

INTERNAL AUDIT REPORT

2019-01

Real Property Exemptions

Property Appraisal Division

Finance Department

January 17, 2019

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Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

January 17, 2019

Honorable Mayor and Members of the Assembly:

I am pleased to present for your review **Internal Audit Report 2019-01, Real Property Exemptions, Property Appraisal Division, Finance Department**. A brief summary of the report is presented below.

In accordance with the 2018 Audit Plan, we have completed an audit of Real Property Exemptions. The objective of this audit was to determine if real property tax exemptions were properly administered. To accomplish our objective, we reviewed files for documentation to support the exemptions and tested selected exemptions for compliance with statutory requirements. Our audit did not include the Military Service Widow/Widower exemptions, since this exemption was recently implemented. Our audit concentrated on the following exemptions: Veterans Organizations, Community Purpose, Deteriorated Properties, Charter Schools, Residential, Senior Citizen/Disabled Veteran, and Nonprofit (religious, charitable, cemetery, hospital, and educational).

Overall, the Property Appraisal Division appears to have improved its administration of exemptions since our last audit in 2012. However, we found that further improvements can still be made. Specifically, some properties registered with the Municipality of Anchorage as "Vacation Rentals" may have incorrectly received senior citizen, disabled veteran and/or residential property tax exemptions because they had been rented or leased while the owner was absent. In addition, the Property Appraisal Division did not perform annual reviews of all exemptions as required by Anchorage Municipal Code section 12.05.045, *Assessor*. Moreover, nonprofit exemption files did not always contain sufficient documentation to support the decision to grant an exemption. Finally, some of the real property tax exemption application forms could be improved to help determine exemption eligibility and Municipal Policy and Procedure 24-18, *Processing Late Filed Applications for the Senior Citizen/Disabled Veterans Property Tax Exemption Program*, needs to be updated.

There were five findings in connection with this audit. Management was responsive to the findings and recommendations.

Michael Chadwick, CIA, CICA
Director, Internal Audit



Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

January 17, 2019

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Introduction. The Property Appraisal Division (Division), led by the Municipal Assessor, is charged with locating, identifying, and valuing all taxable real and personal property within the Municipality of Anchorage (Municipality) to provide a fair and equitable basis for taxation. The Division maintains descriptions and maps of real property detailing ownership, usage, valuation, and tax districts within the Municipality, and processes, approves, and maintains records of real property tax exemptions. According to the Computer Assisted Mass Appraisal (CAMA) database records maintained by the Division, as of September 2018, there were 99,935 parcels within the Municipality of which 5,056 were exempt and 47,693 were partially exempt. Real Property tax exemptions are granted based on three elements: (1) verification of ownership, (2) property usage, and (3) statutory requirements. Alaska State Law includes a range of mandatory exemptions (Alaska Statute 29.45.030, *Required exemptions*) and optional exemptions (Alaska Statute 29.45.050, *Optional exemptions and exclusions*). According to the CAMA database records, the following exemptions were in effect as of September 2018:

Senior Citizen or Disabled Veteran Exemptions: Alaska residents 65 years of age or older, disabled veterans and the widow or widower of a disabled veteran, or a resident at least 60 years old who is the widow or widower of a person who qualified for a senior exemption are exempt from taxation on the first \$150,000 of the assessed value of the real property (application required. 16,419 parcels partially exempt – these properties also automatically qualify for the Residential exemption below).

Residential Exemptions: Residential property may be exempted from taxation, if approved by the voters at an election. Anchorage Municipal Code (AMC) allows a 20 percent exemption of the assessed

property value, up to a maximum of \$50,000, for any one residence (application required. 47,693 parcels partially exempt).

Religious, Charitable, Cemetery, Hospital, and Educational Exemptions: Property used exclusively for nonprofit religious, charitable, cemetery, hospital, or educational purposes (application required. 993 parcels exempt).

Native Exemptions: Real property interests conveyed to a Native individual, Native Group, Village or Regional Corporation which are not developed or leased to third parties or which are used solely for the purposes of exploration are exempt from state and local real property taxes by United States Code, Title 43 (no application required. 456 parcels exempt).

Veterans Organizations Exemptions: Property of a nonbusiness organization composed entirely of persons with 90 days or more of active service in the armed forces of the United States whose conditions of service and separation were other than dishonorable, or the property of an auxiliary of that organization (application required. 18 parcels exempt).

Community Purpose Exemptions: The property of an entity not organized for business or profit-making purposes and used exclusively for community purposes (application required. 25 parcels exempt).

Deteriorated Properties Exemptions: Real commercial property not used for residential purposes or that is multi-unit residential property with at least eight residential units and that meets one of the three conditions specified in AMC section 12.35.005. (application required. 9 parcels exempt).

Charter School Exemptions: Privately-owned real property used as a charter school established under the requirements of Alaska Statute 14.03.250, *Establishment of Charter Schools*, for schools under contract with the Anchorage School District (application required. 8 parcels exempt).

Other Exemptions: Various exemptions based on United States Code and Alaska Statute including municipal, state, and federal properties, Rights of Way, Farm, Common Interest (Condo and Homeowner Associations), Utilities, and Regional Housing Authority properties (no application required, except for Farm. 3,547 parcels exempt).

Objective and Scope. The objective of this audit was to determine if real property tax exemptions were properly administered. Our audit included reviewing files for documentation to support the exemptions and testing selected exemptions for compliance with statutory requirements. Our audit did not include the Military Service Widow/Widower exemptions, since this exemption was recently implemented. Our audit concentrated on the following exemptions:

- Veterans Organizations
- Charter Schools
- Nonprofit (religious, charitable, cemetery, hospital, and educational)
- Community Purpose
- Residential
- Deteriorated Properties
- Senior Citizen/Disabled Veteran

We conducted this performance audit in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was performed during the period of August through October 2018.

Overall Evaluation. Overall, the Division appears to have improved its administration of exemptions since our last audit in 2012. However, we found that further improvements can still be made. Specifically, some properties registered with the Municipality as “Vacation Rentals” may have incorrectly received senior citizen, disabled veteran and/or residential property tax exemptions because they had been rented or leased while the owner was absent. In addition, the Division did not perform annual reviews of all exemptions as required by AMC section 12.05.045, *Assessor*. Moreover, nonprofit exemption files did not always contain sufficient documentation to support the decision to

grant an exemption. Finally, some of the real property tax exemption application forms could be improved to help determine exemption eligibility and Municipal Policy and Procedure (P&P) 24-18, *Processing Late Filed Applications for the Senior Citizen/Disabled Veterans Property Tax Exemption Program*, needs to be updated.

FINDINGS AND RECOMMENDATIONS

1. Some “Vacation Rentals” May Have Incorrectly Received Exemptions.

- a. **Finding.** Some properties registered with the Municipality as “Vacation Rentals” may have incorrectly received senior citizen, disabled veteran and/or residential property tax exemptions because they had been rented or leased while the owner was absent. Specifically, our review of 158 properties registered with the Municipal Treasurer as vacation rentals found 40 properties (25%) that received residential property tax exemptions. Nine of these 40 properties also received the senior citizen exemption and 2 of these 40 properties received the disabled veteran exemption. Upon further review, we found 11 of these 40 properties listed on travel websites where the entire property was advertised as a vacation rental, while the property received the exemption(s). For example, one property in Girdwood was advertised as renting a 4,300-square-foot custom log home with a lodge-like atmosphere. Another Girdwood property was advertised as a one-bedroom cozy log cabin in the forest near Alyeska. Finally, an Anchorage property was advertised as a four-bedroom home that could accommodate 8-12 guests.

To receive the residential, senior citizen, and disabled veteran exemptions, AMC subsection 12.15.015B states that the property must be the primary residence and permanent place of abode for at least 185 days a year, and when absent, the dwelling is not leased or rented to another. According to Treasury Division management, properties registered with the Municipality as vacation rentals are rented or leased as an entire unit

while the owner is absent. "Unit" can be self-contained in either a segregated portion of the home, a separate unit on the property, or the entire home. In our above examples, we found that the entire home was available for rent, suggesting that the owner was absent and was not living on the property. However, if an owner is living on the premises, but is renting a separate segregated area as a unit, they are not considered absent.

- b. **Recommendation.** The Municipal Assessor should coordinate with the Municipal Treasurer to use data from the List of Registered Room Tax Operators to ensure that the senior citizen, disabled veteran, and residential exemptions are not applied to ineligible properties.
- c. **Management Comments.** Management stated, "We concur with the findings. We are in the process of submitting a request for legal services to help us make the determination if spatial apportionment is applicable to the residential exemption. If spatial apportionment is applicable to the residential exemption, it would be a deviation from our current practice. This would require IT to alter the residential calculation in the Computer Assisted Mass Appraisal (CAMA) system and would require Property Appraisal to contact all vacation rental properties."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Exemptions Not Reviewed Annually.**

- a. **Finding.** The Division did not perform annual reviews of all exemptions as required by AMC section 12.05.045. For example, our testing of selected nonprofit exemptions indicated that annual reviews were not performed on over 50 percent of these exempted properties. Although the Division reviews properties with ownership changes, it does

not annually review exemptions without ownership changes to determine eligibility. In addition, during the course of this audit, Division staff acknowledged on several occasions that annual or periodic reviews were not performed. Anchorage Municipal Code subsection 12.05.045B states that “The assessor shall review annually those properties that are exempt from taxation to determine whether such properties continue to qualify for an exemption.” The annual review of exemptions ensures that properties are correctly assessed and validates the ownership and usage of the properties. It should be noted, however, that AMC states that all exemptions should be reviewed annually, but some mandatory exemptions were not reviewed since the Division had no option but to grant the exemption. This similar condition was reported in prior Internal Audit Reports 2006-14 and 2012-10.

We recognize the difficulties in performing an annual review for certain types of exemptions. Currently, a review and verification of all residential, senior, and disabled veteran exemption application files is in progress. This review began about eighteen months ago. According to Division management, this effort requires a significant commitment of time and resources and it is impossible to annually review all exemptions with current resources. For example, according to Division management there are about 50 boxes of exemptions left to review. Each box has about 2,400 active and expired exemption applications. Therefore, there are approximately 120,000 active and expired exemption applications that still need to be reviewed. According to Division management, it takes about 1-2 weeks to review one box of exemption applications.

- b. **Recommendation.** The Municipal Assessor should ensure that Division staff annually review all exemptions to determine if these properties continue to qualify for the exemption as required by AMC subsection 12.05.045B or revise the AMC to eliminate or modify the requirement.

- c. **Management Comments.** Management stated, “We concur with the findings. We have limited staff to review all exemptions on an annual basis. Currently, there are approximately 67,000 total exemptions. To comply with this municipal requirement, it would require approximately two to three additional staff dedicated solely to the annual exemption review. Our preference would be to revise AMC 12.05.045B to review non-government owned exemptions on a six year cycle. Government owned property is exempt by default; therefore, review would only be necessary when there is a change of ownership.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Nonprofit Exemption Files Contain Insufficient Documentation.**

- a. **Finding.** Nonprofit exemption files did not always contain sufficient documentation to support the decision to grant an exemption. Specifically, 14 of 133 (11%) exemptions reviewed had one or more of the required documents missing from their files. For example, 8 of 25 community purpose exemption files did not include financial statements and/or articles of incorporation. In addition, 2 of 12 religious housing exemptions did not include either a copy of articles of incorporation or required documentation indicating that the current resident was an ordained official. Finally, 2 of 18 veterans organization exemptions contained no required documentation other than proof of affiliation with a nationally-recognized veterans organization. According to Division staff, some of these documents were missing because the exemptions were granted many years ago and the supporting documents were not required at that time. Although letters requesting supporting documents were sent to these organizations, no responses were received. Similar conditions were reported in prior Internal Audits 2006-14 and 2012-10.

- b. **Recommendation.** The Municipal Assessor should ensure that all files are complete and support the decision to grant the nonprofit exemption.
- c. **Management Comments.** Management stated, “We concur with this statement. Some exemption files, particularly older files, do not contain complete documentation. The missing documents will be requested during exemption review. Our preference would be to revise AMC 12.05.045B to review nonprofit exemptions on a six year cycle.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Application Forms Could Be Improved.**

- a. **Finding.** Some of the real property tax exemption application forms could be improved to help determine exemption eligibility. Better information could help Division staff when making decisions regarding exemption eligibility. For example:
 - *Residential Property Tax Exemption Application form* – This form did not capture information about the rental of the property to establish the applicant’s “primary residence and permanent place of abode” as defined in AMC subsection 12.15.015B. Specifically, to receive the exemption, a person must reside at their primary residence and permanent place of abode “. . . at least 185 days in the year prior to the exemption year and when absent, the dwelling is not leased or rented to another.”
 - *Senior Citizen, Disabled Veteran Exemption Application and Military Service Widow and Widower Exemption Application forms* – These forms did not capture sufficient information about the rental of the property to determine and establish the applicant’s “primary residence and permanent place of abode” as defined in AMC

subsection 12.15.015B. Although the form asked for the percentage of the property used for a commercial or rental purpose, it was unclear if the property was rented out while the owner was absent. Specifically, to receive the exemption, a person must reside at their primary residence and permanent place of abode “. . . at least 185 days in the year prior to the exemption year and when absent, the dwelling is not leased or rented to another.” Additionally, the disabled veteran exemption application form did not provide information requiring the individual to notify the assessor of any change in disability status within 30 days of a change as required by AMC subsection 12.15.015D.2.g.iv.

- *Nonprofit Property Tax Exemption form* – This form did not provide information requiring the individual to notify the assessor of any change in property ownership within 30 days as required by AMC subsection 12.15.015D.3.d.1.

- b. **Recommendation.** The Municipal Assessor should review and revise the real property tax exemption application forms as necessary to ensure that sufficient information is captured to help determine exemption eligibility.
- c. **Management Comments.** Management stated, “We concur with this statement. We are reviewing the applications, and some changes have already occurred. We have addressed the concerns regarding property being rented or leased while the owner is absent.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. Policy and Procedure 24-18 Needs Updating.

- a. **Finding.** Policy and Procedure 24-18 needs to be updated. It was last updated on June 9, 1992, and does not reflect changes that have been made to AMC section 12.15.015. Specifically, P&P 24-18 “. . . allows the Mayor to act on behalf of the governing body in determining good cause of waiver for a late filing” and references AMC subsection 12.15.015C. However, AMC section 12.15.015 makes no reference to the Mayor.
- b. **Recommendation.** The Municipal Assessor should ensure that P&P 24-18 is updated to conform to AMC section 12.15.015.
- c. **Management Comments.** Management stated, “We concur with this statement. We are currently revising P&P 24-18.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on October 31 and December 5, 2018.

Audit Staff:
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