New York City is the largest, most diverse, and, in places, most inequitable real estate market in the country. The same can be said for its property tax code. The City has undertaken numerous reforms but the last time it seriously tackled the issue was 25 years ago under Mayor Dinkins. At the time the City’s commission concluded that the property tax structure was inherently unfair, and advantaged people with higher incomes over those with lower incomes. But Dinkins was unable to pass reforms before the end of his term, and his successor, Giuliani, shelved the commission’s recommendations.

Today the residential tax burden remains disproportionately shifted onto those less able to afford it. Luxury condominiums are valued more in line with modest rental apartments than high-end townhouses. As for those high-end townhouses, they likely have a substantially lower effective tax rate than similar homes in lower income neighborhoods. Large rental properties generally bear the highest residential tax burden, leading to added pressure on renters.

From City Hall to the State Capitol — not to mention a few courtrooms in between — political leaders, civic groups, landlords, and homeowners are once again pushing for reforms. To create a truly equitable property tax code, it helps to understand how the city got to the system it has, to both overcome the problems of the past and prevent more in the future.

1940s: Beginning during World War II, residential assessments are regularly frozen or raised less than commercial properties, as politicians bow to pressure from homeowners.

1975: A Manhattan couple, the Hellersteins, who own a bungalow on Fire Island sue the town of Islip, in effect arguing their tax assessment is too low. The New York State Court of Appeals agrees and orders the Legislature to create a property tax system that will be more equitable and uniform.

1981: The Legislature passes the New York State Property Tax Law, which creates four classes of property. These designations persist to today and create many of the inequities in the system.

1989: State law further limits the discretionary powers of New York City, which had once again been shifting the tax burden further away from small homeowners.

1993: The Dinkins administration, hoping to rationalize the system and reduce the ongoing inequities, establishes the NYC Real Property Tax Reform Commission. It finds the system favors owners of small homes over midsize apartment buildings, though large commercial and residential landlords, as well as utilities, pay the greatest proportional share.

1994: Mayor Giuliani takes office and the commission’s final report is shelved, having been released only two days before the transition. Still, many of its suggestions, such as uniform residential valuation, a revised class system, and relief for low-income residents remain central to most proposals to this day.

2017: Property tax reform becomes an issue during the mayoral election, leading Mayor de Blasio to promise a commission to study the matter, with members of the commission announced May of 2018. Meanwhile, a coalition of civic, civil rights, and real estate organizations file a lawsuit challenging the regressive nature of the tax system.
The Class Share Conundrum

One of the most persistent problems of the city’s property taxes is the requirement, as established by the Legislature in 1981, that each class bear a specific percentage of the overall tax levy for the city. Because of this, changes or reforms in the property tax structure which do not affect class shares – like exemption policies, assessment caps, and valuation methods – have the effect almost exclusively of simply shifting tax burden within a class, as opposed to changing the overall inequities between classes.

Over the past decade, the tax responsibility allocated to each class has remained relatively steady with Class 1 properties paying much less in taxes as a percentage of market value than other classes. For instance, in FY 2017 Class 1 properties made up just 15% of property tax revenue, despite representing 47% of the market value of real estate in New York City. 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. The low amount of taxes paid by Class 1 shifts the tax burden to other classes, and is often cited as a main rationale for reform.

Figure 1: Tax Levy Distribution by Tax Class: Fiscal Years 1989-2017


The Class System

Today’s quadripartite class system was created by the 1981 tax law as a way of complying with the Hellerstein ruling while not raising taxes on small one- to three-family homeowners. Each class is responsible for meeting a specific share of the overall property tax burden. These shares are determined by New York State each year. What belongs in each class, and whether there should be any classes at all, are regularly debated.

CLASS 1: All residential buildings with one, two, or three dwelling units. Class 1 is further subdivided into: one-family homes; two-family homes; three-family homes; condominiums with one to three units; small mixed-use properties with no more than three units where more than half the square footage is for residential use; and bungalows on cooperatively owned land. Small vacant parcels outside Manhattan that are zoned residential or adjacent to Class 1 properties are also Class 1. There are only small differences in the tax rules and rates between these subdivisions.

CLASS 2: All residential buildings with four or more permanent dwelling units. There are three subdivisions: rental properties with four to six units (Class 2a) and seven to ten units (2b), and condos and co-ops with four to ten units (2c). Larger rental, condominium, and cooperative buildings are simply considered Class 2, as well as larger mixed-use buildings where at least half the space is for residential use. There are significant variations across these subclasses, unlike in Class 1, largely because of an assessment cap on Class 2a, 2b, and 2c properties.

CLASS 3: Properties operated as utilities such as power plants and substations, as well as their infrastructure such as power lines. Taxes on such properties are largely passed directly on to ratepayers because the utilities are highly regulated. Therefore reform to Class 3 properties, while often overlooked, could provide broad relief to New Yorkers by reducing their utility bills.

CLASS 4: All property not included in the other three classes, including: commercial, industrial, non-permanent dwellings such as hotels and dormitories, and mixed-use where less than half the space is residential.

Challenges For Renters

Most renters don’t know how much of their rent goes toward paying a building’s property taxes, especially in large multifamily buildings. Shifting the balance of taxes on larger buildings could enable rent relief for a large number of New Yorkers — but ensuring that at least some portion of any tax savings are directly passed on to renters is the challenge.
Determining Property Taxes

Step One: Market Valuation
There are three methods for determining market value. The first is comparable sales of nearby properties. Familiar to most homeowners, this process relies on recent sales of similar properties. The second determines value based on replacement cost, which is relatively rare and usually reserved for specialized properties, like power plants. The third way is the income-capitalization method. This assigns buildings a value through an estimate of what an investor would pay for the property, with the value derived from the rental (and other) income the building currently produces.

Class 1 properties are valued using comparable sales, even if some or all of the property is rented. Class 2 properties are valued using income capitalization, even if the apartment is owned as a condominium or cooperative. This has led to several inequities in the system, especially for high-end condominiums which sell for significantly more than the value they would have as rental properties.

Step Two: Assessed Valuation
The market value is then used to reach an assessed value. For Class 1 properties, the assessment rate is 6 percent, for the other classes it is 45 percent — though there are notable exceptions. Class 1 properties have a five-year cap of 20 percent on assessment increases, which effectively renders the annual rate at 3.73 percent. And Class 2a, 2b, and 2c properties have an annual cap of 8 percent and a five-year cap of 30 percent, which works out to an effective rate of 5.38 percent.

These caps are meant to prevent spikes in taxation for smaller properties, though they also depress their tax bills over the long term, shifting the burden to buildings with more than 10 units which are not capped. This system also leads to geographic disparities. In many central and gentrifying neighborhoods sharply rising market values often surpass the assessment cap, causing properties in these neighborhoods to pay proportionately less in tax, which in turn leaves properties in other neighborhoods to make up the difference.

Step 3: Exemptions
The city offers a host of exemptions and abatements to modify property tax collections, with the key difference being when they are applied.

Exemptions are applied before tax bills are calculated and class shares are determined. This shifts their cost onto other property owners within the class, since each class must cover a set amount of the total tax levy each year. Abatements are applied after tax bills are calculated and class shares are determined. These are more akin to a direct expenditure because they reduce the total amount of annual taxes collected.

Exemptions fall into two general categories: ones which for which the resident of the property determine eligibility and ones for which aspects of the property itself determine eligibility. The former include benefits for the physically disabled, crime victims, senior citizens, veterans, and clergy members. The state-funded School Tax Relief exemption, or STAR, is the largest; available to primary residents making less than $500,000, it comprises 78 percent of all exemptions and 55 percent of their monetary value.

For properties, a number of programs exist, including 420-c for affordable housing J-51 for recently renovated properties, and 421-a for new mixed-income construction.
Step 4: Tax Rates
The city then applies a tax rate to the assessed value, after exemptions, to arrive at the final tax bill. This rate is set at a different level for each tax class, in order to have each tax class to meet its predetermined share of the overall tax levy. This overall tax levy is itself constrained by a cap laid out in the state constitution. No more than 2.5% of the 5-year average of total market value of property in the city may be raised in property taxes each year, excepting for debt service and few other specific expenditures.

Step 5: Abatements
Abatements are best thought of as city expenditures disbursed through the property tax system. Because they come after tax bills and class shares have been determined, they do not affect other aspects of the system. The largest abatement is the cooperative and condominium abatement, which was instituted in 1996 in order to reduce cooperatives and condominium owners’ tax bills in order to be more in line with 1-3 family homeowners. Other major abatements include ones to encourage building renovations and improvements, as well as programs which freeze rents for certain seniors and disabled residents of rent-regulated apartments.

Reforms
Three key principles are nearly universally supported by all interested in reforming New York City’s property tax system: 1) More uniform residential valuations and tax burdens, 2) some type of revision of the current class share system, and 3) better support for low-income residents.

The City must rely on the State Legislature for virtually all large-scale reforms. However, the City can institute some smaller reforms. In addition, through its recently constructed tax commission it can propose large reforms, or even an entirely new and fairer system overall, for the State to consider. The commission has been assigned to work on a “revenue-neutral” basis, meaning all proposed reforms should result in the same amount of revenue for the city.

NYC Reforms
• The city has the authority to adjust both assessment percentages and tax rates. It could adjust assessment percentages downward and tax rates upward to shift some of the tax burden onto properties that have appreciated more quickly, while still maintaining revenue neutrality. This was last done in 2007 for Class 1 properties.

• The City could provide direct rebates, such as a recent City Council proposal to refund $400 to homeowners making less than $150,000. Such rebates are effectively budget expenditures, not reforms, though, and any tax losses must be covered by other properties or lowered revenues. Certain rebates would also require state approval.

• The City could make it easier to legalize accessory dwelling units. Many smaller properties have illegal apartments in basements, attics, and other areas. Legalizing them could theoretically increase the market value of these properties, and thus increase their tax bill.

• The City could require that landlords break out the proportion of a tenant’s rent bill which goes toward paying property taxes. While this would not alter the tax system, it could raise awareness and inspire renters to lobby for fairer taxation.

State Reforms
The majority of reforms, and most of the transformative ones, would have to be taken up in Albany.

• Reforming the class system has long been considered the most impactful measure. However, the reluctance to raise taxes on 1-3 family homes, a likely effect of any revision of the class share system, has often stood in the way of reform. Reforms could include:
  • Combining Class 1 and Class 2 and having one assessment percentage and tax rate for all residential properties.
  • Rebalancing the amount of tax paid by each class so that they more accurately represent their share of the actual market value.
  • Eliminating the class system altogether.

• The 6 percent/20 percent cap for Class 1 and/or 8 percent/30 percent cap for Class 2 properties could be modified or repealed.

• Condominiums and co-ops could be allowed to be valued on a comparative sales basis, rather than income-valuation basis.

• Exemptions and abatements could be altered or added, including modifying or repealing 421-a; expanding or modifying STAR in New York City; creating a new abatement to relieve burdens on renters; and a more comprehensive, less piecemeal, exemption for affordable housing.

• The state’s Real Property credit could be expanded, which is a refundable income tax credit for low-income residents.

• A pied-a-terre tax could be levied on second homes.

Constitutional Reforms
Some reforms could only be adopted by amending the state constitution. The most significant is raising the 2.5 percent cap on how much the city can levy in taxes for operations. The city regularly levies an overall tax burden very near this cap, in Fiscal Year 2017 the City’s overall tax levy was 99.7% of this limit. Many reforms that would have the net effect of raising taxes overall would likely push the tax levy over this limit.