

Memorandum



DATE: October 23, 2009

TO: Members of the Budget, Finance & Audit Committee
Jerry R. Allen, Chair, Ann Margolin, Vice Chair, Vonciel Jones Hill, Angela Hunt, Delia D. Jasso, Ron Natinsky, David A. Neumann

SUBJECT: **Property Appraisal Process Overview**

The Budget, Finance & Audit Committee's October 26th agenda includes the subject briefing. Ken Nolan (Chief Appraiser of the Dallas Central Appraisal District) will brief the Committee and his briefing materials are attached. In addition, Bo Daffin (Chief Appraiser of the Collin Central Appraisal District) and Joe Rogers (Chief Appraiser of the Denton Central Appraisal District) will be in attendance



David Cook
Chief Financial Officer

Attachment

C: The Honorable Mayor and Members of the City Council
Mary K. Suhm, City Manager
Deborah Watkins, City Secretary
Tom Perkins, City Attorney
Craig Kinton, City Auditor
Ryan S. Evans, First Assistant City Manager
A.C. Gonzalez, Assistant City Manager
Jill A. Jordan, P.E., Assistant City Manager
Forest E. Turner, Assistant City Manager

City of Dallas

Property Appraisal Process Overview Presentation

by

Dallas Central Appraisal District

Ken Nolan

Chief Appraiser/Executive Director

Budget, Finance & Audit Committee

October 26, 2009

TEXAS PROPERTY TAX HISTORY

**Centralized Appraisal District Concept
formulated by**

**66TH Texas Legislature in 1979, Senate Bill
No. 621 (“Peveto Bill”)**

- Funding began in January 1981
- First appraisal roll due in July 1982

WHY APPRAISAL DISTRICTS EXIST

- Avoid additional school finance litigation
 - School funds were distributed according to property wealth, but school districts had widely differing levels of appraisal and appraisal practices. It was impossible to determine what the true property wealth of a district was.

WHY APPRAISAL DISTRICTS EXIST

- Correct inequity and poor performance in tax offices
 - Each taxing unit was responsible for its own appraisals. Many units hadn't reappraised in years. Appraisers were poorly trained and inadequately funded. There were often great differences in appraisal level between homeowners and business property.

WHY APPRAISAL DISTRICTS EXIST

- Restrict political influence
 - Under the old system, the governing bodies of the taxing units, which determined spending, directly controlled the frequency and quality of reappraisals.

TEXAS CONSTITUTION

PRINCIPLES TO PROPERTY TAX SYSTEM

- Taxation must be equal and uniform
- Property must be valued at full market value
- All property is taxable unless exempt by federal law or state constitution
- Property may not be valued above its market value
- All property in county must receive single appraisal
- Single ARB for each Appraisal District

PROPERTY TAX

Tax measured

According To Value

“Ad Valorem”

Duties and Responsibilities

APPRAISAL DISTRICT

Discovers, Lists and Values Property

- **Performs periodic Appraisals**
- **Administers Exemptions**
- **Delivers Certified Appraisal Roll to Taxing Units by July 25th**

APPRAISAL REVIEW BOARD

Settles Disputes Between the Appraisal District and the Property Owner

TAXING UNITS

Decide Amount and Use of Revenue

- **Adopt Tax Rates**
- **Calculate Taxes**
- **Generate Tax Bills**
- **Collect Taxes**

**OVERVIEW OF THE
DALLAS CENTRAL
APPRAISAL DISTRICT
(DCAD)**

DALLAS CENTRAL APPRAISAL DISTRICT BOARD OF DIRECTORS

- 👉 DOROTHY BURTON - CHAIRPERSON
(DALLAS COUNTY)**
- 👉 CHRIS WELLS- VICE CHAIRPERSON
👉 (CITY OF DALLAS)**
- 👉 JEROME GARZA-SECRETARY
(DALLAS I S D)**
- 👉 JERRY JONES-DIRECTOR
(SUBURBAN SCHOOLS)**
- 👉 MICHAEL HURTT-DIRECTOR
(SUBURBAN CITIES)**
- 👉 JOHN R. AMES- EX OFFICIO MEMBER
(COUNTY OF DALLAS)**

RESPONSIBILITIES OF THE BOARD OF DIRECTORS

- ✎ Establish an Appraisal Office
- ✎ Appoint a Chief Appraiser
- ✎ Appoint an Appraisal Review Board
- ✎ Appoint a Taxpayer Liaison Officer
- ✎ Make general policy for the district
- ✎ Provide for necessary services
- ✎ Adopt a budget

MASS APPRAISAL

The process of valuing a universe (a large number of properties), as of a given date, using standardized procedures in a manner which allows for statistical testing.

CHARACTERISTICS OF MASS APPRAISAL

- UNIVERSE 815,689 PROPERTIES
- GIVEN DATE JANUARY 1, 2009
- STANDARDIZED PROCEDURES ACCEPTED PROFESSIONAL APPRAISAL TECHNIQUES USED TO APPRAISE ALL PROPERTY AT 100% OF MARKET VALUE.
- STATISTICAL TESTING RATIO STUDIES

UNIVERSE OF THE DALLAS CENTRAL APPRAISAL DISTRICT

RESIDENTIAL 643,958

COMMERCIAL 72,977

BPP 84,633

*LEASED EQUIPMENT /
AIRCRAFT/UTILITIES* 14,121

TOTAL 815,689

ALL IN DALLAS COUNTY SINCE 2008

DATE OF APPRAISAL

Section 21.01 Real Property

Real Property is taxable by a taxing unit if located in the unit on January 1.

Section 21.02 Tangible Personal Property generally except as provided by Section 21.021 and 21.024 of the Code, tangible personal property is taxable by a taxing unit if:

- 1) It is located in the unit on January 1 for more than a temporary period.**
- 2) It normally is located in the unit, even though it is outside the unit on January 1, if it is outside the unit only temporarily.**
- 3) It normally is returned to the unit between use elsewhere and is not located in any one place for more than a temporary period; or**
- 4) The owner resides (for property not used for business purposes) or maintains his principle place of business in this state (for property used for business purposes) in the unit and the property is taxable in this state but does not have a taxable situs pursuant to Subsection 1-3.**

MARKET VALUE DEFINED (AS OF JANUARY 1ST)

The price at which a property would transfer for cash or its equivalent under prevailing conditions if:

- a) Exposed for sale in the open market within a reasonable time for the seller to find a purchaser;
- b) Both the seller and the purchaser know of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions on its use; and
- c) Both the seller and purchaser seek to maximize their gains and neither is in a position to take advantage of the exigencies of the other.

Limitation on Appraised Value of Residence Homestead

Section 23.23(a), Property Tax Code

- Other than to include new improvements, the appraised value of a residential homestead may not be increased by more than 10% from its appraised value in the prior tax year, regardless of when it was last reappraised.

HJR 36 on November 3 Ballot

- Authorizes the appraisal of homestead property (Section 11.13, Tax Code) to be valued at current use not highest and best use.

THREE APPROACHES TO VALUE

COST APPROACH

DIRECT SALES APPROACH

INCOME APPROACH

PRICE

- The amount a particular purchaser agrees to pay and a particular seller agrees to accept under the circumstances surrounding their transaction

MARKET VALUE

Texas Property Tax Code

- The price at which a property would transfer for cash or its equivalent under prevailing market conditions if:
 - Exposed for sale in the open market with a reasonable time for the seller to find a purchaser;
 - Both the seller and purchaser know of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions on its use;
 - Both the seller and purchaser seek to maximize their gains and neither is in a position to take advantage of the exigencies of the other.
 - Texas Property Tax Code, Section 1.04(7)

MARKET VALUE

Uniform Standards of Professional Appraisal Practice

- A type of value, stated as an opinion, that presumes the transfer of a property (i.e., the right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal

– USPAP, 2002 ed.

MARKET VALUE IRS RULES

- The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specific date and passing of title from seller to buyer under conditions whereby:

MARKET VALUE (cont.)

IRS RULES

- Buyer and seller are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their best interests;
- A reasonable time is allowed for exposure in the open market;
- Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.
 - 12C.F.R. Part 34.43(g); 55 Federal Register 34696, August 24, 1990, as amended at 57 Federal Register 12202, April 9, 1992; 59 Federal register 29499, June 7, 1994.

FEE SIMPLE ESTATES

- Texas Courts have defined Market Value based on Fee Simple Estates.
 - Cherokee Water Co. V. Gregg County Appraisal District (1990)
 - Jagee Corporation V. Dallas Central Appraisal District (1991)

Fee Simple Estate is defined as:

“absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat.”

Typical Property Types that often involve the exchange of the Fee Simple Estate

- Land
- Residential Homes
- Apartment Complexes

LEASED FEE ESTATES

- Defined as:

“an ownership interest held by a landlord with the rights of use and occupancy conveyed by lease to others. The rights of the lessor (the leased fee owner) and the lessee are specified by contract terms contained within the lease.”

LEASED FEE ESTATES

- Any types of property that involve a contract or lease whereby the owner (Lessor) exchanges use of the property to another party (Lessee) for a consideration involves the exchange of a Leased Fee Estate.
- Typical properties that often involve the exchange of a Leased Fee Estate include:
 - Shopping Centers
 - Retail Buildings
 - Office Buildings
 - Multi-Tenant Industrial Buildings

LEASED FEE ESTATES

- Purchasers of Leased Fee Estates are often acquiring income-producing properties which are based upon the economic principle of Anticipation. Buyers consider three essential elements in their decision to purchase a Leased Fee Estate:
 - Quantity
 - Quality
 - Durability

LEASED FEE ESTATES

- Quantity: Usually defined in a legal contract between a lessor and lessee, (i.e. a lease agreement). This is often interchangeably termed “Rent”.
 - Would you pay more for an income-producing property that produces \$90,000 or \$100,000 per year, all other factors being equal?

LEASED FEE ESTATES

- Quality: The ability of the lessee to pay.
 - Would you pay more for a property that is leased to me or to an individual with a higher net worth?

LEASED FEE ESTATES

- Durability: The length of time that a lease agreement extends.
 - Would you pay more for a lease that extends three years or 10 years, all other factors being equal?

Assume the Following:

- Two 100,000 square foot class A office buildings with the exact same physical characteristics and same location
 - Building #1 is 100% occupied, receiving average rents of \$35.00 p.s.f. and all leases have at least 10 remaining with credit worthy tenants. Expenses are \$8.50 psf.
 - Building #2 is 85% occupied, receiving average rents of \$30.00 p.s.f. and the average term left on the leases in place is 5 years with a mix of 50% non worthy and 50% credit worthy tenants. Expenses are \$9.00 psf.
 - Assume cap rates in this market range from 7% - 9%

Income Calculations

- Building #1:

- Gross Potential Income: $100,000 \text{ s.f.} \times \$35.00 \text{ p.s.f.} = \$3,500,000$
- Vacancy & Collection Loss: \$0
- Effective Gross Income: \$3,500,000
- Expenses: \$850,000
- Net Operating Income: \$2,650,000
- Cap Rate: 7%
- Indicated Value: \$37,857,142
- Price Per Square Foot = \$388.57 p.s.f.

Income Calculations

- Building #2:

- Gross Potential Income: $100,000 \text{ s.f.} \times \$30.00 \text{ p.s.f.} = \$3,000,000$
- Vacancy & Collection Loss: \$450,000
- Effective Gross Income: \$2,550,000
- Expenses: \$900,000
- Net Operating Income: \$1,650,000
- Cap Rate: 8.5%
- Indicated Value: \$19,411,764
- Price Per Square Foot = \$194.12 p.s.f.

Market Pro Forma

- Market Rent = \$32.00 p.s.f.
- Market Occupancy = 90%
- Market Expenses = \$8.50 p.s.f.
- Market Cap Rate is 8%

Market Value = \$25,375,000

Market Value Per Square Foot = \$253.75
p.s.f.

What is the Market Value?

- Building #1 Indicated Value = \$388.57 p.s.f.
- Building #2 Indicated Value = \$194.12 p.s.f.
- Market Assumptions = \$253.75 p.s.f.
- **Market Value = \$253.75 p.s.f.**

IRS 1031 Exchanges

- Section 1031 of the Internal Revenue Code provides for the following:

“No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment purposes if such property is exchanged solely for property of a like-kind which is to be held for either productive use in trade or business or for investment purposes.”

1031 Rules

- In order to complete and effective 1031 exchange you have to understand and follow the rules laid out by the IRS. Failure to comply with these rules can lead to your sale proceeds being considered as taxable.
 - The property you sell and the property you buy must be used in a trade or business or for investment purposes.
 - The proceeds from the sale of your original property must be handled by a qualified intermediary and not by you or someone representing you.
 - Any profit from the original sale that is not reinvested in the new property will be taxed. The level of debt on your new property must be equal to or higher than your level of debt on your old property.
 - You have 45 days after you sell your old property to identify the new property or properties you intend to purchase.

1031 Rules (cont.)

- You must purchase your new property within 180 days of the sale of your old property or by the due date for your tax return for the year in which the transfer of the old property takes place, whichever arrives first.
- You may identify three or more properties as possible replacements for your old property.
- If you choose to identify more than three properties, their combined value cannot exceed 200 percent of the value of your old property.
- You must purchase at least 95 percent of the combined value of all the property you list as replacements for your old property.

Possible Conflicts with Market Value

- Most difficult component of a 1031 exchange is identifying replacement properties within the first 45 days following the sale of the previous property. The IRS is very strict in not allowing extensions.
 - Does the compressed time frame mean the buyer is under duress to identify and buy a property?
 - Will the buyer overpay in order to meet the time frame because it is still better than the income tax consequences?

**Does a 1031 exchange meet
the test of market value?**



MAYBE?

**PRICE DOES
NOT ALWAYS
EQUAL VALUE!**

DCAD APPRAISAL TECHNIQUES

Residential

- 1) Direct sales approach
- 2) Cost approach

Commercial

- 1) Direct sales approach
- 2) Cost approach
- 3) Income approach
 - a. direct capitalization
 - b. discounted cash flow

Business Personal Property

- 1) Cost approach
- 2) Direct sales approach
- 3) Income approach

Agricultural and Open-Space Land

- 1) Full market value
 - a. direct sales approach
- 2) Productivity value
 - a. income approach

AUDITS

1. SELF AUDIT OF ALL APPRAISAL DIVISIONS by SPECIAL AUDIT DIVISION
 1. HIRE UNIVERSITY OF TEXAS AT DALLAS TO PERFORM RATIO STUDY ON RESIDENTIAL VALUES
2. TEXAS STATE COMPTROLLER OF PUBLIC ACCOUNTS PERFORMS ANNUAL RATIO STUDY

RATIO STUDY

APPRAISED VALUE divided by SALES PRICE

THE CLOSER TO 100% THE MORE ACCURATE THE VALUES

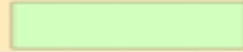
RATIO STUDIES

2001	UTD	93.0%
	PTD	98.0%
2002	UTD	97.0%
	PTD	98.0%
2003	UTD	97.3%
	PTD	99.0%
2004	UTD	99.4%
	PTD	100.0%
2005	UTD	100.0%
	PTD	100.0%
2006	UTD	99.5%
	PTD	100.0%
2007	UTD	99.3%
	PTD	99.0%
2008	UTD	100.0%
	PTAD	99.0%

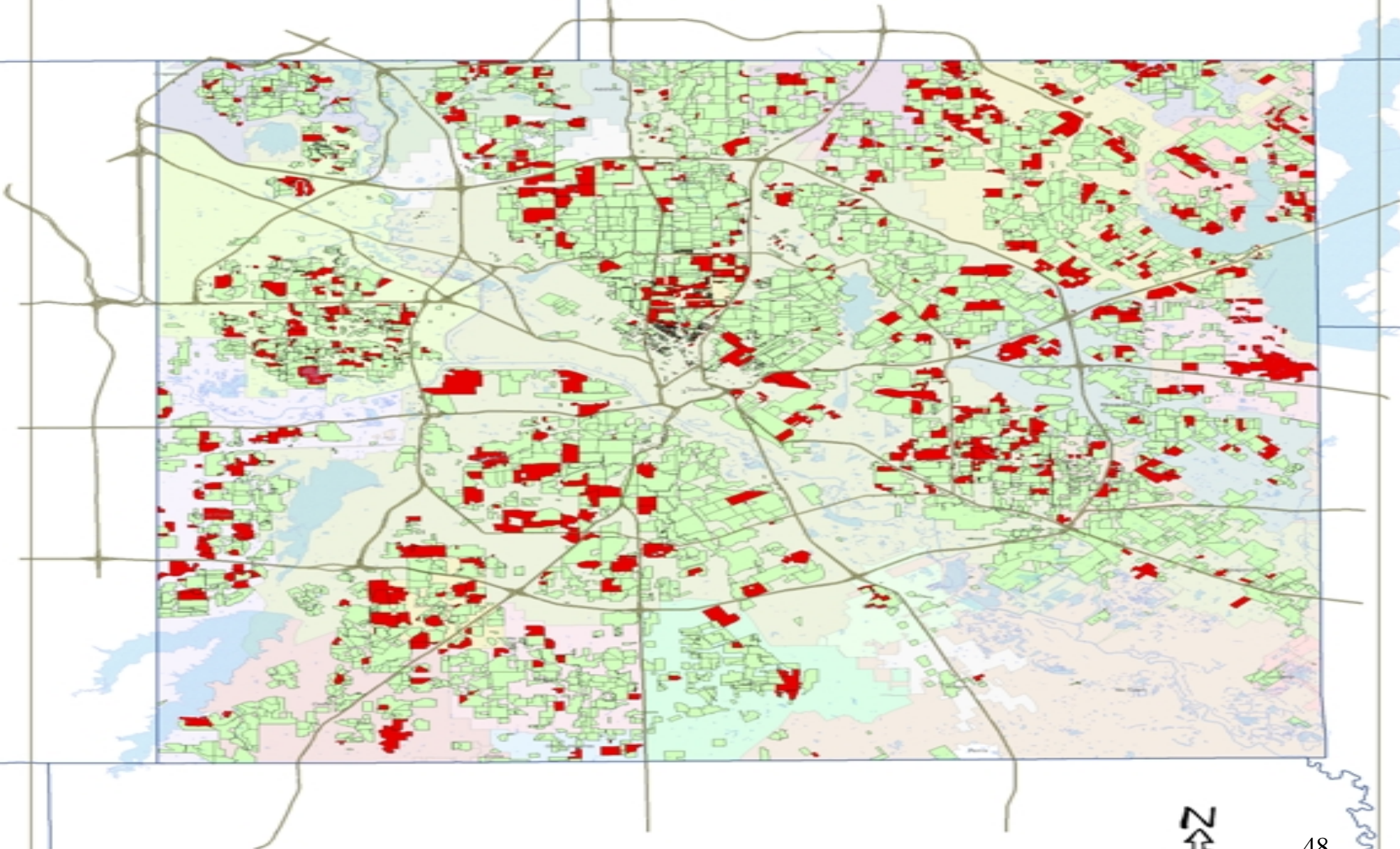
DCAD 2009 Residential Neighborhood Revaluation



2009 Reval Nbhds



Non-Reval Nbhds



2009

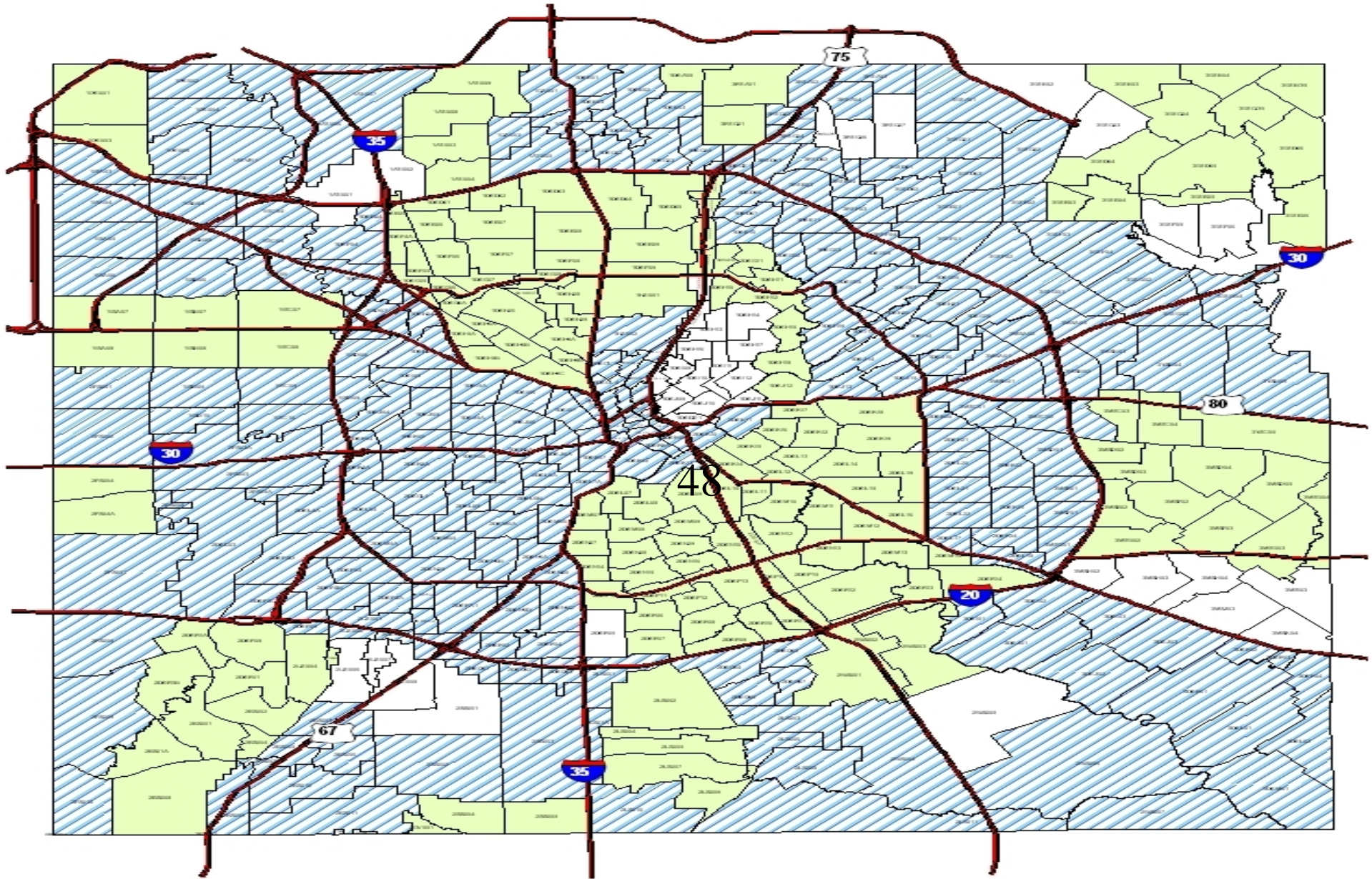
RESIDENTIAL REAPPRAISAL

- Neighborhood Reappraisal (Ratio Analysis conducted October, January, March)
 - 278,166 Accounts
 - 1,786 Neighborhoods
- Mobile Home Reappraisal
 - 11,376 Mobile Home Accounts
- Building Permits
 - 5,670 New Construction Permits
 - 24,641 Miscellaneous Permits


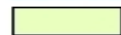
2009 RESIDENTIAL MARKET TRENDS

- New Construction Starts Significantly Down
- Values Flat In Northern Sector
- Values Down In Southern Sector
- Foreclosures Rates Up in Southern Sector
- Days On Market Longer
- Fewer Sales Transactions

2009 Commercial Reappraisal Plan



2009 Commercial Reappraisal Plan

-  2009 Commercial Land Reappraisal
-  2009 Comm Impt Reappraisal

2009

COMMERCIAL REAPPRAISAL

- 1/2 Land Market Areas
- 1/3 Improved Markets
- Major Property Types
 - Office
 - Retail
 - Industrial
 - Apartment
- Building Permits
 - 910 New Construction Permits
 - 8,057 Miscellaneous Permits

2009

COMMERCIAL MARKET TRENDS

- ▶ Extreme Uncertainty In Today's Market
- ▶ Limited Commercial Financing
- ▶ Decline In New Construction
- ▶ Rents & Occupancy Flat To Down
- ▶ Retail Property May See Significant Decline
- ▶ Office Market May See Decline
- ▶ Industrial & Apartment May See Decline
- ▶ **Capitalization Rates Up**
- ▶ Commercial Appraisal Roll Will Likely Decline

2009 BUSINESS PERSONAL PROPERTY REAPPRAISAL

● Field Accounts	70,332
● Tenant Accounts	7,486
● Leased Equipment	13,725
● Aircraft	587
● Special Inventory	1,660
● Utilities/Pipelines	408
● Telecom	3,358

2009 BUSINESS PERSONAL PROPERTY REAPPRAISAL

- Renditions 65,000
April 15/May 15
- Exemptions
 - Freeport 1,500 (Process Thru July)
 - Pollution Control 150

2009 BUSINESS PERSONAL PROPERTY MARKET TRENDS

- Market Value Flat
 - Less inventory in bad economic times
 - Less reinvestment in new assets
- Taxable Value May Decrease
 - Possible new Freeport exemptions

2009 Appraisal Notices

Residential	374,084
Commercial	40,359
Business Personal Property	97,556
Exemption/Agricultural	2,500

2009 Total Mailed **514,499**

2008 Total Mailed **537,722**

Variance ***-23,223***

ACTIVITIES	2003	2004	2005	2006	2007	2008	2009
Telephone Calls	76,100	65,539	74,683	72,026	64,320	52,864	56,935
Walk-Ins	16,176	15,108	18,295	19,258	18,519	18,669	19,603
Informal Hearings	32,973	29,642	36,524	40,380	36,250	39,733	41,349
Protests Received	83,024	83,745	90,913	100,435	97,528	108,329	113,654
Protests Scheduled	82,417	83,485	90,451	99,107	103,820	114,538	120,006
Hearings Held	37,612	30,994	34,064	37,720	39,378	46,710	53,194
Hearing Days	39	40	42	45	43	42	38
ARB Panels Utilized	686	630	526	748	1,189	1,465	1,557
ARB Packets (accounts)	62,570	66,178	72,448	65,982	44,611	71,637	83,998
Reschedules	NA	NA	NA	NA	NA	8,983	11,259
Late Appeals	800	1,302	651	802	614	562	288
Appeal Letters	632	767	854	628	579	387	386
# of Appraisal Notices Mailed	542,372	560,404	597,327	613,092	602,670	547,671	514,499

DCAD CERTIFICATION

- Number of Protests Filed: 113,654
- Total Value of all Properties:
\$214,737,171,130
- Total Value, as Determined by the Chief Appraiser, of Properties with Protests not yet Determined: \$1,472,100,680
- Percentage in Dispute: 0.6903%
- Date Appraisal Roll Certified: July 23, 2009

CHANGES BY CATEGORY COUNTY-WIDE

	2008	2009
● COMMERCIAL:		
– Market Value:	+13.06%	-4.43%
– Taxable Value:	+9.69%	-7.10%
● BUSINESS PERSONAL PROPERTY		
– Market Value:	+1.60%	+0.29%
– Taxable Value:	+3.64%	-1.55%
● RESIDENTIAL:		
– Market Value:	+4.87%	-1.84%
– Taxable Value:	+5.82%	-1.19%
● OVERALL:		
– Market Value:	+7.33%	-2.52%
– Taxable Value:	+6.92%	-3.50%

HIGHLIGHTS OF 2009 CERTIFICATION

	MARKET	TAXABLE
● DALLAS COUNTY:	-2.52%	-3.50%
● CITY OF DALLAS:	-2.90%	-3.63%
● DALLAS ISD:	-2.99%	-3.47%

HIGHS AND LOWS

● CITIES:	MARKET	TAXABLE
– WILMER:	+41.67%	+44.68%
– ADDISON:	-8.66%	-10.91%
● SCHOOLS:		
– SUNNYVALE:	+15.00%	+12.56%
– LANCASTER:	-7.03%	-9.43%
● SPECIAL DISTRICTS:		
– D.C. FCD #1:	+26.00%	+22.33%
– LAN. MUD #1:	-25.54%	-25.67%

QUESTIONS and ANSWERS



THANK YOU