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Residential Property Taxation in New York City

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Abstract

This working paper sets forth the recent history and current structure of New York City's residential property tax system, as well as large-scale inequities, possible points of needed reform, and an assessment of the likelihood and obstacles to these reforms. It begins with a short overview and history of the current class system and proceeds to outlining restrictions on the amount and relative burden of the property tax levy, an examination of the mechanisms by which individual property is taxed and the problems and inequities which result, and concludes with an overview of the large array of exemptions and abatements available in New York City. Throughout the paper inequities and distortions in the system are identified and examined in conjunction with the part of the system which created them. While in a broad sense there is a general consensus about common points of needed reform to the residential property tax system among most civic organizations with an interest in the system the details, implementation, and consequences of reform have yet to be fully examined.

About the Author

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Residential Property Taxation in New York City

The Current Property Tax Class System

The current New York City Property Tax system stems from the state passage of the 1981 Real Property Tax Law embodied in Article 18 of the New York State Real Property Tax Law. Article 18 is specific to New York City & Nassau County, affecting only "Special Assessing Units," which are defined as jurisdictions which assess property taxes with populations of one million or more, of which New York City and Nassau County are the only ones in the state.

Largely known as S7000A, after the Senate Bill introduced creating the system (its Assembly counterpart was A9200), the 1981 law has served as the framework for New York City's property tax system since it went into effect in 1983. The main effect of this law was to create the "Class" system in effect in New York City today.[1]

Under this system, property is divided into one of four property tax classes. These currently are:

Class 1–all residential buildings with one, two, or three Class A (permanent residence) dwelling units. Class 1 is further subdivided into subclasses: one-family homes, two-family homes, three-family homes, condominiums with 1–3 units, small mixed-use buildings with three or fewer residential units and where the majority of square footage is used for residential purposes, and developments consisting of stand-alone bungalow dwellings on cooperatively owned land. Small land parcels outside of Manhattan below 110th street that are either zoned for residential use or adjacent to another Class 1 parcel are also valued as Class 1 property. Subclasses within Class 1 do not have significant differences in valuation or assessment methods, and Class 1 properties are generally treated as one category when discussing possible reforms. However, there are reforms that have been proposed (and many more possible) which would affect only a subclass of Class 1 properties. The most notable of these are various reforms to taxation or valuation of vacant land in Class 1 (Class 1b) property, in order to discourage warehousing and encourage development on these sites.

Class 2–all residential buildings with four or more Class A (permanent residence) dwelling units. Class 2 is also divided into subclasses: Rental properties of 4–6 units (Class 2a), rental properties of 7–10 units (Class 2b) and cooperatives & condominiums of 4–10 units (Class 2c). Larger cooperative, condominium and rental buildings, as well as larger mixed-use buildings with four or more residential units and where the majority of square footage is used for residential purposes, fall into the general Class 2 category and do not have a subclass. Unlike Class 1, there are significant differences in valuation between subclasses of Class 2 properties, most notably the tax cap on 2a, 2b and 2c properties.

Class 3–properties owned by utility corporations and operated as utilities, and special franchises (which consists of utility uses over a public right-of-way). Class 3 properties make up a small

[1] For more on the history of the New York City property tax system see Goor 2017, 15–17 and Furman Center 2011, 12–14.

percentage of New York City's real estate (about 3% of taxable value) and are generally overlooked in discussions of property tax reform. However, by their nature as heavily regulated entities any taxes are likely directly passed through to ratepayers, making this one of the easiest areas to provide direct relief for a broad range of people through lower utility bills. In addition, this tax pass-through to ratepayers is among the most regressive forms of taxation, with the added tax not based on income and likely hitting larger families harder, as well as families who don't have access to energy-efficient fixtures and appliances. While Class 3 is not a focus of this working paper, Class 3 property tax reform should be part of any larger conversation around reforming the New York City Property Tax system.

Class 4–this consists of all real property not a part of one of the three classes above. It includes commercial and industrial properties, mixed-use properties where residential uses are less than 50% of the square footage, and Class B (non-permanent) dwellings such as hotels and dormitories. Class 4 property taxation is not a focus of this working paper; however, the prospect of lowering Class 4 taxes has been a significant driver of many major efforts of tax reform including the reforms that resulted from S7000A.

There have occasionally been minor reclassifications of certain types of property from one class to another, such as in 1992 when single-family bungalows on cooperatively owned land were transferred from Class 2 to Class 1. However, the major categories in the four classes have stayed in place since 1983.

History of the Current Class System

This current class system came about in response to a lawsuit by commercial property owners (Hellerstein v. Assessor, Town of Islip, 37 N.Y.2d 1.) alleging that inequities in the system were in violation of the New York State real property tax law. Beginning during World War II, residential assessments were regularly frozen or raised less than commercial assessments, as politicians were reluctant to raise taxes on homeowners (New York City Property Tax Reform Commission 1993). This resulted in a system in which the relative tax burden of commercial property was much higher than that of homeowners. Hellerstein v. Assessor, Town of Islip was decided by the New York State Court of Appeals (the highest court in New York) in 1975 and required that assessment and taxation of property be uniform and based on full market valuation, and New York State was instructed to implement such a system. However, New York State did not implement any other system until 1981, and when they did the result was to arrange for four "special assessing units" in New York City which correspond to the current class system, as outlined above. Specific shares of the overall levy were assigned to each of these four classes (with homeowners continuing to bear a much smaller taxation burden relative to market value), and the principle of uniformity of assessment and taxation applied only within each class itself, not to property as whole.

The inequities in this system quickly became apparent. To address these and propose reforms for the system overall, the Dinkins administration convened the New York City Real Property Tax Reform Commission chaired by Stanley Grayson and commonly known as the "Grayson Commission." This commission issued a final report on December 30th, 1993 (the second-to-last day of the Dinkins administration) which was a comprehensive analysis of the property tax

system and steps to making it more equitable. Testimony was gathered from stakeholders and the public and the several different scenarios for reforming the class system were explored.

The Grayson Commission's main findings were that the current residential property tax system advantaged Class 1 properties over Class 2 properties (it also found that Class 3 and Class 4 bore an unfair burden as well), advantaged people with higher incomes over those with lower incomes, and that there was little uniformity of taxation even within each residential class. Overall, it was explicit in its assertion that the current system was unfair, writing in the first paragraph of the executive summary: "Inordinately complex taxes suffer inherently from the appearance of unfairness. Further, the property tax in New York City not only appears unfair, it is unfair" (New York City Property Tax Reform Commission 1993, 2). To address these inequalities, the commission recommended moving to a simpler system where residential property was valued uniformly, the class system revised, and low-income residents given more relief through the property tax system.

Because of the transition from the Dinkins to the Giuliani administration, the Grayson report findings were never advanced (although the Giuliani administration did release certain appendixes of the report), and serious efforts at property tax reform were dropped. However, much of the Grayson report findings and recommendations remain the foundation for conversations about property tax reform today. Various civic organizations have issued reports on the property tax system with ideas for reforms since, mostly echoing the broad strokes of the Grayson Commission findings and proposing similar solutions for addressing residential property tax inequalities.[2] More uniform residential valuations and tax burdens, revision of the class system, and better support for low-income residents remain three principles which virtually all people with an interest in the New York City property tax system cite as necessary reforms, although specifics of how these reforms would manifest still vary considerably. Objections to these reforms are generally not based on a defense of the current system as fair and equitable, and instead based on a reluctance to introduce volatility into property taxes and/or values rather than an objection to the principles of the reforms themselves.

Other lawsuits alleging that at least some aspect of the property tax system violates State or Federal law have been filed since the introduction of the tax class system. Most recently, in April of 2017 a lawsuit against the current system was filed in New York Supreme Court by a coalition of civic and real estate organizations called "Tax Equity Now New York" (TENNY). This lawsuit claims that the existing property tax system violates the New York State constitution, The United States Constitution, New York State Real Property Tax Law, and the Federal Fair Housing Act (Tax Equity Now NY LLC v. City of New York, 0153759/2017*)*. RPA is listed as a supporter of this coalition and has also issued its own broad strokes for proposed reform in its Fourth Regional Plan (Regional Plan Association 2017).

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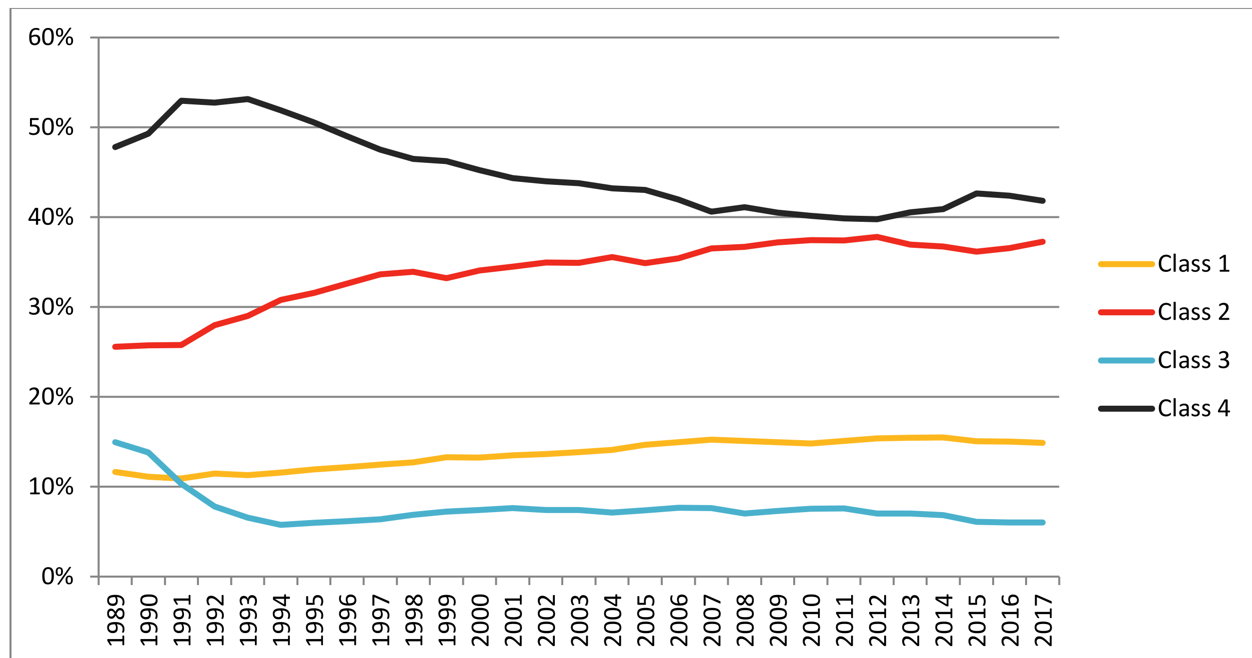
[2] Civic organizations which have recently issued specific ideas for Property Tax reform along these general lines include (but are not limited to) the Citizens Budget Commission (Hayashi 2013), the Independent Budget Office (Sweeting 2016), the Fiscal Policy Institute (Parrott 2015), the Manhattan Institute (Husock 2016), and the Center for New York City Affairs (Parrott 2017). There have also been several reforms proposed by various elected officials in New York City and State. For the specifics and possible effects of some of these reform proposals, see Goor 2017, Chapter 4.

Limitations on Property Tax Levies

Class Shares

As part of the 1981 legislation, each of the tax classes are required to bear a specific percentage of the entire property tax levy of New York City, and methods and restrictions for determining these percentages are spelled out in section 1803 of the New York State Real Property Tax Law. Originally the share of property taxes which each class was required to bear was allowed to vary by up to 5% each year. Quickly, because of the reluctance to raise taxes on homeowners, the share of property taxes paid by Class 1 properties declined relative to the share paid by other classes. In 1989 this system was changed to be less discretionary and, while there have since been several different small adjustments to determining the class shares—the latest being a 2017 directive that no class share should exceed those of the last fiscal year—the actual class shares have stayed relatively consistent since, although the share paid by Class 1 and 2 residential properties has risen while those of utility and commercial properties has declined. For the last 10 years, the class shares have been very consistent, varying by less than 2% in any class over this time.

Chart 1: Tax Levy Distribution by Tax Class: Fiscal Years 1989–2017



Source: The City of New York Department of Finance, 1999 and 2016.

These class shares do not reflect the share of overall market value that the class represents. For instance, for Fiscal Year 2017 (July 1, 2016–June 30, 2017), the overall class shares and market values were as follows:[3]

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[3] Market values exclude fully tax-exempt properties. Class 2 property values reflect the valuations method used by the New York City Department of Finance, including the income-capitalization model for cooperatives and

Table 1: Class Shares and Market Values by Tax Class, FY 2017

Tax Class	Share of Property Tax Burden	Share of Market Value
Class 1:	14.9%	46.6%
Class 2:	37.3%	24.1%
Class 3:	6.0%	3.0%
Class 4:	41.8%	26.3%

Source: The City of New York Department of Finance, 2017.

This leads to vastly different "net effective tax rates" (the actual taxes paid by a property as a ratio of its actual market value) between Class 1 and Class 2 properties. This discrepancy is often cited as a main rationale for reform: because Class 1 properties are mandated to pay a significantly smaller share of taxes than their overall valuation, individual Class 1 properties therefore pay on average less of their market value in property taxes than other classes, who therefore make up the difference needed. In 2015, the net effective tax rate of Class 1 properties was 77 cents per $100 of market value. This is compared to $1.30 for Class 2 properties overall, and even higher rates for Class 2 rental properties, which the IBO puts at $3.60 for elevator rental buildings, and $4.50 for rental walkup buildings (Sweeting 2016).[4]

Because of the state-mandated necessity of raising a certain amount of revenue from each class of property, there is very little the city can do to change the overall tax inequity between Class 1 and Class 2 properties (or between any other classes of property) absent a major adjustment of these shares or a change to the class share system overall, both of which are under the control of New York State. Other than small technical exceptions due to the way abatements and tax credits are accounted for, changes in the property tax structure which do not affect class shares—such as exemption policies, assessment caps, and valuation methods—have the effect only of shifting tax burden within a class, as opposed to changing the overall inequities between classes.

The Case of Renters

This difference in effective tax rates between rental properties, and especially rental properties of 11 units or more without a tax cap, and other residential property is often cited as one of the main inequities of our property tax system. Because they incur costs from property taxes directly, it is relatively easy to measure the effects of property tax reform on homeowners. However, New York City is primarily a city of renters,[5] and if and how property tax reform could benefit renters should be a major part of any conversations around potential reform.

One of the most commonly heard rationales for reducing tax burden for rental properties is that this is passed through to renters in the form of higher rents. Because renters tend to have lower

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condominiums. Some other comparisons, most notably those done by the IBO, adjust cooperative and condominium market values to reflect a value based on a comparable sales valuation method, as used by Class 1 properties.

[4] As mentioned in the footnote above, the IBO uses comparable apartment sales to estimate the true market values for cooperatives and condominiums, and as such the net effective tax rates of these properties.

[5] According to the 2017 New York City Housing and Vacancy Survey, only 32.4% of New York City Households were owner-occupied (Selected Initial Findings of the 2017 New York City Housing and Vacancy Survey, 2018).

incomes than homeowners,[6] this leads to further inequities in the property tax system. However, the heavily regulated nature of the New York City rental market means that this is by no means a dollar-for-dollar pass through. Public housing and most forms of other affordable housing pay little or no property taxes at all. Newly constructed rental buildings generally pay very little taxes through the 421-a program, and recently renovated buildings also have a significant tax incentive through the J-51 program. As such, the largest burden of property taxes on multifamily rental properties falls to large, older rental buildings which are likely to contain rent-stabilized apartments subject to limits on rent increases they can impose on tenants. This does not necessarily mean these apartments have below-market rents, as actual rents could either be below or at the local market depending on a number of factors—most notably, the rent when the apartment was initially regulated (generally in the 1970s) and the number of vacancies that have resulted, which lets owners both take a large as-of-right rent increase as well as renovate the apartment and recover those costs through increased rent. As of March 2017, 31.2% of rent-stabilized apartments have a "preferential rent" (New York City Rent Guidelines Board 2017), meaning a tenant pays less than the highest legal amount possible. This indicates the apartment is likely already commanding the highest actual rent it can on the open market. The Rent Stabilization Association (RSA), which represents landlords of rent stabilized buildings, concur, saying: "There is a very limited ability to increase preferential rents because they are market rents" (Podkul 2017). However, local markets often change quickly in New York City and a preferential rent may catch up with a regulated rent in a short period of time.

A tenant's rent necessarily goes in part to pay operating costs of a building, including property taxes. One suggestion made by former NYC Finance Commissioner O'Cleireacain for reform is to have rent bills for tenants break down how much of their rent is going toward paying property taxes (Furman Center 2011) as an effort to develop tenant awareness and presumably an additional constituency for reducing property taxes in large apartment buildings.

The question that should be asked, however, is not how much tenants are paying currently in indirect property taxes. It is instead how much, and by what mechanism, tenants should expect to benefit from any reduction (or slowing of increase) in the property taxes of multifamily rental buildings. Here there is less consensus. The Furman Center (2011), when discussing the implication of the property tax for renters, noted several possible negative effects of the high multifamily tax burden on renters,[7] but also noted that "further research is required to draw any strong inferences for policy, especially given the complexity of the city's regulatory environment and of its housing market."

In a perfect market, it might be expected that the lower operating costs brought on by lower taxes would eventually find their way to tenant relief in the form of owners having an additional ability to compete for tenants through limiting rent increases while still maintaining the same cash flow. These lower taxes could also serve as an incentive for the development of multifamily rental housing, if not for the fact that New York City already has a property tax program that

[6] According to the 2017 New York City Housing and Vacancy Survey, the median income for renting households in 2016 was $47,200, while for owning households it was $87,000 (Selected Initial Findings of the 2017 New York City Housing and Vacancy Survey, 2018).
[7] These possible negative effects include less rental housing overall, higher rents for both market and rent-stabilized tenants, maintenance cutbacks, and improvements delays.

incentivizes development far more: the 421-a tax exemption program, which virtually all new multifamily rental construction utilizes and which currently provides a 35-year full exemption from property taxes on the value of the new building, only requiring the owner to pay taxes based on the value of what was previously on the site

In rent-regulated buildings which have below-market rents, there is no incentive for owners to compete for tenants or even compete to retain an existing tenant—indeed, it is often more profitable for owners to turn over tenancies in their apartments so that they can command an additional vacancy increase on the apartment. This would lead to owners necessarily not passing through any tax relief to tenants absent a mandate to do so. This could possibly be mitigated by the New York City Rent Guidelines Board (NYC RGB), which is mandated to take in to account operating expenses—including property taxes—when determining allowable rent increases. Significant property tax reduction could lead the NYC RGB to cap increases on rents at a lower level than otherwise, although this is by no means a guarantee. The NYC RGB is appointed by the mayor of New York City, and allowable increases often reflect, at least partially, the policy and political priorities of the particular mayor at the time.

The overall property tax environment for rental properties leads to a paradoxical situation when it comes to potential reform—namely that those tenants most in need of financial relief are disproportionately those who would be least likely to benefit from any reduction in Class 2 property taxes. Those living in public housing or other government-sponsored affordable housing which is exempt from taxation are means tested upon occupancy and can be expected to overwhelmingly be low- or moderate-income households. While below-market rent stabilized housing is not means tested, the New York City Housing and Vacancy Survey (NYC HVS) has consistently shown tenants in rent-stabilized housing have lower incomes than those in market-rate housing. In 2016, renters in rent-stabilized apartments had a median household income of $44,560, compared to $67,000 for renters in private, non-regulated units (New York City Housing and Vacancy Survey 2018).

Somewhat ironically, the place where renters would likely benefit most directly from tax relief—and suffer most directly from tax increases—are those who are in the over one-third of Class 1 units which are renter-occupied, [8] although in 2011 the Furman Center found that "renters living in Class 1 buildings tend to have higher incomes and are less likely to receive public assistance than those living in Class 2 buildings" (Furman Center 2011, 24). However it should be noted that the demographic comparison includes renters in those Class 2 buildings—like public housing—which pay no property taxes and would likely not be affected by any reform. Virtually all of these rental units in Class 1 properties are open-market rentals where there would be no mechanism (other than the market itself) to prevent any additional increases in property taxes that would result from Class 1 property tax reform from being passed on to tenants.

[8] According to the 2016 5-year American Community Survey Data, 34% (317,118 out of 926,757) of units in one- and two-family homes were renter-occupied. Tenure data for three-family homes is combined with four-family homes. Together, 560,217 out of 1,228,591 (45%) of housing units in one-to-four-family homes in New York City are renter-occupied.

This complication of ensuring that any tax relief for rental properties makes its way to renters, and especially low-income renters, is one which is not impossible to overcome but also one for which a deliberate and direct solution will need to be found.

Constitutional Limit

Another significant limitation of the city's property tax authority is a New York State constitutional limit that no more than 2.5% of the five-year average of the total taxable value of all the property in the city may be gathered as property tax for city operations (debt service and certain capital expenditures are excluded from this cap). The city has very often raised a total property tax levy (excluding those parts used for debt service and these certain capital expenditures) very close to this 2.5% cap, and concerns have been raised that at least one of the mechanisms used to adjust the revenue in order to make sure that the city is under this cap, specifically discounting the value of tax abatements from this cap, may not be legal (Stark 2015). For Fiscal Year 2017 the City determined the constitutional limit to be $22,452,400,000 and levied a total property tax subject to this limit of $22,378,200,000, a ratio of 99.7% (City of New York Department of Finance 2016). While there have been some periods when New York City has had a larger margin between the constitutional limit and the tax levy, in general New York City operates very close to this cap—in 10 of the last 20 years New York City has levied at least 95% of the constitutional limit (City of New York Department of Finance 2016). And operating at close to this constitutional limit is not recent phenomenon; a 1983 report put the average property tax levy for New York City from 1975 to 1982 at 96.2% of the constitutional limit (New York State Board of Equalization and Assessment 1983).

In determining any reforms to the property tax system, a "net neutral" basis is often assumed, meaning that reforms would operate under the assumption that the overall property tax levy would stay the same, and that more property tax revenue from one segment of property would then necessarily be offset by reductions in another segment. This is only partially an intellectual exercise. The 2.5% cap, combined with the city consistently levying an overall property tax burden very nearly at this cap, means that there is no practical ability to reform property taxation in a significantly revenue-positive way, although property taxation could be combined with municipal budget cuts (or budget growth that is slower than property value growth) to be reformed in a revenue-negative way. However, one thing to note is that reforms which have the effect of increasing the listed market value of property also have the resultant effect of increasing the constitutional limit.

Determining Property Taxes

Each parcel of property in New York City goes through the following process to determine its relative tax burden. At each step of the process, potential for unfairness or distortion exists and is evident. In many cases, rules concerning one part of the process are set in an attempt to mitigate the effects of another part of the process on the overall tax bill. This process is done on a yearly basis, with initial assessments (and their resulting bills) determined in January and final assessments determined in May. This assessment becomes the basis for the property's tax bill for the City's next fiscal year, which begins July 1st.

First, the market value of the property is determined as described below.

Second, the assessed value of the property is determined. This is based on a percentage of the market value. Class 1 property is currently assessed at 6% of market value, while Classes 2, 3, and 4 are currently assessed at 45% of market value. While this percentage has varied in the past, since 2005 it has stayed consistent for each class, and Class 1 property has always been assessed at a significantly lower percentage than Classes 2, 3 and 4. Some classes of property have caps in place which keep the assessed value from rising more than certain percentage from year to year. Other rules concerning phase-ins and the valuation of improvements also affect assessed valuation.

Third, any exemptions[9] are applied. An exemption is defined as a portion of the assessed value that is exempt from property taxes. While this does not reduce the assessment in itself, it does reduce the amount of assessed value that can be taxed.

Fourth, the current property tax rate is applied to the assessed value after any exemptions. This rate also varies among the four property classes and changes year-to-year. This determines a parcel's property tax bill.

Fifth, any abatements are applied. These are dollar-for-dollar reductions of the parcel's property tax bill and are determined either as a percentage of the total tax bill (as in the cooperative and condominium abatement) or as a specific dollar amount (as in most other abatement programs).

Market Valuation

In interviews with stakeholders and experts, the most commonly heard considerations and ideas for reform were around market valuation procedures. "Get the valuation right" was identified several times as a fundamental step needed.

One of the main considerations of property taxation in general is that it is meant to be ultimately based on the value of the property itself. How this value is determined then becomes a significant question. There are traditionally three main options for determining market value in property tax systems, and market valuations are often the subject of contention and challenges.

The first option is to base valuation on recent comparable sales of nearby property. The main limitation of this method is often the lack of direct comparables, especially during slow markets with fewer recent sales. Properties of similar age and size may be too far away to serve as proper comparables, while recent sales closer by may be of vastly different age, construction type, or configuration.

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[9] "Property tax abatement" and "Property tax exemption" are often used interchangeably in colloquial conversation, although they are different mechanisms for reducing tax burdens, and have significantly different effects on the property tax system overall. Both an abatement and an exemption can be taken in conjunction (subject to the rules of each), most notably in the J-51 program, where the added valuation of the parcel that is a result of certain property improvements is removed from the assessment of the parcel as an exemption, and then additionally part of the actual cost of making these improvements are deducted from the resulting property tax bill itself as an abatement each year for a certain period of years. Together, abatements and exemptions can be referred to as "property tax incentives."

The second option is to base valuation on replacement cost, meaning the cost (including land) of building the same structure anew. This method is usually used to value uncommon and specialized properties which are very rarely sold on the open market, such as power plants.

The third option is the income-capitalization method, which is to base valuation on its function or potential function as an income-producing property. In this instance, the property is assigned a value according to how much net income (generally rental income) it would take in per month, and how much an investor would pay for that stream of income in the current market.

The fact that valuation methods vary by property class (and hence building size) rather than being applied in a uniform manner or by the current tenure of the housing unit (rental or ownership) is the start of the discrepancies in the property tax process.

For Class 1 properties, market valuations are based on the comparable sales model. This is true even if some or all of the property is rented, and despite the fact that, as mentioned before, over one-third of Class 1 property is renter-occupied. For Class 2 properties, the market value is determined based on the income-capitalization method. This is true for cooperatives and condominiums—whether the individual apartments are owner-occupied, renter-occupied, or vacant—as well as for traditional rental properties. The only difference in valuation method depends on the size of the buildings involved. Larger rental buildings are generally required to file a Real Property Income and Expense (RPIE) statement, detailing the operations and net income of a building, which serves as the basis for determining net income and hence valuation for these types of buildings as a whole. It should be noted that a particular building's RPIEs are not the determining factor in its own valuation—instead, RPIEs are taken as overall information which is then adjusted and used to estimate income and property values for similar Class 2 properties overall. Smaller buildings are not required to file RPIEs and use a simpler method (the gross income multiplier method) to determine value based on potential income.

Valuation of Cooperatives and Condominiums

While the valuation method for Class 1 is a matter of administrative policy, the valuation method for Class 2 has restrictions set by law. Section 581 a) of the New York State consolidated code reads:

> Notwithstanding any other provision of law, real property owned or leased by a cooperative corporation or on a condominium basis shall be assessed for purposes of this chapter at a sum not exceeding the assessment which would be placed upon such parcel were the parcel not owned or leased by a cooperative corporation or on a condominium basis.

This is interpreted by New York City to mean that cooperatives and condominiums must be valued by the income capitalization method as Class 2 rental property is, rather than based on comparable sales prices.

Placement of Cooperatives and Condominiums in Class 2

Interviews with stakeholders and experts revealed two reasons why cooperatives and condominiums were put into the Class 2 rather than the Class 1 category, and specifically assigned valuation treatment based on the income-capitalization method rather than the comparable sales method in the 1981 tax reforms.

First, as identified in an interview with former New York City Tax Commission President Glenn Newman, in 1981 most multifamily properties were rent regulated[10], largely as a result of the Emergency Tenant Protection Act (ETPA) stabilizing rents in multifamily buildings of 6 units or more, only eight years previously in 1973. While buildings built after 1973 were not affected by stabilization, there was little multifamily construction between 1973 and 1981 and no mechanism yet existing to take stabilized properties out of the rent stabilization system. This widespread rent stabilization lead to the belief that using the income-capitalization method, which would base the income used for valuation off these rent stabilized buildings, would result in lower tax bills than the comparable sales method, which would base valuations off of the sales prices of the cooperatives and condominiums.

The second reason, as identified in an interview with Mary Anne Rothman, Executive Director of the New York City Council of Cooperatives and Condominiums, was that cooperative and condominium leaders were unsure of how individual sales within a building would affect the valuation of an entire building, or even nearby buildings. Sales prices of cooperatives, especially in Manhattan, were on the upswing in the early 1980s. One sale in a building at a high sales price could have the effect of spiking the valuation of the rest of properties in the building, or even nearby buildings. In contrast, basing the valuation off of nearby rent stabilized buildings not only would likely lead to a lower valuation overall, but rent stabilization also provided a steadiness to the income of a building, and therefore, a steadiness to the income-capitalization method of valuing buildings for tax purposes.

These two considerations led cooperative and condominiums leaders to request to be placed in Class 2, even with its much higher assessment percentage. Thirty-seven years later, however, much has changed about this dynamic. Rent stabilization reforms in the 1990s enabled vacancy decontrol, and a significant amount of new, non-stabilized rental housing has been built. Comparable valuations, especially in Manhattan and other high-market areas, are no longer mostly modest rent stabilized buildings, but increasingly include high-end rental buildings.

Issues with Market Valuation

While currently, according to Sweeting (2016), "virtually all co-ops and condos benefit somewhat from the legally required discount" provided by using the income-capitalization method of valuation, this discount varies drastically in different markets. Cooperatives and condominiums being required to use the income valuation model has the effect of skewing the valuations of building where the sales market and rental market are considerably different, most

[10] Together, rental apartments in the rent stabilization program, the older rent control program (which now affects far few apartments and is being phased out) and in other government programs where the allowable rent increases are regulated are known as "rent-regulated" apartments.

notably the highest end of the luxury market where sales prices far outstrip what the building would be worth as an investment property. This discrepancy at the high end of the market is so pronounced that in 2013, NYU's Furman Center was able to identify 50 individual cooperative or condominium apartments which were sold for more than the official market value of the entire building they were located in (Been, Hayashi, and Yager 2013). Indeed, many ideas for reform of the property tax system start with the proposal to properly value these high-end properties based on either their sales prices or comparable sales prices.

This discrepancy also varies greatly based on geography, with the IBO identifying the median discount for the 10 neighborhoods with the highest discrepancy between the income-capitalization and comparative sales methods at 87.5% as opposed to a median discount of 66% for the 10 neighborhoods with the lowest discrepancy (Sweeting 2016).[11] There are also issues with finding comparable properties—for instance, an older building in New York City tends to be worth less as rental property than a comparable newer building beyond just the value of newer construction, because of its greater probability of being rent-stabilized. Cooperatives and condominiums, however, face no such value discrepancy based on age. Therefore, while using age as a determiner of comparable properties may make sense when comparing rentals to rentals, or cooperatives to cooperatives, it makes very little sense to use age of a rental property as an indicator of comparability for cooperatives and condominiums. Because of the class share system, the effect of revaluing cooperatives and condominiums would be to lower property taxes for other Class 2 properties, namely non-exempt rental buildings, although the effects of Class 2 as whole having a slightly greater market value than before may affect the overall class share assigned to Class 2 property.

Valuing all Class 2 property (not just cooperatives and condominiums) based on the comparable-sales model instead of the income-valuation model is another possible reform to valuation procedures. However, the likely effects on rental properties need to be examined. Rent stabilized apartments, especially in upmarkets, are often sold not based on the current rent role, but on a possible future rent roll based on potential cash flow when a building is destabilized, a practice that can lead to financial and physical distress for buildings as well as severe tenant harassment (ANHD 2009). Basing property taxes on these mainly speculative sales values (or projected income and/or sales profit from when the building is emptied of rent stabilized tenants) instead of on the actual income of comparable properties, would likely have the effect of increasing the valuations of rent stabilized buildings and therefore further increased property taxes.

For Class 1 properties, another possible skewing of market valuation was identified in an interview with former New York City Budget Director and Finance Commissioner Carol O'Cleireacain. This is that many one- two- and three-family homes have illegal accessory dwelling units (ADUs)—converted basements, garages, or attics—which produce income. This additional income stream should theoretically raise their sales value, and hence the market value of it and similar properties. However, because these units are illegal their effect on sales prices is likely less, and perhaps significantly less, than comparable legal units. In addition, because these illegal dwelling units are not officially recognized, comparable market valuations are based on a

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[11] It is important to note that because cooperatives and condominiums are assessed at 45% of market value as opposed to 6% for Class 1, and because Class 1 and Class 2 properties have different tax rates, this does not translate to an effective property tax discount of the same amount.

smaller sized home. For instance, a three-family home where two of the units are legal dwelling units and one of the units is an illegal conversion is valued as a two-family home, not a three-family home. This likely has the effect of dampening market valuations of these illegally converted homes, and in areas with large amounts of these homes, it possibly results in a dampening of the market valuation of the area as a whole due to comparable sales being of less value. A program to legalize these accessory dwelling units would likely have a positive effect on the market values of these properties.

Assessed Valuation

Once a market value is established, the process continues with the determination of the portion of the value which will serve as the basis for taxation—the assessed value of a property. The assessed valuation is the market value multiplied by the assessment percentage. Currently, for Class 1 properties the assessment rate is 6%, and for all other properties the assessment rate is 45%. These rates have varied since 1983 but have always been significantly lower for Class 1 properties than for the other classes. For cooperatives and condominiums, this higher assessment rate is the tradeoff for the advantages of being placed in Class 2 rather than Class 1.

However, this is not necessarily what the tax bill is based on. In order to limit sharp increases in property tax bills, there are phase-ins and caps of assessed valuation for certain properties.

Assessment Caps and Phase-ins

All Class 1 properties are subject to two different caps on assessed value. First, no property's assessed value may increase more than 6% a year. Second, no property's assessed value may increase more than 20% in five years. This has the effect of reducing the 6% cap to an effective 3.73% cap over the long term.

Class 2 properties of less than 10 units (2a, 2b, and 2c properties) also have a cap on assessed value. This cap is higher—8% of valuation or 30% over five years, which has the effect of reducing the 8% cap to an effective 5.38% cap over the long term. These caps are set legislatively by Article 1805 of the Real Property Tax law. Other Class 2 properties, while not having a cap, do require phased-in assessments. Specifically, this manifests itself as assessment increases taking the 5-year average of the increase in assessed valuation.[12] This has the effect of preventing sharp increases and smoothing the rise in a property's assessed valuation, but unlike caps does not have the long-term effect of significantly lowering a property's assessed valuation compared to its market value.

These assessed value caps are caps on the property itself as opposed to the owner of the property. Regardless of recent sales or title transfers, and regardless of the actual most recent sales price of a building, these caps stay in place. This has resulted in a widely disparate tax burden, especially for Class 1 properties, in which neighborhoods which have seen sharply rising market values since 1983 have only seen their assessed values increase at an average of under 4% for Class 1 properties, and under 5½% for smaller condos and cooperatives, even if their actual market

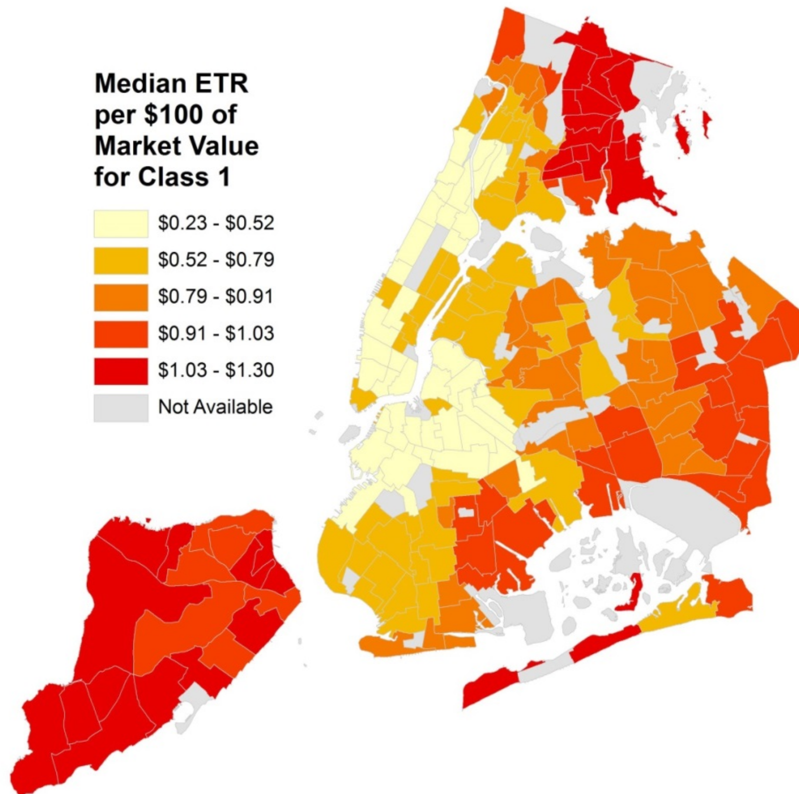
[12] It should be noted that added valuation resulting from improvements on a property are not subject to either caps or the phase-ins, and instead are added to the assessed value *in toto* for the relevant fiscal year.

valuation has far outpaced that rate. According to the NYC Department of Finance, the median sales price of a one-family home in 1993 was $155,000 and in 2016 was $475,000, an annual increase of almost exactly 5% annually (NYC Department of Finance, 2005 and 2016). The median price of a two-family home in 1993 was $174,000 and increased to $600,000 in 2016—a rate of about 5.5% annually. The median price of a three-family home in 1993 was $190,000 and increased to $742,500 in 2016—a rate of about 6.1% annually. This means, on average, Class 1 property valuations have increased faster than the cap for Class 1 properties.

But neighborhood appreciation rates have been very different, and the value of this cap has been very uneven. For instance, a single-family home valued at $100,000 25 years ago in 1993 would have had a market valuation of $100,000 and an assessed value of $8,000 (as the Class 1 assessment rate was 8% in 1993). Because of the cap on assessed valuation of 20% over 5 years, the assessed value in 2018 could be no more than slightly under $20,000 ($19,906.56). At the 2018 assessment rate of 6%, this translates out to a market value of about $332,000. Any value of the building above this is essentially free of assessment and hence taxation. Neighborhoods which have experienced higher market growth therefore get more of this additional value free of taxation than those that have experienced lower growth. Because of the necessity for Class 1 property as a whole to pay a set share of the overall property tax levy, this under-assessment of properties which have seen high market growth is necessarily made up for by higher tax rates for Class 1 properties overall, meaning this underassessment is made up for in part by higher taxes on those properties which have seen lower market appreciation.

An annual increase of 6% in actual property values since 1993 would lead the aforementioned $100,000 home to be worth about $430,000 in 2018 and pay taxes on 77% of its current actual value. But even a slightly higher annual appreciation of 7% would cause it to be worth about $543,000 in 2018 and pay tax on just 61% of its actual value. And many neighborhoods that have undergone heavy gentrification have experienced much greater price appreciation than this. This has the effect of giving owners in heavily gentrified neighborhoods significant property tax advantages over those in less gentrified neighborhoods.

Map 1: Median Effective Tax Rate for Class 1 Properties by NYC Neighborhood Tabulation Area, FY 2017



Source: New York City Independent Budget Office and RPA Analysis.

Even by borough there have been large discrepancies in the rates of property appreciation over the last 20 years. In 1996, the median sales price by borough of single-family homes varied by just $10,000 for the four boroughs outside of Manhattan. By 2016, however, the variance was $255,000.

Table 2: Sales Price and Average Annual Appreciation by Borough for Single-Family Homes, 1996–2016

	Manhattan	Bronx	Brooklyn	Queens	Staten Island
Median Sales Price: 1996	$ 1,252,525	$ 150,000	$ 160,000	$ 159,000	$ 160,000
Median Sales Price: 2016	$ 7,425,000	$ 380,000	$ 635,000	$ 515,000	$ 430,000
Average Annual Appreciation	9.30%	4.75%	7.13%	6.05%	5.06%

Source: The City of New York Department of Finance, Division of Tax Policy, 2005 and 2017.

The main justification for these assessment caps is to keep property owners from experiencing large spikes in their property taxes, ones which they may not be able to afford. However, the fact that these are retained through the sale of the property lead not only to cushioning existing owners from these taxes, but future owners as well. This value to future owners is likely reflected in the sales prices of these properties, meaning these artificially low taxes give an added benefit to owners in neighborhoods experiencing high housing price growth through increased equity upon sale. While cushioning owners from property tax spikes in neighborhoods which are undergoing rapid price appreciation may be a noble goal, increasing their home equity even past the point of these price appreciations is surely not.

Possible Reforms to Assessment Caps

One reform would be to do away with caps altogether. Another would be shifting to a "circuit breaker" system in which all caps or other property tax relief is means-tested.

Another, which has been proposed by RPA, is eliminating these caps upon title transfer—death of the title holder or sale of the property—and resetting the assessed value based on the current market value. This provides a way of eliminating inequities while still protecting existing owners from sharp increases in property taxes, and also brings Class 1 and Class 2a, 2b, and 2c practices in line with larger multifamily (Class 2) properties. However, care would have to be taken to prevent loopholes. California, for instance, has exemptions for transfers to families or transfer of less than 50% of the property, leading to several ways in which lower property taxes can be passed on through title transfer.

Eliminating these tax caps upon title transfer may run into legal issues. Properties within the same tax class—in this case Class 1—are by law required to be valued and assessed on equal terms. By allowing some properties a different tax cap based upon continuity of ownership, this "equal terms" condition could be challenged.

The main objection to eliminating these caps upon title transfer is to avoid introducing volatility into the valuation of 1–3 family homes (and, to a lesser extent, small cooperatives and condominiums). Sales prices are determined in the context of the current property tax system and changing this system would result in changes to home values. By raising Class 1 burdens, home values could expect to be depressed, costing 1–3 family homeowners equity. This would affect recent purchasers the most, who could possibly be put underwater from any changes to the system. However, there are several different factors which change home values, either positively

or negatively, which are beyond the control of the homeowner. Changes to the property tax system are one of many risks incurred by investing in homeownership. Balancing how much of a responsibility the public may bear in mitigating this risk for homeowners versus considerations for making the overall residential property tax system more equitable is a policy conversation that should take place when any property tax reforms are considered.

Yet another option for reform is to raise these caps—especially the Class 1 cap—in order to lessen the inequities. For instance, the 5-year assessment cap on Class 1 property could be raised from 20% to 30%, which would leave it in line with Class 2a, 2b, and 2c. The 30% over 5 years cap (or effective annual cap of 5.38%) would still provide some relief for sharp increases, while reducing inequities between those neighborhoods which experience high and low market appreciation. This would still likely not completely eliminate inequities, as only the Bronx and Staten Island experienced an average annual price appreciation for single-family homes of less than 5.38% between 1996 and 2016.

Taxation Rates

Setting the actual tax rates themselves is a fairly straightforward process. The total tax levy needed is determined, and the shares of this levy by each class of property—which is determined by New York State—leads to a total levy needed from each tax class. The total taxable assessed value of each class of property is determined and the tax rate is then set at the rate for each class that leads to each class producing its share of the total tax levy needed. It should be noted, however, that New York City has long preferred to keep the average tax rate across all properties consistent, with only three changes since 1994, letting a rise in assessed value increase the overall revenue and small changes in class share levies change the rates of the specific classes. This preference necessitates an iterative process with the overall city budget. Because the overall property tax levy needs to fill the gap between other income (over which New York City has much less control) and total expenses, the total expenses can be adjusted to balance the budget as well as the property tax levy and resulting property tax rates.

Note that New York City has jurisdiction over both the assessment percentages of the various tax classes and the tax rate. This appears to be a two-step equation where only one would seem to be needed, as the purpose is to gather predetermined amounts of revenue from an overall market value. A higher assessment percentage would simply necessitate a lower tax rate in order to arrive at the same total levy for each class, and vice-versa.

However, there is an effect in changing the assessment percentage as opposed to the tax rate. Changing the assessment percentage has the effect of shifting the tax burden between properties whose assessed value increase has been limited by a tax cap, and those whose assessed value has not. Specifically, lowering the assessment percentage and raising the tax rate has the effect of raising the overall taxes on properties whose market value has increased at a rate higher than the tax cap, and lowering those on properties whose market value has increased at a lower rate. Raising the assessment percentage and lowering the tax rate has the opposite effect. As such, lowering the assessment percentage is essentially a short-term solution for reducing inequities within a tax class, and one which notably is under the control of New York City alone.

As an example, take the case of the following two hypothetical properties:

Properties A & B (both single-family homes in Class 1) had a market value of $100,000 in 1996 when the Class 1 assessment percentage was 8%, leading to an assessed value of 8,000 for both properties. Property A increased in market value at a rate of 8% a year for 10 years, leading to a market value of $215,892 in 2006. Without tax caps, this property would be assessed at $17,271. However, because of the property tax cap limiting the assessed value to a 20% rise over 5 years, the assessed value of the building was $11,520—now only 5.3% of actual market value. Property B increased at 3% a year, lower than the tax cap, and in 2006 had a market value of $134,392 and an assessed value of $10,751, still a full 8% of market value. In 2006, the Class 1 tax rate was 15.746%, leading to a tax bill of $1,814 for Property A, and $1,693 for Property B.

In 2007, the 8% assessment was lowered to 6%. The actual assessed value of Property A was unaffected, as its actual assessed value was already lower than 6% of market value. Six percent of the now $232,292 market value (accounting for another 8% increase from 2006 to 2007) would be an assessed value of $13,938. However, because of the tax cap, the 2006 assessed value of $11,520 only rose 3.73% to $11,950.

For property B, however, which was still assessed at the full 8% of its market value, the lowering of the assessment percentage did make a difference. Six percent of the now $138,424 market value is $8,305, lower than its previous year's assessed value. The Class 1 tax rate for 2007 was 16.188%, leading to a 2007 tax bill for property A of $1,934, $120 higher and a 6.6% increase over the previous year. Property B, on the other hand, had a tax bill of $1,344 in 2007, $348 lower and more than a 20% decrease from the previous year.

If the assessment percentage had stayed at the same 8% for 2007, the tax bill for House A would have stayed the same, as the tax caps kept the assessed value below both the 8% and 6% assessment percentage. For House B, however, the 8% assessment percentage would have meant a 33% increase in the actual tax bill for 2007, or $448 dollars.[13] The table below illustrates the above scenario.

[13] It should be noted, however, that the tax rate in 2005 if the assessment percentage had stayed the same would likely be lower, in order for Class 1 properties to meet the same total obligation, but would have still resulted in a higher total payment for House B while keeping the payment for House A the same.

Table 3: Hypothetical Property Tax Bill Comparisons as a result of Assessment Percentage Change

		House A (8% appreciation/year)	House B (3% appreciation/year)
1996 (8% Assessment Percentage)			
	Market Value	$ 100,000	$ 100,000
	1994 Assessment Percentage	8%	8%
	Assessed Value (absent caps)	$ 8,000	$ 8,000
	Actual Assessed Value	$ 8,000	$ 8,000
	1994 Tax Rate	10.725%	10.725%
	Taxes	$ 858	$ 858
	Net Effective Tax Rate	*0.86%*	*0.86%*
2006 (8% Assessment Percentage)			
	Market Value	$ 215,892	$ 134,392
	2004 Assessment Percentage	8%	8%
	Assessed Value (absent caps)	$ 17,271	$ 10,751
	Actual Assessed Value	$ 11,520	$ 10,751
	2004 Tax Rate	15.746%	15.746%
	Taxes	$ 1,814	$ 1,693
	Net Effective Tax Rate	*0.84%*	*1.26%*
2007 (change to 6% Assessment Percentage)			
	Market Value	$ 232,292	$ 138,424
	2005 Assessment Percentage	6%	6%
	Assessed Value (absent caps)	$ 13,938	$ 8,305
	Actual Assessed Value	$ 11,950	$ 8,305
	2005 Tax Rate	16.188%	16.188%
	Taxes	$ 1,934	$ 1,344
	Net Effective Tax Rate	*0.83%*	*0.97%*
2007 (if 8% Assessment Percentage were retained)			
	Market Value	$ 232,292	$ 138,424
	2005 Assessment Percentage	8%	8%
	Assessed Value (absent caps)	$ 18,583	$ 11,074
	Actual Assessed Value	$ 11,950	$ 11,074
	2005 Tax Rate	16.188%	16.188%
	Taxes	$ 1,934	$ 1,793
	Net Effective Tax Rate	*0.83%*	*1.30%*

Source: The City of New York Department of Finance

Exemptions and Abatements

There are numerous tax exemptions and tax abatements available for Class 1 and Class 2 properties.[14] In terms of the overall effect on the tax system, the main difference between exemptions and abatements is in who bears the monetary brunt of compensating for these incentives. The amount of taxes due from each tax class is determined after accounting for exemptions, but before accounting for abatements. Therefore, the value of a tax exemption must be made up by other properties within its tax class, in order to arrive at the total tax levy for a class's share of the tax burden.[15]

Abatements, on the other hand, are applied after class shares and the resulting tax levy are determined. In general, abatements can be thought of as simply another city expenditure (borne by taxpayers overall) which does not have an effect on the rest of the overall property tax system or other properties' tax bills. However, since 2005 the value of abatements has been deducted from the overall tax levy for the purposes of ensuring the overall levy remains below the constitutional 2.5% limit on the five-year average of total market value. Without accounting for abatements in this manner, the overall tax levy would often be above this cap, necessitating a lowered overall levy and hence lowered property tax bills for all properties.[16] As such, the value of the abatements is, at least sometimes and in some part, made up by all other taxable property.

Exemptions

Exemptions can generally be put in one of two categories—tax incentives which are conditioned upon the owner or tenant of a property (called individual assistance exemptions), and incentives which are conditioned upon the property itself.

Individual Assistance Exemptions

Individual assistance exemptions are mostly focused on providing financial relief based on social good. These make up the vast majority (76.31%) of the number of tax exemptions overall, although a very small fraction (2.2%) of the overall monetary value of these tax exemptions (New York City Department of Finance 2016). Currently New York City offers some form of tax exemption for physically disabled crime victims, low-income disabled homeowners, senior

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[14] There are many more property tax incentives for other types of property as well, including full exemptions for properties such as cemeteries, government property, and houses of worship; a Payment in Lieu of Taxes (PILOT) program run through the NYC Industrial Development Agency (IDA) and NYC Economic Development Corporation (EDC) for manufacturing, industrial, and certain not-for-profit companies; an abatement program for improvements to industrial and commercial property; and several others.

[15] It should be noted that if the overall tax rate stays consistent exemptions do reduce the overall tax levy, leaving other properties in a tax class to make up a higher share of the levy, but of an overall lower levy. The effect of this is a higher rate for properties in the same class as the property receiving the exemption, and slightly lower rates for properties in other classes. However, if the overall tax rate rises to make up for the lost revenue due to the exemption, then the effect is that the other members of the tax class make up the entire amount of the exemption while taxes for the other classes stay consistent.

[16] Since the start of this practice in 2005, 5 out of 13 years (and 3 out of the last 4 years) the value of abatements has exceeded the additional amount of property tax levy which could be raised under the 2.5% constitutional limit (NYC Department of Finance 2016).

citizens, veterans, and members of the clergy.[17] The largest individual assistance exemption is the School Tax Relief (STAR) exemption, which is available to primary-residence homeowners who make less than $500,000.[18] This exemption makes up 78% of the number of all individual assistance exemptions, and 55% of the monetary value of all individual assistance exemptions (New York City Department of Finance 2016).

Because the STAR program is already tested both for tenure (meaning it is available only for primary-resident homeowners) and means (meaning it is available only for people earning less than a certain amount of money), there is a precedent for reforming the property tax system to directly give benefits in the form of either a credit or exemption based on tenure, means, or both.[19] Any additional property tax reforms which focus on relief for households making under a certain amount of money or certain classes of resident (owners, renters, or primary occupants) could possibly be a simple extension of the STAR program.

Housing Production and Renovation Exemptions

In addition to these individual assistance exemptions, there are also several residential exemptions meant to encourage the production or renovation of housing, and especially affordable housing.

Many of the exemptions are specific to certain types of developments which are all or mostly affordable housing, in order to provide an additional incentive to enable the creation of low-income housing beyond those available from the construction subsidies provided for these programs. These include the Article XI exemption for Housing Development Fund Companies, (HDFCs), 420-c exemption for Low-Income Housing Tax Credit (LIHTC) developments, Limited Profit Housing Company exemption for middle-income Mitchell-Lama housing, and several others. Most of these exemptions come with specific restrictions on the type of ownership structure the building is allowed to have, income restrictions for tenants or owners, and/or restrictions on the type of financing the building can utilize. For instance, some conditions of the 420-c exemption are that the development must be at least 50% owned by a not-for-profit company, receive Low-Income Housing Tax Credits, and restrict 70% of the housing units to households making less than 60% of the Area Median Income (AMI). Some of these exemptions are full while others are partial, some are as-of-right while others are discretionary (meaning they must be approved by the New York City Council), and these exemptions also have different lengths and other small variations in their rules and conditions.

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[17] These exemptions are not necessarily universal, and come with certain conditions and restrictions. For instance, members of the clergy who are owners of cooperative apartments are not eligible for the clergy exemption.

[18] There is also an enhanced STAR exemption available for senior citizen homeowners who make less than $86,000. Both programs are being transitioned from a tax exemption to a credit paid directly to homeowners by New York State. It should also be noted that STAR is the only exemption which is not deducted from the overall levy when determining tax rates under the class share system, leaving it to function as a *de facto* abatement.

[19] New York State has another program, the Real Property Tax Credit program, which is also tested for means (limited to people with gross household incomes of less than $18,000) and tenure (limited to New York State residents who lived in an eligible property for six months or more, although available for both renters and owners) and which takes the form of a refundable credit on an individual's New York State income taxes. Expansion of this program could also serve as a means of delivering property tax relief to individuals which is means- and/or tenure-tested.

In interviews with the New York State Association for Affordable Housing (NYSAFAH), which represents mainly for-profit affordable housing builders, the main reform desired by the affordable housing industry is to replace this patchwork system with some form of long-term, as-of-right blanket tax exemption which would exempt all affordable housing developments (or even some developments which are mixed affordable and market-rate) from property taxation.[20] Even though virtually all new affordable and mixed-income housing developments pay very little in property taxes, this new exemption would still be of value over other exemptions due to one or more of: a longer length, an as-of-right status, and a full exemption from taxation. Because virtually all affordable housing developments utilize some form of city capital subsidy money, the rationale for this blanket exemption is that that it would reduce the amount of city capital needed to incentivize development by instead providing more subsidy through property tax relief instead. This would then either save the city money or enable the creation of more affordable housing while utilizing the same amount of city capital dollars. Because of the class share system, this exemption would have the effect of transferring additional subsidy for affordable housing development from the general capital budget to existing Class 2 properties which do pay taxes.

The two other main tax exemptions for residential housing are the J-51 program (which encourages renovation of existing residential property) and the 421-a program (which encourages the construction of new multifamily buildings). While the J-51 program does not come with affordable housing restrictions,[21] the 421-a program currently does.[22] The 421-a exemptions is by far the largest residential tax exemption by both number of exemptions and dollar value, amounting to $1,319,000,000 in FY 17 and making up over half the dollar value of all residential exemptions overall (Department of Finance 2017), even though its current iteration is generally used for properties with only 25%–30% income-restricted housing, and in past iterations generally used for properties with even less income-restricted housing.

Many proposals to reduce or eliminate the 421-a program have been advanced throughout the years, mainly based on the rationale that the subsidy from this exemption is overly costly to the city, especially when measured against the type and amount of affordable housing produced. In 2015, the IBO estimated that the 421-a exemption (as it existed in 2015) cost $577,300 per affordable housing unit produced (Propheter 2015).

However, like all exemptions, the 421-a exemption does not have the effect of directly costing New York City revenue if the overall tax levy stays the same. Instead, it has the effect of requiring other taxpaying properties in its tax class—in this case Class 2—to make up the

[20] It should be noted that this proposal is generally not supported by not-for-profit housing developers, who currently have a small advantage in the system over the for-profit affordable housing developers which would be eliminated with this reform.

[21] The J-51 program does require that apartments receiving its benefits are rent-stabilized however, as determined by the NY Court of Appeal in Roberts v. Tishman Speyer, 13 NY3d 270 (2009)

[22] There have been many different iterations of the 421-a program since its inception in the 1970s, some involving affordable housing requirements of varying types, which many times depended on the geographic location of the construction. Currently the 421-a program has various affordability options with different requirements depending on building size, geography, financing mechanisms, and use of prevailing wage for labor but all require 25%–30% income-restricted housing at various levels for rental housing.

difference of the exemption. And in the case of eliminating or reducing the exemption, the overall tax levy would necessarily stay the same, or increase only a small amount. This is because the value of the 421-a exemption is currently far more than the amount of additional taxes the city is able to levy overall due to the 2.5% constitutional limit.[23] As such, eliminating or reducing this exemption would put New York City over this limit and necessitate reducing the overall tax levy—and tax rates—in order to fit under the cap. This leaves the maximum potential cost to the city of the 421-a exemption as the gap between the tax levy and the 2.5% constitutional limit.

Abatements

Cooperative and Condominium Abatement

In terms of abatements, the most relevant tax incentive is the cooperative and condominium tax abatement program, which currently makes up over half of the dollar value for all abatements across all classes of property in New York City (NYC Department of Finance 2017). Because of their situation in Class 2, and the resulting higher assessment valuation and tax burden cooperatives and condominiums ended up bearing, an abatement to better bring Class 2 owner-occupied properties in line with Class 1 was instituted in 1997. The abatement is based on a percentage of the assessed valuation of the apartment, the amount of which is mildly progressive depending on the average assessed valuation of all the apartments in the cooperative or condominium development. This program was made applicable only to primary residences in 2012 (Lent 2016).[24]

Table 4: Available Cooperative and Condominium Abatement by Assessed Value

Average Assessed Value	Abatement Percentage
$50,000 or less	28.1%
$50,001 to $55,000	25.2%
$55,001 to $60,000	22.5%
$60,000 and above	17.5%

Source: New York City Department of Finance, Division of Tax Policy 2016.

This is a signature case of the complicating effect of our property tax system adjusting for an inequity in one part of the taxation process through adjustments in others: owner-occupied cooperatives and condominiums are initially put into Class 2 instead of Class 1 in order to

[23] The gap between the tax levy and the constitutional limit in FY 2017 was 74.2 million dollars, compared to the 1.32 billion dollars in 421-a exemptions.

[24] Some form of overall reduction in property tax burden for primary residences, and/or a rise in property tax burden for second homes and pieds-a-terre, is a reform that has been proposed several times in the past including by RPA. There are concerns over the legality of a pied-a-terre tax, mostly resulting from the 2014 Supreme Court Decision in Maryland v. Wynne *(Comptroller of the Treasury of Maryland v. Wynne, 575 U.S. ___ [2015])* concerning taxation by one state of a resident of a different state. However, as is also the case with the STAR and Real Property Tax Credit programs, the current existence of the cooperative and condominium abatement program which only applies to primary residency (although not to primary rental occupants) demonstrates that there is a mechanism to relive property taxes specifically for primary-residency apartments.

provide a market valuation method which was meant to result in lower market values, which is then balanced by the higher assessment percentage of Class 2, which is then further balanced by providing an abatement to reduce the higher taxes which result from this higher assessment percentage, which is then even further balanced by its progressive nature in order not to give an overly large benefit to higher-value apartments which may benefit from the market valuation method required for cooperatives and condominiums.

Improvement Abatements

Other abatements available for residential property are generally to offset the cost of renovations and improvements and/or the higher tax bill that results from these renovations and improvements. These currently include specific abatements for green roofs and solar energy, as well as the aforementioned J-51 abatement to offset the costs of a wider range of building upgrades.

Tenant Assistance Abatements

There are also two abatements which are a direct pass-through to tenants, although the apartments are required to be rent-regulated apartments.[25] These are the Senior Citizens Rent Increase Exemption (SCRIE) and Disability Rent Increase Exemption (DRIE)[26] which exempt certain senior citizens and people with disabilities from rent increases in most rent regulated apartments, which is then refunded to the owner of the building through a dollar-for-dollar reduction in property taxes. While this mechanism would likely be difficult to replicate in non-regulated buildings where the allowable increases are not limited by law and thus there would not be an easy way to determine the value of the incentive, it is a precedent for a direct tenant relief mechanism through the property tax system.

Conclusion

Much has been written about the New York City property tax system, as well as the main cases and broad strokes for reform to residential property taxation. The possible effects of various reforms have also been examined in terms of the theoretical shifting of property tax burden which might result from different reforms (Goor 2017, IBO 2006, New York City Real Property Tax Reform Commission 1993). However, other effects and scenarios such as the likely impact on property values, likely effect of reform for tenants, and means of providing effective tenant relief, have not been fully examined. With possible reform on the horizon because of political and legal pressures, these and other consequences of possible reform should be examined in preparation in order to have a more fully informed discussion about a new system.

Much of determining which reforms are worth pursuing lies in practicalities. The default understanding for any reform should be that it will take State Legislative action. Reforms under the control of New York City, which would be the least difficult to implement, would also entail

[26] Despite the use of "exemption" in the title these take the form of abatements given to property owners. Exemption refers to the exemption tenants have from increased rent.

only small-scale changes to the system. Reforms under the control of the New York State legislature, which would be more difficult to implement, could address larger issues as well as a wider variety of smaller inequities. And reforms that would require a change in the New York State Constitution are more difficult still, but could affect even larger changes. This is leaving alone possible reforms, like a pied-a-terre tax, which might also run into legal challenges on the federal level. As follows is a description of the various reforms mentioned in this working paper, and the likely level of government at which they could be implemented. It should be noted that these assessments of the level of government involvement needed is tentative, and should be vetted with knowledgeable legal counsel for a final determination.

Possible Local Level Reforms

Possible local level reforms are very limited and generally restricted to one-time efforts. The city has jurisdiction over the total levy (within the bounds of the 2.5% constitutional limit), specific assessment percentages and tax rates, but must still operate within the class share system. As explained in the "tax rates" section, the city could (and has before) adjust a class's assessment percentages down and rates up in order to transfer some of the tax burden to properties which have seen rapid valuation increase but capped assessments from those which have seen more modest increases or uncapped increases. This would necessarily be a one-time reform, although it could be repeated on a discretionary basis each year.

Other local level reforms could include other one-time redistributive mechanisms, such as rebates to certain categories of real property owners, or even non-property owners such as tenants, although many of these may need state authorization depending on the exact mechanism. For instance, New York City Council has recently proposed a $400 property tax rebate for homeowners making under $150,000 (Khurshid 2018).[27] These should, however, be thought of as a one-time discretionary expenditure rather than a true reform. While the city could arguably *de facto* change the property tax system through a regular credit to certain categories of residents, this is limited by the 2.5% tax cap and the regularity in which the city nears this cap, as a regular and large-scale credit is an expenditure which would need to be made up through an increased tax levy in order to be revenue-neutral.

One creative but small-scale idea which would be implementable by the city is former commissioner O'Cleireacain's idea to legalize accessory dwelling units, as described in "Issues with Market Valuation," although in some cases state legislation may be either needed or desired to make the legalization process more feasible.[28] However, absent class share reform this would likely only have the effect of slightly lowering tax bills for other Class 1 properties. Another one of O'Cleireacain's ideas, having rent bills for tenants break down how much of their rent goes toward paying property taxes, is also likely implementable by the city although this would not have any direct financial effect on the system.

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[27] The most equitable refundable credits would either be based on financial need or on mitigating a class of resident who is overburdened by the current property tax system. Both of these would disproportionately target renters, or some subset of renters, not homeowners *as per* the current proposal by City Council.

[28] For instance, legalizing a third unit in a legal two-family house would necessarily require compliance with the State's Multiple Dwelling Law which applies to all buildings of three or more units.

The city could also likely change some of its valuation techniques without state approval, as long as the requirement in Section 581 a), requiring cooperatives and condominiums to be valued as if they were rental properties, were followed and the procedures for valuation were uniform within a tax class. However, other than eliminating Section 581 a) and allowing cooperatives and condominiums to be valued by a sales model, there have not been large-scale proposals for reforming valuation methods or analyses of their likely effects.[29]

Possible State Level Reforms

The number of reforms which would require state legislative action is much more robust and range from small-scale adjustments to the ability to restructure the entire system.

Class Share Reform

By far the most impactful reform would be to overhaul the entire class share structure. On a residential taxation level, these could include

- Combining Class 1 and Class 2 and having one assessment percentage and tax rate.
- Rebalancing the amount of taxes paid by each class so that the total takes paid by Class 1 and Class 2 more accurately represent their share of the market value.
- Eliminating the class system overall.

As long as the principle of moving toward more equal net effective tax rates for all residential properties was followed, and the reform was conducted on a revenue-neutral (or revenue-positive) basis, all of these options would necessarily, on average, significantly raise taxes on 1–3 family homes, something which has been avoided by legislators for the entirety of the property tax system in New York. For instance, the Greyson commission found that a revenue-neutral merger of Class 1 and Class 2 would result in a 100.8% tax increase for a single-family home valued at $200,000 (New York City Real Property Tax Reform Commission 1993). A revenue-negative approach in which Class 1 taxes stay steady and Class 2 taxes are reduced is theoretically possible but would have budgetary impacts which would entail either budget cuts or making up revenue through other sources, scenarios that are likely as difficult—if not more difficult—to navigate politically, especially at the scale which would be needed to bring Class 1 and Class 2 into balance. Any reform of the class share system would almost certainly be a gradual process designed to avoid sharp changes in tax bills.

Another way of rebalancing class shares without actually changing the percentage of revenue each class is responsible for is through large-scale abatements, as explained in the "Exemptions and Abatements" section. Like direct rebates or refundable tax credits, these can be thought of as

[29] One idea that could be explored, however, would be to value Class 1 properties used as rental properties by the income-capitalization model instead of a comparable sales price model (possibly in conjunction with state reform which would allow for the valuation of Class 2 properties which are owner-occupied by the comparable sales method), likely using the gross income multiplier method used for smaller multifamily properties. One issue with this would come with determining how to value two- or three-family homes with a mix of owner-occupants and renters.

direct expenditures that will need to be made up by some form of additional revenue or spending cut overall, but not solely by other members of the tax class receiving the abatement.

Absent Class Share reform, there are several smaller reforms which could be effected by the state legislature which would have the effect of rebalancing inequities within a tax class.

Class 1 reforms

The main reform for Class 1 properties is eliminating the 6%/year, 20%/5 years tax cap on 1–3 family properties. This would have the effect of transferring tax burden to Class 1 properties in neighborhoods which have seen rapid valuation increase from Class 1 properties in neighborhoods which have not. This could range from an immediate repeal of the cap and reassessment based on full market value, which would have the effect of large-scale and immediate changes in tax bills, to eliminating the cap upon title transfer and resetting tax assessments, which would likely have the effect of depressing values in properties which would see this reset. The caps could also be raised (such as to the 8%/year, 30%/5 years cap for some Class 2 properties) instead of eliminated. This reform should be examined as to possible New York State constitutional issues around the uniform standards of assessment within a tax class, as this reform would necessarily create different methods of assessment depending on the length of ownership a homeowner has in a property.

Class 2 reforms

- Eliminating or raising the 8%/year, 30%/tax caps for Class 2a, 2b, and 2c properties. This would have similar effects to eliminating the Class 1 tax caps for smaller multifamily properties, although would likely be on a smaller scale as the existing tax cap is higher.

- Repealing section 581 a). This would allow New York City to value cooperatives and condominiums, or some subset of cooperatives and condominiums, according to models different from those used to value rental properties. This would likely be used to value high-end cooperatives and condominiums according to the comparable sales price model, leading to significantly higher valuations for high-end properties. If applied only to a subset of cooperatives and condominiums, this reform should be examined as to possible New York State constitutional issues around the uniform standards of assessment within a tax class, as this reform would necessarily create different methods of assessment depending on the value of the property.

Exemption and Abatement Reforms

Changing or adding exemptions and abatements would need action by the New York State legislature. This would include proposals outlined in the "Exemptions and Abatements" section such as:

- Modifying or repealing the 421a exemption
- Expanding the STAR exemption to affect more people
- Adding a new abatement which would serve as a way to relieve burdens on renters

- Instituting a comprehensive exemption for affordable housing projects.

In addition, any relief for low-income homeowners who would see higher tax bills under any reform proposal (and possibly even low-income homeowners who might not) which would be addressed through a "circuit-breaker" exemption or abatement would need state legislative approval, although there is the possibility of other mechanisms for tax redistribution to low-income homeowners (such as one-time rebates) that could be implemented by the city alone, as detailed in the "Possible Local Level Reforms" section.

Other state-level reforms

- Land value tax or vacant land tax. This would entail a differentiated tax rate for land and improvements on the land (which could also be reserved for vacant land only) designed to raise taxes on underutilized land in order to spur development. Further legal research is necessary to determine which kinds of bifurcated rates may be possible with city action alone or may be prohibited by the New York State constitution.
- Expanded New York State Real Property credit. New York State gives a refundable income tax credit to low-income renters and owners, as explained in the footnote in the "Individual Assistance Exemptions" section, expanding this credit would take state legislative action.
- Pied-a-terre tax. As explained in the footnote in the "Cooperative and Condominium Abatement" section, instituting an additional tax on pieds-a-terre or second homes would need state legislature approval, and may also run into challenges on the federal level.

Possible Reforms Needing State Constitutional Changes

A state constitutional convention has not been called in New York since 1967 and remains an unlikely event. The New York State constitution can also be amended through two consecutive legislatures passing an amendment, followed by a ballot referendum. While the state constitution has been amended several times in this manner, it is still a considerably more difficult process than a simple New York State legislative action. Possibilities discussed in this paper which would require a constitutional change include:

- Raising the 2.5% constitutional limit on overall property taxations. The main effect of this would be to allow revenue-positive options for reform to be explored.
- Addressing issues of uniform valuation within a tax class. Several reform options outlined above may be limited by possible constitutional issues around the principle of uniform valuation, especially within a tax class.

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