

DEPARTMENT OF REVENUE

**ADMINISTRATION OF
AD VALOREM TAX PROGRAM**

Performance Audit



**HEAD OF THE DEPARTMENT OF REVENUE
AND THE EXECUTIVE DIRECTOR**

Pursuant to Section 20.21(1), Florida Statutes, the head of the Department of Revenue is the Governor and Cabinet, which includes the Attorney General, Chief Financial Officer, and the Commissioner of Agriculture. Pursuant to Section 20.05(1)(g), Florida Statutes, the Governor and Cabinet is responsible for employing an Executive Director of the Department of Revenue to serve. Lisa Vickers served as the Executive Director during the audit period.

The audit team leader was Mark Hesoun, and the audit was supervised by Michael J. Gomez, CPA. Please address inquiries regarding this report to Marilyn D. Rosetti, CPA, Audit Manager, by e-mail at marilynrosetti@aud.state.fl.us or by telephone at (850) 487-9031.

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DEPARTMENT OF REVENUE ADMINISTRTION OF AD VALOREM TAX PROGRAM

SUMMARY

Our performance audit of the Department of Revenue's (DOR) administration of the Ad Valorem Tax Program disclosed the following:

REPRESENTATIVENESS IN RATIO STUDIES

Finding No. 1: Problems with DOR's sampling plan caused some in-depth studies to have an inadequate number of samples in certain value groups within some strata, and the lack of samples made it difficult for DOR to accurately calculate statistical measures for those strata and the overall level of assessment for those counties.

OTHER RATIO STUDY ISSUES

Finding No. 2: Appraisal reports and related DOR records were not always adequate to ensure that value estimates for subject properties were reliable and reasonably supported. As a result, to the extent the assessment levels published by DOR for the counties included in our review were based upon appraisal ratio studies, such assessment levels may not be accurate.

Finding No. 3: We noted instances in which DOR changed its appraisal values, subsequent to meeting with the county property appraiser, without adequately supporting its reasoning.

BACKGROUND

Pursuant to Section 195.002, Florida Statutes, DOR is responsible for the general supervision of the assessment and valuation of property so that all property is placed on the tax rolls and is valued according to its just valuation, as required by the State Constitution. DOR is also responsible for the supervision over tax collection and all other aspects of the administration of such taxes. The law further provides that supervision by DOR is to consist primarily of aiding and assisting county officers in the assessment and collection functions, with particular emphasis on the more technical aspects. In this regard, DOR conducts training to upgrade assessment skills of both State and local assessment personnel.

To carry out its assigned duties, Chapter 195, Florida Statutes, requires DOR to:

- Prescribe reasonable rules and regulations for the assessment and collection of taxes, which are to be followed by property appraisers, tax collectors, clerks of the circuit court, and value adjustment boards.
- Promulgate rules and regulations for the exchange of information among DOR, property appraisers, tax collectors, the Auditor General, and the Office of Program Policy Analysis and Government Accountability.
- Establish and promulgate standard measures of value not inconsistent with those standards provided by law, to be used by property appraisers in all counties, including taxing districts, to aid and assist them in arriving at assessments of all property.
- Conduct constant research and maintain accurate tabulations of data and conditions existing as to ad valorem taxation, annually publish such data as may be appropriate to facilitate fiscal policymaking, and annually make such recommendations to the Legislature as are necessary to ensure that property is valued according to its just value and is equitably taxed throughout the State.
- Prepare and maintain a current manual of instructions for property appraisers and other officials connected with the administration of property taxes.
- Promulgate uniform definitions for all classifications of property.

- Review the assessment rolls of each county and conduct, no less frequently than once every two years, an in-depth review of the assessment rolls of each county.
- Issue a notice to any property appraiser who the Executive Director has determined has one or more classes or other strata of property listed on the assessment rolls in a manner inconsistent with the requirements of law, or is otherwise not assessing in accordance with law.
- Annually, not later than 15 days following approval of the assessment roll for a county pursuant to Section 193.1142, Florida Statutes, publish sales ratio studies for that county.
- Periodically review the assessments of new, rebuilt, and expanded businesses reported according to Section 193.077(3), Florida Statutes, to ensure parity of level of assessment with other classifications of property.
- Review the assessments of new and expanded businesses granted an exemption pursuant to Section 196.1995, Florida Statutes, to ensure parity of level of assessment with other classifications of property.
- Determine each year whether counties and municipalities are assessing the real and tangible personal property within their jurisdiction in accordance with law.

FINDINGS AND RECOMMENDATIONS

Article VII, Section 4 of the State Constitution requires that a just valuation be made of all property for ad valorem tax purposes. In arriving at just valuation, property appraisers are required to take into consideration the factors defined in Section 193.011, Florida Statutes. Also, DOR is required to conduct, no less frequently than once every two years, an in-depth review of the assessment rolls of each county to determine whether the property assessments shown on the rolls are indicative of just value. Exhibit B contains a listing of counties included in DOR's 2010 and 2011 in-depth reviews of assessment rolls.

Upon completion of the reviews, DOR publishes the results of the reviews for each county tax roll as a whole, and independently for each class of real property. When one class of real property comprises less than five percent of a county's total assessed value of all real property on the previous assessment roll, DOR may combine it with one or more other classes of real property for purposes of the in-depth review or use the weighted average of the other classes for purposes of calculating the level of assessment for all real property in a county. Section 195.096(3)(a), Florida Statutes, establishes seven classes of real property, commonly referred to as strata, as follows:

1. Residential property that consists of one primary living unit, including, but not limited to, single-family residences, condominiums, cooperatives, and mobile homes;
2. Residential property that consists of two or more primary living units;
3. Agricultural, high-water recharge, historic property used for commercial or certain nonprofit purposes, and other use-valued property;
4. Vacant lots;
5. Nonagricultural acreage and other undeveloped parcels
6. Improved commercial and industrial property; and,
7. Taxable institutional or governmental, utility, locally assessed railroad, oil, gas and mineral land, subsurface rights, and other real property.

DOR's published standards for tax roll approval require that a county's assessment for an individual stratum, and in total, be at least 90 percent of market value (i.e., a 90 percent level of assessment). When one or more of these classes of real property listed on the assessment rolls are in a manner inconsistent with these requirements, DOR issues a review notice to the applicable county property appraiser describing the necessary corrections. If the corrections are

not made, DOR disapproves the assessment roll and begins the process for an interim assessment roll, as outlined in Section 193.1145, Florida Statutes.

For the in-depth reviews of the 2010 and 2011 assessment rolls, DOR used the sales-ratio methodology, the appraisal-ratio methodology, or a combination of the two. The sales-ratio methodology was utilized in the value groups of strata with adequate sales data. Value groups are subgroups of strata by value that are used to enable a more detailed analysis of representative properties within each stratum. Each stratum is divided into four value groups for study purposes. In the value groups of strata with inadequate sales data, the appraisal-ratio methodology was used either exclusively or to supplement the sales-ratio methodology.

Beginning with the 2011 in-depth review, DOR began using time-trended sales from up to 36 months prior to January 1 of the in-depth review year to obtain a sufficient number of sale samples for analyzing the various strata and value groups. Time-trended sales, also referred to as sales ratio trend analysis, is defined as a method of time trend analysis that involves tracking sales ratios (or their reciprocals) over time.¹ This change allowed DOR to reduce the reliance on independent appraisals, which are more labor intensive than using sale samples.

Table 1 summarizes the number of sale and appraisal sample items by stratum Statewide. Stratum 5 and 7 for each county comprised less than five percent and, therefore, were not studied.

Table 1

| Stratum | 2010 | | | 2011 | | |
|---------------|-----------------|--------------|---------------|-----------------|--------------|---------------|
| | Qualified Sales | Appraisals | Total | Qualified Sales | Appraisals | Total |
| 1 | 22,851 | 229 | 23,080 | 94,793* | 0 | 94,793 |
| 2 | 137 | 66 | 203 | 289 | 86 | 375 |
| 3 | 0 | 564 | 564 | 0 | 457 | 457 |
| 4 | 1,282 | 337 | 1,619 | 1,447* | 343 | 1,790 |
| 6 | 203 | 1,138 | 1,341 | 592 | 1,132 | 1,724 |
| Totals | 24,473 | 2,334 | 26,807 | 97,121 | 2,018 | 99,139 |

**Includes time-trended sales*

Once the appraisals are finished, the field work portion of the in-depth review is complete. Each county property appraiser is afforded an opportunity to review with DOR staff each appraisal sample item utilized in the study and sales qualifications exceptions. After the review, a summary report is produced indicating the results of the in-depth review, which is used in the tax roll approval process. Estimated levels of assessment (value-weighted mean assessment ratios) for each county and the entire State are certified to the Commissioner of Education for use in the equalization of required local effort funding for school districts.

¹ International Association of Assessing Officers publication, *Mass Appraisal of Real Property*.

| |
|--------------------------------------------|
| Representativeness in Ratio Studies |
|--------------------------------------------|

Finding No. 1: Inadequate Sample Sizes in the Sampling Plan

Section 195.096(2)(c), Florida Statutes, provides that in conducting assessment ratio studies, DOR must use all practicable steps, including stratified statistical and analytical reviews and sale-qualification studies, to maximize the representativeness or statistical reliability of samples of properties in tests of each classification, stratum, or roll made the subject of a ratio review published by it. The law further provides that, to the greatest extent practicable, DOR study assessment roll strata by sub-classifications, such as value groups and market areas for each classification or stratum to be studied, to maximize the representativeness of ratio study samples.

To allow for more accurate statistical measures and to improve sample representativeness, DOR applied a value group sampling plan when evaluating tax rolls. DOR used four value groups within each stratum, with each value group representing approximately 25 percent of the total property value of the stratum. When calculating the level of assessment, the sampling plan also aids in identifying price-related inequities within a stratum. In previous reports, most recently our report No. 2010-013, we reported that DOR encountered some problems while utilizing the sampling plan, which resulted in some value groups lacking adequate sample items. Similar problems were found during this audit, as follows:

- DOR's sampling plan required a minimum of five sample items per value group when applying the sales-ratio methodology and two sample items per value group when applying the appraisal-ratio methodology. When a value group does not achieve the minimum desired sample size, the value group is effectively not tested. For the 32 counties studied in 2010, 8 value groups had less than the minimum number of sample items, and for the 35 counties studied in 2011, 10 value groups had less than the minimum number of sample items. DOR's sampling plan did not contain a contingency for producing ratio results when value groups did not have an adequate number of samples. Therefore, no ratio results were available for those 18 value groups with a less than desired sample size. Seventeen of the 18 value groups that did not have the minimum number of sample items were in the value groups with the highest-valued properties. The reliability of the statistical results for the 2010 and 2011 in-depth studies was diminished because these high value groups were not represented. Appraisal samples were selected from the prior year tax roll to provide DOR staff adequate time to complete the in-depth studies prior to submission of the current tax roll. According to DOR staff, inadequate sample sizes were generally the result of changes that occur between the prior year and current year tax rolls under review, or because the population from which to draw samples is less than the desired sample size. While DOR implemented a new time trended sales ratio study for the 2011 tax roll approval, still some value groups went untested and therefore some sampling objectives were not met.
- The 95 percent level of confidence objective required by Section 195.096(2)(f), Florida Statutes, was not always obtained (i.e., the population did not always fall within the required range). DOR records indicated that 23 strata in 17 counties did not achieve the 95 percent level of confidence objective for the 2010 in-depth review, and 16 strata in 14 counties did not achieve the required level of confidence objective for the 2011 in-depth review. Inadequate sample sizes likely contributed to the inability to achieve the required 95 percent level of confidence, and diminished the reliability that can be placed on the results. While two sample items can be used to measure the amount of variation among ratios within value groups, the margins of error are frequently large, the confidence interval (i.e., actual range of ratios) is unacceptably wide, and the results often fail to meet the reliability objectives.

As a result of these past difficulties of populating all value groups, particularly some of the high value groups, DOR revised its methodology in determining which parcels are assigned to each value group. The new methodology, which is planned to be implemented in the 2013 in-depth reviews, is expected to resolve many of the problems identified above.

Recommendation: DOR should continue to improve its sampling procedures to acquire the desired number of samples per value group to meet minimum sample sizes. Also, to achieve the targeted confidence interval or margin of error objectives, every value group should contain an adequate number of sample items, using sales, appraisals, or a combination of both.

Other Ratio Study Issues

Finding No. 2: Reliance on Appraisal Ratio Studies

In addition to the sales-ratio methodology, DOR utilized the appraisal-ratio methodology in evaluating the reasonableness of value determinations made by county property appraisers. This involved DOR performing individual appraisals on a random sample of parcels in various strata and value groups, and then comparing their value estimates with the county property appraisers' values to determine if they were reasonable. Based on our review of the 2010 and 2011 in-depth reviews, appraisals continued to play a significant role in DOR's ratio studies, especially in stratum 6, which normally require the application of more complicated and labor-intensive appraisal procedures.

To the extent that DOR's in-depth review process relied on appraisals of sampled properties, we included appropriate tests of the DOR appraisals. For our review, we selected 20 DOR appraisals each in Hillsborough and Holmes Counties (2010 in-depth review), and 20 appraisals in Hamilton County and 8 appraisals in Miami-Dade County (2011 in-depth review). For some appraisals, more than one appraisal method was used. For the selected appraisals, we reviewed the appraisals and related documents, and conducted field verifications, to determine whether DOR complied with applicable appraisal standards, practices, and procedures. As described in the following paragraphs, and as similarly noted in several previous audit reports, most recently in our report No. 2010-013, our review disclosed that appraisals and related DOR records did not always evidence that value estimates for subject properties were reasonably supported. As a result, to the extent the assessment levels published by DOR for the 2010 assessment rolls for Hillsborough and Holmes Counties, and the 2011 assessment rolls for Hamilton and Miami-Dade Counties, relied upon appraisal-ratio studies, some of the assessment levels for these counties may not be adequately supported. The deficiencies noted were generally related to the application of the valuation approaches, as discussed below.

Sales Comparison (Market) Approach

As described in *The Appraisal of Real Estate*,² the sales comparison approach involves an estimation of market value of the subject property based on recent sales of comparable properties, with appropriate quantitative or qualitative adjustments (to the comparable properties) for any value-influencing dissimilarities between the subject and comparable properties. The adjustments to the comparable sales are totaled or reconciled to provide individual value indicators for the subject property. The value indicators are then reconciled to arrive at the estimated value of the subject property.

Of the 68 DOR appraisals included in our review, 33 appraisals used the sales comparison approach. Our review of the 33 appraisals disclosed:

- For seven appraisals in Holmes County, stratum 6, we noted that appraisers increased sale prices of comparable properties (comps) by the exact dollar amounts that buyers stated they spent on improvements, renovations, or alterations since the date of purchase. For one of the comps, which was used in three appraisals, the increase more than doubled the sale price. In the appraiser's notes, there was no mention of

² Appraisal Institute's publication, *The Appraisal of Real Estate*, 13th Edition.

negotiated or agreed-upon sale price adjustments, based on needed improvements, between the buyer and seller prior to the sale. Adjusting the sale price by the amount paid for renovations or improvements may misrepresent the value of the sale. It is important that any dollar amount adjustment made to a sale price represent an amount negotiated by the buyer and seller, and not the actual amount spent after purchase.

- One appraisal in Hillsborough County, stratum 6, was of a large full-service automobile dealership and repair facility with a large tri-level parking garage, automatic car wash, and auto detailing areas. Our review of the appraisal disclosed:
 - The appraiser reported that the subject property's improvements were built in 2008 with an effective age of 1 year old. However, the sales comparison information showed the subject property age as 2 years old, with no reference to the effective age, and the condition as good. The comps indicated the following: comp 1, 10 years old, good condition; comp 2, 9 years old, good condition, and comp 3, 40 years old, effective age 12 years old, average condition. The appraiser reported that all three comps were comparable to the subject property for age and condition, without including any notes on the comps in the valuation analysis in the appraisal report or work file. DOR's records did not evidence the appraiser's basis for comparison, which was important given the wide range of disparity between the comps' data.
 - The subject property's gross building area was three to six times larger than the three comps. The appraiser's only support for the size adjustment was that the comps' small size resulted in the economy of scale theory, without any market support to validate the statement. Economy of scale theory states that as the size increases, the associated price per unit generally decreases. If the comps' sizes were not large enough to operate as a similar full-service dealership, then they may be worth less per square foot than the subject property, and therefore be inferior to the subject property rather than slightly superior, as indicated by the appraiser. Even though a parcel is smaller than the subject property, it may not necessarily mean that the price per square foot will be higher. Market evidence should be obtained to support such a determination.
 - For the amenities criterion, the appraiser reported that the subject property had an automated car wash and wax, while the three comps had none. However, comps 1 and 3 were reported to be comparable to the subject for this feature, while no indication of comparability was reported for comp 2. DOR's records did not evidence that the data was properly evaluated.
 - The prices per square foot for the three comps were \$183.32, \$224.11, and \$73.45, respectively. It was noted that comp 3 was foreclosed on by the bank and subsequently sold for \$73.45 per square foot. In calculating the value of the subject property, the appraiser used an average of the lowest and highest comp amounts without any explanation for the variance in amounts or market representativeness. DOR's records did not evidence the appraiser's reasoning supporting the calculation of the value conclusion, which was important given the significant differences in the comps' data.

Income Approach

As described in *The Appraisal of Real Estate*, the income approach to estimating value utilizing direct capitalization involves a market-derived (based on similar properties) estimation of one year's potential gross income expectancy, a deduction for vacancy and collection loss, and a deduction for operating expenses, resulting in net operating income that is then capitalized into value using an appropriate capitalization rate that reflects one year's anticipated risk and return characteristics.

Of the 68 DOR appraisals included in our review, 31 appraisals used the income approach. Our review of the 31 appraisals is discussed below.

Hillsborough County, Stratum 2 – included 9 of the 31 appraisals using the income approach. Our review of the 9 appraisals disclosed:

- For all nine appraisals, the appraiser used the same methodology for calculating market income. In determining the market-based apartment rental rate for the subject property, the appraiser compared three similar properties to the subject to calculate a market rental rate for each of the subject apartments. For example, the appraiser calculated the rent per square foot for the two bedroom apartments in each of the three comps, regardless of the number of baths, den, or other amenities, and averaged the rental rates. The appraiser used the average rental rate, multiplied by square feet, to calculate the estimated rent for the two bedroom units in the subject property. A similar process was used to estimate rent for the one and three bedroom units. However, DOR's records did not evidence that the appraiser's methodology accounted for differences in size, amenities, and number of apartment units within each category (e.g., two bedroom apartments), and how the differences between the comps and subject properties affect the rental rate.
- For three appraisals, in estimating the market income rate for the parking amenity of subject properties, the appraiser used an average of all carports, attached garages, or detached garage units without regard to differences affecting the prices, such as the apartment community class, quality, and location, or the number or size of units for each carport or garage. All subject properties that included carports or garages were used in the analysis to determine the market rate for carports and garages. However, DOR's records did not evidence that the appraiser considered the most similar apartment complexes and parking facilities in determining the appropriate rate for each subject property's parking amenity. By using an average of rates without regard to the characteristics influencing the rate for the subject property, the parking amenity income estimate may not be reliable for each subject.
- According to Section 14.5 of DOR's training material,³ when choosing comps to obtain market rental rates, it is acceptable to use the subject property's rates if they are not inconsistent with the market. Generally accepted appraisal practice recommends including the subject as a comp, or provide an explanation for not using it. However, in each of the nine appraisals, the appraiser did not use the subject property's rents as a comp for the same subject property, even though the subject property's rents did not appear inconsistent with the market, and were naturally most similar to the subject property. Instead, in many instances, the appraiser used comps that did not appear to be reasonably similar to the subject properties and were not located in the subject properties' neighborhood. DOR's records did not evidence the appraiser's reasoning for using such comps. Determination of the subject property's estimated income potential could be enhanced by including the subject property's rental rates, when the rates are not inconsistent with the market, in determining the market rental rates for the subject property.
- For all nine appraisals, the appraiser used a methodology contrary to generally accepted appraisal practice as described in *The Appraisal of Real Estate* and Section 14.4 of DOR's training material. The appraiser's methodology incorrectly calculated the amount of net operating income (NOI), which negatively affected the final value estimate. Instead of subtracting operating expenses from 100 percent of effective gross income to determine NOI, the appraiser subtracted operating expenses from a lesser value. As a result, for one subject property, the NOI was incorrectly calculated at \$6.7 million, rather than \$8.2 million, which appeared to understate the value estimate by approximately \$15.3 million. The results may have had a material impact on the level of assessment when compared to the county's values, and may have negatively affected the outcome of the approval of the tax rolls for stratum 2, since value groups two, three, and four relied exclusively on appraisal samples.
- There was a mathematical error in the gross income calculation of one appraisal that resulted in an understatement of the potential gross income by \$313,272, and the final value conclusion by approximately \$1.5 million.
- With few exceptions, the same third-party source data was used to estimate the various components of operating expenses for all nine appraisals. To estimate the expense rate for each component of operating expenses, the appraiser averaged the source data amounts. However, the total of the individual expenses did not equal the overall total reported in the appraisal report. DOR records did not evidence how the appraiser

³ DOR Appraisal Development and Reporting document.

determined the overall total expense amount. Additionally, we noted that some of the expense categories (e.g., other administrative services) in the third-party source data were not consistent with the subject properties' expense categories (e.g., contract services), which possibly caused inaccurate estimates of expenses for the subject properties and unreliable final value conclusions.

- Third-party source data included in the appraisal report indicated capitalization rates ranging from 7.32 percent to 9.32 percent. Capitalization rate is defined as any rate used to convert income into value.⁴ The appraiser used the same three capitalization rates as support in all nine appraisals. However, the estimated capitalization rates used for the subject properties ranged from 7.6 percent to 8.5 percent, without any explanation in the appraisal report or work file as to why these rates were used. Furthermore, the capitalization rates used as support were based on outdated information, some as far back as 2008, which may not have been relevant to the subject property's January 1, 2010, date of value. Without appropriate documentation either in the appraisal or work file, DOR's records did not evidence that the data was properly evaluated.
- One appraisal was of a large apartment complex in a desirable residential location where over 75 percent of the apartment units enjoyed direct lake frontage on two sizable lakes. The appraisal did not evidence acknowledgment or consideration of the subject property's waterfront amenity, particularly in the property description section and valuation analysis, even though it was included in two photographs in the appraisal. This material oversight appeared to negatively impact the choice of comps and the comparison of the comps to the subject. Therefore, the estimated market rent and final value conclusion may not be reliable.
- For all nine appraisals, the appraiser did not address tangible personal property (TPP), such as appliances, which are typically found in stratum 2 properties. On the valuation analysis worksheet, there was a TPP line for providing the amount of TPP to be deducted from the property value in determining its estimated value. However, the TPP lines on the worksheets that we reviewed were blank, with no explanation provided. This omission may have resulted in an overstated value estimate for each property, and also may have impacted the level of assessment outcome for stratum 2, as well as the overall tax roll.

Hillsborough County, Stratum 6 – included 10 of the 31 appraisals using the income approach. Our review of the 10 appraisals disclosed:

- Section 193.011(2), Florida Statutes, requires the appraiser to consider the highest and best use of the subject property as part of the valuation process. Our review of the ten appraisals disclosed that the appraiser identified the highest and best use of the subject property as its current use; however, DOR records did not evidence a highest and best use analysis in either the appraisals or work files to document this determination. Some appraisal reports had brief statements concerning the zoning, size, shape, location, or utilities, but did not include an analysis similar to what is necessary to perform a highest and best use determination, as described in *The Appraisal of Real Estate*. Such an analysis would include statements concerning financially feasible uses, and the maximally productive or most profitable use.
- The ten appraisals included copies of published property leasing information from real estate Web sites and third-party surveys regarding income and expense data on comparable property types. However, DOR records did not evidence that the appraiser verified the data, especially details of the lease listings, although recommended by generally accepted appraisal practice. Without verification of the data, its usefulness and relevance may be limited in determining the final value conclusion.
- In calculating potential gross income for market rent analysis, the appraiser considered lease rates ranging from full-service to triple net (NNN). Full-service lease rates are generally higher than NNN lease rates, since the full-service rate includes an amount to cover the operating expenses (e.g., real estate taxes, utilities, janitorial services, etc.) paid by the landlord, while NNN lease rates are generally exclusive of these costs, but paid separately by the tenant. Our review disclosed that for five appraisals, the appraiser used NNN lease

⁴ Appraisal Institute publication, *The Dictionary of Real Estate Appraisal*, Fifth Edition.

rates to determine the potential gross income estimate, and then subtracted operating expenses to calculate net operating income. The appraiser failed to consider that with NNN leases, the tenant generally pays the operating expenses and, therefore, should not have excluded operating expenses, except perhaps a small amount to account for vacant periods and administrative costs, in calculating net operating income for the properties. The appraiser's methodology appeared to have overstated operating expenses, resulting in an understatement of net operating income and the value estimate. Proper consideration of the appropriate income and expense items are necessary in determining accurate value estimates.

- To determine market value lease rates for subject properties as a means to estimate income of the property, the appraiser generally obtained data from comparable properties with similar characteristics. However, for one appraisal, the appraiser used a sublease (with three months remaining) as a comp in determining the market rate. Short-term subleases are usually priced substantially lower than typical leases. Use of the sublease rate did not appear to represent a reasonable comp for providing an indication of the subject property's market rent, and may have resulted in a lower value conclusion.
- For three appraisals of office properties, the appraiser included other income in the valuation analysis. The other income amounts were obtained from third-party survey data of office buildings in the geographical area without differentiation between specific sub-areas or office types. DOR's records did not evidence the reason for including amounts for other income and the relevance to the subject properties. It was apparent that other income was not always considered in the valuation analysis, since we noted two other appraisals representing office properties that did not include other income in the valuation analysis. It is important that the appraisals include appropriate documentation and reasoning for all items considered in the valuation analysis.
- The appraiser used capitalization rates in determining value estimates for all five appraisals of office properties. Although published third-party survey data reported capitalization rates ranging from 8.2 to 9.1 percent, in four appraisals the appraiser used capitalization rates above this range without any market support or justification evident in DOR's records, which may have resulted in an inaccurate value conclusion.
- One appraisal was of a full-service hotel. The appraiser stated that the three comps, which were all limited service hotels, were comparable to the subject for this feature. The appraiser did not explain the comparisons between the comps and the subject property, or provide the reasoning for choosing the estimated average daily rate (ADR) per room for the subject property. Additionally, the appraiser stated that the hotel was in foreclosure and it was the appraiser's opinion that part of the reason for the low ADR and occupancy was management. Notwithstanding this acknowledgement, the appraiser appeared to have placed the most weight on the subject property's ADR of \$82 in determining a conclusion of the estimated market ADR of \$83, even though the other comparable properties and published market reports appeared to indicate a higher ADR. For this appraisal, DOR's records did not evidence a well-supported value conclusion.
- One appraisal included two separate buildings, a discount store and fast food restaurant, each with their own parking areas. Rather than analyze the store and restaurant components separately, and reconcile the two values as one final value as recommended by generally accepted appraisal practices, the appraiser combined the income estimates of the two buildings and analyzed them together. The appraiser applied the same rental rate, other income amount, vacancy rate, expense ratio, and capitalization rate to both properties, although much of the market data was not relevant to the subject property types, or indicated different amounts or rates than those used for one or both property types. Additionally, the appraiser's report included inconsistent and erroneous building areas for the store. The appraiser's atypical methodology of valuing this property, the lack of relevant market data, and the erroneous building area used for the store, appeared to have resulted in an unreliable value conclusion.

Miami-Dade County, Stratum 2 – included 4 of the 31 appraisals using the income approach. Our review of the 4 appraisals disclosed:

- For all four appraisals, in determining the market rental rate per unit for the value estimates, the appraiser's unit of comparison was the average annual rental rate per unit for the entire apartment complex for the subject property, as well as comparable properties used in the analysis. Since the unit of comparison for the market income was each apartment complex's average annual rent per unit, it would have been appropriate to ensure that the unit mix between the subject and comps were consistent. However, DOR's records included little, if any, evidence in the appraisals or work files that such an analysis or comparison was performed. Additionally, it was not clear how the income per unit for most of the comps was calculated. The income for the comps appeared to be based on an average of base unit prices with no consideration of apartment types, sizes, and number of each. This may have resulted in an unreliable estimate of market rent for the subject, which would have had an impact on the value conclusion.
- For all four appraisals, upon determining the rental income per apartment unit, the appraiser reported the range of incomes per unit, the mean and median income of the income data, and the market rate applied to the subject. However, DOR's records did not evidence a comparison of the comps' characteristics to the subject property to determine those most comparable. In addition, the appraiser had not provided in the appraisals or work files an explanation or reasoning for determining the estimated market rental rate applied to the subject to support the value conclusion.
- For one appraisal, the subject property's rental rate was calculated in error. Instead of the \$11,085 per unit amount reported by the appraiser, the correct amount should have been \$11,607. The difference was due to a \$30,000 math error in the calculation of the total rent amount for the apartment complex. The error resulted in an understatement of the final value conclusion by approximately \$1.6 million.
- For all four appraisals, the appraiser used a 9.19 percent nationwide capitalization rate obtained from a national publication of market data. However, property descriptions of the subject property in the appraisal reports were inconsistent with the nationwide property category used by the appraiser for the capitalization rate. The local and regional data included in the appraisal work files were relevant to the subject properties and indicated capitalization rates ranging from 6.5 percent to 7.8 percent. Generally accepted appraisal practice provides that local, relevant data be used when available rather than nationwide data. DOR's records did not evidence why the appraiser used the higher nationwide capitalization rate instead of a lower rate based on local data, which may have resulted in a higher value conclusion.
- For all four appraisals, the appraiser had not addressed TPP, such as appliances, if applicable. Even for unfurnished apartments, kitchen appliances would be present, the value of which would need to be considered to determine the market value, exclusive of personal property. On the appraiser's valuation analysis worksheets, the TPP lines on the worksheets were blank, with no explanation provided. This omission resulted in the value conclusion being overstated by the value of TPP.

Miami-Dade County, Stratum 6 – included 4 of the 31 appraisals using the income approach. Our review of the 4 appraisals disclosed:

- In the comparable rent analysis of all four subject properties, the appraiser used a sufficient number of properties from which to base the estimated market rent for the subject properties. However, while the appraiser indicated the range of rents, which was quite large, DOR's records did not evidence the explanation or reasoning provided in the appraisal reports or work files for choosing the market rental rate. It was not evident that the appraiser analyzed and compared the comps' characteristics to the subject to determine which comps and rents were most similar to the subject. The appraiser listed the rents of the comps, provided the range of rents, and selected a rental rate within the range, but no analysis of the data was evident. Due to the wide range of market data and no explanation for the estimated market rate reported, DOR's records did not evidence that the appraiser's estimate of rent for the subject was reasonable.

Cost Approach

As described in *The Appraisal of Real Estate*, the cost approach consists of procedures through which a value indication is derived for the fee simple interest in a property by estimating the current cost to construct a reproduction of (or replacement for) the existing structure, including a profit or entrepreneurial incentive; deducting all forms of depreciation from the total cost; and adding the estimated land value. Other adjustments may then be made to the indicated fee simple value of the subject property to reflect the value of the property being appraised. To estimate the current cost of a structure, DOR's appraisers utilized a third-party national valuation service.

Of the 68 DOR appraisals included in our review, 7 appraisals used the cost approach. Our review of the 7 appraisals disclosed:

- One appraisal in Holmes County was missing costs for some enclosed areas and extra features, which appeared to have understated the final value.
- For five appraisals in Hamilton County, it appeared that the rate applied to canopy areas was adjusted twice. In the support provided by an independent costing service, it was reported that the cost of large carport canopies was one-fifth to two-fifths of the final base cost per square foot of the main structure. After adjusting the base cost of the structure for current cost, local multipliers, and entrepreneurial incentives, the appraisers took one-fifth of the final base rate, adjusted by the multipliers and incentives a second time, and applied it to the canopy area to determine the value of this extra feature, resulting in an inaccurate value of the subject properties.

Recommendation: DOR should assure that generally accepted appraisal standards and techniques, and its policies and procedures, are properly applied and appropriately documented to clearly evidence the accuracy and credibility of all value estimates. Additionally, DOR should ensure that all analyses included or referred to in the appraisals and work files contain relevant information that completely support and document the value conclusions. Also, DOR should ensure that a highest and best use analysis is included in the appraisal work files to document its consideration in the value conclusions, pursuant to Section 193.011(2), Florida Statutes.

Finding No. 3: DOR and County Property Appraiser Value Changes Subsequent to County Review

As provided in Section 4.0 of DOR's field manual,⁵ county representatives were provided a conference or county review in the final phase of the in-depth review process, where DOR staff met with the county property appraiser to present the results of the in-depth review. At this meeting, the in-depth review samples were disclosed and discussed with the county property appraiser. Also at this time, the county property appraiser or DOR made changes to the value on sampled parcels based on additional appraisal information or errors identified in the review process. If the county property appraiser made changes to a sampled parcel and its population, based on the county review process, DOR allowed the county to conduct a mass update and resubmit the tax roll for review and approval. A mass update consisted of the county property appraiser changing the assessed values of sampled properties based on information identified in the county review process and correcting similar problems of non-sampled parcels of the same property type. The in-depth review results were based on the assumption that mass updates were equitably done and covered all applicable properties.

Our review of DOR appraisal data for the 2010 and 2011 in-depth reviews, comprising 3,331 appraisal samples (excluding stratum 3), disclosed that, subsequent to county review, 141 appraisals (4.2 percent) resulted in changes in appraised value by DOR, and 100 appraisals (3 percent) resulted in changes in assessed value by county property

⁵ DOR 2008 Real Property Field Manual

appraisers. Of the 141 appraisals with changes in appraised value by DOR, 8 of the appraisals were contained within the four counties included in our examination (Hillsborough, Holmes, Hamilton, and Miami-Dade). Our review of the 8 appraisals disclosed that for 3 appraisals, although DOR made changes to appraised values, no supporting documentation was evident in DOR's records for the changes, as follows:

- One appraisal in Hamilton County was of an industrial property consisting of a garage, covered work area, and some extra features, which had a value change after county review, resulting in DOR reducing the overall value from \$76,800 to \$52,100, or 32 percent. The primary reason for the value change was a significant decrease in the percent good (DOR's reciprocal of depreciation) of the extra features. However, DOR records were not sufficient to explain or support this change.
- One appraisal in Hamilton County was of a small retail building on less than half an acre. After county review, DOR changed its value based on the conclusion that it used an incorrect building area for the subject property. Along with the decrease in building area, which would have decreased the value from \$58,240 to \$41,600, DOR increased the price per square foot applied to the subject's gross building area by 25 percent. DOR records were not sufficient to explain or support the increased price per square foot.
- One appraisal in Hamilton County included two improvements, one residential and one commercial, on almost 22.5 acres. The county property appraiser provided DOR with superior land sales after county review. The DOR appraiser used the sale data to adjust the subject's land value down from \$83,600 to \$38,500, or 54 percent. Additionally, while adjusting the land value, the DOR appraiser made adjustments to depreciation for the improvement and extra features, which further lowered the value. DOR records were not sufficient to explain or support these changes.

Recommendation: DOR should explain and document in its records any changes made to its appraisals subsequent to exchange of values between DOR and the county.

PRIOR AUDIT FOLLOW-UP

DOR took corrective actions for findings included in our report No. 2010-013, except as follows:

- Finding No. 1 was also noted in prior audit report No. 2010-013, as finding No. 4, and in prior audit report No. 2007-037, as finding No. 4.
- Finding No. 2 was also noted in prior audit report No. 2010-013, as finding No. 6, and in prior audit report No. 2007-037, as finding No. 7.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Auditor General conducts audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders with unbiased, timely, and relevant information for use in promoting government accountability and stewardship, and improving government operations.

We conducted this performance audit in accordance with applicable generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The overall objectives of this performance audit were to:

- Evaluate DOR management’s performance relevant to the scope of audit promoted and encouraged compliance of the administration of the ad valorem tax program (as described in Section 195.096, Florida Statutes) with applicable laws, rules, policies, and other guidelines.
- Examine internal controls designed and placed in operation to promote and encourage compliance of the administration of the ad valorem tax program (as described in Section 195.096, Florida Statutes) with applicable laws, rules, policies, and other guidelines, and identify weaknesses in those controls.
- Determine whether DOR management had taken corrective actions for findings included in our report No. 2010-013.
- Identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

This audit was designed to identify, for those programs, activities, or functions included within the scope of the audit, deficiencies in management’s internal controls, instances of noncompliance with applicable laws, rules, policies, and other guidelines, and instances of inefficient or ineffective operational policies, procedures, or practices. The focus of this audit was to identify problems so that they may be corrected in such a way as to improve government accountability and efficiency and the stewardship of management. Professional judgment has been used in determining significance and audit risk and in selecting the particular transactions, legal compliance matters, records, and controls considered.

For those programs, activities, and functions included within the scope of our audit, our audit work included, but was not limited to, communicating to management and those charged with governance the scope, objectives, timing, overall methodology, and reporting of our audit; obtaining an understanding of the program, activity, or function; exercising professional judgment in considering significance and audit risk in the design and execution of the research, interviews, tests, analyses, and other procedures included in the audit methodology; obtaining reasonable assurance of the overall sufficiency and appropriateness of the evidence gathered in support of our audit’s findings and conclusions; and reporting on the results of the audit as required by governing laws and auditing standards.

The scope and methodology of this performance audit are described in Exhibit A. Our audit included examinations of various records and transactions from January 1, 2010, through December 31, 2011, and selected actions taken prior and subsequent thereto. Unless otherwise indicated in this report, these transactions and records were not selected with the intent of statistically projecting the results, although we have presented for perspective, where practicable, information concerning relevant population value or size and quantifications relative to the items selected for examination.

AUTHORITY

Pursuant to the provisions of Section 11.45(2)(h), Florida Statutes, I have directed that this report be prepared to present the results of our performance audit



David W. Martin, CPA
Auditor General

MANAGEMENT’S RESPONSE

Management’s response is included as Exhibit C.

EXHIBIT A
AUDIT SCOPE AND METHODOLOGY

| Scope (Topic) | Methodology |
|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Ad Valorem Tax Program Issues | Reviewed management practices to determine whether the duties and responsibilities administratively assigned to DOR by law or rule were being followed. |
| Policies and Procedures | Reviewed DOR policies and procedures relevant to the administration of the ad valorem tax program to determine whether DOR promoted compliance with requirements established in law and industry standards. |
| Statistical Analysis | Tested statistical results to determine reliability of the statistical methodologies used by DOR in conducting in-depth studies of county tax rolls, and to determine compliance with applicable laws and industry standards. Also, determined whether sale sampling was representative of the population. |
| Appraisal and Appraisal Review Analysis | Reviewed DOR appraisals and corresponding appraisal reviews for compliance with industry standards, DOR requirements, reasonableness, and accuracy. |
| Appraisal Sampling | Reviewed properties selected by DOR for appraisal to ensure representativeness of the population. Also, reviewed voided samples for reasonableness and documentation. |
| Property Assessment Changes Resulting from In-depth Reviews | Reviewed changes made to property assessments and corresponding documentation subsequent to the final meeting between DOR and the county property appraisers at the conclusion of the in-depth studies. |
| Sale Qualifications Studies | Reviewed reasons and documentation for disqualification of sales. |

**EXHIBIT B
SCHEDULE OF IN-DEPTH REVIEWS
OF COUNTY PROPERTY ASSESSMENT ROLLS**

| 2010 | | | |
|---------------|-----------------|--------------|---------------|
| County | Qualified Sales | Appraisals | Total |
| Bay | 558 | 47 | 605 |
| Brevard | 1,067 | 22 | 1,089 |
| Calhoun | 33 | 128 | 161 |
| Charlotte | 905 | 51 | 956 |
| Citrus | 398 | 41 | 439 |
| Clay | 421 | 39 | 460 |
| Columbia | 131 | 41 | 172 |
| Gilchrist | 34 | 135 | 169 |
| Gulf | 65 | 60 | 125 |
| Hendry | 71 | 100 | 171 |
| Highlands | 289 | 88 | 377 |
| Hillsborough | 2,757 | 30 | 2,787 |
| Holmes | 0 | 176 | 176 |
| Lafayette | 0 | 173 | 173 |
| Lee | 4,229 | 8 | 4,237 |
| Leon | 455 | 62 | 517 |
| Levy | 68 | 98 | 166 |
| Liberty | 0 | 168 | 168 |
| Madison | 0 | 192 | 192 |
| Marion | 751 | 22 | 773 |
| Martin | 467 | 52 | 519 |
| Okaloosa | 557 | 41 | 598 |
| Okeechobee | 84 | 103 | 187 |
| Palm Beach | 3,783 | 10 | 3,793 |
| Pinellas | 2,570 | 14 | 2,584 |
| Polk | 1,440 | 20 | 1,460 |
| Putnam | 151 | 54 | 205 |
| St. Lucie | 996 | 45 | 1,041 |
| Seminole | 794 | 19 | 813 |
| Suwannee | 77 | 110 | 187 |
| Union | 0 | 157 | 157 |
| Volusia | 1,322 | 28 | 1,350 |
| | | | |
| | | | |
| | | | |
| Totals | 24,473 | 2,334 | 26,807 |

| 2011 | | | |
|---------------|-----------------|--------------|---------------|
| County | Qualified Sales | Appraisals | Total |
| Alachua | 1,503 | 76 | 1,579 |
| Baker | 108 | 105 | 213 |
| Bradford | 175 | 35 | 210 |
| Broward | 24,315 | 13 | 24,328 |
| Collier | 5,819 | 39 | 5,858 |
| DeSoto | 138 | 102 | 240 |
| Dixie | 119 | 108 | 227 |
| Duval | 4,051 | 24 | 4,075 |
| Escambia | 1,691 | 36 | 1,727 |
| Flagler | 767 | 34 | 801 |
| Franklin | 110 | 43 | 153 |
| Gadsden | 122 | 71 | 193 |
| Glades | 51 | 113 | 164 |
| Hamilton | 45 | 78 | 123 |
| Hardee | 151 | 84 | 235 |
| Hernando | 1,587 | 58 | 1,645 |
| Indian River | 2,003 | 33 | 2,036 |
| Jackson | 167 | 143 | 310 |
| Jefferson | 41 | 120 | 161 |
| Lake | 2,414 | 10 | 2,424 |
| Manatee | 3,740 | 36 | 3,776 |
| Miami-Dade | 17,815 | 8 | 17,823 |
| Monroe | 1,175 | 51 | 1,226 |
| Nassau | 571 | 55 | 626 |
| Orange | 8,010 | 17 | 8,027 |
| Osceola | 3,784 | 35 | 3,819 |
| Pasco | 4,699 | 31 | 4,730 |
| St. Johns | 1,959 | 33 | 1,992 |
| Santa Rosa | 1,415 | 45 | 1,460 |
| Sarasota | 4,720 | 11 | 4,731 |
| Sumter | 1,930 | 35 | 1,965 |
| Taylor | 121 | 111 | 232 |
| Wakulla | 193 | 69 | 262 |
| Walton | 1,513 | 35 | 1,548 |
| Washington | 99 | 121 | 220 |
| Totals | 97,121 | 2,018 | 99,139 |

Source: Department of Revenue

**EXHIBIT C
MANAGEMENT'S RESPONSE**



**Interim
Executive
Director**
Marshall Stranburg

**Child Support
Enforcement**
Ann Coffin
Director

**General Tax
Administration**
Maria Johnson
Director

**Property Tax
Oversight**
James McAdams
Director

**Information
Services**
Tony Powell
Director

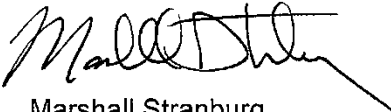
November 2, 2012

Mr. David W. Martin, CPA
Auditor General
Office of the Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

As required by section 11.45(4)(d), Florida Statutes, enclosed is the Department's response to the preliminary and tentative findings and recommendations of your operational audit of the Department of Revenue – Administration Ad Valorem Tax Program.

We appreciate the professionalism displayed by your audit staff. If further information is needed, please contact Sharon Doredant, Inspector General, at 617-8152.

Sincerely,

Marshall Stranburg

MS/SD/bsc

Enclosure

cc: Sharon Doredant, Inspector General
James McAdams, Program Director, Property Tax Oversight

Tallahassee,
Florida
32399-0100
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**Department's Response to the Preliminary and Tentative Findings
Auditor General's Operational Audit of the
Administration of Ad Valorem Tax Program**

***Finding No. 1:** Problems with DOR's sampling plan caused some in-depth studies to have an inadequate number of samples in certain value groups within some strata, and the lack of samples made it difficult for DOR to accurately calculate statistical measures for those strata and the overall level of assessment for those counties.*

***Recommendation:** DOR should continue to improve its sampling procedures to acquire the desired number of samples per value group to meet minimum sample sizes. Also, to achieve the targeted confidence interval or margin of error objectives, every value group should contain an adequate number of sample items, using sales, appraisals, or a combination of both.*

Response: Agree

The Department's sampling process comports to the International Association of Assessing Officers (IAAO) current Standard on Ratio Studies (2010). In addition, the Department implemented a multi-year sales sampling methodology in 2012 that more than doubled the number of samples available for roll evaluation. The Department is also testing a variety of sampling procedures to ensure adequate sample sizes for each value group.

***Finding No. 2:** Appraisal reports and related DOR records were not always adequate to ensure that value estimates for subject properties were reliable and reasonably supported. As a result, to the extent the assessment levels published by DOR for the counties included in our review were based upon appraisal ratio studies, such assessment levels may not be accurate.*

***Recommendation:** DOR should assure that generally accepted appraisal standards and techniques, and its policies and procedures, are properly applied and appropriately documented to clearly evidence the accuracy and credibility of all value estimates. Additionally, DOR should ensure that all analyses included or referred to in the appraisals and work files contain relevant information that completely support and document the value conclusions. Also, DOR should ensure that a highest and best use analysis is included in the appraisal work files to document its consideration in the value conclusions, pursuant to Section 193.011(2), Florida Statutes.*

Response: Agree

The Department agrees it should comply, consistent with Florida Law, with generally accepted appraisal practices and ensure policies and procedures are appropriately applied and documented. DOR appraisers have received additional training, and changes have been made to the Department's appraisal quality review process, to ensure appropriate appraisal standards and procedures are followed.

Finding No. 3: *We noted instances in which DOR changed its appraisal values, subsequent to meeting with the county property appraiser, without adequately supporting its reasoning.*

Recommendation: *DOR should explain and document in its records any changes made to its appraisals subsequent to exchange of values between DOR and the county.*

Response: Agree

The Department has taken steps to ensure adequate documentation is provided for any changes made to appraisal valuations. Improvements to the Department's quality review process helped reduce the number of valuation changes in 2012 by more than 60 percent.