

Audit of the Real Property Assessment Division

Web Link to the Report:

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https://www.honolulu.gov/rep/site/oca/oca_docs/rpad_final_report.pdf

Audit Highlights

In 2010, numerous residential properties were misclassified and incorrectly assessed for real property taxation, which led to public outcry and negative media coverage. There was also an earlier controversy created by a newspaper investigation over historic properties' non-compliance with tax exemption requirements. The City Council passed Council Resolution 10-269, which requested a performance audit of the Department of Budget and Fiscal Services' real property assessment division (RPAD), which sought to determine if real property tax assessment process produced accurate and reliable information to approve the city's certified tax roll and set annual tax rates.

We found that real property was being inconsistently classified for property tax purposes because tax assessment staff was not following best practices such as:

- Performing physical inspections;
- Focusing on quality assurance;
- Maintaining and updating databases; or
- Complying with existing administrative policies and procedures.

This resulted in the following effects:

- Tax assessments were inconsistent and inequitable;
- Exemption and dedication property requirements were violated; and
- Taxes assessed did not reflect the highest and best use of the properties.

This audit had the following impact:

- The City Council and public came to understand the cause of the problems in real property tax assessment
- The department attacked the report, attempted to discredit the results, and categorically denied the issues raised or the need to take corrective action
- After the report was released, the division began to quietly address the general deficiencies that existed for many years, but were not corrected, and many of the examples in the report which directly affected individual taxpayers
- The department also planned the following budget initiatives for the next fiscal year
 - A major review of the real property home exemption program to verify and ensure compliance with city ordinances;
 - A major software upgrade to the real property mass appraisal computer system (*iasWorld*) to improve valuations; and

- Increased consultant services to assist in the upgrade of the treasury portion of the *iasWorld* information system, which includes the delinquent tax collection system.
- Potential for more real property tax revenues existed if (1) the assessment process is properly administered and (2) tax break requirements are monitored and enforced (e.g., exemptions, dedications)
- The City Council put forth legislation in 2014 to address the following areas:
 - Amend the historic residence property exemption
 - Revisit the issue of use of residential homes as vacation rentals or bed & breakfast entities, and taxing such use at the higher hotel or commercial tax rate; and
 - Increase the minimum real property tax amount for historic properties to more than \$300 per year

Audit Objectives

1. Assess RPAD's operational and management practices to develop the annual certified assessment roll;
2. Assess data management practices in the classification and assessment process;
3. Assess use and operations of the *iasWorld* information system to manage and process assessment data; and
4. Make recommendations for improvements needed in the process for classification and assessment of real property tax

General Audit Plan, Tools, or Other Helpful Information

Our review focused on the division's classification and reclassification processes, the reliability and accuracy of property tax records, and the reliability of the assessment process. We also compared the division's practices against professional standards, policies and procedures, and best practices.

Access to the data

A critical factor to this audit was the division providing us with access to the real property tax data. In this case, the division gave use remote, read-only access to their *iasWorld* system, which was easy to use for comparison and verification purposes.

- The typical exceptions we found were incorrect site addresses, inspections that were not logged, recorded, or noted information that was inconsistent with the tax class applied or the tax break given.
- We found that the division was using the system in a spreadsheet-like fashion to hold information and make calculations, rather than in a robust fashion which utilized all system capabilities.
- The division also did not input all information for each parcel, and often the information that was inputted disagreed with classifications made and tax exemptions given.

Selection of samples

The number of parcels in the City and County of Honolulu is approximately 290,000. To make the number more manageable and to provide the City Council and public with more meaningful results, we selected judgmental samples based on the previous controversies (to determine if earlier problems were resolved), and on properties where actual use may not correspond or comply with the requirements of its current classification, dedication, or exemption status.

This approach revealed that:

- Only temporary fixes were applied to deal with the controversies.
- There were systemic operational problems caused by lack of inspection, lack of data validation, and the lack of monitoring and enforcement to ensure property tax classes and tax breaks were appropriate.
- Answered whether certain controversies concerning the real property tax division were handled appropriately, and whether they were likely to occur again.

Site Observations

Of the approximately 1,100 parcels that we reviewed, we performed site inspections on about 950. During site visits, we externally viewed the properties for site characteristics; verified the data maintained by the division; and verified compliance with selected exemption, dedication, and land use requirements. This technique is certainly time consuming, but the value of the observation results can lead to productive discovery or confirmation of whether individual properties are appropriately classed, or compliant with the requirements for tax breaks.

For example:

- One of the exemptions required the landscaping of the property to enable an unobstructed view from the public way, which can only be reviewed by actually going on site to observe.
- As another example, certain tax classes or tax breaks require a certain use to be made of a property, and non-compliance will only be discovered by observing the property.
- In one instance, we saw someone leaving what appeared to be a house with poster tubes. There was an architectural firm operating in the “house”, which led us to review if the house was being taxed at the residential or commercial rate. This would never have been discovered without a site observation.

We also found that using internet tools like Street View in Google maps can help with giving a preliminary visual of properties, and lead to selection of certain properties for actual site observation.

- By using this tool, we were able to obtain a bird’s eye view and to flag certain properties as having odd characteristics (e.g.: buildings or structures split between parcels). We later reviewed the division’s computer assessment system to determine how these characteristics affected the assessment of the parcels involved.
- We were also able to use internet mapping tools and GPS to locate difficult to find properties (e.g., insufficient or incorrect site addresses).
- At times, we used our mobile phones mapping capabilities on site at times to locate parcels or identify property characteristics.

Using technology in this way can help overcome the limitations of identifying properties traditionally, which is not visual and relies on written legal descriptions or survey measurements.

Consideration of Actual Use and Land Use

One of the major issues concerning real property taxation is the relationship between actual use, permitted land use, and tax class. By law, properties in Honolulu are taxed on the basis of “highest and best use”, which is an appraisal concept. (i.e., the reasonably probable and legal use of property physically possible, appropriately supported, financially feasible, and results in the highest value)

In typical situations, the actual use, land use, and tax class are all the same. In Honolulu, there are many areas where the older uses are inconsistent with current zoning (e.g., residences in an industrial zone). On the other hand, there are many current uses which are modern and exceed the allowances of zoning (e.g., group nursing homes in residences and home businesses). These land use issues have real property tax implications.

What we discovered during our audit was that the actual use of the property was not factored into the tax class applied, or the tax break granted. Tax classes were mainly based on zone designation. Actual use was assumed based on the land use designation or zone, or promises made by the property owner. The division would only inspect properties based on complaints and appeals, and not as a regular part of operations. This had great impact on the accuracy of data being used to generate real property tax assessments.

We learned that the division also had an arbitrary rule to place a building or structure that was shared between more than one parcels on only one parcel. This is a violation of the physically possible element. For multiple property assessments where a sizeable building or structure could not fit on a single parcel, one parcel was taxed as if it were so. The other related parcel would then be under assessed.

Using other sources of government data was very productive for this review. Registries, lists, and data created by other government bodies helped provide information on whether a regulated activity was occurring on the property.

In our audit, we used this data to establish that state regulated care home activity was occurring on residential parcels. This provided evidence that land use requirements were violated; there was illegal use of the property; and the need to resolve land use issues so properties could be properly assessed. By not consulting the city’s land use division to resolve these problems, the assessment division could not properly determine the highest and best use.

General Audit Plan

OBJECTIVE 1: Assess Road’s operational and management practices to develop the annual certified assessment roll

1. Identify current operational practices, policies and procedures, administrative guidance, and legal requirements to develop annual certified assessment roll
2. Develop flowchart of processes and information required to develop the annual certified assessment roll

3. Identify recommended best practices for managing and implementing municipal real property assessment
4. Evaluate if current assessment process complies with procedural, administrative, and legal guidance and requirements
5. Evaluate the current roll process and determine if recommended best practices are being followed.
6. Discuss audit observations with management
7. Assess the reliability of the classification and reclassification process, incorporating the results of objectives 2 and 3 in the analysis as appropriate
8. Assess the accuracy of property tax records and the assessment process, incorporating the results of objectives 2 and 3 in the analysis as appropriate
9. Assess the accuracy of the certified assessment roll, incorporating the results of objectives 2 and 3 in the analysis as appropriate
10. Summarize results

OBJECTIVE 2: Assess data management practices in the classification and assessment process

1. Identify current operational practices, policies and procedures, administrative guidance, and legal requirements for classification, reclassification, and data management (e.g., collection, maintenance, quality assurance)
2. Identify key processes for the classification/reclassification process, indicating data transfer, stores, and control points
3. Develop flowchart of processes and data flow for the classification and assessment process
4. Identify recommended best practices for managing and implementing municipal tax data sourcing, validation, transfer, and control
5. Evaluate if current process complies with procedural, administrative, and legal guidance and requirements
6. Evaluate if current data management practices follow recommended best practices
7. Select a judgmental sample of properties and test if the properties have been classified or reclassified accurately
8. Verify property classifications, zoning, mapping and owners are on record with Department of Planning and Permitting records and site observations.
9. Discuss audit observations with management to determine cause of misclassified properties or data management issues, if any
10. Summarize results

OBJECTIVE 3: Assess use and operations of *iasWorld* system to manage and process assessment data

1. Review system documentation to identify system purpose, key processes, key processing modules, processing relationships, data, key products, and managerial reports
2. Develop a flow chart of the system processing, data, and relationships
3. Identify recommended best practices for use and management of *iasWorld* system
4. Identify recommended best practices and controls for computer aided mass appraisal (CAMA) systems
5. Identify system user roles and responsibilities and access

6. Test access controls, using either read-only access or observing authorized users performing designed testing protocols that do not alter production or live data
7. Evaluate if access controls and roles are appropriately controlled and segregated
8. Review and test judgmental sample of properties to determine if property data is accurately inputted, maintained, and validated into the system.
9. If significant irregularities or errors are found initially, subject larger set to ACL testing
10. Observe demonstration of CAMA modeling process, products, and controls
11. Discuss audit observations with management to determine cause of identified errors or issues, if any
12. Evaluate division's use of *iasWorld* capabilities and recommended best practices
13. Evaluate division operations against recommended best practices and controls for CAMA method assessment process

OBJECTIVE 4: Make recommendations for improvements needed in the process for classification and assessment of real property tax.

1. Develop recommendations for improvements for the Real Property Assessment Division
2. Develop recommendations for the Department of Budget and Fiscal Services
3. Develop recommendations for the city administration
4. Develop recommendations for the city council

Criteria

- Review of local laws, ordinances, and regulations
 - Real property tax exemption guidelines
 - Real property dedication guidelines
 - Local land use and zoning designations
- Review of division internal policies and procedures
- Review best practices for assessment and appraisal issued by:
 - The Assessment Standard of the International Association of Assessing Officers (IAAO)
 - Uniform Standards of Professional Appraisal Practice

What kind of impact might this kind of audit have for your jurisdiction?

- Monetary
 - Under/over assessments can be identified
 - The weaknesses of tax break programs can be discovered and corrected
- Taxpayer
 - Greater confidence that assessments are accurate
- Management
 - Improve operations, especially in the area of gathering, maintaining, and validating current data upon which to base assessments
 - Improve confidence that assessment process and programs are accurate and reliable
- Policymakers
 - Revenues are maximized
 - Increase public confidence in equitability and fairness