A Report
to the
Montana
Legislature

Performance Audit

Appraising New Construction to Reduce Property Tax Inequity

Department of Revenue

November 2024

Legislative Audit
Division

23P-05

Performance Audits

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

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. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee, which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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LEGISLATIVE AUDIT DIVISION

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November 2024

The Legislative Audit Committee
of the Montana State Legislature:

We are pleased to present our performance audit of new construction identification and addition to tax rolls by the Property Assessment Division within the Department of Revenue.

This report provides the Legislature information about the department's processes for identifying new construction and the impact of unidentified new construction on property taxes. This report includes recommendations for improving identification and capture of new construction by the Property Assessment Division. A written response from the Department of Revenue is included at the end of the report.

We wish to express our appreciation to the director and the department's staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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Appointed and Administrative Officials

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	Paula Gilbert, Administrator, Property Assessment Division
	Robin Rude, Deputy Administrator, Property Assessment Division
	Bryce Kaatz, Bureau Chief: Program Support Unit, CAMA Unit, and Industrial Unit

Montana Legislative Audit Division

Performance Audit

Appraising New Construction to Reduce Property Tax Inequity

Department of Revenue

A report to the Montana Legislature

Background

The Property Assessment Division of the Department of Revenue is responsible for appraising all property across Montana. As part of this work, staff are responsible for identifying new construction through changes to properties. Capturing this new construction ensures that local governments receive the correct revenue to keep up with development and ensures that property tax liability is equitably distributed across property owners. This division does not receive any revenue from property taxes but is responsible for identifying and consistently capturing new construction across Montana.

Program: Property Assessment Division

Program FTE FY 2023: 285.92 in 30 offices across the state

Program Revenue FY 2023: $350 million from Education Equalization Mills; $23.3 million from University Mills

Program Expenses FY 2023: $24.9 million

The Department of Revenue (DOR) appraises all property in Montana, yet an estimated 14 percent of new construction value—about $300 million—goes unidentified each year. This gap reduces tax revenue and creates inequities among property owners. By formalizing permit processes, using high-quality aerial imagery, prioritizing long-unvisited properties, and improving staff retention, the department can capture more new construction value and ensure fairer taxation.

KEY FINDINGS:

The legislature should require that DOR receive copies of permits that identify new construction and DOR should formalize collaboration with state permitting agencies. The department primarily identifies new construction through various permits associated with new construction, both statewide permitting from the Department of Labor and Industry (DLI) and from local governments that issue permits. Permit requirements are inconsistent across the state, with inconsistent location information and with some local governments reluctant to provide permit information to DOR. The legislature should amend statute to require local governments to provide copies of permits to DOR field offices. Additionally, the department should formalize collaboration with DLI to automatically provide permits and determine useful permit information for identifying new construction.

High-quality aerial imagery can help identify rural new construction and reduce wasted on-site inspections. Besides permit review, aerial imagery is emerging as a best practice in other states to identify new construction, especially in rural areas. DOR has run small trials of these types of imagery and found them beneficial. The Montana State Library has also spearheaded efforts to collaboratively combine and obtain high-quality aerial imagery from across the state to benefit government agencies. DOR should obtain high-quality or oblique aerial imagery, independently or through collaboration with the state library, to efficiently identify and appraise rural new construction.

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For the full report or more information, contact the Legislative Audit Division.

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DOR staff have not inspected about 36 percent of residential and commercial properties in more than six years. Department management does not prioritize reappraisal reviews, including reviews of properties that have not been visited in many years. Instead, department appraisers focus on other priorities depending on the time of year, such as customer service, which often leaves little time for reappraisal reviews. As a result, over a third of properties have not been inspected in more than six years, and about 15 percent have not been inspected in more than 10 years, contributing to unidentified new construction. The department should include information on properties that have not been inspected in more than six years during appraiser planning so they can capture these properties during other work.

Increasing staff retention would improve new construction inspection efficiency. The Department of Revenue has struggled with retaining staff and maintaining the resources to complete an increasing workload. Management has focused on trying to recover the FTE that it lost in previous legislative sessions and has not recently analyzed or focused on retention. Best practices indicate that an organization should establish a retention plan based on benchmarking and a needs assessment. Increasing retention through such a plan increases staff efficiency and identifies staffing needs for workload.

RECOMMENDATIONS:

In this report, we issued the following recommendations:
To the department: 4
To the legislature: 1

Recommendation #1 (page 16):
State Compliance
We recommend the Montana Legislature amend statute to require local entities that issue permits to send a copy of the permit to the relevant DOR field office, including a clear and consistently defined location for the property.

Recommendation #2 (page 18):
Cost Avoidance, Reduction, and Elimination
We recommend that the Department of Revenue formalize collaboration with the Department of Labor and Industry regarding statewide permitting.

Department response: **Conditionally Concur**

Recommendation #3 (page 22):
Cost Avoidance, Reduction, and Elimination
We recommend that the Department of Revenue obtain high-quality or oblique aerial imagery independently or as part of a collaborative effort with other agencies facilitated by the Montana State Library.

Department response: Conditionally Concur

Recommendation #4 (page 27):
Cost Avoidance, Reduction, and Elimination
We recommend that the Department of Revenue include properties that have not had on-site inspections in six or more years as part of appraiser field preparation and develop a GIS interface to identify all appraiser work in an area.

Department response: Conditionally Concur

Recommendation #5 (page 30):
Governance, Risk Assessment, and Planning
We recommend that the Department of Revenue establish and implement a retention plan that identifies performance metrics by tenure and includes strategic objectives to increase staff retention at field offices.

Department response: Partially Concur

Chapter I – Introduction and Background

Introduction

Property taxes impact all Montana residents through housing costs or local services funded by tax revenue. The Property Assessment Division (PAD) of the Department of Revenue is responsible for appraising all property in the state. PAD has about 287 staff, including about 160 appraisers. Montana is one of only two states that conducts all property appraisals through a state department. A key role of PAD is to ensure new construction is promptly added to the tax rolls. Delays in appraising new construction reduce tax revenue and create property tax inequity. This performance audit, prioritized by the Legislative Audit Committee in 2022, examines PAD's timeliness and consistency in adding residential and commercial new construction to the tax rolls.

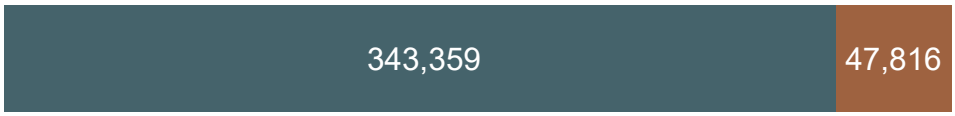
DOR Appraises Properties As of January 1, Including New Construction

The PAD is responsible for appraising all property across the state to assess property taxes. Appraisal is where DOR assigns fair market value to properties, and assessment is where DOR determines the taxable value for property taxes. The statute specifies that DOR appraises properties at 100 percent of their market value as of January 1. Market value is the value at which a willing buyer and willing seller would transfer the property under no compulsion and with no discounts. The statute also directs the department to create a reappraisal plan that revalues residential and commercial property every two years. This does not mean that the department updates properties only every two years. Rather, the value of property features is updated every two years, while property features are updated as of January 1 each year. Property features change when the owner builds a new structure or physically changes the structure in some way, which the department defines as new construction. Demolishing buildings or changing property features to reduce property value is also considered new "construction," but we will refer to it as destruction throughout the report. Through statute and the department's reappraisal plan, new construction in any year should be captured as of January 1 of the following year.

Residential and Commercial Property Taxes Affect Many Montana Residents

We identified 475,000 active properties in 2023 classified as residential or commercial. Of these properties, a little under 400,000 (more than 80 percent) had value attributed to buildings. Across Montana in 2023, residential and commercial building value totaled about $150 billion in market value. According to DOR's most recent biennial report, about two-thirds of property taxes paid in tax year 2021 and 2022 were residential and commercial property taxes.

Figure 1
Residential and Commercial Property Counts



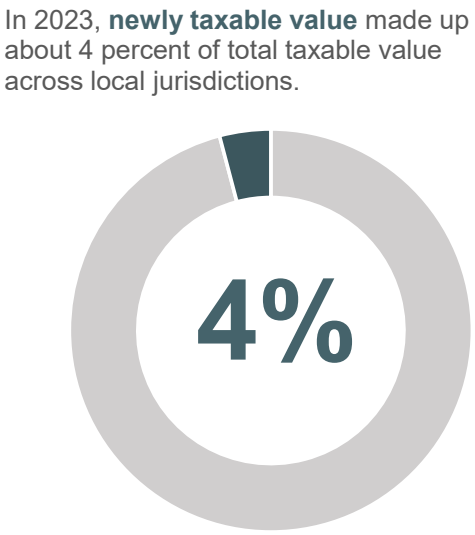
Source: Compiled by the Legislative Audit Division.

Property taxes are important for local jurisdiction revenue. According to a property tax study presented to the Legislature's Revenue Interim Committee in 2022, property taxes make up about 97 percent of local government funding in Montana. Local taxing jurisdictions set their authorized budget according to the previous year's taxable value in their jurisdiction. New construction identified since the previous year is called newly taxable value, and the local jurisdiction is able to assess property taxes on newly taxable value beyond its budget as a way to keep up with development in the area. In 2023, the newly taxable value comprised about 4 percent of the total taxable value across all local jurisdictions.

Owners Not Incentivized To Report New Construction

If a property owner willfully conceals or misrepresents their property to evade taxation, then DOR may tax that property up to 10 times its value. However, owners are not responsible for notifying DOR if they have updated their property features and are not required to review their reappraisal notice for accuracy. It is the department's duty to classify and appraise all properties. If owners have reduced their property value, they are incentivized to notify the department to reduce their property taxes. Alternatively, suppose an owner adds value to their property through construction. In that case, the owner has no monetary incentive to notify the department and may instead wait for the department to identify the construction. If department processes do not identify the construction by the next reappraisal notice, then the owner will pay less tax than they should.

Figure 2
Newly Taxable Value in Local Jurisdictions



Source: Compiled by the Legislative Audit Division from interim committee records.

Additionally, even though property appraisers are statutorily allowed access to private property for appraisal, some property owners will lock their gates or deny appraisers access. In these instances, the department may try to appraise the house from a distance, but this can also result in lower property taxes if department staff cannot identify all property features. In 2023, about 9,000 properties out of 350,000 (2.5 percent) with over $50,000 in building value had been listed as inaccessible at some point in their appraisal history.

Department Primarily Identifies New Construction Through Permits

Primarily, DOR identifies new construction through permits, including building permits, electrical permits, and septic permits. The department also finds new construction through direct observation as the appraisers travel their areas and through some small aerial imagery projects. Though permits are the primary method of identifying new construction, these permits exist to ensure that structures are built up to code. Identifying new construction is only a benefit of various permits, but this is not their intended purpose. Additionally, permitting coverage and standards are inconsistent across Montana. In many parts of the state, remodeling or small additions to a property do not require a permit, and rural areas often do not require building permits for single-family residences.

Appraisers are department staff that visit new construction and determine its features. Property valuation specialists (PVS) at field offices generally search or obtain permits each month and then attach the permits to properties. Then, managers and/or appraisers can run a report that identifies these properties so appraisers can inspect any new construction. When choosing properties to review, appraisers prioritize permits that add additional value to a property, such as a new building, extensive remodels, or additions. Appraisers will not visit permits that do not add market value, such as adding a light switch or updating a water heater.

Department Staff Perform a Variety of Tasks

Identifying new construction through permits is only one part of the field office staff's workload and competes for priority with other work, depending on the time of year. The department has approximately 250 field office positions, of which about 160 are appraiser positions. These positions are divided among 30 field offices across the state. Field office staff perform work in a variety of areas:

- **Customer service:** Property owners will call or walk into field offices to talk with staff. The department prioritizes customer interaction, aiming to be the most "citizen-oriented, efficiently administered, state tax agency."
- **Appeals:** Property owners can appeal their property values within 30 days of the reappraisal notice. Appraisers then reexamine the property within a reasonable time frame but typically schedule this in the summer or fall. If owners are still unsatisfied, they can appeal to the county tax appeal board and then to the Montana Tax Appeal Board.
- **Sales Verifications:** Appraisers perform sales verifications to confirm the features of the property sold as well as determine if the transaction can be included in value modeling. For instance, a sale between family members would likely be below market value and not included. Appraisers can identify new construction at a sales verification if other processes missed it.
- **Property Transfers and Splits:** PVS staff process realty transfer certificates to update ownership information of properties and will process property splits to assign new geocodes to parcels.
- **Reappraisal Reviews:** Reappraisal reviews are where appraisers inspect a property to ensure that features are accurate, including properties that have not been inspected in a while. Reappraisal reviews are important for identifying nonpermitted new construction.

Audit Scope

This performance audit focused on residential and commercial properties between 2018-2023. We examined the department's new construction processes and where these processes fit within other staff workload. We did not examine the general appraisal process for properties, including the calculations for property value based on type, features, and location. Nor did we review the values resulting from appraisals and reappraisals. Instead, we examined the timeliness and consistency of processes that add new value to the property tax rolls. We also examined DOR's processes to identify new construction from permit information, but did not examine DLI's oversight and administration of permit information.

Audit Objective and Methodologies

We developed one objective to assess how the department evaluates new construction:

- Does the Department of Revenue identify and assess new construction on residential and commercial property consistently and in a timely manner?

We conducted the following methodologies to answer this objective:

- Reviewed statute and rule definitions regarding new construction.
- Reviewed department policies and goals related to new construction.
- Interviewed other states, including Maryland, Washington, Oregon, Colorado, and Wyoming.
- Interviewed select counties in other states including King (Wash.), Denver (Colo.), Laramie (Wyo.), Weld (Colo.), Marion (Ore.), and Marrow (Ore.).
- Identified and reviewed best practices and industry standards.
- Interviewed program staff and management, including field office staff and management.
- Surveyed department field staff across Montana.
- Surveyed local jurisdiction (city and county) staff about new construction in their taxing jurisdiction.
- Interviewed private entities who identify new construction or deal with new construction information.
- Observed field staff processes.
- Determined the timeliness and value of new construction identified from permits.
- Estimated the value of nonpermitted new construction by projecting the frequency and value of construction discovered at sales.
- Examined department's allocation of current resources.
- Performed a cost-benefit analysis for potential methods to capture new construction.

Issues for Further Study

We identified two areas that may warrant future study: DLI permitting and DOR appraisal validity. Our audit work found that certified local government permitting across the state had inconsistent forms, information, and availability. These three factors created difficulties for DOR when attaching a permit to a property. In addition, the statewide building permit has many exemptions—for example, a residential building with fewer than five dwelling units does not require a state-issued building permit. DLI emphasized that they would struggle if they were responsible for administering and inspecting all permits or if statewide permitting had fewer exemptions. A future audit could examine the consistency and availability of permits as well as the effectiveness of statewide permitting with its current exemptions.

While we excluded the general appraisal process from our scope, we observed that grade, condition, desirability, and utility were subject to appraiser judgment and inconsistently verified across field offices. These metrics affect the property value and can dramatically increase or decrease property taxes. DOR currently validates its appraisal methods through sales ratio studies, examining how close property sales were to appraisal values. The department is currently working on ways for appraisers to compare properties with the same grade across the state. A performance audit could examine the appraisal process, like a previous audit from 2010, but focus on consistency and validation processes for property appraisal.

Chapter II - New Construction Effects on Property Taxes

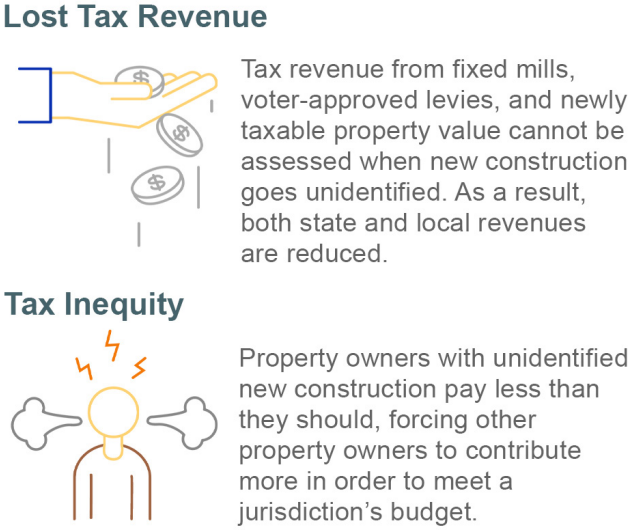
Introduction

New construction is important to ensuring property taxes are accurately calculated and equitably distributed. We estimated that the department does not capture about 14 percent of residential new construction value each year, which is about $300 million in market value. We also estimated that, at any given time in our audit time frame, there was about $1.2 billion in unidentified new construction market value across Montana. To understand the significance of this unidentified new construction, it is important to understand how property taxes are assessed and how new construction affects both property tax revenue and equity.

Property Taxes Assessed Through Fixed and Floating Mills

Residential and commercial properties have a taxable value equal to a flat percentage of the property's market value, as defined in statute. Residential property taxable value is 1.35 percent of market value, while commercial property taxable value is 1.89 percent of market value. Taxing jurisdictions assess property taxes from taxable value in the form of mills, where one mill is worth one-thousandth of a property's taxable value. For example, a residential property valued at $500,000 has a taxable value of $6,750 (1.35 percent of market value). One mill of property tax (0.001 of taxable value) would generate $6.75 from this property. Taxing jurisdictions like counties, cities, and school districts assess property taxes annually, with payments due in November and May. Mills are typically calculated in two main ways:

Figure 3
Effects of Unidentified New Construction



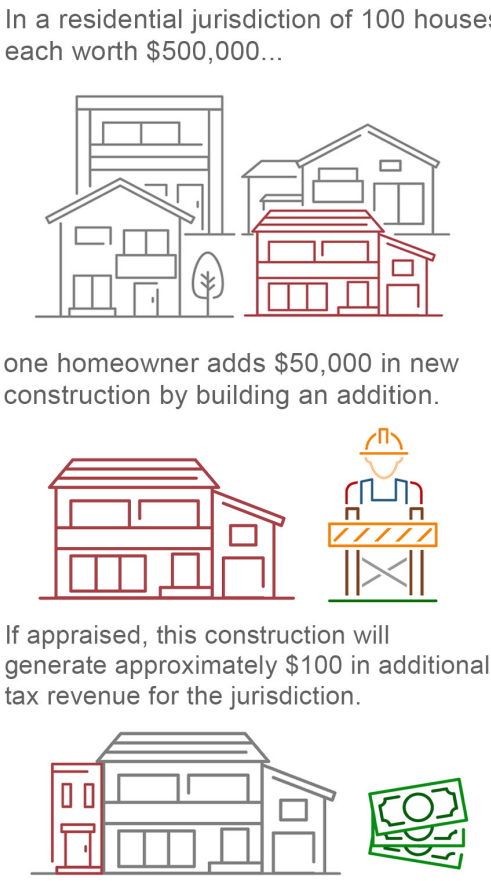
Source: Compiled by the Legislative Audit Division.

- **Fixed Mills:** Fixed mills are directly assessed from taxable value and do not depend on other properties in the taxing jurisdiction. For instance, in Montana statute, six mills of a property's taxable value go to public universities. Fixed mills are usually established in statute or voted as a levy for a taxing jurisdiction.
- **Floating Mills:** Local taxing jurisdictions, such as counties, cities, towns, and school districts, have an authorized budget that increases each year by half the average rate of inflation of the previous three years. Jurisdictions set mills to reach budget from their total taxable value. Property taxes from floating mills depend on other properties in the taxing jurisdiction since all properties in the jurisdiction pay their share to reach the budget.

New Construction Effects Explained Through Example

Unidentified new construction has two effects: lost revenue and tax inequity. Lost revenue occurs from fixed mills, while tax inequity occurs from only floating mills. Local jurisdictions, such as counties, cities, and towns, also rely on newly taxable value from construction and remodeling to keep up with development. As statute outlines, these jurisdictions calculate floating mills to reach their budget without including newly taxable value, then receive additional revenue when these mills are applied to newly taxable value. To better understand the effects of unidentified new construction, consider a hypothetical residential taxing jurisdiction with 100 houses, each appraised at $500,000. The jurisdiction has a budget of $100,000. Each property has a taxable value of $6,750 for a total taxable value of $675,000 in the jurisdiction. To reach its budget, the jurisdiction needs to assess 14.8 percent of this value, so it will set its mills to 148. Therefore, each property pays $1,000 in property taxes for the jurisdiction. Suppose that one property (Property X) adds an addition worth $50,000. If this new construction is not identified, property taxes from both fixed and floating mills will be impacted.

Figure 4
New Construction Example



Source: Compiled by the Legislative Audit Division.

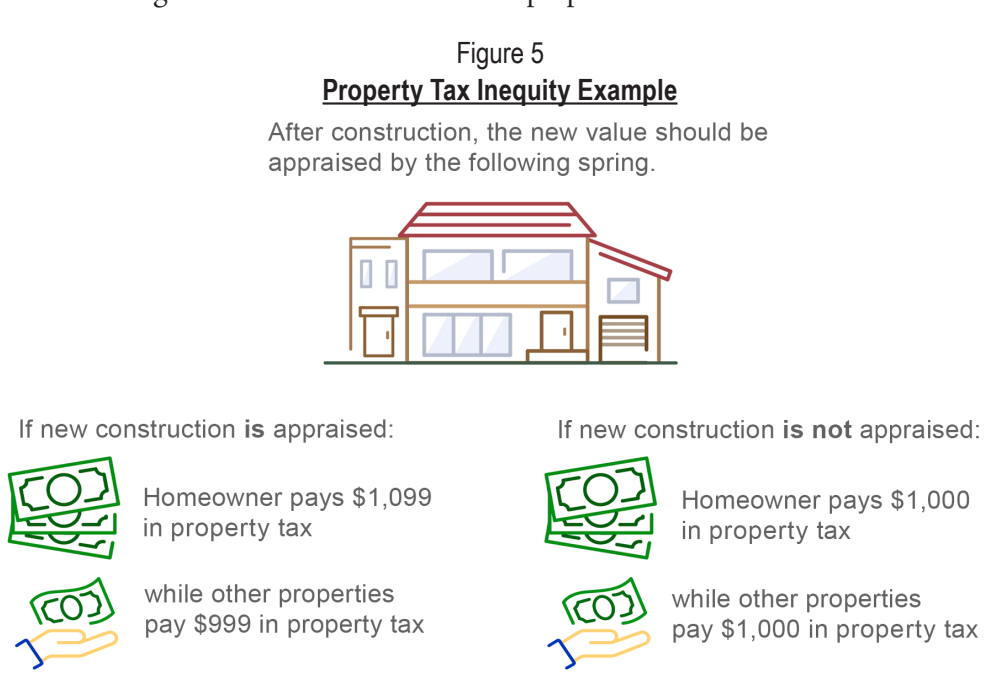
Unidentified New Construction Reduces Property Tax Revenue

If the new construction in our example is missed in a given year, fixed mills will not assess a flat percentage of the missed taxable value. Additionally, when new construction is not identified, taxing jurisdictions cannot apply their calculated mills to the new taxable value. Taxing jurisdictions set their budget according to their previous total taxable value, not including newly taxable value. Then, taxing jurisdictions receive a one-time benefit of applying their calculated mills to newly taxable value from new construction as a way to keep up with development. In our example above, the $50,000 in new construction is worth $4.05 to state universities and about $64 for education equalization. Additionally, the taxing jurisdiction will miss out on an extra $100 in property tax revenue for that year if the construction is considered newly taxable value. Though similar, our definition and valuation of new construction does not necessarily align with the statutory definition of newly taxable value.

Unidentified New Construction Inequitably Distributes Property Taxes

If the new construction in our example is not identified, then the property with the new construction will pay less property taxes than it should, and other properties in the jurisdiction will cover the difference. We define tax inequity as the difference between what properties with new construction should pay versus what they pay without new construction. In our example, Property X should pay $1,099 in property taxes, and all other properties in the jurisdiction should pay $999. IIf the new construction is not identified, then all properties pay $1,000, and there is a tax inequity of $99 or the difference that Property X should pay, but now all other properties are covered to meet the jurisdiction's budget. It's important to note that this is a small example for clarity, and new construction, along with its effects, are much larger in scale across all Montana properties.

Figure 5
Property Tax Inequity Example



Source: Compiled by the Legislative Audit Division.

Unidentified Destruction Results in Overcharging and Tax Inequity

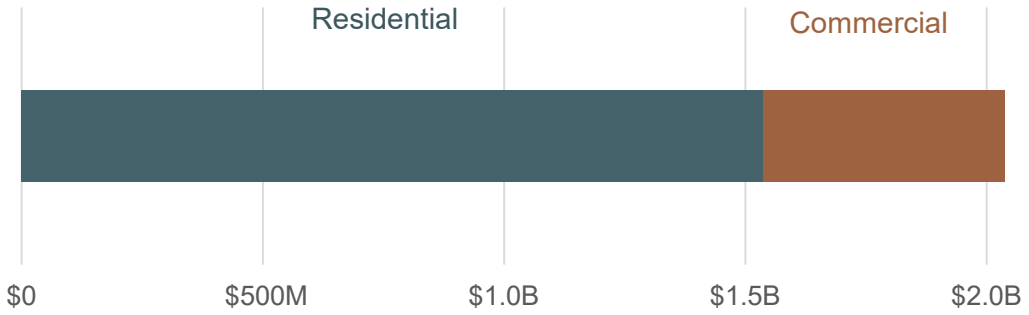
We found that the value of destruction identified by the department is only about 5 percent of the value of new construction. While our report will focus on identifying new construction, there are similar but opposite effects if the department does not identify destruction. If destruction is not identified, then the property owner will be over-charged and will pay higher taxes than they should in their jurisdiction relative to other properties. In the example above, suppose Property X reduced its property value by $50,000, and DOR did not identify the destruction. Property X would pay $99 more than it should, and the other 99 properties would pay $1 less than they should.

DOR Identified Around $1.5 Billion Annually in Residential New Construction Market Value

Through its current permit processes, we estimate the department identified about $1.5 billion on average annually in residential new construction market value across our six-year audit time frame. We also found that residential new construction value increased over our time frame, with less than $1 billion in residential new construction value identified in 2018 growing to over $2.4 billion in residential new construction value identified in 2023. We also estimate that the department identifies about $500 million in commercial new construction market value each year. Our analysis focused on residential new construction, given that it makes up the majority of new construction value and given the complex nature of commercial valuation. DOR management also believed that they could more often capture commercial new construction.

Figure 6
Identified New Construction

DOR captured about $2 billion in new construction market value each year, $1.5 billion from **residential** and about $500 million from **commercial.**



Source: Compiled by the Legislative Audit Division.

We Projected New Construction Discovered at Sales Verifications To Estimate Unidentified New Construction

On average, we found the department identified about $300 million each year in residential new construction from sales verifications in addition to the value discovered from new construction processes. We then calculated the proportion of sales where new construction was discovered as well as the average market value of this new construction. We projected this proportion and average amount to properties that had not been visited in at least three years, generating an estimate of unidentified new construction. Throughout this analysis, we consulted with the department for considerations and feedback on this approach to estimate unidentified new construction. Further information regarding this analysis can be found in the Appendix.

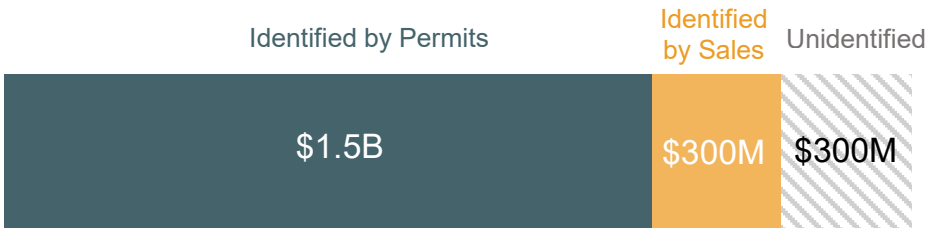
We Estimate DOR Missed About 14% of Residential New Construction Market Value Annually

From our analysis, we estimated the department missed an average of $300 million in new construction market value each year in our time frame. At any given point in time during our time frame, we estimate there was a total of about $1.2 billion in residential new construction that was not identified. It's important to note that $1.2 billion represents only about 1 percent of total residential building value ($114 billion) in 2023. $1.2 billion in residential market value also represents about $16.2 million in taxable value. Overall, we estimate the department captures about $1.5 billion in residential new construction value through its new construction processes, captures about $300 million through sales verifications, and misses about $300 million a year. In other words, we estimate the department captures 72 percent of residential new construction through permits, captures 14 percent through sales verifications, and misses about 14 percent each year.

Figure 7

New Construction Value Identified

DOR captures about 86% of residential new construction value annually through **permits** and **sale verifications**, but an estimated 14% goes unrecorded each year.

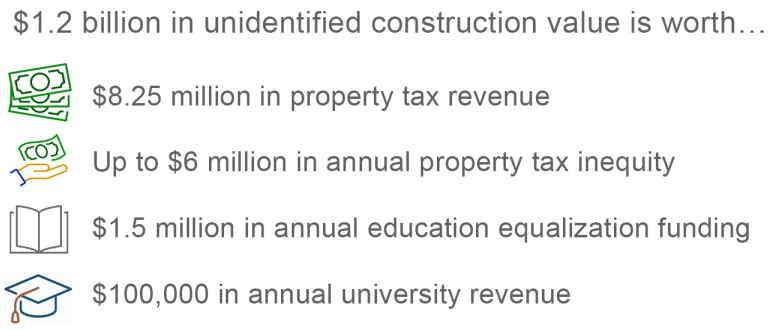


Source: Compiled by the Legislative Audit Division from property database analysis.

Unidentified Residential New Construction Accounts for $8.25 Million in Potential Tax Revenue and up to $6 Million in Annual Tax Inequity

Unidentified residential new construction has various effects on property tax income at both the local and state levels, as well as tax inequity. Using the department's biennial report, we found that properties paid an average of 575 mills, or 57.5 percent of their taxable value, in 2022 and 2023. Additionally, about 77.5 percent of property taxes went to counties, cities/towns, and school districts. Using conservative values for these parameters, we then estimate that this unidentified residential new construction accounts for about $8.25 million in potential tax revenue, including $100,000 in annual revenue to state universities and $1.5 million in annual funding for education equalization. In addition, this residential new construction represents a maximum of $6 million in ongoing tax inequity for property owners. For context, Montanans paid approximately $1 billion in residential property taxes in 2022.

Figure 8
Financial Effects of Unidentified New Construction



Source: Compiled by the Legislative Audit Division.

Addressing Unidentified New Construction

As discussed above, unidentified new construction represents a significant gap in maintaining equitable property tax valuation in the state. The following chapters of this report contain our findings regarding department processes and resources for appraising new construction. We make recommendations that address permit processes, aerial imagery, appraiser route determination, and staff retention. It's important to understand the extent of unidentified new construction and how it affects property taxes as a basis for these findings. Our recommendations aim to reduce the unidentified new construction value discussed above and ensure equitable property taxes.

Chapter III - Identifying New Construction

Introduction

The Department of Revenue (DOR) identifies new construction through state and local permits, small aerial imagery projects, and appraisers' field observations. Permits are the primary vehicle for discovering new construction in Montana and are most useful for identifying urban new construction, especially when local jurisdictions issue their own permits. However, statewide permitting has numerous exemptions and is often only applied to new buildings that require electrical work, especially in rural areas. As an alternative to permits, high-quality or oblique aerial imagery is emerging as a best practice among taxing authorities to identify new construction. These kinds of aerial imagery are particularly effective for spotting rural construction in areas without permit requirements or where appraisers infrequently visit.

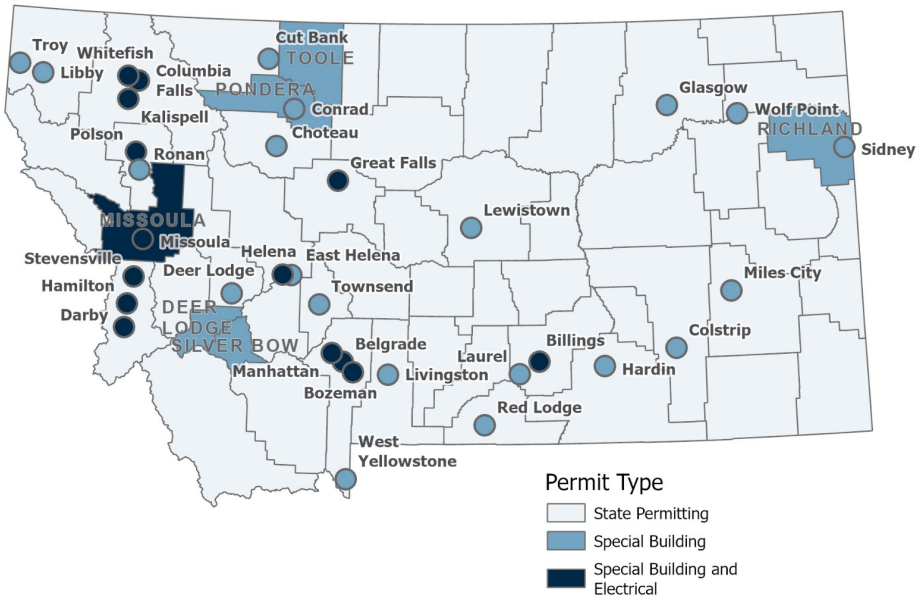
New Construction Identified Through Local and Statewide Permits

In addition to processing and maintaining an online portal of statewide permits, the Department of Labor and Industry (DLI) oversees certified local governments that want to administer their own permitting. Local jurisdictions can opt for additional permitting or remove exemptions from existing statewide permitting. About 40 local jurisdictions administer their own electrical or building permits, and DOR staff have varying success obtaining permits from these jurisdictions. These permits from local jurisdictions are a useful tool for identifying new construction, especially in urban areas. Permitting is less effective in rural settings, where there are generally fewer permit requirements, and it is easier for owners to circumvent permit processes.

Figure 9

Certified Local Government Map

About 53 percent of Montana's population resides in certified local governments that administer their own special electrical or building permits.



Source: Compiled by the Legislative Audit Division from DLI Certified Local Government List.

Survey Shows New Construction is Important to Local Jurisdiction Staff

As part of this audit, we surveyed local government staff, asking about the importance of new construction as well as DOR's performance in capturing new construction in their jurisdiction. We surveyed financial officers, clerks and recorders, treasurers, and commissioners, receiving an overall response rate of 28 percent. Almost two-thirds of respondents indicated that new construction was quite important or extremely important to their jurisdiction's budget. However, less than half of respondents indicated that DOR captures all or even most of new construction.

Local Permitting Inconsistent in Form, Availability, and Frequency

Certified local governments that administer their own permitting do not store all permits in a central location. DOR field offices must reach out to the jurisdictions in their area to request permits useful for identifying new construction, including electrical, building, septic, and other permits. DOR staff try to obtain permits monthly and many local jurisdictions are receptive to providing them. Some jurisdictions only have paper permits and either send these to the field office or have DOR staff pick up permits. Other jurisdictions will automatically provide electronic permit information to field offices. However, not all certified local governments provide permit information to DOR, and available permits often have inconsistent location information between jurisdictions. Additionally, staff at local jurisdictions are inconsistent on the frequency with which they provide permits, especially if the local contact changes.

Local Jurisdictions Are Not Required to Send Permit Information

Montana statute does not require that local jurisdictions provide permit information to DOR to help identify construction. Most local jurisdictions are receptive to providing permits. However, some are not receptive, even though local jurisdictions benefit from the additional property tax revenue brought in by identifying new construction. As part of our audit work, we surveyed local jurisdiction staff, and some respondents indicated that it is DOR's job, not theirs, to identify new construction. DOR management also indicated that some jurisdictions won't provide permits in case property owners are dissuaded from permit processes by the potential for increased property taxes. We learned of only a few local jurisdictions that were not receptive to providing permits. Still, these represent one less source of information to help DOR identify new construction in certain parts of the state.

Inconsistencies in Permitting Contribute to Delays

We observed inconsistent location information on permits during field office observations, especially with new addresses or vague construction locations. This inconsistency can make it difficult for field office staff to find the correct parcels with new construction. DLI also noted that builders inconsistently provide location information. DOR staff believe the best way to streamline their new construction processes would be to provide consistent and accurate location information on permits. Once a permit is attached to a property, that property will show up on new construction reports for appraisers, regardless of whether it is the correct parcel. Errors will result in further research to find the correct parcel or wasted property reviews.

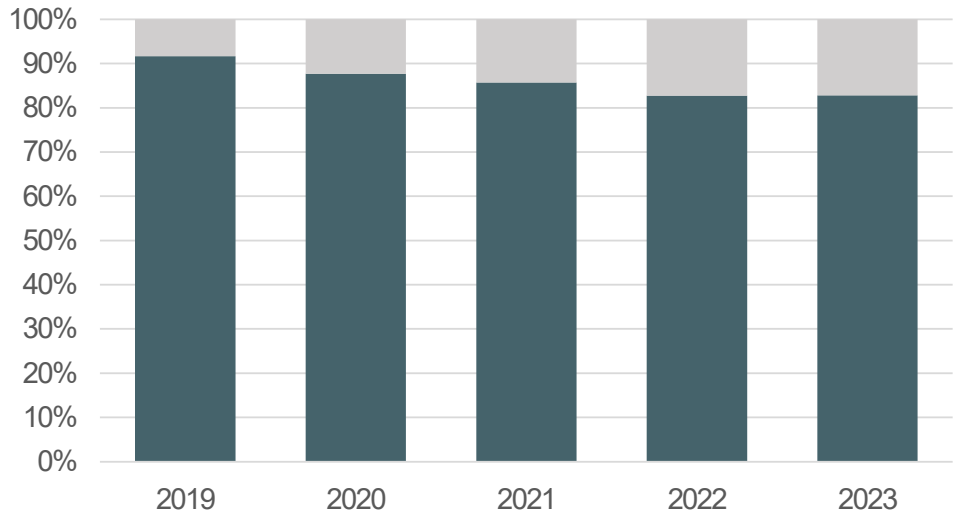
Over 15% of Residential and Commercial Buildings Not Added Timely in 2023

The statute mandates residential and commercial properties to be appraised at 100 percent of market value as they stand on January 1 each year. Therefore, when a residential or commercial building is built within one year, it should be added to the tax rolls for the following year. If DOR does not add a building for two or more years, it reduces tax revenue and creates tax inequity. We found that 11.5 percent of residential buildings and about 19 percent of commercial buildings in our time frame were added two or more years after being built. Further, about 2 percent of residential buildings and about 6.5 percent of commercial buildings were added three or more years after being built. In 2023, residential and commercial properties that were not added timely totaled $635 million in market value. Delays in permit processes contribute to delays in adding new construction value but are not entirely responsible.

Figure 10

Building Capture Timeliness

The department captured over 80 percent of residential and commercial buildings **within two years from construction**, though this percentage decreased over our timeframe.



Source: Compiled by the Legislative Audit Division from property database analysis.

Best Practices Indicate that Permits Should be Provided to Assessors

According to the International Association of Assessing Officers (IAAO), permits are the most efficient method of identifying new construction, and assessors should receive copies of permits. In other states, most assessors are employed by the county, with a state department that oversees the county assessors, and the state department appraises centrally-assessed properties, such as utilities. Maryland is the only other state government responsible for appraising all property. Similar to Montana, Maryland identifies new construction primarily through permits. However, local jurisdictions in Maryland are required by law to send copies of the permits to the assessor. Washington state also requires copies of permits to be sent to the assessor to identify new construction. While not all other states require permits to be provided to the assessor, it's important to note that assessors are most often part of the county and have more direct access to county-level permitting and planning.

Local Entities Should be Required to Provide Permits to the Department of Revenue

Because Montana performs all property appraisals at the state level, DOR must reach out to various county, city, and town governments for help identifying new construction. Though DOR staff try to obtain permits monthly, permits from local entities contain inconsistent location information. Not all local governments are receptive to providing permits despite the additional property tax revenue from identifying new construction. DOR field office staff then struggle to identify new construction, contributing to delays in appraising new buildings. Our closest counterpart, Maryland, requires local governments in statute to provide permits to appraisers. This aligns with industry standards, which suggest permits are a primary vehicle for discovering new construction, and appraisers should receive copies of permits.

RECOMMENDATION #1

We recommend the Montana State Legislature amend statute to require local entities that issue permits identifying new construction to send a copy of the permit to the department field office where the building is located within a month of issuance and provide clear and consistent location information for the parcel.

DLI Administers Statewide Permitting

In addition to overseeing certified local governments, DLI administers several statewide permits, including statewide electrical and building permits. DLI processes these permits and inspects these parcels to ensure that work meets code requirements. DLI makes all statewide permits publicly available through an online portal. However, statewide building permit requirements have numerous exemptions: residential buildings with fewer than five dwelling units, any farm or ranch building, and any private garage or storage structure for the owner's use are exempt from permit requirements. These exemptions, by definition, exclude single-family residencies. Statewide electrical permits have fewer exemptions and are generally required if an owner adds one circuit or more. DLI noted that location information on statewide permits is inconsistent between builders, with some providing a street address, others a geocode, and others a section/township/range or other vague description.

DOR Field Offices Search Statewide Permits Without Collaboration

DOR staff at field offices will generally search statewide permits monthly through DLI's portal. However, the frequency of searches can be inconsistent depending on workload, such as processing property transfers or creating geocodes. Some offices will track when permits have been searched or align their searches when they receive permits from local entities. Since all state-issued permits are available through DLI's online portal, DOR has instead prioritized reaching out and collaborating with local entities whose permits are not as readily available. Local entity permitting is less consistent and lacks a central repository. Though the department is focused on local permitting, DLI permit management has expressed that they would be open to automatically providing statewide permit information to DOR and working with DOR to determine valuable information for identifying new construction.

Permit Inconsistencies Contribute to Delays

Since the department does not formally collaborate with DLI, department management cannot offer input on statewide permits. Most notably, DOR staff at field offices consistently cited that vague location information slowed down their new construction processes and said they would benefit from more specific, standard location information. Inconsistent or minimal location information makes attaching permits to the correct parcel difficult and can delay processes. DLI is looking to establish consistent location information from builders. However, without formalized collaboration, DOR does not offer input on this process or raise issues they find with permit information. Additionally, automatic transfers of statewide permits would remove variation when DOR staff can search through DLI's online portal.

Inconsistencies in permit searching are one factor that contributes to delays in electrical permit review. Electrical permits, including statewide permits, have the most complete coverage across Montana and help identify construction where a building is added. Across our audit time frame, we found about 24,500 electrical permits with a following review from department appraisers. We found that DOR inspected 82.5 percent of the properties requiring electrical permits in a timely manner. However, department staff did not inspect 17.5 percent of these permits in time for the next year's tax rolls, and department staff did not inspect 8.5 percent within two years of issuance. We also found the proportion of timely permit reviews was statistically correlated to the geographic size of the field office area, with a larger area resulting in a lower proportion of timely reviews.

Industry Standards and Other States Emphasize Collaboration

Industry standards are the same for both statewide and local permits. IAAO advises that assessors should receive copies of permits. Though DLI makes statewide permits available to the public (including DOR) through an online portal, other states bolster their efficiency through formal collaboration. In Denver County, the assessor automatically receives electronic permits and building plans from their respective departments. Though other states we interviewed struggle with inconsistent forms and availabilities of permits, most have a close relationship with permitting entities and receive permits monthly.

Further Collaboration Would Benefit New Construction Processes

Unlike permits from certified local jurisdictions, DLI statewide permits are all readily accessible through an online portal. DOR staff search this portal monthly, but it can be inconsistent depending on workload. Since statewide permits are readily available, the department has focused on collaborating with local governments to obtain their permitting. However, other states streamline permit processes through close collaboration with all permitting entities. Additionally, field office staff struggle to find properties with inconsistent location information on permits, a problem that DLI seeks to address. Without formalized collaboration, DOR cannot provide input to consistently identify new construction from permits.

RECOMMENDATION #2

We recommend that the Department of Revenue formalize collaboration with the Department of Labor and Industry to determine permits and permit information useful to identify new construction, establishing a process for the regular automatic transfer of state-issued permits to department field offices.

Aerial Imagery May Also Identify New Construction

Aerial imagery comes in two forms: top-down or oblique. Top-down imagery, such as satellite imagery, can identify new buildings or structures but offers no view of a structure's profile. Oblique imagery is taken from an angle and requires planes to fly over the area with high-definition cameras. Oblique imagery shows the profile of properties and provides a more comprehensive view of property features. Vendors can also measure dimensions using oblique imagery or identify property changes between two sets of aerial images, known as change detection.

There are a variety of sources of aerial imagery. The United States Department of Agriculture flies top-down imagery over about half of the United States every two to three years for its National Agricultural Imagery Program (NAIP). This imagery is public but does not have complete coverage or high-quality imagery without further costs to the state. Private vendors may also contract for high-quality aerial imagery options and change detection. Some local jurisdictions in Montana have flown high-quality or oblique aerial imagery projects for a variety of purposes, such as public planning, 911 services, road review, tracking growth, and disaster tracking. State departments also use aerial imagery from drones, such as DEQ or MDT, using drones to inspect project sites.

Revenue Funded a Small Change-Detection Project Identifying $38 Million in New Construction Value Across Two Counties

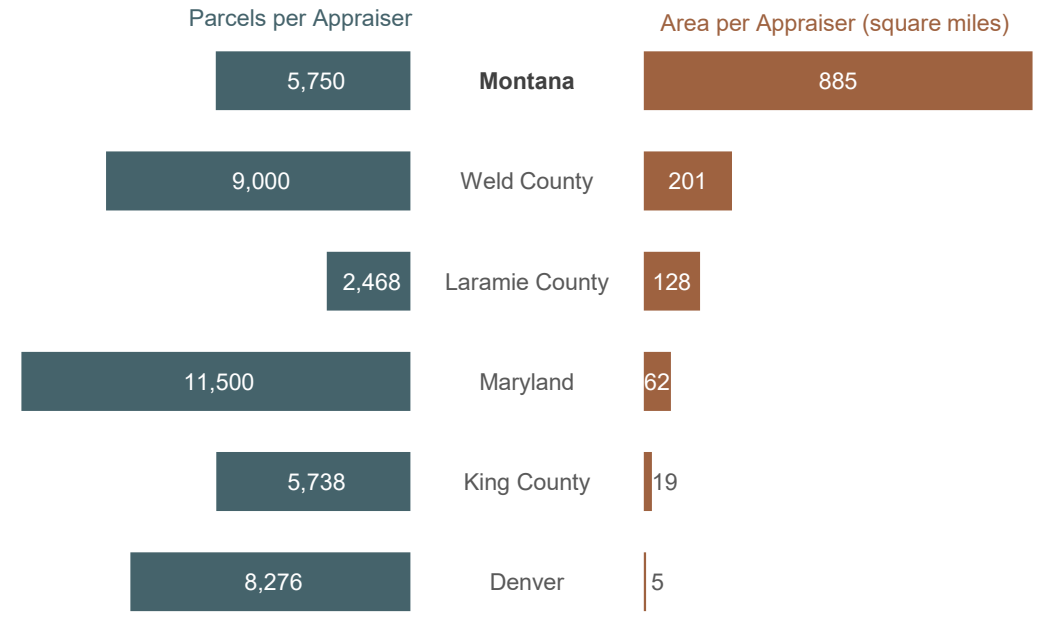
The department contracted with a vendor for change detection software to identify new construction in two counties. In one county, the vendor compared two sets of images from NAIP; in the other, they compared oblique aerial imagery. Between the two counties, the project identified about 29,000 changes across 88,000 parcels. Some changes were major, and others were minor changes that may not have been new construction. As of June 2022, the department reviewed about 2,000 of these changes and identified $38 million in new construction market value across the two counties.

If this market value was all residential and commercial, it would represent less than 0.1 percent of the total taxable value in these jurisdictions. However, this value also represents up to $250,000 in tax revenue, $200,000 in tax inequity, $3,000 in university revenue, and almost $50,000 in education equalization funding. This change-detection project contract costed about $60,000. Program management indicated this project was beneficial. However, poor image quality with the standard NAIP imagery sometimes resulted in false positives, where a subsequent appraiser visit identified no new construction.

Not All Montana Properties Are Easy To Reach

Compared to other states we interviewed, Montana has a similar number of total parcels per appraiser as other states where staff believe they have enough resources to perform their work. However, Montana has at least four times the area per appraiser as the other states we interviewed. Some of Montana's 30 field offices cover multiple counties, and a single field office may be responsible for up to 10,000 square miles. In contrast, the entire state of Maryland covers 12,400 square miles. Department appraisers sometimes must travel for hours to reach a property for appraisal. The appraisers we surveyed most often cite wasted trips as the biggest inefficiency in their new construction processes. Additionally, appraisers indicate that they are less confident in capturing new construction in rural areas rather than urban areas since they do not travel to rural areas as often, and permitting is not as robust in rural areas.

Figure 11
Montana Compared to Other States



Source: Compiled by the Legislative Audit Division.

If an appraiser reaches a property, they may still be unable to appraise its market value. Montana statute gives appraisers access to the property to take measurements and appraise the property. However, property owners are not always willing to allow appraisers on their property. The department has tracked incidences of owners pointing firearms at appraisers, discharging firearms as a warning, or otherwise threatening violence. Owners may also lock their gates and deny appraisers access to the property for appraisal. From our analysis, about 9,000 properties were listed as inaccessible in the inspection history. When appraisers cannot access a property, they will try to schedule a time with the owner to inspect the property or estimate property features to the best of their ability.

Combining Aerial Imagery Across Montana

The Montana State Library is tasked with maintaining a variety of GIS layers for the state and is looking at ways to collaboratively combine existing aerial imagery as well as potentially obtain further aerial imagery. At a 2023 GIS summit, states with high-quality top-down or oblique imagery noted that the imagery was often funded from collaborative efforts among multiple state agencies and local jurisdictions. Other states that we interviewed stated their imagery was often part of a collaborative effort between different levels of government. However, other states, like Wyoming and Oregon, have completely funded their aerial imagery through a single state department. These kinds of aerial imagery in other states cost between $1 million and $1.5 million annually, though these projects do not always cover the entire state. Statewide imagery in Montana would likely cost more, given our state's larger area.

Aerial Imagery Has Not Been Integrated Into Processes

In addition to their change-detection project, department staff used trials of other imagery software and even conducted manual comparisons of aerial imagery to identify new construction. Staff and management that have used oblique imagery and these programs find them beneficial for identifying new construction. However, with these trials and projects, program management has not integrated aerial imagery into appraiser processes. Appraisers will inconsistently check available aerial imagery when preparing to appraise a property, and, given the short time frame of aerial imagery projects, some appraisers do not even use aerial imagery.

The Department Has Not Been Able to Fund Oblique or High-Quality Aerial Imagery

The department requested funding for larger aerial imagery projects from the Office of Budget and Program Planning (OBPP) as part of its 2025 biennium budget proposal but was unsuccessful. OBPP questioned whether the technology was sufficiently developed and made worthwhile use of state resources. Additionally, the Montana State Library has not yet been able to develop or fund a collaborative model for acquiring further aerial imagery for Montana. While it has many uses, aerial imagery is expensive and often requires collaborative funding from multiple agencies.

The Department Cannot Efficiently Identify or Review Rural New Construction

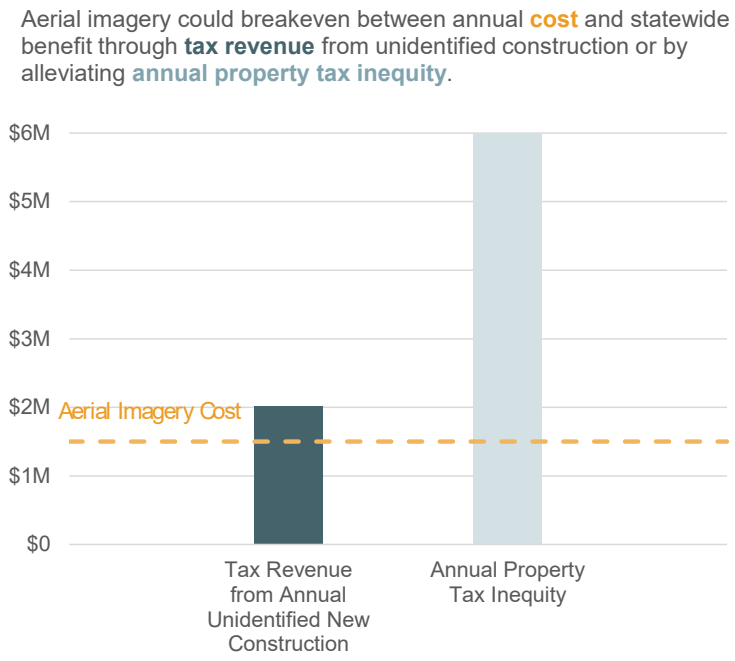
As discussed previously, appraisers have difficulty identifying and appraising new construction in rural areas. Permitting is less robust in rural areas, and appraisers discover less rural new construction from traveling. In some rural areas, without permitting or other methods to identify new construction, appraisers will try to drive rural roads to identify new construction. However, interviews with rural staff indicate they rarely have the time to drive to a rural area, given their workload. Additionally, field office staff consistently cite wasted inspection trips as their largest inefficiency with new construction processes, especially in large, rural areas where they may need to drive hours to reach a property. Some properties are developed very slowly, and appraisers will waste trips to these construction sites just to learn that nothing has changed since the previous year. Oblique imagery can address these issues, and appraisers who used aerial imagery cited its benefits in these areas. Further, IAAO standards emphasize that oblique aerial imagery can substitute for on-site property appraisal, reducing long rural travel for individual inspections. On-site inspections are still necessary for many properties, and oblique imagery cannot be used for appraisal in all cases.

Further Aerial Imagery Could be a Positive Return on Investment from Property Taxes Alone

We interviewed other states and reviewed responses to a Request for Information on aerial imagery submitted by the Montana State Information and Technology Services Division after interest from the Governor's Office. We used information from this request to estimate the cost of aerial imagery and used new construction identification for property taxes as the potential benefit. These benefits are calculated statewide, including state revenue from fixed mills, increased local revenue, and reduced property tax inequity. High-quality aerial imagery is not a one-time investment; it must be updated regularly to track changes in properties. For a cost of $1-$1.5 million, the imagery would need to identify about $250 million in market value, or 20 percent of our estimated total unidentified residential new construction, to offset its cost with corresponding property tax revenue. If ongoing aerial imagery identified all of the $300 million that we estimate the department misses each year on average, it would equal about $2 million in residential property tax revenue statewide each year. It is important to note that nearly all of this revenue goes to local taxing jurisdictions, not the state. Alternatively, assuming a conservative tax inequity estimate, aerial imagery would have to identify about a fourth of our estimated residential unidentified new construction to justify its costs through annual tax inequity. However, these are the only benefits of aerial imagery to property tax assessment. If shared between agencies, aerial imagery would have additional benefits beyond tax revenue and reducing property tax inequity, such as aid in public planning, 911 services, and wildfire/disaster tracking.

Aerial Imagery is Emerging as a Best Practice

Figure 12
Aerial Imagery Return on Investment



Source: Compiled by the Legislative Audit Division.

Counties in Maryland, Wyoming, Oregon, Colorado, and Washington use aerial imagery in their new construction processes. Most use oblique imagery that aligns with IAAO standards to substitute for field inspections so that appraisers can estimate property features from their desks. Other states also highlight that ongoing aerial imagery is useful for detecting changes to structures, either through manual comparison or through change-detection software. Wyoming and Washington specifically highlight using ongoing oblique imagery to identify new construction in rural areas. While these other states often do not fly oblique imagery for the entire state, they find aerial imagery beneficial and cost-effective. Counties in other states that do not find high-quality or oblique imagery beneficial, like Denver County, are often urban areas with robust permitting.

Aerial Imagery Can Efficiently Identify and Appraise New Construction

High-quality or oblique aerial imagery and change detection are useful tools for identifying new construction or property changes, especially in rural areas where appraisers may not often travel. DOR has conducted smaller, localized aerial imagery projects and found them useful. The current administration has also expressed interest in aerial imagery for state use. The Montana State Library is also looking at ways to consolidate or obtain aerial imagery across Montana for various purposes. Aerial imagery is an emerging best practice across other states and would be a positive return on investment from property taxes alone. Industry standards also state that a review of high-quality aerial imagery can substitute for on-site inspections, increasing the efficiency of rural appraisals.

RECOMMENDATION #3

We recommend that the Department of Revenue increase appraiser efficiency by obtaining high-quality or oblique aerial imagery on its own or as part of a collaborative effort with other agencies facilitated by the Montana State Library.

Chapter IV - DOR's Ability to Inspect New Construction

Introduction

The department generally captures new construction through on-site appraisals. DOR processes align with industry standards at the individual inspection level, but appraisers cannot reinspect properties at least every six years, which is an established industry best practice. When planning inspections, department policy does not state that appraisers should consider properties that have not been inspected for many years, and these types of appraisals have not been prioritized by management. Beyond planning, management indicated they lack the resources to keep up with the workload and struggle with turnover. Increased retention could reduce training and allow employees to perform more inspections to capture unidentified new construction.

Reviewing New Construction

After field office staff identify new construction on a property, appraisers then include it in their work for appraisal. Managers or appraisers run reports identifying new construction and creating lists of properties to inspect. Appraisers will use these lists to select properties and plan daily routes. New construction is mainly identified through permits, but department staff can also find new construction during other inspections, especially reappraisal reviews. Though a lower priority to management, reappraisal reviews of properties that have not been inspected in many years are an effective way to identify new construction and keep properties updated. By consistently reviewing properties, DOR ensures that property taxes are equitable across Montana.

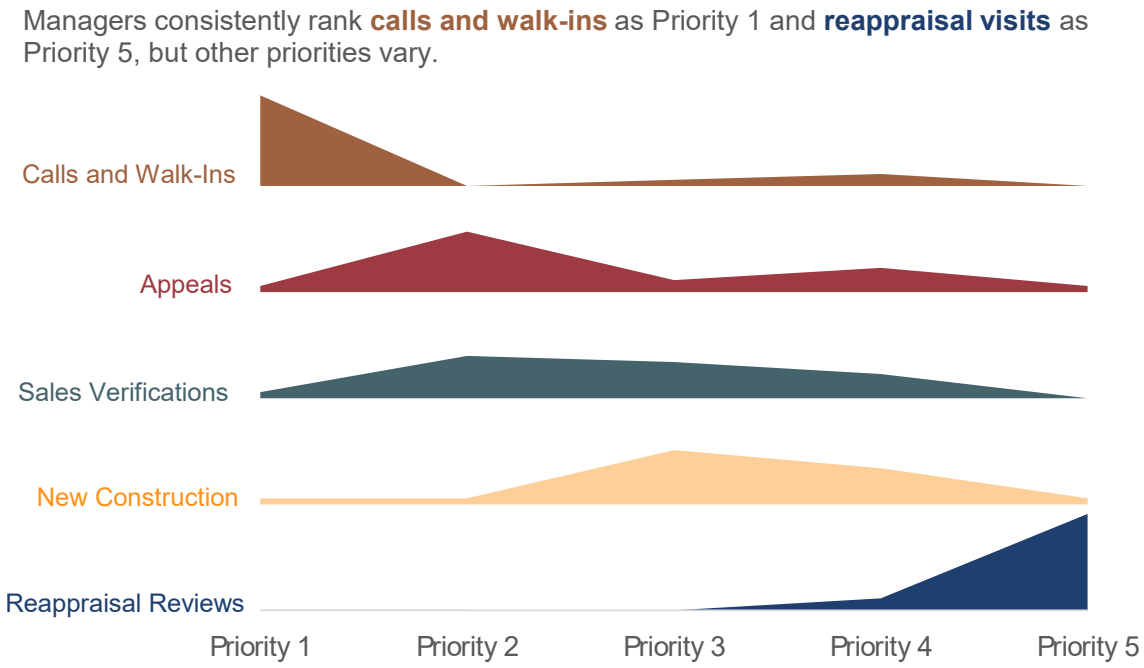
Industry Standards Indicate That Properties Should be Inspected at Least Every Six Years

The International Association of Assessing Officers (IAAO) standards indicate that even if most new construction activity is identified through permits, every property should be reviewed at least every six years. Regularly inspecting properties allows appraisers to stay updated on property changes and appraise properties consistently across the state. Most states we interviewed previously had goals to visit properties every six years at some point but made these goals informal. Due to its statewide appraisal process, Maryland, our closest counterpart, has an informal goal to reach every property every nine years. Only Wyoming and Washington regularly obtain this standard, while other states, like Montana, rely on sales, permits, and appeals to reach enough properties for assessment.

New Construction and Reappraisal Reviews Are Not the Top Priority for Management

As part of the audit work, we surveyed all field staff and management, receiving an 88 percent response rate from almost 240 recipients. From this survey, we learned that customer service is consistently the top priority to management, and reappraisal reviews are consistently the last priority. New construction was most often listed as the third priority. Some field offices are in jurisdictions with a high level of permitting and feel confident that they can keep up with new construction. Other field offices say they just try to stay afloat and struggle to capture new construction. These inconsistencies generally result from the differences in permit information available to the field office and geographic and demographic aspects of the field office area, mainly rural versus urban areas.

Figure 13
Manager Priorities



Source: Compiled by the Legislative Audit Division from field office survey results.

Appraisers Inconsistently Consider Information When Planning Routes

Currently, appraisers at DOR determine their daily routes at their discretion. Often, managers or appraisers will run different reports on potential workloads depending on the time of year and the current priorities. For new construction, managers or appraisers will run a report that lists all properties with recently attached permits, partially complete properties, and properties marked for continued review. When planning their routes, some appraisers will consider all work in the area, such as sales, appeals, or new construction. However, considering this additional workload is not consistent for appraisers across the state. Department policy encourages appraisers to view other work in their area, such as permits and sales verifications, and to determine the most direct route between properties when traveling.

This policy also describes that previously, staff could add a GIS layer showing properties with permits for review. Rarely do appraisers consider properties that have not been visited in more than six years as part of route planning and policy does not include these properties for consideration. Department staff can run reports to identify properties that have not been visited in a given number of years but rarely do so.

The Department is Unable to Regularly Visit All Properties

After reviewing the IAAO standards for mass reappraisal and observing department staff, we found that the department's new construction processes aligned with these standards. However, the department is unable to visit every property every six years. DOR previously established a goal to align with standards but has since made this goal informal, citing the infeasibility of its current resources. Department management and staff consistently maintain they do not have sufficient resources to visit every property every six years, especially given their increasing workload. Instead, the department now tracks the number of on-site inspections for appraisers, even when appraisers inspect the same property multiple times. Wasted or repeat inspections of slow-developing properties reduce appraiser efficiency as these inspections could be of different properties. Again, appraisers consistently cite wasted trips, especially to distant or rural properties, as the biggest inefficiency in their new construction processes.

The Department Has Not Formalized Reappraisal Reviews in Route Planning

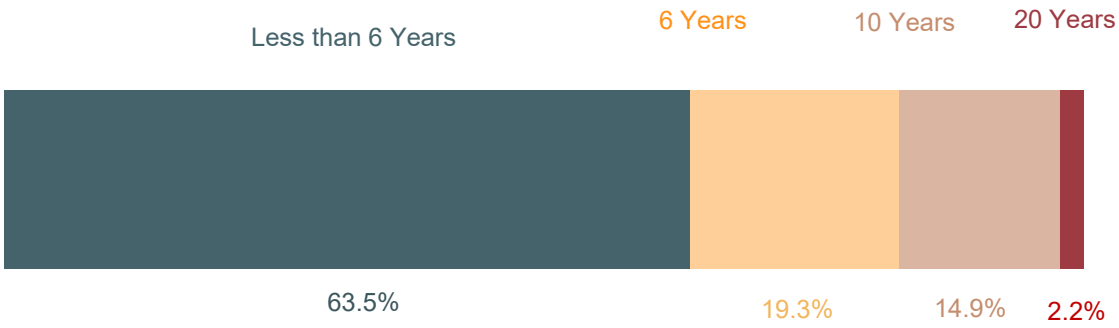
Field office management does not prioritize reappraisal visits or visits to properties that have not been inspected in six or more years. Management indicated that they often do not have enough resources to complete reappraisal reviews and must prioritize other workload. Department staff can run a report to identify properties that have not been visited in a certain number of years but rarely do so, opting to perform reappraisal reviews after all other work. Additionally, policy suggests that appraisers should consider new construction and sales in route planning but does not mention other work or reappraisal reviews for properties that have not been visited in many years. The policy also states that appraisers should be efficient when planning routes, but the policy does not formalize which information should be considered when planning routes. The department has also not developed a tool highlighting all potential workloads in an area to consider by appraisers.

Many Properties Have Not Been Inspected in Over Six Years

We examined how recently residential and commercial properties were last inspected by department staff. We found that about 36 percent of residential and commercial properties with at least $50,000 in building value on the property had not been inspected in 6 years. Additionally, 21 percent of those properties had not been inspected in 10 years, and about 2 percent had not been inspected in 20 years.

Figure 14
Time Since Last Inspection

In 2023, the department had inspected about 64% of residential and commercial properties **within six years**, but 2% **had not been inspected in 20 years**.



Source: Compiled by the Legislative Audit Division from property database analysis.

The department misses nonpermitted new construction without consistent review, especially in rural areas. Department management indicated they do not have the resources to visit all properties that have not been inspected in six years. However, they could add the information to appraiser planning so that appraisers can examine these properties while they are in the area. Properties not inspected regularly contribute to our previously stated estimate of $1.2 billion total in unidentified residential new construction market value at any given time. Again, we estimate this unidentified new construction is worth $8.25 million in property tax revenue, resulting in up to $6 million in tax inequity across Montana.

GIS Tools Could Help Appraisers Efficiently Identify Properties

A representative from the National Association of Counties specifically highlighted King County (Wash.) as an example of efficient appraisal and new construction processes. King County integrates information from many agencies and sources to help identify new construction. Additionally, King County developed a GIS tool that highlights all potential appraisal work in an area so staff can efficiently reach these properties without additional travel. King County appraisal staff explain that integration of this information into route planning and the GIS tool is beneficial for their new construction processes.

Reappraisal Reviews Can Help Identify New Construction

Though reappraisal reviews are the lowest priority of appraiser workload at field offices, reappraisal reviews should help identify new construction. Industry standards recommend that every property be inspected at least every six years. With current resources, this is infeasible for DOR. However, King County in Washington is able to align with industry standards by assimilating all potential workload in an area for appraisers through a GIS interface. King County contains both dense urban areas as well as rural areas. Montana currently runs different reports for workload, and tasks that are not the current priority, including reappraisal reviews, are inconsistently included in appraiser preparation. Including properties that have not been inspected in many years and assimilating all potential workload in an area through a GIS interface would help appraisers efficiently capture new construction without repeat trips.

RECOMMENDATION #4

We recommend that the Department of Revenue work toward inspecting every property every six years by:

A. *Including properties that have not had on-site inspections in more than six years as part of appraiser field preparation, and*

B. *Developing GIS layers that identify parcels for on-site inspections including property sales, new construction, and properties that have not been inspected in more than six years.*

Appraiser Retention Contributes to Inspection Efficiency

Throughout our audit, department management and staff indicated that they did not have sufficient staffing or retention to keep up with the workload. According to the Legislative Fiscal Division (LFD) reports, the Property Assessment Division lost about 25 FTE in 2017 and 2019 due to legislative cuts. Department staff and management also indicated that they face high turnover, especially in high-cost areas. Additionally, lack of resources, given the volume of work, was also one of the most frequently cited challenges by DOR appraisers and managers for new construction in our survey. In addition, department staff and management indicated that they face high turnover in field offices, especially in high-cost areas.

DOR Faces High Turnover but Currently Does Not Track Retention or Performance Metrics for Tenure

Regional and field office management told us they have struggled with employee retention. LFD also indicated that, between July 2021 and August 2022, about 35 employees left PAD, with the majority being property appraisers. We queried the Statewide Accounting, Budgeting, and Human Resources System for terminations/transfers and compared the results to statewide turnover averages. We found that annual voluntary turnover at PAD was comparable with statewide averages between FY21 and FY23, with between 16 percent and 19 percent voluntary turnover. However, best practices indicate that organizations should create a strategic retention plan to aim for 10 percent or less turnover. Management and appraisers cite that wages do not keep up in high-cost areas, and appraisers can often find jobs with higher pay and less stress. Managers say that there are positions with better pay and less stress, even within DOR, and staff can schedule customer interactions. Position salaries are the same statewide and are usually more desirable in low-cost rural areas and less desirable in high-cost urban areas. The department stated it has tried to increase retention through various means, including wage increases. However, management had not tracked retention metrics for the past several years and say they still fall well below market salaries.

Department management indicated they previously analyzed employee tenure every couple of years, usually before the legislative session. However, the department has not performed this analysis in several legislative sessions. DOR human resources staff perform exit interviews for employees leaving but have not provided a summary of leading reasons that employees leave to DOR management. Additionally, the department does not track tenure benchmarks or performance metrics regarding tenure. Management tracks the number of inspections each appraiser completes annually, aiming for around 750 annual on-site inspections per appraiser. This threshold is roughly based on the number of unique properties each appraiser must inspect to reach every property every six years. Department staff indicated that there are various types of appraisals, and staff learn to inspect different property types during their tenure. Therefore, a tenured residential appraiser who has just started appraising commercial properties may still not perform many commercial inspections.

Revenue Has Focused on Recovering FTE

The department has recently focused on recovering the FTE lost in previous 2017 and 2019 sessions. The department estimates they would need 21 additional FTE to reach the 2017 level of efficiency and states that the additional FTE would aid in reducing workload for existing employees and aid in retention. However, the Governor's Office of Budget and Program Planning (OBPP) turned down the department's proposal for 21 FTE. After being turned down for staffing, the department requested funding for aerial imagery (see Chapter III), which OBPP also denied.

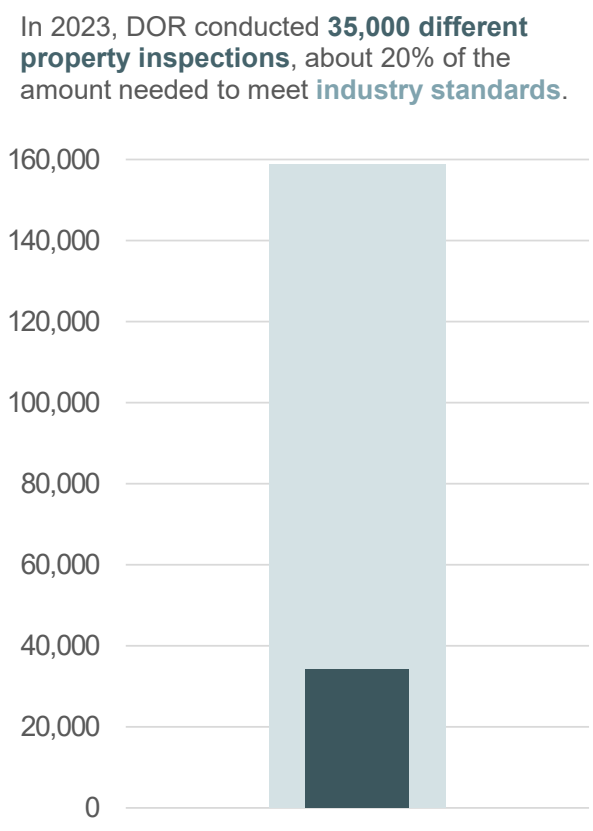
Retention and Turnover Affect Appraiser Performance.

When talking with field office staff, we found that turnover affects appraisers' ability to inspect properties. Staff estimate that it takes up to two years to train appraisers to be able to inspect properties on their own. Additionally, seasoned appraisers must train new staff, which reduces their property inspections. Regional management believes their training and materials are streamlined, but field offices are almost constantly training due to turnover. Additionally, our survey found that appraisers with higher tenure more often indicate they get through their new construction workload.

Department Is Not Close to Reaching Its Inspection Goal

Department management based the desired on-site inspection threshold to match the unique visits necessary to align with industry standards, aiming for around 750 on-site inspections annually per appraiser. Field offices inconsistently track this goal, and some field offices vary the number of on-site inspections for their appraiser goals. Management highlighted that the drive time to properties in Montana makes achieving their goal for on-site inspections difficult. We examined the inspection history and progress toward the department's threshold across appraisers. We found that the department only reached about 21.5 percent of the approximately 160,00 unique property visits necessary to visit every property every six years. We also examined the total number of on-site inspections by appraisers, finding that about 6 percent of appraisers reached 750 on-site visits in 2023.

Figure 15
Goal Process



Source: Compiled by the Legislative Audit Division from department inspection history.

Industry Standards Emphasize Retention is Important for Efficiency

The Society for Human Resources and Management (SHRM) cites that increasing employee retention results in increased performance, productivity, and quality of work. SHRM recommends establishing and implementing a retention plan based on turnover analysis, benchmarking, and needs assessment. Additionally, SHRM recommends that organizations aim for 10 percent or less voluntary turnover. One of DOR's goals is to hire and retain qualified employees, though the department does not track performance metrics by tenure. This goal aligns with our survey results, which show that more tenured appraisers are more comfortable getting through their new construction work. Additionally, tracking tenure and ensuring that qualified employees are retained is an important foundation for determining the number of staff necessary to achieve department goals. A strategic plan that reduces turnover can inform staffing levels and is a necessary precursor to justify staff requests during budgeting.

A Strategic Plan to Increase Retention Could Reduce Unidentified New Construction

DOR has struggled to retain staff and believes they lack the resources to visit enough properties to align with industry standards. Staff will leave for jobs with higher pay, less stress, and more consistent scheduling, even within DOR. With high turnover comes constant training, with tenured appraisers performing training and new staff unable to appraise properties on their own for one to two years. As a result, DOR appraisers only achieve about 20 percent of their on-site inspection goals and cannot review enough properties to consistently capture unidentified new construction or ensure tax equity. Best practices recommend that an organization develop a strategic plan for improving retention based on benchmarks and a needs assessment. Increased retention from such a plan would benefit new construction processes, help keep property taxes equitable, and serve as justification for budget requests for staffing. The department can consider and pursue a variety of strategic objectives, including wage changes, workload balance, and other methods for improving staff retention.

RECOMMENDATION #5

We recommend that the Department of Revenue develop and implement a retention plan that tracks performance metrics for tenure, including strategic objectives to increase staff tenure at field offices.

Appendix A – Estimating Residential Unidentified New Construction Value

Introduction

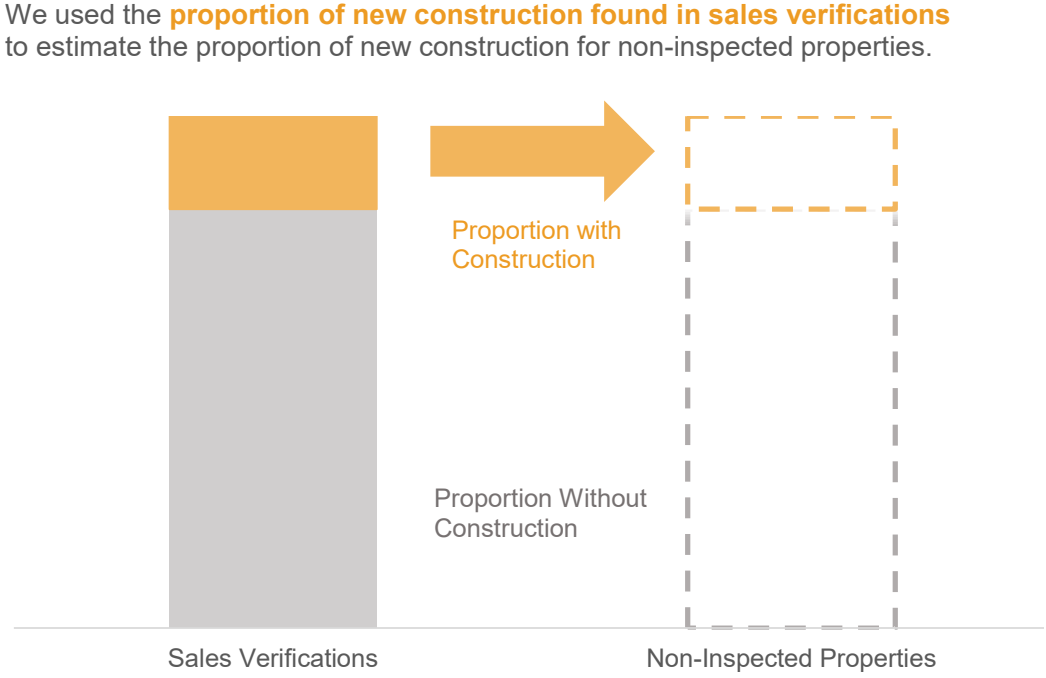
A major methodology of this performance audit estimated unidentified residential new construction value across Montana. All of our recommendations seek to improve the identification of new construction, either by reducing the $300 million that we estimate the department misses each year or by reducing the total unidentified new construction value of $1.2 billion at any given time in our time frame. We consistently reviewed this approach and considerations with the department throughout this analysis. This appendix explains our method for estimating residential unidentified new construction and discusses the results of our analysis in further detail.

Analysis Approach

The department primarily identifies new construction through permits issued for construction or other purposes. However, appraisers can discover new construction outside of their permit processes during other types of inspections, such as sales verifications, appeals, and reappraisal reviews. We estimated the value of unidentified new construction by calculating the frequency and value of new construction discovered at sales verifications. We then used these values to estimate the statewide value of new construction for properties that had not been inspected in three or more years. We chose sales verifications to make our estimates because they are more representative of residential properties than appeals inspections or reappraisal reviews.

Appendix Figure 1

Projecting New Construction at Sales Verifications



Source: Compiled by the Legislative Audit Division.

Our analysis using sales verifications included three main steps:

- Defining new construction from department records
- Identifying new construction frequency and value discovered at sales verifications
- Estimating the value of new construction on properties that had not been inspected in several years

Defining New Construction

First, we used department records on property values and features to identify properties with new construction. We defined new construction at a property as:

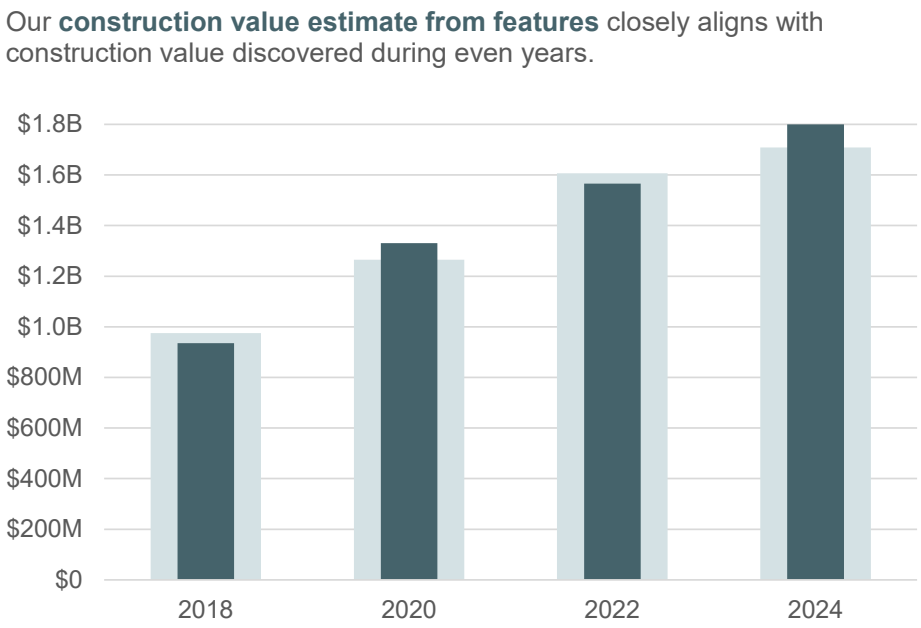
- A new residential building
- A change in livable square footage greater than 100 square feet
- The number of stories for a building changing
- Adding a basement, or finishing a basement area greater than 100 square feet
- A change in building additions, valuing more than $5,000 in odd years and more than $1,000 in even years
- An increase in the number of outbuildings
- The area of outbuildings increasing by greater than 100 square feet
- A change in the percent complete of a structure from the previous year

We accounted for the value of new construction relative to market changes and localized property value changes by calculating the average percent change in value for properties by neighborhood. We calculated market changes by only including properties that were not inspected by the department each year. We grouped all neighborhoods with fewer than 30 properties together by county.

Validating Definition Through Even Years

We checked our estimates of new construction value from property features against the department's even-year value of new construction it identified. The estimates from our feature selection approach were within five percent of the department's construction value from even years, confirming the accuracy of our approach.

Appendix Figure 2
Estimating from Features Comparison



Source: Compiled by the Legislative Audit Division.

New Construction Value At Sales Verifications

We then estimated the proportion of sales verifications that identified new construction as well as the average value of that new construction. We examined all sales verifications between 2018 and 2023, specifically focusing on sales verifications that had no indication of permitted new construction. Using the feature selection approach described above, we identified all residential properties that were updated after the sale verification. We excluded new residential buildings from this analysis, as these are often permitted and rarely unexpectedly "discovered" at sales verifications. Below is the proportion of sales verifications with new construction and the average value of that construction:

Appendix Table 1
Sales Verifications Where New Construction was Identified

Year	Total Sales	Sales with Construction	Percent of Sales with Construction	Average Value of Construction at Sales
2018	14,933	3,618	24.2%	$9,526
2019	11,941	1,975	16.5%	$ 20,436
2020	15,355	3,998	26.1%	$ 20,853
2021	15,681	2,780	17.7%	$ 30,174
2022	18,605	4,787	25.7%	$ 27,286
2023	13,128	2,917	22.2%	$ 39,696

Source: Compiled by the Legislative Audit Division from Department Records.

Projecting Values to Properties Not Inspected in Several Years

Finally, we counted the number of residential properties that had not been inspected in several years to estimate the amount of new construction that went unidentified at these properties. We counted properties that had building value and had not been inspected in at least three years. We then projected the proportion of sales with new construction and the average value of construction discovered at sales verifications to these properties. Table 2 shows the number of residential properties with building value that had not been inspected in at least three years.

Appendix Table 2

Residential Properties Inspected at Least Three Years Ago

Tax Year	Residential Parcels Inspected 3+ Years Ago
2018	211,389
2019	214,700
2020	219,757
2021	227,016
2022	232,900
2023	235,745

Source: Compiled by the Legislative Audit Division from Department Records.

Results

For each year, we projected the sales percentage numbers by the number of residential properties inspected three or more years ago. For instance, in 2020, we estimate that about 26.1 percent (about 57,000) of the nearly 220,000 residential properties had new construction. Then, we estimated each of these 57,000 properties had an average value of $20,000 in new construction market value, totaling about $1.1 billion for 2020. We did this calculation for every year in our time frame and averaged across all years. This yielded our estimate of $1.2 billion in unidentified new construction value at any given time. We also calculated the difference in the total value between each year in our time frame. This difference gave an estimate of how much new construction the department misses each year. We averaged the differences across our time frame to get approximately $300 million missed each year by the department.

Sensitivity Analysis

Throughout this methodology, we explored how the results changed under alternative features and approaches, often consulting with department staff and management on the assumptions and considerations of the analysis. We established our threshold of three or more years for noninspected properties after discussions with the department and internally. However, we also explored a threshold of four and five years. Our results were not sensitive to a change in this threshold. We also ensured that our results aligned with expected values from previous projects and known values. The results were not sensitive to changes in any individual parameters or parameters applied across all years in our time frame.

Department of Revenue

Department Response

MONTANA
DEPARTMENT OF
REVENUE

GOVERNOR GREG GIANFORTE
DIRECTOR BRENDAN BEATTY

November 22, 2024

Angus Maciver, Legislative Auditor
Performance and Information Systems Audits
Legislative Audit Division
Room 160, State Capitol Building
PO Box 201705
Helena, MT 59620-1705

RECEIVED
November 26, 2024
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

The Department of Revenue herein responds to the Appraising New Construction to Reduce Property Tax Inequity Performance Audit.

Recommendation #1

We recommend the Montana Legislature amend statute to require local entities that issue permits identifying new construction to send a copy of the permit to the department field office where the building is located within a month of issuance and provide clear and consistent location information for the parcel.

N/A

Recommendation #2

We recommend that the Department of Revenue formalize collaboration with the Department of Labor and Industry to determine permits and permit information useful to identify new construction, establishing a process for regular automatic transfer of state-issued permits to department field offices.

Conditionally Concur. The department is willing to work with Department of Labor and Industry (DLI) to bolster the required information on the permits to include more substantive locational information through either a geocode or legal description. This additional information would allow our staff to better identify properties to be reviewed for new construction. Additionally, we would like to work with DLI on an automated

system for delivering permits to the department in a fashion that can streamline our processes.

We conditionally concur with this recommendation because we are uncertain of the outcome of this collaboration. We will ultimately have no control over the required information DLI chooses to add to their permitting process.

Recommendation #3

We recommend that the Department of Revenue increase appraiser efficiency by obtaining high-quality or oblique aerial imagery on its own or as part of a collaborative effort with other agencies facilitated by the Montana State Library.

Conditionally Concur. The department is highly motivated to obtain oblique aerial imagery specifically to gain efficiency for our staff. As noted in the audit, we have attempted to obtain imagery in the past and have been unsuccessful. We are hopeful through the request for proposal currently being developed, that funding can be allocated to the department to acquire the needed imagery. Again, we do not have full control over these results; therefore, conditionally concur. It is important to note that imagery is not a one-time acquisition; to maximize its benefit, it must be part of an ongoing effort to periodically obtain new imagery. Not all imagery can meet the industry standard and create efficiency; therefore, oblique imagery, while more costly, will provide the best benefit to the department.

Recommendation #4

We recommend that the Department of Revenue work toward inspecting every property every six years by:

> Include properties that have not had on-site inspections in more than six years as part of appraiser field preparation, and

Conditionally Concur. With the resources available to accomplish the tasks assigned to the department, these types of reviews are generally the lowest priority. The department will develop a plan to start including these properties in our review process. The plan will prioritize properties that have not been reviewed in over 20 years, followed by those without a review in more than 15 years, to minimize the potential for missed new construction. Based on the resources available to us, it is unknown at this time how long it will take us to complete reviews of all properties that have not been reviewed in over

six years. If we can utilize aerial imagery and change detection tools, this can become more realistic in the future.

> Develop a GIS layers that identify parcels for on-sight inspections including property sales, new construction, and properties that have not been inspected in more than six years.

Concur. The department can currently create layers for these types of properties both within our GIS system and through our Field Mobile Application. We can work on different ways to highlight these properties so appraisers can select them for review.

Recommendation #5

We recommend that the Department of Revenue develop and implement a retention plan that tracks performance metrics for tenure, including strategic objectives to increase staff tenure at field offices.

Partially Concur. The Property Assessment Division will work on a strategic retention plan to foster greater tenure for staff. This will begin with better tracking of exit interviews identifying the reasons staff are voluntarily leaving the department. We understand and agree that tenure will result in greater efficiency; however, we cannot guarantee that having a plan in place will automatically improve retention. As noted in the audit findings, some of the most common reasons staff are voluntarily leaving the department are due to items beyond our control, such as pay. We have made attempts to create raises beyond what is provided for through the legislature but have no additional resources in our budget to continue without the assistance of the legislature.

The department believes the portions of these recommendations within our control can be accomplished within one year.

Sincerely,

Brendan Beatty, Director
Montana Department of Revenue