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Testimony of George Sweeting, Deputy Director of the New York City Independent Budget Office On New York City's Property Tax System To the New York State Assembly Committee on Real Property Taxation

Good afternoon Assemblywoman Galef and members of the Committee on Real Property Taxation. I am George Sweeting, deputy director of the New York City Independent Budget Office. Thank you for the opportunity to testify at this hearing on New York City's property tax system.

Over the years my office has produced a number of reports and analyses detailing many of the disparities and inefficiencies in the current system (all are available on our website). While some problems can be addressed by changes to the city's processes and policy, most are rooted in state law and therefore would require state legislation to address. My testimony today will focus on the most important issues that merit Albany's involvement. These concern disparities among similar types of property, disparities between different types of property, and the lack of transparency for taxpayers.

Disparities Among Similar Types of Property. A basic principle of tax policy is that similarly situated properties should be treated similarly. New York's assessment caps on one-, two-, and three-family homes and small apartment buildings, and the requirement to use distorted market value estimates for coop and condo buildings, guarantees that similar properties will face widely different tax burdens depending on where they are located in the city. Moreover, these differences vary systematically so that neighborhoods with faster rates of appreciation tend to face lower tax burdens. These neighborhoods also tend to have higher value properties and higher average household incomes.

For one-, two-, or three-family houses the city has set a "target" assessment ratio of 6 percent of market value, but many properties are assessed at a lower ratio so that for 2016, the citywide median ratio is 5.1 percent of market value. This is because annual assessment increases are limited by state law to no more than 6 percent a year or 20 percent over five years, even when market values are increasing at a faster rate. Any year that market value growth exceeds 6 percent, the assessed value will grow by no more than 6 percent, thereby lowering the assessment ratio. (Apartment buildings with four to ten units also benefit from caps on annual increases of 8 percent and 30 percent over five years.)

These caps were introduced to protect property owners whose ability to pay may not keep up with tax increases driven by rapid appreciation. Because neighborhoods experience different rates of appreciation over time, the caps result in wide disparities in tax burdens across neighborhoods.

To facilitate comparisons of tax burdens between properties and neighborhoods we measure effective tax rates—or ETRs—which are defined as the tax levy divided by market value. Note that the ETRs reported here reflect exemptions, but do not include abatements. In the case of coops and condos we use a sales based market value estimate rather than the official Department of Finance value that is constrained by Section 581 of the state real property tax law.

The city median ETR for one-, two-, and three-family properties is 0.92 or $0.92 for every $100 of market value, based on the 2016 assessment roll. But looking at individual neighborhoods, we see that places such as Park Slope in Brooklyn, which has seen steady appreciation for more than 20 years, the median ETR is $0.30 for every $100 in value, less than one-third of the citywide measure. Just a few miles away in Canarsie the median ETR is 3.7 times higher at $1.09 for every $100 in value. This means the owner of a $500,000 house in Park Slope would pay about $1,241 while the owner of a $500,000 house in Canarsie would pay $5,462. The attached map shows the variation in neighborhood median ETRs across the city.

In addition to producing such wide disparities, assessment caps are an inefficient means of protecting existing homeowners from unaffordable tax increases. Instead of only targeting those homeowners who need assistance, the caps benefit all the owners in areas experiencing rapid appreciation. Moreover, baring a major collapse in home prices in the city, assessments in such areas will not reach the target assessment ratio for many years, which means new owners moving into gentrifying neighborhoods also enjoy the benefit of a lower ETR than homeowners in other parts of the city.

Another by-product of the assessment caps is erosion of the city's property tax base because the caps will continue to suppress assessments relative to market value growth when growth exceeds 6 percent. Assuming the city looks to generate the same revenue, tax rates are higher than they would be in the absence of the caps, meaning owners of uncapped properties pay more.

Some of these problems could be partially addressed without state law by lowering the target assessment ratio from 6 percent, reprising a comparable shift from 8 percent to 6 percent implemented in 2007. Such a change would narrow the disparities between neighborhoods, although it would do little to address the inefficiencies due to the caps. And it would lock in the erosion to the tax base that has already occurred.

ETRs for coops and condos also vary widely across the city as the city is compelled by state law to value these properties as if they were income-producing buildings rather than by estimating or observing the sales prices of individual units in the building. Assessors must look for rental buildings that are comparable by age, size, and location. In many cases, especially for coops in parts of Manhattan and Brooklyn, the available comparables often include one or more rent-regulated buildings with constrained rent rolls. In the case of newer luxury condos there are almost no rental buildings that are truly comparable.

Once comparable buildings are identified, the per square foot net income is then imputed to the coop or condo building. Because coops and condos generally have higher valued finishes and amenities than rental properties, this usually results in official market values that discount sales-based market values. IBO estimates that citywide, the discount—which we refer to as the 581 discount—for condos is about

82 percent; for coops it is around 77 percent. In other words, only 18 percent of the market value of condos is included in the tax base.

While virtually all coops and condos benefit somewhat from this legally required discounting, the extent of the discount varies. The following table shows those neighborhoods with the largest and smallest average market value discounts for condos. The greater the discount, the lower the ETR. As a result, apartments with the similar selling prices can end up paying very different taxes.

Neighborhoods with Largest Market Value Discounts		Neighborhoods with Smallest Market Value Discounts	
Chelsea-Flatiron-Union Square	-91%	Hunts Point	-66%
Prospect Heights	-90%	Pelham Bay-Country Club-City Island	-66%
UpperEastSide - CarnegieHill	-90%	Highbridge	-66%
Midtown - Midtown South	-89%	Pelham Parkway	-66%
DUMBO-Vinegar Hill-Downtown Brooklyn-Boerum Hill	-88%	Melrose South-Mott Haven North	-66%
Crown Heights North	-87%	Williamsbridge-Olinville	-66%
Williamsburg North Side-South Side	-87%	Morrisania-Melrose	-63%
Prospect-Lefferts Garden-Wingate	-87%	Parkchester	-61%
West Village	-87%	Briarwood-Jamaica Hills	-56%
Park Slope-Gowanus	-87%	Jamaica	-28%

The requirement to use imputed income rather than sales price for apartments removes roughly $300 billion from the property tax base. If these dollars were instead included in the base, the overall tax rate could be reduced, although not without some redistribution of tax burdens.

Disparities Between Property Types. Unlike the rest of New York State, where the law calls for uniform assessment across all types of property, New York City and Nassau County classify property by use and uniformity is only required within classes. Although classification and disparate treatment between classes is not uncommon in property tax administration, the size of the differences in ETRs that result between property types in New York City is quite large.

The city, which has discretion to set the assessment ratio, uses 45 percent for commercial property in Class 4, utility property in Class 3, and apartment buildings (including coops and condos) in Class 2, while the target assessment ratio for one-, two-, and three-family homes in Class 1 is only 6 percent, with many of these properties assessed at a lower ratio due to the assessment caps described earlier. As a result, Class 1 accounts for a much lower share of the taxable assessed value than its share of market value, while the other classes contribute a disproportionately higher share of the taxable assessed value relative to their share of market value.

The disparity in tax treatment that results is made worse by an arcane process for setting the tax rates for each class, a process that seeks to preserve each class's share of the levy as it stood in 1989. Only minor annual adjustments are allowed, to account for changing shares of market value. Class 1 has accounted for the largest share of market value growth since 1989, but in most years since the early 1990s, the Legislature has acceded to the city's request to limit even these small potential adjustments in order to hold down the tax burden on homeowners, leaving more of the burden to fall on the other classes.

Comparing Shares of Assessed Value, Market Value, and Levy and Effective Tax Rates

	Assessed Value Share	Taxable Assessed Value Share	Share of Market Value*	Share of Levy	ETR Per $100 of Market Value
Class 1	7.3%	9.3%	30.5%	14.5%	$0.77
Class 2	34.6%	34.5%	45.4%	36.2%	$1.30
Coops (11+ units)	*9.5%*	*10.0%*	*17.6%*	*10.5%*	*$0.97*
Condos (11+ units)	*5.4%*	*5.2%*	*13.1%*	*5.4%*	*$0.68*
Rentals w/elevators	*12.0%*	*10.5%*	*5.0%*	*11.0%*	*$3.60*
Rental walkups	*4.2%*	*4.6%*	*1.7%*	*4.8%*	*$4.50*
Class 3	5.0%	6.8%	2.1%	6.1%	$4.83
Class 4	53.1%	49.4%	22.1%	43.1%	$3.18

Source: IBO, Department of Finance 2015 Assessment Roll
*Market values use apartment sales to estimate the value of cooops and condos

The table above compares the shares of assessed and market value and average ETRs for the four tax classes, as well as specific residential property types in Class 2. The data are from the 2015 assessment roll, with market values adjusted to account for the required discounting of coop and condo properties under Section 581 of state property tax law. Class 1 accounts for 30.5 percent of the market value, but only 9.3 percent of the assessed value subject to taxation. The share of the levy borne by one-, two-, and three-family homeowners is also well below their share of market value. By comparison, commercial properties in Class 4 account for 22.1 percent of the market value, but because they have about 50 percent of taxable assessments, their owners pay 43.1 percent of the levy. Within Class 2, rental properties also pay higher shares of the levy then their shares of market values..

Looked at in ETR terms, we can see that Class 1 owners and coop and condo owners face the lowest average tax burdens measured with IBO's estimated market values, $0.77 per $100 of market value. Class 4 has an average ETR of $3.18 per $100 of market value, more than 4 times higher than the Class 1 ETR. Class 3 utility property is taxed even more heavily at an average of $4.83 per $100; however much of the property tax paid by regulated utility companies is ultimately passed on to consumers through higher prices.

The highest effective tax rates are faced by owners of rental elevator and walkup properties in Class 2, with average ETRs that are 4.7 and 5.8 times higher than those paid by Class 1 owners, respectively. Although landlords bear the legal incidence of the tax, economic theory suggests that at least a portion of the property tax flows through to tenants in the form of higher rents, with the apportionment depending on market conditions and—to some extent—regulatory conditions. But because tenants do not receive a property tax bill, they are generally unaware that they are paying a piece of the landlord's property tax in their rent. And in the city's property tax system, the part of the tax burden their rent helps to pay is disproportionately high compared with the burden on people who own their homes.

While the low ETRs for houses and coop and condo apartments help attract and keep homeowners in the city, the much higher ETRs on rental and commercial property raise the cost of developing these properties. In recent decades the city has offered tax incentives to spur commercial and apartment development in part to help offset the high tax burden of these properties. An alternative approach to relying on tax incentives would be to bring more of the value of residential property into the tax base, which would allow for a reduction in the overall tax rate and remove some of the pressure to offer incentives.

Lack of Transparency. A final issue that merits attention is the opaqueness of the city's property tax. It is so complex, with its multiple assessment methods, assessment caps on small properties, transitional assessments in Classes 2 and 4, multiple exemptions and abatements, and class share system for apportioning the levy, that it is virtually impossible for the typical taxpayer to understand how her tax bill was determined or to understand how her assessment compares with a neighbor's. Even those of us who work on it for a living have a hard time following all of the moving pieces. Yet, the property tax should be a relatively easy tax for citizens to understand, at least in theory. Some complexity is inevitable, particularly if there is a goal of mitigating the effect of rapid appreciation on tax bills for those with fixed and/or low incomes. But such protection can be provided more directly and explicitly via credits or abatements than by the blunt force of assessment caps.

What Is To Be Done? IBO does not make specific policy recommendations and I will not do so today. I will make one general point, however. Over the years since the current system was established in 1981, there have been a series of piecemeal changes to address specific problems with the property tax system. In many cases, these band aids, however well intentioned, have created or exacerbated other problems in the system. The best example is probably the coop-condo abatement, which aimed to bring coop and condo tax burdens more in line with the burdens on homeowners. But because the abatement did not change the underlying assessments, the effect was to widen disparities within the coop and condo class. This suggests that fixing a property tax system that virtually all property owners think does not work for them requires a comprehensive overhaul rather than piecemeal tinkering, with all elements of the system on the table

Thank you again for the opportunity to testify, and I am happy to answer your questions.

Neighborhood Median Effective Tax Rate for Class 1 Properties