New York City Independent Budget Office Fiscal Brief

April 2018

Addressing the Disparities:

Winners & Losers in Two Property Tax Reform Scenarios

Summary

Propelled by a lawsuit from a group of tenants and property owners, reform of the city's property tax system has gathered momentum on the public policy agenda. Mayor de Blasio said last week he will appoint a commission to examine reforming the property tax—which accounts for about 45 percent of city tax revenue—by the end of this month. The City Council issued its own call for a property tax commission in a recent report responding to the Mayor's preliminary budget—but with members appointed by both the Mayor and Council.

While the scope of reform proposals that the Mayor's commission would undertake remains largely unclear, much of the conversation so far has centered on the unequal property tax burdens among similar one- to three-family homes across the city and the disparate tax treatment of different types of residential properties—private homes, coops and condos, and rental apartments. For his part, the Mayor has only said any changes should be revenue neutral.

Addressing these problems while keeping tax revenue constant would undoubtedly create winners and losers. To illustrate this we ran two scenarios. In one, the property tax burdens of all Tax Class 1 properties (mostly one- to three-family homes) are equalized. In the other, all residential properties bear an equal tax burden. Although in all likelihood such changes would be phased in, we present them as immediate, both to simplify the presentation and to show the magnitude of the disparities. Among our findings:

- If owners of the more than 700,000 Tax Class 1 properties in the city all paid taxes on the same share of the market value of their properties, more than 499,000 would receive tax cuts with a median value of $1,100.
- In Staten Island, 97 percent of private homes would see a tax cut. In the other boroughs, the results are more varied.
- On a neighborhood level, owners of private homes in Park Slope would see the biggest swing, with 98 percent getting a higher tax bill. The median increase would amount to more than $11,000.
- If all residential properties were taxed equally, most rental buildings with 11 or more apartments would receive a tax cut while many private homes, coops and condos, and smaller rental buildings would face tax increases.

While a city commission can make recommendations for reform of the property tax system, nearly any change the Mayor, City Council, or other municipal elected officials support must be enacted by the State Legislature. The ability to implement property tax reform ultimately rests in Albany, not City Hall.

IBO

New York City
Independent Budget Office
Ronnie Lowenstein, Director

110 William St., 14th floor
New York, NY 10038
Tel. (212) 442-0632

Fax (212) 442-0350
iboenews@ibo.nyc.ny.us
www.ibo.nyc.ny.us

Attention Getter

Property tax reform has received much attention lately, spurred by frustration with a system that is opaque and riddled with inequities and by a legal challenge brought by a coalition of property owners and tenants known as Tax Equity Now New York (TENNY). Mayor de Blasio has promised that reforming the property tax will be a major part of the agenda in his second term and the City Council recently called for a joint Council/Mayoral tax reform commission.

Four months into his second term, the Mayor has yet to offer any specifics about his plan for property tax reform other than to announce that any change will be revenue neutral—meaning any change will yield the same revenue, before and after. The property tax is the city's largest tax revenue source, and based on IBO's estimate will bring in $26.4 billion (45 percent of total tax revenue) this fiscal year. Given the fiscal challenges from Washington and Albany, it is reasonable for the Mayor to want to maintain that revenue, but that choice also means that any reform will have losers as well as winners.

Two Key Issues. While the New York City property tax is rife with problems and inefficiencies, much of the recent discussion has focused on two specific problems; both are also central to the complaint filed by TENNY. One is the wide gap in effective tax rates (taxes divided by market value) among properties in Tax Class 1 (primarily one-, two-, and three-family houses) that results from limits on annual assessment increases embedded in the state's property tax law. With assessment increases capped at no more than 6 percent per year or 20 percent over five years—even when market values are growing more quickly—effective tax rates in rapidly-appreciating areas such as Park Slope and Boerum Hill tend to fall, while areas of the city with slower growth can face stable or growing effective tax rates, opening up large differences in tax burdens between neighborhoods.

As faster-appreciating neighborhoods tend to have residents with higher incomes—certainly among recent home buyers—than neighborhoods with more moderate appreciation, there is an overall regressive relationship between homeowners' income and property tax burden, although the relationship is not perfect. Consider that the Fieldston neighborhood in the northwest Bronx has one of the highest effective tax rates in the borough.

The second issue is the disparate treatment of rental properties on the one hand, and private homes, which includes Tax Class 1 houses plus coops and condos, on the other. Coops and condos are grouped with rental properties in Tax Class 2 but because state law requires that they be assessed as income producing properties, their values are grossly understated. IBO estimates that on average the city's official market values for coop and condo apartments

Methodology

To estimate taxes under the two equalized scenarios, we first shifted to using full value as the tax base (i.e. all parcels have an assessment ratio of one). For parcels with exemptions we reduced the full value using the same exemption percentage as in the current system (actual exempt value divided by actual assessed value). We then set a tax rate needed to generate the same revenue currently raised from Tax Class 1 in the first scenario and by the total raised from Tax Classes 1 and 2 together in the second scenario. The levy in the second scenario is reduced by the current coop/condo abatement, which would no longer be needed in a fully equalized system. The estimates assume continuation of J-51, SCRIE, and other residential abatements.

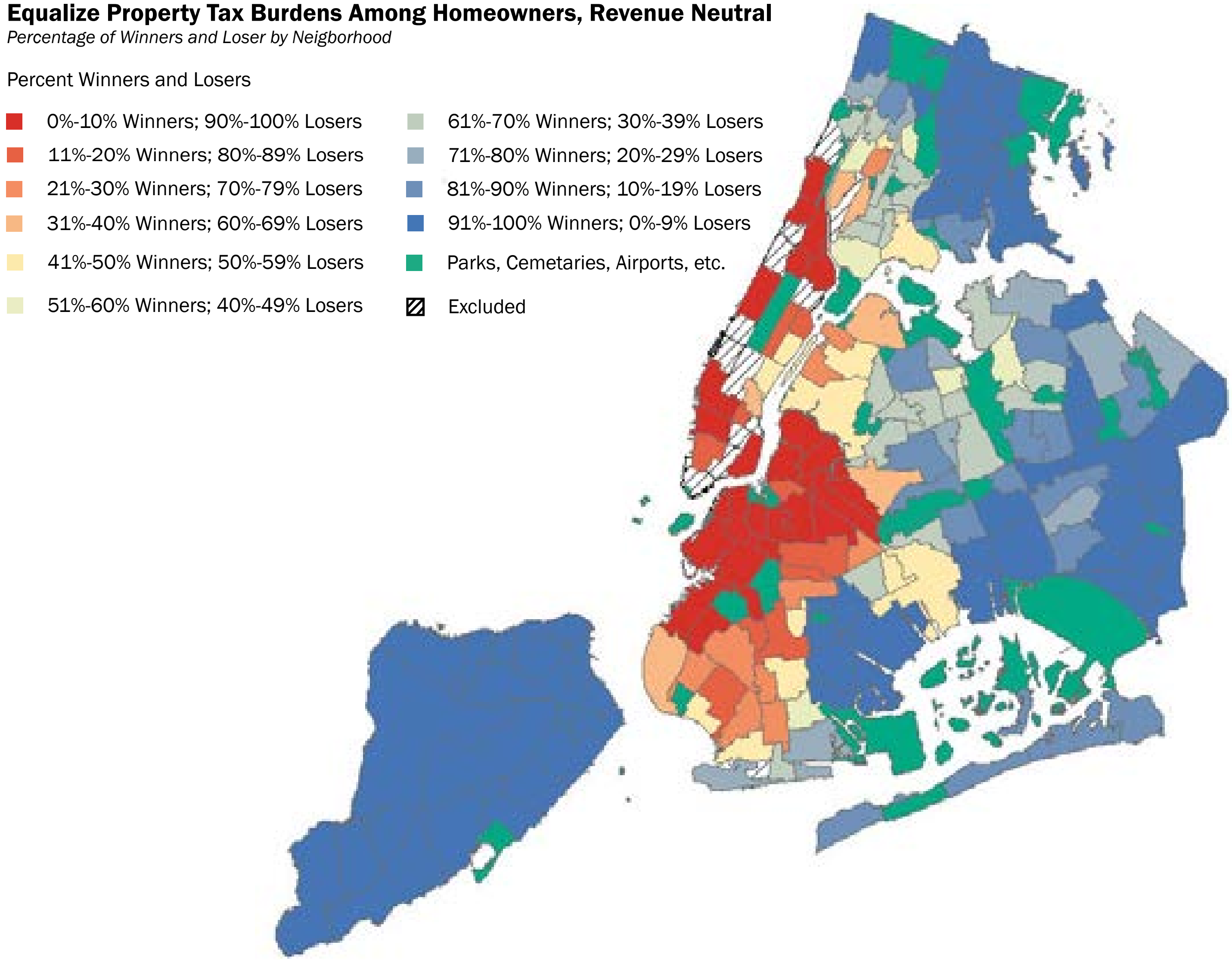
In the second scenario, we replaced the official finance department market values for coops, condos, and small rental properties with IBO's sales-based estimates of market values. IBO's estimates use building characteristics and location of sold properties to project values for similar apartments. This added over $530 billion in estimated market value to the tax base, an increase of about 65 percent over the official total.

The second scenario assumes that larger rental buildings would also be valued using sales price, although the small number of sales of such buildings and limited access to information on building incomes and expenses makes it difficult to develop reliable sales-based estimates of market value. However, because it is likely that the finance department's income-based values for large rentals understate the buildings' true market values, we arbitrarily assumed that the official market values for larger rental buildings understate sales-based values by 50 percent, which would add another $112 billion to the tax base. Making this adjustment has relatively little effect on the overall results.

Finally, results for Tax Class 2 are reported after weighting by the number of apartments. Tax Class 1 results are weighted by parcel.

Equalize Property Tax Burdens Among Homeowners, Revenue Neutral

Percentage of Winners and Loser by Neigborhood



SOURCE: Department of Finance

New York City Independent Budget Office

are only 20 percent of what they would be if the city were allowed to value them using sales prices.

Based on the city's official market values, larger rental properties (those with 11 or more units) face the highest tax burden in the city, with effective tax rates over five times higher than those of Tax Class 1 homeowners—although this disparity is almost certainly overstated due to undervaluation of many rental properties by the finance department (see sidebar). And while landlords are responsible for paying the property tax, some portion of the owner's tax bill is indirectly borne by tenants in the form of higher rents. Given that renters in the city generally have lower incomes than owners of houses, coops, and condos, it is likely that New York City's residential property taxes fall disproportionally on renters—who account for over 60 percent of households in the city.

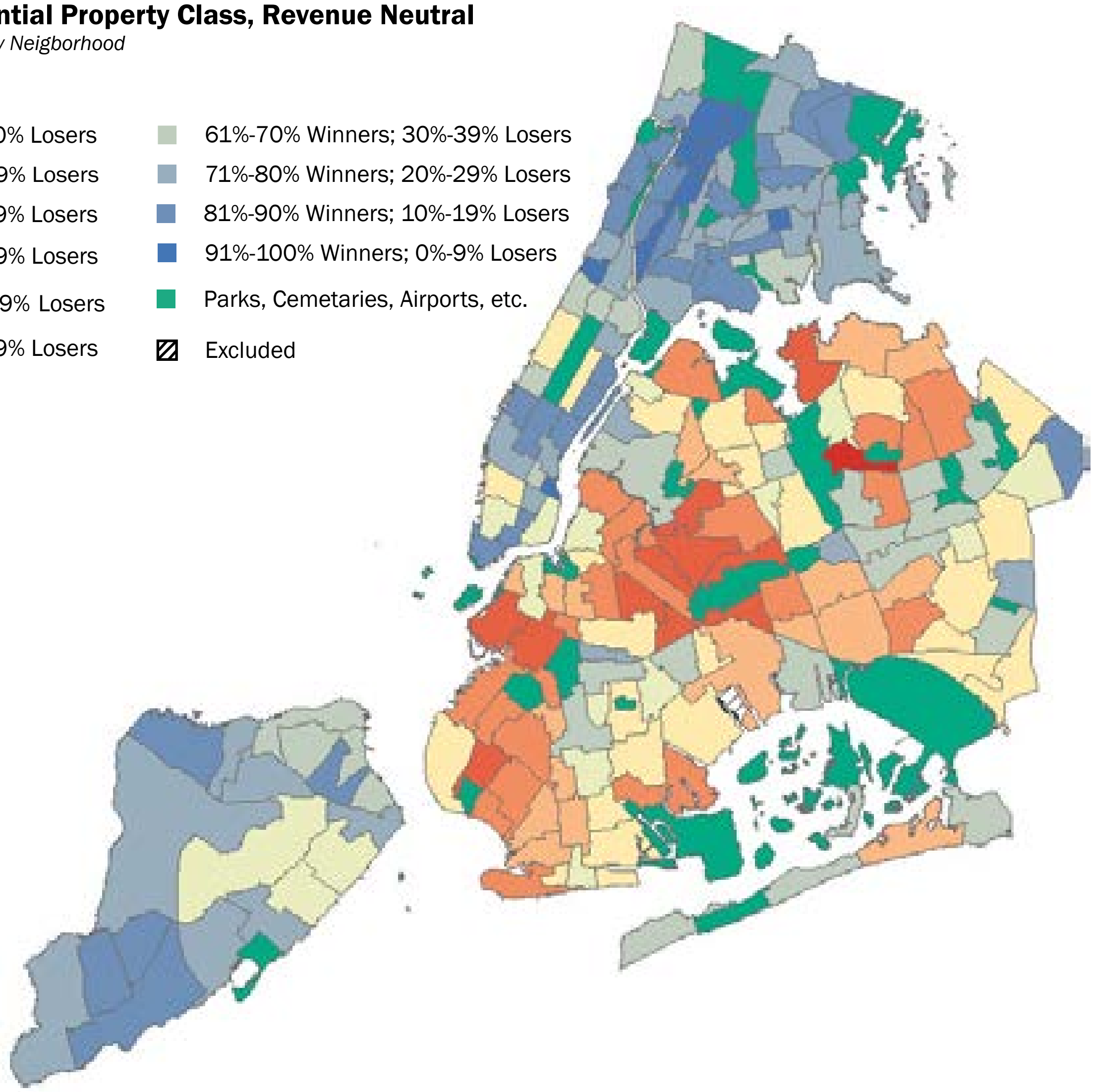
Advocates for dealing with each of these distinct problems have found reason to cheer on the TENNY lawsuit, but assuming any change is implemented so as to be revenue neutral, the types of properties and the areas of the city that "win" or "lose" differ greatly depending on which problem policymakers prioritize.

To illustrate this point we consider two very simplified scenarios: the first equalizes the treatment of all Tax Class 1 properties while the second equalizes the treatment of all residential properties including rental buildings. In both cases total property tax revenue remains constant. For simplicity we assume that all changes are implemented immediately in one year. While this assumption may be unrealistic, as any solution would likely include a transition period in which changes are gradually phased-in, the exercise is useful in that it emphasizes the magnitude of

Creating a Single Residential Property Class, Revenue Neutral
Percentage of Winners and Loser by Neigborhood

Percent Winners and Losers

- 0%-10% Winners; 90%-100% Losers
- 11%-20% Winners; 80%-89% Losers
- 21%-30% Winners; 70%-79% Losers
- 31%-40% Winners; 60%-69% Losers
- 41%-50% Winners; 50%-59% Losers
- 51%-60% Winners; 40%-49% Losers
- 61%-70% Winners; 30%-39% Losers
- 71%-80% Winners; 20%-29% Losers
- 81%-90% Winners; 10%-19% Losers
- 91%-100% Winners; 0%-9% Losers
- Parks, Cemetaries, Airports, etc.
- Excluded



SOURCE: Department of Finance

New York City Independent Budget Office

the current disparities as well as demonstrating the large changes in the distribution of tax burdens that would be needed to resolve them.

Winners & Losers. Equalization of property tax burdens in Tax Class 1—meaning all 700,100 parcels would pay the same percentage of their market value—would bring lower taxes for 499,400 properties. Their median reduction would be $1,109. Owners of 197,200 other properties would pay more, while 3,500 would see changes of less than $10. As shown on the map on page 3, for all neighborhoods on Staten Island the share of properties benefiting from the change exceeds 90 percent. (Areas shaded blue indicate that a majority of owners would receive a lower tax bill—the deeper the blue, the higher the share getting a tax cut.) For the borough as a whole, 97 percent of Tax Class 1 properties would see a tax cut under this scenario.

In other boroughs, the results are more varied. In many Brooklyn neighborhoods, including Bensonhurst, Borough Park, Bushwick, Carroll Gardens, Crown Heights, Williamsburg, Flatbush, Fort Greene, Ocean Hill, Sunset Park, and Windsor Terrace, a majority of homeowners would pay more in taxes. (These areas are shaded red on the map.) No neighborhood in the city would see a bigger swing than Park Slope, where 98 percent of homes would have a higher tax bill, with a median increase of $11,146. Among neighborhoods in southeastern Brooklyn, however, a majority of properties would receive reductions including Sheepshead Bay, Bergen Beach-Marine Park-Mill Basin, Flatlands, Brighton Beach, and Brownsville. Similar intra-borough variation can be seen in Queens and the Bronx. Many of the relatively small number of Tax Class 1 properties in Manhattan would see increased property tax bills.

One solution to the disparity in treatment between rental apartment properties and coops, condos, and one-, two-, and three-family houses would be to combine them all in a single residential class. In this scenario market values of coop and condos as well as rentals would be based on sales prices (see sidebar). Given the current higher tax burden on rental buildings, a revenue neutral equalization of all residential properties would result in tax cuts for most rentals with 11 or more units and tax increases for almost three-quarters of Tax Class 1 properties and about 60 percent of coops, condos, and smaller rental buildings.

The map on page 4 shows the outcome at the neighborhood level. Many neighborhoods in Manhattan, the south and central Bronx, and eastern Queens would on average be winners as their housing stock is dominated by rental properties. Over a quarter of Staten Island Tax Class 1 properties would join those in many Brooklyn neighborhoods in facing higher taxes under this scenario. This is because the size of the tax shift needed to close the gap among Tax Class 1 properties is swamped by the much larger shift that would be needed to bring rental property tax burdens into parity with burdens on Tax Class 1, coop, and condo properties.

Looking Ahead

The coming months are expected to focus even more attention on property tax inequities as the TENNY suit progresses and the Mayor and City Council consider reform options—options that would ultimately have to be approved by Albany legislators.

While the two examples shown here are admittedly extreme cases, they demonstrate that any solution will inevitably involve both winners and losers and that the mix of who wins and who loses will depend a lot on which problems get the most attention.

Prepared by George Sweeting
with map development by Sarah Sayavong