

Final
Advisory
Memorandum

Communication of Building Permit Information to SDAT

Report # OIG-17-001

August 25, 2016

Montgomery County Maryland
Office of the Inspector General





OFFICE OF THE INSPECTOR GENERAL

FINAL ADVISORY MEMORANDUM

August 25, 2016

TO: Timothy L. Firestine
Chief Administrative Officer

FROM: Edward L. Blansitt
Inspector General

SUBJECT: Communication of Building Permit Information to SDAT
OIG-17-001

The Office of the Inspector General (OIG) received a complaint stating that major improvements had been made to houses in the complainant's neighborhood, but that properties' assessments did not reflect the resulting increases in property values. The complainant stated that as a consequence, the County may not be collecting the appropriate additional property taxes from the owners of these properties.

Our inquiry was conducted in accordance with *Government Auditing Standards* issued by the U.S. Government Accountability Office and *Principles and Standards for Offices of Inspector General* issued by the Association of Inspectors General.

Introduction and Background

The State Department of Assessments and Taxation (SDAT) assesses real property in Maryland. According to SDAT, the property tax is primarily a local government revenue, and less than 10% of the property tax collected goes to the State. In recent years, property taxes have been Montgomery County's largest source of revenue.

Section 8-104(c)(1)(iii) of the Tax-Property Article of the Maryland Code requires that property values must be reassessed if "substantially completed improvements are made which add at least \$100,000 in value to the property." In addition, section 8-104(b)(1) of the Tax-Property Article requires that all real property be reassessed every three years, based on an exterior physical inspection of the property.

Reassessments of properties that increase in value may result in greater property tax collections for the County and the State, and they can result in property taxes being levied more appropriately.

The County Department of Permitting Services (DPS) issues building permits for improvements to real property in Montgomery County, including construction, additions, and alterations.

The SDAT Supervisor and the Director of DPS both told us that SDAT had met recently with DPS and discussed SDAT requests for more information from DPS.

Objectives, Scope, and Methodology

We undertook this review (1) to determine if DPS provides information to SDAT as required by law and (2) to consider whether DPS should provide additional information.

The OIG contacted an SDAT assessor to inquire about SDAT's reassessment process and the information that the County provided. We were subsequently contacted by SDAT's Assistant Supervisor of Assessments for Montgomery County and by SDAT's Supervisor of Assessments for Montgomery County (sometimes separately or collectively referred to as "SDAT management" or "SDAT" in the remainder of this memorandum).

We also contacted DPS. The Director, the Chief Operating Officer, and the Manager of Information Technology Services provided us with reports and other information.

DPS provided SDAT with information on building permits, as required by law

We conclude that the County is substantially complying with the requirement in §5-103 of the Maryland Tax-Property Article that copies of building permits be immediately submitted to the State supervisor.

Section 5-103 requires that the "person responsible for issuing building permits shall immediately after issuing a building permit submit a copy of the building permit to the supervisor of the county where the building is located." The reference to the supervisor is to the SDAT supervisor of assessments for Montgomery County.

SDAT employees told the OIG that Montgomery County DPS informs SDAT when permits are issued. The Director of DPS stated that the County sends reports of issued building permits to SDAT nightly. The DPS Director provided a sample permit report that contained information such as address, square footage, and estimated cost. The Director stated that DPS also provides SDAT access to DPS' computer systems to find plans and other information.

Finding 1: Although DPS does what is required by law, the County's best interests might be better served by providing information that would facilitate SDAT's ability to more quickly identify the properties that need to be reassessed.

SDAT employees told the OIG that SDAT sometimes does not timely reassess properties that have increased in value, and that a decrease in the number of assessors made it difficult for SDAT to assess every property soon after an increase in value.

SDAT management stated that the County could help SDAT reassess properties more quickly, if the County would provide better information to SDAT.

SDAT suggested several areas (SDAT property tax account numbers, accurate estimated cost information, and final inspections) in which improved information would help SDAT complete reassessments more quickly, as follows.

i. SDAT Property Tax Account Numbers

Currently, applications for Montgomery County permits do not require SDAT account numbers. DPS is not required by law to provide SDAT account numbers, and SDAT management stated that DPS does not provide them. The Director of DPS confirmed this.

The SDAT Supervisor stated that if the County provided SDAT account numbers, SDAT staff could locate property records more quickly and thus could complete reassessments more quickly. Without account numbers, SDAT staff spend time manually searching for account numbers based on the addresses provided. This is not always straightforward, as there are multiple ways to write an address, and there is not always a one-to-one relationship between account numbers and addresses.

The Director of DPS informed us that years ago DPS required SDAT account numbers from permit applicants, but the numbers were very often missing, incomplete, or incorrect.

The Director informed us that DPS was working with the Maryland-National Capital Park & Planning Commission (M-NCPPC) to enable DPS to download addresses and SDAT account numbers from M-NCPPC's data. The Director plans to have the M-NCPPC data downloaded regularly beginning on September 1, 2016. The DPS Director stated that when this work is complete, DPS will include the SDAT account numbers in the daily reports DPS provides to SDAT.

ii. Accurate Estimated Cost Information

The SDAT Supervisor stated that many cost estimates on County permits were low, and some were extremely low, even \$0. The Director of DPS stated that the cost estimates were provided by permit applicants, and that they were frequently incorrect.

If the estimated cost of the work is understated, a property that has increased in value more than \$100,000 might not be identified as such by SDAT, and therefore it might not be reassessed outside of the 3-year cycle.

The SDAT Assistant Supervisor told the OIG that due to SDAT staffing constraints, if a permit shows an estimated cost of less than \$100,000, then the property is typically not reassessed outside of the three-year cycle.

The DPS Director stated that DPS does not check the estimated costs for residential properties. DPS previously charged residential permit fees based on estimated cost, but now DPS charges based on square footage, so it does not check the estimated costs

provided. The Director stated that this would be another activity that could slow DPS' work and lead to increased DPS costs¹.

SDAT provided three examples of County residential building permits that SDAT management thought had cost estimates that were too low for the work being completed.

Cost Examples Provided by SDAT

Estimated Cost	Sq. Ft.	Cost per Sq. Ft.*	Date	Description
\$0	10,086	\$0.00	4/11/2014	New home
\$1,000	1,100	\$0.91	4/1/2015	Addition
\$20,000	2,251	\$8.88	2/9/2012	Addition

* Calculated by OIG
Source: Data provided by SDAT

The OIG analyzed the sample permit report provided by the DPS Director and identified two permits with estimated costs per square foot similar to SDAT's examples.

Cost Examples from DPS Permits

Estimated Cost	Sq. Ft.	Cost per Sq. Ft.*	Date	Description
\$2,500	2,900	\$0.86	4/25/2016	Addition
\$20,000	3,687	\$5.42	4/25/2016	Addition

* Calculated by OIG
Source: Data provided by DPS

The International Code Council (ICC) reported in June 2016 that residential one- and two-family homes have average square foot construction costs of \$112.65 to \$143.93.

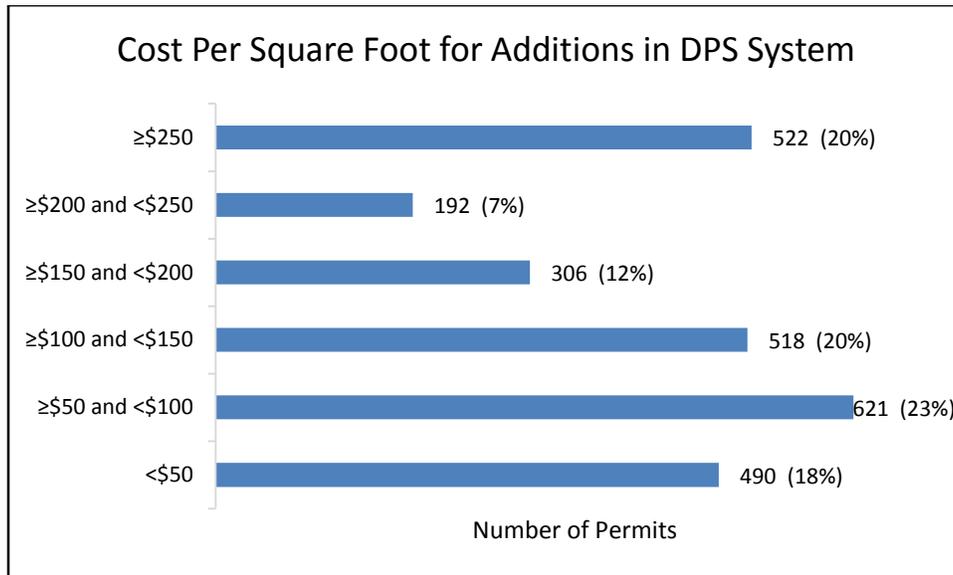
OIG Analysis: Additions

We analyzed data for County building permits issued for additions² to single family homes from Dec. 31, 2013 through May 4, 2016. There were 2,649 such permits.

¹ The DPS Director informed us that for commercial properties, DPS checks the value and the square footage information against information from the International Commercial Code.

² We focused on addition permits so as to exclude decks, sheds, and solar panels, which may have lower costs per square foot. DPS codes building permits according to different work types, such as additions, alterations, construction, and restorations. Permits for decks and sheds are construction permits. Permits for solar panels are alteration permits.

The chart below shows that for 490 (18%) of these permits, the estimated costs recorded in DPS' system were below \$50 per square foot, which is well below the ICC range of \$112.65 to \$143.93.



Source: OIG Calculations based on DPS data

OIG Analysis: 5,000 sq. ft. affected at cost of less than \$100,000

We also analyzed data for building permits issued for single family homes from Dec. 31, 2013 through May 4, 2016 that had an affected building area greater than 5,000 square feet and an estimated cost of less³ than \$100,000. We used these parameters to identify, for testing purposes, properties that appeared to have significant work being done on them at possibly erroneously underestimated costs. We requested and DPS provided application information for these permits.

There were 27 permits meeting the above criteria, and we determined that for most (76%) of the application cost estimates we reviewed, the estimated costs in DPS' computer system were lower than the estimated costs in the applications⁴. In the rest of the cases, they were equal to the estimated costs in the applications. We conclude that most of the low estimated costs per square foot we identified resulted from incorrect data entry.

More than half (53%) of the discrepancies between application data and computer system data appeared to be related to the entry of an incorrect number of zeroes. For example, one application stated an estimated cost of \$730,000, but the computer record showed \$73,000.

³ An estimated cost of above \$100,000 will lead SDAT to be more likely to reassess the property outside of the three-year cycle.

⁴ We calculated that the County's property tax revenue from the discrepancies in this sample would be \$91,692, assuming the differences were taxed at Montgomery County's Fiscal Year 2017 countywide

The DPS Chief Operating Officer told the OIG that numerous permit technicians input information from paper applications into DPS' system.

iii. Final Inspections

Final inspections are conducted after a building is completed and ready for occupancy. The final inspection must be passed before a building, or a portion newly constructed, can be used and occupied.

According to the SDAT Supervisor and the Assistant Supervisor, notice to staff of a final inspection would help staff identify properties that are required to be reassessed, and it would provide SDAT with evidence to use in court, to show that improvements had been substantially completed when SDAT reassessed a property.

SDAT managers stated that Montgomery County does not inform SDAT when the work for which a building permit was issued has passed a final inspection. The DPS Manager of Technology Services informed us that DPS is developing a report that will indicate when residential properties are ready for occupancy, and DPS will provide that soon to SDAT.

Conclusion

DPS could facilitate SDAT's reassessment work, and we believe that it is in the County's interest for DPS to make SDAT's reassessment tasks easier. First, faster reassessments could result in more equitable property tax collections. If some property owners pay more in property taxes due to reassessments, other property owners could pay less. Second, faster reassessments might also lead to an increase in property tax revenues⁵.

DPS should consider ways to make SDAT's reassessment work easier, when it is advantageous to the County. DPS could discuss with SDAT how to focus more quickly on those properties that are likely to increase more than \$100,000 in value. We believe that the cost of the marginal additional effort on the part of DPS is less than the benefit of prompt reassessments to the County and its residents.

The City of Gaithersburg⁶, which we contacted at the suggestion of SDAT, provides SDAT with account numbers, estimated cost information deemed more accurate by SDAT, and final inspection information. Gaithersburg downloads account numbers from SDAT and incorporates them into its Geographic Information System, which the permit system accesses. Gaithersburg reviewers consider the square footage of the work being done and

property tax rate of \$1.0382 per \$100 of assessed value. The State property tax revenue would be \$9,892, applying the State's Fiscal Year 2017 rate of \$0.112 per \$100 of assessed value. We did not determine the actual property taxes for these properties.

⁵ Section 305 of the Montgomery County Charter limits the amount that property tax revenues can increase from year to year. This memo does not address how this Charter limit might affect overall property tax rates.

⁶ Gaithersburg is a municipality in Montgomery County that issues its own building permits and where County building permits are not required.

read the plans to determine if the estimated cost figures are reasonable. Gaithersburg sends reports to SDAT listing completed final inspections.

The DPS Director informed us that since the recent meeting with SDAT, DPS has begun providing additional information that SDAT told DPS would be useful: access to DPS' system of electronically submitted plans, nightly information on demolition permits issued, and a cumulative monthly report of the information provided nightly.

Recommendations

- 1. DPS should continue to work toward incorporating SDAT account numbers into the building permit information it communicates to SDAT.**
- 2. DPS should determine what changes are necessary to improve the accuracy of the estimated costs.**
- 3. DPS should continue to work toward communicating to SDAT when residential properties are ready for occupancy.**

Summary of the Chief Administrative Officer's Response

The response from the Montgomery County Chief Administrative Officer (CAO) to the final draft report is included in its entirety in Appendix A.

In response to Recommendation 1, the CAO wrote that effective August 2, 2016, the County began including tax ID numbers in the reports submitted to SDAT.

In response to Recommendation 2, the CAO wrote that DPS will explore developing a program to provide a calculation based upon square footage of construction, type of construction, and an assumed estimated construction cost based on tables created for the purpose of estimating permit fees.

The CAO wrote that the ICC construction cost tables were developed for the purpose of setting permit fees and are not representative of specific construction. The CAO also wrote that construction costs do not equal increases in fair market value. We are aware of these points but note that SDAT uses estimates of construction costs as indicators of which properties are most likely to have substantially increased in value, and thus may merit reassessment.

In response to Recommendation 3, the CAO wrote that DPS began providing occupancy permit reports to SDAT in April 2016, following SDAT's request for this information. We were informed in May that DPS provided occupancy information for commercial construction, but not for residential construction. Our understanding is that DPS plans to provide comparable information for residential properties soon.

Nothing in the response caused us to alter our findings or recommendations.

Appendix A



OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

August 19, 2016

To: Edward L. Blansitt, Inspector General

From: Timothy L. Firestine, Chief Administrative Officer *Timothy L. Firestine*

Subject: Response to Advisory Memorandum on Communication of Building Permit Information to SDAT

I am in receipt of your advisory memorandum and confidential draft report dated July 25, 2016 detailing the review conducted by your office of a complaint that property assessments of major improvements made to houses in the complainant's neighborhood did not reflect the resulting increases in property values. Per your draft memorandum, you undertook the review to determine if the Department of Permitting Services (DPS) provides information to the Maryland State Department of Assessments and Taxation (SDAT) as required by law and to determine also if DPS should provide additional information. You concluded that DPS provides the information that is required by law and that the County's interests could potentially be furthered if DPS were to provide certain additional information to SDAT.

Before providing specific responses to your recommendations, I would like to emphasize that Montgomery County is fully committed to helping SDAT with information that may be useful for SDAT to properly and timely assess the value of properties and changes in value due to new construction, additions, and demolitions, by sharing information generated through the building permit process.

Our DPS provides SDAT with nightly spreadsheets comprised of information related to building permits issued that day. This is a long standing practice to assure that we are meeting our obligation and that SDAT has the information it needs to assess and reassess the value of buildings. It is important to note that cost of construction is not the same as the assessed value of property.

Please find below specific responses to your recommendations:

Recommendation 1: DPS should continue to work toward incorporating SDAT account numbers into the building permit information it communicates to SDAT.

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

Edward L. Blansitt, Inspector General
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CAO Response: In partnership with MNCCPC, effective August 2, 2016, we began including tax ID numbers in the reports submitted to SDAT. We recommend that SDAT also check these reports against its own address and database since it creates the tax ID numbers for addresses and maintains that database.

Recommendation 2: DPS should determine what changes are necessary to improve the accuracy of the estimated costs.

CAO Response: DPS will explore developing a program to provide a calculation based upon square footage of construction, type of construction, and an assumed estimated construction cost based on tables created for the purpose of estimating permit fees. However, it is important to note that cost information is useful in processing of permits when permit fees are based upon cost of improvements, which is no longer the case for new commercial construction and has not been the case for residential permits. The published ICC 2015 Building Valuation Data table provides, "ICC has developed this data to aid jurisdictions in determining permit fees. It is important to note that while this BVD table does determine an estimated value of a building (i.e., Gross Area x Square Foot Construction Cost), this data is only intended to assist jurisdictions in determining their permit fees. This data table is not intended to be used as an estimating guide because the data only reflects average costs and is not representative of specific construction." Thus, the tables were not intended to be accurate estimated cost information. Furthermore, assessments are based upon fair market value which is what a willing buyer will pay a willing seller in the open market, which is not the same thing as construction costs. See, Lane v. Supervisor of Assessments of Montgomery County, 447 Md. 454 (2016).

Recommendation 3: DPS should continue to work toward communicating to SDAT when residential properties are ready for occupancy.

CAO Response: Occupancy permits are issued when construction is completed and has passed final inspection. DPS began providing occupancy permit reports to SDAT in April 2016, following their request for this information.

We appreciate the opportunity to review and respond to the draft Advisory Memorandum. Please contact Diane Schwartz Jones, Director of Permitting Services, at (240) 777-6363 with additional questions.

cc: Fariba Kassiri, Assistant Chief Administrative Officer
Diane Schwartz Jones, Director, Department of Permitting Services
Alexandre A. Espinosa, Director, Department of Finance