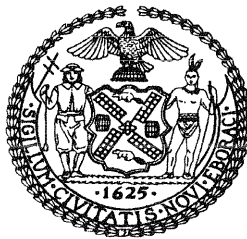


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THE COUNCIL

**REPORT OF THE FINANCE DIVISION
PRESTON NIBLACK, DIRECTOR**

**COMMITTEE ON FINANCE
HONORABLE DOMENIC M. RECCHIA, JR., CHAIR**

May 2, 2011

OVERSIGHT: Property Tax Assessments

I. INTRODUCTION

On Monday, May 2, 2011, the Committee on Finance, chaired by Council Member Domenic M. Recchia, Jr., will conduct an oversight hearing on property tax assessments in New

York City. The purpose of the hearing is to examine the current property tax system and to understand the methodology used by the Department of Finance in determining assessments.

For Fiscal Year 2011, the City is predicted to collect approximately \$16.8 billion from the City's property tax, which accounts for over 40% of the local tax revenues.¹ The City's property tax affects almost every single New York City resident or business – either directly in the form of a tax bill, or indirectly as a portion of rent passed on by the landlord to the tenant. While the property tax is the City's largest and most stable source of revenue, its complexity, lack of transparency, and inequity makes it extremely unpopular with the public.

This year, the Department of Finance ("DOF")², which is the entity charged with assessing real property in New York City, made several changes to the already complex property tax assessment. Three of those changes included:

- Lowering the capitalization rate on Classes 2 and 4, which increases a property's value, thereby increasing its tax bill.
- Switching the value method used on large Class 2 properties and hotels; and
- Using a computer system to determine comparable rental properties, rather than using human assessors.

To fully understand these changes, this report will provide background on the history of the property tax system and its evolution.

II. A Brief History of Property Tax Assessments in New York City

A. Old System

Prior to 1975, localities in New York State, including New York City, routinely assessed

¹ Mayor's Office of Management and Budget, "Financial Plan Fiscal Years 2011-2015," February 18, 2011 p. 2

² See § 11-201 of the New York City Administrative Code.

commercial and industrial property at higher rates than residential property.³ While residential taxpayers paid taxes based on a small fraction of their assessed value, commercial taxpayers, on the other hand, paid taxes on values that resembled market value.⁴ The use of “fractional assessments” by assessors in localities ran contrary to a statutory mandate that all real property in New York State be assessed at full market value and taxed at a uniform rate within a single taxing jurisdiction.⁵

In 1975, in *Matter of Hellerstein v. Assessor of Town Islip*, the New York Court of Appeals found that the Town of Islip’s longstanding practice of assessing residential real property at some fraction of its full or fair market value violated former section 306 of the Real Property Tax Law that required all real property to be assessed at full market value and taxed at a uniform rate.⁶ This decision reverberated throughout the State, forcing localities to comply with State law thereby subjecting all property to the same effective tax rates.⁷ Without an ameliorative legislative response, the Court’s ruling would force an unpopular shift of the property tax burden from commercial to residential taxpayers.⁸ The court acknowledged the “potentially disruptive effects” of its decision and gave the State Legislature a “reasonable” amount of time to comply with State law.⁹

B. Current system

In 1981, after 6 years of fits and starts, public outcry, and political debate, the State Legislature adopted Senate bill, S.7000A, which was intended to significantly reform the

³ See *Matter of John O’Shea v. Board of Assessors of Nassau County et al.*, 8 N.Y.3d 249, 864 (2007)..

⁴ See *id.*

⁵ See former Real Property Tax Law § 306.

⁶ See *Matter of Hellerstein v. Assessor of Town Islip*, 37 N.Y.S. 2d 1 (1975).

⁷ See *id.*

⁸ See *id.*

⁹ See *id.* at 14.

property tax system and end some of the disparity among property owners.¹⁰ Specifically, this legislation would repeal Section 306 of the Real Property Tax Law (RPTL), the provision that required full value assessment, and would add a new section 305 that required “[a]ll real property in each assessing unit shall be assessed at uniform percentage of value (fractional assessment).”¹¹ For New York City and Nassau County, the legislation would create a new Article 18 to the RPTL to allow these “special assessing units” to apply different fractional assessment percentages to each class of property.¹²

The main provisions contained in S.7000A established the framework for the City’s present property tax system. Pursuant to these provisions, DOF and the City Council are subject to classification guidelines, assessment caps, and limits on the ability to shift taxes in and among the four classes of property.

1. Classification

Each parcel of real estate located in the City is categorized by tax class. Pursuant to the newly created Article 18, section 1802 of the Real Property Tax Law established four classes of property for the purposes of taxation.¹³

Class 1 consists primarily of one-, two- and three-family homes.

Class 2 consists of other residential property that is not in Class 1 including rental, cooperative and condominium apartments (but not including motels and hotels).

Class 3 consists of utility property of regulated utilities and holders of franchises, such as cable television providers.

Class 4 consists of real property not designated Class one-three – in general, commercial property.¹⁴

¹⁰ See *Matter of John O’Shea v. Board of Assessors of Nassau County et al.*, 8 N.Y.3d 249, 254 (2007)..

¹¹ See *id.*; see also L. 1981, c. 1057.

¹² See *id.*

¹³ See *id.*

¹⁴ See Real Property Tax Law § 1802(1).

The classification system employed by DOF also contains subsets within each class.

Tax Class 1A = 1-3 Story Condos
Tax Class 1B = Residential Vacant land
Tax Class 1C = 1-3 Unit Condos
Tax Class 1D = Bungalow colonies
Tax Class 2A = Apartments with 4-6 units
Tax Class 2B = Apartments with 7-10 units
Tax Class 2C = Co-ops/Condos with 2-10 units
Tax Class 4A = Utilities-Ceiling Railroads.¹⁵

2. Defining Market Value and Assessed Values

Each year, DOF estimates the value of every taxable property in the city.¹⁶ The determination of value assigned to a property is termed an “assessment,”¹⁷ and is commonly referred to as the “Market Value¹⁸” of the property. Pursuant to section 305 of the Real property Tax law, each class of property must be assessed at the same percentage of full value, which in turn is commonly referred to as the “Assessed Value¹⁹” of the property. To comply with this statute, DOF calculates real property taxes by determining the full “market” value of each parcel, fixing the ratio of full “market” value to “assessed” value in each class, and finally, applying a uniform tax rate for each class of property to the “assessed” value producing the tax due.²⁰

¹⁵ See New York City Budget Office, “Twenty-five Years After S7000A: How Property Tax Burdens Have Shifted in New York City,” December 5, 2006 (“IBO Report”), p.16; *see also* NYC Department of Finance Data Dictionary for the RPAD Master File at <http://www.nyc.gov/html/dof/downloads/tar/tarfieldcodes.pdf> (last visited April 27, 2011). Railroads are subject to special assessment rules that create a ceiling on their maximum assessment. *See* Office of Real Property Tax Services, Determination of Railroad Ceiling, at <http://www.orps.state.ny.us/legal/rules/part200/sub200-6.htm> (last accessed on April 30, 2011).

¹⁶ *See* New York City Charter § 1508.

¹⁷ *See* Real Property Tax Law § 102(2). *See also* New York City Charter § 1506. The term “assessment” shall mean a determination by the assessors of (a) the taxable status of real property as of the taxable status date; and (b) the valuation of real property, including the valuation of exempt real property, and where such property is partially exempt, the valuation of both the taxable and exempt portions.

¹⁸ *See* New York City Department of Finance’s 2010 Annual Report of the New York City Property Tax, at 51

¹⁹ *See id* at 49..

²⁰ *See* 41 Kew Gardens Rd. Associates v. Tyburski, 70 N.Y.2d 325, 330 (1987).

3. Valuation Methods & the Market Value

While state law does not dictate a particular formula for determining a threshold of full value for purpose of city property tax assessment, there are three generally accepted approaches to analyze property data used by appraisers to estimate the property's full market value.²¹ The three methods are (a) the market data or comparable sales approach, (b) the cost approach, and (c) the income capitalization approach.²²

a) Comparable Sale Approach²³

Under the comparable sales approach, the value of a property is determined by using the recent sales of similar properties. This approach develops a value for a particular property by comparing recent similar property sales (comparables) within the same market area and adjusting the comparables for dissimilarities. Appropriate market areas may span across the city. Ideally, the sales are adjusted for dissimilarities, and an indicated value opinion for such property is developed. Theoretically, if the comparable is superior in a specific attribute, a minus adjustment is indicated. If a comparable is inferior in a specific attribute, a plus adjustment is indicated. If the comparable and property are similar in a specific attribute, no adjustment is indicated. DOF uses this approach to value Class 1 residential property and vacant land and is the preferred approach for these properties when sufficient sales data are available.

²¹ See *id.*; see also Office of Real Property Services, Valuation Standards, at <http://www.orps.state.ny.us/ref/pubs/uniformAssmntStd/valuation.htm> (last visited on April 27, 2011).

²² See *id.*

²³ See Office of Real Property Services, Valuation Standards, at <http://www.orps.state.ny.us/ref/pubs/uniformAssmntStd/valuation.htm> (last visited on April 27, 2011).

b) Cost Approach²⁴

Under the Cost Approach, the value of a property is determined by using the depreciated current cost to reconstruct improvements plus land value. The cost approach develops a value estimate by taking the cost of reproducing or replacing the improvements on a property, reducing that cost by any depreciation (physical, functional or economic), and adding the land value of the property. The cost approach is commonly used for new construction, special purpose properties (e.g., religious facilities, museums, schools), and properties with limited sales or income information.

c) Income Capitalization Approach

The last method, the income capitalization approach, is used to determine the market value based on the amount of income that can be generated from renting the property.²⁵ The income approach converts income into value by the application of a rate or a multiplier.²⁶ This approach measures the value of the real estate based on the net rental capacity of the real estate, not the value of the business being conducted.²⁷ This approach is used to assess income-producing properties (as well as coops and condos even though they are not necessarily income producing, as will be explained further in this report).²⁸

²⁴ *See id.*

²⁵ *See id.*

²⁶ *See id.*

²⁷ *See id.*

²⁸ *See id.*

It is important to note that in instances in which a method of valuing rental property may not adequately reflect the property's total value, DOF may use one of the approaches, but adjust it to recognize other factors that necessitate using an additional approach.²⁹

While State law allows DOF discretion in which approach to use to determine fair market value for properties, section 581 of RPTL mandates that coops and condos be valued not as if they were coops or condos, but rather as if they are rental properties. Since DOF uses the income capitalization approach for valuing rental properties, DOF has to impute income and expenses for coops and condos. This is done by determining comparable rental properties to the coop or condo and using those incomes and expenses to estimate the potential income and expense of the coop or condo.³⁰

To determine the income generated by the property, the assessors begin by examining the taxpayer's most recent income and expense statement, provided by the taxpayer. Each year, owners of certain income-producing properties are required to file income and expense information by September 1st so that DOF can use this information to determine the assessment.³¹ If the information is not provided by the taxpayers who are required to file, DOF imposes penalties. The first instance of failure to file is punishable by a fine of up to 3% of the property's assessed value for the current year. Failure to file by a deferred date can result in a

²⁹ See *G.R.F., Inc. v. Board of Assessors*, 41 N.Y.2d 512(1977). In 2005, DOF Commissioner Martha Stark testified before the New York City Council Finance Committee that new construction and alteration of 4 – 10 unit properties are initially calculated using the cost approach to value (in this case, the cost of constructing the property using today's materials), but are then reconciled with a second approach to value as recommended by the International Association of Assessing offices, which in the case of 4 and 5 unit properties is the sales approach, and in 6 – 10 unit properties is the income approach. She emphasized that reconciliation ensures the accurate values. Testimony of Commissioner Martha E. Stark Before the City Council Finance Committee on the Mayor's Preliminary Budget, March 3, 2005.

³⁰ http://www.nyc.gov/html/dof/html/property/property_condo_coop_comp_rental.shtml retrieved April 29, 2011

³¹ See Administrative Code §11-208.1 Not all owner are required to file such statements. For instance, owners of income producing properties who are not required to file include those with assessments under \$80,000, residential properties under 10 units. See 19 R.C.N.Y §33-01

higher penalty of up to 4% of the assessed value; if the required statement is not filed for a second consecutive year, the penalty may reach as high as 5%.³²

As discussed earlier, this approach must be used when determining the assessments on condominium and cooperative apartments. Thus, City assessors will use income and expense statements provided to DOF from the taxpayer, or if not an income-producing unit then the assessment will be based on an estimate of the hypothetical rent that would have been charged for the units if the units were actually rental apartments.³³

Once the income for a property is determined, there are two ways that market value can be derived for Class 2 property. One approach involves the determination of a capitalization rate and the other involves the determination of a gross income multiplier. The main difference between these two methods is that the latter bases value on the gross income of a property while the former uses net income, i.e. gross income minus expenses. Using the capitalization rate, expenses are estimated for a property, then subtracted from the income of the property, and then divided by an estimated rate of return for the owner called a capitalization rate.³⁴ Capitalization rates represent the annual net income stream of a property as a percentage of its value. This rate is inversely proportional to the value of a property; if a capitalization rate declines, then property values will rise.³⁵ With the Gross income multiplier, DOF multiplies the owner's gross income

³² See Administrative Code §11-208.1. In addition to penalties for non-filing, the City's property tax appeals process specifically prohibits the Tax Commission from reducing the assessment if the taxpayer was required to but did not timely file his or her income and expense statements. See Administrative Code §11-216 (b).

³³ In some parts of the City, the suitable comparables are often rent-regulated, and this lowers the imputed income.

³⁴ See Testimony of Commissioner Martha E. Stark Before the City Council Finance Committee on the Mayor's Preliminary Budget, March 4, 2008.

³⁵ An example: A property that produces \$8 in net income a year and costs \$100 would have a cap rate of 8 percent (8 divided by 100 is equal to 8%). Now, let us keep the income the same at \$8, but lower the cap rate in half to 4 percent. This means the new value of the property has to be \$200 (8 divided by 200 is 4%). The quick way to take an income and cap rate to get the formula is to divide the income by cap rate (8 divided by 4% equals 200).

by a multiplier that expresses the relationship between sales price and income. The Gross income multiplier used usually depends on the location within New York City.³⁶

d) Mass Appraisals

Computer-assisted mass appraisal (CAMA) involves the valuing of a group of properties as of a particular date using common data, standardized methods and statistical testing. CAMA was developed in 1992 through a contract with the Cole- Layer-Trumble Company and maintains a database of physical, economic and valuation information for each property and assists DOF assessors in valuing the properties using cost, sales and income methods of valuation.³⁷ The success of CAMA greatly depends on the adequacy of the data used for modeling and effective review and adjustment of modeling output. According to the Office of Real Property Tax Services, CAMA modeling should be utilized where sufficient data is available. DOF used an updated system, CAMA 2, for the first time this year.³⁸

4. Assessment Caps & the Assessed Value

Article 18 sets forth limits on annual assessment increases and this is reflected in the assessed value of a property. Pursuant to section 1805 of RPTL, Class 1 assessment increases due to market conditions are subject to a 6% annual cap and a 20% cap over five years, regardless of the increase in market value.³⁹ These assessment caps were subsequently extended to smaller residential buildings contained in Class 2. These smaller Class 2 properties in Class 2, which are designated on the property tax roll as being 2A, 2B, or 2C subclass, are subject to an

³⁶ Testimony of Commissioner Martha E. Stark Before the City Council Finance Committee on the Mayor's Preliminary Budget, March 3, 2005.

³⁷ See Preliminary Report of the Joint Task Force charged with eliminating corruption in the Real Property Assessment Unit of the New York City Department of Finance (August 2002) at 15.

³⁸ See Office of Real Property Services, Valuation Standards, at <http://www.orps.state.ny.us/ref/pubs/uniformAssmntStd/valuation.htm> (last visited on April 27, 2011).

³⁹ See Real Property Tax Law § 1805(1).

8% annual cap and a 30% cap over five years.⁴⁰ Class 2 (buildings with more than 10 units) and Class 4 have transition assessments which phase in increases and decreases in actual assessments over 5 years, but without caps.⁴¹ Thus, assessment changes resulting from increases or decreases in market conditions must be phased in over 5 years. Consequently, in periods of sharp decline in market values, assessed values may continue to increase because the growth in value is phased in over a period of years. For example, in Fiscal Year 2010, market value growth declined, for the first time since 1995, however, since the changes in market value are phased in over five years, the previous years' increases in market value that resulted from the housing boom are still being reflected in the Fiscal Year 2011 year's assessed values, even as market values fall.⁴²

The assessment limits only apply to increases attributable to sales prices (i.e. market-driven) and not increases due to renovations, demolition or construction.⁴³ With the exception of Class 2C properties, physical changes to a property are not subject to the assessment caps but instead are immediately added to the property's assessed value.⁴⁴

5. Class Share

Each class is responsible for a specific share of the property tax levy, called the class share or class levy.⁴⁵ The class share system was designed to prevent a dramatic shift in the tax burden from commercial to residential taxpayers. The system ensures that each tax class would contribute roughly the same amount as they did in 1981. The shares are adjusted annually to

⁴⁰ See Real Property Tax Law § 1805(2).

⁴¹ See Real Property Tax Law § 1805(3).

⁴² See New York City Department of Finance's 2010 Annual Report of the New York City Property Tax, at ii.

⁴³ See Real Property Tax Law § 1805(3).

⁴⁴ See Real Property Tax Law § 1805(6). The impact of renovations are limited to not greater than one-third of the amount that the increase would have been. This provision effectively reduces the assessment increases from physical improvements for the 1st year to the equivalent of a 15% assessment ratio.

⁴⁵ Each class is responsible for given share of the total tax levy. Baseline shares were based on class shares as of FY82 and then adjusted annually to reflect changes in the roll. Council has the discretion to shift up to 5% (of amend for lower amount) the class's share to other classes.

reflect changes in market value. To avoid large year-to-year shifts in the class shares, State law caps the maximum change in a class' market value share to 5%.⁴⁶ When one class's market share exceeds the 5% cap, the City Council must allocate the excess to the other classes. The City Council has the discretion to lower the cap below 5%, thereby effectively reducing class share increases, if it seeks, and receives, State legislative approval.

The class share system discourages increases in the overall tax rate because the formula ensures the increases will be equally borne by all the classes. While the class share system was established to protect class one from large increases in its share of the real estate levy, following the 18.5% tax increase in 2002, Class 1's shares have increased from 13.6% to more than 14.8% in 2010, while Class 4's share dropped from 44% to 40.1%.⁴⁷

6. Determining the Rate & the Bill

After DOF has completed the assessment rolls, and upon approval of the City budget, the City Council determines the actual levy to be raised from the property tax pursuant to Section 1516 of the New York City Charter. At the same time, the Council fixes the tax rates for each of the four classes based upon the levy to be raised and the class shares. The property owner's bill therefore becomes their Assessed Value (minus any tax exemptions) multiplied by the appropriate Class Tax Rate⁴⁸.

C. Property Tax Appeals

All property owners can file an appeal with the Tax Commission, an independent review board which, if deemed proper, reviews all assessments of real property made by DOF.⁴⁹ There

⁴⁶ See Real Prop. Tax Law § 1803-a.

⁴⁷ See *New York City Department of Finance, Annual Report on the New York City, Fiscal Year 2010*.

⁴⁸ Bills can be reduced by tax abatements. See *New York City Department of Finance, Annual Report on the New York City, Fiscal Year 2010*, page 49.

⁴⁹ See New York City Charter, §§ 153, 1504-A.

are four real property tax assessment-related claims subject to review and corrective action by the Tax Commission:

1. Excessive assessment (claims that an assessment cap has been exceeded or a partial exemption claim);
2. Misclassification (occurs when the assessment roll designates an incorrect tax class for the property);
3. Unequal assessment; (Inequality, the most common claim, compares your assessment to the assessments of all other real property in the same tax class); and
4. Unlawful assessment (covers claims for complete exemption from taxation, that the property is entirely outside the city limits, or that the City lacks authority to assess the property).⁵⁰

Thus, unless the assessment is unlawful the Tax Commission determination can only affirm or lower an original assessment – it cannot result in a higher assessment.⁵¹ The deadline to file an application is March 1st (March 15th for Class 1 owners).⁵²

Moreover, taxpayers who are dissatisfied with the determination of the Tax Commission may appeal by filing a Petition for Review, a lawsuit against the City that taxpayers may file under Title 1 of Article 7 of the New York City Real Property Tax Law.⁵³ Only a person claiming to be aggrieved by an assessment may bring an Article 7 proceeding. This proceeding must be brought within 30 days after the completion and filing of the assessment roll containing the contested assessment.⁵⁴ A property owner bringing such an action need only show that he or she

⁵⁰ See *id.* at § 164-b.

⁵¹ See *id.*

⁵² See *id.* at § 164-b (b)

⁵³ See *id.* at § 165-a.

⁵⁴ See Real Prop. Tax Law §§ 702 and 704.

has filed an application for correction with the Tax Commission. The Tax Commission need not have ruled prior to the Article 7 action.

Lastly, owners of one-, two-, and three-family homes used for residential purposes may appeal a decision of the tax commission through the Small Claims Assessment Review Program (“SCARP”). The assessment must be contested on the grounds of inequality, overvaluation, or improper denial of a partial exemption.⁵⁵

III. Issues with the Current System

This year, DOF made several controversial changes to the way they do assessments on Class 2 and Class 4 properties. The first was a decrease in the capitalization rates used to value these properties. As previously mentioned, capitalization rates are inversely proportional to the value of a property; if a capitalization rate declines, then property values will rise. In the 2012 tentative roll, DOF’s calculations lowered the capitalization rates used to value properties by an average of 90 to 100 basis points, which meant that assuming the same net income, a property’s value would rise about 7% to 10%. The idea that capitalization rates have fallen is not controversial. Rather, the controversy stems from the lack of sufficient data provided by DOF to the public explaining the methods used to determine capitalization rates, and the rationale for employing such methods.

Another change that occurred this year was in the income capitalization approach used in the assessment of larger Class 2 properties⁵⁶ and Hotels in Class 4 from the Gross Income Multiplier to the Net Income Capitalization method. It is generally believed that the net income capitalization approach provides a more accurate estimate of a property’s value as it takes into operating expenses, which may fluctuate from year-to-year and reduce or raise the net income

⁵⁵ See Department of Finance website http://www.nyc.gov/html/dof/html/property/property_val_appeals.shtml (last accessed on April 29, 2011).

⁵⁶ Those with 11 units or more.

realized by property owners. Indeed, this was the method previously used for Class 2 properties.⁵⁷ It is not expected that this had a large overall impact in the valuation of properties, though some particular properties, particularly those with abnormally large or small expenses, may have seen some noticeable shifts due to this change.

Lastly, and what has perhaps caused the greatest controversy stems from DOF's adoption of statistical modeling, CAMA, to choose the comparable rentals from which the incomes of coops and condos are imputed. Previously, the selection of comparables had been done by assessors within guidelines set by DOF. However, for the current tentative roll, the choice of which rentals to use was computerized, albeit with results reviewed by assessors. But according to DOF spokesperson, Owen Stone, "There was a glitch" and errors were made in choosing comparables.⁵⁸ In most cases, the use of CAMA does not appear to have had a large impact. However, in certain areas where few if any truly comparable rental properties exist, such as northeast Queens, many properties saw the comparable rental properties change based on the new model, which in turn spurred extremely large increases in estimated market values.

Between all of these changes, a number of properties have seen very large increases in market values in a period of poor economic conditions. This has provoked a great deal of outrage and confusion over the valuation system. At the time of this writing, DOF is currently reviewing properties with large market value increases and making adjustments where justified, with some adjustments already made.

Additionally, many properties have appealed to the Tax Commission which has the discretion to adjust market valuation they believe to be incorrect. However, as previously

⁵⁷ The Gross Income Multiplier Method was adopted with 2008 tentative roll. *See* Testimony of Commissioner Martha E. Stark Before the City Council Finance Committee on the Mayor's Preliminary Budget, March 4, 2008. Part of the rationale for adoption was that it was a simpler and easier method for property owners to understand.

⁵⁸ Quoted in David Siefman "CO-OOPS – City Goof Over-taxes Homes" New York Post, April 8, 2011 http://www.nypost.com/p/news/local/co_oops_city_goof_overtaxes_homes_J3ePJv7Me0kosPPz11bU5L

mentioned, the deadline for filing appeals was March 1st, thereby leaving many homeowners without recourse this year.

IV. Conclusion

The purpose of the hearing is to shed light on how assessments are conducted in the City by DOF. The DOF Commissioner is expected to testify as well as members of the public.