EMPIRE CENTER
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Enough is Enough

Why and How to Cap
New York's School Property Taxes

DRAFT WHITE PAPER

Submitted to
New York State Commission on Property Tax Relief

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CONTENTS

Executive Summary

New Yorkers have long paid some of the highest real property taxes in the country. And the burden just keeps growing: Since the state School Tax Relief (STAR) program became fully effective in 2001-02, school property tax levies outside New York City have increased by an average of 6 per cent a year.

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.

As Governor Spitzer has now recognized, ***enough is enough***. It's time to clamp a lid on property taxes in New York – once and for all.

The appropriate place to start is with school district property taxes, which make up 61 percent of total property taxes levied outside New York City. This paper is focused on making the case for limiting school taxes, touching only indirectly on some of the related issues raised in the governor's executive order.

As described below, the example of Proposition 2 ½ in Massachusetts demonstrates the potential value of a property tax cap for New York:

An across-the-board cap on school tax levies will encourage fiscal discipline and ensure that increases in state aid lead to tax relief for all property owners.

By forcing Albany to shoulder more of the bill for local school expenditures, a tax levy cap will put pressure on the governor and the Legislature to deal with the state-controlled mandates that drive up costs.

The cap recommended here—limiting annual increases in school tax levies to the prior year's growth in the consumer price index, or 4 percent, whichever is less--should come with two important caveats:

- No loopholes or exceptions to the levy limit will be allowed, other than taxes generated by new construction.
- A 60 percent super-majority of district voters can override the cap for specifically stated operating purposes, or to exclude new capital financing costs from the levy limit. Voters also would have the right to petition for "under-ride" referendums to permanently reduce their levy limits.

The crafting of New York's first real limitation on local school taxes cannot ignore the impact of changing real estate market conditions. Since the late 1990s, the impact of high property taxes has been exacerbated by skyrocketing property values and assessments. Now that prices have begun to fall, there is a real risk that effective tax rates will rise—even under a tight tax levy cap. Therefore, the limit should be accompanied by a freeze on effective tax rates in all school districts.

It should be emphasized that capping levies and freezing rates are merely the first steps in reining in property taxes, once and for all. These changes need to be accompanied by reforms in two key areas:

- A fair and effective tax cap 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.
- School districts must be given greater flexibility to manage their expenses—especially personnel costs, which account for three-quarters of their operating budgets (excluding debt service). 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 a temporary law effectively disallowing changes in retiree benefits unless the same change is negotiated with current employees.[1]

Blunt instrument

As Governor Spitzer put it, "A tax cap is a blunt instrument, but it forces hard choices and discipline when nothing else works."

Nothing else has worked. And experience indicates nothing else will.

Public school advocacy groups have long argued that the state should assume a much larger share of education costs in New York. Some "reformers" have even suggested scrapping the property tax entirely and replacing it with an income tax. Strong arguments can be made against that idea on economic grounds. But whether one favors gradual growth in the state share of spending, or a wholesale shift to the state tax base, such a change could not occur overnight. Under any scenario, the starting point for property tax relief must be a cap on further growth in tax levies.

Cap. Freeze. Reform. Those can and should be the watchwords that guide the Commission on Property Tax Relief in its important mission.

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[1] 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.

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.[2] But New Yorkers have more reason than most Americans to dislike the tax. In most parts 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 neighboring New Jersey.

There are several ways to illustrate the tremendous 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 1 (Appendix p. I). Per-capita property taxes in all of New York State—including taxes on all kinds of property—rank fourth among the 50 states. But when New York City is excluded from the total, the ranking for the rest of New York jumps to the top of the list, just ahead of New Jersey and double 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. As illustrated in Table 2 (Appendix p. II), when taxes are measured as an effective rate of market values, 17 of the 20 the most heavily taxed counties in the country are located in upstate New York; the effective rates range from the more than double to fully triple the median for all large counties. When taxes are considered in absolute terms, as shown in Table 3 (Appendix p. II), five downstate New York counties rank in the top 20; they also rank among the top 20 in terms of property taxes as a share of income.

The overlooked non-residential component

But homes aren't the only heavily taxed New York State properties. As shown in Table 4 (Appendix p.III), taxes on commercial, industrial and apartment properties in Buffalo and Plattsburgh—which, other data would indicate, are not out of line with comparable areas in upstate New York—rank among the highest in the nation, according to an annual comparison of hypothetical taxpayers by the Minnesota Taxpayers Association.

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[2] 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.

Average taxes

School taxes account for 61 percent of all property taxes levied in New York as of 2007, and for 59 percent of the average residential property tax bill. There is fairly wide variation in this proportion, from as low as 33 percent in Allegany County to as high as 84 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.

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.[3] The "basic" exemption is set at $30,000 of a home's estimated full value, with no limit on the homeowner's income.[4] Senior citizens with incomes below $63,000 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.[5]

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.[6]

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.

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[3] 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."

[4] In the many communities that assess properties at only a portion of full value, the full value is estimated using the state equalization rate.

[5] 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.

[6] For example, in the Westchester County town of Rye, where the median home price approaches $1 million, the basic STAR exemption in 2006 was about $119,000.

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. More than 10 percent of New York State's largest revenue source, the personal income tax, is now set aside for STAR, which in turn represents more than 17 percent of total proposed state spending on K-12 public education in fiscal 2008-09.

With a "tax relief" program so big, why are property owners still so unhappy about their property taxes? The explanation can be found in Figure 1 (Appendix p. III). 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 risen 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.

Perverse incentives

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 included a local school tax cap in his original STAR proposal in 1997 (see discussion below). But the Legislature rejected the cap. 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.[7] Tax increases were "strikingly high" in upstate small districts and cities, where STAR generated the largest percentage tax savings for homeowners, they said.[8]

These findings are consistent with those of another academic researcher who found that STAR had a "statistically and economically significant effect" on

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[7] 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.
[8] Ibid., p. 29.

spending increases, concentrated in districts where a larger proportion of the tax base consisted of commercial and rental properties.[9]

The 2006-07 state budget property tax rebates[10] worth a total of $875 million to existing STAR exemptions. Unlike the main STAR program, which sends extra aid to school districts to reduce tax bills, the new program takes the form of direct payments to homeowners—initially timed for delivery in the weeks leading up to the November 2006 elections.

Governor Spitzer's first budget called for an expansion of the rebate under what was termed a new "Middle-class STAR" program. The final budget reserved the maximum rebates for homeowners earning up to $90,000 upstate and $120,000 downstate. The size of the program was expanded to $1 billion in 2008-09, growing to $1.6 billion by 2010-11. Governor Spitzer's 2008-09 budget would postpone the next scheduled increase in the program.

STAR was temporary tax stabilization program—a form of fiscal novocain whose effects, predictably, wore off after a few years. As Governor Spitzer put it in his State of the State address: "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."

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[9] 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.

[10] 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.

2. Reform Models

In announcing his plan for the Commission on Property Tax Relief during his 2008 State of the State address, Governor Spitzer said he wanted the panel to submit "a proposal for a fair and effective cap – to hold the line on sky-high school district property taxes once and for all." The governor's executive order directs the Commission to produce an interim report "setting forth … recommendations with respect to a statutory school property tax cap" by May 15, 2008.

Keeping those objectives in minds, the following section briefly explores the most relevant examples from other states, zeroing in on the approach that is likely to work best in New York.

Limits: not a new idea

Tax caps on local taxes (and debt) are common around in the country—even 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 26 of the state's 675 counties, cities and villages (just 4 percent of the total) had exceeded 80 percent of their constitutional limits as of 2006.[11]

Assessment caps and classification in New York

Another approach to limiting taxes for some classes of property owner 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 level. The law says that assessment increases resulting from market conditions cannot exceed 6 percent in a single year and 20 percent over five years.

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[11] Thomas P. DiNapoli, Office of the New York State Comptroller, "2007 Annual Report on Local Governments," December 2007.

The result is described by the city's Independent Budget Office as follows:

> 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.[12]

Nassau County is the only other sizeable jurisdiction with a four-class system of property taxation. There, too, 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."[13]

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 limit property taxes—by limiting tax rates, limiting assessments, or limiting levies.

A staff working paper submitted to the Commission Real Property Tax Relief noted that levy caps "relevant" to the commission's scope of study are in place in

[12] City of New York, Independent Budget Office, "Twenty-Five Years After S.7000A: How Property Tax Buerdens Have Shifted in New York City," Dec. 6, 2006.
[13] Allen, Marcus T., "Identifying determinants of horizontal property tax inequity: Evidence from Florida," *Journal of Real Estate Research*, September 1 2002.

15 states, and suggested closer consideration of five "peer states": Massachusetts, Illinois, New Jersey, California and Michigan. However, the Illinois and Michigan tax limitations laws are flawed in ways that should make them unacceptable 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[14], the overall Illinois tax burden has actually increased since 1991[15] and property taxes in the state remain well above national averages.

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.[16]

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).

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[14] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Property taxes in Illinois*, 2005 Update.
[15] 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.
[16] 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.

The California Revolution

June 6, 2008, will mark the 30th anniversary of a key event that sparked one of the major tax revolts in U.S. history. 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 due to skyrocketing assessments as skyrocketing real estate values (and thus assessments) were compounded by the stagflation of the 1970.[17] 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.[18] In addition, there were plentiful examples of dramatic disparities in assessments.[19]

Key provisions of Prop 13:

- Capped tax rates at 1% of property values
- Instituted an acquisition-value assessment system. Annual assessments could increase by no more than 2 percent or the rate of inflation. Property is reassessed at market value only after a change of ownership.
- Rolled back initial property valuations to 1975-76 levels.[20]

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) rather than 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

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

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

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

[20] 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.

tax burdens, and that higher value properties have higher tax bills. These benefits are, at the very least, curtailed under Prop 13. [21]

What resulted from Prop 13 in three key areas – 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. As of 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.[22]
- 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.[23]

Proposition 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. [24]

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[21] 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.)

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

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

[24] In 1992, Florida took a step similar to California's. 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.

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 2 ½. 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[25] approved by a majority of voters, and voter-approved exclusions for capital outlays or debt, which exist for only a fixed period of time. Voters can also be asked to "under-ride" the levy limit, permanently reducing the dollar amount of the levy subject to the cap.[26]

As of 2005, some 3,600 proposed Proposition 2 ½ 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.[27] Under-rides have bee much less frequent. Only 16 proposals to reduce the levy limit have made it to local ballots throughout the state. Thirteen have passed, the most recent in 2007, according to data compiled by the Massachusetts Revenue Department's Division of Local Services.

From 2000 through 2007, total property tax levies in Massachusetts increased by an average of 5.9 percent a year, roughly the same as the long-term average since 1986 (the earliest year for which comparable data are available). However, new construction growth has added an average of 2.6 percent a year to increases in local levy limits during this decade. The underlying levy growth of 3.3 percent since 2000 reflects the 2.5 percent limit plus the cost of overrides.

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[25] 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."

[26] 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.

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

Despite the Proposition 2 ½ limits, it is also 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.[28]

Debunking the debunkers

Reacting to Governor Spitzer's creation of the Commission on Property Tax Relief, New York's statewide teachers' union cited "research" claiming that tax caps "erode local control, dismantle strong district programs and penalize the poorest communities."[29]

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 2 ½ significantly reduced property taxes, especially during its early years. Yet, the Propositions' 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."[30]

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[28] 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.

[29] "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.

[30] Cutler, David M., Elmendorf, Douglas W., and Zeckhauser, Richard, ":Restraining the Leviathan: Property Tax Limitation in Massachusetts," National Bureau of Economic Research, August 1997.

Another analyst of Proposition 2 ½ concluded:

> "Predictions of draconian cuts budget cuts never materialized due to state legislative modification of the initiative's provisions, and judicious use of local voter overrides."[31]

State aid made the difference

The key to the success of Proposition 2 ½ 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 very similar to the key goals Governor Spitzer has 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.

In part as a result of MERA, per-pupil spending in Massachusetts during the first 25 years of Proposition 2 ½ actually increased faster than per-pupil spending in New York, as shown in Figure 2 (Appendix p. III). Yet Massachusetts appears to have realized more significant bang for its education bucks. For example:

- In 2007, Massachusetts outscored every other state in the country on three of four National Assessment of Educational Progress (NAEP) exams, and has tied for first on the fourth. By comparison, New York's national rankings on the same tests ranged from 16th to 32nd.
- The average SAT score for Massachusetts high school students was 29 points above the national average, and 61 points above the average for New York. The difference couldn't simply be explained a way as a product of different test-taking levels; in fact, the rate of students taking

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[31] Wallin, Bruce A., "The Tax Revolt in Massachusetts: Revolution and Reason," *Public Budgeting & Finance*, Winter 2004.

the SAT in Massachusetts was second highest in the nation at 85 percent, just below new York's 88 percent.

All this happened within the constraints of Proposition 2 ½ -- without significantly raising 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. In 1980, the combined Massachusetts state-local tax share of personal income was 11.3 percent, second highest in the country behind New York. As of 2007, it ranked 28th, and the total tax bite of 10.6 percent was still below the 1980 level and below the national average.

Here it is worth noting another important 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.

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 less likely to be described as "Taxachusetts."

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. It didn't exactly work out: today, New Jersey has one of the nation's highest marginal income tax rates—and property taxes rivaled only by New York's.

In the 1990s, under then-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 to impose a 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. Compared to Proposition 2 ½, however, the New Jersey cap is in other respects rather porous, making it possible to exceed the levy limit without voter approval. In addition to growth from "new ratables," the New Jersey law (bill number A1/S20 of 2007) allows local governments to claim exemptions for increases in debt service, health care cost obligations exceeding 4 percent, some pension contributions, offsetting state aid reductions from a previous year, uncollected taxes exceeding 4 percent, and lease payments to county improvement authorities.

School districts in New Jersey also can claim exemptions for increases in debt service payments; health care cost obligations exceeding 4 percent; and adjustments due to rising enrollments. Finally, municipalities and school districts also are permitted to apply to the state for discretionary cap waivers for "extraordinary costs."

Given the added exceptions, the New Jersey cap seems less likely to produce the kind of long-term tax reduction that resulted from Proposition 2 ½ in Massachusetts.

3. A Cap for New York

The Massachusetts experience underscores what should be viewed as the crux of the issue for New York: a cap on school property taxes will promote fiscal discipline while ensuring that higher state aid leads to local tax relief for all property owners. By forcing Albany to shoulder more of the local school bill, a broad and uniform cap would also put pressure on the Governor and Legislature to deal with state-controlled mandates that drive up costs.

Imitating the Massachusetts approach (but not the exception-riddled New Jersey variant) is the most promising route to long-term reduction in tax burdens over the long term.

One current legislative proposal comes closest to accomplishing this. Entitled the Property Taxpayer Protection Act (A.8775), its key provisions include the following:

- Starting in 2008-09, school district tax levies could not exceed the previous year's tax levy by more than four percent or by increase in the previous year's consumer price index, whichever is lower.
- Exceptions to the tax cap would be allowed only via voter approval, by a two-thirds majority vote.
- The tax limit would be increased according to the net percentage increase in enrollment, and/or according to expansion of the tax base through new construction, improvements or other physical changes in proportion the net percentage quantity increase.
- Any state mandated program on localities, including school districts, that create an annual net added cost of $10,000 or more, or an aggregate annual net additional cost of $1 million, must be funded by the state. In addition, similar mandates put forth by the New York State Board of Regents must be approved by the state legislature and signed into law by the governor.

The bill could serve as a model for the Commission's consideration—but with two important additions:

- Allow for voters to petition for an "under-ride" to permanently lower the levy cap.
- Freeze effective school tax rates—i.e., levies as a percentage of adjusted market values—at 2007-08 levels, to guard against rate increases resulting from reductions in property values.

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 school 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, including at a minimum a shift to countywide assessment, and a requirement that all property be assessed at full-market value on a three-year cycle.[32]

Reform of state mandates is needed, too, to address the most obvious of the "root causes" driving up costs, and thus property taxes: state mandates on school districts, and rules governing collective bargaining and 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

The Massachusetts-style approach has these distinct advantages:

1. It is ***democratic***, because it gives voters the ultimate right to raise or lower the cap, preserving local control in the process.
2. It is ***fair*** because it treats all taxpayers alike, extending the same protection to every class of property based on assessed market values.
3. It is ***transparent*** — and, therefore, much simpler to administer and enforce than systems involving variations based on property classification; age, income or other characteristics of owners; or duration of ownership (which becomes an issue in acquisition-based assessment systems).

Allowing exceptions to the cap, such as New Jersey's allowance for employee health insurance contributions, would threaten to unravel the entire fabric of the property tax relief package. Moreover, it would undermine a 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.

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[32] The reforms in a proposed constitutional amendment introduced in the current legislative session as A.1572 would implement these changes.

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:

- 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 property 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 ultimately is best fought out at the state government level, through debates over the proper size and configuration of the state school aid budget.

The provision for overriding a tax cap will function as 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 simply cannot afford.

Looking ahead

The financial impact of the cap on total school tax levies, compared to a continuation of the current system, is difficult to project with much precision.[33] Overrides in some districts are inevitable, as is new construction growth

[33] Unfortunately, the Empire State's patchwork system of assessing real property does not provide data analogous to the greatly enriched information available in Massachusetts (another salutary result of Proposition 2 ½). There is some indication, however, that New York's tax levies have been less affected by new growth than those in Massachusetts. Building permit data reported by the U.S. Census Bureau indicate that New York and Massachusetts enjoyed similarly large increases of about 20 percent in residential building activity as measured by construction costs between 2000 and 2006. But during that same period, the net number of housing units increased by 3.2 percent in Massachusetts and only 2.5 percent in New York State counties outside New York City. Translated into marginal changes in residential market values, this may reflect a more significant difference between the two states.

excluded from the cap; indeed, the growth exception will provide advocates of higher school spending with a strong incentive to favor commercial and residential development to fortify the local tax base. But this much is clear: thanks to the override vote, school districts residents also will have new power to veto tax increases they consider excessive.

Excluding overrides and tax base growth, the average *individual* property owner in New York would experience school tax increases no higher than the annual change in the consumer price index—which has averaged 2.8 percent over the past decade and 3.3 percent since 1987—or the ultimate cap of 4 percent. This would represent a significant improvement over the recent average levy growth of 6 percent a year.[34]

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.[35]

Thus, a cap on school tax levies would not represent revolution so much as *evolution*—a recognition of the need to update a traditional response to public concerns about excessive growth in property taxes.

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[34] The 6 percent estimated annual increase from 2002 through 2008 is derived from property tax levy totals after *excluding* STAR homestead exemptions. 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.

[35] The bill, A.6171 of 1995-96 session, was never taken up in the Senate.

Appendix

Table 1: Per Capita State and Local Property Taxes
Fiscal Year 2004-05

1	New Jersey	$2,206	26	Minnesota	$1,024
2	Connecticut	$2,044	27	Maryland	$1,001
3	New Hampshire	$2,028	28	Oregon	$979
4	**New York (incl NYC)**	**$1,768**	29	North Dakota	$977
5	Wyoming	$1,751	30	Nevada	$962
6	Vermont	$1,697	31	South Dakota	$942
7	Rhode Island	$1,695	32	California	$942
8	Maine	$1,632	33	Georgia	$899
9	Massachusetts	$1,607	34	South Carolina	$880
10	Illinois	$1,464	35	Arizona	$861
11	Wisconsin	$1,410	36	Missouri	$810
12	Alaska	$1,345	37	Idaho	$807
13	Texas	$1,320	38	North Carolina	$744
14	Michigan	$1,279	39	Utah	$720
15	Indiana	$1,219	40	Mississippi	$676
16	Nebraska	$1,195	41	Tennessee	$654
17	Florida	$1,148	42	Hawaii	$643
18	Kansas	$1,125	43	Delaware	$577
19	Iowa	$1,114	44	West Virginia	$556
20	Virginia	$1,109	45	Louisiana	$539
21	Pennsylvania	$1,079	46	Kentucky	$538
22	Montana	$1,067	47	Oklahoma	$485
23	Colorado	$1,059	48	New Mexico	$448
24	Washington	$1,055	49	Arkansas	$422
25	Ohio	$1,044	50	Alabama	$394
	US Average	$1,132		**New York (outside NYC)**	**$2,303**

Source: Tax Foundation; U.S. Census Bureau

Table 3. Property Taxes on Owner-Occupied Housing, by County, 2006

Medians for All US Counties With Populations > 65,000

20 Highest Tax Payments

Geography	State	Tax	Rank	Home Value	Tax % Value	Rank	Homeowner Income	Tax % Income	Rank
Hunterdon County	NJ	$7,999	1	$475,300	1.7%	105	$101,955	7.8%	5
Nassau County	NY	$7,706	2	$506,800	1.5%	149	$95,430	8.1%	3
Westchester County	NY	$7,626	3	$581,600	1.3%	213	$103,847	7.3%	10
Somerset County	NJ	$7,318	4	$457,000	1.6%	125	$104,152	7.0%	12
Bergen County	NJ	$7,237	5	$493,400	1.5%	172	$93,441	7.7%	6
Essex County	NJ	$7,148	6	$409,300	1.7%	92	$86,286	8.3%	2
Rockland County	NY	$7,041	7	$502,300	1.4%	186	$93,527	7.5%	7
Morris County	NJ	$6,852	8	$488,900	1.4%	188	$101,670	6.7%	15
Union County	NJ	$6,703	9	$419,000	1.6%	126	$85,327	7.9%	4
Passaic County	NJ	$6,663	10	$406,300	1.6%	114	$79,505	8.4%	1
Putnam County	NY	$6,431	11	$407,800	1.6%	135	$91,203	7.1%	11
Suffolk County	NY	$6,413	12	$445,700	1.4%	178	$85,606	7.5%	8
Monmouth County	NJ	$6,206	13	$444,800	1.4%	189	$93,156	6.7%	16
Hudson County	NJ	$5,887	14	$387,100	1.5%	148	$78,656	7.5%	9
Fairfield County	CT	$5,581	15	$508,100	1.1%	290	$95,415	5.8%	34
Sussex County	NJ	$5,539	16	$332,400	1.7%	108	$86,312	6.4%	18

Source: Tax Foundation and U.S. Census Bureau

Table 4. Effective Property Tax Rates

Commercial & Industrial properties valued at $1 million

Apartment valued at $600,000

From Samples in 53 Urban Areas

	Buffalo		
	Rate	*Rank*	*Average*
Commercial	3.64%	2	1.97%
Industrial	2.06%	12	1.53%
Apartment	3.93%	3	1.73%

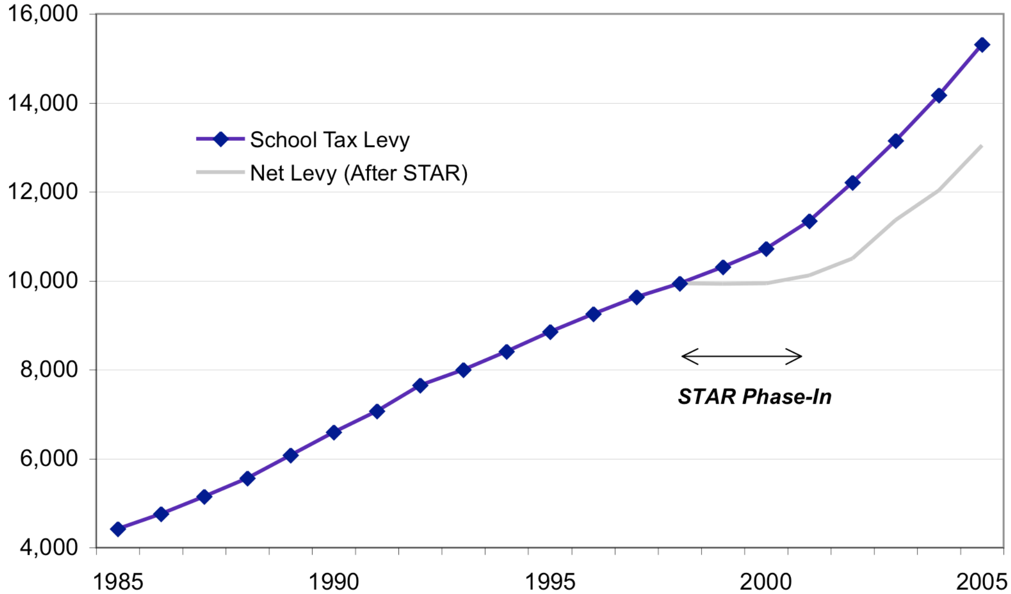
From Samples in 53 Rural Areas

	Plattsburgh		
	Rate	*Rank*	*Average*
Commercial	3.29%	3	1.65%
Industrial	1.97%	6	1.27%
Apartment	3.76%	2	1.53%

Source: Minnesota Taxpayers Association, 50-State Property Tax Comparison Study, Payable Year 2006

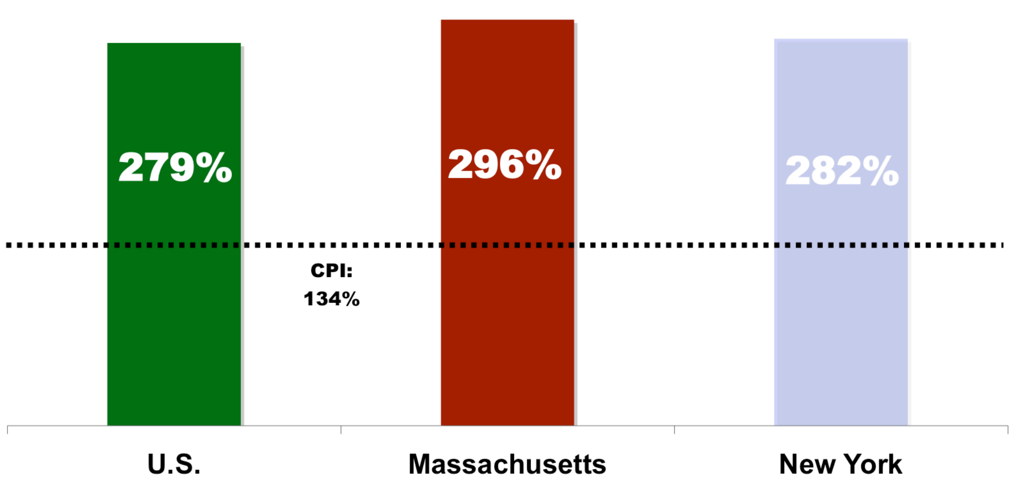
Figure 1. The STAR Bump

School Property Tax Levies and Collections, in Millions of Dollars



Source: State Comptroller's Office, Division of the Budget

Figure 2
Change in Per-Pupil Spending, 1979-80 to 2002-03



Source: U.S. Department of Education, National Center for Education Statistics