Testimony of Mark A. Willis, Senior Policy Fellow
NYU Furman Center for Real Estate and Urban Policy
At the New York City Advisory Commission on Property Tax Reform Public Hearing
October 15, 2018

Co-chairs Professor Vicki Been and Marc Shaw, members of the Advisory Commission, my name is Mark A. Willis, Senior Policy Fellow at the NYU Furman Center for Real Estate and Urban Policy. The views I express in this testimony are my own and should not be construed as representing any official position of New York University or the NYU Furman Center.

My first involvement with NYC's Property Tax pre-dates the current law when, as a regional economist at the Federal Reserve Bank of New York, I used sales data to conducted a pro bono analysis of the assessment ratios across multiple property classes and found great variation across and within use categories. I subsequently was a consultant to a study for the Department of Finance (DOF) on "Real Property Tax Policy for New York City," led by Professor Dick Netzer of the then-named NYU Graduate School of Public Administration. Since those times I have remained a close observer of property tax policy both specifically to New York City and more generally.

It will therefore come as no surprise that I have a number of views that I would like to share with you. I will not, though, spend any time documenting the disparities in assessment ratios and hence in effective tax rates both within classes and across them. The Furman Center recently issued a "Policy Minute" on New York City Property Tax Reform (http://furmancenter.org/thestoop/entry/new-york-city-property-tax-reform) that provides some excellent resources on this topic.

Rather, I want to focus on the causes of these disparities (Part I) and what might be a reasonable way to move to a more equitable, economically efficient, and transparent property tax system (Part II).

I. Key Causes of Disparities in Treatment for similarly Valued Properties

As you well know, the three main causes of the disparities in how we tax properties of similar value are (a) caps on how fast the assessed values of individual properties can increase, (b) limitations on changes in the share of the levy that can be apportioned to each of the four classes, and (c) divergence between actual sale prices and DOF's estimates of market values. Each in its own way, has contributed to the large and, in many cases, growing disparities in effective tax rates for similarly valued properties that we see today.

a. Caps on Increases in Assessed Value

Caps on increases in assessed values have made it harder to eliminate any pre-existing, within class differences in assessment ratios. They have also caused assessment ratios to diverge between properties where market values are rising faster than the caps allow (driving down a property's assessment ratio) and those where market values are rising slower or not at all (allowing a property's assessment ratio to remain at or rise to the class standard). As a result, two properties with the same market values may have very different assessed values.

b. Limits on Adjusting the Share of the Levy Paid by Each Class

The limited ability to adjust the share of the levy paid by each class of property (the class shares) is another central cause of disparities in the property tax system. Failure to adjust class shares to reflect changes in the relative market values of properties in each of the four classes has caused relative effective tax rates to fall generally for properties in classes experiencing the fastest growth in market prices. As a point of history, the average assessment ratio for Class I in the early 1980s was around 18-20 percent and has now fallen to 6 percent, due in no small degree to the straightjacket imposed by state law and further aggravated by a reluctance of the city to take full advantage of the limited flexibility it could have used.

c. DOF's Appraisals of Market Value

DOF's methods of appraising market value have also contributed to the disparities in effective tax rates. Here the impact on inequities tends to be more subtle. The obvious case is coops and condos being in class II, which has required them to be valued as if they were rentals. It is a good question if they should continue to be in this class (with the same target assessment ratio as rental buildings with 4 or more units) and not with other homeownership units in 1-3 unit buildings. It is interesting here to note that, based on some research done at the Furman Center, the ratio of assessed values to actual market prices for condos and coops mirrors pretty closely the Class I 6 percent standard for properties with sale prices of up to roughly $4 million. It is the higher priced condos and coops where the system results in much lower actual assessment ratios.

Others have pointed out that DOF's estimated market values in classes II and IV appear low. As long as the underestimates are uniform within classes, the distribution of the tax burden within classes is not distorted. However, when thinking about inequities across classes, any differences across classes in the degree of undervaluation provides a distorted picture of what would happen to relative effective tax rates under different possible reform scenarios.

I am also concerned that the current appraisal methodology for multifamily properties may also be failing to properly account for government-imposed restrictions on rental income. Much has been made of the need for property tax exemptions for properties providing units at below-market rents. Proper appraisals should account for those lower rents and adjust the market value accordingly, perhaps reducing the need for long-term special exemptions.

II. Moving to a More Fair, Efficient, and Transparent Property Tax System

As the Commission considers reforms, there are a few guiding principles I think it should keep in mind.

a. Changes Should be Phased-in Gradually

It is important to recognize that we are not starting from scratch. We are subject to what is sometimes referred to as path dependency, and for that reason we should implement any changes gradually. Land and property prices today reflect the current system. Significant changes in tax burden can significantly change the market value of a piece of property. As a result of changes, owners of properties with falling nominal values may have to restructure their mortgages, and land owners may withhold properties from sale in the hope that prices will rebound.

Given the need for more housing in the city, it seems particularly appropriate to minimize the chances that a decrease in nominal land prices caused by tax reform will disrupt the rate of production of new residential units. By making changes slowly over time, owners that experience increases in their relative tax burdens will be better able to accommodate any relative decline in the value of their property, and any downward pressure on the nominal property values will likely be mitigated by normal inflation and increases in underlying demand (assuming the city continues to prosper).

b. Changes Should Address Caps on Assessed Value Increases

My first area of focus would be to phase in a fairer system for taxing properties in Class 1 by neutralizing the effects of the assessment caps. This phase-out would be on auto-pilot but could be stretched out over a period as long as 10 or 20 years to limit any short-term adverse effects. In addition, I support the adoption of a robust circuit breaker to help protect low-income homeowners from being forced to sell their properties simply because of their property tax load. The circuit breaker should be set to prevent property taxes from exceeding some reasonable percent of their income for those with the lowest incomes.

Eliminating the effects of the caps can be done by simply repealing them, but that requires action by the state legislature. The city also can effectively neutralize the caps by continually reducing target assessment ratios and correspondingly increasing the tax rate to maintain class revenues. To illustrate the potential of this strategy, if the assessment ratio for Class I were reduced to match the level of the lowest assessment ratio of any of the properties in the class, all properties could be assessed at that same ratio without any property being subject to an increase in its assessed value. While this approach to fairness might add administrative complexity (and it certainly decreases transparency, see below), it would get the job done. Moving in this direction should, as I noted previously, be phased in over an extensive period of time.

c. Changes Should Address Differences in Effective Tax Rates Across Classes

The next area to address are differences in effective tax rates across classes, which influence the choices owners make about how to use their land. For this, you need to consider how you might want the property tax system to change the current pattern of land uses. Currently, 1-3 family homeowners are taxed at a lower rate than larger, residential rental properties—the latter now being taxed at the same rate as other commercial properties. Raising the effective tax rate on Class I without reducing the rate on Class 2 will end up favoring non-residential uses. If the idea is to treat all residential alike but not to disrupt the current relative attractiveness of residential vs. non-residential development, then the average effective tax rate for residential properties will have to reflect the effective tax rate now faced collectively by the properties in Classes I and II.

A note of caution, even if single-family and multifamily properties are combined in one class, the reduction of taxes on the multifamily properties is unlikely in the short or even medium term to provide much relief on rents. The effect on rents of any decrease in property taxes (other than if taken into account by the Rent Guidelines Board in determining allowable rent increases) will only be felt by tenants in the long run if it results in an increased supply of rental units. In the short run, owners of units renting at market rates are unlikely to face additional competitive pressures as a result of property tax changes. In other words, if and until more supply results in relatively lower market rents, the change in tax burden is unlikely to affect an owner's ability to continue to charge the current rent.

d. Changes Should Result in a Transparent System

This brings me to my last area for reform: transparency. It is well-nigh impossible for most property owners to understand whether they are now being taxed fairly or not. Assessed values are only a fraction of what DOF estimates as the market value, a value that seems to undershoot actual market values substantially in some cases. Looking at either DOF assessed values or DOF market values, taxpayers may mistakenly believe that they are getting a bargain, and so be reluctant to protest. For taxpayers to be able to understand how their effective tax rate compares to that of other owners, it is essential that DOF market values reflect actual market prices and that the assessment ratio standard be applied uniformly within classes. It would also be clearer if assessed values were the same as the market values, but if some property types are to be taxed at a lower rate than others, then it may make sense to use a system of fractional assessments. In this case, however, it is particularly important that DOF provide accurate estimates of market values so that taxpayers can determine if they are paying the same effective tax rate as others with similar property—i.e., are they being taxed fairly.

I believe that reforms such as these would go a long way to improving the fairness, efficiency, and transparency of our property tax system.

Thank you.