Ronnie Lowenstein
DIRECTOR

THE CITY OF NEW YORK
INDEPENDENT BUDGET OFFICE
110 WILLIAM STREET, 14th Floor
NEW YORK, NEW YORK 10038
(212) 442-0225 Fax (212) 442-0350
Email: ronniel@ibo.nyc.ny.us

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John H. Banks
Vice President
Government Relations
Con Edison
4 Irving Place
New York, NY 10003

Dear Mr. ~~Banks~~ John,

At your request, the Independent Budget Office (IBO) has updated our June 2012 analysis of the implications for the real property tax of moving Class 3 utility property into Class 4 (commercial property) without changing the city's total property tax levy. As before, the proposal we considered was a revenue neutral shift from a four-class to a three-class system. Switching to a three-class system, while maintaining revenue neutrality, would increase the levy on current Class 4 properties by 0.6 percent, or an additional $59 million. The increase would be offset by a 3.4 percent savings for current Class 3 properties, equal to $46 million. Class 1 and Class 2 properties would also experience reductions in tax liability of $3 million and $9 million, respectively. However, these results are sensitive to conditions at the time of the merger and may not be representative of results in other years; to assess the long term implications of combining Classes 3 and 4, it would be necessary to look at the impact of the combined class over a longer period of time.

While the city has reclassified properties before, there has not been another case where an entire class was eliminated. Therefore a number of issues would need to be considered carefully if all Class 3 properties were to be moved into Class 4.

Methodology. In order to conduct this analysis, it was necessary to make significant assumptions regarding how the tax rate for a newly combined 3/4 class ("combined class") would be calculated. First, we worked with the 2015 final assessment roll and tax levy, since those have already been set and we had final numbers with which to work.

Second, we assumed that the current base proportions—which determine the share of the levy each class will bear—would be recalculated using weighted equalization rates or adjustment factors during the transition to the new combined class. Under this scenario, the market value and base proportion in the combined class would be equal to the sum of the individual Class 3 and 4 valuations and proportions. If the base proportions were calculated using the current Class 4 equalization rate or adjustment factor, the levy implications would be different. The extent and direction of the difference would vary depending on when the change was implemented.

Third, to calculate the 2015 current base proportions we use the statutory five percent cap on base share growth. Since 1992, when the cap on class share growth was implemented, the state legislature has passed legislation at the request of the City Council and the Mayor to reduce the cap in all but three years (1994, 2005, and now 2015). Thus, for 2015 the cap remained 5 percent and as a result, Class 3's base proportion declined 12.3 percent while Class 4's increased 4.0 percent. Under the proposed three-class system, the base proportion for the combined class would grow by 1.8 percent.

Fourth, in calculating the adjusted base proportion, we simply transferred all the assessed value in Class 3 to Class 4. The rest of the calculation followed the preset formula.

Fifth, we used IBO's projection of the adjusted base proportions for 2015 under the current four-class system and with a combined class to calculate the class tax rates necessary to yield the 2015 property tax levy. For illustrative purposes, we calculate the tax rates under the three-class and four-class system using the assessed value net of the assessment of veteran's property. This approach allows for comparable tax rate estimates but results in rates for the four-class system that are slightly higher than the enacted rates in Class 1 and 2 – the increase in these classes is an artifact of our exclusion of the assessed value of veterans' property which is found almost entirely in the two residential classes.

Results. IBO's analysis shows that the tax rate for a combined class would have been 10.749 percent, compared with 11.125 percent for Class 3 and 10.684 percent for Class 4. The tax rates for Class 1 and Class 2 rates would be similar under the current system and the three-class system.

The total levy would remain at $22,388 million. With the shift, current Class 3 properties would pay $46 million less in property taxes while current Class 4 properties would pay $59 million more. Class 1 and Class 2 together would see their liability reduced by $12 million. In percentage terms, Class 3 would experience the largest decline, 3.4 percent, under the three-class system while Class 4 aggregate liability would increase about half a percent.

Property Tax Levy Implications of Merging Class 3 into Class 4

Based on 2015 data, dollars in millions

		Current 4 Class System		Proposed 3 Class System		Change in Levy	
	Assessed Value	***Tax Rate***	***Levy***	***Tax Rate***	***Levy***	***Dollars***	***Percent***
Class 1	$16,915	0.19274	$3,260	0.19253	$3,257	($3)	-0.11%
Class 2	$63,037	0.12875	$8,116	0.12861	$8,107	($9)	-0.11%
Class 3	$12,355	0.11125	$1,375	0.10749	$1,328	($46)	-3.38%
Class 4	$90,207	0.10684	$9,638	0.10749	$9,696	$59	0.61%
TOTAL	$182,515		$22,388		$22,388		

NOTES: Assessed value is billable taxable assessed value. Tax rates are those levied on non-veterans property. Values may not add due to rounding.

SOURCES: IB analysis of Department of Finance Real Property Assessment Database and Real Estate of Utility Companies database, 2015 Tax Fixing Resolution, 2015 Resolutions Certifying Current Base Proportion and Adjusted Base Proportion

IBO also looked at the tax implications for the average parcel in each class. As Class 3 has 299 taxable parcels on the 2015 roll, the average per parcel tax savings is large compared with the other classes. In a combined class, we estimate that an average utility property would save $155,372 in property taxes compared with the current classification system. In addition, the average savings for Class 1 ($5 per parcel) and Class 2 ($34 per parcel) properties would be very modest. Based on the constant revenue assumption, Class 4 would pay for these savings with an average per parcel liability increase of $602.

Remaining Questions. As noted, there are some issues regarding how the merger of Class 3 into Class 4 would be handled that would need to be carefully examined when implementing such a policy change. First, in our analysis, we made a series of assumptions about how the current base proportions and adjusted base proportions for the combined class would be calculated. The extent of the shift in tax burdens depends on how this is done and any legislation implementing such a policy change would need to spell out the precise methodology. For example, while we used a weighted average of the Class 3 and Class 4 equalization rates, another option would be for the state to recalculate an equalization rate for the combined class, while a third option would be to use the Class 4 equalization rate as it currently stands. The latter choice would cause significantly different levy implications than our results suggest.

Second, the method for assessing properties that are transferred from Class 3 to Class 4 would need to be clarified. Currently, most Class 3 properties are assessed by the state using a cost assessment methodology. On the other hand, Class 4 properties are assessed by the city and in most cases the city uses net income capitalization.

Third, market value changes for properties in Class 4—excluding those resulting from physical improvements—are phased-in over five years, while all market value changes are recognized fully in the first year in Class 3. A decision would need to be made on whether to allow utility properties to also benefit from a five-year phase-in of market value changes once they are transferred to Class 4. If properties currently in Class 3 were to start phasing in their market value changes (generally increases in value), then the rate of assessment growth for those properties would be slower for the first few years (as the pipeline is established) and then more stable than is currently the case. This change would have implications for class shares among the three remaining classes.

In conclusion, IBO finds that if Classes 3 and 4 are combined without changing the overall size of the property tax levy, a majority of the tax savings in the first year, about $46 million in total, would accrue to taxable Class 3 properties. Parcels in Classes 1 and 2 would also see modest tax reductions of $3 million and $12 million, respectively. Conversely, Class 4 parcels would see a tax increase of $59 million, an average increase of $602 per parcel.

If you have any further questions about this matter, please feel free to contact me at (212) 442-0225 or Ana Champeny, who supervised the analysis, at anac@ibo.nyc.ny.us or (212) 341-6045.

Sincerely,

Ronnie

Ronnie Lowenstein
Director