MCPB Item # 8

THE MARYLAND-NATIONAL CAPITAL PARK AND PLANNING COMMISSION

Department of Park and Planning, Montgomery County, Maryland
9500 Brunett Avenue•Silver Spring, Maryland 20901

June 14, 2002

AGENDA DATE: 6/20/02

MEMORANDUM

TO: The Montgomery County Planning Board

FROM: Jerry Bush, Administrative Supervisor JB

SUBJECT: Park House Rent Increases

Staff Recommendation: Approval of proposed schedule of rents.

Executive Summary

Staff presents its annual recommendation on park house rent increases to the Planning Board for your consideration and approval. For 2003, staff recommends a **4.7%** increase in park house rents for occupied units. 4.7% is the 2003 voluntary rental increase limit established by the Montgomery County Executive's Office.

The attached schedule of rents for 2003 (Attachment 3, Circle Pages 25-26) reflects the recommended 4.7% increase with a few exceptions explained below. The schedule also reflects a commensurate 4.7% increase in the fair market value for all rental units for 2003. This is consistent with our practice of using the MCEO voluntary limit to adjust the market rents during years that a full market survey is not performed on all the units.

A selected number of employee-occupied units will receive a higher increase in response to a recent report by the Commission's Audit Division. The report raised concerns about certain employees receiving a rent discount in excess of 20%. IRS rules consider any employee discount in excess of 20% a taxable fringe benefit, which is prohibited under Commission Practice #6-50.

One non-employee unit will also receive a substantial increase in response to the same audit report, which cites the requirement in Practice #6-50 that all non-employee units shall be rented at fair market value.

Background

Park house rent increases are implemented on an annual basis at the beginning of each fiscal year. The amount of the increase is determined primarily through the use of formal market surveys, indicators on market trends, and/or the Montgomery County Executive Office's (MCEO) annual voluntary rental increase limit.

Formal market surveys are conducted on five year cycles to assess the current fair market value of each rental unit. The most recent market survey was completed in the spring of 2001. Based on the results of these surveys, a new market rent is set for each unit. In most cases, the new market rents are higher than the previously established fair market value and the actual rents being paid by the current tenants. In some cases, where there have been major capital improvements or repairs performed to a rental unit during the previous five years, the difference can be substantial.

Each intervening year between formal market surveys, the MCEO recommended rent increase is applied to establish a new fair market value for each rental unit. For next year, the MCEO recommended increase has been set at **4.7%**. Accordingly, the new market rents established in 2001 by Legum & Norman, Inc. (L&N), our rental agent, will be increased by 4.7% to reflect an adjusted fair market value for each unit for the coming fiscal year. The adjusted market rents come into play primarily for the vacant units, as each vacated unit is brought up to the currently observed fair market value before it is advertised for rental to a new tenant.

For those rental units that are currently occupied, the MCEO guideline is also used in preparing this annual presentation to the Board on the proposed schedule of rents for the coming year. Staff could elect to use the maximum amount recommended by the MCEO, or some lesser percentage if market factors were to dictate a more conservative increase. In other words, the actual percentage increase realized by the tenants may be the same or less than the amount used to set a new market rent for all the properties. Increases that are in excess of the MCEO amount, are theoretically possible, but should be carefully considered and justified regarding the impact on the tenants and the future marketability of the units.

During years that a formal market survey is conducted, the annual rent increase for that year helps to close any gap between the newly established fair market value of the properties and the actual rent being paid by the tenants. The higher the increase, the smaller that gap and the fewer the properties that will be affected. No increase is assessed, of course, for those units that already have rents at, or in excess, of the new market rent.

However, during the intervening years between market surveys, any rents that are below market at that time will remain so if the recommended increases for the coming year for the occupied units are the same as, or less than, the MCEO guideline. The following simple example illustrates this scenario.

	2001 Actual Rent	2002 Fair Market Value	2002 Rent (w/MCEO increase-5%)	2003 Fair Market Value (w/4.7% increase)	2003 Rent (w/4.7% increase)
	$500	$650	$525	$680	$550
% Under Market	23%		19%		19%

For those tenants paying more than market rent, they receive no increase each year, until the market catches up to the actual rent they pay at some point in time.

Actual Rents Versus Fair Market Value

Over the years, in order to avoid imposing substantial one-year increases on tenants affected by the new market surveys, rental rates for occupied units that lag far behind the fair market rental value for the unit, have been allowed to remain below market on a continuing basis. Based on the above system of assessing yearly rent increases, these situations are corrected only when the units are vacated and brought up to market rent, or a new market survey, by some small chance, corrects the matter.

Currently, the percentage difference between actual rent paid and the fair market value rent for the above affected units varies. In one case, the actual rent paid is 47% below market, but most are in the range of 1%-20% below market. For non-employees, such a situation is contrary to Park Practice #6-50 which specifies that units for non-employees shall be advertised and leased at the fair market value (see Attachment 1, Circle Page 10). With respect to employee tenants, it is the opinion of the Commission's Audit Division that any rent discount in excess of 20% is considered by the IRS as additional compensation, which is taxable as a fringe benefit. This situation is also prohibited under Practice #6-50 (see Circle Page 9). Both these matters are addressed in more detail in the attached Audit Report #01-MC-061 and staff response (see Attachment 2) .

The staff recommendation of an overall 4.7% increase in park house rental rates for 2003 does nothing to correct the problems noted above. Many employees and non-employees will continue to pay less than fair market value for their rental units. If the Board so chooses, this ongoing matter can be corrected in time by imposing a 2%-3%/year additional rate increase for those units that continue to lag behind the fair market value rent. For example, for 2003 the rental rate for some units would increase by as much as 7.7% (4.7% MCEO increase + 3% catch-up). To a degree, this situation occurred by default during the late 1990s when inflation was in the 2% +/- range, but the rent increase cap was set each year at 3%.

Staff makes no such recommendation for a catch-up provision for 2003, but the matter is being raised for future consideration by the Board.

Special Considerations for 2003

Absent a catch-up provision, staff strongly recommends that no future discounts for employee as well as non-employee tenants exceed 20%. Though non-employees are not necessarily subject to the 20% IRS rule, staff believes that the differential between actual paid rents and fair market rental values for everyone should be capped at some logical, defendable level.

Accordingly, there are a few special situations that require Board attention and concurrence at this time per the Audit Division's observations and recommendations in the above referenced audit report.

1905 Arcola Avenue

This unit is occupied by a Commission employee. Due to the timing of his move-in date and the approval of the new market rents by the Planning Board on July 5, 2001, this employee incurred a tax liability for 2001 and the first half of 2002. In response to the concerns expressed by the Audit Division that no rent discount for employees exceed the 20% maximum allowable discount per the IRS, the rent for this unit will increase 24% from $546/mo to $678/mo effective July 1. This employee was notified in January, 2002 that his rent would be adjusted on the anniversary of his lease to eliminate any future tax liability.

This action constitutes a fairly substantial increase that, unfortunately, must be implemented immediately to eliminate any further tax liability for 2002 for the affected employee.

Note: Per the observations in the audit report and for the purposes of the calculations made in that report, the 25% allowable discount applied by the IRS in 1984 was used. The Audit Division notes in their report that the IRS now *observes a 20% maximum allowable discount for employees, and this is the percentage amount that staff will apply in the future.*

At a 20% discount off the fair market value, this unit is receiving a much higher discount than is standard for employee-occupied units. The standard discount for employees is 7% in recognition of the savings realized by the Commission by having rents collected through payroll deduction. Per recommendation #1 in the attached audit report, this and other discounts that exceed the standard 7% will be re-evaluated over the next year.

5030 Muncaster Mill Road

This unit is occupied by a Commission retiree who is disabled and on a severely restricted income. The rent discount afforded this person was approved by Board action beginning in the early 1980's due to this individual's particular circumstances.

The current rent for this unit is approximately 33% below market rent. The Audit Division believes that this discount constitutes additional compensation and hence represents a tax liability for the retiree. Though there are differing opinions as to whether a retiree holds the same status as an employee regarding the IRS 20% rule, the retiree was informed that the additional discount could, in fact, constitute additional income which would be taxable.

At this time, the recommended increase for this unit for 2003 is 4.7%. The appropriateness of the continuing 33% discount will be re-evaluated as well over the coming year in terms of the tenant's ability to pay the market rent, his eligibility for rent assistance, and any other relevant factors.

5320 Willard Avenue

This unit is occupied by non-employees. When the unit was first advertised several years ago, there were no takers at the advertised market rent. The unit was subsequently rented as a slightly reduced rent, more in keeping with what the employee rent would have been, but for a non-employee tenant.

In 2001, the fair market value for this property increased 88% from a reported $1,600/mo to $3,000/mo, and will increase to $3,141/mo for 2003. The Audit Division's recommendation to bring this unit up to the full fair market value would result in a 97% one-year rent increase for the tenants. Last year, the Board elected not to apply such a dramatic increase.

L&N's recommendation for 2003 for this property is to increase the rent to within 20% of the fair market value. Such an increase would be consistent with the staff recommendation above that ensures that no rent discount, employees and non-employees alike, exceed the 20% IRS guideline. This increase could be phased in over a year. Such an action would be responsive to, but still falls short of, the audit report recommendation and Practice #6-50, which call for the unit to be rented at fair market value. Staff suggests that the Board may want to take a more measured approach and phase in the increase over a two year period with the goal of ensuring that the discount eventually be no more than 20%of the fair market value for the unit.

25801 Prescott Road

This unit is rented by a Commission employee. Though it is not identified in the attached audit report, the 26% discount afforded this employee exceeds the 20% IRS rule.

The schedule of rents attached to this memorandum recommends that the rental rate for this property be adjusted to reflect no more than a 20% discount allowable under IRS. Such a move would be consistent with the aforementioned Audit Report recommendations, and would minimize any additional tax liability this employee may incur for 2002.

Accordingly, the rent for this property is recommended to increase 12% from $603 to $678, effective September 1, 2002. The appropriateness of the 20% discount will be reexamined along with all other nonstandard discounts as called for by the Audit Division.

<u>Recommendation</u>

Attached is L&N's proposed residential rent schedule for 2003 (FY03). Commission staff in concert with L&N staff has decided to recommend a 4.7% increase in residential rents for 2003 not to exceed the adjusted 2003 market rents. As usual, if a tenant's rent currently exceeds the fair market rent for that unit, their rent will remain unchanged. Vacant units and new properties will be leased at the fair market value for the unit, minus any applicable discounts.

Staff additionally recommends the following.

- A 24% increase for 1905 Arcola Avenue to reduce the discounted rate for this property to 20% in compliance with IRS rules.

- A 4.7% increase, only, for 5030 Muncaster Mill Road until such time as this situation can be evaluated in response to Audit Division concerns.

- A 57% increase for 5320 Willard Avenue to bring this rental unit to 20% of the fair market value for the property. Staff suggests that the increase be phased in over two years, which would result in a slightly higher increase over the two-year period to adjust for the effects of inflation for year two.

- A 12% increase for 25801 Prescott Road to reduce the discounted rate for this property to 20% in compliance with IRS rules.

As explained above, most of the rental units will continue to remain below market value. Over time, some of the situations will be resolved as units are vacated then re-rented. Some of the smaller disparities may be resolved with the next market survey.

Last year, the Board urged staff to consider a more regular evaluation of the market than the five-year cycle we have previously observed. This is a labor-intensive effort and is not currently provided for in the contract with L&N. However, staff will investigate whether such an approach might be cost-effective and help in minimizing the disparity in rental rates versus market value.

Staff appreciates L&N's continuing efforts in preparing for and implementing the annual rent increases for the residential units.

Attachments

ATTACHMENT 1

THE MARYLAND-NATIONAL CAPITAL PARK AND PLANNING COMMISSION

PRACTICE

approved by Commission

no. 6-50

subject

11 September 1985

effective date

USE OF COMMISSION-OWNED PARK HOUSES

AUTHORITY

This practice, originally approved by the Commission February 11, 1976, was revised by the Executive Committee October 3, 1983, to include provisions for lease extension; security deposits; maintenance of electrical systems in park houses; and coordination of agreements with carry-over provisions for tenancy. The current revision amends the basis for rentals, the date for rental adjustments, and contains new criteria for discounting rents.

Thomas H. Countee, Jr.

Thomas H. Countee, Jr.
Executive Director

REFERENCES

Art. 28, §§5-103, 5-110, 5-113, and 5-115, Annotated Code of Maryland, 1957, as amended, 1983 Replacement Volume.

U.S. Code Annotated, Title 26, Internal Revenue Code, §3501(b).

M-NCPPC Merit System Rules and Regulations, Sections 640 and 641 (as amended by the Commission April 14, 1982).

Prince George's County park houses classifications (Attachment A).

Montgomery County park houses classifications (Attachment B).

PURPOSE

To make Commission-owned park houses available for use in a manner beneficial to the public, the Commission, and its employees.

POLICY

A. General

Commission-owned park houses not otherwise covered by agreements made with the grantor at the time of acquisition shall be made available: (1) for rent to Commission employees; (2) at the discretion of a Planning Board, for use by public agencies or private nonprofit organizations or for individuals as part of an approved public program; and (3) for rent on the open market at fair market value.

Rental of Commission-owned park houses shall be administered without discrimination towards applicants or tenants because of age, sex, race, religion, color, national origin, or disability.

POLICY (Continued)

B. Appraisals

All Commission-owned park houses are appraised by independent certified appraisers when acquired, or on an as needed basis.

C. Rental Adjustments

Rental adjustments as appropriate shall be made July 1 each year to reflect changes in the Metropolitan Area market.

Annual rental adjustments will be based on market surveys or other indices of market rents for single family detached houses and apartments.

Each Planning Board may establish dates for gradual implementation of substantial rent increases necessitated by unusually high changes in appraisals.

* D. Income Tax Liability

The Internal Revenue Service assesses income tax liability to employee-tenants if the rental rate constitutes additional compensation. Such additional compensation is not permissible under the Merit System Rules and Regulations. Accordingly, there should be no income tax liability, but if IRS determines that liability exists, it will be the personal responsibility of the employee.

E. Personnel Action Forms

Personnel Action Forms (PA2's) will show the requirement of an employee's occupancy in a Commission park house as a condition of employment. (See M-NCPPC Merit System Rules and Regulations, Sections 640 and 641.) Such occupancy shall be reevaluated if there is a change in employment status. (See item 2., p.4.)

F. Leases

All terms of rentals of park houses must be contained in written leases between the Commission and tenants. All lease agreements require Legal Department approval of legal sufficiency and form, and must be signed by the Executive Director or designee. Leases shall state that employee-tenants shall be charged rent through payroll deduction.

All leases for park houses, unless otherwise stated, are written on a month-to-month basis for a minimum of 3 months, and must allow at least 90 days prior notice to vacate for the convenience and necessity of the Commission. However, 30 days notice shall be provided in the case of eviction for cause. Tenants may terminate their leases with 30 days notice. To the extent possible, the Property Management Offices will assist in the relocation for employee-tenants forced to vacate.

POLICY (Continued)

Employee-tenants must vacate park houses within 90 days of leaving the Commission's employ, unless granted an extension in writing by the Park Property Managers with approval of the Director of Parks or the Director of Parks and Recreation, as appropriate.

Unless otherwise defined in the lease, the Commission maintains roofs, essential electrical and plumbing systems, and furnaces of its park houses, and provides paint and other maintenance materials to tenants. Employee-tenants will be credited for labor cost to paint the structure, with a reduction in rent to cover that labor cost.

Park houses are rented in "as is" condition.

G. Nonemployee Leases

Leasing of Commission-owned park houses to nonemployees will be allowed when it has been determined that neither Commission employees nor the County Government is interested in leasing a particular park house.

* Availability of those park houses shall be advertised in local newspapers and leased at fair market value.

Property Management Offices shall negotiate these leases based on condition of the structure and repairs to be made.

H. Habitability; Razing

Commission-owned park houses that have no potential use as a park facility or require substantial expense to put into habitable condition to meet housing codes may be demolished, or disposed of by sale or auction as determined by the appropriate Department Director in accordance with applicable local law.

I. Special Provision Regarding Security Deposits

Prior to moving into a park house all prospective tenants must provide a security deposit equal to one month's rent. In unusual or hardship circumstances, this requirement may be waived by the Department Head. When a park house is to be vacated, it is inspected and upon satisfactory inspection, the lease terminated. The deposit and accrued interest, if any, are returned to the tenant. If the house has been damaged or is left in an unclean condition, the cost of the necessary maintenance or repairs will be charged against the security deposit. (NOTE: After the deposit has been held for one year, it will begin to accrue interest at a rate determined by the laws governing security deposits.)

ESPONSIBILITIES

A. Montgomery County Parks and Prince George's Parks and Recreation Property Management Offices

At the time of acquisition of improved park properties with carry-over tenants, the Land Acquisition Offices, General Counsel, and Property Management Offices must coordinate all agreements with any carry-over provisions regarding tenancy, such as life estates, established rentals, etc.

B. Montgomery County Director of Parks and Prince George's County Director of Parks and Recreation

1. On matters pertaining to only one county, each Director is responsible to the appropriate Planning Board. On matters of Commission-wide policy, they receive guidance from the Commission.

2. Both Directors determine the requirement for occupancy of Commission-owned park houses as a condition of employment, and reevaluate such occupancy upon employee reassignment of employment status.

3. Both Directors convey to employee-tenants pertinent information reported on park housing activities by the Secretary-Treasurer and General Counsel.

4. Designation of property to be covered by the provisions of this practice is the responsibility of each Director, as appropriate.

5. Further responsibilities of the Directors, or their designees, are:

   (a) To establish initial rents (to be reviewed annually and adjusted, as appropriate), and to assign and reassign employees, as circumstances require, to occupancy in Commission-owned park houses (See assignment criteria, page 5);

   (b) To keep a complete record of each park house appraisal and assignment;

   (c) To adjust rentals by a percentage and/or a flat dollar amount, estimated to equal the benefit and savings to the Commission for: 1) lack of full landlord services, 2) lack of certain appliances, 3) rent payment through payroll deduction, and 4) other factors where Commission leases differ from conventional leases;

Practice 6-50
USE OF COMMISSION-OWNED PARK HOUSES
Effective 11 September 1985
App. Commission

NOTICES OF AVAILABILITY OF PARK HOUSES

Notices of availability of park houses and conditions of occupancy shall be advertised in UPDATE and by other appropriate means. Such notices must indicate that park houses are available to Commission employees regardless of the County or department in which they are employed.

Availability of park houses for rent to the general public will be advertised in area newspapers.

RESPONSIBILITIES (Continued)

(d) To pay employee-tenants for burdens and services, not directly compensated, governed by the Fair Labor Standards Act and Commission Merit Rules;

(e) To adjust rentals for burdens and services (e.g., security, site protection, visitor intrusion and information, and related duties) on a case-by-case basis, at a discount ceiling as established by the appropriate Planning Board;

(f) To assure that rents do not increase as a result of an increased appraisal resulting from the employee-tenant's improvements to the property where such improvements are made at the employees' full expense; NOTE: Prior permission must be granted by the Director of Parks or Director of Parks and Recreation to improve the property. No reduction in rental appraisals will be made resulting from improper maintenance of park houses.

(g) To approve a discount based on benefits to the Commission for exceptional maintenance by the employee-tenant;

(h) To report current park houses activities periodically to the appropriate Planning Board;

(i) To seek through the appropriate Planning Board authorization to make such other adjustments as the Secretary-Treasurer and General Counsel believe will satisfy IRS and Merit System criteria.

ASSIGNMENT OF PARK HOUSES

A. Assignments of park houses shall be based on responses to advertisements of availability of park houses and review of applications, giving priority consideration to low/moderate income employee families (subject to total family income), place of employment, family size, years of service, hardship, and other factors that benefit the Commission (e.g., security, site protection, visitor intrusion and information, and related duties).

B. Assignments of park houses will be based on the recommendation of the Park Property Managers and the approval of either the Director of Parks or the Director of Parks and Recreation, as appropriate.

ATTACHMENT 2

THE MARYLAND-NATIONAL CAPITAL PARK AND PLANNING COMMISSION

Department of Park and Planning, Montgomery County, Maryland
9500 Brunett Avenue • Silver Spring, Maryland 20901

February 7, 2002

MEMORANDUM

TO: Philip Litman, Audit Manager

FROM: Jerry Bush, Administrative Supervisor JB

SUBJECT: Audit Report #02-MC-061 – Montgomery County Park Houses

The following is my response to the audit recommendations contained in the subject audit report #02-MC-061 (copy attached).

1. We are in the process of reviewing the employee discounts for compliance with the IRS 20% maximum discount standard. It is the intention of the Property Management Office to cap all employee discounts at 20% as a matter of future policy, and to bring into compliance any that exist currently, in conjunction with the next annual rent adjustment.

2. Mr. [redacted] has been notified that his rent will be adjusted on the anniversary of his lease to eliminate the taxable fringe benefit. While there has been some question as to whether Mr. [redacted]s discount represents a taxable fringe benefit as a function of his retirement status, he has been likewise notified that he may be incurring a taxable fringe benefit, and his rent may be adjusted accordingly. Please see the attached letters sent by Legum & Norman to these respective tenants.

Though the audit report makes the assertion that rents can be increased at any time per the terms and conditions of the lease, we use the anniversary of the leases (or the anniversary of the most recent rent increase) as the threshold for any future rent increase.

New leases are generally signed for an initial one-year term, after which the lease continues on a month-to-month basis. The newer leases in use by Legum & Norman clearly indicate that the rent can be increased at the expiration of the lease term and/or upon the one-year anniversary of the commencement of the lease. Therefore, new tenants that sign for a one-year initial term lock into the rent rate established at the commencement of the lease for at least that first year. Mr. [redacted] is one such example.

Regarding leases that start out month-to-month, long running leases that have reverted to month-to-month, or older leases that pre-date Legum & Norman, Montgomery County law specifies that a tenant's rent can be increased no more often than once during each twelve month period. Therefore, once any increase is imposed, further increases must wait until the anniversary of the previous increase.

These distinctions go to the matter of when we can correct the situation we are in with Mr. S[redacted]. Based on the above, he will continue to receive a taxable fringe benefit for about the first six months of this year regardless of our best intentions to reverse this situation at an earlier date.

3. When future rent adjustments are presented to the Planning Board, we will make it clear that their actions should not result in any taxable fringe benefit.

4. Legum and Norman will be instructed to ensure that rental rates do not result in any taxable fringe benefits.

5. Mr. S[redacted] and Mr. C[redacted] have been notified that they may be incurring a taxable fringe benefit as a result of their rent discounts. The taxable fringe benefit will be included on Mr. S[redacted]'s W-2 form for 2001. The Employee's Retirement System was notified of this audit recommendation as it relates to Mr. C[redacted]. Mr. Navarre's e-mail response is attached.

While I don't disagree that Mr. C[redacted]'s rent discount in excess of 25% may be taxable, I have heard enough conflicting opinions on this matter, including the one from Mr. Navarre, to raise a reasonable doubt in my mind. I believe further investigation is necessary. However, without sufficient documentation in the files to support the reasons behind Mr. C[redacted]'s extra discount, I believe the Property Management Office should move in the direction of eliminating or significantly reducing the discount, anyhow, to bring it into compliance with IRS regulations.

6. Legum & Norman will be asked to verify the appraised rental value and inform the tenant accordingly. Subject to approval by the Planning Board, the rent will be increased on the anniversary of the lease to reflect the current market value.

Thank you for the cooperation of you and your staff in issuing a thoughtful and balanced audit report on this matter. I apologize for the extreme delay in responding to the recommendations therein.

Attachments

cc: Legum & Norman
Don Cochran
Les Straw

ATTACHMENT 2

MEMO

THE MARYLAND-NATIONAL CAPITAL PARK & PLANNING COMMISSION

Department of Finance

PL02-061
November 16, 2001

To: Adrian R. Gardner, General Counsel

From: Patricia Colihan Barney, Secretary-Treasurer PCB

Subject: **Montgomery County Park Houses**
Audit Report 02-MC-061

In my August 24, 2001 e-mail message, I advised that I asked the Audit Division to address your concerns about discounted park house rentals.

Their report is attached. I concur with their findings and recommendations.

The audit report has been discussed with Administrative Supervisor Jerry Bush who concurs with both the findings and audit recommendations.

The audit report contains six audit recommendations concerning compliance to the Internal Revenue Code and Regulations, Compliance with Commission Practice 6-50, and the review of a rental appraisal.

If you have any questions, please feel free to call the Audit Manager.

cc: Donald K. Cochran
Lester Straw
Michele Rosenfeld

Report # 02-MC-061

THE MARYLAND-NATIONAL CAPITAL PARK AND PLANNING COMMISSION
Audit Report
Montgomery County Department of Park and Planning
Property Management Office
Residential House Rental Program
November 14, 2001

The Montgomery County Property Manager requested guidance regarding three park house leases which, when rent was incremented on September 1, 2001, still exceeded the maximum 25% discount from market value usually allowed to Commission employees. Of the three, one house is rented to an employee, one to a retiree and one to a non-employee. At the request of the General Counsel, the Secretary-Treasurer assigned this request to the Audit Division for response.

Purpose and Scope:

- To determine the facts of each of these three lease contracts.
- To review actions by Legum and Norman, leasing agent for the Commission.
- To make recommendations regarding taxable income reportable to the IRS as the result of discounts from fair market value rentals.
- To review the July 5, 2001 approved rent increase schedule.
- To measure compliance with Commission Practice 6-50, Use of Commission-owned Park Houses.
- To measure compliance with the Internal Revenue Code (IRC) rules and regulations.
- To develop recommendations as appropriate.

Internal Revenue Code

The Internal Revenue Code and regulations concerning fringe benefits set forth that meals and lodging costs provided by an employer are excludable from gross income if provided for the convenience of the employer. Otherwise, their value is includible (in the employee's gross income.) The IRC regulations limit employee discounts which cannot exceed 20 % of the price at which the services are offered to consumers.

This audit was conducted in accordance with generally accepted Government Auditing Standards for Financial and Compliance Audits.

Prepared by: [signature] Date: 11/16/01 Approved: [signature] Date: 11/16/01

Date of audit close out: September 27, 2001 Noted: [signature] Date: NOV 16 2001

In1984, the Internal Revenue Service conducted an audit of Commission park houses. The Internal Revenue Service determined that the difference between the appraised rent and the actual rent paid (adjusted as described below) represented a taxable fringe benefit to employees who rented these houses.

This taxable fringe benefit is to be reported as income on the employee's W-2 form. In 1984 the Internal Revenue Service allowed a 25% discount from the appraised rental to determine the taxable fringe benefit. The discount represented: the value of landlord services which were not furnished, the fact that rent is deducted from the employee's salary, the nuisance factor of employees living on public lands and the requirement that these employees perform sundry Commission duties where they reside.

Findings:

Commission Park Houses are usually appraised every five years. In the interim the appraisal is adjusted annually by market factors. The park houses were appraised in 1995 and again in 2000.

Commission Practice 6-50, Use of Commission-owned Park Houses, states in Policy D that rentals should not result in an income tax liability. As IRS has determined that discounted rentals constitute additional compensation, this is not permissible under the Merit System Rules and Regulations. The Practice also states that rent to the public (non-employees) must be at fair market value.

The Property Management function has been using the following formula for application of discounts from the appraised rent. These are applied on a case by case basis:

8% for employee duties at the site
5% nuisance value for living on property accessible to the public
7% for payment of rent through payroll deduction, and
5% other for exemplary maintenance

Property Management has furnished the Audit Division with an undated paper entitled "SUMMATION OF BOARD ACTIONS REGARDING CHANGES IN THE HOUSING PRACTICE". This document confirms the above discounts, except for the "exceptional maintenance", where the discount is established on a case by case basis. The document also provides for a $2.00 per month discount when the tenant provides their own refrigerator and a $2.50 per month for providing their own range.

We have reviewed schedules furnished by the Montgomery County Property Management function. These show the appraised rent and the actual rent paid. As set forth below, we have corroborated Property Management's findings that there is one employee and one retiree whose rents are less than 75% of the appraised value. We have also determined that there is one non-employee whose rent is only 53% of the appraised value. These situations are summarized below. For purposes of this audit, we have used the 1984 IRS guideline which allowed a 25 % discount from the appraised rent for determining the taxable fringe benefit.

<u>5030 Muncaster Mill Road, (C[redacted] retiree)</u>

This rental after escalation on September 1, 2001, resulted in a discount of 33% off market value. The tenant is a disabled Commission retiree. After hearing the particular fact pattern of this lease the MCPB, in 1983 and again in 1990, granted him a limited exemption for this unit for rent increases. We were unable to determine whether the Planning Board was aware that their 1990 action was not consistent with Commission Practice 6-50, as their action resulted in a taxable fringe benefit to Mr. C[redacted] The rent was recently increased the maximum 5% to a new rate of $397/month. Actual rent paid is $397. The appraised rent less the 25% discount is $446. Consequently there is a $49 per month taxable fringe benefit. Mr. C[redacted] receives a Form 1099 from the Employees' Retirement System. As the reduction of rent is deemed to be for his past services it has the defacto effect of increasing his retirement income from the Commission. Mr. C[redacted] should be advised of the amount of the fringe benefit which is to be reported to IRS. The lease agreements with Mr. C[redacted] and Mr. S[redacted] (below) permit the Commission to adjust the rent at any time.

<u>5320 Willard Avenue, (R[redacted] Non-employee)</u>

Legum and Norman's market appraisal in the spring of 2001 set a market rent of $3,000. The prior adjusted market value rent was $1,521. The current tenant moved in 12/11/98 and was paying $1,521/month through June, 2001. Rent was raised the maximum 5% to $1,597. At the time, this was above the appraised rent. This arms length lease is for 53% of market value, assuming the revised appraisal is accurate. There is no taxable fringe issue as the tenant is neither an employee or retiree. Both the Audit Division and Property Management note that the appraised rent increased by 97% which appears to be unusually high.

1905 Arcola Avenue, ([redacted], Employee)

The tenant signed a one year lease effective June 1, 2001, at $546/month. This was the same 75% of market rate paid by the previous tenant. The prior market value rent was $795, while the 2001 market value rent increased to $810. The new market value schedule was approved by the MCPB on July 5, 2001, after Mr. [redacted] occupied the house. The full year taxable fringe benefit is $738 (75% of appraised value is $607.50 less monthly payment of $546) or $61.50 per month times 12.

CONCLUSIONS AND OBSERVATIONS:

Audit reviewed the other discount computations in the Approved Residential Rent Schedule of July 5, 2001. No other exceptions were noted to the 25% discount guideline. However in view of the IRS rules and regulations cited above, we question whether we could defend any employee/retiree discount exceeding the 20% maximum set forth in the IRS regulations.

Any adjustments to rents as a result of this audit should have the concurrence of the Planning Board as they have established the rents and changes would result in a change of direction previously received from them.

RECOMMENDATIONS:

1. All employee discounts from the appraised rent should be reviewed by Property Management for compliance to the IRS 20% maximum discount standard set forth above. Legum and Norman should be asked to corroborate that these discounts meet industry standards. Affected employees should be advised of any changes to the discount formula. These should be implemented when the next annual rent adjustment is considered.

2. The current rent for Mr. [redacted] and Mr. [redacted] should be adjusted to bring them into compliance with Practice 6-50 and to eliminate the current taxable fringe benefit. In light of the prior Planning Board action, the Planning Board should be asked to concur in these rent adjustments.

3. When the Planning Board is requested to approve future rent increases, there should be a caveat that no action on their part should result in a taxable fringe benefit and,

to the extent necessary, any rent may be adjusted so that no taxable fringe benefit will result.

4 Legum and Norman should assure that employee leases do not result in taxable fringe benefits.

5. Mr. [redacted] and Mr. [redacted] should be notified of the annual taxable fringe benefit to be included by them in their tax returns. The taxable fringe benefit should be included in Mr. [redacted]s W-2 form for 2001. The Employees' Retirement System should be advised of the taxable fringe benefit for Mr. [redacted] with a request that it be included in his Form 1099 for 2001.

6. In view of the very large increase in the appraised rental value, Legum and Norman should verify that the rent appraisal of 5320 Willard Avenue is accurate. The rent for the non-employee should be adjusted to the accurate appraised value as soon as possible in accordance with Commission Practice 6-50.

ATTACHMENT 2

L&N LEGUM&NORMAN INC.

Community Association Management ■ Multi-Family Rental Management
Facility Services ■ Consulting ■ General Brokerage

January 3, 2002

[redacted]
1905 Arcola Avenue
Wheaton, MD 20902

Dear Mr. S[redacted]

An audit by M-NCPPC has determined that your rent reduction exceeds the 25% allowed by the IRS. When you moved in on June 1, 2001, your rent was based on a prior assessed market value of $585.00. With your 7% discount this gave you a rent of $546.00. On July 5, 2001, a new market value of $810.00 was approved by the Montgomery County Board. The IRS 25% rule would only allow a discount to a rent of $607.50. This gives you a taxable fringe benefit of $61.50 per month. This fringe benefit will be included on your Tax Year 2001 W-2 form.

On the anniversary of your lease, your rent will be increased so that you do not receive a taxable benefit. If you have any questions, please feel free to contact me.

Sincerely,

John Anderson

John Anderson, Property Manager
Legum & Norman Realty, Inc.
Agent for M-NCPPC

cc: Jerry Bush, Administrative Supervisor, M-NCPPC

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ATTACHMENT 2

L&N LEGUM&NORMAN INC.

Community Association Management ▪ Multi-Family Rental Management
Facility Services ▪ Consulting ▪ General Brokerage

January 3, 2002

[redacted]
5030 Muncaster Mill Road
Rockville, MD 20853

Dear Mr. [redacted]

An audit by M-NCPPC has determined that your rent is more than 25% below the market value of $595.00 that was approved on July 5 by the Montgomery County Board. A 25% discount would result in a rent of $446.00. Your current rent is $397.00. This is $49.00 less than a 25% reduction. Please be advised that as a retired M-NCPPC employee the IRS may consider this a taxable benefit. Please check with your tax preparer to see if this may be the case.

If it is determined by M-NCPPC that this is a taxable benefit, your rent may be adjusted accordingly.

If you have any questions, please feel free to contact me.

Sincerely,

John Anderson

John Anderson, Property Manager
Legum & Norman Realty, Inc.
Agent for M-NCPPC

cc: Jerry Bush, Administrative Supervisor, M-NCPPC

METROPOLITAN WASHINGTON ▪ CHICAGO ▪ RESORTS

CORPORATE HEADQUARTERS: 4401 FORD AVENUE ▪ SUITE 1200 ▪ ALEXANDRIA, VA 22302 ▪ 703.600.6000 ▪ FAX: 703.848.0982
www.legumnorman.com

ATTACHMENT 2

Bush, Jerry

From: Bush, Jerry
Sent: Thursday, December 13, 2001 6:09 AM
To: Conner, Brent; John Anderson (E-mail)
Cc: Warnick, Karen
Subject: FW: TFB - [redacted], RE PARK HOUSE

FYI. This has to do with the recent audit on this matter. John perhaps your letter to [redacted] should indicate that he may have a taxable fringe benefit that he should check with a tax preparer or directly with the IRS. My argument all along has been the same as Navarre's, but Audit wasn't convinced. I will continue to pursue this on my end with payroll, but we may not end up issuing the 1099. JB

-----Original Message-----
From: Navarre, Edward
Sent: Wednesday, December 12, 2001 2:15 PM
To: Litman, Phil
Cc: Barney, Patti; Gardner, Adrian; Rosenfeld, Michele; Cochran, Don; Straw, Les; Bush, Jerry; Rose, Andrea; Navarre, Edward
Subject: TFB - [redacted], RE PARK HOUSE

PHIL, ET AL.
PLEASE BE ADVISED THAT IT IS NOT APPROPRIATE FOR ERS TO ISSUE A FORM 1099 TO MR. [redacted]. MR. [redacted] IS NOT AN ERS EMPLOYEE AND HAS NOT RECEIVED A TAXABLE FRINGE BENEFIT FROM THE ERS WHICH IS A SEPARATE EMPLOYER FROM THE COMMISSION.

I WOULD FURTHER SUGGEST THAT YOU REVIEW HIS CASE, AS BASED UPON MY RECOLLECTION OF MEETINGS WITH THE IRS IN THE OLD DAYS, AND MY READING OF THE AUDIT REPORT, TAXABLE FRINGE BENEFITS RELATE TO EMPLOYEES AND MR. [redacted] IS NOT EMPLOYED BY EITHER THE ERS OR THE COMMISSION.

REGARDS/ ED

MONTGOMERY COUNTY DEPARTMENT OF PARK AND PLANNING
Proposed Residential Rents - FY 02 Actual vs. FY 03 Proposed
Planning Board Meeting June 20, 2002

Employee, Non-Employee, Vacant	Address of Property	FY 02 Rent w/Discount	FY 03 Proposed Rent w/ Discounts (4.7% incr. capped at 2002 adjusted market rent)	FY 03 Increase Amount	FY 03 Percent Increase	FY 02 Market Rent (as of Spring 2001)	FY 03 Adjusted Market Rent (2001 Market Rent x 4.7 Percent Adjustment)	FY 02 Rent (w/o Discounts)	FY03 Proposed Rent w/o Discounts (4.7% incr. capped at 2002 adjusted market rent)	FY 03 Percent Proposed Rent (w discount) (Above)/Below 2002 Adjusted Market Rent
E	3000 Airy Hill Lane	$705	$707	$2	0.24%	$675	$707	$758	$758	[illegible]
N	1700 April Lane, Silver Spring, Maryland	$731	$765	$34	4.70%	$780	$817	$731	$765	[illegible]
E**	1905 Arcola Avenue, Wheaton, Maryland	$546	$678	$132	24.18%	$810	$848	$587	$725	[illegible]
N	2320 Baltimore Road, Rockville, Maryland	$573	$597	$24	4.15%	$570	$597	$573	$597	[illegible]
V	20020 Bealesville Road, Bealesville, Maryland	$0	$2,251	$2,251	0.00%	$2,150	$2,251		$2,251	[illegible]
N	24510 Clarksburg Road, Clarksburg, Maryland	$747	$782	$35	4.70%	$810	$848	$747	$782	[illegible]
E	24520 Clarksburg Road, Clarksburg, Maryland	$846	$886	$40	4.70%	$950	$995	$910	$952	[illegible]
E	24620 Clarksburg Road, Clarksburg, Maryland	$638	$668	$30	4.70%	$760	$796	$686	$718	[illegible]
N	24625 Clarksburg Road, Clarksburg, Maryland	$491	$514	$23	4.70%	$570	$597	$491	$514	[illegible]
E	24629 Clarksburg Road, Clarksburg, Maryland	$529	$554	$25	4.70%	$595	$623	$569	$596	[illegible]
E	24801 Clarksburg Road, Clarksburg, Maryland	$529	$554	$25	4.70%	$610	$639	$569	$596	[illegible]
E	25200 Clarksburg Road, Clarksburg, Maryland	$605	$623	$18	2.97%	$595	$623	$651	$651	[illegible]
E	25230 Clarksburg Road, Clarksburg, Maryland	$736	$771	$35	4.70%	$810	$848	$791	$829	[illegible]
E	25300 Clarksburg Road, Clarksburg, Maryland	$795	$832	$37	4.70%	$855	$895	$855	$895	[illegible]
E	14401 Clopper Road, Boyds, Maryland	$736	$771	$35	4.70%	$830	$869	$791	$829	[illegible]
E	14500 Clopper Road, Boyds, Maryland	$430	$450	$20	4.70%	$465	$487	$462	$484	[illegible]
N	125 Dale Drive, Silver Spring, Maryland	$785	$822	$37	4.70%	$785	$822	$785	$822	[illegible]
N	9000 Democracy Boulevard, Potomac, Maryland	$799	$837	$38	4.70%	$810	$848	$799	$837	[illegible]
E	10221 Frederick Avenue, Kensington, Maryland	$712	$746	$33	4.70%	$760	$796	$766	$796	[illegible]
N	23925 Frederick Road, Clarksburg, Maryland	$681	$713	$32	4.70%	$690	$722	$681	$713	[illegible]
E	24615 Frederick Road, Clarksburg, Maryland	$532	$557	$25	4.70%	$595	$623	$572	$599	[illegible]
E	24701 Frederick Road, Clarksburg, Maryland	$564	$591	$27	4.70%	$635	$665	$606	$635	[illegible]
E	24705 Frederick Road, Clarksburg, Maryland	$540	$565	$25	4.70%	$640	$670	$581	$608	[illegible]
E	24709 Frederick Road, Clarksburg, Maryland	$555	$581	$26	4.70%	$620	$649	$597	$625	[illegible]
N	24715 Frederick Road, Clarksburg, Maryland	$890	$932	$42	4.70%	$890	$932	$890	$932	[illegible]
E	24801 Frederick Road, Clarksburg, Maryland	$842	$881	$40	4.70%	$905	$948	$905	$948	[illegible]
N	24819 Frederick Road, Clarksburg, Maryland	$541	$566	$25	4.70%	$595	$623	$541	$566	[illegible]
E	25025 Frederick Road, Clarksburg, Maryland	$618	$647	$29	4.70%	$665	$696	$665	$696	[illegible]
E	25029 Frederick Road, Clarksburg, Maryland	$553	$579	$26	4.70%	$595	$623	$595	$623	[illegible]
N	25101 Frederick Road, Clarksburg, Maryland	$700	$733	$33	4.70%	$700	$733	$700	$733	[illegible]
E	25115 Frederick Road, Clarksburg, Maryland	$532	$557	$25	4.70%	$650	$681	$572	$599	[illegible]
E	25119 Frederick Road, Clarksburg, Maryland	$613	$642	$29	4.70%	$665	$696	$659	$690	[illegible]
E	25201 Frederick Road, Clarksburg, Maryland	$612	$641	$29	4.70%	$665	$696	$658	$689	[illegible]
E	25211 Frederick Road, Clarksburg, Maryland	$642	$672	$30	4.70%	$690	$722	$690	$722	[illegible]
N	25321 Frederick Road, Clarksburg, Maryland	$1,072	$1,094	$22	2.06%	$1,045	$1,094	$1,072	$1,094	[illegible]
N	21414 Georgia Avenue, Brookeville, Maryland	$683	$715	$32	4.70%	$690	$722	$683	$715	[illegible]
N	14300 Gladbeck Drive, Silver Spring, Maryland	$365	$382	$17	4.70%	$425	$445	$365	$382	[illegible]
E	10801 Glen Road, Potomac, Maryland	$616	$645	$29	4.70%	$660	$691	$662	$691	[illegible]

E=MNCPPC Employee (receives 7% discount for payroll deduction payment of rent)
N=Non-employee of M-NCPPC
V=Vacant (all homes that are on hold or off-line are not included)
* Tenant/house recieves additional discounts for duties and/or nuisance.

MONTGOMERY COUNTY DEPARTMENT OF PARK AND PLANNING
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E	1210 Goldmine Road, Brookeville, Maryland	$772	$808	$36	4.70%	$830	$869	$830	$869	0
E	1901 Henderson Avenue, Silver Spring, Md.	$807	$845	$38	4.70%	$945	$989	$868	$909	8
N	2012 Henderson Avenue, Silver Spring, Maryland	$696	$729	$33	4.70%	$817	$855	$696	$729	1
E	9901 Huntmaster Road, Germantown, Maryland	$927	$971	$44	4.70%	$997	$1,044	$997	$1,044	0
E	1500 Jackson Road, Silver Spring, Maryland	$610	$639	$29	4.70%	$690	$722	$656	$687	[illegible]
E	13910 Lewisdale Road, #A, Clarksburg, Maryland	$410	$429	$19	4.70%	$499	$522	$441	$462	1
E	13910 Lewisdale Road, #B, Clarksburg, Maryland	$447	$468	$21	4.70%	$470	$492	$481	$492	0
E	1634 Maydale Drive, Silver Spring, Maryland	$618	$648	$29	4.70%	$665	$696	$665	$696	0
E	11003 MacArthur Boulevard, Potomac, MD	$791	$828	$37	4.70%	$850	$890	$850	$890	0
N	17320 Moore Road, #1, Boyds, Maryland	$812	$850	$38	4.70%	$925	$968	$812	$850	1
E	17320 Moore Road, #2, Boyds, Maryland	$885	$927	$42	4.70%	$1,000	$1,047	$952	$996	[illegible]
N	18228 Muncaster Road, Rockville, Maryland	$1,193	$1,249	$56	4.70%	$1,425	$1,492	$1,193	$1,249	1
N	5030 Muncaster Mill Road, Rockville, Maryland	$397	$416	$19	4.70%	$595	$623	$397	$416	3
N	16401 Old River Road, Poolesville, Maryland	$1,155	$1,209	$54	4.70%	$1,200	$1,256	$1,155	$1,209	4
E	15920 Oursler Road, Burtonsville, Maryland	$740	$775	$35	4.70%	$798	$836	$796	$833	0
N	16100 Oursler Road, Burtonsville, Maryland	$691	$723	$32	4.70%	$718	$752	$691	$723	4
E	25301 Prescott Road, Clarksburg, Maryland	$552	$578	$26	4.70%	$665	$696	$594	$621	1
E	25801 Prescott Road, Clarksburg, Maryland	$603	$678	$75	12.44%	$810	$848	$648	$725	1
E	26025 Prescott Road, Clarksburg, Maryland	$591	$619	$28	4.70%	$620	$649	$635	$649	0
E	1600 E. Randolph Road, Silver Spring, Md.	$750	$785	$35	4.70%	$905	$948	$806	$844	1
N	13325 Riley's Lock Road, Poolesville, Md	$1,255	$1,314	$59	4.70%	$1,305	$1,366	$1,255	$1,314	4
N	4915 River Road, Chevy Chase, Maryland	$1,199	$1,199	$0	0.00%	$1,140	$1,194	$1,199	$1,199	0
N	2001 Shorefield Road, Wheaton, Maryland	$1,165	$1,220	$55	4.70%	$1,165	$1,220	$1,165	$1,220	0
N	12001 Skylark Road, Cedar Grove, Maryland	$1,423	$1,490	$67	4.70%	$1,520	$1,591	$1,423	$1,490	6
V	8700 Snouffer School Road, Gaithersburg, Maryland	$0	$1,220	$1,220	0.00%	$1,165	$1,220	$0	$1,220	0
N	12718 Viers Mill Road, Rockville, Maryland	$815	$853	$38	4.70%	$935	$979	$815	$853	1
E	1900 Windham Lane, Silver Spring, Maryland	$704	$737	$33	4.70%	$760	$796	$757	$793	0
N**	5320 Willard Avenue, Chevy Chase, Maryland	$1,597	$2,513	$916	57.36%	$3,000	$3,141	$1,597	$2,513	2
E	22201 Zion Road, Brookeville, Maryland	$656	$686	$31	4.70%	$705	$738	$705	$738	0
	Totals per month	$47,345	$53,905	$6,560	13.86%	$56,329	$58,976	$49,293	$55,887.68	[illegible]
	Total per year			$78,724						
**Non-Routine increases per prior discussion										

E=MNCPPC Employee (receives 7% discount for payroll deduction payment of rent)
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* Tenant/house recieves additional discounts for duties and/or nuisance.