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CITYLAB

Why Billionaires Don't Pay Property Taxes in New York

It's the extreme end game of a tax code that shifts the burden from owners to renters, and from the wealthy to the poor.

KRISTON CAPPS | @kristoncapps | May 11, 2015 | 86 Comments

"Sure, it's got a great view. But have you read these antiquated tax codes that got me a huge break?" (One57)

When a duplex condominium in New York's new One57 supertall tower sold for $100.5 million dollars in January, it shattered all records. This condo is the most expensive single-family residence ever sold in Manhattan. Yet, at the rate that luxe residential towers are coming online in the part of Midtown known as Billionaires Row—consider the $91.5 million sale just last month—even that mondo One57 record may not last for long.

Steamy eight- or nine-figure sales were always the dream of former Mayor Michael Bloomberg. "If we can find a bunch of billionaires around the world to move here, that would be a godsend," then-Mayor Bloomberg told The New York Times back in 2013. "Because that's where the revenue comes to take care of everybody else."

Construction is now underway on Nordstrom Tower, a supertall residential tower designed by Adrian Smith and Gordon Gill, the architects behind the Burj Khalifa. When the building is finished, the Nordstrom Tower will be the tallest residential building in the world. The one-percenters who can afford its lofts will be treated to some of the best views the United States has to offer.

And that's just one of several buildings coming up that caters to the world's wealthiest. So by Bloomberg's logic, Gotham is saved, right? Not quite.

A rendering of the Nordstrom Tower, currently under construction at 217 W. 57th Street. (Adrian Smith + Gordon Gill Architecture)

Thanks to the structure of city and state tax codes, the billionaires buying pieds-à-terre in the sky over Central Park are hardly paying property taxes at all. The values of these new condos are being assessed at just a fraction of what they're worth. And buyers are paying only a fraction of that fraction in property taxes.

This is a pressing issue for at least three reasons. For one thing, the property-tax levy is New York City's single largest source of revenue. The city is leaving money behind by failing to tax the most valuable homes at a rate closer to their market value. Meanwhile, well apart from the ultra-luxury condos, the city is overtaxing apartment buildings, whose renters are struggling the most with affordability. These outcomes go hand in hand.

Second, with every new supertall residential tower in Midtown—each one more architecturally dramatic than the last—the effective property tax rates paid by owners on Billionaires Row stand to fall even lower. While nice condos attract big tax breaks, nice neighborhoods earn long-lasting tax breaks.

The inequitable distribution of property taxes is the reason the rent is too damned high.

Finally, one major tax break behind the explosion of ultra-luxury development is up for debate right now: Next month, state lawmakers must decide whether to abandon or renew the controversial 421-a exemption program, which lowers the billable-assessed value of a property to incentivize real-estate development (and affordable-housing construction). Arguments for and against 421-a are as philosophical as they are financial.

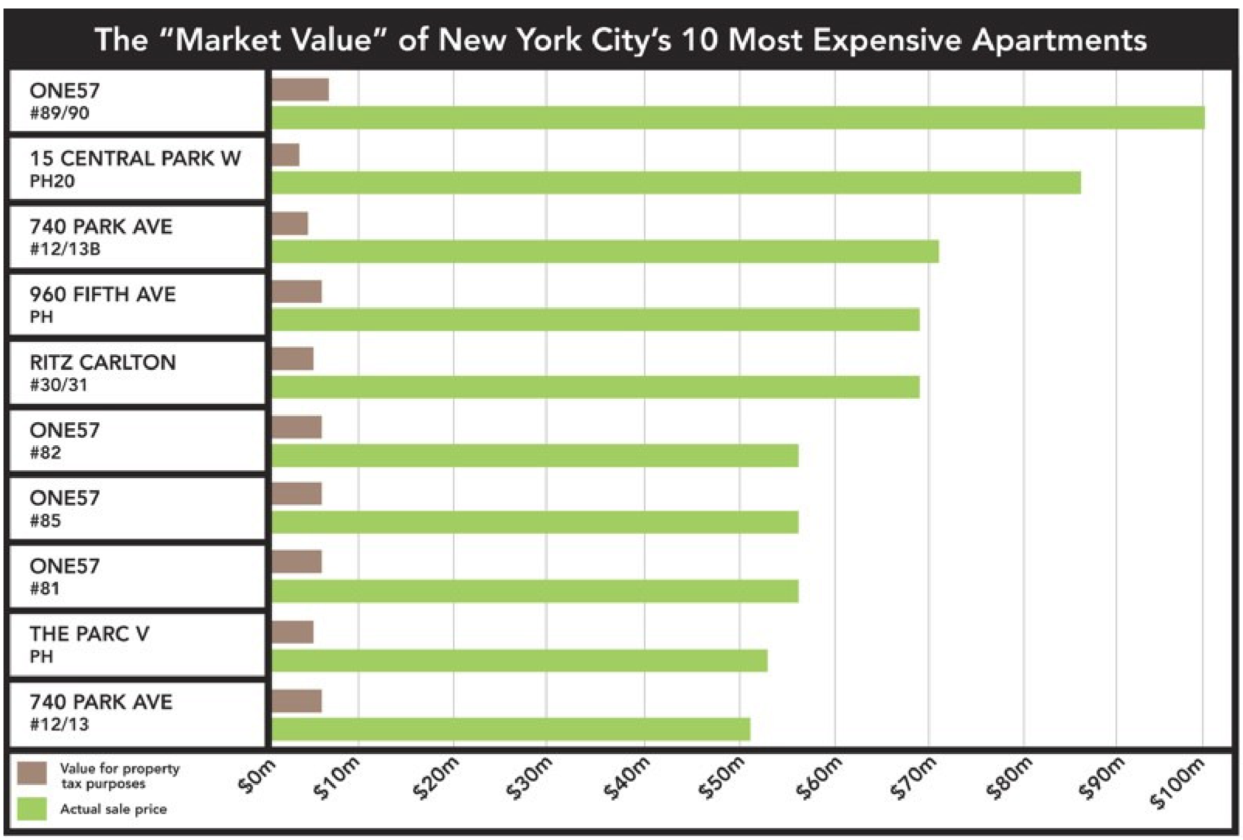
No matter what position the de Blasio administration takes on property-tax breaks in June, it will take more than a tweak in the law to fulfill Bloomberg's vision of redistribution. As it stands, the smallest sliver of New York's wealthiest homeowners pays the tiniest fraction of New York's property taxes.

In NYC, Billionaires Pay 1/100th the Average Property-Tax Rate

The combined 89th and 90th floor penthouse at One57 set the new high-water mark for a single-family residence sale in New York. While the owner paid nine figures for the penthouse, the city only taxed the unit for $17,000 in property taxes. That's an effective property tax rate of 0.017 percent—about one one-hundredth of the average national tax rate.

That One57 penthouse owner didn't just luck out, either. Thanks to abatements, phase-ins, and truly systemic undervaluation, the brightest gems in New York City—and arguably, in the world—are being taxed at the same rate as much lesser homes.

Max Galka, the writer behind Metrocosm and a cofounder of real-estate data site Revaluate, looked at the highest-selling condos in New York to date (minus that $91.5 million sale in April). According to his analysis at Metrocosm, the owner of the One57 penthouse pays property taxes as if the unit were a $3–$6 million condo. The gap between billable-assesed value and market-rate value is similar for all 10 of the top condos. (Three of which are also to be found in One57.)



(Data via Max Galka. Chart by Mark Byrnes/CityLab)

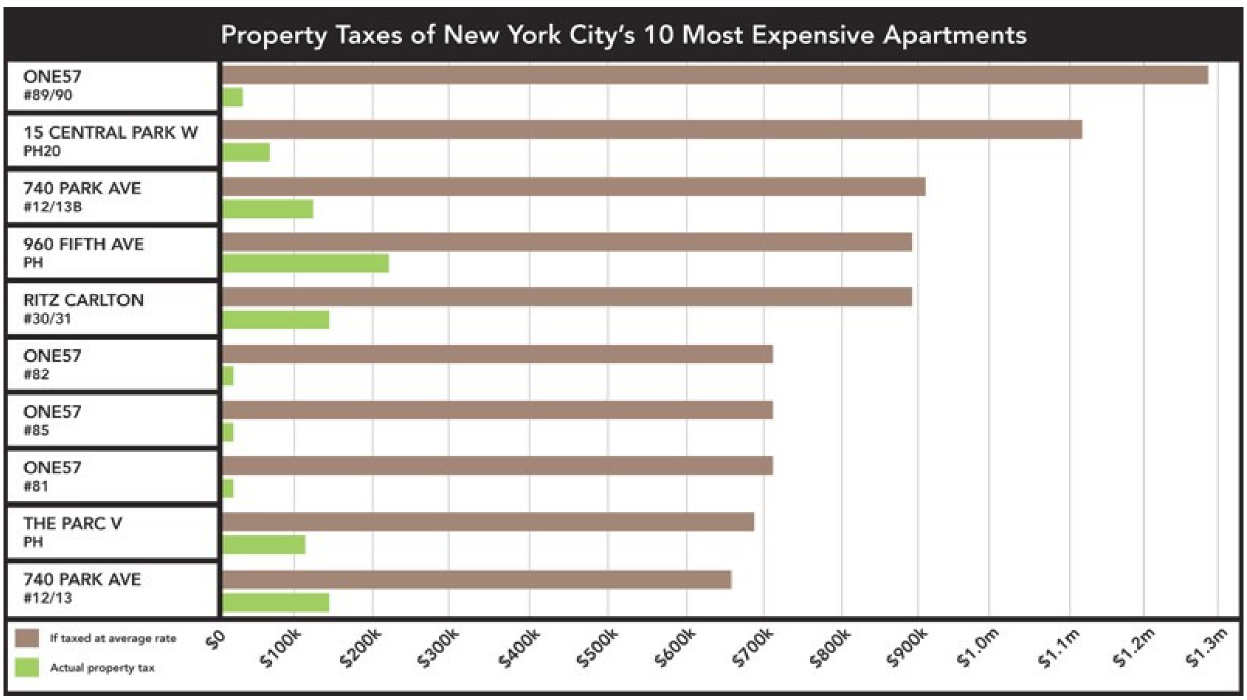
"You might commonly think that the assessed value [of a condo] would be based on the sale price," says Mark Willis, executive director of New York

University's Furman Center for Real Estate and Urban Policy. "In New York, it's not true."

Place matters for property-tax purposes. As a 2013 report by the [Citizens Budget Commission] explains, phase-ins and other mechanisms originally designed to prevent property-tax shocks for homeowners are now a source of "intra-class inequities" across neighborhoods.

"Properties in fast-appreciating neighborhoods end up with lower effective tax rates than identically-valued properties in neighborhoods with more stable prices," the report reads.

Which means that, with Nordstrom Tower going up just a block from One57 (and other supertalls), condo owners on Billionaires Row stand to pay less in property taxes than they would if they owned the same condo in a neighborhood with fewer gee-whiz architectural wonders.



(Data via Max Galka. Chart by Mark Byrnes/CityLab)

What Bloomberg saw as a way to provide for the welfare of New York looks more like one of the firmest expressions of inequality anywhere. And these intra-class inequities are enshrined in state law. There's only so much the de Blasio administration can do about that, but addressing the city's affordability crisis may require him to take a broader stance on property-tax reform.

"Everyone’s waiting to see what the de Blasio administration position on [property taxes] is," says James Parrott, deputy director and chief economist for the Fiscal Policy Institute. "At this point, it’s not clear what proposed changes de Blasio folks will seek, or how Albany will receive them."

Property Taxes for Condos Are Set by Apartment Buildings

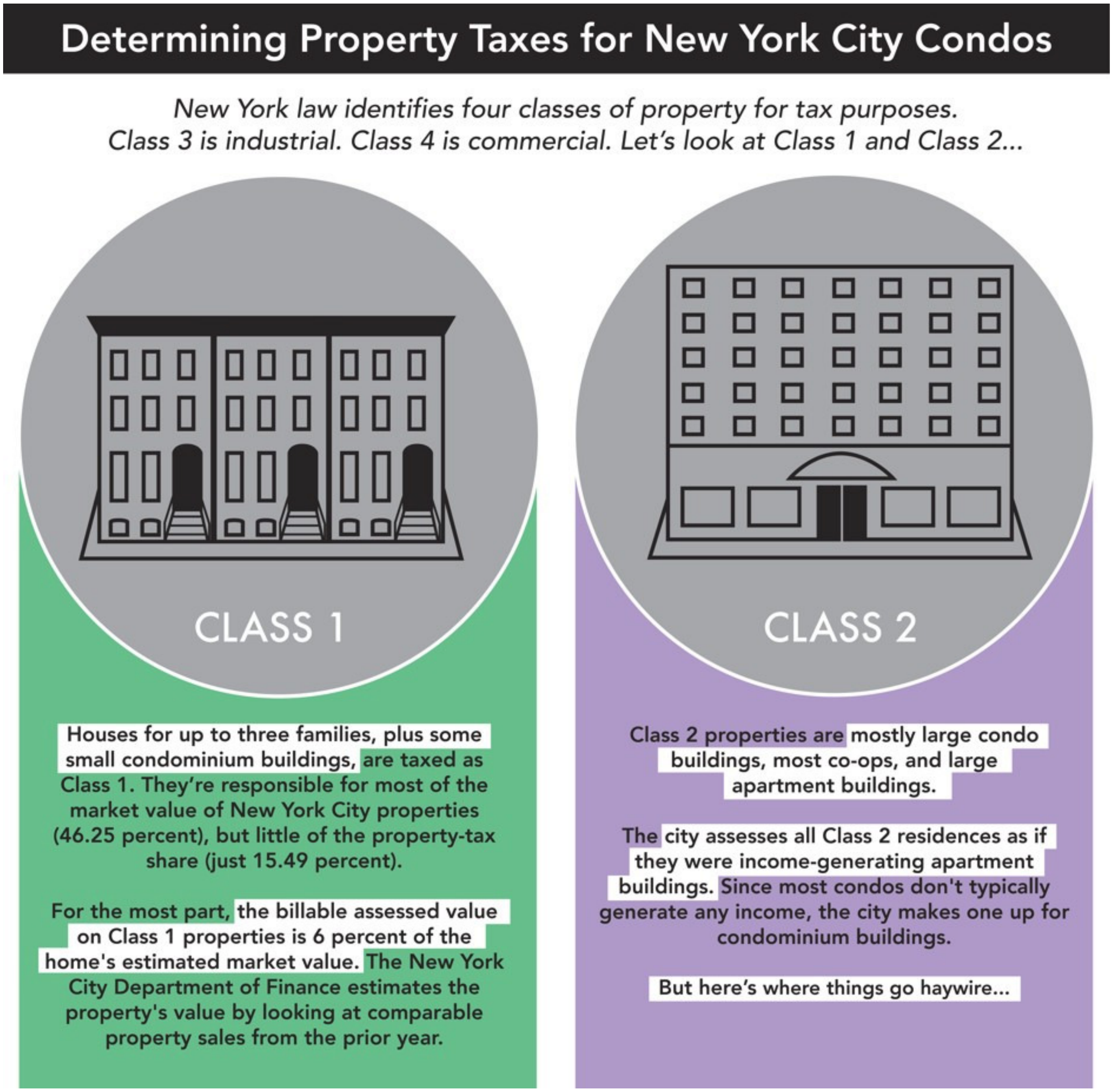
The formula by which New York assesses property taxes is positively byzantine. A 2011 report on tax burden and distribution from the Furman Center for Real Estate & Urban Policy provides a brief history on how it came to be so complicated. It's easy to see why it's outmoded: Changes in state law in 1981 yielded the system that's still in place today.

New York law identifies four classes of property for tax purposes. The law fixes the relative share of property taxes that each class pays into municipal coffers —slices of pie whose proportions are more or less fixed.

Class 1 properties are residential: mostly small homes. Houses for up to three families, plus some small condominium buildings, are taxed as Class 1 properties. Class 1 properties are responsible for most of the market value of New York City properties (46.25 percent), but little of the property-tax share (just 15.49 percent).

Class 3 is industrial. Class 4 is commercial. Class 2 is the focus here: Large condo buildings, most co-ops, and large apartment buildings all fall under this category.

Calculating taxes for Class 1 properties such as brownstones is fairly simple. For the most part, the billable assessed value is 6 percent of the home's estimated market value. The New York City Department of Finance estimates the property's value by looking at comparable property sales from the prior year. Easy-peasy.



(Mark Byrnes/CityLab)

Determining property taxes for Class 2 properties is way weirder. The city assesses all Class 2 residences as if they were income-generating apartment buildings. Since most condos don't typically generate any income, the city makes up income statements for condominium buildings, whole cloth.

Here's the two-step process the city uses for assessing a condo's value:

1. For every condo building in New York, the city identifies a comparable rental building. A condo-comparable rental building means an apartment building with units of a similar number, size, age, location, and so on.
2. Using this rental building's (real) rent roll, the Department of Finance extrapolates an (imaginary) income statement for the condo building. The

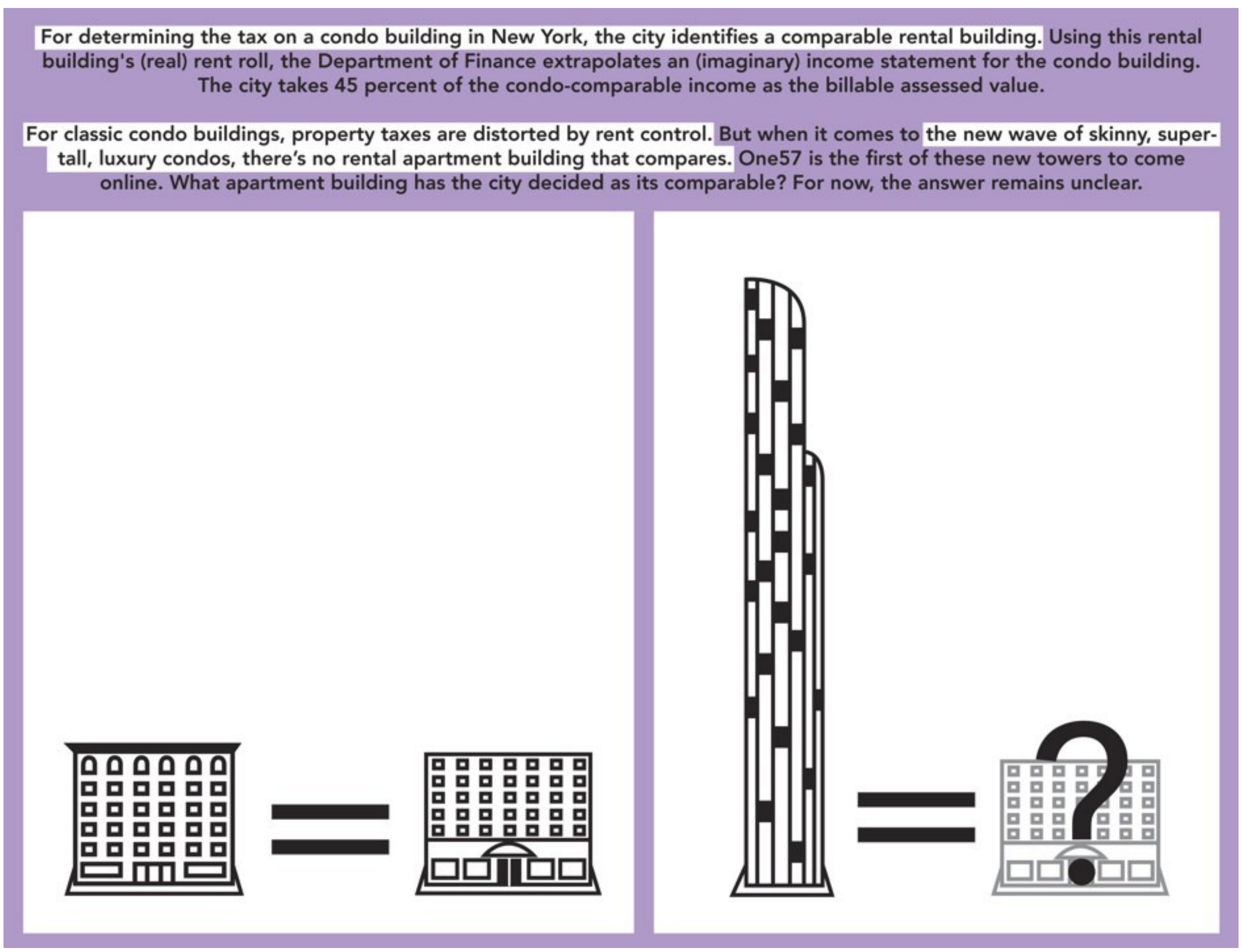
condo board decides the portion allocated to individual units.

The city lists these condo-comparables in this fascinating (but incomplete) database. Then the city takes 45 percent of the condo-comparable income as the billable assessed value. Finally, the city subtracts any exemptions (which reduce the assessed value) and abatements (which reduce the rate-calculated tax bill).

Voilà: the property-tax assessment for a condo.

But You Can't Compare Luxe Condos and Rental Apartments

For two kinds of condos especially, the Class 2 two-step opens up gaping loopholes. The formula simply wasn't designed to anticipate changes in housing more than 30 years after the law was settled.



(Mark Byrnes/CityLab)

For classic condo buildings, property taxes wind up being distorted by rent control. The disparity between the billable-assessed value and the market-rate value for older condos can be severe.

"This process severely undervalues condo or co-op buildings constructed before 1974," the Citizens Budget Commission report reads. "For these properties, the comparable rental buildings chosen by [the Department of Finance] often contain units subject to rent regulation."

For stellar condo buildings—a category that has yet to be wholly accounted for in previous literature on Class 2 property-tax inequity—there simply are no rental apartment buildings that compare for tax purposes.

Look at the tower at 111 W. 57th Street, designed by SHoP Architects. It's unprecedented. It may be the skinniest super-tall tower in the world. And it isn't alone: 432 Park Avenue, designed by Rafael Viñoly, is already an architectural icon. It's the tallest residential tower in the Western Hemisphere (for the time being), and its views are intoxicating.

When the so-called MoMA Tower by Jean Nouvel is finished, the cultural transformation of Midtown and Central Park may be complete. So far, One57, designed by Christian de Portzamparc, a Pritzker Prize–winning architect, is the first in the line. So what apartment building did the city decide on to set the property taxes for its penthouse pied-à-terre?

The answer is unclear. The city's database for condo-comparables doesn't include a listing for the rental building used to draw up the billable-assessed value for One57, or any of the other top-selling condos in the city. (The Department of Finance has not answered a request for this information.)

I'm a Hopelessly Impoverished Renter. Why Should I Care?

Looking back, state lawmakers who passed the bill resetting property taxes for New York couldn't have dreamed of a skyscraper boom almost 35 years later. A recent brief from the State University of New York at New Paltz Center for Research, Regional Education, and Outreach shows that, in fact, in the 1970s, lawmakers were almost certainly looking backward. New York City was struggling.

"The best evidence we have of why it was passed, at least on the political side of things, is a 1982 brief opinion by what is now the State Department of Taxation and Finance," says Geoffrey Propheteer, a property tax analyst for the New York City Independent Budget Office. (Here's that opinion.)

Propheteer says that lawmakers struggled to reconcile what appeared to be two contradictory standards for condos. One standard prohibited using similar condo sales as a system for assessing value (the way the city does for Class 1 homes). "Why they made this decision—no idea," Propheteer says.

The property-tax burden has shifted from owners to renters, and from the wealthier to the poorer.

Another standard set a de facto limit on the assessed value of any individual condo unit: The sum of the assessed values of the condos within a building could not exceed the assessed value of the whole building as a single parcel. So, if there are 50 units in a $50 million building, the cap on assessment for each unit is $1 million, no matter the views, location, or design—full stop.

"That's the letter of the law: 'You must value these things as though they are not these things,'" Propheteer says. "That's the best evidence that currently exists for the legislative intent of the law."

The overarching sentiment behind property-tax reform in the 1970s was understandable: Homeowners were fleeing New York City, and lawmakers at the city and state level had to do something to stop the bleeding.

New York City has since rebounded, of course. And as a result, the property-tax burden has shifted from owners to renters, and from the wealthier to the poorer. The higher taxes assessed for apartment buildings are passed from landlord to tenant. A system of caps, phase-ins, exemptions, and abatements rewards rising neighborhoods and punishes failing ones. The results look like a chapter from Capital in the Twenty-First Century.

FIGURE 9: New York City Local Tax Burden, by Income for a Typical Four-person Household

	Percent of Income			
Income	**Personal income tax**	**Local sales tax**	**Real property tax**	**TOTAL**
$25,000	-0.6%	2.1%	8.8%	10.3%
$50,000	1.8%	1.7%	4.6%	8.1%
$75,000	2.4%	1.5%	3.5%	7.4%
$100,000	2.5%	1.3%	2.9%	6.7%
$250,000	3.1%	0.8%	2.1%	6.0%
$500,000	3.2%	0.7%	2.7%	6.6%
$1,000,000	3.5%	0.6%	2.1%	6.2%
$2,000,000	3.7%	0.5%	1.6%	5.8%
$5,000,000	3.8%	0.4%	1.1%	5.3%

Note: Typical four-person household including two adults and two dependents. Property tax is only for owner-occupied housing, i.e., no assumption is made about the share of property taxes included in rent.

Source: New York State Office of Tax Policy, *New York State Tax Burden Study*, Prepared for the New York State Tax Reform and Fairness Commision, Final Report, Nov. 2013, pg. A-18.

(Fiscal Policy Institute)

A class-action lawsuit filed last year on behalf of renters could bring the whole system crashing down. This might be welcome news for most New Yorkers: The inequitable distribution of property taxes is the reason the rent is too damned high.

Absent a jarring court decision, though, reform may be harder to come by. Parrott has argued explicitly for re-thinking property taxes for co-ops and condos as a way to address affordability and inequity in New York. Fixing the current regime would require the coordinated efforts of Albany and New York City.

Alas, says Parrott. "At this point, there's no appetite for taking on the broad need for property-tax reform."

A June Deadline

The Co-op and Condominium Tax Abatement, a subsidy that's enormously popular with homeowners, will expire in June, absent legislative action. So will the more controversial 421-a exemption, which was launched in 1971 to spur multi-family housing construction.

The central question before Mayor de Blasio and the state is: Did New York already give away the farm?

FIGURE 17: Rise in Private Property Tax Exemptions

share of NYC property tax base that is taxable or tax-exempt *

	1950	1980	2000	2009	2014
Taxable property	73.8%	57.0%	54.9%	58.3%	59.8%
Tax-exempt government property	22.2%	36.1%	33.0%	27.4%	25.7%
Tax-exempt private property	4.0%	6.9%	12.1%	14.3%	14.4%
TOTAL NYC real property	100.0%	100.0%	100.0%	100.0%	100.0%

* Note: Exemptions here do not include property tax abatements; in 2014, abatements were valued at $733 million, of which the largest is the co-op/condo abatement ($412 million).

Source: New York City Dept. of Finance, *Annual Report on the New York City Real Property Tax, FY 2000, 2009, 2014.*

(Fiscal Policy Institute)

"[The 421-a] tax breaks end up subsidizing thousands of luxury residential units," the Fiscal Policy Institute report reads. "The $1.1 billion annual cost of the 421-a tax breaks has soared by over 1100 percent since 1998, more than six times the growth in the City's property tax collections over that 16-year period."

In 1985 and again in 2008, lawmakers took pains to tether 421-a to affordable-housing construction. The success of these efforts is the subject of fierce debate. Since the city does not keep records on the number or location of affordable-housing units built under the 421-a exemption, this debate is usually framed by conjecture.

Serena Li, a graduate student at Columbia University's Center for Urban Real Estate, just completed a thesis that looks at 421-a exemptions borough by borough. Using Department of Finance data, Li discovered that Manhattan accounts for just 6.7 percent of 421-a–exempt buildings across the city. Thousands more were built in the Bronx, Brooklyn, Queens, and Staten Island.

Yet most of the gain accrued to Manhattan, thanks in part to its density. The island accounts for almost 40 percent of all 421-a–exempt units and more than 60 percent of expenditures under the program. Because the 421-a exemption has shifted so much over time, it's hard to say whether mixed-income buildings across Manhattan was ever even the goal—much less the outcome.

> **New Yorkers should complain that billionaires pay too little in taxes, and demand that they pay more.**

"There are certain situations where the real and nominal cost of living in a high-income neighborhood in a mixed-income building doesn't always make sense," says Jesse Keenan, research director at the Center for Urban Real Estate, in an email. "Of course, the counter-argument and policy of mixed-income and economic diversity is a strong one."

The Association for Neighborhood & Housing Development put out a report in January arguing that few of the affordable-housing units created through 421-a are actually affordable. For the defense, the editors of The New York Observer argue that Mayor de Blasio's vision of building 200,000 affordable units is impossible, even naive, absent a legitimate incentive.

Unit 60B of One57. (One57)

One57 is bound to emerge as exhibit A in this debate. Extell Development received a special certificate for One57 that enabled its developers to build affordable housing off-site—no poor door required. New York does not keep public data on where this housing is being built. So it's hard to judge the value of this offsite affordable housing against the tax breaks that One57's billionaire condo owners will enjoy for years.

Even if it were possible to say whether New York got its money's worth, a counterfactual still stands: Would any of it have been built without the subsidy? Propheteer poses this question a different way:

> The 421-a exemption decreases over time. At some point, the building does become taxable. What you want to know is whether or not the levy you've given up during the exemption period is greater or lesser than the present value of the marginal increase in the levy due to the exemption over the building's lifetime. That's a difficult empirical question to answer.

Between the role that 421-a has played in the indictment of former New York State Assembly Speaker Sheldon Silver and the scrutiny it has drawn from the Moreland Commission on public corruption, the era of this particular tax break may be drawing to an end. There is one line of critique that's more damning than corruption: the idea that New York heavily subsidized the construction of luxury condos that the city cannot, by law, effectively tax.

If that criticism turns out to be true—measured, perhaps, by how much it sways the de Blasio administration—then One57 should be renamed the Piketty Tower, as a monument to structural inequality.

Is There Any Hope for Bloomberg's Dream of Soaking These Billionaires (or at Least Taxing Them)?

One all-too-obvious target for reform is replacing the bogus Class 1 and Class 2 property categories with a more intuitive division. Class 1 properties would include homes owned by homeowners: condos, co-ops, brownstones, the whole lot of them. Class 2 properties would include apartment buildings and other rental properties.

Then New York could do away with the caps and phase-ins that set the billable-assessed value for Class 1 homes so far below their market-rate value. In place of so many features designed to prevent property-tax shocks when neighborhood values rise, the city could build in "circuit breakers" to absorb shocks for home-owners who truly can't afford rising property taxes and would be displaced without assistance.

According to the Citizens Budget Commission, the city could raise $1.7 billion in fiscal year 2016, simply by consolidating homeowners into a single tax category and assessing their property taxes based on their true market value. And then—once New York has effectively raised taxes on every homeowner in the city—a pitchfork-wielding mob will drum each and every elected leader in New York City and State government out of office.

Correcting this imbalance is necessary in the long run, but no, restructuring society in a single go is not a winner at the polls. Still, the illogical division between Class 1 and Class 2 properties is an embarrassment. Fixing the flawed classification system—and giving renters a fairer shake—should be a priority for Albany and Gracie Mansion.

Building luxury condos isn't the problem. Subsidizing luxury condos when the city cannot tax those properties fairly is a crisis.

New Yorkers are right to complain that they pay too much in taxes. They do—in part because homes in New York are more valuable than homes in almost any other city in the world. Dwellings are priced high but taxed low for reasons devised in the 1970s, and by means that ultimately distort the value of land in New York City.

New Yorkers are better off in the near term complaining that billionaires pay too little in taxes, and demanding that they pay more. (Millionaires as well, of course: Billionaires are merely a small but extreme tip of the iceberg.) Politically speaking, the optics on raising taxes on billionaires are excellent, if over-reliant on rather nefarious caricatures of Russian oligarchs and Saudi oil barons.

The state has already taken the smart first step of phasing out certain tax breaks for condo owners who don't call New York their primary residence. (Which they do to avoid paying income taxes. Billionaires, man.) There's nothing stopping the state from going further to levy elite properties.

The Fiscal Policy Institute recommends a dedicated pied-à-terre tax: an effective property tax rate of 4 percent applied to the homes of non-primary residents. This tax would be assessed on the true market value of the condo, not on an obscurantist formula. "If this pied-à-terre tax were applied on a graduated basis to the market value above $5 million, it could generate roughly $250 million annually," the recommendation reads.

Building luxury residential condos isn't the problem. Subsidizing luxury residential condos that rise out of reach of the city’s levy is a crisis. Paying for the subsidies by overtaxing renters is a catastrophe. Whatever course the de Blasio administration decides to pursue, it cannot afford to do nothing.

New York City is close to the precipice already. The status quo is one that's captured quite nicely in a line from Withnail & I, a favorite old film: "Free to those that can afford it; very expensive to those that can't."

About the Author

Kriston Capps is a staff writer at CityLab. He writes about housing, architecture, design, and other factors that shape cities. Previously, he was a senior editor at Architect magazine.

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