Memorandum
To: The New York City Council
From: Richard Sullivan, Analyst, New York City Dept. of Finance
Date: 3/27/06
RE: New York City Property Tax Reform

Introduction

“While all cities have real property taxes, few if any could rival the complexity, inequity, and opacity of New York’s system.” This comment by The Manhattan Institutes’ E.J. McMahon accurately depicts the urgency of needed property tax reform in New York City. New York’s current property tax structure places an inequitable tax burden on the city’s lowest earning residents and smaller commercial enterprises. Due to the convolution of the city’s current assessment policy, many of the city’s poorest residents that shoulder the burden of disproportionately high property taxes do not pursue equitable abatement while affluent residents of Manhattan and exclusive neighborhoods in the outer boroughs reap the rewards of rapidly increasing property values and low tax rates. Further exacerbating the ubiquitous inequity, recent property tax reform implemented by city government has provided unnecessary tax relief to wealthy co-op and condominium owners while neglecting the disproportionate tax burden placed on the city’s renters. Furthermore, city hall’s effort to stimulate large scale economic development, in regions such as Manhattan’s Far West Side, has resulted in immensely favorable property tax incentives offered to the city’s leading developers of commercial property while ignoring the city’s smaller commercial enterprises. To ensure equitable tax incidence and efficient assessment practices, the State of New York and New York City governments must reform the entire property tax structure.

In 1981, the New York State Legislature and Governor Hugh Carey codified New York City’s current property tax framework into law. The legislation, State Law S-7000, categorizes properties into four distinct tax classes. The system subjects each class to different assessment rate calculations. New York City government has the legal obligation to set the nominal property tax rate for each property class. Tax Class 1 contains one, two, and three family residences. Class 2 encompasses other residential properties such as co-ops and condominiums, but does not include hotels and motels. Tax Class 3 includes the property owned by utility corporations, and Tax Class 4 includes all other property not included in Tax Classes 1 and 2 such as commercial property. The inequities and inefficiencies present in the current tax system manifest primarily in Classes 1, 2, and 4.

Class 1 Properties

Assessment and tax rate figures for Class 1 properties illustrate horizontal and locally vertical inequities. In 2003, the New York City Department of Finance expected that all Class 1 property assessments reflect 8% of the property’s full market value. Nonetheless in practice, assessment figures demonstrate a much lower percentage. The median assessment rate for all 638,221 Class 1 properties is 5.439%, well below the target percentage promulgated by the department of finance. The New York Public
Interest Research Group has revealed that Class 1 property in 12.2% of the city’s neighborhoods is over assessed while Class 1 property in 18.8% of the city’s neighborhoods is under assessed. The study concluded that horizontal inequity was pervasive. Two properties in different boroughs that have identical market values will often have unequal assessment rates. Vertical inequity was a more localized phenomenon. For example, during the 2003 fiscal year, in Sheepshead Bay, Brooklyn, a one family house with a store had an assessment of $27,504, nearly 7% of the property’s full market value. With a tax rate of $14.16 per $100 of property, the owner of that property paid $3,894 in property taxes. In Park Slope, Brooklyn, a property valued at $1.52 million generated $3,963 in tax revenue at a rate of $14.16. The assessed value of this Class 1 property was $27,993, or 1.8% of market value, well below the median of 5.493%. As a result, the owners of each of the properties paid an almost identical amount in property taxes for the same public services associated with property tax revenue. The owner of the more expensive property received a benefit by paying less for public services relative to the value of that individual’s property, resulting in a display of a regressive property tax incidence.

This inequity arises due to the implementation of a home assessment cap mandated through the legislation passed in 1981 and inconsistent assessment practices. According to the provision, the annual assessed value of Class 1 properties in New York City can not increase by more than 6% in a year or 20% over the course of 5 years. Fortunately, the assessment department does accurately reassess properties during “arms length” transactions. The legislative intent of this policy was to stem rapid assessment increases on homes as a form of tax relief. However, the legislation has resulted in the under assessment of homes that have rapidly increased in market value and the over assessment of homes that have slowly increased in market value. Also, the current assessment practices are highly irregular and complicated. The city’s assessment department is overwhelmed with its responsibilities; struggles to keep assessed values up-to-date; and maintains an arcane appeals process. Many concerned citizens and local scholars have asserted that widespread corruption exists within the department. The combination of the home assessment cap and administrative inefficiency has caused inequities to be commonplace.

**Other Residential Properties**

The New York City property tax system has a great impact on renters. In 1993, the economist Howard Chernick posited that the average New York City landlord shifts 75% of a rental property’s tax burden onto renters. In New York City, the average renter makes roughly $33,000 per year, whereas the average homeowner makes $66,000 per year. In 2005, the New York City Department of Finance reported that rental property generated 16% of the annual property tax revenue. The city government justifies this shift in tax burden as an incentive to stimulate home ownership. However, the noble intentions of the government have not born fruit mainly due to the lower economic standing of the average renter. The average renter does not have the disposable income to afford a house in New York City. Therefore they remain as the economically
disadvantaged victims of one of the most substantial property tax burdens in the city. Additionally, due to the confusing nature of the city’s property tax system, most renters do not realize the inordinate burden that they bear. The owners of co-ops and condominiums in New York City have experienced one of the most generous property tax relief programs in recent New York City history. In 1997, the City Council announced that 78,000 co-op and condominium units would be eligible for a tax break. The intention of this legislation was to equalize the tax burden between homeowners and co-op/condo owners. As a result of this initiative, some of the owners of co-ops in the wealthiest neighborhoods of Manhattan, notably residents living on 5th Avenue of the city’s affluent East Side received tax breaks. Specifically, after passage of this legislation, wealthy owners of co-ops in Manhattan were subject to an effective property tax rate of 0.95%; whereas less wealthy co-op owners in the outer boroughs such as the Bronx received an effective rate of 1.99%. The result of this measure was patently regressive, and it produced close to a $100 million abatement in “waste” because it did not equalize the tax burden between co-op owners and homeowners.

Class 2 property owners experience the same inequities stemming from the home assessment cap and inefficient assessment practices that Class 1 owners bear. Moreover, Class 2 owners experience cross-class horizontal inequities. During 2005, the New York City Department of Finance mandated that assessors must use a 45% assessment ratio for Class 2 properties at a nominal tax rate of 12.396%. In contrast, assessors had to apply a ratio of 6% for Class 1 properties at a nominal tax rate of 15.746%. If two individuals own identically valued properties, one in Class 1 and the other in Class 2, they will pay dramatically different property tax bills. For example, if the both properties are valued at $300,000, the Class 1 owner must pay $2,834 in property taxes while the Class 2 property owner must pay $16,743 resulting in an unmistakable case of horizontal inequity.

Commercial Properties

According to the New York City Department of Finance, commercial property generates 47% of the property tax revenue generated by the city. Since commercial property is very valuable in New York City, this comparatively high percentage does not compel commercial enterprise to flee to cheaper localities. Many of these commercial enterprises represent the wealthiest economic entities in the city. However, city officials have supported the enactment of tax relief for high profile developers who intend to construct commercial office space on the city’s West Side. If implemented, the tax relief could reach a figure close to $100 million. As a result of the tax relief, homeowners, renters, and smaller commercial enterprises would bear a significant portion of the burden because the city can not afford to sacrifice such a significant amount of tax revenue.

Recommended Actions

The New York City government has a myriad of actions that it could choose to implement to remedy the inequity and inefficiency present within its current property tax system. One thing is certain; it must create a uniform and easily administered property
tax structure. Additionally and most importantly, the city government must advocate for the elimination of the current tax classifications promulgated by the 1981 legislation from four categories to two categories: commercial and residential properties. Next the city should advocate for the use of a market value standard of property assessment. Subsequently, changes in assessments will not automatically lead to more property tax revenue for the city. After the implementation of a two class property tax structure, the city will likely have to proportionally increase the nominal property tax rate for residential properties above the current rate for Class 1 properties to compensate for the loss in revenue formerly received from Class 2 property tax payments. As a result, some posit that homeowners that were in Class 1 might flee after an increase in the nominal property tax rate. However, these residents live in Manhattan for the intangible benefits of the city and will most likely not relocate outside of the city after an equitable tax hike. As a result of property class reform, owners of one, two and three families will likely experience an increase in their property tax bills to compensate for a shift in tax burden from properties that were previously Class 2 properties onto those that were Class 1 properties. To offset the potentially negative effects of a tax hike, the city should enact property tax relief measures for low income owners of one, two and three family residences. Furthermore, this relief can offset any losses suffered due to the effects of capitalization on under assessed property owned by poor residents of the city. Next, the city must maintain the current commercial property tax policy without tax relief for the city’s most influential developers. This strategy will not impede development in the city. Commercial development will occur without tax relief due to New York City’s traditionally successful commercial economy. Also, a tax incentive for renters through a city income tax credit could more effectively spur home ownership by giving renters the opportunity to save the funds needed to purchase a mortgage for home ownership. Last, the city should discontinue property tax relief for wealthy co-op and condominium owners. These forms of relief facilitate the creation of patently regressive taxation practices.

Most importantly, New York City should advocate for the revaluation of all properties within its borders. The first option that the city could sponsor is to immediately lower the assessment of over assessed properties. This action may result in a drastic loss of revenue for the city. However, due to capitalization it could infuse more wealth in long term property values in over assessed communities. Ultimately, this option is not optimal because the city depends on the revenue that the current tax system generates to ensure the city’s long term recovery after 9/11 and to protect itself from the vagaries of a global economy on which the city’s fiscal well-being is dependant. And it is in effect impossible to accurately ascertain which properties are over assessed without universal revaluation. The city could also adopt a system that incrementally or immediately brings the assessment of all properties to full market value. These strategies will be much more productive, and the city should advocate for phased in revaluation to market value and simultaneously adjust the nominal tax rate to at least sustain the current level of property tax revenue. If the city implements an immediate market value reassessment, many
expensive under assessed properties will experience an immediate decrease in market values, while over assessed properties will experience a gain\textsuperscript{13}.

Ultimately, the city must attempt to retain affluent citizens that are integral to the economic health of the broader urban economy. They are vital to the city’s commercial health and provide a powerful base for tax revenue. If the city implements a gradual plan, owners of under assessed properties will experience immediate loss, but a phased in revaluation to market value will slightly mitigate the loss in long term property values. Therefore, wealthy individuals who live in under assessed properties will be more inclined to remain in the city because they would experience a mitigated decline in the value of their property. The loss experienced by under assessed property owners is a necessary sacrifice to ensure the existence of an equitable and efficient property tax system in which the citizens of New York have trust.

The New York City Department of Finance should immediately reform assessment practices within the Real Property Assessment Unit. In 2004, city government commissioned a joint task force to evaluate the unit’s assessment practices and provide recommendations for improvement. The city should immediately put the recommended actions into operation. They include:

- Provide equipment to keep assessors technologically current.
- Direct owners’ questions to the Chief Assessor’s Unit.
- Require assessors to file financial disclosure forms for every annual assessment.
- Simplify the assessment appeals process.
- Require assessors to attain the professional credentials and standards required throughout New York State.
- Use state assessing aid to fund assessor training\textsuperscript{14}.

These recommendations will facilitate administrative efficiency and fair assessment practices. They will require the city to incur administrative costs, but these costs are minimal compared to the benefits of a property tax system that is equitable, effective and worthy of the public’s faith.

Conclusion

The time has come for New York City government to advocate for the establishment of a tax system that is more uniformly implemented and less convoluted. The New York State Office of Real Property Services currently requires that all properties in New York, except in New York City and Nassau County, must be “assessed at a uniform percentage of market value each year\textsuperscript{15}.” The state should support the extension of this requirement to all properties in New York, including New York City. Property tax reform will allow the Department of Finance the ability to more accurately assess the impact of tax incidence on residents of every socioeconomic echelon. During an economic downturn, New York City will have to rely on property tax revenue for the provision of public services rendering an effective and efficient property tax system necessary for fiscal stability\textsuperscript{16}. Property tax reform will promote equity and bolster faith in city government, consequently improving the city’s vibrant and diverse society while promoting fiscal stability and accountability.
3 “A Taxing Problem: Assessment Equity for New York City Homeowners.”
4 “A Taxing Problem: Assessment Equity for New York City Homeowners.”
5 “A Taxing Problem: Assessment Equity for New York City Homeowners.”
13 “A Taxing Problem: Assessment Equity for New York City Homeowners.”