

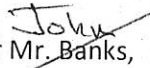


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June 3, 2009

John Banks
Con Edison
4 Irving Place
New York, NY


Dear Mr. Banks,

At your request, the Independent Budget Office (IBO) has analyzed 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. In other words, 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 for current class 4 properties by 2.4 percent, or an additional \$150 million, while Class 3 properties would see a substantial 13.6 percent or \$153 million reduction in their levy. Due to a slight shift in class shares, Classes 1 and 2 would see a levy increase of less than 1 percent, totaling \$4 million.

While the city has reclassified properties before, there has not been another case where an entire class was eliminated. Therefore, as we discuss below, there are a number of issues that 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 the new combined 3/4 class ("combined class") would be calculated.

First, we worked with the 2009 final assessment roll and tax levy, since those have already been set and we had final numbers with which to work. Once the City Council adopts the tax fixing resolution for 2010, IBO could update this analysis using 2010 numbers.

Second, we assumed that the current base proportion—which determines the share of the levy each class will bear—would be recalculated for the combined class using weighted equalization rates or adjustment factors. 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 proportions and valuation. If the base proportions were calculated using the class 4 equalization rates or adjustment factors, the levy implication would be different. Furthermore, we assumed that the cap on the percent increase in the current base proportion was 0 percent, as it was in 2009.

Third, 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. This decision resulted in a slightly lower class adjustment factor (compared to a weighted average). The adjusted base proportion for the combined class was slightly below the sum of the Class 3 and 4 adjusted base proportions, 47.809 for the combined class compared to 47.830 for the individual classes. As a result, there was a very slight increase in the Class 1 and 2 adjusted base proportions.

Fourth, we used the actual adjusted base proportions for 2009 and the new adjusted base proportions with a combined class to calculate the class tax rates necessary to yield the 2009 property tax levy. Note that due to a slight quirk in the calculation, the actual tax rate for Class 1 under our calculation is slightly above the tax rates passed by the Council. In order to be consistent in our comparison, we used the tax rate we calculated for both the current system and a combined class system.

Results. IBO's analysis shows that the tax rate for a combined class would have been 10.108 percent, roughly the weighted average of the individual Class 3 and Class 4 tax rates. The Class 1 and Class 2 tax rates would increase just barely, due to the slight increase in the adjusted base proportion. The total levy would remain at \$15,186 million. Properties formerly in Class 3 would pay \$153 million less in property taxes and Class 4 would pick up virtually all of that, with a \$149 million increase in the property tax levy for Class 4. Of the remaining \$4 million, \$1 million would be shifted to Class 1 and \$3 million to Class 2. Given that the Class 3 levy is currently \$1,122 million, the properties in Class 3 would see a 13.6 percent reduction in levy. Because the Class 4 levy (\$6,209 million) is much higher to begin with, the shift in levy would lead to a 2.4 percent increase for Class 4.

Property Tax Levy Implications of Merging Class 3 into Class 4							
Based on 2009 data, dollars in millions							
	Assessed Value	Current 4 Class System		Proposed 3 Class System		Change in Levy	
		Tax Rate	Levy	Tax Rate	Levy	Dollars	Percent
Class 1	\$13,955	0.15728	\$2,195	0.15734	\$2,196	\$1	0.0%
Class 2	46,544	0.12161	5,660	0.12166	5,663	3	0.0%
Class 3	9,589	0.11698	1,122	0.10108	969	-153	-13.6%
Class 4	62,908	0.09870	6,209		6,359	149	2.4%
TOTAL	\$132,996		\$15,186		\$15,186	\$0	
Notes: Assessed value is billable taxable assessed value in 2009. Values may not add due to rounding.							
Sources: IBO, Department of Finance Record book file, 2009 Tax Fixing Resolution, 2009 Resolutions Certifying Current Base Proportion and Adjusted Base Proportion							

IBO also looked at the tax implications for the average parcel in each tax class. As Class 3 has only 318 parcels with taxable billable assessed value, the average savings per parcel are large. The average parcel currently in class 3 would see a property tax reduction of \$479,485. Class 4 has many more properties across which to distribute the levy increase resulting from combining the two classes. Therefore, the average parcel currently in Class 4 would see a property tax increase of \$1,734. Because of the large number of parcels (far outnumbering those in classes 3 and 4) and very small levy increase, the average parcel in Class 1 would see a \$1 increase, while the average increase for a parcel in Class 2 would be \$11.

Average Parcel Property Tax Levy Implications of Merging Class 3 in Class 4				
Based on 2009 data				
	Parcels	Per Parcel Average Levy		
		Current 4 Class System	Proposed 3 Class System	Change in Levy
Class 1	699,809	\$3,136	\$3,138	\$1
Class 2	217,734	25,995	26,007	11
Class 3	318	3,527,496	3,048,011	-479,485
Class 4	86,219	72,018	73,751	1,734
Sources: IBO, Department of Finance Record book file, 2009 Tax Fixing Resolution, 2009 Resolutions Certifying Current Base Proportion and Adjusted Base Proportion				

Remaining Questions. As noted, there are some issues regarding how the merging 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, one option would be for the state to recalculate an equalization rate for the combined class, while another would be to use the Class 4 equalization rate as it currently stands. The latter choice would have a significantly different impact on the distribution of the tax levy than the results presented above.

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. It would need to be made clear whether utility properties would 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 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 also have implications for class shares among the three remaining classes.

In conclusion, IBO conducted an analysis of the one-year impact of combining Classes 3 and 4, finding that most of the reduction in the levy of the current Class 3, about \$153 million, would be shifted to the properties in Class 4, at an average increase of \$1,734 per parcel. To assess the implications more fully, it would be necessary to look at the impact over a longer period and with a clearer sense of how the merger of the classes would be handled.

If you have any further questions about this matter, please feel free to contact me (212-442-0225, ronniel@ibo.nyc.ny.us) or Ana Champeny (212-442-1524, anac@ibo.nyc.ny.us), IBO's property tax analyst, who conducted the analysis.

Sincerely,

A handwritten signature in dark ink, appearing to read "Ronnie", with a stylized flourish extending from the end.

Ronnie Lowenstein
Director

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