The Case for A Cap

Why and How It Can Work in New York

EMPIRE CENTER
FOR NEW YORK STATE POLICY
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EXECUTIVE SUMMARY

A broad, tight cap on local property taxes is a central element of Governor Andrew Cuomo's agenda for making New York State more affordable and competitive. The governor's tax cap has passed in the state Senate with strong bipartisan support. Its fate will ultimately be decided in the state Assembly.

Cuomo has proposed capping the annual growth in local property tax levies outside New York City at a maximum of 2 percent or the rate of inflation, whichever is less. Tax increases above the cap would require supermajority approval – by more than 60 percent of voters in school districts, or two-thirds of the members of governing bodies of counties, cities, towns, villages and special districts. The governor's bill also would institute a new requirement for simple-majority voter approval of *any* school tax increase below the cap. Cuomo's cap would be more restrictive than those proposed by former Governors George Pataki and David Paterson.

This report analyzes the tax cap proposal in light of previous efforts to limit property taxes in New York and other states. It presents these findings:

- New York's local property tax levels are exceptionally high by national standards and have grown by more than double the inflation rate over the past decade, justifying the governor's push to limit future growth.
- The most significant previous attempt to limit property taxes in New York, the state-subsidized School Tax Relief (STAR) program, acknowledged the problem but did not fix it. The STAR experience indicates that attempts to shift the tax burden from homeowners to the statewide tax base will only encourage more of the spending that only drives up taxes in the long run. Proposed alternatives to a property tax cap would share this shortcoming, while also necessitating increases in state taxes.
- Cuomo's proposed cap is modeled after the most successful tax limitation approach tried in other states—Proposition 2½ in Massachusetts. Proposition 2½, which allows for voter overrides, has restrained the growth of the tax burden without compromising essential public services. Despite the tax limitation, Massachusetts' schools rank among the best in the nation.
- A cap's effectiveness in New York will be compromised if it is amended to allow automatic tax increases for fast-rising employee compensation costs, especially pensions.
- The enactment of Cuomo's cap in New York will further highlight the need for significant mandate relief that gives local governments and school districts the flexibility they need to restructure their budgets, especially rising employee compensation costs. Without mandate relief, some localities and school districts will find it harder to live within the cap without reducing the quality of services.

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INTRODUCTION

New Yorkers have long paid some of the highest real property taxes in the country, with homeowner taxes in most of the state ranging from 30 percent to 178 percent above the national average as a percentage of property values.[1]

Between 1999 and 2009, total property tax levies outside New York City increased by 5.4 percent a year, more than double the average inflation rate of 2.6 percent. School taxes grew the fastest– an average of 6.3 percent a year. Property taxes in New York kept going up even as property values, personal incomes and consumer prices were going down during the severe recession of 2007-09.

A proven model

Keeping a campaign promise and expanding on a proposal first introduced by his predecessors, Governor Andrew Cuomo is pushing to cap school district and local government property taxes in all areas of the state (except New York City, which is subject to its own arcane tax limitations). Cuomo's tax cap bill has passed in the state Senate with strong bipartisan support, by a margin of 45-17. Its fate will ultimately be decided in the state Assembly.

The proposed New York cap (see Table 1 on the following page) is modeled on Proposition 2½, a property tax limitation adopted in 1980 by the voters of Massachusetts. Under Proposition 2½, the state and local tax burden in Massachusetts has decreased, without harming public services. In fact, despite the constraints imposed on school spending by Proposition 2½, public schools in Massachusetts generally rank among the best in the country.

Like the Massachusetts law, Cuomo's cap would uniformly apply to the tax "levy" on all types of property. While the Massachusetts limit is 2.5 percent, Cuomo's proposed cap would be 2 percent or the rate of inflation, whichever is less. Counties, cities, towns and villages could exceed the tax cap in a given year if a two-thirds majority of their governing boards approved. A tougher restriction would apply to school districts, which generate over 60 percent of the property taxes outside New York City. Cuomo's bill would eliminate annual voter referendums on proposed school district budgets, replacing them with votes on proposed tax levies.

A supermajority of at least 60 percent of the voters in a school district referendum would be required to approve a tax increase exceeding the cap. An increase below the cap would still require the approval of at least a simple majority of voters. If a district's tax hikes failed to win approval after two referendums, the tax levy would revert to the previous year's level—a zero increase.

Debating the impact

Opponents of the cap – mainly teacher unions and their allies – frequently contend that limits on taxes will have a "devastating" impact in the wake of state aid cuts.[2] But they offer no alternatives, other than policies that would drive taxes even higher on both the state and local level.

These opponents claim the cap would "erode democracy" by making it more difficult to raise taxes above the cap.[3] However, Cuomo's proposal would be *more* democratic than New York's current system, which allows school districts to impose state-mandated minimum budgets — and the tax hikes necessary to pay for them — *without* voter approval.

Local school finance in New York now effectively rests on a baseline assumption of 4 percent "contingency" spending growth (or 120 percent of inflation, whichever is lower). The issue in annual budget referendums is the extent to which districts will be allowed to spend above the minimum level. The tax cap would shift the focus from spending to taxes, forcing school officials to budget on the assumption that there can be *no* increase in the district tax levy without voter approval.

Table 1. Proposed New York Property Tax Cap (S.2706)

What's covered	Annual property tax levies of all counties, cities, towns, villages, school districts and special districts except for New York City
Allowable tax levy growth	Lesser of 2% per year or rate of inflation* but no less than zero
Exceptions	*For all local governments and school districts:* • Taxes necessary to support capital expenditures on voter-approved projects *For counties only:* • Taxes attributable to any increase or decrease in cost of the county share of direct cash assistance to welfare recipients *For counties, cities, towns, villages and special districts:* • Approved legal settlement of tort action exceeding 10% of prior-year tax levy • Cost of responsibilities shifted to the taxing jurisdiction from another local government
Override provisions	*For counties, cities, towns, villages and special districts:* • Cap can be exceeded in a single year with approval of at least two-thirds of the members of the governing body (e.g., County Legislature, City Council, Town Board). *For school districts:* • Tax levy above cap must be approved by >60% of voters. • Tax levy within cap must be approved by >50% of voters.
Impact on budget process	*For counties, cities, towns, villages and special districts:* • Governing bodies will continue to vote on budgets, with expenditures subject to tax cap limitations. *For school districts:* • Budgets approved by school boards will no longer need voter approval, but tax levy will be frozen at prior year level if increase fails to win approval in two submissions to voters.
"Carryover" allowance	Unused tax levy capacity of up to 1.5% from one year may be used in the following year; e.g., if the cap is 2% in two consecutive years, and the levy increases 0.5% in the first year, the cap in the second year becomes 3.5%.

* Defined as the average monthly national Consumer Price Index calculated by the U.S. Labor Department for the 12-month period ending six months prior to the start of the fiscal year.

Others may argue that the cap is inadequate because it does not slash taxes immediately. However, even small changes in the growth rate of property tax levies could substantially reduce the tax burden over time. For example, if the average annual increase in school taxes alone had been just one percentage point lower in the past 10 years – averaging 5.3 percent instead of 6.3 percent, still double inflation – property owners outside New York City would now be saving nearly $2 billion.

Mandate relief imperative

Local government and school officials understandably are worried about the possible consequences of a tax cap. Faced with a combination of shrinking state aid and mounting costs, especially for employee pensions and benefits, they fear they will have no choice but to cut essential public services.

Thanks to state laws and mandates, many of these costs are difficult for local officials to control in the short term. The answer, however, is not to pass rising costs to property owners, adding to an already overwhelming tax burden.

The cap will bring intense added pressure on state officials to stop ignoring the local consequences of state mandates they impose on local governments, especially those affecting and shaping employee compensation. Local governments and schools have fought these mandates for decades without success, because lawmakers knew that the costs could ultimately be passed on to local taxpayers.

School districts and other local governments must be given greater flexibility to manage their expenses—especially personnel costs, which account for three-quarters of their operating budget. Reform needs to begin with the "Triborough" provision of the Taylor Law, which guarantees continuing pay increases even in the absence of a contract, and with repeal of a provision effectively disallowing changes in retiree benefits unless the same change is negotiated with current employees.[4]

A fair and effective tax cap also requires fair and current property valuations. Therefore, New York should shift to a countywide assessment system based on uniform assessment standards and regular market-value updates.

Blunt instrument

As former Governor David Paterson put it when he introduced New York's first property tax limitation bill in 2008, "All of us understand that the cap is a blunt instrument, but it is needed to force hard choices and to address the fact that New York's local tax burden is the highest in the nation."[5]

As discussed in the following section, the statistics on New York's property tax burden highlight why Cuomo, like Paterson, is arguing that a "blunt instrument" is needed.

1. THE NEED FOR ACTION

National polls have shown that the property tax tends to be the most widely disliked of all taxes, rivaled in unpopularity only by the federal income tax.[6] But New Yorkers have more reason than most Americans to dislike the tax. In most of the Empire State, property taxes aren't just above the national average – they are far above the norm for almost any other state, with the exception of New Jersey.

There are several ways to illustrate the property tax disparity between New York and other states. One is using per-capita comparisons, with and without New York City. The result is shown in Table 2, below. Per-capita property taxes in all of New York State—including taxes on all kinds of property—rank fifth among the 50 states. But when New York City is excluded from the total, the ranking for the rest of New York jumps to fourth highest, 73 percent above the national average.

The impact on homeowners alone can be further illustrated using data from the U.S. Census Bureau's American Community Survey, as further enhanced by the Tax Foundation, a private, non-profit research organization. These comparisons also illuminate the regional differences in the nature of the problem.

Table 2. Per-Capita Property Taxes

States Ranked from Highest to Lowest, 2007-08

1	New Jersey	$2,621	26	Washington	$1,189
2	Connecticut	$2,377	27	Ohio	$1,177
3	Wyoming	$2,364	28	Maryland	$1,168
4	New Hampshire	$2,313	29	North Dakota	$1,154
5	**New York**	**$2,007**	30	Oregon	$1,125
6	Rhode Island	$1,959	31	Indiana	$1,086
7	Vermont	$1,895	32	South Dakota	$1,067
8	Massachusetts	$1,783	33	Georgia	$1,054
9	Illinois	$1,658	34	Arizona	$1,032
10	Florida	$1,642	35	Hawaii	$973
11	Maine	$1,635	36	South Carolina	$955
12	Wisconsin	$1,569	37	Missouri	$920
13	Alaska	$1,553	38	North Carolina	$851
14	California	$1,442	39	Utah	$813
15	Michigan	$1,412	40	Mississippi	$782
16	Nebraska	$1,395	41	Idaho	$773
17	Texas	$1,380	42	Tennessee	$748
18	Virginia	$1,356	43	Delaware	$691
19	Kansas	$1,318	44	West Virginia	$682
20	Minnesota	$1,268	45	Kentucky	$648
21	Iowa	$1,242	46	Louisiana	$638
22	Colorado	$1,242	47	Okalahoma	$580
23	Pennsylvania	$1,236	48	New Mexico	$566
24	Nevada	$1,229	49	Arkansas	$510
25	Montana	$1,214	50	Alabama	$493
U.S. Average		**$1,346**	**NY (Excluding NYC)**		**$2,326**

Source: U.S. Census Bureau

Table 3. Property Taxes on Owner-Occupied Housing

Counties with > 65,000 Residents

County	Median Taxes Paid	U.S. Rank	Percent of Home Value	U.S. Rank	Percent of Income	U.S. Rank
Albany County	$3,760	81	1.75%	122	4.74%	82
Bronx County	$2,412	237	0.61%	652	3.54%	247
Broome County	$2,428	231	2.25%	23	4.53%	101
Cattaraugus County	$1,834	359	2.36%	16	3.83%	192
Cayuga County	$2,486	219	2.41%	12	4.39%	110
Chautauqua County	$2,102	299	2.61%	5	4.26%	129
Chemung County	$2,434	230	2.61%	4	4.41%	108
Clinton County	$2,320	253	1.97%	62	3.97%	170
Dutchess County	$5,118	31	1.65%	142	6.15%	39
Erie County	$3,119	122	2.60%	6	5.04%	65
Jefferson County	$1,996	315	1.55%	166	3.49%	257
Kings County	$2,834	156	0.50%	713	3.70%	215
Madison County	$2,712	179	2.43%	10	4.57%	95
Monroe County	$3,891	71	2.89%	1	5.86%	47
Nassau County	$8,940	2	1.88%	77	8.56%	5
New York County	$4,742	38	0.56%	689	3.66%	223
Niagara County	$2,867	149	2.87%	2	5.17%	59
Oneida County	$2,460	225	2.31%	19	4.36%	119
Onondaga County	$3,156	121	2.50%	7	4.82%	72
Ontario County	$2,927	142	2.14%	33	4.47%	106
Orange County	$5,677	21	1.86%	85	6.37%	30
Oswego County	$2,249	264	2.40%	13	3.85%	187
Putnam County	$7,295	12	1.84%	90	7.81%	9
Queens County	$2,896	143	0.61%	654	3.93%	174
Rensselaer County	$3,749	82	2.09%	43	5.32%	55
Richmond County	$2,966	137	0.66%	612	3.49%	258
Rockland County	$8,542	5	1.84%	89	8.56%	6
Saratoga County	$3,409	105	1.45%	194	4.20%	136
Schenectady County	$3,804	77	2.36%	15	5.80%	48
St. Lawrence County	$1,613	416	2.01%	57	3.08%	348
Steuben County	$2,020	309	2.49%	9	3.99%	165
Suffolk County	$7,361	11	1.81%	102	7.98%	8
Sullivan County	$3,476	99	1.94%	65	6.00%	44
Tompkins County	$3,687	90	2.19%	28	5.40%	53
Ulster County	$4,129	59	1.68%	136	5.97%	45
Warren County	$2,473	223	1.36%	229	4.24%	134
Wayne County	$3,051	129	2.78%	3	5.33%	54
Westchester County	$9,044	1	1.66%	138	8.24%	7

* The figures in this table are for property taxes paid by households on owner-occupied housing. As a result, they exclude property taxes paid by businesses, renters, and others. All data come from the 2009 American Community Survey from the U.S. Census Bureau. This table includes all 792 counties in the United States (excluding Puerto Rico) with populations greater than 65,000 (as of July 1, 2009). There are 3,077 total counties in the United States. Also included are some incorporated cities that belong to no county, but have populations greater than 65,000, most of which are in Virginia. "Median Property Taxes Paid on Homes" is the median real estate tax paid on owner-occupied housing units for that county. The home value statistic used is the median value of owner-occupied housing units for that county. The income statistic used is the median household income for those households that are owner-occupied housing units.

Source: U.S. Census Bureau; Tax Foundation calculations.

As illustrated in Table 3 on page 5, when taxes are measured as an effective rate of market values, 15 of the 20 most heavily taxed counties in the country are located in upstate New York; the effective rates range from more than double to fully triple the median for all large counties. When taxes are considered in absolute terms, five downstate New York counties rank in the top 20; Westchester and Nassau counties had the nation's highest and second highest homeowner property tax burdens, respectively.

The overlooked non-residential component

Homes aren't the only heavily taxed New York State properties. As shown in Table 4 below, taxes on commercial, industrial and apartment properties in the city of Buffalo and the nearby town of Warsaw—chosen as sample communities representative of other urban and rural communities in the state—rank among the highest in the nation. For example, Warsaw's tax burden on a $1 million factory (small by industrial standards) is 35 percent above the average for rural communities.

Table 4. Property Tax Burdens for Sample Communities, 2009

From a 50-State Comparison Study

URBAN AREAS[a]	Tax	Effective Rate	Rank (53)
Homestead Valued at $150,000			
Buffalo, NY	3,636	2.42%	5
Average	1,960	1.36%	-
Apartment Valued at $600,000			
Buffalo, NY	23,437	3.72%	3
Average	10,828	1.72%	-
Commercial Property Valued at $1 million			
Buffalo, NY	39,062	3.26%	4
Average	23,049	1.92%	-
Industrial Property Valued at $1 million			
Buffalo, NY	39,062	1.91%	12
Average	30,974	1.45%	-
RURAL AREAS[b]	**Tax**	**Effective Rate**	**Rank (50)**
Homestead Valued at $150,000			
Warsaw, NY	4,484	2.99%	1
Average	1,852	1.24%	-
Commercial Property Valued at $1 million			
Warsaw, NY	34,260	2.86%	4
Average	19,483	1.62%	-
Industrial Property Valued at $1 million			
Warsaw, NY	34,260	1.67%	11
Average	26,604	1.24%	-

[a] Because New York City and Chicago are in some respects not representative of the typical property tax structures in their states, the cities of Buffalo, NY, and Aurora, IL, were also included. Adding the District of Columbia, there are 53 urban jurisdictions in the "50-state" sample.

[b] Sample rural cities are selected using the rural-urban classification continuum developed by the U.S. Department of Agriculture, and must be county seats with population of 2,500 to 10,000.

Source: Minnesota Taxpayers' Association

Average taxes

School taxes accounted for 61 percent of all property taxes levied in New York as of 2008, and for 59 percent of the average residential property tax bill. There is fairly wide variation in this proportion, from as low as 34 percent in Allegany County to as high as 85 percent in Suffolk County. But school taxes are more than half the average residential tax bill in 42 out of the 58 counties outside New York City.[7]

Heavy property tax burdens strain household budgets and drive up the cost of doing business throughout Long Island, the Hudson Valley and upstate New York. In downstate suburbs, high tax bills put home ownership further out of reach for many young families. In less affluent upstate communities, high tax rates undermine property values and feed a vicious cycle of disinvestment in urban real estate.

STAR: No lasting relief

Initiated by Gov. George Pataki as part of the 1997-98 Executive Budget, STAR finances a partial exemption from school property taxes on owner-occupied homes.[8] The "basic" exemption is set at $30,000 of a home's estimated full value, with no limit on the homeowner's income.[9] Senior citizens with incomes below $79,050 can receive an "enhanced" STAR exemption of $50,000 of full value. Significantly, commercial buildings, rental housing and vacation homes or second homes do not receive a STAR tax break.[10]

For a house valued at $120,000, STAR reduces the taxable assessment to $90,000—effectively cutting the tax that would otherwise apply by 25 percent. The STAR exemption is larger—and the percentage tax break smaller—in areas where home values far exceed the median statewide home price.[11]

The law creating the STAR program included reforms in school budget voting rules and required districts to share more information with the public (in the form of a "Property Tax Report Card") on the impact of their proposed budget changes. But STAR did not require a reduction in school property tax levies. Instead, school districts continue to establish annual tax levies as they did before STAR was created. They receive STAR aid from the state as reimbursement for exemptions granted under the law. The first STAR exemptions became available to senior citizens in 1998 (a statewide election year) and the basic STAR exemption was phased in—at the rate of $10,000 per year—between 1999 and 2001.

Lasting relief proves elusive

In the space of just a few years, STAR emerged as one of the largest single programs in the state budget. Roughly $3.3 billion, or nearly 9 percent of income tax receipts, is now earmarked for STAR, which represented nearly 14 percent of state-funded school aid in fiscal 2010-11.

With a "tax relief" program so big, why are property owners still so unhappy about their property taxes? The answer: growth in total school tax levy accelerated while STAR was being phased in between 1999-2000 and 2001-02. Since then, counting STAR savings through 2007-08, school tax levies have increased an average of nearly

6 percent a year. For the vast majority of homeowners, school taxes are now significantly higher than they were before STAR was enacted.

Owners of commercial and rental properties, which aren't eligible for STAR, have borne the full brunt of the 73 percent increase in school tax levies over the past 10 years.

STAR "relief" = higher spending

By effectively lowering the marginal cost of education to homeowners, STAR made it easier for homeowners to support larger spending increases, and for districts to raise taxes by larger amounts than their voters would otherwise have accepted. Aware of these perverse incentives, Pataki had included a 4 percent growth cap on school property taxes in his original STAR proposal in 1997, but agreed to remove the provision when faced with resistance from the Legislature. The result was a surge in property tax levies during the STAR implementation period.

STAR did little to boost student performance but led to significant increases in spending and taxes, education researchers at Syracuse University have found.[12] Tax increases were "strikingly high" in upstate small districts and cities, where STAR generated the largest percentage tax savings for homeowners, they said.[13]

These findings are consistent with those of another academic researcher who found that STAR had a "statistically and economically significant effect" on spending increases, concentrated in districts where a larger proportion of the tax base consisted of commercial and rental properties.[14]

The 2006-07 state budget added property tax rebates[15] worth a total of $875 million to existing STAR exemptions. The rebate program was expanded to over $1 billion in Governor Eliot Spitzer's first budget in 2007-08, only to be repealed in response to the growing state fiscal crisis in 2009. The primary STAR program survives as a homestead exemption, although the state acted in 2010 to phase out the savings for homeowners with incomes above $500,000.

"A losing game"

STAR in all its forms has been no more than a temporary tax stabilization program—a form of fiscal Novocain whose effects, predictably, wore off after a few years. "In the end, it's a losing game for the taxpayer if the State gives you a rebate check on Monday and then on Tuesday your local government taxes it away," Governor Eliot Spitzer observed in 2008.

Clearly, something more was needed.

Spitzer used his 2008 State of the State address to announce the creation of a Commission on Real Property Tax Relief, which he charged with submitting "a proposal for a fair and effective cap – to hold the line on sky-high school district property taxes once and for all." But what kind of cap would be most "fair and effective" for New York?

2. PROPERTY TAX RELIEF MODELS

Tax caps on local taxes (and debt) are common around the country—including in New York. In fact, the Empire State's first property tax caps date back to 1884. After several updates, Article VIII, Section 10, of the State Constitution limits the taxing power of counties to 1.5 percent of the five-year average full valuation, which can be increased to 2 percent by either a two-thirds vote of the county's legislative body, or a majority vote confirmed in a mandatory referendum. The same provision limits the taxing power of cities and villages to 2 percent of the five-year average full valuation (or 2.5 percent in New York City).

However, in recent decades, these caps have rarely been of any consequence for taxpayers. Only 10 of the state's 675 counties, cities and villages had exceeded 80 percent of their constitutional limits as of fiscal 2011.[16]

Assessment caps and classification in New York

Another approach to limiting taxes for some classes of property owners is incorporated into the tax "classification" system established in New York City in 1981 under a law commonly known by its original legislative bill number, S7000A.

To prevent a shift from commercial properties to homeowners, the law effectively froze the tax share of each type of property at 1981 levels. The law says that assessment increases resulting from market conditions cannot exceed 6 percent in a single year and 20 percent over five years. The result is described by the city's Independent Budget Office:

> Twenty-five years after the enactment of S7000A, dissatisfaction with the city's property tax system is a near-universal complaint among New Yorkers who must pay the tax. The complexity and lack of transparency in the system is part of why everyone feels overburdened. But using IBO's calculations of market values and final tax bills, one basic comparison makes it clear that the burden of paying the property tax is not shared equally: While one-, two-, and three-family homes comprise 41 percent of the market value of property in the city, these homes generate 14 percent of the total property tax levy; commercial property comprises 16 percent of market value and generates 43 percent of the tax levy.[17]

Nassau County is the only other sizeable New York jurisdiction with a classification system of property taxation. In Nassau, as in New York City, the long-range impact of the structure has been to compound inequities that existed when the law was adopted.

Experience in New York and other states indicates that tax schemes designed to protect one class of taxpayers at the expense of others—all in the name of "fairness"—inevitably lead to further disparities and unintended consequences.

In the final analysis, the fairest system is also the simplest, consisting of a single rate for all types of property. In a property tax system based on market value, such as New York's, the academic literature suggests that a tax "is considered equitable if all properties in the taxing jurisdiction are subject to the same effective tax rate. That is,

all properties, regardless of value or type, should be taxed at the same percentage of their market value."[18]

However, a truly fair system also requires an administrative structure that applies well-understood, uniform standards to produce up-to-date estimates of each property's market value—which, in the most populous communities of New York outside New York City, is now rare.

Models from other states

There are three ways to directly limit property taxes—by limiting tax rates, limiting assessments, or limiting levies.

A staff working paper submitted in 2008 to New York's Commission on Real Property Tax Relief noted that levy caps "relevant" to the commission's scope of study were in place in 15 states, and suggested closer consideration of five "peer states": Massachusetts, Illinois, New Jersey, California and Michigan.[19] However, the Illinois and Michigan tax limitations laws are flawed in ways that make them poor models for the Empire State.

The Illinois Property Tax Extension Limitation Law, adopted in 1991, caps increases in local property tax levies at 5 percent a year or the inflation rate, whichever is less. The law was mandatory in Chicago's five "collar counties" but was a local option in the rest of the state; today, it applies in only 39 of Illinois' 102 counties, and it does not apply to "home-rule districts," primarily communities over 25,000 in population. While the law was credited with saving property owners over $207 million in 2000 alone,[20] the overall Illinois tax burden has actually increased since 1991 and property taxes in the state remain well above national averages.[21]

Michigan's biggest recent property tax reform came in 1994 with passage of Proposal A, which replaced $2.5 billion in property taxes with revenue from an increase in the statewide sales tax. The law raised the sales tax rate to 6 percent from a relatively low 4 percent (New York, by contrast, has the highest combined state-local sales tax rates of 8 percent or more, highest in the nation). The law also created a constitutional cap equal to the lesser of 5 percent or the inflation rate on annual increases in assessments based on acquisition values, as opposed to market values. Under Proposal A, further increases in school tax levies are effectively blocked by the requirement that such increases to receive approval from three-quarters of the members of each house of the state Legislature.

Before Proposal A, Michigan imposed above-average property taxes and below-average sales taxes. Afterwards, both taxes were near national average levels relative to income. While property taxes were substantially and permanently reduced, Michigan, like Illinois, has actually experienced an increase in its overall state-local tax burden since its last major property tax reform was adopted.[22]

That leaves two sets of models for the New York commission to consider: California's Proposition 13 and Massachusetts Proposition 2 ½ (recently emulated in New Jersey).

The California Revolution

June 6, 1978, was the high-water mark of a historic nationwide tax revolt. On that day, Proposition 13 was approved by 65 percent of the voters in California, and its political ripple effects were felt across much of the nation for years afterwards.

Prop. 13 tapped into frustrations caused by rapidly rising property taxes, skyrocketing real estate values (and thus assessments) were compounded by the stagflation of the 1970s.[23] Total property taxes in California had jumped from $6.7 billion in 1972 to $11.0 billion in 1978 – a 64 percent increase in just six years – and the California economy was plagued by a state and local tax burden that ranked among the nation's highest.[24] In addition, there were plentiful examples of dramatic disparities in assessments.[25] Under Prop. 13:

- Tax rates were capped at 1% of property values.
- An acquisition-value assessment system was instituted, capping annual assessment increases at no more than 2 percent or the rate of inflation, and limiting reassessments based on market value only after a change of ownership.
- Initial property valuations were rolled back to 1975-76 levels.[26]

The obvious benefits from Prop. 13 were immediate tax relief, and far greater certainty looking ahead regarding property tax payments. The shortcomings of Prop. 13 stem from replacing a system based on current market values (what a property would fetch if sold now) with one based on acquisition values (what the property originally cost its current owner). This creates the ultimate "welcome, stranger" effect, in which newcomers to a community are stuck with a disproportionately large share of the tax bill.

The advantages of a market-based system are twofold: First, the property tax is a very visible tax. That is, taxpayers clearly see the costs of local government services, and can make voting decisions accordingly. Second, there is a clear logic in having a property tax system whereby property of similar values carry similar tax burdens, and that higher value properties have higher tax bills. These benefits are, at the very least, curtailed under Prop. 13.[27]

What was Prop. 13's impact on California's overall tax burden, per capita property taxes, and school spending?

- According to the Tax Foundation, California's state and local tax burden relative to income ranked between 5th and 7th highest among all states during the years from 1970 to 1977, but fell to 25th in the wake of Proposition 13's adoption in 1979. By 2007, however, it had risen back to 12th place. California's total tax burden was 11.2 percent last year—significantly higher than the 1979 level of 9.2 percent.
- In 1977, per capita state and local property taxes in California exceeded the U.S. average by 58 percent, and ranked third highest. In 2005, California's per capita property taxes were 17 percent below the U.S. average, ranking 31st among the states.[28]
- In 1977, California ranked 19th among the states in terms of per pupil school current expenditures, exceeding the U.S. average by just over one percent. In 2005, California ranked 33 among the states in terms of per pupil school current expenditures, and trailed the U.S. average by 11 percent.[29]

Prop. 13 produced the sharpest drop in property tax burdens of any statewide property tax limit in the country over the past 30 years. However, it also created significant economic distortions and inequities, both within the property tax system and in the overall structure of government finances.

Massachusetts: showing the way

The other major landmark in the property tax revolt came in Massachusetts in November 1980. By a 59-41 percent margin, that state's voters passed Proposition 2½. The key provision capped total property taxes in each municipality at 2.5 percent of the full market value of taxable property. Most significantly, the annual growth in each municipality's tax levy was also capped at 2.5 percent.

It's important to note that schools in Massachusetts are funded through municipal budgets, so a single property tax covers all local services. The property tax also is the largest source of revenue for most cities and towns in Massachusetts.

Subject to the 2.5 percent maximum effective rate, which cannot be exceeded, there are three ways in which a municipality can exceed the annual levy cap: taxes generated by "new growth" in taxable properties, permanent or temporary spending overrides approved by a majority of voters, and voter-approved exclusions for capital outlays or debt, which exist for only a fixed period of time.[30] Voters can also be asked to "under-ride" the levy limit, permanently reducing the dollar amount of the levy subject to the cap.[31]

As of 2005, some 3,600 proposed Proposition 2½ overrides involving operating funds had made it to the ballot since 1983, with 40 percent being approved. Capital projects were more popular, with two-thirds of some 3,000 debt exclusions passing.[32] The severe recession did not bring an end to overrides. As *The Boston Globe* reported in June 2009, when economic conditions were nearly at their worst: "In a baffling trend playing out against an abysmal economy, voters have approved property tax increases in at least 11 communities around Boston in recent weeks, reaching into their own pockets to preserve libraries, schools, and public safety services."[33]

Despite the Proposition 2½ limits, it is possible for individual homeowners to experience tax increases of more than 2.5 percent even in the absence of an override. In recent years, tax increases above the cap have been especially common in the roughly one-third of Massachusetts communities, including most urban areas, that have adopted "classification" systems allowing commercial property to be taxed at higher rates than residential property. Because residential values are growing so much faster than commercial values, allowable levy growth has shifted more of the overall burden to homes.

Average increases have been lower in communities that did not choose to tax different types of property at different rates. Yet disparities can still result when one neighborhood has more sales activity than another, leading to higher estimated higher market values within the same town. Homeowners in neighborhoods with more sales and faster rising values end up paying tax increases higher than 2.5 percent; conversely, those whose values are growing more slowly experience much lower tax increases.[34]

Debunking the debunkers

New York's statewide teachers' union has cited "research" claiming that tax caps "erode local control, dismantle strong district programs and penalize the poorest communities."[35]

But the evidence from Massachusetts overwhelmingly contradicts this claim. The Commonwealth has maintained a tradition of strong local control, has expanded its most successful educational programs, and has increased aid to poorer communities over the past 28 years. Based on close study of the Massachusetts tax cap, one research team observed:

> "As expected, Proposition 2½ significantly reduced property taxes, especially during its early years. Yet, the Proposition's effect on total local revenue [was] much smaller than most people had anticipated. Property tax revenue was boosted by new construction that accompanied the booming Massachusetts economy of the mid-1980s. And the strong economy supported a surge in state aid to localities that further reduced the net effect of the Proposition."[36]

Another analyst of Proposition 2½ concluded:

> "Predictions of draconian budget cuts never materialized due to state legislative modification of the initiative's provisions, and judicious use of local voter overrides."[37]

Bang for the buck

As of 2008, Massachusetts schools spent $13,454 per pupil—eighth highest of any state but 28 percent below New York's top-ranking expenditure of $17,173, according to U.S. Census data.[38] Massachusetts appears to get significantly more bang for its education buck. For example:

- In 2009, Massachusetts pupils outscored every other state in the country on three of four NAEP reading and mathematics exams, and tied for first on the fourth. By comparison, New York's national rankings on the same tests were much lower. A composite ranking of state NAEP scores placed Massachusetts first and New York 19th.[39]
- SAT scores for college-bound Massachusetts high school students were well above national averages on the critical reading, mathematics and writing sections of the test in 2010, while the SAT scores of New York's college-bound students were below the national averages in all three categories.[40] The difference couldn't simply be explained a way as a product of different test-taking levels; in fact, the 86 percent SAT participation rate of Massachusetts students was slightly higher than New York's 85 percent.[41]
- A "Quality Counts" ranking of state public school systems by *Education Week*, which gives a heavier weight to relative school spending, assigned a "B" to Massachusetts and New York, although Massachusetts spends considerably less per pupil. Massachusetts topped the *Education Week* K-12 Achievement Index and Chance-for-Success Index.[42]

One key to the success of Proposition 2½ was a significant increase in state aid to local governments and schools—which was also a key goal of the proposition's backers in their effort to build a coalition with municipal and business groups. In 1980, according to U.S. Census Bureau data, state aid accounted for 28 percent of

local revenues in Massachusetts, well below the national average at the time. As of 2005, the state share of Massachusetts local revenue was still 36 percent, slightly above the national average (and also above New York's average of 32 percent).

The pivotal event for school funding in Massachusetts was the passage in 1993 of the Massachusetts Education Reform Act (MERA). The Act's hallmarks were similar to the key goals recent governors have established for New York: holding schools accountable for performance and creating a "foundation" formula for school aid. Under MERA, funding K-12 education doubled, from $1.3 billion in 1993 to $2.6 billion in 2000. Poorer communities spending below foundation-budget levels received more than those already exceeding the threshold. The funding increase was accompanied by a new comprehensive assessment system linked to ambitious learning standards.

All this happened without a significant increase in state taxes. In fact, the current Massachusetts income tax flat rate of 5.3 percent is lower than the rate prevailing for much of the 1980s and '90s, while New York's temporary marginal rate of 8.97 percent is the highest since 1985. In 1980, the combined Massachusetts state-local tax burden was 10.7 percent of resident income, well above the national average and second highest in the country behind New York. As of 2009, the total Massachusetts tax burden was 10 percent and ranked 11th, slightly above the national average of 9.8 percent. New York ranked second (just 0.1 percent below top-ranking New Jersey), with a tax burden a full 2.3 percentage points above the national average.[43]

The bottom line: for all its other problems—including a rate of domestic population loss rivaling New York's in recent years—the Bay State is no longer so deserving of its longtime nickname, "Taxachusetts."[44]

New Jersey

The Garden State has been experimenting with statewide "solutions" to its high local property taxes since the 1970s, when the enactment of New Jersey's first income tax was justified by elected officials on grounds that it would shield property owners from the cost of financing a court-ordered increase in school aid. It didn't exactly work out: today, New Jersey has one of the nation's highest marginal income tax rates—and per-capita property taxes even higher than New York's.

In the 1990s, under Governor Christine Whitman, the state enacted a property tax rebate program known as "New Jersey Saver"—which, like New York's subsequently enacted STAR program, provided temporary relief ultimately swamped by the continuing rise in tax bills. The latest wrinkle in New Jersey's seemingly never-ending property tax relief battles came in 2007, when homeowner rebates and credits were expanded and the New Jersey state sales tax was increased by a percentage point to offset rising property taxes. As part of this deal, the state took steps to limit growth in property tax levies.

Governor Jon Corzine and Democratic majorities in both houses of the New Jersey Legislature agreed in 2007 to impose a Massachusetts-style 4 percent property tax levy cap on school districts, counties and local governments. In order to exceed the cap, school districts and other local governments would need to get approval by 60

percent of the voters. However, the initial New Jersey cap allowed for numerous exclusions, including employee health care cost increases of more than 4 percent.[45]

Republican Chris Christie defeated Corzine in the 2009 gubernatorial election after campaigning on a promise to tighten the local property tax cap. Christie's initial proposal was a constitutional cap of 2.5 percent with none of the exceptions found in the Corzine cap. However, in a compromise with the Legislature, Christie agreed to a 2 percent cap that includes general exceptions for:

- increases in debt service and capital expenditures;
- weather and other "declared" emergencies;
- pension contributions in excess of two percent, and
- health benefit cost increases in excess of 2 percent.[46]

The circuit breaker shift

Some opponents of a cap on property tax levies in New York support an alternative that would directly subsidize property taxes through a state income tax "circuit breaker."

A circuit breaker provides homeowners (and, in some versions, apartment dwellers as well) with a state income tax credit for a portion of their property taxes paid on their homes that exceeds a given percentage of their household income. Relatively few qualify for the state's current circuit breaker, which dates back to the late 1970s and is available only to income tax filers with incomes below $18,000, living in property worth $85,000 or less.

Several proposals for expanding the circuit breaker have been introduced in the Legislature in recent years, including a bill passed by the state Assembly in 2008. One current version, co-sponsored by Assemblywoman Sandra Galef (D-Ossining) and Sen. Elizabeth Little (R-Queensbury) would apply to homeowners with incomes below $250,000 who have lived in their homes for at least five years.[a] The credit would be calculated as 70 percent of the amount by which property taxes exceed a limit depending on income; for example, a downstate homeowner with income of $100,000 and a $9,000 property tax bill would be eligible for a state tax credit of $2,100.

Although the bill sponsors have issued no estimate of its fiscal impact, an independent analysis suggested it would generate about $1.6 billion in tax credits [b] – meaning it would require either a state tax increase or offsetting state budget cuts in the same amount.

The circuit breaker would neither reduce nor restrain the growth in the overall tax burden. Rather, it would shift a portion of the burden from the local property tax base to the statewide tax base. For supporters such as New York State United Teachers (NYSUT), this is obviously a circuit breaker's main virtue. Unlike a local property tax cap, a statewide tax credit would not put pressure on schools to hold down growth in teacher salaries and benefits.

A circuit breaker would also shift more of the upstate property tax burden to downstate New York, which generates a disproportionately large share of state personal and business taxes. If the cost of a circuit breaker was offset by a personal income tax increase alone, a share of local tax bills would also be subsidized by relatively well-paid workers who commute to jobs in New York from New Jersey and Connecticut—where property taxes are also high.

Experience with New York's STAR homestead exemption suggests that a reduction in the perceived local tax burden will promote faster growth in local spending. And a wealth of economic research suggests that higher income tax rates necessary to finance these alternatives would undermine economic growth in the state, ultimately weakening the tax base at every level.

a. The bill is S.137.
b. Fiscal Policy Institute, "Property Taxes in New York: A State Problem Calling for a State Solution," Feb. 11, 2008, at http://www.fiscalpolicy.org/publications2008/FPI_PropertyTax_Feb08.pdf.

Although Christie had proposed retaining the 60 percent threshold for voter overrides of local caps, the final version requires only a simple majority.

Because the new cap excludes fast-rising health and pension costs, New Jersey residents can expect their property taxes to continue rising at well above 2 percent a year, even if they repeatedly reject proposed overrides. However, Christie is also continuing to push for a mandate relief "toolkit" designed to lower local costs, including pension and civil service reforms, and collective bargaining rule changes.[47] One element of the toolkit is already in place: in December 2010, Christie signed a law capping police salary increases at 2 percent in cases where contract disputes go to arbitration.[48]

Cap background in New York

The idea of capping property taxes is not a departure from fiscal tradition in New York; as noted above, the state's constitutional tax caps on counties, cities and villages date back to the late 19th century. Two years before Gov. Pataki proposed his original STAR legislation, including a tax cap, a cap on all local property taxes in the state was proposed by Assembly Speaker Sheldon Silver and passed by the lower house of the Legislature.[49]

The concept was revived in early 2008 by Governor Spitzer, who formed a Commission on Real Property Tax Relief to make specific recommendations for a property tax cap. In June 2008, by which time Spitzer had been succeeded by Governor David Paterson, the Commission called for an annual tax levy cap of 4 percent or 1.2 times the rate of inflation, whichever was less, subject to override by at least 55 percent of voters. That cap[50]—which was very similar to the one inclue din Pataki's original STAR bill—was introduced by Paterson and passed by a Republican-controlled Senate in August 2008, but died in the Assembly.

In 2010, Paterson introduced a new version of the cap, which extended the tax levy limit to all local governments as well as school districts. The bill required voter override of the school tax levy cap but, like the Commission's original recommendation, also preserved the annual school budget voting process and the state-mandated "contingency budget," which school boards can automatically impose if their spending proposals are rejected by voters. For local governments other than school districts, a two-thirds vote of governing bodies would have been empowered to override the cap. This version of the cap[51] was passed by a Democrat-controlled Senate in August 2010, but again died in the Assembly.

Momentum for Cuomo

Spitzer's formation of the Commission on Real Property Tax Relief in early 2008 put the spotlight on a possible property tax cap for the first time since Pataki's abortive proposal to include one in the original STAR bill 10 years earlier. Paterson's repeated efforts to enact a cap kept the issue in the spotlight for most of his tenure.

Cuomo capitalized on this momentum by making a proposed property tax cap the focal point of the campaign agenda he released when nominated as the Democratic candidate for governor in May 2010.[52] As discussed in the following section, Cuomo's cap is the most restrictive and comprehensive yet proposed in New York.

3. THE CAP NEW YORK NEEDS

In formulating his own property tax cap, Cuomo had several models to choose from. New York's STAR program, like property tax rebates in other states, acknowledged the problem of excessive property taxes but failed to fix it—and probably made it worse in the long run. Efforts by some states to control property tax rates or assessments have also been ineffective and inefficient. The nation's most dramatic property tax limitation measure, Proposition 13 in California, significantly reduced taxes but also undermined local governments and schools.

Cuomo, like his predecessors, chose the Massachusetts model, which has been effective at delivering broad restraint in tax growths while providing local voters with the flexibility to target higher taxes when convinced it is needed.

As summarized in Table 1 on page 2, Governor Cuomo's proposed cap is almost as broad as the Massachusetts limit, and in some respects even tighter. Because Massachusetts has a single tax levy, over 50 percent of voters must agree to override the cap for any municipal or school purpose. In New York under Cuomo's cap, approval by more than 60 percent of voters would be required only for an override of the separately levied school tax. The cap on county, city, town, village and special district levies could be overridden by a two-thirds vote of the governing body of a local government.

Proposition 2½ makes an exception for additional property taxes generated by new construction. This exclusion added an average of 2.6 percent a year to increases in local levy limits in Massachusetts between 2000 and 2007, boosting the average annual levy increase from 3.3 percent (including overrides) to 5.9 percent. A similar exclusion was included in the property tax cap first proposed by former Governor Pataki as part of the original STAR program. It was also part of the property tax cap recommended by the Commission on Real Property Tax Relief and supported by former Governor Paterson starting in 2008.

Cuomo's proposal, however, does *not* make any allowance for taxes generated by new construction. This approach would significantly reduce the net growth in taxes—and, in some cases, result in outright tax cuts—for property owners in communities that experience significant development. However, local elected officials also would have less incentive to favor development, since it would add to demand for services without generating additional taxes.

Reforming tax administration

Massachusetts also reformed its property tax administration system, providing for reassessment of all property at market values every three years. By comparison, New York's current patchwork approach to property tax administration is both unfair and inefficient. The reliance on numerous local assessment districts, and the lack of a single assessment standard linked to a regular reassessment cycle, are glaring shortcomings of the system as it now exists.

A tax cap will not make these shortcomings any worse, or any more inequitable. But it will make them all the more glaring; for example, if assessment practices are not made more uniform, current differences in the full-value equalization rates of

portions of different towns within the same school district will lead to disparities in the effective impact of the levy limit within the district. Reform of the property tax system will be all the more essential. At a minimum, changes should include a shift to countywide assessment, and a requirement that all property be assessed at full-market value on a three-year cycle.

Reform of state mandates is needed, too, to address the most obvious of the root causes driving up property taxes: state mandates on local governments, especially the rules controlling terms and conditions of public employment. Reform of the Taylor Law is necessary to restore leverage to the management side in teachers' contract talks. School boards also need greater flexibility to restructure retirement health benefits. And state law should be changed to allow school districts to opt offer newly hired teachers a less expensive, more predictable and portable defined-contribution retirement plans.

Advantages of an across-the-board levy cap

An across-the-board tax levy cap has these distinct advantages:

- It is ***fair*** because it treats all taxpayers alike, extending the same protection to every class of property based on assessed market values.
- It is ***simple*** to understand, administer and enforce.
- It is ***democratic***, strengthening the accountability of county and municipal officials while giving voters direct control over school property taxes.

Exceptions to the cap, such as New Jersey's allowance of tax increases to fund teacher pensions and health care, would undermine the basic premise of any limitation on school property taxes. School districts need to do a better job of controlling costs—and when the factors driving costs are due in whole or in part by state law, the governor and the Legislature need to be more forcefully and directly confronted with the fiscal consequences of failing to address the situation.

The "equity" issue

Discussions of school finance in New York often devolve into debates over the "fairness" of current school funding formulas and the "adequacy" of existing funding levels in a state that already leads the nation in per-pupil spending. If voters in affluent districts are more willing to support tax overrides to boost school funding, it is argued, the cap will exacerbate existing inequities in school funding.

Three points can be made in response to these claims:

- Affluent school districts already receive minimal percentages of state aid, and their residents have been voting to tax themselves more heavily for years. The cap, linked to a supermajority override provision, will make it slightly more difficult for them to do so.
- Leaving tax levies uncapped is ultimately least fair to residents of poorer districts. Absent a cap, as the tax burden continues to grow much faster than inflation even while the tax base stagnates or even shrinks, many struggling communities in upstate New York risk taxing themselves into oblivion.
- The equity issue is best fought out at the state government level, through debates over the proper size and configuration of the state school aid budget.

The override provision is a safety valve, allowing residents of wealthier communities to indulge their appetites for higher spending without clamoring for state aid increases that would have economically damaging implications for the statewide tax base. At the same time, it will allow residents of poorer, more fiscally stressed communities to veto increases they cannot afford.

12 steps to mandate relief for tax-capped localities

Local government and school officials are concerned that a comprehensive property tax cap will make it difficult for them to continue providing essential services while dealing with the mounting costs of state-mandated contracting rules and employee benefits. However, an ever-rising burden of property taxes can't be seen as the only alternative.

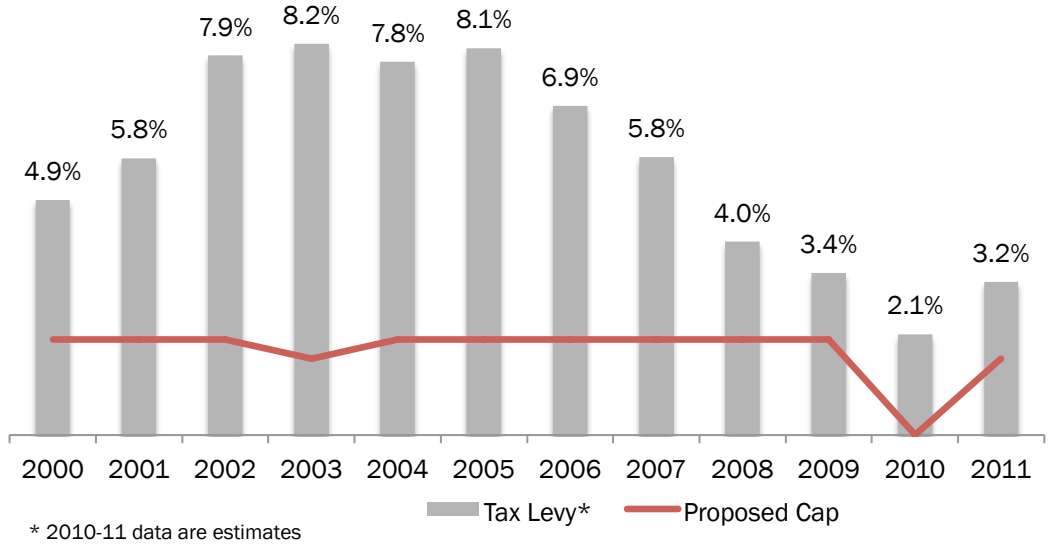
Here are a dozen mandate relief priorities—most of which have been embraced[a] by a broad spectrum of county executive, mayors and school board members around the state—that will give local governments the tools they need to reduce costs and live within a cap:

1. Impose a statewide freeze on public-sector salaries for up to three years. The Legislature has the statutory power to defer scheduled base salary and pay increment increases in light of the state's fiscal crisis.[b]
2. Repeal the Taylor Law's "Triborough" amendment, which requires local governments and schools to continue paying longevity "step" increments even after a contract has expired.
3. Repeal the provision of the state's 2009 "Tier 5" pension bill that permanently disallowed any change in health benefits for retired school employees unless the same change was negotiated with the union representing active employees.
4. Repeal compulsory binding arbitration of contracts for police and firefighters, or at the very least modify the law to require that "ability to pay" be the primary consideration for arbitrators weighing new contract awards.
5. Establish a mandatory minimum employee share of health-insurance premiums. A recent analysis by the Citizens Budget Commission suggests that requiring teachers alone to match the state employee level—10 percent of premiums for individual coverage, and 25 percent for family coverage—could save $500 million statewide.[c]
6. Amend the Taylor Law to prohibit collective bargaining of retiree health benefits, just as it prohibits bargaining of pension benefits. Those benefits currently represent an unfunded liability of more than $200 billion for governments statewide. When current contracts expire, employers should have the ability to restructure them along more affordable lines.
7. Enact fundamental pension reform—putting newly hired civilian employees in defined-contribution plans, like those chosen by nearly two-thirds of State University employees. While this will not reduce short-term costs, it will reduce long-term financial risks for taxpayers by capping public pension liabilities.
8. Amend the General Municipal Law to tighten the "performance of duty" disability standards for police and firefighters, which are now too easily abused.
9. Amend the Taylor Law to correct recent Public Employment Relations Board (PERB) decisions by (a) allowing for transfer of so-called "unit work" functions, which will make it easier for local governments to consolidate or outsource some functions, and (b) making it clear that a particular work rule or employee perk will be considered a binding "past practice" only if it was explicitly authorized by the employer's governing body.
10. Pursue reforms to address the high costs of special education in New York State, which is one of the factors driving up total school costs.
11. Repeal the state law requiring that high prevailing union wages be paid to workers on public construction projects.
12. Repeal the Wicks Law, which adds hundreds of millions of dollars a year to capital construction costs for local governments and school districts by requiring the use of multiple contractors on most public projects.

[a] See, for example, New York State Conference of Mayors, "You Can't Cap What You Can't Control," at http://www.nycom.org/documents/email-3.pdf
[b] http://www.empirecenter.org/AboutUS/news_releases/2010/05/legalop050310.cfm
[c] http://www.cbcny.org/cbc-blogs/blogs/school-districts-should-achieve-substantial-savings-following-state-practices-employ

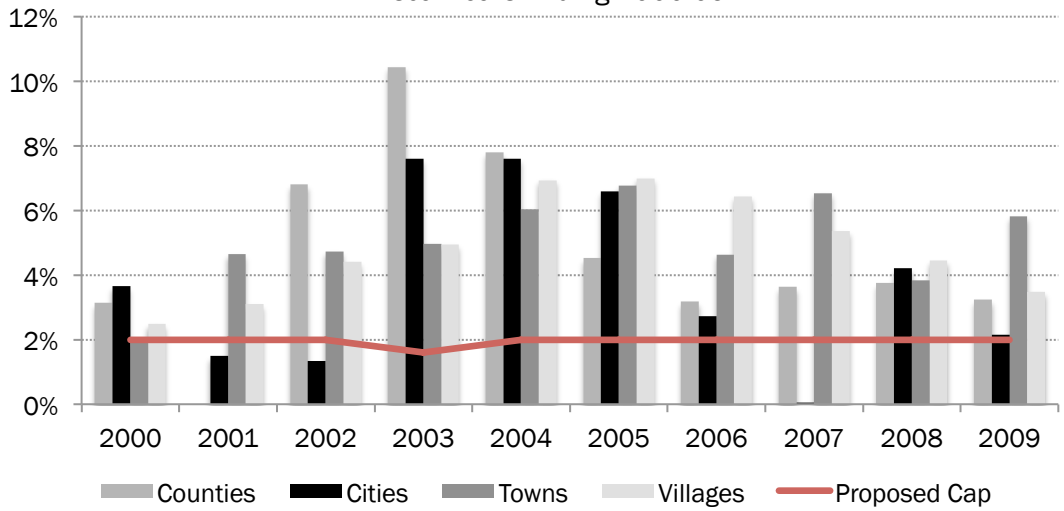
As illustrated in Figures 1 and 2, below, the proposed cap would have been substantially lower than actual tax levy increases since 2000. However, the financial impact of the cap on total school tax levies, compared to a continuation of the current system, is difficult to predict with much precision. The Massachusetts experience would suggest that overrides in New York will not be infrequent, especially since governing bodies of counties, cities, towns and villages will retain the right to override by a two-thirds vote of their members.

Figure 1. School Property Tax Levy Growth and Proposed Tax Cap
School Fiscal Years Ending 2000-2011



* 2010-11 data are estimates

Figure 2. Local Goverment Property Tax Levy Growth and Proposed Tax Cap
Fiscal Years Ending 2000-09



Source: Office of State Comptroller, New York State Education Department, U.S. Department of Labor

The proposed New York cap will give school district residents substantially greater power to veto tax increases they consider excessive. Excluding overrides, the average individual property owner in New York would experience school tax increases no higher than the annual change in the consumer price index or the ultimate cap of 2 percent. Even assuming numerous overrides, the average annual growth in school tax levies is likely to be significantly below the recent average of nearly 6 percent.[53]

Turning a new leaf on an old approach

The adoption of a property tax cap would not be a departure from fiscal tradition in New York; in fact, as noted above, the state's constitutional tax caps on counties, cities and villages date back to the late 19th century. More recently, just two years before Gov. Pataki proposed a levy cap in his original 1997 STAR bill, a cap on all property taxes in the state was proposed by Assembly Speaker Sheldon Silver and passed by the lower house of the Legislature.[54]

CONCLUSION

Governor Cuomo's proposal for a broad and tight cap on property tax levies, allowing for override only by "supermajority" votes, offers a promising way to control New York's tax and spending burden. Common criticisms of the tax cap simply don't stand up to scrutiny. In Massachusetts, Proposition 2½ restrained growth in tax burdens without compromising essential services. Far from eroding local control, Cuomo's cap would give taxpayers new power to check the growth of school taxes.

Having taken a first step toward greater control of property taxes, the governor and tax cap supporters in the state Senate must avoid agreeing to exceptions or exclusions that would reduce such a cap to a mere symbol. For example, teachers' pension costs alone are projected to rise by the equivalent of 3.5 percent of the school tax levy over the next five years,[55] and data from the state Conference of Mayors indicate that city and village tax levies would have to increase by more than 8 percent a year just to keep pace with projected increases in pensions and benefits for municipal employees.[56] Imitating New Jersey and excluding these fastest rising employee compensation costs from the New York cap would be tantamount to imposing no cap at all.

County, municipal and school officials have argued persuasively that they need relief from state mandates to manage expenses within a tight property tax cap. (See "12 steps to mandate relief for tax-capped localities," page 19.) But in putting the cap first, Governor Cuomo and the Senate have kept their priorities in the right order. ***The tax cap is an essential catalyst for the changes in state mandates that local governments and school districts have been futilely seeking for decades.***

In passing the cap, state officials also will have to stop passing the buck for generous pension benefits and collective bargaining rules tilted against the interests of taxpayers. The tax cap will have a twofold effect: it will instill greater fiscal discipline in local government and schools, and it will put tremendous added pressure on the Governor and the Legislature to finally get serious about mandate relief.

ENDNOTES

[1] Tax Foundation, "Property Taxes on Owner Occupied Housing by State," http://www.taxfoundation.org/research/show/1913.html
[2] Testimony of Andrew Pallotta, Executive V.P., NYSUT, to the Senate Standing Committee on Local Government and the Senate Standing Committee on Education, Feb. 17, 2011. http://www.nysut.org/cps/rde/xchg/nysut/hs.xsl/legislation_16239.htm
[3] Ibid.
[4] For further background on this issue, see O'Neil, Terry and McMahon, E.J., *Taylor Made: The Cost and Consequences of New York's Public-Sector Labor Laws*, Empire Center for New York State Policy, October 2007.
[5] New York State Office of Real Property Tax Services, *Property Tax Monitor*, June 2008. http://www.orps.state.ny.us/monitor/jun08/index.cfm
[6] Fisher, Ronald c. 2007. *State and local public finance*, 3rd ed. Mason, OH: Thomson/South-Westerb College Publishing, 318, as quoted in *The Property Tax Funding Dilemma*, by Daphne A. Kenyon, a Policy Focus Report of the Lincoln Institute for Land Policy, 2007, 40.
[7] New York State Office of Real Property Tax Services, Countywide Average Residential Tax Rolls, at http://www.orps.state.ny.us.
[8] More specifically, all one-, two- and three-family homes, as well as condominium and coop apartments, and multi-use buildings that include a residence (such as an apartment above a store), are eligible for STAR if they are the taxpayer's "primary residence."as condominium and coop apartments, and multi-use buildings that include a residence (such as an apartment above a store), are eligible for STAR if they are the taxpayer's "primary residence."
[9] In the many communities that assess properties at only a portion of full value, the full value is estimated using the state equalization rate.
[10] In New York City, which has no separate school property tax, most STAR aid is has been used to finance an across-the-board reduction of 0.2 percentage points in the city resident income tax, which has been phased out for high-income residents starting in 2010.
[11] For example, in the Westchester County town of Rye, where the median home price approaches $1 million, the basic STAR exemption in 2010-11 is $96,350.
[12] Tae Ho Eom, William Duncombe and John Yinger, "Unintended Consequences of Property Tax Relief: New York's STAR Program," October 2005, Abstract. Center for Policy Research, Maxwell School of Citizenship and Public Affairs, Syracuse University, http://www-cpr.maxwell.syr.edu/cprwps/pdf/wp71.pdf.
[13] Ibid., p. 29.
[14] Rockoff, Jonah E., "Community Heterogeneity and Local Response to Fiscal Incentives," December 2003. Text posted at http://www0.gsb.columbia.edu/faculty/jrockoff/papers/rockoff_local_response_dec_03.pdf.
[15] The rebate program was a response by the Legislature—spearheaded by Senate Republicans—to Gov. Pataki's proposal to make an added $400 STAR rebate available to homeowners in any school district that held its annual spending increase within the contingency budget limit of 4 percent. The final bill bases the rebate on existing STAR payments, without limiting district spending.
[16] Office of State Comptroller, "2010 Annual Report on Local Governments," http://www.osc.state.ny.us/localgov/datanstat/annreport/10annreport.pdf..
[17] City of New York, Independent Budget Office, "Twenty-Five Years After S.7000A: How Property Tax Burdens Have Shifted in New York City," Dec. 6, 2006.
[18] Allen, Marcus T., "Identifying determinants of horizontal property tax inequity: Evidence from Florida," *Journal of Real Estate Research*, September 1 2002.
[19] Two large states with property tax limitation laws the Commission rejected as models for New York were Florida and Texas, both of which have adopted convoluted tax cap plans tailored to the idiosyncracies of their state and local finance systems. In 1992, Florida voters approved the "Save Our Homes" amendment to the state's constitution, limiting annual

assessment increases on homestead property to 3 percent, or the rate of inflation, whichever is less. Homes are reassessed at market value when sold, and—unlike Proposition 13—the Florida limit does not apply to rental, second home and business properties. As local government spending increases, the total tax burden grows and is redistributed. A constitutional amendment passed by voters in late January 2008 allowed homeowners to transfer "Save Our Home" tax benefits from their old home to their new home, with a cap of $500,000. In 2006, the Texas Legislature approved a one-third reduction in a *de facto* maximum school property tax rate, backfilling the lost revenue with a state cigarette tax and business tax, and required voter approval for school tax rate increases of more than 4 cents per $100.

[20] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Property taxes in Illinois*, 2005 Update.

[21] According to Tax Foundation calculations, state and local taxes were 10.8 percent of income in Illinois as of 2007, compared to 10.2 percent in 1991.

[22] Michigan's combined state-local tax burden as of 2007 was 11.2 percent, compared to 10.4 percent in 1994, according to the Tax Foundation.

[23] California Taxpayers' Association, "Proposition 13: Love it or Hate it, its Roots Go Deep," November 1993.

[24] Michael J. New, "Proposition 13 and State Budget Limitation: Past Successes and Future Options," *Briefing Papers*, Cato Institute, June 19, 2003.

[25] California Taxpayers' Association, "Proposition 13: Love it or Hate it, its Roots Go Deep," November 1993.

[26] Prop 13 also required that state tax increases be approved by two-thirds of the state legislature, and that local tax rate increases be approved by two-thirds of the voters.

[27] A similar situation was created in Michigan by Proposal A, where the cap based on acquisition value cap "creates situations where a new homeowner living next to a person who has owned an identical house for several years could pay substantially higher property taxes than his or her neighbor whose taxable value is below [market value]," according to a 2002 study by the Michigan Department of the Treasury (*School Finance Reform in Michigan Proposal A: A Retrospective*, available at http://www.michigan.gov/documents/propa_3172_7.pdf.)

[28] Data Source: U.S. Census Bureau, *The Statistical Abstract of the United States*, annual. Calculations by authors.

[29] Ibid.

[30] As explained in the official state "primer" on Proposition 2 ½, "a majority vote of a community's selectmen, or town or city council (with the mayor's approval if required by law) allows an override question to be placed on the ballot" and "override questions must be presented in dollar terms and must specify the purpose of the override."

[31] The under-ride can be placed on a ballot by the municipality's governing body, or voters can use an initiative procedure if one is already provided by local law.

[32] Robert Keough, "Back to Taxachusetts?" *The Boston Globe*, November 6, 2005.

[33] "Property tax hikes winning support," *The Boston Globe*, June 12, 2009. http://www.boston.com/news/local/massachusetts/articles/2009/06/12/despite_economy_property_tax_hikes_okd_in_11_mass_communities/

[34] One homeowner whose taxes have risen faster than 2.5 percent a year is the tax activist who spearheaded Proposition 2 ½, Barbara Anderson. Thanks in part to recent overrides in her home town of Marblehead, Ms. Anderson calculates that her tax bill has risen by an annual average of 5.4 percent since the cap was enacted. Yet she still estimates she is saving $3,600 a year compared to what her payment had been if taxes had continued to increase at the pre-1980 level of 8.8 percent a year.

[35] "The Right Kind of Cap," NYSUT Media Relations, Jan. 29, 2008, at http://www.nysut.org/cps/rde/xchg/nysut/hs.xsl/mediareleases_9409.htm.

[36] Cutler, David M., Elmendorf, Douglas W., and Zeckhauser, Richard, ":Restraining the Leviathan: Property Tax Limitation in Massachusetts," National Bureau of Economic Research, August 1997.
[37] Wallin, Bruce A., "The Tax Revolt in Massachusetts: Revolution and Reason," *Public Budgeting & Finance*, Winter 2004.
[38] U.S. Census Bureau, *Public Elementary–Secondary Education Finance Data*, 2008 data, at http://www.census.gov/govs/school/.
[39] States With the Smartest Kinds," *Daily Beast*, http://www.thedailybeast.com/blogs-and-stories/2011-01-23/states-with-smartest-kids-from-massachusetts-to-mississippi/.
[40] College Board, "College-Bound Seniors 2010," at http://professionals.collegeboard.com /data-reports-research/sat/cb-seniors-2010.
[41] College Board, "SAT Program participation and performance statistics," at http://professionals.collegeboard.com/data-reports-research/sat.
[42] "Quality Counts 2011," *Education Week*, Jan. 13, 2011, summary press release at http://www.edweek.org/media/ew/qc/2011/QualityCounts2011_PressRelease.pdf.
[43] Tax Foundation, *Tax Foundation Special Report No. 189*, "State-Local Tax Burdens Fall in 2009 as Tax Revenues Shrink Faster than Income," http://taxfoundation.org/research/show /22320.html
[44] One other noteworthy difference between Massachusetts and California: Combined with a state court decision requiring statewide equalization of school expenditures, Proposition 13 left California homeowners with much less incentive to support increases in their local school budgets; as a result, school spending in California fell sharply relative to national averages. Massachusetts, however, has sought to mitigate school spending differentials without depriving affluent property owners of the ability to tax themselves more heavily in support of higher spending in their local schools.
[45] State of New Jersey, Department of Community Affairs, Division of Local Government Services, Local Finance Notice (LFN) 2011-3, "2010 Levy Cap Law Guidance and CY 2011 Budgets," http://www.nj.gov/dca/lgs/lfns/11lfns/2011-3.doc.
[46] Ibid.
[47] "Mayors press N.J. lawmakers for 'tool kit' reforms to help manage tight budgets," *Newark Star Ledger*, Feb. 17, 2011, http://www.nj.com/news/index.ssf/2011/02/nj_mayors_ press_lawmakers_for.html
[48] "New police arbitration limits likely to affect future contract negotiations," NorthJersey.com, Jan. 13, 2011, http://www.northjersey.com/news/113436899_Police_raises_capped_at_2_percent.html
[49] The bill, A.6171 of 1995-96 session, was never taken up in the Senate.
[50] S.8736 of the 2007-08 session.
[51] S.67005 of the 2009-10 session.
[52] "The New NY Agenda: A Plan for Action," at http://www.andrewcuomo.com/system/storage/6/34/9/378/acbookfinal.pdf
[53] During the 10 years prior to STAR's enactment and phase-in period (school years ending 1988-1998), school property tax levies also increased by an average of 6 percent a year.
[54] The bill, A.6171 of 1995-96 session, was never taken up in the Senate.
[55] E.J. McMahon and Josh Barro, *New York's Exploding Pension Costs*, Empire Center Special report, December 2010.
[56] Testimony of the New York State Conference of Mayors before the Senate Committee on Local Government and the Senate Committee on Education, Feb. 17, 2011. See chart attached to testimony, entitled "City Employee Benefit Costs Alone Would Exceed Capped Property Taxes."

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