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

Dear Mr. Banks,

At your request, the Independent Budget Office (IBO) has updated our June 2009 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 2.9 percent, or an additional $235 million. That increase would be offset by a substantial 12.4 percent savings for current Class 3 properties, equal to $170 million and a 0.9 percent decrease in the Class 2 levy totaling $65 million. The effect of the simulated merger of Class 3 and Class 4 is highly sensitive to assumptions about the calculation of class shares, especially with regards to Class 2 and Class 4.

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 the new combined 3/4 class ("combined class") would be calculated.

First, we worked with the 2013 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 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 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.

Third, to calculate the 2013 current base proportions—which are used to allocate the levy among the classes—we assumed that the cap on the percentage increase in the current base proportions was 1.5 percent, which corresponds to legislation recently signed by Governor Cuomo that set the cap at that level. However, because the legislation lowering the cap from the statutory 5 percent had not been enacted before the city adopted the budget and fixed the tax rates for 2013, the property tax rates set by the City Council on June 28, 2012 assumed a 5 percent cap. As has been the case in recent years, the City Council is expected to pass a new tax fixing resolution implementing the 1.5 percent cap in the next few months, in advance of the next set of property tax bills.

In the absence of an enacted tax fixing resolution using a 1.5 percent cap, IBO had to make assumptions about how the excess increase above the cap would be redistributed to the other classes under either the current four-class system or the combined class system. This is especially challenging because the redistribution of the excess is at the City Council's discretion. Furthermore, this year there is excess from Classes 1 and 4 that needs to be shifted under a four-class system, while under a combined class system, there would only be excess to be shifted from Class 1. For simulating the tax rate under the current four-class system, we assume the excess from Class 1 and Class 4 will be evenly split between Class 2 and Class 3. In the three-class system, our baseline assumption is that the excess from Class 1 is split evenly between Class 2 and the combined class.

However, the value of the base proportions— and by extension the class share, tax rate, and levy for each class—is sensitive to these assumptions about how the excess is shifted. We discuss that more fully below.

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 2013 under the current four-class system and with a combined class to calculate the class tax rates necessary to yield the 2013 property tax levy.

Results. IBO's analysis shows that the tax rate for a combined class would have been 10.585 percent, close to the weighted average of the individual Class 3 and Class 4 tax rates. The Class 1 tax rate would stay essentially the same. The Class 2 tax rate would decrease by about 1 percent because the amount of excess in the base proportion calculation to be shifted under a three-class system would be lower. Under the four-class system, there is excess to shift from Class 1 and Class 4. Once Class 3 and Class 4 are combined, however, there is only excess to shift from Class 1, reducing the amount shifted onto Class 2 and thereby reducing the Class 2 tax rate.

The total levy would remain at $19,906 million. With the shift, properties formerly in Class 3 would pay $170 million less in property taxes while properties in Class 2 would pay $65 million less. Properties currently in Class 4 would bear the full increase of $235 million in their levy. Given that the Class 3 levy is currently $1,371 million, the properties in Class 3 would see a 12.4 percent reduction in levy. Because the estimated levy paid by current Class 4 properties ($8,162 million) is much higher to begin with, the shift in levy would lead to a smaller, 2.9 percent increase for Class 4.

Property Tax Levy Implications of Merging Class 3 in Class 4							
Based on 2013 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	$15,785	0.18696	$2,951	0.18697	$2,951	$0	0.0%
Class 2	$55,881	0.13280	$7,421	0.13164	$7,356	($65)	-0.9%
Class 3	$11,349	0.12083	$1,371	0.10585	$1,201	($170)	-12.4%
Class 4	$79,331	0.10289	$8,162		$8,397	$235	2.9%
TOTAL	$162,345		$19,906		$19,906		
Notes: Assessed value is billable taxable assessed value in 2013. Values may not add due to rounding.							
Sources: IBO, Department of Finance Real Property Assessment Database and Real Estate of Utility Companies database, 2013 Tax Fixing Resolution, 2013 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 only 300 parcels with taxable assessed value, the average savings per parcel are large, a property tax reduction of about $565,000 per parcel. Class 4 has many more properties across which to distribute the levy increase that results from combining the two classes. Therefore, the average parcel currently in Class 4 would see a property tax increase of about $2,600. The average decrease for a parcel in Class 2 would be about $260.

Variability from Altering the Base Proportion Assumption. As described above, the assumptions made about how the City Council allocates the excess above this year's 1.5 percent cap on the increase in the current base proportion impacts how the levy would be redistributed in a three-class system, if the merger were implemented this year. Distribution of the excess is at the discretion of the City Council. In 2013 this allocation is especially significant because Class 4 has excess to shift in a four-class system, but in a three-class system the combined class would be below the 1.5 percent cap, thereby reducing the amount of excess that needs to be shifted overall, at least for this year.

If the allocation of the excess were more heavily weighted to one class rather than the 50/50 split we assumed in estimating the results presented above, the shift in burden resulting from merging Class 3 and Class 4 would differ. For example, if more of the excess in a three-class system were shifted onto Class 2 in 2013, the Class 2 levy would increase compared with our baseline 50/50 scenario, while the levy for properties previously in Class 3 would decrease.

In a four class system, the levy on Class 4 is roughly the same regardless of how the excess is distributed. But in a three class system, the levy on properties previously in Class 4 could be either higher or lower than our baseline estimate depending on how the excess is shifted.

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, 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.

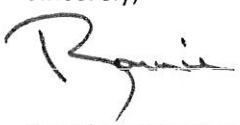
Second, the method for assessing properties that are transferred from Class 3 to Class 4 would need to be clarified. Currently, most Class 3 properties are assessed by the state using a cost assessment methodology. On the other hand, Class 4 properties are assessed by the city and in most cases the city 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. It would need to be clear if 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 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 without changing the overall size of the property tax levy, finding that most of the change in the tax would accrue to Class 3 (savings of $170 million) and Class 2 (savings of $65 million), with the burden shifted to the properties currently in Class 4, at an average increase of $2,594 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 at (212) 442-0225 or Ana Champeny (anac@ibo.nyc.ny.us or (212) 442-1524), who designed the study and analyzed the data.

Sincerely,



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