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Testimony on the Recommendations of the NYC Advisory Commission on Property Tax Reform

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Thank you for the opportunity to testify today. I am Ana Champeny, Vice President for Research at the Citizens Budget Commission (CBC), a nonpartisan, nonprofit think tank and watchdog devoted to constructive change in the finances and services of New York State and City governments. CBC has long advocated for comprehensive reform to the property tax system to increase transparency, equity, simplicity, and fairness, and to help boost housing production.

While momentum for property tax reform was slowed by the pandemic, the need for it has not diminished. The two reports of the Advisory Commission on Property Tax Reform (the Commission) are valuable contributions to longstanding property tax reform efforts in New York City. The Commission documented many of the system's inequities and put forth ten recommendations that would begin to address the system's shortcomings; however, these recommendations did not adequately address valuation and tax burdens for rental and commercial property.

The Commission's recommendations would reduce inequities in tax burdens among many residential properties and largely align with prior CBC recommendations. These recommendations address many of the current inequities in tax burdens among one-to-three family homes, cooperative apartments, and condominiums, and would increase the simplicity and transparency of taxation of cooperative and condominium units.

The specific details for the homestead exemption and circuit breaker were released in late December 2021. While the Final Report provides preliminary data on how effective tax rates would change, the City should release a detailed analysis that assesses how tax burdens would be redistributed within the proposed new residential class. There should be public discussion about the goals of these programs and whether the proposed designs would provide the necessary amount of tax relief to the appropriate set of property owners.

The Commission did not undertake an analysis of whether assessment procedures contribute to inequities in tax burdens for rental buildings and commercial property. These studies are important to determine whether current procedures lead to equitable treatment within those property classes; the Commission should make additional recommendations if they do not.

Furthermore, the Commission's rate-setting recommendation technically eliminates the class share system, which leads to disparities in tax burdens between classes, but it unfortunately recommends maintaining the current relative burdens. This misses the opportunity to address the high tax burdens for rental and commercial property in New York City, which also is critical to supporting rental housing production and the competitiveness of the City's commercial real estate market, respectively.

The Five Main Problems with the New York City Property Tax System

Decades of research and analysis on the City's property tax has led to general agreement on five structural problems and deficiencies that should be addressed:

1. **Lack of transparency and simplicity**
   The current system is overly complex and opaque. Most property owners do not understand their property's market value, assessment, or tax bill.

2. **Valuation of property is not reflective of the market**
   Market values as determined by the Department of Finance (DOF) often do not reflect prices in arm's length transactions.

3. **Assessment growth caps and phase-ins lead to intra-class inequities**
   Within the four classes of property in NYC, there are inequities in tax burdens among similarly valued property; higher valued property may face a lower tax burden than lower valued property.

4. **Distribution of the levy according to class shares leads to inter-class disparities**
   Allocating the property tax levy across the four classes based on shares, which require that each class of property pay a certain portion of the total levy, places higher property tax burdens on certain classes of property.

5. **Exemptions and abatements are poorly targeted**
   Programs to reduce property taxes can provide more relief than is necessary in some cases, while providing too little in other cases.

The total amount of revenue the City chooses to raise from the property tax is a separate policy decision that should occur during the City's budget-making process.

The New Residential Class Would Significantly Improve the Property Tax System

The Commission's first four recommendations establish a new residential class that would be simpler, more transparent, improve valuation relative to the market, and reduce inequities in tax burdens within similar properties in the class.

The proposed new residential class would include nearly two million residential units in one million tax parcels including one- to three-family homes, coops, condos, and small rentals of ten or fewer units.

Market value would be determined based on comparable sales, with the assessed value set at 100 percent of market value. CBC estimates that total market value of the new residential class would be about $1.5 trillion, a 40 percent increase from the current valuation.

With the proposed elimination of assessment caps and fractional assessment, parcels in the new residential class would be assessed at 100 percent of market value, rather than 6 percent or 45 percent (as is currently the case for Class 1 and Class 2, respectively). With assessed values set to 100 percent of market value, the nominal tax rate before a homestead exemption and circuit breaker would around 0.81 percent, far lower than the current rates of 20.309 percent in Class 1 and 12.267 percent in Class 2. (Because the nominal rate would be applied to a higher assessed value, the total levy for the new residential class would equal the sum of the levies under the current system.)

The Commission's recommendations are based on sound tax policy and improve the current system in three ways:

- Values will better reflect the market for coops and condos;
- Values of one- to three-family homes, coops, and condos will be comparable to each other; and
- Tax burdens would be more equitably distributed.

CBC's model of the new residential class found that the redistribution of tax burdens would increase property tax bills for about 35 percent of parcels in the new class and decrease bills for the remaining 65 percent. Tax bills for many properties with lower market values would decrease, while bills for the majority of higher-valued properties would increase.

Furthermore, tax burdens would be more equitable within property types than under the current system for both one- to three-family homes, and cooperative and condominiums units.

- First, among one- to three-family homes, elimination of assessment growth caps would equalize tax burdens. Under the current system, homes in neighborhoods where values have appreciated rapidly have lower property tax burdens than homes with more modest market value growth, as shown in CBC's blog New York City Homeowners: Who's Got the Unfairest Tax Burden of Them All?. Eliminating assessment caps would substantially redistribute liabilities among Class 1 homes: in general, taxes would be lowered for homes in Staten Island, eastern Queens, and northeast Bronx, and increased for homes in Manhattan and northwest Brooklyn.
- Second, shifting coops and condos to comparable sales valuation, rather than comparable rental income as is done now, would also equalize tax burdens. Under current methods, DOF market values capture a declining share of sales-based values as sales-based values increase; for example, the median condominium that sells between $400,000 and $500,000 is assessed at 21 percent of that sales price, while one that sells for between $5 million and $7.5 million is assessed at 15 percent of sales price. Before exemptions, the effective tax rate (ETR), which measures taxes as a share of market value, would be 2.6 percent and 1.8 percent, respectively. By switching to sales-based valuation, both units would face the same ETR before any exemptions; in general, average ETRs would decrease for units with lower sales prices and increase for those with higher sales prices.

Three additional consequences of the new residential class do not pertain to tax burdens but are important:

1. The City's Constitutional property tax limit, also known as the operating limit, which determines how much property tax revenue can be raised for operating expenses excluding long-term debt service, would increase. These reforms would substantially increase how much property tax revenue the City is permitted to levy. The limit is set to 2.5 percent of the average market value of the preceding five years; changing to sales-based valuation for coops, condos, and small rental buildings would substantially increase the total market value in NYC, potentially by as much as 40 percent.
2. The City's Constitutional debt limit, which determines how much outstanding long-term debt the City can issue, would increase dramatically. The constitutional debt limit is equal to 10 percent of the average market value of the preceding five years.

3. The number of property owners challenging their assessment may increase. Currently, due to assessment growth limits that have suppressed assessed value growth, few one-, two-, or three-family homes could successfully challenge their assessments. Even if they successfully argued that the market value was lower than the DOF value, in most cases it would not be enough of a decrease to reduce the assessed value and tax liability. However, under a system where assessments are based on 100 percent of market value, more property owners may challenge their assessments.

More Detailed Analysis of The Proposed Homestead Exemption and Circuit Breaker Needed to Assess Redistribution of Tax Burdens

The Commission also recommended a homestead exemption and a circuit breaker. A homestead exemption would reduce the tax burden on owner-occupied primary residences in the new class, while a circuit breaker would provide tax relief to homeowners who face excessive property tax liability relative to their incomes. The Commission's Final Report presented two options for a homestead exemption and one set of parameters for a circuit breaker and projected the impact of those proposals on effective tax rates. While CBC believes there should be a homestead exemption and a circuit breaker, we have not analyzed the Commission's recommendations to determine whether they are best designed to provide the necessary amount of tax relief to the appropriate set of property owners. The choice for a final design should be based on more analysis of options and discussion of impacts.

Since the proposals are revenue neutral and the new residential class is expected to pay the same share of the levy as those parcels currently pay, the tax relief programs that reduce liability for some are made up by increasing taxes on other properties in the class. The nominal tax rate in the class is raised so that the class generates sufficient revenue from parcels not benefitting from the programs to offset the tax reduction for eligible parcels. The tables in the Commission's Final Report show that the overall tax rate increases from 0.81 percent to 0.94 percent under a flat homestead exemption and 0.96 percent under a graduated homestead exemption. In other words, a property that is not eligible for a homestead exemption, which may be occupied by a renter, would pay $940 or $960 per $100,000 of market value, rather than $810 per $100,000 of market value, an increase of 16 percent or 19 percent, respectively.

The impact of the proposed homestead exemption and circuit breaker are presented in tables that report the 25^{th}, 50^{th}, and 75^{th} percentile ETRs by market value, income, and borough. However, these results do not show how many properties within each band would qualify or what the aggregate shift in tax liability would be. Furthermore, since household income data for individual property owners are not publicly available, CBC is limited in the analysis we can do to develop a granular understanding of how the proposed homestead exemption and circuit would redistribute liabilities across properties in the new residential class.

New Tax Rate System Does Not Address High Tax Burden on Rental and Commercial Property That Depresses Rental Housing Production

The Commission rightly calls for the elimination of class shares—a complicated and hard-to-understand process codified in State law that requires each property class to pay a certain share of the total levy. While class shares can be adjusted modestly from year to year in response to changes in market value and physical changes (new construction or demolition), the overall intent is for class shares to be kept fairly consistent over time. The new method would be to set "predictable and transparent" tax rates for each class, with an assessment of tax burdens to be conducted every five years. This recommendation seeks to reduce complexity and increase transparency.

However, the Commission's recommendation that relative tax burdens among the classes be preserved effectively maintains the class share system. The Commission did not assess whether the current allocation of the property tax across classes is meeting or hindering priorities and policy goals. For example:

- The higher tax burden on rental housing disincentivizes development and contributes to the City's sluggish housing production; and
- Commercial property, negatively impacted by the pandemic, similarly faces higher tax burdens which can put the City at a competitive disadvantage as well as impose high costs on businesses in the City.

The median ETR for one- to three-family homes is $0.83 per $100 in market value; it is $1.53 for large rentals and $1.72 for office buildings. Under the new property tax system, large rental buildings would continue to face an ETR 1.8 times that of one- to three-family homes, while office buildings would pay twice the ETR. High property tax rates are a deterrent to the construction of new rental housing (absent a tax exemption); maintaining a lower ETR for condos compared to rentals will make new construction of condos more profitable and appealing to developers.

While CBC also recommends eliminating class shares, the Commission's recommendation maintains the current disparities in tax burdens among the classes, which does not comport with CBC's recommendation that these differences be narrower, in part to encourage development of rental housing.

Commission Should Closely Examine Valuation of Commercial and Rental Buildings

The Commission does not recommend changes to assessment methodology for large rentals, utilities, and commercial property. In fact, the Preliminary Report goes to great length to argue that DOF methods are the industry standard and in accordance with legal precedent. The method may be the preferred or best approach to valuation, but that does not ensure that its implementation is fair and equitable. Especially opaque is the City's process for setting capitalization rates each year, which directly affect market values. The City should analyze the extent to which there may be intra-class inequities resulting from DOF's methods. For example, are properties of similar sizes and uses valued similarly?

Conclusion

The Commission's Preliminary and Final Reports are critical steps in what is clearly a long and winding road to comprehensive property tax reform. There are many details to be settled—especially regarding the homestead exemption, the circuit-breaker, and the tax rate-setting process. Additionally, the Commission largely maintained the status quo for large rental buildings, utilities, and commercial property – areas that should be given greater attention.

The recommendations, especially the recommendations pertaining to the new residential class, should be considered holistically. Policymakers must resist pulling apart the recommendations—for example, moving coops and condos into Class 1 without eliminating caps, or implementing a circuit breaker without changes in valuation and assessment. These recommendations were made as a package and should be deliberated as such; implementing reforms piecemeal could lead to greater inequities and uncertainty.

CBC looks forward to continued participation in this important policy dialogue. Incremental reform of the system has not worked; the goal is comprehensive reform to create a more equitable and transparent property tax system.