
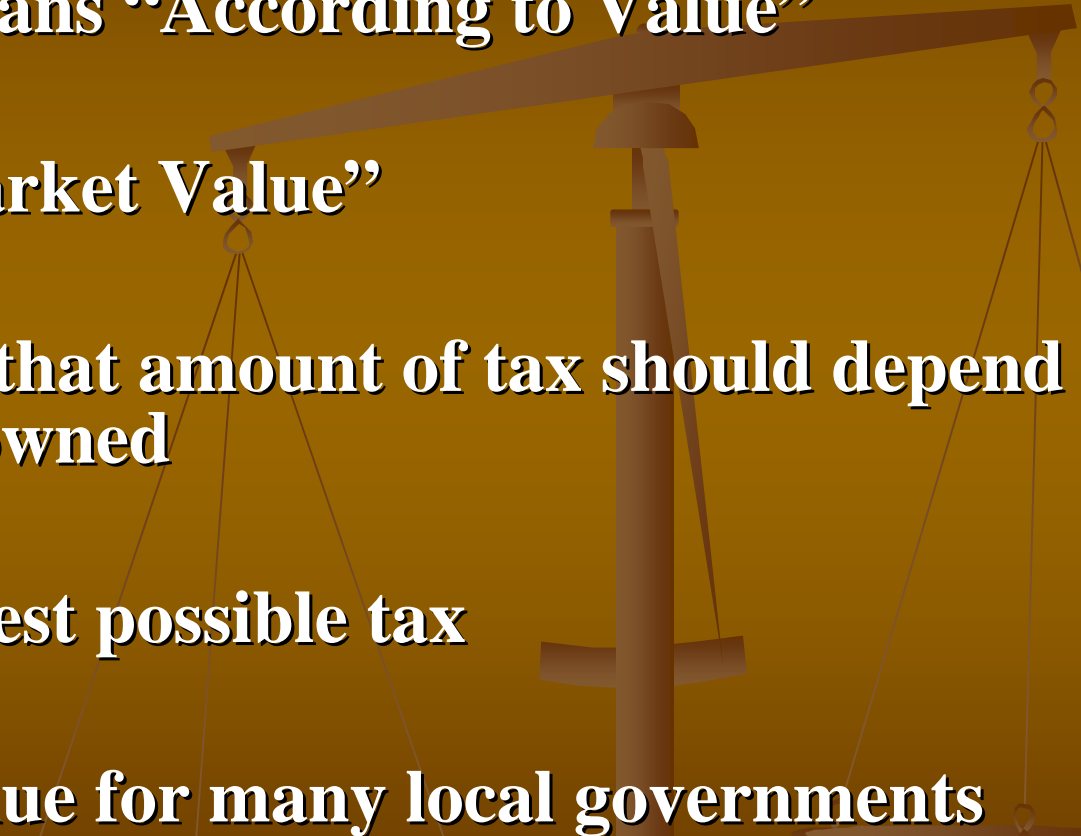


***To Cap, or
Not to Cap,
That is the Question***



Ad Valorem Taxation (Property Tax)

- **Definition literally means “According to Value”**
 - **Value is typically “Market Value”**
 - **Based upon principle that amount of tax should depend on value of property owned**
 - **Once regarded as fairest possible tax**
 - **Major source of revenue for many local governments**
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Property Tax

- **Purpose of property tax:**
 - **A method which will provide a fair & equitable method for sharing the burden of providing government services to property and property owners**
 - **Based upon premise that ownership of property equates to wealth and is a measurement by which property owners may be required to pay their share of the cost of government**

Property Tax



- **Rooted in the principle of “Market Value”**
- **Market Value can be elusive, especially for “assessors”**
- **Assessors asked to value property at market value but not given tools for the requirement- no disclosure, etc**
- **Markets have been “volatile” from year to year**
- **Assessors are not given the best information available to perform task, therefore, equity problems exist**

Property Tax

- Consequently, it is believed that the property tax, based upon a market value assessment, is unfair and inequitable
- Assessments rise and fall each year for different categories of property, depending on the data received by the assessors office
- Increases in assessed values usually do mean an increase in taxes
- Even if mill rates are reduced they are not reduced as much as some property assessments increase
- There has been legislation aimed at correcting these perceived inequities, but appear to create more problems

Property Tax



- Does “Equity” in tax burdens truly exist?
- Market values vary for different property categories yet assessors lack tools necessary to perform their duties
- Market Analysis is determined by past sales of property
- Sales of residential property are generally numerous
- Sales of commercial property are much fewer
- The assessor may receive information on many residential sales , but not commercial sales
- Commercial property should be valued using the income and expense data which the assessor will not get

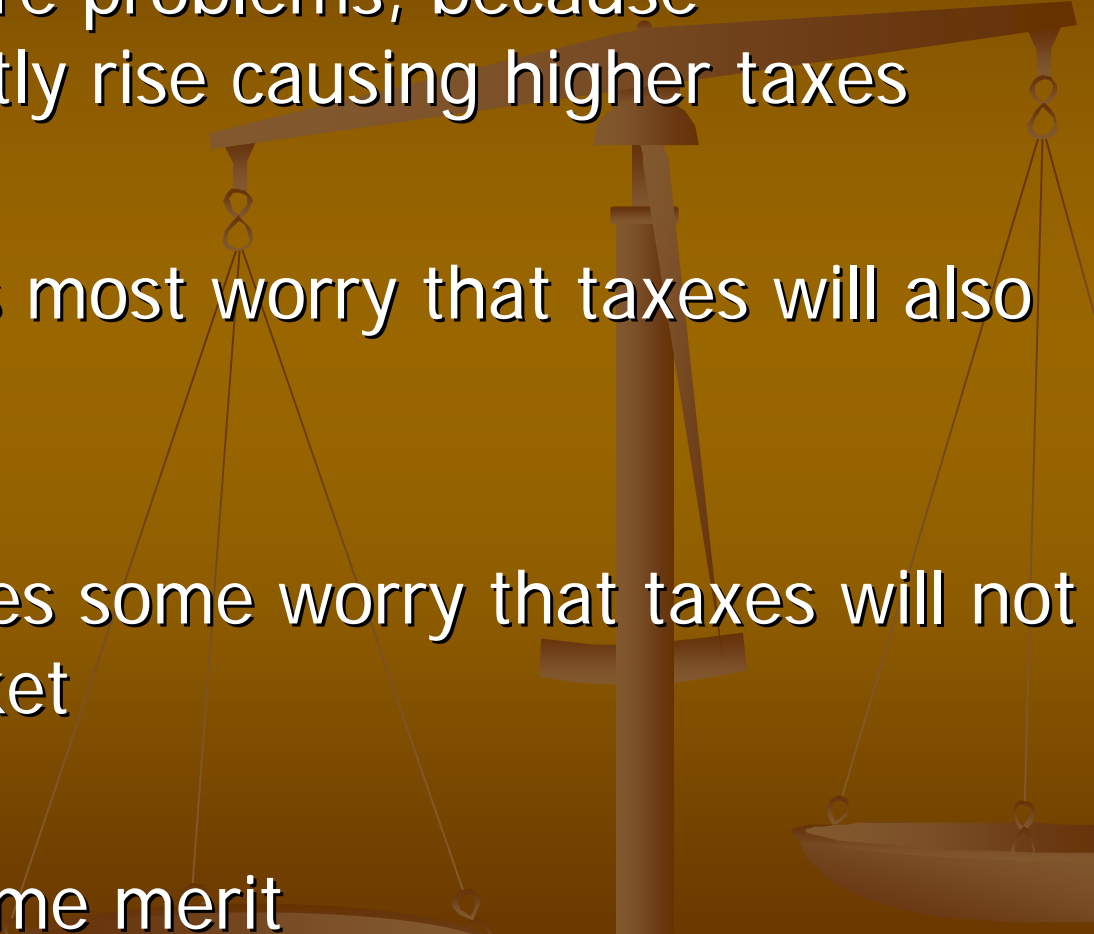
Property Tax

- Although the assessors attempts to value all property at market value, it is not an easy task
- Property owners complain about the increase in assessed values every year
- Most residential properties are assessed closer to market value than commercial property
- Residential properties are assessed at an average of 90%-95% of market value statewide
- Commercial properties are estimated to be assessed between 65%-90% statewide

Property Tax

- The primary difference between residential and commercial property assessment ratios is the availability of data
- However, the difference indicates that there is an inherent inequality between commercial and residential property assessments
- This inequality cannot be corrected unless the existing system is changed, change being a mandatory disclosure system for residential sales data and commercial income and expense data
- Neither is likely to happen

Are There Problems with the System?

- Some believe there are problems, because assessments constantly rise causing higher taxes
 - During rising markets most worry that taxes will also rise
 - During market declines some worry that taxes will not decline with the market
 - Both worries have some merit
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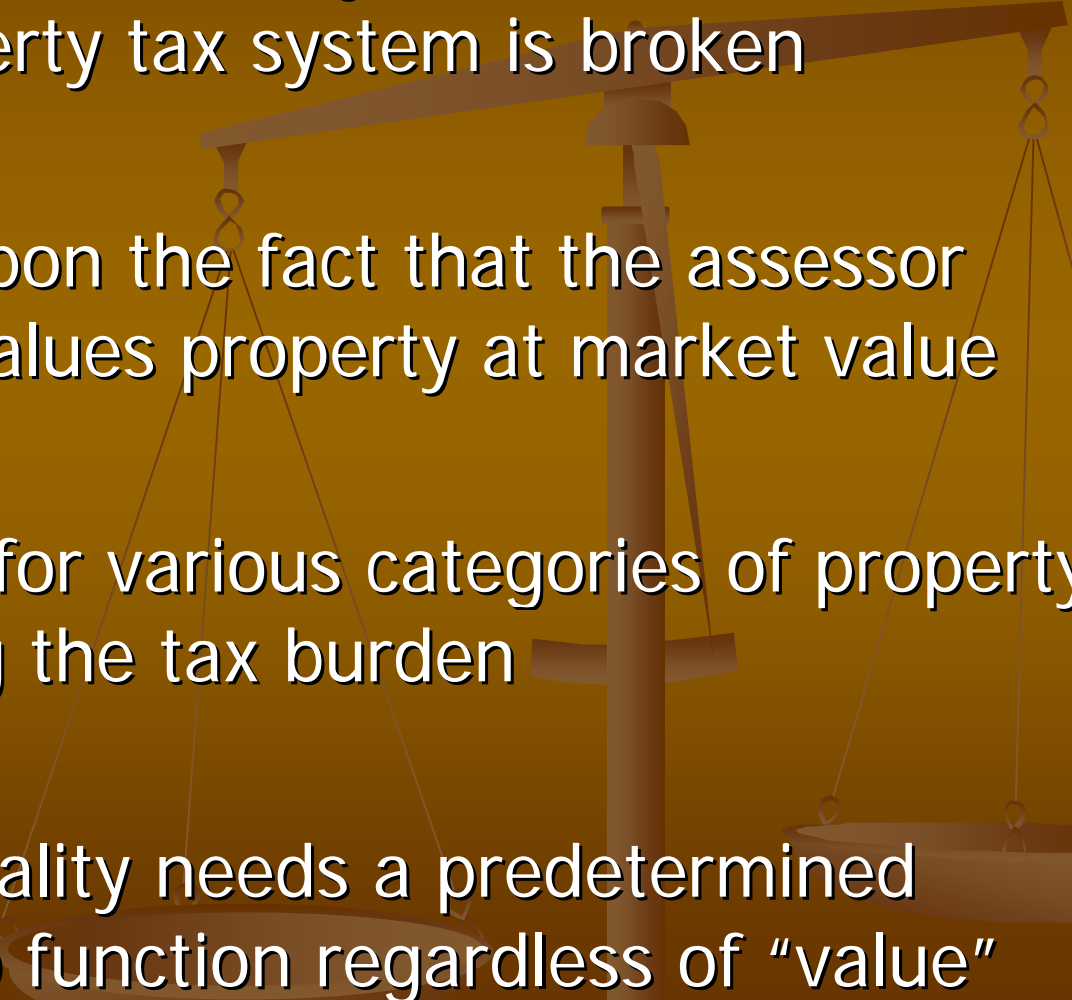
Are There Any Alternatives?

- Legislation similar to California's Proposition 13 was introduced in the legislature last session
- This would cap assessments at no more than a 2% increase per year
- Sounds good, but it will actually create inequities and may tax lower income people more
- The proposed legislation also does not allow for "recapture" of market value if the property sells

Cap Assessments or Something Different?

- Since the assessment process is primarily used for sharing the burden of government services, does it matter whether the value represents “market” or not?
- Since the “market” is somewhat volatile and the assessor is not given the tools to determine the market, and;
- Since there appears to be an inherent inequity built into the current system between commercial and residential property, without additional information;
- An assessment cap will simply create more inequities

The Current Method

- Many property owners and many elected officials believe that the property tax system is broken
 - This belief is based upon the fact that the assessor follows the law and values property at market value
 - When values change for various categories of property we are simply shifting the tax burden
 - The fact is a municipality needs a predetermined amount of revenue to function regardless of "value"
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The Current Method

- Here's how the current system works:

Current Total Assessed Value \$1,500,000,000

Current Year Budget Amount \$ 15,000,000

$$\text{Mill Rate } \frac{\$15,000,000}{\$1,500,000,000} = 10 \text{ mills } (.010)$$

The Current Method

You and your brother are electricians and make \$65,000 per year. There is no chance of a raise for either of you for the next 5 years. You both live in very similar homes but in different neighborhoods.

Your house current market value	\$210,000
Your current property taxes (210,000 X .010)	\$ 2,100

ACROSS TOWN

Your brothers house current market value	\$210,000
Brothers current taxes (210,000 X .010)	\$ 2,100

The Current Method

NEXT YEAR

Budget amount – Same	\$15,000,000
Total Assessed Value – Same	\$1,500,000,000
Mill Rate – Same	10 mills

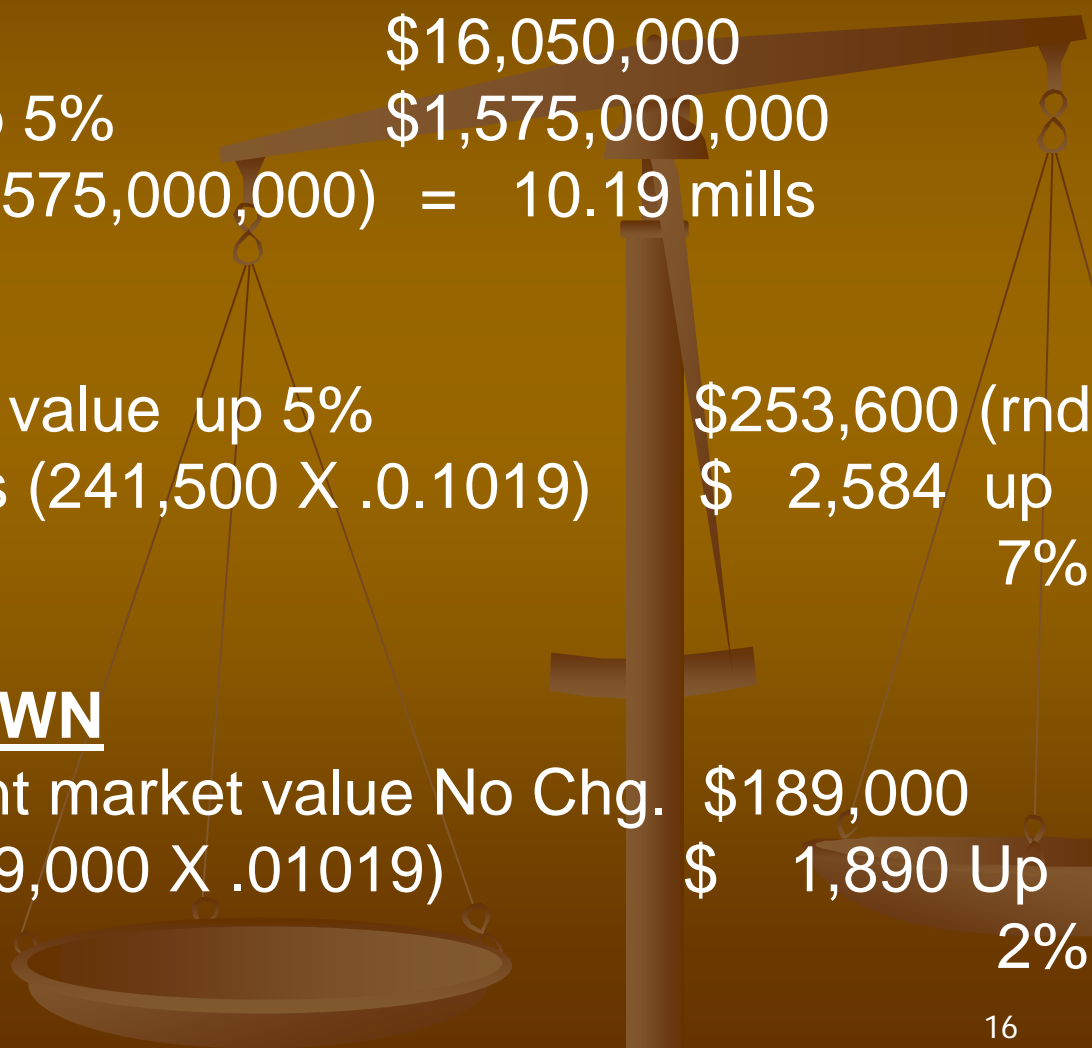
Your house current market value up 15%	\$241,500	
Your current property taxes (241,500 X .0.10)	\$ 2,415	up 15%

ACROSS TOWN

Your brothers house current market value Dn 10%	\$189,000	
Brothers current taxes (189,000 X .010)	\$ 1,890	Dn 10%

The Current Method

2 YEARS OUT



Budget amount – up 7%	\$16,050,000
Total Assessed Value – Up 5%	\$1,575,000,000
Mill Rate – $(16,050,000 \div 1,575,000,000) =$	10.19 mills

Your house current market value up 5%	\$253,600 (rnd)
Your current property taxes $(241,500 \times .01019)$	\$ 2,584 up 7%

ACROSS TOWN

Your brothers house current market value No Chg.	\$189,000
Brothers current taxes $(189,000 \times .01019)$	\$ 1,890 Up 2%

The Current Method

Ad Valorem Method Summary – Taxes

- In 2 years your taxes went up 23% for the same services, yet the budget only increased 7%
- Your brother's taxes went down 8% in the same time period for the same services
- While the ad valorem method measures "wealth", in reality, neither property owner's financial status changes unless they sell their property. But the tax increase/decrease is based upon a perception (unrealized financial gains) of wealth changes.

An Alternate Method

- The Market Value of property can change radically from year to year
- In remote cities around our state, very little market activity occurs making it almost impossible for the assessor to ascertain market value
- So, what can be done to eliminate the changes in someone's tax bill just because the market value may change in a certain portion of the city?
- How about a method that does not use the actual market value, but something a bit different that is not subject to the market swings?

An Alternate Method

- A radical change, yes, but more equitable than assessment caps
- How do we do it? The value of improvements would be built upon a cost manual providing changes/updates every 3 years
- Improvement values would be assessed based upon size, property characteristics, property condition, construction type and overall quality of structure. This is one of the same approaches to value that is currently in use. It is called, "The Cost Approach"
- The difference is that the costs would not be adjusted to reflect the current market value. Instead, the values would remain "fixed" for a period of 3 years at the "cost manual" value
- At the end of 3 years the manual would be updated to reflect general cost increases

An Alternate Method

- Land valuation is more problematic in the alternate methodology, but will be valued using a land allocation method
- Improvements may be valued with any of the 3 approaches to value, cost, sales comparison (market) or the income approach
- Land is usually always valued with the sales comparison approach, although, in certain cases the income approach may be used

An Alternate Method

- Land values may also be obtained with the use of valuation models based upon a land to building ratio (allocation) approach
- This approach is one taught in appraisal schools now although it is sometimes disregarded due to the fact that it does not always achieve “market value”
- Land values will be based upon an allocation method using the land to building ratio and the ratio of building costs to market value

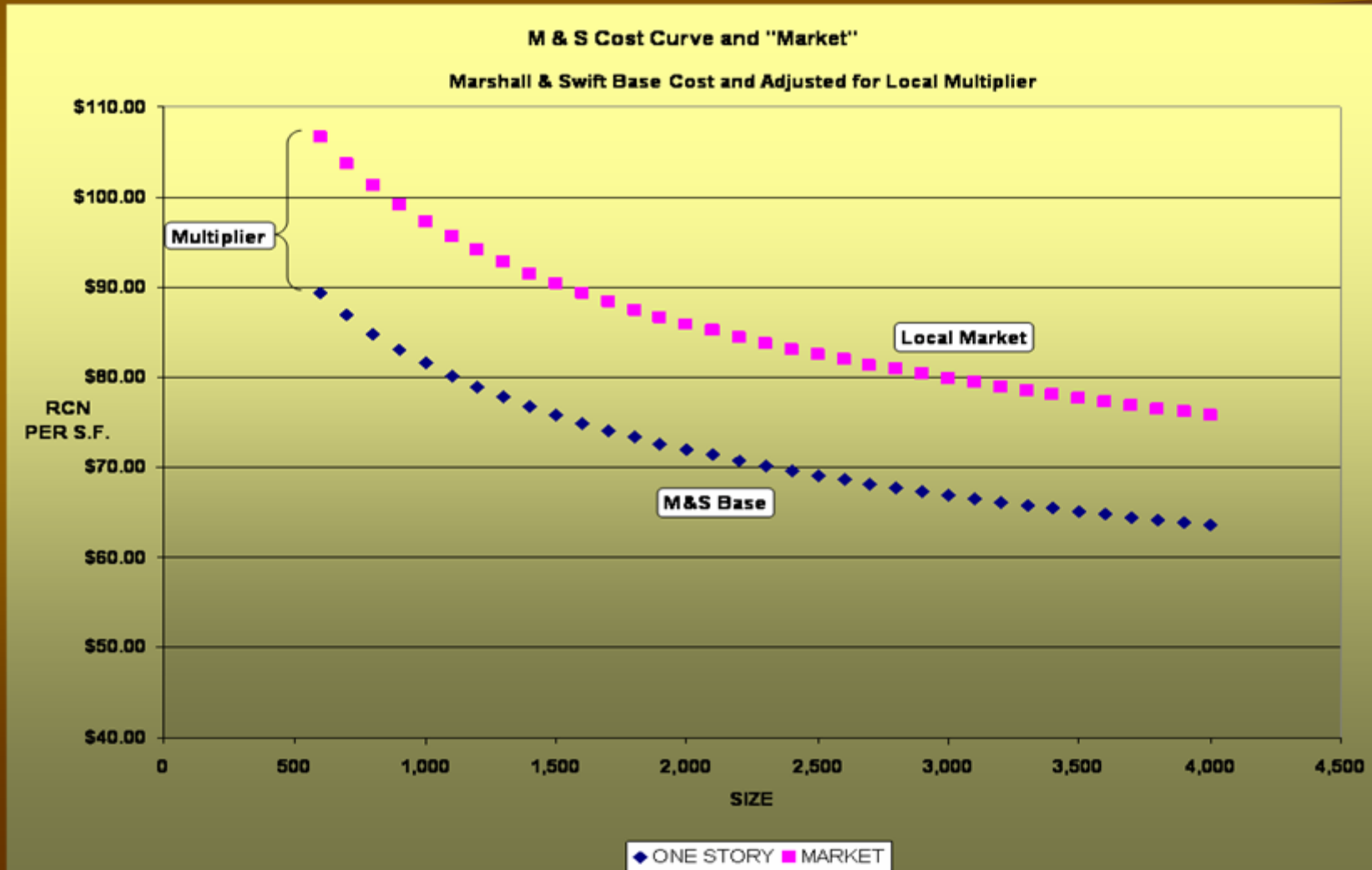
Here's How the Details Work

- Everyone understands the cost approach
- The improvements are valued with your local cost manual as usual
- Although the cost is not trended to "market value"
- They remain at the local costs
- LAND VALUE is a different story.....

Developing a Land Value Schedule Using the Cost Approach

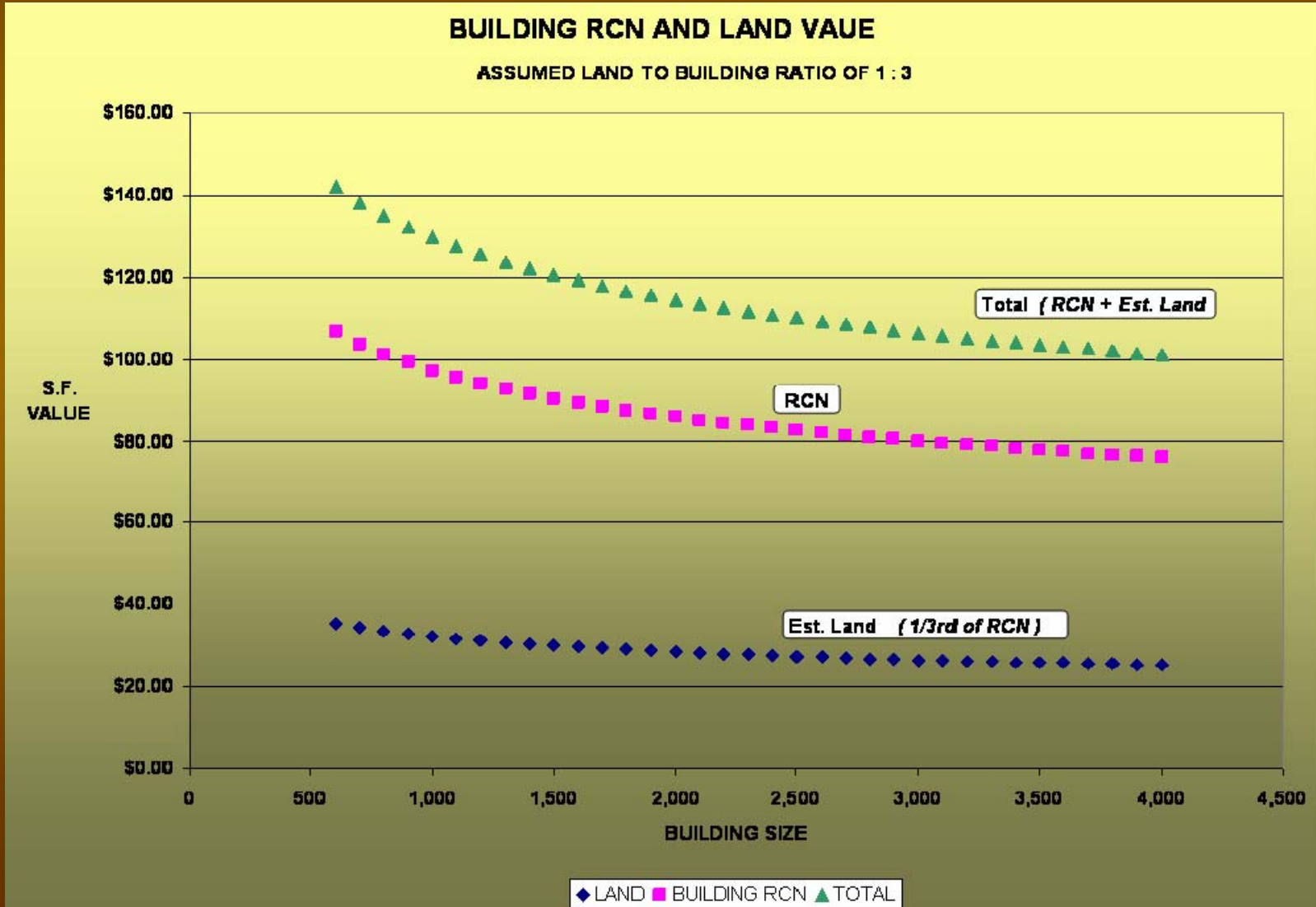
Basic Assumptions:

1. A properly derived Cost Curve reflects the general rate of change in market value as a structure increases in size for all markets. Were this not the case, a cost manual would be worthless to us.



Basic Assumptions (Cont.):

2. Highest and Best Use is a driving force in the evolution of a healthy real estate market. Highest and Best Use includes consideration to a prevailing Land to Building Ratio within that market.



INITIAL AND PERIODIC REVIEW PROCESS

MARKET DATA:	
SALE PRICE	\$95,238
DATE	January 1, 2007
ADJ PRICE (5%)	\$100,000
LAND TO BLDG RATIO	1 : 3
LAND	\$25,000
OTHER BLDG	\$10,000
LIV AREA	\$65,000
	\$100,000
LIVING AREA	
% GOOD	90%
RCN	\$72,222
SFLA	1,000
RCN \$ / S.F.	\$72.22
M&S BASE \$ / S.F.	\$60.00
M&S MULTIPLER	1.10
ADJUSTED TO LOCAL	\$66.00
(RCN \$ / S.F.) / M&S	1.0943
ADJ SALE PRICE	\$91,385
LAND	\$22,846
OTHER BLDG	\$9,138
LIV AREA	\$59,400
	\$91,385

CALCULATION STEPS

Raw Market Sales Data

Time adjusted at 5% to January 1, 2008

Time adjusted sales data is apportioned by the prevailing land to building ratio. A further separation is made to differentiate the building value into living area and non-living area components.

The living area value is divided by percent good to estimate RCN. The RCN is then divided by living area to indicate \$ per square foot.

The Marshall & Swift handbook is consulted to obtain their current multiplier and value for the local area.

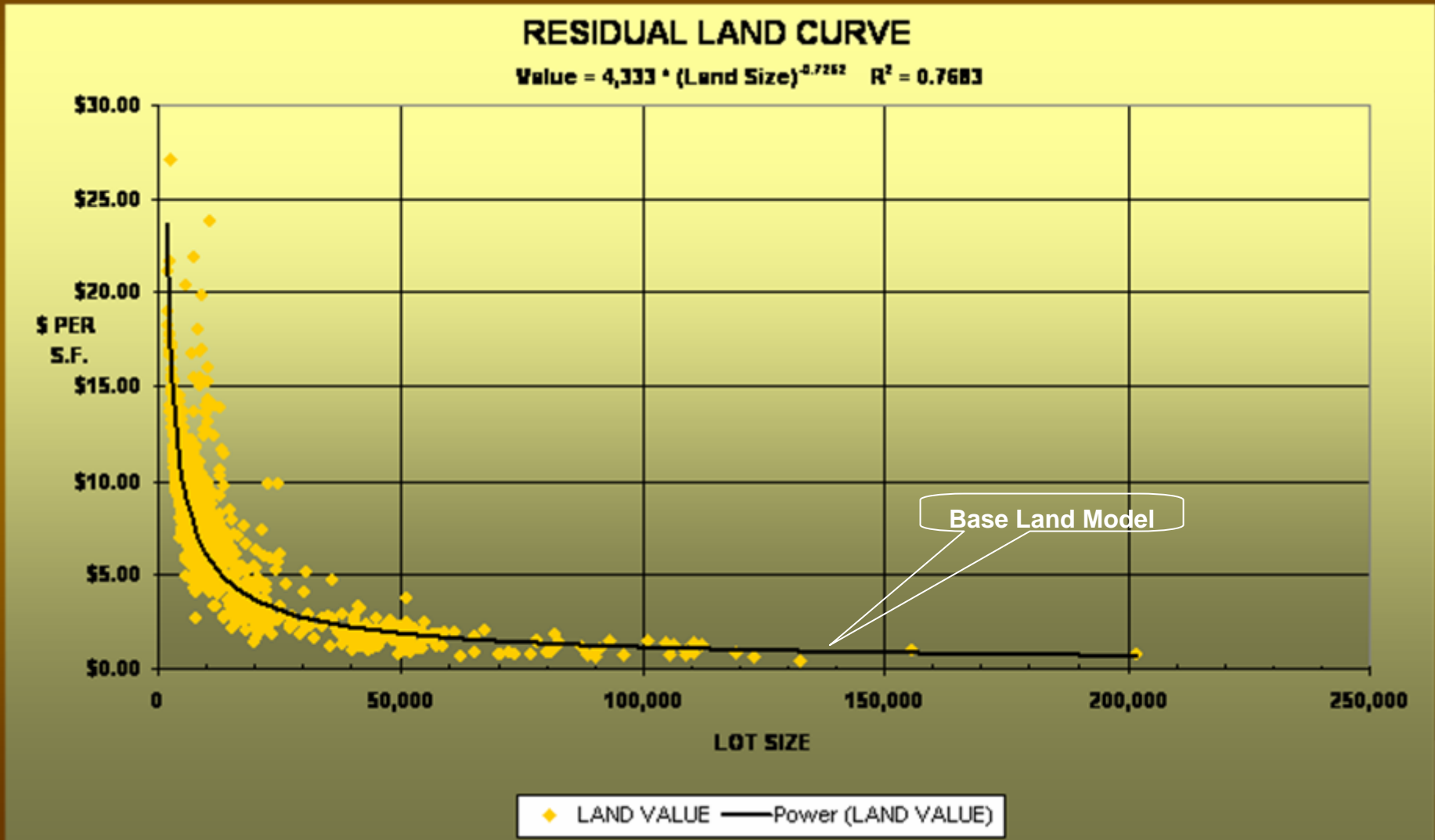
The value per square foot calculated from the sale is divided by the Marshall and Swift p.s.f. value to provided an index factor for the area. This is also used to develop land location adjustment.

The time adjusted sales price (\$100,000) is divided by the index. **NOTE THAT THE SALE IS INDEXED TO M & S.**

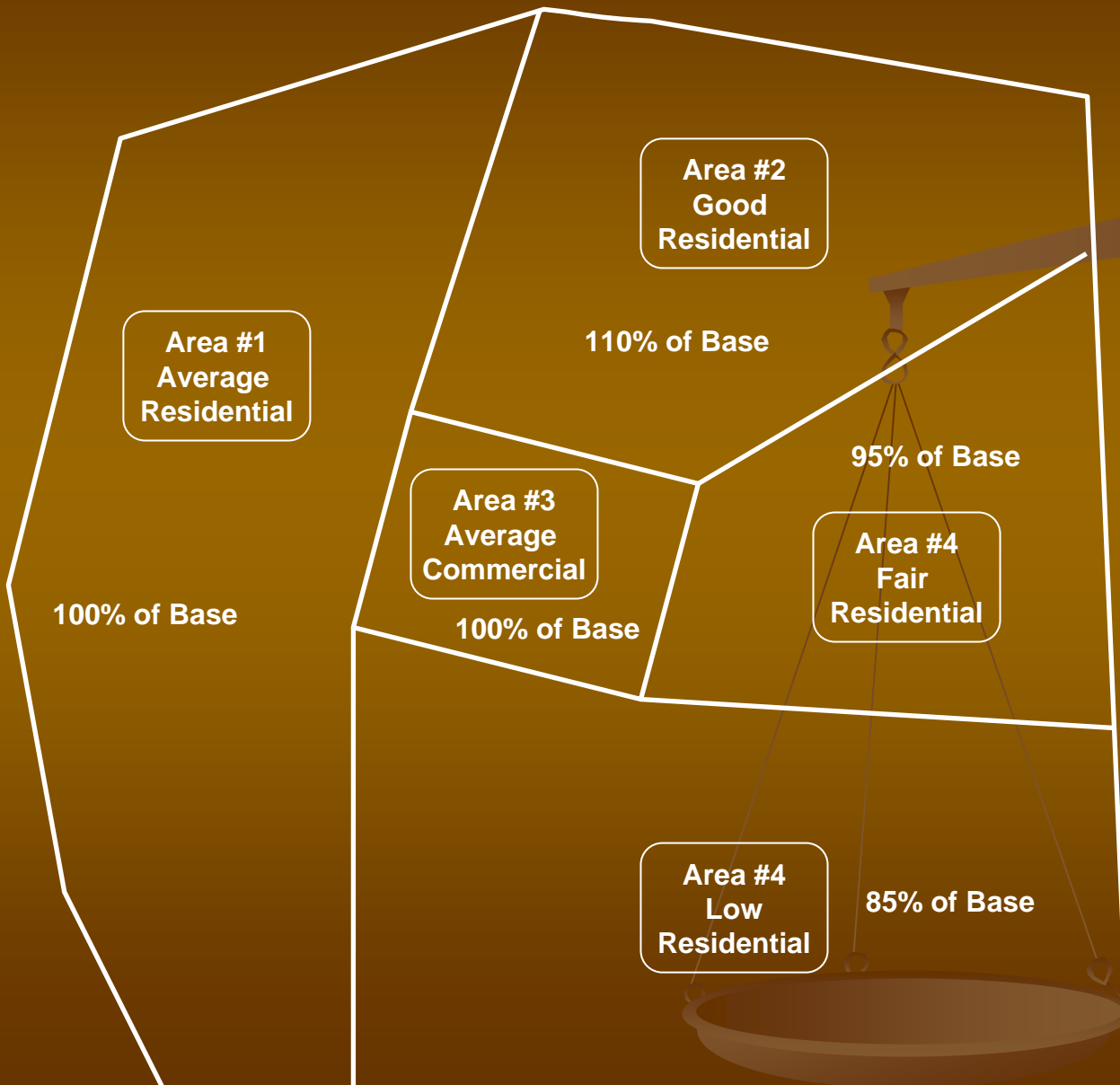
The land and building values are then apportioned to the indexed sales price. The indicated land value can then be used to produce a land value per square foot.

THE BASE LAND SCHEDULE

By simply charting the resulting square foot land values and the size of the land area for each sale, the following graphic is produced. The formula for land value is the Trendline from Excel using the Power Function, which is the best fit in this case.



COMMUNITY LAND STRATIFICATION EXAMPLE



Once the Base land curve is produced, the index factors can be separated by location, neighborhood or use. The average or median value for each segment can then be used to index the base land curve to produce land values for that segment.

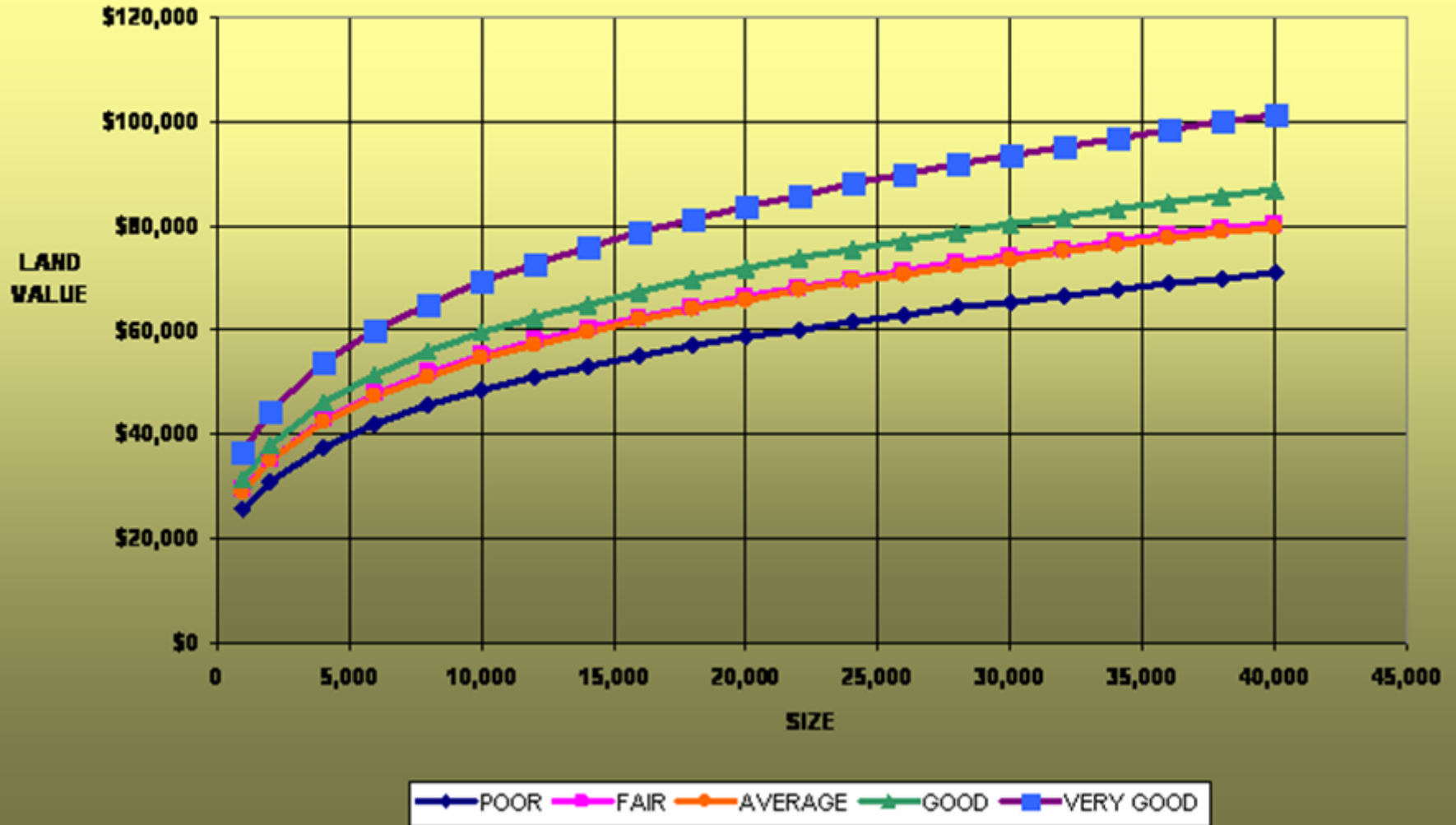
Consequently, each parcel will have a land value that is similar to the lot next door, assuming that the lots are similar. The land value will not be dependant upon the structure, if any, that may on the lot.

However, each parcel with a structure will have a building value that reflects the size, age and quality of that building. And the building value will not be dependent upon the land value or the value of the parcels around it.

Commercial land would be valued on its own land curve which would be valued using the same methodology. However, commercial sales, parcels and commercial cost tables would be used.

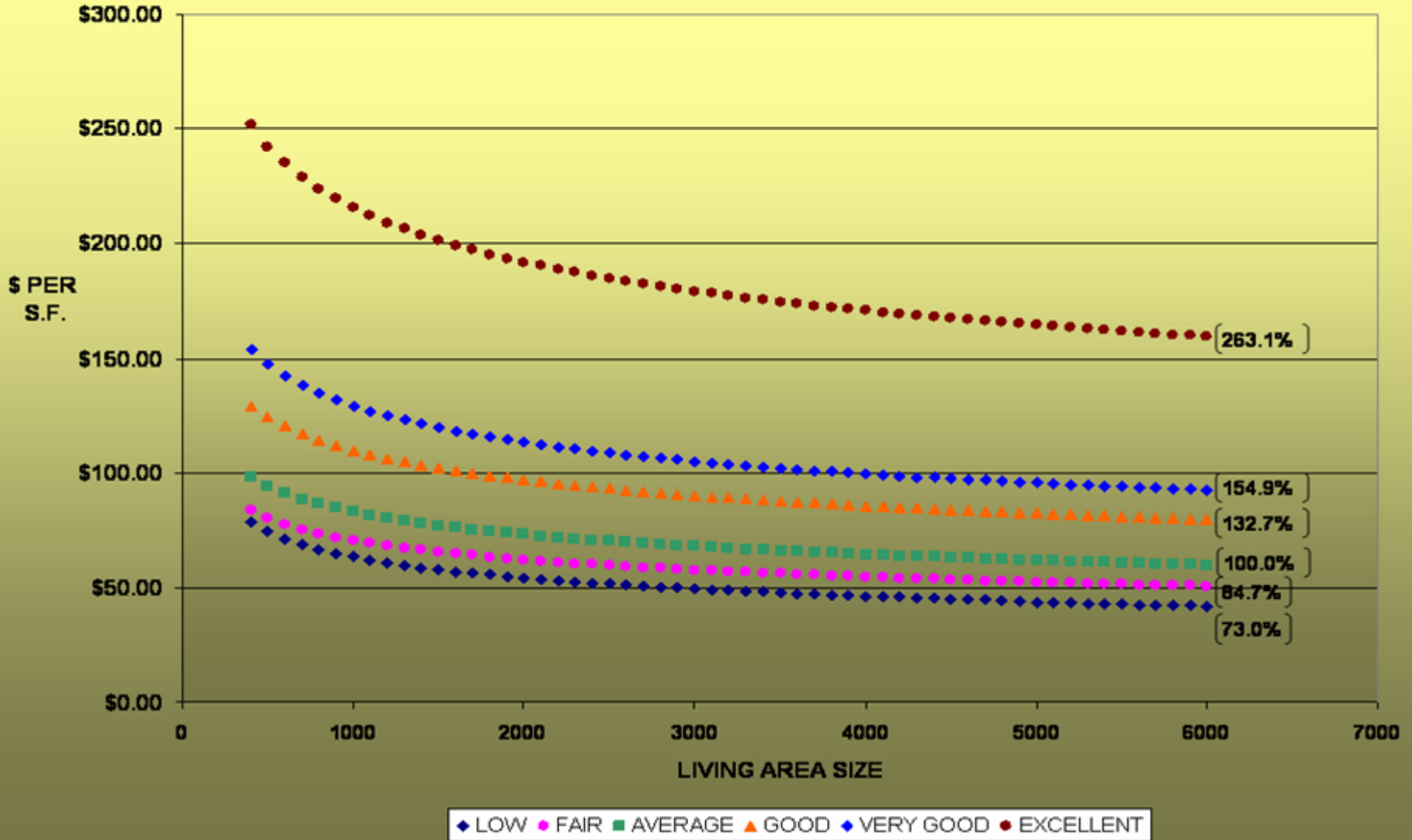
Land Schedules by Neighborhood

LAND SCHEDULES BY NBHD



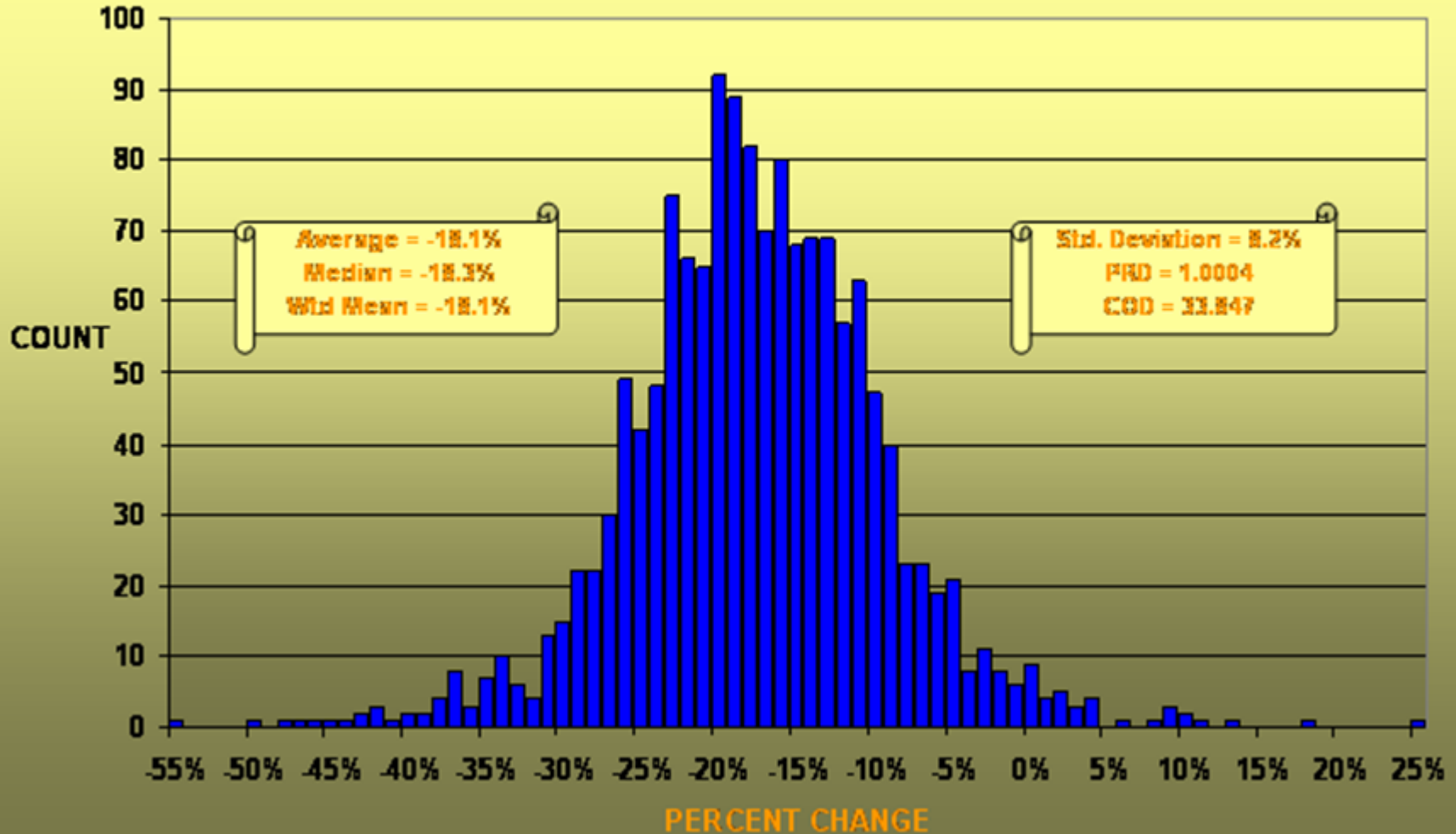
M & S Base Cost Curves for Living Area

Source: Marshall & Swift Residential Cost Handbook
 Data in parentheses equals average % of the Average quality cost curve.



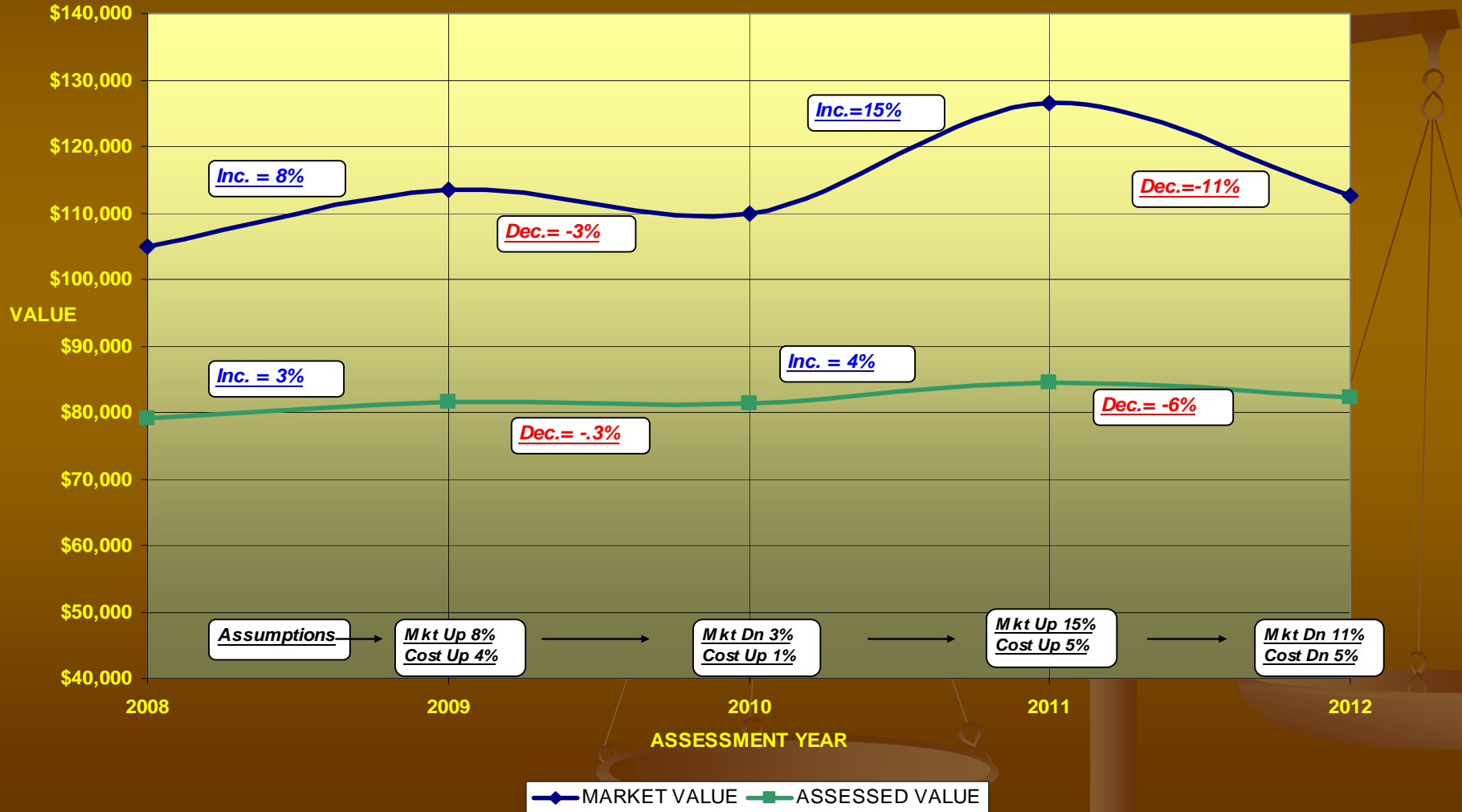
Percent Change in Valuation

Previous year value divided by the estimated cost valuation for the sale.



COMPARISON OF VALUE CHANGE

If Assessed Value Were Changed Each Year Rather Than Every Three Years



The “Cons” of the Proposed Alternative

- Assessments no longer represent “market value”, but cost values
- Primary reason for any tax increases will be reflected by the mill rate, not the assessed value
- Lending institutions may no longer allow assessed values to be used for basis of equity loans
- Will require other statutory changes, such as full value for education, LIHTC property, and some changes in optional exemptions
- Will not require a smaller assessment staff as the only portion of the responsibility removed is the annual analysis of market data- field work must still be completed

The “Pros” of the Proposed Alternative

- Assessments no longer represent “market value”
- Primary reason for any tax increases will be reflected by the mill rate, not the assessed value
- Municipal Assessors will have the tools needed to calculate an accurate assessment
- Assessment appeal process will be simplified
- Assessments will become more stabilized
- Property taxes will be more predictable
- No more “surprisingly” large increases in assessments from year to year
- This approach may lend itself to other small municipalities, not levying property taxes now, as a method to raise revenues

Conclusions

- There probably is a workable alternative to the current property tax system, IF it is decided that the current system will be changed!
- The alternate suggested here will require substantial statutory changes
- Overcoming the “market value” concept will require a lot of education
- The proposed alternative allows for a system that is fair and equitable without following the traditional market value concept
- The proposed alternative removes one element of the formula which some claim raises property taxes every year, market value
- The “CAVE” people (Citizens Against Virtually Everything) will invariably be against it, as they are with most any changes