



Addressing the Unintended Consequences of the Property Tax Cap

June 10, 2015

In 2011 New York established a property tax cap for school districts, counties and municipalities. The cap essentially limits growth in school districts' and other local governments' total property tax levies to the lesser of 2 percent or the rate of inflation. The legislature is currently considering an extension of the property tax cap that will expire next year. This provides an opportunity to examine whether the cap is working as intended and how it could be changed.

When adopted, the cap was hailed as a way to control the growth of local spending in New York while still allowing schools and localities the opportunity to invest in desired services.¹ Many experts find that tax and expenditure limits like New York's property tax cap have problematic unintended consequences.² They reduce localities' flexibility to address growing needs and emergencies, exacerbate inequities, and squeeze investments that could grow local economies.

Increasing state funding of services like education and healthcare or providing targeted property tax relief such as a circuit breaker credit would be more effective and efficient ways to address high property taxes. But short of eliminating the cap, there are some ways to mitigate the most pressing problems.

The Cap restricts the ability of local governments and schools to address growing needs

The property tax cap arbitrarily constrains the ability of schools and localities to raise revenues without any consideration of the actual cost of providing services. It is not tied to changes in demographics such as school enrollment or population and has no relationship to the growth in cost of specific goods and services that local governments must purchase. It would be surprising if the fixed cap of two percent was appropriate for years into the future. In recent years, general inflation (the CPI-U) has been very low so the cap has actually restricted levy growth to less than two percent. However, many of the costs that schools and localities face have grown faster. For example, growth in the medical services portion of the CPI has been consistently above 2 percent

¹ Cap NY Property Taxes – A Citizen's Guide website, Message from the Governor.

² See for example, Iris J. Lav, Hidden Consequences: Lessons from Massachusetts for States Considering a Property Tax Cap, Center on Budget and Policy Priorities, May 25, 2010; Hector Chang, Christine Wen, Tax Caps in Other States: Lessons for New York, Cornell University Department of City and Regional Planning, December 2014; and David S. Gamage and Darien Shanske, The Trouble with Tax Increase Limitations, 6 Alb. Gov't L. Rev. 50 (2013).

and the Employment Cost Index³ is projected to grow between 2.5 and 3.3 percent according to the Congressional Budget Office.⁴

If no changes are made to the cap, local resources for services like education, infrastructure and healthcare will be dramatically squeezed next year. Inflation, as measured by the Consumer Price Index, is projected to be flat between 2014 and 2015 according to the FY 2015-16 Financial Plan. This would mean that schools would have no additional property tax revenue to fund 2017 budgets. And the CPI for the localities' fiscal year may actually decline if current trends continue. This would likely result in diminished local services in communities across the state.

- The cap should allow at least 2 percent growth in the base property tax levy without regard to changes in the Consumer Price Index in order to allow local governments and schools to plan for at least a minimum level of revenues. The CPI or another more appropriate cost index could be used to adjust the 2 percent upward in future years if higher levels of inflation return.
- The cap should be adjusted for costs related to increased enrollment in schools by including a student growth index that is similar to the tax base growth factor. This change would be especially beneficial to school districts that are expanding such as Yonkers, Central Islip, Buffalo, Roosevelt and Westbury.
- New York should allow more carryover of unused space under the cap. Allowing a district to apply unused space under the limit would provide more flexibility for schools and localities to address unanticipated needs in future years while still restraining growth over time. Not allowing this type of carryover could have the perverse effect of encouraging districts to levy up to the cap each year in order to retain the ability to use the maximum levy if needed in the future. Other states with limits include this type of provision. For example, New Jersey schools are allowed to “bank” any carryover for three years and Idaho jurisdictions can recapture amounts permitted but not used in prior years.

Improve ability to cope quickly with emergencies and changing circumstances

The property tax is the major source of local revenue for schools, counties, cities, towns and villages in New York. It accounts for two-thirds of local tax revenue outside of New York City. In school districts outside of New York City, property taxes make up 85 percent of tax revenue. As a result, an arbitrary limit on the amount that can be raised reduces localities' ability to respond to unexpected events such as the damage to or destruction of bridges, roads, buildings and other municipal infrastructure from natural disasters or from an especially tough winter like the last one. The cap should be adjusted to allow localities to raise the revenue needed to address these types of emergencies without crowding out other ongoing services.

³ The Employment Cost Index measures growth in private sector salaries and benefits. In order to attract and retain qualified employees a local government must offer competitive salary increases.

⁴ Budget and Economic Outlook: 2015 To 2025, Congressional Budget Office, January 2015.

Increase flexibility in ways that avoid exacerbating wealth inequities

The property tax cap can be exceeded through a vote of localities' governing bodies or a vote of the electorate in the case of schools. Both of these require super majority (60 percent) approval. These requirements serve to exacerbate disparities in access to quality schools and local services. Wealthier communities are more likely to approve cap overrides. Low-need and average-need school districts in New York were more than twice as likely to override the tax cap.⁵ A similar pattern was seen in Massachusetts which has decades of experience with a property tax cap.⁶

The override provisions could be modified in the following ways:

- The cap should be amended to allow for a simple majority override. Most states with levy limits that allow overrides by a vote of the electorate require that only a simple majority of the voters agree to exceed the limit. This includes Massachusetts and Pennsylvania.⁷
- The state should not penalize school districts as harshly as it does if an override attempt fails. The override procedure could be modified so that the fallback in the case of disapproval is not a levy freeze. For example, voters could be given a choice between a basic budget based on a cap-compliant increase in the levy and one that relies on a greater property tax increase. The basic budget would be the fallback if the higher one is not approved.
- The understandable reluctance of high need/low wealth localities to override the property tax cap highlights the importance of directing additional state aid to these jurisdictions through wealth and need-based formulas such as Foundation Aid and local government revenue sharing.

Increase flexibility for spending on economic development for all types of localities

Capital improvements require short-term spending to bring long-term improvements to the quality of life of schools and localities and the local business climate. The design of the cap acknowledges the need to give schools the flexibility to make these investments when needed but it does not go far enough. Expenses related to capital improvements for local governments and for BOCES are not excluded from the cap calculation.

- The cap should be changed to exclude the capital improvement expenditures of local governments such as infrastructure investments intended to enhance the economic

⁵ Three Years of the Tax Cap – Impact on School Districts, New York State Office of the Comptroller, February 2015.

⁶ Iris J. Lav, Hidden Consequences: Lessons from Massachusetts For States Considering a Property Tax Cap, Center on Budget and Policy Priorities, May 25, 2010.

⁷ Lincoln Institute of Land Policy, Significant Features of The Property Tax, State Summaries, 2013.

development capacity of a community like improvements to municipal water, sewer, or transportation systems.

- The school exemption for capital improvements should be expanded to include school district costs for improvements to BOCES facilities.

Additional technical corrections are also needed

A few years of experience with the property tax cap has revealed some technical corrections that would make administering the cap more efficient and better reflect the intended purpose. For example, the exclusion for court orders and judgements should be expanded to include situations where a major property owner successfully challenges an assessment.

More time and analysis are needed to evaluate and modify the Cap before considering making it permanent

The Governor's 2015 report on the Property Tax Cap declares that the cap has brought "Results. Success. Savings."⁸ But there has not been enough time to know the real effects of the cap on either property tax levels, service provision, the state budget, or the state economy.

The rate of growth of property taxes since the cap was instituted *is* lower than in the past few decades but there is no clear evidence that the cap is the only (or even the major) cause of that change. There are a number of factors that suggest otherwise.

For example, the slowdown in growth in property taxes began before the property tax cap was put in place. The Comptroller noted, "This moderation reflects the residual effects of lost property values since the housing market collapse, as well as responsiveness to citizen concerns over the high tax burden even before the property tax cap law was enacted", in the 2014 Annual Report on Local Governments.⁹ Part of the decrease is no doubt the result of the fact that inflation is currently considerably less than it was in many pre-cap years. The average increase in the New York area CPI between 2000 and 2010 was 3 percent annually while the New York area CPI has increased only 1 percent per year since 2012.¹⁰

In addition, state aid (while still inadequate) has begun to recover from the steep cuts of the recessions of the 2000s. This reduces upward pressure on the property tax. In order to preserve services, local governments often respond to state aid cuts by raising local property taxes.¹¹

⁸ New York State Property Tax Cap: Results. Success. Savings. 2015 report, Office of Governor Andrew M. Cuomo.

⁹ Office of the New York State Comptroller, 2014 Annual Report on Local Governments, Division of Local Government and School Accountability, January 2015.

¹⁰ Fiscal Policy Institute calculation of Bureau of Labor Statistics data on CPI-U for New York, Northern New Jersey, and Long Island.

¹¹ Rajashri Chakrabarti, Max Livingston, and Joydeep Roy, Did Cuts in State Aid During the Recession Lead to Changes in Local Property Taxes?, Federal Reserve Bank of New York, Staff Report No. 643, October 2013.

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The only way to sort out the relative importance of these varying effects is a sophisticated economic analysis. It will be a few more years before sufficient data is available in New York for this type of analysis.

In addition, a critical part of determining the ultimate success of the cap is to assess the impact on local services and on the state's economy. Early indications are that schools and localities have been forced to reduce services in order to stay under the cap. After years of cuts in state aid and recession-induced declines in home values, they have exhausted many potential efficiencies. Other states with tax limits such as Massachusetts and Colorado have found that local services were cut as a result of these types of limits.¹²

A Cornell University study of the impact of the cap so far found that important services have suffered. Cities, towns and villages have cut spending on public safety and transportation. Counties reduced spending on social services, healthcare, and public safety.¹³ Independent school districts cut staff by 4 percent between 2012 and 2014 while enrollment declined by only 2 percent.¹⁴

New York should proceed cautiously before making the cap permanent in order to gather more information on the impact of the cap.

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¹² Tax Caps in Other States, Lessons for New York, Hector Chang and Christine Wen, Cornell University Department of City and Regional Planning, December 2014.

¹³ NY Property Tax Cap, Impact Analysis, Robert Rivera and Yuanshuo Xu, Cornell University Department of City and regional Planning, December 2014.

¹⁴ School District Fiscal Snapshot, New York State Association of School Business Officials, March 2015.