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Audit Report

**Audit of the
Dallas Central Appraisal District
Homestead Exemptions and
Commercial Property Records
(Report No. A07-006)**

March 16, 2007

City Auditor

Craig D. Kinton, CPA

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Executive Summary

Dallas Central Appraisal District (DCAD) is responsible for appraising property for the purpose of ad valorem property tax assessment on behalf of the City. The purpose of this audit¹ was to determine whether property tax exemptions (General Residential Homestead, Over-65 Homestead, Disability Homestead, and Disabled Veteran) are granted in accordance with state law, rates/exemptions for the City of Dallas are comparable to other major Texas cities, commercial property records reflect the correct taxable values, and prior audit recommendations have been implemented.

We conclude that:

- With minor exceptions, the property tax exemptions are granted in accordance with the Texas Property Code (Code) and are calculated correctly.
- Tax rates and exemptions in the City of Dallas are comparable to other major Texas cities.
- Commercial property records facilitate the calculation of the correct taxable values for these properties.
- All previous audit recommendations have been implemented.

During the course of the audit we noted that the Dallas County Assessor/Collector received \$40,789, a payment-in-lieu-of-taxes (PILOT) for the City of Dallas (City) made by the American Housing Foundation Community Development, LLC (AHF). The payment was made pursuant to an agreement between the Texas State Affordable Housing Corporation (TSAHC) and AHF. The authority for the City to accept these types of payments is not clear.

Recommendations Summary

- DCAD periodically sample exemptions to identify questionable exemptions and remove exemptions which are not in accordance with the Code.
- The Director of the Office of Financial Services follow-up with the City Attorney to determine whether the City is entitled to PILOT from tax exempt organizations. If the City is entitled to such payments, implement a process to identify and track PILOT received by the City.

¹ Audit conducted under authority of Dallas City Charter, Chapter IX, Section 3.

Management's Response Summary

DCAD concurs with the recommendation of periodically sampling their records to insure that they continue to have accurate exemptions and that the City is not deprived of tax revenue.

OFS agrees with the recommendations and has requested a written opinion of the City Attorney to determine if the City is entitled to retain PILOT payments.

See Appendix IV for full responses from management.

Audit Results

I. The majority of property tax exemptions are granted in accordance with statute and are calculated correctly.

While accuracy in valuating properties for taxing purposes is the most significant factor in determining the appropriate amount of taxes owed, errors in granting of exemptions can also affect tax collections. Four instances of exemptions granted from statistical samples of fifty-eight properties tested were not in accordance with the Code. The four exceptions identified were composed of one General Residential Homestead and three Over-65 Homestead exemptions. No exceptions were found for Disability Homestead or Disabled Veteran exemptions. The projected loss in property tax revenue for the City of Dallas for the tax year 2005 was at least \$590,000 which approximates to 0.12% (0.0012) of the ad valorem revenue of \$480 million. Table 4 shown in Appendix III provides further detail.

The Code requires that an:

- Individual claiming the General Residential Homestead and Over-65 Homestead exemption reside at the property where the General Residential Homestead and Over-65 Homestead exemption is granted.
- Individual claiming the Over-65 Homestead exemption should be 65 years old or older.

Factors contributing to the granting of inappropriate exemptions include:

- Review procedures of internal records to monitor the continuous legitimacy of exemptions granted to home owners were not performed on a routine basis.
- Lack of an integrated exemption status repository system in Texas to allow for easy searches of other counties.

Recommendation 1:

We recommend that DCAD periodically sample exemptions to identify questionable exemptions and remove ones which are not in accordance with the Code.

Management Response

Agree. DCAD concurs with the recommendation of periodically sampling their records to insure that they continue to have accurate exemptions and that the City is not deprived of tax revenue.

Property tax rates and exemption values are comparable to other major Texas cities.

In 2005, the City of Dallas tax rate of .7417% was the second highest among selected major Texas Cities² (.4430% to .8650%). When applying the General Residential Homestead exemption only, Dallas taxes owed of \$890.04 on a property valued at \$150,000 rank second highest (\$664.50 to \$1,038.00). Dallas has the second highest Over-65 Homestead exemption (\$64,000). For people having a General Residential and an Over-65 Homestead exemption on a \$150,000 house, the Dallas taxes are the lowest of the selected cities (\$415.35 to \$692.00).

Commercial Property records facilitate the calculation of the correct taxable value for these properties.

A value study of commercial appraisal methods was performed by the State of Texas Comptroller's Office. The study determined that the appraisal methods used by DCAD were reasonable. Additionally, we reviewed 19,028 commercial property records that used the cost valuation method. Although we found no reportable conditions as to the correct taxable value of these properties, we did note that the percent-of-completion section of DCAD's commercial property database did not always reflect the correct status. The status of the percent-of-completion of commercial property may affect the method used to calculate taxes. This condition may cause additional work by DCAD to determine the correct method to compute taxes if the percent-of-completion section is not current. We informed DCAD of this minor condition and, therefore, it is not included as a recommendation in this report.

II. The authority to retain Payments-In-Lieu-of-Taxes is not clear.

While not an original objective of the audit, we noted that the Dallas County Assessor/Collector received \$40,789, a payment-in-lieu-of-taxes (PILOT) for the City of Dallas (City) made by the American Housing Foundation Community Development, LLC (AHF). The payment was made pursuant to an agreement between the Texas State Affordable Housing Corporation (TSAHC) and AHF.

The TSAHC provided proceeds to AHF from Texas State Affordable Housing Corporation Multifamily Housing Revenue Bonds. In connection with the issuance of the bonds, AHF was required to pay the applicable taxing units an amount equal to 25% of the amounts that would be due as ad valorem taxes. AHF is a not-for-profit organization and designated as a certified Community Development Housing Organization (CDHO). A CDHO is required to provide decent, clean, and safe

² Austin, Fort Worth, Houston, San Antonio

housing that is affordable to low income and moderate income people in the State of Texas. AHF owns three apartment buildings in the City.

Texas Property Tax Code Section 11.182 exempts a CDHO from ad valorem taxation. The City's entitlement to the refund remains to be resolved.

Recommendation 2:

The Director of the Office of Financial Services (OFS):

- Should request an opinion of the City Attorney to determine if the City is entitled to retain such payments.
- Should establish a process to identify and track PILOT payments due to the City, if such payments are permissible.

Management Response

Agree. OFS agrees with the recommendations and has requested a written opinion of the City Attorney to determine if the City is entitled to retain PILOT payments.

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

Appendix I

Background, Objectives, Scope and Methodology

Background

The Texas Property Tax Code (Code) mandates the administration, appraisal, and collection of property taxes. As established by the Code, the Dallas County Appraisal District (DCAD) is responsible for appraising property and granting property tax exemptions for the City of Dallas. In July of each year, the Chief Appraiser certifies the property appraisal values and tax exemption values for the City. The City contracts with Dallas County to prepare and send tax bills to property owners, collect monies due, and disburse funds back to the City. The City sets the property tax rate, approves exemptions allowed within the City limits, and establishes exemption amounts.

DCAD provides the City with an annual appraisal of all properties located within the City limits on January 1. The appraisal excludes all property exempted from municipal taxation under the Code. As a reporting agency, DCAD keeps track of all the property tax exemptions added and removed in the City. This information is subsequently used to update tax rolls and assign tax liability to properties located within the city limits.

The scope of this audit was limited to the analysis of four exemptions (General Residential Homestead, Over-65 Homestead, Disability Homestead, and Disabled Veteran). The following table summarizes the applicable criteria established by Texas Property Tax Code Section 11.13 and used by DCAD for General Residential Homestead, Over-65 Homestead, Disability Homestead and Disabled Veteran exemptions.

Table 1 - Criteria Used to Establish Eligibility for Property Exemptions City of Dallas		
Type of Exemption	Exemption amount	Criteria
General Residential Homestead	\$5,000 or 20% of the appraised value of the home, whichever is greater.	<ul style="list-style-type: none"> • Owner must own property on January 1 of the year application is made. • Owner must reside in the property on January 1. • This deduction may only be claimed on primary residence.
Over-65 Homestead	\$64,000	<ul style="list-style-type: none"> • Must meet criteria for General Residential Homestead exemption. • The home owner must be 65 years old or older.

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

Type of Exemption	Exemption amount	Criteria
Disability Homestead	The annual exemption is the lesser of \$64,000 or the appraised value of the property.	Disability exemptions are approved for homeowners who: <ul style="list-style-type: none"> • Meet the criteria for General Residential Homestead exemption. • Cannot engage in any substantial gainful work for a period which has lasted or can be expected to last for a continuous period of one year or more. • Submit proof for the Disability exemption from the Social Security Administration or a current letter of verification from a physician.
Disabled Veteran	The exemption amount depends on the percentage of disability and ranges from \$5,000 to \$12,000 of the assessed value of real or personal property.	<ul style="list-style-type: none"> • Must meet the criteria for General Residential Homestead exemption. • Must produce documentary evidence from the United States Veteran Administration of the most recent disability rating.

Source: DCAD

The value of property exemptions varies according to the taxable value of the property and the tax rate of the municipality where the property is located. Some cities in the State of Texas allow eligible property owners to claim all exemptions (General Residential Homestead, Over-65 Homestead, Disability Homestead, and Disabled Veteran) while others exclude some of these exemptions. The following table compares the General Residential Homestead and Over-65 Homestead exemptions allowed for the cities of Austin, Dallas, Fort Worth, Houston, and San Antonio for the tax year 2005.

City	General Residential Homestead exemption as a percentage of taxable value	Dollar value of Over-65 Homestead exemption
Austin	0%	\$ 51,000
Dallas	20%	64,000
Fort Worth	20%	40,000
Houston	20%	53,240
San Antonio	0%	65,000

Sources: Travis Central Appraisal District, DCAD, Tarrant Appraisal District, Harris County Appraisal District, and Bexar Appraisal District

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

To illustrate the difference in property tax dollars between the cities in our analysis, we calculated the related property taxes (net of General Residential Homestead and Over-65 Homestead exemption) for a property with a taxable value of \$150,000. The following table illustrates the tax rate and related tax dollars for the cities of Austin, Dallas, Fort Worth, Houston, and San Antonio for the tax year 2005.

TABLE 3 - CALCULATION OF PROPERTY TAXES BASED ON \$150,000 TAXABLE VALUE – SELECTED MAJOR TEXAS CITIES				
CITY	TAX RATE	TAX WITHOUT EXEMPTION	TAX AFTER DEDUCTING GENERAL RESIDENTIAL HOMESTEAD	TAX AFTER DEDUCTING GENERAL RESIDENTIAL HOMESTEAD AND OVER-65 HOMESTEAD
AUSTIN	.4430%	\$ 664.50	\$ 664.50 (NOT ALLOWED)	\$438.57
DALLAS	.7417%	1,112.55	890.04	415.35
FORT WORTH	.8650%	1,297.50	1,038.00	692.00
HOUSTON	.6475%	971.25	777.00	432.27
SAN ANTONIO	.57854%	867.81	867.81 (NOT ALLOWED)	491.76

Sources: Travis Central Appraisal District, DCAD, Tarrant Appraisal District, Harris County Appraisal District, and Bexar Appraisal District

Prior Audits on Homestead Exemptions

In 1998, the City Auditor’s Office conducted an audit to validate homestead exemptions on the tax rolls. Several procedures were identified which could be improved to minimize the risk of lost revenue to the City from illegitimate exemptions. In 1999, we conducted a follow-up audit to evaluate whether previous recommendations were implemented. As part of our current audit, we reviewed the status of our previous recommendations. In addition, we inquired about recommendations made by Mike Dunson, CPA, on his Agreed Upon Procedures Report, dated July 18, 2003.

Commercial Property Database:

A value study of commercial appraisal methods was performed by the State of Texas Comptroller’s Office. The study determined that the appraisal methods used by DCAD were reasonable. We therefore restricted our work to a review of the commercial properties records. We focused on the records based on the cost method and reviewed a population of 19,028 records.

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

Objective, Scope and Methodology

Objectives

The project objectives were to determine whether:

- Homestead exemptions are granted in accordance with the Texas Property Code and are calculated correctly.
- The tax rates and exemption values for the City of Dallas are comparable to other major Texas cities.
- The commercial property records facilitate the calculation of the correct taxable values of the properties.
- All prior audit recommendations have been implemented.

Scope

The scope of this review included an understanding of the homestead exemptions granting process and commercial property records. This audit was conducted in accordance with generally accepted government auditing standards and included tests of the accounting and related records, inquiries, and other review procedures that we considered necessary in the circumstances. The review covered the period from January 1, 2002 through December 31, 2005. We also examined certain events and transactions occurring before and after this period.

Methodology

To achieve these objectives we:

- Tested the legitimacy of the different types of exemptions as established by the Texas Property Tax Code.
- Conducted independent search through water records, social security death master file, various appraisal districts, and other public records.
- Conducted interviews with DCAD representatives to assess the validity of procedures used to grant property tax exemptions.
- Reviewed four types of property exemptions: (1) General Residential Homestead (2) Over-65 Homestead (3) Disability Homestead (4) Disabled Veteran.

The specific criteria used consisted of the following:

- Texas Property Tax Code Section 11.13

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

Appendix II

Major Contributors to This Report

Paul T. Garner, Assistant City Auditor
Theresa Hampden, CPA, Audit Manager
James Martin, CPA, Audit Manager
Tony Sivasothy, CPA, Auditor
Cristian Aquino, Auditor

**Audit Report on Dallas Central Appraisal District
Homestead Exemptions and Commercial Property Records**

Appendix III

Table 4 – Estimated Property Tax Revenue Loss to the City of Dallas

Type of Exemption	City of Dallas Tax Rate (2005)	Average Dollar Value of Tax Exemption	Ratio of exceptions found to sample size	Population Size	Projected # of Questionable Exemption	Mid Range Projected Loss of Tax Revenue
General Residential Homestead	.7417%	\$271.40	0.03 (1/30)	182,661	6,089	\$557,481
Over-65 Homestead	.7417%	\$415.92	0.11 (3/28)	739 (See Note)	79	\$32,211
Estimated Loss in Property Tax Revenue						<u>\$589,692</u>

Note: The population for the Over-65 Homestead consisted of properties in which the property address differed from the owner address.

**Audit Report on Dallas Central Appraisal District
Homestead Exemptions and Commercial Property Records**

Appendix IV

Management's Response to the Draft Audit

**Dallas Central District Appraisal District
Response**

Pages 13 and 14

Office of Financial Services Response

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Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records



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CITY AUDITOR'S OFFICE

Dallas Central Appraisal District

February 14, 2007

Craig D. Kinton, CPA, City Auditor
City of Dallas
Office of the City Auditor
1500 Marilla, 2FN
Dallas, Texas 75201

RE: DCAD Exemption Audit

Dear Craig:

I appreciate the opportunity to meet with you and your staff concerning the results of the recently completed Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records Audit. Based on your findings your conclusions are as follows:

- With minor exceptions, the property tax exemptions are granted in accordance with the Texas Property Code (Code) and are calculated correctly.
- Tax rates and exemptions in the City of Dallas are comparable to other major Texas cities.
- Commercial property records facilitate the calculation of the correct taxable values for these properties.
- All previous audit recommendations have been implemented.

Based on those conclusions you made one recommendation as it concerns Dallas Central Appraisal District (DCAD). That recommendation was as follows:

- DCAD periodically sample exemptions to identify questionable exemptions and remove exemptions, which are not in accordance with the Code.

First let me address the minor exceptions that were noted in your conclusions. Based on your results an estimated revenue loss of \$589,692 is projected. Let me point out that your projection represents .1062% of the total levy of the City of Dallas for 2006 based on a taxable value of \$76,124,190,818 and an adopted tax rate of \$.7292/\$100. Although the estimate should not be treated lightly in the scheme of things, this literally represents a fraction of the property tax revenue collected by the City. I believe our efforts in the exemption area go above and beyond what is required by the Property Tax Code and far exceed the efforts put forth by all other appraisal districts.

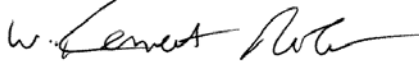
1Office of Executive Director/Chief Appraiser
2949 N. Stemmons Freeway • Dallas, Texas 75247-6195 • (214) 631-0520
Web Site: www.dallascad.org

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

We concur with your recommendation of periodically sampling our records to insure that we continue to have accurate exemptions and that the City of Dallas is not deprived of tax revenue. Since the last audit in 1996, DCAD has performed numerous reviews of our exemption records (A summary of those reviews has been shared with you and your staff) and will continue to do so as a part of our yearly work plan. We look forward to working with the City of Dallas Auditor's office and reviewing the procedures and resources that you used to conduct this audit. We hope that some of those procedures can be incorporated into our operation to help improve our efforts.

We greatly appreciate the time and effort spent by the City of Dallas audit staff and concur with their findings. We welcome their recommendations both in this report and in the future. Cooperation between our two organizations can only lead to a better appraisal roll for not only for the City of Dallas but for all the entities we serve.

Very truly yours,



W. Kenneth Nolan, CTA, RPA, RTA
Executive Director/Chief Appraiser

WKN/vgh

Audit Report on Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records

Memorandum

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CITY AUDITOR'S OFFICE



CITY OF DALLAS

DATE March 1, 2007

TO Craig Kinton, CPA, City Auditor
Office of the City Auditor

SUBJECT Audit of the Dallas Central Appraisal District Homestead Exemptions and
Commercial Property Records

The Office of Financial Services has reviewed the results of audit of the Dallas Central Appraisal District Homestead Exemptions and Commercial Property Records.

One finding was determined to be the responsibility of the Office of Financial Services. It reads as follows:

The Director of the Office of Financial Services (OFS):

1. Should request an opinion of the City Attorney to determine if the City is entitled to retain such payments.
2. Should establish a process to identify and track PILOT payments due to the City, if such payments are permissible.

Response: Agree

OFS has requested a written opinion of the City Attorney to determine if the City is entitled to retain such payments. The City Attorney has not responded as they are trying to get a copy of the contract to determine the relationship between the contracting entities and the City of Dallas. As soon as that determination is complete and if it is concluded such payments are permissible, OFS will establish a process to identify and track these PILOT payments.

If you have additional questions please contact me.



Maria Alicia Garcia, Director
Office of Financial Services

cc: David K. Cook, Chief Financial Officer
Thomas Perkins, City Attorney

"Dallas, The City That Works: Diverse, Vibrant and Progressive."