

Restoring Fairness To NYC's Property Tax System

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Introduction

New York City's property tax system is inherently harmful to renters. Those New Yorkers with the highest tax burden are not wealthy homeowners, but apartment dwellers. Not only is this system morally unjust, but that injustice dramatically reduces the quality of housing for all who live in rental buildings.

This injustice is not by accident, but by design. Our property tax system was designed to entrench the privileged positions of the most fortunate New York property owners. In order to do this, renters, nearly 68% of whom are rent-burdened according to some reports,¹ are forced to bear a disproportionate portion of our tax burden. Indeed, property taxes comprise 43% of the city's revenue.²

Though New York City's system is arcane, the injustice it perpetuates is executed flagrantly. Single-family homes, two and three-family homes, condos, and co-ops all have a significantly lower tax burden than large multifamily rental buildings. The former property types all disproportionately house New York's wealthy and white residents, while the latter disproportionately houses New York's economically disadvantaged.

Rent-stabilized apartments, which represent the bulk of the city's affordable housing stock, are particularly hard-hit. Owners of those apartments lack the ability to raise rents to cover the costs of taxes, so a larger percentage of rent goes towards the property tax bill. The gap between the Rent Guidelines Board (RGB) guideline and the annual tax bill forces funds for maintenance to be diverted to pay for taxes instead. It also places additional pressure to raise rents on market-rate tenants in buildings with significant numbers of rent-stabilized apartments. These problems have become more pronounced as the discrepancy continues to grow.³

Fortunately, there are solutions to alleviate this injustice. For years, legal actions have sought to use the courts to undo New York's discriminatory tax policies.⁴ While we hope these succeed, we do not think the city and state should wait for court orders to act. There are several ways to create a more equitable tax burden for all New Yorkers.

The urgency for policy changes is made more apparent by the desperate financial situation of rent-stabilized housing. Due in large part to an increasing property tax burden, rent-stabilized housing is losing significant value and facing foreclosure.⁵ To alleviate this crisis, legislators must provide both immediate relief to these buildings and longer-term structural changes to reduce the tax burden placed on the rent bill.

1 Moody's (May 16, 2023). "Housing Affordability in the US" <https://www.moody's.com/web/en/us/about/insights/data-stories/us-rental-housing-affordability.html>.

2 NYC Department of Finance. "Tax Bills and Payments." <https://www.nyc.gov/site/finance/taxes/property-bills-and-payments.page>.

3 NYC Department of Finance (May 25, 2023). "2023/24 Final Assessment Roll." https://www.nyc.gov/assets/finance/downloads/pdf/assessments/fy2024_final_roll_summary.pdf.

4 Tax Equity Now. "Lawsuit Filings." <https://taxequitynow.nyc/lawsuit-filings/>.

5 Cavanaugh, Suzannah (September 5, 2023). "Distress in rent-stabilized buildings rises to surface." The Real Deal. <https://therealdeal.com/magazine/national-september-2023/distress-in-rent-stabilized-buildings-rises-to-surface/>.

Historical Background

Traditionally, property taxes in New York State were calculated based on fractional assessment, a system in which taxes were paid on less than the market value of the property. However, in 1975, the New York State Court of Appeals ruled fractional assessment unconstitutional in *Hellerstein v. Islip*.⁶

As a result, the NYS Legislature passed S7000A in 1981, which created a class system to determine property taxes. These classes, which remain today, are as follows:

Class 1: Residential up to three units and condos three stories and under

Class 2: Rentals, Co-ops, and Condos

Class 3: Utilities

Class 4: Commercial and Industrial

Class shares are adjusted based on the value of properties in each class, so since class 1 appreciated so quickly, in 1989 the legislature capped class adjustments due to market value at 5% annually. Therefore, the tax burden began to fall on class 2, angering politically powerful co-op and condo owners. In response, the NYS Legislature passed the 1996 Cooperative and Condominium Property Tax Abatement Program, which significantly reduced taxes for Co-ops and Condos.

Outside of New York City, property taxes continued to increase exponentially, particularly in suburban areas downstate. To counter this, in 2011, the NYS Legislature passed the Property Tax Cap, limiting the increases to taxes levied to no more than 2% or the rate of inflation (whichever is lower).⁷

Since 2011, few major policy changes have been enacted relating to property taxes. This created a system in which most residences in New York State have a property tax cap or major abatement provided, except for predominantly rent-stabilized rental buildings in New York City.

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6 NYU Furman Center (2011). "Distribution of the Burden of New York City's Property Tax." https://furmancenter.org/files/publications/Distribution_of_the_Burden_of_New_York_Citys_Property_Tax_11.pdf.

7 NYS Comptroller. ""Property Tax Cap Summary of the Legislation." <https://www.osc.state.ny.us/files/local-government/property-tax-cap/pdf/legislationsummary.pdf>.



How Taxes are Calculated for Class 2

Before looking at the injustices in our property tax system, and policy options to address them, it is essential to examine the manner in which taxes are determined for class 2 buildings.⁸ Class 2 includes large multifamily rental buildings, as well as co-ops and condos. Yet, it is within the framework of class 2 taxation that the tax burden on those typologies diverges significantly.

The process of calculating property taxes on a class 2 building begins with establishing its market value. The building's market value is determined based on its income producing potential. Larger rental buildings (11+ units) file Real Property Income and Expense (RPIE) statements. RPIEs indicate net income, and then a capitalization rate (expected rate of return) is applied to determine the market value.

Next, the assessed value is determined by multiplying the market value by 45%. Smaller buildings (10 or less units) have their assessment increases capped at 8% per year and 30% over five years. In buildings with 11 or more units, a transitional assessed value is calculated

as well. The transitional assessed value requires that changes in assessed value be phased in at 20% over five years.

Next, personal exemptions are applied including School Tax Relief (STAR), Senior Citizen Homeowners Exemption (SCHE), and Disabled Homeowners Exemption (DHE). They strictly apply to those who own the homes in which they live. There are similar programs for senior and disabled renters of rent-stabilized units, but the income limits significantly restrict their applicability.

Following the instituting of personal exemptions, the taxable value of a building is set. The taxable value is determined to be the assessed value or transitional value, whichever is lower, minus exemptions. The city's tax rate for Class 2 with 11 or more units is then applied to a building's taxable value. Lastly, building exemptions and abatements are applied to determine the final tax bill including the Co-op/Condo tax abatement, J-51, and 421a.

⁸ NYC Department of Finance. NYC Residential Property Taxes Class 2. https://www.nyc.gov/assets/finance/downloads/pdf/brochures/class_2_guide.pdf



Why Rent-Stabilized Buildings Are Unfairly Taxed

There are a few reasons why this method of calculating property taxes produces such an unjust dichotomy in the tax burden:

- The adjustment cap for Class 1 buildings puts pressure on Class 2 buildings to contribute a disproportionate amount to the City's property taxes, since the faster-appreciating market values of Class 1 buildings are not captured in taxes collected.
- Small multifamily rentals (10 units or less) have a property tax cap while larger multifamily rentals do not (11 units or more).
- Class 1 buildings have an assessment ratio (percent of their market value on which they are assessed) of 6%, while Class 2, 3, and 4 buildings have an assessment ratio of 45%.⁹
- There is no property tax cap in New York City, allowing the city to increase taxes overall, particularly harming multifamily rentals due to the adjustment cap.
- Rent-stabilized buildings do not receive a tax abatement unlike the one offered to Co-ops and Condos.
- Additional personal tax exemptions exist specifically for Class 1 and Class 2 (except rentals).
- 421a, the most significant tax exemption for large multifamily rental buildings, does not apply to pre-1974 rent-stabilized apartments, only buildings built since then.

As illustrated above, all residential building types, aside from predominantly rent-stabilized buildings, have major advantages provided to them in the property tax system. This lack of advantages provided to rent-stabilized buildings creates an inherent disadvantage, forcing them to shoulder a disproportionate amount of the city's tax burden.

⁹ NYC Department of Finance. "Determining Your Assessed Value." Accessed 8/3/2023. <https://www.nyc.gov/site/finance/taxes/property-determining-your-assessed-value.page>



Solutions

421A-STYLE TAX BREAK FOR EXISTING AFFORDABLE HOUSING

The crisis facing the financial viability of rent-stabilized housing necessitates immediate relief. In New York City, affordability of new multifamily buildings has been subsidized by 421a over the last few decades. 421a provides owners with a tax exemption which gradually phases out over a period which could last nearly 30 years. In exchange for receiving these benefits, apartments are subject to rent-stabilization.

Yet, rent-stabilized housing built before 1974 (without 421a) does not receive any tax exemption, despite generally having lower rents and higher operating costs than newer buildings. This seems illogical, and it is.

New rent-stabilized housing, which is designed in accordance with modern regulations (therefore, not requiring retrofitting) and can charge market rents, receives a subsidy. However, older rent-stabilized housing, which require major investments to comply with modern regulations and have rents capped at below market rents are taxed at an exorbitant rate and receive no subsidy.

The vast majority of rent-stabilized housing is not receiving 421a or any other tax exemption, creating two tiers within rent-stabilized housing. A comparatively small number of well-designed and financially solvent “affordable” apartments are receiving the 421a tax exemption (117,000 since 2010, including market-rate units),¹⁰ while hundreds of thousands of older and financially struggling apartments are receiving no tax exemption. Though 421a has not been renewed, its legacy of concentrating benefits within a small amount of housing, at the expense of the vast majority of the city’s affordable housing, lives on.

Nevertheless, policymakers can use the example of 421a to address the inequities they created and provide much needed tax relief to rent-stabilized housing by creating a 421a for existing pre-1974 rent-stabilized housing. The program could operate similarly to 421a, with the extent of benefits commensurate with the level of affordability provided by rent-stabilized housing.

A 421a for existing rent-stabilized housing would not need to be constantly renewed like 421a. Rather, it would exist as a bridge to provide essential tax relief as legislators craft a long-term solution to address the inequitable property tax burden facing rent-stabilized housing.

LONG-TERM: NEW PROPERTY CLASS

To find a permanent fix without an endless government subsidy, the best solution is to create a new property tax class for buildings with significant numbers of rent-stabilized apartments. A new property tax class for rent-stabilized housing would enable lawmakers to more effectively craft tax policies to address the unique financial situation these buildings face. It would do so without requiring direct subsidies to counteract the increasing share of the tax burden which falls on rent-stabilized housing.

Logistically, it would require state legislation establishing Property Class 5, with city legislation annually determining the tax rate. This new class would consist of residential buildings with 35% or more of its apartments being rent-stabilized. Such a system would enable the city and state to ensure rent-stabilized housing is sufficiently funded to maintain quality housing for tenants.

Critically, taxable value in this new class would be determined by the revenue collected in a building. This would ensure that buildings are being taxed not on how valuable their property is, but on how much revenue exists to operate the building. Therefore, buildings with low rents in increasingly gentrified areas would not be punished for having rents too low to cover operating costs. This would amount to a massive transfer of wealth to renters, particularly in the outer boroughs, where rent-stabilized rents are often well under \$1,000 per month but market values continue to increase due to gentrification.

¹⁰ Raetz, Hayley and Matthew Murphy (February 2022). The Role of 421-a during a Decade of Market Rate and Affordable Housing Development. NYU Furman Center. https://furmancenter.org/files/publications/The_Role_of_421-a_Final.pdf.

Conclusion

While many wealthy homeowners benefit significantly from the city's property tax system, these benefits come at the expense of renters. No group of renters is more harmed than those who live in buildings with many rent-stabilized units. Over the last few decades, these buildings have had to bear an increasingly large portion of the city's tax burden, while having no legal ability to cover those escalating costs.

Since rents cannot legally be raised to address the unbearable tax burden rent-stabilized housing faces, the property tax system must be reformed to provide relief for renters. In the near-term legislators should create a temporary 421a for rent-stabilized housing to provide immediate relief during an industry-wide financial crisis. This will give them time to craft a more permanent solution by creating a new property tax class for rent-stabilized housing.

The need for relieving the strain of property taxes on rent-stabilized tenants is growing more pressing. Each year, the percentage of the city's tax burden they are forced to bear grows, meaning their homes will have less money for routine maintenance. The longer the city and state wait to act, the more expensive the solution will be.



New York City is in a housing crisis.

New York City's property tax system is inherently harmful to renters. Those New Yorkers with the highest tax burden are not wealthy homeowners, but apartment dwellers. Not only is this system morally unjust, but that injustice dramatically reduces the quality of housing for all who live in rental buildings.

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We must restore fairness to New York's Property Tax System!

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