



## INTERNAL AUDIT

# Appraisal Records Audit

**Prepared by**

**Michelle Tressler, CIA  
City Auditor**

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Report 201701**

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## **Executive Summary**

The City Auditor has conducted an Appraisal Records audit. This audit was conducted under the authority of Resolution #2013-51 and in accordance with the Annual Audit Plan approved by the City Council in Resolution #2014-27. This audit primarily examined the parcels in the Galveston Central Appraisal District's (GCAD) database to determine if exemptions are still applicable and if appraisals seem reasonable.

GCAD is not run by the City, so we did not have authority to perform a complete audit. The purpose of this audit was to provide an educational opportunity as well as a high-level review of League City's land parcels in Galveston County. Property taxes are very important because they are a major revenue for the City, contributing over 40% to the Total Revenue. League City also has some land parcels located in Harris County, but those were deemed immaterial, since there are only estimated to be about 600 parcels in Harris County versus over 40,000 in Galveston County.

The details of the audit and the overall conclusion are discussed in this report.

## **Objective**

The objective of this audit according to the Annual Audit Plan was to determine if GCAD has all League City parcels in its database, determine if exemptions shown are still applicable, and determine on a sample basis if appraisals appear reasonable.

## **Background**

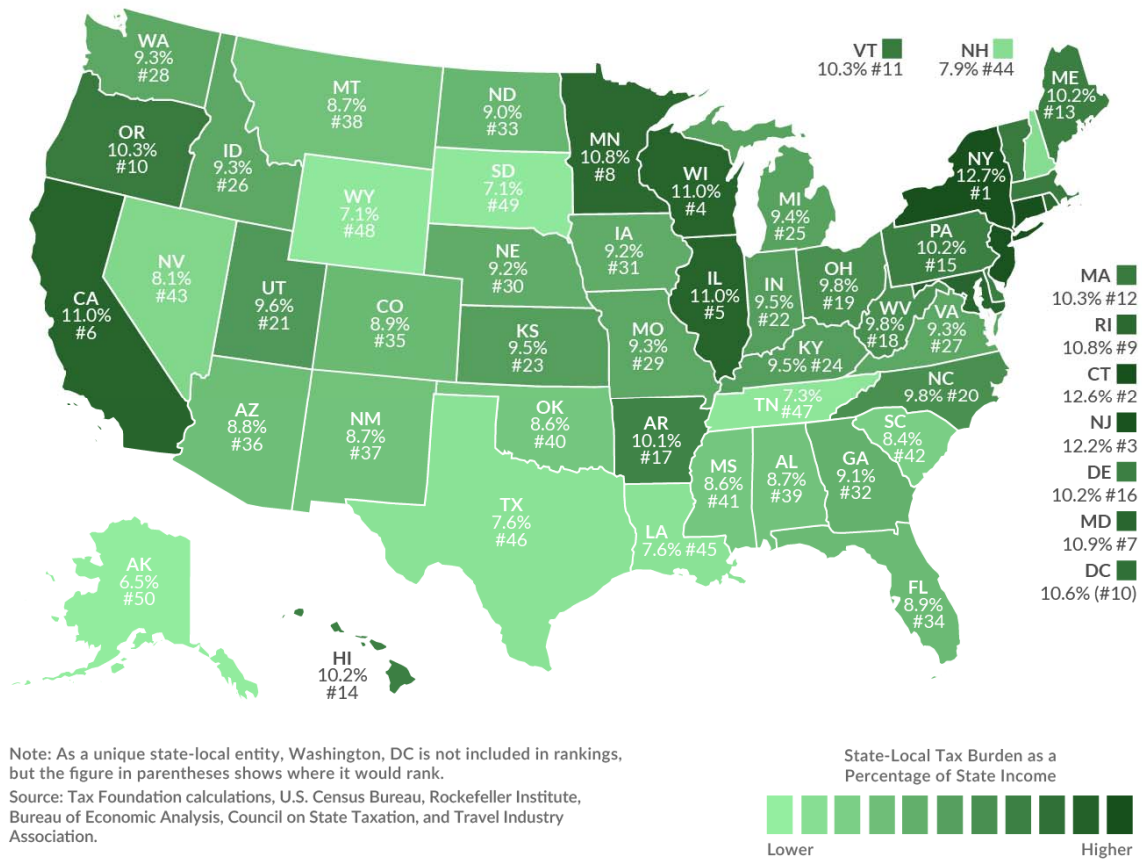
The appraisal districts were created in 1979 by the Texas Legislature. Prior to this, each tax agency in Texas could have its own tax office, if it desired. Accordingly, Texas had over 3000 separate tax offices, each following its own standards and local practices. This resulted in untrained and unqualified personnel administering local tax offices, inaccurate and inequitable values, and property owners had to visit multiple tax offices to resolve any disputes they had regarding a single property. In 1979, new legislation was passed in Senate Bill 621, which required that a centralized agency be established in each county to appraise property for tax purposes. These agencies, called "Central Appraisal Districts," were organized to ensure that property taxation was fair and equitable as well as accurate. It is also required that they are managed by a professional staff that has training and education prescribed by the State of Texas. A Tax Code was also written that outlined appraisal standards and appeal procedures and ensured regular review of each appraisal district by a state agency. Today, the agency that oversees the appraisal districts is the Comptroller.

There is a Board of Directors that represents the governments of Galveston County. The Board appoints the Chief Appraiser and sets the budget. The current Chief Appraiser for Galveston County is Tommy Watson. The Chief Appraiser carries out the appraisal district's legal duties, hires the staff, conducts the appraisals, and operates the appraisal office. The Appraisal Review Board (ARB) members are appointed by a district judge. The ARB is a separate body from the appraisal office; it hears and resolves disputes over appraisal matters. The ARB has no role in the day-to-day operations of the appraisal office or in appraising property. Only in resolving taxpayer protests can the ARB make changes or set a value on its own.

Property tax is the primary source of local government revenue in Texas and provides funding for the services provided by counties, cities, school districts, and a variety of special entities such as community colleges, port authorities, hospital and flood control districts, and municipal utility districts (MUD). While the total combined state and local tax burden in Texas is among the lowest in the nation (see Figure 1), the portion of the tax burden borne by property taxpayers in Texas is relatively high. Under Texas law, all real property and tangible personal property used to produce income is taxable at its January 1<sup>st</sup> market value unless exempt by law or unless subject to special appraisal provisions. Property taxes are local taxes; local officials value the property, set the tax rates, and collect the taxes. However, state law governs how the process works.

## State-Local Tax Burdens by State

State-Local Tax Burdens as a Percentage of State Income, FY 2012



TAX FOUNDATION

@TaxFoundation

Figure 1

The system has four stages: valuing the taxable property, protesting the values, adopting the tax rates, and collecting the taxes. January 1<sup>st</sup> marks the beginning of property appraisal. The appraised value of the property is as of January 1<sup>st</sup>. Notices of Appraised Values must go out to the property owners by May 1<sup>st</sup>. The ARB hears protests from property owners May through July. Once all the protests are completed the Chief Appraiser distributes an updated list of taxable properties known as the appraisal roll to all the taxing units. In September or October, the elected officials of each taxing unit adopt tax rates for their operations and debt payments. Typically, each property is taxed by several taxing units. For example, most property in League City is taxed by the City, Galveston County, Clear Creek Independent School District (CCISD), and any other special district such as MUDs. Tax collection starts in October and November as tax bills go out. Taxpayers have until January 31<sup>st</sup> of the following year to pay their taxes. On February 1<sup>st</sup>, penalty and interest charges begin accumulating on most unpaid tax bills.

Three factors determine the total amount of taxes imposed on a property.

1. Appraised value established by the appraisal district for the county
2. Exemptions
3. Tax rates set by the governing bodies of the taxing units where the property is located

There are several exemptions that are available to property owners. An exemption removes part of the value of your property from taxation and thus lowers your tax bill. The most common exemption is the Homestead Exemption. To qualify for a general homestead exemption the owner must own the home on January 1<sup>st</sup> and it must be his principal residence. This is typically verified by matching the address on the owner's driver's license (or other form of identification) to the property address. There is an Age 65 or Older or Disabled Person Exemption. Once a property owner turns 65 he is qualified to receive this additional exemption. If an owner is disabled, meeting the definition of disabled for the purpose of receiving disability insurance benefits, he is also eligible for this exemption. A person who qualifies as both age 65 or older and disabled does not qualify for both, but must choose which exemption to claim. There is a Disabled Veteran Exemption, which can be partial or total exemption. The amount of exemption is determined according to the percentage of service-connected disability. These exemptions only have to be applied for once and they'll stay with the property unless the property owner's qualifications change. At any time, the Chief Appraiser can ask for additional information or for submittal of a new application. If this request is ignored, then the exemptions could be removed.

The State governs how the appraisal process works and conducts reviews of the appraisal districts every year. The Comptroller's Property Tax Assistance Division (PTAD) performs either a Methods and Assistance Program (MAP) review to verify compliance with mandated operating procedures or a Property Value Study (PVS) to assess the uniformity and level of appraisals. The MAP reviews each appraisal district's governance, taxpayer assistance, operating procedures and appraisal standards, procedures and methodology. The most recent MAP review for GCAD was 2016. There are four mandatory requirements and all four were passed. There are also four appraisal activities that are rated based on a set of questions in each review area. GCAD received a 100 in three of the four categories and a 92 in taxpayer assistance. There was only one recommendation from this review and it was to include a copy of the application form for homestead exemption to those property owners that do not have the exemption, but have matching property and owner addresses. They have until January 2018 to complete the recommendation.

The primary purpose of the PVS is to help ensure equitable distribution of state funding for public education. The PVS estimates a school district's taxable property value and the results of this can affect a school district's state funding. The Commissioner of Education uses the PVS results to ensure equitable distribution of education funds so school districts have roughly the same number of dollars to spend per student, regardless of the school district's property wealth. In general terms, school districts with less taxable property value per student receive more

state dollars for each student than school districts with more value per student. The Comptroller's office tests the values the CAD assigns to each tested property category by constructing a statistical margin of error around the Comptroller's estimate of market value for the selected property categories in each school district. There is an allowable margin of error of 5 percent. Meaning that the CAD's taxable value must be between 95-105% of market value excluding any allowable exemptions and deductions. If the CAD's value falls within this range, then the Comptroller will consider the local value as valid and will certify it. If the CAD's value is outside this range, but greater than 85.5% of market value, then the Comptroller considers the local values invalid, but will certify them with a grace period up to 2 years. If the local values are below 85.5%, then it does not qualify for a grace period and the Comptroller assigns their values.

The last PVS done for Galveston County was in 2015. The PVSs are done by school district. The majority of League City is in CCISD. CCISD spans two counties – Galveston and Harris, so the PVS is further split by county. The property categories that were tested were Single-Family Residences, Rural Real, and Commercial Real. Generally, property categories are not tested if their value is 5% or less of the total value. The tested categories all had local values within the 5% margin of error of the Comptroller's estimate, so the local values were found to be valid and were certified. League City also has a few schools located in Dickinson ISD and those local values were also found to be valid and were certified. In 2015 there were 9 school districts – Dickinson, Galveston, High Island, La Marque, Texas City, Hitchcock, Santa Fe, Clear Creek, and Friendswood. All nine of the districts had their local values certified and all but one, Galveston ISD, had their local values validated. Galveston ISD was given a grace period and the preliminary results for 2016 show that their local values are within the range and are valid.

All properties must be re-assessed at least every 3 years. GCAD splits properties by ISD, so approximately 3 ISDs are done per year. A re-assessment involves a physical look at the property, so at the very least it requires a drive-by of the property. Depending on the physical appearance of the property, if any permits have been issued, and the general sales data for the neighborhood, a more thorough assessment may be completed. Physical assessments of property are also done outside the normal rotation for some of the reasons already stated, like permits being issued, as well as other reasons like new neighborhoods where many houses are incomplete and/or added after the January 1<sup>st</sup> cutoff. Appraisers should attempt to get permission before entering property, but unless expressly prohibited, they are allowed entry. Allowing the appraiser to enter the property should provide a more accurate assessment rather than an estimate. Sales data for all properties are reviewed and tracked the entire year using ratio analysis. Overall sales ratios are generated for each neighborhood to allow the appraisers to review general market trends within specific areas. This enables them to adjust property values according to the current market trend throughout the year.

The Galveston Central Appraisal District (GCAD) appraises property in all of Galveston County. They cover a land area of approximately 380 square miles and are responsible for 188,755 parcels of land with an appraised market value of \$35,088,690,986. League City covers 53 square miles (13.9%) and has 40,656 parcels of land (21.5%) with an appraised market value of \$9,132,346,898 (26.0%). All values are as of March 17, 2017. (see Figure 2)

#### How does League City compare to Galveston County?

	Galveston County	League City	Percentage
<b>Square Miles</b>	<b>380</b>	<b>53</b>	<b>13.9%</b>
<b>Total:</b>			
<b>Parcels</b>	<b>188,755</b>	<b>40,656</b>	<b>21.5%</b>
<b>Market Value</b>	<b>35,088,690,986</b>	<b>9,132,346,989</b>	<b>26.0%</b>
<b>Land Totals</b>			
Land - Homesite	3,996,949,373	1,230,354,199	30.8%
Land - Non Homesite	2,761,090,276	665,812,896	24.1%
Land - Ag Market	335,512,073	60,999,190	18.2%
Land - Exempt Ag/Timber	3,722,560	0	0.0%
Total Land Market Value	7,097,274,282	1,957,166,285	27.6%
<b>Improvement Totals</b>			
Improvements - Homesite	16,731,022,858	5,446,302,483	32.6%
Improvements - Non Homesite	8,441,463,435	1,209,182,538	14.3%
Total Improvements	25,172,486,293	6,655,485,021	26.4%
<b>Other Totals</b>			
Personal Property	2,779,753,073	519,685,206	18.7%
Minerals	39,177,338	10,386	0.0%
Total Other	2,818,930,411	519,695,592	18.4%
<b>Total Market Value</b>	<b>35,088,690,986</b>	<b>9,132,346,898</b>	<b>26.0%</b>
<b>Exemptions</b>			
Exempt Property	3,356,767,396	559,634,138	16.7%
	8,236	1,255	15.2%
Homestead Cap Adjustment	733,983,044	82,895,570	11.3%
	30,619	5,984	19.5%
Homestead	2,750,695,411	1,108,051,278	40.3%
	74,827	24,784	33.1%
Over 65	1,293,643,485	221,786,085	17.1%
	23,078	5,073	22.0%
Disabled Persons	168,267,047	22,166,813	13.2%
	3,260	537	16.5%
Disabled Vet	16,902,233	5,636,000	33.3%
	1,701	580	34.1%
Disabled Vet 100%	124,211,346	50,241,524	40.4%
	765	252	32.9%
Prorated Exempt Property	11,412,722	1,766,470	15.5%
	198	24	12.1%
Other	800,347,105	93,083,847	11.6%
	182	55	30.2%
Total Exemptions	9,256,229,789	2,145,261,725	23.2%
<b>Net Taxable</b>	<b>25,832,461,197</b>	<b>6,987,085,173</b>	<b>27.0%</b>

as of 3/7/17

Figure 2



## **Scope and Methodology**

The City Auditor reviewed the land parcels in League City located in Galveston County, a sample of exemptions, a sample of neighborhood appraisal values, and the accounting of the property tax revenue.

As part of the audit, the following was done:

- Reviewed the 2016 parcel data for each county
- Reviewed GCAD's and the Texas Comptroller's website and supplemental information regarding property taxes
- Interviewed Galveston County's Chief Appraiser
- Reviewed exempt property (total exemptions)
- Reviewed and sampled properties with partial exemptions
- Reviewed and sampled neighborhood appraisal values
- Reviewed the revenue collection for property taxes

Generally, League City is a growing market, residentially as well as commercially. Clear Creek ISD is a sought-after school district. While this provides many benefits to the citizens of League City, unfortunately, with it comes higher tax appraisals due to higher market values, which can lead to higher property tax assessments. GCAD is responsible for appraising almost 200,000 parcels of land and it continues to increase. Real estate is moving quickly and sales data and other cost and income information must be collected from various sources to prepare the appraisals. Overall, based on the reviews by the Comptroller and the limited review done by the Auditor, it appears that GCAD is acting prudently and in the best interest of the City of League City and its citizens within the confines of the law.

This audit was conducted in accordance with Generally Accepted Government Auditing Standards. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

The sampling methodology is discussed in Exhibit A and the reliability and integrity of information is discussed in Exhibit B.

The cooperation and assistance of the Galveston Central Appraisal District, especially Tommy Watson, are much appreciated.

## **Observations**

The audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Observations section presented in this report addresses the overall Objective of this audit.

### **1. Determine if GCAD has all League City parcels in its database.**

Annually, after the final tax roll is released, League City receives a file with all their land parcels that were included. The Geographical Information System (GIS) department reviews this list and annually provides GCAD with current address points for League City. These address points include the geographic coordinates of each postal address and this helps ensure that GCAD has captured all current League City addresses for property tax appraisals. The Building department provides a monthly report of issued permits as well as copies of floor plans with square footage when requested to GCAD. GCAD receives plat information from the County Clerk's office.

Property taxes make up 43% of the City's revenue (FY16), so it is imperative that we are cooperative and proactive, when possible, with GCAD to help ensure that the appraisals are accurate.

### **2. Determine if exemptions shown are still applicable.**

There are two types of exemptions – partial and total. A partial exemption removes a percentage or a fixed dollar amount of a property's value from taxation. A total exemption excludes the entire property from taxation.

There are over 200 properties (~\$560M) in League City that are classified as Residential Exempt, Multifamily Exempt, and Commercial Exempt, which are total exemptions. All appear to be legitimate, the majority of them are religious/charitable organizations, schools, or government (City, County, or State) owned.

Almost 16,000 out of approximately 40,000 land parcels (~40%) in League City have some type of exemption. The majority of these exemptions are Homestead, which is a partial exemption. In League City, this means that if your property is your primary residence that 20% of the property's value is exempt from City of League City taxation. Approximately half of all residential single family homes in League City have Homestead exemptions.

Statistical sampling was used to review all properties with exemptions. 95 properties were reviewed and through a variety of Internet searches 92 of the 95 property addresses could be matched to the property owners. Two of them could not be matched because the owner's names were confidential; according to Sec 25.025 of the Property Tax Code specific employment allows the property owner to

keep their name confidential in the database. The remaining property that could not be matched was sold within the last year and the new owner could not be tied to the address. There was also one property that the “over 65” age could not be verified. These two items have been forwarded to GCAD for them to pursue at their discretion. This provides a high-level assurance at 95% certainty that at least 88% of the exemption population is accurate. This testing did not account for any properties that might be owned outside of Galveston County or that might be in a spouse’s or other family member’s name. League City has approximately \$1.4B in exemptions, which is over \$8.0M in potentially lost property tax revenue. It’s important that these exemptions are being used honestly. GCAD recognizes this as well, so they are in the process of hiring an audit firm to specifically look at all of the Homestead exemptions. Due to the high number of single family residences and homestead exemptions, League City has a very high probability of return from this audit.

**3. Determine on a sample basis if appraisals appear reasonable.**

This test focused on residential properties. All properties are assigned a Neighborhood code. These neighborhoods are usually grouped by subdivision, but there can be multiple neighborhoods within a subdivision. These are determined based on the builders, size and types of houses offered, amenities, and land. For instance, many of the newer subdivisions have “waterfront” property, so those properties are assigned a different neighborhood code than the non-waterfront ones. There are almost 300 neighborhoods with residential property in League City.

The Neighborhoods were sorted by total value as of 2016 and the top 3 were reviewed. The top 3 were Harbour Park Sec 1 (3842), Brittany Lakes Sec 7 & 8 (1999), and Tuscan Lakes Sec SF 50-1 SE (7239). (See Appendix A) 50 properties were selected from each of the neighborhoods and data was calculated, plotted, and reviewed. GCAD values land and improvements separately, so for this test the same was done. The dollars per square foot of land were calculated as well as the dollars per square foot on the improvements. The improvement value was adjusted for any “extra” that the house might have, such as a swimming pool or porch that had a dollar value assigned to it, so that all houses were being compared consistently. Each of the neighborhoods was reviewed as a separate entity.

Generally speaking, the land and improvement values are inversely proportional; smaller houses will have a greater \$/sq ft value than larger houses. This is mainly due to economies of scale. A smaller home still has the same basic functionality of a larger home. The land values follow a very distinct trend line, but there is a bit more variation in the improvements/homes. Some variation is to be expected in the homes due to differing levels of upkeep and upgrades, but homes grouped together in the same neighborhood should be in the same range. A 5% margin of error was used.

## Results

**Harbour Park:** When all the land samples were plotted together, there was no real trendline or strong correlation between them. By splitting them into two sections, the trendlines became much more obvious. There is a group of houses on Kingston Cove that sit separately from the rest of Harbour Park Section 1. They're physically separated and the houses are newer. The houses on Kingston Cove were built around 2003; whereas the houses in the rest of Harbour Park section 1 were built around 1990, so the Kingston Cove houses are on average 13 years newer. This indicates that there might be a need to divide this neighborhood.

The improvements in this neighborhood are a bit unique as well. In most cases, the trendline should have a downward slope, but this one is straight. Even when splitting the houses into two groups as was done with the land, there were still no strong correlations, so all samples were left together. There were 8 high outliers, with 6 of the 8 being houses on Kingston Cove. There were 5 low outliers. This is not a true statistical sample, but 26% of the sample was outside the 5% margin of error. This neighborhood appears to need a more detailed review. All 5 of the low outliers had an increase of at least 12% in their 2017 value. (See Appendix B)

**Brittany Lakes:** All land samples fall almost directly on the trendline. There appears to be an upper limit on the \$/sq ft of land of \$3.95, so that skews the data just slightly.

As expected, there is a downward slope in the trendline for the improvement values. All but two fall within a margin of error of 5%, which is only a 4% error rate. Both low outliers had an increase of at least 19% in their 2017 value. (See Appendix C)

**Tuscan Lakes:** Once again, to have a good correlation in the land, the sample had to be split into two. This section of Tuscan Lakes is on the south side of League City Parkway (FM 96), across from the main entrance to Tuscan Lakes. Louisiana Ave further divides this section. The houses on the west side of Louisiana are newer, built in 2015; whereas the houses on the east side were built around 2009. The newer houses have a higher appraised value on the land. Once the split was made, the plots were almost all right on the trendline. Once again, this is an indication that the neighborhood may need to be divided.

The improvements pretty much followed the trendline with only five low outliers, which is a 10% error rate. All five of the low outliers had an increase of at least 12% in their 2017 value. (See Appendix D)

These results have been shared with GCAD and it is at their discretion how to pursue.

#### **4. Revenue Collection**

Daily, League City receives a deposit from Galveston County Tax. Once notification is received from the bank that the deposit has posted, then the charges are entered into Tyler Cashiering. Once all amounts are entered and verified, a batch is created. The batch is then posted into Tyler Munis where it becomes a journal entry in the General Ledger. All receipts are also entered and tracked in a spreadsheet. The daily amounts were verified for the first 6 months of FY17, October – March. All amounts matched the spreadsheet, the bank details, the Galveston County report, and the GL.

The payments are split into several categories, two of which are Maintenance & Operations (M&O) and Interest & Sinking (I&S). The M&O payments go to the General fund and the I&S payments go to the Debt Service fund. There were a few instances in the beginning of the year where a payment was mistakenly coded to the wrong account, which put it in the incorrect fund. These have been verified and are in the process of being corrected.

#### **5. GCAD Challenges**

As stated earlier, League City is a growing community, with many businesses opening and homes being built and sold. We are in a sellers' market, meaning that real estate often sells quickly and at a premium. GCAD is required to appraise taxable property at 100% market value. They are allowed a slight margin of error of 5%. In a fast-paced market this can sometimes be hard to pinpoint and predict. While many sales data points are available, there are two issues, in particular, that can make this problematic.

**A. Texas is a non-disclosure state.**

A non-disclosure state considers the sale value of property to be private and confidential. Property information and ownership transfers with loan amounts are typically available, but this means that a calculation must be applied to arrive at an estimate of the sales price. GCAD does not have access to the Multiple Listing Service (MLS) that has the sales price information. Since they cannot access all of the sales data in one place this means that they must collect it from a variety of sources. They must visit with cities, builders and developers, and realtors, as well as use their own calculations.

**B. Timing of Comptroller's Review**

GCAD is required to value the property as of January 1<sup>st</sup>. When the PTAD does their review, they review sales data from June of the previous year through June of the current year. This means that the State is including sales for 6 months after the GCAD issues their appraisal value. This puts GCAD in a position where they must make estimates for the future.

GCAD welcomes questions, comments, and concerns from the public and they offer a contact form on their website. This should be used for contact other than property value disputes or value requests.

Contact Form: [http://www.galvestoncad.org/index.php/Contact\\_Form](http://www.galvestoncad.org/index.php/Contact_Form)

Property Search: <http://propaccess.trueautomation.com/clientdb/?cid=81>

## **EXHIBIT A**

### **Sampling Methodology**

Information from the GCAD database was used for all the property testing.

1. 100% sampling was used for the total exempt property.
2. Random sampling was used for the partial exempt property.
3. Judgment sampling was used for the neighborhood reviews.

One month of daily property tax revenue was used as well as 6 months of monthly data, which was provided by Finance and was checked against the reports sent from Galveston County, the deposit report from the bank, and the recorded amounts in the GL.

## **EXHIBIT B**

### **Reliability and Integrity of Information**

There were no findings in this audit, but all observations were based off inquiry, observation, League City's financial system, and information in the GCAD database. The auditor relied on computer-processed data from GCAD during the audit. It is the auditor's belief that there can be reliance on their information system.

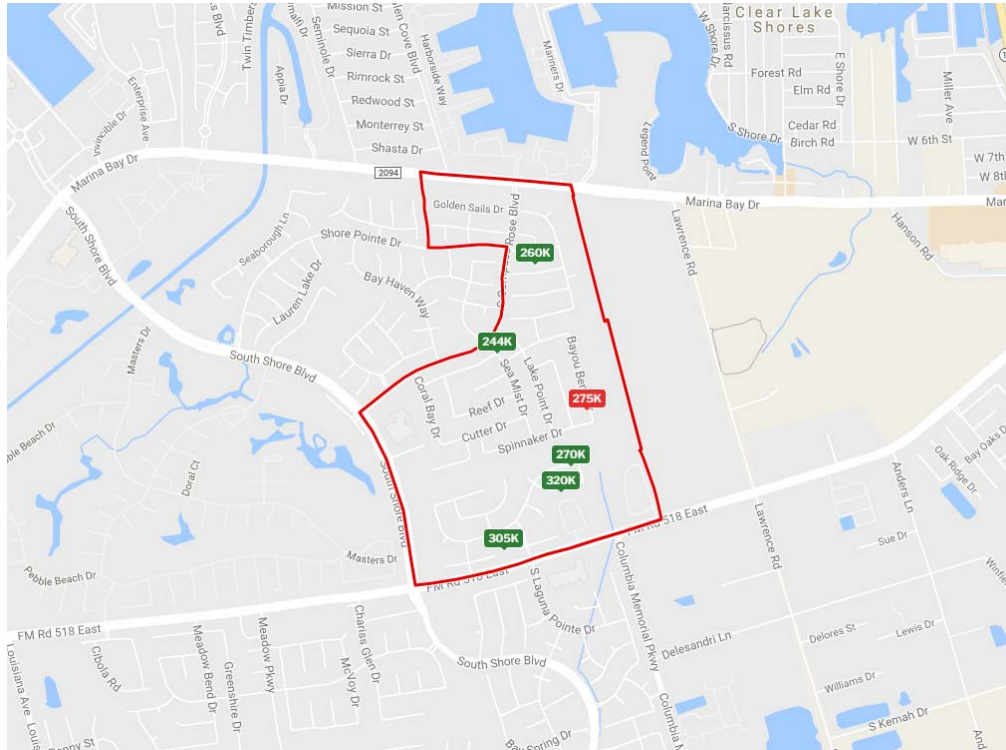
## **Works Consulted**

1. Galveston Central Appraisal District, <http://www.galvestoncad.org/>
2. Texas Comptroller, <https://comptroller.texas.gov/taxes/property-tax/>
3. Cameron Appraisal District, <http://www.cameroncad.org/aboutus.html>
4. Texas Gulf Coast Online, Texas Property Taxes in a Nutshell, <http://www.texasgulfcoastonline.com/News/tabid/86/ctl/ArticleView/mid/466/articleId/104/Texas-Property-Taxes-in-a-Nutshell.aspx>
5. Tax Foundation, State-Local Tax Burden Rankings FY2012, <https://taxfoundation.org/publications/state-local-tax-burden-rankings/>

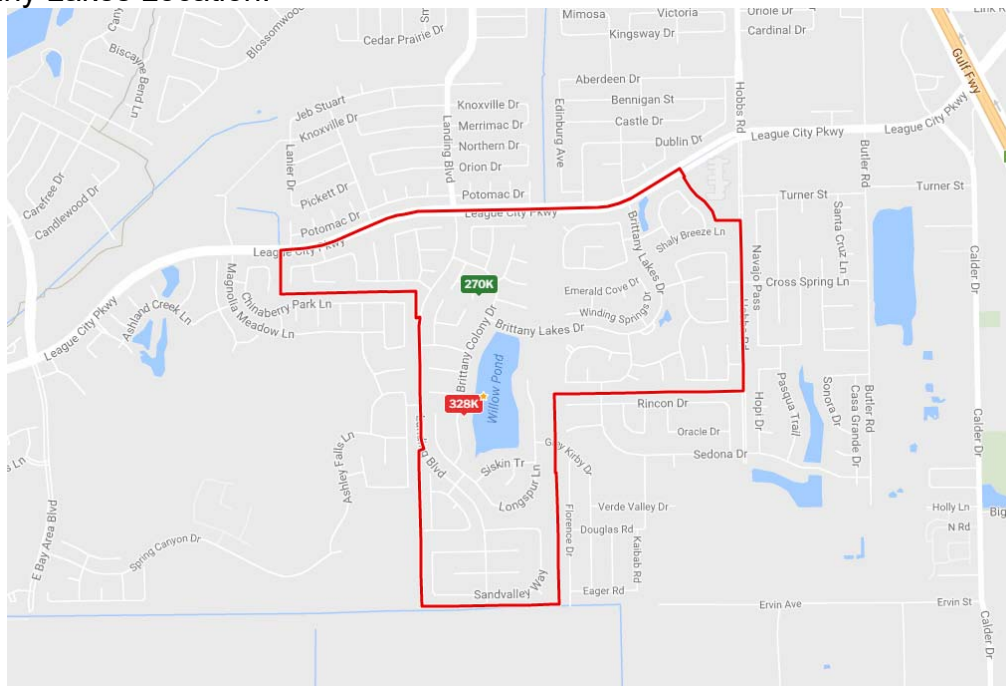


## APPENDIX A

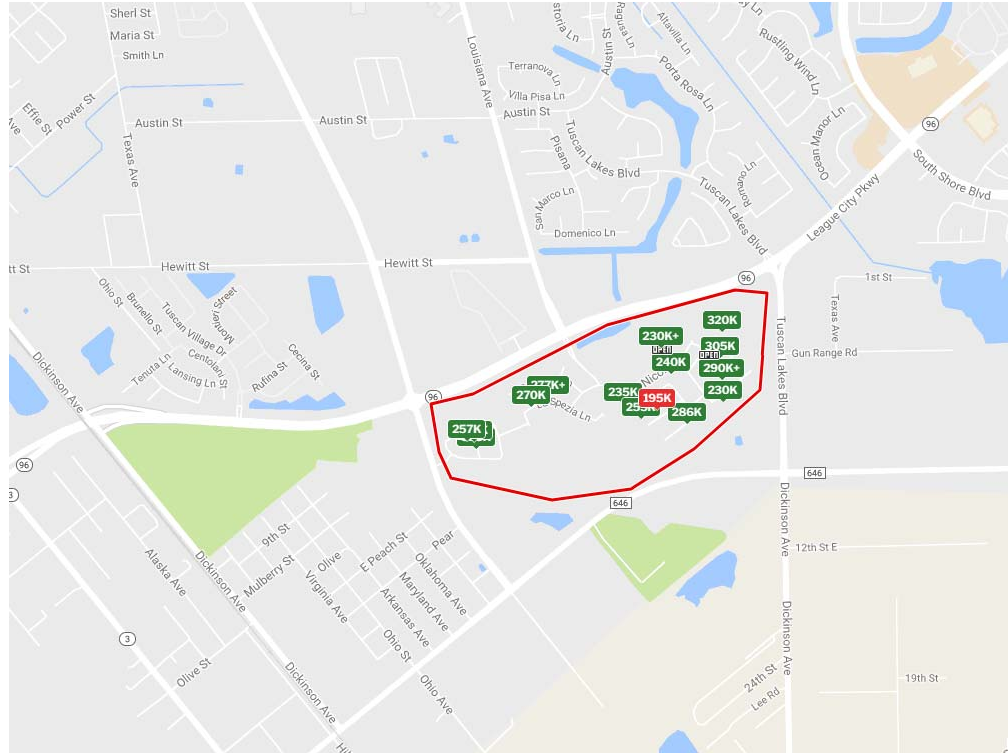
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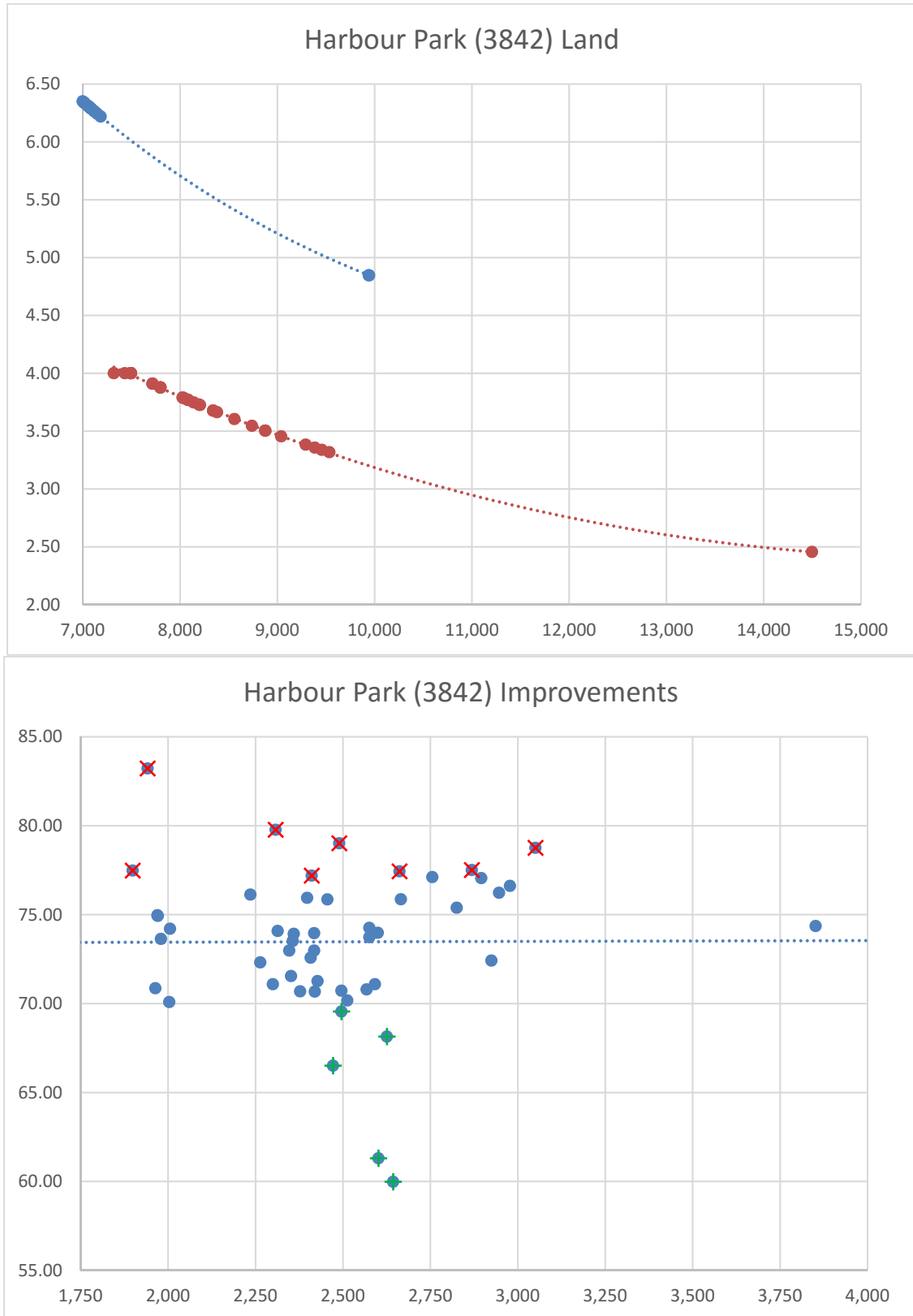
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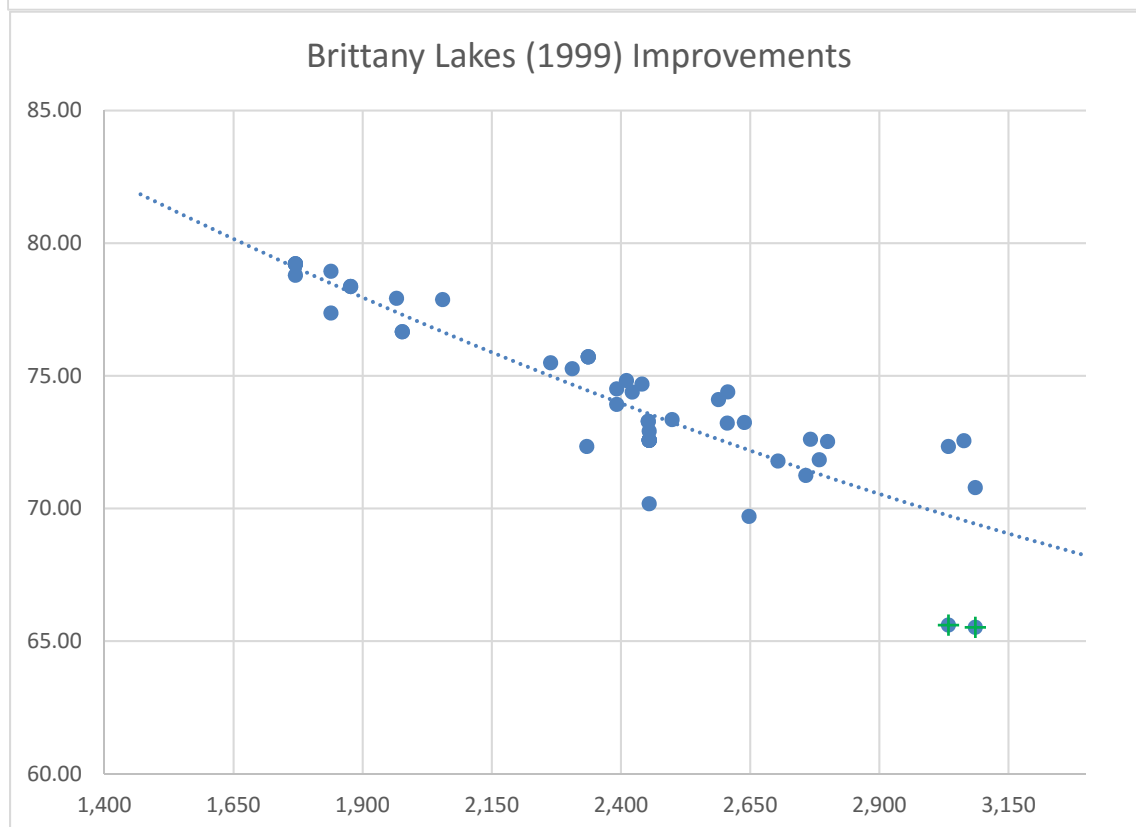
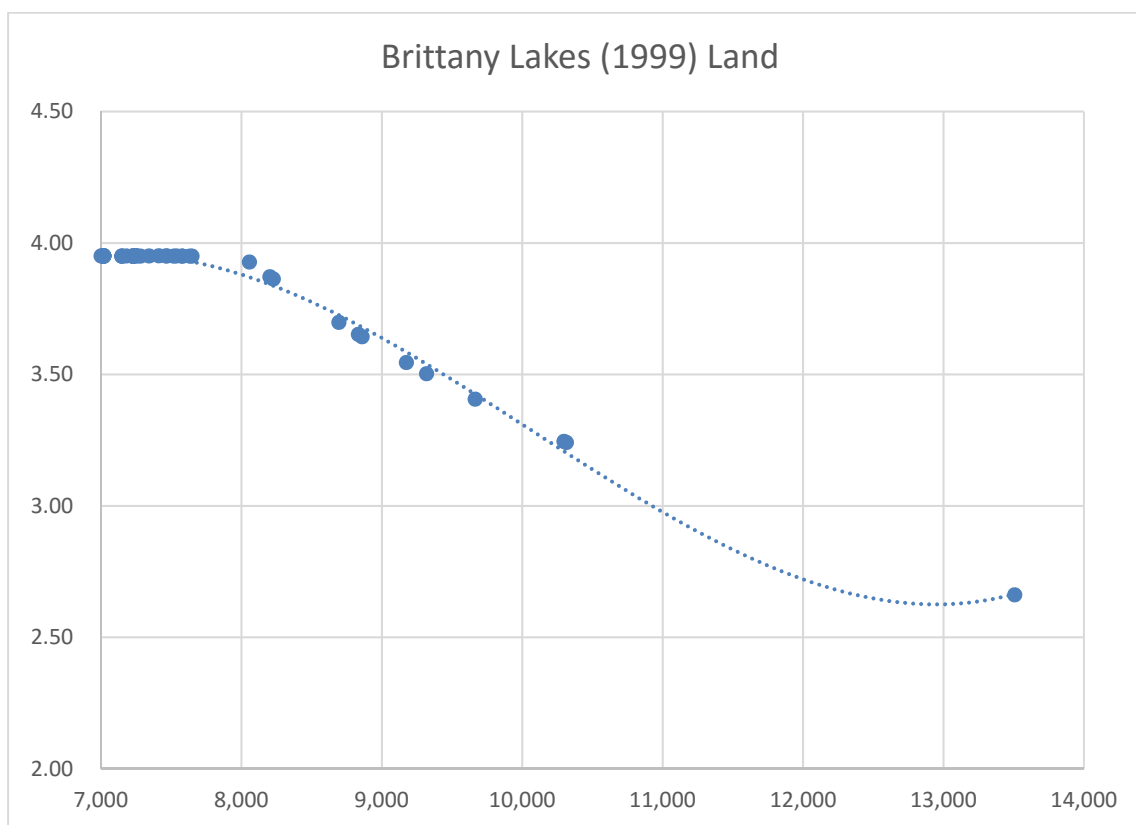
## Tuscan Lakes Location:



## APPENDIX B



## APPENDIX C



## APPENDIX D

