Anticipated Property Tax Increases on New Construction Spur Gentrification: Evidence from New York City

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September 28, 2019

JOB MARKET PAPER

Abstract

Some cities have proposed tax benefits on new investment as a measure to relieve tenants from rising rents. In this paper, I use a property tax reform in New York City to estimate whether such incentives work locally. In 2006, the New York City government decided to make property tax incentives on new construction less generous, starting in 2008. Developers responded by rushing to apply for these benefits and began building before the deadline. The magnitude of excess housing starts at the deadline suggests that a 1% increase in the future property tax increased current residential investment by 0.4%. A naive demand-supply model indicates that these new units brought to the market by the reform should lower rents in nearby incumbent units. On the contrary, I find that the rents in nearby incumbent units increased. Using the baseline land availability within a small radius around an incumbent unit as an instrument, I find that an additional new tax-exempt unit during the bunching period *increased* the incumbent unit rent by 2.3%. I find evidence consistent with the hypothesis that new residential investment made neighborhoods more desirable by attracting affluent households, facilitating the entry of businesses and consumption amenities. Overall, the results indicate that the *new* investment spurred gentrification.

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†I am grateful to my advisers Wojciech Kopczuk, Michael Best, Brendan O'Flaherty and Bernard Salanié. I would also like to thank Donald Davis, Reka Juhasz, Sebastian Siegloch, George Sweeting, Yaw Owusu-Ansah, Andrew Haughwout, Francesco Brindisi, Francois Gerard, Iain Bamford, Pooya Ghorbani, Becka Brolinson for comments and discussion. I thank the Department of Finance, New York City for providing sales tax filers data. I am indebted to the participants at the Fiscal Policy Breakfast at Federal Reserve Board, New York; Mayor's Office of Management and Budget; ZEW Summer Workshop; Young Economists Symposium; New York City Independent Budget Office for their very helpful comments and clarifications. All views expressed are my own.