

FINAL REPORT

Office of the Inspector General

Review of Montgomery County
Commercial Property Tax Assessments

January 10, 2013



Montgomery County, Maryland
Office of the Inspector General

Report in Brief

REVIEW OF MONTGOMERY COUNTY COMMERCIAL PROPERTY TAX ASSESSMENTS

January 10, 2013

BACKGROUND

Assessed values of real property within the County are developed by the Maryland State Department of Assessments and Taxation's Montgomery County Office. Although the County government does not develop real property assessments, Montgomery County Code §20-41A charges the County Department of Finance with protecting the public interest by acting on behalf of the taxpayers and the County to challenge inaccurate property assessments.

WHY WE DID THIS REVIEW

We received information that the Parklawn Building may not have been properly assessed. Its assessed value fell in 2009 to less than half of its 2007 assessed value.

Our objectives in this review were to determine (1) whether SDAT has a consistent process for assessing the value of commercial buildings, (2) if so, whether that process was followed in the case of the Parklawn Building, and (3) what the County's process is for challenging inaccurate commercial property assessments.

WHAT WE FOUND

The State Department of Assessments and Taxation (SDAT) is required to follow methods set out in Maryland statutes and described in the Maryland Assessment Procedures Manual. In the case of the Parklawn Building, which houses the U.S. Department of Health and Human Services, the information in SDAT files did not demonstrate how the assessment methods were followed. Using available information and the required methods, we calculated numbers that were significantly different from the final assessed values, which resulted from a settlement between the property owner and SDAT. We found no support in SDAT files for the amounts agreed to in the settlement, such as analyses of capitalization of income, replacement cost, or comparable recent sales.

For our sample of 20 commercial properties, we found that assessed value was not a good indicator of market value, especially for high value properties. Properties with sales prices over \$10 million were assessed at an average of 68% of sales prices, while properties with sales prices under \$700,000 were assessed at an average of 90% of their sales prices.

Although the Montgomery County Department of Finance has taken steps during FY 2012 to improve the fairness and accuracy of property tax records, it devotes significantly fewer resources to challenging inaccurate property assessments than it did during the 1990s and early 2000s, and consequently it is significantly less active in carrying out its responsibilities under §20-41A. The Department of Finance appeals fewer assessments than it did in previous years, and it does not intervene in or otherwise participate in appeals brought by taxpayers.

WHAT WE RECOMMEND

We recommend that the County Department of Finance review more commercial property assessments, make more appeals, and participate in more taxpayer appeals. This would require that more resources be dedicated to the property assessment review function.

The Department of Finance should develop a method for determining if an assessed value is accurate, which can be applied whether or not a property has recently sold. Specific recommendations begin on page 21 of the Report.

Review of Montgomery County Commercial Property Tax Assessments

Final Report, January 10, 2013

Table of Contents

Introduction.....	1
Objectives, Scope, and Methodology	1
Background.....	1
Property Taxes in Montgomery County	1
The State Assessment and Appeal Process	2
County Rights, Responsibilities, and Roles.....	3
Findings.....	4
Finding 1: Although SDAT is required to use methods set out in Maryland statutes and described in the Maryland Assessment Procedures Manual, the information we reviewed in SDAT files did not support the assessed values and did not clearly reflect how the assessed value was determined in the case of the Parklawn Building. Using available information and the methods required by statute and by the Maryland Assessment Procedures Manual, we calculated assessment numbers for the Parklawn Building that were significantly different from the final assessed values, which resulted from a settlement between the property owner and SDAT.....	4
State Methodology for Assessing Real Property	5
HHS Lease Developments, 2008-2012.....	6
The Parklawn Building Assessments.....	7
SDAT Records of Parklawn Assessments	9
OIG Parklawn Building Calculations for 2009 and 2010.....	10
The SDAT Supervisor’s Letter	13
Finding 2: For our sample of 20 commercial properties, we found that assessed value was not a good indicator of market value, especially for high value properties. Properties with sales prices over \$10 million were assessed at an average of 68% of their selling prices, while properties with sales prices under \$700,000 were assessed at an average of 90% of their selling prices.....	13
SDAT and CountyStat Measures of Assessment Accuracy	14
OIG Research.....	14

Finding 3: Although during FY 2012, the Montgomery County Department of Finance has taken some steps to improve the fairness and accuracy of property tax records, it devotes significantly fewer resources to the implementation of §20-41A of the Montgomery County Code than it did during the 1990s and early 2000s, and consequently it is significantly less active in carrying out its responsibilities under §20-41A.	16
Former Office of the Public Advocate.....	16
Current County Public Advocate Program	17
Finding 3(a): The County Department of Finance does not intervene in or otherwise participate in appeals brought by taxpayers.....	18
Finding 3(b): The County Department of Finance is less involved in assessment appeals than it was in previous years.....	19
Finding 3(c): The Department of Finance has taken other actions to improve the fairness and accuracy of real property tax records.....	21
Recommendations.....	21
Summaries of Responses from the CAO and the Director of SDAT, and OIG Responses.....	22
Appendix A: Objectives, Scope, and Methodology.....	24
Appendix B(1): SDAT Response to Draft	26
Appendix B(2): Request for SDAT Response to Draft	29
Appendix C(1): Montgomery County Chief Administrative Officer Response	32
Appendix C(2): State Department of Assessments and Taxation Response	35
Appendix D: Homestead Property Tax Credit.....	36
Appendix E(1): Letter from Prince George’s County Council Member to the Office of the Maryland Attorney General	37
Appendix E(2): Office of the Maryland Attorney General Response to Prince George’s County Council Member	40

Review of Montgomery County Commercial Property Tax Assessments

Final Report, January 10, 2013

Introduction

Beginning in the summer of 2011, the Office of the Inspector General (OIG) made preliminary inquiries about the real property tax assessments of the building at 5600 Fishers Lane in Rockville, MD (the Parklawn Building), which houses the U.S. Department of Health and Human Services (HHS). The assessed value for the Parklawn Building fell in 2009 to less than half of the 2007 assessed value. In 2008, the U.S. General Services Administration (GSA), which manages leases for federal government agencies, issued a solicitation indicating that it might move HHS to another location in Montgomery County or to Prince George's County.¹ However, GSA has continued to lease and HHS has continually occupied the building. We received information that the building may not have been properly assessed. As a result, we examined the commercial property tax assessment process, using the Parklawn building as a case study. We also reviewed the County's process for challenging inaccurate commercial property assessments.

According to the Maryland government website, Maryland is the only state in which the assessment process is centralized at the State level.² Assessed values within the County are developed by the Maryland Department of Assessments and Taxation's Montgomery County Office.³ Montgomery County Code §20-41A charges the County Department of Finance with protecting the public interest by acting on behalf of the County to challenge inaccurate property assessments.

Objectives, Scope, and Methodology

We describe our objectives, scope, and methodology in Appendix A.

Background

Property Taxes in Montgomery County

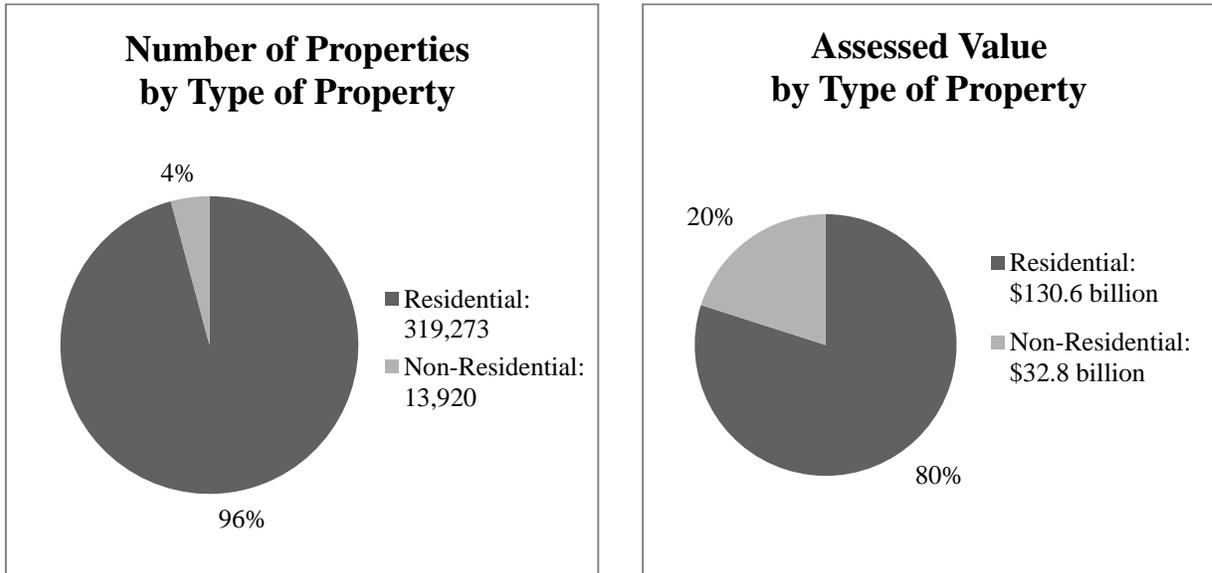
Property taxes are Montgomery County's largest revenue source.⁴ Property tax collections in Montgomery County were \$1.1 billion in fiscal year (FY) 2011, which is the most recent year for which a Comprehensive Annual Financial Report had been issued as of the date our field work was completed.⁵ An estimated \$213 million in County revenues came from non-residential real property taxes in FY 2011.⁶

The assessed value of real property in the County was \$163.4 billion in FY 2012, and non-residential real property was 20% of this amount, or approximately \$33 billion.⁷

In FY2012, of the 333,193 properties on the County tax rolls, 319,273 properties are classified as residential; 8,039 as commercial; 1,840 as apartments; and 4,041 as other types of non-residential, such as industrial.⁸ Residential properties are thus 96% of the total number of properties, while the other categories make up the remaining 4%.

As shown in Chart 1, although only 4% of the properties in the County are non-residential, they account for 20% of the *assessed* property value. The County’s Chief Economist advised us that it is reasonable to estimate that non-residential properties also account for 20% of property tax revenues.⁹

Chart 1 Real Properties and Assessed Values, FY 2012



Sources: The charts above reflect estimates based on information provided by the County’s Chief Economist and the County’s Tax Operations Manager, and a review of State Department of Assessments and Taxation data.

The State Assessment and Appeal Process

Maryland real property is subject to taxation by both the State and the County in which the property is located. Property taxes are a relatively minor source of revenue for the State,¹⁰ but they are a more significant source of revenue for the counties.¹¹ According to the State Department of Assessments and Taxation (SDAT), less than 10% of the property tax collected goes to the State.¹²

Before 1973, the individual counties in Maryland performed the property tax assessments.¹³ According to the Maryland Department of Legislative Services, “[t]he State takeover of the valuation and assessment function was implemented to provide uniform and equitable assessments of property throughout the State, in compliance with the ‘uniformity clause’ of the Maryland Constitution.”¹⁴ The Maryland Constitution states in the Declaration of Rights that the State shall “by uniform rules, provide for the ...assessment...of land...and all taxes...shall be uniform within each class or sub-class.”¹⁵

When the assessments were done by the counties, the ratios of assessed values to sales prices had varied widely across counties, and there were legal challenges to the assessment process. In addition, the Department of Legislative Services noted that “some Baltimore County

homeowners received 100% assessed value increases in the fall of 1972 because the properties had not been subject to reassessment for 10 years.”¹⁶

It is not clear whether the State has sufficiently met the goals of providing uniform and equitable assessments. In 2011, SDAT found that the average ratios of commercial property assessments to sales prices varied from 84.6% in Anne Arundel County to 101.5% in Baltimore County, when counties with fewer than 10 sales were excluded from consideration.¹⁷

SDAT assesses real property every three years, based on an exterior physical inspection of the property.¹⁸

State law currently provides that for each Maryland County and for Baltimore City, there is an SDAT Supervisor of Assessments.¹⁹ In 2009, Maryland Senate Bill 1042, sponsored by two Senators from Montgomery County, would have made the Supervisors and the assessors County employees, not State employees, but the Senate committee hearing on the bill was cancelled.²⁰ The Fiscal and Policy Note stated that the bill would have decreased State expenditures by \$37.6 million in FY 2011.²¹

State law has since been changed to reduce the cost the State bears for SDAT. Beginning in FY 2012, each county and Baltimore City must reimburse the state for 90% of most SDAT administration costs for that county; after FY 2013, this percentage is scheduled to diminish to 50%.²² In 2011, SDAT billed Montgomery County \$5.2 million for annual administration costs, and the amount billed for real property valuation was the major part of those costs, at \$4.1 million.²³

The first method for appealing SDAT’s determination of assessed value is to submit a written appeal to the SDAT Supervisor.²⁴ The next level of appeal is to the Property Tax Assessment Appeals Board (PTAAB) with jurisdiction where the property is located.²⁵ There is one PTAAB for each Maryland county and one for Baltimore City.²⁶

The Montgomery County PTAAB has 3 regular members and 3 alternate members, all of whom are appointed by the Governor for terms of 5 years.²⁷ The Montgomery County PTAAB members are appointed from a list of names submitted by the County Executive with the approval of the County Council.²⁸ PTAABs hold informal hearings on appeals.²⁹

PTAAB decisions may be appealed to Maryland Tax Court by a taxpayer, SDAT, or a County;³⁰ and Maryland Tax Court decisions may be appealed to Circuit Court.³¹

As PTAAB and Maryland Tax Court appeals can consume a great deal of staff time, SDAT staff told us that they must often settle cases, since commercial assessed values are frequently appealed, but SDAT faces staff constraints.³² We were told by SDAT assessors and a PTAAB Board member that the number of SDAT assessors has fallen significantly in recent years.

County Rights, Responsibilities, and Roles

The Maryland Court of Appeals has recognized that “a county has a unique and important interest in the disposition of property tax appeals.”³³ The Maryland Court of Appeals stated that

“[a]lthough counties no longer had authority to set assessments, their interests were adequately protected by their right to appeal to all three administrative levels of the assessment process – the Supervisor, the PTAAB, and the Tax Court.”³⁴

Maryland law sets out counties’ rights to appeal to the SDAT Supervisor,³⁵ the PTAAB,³⁶ and the Maryland Tax Court.³⁷ In addition, counties have the right to participate in cases that other parties bring before the SDAT Supervisor³⁸, the PTAAB³⁹, and the Maryland Tax Court.⁴⁰

Montgomery County Code §20-41A assigns to the County Department of Finance the responsibilities to appeal assessments and to intervene in assessment proceedings on behalf of the taxpayers and the County.

A taxpayer may appeal an assessed value in any year, but a county may not.⁴¹ Counties may appeal only when a property is reassessed,⁴² which happens every three years, as noted above. Previously, counties had the right to appeal an assessed value in any year, but State law was changed in 2002 to remove this right.⁴³ The legislature, in making this change, declared that “certain actions of local governments are contrary to the triennial assessment system and uniformity of taxation.”⁴⁴

Senate Bill 208, which in 2002 restricted County appeal rights, was passed unanimously in the State Senate and the State House.⁴⁵ Montgomery County State Senators were among the sponsors of the Bill.⁴⁶

The Fiscal Note for Senate Bill 208 in the 2002 session of the Maryland General Assembly reported that “[s]ince the petition right was granted to local governments in 1976, Montgomery County has been the only county to use the authority.”⁴⁷ The Fiscal Note also stated that Montgomery County had filed 727 petitions for review in 2002, that SDAT “asserts that the petitions violate assessment uniformity and result in large variances in property assessments within the same neighborhood,” and that 15 Montgomery County homeowners had appealed their increased assessments to Maryland Tax Court.⁴⁸ The fact that appeals of residential but not commercial assessments were mentioned by the Fiscal Note suggests that this Bill responded primarily to concerns on the part of residents.

Findings

Finding 1: Although SDAT is required to use methods set out in Maryland statutes and described in the Maryland Assessment Procedures Manual, the information we reviewed in SDAT files did not support the assessed values and did not clearly reflect how the assessed value was determined in the case of the Parklawn Building. Using available information and the methods required by statute and by the Maryland Assessment Procedures Manual, we calculated assessment numbers for the Parklawn Building that were significantly different from the final assessed values, which resulted from a settlement between the property owner and SDAT.

State Methodology for Assessing Real Property

Maryland law provides that real property must be assessed at its cash value, with certain exceptions not applicable to this analysis.⁴⁹ In addition to being assessed every three years, real property must be revalued in any year if any of the following cause a change in the value of the property: a zoning classification change at the initiative of someone having an interest in the property, a change in use or character, substantially completed improvements which add at least \$100,000 in value to the property, an error in calculation or measurement, the termination of a residential use assessed value, or a subdivision.⁵⁰ A recent sale or lease is not a reason for revaluation outside the normal assessment cycle.

SDAT is required by statute to “consider an income method in valuing income producing commercial real property.”⁵¹ The *Maryland Assessment Procedures Manual* (“Assessment Manual”) states that SDAT may assess rental and commercial properties based on any of three methods: recent sales, replacement cost, and “a fair and reasonable capitalization of income.”⁵²

SDAT describes the capitalization of income approach as “rest[ing] on the premise that a purchaser of a commercial property will pay no more than the property is worth as an investment and the seller will accept no less than it is worth as an investment.”⁵³

The Maryland Court of Appeals explained the capitalization of income method in a 2012 case:⁵⁴

Essentially, the value of a property is based upon what income the property is expected to generate on an annual basis, reduced by its operating expenses to yield its net operating income...Once the net operating income is determined, comparable properties are consulted with respect to their market value as well as their net operating income during the relevant time in issue, in order to determine the capitalization rate or the rate that reflects the anticipated benefits and risk...The capitalization rate may be upwardly adjusted for the risk of investing in the property in issue, or the likelihood that the property will not produce its anticipated income...Once the capitalization rate is calculated, it is then applied to the property at issue, by dividing it into the net operating income to derive value.

The Court referred to *The Appraisal of Real Estate* by the Appraisal Institute.⁵⁵

SDAT staff discussed Maryland assessment procedures generally with us and told us that they assessed the Parklawn Building based on capitalization of income.⁵⁶ Based on interviews with SDAT staff, our review of the Assessment Manual⁵⁷, and our other research, we determined that the following formula for assessed value is applicable to the Parklawn Building and other income-producing commercial property:

$$\text{Assessed Value} = \frac{\text{(Income – Expenses)}}{\text{Capitalization Rate}}$$

As described to us by SDAT, assessed value is determined by subtracting expenses from Income, and dividing the result by the capitalization rate. Income is determined by potential rent and vacancy, as follows:

$$\text{Income} = \text{Potential Rent} - \text{Vacancy}$$

$$\text{Potential Rent} = \text{Rent per square foot} \times \text{Square Footage Rented}$$

The Assessed Value formula is analogous to the formula for the present value of a perpetuity, which equals the periodic cash flow divided by the interest rate.⁵⁸ When interest rates are higher, the present value of an income stream is lower, because the income stream can be generated by a smaller asset. Similarly, when a capitalization rate is higher, the current assessed value of the income stream is lower. As an assessor adjusts a capitalization rate upwards, the calculated assessed value falls.

SDAT staff informed us that expenses are usually 35% of income, and that the capitalization rates in Montgomery County are typically 3% to 7%, with 6 - 7% being more likely.⁵⁹

In a September 20, 2012 letter responding to draft sections of this report, the SDAT Supervisor wrote that we were correct that the income approach is the proper valuation method and that the gross income potential is to be reduced by a vacancy allowance and expenses.⁶⁰

The Supervisor stated that:

the income method is used as part of a mass appraisal process that produces an individual value for many properties. It is not a tool that the average person can use. It takes a lot of education and training to gather and decipher a large amount of information to develop cap rates, expenses, etc.⁶¹

Our request for comment and SDAT's response are included in their entirety in Appendix B.

HHS Lease Developments, 2008-2012

In July 2008, GSA issued a solicitation seeking offers for a 15-year lease of up to 935,401 rentable square feet of office space in Montgomery County or Prince George's County for use by HHS.⁶² In December 2008, GSA received offers from five firms, including the owner of the Parklawn Building.⁶³

In September of 2009, GSA and the owner of the Parklawn Building entered into a Supplemental Lease Agreement under which GSA would continue to lease over 800,000 square feet of space in the Parklawn Building for up to five years, with a termination option at three years and four years.⁶⁴ The lease provided that the government would pay an annual rent of \$27.00 per rentable square foot.⁶⁵

In August of 2011, GSA signed a lease to allow HHS to use 935,000 square feet at the Parklawn Building for 15 years.⁶⁶ The lease, as amended, indicates that the rent will be \$31.36 per square foot, with an adjustment for vacant premises.⁶⁷ The lease provides for a tenant improvement allowance of \$2.25 per square foot, which the GSA may use to pay for improvements it makes.⁶⁸ The lease states that the building's owner is responsible for the modernization of the base building, at its sole cost.⁶⁹

In 2012, after GSA had leased the Parklawn Building for HHS, SDAT reassessed the value of the Parklawn Building. The assessed value increased compared to the previous years but remains well below the 2007 value. As our focus was on the earlier years, we did not analyze the 2012 assessed value in detail.

The Parklawn Building Assessments

The Parklawn Building contains over 1.3 million square feet of enclosed area and was built in 1970.⁷⁰ HHS has occupied most of the building since approximately that time.⁷¹ The most recent sale of the Parklawn Building was in 2003, when the two properties on which the Parklawn Building is located⁷² and other less valuable nearby properties were purchased for a total of \$130 million by the current owner of the Parklawn Building.⁷³

We studied this specific property primarily because we were made aware of the substantial drop in the assessed value of this property relative to its 2003 selling price over a short number of years. Since this building is leased by GSA, we were able to obtain publicly available lease information to use with the capitalization of income method in estimating the value of the property compared to the value assessed by SDAT. We did not attempt to analyze other properties using the capitalization of income method, in large part because information needed to perform an income analysis is difficult to obtain, without purchasing access to commercial sales databases.

The Parklawn Building is located on two lots.⁷⁴ SDAT assigns over 90% of the building's value to one of the lots, which SDAT initially assessed at over \$192 million for 2006.⁷⁵ The owner of the two Parklawn Building lots also owns eight other neighboring properties, most of which are parking lots.⁷⁶ The owner appealed the 2006 and 2009 assessments for all ten properties first to the PTAAB and then to Maryland Tax Court,⁷⁷ and the case was settled while it was pending in Maryland Tax Court.⁷⁸ The property owner and SDAT agreed on the following total assessed values for the 10 properties: \$163 million in 2006-07, \$98 million in 2008, and \$90 million in 2009-2011.⁷⁹

The first column of Table 1 below shows the total assessed value of the 10 properties, with the values for the years 2006 – 2011 determined by the settlement, and the value for 2012 determined by the most recent reassessment.⁸⁰ The second column of Table 1 shows the total assessed value of the two properties on which the Parklawn Building is located.⁸¹ It appears from SDAT files that SDAT assigned portions of the settled amounts for 2006 - 2011 to the two Parklawn Building properties. The values reported for 2012 in the second column are from the most recent reassessment.

Table 1 and Chart 2 show that the assessed values decreased significantly between 2007 and 2009 and began to rebound in 2012.

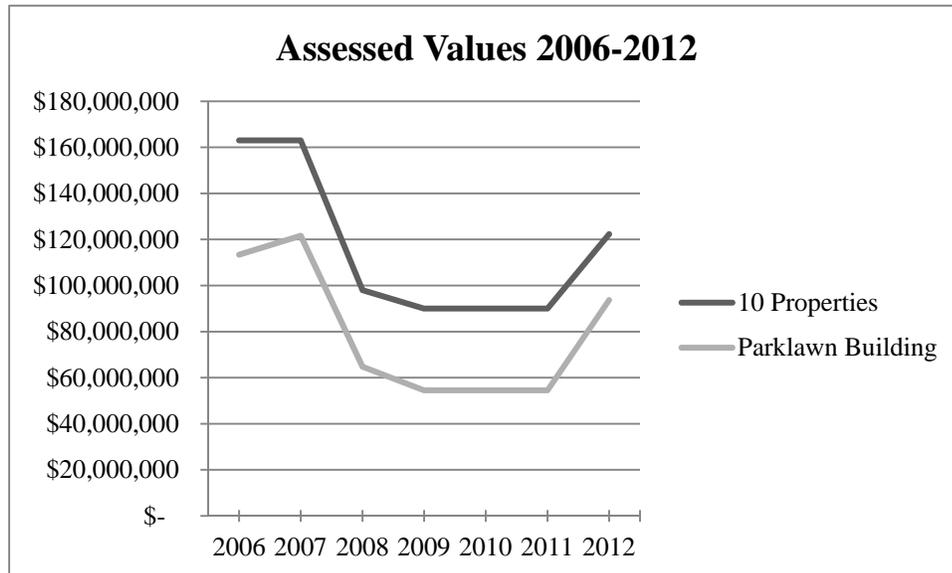
Table 1

Assessed Values of the Parklawn Building and Nearby Properties Under the Same Ownership

	10 Properties Total \$	Parklawn Building Total \$
2006	163,000,000	113,426,433
2007	163,000,000	121,605,766
2008	98,000,000	64,785,100
2009	90,000,000	54,523,800
2010	90,000,000	54,523,800
2011	90,000,000	54,523,800
2012	122,310,800	93,742,600

Sources: letters in SDAT files, SDAT online records, County Department of Finance online records.

Chart 2



Sources: letters in SDAT files, SDAT online records, County Department of Finance online records.

Generally, real estate values declined considerably during the severe recession that occurred during 2007 - 2009. However, the prices of office properties in the Washington area declined on

average 34% from their peak,⁸² which is significantly less than the decline in the Parklawn Building's assessment of 55% from its peak in 2007 to its value in 2009.

SDAT Records of Parklawn Assessments

Given the Maryland Constitution's requirement for uniformity, discussed above, the Parklawn Building's assessed values should have a basis in uniform assessment procedures, even though they resulted from a settlement.

The Montgomery County Supervisor of Assessments told us that SDAT agreed to lower assessed values for the Parklawn Building, because the building was in poor condition, much of the building was vacant, and HHS was considering moving out completely. The Supervisor told us that the risk of losing a tenant had greater consequences for the Parklawn Building than it would for most buildings, since the Parklawn Building was configured for one especially large tenant, of which there are very few. Finding another tenant of this size would be very difficult, and remodeling the building to accommodate multiple separate tenants would be expensive.

We reviewed SDAT files and found that there were few details indicating how SDAT arrived at the final assessed values of the Parklawn Building. We appreciate that SDAT staff were willing to explain their processes to us, and that they provided us with files, but the files made available to us did not contain sufficient information to answer our questions, and they did not contain sufficient quantitative analytical information to support SDAT's final assessed values.

The files we were provided did not contain numeric calculations of the figures agreed to in the settlement. They contained some, but not all, of the data used in assessed value calculations. The files also did not contain sufficient explanations to determine how the settlement figures and final assessed values were calculated. They contained only a few general but incomplete explanations, mostly in correspondence written after the settlement.

The best explanations for the agreement to lower the assessments were in correspondence between a Prince George's County Council Member and the Office of the Maryland Attorney General. The Prince George's County Council Member wrote to the Maryland Attorney General in June of 2011, raising questions about the Parklawn Building assessments.⁸³ An Assistant Attorney General responded to the Council Member in a July 2011 letter.⁸⁴ These two letters are reproduced in their entirety in Appendix E.

The letter from the Assistant Attorney General noted that at the time of the assessment revisions, it was publicly reported that GSA was considering vacating the Parklawn Building, the building was in poor condition and would require major expenditures to be upgraded to a multi-tenant facility, the "federal government did give notice in the latter half of 2008 that it would not renew the lease and that it would vacate the property," and the FDA had vacated 400,000 square feet.⁸⁵ The letter acknowledged that "[i]n light of the August 2010 lease, the assessment may now seem low, but that information was not available to the assessor when the settlement was reached."⁸⁶ The letter stated that "once notice is given by the tenant and an actual move out seems reasonably foreseeable, that reality must be recognized by the assessment office."⁸⁷

We did not find support in SDAT records or elsewhere for the Assistant Attorney General's assertion that the federal government gave notice in the latter half of 2008 that it would not renew the lease and that it would vacate the property, although we did find support for the fact that the federal government, in soliciting bids for a new lease, would consider relocating, as evidenced by the July 2008 GSA announcement noted above.

The SDAT files contained a 2007 Order from the PTAAB regarding the Parklawn Building lot with most of the value,⁸⁸ but when we asked the PTAAB for more information, we were told that, in accordance with the PTAAB records retention policy, files older than three years were destroyed. Similarly, we were told by a Maryland Tax Court clerk that their files that were more than three years old were also destroyed.

Information in SDAT files regarding the assessed values of the Parklawn Building (assuming that no SDAT files exist beyond those made available to us) did not clearly reflect whether or how the assessment process was followed, and the assessed values were thus not well supported. When we asked, SDAT did not provide any calculations to show how SDAT determined the final assessed value in the case of the Parklawn Building.

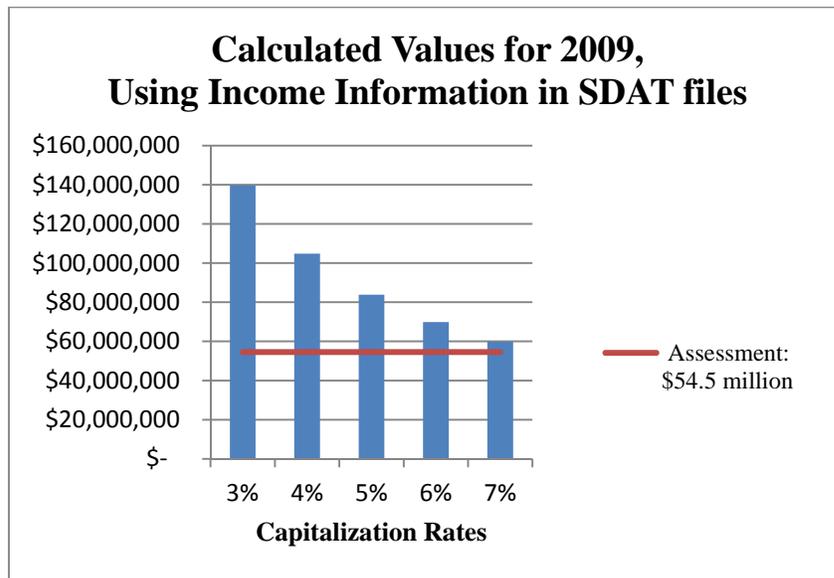
OIG Parklawn Building Calculations for 2009 and 2010

For 2009, we calculated the assessed values that result from applying the formula discussed above to Parklawn Building data we obtained from SDAT files and SDAT staff. Our purpose in doing so was to determine whether the final assessed values were supported by information in the SDAT files.

SDAT staff did not explain to us how they incorporated an amount for vacancy in the Parklawn Building assessment.⁸⁹ As we found notes on vacancy percentages in SDAT's Parklawn files, we subtracted the vacancy percent noted in the SDAT files from the rent GSA paid, to be conservative in our estimates. If we had not done this, our calculated values would have been higher. The letter we received from the SDAT Supervisor indicates that subtracting the vacancy percent was appropriate.⁹⁰

For 2009, our application of the formula yields calculations of values ranging from \$60 million to \$140 million, depending on the capitalization rate used. The differences between these calculated values and the assessed value range from \$5 million to \$85 million. As the County's total property tax rate per \$100 of assessed value was \$.916 in 2009,⁹¹ revenue from property tax that would have been levied on the differences for that year would have ranged from approximately \$49,000 to \$780,000. Chart 3 shows our calculated values for 2009 compared to the final assessed value.

Chart 3



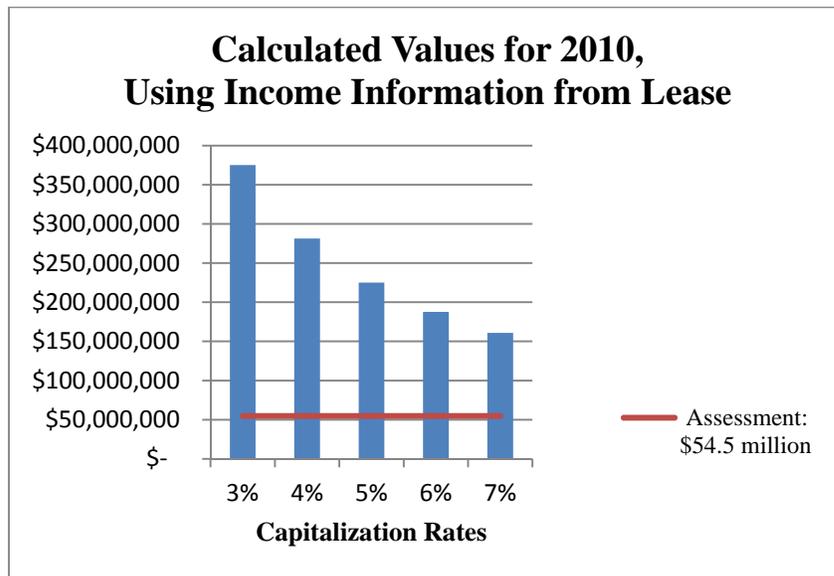
Source: The chart above reflects calculations developed by the Office of Inspector General based on data in SDAT files and Department of Finance online records, and on interviews with SDAT staff.

We calculated that the capitalization rate implied by SDAT’s 2009 assessed value was 8.4%. This is above the range of 3% – 7% the SDAT Supervisor informed us was typically used in Montgomery County. However, it is close to the capitalization rates of 7.5% and 8% presented by SDAT to the PTAAB at hearings held on October 4, 2012 for commercial properties in the \$2 million to \$3 million range.

We also used the formula to calculate assessed values for 2010. We used information from SDAT files and from the lease effective August 2010. Our purpose in doing so was to determine whether the final assessed values were supported by information in the SDAT files, and whether the final assessed values were consistent with the market value of the property, as indicated by the rent paid. We recognize that when SDAT settled the case, the assessors did not have the information in the lease, which was finalized about two months after the settlement.

We determined that for 2010, the formula yields calculated values ranging from \$161 million to \$375 million, depending on the capitalization rate used. The differences between these calculated values and the actual assessed value range from \$106 million to \$321 million. As the County’s total real property tax rate per \$100 of assessed value was \$.915 in 2010,⁹² revenue from real property tax that would have been levied on these differences would have ranged from approximately \$972,000 to \$2.9 million. Chart 4 shows our calculated values for 2010 compared to the final assessed values.

Chart 4



Source: The chart above reflects calculations by the Office of Inspector General based on data in SDAT files, the GSA lease for the Parklawn Building, and Department of Finance online records, and on interviews with SDAT staff.

We calculated that the capitalization rate implied by SDAT’s 2010 assessed value was 20.6%. This is very far above both the range of 3% – 7% the SDAT Supervisor informed us was typically used in Montgomery County, and the capitalization rates of 7.5% and 8% presented by SDAT to the PTAAB at hearings held on October 4, 2012.

Our calculations for 2010 yielded much higher values than did those from 2009, because we used the rental cost and actual square footage from the lease made in September of 2009, which was effective in August of 2010. By contrast, for the 2009 calculations, we used the lower values contained in SDAT files.

We considered the question of whether the figures from the lease effective in August 2010 sufficiently take risk into account. Although we subtracted a vacancy amount, that lease was only for three to five years, and there was a risk that GSA would not continue to lease the building beyond that time. However, five years is one-half of the timeframe SDAT usually considers when determining a capitalization factor.⁹³ As a practical matter, the federal government cannot quickly advertise, negotiate a new lease, and relocate an agency occupying 800,000 square feet.

The information in SDAT files did not clearly reflect a capitalization of income method. We also saw no information that reflected replacement cost or recent sales comparable to the Parklawn Building. We saw information in the file indicating that a settlement agreement had been reached, but we saw no support for the amounts agreed to in the settlement.

For 2009, we concluded that SDAT’s final assessed value is somewhat lower than information we saw in SDAT files would support. We were unable to replicate the assessed value for 2009 using the capitalization rates SDAT informed us are typical. For 2010, we concluded that

SDAT's final assessed value is significantly lower than values resulting from considering the lease as an indicator of market value. The assessed values for 2010 ranged from 15% of market value (as indicated by the lease) to 34% of market value, depending on the capitalization rate used.

The SDAT Supervisor's Letter

The SDAT Supervisor's letter (in Appendix B), in response to a draft of this review, provided us with no values to use in the formula. The Supervisor stated that in the case of the Parklawn Building, the vacancy and the expense figures "were extremely difficult to predict"⁹⁴ and that the capitalization factor "must reflect an appropriate rate of return over a holding period (usually 10 years) for the amount of risk involved...A market cap rate would not have been appropriate for this property...because it would not have recognized the greater risk involved."⁹⁵

The Supervisor stated that the owner had provided information but had not left it with the assessor and that "[o]nce the settlement was reached, the agreed upon value was entered into the Department's records. However, it did not seem to be a necessary or worthwhile use of the assessor's time to redo the worksheet to arithmetically reach the new value through the income approach."⁹⁶ We note that if SDAT agreed to an assessed value to end the appeal process but did not arithmetically reach the value, it is not possible to determine the methodology SDAT used, and whether the result was fair and accurate.

In addition, the Supervisor stressed that the final assessed value was the result of an appeal process that lasted three years and ended with a negotiated settlement.⁹⁷ A letter written by a different Supervisor at the time of the Parklawn Building settlement indicates that even in a negotiation situation, the outcome must be consistent with Maryland uniformity requirements. The letter from that Supervisor contains the settled amount for 2006 and states that "[t]he agreement maintains uniformity in assessments between the subject property and comparable properties in Montgomery County."⁹⁸

Finding 2: For our sample of 20 commercial properties, we found that assessed value was not a good indicator of market value, especially for high value properties. Properties with sales prices over \$10 million were assessed at an average of 68% of their selling prices, while properties with sales prices under \$700,000 were assessed at an average of 90% of their selling prices.

SDAT in its annual reports measures assessment accuracy by comparing assessments to sales prices.⁹⁹ Accordingly, to test the accuracy of SDAT assessments beyond looking at the Parklawn Building assessment, we compared a sample of recent commercial property sales to the properties' SDAT assessments.

The assessment process should result in similar estimates of value for similar properties. Maryland law provides that the Director of SDAT has the power and duty to direct the Department "to value alike all property of a like kind."¹⁰⁰

SDAT and CountyStat Measures of Assessment Accuracy

SDAT states in its 2011 Ratio Report that “[a] measurement of quality is the assessed value/sale price ratio.”¹⁰¹ Studies by SDAT and by Montgomery County government’s CountyStat comparing assessed values to sales prices have found indicators of inaccurately low assessed values in Montgomery County.

SDAT found that for the twelve-month period ending June 30, 2011, commercial properties’ assessed values were on average 98.3% of their sales prices in Montgomery County and 94.4% of their sales prices statewide.¹⁰² For the previous twelve-month period, which ended June 30, 2010, SDAT reported that commercial properties’ assessed values were on average 76.5% of their sales prices in Montgomery County and 92.9% of their sales prices statewide.¹⁰³

Although Montgomery County’s CountyStat has not examined assessed values of commercial property, it found that residential properties in Montgomery County were on average under-assessed compared to calendar year 2010 sales values.¹⁰⁴ CountyStat reviewed the groups assessed in fiscal years 2009, 2010, and 2011, and found that on average, assessed values were 1% above sales values for properties assessed in FY 2009, 9% below sales values for properties assessed in FY 2010, and 10% below sales values for properties assessed in FY 2011.¹⁰⁵

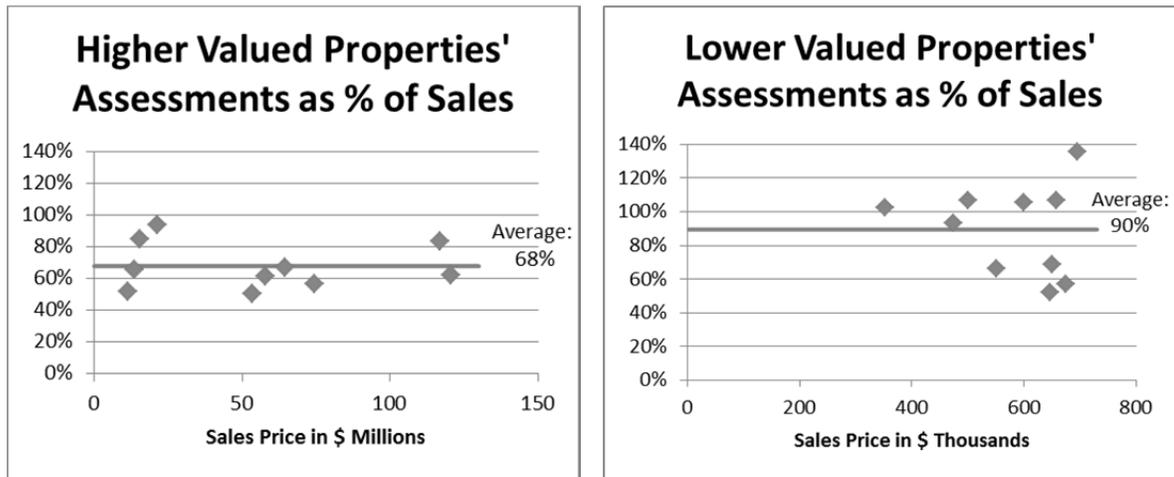
CountyStat compared assessments among properties in different sales value ranges and found that, for residential properties, only the sales of properties in the lowest assessed value range demonstrated over assessment, on average.¹⁰⁶ Furthermore, CountyStat found that in general, for two of the three residential assessment time periods, the most under-assessed properties were the properties with the highest sales prices.¹⁰⁷ CountyStat found that the third group had somewhat different results, but noted that it had a smaller number of properties.

OIG Research

We compared assessed values to sales prices for 10 relatively high value commercial properties that sold recently and for 10 relatively low value commercial properties that sold recently. The higher value properties sold for more than \$10 million, and the lower value properties sold for less than \$700,000. The properties sold during the time period August 2011 through September 2012. We used the full assessed values, not the phased-in values, when doing our comparisons. Our methodology is described in more detail in Appendix A. We would have required a great deal more information to perform an income analysis for these properties, but, as discussed above, the comparison to sales prices is the method SDAT uses to measure assessment accuracy in its annual reports.

We found that for the higher value properties, assessed values were on average 68% of the sales prices. By contrast, for the lower value properties, assessed values were on average 90% of the sales prices. Chart 5 shows these results.

Chart 5 Assessed Values as Percent of Sales for Higher Valued and Lower Valued Properties



Sources: SDAT online records, Maryland land records.

We found that none of the higher value properties were over-assessed, while half of the lower value properties were over-assessed. This can be seen in Chart 5, which shows that none of the higher valued properties had assessed values greater than 100% of sales prices, but 5 of the lower valued properties did.

Our results are consistent with SDAT's result that for FY 2010, commercial assessed values in Montgomery County were 76.5% of sales. However, as stated above, SDAT determined that its FY 2011 commercial assessments were a larger percent of sales: 98.3%. SDAT's FY 2012 results had not been reported as of the date our field work was completed. SDAT did not compare results for high value and low value properties.

We did not analyze these sales according to how recently the properties had been assessed, so most of the sales shown in the above charts were of properties that had been assessed more than a year before the sale date. However, when these sales were removed from the data, the remaining three higher valued properties were still significantly under-assessed, at an average of 66% of sales value. The remaining two lower value properties were on average over-assessed, at 115% of sales value.

In our limited sample and the more comprehensive CountyStat study, assessments did not appear to be an accurate indicator of market value. Specific identification of the causes of the differences between assessments and market value is outside the scope of this review.

Our review also did not focus on the extent to which SDAT is effective in the performance of its duties and responsibilities. However, evidence we reviewed indicates that SDAT should consider taking steps to improve the fairness and accuracy of its assessments.

Finding 3: Although during FY 2012, the Montgomery County Department of Finance has taken some steps to improve the fairness and accuracy of property tax records, it devotes significantly fewer resources to the implementation of §20-41A of the Montgomery County Code than it did during the 1990s and early 2000s, and consequently it is significantly less active in carrying out its responsibilities under §20-41A.

Section 20-41A of the Montgomery County Code provides that

The Director of Finance or designee must...protect the public interest by acting on behalf of the taxpayers and the County to: (1) intervene in tax and assessment proceedings before administrative agencies and the courts; (2) appeal decisions in tax and assessment proceedings; and (3) take any other action permitted by law to review and challenge inaccurate property tax assessments.¹⁰⁸

The Department of Finance has a Public Advocate program that “provides an independent review of State-determined property assessment valuations for fairness and accuracy and, therefore, protects the public interest by acting on behalf of the taxpayers and the County.”¹⁰⁹

Former Office of the Public Advocate

From 1974 to 1994, Montgomery County had an Office of the Public Advocate for Assessments and Taxation (OPA), which was a principal office with an appointed director.¹¹⁰ The County Code governing OPA stated that

The County Council finds that serious inequities exist in the real property assessment structure within the County. Valuable, nonresidential properties frequently are under-assessed in comparison to residential properties, which bear a disproportionate share of the overall property tax burden.¹¹¹

OPA had the power and duty to appeal assessments and intervene in, and otherwise appear in, assessment proceedings.¹¹² OPA reviewed State legislation relating to assessments and tax issues and made recommendations to the County Executive.¹¹³ Tax classifications and exemptions were explicitly listed in the County Code as matters OPA had the power and duty to address.¹¹⁴

In FY 1991-1993, OPA had 4 full-time positions.¹¹⁵ The County Executive’s Recommended Budget for FY 1994 stated that OPA would have 3 full-time positions: 2 professional staff and 1 support staff.¹¹⁶ The work years for the recommended 3 FY 1994 positions were budgeted to be divided approximately as follows: 1.3 work years for Review and Appeal of Commercial Assessments, 0.2 work years for Workshops and Public Information, and 1.5 work years for Administration.¹¹⁷

In 1991, KPMG Peat Marwick (now KPMG LLP), as part of a study it was doing for the Commission on Efficiency and Effectiveness, which was established by the County Council, recommended combining OPA with the Office of Consumer Affairs.¹¹⁸ In its draft report, KPMG had recommended placing OPA within the Department of Finance.¹¹⁹ In 1992, the County Office of Legislative Oversight issued a report on OPA, in which it recommended that the “Council

should consider whether incorporating OPA into another office or department would alter OPA's effectiveness which has been demonstrated over the years as an independent principal office of the County."¹²⁰ The Office of Legislative Oversight also found that OPA generated revenues well in excess of its costs.¹²¹

Bill 30-93, enacted in FY 1994, eliminated OPA as an independent office and transferred responsibility for the public advocate function to the Department of Finance.¹²² It created County Code §20-41A as it presently exists. The Minutes of the Council discussion indicate that a reason that certain Council members voted for the legislation was that it would make the Public Advocate a merit system position, not an appointed position.¹²³

At the time the Council was considering the legislation eliminating OPA, the Director of the Department of Finance testified against the legislation before the Management and Fiscal Policy Committee.¹²⁴ He stated that he believed that any possible efficiencies had already been achieved by moving OPA into space in the Department of Finance.¹²⁵ The Director of the Office of Management and Budget concluded that because of the initiatives already taken by the Executive, which included moving OPA and having the Revenue Division of the Department of Finance provide clerical support to OPA, the legislation would have no fiscal impact.¹²⁶

Current County Public Advocate Program

The County's Public Advocate program is presently within the Tax Operations program of the Department of Finance.¹²⁷

The Tax Operations Manager who carries out public advocate responsibilities within the Department of Finance has informed us that PTAAB appeals account for only about 5% of his responsibilities, and that the Department of Finance is limited in the resources it can devote to this effort, because of the demands of administering other tax programs.¹²⁸ Given that the Tax Operations Manager informed us of no separate involvement in appeals at the SDAT Supervisor level and told us there was no recent participation in Maryland Tax Court proceedings,¹²⁹ this indicates that public advocate activities are currently only about 5% of one work year.

The County's current process for reviewing and challenging inaccurate commercial property tax assessments does not include processes for:

- (1) identifying large changes in assessed values and questioning whether those changes result in accurate assessed values, or
- (2) evaluating whether a property is accurately assessed, if it has not recently been sold.

We were informed by the County's Finance staff that Finance does not compare recent assessed values with previous assessed values, because doing so would require a person to work full-time on this task, and Finance does not have staff available for this.¹³⁰

When Finance receives initial assessed value information from SDAT, Finance staff compares the assessed values to recent sales prices. Finance's decision to appeal depends on the price of the property, and on the difference between the assessed value and the sales price. Finance usually appeals when the sales price is at least 30% higher than the assessed value.¹³¹

Comparing recent sales to assessed values is a method that can identify assessment inaccuracies, but it will leave many assessments unexamined. If an under-assessed property has not recently sold, this approach would not result in challenging that property's low assessed value. For example, it did not result in challenging or otherwise participating in the assessment of the Parklawn Building.

Under Maryland law, SDAT must make valuation information and correspondence available to "an officer of the state or county...affected by the valuation record."¹³² However, Finance does not request income information or other information from SDAT, and it does not estimate values based on capitalization of income calculations.¹³³ Data on assessed values, sales, and leases that are relevant to the sales comparison analysis and the income analysis are also available from private sources.¹³⁴

The Workshops and Public Information function OPA performed apparently no longer exists, as this function is not mentioned in the FY 2013 budget.¹³⁵ This may be a function the County would want to provide, as some owners of residential properties and of small commercial properties participating in PTAAB hearings do not fully understand the type of evidence necessary for convincing the PTAAB to lower assessments.

Finding 3(a): The County Department of Finance does not intervene in or otherwise participate in appeals brought by taxpayers.

State law provides that counties may participate in cases that other parties bring before the SDAT Supervisor, the PTAAB, and the Maryland Tax Court, as discussed above.

We were informed by Finance that the County does not participate in an appeal, unless the County has brought the appeal.¹³⁶ PTAAB Board members and SDAT appraisers confirmed this. By not participating in taxpayer appeals, the County forgoes opportunities to defend assessed values it finds accurate.

The County is notified of taxpayer appeals by SDAT. Under Maryland law, SDAT must notify the County of assessed values that have been appealed, where the property value is greater than \$2,000,000.¹³⁷ Finance staff told us that they receive this notice.¹³⁸ The notice sent by SDAT on April 10, 2012 lists 300 accounts with values under appeal.¹³⁹ The largest assessed value under appeal was \$160 million.¹⁴⁰

The County is also notified by the PTAAB of the cases to be heard in the coming month.¹⁴¹ In addition, copies of PTAAB orders are sent to the County Department of Finance,¹⁴² and this information could be used for deciding whether to participate in or appeal a case to the Maryland Tax Court.

The revisions in the Parklawn assessed values were the result of taxpayer appeals. Consistent with its practice of not participating in taxpayer appeals, the County did not participate in the Parklawn cases.

As stated earlier, in responding to draft sections of this report (see Appendix B), the SDAT Supervisor stated that

the income method is used as part of a mass appraisal process that produces an individual value for many properties. It is not a tool that the average person can use. It takes a lot of education and training to gather and decipher a large amount of information to develop cap rates, expenses, etc.¹⁴³

After reviewing the SDAT files, we had questions about the accuracy of the Parklawn Building's assessed value and about the process that led to that assessed value. If the Supervisor's assertions are correct, only an individual with more specialized knowledge and whose primary duties are to evaluate and understand the outcomes yielded by the SDAT process can realistically exercise the County's rights and obligations to ensure the accuracy of SDAT real property assessments.

In the specific example we studied in this report, if SDAT agreed to an assessed value to end the appeal process but did not arithmetically reach the value, it is not possible to determine the methodology SDAT used, and whether the result was fair and reasonable. A careful examination of the facts raises a number of questions that an advocate for the County would likely have raised.

For example, the Supervisor decided that there was a "greater risk involved" for this property than a market capitalization rate would incorporate, but an experienced advocate for the County would likely have pointed out that the factors SDAT cited as involving greater risk and unpredictability were not new or unusual. An advocate may have argued for and justified a higher assessment. All leases expire at some point, and the basic configuration of the Parklawn Building had been the same since the building was constructed, as had the risk that the owner might, at some date, need to reconfigure the building. Furthermore, GSA is generally required to use competitive procedures when leasing space.¹⁴⁴ The federal government occupied 8.4 million square feet of leased space in the County in 2011,¹⁴⁵ so the general process involved in leasing the Parklawn Building was not unique.

Finding 3(b): The County Department of Finance is less involved in assessment appeals than it was in previous years.

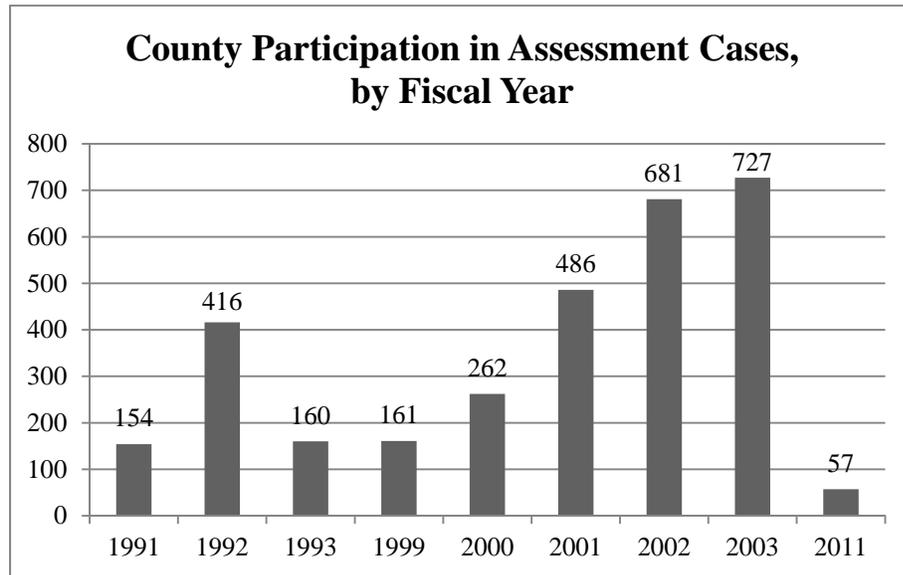
The County has the right to appeal assessed values to the SDAT Supervisor, the PTAAB, and the Maryland Tax Court, as discussed above.

Department of Finance staff informed us that the County appealed 57 assessed values to the PTAAB in FY 2011, most of which were for commercial properties, and staff identified no separate appeals at the Supervisor level.¹⁴⁶

Department of Finance staff told us that they review information that SDAT and taxpayers present at PTAAB hearings.¹⁴⁷ However, without performing a capitalization of income analysis, Department of Finance staff cannot directly address SDAT's or taxpayers' capitalization of income analyses.

Chart 6 shows that the number of cases in which the County participated in FY 2011 is lower than the number of cases in which the County participated in previous years. OPA reported that in FY 1991, it was involved in 154 decisions; in FY 1992, it was involved in 416 decisions; and in FY 1993 it estimated it was involved in 160 decisions.¹⁴⁸ The Maryland General Assembly’s Department of Legislative Services reported that the number of appeals filed by Montgomery County was 161 in FY 1999 and increased to 727 in FY 2003.¹⁴⁹ We do not have data on whether there were County interventions in taxpayer appeals during the years 1999 - 2003, so these figures may understate County activity. We do not have data from years 2004-2010.

Chart 6



Sources: For 1991-93, County Executive’s Recommended FY 94 Budget; for 1999-2003, Maryland Dept. of Legislative Services; for 2011, County Dept. of Finance.

The County devotes much less staff time to the review and appeal of property tax assessments than it did previously. As stated above, OPA devoted 1.3 work years to this work in FY 1994, not including related administrative support. At present, this work is done by one person with other responsibilities, who, as we stated earlier, advised us he spends only about 5% of his time on this function. We were unable to determine the number of work years the County devoted to this function in fiscal years 1999 – 2003.

Department of Finance staff informed us that the County appealed no assessed values to the Maryland Tax Court in the last year, and that no records were available that would indicate how many times the County has appealed to the Maryland Tax Court in the last 10 years.¹⁵⁰ By contrast, OPA reported that in fiscal years 1984 – 1992, it initiated or intervened in 1 to 7 Maryland Tax Court cases per year.¹⁵¹

Department of Finance staff told us that they have records of the success of appeal efforts during the past year, but do not have records of the success of appeal efforts in previous years.¹⁵² The impression of the tax operations manager is that most of the appeals result in assessed values that

are revised upwards, but not to the level of the recent sales price.¹⁵³ Tracking the success of its appeal efforts would help Finance identify the types of arguments that are successful, and the types of cases it is most likely to win.

Department of Finance staff also told us that other jurisdictions appeal assessed values less than does Montgomery County.¹⁵⁴ The 2002 Fiscal note from the Department of Legislative Services, discussed above, which indicated no such activity from other counties, is consistent with this assertion.¹⁵⁵ A review of the case names on the Maryland Tax Court website indicates that since 1999, neither Montgomery County nor other counties were parties to cases regarding property tax assessments.¹⁵⁶

Finding 3(c): The Department of Finance has taken other actions to improve the fairness and accuracy of real property tax records.

During 2011 and early 2012, Montgomery County took action in response to concerns that the homestead property tax credits, available only for owner-occupied principal residences, were incorrectly reflected in the SDAT residential real property assessment database.¹⁵⁷ An explanation of the homestead property tax credit program is in Appendix D. In a meeting among SDAT staff, Department of Finance staff, and OIG staff in November 2011, the Director of Finance proposed recruiting a term employee to help the Department identify properties that appear ineligible for the credit and refer them to the SDAT. SDAT agreed to take necessary action on any properties referred by the County. The County's FY13 Operating Budget provides funding for the addition of a position to the Homestead Property Tax Compliance Program.¹⁵⁸ A Homestead Resident Compliance Manager began working for the Montgomery County Department of Finance in May, 2012.

The current collaborative effort to ensure compliance with the rules regarding residential real property is commendable. No effort of similar magnitude exists to ensure the accuracy of real property assessments. While County spending and overall resources have been especially constrained in recent years because of the general economic situation, the County Code's requirement remains, and the County must determine how best to allocate the resources it has.

Recommendations

Given the role of the OIG under County law, we concluded that our recommendations should focus on actions that should be taken by the County. While we believe it would be appropriate for SDAT to take steps to improve the accuracy of assessments, these recommendations address actions that the County can take unilaterally.

The County Department of Finance should be more active in fulfilling the requirements of §20-41A of the Montgomery County Code, which would require that more resources be dedicated to this function. At a minimum, the Department of Finance should devote sufficient resources to implement the following actions related to commercial property:

- 1. Develop a policy and a method for identifying and analyzing large changes in SDAT's assessed values, to determine if the changes are reasonable.**

- 2. Develop a policy and a method for identifying assessed values to review and a method for determining if the values are accurate.**
- 3. Examine more assessed values and appeal the assessed values that the Department of Finance believes are inaccurate.**
- 4. Make appeals to the Supervisor, to the PTAAB, and to the Maryland Tax Court and beyond, if the County determines it would be cost-effective.**
- 5. Track the success of its appeal and participation efforts.**
- 6. Participate in taxpayer appeals that may result in large changes that are inaccurate. This participation could range from providing an opinion to intervening in a case.**
- 7. Perform a more comprehensive review of commercial property tax assessments similar to the review performed by CountyStat of residential property tax assessments and take appropriate actions based on the results of that review.**

Summaries of Responses from the CAO and the Director of SDAT, and OIG Responses

We shared the final draft of this report with the County's Chief Administrative Officer (CAO) and with SDAT. The responses of the CAO and of the Director of SDAT are included in their entirety in Appendices C(1) and C(2).

CAO Response

The CAO agreed to implement the report's recommendations. In response to the recommendations, the CAO indicated that the following actions are being taken or will be taken:

- The CAO is in the process of identifying an additional, dedicated resource to enhance the Department of Finance's ability to track and strategically analyze SDAT's commercial assessments and, in certain cases, determine if an assessment value is consistent with SDAT's procedures and standards.
- The Department of Finance will work to develop a consistent process for tracking and analyzing changes in commercial assessment values.
- If the County determines it is cost-effective, the Department of Finance will appeal assessments to the Supervisor, PTAAB, and the Maryland Tax Court and will participate in taxpayer appeals.
- The Department of Finance will track the status of its appeals.
- CountyStat, in collaboration with the Department of Finance, will conduct a more comprehensive review of SDAT's commercial property tax assessments, and the CAO will take appropriate action based on that review.

The CAO's response did not cause us to alter our findings or recommendations. We believe that the above actions are reasonable and responsive to our recommendations.

SDAT Response

The Director of SDAT expressed concerns with our analysis of the Parklawn Building. He asserted that the Parklawn Building should not have been used in any comprehensive review of the normal assessment process for commercial properties in Montgomery County. The Director of SDAT also asserted that it is an error to compare a recent sales price with a three year old assessment that would have been the product of a data base of sales that are now three to five years old.

The Director of SDAT's response did not cause us to alter our findings or recommendations. We believe that our report adequately addresses these issues.

Appendix A: Objectives, Scope, and Methodology

Our objectives in this review were to determine (1) whether the State Department of Assessments and Taxation (SDAT) has a consistent process for assessing the value of commercial buildings, (2) if so, whether that process was followed in the case of the Parklawn Building, and (3) what the County's process is for ensuring that commercial property assessments are accurate.

As it is a responsibility of the OIG under County Code §2-151 to review the effectiveness and efficiency of programs and operations of County government, we did not do a comprehensive review and analysis of SDAT's operations, but instead focused on how the County might improve its processes relating to commercial property tax assessments.

For our calculations of value, we focused on 2009 and 2010, because we had more complete data for these years, and these were two of the three years with the lowest assessed values.

Our methodology included the following:

- We reviewed GSA's leases of the Parklawn Building and interviewed GSA staff,
- We reviewed SDAT files and online property records,
- We interviewed SDAT and Montgomery County staff,
- We reviewed SDAT's *Maryland Assessment Procedures Manual*,
- We toured the Parklawn Building,
- We reviewed Maryland statutes, court cases, and legislative history,
- We reviewed County law, budgets, OLO and CountyStat reports, legislative history, and online tax records,
- We reviewed County and State analyses of the accuracy of property tax assessments,
- We compared assessed values to sales prices for a sample of Montgomery County commercial properties sold in the last year,
- We estimated the Parklawn Building's assessed value based on the data we could obtain, and
- We observed PTAAB hearings on residential and commercial property assessments.

For our analysis of commercial property sales prices compared to assessed values, we developed a sample of 10 higher valued properties and 10 lower valued properties. For these properties, we compared the assessed values from SDAT records with the sales prices reported in the deeds. Our sample of lower valued properties consisted of the ten lowest priced arms' length sales of improved commercial property on a list resulting from a search conducted on SDAT's website of properties sold between Sept. 27, 2011 and Sept. 30, 2012. We did not include commercial condominiums, as they might be owner-occupied, which would make an income analysis very difficult. We also did not include vacant property or property that also served as a principal residence.

Our sample of higher valued properties contained the high value commercial property sales reported in the *Washington Post's Capital Business* publication between Sept. 2011 and Sept. 2012, for which we could find assessment records and deeds. We supplemented this list with the five highest arms-length sales on a list resulting from a search conducted on SDAT's website of properties sold between Sept. 27, 2011 and Sept. 30, 2012. We did not include commercial condominiums. We did not include the sale of a U.S. post office, as we decided that this was a unique property with a unique owner, so it was not as indicative of market value.

Where there were multiple properties sold in a single transaction, we compared the total sales prices to the total assessed values for those same properties.

Our review was conducted in accordance with the inspection standards contained in the *Quality Standards for Inspection and Evaluation*, issued by the Council of the Inspectors General on Integrity and Efficiency (January 2012).

Appendix B(1): SDAT Response to Draft



State of Maryland

DEPARTMENT OF ASSESSMENTS AND TAXATION

Montgomery County Office

MARTIN O'MALLEY
Governor

ROBERT E. YOUNG
Director

B. MARIE GREEN
Supervisor of Assessments

September 20, 2012

Dear Mr. Blansitt,

Thank you for your letter of September 14, 2012 and the opportunity to respond to your draft report. While your letter does recognize the income approach as the proper valuation method, it seems to describe it as a fill-in-the-blank methodology. That perspective is incorrect because it overlooks the expertise and experience needed to correctly apply this methodology in the valuation of commercial property, especially the Parklawn Building which was very difficult to value.

At the time of the assessment which you are reviewing, the Parklawn Building was a very large building that was designed for one tenant, the federal government. An interior inspection of the property revealed that it was in poor condition and in need of major renovations. The owner had been complaining to the assessor for multiple assessment cycles that the federal government was threatening to vacate the property, but because the remaining lease term continued for several more years, the assessor gave little adjustment for that potential circumstance. However, when the employees from one portion of the tenant moved out, vacating 400,000 square feet, that potential could no longer be dismissed. There were also reliable indicators that the remaining federal employees might also move out. Such an event would have caused a drastic decrease in value because it would have been extremely speculative to predict any future use or income stream for such a large property designed for one tenant and in its state of poor maintenance and repair. That was the situation when the case was settled.

A basic principle of valuation is important with this property: A buyer buys future income streams, not historic ones. While the valuation of property does use past income and expenses, it uses those historic actuals to predict future income. However, for this property, the historic financials were not a good indicator of the future income stream because a large portion of the property was vacated. Therefore the legitimate concern was that the entire building would be vacated, because the expense percentage could be significantly impacted by occupancy levels since not all expenses change in step with the occupancy level. There would be a large amount of capital expenses incurred to repair the building before reletting to the federal government or there would be an even larger amount of expenses incurred if the building would have to be refitted for smaller new tenants. Also there would be significant rent loss over a lengthy absorption period to bring the vacancy level back to market norms. Accordingly, while you have recognized that the valuation formula requires the gross income potential be reduced by a vacancy allowance and then reduced by expenses, I am not comfortable that your report has recognized that those figures for this building were extremely difficult to predict.

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Telephone: (240) 314-4500 Fax: (301) 424-3849
MRS (Maryland Relay Service) 1-800-735-2258 (TT/VOICE)

Secondly, the capitalization factor applied to the net operating income (NOI) to achieve an indicated value is not simply an interest rate. Rather this rate must reflect an appropriate rate of return over a holding period (usually 10 years) for the amount of risk involved with the subject property. A market cap rate would not have been appropriate for this property based on the above discussion because it would not have recognized the greater risk involved with the fluctuating situation that existed when this property was valued for the assessment being reviewed.

It is also important to understand that when an assessor initially values property, he/she is not doing it as an individual valuation task. Rather, the income method is used as part of a mass appraisal process that produces an individual value for many properties. It is not a tool that an average person can use. It takes a lot of education and training to gather and decipher a large amount of information to develop cap rates, expenses, etc.

Finally, the initial assessment is subject to further review through a three level appeal process:

Supervisor level: A meeting with the Assessor and Property Owner/Representatives

Property Tax Assessment Appeals Board: Three judges appointed by the Governor determine a value after presentations by the Assessor and Property Owner/Representatives

Maryland Tax Court: One or more Judges appointed by the Governor determine a value after presentations by the Assessor or an Assistant Attorney General and the Property Owner/Representative

During each appeal level, the assessor receives more information that has to be analyzed to determine what, if any, effect it has on the value. In the Parklawn appeal, the property was more thoroughly inspected and the owner shared, considerable more information about the ongoing situation with the federal government and its pending decision to vacate or release the property, however they did not leave this information with the assessor. Accordingly, rents, vacancy and expenses were derived as stabilized and not simply based on past actuals. The capitalization rate was defined through market analysis and national reports with consideration given to the unusual circumstances of this building. Ultimately, all of these factors were taken into consideration when the final settlement was reached. However, that final assessment was also the result of a long appeal process over a period of three years that ended with a negotiated settlement. None of that was mentioned in your report.

Once the settlement was reached, the agreed upon value was entered into the Department's records. However, it did not seem to be a necessary or worthwhile use of the assessor's time to redo the worksheet to arithmetically reach the new value through the income approach. Therefore, only the value was entered. Unfortunately, that prevents your office from being able to verify the exact factors used. But in truth, the

final settlement was the result of negotiations in the context of range of value estimates that attempted to capture all the moving parts in the Parklawn situation.

I hope this letter helps explain the final assessment and how our process worked to achieve the final assessment for this property. If you have any other questions, please feel free to contact me.

Sincerely,



B. Marie Green
Supervisor of Assessments
Montgomery County

Appendix B(2): Request for SDAT Response to Draft



OFFICE OF INSPECTOR GENERAL

September 14, 2012

B. Marie Green
Supervisor of Assessments, Montgomery County
State Department of Assessments and Taxation
30 West Gude Drive, Suite 400
Rockville, Maryland 20850

Re: Review of Commercial Property Tax Assessments

Dear Ms. Green:

Thank you for having met with us and for giving us the opportunity to review your files to better understand the State Department of Assessments and Taxation (SDAT) property tax assessment process and the assessments of the Parklawn Building, in particular. We are preparing a report to the Montgomery County Chief Administrative Officer regarding their role in ensuring the accuracy of assessments.

The paragraphs below are excerpted from a draft of this report:

State Methodology for Assessing Commercial Property

SDAT staff discussed Maryland assessment procedures generally with us, but they did not provide us with specific formulas.

Real property in Maryland is assessed every three years by SDAT, based on exterior physical inspections of the properties.¹ The Maryland Code requires that “the supervisor...shall consider an income method in valuing income producing commercial real property.”² The *Maryland Assessment Procedures Manual* (“Assessment Manual”) states that SDAT may assess rental and commercial properties based on recent sales, replacement cost, and “a fair and reasonable capitalization of income.”³ SDAT defines the income approach as “rest[ing] on the premise that a purchaser of a commercial property will pay no more than the property is worth as an investment and the seller will accept no less than it is worth as an investment.”⁴ SDAT staff told us that they assessed the Parklawn Building based on capitalization of income.⁵

¹ Md. Code, Tax-Property Article §8-104(b).

² Md. Code, Tax-Property Article §8-105(a)(1).

³ Assessment Manual, Valuation 014, The Three Approaches to Valuation 060, Responsibility of Assessor 010.

⁴ A Homeowner’s Guide to Property Taxes and Assessments, Part X, Glossary of Terms, SDAT website, <http://www.dat.state.md.us/sdatweb/hog.html>, last accessed Aug. 31, 2012.

⁵ Interview with SDAT staff on Dec. 5, 2011.

Based on interviews with SDAT staff, our review of the Assessment Manual⁶, and our other research, we determined that the following formula for assessed value is applicable to the Parklawn Building:

$$\text{Assessed Value} = (\text{Income} - \text{Expenses}) / \text{Capitalization Rate}$$

where Income = Potential Rent - Vacancy, and
Potential Rent = Rent per square foot x Square Footage rented.

The Assessed Value formula is analogous to the formula for the present value of a perpetuity: the present value of a perpetuity equals the periodic cash flow divided by the interest rate.⁷ When interest rates are higher, the present value of an income stream is lower, because the income stream can be generated by a smaller asset. Similarly, where a capitalization rate is higher, the current assessed value of a future income stream is lower. As an assessor adjusts a capitalization rate upwards, the calculated assessed value falls.

SDAT staff informed us that expenses are usually 35% of income, and that the capitalization rates in Montgomery County are typically 3% to 7%, with 6 - 7% being more likely.⁸

SDAT Records of Parklawn Assessments

We reviewed SDAT files and interviewed SDAT staff and found that there were few details indicating how SDAT arrived at the final assessed values of the Parklawn Building. We appreciate that SDAT staff members were willing to explain their processes to us, and that they provided us with files, but the files shown to us were not sufficiently responsive to our questions, and they did not contain quantitative analytical information supporting SDAT's final assessments. The files we were shown did not contain numeric calculations of the figures agreed to in the settlement. They contained some, but not all, of the data used in assessment calculations. The files also did not contain sufficient explanations to determine how the settlement figures and final assessments were calculated. They contained only general and incomplete explanations, mostly made after the settlement, and there were very few of those.

The SDAT files noted the following as reasons SDAT agreed to lower assessed values: the building was in poor condition, the tenant had partially moved out, and HHS was considering moving out completely. The files contained information that at the time of the assessment, the Food and Drug Administration had moved out of the Parklawn Building, vacating 400,000 square feet. SDAT staff told us that the risk of losing a tenant had greater consequences for the Parklawn Building than it would for most buildings, since the Parklawn Building was configured for one especially large tenant, of

⁶ Assessment Manual, Valuation 014, Low Income Housing Projects 100, Section 42 Tax Credits 050. Although this section contains specific information that is inapplicable to the Parklawn Building, it is an example of the general principles of capitalization of income.

⁷ "Time Value of Money," Prof. Gordon Phillips, Robert H. Smith School of Business, Univ. of Maryland, p. 15, <http://www.rhsmith.umd.edu/faculty/gphillips/courses/Bmgt640/Timeval.pdf>, last accessed Sept. 14, 2012.

⁸ Interview with SDAT staff on Dec. 5, 2011.

which there are very few. Finding another tenant of this size would be very difficult, and remodeling the building to accommodate multiple separate tenants would be expensive.

SDAT staff told us that it is common for commercial assessments to be appealed, and that court proceedings consumed a great deal of staff time, so SDAT staff must settle cases.⁹

Calculations for 2009 and 2010

For 2009, we calculated the assessed values that result from applying the formula discussed above to Parklawn Building data we obtained from SDAT files and SDAT staff. We made the following assumptions:

- Expenses are 35% of income, and
- Rent per square foot, square footage, and vacancy rate are those in SDAT files, but we do not specifically identify them here, because SDAT staff informed us that these must be kept confidential under State law.

SDAT staff did not explain to us how they incorporated an amount for vacancy in the Parklawn Building assessment. In the case of the Parklawn Building, the General Services Administration ("GSA") leased a certain number of square feet. Arguably, this rent should not have a vacancy amount subtracted from it, since GSA was obligated to pay for the space. On the other hand, we understand that there was uncertainty about whether GSA would renew the lease, and a subtraction for vacancy might have accounted for the risk of future vacancy. We found notes on vacancy percentages in SDAT's Parklawn files, so to be conservative in our estimates, we subtracted the vacancy percent noted in the SDAT files from the rent GSA paid. If we had not done this, our calculated values would have been higher.

We would appreciate your letting us know of any inaccuracies in the above paragraphs by Monday, September 24. If you have any questions, please contact me via email or at 240-777-8240.

Sincerely,



Edward L. Blansitt, III
Inspector General

cc: Robert E. Young, Esq., Director, SDAT

⁹ Interview with SDAT staff on Dec. 5, 2011.

Appendix C(1): Montgomery County Chief Administrative Officer Response



OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

January 7, 2013

TO: Edward Blansitt, Inspector General

FROM: Timothy L. Firestine, Chief Administrative Officer 

SUBJECT: Final Draft Report, Review of Montgomery County Commercial Property Tax Assessments

I am in receipt of your memo and final draft report dated December 11, 2012 detailing the audit conducted by your office concerning the property tax assessment of certain commercial properties by the State Department of Assessments and Taxation (SDAT) and the Department of Finance's review of those assessments. Your assessment of this issue has been thorough and fair.

Please find below specific responses to your audit recommendations.

IG Recommendation General:

The Department of Finance should be more active in fulfilling the requirements of §20-41A of the Montgomery County Code, which would require that more resources be dedicated to this function. At a minimum, the Department of Finance should devote sufficient resources to implement the following actions related to commercial property:

IG Recommendation 1:

Develop a policy and a method for identifying and analyzing large changes in SDAT's assessed values, to determine if the changes are reasonable.

CAO Response: We are in the process of identifying an additional, dedicated resource to enhance the Department of Finance's ability to track and strategically analyze SDAT's commercial assessments. While constant in depth analysis would be ideal, we believe, at this point a mid-level research position may be appropriate for performing the necessary research and data compilation to identify material changes in assessment values. In addition, the Department of Finance will work to develop a consistent process for tracking and analyzing changes in commercial assessment values.

101 Monroe Street • Rockville, Maryland 20850
240-777-2500 • 240-777-2544 TTY • 240-777-2518 FAX
www.montgomerycountymd.gov

montgomerycountymd.gov/311  240-773-3556 TTY

IG Recommendation 2:

Develop a policy and a method for identifying assessed values to review and a method for determining if the values are accurate.

CAO Response: As stated above, with an additional resource, the Department of Finance will be able to monitor, track and analyze material changes in commercial assessment values. Also, in certain cases, they can do additional analysis to determine if the assessment value is consistent with SDAT's procedures and standards. However, without a significant increase in resources, County cannot ensure the accuracy of all SDAT commercial assessments nor challenge most of these assessments because of the magnitude and complexity of the workload. We are confident that our proposed strategic monitoring and analysis of SDAT's commercial assessments will improve the current process.

IG Recommendation 3:

Examine more assessed values and appeal the assessed values that the Department of Finance believes are inaccurate.

CAO Response: Please refer to my responses under IG Recommendations 1 and 2. To the extent that the SDAT's values are materially different than our estimate of market value the Department of Finance will be able to appeal these assessments.

IG Recommendation 4:

Make appeals to the Supervisor, to the PTAAB, and to the Maryland Tax Court and beyond, if the County determines it would be cost-effective.

CAO Response: If the County determines it would be cost-effective, the Department of Finance will appeal assessments to the Supervisor, PTAAB, and the Maryland Tax Court. As you are aware, the appeals process can be very time consuming and in many cases quite complex. In particular, the Tax Court appeals require extensive time for expert attorney preparation and the use of outside subject expert consultants to review and analyze the commercial assessment and calculate an alternative market value. The cost of this effort and the tax value of the assessments at issue will be factored into the determination as to whether we will pursue assessment appeals at all levels.

Please note that, as referenced on page 4 of the IG report, in 2002 State law was amended to limit the County's authority to appeal to only when the property is reassessed every three years. This legislative change has also limited the number of appeals that can be performed.

Edward Blansitt, Inspector General
January 7, 2013
Page 3

IG Recommendation 5:

Track the success of its appeal and participation efforts.

CAO Response: The Department of Finance will maintain, track and monitor the status of its appeals on a fiscal year effort.

IG Recommendation 6:

Participate in taxpayer appeals that may result in large changes that are inaccurate. This participation could range from providing an opinion to intervening in a case.

CAO Response: If the County determines it would be cost-effective, the Department of Finance will participate as appropriate in taxpayer appeals.

IG Recommendation 7:

Perform a more comprehensive review of commercial property tax assessments similar to the review performed by CountyStat of residential property tax assessments and take appropriate actions based on the results of that review.

CAO Response: CountyStat, in collaboration with the Department of Finance, will conduct a more comprehensive review of SDAT's commercial property tax assessments and we will take appropriate action based on that review.

If you have any questions, please feel free to contact me or Assistant Chief Administrative Officer Fariba Kassiri, who can be reached at (240) 777-2512 or Fariba.Kassiri@montgomerycountymd.gov.

TLF:fk

cc: Joseph Beach, Director, Department of Finance
Fariba Kassiri, Assistant Chief Administrative Officer
Kathleen Boucher, Assistant Chief Administrative Officer
Robert Hagedoorn, Chief, Division of Treasury, Department of Finance
James Babb, Tax Operations Manager, Division of Treasury, Department of Finance
David Gottesman, CountyStat Manager, Office of the County Executive
Larry Dyckman, Internal Audit Manager, Office of the County Executive

Appendix C(2): State Department of Assessments and Taxation Response



State of Maryland

DEPARTMENT OF ASSESSMENTS AND TAXATION

Office of the Director

MARTIN O'MALLEY
Governor

ROBERT E. YOUNG
Director

January 8, 2013

TO: Edward Blansitt
Inspector General for Montgomery County

FROM: Robert E. Young *Robert E. Young*
Director, State Department of Assessments and Taxation

RE: Final Draft Report, Review of Montgomery County Commercial
Property Tax Assessments

The purpose of this memorandum is to provide the Department's response to your Final Draft Report regarding Montgomery County Commercial Property Tax Assessments and the Parklawn Building in particular. Your Draft Report was forwarded to me by our Supervisor of Assessments for Montgomery County, B. Marie Green.

Your Report's emphasis on the Parklawn Building is symptomatic of the fundamental problems with your underlying analysis. The assessment of the Parklawn Property and the appeal of that assessment was clearly a difficult assignment and represented an anomaly in the assessment process. That unusual situation should not have been used in any comprehensive review of the normal assessment process for commercial properties in Montgomery County. With all due respect, it is readily apparent to us that your office does not include a licensed appraiser and you did not consult with one on this particular property. Ms. Green also advises me that your office did not share with her the data you relied upon in making your comments on the Parklawn Building.

With regards to your sample of the twenty commercial properties, you are making the same fundamental error that County Stats did in its earlier study that does not recognize the significance of the law's January 1 date of finality. One does not compare a recent sales price with a three year old assessment that would have been the product of a data base of sales that are now three to five years old. Similarly, you must take into account for each property whether there has been a reduction in value by the Maryland Tax Court or the Montgomery Property Tax Assessment Appeals Board that the Department legally has to recognize.

If you would like to withhold the release of your Report until you have a licensed appraiser review the Parklawn Building and also have your employees review a random sample of properties that recognizes the date of finality and appeal reductions, then I would very much like to see that data so that the Department could specifically respond on each and every property.

300 West Preston Street – Room 605 – Baltimore, Maryland 21201
Phone: (410) 767-4881 – FAX: (410) 333-5873 – TTY users call Maryland Relay 1-800-735-2258
Toll Free: 1-888-246-5941 – Website: //www.dat.state.md.us



Appendix D: Homestead Property Tax Credit

In Montgomery County, homestead property tax credits essentially limit the annual increase in the taxable value of property to ten percent.¹⁵⁹ The credits are to be provided with respect to only owner-occupied principal residences. Since the properties must be owner-occupied, property that has been foreclosed and is owned by a bank or the federal government does not qualify for the credit. Also, to consider a residence occupied, the owner must have lived in the property for at least six months of the taxable year. Rental properties should not receive the credit. The criterion for a principal residence is that it is the address of record for income tax returns, drivers' licenses, and voter registration.

The *Baltimore Sun* reported, in August 2011 and later, that a number of taxpayers in the City of Baltimore had received the credits inappropriately for several years.¹⁶⁰ The OIG received several complaints regarding homestead tax credits, asserting that Montgomery County had a similar problem.

SDAT is responsible for ensuring that properties are classified as either a "Principal residence" or "Not a principal residence", and the County uses the State's classification to determine whether a property does or does not get the credit.¹⁶¹ The County Department of Finance sends SDAT rental license information every six months. SDAT is thus able to ensure that properties with rental licenses do not get this credit. However, rented but unlicensed properties and foreclosed properties in possession of lenders may still be getting the credit.

**Appendix E(1): Letter from Prince George's County Council Member to
the Office of the Maryland Attorney General**



THE PRINCE GEORGE'S COUNTY GOVERNMENT

RECEIVED
OFF OF ATTY GENERAL

(301) 952-4436

2011 JUN 10 P 1:59

County Council
WILL CAMPOS
Council Member, 2nd District

June 7, 2011

Maryland Attorney General Douglas F. Gansler
Office of the Attorney General
200 St. Paul Place
Baltimore, MD 21202

Dear Mr. Gansler:

I would like to bring to your attention some disturbing facts that I feel may somehow be related to the Department of Health and Human Services' decision to remain at their current Rockville location. For years, Prince Georges County and the district I represent have been pursuing its first Cabinet level agency to be headquartered here. We thought it was finally our time. If we had lost in a fair and open competition, that is fine. However, the facts I outline below suggest that some serious questions need to be answered or there needs to be some level of investigation by your office.

The basic issue here relates to the Real Estate Tax Assessments for the current location of HHS headquarters in Rockville ("Parklawn"). For illustrative purposes, I have compared the Parklawn building to a building in my district which is the same age, with a very similar lease composition (term, GSA, remaining life on lease at time of assessment, etc). The building I reference within my district is 3700 East West Highway and I will refer to herein as "3700".

All the information below is from publically available sources.

Here is some basic comparative data:

	Parklawn	3700
Year built	1970	1967
Size	1.25 M SF	392K SF
Tenant	GSA	GSA
% Occupied by GSA In 2009	100%	100%
% Occupied by GSA In 2010	64%	100%
Total Revenue in 2009	\$16.25M (\$13/SF)	\$7.5M (\$19.13/SF)
Total Revenue in 2010	\$27.2M (\$21.76)	\$7.5M (\$19.13/SF)

County Administration Building – Upper Marlboro, Maryland 20772

Note: Although the leased space decreased by 447,000 SF, the total revenue went up because the rental rate went from \$13/SF to \$33.98/SF.

Note: According to the State Tax Assessment Office, an impending lease expiration has no impact on assessed value.

	Parklawn	3700
Tax Assessment as of		
7/1/2008	\$165M	\$52M
7/1/2010	\$49.9M	\$58.5M
Per SF Assessment as of		
7/1/2008	\$118/SF	\$132/SF
7/1/2010	\$36/SF	\$149/SF
Percentage (Decrease)/ Increase in Assessed Value	(70.0%)	12.5%

Note: 3700 was assessed at \$66M or \$168 per SF. The property owner went through two levels of appeals and was successful in reducing the assessment to \$58.5M or \$149/SF, a reduction of just under 12%.

I suspect that this drop in assessed value for the Parklawn site is linked directly to the developers' ability to offer a more economically favorable deal to the GSA because it either; creates an opportunity for Montgomery County to offer subsidies based on forthcoming huge increases in real estate tax (which appears to have been totally manufactured); or that this increase, in real estate taxes, will be passed onto the GSA, which would result in Parklawn actually being more expensive, rather than cheaper than the other competing sites.

In the meantime, Montgomery County and the State of Maryland, are short \$1.4-\$2.0M per year in real estate tax revenue for at least five years (as much as \$10M).

Because the state determines tax assessments, it appears that the State (although certainly unwittingly) gave Parklawn and Montgomery County an unfavorable advantage with respect to the HHS lease procurement. For this reason, I wanted to personally contact your office Mr. Gansler and request that you review what I have listed here and provide us some feedback. I am not an expert by any means, however, something is just not adding up correctly on this. If you could shed some light on the matter, I would really appreciate it.

Thank you for your time and please feel free to contact me anytime at 301-952-4436.

Sincerely,



Will Campos
Council Member, District 2

Cc: The Honorable Rushern Baker, Prince George's County Executive
The Honorable Benjamin L. Cardin
The Honorable Donna F. Edwards
The Honorable Steny H. Hoyer
The Honorable Barbara A. Mikulski
The Honorable Paul G. Pinsky
The Honorable Mark Tartaro, City of Hyattsville Mayor
The Honorable Christopher Van Hollen, Jr.

**Appendix E(2): Office of the Maryland Attorney General Response
to Prince George's County Council Member**

DOUGLAS F. GANSLER
Attorney General

KATHERINE WINFREE
Chief Deputy Attorney General

JOHN B. HOWARD, JR.
Deputy Attorney General



STATE OF MARYLAND
OFFICE OF THE ATTORNEY GENERAL
DEPARTMENT OF ASSESSMENTS AND TAXATION

DAVID M. LYON
*Assistant Attorney General
Counsel to the
Department of Assessments and Taxation*

WILLIAM K. HAMMOND
Assistant Attorney General

JEFFREY G. COMEN
Assistant Attorney General

July 13, 2011

Mr. William A. Campos
Council Member, Second District
Prince George's County Government
County Administration Building
14741 Governor Oden Bowie Drive
Upper Marlboro, Maryland 20772

Dear Mr. Campos:

Thank you for your letter of June 7, 2011 to the Honorable Douglas F. Gansler, Attorney General of Maryland. Your letter raised concerns about the reduction in the property tax assessment for a certain property in Montgomery County. Since I am Principal Counsel to the Department of Assessments and Taxation, your letter has been referred to me for purposes of a response.

In your letter, you question the appropriateness of the reduction in the assessment of the Parklawn Building located on Fishers Lane in Rockville, Maryland. In support of that concern, you stated that the assessment had decreased from \$165 million (M) to \$49.9M while the revenue for the building had actually increased from 2009 (\$16.25M) to 2010 (\$27.2M). That increase in revenue occurred even though the vacancy at the property increased by 447,000 square feet because the rent went up from \$13/sq. ft. to \$33.98/sq. ft. You additionally made a comparison to the assessment of a building located at 3700 East West Highway, Prince George's County, Maryland, which also houses a government agency.

My investigation into this matter included a review of my office's Maryland Tax Court appeal files for this property and discussions with the attorney assigned to that case. I have discussed the evolution of the situation surrounding this property and the assessments with Marie Green, the Supervisor of Assessments for Montgomery County, and the assessor who was involved in the appeals. Additionally, I have discussed the appeals with Eric Kassoff, the opposing attorney, including the appraisal he had relied upon. Finally, I personally visited the property and met with Edward J. Grau, Jr., Senior Property Manager for The JBG Companies which manages the Parklawn Building.

First, the assessment for the Parklawn Building was the result of an income approach valuation which captured the value of the main building plus the value of all other related property owned by the same taxpayer. The original assessment for all that property as of January 1, 2009 was \$162M. That value was reduced by the Property Tax Assessment Appeals Board to \$150M. After an appeal of that value to the Maryland Tax Court, a settlement was reached that lowered the total property value to \$90M. The \$49.8M is that portion of the total value that was assigned to the Parklawn Building.

Secondly, this account has been appealed repeatedly by the owner since 2006. In each appeal, the owner claimed that the primary occupants, two federal agencies - Federal Drug Administration (FDA) and U.S. Department of Health and Human Services (HHS), were going to move out at the end of the current lease in 2010 and that the property was in poor condition. The initial response by the Montgomery County Assessment Office was to hold the value because the lease termination date was still several years away and it was generally assumed that the federal government would ultimately renew the lease rather than pay the expense of relocating 1.2 million square feet of workspace and employees. However, as the termination date approached, it was publicly reported that GSA, the federal agency which formally leases real property, was considering vacating the Parklawn Building and relocating the two federal agencies.

Because of these appeals, this property was visited multiple times by the Montgomery County Assessment Office. Marie Green, the current Supervisor, was the chief commercial assessor at that time and she personally inspected the building. She found that the condition was poor and would require major capital expenditures to upgrade the existing facility to a multi-tenant type of facility. Consequently, if the federal government did vacate the Parklawn Building, the landlord would not be able to relet the space very quickly because of its condition and because the interior was designed to serve a large tenant.

Ultimately, the federal government did give notice in the latter half of 2008 that it would not renew the lease and that it would vacate the property. Although this large move was done over a period of time, the FDA did actually vacate 400,000 square feet with the last offices leaving in Spring of 2011. While GSA was going through the procurement process to determine the next site for HHS, a five year lease was signed in August, 2010 that allowed that agency to remain in place at an increased rent until a final decision is made.

Maryland has a triennial assessment system in which property is normally assessed every three years. The law allows the property owner to appeal any new assessment and to file mid-cycle appeals for the intervening years. Because of the successive appeals challenging the assessment of this property and the evolving lease situation, the Supervisor with the assistance of my office reached a settlement that maintained the 2006 assessment at \$162M in 2006 but allowed the assessment to step down to \$98M in 2008, and to \$90M in 2009. That settlement was reached by

increasing the vacancy allowance and increasing the capitalization rate to reflect the increase in risk associated with this property. However, those values represented the total value of the building and the other accounts which are owned by the same taxpayer and have functioned as one property. The removal of the value of the other accounts from the total \$90M brought the separate assessment for the Parklawn Building to the current \$49.8M.

While the reduction to \$49.8M was certainly significant, the change in the market conditions of this property was extreme - from a fully occupied building with an excellent tenant to a very large building in need of major renovation with 400,000 square feet of vacancy and the last major tenant publicly announcing that it was seeking other alternatives. In light of the August 2010 lease, the assessed value may now seem low, but that information was not available to the assessor when the settlement was reached. Consequently, the assessed value will not reflect that lease until the next assessment under the triennial system which will be as of January 1, 2012.

Your comparison to a Prince George's County building is not helpful in this situation because that site has remained 100% occupied. While the owner may have raised the possible lease termination with the Prince George's County Assessment Office, the assessors would have approached it in the same fashion as the Montgomery County assessors did when that issue was first raised by the owner of the Parklawn Building. However, once notice is given by the tenant and an actual move out seems reasonably foreseeable, that reality must be recognized by the assessment office. That is what happened in Montgomery County and that is why it is different from your example in Prince George's County.

Accordingly, based on the above, I do not find that the Montgomery County Assessment Office did anything other than attempt to reflect market value as the situation at the Parklawn Building evolved from a fully leased building to one where the tenant was threatening to vacate to one where the tenant gave notice of vacating and did actually vacate a significant portion of the building. I have no reason to suspect that the ongoing competition over the relocation site had any impact on the decisions of the Assessment Office because the assessors were responding to the changing situation at the Parklawn Building. The successive assessments simply reflected that evolving situation.

If you have any other questions, please feel free to contact me.

Sincerely,



David M. Lyon
Assistant Attorney General
Counsel to the Department of
Assessments and Taxation

DML:eja
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- ¹ Government Accountability Office Decision, *One Largo Metro LLC et al.*, June 20, 2011, p. 2.
- ² Maryland Manual Online, State Dept. of Assessments and Taxation, Origins and Functions, <http://www.msa.md.gov/msa/mdmanual/25ind/html/06assesf.html>, last accessed Aug. 28, 2012.
- ³ Md. Code, Tax-Property Article §8-202.
- ⁴ Approved FY13 Operating Budget for Montgomery County, at p. 3-83.
- ⁵ Comprehensive Annual Financial Report (CAFR) for Montgomery County Md., FY 2011, p. 15.
- ⁶ Based on email from Chief Economist of the Dept. of Finance, Aug. 30, 2012. Non-residential real property includes commercial, industrial, apartments, and other classifications.
- ⁷ Based on email from Chief Economist of the Dept. of Finance, Aug. 30, 2012.
- ⁸ Email from Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012.
- ⁹ Email from Chief Economist of the Dept. of Finance, Aug. 30, 2012.
- ¹⁰ Dept. of Legislative Services of the Md. General Assembly, Fiscal and Policy Note for Senate Bill 1042, 2009 session, p. 2.
- ¹¹ *Abramson v. Montgomery County*, 328 Md. 721, 616 A.2d 894, 900 (1992).
- ¹² A Homeowner's Guide to Property Taxes and Assessments, SDAT website, Part 1, The Property Tax, <http://www.dat.state.md.us/sdatweb/hog.html>, last accessed Aug. 31, 2012.
- ¹³ Dept. of Legislative Services of the Md. General Assembly, Fiscal and Policy Note for Senate Bill 1042, 2009 session, p. 3.
- ¹⁴ *Ibid.*, p 2.
- ¹⁵ *Ibid.*, p. 2; Md. Declaration of Rights, Article 15.
- ¹⁶ Dept. of Legislative Services of the Md. General Assembly, Fiscal and Policy Note for Senate Bill 1042, 2009 session, pp. 2-3.
- ¹⁷ *2011 Ratio Report*, State Dept. of Assessments and Taxation, p. 12.
- ¹⁸ Md. Code, Tax-Property Article §8-104(b).
- ¹⁹ Md. Code, Tax-Property Article §2-105(a).
- ²⁰ Bill Information for SB 1042 on the website of the Maryland General Assembly, <http://mlis.state.md.us/2009rs/billfile/sb1042.htm>, last accessed Oct. 26, 2012.
- ²¹ Fiscal and Policy Note for Senate Bill 1042, *op. cit.*, p. 1.
- ²² Md. Code, Tax-Property Article §2-106.
- ²³ Invoice from SDAT to Montgomery County Dept. of Finance, June 14, 2011. The Chief of the Treasury Division emailed us that the County received a refund of \$68,879, since the final cost was slightly less than estimated.
- ²⁴ Md. Code, Tax-Property Article §14-502(a)(1).

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- ²⁵ Md. Code, Tax-Property Article §§ 3-107, 14-509.
- ²⁶ Md. Code, Tax-Property Article §§3-102, 3-103.
- ²⁷ Md. Code, Tax-Property Article §3-103.
- ²⁸ *Ibid.*
- ²⁹ Md. Code, Tax-Property Article §14-510.
- ³⁰ Md. Code, Tax-Property Article §14-512.
- ³¹ Md. Code, Tax-Property Article §14-513.
- ³² Interview with SDAT staff on Dec. 5, 2011.
- ³³ *Abramson*, 328 Md. 721, 616 A.2d 894, 900 (1992) (internal quotations and brackets omitted).
- ³⁴ *Abramson*, 328 Md. 721, 616 A.2d 894, 897 (1992).
- ³⁵ Md. Code, Tax-Property Article §14-502(a).
- ³⁶ Md. Code, Tax-Property Article §14-509.
- ³⁷ Md. Code, Tax-Property Article §14-512(f).
- ³⁸ Md. Code, Tax-Property Article §14-510(b).
- ³⁹ *Abramson*, 328 Md. 721, 616 A.2d 894, 899 (1992); Md. Code, Tax-Property Article §14-510(b).
- ⁴⁰ *Abramson*, 328 Md. 721, 616 A.2d 894, 899 (1992).
- ⁴¹ Md. Code, Tax-Property Article §14-503.
- ⁴² Md. Code, Tax-Property Article §§8-104, 8-401(b), and 14-502(a).
- ⁴³ Bill Information for SB 208 on the website of the Maryland General Assembly, <http://mlis.state.md.us/2002RS/billfile/sb0208.htm>, last accessed Sept. 27, 2012.
- ⁴⁴ SB 208, 2002 Regular Session, p.1.
- ⁴⁵ Bill Information for SB 208 on the website of the Maryland General Assembly, *op. cit.*
- ⁴⁶ Senate Bill 208, 2002 Regular Session; “Former Senators 1996-2011” on the Maryland Manual online, <http://www.msa.md.gov/msa/mdmanual/05sen/former/html/former.html>, last accessed Sept. 28, 2012; “Senators By District” on the Maryland Manual online, <http://www.msa.md.gov/msa/mdmanual/05sen/html/sendist.html>, last accessed Sept. 28, 2012.
- ⁴⁷ Maryland General Assembly, Dept. of Legislative Services, 2002 Session, SB 208 Fiscal Note Revised, p. 2.
- ⁴⁸ *Ibid.*
- ⁴⁹ Md. Code, Tax-Property Article §1-101(b),(c),(qq), §8-102(b).
- ⁵⁰ Md. Code, Tax-Property Article §8-104(c).
- ⁵¹ Md. Code, Tax-Property Article §8-105(a)(1).

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- ⁵² *Assessment Manual*, Valuation 014, The Three Approaches to Valuation 060, Responsibility of Assessor 010.
- ⁵³ A Homeowner's Guide to Property Taxes and Assessments, Part X, Glossary of Terms, SDAT website, <http://www.dat.state.md.us/sdatweb/hog.html>, last accessed Aug. 31, 2012.
- ⁵⁴ *Cordish Power Plant Ltd. Partnership v. Supervisor of Assessments for Baltimore City*, 427 Md 1, 45 A.3d 273, 276 (2012).
- ⁵⁵ *Cordish Power Plant*, 45 A.3d at 275.
- ⁵⁶ Interview with SDAT staff on Dec. 5, 2011.
- ⁵⁷ *Assessment Manual*, Valuation 014, Low Income Housing Projects 100, Section 42 Tax Credits 050. Although this section contains specific information that is inapplicable to the Parklawn Building, it is an example of the general principles of capitalization of income.
- ⁵⁸ See, e.g., "Time Value of Money," Prof. Gordon Phillips, Robert H. Smith School of Business, Univ. of Md., p. 15, <http://www.rhsmith.umd.edu/faculty/gphillips/courses/Bmgt640/Timeval.pdf>, last accessed Sept. 14, 2012.
- ⁵⁹ Interview with SDAT staff on Dec. 5, 2011.
- ⁶⁰ Letter from Marie Green, Montgomery County Supervisor of Assessments, to Edward Blansitt, Montgomery County Inspector General, Sept. 20, 2012, p.1.
- ⁶¹ *Ibid.*, p.2.
- ⁶² Government Accountability Office Decision, *One Largo Metro LLC et al.*, June 20, 2011, p. 2.
- ⁶³ *Ibid.*, p. 4.
- ⁶⁴ Supplemental Lease Agreement Number 59, GS-11B-00082, dated Sept. 19, 2009, pp. 1-2.
- ⁶⁵ *Ibid.*, p. 2.
- ⁶⁶ "GSA Awards 935,000 Square Foot Lease for HHS in Rockville, Maryland," U.S. General Services Administration announcement, Aug. 11, 2011.
- ⁶⁷ General Services Administration Supplemental Lease Agreement, 8-24-11, amended 2-28-12, paragraphs 3 and 6F. In addition to providing for an adjustment for vacant premises, the lease also provides for a tax credit to the tenant if the lessor successfully appeals a tax assessment, in paragraph 6G. The SDAT's income analysis formula accounts for vacancy and expenses, so we did not separately use this information in our calculations. It is unclear how using this information would affect the capitalization of income calculation.
- ⁶⁸ U.S. Government Lease for Real Property, No. GS-11B-02293, 8-24-11, p. 2, paragraph 6B.
- ⁶⁹ *Ibid.*, p. 4, paragraph 6U.
- ⁷⁰ State Dept. of Assessments and Taxation online records, account 04-00135792.

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- ⁷¹ HHS is the successor department to the U.S. Dept. of Health, Education, and Welfare, which first leased the building. Twinbrook Sector Plan, Maryland-National Capital Park & Planning Commission, Jan. 2009, pp. 40, 53.
- ⁷² The Parklawn Building is on two lots, but SDAT assigns the value of the building to only one.
- ⁷³ SDAT online record for account number 00135792; Deed in Montgomery County Land Records, Liber 25043, Folio 00, Aug. 22, 2003.
- ⁷⁴ Montgomery County Department of Technology Services Geographic Information Systems, last accessed Oct. 22, 2012.
- ⁷⁵ SDAT Assessment Notice #362051, Dec. 30, 2005.
- ⁷⁶ Department of Technology Services Geographic Information Systems, *op. cit.*
- ⁷⁷ Interview with SDAT staff on Dec. 5, 2011.
- ⁷⁸ Letter from Eric Kassoff of Wilkes Artis to SDAT, June 5, 2009.
- ⁷⁹ *Ibid.*; Letter from Supervisor of Assessments to Office of the Attorney General, July 16, 2009.
- ⁸⁰ SDAT online records.
- ⁸¹ Montgomery County Department of Finance and SDAT online records. When assessed values increase, property taxes are based on assessed values that are phased in over three years. Maryland Manual online, State Department of Assessments and Taxation p. 2, last accessed Aug. 28, 2012. For the purposes of this analysis, we assumed that the value in the last year of the three year cycle is the full assessed value, which is the value we used.
- ⁸² “CoStar: Region’s Property Prices Continue Recovery,” *Washington Post*, April 1, 2012.
- ⁸³ Letter from Prince George’s County Council Member Will Campos to Attorney General Douglas Gansler, June 7, 2011.
- ⁸⁴ Letter from Assistant Attorney General David Lyon to Prince George’s County Council Member Will Campos, July 13, 2011, p.1.
- ⁸⁵ *Ibid.*, p. 2.
- ⁸⁶ *Ibid.*, p. 3.
- ⁸⁷ *Ibid.*
- ⁸⁸ Order, Property Tax Assessment Appeal Board for Montgomery County. Appeal 06-1721, Oct. 2, 2007.
- ⁸⁹ GSA leased a certain number of square feet in the Parklawn Building. Arguably, the rental income should not have a vacancy amount subtracted from it, since GSA was obligated to pay for the space whether or not it was actually occupied by a tenant agency. On the other hand, we understand that there was uncertainty about whether GSA would renew the lease, and a subtraction for vacancy might have accounted for the risk of future vacancy.
- ⁹⁰ Letter from Montgomery County Supervisor of Assessments, *op. cit.*, p.1.

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- ⁹¹ Montgomery County Department of Finance online records. In addition to the basic real property tax, the County levies other taxes based on real property, such as the Fire District Tax, the Transit District tax, and M-NCPPC taxes. 2011 CAFR, p. 192.
- ⁹² Montgomery County Department of Finance online records.
- ⁹³ Letter from Montgomery County Supervisor of Assessments, op. cit., p.2.
- ⁹⁴ Ibid., p.1.
- ⁹⁵ Ibid., p.2.
- ⁹⁶ Ibid., p.2.
- ⁹⁷ Ibid., p.3.
- ⁹⁸ Letter from Supervisor of Assessments to Office of the Attorney General, July 16, 2009.
- ⁹⁹ E.g., *2011 Ratio Report*, State Dept. of Assessments and Taxation, p. 1.
- ¹⁰⁰ Md. Code, Tax-Property Article §2-202(3).
- ¹⁰¹ *2011 Ratio Report*, State Dept. of Assessments and Taxation, p. 1.
- ¹⁰² Ibid., p. 12.
- ¹⁰³ *2010 Ratio Report*, State Dept. of Assessments and Taxation, p. 12.
- ¹⁰⁴ *Review of Property Assessments and Sales in Montgomery County*, CountyStat, April 26, 2011, p. 5.
- ¹⁰⁵ Ibid.
- ¹⁰⁶ Ibid., p. 24.
- ¹⁰⁷ Ibid., pp. 31-33.
- ¹⁰⁸ Montgomery County Code §20-41A.
- ¹⁰⁹ Approved FY13 Operating Budget for Montgomery County, p. 3-83.
- ¹¹⁰ County Executive's Recommended FY 95 Budget, p. 34-6; Bill No. 30-93, Ch. 44 LMC 1993, enacted Nov. 2, 1993.
- ¹¹¹ Bill No. 30-93, Ch. 44 LMC 1993, enacted Nov. 2, 1993, p.3.
- ¹¹² Ibid., pp. 4-5.
- ¹¹³ Office of Legislative Oversight Report No. 91-7, *Description and Evaluation of the Montgomery County Office of the Public Advocate for Assessments and Taxation*, ("OLO Report 91-7"), issued April 15, 1992, p. 8.
- ¹¹⁴ Bill No. 30-93, op. cit., p.5.
- ¹¹⁵ County Executive's Recommended FY 94 Budget and Public Services Program FYs 94-1999, p. 38-6.
- ¹¹⁶ Ibid., pp. 38-4, 38-6.

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- ¹¹⁷ Ibid., p. 38-2.
- ¹¹⁸ OLO Report 91-7, op. cit., p. 26.
- ¹¹⁹ Ibid., p.26.
- ¹²⁰ Ibid., p. 1(a).
- ¹²¹ Ibid., p. 1.
- ¹²² Bill No. 30-93, Ch. 44 LMC 1993, enacted Nov. 2, 1993.
- ¹²³ Minutes of County Council meeting, Nov. 2, 1993, p.8808.
- ¹²⁴ Minutes of Management and Fiscal Policy Committee meeting on Oct. 22, 1993, p.1; OLO Report 91-7, p. 1.
- ¹²⁵ Ibid.
- ¹²⁶ Memorandum from Robert Kendal, Director, Office of Management and budget, to Marilyn Praisner, President, Montgomery County Council, October 14, 1993.
- ¹²⁷ Approved FY13 Operating Budget for Montgomery County, p. 3-83.
- ¹²⁸ Email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 1.
- ¹²⁹ Ibid., pp. 2-5.
- ¹³⁰ Notes on Aug. 24, 2012 meeting with Finance staff, p. 1; email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 3.
- ¹³¹ Email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 3.
- ¹³² Md. Code, Tax-Property Article §14-201(b)(1)(ii).
- ¹³³ Email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 3.
- ¹³⁴ CoStar Products and Services list from www.costar.com, last accessed Oct. 26, 2012.
- ¹³⁵ Approved FY13 Operating Budget for Montgomery County, at p. 3-83.
- ¹³⁶ Email from Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 5.
- ¹³⁷ Md. Code, Tax-Property Article §2-215.
- ¹³⁸ Email from Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 5.
- ¹³⁹ “Property over 2,000,000 and Under Appeal,” sent by SDAT with cover letter to County Executive Isiah Leggett, April 10, 2012, p. 10.
- ¹⁴⁰ Ibid., pp. 1-10.
- ¹⁴¹ Daily Hearing Dockets for Sept. 5 – 27, 2012, PTAAB for Montgomery County.
- ¹⁴² See, e.g., PTAAB Order, Appeal Number 06-1721, Account Number 04-135792, Oct. 2, 2007.
- ¹⁴³ Letter from Montgomery County Supervisor of Assessments, op. cit., p.2.
- ¹⁴⁴ 41 U.S.C. §253. There is an exception for leasing small amounts of space.

¹⁴⁵ Media Advisory, Montgomery County, “Leggett, Cardin and Van Hollen Headline Montgomery County Sponsored Federal Markets and Property Summit,” Oct. 22, 2012.

¹⁴⁶ Emails from the Tax Operations Manager of the Dept. of Finance, Aug. 27, 2012 and Nov. 5, 2012. This figure is greater than the figure for arms-length commercial sales in Montgomery County that appears in SDAT’s 2011 Ratio Report, because the 57 appeals include more types of property than are included in SDAT’s list. Email from Special Assistant to the Director of SDAT, Nov. 2, 2012.

¹⁴⁷ Email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 3.

¹⁴⁸ County Executive’s Recommended FY 94 Budget, op. cit., p. 38-3.

¹⁴⁹ SB 208 Fiscal Note Revised, op. cit., p. 3.

¹⁵⁰ Email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, p. 4.

¹⁵¹ County Executive’s Recommended FY 92 Budget and Public Services Program FYs 92-97, p. 33-5.

¹⁵² Email from the Tax Operations Manager of the Dept. of Finance, Sept. 6, 2012, pp. 4-5.

¹⁵³ Ibid., p. 5.

¹⁵⁴ Ibid., p. 1.

¹⁵⁵ Maryland General Assembly, Dept. of Legislative Services, 2002 Session, SB 208 Fiscal Note Revised, p. 2.

¹⁵⁶ Tax Court Decisions, Maryland Tax Court website, <http://www.txcert.state.md.us/decisn.html>, last accessed 9/11/2012. : Of the 44 cases decided from April 22, 1999 through August 29, 2012, only three contain names of counties, and none of these was an appeal of a real property tax assessment. We recognize that this list does not reflect cases that settled before adjudication, and that not all parties are included in case names.

¹⁵⁷ Memorandum from Charles H. Sherer, Legislative Analyst, to the MFP Committee, Aug. 26, 2008, p.3.

¹⁵⁸ Approved FY13 Operating Budget for Montgomery County, p. 3-80.

¹⁵⁹ Memorandum from Legislative Analyst to the MFP Committee, op. cit.

¹⁶⁰ “Vacant city houses get property tax break meant for owner-occupied homes,” *Baltimore Sun*, August 23, 2011.

¹⁶¹ Memorandum from Legislative Analyst to the MFP Committee, op. cit., p.2.