STROOCK
SPECIAL BULLETIN

Mandatory Inclusionary Housing: Implications of 421-a and Vested Rights

March 23, 2016

Mandatory Inclusionary Housing: The Future in the Redevelopment of New York City

Since taking office in 2014, the signature policy initiative of the de Blasio Administration has been to create and maintain permanently affordable housing in the City of New York. The centerpiece of this initiative is the text amendment to the Zoning Resolution known as "Mandatory Inclusionary Housing" or "MIH," which the City Council adopted yesterday.[1] MIH seeks to spur the production of affordable housing by making it mandatory under certain circumstances.

As discussed in previous *Stroock Special Bulletins* on the topic, requiring that a certain percentage of residential development be affordable is not a novel housing policy concept, and several jurisdictions, including San Francisco, California and Cambridge, Massachusetts, have adopted similar programs (although most experts consider New York City's MIH to be the most ambitious program of its kind in the United States). As with most major policy changes in New York City, the Mayor's proposal was not adopted wholesale by the City Council, but rather was modified and negotiated among the Department of City Planning ("DCP"), the Department of Housing Preservation and Development ("HPD"), the City Council, and various other stakeholders. MIH's passage is a major victory for the de Blasio Administration.

The new affordability requirements are summarized below. Also discussed are two critical issues with respect to MIH – the expiration of the 421-a tax exemption under New York State law and the doctrine of vested rights.

Summary of the MIH Proposal with City Council Changes

Before turning to the substantive requirements of MIH, it is important to establish the scope of the

[1] The City Council also adopted a series of modifications to the Zoning Resolution involving bulk and parking – commonly known as "Zoning for Quality and Affordability" or "ZQA" – that would relax existing requirements involving parking and height and bulk restrictions as a mechanism to encourage the development of affordable and market-rate senior housing. This *Stroock Special Bulletin* focuses exclusively on the mandatory inclusionary housing proposal.

zoning amendment. Despite its title, MIH does not actually establish mandatory affordable housing throughout the City of New York. Rather, compliance with the MIH provisions will be generally required for certain projects under two scenarios: (a) in connection with a discretionary approval from DCP involving a residential development of a minimum size or (b) in connection with a residential development of a minimum size in a neighborhood that has been rezoned to require compliance with MIH. The following neighborhoods are anticipated to be the first in New York City to require compliance with MIH: East New York in Brooklyn; Inwood and East Harlem in Manhattan; Flushing West and Long Island City in Queens; the Jerome Avenue corridor in the Bronx; and Bay Street in Staten Island.

MIH will not apply to projects with 10 or fewer residential units. For projects with between 11 and 25 residential units, there is the option to pay a fee in lieu of building permanently affordable units on-site.[2]

With respect to what constitutes "affordability," the current version of the MIH amendment has four different options available for each rezoned district to choose from at the time of the City Council vote. They are as follows:

- **Option 1**: 25% of the residential floor area must be affordable, on average, to households making 60% of Area Median Income, or around $47,000 a year for a household of three. Within this requirement, at least 10% of the residential floor area must be affordable to households making an average of 40% of Area Median Income, and there shall be no more than three income bands (*i.e.*, Area Median Income requirements) in the project, and no income band shall exceed 130% of the Area Median Income.

- **Option 2**: 30% of the residential floor area must be affordable, on average, to households making 80% of Area Median Income, or around $62,000 a year for a household of three. The average income of all affordable households shall not exceed 80% of the Area Median Income, and there shall be no more than three income bands (*i.e.*, Area Median Income requirements) in the project, and no income band shall exceed 130% of the Area Median Income.

- **Workforce Option**: Coupled with either Option 1 or 2 above, 30% of the residential floor area must be affordable, on average, to households making 115% of Area Median Income, or around $93,000 a year for a household of three. Within this requirement, at least 5% of the residential floor area must be set aside for households at 70% Area Median Income and 5% at households at 90% Area Median Income, and there shall be no more than four income bands in the project, and no income band shall exceed 135% of the Area Median Income. This option is not available in the Manhattan Core, which is defined as Manhattan Community Boards 1 through 8.

- **Deep Affordability Option**: Coupled with either Option 1 or 2 above, 20% of the residential floor area must be affordable, on average, to households making 40% of Area Median Income, or

[2] MIH also includes a Board of Standards and Appeals ("BSA") special permit to modify the affordability levels of a development based on a showing of financial hardship. Very little has been publically written to date regarding the process and the required findings for this special permit, although it is clear that HPD will be heavily involved in the analysis.

around $31,000 a year for a household of three. There shall be no more than three income bands in any project, and no income band shall exceed 130% of the Area Median Income. No public funding shall be used for this option, unless HPD determines that public funding is necessary to support a significant amount of affordable housing in addition to the requirements of the Deep Affordability Option.

In addition to the foregoing requirements, any project with off-site affordable housing must increase the total affordable floor area by 5%. For on-site projects, the affordable housing units must be distributed on at least 65% of the residential floors of the building, and the zoning amendments further mandate bedroom mixes for the affordable housing units that are proportional to the market-rate units.

MIH In Light of the Expiration of the 421-a Tax Exemption

It is public knowledge at this point that the concept of MIH was developed at a time when most policymakers thought the 421-a tax exemption would continue in place, albeit with serious changes, but as an essential tool for underwriting new rental projects, including mixed-income projects with an affordable housing component. As of the date of this *Stroock Special Bulletin*, there are no discussions taking place to resurrect the revisions to the law from 2015, nor have there been any legislative proposals that would either substantially change New York Real Property Tax Law ("RPTL") § 421-a or replace it with a new tax incentive. Absent a 421-a exemption, questions remain as to how many units will be created under MIH.

Article XI as One Alternative to RPTL § 421-a

Although not a one-size-fits-all or a complete substitute for the 421-a tax exemption, certain projects might be able to utilize a little talked about tax exemption available under Article XI of the New York Private Housing Finance Law ("PHFL"). A very generous tax exemption available to properties that are owned by Housing Development Fund Companies ("HDFC"), an Article XI tax exemption can offer up to 40 years of substantially reduced real estate taxes for low-income projects. Unlike 421-a, Article XI tax exemptions are renewable through a City Council Resolution – something invaluable for permanently affordable units. Low-income is broadly defined by HPD, and would be available to all of the income bands under the MIH options. But Article XI tax exemptions are not available to just anyone. For rental projects, a developer would most likely need to partner with a not-for-profit developer in order to incorporate the HDFC. Most HDFCs are also subject to regulatory agreements and strict oversight by HPD or a third-party monitor.[3] This raises an array of concerns about control, especially for a developer that plans to own and operate the MIH units on a long-term basis.

[3] Because HDFCs are also subject to regulatory agreements, a developer that utilizes this ownership structure may also wish to utilize special allocations of common expenses under New York Real Property Law § 339-m. Special allocations are available in buildings that are operated as condominiums, and the market-rate units pay increased common charges to help subsidize the costs of the affordable units.

Vested Rights – A Consideration for Developers with Existing Projects

By design, MIH creates mandatory affordable housing requirements within certain rezoned districts. The soon-to-be rezoned neighborhoods are similar in many respects, including strong access to public transportation and existing underdevelopment. In some cases, these factors alone have led to substantial reinvestment and redevelopment. Where there is significant planned and ongoing development *and* imminent rezonings, the discussion inevitably must turn to the doctrine of vested rights. The underlying principle of the doctrine is straightforward – where an owner of real property has taken certain steps to develop property in reliance on existing laws and the laws change before development has been completed, the owner may be entitled to complete his development under the prior laws.

The vested rights doctrine arose from the common law, as a form of equitable relief, and the Zoning Resolution codified such rights in 1961. The doctrines are similar in most respects. Both doctrines require, as a threshold matter, confirmation from the Department of Buildings ("DOB") that the permits authorizing the construction were lawfully issued (meaning that the permits contained no "significant" errors upon issuance). Both doctrines require evidence of substantial construction and substantial expenditures.

There are significant differences between the common law and statutory doctrines. First, the statutory framework allows a permit to initially vest by operation of law, *i.e.*, without a public hearing at the BSA. As a general rule, if the foundation for a development has been completed prior to the change in the Zoning Resolution, the development has two years in which to complete construction. The common law doctrine, on the other hand, always requires the involvement of BSA. Second, what constitutes a "substantial expenditure" differs. Soft costs and irrevocable financial commitments may be included in the "substantial expenditures" analysis under the common law, but such expenditures have been historically excluded in cases brought under the statute. Third, under the statute, BSA is constrained on how long it can extend the time to complete construction; extensions are limited to a maximum of two years. Under the common law, however, there is no limit (although a four-year extension has become standard over the decades). Finally, under the common law, it must also be established that the owner will suffer a "serious loss" if the development must be made to comply with the amendment(s).

The connection between vested rights and MIH should be evident: Property owners with ongoing or planned projects in areas slated for rezoning must take into consideration whether their project will be affected by the rezoning and whether they will be forced to demonstrate entitlement to a vested right. Fortunately, the City Planning Commission's ambitious rezonings of the past 15 years, coupled with the financial crisis of 2007-2008—which halted a great many projects throughout the City—led to development of a rich body of BSA vested rights case law. This case law will guide any analysis that seeks to determine whether a project will be required to comply with MIH.

Next Steps

Similar to voluntary inclusionary housing projects within the City of New York, HPD will need to provide detailed guidance to the public on how MIH will work. This will most likely take the form of agency guidance, consumer bulletins, along with a standardized form of application. Agency guidance is also expected from DCP, DOB, and BSA. Stroock will continue to closely monitor all information for its clients to keep them abreast of the changing affordable housing landscape.

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