

# The Abell Report

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## Commercial Property Assessments in Baltimore City

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**ABELL SALUTES:  
Mayor Martin O'Malley,  
the citizens of Baltimore,  
and the more than 60  
departments that provide  
for their quality of life.  
Their combined efforts  
are moving Baltimore City  
in the right direction.**

According to the telephone book, Baltimore City lists more than 60 departments, from "A" ("Abandoned Vehicles") to "Z" ("Zoo") that manage and provide for the quality of life of its citizens: The Abell Foundation salutes Mayor O'Malley and City departments — and especially the citizens of Baltimore who put them in charge. The recognition is for their role in moving Baltimore City, in a time period from 1970 to 2000, back 15 hard-earned points on the Urban Hardship Index, created by researchers to measure "economic conditions of U. S. cities." The good news is that Baltimore moved from sixth ("most troubled city") downwards to 21st. What the improvement in ranking confirms is that the City is making steady and recognizable progress in overcoming its considerable problems. From sixth down 15

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### A Costly Problem, A Strategic Opportunity

*by John J. Hentschel*

**T**he red brick Candler Building on Market Place and the First Union Bank on St. Paul Street are two of downtown Baltimore's best-known commercial buildings. Both were sold to new investors in recent years — the Candler Building for \$65 million and the bank building for \$50.2 million.

However, at the time of the sales, the taxable assessed values assigned to both buildings by the State of Maryland were significantly less than the prices they brought on the open market. For the Candler Building, the assessed value was \$35 million — or 70 percent of the sale price. The assessed value of the First Union building at the time of the sale was \$48 million — 74 percent of its sale price.

The numbers hold important fiscal considerations for the City of Baltimore. The disparity between assessed values and sale prices for those two prominent properties cost the City of Baltimore \$750,000 per year in unrealized property tax revenue — a figure determined by using the City tax rate of \$2.328 per \$100 of assessed value.

Reports of such sales in which properties' market prices far exceeded their assessed valuations prompted this study. The basic question was this: Are such sales merely aberrations, or do they reflect a more pervasive pattern of

underassessment and consequent revenue loss?

After examining data on assessed valuations and sales prices for commercial properties in Baltimore City for several years, this report concludes that, in general, the assessed values of commercial properties have been historically understated. Using key measures known as the Mean Weighted Average and Price Related Differential (explained in a later section), it becomes apparent that the State's assessments of commercial properties in Baltimore City have consistently fallen outside the industry standards for these measures when assessments are compared to market value. An analysis of figures reported by the State Department of Assessments and Taxes (SDAT) suggests that for the period from 1997 to 2003, commercial properties in Baltimore City have been assessed approximately 17 percent below market value.

This is no small concern. Although the factors influencing municipal finance and the tax rate are complex and varied, we can say in the simplest of analyses that the property tax rate could, theoretically, decline by as much as 7 percent, from \$2.328 to \$2.15 per \$100 of assessed value if this variance could be eliminated. Conversely, at the current tax rate, eliminating the assess-

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ment variance could potentially reap an estimated \$20 million to \$25 million a year in revenue to fund City operations. It almost goes without saying that Baltimore City’s financially struggling municipal government, which relies on property tax receipts for more than half of its operating budget, could benefit from such a revenue infusion.

### Summary of Findings

The report attempts to document the causes of the under-valuation of non-residential properties in Baltimore City, and to propose recommendations to improve the accuracy of those assessments. Going further, the report looks at the Baltimore City government’s role monitoring these assessments and makes suggestions for improvements.

To summarize, the report finds that:

1. The State’s non-residential property valuation systems and procedures are structured and administered in a manner that is neither efficient nor uniform. The system also suffers from a lack of transparency and independent oversight.
2. SDAT is inefficiently organized and not equipped with up-to-date tools needed to handle commercial property assessments effectively and accurately.
3. Despite its heavy reliance on property tax revenue, the Baltimore City government lacks a strategic viewpoint of its tax base and has no coordinated program for monitoring the assessments of non-residential



*For the period from 1997 to 2003, commercial properties in Baltimore City have been assessed approximately 17 percent below market value.*



properties in the City. City officials currently focus only on the routine task of collecting taxes, but not on the equally important assessment process performed by the state.

### Recommendations

The report makes 21 key recommendations (See the full version of the report for detailed discussion of these and other recommendations):

#### The State should:

- Reorganize and centralize the State’s commercial assessment function. The existing structure of having commercial assessors working in each local jurisdiction is a redundant and costly legacy dating to the state takeover of the function from local governments 30 years ago.
- Assemble functional centralized SDAT databases containing useful market information on such things

as comparable land and building sales and rentals, and expense and vacancy rates.

- Establish an oversight and advisory board for the assessment operation comprised of members with appropriate valuation and data analysis credentials to review and evaluate SDAT’s valuation policies and procedures, monitor their consistent application and compliance in the State’s various jurisdictions. An important initial step would be to determine the extent to which the issues raised in this report affect assessment levels and uniformity in the State’s other 23 counties.
- Establish a standing oversight committee, within SDAT, to investigate and analyze the reasons underlying assessments materially vary from a property’s sales price.
- Enhance quality control efforts in SDAT employing more intensive statistically based screening devices.
- Review and revamp SDAT’s information system to be more timely, functional, user-friendly and conducive to the retrieval and analysis of data by salient property traits.
- Correct SDAT data system deficiencies including inaccurate and incomplete information, cross-referencing multiple accounts within the system.

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- Enhance commercial assessors' accessibility to information on the Internet.
- Review and clarify SDAT's treatment of "substantial completion" of improvements by property type and classification.
- Draft SDAT directives clarifying when and how to recognize the incremental value derived from building modifications.

#### **State Executive and Legislative**

##### **Leaders should:**

- Recognize the importance of accurate property tax assessments and make it a priority to appropriate adequate funding for functions such as property tax assessments that generate tax revenues for other important governmental units.
- Recognize that expanding the tax base through accurate assessments increases both local and State revenue, promoting local government self-reliance.

##### **The Property Tax Assessment Appeals Board (PTAAB) and Maryland Tax Court should:**

- Report the dollar amounts of increases or decreases in assessed value resulting from their rulings, in addition to the number of cases they handle. This data would be useful to measure SDAT's effectiveness in the appellate process.

##### **The City of Baltimore should:**

- Make it a priority to monitor the assessments of the City's commercial properties.

- Organize and coordinate its effort by defining required tasks and delegating authority, responsibility and accountability to specific agencies or individuals.
- Assemble, maintain and continuously update a database of property sales and rentals by use category, improvement size, geography, and other characteristics.
- Assure that the City's new Manatron & Tidemark Information Systems are coordinated, configured and customized to facilitate the rapid retrieval, review, and analysis of data.
- Devise analytical procedures to monitor and review SDAT non-residential property assessments to detect anomalies, and when appropriate, challenge the veracity of SDAT's conclusions in the appropriate forums.
- Develop a process for filing timely appeals when evidence suggests that SDAT's conclusions are inaccurate.
- Arrange with SDAT, PTAAB and the Maryland Tax Court to notify designated City officials of all commercial property assessment appeals filed by taxpayers.
- Monitor SDAT's timeliness and accuracy when assessing properties subsequent to the issuance of City building/alteration permits.

#### **Overview**

Assessments of real property in Maryland are the responsibility of the State Department of Assessments and

Taxation, which has offices in each of the State's 23 counties and in Baltimore City. The department assesses each property in the State once every three years, with the assessments phased in over the subsequent three-year period.

Along with Montana, Maryland is only one of two states in which a central state agency handles assessments instead of local jurisdictions. The State of Maryland imposes a small property tax (\$0.13 per \$100 of assessed value), while local governments independently impose much higher rates, with the highest, by far, found in Baltimore City (\$2.328 per \$100 of assessed value.)

This study did not examine assessment variation on residential property in Baltimore. While anecdotal evidence suggests that residential properties are also being under-valued, inaccurate assessments of non-residential properties – although taxed at the same rate as residential properties – appear to have a disproportionate effect on State and local property tax revenues over time, and therefore warrant greater attention.

In absolute terms, the number of non-residential properties is relatively small, representing only 6 percent of all properties in Baltimore City. But those properties account for 35 percent of the City's total assessable base as shown in Chart 1. (The chart breaks down properties into the three geographic groups used by assessors.)

While single-family, owner-occupied property is by far the larger component of the City's assessable tax base, the fiscal impact of assessments on these properties is limited by Baltimore City's self imposed, 4 percent annual assessment cap, which applies to many but not all residential properties. Non-residential real property is not subject to this assessment cap. Any change in val-

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**CHART 1**

<b>GROUP TAX BASE</b>	<b>2001 GROUP 1</b>	<b>2000 GROUP 3</b>	<b>1999 GROUP 2</b>	<b>TOTAL ALL GROUPS</b>
<b>RESIDENTIAL</b>	\$11,091,579,586	\$4,330,473,560	\$4,259,640,220	
<b>COMMERCIAL</b>	\$5,926,071,031	\$2,315,712,366	\$2,280,318,410	
<b>TOTAL</b>	\$17,017,650,617	\$6,646,185,926	\$6,539,958,630	
<b>TOTAL ACCOUNTS</b>	67,699	67,474	84,663	219,836
<b>COMMERCIAL ACCOUNTS</b>	3,056	5,374	5,734	14,164
<b>RESIDENTIAL ACCOUNTS</b>	64,643	62,100	78,929	205,672

SOURCE: SDAT Annual Report

NOTE: The significant increase in the tax base figures for 2001 are due to a change in state law that took effect that year requiring that all properties be taxed on 100 percent of their assessed value. Previously, the tax was applied to much less of a property's value, or 40 percent. As the full value of the property became subject to tax, actual tax rates were reduced by a proportional amount.

ue of these properties can lead directly to increased tax collections by both the City and State.

**Uniformity of Assessments**

Each year, the Director of SDAT issues a report that includes the statement:

“Uniform and accurate assessments are the foundation of fair property taxation. Maryland’s Constitution requires that all real property subject to property taxation be assessed uniformly. State law requires that assessments be based on the fair market value of the property. Therefore, uniformity and market value are the standards used to measure the quality of the assessment work performed by the Department.”

By some measures, SDAT appears to be meeting that mandate. In accordance with standards published by the International Association of Assessing Officers (IAAO), the SDAT annually computes and reports ratios that compare the assessed value of properties with their selling prices, as was done in the examples noted at the beginning of

this report. Since all taxable properties in Baltimore do not sell each year, the measure of SDAT’s assessment accuracy must be estimated based on data from those properties that actually do sell within the year.

As illustrated by Chart 2, in four of the last seven years, SDAT reported that the median ratio of its assessments of commercial properties fell between 95 and 100 percent of properties’ market values, as denoted by sales prices during the assessment period.

Median and average ratios of 95 percent to 100 percent might imply that assessments properly reflect the fair market values of all properties. In actuality, they only paint a portion of the picture. For instance, a median ratio of 100 percent merely indicates the middle of the range of ratios, with half above and the other half below the median

ratio. The magnitude of the variation in ratios and the corresponding dollar amounts associated with those properties above and below the median are not addressed.

The following chart illustrates the point. It outlines the relationship between assessments and market value for five hypothetical properties.

The median, or middle, ratio of the five properties in the example is 0.99 (property #3), and the average ratio (the sum of the ratios divided by the number of properties in the sample) is a seemingly acceptable 0.98.

However, the bottom line in this example is that the assessable tax base has been understated by \$3.35 million. Although the assessments of properties #2 and #3 were quite accurate, property #1 was assessed considerably above its

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**CHART 2**

<b>YEAR</b>	2003	2002	2001	2000	1999	1998	1997
<b>MEDIAN RATIO</b>	93%	95%	97%	90%	99%	84%	100%

Source: Assessment Ratios Survey Report, SDAT, Table 1 Real Property Tax Base/Ratio By Subdivision

**CHART 3**

PROPERTY	RATIO	ASSESSED VALUE	MARKET VALUE	DIFFERENCE
1	1.75	\$350,000	\$200,000	\$150,000
2	1.00	\$200,000	\$200,000	\$0
3	0.99	\$950,000	\$1,000,000	-\$50,000
4	0.60	\$1,800,000	\$3,000,000	-\$1,200,000
5	0.55	\$2,750,000	\$5,000,000	-\$2,250,000
<b>TOTAL</b>		<b>\$6,050,000</b>	<b>\$9,400,000</b>	<b>-\$3,350,000</b>

  

MEDIAN	AVG	WEIGHTED AVG.	PRD
0.99	0.98	0.64	1.52

  

TAX RATE	TAXES
0.2328	\$779,880

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*“Uniform and accurate assessments are the foundation of fair property taxation.”*

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market value, while the assessments of properties #4 and #5 were considerably below theirs.

A useful measure of assessment accuracy is the weighted average ratio, which is derived by dividing the sum of the assessed values of all properties in a sample by the sum of their sales prices. In this example, the weighted average of 0.64 is an indicator that the assessed values have understated fair market value, since it accords equal weight to each dollar instead of each property. The final measure, Price Related Differential, or PRD, is determined by dividing the average ratio by the weighted ratio. As shown in the chart, the PRD for the

five assessments would be 1.52. This is considerably above the 0.98 – 1.03 range suggested by the International Association of Assessing Officers for income-producing properties in larger urban jurisdictions, strong evidence that higher-priced properties have been undervalued.

Turning from the hypothetical to the real, the following chart presents the median, average and weighted ratios calculated by SDAT for commercial properties in Baltimore City during the period from 1997 to 2003 – compiled within the three geographic groupings used by SDAT. Although the PRD ratios for commercial properties are not

included in SDAT reports, the chart calculates them for each year. The last line of each column lists the number of commercial property sales transactions that occurred within six months of the date of finality of each assessment.

The chart highlights a consistent and significant differential between weighted ratios and the mean and median ratios. This intimates that, generally, the assessed values of commercial properties have been historically understated, since the weighted ratio gives equal weight to each dollar. SDAT does not include a PRD calculation for non-residential assessments in its Annual Report. However, the calculated PRD for commercial properties in Baltimore City – no lower than 1.11 in five of the last six years – have significantly exceeded the published IAAO standard

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**CHART 4**

	2003 GRP 3	2002 GRP 2	2001 GRP 1	2000 GRP 3	1999 GRP 2	1998 GRP 1	1997 GRP 3
<b>MEDIAN RATIO</b>	93%	95%	97%	90%	99%	84%	100%
<b>WEIGHTED RATIO</b>	91%	85%	95%	83%	78%	58%	93%
<b>AVERAGE RATIO</b>	95%	98 %	105%	95%	93%	102%	95%
<b>PRD RATIO</b>	1.04	1.15	1.11	1.14	1.19	1.76	1.02
<b>PROPERTY SALES</b>	84	111	81	87	96	137	67

in those years, further suggesting that Baltimore’s non-residential properties have historically been under-assessed.

It is worth noting again that the aggregate weighted ratio – the average of the reported weighted averages – of 83 percent for the period 1997 to 2003 suggests that commercial property assessments in Baltimore City have generally been approximately 17 percent below their market value. At the City’s current property tax rate, that differential represents a lost opportunity to collect approximately \$20 million to \$25 million annually in City tax revenues.

### Department of Assessments and Taxation

In addition to studying the foregoing ratios computed and published by SDAT, the author of the report looked at a wide array of SDAT records to examine the underlying issues that might contribute to under-valuation of commercial properties. In particular, all sales of non-residential properties in Baltimore City that occurred during the period July 1, 2000 to June 30, 2001 were identified using transfer data reported by SDAT on its website. Of those, 121 properties priced at \$200,000 or more were selected for further evaluation.

Although deriving statistically valid inferences from the data was not possible, some anecdotal observations are notable. These transactions represented slightly more than \$98 million in sale consideration with a corresponding taxable assessed value at the time of sale of just under \$77 million. Taken together, the assessments represented 79 percent of the reported sale prices. Closer scrutiny showed that 43 percent of the select-

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*At the City’s current property tax rate, that differential represents a lost opportunity to collect approximately \$20 million to \$25 million annually in City tax revenues.*  
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ed properties had assessments at the time of sale that were at least 30 percent below their reported sale prices. The number of properties selling at prices greater than their assessed value (suggesting under-assessment) was five times greater than those that sold at prices less than the assessed value (suggesting over-assessment).<sup>1</sup>

SDAT officials complain that the agency is under-funded and inadequately staffed. Such assertions have some merit. An SDAT report to the legislature noted that over the past 25 years, the

number of real property accounts in the State increased by 68 percent while the number of real property assessor positions declined 30 percent.

SDAT’s office in Baltimore City is staffed with seven commercial real property assessors. Five of the assessors are assigned to specific geographic regions of the City without regard to property type; those assessors handle assessments on all types of commercial properties within the designated geographic areas. One assessor is responsible for assessing all multifamily apartment properties, and one assessor handles all new construction. According to senior SDAT officials, approximately 30-35 percent of the assessors’ annual work schedule is devoted to work related to property tax appeals, thereby leaving only 32 weeks (160 workdays) to perform valuation activities. By apportioning the 7,680 available valuation man-hours (160 days x 6 assessors x 8 hours per workday) to the assessment caseload each year, we can establish the workload calculation in Chart 5.

Regarding new construction, City records indicate that during calendar year 2001, the City issued 746 permits for new commercial construction on projects costing more than \$50,000 – work that totaled more than \$585 million. That meant that the one assessor

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**CHART 5**

AREA OF CITY	COMMERCIAL PROPERTIES	MANHOURS PER PROPERTY
GROUP I	3,282	2.3 HRS
GROUP II	5,744	1.3 HRS
GROUP III	5,374	1.4 HRS
<b>TOTAL</b>	<b>14,400</b>	<b>1.7 HRS</b>

<sup>1</sup> The author examined 25 of the selected properties in depth, visiting each and questioning SDAT officials about information contained within each property’s case file. In addition, the author conducted interviews with many SDAT employees and examined agency procedures.

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assigned to evaluate new commercial construction projects could devote, on average, only 1.7 hours per property.

The average of 1.7 hours that an assessor can devote to each assessed property noted in the chart above is a fraction of the 10 to 20 hours needed to complete similarly complex commercial property appraisals by real property appraisers. Although the objective of both is to estimate the value of property, appraising and assessing are not quite the same. Assessments, particularly of single-family residential properties, rely on the application of mass appraisal techniques, including automated valuation models such as Computer Assisted Mass Appraisal (CAMA) and regression analyses that employ statistically generated tables and mathematical models. However, such mechanized techniques and statistical modeling are not commonly applied as primary valuation tools when valuing commercial properties in Baltimore or elsewhere. Instead, assessors in Baltimore City, as elsewhere, perform commercial property assessments in a manner that is quite similar to a commercial property appraisal, using the traditional approaches to value – only, by necessity, in a fraction of the time.

### **Information Systems and Data Analysis Issues**

As a result, SDAT's work must rely on having up-to-date information and the ability to quickly and efficiently access and analyze that information. Unfortunately, SDAT's access to and use of modern information technology has been lacking. It was only this year, for example, that commercial assessors were provided with access to the Internet from their desks. The inability to access the Internet deprived commer-



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cial assessors of a quick, reliable and inexpensive resource for information critical to the proper application of the Market and Income Approaches, two techniques employed by assessors to determine assessed value. Likewise, there has been for many years a wealth of Internet information about current commercial property sale and rental offerings, reports discussing prevailing market conditions and a steady flow of free information about demographics, emerging trends and market conditions for various real estate market segments.

SDAT has also suffered from a poor ability to analyze data. Although the Department collects abundant information from taxpayers, it has not been aggregated and compiled into functional internal databases of comparable sales, rents, or operating expense and occupancy data in a way that allows assessors to use it efficiently, either on-line or in print format, during the valuation process. Some have argued that compelling taxpayers to provide more complete and timely

information to SDAT would improve assessment accuracy. However, since the assessor is not strictly bound by the income and expense data provided by the owner in developing and defending an assessment and, in the alternative, can rely on data derived from the market, is the problem the availability of data or the way that it is ultimately compiled, analyzed and used? Without the benefit of empirical data afforded by a functional database, the assessor is ill equipped to question or refute the information provided by the owner.

On a basic level, the database is riddled with problems. For instance, the land sizes of some parcels are entered in square feet while others are entered in acres within the same data field thereby undermining any reasonable data search or analysis in which land size is a criterion. Likewise, information about the size and age of improvements is often omitted or unavailable in the records, which precludes useful comparison and analysis.

In addition, properties that are comprised of multiple tax accounts have not been linked or cross-referenced in the database. Only after a cumbersome search of all transactions that occurred on the same title-transfer date could all of the accounts comprising a property be identified. This flaw could result in comparative inaccuracy.

A review of the comparable sales data routinely used by assessors revealed numerous instances of incomplete or inaccurate data – including the omission of land or building areas. The data is organized without reference to geographic location – by neighborhood or zip code, for example. Many of the listings fail to identify a type of property or use, which undermines the usefulness of the information in both the assessment and appeals process.

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SDAT reports that it has taken recent steps to improve its Internet and data analysis capabilities. This is noteworthy. However, since data is the fundamental element in the valuation process, State budget officials, legislators and SDAT administrators should make it a priority to continually update SDAT's data systems to give assessors the best information and most powerful data-analysis tools to do their jobs.

**Procedural Issues**

As mentioned previously, Maryland is one of only two states in which a central, statewide agency handles assessments. In other states, the state government serves an oversight role of local governments that do assessments. With the State itself responsible for assessments in Maryland, SDAT has little independent oversight.

SDAT officials point out that the department has an internal chain of command in which assessors are overseen by supervisors at several levels. This chain of command, while crucial to the functioning of the department, is not a substitute for independent oversight.

While the Governor and General Assembly nominally oversee the department, there is apparently no set schedule for external audits of SDAT's performance. SDAT officials reported that it has been more than five years since the last independent audit by legislative auditors. In any case, legislative auditors without specialized training in valuation principles, practices and procedures would be hard pressed to detect errors or omissions that might result in material misstatements of value, especially with regard to complex income-producing commercial properties.

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*In other states,  
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**Problems with the Appeals Process**

The Maryland Tax Property Article establishes an appellate process for property owners who wish to dispute the validity of the assessed value determination. Section 14-502(a) states that "...any taxpayer, county, or state agency may submit a written appeal to the Supervisor as to the value or classification (of property) on or before 45 days from the date of the notice of assessment..."

The appeal process has three stages. The first is an informal meeting with the assessor. The second is a hearing before a three-member panel that is

independent of SDAT known as the Property Tax Assessment Appeals Board (PTAAB). Finally, a petition for an administrative hearing can be made to The Maryland Tax Court. The General Assembly has conferred PTAAB with the explicit legal authority and responsibility to determine the fair market value of property, together with the power to increase, as well as decrease, a property assessment beyond that proposed by the Supervisor of Assessments. However, the record shows that the Board is hardly a forum for the independent determination of value, as illustrated by the following chart summarizing the results of PTAAB of Baltimore City appeal hearings from 2000-2002.

During the three-year period, in no case did PTAAB of Baltimore City increase an assessment above the assessor's initial finding.

PTAAB lacks the statutory authority to conduct an assessment hearing or alter an assessment unless an appeal is filed. In those instances in which property value is understated, the taxpayer naturally has no motivation to appeal the assessor's findings. As discussed later in this report, although the law provides that any taxpayer or local gov-

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**CHART 6**

	2000	%	2001	%	2002	%
TOTAL APPEALS	2,293		1,926		2,548	
COMMERCIAL APPEALS	603	26%	202	10%	494	19%
AFFIRMED	502	22%	399	21%	619	24%
REDUCED	386	17%	347	18%	400	16%
INCREASED	0	0%	0	0%	0	0%
SETTLED	420	18%	65	3%	858	34%
WITHDRAWN	171	7%	123	6%	244	10%

Source: Property Tax Assessment Appeals Board  
 NOTE: Percentages do not add to 100% since the types of resolution of some appeals, such as cases that are remanded or dismissed, have been omitted. The percentages are computed based on total property tax appeals, not just those involving commercial properties.



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ernment may appeal the valuation of any property, Baltimore City currently has no process in place to identify or to file appeals regarding properties that might be undervalued.

Unlike PTAAB, the Maryland Tax Court is empowered with the express statutory authority to increase as well as decrease assessments *ex parte*. However, during an interview, the clerk of the Maryland Tax Court could recall only one instance during his long tenure in which the Court has increased an SDAT assessment, largely because no party has appeared to argue in favor of an increase above SDAT's determination.

There is no way to readily determine the fiscal impact of PTAAB and Maryland Tax Court decisions on State and local property tax revenues since neither agency collects or reports information about the dollar value changes in assessed value. Likewise, gauging the appellate record of SDAT as a whole or of an individual assessor is difficult since SDAT also does not calculate or report the valuation changes mandated by PTAAB or Maryland Tax Court rulings.

The current assessment appeal process provides ample protection against and redress for the over-valuation of property. But in the absence of active participation by Baltimore and other local governments, it fails to serve as an adequate oversight mechanism to identify and rectify the undervaluation of non-residential properties.

### **The Timeliness of a Triennial Process with Phased-In Conclusions**

The Maryland Tax Property Article requires that each property subject to taxation be valued once every three years based on an exterior physical

inspection, and that any changes in the assessed value be phased in over a three-year period.

Due to the large volume, some valuation assignments must begin as much as 14 months prior to the annual January 1st deadline for mailing assessment notices to taxpayers. This extended timeframe presents an obstacle to ensuring timely valuations and often leads to assessments that are substantially out of date as they are phased in.

When valuing commercial properties, it is not unusual for appraisers and assessors alike to rely on comparable sales data that could itself be several years old and not particularly indicative of current market conditions. In theory, assessors are supposed to address this timeliness problem by doing "time" adjustments to reflect upward changes in the market that are relevant to certain valuations before they are finalized and delivered to the taxpayer. A concerted effort to monitor market trends and rigorously update assessments just prior to the date of finality is needed, but is hampered by the lack of personnel, procedures and accurate, functional, real-time databases that allow for statistical and other analytical techniques to estab-



**2000-2002:**

***During the three-year period, in no case did PTAAB of Baltimore City increase an assessment above the assessor's initial finding.***



lish up-to-the-minute valuations.

Some would attribute assessment inaccuracies to the rise in non-deeded transfers of controlling interests that escape recordation, and thus SDAT's information and taxation system, diminishing the number of commercial property sales transactions available for SDAT to use in the Sales Comparison Approach. Although these transactions pose an important and complex legislative issue with its own revenue implications, such transactions are too select and few to profoundly influence widespread assessment accuracy. This assertion also overlooks that "in the absence of good sales information, there are two remaining options for valuing the property – the cost approach and the income approach" (Procedure 014-100-004).

### **Out of Cycle Revisions**

Although the law calls for properties to be valued once every three years, its provisions also call for SDAT to revalue a property during the three-year cycle to account for owner-initiated zoning changes, changes in the property's use or character, or improvements that add \$50,000 or more to the value of the property.

Information obtained from the Baltimore permit office indicates that 746 building and alteration permits of \$50,000 or greater for commercial properties were issued in 2001. The face amount of these permits totaled \$585,494,610. At the City's tax rate, this permit total represents a potential for collection of an additional \$13.6 million annually in property taxes, although the value of the work stated on the permit is not always indicative of the amount of value added to the property due to improvements.

Changes to the assessed values of properties for alterations, modifications

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and additions are made on the first days of January, April, July, and October. Obviously, the more quickly assessors recognize these increased values, the sooner the City and State are able to capture additional tax revenues. Section 5-103 of the Tax Property Article requires that local jurisdictions notify SDAT immediately after issuing a building permit. However, the Tax Property Article contains no language regarding the timeframe within which SDAT must complete the task of re-valuing a property after it has been altered, modified or improved.

To ascertain the efficiency of the department's efforts to update assessment in the middle of the cycle, the author reviewed 23 properties that had gone through substantial changes. However, conclusions were difficult since City and SDAT officials conceded that neither has a tracking process, an information system that facilitates collection of the requisite data, or a procedure that monitors and assesses SDAT's performance in terms of timeliness or the amount of value added.

According to SDAT staff, assessed value is to be revised when the building is "substantially completed" in accordance with Tax Property Article 8-104 that provide "improvements not substantially completed on the date of finality should not be assessed." However, the criteria used by SDAT employees in evaluating substantial completeness were vague, inconsistent and varied greatly among different buildings and building types, according to interviews. For instance, the assessment for one multi-tenant building that had been newly constructed was being revised in five-floor increments, as the finishes were completed. In another instance,

the re-assessment for an existing multi-tenant structure of similar size that was being completely renovated was being deferred until completion of all renovations, rather than incrementally as floors were retrofitted. In another case, the assessment for a project involving the extended renovation of multiple buildings under multiple permits was delayed until construction within all of the buildings was complete. The SDAT official interviewed reported that revaluation for apartment building renovations typically awaits completion of all construction within the entire building, but was unable to specifically define "completion" or to outline procedures for re-evaluating multiple-building complexes undergoing renovation.

### **Arbitrary geographic divisions do not comport with market boundaries**

The geographic boundaries governing the triennial revaluation cycle in the City are the same for residential and non-residential properties. Unfortunately, this arbitrary geographic division of the city, while suitable for residential

property, has little to do with the existing market for commercial property, which undermines assessors' ability to compare the uniformity of assessments for similar properties.

In particular, the trade areas in which non-residential properties compete and which drive supply and demand forces that influence values tend to be much larger than for residential property. Non-residential property competes on a Citywide and, sometimes, regional or national basis. Re-valuing properties that are similar in use at different times – a schedule determined only by an arbitrary geographic division of the City – precludes informative on-going comparisons for accuracy and uniformity. For instance, Holabird Business Park is in Assessment Group 2, Seton Business Park is in Assessment Group 1, while the business parks located in South Baltimore are in Assessment Group 3. In the same way, such arbitrary divisions hinder inter-jurisdictional comparisons of similar property types within the metropolitan area to gauge uniformity.

### **Highest and Best Use**

Determining a property's highest and best use is a bedrock component of the valuation process. The fair market value of real estate presumes that a parcel of land is devoted to its highest and best use – that is, the physically possible, legally permissible, financially feasible, and maximally productive use that will produce the most benefits or the greatest investment returns over time. If an appraiser or assessor automatically values the existing improvements without considering if, as presently used, they represent the property's highest and best use, an undervaluation may well result, especially in redeveloping neighborhoods.

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*Arbitrary divisions hinder inter-jurisdictional comparisons of similar property types within the metropolitan area to gauge uniformity.*

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The full version of this report examines in detail the issue of highest and best use and the four under-assessed properties in Chart 7 that were sold in 2001, assessments that appear to have been the result of an improper determination of their highest and best use.

Each of these properties was acquired with the intention of immediately changing its use after the purchase. It appears that SDAT assessors, due to time constraints or other factors, did not consider whether the existing uses of the four properties (which were chronically vacant) represented their highest and best use. Nor did they evaluate the economics of redeveloping each property for another use. Although SDAT procedures call for the assessor to consider the probability of developing a property for all current uses permitted by zoning, apparently the procedure is not always followed.

**Recommendations**

Obviously, instituting an annual assessment system would remedy the concern about lagging values that are structurally inherent in the existing triennial process. While expanding SDAT’s capacity to tackle the increased annual volume of assessments and appeals would be a costly undertaking, the incremental expenditure would

likely be recoverable from the corresponding rise in tax revenues attributable to the more current valuations. In the alternative, developing and applying a reliable trending index to annually modify and update triennial property assessments is another viable option, although more suitable to the residential rather than commercial property market due to residential market’s higher annual sales volume from which to construct an index.

Since both of the foregoing would entail major policy shifts and legislative action, the following represents key recommendations applicable to the State’s current assessment practices. (See the full version of the report for detailed discussion and additional recommendations.)

1. In light of the specialized nature of non-residential real property valuation and the limited resources available, SDAT should consider reorganizing and centralizing the commercial assessment function, giving it more of a regional focus in the process. The existing structure of having commercial assessors working in each local jurisdiction is redundant, costly and a holdover from the time three decades ago when the State took over the responsibility for performing assessments from local subdivisions. One possible response would be to

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*Instituting an annual assessment system would remedy the concern about lagging values that are structurally inherent in the existing triennial process.*

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have commercial assessors work out of the Director’s Office, from where they could be deployed across the State, rather than duplicating the function in each county. Although SDAT could continue to do commercial assessments on a triennial basis, the work could be performed within regions – e.g. Southern Maryland or Metropolitan Baltimore – instead of only within a portion of each local jurisdiction. By doing so, SDAT personnel would have the opportunity to become specialists for specific property types – among them warehouse/industrial, apartments, hotels, or offices – giv-

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**CHART 7**

LOCATION	SALE DATE	SALE PRICE	ASSESSED VALUE	DIFFERENCE	AV/SP RATIO
131 E. REDWOOD STREET	Aug-01	\$1,500,000	\$504,500	\$995,500	34%
4601 LIBERTY HEIGHTS AVE	Jul-01	\$630,000	\$325,000	\$305,000	52%
5 N. CALVERT STREET	Jun-01	\$2,200,000	\$437,000	\$1,763,000	20%
2711 FOSTER AVENUE	Feb-01	\$1,200,000	\$452,200	\$747,800	38%

ing them in-depth knowledge of market conditions.

2. Along with the shift of personnel, the department should assemble centralized databases containing useful market information on such things as comparable land and building sales, rentals, operating expenses and vacancy rates. This would allow for cross-jurisdictional comparisons that are not easily accomplished under the current system. To ensure timely assessed values, enhanced data processing and analysis systems would allow assessors to compute trending factors that can update their earlier value conclusions just prior to the date of finality and transmittal of the assessment notice.
3. The State should establish an oversight and advisory board for the assessment operation, with some or all of its members having appropriate valuation and data analysis qualifications. This external board would be responsible for ensuring that the department is using the most appropriate procedures and that values are properly documented and justified.
4. SDAT should establish a standing oversight committee, within the department, that would be responsible for investigating and analyzing the causes underlying assessments that materially vary from sales price. Assessors should be professionally accountable for and capable of defending their value conclusions. When an assessor's valuations are repeatedly found to be



***As the principal beneficiary of the property taxes generated by accurate assessments, the City government could be expected to scour the tax rolls for every opportunity to rectify shortfalls.***



inaccurate (as indicated by subsequent property sales) they should be examined to ascertain the causes underlying the variance. Based on the findings, the Department should provide appropriate training and other remedial actions to forestall future recurrences.

5. SDAT should review its treatment of "substantial completion" of improvements by property type and classification. Based upon the findings, the department should consider revisions to the Valuation Procedures Manual to clarify the criteria for each class and type of property, to ensure uniformity within and between jurisdictions.
6. SDAT should draft directives clarifying when and how to recognize the incremental value derived from building modifications. Correspondingly, SDAT should institute oversight measures to assure com-

pliance with these directives, including adequate documentation of the data and valuation procedures employed to ensure uniformity within and between jurisdictions.

7. In addition to reporting the number of cases handled by category, the Maryland Tax Court and PTAAB should also report the dollar amounts of increases or decreases in assessed value. This data would be useful to measure SDAT's effectiveness in the appellate process.

### **Baltimore City's Role**

Baltimore City policymakers and taxpayers rightfully pay close attention to the City's property tax rate. City leaders also spend time debating the merits of such tax incentives as Payments in Lieu of Taxes, which are designed to spur significant investment but can often be controversial.

By comparison, the underassessment of properties draws less attention because it is inconspicuous, highly variable and somewhat esoteric. As the principal beneficiary of the property taxes generated by accurate assessments, the City government could be expected to scour the tax rolls for every opportunity to rectify shortfalls. However, the City government's oversight of SDAT valuations, despite the role envisioned and reserved for it by General Assembly in the Tax Property Article, has been almost non-existent, with few mechanisms in place to detect or correct inaccuracies. Representatives of the city government do not participate in appeals of property tax assessments at any stage of the appellate process, according to the Administrator of the Property Tax Assessment Appeals Board and the clerk of the Maryland

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Tax Court, who could not recall an occasion when a City representative attended a Tax Court proceeding or presented testimony.

Montgomery County, alone among the State's local governments, makes a concerted effort to both appeal assessments considered too low or to challenge appeals of property assessments filed by taxpayers. [For more details on Montgomery County's experience, see the full version of this report.]

A number of Baltimore City agencies have a role in the property tax assessment process and routinely deal with SDAT as well as each other. However, their efforts appear to be disjointed, with little awareness of how the respective functions relate to each other, and with no overall coordination or direction.

For example, no one within the City government is now responsible for periodically reviewing the accuracy of



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SDAT's value conclusions concerning commercial properties. The City designates no one to oversee a coordinated effort to monitor and manage the City's property tax base on a continual basis. Interviews showed that once the City permits' office forwards building/alteration permit data to SDAT, the City generally views its role as completed. It appears that no one monitors the timeliness or tracks the results of SDAT's subsequent actions regarding the building additions.

### **Data Issues**

Historically, the City has relied on a real-property information system configured primarily as a tool to facilitate the billing and collection of property taxes. The information in this antiquated, mainframe computer system, as well as the system's capability to retrieve and analyze data has been quite constrained. For instance, the current mainframe set-up has no intrinsic analytical capabilities, and no capacity to download data into a spreadsheet for analysis.

The efficient comparison or analysis of assessed values and transfer data for improved properties is precluded since individual property records are devoid of any information about buildings or other improvements including size, dimensions, age or type and use of structure. Likewise, no geographic information such as zip code or neighborhood is presented. Although current phase-in year and base year assessed value data is presented, the individual records lack any historic assessment information, thereby precluding comparisons over time or the detection of trends.

However, the City is in the process of replacing its antiquated system with two new data systems – the Tidemark system introduced in 2002 by the Department of Housing and Community

Development for building and alteration permits, and a real property tax information and billing system in the process of being implemented by Manatron Corporation that is scheduled for service in June, 2005.

It is imperative that the City ensure that the data in the permit system and in the property tax and assessment information system are complete, uniform, compatible, consistently formatted, seamless, synchronized, and available for swift and efficient retrieval and analysis.

### **Procedural Issues**

Once the City's operation is properly organized and equipped with a functional information system, the final task would be to implement an on-going process to monitor and manage the non-residential property tax base in an accurate and equitable manner.

The Tax Property Article restricts a local government's ability to file appeals of assessed values within the same 45-day period from the date of notice allotted the taxpayer. With so many property assessments to review and so little time to act once notices are received, the City must be prepared to immediately identify property assessments that it believes to be erroneous and, when appropriate, file appeal documentation in a timely manner. At the same time, the City must be ready to respond quickly to taxpayer appeals for assessment reductions in those instances that the City believes are unwarranted.

First, the City should arrange with SDAT for the timely receipt of assessment information in a form and format that will facilitate prompt and efficient analysis of the data. Any delay compromises the City's ability to review and respond to the assessments in a timely

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manner. Simple screening techniques to detect value anomalies need to be adopted and applied. Likewise, the City should make arrangements with SDAT, PTAAB, and the Maryland Tax Court for prompt notification of designated City officials concerning all non-residential property assessment appeals filed by taxpayers, not just those exceeding \$2 million in value, as required by the Tax Property Article.

The City's updated real property database should include property sales and rentals by use, improvement size, geography, and other characteristics. The database should also include computed unit rental and unit sale values, as well as capitalization and yield rates. It should be continually analyzed throughout the year to assist in evaluating not only the substance of taxpayer appeals filed with SDAT, but also the annual issuance of new assessments by SDAT that must be promptly evaluated and challenged, when appropriate.

In addition to reviewing and responding to taxpayer appeals and SDAT's cyclical assessments, the City should also take steps to identify and evaluate those properties that pose particularly challenging valuation problems, the complexity of which might not be easily discerned by an assessor with limited time and analytical resources. The City's analysis of vacant or underutilized properties located in speculative or redeveloping neighborhoods where rapidly changing market conditions are influencing highest and best use and property values could be shared with SDAT. This might enable time-strapped SDAT assessors to more readily comprehend subtle or emerging influences on property values, forestalling the potential for under-assessment.

Section 2-203(c) of the Tax Property Article empowers the Property Tax Assessment Appeal Board to request a review of any real property assessment, and the Director of Assessments and Taxation shall order it. However, PTAAB can only respond to actions brought before it by others and not on its own motion. This provision, heretofore unused by the City and other local jurisdictions, renders PTAAB a useful and effective forum within which the City can petition for the review of inaccurate assessments, whether for a single property, or for an entire class of properties.

Finally, the City should develop appropriate procedures to monitor SDAT's actions and conclusions subsequent to the City's issuance of building and alteration permits. The City should ensure that SDAT's response is timely. Moreover, the City should monitor cases in which "substantial completion" is an issue. It should also take steps to ensure that SDAT measures the appro-

prate amount of value added by the improvements made under the permit and captures that value at the earliest permitted opportunity.

## **Important Considerations**

This report makes the case that the City of Baltimore should monitor the assessments process more diligently. Although primarily a matter of equity and parity in taxation, such an effort would most likely enhance the tax base and tax revenues. However, it is important to note that such a strategy carries with it the potential for unintended side effects that should be carefully considered and addressed.

First, under current State funding formulas, the City could inadvertently end up costing itself some State aid if it were to unilaterally pursue a program to monitor assessment accuracy that results in a significantly enhanced property tax base. In particular, State education funding is based in part on a local jurisdiction's relative wealth as measured by its tax base, or its relative ability to generate property tax revenues. In simplest terms, the higher the jurisdiction's property wealth, the less State aid it receives. At stake could be millions of dollars in State education funding.

Similarly, a substantial increase in the City's real property assessable base could lead to a reduction in the City's real property tax rate. Such a rate cut, though, carries other consequences. In particular, the real property tax rate is tied by law to the tax on personal property, such as machinery and equipment. Currently, the personal property rate is set at 2.5 times the real property tax rate. If the City were to reduce the real property tax rate, it would also be cutting personal property rates and collections.

Finally, and most importantly, while this report did not specifically

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look at the assessments process and results in jurisdictions outside Baltimore, the findings here raise red flags about the possible under-valuation of commercial properties throughout the State. For instance, SDAT's 2003 Commercial Ratio Study reports that half of the State's 24 political subdivisions have weighted ratios below the 87 percent statewide average with three below 75 percent. While this could be attributable to a variety of circumstances including a very small sample of property sale transactions, there is reason to believe that the concerns noted here are not limited to the City of Baltimore. If Baltimore alone among the jurisdictions were to take steps to ensure the accuracy of commercial assessments, it could well be put at a competitive disadvantage. It is important that officials of both the city and state carefully consider issues concerning uniformity of assessments and the potential shifting of tax burdens among jurisdictions as they contemplate changes in assessment policies and practices.

## Recommendation

Given Baltimore City's fiscal problems, City leaders should make it a priority to monitor the assessments of the City's commercial properties and assign the task to a unit with the expertise and resources needed to do the job adequately. A number of Baltimore City agencies now have a role in the property tax assessment process and deal with SDAT. However, their efforts appear to be disjointed with little awareness or appreciation of how they relate to those of other units of City government. Rectifying that will require careful planning and attention to the City's data-analysis and collection systems, which would be needed to aid staff in identifying and

evaluating suspect assessments.

## Conclusion

This report concludes that there is much to be done, but also much to be gained. Although fiscal resources at every level of government are scarce, State leaders should recognize that adequately funding the property tax assessment function must be a priority. Unlike many other appropriations, dollars prudently invested in the assessment function should produce more timely and accurate assessments that can translate into an enhanced tax base that generates additional tax revenues. In addition, resources devoted to expanding the tax base will benefit local as well as state government coffers.

Similarly, Baltimore City should begin to play the proactive role in the assessment process that the General

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and no less?*



### About the Study's Author:

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Assembly has envisioned. City officials should start by acknowledging the need to adopt a more strategic viewpoint and coordinated effort to monitor and manage the City's property tax base. In so doing, the City must ensure that any process of reviewing and, when appropriate, challenging commercial property assessments must be done equitably, systematically and transparently to foster public confidence and acceptance.

Each year, taxpayers review their property tax assessments for accuracy to ensure that they are being asked to pay only their appropriate share of taxes and no more. Isn't it only reasonable for taxpayers to expect local public officials to exert a similar degree of fiscal prudence and check assessment accuracy on behalf of the City at large to make sure that the City is receiving its fair share of tax revenues from the assessable tax base and no less?

In closing, it is worth repeating that while this report focuses on the City of Baltimore, the issue discussed should be considered and addressed collectively by jurisdictions throughout the state to prevent an unintentional and unwarranted shift in tax burden or revenues. Baltimore City already faces tough competition from other jurisdictions on business and economic development matters. It would be counter-productive for the city to take unilateral steps that would detrimentally alter the playing field and penalize Baltimore City's economic development interests over time.

## **ABELL SALUTES:**

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levels to 21st on a scale of measurement where movement towards improvement is historically stubborn, is no small victory. Quite the opposite, it is a large one.

The research and rankings ("An Update On Urban Hardship") are the work of the Nelson A. Rockefeller Institute of Government of the State University of New York. The institute looked at 86 cities, measuring unemployment, poverty, per capita income, education, crowded housing, and dependency (percentage of population under age 18 or over 64.)

According to the report's authors, Lisa Montiel, Richard P. Nathan, and David Wright, "Baltimore has steadily improved its rankings through the years." That it has, comes as no surprise to Mayor Martin O'Malley. After reviewing the encouraging findings, he says, "Baltimore's progress is real, and measurable. Businesses, non-profits and individual citizens are all stepping up. And government is becoming a better partner. We're tracking and driving better government services through CitiStat. Neighbors are coming together with their Police Department to reduce crime to levels we haven't seen since 1970. Through the Believe In Our Schools initiative, this summer more than 5,000 volunteers, unions, businesses and non-profits came together to do more than \$4-million of construction, painting and landscaping for our children and our teachers. And Project 5000 is the first comprehensive effort to tackle blight—and return abandoned property to productive use—in Baltimore's history.

"We still have work to do. It will take years of continued progress to get us to where we all believe our city can and should be. But as we make these improvements, private investment is returning to our city—improving neighborhoods and creating jobs. You will see Baltimore's rankings continue to improve,"

The Abell Foundation salutes Mayor O'Malley, all 56 City of Baltimore departments, the people who work in them and all of the citizens of Baltimore— whose combined efforts are moving Baltimore City in the right direction.

***The full report of "Commercial Property Assessments in Baltimore City"  
is available on The Abell Foundation's website at [www.abell.org](http://www.abell.org)  
or: write to The Abell Foundation 111 S. Calvert Street, Baltimore, MD 21202***