



# NYC Residential Property Taxes: Four Reforms

February 2019

In 1993 the New York City Real Property Tax Reform Commission (commonly known as the Greyson Commission) declared, “the property tax in New York City not only appears unfair, it is unfair.” Since then it has been accepted that the way we tax residential property in New York City is unfair and inequitable.

Attempts at reform have been proposed since but not gained much traction. Operating under a revenue-neutral system, changes to the property tax must involve some people paying more, in addition to others paying less. This leads to some form of opposition for almost any proposed reform.

However, a combination of lawsuits and growing support for reform led New York City in 2017 to commission a panel of experts to propose possible changes to the system, although almost all reforms would need New York State legislative action and some would likely need New York State Constitutional changes as well. This panel, the New York City Advisory Committee on Property Tax Reform, is charged with developing proposed reforms to the property tax system on a revenue-neutral basis.

It is difficult to examine possible reforms in isolation – each part of the system has effects on the other, and all changes to the system would have ripple effects which would need to be addressed. A short introduction to the system is provided as an appendix to this report, and for a full explanation of the system, how it works, and legislative avenues to reform, please see RPA’s 2018 working paper “Residential Property Taxation in New York City.”

While building a new system from the ground up may seem to be the best solution, this still cannot be done absent consideration of the current system. An entirely new system would inevitably lead to drastic changes in individual property tax bills. This would necessitate phase-ins and other mechanisms to soften the immediate impact on taxpayers, and as such who pays what under the current system needs to be taken into account.

RPA examined four topics that are consistent subjects of the New York residential property tax debate and developed recommendations. These topics were chosen based on a goal of moving the overall system in a direction which is fairer and more equitable, their ability to be implemented in a revenue-neutral manner, and their ability to be implemented either as stand-alone reforms or in conjunction with more comprehensive reform. It should be noted that recommending certain reforms in certain areas does not mean other reforms are not needed or should not be considered. And because of the complicated and interrelated nature of the tax system, these reforms are not necessarily the most comprehensive or would lead to the most equitable system for residential taxation overall.

## Residential Property Tax Recommendations

1. Reset the taxable assessed value of Class 1 properties upon title transfer or non-occupation by the owner
2. Institute a universal renter’s credit in the case of Class 2 reform
3. Evaluate the impacts of reforms to land valuation or a tax surcharge on vacant land
4. Institute an additional tax or surcharge on pieds-à-terre and non-primary residences

# Reset the taxable assessed value of Class 1 properties upon title transfer or non-occupation by the owner

Currently the residential property tax system is split into two classes. Roughly speaking, Class 1 properties are made up of one to three family homes and Class 2 properties are made up of buildings with four or more units. Class 1 properties generally have a lower net effective tax rate (the ratio of actual taxes paid to actual market value) than Class 2 properties.

All Class 1 properties are subject to two different caps on their 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% yearly cap to an effective 3.73% yearly cap over the long term. Once an assessed value for a property has been determined, the current tax rate is applied to that assessment and the tax bill calculated.

These assessed value caps run with the property itself, irrespective of 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 for Class 1 properties. Class 1 properties in neighborhoods which have seen sharply rising market values since 1983, when these caps were instituted, are especially under-assessed. These properties have necessarily seen their assessed values increase at under 4% annually, even as their actual market valuation has far outpaced that rate.

For instance, between 1996 and 2016, while single-family home market values in every borough increased at an annual rate above the assessment cap, the market value of Manhattan homes increased annually at almost double the rate of Bronx homes. But because of the institution of the assessment cap, the assessed valuation of a typical home in each borough increased at the same rate: 3.73% annually. Because of our class share system, which mandates that Class 1 properties as a whole pay a predetermined share of the overall tax revenue, this cap has had

the effect of shifting the Class 1 tax burden from higher-value homes, mainly in Manhattan and Brooklyn, to lower value homes, mainly in Staten Island and the Bronx.

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 caps 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 which have recently experienced high housing price growth through increased equity in their homes.

In 2018, the New York City Independent Budget Office (IBO) conducted an exercise in which they determined which homeowners would be “winners” and “losers” under a scenario in which these assessment caps were lifted and the property tax burden was equalized as simply a percentage of a home’s actual market value.<sup>1</sup> This was conducted in a revenue-neutral format, in which the overall tax burden of Class 1 would stay the same.<sup>2</sup> Most homeowners (about five in seven) - were found to be “winners” in this scenario, meaning their property taxes would go down. Because this exercise was conducted on a revenue-neutral basis, this means that under the current system a minority of homeowners benefit from large effective property tax discounts due to these assessment caps, while most homeowners pay a somewhat higher rate than they would under an equalized system to compensate for this.

On a neighborhood level, 26 neighborhoods (all in Manhattan or Northwest Brooklyn) out of 176 examined would be the largest losers, with over 90% of homeowners experiencing an increase in property taxes under an equalized system.<sup>3</sup> The median amount of these hypothetical yearly tax increases ranged from to \$2,520 (Sunset Park East) to \$33,048 (West Village). Park Slope was the neighborhood where the largest amount of homeowners would see a tax increase, with 98% of 1-3 homes seeing a median yearly tax increase of \$11,146.

<sup>1</sup> NYC Independent Budget Office. “Addressing the Disparities: Winners and Losers in Two Property Tax Reform Scenarios” April 2018.  
<sup>2</sup> An additional exercise exploring one equalized tax rate for all residential property (Class 1 and Class 2) was also conducted.  
<sup>3</sup> 12 neighborhoods were not tabulated due to fewer than 100 observations

## 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%

Looking at the median home in the three neighborhoods above, RPA conducted an analysis to see how under current mortgage scenarios,<sup>4</sup> resetting a property's assessed value and tax rate to this equalized rate upon title transfer may impact home values, with the assumption that one more dollar in increased property taxes would be one less dollar a homeowner would be able to put toward a mortgage. Under these assumptions the current system of maintaining these assessment caps inflates property values in these neighborhoods by 4.2% (Sunset Park East), 7.4% (West Village) and 10.3% (Park Slope).

However, the IBO analysis is based off of an equalized tax rate for Class 1 properties – what would happen if all of the assessments were reset to be based on market value at once, but Class 1 overall were to pay the same amount. The properties which would see their assessments go up significantly and have higher taxes would have these tax increases be partially offset by the lower rate overall for Class 1 properties. It is also worth noting that under this scenario most Class 1 properties would pay somewhat less in taxes and therefore see a slight increase in their home value, most notably on Staten Island.

We also analyzed what would happen if the effective tax rate was not equalized, and a building's property taxes simply reset to be based on full assessed value under current tax rates.<sup>5</sup> Here, the drop in valuation is more pronounced, and there are no offsetting “winners” whose taxes are lowered and property values increased. However, as more and more properties are sold and pay higher taxes over time, the tax rate for Class 1 would gradually drop (relative to the alternative of retaining the current system). As such, this scenario would likely have the result of disincentivizing home sales in the short term more than a scenario in which caps are eliminated but tax rates are equalized.

<sup>4</sup> This was calculated as a 30 year fixed rate mortgage with a 5.5% interest rate, with 20% of the purchase price as a downpayment.

<sup>5</sup> The FY 2018 Class 1 tax rate, which is the basis for this analysis, was .20385 cents per dollar of assessed value.

## Assessment Cap Reform

There are several possible approaches for reforms to these assessment caps, ranging from keeping the current system to doing away with them altogether and immediately resetting the assessed valuation and resulting tax bill for each Class 1 property according to its market value. Ranging from least impactful to the current system to most impactful to the current system, possibilities are:

1. Retaining the existing system.
2. Keeping the caps, but modifying them to be greater than the existing system of 6% over 1 year and 20% over 5 years. The most obvious possibility is to raise them to the caps which currently exist on smaller Class 2 properties: 8% over 1 year and 30% over 5 years (or an effective annual cap of 5.38%).
3. Keeping the existing caps for current owners, but modifying or eliminating them upon title transfer and/or non-owner occupancy.
4. Raising or eliminating the caps altogether, including for existing owners. Implementation could range from a phase-in of these higher tax rates for existing owners to an immediate reset of all property taxes for Class 1 properties.

While option four – an immediate elimination of the assessment caps and reconfiguration of taxes to be based on market valuation – may seem to be the most equitable, there are mitigating considerations. Primarily, an immediate reset would mean low-income homeowners in neighborhoods which are undergoing or have recently seen gentrification and rapid home price appreciation would be met with unaffordable property tax increases which would likely require them to sell, displacing both them and any likely also any tenants in these homes.

## RPA analysis of median home value inflation due to Class 1 tax caps

	West Village	Park Slope	Sunset Park East
Median monthly property taxes with no caps and an equalized rate	\$6,244	\$1,478	\$754
Current median monthly property tax	\$3,490	\$507	\$544
Median property value with no caps and an equalized rate	\$8,141,701	\$2,076,342	\$1,093,768
Current median property value	\$8,748,000	\$2,290,000	\$1,140,000
<b>Value inflation due to assessment caps</b>	<b>7.4%</b>	<b>10.3%</b>	<b>4.2%</b>
Median monthly property taxes with no caps and the current rate	\$8,468	\$2,391	\$1,063
Current median monthly property tax	\$3,490	\$507	\$544
Median property value with no caps and the current rate	\$7,652,155	\$1,875,245	\$1,025,729
Current median property value	\$8,748,000	\$2,290,000	\$1,140,000
<b>Value inflation due to assessment caps</b>	<b>14.3%</b>	<b>22.1%</b>	<b>11.1%</b>

One solution to this would be to potentially implement a “circuit-breaker” system, where low-income homeowners would be exempt from some or all of these resulting tax increases. However, this circuit-breaker option would necessarily mean an opt-in system on the part of lower-income homeowners. Despite best efforts, opt-in systems often lead to people and institutions – in particular those in low-income neighborhoods – falling through the cracks. For instance, the 2011 changes in lien sales rules in New York, which allowed for non-profit institutions to have their tax liens sold, has led to several improper lien sales of non-profit owned land and buildings simply due to missed or misfiled paperwork.<sup>6</sup> And recently some low-income homeowners have seen their homes improperly foreclosed on through the City’s Third Party Transfer program.<sup>7</sup>

Instead of immediately eliminating assessment caps and resetting assessments and tax bills, option three (eliminating assessment caps upon title transfer and/or non-occupancy of the owner, and resetting the assessed valuation), should be taken. In addition to preserving the affordability of low-income homeowners in sharply gentrifying neighborhoods, this would likely also preserve affordable rental housing in these buildings. Social factors have been shown to limit rent hikes, specifically that non-professional landlords who have a more personal relationship with tenants are less likely to raise rents: for instance, see Gilderbloom’s “Social Factors Affecting Landlords in the Determination of Rent.” If longtime owners are forced to sell, these relationships will be ended and this naturally occurring affordable rental housing will likely be lost.

In addition, this would also help to preserve Class 1 property as the use for which it was intended – as owner-occupied homes. There is a growing trend of absentee investor ownership of Class 1 property. As documented in CNYCN’s recent report, “Affordable Homeownership in New York City: 10 Years after the Crisis” over half of all affordable One to four family home sales since 2009 have been investor purchases. By not pressuring low-income homeowners to sell, as well as by incentivizing owner occupancy in order to keep a favorable tax rate, the overall ownership rate of Class 1 properties can be prevented from further decline.

However, care would have to be taken to prevent loopholes. Proposition 13 in California, for instance, caps property tax increases at 2% annually but generally resets taxes to reflect full market value upon a change in ownership. However, there are several exemptions, such as transfers to families or transfers to different types of legal entities, leading to many ways in which lower property taxes can be passed on through a transfer of title. The requirement of resident-occupancy and care to ensure that

partial transfers or transfers to families, trusts, or business entities result in an elimination of the caps would need to be part of any reform.

Eliminating these assessment caps upon title transfer or non-owner occupancy 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, and instead to keep the existing system or raise the caps to a higher level is to avoid introducing sudden volatility into the valuation of one to three family homes. Sales prices are determined in the context of the current property tax system, and as shown above changing this system would likely result in changes to home values. 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. In addition, the properties which are most likely to see a loss of value as a result of assessment cap reform are also the ones which have seen recent and rapid market value appreciation, meaning any depreciation in home equity brought about by these changes would likely be made up by this recent appreciation in the property.

Another, smaller, option for reform is to raise 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 properties (4-10 unit buildings). 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.



<sup>6</sup> See “Tax Lien Sale Threatens Hundreds of NYC Nonprofits.” Next City, March 24th 2017.

<sup>7</sup> See “New Yorkers in debt losing their homes as part of program designed to preserve quality affordable housing.” PIX 11 News, December 12, 2018.

# Institute a universal renter's credit in the case of Class 2 reform

With Class 2 (buildings with four or more units) having a net effective tax burden greater than Class 1 property (buildings with one to three units), lowering of the Class 2 burden has generally been a goal of tax reform. However, ensuring a fair distribution of relief to the tenants in Class 2 buildings themselves, and not just the owners of the property, has long been a sticking point. A lack of literature on how property taxes get passed on to tenants (or how they might benefit from reductions) compounds this difficulty, as does the disparity in regulation between Class 2 rental properties, with some units being completely free market, some being subject to rent regulations, and some having varying sorts of regulatory agreements or other rental restrictions based on government sponsorship.

This difficulty is further compounded by the fact that 23% of all renters rent in Class 1 properties,<sup>8</sup> and therefore would not benefit from a reduction in Class 2 taxes. In fact, they would likely see a rent hike, as in a revenue-neutral reform scenario Class 1 taxes would likely be increased in order to make up for the decrease in Class 2 taxes, with the tenants of Class 1 properties likely seeing at least some of that hike passed through in the form of higher rent.

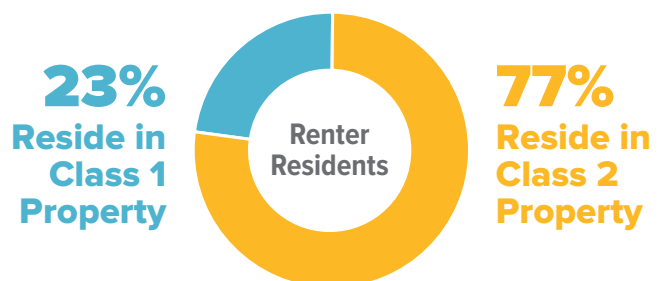
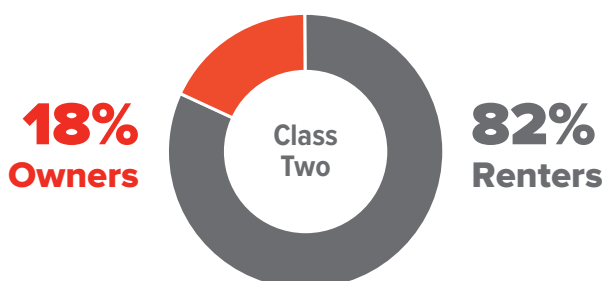
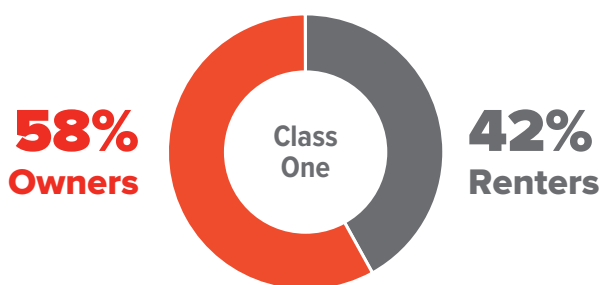
<sup>8</sup> 2017 5-year ACS data. 3 and 4 unit buildings are combined as one category in the ACS, these calculations prorate for their share of the housing stock.

In addition, there are many Class 2 buildings which are fully or heavily tax exempt, including the over 170,000 units owned by the New York City Housing Authority (NYCHA) and hundreds of thousands more of government-sponsored low-income and mixed-income housing developments. Under a system in which a portion of any tax savings is passed along to tenants, the savings to these tenants would necessarily be zero or near-zero. However, tenants of public housing and most other subsidized housing are heavily low-income and would be among the most in need of any form of credit. There is also the issue of overall taxation fairness beyond just the NYC property tax. On a municipal level, New York City has a sales tax, which is a more regressive tax. And on a property-tenure level, even with a reformed New York City property tax system high-income homeowners would still be over-subsidized in the form of federal programs such as the mortgage-interest tax deduction and the property tax deduction.

A universal credit for renters in the case of Class 2 tax burden being lowered – including for renters in Class 1 properties and those living in buildings which do not currently pay property taxes – is something which could ensure some portion of any Class 2 tax relief is passed on to tenants of taxpaying buildings, mitigate any effect on Class 1 renters, and address the issue of non-taxpaying rental buildings being primarily occupied by low-income tenants most in need of relief. A portion of any savings from any Class 2 reform could be put toward this credit, leading to a revenue-neutral scenario.

This would also have the advantage of being simple to implement. The easiest mechanism for this credit would likely be through a refundable income tax credit paid to all full-time residents of New York City who are currently tenants. This could be flat amount for all taxpayers, or preferably be structured progressively according to income.

## Owners and Renters by Tax Class





# Evaluate the impacts of reforms to land valuation or a tax surcharge on vacant land

There are two potential effects of a tax surcharge on vacant land, or institution of a greater tax rate on fully vacant land – the first is to dis-incentivize warehousing of land which could be used for development, and specifically to incentivize the “highest and best use” for a property. The second is to raise additional revenue through this tax. When the theory of land taxation was initially developed the prevailing rationale was to discourage warehousing and stimulate development, and many municipalities (most notably in Pennsylvania) initially instituted it for just that reason. However, current literature suggests economists have moved away from this theory, especially if an increase in land taxes is not accompanied by a decrease in the tax on improvements. This means revenue generation would be the most likely effect of any additional tax on vacant land.<sup>9</sup> We examine both potential effects in the context of New York City vacant land.

## Development Potential

In order to see the possible development effect of a land value tax, we calculated the development potential (under current zoning), of all developable vacant, privately-owned land without a tax exemption in New York City.<sup>10</sup>

### Development potential of vacant privately-owned land by borough

Bronx	46,481,623 SF
Brooklyn	62,740,574 SF
Manhattan	27,427,649 SF
Queens	67,118,307 SF
Staten Island	120,772,735 SF
Total NYC	324,540,888 SF

This 325 million square feet would add approximately 6.5% to the total built area of the city, which is currently slightly less than 5 billion square feet (4,958,731,071 according to the latest available data).

In practicality, the developable square footage on vacant sites is likely larger due to potential rezoning for greater floor area. Balancing that, however, is that the highest allowed floor area is often community facility use, which may be less practical or financially viable than a residential or commercial building with

less floor area, and that a portion of this vacant land, especially on Staten Island which has 37% of the development potential, may be unsuitable physically for development.

## Financial Impact

The total assessed value of this land is \$1,346,972,982, or about .60% of the total \$224,461,259,538 in taxable assessed value in New York City.<sup>11</sup> The total tax paid by this vacant land is approximately 156 million dollars<sup>12</sup> or about .56% of the overall 27.7 billion dollar property tax levy for FY 2018 (and about .17% of the overall 90 billion dollar NYC expense budget).

How much revenue would be raised (or how much development incentivized), would of course be determined by the exact tax on vacant land. The place in the United States with the most municipalities with split-rate taxation is Pennsylvania and, discarding a few outliers, most municipalities in Pennsylvania which have this system tax land at between four and seven times the value of improvements. This would lead to additional revenue of between approximately 468 million and 936 million dollars.

However, this would likely not be expressed as additional revenue to New York City but as a proportional decrease in the property taxes of the rest of the parcels in New York City. This is both because of New York City’s 2.5% constitutional tax cap,<sup>13</sup> and because of the revenue-neutral nature of the reform proposals for the tax system.

This decrease would range from 1.7% to 3.4% in this scenario. This would necessarily be a starting point, and would decline if more development was encouraged by this vacant land tax, leading to less vacant land paying this additional charge.

## Beyond Fully Vacant Land

Because of this lack of truly vacant land in NYC, in order to be highly impactful instituting a land value tax would necessarily need to be graduated to include not just vacant land which is developable but also some form of additional taxation for underutilized land as well, or the institution of split-rate taxation which taxes the value of the land and the value of the improvements on the land at different rates.

The practicality of this would be extremely complicated, and much more study is needed in order to fully examine possible effects. Even if landmarks and small owner-occupied properties – two obvious examples of likely exemptions to the policy – are not subject to this additional levy, a way would need to be found in which the economic pressure to do teardown/rebuilds result-

9 For a full discussion of the land value tax and its history, see Dye and England’s 2010 Lincoln Institute Policy Focus Report “Assessing the Theory and Practice of Land Value Taxation.”  
10 For developability, we restricted vacant land analyzed to lots of 2000 square feet or more where the maximum development potential was also 2000 square feet or more.

11 For FY 2018  
12 Tax burden is not provided directly by PLUTO data, however some classifications of vacant land are treated as Class 1 property for property tax purposes, and others as Class 4. By applying the relevant Class 1 or Class 4 tax rate to the assessed valuation a total tax burden of \$155,820,821 was calculated.  
13 New York City may not levy more than 2.5% of the five-year average of the total taxable value of all the property in the city to finance City Operations (with some small exceptions). In FY 2017 the City levied 99.7% of this cap, leaving only 74.2 million additionally dollars which could have constitutionally been levied in property taxes.

ing in the highest and best economic use of a parcel is balanced against other public interests, such as small business retention and avoiding the displacement of current tenants.

Another consideration is that development in New York City is often encouraged by City-sponsored rezonings which increase the allowed development on a given site. With any sort of land value tax, these rezoning actions would necessarily increase property taxes (if land valuation reflects its development capacity), likely leading to opposition to these rezonings from owners who do not intent to sell or develop their land.

### Transferable Development Rights

As mentioned, split-rate taxation should lead to one of two things: either additional revenue from underutilized land, or incentivizing the development of land to its highest and best use. However, in New York City a third possibility also exists. Development rights are able to be sold to adjacent lots. These sales would have the result of lowering the land value of the parcel, as it would no longer be able to be developed itself, and as such lowering the tax bill as well.

One interesting example is Katz's Delicatessen, a one story, non-landmarked property on the Lower East Side of Manhattan zoned C6-2A, and under current zoning is underbuilt by almost 40,000 square feet, over six times the size of the existing building. Under a land-value tax, Katz's would have faced a huge increase in its prop-

erty tax bill when the market on the Lower East Side started to rise significantly in the late 1990s. This would almost certainly have led to its demolition and replacement. As it was, the rising value of the existing building and resulting taxes was already a significant financial pressure for Katz's. However, Katz's was able to sell its development rights to an adjacent parcel for approximately 17 million dollars in 2016, relieving the financial pressure and preserving Katz's in its existing location.

But the opportunity to sell these rights is limited based on the surrounding built environment as well as the market. Without a potential development site on the same tax block (as Katz's had) development rights are not able to be sold,<sup>14</sup> foreclosing this option for some properties but not others. The fact that these opportunities are based on something fully out of the control of an affected landowner – the surrounding built environment and the willingness of surrounding landowners to develop – is a further consideration.

### Determining land values

Even the maximum effect of a land tax for only fully vacant land would not be significantly impactful from either a development or revenue generation perspective, mostly because New York is a heavily built out city with relatively little privately-owned developable vacant land.

But to consider other split-rate taxation with an impact on developed but underbuilt land, the first step must be to examine and provide accurate land values, which would be inclusive of development potential. The NYC Department of Finance does not currently provide a publically available methodology for determining land vs. total assessed valuation. However, for all tax classes property valuation is done according to the parcel as a whole, with the split between land and improvements being determined as a second step. As such, the relative further development potential of already developed sites is likely not taken into account.

### Total assessed land and improvement value by borough, FY 2018.

Borough	Total Assessed Land Value	Total Assessed Total Value	% of all Value which is Land
Bronx	\$4,894,598,473	\$27,451,834,847	17.8%
Brooklyn	\$15,237,826,075	\$59,616,067,617	25.6%
Manhattan	\$51,298,022,826	\$232,963,374,535	22.0%
Queens	\$21,532,501,506	\$64,581,139,936	33.3%
Staten Island	\$4,836,230,022	\$10,979,402,606	44.0%

By taking further development potential into account when calculating land values (even if this doesn't change the current tax structure), the data necessary to look into possibilities for any sort of split-rate taxation for the future would be provided. Even in the case of a land value tax or split-rate taxation not moving forward, this would still be very valuable municipal data.



Photo: Shutterstock.com

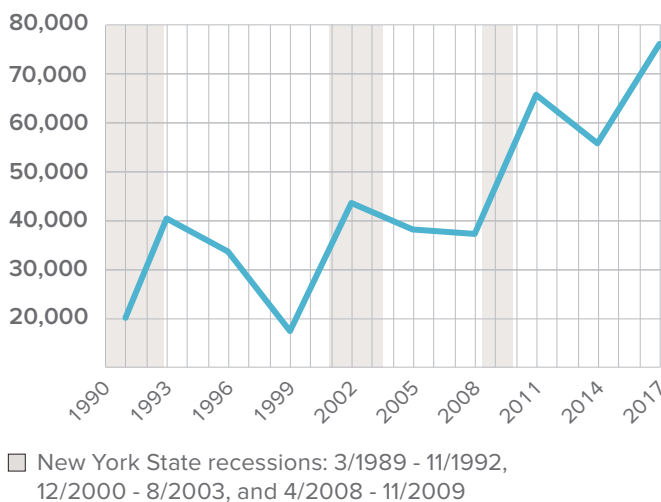
<sup>14</sup> This is absent special circumstances such as landmarks and special districts.

# Institute an additional tax or surcharge on pieds-à-terre and non-primary residences

Like many global businesses and tourism hubs, there is a great deal of property in New York City which is not used as full-time housing but rather as part-time housing for a variety of reasons – pieds-à-terre, summer bungalows, and increasingly short-term rentals on platforms such as Air BnB.<sup>15</sup> This is classified in the New York City Housing and Vacancy Survey (HVS) as being for “Seasonal, Recreational and Occasional” use.<sup>16</sup>

Since 1991, the prevalence of this use has gone up and down. The main pattern that has emerged is that this use generally tracks the economy, with “seasonal, recreational and occasional” use spiking during recessions and declining during economic expansions. From 2014 to 2017, however, this trend was reversed. Despite a strong and growing economy the number of homes reserved for “seasonal, recreational, and occasional” use grew by over 20,000 housing units, although the growth of short-term letting likely accounts for at least some portion of this.

Units held for “seasonal, recreational, and occasional use,” 1991-2017



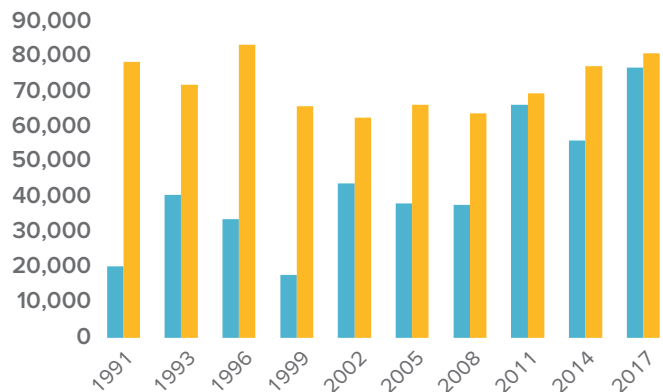
In addition, this increase in “seasonal, recreational, and occasional use” did not track with a corresponding increase in vacant and available rental units, the number of which has remained largely flat over the last 25 years.

<sup>15</sup> This would not encompass resident-occupied houses with occasional short term rentals, but rather housing units with no single primary occupant which are used largely or exclusively for short-term letting.

<sup>16</sup> This is one subcategory of housing units which are vacant, but not available for sale or rent. Other significant subcategories include units which are undergoing or awaiting renovation, units sold or rented but not yet occupied, and units currently in legal dispute.

Units held for “seasonal, recreational, and occasional use” compared to units vacant and available for rent, 1991-2017.

■ Unavailable: Seasonal, Occasional, and Recreational Use  
■ Vacant and Available for Rent



There are two potential advantages to implementing a surcharge on units which are held off the market due to “seasonal, recreational and occasional” use. The first would be as a revenue raising device. Because of the principal of revenue neutrality, like other tax increases the additional revenue would likely not be reflected as an overall addition to the city coffers, but instead as something which would lower property taxes for resident occupied units.<sup>17</sup> However, a non-property tax mechanism such as a surcharge could be used instead. Another possibility is to raise taxes on all units, and then provide an abatement for units with full-time residents. A form of this is already done for the existing cooperative and condominium abatement program, which requires owner-occupancy.

In 2014, the Fiscal Policy Institute estimated that a graduated pied-à-terre surcharge applying to cooperatives and condominiums valued at \$5 million or more would bring in \$665 million annually.<sup>18</sup> On a revenue-neutral basis, this would lower the average property tax bill by 3.1%.<sup>19</sup> The revenue generated would be larger if applied to Class 1 properties (one to three family homes) which are non-primary residences as well. To make this surcharge effective and equitable it is important that it be based on actual market valuation instead of an assessed valuation which could be capped, and that for high-end cooperatives and condominiums the market valuation reflects actual sales prices and not Department of Finance valuation which are often much lower.

The second advantage would be to address New York City’s rental housing emergency. New York City defines a “housing emergency” as one in which the vacancy rate for rental housing is less than 5%, as defined by the number of vacant and available units for rent, divided by this plus all occupied rental units. This leaves units which are vacant but unavailable for rent out of the equation. As of 2017, if another 33,293 units were vacant and

<sup>17</sup> A mechanism to structure any additional surcharge to be outside the property tax system could be explored, which would allow for additional revenue generation.

<sup>18</sup> This proposed tax would range from .5% of sales value for homes valued at 5 million, to 4% of sales value for homes of 25 million or more. For the complete proposal see Parrott, James. “FPI proposed a tax on the most expensive NYC pied-à-terre residential units.” Fiscal Policy Institute, September 22, 2014.

<sup>19</sup> This is calculated from the overall FY 2014 tax levy, the Fiscal Year on which the FPI study is based.





Photo: Shutterstock.com

available for rent, New York’s rental housing emergency would officially be over. This represents just 42% of the 74,945 units currently unavailable due to “seasonal, recreational, and occasional” use, the lowest percentage of any time since at least 1991 and likely in the modern history of New York.

**Percentage of “seasonal, recreational, and occasional” apartments which would need to be added to the rental market in order to eliminate NYCs housing emergency.**

1991	132%
1993	85%
1996	64%
1999	223%
2002	105%
2005	112%
2008	128%
2011	67%
2014	65%
2017	42%



This scenario is also advantageous from a revenue perspective. Any full-time resident use, either by the current owner or any new resident, would also bring in additional income tax revenue for the city. This is especially valuable in the case of high end residences

owned by extremely high-income nonresidents, such as the \$238 million penthouse of 220 Central Park South which was recently sold to hedge fund owner Ken Griffin, a resident of Illinois.

The more this surcharge is restricted to high-value residences, such as in the Fiscal Policy Institute proposal, the likelier it is that owners will simply pay the tax as opposed to putting unit back on the full-time market. However, the proposal itself is a win-win scenario: either revenue is raised through the tax, or a currently vacant and unavailable unit is put back on the market, easing our rental housing emergency. For this reason, the surcharge should be extended to all, or at least a large subset, of “seasonal, recreational and occasional” use homes.

While there has been objections from the representatives of the Real Estate industry to this proposal because it may dampen the market for high-end real estate, the main objection to such a proposal from New York City has not been on the merits, but rather that it would potentially run afoul of a 2015 legal precedent, “Comptroller of the Treasury of Maryland v. Wynne.” However, other legal experts disagree with this, with attorney Alec Schierenbeck writing in a 2018 City and State NY op-ed that the Wynne decision “does nothing of the sort.”<sup>20</sup> With housing construction in New York City expensive and difficult, the ability to add housing supply to the market simply through policy changes, especially changes which also move tax policy overall in a more equitable direction, is low-hanging fruit which should be taken advantage of immediately.

<sup>20</sup> “A pied-à-terre tax is smart policy – and it’s constitutional.” City and State NY, July 4th, 2018.

# Appendix:

# Summary of Residential Property Taxation in New York City

## Timeline

**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.

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.

## 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 technical differences in the tax rules 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.

## 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

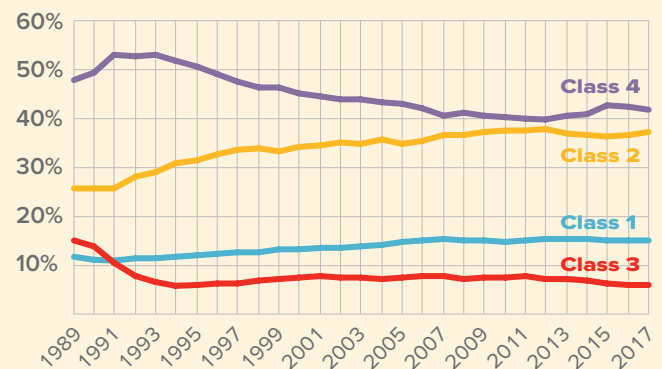
The market value is then used to reach an assessed value. For Class 1 properties, the assessment rate is 6 percent, for the other classes it is 45 percent — though there are notable exceptions. Class 1 properties have a five year cap of 20 percent on assess-

## 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.

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



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

ment 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 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.

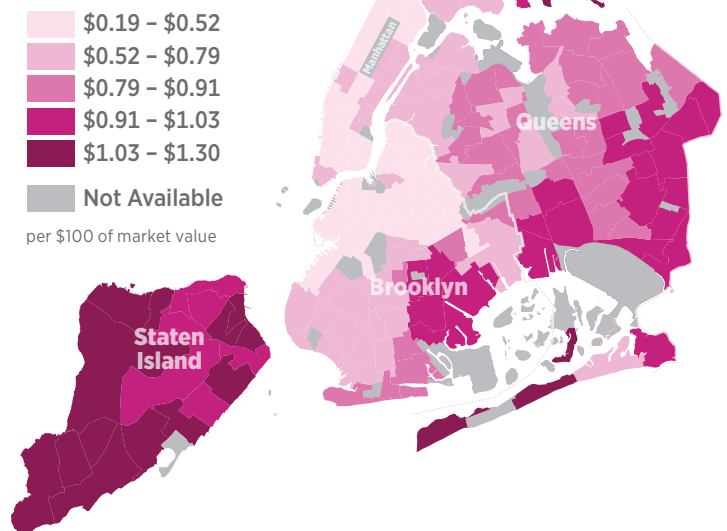
The research that informed this report was carried out in partnership with **Lincoln Institute of Land Policy**.

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**Figure 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.



### 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 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.

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