CITY OF NEW YORK
OFFICE OF THE COMPTROLLER

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COMPTROLLER

FINANCIAL AUDIT

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Audit Report on the Valuation of Class 2 Properties by the New York City Department of Finance

FN11-130A

April 12, 2012

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

John C. Liu
COMPTROLLER

April 12, 2012

To the Residents of the City of New York:

Pursuant to Chapter 5, Section 93 of the New York City Charter, my office has audited the New York City Department of Finance (DOF) valuation of Class 2 properties. We audit City agencies such as DOF as a means of ensuring that they effectively administer City resources entrusted them and do so in accordance with applicable rules and regulations.

The DOF is responsible for billing and collecting City property tax revenues, determining property assessed value for tax purposes, and maintaining accurate property records. Tax Class 2 consists of certain residential properties, including multi-family cooperatives and condominiums.

The audit revealed that DOF's changes in property valuation methodology and the use of inconsistent criteria to determine the market values of Class 2 residential properties resulted in large fluctuations in market values that, in turn, significantly affected some properties' tax liability in Fiscal Year 2011/2012. Before Fiscal Year 2008/2009, DOF valued Class 2 properties using the Net Income Capitalization methodology. In Fiscal Year 2008/2009, DOF changed this methodology to the Gross Income Multiplier method. In Fiscal Year 2011/2012, DOF reverted back to the Net Income Capitalization method. Although both methods are permissible under the RPTL, DOF did not provide a basis for this latest change until complaints were made by taxpayers and City officials. DOF's change in valuation methodology resulted in significant market fluctuations for Class 2 properties with 11 or more units. Further, changes in the criteria DOF used to develop market values for Class 2 properties with less than 11 units in Fiscal Year 2011/2012 also significantly affected the calculated market value of these properties.

In addition, DOF did not properly follow its own Property Valuation Guidelines when selecting comparable properties. Comparable properties are used to help set market value. We found that for certain cooperatives in all boroughs of New York City, the estimated Gross Income per square foot was significantly lower than the income of any of the selected comparable properties. As a result, these coops were under-valued based on their income. In addition, for some properties, the gross income indicated in the Notice of Property Value was much higher than the Gross Income estimated using the comparable properties' income. As a result, these properties were over-valued based on their income. Finally, DOF issued its 2011/2012 Tentative Assessment Roll without sufficient review of the calculated market values and adequate assessment adjustments before sending Notices of Property Value to the properties' owners.

The results of our audit have been discussed with DOF officials and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov.

Sincerely,

John C. Liu

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The City of New York
Office of the Comptroller
Financial Audit

Audit Report on the Valuation of Class 2 Properties By the New York City Department of Finance

FN11-0130A

AUDIT REPORT IN BRIEF

The New York City Department of Finance (DOF) collects City revenues, values all real property in the City, and maintains property records. Each year, DOF determines the market value of the properties, from which the taxable value is calculated. There are three assessment periods: Tentative, Change by Notice, and Final periods.

The process of determining a property's assessment for tax purposes in New York City requires a few calculations with some differences in methodology depending on Tax Classification. According to Article 18, Section 1802 of the Real Property Tax Law (RPTL), DOF assigns every property to one of four real property tax classes. Tax Class 1 consists of one-, two-, and three- family residential properties and small condominiums. Tax Class 2 consists of all other residential property, including multi-family cooperatives and condominiums. Tax Class 3 consists of utility real property. Lastly, Tax Class 4 consists of all other real property, such as office buildings, factories, stores, lofts, and vacant land. For Tax Class 2 residential buildings, the focus of this audit, market value is based on current value of the projected future income stream from the building. To calculate the market values of the properties, DOF uses two methods. These methods are Gross Income Multiplier (GIM) and Net Income Capitalization.

DOF uses mass appraisal techniques to determine market value for assessment purposes. Under DOF's valuation procedure for residential properties, computer-assisted mass appraisal-generated assessments, which have been used since 1989, serve as the initial assessments. These assessments are updated during field inspections for alterations and new construction. DOF upgraded its existing computer applications in 2010 with the implementation of the Computer Assisted Mass Appraisal system (CAMA 2) provided by Vision Appraisal Technology, Inc. (See Comptroller's Audit #7A11-126A *Audit Report on the Development and Implementation of the Computer Assisted Mass Appraisal System by the Department of Finance*.) CAMA 2 collects property-related information, selects comparable properties to be used to value cooperatives and condominiums, and performs valuation calculations.

Audit Findings and Conclusions

DOF's changes in property valuation methodology and the use of inconsistent criteria to determine the market values of Class 2 residential properties resulted in large fluctuations in market values that, in turn, significantly affected some properties' tax liability in Fiscal Year 2011/2012. Before Fiscal Year 2008/2009, DOF valued Class 2 properties using the Net Income Capitalization methodology. In Fiscal Year 2008/2009, DOF changed this methodology to the Gross Income Multiplier method. In Fiscal Year 2011/2012, DOF reverted to the Net Income Capitalization method. Although both methods are permissible under the RPTL, DOF did not provide a basis for this latest change until after complaints were made regarding the Tentative Assessment Roll. DOF's change in valuation methodology resulted in significant market fluctuations for Class 2 properties with 11 or more units. Further, changes in the criteria DOF used to develop market values for Class 2 properties with less than 11 units in Fiscal Year 2011/2012 also significantly affected the calculated market value of these properties.

In addition, DOF did not properly follow its own Property Valuation Guidelines when selecting comparable properties. Comparable properties are used to help set market value. We found that for certain cooperatives in all boroughs of New York City, the estimated Gross Income per square foot was significantly lower than the income of any of the selected comparable properties. As a result, these coops were under-valued based on their income. In addition, for some properties, the gross income indicated in the Notice of Property Value was much higher than the Gross Income estimated using the comparable properties' income. As a result, these properties were over-valued based on their income. Finally, DOF issued its 2011/2012 Tentative Assessment Roll without sufficient review of the calculated market values and adequate assessment adjustments before sending Notices of Property Value to the properties' owners.

Audit Recommendations

We recommend that DOF:

- Review and evaluate the impact of new methodologies and ensure that the same income factors and criteria are consistently applied.
- Ensure that proper disclosure and notification of upcoming changes is provided to the public.
- Re-evaluate the properties that were over-assessed / under-assessed in Fiscal Year 2011/2012 and ensure that in the following years these properties are valued properly.
- Review and analyze the Cooperatives and Condominiums comparables files and check for the existence of unusually low or high gross income numbers assigned to these properties compared to the selected comparable rental properties.

- Run and review reports produced by CAMA 2 and analyze unusual market value fluctuations.
- Make timely adjustments to the properties before the Tentative Assessment Roll is published and the Notice of Property Value is sent to the property owners.

Agency Response

In its response, DOF discussed the differences and merits of the Net Income Capitalization and the Gross income Multiplier methods. DOF officials acknowledged that "DOF had used a different methodology for large Class Two properties for the three years from FY 08/09 – FY 10/11: the Gross Income Multiplier (GIM) method. The Audit Report focuses only on the one year of change from GIM back to Net Income Capitalization and does not discuss Finance's change from income cap to GIM. Both changes resulted in volatility. Any methodological change will involve some adjustments, as property values are 'benchmarked'. The volatility discerned in the audit between FY 10/11 and FY 11/12 generally reflects that the GIM method derived values were too low."

One of our main points is that when DOF reverted back to Net Income Capitalization in FY2011/2012, it did not conduct an analysis of the impact and inform the public prior to releasing the Tentative Assessment Roll. As stated by DOF, "both changes resulted in volatility". Therefore, as discussed in this report, the issue is not which method is better but the fact that such a change was made without a clear public discussion of the impact on taxpayers. DOF states that "the rationale was widely discussed." However, all of the discussion occurred after DOF released its Tentative Assessment Roll and the public outcry occurred. Despite being aware that the change would lead to volatility, there is no evidence that DOF analyzed and disclosed the impact of the change on taxpayers beforehand. Given that DOF acknowledges that there is a significant subjectivity involved in developing these values, it should provide a greater level of transparency and adequate disclosure of these changes to taxpayers.

DOF agreed with four or the six recommendations including reviewing the impact of new methodologies, and ensuring that proper disclosure and notification of upcoming changes is provided to the public (DOF stated that it already provides this information). DOF did not agree to make timely adjustments to the properties before the Tentative Assessment Roll is published and the Notices of Property Value are sent to the property owners, due to the difficulty of doing so within the existing time constraints.

INTRODUCTION

Background

The New York City Department of Finance (DOF) is responsible for billing and collecting City property tax revenues, determining property assessed value for tax purposes, and maintaining accurate property records.

Each year, DOF determines the market value of the properties from which the taxable value is calculated. Based on Article 18, Section 1802 of the Real Property Tax Law (RPTL), DOF assigns every property to one of four real property tax classes. Tax Class 1 consists of one-, two-, and three- family residential properties and small condominiums. Tax Class 2 consists of all other residential property, including multi-family cooperatives and condominiums. Tax Class 3 consists of utility real property. Lastly, Tax Class 4 consists of all other real property, such as office buildings, factories, stores, lofts, and vacant land.

For Tax Class 2 residential properties, the focus of this audit, market value is based on the current value of the projected future income stream from the building. Further, Section 581 of RPTL requires that all condominiums and cooperatives are valued as if they were residential rental apartments. Income information from similar rental properties (comparable properties) is applied to determine value. Comparables are selected based on a combination of factors such as: land location, income levels, building age and construction, and exemptions and subsidies. DOF determines the income for each property based on the Gross Income reported on the RPIE[1] forms. To calculate the market values of the property, DOF uses two methods. These methods are Net Income Capitalization[2] and Gross Income Multiplier (GIM[3]).

Net Income Capitalization method takes into account the difference between the income and expenses of individual properties (Net Income), which is divided by an estimated rate of return for the owner called a Capitalization Rate[4]. DOF develops Capitalization Rates using the

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[1] RPIE - Real Property Income and Expense form should be submitted by the owners of income-producing properties by September 1 of each tax year.

[2] Net Income Capitalization - a capitalization technique that uses net income divided by the Capitalization Rate.

[3] Gross Income Multiplier – a capitalization technique that uses the ratio between the market value of a property and its potential gross income.

[4] Capitalization Rate – any rate used to convert an estimate of future income to an estimate of market value. DOF uses the Band- of- Investment method to obtain the overall rate of return (interest rate/capitalization rate) by taking into account the interest rates paid on mortgages and the anticipated yield that the investors expect on their equity in the property.

Band of Investment approach[5]. Some of the primary data elements comprising the Capitalization Rates include the 30-year mortgage interest rate (weekly average), basis point spread, Aaa corporate bond rates, equity yields, loan-to-value ratios, and Band of Investment method. Other elements include property liquidity and management factors.

The GIM method takes into account the Gross Income of individual properties and multiplies it by a GIM ratio. To develop the GIM ratio, DOF follows a two-step process. First, DOF sets income band ranges. The income band ranges reflect income information at 10 different levels ranging from 10th to 90th percentile and is based on income information DOF receives from owners of rental properties. Second, DOF estimates the market value for a sample of rental properties in each income range by using income and expenses for the sample properties and dividing them by a Capitalization Rate. DOF then divides the estimated market values by the income to arrive at the GIM for each income band range.

DOF uses mass appraisal techniques to determine market value for assessment purposes. Under DOF's valuation procedure for residential properties, computer-assisted mass appraisal-generated assessments, which have been used since 1989, serve as the initial assessments. These assessments are updated during field inspections for alterations and new construction. DOF upgraded its existing computer applications in 2010 with the implementation of the Computer Assisted Mass Appraisal system (CAMA 2) provided by Vision Appraisal Technology, Inc. (See Comptroller's Audit #7A11-126A *Audit Report on the Development and Implementation of the Computer Assisted Mass Appraisal System by the Department of Finance*.) CAMA 2 collects property-related information, selects comparable properties to be used to value cooperatives and condominiums, and performs valuation calculations.

There are three assessment periods during the year: Tentative, Change by Notice, and Final periods. During the Tentative period, the market value of the property is determined by DOF. Change by Notice period is when a property owner can apply to DOF for an informal review of the property value. During the Final period, only the Tax Commissioner can change the assessed value of the property. A Tentative Assessment Roll issued by DOF in January 2011 had significant increases in the market values of some properties. As a result and in response to numerous public complaints, DOF made several large scale revisions to the assessments after the Tentative Roll was issued.

Objective

To determine whether DOF properly calculated Tax Class 2 property values.

[5] The Band of Investment technique is a method of estimating the overall capitalization rate by calculating the weighted average of capitalization or discount rates for the components of the total property investment.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). 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. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93 of the New York City Charter. The scope of this audit covered residential Tax Class 2 properties listed on the Fiscal Year 2011/2012 Tentative Assessment Roll. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results

The matters covered in this report were discussed with DOF officials during and at the conclusion of this audit. A preliminary draft report was sent to DOF officials and discussed at an exit conference held on February 7, 2012. On February 10, 2012, we submitted a draft report to DOF officials with a request for comments. We received a written response from DOF on February 27, 2012.

In its response, DOF discussed the differences and merits of the Net Income Capitalization and the Gross income Multiplier methods. DOF officials acknowledged that "DOF had used a different methodology for large Class Two properties for the three years from FY 08/09 – FY 10/11: the Gross Income Multiplier (GIM) method. The Audit Report focuses only on the one year of change from GIM back to Net Income Capitalization and does not discuss Finance's change from income cap to GIM. Both changes resulted in volatility. Any methodological change will involve some adjustments, as property values are 'benchmarked'. The volatility discerned in the audit between FY 10/11 and FY 11/12 generally reflects that the GIM method derived values were too low."

One of our main points is that when DOF reverted back to Net Income Capitalization in FY2011/2012, it did not conduct an analysis of the impact and inform the public prior to releasing the Tentative Assessment Roll. As stated by DOF, "both changes resulted in volatility". Therefore, as discussed in this report, the issue is not which method is better but the fact that such a change was made without a clear public discussion of the impact on taxpayers. DOF states that "the rationale was widely discussed." However, all of the discussion occurred after DOF released its Tentative Assessment Roll and the public outcry occurred. Despite being aware that the change would lead to volatility, there is no evidence that DOF analyzed and disclosed the impact of the change on taxpayers beforehand. Given that DOF acknowledges that there is a significant subjectivity involved in developing these values, it should provide a greater level of transparency and adequate disclosure of these changes to taxpayers.

DOF agreed with four or the six recommendations including reviewing the impact of new methodologies, and ensuring that proper disclosure and notification of upcoming changes is provided to the public (DOF stated that it already provides this information). DOF did not agree to make timely adjustments to the properties before the Tentative Assessment Roll is published and the Notices of Property Value are sent to the property owners, due to the difficulty of doing so within the existing time constraints.

The full text of the written comments from DOF is included as an addendum to this report.

FINDINGS

DOF's changes in property valuation methodology and the use of inconsistent criteria to determine the market values of Class 2 residential properties resulted in large fluctuations in market values that, in turn, significantly affected some properties' tax liability in Fiscal Year 2011/2012. Before Fiscal Year 2008/2009, DOF valued Class 2 properties using the Net Income Capitalization methodology. In Fiscal Year 2008/2009, DOF changed this methodology to the Gross Income Multiplier method. In Fiscal Year 2011/2012, DOF reverted to the Net Income Capitalization method. Although both methods are permissible under the RPTL, DOF did not provide a basis for this latest change. DOF's change in valuation methodology resulted in significant market fluctuations for Class 2 properties with 11 or more units. Further, changes in the criteria DOF used to develop market values for Class 2 properties with less than 11 units in Fiscal Year 2011/2012 also significantly affected the calculated market value of these properties.

In addition, DOF did not properly follow its own Property Valuation Guidelines when selecting comparable properties. Comparable properties are used to help set market value. We found that for certain cooperatives in all boroughs of New York City, the estimated Gross Income per square foot was significantly lower than the income of any of the selected comparable properties. As a result, these coops were under-valued based on their income. In addition, for some properties, the gross income indicated in the Notice of Property Value report was much higher than the Gross Income estimated using the comparable properties' income. As a result, these properties were over-valued based on their income.

Finally, DOF issued its 2011/2012 Tentative Assessment Roll without sufficient review of the calculated market values and adequate assessment adjustments before sending Notices of Property Value to the properties' owners.

Changes in Valuation Methodology Resulted in Significant Market Value Fluctuation for Properties with 11 or More Units

DOF's change in valuation methodology significantly affected the market value of some Class 2 residential properties citywide. Although DOF was aware of the problem, it did not ensure it reviewed and adjusted the properties' market value before the Tentative Assessment Roll was issued and Notices of Property Value were sent to the taxpayers. As noted during our review, for the Fiscal Year 2008/2009 Assessment Roll, DOF changed its property valuation methodology from Net Income Capitalization to Gross Income Multiplier (GIM) for residential properties with 11 or more units. For Fiscal Year 2011/2012, DOF reversed this decision and switched back to Net Income Capitalization from GIM. Our review found that there was a significant difference in the market values calculated using GIM and Net Income Capitalization. Although both methods are acceptable for valuation of the income-producing real properties, the different factors used with each method resulted in some large differences in calculated market values between the two methods that, in turn, disproportionally affected some properties' tax liability.

For example, the Net Income Capitalization method takes into account operating expenses while GIM does not. As our analysis revealed, the calculated market values produced by these two methods varied for properties with different ratios of net income to gross income (Net Income Ratio). For Fiscal Year 2010/2011, the market values calculated using the Net Income Capitalization method was greater than the market values calculated using GIM for properties with a Net Income Ratio greater than 50 percent. At the same time, the Net Income Capitalization method produced lower market valuations than the GIM method when Net Income Ratio was lower than 50 percent as shown in the Table below.

Table
Impact of Methodology Changes in Market Value Estimations
Fiscal Years 2008-2012

Period	FY 08/09 through FY 10/11	FY 11/12
Methodology Used	Gross Income Multiplier Method	Net Income Capitalization Method
If Net Income Ratio > 50%	Market value is lower when using GIM and higher when using Net Income Capitalization	Market value increases exacerbated by the FY08/09-10/11 lower valuations
If Net Income Ratio < 50%	Market value is higher when using GIM and lower when using Net Income Capitalization	No significant changes in market value since these properties were valued higher in the previous years

Therefore, during the three-year period from FY08/09 to FY10/11 when DOF used the GIM methodology, a certain number of properties that had more than 50 percent Net Income Ratio would have been under-valued and under-taxed based on the GIM methodology while others with Net Income Ratios less than 50 percent would have been over-valued and over-taxed. Based on our review, the market value fluctuations that occurred in Fiscal Year 2011/2012 would not have occurred if DOF had used the Net Income Capitalization in both years. These fluctuations appear to have been primarily the result of the change of methodology from the GIM to the Net Income Capitalization method.

If the Net Income Capitalization method had been used in both FY 2010/2011 and FY 2011/2012, the market value increase for properties with more than 50 percent Net Income Ratio would not have been so dramatic in Fiscal Year 2011/2012 (see Appendix I). For example, in Fiscal Year 2010/2011, DOF assessed the market value of a property located in Queens (Block 148 Lot 1; No. 42 in Appendix I) at $2.36 million using the GIM method. As noted, for this property, the Gross Income and Net Income totaled $758,703 and $495,727, respectively, and the Net Income ratio was 65.34 percent. However, based on our calculation, using the Net Income Capitalization method, the market value of this property would have been $3.087 million or 30.81 percent higher than under the GIM methodology. Therefore, in Fiscal Year 2010/2011, this property was under-valued based on the Net Income methodology. When DOF switched from the GIM to the Net Income Capitalization methodology in Fiscal Year 2011/2012, DOF sent a Notice of Property Value, informing the owners that the property market value was assessed at $3.336 million, an increase of 41.36 percent compared to the prior year ($2.36 million). Based on our review, the Gross Income and Operating Net Income of this property totaled $773,882 and $503,471, respectively, which resulted in a Gross Income increase of only 2 percent. Had DOF used the same methodology in these years, the market value increase would have been 8.06 percent[6] as opposed to 41.36 percent. After complaints, DOF decreased the market value of this property on the Final Assessment Roll to $2.596 million (a $740,000 difference) to get an increase of 10 percent compared to the Fiscal Year 2010/2011 market value.

For the properties with Net Income Ratio lower than 50 percent, our analysis concluded that the market values calculated using the Net Income capitalization method were lower than those calculated by DOF using the GIM method (when Net Income Ratio is lower than 50 percent, the Net Income capitalization method produces lower market values than the GIM method). For example, a market value of a property located in Brooklyn (Block 254 Lot 19; No. 31 in Appendix I) was assessed by DOF using the GIM method at $3 million in Fiscal Year 2010/2011 (GIM was 3.381). The Gross Income and Operating Net Income totaled $887,726 and $430,396, respectively. The Net Operating Income Ratio was 48.48 percent. We recalculated the market value using the Net Income Capitalization method with a corresponding Capitalization Rate of 15.458 percent at $2.784 million. Therefore, it appears that this property was over-valued based on the Net Income Capitalization methodology. When DOF switched methodology in Fiscal Year 2011/2012, DOF sent a Notice of Property Value to the owners of this property, assessing the market value at $3.368 million, an increase of 12.27 percent compared to the prior year. Based on our review, the Gross Income and Operating Net Income totaled $995,535 and $465,720, respectively, a Gross Income increase of 12.14 percent. Had DOF used the same

[6] There was an overall decrease in Capitalization Rates in Fiscal Year 2011/2012 compared to the prior year rates, which resulted in an increase of the market values even if the other factors were the same.

methodology in these years, the market value increase would be 20.96 percent, which is consistent with the Gross Income increase and decrease in Capitalization Rate (15.458 percent versus 13.829 percent in Fiscal Years 2010/2011 and 2011/2012, respectively).

Consequently, DOF has not used a consistent methodology to establish market value from year to year. As a result, properties' market values fluctuated significantly, affecting tax liabilities in FY 2011/2012.

> ***DOF Response:*** In its response, DOF states that "The rationale for DOF's return to Net Income Capitalization was widely discussed. Commissioner Frankel testified to the City Council about this decision at two different hearings during March and May 2011. The testimony was also posted on the DOF web site and copies of the testimony were provided to the auditors. The Commissioner and DOF employees also discussed these issues at many public meetings, including a borough-wide meeting in Queens hosted by the Borough President on May 5, 2011. In addition, the change was discussed in technical terms in the assessor guidelines for FY 11/12, which were published on DOF's web site. In spite of this, the Audit Report states on page 2, that "DOF did not provide a basis for this change. This claim is clearly incorrect."

> ***Auditor Comment:*** Contrary to DOF's assertion, the public was not provided with reasonable and timely notification of the potential changes that could occur due to DOF's change in methodology. DOF issued a Tentative Assessment Roll in January 2011 which had significant increases in the market values of some properties. Providing public notification of their rationale one to two months later (in March 2011) does not represent reasonable and timely disclosure. DOF should not wait for property owners to challenge assessments in the New York City Tax Commission and the New York State courts to explain the reasoning behind changes that impact the tax roll. Instead, DOF should conduct proper timely reviews that would allow it to assess, explain and mitigate the impact of any market value volatility before implementing methodology changes.

Different Criteria Used to Develop GIM Significantly Affected the Market Values of Properties with Less Than 11 Units

Although DOF continued to use the same GIM methodology for valuating properties with less than 11 units, it used different criteria to develop the GIM in Fiscal Year 2011/2012. In 2010/2011, DOF developed the GIM for property valuation based on property location in the borough, four levels of area ratings (1- 4), and income per unit per month. Because properties in the same borough could have different Gross Income per unit, the GIM used for market value calculation for different properties in the same neighborhood was also different. In Fiscal Year 2011/2012, DOF changed the criteria to develop the GIM. This time, DOF based the GIM on only the median income per square foot to determine the market values for each property for the area. This change in criteria resulted in huge market value fluctuations. Specifically, when the median income was used, the properties with low income per unit per month (area rating 4) in Fiscal Year 2010/2011 were overvalued in Fiscal Year 2011/2012 using the prior year's criteria. For example, for some properties in several neighborhoods in Queens, DOF used a GIM of 6.9 in Fiscal Year 2010/2011 versus 10.5 in Fiscal Year 2011/2012 (see Appendix II). The calculated gross income increase would not justify the market value increase identified on the Tentative Assessment Roll for these properties if the criteria for calculating the GIM had not changed. As also noted, the Gross Income per square foot for these properties was significantly lower than a median income per square foot for the area. As a result and based on property owners' complaints, DOF was compelled to make adjustments to decrease these market values and reflect a more accurate property assessed value on the Final Assessment Roll for Fiscal Year 2011/2012.

For example, our review of a property located in Ridgewood, Queens (Block 3614 Lot 6; No. 10 in Appendix II) found that DOF determined the market value at $649,000 using GIM of 6.9 in Fiscal Year 2010/2011. However, in Fiscal Year 2011/2012, DOF calculated the market value using GIM of 8.75 at $896,000, an increase of 38.06 percent. Nevertheless, as DOF's records revealed, the Gross Income for this property increased by only 8.86 percent. The median income in Ridgewood in Fiscal Year 2011/2012 was $14.10 per square foot compared to $11.51 for this property.

In Fiscal Year 2011/2012, properties with high income per unit per month and in area rating 1 in previous Fiscal Year 2010/2011 were under-valued using the prior year's criteria. Based on DOF's records, these properties showed significant decreases in market value although their Gross Income increased. The GIM used in the calculation was 11.7 in Fiscal Year 2010/2011 versus 8.75 in Fiscal Year 2011/2012. For example, DOF assessed the market value of a property located in Ridgewood, Queens (Block 3574 Lot 25; No. 11 in Appendix II) at $1,840,000, using a GIM of 11.7. In Fiscal Year 2011/2012, the market value calculated by DOF using GIM of 8.75 was reduced to $1,465,000, a decrease of 20.38 percent (while Gross income increased by 6.68 percent). The median income in Ridgewood in Fiscal Year 2011/2012 was $14.10 per square foot compared to the actual income of $20.92 reported for this property.

DOF's change in criteria used to develop the GIM ratio resulted in large fluctuations in the market values of some properties with less than 11 units. As a result, DOF was compelled to make adjustments to decrease these market values and reflect a more accurate property assessed value on the Final Assessment Roll for Fiscal Year 2011/2012. At the exit conference, DOF officials asserted that the sample selected was not a true representation of the population because 11 of the 15 properties cited in the report filed their RPIE forms. However, the report issue is not whether the income information was actual or estimated using comparable values, but whether DOF developed the GIM using consistent criteria such as Area Rating based on income per unit per month versus median income per square foot. Specifically, as indicated in our review of the same population of properties, the market value of 39 additional properties fluctuated significantly due to the change in criteria in determining the GIM. For example, of the 39 properties, 15 properties experienced an increase in market value that was not justified by the gross income increase and 24 properties experienced a decrease in market value when their gross income increased.

DOF Response: In its response, DOF stated that "Before FY 11/12, the criteria for GIM included area ratings determined by assessors, which were not uniform or consistently updated. In FY 11/12, the criteria were changed to median income per square foot per neighborhood, using 17 income groups. This change in methodology allowed DOF to use a more empirical approach to developing GIMs, removing the subjectivity embedded in the method used in previous years. . . As demonstrated in the graph below, the rebase lining in FY 11/12 of properties with fewer than 11 units showed an overall minor change for 2-10 family co-ops and condominiums (5% increase and 0% change respectively) and 6-10 family rentals (2% increase)."

Auditor Comment: The graphical presentation is quite misleading. Indeed, as our analysis shows, the market value increased by 45% in 25 of the 121 properties reviewed and decreased by 12 % in 29 of the properties. This is a direct result of the inconsistent criteria DOF used to develop a GIM method. By switching from area rating to median income, DOF classified properties into certain income levels that were far greater or lower than the actual income reported. Also, contrary to DOF's assertions, the analysis included the whole population of Queens' properties with less than 11 units (154 buildings), of which 33 properties were new constructions. It is understandable that properties located in the same neighborhood could be different in terms of construction, age, condition, quality of maintenance, location in the neighborhood, etc. Therefore, it is not reasonable to value them using a single GIM for the neighborhood. DOF should develop at least a high and low value of GIM for each neighborhood to reflect different characteristics of the buildings.

<u>The Estimated Gross Income Did Not Match the Comparables' Income</u>

Our review found that although DOF used CAMA 2 capabilities to select comparable properties to value cooperatives in all boroughs of New York City, for some properties, the estimated gross income per square foot identified in DOF's files did not correspond with any of the comparable properties' income reported in DOF's records. In fact, as our review revealed, the assigned values used by DOF were significantly lower. Consequently, these cooperatives were under-valued based on their income. Specifically, our review of the Department of

Buildings records did not identify any undergoing alteration or major renovation that would substantiate the reduced Gross Income per square foot numbers that DOF used in the calculations of the market values of certain coop properties. Therefore, we were not able to find any information that would support DOF's basis for such valuation.

For example, for a property located in Kips Bay, Manhattan (Block 924, Lot 13), DOF estimated gross income as $18.90, expenses as $12.65 (expense ratio–67 percent) and a corresponding market value of $44.85 per square foot. As noted in our review, for this building with 30 units and a 14,292 gross square foot area, the full market value was assessed by DOF at $641,000. The comparable rental properties selected by CAMA 2 to assess the market value of this cooperative indicated Gross Income of $27.07, $37.58, and $45.22, and corresponding market values of $125.94, $181.56, and $262.76 per square foot, respectively. Had DOF based its estimates of Gross Income on the lowest values of comparable properties, which were $27.07 and $125.94 for Gross Income and market value per square foot, respectively, the market value of this cooperative would be $1,799,934. This is an increase of 180 percent compared to the market value assessed by DOF in Fiscal Year 2011/2012. As noted in Fiscal Years 2009/2010 and 2010/2011, the market value of this building was assessed at $2,330,000. However, on the 2011/2012 Assessment Roll, it was reduced to $641,000. As our analysis revealed, there were two reasons to explain such a difference: first, the estimated income was too low compared to similar properties selected by CAMA 2, and second, the Expense Ratio of 67 percent was too high. According to the Fiscal Year 2011/2012 Residential Guidelines, the Expense Ratio cannot be greater than the maximum expense ratio of 47 percent allowed for this income range. However, DOF did not apply these procedures when adjusting and estimating the values of some properties.

Furthermore, based on the income information reflected in DOF's Comparable Rental Income report for Cooperatives in each borough, we found that Brooklyn represents the greatest percentage of under-valued cooperatives (7.6 percent) compared to other boroughs where the percentage of under-valued properties was between 2.3 percent and 3.3 percent.

DOF Response: In its response, DOF stated that "The Audit Report describes a single example. This is a property where the Gross Income is lower for the subject property than the comparables. The property cited was erroneously valued with filed income instead of comparable income. This created a higher expense ratio than guidelines allow and resulted in a subsequent market value undervaluation. This property has been isolated for further investigation and we appreciate the auditors bringing it to our attention."

Auditor Comment: Contrary to DOF's assertions, the audit found 130 properties with similar characteristics, where the estimated gross income per square foot used in the market value calculations was significantly lower than the same value of any of the comparable properties selected by CAMA 2. These include 39 cooperatives in Brooklyn, 28 cooperatives in Queens, 52 cooperatives in Manhattan, and 11 cooperatives in Bronx.

DOF's Use of Incorrect Gross Income Triggered an Increase in Market Values for 10 Percent of Queens Coops

According to Section 581 of RPTL, all condominiums and cooperatives should be valued as if they were residential rental apartments. Income information from similar rental properties (comparable properties) is applied to determine value. Although DOF used CAMA 2 functionality to select comparables to value cooperatives and condominiums, the values used in the calculation of some coops' market values were much higher than the values assigned based on comparables' data. As a result, the market values of these properties were incorrectly determined. Specifically, we reviewed the whole population of 859 cooperative properties in Queens and found that DOF used much higher Gross Income values for about 10 percent (92) of certain coops, which resulted in a significant increase in the market values and corresponding tax liabilities for these properties. In some cases, the Gross Income used by DOF to calculate the market value of these coops was 25 percent higher than the gross income determined using comparables' data. As a result, some of these coops experienced a huge increase in market values and corresponding tax liabilities.

DOF did not ensure that it followed RPTL guidelines when establishing the values for coops in this particular area. As a result, these coops' market values and their corresponding tax liabilities were overstated based on their income.

DOF Response: In its response, DOF stated that "The auditors are simply wrong to state that incorrect gross incomes affected the values of 10% of Queens's co-ops. Statistical analysis of the 92 Queens properties cited by the auditors as being "over-valued," tells a quite different story. We looked at the data in two different ways to observe the variability in distance between the subject and comparable properties.

Most of the 92 properties cited by the auditors are located in northeastern Queens -- in neighborhoods where rental apartment comps are often not available. Properties from other neighborhoods must be used and the income per square foot may need to be adjusted. However, even with these difficulties, the variability between subject and comparables was minimal, using two different statistical analyses.

Contrary to the Comptroller's allegation, DOF fully complied with Real Property Tax Law (RPTL) requirements in establishing values for Queens's co-ops for FY 11/12.This is demonstrated by the fact that only 3% of the Queens co-ops that appealed to the Tax Commission in FY 11/12, received offers of reduced assessment. 901 Queens's co-ops appealed to the Tax Commission, 29 received offers to reduce their assessments and 22 accepted the offer. The Tax Commission did not make an offer to reduce assessments for 872 Queens's co-ops."

Auditor Comment: We based our review on the selection of comparable rental properties listed in DOF's Comparable Rental Income for Cooperative file. The issue here is that for 92 Queens cooperatives reviewed, we found that in calculating the market value on the Notice of the Property Value, DOF used income information that was completely different from the income information available in the Comparable Rental Income for Cooperative file for Queens. For example, for property Block 4285 Lot 10 in Queens, the gross income estimated using comparables data and stated in the Queens' Comparable Rental Income for Cooperative file was $6,589,344. In calculation of the market value on the Notice of Property Value, DOF used the amount of $8,226,665, an increase of 25 percent. As a result, the market value of this property on the Tentative Assessment Roll was increased to $35,967,000, an increase of 114 percent compared to the $16,800,000 in the prior year. Had DOF used the gross income amount of $ 6,589,344 on the Notice of Value, the market value calculated would be $22,839,754, an increase of 36 percent that is consistent with the income increase and capitalization rate decrease. On the Final Assessment Roll, DOF had to decrease the market value to $18,480,000 to mitigate two factors: 1) an error in gross income value used in the calculations, and 2) the effect of the change in the valuation methodology discussed in previous discussions. These significant changes in property valuations were not appropriately addressed by DOF until the property owners brought them up. Therefore, we continue to emphasize that DOF adhere with the RPTL compliance to ensure an "equitable and transparent assessment" process.

Insufficient Analysis of Tentative Assessment Roll Resulted in Numerous Market Value Adjustments on Final Assessment Roll

DOF did not conduct adequate reviews to ensure that the properties' market value information on the Tentative Assessment Roll was accurate. Specifically, although DOF claimed that it reviewed CAMA 2 reports for unusual variations and accuracy, the changes to the Assessment Roll values were made only after the Tentative Assessment Roll was published, and property owners started to complain about the results.

Had DOF run and reviewed reports produced by CAMA 2 before the Notices of Property Value were sent to the property owners, it would have determined beforehand that the market value changes were significantly affecting all major property types and made all necessary corrections before sending the Notice of Property Value to the taxpayers. However, as evidenced in the Notice of Property Value letters DOF sends to the property owners, the adjustments were made only after the complaints are filed by property owners. As also noted, DOF did not have a process in place to analyze CAMA 2 reports and ensure that the errors in determining property market values were corrected and that the corresponding adjustments were made in a timely manner. Instead, DOF appeared only to rely on property owners' complaints to rectify problems.

DOF Response: In its response, DOF stated that "Due to the very tight timeline for valuation, especially for co-ops and condos, DOF uses the period after the tentative roll is released (the "change-by-notice" period) for review and valuation changes. Property owners are not required to file the RPIE's that are used to value large Class Two rental buildings until September 1…Due to the limited time to review before the tentative roll, DOF continues to correct proposed values during the change by notice period. In FY 11/12, Class Two property values were corrected at that time. DOF has proposed legislation that would require RPIE's to be filed by June 1 every year. This would allow more time for more review before the tentative roll is published in January."

Auditor Comment: Although we understand the constraints in the various aspects of the valuation process, DOF should be able to establish the transitional period to phase in changes within a reasonable period of time and clearly explain to the general public the reason and any potential impact of such change. Specifically, when changes of such magnitude representing drastic departure from a conventional valuation method are implemented, a preliminary analysis of the impact of this change on the market value of different types of properties should be evaluated and properly disclosed. Prudent practice would dictate that such notification should be issued to property owners before the Tentative Assessment Roll is issued and the Notices of Property Value are sent to the property owners. Otherwise, as happened in Fiscal Year 2011/2012, DOF would have to make large scale adjustments after the issuance of the Tentative Roll and after taxpayers initiate numerous complaints about the market value increases.

RECOMMENDATIONS

We recommend that DOF:

1. Review and evaluate the impact of new methodologies and ensure that the same income factors and criteria are consistently applied.

   DOF Response: DOF partially agrees. "We think it is very important to evaluate the impact of new methodologies. Real estate is not a static asset class, but rather one that is quite dynamic and accurate valuations are a higher priority goal for DOF than adhering to the identical valuation methodology, ignoring improvements in technology, statistical techniques, weighting of factors by the market and other criteria that can drive methodological changes. However, DOF recognizes that large scale changes in market value should be the exception and in FY 11/12 moderated the adoption of valuation changes to mitigate the impact on Class Two property owners."

2. Ensure that proper disclosure and notification of upcoming changes is provided to the public.

   DOF Response: "DOF agrees and it already provides this information. During the assessing season, staff holds industry meetings, brief legislators, and do public outreach to discuss policies under consideration."

3. Re-evaluate the properties that were over-assessed / under-assessed in Fiscal Year 2011/2012 and ensure that in the following years these properties are valued properly.

   DOF Response: "DOF already ensures that properties are valued properly. To the extent the recommendation suggests changing prior year assessments; once a final roll is issued DOF cannot change those values in the absence of a clerical error, as opposed to an error of judgment. DOF also does not agree that properties were "over-assessed" or "under-assessed" simply because there is a change in value from the previous year. However, DOF analyses the tentative roll each year to identify areas requiring change during the change-by-notice period, or to consider when developing assessor instructions, guidelines and models for the following years."

   Auditor Comment: We continue to emphasize that DOF should review the properties that were affected by the methodology change or by using incorrect comparables' data in calculation of the market values. DOF should ensure that any incorrect valuations from prior years do not affect the following year valuations. The preliminary review of the Tentative Assessment Roll should be done to avoid large scale adjustments during the change-by-notice period triggered by public complaints.

4. Review and analyze the Cooperatives and Condominiums comparables files and check for the existence of unusually low or high gross income numbers assigned to these properties compared to the selected comparable rental properties.

   DOF Response: "DOF agrees and already performs this analysis. All co-op and condo valuations were reviewed in FY 12/13 if their income per square ft. was more than 10% above or below the median or mean."

5. Run and review reports produced by CAMA 2 and analyze unusual market value fluctuations.

   DOF Response: "DOF agrees and already performs this analysis. DOF reviews extreme value change before the tentative roll is issued and during the change by notice period. We will increase the scrutiny of this area for upcoming assessment rolls."

   Auditor Comment: While we appreciate that DOF agreed, we are not able to confirm that such analysis is being performed. As discussed in this report. DOF did not conduct the necessary analysis or provide taxpayers with adequate disclosure on its change in valuation methodology.

6. Make timely adjustments to the properties before the Tentative Assessment Roll is published and the Notice of Property Value is sent to the property owners.

   DOF Response: "DOF does not agree. While we make adjustments throughout the period leading up to the roll, the tight timeline for valuation between when RPIE's are submitted in September and the need to value rental buildings before they can be used as comparables for co-ops and condos, makes it particularly difficult to make changes to Class Two before January 15. Until the RPIE deadline is moved up, most adjustments will need to be made during the change-by-notice period."

   Auditor Comment: This recommendation is related to large scale adjustments that resulted from DOF's planned changes in valuation methodologies or regulations. The effect of these changes should be evaluated before publishing the Tentative Assessment Roll and the market value of the particular type of properties that would be the most affected should be adjusted. Change the RPIE deadline from the current requirement date to June 1 definitely will be beneficial because it will allow more time to do fair and accurate valuations and avoid massive adjustments during the change-by- notice period.

DETAILED SCOPE AND METHODOLOGY

We conducted this audit in accordance with 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. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93 of the New York City Charter.

The scope of this audit covered residential Tax Class 2 properties listed on the Fiscal Year 2011/2012 Tentative Assessment Roll. To obtain an understanding of the market valuation process, we reviewed Taxable Assessment and Market Value Profiles for the Fiscal Years 2010/2011 and 2011/2012 Tentative Assessment Rolls; Fiscal Year 2011 and 2012 Guidelines for Properties Valued Based on the Income Approach, Including Office Buildings, Retail, Parking Lots and Garages, and Residential Properties; Instructions to Assessors – Business Rules for 2010/11 and 2011/12 Valuations; Assessed Value Business Rules; RPAD General Business Rules; and Uniform Assessment Standards.

To gain an understanding of CAMA 2 functionality and appraisal approaches used in real estate assessment and valuation, we conducted a walk-through of the CAMA 2 system and interviewed DOF officials. We documented the interviews through written narratives.

To determine whether DOF is properly calculating property values, we reviewed Taxable Assessment and Market Value Profiles for Fiscal Year 2011/2012. We analyzed the market value changes for Tax Class 2 properties (rental buildings, cooperatives, condominiums, and others) for each borough for Fiscal Year 2011/2012 and noticed that overall, the market value changes for different types of residential properties in each borough were consistent with the citywide changes. However, we determined that the market value of Queens' cooperatives increased by 32.37 percent while the market value of cooperatives citywide increased by 12.17 percent.

Therefore, we judgmentally selected 20 Queens's properties for our preliminary testing[7]. For selected properties, we recalculated the market values for Fiscal Year 2010/2011 using the Net Income Capitalization method and compared them to the market values assessed by DOF using the GIM method for the same period.

[7] Because the Net Income capitalization method employs Net Income values in calculations, to avoid the effect of Net Income Ratio changes on the calculated market value from year to year, we selected different types of Tax Class 2 residential properties that had similar Net Income Ratios in Fiscal Year 2010/2011 and Fiscal Year 2011/2012.

To determine whether DOF's valuation factors (Capitalization Rates and GIM) were consistently and reasonably developed, we conducted an analysis of the interrelationship between them and the market value calculated using both methods. For the sampled properties, we selected Capitalization Rates that corresponded to GIM indicated on the Notice of Property Value. The Capitalization Rates were obtained from DOF's Guidelines for Properties Valued Based on the Income Approach. We obtained expenses and Net Income information for Fiscal Year 2010/2011 from CAMA 2 records.

To determine what the market value changes would be in Fiscal Year 2011/2012 had DOF used the same valuation method (Net Income Capitalization) in both years, we calculated the market value percentage increase using market values for Fiscal Year 2010/2011 calculated by auditors and market values for Fiscal Year 2011/2012 assessed by DOF.

To determine whether the market values of the properties with more than 11 units were calculated properly citywide, we judgmentally selected 50 properties from the four largest boroughs. The number of properties selected from each borough represented a percentage of the borough's residential units in relation to the citywide number of residential units. These 50 properties included 20 properties from Manhattan (40 percent); eight properties from the Bronx (16 percent); 13 properties from Brooklyn (26 percent), and nine properties from Queens (18 percent). The sampled properties also represented different types of Tax Class 2 residential buildings. For all 50 properties, we performed similar calculations and analysis as for the 20 properties originally selected.

To determine whether the market values of the properties with less than 11 units were calculated properly, we reviewed the whole population of Queens Tax Class 2B residential properties (154 buildings) and judgmentally selected 15 properties for our analysis. Because DOF changed the criteria it used to develop GIM in Fiscal Year 2011/2012, we compared the market values calculated using GIM for Fiscal Years 2010/2011 and 2011/2012 and analyzed the reasons for the changes.

To determine whether DOF properly selected and applied comparable properties' information for cooperatives' valuation, we reviewed the 2011/2012 Comparable Rental Income for Cooperatives files for each borough posted on DOF's website. There were 2,261 cooperatives in Manhattan that DOF valued using comparable properties information, 514 cooperatives in Brooklyn, 859 cooperatives in Queens, and 329 cooperatives in the Bronx. For our analysis, we selected cooperatives for which the estimated gross income per square foot was significantly lower that the income of any of the comparable properties selected by CAMA 2 and posted on DOF's website. We reviewed the Department of Buildings' records to verify whether these properties were undergoing any major renovations that would lead to a lower occupancy and income.

In addition, we reviewed the whole population (859 properties) of Queens' cooperatives to determine whether income information from comparable properties was properly applied in the calculation of the coops' market value.

The result of the above tests, in conjunction with our other audit procedures, while not projected to the respective populations from which the samples were drawn, provided a reasonable basis to satisfy our audit objectives.

ANALYSIS OF MARKET VALUE CALCULATIONS USING GROSS INCOME MULTIPLIERS AND CAPITALIZATION RATES METHODOLGIES FOR TAX CLASS 2 RESIDENTIAL PROPERTIES WITH MORE THAN 11 UNITS

#	Borough	Block	Lot	Bldg. Class	Net Operating Income 2010/2011	Net Operating Income Ratio	GIM FY10/11	Cap. Rate FY10/11	Market Value FY10/11 using GIM	Auditor's Calculated Market Value 2010/2011 using Cap. Rate	Increase/ Decrease in Market Value using Cap. Rate vs. GIM	Market Value % Increase/ Decrease using Cap. Rate vs. GIM	Net Income FY11/12	Cap. Rate FY11/12	Market Value FY11/12 Tentative Roll 1/15/2011	Gross Income % Increase/ Decrease (2011/2012 vs. 2010/2011)	Market Value % Increase/ Decrease (Tentative 2011/2012 vs. Final 2010/2011)	% Changes in Market Value 2012 vs. 2011 if Cap. Rates were used in both years	Final Market Value 5/27/2011	2011/2012 Market Value Adjustment (Final vs. Tentative)	Final Market Value % Increase/ Decrease (Final 2011/2012 vs. Final 2010/2011)
1	1	52	21	D 7	$641,427	73.81%	3.381	15.458%	$2,940,000	$4,149,482	$1,209,482	41.14%	$647,645	14.577%	$4,443,000	2.81%	51.12%	7.07%	$3,234,000	(1,209,000)	10.00%
2	1	79	10	D 8	2,853,894	70.41%	4.658	14.258%	18,900,000	20,016,089	1,116,089	5.91%	2,833,607	13.567%	20,886,000	-3.69%	10.51%	4.35%	20,790,000	(96,000)	10.00%
3	1	116	46	C 7	109,166	69.09%	4.142	14.558%	654,000	749,869	95,869	14.66%	103,635	13.643%	760,000	-5.15%	16.21%	1.35%	719,400	(40,600)	10.00%
4	1	162	14	C 4	85,273	56.47%	3.381	15.458%	511,000	551,643	40,643	7.95%	85,248	13.836%	616,000	14.03%	20.55%	11.67%	562,000	(54,000)	9.98%
5	1	201	8	C 7	58,009	46.78%	3.114	16.058%	386,000	361,247	-24,753	-6.41%	77,017	14.631%	526,000	22.43%	36.27%	45.61%	425,000	(101,000)	10.10%
6	1	374	41	C 4	413,127	71.60%	4.658	14.258%	2,690,000	2,897,510	207,510	7.71%	434,993	13.532%	3,215,000	6.01%	19.52%	10.96%	2,959,000	(256,000)	10.00%
7	1	466	5	D 7	2,069,308	82.44%	4.658	14.258%	11,700,000	14,513,312	2,813,312	24.05%	2,217,458	13.214%	16,781,000	8.65%	43.43%	15.62%	12,870,000	(3,911,000)	10.00%
8	1	501	6	D 7	762,227	73.57%	4.909	14.158%	5,090,000	5,383,719	293,719	5.77%	747,503	13.307%	5,617,000	-6.43%	10.35%	4.33%	5,617,000	0	10.35%
9	1	520	29	D 4	1,379,077	81.33%	4.658	14.258%	7,900,000	9,672,303	1,772,303	22.43%	1,171,848	13.440%	8,719,000	-9.44%	10.37%	-9.86%	8,719,000	0	10.37%
10	1	586	45	D 9	710,604	81.21%	4.658	14.258%	4,080,000	4,983,897	903,897	22.15%	702,668	13.452%	5,224,000	-3.65%	28.04%	4.82%	4,488,000	(736,000)	10.00%
11	1	608	74	D 4	916,168	86.43%	4.658	14.258%	4,940,000	6,425,642	1,485,642	30.07%	721,678	13.316%	5,420,000	-13.83%	9.72%	-15.65%	5,420,000	0	9.72%
12	1	754	19	D 1	343,425	63.72%	4.142	14.558%	2,230,000	2,359,012	129,012	5.79%	357,314	13.706%	2,607,000	6.61%	16.91%	10.51%	2,453,000	(154,000)	10.00%
13	1	792	20	D 6	490,105	59.99%	3.739	14.758%	3,050,000	3,320,945	270,945	8.88%	553,730	13.736%	4,031,000	15.89%	32.16%	21.38%	3,355,000	(676,000)	10.00%
14	1	1061	16	D 1	688,940	65.91%	4.142	14.558%	4,330,000	4,732,381	402,381	9.29%	698,677	13.691%	5,103,000	2.56%	17.85%	7.83%	4,763,000	(340,000)	10.00%
15	1	1117	47	D 1	631,837	70.11%	4.142	14.558%	3,730,000	4,340,136	610,136	16.36%	658,305	13.758%	4,785,000	3.29%	28.28%	10.25%	4,103,000	(682,000)	10.00%
16	1	1244	20	D 5	551,565	74.38%	4.658	14.258%	3,450,000	3,868,460	418,460	12.13%	531,053	13.397%	3,964,000	-3.78%	14.90%	2.47%	3,795,000	(169,000)	10.00%
17	1	1431	29	D 5	368,565	79.15%	4.909	14.158%	2,290,000	2,603,228	313,228	13.68%	377,806	13.294%	2,842,000	2.64%	24.10%	9.17%	2,519,000	(323,000)	10.00%
18	1	1471	38	D 9	491,576	70.01%	3.739	14.758%	2,630,000	3,330,912	700,912	26.65%	576,826	13.694%	4,212,000	17.11%	60.15%	26.45%	2,893,000	(1,319,000)	10.00%
19	1	1552	1	C 7	1,340,405	74.57%	4.658	14.258%	8,370,000	9,401,073	1,031,073	12.32%	1,268,646	13.535%	9,373,000	-5.16%	11.98%	-0.30%	9,207,000	(166,000)	10.00%
20	1	1576	37	D 1	1,220,625	73.19%	4.142	14.558%	6,910,000	8,384,565	1,474,565	21.34%	1,205,448	13.789%	8,742,000	-4.62%	26.51%	4.26%	7,601,000	(1,141,000)	10.00%
21	2	2443	170	D 4	4,013,612	37.87%	2.12	18.158%	22,500,000	22,103,822	-396,178	-1.76%	5,399,240	14.533%	37,152,000	24.30%	65.12%	68.08%	33,750,000	(3,402,000)	50.00%
22	2	3180	13	C 6	68,271	36.49%	2.378	17.958%	445,000	380,170	-64,830	-14.57%	83,447	15.535%	537,000	12.90%	20.67%	41.25%	537,000	0	20.67%
23	2	3237	67	D 4	1,057,867	49.20%	2.592	17.258%	5,570,000	6,129,720	559,720	10.05%	1,126,000	16.169%	6,964,000	1.67%	25.03%	13.61%	6,127,000	(837,000)	10.00%
24	2	3307	1	D 4	362,850	56.84%	2.81	16.758%	1,790,000	2,165,235	375,235	20.96%	372,186	15.659%	2,377,000	3.41%	32.79%	9.78%	2,377,000	0	32.79%
25	2	4251	11	D 4	652,644	60.11%	2.81	16.758%	3,050,000	3,894,522	844,522	27.69%	645,100	15.073%	4,280,000	4.87%	40.33%	9.90%	4,280,000	0	40.33%
26	2	4317	25	D 4	471,554	51.12%	2.592	17.258%	2,390,000	2,732,379	342,379	14.33%	522,377	16.114%	3,242,000	0.66%	35.65%	18.65%	2,629,000	(613,000)	10.00%
27	2	5716	500	D 4	3,396,440	53.35%	3.114	16.058%	19,800,000	21,151,077	1,351,077	6.82%	3,651,912	14.975%	24,387,000	-6.15%	23.17%	15.30%	21,780,000	(2,607,000)	10.00%
28	2	5795	518	D 4	2,160,609	60.22%	2.582	17.258%	9,260,000	12,519,463	3,259,463	35.20%	2,252,640	15.701%	14,347,000	4.35%	54.94%	14.60%	10,186,000	(4,161,000)	10.00%
29	3	208	331	D 4	1,436,093	71.31%	4.142	14.558%	8,340,000	9,864,631	1,524,631	18.28%	1,454,988	13.772%	10,565,000	5.25%	26.68%	7.10%	9,174,000	(1,391,000)	10.00%
30	3	232	1	D 4	3,341,775	52.31%	2.12	18.158%	13,500,000	18,403,872	4,903,872	36.32%	4,319,783	16.154%	31,071,000	30.04%	130.16%	68.83%	20,250,000	(10,821,000)	50.00%
31	3	254	19	D 4	430,396	48.48%	3.381	15.458%	3,000,000	2,784,293	-215,707	-7.19%	465,720	13.829%	3,368,000	12.14%	12.27%	20.96%	3,300,000	(68,000)	10.00%
32	3	258	106	C 6	97,881	62.17%	4.142	14.558%	652,000	672,352	20,352	3.12%	100,063	13.707%	730,000	2.62%	11.96%	8.57%	730,000	0	11.96%
33	3	264	17	D 4	809,645	57.36%	3.381	15.458%	4,770,000	5,237,709	467,709	9.81%	740,520	13.829%	5,355,000	12.14%	12.26%	2.24%	5,247,000	(108,000)	10.00%
34	3	1171	48	D 4	169,279	51.41%	3.114	16.058%	1,030,000	1,054,172	24,172	2.35%	209,384	13.810%	1,516,000	19.06%	47.18%	43.81%	1,133,000	(383,000)	10.00%
35	3	5156	58	D 4	357,050	56.94%	2.592	17.258%	1,630,000	2,068,896	438,896	26.93%	349,490	16.064%	2,176,000	-2.03%	33.50%	5.18%	1,793,000	(383,000)	10.00%
36	3	5241	23	D 4	248,941	52.30%	2.12	18.158%	1,010,000	1,370,971	360,971	35.74%	253,918	16.809%	1,511,000	2.00%	49.60%	10.21%	1,111,000	(400,000)	10.00%
37	3	5268	33	D 4	788,157	54.64%	2.12	18.158%	3,060,000	4,340,550	1,280,550	41.85%	831,392	16.834%	4,939,000	5.62%	61.41%	13.79%	3,366,000	(1,573,000)	10.00%
38	3	6709	1	D 4	886,996	52.70%	2.592	17.258%	4,360,000	5,139,622	779,622	17.88%	835,146	16.014%	5,215,000	-11.51%	19.61%	1.47%	4,796,000	(419,000)	10.00%
39	3	7214	1	D 4	1,625,967	59.11%	3.381	15.458%	9,300,000	10,518,612	1,218,612	13.10%	1,766,460	14.673%	12,039,000	3.60%	29.45%	14.45%	12,039,000	0	29.45%
40	3	7238	49	D 4	832,567	74.29%	3.381	15.458%	3,790,000	5,385,994	1,595,994	42.11%	657,247	14.673%	4,479,000	-3.36%	18.18%	-16.84%	4,479,000	0	18.18%
41	3	1178	57	C 6	129,304	51.14%	3.113	16.058%	787,000	805,231	18,231	2.32%	114,497	15.575%	735,000	-17.89%	-6.61%	-8.72%	735,000	0	-6.61%
42	4	148	1	D 1	495,727	65.34%	3.114	16.058%	2,360,000	3,087,103	727,103	30.81%	503,471	15.094%	3,336,000	2.00%	41.36%	8.06%	2,596,000	(740,000)	10.00%
43	4	166	6	D 1	808,953	58.74%	3.739	14.758%	5,150,000	5,481,454	331,454	6.44%	872,909	13.829%	6,312,000	-2.23%	22.56%	15.15%	6,312,000	0	22.56%
44	4	568	1	D 1	301,806	49.08%	3.114	16.058%	1,920,000	1,879,474	-40,526	-2.11%	339,695	15.153%	2,242,000	3.19%	16.77%	19.29%	2,242,000	0	16.77%
45	4	1218	6	C 7	444,677	67.74%	3.381	15.458%	2,220,000	2,876,679	656,679	29.58%	465,396	15.189%	3,064,000	-6.52%	38.02%	6.51%	3,064,000	0	38.02%
46	4	1290	1	D 7	1,056,438	63.50%	3.739	14.758%	6,220,000	7,158,409	938,409	15.09%	1,104,126	13.821%	7,989,000	-0.59%	28.44%	11.60%	7,989,000	0	28.44%
47	4	1913	1	D 1	901,357	70.83%	3.381	15.458%	4,300,000	5,831,007	1,531,007	35.60%	916,890	14.692%	6,241,000	1.35%	45.14%	7.03%	4,730,000	(1,511,000)	10.00%
48	4	5025	1	D 1	945,358	58.00%	2.81	16.758%	4,580,000	5,641,234	1,061,234	23.17%	1,007,193	14.980%	6,724,000	2.30%	46.81%	19.19%	5,038,000	(1,686,000)	10.00%
49	4	4157	2	D 3	573,997	64.90%	3.381	15.458%	2,990,000	3,713,268	723,268	24.19%	611,569	14.650%	4,175,000	5.07%	39.63%	12.43%	3,289,000	(886,000)	10.00%
50	4	4995	1	D 1	1,039,377	45.44%	2.81	16.758%	6,430,000	6,202,274	-227,726	-3.54%	1,140,327	14.998%	7,603,000	8.33%	18.24%	22.58%	7,073,000	(530,000)	10.00%

APPENDIX II

ANALYSIS OF MARKET VALUES FOR TAX CLASS 2B QUEENS RESIDENTIAL PROPERTIES WITH LESS THAN 11 UNITS

#	Block	Lot	Area Rating	Gross Income FY10/11	# of Units	Income per unit per month	GIM FY10/11	Market Value FY10/11	Gross Income FY11/12	Gross sq.ft.	Gross Income per sq.ft. FY11/12	Neighborhood	Income Group assigned by DOF	Median Income per sq.ft. FY11/12	GIM FY11/12	Market Value FY11/12 Tentative Roll 1/15/2011	Market Value % Increase/Decrease (Tentative 2011/2012 vs. Final 2010/2011)	Gross Income % Increase/Decrease (2011/2012 vs. 2010/2011)	Final Market Value 5/27/2011	Final Market Value % Increase/Decrease (2011/2012 vs. 2010/2011)
1	45	46	4	$53,678	8	$559	6.9	$370,000	$63,840	8,050	$7.93	Long Island City	11	$16.34	10.5	$670,000	81.08%	18.93%	$555,000	50.00%
2	659	8	4	63,520	8	662	6.9	438,000	73,277	5,472	13.39	Long Island City	12	15.76	9.5	696,000	58.90%	15.36%	657,000	50.00%
3	713	82	4	79,077	10	659	6.9	546,000	77,917	4,944	15.76	Long Island City	12	15.76	9.5	740,000	35.53%	-1.47%	740,000	35.53%
4	543	124	4	45,885	10	382	6.9	317,000	50,747	3,220	15.76	Astoria	12	15.76	9.5	482,000	52.05%	10.60%	475,000	49.84%
5	819	75	4	71,112	9	658	6.9	491,000	82,408	7,284	11.31	Astoria	12	15.76	9.5	783,000	59.47%	15.88%	736,000	49.90%
6	1765	25	4	65,802	8	685	6.9	454,000	73,094	5,184	14.10	Corona	8	14.10	8.75	640,000	40.97%	11.08%	640,000	40.97%
7	2903	18	4	85,728	10	714	6.9	592,000	86,837	5,496	15.80	Elmhurst	10	15.80	9.5	825,000	39.36%	1.29%	825,000	39.36%
8	3510	18	4	54,880	9	508	6.9	379,000	62,040	4,400	14.10	Flushing	8	14.10	8.75	543,000	43.27%	13.05%	543,000	43.27%
9	3597	44	4	46,420	10	387	6.9	320,000	49,500	4,108	12.05	Glendale	11	16.34	10.5	520,000	62.50%	6.64%	480,000	50.00%
10	3614	6	4	94,098	10	784	6.9	649,000	102,435	8,900	11.51	Ridgewood	8	14.10	8.75	896,000	38.06%	8.86%	896,000	38.06%
11	3574	25	1	156,912	10	1,308	11.7	1,840,000	167,387	8,000	20.92	Ridgewood	8	14.10	8.75	1,465,000	-20.38%	6.68%	1,465,000	-20.38%
12	9706	58	1	169,570	10	1,413	11.7	1,980,000	181,428	12,795	14.18	Jamaica	9	14.58	8.75	1,587,000	-19.85%	6.99%	1,587,000	-19.85%
13	589	2	1	120,451	9	1,115	11.7	1,410,000	125,827	3,840	32.77	Astoria	12	15.76	9.5	1,195,000	-15.25%	4.46%	1,195,000	-15.25%
14	2007	99	1	244,620	9	2,265	11.7	2,860,000	254,951	10,430	24.44	Corona	8	14.10	8.75	2,231,000	-21.99%	4.22%	2,231,000	-21.99%
15	1311	74	1	156,802	10	1,307	11.7	1,830,000	172,046	10,889	15.80	Flushing	10	15.80	9.5	1,634,000	-10.71%	9.72%	1,634,000	-10.71%

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February 27, 2012

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Sent via e-mail: tkim@comptroller.nyc.gov

Re: Audit Report on the Valuation of Class 2 Properties by the New York City Department of Finance FN11-130A

VALUATION OF CLASS 2 PROPERTIES

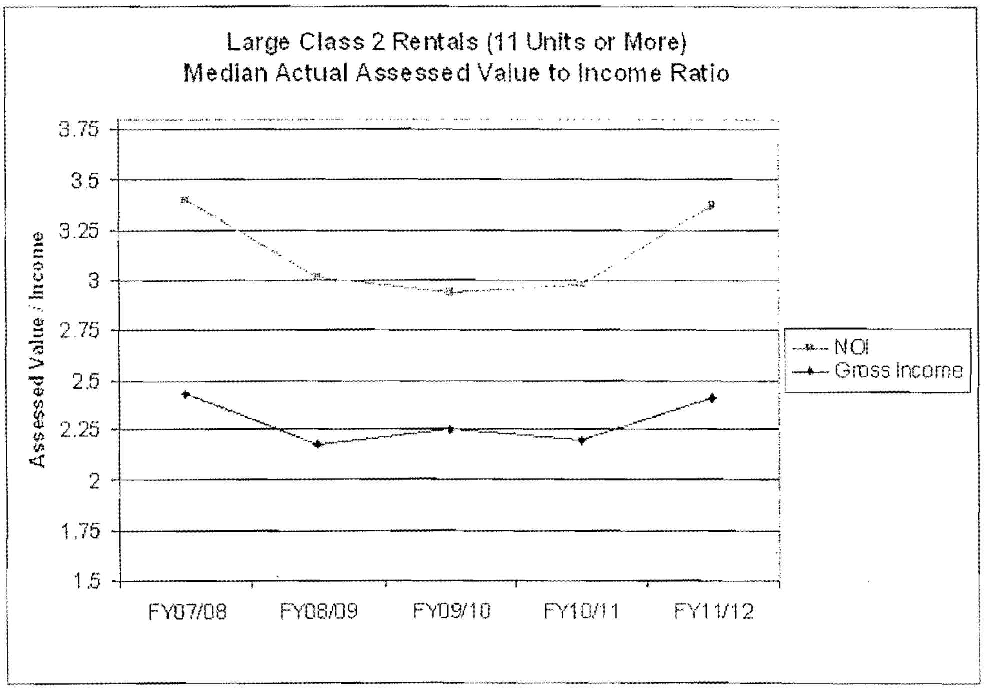
A. Changes in Valuation Methodology Resulted in Significant Market Value Fluctuation For Properties with 11 or More Units

When the Department of Finance (DOF) prepared the FY 11/12 assessment roll, we valued the larger Class Two properties (rentals, co-ops and condos with more than 10 units) using our long standing valuation methodology known as Net Income Capitalization ("income cap"). Net Income Capitalization is the widely accepted methodology used by appraisers and assessors throughout the country to value income producing properties. Significantly, when owners challenge assessments in the New York City Tax Commission and the New York State courts, all sides use Net Income Capitalization to determine whether the values are correct. DOF had previously used Net Income Capitalization until FY 08/09. We returned to this traditional method because it is more accurate and allows assessments to be based on a building's individual economic situation. We agree with the Comptroller's statement that valuing properties using Net Income Capitalization is "permissible under the Real Property Tax Law."[1] More than that, we believe it is the preferable methodology.

DOF had used a different methodology for large Class Two properties for the three years from FY 08/09 – FY 10/11: the Gross Income Multiplier (GIM) method. The Audit Report focuses only on the one year of change from GIM back to Net Income Capitalization and does not discuss Finance's change from income cap to GIM. Both changes resulted in volatility. Any methodological change will involve some adjustments, as property values are "benchmarked." The volatility discerned in the audit between FY 10/11 and FY 11/12 generally reflects that the GIM method derived values were too low.

[1] Audit Report Page 2

The chart below clearly illustrates that GIM derived values were generally too low by showing the relationship between the income of rental properties and their "actual assessed value," which is 45% of market value, for each year from FY 07/08 (the last year DOF used income cap) through FY 11/12 (the year DOF returned to income cap). The median assessed value to net income ratio was 3.4 in FY 07/08 and 3.4 in FY 11/12. The relationship dropped below 3 using the GIM method. For rental buildings, market value should move in tandem with gross and net income. For example, gross income may fall in a building with market rents when rents decline, in which case the building's market value will fall. Net income may fall because of an increase in expenses such as a spike in oil prices, in which case again the building's market value will fall. With a consistent valuation method, the ratio should be stable. We analyzed this ratio for 14 years, since 1998, and found a relatively stable ratio except for the 3-year GIM period. During the three GIM years (FY 08/09 – FY 10/11) the ratio fell not because of changes in income or expense, but because of the change in valuation methodology.



The Audit Report analysis in the table on page 7 and also in Appendix 1, while simplistic, demonstrates the problems with the GIM method and why it was important to return to Net Income Capitalization. The GIM methodology used expense ratios that compressed the actual experience of properties into one size fits all categories. Many properties benefited because the GIM assigned them expenses higher than their actual building history. Those buildings would see an increase in value once DOF returned to income capitalization and considered the buildings' actual experience. Appendix 1 demonstrates how the initial change to GIM in FY 08/09 reduced the value of 35 out of 50 sample properties. The policy change back to Net Income Capitalization allowed for a better reflection of an individual property's expenses and thus a more accurate value. What the Comptroller's auditors saw as a fluctuation in valuation of large Class Two properties was really a return to DOF's historically consistent valuation methodology.

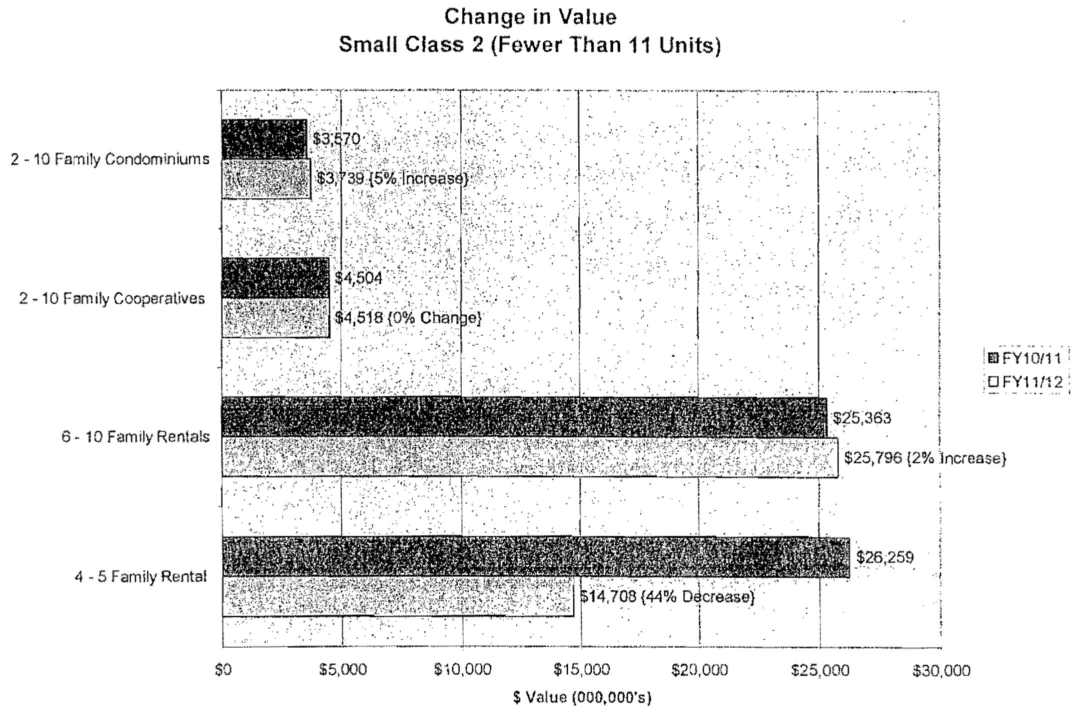
While the return to Net Income Capitalization was consistent with historical valuations, DOF recognized that property owners needed a transition period to absorb the large scale changes in market value. Market value increases for Class Two properties were limited in both FY 11/12 and FY 12/13 to ensure that any potential tax increase related to the current year market value change would be no greater than 10% (excluding the impact of Class Two tax rate changes).

The rationale for DOF's return to Net Income Capitalization was widely discussed. Commissioner Frankel testified to the City Council about this decision at two different hearings during March and May 2011. The testimony was also posted on the DOF web site and copies of the testimony were provided to the auditors. The Commissioner and DOF employees also discussed these issues at many public meetings, including a borough-wide meeting in Queens hosted by the Borough President on May 5, 2011. In addition, the change was discussed in technical terms in the assessor guidelines for FY 11/12, which were published on DOF's web site. In spite of this, the Audit Report states on page 2, that "DOF did not provide a basis for this change." This claim is clearly incorrect.

B. Different Criteria Used to Develop GIM Significantly Affected the Market Values of Properties with Less Than 11 Units

DOF continued to use the GIM methodology for Class Two properties with fewer than 11 units, because the vast majority of these properties are not legally required to file income and expense statements and therefore DOF could not do the individual valuations that are part of the Net Income Capitalization methodology. For FY 11/12 DOF improved how GIMs were developed to make the valuations of these properties more accurate. With the single exception of 4-5 family rental properties, small Class Two properties as a whole saw minimal to no overall changes in value from this refinement of the GIM model.

Before FY 11/12, the criteria for GIM included area ratings determined by assessors, which were not uniform or consistently updated. In FY 11/12, the criteria were changed to median income per square foot per neighborhood, using 17 income groups. This change in methodology allowed DOF to use a more empirical approach to developing GIMs, removing the subjectivity embedded in the method used in previous years. As demonstrated in the graph below, the rebaselining in FY 11/12 of properties with fewer than 11 units showed an overall minor change for 2-10 family co-ops and condominiums (5% increase and 0% change respectively) and 6-10 family rentals (2% increase).



The audit incorrectly cherry picked properties to show significant swings in value for the small Class Two properties highlighted in Appendix 2, "Analysis of Market Values for Tax Class 2B Queens Residential Properties with less than 11 Units." As we explained to the auditors, their finding was probably based on their selection of atypical small Class Two properties that filed income and expense information. Those properties are valued using their reported data. It is always possible to judgmentally select a few properties that are different than the norm, and the Audit Report chooses to discuss these exceptions rather than the City-wide norm. The chart above demonstrates that with the exception of 4-5 family rental buildings, the revisions of the GIM methodology in FY 11/12 had a minimal overall impact on Class Two properties with fewer than 11 units.

DOF made one significant change in FY 11/12, on advice of counsel, to the GIM for 4-5 family rental buildings. To ensure a class-wide consistent methodology, the GIM was changed from sales to an income-based GIM, similar to the 6-10 family rentals and small co-ops and condos. This change in methodology caused a 44% drop in overall value for 4-5 family rentals.

C. The Estimated Gross Income Did Not Match the Comparables' Income

Co-ops and condos are required by law to be valued as if they were rental buildings. DOF's methodology in FY 11/12 was to model the selection of comparable properties through the CAMA system. Through modeling, assessors are presented with 5 comparable properties, which they can add or subtract from. The median income and expense is calculated for use as a potential comparable to the subject co-op or condo. Assessors are expected to make adjustments to take into account differences between the subject co-op and condo and the comparable rental properties.

It is to be expected that the income/square foot would differ between a subject and comp properties. These differences are mischaracterized in the Audit Report as "under-valuations" or "over-valuations." The goal is to have an accurate value, not to exactly match the median comp. A statistically-based modeled comparable system is a tool for assessors, but to arrive at an accurate valuation, the assessor should make appropriate adjustments. For example, adjustments are warranted where the subject is in a neighborhood with no rentals to use as comps, or the comps are less well maintained, older or have different sized units. Other reasons for a difference include when there are an even number of comps, so the system takes the average of the two middle comps, or where a property used as a comp was subsequently revalued (due to a review or physical change).

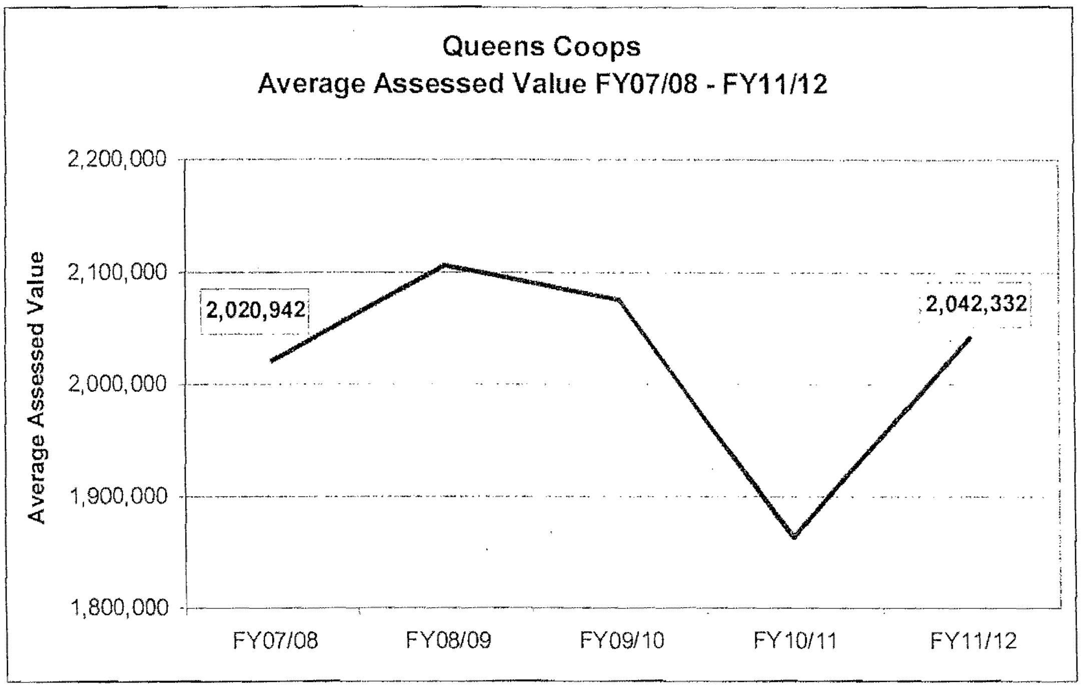
The Audit Report describes a single example. This is a property where the Gross Income is lower for the subject property than the comparables. The property cited was erroneously valued with filed income instead of comparable income. This created a higher expense ratio than guidelines allow and resulted in a subsequent market value undervaluation. This property has been isolated for further investigation and we appreciate the auditors bringing it to our attention.

D. DOF's Use of Incorrect Gross Income Triggered an Increase in Market Values for 10 Percent of Queens Co-ops

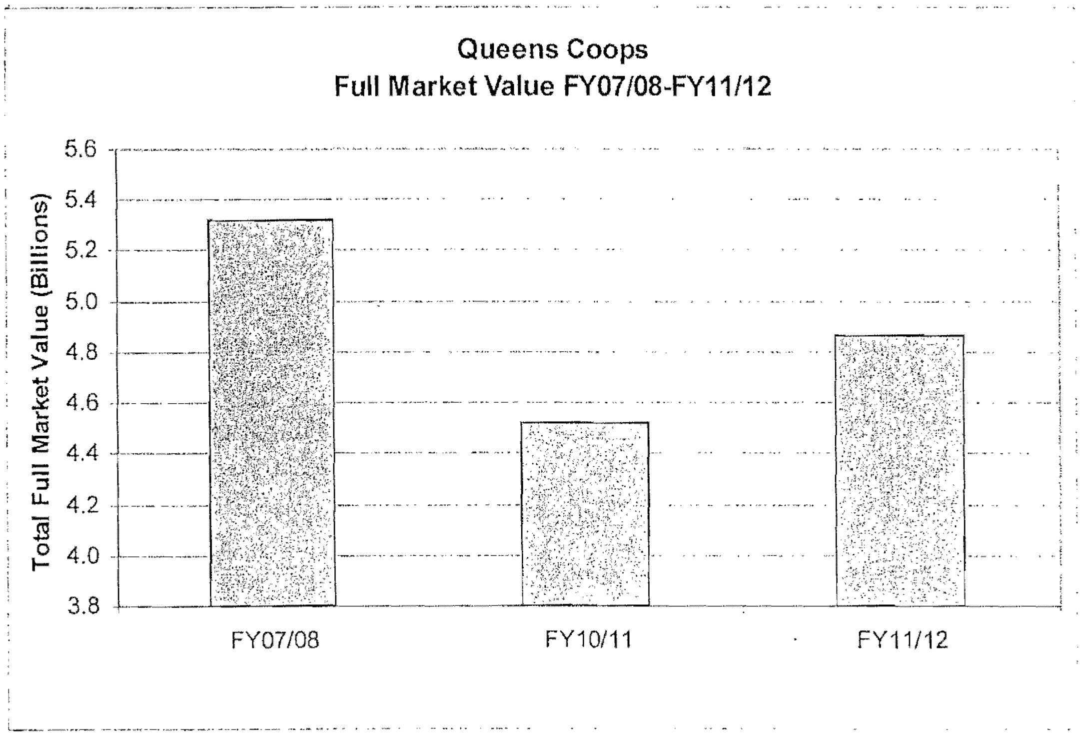
Much of the Audit Report refers to the valuation of Queens co-ops in FY 11/12 and it is well known that co-op owners in Queens in particular were concerned and disturbed by large initial increases in market values on the tentative roll in FY 11/12. The Department carefully reviewed the values of each large Queens co-op and corrected many assessments before the final roll.

The assessment increases for Queens co-ops were due in large part to the return to Net Income Capitalization valuation. Queens co-op market values dropped in FY 11/12 and assessed values were virtually unchanged when compared with FY 07/08 (the last year income cap was used).

The median increase in taxable AV from the FY 07/08 final roll to the FY 11/12 tentative roll was only 1%.

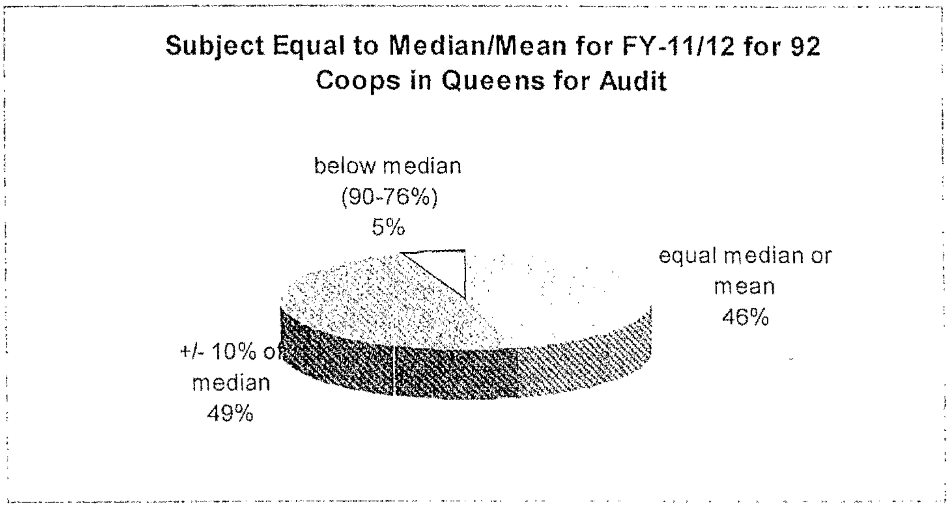


Market values for Queens co-ops actually declined by 8.44% when the FY 11/12 final roll is compared to the FY 07/08 final roll.

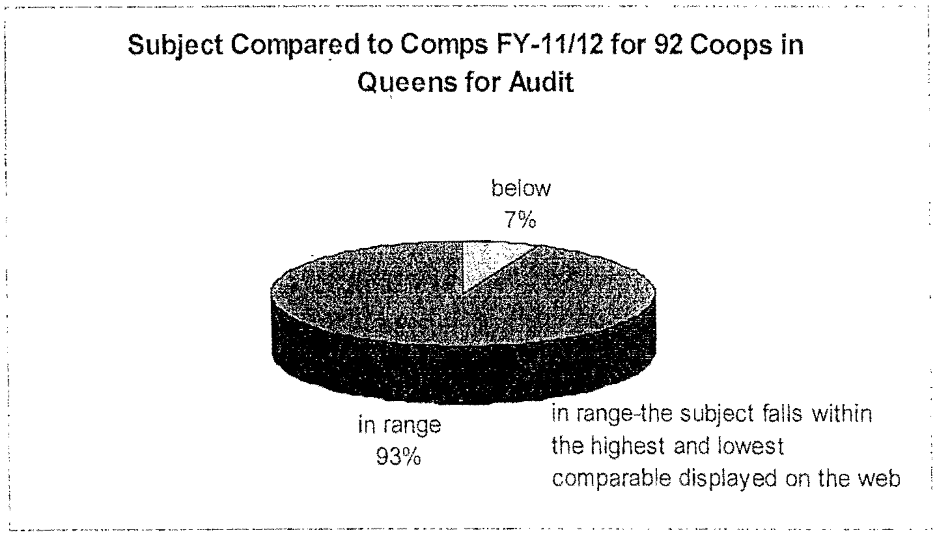


The auditors are simply wrong to state that incorrect gross incomes affected the values of 10% of Queens's co-ops. Statistical analysis of the 92 Queens properties cited by the auditors as being "over-valued," tells a quite different story. We looked at the data in two different ways to observe the variability in distance between the subject and comparable properties.

We found that adjusted gross income (AGI) used as comparable values for Queens's co-ops was within 10% of the median or mean of comparables' income 95% of the time.[2]



We also found that 93% of the AGI fell within the highest and lowest comparables displayed in the spreadsheet on DOF's website.



[2] Mean is used when there is an even number of comps used.

Most of the 92 properties cited by the auditors are located in northeastern Queens -- in neighborhoods where rental apartment comps are often not available. Properties from other neighborhoods must be used and the income per square foot may need to be adjusted. However, even with these difficulties, the variability between subject and comparables was minimal, using two different statistical analyses.

Contrary to the Comptroller's allegation, DOF fully complied with Real Property Tax Law (RPTL) requirements in establishing values for Queens's co-ops for FY 11/12. This is demonstrated by the fact that only 3% of the Queens co-ops that appealed to the Tax Commission in FY 11/12, received offers of reduced assessment. 901 Queens co-ops appealed to the Tax Commission, 29 received offers to reduce their assessments and 22 accepted the offer. The Tax Commission did not make an offer to reduce assessments for 872 Queens co-ops.

Section 581 of the RPTL provides that co-ops and condos should be valued as if they were not owned as co-ops or condos, but rather as if they had remained as rental apartment buildings. This is the extent, however, of the RPTL requirement. While DOF typically relies on the income and expenses of comparable rental buildings in valuing co-ops and condos, such methodology is not mandated by the RPTL. In appropriate circumstances values could also be estimated based on rents derived from the market or rents from sponsor-held units within the subject co-op or condo. Even if based on comparable rental buildings, however, the RPTL does not mandate 1) which buildings should be selected as comparables, 2) that all comparable buildings be given equal weight, or 3) that the median, average, mean or any other measure be used. Due to the varying degrees of differences between comparables and subject properties, the important metric for valuation purposes is not whether the income estimated is the median of the comparables but whether the income is within the range indicated by the comparables.

E. Insufficient Analysis of Tentative Assessment Roll Resulted in Numerous Market Value Adjustments on Final Assessment Roll

Due to the very tight timeline for valuation, especially for co-ops and condos, DOF uses the period after the tentative roll is released (the "change-by-notice" period) for review and valuation changes. Property owners are not required to file the RPIE's that are used to value large Class Two rental buildings until September 1. The assessors must first value the approximately 21,000 large Class Two rentals that file RPIE's so guidelines can be developed and models calibrated. It is only after tax Class Two rentals are valued, that they can be used as comps for co-ops and condos. Despite this tight timeline, there are reviews that occur throughout the valuation period, such as the extreme value change reviews, error reports, and specific target area reviews. Due to the limited time to review before the tentative roll, DOF continues to correct proposed values during the change by notice period. In FY 11/12, Class Two property values were corrected at that time.

DOF has proposed legislation that would require RPIE's to be filed by June 1 every year. This would allow more time for more review before the tentative roll is published in January.

Audit Recommendations and DOF Response

1. Review and evaluate the impact of new methodologies and ensure that the same income factors and criteria are consistently applied.

DOF partially agrees. We think it is very important to evaluate the impact of new methodologies. Real estate is not a static asset class, but rather one that is quite dynamic and accurate valuations are a higher priority goal for DOF than adhering to the identical valuation methodology, ignoring improvements in technology, statistical techniques, weighting of factors by the market and other criteria that can drive methodological changes. However, DOF recognizes that large scale changes in market value should be the exception and in FY 11/12 moderated the adoption of valuation changes to mitigate the impact on Class Two property owners.

2. Ensure that proper disclosure and notification of upcoming changes is provided to the public.

DOF agrees and it already provides this information. During the assessing season, staff hold industry meetings, brief legislators, and do public outreach to discuss policies under consideration. Often, the policy changes (or valuation methodology changes) made by DOF are in response to concerns from the public. The Notice of Property Value and DOF's website provides detailed explanation concerning how property valuations are derived.

3. Re-evaluate the properties that were over-assessed/under-assessed in Fiscal Year 2011/2012 and ensure that in the following years these properties are valued properly.

DOF already ensures that properties are valued properly. To the extent the recommendation suggests changing prior year assessments, once a final roll is issued DOF cannot change those values in the absence of a clerical error, as opposed to an error of judgment. DOF also does not agree that properties were "over-assessed" or "under-assessed" simply because there is a change in value from the previous year. However, DOF analyses the tentative roll each year to identify areas requiring change during the change-by-notice period, or to consider when developing assessor instructions, guidelines and models for the following years.

4. Review and analyze the Cooperatives and Condominiums comparables files and check for the existence of unusually low or high gross income numbers assigned to these properties compared to the selected comparable rental properties.

DOF agrees and already performs this analysis. All co-op and condo valuations were reviewed in FY 12/13 if their income per square ft. was more than 10% above or below the median or mean.

5. Run and review reports produced by CAMA 2 and analyze unusual market value fluctuations.

DOF agrees and already performs this analysis. DOF reviews extreme value change before the tentative roll is issued and during the change by notice period. We will increase the scrutiny of this area for upcoming assessment rolls.

6. Make timely adjustments to the properties before the Tentative Assessment Roll is published and the Notice of Property Value is sent to the property owners.

DOF does not agree. While we make adjustments throughout the period leading up to the roll, the tight timeline for valuation between when RPIE's are submitted in September and the need to value rental buildings before they can be used as comparables for co-ops and condos, makes it particularly difficult to make changes to Class Two before January 15. Until the RPIE deadline is moved up, most adjustments will need to be made during the change-by-notice period.

Sincerely,

Elizabeth Botwin

cc: George Davis III, Deputy Director, Mayor's Office of Operations
Michael Hyman, Deputy Commissioner, Tax Policy and Planning
Timothy Sheares, Assistant Commissioner, Property
Celia Carino, Director, Internal Audit