

TRIBUNE WATCHDOG: THE TAX DIVIDE

AN ERA OF ERRORS

As assessor, James Houlihan knowingly sent out inaccurate property valuations. The future consequences could be costly.

North Center, Chicago (Terrence Antonio James / Chicago Tribune)

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By Jason Grotto (<mailto:jgrotto@chicagotribune.com>?
subject=Regarding:)

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For more than a decade, the Cook County assessor's office hid a secret inside the massive computer programs used to calculate property tax assessments for single-family homes.

It didn't look like much — just a few snippets of code amid thousands of lines — but it created erroneous valuations for homes throughout the county, affecting the tax bills sent to more than 1 million residential property owners every year.

What the code did was deceptively simple: It decreased every estimated home value in the county by about 40 percent, a troubling practice that ignored legal requirements set out in county ordinances.

The artificially low values threw the property tax system so far out of whack that it may have violated provisions of the state constitution. But, shrouded by an opaque and convoluted assessment system, these widespread inaccuracies were invisible to the average homeowner.

The Tribune already has revealed how the county's assessment system under Joseph Berrios has been riddled with errors that punished the poor (<http://apps.chicagotribune.com/news/watchdog/cook-county-property-tax-divide/index.html>) while providing breaks to the wealthy.

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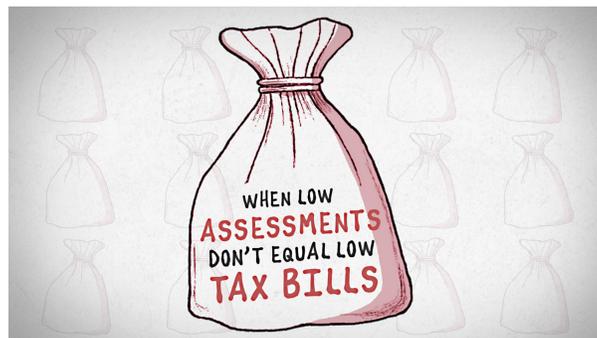
Now the investigation shows that the assessor's office knowingly produced inaccurate property assessments during the long tenure of his predecessor, James Houlihan, and even as far back as the 1980s.

Houlihan removed the snippets of code in 2009, a year before he left office. But their existence reflects the assessor office's long history of flouting legal requirements and operating outside professional standards while keeping taxpayers in the dark about fundamental problems with assessments. It also exposes the far-reaching consequences when a crucial county agency is allowed to function with little oversight.

The undervaluing of residential properties, for instance, may have given homeowners a false sense that they were getting a huge break on their tax bills. In reality, that was far from the case, because the computer code undervalued all homes in pretty much the same way.

The Tribune also found that for many years commercial and industrial properties were undervalued even more than residential ones. If all properties had been assessed accurately during that time, homeowners would have paid less in property taxes, according to Tribune estimates.

Low assessments, high tax bills



And the consequences continue to this day, with taxpayers potentially paying the price in a different way. A prominent law firm has filed lawsuits on behalf of

dozens of properties contending that Houlihan produced “fictitious” residential valuations between 2000 and 2008.

The suits seek to claw back as much as \$100 million in tax dollars, the Tribune estimated — money that Chicago Public Schools and other financially struggling agencies and municipalities would have to repay.

Houlihan, now a state lobbyist, declined to be interviewed for this story.

In 2008, Houlihan pushed through sweeping changes to the assessment system, saying they would make the system more fair and transparent. His office also quietly removed the hidden calculations.

Within months, the housing market had collapsed, and home prices were plummeting. But when people got their assessment notices, their values had gone up dramatically because the snippets of code had been taken out.

Complaints poured in, but Houlihan never told the public about his office’s failure to produce accurate and lawful valuations.

“It sounds like for years the assessor’s office was shooting for a target rather than using legitimate methods to value property,” said Ralph Martire, executive director of the Center for Tax and Budget Accountability. “If your property tax system is not properly run, it has a ripple effect that impacts every level of government.”



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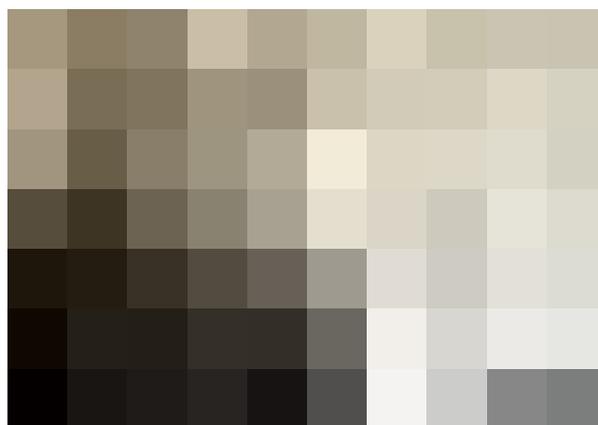
The 40 percent trick

A former theologian turned politician, Houlihan was hand-picked by Cook County Assessor Thomas Hynes as his successor. Hynes, a longtime Democratic power broker, left office in 1997 after serving for 18 years.

Before Houlihan took over, the assessor's office was already ignoring county laws by undervaluing homes across the board, state records show.

At the time, the assessment level for residential properties in Cook County was set at 16 percent. This means that the total assessed value of all homes in the county should have been equal to about 16 percent of their total market value.

But that was not the case. Studies from the Illinois Department of Revenue that compare assessments to actual sale prices show that at least as far back as 1994, the earliest year of available records, the median assessment level for residential properties in the county had been much lower: less than 10 percent.



James Houlihan, shown in 2009, preceded Joseph Berrios as Cook County assessor. When he took office in 1997, residential properties were already being dramatically undervalued. (Jose M. Osorio/Chicago Tribune)

How could that be happening when homeowners' tax bills stated in black and white that their property was being assessed at 16 percent?

The answer lies with an earlier step in the process, in which the assessor's office applied what's known as an "adjustment factor." This adjustment purposefully lowered the market value of each home, before the assessment level was applied.

The Tribune figured this out by combing through thousands of lines of computer code used to value residential properties during the Houlihan era.

The programs, known as hedonic regression models, take characteristics of homes that sold in the prior three or five years and compute values for each one — the value per bathroom, per square foot and so on. The models then use those values to estimate market prices for every home.

But in this case, snippets of code were tacked onto the end that dramatically decreased those estimates by about 40 percent. So for example, a home that was valued at \$326,530 would be reduced to about \$200,000.

The county then multiplied that new, lower value by the legal assessment level of 16 percent. To use the last example, 16 percent of \$200,000 is \$32,000. And that is roughly 10 percent of the home's market value.

Applying this mathematical wizardry to all of the county's homes is what set the county's de facto assessment level at about 10 percent, in apparent violation of the law.

Figuring out why or when this practice started is difficult to discern. But the man who built the computer models, John Horbas, has testified that an adjustment factor was part of the valuation process for more than a decade before Houlihan took office.

"I know for sure from 1984 on there was an adjustment factor," Horbas said in an October 2015 deposition.

When Houlihan inherited that problem, he took on another one as well.

Constitutional crisis

Property valuations in Cook County are handled differently from anywhere else in the state, thanks to a complicated system that makes it difficult for most taxpayers to fully understand how their taxes are calculated.

Unlike the other 101 counties in Illinois, Cook County assesses the value of property at different levels depending on their use. Known as classification, the system is meant to give homeowners a break on taxes.

To shift more of the burden onto businesses, the assessment level for residential properties has always been lower than the levels for commercial and industrial properties.

Still, the categories can't be too different. Under the state constitution, no one class of property can be assessed at a level that exceeds 2.5 times the level of any other.

On the surface, Cook County met that standard under Houlihan and Hynes.

The reality, however, was different — thanks to the county’s practice of undervaluing residential properties.

State revenue department studies show that from at least 1994 to 2003, the median assessment level for commercial properties in Cook County was more than 2.5 times greater than the roughly 10 percent median assessment level for residential homes.

Most taxpayers would never know any of this. But more than a decade ago, some influential lawyers started suing.

The law firm of O’Keefe, Lyons & Hynes was well positioned to know what was wrong. Thomas Lyons was a former deputy assessor and state senator who pushed to allow Cook County to continue using classification during the 1970 state constitutional convention. Robert Hynes was the brother of longtime assessor Hynes. And lead attorney Mark Davis once headed the tax division for the Cook County state’s attorney’s office.

Before joining the firm, Davis helped write changes to the state’s property tax code in a way that made it easier to challenge assessments in circuit court. Prior to the new law, taxpayers had to prove their assessments were so faulty as to suggest the assessor targeted them specifically, an impractically high burden of proof.

Since 2000, O’Keefe, Lyons & Hynes has filed suits involving dozens of commercial, industrial and residential properties, arguing that the assessor’s office trampled state and federal constitutional provisions between 2000 and 2008 — not just the 2.5 rule, but also provisions that guarantee equal protection under the law. Most of the suits are still being argued in county court.

The firm declined requests for an interview but issued a statement to the Tribune: “Discriminatory assessments and opaque methodologies destroy the fairness of the property tax system for all taxpayers — not just the plaintiffs in the ongoing lawsuits. Instead of opposing the rights of taxpayers, agencies of local government should work to remedy past discrimination and to ensure a future system that is equitable.”



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“Discriminatory assessments and opaque methodologies destroy the fairness of the property tax system for all taxpayers.”

Statement from O’Keefe, Lyons & Hynes law firm

The foundation of the O’Keefe suits is a study by their expert witness, University of Illinois economics professor Daniel McMillen. He found that median assessment levels for all classes of property in Cook County were far lower than county ordinances dictated at the time.

Many findings in the McMillen study mirror those from the Tribune’s analysis as well as from studies conducted by the state Department of Revenue. In an affidavit filed in September, for instance, McMillen independently cited the same computer code that the Tribune had identified as the cause of low residential assessments.

When Houlihan took charge of the assessor’s office in 1997, those with deep knowledge of the property tax system would have understood that the ongoing drastic undervaluation of residential homes left the county vulnerable to legal challenges.

One way to fix that problem would have been to raise residential assessments to legal levels.

But that would have increased many people’s taxes, and that is not what Houlihan chose to do.

Instead, records show, the assessor’s office left the residential level where it was — at 10 percent — and began taking measures that reduced the levels for commercial and industrial properties.

Over the next decade, the median commercial and industrial assessment levels in Cook County fell by more than a third. In 2007, the median level for commercial property was about 17 percent — less than half of what it was supposed to be, according to state studies.

Internal studies unearthed in the O’Keefe lawsuits show the assessor’s office knew about the low valuations. One report, titled “The Effects of the Decline in Commercial Assessment,” detailed a significant drop in commercial assessment levels between 2003 and 2004.

The Tribune was able to analyze how the assessor’s office valued residential properties by examining records and formulas obtained through a freedom of

information request, but Berrios has declined to release similar information about how commercial and industrial properties are assessed. He argues that the office's valuations are a deliberative process protected under the Freedom of Information Act.

In response, the Tribune filed a lawsuit and won a ruling in its favor from Cook County Circuit Court Judge Neil H. Cohen. "I think it leads to an absurd result if anyone were to accept this argument. I think it's actually a violation of trust that the public officials are given by the people," Cohen said in court.

Despite Cohen's sharp rebuke, the assessor's office is appealing that decision, at taxpayer expense.

The lower assessments for commercial and industrial properties solved a problem for the assessor's office — the county was no longer valuing one category at a level more than 2.5 times higher than another.

But the changes meant many homeowners were paying more in taxes.

Paying the price

To gauge the impact of the county's questionable practices on property owners' pocketbooks, the Tribune studied the 2008 tax year.

That year, homeowners' properties were still being dramatically undervalued, at 10 percent. The tricky snippet of computer code — the adjustment factor — was still in place. Commercial and industrial properties were being undervalued more than ever.

All that undervaluing meant that, in 2008, the assessor's office shaved tens of billions of dollars from the total assessed value of the county, the Tribune estimated. The result was a cascading series of problems that increased the tax burden for residential property owners.

The reasons lie with two factors in property tax bills: the multiplier and the tax rate.

Your tax bill, explained



The multiplier comes from a provision in state law requiring that the total market value of all property in every county be assessed at 33⅓ percent. The state revenue department compares assessments to actual sales to test whether counties reach that number.

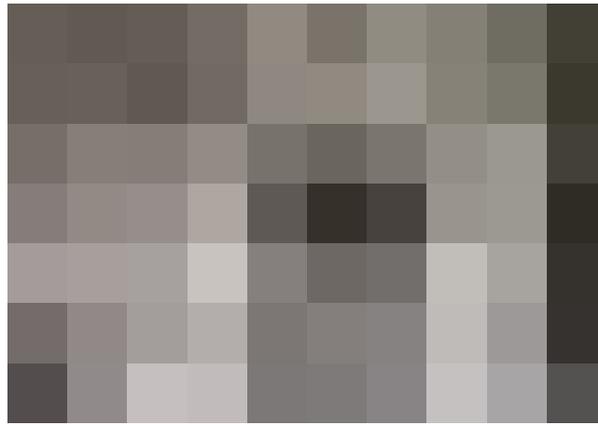
If the assessment level is less than 33⅓ percent, the state applies a multiplier, known as an “equalization factor,” to the assessed value of every property in the county to bring it up to the statutory level. The result is called the equalized assessed value. Taxpayers can see these figures spelled out on their bills.

In nearly every other county in Illinois, the multiplier is always around 1. But because the assessor’s office was depressing values across Cook County, the multiplier for Cook in 2008 was nearly 3.

Depressing property values also can increase tax rates, which are derived by dividing a taxing district’s total equalized assessed value into the tax levy — the total amount of money that local government units say they need to operate.

In Cook County, the bigger multiplier and higher tax rates were applied to all properties. But because commercial and industrial properties were undervalued more than residential properties, homeowners ended up paying a bigger share.

The owner of a \$326,000 home in Chicago that was undervalued at \$200,000 in 2008 would have paid about \$500 less in taxes if all property had been valued accurately, the Tribune estimated. In towns where tax rates are far higher than Chicago’s, the amounts would have been much larger.

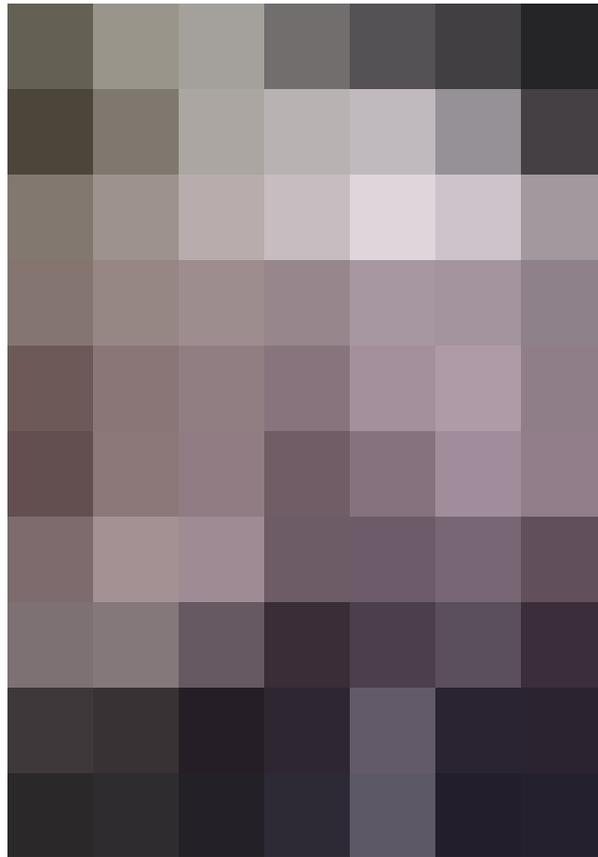


The severe undervaluing of both commercial and residential properties under James Houlihan ultimately increased the money homeowners paid to the Cook County treasurer's office. (Terrence Antonio James/Chicago Tribune)

In fact, an internal study disclosed in discovery for the O'Keefe lawsuit shows that Houlihan knew this was happening. "In 1996, commercial property held a disproportionate amount of the assessed value distribution. By 2006, the declining commercial ratio reversed the situation, causing residential to have the disproportionate amount of assessed value," the study concluded.

In April 2008, Houlihan stood before the City Club of Chicago to propose a major overhaul of the county's assessment system. Among other changes, it streamlined the classification system in Cook County by reducing the number of categories.

Houlihan's proposal, which the County Board approved five months later after one day of debate, also set a new legal assessment level for homes: 10 percent. In effect, he changed the law to align with reality.



In 2008, James Houlihan proposed an overhaul of the county's classification system, saying the changes would "result in additional clarity, simplicity and uniformity." (Nancy Stone/Chicago Tribune)

Houlihan vowed the changes would "result in additional clarity, simplicity and uniformity."

"Transparency can't just be a buzzword," he said. "We need to strive for transparency in everything we do."

Yet Houlihan never came clean about the adjustment factor hidden in the snippets of code — or the fact that Cook County had been quietly assessing residential property at about 10 percent for many years.

Then a crisis arrived, creating problems that couldn't be hidden.

New leadership

When the U.S. housing market collapsed, it sent home prices plunging. But because Houlihan had removed the adjustment factor, people were seeing steep increases in the assessor's estimates of market value.

Confusion and resentment ensued, throwing the entire system into disarray.

In January 2010, the Cook County Board of Review, a three-member panel charged with ensuring assessments are fair, sent Houlihan a stern letter requesting an explanation.