51 benefits for alterations to a building which had existed as a class A multiple dwelling prior to 1935 but was not an "existing dwelling" within the meaning of Section J-51-2.5(a)(2) immediately prior to the renovation. The court indicated that a broader scope should be given to J-51, at least, in an area where allowable costs were not at issue:

The intent of the statute was to induce landowners to improve their buildings and to create new much-needed units in existing buildings. To further this end, the statute should be interpreted to encourage conversions rather than to circumscribe the activity with narrow, limited, strictly structured construction. Thusly construed, petitioner's building falls within the definition of "existing dwellings." *Id.* at 992-93.

122. N.Y., N.Y. LAW 60, § 3 (1975).

123. N.Y. Times, Jan. 21, 1977, at A17, col. 6.

124. RULES & REGS., Itemized Cost Breakdown Schedule.

paired or replaced to its original profile and details. This task becomes expensive when the structure's facade is badly deteriorated. J-51's habitable standard of repair directly conflicts with historic or landmark specifications, encouraging the less expensive route of blotting out the chipped or pitted architectural design.

The city now has adopted amendments to J-51 which provide tax relief for the restoration of the exterior facade of a historic or landmark building or one facing a public street in a designated historic or landmark district.¹²⁵ Before enacting similar legislation, a municipality should examine whether existing state or federal tax laws grant duplicative or sufficient inducement to cover this restoration.

D. *Energy Conservation Items*

In a decade marked by scarce and expensive energy sources, the use of tax abatement to induce energy conservation improvements deserves consideration. The city provides abatement for the installation of solar energy heating and individual building fuel computers to better regulate the level of heating and cooling.¹²⁶ Benefits for oil burner and incinerator upgrading have been granted for some time because they have a direct impact upon the quality of the city's air and the health of its inhabitants as well as the level of energy consumption.

E. *Building Must be in Good Repair and Condition*

Other standards imposed by New York City upon a J-51-benefited building mandate that upon completion of improvements, a building must be structurally sound, in compliance with building code re-

125. N.Y., N.Y. LAW 12, § 2 (1978), amended NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(b), to provide, in part, that:

b. Any increase in the assessed valuation of real property shall be exempt from taxation for local purposes to the extent such increase results from the reasonable cost of . . . (3) alterations or improvements to the exterior facade of a building or structure facing a public street pursuant to a certificate of appropriateness with respect to a designated historic or landmark site or structure provided that construction is completed within twenty-four months from the date on which it was started if started before January first, nineteen hundred seventy-nine or construction is completed within thirty-six months from the date on which it was started if started on or after January first, nineteen hundred seventy-nine. . . .

126. *See* RULES & REGS., Itemized Cost Breakdown Schedule.

quirements, free from hazardous or immediately hazardous conditions, and must contain both lawful sanitary facilities and a lawful kitchen or kitchenette for the exclusive use of the persons residing in each unit.¹²⁷

Although these basic habitable requirements generate little controversy, considerable administrative time must be spent to ensure they are met. Each building must be checked. The city's J-51 program provides that certification by a licensed architect or engineer as to the removal of any hazardous or immediately hazardous code violations constitutes proof of code compliance. This alternative procedure attempts to avoid lengthy delays caused by multiple inspections and the process of removing violations which have been corrected.¹²⁸ Furthermore, this certification procedure reduces the temptation to bribe inspectors either to certify or to speed up the certification processing. An architect or engineer risks losing a license for false certification, making such unscrupulous practices unlikely.

F. *Repairs*

In 1975, the city granted tax abatement for the first time for certain ordinary repairs and normal replacement of maintenance items, where the improvements

- (a) were started and completed within a twelve-month period;
- (b) were made to a common area of the building;
- (c) required the issuance of a permit for at least one item by a City agency; and
- (d) were made concurrently with a major capital improvement to the building. The amount of abatement granted is limited to four times the amount of this major capital improvement.¹²⁹

Tax relief for ordinary repairs represents a much disputed policy. Arguably, such abatement penalizes owners who maintain their properties while it rewards those who do not. Offering tax incentives for repairs, it is maintained, only invites an owner to postpone preventive maintenance until conditions deteriorate to a point where abatement is available.

By allowing benefits for ordinary repairs, the city sought to assist

127. *See Id.* at § 3.2(3)(4)(8); NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(g).

128. *Id.*

129. N.Y., N.Y. LAW 60, § 1 (1975), amending § J-51-2.5(a)(1).

buildings in transitional or run-down neighborhoods where ordinary maintenance had been neglected for a substantial period of time due to rent control policies or simply because a changing neighborhood pattern had effectively eradicated any incentive to keep up multi-family housing. Other municipalities should note that this objective can be best effectuated if abatement is permitted only once during a specified period: a time span long enough to deter the calculated accumulation of repair items.¹³⁰

Aware of both concerns and the unlikelihood that repairs alone will sufficiently extend the useful life of a building to enable New York City to recoup lost taxes in later years, the city attempted to preserve and improve at least some units by granting an abatement for limited repairs. In its regulations, HPD defined ordinary repairs to include only the replacement of any component part of any item of work listed as an eligible item of rehabilitation.¹³¹ Much intra-agency discussion preceded this determination.¹³²

130. *Id.* at § 6 (J-51 benefits do not apply to multiple dwellings for ordinary repairs and normal replacement of maintenance items in the event a dwelling is receiving J-51 benefits for these items as of the Dec. 31st preceding the date of the application).

131. RULES & REGS., Rehabilitation Schedule.

132. Several issues were raised prior to HPD's determination of ordinary repairs. The first question which arose was whether painting should be considered an ordinary repair. HPD's immediate concern was how this work could be verified. If inspection did not take place at the time the painting was done, it might be impossible to later confirm. It was felt that this was work an owner would do first and irrespective of tax abatement. Painting of lobbies and hallways costs little but can have a sizeable impact upon the rent roll of a building by creating a positive ambiance.

Real estate operators argued, however, that painting of common areas would prevent the attrition of a structure from normal wear and tear. Tax benefits for the painting of window frames and fire escapes were also pressed by the real estate industry for the same reason.

HPD ultimately held its position that only the new installation of a component part of an eligible item of work could be treated as an abatable repair. Thus, neither the repair of existing doors or windows in lieu of new ones, nor the repair of existing copings, cornices, fire escapes, handrails, or riser treads is allowed. If 15 feet of coping is replaced with new coping, or new windows are installed, however, J-51 applies even though not all of the coping or all the old windows are replaced.

The concept of replacement was a direct outgrowth of the view that abatement should be given for something new of value which will prolong the life of the building. As such, it can be documented easier than the repair of a fire escape where only the cost of labor could be abatable because no new materials are installed. Many viewed this type of repair as one which should be made at the owner's expense.

III. ONLY REASONABLE COST IS ABATABLE

A. *Determination of Reasonable Cost*

J-51 allows tax abatement only for the reasonable cost of the renovation.¹³³ To determine reasonable cost, HPD developed two schedules: the Rehabilitation Schedule and the Itemized Cost Breakdown Schedule. These schedules list all of the items of work eligible for J-51 treatment which HPD believed would comprise a structure's conversion to a class A multiple-dwelling or the rehabilitation of a class A structure to a safe and sanitary condition. These schedules reflect the city's determination of the reasonable cost of the listed items and the corresponding amount of maximum allowable abatement. They are updated annually. Items not listed on the schedules are not eligible for certification as to reasonable cost.

The applicant's certified reasonable cost, ninety percent of which may be tax abated, is the lesser of the allowable reasonable cost for each item of work as calculated pursuant to the Itemized Cost Breakdown Schedule, or the applicant's documented actual cost of each eligible item of work, or the dollar limit of abatable cost as computed pursuant to the Rehabilitation Schedule.¹³⁴

The "dollar limit" is the regulatory imposed outer limit.¹³⁵ The reasonable cost computation is another statutory check to prevent the city from granting tax abatement for luxury items and for work which costs more than the prevailing rate. By checking actual costs the city hopes to prevent owners from receiving more in abatement than they have actually spent.¹³⁶

133. NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(c).

134. RULES & REGS., Rehabilitation Schedule.

135. See note 79 and accompanying text *supra*.

136. In *225 E. 70th St. Corp. v. Weaver*, 6 N.Y.2d 197, 160 N.E.2d 459, 189 N.Y.S. 153 (1959), the court upheld the right of the City Rent Commission to adjust and revise rent increases obtained for capital improvements where the owner later was granted a tax abatement for the same improvement. The rationale behind the decision and others interpreting the J-51 statute is that tax abatement can be given only when renovation costs are actually incurred, for which compensation in no other form is realized. As the *Weaver* court observed:

[W]hen such tax abatement relief was later obtained by the landlord, the Rent Administrator was fully warranted in "adjusting" the rent increases previously granted, for, otherwise, the cost of the improvement would have been paid, in effect, twice, once by the tenants through rent increases and once by the city through tax abatement. The purpose of the local legislation was to assist owners to remove fire and health hazards and render less burdensome the replacement of inadequate and obsolete sanitary facilities by reducing the cost of the improve-

The comparison of actual and reasonable costs bars tax relief greater than the cost of the improvements or conversion and mitigates against the possibility of graft and windfall profits.¹³⁷ Past experience demonstrates that the benefits are still substantial enough to induce rehabilitation in areas where a developer can anticipate a favorable return on his investment.

This approach of checking actual costs and the cost of items against the schedules has been criticized by the real estate industry.¹³⁸ Arguably, the supervisory system penalizes the cost efficient person because he receives less abatement if the work is completed at prices below those deemed reasonable. The abolition of checking items of work against an Itemized Cost Breakdown Schedule has been suggested in favor of the dollar limit as the sole determinant of reasonable cost.¹³⁹

Another method for determining an abatable reasonable cost involves first establishing a minimum list of work to be done and then granting additional allowances for other necessary or appropriate work.

ments by a grant of tax abatement. While the legislation permitted the owners to reduce their cost, it was never its design that the landlords, in addition, would be entitled to receive thoroughly duplicating rent increases based upon the total expenditures for the same improvements.

Id. at 201, 160 N.E.2d at 461, 189 N.Y.S. at 156. See *Harby Realty Corp. v. Gilroy*, 17 Misc. 2d 76 (N.Y. City Sup. Ct. 1958).

137. See 225 E. 70th St. Corp. v. Weaver, 6 N.Y.2d 197, 160 N.E.2d 459, 189 N.Y.S. 153 (1959).

138. N.Y. Times, Jan. 21, 1977, at A17, col. 6. *Contra* N.Y. Times, Oct. 17, 1976, § 8 Real Estate, at 1, col. 1 ("J-51 has created what many builders consider the most effective governmental aid to their industry since Federal mortgage insurance became available four decades ago.").

139. If a developer renovates a fireproof building with interior stairs and no new fire escapes, for example, there would be no allowance for the reasonable cost of fire escapes from this schedule. The total reasonable cost calculated pursuant to the schedules thus becomes less than a comparable renovation of a building when fire escapes are installed. If a building requires somewhat less work because a component part such as an elevator or stairs is re-usable in the conversion, arguably, the acquisition cost for that building would generally be higher than that of a structure which required replacement of all of the items of work listed on the schedules. The higher acquisition cost is thought to cancel the greater construction cost.

While this approach would simplify the administration of the program, it also is somewhat inequitable in that buildings requiring less renovation than others would be eligible to receive abatement equalling the dollar limit which is based upon the cost of complete rehabilitation. If the practice of checking actual costs was retained the owner would be entitled to the lesser of the dollar limit or actual cost, eliminating any comparison of actual costs against reasonable costs except where the structure has been completely reconstructed.

The existing schedules attempt to establish this minimum level of rehabilitation work. Any discretionary additions to this minimum list, while theoretically appealing, could lead to the discriminatory application of tax abatement. Owners capable of influencing governmental officials or employees might receive a higher reasonable cost allocation than was actually warranted. Indeed, the best advocate or processing expert would most likely maximize abatement if the city adopted this sort of procedure.

B. *Items Included in the Schedules, Prices and Units of Measurement*

Criticism of the Itemized Cost Breakdown Schedule has centered on three points:¹⁴⁰

- (1) the costs allocated were stated to be below market prices;
- (2) the units of measurement were claimed to be arbitrary and inapplicable in many instances; and
- (3) certain items which builders considered vital were not included. The most strenuous objections were the failure to include kitchen cabinets, air conditioning and items of work unique to the conversion of commercial structures into apartment houses.¹⁴¹

An examination of the schedules reveals that the allowable cost of items of work is measured in one of three principal ways. First, the allowable cost might be determined by counting square feet, linear feet, cubic yards, or pounds of material used or installed; second, counting the number of stories (per floor), rooms and dwelling units in the building; and third, counting each item of work such as a kitch-

140. N.Y. Times, Jan. 21, 1977, at A17, col. 6.

141. Commercial conversions may necessitate, for example, removal of an existing wall or cutting windows in the wall of a building not originally constructed for residential purposes, in order to provide legal amounts of air and light. Despite J-51's critics, the city attempted to account for some unique additional costs which commercial conversions might encounter. Demolition costs are thus covered and an additional cost allowance is granted for extraordinary structural alterations involving structural concrete, masonry, structural steel or joist replacements. Several technical criticisms of the regulations have been made by builders:

- (1) the law fails to provide that the sales price be used as the basis for the assessment;
- (2) builders cannot apply for the benefits until the job is fully completed;
- (3) critical items such as kitchen cabinets, painting and air-conditioners are excluded from "reasonable costs;"
- (4) costs are based on nonunion rather than union wage scales; and
- (5) units of measurement in the regulations are unworkable. *Id.*

en sink or trash compactor. Critics claim that those units measured by room, dwelling unit and floors foster the creation of smaller apartments because no more allowance is given for larger dwelling units than smaller ones.¹⁴² Since the reasonable cost of flooring is based on the number of rooms, as opposed to the square footage of the flooring, for example, the allowable cost of flooring for a room ten feet by twelve feet is the same as that of a room fourteen feet by twenty-two feet. Assuredly, this policy of measuring by rooms, units or floors, while simplifying the determination of reasonable cost, encourages smaller units. Where a strong market for more spacious apartments exists, however, J-51 has not deterred their creation.¹⁴³

In valuing items in the schedules the city experienced difficulty in getting market feedback on costs, particularly labor expenses. Generally, developers succeeded in renovating existing class A multiple dwellings with nonunion labor. Several builders employed union workers, however, especially on large conversions with guaranteed completion dates.¹⁴⁴ Labor expenses represent a particularly sensitive issue. The construction trades are highly unionized in New York. New York City did not want to place itself in the situation of checking the status of those on the job; nor did the city want to provide for union labor costs if nonunion labor was used. In the existing downturn of new construction some New York building trades unions have taken pay reductions.¹⁴⁵ The Department of Commerce reported in December 1977 that nonunion workers are building an estimated eighty to eighty-five percent of the \$80 billion worth of housing being constructed.¹⁴⁶ The city takes cognizance of these factors and others in preparing the schedules of allowances.

Some urged that tax abatement be allowed for the reasonable cost of "sweat equity" or labor contributed without compensation, usually by the owner occupant. "Sweat equity" could be valued by multiplying the number of hours reasonably required to complete the work by the prevailing wage rate applicable pursuant to state law. The

142. N.Y. Times, July 29, 1977 at A17, col. 2.

143. *Id.* at cols. 2-3. The sponsors of the conversion of several manufacturing and commercial properties into residential cooperatives are creating units which are quite commodious by New York standards. *See, e.g.*, N.Y. Times, Sept. 16, 1977, at B11, col. 5 (former Stafford Ink building in the West Village of Manhattan proposes loft co-ops ranging from 1,350 square feet to 2,500 square feet).

144. N.Y. Times, Dec. 4, 1977, § 3 Business and Finance, at 7, col. 4.

145. *Id.* at 7, col. 3; N.Y. Times, Dec. 12, 1977, at 40, col. 4.

146. *Id.* at col. 3; N.Y. Times, Dec. 12, 1977, at 40, col. 3.

number of hours allowed in no event would exceed the actual hours worked and could be documented by an affidavit of the laborer.

Although the city encourages "sweat equity" by making mortgage loans to rehabilitation projects where it is utilized, the city did not promulgate regulations implementing these recommendations. The statute is silent on this issue and expresses no intent to offer additional incentives to effectuate economy of construction.¹⁴⁷

IV. PROCESSING REQUIREMENTS

A. *Expedited Processing*

Any city engaged in implementing a tax abatement program must constantly reevaluate its administrative procedures for processing applications. Indeed, it is largely at the administrative level that a program succeeds or fails. In evaluating the city's application procedures, New York City administrators had to recognize that the J-51 program primarily assisted old apartment buildings that were usually owned by one or a few individuals.¹⁴⁸ Furthermore, as the owners of one renovated structure observed, J-51 is "an 'as of right' program,"¹⁴⁹ granting automatic benefits if the prescribed qualifications and criteria are met. The city was thus also forced to recognize the importance of clearly explaining the eligibility criteria and the documentation necessary to complete an application. Filing for J-51 can be done on a quarterly basis¹⁵⁰ and processing is usually completed within three months.¹⁵¹

147. Placing a value upon sweat equity could prove to be an insuperable task. One owner could claim union scale wages. Another owner might ask for the prevailing market value of labor in his neighborhood. An owner who is an experienced artisan might show that his sweat equity is of exceptional value. In no case will there be an actual expenditure of dollars for the labor, thereby reducing the owner's cost per unit and outstanding mortgage.

148. The City of New York, Department of Housing Preservation and Development, J-51 Tax Exemption-Tax Abatement Program, Report of Yearly Statistics, March 16, 1976-March 15, 1977, Comparison of Annual J-51 Statistics.

149. N.Y. Times, Jan. 13, 1978, at B5, col. 2. See also *Punnett v. Evans*, 26 A.D.2d 396, 399 (1966) (court emphasized the importance of having administrative interpretation of J-51 statute or criteria relied upon in applying the statute made known to applicants).

150. See N.Y., N.Y. LAW 12 (1978), amending NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(h) to provide for the filing of applications within time periods established by rules and regulations promulgated by HPD.

151. N.Y. Times, Jan. 13, 1978 at B5, col. 2.

B. *Processing Done after Construction Completion*

Applications for J-51 benefits are not processed until construction is completed.¹⁵² Builders cite this requirement as one of the program's major drawbacks, making it impossible for them to ascertain with certainty what HPD will certify as the reasonable cost of a major reconstruction effort until after the project is completed.¹⁵³ The extent to which this uncertainty affects the willingness of banks to make construction loans or long-term financing available is not known.¹⁵⁴ HPD has maintained that this policy reduces the possibility of scandal and waste of public resources for partial or nonexistent renovations or for work which may later fail to meet the program eligibility criteria.

To improve the "bankability" of a project involving complete interior reconstruction, builders have suggested that HPD certify the amount of cost which will be allowed from an examination of the plans and specifications. Construction and permanent lenders would then ensure that the rehabilitation is carried out according to those approved plans and HPD could inspect the construction in progress.

This city inspection-verification approach increases administrative costs which, of course, would have to be passed on to the applicant through a fee structure. Certainly, in a three-month period, it would be unfeasible for the city to process 1,200¹⁵⁵ applications if on-site inspections were required. The city lacks the manpower and the resources to continuously check construction work to ensure the work is meeting J-51 program objectives.

Furthermore, if HPD certifies a reasonable cost prior to conclusion of construction and a building later goes uncompleted and into foreclosure and remains so for many years, those dollars, to the extent they are converted into tax abatement, will have been lost on an incomplete building which is probably unsafe and surely unmarketable without an infusion of new cash. The tax abatement dollars may

152 See NEW YORK CITY, ADMINISTRATIVE CODE § J-51-2.5(h), providing that an application for J-51 benefits cannot be accepted unless accompanied by HPD certification as to reasonable cost and eligibility. HPD cannot finalize this certificate until after construction is completed.

153. N.Y. Times, Jan. 21, 1977, at A17, col. 6.

154. *Id.* at col. 5.

155. The City of New York, Department of Housing Preservation and Development, J-51 Tax Exemption-Tax Abatement Program, Report of Yearly Statistics, March 16, 1976-March 15, 1977, Comparison of Annual J-51 Statistics.

never be recovered. If, however, the bank makes a construction loan in reliance upon a HPD certificate of reasonable cost, which is based upon construction specifications and rendered before completion, it would seem that the bank would have a claim against the city if it later determines that the building upon completion is not entitled to the reasonable cost initially certified.

C. *Later Revocation of Tax Exemption and Tax Abatement*

Revocation of tax exemption and abatement is a contingency which will affect the availability of construction and mortgage loans. The city revokes benefits if a building in the J-51 program later becomes used for commercial or hotel purposes, or, if real estate taxes or water or sewer charges with respect to it remain unpaid for one year.¹⁵⁶ Although the mortgagee undoubtedly based his mortgage loan upon the availability of tax relief, it can be later revoked and lost. To prevent a mortgagee from being caught unaware of owner violations, the regulations provide that no revocation shall take place unless the breach or omission remains outstanding following the elapse of thirty days after notice has been given to the owner or mortgagee. Mortgagees are allowed to register with HPD for the purpose of receiving this notification.¹⁵⁷

D. *Other Processing Requirements*

Buildings started before Jan. 1, 1979 must be completed within two years from the start of construction to receive J-51 benefits. Those started after Jan. 1, 1979, will be given thirty-six months to complete construction.¹⁵⁸ Thus, the regulations specify what will be deemed the start and completion of the work. The city takes a flexible administrative approach, permitting start and completion to be documented either by the applicable city permit or by an affidavit from a person such as a licensed architect or a professional engineer.¹⁵⁹ If the cost of work is less than \$3,000, an affidavit by the owner is sufficient.¹⁶⁰

Acceptance by the city of a certificate by a licensed professional helps expedite processing where it is impossible to obtain a timely

156. RULES & REGS. § 4.1.

157. *Id.* § 4.2.

158. N.Y., N.Y. LAW 12, § 2 (1978).

159. RULES & REGS. § 6.1.

160. *Id.*

permit to meet filing deadlines. It also reduces the likelihood that parties responsible for giving permits will delay issuing a permit to encourage bribes for fast service.

The city requires documentation of costs incurred and written approvals from applicable city agencies that the work meets city building code and other mandated standards. Costs may be documented by paid bills or invoices or by cancelled checks indicating the work and location of the building.¹⁶¹ A copy of the contract for the work, if there is one, must be submitted.¹⁶² In lieu of this documentation, the city will rely upon a statement of the cost of construction by a certified public accountant based upon the audited books and records of the owner.¹⁶³ Although a certificate from a CPA should prove reliable, there is insufficient experience with the latter to indicate whether it will prevent the certification of costs which have been inflated by the owner or his contractor.

A cooperative or condominium owner must provide an opinion of legal counsel that the building is owned as a legal cooperative or condominium or produce an affidavit from two authorized officers with ownership interests attesting that the building is in fact a legal cooperative or condominium.¹⁶⁴ If the applicant is the owner of a rental property, documentation showing that it is subject to either rent control or rent stabilization must be supplied.¹⁶⁵

V. CONCLUSION

J-51 is not the sole solution to the problems of preserving and renovating irreplaceable older city housing. J-51 has, however, during the past seventeen years, established itself as a major force promoting the creation and revitalization of New York City housing.

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

NOTES

