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AT THE MANHATTAN INSTITUTE

This Works: Expanding Urban Housing

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The mid-1980s were a turning point in American housing policy. As the federal Section 8 production programs ended and federal budgetary constraints grew, the locus of innovation in housing policy shifted from the federal government to states and cities. Any examination of local innovations in housing must include a particular focus on the experience of New York City. For decades the city has been the testing ground for new policies that were later emulated, for good and bad, by both the federal government and by other cities throughout the nation. In addition to its policies, New York City has committed unprecedented resources to housing production. Its Ten Year Capital Plan for housing (hereinafter referred to as “The Ten Year Plan”), announced by Mayor Edward I. Koch in 1985, has stretched to fifteen years. Over this period, the city has spent more than \$5.1 billion to build or rehabilitate over 180,000 housing units.

In this Bulletin, we briefly describe what led New York to embark on the Ten Year Plan and what it encompassed. We evaluate some of the achievements of the Plan and seek to isolate some of its

most innovative and potentially replicable elements. Finally, we speculate on some of the opportunities that were missed by the city as it spent billions of dollars to build housing and spur neighborhood revitalization.

A Description of the Ten Year Capital Plan for Housing

For New York City, innovation in housing policy is not an isolated or unusual occurrence. Before the federal government moved to the forefront of housing policy creation and funding as a result of the New Deal, New York City was the unquestioned national leader. At the turn of the last century, the city enacted the nation’s first housing code, the Tenement Housing Act of 1905. The nation’s first publicly owned housing for low income families, the First Houses, were built on Manhattan’s Lower East Side in 1934 three years before the federal public housing program was authorized by Congress. In 1957, the city passed the first law in the nation to outlaw discrimination based upon race in the sale or rental of privately owned homes. And, in the mid-1960s, together with the state, the city

used interest rate subsidies and tax exemptions to spur the construction of tens of thousands of apartments for middle income families under the Mitchell-Lama Program.

Mayor Koch's announcement in the mid-1980s of a multi-billion dollar commitment to housing was surprising in its scale, but not unusual in light of the city's history of innovative housing programs. The city had just emerged from its brush with bankruptcy and a strong economy, together with its newly established solvency, allowed New York to borrow again in the capital market and to refinance existing debt on favorable terms. The need was apparent. Housing prices were rapidly escalating beyond the means of many of the city's residents. In addition, the city had just signed consent decrees in which it promised to provide housing to each and every homeless family and individual. The program also fit political needs as the Mayor ran for reelection in November of 1985 and sought support from low-income and minority communities.

Without the ability to provide free or nominally priced buildings and land to the hundreds of nonprofit and for profit developers who participated in the programs created under the Plan, New York would never have been able to achieve the high levels of production it experienced in the year's following 1985.

Despite the revival of New York City's economy in the mid-1980s, many of the neighborhoods north of 96th Street in Manhattan, in the South Bronx, Central Brooklyn and Southeastern Queens had not recovered from the devastation of the 1960s and 1970s. During this period the city lost over 700,000 people and over 300,000 units of housing were burned to the ground by arsonists or lost to abandonment. In some neighborhoods block after block resembled the destruction left after a war. The City's response was to accelerate its process for foreclosing properties

with real estate tax delinquencies. Seemingly overnight, the city took title to over 100,000 units of housing and a significant inventory of vacant land through *in rem* tax foreclosure proceedings. Most of this housing was severely deteriorated and much of it was occupied by the poorest households in the city. The city's housing agency, the Department of Housing Preservation and Development ("HPD"), was unprepared to become the second largest landlord in New York and this lack of preparation showed in further property deterioration despite the expenditure of millions of dollars to operate the buildings.

In the end, the city's vast stock of *in rem* housing and land proved to be both a burden to the city as well as the raw material for the Ten Year Plan. Without the ability to provide free or nominally priced buildings and land to the hundreds of nonprofit and for profit developers who participated in the programs created under the Plan, New York would never have been able to achieve the high levels of production it experienced in the year's following 1985. In that year, Mayor Koch announced his plan to create a "five-year \$4.4 billion program to build or rehabilitate around 100,000 housing units for middle class, working poor and low-income families and individuals" (Koch 1985, 8). To fund the program, Koch proposed using excess financing proceeds to float approximately \$1 billion in bonds. Other revenues would come from the city's Housing Development Corporation and its capital budget. The financial commitment to the program would soon grow to \$5.1 billion over ten years (New York City, Office of the Mayor 1988).

Although the sources of revenue would shift over the course of the Ten Year Plan, use of the city's capital budget for housing construction and rehabilitation was unprecedented. Normally, the city uses capital dollars to fund transportation, public facilities and other infrastructure improvements

that are necessary to meet future needs. The capital dollars invested in housing beginning in the mid-1980s, amounted to a municipal recognition of the importance of housing to the city's economic future.

One of the main purposes of the Ten Year Plan was to address the shortage of housing that the city was experiencing. A second principal focus, from the beginning of the program, was neighborhood revitalization. According to the Mayor, “[f]irst we intend to undertake a major effort to rebuild entire neighborhoods or, perhaps 15 to 25 square blocks throughout the city...[i]t is anticipated that such a concentrated revitalization would provide the hub for further development.” This emphasis on rebuilding neighborhoods devastated by abandonment was reiterated in 1989: “We’re creating more than just apartments—we’re re-creating neighborhoods. We’re revitalizing parts of the city that over the past two decades had been decimated by disinvestment, abandonment and arson.” (New York City, Department of Housing Preservation and Development 1989).

Over the period 1987 to 2000, New York City built or rehabilitated approximately 182,000 units of housing under the Ten Year Plan.¹ Over \$5.1 billion was spent, the overwhelming majority of which came from the city's capital budget (Schill et al. forthcoming). The remaining funds were obtained from the federal and state governments. In its peak year, FY 1992, the city spent over \$660 million on housing production and development. By FY 2000, this sum had declined to \$269 million, an annual amount that still exceeded the amount the city spent on housing prior to the Ten Year Plan by a factor of ten.

The Innovations of the Ten Year Plan

Between 1987 and 2000, New York City implemented the largest municipal housing program in

the nation's history. According to various estimates, the city spent more than three times the total housing expenditures of the next several dozen largest cities combined (Berenyi 1989, Schwartz 1999). The Ten Year Plan was marked by innovation—innovation in terms of the types of housing that were built, the financing streams that were created, the partnerships that were forged. While it is highly unlikely that any other city in the country would ever mount a housing program of the same scale, it is extremely likely that experiences of the Ten Year Plan would be instructive to other cities in the creation and implementation of their own housing programs. In this section, we will outline a number of the innovations of the Ten Year Plan.

The wide variety of programs enabled the city to be flexible in creating strategies for particular buildings and neighborhoods. At the same time, many of the programs utilized similar tools and principles which resulted in economies of scale and replicability.

Creating a Mix of Programs and Fostering Flexibility without Sacrificing Replicability

Most housing initiatives, both at the federal and local levels, typically involve one program which is replicated over and over again in all types of neighborhoods. New York City's Ten Year Plan encompassed over one hundred different programs. This large number of programs was, in part, caused by the tendency of each succeeding mayoral administration to re-name many of the existing programs as it took office. Nevertheless, HPD funded dozens of different programs that existed simultaneously. The wide variety of programs enabled the city to be flexible in creating strategies for particular buildings and neighborhoods. At the same time, many of the programs utilized similar tools and principles which resulted in economies of scale and replicability (Wylde 1999).

Unlike most federal programs, city programs typically used a gap finance approach to subsidize the capital, and, indirectly, the operating costs of the housing. Typically, the city would determine the cost of a project, the amount of equity the owner could contribute and the amount of private market debt the owner could service (after operating costs were subtracted from rental income) based upon prevailing and expected market conditions and, in the case of occupied rental buildings, the rent-paying ability of current tenants. The difference between the cost of rehabilitation or new construction on the one hand, and the sum of equity and private market debt on the other, would be filled with city financing, typically in the form of nominal interest rate mortgage loans.

Perhaps nowhere was the city's creativity in crafting flexible programs that are replicable within New York City more apparent than in its efforts to deal with the land and buildings to which it took title as a result of tax foreclosure.

The single largest set of programs involved the moderate rehabilitation of over 73,000 private, occupied rental units. Many of the buildings treated under these programs only required upgrading or replacement of major building systems such as boilers, plumbing, roofs or windows. For buildings with relatively modest needs, 3 percent loans were made available to owners under the Article 8-A program. For those with greater requirements, HPD used the innovative Participation Loan Program (PLP). Under PLP, building owners received loans that combined funds from private market-rate lenders and the city itself, which charged a 1% interest rate. The net interest rate charged to the owner depended upon the building's rent roll (or rent paying capacity) and the amount of work that was required. Buildings with especially high needs and/or extremely low income tenants would receive loans in which the city's contribution was

proportionately greater and the blended interest rate lower as compared to buildings with more modest needs or higher income tenants.

Perhaps nowhere was the city's creativity in crafting flexible programs that are replicable within New York City more apparent than in its efforts to deal with the land and buildings to which it took title as a result of tax foreclosure². Close to 20,000 units of housing were created for homeowners on plots of vacant, city-owned land. The city's contribution to this housing typically was limited to the sale of land at nominal prices (\$500 per unit) and a capital subsidy ranging from \$10,000 to \$15,000 per unit. In addition, over 41,000 units of vacant *in rem* housing were rehabilitated together with an additional 28,000 units of occupied *in rem* units. In some programs, the city owned the properties during rehabilitation; in others, rehabilitation was undertaken after the properties were transferred to a variety of for-profit and non-profit owners.

The city's flexibility also extended to the ultimate owners of the properties. Rather than a one-size-fits-all approach of public or private ownership, the city was able to create enough program variety to utilize for-profit real estate entrepreneurs as well as non-profit organizations (city-wide organizations and community-based developers). For example, local entrepreneurs were enlisted in the Neighborhood Entrepreneurs Program ("NEP") to take title to abandoned buildings, rehabilitate them with city and federal dollars and operate them. Similarly, non-profit, community-based organizations participated in the Neighborhood Redevelopment Program ("NRP") and its predecessor, the Community Management Program, taking over and rehabilitating over 5,500 housing units. Indeed, the city was even able to promote homeownership among thousands of former renters in its Tenant Interim Lease Program ("TIL"). Under TIL, the city conveyed

rehabilitated multifamily properties to very low income tenants who had proved their ability to manage their buildings. This approach allowed the city to tap the capacity of the full spectrum of qualified owners and developers in its efforts.

Leveraging Private Resources and Capacity

Had New York City not taken advantage of the resources and capacity of a wide variety of private sector actors, it would never have been able to maintain both the enormous level of production and diversity of programs under the Ten Year Plan. In terms of financial resources, we have already mentioned the pivotal role of private mortgage capital. Many of the city's leading financial institutions made the construction and permanent loans needed for the city's gap financing method of subsidizing the Ten Year Plan.

In addition to leveraging private capital, the city's use of banks to finance the Ten Year Plan also allowed it to leverage their capacity and expertise. One of the signal achievements of the Ten Year Plan was the remarkably low level of corruption or fraud that accompanied the expenditure of huge sums of public money. It is doubtful that HPD would have had the staff and expertise to effectively monitor the use of funds itself. Instead, under many programs, the banks performed this monitoring function as they disbursed construction loans, much as they would for any other real estate loan. In some instances, the banks acted individually; in others they worked together. For example, many of the banks provided funds to the Community Preservation Corporation (CPC), an intermediary, which in turn underwrote and monitored the loans to developers.

CPC was only one among several important intermediary organizations that were enlisted to stretch the capacity of HPD. The day-to-day management of the homeownership initiatives of the

Ten Year Plan was entrusted to two nonprofit organizations. Over 13,000 units of one- to three-family homes were built by for profit developers working under the supervision of the New York City Housing Partnership, a subsidiary of the city's leading business group, The New York City Partnership and Chamber of Commerce. An additional 4,000 single family homes were built under the Nehemiah Program by coalitions of churches in East Brooklyn and the South Bronx. These intermediaries supervised development, arranged financing and marketed the homes under the watchful eye of HPD.

One of the signal achievements of the Ten Year Plan was the remarkably low level of corruption or fraud that accompanied the expenditure of huge sums of public money.

Community-based nonprofit housing developers also worked with intermediary organizations in rehabilitating city-owned rental buildings. New York was fortunate to be the only city in the nation where both major low income housing intermediaries—the Enterprise Foundation and the Local Initiatives Support Corporation (LISC)—worked with community development corporations. LISC and Enterprise created programs, provided technical assistance and, perhaps most importantly, through their joint New York Equity Fund, raised and invested equity through the syndication of the Low Income Housing Tax Credit to private investors including many Fortune 500 companies. Because the two intermediaries were fiduciaries to the entities that invested in the Equity Fund, they provided needed oversight over, and gave credibility to, the work undertaken by the hundreds of community-based developers.

Perhaps nowhere has the city's privatization of functions been more apparent than in its efforts to stem the abandonment of privately owned

housing. When Rudolph Giuliani became Mayor, the city stopped vesting title to tax-delinquent properties. This was largely attributable to the high cost of managing the properties and the poor record the city enjoyed as a landlord. Yet without a credible threat that their properties would be taken away from them for failure to pay taxes, property owners would have little incentive to remain current in tax payments. In 1996, the city adopted a two-pronged tax collection and anti-abandonment strategy that would make extensive use of the private sector. The city would no longer take ownership of tax delinquent properties. Instead, like other major U. S. jurisdictions, it would sell tax liens to a private trust which would then, if it chose, seek collection or foreclosure.

In the end, the city, for the most part, made significant efforts to promote a mix of incomes in the buildings that were constructed or rehabilitated under the Ten Year Plan.

Not all buildings would be subject to tax lien sales; buildings that met the statutory definition of “distressed” would be removed from the tax lien sale.³ Instead, for these buildings, a newly enacted program called the Third Party Transfer Program was created. Under Local Law 37 of 1996, the city would commence foreclosure proceedings against these distressed buildings which would be transferred not to the city, but directly to new responsible third parties, with city financing. In 1999, the city began transfers to a non-profit intermediary in contemplation of transfers to third parties. This intermediary, the Neighborhood Restore Corporation, would hold title to the buildings, stabilize them and manage them until the city could designate the ultimate third party. This period of ownership by Neighborhood Restore would allow the city and the ultimate owners to inspect the properties, develop scopes of work for rehabilitation and arrange the financing necessary to rehabilitate them.

To date, three rounds of property vestings have been begun involving over 250 properties. The city has identified a variety of for profit, non-profit and tenant cooperative owners for the buildings. Although the program has not been free from controversy,⁴ it has won recognition for its innovativeness from the Pioneer Foundation.

Achieving a Mix of Incomes

One of the most contentious issues during the early years of the Ten Year Plan was the appropriate mix of incomes of the households that would live in the buildings. From the beginning, tenant advocates pressed the city to increase the proportion of units that would be allocated to poor families. In addition, the city, under pressure from consent decrees guaranteeing each homeless family housing, sometimes sought to house high proportions of homeless families in the buildings. Countervailing pressure came from the neighborhoods in which the housing was located. Many community residents were seeking to rebuild and stabilize their neighborhoods and felt that these efforts would be jeopardized by large numbers of households who might be prone to crime, substance abuse or mental illness. In addition to community pressure, evidence from the academic community was beginning to accumulate in the late 1980s and 1990s, that housing programs that concentrated poor people together sometimes caused more problems than they solved.

In the end, the city, for the most part, made significant efforts to promote a mix of incomes in the buildings that were constructed or rehabilitated under the Ten Year Plan. With the exception of supportive housing projects which sought to provide needed services to a formerly homeless population with special needs, most of the rental programs limited the proportion of homeless families to around 15% of all tenants. In addition,

most of the Ten Year Plan programs sought to house a mixture of low and moderate income tenants. This income mixing served two purposes. First, it reduced the concentration of extremely needy people, providing children with role models of working families and reducing the prevalence of social problems. Second, it provided an opportunity for cross-subsidy. This was made possible, in part, because of the city's ability to restructure rents as a result of the *in rem* vesting and use of city financing. Apartments, which were typically subject to stringent rent regulation, had their rents increased to achieve economic feasibility. Existing low-income tenants were spared the impact of the new higher rents. But relatively higher income and new tenants who could pay higher rents did so, which in turn helped offset some of the extremely low rents paid by the poor.

Reaching the Middle Class

In many American cities, the private market adequately provides affordable housing for all but the poor. In New York City, however, high rents and persistently low levels of housing production have resulted in significant affordability problems for all but the upper middle class and the wealthy. Young families starting out, immigrants and one wage-earner families are particularly ill-served. The diversity of programs that was the cornerstone of the Ten Year Plan also encompassed income diversity.

The homeownership programs of the Ten Year Plan were the major programs to serve the middle class. Under the Partnership's New Homes Program, one- to three-family homes were sold to families with annual incomes that range from \$32,000 to \$75,000. The Nehemiah Program reached even lower incomes, selling somewhat more modest homes to households with incomes as low as \$27,000 per year. In addition to allowing families the opportunity to accumulate assets, the

homeownership programs served other functions. First, in the absence of these programs, many upwardly mobile families might have left the city and moved to the suburbs. Second, the programs drew middle income people into many of the city's distressed neighborhoods. Many people believe that increasing the income diversity of poor neighborhoods will help stabilize communities by providing them with residents who will have the resources to spend on upkeep and the political influence to demand additional city services and investments.⁵

Most housing programs in New York City and elsewhere in the nation that preceded the Ten Year Plan usually lacked a focus on neighborhood impact. HPD, from the beginning of the Ten Year Plan sought to use the housing that would be produced to catalyze other forms of economic and community development.

As the city attempts to squeeze more production out of a declining capital budget, it has also experimented with other middle income housing initiatives. For example, city-owned land was made available for the development of 3,000 new middle-income rental apartments through the Cornerstone Program. Some of these projects will be financed by a second new initiative, The New Housing Opportunities Program (New Hop). Under New Hop, the city's Housing Development Corporation blends taxable bond proceeds with its own corporate reserves to offer developers below market interest rate financing. This program, like Cornerstone, does not entail the expenditure of city capital funds.

Promoting Neighborhood Revitalization

One of the greatest innovations of the Ten Year Plan was that it married the twin objectives of housing production and neighborhood revitalization. Most housing programs in New York City and elsewhere in the nation that preceded the Ten

Year Plan usually lacked a focus on neighborhood impact. HPD, from the beginning of the Ten Year Plan sought to use the housing that would be produced to catalyze other forms of economic and community development. This was evident in its choice of sites and its partnerships with community-based organizations and neighborhood entrepreneurs.

Anecdotal evidence of the success of the Ten Year Plan in promoting neighborhood revitalization can be obtained from a brief walk or ride through neighborhoods in the South Bronx, Harlem and Central Brooklyn. Where once all that stood were block after block of devastation, today most vacant buildings have been renovated, are in the process of rehabilitation or have signs announcing future work. Commercial areas which were once barren are today thriving. Streets which used to be deserted by people fearful of random violence are bustling.

Although the city used private market actors to expand its capacity and leverage an array of private resources, it did not sufficiently employ market-based incentives in the administration of programs.

Social science research is beginning to confirm what our eyes see. Several recent studies have examined the impact of the Ten Year Plan on neighboring property values (Ellen et al. 2001; Schill et al. forthcoming 2002). They have found that upon the completion of the development or rehabilitation of housing under the Ten Year Plan, the sales prices of properties within 500 feet of a rental project increase by between 1.3 and 7.7 percentage points relative to the prices of homes located in the same census tract but more than 500 feet from the project. The relative increase for sales proximate to ownership projects range from 2.3 to 7.0 percentage points. This provides empirical evidence that the housing built under the Ten Year Plan has generated spillover benefits

that are capitalized in nearby property values. These benefits might be attributable to the elimination of blighted and dangerous conditions, the creation of good quality buildings, or the immigration of additional population.

Missed Opportunities

Although the innovations and achievements of the Ten Year Plan were extraordinary, New York City did not fully capitalize on all of the possibilities that accompanied such a large expenditure of public resources. Although the city used private market actors to expand its capacity and leverage an array of private resources, it did not sufficiently employ market-based incentives in the administration of programs. For example, the selection of developers to participate in programs was typically not based upon considerations of cost saving. Instead, requests for qualifications were solicited, developers were designated and the city together with selected developers would work out project budgets.

These budgets did not typically include incentives for cost saving. In the early years of the Ten Year Plan, the Construction Management Program (CMP) demonstrated for all how serious the consequences of such a program flaw could be. In an attempt to accelerate the pace of rehabilitation, HPD retained large construction companies to rehabilitate over 1,500 units of housing. The construction managers simply bid out the subcontracts without budget limitations. With no financial incentives to rein in costs, hard costs exceeded \$100,000 per unit rather than the \$60,000 to \$65,000 per unit typical of that time period. Although less serious, other programs also lacked incentives to cut costs. For example, soft costs for NEP and NRP are determined according to a set schedule. Since developers are not rewarded for obtaining lower prices for such expenses as attorneys' and architects' fees, they

seldom do so. Similarly, for many other programs, the developer's fee is based upon a percentage of the unsubsidized total development cost. Obviously, the higher the cost, the greater the return to the builder.

In addition to the lack of market-based incentives, the city could have achieved more "bang for its buck" over the course of the Ten Year Plan if it had simultaneously made headway on the problem of high construction costs. A recent report for HPD and the New York City Partnership found that the cost of construction in New York City was the highest in the nation (Salama et al. 1999). According to one set of estimates, the cost to construct a mid-rise building in the city was 4% more than in Los Angeles, 10% more than in Chicago and 22% more than in Dallas. The culprits of the high costs are varied. For example, New York City's labor costs are much higher than those of other cities and union work rules add thousands of dollars in useless requirements and lost productivity.

New York City itself is to blame for much of the high cost of construction. Its zoning resolution is hopelessly complex and outdated; its environmental and land use procedures are burdensome and invite costly litigation; its building code is chock full of special interest provisions and its building department mismanaged. The high cost of construction in New York City is not a secret; previous studies had documented the problem and made recommendations. Nevertheless, the city has failed to act to implement reforms; instead it has used subsidy dollars as a bandage for the problem. The achievements of the Ten Year Plan are

impressive, but one can only imagine how much more housing could have been produced if each and every one of the \$5.1 billion spent would have been spent on housing rather than wasteful regulations and practices.

Conclusion

Despite the fact that New York City missed some opportunities to innovate in the creation and implementation of the Ten Year Plan and utilize efficiently all of the \$5.1 billion spent, there can be little doubt that the city's 15 year experiment in housing production has been anything less than remarkable. The city committed more capital and produced more housing than any other city in the nation's history. It accommodated the twin needs of flexibility and replicability. It served a wide variety of incomes and has been credited with the revival of entire neighborhoods that were once synonymous with the expression "urban blight."

The recession of 2001 and 2002, together with the impact of the destruction of the World Trade Center, will make it difficult for the current administration to carry on many of the achievements of the past fifteen years. Capital for housing will be limited and attention will be diverted to rebuilding lower Manhattan. Nevertheless, under any reasonable set of budget estimates, New York will continue to spend more money than any other city in the nation. The challenge for the first decade of the twenty-first century will be how to achieve more with less. New York has shown in the past that it is able to innovate to meet the needs of changing times. This track record of innovation augurs well for the future.

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Endnotes

1. This estimate excludes most housing that was subsidized by the federal government.
2. This was a unique problem and opportunity as no other major cities in the United States took title to properties as part of a real estate tax enforcement strategy.
3. A "distressed" building is one that has a high tax lien-to-value ratio and several housing code violations.
4. Some housing advocates have criticized HPD for slowness in getting the program off the ground and for not promoting tenant cooperatives. In the second round of designations, however, several petitions from tenants to form cooperatives were granted.
5. In addition, many people believe that homeownership stabilizes neighborhoods regardless of the income group of the homeowners. Homeowners are thought to have a greater incentive to maintain their properties and to demand high levels of services and amenities (Ellen et al. 2001).

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