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How Changes in J51 Law Affect Loft Conversion to Apartments

Paul J. Korngold

With the passage of amendments to New York City's J51 law — approved by the City Council on April 24 and signed by Mayor Koch on May 14 — radical changes have been made in the incentive nature of this tax-benefit program.

Faced with increasing opposition from elected officials, business and labor representatives, the law has been altered so that the conversion of lofts to residential apartments will be restricted. In addition, large areas of real property in Manhattan are no longer eligible for J51 benefits.

Section J51-2.5 of the Administrative Code of the City of New York (hereinafter referred to as J51) was originally enacted in the 1950's to assist owners of rent controlled buildings to upgrade substandard dwellings. The program slowly evolved so that by 1976, rent stabilized buildings and cooperative conversions were added to the program. An explosion of J51 conversions ensued.

Benefits Under Program

The J51 program is authorized under the statutory authority of New York Real Property Tax Law 489. The program assists owners of eligible residential properties by granting tax abatement and tax exemption

benefits. The benefits are granted when an owner makes qualifying physical improvements to his property. Eligible improvements include such diverse items as boilers, windows, water proofing, insulation and flooring. The owner recovers the cost of these items based on what the New York City Department of Housing Preservation & Development considers the reasonable cost (not necessarily the same as the actual cost) of the work at the rate of 8 1/8 percent per year until 90 percent of the certified reasonable cost is recovered. In certain cases, the abatement is limited to 50 percent of the cost, where in other cases it can

489(9) further provides that while there is an exemption on the property, there shall be no increase in the building portion of the assessed valuation. This valuable benefit of the J51 program is currently in question and has been renounced by the Tax Commission of the City of New York.³ The value of the exemption is often greater than the abatement on conversion jobs, since the abatement will be applied to a pre-existing, often miniscule, building value and the exemption will remove an often astronomic increase in the assessment due to the reconstruction.

The new amendments to the J51 law were aimed at limiting tax breaks for Manhattan real estate developers. Two new restrictive abatement zones were created, a minimum tax zone and a tax abatement exclusion zone. The zones overlap in some areas but generally encompass parts of Manhattan from Eighty-sixth Street south to Houston Street.⁴ A third zone eliminates J51 exemption and abatement benefits entirely.

With the creation of the minimum tax zone,⁵ the era of totally tax free real estate in central Manhattan seems to have come to an end. In the past, many properties were able to totally eliminate all real property taxes through the J51 program. The new amendment provides that in this zone, the land portion of the assessment will continue to be subject to real estate taxes. Any new tax abatement will apply only to the building assessment.

There are two exceptions to the minimum tax zone restriction. One is for governmentally assisted buildings and the other is for buildings undergoing a moderate rehabilitation.

Term Defined

The term "moderate rehabilitation" is statutorily defined in the New York City Administrative Code to be a moderate rehabilitation

The tax abatement exclusion zone is a geographic area within Manhattan where there will be no tax abatement granted.⁷ Again, there are two exceptions to this amendment of the law. The first exception is for governmentally assisted properties. The other and more notable exception is for major capital improvements. The new J51 law provides that the limitation shall not apply to any alteration designated as a major capital improvement provided that the certified reasonable cost of such major capital improvement shall not exceed \$2,500 per dwelling unit.⁸ Thus, many of the major expense items such as roofs, boilers, electrical wiring, piping and windows would be exempt provided that the cost of that item did not exceed the average price of \$2,500 per apartment. The law is unclear as to whether items which are in excess of the \$2,500 limitation would be totally ineligible or merely limited to a maximum certified cost of the \$2,500 amount.

Problem for Some Owners

This creates an apparent problem for those owners in geographic areas covered by both the land tax and tax abatement exclusion zones and who otherwise qualify for moderate rehabilitation benefits. If the owner spends in excess of \$2,500 per unit, as is required under the moderate rehabilitation section, he obviously will have exceeded the \$2,500 limit to qualify as an exception to the tax abatement exclusion zone. Hopefully, the regulations that will be drafted by the Department of Housing Preservation and Development in the coming months will clarify this problem.

Attorneys for residential property owners and lenders should note that the fact that an item qualifies as a capital improvement for sales tax exemption does not necessarily mean it is considered a major capital improvement by the Department of Housing Preservation and Develop-

If this property is within the tax abatement exclusion zone, only the minimal waterproofing work will be eligible for tax abatement work. Furthermore, if the amount spent on the waterproofing is equivalent to eighty cents per square foot, it will be reduced by the HPD approved rate of 60 cents per square foot. Thus, the owner in this zone who has spent \$10,500 for waterproofing, ceilings and floors, will find himself with a total tax abatement of \$375.

Although the abatement portion of the J51 law has been restricted in these two areas, the exemption is still a valuable asset. With the exemption still available, an owner can assume an initial constant tax payment since any initial building assessment increase should eventually be exempted. The problem for developers comes where there is an increase in the building assessment prior to the granting of the J51 certificate of reasonable cost. This problem will continue to exist under the new law and owners will have to consider as a part of their construction cost a potentially drastic real estate tax increase during the period of construction.

The tax abatement exclusion and land tax zones apply to any property where work is commenced on or after Jan. 1, 1982.¹⁰ Attorneys should advise their clients with properties in these zones that if any eligible work is contemplated in their buildings in the foreseeable future, the work should be done immediately. It should be suggested that where an application must be filed with the Department of Buildings for a work permit, the application should be filed as soon as possible, since there will undoubtedly be a last minute rush as the Jan. 1, 1982 cutoff date approaches.

A third zone was created under the amended law where both tax abatement and tax exemption benefits are prohibited.¹¹ This area is any district in Manhattan where a floor area ratio of fifteen or greater is permitted by the Zoning Resolution of the City of New York or where residential conversion as of right is not permitted by said Zoning Resolution. This change will effectively bar residential conversions in the Garment Center, Northeast Chelsea, the Meat Market area and the Graphic Arts Center. This section is applicable for work not commenced under an alteration permits for conversions in these districts will no longer be granted. This portion of the Zoning Resolution has already become effective.

Some Hope

For those illegal residential occupants in the third zone, the amended J51 law does provide a small ray of hope. If HPD deems it to be proper, they can issue regulations allowing these buildings with illegal residen-

A major change in the law was the requirement of relocation payments. The relocation award in the J51 law covers properties in all boroughs except Manhattan south of fifty-ninth street.¹² The area south of fifty-ninth street is covered by the changes in the Zoning Resolution.¹³

For buildings in the City of New York, but not below fifty-ninth street in Manhattan, the law now requires that when any non-residential building is converted to a Class A multiple dwelling, tax abatement and tax exemption benefits will not be granted unless a relocation award is made to a former tenant. To be considered an eligible tenant, the tenant must have:

1. Leased and used the vacated premises to conduct a manufacturing, warehousing, or wholesaling business for not less than two consecutive years immediately prior to vacating;

2. Vacated such premises on or after April first, nineteen hundred eighty-one for any reason other than eviction for non-payment of rent;

3. Vacated such premises (a) no earlier than twenty-four months prior to the filing date of an application for such alteration permit and (b) no later than the completion of the conversion as evidenced by the issuance of a permanent certificate of occupancy for a Class A multiple dwelling;

4. Either purchased or leased for a term of not less than eighteen months other premises within the City of New York with a floor area not less than one-third of the floor area of the vacated premises;

5. Relocated their business to such other premises within one year of vacating the vacated premises; and

6. Paid all commercial rent or occupancy tax for the vacated premises. A sub-tenant shall be eligible to receive a relocation award notwithstanding any lack of eligibility of its prime tenant.¹⁴

Who Gets Award

The award that must be paid to the eligible tenant by the developers will be the greater of (1) the aggregate base rent which accrued and was paid by the eligible tenant during the final twenty-four months of its occupancy of the vacated premises, or (2) \$4 for each square foot that the eligible tenant occupied in the vacated premises during the final twenty-four months of its occupancy of the vacated premises.

For properties in Manhattan but south of Fifty-ninth Street, the relocation procedure is different. Relocation benefits are granted not by the J51 law, but by the Zoning Resolution. Owners of applicable buildings in the areas outlined in the Zoning Resolution will now be required to make a conversion contribution prior to the issuance of an alteration permit from the Depart-

- (1) Occupied and used space within an applicable building for not less than twenty-four months immediately prior to vacating;

- (2) Vacated the premises on or after April 9, 1981;

- (3) Either purchased, or leased for a term of not less than twenty-four months, other premises within the City of New York for the purpose of engaging in a business listed as eligible in the Zoning Resolution.¹⁶

If payment is made directly to an eligible tenant, the owner need only pay \$4.50 per square foot. The \$9 per square foot rate is subject to yearly adjustments for inflation.

HPD Administers Loans

For a number of years, HPD has administered the 8-A loan program. This program, authorized by Article 8-A of the New York Private Housing Finance Law, lends money to owners of eligible multiple dwellings at an interest rate of 8 percent for certain capital improvements to their properties. The amended J51 law now allows owners who qualify for 8-A loans to receive the benefits of tax abatement and tax exemption as soon as construction has commenced.¹⁷ This is a valuable benefit for those owners since they had previously been required to wait until all work was physically completed, all contractors paid and all permits received before J51 benefits could commence. The change in the law is practical since the 8-A program administrators determine whether a loan should be granted in part on the basis of the projected expenses of the owner assuming the J51 application will be granted. Where tax abatement is delayed due to failure to obtain all of the necessary documentation, the 8-A mortgage is in jeopardy since the owner is not making a profit to enable him to repay the loan. This change in the law will help alleviate the problem.

An additional part of the J51 package signed by the Mayor was the passage of a new section of the Administrative Code, J51-5.0. The section of the Code extends tax benefits to Class B multiple dwellings and Class A multiple dwellings used for single room occupancy. The list of eligible items is somewhat more restricted than the list for eligible buildings under Section J51-2.5. The tax exemption benefit under the new section will be limited to ten years. However, tax abatement benefits will be granted to the extent of 100 percent of the certified reasonable cost at a rate of 10 percent per year.¹⁸

- (1) Administrative Code of the City of New York, Section J51-2.5c.
- (2) Administrative Code of the City of New York, Section J51-2.5b; 111 Fourth Ave. Assoc. v. Finance Administration, 191 Misc. 2d 960 (Sup. Ct. N.Y. Co., 1979).
- (3) The City of New York, Department of Investigation Post Audit Implementation Review: The J-51 Tax Exemption-Tax Abatement Program, January, 1981, p. 30. See also Linden Hill No. 2 Cooperative Corp. v. Tishelman, 435 N.Y.S. 2d 936 (Sup. Ct. Qns. Co., 1981); 600 W. 183rd St. Corp. v. Tishelman, (NYLJ Dec. 29, 1980, Sup. Ct., N.Y. Co.).
- (4) Minimum tax zone: Beginning at Central Park West and Eighty-sixth Street; thence easterly along Eighty-sixth Street to the East River; thence southerly along the easterly boundary of New York county to Twenty-third Street; thence westerly along Twenty-third Street to Third Avenue; thence southerly along Third Avenue to Fourteenth Street; thence westerly along Fourteenth Street to Broadway; thence southerly along Broadway to Houston Street; thence westerly along Houston Street to West Street; thence northerly along West Street to Fourteenth Street; thence easterly along Fourteenth Street to Ninth Avenue; thence northerly along Ninth Avenue to Fifty-seventh Street; thence westerly along Fifty-seventh Street to the Hudson River; thence northerly along the westerly boundary of New York county to Seventy-second Street; thence easterly along Seventy-second Street to Central Park West; thence northerly along Central Park West to Eighty-sixth Street and Central Park West, which is the place of beginning.
- Tax abatement exclusion zone: Beginning at the intersection of Ninety-sixth Street and Central Park West; thence easterly to Park Avenue; thence southerly along Park Avenue to the intersection of Park Avenue and Seventy-second Street; thence easterly along Seventy-second Street to York Avenue; thence northerly along York Avenue to the Franklin Delano Roosevelt Drive; thence north-westerly along the Franklin Delano Roosevelt Drive to as far as Ninety-sixth Street; thence easterly to the easterly border of New York county; thence thence southerly along such border to Thirty-fourth Street; thence westerly along Thirty-fourth Street to Eighth Avenue; thence northerly, along Eighth Avenue and Central Park West as far as Ninety-sixth Street, which is the place of beginning. Additionally, the following North/South and East-West thoroughfares shall be included in the tax abatement exclusion zone: Ninth-sixty Street between Central Park West and the East River; Eighty-sixth Street between Central Park West and the East River; Seventy-ninth Street between West End Avenue and the East River; Seventy-second Street between West End Avenue and the East River; West End Avenue from Seventy-second Street to Eighty-sixth Street; and Riverside Drive from Seventy-second Street to Ninety-sixth Street.
- (5) Administrative Code of the City of New York, Section J51-2.5d4.
- (6) Administrative Code of the City of New York, Section J51-2.5a4.
- (7) Administrative Code of the City of New York, Section J51-2.5a5.
- (8) Administrative Code of the City of New York, Section J51-2.5a6(A).
- (9) Rules and Regulations Governing Tax Exemption Tax Abatement Pursuant to Section J51-2.5, Department of Housing Preservation and Development, July 1, 1980, Section 7.4.
- (10) Administrative Code of the City of New York, Section J51-2.5d4.
- (11) Administrative Code of the City of New York, Section J51-2.5i6.
- (12) Administrative Code of the City of New York, Section J51-2.5z.
- (13) Zoning Resolution of the City of New York 16-50.
- (14) Administrative Code of the City of New York Section J51-2.5z(1).
- (15) Administrative Code of the City of New York, Section J51-2.5z(2).
- (16) Zoning Resolution of the City of New York 16-52.
- (17) Administrative Code of the City of New York, Section J51-2.5b.
- (18) Administrative Code of the City of New York, Section J51-2.5c.