New York City Independent Budget Office

Focus On:
The Preliminary Budget

April 2021

Assessments & Revenue: Understanding Next Year's Projected Billion Dollar Fall in Property Tax Revenue

While the real property tax (RPT) is normally a steady source of revenue growth for the city, the outlook for the upcoming 2022 fiscal year is quite different. (Unless otherwise noted, years refer to city fiscal years.) Anticipating major declines in rental income for commercial properties and residential apartment buildings as Covid-19 altered how and where people worked, the Department of Finance (DOF) sharply reduced the assessments that will be used for 2022 tax bills. As a result, IBO now forecasts a $1.0 billion decline in RPT revenue from 2021 to 2022.

Revenue. IBO forecasts $30.9 billion in real property tax revenue for 2021, an increase of 4.6 percent ($1.2 billion) from the prior year. Based on the Department of Finance's tentative assessment roll for 2022 released in January 2021, IBO forecasts $29.9 billion in RPT revenue next year, a decrease of 3.3 percent. In the last 25 years, the only other year when property tax revenue declined was in 1998, when revenue decreased by 2.8 percent. The projected decrease in property tax revenue next year is attributable to significant declines anticipated in the market value and assessed value for tax purposes of Class 2 and Class 4 properties due to the Covid-19 pandemic. IBO expects RPT growth to resume after 2022, although at a much slower pace than in recent years, averaging 1.8 percent annually in 2023 through 2025 to reach $31.5 billion. By way of comparison, annual growth in property tax revenue averaged 6.0 percent in 2017 through 2021.

Income and Expense Reports and Property Valuation. Unlike the market values of Class 1 properties (one-, two-, and three-family homes) which are based on sales transactions, the market values of Class 2 (apartment buildings) and Class 4 (commercial) properties are based on estimates of their income and expenses.[1] Values of rental buildings and commercial properties (office, retail, etc.) are derived from annual income and expense statements that owners are required to file with DOF every June, usually for the preceding calendar year.[2] The finance department then uses this information to estimate properties' income and expenses for the current calendar year, which—after applying the appropriate capitalization rates—become the basis for determining market values for the assessment roll used for the upcoming fiscal year.[3] In other words, the market values on the 2022 assessment roll are based on DOF's estimation of income and expense for calendar year 2020 using the filed income and expense reports for calendar year 2019.[4] The market values of coop and condo buildings, which by law must be estimated as if they were income-producing properties, are determined using the net income of comparable rental buildings as a proxy of their income-generating ability.

The significant decrease in the market values on the 2022 tentative roll is mainly due to DOF projecting substantial decreases in Class 2 and Class 4 properties' incomes from calendar year 2019 to 2020—decreases that will affect assessed values and tax bills for 2022 and subsequent years. For elevator rental apartment buildings in Manhattan, the finance department projects a median decrease in buildings' income used for 2021 to the income used for 2022 of 8.1 percent; for similar buildings in the other boroughs, DOF projected a median decline of 6.5 percent in income. Citywide, the declines in median income were larger for office, retail, hotel, warehouse/factory, and garage properties, ranging from -15.5 percent to -31.9 percent. Increases in capitalization rates assigned by DOF also contributed to decreases in market values, though the effect was relatively small.

The finance department had a difficult challenge in estimating 2020 incomes given the pandemic's effect on commercial property markets. DOF has acknowledged that it could not employ its usual methodology to adjust the reported calendar year 2019 data to 2020 conditions, in part because it is still not clear how atypical 2020 was for the income of commercial landlords. For example, we do not yet know how many office tenants continued to pay rent even as many of them shifted to remote work arrangements, but given that office tenants were largely able to sustain their businesses despite the disruptions, it is possible that many also continued to pay their rent.

On the other hand, with the sharp drop in earnings in the retail and leisure and hospitality sectors, it is quite likely that landlords of retail, restaurant, and hotel space saw major declines in income, although the size of the decline is not yet known. Available data also show that retail and office vacancies grew as newly vacated space languished on the market, which is likely to dampen future market value growth. Regardless of whether the finance department's income projections prove correct, once the assessment roll is finalized in late May, the resulting market values and assessed values are not subject to revision for 2022, even if different information about the commercial property market becomes available.

The table on the right presents the finance department's estimates of the median change in income, expense, cap rates, and market values for office, retail, and hotel properties from 2021 to 2022. For each category of property, projected declines in net operating income were driven primarily by projected decreases in income rather than increases in expenses. Manhattan retail properties, which make up a relatively large portion of commercial spaces, had their median income decreased by 24.8 percent and their cap rate increased by 3.9 percent, leading to a decline in median market value of 29.9 percent. While the number of hotel properties is small compared with the total number of Class 4 properties, hotels were one of the Class 4 properties that were hit the hardest by the pandemic. The median change in net operating income for Manhattan hotels was -30.1 percent, leading to a median decrease of 30.9 percent in market values.

Median Percentage Changes in Valuation Variables From Fiscal Year 2021 to Fiscal Year 2022

Property Type	Borough	Valuation Variables	Fiscal Year 2022 Over Fiscal Year 2021 Median Percentage Change
Office	Manhattan	Income	(18.0%)
		Expense	2.5%
		Net Operating Income	(24.2%)
		Base Cap Rate	2.3%
		Full Market Value	(25.4%)
	Other Boroughs	Income	(15.9%)
		Expense	2.2%
		Net Operating Income	(19.7%)
		Base Cap Rate	2.0%
		Full Market Value	(20.7%)
Retail	Manhattan	Income	(24.8%)
		Expense	2.2%
		Net Operating Income	(27.7%)
		Base Cap Rate	3.9%
		Full Market Value	(29.9%)
	Other Boroughs	Income	(17.6%)
		Expense	2.2%
		Net Operating Income	(21.3%)
		Base Cap Rate	3.0%
		Full Market Value	(23.2%)
Hotel	Manhattan	Income	(31.9%)
		Expense	(31.5%)
		Net Operating Income	(30.1%)
		Base Cap Rate	1.0%
		Full Market Value	(30.9%)
	Other Boroughs	Income	(30.1%)
		Expense	(34.1%)
		Net Operating Income	(30.1%)
		Base Cap Rate	0.7%
		Full Market Value	(27.0%)

SOURCE: Department of Finance Fiscal Year 2022 and Fiscal Year 2021 Notice of Property Value Data

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Market Values. Market values for New York City properties increased at a brisk pace over the last five years. From 2017 through 2021, the total market value for all properties—including existing properties as well as newly constructed properties coming onto the tax rolls—increased at an average rate of 6.4 percent per year. The growth rate was highest for Class 2 and Class 1 properties during this period, which increased an average of 7.9 percent and 7.3 percent annually, respectively. On the tentative 2022 assessment roll, however, total market value decreased by 5.2 percent. After a period for appeals and review, the final roll for 2022 will be released in May 2021.

Based on historical trends, IBO anticipates the final roll will show a 5.5 percent decrease in total market values, which would be only the third such decline in the last 25 years and a much larger decrease than the two previous instances.[5] The decrease would be most severe for Class 2 and Class 4 properties, which we project to decline by 8.3 percent and 17.3 percent, respectively. Despite the pandemic, the median price of Class 1 properties sold in the city increased by 4.5 percent during calendar year 2020 and IBO projects that the total market value of Class 1 properties will increase by 0.7 percent.

Assessed Value for Tax Purposes. Because features of the state's property tax law create lags between market value changes and changes in assessed value, the decline in total assessed value for tax purposes was somewhat smaller than the decline in market value. For 2022, IBO forecasts that total assessed value for tax purposes will shrink by 4.8 percent, from $271.2 billion to $258.7 billion. This would be the first decrease in total assessed value for tax purposes in the last 25 years. While we project that total assessed value in Class 1 will increase by 4.9 percent, we expect assessed values of Class 2 and Class 4 properties to decrease by 1.5 percent and 11.1 percent, respectively. In the last 25 years, the only other year in which Class 4 assessed values declined was 1998, and Class 2 assessed values have never fallen over the period.

In most cases, changes in assessed values in Class 2 and Class 4 are phased in over five years. Only one-fifth of the change in assessed value in any one year enters into the calculation of billable assessed value—the value used for tax purposes—in that same year, and another fifth enters into the calculations of billable assessed value for each of the four subsequent years. Looked at from a different perspective, the change in billable assessed value for tax purposes in any one year is the sum of one-fifth of the change in assessed value that year, plus one-fifth of the change in assessed value of the year before, plus one-fifth of the assessed value change two years before, etc. This feature of the property tax system makes property tax revenue less immediately sensitive to business cycle shocks, spreading the revenue effect of a shock over several future years. When the economy is booming, it also allows the property owner to defer paying some of the tax on the full increase in their property's value in a given year.

The assessed value changes from the preceding four years that have yet to be recognized on the tax roll form a pipeline of assessment changes that can result in higher assessments, even when current market values are stable or declining. The strong growth in market values over recent years has led to a robust buildup of the pipeline of prior assessment increases waiting to be phased in. However, the steep reductions projected by DOF in the market values of Class 2 and Class 4 properties for 2022 have wiped out the entire pipeline. For 2022, the pipeline now has $19.4 billion of assessment reductions to be factored into assessed value for tax purposes over the next four years, dampening the growth of property tax revenue over the next few years. It also means the city could lose some of the tax revenue growth from prior assessment increases that was deferred in the pipeline. With IBO projecting an average growth rate of 4.1 percent in market values for Class 2 and Class 4 properties from 2022 through 2025, we expect the pipeline to remain negative until 2025, when assessment increases to be factored in will outweigh assessment reductions by $6.0 billion.

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Endnotes

[1]Properties of utility companies make up Class 3, which is far smaller than the other classes.
[2]See https://www1.nyc.gov/site/finance/taxes/property-rpie.page for more information.
[3]A property's capitalization rate is the expected rate of return on a real estate investment property, and it is measured as the ratio of a property's net income to its estimated market value. Looked at another way, the market value of a property is estimated by dividing its net income by a capitalization rate. All else being equal, an increase in the cap rate results in a lower estimated market value.
[4]Income and expense statements for calendar year 2020 will be filed in June 2021.
[5]In 2010 and 2011, there were total market value decreases of 1.9 percent and 0.2 percent, respectively.