

Reforming New York City's Property Tax: Issues and Options

In 1975 the New York State Court of Appeals upheld the state law requiring property to be assessed at full market value for tax purposes.¹ Prior to the ruling, few localities had been enforcing this standard. In fact, in many communities residential properties were assessed at a lower fraction of market value than were nonresidential. The switch to "full value" assessment since 1975 has been slow. To date, only a small part of the state's real estate has been brought into compliance. In addition to the high cost of revising the property tax rolls, communities are reluctant to make a major tax change when it is possible the state legislature will amend the law. Since the property tax accounts for over two out of every three dollars of locally raised revenues in the state, the potential tax reallocations are of major importance to taxpayers. The ramifications of the court's decision are readily illustrated by examining New York City which annually raises more than \$3 billion in revenues through its property tax.² Such an examination

also provides a basis for evaluating the relative advantages of the various alternative ways to reform the property tax.

Complying with the law

State law calls for all property to be assessed at full market value and to be taxed at the same statutory rate.³ Because tax liability is determined according to the property's assessed value, such a uniform tax system means that every property is subject to the same effective tax rate, *i.e.*, the same taxes per dollar of market value.

Current property tax practices in New York City contrast sharply with these requirements of state law.⁴ Properties in the city are assessed at differing percentages of market value. These assessment variations, in turn, produce wide differences in effective tax rates, particularly between residential and nonresidential properties. For example, the property taxes paid by owners of single-family houses in the city are only about half of what they would be if the property tax

¹ *Hellerstein v. Assessor of Islip*, 37 N.Y.2d 1, 332 N.E.2d 279, 371 N.Y.S.2d 388 (1975).

² This examination of New York City's property tax was based on property sales from July 1, 1977 to June 30, 1978. After making adjustments to the data recorded by the city to allow for only transactions that appeared indicative of "true" market prices, there were close to 26,000 sales. The procedures used, as well as the shortcomings of the resulting data, are discussed in technical appendices to the report filed by this author with the city's Business Tax Task Force and the Department of Finance. Although there seems little reason to doubt the overall findings of the study regarding dispersion in effective tax rates, data limitations suggest that caution should be exercised in relying on any particular number as a precise estimate.

³ N.Y. Real Property Tax Law, § 306.

⁴ As a result of a recent court ruling, there is now a question of whether the provision of New York State's Real Property Tax Law requiring "full value" assessments governs in New York City. The court found the appropriate standard to be the one embodied in the city's Administrative Code. *Colt Industries Inc. v. Finance Administrator and Tax Commission of the City of New York*, 183 N.Y.L.J. 108 (Sup. Ct., New York Co., June 4, 1980), pages 10-11. If this decision stands, then the city will not need any further legislation to implement a classified system as discussed in the text.

were levied on the basis of market values (Chart 1). At the other extreme, owners of office buildings tend to pay a relatively large share of taxes—over 60 percent more than they would if the tax burden were distributed according to actual property values. These and other disparities in effective tax rates mean that a switch to a uniform tax system would result in a major reallocation of the tax load among the different property groups. The size of these tax shifts underscores the potential for economic disruptions from the court's mandating of full market value assessment.

Not only do effective tax rates in New York City differ by property type, but they also differ by borough. For example, single-family houses in Manhattan are assessed on average at a much higher percentage of market value than houses in other boroughs. In fact, Manhattan appears to be the most heavily taxed borough overall (Chart 2). Consequently, a switch to a uniform tax system would reduce the share of taxes paid by owners of Manhattan properties by some 30 percent. At the opposite end of the scale, Staten Island property owners would face a two-thirds increase since they now pay only a fraction of their proportional share.

Part of the sharp divergence in the effective tax rates paid in the two boroughs is due simply to differing

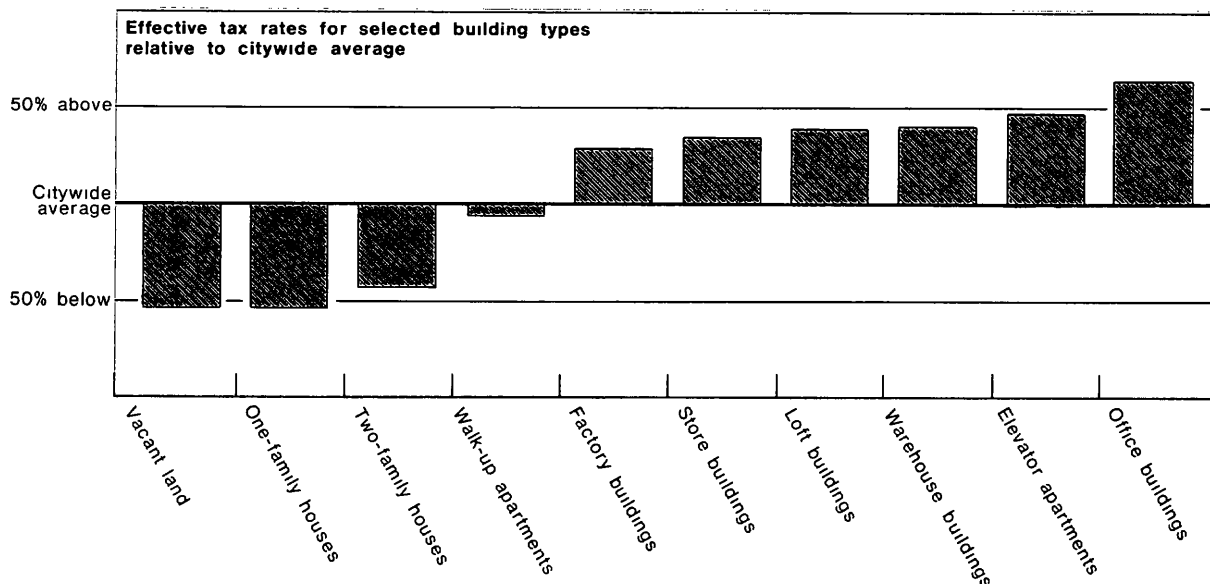
property mixes. Manhattan contains a large proportion of office buildings which are relatively heavily taxed, while Staten Island consists largely of houses which are relatively lightly taxed. However, after taking account of these differences, there is still a wide gap among the boroughs (Chart 2). One striking feature of adjusting for the differing properties in each borough is the change in the relative position of the Bronx. Rather than appearing to be taxed at about the city-wide average, this borough turns out to be taxed at an effective tax rate almost as high as Manhattan's.

A switch to a uniform tax system would do more than change real estate taxes; it would likely affect property values. Increases in taxes tend to lower the demand for a property, thus depressing its market price. This in turn leads to a downward readjustment in assessed value, which offsets part of the initial tax increase. The opposite happens for those properties experiencing a tax reduction. Thus, with a reallocation of taxes, the owner may receive a capital loss or gain which is then realized when the real estate is sold.⁵

⁵ The tax shift estimates presented assume that a property's market value is unaffected by the level of taxes. Factoring in changes in market value has only a relatively small impact on the size of the tax shifts.

Chart 1

Effective Property Tax Rates Vary Widely Across Building Types



Source Estimates derived by the author from data furnished by the New York City Department of Finance

Other alternatives

To avoid the enormous tax shifts associated with full market value assessment, the state legislature has a number of options to modify the present property tax law.⁶ The simplest and most direct way to lessen the tax shifts among property groups is to establish a classified tax system. Under this scheme, properties are divided into selected tax groups. The assessment standard or tax rate can then be adjusted to the current effective tax rate so that the total taxes paid by each group of properties are unchanged. Thus, the share of total taxes borne by single-family houses in New York City could be kept from rising by treating these houses as a separate property class.

Another option available to hold down the taxes paid by homeowners is to combine a homestead exemption program with a uniform tax system. This would allow each homeowner to exempt the same fixed amount of the assessed value of the property from taxation. Taxes are then paid only on the assessed value of the property in excess of the exemption. Such a tax program, however, dramatically affects the distribution of taxes within this group. Unlike a classified tax system in which all properties within a class pay at the same effective rate, the more valuable properties pay taxes at effective rates much higher than the present average. The degree of progressivity with respect to assessed real estate values varies with the size of the exemption. In New York City the exemption would have to be very large—about half the average assessed values of houses—in order to prevent any increase in taxes on homeowners as a group. With such a large exemption, the resulting tax would be highly progressive.

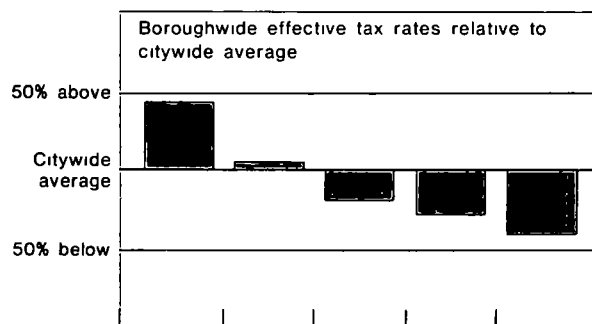
A similar program, also introducing some element of progressivity to the tax system, is the circuit breaker. Named after its electrical counterpart, it limits homeowners' taxes by providing credits that can be applied against other taxes (usually against the state income tax).⁷ The main difference between the circuit-breaker program and the homestead exemption is that the tax relief under the circuit breaker is contingent on property taxes exceeding some percentage of the homeowner's income. Thus, even for two properties of equal assessed values, the property tax for the owner

⁶ Because little is known at present about how property and other taxes now levied in New York City affect economic decisions, the analysis in the text of the various options for reform does not rely on any theoretical model of an optimal tax system but focuses solely on the question of tax shifts.

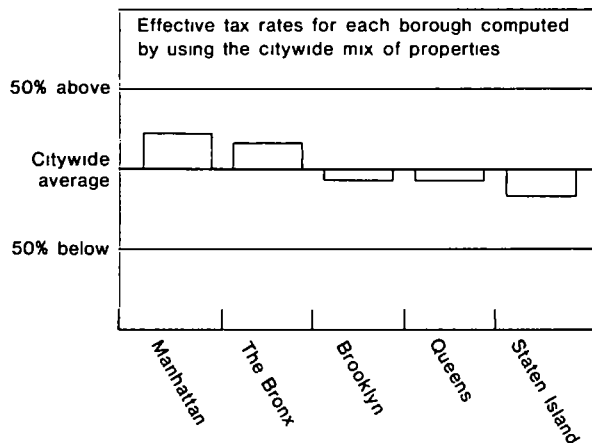
⁷ New York State now offers a limited circuit-breaker program. The maximum credit available is \$200 for the elderly poor and \$20 for other low-income households.

Chart 2

Effective property tax rates vary across boroughs . . .



. . . even after allowing for differences in property mix.



Source: Estimates derived by the author from data furnished by the New York City Department of Finance.

with the lower income may be at a lower effective, after-credit rate. In this way, a circuit-breaker program causes the property tax to be progressive with respect to income.

Another way to limit property tax increases is to find a substitute for some or all of the revenue now raised by this tax. However, since adoption of this alternative by New York City could result in a major realignment of its overall taxes, careful study is required. The effects of the new taxes may not be any less harmful than those resulting from going directly to a uniform

tax system. As an example of the magnitude of the revenues involved, take the case of single-family homeowners. To prevent taxes from more than doubling on this group, the city would have to cut its reliance on the property tax by more than half, thus forcing it to replace some \$1½ billion or one fifth of its locally raised funds.

A different approach to the problems posed by full market assessment is to minimize its adverse effects simply by easing the transition. Relief to the taxpayer can be provided in at least two ways: (1) the increase can be phased-in to give the taxpayer time to adjust or (2) part or all of tax payments can be deferred until the property changes hands.

However, the more substantial the tax shifts, the less attractive these programs become from the point of view of both the city and the taxpayers. With a phase-in, the larger the increase, the larger will be some or all of the steps. To hold down annual jumps, the city would have to lengthen the transition period. For example, to keep the annual tax increase for homeowners as a group to 10 percent or less, a uniform tax would have to be phased-in over eight years. The longer the period, however, the longer the initial disparities are perpetuated. Furthermore, since tax decreases are likely to be granted immediately and thus not phased-in, collections from the property tax will drop temporarily. The revenue loss will most likely be made up by raising other taxes.

For the deferral of tax payments to be effective, eligible taxpayers, usually limited to the elderly, must accept a tax lien against their property as an alternative to selling their property. Thus, the larger the tax increase, the greater the ultimate size of the encumbrance and hence the less the appeal of this alternative. After all, for most people a house is a major asset and an important source of security.

More than classification is needed

Preventing any reallocation of property taxes requires each property now taxed at a different effective rate to be in a separate class. However, there are practical limits on the number of classes that can be established.⁸ Therefore, it may not be possible to eliminate all tax shifts through classification. In fact, this

seems to be the case in New York City where even similar properties are taxed at different effective rates.

This dispersion in effective tax rates is readily illustrated by examining the range of assessment ratios—assessed value over market value—for single-family houses in Brooklyn. Most of these properties have assessment ratios around 20 percent, i.e., the assessed value is approximately one fifth of the market value. However, the range is wide. As a result, many properties are taxed much more heavily than others. For example, over one sixth of the properties are assessed at more than 30 percent of their market values. These properties pay effective tax rates that are at least twice those of the 9 percent of the houses assessed at less than 15 percent of their market values (Table 1). This lack of uniformity can be measured by the coefficient of dispersion. The United States Bureau of the Census recognizes a coefficient of 0.20 as indicative of un-

Table 1

Distribution of Assessment Ratios for One-Family Houses in Brooklyn

Total number of sales 2,166

Assessment ratios*	Percentage of total	Cumulative distribution (in percent)
0 10-0 11	0 4	0 4
0 11-0 12	0 9	1 3
0 12-0 13	1 6	2 9
0 13-0 14	2 5	5 4
0 14-0 15	3 4	8 9
0 15-0 16	4 6	13 4
0 16-0 17	6 0	19 5
0 17-0 18	6 7	26 2
0 18-0 19	8 4	34 6
0 19-0 20	6 1	40 7
0 20-0 21	7 4	48 1
0 21-0 22	6 9	54 9
0 22-0 23	5 0	60 0
0 23-0 24	5 0	65 0
0 24-0 25	4 4	69 4
0 25-0 26	4 2	73 6
0 26-0 27	2 7	76 3
0 27-0 28	2 4	78 7
0 28-0 29	2 1	80 8
0 29-0 30	1 8	82 6
0 3-0 4	9 3	92 0
0 4-0 5	3 0	95 0
0 5-0 6	1 9	97 0
0 6-0 7	1 1	98 0
0 7-0 8	0 6	98 6
0 8-0 9	0 4	99 0
0 9-1 0	0 3	99 3
1 0-2 0	0 7	100 0

* Assessed value divided by market value

Source: Estimates derived by the author from data furnished by the New York City Department of Finance

⁸ The number of classes is limited by administrative, legal, and political considerations. The larger the number of classes, the more difficult it would be for the assessors to make the distinctions required. Record-keeping problems would also multiply as classes abound. Furthermore, as the bases for drawing the lines become more intricate, they become more vulnerable to legal challenge as violating the equal protection provisions of the state and Federal constitutions. Also, by allowing a large number of classes, the legislature would open itself up to pleas from every special interest group for favorable treatment.

Table 2

Coefficients of Dispersion*

By major building type and borough

Building type	Manhattan	The Bronx	Brooklyn	Queens	Staten Island
One-family houses	0 35	0 34	0 34	0 24	0 27
Two-family houses	0 35	0 33	0 40	0 31	0 26
Walk-up apartments	0 40	0 53	0 46	0 35	0 55
Elevator apartments	0 30	0 24	0 23	0 20	†
Warehouse buildings	0 46	0 45	0 34	0 39	†
Factory buildings	0 47	0 42	0 38	0 32	†
Garages	0 30	0 78	0 51	0 54	0 73
Hotels	0 41	†	†	†	†
Theatres	†	†	†	†	†
Store buildings	0 34	0 52	0 40	0 39	0 67
Loft buildings	0 45	†	†	†	†
Office buildings	0 37	†	†	0 38	†
Condominiums	0 23	0 13	†	0 15	†
Vacant land	0 55	0 97	0 77	0 84	0 80
Miscellaneous	0 46	0 70	0 58	0 41	†

* The coefficient of dispersion measures the deviation of the individual assessment ratios from the average assessment ratio for the group as a whole. It is computed by dividing the average amount of these deviations by the average assessment ratio, thereby making it useful for comparing degrees of dispersion between groups with different average ratios. A coefficient of 0.20 or above is considered indicative of unacceptable assessment practices by the United States Bureau of the Census.

† No coefficients of dispersion shown because of only ten or fewer observations.

Source: Estimates derived by the author from data furnished by the New York City Department of Finance.

acceptable assessment practices. The coefficient for these Brooklyn properties was considerably higher at 0.34.

Similar degrees of dispersion exist within virtually all property groups in the city (Table 2). In only two cases does the coefficient fall below the acceptable level of 0.20, and in most cases it ranges far above it. The message is clear: there are wide variations in the effective tax rates paid on similar properties.

The variation in assessments within a real estate class limits the effectiveness of a classification scheme to prevent tax shifts. Since each property cannot be assigned its own class, individual taxpayers will still face tax changes. However, the changes in taxes under a classified system are in general less extreme than those caused by a switch to a uniform tax. In some cases the tax change may actually be in the opposite direction. For example, taxes on properties now assessed at ratios above the citywide average but below the average for their class will rise instead of fall. As an example, if factory buildings were assigned a separate class, one fifth of them would face a tax increase of 50 percent or more. In contrast, since the average assessment ratio for factory buildings now exceeds

the citywide average, the switch to a uniform tax system would result in major tax increases for only a few of these buildings. Indeed, the group as a whole would benefit from a 23 percent tax reduction.

Since classification cannot moderate, let alone eliminate, all tax increases on property in New York City, additional tax relief seems appropriate. To soften the effects of these remaining intraclass shifts, however, it may be necessary only to ease the transition with a phase-in program that also offers tax deferral for the elderly.⁹

A tax freeze in disguise

Workable options exist for dealing with the problems posed by full market assessment. However, much of the public debate over what to do about revaluing properties and the resulting potential for large tax shifts has focused on a totally different approach. This involves adjusting the assessed values of a large number of properties as a group. When all the properties

⁹ By allowing the payments of taxes to be deferred, the local government may be forced to borrow the cash it needs to meet its expenses. This may pose a problem for New York City in view of its fragile fiscal condition.

in the group are assessed at the same fraction of market value, this use of a single multiplicand brings assessed values to the desired standard. For example, if properties were assessed at one fifth of market value, then multiplication by a factor of five would ensure compliance with a "full value" standard. Because this process works by multiplying each of these properties by the same constant, it is called mathematical revaluation. By using a different factor for each group, disparities in assessment ratios between groups can be eliminated.

Although appealing in its simplicity, mathematical revaluation suffers from a critical flaw—it leaves intra-group variations in place. For New York City, this creates a problem because of the apparent impossibility of dividing its tax rolls into groups within which the ratios are uniform.¹⁰ Mathematical revaluation merely perpetuates existing assessment disparities within groups, and so similar properties would continue to be taxed at different rates. In fact, when combined with a classified tax system, mathematical revaluation may serve only to prolong the present distribution of taxes. When the same groupings are used as the basis for both the revaluation process and the classification scheme, every property continues to be taxed as before.

By temporarily freezing taxes in this way, mathematical revaluation may also prompt more of the owners now relatively overassessed to appeal, thus clogging the appeals process and ultimately undermining the city's tax base. The reason is that a property now assessed at a ratio of 0.22, if in a group with a factor of 5, will end up assessed at 10 percent above its market value ($5 \times 0.22 = 1.10$). While under current assessment procedures an owner may fail to realize his relative overtaxation, once the assessed value exceeds the property's worth it is very likely that the owner will become aware of the relative overestimate.¹¹

The increase in the number of appeals could be enormous. A rough estimate, based on the use of fifteen building classes, projects over a quarter of a

million appeals, including 180,000 homeowners.¹² This number is many times the current average of about 40,000 per year—only a few thousand of these are homeowners—and so would greatly overburden the city's Tax Commission which must hear each appeal. If fewer classes were used, the number of appeals could be even higher. In addition, to the extent the appeals are successful, mathematical revaluation will reduce the city's tax base. If the assessed value reductions are granted in all the appeals estimated above, the loss to the city's taxable rolls could amount to almost 17 percent

Reform of the property tax rolls

To reduce the potential for appeals, it is necessary to eliminate the disparities in assessment ratios. The only way to do this is to reappraise individually each property. This is a lengthy and expensive undertaking. However, it is not all that is required. In the future, these assessments must be maintained over time to keep them in line with the official standard. Through careful planning the tasks of reappraising properties and of establishing a system to maintain the integrity of the tax roles can be combined, thus reducing substantially the cost of doing each separately.

At present, the city's Real Property Assessment Bureau does not appear able to handle the tasks of appraisal and of updating assessments. In fact, this study and others have found it deficient in even the most basic kinds of bookkeeping functions.¹³ Not all responsibility for the present disarray of the tax rolls rests with the Bureau's procedures. It has only some 125 field assessors to review annually the assessments on the city's 830,000 parcels. Priorities have had to be set, with the result that some properties were not reassessed even when they were sold.

As a test for carrying out any reform program, the city has set up a separate organization to investigate the feasibility for using techniques such as computer-

¹⁰ The possibility of devising a scheme to divide the city's tax rolls into groups containing uniform assessment ratios appears remote. Attempts to construct such groups using the building classifications and geographic locations available were unsuccessful. The data provided for the subdivision of each of the fifteen major building types into as many as nine subgroups and each borough into as many as eighteen community planning districts.

¹¹ By enlarging the overassessment from 2 percent of market value (22 percent minus 20 percent) to 10 percent, mathematical revaluation also increases the visibility of the gains to be won through appealing the assessment. However, the actual tax reduction possible remains the same as long as the total tax on the group is unchanged. Thus, while the amount of the overassessment for a property worth \$40,000 would increase from \$800 to \$4,000, the tax rate needed to raise the same revenue would have fallen by four-fifths.

¹² These estimates were calculated by extrapolating the results obtained from the sales data to the tax rolls as a whole. All owners of properties relatively overassessed by 10 percent or more compared with their class average (there were fifteen classes based on building type) were assumed to appeal. To arrive at the estimated loss to the city's tax base, it was assumed that each of the appeals resulted in a reduction of the property's assessed value to a level commensurate with the average assessment ratio for the class as a whole. The percentage reductions of total assessed value for each of seventy-five subdivisions of the sales data (fifteen building types in five boroughs) were then extrapolated to cover all the properties on the tax rolls.

¹³ See, for example, Office of the Comptroller, State of New York, *Assessment Practices of the Bureau of Real Property Assessment*, New York City Department of Finance, Audit Report NYC-66-76 (November 1, 1978).

assisted mass appraisal (CAMA) systems which are being used elsewhere. If this computerization effort is successful, it will help alleviate much of the paperwork and eliminate many of the value judgments now involved in appraisal work. The same level of staffing will then be able to monitor more closely the assessments of a larger number of properties. Greater use of computers to store and process data on each property should also help control one of the major sources of dispersion in assessment ratios—the delays in reassessing properties following changes in their market values.¹⁴

A need for action

Moving to a more equitable tax without creating major problems is possible, but the reform will not be

painless. Reappraising properties will be costly and some owners will face tax increases. Classifying real estate into groups, however, can prevent shifts in taxes among these groups, thereby reducing the extreme changes in taxes. A phase-in program with tax deferral for the elderly could then ease the adjustment to the tax changes that remain.

Continued delay in reforming the property tax could itself prove costly. The inequalities in the present system have spawned appeals which even now represent outstanding claims against the city of over \$1.5 billion, or almost half of the yearly collections from the property tax. Unless changes are made, this amount could rise even higher. The uncertainties over future taxes also discourage economic activity. With the shape of the tax system in doubt and with no clear assessment standard, households and businesses shy away from making further investments in structures and in related activities in New York City. Finally, continued noncompliance with existing law could force the courts to impose immediate deadlines, causing a too hasty revamping of this complex and important tax.

For reform to proceed, the legislature must act decisively. Past attempts to legalize the status quo have merely prolonged the period of uncertainty. Once the legislature establishes a viable set of programs, New York City and other municipalities in the state can then get on with the difficult job of reforming their property taxes with a minimum of disruption to taxpayers and the economy.

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¹⁴ Lags in reassessing properties cause assessment ratios to fall (rise) as their values in the marketplace increase (decrease). Although the exact importance of lags is hard to show without information on the movements over time of price and assessed value for specific properties, many characteristics of the tax rolls suggest that lags are a major source of the dispersion. For example, the generally high level of the ratios for properties in the Bronx may reflect a failure by the city to readjust promptly and fully the assessed values as properties fall in price. In fact, many of the properties found to have high assessment ratios seem to have depreciated in value inasmuch as they have relatively low selling prices for their property type. In contrast, the low average assessment ratios for most one- and two-family houses seem attributable to the absence of any comprehensive program since World War II to reassess these properties. The one area of the city which apparently has received the most attention from the Real Property Assessment Bureau is Manhattan, and its high average assessment ratio, the nearest of all the boroughs to the "full value" standard, reflects this fact.