



THE CITY OF NEW YORK
INDEPENDENT BUDGET OFFICE

110 WILLIAM STREET, 14TH FLOOR
NEW YORK, NEW YORK 10038
(212) 442-0632 • FAX (212) 442-0350 • EMAIL: iboenews@ibo.nyc.ny.us
<http://www.ibo.nyc.ny.us>

Testimony of George Sweeting
Deputy Director, New York City Independent Budget Office
To the New York City Council Finance Committee
Oversight Hearing on Property Tax Assessments

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Good morning Chairman Recchia and members of the Finance Committee. My name is George Sweeting and I am a deputy director of the New York City Independent Budget Office. Thank you for the opportunity to appear before you as part of this oversight hearing on the city's property tax assessments

The backdrop to this hearing is the issue of the assessments for Queens coops on the 2012 tentative assessment roll, and I will be discussing these, as well as some additional issues that our office has uncovered, including further questions about the selection of comparable buildings for coop and condo assessments, and the use of a trend to value about 10 percent of coop and rental properties across the city. But I also want to raise a broader problem—the pattern that has developed over the last five years for the Department of Finance (DOF) to have to make large scale revisions to assessments after the tentative roll is released in January. The need to make so many changes after the tentative roll undermines taxpayers' ability to understand how their individual liability was calculated and challenge it if appropriate. The city's property tax system is already opaque and this pattern further clouds the system.

The Queens Coop Story. You have already heard much about the coop assessments in Queens. The Department of Finance has previously testified that they found a pattern of underassessment in Queens coops and that the large increases in market values shown on the January 5th tentative roll were believed to reflect more accurate values. IBO's review of the 2011 assessment roll confirms that the estimated market values of Queens coops took a sharp dip last year while rental buildings in the borough were seeing little change. The median market value change for Queens elevator coops was -9.0 percent last year, while the median change for similar buildings in Manhattan and Brooklyn was essentially flat. The picture is less clear in earlier years, with the median market value change for Queens coops generally being more negative than in the other boroughs, although the differences were not as striking as in 2011.

The finance department has previously testified about the procedural changes this year which presumably account for much of the market value increase, but It is still not entirely clear why Queens coop market value growth was so large this year—the median increase for elevator buildings was 21 percent compared with 7 percent in both Manhattan and Brooklyn. The divergence in Queens coop values from those in Manhattan and Brooklyn appears to coincide

with the department's switch to using gross income multipliers to value Class 2 buildings. The switch back to the more common income capitalization method this year appears to have resulted in some catching up with current market values.

One theory for why the change was so large in Queens this year was that DOF erroneously relied on commercial properties as comparables in some cases, but this does not appear to be true. The department has indicated to us that in all but one of the cases the department's Web site originally indicated the use of commercial "comps," the mistake was found and corrected before the January 5th tentative roll was completed. Thus, the mistake was in reporting that they had used the commercial properties rather than actually using them. In the file currently posted on the finance department Web site, there is no evidence of commercial properties being used as comparables.

Problems with Comparables. In analyzing the Queens coop story, IBO looked further into the use of comparables to value coops and condos citywide and found some additional concerns. Our review found that proximity of comps may have been given too much weight compared with other building characteristics, inconsistency in how assigned income and expenses relates to the income and expenses of the selected comps, and the use of trending to value almost 10 percent of rental and coop buildings rather than using comps.

You will recall that under Section 581 of the New York State Real Property Tax Law, the city is required to value coop and condo properties as if they were income producing rental properties rather than the more conventional use of sales prices of individual apartments to estimate market value. Thus, the finance department must find rental buildings that are comparable based on characteristics such as age, size, and location, and then use the income and expense information of the comps to assign an estimated income and expense to the subject coop or condo property. Few tax analysts would choose this approach to valuing coops and condos if the law did not compel them to do so. One of the significant procedural changes made by the Department of Finance this year was the introduction of a new Computer Assisted Mass Appraisal system, which included a process for computerized selection of the comps to be used to value coops and condos. IBO's understanding is that in the past assessors were largely responsible for the selection of comps.

IBO's review of the list of comps posted on DOF's Web site suggests that there were other problems with the comparable selections this year, beyond the initial selection of commercial properties, and indeed beyond Queens. That does not mean that the process used in other years was always correct; rather the transition may have introduced a different set of issues which the Department of Finance is now working hard to resolve.

First, our analysis suggests that the finance department's system may have given too much weight to location, preferring nearby rental buildings over ones further away from the subject that were otherwise closer matches, particularly on size. For example, we found 44 Class 2 buildings—which by definition have 11 or more units—that appear to have been valued using smaller Class 2A and 2B comparables. Of the 44 buildings, 16 had at least 17 apartments. Last year most of these 44 buildings were valued with comps that were closer in size, albeit further away. The Department of Finance has assured IBO that they believe these smaller comps are an

appropriate source of income information for larger buildings, although the department has also indicated to IBO that they intend to reexamine the weights they assign to these criteria next year.

A second issue was the number of comps used to value individual buildings and how the income assigned to the subject property lined up with the incomes reported for the indicated comps. We found many more parcels this year that appeared to have been valued with only one comp and a significant increase in the number of parcels where the assigned income exceeded the highest income among the comps, let alone the median of the comps. The finance department has informed us that the file of comps we downloaded from their Web site—and was still posted as of Friday—is “out of date” and that “a new comp file with additional updates will be posted in the near future.” In the meantime the department advises that their analysis of the updates indicates that “most coops were assigned incomes...that fell within the range of the incomes...of the comparables selected for the parcels.”

A third issue was that 1,536 coops on the 2012 tentative roll appeared to have no comps, based on the April 3 file that we downloaded. Of these coops, 457 showed income in the Notice of Value file that is used to inform taxpayers as to how their market value was determined. Without comps available for analysis, the source of that information is unclear. The finance department informed us that “in some cases, we use income and expenses reported by coops” rather than comps, although the department did not indicate if that was true for this entire subgroup. Many coops are not required to file income and expense statements. The remaining 1,079 coops without comps had no income, expenses, or cap rates shown in the Notice of Value file. Of these coops, 910 showed market value increases of 7 percent. The department has informed IBO that these buildings were assigned a trend value via a system override and therefore there are no comps and Notice of Value income fields to display.

Trending. This trending was not limited just to coops. IBO found that approximately 2,800 Class 2 parcels, or about 8.8 percent of coop and rental properties with 11 or more units, were assigned 2012 market values that were 7 percent higher than their 2011 value. It is not clear how the 7 percent increase was determined nor how the buildings were chosen, although there is a concentration in Brooklyn (15.4 percent of the coop and rental buildings) and Manhattan (7.8 percent). Citywide, the coop and rental buildings that were not trended had a median market value increase of 10.7 percent. In some neighborhoods such as Northern Flatbush, where nearly 14 percent of the buildings got the trend increase, the median increase for those not trended was 15.1 percent, more than twice the increase for those with the trend value. On the other hand, there were neighborhoods such as Midtown East where the buildings not trended had a median market value increase of 5.8 percent. It would not be surprising for those owners who got the trend value in Midtown and those who did not in Flatbush to question the city’s administration of the property tax.

Trending is sometimes used in mass appraisal systems to treat a whole area or neighborhood uniformly when computer models generate distorted values for some local reason, but that does not appear to be the case here. Trending tends to treat individual neighborhoods uniformly, which did not seem to occur in this instance. At the same time, when trending is used, it is more common to see variation in the trend percentage from one neighborhood to the next, reflecting differences in conditions in local markets.

Transparency and Stability. The Department of Finance has been working to address some of the anomalies on this year's roll, particularly for Queens coops. One consequence of this effort is that the city still does not have a truly completed tentative assessment roll which a property owner can use to judge the fairness of their assessments against others. This pattern of major changes after the tentative roll is released has been repeated for the past four or five years. Even though the changes are aimed at getting the numbers right, this process comes at a cost to the transparency and administrative openness of the system.

In theory all policy changes and systematic adjustments should be implemented before the tentative roll is completed each January 5th. The tax law allows for so-called Change by Notice adjustments that are initiated by the department after January 5th, but until four or five years ago, such changes had most commonly been used to make corrections of egregious errors in individual property records and apply new exemptions and updates for buildings under construction. Therefore, property owners considering whether to appeal their assessment to the Tax Commission could largely rely on the information released in January with the tentative roll.

In recent years, however, the Department of Finance has regularly dealt with the need to make large scale changes either to correct systematic problems or to implement last minute policy changes, leaving owners with a moving target when judging the fairness of their assessments. The city's convoluted property tax system already makes it hard enough to understand and compare assessments. While the department is working to resolve some of this year's issues in time for the final roll due date of May 25th, it would be a step towards a more predictable and transparent system if in the future the city returned to making sure the roll was ready to go on January 5th and avoided the need for big changes in the subsequent months.

Again, thank you for the opportunity to testify and I am happy to take your questions.