



Office of the City Auditor

*Committed to increasing government efficiency, effectiveness,
accountability and transparency*

City Assessor's Office

Real Estate Assessment Audit

Report#: 2017-07



Issue Date: January 10, 2017

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Richmond City Council

The Voice of the People

Richmond, Virginia

Office of the City Auditor

Executive Summary

January 10, 2017

Ms. Lou Ali, Council Chief of Staff

Subject: Real Estate Assessment Audit

The City Auditor's Office has completed an audit of the Office of the City Assessor's real estate assessments effective January 1, 2016. The objectives of this audit were to:

- Determine if real estate taxes were properly assessed and adjusted; and
- Evaluate whether the certified tax roll was adequately communicated in compliance with laws, regulations, and policies.

Overall, the audit found that the Assessor's Office is compliant with the State and City codes as it relates to the assessment of real estate taxes. The Assessor staff is well qualified for the function they are providing. However, the auditors observed that triennial reviews for tax-exempt properties were not done timely due to the departure of an employee that handled such reviews six years ago. Since that time, reviews have not been conducted despite the availability of an exempt property tracking system designed for that purpose.

The City offers the Tax Rehabilitation Program. This incentive allows for certain older, qualified properties to be improved both in appearance and value, and have that improvement value be exempted from real estate taxes for seven to ten years, depending on the type of rehabilitation. The City has traditionally offered the tax abatement program over 15 years (legacy program), which has been discontinued. This program has been replaced by the current 10-year abatement program. A number of properties are still receiving abatement from the legacy tax abatement

program. The City's Tax Rehab program has grown to be one of the largest of its kind in the State of Virginia. The next largest rehab program surveyed, offered tax abatements to a significantly lower number of properties.

Currently, about 7,400 projects are receiving rehab tax abatement from the legacy and the current rehab programs. A total of \$182 million in taxes have been abated from 2006 to 2016 (\$138 million through the legacy program and \$44 million through the current program). The projected additional abatement for projects in the current program will total \$50 million at the end of their lifecycle. At this time, Richmond is experiencing both an increase in the rehabilitation of the properties and City population. The number of rehab properties have increased in the City. Future additional abatements will further defer revenue to be collected by the City.

Of the current properties in the program, 36% were resold after being rehabilitated. Analysis show that almost all the properties after rehab increase in value substantially. Therefore, there is an incentive for investors and property owners to rehab their properties due to monetary gain. At some point, the City may have to consider modifying the rehabilitation program as substantial future revenues are committed in these efforts. The scenarios presented in Appendix C depict several million dollars of potential revenue gain due to altering the current rehab program. If the City Council decides to revisit this program, additional analysis may be needed to make a policy decision. The City Auditor's Office has resources to conduct such an analysis and will be available for that purpose.

The City Auditor's Office appreciates the cooperation of the staff in the City Assessor's Office. A response to the recommendation made is attached in Appendix D. Please call the City Auditor's Office for additional information or for a response to any questions.

Sincerely,

Umesh Dalal

Umesh Dalal, CPA, CIA, CIG
City Auditor

cc: The Richmond City Audit Committee
Ms. Selena Cuffee-Glenn, CAO
Mr. Melvin Bloomfield, Interim Assessor

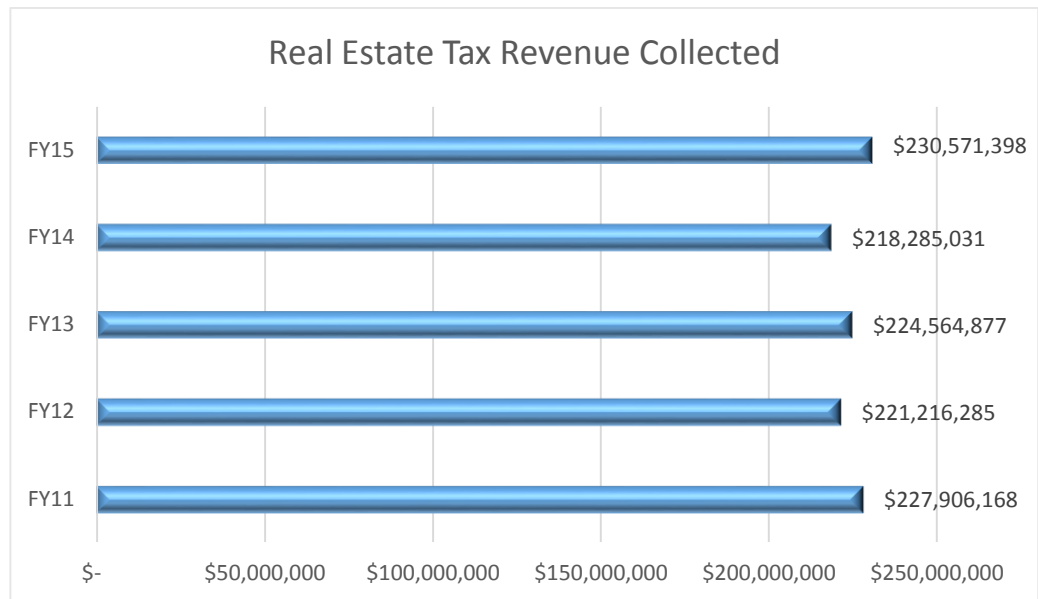
RECOMMENDATION

#		PAGE
1	The Interim City Assessor needs to develop and implement written procedures to compile and track all exempt properties, and to conduct triennial reviews of those exemptions.	10

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BACKGROUND

The Richmond Real Estate Assessor's Office handles the valuation of all real estate in the City. Their valuations are used to levy real estate taxes. Real estate taxes are the single largest source of revenue for the City, exceeding \$200 million annually. The past five years' real estate tax revenue is depicted in the following chart:



Source: City of Richmond CAFR Statement of Activities

The Assessor's Office belongs to the International Association of Assessing Officers (IAAO), a professional organization for government assessment officials. The IAAO awards professional designations to individuals who signify exceptional competence in certain aspects of the assessment profession. The Assessor's Office has seven employees that have achieved one or more designations from the IAAO, and another eight that are currently candidates for their first designation. In addition, 17 City appraisers have a certified residential or general license. Furthermore, the appraisers and supervisors have prior

experience in the industry as real estate agents, contractors, mortgage bankers, mass appraisers, etc. that helps them understand and evaluate situations as they arise during their work.

Allocation of Workload

In the 2016 tax year, properties were assessed at over \$27 billion. There were 23 appraisers and supervisors tasked with assessing approximately 74,000 commercial and residential properties in the City of Richmond at an average of 3,000 to 5,000 properties per appraiser. Appraisers are segmented into three groups by property type:

- Residential North of the James River
- Residential South of the James River
- Commercial

Property Value Assessment Process

At the beginning of each May, the values assigned to the properties by the respective appraisers are reviewed by their supervisor using established criteria. The Deputy City Assessor performs a final review of appraisals.

The auditors tested a sample of properties, both residential and commercial, to review their 2016 tax year assessments and ensure that the office's procedures were followed and proper approvals were given to each one. Based on the results of the auditors' testing, the appraisers and supervisors in the City Assessor's Office are properly assessing real estate in the City of Richmond based on the methods they have chosen. The leadership in the Office has made it a priority to have educated and experienced appraisers assigned to neighborhoods based on each individual's strengths.

Using valuation software developed by an industry leader in such products, the Assessor's Office is able to create model homes to use as the basis of their appraisals. The software captures any and all qualities that would affect a property's value by using approximately 100 different qualities of a home, including plumbing fixtures, building materials, square footage, etc. Appraisers assign a grade to their assigned properties that correlates to their determination of how the subject property compares to the model home created by the software. The assigned grade, combined with the age of the property, interacts with the Assessor's ProVal property database to adjust the overall assessed value.

MANAGEMENT RESPONSIBILITY

The City management is responsible for ensuring resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

OPPORTUNITY TO GENERATE ADDITIONAL REVENUE

Rehabilitation Program

One of the major activities in the Assessor's Office is the Tax Rehabilitation Program. This incentive allows for certain older, qualified properties to be improved both in appearance and value, and have that improvement value be exempted from real estate taxes for seven to ten years, depending on the type of rehabilitation. The City has traditionally offered a tax abatement program over 15 years (legacy program), which has been discontinued. This program has

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been replaced by the current 10-year abatement program. A number of properties are still receiving abatement from the legacy tax abatement program. In 2016, there were 7,387 rehab projects receiving a total of \$22.7 million in tax abatement credit; 4,429 of these properties are in the legacy rehabilitation program, established prior to 2007, and are not considered in the analysis described in this report. From 2006 to 2016, this program has abated \$182 million of real estate taxes. This program has resulted in increased tax base and urban renewal. The current program's tax abatement descriptions by parcel type are as follows:

- Single Family, Multi-Family, Commercial (inside Enterprise Zone) - seven full years of tax abatement and three partial years of tax abatement (75%, 50%, 25%)
- Commercial (outside Enterprise Zone) - five full years of tax abatement and two partial years of tax abatement (66%, 33%)
- Redevelopment/Conservation/Rehab District- 10 full years of tax abatement

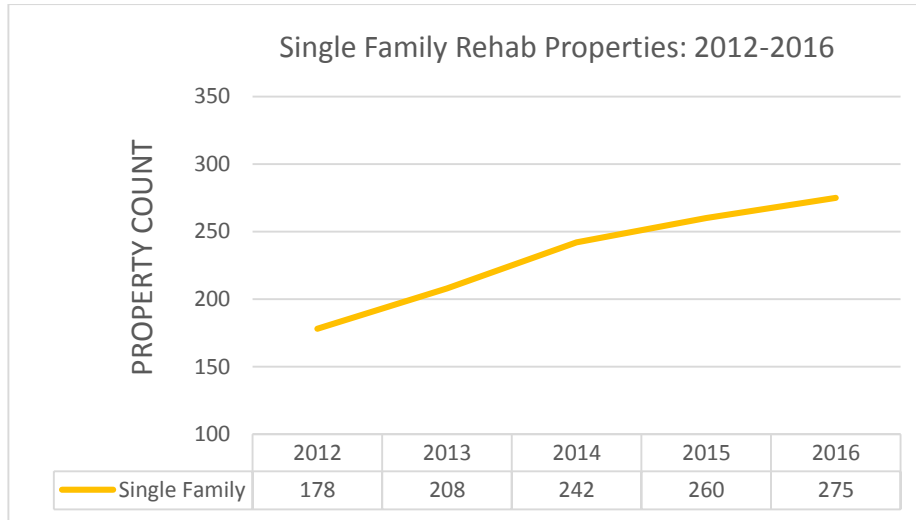


Figure 1: Rehabilitation Project before (left) and after (right)

Source: Assessor's Office records

The City's Tax Rehab program has grown to be one of the largest of its kind in the State of Virginia. The next largest rehab program the auditors surveyed, offered tax abatements to a significantly lower number of properties. The vast majority of the properties in the program are single family homes, of which one-third are being sold after the rehab has completed. The auditors contacted multiple localities in Virginia with rehabilitation programs similar in benefit to Richmond's to gauge property improvement incentives across the state. Lynchburg, Chesterfield, and Henrico all have programs that offer 100% tax abatement for 15, 8 and 7 years, respectively. However, these programs only have between 40 and 202 residential properties currently in their programs compared to Richmond's 2,371 residential properties. A map of the location of rehab properties in the City can be found in Appendix A.

Currently, Richmond is experiencing both an increase in the rehabilitation of the properties and City population. The US Census indicates that the population in Richmond has increased from 204,214 to 220,289 between 2010 and 2015. This population increase has naturally created more demand for residential units and property rehabilitation within the city limits. The upward trend of single family rehabilitation properties is presented below:



Source: Auditor Prepared

The auditors pointed out that the investors are generating substantial profit from rehabilitated properties. Since this demand already exists, the additional allowance from the City adds to their profit. At some point, the City may have to consider modifying the rehabilitation program as substantial future revenues are committed in these efforts. The scenarios presented in Appendix C depict several million dollars of potential revenue gain due to altering the current rehab program. Across the State there are no standard rehabilitation program structures. The alternative scenarios were modeled on the changes made from the previous to current rehabilitation program and the programs in other Virginia localities. If the City Council desires to consider changes in the rehab program, the scenarios included in Appendix C of the report presents examples of three modifications and corresponding additional substantial revenue the City could realize. If the City Council decides to revisit this program, additional analysis may be needed to make a policy decision. The City Auditor's Office has resources to conduct such an analysis and will be available for that purpose.

COMPLIANCE WITH APPLICABLE LAWS

The State of Virginia and City of Richmond both govern the City's assessment of real estate. The Code of Virginia's Title 58.1, Chapter 32 includes laws governing real estate assessment and all nuances involved with exemptions, valuations, appeals, etc. The Richmond City Code mostly defers real estate assessment laws to the State with the exception of a permanent board of equalization, which is specifically allowed for the City by State Code.

In determining that the City Assessor's Office conducted and submitted the 2016 real estate assessment in compliance with applicable laws, the auditors validated that:

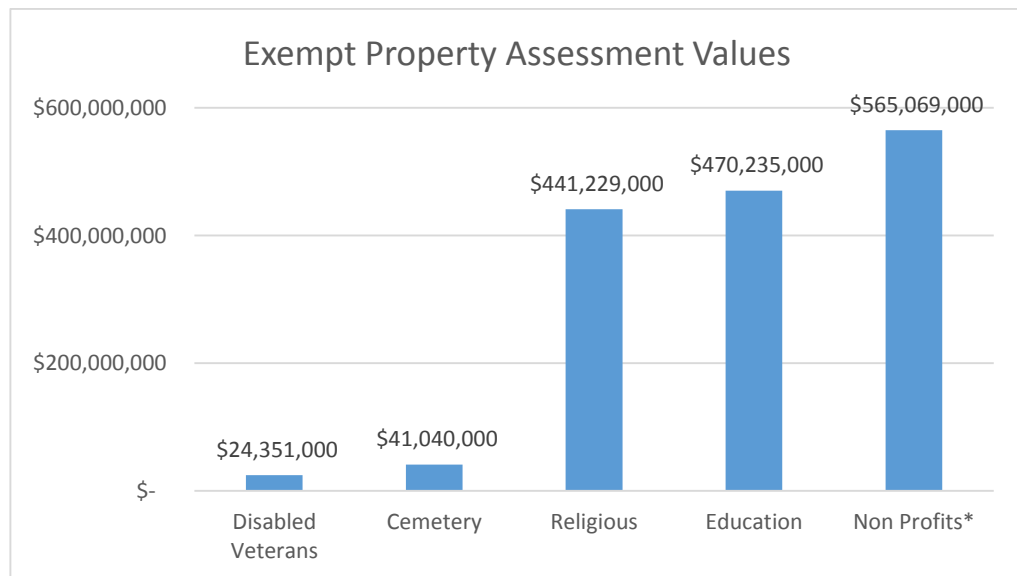
- Total assessment was done at 100% market value. This means that the ratio is between 70% and 130% for the State, and a range of 90% to 110% according to IAAO performance standards.
 - Auditors observed that the City's market value ratio was 92% for the 2016 tax year.
- The State requires the land book to be completed by December 31 of the prior year.
 - The auditors noted that the 2016 land book was completed in November 2015, well before the due date.
- Original copy of the land book is on file with the circuit court and all copies were distributed appropriately and in the proper form
 - Two microfilm copies were hand-delivered to the Circuit Court, one was then sent to the Library of Virginia
 - Electronic file was maintained for the Finance Department and Board of Equalization to access

- Assessment notices were sent to the tax payers at least 15 days prior to the end of the appeal period.
 - Notices were mailed out on June 25, 2015
 - Appeal period was July 1 to July 31, 2015; thus allowing over 30 days to appeal

Based upon the test results above, the auditors concluded that the Assessor's Office demonstrated compliance with all applicable State of Virginia and City of Richmond laws as they related to the 2016 real estate assessment.

TAX EXEMPT PROPERTIES

In 2016, the City had 3,774 tax-exempt properties with a total assessment value of \$6.8 billion, or \$82 million in exempt tax revenue. Government-owned properties are automatically exempted and account for \$5.3 billion in assessed value. The remaining exempt property types and their assessed values are presented below:



* Includes Libraries, Museums, and Charities

Source: Assessor's Office property record database

Veterans with a service-connected disability are exempt from local real estate taxation. They must fill out an application with the Assessor's Office and submit a letter from the Department of Veteran's Affairs and proof of residency. Once approved, the exemption lasts for the life of the veteran or his surviving spouse as long as they own and live in the property.

The State of Virginia holds the power to declare certain properties as exempt by classification. These properties include:

- Property owned by the State or any political subdivision
- Property owned and used by churches or religious bodies
- Cemeteries or burying grounds
- Libraries
- Museums
- Charitable organizations, etc.

The Assessor's Office has an application form for the non-governmental properties that is reviewed and approved for exemption status in the City. The application requires the owners of the non-governmental properties to provide supporting documentation that validates their tax-exempt status and subjects the property to a triennial review of that exemption status by the Assessor's Office.

The auditors observed that triennial reviews were not done timely due to the departure of an employee that handled such reviews for the prior six years. Since that time, reviews have not been conducted despite the availability of an exempt property tracking system designed for that purpose.

The City Assessor did not designate anyone to track and initiate re-checks of all exempt properties that were subject to a triennial review. The review consists of verifying the applicant's exempt status by evaluating appropriate evidence. Continued use of the tracking system for all exempt properties, and the development of written procedures for triennial reviews, would strengthen the review process.

Recommendation

- 1. The Interim City Assessor needs to develop and implement written procedures to compile and track all exempt properties, and to conduct triennial reviews of those exemptions.**

INTERNAL CONTROLS

According to the Government Auditing Standards, internal control, in the broadest sense, encompasses the agency's plan, policies, procedures, methods, and processes adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes systems for measuring, reporting, and monitoring program performance. An effective control structure is one that provides reasonable assurance regarding:

- Efficiency and effectiveness of operations;
- Accurate financial reporting; and
- Compliance with laws and regulations.

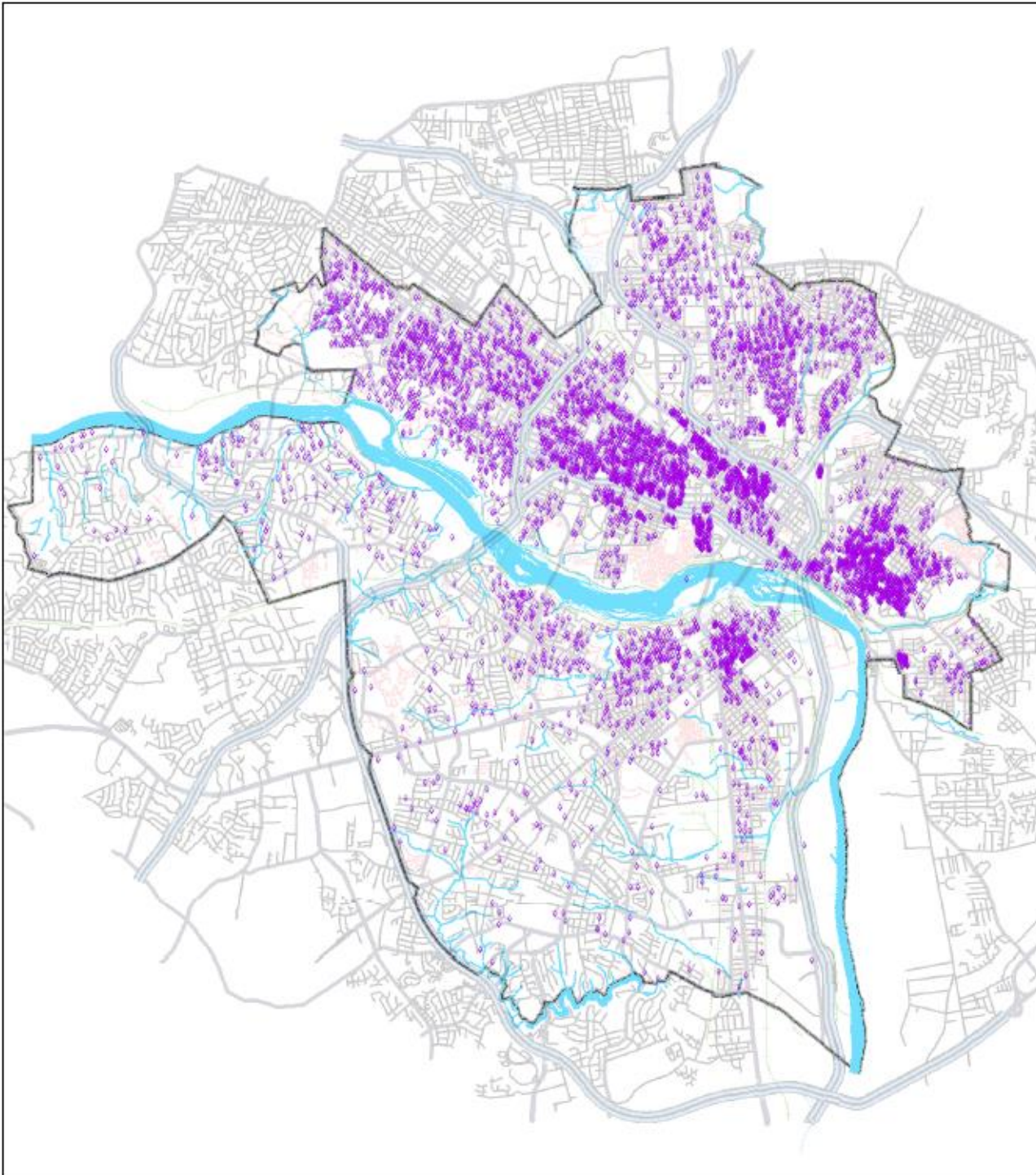
Based on the audit test work, the auditors concluded that internal controls in the assessment process are strong.

OVERALL CONCLUSION

Based on audit procedures and observations, the auditors concluded that the City Assessor's Office properly assessed and adjusted real estate property values, and adequately communicated those values in compliance with applicable laws and regulations.

Appendix A

Rehabilitated Properties in Richmond



Source: Office of the Assessor of Real Estate

Appendix B

OBJECTIVES, SCOPE, AND METHODOLOGY

The main function of the City Assessor's Office is to conduct an annual assessment of the real estate property values in the City. Appraisers use market sales data, building costs, and income derived from properties to help them determine assessment values.

The City Auditor's Office has completed an audit of real estate assessments made by the City Assessor's Office effective January 1, 2016. The objectives of this audit were to:

- Determine if real estate taxes are properly assessed and adjusted; and
- Evaluate whether the certified tax roll is adequately communicated in compliance with laws, regulations, and policies.

The auditors conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those Standards require that the auditors plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions based on the audit objectives. The auditors believe that the evidence obtained provides a reasonable basis for their findings and conclusions based on the audit objectives.

Methodology

The auditors performed the following procedures to complete this audit:

- Analyzed assessment procedures and approved assessment values for 100 commercial and residential properties.

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- Reviewed the 2016 assessment and tax roll for compliance with State and City laws.
- Analyzed property exempt from local real estate assessment to ensure they are appropriately exempted.
- Conducted a cost analysis of the current Tax Rehab program and proposed alternative tax abatement plans.
- Surveyed other Virginia localities regarding their Tax Rehab programs to compare to Richmond's program.

Appendix C

PROPERTY REHABILITATION PROGRAM ANALYSIS

A 2005 audit of the rehab program recommended a reduction in the length of the 15 year program to 10 years. This recommendation was considered and implemented by the City Council in 2006 making 2007 the first year a property rehabilitation could fall under the new program. Currently, about 7,400 projects are receiving rehab tax abatement from the legacy and the current rehab programs. A total of \$182 million in taxes have been abated from 2006 to 2016 (\$138 million through the legacy program and \$44 million through the current program). The projected additional abatement for projects in the current program will total \$50 million at the end of their lifecycle.

Auditors conducted an analysis on Single Family, Multi-Family, and Commercial properties. To reiterate, the 10 year program offers 100% tax abatement on rehabilitation project assessment value for seven years and then tapers off at a rate of 25% per year until the full tax amount is being collected on the property.

The single family category is by far the most popular of the rehab property types making up 87% of the properties in the program. Multi-Family Residential have shown low but steady growth since 2008, while the program has yet to catch on with Commercial properties.

To gauge the magnitude of this program, the auditors took a closer look at the amount of taxes that would be abated over the course of the program. To calculate this, the projected tax abatement amount for each property was used

to derive the total amount of tax abatement for the life of the project. Figure 2 summarizes these findings.

Figure 2			
Property Type	Sum of Tax Abatement per Year	Sum of Total Tax Abatement for Project Lifetime	Percentage of Total Amounts
Multi-Family Residential	\$ 6,003,550.80	\$ 51,030,181.80	53.78%
Single Family	\$ 3,650,866.71	\$ 31,032,367.04	32.70%
Enterprise Zone	\$ 1,497,997.20	\$ 12,732,976.20	13.42%
Commercial	\$ 11,318.40	\$ 96,206.40	0.10%
Grand Total	\$ 11,163,733.11	\$ 94,891,731.44	100.00%

Source: Auditor Prepared

The total tax abatement amount for this program is \$94.9 million over the lifetime of the properties currently in the program. Despite the relatively small application count in the Multi-Family Residential category, the bulk of the total tax abatements belong to this category, totaling \$51 Million over the projects' lifetime. To illustrate, approximately half of the properties in the Multi-Family Residential program received tax abatements between \$10,920 and \$301,620 each year for the first seven years of the program and then tapering off at 25% per year until the full tax abatement amount. The Single Family category represents the next highest amount, totaling \$31 million. The Enterprise Zone and Commercial category make up the rest with \$12.7 million and \$96,000, respectively.

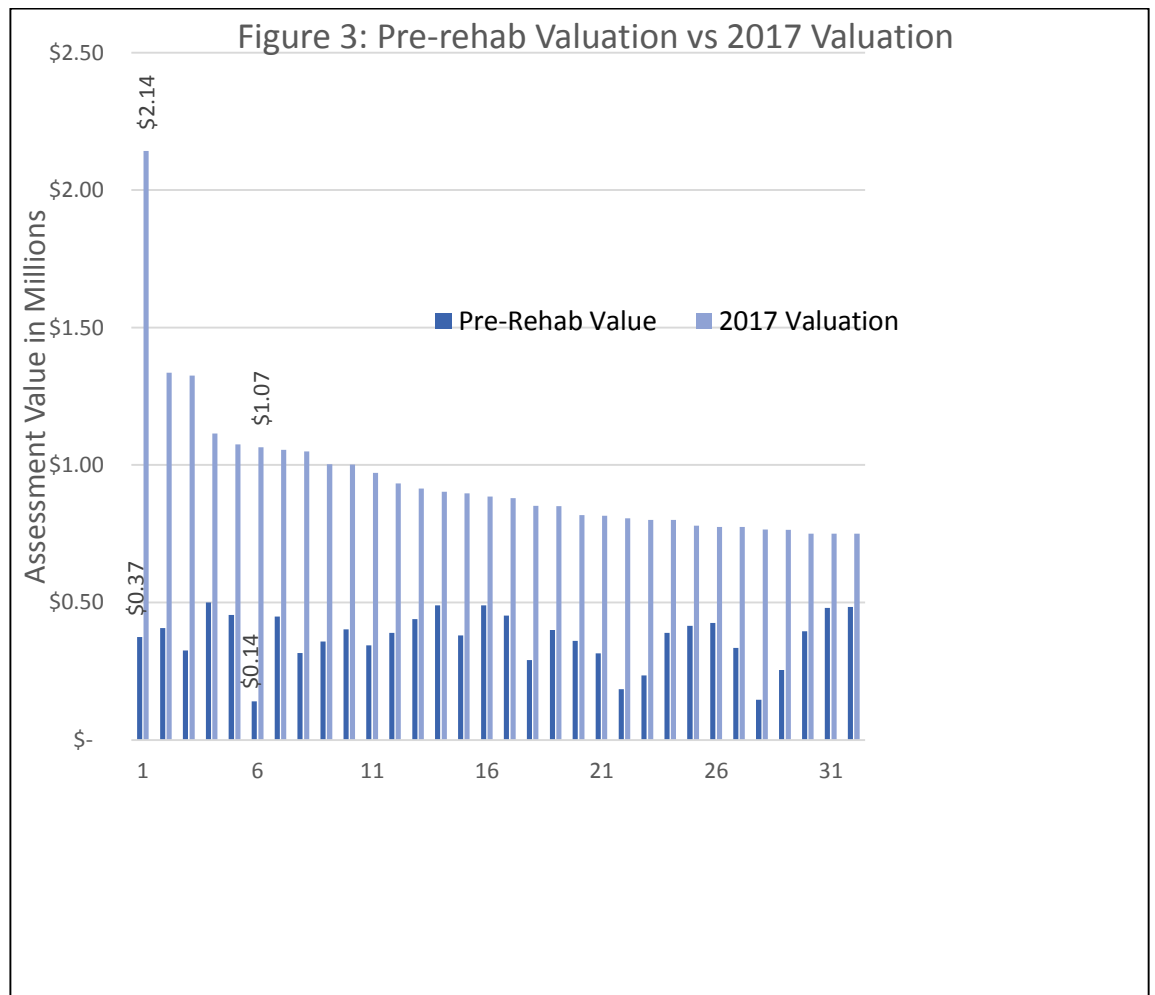
General Program Observations

Analysis of the rehabilitation program unearthed some important points regarding property resale and the types of parcels being rehabbed. The rehabilitation program's abatement benefit stays with the property, independent of the property owner. Of the current properties in the program, 36% were resold after being rehabilitated. The following analysis depicts that

there is an incentive for investors and property owners to rehab their properties due to monetary gain:

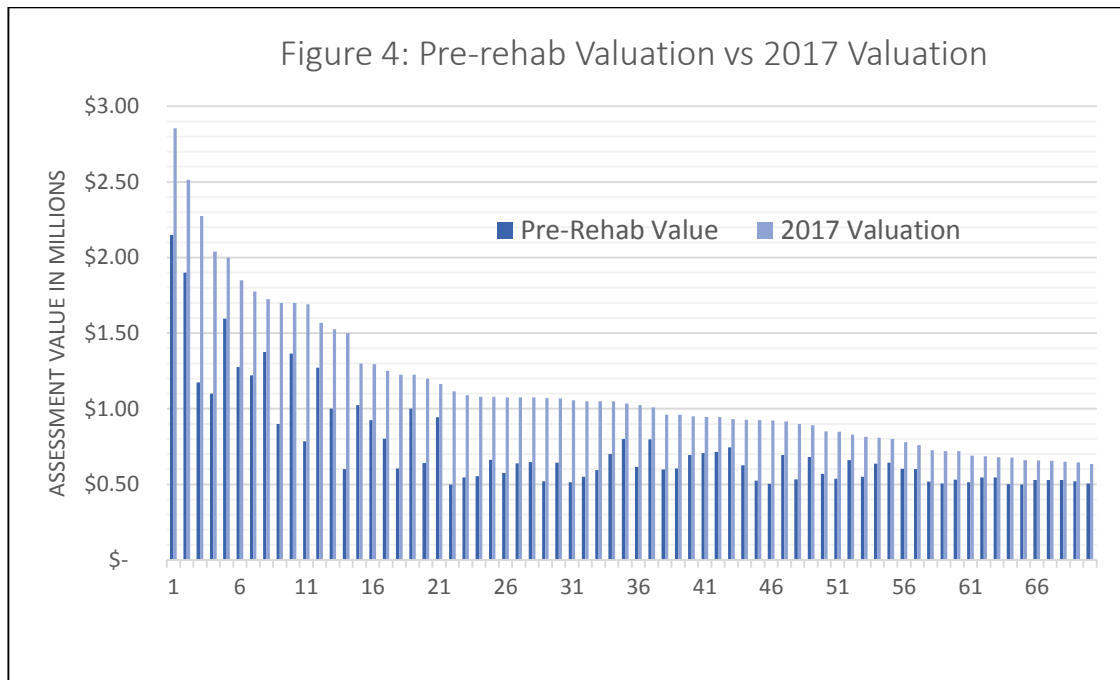
Figure 3 shows parcels where the base values were assessed at less than \$500k and then increased to at least \$750k in the 2017 assessment. To highlight two extreme cases:

- One parcel, valued at \$140k before rehabilitation, was valued at \$1.7 million during the 2017 assessment.
- Another parcel was valued at \$374k pre-rehab, and is now valued at \$2.14 million.



Source: Auditor Prepared

Figure 4 illustrates the 70 single family homes in the rehabilitation program that were valued at over \$500k pre-rehab. 37 of these properties were valued between \$2.8 and \$1 million in the 2017 assessment.



Source: Auditor Prepared

Alternative Program Proposal

The current 10 year program will result in a total tax abatement sum of \$94,891,731 based on all of the properties in the program as of 2016. Using the current and legacy rehabilitation programs as a model, the audit team created three alternative programs to compare to the current rehabilitation program to understand the opportunity the city has to increase tax revenue.

- The first program lasts a total of seven years.
 - Taxes in the first five years of this program are abated at 100%, then at 66% and 33% for years six and seven respectively.

- The second program lasts a total of five years.
 - Taxes in the first three years of this program are abated at 100%, then at 66% and 33% for years four and five respectively.
- The third program lasts for 10 years.
 - In the first year of this program taxes are abated at 100%, and then each consecutive year this abatement is reduced by 10% until 100% of property taxes are being paid.

Figure 5 shows a summary of the impact these programs would have if applied to the current parcels in the program.

Figure 5: Cost Analysis Summary		
Program	Tax Abated	Potential Revenue
Current - 10 year program	\$94,903,971	-
Proposed - 7 year program	\$66,879,386	\$28,024,584
Proposed - 5 year program	\$44,549,040	\$50,354,930
Proposed - 10 year taper program	\$61,408,452	\$33,495,519

Source: Auditor Prepared

The opportunity for increased tax revenue is available with the adoption of a pared-down rehabilitation program. However, it would be important to learn more about the property owners in the current rehabilitation program so that it can be determined how much the program drives the decision to improve a property.

MANAGEMENT RESPONSE FORM
2017-07 Real Estate Assessments

APPENDIX D

#	RECOMMENDATION	CONCUR Y/N	ACTION STEPS
1	<p>The Interim City Assessor needs to develop and implement written procedures to compile and track all exempt properties, and to conduct triennial reviews of those exemptions.</p>		<p>The Interim Assessor recognized the need to review the Exempt Program which began in July of 2016 prior to the audit to address the issues recommended by this Audit. The Interim Assessor had the Customer Service staff begin the process of reviewing the files and putting them in order by Parcel ID. Once that process was completed they started to match the files up against what was currently in our exempt tracker database to ensure we have an accounting of each file for triennial review. Our next step is to identify which exempt entities needed to submit documentation to satisfy the mandated triennial review process. Once complete, we will be sending out letters from our office to alert those entities that they must respond and show evidence they are still operating in a legal way to continue to receive an exemption from taxation. Our goal is to start having those letters sent by April 15th 2017 allowing 30 days for a response from the exempt entity before any further action will be taken on their exempt status. The Project Management Analyst will begin to develop a policies and procedures manual outlining the program and all administrative duties from intake of applications to completion of the review process. The Project Management Analyst will keep the database and exempt files updated and in compliance with all statutes and ordinances that govern this program. They will be responsible for the overall oversight of the program and submit the file to the Assessor for final approval of all tax exemptions. They will annually prepare a report to the Assessor on the number of new applications for each year and give an overview of the exempt program and where it stands for compliance.</p>
	<p align="center">TITLE OF RESPONSIBLE PERSON</p>		<p align="center">TARGET DATE</p>
	<p align="center">Project Management Analyst/Assessor</p>		<p align="center">April 15th, 2017</p>
	<p align="center">IF IN PROGRESS, EXPLAIN ANY DELAYS</p>		<p align="center">IF IMPLEMENTED, DETAILS OF IMPLEMENTATION</p>
	<p>Exempt files have been preliminarily reviewed and matched with what is in our Exempt Tracker database. All files have been accounted for and organized in a filing system for easy retrieval. The next step is to send out letters alerting exempt entities of their responsibility to submit verification documentation for triennial review. Our current delay is due to our front office staff resigning which has temporarily slowed that progress however the new person that will be responsible for the program will be the Project Management Analyst that will do the administrative duties for the program such as create new policies and procedures, intake of applications, identifying, sending out and receiving triannual review letters and documentation along with updating each file.</p>		