

## **AUTHOR'S REBUTTAL TO THE RESPONSE OF THE DIRECTOR OF ASSESSMENTS AND TAXATION**

### **SALE PRICES FOR PROPERTIES WHICH SELL OUTSIDE OF LAND RECORDS IS NOT PUBLIC INFORMATION**

The Director indicates that, although small, the number of unrecorded property transfers is on the rise for benchmark properties. Since the General Assembly has failed to take action to curtail the use of this transfer technique, instead of merely lamenting the circumstance, shouldn't SDAT acknowledge reality and focus on the application of techniques other than the Market Data Approach that must rely on recorded sales transactions to estimate value?

Contrary to the Director's inference, not only does the author of the report "...*contend(s) that there are two other methods for valuing properties, the cost and income approaches to value...*" the Appraisal Foundation's Uniform Standards of Professional Appraisal Practice, SDAT's own Valuation Procedures Manual (Procedure 014-100-004), and the International Association of Assessing Officers (IAAO) also support the application of these two recognized traditional approaches to value. In fact, section 4.2 of IAAO's Standard on Mass Appraisal of Real Property states "...the Cost Approach is applicable to virtually all improved parcels, and, if used properly, can produce highly accurate valuations." Section 4.6.2 goes on to say "...the cost approach is useful in providing supplemental valuations and can serve as the primary approach when good sales and income data are not available..." Section 4.4 of IAAO's Standard on Mass Appraisal of Real Property states "... for income producing properties the income approach is the *preferred* (emphasis added) valuation approach when reliable income and expense data are available..."

The Director comments that "By simply knowing what the income is but not the relationship between income and value, the income approach becomes difficult to defend." The author concurs that the Income Approach to value is based upon a defensible relationship between a property's value and its income, a relationship that is mathematically expressed as a capitalization rate (income divided by value or sale price). Section 4.4 of IAAO's Standard on Mass Appraisal of Real Property states that "...successful application of the income approach requires the collection, maintenance and careful analysis of income and expense data..." The Department's ability to discern and defend the relationship between income and value could be materially enhanced, as discussed on page 16 of the report, by compiling functional databases from the income and expense data that it already collects from property owners, and thereafter matching gross and net income with property sales data to compute market derived gross rent multipliers and overall rates of capitalization to support and defend its value conclusions derived via the Income Approach as recommended by Section 4.4 of IAAO's Standard on Mass Appraisal of Real Property.

The Director's inference that the Cost Approach... "*does not indicate a land value*" is inaccurate. The Cost Approach is also known as Value by Summation in which the values of the property's physical components (land and building) are determined separately and then summed. Determining the value of land, either directly from the analysis of market transactions, or indirectly as a residual of property income, is an inherent step in performing the Cost Approach. The Director's assertion also overlooks that SDAT computes and reports the assessed value for each property in Maryland in terms of its physical components, viz. a value for land and a value for building in addition to the total value. Since the assessor must already determine and report the value of land for each property, why would the cost approach, as the Director contends, "*...not indicate the land value...*"?

### **TRIENNIAL ASSESSMENTS ARE LAW**

The report does not recommend or espouse, as the Director alleges, that maximizing revenue should be the goal of SDAT. The goal of SDAT should be producing accurate, reliable, and credible property valuations as the report states in its Conclusion. The report merely highlights some shortcomings that were observed during the course of the study and offers suggestions aimed at improving the accuracy and timeliness of the valuations performed by SDAT, the effect of which might, indirectly, have the effect of augmenting revenues to the state, and, to a greater extent, the City. The report does encourage the City (and by extension other local governments) to assume a more pro-active role in the assessment process as an interested party and tax revenue recipient, a role that was envisioned by the General Assembly as outlined in the report. The Director's comment that "*the Department wants to place a fair and uniform value on all properties*", while acknowledging the concept of uniformity of assessment, ignores the other component cited by IAAO, the level of assessment that is examined on page 5 of the report.

The report details the statutory requirement for a triennial process and its role in lagging assessed values. The influence of the triennial process with phased-in conclusions was examined on pages 4, 5 and 25. The discussion also recognizes that timeliness of data as a result of the process is a problem and includes some suggestions to *alleviate* the problem. The report also suggests that adopting an annual assessment cycle could virtually eliminate the problem that is inherent in the current statutorily mandated triennial process.

The two property transfers recited at the beginning of the report (the First Union Building and the Candler Building) were presented as a means to frame the question posed on page 2 of the report, which underlies the fundamental premise of the study: "*Are the two sales recited above aberrations, or do they reflect a more pervasive pattern of underassessment and consequent revenue loss.*" The rest of the report addresses this issue.

The Director's allusion to the use of the sales of the First Union and Candler Buildings in the subsequent valuation of each building is tantamount to saying that the weatherman is

100% accurate when forecasting the weather in arrears. Hindsight is always 20-20. Assessing, like appraising, is about foresight, estimating the present worth of future benefits. The report seeks to identify ways for the Department to hone its foresight. The Director ignores or doesn't seem to understand that the City relinquished approximately \$750,000 per year in tax revenue as a result of the assessment shortfall (as indicated by the properties' selling prices). Correction of the inaccuracy at a future date subsequent to property sale does not recapture the revenue already lost. What if the buildings hadn't sold? How then would the apparent under-valuations have come to light and been identified? The Director indicates that the assessor valued the properties in September 2000 and would have been examining comparable sales from a time before then. The report addresses the issue of timeliness from a number of perspectives including the availability, compilation, processing and use of data. The Director's complaint that "*without the sale of the same or similar properties over time, any trend which would be applied could be argued as capricious*" corroborates the author's identification of this very shortcoming in SDAT's data system and a recommendation for its correction on page 17 of the report.

## **REPORT RECOMMENDS IDEAS AGAINST THE LAW IN MARYLAND**

### PTAAB ADMINISTRATOR REPORT REGARDING RESIDENTIAL PROPERTY

The Director's comment about anecdotal evidence concerning the under-valuation of residential property deals with an endnote that was properly cited in the report as an official communication (a copy of which was included in the report) between the Administrator of a state agency (PTAAB) that is independently involved in the property tax assessment process, and an elected legislative official regarding residential property tax assessments. The author was neither provided nor did he request a copy of the full PTAAB report since it was tangential to the topic under investigation, viz. commercial property assessments.

### EQUALIZATION OF ASSESSMENTS IS AGAINST THE LAW IN MARYLAND

On page 5 of the report the author discusses Ratio Analysis, only one use of which deals with Assessment Equalization, a process performed by State Agencies in their oversight capacity as described in Sections 2.3.1 and 2.3.2 of the IAAO Standard on Ratio Studies. Among the other uses of Ratio Studies described in Section 2.3 *Uses of Ratio Studies* of the IAAO Standard on Ratio Studies include monitoring appraisal performance, identifying potential problems with appraisal procedures, and conducting market analysis. The discussion of Ratio Analysis in the report is for the purpose of performance evaluation and identification of procedural problems, ***not*** equalization. As the report discusses, in Maryland, a state agency actually performs the assessments. It, therefore, cannot also perform oversight. The report does not suggest that SDAT should engage in assessment equalization. It recommends oversight that is now missing in the Maryland model.

### CURRENT AGENCY STRUCTURE REFLECTS REQUIREMENTS OF LAW

The report discusses the need for SDAT to adopt a more progressive perspective and adopt more “outside of the box” thinking. The Director’s comment that “*the Department is organized as the law currently requires*” reinforces the author’s finding. Just because current law stipulates a specific organizational structure does not necessarily mean that it is the ideal organizational structure at this time and cannot be improved. If a superior organizational structure were to be devised, with proper justification, the legislature might be prompted to change the law. New laws are enacted every year. The Director’s stance is tantamount to saying that SDAT couldn’t use copy machines or computers if the law stipulated that it must use carbon paper and handwritten, preprinted forms. Obviously, the legislature is capable of judiciously recognizing an anachronism in the light of contemporary best practice. If, as the Director contends, the law precludes organization and deployment of personnel on a regionalized basis as suggested at the beginning of the Director’s comments, how is the current inter-jurisdictional deployment of assessment personnel discussed at the end of his comments conducted and justified?

### **GENERAL ASSEMBLY PASSED BILL PREVENTING MONTGOMERY COUNTY ADVOCATE’S OFFICE FROM PURSUING OUT OF CYCLE ASSESSMENT APPEALS**

Contrary to the Director’s inference, the report does not commend the job done by the Montgomery County Advocate it merely describes the Montgomery County Tax Advocacy program. The report specifically points out the shortcomings of the Montgomery County program and what steps must be taken to avoid and overcome them.

The Director’s interpretation of the language of Senate Bill 208 (2000) as “a strong indication of the legislature’s opinion toward the concept of tax base maximization” is tenuous. Specifically, the wording of the Senate Bill 208 is “... that certain actions of local governments are contrary to the triennial assessment system and uniformity of taxation...” The specific actions to which the bill refers, however, are quite limited. The Fiscal Note issued by the Department of Legislative Services states “The emergency bill repeals the authority for municipalities, counties and the Attorney General to appeal a real property tax assessment outside of an assessment cycle. The right to appeal within 45 days after an assessment is issued remains unchanged.”

Contrary to the Director’s assertion, Senate Bill 208 makes no reference to a position concerning tax base maximization by local governments. While Senate Bill 208 did repeal certain provisions of the Tax Property Article, it left intact those Tax Property Article provisions discussed on page 36 of the report that envision an active role for local governments in the property tax assessment process. As the report discusses on page 37 “The Advocate’s focus strictly on the filing of out-of-cycle appeals of recently sold homes eventually attracted the attention of state lawmakers, and the legislature reacted by ending a practice that it perceived to be inherently inequitable and contrary to the concept of assessment uniformity”, viz. the filing of out of cycle appeals.

The report does not espouse the filing of out of cycle assessment appeals. It does provide recommendations for Baltimore City and other local governments to “equitably, systematically, and transparently” monitor, manage, and when appropriate, challenge suspect commercial property assessments in a manner that fosters public confidence and acceptance within the provisions of the Tax Property Article (see page 44 of the report)

## **OVERSIGHT OF SDAT EXISTS**

The report discusses the issue of oversight in detail. Internal management controls do not constitute oversight, nor are they a substitute for it, as discussed in the report. The legislative audit during the summer of 2004 occurred after completion of the author’s work and drafting of the report. SDAT staff responded to the author’s direct question during an interview that it had been a number of years since a legislative audit had been conducted on the Real Property function of SDAT’s Baltimore office, and that there was no established timetable for performing such audits. Despite a thorough discussion of the topic in the report, the Director’s comments demonstrate a failure to understand and appreciate that, although the appeals process, as presently conducted, might adequately deal with instances of over-assessment, it cannot and will not identify instances of property under-assessment. If the property sales transactions used for the Department’s annual ratio analyses are not confidential, why doesn’t SDAT identify and publish them each year together with the computed measures of dispersion in the Department’s Annual Reports for all to see and evaluate?

## **REPORT ADMITS THAT MANY OF ITS RECOMMENDATIONS ABOUT INFORMATION SYSTEMS HAVE BEEN CORRECTED**

Unfortunately, studies like this one are conducted sequentially in a dynamic, rather than static environment with a finite amount of time and resources to be devoted to the topic. The Director’s assertion that SDAT has corrected some of the data system deficiencies since the time that the study was performed confirms the existence of the shortcomings and corroborates the report’s original findings. The author commends the Department’s progress in this area. Without specifically identifying them, the report overtly acknowledges that changes and improvements have been implemented by SDAT since the report’s research was conducted. Regrettably, the author was not apprised of the enhancements until after the research had been completed and the report written, a process that had already entailed twice the amount of time originally budgeted and approved. The author was not authorized to perform any additional research subsequent to completion of the final draft of the report. Without having observed and confirmed the Department’s representations about the nature and extent of any of the data system modifications and enhancements that were implemented by SDAT subsequent to completion of the report, it would have been equally inappropriate for the author to have deleted the discussion of conditions actually observed during performance of the

research, or to have cited unobserved modifications and enhancements except in the most general terms as presented in the final report.

The confusion over the Homestead versus Homeowner's Tax Credit alluded to by the Director, was a semantic rather than substantive error that, despite five edits of drafts and three different editors, nevertheless, made it into the final draft of the report that was transmitted for vetting.

### **SALES EDIT NOT PERFORMED**

Notwithstanding the Director's mistaken assertion, any statistical findings presented in the report were based solely on assessment ratios that were calculated and reported by the Maryland Department of Assessments and Taxation in its Annual Reports (see the discussion in the text and charts on page 8 of the report). As detailed in the report's Exhibit 3, Methodology and Scope of Work, and as set forth in the report's objectives on page 3, the study sought to identify specific tangible examples of significantly under-assessed non-residential properties to exemplify and corroborate the conclusions of SDAT's ratios presented in its Annual Reports. These properties were identified in Exhibit 3. As specifically stated in end note 29, "*properties were selected with the intent to target and screen potential candidates for closer scrutiny, not for statistical analysis...*" a point that was reiterated on page 9 "*...Although deriving statistically valid inferences from the data was not possible due to protocols followed, the following anecdotal observations (with regard to the properties identified in Exhibit 3) are notable...*" The editing of the sales data (ostensibly from exhibit 3) espoused by the Director's comments would have been inconsequential since that information was never intended, nor used, for the purpose of statistical analysis. Any reference to statistical conclusions presented within the report (e.g. on page 9 that "*...the aggregated weighted ratio of 83%... suggests that commercial properties have generally been assessed approximately 17% below market value...*") were strictly the result of data analyses and conclusions performed and reported by the Maryland Department of Assessments and Taxation in its Annual Reports, not by the author.