Tax assessments rising at a faster rate than market values

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On January 15, the New York City Department of Finance (DOF) released the tentative real property assessment roll for fiscal year 2010 which begins on July 1, 2009. In introductory remarks about the roll, finance commissioner Martha Stark said, "Despite a severe downturn in the economy, it has been a mixed year for New York City's real estate market. Overall, the market value of the City's more than one million properties declined slightly, from $811 billion to $801 billion. Home values dropped, but the value of commercial properties grew. The real estate market is weathering this storm, and thanks to the city's competitive advantages as a cultural, financial, and intellectual hub, I am confident that the market will rebound as the economy recovers."

Unfortunately, for commercial owners and tenants the assessed value of commercial property is rising at a greater rate than the market value because of the provisions in the real property tax law.

It is easy to understand how the decline in the value of homes can lower the total market value citywide. Homes (1-3 family dwellings and townhouses), or class 1 properties, account for more than half of the market value of real estate in New York. In comparison, commercial properties (office buildings, stores, hotels, theatres), or class 4 properties, account for less than a quarter of the market value of real estate in the city.

Class 1 property is valued based on sales and these properties have seen prices decline in the last year nearly 5%. Though this drop is nowhere near as steep as home sale price declines in other parts of the country, it was significant enough for this largest of the four real property tax classes to offset the market value rise in classes 3 and 4.

In comparison, class 4 property's market value is based on income. These properties have seen their market value increase 7.12%; assessed value for this class has grown 9.91%. Here is an explanation of how this is possible.

We know that, starting in October, office asking rents have declined rapidly and vacancy rates have risen at an equally quick pace. The tentative assessment roll has not yet captured this changing market and its impact on the value of commercial property. The DOF is using income and expense information from 2007, the last full year of information available when they prepared the roll, to value these properties. As a result, their market value and their assessed value is not a reflection of current market conditions.

In its release, the DOF said that "its capitalization rates and gross income multipliers reflect changes in the market." It also noted that for commercial properties their market values lag when the market is up and lag when the market is down.

For commercial property, state law requires that market value increases be phased-in over 5 years. What we are also seeing with this year's nearly double digit growth in assessments is the phasing in of assessment increases for years when the market value increased more that it did this year.

As a result of the lag and the phase-in, DOF believes it will be a few years before market value

declines will result in assessment declines.

In addition to these anomalies, the real property tax system has a significant structural flaw that imposes an inequitable tax burden on commercial property. State law limits annual assessment increases for individual properties in class 1 to not more than 6% a year and 20% over five years. As a result of these assessment caps, many homes whose value has risen dramatically in the last few years are taxed at increasingly lower ratios of their market value. Commercial property has no such cap. As a result, the assessed value of commercial property reflects over time the full value of the market increases and ultimately carries a disproportionate share of the real property tax burden relative to its value.

A glaring example of this unfairness is in the disparity between class 1 and class 4. Class 1 with more than 53% of the total value of real estate pays only 15% ($2.17 billion) of the city's $14 billion tax levy. In comparison, class 4 pays 41% ($5.9 billion) of the tax levy, yet its share of value is less than 22%.

Individual commercial property owners feel the impact of this inequity when they see that their property taxes are more than 20% of a building's gross income, approximately $20 to $30 per s/f for class A office space.

Market value changes for individual commercial properties will be higher or lower than the class average depending on the property's location and current condition, but all will be impacted by the lag in income information and the five-year phase-in of assessment increases.

Despite these tax increases hitting properties at the worst time, the DOF should be commended for the transparency and clarity they have introduced into the assessment process. Since 2002, the DOF has made great strides in providing property owners with the income, cap rates and sale price information used to value property. This information has made it easier for owners to understand how the DOF arrived at value and determine the accuracy of their property's tentative assessment.

We have welcomed the openness that the DOF has brought to the assessment process. As we face the economic challenges ahead we need the city to introduce fairness and equity for commercial and residential rental property into the real property tax system.

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