

Options for Property Tax Reform: Equitable Revenue Raising Reforms for New York City's Property Tax

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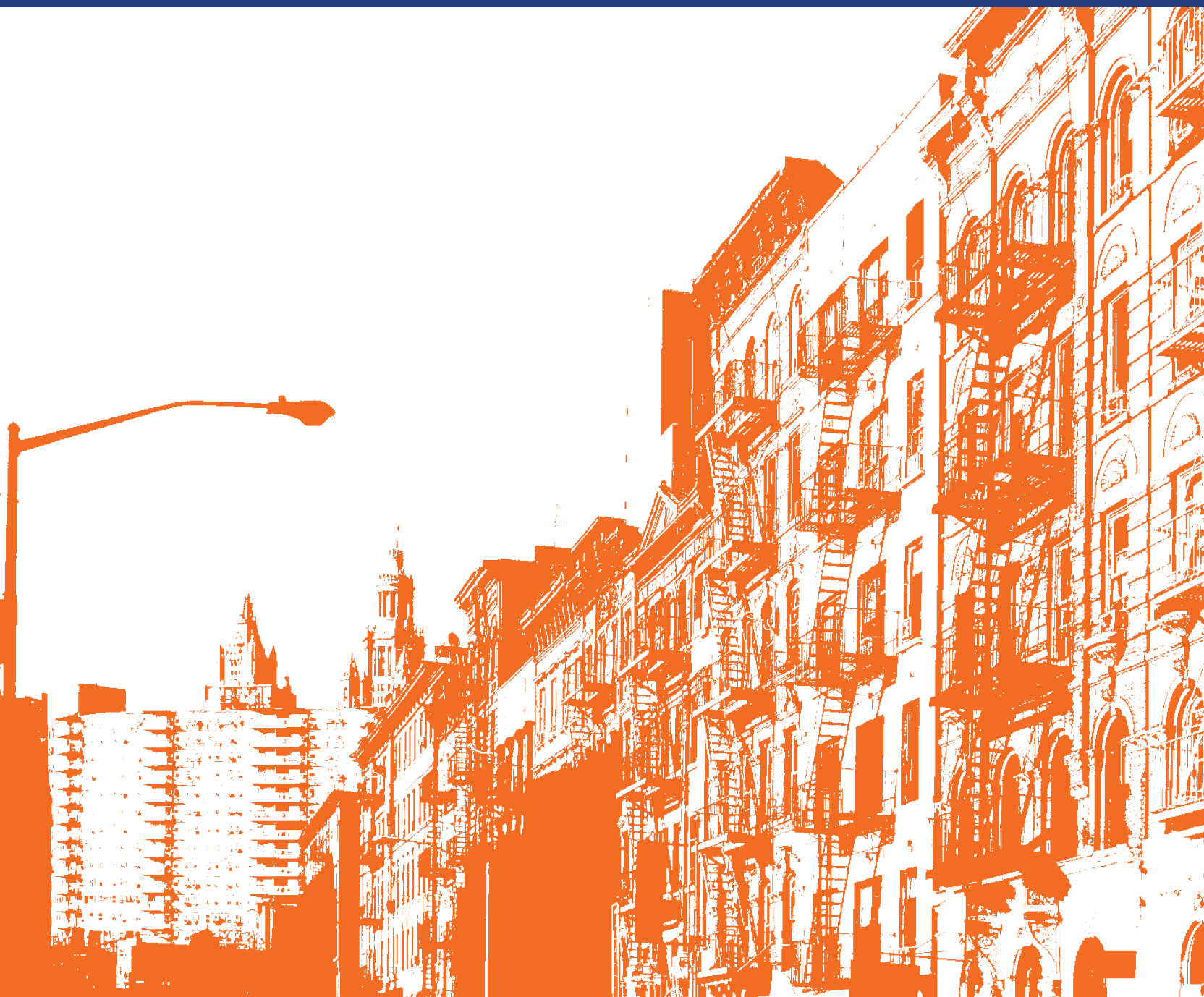


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INTRODUCTION

Mayor-elect Bill de Blasio inherits a budget that is balanced in the short-term and has relatively modest gaps in the later years of the four-year financial plan prepared by the Bloomberg Administration. But the balanced budget provides no money for pay increases for past years when municipal employees worked under expired contracts, does not fund the expanded prekindergarten program that is a high priority for the new administration, and makes no provision for other new needs or initiatives that may be identified. In order to address these concerns, more money will be needed.

New York City's property tax deserves an especially close look as a potential source of revenue for two reasons. First, the property tax is the single largest source of tax revenue for New York City. Second, New York's complex and opaque property tax is riddled with inequities and inefficiencies. Budgetary necessity will likely require some form of increase in the property tax levy. The moment should not be wasted as an opportunity to make the system more transparent and equitable as well.

The purpose of this report is to describe three options for increasing property tax revenues. The first of these options maintains status quo inequities; in contrast, the other two address some major problems with fairness and efficiency that characterize current policy. In assessing each option we focus on the effective tax rates (ETRs) borne by property owners and how the burden of raising additional revenue would be spread across different categories of property. The ETR for a property is equal to the tax billed to the property owner divided by the property's market value.

THE CURRENT PROPERTY TAX SYSTEM AND ITS INEQUITIES

The City calculates a property's tax bill by applying a specified rate to a portion of the property's market value known as its billable assessed value.¹ The billable assessed value of a property is derived from its estimated market value in a sequence of steps that, although complex, must be understood in order to identify the sources of inequities and the opportunities for reform. We begin by describing these steps.

Calculating Property Assessments

The billable assessed value of a property is calculated in three steps. First, the property is assigned to one of four tax classes based on its size and use. Class 1 is comprised of 1-3 family homes. Class 2 is the remaining housing stock, including rental buildings and condominium ("condo") and co-operative ("co-op") properties. Utility properties are assigned to Class 3. Class 4 includes all other, primarily commercial, properties.

Second, the property's market value is estimated by the Department of Finance (DOF). If the property is in Class 1, DOF examines the sales of comparable properties in the prior year and uses information from those sales to estimate the property's market value. DOF views properties in Class 2 or Class 4 as being operated by their owners for profit, and so it estimates the market values of these properties using the income that they generate.² Many Class 2 buildings, however, are not rental properties; they are owner-occupied condos and co-ops. Under state law, these buildings are also valued as if they were income-producing properties. Because owner-occupied condos and co-ops do not generate income, DOF looks to the income and expenses from comparable rental buildings to estimate the income that they would generate if rented.

The third step is the calculation of the property's assessed value. A property's assessed value is equal to the property's estimated market value multiplied by the applicable target assessment ratio. The target assessment ratio for a Class 1 property is 6 percent. All other classes have a target assessment ratio of 45 percent. In the absence of any other rules, the assessed value of a Class 1 property would be 6 percent of its estimated market value and the assessed value of any other property would be 45 percent of its estimated market value.

However, to provide taxpayers with relief from the increases in tax liabilities that would otherwise accompany sharp increases in property market values, the assessed values of certain properties are "capped." The assessed value of a Class 1 property cannot grow by more than 6 percent in one year or more than 20 percent over five years.³ Assessment increases on residential properties with 4-10 units are capped as well; the assessed values of these properties cannot increase by more than 8 percent in one year or 30 percent over five years. Because home values in many neighborhoods often grow at a rate faster than this, assessment caps result in many properties having assessed values that are less than 6 percent of their market values.

Although Class 2 properties with more than 10 units and Class 4 properties are not subject to caps on increases in their assessed values, similar rules apply to "phase-in" year-to-year changes in market values and reduce fluctuations in tax liability. The assessed value for one of these properties is the lesser of: 45 percent of its market value or its transitional assessed value. The transitional assessed value incorporates only a portion (20 percent) of the year-to-year changes in assessed value for each of the previous five years.

The assessed value of a property, net of any exemptions and after taking into account the rules for

caps and phase-ins, is its billable assessed value.⁴ The tax due on a property is equal to the nominal tax rate for the class to which the property belongs multiplied by its billable assessed value, offset by any abatements to which the property is entitled. One notable abatement – taken into account in this analysis – is the reduction in tax liability for co-ops and condos; most such units are entitled to abatements that offset 17.5 percent of the tax otherwise due, with reductions up to 28.1 percent in the coming fiscal year for buildings with relatively low assessed values.

Setting the Tax Rates under the Class Share System

For many years, New York State assessors exercised significant discretion in assessing properties at fractions of their market values, discretion that resulted in an uneven distribution of the property tax burden. In 1975 the Court of Appeals heard a challenge from a law professor and the town of Islip, and ruled to end this practice of “fractional assessment.”⁵ The New York State Legislature responded in 1981 by passing a tax reform bill known as S7000A, which created the property classification system for New York City, described above. In addition to creating property classification in New York City, S7000A also works to ensure that the share of the property tax levy collected from each class remains approximately what it was in 1981.⁶ In order to ensure that each class pays its assigned share, four different nominal tax rates are set each year, one for each class. The City Council determines these rates to ensure that the intended and statutorily allowable share of the levy is collected from each class.

Although each class' share of the levy remains relatively stable from year to year, the share of market value each class represents is not constrained. The discrepancy between class shares of the levy and of market values causes effective tax rates on properties in different classes to diverge. (See Table 1.) The differences are stark. Although nearly half of all property value in the city belongs to Class 1, only 15.28 percent of the levy is collected from that class. The implications of this favorable treatment are reflected in the tax burdens on the other classes, all of which bear a much larger share of the property

Table 1: Class Shares of New York City Market Value and Tax Levy, Fiscal Year 2014
(dollars in millions)

	Market Value	Share of Market Value	Tax Levy	Share of Tax Levy	Effective Tax Rate
Class 1	\$396,855	46.25%	\$3,212	15.28%	0.81%
Class 2	\$202,479	23.60%	\$7,679	36.53%	3.79%
Class 3	\$28,193	3.29%	\$1,289	6.13%	4.57%
Class 4	\$230,576	26.87%	\$8,840	42.06%	3.83%
Total	\$858,102	NAP	\$21,020	NAP	2.45%

NAP = Not Applicable

Note: Tax levy based on nominal tax rates and taxable billable assessed values.

Sources: New York City Department of Finance, *The New York City Property Tax FY 2014: Market and Assessed Value Summary Tables*, June 2013; New York City Council, *Resolutions of the Council: Fixing the Tax Rates, Fiscal Year 2014*.

tax levy than their share of market value. The result is that the ETR on Class 1 properties is much lower than the ETRs for other kinds of properties.⁷

Inequities across Classes

The most often discussed inequity in New York’s property tax system is the difference in ETRs across different kinds of properties. As shown in Table 1, the average ETR for Class 1 is much lower than for the other classes. However, the disparities among individual properties can be far greater than these average figures suggest.

The tax bill for two actual properties – a two-family brick home (Class 1) in Park Slope/Carroll Gardens and an office building (Class 4) in East New York /Starrett City – highlights the disparity. (See Table 2.) For each property, the market value in fiscal year 2013 was \$483,000. Under a “pure” property tax system, both properties would be assessed and taxed at the same rate. However, the home in Brooklyn has an assessment ratio of only 1.21 percent while the commercial property is assessed at 45 percent.

Table 2: Illustration of Class 1 vs. Class 4 Inequity, Fiscal Year 2013

Property Characteristics	Class 1	Class 4
Community District	Park Slope/Carroll Gardens	East New York/Starrett City
Fair Market Value	\$483,000	\$483,000
Actual Assessed Value	\$5,820	\$217,350
Assessment Ratio	1.21%	45.00%
Nominal Tax Rate	18.57%	10.29%
Tax Liability	\$1,063	\$22,363
Effective Tax Rate	0.22%	4.63%

Source: New York City Department of Finance, *Property Tax Rolls, Fiscal Year 2013*.

Although the target assessment ratio for 1-3 family homes is 6 percent, the home in this example has an even lower assessment ratio because of the caps that limit assessment increases over one- and five-year periods. Although the nominal tax rate on Class 1 properties is higher than the nominal rate for Class 4, the enormous difference in assessment ratios results in the owner of the commercial property paying an ETR and tax bill *21 times greater* than the owner of the two-family home.

Similar discrepancies in assessment ratios and ETRs arise between 1-3 family homes and large rental properties. Of course, the decision to tax commercial and large rental properties much more heavily than homeowners is an explicit policy decision, which we discuss at greater length below. However, it is important to note that homeowners are, on average, wealthier than renters. It is almost certainly the case that some portion of the high property tax burden imposed on large rental properties is borne by renters in the form of higher rents or lower housing quality, although this effect is likely to vary considerably by neighborhood and we cannot say with precision how large that share is.

Inequities within Classes

In addition to large inter-class inequities, there are also significant within-class differences in ETRs. One source of inequity is the set of rules for assessment caps and phase-ins. By slowing the rate of assessment increases, these rules limit the tax liability imposed on property owners in appreciating

markets, causing assessments to diverge from market values. Because the rate of property appreciation varies among neighborhoods, these rules generate significant differences in ETRs across properties of the same value in different neighborhoods.

The Effect of Caps

The tax bills for a pair of three-family homes – one in Brownsville and the other in Kew Gardens/Woodhaven – illustrates the disparate effect of assessment caps within Class 1. (See Table 3.) Both properties were valued at \$490,000 by DOF for fiscal year 2013. The first home has an assessment ratio of 1.35 percent while the Kew Gardens/Woodhaven home has an assessment ratio of 6.0 percent. The owner of property 2 pays 4.5 times the taxes of property 1's owner, despite the fact that the homes are worth the same amount.

This difference in tax liability for equally valuable homes is a combined result of the different patterns of

appreciation and depreciation in earlier years and the effects of the property tax caps. In 2003, property 2 was more valuable than property 1 (about \$450,000 versus \$300,000). Both experienced significant appreciation from 2003 to 2006, and for each property the cap on the increase in assessed value kept assessed billable value relatively low and reduced the ETR. After this point, the value of property 2

Table 3: Illustration of Inequity within Class 1, Fiscal Year 2013

Property Characteristics	Property 1: Brownsville	Property 2: Kew Gardens/Woodhaven
Tax Class	One	One
Fair Market Value	\$490,000	\$490,000
Actual Assessed Value	\$6,592	\$29,400
Assessment Ratio	1.35%	6.00%
Nominal Tax Rate	18.57%	18.57%
Tax Liability	\$980	\$4,410
Effective Tax Rate	0.20%	0.90%

Source: New York City Department of Finance, *Property Tax Rolls, Fiscal Year 2013*.

Table 4: Illustration of Class 2 Inequity for Small vs. Large Rental Properties, Fiscal Year 2013

Property Characteristics	6-Unit Property	11-Unit Property
Community District	Elmhurst/Corona	Central Harlem
Fair Market Value	\$501,000	\$501,000
Tax Class	Two	Two
Assessed Value	\$57,562	\$225,450
Assessment Ratio	11.49%	45.00%
Nominal Tax Rate	13.18%	13.18%
Tax Liability	\$7,587	\$29,717
Effective Tax Rate	1.51%	5.93%

Source: New York City Department of Finance, *Property Tax Rolls, Fiscal Year 2013*.

fell to approximately what it was in 2003, while the value of property 1 remained roughly constant at its new, higher level. Because the caps place strong limits only on the rate at which assessed values *increase*, the assessment ratio and ETR for property 2 increased sharply as its value declined, while the assessment ratio and ETR for property 1 increased only very slightly. The fact that assessments can increase at the same time that market values fall is a source of anger and confusion for property owners.

Caps generate similar effects on the assessed values of 4-10 unit properties in Class 2. In fact, the reductions in ETRs for these properties that result from the caps are even greater. Indeed, *most* small Class 2 buildings are assessed at less than half of the target assessment ratio (*i.e.*, less than 22.25 percent). To illustrate, one 6-unit apartment building in Queens has an ETR of only 1.51 percent, on account of the caps, and one 11-unit property in Central Harlem with the same market value has an assessment ratio of a full 45 percent and pays nearly four times as much in taxes. (See Table 4.)

The inequities illustrated in Tables 3 and 4 occur across boroughs – Brooklyn versus Queens and Queens versus Manhattan. Similar inequities can and do occur within boroughs and notably within Manhattan. Valuable townhouses in Manhattan’s most desirable neighborhoods often have far lower ETRs than similar properties in other parts of Manhattan because of the caps or phase-ins.

The Effect of Phase-Ins

Although residential buildings with more than 10 units and commercial buildings are not protected by the kind of assessment caps described above, the phase-in rules applicable to these properties generate intra-class inequities in a similar manner: properties in fast-appreciating neighborhoods end up with lower ETRs than identically-valued properties in neighborhoods with more stable prices.

Table 5: Illustration of Class 2 Inequity from the Effect of Market Value Phase-Ins, Fiscal Year 2013

Property Characteristics	Appreciating Property	Depreciating Property
Community District	Bay Ridge/ Dyker Heights	Kingsbridge Heights/ Bedford
Fair Market Value	\$1,272,000	\$1,253,000
Tax Class	Two	Two
Transitional Assessed Value	\$333,090	\$658,080
Actual Assessed Value	\$572,400	\$563,850
Assessed Value	\$333,090	\$563,850
Assessment Ratio	26.19%	45.00%
Nominal Tax Rate	13.18%	13.18%
Tax Liability	\$36,888	\$62,524
Effective Tax Rate	2.90%	4.99%

Source: New York City Department of Finance, *Property Tax Rolls, Fiscal Year 2013*.

Two residential properties with more than six families and no commercial space illustrate the issue. (See Table 5.) One is in Bay Ridge/Dyker Heights and the other in Kingsbridge Heights/Bedford. Although the first property is worth \$19,000 more than the second property, its assessment ratio is only 26.19 percent while the ratio for the second property is 45 percent. The reason is that the first property has been appreciating while the second property is depreciating. The billable assessed values of these properties are *the lesser* of their transitional assessed values or their actual assessed values. In an appreciating market, the transitional assessed value is less than the actual assessed value, and so the property derives a benefit from the transitional value rules. When a property is falling in value, its actual assessed value is less than its transitional value and it gets no benefit. In this case, the result is that the ETR for the Kingsbridge Heights property is 72 percent higher than the effective rate for the property in Bay Ridge.

Undervaluation of Co-ops and Condos

The valuation methodology for Class 2 condos and co-ops is another source of intra-class inequity, both among Class 2 co-ops and condos themselves and between co-ops and condos and large rental buildings. Section 581-a of New York State's Real Property Tax Law requires the city to value condos and co-op buildings as if they were rental properties. To do so, DOF attempts to identify comparable rental buildings and then impute the income and expenses from these properties to the condo or co-op buildings being valued.⁸ This process severely undervalues condo or co-op buildings constructed before 1974.⁹ For these properties, the comparable rental buildings chosen by DOF often contain units subject to rent regulation. Rent regulated buildings typically generate less income than unregulated buildings and serve as a poor basis for estimating potential income for pre-war co-ops. Because condos and co-op buildings are typically undervalued they have lower assessed values and, consequently, lower tax bills and ETRs than if they were assessed on the basis of more accurate valuations. In addition, as noted earlier, Class 2 condos and co-ops receive significant tax abatements, reducing their bills by at least 17.5 percent. The combined effect of undervaluation and the abatement is enormous. The ETR for Class 2 condos and co-ops is 4.08 percent based on DOF's determinations of market value, and only 0.78 percent when an alternative, sales-based, valuation methodology is used and the abatement is taken into account. By contrast, the ETR for large Class 2 rental buildings is 4.60 percent.

It might be argued that the relevant comparison is not between Class 2 condos and co-ops and Class 2 rental buildings, but between Class 2 homeowners and Class 1 homeowners. In that case, the undervaluation of condos and co-ops and the tax abatement benefit might be viewed as compensating their owners for the fact that, as members of Class 2, they have an assessment ratio of 45 percent whereas homeowners in Class 1 face an assessment ratio of only 6 percent. The net effect of undervaluation, the condo/co-op abatement, and a target assessment ratio of 45 percent, is that Class 2 condos and co-ops have an effective tax rate of 0.78 percent, while Class 1 homeowners have an ETR of 0.77 percent.

However, if undervaluation is meant to offset higher assessment ratios, it does so in a crude way that generates significant variation across neighborhoods. In a 2006 report, the Independent Budget Office documented the degree of undervaluation varied from 55.2 percent of market value in Jamaica, Queens, to 87.5 percent in Park Slope/Carroll Gardens. This variation generates dramatically different ETRs for condos and co-ops across neighborhoods, for reasons that have only to do with the availability of comparable local properties rather than some underlying policy goal.

The valuation practices may also lead to disparities between the ETRs of older co-ops and new buildings, typically condos. While older buildings are especially undervalued for the reasons described, it is easier to identify rental buildings that are truly comparable to newly constructed condos and,

therefore, valuations for these newer buildings tend to be more accurate. This generates substantially higher tax bills for the newly constructed units.

The Pervasiveness of Intra-class Inequities

Caps, phase-ins, and the undervaluation of condos and co-ops result in a property tax regime with pervasive intra-class inequities. While anecdotes or examples illustrate the phenomenon, several indicators frequently used to describe the extent of dispersion for a given variable – in this case the ETR for properties in a given category – describe it more systematically. (See Table 6.)

Table 6: Effective Tax Rate Dispersion by Property Type, Fiscal Year 2013

Property Type	Mean	Range	Interquartile Range (25th-75th percentile)	Standard Deviation	Coefficient of Variation
1-3 Family Homes	0.80%	0-1.11%	0.66-1.01%	0.27%	33.03
Condos & Co-ops	0.82%	0-3.10%	0.29-1.07%	0.68%	83.06
4-10 Unit Rentals	2.12%	0-5.93%	1.19-2.69%	1.35%	63.66
11+ Unit Rentals	4.72%	0-5.93%	4.54-5.56%	1.39%	29.40
Commercial Property	3.63%	0-4.63%	3.52-4.60%	1.39%	38.30

Note: The mean effective tax rates diverge from the class wide measure because they are unweighted.

Source: New York City Department of Finance, *Property Tax Rolls, Fiscal Year 2013*.

1-3 family homes and condos and co-ops have the lowest ETRs, on average, and large rental buildings have the highest ETRs. In all cases a variety of exemptions can bring the ETR close to zero for some properties, adding to the disparities created by phase-ins and caps. The range of ETRs is greatest among rental properties and is also large for commercial properties. The range of ETRs is the difference between the highest and lowest value; it indicates how far apart the extreme values are. However, the coefficient of variation is greatest for co-ops and condos, indicating the uneven impact of the undervaluations. The coefficient of variation expresses the standard deviation as a percent of the average; the larger this measure is, the greater the relative dispersion of the values. Appendix A includes five figures showing the distribution of ETRs for each category of property.

Why Inequities Matter

Many economists argue that the best property tax regime is one in which all properties have the same ETR. Properties with the same value would pay the same taxes, and higher taxes would be due in respect of more valuable properties. Both are desirable characteristics from an equity perspective. In addition such a property tax would be economically efficient, inexpensive to administer, transparent to taxpayers, and susceptible to few unintended consequences.

Yet, few jurisdictions have such a property tax. One concern is that a “pure” property tax is insensitive to the cash income of the property owner. The risk of dispossessing an elderly homeowner living on a

fixed income because they cannot make the tax payments on an appreciating property is a nightmare that many politicians want to avoid. But this does not require caps or phase-ins; by providing special exemptions or property tax “circuit breakers” to elderly or low-income homeowners, relief can be targeted to those with limited cash incomes.¹⁰

However, adherence to a pure property tax system also removes the property tax as a tool of urban planning and social policy. In New York, property tax policy strongly favors the use of land for building owner-occupied properties, including 1-3 family homes and condos and co-ops. Although it seems quixotic to suppose that the tax preference for homeownership in New York will disappear, it is worth highlighting the magnitude of the disparity in ETRs between owner-occupied and rental properties, and asking whether the size of the tax subsidy is warranted, or whether the system is far too skewed in favor of Class 1 properties and condos and co-ops in light of the limited evidence that homeownership generates the social benefits to justify such favorable tax treatment.

Another cause for concern with the highly favorable treatment of owner-occupied properties is that it contributes to the limited affordability of rental housing. The large difference in ETRs between owner-occupied properties and rental properties tends to encourage the development of condos rather than rentals. Moreover, although the incidence of the property tax between landlords and tenants is debated in the economic literature, and will vary with local market conditions in different parts of New York City, it is likely that taxes on rent-regulated properties are passed on to tenants through the annual rent guidelines adjustments and at least some of the taxes on non-regulated properties are borne by those tenants as well. Since renters outnumber owners and have on average lower household incomes than owners, the affordability of housing is adversely affected to the extent the taxes are passed on to tenants and through restrictive supply of rental housing.

In addition to the intuitive (although not universally accepted) unfairness of taxing two properties of the same value at different rates depending on their use, economists tend to disfavor this sort of differential taxation on efficiency grounds. Differential taxation tends to distort the allocation of resources away from their most productive use. For example, a property that may be most profitably employed for commercial purposes may instead be used to build condos and co-ops, because the strong property tax preference for such a use changes the developer's cost-benefit calculation on an after-tax basis.

An additional consideration relevant to deciding whether to tax homeownership differently than other property uses is important in New York City. The economic analysis of any tax begins by specifying whose welfare matters to the policymaker. In New York City, the answer to that question is, presumably, New Yorkers. The actual burden of the property tax, its economic incidence, is shared by renters (who must pay higher rents), commercial tenants (through higher operating costs) and their customers (who will pay higher prices that incorporate the sellers' costs), and the property owners. Many of the owners of New York City real estate, particularly large commercial properties, may not be New Yorkers. For example, they may be individual and institutional investors resident in other parts of the U.S. or abroad. Similarly, many of the customers of some of the large commercial tenants, such as investment banks and law firms, may not have any other nexus with New York City. Owner-occupiers, on the other hand, are by definition taxpayers whose welfare is of paramount concern to their elected officials. To the extent that the economic incidence of the property tax can be passed to non-New Yorkers, this may be desirable. The desire to shift the burden to nonresidents must, however, be tempered by the risk that increasing their share of the tax burden will discourage them from investing in New York real estate or doing business with New York City firms.

REFORM PROPOSALS

This section presents and analyzes three options for raising property tax revenue during the five-year period from fiscal year 2015 to 2019. Details about the data and the assumptions made in generating our forecasts are in Appendix C. For each option we report how the distribution of the property tax levy would change after adopting that option.¹¹ Throughout this report we assume that changes in property tax policy will not affect projected market values or appreciation rates.

Two of the three options would significantly change the taxation of 4-10 unit rental properties (those currently subject to annual and five-year caps) and of condos and co-ops. If we were to report the effects of these options by tax class, rather than by category of property, these important effects would be obscured. For that reason, we report the effects of each option on six different categories of properties, rather than on each of the four tax classes. Reporting in this way also makes it easier to identify who will be affected by the reforms. The six categories of properties are: 1-3 family homes, 4-10 unit rental buildings, 11+ unit rental buildings, condos and co-ops, utility properties, and commercial properties. For all the proposals we compare the forecasted market values, tax levy, and ETRs under that option with the forecasted values if no changes were made to the existing property tax regime (the “baseline”). Each of the options is designed to raise \$2 billion more than the baseline in fiscal year 2015.¹²

Option 1: Raise Revenue Proportionally from All Classes

The first option raises \$2 billion in additional revenue proportionally from each category of property. In fiscal year 2015 we estimate a baseline property tax levy of \$21.1 billion.¹³ Raising an additional \$2 billion in fiscal year 2015 requires increasing the average nominal tax rate from 12.283 percent to 13.447 percent. An advantage of this option is that the Mayor and City Council have the discretion to change the nominal rate without state legislation. Moreover, the average nominal rate has changed three times since 2003, so such a move would not be unprecedented. Property tax rates have fluctuated during the Bloomberg Administration in response to fiscal pressures, rising from 10.366 percent to 12.283 percent halfway through fiscal year 2003, falling to 11.423 percent in fiscal year 2008 and then rising again to 12.283 percent halfway through fiscal year 2009.¹⁴

In order to preserve the class shares, each of the four class-specific nominal rates must increase proportionally. Raising taxes on all properties by the same percentage has the appearance of fairness, which may make such a rate increase more palatable to property owners. However, proportional increases in the rates preserve both the

inter-class and the intra-class inequities described in the previous section. Because rates increase proportionally, this option has no effect on differences in ETRs across properties. (See Table 7.)

Because commercial properties currently account for the greatest share of the levy, those properties

Table 7: Nominal Tax Rates Under Proportionate Increase (Option 1)

Type of Property	Fiscal Year 2013 Rate	Revised Fiscal Year 2015 to 2019 Rate
1-3 Family Homes	18.57%	20.33%
4+ Unit Rentals, Condos and Co-ops	13.18%	14.43%
Utilities	12.48%	13.66%
Commercial	10.29%	11.26%

would account for the largest share of the additional levy under this option. (See Table 8.) The levy on all tax classes increases proportionally, by approximately 9.46 percent.

Over time, as property assessments grow, this increase in rates will generate even more revenue, from \$2.09 billion in fiscal year 2016 to \$2.34 billion in fiscal year 2019, as assessed values continue to rise due to the effect of phase-ins and price appreciation.

Table 8: Additions to the Tax Levy by Property Type and Fiscal Year Under Proportionate Rate Increase (Option 1)

(dollars in millions)

Property Type	2015	2016	2017	2018	2019
1-3 Family Homes	\$298	\$310	\$321	\$333	\$348
Condos & Co-ops	\$308	\$321	\$335	\$348	\$360
4-10 Unit Rentals	\$76	\$81	\$86	\$92	\$98
11+ Unit Rentals	\$333	\$348	\$364	\$378	\$390
Utilities	\$149	\$153	\$157	\$161	\$166
Commercial	\$837	\$878	\$918	\$952	\$982
Total	\$2,000	\$2,090	\$2,181	\$2,263	\$2,344

From an individual property owner's perspective, it is the ETR that matters. Under a proportionate rate increase, the ETRs for each type of property would also increase roughly proportionately. (See Table 9.)

Option 1 has the virtues of being simple and within the City's power to execute. Although this option would be an effective way of raising revenue for the City, it would do nothing to address the inequities built into the system. Below we describe two proposals that would both raise revenue *and* begin to address these inequities.

Option 2: Address the Inequities Affecting Homeowners

Option 2 raises \$2 billion in additional revenue but also addresses three types of inequities affecting homeowners. First, homeowners – both 1-3 family homeowners and co-op and condo owners – enjoy the lowest effective tax rates in the city,

Table 9: Effective Tax Rates by Property Type Under Proportionate Rate Increase (Option 1)

Property Type	Fiscal Year 2013	Fiscal Year 2015
1-3 Family Homes	0.77%	0.84%
Condos & Co-ops	0.78%	0.86%
4-10 Unit Rentals	1.89%	2.06%
11+ Unit Rentals	4.60%	5.03%
Utilities	5.42%	5.42%
Commercial	3.86%	4.22%

Note: The effective tax rates for condos and co-ops reflects the continued benefit of the abatement.

by far. Their tax rates are a fraction of those paid by owners of larger residential rental properties and commercial properties. This option would reduce these inequities by raising all of the \$2 billion only from homeowners.

Second, as seen in Table 6, 1-3 family homeowners are treated more generously than many co-op and condo owners. The maximum ETR for a 1-3 family homeowner is 1.11 percent, whereas one quarter of condo or co-op owners have an ETR of more than 1.07 percent. This option eliminates all disparities among homeowners by assessing and taxing both categories of property in the same way.

Third, individual homeowners have widely varying ETRs because of the impacts of the valuation methodology for co-ops and condos and of the caps and phase-ins. This option eliminates these disparities by eliminating the caps for Class 1 properties and by treating co-ops and condos identically to Class 1 properties. That is, co-ops and condos would be assessed based on their true market values, would have the same 6 percent assessment ratios as Class 1 properties, would not be subject to any phase-in provisions, and would not receive the abatement and have the same nominal tax rate as Class 1. The result is a common ETR for all homeowners.

We describe the impact of this option in three steps. The first is to value condos and co-ops based on market values using sales prices (as is currently the case for Class 1). The second is to assess co-ops and condos with 1-3 family homes at an assessment ratio of 6 percent. All condos and co-ops are effectively moved into Class 1 and are no longer subject to the caps or phase-ins that they may currently benefit from. Assessing condos and co-ops at 6 percent would offset much of the increase in property taxes that would otherwise follow from more accurate market valuations. The effect of placing all homeowners on the same footing would raise some revenue, but not enough to reach \$2 billion. The third step is to increase the nominal tax rate on homeowners sufficiently to raise the rest.

Step 1: Revaluation

As discussed above, condos and co-ops are currently valued as if they were income-producing properties, a methodology that often results in severe undervaluation. A hypothetical \$500,000 co-op on the Upper East Side illustrates the potential impact of revaluation. At a tax rate of 13.181 percent this hypothetical property has an ETR of 5.93 percent. The New York City Independent Budget Office (IBO) reported in 2006 that the undervaluation of Upper East Side co-ops was 76.7 percent, implying a true market value of the hypothetical co-op of \$2,145,912.¹⁵ If the property were revalued and assessed at a full 45 percent of this amount, the tax would jump from \$29,657 to \$127,284.

Because of the magnitude of the current undervaluations, the impact of the revaluation, if not accompanied by other changes, would be enormous. Based on the IBO-estimated citywide average undervaluation of nearly 80 percent, the aggregate measured market value for condos and co-ops would increase almost fivefold.¹⁶

Step 2: Consolidating Homeowners

Correcting the valuation of co-ops and condos and assessing them at 45 percent would subject their owners to radically higher ETRs than other homeowners. Because this step alone would raise significant fairness concerns, this option involves also assessing co-ops and condos at the same 6 percent rate as 1-3 family homes. In addition, the caps on Class 1 assessed values would be eliminated. Two effects are noteworthy. The revaluation and of condos and co-ops and the application of a 6 percent assessment ratio raises approximately \$846 million in fiscal year 2015. The elimination of the assessment growth caps on 1-3 family homes, causing all homeowners to face the same ETR, raises \$936 million in fiscal

Table 10: Addition to the Tax Levy by Property Type and Fiscal Year from the Revaluation of Condos & Co-ops, Assessing Condos & Co-ops at 6 Percent, and Removing Class 1 Assessment Growth Cap (Option 2, Step 2)

(dollars in millions)

Property Type	2015	2016	2017	2018	2019
1-3 Family Homes	\$936	\$923	\$916	\$913	\$881
Condos & Co-ops	\$846	\$821	\$792	\$778	\$772
Total	\$1,782	\$1,744	\$1,709	\$1,691	\$1,654

year 2015 from those homeowners. (See Table 10.) The decline in the addition to the levy over time comes about because the levy is increasing under the baseline, due to the rise in assessed value under the caps. In other words, this option accelerates into 2015 the increase in assessed value that otherwise would be deferred to later years.

Step 3: Increasing the Rate on Homeowners

Steps 1 and 2 would not generate enough revenue to meet the \$2 billion target. Raising \$2 billion requires also increasing the nominal tax rate on 1-3 family homeowners and condos and co-ops. The baseline Class 1 nominal tax rate is 18.569 percent; getting to \$2 billion would require bumping the nominal rate to 19.064 percent. This would increase the levy on 1-3 family homes and on condos and co-ops by approximately \$109 million, each.

The gap between the ETR of homeowners and other property owners would be narrowed somewhat, but homeowners would still enjoy highly favorable

treatment. Nonetheless, the increase in tax bills for homeowners would be substantial. (See Table 11.)

The net effect of this proposal for raising \$2 billion, relative to the baseline, would be a 35 percent increase in the tax on 1-3 family homes and a 25 percent increase in the tax on condos and co-ops. The larger effect on 1-3 family homes is due to removing the assessment caps. That said, removing the caps would be a progressive reform, as it would disproportionately increase the tax bills for more valuable properties. The increase would be largest for those 1-3 family homes in the top quintile by

Table 11: Effective Tax Rates by Property Type in Fiscal Year 2015 from the Revaluation of Condos & Co-ops, Assessing Condos & Co-ops at 6 Percent, Removing Class 1 Assessment Growth Cap, and Increasing Nominal Rate for Class 1 and Condos & Co-ops (Option 2, Step 3)

(dollars in millions)

Property Type	Fiscal Year 2013	Fiscal Year 2015
1-3 Family Homes	0.77%	1.03%
Condos & Co-ops	0.78%	0.97%
4-10 Unit Rentals	1.89%	1.89%
11+ Unit Rentals	4.60%	4.60%
Utilities	5.42%	5.42%
Commercial	3.86%	3.86%

Table 12: Distribution of Class 1 Tax Levy With and Without Assessment Caps by Property Value, Fiscal Year 2013
(dollars in millions)

Property Value	Fiscal Year 2013 Levy	Levy Without Caps	Levy Increase	Share of Levy Increase
< \$349,520	\$324	\$365	\$41	4.38%
\$349,520-\$436,900	\$493	\$546	\$53	5.65%
\$436,900-\$533,532	\$571	\$663	\$92	9.80%
\$533,532-\$695,956	\$686	\$838	\$152	16.25%
> \$695,956	\$1,070	\$1,668	\$598	63.91%
Total	\$3,145	\$4,081	\$936	100.00%

market value; 64 percent of the increase in the levy would come from the top 20 percent most valuable properties. (See Table 12.)

The six neighborhoods receiving the largest benefits from the assessment caps on Class 1 properties are those with the highest median incomes. (See Appendix B.) Thus, not only are the most valuable properties in the city receiving the largest benefits from the caps, so are the neighborhoods with the highest incomes.

Option 3: Eliminating Disparities among Appreciating and Depreciating Properties

The third option would raise \$2 billion in revenue and addresses the inequities among properties by eliminating the caps and phase-in provisions for all properties. While Option 2 included the elimination of the caps on assessment increases for 1-3 family homes and the caps and phase-ins for condos and co-ops in Class 2, this option includes these measures as well as elimination of the cap on small rental properties and the phase-ins for large rental and commercial properties. As with Option 2, these changes would require state legislation.

The justification typically offered for caps and phase-ins is not convincing. They are intended to provide relief from sharp tax increases for property owners who cannot afford them. From the taxpayers’ perspective, sharp tax increases are certainly undesirable. If city officials are concerned with protecting homeowners who do not have sufficient cash incomes to cover comfortably their property taxes, caps on increases in assessments should be means-tested.¹⁷ More fundamentally, smoothing property tax liability over time need not be implemented in a way that confers a tax reduction at the same time. For example, the foregone revenue for each year in which a property’s assessment is capped might be viewed as a loan, secured by a lien that attaches to the property and accrues interest until paid off. Similar deferral options are available in many other jurisdictions. Moreover, the largest benefits of the Class 1 caps go to owners of the most valuable properties, living in neighborhoods with the highest incomes.

The cost of using the caps and phase-ins as a protective device for all owners is great. These provisions are not just smoothing tax liability over time, but permanently forego revenue. The foregone revenue from 1-3 family homes that are assessed at less than 6 percent in a given year is not recovered later or over time; it is never recovered at all. The phase-ins, like the caps, do not simply reduce the variation in tax liability for a property owner from year to year; they permanently reduce it and only serve to place an upper bound on property assessments, never a lower bound.

The amount of revenue at stake is enormous. In fiscal year 2015 the estimated revenue foregone due to the cap and phase-in rules will be \$4.5 billion. (See Table 13.)

The amount of foregone revenue will decline slowly over time, as assessed and transitional values under the baseline scenario rise, but it remains well in excess of \$4 billion by fiscal year 2019. Thus, in order to raise “only” \$2 billion in the next fiscal year, nominal rates on each category of property benefitting from the caps would be cut proportionally by 56 percent. (See Table 14.)

Table 13: Revenue Foregone from Caps and Phase-ins, Fiscal Year 2015

(dollars in millions)

Property Type	Foregone Revenue
1-3 Family Homes	\$936
Condos & Co-ops	\$550
4-10 Unit Rentals	\$1,578
11+ Unit Rentals	\$425
Utilities	\$0
Commercial	\$1,018
Total	\$4,507

Table 14: Additions to the Tax Levy by Property Type and Fiscal Year Under Elimination of Assessment Caps and Phase-Ins and Rate Reduction (Option 3)

(dollars in millions)

Property Type	2015	2016	2017	2018	2019
1-3 Family Homes	\$415	\$410	\$407	\$405	\$391
Condos & Co-ops	\$244	\$229	\$213	\$202	\$196
4-10 Unit Rentals	\$700	\$708	\$713	\$719	\$721
11+ Unit Rentals	\$189	\$165	\$142	\$129	\$123
Utilities	\$0	\$0	\$0	\$0	\$0
Commercial	\$452	\$384	\$324	\$292	\$285
Total	\$2,000	\$1,896	\$1,798	\$1,748	\$1,717

One striking finding from the analysis is the magnitude of the foregone revenue due to the assessment caps applied to smaller rental properties. This category of property alone accounts for nearly \$1.6 billion in lost revenue, more than other categories with much larger total market values. As a consequence, eliminating the caps dramatically raises ETR for these smaller rental properties; it jumps from 1.89 percent under the baseline to 5.04 percent under Option 3.

By design, Option 3 eliminates intra-class inequities in Class 1, but it also would lead to a significant reduction of inequities among Class 2 rental properties. (See Table 15.) The disparities between 4-10 unit rental properties and 11+ unit rental properties would shift from a rate on larger properties that is more than double the rate on smaller properties, to a slightly higher rate for the smaller buildings. A disparity remains because larger properties currently benefit more from exemptions such as the 421-a program.

Table 15: Effective Tax Rates by Property Type Under Elimination of Caps and Phase-Ins and Rate Reduction (Option 3)

Property Type	Fiscal Year 2013	Fiscal Year 2015
1-3 Family Homes	0.77%	0.90%
4-10 Unit Rentals	1.89%	5.04%
Condos & Co-ops	0.78%	0.79%
11+ Unit Rentals	4.60%	4.65%
Utilities	5.42%	4.89%
Commercial	3.86%	3.88%

SUMMARY

Reporting the effect of the options on the effective tax rates makes transparent which properties are bearing the greatest burden, as a share of their property value. Calculating the added burden to any individual property is also straightforward, and equal to the increase in effective tax rate under a given option multiplied by the value of the property in question. (See Table 16.)

Table 16: Effect of Each Option on Effective Tax Rates by Type of Property, Fiscal Year 2015

Property Type	Fiscal Year 2013 Baseline	Option 1	Option 2	Option 3
1-3 Family Homes	0.77%	0.84%	1.04%	0.90%
Condos & Co-ops	0.78%	0.86%	0.98%	0.79%
4-10 Unit Rentals	1.89%	2.06%	1.89%	5.04%
11+ Unit Rentals	4.60%	5.03%	4.60%	4.65%
Utilities	5.42%	6.13%	5.42%	4.89%
Commercial	3.86%	4.22%	3.86%	3.88%

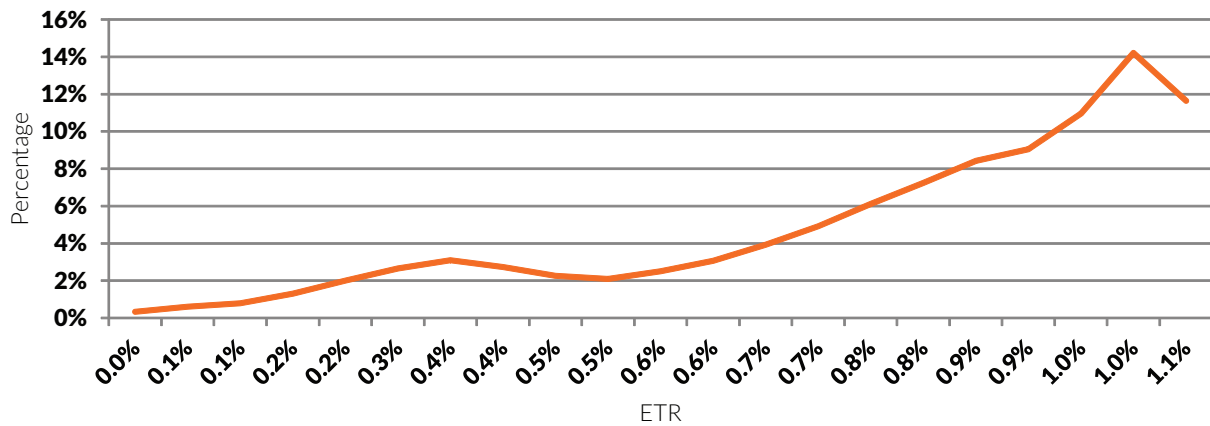
Option 1, which involves a proportional increase in nominal tax rates across all categories of properties, spreads the burden of increasing revenue across all property owners. However, by raising revenue proportionally based on each property type’s current rate, it only reinforces the existing inequities in the system.

Option 2, which consolidates all homeowners into a single category and raises the entire target of \$2 billion from that new consolidated class, has the benefit of reducing the ETR gap between homeowners and owners who use their property for other purposes. It would reduce the inefficiencies created by New York’s system of differential property taxation, but would require state authorization to adjust the class share system and would be politically difficult to implement. It would also eliminate differences in the taxation of condos and co-ops attributable to the current valuation methodology and tax all homeowners at the same rate.¹⁸

Option 3 would collect the greatest share of the \$2 billion from those properties that benefit the most from caps and phase-ins. This option would preserve much of the inter-class inequities, but would be a large step toward eliminating intra-class inequities, particularly between 4-10 unit rental properties and 11+ unit rental properties. Moreover, the elimination of the caps on 1-3 family homes would have desirable redistributive effects. This option also would reduce the complexity of the current system, making it more transparent for taxpayers.

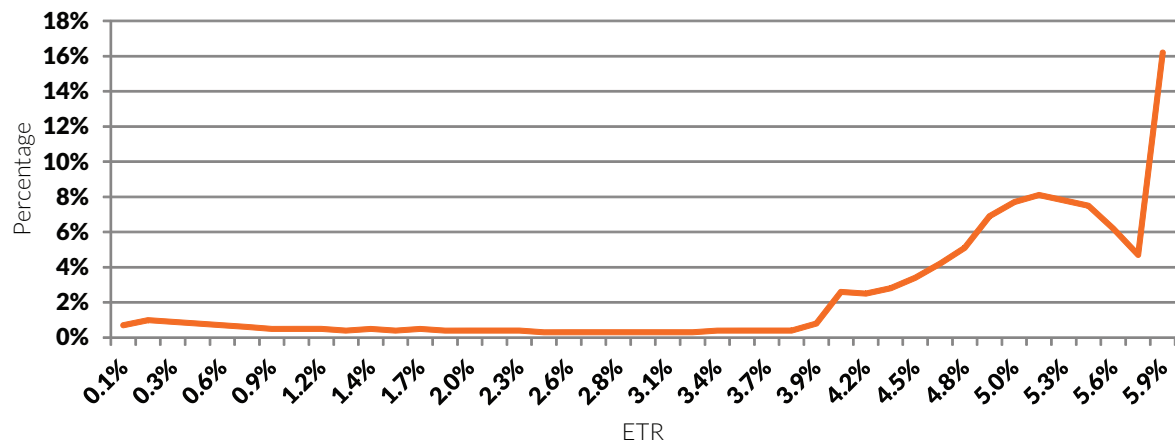
APPENDIX A

Figure 1: Distribution of Effective Tax Rates for 1-3 Family Homes, Fiscal Year 2015



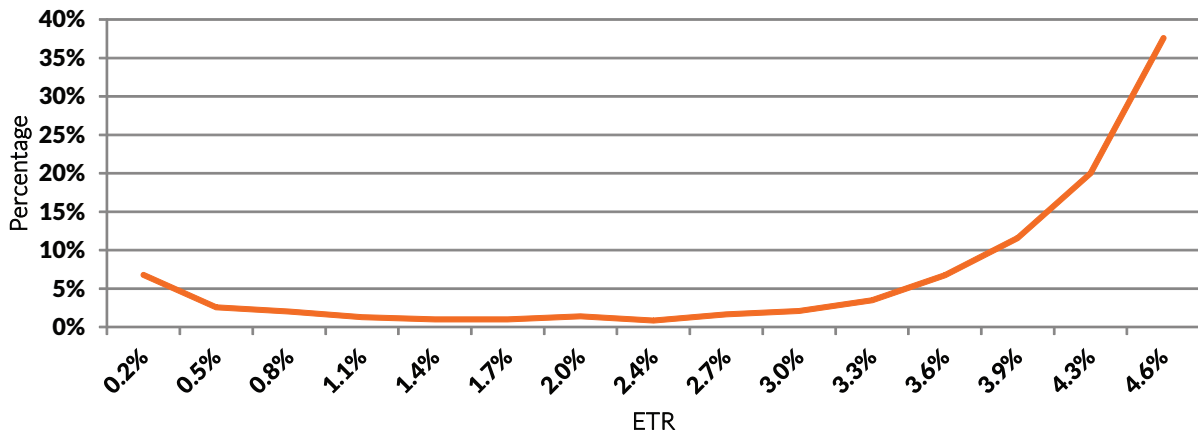
Source: Author analysis of New York City Department of Finance, *Real Property Assessment Database, Fiscal Year 2014*.

Figure 2: Distribution of Effective Tax Rates for 11+ Unit Rental Properties, Fiscal Year 2015



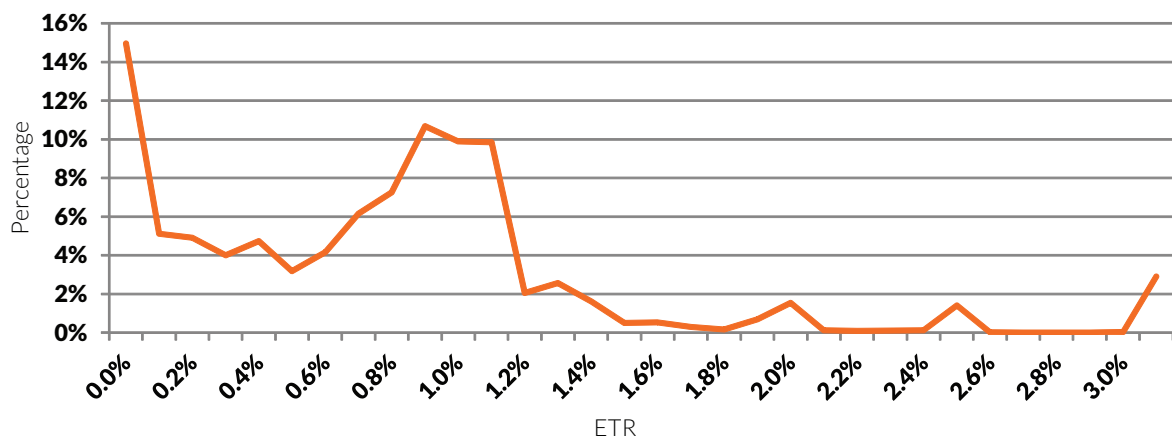
Source: Author analysis of New York City Department of Finance, *Real Property Assessment Database, Fiscal Year 2014*.

Figure 3: Distribution of Effective Tax Rates for Commercial Properties, Fiscal Year 2015



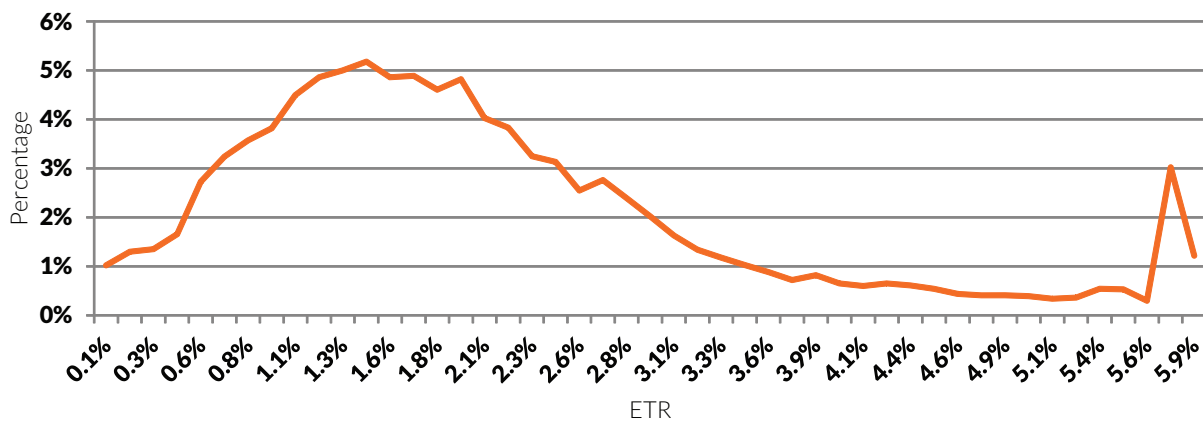
Source: Author analysis of New York City Department of Finance, *Real Property Assessment Database, Fiscal Year 2014*.

Figure 4: Distribution of Effective Tax Rates for Condos and Co-ops with 4+ Units, Fiscal Year 2015



Source: Author analysis of New York City Department of Finance, *Real Property Assessment Database, Fiscal Year 2014*.

Figure 5: Distribution of Effective Tax Rates for 4-10 Unit Rental Properties, Fiscal Year 2015



Source: Author analysis of New York City Department of Finance, *Real Property Assessment Database, Fiscal Year 2014*.

APPENDIX B

Table B-1: Average Benefit from Assessment Caps and Median Household Income by Neighborhood, Fiscal Year 2013 (Part 1)

Community District	Neighborhood	Average Assessment Cap Benefit		Median Household Income	
		1-3 Family Homes	4-10 Family Rentals	All Residents	Homeowners
301	Greenwich Village/Financial District	\$32,626	\$124,624	\$105,000	\$200,000
302	Greenwich Village/Financial District	\$39,680	\$103,567	\$105,000	\$200,000
306	Stuyvesant Town/Turtle Bay	\$22,566	\$89,459	\$100,000	\$140,000
307	Upper West Side	\$37,900	\$76,869	\$92,800	\$150,000
308	Upper East Side	\$36,288	\$98,103	\$90,000	\$146,500
304	Chelsea/Clinton/Midtown	\$35,108	\$109,036	\$82,000	\$145,000
305	Chelsea/Clinton/Midtown	\$33,314	\$108,659	\$82,000	\$145,000
206	Park Slope/Carroll Gardens	\$10,760	\$58,787	\$79,000	\$123,000
503	South Shore	\$413	\$16,908	\$75,000	\$86,900
413	Queens Village	\$394	\$18,552	\$74,000	\$80,000
202	Brooklyn Heights/Fort Greene	\$10,536	\$48,392	\$60,000	\$80,000
411	Bayside/Little Neck	\$1,340	\$19,656	\$60,000	\$66,000
410	South Ozone Park/Howard Beach	\$402	\$17,194	\$59,200	\$65,000
502	Mid-Island	\$394	\$13,801	\$59,000	\$74,940
406	Rego Park/Forest Hills	\$1,868	\$21,631	\$58,000	\$75,000
408	Hillcrest/Fresh Meadows	\$869	\$22,431	\$57,300	\$73,000
402	Sunnyside/Woodside	\$1,373	\$23,418	\$51,000	\$74,400
405	Middle Village/Ridgewood	\$1,001	\$23,395	\$50,208	\$61,500
201	Williamsburg/Greenpoint	\$4,080	\$29,454	\$50,000	\$67,000
214	Flatbush	\$2,396	\$26,173	\$50,000	\$75,500
215	Sheepshead Bay/Gravesend	\$1,600	\$15,237	\$50,000	\$80,000
218	Flatlands/Canarsie	\$424	\$14,259	\$50,000	\$67,400
403	Jackson Heights	\$908	\$19,433	\$50,000	\$55,000
412	Jamaica	\$621	\$18,862	\$50,000	\$60,600
501	North Shore	\$371	\$18,968	\$50,000	\$70,000
407	Flushing/Whitestone	\$1,372	\$20,734	\$49,700	\$65,000
210	Bay Ridge	\$2,324	\$24,652	\$46,808	\$66,000
110	Throgs Neck/Co-op City	\$535	\$16,286	\$45,961	\$50,000
303	Lower East Side/Chinatown	\$28,317	\$99,968	\$45,480	\$110,000

Table B-1: Average Benefit from Assessment Caps and Median Household Income by Neighborhood, Fiscal Year 2013 (Part 2)

Community District	Neighborhood	Average Assessment Cap Benefit		Median Household Income	
		1-3 Family Homes	4-10 Family Rentals	All Residents	Homeowners
401	Astoria	\$1,785	\$24,765	\$45,000	\$61,000
404	Elmhurst/Corona	\$1,418	\$17,469	\$45,000	\$50,000
409	Ozone Park/Woodhaven	\$484	\$20,490	\$45,000	\$70,000
414	Rockaways	\$669	\$11,849	\$45,000	\$79,745
111	Pelham Parkway	\$466	\$18,887	\$43,741	\$80,000
108	Riverdale/Kingsbridge	\$1,275	\$22,761	\$43,725	\$87,400
209	South Crown Heights	\$2,274	\$17,163	\$43,000	\$73,500
211	Bensonhurst	\$2,061	\$12,781	\$43,000	\$71,000
312	Washington Heights/Inwood	\$4,242	\$17,135	\$42,200	\$95,000
217	East Flatbush	\$745	\$7,992	\$42,000	\$58,870
309	Morningside Heights/Hamilton Heights	\$7,144	\$22,309	\$42,000	\$96,564
208	North Crown Heights/Prospect Heights	\$3,513	\$32,435	\$41,000	\$110,000
207	Sunset Park	\$4,429	\$33,742	\$40,000	\$58,200
310	Central Harlem	\$8,226	\$17,899	\$39,000	\$90,000
212	Borough Park	\$2,900	\$17,097	\$36,696	\$69,464
112	Williamsbridge/Baychester	\$313	\$12,474	\$35,662	\$56,472
204	Bushwick	\$2,394	\$19,716	\$35,000	\$40,000
205	East New York/Starrett City	\$1,601	\$5,498	\$35,000	\$70,000
203	Bedford Stuyvesant	\$2,890	\$4,832	\$32,496	\$71,870
109	Soundview/Parkchester	\$532	\$13,531	\$32,000	\$68,000
311	East Harlem	\$6,236	\$29,459	\$31,870	\$47,200
213	Coney Island	\$905	\$13,790	\$31,000	\$66,043
107	Kingsbridge Heights/Moshulu	\$884	\$24,448	\$30,000	\$59,000
104	Highbridge/South Concourse	\$2,251	\$22,891	\$27,000	\$63,000
103	Morrisania/Belmont	\$1,075	\$21,177	\$22,601	\$40,000
106	Morrisania/Belmont	\$1,036	\$25,614	\$22,601	\$40,000
216	Brownsville/Ocean Hill	\$1,897	\$16,587	\$22,000	\$63,800
105	University Heights/Fordham	\$1,700	\$21,731	\$20,700	\$50,000
101	Mott Haven/Hunts Point	\$943	\$25,827	\$18,000	\$62,520
102	Mott Haven/Hunts Point	\$1,203	\$19,147	\$18,000	\$62,520

Source: New York City Department of Finance, *Property Tax Rolls, Fiscal Year 2013*. U.S. Department of Commerce, Census Bureau, *American Community Survey*, 2011.

APPENDIX C

Data and Forecasting Assumptions

Forecasts are generated using DOF's Real Property Assessment Database (RPAD) for fiscal year 2014, which includes market value estimates, actual and transitional assessed values, and exemption data for all tax lots in the city.

RPAD does not include data on abatements, so we cannot tabulate disaggregated statistics on the current beneficiaries of the abatement or the effect of revising the abatement rules. However, because it has such a large effect on tax liabilities for Class 2 condos and co-ops, we report estimates under the assumption that the condo/co-op abatement in future years will be equal to 14.12 percent of the value of the levy on Class 2 condos and co-ops. This is the value of the abatement in fiscal year 2012, the last year for which we have data.¹⁹ The effect of other abatements on the overall tax burden is less significant, and we ignore them in this report.²⁰

In generating our forecasts we assume that market values for all properties in the city increase 2.8% per year. This is the average percentage increase in the full value of taxable real estate between 2014 and 2017 assumed by the city's Office of Management and Budget in its annual statement of debt affordability.²¹ Because the nominal tax rates for fiscal year 2014 have not been released, we use the nominal rates for fiscal year 2013 unless otherwise specified. We assume that the exempt portion of a property's assessed value remains fixed at the value in fiscal year 2014. This is likely to overstate the amount of exempt value for properties currently benefitting from a 421-a exemption, which phases out over time.

In order to estimate the true market values of condos and co-ops in New York City we rely on analysis provided in a report by New York City's Independent Budget Office.²² In that report, the IBO calculated alternative estimates for the market values of condos and co-ops using a sales-based methodology. Their report then calculated, for each sub-borough area in New York City, the difference between the aggregate market value of condos and co-ops using DOF's estimates and the aggregate market value using their methodology. We assume that the sub-borough area undervaluation rates taken from the IBO report remain fixed throughout the entire period of our study and use them in Option 2 to estimate the value of eliminating the undervaluation.

One final methodological point is worth noting here. RPAD is incomplete with respect to Class 3 properties, in part because the New York State Office of Real Property Services, rather than DOF, is responsible for valuing these properties. Consequently, we estimate future assessed values by assuming the same 2.8 percent rate of market growth on the assessed value for the entire class reported in the city's tax revenue forecasts for fiscal year 2013.

ENDNOTES

¹We provide only a high-level overview of New York City's property tax here. For greater detail, see New York City Independent Budget Office, "Twenty-five Years After S7000A: How Property Tax Burdens Have Shifted in New York City," December 5, 2006, <http://www.ibo.nyc.ny.us/iboreports/propertytax120506.pdf>; and New York University Furman Center for Real Estate and Urban Policy, "Distribution of the Burden of New York City's Property Tax," May 2012, http://furmancenter.org/files/publications/Distribution_of_the_Burden_of_New_York_Citys_Property_Tax_11.pdf.

²Class 3 properties are valued under a different set of rules by New York's Office of Real Property Services.

³That is, the assessed value both: (i) cannot increase by more than 6 percent from one year to the next and (ii) cannot exceed 6 percent of the property's market value in any year.

⁴For a variety of reasons, some portion of the assessed value of a property may be exempt from taxation. For example, in FY 2013, the 421-a exemption for the construction of new multiple dwellings represented over \$1.0 billion of foregone revenue. New York City Department of Finance, *Annual Report on Tax Expenditures for, Fiscal Year 2013*, http://www.nyc.gov/html/dof/downloads/pdf/13pdf/ter_2013_final.pdf.

⁵Hellerstein v. Islip, 37 N.Y.2d 1 (1975).

⁶These "class shares" adjust slowly over time as properties move between classes, as improvements are made to properties, and to partially reflect changes in market values.

⁷The market value amount in Table 1 for Class 2 properties reflects the undervaluation of co-ops and condos discussed later in this paper. If adjustment were made for this undervaluation, the ETR for Class 2 would be lower and the gap between Class 1 and Class 2 ETRs would be narrower.

⁸This income and expense information is used to generate an estimate of the value of the property by calculating the net present value of these imputed income and expenses, or by multiplying the gross income by a factor that captures the relationship between gross income and market value.

⁹See New York City Independent Budget Office, "Twenty-five Years After S7000A: How Property Tax Burdens Have Shifted in New York City," December 5, 2006, <http://www.ibo.nyc.ny.us/iboreports/propertytax120506.pdf>; and New York University Furman Center for Real Estate and Urban Policy, "Shifting the Burden: Examining the Undertaxation of Some of the Most Valuable Properties in New York City," July 2013, http://furmancenter.org/files/FurmanCenter_ShiftingtheBurden.pdf.

¹⁰New York provides limited property tax exemptions for seniors and disabled persons that are means-tested.

¹¹The property tax levy is not the same as the amount of property tax revenue. The difference between the property levy and property tax revenue is the property tax "reserve," which includes both property tax abatements and uncollectible taxes due to the effect of property tax appeals and delinquencies. From fiscal year 2010 to 2012, the average reserve was 8.5 percent of the levy, so a reasonable estimate of the effect on property tax revenue can be generated by multiplying the change in the levy by 91.5 percent. See New York City Department of Finance, *Annual Report of the New York City Property Tax, Fiscal Year 2012*, July 2012, http://www.nyc.gov/html/dof/downloads/pdf/12pdf/nyc_property_tax_fy12.pdf.

¹²The \$2 billion target was selected as a round number that would illustrate the implications of each option in amounts of substantial magnitude. It is not a recommended target. The \$2 billion increment might cause the property tax revenue to exceed the allowable cap on such revenue in the State Constitution, another reason it should be interpreted only for illustrative purposes rather than as a recommendation.

¹³This is an estimate from Department of Finance's real property assessment database. New York City's Office of Management and Budget estimates revenues of approximately \$20.3 billion. OMB's estimate takes into account refunds, prior year collections, and other items of the tax reserve that we do not, such as, abatements other than

the condo/co-op abatement and uncollectible taxes (including those resulting from the tax appeals process).

¹⁴ New York City Office of Management and Budget, *Tax Revenue Forecasting Documentation: Financial Plan Fiscal Years 2011-2015*, p. I-5, http://www.nyc.gov/html/omb/downloads/pdf/methodology_2012_04.pdf.

¹⁵ New York City Independent Budget Office, "Twenty-five Years After S7000A: How Property Tax Burdens Have Shifted in New York City," December 5, 2006, p. 35, <http://www.ibo.nyc.ny.us/iboreports/propertytax120506.pdf>.

¹⁶ Although this option does not contemplate stopping at revaluation, it is worth pausing to consider how the city might more accurately value condos and co-ops. One possibility is to value these properties based on the sales of units within the same, or similar, buildings. Sales-based measures, when available, should provide better estimates of the properties' true values. State legislative action would be necessary to enact this reform, however. Alternatively, it may be possible to use income and expense data from the condos and co-ops themselves to estimate market values. This approach requires that there be a sufficient number of units in these buildings rented by their owners in order to generate reliable estimates, but would avoid the need for state legislation.

¹⁷ The City currently uses means-tests for certain property tax benefits, such as the basic and enhanced School Tax Relief Program (STAR) exemptions.

¹⁸ The residual difference in the ETRs of 1-3 family homes and condos and co-ops is due to the fact that condos and co-ops currently have a higher proportion of the assessed values exempt from tax. Analysis assumes that the share of a property's assessed value that was exempt in fiscal year 2014 remains that way from fiscal year 2015 to 2019.

¹⁹ Calculated using the fiscal year 2012 Department of Finance annual property tax report, as the amount of Class 2 abatements over the Class 2 levy (excluding rentals, and 4-10 family rentals).

²⁰ These include the J-51 abatement, the lower Manhattan conversion abatement, the Industrial and Commercial Abatement Program, and the Green Roof and Solar Electric Generating abatements. The aggregate value of these in fiscal year 2013 was \$137.1 million. See New York City Department of Finance, *Annual Report on Tax Expenditures for, Fiscal Year 2013*, February 2013, http://www.nyc.gov/html/dof/downloads/pdf/13pdf/ter_2013_final.pdf.

²¹ New York City Office of Management and Budget, *Statement of Debt Affordability*, May 2, 2013, http://www.nyc.gov/html/omb/downloads/pdf/sda5_13.pdf.

²² New York City Independent Budget Office, "Twenty-five Years After S7000A: How Property Tax Burdens Have Shifted in New York City," December 5, 2006, p. 35, <http://www.ibo.nyc.ny.us/iboreports/propertytax120506.pdf>.