

The \$3 billion New York tax giveaway

Underassessment of commercial real estate is draining the treasury, Lydia Schulman reports in Part Three of our urban series.

Austerity in New York City has been accompanied by some remarkable liberality. Through underassessment of commercial real estate, and tax-exempt loopholes, the administration of Mayor Edward Koch is giving away from \$2.5 to \$3.5 billion a year in city tax revenues to major real-estate speculators and holding companies like the Penn Central Corporation.

By enforcing existing real-estate tax laws, and ending welfare exemptions for these beneficiaries, the city could double real-estate tax collections while providing relief to overtaxed small homeowners.

Such measure would generate enough funds, for example, to overhaul the entirety of the decayed subway system, and still leave plenty to spare. The Transport Workers Union, representing employees of the city's transit system, has proposed a 10-year, \$18 billion program to revive the subways. The traditional source of funds for a major capital improvement program of this type is the city real-estate tax. Thus, *EIR* researchers decided to examine the city's various controversial tax-abatement programs (J-51, 421a, the ICIB program, and so forth) in the expectation that if some of those programs were tightened up, several hundred millions of dollars in lost taxes might be recaptured per annum.

We discovered that the city is foregoing not several hundred million, but several hundred billion dollars a year, as a result of gross underassessment of prime Manhattan commercial property, unwarranted tax exemptions, and the controversial tax-incentive programs instituted by the Koch administration and its predecessor under Abraham Beame. We estimate that if existing real-estate tax laws and assessment practices were merely adhered to, another several billion dollars in real-estate taxes a year would materialize.

The dimensions of the underpayment are as follows:

During the past five years, total yearly real-estate tax collections inched up from about \$3.2 billion to \$3.3 billion in current dollars. Not taking inflation into account, this was a 3 percent increase. During the same

period, the market value of prime commercial property soared by roughly 300 percent. The discrepancy is on the order of 100 to one between the rise in market values and tax collections.

With the habitual underassessment of prime commercial properties, the city is losing an estimated \$1.7 to \$2.5 billion a year on Manhattan office properties alone. These funds would be sufficient to revamp New York's undercapitalized subway system.

Beyond this, we have not yet put a total price tag on the unwarranted exemptions and special tax-incentive programs; however, these practices are easily costing the city upward of \$1 billion a year.

One of the biggest current speculative boondoggles in New York is the so-called development of former Penn Central and other railroad properties, parcels that are tax-exempt due to their railroad classification. (These properties include the West 30s and 60s railyards and the environs of Grand Central Station.) It is an ironical fact of history that the Penn Central ran its railroads into the ground as a result of siphoning off railroad funds into real-estate ventures. Then, in 1976, it palmed off its transportation assets to the federal government for \$2.11 billion, and emerged out of bankruptcy proceedings as a profitable real-estate holding company. Yet the Penn Central still claims railroad status for the city real-estate tax exemption, while, along with allied developers such as Donald Trump, it benefits from the speculative runup in the value of those tax-exempt properties.

The myth of New York's recovery

New York City's "favorable real-estate tax climate" is universally cited as the basis for the city's recovery from its 1975 fiscal crisis and economic slump—the burst in office and hotel construction, the improvement in construction and service employment, and the re-emergence of New York as an international tourist center.

"Everyone knows that the real-estate market would

never have recovered without help of the tax breaks and the UDC [Urban Development Corporation]," a highly placed Planning Commission official commented in an interview. "With regard to real-estate, the Koch administration has been unquestionably prodevelopment. Guys like [John] Zuccotti [former deputy mayor under Beame and currently counsel to the Canadian-based Olympia & York Developments, Ltd.], foresaw the need for tax abatements and other real-estate tax breaks."

In a lead editorial on Feb. 23, "The Supply Side Saves New York," the *Wall Street Journal* held up the tax policies of Mayors Beame and Koch as the model for the Reagan administration.

The question remains whether New York's real-estate boom is the basis of a lasting recovery.

The evidence is that the stagnation of city tax revenues has cut into the delivery of vital services to the point that the city's basic infrastructure is now threatened.

To take the case of mass transit, the breakdown of a once reliable, efficiently functioning subway system has had a devastating impact on the city's economy: employees chronically arrive at work late and enraged or depressed; employers complain about the shortened work day and reduced productivity. Education, health care, and other services are under knife after knife for lack of revenue. New York will never again be able to provide employers with a skilled workforce if this situation continues.

The underassessment

The discrepancy between the taxes the city collects on Manhattan office properties and what it could be collecting is due to the gross undervaluation of these properties by the Real Property Assessor's Office and other city departments.

In the current fiscal year, the city assumed that the market value of the totality of Manhattan office properties was \$12.7 billion. It was actually in the range of \$45 to \$60 billion, according to *EIR* estimates cross-checked with numerous real-estate analysts. (The absurdity of the city's claim can be seen in the fact that last July the Pan Am building—a single building—sold for \$400 million. And there are 233 prime office towers in Manhattan, whose current resale value is \$85 to \$100 million apiece, or upward of \$23.3 billion total.)

At the current rate of 60 percent—meaning that the assessed or taxable value of a property is 60 percent of its full market value—the assessed valuation of Manhattan office property was \$7.6 billion in fiscal 1980-81.* Given the current tax rate of 8.95 percent, those properties yielded about \$680 million in tax revenues.

If the city had begun with the realistic market value of those properties, \$45 to \$60 billion total, then at the customary 60 percent assessment rate and 8.95 percent

tax rate, Manhattan office properties alone would be yielding \$2.4 to \$3.2 billion per annum, not \$680 million. And the city would have at its disposal an additional \$1.72 to \$2.54 billion in tax revenues a year.

Questioned about the giant discrepancy between the city's assessments and the true market values of the same properties, one city tax official sheepishly offered the explanation that commercial property values are rising so fast in the city that the Assessor's Office can't keep up with them.

New York's undertaxation system is even greater than it seems, however. The \$680 million in real-estate taxes levied on Manhattan office property in the current fiscal year compared with a levy of roughly \$600 million in fiscal 1976-77. During the same period, rents on prime Park Avenue office space jumped 300 percent to \$50-\$60 per square foot, and market values rose accordingly. And the city's operating expenses and capital costs, like everything else in the national economy, were hit by double-digit inflation. Inflation also pushed wage earners into higher tax brackets, leading to a higher rate of taxation on their income and lowering of disposable income. In such a period, the freeze on New York real-estate taxes in fact amounted to a massive tax cut.

Special deals

Thus far we have only been considering the undervaluation of taxable property. However, less than half the property in New York is subject to taxation at all; the rest is fully tax-exempt or nearly so.

Newspapers like the *Village Voice* and *Our Town* regularly report on the huge tax exemptions granted to foundations, schools, churches, and so forth. Yet in many cases these exemptions are entirely justified. But what about the tax exemptions granted to utility companies and the quasi-public authorities and corporations in return for the services they ostensibly provide to the public?

Every private railroad operating in New York enjoys a ceiling on its taxable assessment, calculated on the basis of its earnings in a given year. During the current fiscal year, the railroads qualified for a full exemption on \$2.49 billion of their \$2.52 billion in assessed valuation, because of poor earnings and other breaks granted on properties within a five-mile radius of railroad passenger terminals. While there is ample reason to award exemptions on subway property to the MTA, it is wholly unreasonable for the city to shower benefits on the Penn Central and other railroads that have done nothing but deliberately triage rail service and fuel real-estate speculation. The tax-free railyards along Manhattan's West Side waterfront are the site of the next phase of New York's real-estate bubble. As these choice parcels are sold off to developers, they lose their tax-exempt railroad classification; but according to a highly



Manhattan office property—full market value

Location	Square footage adjusted for vacancy rate	Average rent/ square foot	Annual rental income
I. Higher estimate based on Planning Commission estimates			
All office space below 60th St.	275 less 3.5% = 265	\$33	\$8.8
			Total rental income \$8.8
			Total market value \$8.8 × 7 = \$61.6
II. Lower estimate based on Jones Lang Wootten estimates			
Park Ave.	15.7 less 0.3% = 15.6	\$45	\$0.7
Ave. of Americas*	25 less 1.7% = 24.6	\$35	\$0.9
5th, Madison, Lexington, 3rd Aves.	42 less 2.3% = 41.0	\$40	\$1.6
Downtown	65 less 4.3% = 62.2	\$20	\$1.2
Non-prime space	127 less 3% = 123.5	\$15	\$1.9
			Total rental income \$6.3
			\$6.3 × 7 = \$44.1

Calculating Real Market Value

To calculate the real market value of Manhattan office properties, we started with square footages of different qualities of office space average rents, and vacancy rates. The table above represents two sets of estimates: the gross figures currently cited by the city Planning Commission for all office space below 60th Street—275 million square feet, at an average rent of \$33 per square foot and vacancy rate of 3 percent; and the finer breakdown of different grades of office space contained in a recent survey conducted by the firm of Jones Lang Wootton. On this basis we arrived at an upper and lower estimate of gross

annual rental income from these buildings: \$8.8 and \$6.3 billion. Using the traditional rule of thumb that a building's market value is seven times its annual rent roll, we arrived at an upper and lower estimate of market value of \$61.6 and \$44.1 billion.

The price-earnings ratio is actually higher than the traditional seven today, because rental income on properties is expected to rise sharply over the next several years; a huge proportion of existing office leases are due to expire over the next several years, and they will be renegotiated at going rentals of \$30 to \$60 per square foot.

placed Planning Commission official, they will get another tax exemption, probably through the UDC.

The tax-exempt status of bonded public authorities represents a second major drain on potential city tax revenues.

Beginning with the creation of the Port Authority in the early 1960s, these entities have removed key sources of tax revenue—the Port of New York, the bridges, tunnels, airports, and later the \$1 billion World Trade Center—from the city's taxing powers, and placed them under the jurisdiction of quasi-public bodies subject to no constituency.

Finally, there is the wholly tax-exempt New York State Urban Development Corporation generally recognized as the kingpin of the last several years' hotel and office building spree. UDC projects, including Donald Trump's Grand Hyatt Hotel, the Convention Center, and the new home of the American Stock Exchange, pay no city sales taxes on their construction material—which can run into the tens of millions of dollars—and no real-estate taxes. They pay only a negotiated percentage of whatever operating profits they choose to report to the city.

“The big flap over the Commodore-Grand Hyatt was over the fact that the percentage of cash flow they agreed to pay is so low,” a Planning Commission official recalled. “The hotel can inflate its costs and reduce its taxable cash flow to nothing, and be sure that its books will never be audited. In fact, the hotel will pay practically nothing to the city until 2000.”

The city is losing an additional estimated \$100 million per year as a result of various tax abatements (J-51, 421a, the ICIB program, etc.) for rehabbers and hotel and office-building developers. Among the recipients of the city's munificence have been IBM, AT&T, Goldman Sachs Investment Company, and Harry Helmsley's Palace Hotel. There is plenty of recoverable tax money to rebuild the transit system, in short, and restore other vital city services.

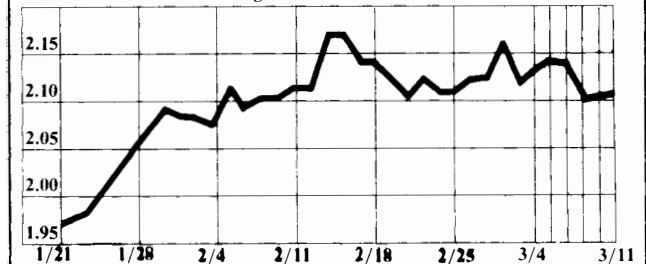
*When the tentative assessments for fiscal 1981-82 were made public Jan. 29, Finance Commissioner Philip Michael stated that the city has followed the practice of assessing commercial properties at about 60 percent of their full market value and residential properties at 20 percent of market value. The new assessments showed a record 10 percent increase, most of it due to higher assessments on Manhattan commercial properties. However, many of these assessments are being challenged on the grounds that the city discriminates against commercial property, assessing it at a higher rate than residential. In fact, *EIR's* calculation of true market value indicates that Manhattan office property was assessed at only 13 to 17 percent of its market value in fiscal 1980-81.

Nevertheless, as a result of the 1975 State Court of Appeals *Hellerstein* decision, which declared New York State's de facto system of classified assessments illegal, the city has a potential liability of about \$2 billion from tax certiorari claims hanging over it.

Currency Rates

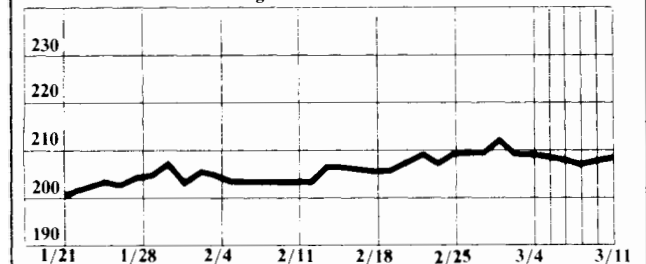
The dollar in deutschemarks

New York late afternoon fixing



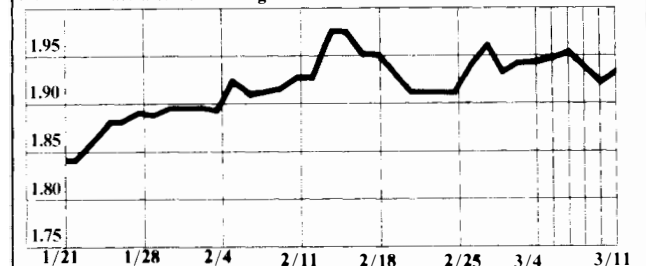
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing

