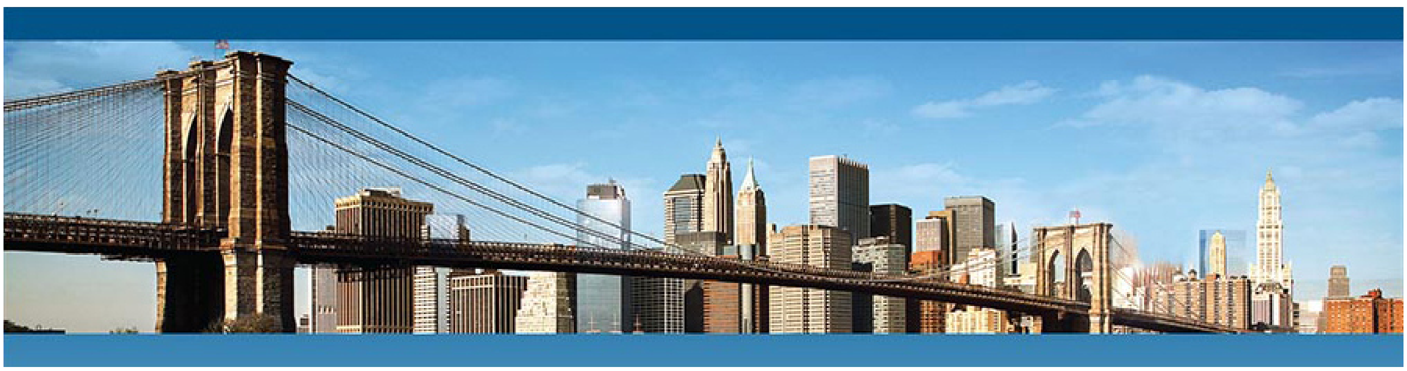
City of New York

OFFICE OF THE COMPTROLLER

Scott M. Stringer
COMPTROLLER



AUDIT AND SPECIAL REPORTS

Marjorie Landa
Deputy Comptroller for Audit

Audit Report on the Tax Classification of Real Property in the Borough of Queens by the New York City Department of Finance

SR16-091A

June 10, 2016

http://comptroller.nyc.gov

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, NY 10007

SCOTT M. STRINGER
COMPTROLLER

June 10, 2016

To the Residents of the City of New York:

My office has audited the New York City Department of Finance (DOF) to determine whether DOF's procedures ensure that mixed-use properties in the borough of Queens classified as Tax Class 1 are correctly classified. We audit City agencies such as DOF as a means of increasing accountability and ensuring that City resources are used effectively, efficiently and in the best interest of the public.

This audit found that DOF's procedures did not consistently ensure that Queens properties listed as mixed-use within Tax Class 1 on the assessment rolls have been correctly classified. Based on our inspections of Class 1 mixed-use properties in January 2016, we identified 154 out of 4,607 properties listed as Tax Class 1 that appeared, based on our preliminary analysis, to have been misclassified. While our audit was in process, DOF requested the list of the 154 properties prior to the completion of our analysis. DOF assessors then inspected the 154 properties and determined that 78 were incorrectly classified, 19 properties required an interior inspection, and 57 required no change. After reviewing its inspection results, we agreed with them. Using DOF's guidelines, we calculated that changing the tax classification of the 97 properties (78 DOF agreed were incorrectly classified plus the 19 that required an interior inspection) would result in an additional $1.28 million in taxes after the increases phase in over the required five-year period.

We appreciate DOF's efforts to address apparent problems prior to the completion of the audit. We note, however, that the audit revealed some weaknesses in DOF's assessment process as evidenced by the fact that several of the properties DOF agreed had been improperly classified had been inspected by the agency not long before our inspections and so should already have had their tax classes changed. The audit made three recommendations, including that DOF conduct interior inspections of the 19 remaining properties and make the necessary adjustments to the assessment rolls for any of the properties that are determined to be misclassified. DOF should also ensure that assessors are properly trained and able to perform their responsibilities. Finally, DOF should consider enhancing its oversight and quality assurance functions to ensure that assessors properly inspect properties and recommend revisiting misclassified properties as required by the Administrative Inspection Project Instruction manual.

The results of the 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,

Scott M. Stringer

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THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
AUDIT AND SPECIAL REPORTS

Audit Report on the Tax Classification of Real Property in the Borough of Queens by the New York City Department of Finance

SR16-091A

EXECUTIVE SUMMARY

This audit of the New York City Department of Finance (DOF) was conducted to determine whether DOF's procedures ensure that mixed use properties in the borough of Queens classified as Tax Class 1 are correctly classified. In accordance with the *New York City Real Property Tax Law* (RPTL), DOF classifies every parcel of property in New York City for real-estate purposes. These tax classes are as follows:

- *Class 1:* Consists of residential properties with three or fewer units and "Mixed Commercial/Residential Use" (mixed-use) properties with three or fewer residential and commercial units, where 50 percent or more of the space is used for residential purposes.
- *Class 2:* Includes all other primarily residential properties that are not designated Class 1. Class 2 also has three sub-classes:
    - Class 2a for a 4-to-6 unit rental building;
    - Class 2b for a 7-to-10 unit rental building; and
    - Class 2c for a 2-to-10 unit cooperative or condominium.
- *Class 3:* Includes real estate of utility corporations and special franchise properties, excluding land and certain buildings.
- *Class 4:* Includes all other properties, such as stores, warehouses, hotels, office buildings and any vacant land not classified as Class 1.

Properties are assessed at a percentage of their full market value based on their classifications. Class 1 properties are assessed at 6 percent of market value and Class 2, 3, and 4 properties are assessed at 45 percent.

Audit Findings and Conclusion

DOF's procedures did not consistently ensure that Queens properties listed as mixed-use within Tax Class 1 on the assessment rolls have been correctly classified. Based on our inspections of properties listed by DOF as Class 1 mixed-use in January 2016 on the assessment rolls, we identified 154 out of 4,607 that, based on our preliminary review, appeared to be misclassified. While our audit was in process, DOF requested our preliminary list of the 154 properties with questionable classifications prior to the completion of our analysis. DOF assessors then inspected the 154 properties and determined that, in fact, 78 had been incorrectly classified by DOF, 19 properties required an interior inspection, and 57 required no change. After reviewing DOF's inspection results, we agreed with them. We appreciate DOF's efforts to address apparent problems prior to the completion of the audit. We note, however, that the audit revealed some weaknesses in DOF's assessment process as evidenced by the fact that several of the properties DOF agreed had been improperly classified had been inspected by the agency not long before our inspections and so already should have had their tax classes changed.

Using DOF's guidelines, we calculated that changing the tax classification of the 97 properties (78 DOF agreed were incorrectly classified plus the 19 that require an interior inspection) would result in an additional $1.28 million in taxes after increases phase in over the required five-year period.

Audit Recommendations

The audit made the following three recommendations:

- DOF should conduct an interior inspection of the 19 remaining properties and make the necessary adjustments to the assessment rolls for any of the properties that are determined to be misclassified to ensure that the property owner is assessed the proper amount of tax.
- DOF should ensure that assessors are properly trained and able to perform their responsibilities, including conducting inspections of mixed use properties.
- DOF should consider enhancing its oversight and quality assurance functions to ensure that assessors properly inspect properties and recommend re-visiting misclassified properties as required by the Administrative Inspection Project Instruction manual.

Agency Response

We received a written response from DOF officials on May 18, 2016. In its response, DOF agreed with the audit's recommendations and stated that it would address the issues identified.

Further, the agency stated that it "appreciates the Comptroller's findings that out of 4,607 Tax Class 1 mixed-use properties in Queens, 78 were improperly classified with an additional 19 scheduled for additional inspections. All of the lots provided by the City Comptroller's office have been inspected by assessing staff and those requiring a change in tax classification have been reclassified in the Computer Assisted Mass Appraisal application." However, the agency contends that the "audit estimate of an additional $1.28 million in tax revenue includes 19 parcels requiring interior inspection. DOF believes that this estimate is overstated."

AUDIT REPORT

Background

The New York City Department of Finance (DOF) assesses the value of all New York City properties, collects property taxes and other property-related charges, maintains property records, administers exemptions and abatements and collects unpaid property taxes and other property-related charges through annual lien sales. In accordance with the *New York Real Property Tax Law* (RPTL), DOF classifies every parcel of property in New York City for real-estate purposes. These tax classes are as follows:

- *Class 1:* Applies to residential properties with 3 units or less and "Mixed Commercial/Residential Use" (mixed-use) properties (with 3 or fewer residential and commercial units) where 50 percent or more of the space is used for residential purposes. This class includes primarily residential property such as 1, 2, and 3 family homes, condominiums of 3 stories or less that were originally built as condominiums; and condominiums of 3 dwelling units or less that were previously 1, 2, and 3 family homes and certain vacant land zoned for residential use outside of Manhattan.

- *Class 2:* Includes all other primarily residential properties that are not designated Class 1. These include co-ops but do not include hotels, motels, or other similar property. Class 2 also has 3 sub-classes: Class 2a for a 4-to-6 unit rental building; Class 2b for a 7-to-10 unit rental building; and Class 2c for a 2-to-10 unit cooperative or condominium building.

- *Class 3:* Includes real estate owned and occupied by utility corporations and special franchise properties, excluding land and certain buildings.[1]

- *Class 4:* Includes all other properties, such as stores, warehouses, hotels, office buildings, and any vacant land not classified as Class 1.[2]

Properties are assessed at a percentage of their full market value based on their classification. Class 1 properties are assessed at 6 percent of market value and Class 2, 3 and 4 properties are assessed at 45 percent. Increases to assessed values for Tax Class 1 are limited to 6 percent per year, and no more than 20 percent over 5 years. Increases to Tax Classes 2a, 2b and 2c are limited to 8 percent per year, and no more than 30 percent over five years. Increases to Class 2 properties with more than 10 units and Class 4 properties are generally phased in over a 5-year period. If the property owner makes physical changes to the property, the phase-in cap does not apply and the full value of the improvements is applied.

DOF's Property Division is responsible for producing a fair, accurate and legal assessment roll each year. DOF's assessors value properties by verifying that they are assigned to the correct building class and tax class; that the physical characteristics of the building, including the square

[1]Special franchise property are properties situated in, under, above, upon or through any public street, highway, water, or other public place.
[2] Vacant land outside of Manhattan would be classified as Tax Class 1 if it is zoned residential.

footage, have been recorded accurately; and that the properties are valued in accordance with assessment roll guidelines and general appraisal rules.

Assessors must physically visit a property once every three years. DOF currently is in the second year of a three-year administrative inspection cycle for such visits. DOF has an *Administrative Inspection Project Instruction* manual that sets forth instructions for assessors on how they are to conduct inspections, known as "administrative inspections."[3] In advance of these administrative inspections, assessors receive a form with data about each property, including tax class and building class. The assessor must make notes and photograph the property if the property data on the form does not match their field observations. The inspection results are recorded in DOF's computer-assisted mass appraisal system, VISION. If any of the parcel's basic property data does not agree with City records, the assessor records an "X" in the "Re-Visit" column and a brief note to explain why a re-visit is recommended.

During Fiscal Year 2015, DOF collected $21.5 billion in property taxes. According to DOF records, there were 1,096,247 taxable properties, consisting of 708,676 Class 1 properties, 272,640 Class 2 properties, 4,603 Class 3 properties and 110,328 Class 4 properties in New York City.

Objective

The objective of this audit was to determine whether DOF's procedures ensure that mixed use properties in the borough of Queens classified as Tax Class 1 are correctly classified.

Scope and Methodology Statement

We conducted this performance 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 properties in the borough of Queens that DOF classified as mixed-use properties in Tax Class 1 on DOF's Final Assessment Roll as of May 2015. 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 findings in this report were discussed with DOF officials during and at the conclusion of this audit. This preliminary draft was sent to DOF and discussed at an exit conference held on May 3, 2016. On May 4, 2016, we submitted a draft report to DOF officials with a request for comments. We received a written response from DOF officials on May 18, 2016. In their response, DOF officials agreed with the audit's recommendations and stated that it would address the issues identified.

[3] DOF's Administrative Inspection Project briefing defines an administrative inspection as "an exterior inspection used to check the reasonableness of basic property data (e.g., Building Class, Number of Residential and Commercial Units, Number of Stories) of contiguous parcels located on blocks."

Further, the agency stated that it “appreciates the Comptroller's findings that out of 4,607 Tax Class 1 mixed-use properties in Queens, 78 were improperly classified with an additional 19 scheduled for additional inspections. All of the lots provided by the City Comptroller's office have been inspected by assessing staff and those requiring a change in tax classification have been reclassified in the Computer Assisted Mass Appraisal application.

The audit estimate of an additional $1.28 million in tax revenue includes 19 parcels requiring interior inspection. DOF believes that this estimate is overstated. As these inspections are currently being scheduled, it is an overestimation to assume that all 19 parcels will be reclassified from Tax Class 1 to Tax Class 4.”

The 19 parcels that DOF identifies as requiring interior inspections have already been inspected from the outside. Thereafter, DOF determined that these 19 require also need an interior inspection. Based on the exterior inspection, we still believe that the calculation of an additional $1.28 million in tax revenue to the City is a reasonable estimate.

FINDINGS AND RECOMMENDATIONS

DOF's procedures did not consistently ensure that Queens properties listed as mixed-use within Tax Class 1 on the assessment rolls have been correctly classified. Based on our inspections of Class 1 mixed-use properties in January 2016, we identified 154 out of 4,607 properties listed as Tax Class 1 that appeared, based on our preliminary analysis, to have been misclassified. While our audit was in process, DOF requested the list of the 154 properties prior to the completion of our analysis. DOF assessors then inspected the 154 properties and determined that 78 were incorrectly classified,19 properties required an interior inspection, and 57 required no change. After reviewing DOF's inspection results, we agreed with them. We appreciate DOF's efforts to address apparent problems prior to the completion of the audit. We note, however, that the audit revealed some weaknesses in DOF's assessment process as evidenced by the fact that several of the properties DOF agreed had been improperly classified had been inspected by the agency not long before our inspections and so should already have had their tax classes changed.

Using DOF's guidelines, we calculated that changing the tax classification of the 97 properties (the 78 DOF agreed were incorrectly classified plus the 19 that require an interior inspection) would result in an additional $1.28 million in taxes after the increases phase in over the required five-year period.

Improper Classification of Mixed-Use Properties as Tax Class 1

DOF's assessors are supposed to value properties by verifying that they are assigned to the correct building class and tax class; that the physical characteristics of the building, including the square footage, have been recorded accurately; and that the properties are valued in accordance with assessment roll guidelines and general appraisal rules. We found that assessors do not consistently accurately assess the properties. After DOF inspected the 154 properties that we had identified in January 2016 as possibly misclassified, the agency agreed that 78 had been incorrectly classified and that 19 properties required interior inspections to determine their classification. DOF changed 71 of the 78 properties to Tax Class 4 and the remaining 7 to Tax Class 2a.

Our findings, as confirmed by DOF's re-inspections, suggest weaknesses in DOF's inspection process, since 33 of the 78 properties that DOF eventually agreed had been misclassified had already been re-inspected as part of DOF's 3-year inspection cycle, and only 9 of these 33 properties had been identified by the assessor as needing to be re-inspected for a possible change in tax and building classifications. Further, for the remaining 24 properties, photographs taken during our observations as well as pictures in Google Maps show that the properties appear to have more than 50 percent of their space used for commercial purposes. However, DOF inspectors did not recommend that any of these 24 properties be revisited as required by the Administrative Inspection Project Instruction manual even though the building class was apparently incorrect at the time of their visit.

For example, one property that DOF assessors had visited and not noted needed a re-inspection based on its apparent improper classification was a two-story building with a borough, block and lot (BBL) identified as Borough 4, Block 12102, and Lot 31. At the time of the most recent DOF inspection, that property was listed on the assessment rolls as "Primarily One-Family with One

Store or Office" (Tax Class 1, Building Class S1).[4] Our inspection, as reflected in the photograph below, disclosed that the building had a medical and dental office that appeared to occupy more than 50 percent of the property's square footage. DOF's assessor visited this site on May 29, 2014, and a year later on May 20, 2015, but on neither occasion indicated in VISION that a change to the tax class and building class were required, nor do the notes indicate a re-visit was required, as would be the procedure if the assessor concluded that a change in classification was required.

After DOF inspected the properties we identified as appearing to be improperly classified in February 2016, it changed its classification of this property to "Predominant Retail with Other Uses" (Tax Class 4, Building Class K4). However, given the timing of the change, for Fiscal Year 2016, DOF incorrectly assessed the owner of this property $5,136 rather than $17,790 in property taxes due based on the appropriate Tax Class 4 classification. We further note that while the picture above was taken during our visit on January 11, 2016, a photo of this property found on Google Map dated September 2011 shows that the same business apparently operating at that time in this location. Thus, this property appears to have been incorrectly assessed for at least four years prior to our January 2016 visit.

Similarly, we visited a two-story building with BBL 4, 9935, 36, that was listed on the assessment rolls as a "Primarily Two-Family with One Store or Office" (Tax Class 1, Building Class S2). However, our inspection, as shown in the picture below, disclosed that the building was used primarily for commercial purposes, with a store on the first floor and an insurance office on the second floor. Prompted by our preliminary audit findings, DOF changed the classification of this property to "Predominant Retail with Other Uses" (Tax Class 4, Building Class K4) after it conducted its own inspection on February 2, 2016. However, given the timing of its re-classification of this property, for Fiscal Year 2016, DOF incorrectly assessed the owner of this property $4,508 rather than $16,879 based on a Tax Class 4 classification.

[4] DOF assigns properties that are mixed-use an "S" code in the building classification.

We note that DOF assessors visited this site on June 17, 2015, and July 21, 2015, but only after the July 21, 2015, visit did the assessor indicate in VISION that a re-visit was required because of an apparent need for a classification change. However, the revisit to the property on February 2, 2016, did not occur until after we sent the list of 154 properties to DOF. The picture above was taken during our visit on January 13, 2016. A picture of this same property found on Google maps dated September 2013 clearly shows signs for both businesses at that time, indicating that the misclassification existed for the property for possibly two or three years prior to our visit.

Improper Classification of Mixed Use Properties in Other Tax Classes

Our inspections found two properties that were classified as primarily residential, but in Tax Class 2A and 2B, respectively, due to their size and other conditions.[5] However it appears that more than 50 percent of each property is being used for commercial purposes and thus neither of them appear to have been properly classified. In addition, during June and August 2015, DOF assessors inspected one of these properties as part of their three-year inspection cycle, but the assessors did not request that this property be re-inspected for a possible change in tax and building classifications.

When we inspected one, a three-story building with BBL 4, 9706, 58, listed on the assessment rolls as "Walk-Up Apt, Over Six Families with Stores" (Tax Class 2B, Building Code C7), we found three different businesses on the first floor and a medical assistant training center on the second floor. This condition is reflected in the photograph below that we took of the building at the time of our inspection on January 13, 2016. Following our disclosure of our preliminary findings to DOF, it re-inspected the property on February 4, 2016, and thereafter reclassified it as "Predominant Retail with Other Uses" (Tax Class 4, Building Class K4). However, given the timing

[5] While our audit scope was properties DOF classified as mixed-use in Tax Class 1 on DOF's Final Assessment Roll as of May 2015, during our field visits we randomly selected similar properties that had a commercial establishment on the second floor. At the time of our observations we did not know the tax class of those randomly selected properties. We later checked the tax class of the randomly selected properties and found 5 were in 2a or 2b tax class as detailed herein.

of the re-classification for Fiscal Year 2016, DOF incorrectly assessed the owner of this property $38,265 rather than $44,595 based on a Tax Class 4 classification.

We note that DOF assessors visited this site on July 23, 2013, June 2, 2015, and August 6, 2015, and at none of those times did any of them indicate in VISION that a change to the tax class and building class were required or that a re-visit was required because of a possible erroneous classification. However, Google Maps has a picture of this property dated June 2012 with similar signs indicating that businesses were on the first floor and the medical assistant training facility was on the second floor. Thus it appears that the usage has not changed in the past four years and the City has incorrectly classified this property since then.

Recommendations

1. DOF should conduct an interior inspection of the 19 remaining properties and make the necessary adjustments to the assessment rolls for any of the properties that are determined to be misclassified to ensure that the property owner is assessed the proper amount of tax.

   DOF Response: "DOF agrees. In February of 2016 DOF received the list of 154 parcels from the City Comptroller that were potentially misclassified. At that time the Senior Supervising Assessor in the Queens office assigned them for immediate inspection. To ensure proper classification a team of trained assessors worked through the list by visiting each parcel in person. Care was taken to determine the use of each property and the results were documented by notes and photos. At present the 19 parcels mentioned in this audit have been sent inspection request letters. Assessors will revisit these parcels to ensure proper classification on the next assessment roll."

2. DOF should ensure that assessors are properly trained and able to perform their responsibilities, including conducting inspections of mixed use properties.

   DOF Response: "DOF agrees. Training is critical to ensure the quality of the work done by assessors. Assessors are required to be New York State certified and this certification process includes a field component. In 2015 the Chief Review Assessor designed a Data Collection course which was approved by the New York State Office of Real Property Tax Services. The inspection and classification of real property is the primary focus of the course which was offered for the first time in 2015. The Property Division will continue to work with assessing staff to develop skills in this area. Additional classes have already been held in the spring of 2016 with more sessions scheduled for the summer."

3. DOF should consider enhancing its oversight and quality assurance functions to ensure that assessors properly inspect properties and recommend re-visiting misclassified properties as required by the Administrative Inspection Project Instruction manual.

   DOF Response: **"**DOF agrees. Real estate in New York City is dynamic and constantly changing. This is particularly true in Queens for mixed use properties. An inspection is a snapshot in time. At DOF we strive to continually update our data and maintain a high level of quality.

   In an effort to strengthen our quality assurance functions, supervisors and assessor managers will be implementing additional field checks to ensure the proper classification of real property. The Quality Assurance group will also coordinate random sampling of field work to identify errors and potential training needs."

DETAILED SCOPE AND METHODOLOGY

We conducted this performance 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 period of this audit covers properties in the borough of Queens that DOF classified as mixed-use in Tax Class 1 on DOF's Final Assessment Roll as of May 2015.

To achieve our audit objective, we reviewed DOF's *NYC Residential Property Taxes Guidelines for Tax Class 1 and Tax Class 2 Properties*. We also reviewed the tax rates for each class of real property in Fiscal Year 2016 and DOF's procedures to calculate the real estate taxes. To gain an understanding of the regulations governing the classification of real property and DOF's procedures for ensuring that properties are correctly classified, we confirmed the Building Classification Process with DOF's Deputy Director of Property Quality Assurance Division and an Administrative Assessor from DOF's Property Division. The results were documented in memorandum. We used *New York City Administrative Code §11-207 – Duties of Assessors in Assessing Property* and *New York Real Property Tax Law §1802 – Classification of Real Property in a Special Assessing Unit* and DOF's Administrative Inspection Project Instruction manual as audit criteria for assessing and classifying real properties.

We reviewed DOF's *Final Assessment Roll* (AVRoll) for Fiscal Year 2016 that we obtained from DOF's website published in May 2015. We extracted all one- to less than three-story mixed-use properties in Tax Class 1 in the borough of Queens. As of May 2015, there were 4,607 one- to less than three-story mixed-use properties listed as Tax Class 1. Based on our research using Google Visual Tour, we identified 261 potentially misclassified properties. We relied on our physical observations to test the accuracy and completeness of the AVRoll.

We reviewed DOF's AVRoll to confirm the building classification of the 261 potential misclassified properties. We then visited each property to physically observe whether they were properly classified. During our visits, we identified another 31 properties that appear to be misclassified (26 properties in Tax Class 1, three (3) properties in Tax Class 2a and two (2) properties in Tax Class 2b). We verified each building classification by reviewing the Final Assessment Roll. Upon review of our pictures and notes taken during our observations, we determined that 154 preliminarily appeared to be misclassified. DOF requested and were provided with a list of the 154 properties prior to completing our analysis.

We received DOF's results of the inspections for the 154 properties on March 7, 2016. We reviewed DOF's results and compared the building classification changes recorded on the AVRoll and the Tentative Assessment Roll Fiscal Year 2017 to DOF's results of inspections. We estimated the amount of additional tax due based on property tax class and the market value provided by DOF and the appropriate property tax rate for Fiscal Year 2016.

DOF used the VISION system to process the full detailed evaluation on the assessed properties. To determine if DOF's Administration Inspection Project result was properly documented, after our observations we reviewed the Visit History of the 154 mixed-use properties for the date of inspection, inspection type, and the inspection result in DOF's VISION system. We also reviewed

DOF's inspection results on the 78 properties that its assessors determined required reclassification of the 154 we had previously found and the 19 properties that still required an interior inspection. We compared DOF's inspection results to the results from our visits. We also reviewed DOF's Instructions for Field Valuation for the inspection procedures. We also reviewed DOF's inspection results for the remaining 57 properties that DOF stated needed no change in classification.

Department of Finance

City of New York
Department of Finance
nyc.gov/finance

Jacques Jiha, Ph.D.
Commissioner

1 Centre Street, 5th Floor
New York, NY 10007

May 18, 2016

Ms. Marjorie Landa
Deputy Comptroller for Audit
Office of the City Comptroller
1 Centre Street, 11th Floor
New York, NY 10007

Re: Audit Report on the Tax Classification of Real Property in the Borough of Queens by the New York City Department of Finance (SR16-091A)

Dear Deputy Comptroller Landa,

Introduction

The Department of Finance (DOF) appreciates the Comptroller's findings that out of 4,607 Tax Class 1 mixed-use properties in Queens, 78 were improperly classified with an additional 19 scheduled for additional inspections. All of the lots provided by the City Comptroller's office have been inspected by assessing staff and those requiring a change in tax classification have been reclassified in the Computer Assisted Mass Appraisal application.

The audit estimate of an additional $1.28 million in tax revenue includes 19 parcels requiring interior inspection. DOF believes that this estimate is overstated. As these inspections are currently being scheduled, it is an overestimation to assume that all 19 parcels will be reclassified from Tax Class 1 to Tax Class 4.

Background

In general, the Department of Finance Property Division inspects thousands of parcels each year which have filed for a construction permit with the Department of Buildings. Other inspections include neighborhood surveys, special projects and taxpayer-initiated inspections from *Requests to Update* form submissions.

In the spring of 2015 DOF initiated an Administrative Inspection Project to visit all parcels citywide. In this first year more than 300,000 parcels were seen by assessing staff. This was made possible by the addition of new assessing staff hired over the past several years. It should be noted however that due to the Principal of Change, a margin of error will permanently exist in real estate. The International Association of Assessing Officers (IAAO) defines the Principal of Change in real estate as "the market value is never constant because physical, economic, governmental, and social forces are at work to change the property and its environment."

TC1 mixed-use properties represent a relatively small portion of all parcels citywide. Their use can vary over time and their classification can be difficult to establish with an exterior inspection. There are other considerations outside of business signs which assessors must take into account before reclassifying a property. This is illustrated in the auditors' own field work that of 154 in the preliminary findings, only 78 were actual cases of misclassification.

The predominant active use, which determines the classification of a property, is determined by square footage. An interior inspection may be necessary to establish the commercial percentage before reclassification. Gaining access to these properties is often difficult and several attempts are required.

One example is a two-story building which has retail on the first floor and a small extension in the rear. While the second story is fully residential 55% of the total square footage of the building is commercial. This observation is difficult to make in the field. Internal inspections, speaking with tenants or neighbors as well as researching various records (such as filed RPIEs) may be required.

<u>Responses to Recommendations</u>

1. **DOF should conduct an interior inspection of the 19 remaining properties and make the necessary adjustments to the assessment rolls for any of the properties that are determined to be misclassified to ensure that the property owner is assessed the proper amount of tax.**

DOF agrees.

In February of 2016 DOF received the list of 154 parcels from the City Comptroller that were potentially misclassified. At that time the Senior Supervising Assessor in the Queens office assigned them for immediate inspection. To ensure proper classification a team of trained assessors worked through the list by visiting each parcel in person. Care was taken to determine the use of each property and the results were documented by notes and photos. At present the 19 parcels mentioned in this audit have been sent inspection request letters. Assessors will revisit these parcels to ensure proper classification on the next assessment roll.

2. **DOF should ensure that assessors are properly instructed regarding their responsibilities when performing inspections of mixed use properties.**

DOF agrees.

Training is critical to ensure the quality of the work done by assessors. Assessors are required to be New York State certified and this certification process includes a field component. In 2015 the Chief Review Assessor designed a Data Collection course which was approved by the New York State Office of Real Property Tax Services. The inspection and classification of real property is the primary focus of the course which was offered for the first time in 2015. The Property Division will continue to work with assessing staff to develop skills in this area. Additional classes have already been held in the spring of 2016 with more sessions scheduled for the summer.

3. **DOF should consider enhancing its oversight and quality assurance functions to ensure that assessors inspect the properties and recommend re-visiting misclassified properties as required by the Administrative Inspection Project Instruction manual.**

DOF agrees.

Real estate in New York City is dynamic and constantly changing. This is particularly true in Queens for mixed use properties. An inspection is a snapshot in time. At DOF we strive to continually update our data and maintain a high level of quality.

In an effort to strengthen our quality assurance functions, supervisors and assessor managers will be implementing additional field checks to ensure the proper classification of real property. The Quality Assurance group will also coordinate random sampling of field work to identify errors and potential training needs.

Sincerely,

Carmela Quintos, Assistant Commissioner

cc: Michael Hyman, First Deputy Commissioner
Timothy Sheares, Deputy Commissioner
Sam Mayer, Senior Director, Internal Audit